



東瑞製藥(控股)有限公司

DAWNRAYS PHARMACEUTICAL (HOLDINGS) LIMITED

(Incorporated in the Cayman Islands with limited liability)



Annual Report 2004

EXECUTIVE DIRECTORS

LI Kei Ling
HUNG Yung Lai
ZHANG Jing Xing
LAM Kam Wah
LI Tung Ming
XU Kehan

INDEPENDENT NON-EXECUTIVE DIRECTORS

PAN Xue Tian
LEE Cheuk Yin Dannis
CHOI Tat Ying Jacky

COMPANY SECRETARY

PANG Kit Ling

AUTHORISED REPRESENTATIVES

LI Kei Ling
LAM Kam Wah

AUDIT COMMITTEE

LEE Cheuk Yin Dannis (*Chairman*)
PAN Xue Tian
CHOI Tat Ying Jacky

AUDITORS

Ernst & Young
Certified Public Accountants, Hong Kong

PRINCIPAL BANKERS

Bank of China (Hong Kong) Limited
Standard Chartered Bank (HK) Limited
Industrial and Commercial Bank of China
Wuzhong Sub-Branch
Agricultural Bank of China Suzhou Branch

SHAREHOLDER'S CALENDAR

| | |
|--------------------------------|---|
| Closure of Register of Members | Monday, 18 April 2005 to Friday, 22 April 2005 (both dates inclusive) |
| Annual General Meeting | Friday, 22 April 2005 |
| Interim Dividend, paid | HK\$0.015 per share, paid on 8 October 2004 |
| Final Dividend, payable | HK\$0.023 per share, payable on or about 28 April 2005. |

HEAD OFFICE AND PRINCIPAL PLACE OF BUSINESS

Suites 3212-13 Shell Tower, Times Square
1 Matheson Street
Causeway Bay
Hong Kong

REGISTERED OFFICE

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

PRINCIPAL SHARE REGISTRAR AND TRANSFER OFFICE

Bank of Bermuda (Cayman) Limited
36C Bermuda House
British American Centre, Dr. Roy's Drive
George Town, Grand Cayman
Cayman Islands
British West Indies

HONG KONG BRANCH SHARE REGISTRAR AND TRANSFER OFFICE

Abacus Share Registrars Limited
Ground Floor
Bank of East Asia Harbour View Centre
56 Gloucester Road
Wanchai
Hong Kong

STOCK CODE

2348

DEAR SHAREHOLDERS,

On behalf of the board of directors (the "Board") of Dawnrays Pharmaceutical (Holdings) Limited (the "Company") and its subsidiaries (collectively referred to as the "Group"), I am pleased to present the results of the Group for the year ended 31 December 2004.

RESULTS

The Group recorded a turnover of approximately RMB584,758,000 (2003: RMB491,388,000) for the year ended 31 December 2004, which was increased by 19.0% from that of 2003. Net profit from ordinary activities attributable to shareholders was approximately RMB80,171,000 (2003: RMB108,022,000), which was decreased by 25.8% from that of 2003. The growth in turnover was mainly attributable to the significant increase in the production and sales volume of cephalosporin powder for injection form and bulk medicine, as well as new types of generic drugs (system specific medicine) which successfully tapped into the market as planned (with an average gross profit margin over 70%). The decrease in profit was principally attributable to the following reasons:

1. On 7 June 2004, the National Development and Reform Commission of the PRC ordered a reduction in the retail price of antibiotics. The average rate of reduction in price for 24 species of antibiotics was about 30%. The Group took the initiative to reduce the ex-factory price of cephalosporin powder for injection form so as to expand its market share. In 2004, the sales volume of cephalosporin powder for injection form was increased by 51.4%, whilst the gross profit margin was 42.0% (2003: 54.6%), representing a decrease of 12.6%. The turnover of cephalosporin powder for injection form was RMB216,979,000 (2003: RMB230,976,000), representing a decrease of RMB13,997,000;
2. In 2004, the Group established an effective mechanism for optimizing technologies, marketing, research and development, as well as determining remuneration so as to motivate management. Experts in high-end technologies and marketing were recruited from competitors for the development of generic drugs (system specific medicine). Bonuses given during the year amounted to RMB7,422,000 (2003: Nil);
3. As the Group was listed on 11 July 2003, no expense was incurred in the head office in Hong Kong for the first half of 2003. In 2004, administrative expenses incurred in the head office in Hong Kong amounted to RMB9,979,000 (2003: RMB5,155,000), representing an increase of RMB4,824,000; and
4. In 2004, the Group devoted more efforts to the research and development of new products. Expenses on research and development amounted to RMB12,309,000 (2003: RMB10,305,000), representing an increase of RMB2,004,000.

FINAL DIVIDEND

The Board has declared a final dividend of HK\$0.023 per share for the year ended 31 December 2004, amounting to a total sum of HK\$18,400,000 (equivalent to RMB19,543,000).

Together with the interim dividend of HK\$0.015 per share, this will bring the total dividend distribution for the year to HK\$0.038 per share, representing a dividend payout of approximately 40%.

BUSINESS OUTLOOK

I. ANALYSIS ON MARKET POSITIONING OF CEPHALOSPORIN

According to the "China Medical Statistical Year Book 2002" 《二零零二年中國藥業統計年報》, the market scale for finished preparations of cephalosporin in the PRC as a whole exceeded RMB10 billion in 2002. As indicated by such analysis, the growth in the consumption of cephalosporin per annum was increased by more than 20% in the recent five years.

The Group is principally engaged in the PRC in the manufacture and sale of non-patented chemical medicine, including cephalosporin bulk medicine and powder for injection form. It is one of the few third generation cephalosporin manufacturers in the PRC which has adopted a comprehensive vertically integrated production process. The Group plans to launch the fourth generation cephalosporin bulk medicine and powder for injection form into the market in 2005. Currently, the Group's solvent crystallisation techniques for Cefoperazone is a leading technology employed in the PRC, having a market share of about 60% in the PRC. The market share of Ceftriaxone was about 30%.

As the market prospects of the production of cephalosporin is highly attractive, large pharmaceutical enterprises in the PRC, including State owned enterprises, foreign invested enterprises and private owned enterprises, are gradually starting to increase their investments in this industry. However, the PRC government is expected to further reduce the retail price of cephalosporin so that more people will be able to afford to use cephalosporin. Therefore, we consider that enterprises with adequate capital, technical process advantages and strong sales capabilities will have a competitive advantage in the cephalosporin pharmaceutical industry. Competition among such enterprises, in particular with respect to price, will also increase.

II. ANALYSIS ON MARKET POSITIONING OF GENERIC DRUGS (SYSTEM SPECIFIC MEDICINE)

In an article titled "Game theory" of The Lex Column on page 14 of the Financial Times of UK published on 22 February 2005, it was stated that *"It is a testament to the woes of the pharmaceuticals sector that off-patent drugs have become its sexiest segment. In the US alone, some \$60bn of prescription medicines will lose legal protection over the next four years, slowing industry revenue growth to 7-8 per cent per annum. By contrast, generics are winning market share, as cost pressures on healthcare providers increase, and should grow by more than 10 per cent a year"*, and also in another article titled "Generics bring potent ingredient to drug mix" on page 16, it was stated that *"Novartis' predicts the generics market will be worth about \$100bn by 2010, by which time it expects to have a 10 per cent share"*. With doubts in the medical sector on the safety of the new drugs launched recently by major prescription drugs manufacturers resulting in some cases of suspension of production, as well as increasing concerns over the deficit incurred by the medical welfare funds of governments around the world, and the increase in pressure on reimbursement by private medical insurance arising from aging problems in the population, generic drugs (system specific medicine) are expected to be warmly received by communities.

Meanwhile, it is expected that the development of generic drugs will draw the attention of the pharmaceutical manufacturers to the distinct predictability in the market, lower costs in the development techniques, shorter product development cycle, higher gross profit margin, and longer cycle for profitability.

¹ Novartis Group, the largest Swiss pharmaceutical company with operations covering more than 140 countries and regions around the world.

III. OUR STRATEGIES

Under such circumstances, the Group has formulated and implemented the following strategies:

1. Establishment of an expert network

In 2004, the Group successfully established an expert network which was formed by well known experts, such as Professor Zhong Nan Shan and Professor Mei Hua, who are very influential in the medical sector, as representatives. Such network provided support to the decision on the marketing strategies of the Group in the medical and pharmaceutical sectors.

2. Enhancement of research and development capabilities with integrated models of research and development, and launch generic drugs (system specific medicine) with huge market potential and business value

In 2004, the Group received 45 approvals on clinical testing and production from the State Food and Drug Administration of the PRC in total, which increased by 12 approvals as compared with the total of 33 approvals received in 2003. In 2005, it is prudently estimated that the Group will receive more than 40 approvals on clinical testing and production, which will include the fourth generation cephalosporin and several generic drugs (system specific medicine).

For cephalosporin, the Group will conduct further research so as to improve its technique and technologies, thereby reducing costs and enhancing yield rate.

As to generic drugs (system specific medicine), the Group will adopt various models for cooperation, which will facilitate knowledge exchange with various research institutes and multinational technology companies for determination on the academic orientation. Finasteride Tablet and Metformin Hydrochloride & Glibenclamide Tablet which commenced production in bulk in 2004 complemented the generic drugs (system specific medicine) portfolio of the Group that was previously made up of Amlodipine Besylate Tablet, Compound Ranitidine Capsule, Cetirizine Hydrochloride Tablet and Bismuth Potassium Citrate Capsule etc. Such portfolio will be developed to a greater extent in 2005 and 2006.

3. Pool of resources and central coordination for marketing of generic drugs (system specific medicine)

In 2004, the Group devoted more efforts to the establishment of a new sales team for the marketing and sales of generic drugs (system specific medicine). A team dedicated to serve the medical sector was also established. Finasteride tablet which commenced production in 2004 and Amlodipine Besylate tablet which commenced production in 2002 were centrally coordinated by the new drug sales department. As at year end, the new drug sales department has about 30 offices across the PRC, and actively engaged in academic promotion activities in the medical sector.

4. Scale of development and economies of scale

In 2004, the production capacity for the workshop of cephalosporin powder for injection form was upgraded to 240 million vials. As the average gross profit margin for cephalosporin is demonstrating a downward trend, the Group is expected to expand its output significantly in 2005 in order to expand the market share and cultivate the brand. At the same time, in June 2005, a workshop of 450 tonnes for cephalosporin bulk medicine will commence operation. Hence, the production capacity of the Group's third generation cephalosporin bulk medicine will exceed 800 tonnes, and account for about 30% of the total market share in the third generation cephalosporin bulk medicine in the PRC.

5. Tapping into international market and actively seeking strategic partners for cooperation

Sales to overseas increased by four times compared with that in 2003, and amounted to RMB22,088,000. It is expected that, as a powerful sales strategy, through devoting more efforts to expand the international market for cephalosporin, the Group will be able to set off the effect of the government price reduction policy. Meanwhile, it will also solidify a foundation for expanding the sales of generic drugs (system specific medicine) in the international market.

Under the premises of globalized economy and China's accession to World Trade Organisation, the Group has been actively seeking partners for strategic cooperation so as to expand its capital operation and provide opportunities for business development.

6. Tightening cost control

The Group constructed and operated a system for the recycling of solvents, which is in the capacity to recycle 15,500 tonnes of chemical solvents per year, thereby reducing the production costs on the purchases of solvents.

IV. CORPORATE GOVERNANCE

The Board has established an Audit Committee and a Remuneration Committee, which contributed to the development of the Group into a more professional and international corporation, with respect to investment direction, product creation, officers' appointment and removal and remuneration structure. The Board will continue to improve the capabilities of the Group in the area of corporate governance, so as to enhance the flexibility and the science of the management platform. Effective internal control mechanism on financial management was also established, so as to maintain sustainable and healthy development of the enterprise. This will further solidify the foundation for the Group's growth in capital operations.

V. THE CREATION OF FUTURE JOINTLY BY THE ENTERPRISE AND ITS STAFF

After the Group was listed, the Board increased its pace in the training and recruitment of expertise with international perspectives and good knowledge of the national situation of the PRC, so as to meet with the needs for the rapid development in the enterprise professionalization and internationalization. In 2004, share options to subscribe for about 3.5% (2003: 5%) of the Company's shares as at 31 December 2004 were granted to the senior management. The Group has always treated its management team as well as its staff nationwide as the most valuable intangible assets of the Group, which have been the greatest driving force behind the further development of the Group. I would like to take this opportunity to express my deepest gratitude to the members of the Board, and to the staff of the Group's subsidiary companies and various departments who have used their best endeavours at work and dedicatedly served the Group in the past year.

Li Kei Ling
Chairman

Hong Kong , 7 March 2005

Management Discussion and Analysis

BUSINESS REVIEW

1. PRODUCTION & SALES OPERATION

Each of the Group's products in terms of production volume and sales volume recorded growth over the previous year. During the year, 371.4 tonnes of bulk medicine were produced, which was increased by 66.5% over the previous year. Sales of bulk medicine were 301.0 tonnes, which was increased by 66.5% over the previous year. 85,766,000 vials of cephalosporin powder for injection form were produced, which was increased by 35.9% over the previous year. Sales of cephalosporin powder for injection form were 85,736,000 vials, which was increased by 51.4% over the previous year. 8,915,000 boxes of generic drugs (system specific medicine) were produced, which was increased by 32.9% over the previous year. Sales of generic drugs (system specific medicine) were 8,396,000 boxes, which was increased by 28.1% over the previous year. Overseas export sales of medicine increased rapidly by about four times over the previous year to more than ten countries over Europe, South America and Asia.

2. PRODUCTS IN THE PIPELINE

In 2004, the Group obtained 22 production permits from the State Food and Drug Administration of the PRC. Of which, there were five new medicines, namely Cefuroxime Sodium Sterile bulk medicine, Cefixime bulk medicine, Finasteride bulk medicine, Finasteride tablet, Metformin Hydrochloride & Glibenclamide tablet. The Group was also awarded 23 permits for clinical testing. 16 projects for pre-clinical testing and 10 projects for clinical testing were completed. The Group's research and development team, completed a survey covering the local and global market, trend of frequent illness, trend of overall adjustment of medicine development and analysis of the outlook for all kinds of medicine markets, and incorporated the Group's special features and the direction of research and development, and completed the preliminary report on the development of products. A total of 20 projects were embarked in 2004.

3. RECOGNITIONS OBTAINED IN 2004

On 5 February 2004, Ceftriaxone Sodium Sterile bulk medicine and powder for injection form, and Amlodipine Besylate bulk medicine and its tablet were classified as projects under the Torch Plan in Jiangsu Province by the Department of Science and Technology of Jiangsu Province;

On 18 February 2004, the Company's research and development centre was endorsed by the Department of Science and Technology of Jiangsu Province as the first batch of foreign research and development entities in Jiangsu Province;

On 28 May 2004, Amlodipine Besylate bulk medicine and its tablet, products of the Company, were endorsed by the Department of Science and Technology of Jiangsu Province as a high tech product of Jiangsu Province;

On 7 July 2004, Amlodipine Besylate bulk medicine and its tablet, products of the Company, were endorsed by the Ministry of Science and Technology as a project under the State Torch Plan; and

On 12 August 2004, Xi Ke Wei (Cetirizine Hydrochloride Tablet), a product of the Company, was endorsed by the Department of Science and Technology of Jiangsu Province as a high tech product of Jiangsu Province.

4. CONSTRUCTION PROJECTS FOR THE EXPANSION OF PRODUCTION FACILITIES

The construction of engineering projects for the Group in 2004 proceeded as scheduled:

85% of the overall construction work of the new workshop of Suzhou Dawnrays Pharmaceuticals Co., Ltd. for the cephalosporin bulk medicine was completed. It is expected to commence operation in June 2005. After the construction is completed, it is expected that the output of cephalosporin will be increased by 450 tonnes. The Group's products will become more comprehensive and enjoy comparative advantage in terms of costs. It will also solidify the Group's leading position in third generation cephalosporin.

The project for the output expansion of Ceftriaxone Crude for Suzhou Dawnrays Chemical Co., Ltd. proceeded smoothly. After the construction is completed, it is expected to increase the output of Ceftriaxone Crude from 200 tonnes to 400 tonnes.

Expansion in the workshop of Suzhou Dawnrays Chemical Co., Ltd. for the recycling of solvents was completed successfully. The capability in recycling is now expanded to 15,500 tonnes per annum, and will provide enormous support as to cost savings for cephalosporin products.

As at the end of 2004, the projects of the pilot production workshop, upgrade of environmental protection facilities, and quality assurance for the Group established and commenced smoothly. It is expected to complete within the first half of 2005, which will optimize the infrastructure facilities and enhance the overall competitiveness of the Group.

PROSPECTS

The Group's principal product, third generation cephalosporin, has been the most popular medicine within its category in the PRC. It is anticipated that the demand of cephalosporin will increase in 2005. Various cephalosporin products of the Group have adopted our core technology. The potential growth of sales remains high. Sales of cephalosporin powder for injection form in 2005 will not be limited by the production capacity. With the 450 tonnes workshop for cephalosporin bulk medicine commencing operation in June 2005, it is expected that production capabilities and sales of cephalosporin bulk medicine will exceed 800 tonnes per annum. In 2005, the Group will also launch the fourth generation cephalosporin products into the market so as to assure its competitive edge. However, followed by the increasing keen competition in the cephalosporin medicine market, the market will be driven by the integrated and consolidated pharmaceutical business model of "Intermediate - Bulk medicine - Preparation medicine". Price competition will soon emerge. The Group will continue to devote efforts in strengthening antibiotics as a foundation for stable cashflow.

The Group has devoted a lot of efforts and resources to develop the business of generic drugs (system specific medicine) in 2004, which now accounts for about 9% of the total sales. The Group has improved its market expansion capability for system specific medicine and is now well positioned to grow. It is believed that satisfactory results will be achieved by strengthening marketing efforts and network building.

The Group has been implementing a standard system of corporate governance, which forms the basis for the conduct of globalization strategy. The Group will actively develop international trade and cooperation projects, and seek strategic cooperation in the international capital market so as to optimize the Group's capital structure, absorb premium resources and state-of-the-art management philosophies in the coming year.

Management Discussion and Analysis

FINANCIAL REVIEW

SALES AND GROSS PROFIT

During the year, the Group recorded a turnover of approximately RMB584,758,000, representing an increase of 19.0% as compared with the previous year. Gross profit was approximately RMB192,677,000, representing a decrease of 6.4% as compared with the previous year. Gross profit margin was 32.9% (2003: 41.9%). The main reasons for the decrease in gross profit margin are as follows: firstly, the Group took the initiative in reducing prices of cephalosporin powder for injection form to gain higher market share; secondly, the Group increased sales proportion of bulk medicine which has relatively lower gross profit margin.

During the year, sales of bulk medicine amounted to RMB311,457,000, representing an increase of 48.3% as compared with RMB209,950,000 of the previous year. Sales of bulk medicine accounted for 53.2% of total sales (2003: 42.7%). Gross margin of bulk medicine was approximately 19.3% (2003: 20.2%).

Sales of powder for injection form amounted to RMB216,979,000, representing a decrease of 6.1% as compared with RMB230,976,000 of the previous year. Sales of powder for injection form accounted for 37.1% of total sales (2003: 47.0%). Gross margin of powder for injection form was approximately 42.0% (2003: 54.6%).

Sales of generic drugs (system specific medicine) amounted to RMB51,554,000, representing an increase of 5.9% as compared with RMB48,681,000 of the previous year. The proportion of generic drugs (system specific medicine) to total sales was 8.8% (2003: 9.9%). Gross profit margin for generic drugs (system specific medicine) was approximately 73.6% (2003: 77.5%).

During the year, overseas export sales increased rapidly as compared with the previous year, which was mainly attributable to the increased overseas export sales of bulk medicine from RMB3,769,000 of the previous year to RMB21,086,000 of this year, representing an increase of 459%.

EXPENSES

Total expenses incurred during the year amounted to approximately RMB108,221,000, representing an increase of 14.7% over the previous year. Total expenses as a percentage of turnover was 18.5% (2003: 19.2%).

Of which, selling and distribution costs amounted to RMB58,987,000, representing an increase of 3.9% over the previous year. Selling and distribution costs as a percentage of turnover was 10.1% (2003: 11.6%).

Administrative expenses and other operating expenses amounted to RMB49,234,000, representing an increase of 34.0% over the previous year. The increase was due to the full year operation of the head office in Hong Kong, increase in research and development expenditure, and the giving of bonuses to attract experts and attractive remuneration to motivate core members with technology expertise.

NET PROFIT FROM OPERATING ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS

During the year, net profit from operating activities attributable to shareholders amounted to RMB80,171,000, representing a decrease of approximately 25.8% as compared with the previous year.

ANALYSIS ON RETURN OF ASSETS

As at 31 December 2004, net assets of the Group were about RMB411,471,000. Net return on assets, which is defined as the net profit from operating activities attributable to shareholders divided by net assets, was 19.5%. The turnover days for account receivables on bulk medicine (including notes receivables) was about 135 days. The turnover days for the account receivables on cephalosporin powder for injection form and generic drugs (system specific medicine) was about 100 days, whilst the inventory turnover was about 65 days.

CASHFLOW

As at 31 December 2004:

1. Net cash inflows from operating activities were RMB73,740,000;
2. Expenditures on construction projects and purchases of fixed assets amounted to RMB63,964,000; and
3. Profit distributions (including dividend paid to minority shareholders) amounted to RMB42,889,000.

As at 31 December 2004, the Group has RMB98,382,000 cash and cash equivalents, and no bank loans.

LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE

As at 31 December 2004, the Group's current assets amounted to approximately RMB435,900,000, whilst current liabilities was approximately RMB274,896,000. Net current assets were approximately RMB161,004,000.

As at 31 December 2004, the Group has aggregate bank facilities of approximately RMB387,000,000, with no asset being pledged to banks.

As at 31 December 2004, the Group's capital commitments amounted to approximately RMB91,989,000 which will be funded by proceeds from listing and by internal resources.

Management Discussion and Analysis

FINANCIAL MANAGEMENT, FINANCIAL INSTRUMENTS AND EXCHANGE RATE RISK

The Group implements a steady and prudent financial strategy. Exposure incurred during its course of financial management are managed in accordance with policies approved by the Board.

Substantially all of the Group's operations are normally transacted in Renminbi, which is not freely convertible into foreign currencies.

The Group's monetary assets and liabilities are normally denominated in Hong Kong Dollars, Renminbi and US Dollars.

The carrying amount of the Group's cash and cash equivalents, trade receivables and payables, other receivables and payables, borrowings and balances with related parties approximate their values because of the short maturity of these instruments.

The Group did not enter into any foreign exchange forward contracts or other hedging instruments to hedge against fluctuations, and the Group did not use any financial instruments.

STAFF

Human resources is the most valuable assets of the Group. A professional, pragmatic, and highly efficient management team together with the staff as a whole is the Company's most valuable competitive advantage. The Group provides a competitive remuneration policy.

As at 31 December 2004, the Group employed approximately 1,200 employees (31 December 2003: approximately 749 employees) with attractive remuneration and employee benefits such as defined contribution retirement schemes, share option scheme and medical coverage. The Group provides certain of its employees in PRC with dormitory accommodation, and makes monthly contribution to State unemployment insurance funds and State housing fund for the employees in the PRC. During the year, staff costs amounted to RMB39,682,000 (31 December 2003: RMB27,537,000).

The Company has adopted a share option scheme. Under the share option scheme, the Eligible Persons (including the executive and independent non-executive directors and employees of the Group (whether full time or part time)) may be granted options which enable them to subscribe for shares in the Company, up to a maximum of 10% of the shares of the Company in issue upon listing.

Options in respect of about 3.5% of shares in the Company as at 31 December 2004 has been granted by the Company to Eligible Persons during the year.

CHARGE ON ASSETS

As at 31 December 2004, no asset of the Company was pledged to banks to obtain credit facilities.

PLANS FOR SIGNIFICANT INVESTMENTS AND EXPECTED SOURCE OF FUNDING

Details of the Group's future plans for significant investments and their expected source of funding have been stated in the Company's prospectus dated 30 June 2003 under the section headed "Future Plans and Use of Proceeds".

In order to further expand the Group's production facilities, the Group plans to invest RMB38,823,000 to construct five infrastructure projects commencing from 2005:

1. A multi-function pilot production workshop for Suzhou Dawnrays Pharmaceuticals Co., Ltd. of around RMB4,575,000;
2. A workshop of cephalosporin in solid dosage form for Suzhou Dawnrays Pharmaceuticals Co., Ltd. of around RMB15,570,000;
3. An integrated warehouse for Suzhou Dawnrays Pharmaceuticals Co., Ltd. of around RMB10,000,000;
4. Upgrade of auxiliary utilities facilities for the whole plant of Suzhou Dawnrays Chemical Co., Ltd. of around RMB7,112,000;
and
5. Expansion of the workshop for the intermediates of cephalosporin for Suzhou Dawnrays Chemical Co., Ltd. of around RMB1,566,000.

Other than those disclosed above, the Group did not have any plan for material investments or acquisition of capital assets.

CONTINGENT LIABILITIES

As at 31 December 2004, the Group had no material contingent liabilities (31 December 2003: Nil).

Directors' and Senior Management's Biographies

EXECUTIVE DIRECTORS

Ms. LI, Kei Ling (李其玲女士), aged 56, is an executive director and the Chairman of the Company and one of the founders of the Group. Ms. Li has over twenty years of experience in corporate management, strategic planning, business operations and finance, in particular for pharmaceutical enterprises in the PRC. She is responsible for supervising the strategic management decisions and business policies, ensuring corporate governance and executing the overall developmental strategies of the Group. Ms. Li was an executive director of Sing Lee Software (Group) Limited, a company listed on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited, and resigned from such position on 6 January 2004.

Mr. HUNG, Yung Lai (熊融禮先生), aged 60, is an executive director and one of the founders of the Group. Mr. Hung holds a degree from Shanghai Conservatory of Music (上海音樂學院). He has over twenty years of experience in corporate management and corporate development, and has participated in the founding and managing of pharmaceutical and high-tech enterprises. Mr. Hung is an executive director and the chairman of Sing Lee Software (Group) Limited, a company listed on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited.

Mr. ZHANG, Jing Xing (張京星先生), aged 49, is an executive director of the Company. Mr. Zhang has over twenty years of experience in corporate management, production, marketing and research and development of pharmaceutical enterprises. He previously was the vice general manager of 麗珠醫藥集團股份有限公司 (Livzon Pharmaceutical Group Inc.), a company listed on the Shenzhen Stock Exchange, and has a sound understanding of the pharmaceutical industry in the PRC. Mr. Zhang joined the Group in September 1996.

Mr. LAM, Kam Wah (林錦華先生), aged 51, is an executive director and the Vice President of the Company. He graduated from The Chinese University of Hong Kong with a bachelor's degree in social sciences. Mr. Lam has over fifteen years of experience in pharmaceutical trading and corporate management. He joined the Group in December 1995 and is responsible for overseeing the international businesses of the Group and the daily administration of the Company.

Mr. LI, Tung Ming (李東明先生), aged 56, is an executive director of the Company. Mr. Li has over twenty years of experience in the pharmaceutical industry in the PRC, and began his career in product development, promotion, sales and corporate management in the pharmaceutical market in the PRC in 1980. Mr. Li joined the Group in April 2000 and is responsible for the product development and expansion of the Group's network of medical experts and academic advisors.

Mr. XU, Kehan (許克寒先生), aged 32, joined the Group in November 2003 and was appointed as an executive director and the Chief Financial Officer of the Company in March 2004 and in September 2004, respectively. Mr. Xu is responsible for the planning and execution of the corporate financial and investment policies, capital budgeting, investor relations, risk management, business development, strategic positioning and corporate development research of the Group. Mr. Xu has served the Group as the Strategic Adviser to the Chairman of the Board and the Chief Investment Officer of the Group. Mr. Xu holds a master's degree in Business Administration from the University of Miami, USA with specialization in investments. Mr. Xu is currently a doctoral candidate (part-time) in strategy management of the Graduate School of Business of The Hong Kong Polytechnic University.

Directors' and Senior Management's Biographies

INDEPENDENT NON-EXECUTIVE DIRECTORS

Mr. PAN, Xue Tian (潘學田先生), aged 68, is an independent non-executive director of the Company. He joined the Group in June 2003. Mr. Pan is the Vice President and Secretary General of 中華醫院管理學會 (Chinese Hospital Association), an adviser to 中國藥典委員會 (Pharmacopoeia Commission of the PRC) and the Management Vice President of 中國保健協會 (China Health Care Association). Mr. Pan has extensive experience in drug administration and supervision, medical hygiene and hospital management, and has assumed various senior management positions in the Ministry of Health of the PRC. He graduated from the medicine faculty of 中國大連醫學院 (Dalian Medical University of the PRC).

Mr. LEE, Cheuk Yin Dannis (李卓然先生), aged 34, is an independent non-executive director of the Company. He joined the Group in November 2003. Mr. Lee is a first class honours graduate of Bachelor of Business Administration from Texas A&M University, USA and is an associate member of the Hong Kong Institute of Certified Public Accountants and a member of the American Institute of Certified Public Accountants. From 1992 to 1995, Mr. Lee worked in an international accounting firm as a senior accountant. From 1995 to 1996, Mr. Lee worked in Philip Morris Asia Inc. as a senior accountant. From 1996 to 2001, Mr. Lee worked in an international accounting firm as a manager. Mr. Lee is an executive director and financial controller of Vision Grande Group Holdings Limited, an executive director of Norstar Founders Group Limited and also an independent non-executive director of Geely Automobile Holdings Limited (formerly known as Guorun Holdings Limited). All these three companies are listed on the Main Board of The Stock Exchange of Hong Kong Limited.

Mr. CHOI, Tat Ying Jacky (蔡達英先生), aged 36, is an independent non-executive director of the Company. He joined the Group in September 2004. Mr. Choi has extensive experience in financial and treasury management, corporate finance, investment and audit. He earned his Bachelor of Business Administration degree from Hong Kong Baptist University with a first class honours in 1990. Mr. Choi is a practising member of the Hong Kong Institute of Certified Public Accountants and currently serving as the Chief Financial Officer of AIG Finance (Hong Kong) Ltd, which he has served as director since 20 March 2004. He is also an independent non-executive director of both Norstar Founders Group Ltd, a company listed on the Main Board of The Stock Exchange of Hong Kong Limited, and Enzyme Engineering Corporation, a private company. From March 2002 to June 2002, Mr. Choi was an independent non-executive director of Oriental Investment Corporation Ltd (formerly known as Quality Food International Limited), a company listed on the Main Board of The Stock Exchange of Hong Kong Limited.

ACADEMIC ADVISORS

Mr. ZHONG, Nan Shan (鍾南山先生), joined our Group as an academic advisor in April 2004. He graduated from the 北京大學醫學部 (Beijing Medical University), and obtained the Respiratory Medicine from the University of Edinburgh Royal Infirmary and the St. Bartholomew's Hospital University of London. He is currently the Academician of the Department of Medicine of The Chinese Academy of Engineering, Professor of Medicine in Guangzhou Medical College, the President of Guangzhou Association of Science and Technology and the Director of Guangzhou Institute of Respiratory Disease. He has been a Medical Advisor of the World Health Organisation Advisory Panel on Chronic Respiratory Disease since 2000. He has written 4 books and published over 120 papers in the last decade. After the battle of Severe Acute Respiratory Syndrome ("SARS"), he was invited to be the lecturer in the annual meeting of American Thoracic Society – "Management of SARS in China" in Seattle, the United States.

Directors' and Senior Management's Biographies

Mr. MEI, Hua (梅驊先生), joined our Group as an academic advisor in April 2004. He graduated from the 廣州華南醫學院 (Guangzhou South China Medical College) and qualified as the specialist in Urology from 北京醫學院附屬第一醫院 (The First Affiliated Hospital of Beijing Medical University) and Massachusetts General Hospital, USA (美國麻省總醫院). He has been a professor of 中山大學附屬第一醫院 (The First Affiliated Hospital of Sun Yat-sen University) since 1980 and a director of 深圳中山泌尿外科醫院 (Department of Urology of Shenzhen Sun Yat-sen Hospital) since 1986. Since 1991, he has been the Advisor for doctoral candidates in the First Affiliated Hospital of Sun Yat-sen University. He has also written 3 books about urology and surgery in the past five years.

SENIOR MANAGEMENT

Mr. DONG, Shao Zhi (董紹志先生), aged 63, is the President of the Company and is responsible for the daily business operations and management of the Group. He graduated from 瀋陽化工學院 (Shenyang Institute of Chemical Technology) and was an engineer of 石家莊第一製藥廠 (The First Affiliated Pharmaceutical Manufacturer of Shijiazhuang) in 1980, the senior engineer of 石家莊市科委 (the Scientific Committee of City of Shijiazhuang) in 1985 and the chief engineer of 石家莊中興實業有限公司 (Zhongxing Industrial Company Ltd of Shijiazhuang) in 1988. He has been 河北省藥學會秘書長 (the Chief Secretary of Hebei Province Pharmaceutical Society), 石家莊藥學會副理事長 (the Vice Managing Director of Shijiazhuang Pharmaceutical Society), 河北省藥學會常務理事 (the Managing Director of Hebei Province Pharmaceutical Society) from 1985 to 1992, and 廣東省珠海市藥學會質量協會副會長 (the Vice President of Guangdong Province Zhuhai City Pharmaceutical Society Quality Assurance Association) from 2000 onwards. Before joining the Group in July 2004, from 2001 to 2004, Mr. Dong was the vice president of Livzon Pharmaceutical Group Inc., a company listed on the Shenzhen Stock Exchange, and a director of such company since 2003, and resigned from the positions of vice president and director in August 2004 and January 2005, respectively.

Mr. GAO, Yi (高毅先生), aged 51, is the Executive Vice President of the Company, responsible for overseeing the sales and marketing of the Group. Mr. Gao graduated from 廣州市衛生中等技術專科學校 (藥業專業) (Guangzhou Health Secondary Technical School (pharmaceutical profession)) and 廣州醫科大學 (醫科專業) (Guangzhou Medical University (medical profession)). Mr. Gao has worked at 廣州市藥品檢驗所 (Guangzhou Institute for Drug Control) as a medical inspector for seven years. From 1994 to 2003, Mr. Gao has been the deputy general manager and general manager of 石家莊石藥集團聯合製藥廠 (Shijiazhuang Shiyao Group Union Pharmaceutical Factory) and 珠海經濟特區麗康醫藥有限公司 (Zhuhai Economic Zone Li Kang Pharmaceuticals Company Limited), respectively, for five years each. Mr. Gao joined the Group in July 2003.

Mr. ZHAO, Shi Xi (趙是熙先生), aged 41, is the Vice President of the Company. Mr. Zhao is a pharmaceuticals engineer and obtained a master's degree in inorganic chemistry from 蘇州大學 (Suzhou University) and was a practical assistant teacher of Suzhou Vocational University in basic chemistry for six years. Before joining the Group, Mr. Zhao was the chief officer of the quality control department of 蘇州中化藥品工業有限公司 (Suzhou Chung-Hwa Chemical & Pharmaceutical Industrial Co. Ltd). Mr. Zhao joined the Group in May 1997.

Mr. SUN, Ming Yao (孫明耀先生), aged 46, is the Head of Sales of the Company. Mr. Sun has over twenty years of experience in sales, marketing and business development and held managerial positions in pharmaceutical trading companies including 蘇州醫藥採購供應站 (Suzhou Pharmaceuticals Supply Station) and 蘇州藥品經營公司 (Suzhou Pharmaceuticals Trading Company) before joining the Group in September 1998.

Directors' and Senior Management's Biographies

Ms. CHU, Hong (初虹女士), aged 40, is the Head of Research and Development of the Company. Ms. Chu is a licensed pharmacist and senior engineer. She graduated from 瀋陽藥學院 (Shenyang Institute of Pharmacy) with a bachelor's degree in microbial pharmacy and has sixteen years' experience in production, quality control and research and development for pharmaceutical operations. Before joining the Group in August 2002, Ms. Chu was the vice factory manager of 蘇州第二製藥廠 (Suzhou Second Pharmaceutical Factory) and the vice director of the development department of 蘇州醫藥集團有限公司 (Suzhou Pharmaceutical Group Co. Ltd).

Mr. SU, Guo Qiang (蘇國強先生), aged 35, is the General Manager of Suzhou Dawnrays Pharmaceuticals Co., Ltd and is responsible for overseeing the operations of Suzhou Dawnrays Pharmaceuticals Co., Ltd. Mr. Su graduated from 武漢化工學院 (Wuhan Institute of Chemical Technology) in Biopharmaceutical profession and qualified as a pharmaceutical engineer. He was the chief engineer and the head of the research centre of 蘇州第二製藥廠研究所 (Suzhou Second Pharmaceutical Factory). He joined the Group in November 2001.

Mr. ZHU, Qin Sheng (朱琴生先生), aged 52, is the General Manager of Shanghai Dawnrays Chemical Co., Ltd, responsible for overseeing the operations of Shanghai Dawnrays Chemical Co., Ltd. Mr. Zhu has over twenty-five years' experience in production management, financial management and operations for pharmaceutical enterprises. He was the deputy factory director of 蘇州第三製藥廠 (Suzhou Third Pharmaceutical Factory) before joining the Group in April 1998.

Mr. LI, Jian Xiang (李建翔先生), aged 49, is the General Manager of Suzhou Dawnrays Chemical Co., Ltd, responsible for overseeing the operations of Suzhou Dawnrays Chemical Co., Ltd. Mr. Li has over twenty-five years' experience in production management, engine facilities maintenance and operations for pharmaceutical enterprises. He was the factory director of 蘇州第二製藥廠 (Suzhou Second Pharmaceutical Factory) before joining the Group in April 1998.

Mr. CHEN, Jian Dong (陳建東先生), aged 40, is the General Manager of Suzhou Dawnrays Pharmaceutical Technology Co., Ltd and the General Manager of the President's office. Mr. Chen is a qualified pharmaceutical engineer and licensed pharmacist and has a bachelor's degree in chemical pharmacology from 中國藥科大學 (The Pharmaceuticals University of the PRC) where he spent three years as an assistant teacher. He was the head of the research centre and antibiotics workshop manager at 蘇州第四製藥廠 (Suzhou Fourth Pharmaceutical Factory) and the head of the registration section of the research and development department of 蘇州中化藥品工業有限公司 (Suzhou Chung-Hwa Chemical & Pharmaceutical Industrial Co. Ltd) before joining the Group in April 2002.

Ms. CHAN, So Fong (陳素芳女士), aged 31, is the Qualified Accountant of the Company. She earned a Bachelor Degree in Business Administration with major in Professional Accountancy from The Chinese University of Hong Kong in 1996 and is an associate member of the Hong Kong Institute of Certified Public Accountants and The Association of Chartered Certified Accountants. Ms. Chan has over eight years' experience in auditing, budgeting, financial and management accounting. She joined the Group in September 2004.

Report of the Directors

The board of directors (the "Board") herein present their report and the audited financial statements of Dawnrays Pharmaceutical (Holdings) Limited (the "Company") and its subsidiaries (collectively referred to as the "Group") for the year ended 31 December 2004.

PRINCIPAL ACTIVITIES

The principal activity of the Company is investment holding. Details of the principal activities of the subsidiaries are set out in note 19 to the financial statements. There were no significant changes in the nature of the Group's principal activities during the year.

RESULTS AND DIVIDENDS

The Group's profit for the year ended 31 December 2004 and the state of affairs of the Company and the Group at that date are set out in the audited financial statements on pages 27 to 62.

An interim dividend of HK\$0.015 per ordinary share was paid on 8 October 2004. The Board recommends the payment of a final dividend of HK\$0.023 per ordinary share in respect of the year, to shareholders on the register of members on 15 April 2005. This recommendation has been incorporated in the financial statements as an allocation of retained profits within the capital and reserves section of the balance sheet.

SUMMARY FINANCIAL INFORMATION

A summary of the published results and of the assets, liabilities and minority interests of the Group for the last five financial years, as extracted from the published audited financial statements and Accountants' Report included in the Prospectus of the Company dated 30 June 2003 and reclassified as appropriate, is set out on pages 63 to 64. This summary does not form part of the audited financial statements.

PROPERTY, PLANT AND EQUIPMENT AND LAND USE RIGHTS

Details of movements in property, plant and equipment and land use rights of the Company and the Group during the year are set out in notes 15 and 16 to the financial statements, respectively.

SHARE CAPITAL AND SHARE OPTIONS

There were no movements in either the Company's authorised or issued share capital during the year. Details of movements in the Company's share options during the year are set out in note 28 to the financial statements.

PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights under the Company's articles of associations 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, REDEMPTION OR SALE OF LISTED SECURITIES OF THE COMPANY

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

RESERVES

Details of movements in the reserves of the Company and the Group during the year are set out in statement of changes in equity and note 29 to the financial statements.

DISTRIBUTABLE RESERVES

At 31 December 2004, the Company's reserves available for distribution amounted to RMB199,053,000, of which RMB19,543,000 has been proposed as a final dividend for the year. Under the Companies Law, Cap. 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands, the share premium account of the Company of approximately RMB69,583,000 as at 31 December 2004 are distributable to the shareholders of the Company provided that immediately following the date on which the dividend is proposed to be distributed, the Company will be in a position to pay off its debts as they fall due in the ordinary course of business. The share premium account may also be distributed in the form of fully paid bonus shares.

MAJOR CUSTOMERS AND SUPPLIERS

In the year under review, sales to the Group's five largest customers accounted for 27% of the total sales for the year and sales to the largest customer included therein amounted to 11%. Purchases from the Group's five largest suppliers accounted for 60% of the total purchases for the year and purchases from the largest supplier included therein amounted to 42%.

None of the directors of the Company or any of their associates or any shareholders (which, to the best knowledge of the directors, own more than 5% of the Company's issued share capital) had any beneficial interest in the Group's five largest customers or suppliers.

Report of the Directors

DIRECTORS

The directors of the Company during the year were:

EXECUTIVE DIRECTORS

Ms. Li Kei Ling

Mr. Hung Yung Lai

Mr. Zhang Jing Xing

Mr. Lam Kam Wah

Mr. Li Tung Ming (appointed on 14 January 2004)

Mr. Xu Kehan (appointed on 17 March 2004)

NON-EXECUTIVE DIRECTOR

Mr. Sik Siu Kwan Gary (resigned on 13 January 2004)

INDEPENDENT NON-EXECUTIVE DIRECTORS

Mr. Pan Xue Tian

Mr. Lee Cheuk Yin Dannis

Mr. Choi Tat Ying Jacky (appointed on 30 September 2004)

In accordance with the article 87 of the Company's articles of association, Mr. Hung Yung Lai and Mr. Lam Kam Wah will retire by rotation. However, only Mr. Hung Yung Lai will offer himself for re-election at the forthcoming annual general meeting ("AGM") whilst Mr. Lam Kam Wah will not offer himself for re-election. As Mr. Choi Tat Ying Jacky was appointed by the Board as an additional director after the AGM held on 29 April 2004, he will retire from office at the forthcoming AGM, and, being eligible, offer himself for re-election. Ms. Li Kei Ling, the Chairman, will also retire from office and offer herself for re-election in view of the provisions in paragraph A.4.2 of the new Appendix 14 of the Listing Rules, which came into effect on 1 January 2005.

The Company has received annual confirmations of independence from Mr. Pan Xue Tian, Mr. Lee Cheuk Yin Dannis and Mr. Choi Tat Ying Jacky, and as at the date of this report still considers them to be independent.

DIRECTORS' AND SENIOR MANAGEMENT'S BIOGRAPHIES

Biographical details of the directors of the Company and the senior management of the Group are set out on pages 14 to 17 of the annual report.

DIRECTORS' SERVICE CONTRACTS

Ms. Li Kei Ling, Mr. Hung Yung Lai and Mr. Lam Kam Wah have each entered into a service contract with the Company for a term of two years which commenced on 1 July 2003 and will continue thereafter until terminated by either party giving not less than three months' written notice. Each of the above three executive directors is entitled to a basic salary which will be reviewed at the discretion of the Board after she or he has completed 12 months of service. The current basic annual salary of each of Ms. Li Kei Ling, Mr. Hung Yung Lai and Mr. Lam Kam Wah amounts to approximately HK\$360,000, HK\$360,000 and HK\$646,000, respectively.

Mr. Zhang Jing Xing has entered into a service contract with the Company for a term of two years which commenced on 1 July 2003 and is subject to termination by either party giving not less than three months' written notice. On 1 August 2004, Mr. Zhang's service contract was revised to a term of three years which commenced on 1 August 2004 and is subject to termination by the Company giving not less than one month's written notice. Mr. Zhang is entitled to a basic annual salary of approximately HK\$880,000 which will be reviewed at the discretion of the Board after he has completed 12 months of service.

Mr. Li Tung Ming has entered into a service contract with the Company for a term of two years which commenced on 14 January 2004 and will continue thereafter until terminated by either party giving not less than three months' written notice. Mr. Li is entitled to a basic annual salary of HK\$360,000 which will be reviewed at the discretion of the Board after he has completed 12 months of service.

Mr. Xu Kehan has entered into a service contract with the Company for a term of three years which commenced on 17 March 2004 and is subject to termination by the Company giving not less than one month's written notice. Mr. Xu is entitled to a basic annual salary of HK\$504,000 which will be reviewed at the discretion of the Board after he has completed 12 months of service.

Mr. Pan Xue Tian and Mr. Lee Cheuk Yin Dannis have been appointed as an independent non-executive director for the period commencing on 1 July 2003 and 25 November 2003, respectively, to 30 June 2005. Mr. Choi Tat Ying Jacky has been appointed as an independent non-executive director for a term of two years which commenced on 30 September 2004 and is subject to termination by either party giving not less than one month written notice. Each of Mr. Pan, Mr. Lee and Mr. Choi are currently entitled to an annual remuneration of HK\$72,000. Save for the above directors' fees, the three independent non-executive directors are not entitled to any other remuneration.

No director proposed for re-election at the forthcoming AGM has 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 director had a material interest, either directly or indirectly, in any contract of significance to the business of the Group. There is no contract of significance between the Group, its controlling shareholder or any of its subsidiaries during the year.

MANAGEMENT CONTRACTS

No contracts concerning the management and administration of the whole or any substantial part of the business of the Company were entered into or were in existence during the year.

DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS AND SHORT POSITIONS IN SHARES AND UNDERLYING SHARES

At 31 December 2004, the interests and short positions of the directors and chief executive in the shares or underlying shares or debentures of the Company or its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (the "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 of Hong Kong Limited (the "Stock Exchange") pursuant to the Model Code for Securities Transactions by directors of Listed Issuers, were as follows:

Long positions in ordinary shares of the Company:

| Name | Notes | Number of shares held, capacity and nature of interest | | Total | Percentage of the Company's issued share capital |
|------------------------|-------|---|--------------------------------------|-------------|---|
| | | Directly beneficially owned | Through controlled corporation | | |
| Directors | | | | | |
| Ms. Li Kei Ling | (a) | — | 342,072,000 | 342,072,000 | 42.76 |
| Mr. Hung Yung Lai | (a) | — | 342,072,000 | 342,072,000 | 42.76 |
| Mr. Zhang Jing Xing | (b) | — | 154,000,000 | 154,000,000 | 19.25 |
| Mr. Li Tung Ming | (c) | 2,360,000 | 56,000,000 | 58,360,000 | 7.30 |
| Mr. Xu Kehan | | 120,000 | — | 120,000 | 0.02 |
| Chief Executive | | | | | |
| Mr. Dong Shao Zhi | | 1,000,000 | — | 1,000,000 | 0.13 |

The interests of the directors and chief executive in the share options of the Company are separately disclosed in note 28 to the financial statements.

Long positions in shares and underlying shares of associated corporation:

| Name of director | Name of associated corporation | Relationship with the Company | Shares | Number of shares | Capacity and nature of interest | Percentage of the associated corporation's issued share capital |
|-------------------|--------------------------------|-------------------------------|-----------------|------------------|----------------------------------|---|
| Ms. Li Kei Ling | Fortune United Group Limited | Company's holding company | Ordinary shares | 2 | Through a controlled corporation | 50 |
| Mr. Hung Yung Lai | Fortune United Group Limited | Company's holding company | Ordinary shares | 2 | Through a controlled corporation | 50 |

Notes:

- (a) 342,072,000 shares are held by Fortune United Group Limited, a company incorporated in the British Virgin Islands. Keysmart Enterprises Limited, which is wholly-owned by Ms. Li Kei Ling, and Hunwick International Limited, which is wholly-owned by Mr. Hung Yung Lai, are each beneficially interested in 50% of the share capital of Fortune United Group Limited.
- (b) 154,000,000 shares are held by Ray Sheen Company Limited, a company incorporated in the British Virgin Islands. The entire issued share capital of Ray Sheen Company Limited is beneficially owned by Mr. Zhang Jing Xing.
- (c) 56,000,000 shares are held by Time Lead Investments Limited, a company incorporated in the British Virgin Islands. The entire issued share capital of Time Lead Investments Limited is beneficially owned by Mr. Li Tung Ming.

Save as disclosed above, as at 31 December 2004, none of the directors or chief executive had registered an interest or short position in the shares or 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 for Securities Transactions by directors of Listed Issuers.

DIRECTORS' RIGHTS TO ACQUIRE SHARES OR DEBENTURES

Save as disclosed under the heading "Directors' and chief executive's interests and short positions in shares and underlying shares" above and in the share option scheme disclosures in note 28 to the financial statements, at no time during the year were rights to acquire benefits by means of the acquisition of shares in or debentures of the Company granted to any director or their respective spouse or minor children, or were any such rights exercised by them; or was the Company, its holding company, or any of its subsidiaries a party to any arrangement to enable the directors to acquire such rights in any other body corporate.

SHARE OPTION SCHEME

The detailed disclosures relating to the Company's share option schemes are set out in note 28 to the financial statements.

Concerning the share options granted during the year to the directors and employees, as detailed in note 28, the directors do not consider it appropriate to disclose a theoretical value of the options granted, because, in the absence of a market value of the share options over the ordinary shares of the Company, the directors were unable to arrive at an assessment of the value of these share options.

SUBSTANTIAL SHAREHOLDERS' AND OTHER PERSONS' INTERESTS IN SHARES AND UNDERLYING SHARES

At 31 December 2004, the following interests or short positions in the shares and underlying shares of the Company were recorded in the register of interests required to be kept by the Company pursuant to Section 336 of the SFO:

Long positions:

| Name | Notes | Capacity and nature of interest | Number of ordinary shares held | Percentage of the Company's issued share capital | Number of share options held |
|-------------------------------|-------|----------------------------------|--------------------------------|--|------------------------------|
| Fortune United Group Limited | (a) | Directly beneficially owned | 342,072,000 | 42.76 | — |
| Keysmart Enterprises Limited | (a) | Through a controlled corporation | 342,072,000 | 42.76 | — |
| Hunwick International Limited | (a) | Through a controlled corporation | 342,072,000 | 42.76 | — |
| Mdm. Lu Pun | (b) | Family | 342,072,000 | 42.76 | 700,000 |
| Ray Sheen Company Limited | (c) | Directly beneficially owned | 154,000,000 | 19.25 | — |
| Mdm. Luo Yang | (d) | Family | 154,000,000 | 19.25 | 1,500,000 |
| Time Lead Investments Limited | (e) | Directly beneficially owned | 56,000,000 | 7.00 | — |

Notes:

- (a) The issued capital of Fortune United Group Limited is equally beneficially owned by Keysmart Enterprises Limited and Hunwick International Limited which are in turn, respectively, wholly-owned by Ms. Li Kei Ling and Mr. Hung Yung Lai, executive directors of the Company.
- (b) Mdm. Lu Pun is the wife of Mr. Hung Yung Lai and is deemed to be interested in the shares and share options of the Company held by Mr. Hung Yung Lai. The interests of Mdm. Lu Pun in the shares options of the Company as referred to above are the same as those interested by Mr. Hung Yung Lai, details of which are separately disclosed in note 28 to the financial statements.
- (c) The entire issued capital of Ray Sheen Company Limited is beneficially owned by Mr. Zhang Jing Xing, an executive director of the Company.
- (d) Mdm. Luo Yang is the wife of Mr. Zhang Jing Xing and is deemed to be interested in the shares and share options of the Company held by Mr. Zhang Jing Xing. The interests of Mdm. Luo Yang in the shares options of the Company as referred to above are the same as those interested by Mr. Zhang Jing Xing, details of which are separately disclosed in note 28 to the financial statements.
- (e) The entire issued capital of Time Lead Investments Limited is beneficially owned by Mr. Li Tung Ming, an executive director of the Company.

Save as disclosed above, as at 31 December 2004, no person, other than the directors and chief executive of the Company, whose interests are set out in the section "Directors' and chief executive's interests and short positions in shares and underlying shares" above, had registered an interest or short position in the shares or underlying shares of the Company that was required to be recorded pursuant to Section 336 of the SFO.

SUFFICIENCY OF PUBLIC FLOAT

Based on information that is publicly available to the Company and within the knowledge of the directors, at least 25% of the Company's total issued share capital was held by the public as at the date of this report.

POST BALANCE SHEET EVENT

Details of the significant post balance sheet event of the Group are set out in note 33 to the financial statements.

CODE OF BEST PRACTICE

The Company has complied with the Code of Best Practice as set out in Appendix 14 of the Rules Governing the Listing of Securities of the Stock Exchange for the year ended 31 December 2004.

MODEL CODE FOR SECURITIES TRANSACTIONS

The Company has adopted the Model Code for Securities Transactions by Directors of Listed Issuers of the Listing Rules ("Model Code") as the Company's code of conduct for dealings in securities of the Company by the directors. Based on specific enquiry of the Company's directors, the directors have complied with the required standard set out in the Model Code, throughout the accounting period covered by the annual report.

AUDIT COMMITTEE

The Company has an audit committee which was established in compliance with Rule 3.21 of the Listing Rules for the purpose of reviewing and providing supervision over the Group's financial reporting process and internal controls. The audit committee comprises the three independent non-executive directors of the Company.

The audited financial statements of the Company for the year ended 31 December 2004 have been reviewed by the Audit Committee before recommending it to the Board for approval.

AUDITORS

Ernst & Young retire and a resolution for their reappointment as auditors of the Company will be proposed at the forthcoming AGM.

ON BEHALF OF THE BOARD

Li Kei Ling

Chairman

Hong Kong, 7 March 2005

Report of the Auditors



TO THE MEMBERS

DAWNRAYS PHARMACEUTICAL (HOLDINGS) LIMITED

(Incorporated in Cayman Islands with limited liability)

We have audited the financial statements on pages 27 to 62 which have been prepared in accordance with International Financial Reporting Standards.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The Company's directors are responsible for the preparation of financial statements which give a true and fair view. In preparing financial statements 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 financial statements 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 Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public Accountants. An audit includes an examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's and the Group's circumstances, 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 financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

OPINION

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2004 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the disclosure requirements of Hong Kong Companies Ordinance.

Ernst & Young

Certified Public Accountants

Hong Kong

7 March 2005

Consolidated Income Statement

Year ended 31 December 2004

| | Notes | 2004 RMB'000 | 2003 RMB'000 |
|---|-------|-----------------|-----------------|
| TURNOVER | 5 | 584,758 | 491,388 |
| Cost of sales | | (392,081) | (285,485) |
| Gross profit | | 192,677 | 205,903 |
| Other revenue | 5 | 1,956 | 867 |
| Selling and distribution costs | | (58,987) | (56,795) |
| Administrative expenses | | (34,375) | (26,231) |
| Other operating expenses | | (14,859) | (10,511) |
| PROFIT FROM OPERATING ACTIVITIES | 6 | 86,412 | 113,233 |
| Finance costs | 7 | — | (809) |
| PROFIT BEFORE TAX | | 86,412 | 112,424 |
| Tax | 11 | (6,225) | (3,996) |
| PROFIT BEFORE MINORITY INTERESTS | | 80,187 | 108,428 |
| Minority interests | | (16) | (406) |
| NET PROFIT FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS | | 80,171 | 108,022 |
| DIVIDENDS | 13 | | |
| Interim | | 12,760 | 12,760 |
| Proposed final | | 19,543 | 29,840 |
| | | 32,303 | 42,600 |
| EARNINGS PER SHARE | 14 | | |
| Basic | | RMB0.1002 | RMB0.1551 |

Balance Sheets

31 December 2004

| | | Group | | Company | |
|--|-------|-----------------|-----------------|-----------------|-----------------|
| | Notes | 2004 RMB'000 | 2003 RMB'000 | 2004 RMB'000 | 2003 RMB'000 |
| NON-CURRENT ASSETS | | | | | |
| Property, plant and equipment | 15 | 183,016 | 115,914 | 529 | 652 |
| Land use rights | 16 | 13,817 | 14,123 | — | — |
| Construction in progress | 17 | 40,689 | 57,529 | — | — |
| Deferred development costs | 18 | 13,661 | 10,787 | — | — |
| Interests in subsidiaries | 19 | — | — | 249,566 | 248,151 |
| | | <u>251,183</u> | <u>198,353</u> | <u>250,095</u> | <u>248,803</u> |
| CURRENT ASSETS | | | | | |
| Inventories | 20 | 84,766 | 54,342 | — | — |
| Trade and notes receivables | 21 | 236,010 | 153,797 | — | — |
| Prepayments, deposits and other receivables | 22 | 16,144 | 17,481 | 361 | 365 |
| Short term investments | 23 | 598 | — | 598 | — |
| Cash and cash equivalents | 24 | 98,382 | 134,521 | 33,652 | 74,215 |
| | | <u>435,900</u> | <u>360,141</u> | <u>34,611</u> | <u>74,580</u> |
| CURRENT LIABILITIES | | | | | |
| Trade and notes payables | 25 | 234,277 | 142,232 | — | — |
| Tax payable | | 2,093 | 4,934 | — | — |
| Other payables and accruals | 26 | 38,526 | 36,435 | 773 | 1,115 |
| | | <u>274,896</u> | <u>183,601</u> | <u>773</u> | <u>1,115</u> |
| NET CURRENT ASSETS | | <u>161,004</u> | <u>176,540</u> | <u>33,838</u> | <u>73,465</u> |
| TOTAL ASSETS LESS CURRENT LIABILITIES | | <u>412,187</u> | <u>374,893</u> | <u>283,933</u> | <u>322,268</u> |
| MINORITY INTERESTS | | <u>716</u> | <u>989</u> | <u>—</u> | <u>—</u> |
| | | <u>411,471</u> | <u>373,904</u> | <u>283,933</u> | <u>322,268</u> |
| CAPITAL AND RESERVES | | | | | |
| Issued capital | 27 | 84,880 | 84,880 | 84,880 | 84,880 |
| Reserves | 29 | 307,048 | 259,184 | 179,510 | 207,548 |
| Proposed final dividend | 13 | 19,543 | 29,840 | 19,543 | 29,840 |
| | | <u>411,471</u> | <u>373,904</u> | <u>283,933</u> | <u>322,268</u> |

Li Kei Ling
Director

Xu Kehan
Director

Statements of Changes in Equity

Year ended 31 December 2004

| | Notes | Group | | Company | |
|---|-------|-----------------|-----------------|-----------------|-----------------|
| | | 2004 RMB'000 | 2003 RMB'000 | 2004 RMB'000 | 2003 RMB'000 |
| Issued capital | 27 | | | | |
| At beginning of year | | 84,880 | — | 84,880 | — |
| Issue of shares | | — | 21,220 | — | 21,220 |
| Capitalisation of share premium | | — | 63,660 | — | 63,660 |
| At end of year | | 84,880 | 84,880 | 84,880 | 84,880 |
| Share premium | | | | | |
| At beginning of year | | 69,583 | — | 69,583 | — |
| Issue of shares | | — | 148,263 | — | 148,263 |
| Share issue expenses | | — | (15,020) | — | (15,020) |
| Capitalisation of share premium | | — | (63,660) | — | (63,660) |
| At end of year | | 69,583 | 69,583 | 69,583 | 69,583 |
| Contributed surplus | 29 | | | | |
| At beginning of year | | 100,175 | 100,175 | 100,175 | — |
| Capitalisation of loans from shareholders | | — | — | — | 100,175 |
| At end of year | | 100,175 | 100,175 | 100,175 | 100,175 |
| Statutory surplus reserve | 29 | | | | |
| At beginning of year | | 22,837 | 11,722 | — | — |
| Transfer from retained profits | | 10,090 | 11,115 | — | — |
| At end of year | | 32,927 | 22,837 | — | — |
| Exchange fluctuation reserve | | | | | |
| At beginning of year | | 823 | — | 666 | — |
| Exchange realignment | | (4) | 823 | 81 | 666 |
| At end of year | | 819 | 823 | 747 | 666 |

Statements of Changes in Equity

Year ended 31 December 2004

| | Notes | Group | | Company | |
|--|-------|-----------------|-----------------|-----------------|-----------------|
| | | 2004 RMB'000 | 2003 RMB'000 | 2004 RMB'000 | 2003 RMB'000 |
| Retained profits/(accumulated loss) | | | | | |
| At beginning of year | | 65,766 | 11,459 | 37,124 | (43) |
| Net profit for the year | | 80,171 | 108,022 | 4,184 | 79,767 |
| Transfer to statutory surplus reserve | 29 | (10,090) | (11,115) | — | — |
| Interim dividend | 13 | (12,760) | (12,760) | (12,760) | (12,760) |
| Proposed final dividend | 13/33 | (19,543) | (29,840) | (19,543) | (29,840) |
| At end of year | | 103,544 | 65,766 | 9,005 | 37,124 |
| Total Reserves | | 307,048 | 259,184 | 179,510 | 207,548 |
| Proposed dividend | | | | | |
| At beginning of year | 13 | 29,840 | 69,245 | 29,840 | — |
| Final dividend declared | 13 | (29,840) | (69,245) | (29,840) | — |
| Proposed final dividend | 13/33 | 19,543 | 29,840 | 19,543 | 29,840 |
| At end of year | | 19,543 | 29,840 | 19,543 | 29,840 |
| Total | | 411,471 | 373,904 | 283,933 | 322,268 |

Consolidated Cash Flow Statement

Year ended 31 December 2004

| | <i>Notes</i> | 2004 <i>RMB'000</i> | 2003 <i>RMB'000</i> |
|--|--------------|-------------------------------|------------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | | |
| Profit before tax | | 86,412 | 112,424 |
| Adjustments for: | | | |
| Interest expenses | 7 | — | 809 |
| Interest income | 5 | (1,165) | (770) |
| Dividend income from short term investments | 5 | (110) | — |
| Loss on disposal of property, plant and equipment | 6 | 1,427 | 128 |
| Depreciation | 6 | 12,389 | 6,097 |
| Amortisation of deferred development costs | 6 | 742 | 566 |
| Amortisation of land use rights | 6 | 306 | 212 |
| Gain on disposal of short term investments | 6 | (105) | (8) |
| Unrealised loss on revaluation of short term investments | 6 | 247 | — |
| | | <hr/> | <hr/> |
| Operating profit before working capital changes | | 100,143 | 119,458 |
| (Increase)/decrease in inventories | | (30,424) | 250 |
| Increase in trade and notes receivables | | (82,213) | (85,376) |
| Increase in prepayments, deposits and other receivables | | (1,533) | (1,889) |
| Increase in trade and notes payables | | 91,305 | 65,158 |
| Increase in other payables and accruals | | 2,432 | 105 |
| | | <hr/> | <hr/> |
| Cash generated from operations | | 79,710 | 97,706 |
| Income tax paid | | (5,970) | (8,770) |
| | | <hr/> | <hr/> |
| Net cash inflows from operating activities | | 73,740 | 88,936 |
| | | <hr/> | <hr/> |

Consolidated Cash Flow Statement

Year ended 31 December 2004

| | Notes | 2004 RMB'000 | 2003 RMB'000 |
|---|-------|-----------------|-----------------|
| Net cash inflows from operating activities | | 73,740 | 88,936 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | |
| Cash received from matured time deposits with original maturity of more than three months | | — | 828 |
| Dividends received from short term investments | | 110 | — |
| Purchases of property, plant and equipment | | (63,964) | (59,792) |
| Proceeds from disposal of property, plant and equipment | | 281 | 138 |
| Additions of deferred development costs | | (3,616) | (4,671) |
| Addition of land use rights | | — | (5,200) |
| Purchases of short term investments | | (4,572) | (20) |
| Proceeds from disposal of short term investments | | 3,832 | 28 |
| Interest received | | 939 | 770 |
| Net cash flows used in investing activities | | (66,990) | (67,919) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | |
| Proceeds from issue of shares | | — | 170,306 |
| Share issue expenses | | — | (15,020) |
| New bank loans | | — | 31,000 |
| Repayment of bank loans | | — | (31,000) |
| Interest paid | | — | (897) |
| Dividend paid | | (42,600) | (82,005) |
| Dividend paid to minority shareholders | | (289) | (355) |
| Net cash flows (used in) / from financing activities | | (42,889) | 72,029 |
| NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS | | | |
| Cash and cash equivalents at beginning of year | | 134,521 | 41,475 |
| CASH AND CASH EQUIVALENTS AT END OF YEAR | | | |
| | | 98,382 | 134,521 |
| ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS | | | |
| Cash and bank balances | 24 | 45,174 | 61,706 |
| Non-pledged time deposits with original maturity of less than three months when acquired | 24 | 53,208 | 72,815 |
| | | 98,382 | 134,521 |

1. CORPORATE INFORMATION

The Company was incorporated as an exempted company with limited liability in the Cayman Islands on 20 September 2002 under the Companies Law, Cap. 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands.

The companies comprising the Group underwent a reorganisation on 21 June 2003 to rationalise the Group's structure in preparation for the listing of the shares of the Company on the Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange"), pursuant to which the Company became the holding company of the Group (the "Group Reorganisation").

During the year, the Group was principally engaged in the development, manufacture and sale of non-patented chemical medicines including cephalosporin in bulk medicine and powder for injection form, their intermediate pharmaceuticals and system specific medicines in the People's Republic of China (the "PRC"). In the opinion of the directors, Fortune United Group Limited, a company incorporated in the British Virgin Islands, is the holding company of the Company.

The shares of the Company were listed on the Main Board of the Stock Exchange on 11 July 2003.

2. IMPACT OF RECENTLY ISSUED INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS")

The following revised, amended and new standards which are generally effective for accounting periods beginning on or after 1 January 2005 may result in changes in the future as to how the Group's financial performance and financial position are prepared and presented:

- IAS 1 Presentation of Financial Statements (amended 2004);
- IAS 2 Inventories (revised 2003);
- IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors (revised 2003);
- IAS 10 Events after the Balance Sheet Date (amended 2004);
- IAS 16 Property, Plant and Equipment (amended 2004);
- IAS 17 Leases (amended 2004);
- IAS 24 Related Party Disclosures (revised 2003);
- IAS 27 Consolidated and Separate Financial Statements (amended 2004);
- IAS 32 Financial Instruments: Disclosure and Presentation (amended 2004);
- IAS 33 Earnings per Share (amended 2004);
- IAS 39 Financial Instruments: Recognition and Measurement (amended 2004); and
- IFRS 2 Share-Based Payments.

The Group has not early adopted these revised, amended and new standards for the year ended 31 December 2004. The Group has commenced its assessment of the impact of these standards but it is not yet in a position to state whether these standards would have a material impact on its results of operations and financial position.

Notes to Financial Statements

31 December 2004

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PREPARATION

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board, the disclosure requirements of the Hong Kong Companies Ordinance and the Rules Governing the Listing of Securities on the Stock Exchange. They have been prepared under the historical cost convention, except for the periodic remeasurement of certain short term listed investments, as further explained below.

BASIS OF CONSOLIDATION

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries. The financial statements of the subsidiaries are prepared using consistent accounting policies. Subsidiaries are consolidated from the date on which control is transferred to the Group and ceased to be consolidated from the date on which control is transferred out of the Group. All significant intercompany transactions and balances within the Group are eliminated on consolidation.

Minority interests represent the interests of outside shareholders in the results and net assets of the Company's subsidiaries.

The consolidated financial statements for the year ended 31 December 2003 were prepared by adopting uniting of interests method of accounting as a result of the Group Reorganisation which involved entities under common control. Under this method, the Company had been treated as the holding company of its subsidiaries for the year ended 31 December 2003 rather than from the date of acquisition of the subsidiaries. The consolidated results, statements of changes in equity, cash flows and the consolidated balance sheets of the companies now comprising the Group had been prepared as if the current Group structure were in existence throughout 2003.

SUBSIDIARIES

A subsidiary is a company whose financial and operating policies the Company controls, directly or indirectly, so as to obtain benefits from its activities.

The results of subsidiaries are included in the Company's income statement to the extent of dividends received and receivable. The Company's interests in subsidiaries are stated at cost less any impairment losses.

RELATED PARTIES

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

IMPAIRMENT OF ASSETS

An assessment is made at each balance sheet date of whether there is any indication of impairment of any asset, or whether there is any indication that an impairment loss previously recognised for an asset in prior years may no longer exist or may have decreased. If any such indication exists, the asset's recoverable amount is estimated. An asset's recoverable amount is calculated as the higher of the asset's value in use and its net selling price.

An impairment loss is recognised only if the carrying amount of an asset exceeds its recoverable amount. An impairment loss is charged to the income statement in the period in which it arises.

A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the recoverable amount of an asset, however not to an amount higher than the carrying amount that would have been determined (net of any depreciation/amortisation), had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is credited to the income statement in the period in which it arises.

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are stated at cost less accumulated depreciation and any impairment losses.

The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after property, plant and equipment have been put into operation, such as repairs and maintenance, is normally charged to the income statement in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the property, plant and equipment, the expenditure is capitalised as an additional cost of the property, plant and equipment.

Depreciation is calculated on the straight-line basis to write off the cost of each asset over its estimated useful life, after taking into account its estimated residual value. The estimated useful lives of property, plant and equipment are as follows:

| | |
|-------------------------------|---------------|
| Buildings | 20 years |
| Machinery and other equipment | 5 to 10 years |
| Office equipment | 5 years |
| Motor vehicles | 5 years |

The gain or loss on disposal or retirement of property, plant and equipment recognised in the income statement is the difference between the net sales proceeds and the carrying amount of the relevant asset.

Notes to Financial Statements

31 December 2004

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

LAND USE RIGHTS

Land use rights are stated at cost less accumulated amortisation. Land use rights are amortised on the straight-line basis over a period of 50 years.

CONSTRUCTION IN PROGRESS

Construction in progress represents property, plant and equipment under construction and is stated at cost. The acquisition period of an asset includes the period when the asset is under construction, installation and testing. Cost comprises direct costs of construction and capitalised borrowing costs on related borrowed funds during the period of construction. Construction in progress is transferred to the appropriate category of plant and equipment when it is completed and ready for its intended use. No depreciation is provided on construction in progress until the asset is completed and is ready for its intended use.

RESEARCH AND DEVELOPMENT COSTS

All research costs are charged to the income statement as incurred.

Expenditure incurred on projects to develop new products are capitalised and deferred only when the projects are clearly defined, the expenditure is separately identifiable and can be measured reliably; there is reasonable certainty that the projects are technically feasible; and the products have commercial value. Product development expenditure which does not meet these criteria is expensed when incurred.

Deferred development costs are stated at cost less any impairment losses and are amortised using the straight-line basis over the commercial lives of the underlying products not exceeding ten years, commencing from the date when the products are put into commercial production.

OPERATING LEASES

Leases where substantially all the rewards and risks of ownership of assets remain with the lessors are accounted for as operating leases. Where the Group is the lessee, rentals payable under the operating leases are charged to the income statement on the straight-line basis over the lease terms.

TRADE AND OTHER RECEIVABLES

Trade receivables, which generally have terms of about 60 days, are recognised and carried at original invoice amount less allowance for any uncollectible amounts. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off as incurred.

Prepayments, deposits and other receivables are recognised and carried at cost less allowance for any uncollectible amounts.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Cont'd)*

TRADE AND OTHER PAYABLES

Liabilities for trade and other payables which are normally settled on terms of about 90 to 180 days are carried at cost which is the fair value of the consideration to be paid in the future for goods and services received, whether or not billed to the Group.

INTEREST-BEARING LOANS AND BORROWINGS

All loans and borrowings, which are interest-bearing and held to maturity, are initially recognised at cost, being the fair value of the consideration received, and are subsequently measured at amortised cost.

BORROWING COSTS

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, i.e. assets that necessarily take a substantial period of time to get ready for their intended use or sale, are capitalised as part of the cost of those assets. The capitalisation of such borrowing costs ceases when the assets are substantially ready for their intended use or sale.

SHORT TERM INVESTMENTS

Short term investments are investments in equity securities held for trading purposes and are stated at their fair values on the basis of their quoted market prices at the balance sheet date, on an individual investment basis. The gains or losses arising from changes in the fair value of a security are credited or charged to the income statement in the period in which they arise.

INVENTORIES

Inventories are stated at the lower of cost and net realisable value. Cost is determined on the weighted average basis and, in the case of work in progress and finished goods, comprises direct materials, direct labour, subcontracting fees and an appropriate proportion of overheads.

Net realisable value is based on estimated selling prices less any estimated costs to be incurred to completion and disposal.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents in the balance sheets comprise cash in hand and at banks and short term deposits with an original maturity of three months or less.

For the purpose of the consolidated cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above.

Notes to Financial Statements

31 December 2004

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

INCOME TAX

Income tax comprises current and deferred tax. Income tax is recognised in the income statement, or in equity if it relates to items that are recognised in the same or a different period directly in equity.

Deferred income tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Currently enacted tax rates are used to determine deferred tax.

Deferred income tax assets are recognised for all deductible temporary differences, carry forward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry forward of unused tax assets and unused tax losses can be utilised.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax assets to be utilised.

GOVERNMENT GRANTS

Government grants are recognised at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. Where the grant is related to an expense item, it is recognised as income over the periods necessary to match the grant on a systematic basis to the costs that it is intended to compensate.

REVENUE RECOGNITION

Revenue is recognised when it is probable that the economic benefits will flow to the Group and when the revenue can be measured reliably, on the following bases:

- (a) from the sale of goods, when the significant risks and rewards of ownership have been transferred to the buyer, provided that the Group maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold;
- (b) interest income, on a time proportion basis, taking into account the principal outstanding and the effective interest rate applicable; and
- (c) dividend income, when the shareholders' right to receive payment has been established.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

RETIREMENT BENEFITS SCHEMES

The Group operates a defined contribution Mandatory Provident Fund retirement benefits scheme (the "MPF Scheme") under the Mandatory Provident Fund Schemes Ordinance, for those employees who are eligible to participate in the MPF Scheme. Contributions are made based on a percentage of the employees' basic salaries and charged to the income statement as they become payable in accordance with the rules of the MPF Scheme. The assets of the MPF Scheme are held separately from those of the Group in an independently administered fund. The Group's employer contributions vest fully with the employees when contributed into the MPF Scheme.

The employees of the Group's subsidiaries which operate in the PRC (the "PRC Subsidiaries") are required to participate in a central pension scheme operated by the local municipal government. The contributions are charged to the income statement as they become payable in accordance with the rules of the central pension scheme.

ACCOMMODATION BENEFITS

Contributions to an accommodation fund administered by the Public Accumulation Funds Administration Centre are charged to the income statement as incurred.

SHARE OPTION SCHEME

The Company operates a share option scheme for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operations. The financial impact of share options granted under the share option scheme is not recorded in the Group's balance sheet until such time as the options are exercised, and no charge is recorded in the income statement or balance sheet for their cost. Upon the exercise of share options, the resulting shares issued are recorded by the Company as additional share capital at the nominal value of the shares, and the excess of the exercise price per share over the nominal value of the shares is recorded by the Company in the share premium account. Options which are cancelled prior to their exercise date, or which lapse, are deleted from the register of outstanding options.

DIVIDENDS

Final dividends proposed by the directors are classified as a separate allocation of retained profits within the capital and reserves section of the balance sheet, until they have been approved by the shareholders in a general meeting. When these dividends have been approved by the shareholders and declared, they are recognised as a liability.

Interim dividends are simultaneously proposed and declared, because the Company's memorandum and articles of association grant the directors the authority to declare interim dividends. Consequently, interim dividends are recognised immediately as a liability when they are proposed and declared.

Notes to Financial Statements

31 December 2004

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Cont'd)*

FOREIGN CURRENCIES

The principal activities of the Group are transacted in RMB. Accordingly, the Group's functional and reporting currency is RMB.

Foreign currency transactions are recorded at the applicable rates of exchange ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated into RMB at the applicable exchange rates ruling at that date. Exchange differences are dealt with in the income statement.

On consolidation, the financial statements of the Company and its subsidiaries, other than the PRC Subsidiaries, are translated into RMB at the applicable rates of exchange ruling at the balance sheet date. The resulting translation differences are included in the exchange fluctuation reserve.

4. SEGMENT INFORMATION

The Group's turnover and profit were mainly derived from the sale of medicines by the PRC Subsidiaries to customers in the PRC. The principal assets employed by the Group are located in the PRC. Accordingly, no segmental analysis by business and geographical segments is provided.

5. TURNOVER AND REVENUE

Turnover represents the net invoiced value of goods sold, net of value-added tax, after allowances for returns, trade discounts and various types of business tax and government surcharges where applicable.

| | Group | |
|---|------------------------|------------------------|
| | 2004 <i>RMB'000</i> | 2003 <i>RMB'000</i> |
| Turnover | | |
| Sale of goods | 585,058 | 491,881 |
| Less: Sales tax and government surcharges | (300) | (493) |
| | <u>584,758</u> | <u>491,388</u> |
| Other revenue | | |
| Interest income from bank balances | 1,165 | 770 |
| Government grants | 50 | 67 |
| Dividend income from short term investments | 110 | — |
| Gain on disposal of short term investments | 105 | 8 |
| Others | 526 | 22 |
| | <u>1,956</u> | <u>867</u> |
| Other revenue | | |
| Total revenue | <u><u>586,714</u></u> | <u><u>492,255</u></u> |

Notes to Financial Statements

31 December 2004

6. PROFIT FROM OPERATING ACTIVITIES

The Group's profit from operating activities is arrived at after charging/(crediting) :

| | Notes | Group | |
|--|-------|-----------------|-----------------|
| | | 2004 RMB'000 | 2003 RMB'000 |
| Auditors' remuneration | | 691 | 893 |
| Cost of inventories sold | | 392,081 | 285,485 |
| Amortisation of: | | | |
| Deferred development costs * | 18 | 742 | 566 |
| Land use rights ** | 16 | 306 | 212 |
| Depreciation | 15 | 12,389 | 6,097 |
| Loss on disposal of property, plant and equipment | | 1,427 | 128 |
| Minimum lease payments under operating leases in respect of buildings | | 963 | 631 |
| Staff costs (including directors' remuneration (note 8)): | | | |
| Retirement costs | 10 | 4,071 | 2,715 |
| Accommodation benefits | 10 | 2,734 | 1,348 |
| Salaries and other staff costs | | 32,877 | 23,474 |
| Total staff costs | | 39,682 | 27,537 |
| Research and development costs | | 12,309 | 10,305 |
| Exchange losses, net | | 42 | 48 |
| Unrealised loss on revaluation of short term investments | | 247 | — |
| Interest income | | (1,165) | (770) |
| Dividend income from short term investments | | (110) | — |
| Gain on disposal of short term investments | | (105) | (8) |

* The amortisation of deferred development costs for the year are included in "Other operating expenses" on the face of the consolidated income statement.

** The amortisation of land use rights for the year are included in "Administrative expenses" on the face of the consolidated income statement.

7. FINANCE COSTS

| | Group | |
|----------------------------|-----------------|-------------------|
| | 2004 | 2003 |
| | RMB'000 | RMB'000 |
| Interest on bank loans | — | 897 |
| Less: Interest capitalised | — | (88) |
| | <u>—</u> | <u>809</u> |
| | <u><u>—</u></u> | <u><u>809</u></u> |

8. DIRECTORS' REMUNERATION

Directors' remuneration for the year, disclosed pursuant to the Listing Rules and Section 161 of the Companies Ordinance, is as follows:

| | Group | |
|---|---------------------|---------------------|
| | 2004 | 2003 |
| | RMB'000 | RMB'000 |
| Fees | <u>175</u> | <u>115</u> |
| Other emoluments: | | |
| Salaries, allowances and benefits in kind | 3,649 | 1,707 |
| Performance related bonuses | 29 | — |
| Pension scheme contributions | <u>64</u> | <u>28</u> |
| | <u>3,742</u> | <u>1,735</u> |
| | <u><u>3,917</u></u> | <u><u>1,850</u></u> |

Fees include RMB175,000 (2003: RMB115,000) payable to the independent non-executive directors. There were no other emoluments payable to the independent non-executive directors during the year (2003: Nil).

Notes to Financial Statements

31 December 2004

8. DIRECTORS' REMUNERATION (Cont'd)

The number of directors whose remuneration fell within the following bands is as follows:

| | Number of directors | |
|----------------------|---------------------|------|
| | 2004 | 2003 |
| Nil to HK\$1,000,000 | 10 | 8 |

There was no arrangement under which a director waived or agreed to waive any remuneration during the year.

During the year, certain directors were granted share options in respect of their services to the Group under the share option scheme of the Company, further details of which are set out in note 28 to the financial statements. No value in respect of the share options granted during the year has been charged to the income statement, or is otherwise included in the above directors' remuneration disclosures.

9. FIVE HIGHEST PAID EMPLOYEES

The five highest paid employees during the year included three (2003: four) directors, details of whose remuneration are set out in note 8 above. Details of the remuneration of the remaining two (2003: two) non-director, highest paid employees for the year are as follows:

| | Group | |
|---|-----------------|-----------------|
| | 2004 RMB'000 | 2003 RMB'000 |
| Salaries, allowances and benefits in kind | 914 | 567 |
| Performance related bonuses | 12 | — |
| Pension scheme contributions | 26 | 18 |
| | 952 | 585 |

The number of non-director, highest paid employees whose remuneration fell within the following bands is as follows:

| | Number of employees | |
|----------------------|---------------------|------|
| | 2004 | 2003 |
| Nil to HK\$1,000,000 | 2 | 2 |

During the year, 2,300,000 share options were granted to the two non-director, highest paid employees in respect of their services to the Group, further details of which are included in the disclosures in note 28 to the financial statements. No value in respect of the share options granted during the year has been charged to the income statement, or is otherwise included in the above non-director, highest paid employees' remuneration disclosures.

10. RETIREMENT BENEFITS AND ACCOMMODATION BENEFITS

In compliance with the Mandatory Provident Fund Schemes Ordinance (“MPF Ordinance”), the Company has participated in the MPF scheme, a defined contribution scheme managed by an independent trustee, to provide retirement benefits to its Hong Kong employees. Contributions to the MPF scheme are made in accordance with the statutory limits prescribed by the MPF Ordinance.

As stipulated by the PRC state regulations, the PRC Subsidiaries participate in a defined contribution retirement scheme. All employees are entitled to an annual pension equal to a fixed proportion of the average basic salary amount within the geographical area of their last employment at their retirement date. The PRC Subsidiaries are required to make contributions to the local social security bureau at 20% to 22.5% (2003: 20% to 22.5%) of the previous year’s average basic salaries within the geographical area where the employees are under employment with the PRC Subsidiaries. The Group has no obligation for the payment of pension benefits beyond the annual contribution as set out above.

According to the relevant rules and regulations of the PRC, the PRC Subsidiaries and their employees are each required to make contributions to an accommodation fund at 7% to 10% (2003: 7% to 10%) of the salaries and wages of the employees which is administered by Public Accumulation Funds Administration Centre. There is no further obligation on the part of the Group except for such contribution to the accommodation fund.

At 31 December 2004, the Group had no significant obligations apart from the contributions as stated above.

11. TAX

(I) INCOME TAX EXPENSE

The income tax expense, all current, charged to the consolidated income statement for the year ended 31 December 2004 was as follows:

| | Group | |
|--------------------|----------------|----------------|
| | 2004 | 2003 |
| | <i>RMB'000</i> | <i>RMB'000</i> |
| Income tax expense | 7,947 | 13,704 |
| Tax refund | (1,722) | (9,708) |
| | 6,225 | 3,996 |
| | 6,225 | 3,996 |

No provision for Hong Kong profits tax has been made as the Group had no profits arising in Hong Kong during the year.

Notes to Financial Statements

31 December 2004

11. TAX (Cont'd)

(I) INCOME TAX EXPENSE (Cont'd)

According to the Income Tax Law of the PRC, four subsidiaries of the Company, namely Suzhou Dawnrays Pharmaceuticals Co., Ltd. ("Suzhou Dawnrays Pharmaceuticals"), Suzhou Dawnrays Chemical Co., Ltd. ("Suzhou Dawnrays Chemical"), Suzhou Dawnrays Pharmaceutical Technology Co., Ltd. ("Suzhou Dawnrays Technology") and Shanghai Dawnrays Chemical Co., Ltd. ("Shanghai Dawnrays Chemical"), which operate in approved economic development zones of the PRC, are exempted from corporate income tax of the PRC for the two years starting from the first profitable year of operation, after setting off losses carried forward, and are entitled to a 50% relief from corporate income tax of the PRC for the following three years.

Suzhou Dawnrays Pharmaceuticals is in its fourth profitable year in 2004 and therefore its applicable income tax rate is 12%. However, Suzhou Dawnrays Pharmaceuticals obtained tax approval from the relevant tax authorities as a qualified foreign-owned manufacturing enterprise engaging in technology-intensive and knowledge-intensive projects ("Double-intensive Enterprise"). According to PRC tax laws and regulations, Suzhou Dawnrays Pharmaceuticals is subject to the corporate income tax of the PRC at a rate of 7.5% from 1 January 2003 to 31 December 2005, and at 15% from 1 January 2006 onwards. Its status as a Double-intensive Enterprise is subject to periodic reassessment by the relevant PRC government authorities.

The paid-up capital of Suzhou Dawnrays Pharmaceuticals was increased by US\$15,000,000 from US\$10,000,000 to US\$25,000,000 during the year. According to PRC tax laws and regulations, taxable profits generated in the first two years and the three years thereafter from the aforesaid additional capital is exempted from corporate income tax and taxed at a 50% reduced rate, respectively. The relevant PRC tax laws and regulations also granted enterprises qualified an option to use the tax concession in respect of the taxable profit in the following year after the additional capital has been contributed. Since the operation period for the aforesaid additional capital injected is less than six months, Suzhou Dawnrays Pharmaceuticals has opted to commence the tax concession in 2005. Consequently, profits generated from the aforesaid additional capital is still subject to the corporate income tax of the PRC at a rate of 7.5% in 2004.

Shanghai Dawnrays Chemical is in its third profitable year based on the income for statutory financial reporting purposes. It is subject to the corporate income tax of the PRC at a rate of 12% and local corporate income tax at a rate of 1.5% from 1 January 2004 to 31 December 2006.

Suzhou Dawnrays Chemical and Suzhou Dawnrays Technology had no assessable profits and therefore, no provision for income tax has been made for the year.

No provision for deferred tax has been made as the net effect of all temporary differences is immaterial.

11. TAX (Cont'd)

(I) INCOME TAX EXPENSE (Cont'd)

The reconciliation between tax expense and the product of accounting profit in the accompanying consolidated results of operation multiplied by the applicable income tax rate is as follows:

Group – 2004

| | RMB'000 | % |
|--|---------------|------------|
| Profit before tax | <u>86,412</u> | |
| Tax at the statutory tax rate | 28,516 | 33.0 |
| Lower tax rate for specific provinces or local authorities | (21,735) | (25.2) |
| Expenses not deductible for tax | <u>1,166</u> | <u>1.3</u> |
| Tax charge at the Group's effective rate | <u>7,947</u> | <u>9.1</u> |

Group – 2003

| | RMB'000 | % |
|--|----------------|-------------|
| Profit before tax | <u>112,424</u> | |
| Tax at the statutory tax rate | 37,100 | 33.0 |
| Lower tax rate for specific provinces or local authorities | (23,609) | (21.0) |
| Expenses not deductible for tax | <u>213</u> | <u>0.2</u> |
| Tax charge at the Group's effective rate | <u>13,704</u> | <u>12.2</u> |

(II) TAX REFUND

As Suzhou Dawnrays Pharmaceuticals is an approved Double-intensive Enterprise as mentioned above, Suzhou Dawnrays Pharmaceuticals received a refund of the excess of the corporate income tax paid in 2003 in relation to the aforesaid reduced corporate income tax rate amounting to RMB4,818,000 in 2004.

Pursuant to board resolutions of Suzhou Dawnrays Pharmaceuticals dated 15 December 2003 and 8 March 2004, Suzhou Dawnrays Pharmaceuticals declared a dividend of RMB82,205,630 to Dawnrays International Company Limited ("Dawnrays International") pertaining to the year ended 31 December 2003. Pursuant to board resolutions of Dawnrays International dated 18 December 2003 and 9 March 2004, Dawnrays International reinvested the aforesaid dividend of RMB82,205,630 into Suzhou Dawnrays Pharmaceuticals. According to PRC tax laws and regulations, Dawnrays International accrued a tax refund in relation to the aforesaid reinvestment amounting to RMB9,708,000 in 2003, based on the then effective corporate income tax of 12%. As Suzhou Dawnrays Pharmaceuticals is now an approved Double-intensive Enterprise, Dawnrays International reduced the tax refund accrued in relation to the aforesaid reinvestment to RMB6,612,000 by RMB3,096,000 which has been charged to the current year tax expense.

Notes to Financial Statements

31 December 2004

12. NET PROFIT FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS

The net profit from ordinary activities attributable to shareholders for the year ended 31 December 2004 dealt with in the financial statements of the Company was RMB4,184,000 (2003: RMB79,767,000).

13. DIVIDENDS

| | Company | |
|---|----------------|----------------|
| | 2004 | 2003 |
| | <i>RMB'000</i> | <i>RMB'000</i> |
| Dividend pertaining to the prior year declared during the year | 29,840 | 69,245 |
| Interim – HK\$0.015 (2003: HK\$0.015) per ordinary share | 12,760 | 12,760 |
| | <u>42,600</u> | <u>82,005</u> |
| Proposed final – HK\$0.023 (2003: HK\$0.035) per ordinary share | 19,543 | 29,840 |
| | <u>19,543</u> | <u>29,840</u> |

On 7 March 2005, the Company declared a final dividend for the year ended 31 December 2004, at HK\$0.023 per share, amounting to a total sum of HK\$18,400,000 (equivalent to RMB19,543,000).

14. EARNINGS PER SHARE

The calculation of basic earnings per share is based on the net profit attributable to shareholders for the year of RMB80,171,000 (2003: RMB108,022,000), and the weighted average of 800,000,000 (2003: 696,438,356) ordinary shares in issue during the year.

As the exercise price of outstanding share options is higher than the average fair value of the ordinary share during the year, the conversion to ordinary shares would increase earnings per share.

The diluted earnings per share amount for the year ended 31 December 2004 has not been presented, as the share options outstanding during the year had an anti-dilutive effect on the basic earnings per share calculation.

15. PROPERTY, PLANT AND EQUIPMENT

| | Group | | | | Total RMB'000 |
|--|----------------------|--|--------------------------------|------------------------------|------------------|
| | Buildings RMB'000 | Machinery and other equipment RMB'000 | Office equipment RMB'000 | Motor vehicles RMB'000 | |
| Cost: | | | | | |
| At beginning of year | 41,902 | 86,684 | 6,095 | 6,952 | 141,633 |
| Additions | — | 1,029 | 1,246 | 2,133 | 4,408 |
| Transferred from construction in progress | 38,601 | 38,137 | 53 | — | 76,791 |
| Disposals | (1,230) | (1,619) | (553) | (188) | (3,590) |
| At 31 December 2004 | 79,273 | 124,231 | 6,841 | 8,897 | 219,242 |
| Accumulated depreciation: | | | | | |
| At beginning of year | 5,297 | 16,861 | 2,488 | 1,073 | 25,719 |
| Provided for the year | 2,599 | 7,391 | 735 | 1,664 | 12,389 |
| Disposals | (303) | (972) | (492) | (115) | (1,882) |
| At 31 December 2004 | 7,593 | 23,280 | 2,731 | 2,622 | 36,226 |
| Net book value: | | | | | |
| At 31 December 2004 | 71,680 | 100,951 | 4,110 | 6,275 | 183,016 |
| At 31 December 2003 | 36,605 | 69,823 | 3,607 | 5,879 | 115,914 |

Buildings with net book values of RMB3,500,000 as at 31 December 2003 were pledged to banks to obtain credit lines from banks, such credit lines had not been utilised as at 31 December 2003. The pledge was subsequently released by the banks in January 2004.

Notes to Financial Statements

31 December 2004

15. PROPERTY, PLANT AND EQUIPMENT (Cont'd)

| | <u>Company</u> |
|----------------------------------|------------------|
| | Office equipment |
| | <i>RMB'000</i> |
| Cost: | |
| At beginning of year | 652 |
| Additions | 70 |
| | <hr/> |
| At 31 December 2004 | 722 |
| | <hr/> |
| Accumulated depreciation: | |
| At beginning of year | — |
| Provided for the year | 193 |
| | <hr/> |
| At 31 December 2004 | 193 |
| | <hr/> |
| Net book value: | |
| At 31 December 2004 | 529 |
| | <hr/> <hr/> |
| At 31 December 2003 | 652 |
| | <hr/> <hr/> |

16. LAND USE RIGHTS

| | <u>Group</u> |
|----------------------------------|----------------|
| | <i>RMB'000</i> |
| Cost: | |
| At beginning of year | 14,926 |
| Additions | — |
| | <hr/> |
| At 31 December 2004 | 14,926 |
| | <hr/> |
| Accumulated amortisation: | |
| At beginning of year | 803 |
| Provided for the year | 306 |
| | <hr/> |
| At 31 December 2004 | 1,109 |
| | <hr/> |
| Net book value: | |
| At 31 December 2004 | 13,817 |
| | <hr/> <hr/> |
| At 31 December 2003 | 14,123 |
| | <hr/> <hr/> |

17. CONSTRUCTION IN PROGRESS

| | <u>Group</u> |
|--|-----------------------------|
| | <i>RMB'000</i> |
| At beginning of year | 57,529 |
| Additions | 59,951 |
| Transferred to property, plant and equipment | <u>(76,791)</u> |
| At 31 December 2004 | <u><u>40,689</u></u> |

18. DEFERRED DEVELOPMENT COSTS

| | <u>Group</u> |
|----------------------------------|-----------------------------|
| | <i>RMB'000</i> |
| Cost: | |
| At beginning of year | 11,647 |
| Additions | <u>3,616</u> |
| At 31 December 2004 | <u>15,263</u> |
| Accumulated amortisation: | |
| At beginning of year | 860 |
| Provided for the year | <u>742</u> |
| At 31 December 2004 | <u>1,602</u> |
| Net book value: | |
| At 31 December 2004 | <u><u>13,661</u></u> |
| At 31 December 2003 | <u><u>10,787</u></u> |

Notes to Financial Statements

31 December 2004

19. INTERESTS IN SUBSIDIARIES

| | Company | |
|-------------------------------|-----------------|-----------------|
| | 2004 RMB'000 | 2003 RMB'000 |
| Unlisted shares, at cost | 100,175 | 100,175 |
| Amounts due from subsidiaries | 149,391 | 147,976 |
| | <u>249,566</u> | <u>248,151</u> |

The amounts due from subsidiaries of RMB149,391,000 (2003: RMB147,976,000) are trading balances which, although technically are repayable under the original terms of the transactions giving rise thereto, have been deferred for a longer term and are therefore classified as non-current.

Particulars of the subsidiaries are as follows:

| Name | Place of incorporation/ registration and operations | Nominal value of issued shares/ paid-up capital | Percentage of equity attributable to the Group | Principal activities |
|---|---|---|--|--|
| <i>Directly held</i> | | | | |
| Dawnrays International Company Limited | British Virgin Islands | US\$100 | 100 | Investment holding |
| <i>Indirectly held</i> | | | | |
| Suzhou Dawnrays Pharmaceuticals Co., Ltd. | PRC | US\$25,000,000 | 100 | Manufacture and sale of pharmaceutical products |
| Shanghai Dawnrays Chemical Co., Ltd. | PRC | US\$680,000 | 92 | Manufacture and sale of pharmaceutical intermediates |
| Suzhou Dawnrays Pharmaceutical Technology Co., Ltd. | PRC | US\$480,413 | 100 | Research and development of pharmaceutical technology and products |

19. INTERESTS IN SUBSIDIARIES (Cont'd)

| Name | Place of incorporation/ registration and operations | Nominal value of issued shares/ paid-up capital | Percentage of equity attributable to the Group | Principal activities |
|-------------------------------------|---|---|--|--|
| Suzhou Dawnrays Chemical Co., Ltd. | PRC | US\$3,667,452 | 100 | Manufacture and sale of pharmaceutical intermediates |
| Dawnrays Pharma (Hong Kong) Limited | Hong Kong | HK\$1 | 100 | Dormant |

20. INVENTORIES

| | Group | |
|------------------|-----------------|-----------------|
| | 2004 RMB'000 | 2003 RMB'000 |
| Raw materials | 13,759 | 13,862 |
| Work in progress | 48,645 | 20,489 |
| Finished goods | 22,362 | 19,991 |
| | <u>84,766</u> | <u>54,342</u> |

No inventories were stated at net realisable value at 31 December 2004 (2003: Nil).

Notes to Financial Statements

31 December 2004

21. TRADE AND NOTES RECEIVABLES

An aged analysis of the trade and notes receivables as at the balance sheet date, based on invoice date, is as follows:

| | Group | |
|--|-------------|-------------|
| | 2004 | 2003 |
| | RMB'000 | RMB'000 |
| Trade receivables | | |
| Outstanding balances with ages: | | |
| Within 90 days | 119,210 | 101,461 |
| Between 91 to 180 days | 2,932 | 3,937 |
| Between 181 to 270 days | 1,135 | 1,654 |
| Between 271 to 360 days | 990 | 566 |
| Over one year | 199 | 683 |
| | <hr/> | <hr/> |
| | 124,466 | 108,301 |
| | <hr/> | <hr/> |
| Notes receivables | | |
| Outstanding balances with ages: | | |
| Within 90 days | 54,318 | 34,247 |
| Between 91 to 180 days | 57,736 | 11,759 |
| | <hr/> | <hr/> |
| | 112,054 | 46,006 |
| | <hr/> | <hr/> |
| | 236,520 | 154,307 |
| Less: Provision for bad and doubtful debts | (510) | (510) |
| | <hr/> | <hr/> |
| | 236,010 | 153,797 |
| | <hr/> <hr/> | <hr/> <hr/> |

Included in the Group's trade receivables is an amount due from a company in which the chief executive of the Company is a director, of RMB3,450,000 (2003: Nil), which are repayable on similar credit terms to those offered to the major customers of the Group.

Notes to Financial Statements

31 December 2004

22. PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

| | Group | | Company | |
|----------------------------|-----------------|-----------------|-----------------|-----------------|
| | 2004 RMB'000 | 2003 RMB'000 | 2004 RMB'000 | 2003 RMB'000 |
| Tax refund | 6,612 | 9,708 | — | — |
| Prepayments | 7,056 | 5,476 | — | — |
| Deposits and other debtors | 2,476 | 2,297 | 361 | 365 |
| | <u>16,144</u> | <u>17,481</u> | <u>361</u> | <u>365</u> |

23. SHORT TERM INVESTMENTS

| | Group | | Company | |
|--|-----------------|-----------------|-----------------|-----------------|
| | 2004 RMB'000 | 2003 RMB'000 | 2004 RMB'000 | 2003 RMB'000 |
| Listed equity investments, at market value: | | | | |
| Hong Kong | 598 | — | 598 | — |
| | <u>598</u> | <u>—</u> | <u>598</u> | <u>—</u> |

24. CASH AND CASH EQUIVALENTS

| | Group | | Company | |
|---------------------------|-----------------|-----------------|-----------------|-----------------|
| | 2004 RMB'000 | 2003 RMB'000 | 2004 RMB'000 | 2003 RMB'000 |
| Cash and bank balances | 45,174 | 61,706 | 6,444 | 6,401 |
| Time deposits | 53,208 | 72,815 | 27,208 | 67,814 |
| Cash and cash equivalents | <u>98,382</u> | <u>134,521</u> | <u>33,652</u> | <u>74,215</u> |

Notes to Financial Statements

31 December 2004

25. TRADE AND NOTES PAYABLES

An aged analysis of the trade and notes payables as at the balance sheet date, based on invoice date, is as follows:

| | Group | |
|---------------------------------|-----------------|-----------------|
| | 2004 RMB'000 | 2003 RMB'000 |
| Outstanding balances with ages: | | |
| Within 90 days | 107,486 | 104,598 |
| Between 91 to 180 days | 126,472 | 30,867 |
| Between 181 to 270 days | 42 | 6,045 |
| Between 271 to 360 days | 41 | 283 |
| Over one year | 236 | 439 |
| | <u>234,277</u> | <u>142,232</u> |

26. OTHER PAYABLES AND ACCRUALS

| | Group | | Company | |
|----------------|-----------------|-----------------|-----------------|-----------------|
| | 2004 RMB'000 | 2003 RMB'000 | 2004 RMB'000 | 2003 RMB'000 |
| Other payables | 34,406 | 34,678 | — | — |
| Accruals | 4,120 | 1,757 | 773 | 1,115 |
| | <u>38,526</u> | <u>36,435</u> | <u>773</u> | <u>1,115</u> |

27. SHARE CAPITAL

SHARES

| | 2004 RMB'000 | 2003 RMB'000 |
|---|------------------|------------------|
| Authorised: | | |
| 10,000,000,000 (2003: 10,000,000,000) ordinary shares of HK\$0.1 each | <u>1,000,000</u> | <u>1,000,000</u> |
| Issued and fully paid: | | |
| 800,000,000 (2003: 800,000,000) ordinary shares of HK\$0.1 each | <u>80,000</u> | <u>80,000</u> |
| Equivalent to RMB'000 | <u>84,880</u> | <u>84,880</u> |

27. SHARE CAPITAL (Cont'd)

SHARE OPTIONS

Details of the Company's share option scheme and the share options issued under the scheme are included in note 28 to the financial statements.

28. SHARE OPTION SCHEME

The Company operates a share option scheme (the "Scheme") for the purpose of providing incentives and rewards to eligible persons (including the Company's directors, employees of the Group and other eligible participants as defined under the Scheme) who contribute to the success of the Group's operations. The Scheme was adopted on 21 June 2003 and will remain in force for 10 years from that date until 20 June 2013.

The maximum number of share currently permitted to be issued upon the exercise of options under the Scheme is an equivalent to 10% of the shares of the Company in issue upon listing (unless refreshed) which is 80,000,000 shares, which represents 10% of the issued share capital of the Company at the date of this annual report. The maximum number of shares issuable under share options to each eligible person in the Scheme within any 12-month period, is limited to 1% of the shares of the Company in issue at that time. Any further grant of share options in excess of this limit is subject to shareholders' separately approval in a general meeting.

Share options granted to a director, chief executive or substantial shareholder of the Company, or to any of their associates, are subject to approval in advance by the independent non-executive directors. In addition, any share options granted to a substantial shareholder or an independent non-executive director of the Company, or to any of their associates, in excess of 0.1% of the shares of the Company in issue at any time or with an aggregate value (based on the closing price of the Company's shares at the date of the grant) in excess of HK\$5 million, within any 12-month period, are subject to shareholders' approval in advance in a general meeting.

An option may be exercised in accordance with the terms of the Scheme at any time during a period commencing on such date on or after the date on which the option is granted as the Board may determine in granting the option and expiring at the close of business on such date as the Board may determine in granting the option but in any event shall not exceed ten years from the date of grant.

A non-refundable remittance of HK\$10 by way of consideration for the grant of an option is required to be paid by each grantee upon acceptance of the option.

The exercise price of the share options is determinable by the directors, but shall not be less than the higher of (i) the Stock Exchange closing price of the Company's shares on the date of the offer of the share options; and (ii) the average Stock Exchange closing price of the Company's shares for the five trading days immediately preceding the date of the offer, provided that the exercise price shall not be less than the nominal value of the ordinary shares of the Company.

Share options do not confer rights on the holders to dividends or to vote at shareholders' meetings.

Notes to Financial Statements

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28. SHARE OPTION SCHEME (Cont'd)

The following share options were outstanding under the Scheme during the year:

| Name or category of participant | Number of share options | | | | Date of grant of share options* | Exercise period of share options | Exercise price of share options** HK\$ | Price of Company's shares*** | |
|---------------------------------|-------------------------|-------------------------|------------------------|---------------------|---------------------------------|--------------------------------------|---|----------------------------------|-------------------------------------|
| | At 1 January 2004 | Granted during the year | Lapsed during the year | At 31 December 2004 | | | | At grant date of options HK\$ | At exercise date of options HK\$ |
| Directors | | | | | | | | | |
| Ms. Li Kei Ling | 700,000 | — | — | 700,000 | 11 November 2003 | 11 November 2004 to 10 November 2007 | 0.83 | 0.87 | N/A |
| Mr. Hung Yung Lai | 700,000 | — | — | 700,000 | 11 November 2003 | 11 November 2004 to 10 November 2007 | 0.83 | 0.87 | N/A |
| Mr. Zhang Jing Xing | 1,500,000 | — | — | 1,500,000 | 11 November 2003 | 11 November 2004 to 10 November 2007 | 0.83 | 0.87 | N/A |
| Mr. Lam Kam Wah | 848,000 | — | — | 848,000 | 11 November 2003 | 11 November 2004 to 10 November 2007 | 0.83 | 0.87 | N/A |
| | — | 1,000,000 | — | 1,000,000 | 17 November 2004 | 17 November 2005 to 16 November 2010 | 0.63 | 0.62 | N/A |
| | 848,000 | 1,000,000 | — | 1,848,000 | | | | | |
| Mr. Li Tung Ming | 1,048,000 | — | — | 1,048,000 | 11 November 2003 | 11 November 2004 to 10 November 2007 | 0.83 | 0.87 | N/A |
| Mr. Xu Kehan | 548,000 | — | — | 548,000 | 11 November 2003 | 11 November 2004 to 10 November 2007 | 0.83 | 0.87 | N/A |
| | — | 1,500,000 | — | 1,500,000 | 17 November 2004 | 17 November 2005 to 16 November 2010 | 0.63 | 0.62 | N/A |
| | 548,000 | 1,500,000 | — | 2,048,000 | | | | | |
| Chief executive | | | | | | | | | |
| Mr. Dong Shao Zhi | — | 2,000,000 | — | 2,000,000 | 17 November 2004 | 17 November 2005 to 16 November 2010 | 0.63 | 0.62 | N/A |
| Other employees | | | | | | | | | |
| In aggregate | 34,572,000 | — | (3,484,000) | 31,088,000 | 11 November 2003 | 11 November 2004 to 10 November 2007 | 0.83 | 0.87 | N/A |
| | — | 23,360,000 | — | 23,360,000 | 28 December 2004 | 28 December 2005 to 27 December 2010 | 0.58 | 0.59 | N/A |
| | 34,572,000 | 23,360,000 | (3,484,000) | 54,448,000 | | | | | |
| | 39,916,000 | 27,860,000 | (3,484,000) | 64,292,000 | | | | | |

28. SHARE OPTION SCHEME (Cont'd)

- * The vesting period of the share options is from the date of the grant until the commencement of the exercise period.
- ** The exercise price of the share options is subject to adjustment in accordance with the terms of the Scheme in the case of rights or bonus issues, or other similar changes in the Company's share capital.
- *** The price of the Company's shares disclosed as at the date of the grant of the share options is the Stock Exchange closing price on the trading day immediately prior to the date of the grant of the options. The price of the Company's shares disclosed as at the date of the exercise of the share options is the weighted average of the Stock Exchange closing prices.

At the balance sheet date, the Company had 64,292,000 share options outstanding under the Scheme, which represented approximately 8% of the Company's shares in issue as at that date. Up to the balance sheet date, none of such options granted was exercised or cancelled. The exercise in full of the remaining share options would, under the present capital structure of the Company, would result in the issue of 64,292,000 additional ordinary shares of the Company, additional share capital of HK\$6,429,200 (before share issue expenses).

29. RESERVES

The amounts of the Company's and the Group's reserves and the movements therein for the current and prior years are presented in the statements of changes in equity on pages 29 to 30 of the financial statements.

(I) CONTRIBUTION SURPLUS

The contribution surplus of the Group represents the difference between the aggregate of the nominal value of the paid-up capital of the subsidiaries acquired pursuant to the Group Reorganisation as set out in note 1, over the nominal value of the Company's shares issued in exchange therefor. The contribution surplus of the Company represents the excess of the then consolidated net assets of the subsidiaries acquired pursuant to the Group Reorganisation, over the nominal value of the Company's shares issued in exchange therefor.

(II) STATUTORY SURPLUS RESERVE ("SSR")

In accordance with the Company Law of the PRC and the articles of association of the PRC Subsidiaries, the PRC Subsidiaries are each required to allocate 10% of their profit after tax, as determined in accordance with PRC General Accepted Accounting Principles, to the SSR until such reserve reaches 50% of the registered capital of the PRC Subsidiaries. Part of the SSR may be converted to increase paid-up capital, provided that the remaining balance after the capitalisation is not less than 25% of the registered capital.

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30. FINANCIAL INSTRUMENTS

FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group is exposed to market risk, including primarily, changes in interest rates. The Group does not hold or issue derivative financial instruments for trading purposes.

The Group does not hedge interest rate fluctuations.

EXCHANGE RATE RISK

The Group did not have significant exposure to market risk for changes in foreign currency exchange rates for the year ended 31 December 2004.

CREDIT RISK

Credit risk arising from the inability of a counterpart to meet the terms of the Group's financial instrument contracts is generally limited to the amounts, if any, by which the counterpart's obligations exceed the obligations of the Group. The Group minimises its exposure to credit risk by only dealing with counterparts with acceptable credit ratings.

NET FAIR VALUES

The aggregate net fair values of the financial assets and financial liabilities of the Group are not materially different from their carrying amounts.

CREDIT RISK EXPOSURES

The Group's maximum exposure to credit risk (not taking into account the value of any collateral or other securities held) in the event that the counterparts fail to perform their obligations as at 31 December 2004 in relation to each class of recognised financial assets is the carrying amount of those assets as indicated in the balance sheets.

SIGNIFICANT CONCENTRATIONS OF CREDIT RISK

Concentration of credit risk exists when changes in economic, industrial or geographic factors similarly affect groups of counterparts whose aggregate credit exposure is significant in relation to the Group's total credit exposure. Significant concentration of credit risk arises from exposure to substantial amounts due from hospitals and medical institutions operating in the PRC.

31. COMMITMENTS

(I) LEASE COMMITMENTS

At 31 December 2004, the Group and the Company had total future minimum lease rentals payable under non-cancellable operating leases falling due as follows:

| | Group | | Company | |
|---|----------------|----------------|----------------|----------------|
| | 2004 | 2003 | 2004 | 2003 |
| | <i>RMB'000</i> | <i>RMB'000</i> | <i>RMB'000</i> | <i>RMB'000</i> |
| Within one year | 1,131 | 935 | 500 | 439 |
| In the second to fifth years, inclusive | 1,855 | 2,404 | 438 | 814 |
| After five years | 971 | 1,295 | — | — |
| | <u>3,957</u> | <u>4,634</u> | <u>938</u> | <u>1,253</u> |

(II) CAPITAL COMMITMENTS

| | Group | |
|-------------------------------------|----------------|----------------|
| | 2004 | 2003 |
| | <i>RMB'000</i> | <i>RMB'000</i> |
| Contracted, but not provided for: | | |
| Land use rights | 631 | — |
| Buildings | 3,420 | 17,150 |
| Plant and machinery | 4,965 | 7,817 |
| | <u>9,016</u> | <u>24,967</u> |
| Authorised, but not contracted for: | | |
| Plant and machinery | 82,973 | 78,979 |
| | <u>91,989</u> | <u>103,946</u> |

Notes to Financial Statements

31 December 2004

32. RELATED PARTY TRANSACTIONS

The Group had the following related party transactions during the year ended 31 December 2004:

| Notes | Group | | Company | |
|---|-----------------|-----------------|-----------------|-----------------|
| | 2004 RMB'000 | 2003 RMB'000 | 2004 RMB'000 | 2003 RMB'000 |
| Recurring transaction: | | | | |
| Sales of products to Livzon Pharmaceutical Group Inc. (a) | 3,889 | — | — | — |
| Non-recurring transaction: | | | | |
| Rental paid to Sing Lee Pharmaceutical Import & Export Co., Limited for lease of office premises (b) | — | 319 | — | 319 |

Notes:

- (a) The Company's chief executive, Mr. Dong Shao Zhi is also a director of Livzon Pharmaceutical Group Inc. ("Livzon"). The sales included the transaction with Livzon from July 2004 (date of Mr. Dong Shao Zhi's appointment) to the year end, which were made according to the published prices and conditions offered to the major customers of the Group. Details of the Group's trade balance with Livzon as at the balance sheet date is disclosed in note 21 to the financial statements.
- (b) Sing Lee Pharmaceutical Import & Export Co., Limited is a company equally owned by Ms. Li Kei Ling and Mr. Hung Yung Lai.

33. POST BALANCE SHEET EVENT

On 7 March 2005, the Company declared a final dividend for the year ended 31 December 2004, at HK\$0.023 per share, amounting to a total sum of HK\$18,400,000 (equivalent to RMB19,543,000).

34. COMPARATIVE FIGURES

Certain comparative amounts have been reclassified to conform with the current year's presentation.

35. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors on 7 March 2005.

RESULTS

Year ended 31 December

| | 2004 <i>RMB'000</i> <i>(Note a)</i> | 2003 <i>RMB'000</i> <i>(Note a)</i> | 2002 <i>RMB'000</i> <i>(Note a)</i> | 2001 <i>RMB'000</i> <i>(Note a)</i> | 2000 <i>RMB'000</i> <i>(Note a)</i> |
|--|---|---|---|---|---|
| TURNOVER | 584,758 | 491,388 | 327,924 | 176,718 | 58,508 |
| Cost of sales | (392,081) | (285,485) | (155,617) | (80,350) | (25,462) |
| Gross profit | 192,677 | 205,903 | 172,307 | 96,368 | 33,046 |
| Other revenue | 1,956 | 867 | 527 | 1,588 | 2,073 |
| Selling and distribution costs | (58,987) | (56,795) | (52,305) | (36,387) | (23,451) |
| Administrative expenses | (34,375) | (26,231) | (10,643) | (5,591) | (6,713) |
| Other operating expenses | (14,859) | (10,511) | (8,767) | (5,110) | (2,115) |
| PROFIT FROM OPERATING ACTIVITIES | 86,412 | 113,233 | 101,119 | 50,868 | 2,840 |
| Finance costs | — | (809) | (521) | (2,165) | (2,719) |
| PROFIT BEFORE TAX | 86,412 | 112,424 | 100,598 | 48,703 | 121 |
| Tax | (6,225) | (3,996) | — | — | — |
| PROFIT BEFORE MINORITY INTERESTS | 80,187 | 108,428 | 100,598 | 48,703 | 121 |
| Minority interests | (16) | (406) | (479) | (435) | 96 |
| NET PROFIT FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS | 80,171 | 108,022 | 100,119 | 48,268 | 217 |

ASSETS, LIABILITIES AND MINORITY INTERESTS

| | At 31 December | | | | |
|--------------------|-----------------------|-----------------|-----------------|-----------------|-----------------|
| | 2004 | 2003 | 2002 | 2001 | 2000 |
| | <i>RMB'000</i> | <i>RMB'000</i> | <i>RMB'000</i> | <i>RMB'000</i> | <i>RMB'000</i> |
| | <i>(Note b)</i> | <i>(Note b)</i> | <i>(Note b)</i> | <i>(Note b)</i> | <i>(Note b)</i> |
| TOTAL ASSETS | 687,083 | 558,494 | 271,837 | 168,355 | 120,359 |
| TOTAL LIABILITIES | (274,896) | (183,601) | (78,298) | (59,537) | (60,460) |
| MINORITY INTERESTS | (716) | (989) | (938) | (459) | (920) |
| | <u>411,471</u> | <u>373,904</u> | <u>192,601</u> | <u>108,359</u> | <u>58,979</u> |

Notes:

- (a) The summary of the combined results of the Group for the years ended 31 December 2000, 2001 and 2002, have been extracted from the Company's prospectus dated 30 June 2003. Such summary was prepared as if the current structure of the Group had been in existence throughout these financial years. The results of the Group for the years ended 31 December 2003 and 2004 are those set out on page 27 of the financial statements.
- (b) The Group's combined balance sheets as at 31 December 2000, 2001 and 2002 have been extracted from the Company's prospectus dated 30 June 2003 and were prepared on the basis as if the Group had been in existence as at 31 December 2000, 2001 and 2002. The Group's consolidated balance sheet as at 31 December 2003 and 2004 are those set out on page 28 of the financial statements.