

The following is the text of a report, prepared for the purpose of inclusion in this prospectus, from the auditors and reporting accountants of the Company, PricewaterhouseCoopers, Certified Public Accountants, Hong Kong.



羅兵咸永道會計師事務所

PricewaterhouseCoopers
22nd Floor Prince's Building
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30th January, 2002

The Directors
Vital BioTech Holdings Limited
Core Pacific - Yamaichi Capital Limited

Dear Sirs

We set out below our report on the financial information relating to Vital BioTech Holdings Limited (the "Company") and its subsidiaries (hereinafter collectively referred to as the "Group") for each of the two years ended 31st December, 1999 and 2000 and the six months ended 30th June, 2001 (the "Relevant Periods") and as at 30th June, 2001 for inclusion in the prospectus of the Company dated 30th January, 2002 (the "Prospectus") in connection with the listing of the shares of the Company on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited.

The Company was incorporated in the Cayman Islands on 30th May, 2001 under the name of Vital*BioTech Holdings Limited as an exempted company with limited liability under the Companies Law Cap 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands. On 16th July, 2001, the Company changed its name to Vital BioTech Holdings Limited. Pursuant to a group reorganisation (the "Reorganisation") as detailed in the section headed "Group reorganisation" in Appendix IV to the Prospectus, which was completed on 26th January, 2002, the Company became the holding company of the subsidiaries now comprising the Group, details of which are set out in Section VI below.

No audited accounts have been prepared by the Company, Farthinghoe Enterprises Limited, Vital BioTech (Hong Kong) Company Limited, Ever Power Holdings Inc., Gainful Plan Limited, Vital (Sichuan) Biotech Limited and Maxsun International Limited since their respective dates of incorporation/establishment or dates of effective acquisition by the Group. These companies were either newly incorporated/establishment and/or have not been involved in any material transactions since their respective dates of incorporation/establishment or dates of effective acquisition by the Group other than the Reorganisation referred to herein. We have, however, reviewed the unaudited management accounts or, where appropriate, major transactions of these companies since their respective dates of incorporation/establishment or dates of effective acquisition by the Group.

We have acted as auditors of other companies comprising the Group for the Relevant Periods (or from their respective dates of incorporation/establishment or dates of effective acquisition by the Group to 30th June, 2001, where this is a shorter period), except for the following companies in respect of the specified financial periods:

Company	Financial periods	Auditors
Sichuan Weiao Pharmacy Co., Ltd. ("Weiao", formerly Sichuan Kangbai Pharmacy Co., Ltd.)	Year ended 31st December, 2000	Sichuan Tianzheng Certified Public Accountants Limited Certified Public Accountants
Wuhan Tianao Pharmaceuticals Co., Ltd. ("Tianao")	Two years ended 31st December, 2000	Hubei Hongda Certified Public Accountants Limited Certified Public Accountants
Vitapharm Research Pty. Ltd. ("Vitapharm Research")	Two years ended 31st December, 2000 and the six months ended 30th June, 2001	William Buck Chartered Accountants

On 23rd January, 2002, Yugofoil Holdings Limited ("Yugofoil"), a subsidiary of the Group, acquired the entire share capital of Farthinghoe Enterprises Limited ("Farthinghoe"), which directly holds a 100% interest in Vitapharm Research, through a share exchange of Yugofoil's shares to Mr. Ko Sai Ying, Thomas ("Mr. Ko"), Mr. Au Yeung Ping Yuen, Terence ("Mr. Au Yeung") and Mr. Liu Jin, James ("Mr. Liu"), shareholders of Farthinghoe. Yugofoil and Farthinghoe are companies under common control by Mr. Ko, Mr. Au Yeung and Mr. Liu, who are directors and initial management shareholders of the Company, and accordingly the financial information of Farthinghoe and Vitapharm Research for the Relevant Periods and as at 30th June, 2001 has been included in the Group on a combined basis as a reorganisation of companies under common control.

For the purpose of this report, we have undertaken independent audits of the accounts of Weiao and Tianao for the year ended 31st December, 2000 and the six months ended 30th June, 2001 and of the accounts of Vitapharm Research for the Relevant Periods in accordance with Statements of Auditing Standards issued by the Hong Kong Society of Accountants. The accounts of Tianao, prepared in accordance with accounting principles generally accepted in Hong Kong, for the year ended 31st December, 1999 were audited by K. L. Lee & Partners CPA Limited, Certified Public Accountants in Hong Kong.

All companies now comprising the Group have adopted 31st December as their financial year end date throughout the Relevant Periods.

We have examined the audited accounts or, where appropriate, the management accounts of the companies now comprising the Group for the Relevant Periods or from their respective dates of incorporation/establishment or dates of effective acquisition by the Group to 30th June, 2001, where this is a shorter period, and carried out such additional procedures as are necessary in accordance with the Auditing Guideline "Prospectuses and the Reporting Accountant" issued by the Hong Kong Society of Accountants.

The summary of the combined results of the Group for the Relevant Periods and the summary of the combined net assets of the Group as at 30th June, 2001 (the "Summaries") as set out in this report, have been prepared based on the audited accounts or, where appropriate, management accounts of all companies now comprising the Group, on the basis set out in Section III(1) below, after making such adjustments as are appropriate. The directors of the respective companies of the Group are responsible for preparing these accounts which give a true and fair view. In preparing these accounts which give a true and fair view, it is fundamental that appropriate accounting policies are selected and applied consistently.

The directors of the Company (the "Directors") are responsible for the Summaries. It is our responsibility to form an independent opinion on the Summaries.

In our opinion, the Summaries, together with the sections thereto, for the purpose of this report, and prepared on the basis set out in Section III(1) below, give a true and fair view of the combined results of the Group for the Relevant Periods and of the combined net assets of the Group as at 30th June, 2001.

I. COMBINED RESULTS

The following is a summary of the combined results of the Group for the Relevant Periods, prepared on the basis set out in Section III(1) below, and after making such adjustments as are appropriate:

		Year ended 31st December,		Six months ended 30th June,
	Section	1999	2000	2001
		HK\$'000	HK\$'000	HK\$'000
Turnover	III (3)	22,875	64,128	52,767
Cost of sales		<u>(14,435)</u>	<u>(37,921)</u>	<u>(28,953)</u>
Gross profit		8,440	26,207	23,814
Other revenues	III (3)	10	28	58
Selling and distribution expenses		(1,084)	(1,452)	(1,333)
Administrative expenses		(2,546)	(5,504)	(5,427)
Other operating expenses (net)		<u>(1,441)</u>	<u>(2,146)</u>	<u>(2,195)</u>
Operating profit	III (5)	3,379	17,133	14,917
Finance costs	III (6)	<u>(2,233)</u>	<u>(1,836)</u>	<u>(1,220)</u>
Profit before taxation		1,146	15,297	13,697
Taxation	III (7)	<u>—</u>	<u>(15)</u>	<u>(25)</u>
Profit after taxation		1,146	15,282	13,672
Minority interests		<u>(545)</u>	<u>(743)</u>	<u>(188)</u>
Profit attributable to shareholders		<u>601</u>	<u>14,539</u>	<u>13,484</u>
Dividends	III (11)	<u>—</u>	<u>—</u>	<u>—</u>

II. COMBINED NET ASSETS

The following is a summary of the combined net assets of the Group as at 30th June, 2001, prepared on the basis set out in Section III(1) below, and after making such adjustments as are appropriate:

	<i>Section</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Non-current assets			
Intangible assets	<i>III (13)</i>		8,696
Fixed assets	<i>III (14)</i>		<u>26,305</u>
			35,001
Current assets			
Inventories	<i>III (15)</i>	5,898	
Trade receivables		38,321	
Other receivables	<i>III (16)</i>	4,963	
Prepayments and other deposits	<i>III (17)</i>	15,238	
Value added tax recoverable		2	
Bank balances and cash	<i>III (18)</i>		
– pledged		5,081	
– unpledged		<u>15,964</u>	
		85,467	
Current liabilities			
Trade payables		19,692	
Accrued charges and other payables	<i>III (19)</i>	13,122	
Amounts due to minority shareholders of subsidiaries	<i>III (20)</i>	6,127	
Amounts due to Directors	<i>III (21)</i>	4,772	
Amount due to a related company	<i>III (21)</i>	210	
Tax payable		40	
Value added tax payable		2,942	
Current portion of long-term bank loans	<i>III (24)</i>	1,887	
Short-term bank loans	<i>III (22)</i>	20,566	
Trust receipt loans		3,794	
Other loans	<i>III (23)</i>	<u>6,009</u>	
		<u>79,161</u>	
Net current assets			6,306
Non-current liabilities			
Long-term bank loans	<i>III (24)</i>		(12,264)
Minority interests			
			<u>(1,704)</u>
Net assets			<u><u>27,339</u></u>

III. NOTES TO THE FINANCIAL INFORMATION

(1) Basis of preparation

The summary of the combined results includes the results of the companies now comprising the Group as if the current group structure had been in existence throughout the Relevant Periods, or since their respective dates of incorporation/establishment or dates of effective acquisition by the Group, whichever is a shorter period.

Weiao and Tianao were acquired by the Group during the Relevant Periods (refer Section VI notes (c) and (d)) and accordingly the Group includes the results of these companies under acquisition accounting from the respective dates of effective acquisition. Farthinghoe and Vitapharm Research were acquired by the Group through a share exchange on 23rd January, 2002 (refer Section VI note (a)) and their financial information for the Relevant Periods and as at 30th June, 2001 has been included in the Group on a combined basis as a reorganisation of companies under common control as disclosed above.

The summary of the combined net assets of the Group as at 30th June, 2001 has been prepared to present the assets and liabilities of the Group as at that date as if the current group structure had been in existence at that date.

All significant inter-company transactions and balances within the Group have been eliminated on combination.

Minority interests represent the interests of outside shareholders in the operating results and net assets of subsidiaries.

(2) Principal accounting policies

The financial information is prepared under the historical cost convention. The principal accounting policies adopted in the preparation of the financial information in this report are set out below. These policies conform with accounting principles generally accepted in Hong Kong and comply with accounting standards issued by the Hong Kong Society of Accountants.

(a) Subsidiaries

A subsidiary is an entity in which the Group has an interest of more than one half of the voting rights, or otherwise has power to exercise control over the operations.

(b) Intangible assets

Intangible assets comprise goodwill and patent.

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets of the acquired subsidiary at the date of acquisition. Goodwill on acquisition is included in intangible assets and is amortised using the straight-line method over its estimated useful life, which is generally 10 to 13 years.

Amount paid or payable on acquired patent is capitalised in the balance sheet and is amortised by equal annual instalments over the estimated useful life of fifteen years.

The carrying amount of each intangible asset is reviewed when there is an indication that an asset is impaired. An asset is considered to be impaired when its carrying amount exceeds its recoverable amount. The loss as a result of impairment is recognised in the operating profit.

(c) Construction in progress

Construction in progress is investment in buildings where construction work has not been completed. The investment is carried at cost which includes development and construction expenditure incurred and interest and other direct costs attributable to the development less any accumulated impairment losses.

No depreciation is provided for construction in progress.

(d) Fixed assets

Fixed assets consist of construction in progress (Section III (2)(c)), land use rights and other tangible fixed assets.

Land use rights are stated at cost and are amortised over the unexpired period of rights granted on a straight-line basis.

Other tangible fixed assets are stated at cost less accumulated depreciation and are depreciated at rates sufficient to write off their cost over their estimated useful lives on a straight-line basis. The principal annual rates are summarised as follows:

Leasehold improvements	20% or over lease term, whichever is shorter
Plant and machinery	6.67% – 12.5%
Motor vehicles	20%
Furniture and fixtures	10 – 20%
Office equipment	10 – 20%

Major costs incurred in restoring fixed assets to their normal working condition are charged to the operating profit. Improvements are capitalised and depreciated over their expected useful lives to the Group.

The carrying amount of a fixed asset is reviewed when there is an indication that an asset is impaired. An asset is considered to be impaired when its carrying amount exceeds its recoverable amount. Recoverable amount is the higher of an asset's net selling price and its value in use. The loss as a result of impairment is recognised in the operating profit.

The gain or loss on disposal of a fixed asset is the difference between the net sales proceeds and the carrying amount of the relevant asset, and is recognised in the operating profit.

(e) Assets under operating leases

Leases where substantially all the risks and rewards of ownership of assets remain with the leasing company are accounted for as operating leases. Payments made under operating leases net of any incentives received from the leasing company are charged to the operating profit on a straight-line basis over the lease term.

(f) Inventories

Inventories mainly represent pharmaceutical products, which comprise stocks and work in progress, and are stated at the lower of cost and net realisable value. Cost, calculated on the weighted average basis, comprises materials, direct labour and an appropriate proportion of all production overhead expenditure. Net realisable value is determined on the basis of anticipated sales proceeds less estimated selling expenses.

(g) Accounts receivable

Provision is made against accounts receivable to the extent that they are considered to be doubtful. Accounts receivable in the balance sheet are stated net of such provision.

(h) Government grants

Government grants relating to monetary assets that become receivable as compensation for expenses or losses already incurred or for the purpose of providing financial assistance to the Group with no future related costs are recognised as income in the period in which they become receivable.

The monetary assets received or receivable under the government grants are recorded as assets of the Group at fair value at the date of the grants.

(i) Revenue recognition

The Group recognises revenue on the following bases:

- (i) Revenue from the sale of goods is recognised on the transfer of risks and rewards of ownership, which generally coincides with the time when the goods are delivered to customers and the title has passed.
- (ii) Consultancy fee income is recognised when the services are rendered.
- (iii) Interest income is recognised on a time proportion basis, taking into account the principal amounts outstanding and the interest rates applicable.
- (iv) Operating lease rental income is recognised on a straight-line basis over the period of each lease.

(j) Retirement benefit costs

The subsidiaries in Hong Kong and Australia operate defined contribution schemes which are available to qualified employees. The assets of the schemes are held separately from those of the subsidiaries in independently administered funds. Monthly contributions made by the subsidiaries are calculated based on certain percentages of the applicable payroll costs. Contributions under the defined contribution schemes are charged to the operating profit as incurred.

Pursuant to the relevant regulations of the municipal governments in China mainland, the subsidiaries of the Group in this country participate in respective government retirement benefit schemes (the "Schemes") whereby the subsidiaries are required to contribute to the Schemes to fund the retirement benefits of the eligible employees. Contributions made to the Schemes are calculated based on certain percentages of the applicable payroll costs, as stipulated under the requirements in China mainland. The municipal governments of China mainland are responsible for the entire pension obligations payable to the retired employees. The only obligation of the Group with respect to the Schemes is to pay the ongoing required contributions under the Schemes. Contributions under the Schemes are charged to the operating profit as incurred.

(k) Research and development costs

Research and development costs are expensed as incurred, except where it is expected that the technical feasibility and intention of completing the product under development has been demonstrated and the resources are available to do so, costs are identifiable and there is an ability to sell or use the asset that will generate probable future economic benefits. During the Relevant Periods, all research and development costs incurred have been expensed to the operating profit as no such costs satisfied the criteria for capitalisation as an asset.

(l) Borrowing costs

Borrowing costs that are directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale are capitalised as part of the cost of that asset.

All other borrowing costs are charged to the profit and loss account in the period in which they are incurred.

(m) Pre-operating costs

Pre-operating costs are expensed in the period in which they are incurred.

(n) Deferred taxation

Deferred taxation is accounted for at the current tax rate in respect of timing differences between profit as computed for taxation purposes and profit as stated in the accounts to the extent that a liability or an asset is expected to be payable or recoverable in the foreseeable future.

(o) Translation of foreign currencies

Transactions in foreign currencies are translated at exchange rates ruling at the transaction dates. Monetary assets and liabilities expressed in foreign currencies at the balance sheet date are translated at rates of exchange ruling at the balance sheet date. All exchange differences are dealt with in the operating profit.

The accounts of subsidiaries expressed in foreign currencies are translated at rates of exchange ruling at the balance sheet date. Exchange differences are dealt with as a movement in reserves.

(p) Related parties

For the purpose of this report, parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common control or common significant influence. Related parties may be individuals or other entities.

(3) Revenues and turnover

The Group is principally engaged in the trading and manufacturing of pharmaceutical products and the provision of consultancy services in connection with pharmaceutical business. Turnover represents invoiced value of sales, net of returns, discounts allowed or sales taxes, where applicable, and consultancy fee. The amounts of each significant category of revenues during the Relevant Periods are as follows:

	Year ended		Six months
	31st December,		ended
	1999	2000	30th June,
	<i>HK\$'000</i>	<i>HK\$'000</i>	2001
			<i>HK\$'000</i>
Turnover			
Sale of goods	22,875	63,725	52,767
Consultancy fee	—	403	—
	<u>22,875</u>	<u>64,128</u>	<u>52,767</u>
Other revenues			
Interest income	10	28	20
Rental income from hire of plant and machinery	—	—	38
	<u>10</u>	<u>28</u>	<u>58</u>
Total revenues	<u><u>22,885</u></u>	<u><u>64,156</u></u>	<u><u>52,825</u></u>

(4) Segmental information

No segmental information analysed by principal activity is separately presented as the Group's segment revenue, expenses, results, assets and liabilities are primarily attributable to the trading and manufacturing of pharmaceutical products.

No segmental information analysed by geographical area is separately presented as the Group's principal market is China mainland.

(5) Operating profit

	Year ended		Six months
	31st December,		ended
	1999	2000	30th June,
	<i>HK\$'000</i>	<i>HK\$'000</i>	2001
			<i>HK\$'000</i>
Operating profit is stated after crediting and charging the following:			
Crediting:			
Grants and subsidy from governments (note)	<u>—</u>	<u>16</u>	<u>200</u>
Charging:			
Amortisation of intangible assets	566	692	416
Auditors' remuneration	83	104	94
Cost of inventories sold	11,920	30,602	23,534
Depreciation and amortisation of fixed assets	720	669	468
Operating lease rental expense on land and buildings	621	712	405
Provision for trade receivables	126	221	—
Provision for other receivables	—	286	95
Provision for inventories	—	259	292
Research and development costs	21	216	534
Staff costs	<u>2,150</u>	<u>3,843</u>	<u>4,267</u>

Note:

During the six months ended 30th June, 2001, the Group received a subsidy of HK\$142,000 from the People's Government of Wuhan City, the People's Republic of China (the "PRC"), in respect of finance costs of a subsidiary as assistance for the Group's development of the pharmaceutical business in that region.

The grants and subsidy have been deducted from other operating expenses.

(6) Finance costs

	Year ended		Six months
	31st December,		ended
	1999	2000	30th June,
	<i>HK\$'000</i>	<i>HK\$'000</i>	2001
			<i>HK\$'000</i>
Interest expense on:			
– amount due to a minority shareholder of a subsidiary (<i>Section III(20)</i>)	–	16	255
– bank loans	1,608	1,289	723
– other loans wholly repayable within five years	398	313	153
– trade payables	212	165	–
– loans due to staff	–	–	53
– trust receipt loans	–	69	444
– finance leases	15	–	–
	<hr/>	<hr/>	<hr/>
Total borrowing costs incurred	2,233	1,852	1,628
Less: Interest capitalised on construction in progress	–	(16)	(408)
	<hr/>	<hr/>	<hr/>
Total borrowing costs charged to the profit and loss account	<u>2,233</u>	<u>1,836</u>	<u>1,220</u>

The capitalisation rate applied to funds borrowed generally and used for the development of construction in progress is between 6.63% and 18% per annum (2000: 7.56% per annum; 1999: nil).

(7) Taxation

Hong Kong profits tax has been provided at the rate of 16% on the estimated assessable profits in Hong Kong for the year ended 31st December, 2000 and the six months ended 30th June, 2001. No Hong Kong profits tax was provided for the year ended 31st December, 1999 as the Group had no estimated assessable profits for that year.

The subsidiaries of the Group in China mainland have been granted tax exemption from income tax for two years starting from the first year of profitable operations after setting off accumulated losses brought forward, followed by a 50% reduction in income tax for the next three years. These subsidiaries were still under the tax holiday during the Relevant Periods.

No Australian income tax has been provided as the subsidiary operating in Australia had no estimated assessable profits during the Relevant Periods.

The amount of taxation charged to the combined profit and loss account represents:

	Year ended		Six months
	31st December,		ended
	1999	2000	30th June,
	<i>HK\$'000</i>	<i>HK\$'000</i>	2001
			<i>HK\$'000</i>
Hong Kong profits tax	—	15	25
	<u>—</u>	<u>15</u>	<u>25</u>
	<u>—</u>	<u>15</u>	<u>25</u>

For the Relevant Periods, deferred taxation in respect of timing differences between profit as computed for taxation purposes and profit as stated in the accounts has not been accounted for as the effect of timing differences is not material.

(8) Retirement benefit costs

	Year ended		Six months
	31st December,		ended
	1999	2000	30th June,
	<i>HK\$'000</i>	<i>HK\$'000</i>	2001
			<i>HK\$'000</i>
Retirement benefit costs	48	172	170
	<u>48</u>	<u>172</u>	<u>170</u>

The retirement benefit costs represent gross contributions paid and payable by the Group to the schemes operated by the municipal governments of China mainland and the defined contribution schemes operated in Hong Kong and Australia (collectively the "Retirement Schemes"). Contributions totalling HK\$56,000 payable to the Retirement Schemes as at 30th June, 2001 are included in accrued charges and other payables. There were no forfeited contributions throughout the Relevant Periods.

(9) Directors' and senior management's emoluments

- (i) Details of the emoluments paid and payable to the Directors during the Relevant Periods are as follows:

	Year ended 31st December,		Six months ended 30th June,
	1999	2000	2001
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Fees	–	–	–
Salaries, allowances and benefits in kind	473	1,175	1,164
Bonuses	–	–	–
Retirement scheme contributions	33	76	74
	<u>506</u>	<u>1,251</u>	<u>1,238</u>

Each of the four executive directors of the Company received emoluments from subsidiaries of approximately HK\$Nil, HK\$337,000, HK\$169,000 and HK\$Nil for the year ended 31st December, 1999, approximately HK\$200,000, HK\$529,000, HK\$325,000 and HK\$197,000 for the year ended 31st December, 2000, and approximately HK\$240,000, HK\$408,000, HK\$295,000 and HK\$295,000 for the six months ended 30th June, 2001.

No emoluments were paid to non-executive directors of the Company during the Relevant Periods.

The emoluments of the Directors fall into the following bands:

	Number of Directors		
	Year ended 31st December,		Six months ended 30th June,
	1999	2000	2001
Emolument bands			
Nil to HK\$1,000,000	<u>6</u>	<u>6</u>	<u>6</u>

- (ii) The five individuals whose emoluments were the highest in the Group for the years ended 31st December, 1999 and 2000 and the six months ended 30th June, 2001 include two, four, and four directors of the Company respectively whose emoluments are reflected in the analysis presented above. The five individuals whose emoluments were the highest in the Group were as follows:

	Year ended		Six months
	31st December,		ended
	1999	2000	30th June,
	HK\$'000	HK\$'000	2001
			HK\$'000
Directors	506	1,251	1,238
Employees	217	209	294
	<u>723</u>	<u>1,460</u>	<u>1,532</u>

- (iii) Details of the emoluments paid by the Group to the highest paid employees as mentioned in Section III(9)(ii) above are as follows:

	Year ended		Six months
	31st December,		ended
	1999	2000	30th June,
	HK\$'000	HK\$'000	2001
			HK\$'000
Salaries, allowances and benefits in kind	217	209	281
Bonuses	—	—	—
Retirement scheme contributions	—	—	13
	<u>217</u>	<u>209</u>	<u>294</u>

The emoluments of these highest paid employees fall into the following bands:

	Number of individuals		
	Year ended		Six months
	31st December,		ended
	1999	2000	30th June,
			2001
Emolument bands			
Nil to HK\$1,000,000	<u>3</u>	<u>1</u>	<u>1</u>

- (iv) During the Relevant Periods, no emoluments have been paid by the Group to the Directors or the five highest paid individuals as an inducement to join or upon joining the Group, or as compensation for loss of office. No Directors waived or agreed to waive any emoluments during the Relevant Periods.

(10) Earnings per share

No earnings per share information is presented as its inclusion would not be meaningful due to the Reorganisation and preparation of the results on a combined basis, as disclosed in Section III(1) above.

(11) Dividends

No dividends have been paid or declared by the Company since its incorporation or by companies now comprising the Group to their then shareholders during the Relevant Periods.

(12) Related party transactions

In addition to those transactions and balances with related parties disclosed in Section III (6), (13), (16), (20), (21), (22), (23) and (30) and Section V of this report, the following significant related party transactions have been entered into by the Group during the Relevant Periods:

Non-continuing transactions

	Year ended		Six months
	31st December,		ended
	1999	2000	30th June,
	HK\$'000	HK\$'000	2001
			HK\$'000
(a) Management fee paid to Wuhan Institute of Virology, the Chinese Academy of Sciences (中國科學院武漢病毒研究所)	425	425	—

Management fee was paid to Wuhan Institute of Virology, the Chinese Academy of Sciences ("Wuhan Institute of Virology"), an immediate holding company of the minority shareholder of Tianao, at a lump sum of RMB450,000 (equivalent of approximately HK\$425,000) per annum as set out in an agreement entered into between Tianao and Wuhan Institute of Virology dated 26th January, 1997 for the period from February 1997 to December 2000. No management fee was charged by Wuhan Institute of Virology for the six months ended 30th June, 2001.

- (b) As at 31st December, 1999 the Group had an amount of approximately HK\$4,290,000 due by a company of which two of its directors are also the directors of Tianao. The balance was interest free, unsecured and had no fixed terms of repayment. The balance was fully settled as at 31st December, 2000.

If interest was charged on this balance at best lending rate in the PRC for the year ended 31st December, 1999, the amount of notional interest would not be significant to the Group's combined results.

- (c) On 26th December, 2000, Maxsun International Limited ("Maxsun"), a subsidiary of the Group, purchased a trademark of Osteoform from Pharmco International, Inc., a company wholly owned by the minority shareholders of Maxsun, at a consideration of US\$1.

- (d) No interest was charged on certain amounts due to minority shareholders of subsidiaries, amounts due to Directors and a related company during the Relevant Periods. If interest was charged on the amounts due to minority shareholders of subsidiaries, Directors and a related company at best lending rates in the PRC, Hong Kong Interbank Offered Rate, or best lending rates in Australia, where appropriate, for each of the Relevant Periods, the amount of notional interest would not be significant to the Group's combined results.

The Directors consider that the above transactions were conducted in the ordinary course of the Group's businesses. The Directors have confirmed that these transactions will not continue after the listing of the Company's shares.

Continuing transactions

		Year ended		Six months
	Note	31st December,	2000	ended
		1999	2000	30th June,
		HK\$'000	HK\$'000	2001
				HK\$'000
Rental expense paid to				
Wuhan Institute of Virology	(e)	208	226	113
Rental and renovation expenses paid to				
Wuhan Maxin Industrial Company				
Limited (武漢馬新實業有限公司)	(f)	329	329	78
Raw materials purchased from				
Pharmco International Inc.	(g)	—	12,928	11,221

Notes:

- (e) Rental expense was paid to Wuhan Institute of Virology at a lump sum of RMB220,000 (equivalent of approximately HK\$208,000) and RMB240,000 (equivalent of approximately HK\$226,000) per annum for the years ended 31st December, 1999 and 2000 respectively as set out in an agreement entered into between Tianao and Wuhan Institute of Virology dated 26th January, 1997. Rental expense was paid to Wuhan Institute of Virology at a lump sum of RMB240,000 (equivalent of approximately HK\$226,000) per annum for the year ending 31st December, 2001 as set out in an agreement entered into between Tianao and Wuhan Institute of Virology dated 20th December, 2000 and an addendum dated 20th January, 2001.
- (f) Pursuant to agreements entered into between Tianao and Wuhan Maxin Industrial Company Limited (武漢馬新實業有限公司) ("Wuhan Maxin"), a company of which Mr. Huang Jian Ming, one of its directors, is also the director of Tianao, rental expenses of RMB30,680 (equivalent of approximately HK\$29,000) and renovation expenses of RMB666,400 (equivalent of approximately HK\$629,000) were paid to Wuhan Maxin for the two years ended 31st December, 2000. The total expenses incurred as aforementioned of HK\$658,000 was amortised on a straight-line basis over the lease term during 1999 and 2000.

Rental expense was paid to Wuhan Maxin at an amount of RMB13,800 (equivalent of approximately HK\$13,000) per month for a term of six years commencing on 1st January, 2001 as set out in an agreement entered into between Tianao and Wuhan Maxin dated 15th March, 2001. The rental expense for the six months ended 30th June, 2001 was HK\$78,000.

- (g) Beshabar Trading Limited ("Beshabar (HK)"), a company incorporated in Hong Kong and a wholly owned subsidiary of the Group, purchased raw materials from Pharmco International Inc at prices and terms as set out in the agreement entered into between Beshabar (HK) and Pharmco International Inc.

The Directors consider that the above transactions were conducted in the ordinary course of the Group's businesses. The Directors have confirmed that these transactions will continue after the listing of the Company's shares.

(13) Intangible assets

	Cost	Accumulated amortisation	Net book value
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Goodwill	7,960	(1,246)	6,714
Patent	2,831	(849)	1,982
	<u>10,791</u>	<u>(2,095)</u>	<u>8,696</u>

The goodwill arose from the acquisitions of Tianao and Weiao by the Group during the Relevant Periods.

The patent represented the right in respect of knowledge knowhow and related manufacturing process of a pharmaceutical product acquired from Wuhan Institute of Virology upon establishment of Tianao in 1996. The cost of the patent to the Group was determined by reference to a valuation conducted by Wuhan Zhong Hua Certified Public Accountants.

(14) Fixed assets

	Cost	Accumulated depreciation/ amortisation	Net book value
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Construction in progress	14,405	–	14,405
Land use rights	7,999	(63)	7,936
Leasehold improvements	1,523	(756)	767
Plant and machinery	3,253	(1,194)	2,059
Motor vehicles	1,553	(1,028)	525
Furniture and fixtures	595	(320)	275
Office equipment	367	(29)	338
	<u>29,695</u>	<u>(3,390)</u>	<u>26,305</u>

Notes:

- (a) The Group's land use rights are held outside Hong Kong under leases of 10 to 50 years.
- (b) At 30th June, 2001, the net book value of fixed assets pledged as security for the Group's long-term bank loans amounted to approximately HK\$22,341,000.
- (c) The aggregate cost and accumulated depreciation of the plant and machinery held for use in operating leases as at 30th June, 2001 amounted to approximately HK\$344,000 and HK\$157,000 respectively.

(15) Inventories

	<i>HK\$'000</i>
Raw materials	3,055
Work in progress	221
Finished goods	2,576
Packing materials	46
	<hr/>
	5,898
	<hr/> <hr/>

At 30th June, 2001, all inventories were carried at cost.

(16) Other receivables

- (a) Included in other receivables was a short-term loan of approximately HK\$2,830,000 to Sichuan Zhongwei Biotechnology Development Company Limited (四川中維生物技術開發有限公司) ("Sichuan Zhongwei"), an independent third party. The loan was to finance the research and development activities undertaken by Sichuan Zhongwei which the Directors believe would be beneficial to the Group. The loan has been settled subsequent to 30th June, 2001.
- (b) Included in other receivables were amounts of approximately HK\$1,733,000 due from two directors of subsidiaries as at 30th June, 2001. These amounts are unsecured, interest free and have no fixed terms of repayment. The amounts have been settled subsequent to 30th June, 2001.

(17) Prepayments and other deposits

Prepayments and other deposits mainly related to the purchases of fixed assets and raw materials amounting to approximately HK\$5,441,000 and HK\$7,344,000 respectively.

(18) Bank balances and cash

Included in bank balances and cash as at 30th June, 2001 were amounts of approximately HK\$18,033,000 denominated in Renminbi not freely convertible to other currencies.

Included in bank balances and cash as at 30th June, 2001 were deposits of approximately HK\$3,577,000 and HK\$1,504,000 pledged as collateral for short-term bank loans (Section III(22)) and trust receipt loans (Section III(30)) respectively.

(19) Accrued charges and other payables

Accrued charges and other payables mainly represented outstanding payables of approximately HK\$6,895,000 for purchases of land use rights.

Included in accrued charges and other payables were also loans from staff amounting to approximately HK\$947,000. These loans were interest bearing at a fixed interest rate of 18% per annum, and repayable within six months from date when the loans were granted. These loans have been fully repaid subsequent to 30th June, 2001.

(20) Amounts due to minority shareholders of subsidiaries

The amounts due to minority shareholders of subsidiaries mainly represented a loan from Sichuan Kangao Pharmaceutical Technology Development Co., Ltd. (四川康奧醫藥科技開發有限責任公司), a minority shareholder of Weiao, of approximately HK\$4,387,000 and the outstanding payable to Wuhan Tianao Pharmaceutical Factory (武漢天奧製藥廠), a minority shareholder of Tianao, for purchase of equity interest in Tianao of approximately HK\$1,193,000. The amounts are unsecured, interest free and have no fixed terms of repayment, except for the loan from Sichuan Kangao Pharmaceutical Technology Development Co., Ltd. of approximately HK\$4,387,000 which is interest bearing at 7.56% per annum.

(21) Amounts due to Directors and a related company

Amounts due to Mr. Tao Lung and Mr. Ko, Directors, and a related company which is owned by the spouse of Mr. Au Yeung, a Director, of approximately HK\$4,352,000, HK\$420,000 and HK\$210,000 respectively are unsecured, interest free and have no fixed terms of repayment. The amounts have been settled subsequent to 30th June, 2001.

(22) Short-term bank loans

As at 30th June, 2001, short-term bank loans of approximately HK\$12,547,000 and approximately HK\$3,396,000 were secured by properties of Wuhan Maxin and certain bank deposits of Weiao respectively. Short-term bank loans of approximately HK\$2,830,000 and approximately HK\$1,793,000 were guaranteed by Wuhan Maxin and The Chinese Academy of Sciences, Wuhan Branch (中國科學院武漢分院), an intermediate holding company of the minority shareholder of Tianao, respectively.

The bankers of short-term bank loans have agreed in principle that the securities and guarantees provided by Wuhan Maxin will be released and replaced by corporate guarantees to be given by Weiao upon the listing of the Company's shares. The Directors have undertaken to fully repay the short-term bank loan guaranteed by The Chinese Academy of Sciences, Wuhan Branch, upon the listing of the Company's shares.

(23) Other loans

As at 30th June, 2001, other loan of approximately HK\$2,830,000 was secured by properties of Wuhan Maxin and was wholly repayable within one year. The lender has agreed in principle that the securities provided by Wuhan Maxin will be released and replaced by a corporate guarantee to be given by the Company upon the listing of the Company's shares.

Included in other loans are also loans of approximately HK\$693,000 from certain strategic investors. These loans are unsecured, interest free and have been fully repaid subsequent to 30th June, 2001.

(24) Long-term bank loans

	<i>HK\$'000</i>
Secured bank loans wholly repayable within five years	14,151
Current portion of long-term bank loans	(1,887)
	<hr/>
Long-term portion	<u>12,264</u>

The maturity of the long-term bank loans is as follows:

	<i>HK\$'000</i>
Within one year	1,887
In the second year	2,830
In the third to fifth years inclusive	9,434
	<hr/>
	<u>14,151</u>

The loans are secured by certain fixed assets of Weiao.

(25) Deferred taxation

At 30th June, 2001, the Group had no material unprovided deferred taxation.

(26) Movement in reserves

Movements in reserves of the Group for the Relevant Periods are set out as follows:

	Year ended		Six months
	31st December,		ended
	1999	2000	30th June,
	<i>HK\$'000</i>	<i>HK\$'000</i>	2001
			<i>HK\$'000</i>
Reserve fund (<i>note</i>)			
Transfer from retained profits	—	42	—
	<u> </u>	<u> </u>	<u> </u>
Enterprise development fund (<i>note</i>)			
Transfer from retained profits	—	21	—
	<u> </u>	<u> </u>	<u> </u>
Retained profits			
Profit for the year/period	601	14,539	13,484
Transfer to various funds	—	(63)	—
	<u> </u>	<u> </u>	<u> </u>

Note:

In accordance with the relevant government regulations and the articles of association of Tianao in the PRC, it is required to appropriate at each year end 10% and 5% respectively of the profit for the year, after setting off accumulated losses brought forward, (based on figures reported in the statutory accounts) to reserve fund and enterprise development fund respectively. The appropriation is made only at the year end.

(27) Capital commitments

As at 30th June, 2001, the Group had the following capital commitments which related to the construction in progress.

	<i>HK\$'000</i>
Authorised but not contracted for	—
Contracted but not provided for	20,321
	<u> </u>
	<u>20,321</u>

(28) Lease commitments

At 30th June, 2001, the Group had total future aggregate minimum lease payments in respect of land and buildings under non-cancellable operating leases as follows:

	<i>HK\$'000</i>
Within one year	1,258
In the second to fifth year inclusive	1,208
After the fifth year	191
	<hr/>
	<u>2,657</u>

(29) Contingent liabilities

As at 30th June, 2001, the Group had no significant contingent liabilities.

(30) Banking facilities

The Group had aggregate banking facilities for overdrafts and documentary credits of approximately HK\$7,000,000 as at 30th June, 2001. The facilities were secured by the following:

- (i) a personal guarantee of US\$400,000 from a third party;
- (ii) an unlimited joint and several guarantee of Mr. Tao Lung, a Director, and Mr. Huang Jian Ming, a director of a subsidiary;
- (iii) 5% of gross receipts from trade receivables as deposits pledged to a bank (the deposits pledged was approximately HK\$1,504,000 at 30th June, 2001); and
- (iv) all export documentary credits of a subsidiary.

Subsequent to 30th June, 2001, the guarantee provided by the third party has been released and the banker has agreed in principle that the guarantee provided by Mr. Tao Lung and Mr. Huang Jian Ming will be released upon the listing of the Company's shares.

(31) Distributable reserve of the Company

The Company was incorporated on 30th May, 2001 and there was no reserve available for distribution to its shareholders at 30th June, 2001.

(32) Net assets of the Company

The Company was incorporated in the Cayman Islands on 30th May, 2001. On the basis set out in Section III(1) above, the net asset value of the Company as at 30th June, 2001 would have been approximately HK\$27,339,000, representing its investments in subsidiaries.

IV ULTIMATE HOLDING COMPANY

The Directors regard Perfect Develop Holding Inc., a company incorporated in the British Virgin Islands, as being the ultimate holding company of the Group.

V SUBSEQUENT EVENTS

The following significant events took place subsequent to 30th June, 2001:

- (1) The companies in the Group underwent a group reorganisation in preparation for a listing of the shares of the Company on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited. Details of the reorganisation and the alterations in the share capital of the Company are set out in the subsections headed "Group reorganisation" in Appendix IV to the Prospectus.
- (2) On 21st December, 2001, Mr. Ko, Mr. Au Yeung and Mr. Liu, Directors of the Company lent to the Company an amount of AUD475,000 (equivalent of approximately HK\$1,900,000) for settlement of amounts due to Mr. Ko, and a related company as disclosed in Section III (21) and other loans of approximately HK\$1,270,000 as included in Section III (23) above.

On 23rd January, 2002, the Company allotted and issued, at the joint direction of the three Directors, one share of HK\$0.10 each to Mr. Ko for the settlement of the amount of AUD475,000 due to the Directors.

VI PARTICULARS OF SUBSIDIARIES

Immediately following the completion of the Reorganisation as described in Appendix IV to the Prospectus and for the purpose of this report, the Company has direct and indirect interests in the following subsidiaries, all of which are private companies or, if incorporated outside Hong Kong, have substantially the same characteristics as a Hong Kong incorporated private company. All subsidiaries have adopted 31st December as their financial year end date. Details of these companies are as follows:

Company	Place and date of incorporation/ establishment	Issued and fully paid up capital/ registered capital	Attributable equity interest	Principal activities
Direct subsidiaries:				
Ever Power Holdings Inc.	British Virgin Islands ("BVI") 25th May, 2001	2 ordinary shares of US\$1 each	100%	Investment holding
Farthinghoe Enterprises Limited (<i>note a</i>)	BVI 1st September, 1997	3 ordinary shares of US\$1 each	100%	Investment holding
Gainful Plan Limited	BVI 25th May, 2001	2 ordinary shares of US\$1 each	100%	Investment holding
Yugofoil Holdings Limited	BVI 11th May, 1993	100 ordinary shares of US\$1 each	100%	Investment holding and provision for management services
Vital BioTech (Hong Kong) Limited (<i>note b</i>)	Hong Kong 17th November, 2000	2 ordinary shares of HK\$1 each	100%	Investment holding
Indirect subsidiaries:				
Beshabar Trading Limited	BVI 22nd April, 1997	1 ordinary share of US\$1	100%	Investment holding
Beshabar Trading Limited (formerly Wise Shine Limited)	Hong Kong 25th August, 2000	100 ordinary shares of HK\$1 each	100%	Trading of pharmaceutical products
Maxsun International Limited	Hong Kong 29th March, 2000	100 ordinary shares of HK\$1 each	51%	Investment holding

Company	Place and date of incorporation/ establishment	Issued and fully paid up capital/ registered capital	Attributable equity interest	Principal activities
Indirect subsidiaries:				
Sichuan Weiao Pharmacy Co., Ltd. (formerly Sichuan Kangbai Pharmacy Co., Ltd.) (note c)	PRC 8th January, 1998	RMB9,000,000	76.7%	Manufacturing and trading of pharmaceutical products in the PRC
Wuhan Tianao Pharmaceuticals Co., Ltd. (note d)	PRC 30th October, 1996	RMB7,140,000	95%	Manufacturing and trading of pharmaceutical products in the PRC
Vitapharm Research Pty. Ltd. (note a)	Australia 1st April, 1998	20 ordinary shares of AUD\$1 each	100%	Research and development of pharmaceutical products in Australia
Vital (Sichuan) Biotech Limited	PRC 25th July, 2001	US\$1,400,000 (note e)	100%	Research and development of pharmaceutical products in the PRC

Notes:

- (a) Farthinghoe Enterprises Limited and Vitapharm Research Pty. Ltd. are under common control of Mr. Ko, Mr. Au Yeung and Mr. Liu. These companies were acquired by the Group through a share exchange on 23rd January, 2002 and their financial information for the Relevant Periods and as at 30th June, 2001 has been included in the Group on a combined basis.
- (b) Vital BioTech (Hong Kong) Limited was acquired by the Group on 19th June, 2001.
- (c) Sichuan Weiao Pharmacy Co., Ltd. was acquired by the Group on 16th November, 2000 and its results are included in the Group since that date.
- (d) Equity interests of 70%, 10%, 10% and 5% in Wuhan Tianao Pharmaceuticals Co., Ltd. were acquired by the Group on 10th November, 1998, 3rd November, 1999, 27th December, 1999 and 1st April, 2001 respectively. The results of this subsidiary are accounted for by the Group since its respective dates of acquisitions.
- (e) On 18th October, 2001, the capital of Vital (Sichuan) Biotech Limited was paid up to the extent of US\$210,000.

VII SUBSEQUENT ACCOUNTS

No audited accounts have been prepared for the Company or any of the companies now comprising the Group in respect of any period subsequent to 30th June, 2001.

Yours faithfully,
PricewaterhouseCoopers
Certified Public Accountants
Hong Kong