利君國際醫藥
(控股)有限公司
Lijun International Pharmaceutical (Holding) Co., Ltd.

(Incorporated in the Cayman Islands with limited liability)

Stock Code : 2005

Annual Report

2005

CONTENTS

CORPORATE INFORMATION

STOCK CODE

2005

EXECUTIVE DIRECTORS

Mr. Wu Qin *(Chairman)*
Mr. Wu Zhihong
Mr. Huang Chao
Mr. Xie Yunfeng
Ms. Sun Xinglai

NON-EXECUTIVE DIRECTOR

Mr. Liu Zhiyong

INDEPENDENT NON-EXECUTIVE DIRECTORS

Mr. Qu Jiguang
Mr. Leung Chong Shun
Mr. Chow Kwok Wai

COMPANY SECRETARY

Mr. Lam Yiu Por

REGISTERED OFFICE

Century Yard, Cricket Square, Hutchins Drive,
P.O. Box 2681 GT, George Town, Grand Cayman,
British West Indies

HEAD OFFICE AND PRINCIPAL PLACE OF BUSINESS IN HONG KONG

Office 1606, 16th Floor, Office Tower, Convention Plaza, 1 Harbour Road, Wanchai, Hong Kong

AUTHORISED REPRESENTATIVES

Mr. Wu Zhihong
Ms. Sun Xinglai

COMPLIANCE ADVISER

Guotai Junan Capital Limited

AUDIT COMMITTEE

Mr. Chow Kwok Wai *(Chairman)*
Mr. Qu Jiguang
Mr. Leung Chong Shun

REMUNERATION COMMITTEE

Mr. Leung Chong Shun *(Chairman)*
Mr. Qu Jiguang
Mr. Chow Kwok Wai

PRINCIPAL SHARE REGISTRAR AND TRANSFER OFFICE

Butterfield Fund Services (Cayman) Limited
P.O. Box 705, Butterfield House, 68 Fort Street
George Town, Grand Cayman, Cayman Islands
British West Indies

HONG KONG BRANCH SHARE REGISTRAR AND TRANSFER OFFICE

Computershare Hong Kong Investor Services Limited
Shops 1712-16, 17th Floor, Hopewell Centre
183 Queen's Road East, Hong Kong

PRINCIPAL BANKERS

Industrial and Commercial Bank of China
China Construction Bank
China Merchants Bank
China Minsheng Banking Corp., Ltd.
CITIC Industrial Bank
Standard Chartered Bank

LEGAL ADVISERS TO THE COMPANY AS TO HONG KONG LAW

Mallesons Stephen Jaques

AUDITORS

PricewaterhouseCoopers

CHAIRMAN'S STATEMENT

On behalf of the board ("Board") of directors ("Directors") of Lijun International Pharmaceutical (Holding) Co., Ltd. ("Company"), I am pleased to present the first results report of the Company.

RESULTS AND DIVIDEND PAYMENTS

In 2005, despite fierce competition in the pharmaceutical market and pressure from the State's pharmaceutical policies, the Company recorded satisfactory results. The annual sales income amounted to RMB884,709,000, representing a mild decrease of 2.0% as compared to the same period last year. Profit after taxation was RMB93,311,000, representing an increase of 5.3% as compared to the same period last year.

The Board proposed a final dividend of HK$0.16 for the year 2005.

BUSINESS REVIEW

For the year 2005, the national antibiotics market remained sluggish, under the impact of the "Notice on Strengthening Controls on Sale of Antibacterial Agents in Retail Pharmacy Stores"(關於加強零售藥店抗菌藥物銷售監管合理用藥的通知)("No. 289 Document") issued by the State Food and Drug Administration ("SFDA") which provides that antibiotics can only be sold by retail drug stores with the prescription of physicians, in addition to the order issued by the National Development and Reform Commission to further reduce the prices of antibiotics. The core product of the Company, Lijunsha(利君沙), and other antibiotic products experienced immense challenge in the market. However, the Company timely adjusted its sales strategies and adopted a number of measures for stabilizing its sales to maintain a respectable performance. Despite a diminished market, the core product, Lijunsha(利君沙), managed to record a sales of RMB422,341,000 and successfully repositioned itself and put the decreasing sales to a halt. As a result, it achieved a higher sales income in the second half of the year than the first, forming a sound basis for its market sales in the coming year. Key products, Paiqi(派奇) and Limaixian(利邁先), sustained a high rate of growth, with an increase in sales income of 23.3% and 27% as compared to those of last year respectively. Dobesilate(多貝斯) achieved a sales income of RMB29,934,000, representing an increase of 46.1% as compared to that of last year. The sales of Cephalosporins(頭孢類) remained level, while sales of other finished medicines and bulk pharmaceuticals for foreign trade reflected a mild steady growth. The Company has further reduced its reliance on the sales of Lijunsha(利君沙) with a diversified product mix.

The Company has experienced a decrease in production cost. Despite the increase in raw materials prices and energy cost, the Company has effectively reduced its production cost as compared to that of last year by technical renovations, reinforced internal management for its production system and other measures.

The research for new products has reaped tremendous results. In the year 2005, the Company has obtained production permits for 27 new products and has completed the registration for non-prescriptive medicine in respect of Dobesilate(多貝斯) and 6 Chinese medicinal products, thus enriching its product mix for non-prescriptive medicines. The Company has also obtained 3 State Utility Patents. With continuous fruitful development of new products, the Company has put the industrialized production of new products in its full gear. Up to now, 13 new products have been successfully put into industrialized production and started to be launched onto the market, including Azithromycin Dispersible Tablets(阿奇霉素分散片), Potassium Dehydroandrographolide Succinate for Injection(穿琥寧凍乾粉針) and OTC Dobesilate(多貝斯). In the coming years, new products put into industrialized production will reach a peak in terms of both quantity and rate.

CHAIRMAN'S STATEMENT

OUTLOOK

Antibiotics products will remain the focal sale product of the Company in 2006. Efforts to adjust to the markets of Lijunsha(利君沙)and other products and to establish first-tier and second-tier agent networks throughout the People's Republic of China ("PRC") will continue, and these will be paralleled by moves to increase sales in rural markets and markets in small to medium cities. With the State's investment into rural medical systems and the emergence of new models of cooperative medical services in rural areas, there is immense growth potential in the rural markets. Meanwhile, in medium to large cities, the Company will prioritise the promotion of Paiqi(派奇), Limaixian(利邁先)and Cephalosporins(頭孢類)products. It is the Company's objective to maintain the Company's leading position in Macrolide antibiotics(大環內脂抗生素)in the PRC.

In the meantime, the Company will devote to the development of non-antibiotics medicines and non-prescriptive products to continue enhancing its product mix and reinforce its efforts to develop value-added end products. In particular, the market of OTC products in the PRC has seen swift growth at double-digit rate, reflecting the potential in this area. The Company will focus on developing and building up the market of OTC Dobesilate(多貝斯)and other products this year to facilitate them becoming one of the focal products of the Company.

In the year 2006, the Company is planning to start building one production line for modern oral solution, one for modern soft capsules and expanding the production line for lyophilized powder for injection. These three production lines will mainly be used for manufacturing new products, including several new products with the patents owned by the Company. The order for the equipments for the new production lines has already been placed, and it is estimated that the two production lines for modern oral solution and modern soft capsules will be completed by the end of the year. By then, a number of the Company's new products will be launched onto the market to further enrich its product offer.

In summary, we believe that the hardest time is already a history for us, and look forward to the regaining of momentum in terms of our sales. The development of new products will also reap better results.

Every member of the Company will unite their efforts and strive for satisfactory returns for the shareholders.

On behalf of the Board, I hereby express our genuine gratitude to our investors and employees for their support in the past.

Wu Qin
Chairman

Hong Kong, 20 March 2006

MANAGEMENT DISCUSSION AND ANALYSIS

SALES

As at 31 December 2005, the sales of the Company and its subsidiaries ("Group") amounted to approximately RMB884,709,000, representing a decrease of 2.0% as compared with RMB903,006,000 in last year.

	2004			**2005**		
	First Half	Second Half	Full Year	**First Half**	**Second Half**	**Full Year**
	RMB'000	*RMB'000*	*RMB'000*	***RMB'000***	***RMB'000***	***RMB'000***
Group's total sales	457,531	445,475	903,006	**433,092**	**451,617**	**884,709**

The No. 289 Document issued by the SFDA has become effective on 1 July 2004. Pursuant to the No. 289 Document, antibacterial agents (including antibiotics, sulfonamides, quinolones, drugs acting on tuberculosis and antifungal agents) not listed on the over-the-counter medicines catalogues can only be sold by retail drug stores in the PRC with the prescriptions of practising physicians. This policy has affected the overall sales of antibiotics. The sales of antibiotics, which accounted for 75.4% (2004: 77.7%) of the Group's total sales, has been the Group's major source of income. Therefore, the implementation of No.289 Document has led to the decline in the Group's total sales starting from the second half of 2004, and a further slowdown was seen during the first half of 2005. After the implementation of No. 289 Document, the Group has adopted various measures targeting to reduce its impact on the Group, including consolidating the relations with the distributors and pushing up the sales of other products, which began to bring fruits in the second half of 2005 when the Group's total sales started to rebound. However, there was still a slight decrease in the Group's total sales in 2005 as compared with that of last year.

	2004		**2005**	
	RMB'000	%	***RMB'000***	**%**
Antibiotics				
— Lijunsha	489,825	54.2	**422,341**	**47.7**
— Paiqi	72,224	8.0	**89,083**	**10.1**
— Erythromycin tablets	52,761	5.8	**54,002**	**6.1**
— Cephalosporin	53,663	5.9	**52,927**	**6.0**
— Limaixian	12,688	1.4	**16,119**	**1.8**
— Other antibiotics	21,365	2.4	**32,692**	**3.7**
Total sales of antibiotics	702,526	77.7	**667,164**	**75.4**
Other finished medicines	126,061	14.0	**130,222**	**14.7**
Sales of bulk pharmaceuticals	60,842	6.8	**72,825**	**8.2**
Sales of Chinese medicines	7,600	0.8	**10,241**	**1.2**
Others	5,977	0.7	**4,257**	**0.5**
Group's total sales	903,006	100	**884,709**	**100**

ANTIBIOTICS

The sales of antibiotics for the year amounted to RMB667,164,000 (2004: RMB702,526,000), of which "Lijunsha" accounted for 63.3% or RMB422,341,000 (2004: RMB489,825,000). Since Lijunsha, the major product of the Group, accounted for 47.7% of the Group's total sales and enjoyed a greater market share among similar products in the major cities, its sales received the heaviest blow caused by the No. 289 Document. Sales of Lijunsha started to slow down since the second half of 2004 and suffered from a year-on-year decrease of 13.8%. Nevertheless, its sales has been recovering and amounted to RMB218,989,000 during the second half of 2005. This represented an increase of 7.7% as compared with RMB203,352,000 recorded in the first half of 2005.

Due to the increasing market demand for azithromycin, a third-generation of macrolide antibiotics, the Group's "Paiqi" has become the key product of the Group in terms of sales. During 2005, sales of Paiqi was RMB89,083,000, representing a year-on-year growth of 23.3%. It accounted for 10.1% of the Group's total sales, representing an increase as compared with 8.0% of last year.

OTHER FINISHED MEDICINES

As for the sales of the Group's other products not affected by the No. 289 Document, an overall increase was recorded. Sales of other finished medicines amounted to RMB130,222,000 (2004: RMB126,061,000) in 2005, representing an increase of 3.3% as compared to that of last year. "Dobesilate", a kind of Calcium dobesilate product effective for preventing and treating various illnesses caused by obstruction in the microcirculation, was another key product of the Group which has achieved rapid growth among others. "Dobesilate" was, among the same kind of products, the first one to be listed by the related authority as an over-the -counter medicine in September 2005 and this has greatly increased its sales. In 2005, the sales of Dobesilate amounted to RMB29,934,000, representing a year-on-year growth of 46.1%.

BULK PHARMACEUTICALS AND CHINESE MEDICINES

Sales of bulk pharmaceuticals and Chinese medicines amounted to RMB72,825,000 (2004: RMB60,842,000) and RMB10,241,000 (2004: RMB7,600,000) respectively, representing an increase of 19.7% and 34.8% respectively.

COST OF GOODS SOLD

The cost of goods sold decreased 2.8% from RMB449,318,000 for the year ended 31 December 2004 to RMB436,842,000 for the year ended 31 December 2005. The cost of direct materials, direct labour and overhead represented approximately 70.8%, 9.0% and 20.2% of the total cost of goods sold respectively for the year ended 31 December 2005 while their comparative percentage for 2004 were 68.8%, 8.9% and 22.3% respectively.

GROSS PROFIT

Total gross profit of the Group in 2005 amounted to RMB447,867,000 (2004: RMB453,688,000), while the gross profit margin was 50.6%, which was similar to that recorded in last year (50.2%).

SELLING AND MARKETING EXPENSES

For the year ended 31 December 2005, selling and marketing expenses amounted to approximately RMB202,793,000 (2004: RMB220,599,000), which mainly comprised of advertising expenses of approximately RMB37,781,000 (2004: RMB79,854,000), sales commission of approximately RMB97,331,000 (2004: RMB83,646,000), salaries expenses of sales and marketing staff of approximately RMB17,182,000 (2004: RMB23,156,000) and office and rental expense of approximately RMB14,046,000 (2004: RMB11,242,000).

The decrease of 8.1% in selling and marketing expenses in 2005 as compared with that of 2004 was mainly attributable to the Group's reduction in advertising expenses in the mass media and the reinforcement of its marketing efforts directly on the distributors and ultimate customers such as hospitals and clinics after the implementation of No. 289 Document. Consequently, the advertising expense enjoyed a year-on-year decrease of 52.7% while sales commission suffered from a year-on-year increment of 16.4%.

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses amounted to approximately RMB108,414,000 (2004: RMB96,686,000) for the year ended 31 December 2005 which mainly comprised of salaries of approximately RMB33,877,000 (2004: RMB34,071,000), depreciation of approximately RMB10,663,000 (2004: RMB10,063,000), office and rental expenses of approximately RMB11,195,000 (2004: RMB7,793,000), sharing of administrative costs of Shaanxi Xi'an Pharmaceutical Factory of approximately RMB12,063,000 (2004: RMB13,105,000) and research and development expenses of approximately RMB7,429,000 (2004: RMB6,166,000).

The increase of 12.1% in general and administrative expenses in 2005 as compared with that of 2004 was mainly attributable to the increase in office and rental expenses and research and development expenses, as well as the accrued staff welfare fund and the expenses for the establishment of the offices in Hong Kong

OPERATING PROFIT

In 2005, despite the decrease in the Group's sales and gross profit and the increase in general and administrative expenses as compared with that of last year, these impacts were eliminated by the decrease in selling and marketing expenses. As a result, the Group's operating profit in 2005 remained at similar level as compared with that of last year, amounted to RMB138,737,000 (2004: 138,503,000) with its operating profit margin (defined as operating profit divided by total sales) increased from 15.3% to 15.7%.

FINANCE COSTS

As the Group has repaid certain bank borrowings during the year, the finance cost for the year has decreased slightly to RMB7,069,000 (2004: RMB7,111,000) as compared with that of last year.

INCOME TAX EXPENSE

The income tax expenses decreased from approximately RMB22,331,000 for the year ended 2004 to approximately RMB15,122,000 for the year ended 2005 while the effective tax rate reduced from 17.0% to 11.5%. Pursuant to the "Reply on Enjoying Statutory Reduction and Exemption of Enterprise Income Tax"（享受企業所得稅法定減免的覆函）issued by the Foreign-related branch of Xi'an State Tax Bureau（西安市國家稅務局涉外分局）on 13 May 2005, Xi'an Lijun Pharmaceutical Co., Ltd ("Xi'an Lijun") is entitled to an exemption from the enterprise income tax for the first two years and a 50% reduction in the enterprise income tax for the subsequent three years for the years 2005 to 2009.

PROFIT ATTRIBUTABLE TO EQUITY HOLDERS FOR THE YEAR

Although the Group's operating profits for 2005 remained at a similar level as compared with that of last year, the profit attributable to equity holders for the year increased by 5.3% to RMB93,311,000 (2004: RMB88,632,000) while net profit margin (profit attributable to equity holders for the year divided by total sales) increased from 9.8% in 2004 to 10.5%.

LIQUIDITY AND FINANCIAL RESOURCES

The Group primarily finances its working capital and other capital requirements by net cash generated from operating activities and resorts to external financing including both long-term and short-term loans from time to time in case the operating cashflow is insufficient to meet the capital requirements.

As the Group was listed on The Stock Exchange of Hong Kong Limited ("Stock Exchange") on 20 December 2005 and raised a net amount of HK$145,557,000, the Group's capital structure was remarkably improved. As at 31 December 2005, the cash and bank balance aggregated to RMB275,122,000 (2004: RMB138,674,000) while bank loans amounted to RMB113,000,000 (2004: RMB137,000,000). On the other hand, the gearing ratio (defined as total liabilities divided by total assets) decreased from 56.1% as at 31 December 2004 to 36.6% as at 31 December 2005. Current ratio (defined as current assets divided by current liabilities) increased from 1.11 as at 31 December 2004 to 1.79 as at 31 December 2005.

INTEREST RATE AND FOREIGN EXCHANGE RISK

Substantially all of the Group's businesses are operated in the PRC and are denominated in RMB while a small portion of which is denominated in US dollar or HK dollar. Therefore, interest rate and foreign exchange risk is insignificant.

CONTINGENT LIABILITIES

As at 31 December 2005, the Group did not have any contingent liabilities.

MANAGEMENT DISCUSSION AND ANALYSIS

PROCEEDS FROM INITIAL PUBLIC OFFERING

Proceeds from initial public offering amounted to approximately HK$145,557,000, net of relevant expenses. As the Group was listed on the Stock Exchange on 20 December 2005, most of the proceeds from initial public offering have not been utilized as at 31 December 2005 and such proceeds were mainly deposited in the bank account of the Group and the bank account of the placing underwriters in Hong Kong.

Proceeds from initial public offering will be applied as follows:

	HK$'000
Setting up of the new production line of spray form products	3,800
Setting up of the new production line of oral solution products	43,300
Setting up of the new production line of soft capsule form products	21,200
Expansion of production capacities of lyophilized powder for injection	17,300
Improvement of existing products and production technology of Chinese medicines, improvement and expansion of the Group's existing production facilities of Chinese medicines, development of new forms of Chinese medicines, and promotion of the brand name of the Group's Chinese medicines	19,200
Enhancement and expansion of the Group's distribution network	9,200
Setting up of centralised information and management systems for sales networks	5,800
Enhancement of the research and development capability to improve existing and develop new pharmaceutical technology	21,400
Group's Working capital	4,357
Total	145,557

BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

DIRECTORS

Executive Directors

Mr. Wu Qin (吳秦), aged 53, the chairman of the Company, is responsible for the strategic planning, business development and overall management of the Group. Mr. Wu has been the chairman of Rejoy Group Limited Liability Company ("Rejoy Group") since October 1998. He has also been the chairman and a director of Xi'an Lijun since November 1999. He is also a director of Prime United Industries Limited ("Prime United"), a controlling shareholder of the Company and a director of Success Manage International Limited ("Success Manage"), which held 7.69% interest in the Company. Mr. Wu was the general manager of Xi'an Lijun from November 1999 to April 2002. Mr. Wu has over 30 years of experience in the pharmaceutical industry. Mr. Wu graduated from The Open University of Hong Kong with a degree of Master in Business Administration in 2002. He has been awarded with the Model of National Labor and National May First Labor Award and has been an executive director of Pharmaceutical Administration Association/China Pharmaceutical Association. He also enjoys special subsidy for the year 2002 granted by the State Council of the PRC. He is currently a Deputy of the Tenth National People's Congress, vice president of Shaanxi Industrial and Economic Federation and Deputy Chairman of the Shaanxi Association of Commerce of the China International Association of Commerce. He is also a senior economist, the Deputy Chairman of Law and Social Order Committee of the Standing Committee of Shaanxi Province People's Congress and member of Strategies & Advisory Committee of Shaanxi Province.

Mr. Wu Zhihong (烏志鴻), aged 57, the vice-chairman of the Company and is responsible for investment of the Group. Mr. Wu has been the deputy chairman of Rejoy Group since October 1999 and was the chief executive officer of Rejoy Group from October 1999 to April 2005. He has also been the deputy chairman and a director of Xi'an Lijun since November 1999. Mr. Wu joined the Group since its establishment in November 1999 and has over 30 years of experience in the pharmaceutical industry. He is a director of Prime United and Success Manage. Mr. Wu graduated from Shenyang College of Pharmaceutical with pharmaceutical management profession in 1985. He is also a senior economist and a registered pharmacist accredited by the SFDA in February 2004.

Mr. Huang Chao (黃朝), aged 50, an executive Director and is responsible for finance, production and sales of the Group. Mr. Huang has been a director of Xi'an Lijun since November 1999 and is currently the general manager of Xi'an Lijun. He had been the deputy chairman of Xi'an Lijun until December 2004 and was the deputy chairman of Rejoy Group from August 1999 to September 2005. Mr. Huang joined the Group since its establishment in November 1999 and has over 30 years of experience in pharmaceutical production. He is a director of Prime United and Success Manage. Mr. Huang graduated from The Open University of Hong Kong with a Postgraduate Certificate in Business Administration in 2000.

Mr. Xie Yunfeng (謝雲峰), aged 51, an executive Director and is responsible for supplies and construction of workshops of the Group. Mr. Xie has been a director and the deputy general manager of Xi'an Lijun since November 1999. He was a director of Rejoy Group from August 1999 to May 2004. Mr. Xie joined the Group since its establishment in November 1999 and has over 26 years of experience in pharmaceutical production. He is also a director of Prime United. Mr. Xie graduated from Party School of the CPC Central Committee majoring in law in 2001.

Ms. Sun Xinglai (孫幸來), aged 49, an executive Director and is responsible for public relation of the Group. Ms. Sun has been a director of Xi'an Lijun since May 2004. She was the deputy general manager of Xi'an Lijun during November 1999 to May 2004. Ms. Sun joined the Group since its establishment in 1999. Ms. Sun was a director of Rejoy Group from May 2004 to September 2005 and the chief executive officer of Xi'an Rejoy Technology Investment Co. Ltd. ("Rejoy Technology") from May 2004 to April 2005, and the chairmans of labour unions of Rejoy Group and Xi'an Lijun. Ms. Sun graduated from The Open University of Hong Kong with a degree of Master in Business Administration in 2002.

BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

DIRECTORS *(Continued)*

Non-executive Director

Mr. Liu Zhiyong(劉志勇), aged 35, is a non-executive Director and a director of Xi'an Lijun. He joined China National Technical Import and Export Corporation as a finance personnel and became the assistant managing director and an executive director of CNTIC Group International Finance Limited in May 1998. Mr. Liu took up the post of the president of Genertec Hong Kong International Capital Limited in July 2003. Mr. Liu is a director of Victory Rainbow Investment Limited, a substantial shareholder of the Company. Mr. Liu graduated from Renmin University of China with a bachelor's degree in Accounting in 1992 and he is a member of CICPA. He was appointed as a non-executive Director in December 2004.

Independent non-executive Directors

Mr. Qu Jiguang(曲繼廣), aged 50, is an independent non-executive Director. Mr. Qu joined Shijazhuang No.1 Pharmaceutical Factory as deputy factory manager in 1995. He later became a director and the vice general manager of Shijiazhuang Pharmaceutical Group. From January 2000, Mr. Qu has been the chairman and general manager of Shijiazhuang Siyao Pharmaceutical Ltd. Mr. Qu was an executive director of China Pharmaceutical Group Limited, a company listed on the Stock Exchange, from February 2001 to September 2004. Mr. Qu graduated from Tianjin Finance College with a postgraduate degree in Finance in 1999. He is also an economist accredited by The Ministry of Personnel of China. He was appointed as an independent non-executive Director in October 2005.

Mr. Leung Chong Shun(梁創順), aged 40, is an independent non-executive Director. Mr. Leung graduated from the University of Hong Kong with a Bachelor of Laws degree in 1988 and obtained the Postgraduate Certificate in Laws in 1989. Mr. Leung was qualified as a solicitor in Hong Kong in 1991 and England & Wales in 1994. He has been a partner of Woo, Kwan, Lee & Lo, a law firm in Hong Kong, since 1997 and is experienced in corporate finance. Mr. Leung was appointed as an independent non-executive Director in October 2005.

Mr. Chow Kwok Wai(周國偉), aged 39, joined the Board as an independent non-executive director in 2005. He is also a director, the deputy general manager and qualified accountant of Silver Grant International Industries Limited, a company listed on the Stock Exchange. Mr. Chow has worked in Price Waterhouse, which is now known as PriceWaterhouseCoopers and accumulated valuable audit experience. Mr. Chow received his Bachelor's degree in Social Sciences from the University of Hong Kong in 1990. He is a Fellow Member of the Association of Chartered Certified Accountants and a Fellow CPA of the Hong Kong Institute of Certified Public Accountants. Mr. Chow has over 10 years of experience in accounting financial management and corporate finance.

SENIOR MANAGEMENT

Mr. Wang Xian Jun(王憲軍), aged 42, is the chief executive officer of the Company and is responsible for investor relation and public relation of the Group. He has over 20 years' experience in pharmaceutical industry. Mr. Wang joined Shijazhuang Pharmaceutical Group in 1987 and became the deputy chief engineer in 1989 and director in 1993. Mr. Wang was the executive director and vice-chairman of China Pharmaceutical Group Limited, a company listed on the Stock Exchange, until December 2002. Mr. Wang graduated from Beijing Chemical Engineering College with a Master's degree in Engineering in 1987. He joined the Group in July 2004 and was the deputy general manager of Xi'an Lijun from July 2004 to December 2004. He was appointed as the general manager of the Company in December 2004 and promoted to the chief executive officer of the Company in October 2005.

SENIOR MANAGEMENT *(Continued)*

Ms. Han Yamei（韓雅美）, aged 58, is a director of Xi'an Lijun and is responsible for overseeing human resources and sales and marketing of Xi'an Lijun. She joined the Group since its establishment in August 1999. Ms. Han has over 30 years' experience in sales and marketing. She is an economist accredited by Ministry of Personnel of the PRC（中華人民共和國人士部）.

Mr. Zhang Yabin（張亞濱）, aged 38, is a director of Xi'an Lijun and is responsible for overseeing the marketing and promotion of the Xi'an Lijun as well as the development of sale networks. He joined the Group since its establishment in November 1999. Mr. Zhang has over 15 years' experience in pharmaceutical industry. Mr. Zhang graduated with a degree of Master in Business Administration from Online Education College of Renmin University of China（中國工商管理碩士研究生（網絡）學院）in 2002 and also obtained a Bachelor's degree in Organic Chemical Engineering from Dalian University of Technology（大連理工學院）in 1988. He is also a senior engineer accredited by Senior Professional Personnel Qualification of Shaanxi Provincial Government（陝西省人民政府高級專業技術任職資格）and a senior manager accredited by Occupational Skill Testing Authority（職業技能鑑定（指導）中心）.

Mr. Wang Jiding（王繼丁）, aged 56, is the chief accountant of Xi'an Lijun and is responsible for overseeing the finance and accounting function of Xi'an Lijun. He joined the Group since its establishment in November 1999. Mr. Wang has over 25 years' of experience in finance and accounting in the PRC.

Mr. Wang Jianting（王建廷）, aged 58, is a vice general manager of Xi'an Lijun and is responsible for production function of Xi'an Lijun. He joined the Group since its establishment in November 1999 and has over 35 years' experience in pharmaceutical industry.

Mr. Chen Xiaojun（陳曉軍）, aged 42, is the chief engineer of Xi'an Lijun. He joined the Group since its establishment in November 1999 and is responsible for the research and development of Xi'an Lijun. He was also an officer of technology committee. Mr. Chen graduated from Shenyang School of Pharmacy with a Bachelor's degree in Pharmacy in 1986. He is also a registered pharmacist accredited by the SFDA in 2004.

Mr. Xu Gang（許剛）, aged 41, is the managing director of Shaanxi Lijun Heng Xin Tang Pharmaceutical Co., Ltd. ("Heng Xin Tang") and is responsible for overseeing the overall daily operation of Heng Xin Tang. Mr. Xu joined Heng Xin Tang in January 2005. He has over 10 years of experience in financial management and, sales and marketing. Mr. Xu graduated from Shanghai Jiao Tong University（上海交通大學）with a Bachelor of Sciences degree in Engineering in 1986. He obtained a Master's degree in Business Administration from University of Ottawa in October 2000.

QUALIFIED ACCOUNTANT AND COMPANY SECRETARY

Mr. Lam Yiu Por（林曉波）, aged 29, is the qualified accountant, company secretary and financial controller of the Company. Mr. Lam was appointed as the qualified accountant, company secretary and financial controller of the Company in October 2005. He graduated with a Bachelor's degree in Accountancy from Hong Kong Polytechnic University in 1997. Mr. Lam has more than eight years of experience in the field of finance and accounting. Prior to joining the Company as its qualified accountant, he was the qualified accountant of a company listed on the Stock Exchange. He is a member of the Hong Kong Institute of Certified Public Accountants and an associate member of the Association of Chartered Certified Accountants.

REPORT OF THE DIRECTORS

The Board present their report together with the audited financial statements for the year ended 31 December 2005.

CORPORATE REORGANISATION

The Company was incorporated with limited liability in the Cayman Islands on 28 September 2004. In preparation for the public listing of the shares of the Company ("Shares") on the Stock Exchange, the Group underwent a reorganisation and the Company became the holding company of the Group. Details of the reorganisation are set out in note 2 to the financial statements.

ISSUE AND LISTING OF SHARES

The Shares were listed on the Stock Exchange on 20 December 2005 by way of public offer and placing.

Under the public offer and placing, 80,500,000 shares (including 10,500,000 over-allotment Shares) were issued at the share offer of HK$2.15 per Share.

PRINCIPAL ACTIVITIES

The principal activity of the Company is investment holding and the activities of its subsidiaries are set out in note 17 to the financial statements.

RESULTS AND APPROPRIATIONS

The results of the Group for the year are set out in the consolidated income statement on page 33.

The Directors recommend the payment of a final dividend of HK$0.16 per Share totalling HK$46,480,000.

RESERVES

Details of movements in the reserves of the Group and of the Company during the year are set out in note 31 to the financial statements.

DONATIONS

Charitable and other donations made by the Group during the year amounted to HK$1,181,000.

PROPERTY, PLANT AND EQUIPMENT

Details of the movements in property, plant and equipment of the Group and of the Company during the year are set out in note 15 to the financial statements.

SHARE CAPITAL

Details of the movements in share capital of the Company during the year are set out in note 30 to the financial statements.

DISTRIBUTABLE RESERVES

Reserves of the Company as at 31 December 2005 available for distribution amounted to RMB54,426,000. The Company's share premium account and capital surplus, in the amount of RMB121,239,000 and RMB152,040,000 respectively are also available for distribution to shareholders, subject to the condition that the Company cannot declare or pay a dividend, or make a distribution of share premium and contributed surplus if (a) the Company is, or would after the payment be, unable to pay its liabilities as they become due in the ordinary course of business; or (b) the realizable value of the Company's assets would thereby be less than the aggregate of its liabilities and its issued share capital account.

PRE-EMPTIVE RIGHTS

There is no provision for pre-emptive rights under the Company's articles of association or the laws of the Cayman Islands, which would oblige the Company to offer new shares on a pro-rata basis to existing shareholders.

PURCHASE, SALE OR REDEMPTION OF SECURITIES

The Company has not redeemed any of its Shares during the year. Neither the Company nor any of its subsidiaries has purchased or sold any of the Company's listed securities during the year.

SHARE OPTION SCHEME

Pursuant to a share option scheme approved by a written resolution of all shareholders of the Company on 16 October 2005 ("Scheme"), the Company may grant options to, amongst others, the directors or employees of the Company or its subsidiaries, for the recognition of their contributions to the Group, to subscribe for the Shares. The offer for grant of options ("Offer") must be taken up within 28 days from the date of Offer, with a payment of HK$1.00 as consideration for the grant. The exercise price of the share option will be determined at the higher of (i) the average closing prices of Shares as stated in the Stock Exchange's daily quotations sheets for the five trading days immediately preceding the date of Offer; (ii) the closing price of Shares as stated in the Stock Exchange's daily quotations sheet on the date of Offer; and (iii) the nominal value of the Shares. The share options are exercisable at any time during a period of not more than 10 years from the date of Offer, subject to the terms and conditions of the Scheme and any conditions of grant as may be stipulated by the Board. Unless terminated by the Company by resolution in general meeting, the Scheme shall be valid and effective for a period of 10 years commencing on the date on which the Scheme becomes unconditional.

The maximum number of Shares which may be issued upon exercise of all outstanding options granted and yet to be exercised under the Scheme and any other schemes shall not exceed 30% of the issued share capital of the Company from time to time. The total number of Shares which may be issued upon exercise of all options to be granted under the Scheme and any other schemes must not, in aggregate, exceed 10% of the number of Shares in issue as at the date dealings in the Shares first commence on the Stock Exchange unless further shareholders' approval has been obtained pursuant to the conditions set out in the Scheme. The total number of Shares issued and to be issued upon exercise of all options granted under the Scheme and any other schemes (including both exercised or outstanding options) to each participant in any 12-month period shall not exceed 1% of the issued share capital of the Company.

No option has been granted by the Company under the Scheme since its adoption.

REPORT OF THE DIRECTORS

DIRECTORS

The Directors during the year were:

Executive Directors

Mr. Wu Qin	(appointed on 27 December 2004)
Mr. Wu Zhihong	(appointed on 27 December 2004)
Mr. Huang Chao	(appointed on 27 December 2004)
Mr. Xie Yunfeng	(appointed on 27 December 2004)
Ms. Sun Xinglai	(appointed on 27 December 2004)

Non-executive Directors

Mr. Liu Zhiyong	(appointed on 27 December 2004)

Independent Non-executive Directors

Mr. Qu Jiguang	(appointed on 16 October 2005)
Mr. Leung Chong Shun	(appointed on 16 October 2005)
Mr. Chow Kwok Wai	(appointed on 16 October 2005)

In accordance with Article 86 of the Company's articles of association, Mr. Wu Qin, Mr. Wu Zhihong, Mr. Huang Chao, Mr. Xie Yunfeng, Ms. Sun Xinglai, Mr. Liu Zhiyong, Mr. Qu Jiguang, Mr. Leung Chong Shun and Mr. Chow Kwok Wai will hold office as Directors only until the forthcoming annual general meeting and being eligible offer themselves for re-election.

The Company has received from each of the independent non-executive Directors an annual confirmation of his independence pursuant to Rule 3.13 of the Rules Governing the Listing of Securities on the Stock Exchange ("Listing Rules") and considers the independent non-executive Directors to be independent.

DIRECTORS' SERVICE CONTRACTS

Each of the Directors has entered into a service agreement with the Company for an initial term of 3 years commencing from 16 October 2005.

Save as disclosed above, none of the Directors has entered into a service contract with the Company which is not determinable by the Company within one year without payment of compensation other than statutory compensation.

DIRECTORS' INTERESTS IN CONTRACTS

No contracts of significance in relation to the Group's business to which the Company, its holding company or any of its subsidiaries and fellow subsidiaries was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

DIRECTORS' RIGHTS TO ACQUIRE SHARES

Apart from the Scheme disclosed above, at no time during the year was the Company, its holding company or any of its subsidiaries and fellow subsidiaries a party to any arrangement to enable the Directors, their respective spouse or minor children to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or in any other body corporate.

BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

Brief biographical details of Directors and senior management are set out on page 10 to 12.

EMPLOYEES AND REMUNERATION POLICY

Emoluments of the directors are determined by the Board with reference to the prevailing market practice, the Company's remuneration policy, duties and responsibilities of the Directors within the Group and their contribution to the Group.

As at 31 December 2005, the Group had 2,580 employees, most of whom were members of the Group's production team based in the PRC. The number of workers employed by the Group varies from time to time depending on its needs and the emolument policy of employees is based on industry practice.

The remuneration policy of the Group's employees are periodically reviewed. Apart from social insurance and in-house training programmes, discretionary bonuses and share options may be awarded to employees according to the assessment of individual performance.

The total remuneration cost incurred by the Group for year ended 31 December 2005 was RMB87,408,000 (2004: RMB78,429,000).

RETIREMENT BENEFIT PLANS

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. Otherwise, the Group would pay monthly allowance to old retired persons. The Group has no further pension obligation beyond the above contributions. Expenses incurred by the Group in connection with the retirement benefit plans were approximately RMB9,912,000 for the year ended 31 December 2005 (2004: RMB9,523,000).

In Hong Kong, the Group has set up a retirement scheme in accordance with the mandatory provident fund requirements prescribed by the Mandatory Provident Fund Schemes Ordinance, Chapter 485 of the Laws of Hong Kong. All Hong Kong based employees and the Group are required to contribute 5% of their respective monthly wages (up to a maximum contribution of HK$1,000 by each of the employee and the Group) on a monthly basis to the fund.

DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS IN THE SHARES

As at 31 December 2005, the interests of the Directors in the share capital of the Company and its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) as recorded in the register required to be kept by the Company pursuant to section 352 of the SFO, or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers ("Model Code") in the Listing Rules once the Shares are listed, were as follows:

Long positions in the Shares

Name of Director	Capacity	Number of shares held	% of the issued share capital of the Company
Mr. Wu Qin	Interest in a controlled corporation *(Note)*	22,344,000	7.69%

Note: These Shares were registered in the name of and beneficially owned by Success Manage, the issued share capital of which is held as to approximately 37.88% by Mr. Wu Qin. Pursuant to Part XV of the SFO, Mr. Wu Qin is deemed to be interested in all the Shares held by Success Manage.

Save as disclosed above, as at 31 December 2005, none of the Directors or chief executives had an interest or short position in the Shares, underlying shares or debentures of the Company or any of its associated corporations that was required to be recorded pursuant to Section 352 of the SFO, or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code.

SUBSTANTIAL SHAREHOLDERS' AND OTHER PERSON'S INTERESTS IN THE SHARES

The register of substantial shareholders required to be kept by the Company under section 336 of the SFO shows that as at 31 December 2005, the Company had been notified of the following interests and short positions, being 5% or more in the issued share capital of the Company. These interests are in addition to those disclosed above in respect of the Directors and chief executives.

Long positions in the Shares

Name of shareholder	Capacity	Number of Shares	% of the issued share capital of the Company
Prime United *(Note 1)*	Beneficial owner	123,984,000	42.68%
Victory Rainbow Investment Limited	Beneficial owner	52,500,000	18.07%
Grand Ocean Shipping Company Ltd. *(Note 2)*	Interest of controlled corporation	52,500,000	18.07%
Ms. Chen Lin-Dong *(Note 2)*	Interest of controlled corporation	52,500,000	18.07%
Mr. Xu Ming *(Note 2)*	Interest of controlled corporation	52,500,000	18.07%
Success Manage	Beneficial owner	22,344,000	7.69%
Ms. Zhang Minfang *(Note 3)*	Interest of spouse	22,344,000	7.69%

Notes:

1. Prime United is held as to 2.43% by Mr. Wu Qin, an executive Director, as to approximately 2.43% by Mr. Wu Zhihong, an executive Director, as to approximately 2.41% by Mr. Huang Chao, an executive Director, as to approximately 4% by Mr. Xie Yunfeng, an executive Director, as to approximately 4% by Ms. Han Yamei, a member of the management of Xi'an Lijun, and as to approximately 84.73% by Mr. Wu Qin, Mr. Wu Zhihong, Mr. Huang Chao, Mr. Xie Yunfeng and Ms. Han Yamei who jointly hold such shares on trust for 4,965 individuals who are present and former employees or their respective estates of Xi'an Lijun and Rejoy Group. The beneficial ownership structure in Prime United is a replication of the ownership structure of Rejoy Technology.

2. Victory Rainbow Investment Limited is wholly-owned by Grand Ocean Shipping Company Ltd., a company incorporated in the Republic of Liberia, which in turn is owned as to 50% by Ms. Chen Lin-Dong and 50% by Mr. Xu Ming. By virtue of Part XV of the SFO, each of Grand Ocean Shipping Company Ltd., Ms. Chen Lin-Dong and Mr. Xu Ming is deemed to be interested in the Shares held by Victory Rainbow Investment Limited.

3. Success Manage is held as to approximately 37.88% by Mr. Wu Qin. Pursuant to Part XV of the SFO, the spouse of Mr. Wu Qin, Ms. Zhang Minfang, is deemed to be interested in all the Shares held by Success Manage.

MANAGEMENT CONTRACTS

Save as disclosed under the heading "Connected transactions", no other contracts concerning the management and administration of the whole or any substantial part of the business of the Group were entered into or in existence during the year.

MAJOR SUPPLIERS AND CUSTOMERS

During the year, the Group purchased less than 30% of its total purchases from its 5 largest suppliers and sold less than 30% of its turnover to its 5 largest customers.

CONNECTED TRANSACTIONS

Certain related party transactions as disclosed in note 33 to the financial statements also fell under the definition of "connected transaction" or "continuing connected transaction" in Chapter 14A of the Listing Rules, details of which are set out below. The Company has complied with the disclosure requirements, where applicable, in accordance with Chapter 14A of the Listing Rules.

(1) Discontinued Continuing Connected Transaction

(a) Purchase of raw materials from Rejoy Group Zhenjiang Pharmaceutical Co., Ltd.（利君集團鎮江製藥有限責任公司）("Zhenjiang Pharmaceutical")

Zhenjiang Pharmaceutical was principally engaged in the sale and production of bulk pharmaceuticals and was one of the suppliers of the Group in raw material. It was previously held as to 51% by Rejoy Group, a substantial shareholder of Xi'an Lijun and accordingly was a connected person of the Company under the Listing Rules. On 26 September 2005, Rejoy Group had entered into an agreement to dispose of its 51% equity interest in Zhenjiang Pharmaceutical to an independent third party and Zhenjiang Pharmaceutical was therefore no longer a connected person of the Company.

Following the above mentioned equity transfer and the contemplated change in shareholders and management of Zhenjiang Pharmaceutical, the Group had ceased to purchase raw materials from Zhenjiang Pharmaceutical. For the year ended 31 December 2005, the total amount paid by the Group to Zhenjiang Pharmaceutical for the purchase of raw materials amounted to approximately RMB5,143,000.

CONNECTED TRANSACTIONS *(Continued)*

(1) Discontinued Continuing Connected Transaction *(Continued)*

(b) Provision of guarantee by Rejoy Group to a bank for loan drawn by Xi'an Lijun

Rejoy Group had entered into the following guarantee contract to act as the guarantor for loan drawn by Xi'an Lijun:

Bank	Amount *(RMB)*	Date of commencement of the loan	Date of expiry of loan	Term of the guarantee
China Everbright Bank (Xi'an Branch)	10,000,000	15 July 2004	14 July 2005	Guarantee for the principal amount of the loan of RMB10,000,000 and interests, damages and other relevant expenses arising therefrom after 2 years of the expiry date of the loan

To facilitate the borrowing of loan for Xi'an Lijun, the above guarantee was provided by Rejoy Group for no consideration. For the loan set out above, a loan agreement was entered into between the relevant bank and Xi'an Lijun and a corresponding guarantee contract has been entered into between the relevant bank and Rejoy Group.

The loan was required for the expansion of the Group in recent years. Rejoy Group, as a substantial shareholder of Xi'an Lijun, was required to provide the above guarantee to facilitate the borrowing of loan for Xi'an Lijun from the bank. The above bank loan has been fully repaid and the corporate guarantee provided by Rejoy Group was released.

(2) Continuing connected transactions

(a) Lease of land-use rights by Xi'an Lijun from Rejoy Group

Pursuant to the lease of land-use rights agreement entered into between Xi'an Lijun and Rejoy Group on 16 October 2005 ("Land-Use Rights Agreement"), Xi'an Lijun leased land-use rights from Rejoy Group for a term commencing from 1 July 2005 and ending on 31 December 2007. Particulars of the areas of leased land were set out in the property valuation report in Appendix III to the Prospectus dated 2 December 2005 ("Prospectus"). The total areas of the leased land amounted to approximately 113,768 square metres and the rent paid by Xi'an Lijun was at RMB4 per square metre per month. The Group entered into the Land-Use Rights Agreement as the production plants, storage, office buildings of Xi'an Lijun are located on the relevant land. For the period from 1 January 2005 to 30 June 2005, Xi'an Lijun had also leased the land-use rights from Rejoy Group with similar terms as the Land-Use Rights Agreement. Sallmanns (Far East) Limited, an independent valuer, had confirmed that the rent payable for these land-use rights under the Land-Use Rights Agreement was fair and reasonable and reflected the prevailing market rates.

CONNECTED TRANSACTIONS *(Continued)*

(2) Continuing connected transactions *(Continued)*

(a) Lease of land-use rights by Xi'an Lijun from Rejoy Group *(Continued)*

Rejoy Group is a connected person of the Company under the Listing Rules as it holds 20% of interests of Xi'an Lijun. For the year ended 31 December 2005, the total amount paid by the Group to Rejoy Group in respect of the land-use rights was approximately RMB5,460,864, which did not exceed the annual cap of RMB5,460,864 prescribed for the year ended 31 December 2005 as disclosed in the Prospectus.

(b) Purchase of packaging materials from Xi'an Global Printing Co., Ltd.（西安環球印務有限公司）("Global Printing")

The principal business of Global Printing is printing of packaging materials. The Group had been purchasing packaging materials from Global Printing on an ongoing basis for packaging its own products.

Pursuant to the supply agreement dated 16 October 2005 entered into between Xi'an Lijun and Global Printing on 16 October 2005, Xi'an Lijun purchased packaging materials from Global Printing for a term of 3 years commencing from 1 January 2005 and ending on 31 December 2007. The Directors confirmed that the purchase prices of packaging materials from Global Printing had been determined in accordance with the market prices and on normal commercial terms, and that the Group had paid to Global Printing for the packaging materials at prices no less favorable than those paid to independent third parties and on terms no less favorable than those the Group could obtain from independent third parties.

Global Printing is connected person of the Company under the Listing Rules as it is held as to 45% by Shaanxi Pharmaceutical Company（陝西省醫藥總公司）("SPC"), which also holds all the interests in Rejoy Group, a substantial shareholder of Xi'an Lijun. For the year ended 31 December 2005, the total amount paid by the Group to Global Printing for the purchase of packaging materials amounted to approximately RMB6,883,000, which did not exceed the estimated annual cap of RMB8,500,000 prescribed for the year ended 31 December 2005 as disclosed in the Prospectus.

(c) Provision of utilities such as electricity, water, steam, cooling salt water and compressed air by Shaanxi Xi'an Pharmaceutical Factory ("Xi'an Pharmacy Factory")

Xi'an Pharmacy Factory had been supplying utilities to Xi'an Lijun. Pursuant to the utilities services agreement entered into between Xi'an Lijun and Xi'an Pharmacy Factory on 16 October 2005, Xi'an Pharmacy Factory supplied utilities including electricity, water, steam, cooling salt water and compressed air to Xi'an Lijun for a term of three years commencing from 1 January 2005 and ending on 31 December 2007. The charges for electricity and water payable by Xi'an Lijun were calculated based on the state-prescribed prices (tax inclusive) plus actual processing costs of Xi'an Pharmacy Factory. In respect of steam, cooling salt water and compressed air, such charges were determined based on actual costs of production incurred by Xi'an Pharmacy Factory. The reason for the Group entering into the above agreement was to satisfy the needs of Xi'an Lijun in respect of its production, office and storage.

CONNECTED TRANSACTIONS *(Continued)*

(2) Continuing connected transactions *(Continued)*

(c) Provision of utilities such as electricity, water, steam, cooling salt water and compressed air by Shaanxi Xi'an Pharmaceutical Factory ("Xi'an Pharmacy Factory") *(Continued)*

Xi'an Pharmacy Factory is a connected person to the Company as it is a wholly-owned subsidiary of Rejoy Group, a substantial shareholder of Xi'an Lijun. For the year ended 31 December 2005, the total amount paid by the Group to Xi'an Pharmacy Factory in respect of supply of utilities amounted to approximately RMB50,973,000, which did not exceed the estimated annual cap of RMB55,000,000 prescribed for the year ended 31 December 2005 as disclosed in the Prospectus.

(d) Sharing of administrative costs between Xi'an Lijun and Xi'an Pharmacy Factory

Xi'an Lijun had been sharing the administrative costs of Xi'an Pharmacy Factory so that the employees of Xi'an Lijun were entitled to enjoy certain facilities and services including hospitals, nursery, schools, security, property management and environmental beautification provided by Xi'an Pharmacy Factory. Pursuant to the agreement entered between Xi'an Lijun and Xi'an Pharmacy Factory on 16 October 2005, Xi'an Lijun shared the administrative costs of Xi'an Pharmacy Factory so that the employees of Xi'an Lijun would continue to be able to enjoy the aforesaid facilities and services provided by Xi'an Pharmacy Factory for a term of three years commencing from 1 January 2005 and ending on 31 December 2007. The total amount of administrative costs was based on the actual costs incurred for the provision of the aforesaid facilities and services. The share of administrative costs borne by Xi'an Lijun was determined with reference to the actual number of employees of Xi'an Lijun utilizing such facilities and services.

Xi'an Pharmacy Factory is a connected person to the Company by virtue of being a wholly-owned subsidiary of Rejoy Group, a substantial shareholder of Xi'an Lijun. For the year ended 31 December 2005, the total amount paid by the Group to Xi'an Pharmacy Factory in respect of the administration costs amounted to approximately RMB12,926,000, which did not exceed the estimated annual cap of RMB13,000,000 prescribed for the year ended 31 December 2005 as disclosed in the Prospectus.

(e) Distribution of the Group's products by Xi'an Rejoy Medicine Co., Ltd. (西安利君醫藥有限責任公司) ("Rejoy Medicine")

Rejoy Medicine has been one of the Group's distributors in Xi'an and is principally engaged in the retail and distribution of pharmaceutical products. Pursuant to the purchase and distribution agreement entered into between Rejoy Medicine and Xi'an Lijun on 16 October 2005, Rejoy Medicine purchased products from Xi'an Lijun and distributed such products to other distributors and end customers for a term of three years commencing from 1 January 2005 and ending on 31 December 2007. The Directors confirmed that the selling prices of the Group's products sold to Rejoy Medicine had been determined in accordance with the market prices and that the Group charged Rejoy Medicine for the products at prices no less favorable than those charged to independent third parties and on terms no less favorable than those the Group could obtain from independent third parties.

Rejoy Medicine is a connected person to the Company as it is held as to 55% by Rejoy Group, a substantial shareholder of the Xi'an Lijun. For the year ended 31 December 2005, the Group's sale to Rejoy Medicine amounted to approximately RMB20,886,000, which did not exceed the estimated annual cap of RMB27,000,000 prescribed for the year ended 31 December 2005 as disclosed in the Prospectus.

CONNECTED TRANSACTIONS *(Continued)*

(2) Continuing connected transactions *(Continued)*

(f) Distribution of the Group's products by Rejoy Baichuan Medicines Chemical Engineering Co., Ltd. ("Rejoy Baichuan")

Rejoy Baichuan has been one of the Group's distributors in the northwest market of the PRC and is principally engaged in the retail and distribution of pharmaceutical products. Pursuant to the purchase and distribution agreement entered into between Xi'an Lijun and Rejoy Baichuan on 16 October 2005 , Rejoy Baichuan purchased products from Xi'an Lijun and distributed such products to other distributors and end customers for a term of three years commencing from 1 January 2005 and ending on 31 December 2007. The Directors confirmed that the selling prices of the Group's products sold to Rejoy Baichuan had been determined in accordance with the market prices and that the Group charged Rejoy Baichuan for the products at prices no less favorable than those charged to independent third parties and on terms no less favorable than those the Group could obtain from independent third parties.

Rejoy Baichuan is held as to 84% by Rejoy Technology, the issued share capital of which is held as to 100% by the beneficial shareholders of Prime United, one of the controlling shareholders of the Company. Accordingly, Rejoy Baichuan is a connected person of the Company under the Listing Rules. For the year ended 31 December 2005, the Group's sales to Rejoy Baichuan amounted to approximately RMB9,043,000, which did not exceed the estimated annual cap of RMB24,000,000 prescribed for the year ended 31 December 2005 as disclosed in the Prospectus.

(g) Distribution of the Group's products by Liaoning Huabang Pharmaceutical Co., Ltd.（遼寧華邦醫藥有限公司）("Huabang Pharmaceutical")

Huabang Pharmaceutical has been one of the Group's distributors in the northeast market of the PRC and is principally engaged in the retail and distribution of pharmaceutical products. Pursuant to the purchase and distribution agreement entered into between Xi'an Lijun and Huabang Pharmaceutical on 16 October 2005, Huabang Pharmaceutical purchased products from Xi'an Lijun and distributed such products to other distributors and end customers for a term of three years commencing from 1 January 2005 and ending on 31 December 2007. The Directors confirmed that the selling prices of the Group's products sold to Huabang Pharmaceutical had been determined in accordance with the market prices and that the Group charged for the products at prices no less favorable than those charged to independent third parties and on terms no less favorable than those the Group could obtain from independent third parties.

The registered capital of Huabang Pharmaceutical is held as to 100% by the beneficial shareholders of Bondwide Trading Limited, one of the controlling shareholders of the Company. Accordingly, Huabang Pharmaceutical is a connected person of the Company under the Listing Rules. For the year ended 31 December 2005, the Group's sale to Huabang Pharmaceutical amounted to approximately RMB4,526,000, which did not exceed the estimated annual cap of RMB11,000,000 prescribed for the year ended 31 December 2005 as disclosed in the Prospectus.

The aforesaid continuing connected transactions have been reviewed by independent non-executive Directors of the Company. The independent non-executive Directors confirmed that the aforesaid connected transactions were entered into (a) in the ordinary and usual course of business of the Group; (b) either on normal commercial terms or on terms no less favourable to the Group than terms available to or from independent third parties; (c) in accordance with the relevant agreements governing them on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole; (d) have not exceeded the relevant maximum amount capped in accordance to the waiver previously granted by the Stock Exchange.

CONNECTED TRANSACTIONS *(Continued)*

Based on the work performed, the auditors of the Company have confirmed that the aforesaid continuing connected transaction (a) have been approved by the Board of the Company; (b) have been entered into in accordance with the terms of the relevant agreements governing the transactions; and (c) have not exceeded the caps allowed by the Stock Exchange in the previous waiver.

SUFFICIENCY OF PUBLIC FLOAT

Based on the information that is publicly available to the Company and within the knowledge of the Directors, it is confirmed that a sufficient public float of more than 25% of the issued capital of the Company has been maintained as at 31 December 2005.

POST BALANCE SHEET EVENTS

No significant events occurred after the balance sheet date.

MODEL CODE FOR SECURITIES TRANSACTIONS BY DIRECTORS

The Board has adopted a new code of conduct regarding Directors' securities transactions on terms no less exacting than the required standard set out in the Model Code for Securities Transactions by Directors of Listed Issuers as set out in Model Code. The Directors confirmed that there were not any non-compliance with the standard set out in the Model Code and the Company's code of conduct regarding Directors' securities transactions during the year ended 31 December 2005.

AUDITORS

The financial statements have been audited by PricewaterhouseCoopers who retire and, being eligible, offer themselves for re-appointment at the forthcoming annual general meeting.

CLOSURE OF REGISTER OF MEMBERS

The register of members of the Company will be closed from Monday, 10 April 2006 to Thursday, 13 April 2006 (both days inclusive) during which period no transfer of Shares will be effected. In order to qualify for the proposed final dividend and the entitlement to attend and vote at the forthcoming annual general meeting, all transfer documents, accompanied by the relevant share certificates, must be lodged with the Company's branch share registrar and transfer office of the Company in Hong Kong, Computershare Hong Kong Investor Services Limited, at Shops 1712-16, 17th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong not later than 4:00 p.m. on Friday, 7 April 2006.

On behalf of the Board
Wu Qin
Chairman

Hong Kong, 20 March 2006

CORPORATE GOVERNANCE REPORT

REPORT ON CORPORATE GOVERNANCE PRACTICES

The Company applied the principles and complied with all requirements of the Code on Corporate Governance Practices ("CG Code") contained in Appendix 14 of the Listing Rules, with deviations from code provisions as follows:

A1.1 due to the Company was listed on the main board of the Stock Exchange on 20 December 2005, only one Board meeting was convened in 2005. At least four regular meetings will be convened each year starting from the year of 2006.

A4.2 currently, a Director appointed to fill a casual vacancy on the Board of Directors (the "Board") holds office only until the next following annual general meeting rather than the next following general meeting, so as to comply with the requirement under Appendix III of the Listing Rules. A special resolution will be proposed in the annual general meeting to be held on 18 April 2006 to amend the articles of association of the Company, since then the relevant requirement under the CG Code will be fully complied.

The following summarises the Company's corporate governance practices and explains deviations, if any, from the CG Code.

Key Corporate Governance Principles and the Company's Practices

A.1 Board of Directors

The Board is responsible for leadership and control of the Company and oversees the Group's businesses, strategic direction and performance. The Management was delegated the authority and responsibility by the Board for the management of the Group. In addition, the Board has also delegated various responsibilities to the Board Committees. Further details of these committees are set out in this report.

As the Company was listed on the Stock Exchange on 20 December 2005, only one board meeting was held for the year ended 2005 and the attendance was as follows:

Number of meeting	1	Attendance
Wu Qin	1/1	100%
Wu Zhihong	1/1	100%
Huang Chao	1/1	100%
Xie Yunfeng	1/1	100%
Sun Xinglai	1/1	100%
Liu Zhiyong	1/1	100%
Qu Jiguang	1/1	100%
Leung Chong Shun	1/1	100%
Chow Kwok Wai	1/1	100%

All directors were given an opportunity to contact the Company Secretary to include matters in the agenda for regular board meeting.

Notice of at least 14 days were given of a regular board meeting. For all other board meeting, reasonable notice will be given.

All minutes of Board meetings were recorded in sufficient detail the matters considered by the board and decisions reached. Draft and final versions of minutes of Board meetings were sent to all directors for their comment and record respectively within 3 business days after the board meeting was held.

REPORT ON CORPORATE GOVERNANCE PRACTICES *(Continued)*

Key Corporate Governance Principles and the Company's Practices *(Continued)*

A.1 Board of Directors *(Continued)*

The Company has established the Policy on obtaining independent professional advice by directors to enable the directors, upon reasonable request, to seek independent professional advice in appropriate circumstances, at the Company's expense.

If a substantial shareholder or a Director has a conflict of interest in a matter to be considered by the Board which the Board has determined to be material, the matter shall be discussed by a Board meeting actually hold.

A.2 Chairman and Chief Executive Officer

The Board appointed Mr. Wu Qin as the Chairman, who was responsible for the leadership and effective running of the Board, and ensuring that all key and appropriate issues were discussed by the Board in a timely and constructive manner.

The Board appointed Mr. Wang Xian Jun as the Chief Executive Officer, who was delegated with the responsibilities of investor relation and public relation of the Group. The Board also comprises Independent Non-Executive Directors who bring strong independent judgment, knowledge and experience to the Board. As noted below, all the Audit Committee members are Independent Non-Executive Directors. This structure is to ensure a sufficient balance of power and authority in place within the Group.

A.3 Board Composition

The Board comprises five executive Directors, being Mr. Wu Qin, Mr. Wu Zhihong, Mr. Huang Chao, Mr. Xie Yunfeng and Ms. Sun Xinglai, one non-executive Directors, being Mr. Liu Zhiyong, and three independent non-executive Directors, being Mr. Qu Jiguang, Mr. Leung Chong Shun and Mr. Chow Kwok Wai. The Directors are considered to have a balance of skill and experience appropriate for the requirements of the business of the Company, details of the directors are shown on page 10 to 11 under the section of Directors and Senior Management.

All Directors are expressly identified by categories of executive directors, non-executive director and independent non-executive directors, in all corporate communications that disclose the names of Directors of the Company.

A.4 Appointments, Re-election and Removal

At each annual general meeting one third of the Directors for the time being (or, if their number is not a multiple of three, the number nearest to but not less than one-third) shall retire from office by rotation provided that every Director shall be subject to retirement at least once every three years.

Currently, a Director appointed to fill a casual vacancy on the Board holds office only until the next following annual general meeting rather than the next following general meeting, so as to comply with the requirement under Appendix III of the Listing Rules. A special resolution will be proposed in the annual general meeting to be held on 18 April 2006 to amend the articles of association of the Company, since then the relevant requirement under the CG Code will be fully complied.

REPORT ON CORPORATE GOVERNANCE PRACTICES *(Continued)*

Key Corporate Governance Principles and the Company's Practices *(Continued)*

A.4 Appointments, Re-election and Removal *(Continued)*

According to the Articles of Association, Mr. Wu Qin, Mr. Wu Zhihong, Mr. Huang Chao, Mr. Xie Yunfeng, Ms. Sun Xinglai, Mr. Liu Zhiyong, Mr. Qu Jiguang, Mr. Leung Chong Shun and Mr. Chow Kwok Wai will retire from office as Directors at the forthcoming annual general meeting and being eligible offer themselves for re-election.

Every Director, including those appointed for a specific term, were subject to retirement by rotation at least once very three years.

The Company had not established a Nomination Committee and retained the functions to the Board. The Directors from time to time identify individual suitable to be a Board member and make recommendation to the Board. The main criteria in selecting a candidate are whether if he can add value to the management through his contributions in the relevant strategic business areas and if the appointment results a strong and diverse Board. In 2005, the Board had nominated and appointed Mr. Qu Jiguang, Mr. Leung Chong Shun and Mr. Chow Kwok Wai as independent non-executive Directors. Before they were nominated for election, the Board had assessed their independence.

A.5 Responsibilities of Directors

Every newly appointed Director of the Company received an information package from the Company on the first occasion of his appointment. This information package is a comprehensive, formal and tailored induction on the responsibilities and ongoing obligations to be observed by a director. In addition, the package includes materials on the operations and business of the Company. The management of the Company conducted briefing on their responsibilities and obligations under the laws and applicable regulations such as Listing Rules and Company Ordinance as was necessary.

The Board has adopted a new code of conduct regarding Directors' securities transactions on terms no less exacting than the required standard set out in the Model Code for Securities Transactions by Directors of Listed Issuers as set out in Model Code. The Directors confirmed that there were not any non-compliance with the standard set out in the Model Code and the Company's code of conduct regarding Directors' securities transactions during the year ended 31 December 2005.

A.6 Supply of and Access to Information

In respect of regular board and committee meetings, agendas and accompanying board papers were sent in full to all directors at least 3 days before the intended date of meetings.

The management and the Company Secretary assists the Chairman in establishing the meeting agenda and board papers, providing with adequate information in a timely manner to enable the board and committees in making decision to the matter being discussed in the meetings. Each Director may request inclusion of items in the agenda. The Board and each Director may separately and independently access to the issuer's senior management.

Minutes of the Board/committees meetings are kept by the Company Secretary and are open for inspection by Directors.

REPORT ON CORPORATE GOVERNANCE PRACTICES *(Continued)*

Key Corporate Governance Principles and the Company's Practices *(Continued)*

B.1 Remuneration of Directors and Senior Management

The Board has established a Remuneration Committee, chaired by Mr. Leung Chong Shun and with committee members of Mr. Qu Jiguang and Mr. Chow Kwok Wai, all of them are independent non-executive directors appointed by the Board.

The principal responsibilities of Remuneration Committee include formulation of the remuneration policy, review and recommending to the Board the annual remuneration policy, and determination of the remuneration of the executive Director and members of the Senior Management. The overriding objective of the remuneration policy is to ensure that the Group is able to attract, retain, and motivate a high-calibre team which is essential to the success of the Group.

As the Company was listed on the Stock Exchange on 20 December 2005, no meeting was convened by the Remuneration Committee during the year ended 2005. Starting from 2006, the Remuneration Committee will meet at least once a year.

The functions specified in Code Provision B1.3 (a) to (f) of the CG Code had included in the Terms of Reference of the Remuneration Committee. Which also explain the role and the authority delegated by the Board.

The Remuneration Committee will be provided with sufficient resources to discharge its duties.

The following is a summary of the work of the Board during 2005 regarding the remuneration of Directors:

(i) review of the remuneration policy for 2005;
(ii) review and determine of the remuneration of Non-executive Directors;
(iii) review of the annual performance bonus policy;
(iv) discussion of the long term incentive arrangements;
(v) review and establish of the annual share option policy; and
(vi) review of the accounting treatment and financial implications of the share options scheme under the newly issued Hong Kong Financial Reporting Standard.

Details of the remuneration of Directors for the year ended 31 December 2005 are set out in the page 57 of the Annual Report.

C.1 Accountability and Audit

The Board presents a balanced, clear, and comprehensible assessment of the Company's performance, position, and prospects

Management of the Company provides such explanation and information to the Board as will enable the Board to make an informed assessment of the financial and other information put before the Board for approval.

REPORT ON CORPORATE GOVERNANCE PRACTICES *(Continued)*

Key Corporate Governance Principles and the Company's Practices *(Continued)*

C.1 Accountability and Audit *(Continued)*

The Directors are responsible for overseeing the preparation of accounts of each financial period, which give a true and fair view of the state of affairs of the Group and of the results and cash flow for that period. In preparing the accounts for the year ended 31 December 2005, the Directors have:

1. selected suitable accounting policies and applied them consistently;
2. approved adoption of all HKFRSs;
3. made judgments and estimates that are prudent and reasonable; and
4. have prepared the accounts on the going concern basis.

Acknowledgement from the Directors of their responsibility for preparing the accounts has been received.

A statement by the auditors about their reporting responsibilities is included in the page 32 of the 2005 Annual Report under the section Report of the Auditors.

The Company has announced its annual results in a timely manner after the end of the relevant period, as laid down in the Listing Rules.

C.2 Internal Controls

The Board is responsible for the Group's internal control system and has reviewed the effectiveness of the system. Such evaluation covers all material controls, including financial, operational and compliance controls and risk management functions.

C.3 Audit Committee

The Board establishes formal and transparent arrangements for considering how it apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the Company's auditors. The audit committee established by the Company have clear terms of reference.

All the members of the Audit Committee are independent non-executive Directors. The Audit Committee is chaired by Mr. Chow Kwok Wai who is a certificated public accountant and the committee members are Mr. Qu Jiguang and Mr. Leung Chong Shun.

The functions specified in Code Provision C3.3 (a) to (n) of the CG Code had included in the Terms of Reference of the Audit Committee. The Terms of Reference of the Audit Committee also explains the role and the authority delegated by the Board.

As the Company was listed on the Stock Exchange on 20 December 2005, no meeting was convened by the Audit Committee during the year ended 2005. The Audit Committee will meet at least twice a year.

Full minutes of audit committee meetings will be kept by the Company Secretary. Draft and final versions of minutes of the audit committee meetings will be sent to all members of the committee for their comment and records respectively, within 3 business days after the meeting.

The Audit Committee of the Company does not have a former partner of the Company's existing audit firm.

REPORT ON CORPORATE GOVERNANCE PRACTICES *(Continued)*

Key Corporate Governance Principles and the Company's Practices *(Continued)*

C.3 Audit Committee *(Continued)*

PricewaterhouseCoopers had been appointed to be the auditor of the Group. During 2005, total fees amounted HK$5,469,000 paid/ payable to PricewaterhouseCoopers were wholly related to audit services, being HK$1,789,000 related to annual audit and HK$3,680,000 related to the listing of the Company.

The Audit Committee recommended the re-appointment of PricewaterhouseCoopers to be the auditor of the Group in 2006.

D.1 Delegation by the Board

The Company has a formal schedule of matters specifically reserved to the Board and those delegated to management. There should be a clear division of responsibilities amongst committees and each of them should have a specific terms of reference

The Board is responsible for determining the overall strategy and approving the annual business plan of the Group, and ensuring the business operations are properly planned, authorised, undertaken and monitored. All policy matters of the Group, material transactions or transactions where there is conflict of interests are reserved for the Board's decisions.

The Board has delegated the day-to-day responsibility to the executive management.

D.2 Board Committees

The Board has prescribed sufficiently clear terms of reference for the Audit Committee and the Remuneration Committee.

The terms of reference of the Audit Committee and the Remuneration Committee require the committees to report back to the board on their decisions or recommendations.

E.1 Effective Communication

In respect of each substantially separate issue at a general meeting, a separate resolution will be proposed by the chairman of the meeting.

The chairman of the Board will attend the annual general meeting and arrange for the chairman of the Audit and Remuneration Committees or members to be available to answer questions at the annual general meeting.

E.2 Voting by Poll

The chairman of a meeting will ensure disclosure in the Company's circulars to shareholders of the procedures for and the rights of shareholders to demand a poll in compliance with the requirements about voting by poll contained in the Listing Rules.

REPORT ON CORPORATE GOVERNANCE PRACTICES *(Continued)*

Key Corporate Governance Principles and the Company's Practices *(Continued)*

E.2 Voting by Poll *(Continued)*

The chairman of a meeting and/or Directors who, individually or collectively, hold proxies in respect of shares representing 5% or more of the total voting rights at a particular meeting will demand a poll in certain circumstances where, on a show of hands, a meeting votes in the opposite manner to that instructed in those proxies. If a poll is required under such circumstances, the chairman of the meeting will disclose to the meeting the total number of votes represented by all proxies held by directors indicating an opposite vote to the votes cast at the meeting on a show of hands.

The Company will count all proxy votes and, except where a poll is required, the chairman of a meeting will indicate to the meeting the level of proxies lodged on each resolution, and the balance for and against the resolution, after it has been dealt with on a show of hands. The Company will ensure that votes cast are properly counted and recorded.

The chairman of a meeting will at the commencement of the meeting ensure that an explanation is provided of:

(a) the procedures for demanding a poll by shareholders before putting a resolution to the vote on a show of hands; and

(b) the detailed procedures for conducting a poll and then answer any questions from shareholders whenever voting by way of a poll is required.

羅兵咸永道會計師事務所

PricewaterhouseCoopers
22/F, Prince's Building
Central, Hong Kong

AUDITORS' REPORT TO THE SHAREHOLDERS OF
LIJUN INTERNATIONAL PHARMACEUTICAL (HOLDING) CO., LTD.
(Incorporated in the Cayman Islands with Limited Liability)

We have audited the accounts on pages 33 to 75 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The Company's directors are responsible for the preparation of accounts which give a true and fair view. In preparing accounts which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those accounts and to report our opinion solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

BASIS OF OPINION

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the circumstances of the Company and the Group, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the accounts are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the accounts. We believe that our audit provides a reasonable basis for our opinion.

OPINION

In our opinion the accounts give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2005 and of the Group's profit and cash flows for the year then ended and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong, 20 March 2006

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2005
(Amounts in Renminbi)

		Year ended 31 December	
	Note	**2005** **RMB'000**	2004 *RMB'000*
Sales	*6*	**884,709**	903,006
Cost of goods sold		**(436,842)**	(449,318)
Gross profit		**447,867**	453,688
Other gains — net	*6*	**2,077**	2,100
Selling and marketing costs		**(202,793)**	(220,599)
General and administrative expenses		**(108,414)**	(96,686)
Operating profit	*7*	**138,737**	138,503
Finance costs	*8*	**(7,069)**	(7,111)
Profit before income tax		**131,668**	131,392
Income tax expense	*9*	**(15,122)**	(22,331)
Profit for the year		**116,546**	109,061
Attributable to:			
Equity holders of the Company		**93,311**	88,632
Minority interest		**23,235**	20,429
		116,546	109,061
Earnings per share for profit attributable to the equity holders of the Company during the year (expressed in RMB per share)			
— Basic	*14*	**0.44**	0.42
Dividends	*13*	**48,367**	—

The notes on pages 39 to 75 are an integral part of these financial statements.

CONSOLIDATED BALANCE SHEET

As at 31 December 2005
(Amounts in Renminbi)

	Note	As at 31 December 2005 RMB'000	2004 RMB'000
ASSETS			
Non-current assets			
Property, plant and equipment	*15*	**336,726**	335,313
Land use rights	*16*	**7,014**	10,014
Deferred income tax assets	*20*	**7,436**	22,558
Available-for-sale financial assets/Other investments	*18*	**609**	609
Goodwill	*19*	**—**	601
		351,785	369,095
Current assets			
Inventories	*21*	**93,385**	81,059
Trade and bills receivables	*22*	**151,326**	153,984
Prepayments, deposits and other receivables	*23*	**66,000**	43,802
Bank and cash balances	*24*	**275,122**	138,674
		585,833	417,519
Total assets		**937,618**	786,614
EQUITY			
Capital and reserves attributable to the Company's equity holders			
Share capital	*30*	**151,468**	1
Other reserves	*31*	**228,505**	214,701
Retained earnings	*31*		
— Proposed final dividends		**48,367**	—
— Others		**72,385**	44,617
		500,725	259,319
Minority interest		**93,647**	86,022
Total equity		**594,372**	345,341

CONSOLIDATED BALANCE SHEET *(CONTINUED)*

As at 31 December 2005
(Amounts in Renminbi)

		As at 31 December	
	Note	**2005** **RMB'000**	2004 *RMB'000*
LIABILITIES			
Non-current liabilities			
Long-term bank loans	*28*	**—**	3,000
Long-term payables	*29*	**16,512**	15,342
Shareholders' loan	*33(c)*	**—**	47,594
		16,512	65,936
Current liabilities			
Trade and bills payables	*25*	**60,264**	48,282
Deposits and advance receipts from customers	*26*	**14,516**	32,235
Accruals and other payables	*27*	**108,831**	117,718
Income tax payable		**14,628**	17,456
Dividend payable	*14,33(c)*	**14,763**	24,743
Short-term bank loans	*28*	**108,000**	122,000
Current portion of long-term bank loans	*28*	**5,000**	12,000
Current portion of long-term payables	*29*	**732**	903
		326,734	375,337
Total liabilities		**343,246**	441,273
Total equity and liabilities		**937,618**	786,614
Net current assets		**259,099**	42,182
Total assets less current liabilities		**610,884**	411,277

Wu Qin
Director

Wu Zhihong
Director

The notes on pages 39 to 75 are an integral part of these financial statements.

BALANCE SHEET OF THE COMPANY

As at 31 December 2005
(Amounts in Renminbi)

		As at 31 December	
		2005	2004
	Note	***RMB'000***	*RMB'000*
ASSETS			
Non-current assets			
Property, plant and equipment	*15*	**1,040**	—
Investment in a subsidiary	*17*	**152,040**	152,040
		153,080	152,040
Current assets			
Dividend receivable		**59,052**	—
Prepayments, deposits and other receivables	*23*	**32,081**	—
Bank and cash balances		**129,745**	1
		220,878	1
Total assets		**373,958**	152,041
EQUITY			
Capital and reserves attributable to the Company's equity holders:			
Share capital	*30*	**151,468**	1
Other reserves	*31*	**152,040**	152,040
Retained earnings	*31*		
— Proposed final dividend		**48,367**	—
— Others		**6,059**	—
Total Equity		**357,934**	152,041
LIABILITIES			
Current liabilities			
Accruals and other payables	*27*	**16,024**	—
Total liabilities		**16,024**	—
Total equity and liabilities		**373,958**	152,041
Net current assets		**204,856**	1
Total assets less current liabilities		**357,934**	152,041

Wu Qin
Director

Wu Zhihong
Director

The notes on pages 39 to 75 are an integral part of these financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2005
(Amounts in Renminbi)

	Attributable to equity holders of the Company			Minority interest	Total
	Share capital	**Other reserves**	**Retained earnings**		
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
	(Note 30)	*(Note 31)*	*(Note 31)*		
Balance at 1 January 2004	—	201,406	41,099	83,548	326,053
Issue of share capital	1	—	—	—	1
Profit for the year	—	—	88,632	20,429	109,061
Transfer to statutory reserves	—	13,295	(13,295)	—	—
Dividends declared	—	—	(71,819)	(17,955)	(89,774)
Balance at 31 December 2004	1	214,701	44,617	86,022	345,341
Issue of share capital	151,467	—	—	—	151,467
Profit for the year	—	—	93,311	23,235	116,546
Transfer to statutory reserves	—	13,804	(13,804)	—	—
Dividends declared	—	—	(3,372)	(15,610)	(18,982)
Balance at 31 December 2005	151,468	228,505	120,752	93,647	594,372

The notes on pages 39 to 75 are an integral part of these financial statements.

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2005
(Amounts in Renminbi)

		Year ended 31 December	
		2005	2004
	Note	***RMB'000***	*RMB'000*
Cash flows from operating activities:			
Net cash inflow generated from operations	*32(a)*	**152,280**	53,747
Interest paid		**(7,069)**	(7,111)
Income tax paid		**(2,828)**	(2,744)
Net cash generated from operating activities		**142,383**	43,892
Cash flows from investing activities:			
Purchase of property, plant and equipment	*15*	**(30,028)**	(56,747)
Interest received		**1,569**	1,735
Proceeds from sale of property, plant and equipment	*32(c)*	**1,498**	1,631
Disposal of an associated company	*32(b)*	**—**	2,400
Decrease in due from related parties		**236**	43,627
Proceeds from sales of a land use right		**486**	—
Net cash used in investing activities		**(26,239)**	(7,354)
Cash flows from financing activities:			
New bank loans		**73,000**	157,000
Repayment of bank loans		**(97,000)**	(100,000)
Proceeds from share issue	*32(d)*	**120,861**	1
Dividend paid		**(28,963)**	(50,122)
Repayment of shareholders' loan		**(47,594)**	—
Net cash generated from financing activities		**20,304**	6,879
Increase in bank and cash balances		**136,448**	43,417
Bank and cash balances at beginning of year		**138,674**	95,257
Bank and cash balances at end of year	*24*	**275,122**	138,674

The notes on pages 39 to 75 are an integral part of these financial statements.

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 GT George Town, Grand Cayman British West Indies.

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 thousands of units of Renminbi (RMB'000), unless otherwise stated. These consolidated financial statements have been approved for issue by the Board of Directors on 20 March 2006.

2. GROUP REORGANISATION AND BASIS OF PRESENTATION

(a) Reorganisation

The Company undertook a group reorganisation ("the Reorganisation"), mainly comprised the following:

(i) Pursuant to agreements dated 28 December 2004 entered into between the Company and certain former shareholders of Xi'an Lijun Pharmaceutical Co., Ltd., the Company acquired an aggregate of 51.49% equity interest in Xi'an Lijun Pharmaceutical Co., Ltd. for an aggregate cash consideration of RMB152,040,000, which was financed by shareholders' loans. On the same date, the shareholders waived their entitlement to these shareholders' loans.

(ii) Pursuant to an agreement dated 28 December 2004 entered into between the Company and a former shareholder of Xi'an Lijun Pharmaceutical Co. Ltd., the Company acquired 28.51% equity interest in Xi'an Lijun Pharmaceutical Co., Ltd., by the allotment and issue of 3,564 shares of the Company to the former shareholder.

Upon completion of the Reorganisation, Xi'an Lijun Pharmaceutical Co., Ltd. had 51% equity interest in Shaanxi Rejoy Heng Xin Tang Pharmaceutical Co., Ltd., which was acquired by Xi'an Lijun Pharmaceutical Co., Ltd. in July 2003.

After the above group reorganisation, the Company became the holding company of following subsidiaries as set out in Note 17.

(b) Basis of presentation

The Group resulting from the Reorganisation is regarded as a continuing entity. Accordingly, the consolidated financial statements have been prepared on the merger basis as if the Company had been the holding company of the companies comprising the Group throughout the years, or from their respective dates of incorporation/establishment of effective acquisition by the Group, where this is a shorter period.

(Amounts in Renminbi)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

3.1 Basis of preparation

The consolidated financial statements of the Group have been prepared in accordance with Hong Kong Financial Reporting Standards (the "HKFRS"). The consolidated financial statements have been prepared under the historical cost convention, except for fair value adjustments on available-for-sale investments.

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 Company'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 5.

In 2005, the Group adopted the new/revised standards and interpretations of HKFRS below, which are relevant to its operations. The comparatives of prior years have been amended as required, in accordance with the relevant requirements.

HKAS 1	Presentation of Financial Statements
HKAS 2	Inventories
HKAS 7	Cash Flow Statements
HKAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
HKAS 10	Events after the Balance Sheet Date
HKAS 16	Property, Plant and Equipment
HKAS 17	Leases
HKAS 21	The Effects of Changes in Foreign Exchange Rates
HKAS 23	Borrowing Costs
HKAS 24	Related Party Disclosures
HKAS 27	Consolidated and Separate Financial Statements
HKAS 28	Investments in Associates
HKAS 32	Financial Instruments: Disclosures and Presentation
HKAS 33	Earnings per Share
HKAS 36	Impairment of Assets
HKAS 38	Intangible Assets
HKAS 39	Financial Instruments: Recognition and Measurement
HKAS 39 (Amendment)	Transaction and Initial Recognition of Financial Assets and Financial Liabilities
HKAS-Int 15	Operating Leases — Incentives
HKFRS 3	Business Combinations

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

3.1 Basis of preparation *(Continued)*

The adoption of new/revised HKASs 1, 2, 7, 8, 10, 16, 21, 23, 24, 27, 28, 33 and HKAS-Int15 did not result in substantial changes to the Group's accounting policies. In summary:

— HKAS 1 has affected the presentation of minority interest, share of net results of associates and other disclosures.

— HKASs 2, 7, 8, 10, 16, 23, 27, 28, 33 and HKAS-Int 15 had no material effect on the Group's policies.

— HKAS 21 had no material effect on the Group's policy. The functional currency of each of the consolidated entities has been re-evaluated based on the guidance to the revised standard. All the Group entities have the same functional currency as the presentation currency for respective entity financial statements.

— HKAS 24 has affected the identification of related parties and some other related-party disclosures.

The adoption of revised HKAS 17 has resulted in a change in the accounting policy relating to the reclassification of land use rights from property, plant and equipment to operating leases. The up-front prepayments made for the land use rights are expensed in the income statement on a straight-line basis over the period of the lease or when there is impairment, the impairment is expensed in the income statement. In prior years, the land use rights was treated as property, plant and equipment and therefore accounted for at cost less accumulated depreciation and accumulated impairment.

The adoption of HKASs 32 and 39 has resulted in a change in the accounting policy relating to the classification of available-for-sale financial assets.

The adoption of HKFRS 3, HKAS 36 and HKAS 38 results in a change in the accounting policy for goodwill. Until 31 December 2004, goodwill was:

— Amortised on a straight line basis over a period of 10 years; and

— Assessed for an indication of impairment at each balance sheet date.

In accordance with the provision of HKFRS 3 (see Note 3.5 of this section):

— The Group ceased amortisation of goodwill from 1 January 2005;

— Accumulated amortisation as at 31 December 2004 has been eliminated with a corresponding decrease in the cost of goodwill;

— From the period ended 30 June 2005 onwards, goodwill is tested annually for impairment, as well as when there is indication of impairment.

The Group has reassessed the useful lives of its intangible assets in accordance with the provisions of HKAS 38. No adjustment resulted from this reassessment.

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

3.1 Basis of preparation *(Continued)*

All changes in the accounting policies have been retrospectively made in accordance with the respective transitional provisions, wherever required or allowed. The accounting policies set out below have been consistently applied throughout the Relevant Periods, other than:

HKAS 39 — generally does not permit to recognise, derecognise and measure financial assets and liabilities in accordance with this standard on a retrospective basis.

HKFRS 3 — prospectively after 1 January 2005.

Certain new standards, amendments and interpretations to existing standards have been published that are mandatory for the Group's accounting periods beginning on or after 1 January 2006 or later periods but which the Group has not early adopted, as follows:

HKAS 19 (Amendment), Employee Benefits (effective from 1 January 2006). This amendment 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. As the Group does not intend to change the accounting policy adopted for recognition of actuarial gains and looses and does not participate in any multi-employer plans, adoption of this amendment will only impact the format and extent of disclosures presented in the accounts. The Group will apply this amendment from annual periods beginning 1 January 2006.

HKAS 39 (Amendment), Cash Flow Hedge Accounting of Forecast Intragroup Transactions (effective from 1 January 2006). The amendment allows the foreign currency risk of a highly probable forecast intragroup transaction to qualify as a hedged item in the consolidated financial statements, provided that: (a) the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction; and (b) the foreign currency risk will affect consolidated profit or loss. This amendment is not relevant to the Group's operations, as the Group does not have any intragroup transactions that would qualify as a hedged item in the consolidated financial statements as of 31 December 2005 and 2004.

HKAS 39 (Amendment), The Fair Value Option (effective from 1 January 2006). This amendment changes the definition of financial instruments classified at fair value through profit or loss and restricts the ability to designate financial instruments as part of this category. The Group believes that this amendment should not have a significant impact on the classification of financial instruments, as the Group should be able to comply with the amended criteria for the designation of financial instruments at fair value through profit and loss. The Group will apply this amendment from annual periods beginning 1 January 2006.

HKAS 39 and HKFRS 4 (Amendment), Financial Guarantee Contracts (effective from 1 January 2006). This amendment requires issued financial guarantees, other than those previously asserted by the entity to be insurance contracts, to be initially recognised at their fair value, and subsequently measured at the higher of (a) the unamortised balance of the related fees received and deferred, and (b) the expenditure required to settle the commitment at the balance sheet date. Management considered this amendment to HKAS 39 and concluded that it is not relevant to the Group.

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

3.1 Basis of preparation *(Continued)*

HKFRS 1 (Amendment), First-time Adoption of International Financial Reporting Standards and HKFRS 6 (Amendment), Exploration for and Evaluation of Mineral Resources (effective from 1 January 2006). These amendments are not relevant to the Group's operations, as the Group is not a first-time adopter and does not carry out exploration for and evaluation of mineral resources.

HKFRS 6, Exploration for and Evaluation of Mineral Resources (effective from 1 January 2006). IFRS 6 is not relevant to the Group's operations

HKFRS 7, Financial Instruments: Disclosures, and a complementary Amendment to HKAS 1, Presentation of Financial Statements - Capital Disclosures (effective from 1 January 2007). HKFRS 7 introduces new disclosures to improve the information about financial instruments. It requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, including sensitivity analysis to market risk. It replaces HKAS 30, Disclosures in the Financial Statements of Banks and Similar Financial Institutions, and disclosure requirements in HKAS 32, Financial Instruments: Disclosure and Presentation. It is applicable to all entities that report under HKFRS. The amendment to HKAS 1 introduces disclosures about the level of an entity's capital and how it manages capital. The Group assessed the impact of HKFRS 7 and the amendment to HKAS 1 and concluded that the main additional disclosures will be the sensitivity analysis to market risk and the capital disclosures required by the amendment of HKAS 1. The Group will apply HKFRS 7 and the amendment to HKAS 1 from annual periods beginning 1 January 2007.

HKFRS-Int 4, Determining whether an Arrangement contains a Lease (effective from 1 January 2006). HKFRS-Int 4 requires the determination of whether an arrangement is or contains a lease to be based on the substance of the arrangement. It requires an assessment of whether: (a) fulfillment of the arrangement is dependent on the use of a specific asset or assets (the asset); and (b) the arrangement conveys a right to use the asset. Management is currently assessing the impact of HKFRS-Int 4 on the Group's operations.

HKFRS-Int 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds (effective from 1 January 2006). HKFRS-Int 5 is not relevant to the Group's operations.

HK (IFRIC)-Int 6, Liabilities arising from Participating in a Specific Market — Waste Electrical and Electronic Equipment (effective from 1 December 2005). HK (IFRIC)-Int 6 is not relevant to the Group's operations.

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

3.2 Consolidation

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

(i) 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.

Except for the merger accounting for group reorganisation as mentioned in Note 2(b), 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. 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. 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.

In the Company's balance sheet, the investment in a subsidiary is stated at cost less accumulated impairment losses, if any. The results of subsidiary are accounted by the Company on the basis of dividend received and receivable.

All significant intra-group transactions and balances within the Group have been eliminated upon consolidation.

(ii) Associates

Associates are all entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investment in associated company is accounted for using the equity method of accounting and are initially recognised at cost.

The Group's share of its associates' post-acquisition profits or losses is recognised in the income statement, and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

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

3.3 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.

In accordance with the Group's internal financial reporting, the Group has determined that business segment be presented as the primary reporting format and geographical as the secondary reporting format.

3.4 Translation of foreign currencies

(i) Functional and presentation currency

Items included in the account 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 Information are presented in Chinese Renminbi ("RMB"), which is the Company's functional and presentation currency.

(ii) 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.

3.5 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.

Effective from 1 January 2005, goodwill is tested annually for impairment and carried at cost less accumulated impairment losses, if any. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. The allocation is made to those cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose.

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

3.6 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. All other repairs and maintenance are charged to the income statement during the period in which they are incurred.

Depreciation is calculated using the straight-line method to allocate the cost less accumulated impairment loss of each asset to its residual value over its estimated useful life, as follows:

Buildings	20 — 40 years
Plant and machinery	8 — 18 years
Furniture and fixtures	8 — 10 years
Vehicles	5 — 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.

Gains and losses on disposals are determined by comparing proceeds with carrying amount and are included in the income statement.

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 brought into use, the costs are transferred to property, plant and equipment and depreciated in accordance with the policy as stated above.

3.7 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.

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

3.8 Available-for-sale financial assets

Effective from 1 January 2005, available-for-sale financial assets are non-derivatives that are designated in this category upon initial recognition and reassessment at every reporting date. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date.

They are initially recognised at fair value plus transaction costs and subsequently carried at fair value. Unrealised gains and losses arising from changes in the fair value of 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 are included in the income statement as gains or losses from investment securities.

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is 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 an indicator that whether 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 the income statement — 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.

3.9 Impairment of non-financial assets

Assets that have an indefinite useful life are not subject to amortisation, which are at least tested annually for impairment and are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. 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). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

3.10 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.

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

3.11 Trade and other receivables

Trade and other receivables are recognised initially at fair value to the original invoice amounts, 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 receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy financial reorganisation, and default or delinquency in payments are considered indicators that trade receivables are 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 effective interest rate. The amount of the provision is recognised in the income statement.

3.12 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 and bank overdrafts.

3.13 Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability, including fees and commissions paid to agents, advisers, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. 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 are expensed as incurred.

3.14 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 accounts. 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, it is not accounted for. 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.

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

3.15 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 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.

3.16 Provisions

Provisions recognised when the Group has a present legal or constructive obligation as a result of past events; it is more likely than not 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.

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

3.17 Government grants

A government grant in the form of subsidy or financial refund is recognised when there is a reasonable assurance that the Group will comply with the conditions attached to the grant and that the grant will be received.

Grants relating to income are deferred and recognised in the income statement over the period necessary to match them with the costs they are intended to compensate.

Grants relating to the purchase of property, plant and equipment are deducted from the carrying amount of the asset. The grant is recognised as income over the life of a depreciable asset by way of a reduced depreciation charge.

3.18 Revenue recognition

Revenue comprises the fair value of consideration received or receivable for the sale of goods, net of value-added tax, rebates and discounts.

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 rate.

3.19 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 in the income statement on a straight-line basis over the lease periods.

3.20 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.

3.21 Dividend distribution

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

4. FINANCIAL RISK MANAGEMENT

4.1 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. The Group's overall risk management program focuses on the unpredictability of financial market and seeks to minimise potential adverse effects on the Group's financial performance.

(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 28 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.

(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. Details of the Group's bank and cash balances as at 31 December 2004 and 2005 are disclosed in Note 24 of this section.

The Group has not used any forward contracts, currency borrowings or other means to hedge its foreign currency exposure. RMB against USD was relatively stable during the years and as a result, the Group considers it has no material foreign exchange risk.

4. FINANCIAL RISK MANAGEMENT *(Continued)*

4.2 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 28 in this section.

5. CRITICAL ACCOUNTING ESTIMATES

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

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.

(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.

5. CRITICAL ACCOUNTING ESTIMATES *(Continued)*

(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 3.9 of this section. 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.

6. SALES, OTHER GAINS AND SEGMENT INFORMATION — GROUP

(a) Sales 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	
	2005	2004
	RMB'000	*RMB'000*
Sales:		
— Sales of pharmaceutical products	**880,452**	897,029
— Sales of raw materials and by products	**847**	1,473
— Processing income	**3,410**	4,504
	884,709	903,006
Other gains — net:		
— Interest income	**1,569**	1,735
— Subsidy income*	**—**	100
— Gain of investment disposal**	**—**	265
— Gain on disposal of a land use right***	**508**	—
	2,077	2,100
	886,786	905,106

* Subsidy was received from local government.

** Gain of investment disposal represents the net income relates to the disposal of the interest in an associated company in 2004.

*** Gain on disposal of a land use right represents that net income relates to the disposal of a land use right of a subsidiary in 2005.

(b) 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.

7. OPERATING PROFIT — GROUP

Operating profit is stated after charging/crediting the following items:

	Year ended 31 December	
	2005	2004
	RMB'000	*RMB'000*
Crediting		
Reversal of inventory write-down	**(2,764)**	(4,556)
Reversal of impairment of receivables	**(3,508)**	—
Gain on disposal of property, plant and equipment	**(39)**	—
Charging		
Cost of inventories	**319,704**	309,058
Staff costs including directors' emoluments		
— wages and salaries	**66,635**	51,893
— pension costs *(Note 11)*	**9,912**	9,523
— welfare expenses	**10,861**	17,013
Depreciation of property, plant and equipment	**35,044**	36,398
Impairment loss of property, plant and equipment	**—**	865
Loss on disposal of property, plant and equipment	**—**	80
Amortisation of land use rights (charged to general and administrative expenses)	**82**	133
Amortisation of goodwill (charged to general and administrative expenses)	**—**	75
Impairment of goodwill	**601**	—
Provision for impairment of receivables	**—**	1,404
Operating leases-rental expenses in respect of land use rights in the PRC	**5,461**	6,826
Advertising expenses	**37,781**	79,854
Research and development costs	**7,429**	6,166
Auditors' remuneration	**1,768**	829

8. FINANCE COSTS — GROUP

	Year ended 31 December	
	2005	2004
	RMB'000	*RMB'000*
Interest expense		
— On bank borrowings wholly repayable within five years	**7,069**	7,111

9. TAXATION — GROUP

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 during the years.

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 January 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 2005, 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 charged to the income statement represent:

	Year ended 31 December	
	2005	2004
	RMB'000	*RMB'000*
Current taxation — EIT	**—**	19,808
Deferred taxation *(Note 20)*	**15,122**	2,523
	15,122	22,331

9. TAXATION — GROUP *(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	
	2005	2004
	RMB'000	*RMB'000*
Profit before income tax	**131,668**	131,392
Weighted average EIT rates in PRC	**24%**	15%
Tax calculated at the weighted average EIT rate	**31,600**	19,709
Tax exemption	**(28,259)**	—
Additional deductible expense allowance granted by tax authorities	**—**	(1,617)
Expenses not deductible for tax purposes	**345**	3,912
Effect of change of tax rate for the calculation of deferred taxation	**11,436**	—
Others	**—**	327
Tax charge	**15,122**	22,331

10. PROFIT ATTRIBUTABLE TO THE COMPANY'S EQUITY HOLDERS

The consolidated profit attributable to the Company's equity holders includes profit of RMB54,426,000 (2004: Nil) dealt with in the financial statements of the Company.

11. 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.

12. DIRECTORS AND SENIOR MANAGEMENT'S EMOLUMENTS — GROUP

(a) Directors' emoluments

The emoluments of all executive directors 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*
2004					
Executive Directors					
Mr. Wu Qin	—	516	4	7	527
Mr. Wu Zhihong	—	486	4	7	497
Mr. Huang Chao	—	447	3	7	457
Mr. Xie Yunfeng	—	247	3	7	257
Ms. Sun Xinglai	—	247	3	6	256
	—	1,943	17	34	1,994
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

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

12. 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.

13. DIVIDENDS

A dividend in respect of 2005 of HK$0.16 per share, amounting to a total dividend of RMB48,367,000 is to be proposed at the annual general meeting on 18 April 2006. These financial statements do not reflect this dividend payable.

	2005 *RMB'000*	2004 *RMB'000*
Proposed final dividend of HK$0.16 (2004:Nil) per ordinary share	**48,367**	—

14. EARNINGS PER SHARE — GROUP

Basic earnings per share is calculated by dividing the profit attributable to equity holders of the Company of RMB93,311,000 by the weighted average number of 212,426,000 ordinary shares in issue during the year.

The comparative basic earnings per share is calculated by dividing the profit attributable to equity shareholders of the Company of RMB 88,632,000 by an aggregate of 210,000,000 shares, comprising 1 share issued after incorporation of the Company and 209,999,999 shares issued after the Capitalisation Issue completed, which were deemed to have been in issue since 1 January 2004.

No diluted earnings per share is presented, as the Company has no dilutive potential shares.

15. PROPERTY, PLANT AND EQUIPMENT — GROUP

	Buildings	Plant and machinery	Furniture and fixtures	Vehicles	Construction-in-progress	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
At 1 January 2004						
Cost	165,656	237,472	15,005	23,693	43,194	485,020
Accumulated depreciation and impairment losses	(37,574)	(121,341)	(5,127)	(7,104)	—	(171,146)
Net book amount	128,082	116,131	9,878	16,589	43,194	313,874
Year ended 31 December 2004						
Opening net book amount	128,082	116,131	9,878	16,589	43,194	313,874
Additions	663	2,426	3,308	1,960	52,056	60,413
Transfer	41,498	31,461	107	—	(73,066)	—
Disposals	(1,226)	(31)	(441)	(13)	—	(1,711)
Depreciation charge	(7,848)	(23,606)	(2,404)	(2,540)	—	(36,398)
Impairment charge	(804)	—	—	(61)	—	(865)
Closing net book amount	160,365	126,381	10,448	15,935	22,184	335,313
At 31 December 2004						
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

15. PROPERTY, PLANT AND EQUIPMENT — GROUP *(Continued)*

	Buildings *RMB'000*	Plant and machinery *RMB'000*	Furniture and fixtures *RMB'000*	Vehicles *RMB'000*	Construction-in-progress *RMB'000*	Total *RMB'000*
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 period	(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

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

The impairment for property, plant and equipment is recognised in accordance with the accounting policy and estimates stated in Note 3.6 and Note 5(iv) respectively.

Company

	Furniture and fixtures *RMB'000*
Year ended 31 December 2005	
Additions	1,076
Charge for the period	(36)
Closing net book amount	1,040
At 31 December 2005	
Cost	1,076
Accumulated depreciation and impairment losses	(36)
Net book amount	1,040

16. LAND USE RIGHTS — GROUP

	RMB'000
At 1 January 2004	
Cost	10,455
Accumulated amortisation	(308)
Net book amount	10,147
Year ended 31 December 2004	
Opening net book amount	10,147
Amortisation charge	(133)
Closing net book amount	10,014
At 31 December 2004	
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

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 2004 and 2005, the net book amount of the Group's land use rights of approximately RMB4,000,000 was pledged as collateral for the Group's bank loans *(Note 28(d))*.

17. INVESTMENT IN A SUBSIDIARY — COMPANY

	As at 31 December	
	2005	2004
	RMB'000	*RMB'000*
Unlisted shares	**152,040**	152,040

The following is a list of the principal subsidiaries as at 31 December 2005:

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
Xi'an Lijun Pharmaceutical Co., Ltd. ("Xi'an Lijun")	Limited liability company incorporated in PRC	Manufacturing and sale of pharmaceutical products in PRC	RMB210,900,000	81% (Directly held)
Shaanxi Rejoy Hengxintang Pharmaceutical Co., Ltd. ("Hengxintang")	Limited liability company incorporated in PRC	Manufacturing and sale of traditional Chinese medicine in PRC	RMB10,000,000	41%* (Indirectly held)

* 51% interest was held by an 80% subsidiary

18. AVAILABLE-FOR-SALE FINANCIAL ASSETS/OTHER INVESTMENTS — GROUP

Available-for-sale financial assets (effective from 1 January 2005)/Other investments (for the year ended 31 December 2004) represent unlisted and listed shares in certain limited liability companies in the PRC.

	As at 31 December	
	2005	2004
	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..

The Directors are of the opinion that the carrying amounts approximate their fair values and there is no significant impairment to these available-for-sale financial assets.

19. GOODWILL — GROUP

	RMB'000
At 1 January 2004	
Cost	751
Accumulated amortisation	(75)
Net book amount	676
Year ended 31 December 2004	
Opening net book amount	676
Amortisation expenses charged	(75)
Closing net book amount	601
At 31 December 2004	
Cost	751
Accumulated amortisation	(150)
Net book amount	601
Year ended 31 December 2005	
Opening net book amount	601
Impairment expense	(601)
Closing net book amount	—
At 31 December 2005	
Cost	751
Accumulated amortisation and impairment	(751)
Net book amount	—

20. DEFERRED INCOME TAX ASSET — GROUP

	As at 31 December	
	2005	2004
	RMB'000	*RMB'000*
Deferred tax assets:		
— Deferred tax asset to be recovered after more than 12 months	**7,436**	13,995
— Deferred tax asset to be recovered within 12 months	**—**	8,563
	7,436	22,558

20. DEFERRED INCOME TAX ASSET — GROUP *(Continued)*

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 2004	8,622	6,874	2,562	7,023	25,081
Recognised in the income statement *(Note 9)*	(59)	119	(683)	(1,900)	(2,523)
At 31 December 2004	8,563	6,993	1,879	5,123	22,558
Recognised in the income statement *(Note 9)*	(8,563)	(4,086)	(708)	(1,765)	(15,122)
At 31 December 2005	—	2,907	1,171	3,358	7,436

21. INVENTORIES — GROUP

	As at 31 December	
	2005	2004
	RMB'000	*RMB'000*
Raw materials	**37,801**	30,552
Work in progress	**12,802**	12,513
Finished goods	**42,782**	37,994
	93,385	81,059

22. TRADE AND BILLS RECEIVABLES — 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	
	2005	2004
	RMB'000	*RMB'000*
Within 3 months	**127,698**	144,032
4 to 6 months	**18,525**	11,172
7 to 12 months	**9,534**	2,654
1 to 2 years	**2,204**	2,774
2 to 3 years	**2,234**	3,827
More than 3 years	**13,638**	16,798
	173,833	181,257
Less: Provision for impairment of receivables	**(22,507)**	(27,273)
	151,326	153,984

The Group has written off approximately RMB982,627 (2004: RMB1,404,000) and written back RMB3,783,620 (2004: Nil) for impairment of its trade receivables during the year ended 31 December 2005. 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.

23. PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

	Group As at 31 December		Company As at 31 December	
	2005	2004	**2005**	2004
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Proceeds from new issue of shares retained by the underwriter	**30,606**	—	**30,606**	—
Receivables related to disposal of staff quarters	**12,916**	9,770	**—**	—
Prepayments to suppliers	**9,633**	25,935	**—**	—
Prepaid advertising expenses	**3,067**	3,068	**—**	—
Receivables related to disposal of land use right	**2,940**	—	**—**	—
Other receivables	**6,838**	5,029	**1,475**	—
	66,000	43,802	**32,801**	—

24. BANK AND CASH BALANCES — GROUP

Bank and cash balances were denominated in currencies as follows:

	As at 31 December	
	2005	2004
	RMB'000	*RMB'000*
RMB	**145,107**	136,484
USD	**271**	2,190
HKD	**129,744**	—
	275,122	138,674

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% (2004: 0.72%).

25. TRADE AND BILLS PAYABLES — GROUP

	As at 31 December	
	2005	2004
	RMB'000	*RMB'000*
Accounts payable	**56,264**	48,282
Bills payable	**4,000**	—
	60,264	48,282

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

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

	As at 31 December	
	2005	2004
	RMB'000	*RMB'000*
Within 3 months	**55,037**	42,843
4 to 6 months	**1,003**	579
7 to 12 months	**897**	2,323
1 to 3 years	**1,709**	1,112
More than 3 years	**1,618**	1,425
	60,264	48,282

26. DEPOSITS AND ADVANCE RECEIPTS FROM CUSTOMERS — GROUP

	As at 31 December	
	2005	2004
	RMB'000	*RMB'000*
Advance receipts from customers	**14,516**	32,235

27. ACCRUALS AND OTHER PAYABLES

	Group As at 31 December		Company As at 31 December	
	2005	2004	**2005**	2004
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
Accrued distribution expenses	**27,016**	27,566	**—**	—
Accrued advertising expenses	**1,940**	10,251	**—**	—
Advertising expense payables	**2,871**	12,546	**—**	—
Accrued management bonus	**3,000**	4,218	**—**	—
Welfare payables	**23,271**	25,343	**—**	—
Taxation payables, other than income tax	**10,527**	11,865	**—**	—
Salary and wages payable	**11,148**	13,632	**—**	—
Payable for property, plant and equipment	**9,367**	1,479	**—**	—
Loan from employees	**5,407**	1,717	**—**	—
Professional fee payables	**6,592**	1,100	**6,592**	—
Others	**7,692**	8,001	**9,432**	—
	108,831	117,718	**16,024**	—

28. BANK LOANS — GROUP

	As at 31 December	
	2005	2004
	RMB'000	*RMB'000*
Non-current		
— Due within one year	**5,000**	12,000
— Due over one year	**—**	3,000
Current	**108,000**	122,000
Total borrowings	**113,000**	137,000
Representing:		
Unsecured	**108,000**	70,000
Secured*	**5,000**	5,000
Guaranteed**	**—**	62,000
	113,000	137,000

28. BANK LOANS — GROUP *(Continued)*

* As at 31 December 2004 and 2005, the net book amount of the Group's land use rights *(Note 16)* of approximately RMB4,000,000 was pledged as collateral for the Group's bank loans.

** The guaranteed bank loan as at 31 December 2004 was guaranteed by the Rejoy Group Limited Liability Company.

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

	As at 31 December	
	2005	2004
	RMB'000	*RMB'000*
RMB		
— at floating rates	**113,000**	137,000

The carrying amounts of the Group's bank borrowings approximate their fair values.

(b) The weighted average effective interest rates per annum for bank loans was approximately 6.40% (2004: 5.90%).

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

	As at 31 December	
	2005	2004
	RMB'000	*RMB'000*
Within 1 year	**5,000**	12,000
Between 1 to 2 years	**—**	3,000
	5,000	15,000

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

	As at 31 December	
	2005	2004
	RMB'000	*RMB'000*
Net book amount of land use right *(Note 16)*	**4,000**	4,000

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

	As at 31 December	
	2005	2004
	RMB'000	*RMB'000*
Floating rate and expiring within one year	**214,000**	80,000

29. 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	
	2005	2004
	RMB'000	*RMB'000*
Within 1 year	**732**	903
Between 1 to 2 years	**659**	832
Between 2 to 5 years	**1,680**	2,123
More than 5 years	**14,173**	12,387
	17,244	16,245
Less: Current portion included in current liabilities	**(732)**	(903)
	16,512	15,342

30. SHARE CAPITAL

	Number of shares *(thousands)*	**Amount** *RMB'000*	**Share premium** *RMB'000*	**Total** *RMB'000*
At 1 January 2004	—	—	—	—
Share issue and alloted	10	1	—	1
At 31 December 2004	10	1	—	1
Capitalisation issue	209,990	21,851	—	21,851
	210,000	21,852	—	21,852
New share issue	80,500	8,377	121,239	129,616
At 31 December 2005	**290,500**	**30,229**	**121,239**	**151,468**

The total authorised number of ordinary share is 1,000,000,000 (2004: 3,900,000) with a par value of HK$0.10 per share (2004: 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 new shares on 19 December 2005 and over-allotment of 10,500,000 shares on 21 December 2005) in connection with the listing of the Company's share on the SEHK, and raised proceeds of approximately RMB151,467,000. In addition, 209,990,000 shares are credited as fully paid pursuant to the capitalisation issue immediately following the issue of new shares.

31. OTHER RESERVES

Group

	Merger reserve *RMB'000* *(Note a)*	**Capital surplus** *RMB'000*	**Statutory reserves** *RMB'000* *(Note b)*	**Retained earnings** *RMB'000*	**Total** *RMB'000*
At 1 January 2004	168,720	32	32,654	41,099	242,505
Profit for the year	—	—	—	88,632	88,632
Transfer to statutory reserves	—	—	13,295	(13,295)	—
Dividends	—	—	—	(71,819)	(71,819)
At 31 December 2004	168,720	32	45,949	44,617	259,318
Profit for the year	—	—	—	93,311	93,311
Transfer to statutory reserve	—	—	13,804	(13,804)	—
Dividends	—	—	—	(3,372)	(3,372)
At 31 December 2005	168,720	32	59,753	120,752	349,257

Company

	Capital surplus *RMB'000*	**Retained earnings** *RMB'000*	**Total** *RMB'000*
At 1 January 2004	—	—	—
Loan from shareholders waived	152,040	—	152,040
At 31 December 2004	—	—	152,040
Profit for the year	—	54,426	54,426
At 31 December 2005	**152,040**	**54,426**	**206,466**

(a) Merger reserve

Merger reserve of the Company represents 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.

32. CONSOLIDATED CASH FLOW STATEMENT — GROUP

(a) Reconciliation of profit before income tax to net cash inflow generated from operations

	Year ended 31 December	
	2005	2004
	RMB'000	*RMB'000*
Profit before income tax	**131,668**	131,392
(Reversal of)/Provision for impairment of receivables	**(3,508)**	1,404
Reversal of inventory write-downs	**(2,764)**	(4,556)
Impairment losses of property, plant and equipment	**—**	865
Depreciation of property, plant and equipment	**35,044**	36,398
(Gain)/loss on disposals of property, plant and equipment	**(39)**	80
Gain on disposal of a land use right	**(508)**	—
Amortisation of land use rights	**82**	133
Amortisation of goodwill	**—**	75
Impairment loss of goodwill	**601**	—
Interest income	**(1,569)**	(1,735)
Interest expense	**7,069**	7,111
Operating profit before working capital changes	**166,076**	171,167
(Increase)/decrease in inventories	**(9,562)**	16,058
Increase in trade and bills receivables	**(21,076)**	(99,464)
Decrease/(increase) in prepayments, deposits and other receivables	**10,835**	(22,119)
Decrease in amounts due from related parties	**27,518**	3,299
(Decrease)/increase in trade and bills payables and deposits and advance receipts from customers	**(5,737)**	16,495
Decrease in taxation payable, accruals, and other payables	**(12,538)**	(28,637)
Decrease in amounts due to related parties	**(3,236)**	(3,052)
Net cash inflow generated from operations	**152,280**	53,747

(b) Disposal of an associated company

On 24 December 2004, the Group disposed its entire 30% equity interest in Xi'an Rejoy Real Estate Co., Ltd. to Xi'an Rejoy Technology Investment Co., Ltd. for a consideration of RMB2,400,000 and recognised a gain on disposal of RMB265,000.

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

	Year ended 31 December	
	2005	2004
	RMB'000	*RMB'000*
Net book amount disposed *(Note 15)*	**1,459**	1,711
Gain/(loss) on disposal of property, plant and equipment	**39**	(80)
Proceeds from disposal of property, plant and equipment	**1,498**	1,631

32. CONSOLIDATED CASH FLOW STATEMENT — GROUP *(Continued)*

(d) Proceeds from issue of new shares

	Year ended 31 December	
	2005	2004
	RMB'000	*RMB'000*
Issue of new shares (including share premium)	**151,467**	1
Proceeds retained by the underwriters *(Note 23)*	**(30,606)**	—
Proceeds from share issue	**120,861**	1

33. RELATED PARTY TRANSACTIONS AND BALANCES — GROUP

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

Name	**Relationship**
Rejoy Group Limited Liability Company ("Rejoy Group")	Shareholder of Xi'an Lijun Pharmaceutical Co., Ltd.
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

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

(b) In addition to the disposal of investment in an associated company as disclosed in Note 32(b) during the year, the Group had the following significant transactions with related parties:

Nature of transactions	Name of related party	Year ended 31 December 2005 RMB'000	2004 RMB'000
Continuing:			
Purchasing of raw materials and packaging materials	Zhenjiang Pharmaceutical	**5,143**	11,900
	Rejoy Baichuan	**68**	6,816
	Rejoy Packaging	**717**	674
	Global Printing	**6,883**	6,854
		12,811	26,244
Sales of finished goods	Rejoy Medicine	**20,886**	26,663
	Rejoy Baichuan	**9,043**	27,079
	Huabang Pharmaceutical	**4,526**	5,953
		34,455	59,695
Provision of utilities from	Xi'an Pharmacy Factory	**50,973**	41,603
Sharing of administrative costs from	Xi'an Pharmacy Factory	**12,926**	13,105
Lease of land use rights from	Rejoy Group	**5,461**	6,826
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**	7,403
Disposal of property, plant and equipment to	Rejoy Group	**—**	946
	Xi'an Pharmacy Factory	**—**	165
		—	1,111
Guarantee:			
Guarantee of loans by a related party	Rejoy Group	**—**	62,000

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

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

	As at 31 December	
	2005	2004
	RMB'000	*RMB'000*
Amounts due from related parties included in trade receivables		
— Rejoy Medicine	**4,879**	16,900
— Rejoy Baichuan	**1,627**	17,712
— Huabang Pharmaceutical	**1,733**	1,128
— Xi'an Pharmacy Factory	**—**	17
	8,239	35,757
Amounts due from related parties included in prepayments, deposits and other receivable		
— Rejoy Real Estate	**30**	320
— Rejoy Group	**60**	—
— Rejoy Technology	**59**	99
— Xi'an Pharmacy Factory	**404**	223
— Xiyao Construction	**—**	147
	553	789
Amounts due to related parties included in trade payables		
— Zhenjiang Pharmaceutical	**—**	200
— Rejoy Baichuan	**5**	45
— Rejoy Packaging	**177**	—
— Global printing	**1,656**	1,733
	1,838	1,978
Amounts due to related parties included in accruals and other payables		
— Xi'an Pharmacy Factory	**—**	3,217
— Xiyao Construction	**—**	19
	—	3,236
Amounts due to shareholders		
— Dividend payable	**14,763**	24,743
— Shareholders' loan*	**—**	47,594
	14,763	72,337

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

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

* The shareholders' loan had been settled in September 2005.

Except for the shareholders' loan as stated above, the related party balances are all unsecured, interest-free and have no pre-determined terms of repayment.

34. COMMITMENTS — GROUP

(a) Capital commitments

	As at 31 December	
	2005	2004
	RMB'000	*RMB'000*
Purchase of property, plant and equipment		
— Contracted but not provided for	**10,158**	25,203

(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	
	2005	2004
	RMB'000	*RMB'000*
Not later than one year	**6,821**	5,461
Later than one year and not later than five years	**6,824**	13,337
	13,645	18,798

35. CONTINGENT LIABILITIES

The Group did not have significant contingent liabilities as at 31 December 2005.

36. APPROVAL OF ACCOUNTS

The accounts were approved by the Board of Directors on 20 March 2006.

FINANCIAL SUMMARY

For the year ended 31 December 2005
(Amounts in Renminbi)

	Year ended 31 December			
	2002	2003	2004	**2005**
	RMB'000	*RMB'000*	*RMB'000*	***RMB'000***
	(Audited)	(Audited)	(Audited)	**(Audited)**
RESULTS				
Turnover	860,863	896,307	903,006	**884,709**
Profit before income tax	116,517	102,790	131,392	**131,668**
Income tax expense	(40,493)	(15,056)	(22,331)	**(15,122)**
Profit for the year	76,024	87,734	109,061	**116,546**
Attribute to:				
Equity holders of the Company	60,819	70,333	88,632	**93,311**
Minority interest	15,205	17,401	20,429	**23,235**

	As at 31 December			
	2002	2003	2004	**2005**
	RMB'000	*RMB'000*	*RMB'000*	***RMB'000***
ASSETS AND LIABILITIES				
Total assets	595,453	661,711	786,614	**937,618**
Total liabilities	(299,531)	(335,658)	(441,273)	**(343,246)**
Minority interest	(73,134)	(83,548)	(86,022)	**(93,647)**
Shareholder's equity	222,788	242,505	259,319	**500,725**