

The following is the text of a report for the purpose of incorporation in this prospectus, from the auditors and reporting accountants of the Company, Ernst & Young, Certified Public Accountants, Hong Kong:—



15th Floor
Hutchison House
10 Harcourt Road
Central
Hong Kong

22 September, 2000

The Directors
Sino Biopharmaceutical Limited
DBS Asia Capital Limited

Dear Sirs,

We set out below our report on the financial information regarding Sino Biopharmaceutical Limited (the “Company”) and its subsidiaries (hereinafter collectively referred to as the “Group”) prepared on the basis set out in Section 1 below, for inclusion in the prospectus of the Company dated 22 September, 2000 (the “Prospectus”).

The Company was incorporated as an exempted company with limited liability in the Cayman Islands on 2 February, 2000 under the Companies Law (2000 Revision) of the Cayman Islands for the purpose of acting as a holding company of the subsidiaries set out in Section 1 below. The Company has not carried on any business since the date of its incorporation save for the acquisition on 19 September, 2000 of the subsidiaries listed in Section 1 below.

As at the date of this report, no audited financial statements have been prepared for the Company and certain of its subsidiaries namely Chia Tai Pharmaceutical (Lianyungang) Company Limited (“CTL”) and Champion First Investments Limited (“Champion First”) since the dates of their incorporation. We have, however, performed our own independent review of the management accounts and all relevant transactions of the Company and these subsidiaries since these respective dates of incorporation.

We have examined the audited financial statements or, where appropriate, the management accounts of all other companies now comprising the Group, for each of the periods referred to in this report, or from the respective dates of their incorporation/registration where this is a shorter period, in accordance with the Auditing Guideline “Prospectuses and the reporting accountant” issued by the Hong Kong Society of Accountants.

We have acted as auditors of the companies now comprising the Group for each of the periods referred to in this report, except for the following periods:—

Company	Financial period	Auditors
Sino Concept Technology Limited ("Sino Technology")	Year ended 31 December, 1998	Francis S. L. Yan & Co. Certified Public Accountants Hong Kong
Shandong Chia Tai Freda Pharmaceutical Co., Ltd. ("CTF")	Each of the two years ended 31 December, 1999	Shandong Zhenlu Certified Public Accountants (formerly known as Shandong No. 2 Certified Public Accountants) People's Republic of China
Lianyungang Chiatai-Tianqing Pharmaceutical Co., Ltd. ("CTT")	Each of the two years ended 31 December, 1999	Lianyungang Jinhua Certified Public Accountants (formerly known as Lianyungang Certified Public Accountants) People's Republic of China

The statutory financial statements of CTF and CTT were audited by Shandong Zhenlu Certified Public Accountants and Lianyungang Jinhua Certified Public Accountants, respectively, certified public accountants registered in the PRC, for each of the two years ended 31 December, 1999. These statutory financial statements were prepared in accordance with the relevant accounting principles and financial regulations applicable to foreign investment enterprises in the PRC. For the purpose of this report, we have undertaken an independent audit of the financial statements of CTF and that of CTT for each of the two years ended 31 December, 1999 and for the five months ended 31 May, 2000 in accordance with the Statements of Auditing Standards issued by the Hong Kong Society of Accountants. We have also carried out such procedures as we considered necessary with regard to audited financial statements of Sino Technology for the year ended 31 December, 1998 and made such adjustments as we considered appropriate for them to be in conformity in all material respects with the accounting policies set out in Section 2 below. In respect of the year ended 31 December, 1999 and the five months ended 31 May, 2000, we have performed a separate audit of the accounts of Sino Technology in accordance with Statements of Auditing Standards issued by the Hong Kong Society of Accountants.

The financial statements of Sino Technology for the year ended 31 December, 1998 were qualified by the then auditors of Sino Technology because of limitations of scope with regard to its continuance in business as a going concern. In addition, the financial statements of CTT for the year ended 31 December, 1999 were also qualified because the then auditors of CTT had not been able to satisfy themselves with that a credit balance of inventory variance accounts amounting to RMB6,599,156, equivalent to HK\$6,196,000 as at 31 December, 1999 was not credited to the profit and loss accounts for the year ended 31 December, 1999. For the purpose of this report, we have performed additional procedures necessary to satisfy ourselves that Sino Technology will continue to

operate as a going concern and that, with regard to CTT, appropriate adjustments have been made and reflected in the combined results of the Group for each of the periods referred to in this report and of the combined net assets of the Group as at 31 May, 2000.

The summaries of the combined results of the Group for the periods referred to in this report and of the combined net assets of the Group as at 31 May, 2000 (the "Summaries") set out in this report have been prepared from the audited financial statements or, where appropriate, the management accounts of the companies now comprising the Group, after making such adjustments as we consider appropriate and are presented on the basis set out in Section 1 below.

In our opinion, the Summaries together with the notes thereon give, for the purpose of this report, a true and fair view of the combined results of the Group for each of the periods referred to in this report and of the combined net assets of the Group as at 31 May, 2000.

1. BASIS OF PRESENTATION

The Summaries, which are based on the audited financial statements or, where appropriate, the management accounts of the companies now comprising the Group, after making such adjustments as we consider appropriate, include the results and net assets of the companies now comprising the Group as if the current Group structure had been in existence throughout the periods referred to in this report, or since the dates of their incorporation/registration where this is a shorter period. All material intra-group transactions and balances have been eliminated on combination.

At the date of this report, the Company had direct or indirect interests in the following subsidiaries, all of which are private companies (or, if incorporated/registered outside Hong Kong, have characteristics substantially similar to a private company incorporated in Hong Kong), the particulars of which are set out below:—

Company	Place and date of incorporation/registration	Paid-up share/registered capital	Attributable equity interest	Principal activities
CTL	British Virgin Islands 2 July, 1998	US\$3 Ordinary	100% [#]	Investment holding
Sino Technology	Hong Kong 21 February, 1991	HK\$10,100 Ordinary	100% ^{**}	Investment holding and provision of management services
Champion First	British Virgin Islands 22 September, 1998	US\$2 Ordinary	100% [#]	Investment holding
CTF	People's Republic of China 31 March, 1992	RMB20,000,000	55%	Development, manufacture and distribution of pharmaceutical products
CTT	People's Republic of China 16 April, 1997	RMB68,000,000	60%	Development, manufacture and distribution of pharmaceutical products

Directly held by the Company

* *According to the Corporate Reorganisation as detailed in Appendix V to this Prospectus, the Company holds 100% equity interest in Sino Technology by acquiring its entire equity interest from Mr. Tse Ping and Well Base (Asia) Limited ("Well Base"), the existing shareholders. For the purpose of this report, Sino Technology has been accounted for as a wholly owned subsidiary of the Group throughout the periods referred to in this report.*

2. PRINCIPAL ACCOUNTING POLICIES

The principal accounting policies adopted by the Group in arriving at the financial information set out in this report, which conform with Statements of Standard Accounting Practice issued by the Hong Kong Society of Accountants, are set out below:—

Joint ventures

A joint venture is a contractual arrangement whereby the Group and other parties undertake an economic activity which is subject to joint control and none of the participating parties has unilateral control over the economic activity. The joint venture agreement stipulates the composition of the joint venture parties' capital contributions, the duration of the joint venture, and the basis on which assets are to be realised upon its dissolution. The profits and losses from operations and any distribution of surplus assets are shared by the joint venture parties in proportion to their respective capital contributions.

A joint venture is treated as a subsidiary if, under the joint venture contract, the Group holds more than half of the joint venture company's registered capital and the Group can control the composition of the board of directors or exercise unilateral influence over the joint venture.

Interests in subsidiaries are stated at cost unless, in the opinion of the directors, there have been permanent diminutions in values, when they are written down to values determined by the directors.

Goodwill

Goodwill arising on consolidation of subsidiaries represents the excess of purchase consideration paid for subsidiaries over the fair values ascribed to the net underlying assets acquired at the date of acquisition. Goodwill is amortised on a straight-line basis over its useful life, not exceeding a period of 10 years, starting from the commencement date of the subsidiaries' operations.

Fixed assets and depreciation

Fixed assets are stated at cost less accumulated depreciation. 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 the tangible fixed assets have been put into operation, such as repairs and maintenance, is normally charged to the profit and loss account 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 tangible fixed asset, the expenditure is capitalised as an additional cost of that tangible fixed assets.

When assets are sold or retired, their cost and accumulated depreciation are eliminated from the financial statements and any gain or loss resulting from their disposal is included in the profit and loss account.

Depreciation is calculated on the straight-line basis to write off the cost of each asset, less its estimated residual value, over its estimated useful life. The principal annual rates used for this purpose are as follows:—

Leasehold improvement	10%–20%
Leasehold buildings	4%–5%
Plant and machinery	6%–9%
Furniture and fixtures	18%
Motor vehicles	18%

The carrying amounts are reviewed periodically in order to assess whether they are recorded in excess of their recoverable amounts, and where carrying amounts exceed the estimated recoverable amounts, assets are written down to their recoverable amounts. In determining the recoverable amounts of items of fixed assets, expected future cash flows have not been discounted to their present values.

Construction in progress

Construction in progress represents factory buildings, plant and machinery and other fixed assets under construction or installation and is stated at cost. Cost comprises the direct costs of construction, installation and testing as well as capitalised borrowing costs during the periods of construction, installation and testing. Construction in progress is transferred to fixed assets when it is completed and available for its intended use.

Research and development costs

All research costs are charged to the profit and loss account as incurred.

Expenditure incurred on projects in developing new products is capitalised and deferred only when the projects are clearly defined, the expenditure is separately identified and 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 as incurred.

Deferred development costs are amortised on the straight-line basis over the shorter of the expected life of the products or 5 years, commencing from the year when the products are put into commercial production.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of an asset which takes a substantial period of time to be available for its intended use or sale are capitalised as part of the cost of the asset. The capitalisation rate for the year is based on the weighted average cost of the related borrowings.

All other borrowing costs are recognised as expenses in the period in which they are incurred.

Operating leases

Leases where substantially all the rewards and risks of ownership of the assets remain with the leasing company are accounted for as operating leases. Rentals applicable to such operating leases are charged to the profit and loss account on the straight-line basis over the lease terms.

Long-term investments

Long term investments are non-trading investments in unlisted equity securities intended to be held on a long term basis.

Unlisted securities are stated at their cost, less any provision for permanent diminution considered necessary by the directors on an individual basis. The provision is recognised as an expense immediately. The profit or loss on disposal of unlisted securities is accounted for in the period in which the disposals occurs as the difference between the net sales proceeds and the carrying amount of the securities.

Inventories

Inventories are stated at the lower of cost and net realisable value after making due allowance for any obsolete or slow-moving items. Cost is determined on the weighted average basis and, in the case of work in progress and finished goods, comprises direct materials, direct labour and an appropriate proportion of overheads.

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

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 significance influence.

Foreign currencies

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 Hong Kong dollars (“HK\$”) at the applicable rates of exchange ruling at that date. Exchange differences are dealt with in the profit and loss account.

On combination, the financial statements of overseas subsidiaries are translated into HK\$ at the applicable rates of exchange ruling at the balance sheet date. The resulting translation differences are included in the exchange fluctuation reserve.

Deferred taxation

Deferred taxation is provided, using the liability method, on all significant timing differences to the extent it is probable that the liability will crystallise in the foreseeable future. A deferred tax asset is not recognised until its realisation is assured beyond reasonable doubt.

Pension costs

Pension costs are charged to the profit and loss account as incurred.

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:—

- (i) on 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;
- (ii) sales tax refunds, on an accrual basis;
- (iii) interest income, on a time proportion basis taking into account the principal outstanding and the effective interest rate applicable; and
- (iv) dividends, when the shareholders' right to receive payment is established.

3. RESULTS

The following is a summary of the combined results of the Group for each of the two years ended 31 December, 1999 and the five months ended 31 May, 2000 (the "Relevant Years/Period"), after making such adjustments as we consider appropriate and on the basis set out in Section 1 above:—

		Year ended 31 December,		Five months ended
		1998	1999	31 May, 2000
	Notes	HK\$'000	HK\$'000	HK\$'000
Turnover	(a)	237,972	305,776	151,227
Cost of sales		<u>(74,080)</u>	<u>(82,161)</u>	<u>(31,870)</u>
Gross profits		163,892	223,615	119,357
Less: Selling expenses		(84,114)	(112,838)	(59,754)
Administrative expenses		(36,147)	(44,698)	(18,511)
Finance charges		(4,400)	(3,721)	(1,176)
Other (expenses)/income		(331)	(1,825)	59
Add: Interest income		<u>1,000</u>	<u>881</u>	<u>832</u>
Profit before taxation	(b)	39,900	61,414	40,807
Taxation	(e)	<u>—</u>	<u>(2,611)</u>	<u>(3,577)</u>
Profit before minority interests		39,900	58,803	37,230
Minority interests		<u>(17,796)</u>	<u>(22,969)</u>	<u>(15,752)</u>
Profit attributable to shareholders		<u>22,104</u>	<u>35,834</u>	<u>21,478</u>
Dividends	(f)	<u>—</u>	<u>24,820</u>	<u>—</u>
Earnings per share — basic (<i>Note</i>)		<u>HK9.2 cents</u>	<u>HK14.9 cents</u>	<u>HK8.9 cents</u>

Note: The calculation of the basic earnings per share is based on the net profit attributable to shareholders for each of the Relevant Years/Period and on the assumption that 240,000,000 shares had been in issue throughout the Relevant Years/Period as at the date of this prospectus.

(a) Turnover and revenue

Turnover represents the invoiced value of goods sold, net of discounts and returns, sales tax refunds, and dividend income.

The Group's turnover and revenue for the Relevant Years/Period arose from the following activities:—

	Year ended 31 December,		Five months ended
	1998	1999	31 May, 2000
	HK\$'000	HK\$'000	HK\$'000
Sale of goods	229,684	298,570	151,227
Sales tax refunds — note	8,288	—	—
Dividend income	—	7,206	—
	<u>237,972</u>	<u>305,776</u>	<u>151,227</u>
Turnover	237,972	305,776	151,227
Interest income	<u>1,000</u>	<u>881</u>	<u>832</u>
	<u>238,972</u>	<u>306,657</u>	<u>152,059</u>
Total revenue for the year/period	<u>238,972</u>	<u>306,657</u>	<u>152,059</u>

Note: On 1 January, 1994, the PRC government abolished the Commercial and Industrial Consolidated Tax ("CICT") and introduced a new system of indirect taxes including Value Added Tax ("VAT"), Business Tax and Consumption Tax. Pursuant to a provision issued by the National People's Congress on 29 December, 1993, foreign investment enterprises established before 31 December, 1993 may, upon the approval by the tax authorities, be entitled to a refund of the excess sales tax paid under the new tax legislation for a period of five years from 1 January, 1994 to 31 December, 1998.

Under the new tax legislation, CTF was subject to higher net sales tax payable when compared with sales tax calculated under CICT for the Relevant Years/Period and has obtained approvals for sales tax refunds, as disclosed in turnover above, on the excess of sales tax paid over CICT that would otherwise be payable in accordance with the relevant tax rules.

(b) Profit before taxation

Profit before taxation is arrived at after charging/(crediting):—

	Year ended 31 December,		Five months
	1998	1999	ended
	HK\$'000	HK\$'000	31 May, 2000
			HK\$'000
Directors' remuneration	130	240	52
Auditors' remuneration	26	155	11
Depreciation of fixed assets	5,834	7,043	3,629
Amortisation of goodwill	681	792	285
Interests on:—			
Bank loans repayable within one year	3,114	2,065	1,132
Loans from related companies wholly repayable within one year	1,124	1,261	61
Other loans wholly repayable within one year	<u>162</u>	<u>395</u>	<u>—</u>
Total interests	4,400	3,721	1,193
Less: amounts capitalised	<u>—</u>	<u>—</u>	<u>—</u>
Total interest expenses	<u>4,400</u>	<u>3,721</u>	<u>1,193</u>
Operating lease rentals on land and buildings	2,082	2,878	577
Operating lease rentals on plant and machinery	377	1,137	826
Marketing and promotion expenses	52,487	64,816	45,751
Research and development expenses	3,270	3,151	3,803
Provision for doubtful debts	3,529	1,459	—
Loss on disposal of fixed assets	346	1,094	41
Staff costs	20,618	28,892	13,050
Staff welfare and bonus fund (<i>note 4(i)</i>)	4,903	4,961	—
Pension contributions (<i>note</i>)	3,486	4,704	2,155
Foreign exchange gains, net	(12)	(46)	(80)
Interest income	(1,000)	(881)	(832)
Dividend income from unlisted investment	<u>—</u>	<u>(7,206)</u>	<u>—</u>

Note: During the Relevant Years/Period, certain of the Company's subsidiaries in the PRC were members of a defined pension contribution scheme managed by the respective local governments in the PRC. Contributions made were based on 25% of the employees' salaries and were charged to the profit and loss account as they became payable. According to the existing PRC regulations, no forfeited contributions may be used by the employer to reduce the existing level of contributions.

(c) Directors' remuneration

Details of the remuneration of the directors during the Relevant Years/Period are as follows:—

	Year ended 31 December,		Five months
	1998	1999	ended
	HK\$'000	HK\$'000	31 May, 2000
Fees	—	—	—
Other emoluments:—			
Salaries, allowances and benefits in kind	75	96	40
Pension contributions	8	8	3
Discretionary bonuses	47	136	9
	<u>130</u>	<u>240</u>	<u>52</u>

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

	Year ended 31 December,		Five months
	1998	1999	ended
			31 May, 2000
HK\$Nil–HK\$1,000,000	<u>4</u>	<u>4</u>	<u>4</u>

Three directors received no emoluments and one director received emoluments of approximately HK\$130,000, HK\$240,000 and HK\$52,000 respectively for the two years ended 31 December, 1999 and the five months ended 31 May, 2000.

There was no arrangement under which a director waived or agreed to waive any remuneration during the Relevant Years/Period.

(d) Five highest-paid employees

The five highest-paid employees of the Group included one director whose remuneration has been disclosed in note (c) above, for the Relevant Years/Period.

Details of the remuneration and the designated band of the remaining four highest-paid employees during the Relevant Years/Period are as follows:—

	Year ended 31 December,		Five months
	1998	1999	ended
	HK\$'000	HK\$'000	31 May, 2000
Salaries, allowances and benefits in kind	586	626	211
Pension contributions	24	24	10
Discretionary bonuses	140	135	24
	<u>750</u>	<u>785</u>	<u>245</u>

The remuneration of the highest paid employees, other than the directors, fell within HK\$Nil–HK\$1,000,000 band.

During the Relevant Years/Period, no emoluments were paid by the Group to the directors or the other highest-paid employees either as an inducement to join the Group, or as compensation for loss of office.

(e) **Taxation**

	Year ended 31 December,		Five months ended
	1998	1999	31 May, 2000
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Provision for the year/period:—			
PRC income tax	—	2,611	3,577
	<u> </u>	<u> </u>	<u> </u>
Taxation charge for the year/period	—	2,611	3,577
	<u> </u>	<u> </u>	<u> </u>

No provision for Hong Kong profits tax has been made as the Group had no assessable profits arising in or derived from Hong Kong during the Relevant Years/Period.

PRC income tax is provided at the rates applicable to enterprises in the PRC on the income for statutory reporting purposes, adjusted for income and expenses items which are not assessable or deductible for income tax purposes based on existing PRC income tax regulations, practices and interpretations thereof. The deferred taxation represents timing differences in respect of the recognition of income and expenditure items under the generally accepted accounting principles between Hong Kong and the PRC.

Pursuant to the Income Tax Law of the PRC concerning Foreign Investment Enterprises and Foreign Enterprises and various local income tax laws (the "Income Tax Laws"), joint venture companies are subject to the statutory income tax rate of 33% (30% state income taxes plus 3% local income taxes) unless the enterprise is qualified as "High and New Technology Enterprise" or located in specially designated regions or cities for which more favorable effective tax rates apply. CTT is located in regions where preferential tax rates apply and currently qualify for reduced rates of taxation of 24%. CTF was qualified as a "High and New Technology Enterprise" for which preferential tax rate of 15% applies. Both companies are entitled to an income tax exemption for two years commencing from the first profitable year (after deducting losses carried forward), and a 50% reduction for the succeeding three years. As of 31 December, 1999, CTF is in its third profitable year and accordingly, it became subject to income tax rate of 7.5%. Should CTF continue to be profitable in year 2000, CTF will be in its fourth profitable year and will be subject to an income tax rate of 7.5%.

Furthermore, according to the relevant Income Tax Laws in the PRC, should a joint venture company be profitable in the first year of operations, in which the operating period is less than six months, the Company can opt for the commencement of the above tax exemption in the following fiscal year. However, the joint venture company is subject to income tax for the net income earned in that first profitable year. During the period ended 31 December, 1997, CTT was profitable in its first year of operations and it opted for the commencement of tax exemption in the fiscal year 1998. As of 31 December, 1999, CTT is in its second profitable year and accordingly, is exempted from income tax for that year. Should CTT continue to be profitable in year 2000, CTT will be in its third profitable year and will be subject to an income tax rate of 12%.

There were no material unprovided deferred tax liabilities during the Relevant Years/Period.

(f) Dividends

No dividends have been paid or declared by the Company since the date of its incorporation. The dividends paid or declared by the Company's subsidiaries to their then shareholders during the Relevant Years/Period were as follows:—

	Year ended 31 December,		Five months
	1998	1999	ended 31 May,
	HK\$'000	HK\$'000	2000
			HK\$'000
CTF	29,772	27,822	—
CTT	16,011	28,026	—
CTL	—	—	—
Sino Technology	—	17,626	—
Champion First	—	7,194	—
	<u>45,783</u>	<u>80,668</u>	<u>—</u>
Less: Elimination of dividends received by			
— members of the Group	(25,982)	(32,118)	—
— minority shareholders of subsidiaries	(19,801)	(23,730)	—
	<u>—</u>	<u>24,820</u>	<u>—</u>

The rates of dividends/distribution and the number of shares ranking for dividends are not presented, as such information is not meaningful with regard to the purpose of this report.

(g) Related party transactions

During the Relevant Years/Period, the Group had material transactions with the following related parties:—

	Year ended 31 December,		Five months
	1998	1999	ended 31 May,
	HK\$'000	HK\$'000	2000
			HK\$'000
Continuing transactions			
Bank loans guaranteed at end of year/period by:—			
— Jiangsu Tianqing	6,480	7,902	15,121
— Shangdong Biopharmaceutical	—	—	7,537
Sales to Shandong Biopharmaceutical			
(note i)	33	1,584	822
Sales to Shandong Research Institute (note i)			
	6	10	7
Operating lease rentals payable to:—			
— Shandong Research Institute (note ii)	1,444	2,974	1,125
— Jiangsu Tianqing (note ii)	562	563	236
Non-continuing transactions			
Interest payable to:—			
— Shandong Research Institute (note iii)	227	390	—
— Shandong Biopharmaceutical (note iii)	—	73	—
— Jiangsu Tianqing (note iv)	<u>897</u>	<u>798</u>	<u>61</u>

All the above companies are related to the PRC joint venture partners of the Group's subsidiaries.

In the opinion of the directors of the Company, the transactions with the above related parties were carried out on normal commercial terms and in the ordinary course of business.

Notes:—

- (i) Sales to Shandong Biochemical Pharmaceutical Co. ("Shandong Biopharmaceutical"), the Chinese joint venture partner of CTF, and Shandong Biopharmaceutical Research Institute ("Shandong Research Institute"), a fellow subsidiary of Shandong Biopharmaceutical, were conducted at market prices.
- (ii) Operating lease rentals payable to Shandong Research Institute and Jiangsu Tianqing Pharmaceutical Company (Lianyungang) ("Jiangsu Tianqing"), the Chinese joint venture partner of CTT, were determined at an agreed rate in accordance with the relevant lease contracts.
- (iii) Interest payable to Shandong Research Institute and Shandong Biopharmaceutical was charged at 6.138% per annum in accordance with the relevant loan agreements.
- (iv) Interest payable to Jiangsu Tianqing was charged at 50% of the prevailing bank interest rate for the period from January 1998 to March 1998; 80% of the prevailing bank interest rate for the period from April 1998 to March 1999; and 100% of the prevailing bank interest rate commencing from April 1999 in accordance with the relevant loan agreements.

The loans from Jiangsu Tianqing, Shandong Research Institute and Shandong Biopharmaceutical were repaid subsequent to 31 December, 1999 and the related finance was met by the Group's internal resources.

- (v) As disclosed in note 4(f), the Group had amounts due from related companies of HK\$123,000 as at 31 May, 2000 mainly arising from transactions described in (i) above.
- (vi) As disclosed in note 4(f), the Group had amounts due to related companies amounting to HK\$1,558,000 as at 31 May, 2000 mainly arose from transactions described in (ii) above.
- (vii) As disclosed in note 4(h), the Group had amounts due to a shareholder and a company related to a shareholder aggregately amounted to HK\$69,347,000 as at 31 May, 2000 as long term loan to the Group during the Relevant Years/Period. Subsequent to 31 May, 2000, the aggregate amounts of approximately HK\$76,595,000 due to a shareholder and a company related to a shareholder as at 30 June, 2000 was capitalised as disclosed in note 7(b).
- (viii) On 20 July, 1998, with the approval of the originating approving authority in Jiangsu Province, Chia Tai Health Products Company Limited ("CTH"), a company incorporated in Hong Kong and wholly owned by Mr. Tse Ping, transferred its entire interest in CTT to CTL, in consideration of HK\$38,130,000. The original rights and obligations of CTH and Jiangsu Tianqing in respect of the equity joint venture agreement and articles of association of CTT were assumed by CTL.

Except for the capitalisation of amounts due to a shareholder and a company related to a shareholder, the transfer of interest in CTT to CTL and the interest payable to related parties as explained above, in the opinion of the directors, all other related party transactions will continue after the listing of the shares of the Company on the Growth Enterprise Market of the Stock Exchange of Hong Kong Limited ("GEM").

4. NET ASSETS

The following is a summary of the combined net assets of the Group as at 31 May, 2000, after making such adjustments as we consider appropriate and on the basis set out in Section 1 above:—

	<i>Notes</i>	Group <i>HK\$' 000</i>
FIXED ASSETS	(a)	74,276
CONSTRUCTION IN PROGRESS		14,534
GOODWILL	(b)	4,163
LONG-TERM INVESTMENT	(c)	29,820
CURRENT ASSETS		
Cash and bank balances	(d)	38,475
Accounts receivable		61,868
Inventories	(e)	32,901
Prepayments, deposits and other receivables		23,463
Dividend receivable		1,402
Amounts due from related companies	(f)	<u>123</u>
		<u>158,232</u>
CURRENT LIABILITIES		
Bank loans	(g)	37,260
Accounts payable		12,815
Other payables and accrued liabilities		50,668
Amounts due to related companies	(f)	1,558
Taxation		2,161
Dividends payable to minority shareholders of subsidiaries		<u>8,880</u>
		<u>113,342</u>
NET CURRENT ASSETS		<u>44,890</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		<u>167,683</u>
LONG TERM LIABILITIES		
Amounts due to a shareholder and a company related to a shareholder	(h) & 7(b)	<u>69,347</u>
NET ASSETS BEFORE MINORITY INTERESTS		98,336
MINORITY INTERESTS		<u>(49,448)</u>
NET ASSETS		<u><u>48,888</u></u>

Notes:—

(a) Fixed assets

	At cost	Accumulated depreciation	Net book value
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Leasehold improvement	7,187	2,512	4,675
Leasehold buildings	40,050	11,423	28,627
Plant and machinery	47,638	15,550	32,088
Furniture and fixtures	7,736	2,972	4,764
Motor vehicles	<u>6,692</u>	<u>2,570</u>	<u>4,122</u>
	<u>109,303</u>	<u>35,027</u>	<u>74,276</u>

All leasehold buildings located in the PRC are held under medium term leases by the Group.

The relevant title certificates of certain of the above leasehold buildings (the "Property") with net book value of approximately HK\$587,925 as at 31 May, 2000 are in the process of being transferred to the name of the Group's subsidiary. As the relevant title has not been obtained, no commercial value was assigned to these buildings by DTZ Debenham Tie Leung Limited ("DTZ"), a registered professional surveyor incorporated in Hong Kong. For the purposes of this combined financial statements, these buildings are stated at their net book value as at 31 May, 2000 as in the opinion of the directors, no impairment to the value of these buildings to the Group has occurred. In the opinion of the Group's PRC legal advisers, there is no legal impediment for the Group to obtain good title to the Property after compliance with outstanding requisite procedures and the Group would be entitled to transfer, dispose of, let or mortgage the Property after such compliance. The major shareholders of the Company have given an indemnity to the Company against any financial loss to the Group arising from the failure of securing the transfer of the titles to the Group.

As at 31 May, 2000, certain of the above leasehold buildings with an aggregate net book value of approximately HK\$26,535,000 were pledged to secure certain of the Group's bank loans.

(b) Goodwill

	<i>HK\$'000</i>
Costs:—	6,781
Amortisation:—	
At beginning of period	2,333
Amortisation for the period	<u>285</u>
At end of period	<u>2,618</u>
Net book value	<u>4,163</u>

(c) Long-term investment*HK\$'000*

Unlisted shares, at cost	<u>29,820</u>
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The long term investment represented the Group's 8.33% interest in Golden News Enterprises Limited ("Golden News") which was incorporated in British Virgin Islands and is a subsidiary indirectly held by SIIC Medical Science and Technology (Group) Limited, a company listed on the GEM in 1999. Golden News, whose principal activity is investment holding, through Chia Tai Health Products Company Limited ("CTH"), indirectly holds 60% interest in Chia Tai Qingchunbao Pharmaceutical Co., Ltd. ("CTQ"), a sino-foreign equity joint venture company registered in the PRC.

(d) Cash and bank balances

The cash and bank balances included HK\$34,246,000 which were denominated in Renminbi ("RMB") in the amount of Rmb36,351,000. RMB is not freely convertible into foreign currencies. Under the PRC's Foreign Exchange Control Regulations and Administration of Settlement, Sale and Payment of Foreign Exchange Regulations, the Group is permitted to exchange RMB for foreign currencies through banks authorised to conduct foreign exchange business.

(e) Inventories*HK\$'000*

Raw materials	9,628
Work in progress	5,522
Finished goods	16,687
Spare parts and consumables	<u>1,064</u>
	32,901
Less: Provision for slow-moving and obsolete inventories	<u>—</u>
	<u>32,901</u>

(f) Amounts due from/to related companies

The amounts due from/to related companies are unsecured, interest-free and have no fixed terms of repayment.

(g) Bank loans*HK\$'000*

Secured	14,602
Guaranteed	<u>22,658</u>
	<u>37,260</u>

Details of the Group's banking facilities and assets pledged are set out in Section 6 below.

(h) Amounts due to a shareholder and a company related to a shareholder

The amounts due to a shareholder and a company related to a shareholder are unsecured, interest-free and are not repayable within one year. As disclosed in Note 7(b), the amounts due to a shareholder and a company related to a shareholder were subsequently capitalised in accordance with the Group reorganisation arrangement.

(i) Reserves

Movements in the reserves of the Group during the Relevant Years/Period were as follows:—

	31 December,		31 May,
	1998	1999	2000
	HK\$'000	HK\$'000	HK\$'000
General reserve fund (<i>Note</i>):—			
At beginning of year/period	462	2,116	3,311
Movements for the year/period	<u>1,654</u>	<u>1,195</u>	<u>—</u>
At end of year/period	<u><u>2,116</u></u>	<u><u>3,311</u></u>	<u><u>3,311</u></u>
Enterprise expansion fund (<i>Note</i>):—			
At beginning of year/period	885	3,628	5,028
Movements for the year/period	<u>2,743</u>	<u>1,400</u>	<u>—</u>
At end of year/period	<u><u>3,628</u></u>	<u><u>5,028</u></u>	<u><u>5,028</u></u>
Exchange fluctuation reserve:—			
At beginning of year/period	75	117	115
Arising on combination of PRC subsidiaries	<u>42</u>	<u>(2)</u>	<u>—</u>
At end of year/period	<u><u>117</u></u>	<u><u>115</u></u>	<u><u>115</u></u>

Note: According to the relevant laws and regulations for foreign investment enterprises incorporated under the law of the PRC on Joint Venture Using Chinese and Foreign Investment and the articles of association of the Group's PRC joint ventures, profits of the Group's PRC joint ventures, as stated in the statutory financial statements prepared in accordance with the accounting rules and regulations in the PRC, are available for distribution in the form of cash dividends to the joint venture partners after the joint ventures (1) satisfy all tax liabilities; (2) provide for losses in previous years and (3) make any required appropriations to the statutory reserve funds, including general reserve fund, enterprise expansion fund and staff welfare and bonus fund. The appropriation to the statutory reserve funds are at the discretion of the joint ventures' board of directors.

The general reserve fund can be used either to offset previous years' losses or to be capitalised as equity. The enterprise expansion fund can be used to expand the joint ventures' production and operations and subject to the approval of the relevant government authorities, can be utilised for increasing the capital of the joint ventures. The staff welfare and bonus fund is recorded and reported as a current liability of the joint ventures and can be utilised for making special bonus or collective welfare to the employees of the joint ventures.

In accordance with the articles of association of the Group's PRC joint ventures, profit after taxation, as determined in accordance with the PRC statutory financial statements, may be transferred to the general reserve fund, the enterprise expansion fund and the staff welfare and bonus fund at the discretion of the joint ventures' board of directors.

(j) Commitments

As at 31 May, 2000, the Group had the following commitments:—

	<i>HK\$'000</i>
Capital commitments in respect of plant and machinery:—	
Authorised, but not contracted for	15,259
Contracted, but not provided for	<u>10,880</u>
	<u><u>26,139</u></u>

Annual commitments payable in the following year under non-cancellable operating leases for land and buildings, and plant and machinery expiring:—

	Land and buildings	Plant and machinery	Total
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Within one year	1,288	1,982	3,270
In the second to fifth years, inclusive	50	—	50
After five years	<u>565</u>	<u>—</u>	<u>565</u>
	<u><u>1,903</u></u>	<u><u>1,982</u></u>	<u><u>3,885</u></u>

(k) Contingent liabilities

As at 31 May, 2000, the Group had no material contingent liabilities.

(l) Net assets of the Company

The Company was incorporated on 2 February, 2000. On the basis set out in Section 1 above, the net assets of the Company as at 31 May, 2000 would have been approximately HK\$48,888,000, representing its investment in subsidiaries.

(m) Distributable reserves

As at 31 May, 2000, the Company had no reserve available for distribution to the shareholders of the Company.

5. DIRECTORS' REMUNERATION

Save as disclosed herein, no remuneration has been paid or is payable in respect of the Relevant Years/Period by the Company or any of its subsidiaries to the directors of the Company.

Under the arrangements currently in force, the aggregate amount of directors' fees and other emoluments for the year ending 31 December, 2000 are approximately HK\$931,000, excluding discretionary bonuses payable under directors' service contracts, the terms of which are set out in the paragraph headed "Disclosure of interests" in Appendix V of the Prospectus.

6. BANKING FACILITIES AND PLEDGE OF ASSETS

The Group's bank loans bear interest at rates ranging from 6.435% to 7.326% per annum.

As at 31 May, 2000, the Group's secured bank loans of approximately HK\$14,602,000 were secured by certain fixed assets, with net book values of HK\$26,535,000. In addition, approximately HK\$15,121,000 and HK\$7,537,000 of the unsecured bank loans were guaranteed by Jiangsu Tianqing and Shandong Biopharmaceutical, the PRC joint venture partner of CTT and CTF, respectively. The guarantors have agreed to continue to provide the guarantees until the bank loans are fully repaid.

7. SUBSEQUENT EVENTS

- (a) On 19 September, 2000, the companies now comprising the Group effected a reorganisation arrangement to rationalise the Group structure in preparation for the listing of the Company's shares on the Growth Enterprise Market of the Stock Exchange of Hong Kong Limited and the Company became the holding company of the Group. Details of this reorganization are set out in the paragraph headed "Corporate Reorganisation" in Appendix V of the Prospectus;
- (b) On 30 June, 2000, CTL issued and allotted 1 share of US\$1 each to Mr. Tse Ping, the chairman and major shareholder of the Company, as directed by Chia Tai Pharmaceutical & Medicines Limited ("CTPM"), a company ultimately owned by Mr. Tse Ping, for a consideration of HK\$36,217,658 paid by way of the capitalisation of the balance then due to CTPM in the amount of HK\$36,217,658 as at 30 June, 2000.

Pursuant to an ordinary resolution passed on 24 March, 2000, the authorised share capital of Sino Technology was increased from HK\$10,000 to HK\$10,100 by the creation of 100 additional shares of HK\$1 each, ranking pari passu in all respects with the existing ordinary share capital of Sino Technology. Thereafter, 100 shares of HK\$1 each were issued and allotted to the existing shareholders on 30 June, 2000. Out of the 100 shares, 91 shares of HK\$1 each were issued to Mr. Tse Ping, one of the shareholders of Sino Technology and the chairman of the Company, for a consideration of HK\$10,542,859 paid by way of the capitalisation of the balance then due to CTPM in the amount of HK\$10,542,859 as at 30 June, 2000. The remaining 9 shares of HK\$1 each were issued to Well Base, the remaining shareholder of Sino Technology, for cash at a subscription price of HK\$1 for a total cash consideration of HK\$9.

On 30 June, 2000, Champion First allotted and issued 1 share of US\$1 to Mr. Tse Ping to set off the outstanding indebtedness in the sum of HK\$29,834,244 due from Champion First to Mr. Tse Ping as of 30 June, 2000.

Henceforth, the amounts due to a shareholder and a company related to a shareholder, which aggregatedly amounted to HK\$76,594,761 as at 30 June, 2000, were capitalised.

Save as aforesaid, no other material significant events have taken place subsequent to 31 May, 2000.

8. SUBSEQUENT FINANCIAL STATEMENTS

No audited financial statements have been prepared by the Company or its subsidiaries in respect of any period subsequent to 31 May, 2000.

Yours faithfully,
Ernst & Young
Certified Public Accountants
Hong Kong