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## IMPORTANT

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If you are in any doubt about this prospectus, you should consult your stockbroker, bank manager, solicitor, accountant or other professional adviser.



# Tong Ren Tang Technologies Co. Ltd. \*

## 北京同仁堂科技發展股份有限公司

*(a joint stock limited company incorporated in the People's Republic of China with limited liability)*

### Listing on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited by way of Placing

**Number of Shares : 72,800,000 H Shares**  
**(subject to Over-allotment**  
**Option adjustment)**

**Issue price : not more than HK\$3.62 per H Share**

**Nominal value : RMB1.00 each**

**Stock code : 8069**

**Global Coordinator, Sponsor and Lead Manager**



**BOCI Asia Limited**

**Co-Managers**

**BNP Paribas Peregrine Securities Limited**

**CEF Capital Limited**

**Core Pacific-Yamaichi International (H.K.) Limited**

**First Shanghai Capital Limited**

**Grand Cathay Securities (Hong Kong) Limited**

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The Stock Exchange of Hong Kong Limited and Hong Kong Securities Clearing Company Limited take no responsibility for the contents of this prospectus, make no representation as to its accuracy or completeness and expressly disclaim any liability whatsoever for any loss howsoever arising from or in reliance upon the whole or any part of the contents of this prospectus.

A copy of this prospectus, together with the documents specified in the paragraph headed "Documents delivered and available for inspection" in Appendix VIII to this prospectus, has been registered by the Registrar of Companies in Hong Kong as required by Section 342C of the Companies Ordinance of Hong Kong. The Securities and Futures Commission and the Registrar of Companies in Hong Kong take no responsibility as to the contents of this prospectus or any other documents referred to above.

The Company is incorporated, and its businesses are located, in the PRC. Potential investors in the Company should be aware of the differences in the legal, economic and financial systems between the mainland of the PRC and Hong Kong and that there are different risk factors relating to investment in the PRC-incorporated companies. Potential investors should also be aware that the regulatory framework in the PRC is different from the regulatory framework in Hong Kong and should take into consideration the different market nature of the shares of the Company. Such differences and risk factors are set out in the section headed "Risk factors" and Appendix V — "Summary of relevant PRC and Hong Kong laws and regulations".

The Issue Price is expected to be fixed by agreement between BOCI Asia Limited, on behalf of the Placing Underwriters, and the Company before the Price Determination Time and will be not more than HK\$3.62 per H Share although the Company and BOCI Asia Limited, on behalf of the Placing Underwriters, may agree a lower price. The Price Determination Time is on or before 12:00 noon 24 October 2000. If BOCI Asia Limited, on behalf of the Placing Underwriters, and the Company are unable to reach an agreement on the Issue Price or a postponement of the Price Determination Time by 12:00 noon on 24 October 2000, the Placing will not proceed.

24 October 2000

\* For identification purpose only

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## **CHARACTERISTICS OF THE GROWTH ENTERPRISE MARKET (“GEM”)**

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### **Characteristics of The Growth Enterprise Market (“GEM”) of The Stock Exchange of Hong Kong Limited:**

**The GEM has been established as a market designed to accommodate companies to which a high investment risk may be attached. In particular, companies may list on the GEM with neither a track record of profitability nor any obligation to forecast future profitability. Furthermore, there may be risks arising out of the emerging nature of companies listed on the GEM and the business sectors or countries in which the companies operate. Prospective investors should be aware of the potential risks of investing in such companies and should make the decision to invest only after due and careful consideration. The greater risk profile and other characteristics of the GEM mean that it is a market more suited to professional and other sophisticated investors.**

**Given the emerging nature of companies listed on the GEM, there is a risk that securities traded on the GEM may be more susceptible to high market volatility than securities traded on the Main Board and no assurance is given that there will be a liquid market in the securities traded on the GEM.**

**The principal means of information dissemination on the GEM is publication on the Internet website operated by the Stock Exchange. Listed companies are not generally required to issue paid announcements in gazetted newspapers. Accordingly, prospective investors should note that they need to have access to the GEM website at [www.hkgem.com](http://www.hkgem.com) in order to obtain up-to-date information on GEM-listed issuers.**

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## EXPECTED TIMETABLE

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2000

Allocation to placees on or before . . . . . Monday, 30 October

Announcement of the level of indication of interests in the Placing  
to be published on the GEM website at  
www.hkgem.com . . . . . Monday, 30 October

H Share certificates available on or before (*Note*) . . . . . Monday, 30 October

Dealings in the H Shares on the GEM to commence on . . . . . Tuesday, 31 October

*Note:* H Share certificates for the placees who wish to receive their Placing Shares via CCASS will be issued in the name of HKSCC Nominees Limited and are expected to be deposited into CCASS on or before 30 October 2000 for the purpose of crediting the same to the respective CCASS participants' stock accounts designated by the placees. No temporary documents of title will be issued.

For details of the structure of the Placing, including conditions thereto, see the section headed "Structure and conditions of the Placing" in this prospectus.

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*You should rely only on the information contained in this prospectus to make your investment decision.*

*The Company has not authorized anyone to provide you with information that is different from what is contained in this prospectus.*

*Any information or representation not made in this prospectus must not be relied on by you as having been authorized by the Company, the Sponsor, the Placing Underwriters, the directors of any of them, or any other parties involved in the Placing.*

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## SUMMARY OF THIS PROSPECTUS

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*This summary aims to give you an overview of the information contained in this prospectus. As it is a summary, it does not contain all the information that may be important to you. You should read the whole document before you decide to invest in the H Shares.*

*Any investment is associated with risk. Some of the particular risks in investing in the H Shares are set out in the section headed "Risk factors". You should read that section carefully before you decide to invest in the H Shares.*

### INTRODUCTION

The Company was established by Tongrentang Holdings, Tongrentang Ltd. and six individual promoters on 22 March 2000. The Company is mainly engaged in the manufacturing and sales of Chinese Patent Medicine. The Company strives to promote modern Chinese medicine into the mainstream international pharmaceutical market by improving its existing Chinese medical products and strengthening the research on natural medicine. At the same time, the Company endeavours to expand its sales networks and venture into the e-business in the area of Chinese medicine.

### EXISTING BUSINESS

The existing operations of the Company consist of Factory No. 2, the Chinese Medicine Refinery, Import and Export Department and Research and Development Centre. Currently, the main forms of the Company's Chinese medicine products sold are: granules (沖劑), pills (水蜜丸劑), tablets (片劑) and soft capsules (軟膠囊劑). Total turnover generated from these 4 forms of Chinese medicine amounted to approximately RMB145.9 million (HK\$137.5 million), RMB201.1 million (HK\$189.5 million) and RMB92.0 million (HK\$86.6 million) for the two years ended 31 December 1999 and the four months ended 30 April 2000 respectively, which represented 59%, 65% and 73% of the Company's total turnover for the respective periods. The rest of the turnover was attributable to the sales of other forms of products manufactured by the Company.

The main products are Ganmao Qingre Granule (感冒清熱沖劑), Liuwei Dihuang Pill (六味地黃丸), Niu Huang Jiedu Tablet (牛黃解毒片) and Banlangen Granule (板藍根沖劑) etc. For the two years ended 31 December 1999 and the four months ended 30 April 2000, total turnover of these products were RMB112 million (HK\$106 million), RMB156 million (HK\$147 million) and RMB72 million (HK\$68 million) respectively, which accounted for 45%, 51% and 57% of the Company's turnover for the respective periods.

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The Company has 11 workshops. Among the 275 Chinese Patent Medicine which have obtained approval for production from SPSAC, MPH and other relevant authorities by the Company, 10 were granted State Class 2 protection to enjoy an initial protection period of 7 years during which no other manufacturer can produce these products. For the two years ended 31 December 1999 and the four months ended 30 April 2000, the sales of those protected products accounted for 5%, 4% and 3% respectively of the Company's turnover. During the two years ended 31 December 1999 and the four months ended 30 April 2000, the Company manufactured a total of 86 types of Chinese Patent Medicine, among which over 30 items were exported, primarily to southeast Asia, Australia and North America. Such exports respectively accounted for 72%, 11% and 17% of the total export of the Company for the four months ended 30 April 2000. For the two years ended 31 December 1999 and the four months ended 30 April 2000, the Company's total export reached RMB4.9 million, RMB5.6 million and RMB3.4 million respectively, which accounted for 2%, 1.8% and 2.7% of the Company's total turnover for the respective periods. The remaining turnover represent sales in the PRC, with Guangdong, Beijing, Jilin, Hebei and Anhui, being the major markets.

The Directors consider that the existing business of the Company will serve as the foundation to expand the market share of the Company's products and to enter the international pharmaceutical market.

The Company's main products are marketed and sold under the trademark of 「同仁堂」 which is owned by Tongrentang Holdings. The brand name of 「同仁堂」 is a household label with 331 years of history. The Company has obtained from Tongrentang Holdings the right to use the trademark 「同仁堂」 for an initial term from 6 October 2000 up to 28 February 2003, subject to further extension, under a licensing agreement dated 6 October 2000. For details, please see the paragraph headed "Permission to use tradenames and certain trademarks" set out in the sub-section headed "Connected transactions" under the section headed "Relationship with Tongrentang Holdings and Tongrentang Ltd."

The Company utilizes the existing nationwide distribution network of Tongrentang Ltd. for the distribution of the Company's products in the PRC. Tongrentang Ltd. has more than 110 major distributors throughout the PRC. The Company also sells its products through various entities under Tongrentang Holdings and Tongrentang Ltd.. For details, please see the paragraph headed "Transaction between the Company and subsidiaries and associates of Tongrentang Holdings and Tongrentang Ltd." set out in the sub-section headed "Connected transactions" under the section headed "Relationship with Tongrentang Holdings and Tongrentang Ltd."

### STRENGTHS

The Directors believe that the Company possesses the following strengths:

**Reputable brandname** — The brandname of 「同仁堂」 has 331 years of history and was the first Chinese trademark ever registered in the International Registrar of Madrid. The

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use of such a prestigious brandname significantly promotes customer awareness and recognition of the Company's products both domestically and overseas;

**Expertise in research and development** — The Company is equipped with advanced and comprehensive research facilities as well as well-qualified research staff. Over the last decade, the Company has been involved in developing over twelve types of major new products. This demonstrates the Company's outstanding ability in this area;

**Green medicine** — Green medicine has been increasingly popular among developed countries in light of the side effects of synthetic medicine. The Company is well positioned to penetrate into the green medicine market as the Company's products are substantially made of natural Chinese medicinal raw materials;

**Wide range of existing products** — The Company has obtained production approvals for 275 Chinese Patent Medicine which cover a wide range of Chinese medicine. This provides the Company with a strong foundation to further improve its research and development capabilities;

**Extensive distribution channels** — The Company utilizes Tongrentang Ltd.'s nationwide sales and marketing network to distribute the Company's products. Tongrentang Ltd. has more than 110 major distributors throughout the PRC. The Company also markets and exports its own products and those of Tongrentang Ltd. through the Company's international sales network to 18 countries and regions;

**Geographical advantage** — The Company is located in Beijing, the PRC, which has long been regarded as the centre of high standard research and studies of Chinese medicine. The Company has established good relationships with various research and academic institutes in Beijing. The Company capitalizes on the research power of these institutes by cooperating with them in researching and developing new medicine;

**Experienced and dedicated management** — The Company's managerial staff possesses extensive experience and expertise in manufacturing and selling Chinese medicine.

The Directors believe that the Company's competitive advantage will help to enhance its development in the Chinese medicine industry and to allow the Company to expand and compete for greater market share in the future.

### BUSINESS STRATEGY

The Company aims to modernize and internationalize TCM with consistent improvement in technology to preserve the characteristics of natural Chinese medicinal raw materials and maintain the special production features of the Chinese medicine. The Company plans to make use of advanced technology and research results to improve the quality of its existing products

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## SUMMARY OF THIS PROSPECTUS

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and upgrade its production efficiency to achieve economies of scale. The Company endeavours to develop new scientific and effective products of international standard in respect of which it will enjoy intellectual property rights and to introduce bio-pharmaceutical products into the healthcare products market. At the same time, the Company plans to venture into the e-commerce business to further expand the Company's market share.

### **BUSINESS OBJECTIVES**

The Company's business objectives are product modernization, product differentiation, meeting of international quality standards, modernization of production techniques, standardization of production and achieving economies of scale.

**Product modernization** — The Company seeks to develop effective medical products with minimal side effects to meet demand from both domestic and overseas markets. Emphasis on product development will be placed on anti-virus medicine and the treatment of common and complicated illness such as cardiovascular and neurovascular diseases, digestive system diseases, cancer, etc.;

**Product differentiation** — The Company seeks to overcome the traditional disadvantages of large dosage and inconvenient usage of TCM, and develop product forms to achieve the high effectiveness, quick soothing, sustainability as well as small dosage requirements. Currently, the Company's products are mainly in the forms of tablets, soft capsules, granule and pills;

**Meeting of international quality standards** — Based on the characteristics of Chinese medicine and the international standards of quality as benchmark, the Company will take measures to investigate and improve the effectiveness and quality of the existing products to ensure the safety, effectiveness and controllability of Chinese medicine;

**Modernization of production techniques** — The Company aims to raise the overall standard in its production process by introducing new techniques in the preparation of raw materials, extracting of essence of herbs, production and packaging. The Company will also apply computerized technologies in the production and management control so as to reduce wastage and to increase productivity and efficiency;

**Standardization of production** — The Company aims to reform its factory, facilities and improve the quality of its staff in accordance with SPSAC's requirement;

**Achieving economies of scale** — With its commitment to product research and development, technological enhancement, quality improvements, productivity improvements and scientific operations, the Company aims to achieve economies of scale to further penetrate into the international market.

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## SUMMARY OF THIS PROSPECTUS

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### **WARNING:**

**The aforesaid business objectives are based on the existing strategy, targets and intentions of the Company. As such, strategy and targets are based on the assumption of future events which by their nature are subject to uncertainty, the Company's actual course of action may vary from the strategy and targets set out above. Although the Directors will endeavour to execute such targets in accordance with the aforesaid timeframe, there is no assurance that targets of the Company will materialize, result in the conclusion of any agreement or be executed in accordance with the aforesaid timeframe or that its objectives will be fully accomplished or accomplished at all.**

### **FUTURE BUSINESS PLAN**

#### **I. Expansion of production capability and establishment of production bases**

Although the Company's existing production bases (comprising Factory No. 2 and the Chinese Medicine Refinery) are equipped with the necessary manufacturing capabilities and staffed with managerial expertise, and notwithstanding that three of its production lines have already received Australia's GMP recognition, the Company intends to further improve the production standard and modify its operation in accordance with the GMP requirement on the equipment, manufacturing base and personnel. The Company also endeavours to produce new forms of medicine to complement the existing forms of Chinese Patent Medicine of the Company. In addition, the Company needs to establish new production bases to strengthen the production capability and in order to accommodate the production of its new products as a result of the Company's research and development.

#### **II. Investment in research centre, new medicine development and bio-pharmaceutical technologies**

1. The Company's existing research institute is equipped with advanced and comprehensive instruments and facilities. The Company plans to further strengthen its research capability by cooperation with universities in Beijing and recruit more high calibre research personnel.
2. In response to the market needs, the Company has been engaged in the research and development of a wide range of new medicine products, including anti-influenza drug (抗病毒感冒新藥), anti-cardiovascular system disease drug (心血管疾病新藥) and anti-menopause syndrome drug (更年期綜合症新藥). The Directors believe that these new medicine, if successfully developed, will have huge market potential.
3. The Company has signed a joint-venture agreement, with WM Dianorm Biotech to establish Tong Ren Tang WM Dianorm Biotech, in order to research and develop biopharmaceutical products using the liposome (脂質體) technology developed by Dianorm. The Company aims to put new products, based on the research result of the joint venture, into production with a view to capitalise on the immense market potential in China.

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## SUMMARY OF THIS PROSPECTUS

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### **III. Establishing sales network and venturing into e-commerce business**

#### *1. Sales network*

The Company will continue to utilize the existing nationwide distribution network of Tongrentang Ltd. for distribution of the Company's products in mainland China. At the same time, the Company plans to establish its own domestic sales network and strengthen its existing overseas sales and marketing network so as to further increase market penetration in the international market.

#### *2. E-commerce*

The internet is a new channel for marketing products. The Company will make use of e-commerce to widen its distribution channel so as to increase sales and promote its image. The Company plans to establish websites on Chinese medicine to provide online medical consultancy services and sell medicine.

### **IV. Establishing production base for Chinese medicinal raw herbs materials**

Chinese medicinal raw herbs are the fundamental components of Chinese medicine. With the development and modernization of the TCM industry, the demand for quality Chinese medicinal raw herbs is also increasing. To raise and maintain the quality of Chinese medicine, it would be necessary to have consistent access to high quantities of high quality Chinese medicinal raw herbs. High quality includes the ability of such herbs to maintain its medical effects while being used in low dosages. Traditionally, the quality of Chinese medicine is affected by the unstable quality of Chinese medicinal raw herbs and the disorderliness of different species.

To overcome the above problems, the Company intends to set up a Chinese medicinal raw herbs production base in a suitable location in the PRC. Such a move could secure quality and consistency in the supply of raw materials which are required by the Company.

### **V. Investment in Tong Ren Tang Hutchison Pharmaceutical Development**

The Company signed an agreement on 7 October 2000 with Hutchison Chinese Medicine, an indirect wholly owned subsidiary of Hutchison Whampoa Limited, and Beijing Holdings, the majority shareholder of Beijing Enterprises Holdings Limited, to form a joint venture company, Tong Ren Tang Hutchison Pharmaceutical Development, in Hong Kong. The joint venture will be engaged in the research, development and sale of Chinese medicines mainly in Hong Kong with an aim to modernize and internationalize Chinese medicines. The joint venture will be held as to 40% by the Company, 10% by Beijing Holdings and 50% by Hutchison Chinese Medicine. The Company will contribute HK\$40 million as investment to the joint venture within one year after its establishment. This agreement will take effect upon all requisite PRC governmental or other approvals for the consummation of the transaction contemplated thereby being obtained.

## SUMMARY OF THIS PROSPECTUS

The following table shows the anticipated progress of the Company's business objectives during each of the six-month period up to 31 December 2002.

Principal areas	Business objectives	Latest Practicable Date to December 2000	2001		2002	
			1st half year	2nd half year	1st half year	2nd half year
Expansion of production capability and establishment of production base	Expansion of production capability and establishment of production base	— Conduct feasibility studies	— Conduct feasibility studies and preparation	— Implementation plan confirmed  — Commence construction	— Construction in-progress  — Purchase of equipment	— Construction in-progress  — Installation of equipment  — Trial production
Investment in research centre, new medicine development and bio-pharmaceutical technologies	Investment in research centre	— Preparation and design	— Preparation, design and construction — Equipment purchase	— Purchase of equipment — Completion of initial phase of construction	— Continue construction process — Completion of construction	
	Development of new medicine					
	A. Research of new anti-influenza drug	— Clinical trial commences	— Continue clinical trial	— Clinical trial in progress	— Clinical trial completed — Prepare to apply for SPSAC approval	— Apply and obtain SPSAC approval for production and trial production
	B. Development of the new anti-cardiovascular system diseases drug	— Clinical trial commences	— Continue clinical trial	— Clinical trial in progress	— Clinical trial completed — Prepare to apply for SPSAC approval	— Apply and obtain SPSAC approval for production and trial production
	C. Development of new anti-menopause syndrome drug	— Clinical trial commences	— Continue clinical trial	— Clinical trial in progress	— Clinical trial completed — Prepare to apply for SPSAC approval	— Apply and obtain SPSAC approval for production and trial production
	Developing bio-pharmaceutical technologies	— Prepare for incorporation of the joint venture Company	— Finish incorporation of the joint-venture company  — Introduce new technology	— Preliminary research  — Apply for production approval of SPSAC	— Obtain production approval from SPSAC  — Trial production	— Production commences
Establishing sales network and venturing into e-commerce	Establish sales network	—	— Site selection — Liaise with local relevant departments for preliminary approval	— Obtain approval — Construct and decorate properties	— Construct and decorate properties — Obtain certificate — Trial run	—
	Venture into e-commerce	—	— System development — Equipment and software purchase	— Websites trial operation — Development of online medical business	— Increase types of information service — Online medical business commences	—
Establishing production base for Chinese medicinal raw materials	Establish production base for Chinese medicinal raw materials	— Feasibility studies	— Select sites	— Preparation for plantation	— Planting and field management	— Field management and partial harvest
Investment in Tong Ren Tang Hutchison Pharmaceutical Development	Establishment of a joint venture with Hutchison Chinese Medicine and Beijing Holdings to promote the internationalization and modernization of Chinese medicine	— Prepare for incorporation of the joint-venture company	— Finish incorporation of the joint-venture company	—	—	—

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### **Direct competition with Tongrentang Ltd. and Tongrentang Holdings**

The curative effects of Chinese medicine are brought about by not only treating the symptoms of the disease, but also treating and regulating other implicit problems of the body which may have direct or indirect influences on the explicit symptoms. As such, the curative effects of Chinese medicine are usually very broad. The proper medicine is selected with reference to a number of variables such as the patient's state of illness, gender, age and constitution, the occurring season of the disease and its curative effects on the implicit problems of the patient. As such, any particular type of Chinese medicine usually has several curative effects, some of which may be in common with those of other products. **Given this nature of Chinese medicine, and the fact that the Company has been relying and will continue to rely on the distribution network of Tongrentang Ltd. for distribution of the Company's products, there may exist direct competition between the products of the Company and those of Tongrentang Holdings and Tongrentang Ltd.. The Company's business may be affected adversely due to such direct competition.**

After the listing of the Company, the Company, Tongrentang Holdings and Tongrentang Ltd. will not have any products in common except for Angong Niu Huang Pills (安宫牛黄丸). The sales of Angong Niu Huang Pills contributed approximately 4.4%, 4.5% and 4.5% of total sales of the Company for the two years ended 31 December 1999 and the four months ended 30 April 2000, respectively. As there are numerous manufacturers producing this product in the PRC, the Company will be in direct competition with such manufacturers, including Tongrentang Ltd., in respect of such product. A reduction in the demand for such product manufactured by the Company will have an impact on the Company's future turnover and profitability.

### **No clear business delineation with Tongrentang Ltd. and Tongrentang Holdings**

Although the Company has a total of 86 production permits in common with those of Tongrentang Ltd. and Tongrentang Holdings, their businesses are delineated in accordance with their respective focus on the forms of medicine they produce. The Company focuses on producing products in the forms of granules, pills, tablets and soft capsules while Tongrentang Ltd. and Tongrentang Holdings focus on producing Chinese medicine in the forms of large pills, powder, ointment, pellet and medicinal wine. However, Tongrentang Ltd. also has some minor production lines for the productions of granules and pills. In addition, due to the nature of Chinese medicine as described in the following paragraph, products in different forms may have similar curative effects and properties. As all the three companies are engaging in the business of manufacturing Chinese Patent Medicine, the delineation of business between these three companies is not clear. As a result, the Company's business may be adversely affected by products of Tongrentang Holdings and Tongrentang Ltd. with similar curative effects in different forms.

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## SUMMARY OF THIS PROSPECTUS

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### TRADING RECORD

The following is a summary of results of the Company for each of the two years ended 31 December 1999 and the four months ended 30 April 2000 (“the Relevant Period”) extracted from the accountants’ report set out in Appendix I to this prospectus and has been prepared on the basis that the existing Company structure had been in place throughout the Relevant Period:

	<b>Year ended 31 December</b>		<b>Four months ended 30 April 2000</b>
	<b>1998</b>	<b>1999</b>	<b>2000</b>
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Sales	248,672	308,068	126,580
Operating profit	40,632	60,136	36,520
Profit before taxation	36,264	57,102	35,475
Taxation	11,967	18,844	11,707
Profit attributable to shareholders	24,297	38,258	23,768
Dividends	24,297	38,258	–

*Note:* Prior to the establishment of the Company, Tongrentang Ltd. had all along been responsible for the distribution of most of the Company’s products (the “Relevant Products”) to ultimate customers. Customers generally did not, when making payment, specifically indicate the invoice to which a certain payment should apply. Although the Company’s revenue can be specifically identified based on product lines restructured to the Company (see the section headed “Business”), it is not possible for Tongrentang Ltd. to know with certainty whether any part of the remaining balance of accounts receivable from an individual customer should be attributed to the sale of the relevant products. For this reason, Tongrentang Ltd. took up the credit risk of such receivables by not injecting any balance of such accounts receivable to the Company upon restructuring.

For the two years ended 31 December 1999 and the four months ended 30 April 2000, the estimated provision for doubtful debts in relation to the sales of products of Tongrentang Ltd. and the relevant products of the Company amounted to approximately RMB9,376,000, RMB4,378,000 and RMB75,000 respectively.

Assuming that during the two years ended 31 December 1999 and the four months ended 30 April 2000, the Relevant Products were sold directly by the Company to the ultimate customers and that the Company bore the related credit risk, the provision for doubtful debt of the Company for the two years ended 31 December 1999 would have been approximately RMB4,000,000 and RMB2,000,000 respectively, and no provision for doubtful debt of the Company for the four months ended 30 April 2000. These amounts were estimated by applying the proportion of annual sales of the Company over that of Tongrentang Ltd. to the total provision for doubtful debts resulting from the sales of products of Tongrentang Ltd. and the Relevant Products of the Company.

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After pro forma adjustments made for provision of doubtful debts, the results of operations for each of the two years ended 31 December 1999 and the four months ended 30 April 2000 were as follows:

	<b>Year ended 31 December</b>		<b>Four months</b>
	<b>1998</b>	<b>1999</b>	<b>ended</b>
	<i>RMB '000</i>	<i>RMB '000</i>	<b>30 April</b>
			<b>2000</b>
			<i>RMB '000</i>
Profit before taxation (profit before pro forma adjustment)	36,264	57,102	35,475
Pro forma provision for doubtful debts	<u>(4,000)</u>	<u>(2,000)</u>	<u>–</u>
Adjusted profit before taxation	32,264	55,102	35,475
Adjusted taxation	<u>(10,647)</u>	<u>(18,184)</u>	<u>(11,707)</u>
Adjusted profit attributable to shareholders	<u>21,617</u>	<u>36,918</u>	<u>23,768</u>

### Other information

Pursuant to paragraphs 27 and 31, Third Schedule to the Companies Ordinance, the Company is required to include in this prospectus an accountants' report covering at least three financial years immediately preceding the issue of this prospectus.

As a result of an application made by the Company, the SFC has granted a waiver in relation to strict compliance with paragraphs 27 and 31, Third Schedule to the Companies Ordinance such that the accountants' report covers only the period from 1 January 1998 to 30 April 2000.

### REASONS FOR THE PLACING AND USE OF PROCEEDS

The Directors consider that “Tongrentang” is a household name and the Company's products enjoy a highly prestigious status in the domestic and overseas medicine and drug markets. However, as the TCM market has entered into a new age of intense competition, product differentiation, re-organization, economy of scale and modernization dominate the direction of development of TCM enterprises, therefore, TCM enterprises must adopt changes to survive intense competition and to make innovation on technology in order to internationalize and modernize TCM. In this regard, the Company intends to raise capital through listing on GEM to research and develop new forms of TCM and new medicine, to expand sales and marketing network and to develop e-commerce related business, in order to compete in the global medicine market and to enhance its presence in the international medical industry.

The net proceeds from the Placing will be used as described in details in the section headed “Business objectives”.

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## SUMMARY OF THIS PROSPECTUS

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The net proceeds of the Placing after deduction of relevant expenditure (payable by the Company in relation to the Placing, assuming that the Over-allotment Option is not exercised and assuming an Issue Price of HK\$3.255, being the mid point of the proposed Issue Price range of HK\$2.89 to HK\$3.62) are estimated at about HK\$214 million. The Directors plan to use such proceeds for the following purposes:

<b>Business objective</b>	<b>Total amount to be invested</b>
Construction of production base	HK\$45 million
Investment in research centre	HK\$21 million
Development of new medicine	HK\$10 million
Development of bio-pharmaceutical technologies	HK\$24 million
Establishing sales network	HK\$32 million
Establishing e-commerce	HK\$8 million
Establishing production base for Chinese medicinal raw materials	HK\$20 million
Investment in Tong Ren Tang Hutchison Pharmaceutical Development	HK\$40 million

The balance of the Placing proceeds will be used as general working capital.

In the event that the Over-allotment Option is exercised in full, the Company will receive additional net proceeds of approximately HK\$22 million (assuming an Issue Price of HK\$3.255, being the mid point of the proposed Issue Price range of HK\$2.89 to HK\$3.62). The Directors intend to use such proceeds for general working capital purposes.

In the event that any part of the business plans of the Company does not materialize or proceed as planned, the Directors will carefully evaluate the situation and may reallocate the intended funds to other business plans and/or to new projects of the Company and/or to hold it as short term deposits so long as the Directors deem it to be in the best interest of the Company and its shareholders taken as a whole.

To the extent that the net proceeds from the Placing are not immediately required for the above purposes, it is the present intention of the Directors that they be placed on short-term deposits with financial institutions or used for short-term investment.

In the event of any material modification to the use of proceeds as described above, the Company, as appropriate, will issue an announcement in respect of the changes.

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## SUMMARY OF THIS PROSPECTUS

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### RISK FACTORS

The Directors consider the Company's business involves a number of risks and they are summarized as follows:

#### Risks related to the Company

Direct competition with Tongrentang Ltd. and Tongrentang Holdings  
No clear business delineation with Tongrentang Ltd. and Tongrentang Holdings  
Reliance on Tongrentang Holdings and Tongrentang Ltd.  
Controlling interest of Tongrentang Ltd. in the Company  
Provisions for bad and doubtful debts  
Product liability  
Permits and business licences  
Achieving business objectives  
Research and development risks  
Price fluctuation of raw materials  
GMP  
Trademarks  
Product concentration  
Exchange rate risks  
Counterfeits  
Product liability insurance  
Overseas markets  
Property leasing agreement  
The State-owned land use right certificate  
Use of proceeds  
Dividend policies

#### Risks related to the industry

Medicare reforms in the PRC  
Product substitution  
Competition  
Price control  
Export of pharmaceutical products  
WTO  
Foreign exchange remittance

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## SUMMARY OF THIS PROSPECTUS

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### Risks related to the PRC

Economic and political considerations  
Legal system  
Conversion of foreign exchange in the PRC

### Risks related to the Placing

There has been no prior public market for the H Shares; the liquidity and market price of the H Shares following the Placing may be volatile

Certain statistics are derived from unofficial publications

### FORECAST FOR THE YEAR ENDED 31 DECEMBER 2000

Forecast profit after taxation but

before extraordinary items (*Note 1*) ..... not less than RMB43.7 million

Earnings per H Share

(a) Weighted average (*Note 2*) ..... RMB0.358

(b) Pro forma fully diluted (Based on the Issue Price of HK\$2.89) (*Note 3*) ..... RMB0.294

(c) Pro forma fully diluted (Based on the Issue price of HK\$3.62) (*Note 3*) ..... RMB0.310

### ISSUE STATISTICS (*Note 4*)

	<b>Based on an Issue Price of HK\$2.89 per H Share</b>	<b>Based on an Issue Price of HK\$3.62 per H Share</b>
Market capitalization of H Shares ( <i>Note 5</i> )	HK\$210 million	HK\$263 million
Prospective price/earnings multiple ( <i>Note 6</i> )		
(a) weighted average	8.63 times	10.82 times
(b) pro forma fully diluted	10.50 times	12.50 times
Adjusted net tangible asset value per H Share ( <i>Note 7</i> )	RMB1.87	RMB2.18

*Notes:*

- 1 The bases and assumptions on which the above profit forecast have been prepared are set out in Appendix II.
- 2 The calculation of the forecast earnings per H Share on a weighted average basis is based on the forecast profit after taxation but before extraordinary items and a weighted average number of 122,942,222 Shares expected to be in issue during the year ending 31 December 2000. It does not take into consideration any H Shares which may fall to be issued upon exercise of the Over-allotment Option.

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## SUMMARY OF THIS PROSPECTUS

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3. The calculation of the forecast earnings per H Share on a pro forma fully diluted basis is based on the forecast profit after taxation but before extraordinary items for the year ending 31 December 2000. It assumes that the Company had been listed since 1 January 2000 and that the 182,800,000 H Shares in issue following the Placing had been in issue on 1 January 2000. The forecast profit after taxation but before extraordinary items of the Company for the year ending 31 December 2000 has been adjusted to include interest income, which would have been earned if the proceeds from the Placing were received on 1 January 2000 assuming an interest rate of 5% per annum. It takes no account of any H Shares which may fall to be issued upon exercise of the Over-allotment Option.
4. Except where otherwise indicated, the issue statistics have been prepared on the assumption that the Over-allotment Option will not be exercised. Hong Kong dollars have been translated for information only into Renminbi at the exchange rate HK\$1=RMB1.07. The Issue Price does not include 1% brokerage and 0.01% Stock Exchange transaction levy.
5. The market capitalization of the H Shares is based on the 72,800,000 H Shares to be issued under the Placing and does not take into consideration any H Share which may fall to be issued upon exercise of the Over-allotment Option.
6. The calculation of the prospective price/earnings multiple on a weighted average basis and a pro forma fully diluted basis is based on the forecast earnings per Share as set out in notes 2 and 3 above respectively.
7. The adjusted net tangible asset value per H Share has been arrived at after the adjustments referred to in the paragraph headed "Adjusted net tangible assets" under the section headed "Financial information" and on the basis of a total of 182,800,000 H Shares expected to be in issue after completion of the Placing at Issue Price.

**If the Over-allotment Option is exercised in full, the adjusted net tangible asset value per H Share will be increased, while the earnings per Share will be diluted correspondingly. However, the Company believes that this will not have any material effect on the shareholders of the Company.**

### STRATEGIC INVESTORS

The Company's three Strategic Investors are: Hutchison Whampoa Limited, Peking University Founder Group Corporation and Chuan Chiong Co. Ltd, which have agreed to subscribe for 6,000,000 H Shares, 5,000,000 H Shares and 3,000,000 H Shares respectively, representing 3.28%, 2.74% and 1.64% respectively of the Company's enlarged share capital after listing but before the exercise of the Over-allotment Option. None of the Strategic Investors is an Initial Management Shareholder, a substantial shareholder of the Company, or has any representation on the board of Directors upon listing. All of the three Strategic Investors are independent third parties of the Company.

In addition, each of the three Strategic Investors has undertaken to the Company that it will not at any time during the 3-month period from the date of listing of the H Shares on GEM, except with prior written consent of the Company and the Sponsor, directly or indirectly, offer, sell, transfer, create any mortgage, charge, pledge or otherwise dispose of (including, but without limitation, by creation of any option) any interest (whether legal or beneficial) in any of the H Shares that it acquires pursuant to each of their respective Subscription Agreements.

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## SUMMARY OF THIS PROSPECTUS

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### RESTRICTIONS ON DISPOSAL OF DOMESTIC SHARES

Under the Company Law, transfer of Domestic Shares in the Company by the promoters, Directors, Supervisors and general manager of the Company is subject to the following restrictions:

- (i) none of the promoters may transfer its (or his) Domestic Shares during a period of three years from the date of incorporation of the Company (whether such Domestic Shares are acquired on or subsequent to incorporation), such three-year period being due to expire on 21 March 2003;
- (ii) none of the Directors, Supervisors nor general manager of the Company may transfer his Domestic Shares during such time as he remains in office.

According to the advice of the Company's PRC legal adviser, the prohibition on the transfer of Domestic Shares under the Company Law applies to the Domestic Shares directly held by the promoters, Directors, Supervisors or general manager of the Company.

Each of Tongrentang Ltd., Tongrentang Holdings, Zhao Bing Xian, Yin Shun Hai, Wang Zhao Qi, Mei Qun and Tian Rui Hua (as promoters and Directors), Jin Shi Yuan, Tam Wai Chu, Maria and Ting Leung Huel, Stephen (as Directors), Tian Da Fang (as promoter and Supervisor), Yang Liang and Sun Fung Sheng (as Supervisors), is subject to the transfer restrictions under the Company Law described above. The said restrictions do not apply to Tam Wai Chu, Maria and Ting Leung Huel, Stephen because they do not hold any Domestic Shares.

As there is a difference in length between the lock-up period imposed under the GEM Listing Rules and the prohibition on transfer period under the Company Law, the above-named parties who are subject to both sets of restrictions will not be able to dispose of their respective relevant securities until the expiry of the longer of the two restriction periods (see table set out on page 17).

If, after the date of this prospectus, any subsequent change in the restrictions on the transfer of Domestic Shares under the Company Law should result in any of Tongrentang Ltd., Tongrentang Holdings, Zhao Bing Xian, Yin Shun Hai, Tian Da Fang, Wang Zhao Qi, Mei Qun, Tian Rui Hua, Jin Shi Yuan, Yang Liang and Sun Fung Sheng being able to transfer its (or his) Domestic Shares before the expiry of the lock-up period under the GEM Listing Rules, such party would remain bound by its (or his) non-disposal undertaking to the Stock Exchange, the Company and the Placing Underwriters until the expiry of such lock-up period.

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## SUMMARY OF THIS PROSPECTUS

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The following table sets out the respective interests of Initial Management Shareholders of the Company upon completion of the Placing, without taking into account any H Shares to be issued pursuant to the exercise of the Over-allotment Option:

Name of Initial Management Shareholders	Date of entry	Number of Shares held immediately after the Placing	Approximate percentage of shareholding immediately after the Placing <i>(Note 1)</i>	Approximate cost of investment per Share <i>RMB</i>	Approximate total cost of investment <i>RMB</i>
Tongrentang Holdings	20 March 2000	2,900,000	1.586%	1.00354	2,910,266
Tongrentang Ltd. <i>(Note 2)</i>	20 March 2000	100,000,000	54.705%	1.00354	100,354,000
Yin Shun Hai	20 March 2000	500,000	0.274%	1.00354	501,770
Wang Zhao Qi	20 March 2000	500,000	0.274%	1.00354	501,770
Mei Qun	20 March 2000	500,000	0.274%	1.00354	501,770
Tian Rui Hua	20 March 2000	100,000	0.055%	1.00354	100,354
Zhao Bing Xian	20 March 2000	5,000,000	2.735%	1.00354	5,017,700
Tian Da Fang	20 March 2000	500,000	0.274%	1.00354	501,770

*Notes:*

1. The calculation of the approximate percentage of shareholding immediately following the Placing is based on the assumption that the Over-allotment Option is not exercised.
2. Tongrentang Ltd. is owned as to 75% by Tongrentang Holdings.

## SUMMARY OF THIS PROSPECTUS

### RESTRICTION ON DISPOSAL OF SHARES

Name of shareholders	Number of Shares directly held immediately following the Placing	Approximate percentage of shareholding immediately following the Placing <i>(Note 1)</i>	Lock-up period commencing from the date of incorporation/ listing <i>(Note 2)</i> <i>(Note 3)</i>
<b>Initial Management Shareholders/Promoters</b>			
Tongrentang Holdings	2,900,000	1.586%	3 years
Tongrentang Ltd. <i>(Note 4)</i>	100,000,000	54.705%	3 years
Yin Shun Hai	500,000	0.274%	3 years
Wang Zhao Qi	500,000	0.274%	3 years
Mei Qun	500,000	0.274%	3 years
Tian Rui Hua	100,000	0.055%	3 years
Zhao Bing Xian	5,000,000	2.735%	3 years
Tian Da Fang	500,000	0.274%	3 years
<b>Strategic Investors</b>			
Hutchison Whampoa Limited <i>(Note 5)</i>	6,000,000	3.28%	3 months
Peking University Founder Group Corporation <i>(Note 6)</i>	5,000,000	2.74%	3 months
Chuan Chiong Company Limited	3,000,000	1.64%	3 months

*Notes:*

1. The calculation of the approximate percentage of shareholding immediately following the Placing is based on the assumption that the Over-allotment Option is not exercised.
2. Pursuant to rule 13.16 of the GEM Listing Rules, each of the Initial Management Shareholders has undertaken to the Company and the Stock Exchange that, he/it will not, for a period of 2 years from the date on which dealings in the H Shares commence, save as provided in rule 13.17 of the GEM Listing Rules, dispose of (or to enter into any agreement to dispose of) any of his/its direct/indirect interest in relevant securities (as defined in the GEM Listing Rules).

The Initial Management Shareholders have also given various undertakings to the Company and the Placing Underwriters as set out in the section "Underwriting" below.

Pursuant to article 147 of the Company Law, the promoters cannot transfer their Shares within three years after establishment of the Company. Accordingly, the promoters are subject to a lock up period of three years commencing from the date of incorporation of the Company, which is longer than the lock up period under the GEM Listing rules.

3. Each of the Strategic Investors has undertaken to the Company and BOCI Asia that each of them will not, at any time during the three-months period from the date of listing of H Shares on GEM, except with prior consent of the Company and BOCI Asia, directly or indirectly offer, sell, transfer, create any mortgage, charge, pledge or otherwise dispose of any interest in any of the H Shares that it acquires pursuant to the Subscription Agreements.
4. Tongrentang Ltd. is owned as to 75% by Tongrentang Holdings.
5. Hutchison Whampoa Limited through its indirectly wholly-owned subsidiary, North Cerney Limited, owns 6,000,000 H Shares in the Company.
6. Peking University Founder Group Corporation is the ultimate beneficial owner of 5,000,000 H Shares in the Company which are held through Super Highway Limited.

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## DEFINITIONS

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*In this prospectus, unless the context otherwise requires, the following expressions have the following meanings:*

“Affiliated Companies”	has the meaning ascribed to it in the GEM Listing Rules
“Articles of Association”	the articles of association of the Company adopted at the Company’s extraordinary general meeting held on 11 October 2000
“associates”	has the meaning ascribed to it in the GEM Listing Rules
“Beijing Government”	the Beijing Municipal People’s Government
“Beijing Holdings”	Beijing Holdings Limited (京泰實業(集團)有限公司), a company incorporated in Hong Kong with limited liability
“Board”	the board of Directors
“BOCI Asia”	BOCI Asia Limited, a dealer registered with the SFC under the Securities Ordinance
“CCASS”	the Central Clearing and Settlement System established and operated by Hongkong Clearing
“Central Government”	the government of the PRC
“Chinese Medicine Ordinance”	the Chinese Medicine Ordinance (Chapter 549 of the Laws of Hong Kong), as amended from time to time
“Chinese Medicine Refinery”	Tongrentang Chinese Medicine Refinery, comprising Chinese Medicine Refinery (Xi Zhi Men Nei Da Street) and Chinese Medicine Refinery (No. 33 Yang Fang Hu Tong)
“Chinese Pharmacopeia”	the Pharmacopeia of the PRC (中華人民共和國藥典) edited and published by the Pharmacopeia Committee of MPH and issued by MPH with the consent of the State Council, which is the statutory standard that forms the basis of monitoring the production, quality control, supply and usage of medicine and includes the name, nature, shape, component, dosage as well as the method of storage and prescription

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## DEFINITIONS

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“CSRC”	China Securities Regulatory Commission (中國證券監督管理委員會)
“Company” or “Tong Ren Tang Technologies”	Tong Ren Tang Technologies Co. Ltd. (北京同仁堂科技發展股份有限公司), a joint stock limited company established in the PRC on 22 March 2000 under the laws of the PRC, and where the context refers to any time prior to the establishment of the Company, those entities and businesses which were contributed to, and became part of, the Company upon its establishment
“Company Law” or “PRC Company Law”	the Company Law of the PRC (中華人民共和國公司法) adopted at the Standing Committee of the Eighth National People’s Congress on 29 December 1993 and effective from 1 July 1994 as amended, supplemented or otherwise modified from time to time
“Companies Ordinance”	the Companies Ordinance (Chapter 32 of the Laws of Hong Kong), as amended from time to time
“Dianorm”	Dianorm G. Maierhofer GMBH, a company incorporated in Munich, Germany, which mainly engages in the manufacturing and trading of cosmetic and medicinal products
“Director(s)”	the director(s) of the Company
“Domestic Shares”	ordinary shares issued by the Company, with a nominal value of RMB1.00 each, which are subscribed for or credited as paid up in Renminbi
“Factory No. 2”	Tongrentang Pharmaceutical Manufacturing No. 2 Plant
“Foreign Shares”	ordinary shares issued by the Company, the par value of which is denominated in Renminbi, and which are subscribed for in a currency other than Renminbi
“GEM”	the Growth Enterprise Market of the Stock Exchange
“GEM Listing Committee”	the listing sub-committee of the council of the Stock Exchange with responsibility for GEM

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## DEFINITIONS

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“GEM Listing Rules”	the Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited (as amended from time to time)
“GMP”	Good Manufacturing Practice was initiated by the World Health Organisation to establish guidelines for pharmaceutical manufacturers in manufacturing their products, so as to assure the quality of products and to protect consumer interests
“Guangzhou Trade Fair”	the Export Trade Fair of the PRC which is currently held twice a year in spring and autumn in Guangzhou, and known as the Spring Trade Fair and Autumn Trade Fair, respectively
“H Shares”	Foreign Shares issued by the Company, with nominal value of RMB1.00 each, which are subscribed for and traded in Hong Kong dollars and for which applications have been made for the granting of listing, and permission to deal, on GEM
“Hong Kong”	the Hong Kong Special Administrative Region of the PRC
“Hong Kong Government”	the government of Hong Kong
“Hongkong Clearing”	Hong Kong Securities Clearing Company Limited
“Hutchison Chinese Medicine”	Hutchison Chinese Medicine Investment Limited (和記中藥投資有限公司), a company incorporated in the British Virgin Islands, an indirect wholly owned subsidiary of Hutchison Whampoa Limited
“IAS”	International Accounting Standard
“Import and Export Department”	Tongrentang Import and Export Branch Company
“Initial Management Shareholders”	shareholders of the Company as at the date of this prospectus as set out in the section headed “Undertakings by Initial Management Shareholders”
“Issue Price”	the price of not more than HK\$3.62 per Placing Share
“Latest Practicable Date”	16 October 2000, being the latest practicable date prior to the printing of this prospectus for ascertaining certain information contained herein

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## DEFINITIONS

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“MOFTEC”	The Ministry of Foreign Trade and Economic Cooperation of the PRC (中華人民共和國對外貿易經濟合作部)
“MPH”	The Ministry of Public Health of the PRC (中華人民共和國衛生部)
“Main Board”	the stock market operated by the Stock Exchange other than GEM (excluding the option market)
“Mandatory Provisions”	the Mandatory Provisions for Articles of Association of Companies to be Listed Overseas (到境外上市公司章程必備條款) promulgated by the former Securities Commission of the State Council and SCRES on 27 August 1994, as amended, supplemented or defined from time to time
“NPC” or “National People’s Congress”	the National People’s Congress of the PRC (中華人民共和國全國人民代表大會)
“OTC”	Over the counter medicine (非處方藥), which can be purchased over the counter without doctor’s prescription
“Over-allotment Option”	the option granted by the Company to the Placing Underwriters and exercisable by BOCI Asia pursuant to which the Company may be required to issue up to an additional aggregate of 7,200,000 H Shares to cover over allocations in the Placing, details of which are described in the section headed “Structure and conditions of the Placing” in this prospectus
“PBOC”	the People’s Bank of China (中國人民銀行), the central bank of the PRC
“PBOC Exchange Rate”	the exchange rate for foreign exchange transactions set daily by PBOC based on the previous day’s PRC interbank foreign exchange rate
“Placing”	the conditional placing of Placing Shares, as described in the section headed “Structure and conditions of the Placing”

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## DEFINITIONS

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“Placing Shares”	the 72,800,000 new H Shares initially being offered by the Company for subscription under the Placing subject to the exercise of the Over-allotment Option as described in the section headed “Structure and conditions of the Placing”
“Placing Underwriters”	BOCI Asia, CEF Capital Limited, First Shanghai Capital Limited, BNP Paribas Peregrine Securities Limited, Grand Cathay Securities (Hong Kong) Limited and Core Pacific-Yamaichi International (H.K.) Limited
“PRC” or “China”	the People’s Republic of China. Except where the context requires, references in this prospectus to the PRC or China do not apply to Hong Kong, Macau or Taiwan
“Price Determination Agreement”	the agreement to be entered into between the Company and BOCI Asia, on behalf of the Placing Underwriters, before the Price Determination Time to record the Issue Price, or a postponement of the Price Determination Time as mutually agreed between the Company and BOCI Asia (on behalf of the Placing Underwriters)
“Price Determination Time”	on or before 12:00 noon on 24 October 2000, by which time the Issue Price has been fixed
“Research and Development Centre”	research and development centre of the Company
“SAFE”	the State Administration of Foreign Exchange of the PRC (中華人民共和國國家外匯管理局), the PRC government authority responsible for matters relating to foreign exchange administration
“SCRES”	State Commission for Restructuring the Economic System of the PRC (中國國家經濟體制改革委員會) (dissolved in March 1998 and became an office of the State Council for restructuring the economic system)
“SFC”	the Securities and Futures Commission
“SDI Ordinance”	the Securities (Disclosure of Interests) Ordinance (Chapter 396 of the Laws of Hong Kong), as amended from time to time

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## DEFINITIONS

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“Securities Ordinance”	the Securities Ordinance (Chapter 333 of the Laws of Hong Kong), as amended from time to time
“Seventh, Eighth and Ninth Five-Year Plan”	the five-year development plans implemented by the PRC government. The Seventh Five-Year Plan refers to the period 1986-1990; the Eighth Five-Year Plan refers to 1991-1995 while the Ninth Five-Year Plan refers to 1996-2000
“Shares”	Domestic Shares and H Shares
“Special Regulations”	the PRC Special Regulations on the Overseas Offering and Listing of Shares by Joint Stock Limited Companies (國務院關於股份有限公司境外募集股份及上市的特別規定), issued by the State Council on 4 August 1994, as amended, supplemented or otherwise modified from time to time
“Sponsor”	BOCI Asia
“SPSAC”	The State Pharmaceutical Supervision and Administration of the PRC (國家藥品監督管理局)
“State”	the PRC government
“State Council”	the State Council of the PRC (中華人民共和國國務院)
“Statutory Standard”	the statutory standards applied in China by MPH as the quality control standards for production, supply, usage and monitoring of medicine
“Stock Exchange”	The Stock Exchange of Hong Kong Limited
“Strategic Investors”	Hutchison Whampoa Limited (through its indirect wholly-owned subsidiary, North Cerney Limited), Peking University Founder Group Corporation (through Super Highway Limited, a company beneficially owned by it) and Chuan Chiong Company Limited, all being independent third parties not associated with the Company or the Directors, Supervisors, promoters, chief executives or substantial shareholders of the Company or their

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## DEFINITIONS

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	respective associates (as defined in the GEM Listing Rules), save for Hutchison Whampoa Limited's indirect interest in Tong Ren Tang Hutchison Pharmaceutical Development through Hutchison Chinese Medicine
“Subscription Agreements”	the three conditional subscription agreements entered into between each of the Strategic Investors and the Company dated 19 October 2000, pursuant to which the Strategic Investors have agreed to subscribe for Placing Shares
“Supervisor(s)”	member(s) of the supervisory committee of the Company
“Tong Ren Tang Hutchison Pharmaceutical Development”	Tong Ren Tang Hutchison (H.K.) Pharmaceutical Development Company Limited (同仁堂和記(香港)藥業發展有限公司), a joint venture owned as to 40% by the Company, as to 10%, by Beijing Holdings and as to 50% by Hutchison Chinese Medicine
“Tong Ren Tang WM Dianorm Biotech”	Beijing Tong Ren Tang WM Dianorm Biotech Co., Limited, a joint venture owned as to 60% by the Company and as to 40% by WM Dianorm Biotech
“Tongrentang Advertising”	Beijing Tongrentang Advertising Company (北京同仁堂廣告公司), a State-owned enterprise established in the PRC under the laws of the PRC and a wholly owned subsidiary of Tongrentang Holdings
“Tongrentang Group” or “Tongrentang”	Tongrentang Holdings and its subsidiaries, including Tongrentang Ltd. and the Company
“Tongrentang Holdings”	China Beijing Tong Ren Tang Holdings Corp. (中國北京同仁堂集團公司), a State-owned enterprise established in the PRC under the laws of the PRC and the ultimate holding company of the Company and Tongrentang Ltd., and where the context refers to any time prior to the establishment of Tongrentang Holdings, those entities and businesses which were contributed to Tongrentang Holdings upon its establishment (for the purpose of this prospectus, not including Tongrentang Ltd. and the Company)

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## DEFINITIONS

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“Tongrentang Ltd.” or “A Share Company”	Beijing Tongrentang Company Limited (北京同仁堂股份有限公司), a joint stock limited company established in the PRC, the shares of which have been listed on the Shanghai Stock Exchange A Shares Market since 1997, and is the holding company of the Company
“Underwriting and Placing Agreement”	an underwriting and placing agreement dated 21 October 2000 entered into between, inter alia, the Company and the Placing Underwriters relating to the Placing, details of which are set out in the paragraph headed “Underwriting arrangements and expenses” in the section “Underwriting” of this prospectus
“U.S.” or “United States”	The United States of America
“WTO”	World Trade Organisation
“WM Dianorm Biotech”	WM Dianorm Biotech Co., Limited, a limited company incorporated in Hong Kong
“HK\$” and “cents”	Hong Kong dollars and cents respectively
“RMB” or “Renminbi”	Renminbi yuan, the lawful currency of the PRC
“US\$” or “U.S. Dollars”	United States dollars, the lawful currency of the U.S.
“Yen”	Japanese yen, the lawful currency of Japan
“ml”	millilitre(s)
“sq.ft.”	square feet
“sq.m.”	square metre(s)

*Unless otherwise specified in this prospectus, amounts denominated in RMB and US\$ have been translated, for the purpose of illustration only, into Hong Kong dollars as follows:*

*HK\$1.00 = RMB1.0614*

*HK\$7.75 = US\$1.00*

*No representation is made that any amounts in RMB, US\$ or HK\$ have been or could be converted at the above rate or at any other rates or at all.*

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## GLOSSARY OF TECHNICAL TERMS

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*This glossary contains explanations of certain terms used in this prospectus in connection with the Company and its business. The terminology and their meanings may not correspond to standard industry meanings or usage of those terms.*

- “Atomic absorption flame spectrophotometer”  
(原子吸收分光光度計)
- an analytical instrument based on the use of atomic absorption theories and for use in determining the content quantities of trace elements and heavy metals
- “Chinese Patent Medicine”  
(中成藥)
- readily processed Chinese medicine in various intake forms (such as pills, granules and soft capsules) based on the prescription, nature and functions of Chinese medicine
- “Gas chromatograph”  
(氣相色譜儀)
- the gas chromatography employing the use of the gaseous mobile state, which is named gas chromatography. Its properties are high efficiency, high selectivity, high sensitivity, making use of small quantities and high analytical speed, and it is now being widely used in the production and scientific research of industries such as petrochemistry, chemical industry, organic synthesis, medicinal drugs and foods. In addition it can be used in researches in areas like biochemistry, clinical diagnosis and pharmacological research. Gas chromatographer is an instrument based on the use of gas chromatographic theories, for use in qualitative and quantitative analyses of volatile materials or components
- “High pressure liquid chromatograph”  
(高壓液相色譜儀)
- a high-efficiency liquid chromatographer, an instrument based on the use of liquid chromatographic theories, suited to be used for amino acids, proteins, biological alkalis, nucleic acids, vitamins, anti-microbials and for the separation and qualitative and quantitative analyses of other synthetic medicine. In the current development or novel drugs in traditional Chinese medicine, quality control normally requires the use of high-Chinese medicine, quality control normally requires the use of high-efficiency liquid chromatographer to determine analytical qualities

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## GLOSSARY OF TECHNICAL TERMS

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“Liposome”	well defined lipid vesicles that allow the targeting of drug to selected tissue via appropriate modification mediated by either passive or active mechanism
“Membrane filtration technology”	a filtration technique which employs super hollow fibre filtration membranes and which does selective cut-off flows on tested liquid contents in respect to the sizes of their molecular weights
“Polyploid”	a cell or an entity which contains three or more than three chromosomes in the cellular nucleus. On the basis of whether the polyploids’ chromosome groups come from the same one species, they can be classified into auto-polyploids and allo-polyploids.
“TCM”	traditional Chinese medicine, a term used to describe a complex system of medicine developed in China
“Thin layer chromatograph” (薄層掃描儀)	an instrument which does quantitative analysis by directly scanning thin-layer plates with the use of the visible ultraviolet light of various wavelengths upon isolation of the specimen with thin layer plates

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## RISK FACTORS

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*An investment in the H Shares involves a high degree of risk and is speculative. Potential investors should carefully consider all of the information set out in this prospectus and, in particular, should consider the following risks and special considerations associated with an investment in the Company before making any investment decision in relation to the Company. Additional risks and uncertainties not presently known to the Company or that the Company currently deems immaterial could also harm the business, financial condition and operating results of the Company.*

*This prospectus contains certain forward looking statements relating to the Company's plans, objectives, expectations and intentions. The cautionary statements in this prospectus should be read as applicable to all forward looking statements herein. The Company's future financial results or operations could differ materially from those discussed in this prospectus. Factors that could cause or contribute to such differences include those discussed below, as well as those discussed elsewhere in this prospectus.*

### RISKS RELATED TO THE COMPANY

#### **Direct competition with Tongrentang Ltd. and Tongrentang Holdings**

The curative effects of Chinese medicine are brought about by not only treating the symptoms of the disease, but also treating and regulating other implicit problems of the body which may have direct or indirect influences on the explicit symptoms. As such, the curative effects of Chinese medicine are usually very broad. The proper medicine is selected with reference to a number of variables such as the patient's state of illness, gender, age and constitution, the occurring season of the disease and its curative effects on the implicit problems of the patient. As such, any particular type of Chinese medicine usually has several curative effects, some of which may be in common with those of other products. **Given this nature of Chinese medicine, and the fact that the Company has been relying and will continue to rely on the distribution network of Tongrentang Ltd. for distribution of the Company's products, there may exist direct competition between the products of the Company and those of Tongrentang Holdings and Tongrentang Ltd.. The Company's business may be affected adversely due to such direct competition.**

After the listing of the Company, the Company, Tongrentang Holdings and Tongrentang Ltd. will not have any products in common except for Angong Niu Huang Pills (安宮牛黃丸). The sales of Angong Niu Huang Pills contributed approximately 4.4%, 4.5% and 4.5% of total sales of the Company for the two years ended 31 December 1999 and the four months ended 30 April 2000 respectively. As there are numerous manufacturers producing this product in the PRC, the Company will be in direct competition with such manufacturers, including Tongrentang Ltd., in respect of such product. A reduction in the demand for the above-mentioned product manufactured by the Company will have an impact on the Company's future turnover and profitability.

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## RISK FACTORS

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### **No clear business delineation with Tongrentang Ltd. and Tongrentang Holdings**

Although the Company has a total of 86 production permits in common with those of Tongrentang Ltd. and Tongrentang Holdings, their businesses are delineated in accordance with their focus on the forms of medicine they produce. The Company focuses on producing products in the forms of granules, pills, tablets and soft capsules while Tongrentang Ltd. and Tongrentang Holdings focus on producing Chinese medicine in the forms of large pills, powder, ointment, pellet and medicinal wine. However, Tongrentang Ltd. also has some minor production lines for the productions of granules and pills. In addition, due to the nature of Chinese medicine as described in the following paragraph, products in different forms may have similar curative effects and properties. As all the three companies are engaging in the business of manufacturing Chinese Patent Medicines, the delineation of business between these three companies is not clear. As a result, the Company's business may be adversely affected by products of Tongrentang Holdings and Tongrentang Ltd. with similar curative effects in different forms.

### **Reliance on Tongrentang Holdings and Tongrentang Ltd.**

Tongrentang Holdings and Tongrentang Ltd. have been the Company's main source of supply of raw material for the past two years. For the two years ended 31 December 1999 and the four months ended 30 April 2000, such supplies accounted for 42%, 47% and 48% respectively of the Company's total purchase. It is the Company's current intention to gradually increase the portion of independent sourcing and resort to Tongrentang Holdings and Tongrentang Ltd. for the balance. On 6 October 2000, Tongrentang Holdings and the Company signed a raw materials supply agreement. For details, please refer to the sub-section headed "Connected transactions" under the section headed "Relationship with Tongrentang Holdings and Tongrentang Ltd.".

The Company also makes use of the sales network of Tongrentang Ltd. to market its products to consumers within the PRC. For the two years ended 31 December 1999 and the four months ended 30 April 2000, the percentage of sales of the Company through the distribution network of Tongrentang Ltd. were approximately 90%, 91% and 83% respectively. For details, please refer to the sub-section headed "Connected transactions" under the section headed "Relationship with Tongrentang Holdings and Tongrentang Ltd.".

In addition, pursuant to the "Land use right leasing agreement" dated 6 October 2000 entered into by the Company and Tongrentang Holdings as well as the "Agreement supplemental to the building leasing agreement" dated 6 October 2000 entered into by the Company with Tongrentang Holdings and Tongrentang Ltd., the Company has leased from Tongrentang Holdings land use right at a consideration of RMB2,685,434 per annum and the property at a consideration of RMB3,000,000 per annum. For details, please refer to the sub-section headed "Connected transactions" under the section headed "Relationship with Tongrentang Holdings and Tongrentang Ltd.".

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## RISK FACTORS

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The Company's products are sold under the 「同仁堂」, 「京花」 and 「山花」 trademarks. In this regard, the Company entered into a “Tongrentang trademark licensing contract” with Tongrentang Holdings on 6 October 2000. Please refer to the sub-section headed “Connected transactions” under the section headed “Relationship with Tongrentang Holdings and Tongrentang Ltd.” for details.

It is expected that such transactions will continue in the future and the relationships between the Company, Tongrentang Holdings and Tongrentang Ltd. will therefore affect the Company's future business significantly. If there is any significant adverse change in the relationships between Tongrentang Holdings or Tongrentang Ltd. and the Company, or if Tongrentang Holdings and Tongrentang Ltd. fail to discharge the liabilities of their respective agreements or undertakings, or refuse to renew the agreements upon expiry, the Company's operating results and financial conditions will be adversely affected.

### **Controlling interest of Tongrentang Ltd. in the Company**

Upon completion of the Placing, approximately 54.705% of the issued share capital of the Company (assuming no exercise of the Over-allotment Option) will be held by Tongrentang Ltd.. As a result of its majority shareholding in the Company, Tongrentang Ltd. will have the ability to elect all of the Company's directors. At present, all of the executive Directors are also the directors of Tongrentang Ltd. and/or the senior management of Tongrentang Holdings. Accordingly, while the Company is a separate legal entity, Tongrentang Ltd. and/or Tongrentang Holdings will have the ability to influence the Company's corporate actions. In addition, Tongrentang Ltd. will have the ability to decide any matters and effect any corporate transactions that, under the Articles of Association, may be decided or effected by a vote of the majority of shareholders, subject to the provisions of the Articles of Association that afford the holders of H Shares the right to vote separately on certain matters and provide for certain restrictions on controlling shareholders and subject to the laws, regulations and rules applicable to the Company. For details, please see “Summary of relevant PRC and Hong Kong laws and regulations” and “Summary of Articles of Association” set out in Appendix V and VI respectively. Accordingly, Tongrentang Ltd. has voting and management control over the Company, and the interests of Tongrentang Ltd. may be different from the interests of the other shareholders of the Company.

### **Provisions for bad and doubtful debts**

Prior to the establishment of the Company, Tongrentang Ltd. had been solely responsible for the distribution of most of the Company's products (“the Relevant Products”) to the ultimate customers. Customers generally did not, when making payment, specifically indicate the invoice to which a certain payment should apply. Although the Company's revenue can be specifically identified based on product lines restructured to the Company (see section headed “Business”), it is not possible for Tongrentang Ltd. to know with certainty whether any part of the accounts receivable from an individual customer should be attributed to the sale of the Relevant Products. For this reason, Tongrentang Ltd. took up the credit risk of such receivables by not injecting any balance of such accounts receivable to the Company.

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## RISK FACTORS

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For the two years ended 31 December 1999 and the four months ended 30 April 2000, provision for doubtful debt for the sales of products of Tongrentang Ltd. and the Relevant Products of the Company amounted to approximately RMB9,376,000, RMB4,378,000 and RMB75,000 respectively.

Assuming that during the two years ended 31 December 1999 and the four months ended 30 April 2000, the Relevant Products were sold directly by the Company to the ultimate customers and that the Company bore the related credit risk, provisions for doubtful debt of the Company for the two years ended 31 December 1999 of approximately RMB4,000,000 and RMB2,000,000 respectively were made, and no provision for doubtful debt of the Company for the four months ended 30 April 2000 was made, estimated by reference to the proportion of annual sales of the Company over that of Tongrentang Ltd. to the total provision for doubtful receivables resulted from the sales of products of Tongrentang Ltd. and the Relevant Products of the Company. For details of the provision of pro forma doubtful debt, please refer to the accountants' report in Appendix I to this prospectus.

Following the reorganization, (1) the Company began issuing its own invoices to customers starting from 1 June 2000; (2) the Company has requested the customers to indicate clearly the invoice to which a particular payment they purport to settle related; (3) bank accounts have been opened under the Company's name and customers have been instructed to settle invoices relating to the Company's products by paying amounts due directly into the Company's bank account; (4) the Company also entered into an agreement with Tongrentang Ltd. on 31 May 2000 supplemented by another agreement entered into between the same parties on 19 October 2000 which together provide that in the event that customers failed to identify the invoices to which the lump sum payment should be applied, the amount will be divided between Tongrentang Ltd. and the Company in proportion to the customer's accounts receivable balances of Tongrentang Ltd. and the Company respectively, as of the month end. It was further agreed between Tongrentang Ltd. and the Company that in case of dispute with customers, both of them will exercise joint efforts to collect the receivables; and (5) the Company was authorized to periodically review the distribution, invoicing and receivables collection procedures and to test the implementation of the control procedures (i.e. authorization controls on invoicing of the Company) of Tongrentang Ltd. to ensure that the Company's revenue are properly captured and reported to the Company. However, despite the above measures, should the Company fail to collect the relevant receivables from its customers, the Company would have to make a corresponding provision for bad and doubtful debts, which may adversely affect the financial performance of the Company.

### **Product liability**

Substantially all of the products of the Company, Tongrentang Holdings and Tongrentang Ltd. are manufactured and marketed under the 「同仁堂」 trademark. Although the name of the factory and the company producing the medicine are printed on the packages of the medicine, consumers may not be able to distinguish the products of the Company from those of

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## **RISK FACTORS**

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Tongrentang Holdings or Tongrentang Ltd.. As such, any actions taken by consumers against Tongrentang Holdings and Tongrentang Ltd in respect of any product liability arising from their respective products may possibly create a knock-on impact on the image of the Company's products which may in turn adversely affect the sales of the Company.

### **Permits and business licences**

In order to carry out pharmaceutical businesses in the PRC, pharmaceutical enterprises are required to obtain certain permits and business licences from various governmental authorities. For details of these permits and business licences, please refer to the section headed "Industry overview". The Company has obtained all requisite permits and business licences from the relevant regulatory authorities in the PRC for its operations. The Company is required to apply for renewal of all such permits upon their expiry. The Company will be subject to re-assessment by the issuing authorities in accordance with the prevailing legal and regulatory requirements for the purposes of such renewal. It should be noted that the requirements under these permits and business licences may change from time to time, which may give rise to compliance problems. In addition, it may be costly for the Company to comply with all changes or additions to the requirements relating to the renewal of the relevant permits and business licences. In the event that the renewal of any of these permits or business licences is not granted, the relevant Company's operations would have to cease.

### **Achieving business objectives**

As described in the section headed "Business objectives", the Company intends to expand its existing business. However, the Company's future development will depend, amongst other things, on the identification of attractive investment opportunities and the successful conclusion of negotiations. In addition, the Company's ability to raise additional capital for its expansion is in turn affected by economic conditions in general and conditions in the capital market. Inability to raise adequate funds will hinder the Company's growth and achieving its objectives as described in the section headed "Business objectives".

### **Research and development risks**

One of the major emphasis of the Company's future strategy is on improving its existing Chinese medicine products and on developing new natural medicine. Before commencing any particular item of research, the Company carefully considers such factors as market analysis, technology survey, research cost, the reputation of its research partners, the period of time required for research, and the probability of success, etc. However, because of the many uncertain factors such as rapid changes in market demands, the long period of time required for new medicine development (which usually takes 3-5 years) and heavy initial investment, there is no assurance that the research projects, either those initiated or acquired by the Company can be completed within the timeframe anticipated, or that the new product can obtain approval for production issued by relevant government authority, or that the research results can be converted into production, or that the products will be in high demand in the market.

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## RISK FACTORS

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### Price fluctuation of raw materials

To a great extent, the Company relies heavily on the supplies of Chinese medicinal raw materials for the production of its products. Most of these Chinese herbs are agricultural by-products, which are subject to their respective production and harvest cycles. The supplies and market price of these Chinese herbs may be affected during period of natural disasters, periodical reduction of output or environmental change. Such fluctuation in supplies and market prices of these Chinese herbs may have an impact on the production cost of the Company.

### GMP

GMP was initiated by the World Health Organization. The purpose of GMP is to establish guidelines for pharmaceutical manufacturers in manufacturing their products, so as to assure the quality of products and to protect consumer interests. So far, the U.S., Japan, the European Union and other developed countries have set up their own standards in enforcing the quality of pharmaceutical products which are compatible with the guidelines set by GMP.

Compliance with GMP is viewed internationally as a pre-requisite to an assured quality of pharmaceutical products. Pursuant to the “Notice regarding relevant stipulations on implementing pharmaceuticals GMP” (關於《藥品生產質量管理規範》有關規定的通知) issued by SPSAC in 1999 for the systematic implementation of GMP certification by form and category, manufacturers of certain kinds of pharmaceuticals are required to comply with GMP standards within the time limit stipulated by SPSAC. If these manufacturers have not obtained the GMP certification within the stipulated time limit, their Pharmaceutical Manufacturing Enterprise Permit (藥品生產企業許可證) will not be renewed and the production of such pharmaceutical products will have to cease. Currently, there is no guideline on the said stipulated time limit regarding the manufacturing of the Company’s products. However, any change in the policy of the SPSAC could have an adverse effect on the profitability of the Company. It is understood by the Directors that currently, those individual production workshops that are deemed to have the ability to comply with GMP standards are permitted to continue to operate. During the period of non-compliance, those production workshops can continue to manufacture their existing products but not new medicinal products. However, there is no assurance that such extension arrangement will continue in the future.

On 27 June 2000, the Company’s production lines for tablets and soft capsules of the Chinese Medicine Refinery and that for granules of Factory No. 2 obtained the GMP certification in Australia. If any product under development by the Company fails to meet the GMP requirements or other requirements of the importing countries, the entry of such product into that foreign market would be affected. At present, the Company’s production line for pills does not possess GMP certification.

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## RISK FACTORS

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It should be noted that the standards of GMP may be revised from time to time in accordance with new developments in the industry and such revisions may give rise to compliance problems. In addition, it may be costly for the Company to comply with all changes or additions to the GMP standards. In the event that the renewal of any required GMP-related status is not granted, the relevant operations of the Company may have to cease which in turn may have an adverse impact on the Company's profitability.

### **Trademarks**

The Company's products are being sold mainly under the trademark of 「同仁堂」. Sales of the Company's major products under this trademark represent 61%, 66% and 73% of the total turnover of the Company for the two years ended 31 December 1999 and the four months ended 30 April 2000 respectively. The Company also uses the trademarks 「京花」 and 「山花」 for certain of its products. The Directors consider that the use of 「同仁堂」, 「京花」 and 「山花」 trademarks is very important to the Company's business. The Company has entered into an agreement with Tongrentang Holdings for the use of 「同仁堂」, 「京花」 and 「山花」 trademarks up to 28 February 2003, which is the expiry date of these trademarks registered by Tongrentang Holdings. For details, please refer to the sub-section headed "Connected transactions" under the section headed "Relationship with Tongrentang Holdings and Tongrentang Ltd.". If, for whatever reason, the Company is no longer able to use the 「同仁堂」, 「京花」 or 「山花」 trademarks or is only able to use these trademarks at an unreasonably high fees, the Company's operations may be adversely affected.

### **Product concentration**

Sales of the Company's Ganmao Qingre Granule (感冒清熱沖劑) and Liuwei Dihuang Pill (六味地黃丸) accounted for 31.5%, 35.2% and 39.4% of the Company's total turnover for the two years ended 31 December 1999 and the four months ended 30 April 2000 respectively. Therefore, the Company's turnover and profits may be materially affected by any fluctuation in the demand or market price of these products or any increase in competition.

### **Exchange rate risks**

A portion of the Company's products is exported overseas through the Import and Export Department, which accounted for 2.0%, 1.8% and 2.7% of the total sales of the Company for the two years ended 31 December 1999 and the four months ended 30 April 2000 respectively. At the same time, the Company may have to import a small quantity of herbal materials from overseas. Therefore, the Company has to face a certain degree of exchange rate risks.

### **Counterfeits**

The high quality of the Company's products and the increasing popularity associated with them may attract counterfeits. Though the Chinese government is endeavoring to stamp out counterfeits in general, the lack of enforcement of the anti-counterfeit measures has caused many enterprises to suffer in the face of competition from the counterfeit products. Counterfeit products may also be of inferior quality which will in turn affect the Company's image.

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## RISK FACTORS

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### **Product liability insurance**

The Company has not taken out any insurance against liability for products sold or distributed by it or any indirect losses from termination of the business (such as loss of profit) as this is not a statutory requirement under current PRC laws and regulations. At present, as confirmed by the Directors, the Company's overseas customers are responsible for all importing procedures, including obtaining custom clearance, regulatory approvals, repackaging (if necessary) and arranging product liability insurance (if necessary) for the Company's products. The Directors confirm that the Company has never encountered any material litigation or claims from customers arising from its products. Should any product liability claim be brought against the Company, there is no assurance that it would not have an adverse effect on the reputation and/or the performance and profitability of the Company.

### **Overseas markets**

At present, the Company exports its products to overseas markets either as health care products, food supplements or medicine. The Company intends to expand its overseas sales and marketing network upon listing. However, there may be a number of risks associated with the expansion into new overseas markets, including differences in regulatory requirements, more stringent product liability exposure, potentially adverse tax consequences, fluctuations in currency exchange rates, burdens in complying with foreign laws, import restrictions regulations and administrative difficulties in staffing and managing foreign operations. Therefore, there is no assurance that the Company can expand its sales and marketing network as intended.

### **Property leasing agreement**

Pursuant to an agreement dated 6 October 2000 entered into between the Company as sub-tenant, Tongrentang Holdings as landlord and Tongrentang Ltd. as tenant supplemental to the building leasing agreement dated 15 November 1998 made between Tongrentang Holdings as landlord and Tongrentang Ltd. as tenant in respect of, among others, the Chinese Medicine Refinery (Xi Zhi Men Nei Da Street) (in this sub-section referred to as the "Property") erected on No. 130 Xi Zhi Men Nei Da Street (in this sub-section referred to as the "Land"), Xi Cheng District, Beijing, the PRC with an approximate area of 6,667 sq.m. (i.e. the properties referred to in no. 4 of Group I of the valuation report in Appendix III hereto) (in this sub-section referred to as the "Supplemental Agreement"), the Company has leased from Tongrentang Holdings the Property for a term of 10 years from 1 January 1997 to 31 December 2006 at an annual rental of RMB3,000,000.

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## RISK FACTORS

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Pursuant to a legal opinion dated 10 October 2000 issued by the Company's legal advisers on the PRC laws, Zhong Yin Law Firm, in respect of the Supplemental Agreement:

- i. due to historical reasons, currently, Tongrentang Holdings still uses and occupies the Land at no consideration and no document was signed in respect of such use and occupation and the PRC government does not issue any title documents to properties of this nature; and
- ii. the legal owner of the Property is Tongrentang Holdings. According to the minutes of a meeting dated 9 January 1995 issued by the Beijing Government in respect of, among other things, the arrangement for the use and occupation of the Land and all the buildings erected thereon, Tongrentang Holdings can continue to occupy the Land and the Property.

In the event that the use and occupation of the Property is interrupted due to circumstances beyond the control of Tongrentang Holdings, such as a change of policy of the PRC government in respect of the use and occupation of the Land, the Company might be required to move, among other things, the Chinese Medicine Refinery (Xi Zhi Men Nei Da Street) to another suitable location, which might adversely affect the Company's operations.

### **The State-owned land use right certificate**

The land where the Company's production plants, Factory No. 2 and the Chinese Medicine Refinery (No.33 Yang Fang Hu Tong), are located is leased from Tongrentang Holdings, while the ownership of the buildings belongs to the Company. Tongrentang Ltd. and Tongrentang Holdings have leased the land concerned to the Company by entering into relevant leasing agreements with the Company (please refer to the sub-section headed "Connected transactions" under the section headed "Relationship with Tongrentang Holdings and Tongrentang Ltd."). If any of such agreements cease to have effect due to circumstances beyond the control of the Company, the Company would have no other alternative but to move its factory facilities to another suitable location, which would adversely affect the Company's operations.

### **Use of proceeds**

The business plan of the Company as described in the section headed "Business objectives" below is based on assumptions of future events which by their nature are subject to uncertainty and there is no assurance that the plans of the Company will materialize as intended. In the event that any part of the business plans of the Company does not materialize or proceed as planned, the Directors will carefully evaluate the situation and may reallocate the intended funding to other business plans and/or to new projects of the Company and/or to hold it as short term deposits so long as the Directors consider it to be in the best interest of the Company taken as a whole.

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## RISK FACTORS

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### **Dividend policies**

For the two years ended 31 December 1999, the Company distributed RMB24,297,104 and RMB38,258,546 to Tongrentang Ltd. as dividend respectively, which was equivalent to the Company's profit attributable to shareholders for the two years ended 31 December 1999, respectively. The payment of the dividend was financed by internal resources of the Company. However, there is no assurance that this dividend payout ratio will continue in the future. The past dividend payments referred to above should not be used as a reference or basis to determine the amount to dividend payable in the future.

### **RISKS RELATED TO THE INDUSTRY**

#### **Medicare reforms in the PRC**

The growth of the pharmaceutical sector in the PRC may be slowed down for a short term due to the release of "Opinion on medical and hygiene system reform in cities and towns" (關於城鎮醫藥衛生體制改革的指導意見) in February 2000. The medicare reforms in the PRC seek to promote the separation of the doctoring and medicine dispensing functions and the removal of hospitals' incentive to sell medicine. The Directors believe that the likely impact of such reforms will result in a change in the structure of the distribution channel for medicine whereby hospitals will reduce their purchases for pharmaceutical products which may in turn affect the profitability of the Company.

#### **Product substitution**

The Company has so far obtained the approval for producing 275 types of Chinese Patent Medicine. Certain pharmaceutical products produced by the PRC manufacturers are subject to product protection for a period of time during which no other manufacturer or only a limited number of manufacturers may manufacture such products. Between 1994 and 1999, ten products of the Company have obtained State Class 2 protection under the "Protection of different classes of Chinese medicine regulations" (中藥品種保護條例). Sales of such products accounted for approximately 5%, 4% and 3% of the Company's total turnover for the two years ended 31 December 1999 and the four months ended 30 April 2000 respectively. The Company has not applied for such production protection for the remainder of its products. The introduction of substitutes at prices comparable to or lower than prices of those products distributed or manufactured and sold by the Company would adversely affect the profitability of the Company.

#### **Competition**

The business of medicine manufacturing is very competitive. There are currently over 1,000 Chinese medicine industrial enterprises in the PRC of which more than 170 are of large and medium size. The Company is facing fierce competition in the areas of new product development, product quality and marketing. Since a certain portion of the Company's products are not produced with economy of scale, the Company may be placed in a disadvantaged position in competition with other manufacturers.

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## RISK FACTORS

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In recent years, many new herbal medicine producers have entered into the Chinese medicine market. They adopt high technology and form joint-ventures to penetrate into the Chinese medicine market, and have acquired a lot of State-owned herbal medicine enterprises. These new producers are well structured, with low level of debts, and enjoy fringe benefits from various levels of the PRC government. Therefore, these new producers will have a competitive advantage over their competitors, including the Company.

In the meantime, the greatest challenge to Chinese medicine producers comes from western medicine producers. The improvement in the effectiveness of western medicine and the continued development of new products by western medicine producers have to a certain extent reduced the demand for Chinese medicine products. As herbal medicine become more and more popular, and as people become more aware of the importance of intellectual property by the imminent entry of China into WTO, more and more western medicine producers are moving into the production of Chinese medicine. The western medicine producers are in general superior to the Chinese medicine producers in terms of production facilities, management and personnel qualities, they present formidable competition to the local manufacturers of the Chinese Patent Medicine in the PRC.

The competition among the Chinese medicine producers in China varies in terms of medicine products. In general, the greater the demand there is for a certain product, the greater the market value is assigned to that product, which in turn draws in more competitors in producing that product. Should there be any significant increase in the number of distributors and/or manufacturers in the category of pharmaceutical products in which the Company is engaged in and/or if the Company is unable to cope with the changing market conditions by improving its competitiveness, the Company's profitability will be adversely affected.

### **Price control**

The prices of certain main products of the Company, including Ganmao Qingre Granule (感冒清熱沖劑), Banlangen Granule (板藍根沖劑), Liuwei Dihuang Pill (六味地黃丸), Niu Huang Jiedu Tablet (牛黃解毒片) and Angong Niu Huang Pill (安宮牛黃丸) are subject to control by the State and price administration authorities in Beijing. Sales of these products accounted for 49.4%, 55.5% and 61.5% of the turnover of the Company for each of the two years ended 31 December 1999 and for the four months ended 30 April 2000 respectively. In the event that the cost of manufacturing these price-controlled products increases while applications for upward adjustments of price ceilings of these price-control products are not approved, and/or if there are downward adjustments of the price ceilings of these price-control products and the Company is unable to reduce its production costs accordingly, the Company's profit may be adversely affected.

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## **RISK FACTORS**

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### **Export of pharmaceutical products**

At present, MOFTEC and its authorized government authorities implement export restrictions on certain pharmaceutical products. For each of the two years ended 31 December 1999 and the four months ended 30 April 2000, the Company's export sales amounted to RMB4.9 million, RMB5.6 million and RMB3.4 million respectively. The Company intends to further develop its operations such that export sales will increase in the future. Should additional conditions be imposed by the Central Government and/or the governments of the countries to which the Company intends to export its products to, future export sales of the Company might be negatively affected which may in turn have an adverse effect on the performance and profitability of the Company.

The PRC regulations for the export of Chinese medicine may also be different from the prospective importing countries. As natural medicine become increasingly popular worldwide, the yardsticks for imported herbal medicine by various countries may be modified from time to time. These changes will pose limitations on the Company's export.

### **WTO**

A bilateral WTO agreement was entered into between the PRC government and the U.S. government in November 1999 ("WTO Agreement"). It is expected that the WTO Agreement will pave the way for the PRC to enter into the WTO. However, the PRC government has yet to complete negotiations with other WTO members. Pursuant to the WTO Agreement, the industrial tariffs of the PRC will fall from an overall average of 24.6% in 1997 to an overall average of 9.4% by 2005. On U.S. priority industrial products, tariffs will fall to 7.1% with the majority of tariff cuts fully implemented by 2003. Tariffs will fall on a range of products including wood, paper, chemicals, capital and medical equipment. The tariffs on pharmaceutical products will be reduced to 5.5%-6% after China joins WTO. The PRC government will also eliminate non-tariff quotas within two to five years. Should the tariff rate on pharmaceutical products be lowered, competition from overseas pharmaceutical products may increase which in turn may have an adverse effect on the performance and profitability of the Company.

### **Foreign exchange remittance**

The Company currently receives substantially all of its revenues and makes substantially all of its payments in Renminbi. Renminbi is currently not a freely convertible currency. However, pursuant to the Regulations on the Administration of Foreign Exchange Settlement, Payment and Sale (結匯、付匯及售匯管理規定), foreign currencies required for the distribution of profits and payment of dividends may be purchased from designated foreign exchange banks upon presentation of board resolutions authorizing the distribution of profits or dividends of the company.

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## **RISK FACTORS**

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Under the current foreign exchange control system, there is no guarantee that sufficient foreign currency will be available at a given exchange rate to satisfy the demand of a particular enterprise in full. There can be no assurance that shortages in the availability of foreign currency will not restrict the Company's ability to obtain sufficient foreign currency to pay dividends on Shares or to satisfy its other foreign currency requirements.

### **RISKS RELATED TO THE PRC**

#### **Economic and political considerations**

The political, economic and legal systems in the PRC differ from those in Hong Kong and many other jurisdictions. Since 1978, the PRC government has been undertaking reforms of the economic and political structures, which are expected to continue. Currently, China is going through a transition from a planned economy into a socialist market economy. Although in the past decade these reforms have brought about significant economic growth and social progress, many of these reforms are unprecedented or in their experimental stage, and are expected to be refined and improved upon.

Although in the opinion of the Directors, these adjustments and refinements of reforms will have a positive effect on the Company's business, there is no assurance that these reforms will necessarily benefit the Company. For example, the use of anti-inflationary and anti-deflationary measures may have an adverse effect on the Company.

#### **Legal system**

Although many laws and regulations governing economic matters have been promulgated and amended in the PRC since 1979, the PRC legal system is still not sufficiently comprehensive when compared with the legal systems of certain developed western countries. The interpretation of the PRC laws may be influenced by policy changes reflecting domestic political and social changes. In addition, it may also be difficult to enforce judgments in the PRC.

Many laws and regulations in the PRC are promulgated in broad principles and the Central Government has gradually laid down implementation rules and has continued to refine and modify such laws and regulations. As the PRC legal system develops, the promulgation of new laws or refinement and modification of existing laws may affect foreign investors. The general effect of legislation since 1982, when the National People's Congress amended the constitution to authorize foreign investment, has been to enhance significantly the protection afforded to foreign investment enterprises in the PRC. However, there can be no assurance that future changes in legislation or the interpretation thereof will not have an adverse effect upon the Company.

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## RISK FACTORS

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### **Conversion of foreign exchange in the PRC**

The Central Government had abolished its two-tier exchange rate system and replaced it with a unified floating exchange rate system largely based on market supply and demand. Under the new system, the PBOC publishes daily exchange rates for Renminbi based on the previous day's dealings in the inter-bank foreign exchange market. Since the introduction of this unified floating rate system, movements in the exchange rate of the Renminbi against other currencies, such as U.S. Dollars, are to an extent subject to market forces. Despite such developments, Renminbi is still not a freely convertible currency. In addition, there is no assurance that Renminbi will not be subject to devaluation or depreciation due to administrative or legislative intervention by the Central Government or adverse market movements, or that shortages in the availability of foreign currency will not develop. Although recently the Asian economies seem to be recovering from the Asian economic crisis, investors continue to speculate that the Renminbi may depreciate in the short term. Should the Renminbi be devalued, the value of the Company's investments and its profitability may be adversely affected.

### **RISKS RELATED TO THE PLACING**

#### **There has been no prior public market for the H Shares; the liquidity and market price of the H Shares following the Placing may be volatile**

Before the Placing, there was no public market for the H Shares. The Issue Price for the H Shares was the result of negotiations between the Company and the Sponsor on behalf of the Placing Underwriters and the Issue Price may differ significantly from the market price for the H Shares following the Placing. The Company has applied to list and deal in the H Shares on the GEM. However, being listed on the GEM does not guarantee that an active trading market for the H Shares will develop following the Placing.

The price and trading volume for the H Shares may be highly volatile. Factors such as variations in the Company's revenue, earnings and cash flow, announcements of new products, technology innovation, changes in top management, opportunity for business development in e-commerce, announcements of new investments, strategic alliances and/or acquisitions, or fluctuations in market prices for its products, penetration and the trading volume of H Shares in the market, the development of the GEM market, the overall economy as well as other factors could cause the market price and/or trading volume for the H Shares to change substantially. The Company can give no assurance that these developments will not occur in the future.

#### **Certain statistics are derived from unofficial publications**

Certain statistics in this prospectus relating to the pharmaceutical industry are derived from unofficial publications. Such information has not been independently verified by the Company and may not be accurate, complete or up-to-date. The Company makes no representation as to the correctness or accuracy of such statements and, accordingly, such information should not be unduly relied upon.

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## **WAIVERS FROM STRICT COMPLIANCE WITH THE GEM LISTING RULES**

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For the purpose of listing of the Shares on GEM, the Company has sought a number of waivers from the GEM Listing Committee in relation to certain requirements under the GEM Listing Rules. Details of such waivers are categorized and described below.

### **CONTINUING CONNECTED TRANSACTIONS**

The Company has entered into and will continue the following transactions following the listing of Shares on the GEM:

#### **(A) Transaction between the Company and Tongrentang Holdings**

1. *Contract for storage and custody*

Tongrentang Holdings has provided and will continue to provide storage and custody services to the Company.

2. *Raw material supply agreement*

Tongrentang Holdings has supplied and will continue to supply the Company with part of the Chinese medicinal raw materials that are required for its production.

3. *Permission to use tradenames and certain trademarks*

Tongrentang Holdings has allowed and will continue to allow the Company to use certain trademarks, tradenames and trademark logos of Tongrentang Holdings.

#### **(B) Transaction between the Company and Tongrentang Ltd.**

*Distribution agency agreement*

- (a) Distribution of Tongrentang Ltd.'s products by the Company in overseas market under agency agreement

Tongrentang Ltd. has appointed and will continue to appoint the Company to handle, as its non-exclusive agent, the sale of its products outside the PRC.

- (b) Distribution of the Company's products by Tongrentang Ltd. in the PRC under agency agreement

The Company has appointed and will continue to appoint Tongrentang Ltd. to handle, as its non-exclusive agent, the sale of its products in the PRC.

**(C) Transaction between the Company, Tongrentang Holdings and Tongrentang Ltd.***1. Land use right leasing agreement*

Tongrentang Holdings has leased and will continue to lease to the Company two pieces of land situated at (i) No. 33 Yang Fang Hu Tong, Xi Cheng District, Beijing, the PRC (approximate area: 5,961.2 sq.m.); and (ii) No. 20 Nan San Huan Zhong Road, Feng Tai District, Beijing, the PRC (approximate area: 43,815.15 sq.m.).

*2. Agreement supplemental to the building leasing agreement (i.e. the Supplemental Agreement referred to in the paragraph headed “Property leasing agreement” under the section headed “Risk factors”)*

Tongrentang Holdings and Tongrentang Ltd. have sub-let and will continue to sub-let the medicine production building, office and ancillary buildings in No. 130 Xi Zhi Men Nei Da Street, Xi Cheng District, Beijing, the PRC, with an approximate area of 6,667 sq.m., to the Company.

**(D) Transaction between the Company and Tongrentang Advertising***Advertising agency agreement*

Tongrentang Advertising has handled and will continue to handle, as an agent of the Company, the Company’s advertisement releases.

**(E) Transaction between the Company and subsidiaries and associates of Tongrentang Holdings and Tongrentang Ltd.**

The Company has distributed and will continue to distribute its products to the subsidiaries and associates of Tongrentang Ltd. and Tongrentang Holdings.

Details of the above connected transactions are set out in the sub-section headed “Connected transactions” under the section headed “Relationship with Tongrentang Holdings and Tongrentang Ltd.” in this prospectus. The above continuing transactions constitute continuing connected transactions (the “Continuing Connected Transactions”) under the GEM Listing Rules, and are subject to reporting, announcements and shareholders’ approval requirements. Since the above transactions are conducted in the ordinary and usual course of business of the Company and on a regular basis, the Directors do not believe that it would be practical to make disclosure of or, where necessary, obtain shareholders’ approval for each of such transactions. Accordingly, the Company has applied to the Stock Exchange for waivers from strict compliance with the announcement and shareholders’ approval

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## WAIVERS FROM STRICT COMPLIANCE WITH THE GEM LISTING RULES

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requirements under rules 20.35 and 20.36 of the GEM Listing Rules for each of the Continuing Connected Transactions and the Stock Exchange has indicated that such waivers will be granted for the three financial years ending 31 December 2002 subject to the following conditions:

- (a) *in any financial year ending 31 December 2002*
- (i) *the aggregate amount relating to the “Contract for storage and custody” does not exceed RMB 3,500,000;*
  - (ii) *the aggregate amount relating to the “Raw material supply agreement” does not exceed RMB 75,000,000;*
  - (iii) *the aggregate amount relating to “Permission to use tradenames and certain trademarks” does not exceed RMB 900,000;*
  - (iv) *the aggregate amount relating to the “Overseas distribution agency agreement” does not exceed RMB 10,000,000;*
  - (v) *the aggregate amount relating to “PRC distribution agency agreement” does not exceed RMB 14,500,000;*
  - (vi) *the aggregate amount relating to “Land use right leasing agreement” does not exceed RMB 3,000,000;*
  - (vii) *the aggregate amount relating to “Agreement supplemental to the building leasing agreement” does not exceed RMB 3,600,000;*
  - (viii) *the aggregate amount relating to “Advertising agency agreement” does not exceed RMB 30,000,000; and*
  - (ix) *the aggregate amount relating to the transactions between the Company and subsidiaries and associates of Tongrentang Holdings and Tongrentang Ltd. does not exceed RMB 150,000,000.*
- (b) *the details of the transactions described in the above agreements shall be disclosed in the Company’s annual report and accounts pursuant to rules 20.34(1) to (5) of the GEM Listing Rules;*

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## WAIVERS FROM STRICT COMPLIANCE WITH THE GEM LISTING RULES

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- (c) *the Company's independent non-executive Directors shall examine the transactions described in the above agreements every year and make their confirmation in the Company's annual report and accounts:*
- (i) *these transactions are executed in the ordinary and usual course of business of the Company;*
  - (ii) *these transactions are executed on normal commercial terms or on terms not less favorable than those given to (or obtain from, wherever applicable) independent third parties (if no comparable transaction can be referred to judge whether the transaction is executed on normal commercial terms);*
  - (iii) *these transactions are executed in accordance with the relevant agreement governing them on terms that are fair and reasonable and in the interest of the Company's shareholders as a whole; and*
  - (iv) *aggregate amount of each of these transactions has not exceeded the cap amount set out in paragraph (a) above;*
- (d) *the Company's auditors shall review these transactions every year and confirm in writing (with a copy provided to the Stock Exchange) to the Board in respect of the following matters:*
- (i) *the transactions described in the above agreements have been approved by the Board;*
  - (ii) *these transactions have been executed according to the pricing policies of the Company and the terms of the agreements governing the same transactions; and*
  - (iii) *aggregate amount of each of these transactions has not exceeded the cap amount set out in paragraph (a) above;*
- (e) *the Company and each party to the transactions described in the above agreements have undertaken to provide sufficient facility for the Company's auditors to inspect their respective accounts and records, thus enabling the auditors to assess the above connected transactions and make the relevant reports; and*
- (f) *the Company has undertaken to immediately notify the Stock Exchange if it comes to its knowledge or has reasons to believe that the independent non-executive Directors and/or auditor will be unable to confirm the matters set out in rules 20.27 and 20.28 of the GEM Listing Rules.*

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## **WAIVERS FROM STRICT COMPLIANCE WITH THE GEM LISTING RULES**

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*If there are changes or updates in any terms of the above agreements and contracts or that the Company and any connected persons (within the definition of the existing GEM Listing Rules) reach any new arrangements, the Company undertakes to comply with the requirements in the corresponding provisions of Chapter 20 of the GEM Listing Rules, unless the Company reports to the Stock Exchange and is granted an exemption.*

### **ESCROW ARRANGEMENT**

Immediately prior to the listing of the Shares on GEM, Tongrentang Holdings, Tongrentang Ltd., Mr. Zhao Bing Xian, Mr. Yin Shun Hai, Mr. Tian Da Fang, Mr. Wang Zhao Qi, Mr. Mei Qun and Mr. Tian Rui Hua are regarded as the initial management shareholders of the Company.

Pursuant to rule 13.16(1) of the GEM Listing Rules, a new applicant shall procure that every initial management shareholder places in escrow, with an escrow agent acceptable to the Stock Exchange, his relevant securities (as defined in rule 13.15(4) of the GEM Listing Rules) for a period of two years from the listing date, on term acceptable to the Stock Exchange. However, the Shares held by the Initial Management Shareholders are not represented by any form of physical scrip title documents, which means that the subject matter for custody by the escrow agent under rule 13.16(1) of the GEM Listing Rules does not physically exist in any form available for custody purposes. Therefore, the Company has applied for waiver from strict compliance with rule 13.16(1) of the GEM Listing Rules and the waiver has been granted by the Stock Exchange.

### **NON-POSSESSION OF TITLE CERTIFICATE**

*(A) Supplemental Agreement (hereinafter defined) in respect of No. 130 Xi Zhi Men Nei Da Street, Beijing, the PRC*

According to the property valuation report set out in Appendix III to this prospectus and pursuant to the Supplemental Agreement referred to in the paragraph headed “Property leasing agreement” under the section headed “Risk factors”, the Company has leased from Tongrentang Holdings the Property (as defined under the paragraph headed “Property leasing agreement” in the section headed “Risk factors”) originally leased to Tongrentang Ltd., for a term of 10 years from 1 January 1997 to 31 December 2006 at an annual rental of RMB3,000,000.

According to the property valuation report set out in Appendix III to this prospectus, the Chinese medicine refinery (Xi Zhi Men Nei Da Street) of the Property is one of the two factories of the Chinese Medicine Refinery. Based on the property valuation report, there is no commercial value attributable to the Company as at 31 July 2000 in respect of the interests of the Property.

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## WAIVERS FROM STRICT COMPLIANCE WITH THE GEM LISTING RULES

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(B) *Land use right leasing agreement in respect of (i) No. 33 Yang Fang Hu Tong, Xi Cheng District, Beijing, the PRC and (ii) No. 20 Nan San Huan Zhong Road, Feng Tai District, Beijing, the PRC (collectively, “Properties”)*

According to the property valuation report set out in Appendix III to this prospectus:

- (i) pursuant to an agreement dated 6 October 2000 entered into between the Company and Tongrentang Holdings, Tongrentang Holdings has agreed to lease to the Company the Properties for a term of 20 years commencing from the date thereof on the terms and conditions contained therein;
- (ii) the right to use the Properties is granted to Tongrentang Holdings which has valid title deeds of the Properties.

Pursuant to rule 11.19 of the GEM Listing Rules where a PRC property is otherwise significant to the issuer’s activities, the issuer will be expected to have the relevant long-term title certificate, unless otherwise permitted by the Stock Exchange.

Based on the opinions contained in the PRC legal opinion referred to in the paragraph headed “Property leasing agreement” under the section headed “Risk factors”, the Directors and Supervisors of the Company consider that it would be impractical and unduly onerous on the part of the Company if the Company is required to produce any title certificate in respect of the Land (as defined under the paragraph headed “Property leasing agreement” in the section headed “Risk factors”) and/or the Property so as to fully comply with the possession of title documents requirement as set out in rule 11.19 of the GEM Listing Rules. Moreover, since the Company is occupying the Properties as tenant, the Company does not possess any long-term title certificate of the Properties as required under rule 11.19 of the GEM Listing Rules. Therefore, the Company has applied for waiver from strict compliance with rule 11.19 of the GEM Listing Rules and the waiver has been granted by the Stock Exchange.

### **FINANCIAL PERIOD REPORTED ON**

Section 342 of the Companies Ordinance requires the inclusion in the prospectus of all matters set out in the Third Schedule to the Companies Ordinance, which include, among others, a report by the reporting accountant in respect of the profits and losses and assets and liabilities of the Company in respect of each of the three financial years immediately preceding the issue of the prospectus.

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## **WAIVERS FROM STRICT COMPLIANCE WITH THE GEM LISTING RULES**

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An accountants' report has been prepared on the financial information relating to the Company for the two years ended 31 December 1999 and the four months ended 30 April 2000 as set out in Appendix I to this prospectus which is in compliance with Chapter 7 of the GEM Listing Rules. The Company has applied for a waiver from the SFC from full compliance with the three-year requirement under paragraphs 27 and 31 of the Third Schedule to the Companies Ordinance and the SFC has granted such a waiver to the Company under Section 342A of the Companies Ordinance.

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## **INFORMATION ABOUT THIS PROSPECTUS AND THE PLACING**

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### **DIRECTORS' RESPONSIBILITY FOR THE CONTENTS OF THIS PROSPECTUS**

This prospectus, for which the Directors collectively and individually accept full responsibility, includes particulars given in compliance with the GEM Listing Rules for the purpose of giving information with regard to the Company. The Directors, having made all reasonable enquiries, confirm that, to the best of their knowledge and belief:

- (a) the information contained in this prospectus is accurate and complete in all material respects and not misleading;
- (b) there are no other matters the omission of which would make any statement in this prospectus misleading; and
- (c) all opinions expressed in this prospectus have been arrived at after due and careful consideration and are founded on bases and assumptions that are fair and reasonable.

The H Shares are offered solely on the basis of the information contained and representations made in this prospectus. No person is authorized in connection with the Placing to give any information or to make any representation not contained in this prospectus, and any information or representation not contained herein must not be relied upon as having been authorized by the Company, the Placing Underwriters, any of their respective directors or any other person involved in the Placing.

### **UNDERWRITING**

This prospectus is published in connection with the Placing which is sponsored by BOCI Asia. The Placing Shares are fully underwritten by the Placing Underwriters pursuant to the Underwriting and Placing Agreement. For further information relating to the underwriting arrangements, please see the section headed "Underwriting" in this prospectus.

### **RESTRICTIONS ON OFFER OF H SHARES**

No action has been taken to permit a public offering of the H Shares or the distribution of this prospectus in any jurisdiction (in particular in the United States) other than Hong Kong. Accordingly, this prospectus may not be used for the purpose of, and does not constitute, an offer or invitation in any other jurisdiction or in any circumstances in which such offer or invitation is not authorized or to any person to whom it is unlawful to make such an offer or invitation.

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## **INFORMATION ABOUT THIS PROSPECTUS AND THE PLACING**

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This prospectus shall not be deemed as a public offer of the H Shares, whether by way of sale or subscription, in the PRC. The H Shares are not being offered and may not be offered or sold directly or indirectly in the PRC to or for the benefit of, natural or legal persons of the PRC. According to the laws and regulatory requirements of the PRC, the H Shares shall only be offered or sold to natural or legal persons in Taiwan, Hong Kong or Macau or any country or areas other than the PRC by means of this prospectus or otherwise.

### **UNITED KINGDOM**

This prospectus has not been approved by an authorized person in the United Kingdom and has not been registered with the Registrar of Companies in the United Kingdom. The H Shares may not be offered or sold in the United Kingdom except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purpose of their businesses or otherwise in circumstances which have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995, as amended. In addition, no person may issue or pass on to any person in the United Kingdom any document received by him in connection with the Placing unless that person is of a kind described in Article 11(3) of the Financial Services Act 1986 (Investment Advertisements) (Exemptions) Order 1997, as amended, or is a person to whom such document may otherwise lawfully be issued or passed on.

### **SINGAPORE**

This prospectus has not been and will not be registered as a prospectus with the Registrar of Companies and Businesses in Singapore and the Shares will be offered in Singapore pursuant to exemptions invoked under Division 5A of Part IV of the Companies Act (Chapter 50 of Singapore) (the “Singapore Companies Act”). Accordingly, this prospectus and any other offering document or materials in connection with the Placing may not be issued, circulated or distributed in Singapore nor may any of the H Shares be offered for subscription or purchase or sold, directly or indirectly, nor may an invitation or offer to subscribe for or purchase any H Shares be made, directly or indirectly, to the public or any member of the public in Singapore other than (a) pursuant to, and in accordance with the conditions of, exemption invoked under Division 5A of Part IV of the Singapore Companies Act and to persons to whom the H Shares may be offered or sold under such exemption; or (b) otherwise pursuant to, and in accordance with the conditions of any other provision of the Singapore Companies Act.

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## **INFORMATION ABOUT THIS PROSPECTUS AND THE PLACING**

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### **APPLICATION FOR LISTING ON GEM**

CSRC has given its approval to the issuing of H Shares and the listing of the H Shares on GEM of the Stock Exchange. In granting such approval, CSRC accepts no responsibility for the financial soundness of the Company nor the accuracy of any of the statements made or opinions expressed in this prospectus.

The Company has applied to the GEM Listing Committee of the Stock Exchange for the listing of and permission to deal in the H Shares which are to be issued pursuant to the Placing and as otherwise described herein, on GEM.

No part of the share or loan capital of the Company is listed or dealt in on any other stock exchange and at present no such listing or permission to deal is being or proposed to be sought.

Pursuant to rule 11.23 (1) of the GEM Listing Rules, at the time of listing and at all times thereafter, the Company must maintain the “minimum prescribed percentage” of 20% of the issued share capital of the Company in the hands of the public.

### **PROFESSIONAL TAX ADVICE RECOMMENDED**

If you are unsure about the taxation implications of the subscription, purchase, holding or disposal of, dealing in, or the exercise of any rights in relation to the H Shares, you should consult an expert.

The Company, the Directors, the Sponsor, the Placing Underwriters and any other person involved in the Placing do not accept responsibility for any tax effects on or liabilities resulting from the subscription for, or purchase, holding or disposal of, or dealing in or the exercise of any rights in relation to, the H Shares.

### **STAMP DUTY**

Dealings in H Shares registered on the Company’s Hong Kong branch register of members will be subject to Hong Kong stamp duty.

### **EXCHANGE RATE CONVERSION**

Except as otherwise noted, this prospectus contains translations of Renminbi amounts into Hong Kong dollars at the rate of HK\$1.00 = RMB1.0614 and translations of US Dollars amounts into Renminbi at the rate of HK\$7.75 = US\$1.00, and such rates are for reference only. No representation is made that Renminbi or Hong Kong dollar amounts or US Dollars amounts set out in this prospectus could have been or can be converted into Hong Kong dollars or Renminbi or US Dollars amounts, as the case may be, at any particular rate on such date or any other date.

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## INFORMATION ABOUT THIS PROSPECTUS AND THE PLACING

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### REGISTRATION OF SUBSCRIPTION, PURCHASE AND TRANSFER OF H SHARES

The Company has instructed HKSCC Registrars Limited, its Hong Kong share registrar, and HKSCC Registrars Limited has agreed not to register the subscription, purchase or transfer of any H Shares in the name of any particular holder unless and until the holder delivers a signed form to the share registrar in respect of those H Shares bearing statements to the effect that the holder:

- (i) agrees with the Company and each shareholder of the Company, and the Company agrees with each shareholder, to observe and comply with the Company Law, the Special Regulations and the Articles of Association;
- (ii) agrees with the Company, each shareholder, Director, Supervisor, manager and other officer of the Company, and the Company acting for itself and for each Director, Supervisor, manager and other officer of the Company agrees with each shareholder to refer all differences and claims arising from the Articles of Association or any rights obligations conferred or imposed by the Company Law or other relevant laws and administrative regulations concerning the affairs of the Company to arbitration in accordance with the Articles of Association, and any reference to arbitration shall be deemed to authorize the arbitration tribunal to conduct hearings in open session and to publish its award, which arbitration shall be final and conclusive;
- (iii) agrees with the Company and each shareholder of the Company that H Shares in the Company are freely transferable by the holders thereof; and
- (iv) authorizes the Company to enter into a contract on his behalf with each Director and officer of the Company whereby such Directors and officers undertake to observe and comply with their obligations to shareholders as stipulated in the Articles of Association.

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**DIRECTORS AND PARTIES INVOLVED IN THE PLACING**

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<b>Name</b>	<b>Address</b>	<b>Nationality</b>
<i>Executive Directors</i>		
Yin Shun Hai	Block No. 20 Nan San Huan Zhong Road Feng Tai District Beijing PRC	Chinese
Wang Zhao Qi	Block No.16 Nan San Huan Zhong Road Feng Tai District Beijing PRC	Chinese
Mei Qun	Unit 4-4 Block No.1 No.7 Building Tong Street De Wai Wu Lu Xi Cheng District Beijing PRC	Chinese
<i>Non-executive Directors</i>		
Tian Rui Hua	Unit 2-303 Block No.508 Jin Song Wu Qu Chao Yang District Beijing PRC	Chinese
Zhao Bing Xian	Unit 101 Block No. 58 Hong Miao No. 1 Hai Dian District Beijing PRC	Chinese

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## DIRECTORS AND PARTIES INVOLVED IN THE PLACING

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### *Independent non-executive Directors*

Ms. Tam Wai Chu, Maria	3/F, 52A MacDonnell Road Hong Kong	Chinese
Mr. Ting Leung Huel, Stephen	Flat A, 26/F Cumine Court No. 52 King's Road North Point Hong Kong	British
Mr. Jin Shi Yuan	No. 94 South Heng Xi Street Xuan Wu District Beijing PRC	Chinese

### *Supervisors*

Tian Da Fang	Xi He Yan Jia No. 160 Chong Wen Men Chong Wen District Beijing PRC	Chinese
Yang Liang	Unit 9-301 No. 255 Dong Tie Jiang Ying Feng Tai District Beijing PRC	Chinese
Sun Feng Sheng	Unit 11-06 Block No. 16 Nan San Huan Zhong Road Feng Tai District Beijing PRC	Chinese
<b>Sponsor, global coordinator and lead manager</b>	BOCI Asia Limited 35th Floor Bank of China Tower 1 Garden Road Central Hong Kong	

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## DIRECTORS AND PARTIES INVOLVED IN THE PLACING

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### Placing Underwriters

BOCI Asia Limited  
35th Floor  
Bank of China Tower  
1 Garden Road  
Central  
Hong Kong

BNP Paribas Peregrine Securities Limited  
36th Floor  
Asia Pacific Finance Tower  
3 Garden Road  
Central  
Hong Kong

CEF Capital Limited  
Suite 2001  
20th Floor  
Cheung Kong Center  
2 Queen's Road Central  
Hong Kong

Core Pacific-Yamaichi International  
(H.K.) Limited  
30th Floor  
Two Pacific Place  
88 Queensway  
Hong Kong

First Shanghai Capital Limited  
19th Floor  
Wing On House  
71 Des Voeux Road Central  
Hong Kong

Grand Cathay Securities (Hong Kong) Limited  
Suite 1120  
11th Floor  
Two Pacific Place  
88 Queensway  
Admiralty  
Hong Kong

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## DIRECTORS AND PARTIES INVOLVED IN THE PLACING

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**Legal advisers to the Company**

*as to Hong Kong Law:*

Kwok & Yih

In association with Blake Dawson Waldron

37th Floor, Gloucester Tower

The Landmark

11 Pedder Street

Central

Hong Kong

*as to the PRC Law:*

Zhong Yin Law Firm

Room 609 Pingan Mansion

No. 23

Jinrong Dai Jie

Xicheng District

Beijing

PRC

**Legal advisers to the Placing Underwriters**

*as to Hong Kong Law:*

Koo and Partners

22nd Floor

Bank of China Tower

1 Garden Road

Central

Hong Kong

**Auditors and reporting accountants**

Arthur Andersen & Co

21st Floor Edinburgh Tower

The Landmark

15 Queen's Road Central

Hong Kong

**Property valuer**

LCH (Asia-Pacific) Surveyors Limited

1506 Vicwood Plaza

199 Des Voeux Road Central

Hong Kong

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## CORPORATE INFORMATION

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<b>Registered office</b>	No. 10 Hong Da Bei Road Beijing Economic and Technology Development Zone, Yi Zhuang, Beijing, China
<b>Principal place of business in Hong Kong</b>	18th Floor Workington Tower 78 Bonham Strand Sheung Wan Hong Kong
<b>Company secretary</b>	So Yuen Bing, Maggie, AHKSA, FCCA, MBA
<b>Compliance officer</b>	Wang Zhao Qi
<b>Qualified accountant</b>	So Yuen Bing, Maggie, AHKSA, FCCA, MBA
<b>Audit committee</b>	Ms. Tam Wai Chu, Maria Mr. Ting Leung Huel, Stephen
<b>Authorized representatives</b>	Wang Zhao Qi So Yuen Bing, Maggie, AHKSA, FCCA, MBA
<b>Authorized persons to accept service of process and notice</b>	Yang Qiong
<b>Hong Kong branch share registrar and transfer office</b>	HKSCC Registrars Limited 2nd Floor Vicwood Plaza 199 Des Voeux Road Central Hong Kong

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## CORPORATE INFORMATION

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### Principal bankers

Industrial and Commercial Bank of China  
Beijing Branch  
No. All  
Sports Stadium West Road  
Chong Wen District  
Beijing  
PRC

Bank of China  
Beijing Branch  
No. 8 Ya Bao Road  
Chao Yang District  
Beijing  
PRC

## INDUSTRY OVERVIEW

*The information provided in this section comes from various private and/or government publications. None of the parties including the Company, the Sponsor, the Placing Underwriters and their respective advisors have provided or independently verified such information.*

The advancement in scientific technology and the improvement in people's living standards have accelerated the development of the pharmaceutical industry on a global perspective. New synthetic medicine are developed to cope with mutation of diseases. The most notable is the rapid advancement in bio-pharmaceuticals and the enlargement of the market of natural medicine. In 1998, sales in the world medicine industry has reached US\$330.1 billion, of which the sales of natural medicine accounted for about 30%. According to the forecast of experts, the mainstream of the world medicine industry will be dominated in the 21st century by both natural medicine and synthetic medicine.

### Development of the global medicine industry

Globalization of the world economies has become prominent with the extension of the global trade network. The southeast Asian financial crisis in 1997 not only has tremendous impact on the economy of southeast Asia, but also hampered the growth of the world economy as a whole. Nevertheless, given the unique and specific industrial background, the medicine industry was only slightly affected and the steady growth trend remains intact with an annual compound growth rate of 6%-7%. The size of the world medicine market has increased from US\$21.77 billion in 1970 to US\$330.1 billion in 1998 (See Table 1).

**Table 1: Total sales value of the world medicine market**

	1970	1975	1980	1985	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
(US\$100 mn)														
Total sales value	217.7	429.1	790.3	929.7	1,589	1,821	2,058	2,266	2,381	2,562	2,858	2,964	3,085	3,301
Annual growth rate (%)	n/a	n/a	n/a	n/a	n/a	14.6	13	10.1	5.1	7.6	11.6	3.7	4.1	7

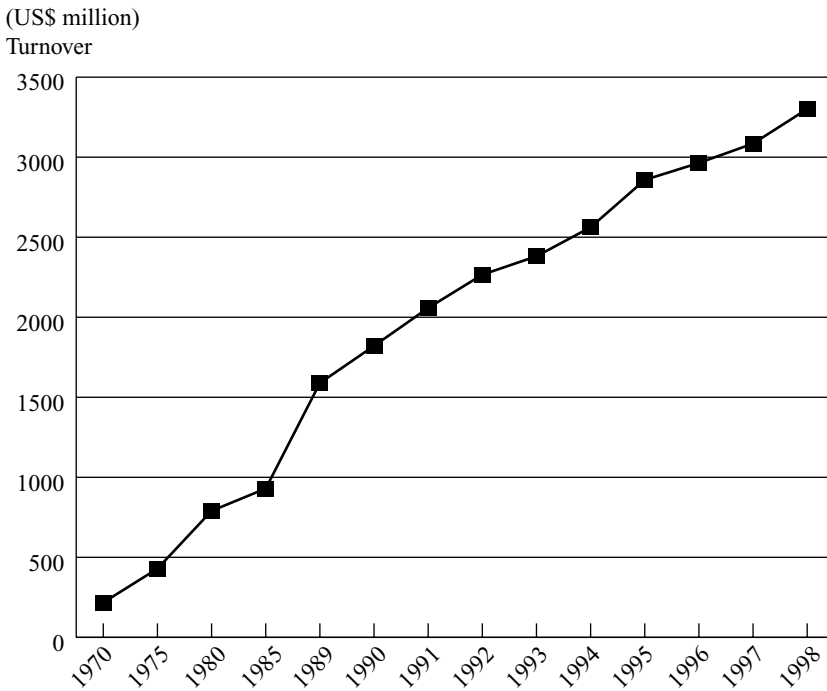
*Source: China Medication Economic and Trading Year 2000, Issue No. 3*

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## INDUSTRY OVERVIEW

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**Diagram 1: Global medicine market trend (1970-1998)**



*Source: China Medication Economic and Trading Year 2000, Issue No. 3*

From Diagram 1, it can be seen that the development of the world medicine industry is on an upward trend with steady growth. It is expected that in 2002, the global market of pharmaceutical products will reach US\$411.9 billion representing an average compound growth rate of 8% per annum from 1998 to 2002.

It is forecasted that in the 5-year period starting from 1998, the U.S. will maintain its strong growth trend, with an annual compound growth rate of 9.8%. The Japanese market, with an annual compound growth rate of 4.9%, is also promising. The market of Africa bears the lowest growth rate which is consistent with its economic status. Some analysts are particularly optimistic towards the Chinese pharmaceutical market where an average compound growth rate of 12.4% is forecasted for the five year period.

### **The market status of Chinese medication industry**

Chinese medicine is one of China's cultural treasures. Over thousands of years, it has made a significant contribution to the prosperity of the Chinese people. At the same time, it has laid a solid foundation for the development of the world tribal medical science. With the acceleration of industrialization, the change in people's living conditions and living environment together with the increasingly common occurrence of new disease caused by abuse of synthetic medicine, the approach in world medical science is shifting from the traditional pure biological medical approach to an integrated biological – psychological – sociological medical science approach. The mode of treatment accordingly is changing from pure medical treatment towards

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an integrated approach combining prevention, health care, curing and rehabilitation. This is in line with the Chinese medical science which stresses on the concept of holistic treatment and diagnosis and which is also consistent with the traditional emphasis on social environmental and psychological factors. In addition there has been increasing concern in recent years about problems of environmental pollution and ecological imbalance. The side effects of chemical drugs and diseases originated from abuse of medicine has also become increasingly common. In addition, people are further faced with mutation of diseases and an ageing society. All these problems have led people to develop modern applications of traditional medicine. Alternative medical treatments and traditional medical science have entered the front stage. The voice of “Back to nature, live a simple and healthy life” has become more popular all over the world and the traditional treatment approach, which stresses the importance of natural medicine, has become an important trend for contemporary medical science. Accordingly, the role of Chinese medicine which has been clinically tested for thousands of years and which has a complete theoretical backup, is becoming increasingly important in the health business.

The global natural medicine market has been growing with an increasing worldwide demand for natural medicine and Chinese medicine. Since 1987, the purchase of herbal medicine in the United Kingdom and in France has increased by 70% and by 50% respectively. The growth rate of the herbal medicine market in the U.S. has exceeded 20% per annum. The turnover of Chinese medicine in Japan has been growing at over 15% per annum since the 1990s. It is estimated that the turnover of herbal medicine in the world has reached US\$27 billion per annum. In 1998, global trading of Chinese medicine reached US\$16.4 billion.

Chinese medicine has been gradually accepted all over the world. With the outstanding results of the Chinese medical profession in the PRC, people have in recent years attached greater importance to the traditional medicine industry. In 1994, the U.S. issued the “Dietary Supplement Health and Education Act” which admitted the prevention and therapeutic value of herbal medicine, and categorized herbal medicine as some kind of food supplement. More recently, the “Herbal Medicine Investigation Directory” is being compiled, moving a step further in the acceptance and recognition of synthetic use of traditional natural medicine in curing disease. These steps serve to open a gateway for Chinese medicine to enter into the U.S. market.

To promote Chinese culture and revive the professional status of Chinese medicine, the Central Government has put forward the “Implementation scheme for the research and development in modernizing Chinese medicine”. Its principal goal is to promote the inherited features of Chinese medicine based on modernized scientific technology in developing Chinese medicine, so that they can comply with the internationally-recognized medical standard and specification, with an aim to entering the international market. To this end, the first step is to establish a standardized system for the research and development as well as the production of Chinese herbal medicine, and endeavour to make such a system the standard for the research

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and development of international traditional medicine. The second step is to foster a batch of multi-national Chinese medicine corporations in an attempt to enhance the competitiveness of Chinese medicine in the global area. It is hoped that such strategy can raise the current market share of Chinese medicine in the international herbal medicine market from 3% to 15% thereby propelling Chinese medicine sector into a new area that promotes economic growth, and into a pillar for industrial growth in China.

As the information on the global medicinal herbal trade and the medicinal herbal trade in the PRC is based on information prepared by private organizations, such information might not be reliable. As such, the potential market size for modernized Chinese medicine might be significantly different from that presented above.

The Directors believe that given the size of the world prescription drugs market and the medicinal herbal trade, the potentials for modern herbal products/medicine based on modernized Chinese medicine in the international market can be significant.

### **Traditional Chinese medicine**

Of the various forms of alternative medicine currently being practised in the world, the Directors believe that none of them is more commonly used than the traditional Chinese medicine, which has been practised in China for thousands of years. The basis of traditional Chinese medicine is a complex system that is vastly different from the western scientific medical system. Whereas the western scientific medical system is based on the symptomatic treatment of specific illnesses, traditional Chinese medicine uses individualized prescriptions (配方), mostly based on herbal ingredients, to harmonize, rejuvenate and revitalize the body system to its natural healthy state.

Chinese medicine productions are categorized by the form of medicine produced rather than by the properties and curative effects of such medicine. This is because of the inherent differences of the Chinese and western medical systems. The strength of the western medical system lies in the diagnosis of “symptoms”, while the Chinese medical practitioners follow the tradition of overall analysis of the “syndrome” of disease through observation, inquiry and palpation. A diagnosis is made by integrating and analyzing the information on the *overall* body condition gathered through the above processes. The development of Chinese medicine is thus founded on this method of diagnosis and corresponding integral treatment. Western medicine generally treat one type of symptoms with a particular medicine (i.e., one prescription is targeted primarily at curing one disease). Chinese medicine, however, treats not only the symptoms of a disease, but also treats and regulates other implicit problems of the body which may have direct or indirect influences on the explicit symptoms. As such, a particular type of Chinese medicine may have more than one major effect and therefore it is very difficult, if not impossible, to categorize different medicine in accordance with their

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effects. For the above reasons, the Company considers that the generalization of using the same method to categorize Chinese medicine and western medicine contradicts the traditional Chinese medicine theory.

In line with the above analysis, it has been a tradition to classify different Chinese medicine in terms of their form. The form of Chinese medicine is selected according to the medical property of the medicine and its efficacy on a specific disease. One form of Chinese medicine can have several curative effects and the same kind of disease can be treated by different forms of Chinese medicine (The theories of Chinese medical treatment include: curing the source of disease; regulating the yin (陰) and yang (陽) ; quick relief of symptoms of a disease and slow elimination of its root cause; curing the symptoms and cause together; strengthening body and expelling the evil, optimizing treatment based on the seasonal, geographical and physical factors, applying different treatments for the same disease and same treatment for different diseases and etc.).

### **Modernization of Chinese medicine**

The Directors believe that the modernization of Chinese medicine can be achieved by maintaining its macro advantages and overcoming its micro disadvantages. Modern scientific technology can be used to investigate and develop Chinese medicine that is safe, effective, easy for intake and with persistent result. Modern Chinese medicine must survive the stringent testing of modern scientific technology of its ingredients, application and mechanism in order to be viable for commercial production, with international recognition and competitive in the world market.

The modernization of Chinese medicine, in substance and on a whole, has to be built up from the foundation of the knowledge of traditional Chinese medical knowledge and repeated research and modification.

### **Development plan of the Chinese medicine industry of the Hong Kong Government**

In his 1998 Policy Address, the Chief Executive of the Hong Kong Government, Mr. Tung Chee-hwa, set forth the vision of making Hong Kong as a world centre for the development of health food and pharmaceuticals based on Chinese medicine. In the First Report of the Chief Executive's Commission on Innovation and Technology, Chinese medicine was identified as one of the technology areas where Hong Kong's close relationship with the mainland PRC can offer distinct competitive advantages. The development of a modern Chinese medicine industry also fits in with Hong Kong's policy direction of moving towards higher value-added production.

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Since 1995, the Industry Department of the Hong Kong Government has, through the Industrial Support Fund, been supporting research and development projects in relation to Chinese medicine. The Industrial Support Fund has thus far supported over 20 Chinese medicine-related projects. These projects cover a wider spectrum, including the construction of essential infrastructures, improving the technology for Chinese medicine production, assisting in the development of new products, setting up a complete database of Chinese medicine as well as encouraging and promoting the development of and exchanges in the Chinese medicine industry. Through these projects, the Hong Kong Government aims to nurture a business-friendly environment and to build up a solid foundation for the development of the Chinese medicine industry. In addition, the Hong Kong Government is in the process of launching the proposed Innovative and Technology Fund with funding of HK\$5 billion and the establishment of the Applied Science and Technology Research Institute, which will offer strong research and development support to the Chinese medicine industry.

The Chinese Medicine Ordinance came into operation on 6 August 1999 for implementation in stages. The statutory framework will regulate the practice, use, manufacture and trading of Chinese medicine in Hong Kong. A Chinese Medicine Council had been established to implement various control measures through a system of registration and licensing. The system of control will include two areas, namely Chinese herbal medicine and Chinese Patent Medicine. Control over Chinese herbal medicine is necessary to ensure that the Chinese medicine sold is fit for human consumption. The Hong Kong Government proposes to set up a licensing and registration framework, including licensing of retailers and wholesalers of Chinese herbal medicine. With respect to Chinese Patent Medicine, apart from setting up a system for the licensing of manufacturers and wholesalers of Chinese Patent Medicine, all Chinese Patent Medicine manufactured or offered for sale in Hong Kong needs to be individually registered with the authorities concerned.

In July 1999, the Hong Kong Government announced a ten-year development plan for Chinese medicine.

The plan suggests for the development of Hong Kong to become an international centre for Chinese medicine. The role of the Hong Kong Government is to create the most favourable market conditions, under the free market principle, to allow more private investors to take part in the development of Chinese medicine and related high value added products.

In the coming 10 years, the development of the Chinese medicine industry in Hong Kong will be implemented in 4 stages. Focus will also gradually be shifted from the public sector to the private sector. The objective of the first stage is to strengthen the foundation of the Chinese medicine industry by 2000. The main tasks are to introduce the regulatory system and attract talents in the profession.

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The second stage is to be implemented from 2000 to 2002. The objective is to promote modernization of Chinese medicine. In this stage, enterprises will produce health food products and nutritious supplements based on traditional Chinese medicine formulations and using modern production technologies, quality control and other science-based techniques. In this way the overall technological level can be improved with added value.

The third stage, to be implemented from 2002 to 2004, will be the Chinese medicine stage. Chinese medical health food products and nutritious supplements will be produced by enterprises based on new formulation and using modern production technologies. In this stage, the Hong Kong Government expects that venture funds will continue to increase their investment in Chinese medicine projects, and Hong Kong will have its first listed company engaged in Chinese medicine business.

The fourth stage, to be implemented from 2004 to 2009, will be the modern medicine stage. New medicine based on Chinese medical knowledge and approach will be developed by enterprises. During this stage it is expected that more companies engaged in Chinese medicine will be listed and more pharmaceutical companies will participate in the development of Chinese medicine with new formulation.

### **The pharmaceutical industry in the PRC**

China is the world's biggest developing country with its population accounts for 20% of the world's population. Because of the natural increase in population, the gradual aging society, the revolution of the urban medical insurance system and other related factors, growth in the overall demand for medicine will remain stable.

China is the country which is endowed with the richest natural herbs in the world, with more than 12,800 species of Chinese medicine resources.

According to statistics of "Journal of Chinese medicine in China" 1999, there are 1,059 Chinese medicine manufacturers, of which 178 are medium to large enterprises. Traditional Chinese medicine has been spread over to 130 countries and regions.

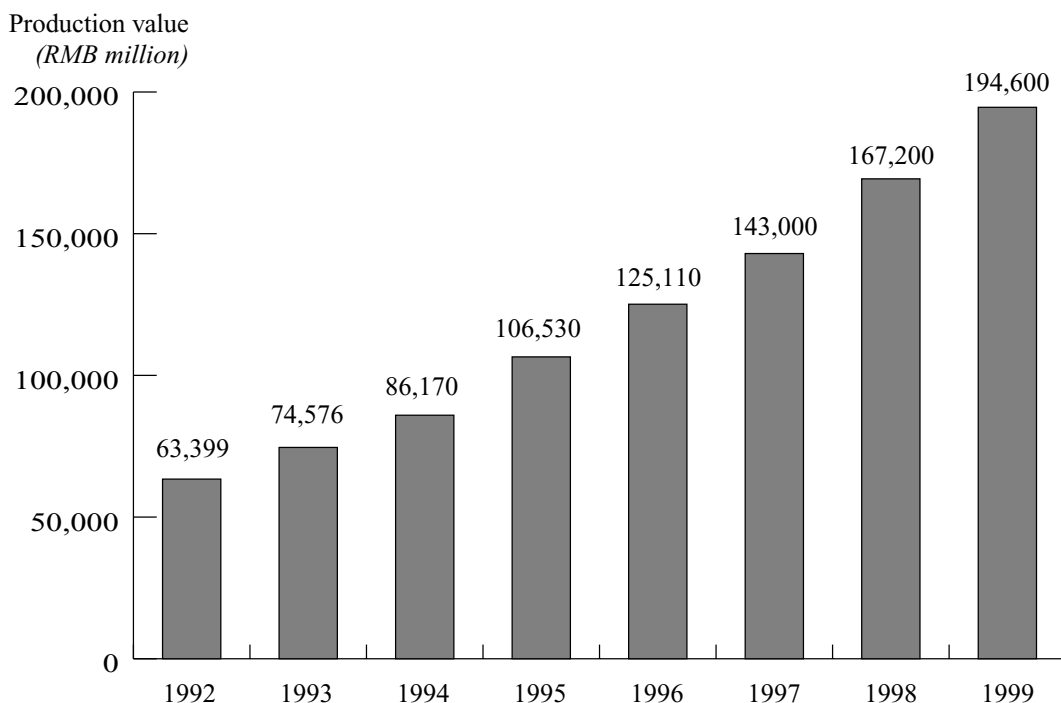
According to statistics of the State Economic and Trade Commission, the total production value of the PRC pharmaceutical industry amounted to RMB194.6 billion in 1999, representing

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an increase of 14.2% compared to 1998. The following table shows the total production value of pharmaceutical industry from 1992 to 1999:



*Source: China Pharmaceutical Yearbooks 1993 – 1998, China Economic Yearbook 1999 and Capital Pharmaceutic Industry 2000, 7(5)*

As indicated from statistical information, the economic development of the Chinese medicine industry was traditionally higher in the eastern region than in the central and western regions in the PRC. However, the rich natural resources of the central and western regions have begun to turn into economic strength. Hence, in 1998, development of the Chinese medicine industry in the western region was faster than the eastern region.

## REGULATIONS GOVERNING THE PHARMACEUTICAL INDUSTRY IN THE PRC

### Legal framework

The Law of the PRC on the Administration of Pharmaceuticals (中華人民共和國藥品管理法) (“Administration Law”) promulgated by the National People’s Congress in September 1984 and The Implementing Measures of the Law of the PRC on the Administration of Pharmaceuticals (中華人民共和國藥品管理法實施辦法) (“Implementing Measures”) promulgated by the MPH in 1989 have laid down the legal framework for the manufacture of pharmaceuticals and the administration of the industry. The Administration Law regulates the production of medicine, administration of pharmaceutical enterprises and medicinal preparations, packaging and distribution of pharmaceuticals, pharmaceutical trademarks and advertising. The Implementing Measures provide measures for regulating the manufacture, operation, application, inspection and scientific research of pharmaceuticals and etc., in accordance with the Administration Law.

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### **Industrial administration**

In the PRC, the supervision and administration of the Chinese and western pharmaceutical industry previously undertaken by the State Pharmaceutical Administration Bureau and SPSAC are now vested with the State Economic and Trade Commission by the State Council. Under the State Economic and Trade Commission, a Pharmaceutical Department has been established to assume functions which include:

- review and formulation of the development plan, industry regulation and technical and economic policy of the pharmaceutical industry;
- organization and establishment of constitution for the industry, set up boundary and technical standards, execute administrative function within the industry; and
- control of pharmaceutical product reserves in the PRC.

SPSAC is responsible for technical supervision and administrative functions over research, production, distribution and application of all pharmaceutical products (including Chinese herb medicine and processed capsules for oral consumption, raw chemicals and its processed products, anti-biotics, bio-chemical pharmaceuticals, organic processed products, medical equipment, packaging material for medicine etc.). Its major responsibilities include:

- formulation and amendment regulations governing pharmaceutical products and supervise its implementation;
- formulation, amendment and announcement of statutory standards for pharmaceutical products, establishment of basic pharmaceutical products lists in the PRC;
- registration of new medicine, imitated and imported medicine, types of protected Chinese medicine; organization and establishment of systems for OTC, accessing and announcement of the OTC list; re-evaluation of medicine, testing side effects, clinical trial and examination of out-dated medicine;
- formulation, amendment of the production quality standards of medicine, execute and control quality standard of medical units; issuing of production and business permits to business enterprises and medical units;
- formulation of the quality standards of non-clinical experimental medicine, supervision and administration of the standards of clinical trial;
- supervision of inspection, random inspection on production; supervision of medicine quality of business enterprises and medical units; release of publication on medicine quality within the country; investigation of illegal production and trading of fake and sub-standard medicine, supervision of the trading market of raw Chinese medicine;

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- examination of medical advertisements, responsible for administration of medicine protection, guide related authorities in its business operation;
- review of legislation on distribution of medicine, establishing and implementing the qualification system for wholesalers and retailers; formulating regulations on sales and purchase of prescribed, non-prescribed, Chinese herbal and Chinese oral consumption medicine; and
- implementing state medicine industry policy and co-operation with macrocontrol sectors.

### **Medication policy and development plan**

The Central Government and the Medical Technology Department recognized the importance in developing Chinese medicine. During the Seventh, Eighth and Ninth “Five-Year Plan” periods, researches on Chinese medicine were listed as one of the major items. Systematic researches on resources, quality, planting, processing and innovation of modernized Chinese medicine were carried out. These researches have played an important role in the modernization of Chinese medicine. In 1997, the State Technology Department formulated the “Strategic plans for modernization of Chinese medicine”, giving rise to the “Action plans for modernization of Chinese medicine”, which is a major strategic decision for modernization and globalization of Chinese medicine.

As indicated in the “Decision on the development and reformation of health services” issued by the State Council and Central Party (15 January 1997), emphasis will be placed on the development and modernization of the Chinese medicine industry, reformation and improvement in management and production method within the industry, the establishment of quality standard of Chinese medicine as well as the scientific management of quality and production, and the establishment of favorable policy to protect and extract resources of Chinese medicine. In addition, continuous progress will be made in reforming the production of Chinese medicine by the formation by business enterprises in a uniform, open, competitive and viable circulation system.

### **Permits and business licence**

Before any pharmaceutical manufacturing and trading enterprises can manufacture pharmaceutical products in the PRC, they must obtain the following permits and business licence:

- *The Pharmaceutical Manufacturing Enterprise Permit (藥品生產企業許可證)*

Issued by the public health bureau at the provincial, autonomous region or centrally administered municipality level.

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- *The Pharmaceutical Management Enterprise Permit* (藥品經營企業許可證)

Issued by the public health bureau at county level or above.

- *Business licence* (營業執照)

Issued by the relevant Administrative Bureau of Industry and Commerce after the issuance of the above two permits.

The above permits and business licence must state the period of validity and are subject to re-examination by the competent authorities prior to renewal.

### Approval of new medicine

In accordance with the “Regulations on the approval of new medicine” (新藥審批辦法) promulgated on 22 April 1999 by SPSAC, new medicine generally refer to those which have never been produced in the PRC. However, new forms, new methods of intake, new therapeutic functions of new complex prescription preparations of existing medicine can also be considered as new medicine. Application and approval of new medicine will go through two principal phases, being clinical examination and commercial production. Application for new medicine shall be submitted to the provincial pharmaceutical supervisory authority. Information on and samples of new medicine for clinical examination and commercial production shall be submitted together with a completed application form to the provincial pharmaceutical supervisory authority for preliminary approval. Final approval will be granted by state level SPSAC. Normally, a New Medicine Certificate (新藥證書) will be issued by the state level SPSAC upon completion of the third stage clinical examination. An enterprise or manufacturer which has obtained a valid Pharmaceutical Manufacturing Enterprise Permit (藥品生產企業許可證), with an approval number and is in compliance with the relevant GMP requirement of SPSAC may then commence commercial production of the new medicine.

According to the “Regulations on the approval of new medicine”, new medicine are divided into Chinese medicine, chemical medicine and biological medicine, with Chinese medicine being further classified into five categories as follows:

#### *Category 1*

- Synthetic materials from Chinese medicinal raw materials.
- Newly discovered Chinese medicinal raw materials and their semi-finished components.
- The active ingredients and their semi-finished components derived from Chinese medicinal raw materials.
- The active ingredients derived from a complex prescription.

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### *Category 2*

- Injections manufactured from Chinese medicinal raw materials.
- New medicinal applications and their semi-finished components from anatomical components of existing Chinese medicinal raw materials.
- The active components and its semi-finished components derived from existing Chinese medicinal raw materials and their derivatives.
- Medicinal products extracted from animals, and its semi-finished components obtained from artificial means.
- The active components cluster derived from complex prescription.

### *Category 3*

- New semi-finished components from complex prescription.
- Semi-finished components from Chinese medicine and synthetic drugs based on theory of Chinese medicine prepared from a complex prescription.
- Common imported medicinal raw materials and their semi-finished components introduced from overseas.

### *Category 4*

- Alternation of preparation and form of intake.
- Transplanted from overseas or domesticated animal and herbal medicine.

### *Category 5*

- Newly-discovered medical applications of existing drugs.

In accordance with the “Regulations on new medicine protection and technology transfer” (新藥保護和技術轉讓的規定) promulgated by SPSAC and effective on 1 May 1999, the State has a classified product protection system for new medicine. The protection period is 12 years for category 1 new medicine; 8 years for category 2 and category 3 new medicine; and 6 years for category 4 and category 5 new medicine. During the protection period, no other manufacturer can produce such products. An enterprise which has been granted a New Medicine Certificate (新藥證書) may transfer the production technology of a new medicine to a manufacturing enterprise but the transferee is not permitted to further transfer the same technology to other manufacturers.

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In the event that the manufacturer does not commence production of the new medicine or does not transfer the relevant technology to other manufacturers within two years after obtaining New Medicine Certificate (新藥證書) without acceptable reasons, SPSAC may revoke the protection and issue an announcement in this regard, following which other enterprises may apply to SPSAC for the manufacture of the new medicine.

There is no legal requirement on the timeframe for the approval process of new medicine, the length of such period depends on the nature of the medicine and the speed of approval by the regulators.

### Protected products

In order to assist the development of the Chinese medicine industry, the “Protection of different classes of Chinese medicine regulations” (中藥品種保護條例) was promulgated to protect the rights of enterprises manufacturing Chinese Patent Medicine. After the expiration of the protection period for new medicine under the “Regulation on the approval of new medicine” (新藥審批辦法), an enterprise may apply for additional protection period under this regulation. Based on the type of raw materials and the therapeutic functions of the medicine, the protected products are divided into State Class 1 or State Class 2 protected products. State Class 1 protected products enjoy an initial protection period of 10, 20 or 30 years and State Class 2 protected products enjoy an initial protection period of seven years. After the expiry of the initial period, the protection period can be further extended through further application and approval procedures under this regulation.

Applications for the extension of the protection period of State Class 1 and State Class 2 protected products will be granted subject to the maximum of the relevant initial protection period.

### Price control

Prices of certain western and Chinese pharmaceutical products in the PRC are subject to the control of the relevant State and provincial price administrative authorities. The prices of medicine included in the price control lists are adjusted by the relevant authorities or its delegates from time to time. The price administration authorities may approve an increase in the price of a particular product based on the information submitted by the manufacturer on, among other things, the costs of raw materials and production.

The Company sets prices of its products in accordance with the “Provisional regulations of Beijing on the price management of medicine” (北京市藥品價格暫行管理辦法). The prices of Ganmao Qingre Granule (感冒清熱沖劑), Liuwei Dihuang Pill (六味地黃丸), Banlangen Granule (板藍根沖劑), Niu Huang Jiedu Tablet (牛黃解毒片) and Angong Niu Huang Pill (安宮牛黃丸) are regulated by the Beijing pricing authority. As for other

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products, the authority empowers the Tongrentang Holdings to set and adjust the prices in accordance with the “Regulations on the price setting of Chinese Patent Medicine” (中成藥作價辦法) or other similar methods.

### **GMP**

GMP was initiated by the World Health Organisation, the purpose of GMP is to establish guidelines for pharmaceutical manufacturers in manufacturing their products, so as to assure the quality of products and to protect consumer interests. Currently, some developed countries including the U.S., Japan and the European Union have adopted standards equivalent to GMP into their respective legislation. GMP imposes strict compliance procedures on pharmaceutical manufacturing processes, including, inter alia, the design of production facilities; the qualification of the personnel involved in the production processes; plant, machinery, hygiene and raw materials handling; materials packaging and labelling; production management; and documentation of production processes, quality control, sales records, customer comments and complaints.

On 18 March 1999, the “Pharmaceutical products — GMP (1998 revised)” was issued by SPSAC which came into effect on 1 August 1999. Pursuant to the “Notice regarding relevant stipulations on implementing pharmaceuticals GMP” issued by SPSAC in 1999, manufacturers of certain kinds of pharmaceuticals shall also comply with GMP standards by the time limit stipulated by SPSAC. If these manufacturers have not obtained the GMP certification in the stipulated time limit, their Pharmaceutical Manufacturing Enterprise Permits will not be renewed. Presently, products of the Company are not subject to such deadline.

### **Import and export**

Local public health authorities in the PRC are responsible for the control of imported medicine in their respective administrative areas. The PRC has a registration and approval system for imported medicine. Foreign producers or sales agents must apply to the PRC public health authorities for Certificate of Registration of Imported Medicine (進口藥物註冊證) before they can export the medicine for sale in the PRC market. For over a decade, the Central Government has been working towards joining the General Agreement on Tariffs and Trade, which later became the WTO. To gain entry into the WTO, the Central Government has promised to substantially cut tariffs rates, reduce non-tariff protection and increase market openness. For pharmaceutical products, the import tariff rate is expected to drop gradually over the years.

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Export restrictions on certain products are implemented by MOFTEC and departments authorized by it. According to the “Opinion on problem regarding export of medicine” (關於藥品出口有關問題的批復) issued by SPSAC on 20 September 1999, the export of medicine depends largely on the requirement of the importing country. When there is no specific requirement from the importing country, SPSAC is in principle supportive of the export of Chinese medicine which is in line with the Central Government’s macro-economic policy of encouraging exports.

### **The social medical protection system of the PRC**

The Central Government has reformed its regional medical insurance system for employees nationwide since 1999. As a direct result of this major reform, the operating environment for medical enterprises were improved and competition within the pharmaceutical industry is expected to regain its order soon. Also, it is expected that there will be changes in the medicine consumption pattern with a decrease in market share of imported and expensive medicine while cheaper but good quality medicine will have a bigger market share. Changes in the business operation of commercial and industrial medical enterprises may also result in their distribution costs being reduced.

### **E-commerce**

In early 2000, the SPSAC and other eight related authorities jointly issued the “Guidelines on reforming the medication system of towns and cities”, which indicated that they encourage the use of electronic web technology to reduce the medical distribution costs and hence increases efficiency.

The State Economic and Trade Commission is promoting the use of electronic commerce in certain areas. Two medical enterprises are being chosen to commence a pilot scheme on electronic commerce. The Directors believe that with the strengthening of legislation in electronic commerce, it is obvious that the development of electronic commerce would be the future trend.

### INTRODUCTION

The Company was established on 22 March 2000 by 8 promoters namely, Tongrentang Ltd. (as the primary promoter through contributing its existing operations: Factory No. 2, the Chinese Medicine Refinery, the Import and Export Department and Research and Development Centre), Tongrentang Holdings and six other natural persons, who are the Directors and Supervisors of the Company. The Company is engaged in the exploration of Chinese medicine technology, technical consulting, manufacturing and sales of Chinese medicine and bio-pharmaceutical products. The Company strives to modernize and internationalize TCM by improving its existing Chinese medical products while engaging in the research of the use of natural medicine so as to promote modern Chinese medicine into the mainstream international pharmaceutical market. It also seeks to develop e-business in the area of Chinese medicine. Currently, the main forms of the Company's Chinese medicine products sold are: granules (冲剂), pills (水蜜丸剂), tablets (片剂) and soft capsules (软胶囊剂) and the main products are Ganmao Qingre Granule (感冒清热冲剂), Liuwei Dihuang Pill (六味地黄丸), Niu Huang Jiedu Tablet (牛黄解毒片) and Banlangen Granule (板蓝根冲剂), etc.

### HISTORY AND DEVELOPMENT

Tongrentang is one of the largest Chinese Patent Medicine entities in the PRC with long established reputation. It was established in 1669 (Qing Dynasty Kang Xi, eighth year) with a history of 331 years.

In 1992, with the approval of the Beijing Government, Tongrentang Holdings was established to fully utilize the combined strengths of Tongrentang and its products.

In 1997, Tongrentang Holdings was selected by the State Council as one of the 120 units under the PRC major enterprise group and was the only TCM enterprise among them. In 1996 and 1997, Tongrentang Holdings was elected as Beijing's "Double Ten Good Enterprises".

In 1997, with the approval of the Beijing Government, Tongrentang Holdings as the sole promoter established Tongrentang Ltd. by way of public subscription. Tongrentang Ltd. was consisted of four Chinese Patent Medicine production units, namely Tongrentang Pharmaceutical Manufacturing Plant, Factory No. 2, Tongrentang Medicinal Wine Plant and the Chinese Medicine Refinery, as well as three business sales divisions including Import and Export Department, Foreign Business Department and Medicinal Wine Business Department and one technical research centre. Tongrentang Ltd. produced over 400 types of Chinese Patent Medicine in the past. Its products are sold all over the PRC and 18 other countries and regions (mainly southeast Asia, Japan, Europe, the U.S. and etc.).

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## BUSINESS

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In March 2000, after obtaining the approval from the Beijing Government, Tongrentang Ltd. as the major promoter established the Company with Tongrentang Holdings and six natural persons as co-promoters. The Company comprises four divisions, namely, Factory No. 2, Chinese Medicine Refinery, Import and Export Department and Research and Development Centre.

### ESTABLISHMENT

In anticipation of the Placing of H Shares, the Company was established by way of promotion in March 2000, with Tongrentang Ltd. as the major promoter and controlling shareholder, together with Tongrentang Holdings and six natural persons as co-promoters. Tongrentang Ltd. contributed its assets and related businesses comprising Factory No. 2, the Chinese Medicine Refinery, Import and Export Department, Research and Development Centre into the Company. Other promoters contributed capital in cash to the Company.

The forms of the Company's major products are granule, pill, tablets and soft capsule. The Directors consider that these forms are currently the most popular and common forms of medicine in the market. The major products of the Company are Ganmao Qingre Granule (感冒清熱沖劑), Liuwei Dihuang Pill (六味地黃丸), Niuhuang Jiedu Tablet (牛黃解毒片) and Ganmao Soft Capsule (感冒軟膠囊). Tongrentang Ltd. and Tongrentang Holdings are also engaging in the production and sales of Chinese Patent Medicine. They mainly concentrate on traditional forms of Chinese medicine such as large pill, powder, ointment, small pill and medicinal wine. Tongrentang Ltd.'s major products include Angong Nuhuang Pill (安宮牛黃丸), Tongren Niuhuang Qingxin Pill (同仁牛黃清心丸), Tongren Wuji Baifeng Pill (同仁烏雞白鳳丸), Tongren Dahuoluo Pellet (同仁大活絡丹) and Guogong Wine (國公酒) etc..

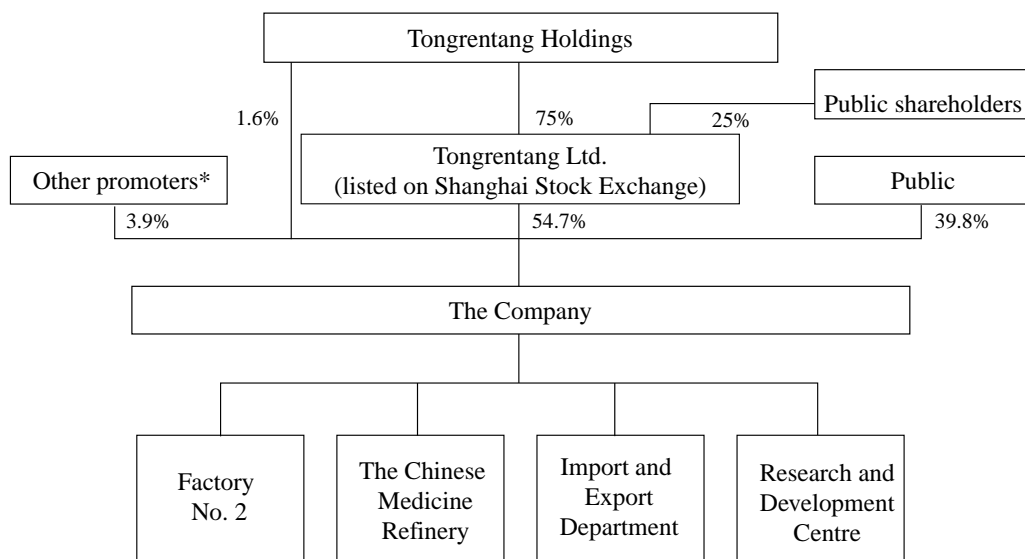
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# BUSINESS

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## ORGANISATION STRUCTURE

The following chart shows the structure of the Company, its parent company and ultimate holding company after the Placing (but without taking into account the exercise of the Over-allotment Option):



\* Other promoters include Mr. Zhao Bing Xian (2.735%), Mr. Yin Shun Hai (0.274%), Mr. Tian Da Fang (0.274%), Mr. Wang Zhao Qi (0.274%), Mr. Mei Qun (0.274%) and Mr. Tian Rui Hua (0.055%).

## STRENGTHS

The Directors believe that the Company possesses the following strengths:

**Reputable brandname** — The brandname of 「同仁堂」 has 331 years of history and was the first Chinese trademark ever registered in the International Registrar of Madrid. The use of such a prestigious brandname significantly helps the Company to get customer awareness and recognition of its products both domestically and overseas;

**Expertise in research and development** — The Company is equipped with advanced and comprehensive research facilities as well as well-qualified research staff. Over the last decade, the Company has been involved in developing over twelve types of major new products. This demonstrates the Company's outstanding ability in research and development;

**Green medicine** — Green medicine have been increasingly popular among developed countries in light of the side effects of synthetic medicine. The Company is well positioned to penetrate into the green medicine market as the Company's products are substantially made from natural Chinese medicinal raw materials;

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## BUSINESS

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**Wide range of existing products** — The Company has obtained production approvals for 275 Chinese Patent Medicine which covers a wide range of Chinese medicine. This provides the Company with a strong foundation to further improve its research and development capabilities;

**Extensive distribution channels** — The Company utilizes Tongrentang Ltd.'s nationwide sales and marketing network to distribute the Company's products. Tongrentang Ltd. has more than 110 major distributors throughout the PRC. The Company also markets and exports its own products and those of Tongrentang Ltd. through the Company's international sales network to 18 countries and regions;

**Geographical advantage** — The Company is located in Beijing, the PRC, which has long been regarded as the centre of high standard research and studies of Chinese medicine. The Company has established good relationships with various research and academic institutes in Beijing. The Company capitalizes the research power of these institutes by cooperating with them in researching and developing new medicine;

**Experienced and dedicated management** — The Company's managerial staff possesses extensive experience and expertise in manufacturing and selling Chinese medicine.

The Directors believe that the Company's competitive advantage will help enhance its development in the Chinese medicine industry and allow the Company to expand and compete for greater market share in the future.

### BUSINESS STRATEGY

The Company aims to modernize and internationalize TCM with consistent improvement in technology to preserve the characteristics of natural Chinese medicinal raw materials and maintain the special production features of the Chinese medicine. The Company plans to make use of advanced technology and research results to improve the quality of its existing products and upgrade its production efficiency to achieve economy of scale. The Company endeavours to develop new scientific and effective products of international standards which enjoy intellectual rights and introduce bio-pharmaceutical products into the healthcare products market. At the same time, the Company plans to venture into e-commerce business to further expand the Company's market share.

### EXISTING BUSINESS

#### Introduction

The Company mainly engages in the manufacturing and sales of Chinese Patent Medicine in the forms of granules, pills, tablets and soft capsules. At present, there are altogether four

operating divisions under the Company, namely, Factory No. 2, the Chinese Medicine Refinery, Import and Export Department and Research and Development Centre.

**Factory No. 2**

Factory No. 2 is engaged in large scale manufacturing of new forms of medicine which was the major operation of Tongrentang Ltd.. At present, there are 891 workers and 6 workshops in Factory No. 2. It mainly produces medicine in the forms of granules and pills. Major products include Ganmao Qingre Granule (感冒清熱沖劑) and Liuwei Dihuang Pill (六味地黃丸), etc.. For the two years ended 31 December 1999 and the four months ended 30 April 2000, the sales generated by Factory No. 2 accounted for approximately 81.2%, 81.8% and 81.9% of the turnover of the Company respectively.

**Chinese Medicine Refinery**

There are currently 391 workers working in the five workshops of the Chinese Medicine Refinery which mainly produces tablets and soft capsules. Products include Niu Huang Jiedu Tablet (牛黃解毒片) and Ganmao Soft Capsule (感冒軟膠囊). For the two years ended 31 December 1999 and the four months ended 30 April 2000, the sales generated by the Chinese Medicine Refinery accounted for approximately 18.8%, 18.2% and 18.1% of the turnover of the Company respectively.

**Import and Export Department**

The Import and Export Department was established in 1993. It is mainly engaged in the export of products manufactured by the Company and Tongrentang Ltd. and their respective subsidiaries and associates. It is also involved in the import of raw materials, equipments, machinery and technologies for the Company. There are 27 staff in the Import and Export Department. It now exports over 36 items, including Chinese Patent Medicine and nutritious health care products of the Company to over 18 countries and regions in the world. Total export generated by the operation of the Import and Export Department for the two years ended 31 December 1999 and the four months ended 30 April 2000 were US\$6.0 million (HK\$46.5 million), US\$7.1 million (HK\$55 million) and US\$2.5 million (HK\$19.30 million) respectively.

**Research and Development Centre**

At present, the Research and Development Centre of the Company employs 25 researchers who have extensive experience in research and development. The centre is well equipped with a full range of advanced research equipments and machineries. Over the past 10 years, the centre has developed over twelve different new products. The Directors believe that these highly qualified professionals can help the Company to adapt to different approaches and to develop high standard of new medicine through their superior research and development capabilities and by utilizing the technological advantage in Beijing. At present, the Research and

## BUSINESS

Development Centre has two researchers with doctorate degrees, three researchers with master degrees and 18 researchers with bachelor degree.

The new products being developed in the Research and Development Centre include a new anti-influenza drug, new anti-cardiovascular system diseases drug and new anti-climacteric drug. For details, please refer to the section headed "Business objectives".

### PRODUCTS

At present, the Company has 275 types of Chinese Patent Medicine with approval certificates, out of which the Company produced 86 types in the years 1998 and 1999 and for the four months ended 30 April 2000. The Company produces and sells four major forms of medicinal products being: granule, pill, tablets and soft capsules. Turnover of the respective products for the two years ended 31 December 1999 and the four months ended 30 April 2000 were as follows:

Forms of Products	Year ended 31 December								
	Accounting for turnover of the Company			Accounting for turnover of the Company			Four months ended 30 April 2000		Accounting for turnover of the Company
	1998		%	1999		%	30 April 2000		%
HK\$'000	RMB'000	HK\$'000		RMB'000	HK\$'000		RMB'000		
Pills	40,413	42,894	18%	64,355	68,307	22%	35,676	37,867	30%
Granule	61,306	65,070	26%	78,747	83,582	27%	30,657	32,539	26%
Tablets	24,131	25,613	10%	36,378	38,612	12%	16,752	17,781	14%
Soft capsule	11,603	12,315	5%	10,025	10,641	4%	3,563	3,782	3%
Other <sup>#</sup>	96,834	102,780	41%	100,741	106,926	35%	32,609	34,611	27%
<b>Total</b>	<b>234,287</b>	<b>248,672</b>	<b>100%</b>	<b>290,246</b>	<b>308,068</b>	<b>100%</b>	<b>119,257</b>	<b>126,580</b>	<b>100%</b>

# Notes: 1. Other forms of products include syrup pills, oral tonic, etc.

2. Including Angong Niu Huang Pill (安宮牛黃丸). Sales of the product accounted for 4.4%, 4.5% and 4.5% of the turnover of the Company for the two years ended 31 December 1999 and the four months ended 30 April 2000 respectively. Tongrentang Ltd. also manufactures Angong Niu Huang Pills. For details, please refer to the section headed "Business competition".

Ten of the products manufactured by the Company are patented medicine under State Class 2 protected products. Sales of these ten types of products represent 5%, 4% and 3% of the total turnover of the Company for the two years ended 31 December 1999 and the four months ended 30 April 2000 respectively.

The following is a summary of the major products of the Company categorized by production forms.

1. Granules refer to compressed extracts in the form of small granules extracted from herbs mixed with suitable supplements or medicinal powder. Granules are dissoluble in water.

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## BUSINESS

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Granules are mainly manufactured in Factory No. 2. Listed below are the three best selling products under this category:

1) Ganmao Qingre Granule (感冒清熱沖劑)

Properties and effects: expelling wind, dispersing cold, relieving external syndrome and dissipating heat, intended for body ache, coughing, congested and runny nose, cough and sore throat.

Sales on Ganmao Qingre Granule represents 17.6%, 18.5% and 17.0% of the turnover of the Company for the two years ended 31 December 1999 and the four months ended 30 April 2000 respectively.

2) Banlangen Granule (板藍根沖劑)

Properties and effects: dissipating heat, cooling the blood and relieving sore throat, repercussive, intended for tonsillitis, parotitis, sore throat infection, preventing infective hepatitis, children's measles.

Sales on Baulangen Granule represents 7.4%, 7.6% and 8.1% of the turnover of the Company for the two years ended 31 December 1999 and the four months ended 30 April 2000 respectively.

3) Xiaoer Ganmao Granule (小兒感冒沖劑)

Properties and effects: ventilating and relieving exterior syndrome, dissipating heat and antidotic, intended for influenza and common cold.

Sales on Xiaoer Ganmao Granule represents 1.1%, 0.9% and 0.9% of the turnover of the Company for the two years ended 31 December 1999 and the four months ended 30 April 2000 respectively.

2. Pills refer to pills manufactured by mixing honey and water with medicinal powder.

Pills are mainly manufactured in Factory No. 2. Listed below are the three best selling products under this form:

1) Liuwei Dihuang Pill (六味地黃丸)

Properties and effects: nourishing the yin (陰) and reinforcing the kidney, intended for treatment of general weakness and dizziness, tinnitus, lassitude in the knees, hectic fever, night sweating, and emission and diabetics.

Sales on Liuwei Dihuang Pill represents 13.9%, 16.7% and 22.4% of the turnover of the Company for the two years ended 31 December 1999 and the four months ended 30 April 2000 respectively.

2) Zhibai Dihuang Pill (知柏地黃丸)

Properties and effects: Nourishing the yin (陰) to reduce internal heat. Intended for symptoms caused by the deficiency of the yin (陰) which leads to internal over heat, fever and over perspiration dry and sore throat, tinnitus, nocturnal emission, oliguria with reddish urine.

Sales on Zhibai Dihuang Pill represents 1.8%, 3.1% and 5.3% of the turnover of the Company for the two years ended 31 December 1999 and the four months ended 30 April 2000 respectively.

3) Jinkui Shenqi Pill (金匱腎氣丸)

Properties and effects: A tonic for warming and reinforcing the kidney-yang (陽), promoting the activities of qi (氣). Intended for general debility, lassitude in the knees, atony of the legs, frequent urination, excessive sputum panting and cough.

Sales on Jinkui Shenqi Pill represents 1.4%, 2.1% and 2.2% of the turnover of the Company for the two years ended 31 December 1999 and the four months ended 30 April 2000 respectively.

3. Tablets refer to the mixture of powder extracted from herbs or extracts from herbs added with medicinal powder and compressed in tablets forms.

Tablets are mainly manufactured in the Chinese Medicine Refinery. Listed below are the three best selling products:

1) Niu Huang Jiedu Tablet (牛黃解毒片)

Properties and effects: dissipating heat and antidotic, relieving internal over-heat, intended for swollen and painful throat, and gingivitis.

Sales on Niu Huang Jiedu Tablet represents 6.2%, 7.7% and 9.3% of the turnover of the Company for the two years ended 31 December 1999 and the four months ended 30 April 2000 respectively.

2) Yufeng Ningxin Tablet (愈風寧心片)

Properties and effects: cramp stopping and pain killing, adding strength to brain and blood circulation. Intended for those with high blood pressure, vertigo and headache, neck pain, cardiomyopathy, neuro-headache, early and sudden deafness.

Sales on Yufeng Ningxin Tablet represents 0.9%, 1.3% and 1.4% of the turnover of the Company for the two years ended 31 December 1999 and the four months ended 30 April 2000 respectively.

3) Yinqiao Jiedu Tablet (銀翹解毒片)

Properties and effects: cooling and relieving external syndrome with the cold pungent, dissipating heat and antidotal. Intended for those common colds, cough, dry and sore throat, fever and headaches.

Sales on Yinqiao Jiedu Tablet represents 0.4%, 0.2% and 0.1% of the turnover of the Company for the two years ended 31 December 1999 and the four months ended 30 April 2000 respectively.

4. Soft capsules refer to extracts from herbs added with medicinal additives and sealed in spherical-shaped capsule, tube-shaped capsule or other shapes of soft capsules.

Soft capsules are mainly manufactured in the Chinese Medicine Refinery. Listed below are the two best selling products under this category:

1) Ganmao Soft Capsule (感冒軟膠囊)

Properties and effects: cooling and wind-expelling. Intended for colds and influenza, lassitude in bone and joint, headache and fever, cold and bodily pain, runny nose, cough and dry throat.

Sales on Ganmao Soft Capsule represents 3.8%, 2.6% and 2.6% of the turnover of the Company for the two years ended 31 December 1999 and the four months ended 30 April 2000 respectively.

2) Huoxiang Qieshu Soft Capsule (藿香祛暑膠囊)

Properties and effects: eliminating summer-heat, relieving water retention, relieving external syndrome and revitalizing internal organs. Intended for treatment of internal water retention, fever caused by heat and cold, headache and sweating, lassitude in the limbs, vomiting, abdominal pain and diarrhoea.

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Sales on Huoxiang Queshu Soft Capsule represents 1.1%, 0.8% and 0.3% of the turnover of the Company for the two years ended 31 December 1999 and the four months ended 30 April 2000 respectively.

### PRODUCT AWARDS

Since 1982, the Company has obtained various awards for the quality of its products of which four of them are national awards. Listed below are a selection of the awards in respect of certain major products.

Product	Factory	Awards	Awarding Authority	Year of Award
Banlangen Granule (板藍根沖劑)	Factory No. 2	Beijing City High Quality Products Award (北京市優質產品獎)	Beijing Government	October 1983
Ganmao Qingre Granule (感冒清熱沖劑)	Factory No. 2	Silver National Award (國家銀質獎)	State Economic Commission	September 1984
Xiaoshuan Tongluo Tablet (消栓通絡片)	Chinese Medicine Refinery	Beijing City High Quality Product Award (北京市優質產品獎)	Beijing Government	September 1984
Yufeng Ningxin Tablet (愈風寧心片)	Chinese Medicine Refinery	Silver National Award (國家銀質獎)	State Quality Control Prize Committee (國家質量獎審定委員會)	December 1985
Shengmai Yin Oral Liquid (人參生脈飲)	Factory No. 2	Silver National Award (國家銀質獎)	State Quality Control Prize Committee (國家質量獎審定委員會)	December 1989
Niu Huang Jie Du Tablet (牛黃解毒片)	Chinese Medicine Refinery	Quality Products Award by State Administration Bureau of Traditional Chinese Medicine (國家中醫藥管理局優質產品)	State Administration Bureau of Traditional Chinese Medicine (國家中醫藥管理局)	December 1990
Liuwei Dihuang Pill (六味地黃丸)	Factory No. 2	Beijing City High Quality Products Award (北京市優質產品獎)	Economic Commission of Beijing (北京市經濟委員會)	December 1990

### PRODUCTION

#### *Production equipment*

The Company's eleven production workshops are located in Beijing, the PRC and the land of which the workshops are situated is leased by the Company from Tongrentang Holdings. The gross floor area of the plants is 54,304.2 sq.m..

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## BUSINESS

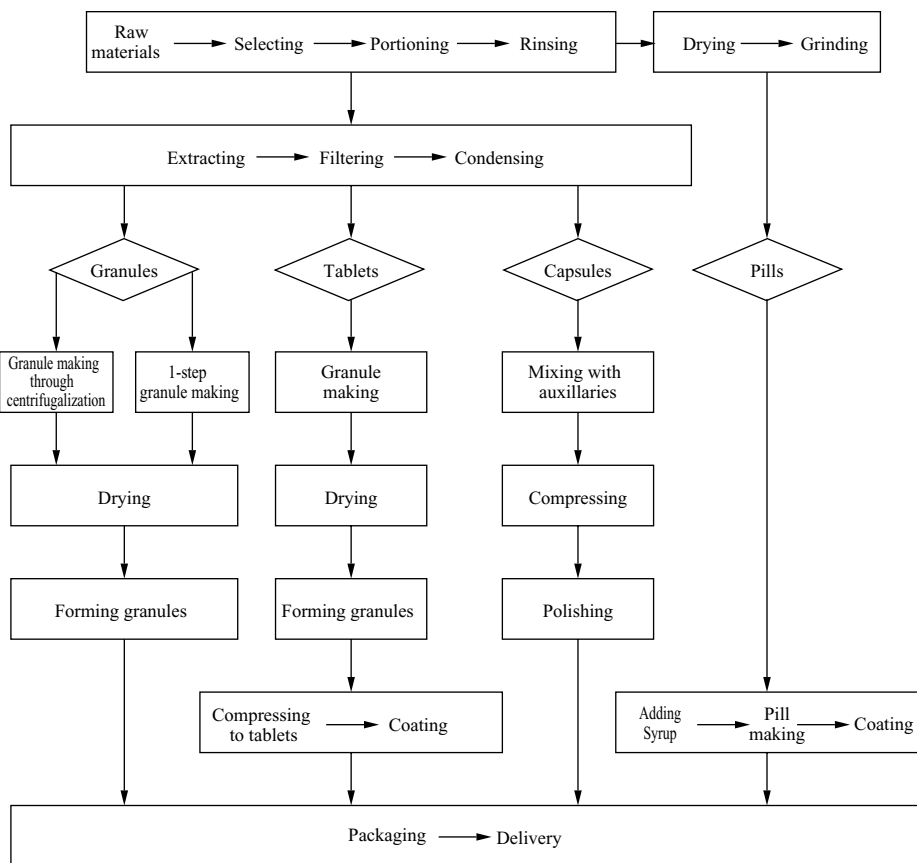
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The three production lines for tablets, granules and soft capsules have obtained Australian GMP certificates. The Company is equipped with modern Chinese medicine production equipments and will continue its research and development to introduce new technologies, new equipments in order to increase productivity and to improve quality of the products.

### *Production plan*

The Company devises its annual production plan mainly in accordance with market demand. The quarterly production plan and raw materials purchase plan are devised based on the market demand forecast and the sales plan of the forthcoming season by taking into account the production capabilities of the Company. However, the actual production plan will be adjusted in advance in accordance with actual demand and inventory levels.

### *Production Procedures*



**RAW MATERIALS**

The main Chinese medicinal raw herbs required by the Company are classified mainly into twelve types: root, stem, leaf, flower, peel, grass, ivy, fruit seeds, resin, mineral, animal, fungi and others. Apart from some of those which can be found in the wilderness, most of the above are grown, cultivated and processed. Costs of raw materials accounted for approximately 44%, 41% and 39% of the total costs of the Company for the two years ended 31 December 1999 and the four months ended 30 April 2000 respectively. Cost of sales also include direct labour and overhead. Before the formal establishment of the Company, a major portion of the raw materials was supplied by Tongrentang Holdings and Tongrentang Ltd. which accounted for approximately 42%, 47% and 48% of the total purchase of the Company for the two years ended 31 December 1999 and the four months ended 30 April 2000 respectively. The purchase of raw materials from Tongrentang Ltd. will be terminated upon the listing of the Company while the Company will continue to source raw materials from Tongrentang Holdings after listing. On 6 October 2000, an agreement for the supply of raw materials was made between Tongrentang Holdings and the Company. For details, please refer to the paragraph headed “Raw material supply agreement” in the section headed “Relationship with Tongrentang Holdings and Tongrentang Ltd.”.

Purchases from the five largest raw material suppliers (including Tongrentang Holdings and Tongrentang Ltd.) accounted for approximately 56%, 63% and 58% of the Company’s total purchases for the two years ended 31 December 1999 and the four months ended 30 April 2000 respectively. Tongrentang Holdings was the largest supplier of the Company, purchase from Tongrentang Holdings accounted for 41%, 43% and 40% of the total purchases for the two years ended 31 December 1999 and the four months ended 30 April 2000 respectively. Tongrentang Ltd. was one of the five largest raw material suppliers of the Company which accounted for 1%, 4% and 8% of the total purchases for the two years ended 31 December 1999 and the four months ended 30 April 2000 respectively. The payment was usually settled by bank draft, cheques or cash in RMB and payable upon receipt of goods. However, the reliance on Tongrentang Holdings is expected to be reduced after listing as the Company plans to set up a production base for Chinese medicinal raw materials and to gradually increase the proportion of direct purchase after listing.

Each of Yin Shun Hai and Tian Da Fang owns 12,000 shares of Tongrentang Ltd., representing 0.005% of the issued share capital of Tongrentang Ltd., whereas each of Wang Zhao Qi and Mei Qun owns 9,600 shares of Tongrentang Ltd., representing 0.004% of the issued share capital of Tongrentang Ltd. respectively. Save as disclosed above, neither Tongrentang Holdings, Tongrentang Ltd., the Company, their directors and supervisors nor their respective associates had any interest in the five largest suppliers of the Company.

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As the major Chinese medicinal herbal materials are agricultural by-products, market prices and supply are affected by the yearly crop. The Company has been successful in the past in minimizing the effect of price fluctuations by adjusting the product portfolio and increasing the prices of the products. As to the products in respect of which prices are regulated by the provincial authorities, the Company can also apply for appropriate price increases.

### INVENTORY CONTROL

In order to ensure the availability of ample and timely supplies for the manufacturing of products and to increase inventory turnover, the Company's production units adopt strict inventory management control by closely monitoring the sales of the Company's products.

### QUALITY CONTROL

The Directors consider that quality control is the major factor contributed to the success of Tongrentang. Therefore, the Company has been making every effort to implement and maintain quality control. The Company adheres to the ancient teaching "meticulous processes and not dismissing human techniques, precious quality and not saving good materials", as well as maintains the characteristics of "unique prescription, superior materials, superb technique, obvious effects". The strict quality control system of the Company is described in detailed below:

*1. Quality supervision:*

The Company has set up strict quality assurance and advance quality testing system. It adopts various internal management systems and standard operating procedures. Quality assurance personnel supervises the implementation of all production procedures. Quality control personnel tests the quality of raw materials, semi-finished products and end-products. The Company also increases its standard of quality control by using atomic absorption flame spectrophotometer, gas chromatograph and high pressure liquid chromatograph as well as thin layer chromatograph which help to guarantee the stability and quality of its products, so as to attain a higher product quality than is required by the national standard.

*2. Personnel quality:*

The number of technical personnel has been increasing every year which strengthens the quality control capabilities of the Company. Currently, the Company employs 215 technical personnel. The Company provides staff training every year with a view to raise the professional ethics, technical expertise and operating standard of its employees.

### 3. *Plant and equipment:*

At present, three of the production lines of the Company have obtained the Australian GMP certificates. These production lines are granules, tablets and soft capsules.

## **SALES**

The products of the Company are mainly sold in the domestic market of the PRC. For the two financial years ended 31 December 1999 and for the four months ended 30 April 2000, domestic sales accounted for 98%, 98.2% and 97.3% of the total sales of the Company respectively. The remaining of the sales represents export to eighteen countries and regions in the world.

Prior to the sales agency agreement coming into effect on 6 October 2000, the Company's sales in the PRC was conducted through the sales company of Tongrentang Ltd. The sales company distributed products to the customers through its distribution channels consists of more than 110 distributors all over PRC. For the two years ended 31 December 1999 and the four months ended 30 April 2000, the sales company conducted sales based on the pricing of the Company and did not charge any fee to the Company. The Import and Export Department was responsible for overseas sales and provided related export services to Tongrentang Ltd. at no consideration in the past. The Company has entered into an overseas sales agency agreement with Tongrentang Ltd. for the provision of the Company's export services in the future. Please refer to the paragraphs headed "The PRC sales network" and "International sales network" below for details.

## **SALES ARRANGEMENT AFTER LISTING**

### **The PRC sales network**

On 6 October 2000, the Company and Tongrentang Ltd. signed the PRC sales agency agreement for a term of 3 years. This agreement will enable the Company to continue using the distribution channels of Tongrentang Ltd. throughout China. According to the PRC sales agency agreement, Tongrentang Ltd. would continue to be a non-exclusive distribution agent of the Company, responsible for the sales and marketing of the Company's products in the PRC. The agency fee charged by Tongrentang Ltd. to the Company was fixed at 3.5% of the actual total agency revenue.

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## BUSINESS

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The distribution channel was built up over many years by Tongrentang Ltd. and its predecessor throughout China. Tongrentang Ltd. has over 160 personnel in its sales and marketing team together with more than 110 major distributors (12 of which are the various joint ventures or related companies of Tongrentang Holdings and Tongrentang Ltd.) who further distribute the Company's products to second layer distributors and Chinese Medicine shops throughout the country. To secure the relationships with its major distributors, Tongrentang Ltd. signed a distribution agreement with each of the major distributors stipulating, among others, the contract sum, supply method and price, credit limit, settlement method and period. The Directors believe that this arrangement helps to ensure long term and stable business relationship with such distributors. The five largest customers are all domestic customers.

The Company adopts strict control over the payment terms of customers from domestic sales. The sales are settled in Renminbi. The methods of settlement include telegraphic transfer, cheque, money order, bank draft and cash in Renminbi. The credit period for the major distributors is usually 30 days after receipt of supplies.



**PRC Distribution Network**

**International sales network**

Pursuant to the overseas sales agency agreement signed between the Company and Tongrentang Ltd. on 6 October 2000, the Company is appointed as a non-exclusive agent for Tongrentang Ltd.'s products outside China. By 31 December 1999, the Import and Export Department was involved in business in eighteen countries or regions, namely, Hong Kong, Japan, Malaysia, Thailand, the U.S., Australia, etc. The total export generated by the Import and Export Department for the two years ended 31 December 1999 and the four months ended 30 April 2000 were US\$6.0 million (HK\$46.5 million), US\$7.1 million (HK\$55 million) and US\$2.5 million (HK\$19.4 million) respectively, and out of which approximately US\$0.59 million (HK\$4.6 million), US\$0.67 million (HK\$5.2 million) and US\$0.41 million (HK\$3.2 million) were generated from the export of the Company's products, represented 10%, 11% and 16% of the total export generated by the Import and Export Department for the respective periods, while the remaining were generated from the export of the products of Tongrentang Ltd..

At present, the majority of the Company's export orders are secured at the Guangzhou Trade Fairs. The Company directly negotiates sales terms with foreign importers. The Import and Export Department is solely responsible for all the export businesses of the Company. In addition, the Import and Export Department is also responsible for the export of products of Tongrentang Ltd.. Prior to the overseas sales agency agreement coming into effect, the Import and Export Department has been providing related services to Tongrentang Ltd. at no consideration.

The Company's export products are mainly sold to southeast Asia, North America and Australia which accounted for 72%, 17% and 11% respectively of the total export sales of the Company for the four months ended 30 April 2000, etc.. For the two years ended 31 December 1999 and the four months ended 30 April 2000, the Company's export sales reached RMB4.9 million, RMB5.6 million and RMB3.4 million respectively, out of which the best selling products were Niuhuang Jiedu Tablet (牛黃解毒片), Liuwei Dihuang Pill (六味地黃丸), Yinqiao Jiedu Tablet (銀翹解毒片), the aggregate revenue of such products are US\$0.37 million (HK\$2.9 million), US\$0.5 million (HK\$3.9 million) and US\$0.14 million (HK\$1.1 million) during the respective periods.

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## BUSINESS

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Products are exported either as health care products, food supplements or medicine to overseas markets. The overseas customers (who are mainly local distributors in the respective importing countries) are responsible for handling all import procedures involved in the export of such products in their respective countries, including products inspection, custom clearance and purchasing product insurance, if necessary. It is up to the customers to decide whether to purchase product liability insurance as such insurance is not required in some of the importing countries and that all of its customers, as far as the Company is aware, have been acting in accordance with the relevant laws and regulations of the respective importing countries in this regard.

The sales and marketing department of the Company is responsible for market promotion, analysis and advertising activities. The advertising subsidiary of Tongrentang Holdings also assists in promoting the image of the Company's products. For the two years ended 31 December 1999 and the four months ended 30 April 2000, the promotional and advertising expenses accounted for 5.5%, 5.1% and 3.5% of the total sales of the Company respectively. For details of the connected transaction with the advertising company, please refer to the paragraph headed "Advertising agency agreement" in the section headed "Relationship with Tongrentang Holdings and Tongrentang Ltd."

For the two financial years ended 31 December 1999 and the four months ended 30 April 2000, the five largest customers of the Company accounted for about 12%, 10% and 32% of the Company's total sales respectively, whereas sales to the largest customer accounted for 4.7%, 3.8% and 9.1% for the two years ended 31 December 1999 and the four months ended 30 April 2000 respectively. On average, the Company has had only business relationships with these customers for over two years.

Save as mentioned on page 85 above, none of the Directors or Supervisors or directors or supervisors of Tongrentang Holdings and Tongrentang Ltd., or their respective associates, or any shareholder (which to the knowledge of the Directors and Supervisors owns more than 5% of the share capital of the Company following completion of the Placing) has any interest in these five largest customers and the five largest raw material suppliers referred to in the sub-section headed “Raw materials” above.



**Overseas Distribution Network**

### **RESEARCH AND DEVELOPMENT**

Traditionally, the Company has been focusing on research and development, which is mainly undertaken by the Research and Development Centre formed on the basis of the research and development centre of Factory No. 2. There are full time research and development staff, intermediate and senior technicians. Currently, there are two researchers with doctorate degree, three researchers with master’s degree and 18 researchers with bachelor’s degrees working in the Research and Development Centre.

The three main aspects of research and development work are new product development, subsequent research and development on existing products and technology modernization. The research institute is responsible for developing new medicine, new techniques and new materials. The Research and Development Centre also conducts in depth research and development on the existing products. Moreover, the Company has research and development units on bio-pharmaceutical projects.

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Apart from conducting research and development in the Research and Development Centre or the research and development unit of the respective production centres, the Company also cooperates with universities and research institutes in China on various projects on a long term partnership basis.

Product developments are made in accordance with the regulations of the national medicine authorities in respect of development of new medicine in China. In deciding whether a new product is to be developed, the Company conducts market research and explores new techniques so as to ensure market demand and technical feasibilities. The Company would launch the products within a short period of time after completing clinical tests and obtaining approval from SPSAC and will conduct tests on production and sales on a continuing basis.

The Company is presently engaging in the research and development of the following new products: new anti-influenza drug, new anti-cardiovascular system diseases drug and new anti-climacteric syndrome drug. The Directors believe that there is great market potential for these new products. The Company has also entered into a joint-venture agreement to establish Tong Ren Tang WM Dianorm Biotech with WM Dianorm Biotech for researching and developing bio-pharmaceutical medical products using the liposome technology developed by Dianorm. For details of the joint-venture agreement, please refer to the paragraph headed “Summary of joint venture agreements” in Appendix VII to this prospectus.

In order to enable the Company to concentrate its resources on developing new products acceptable to the market, Tongrentang Holdings and Tongrentang Ltd. have granted a first right of refusal to the Company on developing and manufacturing any new products in the forms of granules, pills, tablets and soft capsules. For details, please see the section headed “Relationship with Tongrentang Holdings and Tongrentang Ltd.”.

For the two years ended 31 December 1999 and the four months ended 30 April 2000, research and development expenditures amounted to about RMB2.64 million (HK\$2.49 million), RMB4.62 million (HK\$4.35 million) and RMB1.06 million (HK\$1.0 million) respectively and all are expensed as incurred.

For details of the Company’s accounting treatment for research and development expense, please refer to note (e) to the section headed “Principal accounting policies” in Appendix I to this prospectus.

### **PRICING MANAGEMENT**

The price control system of Chinese medicine is managed by the Central Government and provincial pricing authorities. Its objective is to regulate the upper limit of the retail prices. However, the Company can apply to the provincial pricing authorities for adjustment of the retail prices.

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The Company sets the prices of its products in accordance with the “Provisional regulations of Beijing on the price management of medicine”. (北京市藥品價格暫行管理辦法) The prices of Ganmao Qingre Granule (感冒清熱沖劑), Liuwei Dihuang Pill (六味地黃丸), Banlangen Granule (板藍根沖劑), Niuhuang Jiedu Tablet (牛黃解毒片) and Angong Niuhuang Pill (安宮牛黃丸) are regulated by the Beijing pricing authorities. Total sales of these products represent 49.4%, 55.5% and 61.5% of the turnover of the Company for the two years ended 31 December 1999 and the four months ended 30 April 2000 respectively. As for other products, the authorities allow Tongrentang Holdings to set and adjust the prices in accordance with the pricing management regulations regarding Chinese medicine or similar methods.

### INTELLECTUAL PROPERTY RIGHTS

At present, the Company uses the 「同仁堂」 trademark for promotion and sales of most for its products, while other products are promoted and sold mainly under the trademarks of 「京花」 and 「山花」. The trademarks were registered with the Chinese National Industrial and Commercial Administration Bureau on 15 February 1983. The trademark 「同仁堂」 is well known in China, and has been registered in over thirty countries and areas through its registration in the International Registrar of Madrid. Tongrentang Holdings owns the 「同仁堂」, 「京花」 and 「山花」 trademarks. On 6 October 2000 the Company signed a contract with Tongrentang Holdings for the use of the trademarks 「同仁堂」, 「京花」 and 「山花」 for a term of three years from the date of registering the contract with the relevant trademark management authority to 28 February 2003. The trademark registrations of 「同仁堂」, 「京花」 and 「山花」 will expire on 28 February 2003, subject to the extension of the aforesaid expiry date by Tongrentang Holdings, whose extension is expected to be successful. For details, please refer to the sub-section headed “Connected transactions” in the section headed “Relationship with Tongrentang Holdings and Tongrentang Ltd.”.

### COMPETITION

According to the 1998 statistical reports for Chinese medicine published by the National Economic and Trade Commission, Tongrentang Holdings is one of the ten largest Chinese medicine manufacturers in terms of profits in China. At present, there are more than 1,000 domestic Chinese medicine industrial enterprises of which only about 170 are of large and medium size and the remainder are small enterprises. The Directors believe that the Company has comparative advantages over these manufacturers with the 「同仁堂」 trademark and product quality.

In terms of production, the Company is one of the major supplier for Ganmao Qingre Granule (感冒清熱沖劑) and Ganmao Soft Capsule (感冒軟膠囊). For the year ended 31 December 1998, production of Ganmao Qingre Granule (感冒清熱沖劑) amounted to 6,979,727 packets and that of Ganmao Soft Capsule (感冒軟膠囊) amounted to 434,880 packets.

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Productions of Liuwei Dihuang Pill (六味地黃丸) and Niuhuang Jiedu Tablet (牛黃解毒片) are also very substantial, they amounted to 2,086,398 packets and 1,777,478 packets respectively for the year ended 31 December 1998.

Although there are some manufacturers for similar products in the overseas markets, the Directors consider that the Company has comparative advantages both in quality and reputation, and has established long term relationships with its major customers.

The Directors believe that the Company is more competitive than the other manufacturers due to the popularity of the 「同仁堂」 trademark and the superior quality of its products. Please refer to the section headed “Business competition” for details of the competition between Tongrentang Ltd. and the Company arising from the sales of Angong Niuhuang Pills (安宮牛黃丸).

### INSURANCE

The Company’s fixed and current assets are insured with Chinese Property Insurance Company. However, in accordance with the established industry practice in the PRC, the above policy does not cover any indirect losses arising from the termination of business (e.g. loss of profit). The Company has not taken any product liability insurance. However, the Company has never received any material claims from third parties in respect of its products. The Directors believe that the Company can effectively control the product liability risks through stringent quality control of its operations. In addition, all of the Company’s products must meet quality standards imposed by the regulatory authorities in its principal markets in order for the Company to obtain and maintain the necessary certificate, permits and approvals for the production, sale and distribution of such products. The Directors believe that product liability claims are not common in the PRC, the principal market for its products.

At present, the Directors confirm that the Company’s overseas customers are responsible for all import procedures involved in the import of such products into their respective countries, including, product inspection, custom clearance and taking out product insurance, if necessary. It is up to the customers to decide whether to take out product liability insurance, as such insurance is not required in some of the importing countries.

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### STATEMENT OF ACTIVE BUSINESS PURSUITS

As stated above, the Company was established on 22 March 2000 and the operations of the Company has been gradually developing within Tongrentang Holdings and Tongrentang Ltd.. During the period from 1 January 1998 to 30 April 2000, the business of the Company was managed by Tongrentang Ltd.. Some important operating activities are recorded below:

#### *Sales*

The following table sets out the turnover of the Company's major products for the period from 1 January 1998 to 30 April 2000:

	<b>1 January 1998 to 31 December 1998 (RMB'000)</b>	<b>1 January 1999 to 31 December 1999 (RMB'000)</b>	<b>1 January 2000 to 30 April 2000 (RMB'000)</b>
<b>Granule (沖劑)</b>			
Ganmao Qingre Granule (感冒清熱沖劑)	43,671	56,962	21,565
Banlangen Granule (板藍根沖劑)	18,288	23,947	10,260
Xiaoer Ganmao Granule (小兒感冒沖劑)	3,110	2,672	5,783
<b>Pill (水蜜丸劑)</b>			
Liuwei Dihuang Pill (六味地黃丸)	34,682	51,459	28,302
Zhibai Dihuang Pill (知柏地黃丸)	4,496	9,672	6,697
Jinkui Shenqi Pill (金匱腎氣丸)	3,405	6,581	2,763
<b>Tablets (片劑)</b>			
Niu Huang Jiedu Tablet (牛黃解毒片)	15,523	23,802	11,716
Yinqiao Jiedu Tablet (銀翹解毒片)	940	722	94
Yufeng Ningxin Tablet (愈風寧心片)	2,159	3,855	1,749
<b>Soft Capsule (軟膠囊劑)</b>			
Ganmao Soft Capsule (感冒軟膠囊)	9,492	8,113	3,278
Huoxiang Qeshu Soft Capsule (藿香祛暑膠囊)	2,822	2,528	432

#### *Marketing*

For the period from 1 January 1998 to 30 April 2000, the Company adopted a marketing strategy principally through advertisements, and participation in trade fairs such as the Guangdong Trade Fair in the PRC. Advertisements of the Company are usually placed on televisions, radio, newspapers, magazines and billboards.

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### *Research and development*

The Company endeavours to take a leading role in the areas of research and development. Apart from transferring technologies from abroad, it also has research and development units on bio-pharmaceutical projects.

During the period from 1 January 1998 to 30 April 2000, the Company has continuously developed new medicine. The progress is shown below:

<b>New drugs</b>	<b>Stage of development</b>
New anti-influenza drug	clinical testing commenced
New anti-cardiovascular system diseases drug	clinical testing commenced
New anti-climacteric syndrome drug	clinical testing commenced

For details of the plan of new medicine development, please refer to the section headed “Business objectives”.

### *Financing*

For the period from 1 January 1998 to 30 April 2000, the Company had taken out some bank loans as its operating funds. The borrowings of the Company amounted to RMB53,700,000, RMB45,400,000, RMB45,400,000 respectively as at 31 December 1998, 31 December 1999 and 30 April 2000, respectively. As at the above dates, the Company had cash surpluses.

### *Number of full-time staff*

During the period from 1 January 1998 to 30 April 2000, the Company had maintained a stable number of full-time staff. In 2000, the Company has 1,336 employees, among whom about 215 are technical staff, 760 are technical workers, 27 are sales staff, 35 are financial staff, 98 are administrative staff and 201 are assistant staff.

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## BUSINESS OBJECTIVES

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### BUSINESS OBJECTIVES OF THE COMPANY

The objectives of the Company are product modernization, product differentiation, meeting of international quality standard, modernization of production techniques, standardization of production and economies of scale, details of which are described as follows:

#### 1. Product modernization

The unique characteristics of Chinese medicine create excellent prospects for development. The application of modern technology to develop new products has become an important means to achieve modernization and internationalization of Chinese medicine. Therefore, the Company aims to develop new products with proprietary rights which can meet the demand of both the domestic and overseas markets and achieve economy of scale in production.

For a number of common diseases, there are still limited choices of medicine with assured effectiveness and little side effects. Therefore, the emphasis of product development will be placed on developing new products for common and difficult illness such as anti-virus, heart and blood vessels diseases, digestive system diseases and cancer.

There are three stages for product development:

##### *Stage 1 New product development*

The Research and Development Centre and the various research and development institutes to be set up by the Company in the future endeavour to develop effective and valuable new products with high technological contents. The Company will also continue to seek guidance and assistance from various national research institutes.

##### *Stage 2 Further development of existing preeminent products*

At present, the Company has obtained production approvals for 275 Chinese Patent Medicine which covers a wide range of Chinese Medicine, all with proven effectiveness, assured quality and with good potential for further development. To expand its market share especially in the international market, the Company will strive to increase the quality of its products and to make its products more easy to consumed. The Company will make full use of all available technologies, resources and strategic advantages to reform its existing products in order to increase their quality, effectiveness and at the same time decrease the dosage required and make them more convenient to consume by converting existing products into new forms. In respect of the above, the Company's products should become more competitive to promote the sales of traditional Chinese medicine in the international market.

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## BUSINESS OBJECTIVES

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### *Stage 3 Development of bio-pharmaceutical products*

Biotechnology has been applied to the pharmaceutical field very successfully with huge economic benefits and is expected to have significant impact on human health and living. Based on in-depth analysis of the development of the pharmaceutical industry and taking into consideration its competitive advantages, the Company has decided to diversify into the bio-pharmaceutical industry.

The Company will implement the principles of “Active participation, stable progress, good selection, proceeding from easy to difficult, gradual expansion, and economies of scale” when developing bio-pharmaceutical products. At present, the Company will concentrate its efforts on making breakthroughs in liposome technology, researching on new products and achieving new economic progress. This will raise the technological level of Chinese medicine, and such technology may also be applied to other fields in the future.

#### **2. Product differentiation**

In the course of developing and improving its products, the Company intends to overcome the disadvantages of large dosage and inconvenient usage of TCM, and adopts advanced product forms with a view to achieving the results of effectiveness, quick soothing and sustainable as well as consumption in small dosages. The products are mainly in the forms of tablets, soft capsules, granule and pills.

#### **3. Meeting of international quality standards**

In order to improve the market position of Chinese medicine in the international market, it is important to improve and upgrade the quality standard of Chinese medicine. Taking into account of the characteristics of Chinese medicine and using the international quality standard as benchmark, the Company adopts advanced scientific research and testing measures to research and improve the effectiveness and quality standards of its existing products by ensuring their safety, effectiveness and controllability. This enhances the status of Chinese medicine in the international medicine market.

The Company is prepared to set up a major production base for Chinese medicinal herbal raw materials to ensure their quality, specification and pricing. Please refer to the paragraph headed “Establishing production base for Chinese medicinal raw materials” below for details.

#### **4. Modernization of production techniques**

Although there has been great transformation and progress in the production techniques of TCM products in the past few decades, further improvements are required for engineering of

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## **BUSINESS OBJECTIVES**

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production techniques. In order to guarantee quality, to maintain the characteristics of Chinese medicine and to meet the GMP requirements, it is pertinent to standardize production techniques and to control different variables in production and quality control. In order to modernize Chinese medicine, large scale production lines with modernized equipment are required for the engineering of production techniques. The Company adopts advanced production techniques available to raise its technological level in raw materials processing, chemical separation, manufacturing and packaging, etc. The Company will also computerise its production process and management system so as to reduce wastage and increase productivity and efficiency.

### **5. Standardization of production**

Most countries have strict control over pharmaceutical production. Standardized management of pharmaceutical production is universally recognized and GMP ratification is the pre-requisite for introducing Chinese medicine to the world market. In 1999, SPSAC modified the Chinese GMP. In view of this, the Company intends to renovate its plants, equipment and personnel in accordance with the GMP requirements. The Company will also apply for the Chinese GMP certification for its production lines within the timeframe to be stipulated by SPSAC. At present, three production lines of the Company have been certified by the Australian GMP.

### **6. Achieving economies of scale**

The Company is confident that with its product research and development, technological enhancement, quality improvements, productivity improvements and scientific operations in the domestic and overseas markets, economies of scale will be achieved, which allows the Company's Chinese medicine products to penetrate further into the international market.

## **BASIS AND ASSUMPTIONS**

The development objectives and strategies as stipulated by the Directors are based on the following general assumptions:

- there will be no material changes in the existing laws (whether in the PRC, Hong Kong or any part of the world), policies or industry or regulatory treatment relating to the Company, or in the political, economic or market conditions in which the Company operates;
- inflation, interest rate and exchange rates will not differ materially from those prevailing as at the date of this prospectus;
- no material changes in the bases or rates of taxation applicable to the Company;

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## BUSINESS OBJECTIVES

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- suitable personnel can be recruited and retained by the Company;
- there will be no change in the funding requirement for each of the development objectives and strategies described herein from the amount as currently estimated by the management of the Company;
- external financing will be readily available to the Company; and
- there will be no disasters, natural, political or otherwise, which would materially disrupt the business or operations of the Company or cause substantial loss, damage or destruction to its property or facilities.

### IMPLEMENTATION PLAN

Under the plan of the Directors, the short term development strategy of the Company will be as follows:

#### I. EXPANSION OF PRODUCTION CAPABILITY AND ESTABLISHMENT OF PRODUCTION BASE

The Company is well-equipped with the necessary production capabilities, technical expertise and quality management. Currently, there are 3 production lines which have obtained the GMP certificates in Australia. The Company intends to continue upgrading its production capability, and to carry out improvement on its hardware and software as required by GMP. This will help the Company to obtain the domestic GMP certificates in PRC within the time limit to be specified by the SPSAC from time to time. The Company also plans to introduce new form of medicine (e.g., injection) so as to complement the original forms of such medicine.

The research and development results of the Company will be gradually converted into commercial production. The Company will manufacture such new products in the existing manufacturing plants and the bio-pharmaceutical product production base to be established in Beijing. The expected timetable for the expansion of production bases is as follows:

Time	Latest Practicable Date to December 2000	2001		2002	
		First half	Second half	First half	Second half
Description	Conduct feasibility studies	Conduct feasibility studies and preparation	– Implementation plan confirmed – Commence construction	– Construction in progress – Purchase of equipment	– Construction in progress – Installation of equipment – Trial production
Amount to be invested	–	HK\$5 million	HK\$15 million	HK\$15 million	HK\$10 million

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## BUSINESS OBJECTIVES

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### II. INVESTMENT IN RESEARCH CENTRE, NEW MEDICINE DEVELOPMENT AND BIO-PHARMACEUTICAL TECHNOLOGIES

#### 1. Investment in research centre

The existing research institute of the Company has 25 front-line research and development staff and is equipped with advanced and comprehensive support instruments and facilities. Over the past decade, the institute has successfully developed and obtained approvals for production for more than twelve new products. Capitalizing on its extensive research and development experience, the institute will increase its research capability in the future by taking advantage of the additional funding from the Placing to recruit more high calibre research personnel and to capitalize on the research and development strength of universities in Beijing to develop new drugs. The institute will also be responsible for arranging for approval from the relevant PRC authorities for the Company's new pharmaceutical products.

Initially the Company plans to establish the following bases:

1. Pathology and toxicology research base;
2. Raw material and plantation base;
3. New medicine research and development base;
4. Professional training and research and development base; and
5. Biotechnology research and development base.

The expected timetable for the establishment of the above bases is as follows:

Time	Latest Practicable Date to December 2000	2001		2002	
		First half	Second half	First half	Second half
Description	- Preparation and design	- Preparation, design and construction - Purchase of equipment	- Purchase of equipment - Completion of initial phase of construction	- Continue construction process - Completion of construction	-
Amount to be invested	HK\$1 million	HK\$4 million	HK\$10 million	HK\$6 million	-

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## BUSINESS OBJECTIVES

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### 2. Development of new medicine

The Company is currently working on the following new products to cater for the market demand.

a) *Research on new anti-influenza drug*

Influenza is most commonly caused by virus at the upper respiratory system. It occurs during any of the four seasons, but is especially prevalent in autumn, spring and winter. Viruses spread in the air may cause many other complications. It is particularly harmful to the elderly and children, and is generally more dangerous and sometimes even fatal for caucasians. Therefore anti-influenza drugs are expected to have a huge market in the western countries. The Company is conducting research on the production of new anti-influenza medicine in the form of effervescent tablet, which contains no cane sugar and can be taken by people with diabetes, to suit the intake habit of the western people. This medicine is developed in accordance with international technical and quality standards, and therefore is expected to become a competitive product in the international market.

This medicine was approved for clinical testing in April 1999, which is expected to complete by 2002. Upon obtaining approval for production in 2002, it is expected that trial production of the medicine will commence.

b) *Development of the new anti-cardiovascular system diseases drug*

Each year about 20 million people die from cardiovascular system diseases. Such disease is the no. 1 killer in the PRC and death rate attributable to cardiovascular system disease is gradually increasing.

There are many kinds of cardiovascular system diseases with high rate of occurrence. Although many treatment methods have been researched on the diseases by both Chinese and western medical science, few effective medicine are available. Therefore, the successful research and development for this medicine can bring about great potential social and economic benefits.

The Company's new anti-cardiovascular medicine is based on clinically proved prescriptions and has been developed into three types of pure Chinese medicine to cure and prevent the diseases. In 1998 this medicine was approved for clinical testing which is expected to be completed in 2002. The new product would be submitted for SPSAC approval in 2002 and is expected to be granted such approval in the second half of 2002. Trial production will then follow.

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## BUSINESS OBJECTIVES

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*c) Development of new anti-menopause syndrome drug*

Menopause appears as a syndrome when people enter advanced age after the sexually mature period of their lives. Various symptoms of menopause are commonly found in women and it is becoming increasingly a matter of concern. If mortality of life is about 70 years, about 1/3 of human life will be spent in the menopausal stage. Therefore, the fight against this syndrome is essential to prevent old age diseases.

The Company's anti-menopause syndrome medicine is based on clinically proved prescriptions and is developed into three main types of pure Chinese medicine to nourish liver and kidney, smoothing kidney and relieving "Yang" and releasing pressure.

Its function is to regulate the central nervous system by a tranquillizing effect, as well as to raise oestrogen levels. The Directors believe that there will be a huge market for this product if successfully developed. In 1998 it was approved for clinical testing which is expected to be completed in 2002. The Company intends to submit the new product for SPSAC approval in 2002 and is expected to obtain such approval in the second half of 2002. Trial production will then commence.

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The expected progress of research and development of new products is illustrated as follows:

Time	New product	Latest	2001		2002	
		Practicable Date to December 2000	First half	Second half	First half	Second half
Description	New anti influenza drug	Clinical trial commences	Continue clinical trial	Clinical trial in progress	– Clinical trial completed – Prepared to apply for SPSAC approval	Apply and obtain SPSAC approval for production and trial production
	Development of new anti-cardiovascular system diseases drug	Clinical trial commences	Continue clinical trial	Clinical trial in progress	– Clinical trial completed – Prepare to apply for SPSAC approval	Apply and obtain SPSAC approval for production and trial production
	Development of new anti-menopause syndrome drug	Clinical trial commences	Continue clinical trial	Clinical trial in progress	– Clinical trial completed – Prepare to apply for SPSAC approval	Apply and obtain SPSAC approval for production and trial production
Amount to be invested	–	HK\$0.5 million	HK\$3 million	HK\$5.5 million	HK\$1 million	–

The completion of the above projects will depend on:

1. the due completion of the research and development work;
2. the due obtaining of all approval documents for the research and development projects;
3. the due commencement of the trial production;
4. the satisfactory launch of the new medicinal products; and
5. the due obtaining of the GMP certificate of SPSAC from time to time.

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### 3. Developing bio-pharmaceutical technologies

In order to maintain its leading position in the Chinese medicine industry and to compete in the international pharmaceutical market, the Company strives to strengthen its foundation in technology. The Company aims to combine the western new technologies with the characteristics of TCM and the tradition of Tongrentang to modernize and improve the products of the Company. Taking advantage of Beijing's policy of encouraging the development of biotechnology, the Company and WM Dianorm Biotech entered into an agreement to form a joint venture company, Tong Ren Tang WM Dianorm Biotech, in May 2000. The registered capital of the joint venture company is US\$3,000,000, total investment is proposed to be US\$5,000,000. For details of the joint venture agreement, please refer to the paragraph headed "Summary of joint venture agreements" in Appendix VII to this prospectus. The joint venture company is expected to be incorporated in the first half of 2001. The Company intends to use the proceeds from the Placing to pay up its share of capital. By utilizing Dianorm's advances in liposome and other bio-pharmaceutical technologies, the Company will be able to promote the technological level of Chinese medicine and will be able to develop other new bio-pharmaceutical products.

Liposome is an oriented medicine carrier which belongs to a target pharmaceuticals supply system. The Directors believe that the introduction of new products based on the patented liposome technology will have immense market potential.

Tong Ren Tang WM Dianorm Biotech plans to establish a biotechnology research and development base in Beijing. It will initially carry out research on liposome patented technology and the corresponding product development. Based on the new bio-pharmaceutical products developed by the Beijing Biotechnology Research and Development Base, the Company plans to set up the Beijing Bio-pharmaceutical Product Production Base to manufacture bio-pharmaceutical products and bio-technology products. The Company strives to capitalise on the research results to produce and market new bio-pharmaceutical products, thereby realizing the immense economic values of such a technology.

The expected timetable for the development of bio-pharmaceutical products is as follows:

Time	Latest Practicable Date to December 2000	2001		2002	
		First half	Second half	First half	Second half
Description	Prepare for the incorporation of the joint venture company	- Finish incorporation of the joint venture company	- Preliminary research - Apply for production approval of SPSAC	- Obtain production approval from SPSAC	- Production of bio-pharmaceutical products commences
Amount to be invested	-	HK\$14 million	HK\$10 million	-	-

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## BUSINESS OBJECTIVES

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### III. ESTABLISHING SALES NETWORK AND VENTURING INTO E-COMMERCE BUSINESS

#### 1. Establishing sales network

The Company will continue to utilize the existing nationwide distribution network of Tongrentang Ltd. for distribution of products in the PRC. On the other hand, the Company plans to establish its own domestic sales network after listing, and strengthen its existing overseas sales and marketing network so as to further increase the penetration of products in the domestic market and the overseas market respectively. It is tentatively planned that the network would only focus on the areas in which the existing distribution network of Tongrentang Ltd. does not cover. In view of this, it is envisaged that there would not be any material conflict of interest between the Company and Tongrentang Ltd.

The expected timetable for the establishment of sales network is as follows:

Time	Latest Practicable Date to December 2000	2001		2002	
		First half	Second half	First half	Second half
Description	–	– Site selection – Liaise with local relevant departments for preliminary approval	– Obtain approval – Construct and decorate properties	– Construct and decorate properties – Obtain certificate – Trial run	–
Amount to be invested	–	HK\$5 million	HK\$17 million	HK\$10 million	–

#### 2 Venturing into e-commerce

The internet has been a new channel for marketing products. It allows companies to provide medical information on-line; it also allows e-commerce to take place among medicine production enterprises, medicine sales and distribution enterprise and hospitals and to allow online transaction between retail medical shops and consumers.

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## BUSINESS OBJECTIVES

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The Directors consider that e-commerce will increase the sales of the Company and promote the high-technology image of the Company. The Company plans to establish websites on Chinese medicine so as to provide online medical consultancy services and the sale of medicine.

The expected timetable for the venture into e-commerce is as follows:

Time	Latest Practicable Date to December 2000	2001		2002	
		First half	Second half	First half	Second half
Description	–	– Development of system	– Trial operation of websites	– Increase types of information service	–
		– Equipment and software purchase	– Development of online medical business	– Online medical business commences	
Amount to be invested	–	HK\$3 million	HK\$5 million	–	–

#### IV. ESTABLISHING PRODUCTION BASE FOR CHINESE MEDICINAL RAW MATERIALS

Chinese medicinal raw materials are the major constituents of traditional Chinese medicine. Following the development of the Chinese medicine industry, requirements on the quality of Chinese medicinal raw materials are increasing. It is therefore necessary for Chinese medicinal raw materials to achieve the requirements of high production, fine quality, low wastage and high efficiency in order to guarantee and increase the quality of traditional Chinese medicine. The current inconsistent quality of Chinese medicinal raw materials and confusion in similar varieties have restrained the development of Chinese medical products.

With the increasing awareness on environmental protection, there is a growing understanding of developing the economy without destruction of ecology. The problems of over-utilization and over-consumption of natural resources have been causing concern among the public.

In view of the above, it is necessary for Chinese medicine manufacturers to establish Chinese medicinal raw material production base so as to meet the following purposes:

- 1) to alleviate the tight supply of Chinese medicinal raw material in order to guarantee the continuous supply of all materials used for the production of medicine;
- 2) to prevent the retardation of varieties and to promote the quantity and quality of medicinal materials by utilizing quality nurturing techniques;

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## BUSINESS OBJECTIVES

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- 3) to realize the research results in biotechnology such as polyploid and plant gene induction; and
- 4) to promote the Company's image through protecting the ecological environment.

The Company plans to establish a production base for Chinese medicinal raw materials tentatively in Beijing, China so as to ensure the quality and supply of raw materials.

The expected timetable for establishment of such production base is as follows:

Time	Latest Practicable Date to December 2000	2001		2002	
		First half	Second half	First half	Second half
Description	Feasibility studies	Select sites	Preparation for plantation	Planting and field management	Field management and partial harvest
Amount to be invested	HK\$0.1 million	HK\$2.9 million	HK\$8 million	HK\$3 million	HK\$6 million

## V. INVESTMENT IN TONG REN TANG HUTCHISON PHARMACEUTICAL DEVELOPMENT

The Company signed an agreement on 7 October 2000 with Hutchison Chinese Medicine, an indirect wholly owned subsidiary of Hutchison Whampoa Limited, and Beijing Holdings, the majority shareholder of Beijing Enterprises Holdings Limited, to form a joint venture company, proposed to be named Tong Ren Tang Hutchison Pharmaceutical Development, in Hong Kong. This agreement will take effect upon all requisite PRC governmental or other approvals for the consummation of the transaction contemplated thereby being obtained. The joint venture will be engaged in the research, development and sale of Chinese medicine mainly in Hong Kong with an aim to modernize and internationalize Chinese medicine. The joint venture will be held as to 40% by the Company, 10% by Beijing Holdings and 50% by Hutchison Chinese Medicine. The authorized share capital of the joint venture company is HK\$15 million. The total investment proposed to be made by the shareholders in the joint venture company is HK\$200 million. The Company will contribute HK\$40 million to the joint venture within one year after its establishment upon all requisite regulatory and other approvals being obtained, with the remaining HK\$40 million to be invested by the Company within 3-4 years after the incorporation of the joint venture company. For details of the joint venture agreement, please refer to the paragraph headed "Summary of joint venture agreements" in Appendix VII to this prospectus.

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## BUSINESS OBJECTIVES

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In the board of directors of the joint venture company, the Company can appoint 2 directors out of 6 of the directors. If there is any profit of the joint venture company, subject to the shareholders' resolution to retain a certain proportion as decided by the shareholders for the development of the joint venture company, the balance can be distributed annually according to the shareholders' proportion of investment in the joint venture company.

The expected timetable for establishment of the joint venture is set out as follows:

Time	Latest Practicable Date to December 2000	2001		2002	
		First half	Second half	First half	Second half
Description	Prepare for incorporation of the joint-venture company	Finish incorporation of the joint- venture company	-	-	-
Amount to be invested	HK\$6 million	HK\$14 million	HK\$20 million	-	-

The aforesaid plans are formulated according to the existing plans and intentions of the Company, and such plans are in a conceptual or preliminary stage. In addition, such intentions and plans will be formulated based on the Company's assumptions of unclear events in future. Therefore, the actual action of the joint venture may vary from the aforesaid intents and plans. Notwithstanding the Directors' endeavours to carry out the aforesaid intentions and plans, there is no guarantee that the joint venture will finalize any plans, draw up or execute any agreements within the aforesaid time limit or fully arrive at the aims of the Company.

The Company will abide by the provisions of the GEM Listing Rules in the acquisition or sale of assets in future. According to the GEM Listing Rules, when the Company proposes to acquire or sell assets, whatever the scale of acquisition or sale, in particular when the acquisition or sale deviates from the principal business of the Company, the Stock Exchange will be entitled to request the Company to issue circulars to the shareholders. According to the GEM Listing Rules, the Stock Exchange will also be entitled to consider a series of acquisitions or sales of the Company as a whole and the Company may be deemed to be a new applicant for listing and may therefore be required to meet the requirements of the listing of new applications set out in the GEM Listing Rules.

In the opinion of the Directors, the proceeds of the Placing may not provide all the funds for all the plans and/or intended involvement of projects of the Company. The Directors expect that, after the H Shares have been listed on the GEM, the Company will consider a variety of financing means, including, as appropriate, through the international capital markets, bank financings, and through the Company's internal resources, so as to ensure that the Company has access to the required funds to carry out the aforesaid plans and/or projects.

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## BUSINESS OBJECTIVES

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### REASONS FOR THE PLACING AND USE OF PROCEEDS

According to the aforesaid statement of business objective of the Company, in the opinions of the Directors, modern Chinese medicine have great development potential in China, Hong Kong and in the international market, therefore the Directors intend to expand the existing business of the Company. The net proceeds obtained by the Placing will be used by the Company to realize plans as mentioned above in this section.

The net proceeds of the Placing after deduction of relevant expenditure (payable by the Company in relation to the Placing, assuming that the Over-allotment Option is not exercised and assuming an Issue Price of HK\$3.255, being the mid point of the proposed Issue Price range of HK\$2.89 to HK\$3.62) are estimated at about HK\$214 million. The Directors plan to use such proceeds for the following purposes:

<b>Business objective</b>	<b>Total amount to be invested</b>
Construction of production base	HK\$45 million
Investment in research centre	HK\$21 million
Development of new medicine	HK\$10 million
Development of bio-pharmaceutical technologies	HK\$24 million
Establishing sales network	HK\$32 million
Establishing e-commerce	HK\$8 million
Establishing production base for Chinese medicinal raw materials	HK\$20 million
Investment in Tong Ren Tang Hutchison Pharmaceutical Development	HK\$40 million

The balance of the Placing proceeds will be used as general working capital.

In the event that the Over-allotment Option is fully exercised, the Company will receive additional net proceeds of approximately HK\$22 million (assuming an Issue Price of HK\$3.255, being the mid-point of the proposed Issue Price range of HK\$2.89 to HK\$3.62). The Directors intend to use such proceeds for general working capital purposes.

In case any part of the business plans of the Company cannot be put into practice or proceed as scheduled, the Directors will carefully evaluate the current situation, or reallocate the intended funds to other business plans and/or new projects of the Company, and/or deposit the same as short-term deposits whichever may serve the best interests of the Company and all shareholders in general.

In case all the net proceeds for the Placing are not immediately used for the aforesaid purposes, at present, it is planned to deposit the same with financial institutions in Hong Kong as short-term deposits.

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## **YEAR 2000 COMPLIANCE**

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The Company has reviewed its computer hardware and software to ensure that they are year 2000 compliant. The Directors believe that they have taken all necessary steps to ensure the computer systems of the Company are year 2000 compliant but is aware that many year 2000 issues are outside the Company's control and may continue to pose a threat to its business well into year 2000.

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## **DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND STAFF**

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### **DIRECTORS**

The Company was established on 22 March 2000. All Directors, except independent non-executive Directors, joined the Board on 9 March 2000.

The executive directors of the Company are also the directors of Tongrentang Ltd. and/or the senior management of Tongrentang Holdings. The Board is responsible for determining the overall business strategy of the Company while the senior management is responsible for overseeing the daily operation of the Company.

#### **Executive Directors**

Mr. Yin Shun Hai, aged 47, chairman of the Company, is a senior economist with postgraduate qualification. Mr. Yin was formerly the factory manager of Factory No. 2, the deputy general manager of Tongrentang Holdings. He is now the general manager of Tongrentang Holdings, chairman of Tongrentang Ltd., the vice president of China Chinese Medicine Research Society Councillor Committee, and the vice president of Beijing Industry and Commerce Federation. He is responsible for the overall decision making of the Company. He will tentatively spend approximate half of his time on the business of the Company. He is one of the promoters of the Company.

Mr. Wang Zhao Qi, aged 52, vice-chairman of the Company, is a senior accountant with post-secondary qualification. Mr. Wang was formerly the chief of finance and accounting section of Beijing Medicinal Materials Company, the assistant to general manager of Tongrentang Holdings. He is now the deputy general manager of Tongrentang Holdings, the vice chairman of Tongrentang Ltd., and the standing councillor of China Chinese Medicine Information Research Society. He is the compliance officer of the Company and responsible for overseeing all matters relating to the listing of the Company. He will spend approximately four-fifth of his time in the business of the Company. He is one of the promoters of the Company.

Mr. Mei Qun, aged 44, vice-chairman of the Company with postgraduate qualification, Mr. Mei was formerly the deputy chief of education section of Beijing Tongrentang Pharmaceutical Factory, the assistant to manager of Beijing Medicinal Materials Company and the assistant to the general manager and deputy general manager of Tongrentang Holdings. He is a director and general manager of Tongrentang Ltd.. He is responsible for overseeing the sales and marketing operation of the Company. He will spend approximately one-fifth of his time in the business of the Company. He is one of the promoters of the Company.

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## **DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND STAFF**

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### **Non-executive Directors**

Mr. Tian Rui Hua, aged 40, is a PhD in pharmacy of Kumamoto University in Japan. He was formerly the deputy director of Research Laboratory of Factory No. 2 and was awarded the third prize for Beijing Excellent Scientific Workers in 1989. He went to Japan to study in the 1990's and was engaged in the research of tallow and saponin components of medicinal plants. He is now a member of biological technical project group of the Company. He is one of the promoters of the Company.

Mr. Zhao Bing Xian, aged 36, is a management engineering post graduate of Shanghai Communications University. Mr. Zhao is the chairman of the board of directors and president of Beijing Zhong Zheng Wan Rong Investment Service Company Limited. He has extensive experience in corporate finance and securities investment and is the senior economic and financial adviser for over ten enterprises. He published a book titled "Capital operation – the role of a merchant banker in China" in January of 1997. He is one of the promoters of the Company.

### **Independent non-executive Directors**

Madam Maria Tam Wai-Chu, GBS, JP, LL.D (Hon), LL.B (Hon), barrister, aged 55, is a non-executive director of five listed companies, namely, Guangnan (Holdings) Limited, ONFEM Holdings Limited, Ryoden Development Limited, Sinopec Kantons Holdings Limited and Wing On Company International Limited respectively. She is also a member of the Hong Kong Airport Authority and her other public offices includes being a member of the Basic Law Committee of Hong Kong and a delegate to the 9th National People's Congress.

Mr. Ting Leung Huel, Stephen, FCCA, FHKSA, FTIHK, CPA, aged 47, is an accountant in public practice as Managing Partner of Ting Ho Kwan & Chan, Certified Public Accountants since 1987. He is also an independent non-executive director of three listed companies namely Chow Sang Sang Holdings International Ltd, eForce Holdings Ltd and HiNet Holdings Ltd respectively.

Mr. Jin Shi Yuan, aged 74, chief pharmacist, is an expert serving the investigation team for the state secret technology of the State Science Commission, and member of the Committee for Clinical Medicine Appraisal Experts of the Chinese Medicine Society of China. He is also consultant to the Eighth Council of the Beijing Chinese Medicine Society, visiting professor of Chinese medicine at the Chinese Medical Institute of the Beijing Union University and consultant to the Fourth Expert Committee of the Chinese Health Food Association.

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## DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND STAFF

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### SUPERVISORS

Mr. Tian Da Fang, aged 54, is a senior economist with postgraduate qualification. Mr. Tian was formerly the deputy manager, secretary of the party committee of Beijing Medicinal Materials Company, the deputy secretary of the party committee, secretary of disciplinary committee of the Headquarters of Beijing Medicine Company. He is now secretary of the party committee of Tongrentang Holdings, vice-chairman of Tongrentang Ltd., the vice president of the councillor committee of Beijing Chinese Medicine Research Society. He is one of the founders of the Company.

Mr. Yang Liang, aged 43, is an accountant with a post-secondary qualification. He served as Deputy Head of Finance and Accounting section of Tongrentang pharmaceutical manufacturing plant, Deputy Section Head of Operation Section of Tongrentang pharmaceutical manufacturing plant, Section Head of Finance and Accounting Section of Tongrentang pharmaceutical manufacturing plant, Deputy Officer of Financial Planning Section of Tongrentang Ltd. and Deputy Project Manager (Deputy Directorate Grade) of Tong Ren Tang Development Office.

Ms Sun Feng Sheng, aged 51, with a post-secondary qualification. She served as Deputy Head of Organizational Department of Factory No. 2, Chairperson of Labour Union of Factory No. 2. She is currently the Chairperson of Labour Union of Factory No. 2 and Chinese Medicine Refinery of the Company.

### SENIOR MANAGEMENT

1. Mr. Kuang Gui Shen, aged 44, is a senior economist with a post-secondary qualification. He served as Vice Factory Manager of Factory No. 2, Factory Manager of Chinese Pharmaceutical Factory No. 5, Manager of the Operation Company of Tongrentang Holdings, Factory Manager of Chinese Pharmaceutical Factory No. 3, Factory Manager of Da Xing New Factory, Factory Manager of Chinese Pharmaceutical Factory No. 5 (北京同仁堂制劑廠) . and is currently the General Manager of the Company.
2. Ms Ding Yong Ling, aged 37, is a chief pharmacist (internal engaged) with a bachelor's degree. She served as Deputy Head of the Foreign Trade Department of Tongrentang Holdings, Manager of Import and Export Branch of Tongrentang Holdings, Manager of Import and Export Branch of Tongrentang Ltd. She is currently the Deputy General Manager of the Company.

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## DIRECTORS, SUPERVISORS, SENIOR MANAGEMENT AND STAFF

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3. Mr. Liu Shi Yi, aged 44, is a deputy pharmaceutical officer with a bachelor's degree. He served as Deputy Officer of Technology Quality Department of Tongrentang Ltd., Officer of Quality and Technology Development Department of Tongrentang Ltd., and Project Manager (Directorate Grade) of Tongrentang Development Office. He is currently the Deputy General Manager of the Company.
4. Mr. Li Zheng Hua, aged 46, is a Chief Pharmacist (internal appointment) with a bachelor's degree. He served as Deputy Factory Manager of Beijing Tongrentang Chinese Pharmaceutical Factory, Deputy Chief of Production Section of Factory No. 2, and Deputy Factory Manager of Factory No. 2. He is currently the Deputy General Manager of the Company, Factory Manager of Factory No. 2 and Chinese Medicine Refinery of the Company.
5. Mr. Zhang Sheng Yu, aged 31, is an economist with a bachelor's degree. He served as deputy department head of corporate management and deputy department head of planning department of Tongrentang Holdings, deputy officer of securities department of Tongrentang Ltd. and he is currently the Secretary of the Company's Board of Directors.

### STAFF

#### Number of staff

As at 31 December 1999, the Company had a total of 1,336 full-time employees. They are classified by functional posts as follows:

Technical staff	215
Technical workers	760
Sales staff	27
Financial staff	35
Administrative staff	98
Assistant staff	201
	<hr/>
Total	<u>1,336</u>

**Relationship between the Company and its employees**

The Company has never experienced any disruption of business due to labour dispute. The Directors consider that the Company maintains good relations with its employees.

**Staff welfare**

The Company has maintained retirement insurance, unemployment insurance and hospitalization insurance for all of its employees. A housing provident fund system is also implemented for its employees.

According to relevant regulations of the Beijing Government, employees of an enterprise may no longer enjoy the benefit of housing allocation. The accommodation needs of employees may now be satisfied by the use of housing reserves, housing subsidy and housing loans. The Company has never and does not intend to provide any staff quarters to the Company's staff.

**Audit committee**

The Company has set up an audit committee according to "Guideline to set up an audit committee" compiled by the Hong Kong Society of Accountants. The committee's main duty is to review and monitor the Company's finance reporting process and internal control system. The committee now comprises Ms. Tam Wai Chu, Maria, and Mr. Ting Leung Huel, Stephen.

**Retirement benefits**

All of the PRC employees duly employed by the Company are entitled to a pension equal to the basic salary of the employees as of their retirement dates. The Company is required to make contributions to the retirement plan managed by the relevant governmental authorities at a rate of 19% of the employees' salaries. There is no obligation apart from the contribution as stated above.

During the Relevant Periods, the Company provides neither retirement nor termination benefits other than those described above.

**BACKGROUND OF TONGRENTANG HOLDINGS AND TONGRENTANG LTD.****Tongrentang Holdings**

Tongrentang is a long-established and reputable brandname in the Chinese pharmaceutical industry in China. It has a proud history of over 331 years which was made possible by the dedication of people at Tongrentang who have inherited for generations the excellent tradition of medicine refining, complying with the old admonition that “Although the producing process is complex, no one procedure can be omitted; although the raw materials are expensive, no poor quality materials can be used”. Tongrentang has never given up in its principle of “unique prescription, high quality material, consummate workmanship and remarkable curative effect” in the production of medicine.

In 1992 Tongrentang Holdings was officially set up. In 1996 and 1997 it was elected as Beijing’s “Double Ten Good Enterprise”, being the only TCM enterprise among the 120 major enterprise group trial units in China selected by the State Council 1997.

According to the State’s Economic and Trading Committee’s statistics report, Tongrentang Holdings is the leader among the key Chinese medicine enterprises in China in terms of total profits and total profit tax paid.

Tongrentang Holdings owns the well-known trademark of 「同仁堂」, which is protected by the State. 「同仁堂」 is China’s first trademark ever registered in the International Registrar of Madrid. It has already been registered in United Kingdom, Australia, Singapore, Malaysia, Thailand, Hong Kong and Taiwan.

Tongrentang Holdings also has its own Chinese Patent Medicine production plants. It principally produces traditional forms of Chinese medicine.

**Tongrentang Ltd.**

In 1997, with the approval of Beijing Government, Tongrentang Holdings, acted as the sole promoter, initiated the establishment of Tongrentang Ltd. by way of subscription. The shares of Tongrentang Ltd. were listed in the A share market of Shanghai Stock Exchange in the same year. Upon the separate listing of the Company, Tongrentang Ltd. will comprise two Chinese Patent Medicine production entities including Tongrentang pharmaceutical manufacturing plant, Tongrentang medicinal wine plant, one sales department, the medicinal wine business department, and one technical centre.

In addition, all the executive Directors and one of the Supervisors, Mr. Tian Da Fang, have at the date of this prospectus an aggregate of 0.018% interest in Tongrentang Ltd.

Tongrentang Ltd. mainly produces traditional medicine in forms of large pill, powder, ointment, pellet and medicinal wine. The principal products include Angong Niu Huang Pill (安宮牛黃丸), Tongren Niu Huang Qingxin Pill (同仁牛黃清心丸), Tongren Wuji Baifeng Pill (同仁烏雞白鳳丸), Tongren Dahuoluo Pellet (同仁大活絡丹) and Guogong Wine (國公酒).

## **CONNECTED TRANSACTIONS**

Prior to the listing of the Shares on GEM, the Company has entered into various related party transactions which are expected to continue after the listing of the Shares on GEM and will therefore constitute connected transactions of the Company (as defined in the GEM Listing Rules). These transactions are described below:

### **(A) Transactions between the Company and Tongrentang Holdings**

#### *1. Contract for storage and custody*

A contract for storage and custody dated 6 October 2000 was entered into between the Company and Tongrentang Holdings whereby Tongrentang Holdings has agreed to provide storage and custody services to the Company for a term of 3 years, commencing from the date thereof. For the initial 2 years from the effective date of the contract, the storage fee shall be fixed at RMB252 per sq.m. per year<sup>1</sup>. Adjustment to the storage fee is permitted after the initial 2-year period provided that the annual increase or decrease shall not exceed 10% of that of the previous year. The Company is entitled to give Tongrentang Holdings 6 months' prior notice to terminate the contract.

The Directors (including independent non-executive Directors) consider that Chinese medicinal materials must be handled with great care and stored in specific conditions in respect of temperature and humidity to retain their integrity and attributes. At present the warehouse of Tongrentang Holdings is one of the few large-scale warehouses in Beijing that is suitably equipped for such purpose. By entering into the contract, the Company's raw materials and products will be stored in the warehouse under the experienced supervision and management of Tongrentang Holdings.

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<sup>1</sup> LCH (Asia-Pacific) Surveyors Limited has confirmed that the basis of RMB252 per sq.m. per year is in line with the market rent of similar term of lease agreements in the same locality. During the two years ended 31 December 1999, the Company rented a total area of 8,000 sq.m. for storage under Tongrentang Holdings. To cope with the future expansion of the Company after listing, the area under the rental agreement will be increased to 12,000 sq.m.. Based on the above, the rent has been agreed to be RMB3,024,000 (HK\$2,849,067) per year on the basis of RMB252 per sq.m. per year.

The grant of a waiver to the Company, as described below, in respect of this connected transaction from the relevant requirements of the GEM Listing Rules will be subject to the annual consideration for the use of the storage and custody services in respect of such connected transaction not exceeding RMB3,500,000<sup>2</sup> subsequent to the listing. When this limit is likely to be exceeded, the Company shall promptly notify Tongrentang Holdings, the Stock Exchange and BOCI Asia in writing and seek the approval of independent shareholders, if necessary.

## *2. Raw material supply agreement*

A raw material supply agreement dated 6 October 2000 was entered into between the Company and Tongrentang Holdings, pursuant to which Tongrentang Holdings has agreed to supply the Company with part of the Chinese medicinal raw materials that is required for its production for a term of 3 years. Under the agreement, Tongrentang Holdings is obliged to ensure the quality of the raw materials by screening them before they are supplied. The price of such raw materials is to be determined by negotiation between both parties and shall fall within the range of market price. Tongrentang Holdings shall not supply the materials to the Company at a price higher than that of the same products sold to independent third parties or the average market price, whichever is lower. The Company is entitled to give Tongrentang Holdings six-months' prior notice to terminate the agreement. The term of the agreement can be extended by agreement of both parties prior to the date of expiry.

The Directors (including independent non-executive Directors) consider that as the Company is a newly established enterprise, it does not possess the conditions required for bulk purchases of Chinese medicinal raw materials directly from suppliers at the present initial stage, and it is more convenient and cost-effective to place its orders with Tongrentang Holdings which would be able to secure greater discount for the combined order from the first hand suppliers. Having stated so however, under the agreement the Company is at liberty to purchase its raw materials from other sources.

The Directors further envisage that with the increase in the Company's volume of output and corresponding increase in the need of raw materials, the Company will be in a position to purchase raw materials in bulk directly from the first hand suppliers and thereby be able to minimize its reliance on Tongrentang Holdings in the long run.

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<sup>2</sup> The extra amount of RMB476,000 by which the cap exceeds the amount stated in the agreement is to provide for any further increase of storage area which may be necessitated by the increase in business.

The Company will be able to further diversify sourcing of raw materials when its plan to set up the raw material production base is implemented in the future.

The amount of raw materials purchased from Tongrentang Holdings for the two years ended 31 December 1999 and the four months ended on 30 April 2000 were RMB42,414,722, RMB53,423,157 and RMB19,805,660<sup>3</sup> respectively.

The grant of a waiver to the Company, as described below, in respect of this connected transaction from the relevant requirements of the GEM Listing Rules will be subject to the annual consideration for the purchase of medicinal raw materials in respect of such connected transaction not exceeding RMB75,000,000<sup>4</sup> subsequent to the listing. When the above limit is likely to be exceeded, the Company shall promptly notify Tongrentang Holdings, the Stock Exchange and BOCI Asia in writing and seek the approval of independent shareholders if necessary.

### 3. Permission to use tradenames and certain trademarks

An undertaking dated 28 February 2000 as supplemented by an undertaking dated 17 October 2000 was issued by Tongrentang Holdings in favor of the Company whereby the Company is permitted to use the words “同仁堂” as its tradename free of charge, including the usage of the names “同仁堂”, “北京同仁堂”, “TONG REN TANG” and “創建於一六六九年”, together or separately, in the prospectus and the share certificate of the Company in whatever form, style or manner of representation.

A licence agreement dated 6 October 2000 was entered into between the Company and Tongrentang Holdings whereby the Company is allowed to use certain trademarks and trademark logos (collectively, “Trademarks”) of Tongrentang Holdings which include the following:

- a. 「同仁堂」 trademark logo
- b. “TONG REN TANG” trademark logo
- c. 「堂仁同」 trademark
- d. 「京花」 trademark
- e. 「山花」 trademark

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3 For the purpose of stipulating the maximum amount of the connected transaction in excess of which disclosure and/or approval will have to be sought, the Company has derived such figures on the basis of, where monies have historically been paid by Tongrentang Ltd. to Tongrentang Holdings in similar transactions, the total amount of such monies multiplied by the proportion of the Company’s relevant capacity in relation to Tongrentang Ltd.’s relevant capacity at the time of its incorporation.

4 The figure, slightly bigger than the annualized figure of RMB59,416,180 for the year 2000 is to make allowance for the expected increase in sales upon listing.

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## RELATIONSHIP WITH TONGRENTANG HOLDINGS AND TONGRENTANG LTD.

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Under the agreement, the Company is permitted to use the Trademarks within the area specified in the agreement. The term of the licence shall commence from the date of completion of filing the agreement by Tongrentang Holdings with the relevant authorities up to 28 February 2003. Upon the expiration of the licence, if Tongrentang Holdings successfully renews the right to use the Trademarks and if the Company fully complies with the terms and conditions of the agreement and requests to continue to use the Trademarks, Tongrentang Holdings shall renew the agreement with the Company. Such renewal will be subject to the approval of the independent shareholders of the Company. The renewed term of the licence shall not be shorter than 5 years. The annual licence fee during the term of the agreement is RMB793,000.

The license fees paid by the Company to Tongrentang Holdings for the two years ended in 1998 and 1999 and the four months ended on 30 April 2000 were RMB714,648 (HK\$673,307), RMB793,146 (HK\$747,264) and RMB334,400<sup>5</sup> (HK\$315,056) respectively.

The parties are entitled to adjust the annual licence fee during the renewed term commencing on or after 28 February 2003, such annual increase or decrease shall not exceed 10% of that of the previous year.

The Directors (including independent non-executive Directors) consider that the agreement ensures that the Company will be entitled to use the Trademarks which are well recognized and have always been used by the Company in the past, and is therefore conducive to the sales of the Company's products.

The grant of a waiver to the Company, as described below, in respect of this connected transaction from the relevant requirements of the GEM Listing Rules will be subject to the annual licence fee in respect of such connected transaction not exceeding RMB900,000<sup>6</sup> (HK\$848,000) subsequent to the listing. When the above limit is likely to be exceeded, the Company shall promptly notify Tongrentang Holdings, the Stock Exchange and BOCI Asia in writing and seek the approval of independent shareholders if necessary.

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5 These figures are calculated on the basis that the trademarks are worth RMB2,640,000 which is a figure valued by professional valuer and approved by the authorities.

6 According to the agreement, the annual royalty payment is around RMB793,000. After February 2003, Tongrentang Holdings will be allowed to increase the annual payment by a maximum of 10%. This figure of RMB900,000 is accordingly enlarged in anticipation of the possible increase.

**(B) Transactions between the Company and Tongrentang Ltd.***1. Distribution agency agreement*

- (a) Distribution of Tongrentang Ltd.'s products by the Company in overseas market under agency agreement

A distribution agency agreement dated 6 October 2000 was entered into between the Company and Tongrentang Ltd., pursuant to which Tongrentang Ltd. has agreed to appoint the Company to handle, as its non-exclusive agent, the sale of its products outside the PRC. The prices of products to be sold shall comply with the price range determined by Tongrentang Ltd.. However, Tongrentang Ltd. has warranted that the price determined shall not be higher than what is set for other independent third party buyers or agents for the same products. The agency fees payable to the Company under the distribution agency agreement shall be 8.5%<sup>7</sup> of the total turnover of the year.

The cost for distributing of the parent company's products by the Company during the two years ended 31 December 1999 and the four months ended 30 April 2000 were RMB6.2 million, RMB6 million and RMB1.1 million respectively.

The term of the agreement is three years, but the Company is entitled to give Tongrentang Ltd. six months' prior notice to terminate the agreement. If Tongrentang Ltd. requires the Company to continue to sell its products as its agent after the initial 3-year term, both parties may extend the term of the agreement in accordance with the terms and conditions thereof. To date, no transaction under the agreement has taken place.

The Directors (including independent non-executive Directors) consider that the agreement allows the Company to make better use of its overseas distribution network which covers eighteen countries or regions and helps increase the Company's revenue by way of agency fee.

The grant of a waiver to the Company in respect of this connected transaction from the relevant requirements of the GEM Listing Rules will be subject to the annual agency fees in respect of such connected transaction not exceeding RMB10,000,000<sup>8</sup> (HK\$9,421,000) subsequent to the listing.

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7 8.5% is calculated with reference to the estimated cost of the Company in providing the overseas sales agency services (i.e. 7.5% of turnover) plus 1% profit margin.

8 Since no transaction of this kind has ever taken place before the incorporation of the Company, the figure is determined by reference to the total amount of agency fees paid by Tongrentang Ltd. multiplied by the proportion of the Company's relevant capacity in relation to Tongrentang Ltd.'s relevant capacity at the time of its incorporation. The notional distribution agency fees received for the 2 years ended 31 December 1999 and the 4 months ended 30 April 2000 were RMB7,314,036, RMB8,139,140 and RMB2,122,278 respectively. This figure of RMB10,000,000 makes allowance for the anticipated increase in the sale of Tongrentang Ltd.'s products in overseas market in the next few years given the Company's plan to expand overseas sales network after listing.

- (b) Distribution of the Company's products by Tongrentang Ltd. in the PRC under agency agreement

A distribution agency agreement dated 6 October 2000 was entered into between the Company and Tongrentang Ltd., pursuant to which the Company has agreed to appoint Tongrentang Ltd. to handle, as its non-exclusive agent, the sale of its products in the PRC. The prices of products to be sold shall comply with the price range determined by the Company. The Company has warranted that the price set shall not be higher than the price set for other independent third-party buyers or agents for the same products. The agency fee payable to Tongrentang Ltd. shall be 3.5%<sup>9</sup> of the total turnover of the year.

The cost for distributing of the Company's products by Tongrentang Ltd. in the PRC during the two years ended 31 December 1999 and the four months ended 30 April 2000 were RMB5.6 million, RMB8.2 million and RMB3.2 million respectively.

The term of the agreement is three years, but the Company is entitled to give Tongrentang Ltd. six months' prior notice to terminate the agreement. If the Company requires Tongrentang Ltd. to continue to sell its products as its agent, both parties may extend the term of the agreement in accordance with the terms and conditions thereof.

The agreement allows the Company to take advantage of the organized and effective distribution network of Tongrentang Ltd. in the PRC which currently comprises more than 110 major distributors who further distribute the Company's products to second layer distributors and Chinese medicine shops throughout the country. The Company can have, through the network, access to the latest and most reliable market information. The agreement further provides that Tongrentang Ltd., as agent, is responsible for the transportation of the product. The Directors are of the view that this arrangement complements the Company's current lack of transportation facilities.

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<sup>9</sup> 3.5% is calculated with reference to the estimated cost of Tongrentang Ltd. in providing the agency services (i.e. 2.5% of turnover) plus 1% profit margin.

The Directors believe that the Company is not as reliant on Tongrentang Ltd. as perceived for the following reasons:

- (i) the price of many of the products and any changes thereof need to be approved by Beijing Pricing Bureau (北京市物價局) and the products are sold to all the agents and customers at uniform prices.
- (ii) all agents, including Tongrentang Ltd., enjoy a standardized commission of 3.5% of the turnover of the products. This commission is considered to be effective in neutralizing any disincentive or self-interest the agents might have in marketing the products.

The grant of a waiver to the Company, as described below, in respect of this connected transaction from the relevant requirements of the GEM Listing Rules, will be subject to the annual consideration for the use of Tongrentang Ltd.'s sales agency services in respect of such connected transaction, not exceeding RMB14,500,000<sup>10</sup> (HK\$13,661,000) subsequent to the listing. When the above limit is about to be exceeded, the Company shall promptly notify Tongrentang Ltd., BOCI Asia and the Stock Exchange in writing and seek the approval of the independent shareholders, if necessary.

**(C) Transactions between the Company, Tongrentang Holdings and Tongrentang Ltd.**

*1. Land use right leasing agreement*

A land use right leasing agreement dated 6 October 2000 was entered into between the Company and Tongrentang Holdings, pursuant to which Tongrentang Holdings has agreed to lease to the Company two pieces of land at (i) No. 33 Yang Fang Hu Tong, Xi Cheng District, Beijing, the PRC (approximate area: 5,961.2 sq.m.); and (ii) No. 20 Nan San Huan Zhong Road, Feng Tai District, Beijing, the PRC (approximate area: 43,815.15 sq.m.) (collectively, under this paragraph referred to as the "Properties"), total area being 49,776.35 sq.m. for a term of 20 years commencing from the date thereof<sup>11</sup>. The Company is entitled to give Tongrentang Holdings six months' prior notice in writing to terminate the agreement. Tongrentang

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10 This figure is determined by reference to 3.5% of the total amount of the total amount of agency fees receivable by Tongrentang Ltd. multiplied by the proportion of the Company's relevant capacity in relation to Tongrentang Ltd.'s relevant capacity at the time of its incorporation. The cap is enlarged to cope with the expected increase in the sales quantum of the Company's products through the domestic distribution network of Tongrentang Ltd..

11 The waiver is applied for a term of three years from the date of the listing, notwithstanding that the term of the agreement is for twenty years. Upon expiry of the term of the waiver, the Company is required to apply for another waiver from the Stock Exchange and seek shareholders' prior approval in respect of this connected transaction, whether or not the then annual rental payment shall exceed the cap.

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## RELATIONSHIP WITH TONGRENTANG HOLDINGS AND TONGRENTANG LTD.

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Holdings has warranted that, save as otherwise stipulated in the agreement, the Company shall enjoy full and uninterrupted land use right to the Properties during the term. Subject to force majeure events, namely, wars, change of government policies or temporary resumption by the government mentioned in the agreement, Tongrentang Holdings shall compensate the Company for all losses incurred from the termination of such right.

The rental paid by the Company to Tongrentang Holdings during the two years ended 31 December 1999 and the four months ended 30 April 2000 were RMB2,685,434, RMB2,685,434 and RMB895,145<sup>12</sup> respectively.

Pursuant to the agreement, the annual rental of the Properties for the initial 2 years is calculated at the market rate of RMB53.95 per sq.m.<sup>13</sup>, i.e. RMB2,685,434 in total, which shall remain unchanged for the initial 2 years. Any adjustments to the annual rental shall be made after the initial 2-year period at the then market rent, provided that such adjustment shall in no event exceed 10% more or less than of that of the previous year.

As the superstructures on the Properties are part of the Chinese Medicine Refinery and Factory No. 2 owned by the Company, it is necessary for the Company to rent the Properties for the purposes of its operations.

The Directors (including independent non-executive Directors) consider that the agreement will enable the Company to continue to use the structures on the Properties and the plant and machinery therein and thereat.

The grant of a waiver to the Company, as described below, in respect of this connected transaction from the relevant requirements of the GEM Listing Rules will be subject to the annual rental in respect of such connected transaction not exceeding RMB3,000,000<sup>14</sup> subsequent to the listing. When the above limit is likely to be exceeded, the Company shall promptly notify Tongrentang Holdings, the Stock Exchange and BOCI Asia in writing and seek the approval of independent shareholders if necessary.

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12 LCH (Asia-Pacific) Surveyors Limited, the Company's independent valuer, has confirmed that these figures were in line with obtainable market rent of similar properties in the same location.

13 LCH (Asia-Pacific) Surveyors Limited, the Company's independent valuer, has confirmed that this figure was in line with obtainable market rent of similar properties in the same location.

14 According to the agreement, the annual rental payment will be RMB2,685,434 subject to adjustment after the second year, provided that such adjustment shall not exceed 10% more or less of that of the previous year. The cap is thus enlarged to make allowance for the possible increase.

2. *Agreement supplemental to the building leasing agreement*

An agreement dated 6 October 2000 was entered into between the Company and Tongrentang Holdings and Tongrentang Ltd. (“Supplemental Agreement”) supplemental to the building leasing agreement dated 15 November 1998 made between Tongrentang Holdings and Tongrentang Ltd. (“Principal Agreement”) in respect of the medicine production building, office and ancillary buildings in No. 130 Xi Zhi Men Nei Da Street, Xi Cheng District, Beijing, the PRC (under this paragraph referred to as the “Properties”) with an approximate area of 6,667 sq.m..

The rental paid by Tongrentang Ltd. to Tongrentang Holdings during the two years ended 31 December 1999 and the four months ended 30 April 2000 were RMB3,000,000 (HK\$2,826,456), RMB3,000,000 (HK\$2,826,456) and RMB1,000,000 (HK\$942,152) respectively<sup>15</sup>.

Pursuant to the Supplemental Agreement, Tongrentang Holdings has agreed to lease to the Company the Properties originally leased to Tongrentang Ltd. under the Principal Agreement, at an annual rental of RMB3,000,000 subject to adjustment each year at market rate, provided that such adjustment shall not exceed 10% more or less than that of the previous year. The term of the lease is 10 years from 1 January 1997 to 31 December 2006<sup>16</sup>. The Company is entitled to give Tongrentang Ltd. and Tongrentang Holdings six months’ prior notice to terminate the Supplemental Agreement. Tongrentang Holdings has warranted that the Company shall enjoy full and uninterrupted right of use to the Properties. Where the Company’s right of use to the Properties is affected or hindered, Tongrentang Holdings shall compensate the Company for all loss incurred therefrom.

The Directors (including independent non-executive Directors) consider that as the Properties are the Chinese Medicine Refinery, which is an essential part of the Company’s operations, the Supplemental Agreement shall enable the Company to continue to use the Properties.

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15 LCH (Asia-Pacific) Surveyors Limited, the Company’s independent valuer, has confirmed that these figures were in line with obtainable market rent of similar properties in the same location.

16 The waiver is applied for a term of three years from the date of the listing, notwithstanding that the term of the agreement is ten years. The Directors understand that upon expiry of the term of the waiver, the Company is required to apply for another waiver from the Stock Exchange and seek independent shareholders’ prior approval in respect of this connected transaction, whether or not the then annual rental payment shall exceed the cap.

The grant of a waiver to the Company, as described below, in respect of this connected transaction from the relevant requirements of the GEM Listing Rules will be subject to the annual rental in respect of such connected transaction not exceeding RMB3,600,000<sup>17</sup> (HK\$3,392,000) subsequent to the listing. When the above limit is likely to be exceeded, the Company shall promptly notify Tongrentang Holdings, the Stock Exchange and BOCI Asia in writing and seek the approval of independent shareholders if necessary.

**(D) Transactions between the Company and Tongrentang Advertising, a subsidiary of Tongrentang Holdings**

*Advertising agency agreement*

An advertising agency agreement dated 6 October 2000 was entered into between the Company and Tongrentang Advertising for a term of 3 years commencing from the date thereof, pursuant to which Tongrentang Advertising has agreed to handle, as an agent of the Company, the Company's advertisement releases. The content of the advertisements and the advertising expenses shall be determined by the Company. Tongrentang Advertising is responsible for reporting to the relevant PRC authorities the content and the form of display of the advertisements to ensure that they are in compliance with the relevant laws and regulations of the PRC.

The advertising agency fee shall be charged at the rate of 15% of the whole quantum of total advertising expenditure, payable quarterly by the Company. This agency fee is determined by the PRC authorities and applied uniformly to all advertising agencies in the PRC.

Pursuant to the agreement, the Company is entitled to give six months' prior notice to Tongrentang Advertising to terminate the agreement.

The Directors (including independent non-executive Directors) consider that as Tongrentang Advertising is experienced in advertising medicinal products and "The Advertising Administration Law" requires that advertisement release/promotion be handled by an advertising company registered in the PRC, the agreement ensures that the Company is able to use its services and rely on its experience in complying with the requirements of the relevant laws, which will be conducive to product marketing in the PRC.

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<sup>17</sup> According to the Supplemental Agreement, the annual rental payment will be RMB3,000,000 (HK\$2,826,456) subject to adjustment each year, provided that such adjustment shall not exceed 10% more or less of that of the previous year. The amount is enlarged to make allowance for the possible increase over the next two years.

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## **RELATIONSHIP WITH TONGRENTANG HOLDINGS AND TONGRENTANG LTD.**

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The grant of a waiver to the Company, as described below, in respect of this connected transaction from the relevant requirements of the GEM Listing Rules will be subject to the annual advertising agency fees in respect of such connected transaction not exceeding RMB30,000,000<sup>18</sup> subsequent to the listing. When the above limit is likely to be exceeded, the Company shall promptly notify Tongrentang Holdings, the Stock Exchange and BOCI Asia in writing and seek the approval of independent shareholders if necessary.

### **(E) Transactions between the Company and subsidiaries and associates of Tongrentang Holdings and Tongrentang Ltd.**

At present, Tongrentang Ltd. has formed a network of distributors and agents for the distribution of pharmaceutical products (the “Network Agents”). The Network Agents are made up of more than 110 major distributors and second layer distributors in the PRC, Tongrentang Ltd. and Tongrentang Holdings are directly or indirectly interested in 12 of them (the “Connected Network Agents”) while the rest are independent.

In terms of sales of the Company’s products in the PRC, while the majority of the products are sold to the independent Network Agents by Tongrentang Ltd. for onward sale to the ultimate customers<sup>19</sup>, the balance is sold to the Connected Network Agents by Tongrentang Ltd., thereby constituting connected transactions within the meaning of the GEM Listing Rules<sup>20</sup>.

The Directors (including independent non-executive Directors) consider that since the Company has the right to set the selling price of its products sold to the Tongrentang Ltd., the Company should not be affected by or prejudiced against in terms of competitiveness or revenue whether its products are subsequently sold to independent or Connected Network Agents.

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18 Advertising expenses generally tie in with the level of turnover. With the launch of new products, greater efforts and resources will be channelled into promotion and advertising campaign.

19 Application for waiver regarding these transactions has been made as referred to in the paragraph headed “Distribution of the Company’s products by Tongrentang Ltd. in the PRC under agency agreement” above.

20 It is noted from the accounts that one of the 30 traditional Chinese medicine shops in which Tongrentang Holdings is indirectly interested has purchased products of the Company from Tongrentang Ltd.. Such purchases amounted to RMB7,860,000 and RMB2,480,000 for the year ended 31 December 1999 and the four months ended 30 April 2000 respectively, which were minimal compared to the total turnover of the Company for the said periods. However, the Company is unable to rule out the possibility that transaction(s) of similar nature may occur in the future as these medicine shops are at liberty to source from Tongrentang Ltd. and other Network Agents by taking into such factors as the availability of the products and convenience into consideration. Should such transactions occur, they would be regarded as connected transactions within the meaning of the GEM Listing Rules and as such and in anticipation of such possibility, the Company has taken such transactions into account when applying for a waiver from strict compliance with the GEM Listing Rules.

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## RELATIONSHIP WITH TONGRENTANG HOLDINGS AND TONGRENTANG LTD.

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The Directors estimate that the annual total sales of the Company's products to the Network Agents through Tongrentang Ltd. will not exceed RMB150,000,000<sup>21</sup> (HK\$141,323,000). When the above limits are likely to be exceeded, the Company shall promptly notify BOCI Asia and the Stock Exchange in writing and seek the approval of the independent shareholders.

According to the GEM Listing Rules, the transactions mentioned in the above agreements constitute on-going connected transactions, so that the requirements of reporting, announcement, shareholders' approval and annual review shall apply.

The Directors (including independent non-executive Directors) believe that the terms of all the above agreements under paragraphs (A) to (E) are made on arm's length basis and on normal commercial terms which are no less favourable than terms available to or from independent third parties. The Directors (including independent non-executive Directors) believe that they are made in the ordinary and usual course of business of the Company and are fair and reasonable and in the interest of the Company's shareholders as a whole.

Based solely on the documents and information provided by the Company and relying upon the representations and confirmations made by the Directors and upon the information and/or independent professional opinions (by LCH (Asia-Pacific) Surveyors Limited as to the premises occupied/land leased/fees for contract for storage and custody and Arthur Andersen & Co on those related-party transactions in the accountants' report) provided to BOCI Asia, BOCI Asia is of the view (based on the foregoing but without any independent verification) that the connected transactions referred to above are in the ordinary and usual course and on normal commercial terms of the Company's business and the terms of each of the connected transaction agreements are fair and reasonable so far as the Company's shareholders are concerned as a whole or in the interest of the Company having regard to the circumstances in which they were entered into. BOCI Asia therefore, in reaching their view with respect to the connected transactions, relied very significantly upon such information and representations.

Under the GEM Listing Rules, such transactions are considered to be "connected transactions" and would normally require full disclosure and prior independent shareholders' approval on each occasion on which they arise. As the transactions are expected to continue in the normal course of business, the Directors consider that such disclosure and approval would be impractical. Accordingly the Directors have requested the Stock Exchange to grant a waiver from these requirements. The Stock Exchange has indicated that a waiver would be granted for a period of three financial years expiring on 31

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21 According to the Directors, this figure is determined on the basis of the envisaged expansion plan of Tongrentang Ltd. by which its retail shops will be increased from 30 to 100 in the next 3-5 years, coupled with the Company's expected increase in turnover after listing.

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**RELATIONSHIP WITH TONGRENTANG HOLDINGS AND TONGRENTANG LTD.**

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December 2002 from compliance with the normal approval and disclosure requirements related to connected transactions under the GEM Listing Rules on the following conditions:

- (a) *in any financial year ending 31 December 2002*
  - (i) *the aggregate amount relating to the “Contract for storage and custody” does not exceed RMB 3,500,000;*
  - (ii) *the aggregate amount relating to the “Raw material supply agreement” does not exceed RMB 75,000,000;*
  - (iii) *the aggregate amount relating to “Permission to use tradenames and certain trademarks” does not exceed RMB 900,000;*
  - (iv) *the aggregate amount relating to the “Overseas distribution agency agreement” does not exceed RMB 10,000,000;*
  - (v) *the aggregate amount relating to “PRC distribution agency agreement” does not exceed RMB 14,500,000;*
  - (vi) *the aggregate amount relating to “Land use right leasing agreement” does not exceed RMB 3,000,000;*
  - (vii) *the aggregate amount relating to “Agreement supplemental to the building leasing agreement” does not exceed RMB 3,600,000;*
  - (viii) *the aggregate amount relating to “Advertising agency agreement” does not exceed RMB 30,000,000; and*
  - (ix) *the aggregate amount relating to the transactions between the Company and subsidiaries and associates of Tongrentang Holdings and Tongrentang Ltd. does not exceed RMB 150,000,000.*
- (b) *the details of the transactions described in the above agreements shall be disclosed in the Company’s annual report and accounts pursuant to rules 20.34(1) to (5) of the GEM Listing Rules;*

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**RELATIONSHIP WITH TONGRENTANG HOLDINGS AND TONGRENTANG LTD.**

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- (c) *the Company's independent non-executive Directors shall examine the transactions described in the above agreements every year and make their confirmation in the Company's annual report and accounts:*
- (i) *these transactions are executed in the ordinary and usual course of business of the Company;*
  - (ii) *these transactions are executed on normal commercial terms or on terms not less favorable than those given to (or obtained from, wherever applicable) independent third parties (if no comparable transaction can be referred to to judge whether the transaction is executed on normal commercial terms);*
  - (iii) *these transactions are executed in accordance with the relevant agreement governing them on terms that are fair and reasonable and in the interest of the Company's shareholders as a whole; and*
  - (iv) *the aggregate amount of each of these transactions has not exceeded the cap amount set out in paragraph (a) above;*
- (d) *the Company's auditors shall review these transactions every year and confirm in writing (with a copy provided to the Stock Exchange) to the Board in respect of the following matters:*
- (i) *the transactions described in the above agreements have been approved by the Board;*
  - (ii) *these transactions have been executed according to the pricing policies of the Company and the terms of the agreements governing the same transactions;*
  - (iii) *the aggregate amount of each of these transactions has not exceeded the cap amount set out in paragraph (a) above;*
- (e) *the Company and each party to the transactions described in the above agreements have undertaken to provide sufficient facility for the Company's auditors to inspect their respective accounts and records, thus enabling the auditors to assess the above connected transactions and make the relevant reports; and*

- (f) *the Company has undertaken to immediately notify the Stock Exchange if it comes to its knowledge or has reasons to believe that the independent non-executive Directors and/or auditor will be unable to confirm the matters set out in rules 20.27 and 20.28 of the GEM Listing Rules.*

*If there are changes or updates in any of the terms of the above agreements and contracts or that the Company and any connected persons (within the definition of the GEM Listing Rules) reach any new arrangements, the Company undertakes to comply with the requirements in the corresponding provisions of Chapter 20 of the GEM Listing Rules, unless the Company reports to the Stock Exchange and is granted an exemption.*

## **BUSINESS COMPETITION**

### **Introduction**

The Chinese Patent Medicine manufactured and sold by the Company mainly includes four newer and more popular forms: granule, pill, tablets, and soft capsule. The main products are Ganmao Qingre Granule (感冒清熱沖劑), Banlangen Granule (板藍根沖劑), Liuwei Dihuang Pill (六味地黃丸), Nihuang Jiedu Tablet (牛黃解毒片) and Ganmao Soft Capsule (感冒軟膠囊).

### **No clear business delineation with Tongrentang Ltd. and Tongrentang Holdings**

The curative effects of Chinese medicine are brought about by not only treating the symptoms of the disease, but also treating and regulating other implicit problems of the body which may have a direct or indirect influence on the explicit symptoms. As such, the curative effects of Chinese medicine are usually very broad. The proper medicine is selected with reference to a number of variables such as the patient's state of illness, gender, age and constitution, the occurring season of the disease and its curative effects on the implicit problems of the patient. As such, any particular type of Chinese medicine usually has several curative effects, some of which may be in common with those of other products under different names. Given this nature of Chinese medicine, there may exist direct competition between the products of the Company and those of Tongrentang Holdings and Tongrentang Ltd..

The Company, Tongrentang Ltd. and Tongrentang Holdings are all engaged in the manufacturing of Chinese Patent Medicine. Their businesses are delineated in accordance with their differences in focus on the forms of medicine they produce. Tongrentang Ltd. mainly produces Chinese Patent Medicine in traditional form such as large pill, powder, ointment, pellet and medicinal wine. It also has some minor production lines for the production of granule and pills. On the other hand, the Company focuses on manufacturing products in forms of granules, pills, tablets and soft capsules. Tongrentang Ltd.'s main products include Angong Niu Huang Pills (安宮牛黃丸), Tongren Wuji Baifen Pills (同仁烏雞白鳳丸), Tongren Dahuolo Pellets (同仁大活絡丹) and Guogong Wine (國公酒). Tongrentang Holdings focuses on producing medicine in traditional forms such as honeyed pills.

## **RELATIONSHIP WITH TONGRENTANG HOLDINGS AND TONGRENTANG LTD.**

Before the restructuring of the Company, the factories of the Company were an integral part of the operations of Tongrentang Ltd.. As the production permit of a particular type of Chinese Patent Medicine is issued to a particular factory rather than to a company, there were usually more than one factory under the same company holding such permit for a particular products to allow flexibility in production management. As such, after the restructuring of the Company, the Company has 86 production permits which is in common with those of Tongrentang Ltd. and Tongrentang Holdings. However, as confirmed by the Directors, many of such products have been out of production or have only been produced by one of the companies in the past few years.

In order to ensure that the business delineation between the Company and Tongrentang Holdings and Tongrentang Ltd. are properly documented and formalized, pursuant to an undertaking dated 19 October 2000 given by Tongrentang Holdings and Tongrentang Ltd. in favor of the Company (“Undertaking”), Tongrentang Holdings and Tongrentang Ltd. undertook that, except for Angong Niu Huang Pills (安宮牛黃丸), Tongrentang Holdings, Tongrentang Ltd. and their respective subsidiaries would not produce any common products of the same names or under the same names with different forms that may compete directly with those of the Company in the future. In this regard, the Company, Tongrentang Ltd. and Tongrentang Holdings have agreed not to produce certain of their products so that only one of them will continue the production of each of the products with common production permits. As such, it is agreed that out of the 86 products of the Company with common production permits, 49 of them will only be manufactured by the Company in the future, while 31 and 5 of them will only be manufactured by Tongrentang Ltd. and Tongrentang Holdings respectively upon listing and only one of them, Angong Niu Huang Pills (安宮牛黃丸), will be manufactured by both the Company and Tongrentang Ltd. in the future. However, as the majority of the products have been out of production in the past few years, the above arrangement would effectively only terminate the production of a few of such products that have been under production in the past few years. Out of the products which manufactured by the Company throughout the years, 8 of them are found to have common production permits with Tongrentang Ltd.. After the listing of the Company, apart from Angong Niu Huang Pills, the Company will manufacture 4 out of the 7 of them while Tongrentang Ltd. will manufacture the remaining 3. The infrequent production of three of the products Niu Huang Qinxin Pill (牛黃清心丸), Niu Huang Qinxin Zai Zao Pill (再造丸) and Wuji Baifeng Pill (烏雞白鳳丸), of which the Company had been manufacturing before listing, will be terminated upon the listing of the Company. Such products in aggregate contributed RMB5,404,187, RMB2,698,745 and RMB258,869 respectively of the total sales of the Company for the two years ended 31 December 1999 and for the 4 months ended 30 April 2000, respectively, which accounted for 2%, 0.9% and 0.2% of the total sales of the Company during the respective periods. Tongrentang Holdings and Tongrentang Ltd. have also undertaken to terminate the production of four of their products Huoxiang Zhengqi Tablet (藿香正氣丸), Lingqiao Jiedu Pill (羚翹解毒丸), Yinqiao Jiedu Pill (牛黃解毒丸) and Ninhuang Jiedu Pill (銀翹解毒丸), so that the Company will be the sole producer of such products among the three companies upon the listing of the Company.

**Direct competition with Tongrentang Ltd. and Tongrentang Holdings**

Both the Company and Tongrentang Ltd. produce Angong Niu Huang Pill (安宮牛黃丸). For the two years ended 31 December 1999 and the four months ended 30 April 2000, Angong Niu Huang Pills (安宮牛黃丸) represents only 4.4%, 4.5% and 4.5% of the Company's total turnover.

The Directors consider that, except for Angong Niu Huang Pill (安宮牛黃丸) produced by the Company and Tongrentang Ltd., there is no other competition among the Company, Tongrentang Ltd. and Tongrentang Holdings. The Directors consider that as Angong Niu Huang Pill (安宮牛黃丸) only represents a small percentage of Company's turnover and is not one of the major forms of medicine for development after the listing of the Company, the Company will continue to manufacture and sell Angong Niu Huang Pill (安宮牛黃丸) after listing. Tongrentang Ltd. also undertakes to offer the same sales service to the Angong Niu Huang Pill (安宮牛黃丸) made by the Company after listing. Save as mentioned herein, the Directors confirm that no other products of the Company have any competition with Tongrentang Ltd. or Tongrentang Holdings.

**First right of refusal**

Although the Company, Tongrentang Ltd. and Tongrentang Holdings all engage in the business of production, manufacturing and sale of Chinese medicine, the principal products by each of these companies are different. It has been decided that the Company will concentrate on new forms of products which are believed to be more competitive against western pharmaceutical products while Tongrentang Ltd. and Tongrentang Holdings will continue to focus on developing existing traditional forms of products.

To provide for the Company's focus on developing the four major forms of products (namely, granules, pills, tablets and soft capsules), pursuant to the Undertaking, Tongrentang Holdings and Tongrentang Ltd. have granted to the Company a first right of refusal to manufacture and sell any of the new products developed by Tongrentang Holdings, Tongrentang Ltd. or any of their respective subsidiaries and which belong to one of the four main forms of the Company. Once the first right of refusal is exercised, both Tongrentang Ltd. and Tongrentang Holdings or their respective subsidiaries are not allowed to manufacture any of such new products. In the event the Company develops any new product based on the existing products of Tongrentang Holdings, Tongrentang Ltd. or their respective subsidiaries, and such new product falls into one of the major forms of the Company, the Company will be entitled to manufacture such new product and Tongrentang Holdings, Tongrentang Ltd. and their respective subsidiaries will not be allowed to manufacture such new product. The Directors believe that the above undertaking would clarify that both Tongrentang Ltd. and Tongrentang Holdings would support the Company in its development of the four major forms of products in the future.

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## **RELATIONSHIP WITH TONGRENTANG HOLDINGS AND TONGRENTANG LTD.**

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In order for the Company to have an independent review in deciding whether to proceed with the research and development of new products, the Company confirms that the independent non-executive Directors, one of whom being a reputable person in the Chinese medicine industry, will determine whether to exercise the first right of refusal granted by Tongrentang Holdings or Tongrentang Ltd. to develop any proposed new products which belong to one of the major forms (namely, granules, pills, tablets and soft capsules) of the Company.

In the event that the Company refuses the first right of refusal offered by Tongrentang Ltd. and/or Tongrentang Holdings, terms of the option to be offered to independent third party should not be more favourable than that originally offered to the Company. Otherwise, the Company should be given the opportunity to re-consider the option under the new terms.

The above undertaking would no longer be valid in the event that the direct or indirect aggregate shareholdings of Tongrentang Holdings or Tongrentang Ltd. in the Company falls below 30%.

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## SUBSTANTIAL SHAREHOLDERS

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As far as the Directors are aware, upon the completion of the Placing, the only person who directly or indirectly owns 10% or more of the Shares in issue is:

<b>Name</b>	<b>Number of Shares</b>	<b>Shareholding percentage <i>(Note 1)</i></b>
Tongrentang Ltd. <i>(Note 2)</i>	100,000,000	54.705

*Notes:*

- (1) If the Over-allotment Option is exercised, the shareholding percentage will drop to 52.6%.
- (2) As Tongrentang Ltd. is 75% owned by Tongrentang Holdings, according to the SDI Ordinance, Tongrentang Holdings is deemed to own the 100,000,000 Shares held by Tongrentang Ltd..

Except as disclosed in this prospectus but not including the Shares which may be taken up under the Placing, to the knowledge of the Directors, no person will directly or indirectly own 10% of or above the issued shares or equities in the Company immediately after the completion of the Placing.

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## STRATEGIC INVESTORS

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The Company has entered into the Subscription Agreements with the Strategic Investors pursuant to which the Strategic Investors have agreed to subscribe an aggregate of 14,000,000 H Shares, representing a total of 7.66% interest in the enlarged issued share capital of the Company (assuming no exercise of the Over-allotment Option). The total number of H Shares to be subscribed by the Strategic Investors under the Placing will not be affected by any exercise of the Over-allotment Option.

### **HUTCHISON WHAMPOA LIMITED**

Hutchison Whampoa Limited (“Hutchison”) is the holding company of a group of companies which carries out a diverse range of businesses including ports and related services, telecommunications and e-commerce, property development and holdings, retail, manufacturing and other services and energy, infrastructure, finance and investments. It is also actively pursuing opportunities involving the development and modernization of Chinese medicine. The geographical scope of its global business includes Hong Kong, mainland China, Asia, Europe and North America. An indirect wholly-owned subsidiary of Hutchison has formed a joint venture, Tong Ren Tang Hutchison Pharmaceutical Development, with the Company. Pursuant to a subscription agreement dated 19 October 2000, North Cerney Limited, an indirect wholly-owned subsidiary of Hutchison, agreed to subscribe for 6,000,000 H Shares, which represents 3.28% of the enlarged issued share capital of the Company immediately after listing but before the exercise of the Over-allotment Option, or 8.24% of the total number of H Shares under the Placing. It is expected that investment of Hutchison in the Company and in the joint venture will enhance the Company’s international recognition, and improve the Company’s overseas distribution and marketing abilities so as to modernize and internationalize its products.

Save as disclosed above, Hutchison is an independent third party of the Company. Hutchison will not be an Initial Management Shareholder or a substantial shareholder of the Company and will not have any representation on the board of Directors upon listing of H Shares on GEM.

### **PEKING UNIVERSITY FOUNDER GROUP CORPORATION**

Peking University Founder Group Corporation (“Founder”) is a hi-tech enterprise founded by Peking University. It is mainly engaged in manufacturing hardware products (including Founder-brand computers), internet-based software development and system integration. It not only has information integration systems widely applied in newspapers, publishing and printing, broadcasting and television, internet industries in both China and other countries, but also possesses large information systems catering to the needs of banking, insurance, taxation and securities industries. Pursuant to a subscription agreement dated 19 October 2000, Super Highway Limited, a company in which Founder has beneficial interest, agreed to subscribe for 5,000,000 H Shares, which equals to 2.74% of the enlarged issued share capital of the Company after listing but before the exercise of the Over-allotment Option, or 6.87% of the

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## STRATEGIC INVESTORS

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total number of H Shares under the Placing. It is expected that the expertise of Founder in information technology may assist the Company in its efforts to enter into e-commerce business in the future.

Founder is an independent third party of the Company. Founder will not be an Initial Management Shareholder or a substantial shareholder of the Company and will not have any representation on the board of Directors of the Company upon listing of the Company on GEM.

### **CHUAN CHIONG COMPANY LIMITED**

Chuan Chiong Company Limited (“Chuan Chiong”) was founded in 1931. Its primary business is import, export and distribution of Chinese medicine, food products and tea. Pursuant to a subscription agreement dated 19 October 2000, Chuan Chiong agreed to subscribe for 3,000,000 H Shares, which equals to 1.64% of the enlarged issued share capital of the Company after listing but before the exercise of the Over-allotment Option, or 4.12% of the total number of H Shares under the Placing. It is expected that the investment would further strengthen the Company’s relationship with Chuan Chiong which may help the Company to achieve better result in the future.

Chuan Chiong is an independent third party of the Company. Chuan Chiong will not be an Initial Management Shareholder or a substantial shareholder of the Company and will not have any representation on the board of Directors upon listing of the Company on GEM.

Pursuant to the Subscription Agreements, the Strategic Investors will subscribe for the H Shares under the Placing at the Issue Price. Further information in relation to the conditions of the Placing is set out in the section headed “Structure and conditions of the Placing” in this prospectus.

Each of the Strategic Investors has undertaken to the Company, and the Sponsor that it will not at any time during the three-month period from the date of listing of H Shares on GEM, except with prior written consent of the Company and the Sponsor, directly or indirectly offer, sell, transfer, create any mortgage, charge, pledge or otherwise dispose of (including, without limitation, by the creation of any option) any interest (whether legal or beneficial) in any of the H Shares that it acquires pursuant to the Subscription Agreements. Such restriction will not apply to the transfer or disposal of any of such interests to a company of which the Strategic Investors or any of its ultimate shareholders is a controlling shareholder (“Exempted Transferee”), provided that, inter alia, each of the Strategic Investors shall procure that (i) all reasonable steps have been taken to ensure that such disposal to the Exempted Transferee will not create a disorderly or false market; (ii) such disposal shall involve all (but not some) of the Placing Shares then held by the relevant Strategic Investors and can only be made once and be made to one Exempted Transferee only; (iii) the Exempted Transferee undertakes to be bound by the same transfer restrictions during such three-month period; and (iv) such interests in the H Shares shall be transferred back to the relevant Strategic Investors from the Exempted Transferee upon the latter ceasing to be an Exempted Transferee during such three-month period.

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## UNDERTAKINGS BY INITIAL MANAGEMENT SHAREHOLDERS

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Tongrentang Ltd. is a 75% owned subsidiary of Tongrentang Holdings. Tongrentang Ltd. is the controlling shareholder of the Company after listing and thus deemed as a management shareholder of the Company as defined under the GEM Listing Rules. Immediately after the listing date, Tongrentang Ltd. will be interested in 100,000,000 Shares (“Relevant Securities”) and will be entitled to exercise or control the exercise of 54.705% of the voting power at general meetings of the Company (assuming that the Over-allotment Option will not be exercised) and will also be deemed to be a management shareholder of the Company as defined under the GEM Listing Rules. The six individual promoters, together with Tongrentang Ltd. and Tongrentang Holdings are regarded as Initial Management Shareholders of the Company.

Each of the Initial Management Shareholders has undertaken with the Stock Exchange that, save as provided in rule 13.17 of the GEM Listing Rules, (i) for a period of two years from the date on which dealings in the Shares first commence on the GEM, he/it will neither dispose of (or enter into any agreement to dispose of) nor permit the registered holder to dispose of (or enter into any agreement to dispose of) any of his/its direct or indirect interests in his/its Relevant Securities; and (ii) he/it will comply with the requirements under rule 13.20 of the GEM Listing Rules. Such undertaking has been made according to the requirements of the GEM Listing Rules, in the event that the relevant requirements of the GEM Listing Rules are altered in future, such undertaking may be revised accordingly.

Each of the Initial Management Shareholders has further undertaken with the Stock Exchange that, save with the prior consent of the Stock Exchange, he/it will not dispose any of his/its interests in the Company during the period in which disposal of his/its Relevant Securities is not permitted under the GEM Listing Rules.

Each of the Initial Management Shareholders has undertaken with the Company, the Sponsor and the Placing Underwriters, inter alia, that neither he/it nor any of his/its associates nor any company controlled by him/it nor any nominee or trustee holding in trust for him/it will, for a period of two years from the date on which dealings in the H Shares first commence on the GEM, (save as provided in the GEM Listing Rules) sell, transfer or otherwise dispose of (including without limitation the creation of any option over) any Shares in issue and to be issued as mentioned herein (“Issued Capital”) or any interest therein which are owned by him/it or their associates or the relevant company, nominee or trustee after completion of the Placing or sell, transfer or otherwise dispose of any interest in any shares in any company controlled by him/it which is directly, or indirectly, the beneficial owner of any of the Issued Capital. Such restriction, however, shall not apply to any Shares which the Initial Management Shareholders or any of his/its associates which may acquire or become interested in following the date on which dealings in the H Shares first commence on the GEM.

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## UNDERTAKINGS BY INITIAL MANAGEMENT SHAREHOLDERS

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Each of the Initial Management Shareholders has further undertaken to the Company and the Placing Underwriters that he/it shall, within the period of 2 years from the date on which dealings in the Shares commence on the GEM (i) if and when he/it pledges or charges any direct or indirect interest in securities in the Company beneficially owned by him/it, to immediately inform the Company in writing of such pledge or charge together with the number of such securities so pledged or charged and other details set out in rules 17.43(1) to (4) of the GEM Listing Rules; and (ii) if and when he/it receives indications, either verbal or written, from any pledgee or chargee that any securities in the Company pledged or charged by him/it will be disposed of, immediately inform the Company in writing of such indications.

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## SHARE CAPITAL

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The share capital of the Company, issued and to be issued, fully paid or credited as fully paid, immediately after the completion of the Placing and assuming the Over-allotment Option is not exercised, will be as follows:

	<b>Number of Shares</b>	<i>RMB</i>	<b>Percentage of total share capital</b>
Domestic Shares, nominal value of RMB1.00 each in issue	110,000,000	110,000,000	60.18%
H Shares, nominal value of RMB1.00 each, to be issued under the Placing	72,800,000	72,800,000	39.82%
	182,800,000	182,800,000	100.00%

In the event that the Over-allotment Option is exercised in full, the share capital of the Company will be increased up to RMB190,000,000, and the H Shares will then represent approximately 42.11% of the Company's enlarged issued share capital immediately following the Placing.

Domestic Shares and H Shares are both ordinary shares in the share capital of the Company. Domestic Shares are subscribed for in Renminbi. Pursuant to the special regulations, H Shares, in contrast, may only be subscribed for by, and traded between, legal or natural persons of Taiwan, Hong Kong, Macau, and countries other than the PRC and must be subscribed for, and trade in, Hong Kong dollars. Additional differences are stipulated in the Company Law and special regulations promulgated by the State Council. Further details are set out in Appendix IV – Summary of relevant PRC and Hong Kong laws and regulations.

All of the existing Domestic Shares are held by Tongrentang Ltd. and 7 other promoters. Their respective shareholdings are 100,000,000 Shares (54.705%), 5,000,000 Shares (2.735%), 2,900,000 Shares (1.586%), 500,000 Shares (0.274%), 500,000 Shares (0.274%), 500,000 Shares (0.274%), 500,000 Shares (0.274%) and 100,000 Shares (0.055%). Pursuant to the Company Law, all the existing Shares prior to the Placing are promoter shares (as defined in the Company Law), which may not be sold within a period of three years from the date of incorporation of the Company. The Articles of Association further provide that all dividends in respect of H Shares are to be paid by the Company in Hong Kong dollars in accordance with the relevant provisions of the State foreign exchange rules. All dividends in respect of Domestic Shares are to be paid by the Company in Renminbi.

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## SHARE CAPITAL

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Except in relation to notices and financial reports to be sent to shareholders, the method of share transfer, the appointment of dividend receiving agents, the registration of shares on different parts of the register of shareholders and the dispute resolution provisions are all provided for in the Articles of Association. Domestic Shares and H Shares will rank pari passu with each other and, in particular, will rank in full for all dividends or distributions declared, paid or made after the date of this prospectus. However, the transfer of Domestic Shares is subject to such restrictions as the PRC law may impose from time to time.

The Company has no present intention to issue additional Domestic Shares. No part of the share capital is, or is proposed to be, listed on or dealt in on any stock exchange other than the Stock Exchange.

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## FINANCIAL INFORMATION

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### TRADING RECORD

#### Summary of results of the Company

The results of the Company for each of the two years ended 31 December 1999 and the four months ended 30 April 2000 (the “Relevant Period”), which have been prepared on the basis that the existing Company structure had been in place throughout the Relevant Period, and based on the accountants’ report, the text of which is set out in Appendix I to this prospectus, are summarized below:

	<b>Year ended 31 December</b>		<b>Four months ended</b>
	<b>1998</b>	<b>1999</b>	<b>30 April 2000</b>
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Revenue	248,672	308,068	126,580
Cost of sales	(139,174)	(167,507)	(65,542)
Gross profit	109,498	140,561	61,038
Selling and distribution expenses	(21,766)	(26,343)	(9,102)
Administrative expenses	(47,100)	(54,082)	(15,416)
Operating profit from operations	40,632	60,136	36,520
Finance cost	(4,368)	(3,034)	(1,045)
Profit before tax	36,264	57,102	35,475
Income tax expense	(11,967)	(18,844)	(11,707)
Net profit	<u>24,297</u>	<u>38,258</u>	<u>23,768</u>
Dividends	<u>(24,297)</u>	<u>(38,258)</u>	<u>–</u>
Earnings per share – Basic	<u>RMB0.22</u>	<u>RMB0.35</u>	<u>RMB0.22</u>

## FINANCIAL INFORMATION

*Note:* Prior to the establishment of the Company, Tongrentang Ltd. had all along been solely responsible for the distribution of most of the Company's products (the "Relevant Products") to ultimate customers. Customers generally did not, when making payment, specifically indicate the invoice to which a certain payment should apply. Although the Company's revenue can be specifically identified based on product lines restructured to the Company (see the section headed "Business"), it is not possible for Tongrentang Ltd. to know with certainty whether any part of the remaining balance of accounts receivable from an individual customer should be attributed to the sale of the relevant products. For this reason, Tongrentang Ltd. took up the credit risk of such receivables by not injecting any balance of such accounts receivable to the Company upon restructuring.

For the two years ended 31 December 1999 and the four months ended 30 April 2000, the estimated provision for doubtful debts in relation to the sales of products of Tongrentang Ltd. and the relevant products of the Company amounted to approximately RMB9,376,000, RMB4,378,000 and RMB75,000 respectively.

Assuming that during the two years ended 31 December 1999 and the four months ended 30 April 2000, the Relevant Products were sold directly by the Company to the ultimate customers and that the Company bore the related credit risk, the provision for doubtful debt of the Company for the two years ended 31 December 1999 would have been approximately RMB4,000,000 and RMB2,000,000 respectively, and no provision for doubtful debt of the Company for the four months ended 30 April 2000. These amounts were estimated by applying the proportion of annual sales of the Company over that of Tongrentang Ltd. to the total provision for doubtful debt resulting from the sales of products of Tongrentang Ltd. and the Relevant Products of the Company.

After pro forma adjustments made for provision of doubtful debts, the results of operations for each of the two years ended 31 December 1999 and the four months ended 30 April 2000 were as follows:

	<b>Four months ended</b>		
	<b>Year ended 31 December</b>	<b>1999</b>	<b>30 April</b>
	<b>1998</b>	<b>1999</b>	<b>2000</b>
	<i>RMB '000</i>	<i>RMB '000</i>	<i>RMB '000</i>
Profit before taxation (profit before pro forma adjustment)	36,264	57,102	35,475
Pro forma provision for doubtful debts	<u>(4,000)</u>	<u>(2,000)</u>	<u>–</u>
Adjusted profit before taxation	32,264	55,102	35,475
Adjusted taxation	<u>(10,647)</u>	<u>(18,184)</u>	<u>(11,707)</u>
Adjusted profit attributable to shareholders	<u>21,617</u>	<u>36,918</u>	<u>23,768</u>

The following table is an analysis of the turnover of the Company attributable breakdown by type of products of the Company for each of the two years ended 31 December 1999 and for the four months ended 30 April 2000 and is prepared on the same basis on which the above summary is prepared:

	<b>Year ended 31 December</b>		<b>Four months ended</b>
	<b>1998</b>	<b>1999</b>	<b>30 April</b>
	<i>RMB '000</i>	<i>RMB '000</i>	<b>2000</b>
	<i>RMB '000</i>	<i>RMB '000</i>	<i>RMB '000</i>
Pills	42,894	68,307	37,867
Granule	65,070	83,582	32,539
Tablets	25,613	38,612	17,781
Soft capsule	12,315	10,641	3,782
Other	<u>102,780</u>	<u>106,926</u>	<u>34,611</u>
Total	<u>248,672</u>	<u>308,068</u>	<u>126,580</u>

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## FINANCIAL INFORMATION

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### Other Information

Pursuant to paragraphs 27 and 31, Third Schedule to the Companies Ordinance, the Company is required to include in this prospectus an accountants' report covering at least three financial years immediately preceding the issue of this prospectus.

As a result of an application made by the Company, the SFC has granted a waiver in relation to strict compliance with paragraphs 27 and 31, Third Schedule to the Companies Ordinance such that the accountants' report covers only the period from 1 January 1998 to 30 April 2000.

### ANALYSIS OF BREAKDOWN OF TURNOVER, MAJOR EXPENSES AND PROFITS

#### General

- *Turnover*

The Company's turnover is derived principally from the manufacture and sale of Chinese traditional medicine. Sales represent the net amount received and receivable from third parties for goods sold during the period. During the year ended 31 December 1998 and 1999 and the four months ended 30 April 2000, all development costs were expenses.

- *Net profit*

The Company's net profit margin has been increasing for the two years ended 31 December and the four months ended 30 April 2000 as a percentage of turnover, which amounted to about 9.8%, 12.4% and 18.8% respectively. The stable increase in net profit margin was due to the fact that the Company increased the product quantity and improved the scale of sales by prompting the selling employees, and the management made overall efforts to reduce the production costs and expenses.

- *Gross profit*

The increase by 29% of gross profit from RMB109 million for the year ended 31 December 1998 to RMB141 million for the year ended 31 December 1999 was due to the Company's efforts on marketing by increasing the advertisement expenses. The gross profit margin for the four months ended 30 April 2000 was 48%, which was increased by 2% compared with 46% of 1999. The increase was resulted from the increase in sales price of the Company's major products such as Niu Huang Jiedu Tablet and Liuwei Dihuang Pill.

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## FINANCIAL INFORMATION

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- *1999 compared with 1998*

Turnover for the year ended 31 December 1998 amounted to about RMB249 million. Sales of main products such as Liuwei Dihuang Pill, Ganmao Qingre Granule, Banlangen Granule and Niuhuang Jiedu Tablet amounted to RMB34.7 million, RMB43.7 million, RMB18.3 million and RMB15.5 million respectively, which together represented 45% of the turnover.

Turnover for the year ended 31 December 1999 amounted to about RMB308 million. Sales of main products such as Liuwei Dihuang Pill, Ganmao Qingre Granule, Banlangen Granule and Niuhuang Jiedu Tablet amounted to RMB51.5 million, RMB57 million, RMB24 million and RMB23.8 million respectively, each with an increase of more than 30% from the previous year. Total turnover of 1999 increased by 24% from the previous year, which was due principally to the Company's efforts on marketing (especially in southern area of the PRC), which is proved by the increase of selling expenses in 1999.

Cost of sales as a percentage of turnover amounted to about 54% for the year ended 31 December 1999 compared with 56% for the previous year. The reduction in cost of sales as a percentage of turnover was due to increase in turnover and the management's overall efforts in reducing the production costs.

Sales and distribution expenses for the year ended 31 December 1999 amounted to RMB26.3 million, representing an increase of 21% from the previous year. In 1999, sales and distribution expenses accounted for 9% of turnover. The increase in sales expenses was principally due to the increase of advertisement expenses.

Financial expenses represented a decrease of 30% from the previous year. The decrease was mainly due to the settlement of long-term bank loan of RMB8.3 million in 1999 and the corresponding decline of the interest rate.

In 1999, administrative expenses accounted for 17.6% of the turnover. The administrative expenses mainly comprised salary and bonus for employees, research and development expenses, insurance, rental and trade mark use fees. The increase in administrative expenses in 1999 was due principally to the increase in research and development expenses and write-off of about RMB4 million for obsolete inventory.

- *Four months ended 30 April 2000*

Turnover for the four months ended 30 April 2000 amounted to about RMB127 million. Sales of main products such as Liuwei Dihuang Pill, Ganmao Qingre Granule, Banlangen Granule and Niuhuang Jiedu Tablet amounted to RMB34.7 million, RMB21.6 million, RMB10.3 million and RMB11.7 million respectively,

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## FINANCIAL INFORMATION

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which together represented 57% of the turnover, representing an increase of 6% compared to 51% in 1999. The increase was due principally to the price increase of Liuwei Dihuang Pill and increase of sales of Banlangen Granule and Niu Huang Jiedu Tablet due to seasonal influence. Historical experience suggests that first half year's performance is generally better than second half year's. Most of the sales promotion fairs are held in the first half of the year.

Cost of sales as a percentage of turnover amounted to about 52% for the four months ended 30 April 2000 compared with 54% for the previous year. The reduction in cost of sales as a percentage of turnover was due to the price increase as mentioned in the paragraph above. As the Tongrentang Ltd. and Tongrentang Holdings have been the Company's main source of supply of raw material during the Relevant Period, the supply of raw material was rather stable compare to sales.

Sales and distribution expenses for the four months ended 30 April 2000 amounted to RMB9.1 million, which accounted for 7% of turnover. The sales and distribution expenses mainly comprised of advertisement expenses, transportation expenses and travelling expenses, which amounted to RMB4.5 million, RMB1.4 million and RMB1.7 million respectively. The decrease of selling expenses as a percentage of turnover was due to the increase of sales without a corresponding increase on selling expense.

Financial charges for the four months ended 30 April 2000 amounted to HK\$1 million, which comprised mainly the loan interest expenses and the interest income from the cash deposit in bank.

Administrative expenses for the four months ended 30 April 2000 amounted to RMB15.4 million, which accounted for 12% of turnover. The administrative expenses mainly comprised salary and pension fund for employees. For the two years ended 31 December 1999 and the four months ended 30 April 2000, the amount of researching and development expenses amounted to RMB2.64 million, RMB4.62 million and RMB1.06 million respectively. The decrease of administrative expenses as a percentage of turnover was due to the increase of sales with the stable administrative expenses in the previous years as mentioned above.

- *Taxation*

The Company's income is subject to enterprise income tax at the statutory rate of 33% throughout the Relevant Period.

The Company incurred enterprise income tax of RMB12 million in 1998, RMB19 million in 1999 and RMB12 million in the four months ended 30 April 2000, reflecting a constant effective tax rate of 33%. Please see Note 4(c) to the accountants' report as set out in Appendix I to this prospectus for details.

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## FINANCIAL INFORMATION

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### Adjusted net tangible asset

The following statement of adjusted net tangible assets is based on the audited summary of net assets as of 30 April 2000 included in Appendix I to this prospectus, adjusted as described below:

	<i>RMB'000</i>
Net tangible assets as of 30 April 2000	115,528
Unaudited net profit for the period from 1 May 2000 to 31 August, 2000	11,388
Estimated net proceeds from the Placing	230,011
Revaluation surplus of fixed assets as of 31 July 2000	11,619
	<hr/>
Adjusted net tangible assets	<u>368,546</u>

*Note:* The text of the letter, summary of valuation and valuation certificates issued by LCH (Asia-Pacific) Surveyors Limited in respect of such valuation is set out in Appendix II and III respectively to this prospectus. The revaluation surplus of fixed assets amounted for approximately 3.2% of the adjusted net tangible assets of the Company and will be incorporated in the Company's financial statements for the year ending 31 December 2000.

### PROFIT FORECAST

The Directors forecast that, in the absence of unforeseen circumstances, and based on the assumptions set out in Appendix II to this prospectus, the profit after taxation but before extraordinary items of the Company for the year ending 31 December 2000 will amount to not less than RMB43.7 million. The Directors are not aware of any extraordinary items which have arisen, or are likely to arise, during the financial year ending 31 December 2000. The texts of letters from Arthur Andersen & Co, the reporting accountants of the Company, and from the Joint Sponsors in respect of the profit forecast are set out in Appendix II to this prospectus.

On the basis of the above forecast profit after taxation but before extraordinary items and taking into account the 72,800,000 new H Shares expected to be in issue following the Placing (taking no account, however, of any H Shares which may be issued upon exercise of the Over-allotment Option), the forecast net profit per H Share for the financial year ending 31 December 2000 will be approximately 0.36 cents. No account has been taken in the calculation of any interest which may have been earned if the estimated net proceeds of the Placing had been received on 1 January 2000.

### INDEBTEDNESS

At the close of business on 31 August 2000, being the latest practicable date in relation to this indebtedness statement, the Company had outstanding borrowings of approximately RMB45 million, all of which will be due within one year, amounts due to related companies of approximately RMB32 million.

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## **FINANCIAL INFORMATION**

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All of the borrowings of amount RMB45,400,000 (HK\$42,773,695) were guaranteed by China Beijing Tong Ren Tang Corp.. The Company is in the process of releasing a guarantee and it is expected the process will be completed three months after the listing of the Company.

Save as aforesaid and apart from intra-company liabilities, the Company did not have outstanding, at the close of business on 31 August 2000, any loan capital, bank overdrafts and liabilities under acceptances or other similar indebtedness, debentures, mortgages, charges or loans or acceptance credits or hire purchase commitments, guarantees or other material contingent liabilities.

### **NO MATERIAL CHANGE**

The Directors have confirmed that there has not been any material change in the indebtedness and contingent liabilities of the Company since 31 August 2000.

All amounts referred to in this indebtedness statement which are denominated in foreign currencies have been translated into RMB at the applicable exchange rate quoted by the People's Bank of China at the close of business on 31 August 2000.

The Company has not advanced any money to any entity which exceeds 25% of the Company's net tangible assets as at 31 August 2000, being the latest practicable date for the Company's indebtedness. The Company did not have any pledge over the Shares held by the controlling shareholder to secure debts, guarantees or support of other obligations of the Company, and has not entered into any loan agreements importing specific performance obligations on the controlling shareholder. The Directors have confirmed that as at 31 August 2000, they were not aware of any circumstances that would give rise to a disclosure requirement under rules 17.5 to 17.21 of the GEM Listing Rules.

### **LIQUIDITY AND CAPITAL RESOURCES**

Since inception, the Company has founded its operation through cash from operation. Apart from intra-company liabilities and normal trade payable, the Company had no other outstanding amount due to related company as at 31 August 2000. The Directors believe that the Company will fund its working capital and capital expenditures through cash flow from operations, the net proceeds of the Placing and its cash in bank or on hand. The Directors believe that on a long-term basis the Company's liquidity will be funded from operations and, if necessary, additional equity financing or bank lending.

As of 31 August 2000, the Company had current assets of RMB226.6 million, which principally comprised cash and bank balances of RMB85.2 million, accounts receivable of RMB50.5 million, inventories of RMB88.9 million, and prepayments of RMB2.0 million.

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## FINANCIAL INFORMATION

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As of 31 August 2000, the Company's current liabilities comprised amounts due to short-term bank loans of RMB45.4 million, accounts payable of RMB38 million, accruals and other current liabilities of RMB50.3 million, amounts due to related parties of RMB32.1 million, and overpaid tax of 3.2 million.

### **PROFIT**

Profit appropriation is subject to approval of Board resolution and shareholders of annual general meeting. In accordance with the Articles of Association of the Company, the reserve available for distribution is the lower of the amount determined under the PRC accounting standards and the amount determined under IAS.

As of 30 April 2000, the distributable reserve of the Company amounted to approximately RMB23,768,000. The Company has neither declared nor paid dividends subsequent to 30 April 2000.

### **DIVIDENDS AND WORKING CAPITAL**

#### **(a) Dividend**

The Company declared and paid dividends of 24,297,104 and 38,258,546 for the two years ended 31 December 1999 as dividends to its then shareholder, Tongrentang Ltd., out of its retained profits. Payment of the dividends was financed by the internal resources of the Company.

There is no assurance that dividends of similar amount or at similar rate will be made in the future and the past dividend payments referred to above should not be used as a reference or basis to determine the amount of dividend payable in the future.

The holders of H Shares will share proportionately, on a per Share basis, all dividends and other distributions declared by the Board. The Board will declare dividends every year, if any, in Renminbi, with respect to H Shares on a per Share basis and will pay dividends in Hong Kong dollars.

The Board at present do not intend to recommend any dividend in respect of the year ending 31 December 2000. The declaration of dividends is subject to the discretion of the Board. The amount of dividends actually distributed to H Share holders will depend upon the following factors:

- general business conditions;
- financial results of the Company;
- capital requirements;

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## FINANCIAL INFORMATION

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- contractual restrictions on the payment of dividends by the Company to its shareholders or by the Company's subsidiaries to the Company;
- interests of the Company's shareholders;
- the effect on the Company's debt ratings; and
- other factors the Board may deem relevant.

The Company may only distribute dividends after it has made allowance for:

- recovery of losses, if any;
- allocations to the statutory common reserve fund;
- allocations to the statutory common welfare fund; and
- allocations to a discretionary common reserve fund if approved by its shareholders.

The minimum and maximum aggregate allocations to the statutory funds are both at 10 per cent. of the Company's net profit determined in accordance with the PRC accounting rules. Under the PRC law, the Company's distributable earnings will be equal to its net profit determined in accordance with PRC accounting rules or IAS, whichever is lower, less allocations to the statutory and discretionary funds.

The Articles of Association require that cash dividends of H Shares will be declared in Renminbi and paid in Hong Kong dollars to H Share holders. Conversion of Renminbi into Hong Kong dollars will be subject to the relevant PRC foreign exchange regulations and will be calculated at an exchange rate which will be the average of the PBOC Exchange Rate one calendar week preceding the date of declaration of dividends. If the Company does not have sufficient foreign exchange reserves to pay its Hong Kong dollar dividends, it intends to exchange the required Hong Kong dollars from authorized banks or through other approved means.

### **(b) Working capital**

The Directors are of the opinion that taking into account in internally generated cash flow, the estimated net proceeds of the Placing and the available banking facilities, the Company has sufficient working capital for its present requirements.

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## **SPONSOR'S INTERESTS**

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Neither BOCI Asia nor its associates expect to have accrued any material benefit as a result of the successful outcome of the Placing, other than the following: (i) by way of underwriting commission by its fellow subsidiary and by acting as one of the Placing Underwriters to the Placing; (ii) the respective normal advisory and documentation fees to be paid to BOCI Asia as Sponsor of the Placing; (iii) by a sponsorship agreement entered into between BOCI Asia and the Company pursuant to which BOCI Asia has been appointed as Sponsor of the Company for the remainder of the year ended 31 December 2000 and for the period of two years commencing from 1 January 2001 and the Company shall pay an agreed amount of fee to BOCI Asia for its provision of services; and (iv) certain fellow subsidiaries of BOCI Asia, whose ordinary businesses involve the trading of and dealing in securities, may involve in the trading of and dealing in the securities of the Company.

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## UNDERWRITING

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### PLACING UNDERWRITERS

**BOCI Asia Limited**

**BNP Paribas Peregrine Securities Limited**

**CEF Capital Limited**

**Core Pacific-Yamaichi International (H.K.) Limited**

**First Shanghai Capital Limited**

**Grand Cathay Securities (Hong Kong) Limited**

### UNDERWRITING ARRANGEMENTS AND EXPENSES

#### **Underwriting and Placing Agreement**

Pursuant to the Underwriting and Placing Agreement, the Company is offering the Placing Shares for subscription by way of Placing on and subject to the terms and conditions of this prospectus. In addition, the Company has granted the Over-allotment Option to BOCI Asia (on behalf of the Placing Underwriters) from time to time during the period of 30 days from the date of this prospectus to require the Company to issue up to an aggregate of 7,200,000 additional Shares, representing approximately 9.89% of the H Shares initially offered in the Placing, on the same terms as those applicable to the Placing.

Subject to the GEM Listing Committee of the Stock Exchange granting listing of and permission to deal in the Shares (subject only to allotment) not later than 23 November 2000 (or such later date as BOCI Asia (on behalf of the Placing Underwriters) may agree) and to certain other conditions set out in the Underwriting and Placing Agreement, the Placing Underwriters have agreed to apply and/or purchase or procure places to apply and/or purchase for the Placing Shares which have not been placed pursuant to the Placing.

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## UNDERWRITING

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### Grounds for termination

The obligations of the Placing Underwriters under the Underwriting and Placing Agreement will be subject to termination if, inter alia, any of the following events occur prior to 7:00 p.m. on the day immediately preceding the date on which dealings in the Shares first commence on the Stock Exchange (expected to be on 31 October 2000):

1. If there shall have developed, occurred, existed or come into effect any event or series of events, matters or circumstances concerning or relating to any of the following:
  - (A) any event, or series of events of force majeure including, without limitation, any act of government, strike, lock-out, fire, explosion, flooding, civil commotion, act of war, act of God, riot, public disorder, epidemic, terrorism or interruption or delay in transportation); or
  - (B) any change in or any event or series of events resulting in any change in local, national or international financial, economic, political, military, industrial, fiscal, regulatory, stock market, currency or market conditions (including without limitation the imposition of any moratorium, suspension or material restriction on trading in securities generally on the Stock Exchange or any stock exchange in the PRC); or
  - (C) any new law or regulation or change in existing laws or regulations or any change in the interpretation or application thereof by any court or other competent authority in the PRC or Hong Kong or any other jurisdiction relevant to the Company; or
  - (D) the imposition of economic sanctions or withdrawal of trading privileges, in whatever form, directly or indirectly, by the U.S. or by the European Union (or any member thereof) on Hong Kong or the PRC; or
  - (E) a change or development occurs involving a prospective change in taxation or exchange control (or the implementation of any exchange control) in the PRC, Hong Kong or any jurisdiction relevant to the Company; or
  - (F) any litigation or claim of material importance of any third party being threatened or instigated against the Company; or
  - (G) there occurs a general moratorium on commercial banking activities in New York, London, Hong Kong or the PRC declared by the relevant authorities; or

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## UNDERWRITING

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- (H) any material adverse change or prospective material adverse change in the business or in the financial or trading position of the Company; or
- (I) any other change whether or not ejusdem generis with any of the foregoing;

which, in the sole opinion of BOCI Asia:

- (a) is or will be, or is likely to be, adverse, in any material respect, to the business, financial or other condition or prospects of the Company and its operating divisions taken as a whole or (where relevant) on any present or prospective shareholder in his/its capacity as such shareholder of the Company; or
  - (b) has or will have or is likely to have a material adverse effect on the success of the Placing or the level of the Placing Shares being applied for or accepted or the distribution of Placing Shares; or
  - (c) for any other reason makes it impracticable, inadvisable or inexpedient to proceed with the Placing; or
2. If:
- (A) any statement contained in this prospectus was when this prospectus were issued, or has become, untrue, incorrect or misleading in any respect; or
  - (B) any event or series of events, matter or circumstances occurs or arises which would, had it occurred or been discovered before the date of the Underwriting and Placing Agreement would have rendered any of the warranties, representations or undertakings therein untrue or incorrect in any respect or, constitute an omission from this prospectus considered by BOCI Asia to be material; or
  - (C) any event, act or omission occurs and/or is discovered which gives or is likely to give rise to any material liability of the Company and/or Tongrentang Ltd. and/or the promoters of the Company and/or Tongrentang Holdings; or
  - (D) there comes to the notice of the Sponsor any breach of any of the obligations imposed upon any party to the Underwriting and Placing Agreement (other than on any of the Placing Underwriters or the Sponsor) which is in the sole opinion of the Sponsor material; or

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## UNDERWRITING

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- (E) there comes to the notice of BOCI Asia any matter or event showing any of the warranties, representations and undertakings contained in the Underwriting and Placing Agreement to be breached, untrue or misleading in any respect when given or repealed.

### **Commission and expenses**

The Placing Underwriters will receive a commission of 3.5% of the aggregate Issue Price of all the H Shares, out of which they will pay any sub-underwriting commission, and BOCI Asia will in addition receive a financial advisory fee and a documentation fee in relation to the Placing. Such fee and commission, together with the Stock Exchange listing fees, the Stock Exchange transaction levy, legal and other professional fees, printing and other expenses relating to the Placing which are currently estimated to be approximately HK\$22 million in aggregate.

### **Undertakings**

Each of the Initial Management Shareholders has undertaken with the Company, the Sponsor and the Placing Underwriters, inter alia, that neither he/it nor any of its associates nor any company controlled by it nor any nominee or trustee holding in trust for he/it will, for a period of two years from the date on which dealings in the H Shares first commences on the GEM (save as provided in the GEM Listing Rules) sell, transfer or otherwise dispose of (including without limitation the creation of any option over) any H Shares in issue and to be issued as mentioned herein (“Issued Capital”) (or any interest therein) which are owned by him/it or his/its associates or the relevant company, nominee or trustee after completion of the Placing or sell, transfer or otherwise dispose of any interest in any shares in any company controlled by him/it which is directly, or indirectly, the beneficial owner of any of the Issued Capital. Such restriction, however, shall not apply to any Shares which the Initial Management Shareholders or any of their associates may acquire or become interested in following the date on which dealings in the H Shares first commence on the Stock Exchange.

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## UNDERWRITING

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Each of the Initial Management Shareholders has further undertaken to the Company and the Placing Underwriters that he/it shall, within the period of 2 years from the date on which dealings in the Shares commence on the GEM (i) if and when he/it pledges or charges any direct or indirect interest in securities in the Company beneficially owned by it, immediately inform the Company in writing of such pledge or charge together with the number of such securities so pledged or charged and other details set out in Rules 17.43(1) to (4) of the GEM Listing Rules; and (ii) if and when he/it receives indications, either verbal or written, from any pledgee or chargee that any securities in the Company pledged or charged by him/it will be disposed of, immediately inform the Company in writing of such indications.

### **Underwriters' interests in the Company**

Save as pursuant to the Underwriting and Placing Agreement, none of the Placing Underwriters has any shareholding in any member of the Company or any right (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for securities in any member of the Company.

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## STRUCTURE AND CONDITIONS OF THE PLACING

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Pricing of the H Shares for the purposes of the Placing will be fixed by agreement between the Company and BOCI Asia before the Price Determination Time, which is before 12:00 noon on 24 October, 2000. If BOCI Asia, on behalf of the Underwriters, and the Company are unable to reach an agreement on the Issue Price or a postponement of the Price Determination Time by the Price Determination Time, the Placing will not proceed.

The Issue Price will not be more than HK\$3.62 per H Share.

### PRICE PAYABLE ON SUBSCRIPTION

The Issue Price will be between HK\$2.89 and HK\$3.62 per H Share. Based on the maximum Issue Price of HK\$3.62 per H Share, plus one per cent. brokerage and 0.01 per cent. Stock Exchange transaction levy, on board lot of 2,000 H Shares will amount to a total of HK\$7,313.13.

### CONDITIONS OF THE PLACING

Acceptance of applications for the Placing Shares is conditional upon:

**(a) Listing**

The GEM Listing Committee of the Stock Exchange granting listing of and permission to deal in all the H Shares to be issued as mentioned herein.

**(b) Underwriting and Placing Agreement**

The obligations of the Placing Underwriters under the Underwriting and Placing Agreement becoming unconditional which requires, amongst other things, the Underwriting and Placing Agreement not being terminated in accordance with its terms or otherwise prior to 7:00 p.m. on the day immediately preceding the date on which trading of the Shares commences on the Stock Exchange or such later date as BOCI Asia (on behalf of the Placing Underwriters) may agree with the Company from time to time.

If these conditions are not fulfilled (or, where applicable, waived by BOCI Asia (on behalf of the Placing Underwriters)) on or before 23 November 2000, any allotment made pursuant to the Placing will be void.

### The Placing

72,800,000 H Shares are being offered for subscription under the Placing. Pursuant to the Placing, 72,800,000 Placing Shares will be conditionally placed to professional, institutional and other investors by the Placing Underwriters or through selling agents appointed by them at the Issue Price.

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## **STRUCTURE AND CONDITIONS OF THE PLACING**

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It is expected that the Placing Shares will be placed to professional, institutional and other investors in Hong Kong, Europe and Singapore. Professional investors generally include brokers, dealers, companies (including fund managers) whose ordinary business involves dealing in shares and other securities and corporate entities which regularly invest in shares and other securities.

Allocation of Placing Shares to professional, institutional and other investors pursuant to the Placing is based on a number of factors including the level and timing of demand, and whether or not it is expected that the relevant investor is likely to buy further H Shares, or hold or to sell its H Shares, after the listing of the H Shares on the GEM. Such allocation is generally intended to result in a distribution of the Placing Shares on a basis which would lead to the establishment of a broad shareholder base to the benefit of the Company and its shareholders as a whole.

### **OVER-ALLOTMENT OPTION**

Pursuant to the Underwriting and Placing Agreement, the Company has granted to BOCI Asia (on behalf of the Placing Underwriters) the right but not the obligation of the Over-allotment Option, exercisable for 30 days from the date of this prospectus, to require the Company to issue up to an aggregate of 7,200,000 additional H Shares, representing approximately 9.89% of the number of H Shares initially available under the Placing. These Shares will be issued at the Issue Price for the purpose of covering over-allocations in the Placing. In the event that the Over-allotment Option is exercised, the additional Shares issued will be allotted to the Placing at the discretion of BOCI Asia who may, at their option, also cover any over-allocations through stock borrowing arrangements and the purchase of Shares in the secondary market or otherwise as may be permitted under applicable laws.

### **H SHARES WILL BE ELIGIBLE FOR CCASS**

If the Stock Exchange grants the listing of and permission to deal in the H Shares on the GEM and the Company complies with the stock admission requirements of Hongkong Clearing, the H Shares will be accepted as eligible securities by Hongkong Clearing for deposit, clearance and settlement in CCASS with effect from the commencement date of dealings in the H Shares on the GEM or on any other date as determined by Hongkong Clearing. Investors should seek advice from their stockbroker or other professional adviser for details of those settlement arrangements, as such arrangements will affect their rights and interests.

Settlement of transactions between participants of the Stock Exchange is required to take place in CCASS on the second business day after any trading day.

All necessary arrangements have been made for the H Shares to be admitted into CCASS.

All activities under CCASS are subject to the General Rules of CCASS and CCASS Operational Procedures in effect from time to time.

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



**Arthur Andersen & Co**

21st Floor, Edinburgh Tower  
The Landmark  
15 Queen's Road Central  
Hong Kong

Tel 852 2852 0222  
Fax 852 2815 0548

24th October 2000

The Directors  
Tong Ren Tang Technologies Co. Ltd.  
BOCI Asia Limited

Dear Sirs,

We set out below our report on the financial information relating to Tong Ren Tang Technologies Co. Ltd. (the “Company”) for the two years ended 31st December 1999 and the four months ended 30th April 2000 (the “Relevant Periods”) prepared on the basis set out in Section 2 below for inclusion in the prospectus of the Company dated 24th October 2000 (the “Prospectus”).

The Company was incorporated as a joint stock company with limited liability in the People’s Republic of China (the “PRC”) on 22nd March 2000. Pursuant to a board resolution dated 13th January 2000 of Beijing Tongrentang Company Limited (the “Parent Company”), the Parent Company agreed to transfer part of its Chinese medicine production and sales businesses together with the related assets and liabilities (the “Relevant Businesses”) to the Company at revalued amount in exchange for 90.91% equity interest of the Company (the “Restructuring”). The remaining 2.64% and 6.45% equity interest of the Company were respectively allotted to China Beijing Tong Ren Tang Holdings Corp. (the “Ultimate Holding Company”), a State-owned enterprise established in the PRC, and six natural persons (“Other Promoters”) for cash at par value. After the Restructuring, the Parent Company continues to produce and sell Chinese medicine substantially other than those produced from the Relevant Businesses.

After the Restructuring, the Company is principally engaged in production and sales of Chinese medicine.

The financial statements of the Company for the Relevant Periods were prepared in accordance with the accounting principles and financial regulations applicable to the PRC entities and based on the assumption that the current structure of the Company had been in existence throughout the Relevant Periods. For the purpose of this report, we have undertaken our own independent audit of the financial statements of the Company for the Relevant Periods in accordance with Auditing Standards and Guidelines issued by the Hong Kong Society of Accountants (“HKSA”), and have carried out such additional procedures as we considered necessary in accordance with the Auditing Guideline “Prospectuses and the Reporting Accountant” issued by the HKSA.

The summaries of the results of operations of the Company for the Relevant Periods and the net assets of the Company as of 30th April 2000 (the “Summaries”), as set out in Sections 4 and 5 below, have been prepared by management based on the financial statements of the Parent Company, and on the basis set out in Sections 1 and 2 below as if the Restructuring had been completed as of the beginning of the Relevant Periods and the business activities had been conducted by the Company throughout the Relevant Periods. Adjustments have been made for the purpose of this Report to restate those financial statements to conform to the accounting policies as referred to in Section 3, which are in compliance with International Accounting Standards (“IAS”) issued by the International Accounting Standards Committee and after making such adjustments as are considered appropriate.

The Directors of the Company are responsible for preparing financial statements of the Company which give a true and fair view. In preparing these financial statements, it is fundamental that appropriate accounting policies are selected and applied consistently. The Directors of the Company are also responsible for the summaries of the results of operations of the Company for the two years ended 31st December 1999 and the four months ended 30th April 2000 and of the net assets of the Company as of 30th April 2000. It is our responsibility to form an independent opinion on the summaries of the results of operation and of the net assets of the Company.

In our opinion, the Summaries together with the notes thereto give, for the purpose of this Report, a true and fair view of the results of operations of the Company for the Relevant Periods and the net assets of the Company as of 30th April 2000.

## **1. RESTRUCTURING**

As described in the “Establishment” of “Business” of the Prospectus, the Parent Company underwent a restructuring on 22nd March 2000 in preparation for the offering of the Company’s shares. Pursuant to the Restructuring, the Parent Company transferred the Relevant Businesses together with the related assets and liabilities to the Company in exchange for 90.91% equity interest in the form of ordinary shares of the Company. The remaining 2.64% and 6.45% equity

interest of the Company, in the form of ordinary shares of the Company, were respectively allotted to the Ultimate Holding Company and Other Promoters for cash at par value. Accordingly, the Company received cash proceeds amounting to RMB10,035,400 from Other Promoters. The Parent Company has retained and operates part of its Chinese medicine production and sales businesses not transferred to the Company.

The Relevant Businesses of the Parent Company transferred to the Company comprised the assets and liabilities of the business units including Factory No. 2, the Chinese Medicine Refinery Plant, Import and Export Department and Research & Development Centre.

## 2. BASIS OF PRESENTATION

As the Parent Company controlled the Relevant Businesses before the Restructuring and continues to control the Company after the Restructuring, the Restructuring has been accounted for as a reorganisation of entities under common control. Accordingly, the Summaries have been prepared as if the Restructuring had been completed as of the beginning of the Relevant Periods. The assets and liabilities transferred to the Company have been stated at historical amounts. In preparing the Summaries, those assets, liabilities, revenues and expenses that are identifiable and related to the Relevant Businesses are included in the Summaries. For those expenses which the specific identification method was not practical, the following allocation bases were adopted:

	<b>Bases</b>
Salaries	Number of employees
Advertising expenses	Revenues
Training expenses	Number of employees
Retirement benefits	Number of employees
Rent and depreciation	Floor area
Other selling and administrative expenses	Revenues

Management believes that the above allocation bases are appropriate in estimating the expenses relating to the Relevant Businesses.

**3. PRINCIPAL ACCOUNTING POLICIES**

The principal accounting policies adopted by the Company in arriving at the financial information included in this report, which conform to IAS, are as follows:

**(a) Revenue recognition**

Provided it is probable that the economic benefits associated with a transaction will flow to the Company and the revenue and costs, if applicable, can be measured reliably, revenue is recognized on the following bases:

*(i) Sales of goods*

Revenue is recognized when the significant risks and rewards of ownership of goods have been transferred to the buyer.

*(ii) Interest income*

Interest income is recognized on a time-proportion basis that take into account applicable interest rates and effective yields on the assets.

**(b) Fixed assets and depreciation**

Property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment loss. The initial 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.

Expenditures incurred after the property, plant and equipment have been put into operation, such as repairs and maintenance and overhaul costs, are recognized as expense in the period in which they are incurred. In situations where it is probable that the expenditures have resulted in an increase in the future economic benefits expected to be obtained from the use of the asset beyond its originally assessed standard of performance, the expenditures are capitalized as an additional cost of the asset.

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

Buildings	8-30 years
Equipment and machinery	8-15 years
Office equipment	4-5 years
Motor vehicles	6 years

The useful lives of assets and depreciation method are reviewed periodically.

When assets are sold or retired, their cost and accumulated depreciation are eliminated from the accounts and any gain or loss resulting from their disposal is included in the determination of the results of operations.

**(c) Construction-in-progress**

Construction-in-progress represents plant and properties under construction and is stated at cost. This includes cost of construction, plant and equipment and other direct costs plus borrowing costs which include interest charges and exchange differences arising from foreign currency borrowings used to finance these projects during the construction period, to the extent these are regarded as an adjustment to interest costs.

Construction-in-progress is not depreciated until such time as the assets are completed and ready for use.

**(d) Borrowing costs**

Borrowing costs include interest charges and other costs incurred in connection with the borrowing of funds, including amortization of discounts or premiums relating to borrowings, amortization of ancillary costs incurred in connection with arranging borrowings and exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

Borrowing costs are expensed as incurred, except when they are directly attributable to the acquisition, construction or production of long-term construction projects that necessarily takes a substantial period of time to get ready for their intended use in which case they are capitalized as part of the cost of the assets. Capitalization of borrowing costs commences when expenditures for the asset and borrowing costs are being incurred and the activities to prepare the asset for its intended use are in progress. Borrowing costs are capitalized at the weighted average cost of the related borrowings until the asset is ready for its intended use. If the resulting carrying amount of the asset exceeds its recoverable amount, an impairment loss is recorded.

**(e) Research and development costs**

Expenditures for research and development are charged against income in the period incurred except for project development costs which comply strictly with the following criteria:

- the product or process is clearly defined and costs are separately identified and measured reliably;
- the technical feasibility of the product is demonstrated;
- the product or process will be sold or used in-house;
- a potential market exists for the product or its usefulness in case of internal use is demonstrated; and
- adequate technical, financial and other resources required for completion of the project are available.

Capitalized development costs are amortized on a straight-line basis over their expected useful lives.

The recoverable amount of development costs is estimated whenever there is an indication that the asset has been impaired or that the impairment losses recognized in previous years no longer exist.

**(f) Inventories**

Inventories are stated at the lower of cost and net realizable value. Cost, calculated on the weighted average basis, comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

When inventories are sold, the carrying amount of those inventories is recognized as an expense in the period in which the related revenue is recognized. The amount of any write-down of inventories to net realizable value and all losses of inventories are recognized as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories, arising from an increase in net realizable value, is recognized in the period in which the reversal occurs.

**(g) Foreign currency translation**

The Company maintains its books and records in RMB. Transactions denominated in currencies other than RMB are translated into RMB at the applicable rates of exchange quoted by the People's Bank of China ("PBOC Rates") prevailing at the dates of the transactions. Monetary assets and liabilities denominated in other currencies are translated into RMB at the applicable PBOC Rates prevailing at the balance sheet dates. Non-monetary assets and liabilities in other currencies are translated at historical rates. Exchange differences other than those capitalised as a component of borrowing costs are recognized in the income statement in the period in which they arise.

**(h) Taxation**

The Company provides for income tax on the basis of its profit for financial reporting purposes, adjusted for income and expense items which are not assessable or deductible for income tax purposes. The applicable income tax rate is 33%.

Deferred taxation is provided under the balance sheet liability method in respect of significant taxable or deductible temporary differences between the carrying amount of assets or liabilities in the balance sheet and their respective tax bases. The tax basis of an asset or liability is the amount attributed to that asset or liability for tax purpose. Deferred tax liabilities are recognised for all taxable temporary differences. Deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which the deferred tax asset can be utilized.

**(i) Operating leases**

Leases where substantially all of the rewards and risks of the ownership of the assets remain with the lessors are accounted for as operating leases. Rental payments under operating leases are charged to the results of operations on a straight-line basis over the period of the relevant leases.

**(j) Retirement benefits**

Pursuant to the PRC laws and regulations, contributions to the basic old age insurance for the Company's local staff are to be made monthly to a government agency based on 25% of the standard salary set by the provincial government, of which 19% is borne by the Company and the remainder is borne by the staff. The government agency is responsible for the pension liabilities relating to such staff on their retirement. The Company accounts for these contributions on an accrual basis.

**(k) Earnings per share**

The calculation of earnings per share is based on net profit during the Relevant Periods and the number of ordinary shares outstanding prior to the public offering.

**(l) Impairment of assets**

Property, plant and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Whenever the carrying amount of an asset exceeds its recoverable amount, an impairment loss is recognized in income for items of property, plant and equipment carried at cost. The recoverable amount is the higher of an asset's net selling price and value in use. The net selling price is the amount obtainable from the sale of an asset in an arm's length transaction while value in use is the present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life. Recoverable amounts are estimated for individual assets or, if it is not possible, for the cash-generating unit.

Reversal of impairment losses recognized in prior years is recorded when there is an indication that the impairment losses recognized for the asset no longer exist or has decreased. The reversal is recorded in income or as a revaluation increase.

**(m) Provisions**

A provision is recognized when, and only when an enterprise has a present obligation (legal or constructive) as a result of a past event and it is probable (i.e. more likely than not) that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. Provisions are reviewed at each balance sheet date and adjusted to reflect the current best estimate. Where the effect of the time value of money is material, the amount of a provision is the present value of the expenditures expected to be required to settle the obligation.

## 4. RESULTS OF OPERATIONS

The following is a summary of the results of operations of the Company for the Relevant Periods, prepared on the bases set out in Sections 2 and 3 above, and after making such adjustments as are considered appropriate:

		Year ended 31st December		Four months ended
		1998	1999	30th April 2000
	Notes	RMB'000	RMB'000	RMB'000
Revenue	(a)	248,672	308,068	126,580
Cost of sales		<u>(139,174)</u>	<u>(167,507)</u>	<u>(65,542)</u>
Gross profit		109,498	140,561	61,038
Selling and distribution costs		(21,766)	(26,343)	(9,102)
Administrative expenses		<u>(47,100)</u>	<u>(54,082)</u>	<u>(15,416)</u>
Profit from operations		40,632	60,136	36,520
Finance cost		<u>(4,368)</u>	<u>(3,034)</u>	<u>(1,045)</u>
Profit before tax	(b)	36,264	57,102	35,475
Income tax expense	(c)	<u>(11,967)</u>	<u>(18,844)</u>	<u>(11,707)</u>
Net profit	5(g)	<u>24,297</u>	<u>38,258</u>	<u>23,768</u>
Dividends	(d)	<u>(24,297)</u>	<u>(38,258)</u>	<u>–</u>
Earnings per share	(e)			
– Basic		<u>RMB0.22</u>	<u>RMB0.35</u>	<u>RMB0.22</u>

Notes:

(a) Revenue

	Year ended 31st December		Four months ended
	1998	1999	30th April 2000
	RMB '000	RMB '000	RMB '000
Sales of goods:			
Domestic	243,816	302,502	123,222
Overseas	4,856	5,566	3,358
	<u>248,672</u>	<u>308,068</u>	<u>126,580</u>

(b) Profit before tax

Profit before tax was determined at after crediting and charging the following:

	Year ended 31st December		Four months ended
	1998	1999	30th April 2000
	RMB '000	RMB '000	RMB '000
Crediting:			
Interest income	266	242	121
Exchange gains, net	–	149	47
Charging:			
Interest expenses on bank loans repayable within five years	4,581	3,397	1,199
Less: Amount capitalized as construction-in-progress	–	–	–
	<u>4,581</u>	<u>3,397</u>	<u>1,199</u>
Depreciation	7,161	8,475	2,972
Operating lease rentals	6,211	6,274	1,950
Staff costs	24,078	25,498	8,673
Contribution to retirement benefits	3,870	4,306	1,499
Auditors' remuneration	–	–	–
Exchange loss, net	52	–	–
Provision for (write-back of) doubtful debts*	–	(617)	271
Write-off of obsolete inventory	1,998	3,951	–
Research and development expenses	2,639	4,619	1,057

\* As more fully explained in Section 9, the Parent Company had all along been responsible for the distribution of most of the Company's products to the ultimate customers. Accordingly, additional pro forma financial information has been included in Section 9. The provision for (write-back of) doubtful debts as stated above represented provision for or write-back of doubtful debts arising from the Company's direct sales.

**(c) Income tax expense**

Details of taxation charged during the Relevant Periods are as follows:

	Year ended 31st December		Four months ended
	1998	1999	30th April 2000
	RMB '000	RMB '000	RMB '000
Current income tax	<u>11,967</u>	<u>18,844</u>	<u>11,707</u>

The income tax rates are analyzed as follows:

	Year ended 31st December				Four months ended	
	1998		1999		30th April 2000	
	RMB '000		RMB '000		RMB '000	
Accounting profit	<u>36,264</u>	100%	<u>57,102</u>	100%	<u>35,475</u>	100%
Tax at the statutory tax rate of 33%	<u>11,967</u>	33%	<u>18,844</u>	33%	<u>11,707</u>	33%
Tax expense	<u>11,967</u>	33%	<u>18,844</u>	33%	<u>11,707</u>	33%

There was no significant deferred taxation for the Relevant Periods, as there were no significant temporary differences.

**(d) Dividends**

Please refer to Section 5(g) "Reserves and profit appropriation" for detailed information on dividends.

**(e) Earnings per share**

The calculation of basic earnings per share is based on net profit during the Relevant Periods and assuming 110,000,000 ordinary shares outstanding prior to the public offering as if the Restructuring had taken place on 1st January 1998. The diluted earnings per share is not presented as there were no potential dilutive ordinary shares as at the Relevant Period end and during the Relevant Periods.

**(f) Provision for doubtful debts**

Please refer to Section 9 "Pro Forma Financial Information" for detailed information on pro forma provision for doubtful debts.

**(g) Directors' and senior executives' emoluments**

- (1) During the Relevant Periods, no emolument was paid to the directors and supervisors of the Company. Under the arrangement presently in force, the aggregate amount of emoluments of directors and supervisors of the Company payable for the year ending 31st December 2000, including performance bonuses, are estimated to be approximately RMB1,500,000.

- (2) Details of emoluments paid to the five highest-paid individuals were:

	Year ended 31st December		Four months ended
	1998	1999	30th April 2000
	RMB '000	RMB '000	RMB '000
Basic salaries and allowances	<u>150</u>	<u>175</u>	<u>96</u>

- (3) During the Relevant Periods, no emolument was paid to the five highest-paid individuals (all senior executives including directors) as inducement to join or upon joining the Company or as compensation for loss of office.

The annual emoluments of each of the highest-paid individuals fall within the band of nil to RMB1,000,000 during the Relevant Periods.

**(h) Retirement benefits**

All of the full-time PRC employees of the Company are entitled to a pension equal to the basic salary of the employees as of their retirement dates. The PRC government is responsible for the pension liabilities to these retired staff. The Company is required to make contributions to the state-sponsored retirement plan at a rate of 19% of the employees' salaries. There is no obligation apart from the contribution as stated above.

During the Relevant Periods, the Company provided neither retirement nor termination benefits other than those described above.

**(i) Profit appropriation**

According to the Company Laws of the PRC and Articles of Association of the Company, when distributing net profit of each year, the Company shall set aside 10% of its net profit after tax (based on the Company's local statutory accounts) for the statutory revenue reserve fund (except where the reserve balance has reached 50% of the Company's paid-up share capital), and 5% to 10% for the statutory public welfare fund. These reserves cannot be used for purposes other than those for which they are created and are not distributable as cash dividends without the prior approval by shareholders under certain conditions.

When the statutory revenue reserve is not sufficient to cover the prior years' losses, the current year's net profit will first be used to compensate the previous losses before the appropriations to the statutory revenue reserve and statutory public welfare fund.

The statutory revenue reserve, discretionary revenue reserve and capital reserve fund as approved by shareholders may be converted into share capital provided that the balance of the statutory reserve does not fall below 25% of the registered share capital.

Profit appropriation is subject to approval of the board of Directors and shareholders' meeting. In accordance with the Articles of Association of the Company, the reserve available for distribution is the lower of the amount determined under the PRC accounting standards and the amount determined under IAS.

As of 30th April 2000, the distributable reserves of the Company amounted to approximately RMB23,768,000. The Company has neither declared nor paid dividends subsequent to 30th April 2000.

## 5. NET ASSETS

The following is a summary of the net assets of the Company as of 30th April 2000, prepared on the bases set out in Sections 2 and 3 above, and after making such adjustments as are considered appropriate:

	<i>Note</i>	<i>RMB'000</i>	<i>RMB'000</i>
FIXED ASSETS, net	(a)		65,626
CURRENT ASSETS			
Cash and bank balances		43,470	
Accounts receivable, net	(b)	15,758	
Inventories	(c)	116,242	
Prepayments, deposits and other current assets		2,347	
TOTAL CURRENT ASSETS		<u>177,817</u>	
CURRENT LIABILITIES			
Short-term bank loans	(d)	(45,400)	
Accounts payable		(26,114)	
Accruals and other current liabilities		(19,792)	
Due to related parties	(f)	(31,039)	
Dividends payable		(3,293)	
Taxes payable	(e)	(2,277)	
TOTAL CURRENT LIABILITIES		<u>(127,915)</u>	
NET CURRENT ASSETS			<u>49,902</u>
NET ASSETS			<u><u>115,528</u></u>

Notes:

(a) Fixed assets, net

	Buildings <i>RMB'000</i>	Equipment and machinery <i>RMB'000</i>	Office equipment <i>RMB'000</i>	Motor vehicles <i>RMB'000</i>	Construction- in-progress <i>RMB'000</i>	Total <i>RMB'000</i>
Cost						
As of 1st January 2000	64,528	50,705	2,813	5,390	1,125	124,561
Additions	–	122	5	195	2,395	2,717
As of 30th April 2000	64,528	50,827	2,818	5,585	3,520	127,278
Accumulated depreciation and impairment losses						
As of 1st January 2000	24,979	29,397	1,476	2,828	–	58,680
Additions	852	1,595	240	285	–	2,972
As of 30th April 2000	25,831	30,992	1,716	3,113	–	61,652
Net book value						
As of 30th April 2000	38,697	19,835	1,102	2,472	3,520	65,626
As of 1st January 2000	39,549	21,308	1,337	2,562	1,125	65,881

(b) Accounts receivable, net

	<i>RMB'000</i>
Accounts receivable	17,126
Less: provision for doubtful debts	(1,368)
	<u>15,758</u>

(c) Inventories

	<i>RMB'000</i>
Raw materials	15,427
Work-in-progress	46,896
Finished goods	53,919
	<u>116,242</u>

(d) Short-term bank loans

As of 30th April 2000, the Company had short-term bank loans of approximately RMB45,400,000 which were guaranteed by the Ultimate Holding Company.

The Company's short-term bank loans bore interest at 6.435% per annum.

**(e) Taxes payable**

Taxes payable mainly represented value added tax payable.

The Company is subject to value added tax ("VAT") on its sales in the PRC, which is levied at the general rate of 17 per cent. on the gross selling price upon sales of goods. Input VAT paid on purchases of raw materials, semi-finished products, etc. can be used to offset the VAT payable on sales to determine the net VAT payable.

**(f) Related party transactions**

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

**(1) Transactions with the Parent Company**

Transactions with the Parent Company during the Relevant Periods are summarized as follows:

	<b>Year ended 31st December</b>		<b>Four months ended</b>
	<b>1998</b>	<b>1999</b>	<b>30th April 2000</b>
	<i>RMB '000</i>	<i>RMB '000</i>	<i>RMB '000</i>
Purchases of raw materials from the Parent Company	1,382	4,942	3,836
Purchase of raw materials for the Parent Company	<u>16,663</u>	<u>22,240</u>	<u>6,889</u>

The Company intended to discontinue to purchase raw materials from or for the Parent Company upon the listing of the Company's shares.

The agency fee charged by the Parent Company for distribution of the Company's products by the Parent Company in the PRC during the Relevant Periods were RMB5.6 million, RMB8.2 million and RMB3.2 million respectively.

The agency fee charged to the Parent Company for distribution of the Parent Company's products by the Company during the Relevant Periods were RMB6.2 million, RMB6 million and RMB1.1 million respectively.

**(2) Transactions with the Ultimate Holding Company**

Transactions with the Ultimate Holding Company during the Relevant Periods are set out as follows:

	<b>Year ended 31st December</b>		<b>Four months ended</b>
	<b>1998</b>	<b>1999</b>	<b>30th April 2000</b>
	<i>RMB '000</i>	<i>RMB '000</i>	<i>RMB '000</i>
Purchases of raw materials	42,415	53,423	19,806
Trademark royalty	715	793	334
Land use fee	2,685	2,685	895
Operating lease rentals	3,000	3,000	1,000
Storage expenses	726	1,438	325

- (3) Transaction with the subsidiaries and associates of the Parent Company

The Company's products sold to the distribution agents which are the related companies of the Ultimate Holding Company for the two years ended 31st December 1999 and the four months ended 30th April 2000 amounted to RMB59.25 million, RMB83.58 million and RMB14.4 million respectively.

- (4) The Company's short-term bank loans are guaranteed by the Ultimate Holding Company.
- (5) During the Period, the Parent Company provided free advertising agency services for the Company.
- (6) Balances with the Parent Company, the Ultimate Holding Company are unsecured, non-interest bearing and have no fixed repayment dates. The Company will settle these balances prior to the listing of the Company's shares.

In the opinion of the directors of the Company, the above related party transactions were carried out in the usual course of business and on normal commercial terms except for the advertising agency services. The Company considered that had the advertising agency agreement been effective during the Relevant Periods, there would not have been any substantial impact to the operating results of the Company.

**(g) Reserves and profit appropriation**

Movements of reserves of the Company during the Relevant Periods were as follows:

	<b>Year ended 31st December</b>		<b>Four months ended 30th April 2000</b>
	<b>1998</b>	<b>1999</b>	<b>2000</b>
	<i>RMB '000</i>	<i>RMB '000</i>	<i>RMB '000</i>
Beginning of the year/period	–	–	–
Profit for the year/period	24,297	38,258	23,768
Dividends	(24,297)	(38,258)	–
	<u>          </u>	<u>          </u>	<u>          </u>
End of the year/period	<u>          </u>	<u>          </u>	<u>          </u>
	–	–	23,768

As stated in Section 4(i), the Company needs to appropriate a certain portion of profit to the reserves after the establishment of the Company. Prior to the establishment of the Company, there were no requirement for such appropriation and all profits generated from the Relevant Businesses was distributed to the Parent Company.

## 6. COMMITMENTS AND CONTINGENT LIABILITIES

### (a) Capital commitments

As of 30th April 2000, the Company had authorized and contracted capital expenditures of approximately RMB1,710,000 for purchases of plant and equipment.

**(b) Operating lease commitments**

As of 30th April 2000, the Company had commitments in respect of leased land and buildings under various non-cancellable operating lease agreements extending to 30th May 2020 amounting to approximately RMB73,709,000. Total future minimum lease payments under non-cancellable operation leases are as follows:

	<i>RMB'000</i>
Land and building:	
– not later than one year	5,685
– later than one year and not later than five years	22,740
– later than five years	45,284
	73,709
	73,709

**(c) Contingent liabilities**

As of 30th April 2000, the Company did not have any significant contingent liabilities.

**7. FINANCIAL INSTRUMENTS**

The carrying amounts of the Company's cash, accounts receivable, short-term bank loans and accounts payable approximate their fair values because of the short maturity of these instruments.

**8. ULTIMATE HOLDING COMPANY**

The directors of the Company consider China Beijing Tong Ren Tang Holdings Corp., a company established in Beijing, the PRC, to be the ultimate holding company.

**9. PRO FORMA FINANCIAL INFORMATION**

Prior to the establishment of the Company, the Parent Company had all along been responsible for the distribution of most of the Company's products (the "Relevant Products") to the ultimate customers. Customers generally did not specifically indicate the invoice to which a certain payment should apply. Although the Company's revenue can be specifically identified based on product lines transferred to the Company (see Section "Business" of the Prospectus), it is not possible for the Parent Company to know with certainty whether any part of the remaining balance of accounts receivable for an individual customer should be attributed to the sale of the relevant products. For this reason, the Parent Company took up the credit risk of such receivables by not injecting any balance of such accounts receivable into the Company upon the Restructuring.

For each of the two years ended 31st December 1999 and the four months ended 30th April 2000, the estimated provision for doubtful debts in relation to the sales of products of the Parent Company and the relevant products of the Company amounted to approximately RMB9,376,000, RMB4,378,000 and RMB75,000 respectively.

With the assumption that during the Relevant Periods, the Relevant Products were sold directly by the Company to the ultimate customers and the Company bore the related credit risk, the provision for doubtful debts of the Company for each of the two years ended 31st December 1999 would have been approximately RMB4,000,000 and RMB2,000,000 respectively, and no provision for doubtful debts of the Company for the four months ended 30th April 2000. These amounts were estimated by applying the proportion of annual sales of the Company over that of the Parent Company to the total provision for doubtful receivables resulting from the sales of products of the Parent Company and the Relevant Products of the Company.

The total provision for doubtful receivables resulting from the sales of products of the Parent Company and the relevant products of the Company was provided based on the following bases:

Aging	Provision rate
Within one year	5%
One to two years	20%
Two to three years	50%
More than three years	100%

After pro forma adjustments made for the provision for doubtful debts, the results of operations for each of the two years ended 31st December 1999 and the four months ended 30th April 2000 would have been as follows:

	Year ended 31st December		Four months ended 30th April
	1998	1999	2000
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Profit before taxation (Profit before pro forma adjustment)	36,264	57,102	35,475
Pro forma provision for doubtful debts	<u>(4,000)</u>	<u>(2,000)</u>	<u>–</u>
Adjusted profit before taxation	32,264	55,102	35,475
Adjusted taxation	<u>(10,647)</u>	<u>(18,184)</u>	<u>(11,707)</u>
Adjusted profit attributable to shareholders	<u><u>21,617</u></u>	<u><u>36,918</u></u>	<u><u>23,768</u></u>

The Company considered that there was no other material pro forma financial information that should be disclosed for the purpose of this Prospectus.

#### **10. SUBSEQUENT EVENTS**

In accordance with the “Law of the Peoples’ Republic of China on Chinese-Foreign Equity Joint Ventures” and other relevant laws and regulations of the PRC, the Company signed a contract with WM Dianorm Biotech Co., Limited on 10th May 2000 to establish a joint venture enterprise, namely Beijing Tong Ren Tang WM Dianorm Biotech Co., Limited, in Beijing.

The total investment in Beijing Tong Ren Tang WM Dianorm Biotech Co., Limited will be USD5,000,000. The Company will contribute USD3,000,000, which accounted for 60% of the registered capital of the joint venture. WM Dianorm Biotech Co., Limited agrees to contribute USD2,000,000, which accounted for 40% of the registered capital.

#### **11. SUBSEQUENT FINANCIAL STATEMENTS**

No audited financial statements have been prepared by the Company in respect of any period subsequent to 30th April 2000. No dividends or other distributions have been declared, made or paid by the Company in respect of any period subsequent to 30th April 2000.

Yours faithfully,  
**ARTHUR ANDERSEN & CO.**  
*Certified Public Accountants*  
Hong Kong

The profit after taxation of the Company for the year ending 31st December 2000 is set out under “Profit forecast” in the section headed “Financial Information” in the Prospectus.

### **1. BASES AND ASSUMPTIONS**

The Directors have prepared the forecast of profit after taxation but before extraordinary items of the Company for the year ending 31st December 2000, based on the results shown in the audited financial statements of the Company for the four months ended 30th April 2000, the unaudited results of operations for the period from 1st May 2000 to 31st August 2000 and a forecast of the results for the remaining four months ending 31st December 2000. The Directors are not aware of any extraordinary items, which had arisen or are likely to arise during the year ending 31st December 2000. The forecast has been prepared on the basis of accounting policies consistent in all material respects with those normally adopted by the Company as summarized in the Accountants’ Report, the text of which is set out in Appendix I to this Prospectus, and is based on the following assumptions:

- (i) there will be no material changes in existing laws, policies or regulations applicable to the Company, or in the political, economic or market conditions in which the Company operates;
- (ii) inflation, interest rates and exchange rates will not differ materially from those prevailing as of the date of the prospectus; and
- (iii) there will be no material changes in the bases or rates of taxation in any of the countries in which the Company or any of the companies operates.

**2. LETTERS**

Set out below are texts of letters received by the Directors from Arthur Andersen & Co., the auditors and reporting accountants of the Company, and from BOCI Asia Limited in connection with the forecast of profit after taxation but before extraordinary items of the Company for the year ending 31st December 2000 and prepared for the purpose of inclusion in this prospectus.

**(i) Letter from Arthur Anderson & Co**

Arthur Andersen & Co

21st Floor, Edinburgh Tower  
The Landmark  
15 Queen's Road Central  
Hong Kong

Tel 852 2852 0222  
Fax 852 2815 0548

24th October 2000

The Directors  
Tong Ren Tang Technologies Co. Ltd.  
BOCI Asia Limited

Dear Sirs

We have reviewed the accounting policies applied and the calculations made in arriving at the forecast of the profit after taxation but before extraordinary items of Tong Ren Tang Technologies Co. Ltd. (the "Company") for the year ending 31st December 2000 (the "Forecast"), for which the directors of the Company (the "Directors") are solely responsible. The Forecast has been prepared by the Directors based on the audited results of operations of the Company for the four months ended 30th April 2000, the unaudited results shown in the management accounts of the Company for the period from 1st May 2000 to 31st August 2000, and a forecast of the results of the Company for the remaining four months ending 31st December 2000.

In our opinion, the Forecast, so far as the accounting policies and calculations are concerned, has been properly compiled on the basis of the assumptions made by the Directors as set out in Appendix II of the Prospectus, and is presented on a basis consistent in all material respects with the accounting policies presently adopted by the Company as set out in our accountants' report dated 24th October 2000, the text of which is set out in Appendix I of the Prospectus.

Yours faithfully,  
**Arthur Anderson & Co.**  
*Certified Public Accountants*  
Hong Kong

**(ii) Letter from BOCI Asia**

**BOCI Asia Limited**  
**35th Floor**  
**Bank of China Tower**  
**Central**  
**Hong Kong**

24th October, 2000

The Directors

Tong Ren Tang Technologies Co. Ltd.

Dear Sirs,

We refer to the forecast of the profit after taxation but before extraordinary items of Tong Ren Tang Technologies Co. Ltd. (the “Company”) for the year ending 31st December, 2000 (the “Forecast”) as set out under the prospectus of the Company dated 24th October, 2000.

We have discussed with you the bases and assumptions upon which the Forecast has been made. We have also considered the letter dated 24th October, 2000 addressed to you and ourselves from Arthur Andersen & Co. regarding the accounting policies and calculations upon which the forecast has been made.

On the basis of the foregoing, the bases and assumptions made by you and on the accounting policies and calculations reviewed by Arthur Andersen & Co., we have formed the opinion that the profit forecast, for which you as Directors are solely responsible, has been made after due and careful consideration.

Yours faithfully,  
For and on behalf of  
**BOCI Asia Limited**  
**Simon Harding**  
*Managing Director*

The following is the text of a letter and valuation certificate received from independent property valuer, LCH (Asia-Pacific) Surveyors Limited, prepared for the purpose of incorporation in this prospectus, in connection with their valuation of the property interests of the Company as at 31st July, 2000.



利駿行測量師有限公司  
**LCH (Asia-Pacific) Surveyors Limited**  
CANADA • HONG KONG • PRC • PHILIPPINES  
REGISTERED PROFESSIONAL SURVEYORS • INTANGIBLE ASSET VALUERS  
PLANT AND MACHINERY VALUERS • INTERNATIONAL PROPERTY CONSULTANTS

1506, Vicwood Plaza  
199 Des Voeux Road Central  
Hong Kong

24th October, 2000

The Directors

Tong Ren Tang Technologies Co. Ltd.  
Unit 305-1 of District A, Level 3  
Wan Yuan Commercial Centre  
No. 10 Hong Da Bei Road  
Beijing Economic and Technology Development Zone  
Yi Zhuang, Beijing  
The People's Republic of China

Dear Sirs,

In accordance with your instructions to value the properties in which Tong Ren Tang Technologies Co. Ltd. (hereinafter known as the "Company") has interests in the People's Republic of China (hereinafter known as "PRC" or "China"), we confirm that we have carried out inspections, made relevant enquiries and searches and obtained such further information as we consider necessary for the purpose of providing you with our opinion of the value of the properties as at 31st July, 2000 (hereinafter known as the "date of valuation").

The properties being valued are classified as specialised properties for private sector. Our valuations of the properties are based on Depreciated Replacement Cost (hereinafter known as "DRC") and being subject to the adequate potential profitability of the business having due regard to the value of the total assets employed and the nature of the operation. The DRC basis of valuation is used for the valuation of specialised properties. It is a method of using net current replacement costs to arrive at the value to the undertaking in occupation of the property as existing at the date of valuation, where it is not practicable to ascertain existing use value on market bases.

According to the RICS Appraisal and Valuation Manual issued by the Royal Institution of Chartered Surveyors (hereinafter known as the "RICS Manual"), the DRC is defined as the aggregate amount of the value of the land for the existing use or a notional replacement site in

the same locality, and the gross replacement cost of the buildings and other site works. From which appropriate deductions may then be made to allow for the age, condition, economic or functional obsolescence, environmental and other relevant factors; all of these might result in the existing property being worth less to the undertaking in occupation than would a new replacement. The DRC generally furnishes the most reliable indication of value for property in the absence of a known market based on comparable sales.

According to the RICS Manual, specialised properties are those which, due to their specialised nature, are rarely, if ever, sold on the open market for single occupation for a continuation of their existing use, except as part of a sale of the business in occupation. Their specialised nature may arise from the construction, arrangement, size or location of the property, or a combination of these factors, or may be due to the nature of the plant and machinery and items of equipment which the buildings are designed to house, or the function, or the purpose for which the buildings are provided. Standard properties in particular geographical areas and remote from main business centres, located there for operational or business reasons, which are of such an abnormal size for that district, that there would be no market for such buildings, are a type of specialised property. Having considered the inherent and general characteristic of the properties, we are of the opinion that the properties belong to specialised properties.

In valuing the properties, we have complied with all the requirements contained in Chapter 8 of the Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited and the RICS Manual.

The current status of the properties regarding major approvals, consents or licences required in the PRC is set out as follows:

Property	Document/Approval			
	State-owned Land Grant/Land Transfer Contract accompanied with the PRC legal opinion	State-owned Land Use Rights Certificate	Building Ownership Certificate/Realty Title Certificate	Lease Agreement
<b>Group I</b>				
Property 1	N/A	N/A	N/A	Yes
Property 2	N/A	N/A	N/A	Yes
Property 3	N/A	N/A	N/A	Yes
Property 4	N/A	N/A	N/A	Yes
Property 5	N/A	N/A	N/A	Yes
<b>Group II</b>				
Property 1	N/A	Note 1	Yes	Yes
Property 2	N/A	Note 2	Yes	Yes

*Notes:*

1. The right to use the land is held by 中國北京同仁堂集團公司 (China Beijing Tong Ren Tang Holdings Corporation) through a State Owned Land Use Rights Certificate Xi Qi Guo Yong (97) Zi Di 00044 Hao dated 22nd April, 1997.
2. The right to use the land is held by 中國北京同仁堂集團公司 (China Beijing Tong Ren Tang Holdings Corporation) through a State Owned Land Use Rights Certificate Fang Guo Yong (97) Zi Di 000485 Hao dated 3rd April, 1997.

All properties are rented by the Company in China, and have no commercial value due mainly to the prohibition against assignment or sub-letting or not owned by the Company.

We have relied to a considerable extent on the information provided by the Company and the Company's PRC legal adviser and have accepted advice given to us on such matters as planning approvals or statutory notices, easements, tenure, occupation, lettings, rental, site and floor areas and all other relevant matters.

We have not carried out detailed site measurements to verify the correctness of the site area in respect of the properties but have assumed that the site area shown on the documents and official site plans handed to us are correct. Based on our valuation experience of similar properties in China, we consider the assumptions so made to be reasonable. All documents and contracts have been used as reference only and all dimensions, measurements and areas are approximations. No on-site measurements have been taken.

We have inspected the exterior and, where possible, the interior of the properties but no structural survey, investigation or examination has been made and we are unable to report that the properties are free from rot, infestation or any other structural defects. No tests were carried out to any of the services.

No allowance has been made in our valuation for any charges, mortgages or amount owing on the properties. Unless otherwise stated, it is assumed that the properties are free from encumbrances, restrictions, and outgoings of an onerous nature which could affect their value.

We have been shown copies of various documents relating to the properties. However, we have not searched the original documents to verify any amendments which may not appear on the copies handed to us. Due to inherent defects in the land registration system of China, we are unable to search the original documents from the relevant land registration departments to verify the existing title of the properties or any material encumbrances that might be attached to the properties. However, we have made reference to the opinion given by the Company's PRC legal adviser on the PRC laws in respect of the Company's title to the properties.

We are not aware of the content of any environmental audit or other environmental investigation or soil survey which may have been carried out on the properties, and which may draw attention to any contamination or the possibility of any such contamination. In undertaking our work, we have been instructed to assume that no contaminative or potentially contaminative uses have ever been carried out in the properties. We have not carried out any investigation into past or present uses, either of the properties or of any neighbouring land, to establish whether there is any contamination or potential for contamination to the subject properties from these uses or sites, and have therefore assumed that none exists. However, should it be established subsequently that contamination, seepage or pollution exists at the properties or on any neighbouring land, or that the premises have been or are being put to a contaminative use, this might reduce the values now reported.

We have had no reason to doubt the authenticity and accuracy of the information provided to us by the Company. We have also sought and received confirmation from the Company that no material factors have been omitted from the information supplied. We consider that we have been provided with sufficient information to reach an informed view, and have had no reason to suspect that any material information has been withheld.

The scope of valuations has been determined with reference to the property list provided by the Company. All properties on the list have been included in this valuation certificate. The Company has confirmed to us that it has no property interest other than those specified on the list supplied to us.

Unless otherwise stated, all monetary amounts stated are in Hong Kong Dollars. The adopted exchange rate was the prevailing rate as at the date of valuation, being HK\$1 to RMB1.06 and no significant fluctuation in exchange rate has been found between that date and the date of this letter.

Our valuations are summarized below and the valuation certificate is attached.

Yours faithfully,  
For and on behalf of  
**LCH (ASIA-PACIFIC) SURVEYORS LIMITED**  
**Joseph Ho Chin Choi** B.Sc. TechRICS  
*Managing Director*

*Note:* Mr. Joseph Ho Chin Choi has been conducting asset valuation and advisory work in China and South East Asia for various purposes since 1988

## SUMMARY OF VALUES

## Group I – Property interests occupied by the Company under short term leases in the PRC

<b>Property</b>	<b>Amount of valuations in existing state attributable to the Company as at 31st July, 2000</b> <i>HK\$</i>
1. Unit 305-1 of District A on Level 3 Wan Yuan Commercial Centre No. 10 Hong Da Bei Road Beijing Economic and Technology Development Zone Yi Zhuang Beijing China	No commercial value
2. Room No. 1101, 1102, 1103, 1105, 1106, 1107, 1108 and 1110 on Level 11 and Room No. 1202, 1203, 1205, 1206, 1207, 1208, 1209 and 1210 on Level 12 Pei Xin Hotel No. Jie 5 Pei Xin Street Chong Wen District Beijing China	No commercial value
3. No. 38 and No. 39 Warehouse with Pharmacopoeia Testing Room China Beijing Tong Ren Tang Holdings Corporation Tong Xian Warehouse Dong Zong Tun Tong Zhou District Beijing China	No commercial value
4. A parcel of land together with various buildings and structures erected thereon No. 130 Xi Zhi Men Nei Da Street Xi Cheng District Beijing China	No commercial value

<b>Property</b>	<b>Amount of valuations in existing state attributable to the Company as at 31st July, 2000</b> <i>HK\$</i>
5. Various houses situated at the front portion of No. 130 Xi Zhi Men Nei Da Street Xi Cheng District Beijing China	No commercial value
<b>Sub-total:</b>	<u>Nil</u>

**Group II – Property interests occupied by the Company under long term leases in the PRC**

<b>Property</b>	<b>Amount of valuations in existing state attributable to the Company as at 31st July, 2000</b> <i>HK\$</i>
1. A parcel of land together with various buildings and structures erected thereon (also known as Tongrentang Chinese Medicine Refinery) No. 33 Yang Fang Hu Tong Xi Cheng District Beijing China	No commercial value
2. A parcel of land together with various buildings and structures erected thereon (also known as Tongrentang Pharmaceutical Manufacturing No. 2 Plant) No. 20 Nan San Huan Zhong Road Feng Tai District Beijing China	No commercial value
<b>Sub-total:</b>	Nil
<b>Grand Total:</b>	<u>Nil</u>

## VALUATION CERTIFICATE

## Group I – Property interests occupied by the Company under short term leases in the PRC

Property	Description	Particulars of Tenancy	Amount of valuations in existing state attributable to the Company as at 31st July, 2000
			HK\$
1. Unit 305-1 of District A on Level 3, Wan Yuan Commercial Centre, No. 10 Hong Da Bei Road, Beijing Economic and Technology Development Zone, Yi Zhuang Beijing, China	<p>The subject property comprises an office unit on Level 3 of an 8-storeyed (excluding basement) commercial building which was completed in 1999.</p> <p>The property has a lettable area of approximately 56 sq.m.</p> <p>The property is currently occupied by the Company for office purposes.</p>	<p>The property is rented by the Company for a term of one year from 20th February, 2000 to 19th February, 2001 at a total annual rental of RMB61,320 inclusive of water and electricity charges.</p>	No commercial value

Property	Description	Particulars of Tenancy	Amount of valuations in existing state attributable to the Company as at 31st July, 2000 <i>HK\$</i>
2. Room No. 1101, 1102, 1103, 1105, 1106, 1107, 1108 and 1110 on Level 11 and Room No. 1202, 1203, 1205, 1206, 1207, 1208, 1209 and 1210 on Level 12, Pei Xin Hotel, No. Jie 5 Pei Xin Street, Chong Wen District, Beijing, China	<p>The subject property comprises 16 rooms of a 12-storeyed (excluding basement) hotel which was completed in 1999.</p> <p>The property has a total lettable area of approximately 416 sq.m.</p> <p>The property is currently occupied by the Company for office purposes.</p>	<p>The property is rented by the Import and Export Department of the Company from 1st March, 2000 to 1st March, 2001 at a total annual rental of RMB680,000 inclusive of water and electricity charges.</p>	<p>No commercial value</p>

Property	Description	Particulars of Tenancy	Amount of valuations in existing state attributable to the Company as at 31st July, 2000 <i>HK\$</i>
3. No. 38 and No. 39 Warehouse with Pharmacopoeia Testing Room, China Beijing Tong Ren Tang Holdings Corporation Tong Xian Warehouse, Dong Zong Tun, Tong Zhou District, Beijing, China	<p>The subject property comprises two single storeyed warehouses and a 2-storeyed pharmacopoeia testing building which were completed between 1970 and 1994.</p> <p>The property has a total lettable area of approximately 1,400 sq.m.</p> <p>The property is currently occupied by the Company for storage and testing purposes.</p>	<p>The property is rented by the Import and Export Department of the Company for a term of 10 years and 1 day from 1st March, 1994 to 1st March, 2004 at a monthly rental of RMB5,000 exclusive security and loading/unloading charges.</p>	<p>No commercial value</p>

Property	Description	Particulars of Tenancy	Amount of valuations in existing state attributable to the Company as at 31st July, 2000 <i>HK\$</i>
4. A parcel of land together with various buildings and structures erected thereon, No. 130 Xi Zhi Men Nei Da Street, Xi Cheng District, Beijing, China	<p>The subject property comprises a parcel of land having a site area of approximately 3,842 sq.m. together with 15 various buildings and structures erected thereon.</p> <p>The buildings and structures were completed between 1969 and 1990. The total lettable area of the buildings and structures is approximately 6,617 sq.m.</p> <p>The property is currently occupied by the Company for manufacturing and extraction of Chinese medicines and other ancillary and supporting purposes.</p>	<p>The property is rented by Tongrentang Chinese Medicine Refinery of the Company for a term of 10 years from 1st January, 1997 to 31st December, 2006 at a total annual rental of RMB3,000,000 exclusive maintenance charges.</p>	No commercial value

Property	Description	Particulars of Tenancy	Amount of valuations in existing state attributable to the Company as at 31st July, 2000 <i>HK\$</i>
5. Various houses situated at the front portion of No. 130 Xi Zhi Men Nei Da Street, Xi Cheng District, Beijing, China	<p>The subject property comprises 9 various houses which were completed in approximately 1960s.</p> <p>The houses have a total lettable area of approximately 582.7 sq.m.</p> <p>The property is currently occupied by the Company for supporting purposes.</p>	<p>The property is rented by Tongrentang Chinese Medicine Refinery of the Company for an open term at a monthly rental of RMB1,560.71 exclusive maintenance charges.</p>	No commercial value

**Group II – Property interests occupied by the Company under long term leases in the PRC**

Property	Description	Particulars of Occupancy	Amount of valuations in existing state attributable to the Company as at 31st July, 2000 <i>HK\$</i>
<p>1. A parcel of land together with various buildings and structures erected thereon (also known as Tongrentang Chinese Medicine Refinery), No. 33 Yang Fang Hu Tong, Xi Cheng District, Beijing, China</p>	<p>The property comprises a parcel of land having a total of 22 various buildings and structures erected thereon. The site has an area of approximately 5,961.2 sq.m.</p> <p>The buildings and structures were completed between 1950 and 1990.</p> <p>The total built-over area of these buildings and structures is approximately 2,960.3 sq.m. and their total gross floor area is approximately 4,427.4 sq.m.</p> <p>The major buildings and structures on the site include a 2-storey (excluding the basement floor) multi-purposes building, a single-storey canteen, two single-storey warehouses and a single-storey workshop.</p>	<p>The property is currently occupied by the Company for manufacturing and extraction of Chinese medicines and other ancillary and supporting purposes.</p>	<p>No commercial value</p>

*Notes:*

1. The right to possession of the land is held by the State and the right to use the land has been granted by the State to 中國北京同仁堂集團公司 (China Beijing Tong Ren Tang Holdings Corporation) (hereinafter known as “TRTH”) through a State Owned Land Use Rights Certificate Xi Qi Guo Yong (97) Zi Di 00044 Hao dated 22nd April, 1997. According to this Certificate, the land is granted to TRTH for a term of 50 years from 22nd April, 1997. The land is restricted for industrial usage.
2. According to a Realty Title Certificate known as Jing Fang Quan Zheng Xi Gu Zi Di 00032 Hao dated 6th April, 2000, the legal occupier of the property is 北京同仁堂科技發展股份有限公司 (Tong Ren Tang Technologies Co. Ltd. (hereinafter known as the “Company”).
3. Accordingly to a Lease Agreement made between TRTH and the Company dated 6th October, 2000, the subject land was leased to the Company for a term of 20 years from 6th October, 2000 at an annual rental of RMB321,606.70 payable to TRTH and the next rent review day is on 7th October, 2002.
4. According to the advice given by the Company’s PRC legal adviser, the Company holds a limited title of the land and the buildings of the property and the Company is not allow to assign, sub-let or mortgage the land use rights of the property.
5. For information purpose, the depreciated replacement cost of the 22 various buildings and structures were RMB4,411,000 as at 31st July, 2000.
6. A detailed breakdown of gross floor area of each major building and structure is as follows:–

	<b>Gross Floor Area</b> ( <i>sq.m.</i> )
a) Single-storey canteen	113.60
b) Single-storey warehouse	531.90
c) Single-storey workshop	240.70
d) Single-storey warehouse	334.60
e) Single-storey maintenance room	130.60
f) Single-storey simple warehouse	144.30
g) 2-storey multi-purposes building	2,166.20
h) Single-storey shower room	119.50
	<hr/>
	Total : <u>3,781.40</u>

Property	Description	Particulars of Occupancy	Amount of valuations in existing state attributable to the Company as at 31st July, 2000 <i>HK\$</i>
2. A parcel of land together with various buildings and structures erected thereon (also known as Tongrentang Pharmaceutical Manufacturing No. 2 Plant), No. 20 Nan San Huan Zhong Road, Feng Tai District, Beijing, China	<p>The property comprises a parcel of land having a total of 36 various buildings and structures erected thereon. The site has an area of approximately 43,815.15 sq.m.</p> <p>The buildings and structures were completed between 1940 and 1998.</p> <p>The total built-over area of these buildings and structures is approximately 17,938.5 sq.m. and their total gross floor area is approximately 43,259.8 sq.m.</p> <p>The major buildings and structures on the site include a low-rise factory complex, a 4-storey workshop building, a 3-storey factory building, a single-storey workshop and a 4-storey warehouse.</p>	The property is currently occupied by the Company for manufacturing and extraction of Chinese medicines and other ancillary and supporting purposes.	No commercial value

*Notes:*

1. The right to possession of the land is held by the State and the right to use the land has been granted by the State to 中國北京同仁堂集團公司 (China Beijing Tong Ren Tang Holdings Corporation) (hereinafter known as "TRTH") through a State Owned Land Use Rights Certificate Fang Guo Yong (97) Zi Di 000485 Hao dated 3rd April, 1997. According to this Certificate, the land is granted to TRTH for a term of 50 years from 3rd April, 1997. The land is restricted for industrial usage.
2. According to a Realty Title Certificate known as Jing Fang Quan Zheng Feng Gu Zi Di 01115 Hao dated 23rd August, 2000, the legal occupier of the property is 北京同仁堂科技發展股份有限公司 (Tong Ren Tang Technologies Co. Ltd. (hereinafter known as the "Company").
3. Accordingly to a Lease Agreement made between TRTH and the Company dated 6th October, 2000, the subject land was leased to the Company for a term of 20 years from 6th October, 2000 at an annual rental of RMB2,363,827.30 payable to TRTH and the next rent review day is on 7th October, 2002.
4. According to the advice given by the Company's PRC legal adviser, the Company holds a limited title of the land and the buildings of the property and the Company is not allow to assign, sub-let or mortgage the land use rights of the property.
5. For information purpose, the depreciated replacement cost of the 36 various buildings and structures were RMB44,993,000 as at 31st July, 2000.
6. A detailed breakdown of gross floor area of each major building and structure is as follows:–

	<b>Gross Floor Area</b> ( <i>sq.m.</i> )
a) 4-storey Oral Tonic Drink Building	3,807.70
b) 4-storey warehouse	4,471.10
c) A low-rise factory complex	9,143.80
d) 3-storey Granule Production Building	3,206.90
e) 4-storey workshop building	4,380.40
f) Single-storey Extraction Workshop	1,177.50
g) 3-storey office building	2,035.70
h) 5-storey office building	1,661.70
i) 6-storey Science Research Building (excluding the basement floor)	3,191.10
j) 2-storey boiler room	1,004.50
k) 2-storey bicycle shelter	1,072.40
	<hr/>
Total :	<u>35,152.80</u>

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## APPENDIX IV VALUATION REPORT OF PLANT AND MACHINERY

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The following is the text of a valuation letter received from independent valuer, LCH (Asia-Pacific) Surveyors Limited, prepared for the purpose of incorporation in this prospectus, in connection with their valuation of the plant and machinery interests of the Company as at 31st July, 2000.



利駿行測量師有限公司  
**LCH (Asia-Pacific) Surveyors Limited**  
CANADA • HONG KONG • PRC • PHILIPPINES  
REGISTERED PROFESSIONAL SURVEYORS • INTANGIBLE ASSET VALUERS  
PLANT AND MACHINERY VALUERS • INTERNATIONAL PROPERTY CONSULTANTS

1506, Vicwood Plaza  
199 Des Voeux Road Central  
Hong Kong

24th October, 2000

The Directors  
Tong Ren Tang Technologies Co. Ltd.  
Unit 305-1 of District A, Level 3  
Wan Yuan Commercial Centre  
No. 10, Hong Da Bei Road  
Beijing Economic and Technology Development Zone  
Yi Zhuang, Beijing  
The People's Republic of China

Dear Sirs,

We refer to your instructions to conduct an inspection and valuation of the plant and machinery presented to us as those held by Tong Ren Tang Technologies Co. Ltd. (hereinafter referred to as the "Company"). We confirm that we have carried out inspections, made relevant enquiries and obtained such further information as we consider necessary for the purpose of providing you with our opinion of the fair market value in continued use of the subject plant and machinery as at 31st July, 2000. It is understood that this valuation letter will be used for inclusion in a prospectus for listing on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited. It forms part of our detailed valuation of the subject plant and machinery.

### **DESCRIPTION OF THE ASSETS**

The assets included in this valuation comprise various plant and machinery utilised by the Company in the manufacture of various traditional Chinese pharmaceutical products. These are described as follows:

#### **Tongrentang Pharmaceutical Manufacturing No. 2 Plant**

The factory manufactures various traditional Chinese medicines in pill form, soluble granulated drinks in sachet, oral liquid and medical ointment.

The production process starts with the cutting, crush and/or grinding of various natural raw materials, extraction of useful materials in either atmospheric or pressurised tanks, removal

of excess liquid in concentration tanks and filtration to remove non-soluble materials in the concentrate. The plant and machinery utilised comprise various crushers and grinders, mixing tanks, extraction tanks, concentration tanks and evaporators.

The concentrate is then mixed with other materials required by the prescription and bottled in the case of liquid form products such as oral liquids and syrups or processed further for solid form products. Depending on the intake form of the product, concentrates are heated and condensed to desired form.

Pills are produced using various pill making machines, coating machines, bottle filling and sealing machines and labelling machines. Soluble granulated drinks are dried using spray dryers or swing type dryers and packaged in sachet using small packet filling and sealing machines.

Other plant and machinery in the factory comprise steam generators, air compressors, various testing and laboratory equipment, air conditioners, dehumidifiers, computers and office equipment, canteen equipment, motor vehicles and construction-in-progress.

The plant and machinery were inspected at the following locations:

Tongrentang Pharmaceutical Manufacturing No. 2 Plant (“Main Factory”)  
No. 20, Nan San Huan Zhong Road  
Feng Tai District  
Beijing  
The People’s Republic of China

Rui Ge Er Dui Medicine Processing Factory (“Rui Ge Processing Factory”)  
Tai He Xiang  
Da Xing Xian  
Beijing  
The People’s Republic of China

Ping Shan Processing Factory (“Ping Shan Processing Factory”)  
Shan Dong Zhuang Cun  
Shan Dong Zhuang Zhen  
Ping Gu Xian  
Beijing  
The People’s Republic of China

#### **Tongrentang Chinese Medicine Refinery**

The factory manufactures various traditional Chinese medicines in capsule, soft capsule and tablet form.

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## **APPENDIX IV VALUATION REPORT OF PLANT AND MACHINERY**

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As in the above factory, the production process starts with the cutting, crush and/or grinding of various natural raw materials, extraction of useful materials in either atmospheric or pressurised tanks, removal of excess liquid in concentration tanks and filtration to remove non-soluble materials in the concentrate. The plant and machinery utilised comprise various crushers and grinders, mixing tanks, extraction tanks, concentration tanks and evaporators. These are generally of the same type and construction as those in the above factory.

The concentrate is then mixed with other materials required by the prescription, heated, condensed and dried to desired form. They then go to either the capsule filling machines, soft capsule making machines from Italy or rotary tablet presses. These are then packaged using bottle filling and sealing machines or aluminium foil blister packaging machines and labelling machines.

Other plant and machinery in the factory comprise steam generators, air compressors, various testing and laboratory equipment, air conditioners, dehumidifiers, computers and office equipment, canteen equipment and motor vehicles.

The plant and machinery were inspected at the following locations:

Tongrentang Chinese Medicine Refinery (“Main Factory”)

No. 130, Xi Zhi Men Nei Da Street

Xi Cheng District

Beijing

The People’s Republic of China

Tongrentang Chinese Medicine Refinery (“Yang Fang Hu Tong Factory”)

No. 33, Yang Fang Hu Tong

Xi Cheng District

Beijing

The People’s Republic of China

Tong Xian Niu Bao Tun Medicine Factory (“Tong Zhou Factory”)

Fa Tou Cun Nan

Niu Bao Tun

Tong Zhou District

Beijing

The People’s Republic of China

**Tongrentang Import and Export Branch Company**

The branch company is generally the sales and marketing office of the Company. The plant and machinery valued comprise various office furniture and equipment, computers and servers, various testing and laboratory equipment, canteen equipment and motor vehicles.

The plant and machinery were inspected at the following locations:

Tongrentang Import and Export Branch Company (“Main Office”)

East Wing

No. 5, Pei Xin Street

Chong Wen District

Beijing

The People’s Republic of China

Tongrentang Import and Export Branch Company (“Tong Xian Warehouse”)

Dong Zong Tun

Tong Zhou District

Beijing

The People’s Republic of China

Subsequent to our inspection, the plant and machinery located at the Main Office were transferred to Levels 11 and 12 of Pei Xin Hotel, No. Jie 5 Pei Xin Street, Chong Wen District, Beijing, the People’s Republic of China.

Excluded from this valuation are buildings and structures, spare parts, supplies, inventories, materials on hand and all other tangible assets that are current in nature and intangible assets that might exist.

**BASIS OF VALUATION**

Fair market value in continued use is defined as:

“the estimated amount in terms of money that may be reasonably expected for assets in exchange between a willing buyer and a willing seller with equity to both, neither being under any compulsion to sell or buy, both fully aware of all relevant facts and including installation, as of an appraisal date, and assuming that the earnings support the value reported.”

## **VALUATION METHODOLOGY**

There are three generally accepted approaches to value, namely:

### *The Cost Approach*

The cost approach considers the cost to reproduce or replace in new condition the assets appraised in accordance with current market prices for similar assets including costs of transportation, installation, commissioning and consultants' fees. Adjustment is then made for accrued depreciation from physical deterioration, condition, utility, age and functional and economic/external obsolescence.

### *The Market Approach*

The market approach considers prices recently paid for similar assets in the used market, with adjustments made to the indicated market prices to reflect condition and utility of the appraised assets relative to the market comparative.

### *The Income Approach*

The income approach is the present worth of the future economic benefits of ownership. This approach is generally applied to investment properties, general-use properties where there is an established and identifiable rental market or to an aggregation of assets in an entire business enterprise including working capital and tangible and intangible assets.

In all situations, all approaches to value must be considered, as one or more may be applicable to the subject assets. In some situations, elements of the three approaches may be combined to reach a value conclusion. However, the relative strength, applicability, and significance of the approaches and their resulting values must be analysed and reconciled.

## **VALUATION ANALYSIS**

In developing our opinion of value, we considered the income approach and concluded that it was not appropriate as we were not able to identify discrete cash flows attributable to the subject plant and machinery that constitute the facility. We considered the market approach and considered it inappropriate due to insufficient used market information in the People's Republic of China ("China"). We have therefore relied on the cost approach in arriving at our opinion of values.

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## **APPENDIX IV VALUATION REPORT OF PLANT AND MACHINERY**

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In arriving at our estimated value using the cost approach, we conducted an inspection of the subject plant and machinery to establish their condition and extent of various facilities and cost components involved. We then reviewed accounting records, construction costs and interviewed relevant engineering and accounting personnel to understand the history, maintenance and utility of the subject plant and machinery.

We then developed replacement costs by enquiry from respective suppliers, reference to recognised plant and machinery database providers in China, reference to our internal database regarding current pricing of comparable machines and indexing of historical cost information. Where current pricing from suppliers and databases were adopted, basic equipment price, duties and taxes, cost of freight, installation, commissioning and other fees were considered. In indexing historical information, we referred to statistical information from financial and mechanical database providers in China as well as country specific indices in the case of imported equipment. We identified the different cost components of an asset and used an appropriate price index in arriving as the estimated replacement cost.

The replacement cost developed above was depreciated by reference to generally accepted service lives of respective plant and machinery and adjusted to reflect their existing condition. Existing condition was based on our interview with relevant personnel and our observation during our inspection. Allowance for functional and economic obsolescence was also considered to arrive at the depreciated replacement cost which we have then taken to be the fair market value in continued use.

Construction-in-progress was valued using the reported cost incurred as of the valuation date without provision for depreciation.

### **VALUATION COMMENTS**

We have reviewed the historical accounting records, technical specifications and other documents relating to the subject plant and machinery valued. Though we have not carried out an independent investigation of the said information, we found no reason not to rely to a considerable extent on such information in arriving at our opinion of value.

This valuation is issued subject to our General Assumptions and Limiting Conditions.

For reference purposes, we have used the exchange rate of RMB1.06 per HK\$ which is the prevailing rate as at 31st July, 2000.

No deduction has been made in our valuation in respect of any outstanding amounts owed under any finance lease or hire purchase agreement. The assets have been valued as being wholly owned and free of all encumbrances. We have not investigated the titles to or any liabilities affecting the subject plant and machinery.

This valuation is concerned solely with the value of the subject plant and machinery and our opinion of value is not related to or dependent upon the earning capacity of the business. We did not attempt to arrive at the value of the Company as a total business entity.

We confirm that we have no present or contemplated future interest in the subject plant and machinery or any other interests that may prevent our having arrived at a fair and unbiased assessment of value.

#### **OPINION OF VALUE**

Based on the above, we are of the opinion that as at 31st July, 2000 the appraised fair market value in continued use of the subject plant and machinery was reasonably represented by the amount of **RMB37,971,800 (Renminbi Thirty Seven Million, Nine Hundred Seventy One Thousand, Eight Hundred Only)**. A breakdown is shown in the accompanying summary of values.

Yours faithfully,  
For and on behalf of  
**LCH (ASIA-PACIFIC) SURVEYORS LIMITED**  
**Rolando R. Arcaya** BSME, ASA  
*Director*

*Note:* Mr. Rolando R. Arcaya is a mechanical engineer and a senior accredited appraiser of the American Society of Appraisers in Machinery and Technical Specialties. He has 21 years plant and machinery valuation experience of which 11 years were spent in Hong Kong and China.

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**APPENDIX IV VALUATION REPORT OF PLANT AND MACHINERY**

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**SUMMARY OF VALUES**

<b>Description</b>	<b>Fair Market Value in Continued Use (RMB)</b>
<b>Tongrentang Pharmaceutical Manufacturing No. 2 Plant</b>	
Machinery and Equipment	
Main Factory	21,901,000
Rui Ge Processing Factory	75,700
Ping Shan Processing Factory	90,500
	<hr/>
	<i>Sub-Total:</i> 22,067,200
Computers and Office Equipment	
Main Factory	98,300
	<hr/>
	<i>Sub-Total:</i> 98,300
Motor Vehicles	
Main Factory	1,152,700
	<hr/>
	<i>Sub-Total:</i> 1,152,700
Construction-in-Progress	
Main Factory	1,800,000
	<hr/>
	<i>Sub-Total:</i> 1,800,000
	<b><i>Total:</i></b> <u><u>25,118,200</u></u>
<b>Tongrentang Chinese Medicine Refinery</b>	
Machinery and Equipment	
Main Factory	7,205,600
Yang Fang Hu Tong Factory	1,298,400
Tong Zhou Factory	1,918,200
	<hr/>
	<i>Sub-Total:</i> 10,422,200
Computers and Office Equipment	
Main Factory	304,600
Yang Fang Hu Tong Factory	300
	<hr/>
	<i>Sub-Total:</i> 304,900
Motor Vehicles	
Main Factory	668,600
	<hr/>
	<i>Sub-Total:</i> 668,600
	<b><i>Total:</i></b> <u><u>11,395,700</u></u>

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**APPENDIX IV VALUATION REPORT OF PLANT AND MACHINERY**

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<b>Description</b>	<b>Fair Market Value in Continued Use</b> <i>(RMB)</i>
<b>Tongrentang Import and Export Branch Company</b>	
Machinery and Equipment	
Main Office	43,400
Tong Xian Warehouse	137,600
	<hr/>
	<i>Sub-Total:</i> 181,000
Computers and Office Equipment	
Main Office	156,400
	<hr/>
	<i>Sub-Total:</i> 156,400
Motor Vehicles	
Main Office	1,120,500
	<hr/>
	<i>Sub-Total:</i> 1,120,500
	 <b>Total:</b> 1,457,900
	<hr/> <hr/>
	<b>Grand Total:</b> 37,971,800
	<hr/> <hr/>

This appendix sets out summaries of certain aspects of the PRC legal and judicial system, its arbitration system and its company and securities regulations. It also contains a summary of certain Hong Kong legal and regulatory provisions, including summaries of certain of the material differences between the PRC and Hong Kong company law, certain requirements of the Listing Rules and the additional provisions required by the Stock Exchange for inclusion in the articles of association of the PRC issuers.

## **1. THE PRC LAWS AND REGULATIONS**

### **(a) The PRC legal system**

The PRC legal system is based on the PRC Constitution and is made up of written laws, regulations, directives and local laws, regulations, laws of the Special Administrative Regions and international treaties entered into by China. Decided court cases do not constitute binding precedents, although they are used for the purposes of judicial reference and guidance.

The National People's Congress of the PRC (the "NPC") and the Standing Committee of the NPC are empowered by the PRC Constitution to exercise the legislative power of the State. The NPC has the power to amend the PRC Constitution and enact and amend basic laws governing the State organs, civil and criminal matters. The Standing Committee of the NPC is empowered to interpret, enact and amend laws other than those required to be enacted by the NPC.

The State Council is the highest organ of state administration and has the power to enact administrative rules and regulations. The ministries and commissions under the State Council are also vested with the power to issue orders, directives and regulations within the jurisdiction of their respective departments. All administrative rules, regulations, directives and orders promulgated by the State Council and its ministries and commissions must not conflict with the PRC Constitution and the national laws enacted by the NPC. In the event that any such conflict arises, the Standing Committee of the NPC has the power to annul such administrative rules, regulations, directives and orders.

At the regional level, the people's congresses of provinces and municipalities and their respective standing committees may enact local rules and regulations and the people's governments may promulgate administrative rules and directives applicable to their own administrative areas. These local laws and regulations cannot be in conflict with the PRC Constitution, the national laws, or the administrative rules and regulations promulgated by the State Council.

Rules, regulations or directives may be enacted or issued at the provincial or municipal level or by the State Council or its ministries and commissions in the first instance for experimental purposes. After sufficient experience has been gained, the State Council may submit legislative proposals to be considered by the NPC or the Standing Committee of the NPC for enactment at national level.

The power to interpret laws is vested by the PRC Constitution in the Standing Committee of the NPC. According to the Decision of the Standing Committee of the NPC Regarding the Strengthening of Interpretation of Laws (全國人民代表大會常務委員會關於加強法律解釋工作的決議) passed on 10 June 1981, the Supreme People's Court has the power to give general interpretation on the application of laws in judicial proceedings in addition to its power to issue specific interpretation for specific cases. The State Council and its ministries and commissions are also vested with the power to give interpretation of the rules and regulations which they have promulgated.

At the regional level, the power to give interpretations of the regional laws is vested in the regional legislative and administration organs which promulgate such laws.

All such interpretations carry legal effect.

#### **(b) Judicial system**

The people's courts are the judicial organs of the PRC. Under the PRC Constitution and the Law of Organization of the People's Courts of the PRC (中華人民共和國人民法院組織法), the people's courts are made up of the Supreme People's Court, the local people's courts, military courts and other special people's courts. The local people's courts are divided into three levels, namely, the basic people's courts, the intermediate people's courts and the higher people's courts. The basic people's courts are divided into civil, criminal, economic and administrative divisions. The intermediate people's courts have divisions similar to those of the basic people's courts and other special divisions (such as the intellectual property division), in accordance with needs. The judicial work of people's courts at lower levels is subject to the supervision of people's courts at higher levels. The people's procuratorates also have the right to exercise legal supervision over the civil proceedings of people's courts of the same level and the lower level. The Supreme People's Court is the highest judicial organ of the PRC. It supervises the administration of justice by the people's courts at all levels.

The people's courts adopt a two-tier final appeal system. A party may, before the taking effect of a judgment or order, appeal against the judgment or order of the first instance of a local people's court to the people's court at the next higher level. Judgments or orders of the second instance at the next higher level are final and binding. Judgments

or orders of the first instance of the Supreme People's Court are also final and binding. If, however, the Supreme People's Court or a people's court at a higher level finds an error in a final and binding judgment which has taken effect in any people's court at a lower level, or the presiding judge of a people's court finds an error in a final and binding judgment which has taken effect in the court over which he presides, a retrial of the case may be conducted according to the judicial supervision procedures.

The PRC civil procedures are governed by the Civil Procedure Law of the PRC (中華人民共和國民事訴訟法) (the "Civil Procedure Law") adopted on 9 April 1991 prescribes the criteria for instituting a civil action, the jurisdiction of the people's courts, the procedures to be followed for conducting a civil action, the court procedures, and the procedures for enforcement of a civil judgment or order. All parties to a civil action conducted within the PRC must comply with the Civil Procedure Law. A civil case is generally heard by a court located in the defendant's place of domicile. The jurisdiction may also be selected by express agreement by the parties to a contract provided that the people's court having the jurisdiction is located at the plaintiff's or the defendant's place of domicile, the place of execution or implementation of the contract or the object of the action but it must not violate the regulations in respect of hierarchy and jurisdiction of the courts as stated in the Civil Procedure Law. A foreign national or foreign enterprise is given the same litigation rights and obligations as a citizen or legal person of the PRC. Should a court of a foreign country limit the litigation rights of the PRC citizens and enterprises, the PRC courts shall apply the same limitations to the citizens and enterprises of that foreign country. If any party to a civil action refuses to comply with a judgment or order made by a people's court or an award made by an arbitration organ in the PRC, the aggrieved party may apply to the people's court to enforce the judgment, order or award. There are time limits imposed on the right to apply for such enforcement. If at least one of the parties to the dispute is an individual, the time limit is one year. If both parties to the dispute are legal persons or other institutions, the time limit is six months. If a person fails to satisfy a judgment which the court has granted approval to enforce within the stipulated time, the court will, upon application of either party, mandatorily enforce the judgment.

A party seeking to enforce a judgment or order of a people's court against a party who or whose property is not within the PRC may apply to a foreign court with jurisdiction over the case for recognition and enforcement of such judgment or order. A foreign judgment or ruling may also be recognised and enforced according to the PRC enforcement procedures by the people's court in accordance with the principle of reciprocity or if the PRC has entered into an international treaty with the relevant foreign country or which is acceded to by the PRC which provides for such recognition and enforcement unless the people's court considers that the recognition or enforcement of a judgment or ruling will violate the basic legal principles of the PRC or its sovereignty or security, or for reasons of social and public interest.

**(c) Arbitration and enforcement of arbitral awards**

The Arbitration Law of the People's Republic of China (中華人民共和國仲裁法) (the "Arbitration Law") was passed by the Standing Committee of the NPC on 31 August 1994 and came into effect on 1 September 1995. It is applicable to, among other matters, trade disputes involving foreign parties where the parties have entered into a written agreement to refer the matter to arbitration before an arbitration committee constituted in accordance with the Arbitration Law. Under the Arbitration Law, an arbitration committee may, before the promulgation by the PRC Arbitration Association of arbitration regulations, formulate interim arbitration rules in accordance with the Arbitration Law and the PRC Civil Procedure Law. Where the parties have by agreement provided arbitration as the method for dispute resolution, the people's court will refuse to handle the case if one party institutes legal proceedings in a people's court.

The Listing Rules and the Mandatory Provisions require an arbitration clause to be included in the articles of association of a company listed in Hong Kong and, in the case of the Listing Rules, also in a contract between the company and each director and supervisor, to the effect that whenever any dispute or claim arises from the articles of association, or from any rights or obligations conferred or imposed by the Company Law or other relevant laws and administrative regulations concerning the affairs of a company between (i) a holder of overseas listed foreign shares and the company and its directors or supervisors; or (ii) a holder of overseas listed foreign shares and the directors, supervisors, manager or other officers of the company, such parties shall submit that dispute or claim for arbitration before either the China International Economic and Trade Arbitration Commission ("CIETAC") or the Hong Kong International Arbitration Centre ("HKIAC"). If the party seeking arbitration elects to arbitrate the dispute or claim at the HKIAC, then either party may apply to have such arbitration conducted in Shenzhen according to the securities arbitration rules of the HKIAC. CIETAC is a foreign affairs arbitration organ in the PRC. CIETAC is located in Beijing with branch offices in Shenzhen and Shanghai.

Under the Arbitration Law and the PRC Civil Procedure Law, an arbitral award is final and binding on the parties. If a party fails to comply with an award, the other party to the award may apply to the people's court for enforcement. A people's court may refuse to enforce an arbitral award made by an arbitration commission if there is any procedural or membership irregularity specified by law or the award exceeds the scope of the arbitration agreement or is outside the jurisdiction of the arbitration commission.

A party seeking to enforce an arbitral award of a foreign affairs arbitration organ of the PRC against a party who or whose property, is not within the PRC, may apply to a foreign court with jurisdiction over the case for enforcement. Similarly, an arbitral award

made by a foreign arbitration body may be recognised and enforced by the PRC courts in accordance with the principles of reciprocity or any international treaty concluded or acceded to by the PRC. The PRC acceded to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the “New York Convention”) adopted on 10 June 1958 pursuant to a resolution of the Standing Committee of the NPC passed on 2 December 1986. The New York Convention provides that all arbitral awards made in a state which is a party to the New York Convention shall be recognised and enforced by other parties to the New York Convention, subject to their right to refuse enforcement under certain circumstances, including where the enforcement of the arbitral award is against the public policy of the State to which the application for enforcement is made. It was declared by the Standing Committee of the NPC simultaneously with the accession of the PRC that (i) the PRC will only recognize and enforce foreign arbitral awards on the principle of reciprocity; and (ii) the PRC will only apply the New York Convention in disputes considered under the PRC laws to arise from contractual and non-contractual mercantile legal relations.

**(d) Taxation**

*(a) Taxes applicable to joint stock limited companies*

1. Taxation of joint stock limited companies

(1) Income tax

According to the Provisional Regulations of Income Tax for Domestic Companies (中華人民共和國企業所得稅暫行條例) effective in January 1994 and stipulated by the State Council, all the Chinese companies, including State-owned companies, collective enterprises, private enterprises, joint stock limited companies and other companies (excluding joint ventures and foreign companies) are required to pay income tax at a rate of 33 per cent. on taxable income derived from their production of goods and business activities.

However, income taxes could be reduced pursuant to any promulgations of new regulations by the State Council.

## (2) Value Added Tax (“VAT”)

Both the Provisional Rules of the People’s Republic of China on VAT (中華人民共和國增值稅暫行條例) and the Details Rules for the Implementation of the Provisional Rules of the People’s Republic of China on VAT (中華人民共和國增值稅暫行條例實施細則) (effective from 1 January 1994) stipulate that all units or individuals who are engaged in the sale of goods, the provision of processing, repairs and replacement services, and the importation of goods within the territory of the PRC are required to pay VAT. “General tax payers”, as certified by local tax bureaus, are generally required to pay the basic rate of VAT at 17 per cent. “Small scale tax payers”, as certified by local tax bureaus, are required to pay 6 per cent. VAT.

## (3) Business tax

Both the Provisional Rules of the People’s Republic of China on Business Tax (中華人民共和國營業稅暫行條例) effective on 1 January 1994 and the Details Rules for the Implementation of the Provisional Rules of the People’s Republic of China on Business Tax (中華人民共和國營業稅暫行條例實施細則) effective on 25 January 1993, stipulate that all units and individuals engaged in the provision of taxable labor services, the assignment of intangible assets or sale of immovable properties, within the territory of the PRC, are required to pay 3 per cent. to 20 per cent. business tax on their gross business turnover.

*(b) Taxation of shareholders*

## (i) Tax on dividends

On 21 July 1993 the State Tax Bureau, by a notice (the “Notice Relating to Taxes Applicable to Foreign Enterprises and Foreign Nationals in Relation to Dividends and Gains obtained from the Holding and Transferring of Shares”) (國家稅務局關於外商投資企業、外國企業和外籍個人取得股票(股權)轉讓收益和股息所得稅收問題的通知) (the “Tax Notice”) confirmed that dividends received by foreign investors from the PRC listed domestic shares, and overseas listed shares such as H shares (H shares are shares issued by Chinese companies outside China and denominated in a foreign currency), were exempted from withholding tax, which would otherwise have been applicable at a rate of 20 per cent..

On 31 October 1993, the Amendments to the Income Tax Law Applicable to Individuals of the PRC (關於修改《中華人民共和國所得稅法》的決定) (the “Amendments”) were promulgated taking effect from 1 January 1994. The Amendments stipulate that all previously announced taxation laws and regulations which contradict the Amendments shall be invalid. Under the Amendments, any foreign national who is not a resident of the PRC will be subject to a withholding tax on dividends received from H shares at a rate of 20 per cent. On 26 July 1994, the State Tax Bureau issued the 關於外籍個人持有中國境內外上市公司股票所取得的股息有關稅收問題的通知 (the “Notice”) under which dividends or other distributions received by foreign individuals who hold overseas shares (including H shares) and/or domestic listed foreign shares from a PRC listed company are, for the time being, exempted from individual income tax.

Accordingly, under current PRC laws and regulations, no withholding tax is payable in respect of dividends or other distributions on H shares held by any foreign enterprise or foreign national. If, however, the Tax Notice and the Notice are withdrawn, a 20 per cent. withholding tax may be applied on such dividends or distributions, subject to any tax reductions pursuant to an applicable double taxation avoidance treaty.

(ii) Tax on the transfer of shares

Although the Implementing Rules of Individual Income Tax Law of the PRC (中華人民共和國個人所得稅法實施條例) (the “Implementing Rules”), issued on 28 January 1994, stipulated that gains realized on the sale of equity securities by an individual are subject to income tax at the rate of 20 per cent. and empower the Ministry of Finance to draft detailed rules on the mechanisms of collecting such tax, the Tax Notice exempted holders of H shares from capital gains tax on the disposal of H shares. On 20 June 1994, the Ministry of Finance and the State Tax Bureau jointly issued the Notice on the Temporary Non-Levy of Individual Income Tax on Gains from Share Transfers (關於股票轉讓暫不徵收個人所得稅的通知), exempting individuals from the payment of income tax on gains from the transfer of shares for the years 1994 and 1995. On 9 February 1996, the Ministry of Finance and the State Tax Bureau jointly issued the Notice on the Temporary Non-Levy of Individual Income Tax on Gains from Share Transfers for 1996 (關於股票轉讓暫不徵收個人所得稅的通知), exempting individuals from the payment of tax on gains from the transfer of shares for the year of 1996. On 30 March 1998, the Ministry of Finance and the State Tax Bureau jointly issued the Notice on the Non-levy of Individual Income Tax on Gains from Share Transfers (關於個人轉讓股票所得繼續暫免徵收個人所得稅之通知), exempting individuals from the payment of tax on gains from the transfer of shares since 1997.

The exemption enjoyed by a foreign enterprise under the Tax Notice is not affected by the Implementing Rules and continues to apply.

(iii) Tax treaties

In the event that withholding tax is payable as referred to in (i) or (ii) above, foreign enterprises without an establishment or office in the PRC and non-PRC individual investors residing in countries which have entered into the avoidance of double-taxation treaties with the PRC may be entitled to a reduction of withholding tax imposed on the payment of dividends to such investors. The PRC is currently a party to the avoidance of double taxation treaties with a number of countries, including Australia, Canada, France, Germany, Japan, Malaysia, the Netherlands, Singapore, the United Kingdom and the U.S..

(iv) Stamp duty

By virtue of the Interim Regulations Concerning Taxation Issues for Joint Stock Trial Enterprises (關於股份制試點企業稅收問題的暫行規定) and the Interim Regulations of the PRC Concerning Stamp Duty (關華人民共和國印花稅暫行規定) taking effect on 1 October 1988, PRC stamp duty is imposed on the transfer of the PRC listed domestic shares. However, H shares which are transferred outside the PRC are exempted from the payment of the PRC stamp duty.

(v) Estate, inheritance or gift tax

The PRC does not currently have any estate, inheritance or gift tax.

**(e) Foreign exchange control**

Major reforms have been introduced to the foreign exchange control system of the PRC since 1993.

On 28 December 1993, the People's Bank of China ("PBOC"), with the authorization of the State Council, issued the Notice on Further Reform of the Foreign Exchange Control System (中國人民銀行關於進一步改革外匯管理體制的公告) which came into effect on 1 January 1994. Other main regulations and implementation measures include the PRC Foreign Exchange Control regulations (中華人民共和國外匯管理條例) effective on 1 April 1996 and promulgated by the State Council on 29 January 1996 and the Regulations on the Foreign Exchange Settlement, Sale and Payments (結匯、售

滙及付滙管理規定) which were promulgated by PBOC on 20 June 1996 and took effect on 1 July 1996 and which contain detailed provisions regulating the settlement, sale and payment of foreign exchange by domestic enterprises, individuals, economic organizations and social organizations in the PRC.

Under such new regulations, the previous dual exchange rate system for Renminbi was abolished and a unified floating exchange rate system, based largely on supply and demand, was introduced. The PBOC publishes, on each business day, the Renminbi exchange rate against other major foreign currencies. Such rate is to be set by reference to the Renminbi/major foreign currencies trading price on the previous day on the inter-bank foreign exchange market.

In general, all organizations and individuals within the PRC, including foreign invested enterprises, are required to remit their foreign exchange earnings to the PRC. In relation to the PRC enterprises, their recurrent foreign exchange earnings are generally required to be sold to designated banks unless specifically approved otherwise. Foreign-invested enterprises, on the other hand, are permitted to retain certain percentage of their recurrent foreign exchange earnings and the sums retained may be deposited into foreign exchange bank accounts maintained with designated banks. Capital foreign exchange must be deposited into foreign exchange bank accounts maintained with designated banks and can generally be retained in such accounts.

At present, control on the purchase of foreign exchange is being relaxed. Enterprises which require foreign exchange for their recurrent activities such as trading activities and payment of staff remuneration may purchase foreign exchange from designated banks, subject to the production of relevant supporting documents.

In addition, where an enterprise requires any foreign exchange for the payment of dividends that are payable in foreign currencies under applicable regulations, such as the distribution of profits by a foreign invested enterprise to its foreign investment party, then, subject to the due payment of tax on such dividends, the amount required may be withdrawn from funds in foreign exchange accounts maintained with designated banks, and where the amount of the funds in foreign exchange is insufficient, the enterprise may purchase additional foreign exchange from designated banks upon the presentation of the resolutions of the directors on the profit distribution plan of that enterprise.

Despite the relaxation of foreign exchange control over current account transactions, the approval of the SAFE is still required before an enterprise may borrow a loan in foreign currency or provide any foreign exchange guarantee or to make any investment outside of the PRC or to enter into any other capital account transaction which involves the purchase of foreign exchange.

When conducting actual foreign exchange transactions, the designated banks may, based on the exchange rate published by the PBOC and subject to certain limits, freely determine the applicable exchange rate.

Foreign exchange quota entitlements brought forward under the old system will be gradually phased out, and the holders of these entitlements will be permitted to use their remaining quotas to purchase foreign exchange through swap centres within a prescribed period.

**(f) Company law**

On 29 December 1993, the Standing Committee of the NPC promulgated the Company Law (中華人民共和國公司法) which came into effect on 1 July 1994. Before implementation of the Company Law, the formation and regulation of joint stock limited companies were governed by the Standard Opinion for Joint Stock Companies (關於股份有限公司的規範意見) (the “Standard Opinion”) promulgated by the State Restructuring Commission on 15 May 1992. The Standard Opinion was superseded by the Company Law. The legal status of joint stock limited companies established pursuant to the Standard Opinion is preserved and these companies are required to conform to the provisions of the Company Law and apply for re-registration before 31 December 1996. The Overseas Listing Special Regulations (境外上市的特別規定) were passed by the State Council on 4 August 1994 pursuant to Articles 85 and 155 of the Company Law. On 27 August 1994, the Mandatory Provisions, which must be incorporated in the articles of association of all the PRC joint stock limited companies to be listed overseas, were jointly promulgated by the Securities Committee and the State Restructuring Commission.

Set out below is a summary of the provisions of the Company Law, the Overseas Listing Special Regulations and the Mandatory Provisions:

*(i) General*

The Company Law governs two types of companies, namely companies incorporated in the PRC with limited liability and companies incorporated in the PRC as joint stock limited companies. Both types of companies have the status of an enterprise legal person.

The liability of shareholders of a limited liability company is limited to the extent of the amount of capital contributed by them and the company is liable to its creditors to the full amount of the assets owned by it. A joint stock limited company is a company having a registered share capital divided into shares of equal par value. The liability of its shareholders is limited to the extent of the amount of shares subscribed by them and the company is liable to its creditors to the full amount of all the assets owned by it.

A company may invest in other limited liability companies and joint stock limited companies. Apart from investment companies and holding companies authorized by the State Council, the amount of a company's aggregate investment in other joint stock limited companies and limited liability companies may not exceed 50 per cent. of its net assets. The Mandatory Provisions provide that a company may, subject to the approval of the company's supervisory department authorized by the State Council, operate as a holding company.

*(ii) Incorporation*

Under the Company Law, a joint stock limited company may be incorporated by either the promotion method or public issue.

The method of promotion means that for the purpose of establishing a joint stock limited company, all the shares to be issued by the company shall be subscribed by the promoters. Where a company is established by means of public issue, not less than 35 per cent. of the shares to be issued by the company shall be subscribed by its promoters and the remaining shares to be issued shall be offered to the public for subscription.

The establishment of a joint stock limited company requires a minimum of five promoters with at least half of the promoters having a residence within the PRC. The establishment of a limited liability company, as opposed to a joint stock limited company, requires a minimum of two and a maximum of fifty shareholders. A State-owned enterprise which is to be restructured into a joint stock limited company by the public issue method may have less than five promoters.

Under the Overseas Listing Special Regulations, a State-owned enterprise or an enterprise with the majority of its assets owned by the State can be restructured in accordance with the relevant regulations to become a joint stock limited company and may offer shares for subscription to overseas investors. If such a company is to be established by the promotion method, it may have less than five promoters and the company may issue H shares once incorporated.

*(iii) Procedures for establishment of companies*

The establishment of a joint stock limited company must be approved by the relevant governmental departments authorized by the State Council or by the relevant provincial people's government.

Where a company is established by the promotion method, the promoters shall pay for their shares in full immediately after they have completed their written subscriptions for the shares to be issued in accordance with the articles of association of the company. For shares to be issued through contributions of industrial property, non-patented technology and land use rights, the legal procedures for transferring these property rights shall be carried out in accordance with the law. When all subscription payments by the promoters have been made, the promoters shall elect the board of directors and the members of the supervisory committee. The board of directors of the company shall submit the supporting documents, such as the approval documents for the establishment of the company, its articles of association and the capital verification certificate, to the Administration of Industry and Commerce Bureau for registration of the company.

Where a company is established by the public issue method, the value of the shares to be issued through contribution of industrial property rights and non-patented technology shall not exceed twenty (20) per cent. of the registered capital of the company. Where a State-owned enterprise is converted into a joint stock limited company, the State assets shall not be under-valued in exchange for shares, be sold at prices below the prevailing market price, or be allocated to any person without consideration. The promoters must submit to the relevant securities administration authority of the State Council an application for public issue together with other supporting documents including, among others, (i) the draft articles of association; (ii) the prospectus; (iii) the particulars of receiving banker; (iv) the name of underwriters and the Underwriting and Placing Agreement; (v) the approval document for the establishment of the company; (vi) the names of the promoters, the number of shares subscribed for by the promoters, the investment made and the capital verification certificate; and (vii) a business forecast report. The promoters may proceed with the public offering of shares only after the approval of the relevant securities administration authority has been obtained.

An inaugural meeting of the company shall be convened by the promoters within 30 days after the shares have been paid up in full. Matters required to be transacted at the inaugural meeting include, among others, the adoption of the company's articles of association, the election of the members of the board of directors, the election of members of the supervisory committee and the review of the value attributed to the assets injected by the promoters into the company in return for its shares. The board of directors of the company is required to submit the requisite documents of the company to the Administration of Industry and Commerce Bureau for registration within 30 days after the inaugural meeting.

The date of establishment of a company is the day when its business licence is issued by the Administration of Industry and Commerce Bureau. A joint stock limited company established by means of public issue shall after its establishment, report to the relevant securities administration authority of the State Council on its share subscription for record.

*(iv) Responsibilities of promoters*

Under the Company Law, the promoters of a company are liable for:

- (1) joint liabilities for payment of expenses and liabilities incurred in connection with the establishment of the company in the event of the company being established;
- (2) joint liabilities for repayment of the subscription monies to the subscribers together with interest at bank rate for savings deposit for the same period of time, in the event of the company not being established; and
- (3) damages to the company for losses suffered by the company as a result of the default of the promoters in the course of the establishment of the company.

According to the Provisional Regulations Concerning the Issue and Trading of Shares (股票發行與交易管理暫行條例) (the “Provisional Regulations”) promulgated by the State Council on 22 April 1993, the promoters of a company are required to assume joint and several responsibility for the accuracy of the contents of the prospectus and to ensure that the prospectus does not contain any misleading statement or omit any material information.

*(v) Shares*

*(aa) Registered capital*

The registered capital of a company is the total amount of paid-up capital of the company registered with the Administration of Industry and Commerce Bureau. The minimum amount of registered capital of a joint stock limited company is RMB10,000,000. A company, the shares of which are authorized by the relevant securities administration authority to list on a stock exchange, must have a registered capital of not less than RMB50,000,000. The registered capital of a company shall be divided into shares of equal par value.

(bb) Allotment and issue of shares

The issue of shares must be based on the principles of transparency, equality and fairness. The same class of shares must carry equal rights. Where shares are issued at the same time, the terms (including the subscription price) of allotment of each share must be identical to the others of the same class. Any entity or individual subscribing for shares in a joint stock limited company shall pay the same price for each share.

Shares may be issued at par or at a premium but may not be issued below the par value. Shares to be issued as a premium shall require the approval of the securities administration authority of the State Council.

The premiums generated from issuing shares at a premium shall be allocated to the capital accumulation fund of the company.

(cc) Registered or bearer shares

Shares may be issued in registered form or bearer form. Shares issued by the company to promoters, State-designated investment institutions or legal persons shall be in registered form and shall state the name of the promoters, State-authorized investment institutions or legal persons. Such shares may not be registered under any other name, or under the name of a nominee. Shares issued to the public may be either registered or bearer shares. The Overseas Listing Special Regulations and the Mandatory Provisions provide that shares issued to foreign investors and listed overseas shall be issued in registered form, denominated in Renminbi and subscribed for in foreign currency.

Under the Overseas Listing Special Regulations and the Mandatory Provisions, shares issued to foreign investors, including investors from the territories of Hong Kong, Macau and Taiwan and listed overseas are known as “overseas listed foreign shares”, and those shares issued to investors within the PRC other than the territories specified above are known as “domestic shares”.

The State Council is empowered to prescribe detailed measures in connection with any offer of shares. A joint stock limited company may offer its shares to the overseas public with the approval of the securities administration department of the State Council. In addition to providing for the number of shares to be underwritten, an Underwriting and Placing Agreement may, subject to the prior approval of the Securities Committee, make provisions to set aside

up to 15 per cent. of the overseas listed foreign shares in the Underwriting and Placing Agreement as part of the total number of shares to be offered under the Overseas Listing Special Regulations.

A register of shareholders shall be maintained by the company in respect of shares issued in registered form. Information such as the names and addresses of shareholders, number of shares held by each shareholder and the dates on which the shareholders became holders of the relevant shares is required to be entered into the register.

Where bearer shares are issued, the company shall keep a record of the amount of bearer shares issued, the number designated to each bearer share and the date of issue of each bearer share.

*(vi) Increase of share capital*

Under the Company Law, a joint stock limited company may increase its share capital by means of an issue of H shares subject to the following:

- (1) share subscription for the previous issue must have been paid in full and at least one year has elapsed since the date of the immediately preceding share issue. However, under the Overseas Listing Special Regulations, if the company increases its capital by way of an issue of overseas listed foreign shares, the time period elapsed since the last share issue may be less than 12 months;
- (2) the company must have made profits for the immediately three preceding years and its distributable profits must have been sufficient to pay dividends;
- (3) the financial and accounting statements of the company in the immediately three preceding years must not have contained any false information; and
- (4) the forecast dividend yield of the company shall exceed the interest rate of bank for savings deposit for the same period.

An issue of shares shall be approved by shareholders in general meeting. After the shareholders' approval has been obtained, the board of directors of the company shall also obtain the approval of the departments authorized by the State Council or that of the provincial people's government. If a company issues shares by way of an offer to the public, the approval of the relevant securities administration authority of

the State Council will also have to be obtained. Upon completion of the subscription of H shares, the company must register the increase in its registered capital with the Administration of Industry and Commerce Bureau and issue a public notice.

*(vii) Reduction of share capital*

Subject to the minimum registered capital requirements, a joint stock limited company may reduce its registered capital in accordance with the following procedures prescribed:

- (1) the company shall prepare a balance sheet and a detailed inventory of its assets;
- (2) the reduction of registered capital must be approved by shareholders in general meeting;
- (3) the company shall inform its creditors of the intended reduction in capital within 10 days and publish a public announcement of the intended reduction in a newspaper at least three times within 30 days after the resolution approving the reduction has been passed;
- (4) the creditors of the company are entitled within the statutory prescribed time limit require the company to pay its debts or provide guarantees covering the debts within 30 days from the date the creditor receives the notice or, where the notice has not been received, within 90 days after the date on which the public announcement is made; and
- (5) the company must apply to the Administration of Industry and Commerce Bureau for registration of the reduction in registered capital.

*(viii) Repurchase of shares*

A company may not purchase its own shares except in cases where a company effects a cancellation of shares due to a reduction in registered share capital or a merger with another company which holds shares in the company or such other purpose permitted by law and administrative regulations. The Mandatory Provisions provide that, upon obtaining the necessary approvals in accordance with the articles of association of a company and that of the relevant supervisory authorities, the company may repurchase its issued shares for the foregoing purposes by way of a general offer to the shareholders of the company or purchase on a stock exchange or by way of an off market contract.

Under the Company Law, within 10 days following a repurchase of a company's own shares, a company must, in accordance with the applicable law and administrative regulations, cancel the portion of the shares repurchased, register the change of its capital and issue a public announcement thereafter.

*(ix) Transfer of shares*

Shares may be transferred in accordance with the relevant law and regulations.

A shareholder may only effect a transfer of its shares on a stock exchange established in accordance with law. Registered shares may be transferred either by endorsement by the shareholders or by such other method specified by the applicable law and administrative regulations.

Promoters shall not transfer their shares in a company within three years after the establishment of the company. Directors, supervisors and the manager of a company shall not transfer their shares in the company during their term of office with the company and shall declare their shareholdings to the company.

There is no restriction under the Company Law as to the percentage shareholding of a single shareholder of a company.

*(x) Shareholders*

Under the Company Law and the Mandatory Provisions, the rights of a shareholder include the rights to:

- (1) attend and vote in person or to appoint a proxy to attend and vote on his behalf at general meetings of the company;
- (2) inspect the articles of association of the company, the minutes of shareholders' meetings and the financial report of the company and to put forward propositions and enquiries relating to the operation of the company;
- (3) transfer the shares held by it in accordance with law on a stock exchange established in accordance with the relevant laws;
- (4) receive the surplus assets of the company in its winding up in proportion to its shareholding; and.

- (5) may initiate legal proceedings in the people's court if a resolution passed at a shareholders' meeting or directors' meeting has infringed the law or administrative regulations or the legitimate interests of the shareholders.

A shareholder is liable to the company to the extent of the amount of shares he subscribed for.

A shareholder may enjoy such other rights and is required to assume such other obligations as specified in the company's articles of association.

*(xi) Shareholders' general meetings*

(aa) Powers of shareholders in general meeting

The shareholders' general meeting is the organ of authority of the company and may exercise the following powers:

- (1) to determine the company's business policies and investment plans;
- (2) to elect or remove directors and supervisors who are the representatives of shareholders and to fix the remuneration and to decide upon such related matters relating to directors and supervisors;
- (3) to consider and approve the reports of board of directors and the supervisory committee;
- (4) to consider and approve the company's annual financial budget and accounting plans;
- (5) to consider and approve the profit distribution plan and plans for recovery of losses;
- (6) to approve the increase or reduction in the registered share capital of the company;
- (7) to approve the issue of debentures by the company;
- (8) to approve the merger, demerger, dissolution and liquidation of the company; and
- (9) to approve amendments to the company's articles of association.

(bb) Annual general meetings and extraordinary shareholders' general meetings

Shareholders' general meetings are divided into annual general meetings and extraordinary shareholders' general meetings. Annual general meetings must be held once every year. Extraordinary shareholders' general meetings are general meetings other than annual general meetings and shall be convened within two months after the occurrence of any of the following circumstances:

- (1) the number of directors is less than two thirds of the number required under the Company Law or the company's articles of association;
- (2) the company's accumulated losses amount to one-third of its total paid up capital;
- (3) upon requisition by holders of not less than 10 per cent. of the shares of the company; or
- (4) the board of directors or the supervisory committee considers such a meeting necessary.

(cc) Proceedings of shareholders' general meetings

A shareholders' general meeting shall be convened by the board of directors in accordance with the Company Law and presided over by the chairman of the board of directors. Notice of shareholders' meeting shall be given not less than 30 days before the date of such meeting. A company which has bearer shares in issue shall make a public announcement of the shareholders' general meeting at least 45 days prior to the meeting being held. Under the Overseas Listing Special Regulations and the Mandatory Provisions, 45 days' notice of a shareholders' general meeting is required to be given to shareholders specifying the matters to be considered at and the date and place of the meeting.

Under the Overseas Listing Special Regulations and the Mandatory Provisions, shareholders who intend to attend a shareholders' general meeting are required to provide the company with a written confirmation of their attendance 20 days prior to the meeting. Shareholders holding 5 per cent. or more of the voting rights of a company are entitled, under the Overseas Listing Special Regulations, to propose to the company, in writing, new resolutions to be considered at an annual general meeting and the company shall include any proposed resolutions which are within the powers of a shareholders' general meeting in the agenda of that meeting.

The Company Law does not specify any quorum requirement for a general meeting. The Overseas Listing Special Regulations and the Mandatory Provisions provide that a shareholders' general meeting may be held if shareholders holding 50 per cent. or more of the voting rights of a company have replied in writing 20 days prior to the proposed date of the meeting that they intend to attend the meeting. In the event that the 50 per cent. level is not attained, a shareholders' general meeting may be held if the company shall within 5 days after the last day for receipt of the replies notify shareholders by public announcement of the matters to be considered at and the place and date of the meeting.

Each shareholder present at a shareholders' general meeting is entitled to one vote for every share held. A shareholder may appoint a proxy to attend and vote on his behalf at a shareholders' general meeting. Ordinary resolutions proposed at a shareholders' general meeting must be passed by more than half of the votes cast by shareholders present in person or by proxy at the meeting. Resolutions on: (i) amendments to the company's articles of association; (ii) the merger, division or dissolution of the company; (iii) the increase and reduction of capital of and the issue of any class of shares, bonds and securities by the company; and (iv) other matters which the shareholders' general meeting has resolved by way of ordinary resolution as having a potentially material effect on the company and should be approved by special resolution of more than two-thirds of the votes so cast.

The Mandatory Provisions require class meetings to be held in the event of a variation or abrogation of the class rights of a class of shareholders. Holders of domestic shares and holders of overseas listed foreign shares are deemed to be different classes of shareholders.

*(xii) Directors*

(aa) Board of directors

The board of directors of a joint stock limited company shall comprise between 5 and 19 directors. The term of office of a director shall be prescribed by the company's articles of association but shall not exceed three years. A director may serve consecutive terms if re-elected. The board of directors of a company may exercise the following powers:

- (1) to convene shareholders' meetings and to report on its work to the shareholders;
- (2) to implement resolutions passed by shareholders in general meetings;
- (3) to formulate on the company's business plans and investment plans;
- (4) to formulate the company's annual budgets and accounts;
- (5) to formulate profit distribution plans and plans for recovery of losses;
- (6) to formulate plans for the increase or decrease in registered capital and plans for issue of debentures;
- (7) to formulate plans for the merger, division or dissolution of the company;
- (8) to decide on the internal management structure of the company;
- (9) to appoint or dismiss the manager, and at the recommendation of the manager, employ or dismiss deputy managers and financial controllers and to fix their remuneration; and
- (10) to formulate the management control system of the company.

In addition, the Mandatory Provisions provide that the board of directors is also responsible for formulating proposals for amending the articles of association of the company.

(bb) Board meetings

Regular meetings of the board of directors of a company shall be held at least twice every year. Notice of regular board meetings shall be given at least 10 days before the date of the meeting. Notices of any other extraordinary board meetings shall be given in such manner and for such notice period as may be determined by the board of directors.

A quorum for a board meeting shall be constituted by more than half of the directors. A director may attend a board meeting personally or may authorize in writing another director as his representative to attend on his behalf. The power of attorney shall define the scope of the representative's authority. All board

resolutions must be passed by the affirmative votes of more than half of the directors. All resolutions passed at a board meeting shall be recorded in the minutes of the relevant meeting and the minutes shall be signed by the directors who attended the meeting and the person who recorded the minutes.

If any board resolution contravenes any applicable laws and regulations or the company's articles of association and results in substantial damages to the company, any director who participated in passing the resolution (except those who voted against the resolution and whose dissenting vote is recorded in the relevant minutes) shall be personally liable to the company.

(cc) Chairman of the board of directors

The board of directors shall appoint a chairman. The appointment of the chairman shall be approved by more than half of the directors. The chairman is the legal representative of the company and may exercise the following powers:

- (1) to preside over shareholders' meetings and convene and preside over meetings of the board of directors;
- (2) to examine the implementation of resolutions of the board of directors; and
- (3) to sign the share certificates and debentures issued by the company.

(dd) Qualification of directors

The Company Law provides that the following persons are not eligible to act as directors:

- (1) a person who has no civil capacity or has a restricted civil capacity;
- (2) a person who has been convicted of offences relating to bribery, corruption, misappropriation of property, or the sabotage of social economic order, where less than five years have elapsed since the date of completion of the sentence; or a person who has been deprived of his political rights where less than five years have elapsed since completion of such deprivation;

- (3) a person who is a former director, factory manager or manager of a company or enterprise which has become bankrupt or has been liquidated due to mismanagement and who is personally liable for the bankruptcy or liquidation of such company or enterprise, where less than three years have elapsed since the date of the completion of the liquidation of the company or enterprise;
- (4) a person who has been a legal representative of a company or enterprise the business licence of which has been revoked due to unlawful operation by the company or enterprise and the person is personally responsible for such revocation, where less than three years has elapsed since the date of such revocation;
- (5) a person who is liable for a relatively large amount of debt which has not been repaid when due; or
- (6) a person who is a State civil servant.

Other circumstances under which a person is disqualified from acting as a director of a company are set out in the articles of association and the Mandatory Provisions.

*(xiii) Supervisory committee*

A company is required to establish a supervisory committee comprising not less than three members. The supervisory committee is responsible for:

- (1) examining the financial matters of the company;
- (2) supervising the directors and manager of the company to ensure that they carry out their duties in compliance with the relevant laws and regulations and the company's articles of association;
- (3) requiring the directors and manager to rectify any action which adversely affects the interests of the company;
- (4) proposing the convening of extraordinary shareholders' general meetings; and
- (5) carrying out other duties specified in the company's articles of association.

A supervisor is also required to attend board meetings.

Under the Supplemental Amendments, resolutions of a supervisory committee are required to be passed by the affirmative votes of two thirds or more of the supervisors.

Members of the supervisory committee shall comprise representatives elected by the workers of the company and representatives elected by shareholders in general meeting in an appropriate proportion specified in the company's articles of association. A director, manager or financial controller of the company cannot become a supervisor. The term of office of a supervisor is three years and a supervisor may serve consecutive terms if re-elected. The circumstances under which a person is disqualified from acting as a director of a company under the Company Law and the Mandatory Provisions apply equally to a supervisor of the company.

*(xiv) Manager and officers*

The company shall have a manager who shall be appointed or removed by the board of directors. The manager is accountable to the board of directors and may exercise the following powers:

- (1) to supervise the production, business and administration of the company and to organize the implementation of resolutions of the board of directors;
- (2) to organize the implementation of the company's business and investment plans;
- (3) to formulate plans for the establishment of the company's internal management structure;
- (4) to formulate the basic administration system of the company;
- (5) to formulate the company's internal rules;
- (6) to recommend the appointment and dismissal of deputy managers and the financial controller and appoint or dismiss other administration officers (other than those required to be appointed or dismissed by the board of directors);

- (7) to attend board meetings; and
- (8) other powers conferred by the board of directors or the company's articles of association.

The Overseas Listing Special Regulations provide that the officers of a company shall include its financial controller, company secretary and other executives specified in the company's articles of association.

The circumstances under which a person is disqualified from acting as a director of a company under the Company Law and the Mandatory Provisions apply equally to managers and officers of the company.

*(xv) Duties of directors, supervisors, managers and officers*

A director, supervisor, manager and an officer of a company are required under the Company Law to comply with the relevant laws, regulations and the company's articles of association, carry out their duties honestly, and protect the interests of the company. The Overseas Listing Special Regulations and the Mandatory Provisions provide that a director, a supervisor, a manager or an officer of a company owes fiduciary duties to the company and is required to perform its duties faithfully, protect the interests of the company and not to make use of its positions in the company for its own benefit. A director, supervisor, manager and an officer of a company is also under a duty of confidentiality to the company and is prohibited from divulging the secret information of the company save as permitted by the relevant law and regulations or by the shareholders.

A director, supervisor, manager or an officer who contravenes any law, regulation or the company's articles of association in the performance of his duties which resulted in any loss to the company shall be personally liable to the company.

*(xvi) Finance and accounting*

A company is required to establish a financial and accounting system in accordance with the relevant laws and regulations as well as rules stipulated by the Ministry of Finance and the State Council.

A company is required to prepare its financial statements at the end of each financial year, comprising its balance sheet, profit and loss account, a statement on financial status and changes of financial status and a profit distribution statement. The financial statements shall be made available for inspection by the shareholders of the joint stock limited company at least 20 days prior to the annual general meeting of the company. A joint stock limited company established by the public subscription method must publish its financial statements by way of public announcement.

A company is required to make the following transfers from its after tax profit before distributing its profits to the shareholders of the company:

- (1) 10 per cent. of its after tax profit to the statutory common reserve of the company provided that no further transfer is required to be made if the accumulated statutory common reserve exceeds/reaches 50 per cent. of the registered capital of the company;
- (2) between 5 per cent. and 10 per cent. of its after tax profit to the statutory public welfare fund;
- (3) subject to the shareholders' approval in shareholders' general meeting and after transfer of the requisite amount to the statutory common reserve, the amount from the after tax profit of the company to the discretionary common reserve; and
- (4) any balance of the after tax profit after making up losses and transfers to the common reserve and statutory public welfare fund shall be distributed to the shareholders in proportion to their respective shareholdings in the company.

When a company's statutory common reserve is insufficient to make up for the company's losses for the previous year, the profits of the company for the current year shall be applied to make up such losses before making allocations in accordance with the foregoing requirements to the statutory common reserve and the statutory public welfare fund.

The common reserve of a joint stock limited company comprises the statutory common reserve, discretionary common reserve and the capital common reserve.

The capital common reserve of a company is made up of the premium over the nominal value of the shares of the company and other amounts required by the relevant governmental financial authority are to be treated as the capital common reserve.

The common reserve of a company shall be applied for the following purposes:

- (1) to make up the company's losses;
- (2) to expand the business operations of the company; and
- (3) to pay up the registered share capital of the company by the issue of H shares to shareholders in proportion to their existing shareholdings in the company or by increasing the par value of the shares currently held by the shareholders, provided that if the statutory common reserve is converted into registered capital, the balance of the statutory common reserve after such conversion shall not be less than 25 per cent. of the registered capital of the company.

The statutory public welfare fund shall be applied for the collective welfare of the company's employees.

*(xvii) Appointment and retirement of auditors*

The Overseas Listing Special Regulations require a company to employ an independent PRC qualified firm of accountants to audit the company's annual financial statements and review other financial reports.

The auditors are to be appointed for a term commencing from their appointment at an annual general meeting to the close of the next annual general meeting.

If a company removes or ceases to continue to appoint its existing auditors, it is required by the Overseas Listing Special Regulations to give prior notice to the auditors and the auditors are entitled to make representations before the shareholders in general meeting. The auditors who resigned from their office should make a statement to the shareholders stating whether or not the company has undertaken any inappropriate transactions. The appointment, removal or non-renewal of appointment of auditors shall be decided by the shareholders and shall be registered with the CSRC.

*(xviii) Distribution of profits*

Overseas Listing Special Regulations provide that the dividends and other distributions payable to holders of overseas listed foreign shares shall be declared and calculated in Renminbi and paid in foreign currency. Under the Mandatory Provisions, the payment of foreign currency to shareholders shall be made through a receiving agent.

*(xix) Amendments to articles of association*

Amendments to a company's articles of association must be approved by more than two thirds of the votes cast by shareholders present at the shareholders' general meeting. Any amendment to the provisions in a company's articles of association in accordance with the Mandatory Provisions will only be effective after the approval of the relevant department authorized by the State Council and the Securities Committee are obtained. A company must change its registration particulars in accordance with the applicable law if any amendments to its articles of association involving registration matters are adopted.

*(xx) Merger and demerger*

The merger or demerger of a company shall be approved by the shareholders in general meeting and the relevant governmental authority. The merger of a company may be effected either by way of absorption followed by the dissolution of the company being absorbed or by the establishment of a new entity followed by the dissolution of the original entities.

All parties to a merger are required to sign a merger agreement and to prepare their respective balance sheets and inventory of assets. Each relevant party to a merger shall notify the creditors of the merger within 10 days and publicly announce the merger in the newspapers at least three times within 30 days after the resolution approving the merger has been passed. The creditors are required within the statutory prescribed time limit to request the company to repay any outstanding indebtedness or provide guarantees covering such indebtedness. Any company which is unable to repay its debts or provide such guarantees is prohibited from proceeding with the merger.

A company is required to prepare its balance sheet and inventory of assets prior to its demerger. Similar requirements on notification of the demerger to creditors, publication of notice of the demerger and repayment of or provision of guarantees to creditors are applicable in the case of a demerger.

Any changes in the registrar's particulars of the companies resulting from merger or demerger should be re-registered with the company registration authority in accordance with the law.

*(xxi) Dissolution and liquidation*

Under the Company Law, a company shall be dissolved and liquidated if any of the following events shall occur:

- (1) the term of its operations stipulated in the company's articles of association has expired or on the occurrence of an event provided in the company's articles of association which triggers the dissolution of the company;
- (2) the shareholders in general meeting have resolved to dissolve the company by special resolution;
- (3) a merger or demerger of the company which requires the company to be dissolved;
- (4) the declaration of the insolvency of the company according to law by reason of its not being able to pay its debts when become due and payable;  
or
- (5) the company has been ordered to close down as a result of violation of the law or administrative regulations.

Where a company is dissolved in the circumstances referred to in (1) or (2) above, the shareholders in general meeting shall, within 15 days of the occurrence of the event, appoint the members of the liquidation committee. If the liquidation committee is not established within the specified time, the creditors of the company may apply to the people's court to appoint the members of the liquidation committee. The people's court or the relevant supervising department shall organize a liquidation committee to conduct the liquidation. A liquidation committee shall comprise shareholders, the relevant department and the relevant professional personnel if the company is dissolved in the circumstances described in (4) or (5) above. A liquidation committee shall be responsible for dealing with the assets of the company, preparing a balance sheet and an inventory of the company's assets, notifying the creditors of the company's dissolution, handling the outstanding business of the company, discharging the outstanding indebtedness (including unpaid taxes) of the company, distributing the company's surplus assets after repayment of all its indebtedness and representing the company in all civil litigation.

A liquidation committee is required to notify the creditors of the dissolution of the company within 10 days after its establishment and issue a public announcement of the dissolution of the company at least three times within 60 days after its establishment. A creditor is required to lodge its claim with the liquidation committee within the statutory prescribed time limit.

The company's assets shall be applied to pay all expenses incurred in connection with the liquidation, the employees' wages, employees' insurance, tax and the indebtedness of the company. Any surplus assets after discharge of the company's liabilities shall be distributed to the shareholders in proportion to their respective shareholdings in the company. If the assets of the company are insufficient to repay/discharge its indebtedness, the liquidation committee shall apply to the people's court for a declaration of insolvency and shall transfer the liquidation proceedings to the people's court.

A company cannot engage in any new business operations during its liquidation.

On completion of the liquidation process, the liquidation committee is required to submit a liquidation report to the shareholders in general meeting and the relevant administrative department for confirmation. The liquidation committee is also required to apply to the Administration of Industry and Commerce Bureau for the cancellation of the company's registration and to make a public announcement of the company's dissolution following such cancellation.

Members of the liquidation committee are required to discharge their duties honestly and in compliance with laws. A member of the liquidation committee is liable to indemnify the company and its creditors in respect of any loss arising from his wilful or material default.

*(xxii) Overseas listing*

The shares of a company shall only be listed overseas after obtaining approval from the CSRC and the listing must be arranged in accordance with procedures specified by the Overseas Listing Special Regulations.

According to the Overseas Listing Special Regulations and the Mandatory Provisions, a company's plan to issue overseas listed foreign shares and domestic shares, which has been approved by the Securities Committee, may be implemented by its board of directors separately within 15 months after approval is obtained from the Securities Committee.

*(xxiii) Loss of shares certificates*

In the event that share certificates in registered form are either stolen or lost, a shareholder may apply, in accordance with the relevant provisions set out in the PRC Civil Procedure Law, to a people's court for a declaration that such certificates will no longer be valid. After such a declaration has been made by the people's court, the shareholder may apply to the company for the issue of replacement certificates.

A separate procedure regarding the loss of H share certificates is provided in the Mandatory Provisions, which has been incorporated into the Company's Articles of Association, a summary of which is set out in Appendix VI to this prospectus.

*(xxiv) Suspension and termination of listing*

A company which is listed on a stock exchange may have its listing suspended by the securities administration department of the State Council if any of the following event occur:

- (1) the registered capital of the company or the distribution of the company's shares no longer complies with the relevant listing requirements;
- (2) the company has failed to disclose its financial position in accordance with the relevant law and regulations or the financial report of the company contains false information;
- (3) the company has committed a material breach of the law; or
- (4) the company has incurred losses for each of the immediately preceding three years.

If the circumstances referred to in (2) or (3) above have occurred and investigation has established that the consequences are serious, or if the circumstances referred to in (1) or (4) above have occurred and the situation has not been rectified within the time stipulated and not fulfilling the listing requirements, the securities administration department of the State Council may decide to terminate the listing of a company's shares.

The securities administration department of the State Council may also terminate the listing of a company's shares in the event that the company has resolved to be wound up or is ordered by the relevant governmental authority to be dissolved, or the company is declared insolvent.

**(g) Securities law and regulations**

At present, the PRC has promulgated a number of regulations in relation to the issue and trading of shares and disclosure of information.

In early 1993, the State Council established the Securities Committee and the CSRC. The Securities Committee is responsible for co-ordinating the drafting of securities regulations, formulating securities related polices, planning the development of securities markets, directing, coordinating and supervising all securities related institutions in the PRC and administering the CSRC. The CSRC is the regulatory arm of the Securities Committee and is responsible for the drafting of regulatory provisions of securities markets, supervising securities companies, regulating public offers of securities by the PRC companies in the PRC or overseas, regulating the trading of securities, compiling securities related statistics and undertaking research and analysis. In 1998, the Securities Committee was canceled and its main functions were merged into the CSRC due to the restructuring reforms of the State Council.

On 22 April 1993, the State Council promulgated the Provisional Regulations Governing the Issue and Trading of Shares (股票發行與交易管理暫行條例) (the “Securities Provisional Regulations”). These regulations deal with the application and approval procedures for public offerings of equity securities, trading in equity securities, the acquisition of listed companies, deposit, settlement, clearing and transfer of listed equity securities, the disclosure of information with respect to a listed company, investigation and penalties and dispute settlement. These regulations specifically provide that the offer of shares by a PRC company directly and indirectly outside the PRC requires the approval of the Securities Committee and also provide that separate measures will be promulgated in relation to the issue of and trading in special Renminbi-denominated shares. However, (i) if a PRC joint stock limited company proposes to issue Renminbi denominated ordinary shares as well as special Renminbi-denominated shares, it has to comply with the Securities Provisional Regulations; and (ii) provisions of the Securities Provisional Regulations in relation to acquisitions of listed companies and disclosure of information are expressed to apply to companies listed on a stock exchange in general without being confined to companies listed on any particular stock exchange. Such provisions may, therefore, be applicable to joint stock limited companies with shares listed on a stock exchange outside the PRC including, for instance, joint stock limited companies with shares listed on the Stock Exchange.

On 12 June 1993, the CSRC promulgated the Implementation Measures (Provisional) on Disclosure of Information of the Public Issuing Share’s Company (公開發行股票公司信息披露的實施細則(暫行)) pursuant to the Securities Provisional Regulations. Under these measures, the CSRC is responsible for supervising the disclosure of

information by companies which have offered shares to the public in the PRC. These measures contain provisions regarding prospectuses and listing reports to be issued in connection with a public offering of shares in the PRC, publication of interim and final reports and announcement of material transactions or matters by companies which have offered shares to the public. Material transactions or matters are those the occurrence of which may have a material effect on the share price of a company. They include changes to a company's articles of association or registered capital, removal of auditors, mortgage or disposal of major operating assets or writing down the value of such assets where the amount being written down exceeds 30 per cent. of the total value of such assets, revocation by a court of any resolution passed by the shareholders or the supervisors of a company and the merger or demerger of a company. These measures also contain disclosure provisions in relation to acquisition of listed companies which supplement the requirements contained in the Securities Provisional Regulations.

On 2 December 1993, the Securities Committee promulgated the Provisional Measures Prohibiting Fraudulent Conduct Relating to Securities (禁止證券欺詐行為暫行辦法). The prohibitions imposed by these measures include the use of insider information in connection with the issue of or trading in securities (insider information being defined to include undisclosed material information known to any insider, which may affect the market price of securities); the use of funds or information or through an abuse of power in creating a false or disorderly market or influencing the market price of securities or inducing investors to make investment decisions without knowledge of actual circumstances; and the making of any statement in connection with the issue of and trading in securities which is false or materially misleading or in respect of which there is any material omission. Penalties imposed for contravening any of the provisions of the measures include fines, confiscation of profits and suspension of trading. In serious cases, criminal liability may be imposed.

On 4 July 1994, the State Council promulgated the Special Regulations. These provisions deal mainly with the issue, subscription, trading and declaration of dividends and other distributions of foreign capital stock listed aboard and disclosure of information, articles of association of joint stock limited companies having foreign capital stock listed aboard.

On 25 December 1995, the State Council promulgated the Regulations of the State Council Concerning Domestic Listed Foreign Shares of Joint Stock Limited Companies (國務院關於股份有限公司境內上市外資股的規定). These regulations deal mainly with the issue, subscription, trading and declaration of dividends and other distributions of domestic listed foreign shares and disclosure of information of joint stock limited companies having domestic listed foreign shares.

On 29 December 1998, the Securities Law of the PRC (中華人民共和國證券法) (the “Securities Law”) was passed by the Standing Committee of the NPC (全國人民代表大會常務委員會). The Securities Law took effect on 1 July 1999. This is the first national securities law in the PRC, and it is divided into 12 chapters and 214 articles regulating, among other things, the issue and trading of securities, takeovers by listed companies, securities exchanges, securities companies and the duties and responsibilities of the State Council’s securities regulatory authorities. The Securities Law is the fundamental law which comprehensively regulates activities in the PRC securities market. Article 29 of the Securities Law provides that enterprises in the PRC which intend to directly or indirectly issue securities outside the PRC or to list their securities outside the PRC must obtain prior approval from the State Council’s regulatory authorities. Article 213 of the Securities Law provides that specific measures in respect of shares of companies in the PRC which are to be subscribed and traded in foreign currencies by person and organization outside the PRC shall be separately formulated by the State Council. Currently, the issue and trading of foreign issued shares (including H shares and B shares) are still mainly governed by the rules and regulations promulgated by the State Council and the CSRC.

In order to further promote strict compliance of “companies listed outside China” (“Listed Company”) with the relevant domestic and foreign laws and regulations, their conscientious performance of their continuing obligations toward investors and their establishment of a good corporate image on domestic and foreign capital markets, the State Economic and Trade Commission and the CSRC jointly issued the Further Standardizing Operations and Reform of Companies Listed Outside China Opinion (關於進一步促進境外上市公司規範運作和深化改革的意見) (“Standardizing Opinion”) on 29 March 1999. The Standardizing Opinion sets out regulations governing the relationship between the Companies and their controlling entities (hereafter “controlling entities” refers to companies or enterprises with legal person status that have a controlling interest in a listed company) and the operations of the administrative organizations of the Listed Companies. The board of directors, management, the financial and marketing organizations of a listed company must be independent from those of the controlling entity. No more than two senior management personnel from the controlling entity (i.e. the chairman of the board, vice-chairman of the board and executive directors) may concurrently hold the position of senior management personnel in the company. The Standardizing Opinion also requires a company to specify its decision-making process, strengthen director responsibility, establish a sound external director and independent director system, strengthen the functions of its supervisory board and secretary of the board of directors, explore methods to motivate its senior management personnel and to intensify its internal reform.

**(h) Legal opinion**

Zhong Yin Law Firm, the Company's legal advisor on the PRC laws, has sent to the Company a letter confirming that they have reviewed the summary of relevant PRC laws and regulations contained in this appendix and that, in their opinion, such summary is a correct summary of the relevant PRC laws and regulations. A copy of this letter is available for inspection as referred to in paragraph (2) headed "Documents available for inspection" in Appendix VIII to this prospectus. Any person wishing to obtain detailed information on the PRC laws and regulations is recommended to seek independent legal advice.

**2. HONG KONG LAWS AND REGULATIONS****(a) Company law**

The Hong Kong law applicable to a company having share capital incorporated in Hong Kong is based on the Companies Ordinance and supplemented by the common law and the rules of equity which apply to Hong Kong by virtue of section 3 of the Application of English Law Ordinance (Chapter 88 of the Laws of Hong Kong).

The Company, which is a joint stock limited company established in the PRC seeking a listing of H Shares on the GEM is governed by the Company Law which came into effect on 1 July 1994 and all other rules and regulations promulgated pursuant to the Company Law applicable to a joint stock limited company established in the PRC issuing overseas listed foreign shares to be listed on the Stock Exchange.

Set out below is a summary of certain material differences between the Hong Kong company law applicable to a company incorporated in Hong Kong and the PRC company law applicable to a joint stock limited company incorporated and existing under the Company Law. This summary is, however, not intended to be an exhaustive comparison:

*(i) Corporate existence*

Under Hong Kong company law, a company having share capital is incorporated by the Registrar of Companies in Hong Kong issuing a certificate of incorporation and upon its incorporation, a company will acquire an independent corporate existence. A company may be incorporated as a public company or a private company. The articles of association of a private company incorporated in Hong Kong are required by the Companies Ordinance to contain certain pre-emptive and other provisions. Any company which does not contain such provisions in its articles of association is a public company.

Under the Company Law, a joint stock limited company may be incorporated by either the promotion method or the public subscription method. A company established by the public subscription method will only acquire its corporate existence after it has completed its initial share offering to the public and a company may only issue further shares after a year has elapsed since its last share issue. The Company Law requires a State-owned enterprise to be converted into a joint stock limited company by the public subscription method. The Special Regulations, however, permit a State-owned enterprise to be converted into a joint stock limited company by the promotion method and to offer H shares to the public on its establishment.

Under the Company Law, a company which is authorized by the relevant securities administration authority to list its shares on a stock exchange must have a registered capital of not less than RMB50,000,000. Hong Kong law does not prescribe any minimum capital requirements for a Hong Kong company.

Under the Company Law, the shares allotted by a joint stock limited company in return for injection of intellectual property rights and non-patented technology shall not exceed 20 per cent. of the registered capital of a company. There is no such restriction on a Hong Kong company under Hong Kong law.

*(ii) Share capital*

Under Hong Kong law, the authorized share capital of a Hong Kong company is the amount of share capital which the company is authorized to issue and a company is not bound to issue the entire amount of its authorized share capital. The Company Law does not have the concept of authorized share capital. The registered capital of a joint stock limited company is the amount of the issued share capital. Any increase in registered capital must be approved by the shareholders in general meeting and the relevant PRC governmental and regulatory authorities.

*(iii) Restrictions on shareholding and transfer of shares*

Under the PRC law, the domestic shares in the share capital of a joint stock limited company (“domestic shares”) which are denominated and subscribed for in Renminbi may only be subscribed or traded by the State, the PRC legal persons and natural persons. The overseas listed foreign shares (“foreign shares”) issued by a joint stock limited company which are denominated in Renminbi and subscribed for in a currency other than Renminbi may only be subscribed and traded by investors from Hong Kong, Macau and Taiwan or any country and territory outside the PRC.

Under the Company Law, shares in a joint stock limited company held by its promoters cannot be transferred within three years after the date of establishment of the company. Shares in a joint stock limited company held by its directors, supervisors and manager cannot be transferred during their term of office.

There are no such restrictions on shareholdings and transfers of shares under Hong Kong law.

*(iv) Financial assistance for acquisition of shares*

The Company Law does not contain any provision prohibiting or restricting a joint stock limited company or its subsidiaries from providing financial assistance for the purpose of an acquisition of its own or its holding company's shares. The Mandatory Provisions contain certain restrictions on a company and its subsidiaries providing such financial assistance similar to those under Hong Kong company law.

*(v) Variation of class rights*

Under Hong Kong company law, if the share capital of a company is divided into different classes of shares, special rights attaching to any class of shares may only be varied if approved by a specified proportion of the holders of the relevant class.

The Company Law does not contain any specific provision relating to variation of class rights. Under the Mandatory Provisions, class rights may not be varied or abrogated unless approved by a special resolution of shareholders in general meeting and by two thirds of the votes cast by shareholders of the affected class present in person or by proxy at a separate class meeting. For the purpose of a variation of class rights, domestic shares and foreign shares are treated as separate classes of shares except in the case of (i) an issue of shares by the joint stock limited company once every 12 months either separately or concurrently following the approval by a special resolution of shareholders in general meeting not exceeding 20 per cent. of each of the issued domestic shares and foreign shares existing as at the date of such special resolution; and (ii) an issue of domestic shares and foreign shares in accordance with the plan of the company at the time of its establishment approved by the Securities Committee and which are completed within 15 months from the date of the approval. The Mandatory Provisions contain detailed provisions relating to circumstances which are deemed to constitute a variation of class rights.

*(vi) Directors*

The Company Law, unlike Hong Kong company law, does not contain any requirements relating to the declaration of interests in material contracts, restrictions on interested directors being counted towards the quorum of and voting at a meeting of the board of directors at which a transaction in which a director is interested is being considered, restrictions on directors' authority in making major dispositions, restrictions on companies providing certain benefits such as loans to directors and guarantees in respect of directors' liability and prohibition against compensation for loss of office without shareholders' approval.

The Mandatory Provisions contain requirements and restrictions in relation to the foregoing matters similar to those applicable under Hong Kong law.

*(vii) Supervisory committee*

Under the Company Law, the directors and managers of a joint stock limited company is subject to the supervision of a supervisory committee but there is no mandatory requirement for the establishment of a supervisory committee for a company incorporated in Hong Kong.

The Mandatory Provisions provide that each supervisor owes a duty, in the exercise of his powers, to act in good faith and honestly in what he considers to be in the best interests of the company and to exercise the care, diligence and skill that a reasonable prudent person would exercise in comparable circumstances.

*(viii) Derivative action by minority shareholders*

Hong Kong law permits minority shareholders to start a derivative action on behalf of all shareholders against directors who have committed of a breach of their fiduciary duties to the company, if they control a majority of votes at a general meeting thereby effectively preventing a company from suing the directors in breach of their duties in its own name. Although the Company Law gives a shareholder of a joint stock limited company the right to initiate proceedings in the people's court to restrain the implementation of any resolution passed by shareholders in general meeting or by the board of directors which violates any law or infringes the lawful rights and interests of shareholders, the PRC law does not have a form of proceedings which is the same as a derivative action. The Mandatory Provisions, however, provide remedies to the company against directors, supervisors and officers in breach of their duties to the company. In addition, every director and supervisor of a joint stock limited company applying for a listing of its foreign shares on the Stock Exchange is required to give an undertaking in favour of the company acting as agent

for each shareholder to comply with the company's articles of association. This allows minority shareholders to act against directors and supervisors in default.

*(ix) Protection of minorities*

Under Hong Kong law, a shareholder who complains that the affairs of a company incorporated in Hong Kong are conducted in a manner unfairly prejudicial to his interests may petition to court to either wind up the company or make an appropriate order regulating the affairs of the company. In addition, on the application of a specified number of members, the Financial Secretary may appoint inspectors who are given extensive statutory powers to investigate the affairs of a company incorporated in Hong Kong. The PRC law does not contain similar safeguards. The Mandatory Provisions, however, contain provisions to the effect that a controlling shareholder may not exercise its voting rights in a manner prejudicial to the interests of the shareholders generally or of some part of the shareholders of a company to relieve a directors or supervisor of his duty to act honestly in the best interests of the company or to approve the expropriation by a director or supervisor of the company's assets or the individual rights of other shareholders.

*(x) Notice of shareholders' meetings*

Under the Company Law, notice of a shareholders' general meeting must be given not less than 30 days before the meeting or, in the case of a company having bearer shares, public announcement of a shareholders' general meeting must be made at least 45 days prior to it being held. Under the Special Regulations and the Mandatory Provisions, 45 days' written notice must be given to all shareholders and shareholders who wish to attend the meeting must reply in writing 20 days before the date of the meeting. For a company incorporated in Hong Kong, the minimum notice period of a general meeting convened for passing an ordinary resolution and a special resolution is 14 days and 21 days respectively; and the notice period for an annual general meeting is 21 days.

*(xi) Quorum for shareholder's meetings*

Under Hong Kong law, the quorum for a general meeting is provided for in the articles of association of a company, which shall not in any event be less than two members. The Company Law does not specify any quorum requirement for shareholders' general meeting but the Special Regulations and the Mandatory Provisions provide that a company's general meeting can be convened when replies to the notice of that meeting have been received from shareholders whose shares represent 50 per cent. of the voting rights in the company at least 20 days before the

proposed date of the meeting, or if that 50 per cent. level is not achieved, the company shall within 5 days notify shareholders by public announcement and the shareholders' general meeting may be held thereafter.

*(xii) Voting*

Under Hong Kong law, an ordinary resolution is passed by a simple majority of votes cast by members present in person or by proxy at a general meeting and a special resolution is passed by a majority of not less than three fourths of votes cast by members present in person or by proxy at a general meeting.

Under the Company Law, the passing of any resolution requires one half or more votes held by shareholders present in person or by proxy at a shareholders' general meeting except in cases of proposed amendment to the articles of association, merger, demerger or dissolution of a joint stock limited company which requires two thirds of votes held by shareholders present in person or by proxy at a shareholders' general meeting.

*(xiii) Financial disclosure*

A joint stock limited company is required under the Company Law to make available at its office for inspection by shareholders its annual balance sheet, profit and loss account, changes in financial position and other relevant annexure 20 days before the annual general meeting of shareholders. In addition, a company established by the public subscription method under the Company Law must publish its financial statements. The annual balance sheet has to be verified by registered accountants. The Companies Ordinance requires a company to send to every shareholder a copy of its balance sheet, auditors' report and directors' report which are to be laid before the company in its annual general meeting not less than 21 days before such meeting.

A joint stock limited company is required under the PRC law to prepare its financial statements in accordance with the PRC accounting standards. The Mandatory Provisions require that the company must, in addition to preparing accounts according to the PRC standards, have its accounts prepared and audited in accordance with IAS or Hong Kong accounting standards and its financial statements must also contain a statement of the financial effect of the material differences (if any) from the financial statements prepared in accordance with the PRC accounting standards.

(xiv) Information on directors and shareholders

There are no provisions in the Company Law concerning the public's or a joint stock limited company's shareholders' right to access information on its directors and shareholders. Under the Mandatory Provisions, shareholders have the right to inspect and copy (at reasonable charges) certain information on shareholders and on directors similar to that available under Hong Kong law to shareholders of a company incorporated in Hong Kong.

(xv) *Receiving agent*

Under both the PRC and Hong Kong law, dividends once declared become debts payable to shareholders. The limitation period for debt recovery action under Hong Kong law is six years while that under the PRC law such limitation period is two years. The Mandatory Provisions require the appointment of a trust company registered under the Hong Kong Trustee Ordinance (Chapter 29 of the Laws of Hong Kong) as receiving agent to receive on behalf of holders of foreign shares dividends declared and all other monies owing by a joint stock limited company in respect of such foreign shares.

(xvi) *Corporate reorganization*

Corporate reorganization involving a company incorporated in Hong Kong may be effected in a number of ways, such as a transfer of the whole or part of the business or property of the company in the course of being wound up voluntarily to another company pursuant to section 237 of the Companies Ordinance or a compromise or arrangement between the company and its creditors or between the company and its members pursuant to section 166 of the Companies Ordinance which requires the sanction of the court. Under the PRC law, the merger or demerger of a joint stock limited company has to be approved by shareholders in general meeting and the relevant governmental authorities.

(xvii) *Arbitration of disputes*

In Hong Kong, disputes between shareholders and a company incorporated in Hong Kong or its directors may be resolved through the courts. The Mandatory Provisions provide that such disputes should be submitted to arbitration at either the HKIAC or the CIETAC, at the claimant's choice.

*(xviii) Mandatory transfers*

Under the Company Law, a joint stock limited company is required to make transfers equivalent to certain prescribed percentages of its after tax profit to the statutory common reserve and statutory public welfare fund. There are no such requirements under Hong Kong law.

**(b) The GEM Listing Rules**

The GEM Listing Rules provide additional requirements which apply to an issuer which is incorporated in the PRC as a joint stock limited company and seeking a primary listing or whose primary listing is on the GEM. Set out below is a summary of the principal provisions containing such additional requirements which apply to the Company:

*(i) Accountants' report*

An accountants' report for a PRC issuer will not normally be regarded as acceptable unless the relevant accounts have been audited to a standard comparable to that required in Hong Kong. Such report will normally be required to conform to either Hong Kong or IAS.

*(ii) Process agent*

The Company is required to appoint and maintain a person authorized to accept service of process and notices on its behalf in Hong Kong throughout the period during which its securities are listed on the GEM and must notify the Stock Exchange of his appointment, the termination of his appointment and his contract particulars.

*(iii) Public shareholdings*

If a PRC issuer do not have existing issued securities in public hands other than H shares (that is, overseas shares of the Company which are listed on the Stock Exchange), the GEM Listing Rules require that, the H shares must constitute not less than 20 per cent. of the issuer's issued share capital unless the market capitalization of the total existing issued share capital at the time of listing is over HK\$1,000 million in which case, the prescribed minimum public shareholdings percentage is between 15 and 20 per cent.

If at any time there are other existing issued securities of a PRC issuer in public hands other than H shares, the GEM Listing Rules require that:

- (aa) all H shares must be held by the public;
- (bb) the H shares held by the public must represent not less than 10 per cent. of the PRC issuer's total existing issued share capital; and.
- (cc) the aggregate amount of H shares and other existing securities in public hands must constitute not less than 20 per cent. of the PRC issuer's issued share capital unless the expected market capitalization of the total existing issued share capital at the time of listing of the H shares is over HK\$1,000 million in which case, the prescribed minimum public shareholdings percentage is between 15 and 20 per cent.

*(iv) Independent non-executive directors and supervisors*

The independent non-executive directors of a PRC issuer are required to demonstrate an acceptable standard of competence and adequate commercial or professional expertise to ensure that the interests of the general body of shareholders will be adequately represented. The supervisors of a PRC issuer must have the character, expertise and integrity and be able to demonstrate a standard of competence commensurate with their position as supervisors.

*(v) Restrictions on purchase and subscription of its own securities*

Subject to governmental approvals and the provisions of the Articles of Association, the Company may repurchase its own H Shares on the GEM in accordance with the provisions of the GEM Listing Rules. Approval by way of special resolution of the holders of domestic shares and the holders of H Shares at separate class meetings conducted in accordance with the Articles of Association is required for shares repurchases. In seeking approvals, the Company is required to provide information on any proposed or actual purchases of all or any of its equity securities, whether or not listed or traded on the GEM. The Directors must also state the consequences of any purchases which will arise under either or both of the Hong Kong Code on Takeovers and Mergers and any similar PRC law of which the Directors are aware, if any. Any general mandate given to the Directors to repurchase H Shares must not exceed 10 per cent. of the total amount of existing issued H Shares of the Company.

*(vi) Continuing obligations and financial information*

(aa) Redeemable shares

The Company must not issue any redeemable shares unless the Stock Exchange is satisfied that the relative rights of the holders of the H Shares are adequately protected.

(bb) Pre-emptive rights

Except in the circumstances mentioned below, the Directors are required to obtain the approval by a special resolution of shareholders in general meeting, and the approvals by special resolutions of the holders of domestic shares and H Shares (each being otherwise entitled to vote at general meetings) at separate class meetings conducted in accordance with the Articles of Association, prior to: (i) authorizing, allotting, issuing or granting shares or securities convertible into shares, or options, warrants or similar rights to subscribe for any shares or such convertible securities; or (ii) any major subsidiary (if any) of the Company making any such authorization, allotment, issue or grant so as materially to dilute the percentage equity interest of the Company and its shareholders in such subsidiary.

No such approval will be required, but only to the extent that, the existing shareholders of the Company have by special resolution in general meeting given a mandate to the Directors, either unconditionally or subject to such terms and conditions as may be specified in the resolution, to authorize, allot or issue, either separately or concurrently once every 12 months, not more than 20 per cent. of each of the existing issued domestic shares and H Shares of the Company or, such shares are part of the Company's plan at the time of its establishment to issue domestic shares and H Shares and which plan is implemented within 15 months from the date of approval by the CSRC or such other competent share council securities regulatory authority.

(cc) Supervisors

The Company is required to adopt rules governing dealings by its supervisors in securities of the Company in terms no less exacting than those minimum standard of good practice, as set out in rules 5.40 to 5.59 of the GEM Listing Rules, issued by the Stock Exchange.

The restriction on the Company or any of its subsidiaries entering into a service contract of ten years or longer duration with a Director or proposed Director of the Company or its subsidiary without the prior approval of the shareholders in a general meeting at which the relevant Director did not vote on the matter also applies to a service contract of such duration between the Company or its subsidiary with a Supervisor or proposed Supervisor.

(dd) Amendment to Articles of Association

The Company is required not to permit or cause any amendment to be made to its Articles of Association which would cause the same to cease to comply with the mandatory provisions of the GEM Listing Rules relating to such Articles of Association.

(ee) Documents for inspection

The Company is required to make available at a place in Hong Kong for inspection by the public and shareholders free of charge, and for copying by shareholders at reasonable charges the following:

- a complete duplicate register of shareholders;
- a report showing the state of the issued share capital of the Company;
- the Company's latest audited financial statements and the reports of the Directors, auditors and Supervisors, if any, thereon;
- special resolutions of the Company;
- reports showing the number and nominal value of securities repurchased by the Company since the end of the last financial year, the aggregate amount paid for such securities and the maximum and minimum prices paid in respect of each class of securities repurchased (with a breakdown between Domestic Shares and H Shares);
- a copy of the latest annual return filed with the Administration for Industry and Commerce Bureau of the PRC; and
- for shareholders only, copies of minutes of meetings of shareholders.

(ff) Receiving agents

The Company is required to appoint one or more receiving agents in Hong Kong and pay to such agents dividends declared and other monies owing in respect of the H Shares to be held, pending payment, in trust for the holders of such H Shares.

(gg) Statements in share certificates

The Company is required to ensure that all its listing documents and share certificates include the statements stipulated below and to instruct and cause each of its share registrars not to register the subscription, purchase or transfer of any of its shares in the name of any particular holder unless and until such holder delivers to such share registrar a signed form in respect of such shares bearing statements to the following effect that the acquirer of shares:

- agrees with the Company and each shareholder of the Company, and the Company agrees with each shareholder, to observe and comply with the Company Law, the Special Regulations and the Articles of Association;
- agrees with the Company, each shareholder, Director, Supervisor, manager and other officer of the Company and the Company acting for itself and for each Director, Supervisor, manager and other officer agrees with each shareholder to refer all differences and claims arising from the Articles of Association or any rights or obligations conferred or imposed by the Company Law or other relevant laws and administrative regulations concerning the affairs of the Company to arbitration in accordance with the Articles of Association. Any reference to arbitration will be deemed to authorize the arbitration tribunal to conduct its hearing in open session and to publish its award. Such arbitration will be final and conclusive;
- agrees with the Company and each shareholder of the Company that shares in the Company are freely transferable by the holder thereof; and
- authorizes the Company to enter into a contract on his behalf with each Director and officer whereby such Director and officer undertake to observe and comply with their obligations to shareholders stipulated in the Articles of Association.

(hh) Compliance with the Company Law, the Special Regulations and the Articles of Association

The Company is required to observe and comply with the Company Law, the Special Regulations and the Articles of Association.

(ii) Contract between the Company and its Directors, officers and Supervisors

The Company is required to enter into a contract in writing with every Director and officer containing at least the following provisions:

- an undertaking by the Director or officer to the Company to observe and comply with the Company Law, the Special Regulations, the Articles of Association, the Hong Kong Codes on Takeovers and Mergers and Share Repurchases and an agreement that the Company shall have the remedies provided in the Articles of Association and that neither the contract nor his office is capable of assignment;
- an undertaking by the Director or officer to the Company acting as agent for each shareholder to observe and comply with his obligations to shareholders stipulated in the Articles of Association; and
- an arbitration clause which provides that whenever any differences or claims arise from that contract, the Articles of Association or any rights or obligations conferred or imposed by the Company Law or other relevant law and administrative regulations concerning the affairs of the Company between the Company and its Directors or officers and between a holder of H Shares and a Director or officer of the Company, such differences or claims will be referred to arbitration at either the CIETAC in accordance with its rules or the HKIAC in accordance with its Securities Arbitration Rules, at the election of the claimant and that once a claimant refers a dispute or claim to arbitration, the other party must submit to the arbitral body elected by the claimant. Such arbitration will be final and conclusive.

The Company is also required to enter into a contract in writing with every Supervisor containing statements in substantially the same terms.

(jj) Subsequent listing

The Company must not apply for the listing of any of its foreign shares on a PRC stock exchange unless the Stock Exchange is satisfied that the relative rights of the holders of foreign shares are adequately protected.

(kk) English translation

All notices or other documents required under the listing agreement to be sent by the Company to the Stock Exchange or to holders of the H Shares are required to be in the English language, or accompanied by a certified English translation.

*(viii) General*

If changes in the PRC law or market practices materially alters the validity or accuracy of any of the basis upon which the additional requirements have been prepared, then the Stock Exchange may impose additional requirements or make listing of the equity securities of a PRC issuer, including the Company, subject to special conditions as the Stock Exchange considers appropriate. Whether or not any such changes in the PRC law or market practices occur, the Stock Exchange retains its general power under the GEM Listing Rules to impose additional requirements and make special conditions in respect of the listing of the Company.

**(c) Other legal and regulatory provisions**

Upon the listing of the Company on the GEM, the provisions of the Securities Ordinance (Chapter 333 of the Laws of Hong Kong), the Securities (Disclosure of Interests) Ordinance (Chapter 396 of the Laws of Hong Kong), the Securities (Insider Dealing) Ordinance (Chapter 395 of the Laws of Hong Kong), the Hong Kong Codes on Takeovers and Mergers and Share Repurchases and such other relevant ordinances and regulations as may be applicable to companies listed on the Stock Exchange will apply to the Company.

**(d) Securities Arbitration Rules**

The Articles of Association provide that certain claims arising from the Articles of Association or the Company Law shall be arbitrated at either the CIETAC or the HKIAC in accordance with their respective rules.

The Securities Arbitration Rules of the HKIAC contain provisions allowing an arbitral tribunal to conduct a hearing in Shenzhen for cases involving the affairs of companies incorporated in the PRC and listed on the Stock Exchange so that PRC parties and witnesses may attend. Where any party applies for a hearing to take place in Shenzhen, the tribunal shall, where satisfied that such application is based on bona fide grounds, order the hearing to take place in Shenzhen conditional upon all parties including witnesses and the arbitrators being permitted to enter Shenzhen for the purpose

of the hearing. Where a party, other than a PRC party, or any of its witnesses or any arbitrator is not permitted to enter Shenzhen, then the tribunal shall order that the hearing be conducted in any practicable manner, including the use of electronic media.

For the purpose of the Securities Arbitration Rules, a PRC party means a party domiciled in the PRC other than the territories of Hong Kong, Macau and Taiwan.

**(e) Taxation in Hong Kong**

*(i) Dividends*

Where a company is not chargeable to Hong Kong profits tax, any dividends paid by it to persons who carry on a business in Hong Kong are liable to profits tax, to the extent that such dividends form part of the profits of such persons arising from their Hong Kong business.

*(ii) Profits tax*

Hong Kong does not have any capital gains tax. Persons who carry on a trade, profession or business in Hong Kong and derive income in Hong Kong from such trade, profession or business are liable to profits tax. Securities dealers carrying on a business in Hong Kong and making trading gains from the sale and purchase of shares will be subject to profits tax. Currently, profits tax for corporations is payable at the rate of 16 per cent. of their assessable profits.

Profits tax for individuals is levied on a progressive scale and the maximum rate is 15 per cent.

*(iii) Stamp duty*

The sale and purchase of shares is subject to stamp duty payable by both the seller and the buyer. Duty is payable with reference to the amount of the consideration or, if higher, the fair value of the shares being sold. In respect of every HK\$1,000, or part thereof, of the consideration or, if higher, the fair value of the shares, the current rate of duty is HK\$2.25. Stamp duty is usually shared between the buyer and the seller equally in respect of transactions on the Stock Exchange. A fixed rate of duty of HK\$5 is also payable in respect of every instrument of transfer which is required to be registered on a register or branch register maintained in Hong Kong.

*(iv) Estate duty*

Properties situated in Hong Kong which pass or are deemed to pass upon the death of a person, wherever domiciled or resident, are liable to estate duty based on the value of the property in question. H Shares will constitute property situated in Hong Kong for estate duty purposes by virtue of them being on the Hong Kong branch register of the Company. Hong Kong estate duty is imposed on a progressive scale from 5 per cent. to 15 per cent. The rate of and the threshold for estate duty have, in the past, been adjusted on a fairly regular basis. No estate duty is payable where the aggregate value of the dutiable estate does not exceed HK\$7.5 million, and the maximum rate of duty of 15 per cent. applies where the aggregate value of the dutiable estate exceeds HK\$10.5 million.

**ARTICLES OF ASSOCIATION**

Set out below is a summary of the principal provisions of the Articles of Association which were approved at the extraordinary general meeting of the Company held on 11 October, 2000. However, the Articles of Association has to be filed to the Business Administration and Management Bureau in Beijing for registration after the completion of Placing. A copy of the Articles of Association, together with an uncertified English translation, is available for inspection as mentioned in paragraph (2) headed “Documents available for inspection” in Appendix VII to this prospectus.

**(A) Directors and other officers***(i) Power to allot and issue Shares*

Subject to the approval of the authorities the Directors are empowered to allot and issue Shares.

To increase the capital of the Company, the Board is responsible for formulating proposals for approval at a shareholders’ general meeting by way of special resolution. Any such increase must be conducted in accordance with the procedures stipulated by the relevant laws and administrative regulations.

*(ii) Power to dispose of the assets of the Company or any subsidiary.*

The Board is accountable to the shareholders’ general meeting.

The Board shall not, without the prior approval of shareholders in a general meeting, dispose or agree to dispose of, any fixed assets of the Company where the aggregate of the amount or value of the consideration for the proposed disposition, and the amount or value of the consideration for any such disposition of any fixed assets of the Company that has been completed in the period of four (4) months immediately preceding the proposed disposition, exceeds 33 per cent. of the value of the Company’s fixed assets as shown in the last balance sheet placed before the shareholders in general meeting.

The validity of a disposition by the Company shall not be affected by the breach of the above paragraph.

For the purposes of the Articles of Association, a disposition includes an act involving the transfer of an interest in assets but does not include the provision of fixed asset by way of security.

*(iii) Compensation or payments for loss of office*

The Company shall, with the prior approval of shareholders in general meeting, enter into a contract in writing with a director or supervisor wherein his emoluments are stipulated. The aforesaid emoluments include:

- (1) emoluments in respect of his service as Director, Supervisor or senior administrative officer of the Company;
- (2) emoluments in respect of the provision of other services in connection with the management of the affairs of the Company and any of its subsidiaries (if any); and
- (3) payment by way of compensation for loss of office, or as consideration for or in connection with his retirement from office.

*(iv) Loans to Directors, Supervisors and other officers*

The Company shall not directly or indirectly make a loan to, or provide any guarantee in connection with, the making of a loan to a director, supervisor, general manager or other senior administrative officer of the Company or of the Company's holding company or any of their respective associates. However, the following transactions are not subject to such prohibition:

- (1) the provision by the Company of a loan or a guarantee of a loan to a company which is a subsidiary of the Company;
- (2) the provision by the Company of a loan or a guarantee in connection with the making of a loan or any other funds to any of its Directors, Supervisors, general manager and other senior administrative officers to meet expenditure incurred or to be incurred by him for the purposes of the Company or for the purpose of enabling him to perform his duties properly, in accordance with the terms of a service contract approved by the shareholders in general meeting; and
- (3) the Company may make a loan to or provide a guarantee in connection with the making of a loan to any of the relevant Directors, Supervisors, general manager and other senior administrative officers or their respective associates in the ordinary course of its business on normal commercial terms, provided that the ordinary course of business of the Company includes the lending of money or the giving of guarantees.

A loan made by the Company in breach of the above provisions shall be forthwith repayable by the recipient of the loan regardless of the terms of the loan.

A guarantee provided by the Company in breach of the above provisions shall be unenforceable against the Company, unless:

- (1) the guarantee was provided in connection with a loan to an associate of any of the directors, supervisors, general manager and other senior administrative officers of the Company or of the Company's holding company and at the time the loan was advanced the lender did not know the relevant circumstances; or
- (2) the collateral provided by the Company has been lawfully disposed of by the lender to a bona fide purchaser.

For these purposes:

- (a) a guarantee includes an undertaking or property provided to secure the performance of obligations by the obligor; and
  - (b) a definition of an associate as referred to in paragraph (A)(x) below applies, *mutatis mutandis*, to this provision.
- (v) *Financial assistance for the acquisition of shares in the Company or any subsidiary (if any)*

Subject to the exceptions in the Articles of Association, the Company and its subsidiaries shall not, by any means at any time, provide any kind of financial assistance (as defined below) to a person who is acquiring or is proposing to acquire Shares. The said acquiror of shares of the Company includes a person who directly or indirectly incurs any obligations (as defined below) due to the acquisition of Shares. The Company and its subsidiaries shall not, by any means at any time, provide financial assistance to the said acquiror as referred to in the preceding paragraph for the purpose of reducing or discharging the obligations assumed by that person.

The following activities shall not be deemed to be prohibited activities:

- (1) the provision of financial assistance by the Company where the financial assistance is given in good faith in the interest of the Company, and the principal purpose in giving the financial assistance is not for the acquisition of Shares, or the giving of the financial assistance is an incidental part of some larger purpose of the Company;

- (2) the lawful distribution of the Company's assets by way of dividend;
- (3) the allotment of bonus shares as dividends;
- (4) a reduction of registered capital, a repurchase of Shares or a reorganization of the share capital structure of the Company effected in accordance with these Articles of Association;
- (5) the lending of money by the Company within its scope of business and in the ordinary course of its business, where the lending of money is part of the scope of business of the Company (provided that the net assets of the Company are not thereby reduced or that, to the extent that the assets are thereby reduced, the financial assistance is provided out of distributable profits);
- (6) the provision of money by the Company for contributions to staff and workers' share schemes (provided that the net assets of the Company are not thereby reduced or that, to the extent that the assets are thereby reduced, the financial assistance is provided out of distributable profits).

For these purposes:

- (a) "financial assistance" includes, (without limitation), the following meanings:
  - (1) gift;
  - (2) guarantee (including the assumption of liability by the guarantor or the provision of assets by the guarantor to secure the performance of obligations by the obligor), or compensation (other than compensation in respect of the Company's own default) or release or waiver of any rights;
  - (3) provision of loan or any other agreement under which the obligations of the Company are to be fulfilled before the obligations of another party, or the novation of, or the assignment of rights arising under, such loan or agreement; or
  - (4) any other form of financial assistance given by the Company when the Company is insolvent or has no net assets or when its net assets would thereby be reduced to a material extent.

- (b) “incurring an obligation” includes the incurring of obligations by the changing of the obligor’s financial position by way of contract or the making of arrangement (whether enforceable or not, and whether made on his own account or with any other persons), or by any other means.

*(vi) Disclosure of interests in contracts with the Company or any of its subsidiaries (if any)*

Where a Director, Supervisor, general manager or other senior administrative officer of the Company is in any way, directly or indirectly, materially interested in a contract, transaction or arrangement or proposed contract, transaction or arrangement with the Company, (other than his contract of service with the Company), he shall declare the nature and extent of his interests to the Board at the earliest opportunity, whether or not the contract, transaction or arrangement or proposal therefor is otherwise subject to the approval of the Board.

Unless the interested Director, Supervisor, general manager or other senior administrative officer discloses his interests in accordance with the above and the contract, transaction or arrangement is approved by the Board at a meeting in which the interested Director, Supervisor, general manager or other senior administrative officer is not counted in the quorum and refrains from voting, a contract, transaction or arrangement in which that Director, Supervisor, general manager or other senior administrative officer is materially interested is voidable at the instance of the Company except as against a bona fide party thereto acting without notice of the breach of duty by the interested Director, Supervisor, general manager or other senior administrative officer.

For these purposes, a Director, Supervisor, general manager or other senior administrative officer of the Company is deemed to be interested in a contract, transaction or arrangement in which an associate of him is interested.

Where a Director, Supervisor, general manager or other senior administrative officer of the Company gives to the Board a general notice in writing stating that, by reason of the facts specified in the notice, he is interested in contracts, transactions or arrangements of any description which may subsequently be made by the Company, such notice shall be deemed for the purposes of this paragraph (vi) to be a sufficient declaration of his interests, so far as the content stated in such notice is concerned, provided that such general notice shall have been given before the date on which the question of entering into the relevant contract, transaction or arrangement is first taken into consideration on behalf of the Company.

*(vii) Remuneration*

The remuneration of Directors must be approved by shareholders in general meeting, as referred to under the paragraph headed “Compensation or payments for loss of office”.

*(viii) Retirement, appointment and removal*

The term of office of the Board members shall be three years.

Directors shall be elected and removed by the shareholders in general meeting. A Director is not required to hold shares of the Company.

The Board shall consist of 7 Directors (more than half of which shall be external Directors). Directors mean both internal and external Directors. External Directors are those Directors who are independent from the Company and do not occupy any other position in the Company. The meaning of “external Director” shall include independent Directors. The Board shall have one general manager. The general manager shall be appointed and removed by the Directors.

A person may not serve as a director, supervisor, general manager or any other senior administrative officer of the Company if any of the following circumstances apply:

- (1) a person without legal or with restricted legal capacity;
- (2) a person who has committed an offence of corruption, bribery, infringement of property, misappropriation of property or sabotaging the social economic order and has been punished because of committing such offence; or who has been deprived of his political rights, in each case where less than five (5) years have elapsed since the date of the completion of implementation of such punishment or deprivation;
- (3) a person who is a former director, factory manager or manager of a company or enterprise which has entered into insolvent liquidation because of mismanagement and he is personally liable for the insolvency of such company or enterprise, where less than three (3) years have elapsed since the date of the completion of the insolvency and liquidation of the Company or enterprise;
- (4) a person who is a former legal representative of a company or enterprise which had its business licence revoked due to a violation of the law and who incurred personal liability, where less than three (3) years has elapsed since the date of the revocation of the business licence;

- (5) a person which has a relatively large amount of debts due and outstanding;
- (6) a person who is under criminal investigation or prosecution by judicial organization for violation of the criminal law which is not yet concluded;
- (7) a person who is not eligible for enterprise leadership according to laws and administrative regulations;
- (8) a non-natural person; or
- (9) a person convicted of the contravention of provisions of relevant securities regulations by a relevant government authority, and such conviction involves a finding that he has acted fraudulently or dishonestly, where less than five (5) years has elapsed since the date of the conviction.

The validity of an act of a director, general manager or other senior administrative officer on behalf of the Company is not, vis-a-vis a bona fide third party, affected by any irregularity in his office, election or any defect in his qualification.

*(ix) Duties*

In addition to obligations imposed by laws, administrative regulations or required by the stock exchanges on which Shares are listed, each of the Company's Directors, Supervisors, general manager and other senior administrative officers owes a duty to each shareholder, in the exercise of the functions and powers of the Company entrusted to him, including:

- (1) not to exceed the scope of authority;
- (2) to act honestly in the best interest of the Company;
- (3) not to expropriate in any guise the Company's property, including (without limitation) usurpation of opportunities advantageous to the Company;
- (4) not to expropriate the individual rights of shareholders, including (without limitation) rights to distribution and voting rights, save pursuant to a restructuring of the Company submitted to shareholders for approval in accordance with the Articles of Association.

Each of the Company's Directors, Supervisors, general manager and other administrative officers owes a duty, in the exercise of his powers and discharge of his duties, to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

Each of the Company's Directors, Supervisors, general manager and other senior administrative officers shall exercise his powers or carry on his duties in accordance with the principle of fiduciary and shall not put himself in a position where his duty and his interest may conflict. This principle includes (without limitation) discharging the following obligations:

- (1) to act honestly in the best interests of the Company;
- (2) to exercise powers within the scope of his powers and not to exceed those powers;
- (3) to exercise the discretion vested in him personally and not to allow himself to act under the control of another and, unless and to the extent permitted by laws, administrative regulations or with the informed consent of shareholders given in general meeting, not to delegate the exercise of his discretion;
- (4) to treat shareholders of the same class equally and to treat shareholders of different classes fairly;
- (5) except in accordance with the Articles of Association or with the informed consent of shareholders given in general meeting, not to enter into any contract, transaction or arrangement with the Company;
- (6) without the informed consent of shareholders given in general meeting, not to use the Company's property for his own benefit;
- (7) not to exploit his position to accept bribes or other illegal income or expropriate the Company's property by any means, including (without limitation) opportunities advantageous to the Company;
- (8) without the informed consent of shareholders given in general meeting, not to accept commissions in connection with the Company's transactions;
- (9) to abide by the Articles of Association, faithfully execute his official duties and protect the Company's interests, and not to exploit his position and power in the Company to advance his own private interests;

- (10) not to compete with the Company in any form unless with the informed consent of shareholders given in general meeting;
- (11) not to misappropriate the Company's funds or lend such funds to others, not to open accounts in his own name or other names for the deposit of the Company's assets and not to provide a guarantee for debts of a shareholder of the Company or other individual(s) with the Company's assets; and
- (12) unless otherwise permitted by informed shareholders in general meeting, to keep in confidence information acquired by him in the course of and during his tenure and not to use the information other than in furtherance of the interests of the Company, save that disclosure of such information to the court or other governmental authorities is permitted if:
  - (i) disclosure is made under compulsion of law;
  - (ii) the interests of the public require disclosure;
  - (iii) the interests of the relevant Director, Supervisor, general manager or other senior administrative officer require disclosure.

Each Director, Supervisor, general manager or other senior administrative officer of the Company shall not cause the following persons or institutions ("associates") to do what he is prohibited from doing:

- (1) the spouse or minor child of that Director, Supervisor, general manager or other senior administrative officer;
- (2) a person acting in the capacity of trustee of that Director, Supervisor, general manager or other senior administrative officer or any person referred to in the preceding paragraph;
- (3) a person acting in the capacity of partner of that Director, Supervisor, general manager or other senior administrative officer or any person referred to in paragraphs (1) and (2) above;
- (4) a company in which that Director, Supervisor, general manager or other senior administrative officer, alone or jointly with one or more persons referred to in paragraphs (1), (2) and (3) above and other Directors, Supervisors, general manager and other senior administrative officers have a defacto controlling interest; and

- (5) the Directors, Supervisors, general manager and other senior administrative officers of the controlled company referred to in the preceding paragraph.

The fiduciary duties of the Directors, Supervisors, general manager and other senior administrative officers of the Company do not necessarily cease with the termination of their tenure. The duty of confidence in relation to trade secrets of the Company survives the termination of their tenure. Other duties may continue for such period as fairness may require depending on the time lapse between the termination and the act concerned and the circumstances under which the relationships between them and the Company are terminated.

**(A) Alterations to constitutional documents**

The Company may amend its Articles of Association in accordance with the requirements of law, administrative regulation and the Articles of Association.

Amendments to the Articles of Association involving the contents of the Mandatory Provisions shall become effective upon approvals by the companies approving department authorized by the State Council and relevant foreign trade and economics authorities. If there is any change relating to the registered particulars of the Company, application shall be made for registration of the changes in accordance with law.

**(B) Variation of rights of existing shares or classes of shares**

Rights conferred on any class of shareholders in the capacity of shareholders (“class rights”) may not be varied or abrogated unless approved by a special resolution of shareholders in general meeting and by holders of shares of that class at a separate meeting conducted in accordance with the Articles of Association.

The following circumstances shall be deemed to be variation or abrogation of the class rights of a class:

- (1) to increase or decrease the number of shares of such class, or increase or decrease the number of shares of class having voting or equity rights or privileges equal or superior to those of the shares of such class;
- (2) to effect an exchange of all or part of the shares of such class into shares of another class or to effect an exchange or create a right of exchange of all or part of the shares of another class into the Shares of such class;
- (3) to remove or reduce rights to accrued dividends or rights to cumulative dividends attached to shares of such class;

- (4) to reduce or remove a dividend preference or a liquidation preference attached to shares of such class;
- (5) to add, remove or reduce conversion privileges, options, voting rights, transfer or pre-emptive rights, or rights to acquire securities of the Company attached to shares of such class;
- (6) to remove or reduce rights to receive payment payable by the Company in particular currencies attached to shares of such class;
- (7) to create a new class of shares having voting or equity right or privileges equal or superior to those of the shares of such class;
- (8) to restrict the transfer or ownership of the shares of such class or add to such restriction;
- (9) to allot and issue rights to subscribe for, or convert into, shares in the Company of such class or another class;
- (10) to increase the rights or privileges of shares of another class;
- (11) to restructure the Company where the proposed restructuring will result in different classes of shareholders bearing a disproportionate burden of such proposed restructuring; and
- (12) to vary or abrogate provisions in the Articles of Association.

Shareholders of the affected class, whether or not otherwise having the right to vote at shareholders' general meetings, shall nevertheless have the right to vote at class meetings in respect of matter concerning paragraphs (2) to (8), (11) and (12) above, but interested shareholder(s) (as defined below) shall not be entitled to vote at class meetings.

Resolutions of a class of shareholders shall be passed by votes representing more than two-thirds of the voting rights of shareholders of that class represented at the relevant meeting who are entitled to vote at class meetings.

Written notice of a class meeting shall be given forty-five (45) days before the date of the class meeting to notify all of the shareholders in the share register of the class of the matters to be considered, the date and the place of the class meeting. A shareholder who intends to attend the class meeting shall deliver his written reply concerning attendance at the class meeting to the Company twenty (20) days before the date of the class meeting.

If the number of shares carrying voting rights at the meeting represented by the shareholders who intend to attend the class meeting reaches more than one half of the voting shares at the class meeting, the Company may hold the class meeting; if not, the Company shall within five (5) days notify the shareholders, again by public notice, of the matters to be considered, the date and the place for the class meeting. The Company may then hold the class meeting after such publication of such notice.

Notice of class meetings need only be served on shareholders entitled to vote thereat.

Meetings of any class of shareholders shall be conducted in a manner as similar as possible to that of general meetings of shareholders. The provisions of the Articles of Association relating to the manner of conducting any shareholders' general meeting shall apply to any meeting of a class of shareholders. Holders of domestic-invested shares and foreign-invested shares are deemed to be shareholders of different classes.

The special procedures for voting at a class of shareholders shall not apply in the following circumstances:

- (1) where the Company issues, upon the approval by a special resolution of its shareholders in general meeting, either separately or concurrently once every twelve months, not more than 20 per cent. of each of its existing issued domestic-invested shares and overseas-listed foreign-invested Shares; or
- (2) where the Company's plan to issue domestic-invested shares and overseas-listed foreign-invested Shares at the time of its establishment is carried out within fifteen (15) months from the date of approval of the Securities Committee of the State Council.

For the purposes of the class rights provisions of the Articles of Association, the meaning of "interested shareholder(s)" is:

- (1) in the case of a repurchase of shares by offers to all shareholders or public dealing on a stock exchange, a "controlling shareholder" within the meaning of the Articles of Association;
- (2) in the case of a repurchase of shares by an off-market contract, a holder of the shares to which the proposed contract relates; and
- (3) in the case of a restructuring of the Company, a shareholder within a class who bears less than a proportionate burden imposed on that class under the proposed restructuring or who has an interest in the proposed restructuring different from the interest of shareholders of that class.

**(C) Resolutions – majority required**

Resolutions of shareholders' general meetings shall be divided into ordinary resolutions and special resolutions.

To adopt an ordinary resolution, votes representing more than one half of the voting rights represented by the shareholders (including proxies) present at the meeting must be exercised in favour of the resolution in order for it to be passed.

To adopt a special resolution, votes representing more than two-thirds of the voting rights represented by the shareholders (including proxies) present at the meeting must be exercised in favour of the resolution in order for it to be passed.

**(D) Voting rights (generally, on a poll and right to demand a poll)**

The ordinary shareholders of the Company have the right to attend or appoint a proxy to attend shareholders' general meetings and to vote thereat. A shareholder (including proxy) when voting at a shareholders' general meeting may exercise voting rights in accordance with the number of shares carrying the right to vote and each share shall have one vote.

At any general meeting of shareholders a resolution shall be decided on a show of hands unless a poll is (before or after any vote by show of hands) demanded:

- (1) by the chairman of the meeting;
- (2) by at least two shareholders entitled to vote present in person or by proxy; or
- (3) by one or more shareholders present in person or by proxy and representing 10 per cent. or more of all shares carrying the right to vote at the meeting.

Unless a poll be so demanded, a declaration by the chairman that a resolution has on a show of hands been carried unanimously, or carried by a particular majority, or lost, and an entry to that effect in the minutes of the meeting shall be conclusive evidence of the fact without proof of the number or proportion of the votes recorded in favour of or against such resolution. The demand for a poll may be withdrawn by the person who makes such demand.

A poll demanded on the election of the chairman of the meeting, or on a question of adjournment of the meeting, shall be taken forthwith. A poll demanded on any other question shall be taken at such time as the chairman of the meeting directs, and any business other than that upon which a poll has been demanded may be proceeded with, pending the taking of the poll. The result of the poll shall be deemed to be a resolution of the meeting at which the poll was demanded. On a poll taken at a meeting, a shareholder (including proxy) entitled to two or more votes need not cast all his votes in the same way.

In the case of an equality of votes, whether on a show of hands or on a poll, the chairman of the meeting at which the show of hands takes place or at which the poll is demanded shall be entitled to one additional vote.

**(E) Requirements for annual general meetings**

The Board shall convene an annual shareholders' meeting once each year and within six (6) months from the close of the preceding financial year.

**(F) Accounts and audit**

The Company shall establish its financial and accounting system and internal audit system in accordance with the laws, administrative regulations and the PRC accounting standards formulated by the finance regulatory department of the State Council.

The Board shall place before the shareholders at every annual general meeting such financial reports as are required by any laws, administrative regulations or directives promulgated by competent regional and central governmental authorities to be prepared by the Company.

The Company's financial reports shall be made available for shareholders' inspection at the Company twenty (20) days before the date of every shareholders' annual general meeting. Each shareholder shall be entitled to obtain a copy of the financial reports.

The financial statements of the Company shall, in addition to being prepared in accordance with the PRC accounting standards and regulations, be prepared in accordance with either IAS, or that of the overseas place where the Company's shares are listed. If there is any material difference between the financial statements prepared respectively in accordance with the two accounting standards, such difference shall be stated in an appendix to the financial statements. When the Company is to distribute its after-tax profits, the lower of the after-tax profits as shown in the two financial statements shall be adopted.

Any interim results or financial information published or disclosed by the Company must also be prepared and presented in accordance with the PRC accounting standards and regulations, and also in accordance with either IAS or that of the overseas place where the Company's shares are listed.

The Company shall publish its financial reports two times every fiscal year, that is, the interim financial report shall be published within 60 days after the first 6 month periods of each fiscal year and the annual financial report shall be published within 120 days after the expiration of each fiscal year.

**(G) Notice of meetings and business to be conducted thereat**

The shareholders' general meeting is the organ of authority of the Company and shall exercise its functions and powers in accordance with law.

The Company shall not, without the prior approval of shareholders in general meeting, enter into any contract with any person other than a Director, supervisor, general manager or other senior administrative officer whereby the management and administration of the whole or any substantial part of the business of the Company is to be handed over to such person.

Shareholders' general meetings are divided into annual general meetings and extraordinary general meetings. Shareholders' general meetings shall be convened by the Board.

Under any of the following circumstances, the Board shall convene an extraordinary general meeting within two (2) months:

- (1) when the number of directors is less than the number of directors required by the Company Law or two-thirds of the number of directors specified in the Articles of Association;
- (2) when the unrecovered losses of the Company amount to one third of the total amount of its share capital;
- (3) when shareholder(s) holding 10 per cent. or more of the Company's issued and outstanding shares carrying voting rights request(s) in writing the convening of an extraordinary general meeting; or
- (4) when deemed necessary by the Board or as requested by the supervisory committee.

When the Company convenes a shareholders' general meeting, written notice of the meeting shall be given forty-five (45) days before the date of the meeting to notify all of the shareholders in the share register of the matters to be considered and the date and the place of the meeting. A shareholder who intends to attend the meeting shall deliver his written reply concerning the attendance of the meeting to the Company twenty (20) days before the date of the meeting.

When the Company convenes a shareholders' annual general meeting, shareholders holding 5 per cent. or more of the total voting Shares of the Company shall have the right to propose new motions in writing, and the Company shall place matters in the proposed motions within the scope of functions and powers of the shareholders' general meeting on the agenda.

A shareholders' extraordinary general meeting shall not decide on those matters not stated in the notice of meeting.

The Company shall, based on the written replies received twenty (20) days before the date of the shareholders' general meeting from the shareholders, calculate the number of voting shares represented by the shareholders who intend to attend the meeting. If the number of voting shares represented by the shareholders who intend to attend the meeting reaches one half or more of the Company's total voting shares, the Company may hold the meeting. If not, then the Company shall within five (5) days notify the shareholders again by public notice of the matters to be considered, the place and the date for the meeting. The Company then may hold the meeting after such publication of such notice.

A notice of meeting of shareholders shall comply with the following requirements:

- (1) be in writing;
- (2) specify the place, the day and the hour of the meeting;
- (3) state the matters to be discussed at the meeting;
- (4) provide such information and explanation as are necessary for the shareholders to exercise an informed judgment on the proposals before them. Without limiting the generality of the foregoing, where a proposal is made to amalgamate the Company with another, to repurchase shares, to reorganize the share capital, or to restructure the Company in any other way, the terms of the proposed transaction must be provided in detail together with copies of the proposed agreement, if any, and the cause and effect of such proposal must be properly explained;

- (5) contain a disclosure of the nature and extent, if any, of the material interests of any Director, Supervisor, general manager or other senior administrative officer in the transaction proposed and the effect of the proposed transaction on them in their capacity as shareholders in so far as it is different from the effect on the interests of the shareholders of the same class;
- (6) contain the full text of any special resolution proposed to be moved at the meeting;
- (7) contain conspicuously a statement that a shareholder entitled to attend and vote is entitled to appoint one or more proxies to attend and vote instead of him and that a proxy need not be a shareholder; and
- (8) specify the delivery time and place for lodging proxy forms for the relevant meeting.

Notice of shareholders' general meeting shall be served on the shareholders (whether or not entitled to vote at the meeting), by delivery or prepaid mail to their addresses as shown in the register of shareholders. For the holders of Domestic Shares, notice of the meetings may be issued by way of public notice.

The public notice shall be published in one or more newspapers designated by the securities governing authority of the State Council within the interval between forty-five (45) days and fifty (50) days before the date of the meeting. After the publication of such notice, the holders of domestic-invested Shares shall be deemed to have received the notice of the relevant shareholders' general meeting. The accidental omission to give notice of a meeting to, or the non-receipt of notice of a meeting by, any person entitled to receive notice shall not invalidate the proceedings at that meeting.

When the Company convenes a shareholders' annual general meeting, shareholders holding 5 per cent. or more of the total voting shares of the Company shall have the right to propose new motions in writing, and the Company shall place those matters in the proposed motions within the scope of functions and powers of the shareholders' general meeting on the agenda.

The following matters shall be resolved by an ordinary resolution at a shareholders' general meeting:

- (1) work reports of the Board and the supervisory committee;
- (2) plans formulated by the Board for the distribution of profits and for making up losses;

- (3) removal of the members of the Board and members of the supervisory committee, their remuneration and method of payment;
- (4) annual preliminary and final budgets, balance sheets and profit and loss accounts and other financial statements of the Company; and
- (5) matters other than those required by the laws and administrative regulations or by the Articles of Association to be adopted by special resolution.

The following matters shall be resolved by a special resolution at a shareholders' general meeting:

- (1) the increase or decrease of share capital and the issue of shares of any class, warrants and other similar securities;
- (2) the issue of debentures of the Company;
- (3) the division, merger, dissolution and liquidation of the Company;
- (4) amendments to the Articles of Association; and
- (5) any other matters considered by the shareholders' general meeting, by way of an ordinary resolution, to be of a nature which may have a material impact on the Company and should be adopted by a special resolution.

#### **(H) Transfer of Shares**

All the fully paid-up H Shares can be freely transferred in accordance with the Articles of Association. However, the Board may refuse to recognize any instrument of transfer without giving any reason, unless:

- (1) any fees as decided by the Stock Exchange or any other lower fees as may be requested by the board of directors of the Company at any time has been paid to the Company for registration of any transfer or any other document which is related to or will affect ownership of or change of ownership of the Shares;
- (2) the instrument of transfer only involves H Shares;
- (3) the stamp duty chargeable on the instrument of transfer has been paid; and
- (4) if it is intended to transfer the shares to joint owners, then the maximum number of joint owners shall not exceed four.

**(I) Power of the Company to purchase its own shares**

In accordance with the provisions of the Articles of Association, the Company may reduce its registered share capital.

The Company may, with approval according to the procedures provided in the Articles of Association and subject to the approval of the relevant governing authority of the State, repurchase its issued shares under the following circumstances:

- (1) cancellation of Shares for the reduction of its capital;
- (2) merging with another company that holds Shares in the Company; and
- (3) other circumstances permitted by laws and administrative regulations.

The Company may, with the approval of the relevant State governing authority for repurchasing its Shares, conduct the repurchase in one of the following ways:

- (1) making a pro rata general offer of repurchase to all of its shareholders;
- (2) repurchase shares through public dealing on a stock exchange; or
- (3) repurchase by an off-market agreement.

Unless the Company is in the course of liquidation, it must comply with the following provisions in relation to repurchase of its issued shares:

- (1) where the Company repurchases shares of the Company at par value, payment shall be made out of book surplus distributable profits of the Company or out of proceeds of a fresh issue of shares made for that purpose;
- (2) where the Company repurchases shares of the Company at a premium to its par value, payment up to the par value shall be made out of the book surplus distributable profits of the Company or out of the proceeds of a fresh issue of shares made for that purpose. Payment of the portion in excess of the par value shall be effected as follows:
  - (i) if the Shares being repurchased were issued at par value, payment shall be made out of the book surplus distributable profits of the Company; or

- (ii) if the Shares being repurchased were issued at a premium to its par value, payment shall be made out of the book surplus distributable profits of the Company or out of the proceeds of a fresh issue of shares made for that purpose, provided that the amount paid out of the proceeds of the fresh issue shall not exceed the aggregate of premiums received by the Company on the issue of the Shares repurchased nor the current amount of the Company's share premium account (including the premiums on the fresh issue);
- (3) payment by the Company in consideration of the following shall be made out of the Company's distributable profits:
  - (i) acquisition of rights to repurchase shares of the Company;
  - (ii) variation of any contract to repurchase shares of the Company; and
  - (iii) release of any of the Company's obligation under any contract to repurchase shares of the Company; and
- (4) after the Company's registered shares capital has been reduced by the total par value of the cancelled shares in accordance with the relevant provisions, the amount deducted from the distributable profits of the Company for payment up the par value portion of the Shares repurchased shall be transferred to the Company's share premium account.

**(J) Power for any subsidiary of the Company to own Shares**

There are no provisions in the Articles of Association preventing ownership of Shares by a subsidiary.

**(K) Dividends and other method of profit distribution**

The Company may distribute dividends in the following manner:

- (1) cash; or
- (2) shares.

Dividends or other payments declared by the Company to be payable to holders of domestic-invested Shares shall be declared and calculated in Renminbi, and paid in Renminbi. Those payable to holders of foreign-invested Shares shall be declared and calculated in Renminbi, and paid in foreign currency.

The Company shall appoint receiving agents on behalf of the H Shares to receive on behalf of such shareholders dividends declared and all other monies owing by the Company in respect of their Shares. The receiving agents appointed on behalf of holders of the H Shares shall be a company registered as a trust company under the Trustee Ordinance of Hong Kong.

**(L) Proxies**

Any shareholder entitled to attend and vote at a meeting of the Company shall be entitled to appoint one or more other persons (whether a shareholder or not) as his proxy to attend and vote on his behalf, and a proxy so appointed shall:

- (1) have the same right as the shareholder's to speak at the meeting;
- (2) have authority to demand or join in demanding a poll; and
- (3) have the right to vote by hand or on a poll, but a proxy of a shareholder who has appointed more than one proxy may only vote on a poll.

The instrument appointing a proxy shall be in writing under the hand of the appointer or his attorney duly authorized in writing, or if the appointer is a legal entity either under seal or under the hand of a director or attorney duly authorized. The instrument appointing a voting proxy and, if such instrument is signed by a person under a power of attorney or other authority on behalf of the appointer, a notarially certified copy of that power of attorney or other authority, shall be deposited at the residence of the Company or at such other place as is specified for that purpose in the notice convening the meeting, not less than twenty-four (24) hours before the time for holding the meeting at which the proxy proposes to vote or the time appointed for the passing of the resolution.

If the appointor is a legal entity, its legal representative or such person as is authorized by resolution of its board of directors or other governing body to act as its representative may attend at any meeting of shareholders of the Company.

Any form issued to a shareholder by the Directors for use by him for appointing a proxy to attend and vote at meeting of the Company shall be such as to enable the shareholder, according to his intention, to instruct the proxy to vote in favour of or against each resolution dealing with business to be transacted at the meeting. Such a form shall contain a statement that in the absence of instructions by the shareholder the proxy may vote as he thinks fit.

A vote given in accordance with the terms of an instrument of proxy shall be valid notwithstanding the previous death or loss of capacity of the appointor or revocation of the proxy or of the authority under which the proxy was executed, or the transfer of the Shares in respect of which the proxy is given, provided that no notice in writing of such death, insanity, revocation or transfer as aforesaid shall have been received by the Company at its residence before the commencement of the meeting at which proxy is used.

**(M) Calls on shares and forfeiture of shares**

There are no provisions in the Articles of Association relating to the making of calls on shares or for the forfeiture of shares.

**(N) Rights of shareholders (including inspection of register)**

The ordinary shareholders of the Company shall enjoy the following rights:

- (1) the right to dividends and other distributions in proportion to the number of shares held;
- (2) the right to attend or appoint a proxy to attend shareholders' general meetings and to vote thereat;
- (3) the right of supervisory management over the Company's business operations, and the rights to present proposals or enquiries;
- (4) the right to transfer shares in accordance with laws, administrative regulations and provisions of the Articles of Association;
- (5) the right to obtain relevant information in accordance with the provisions of the Articles of Association, including:
  - (i) the right to obtain a copy of the Articles of Association, subject to payment of the cost of such copy;

- (ii) the right to inspect and copy, subject to payment of a reasonable charge:
  - (a) all parts of the register of shareholders;
  - (b) personal particulars of each of the Company's Directors, Supervisors, general manager and other senior administrative officers as follows:
    - (aa) present name and alias and any former name or alias;
    - (bb) principal address (residence);
    - (cc) nationality;
    - (dd) primary and all other part-time occupations; and
    - (ee) identification document and its number;
  - (c) state of the Company's share capital;
  - (d) reports showing the aggregate par value, quantity, maximum and minimum price paid in respect of each class of shares repurchased by the Company since the end of the last accounting year and the aggregate amount incurred by the Company for this purpose; and
  - (e) minutes of shareholders' general meetings;
- (6) in the event of the termination or liquidation of the Company, to participate in the distribution of remaining assets of the Company in accordance with the number of Shares held; and
- (7) other rights conferred by laws, administrative regulations and the Article of Association.

**(O) Quorum for meetings and separate class meetings**

The Company may convene a shareholders' general meeting where the number of voting shares represented by those shareholders from whom the Company has received, twenty (20) days before the meeting, notices of intention to attend the meeting reaches one half or more of the Company's voting share; or, if not, the Company shall notify the shareholders again by an announcement on the proposed topics, date and place of the meeting within 5 days. After such an announcement, the Company may convene the meeting.

The Company may convene a class meeting where the number of voting shares represented by those shareholders from whom the Company has received, twenty (20) days before the meeting, notices of intention to attend the meeting reaches one half or more of the total number of voting Shares of that class; or, if not, the Company shall notify the shareholders again by an announcement on the proposed topics, date and place of the meeting within 5 days. After such an announcement, the Company may convene the meeting.

**(P) Procedures on liquidation**

The Company shall be dissolved and liquidated upon the occurrence of any of the following events:

- (a) a resolution for dissolution is passed by shareholders at a general meeting;
- (b) dissolution is necessary due to a merger or division of the Company;
- (c) the Company is legally declared bankrupt due to its failure to repay debts due;
- (d) the Company is ordered to close down because of its violation of laws and administrative regulations; or
- (e) the limitation of business operation expires.

Where the Board proposes to liquidate the Company due to causes other than where the Company has declared that it is insolvent, the board shall include a statement in its notice convening a shareholders' general meeting to consider the proposal to the effect that, after making full inquiry into the affairs of the Company, the Board is of the opinion that the Company will be able to pay its debts in full within twelve (12) months from the commencement of the liquidation.

Upon the passing of the resolution by the shareholders in general meeting for the liquidation of the Company, all functions and powers of the Board shall cease.

The liquidation committee shall act in accordance with the instructions of the shareholders' general meeting to make a report at least once every year to the shareholders' general meeting on the committee's receipts and payments, the business of the Company and the progress of the liquidation and to present a final report to the shareholders' general meeting on completion of the liquidation.

**(Q) Other provisions material to the Company or its shareholders***(i) General provisions*

The Company is a joint stock limited company in perpetual existence.

From the date of the Articles of Association becoming effective, the Articles of Association constitute a legally binding document regulating the Company's organization and activities, and the rights and obligations between the Company and each shareholder and among the shareholders inter se.

The Company may invest in other limited liability companies or joint stock limited companies. The Company's liabilities to an investee company shall be limited to the amount of its capital contribution to such investee company.

Upon approval of the companies approving department authorized by the State Council, the Company may, according to its need of operation and management, operate as a holding company.

The Company may, based on its requirements for operation and development and in accordance with the relevant provisions of the Articles of Association, approve an increase of capital.

The Company may increase its capital in the following ways:

- (1) offering fresh Shares to non-specially-designated investors for subscription;
- (2) placing fresh Shares to its existing shareholders;
- (3) distributing fresh Shares to its existing shareholders by way of bonus issues; and
- (4) any other way permitted by law and administrative regulations.

The Company's increase of capital by issuing fresh Shares shall, after being approved in accordance with the provisions of the Articles of Association, be conducted in accordance with the procedures stipulated by relevant laws and administrative regulations.

Unless otherwise provided by law or administrative regulation, shares of the Company are freely transferable and are not subject to any lien.

When the Company reduces its registered shares capital, it must draw up a balance sheet and an inventory of assets. The Company shall notify its creditors within ten (10) days of the date of the Company's resolution for reduction of shares capital and shall publish a notice in a newspaper at least three times within thirty (30) days of the date of such resolution. A creditor has the right within thirty (30) days of receiving the notice from the Company or, in the case of a creditor who does not receive the notice, within ninety (90) days of the date of the first public notice, to demand the Company to repay its debts or provide a corresponding guarantee for such debt. The Company's registered capital after reduction shall not be less than the statutory minimum amount.

The ordinary shareholders of the Company shall assume the following obligations:

- (1) to abide by the Articles of Association;
- (2) to pay subscription monies according to the number of shares subscribed and the method of subscription; and
- (3) other obligations imposed by laws, administrative regulations and the Articles of Association.

Shareholders are not liable to make any further contribution to the share capital other than as agreed by the subscriber of the relevant shares on subscription.

*(ii) Secretary of the Board*

The secretary of the Board shall be a natural person who has the requisite professional knowledge and experience, and shall be appointed by the Board. His primary responsibilities are to ensure that:

- (1) the Company has complete organizational documents and records;
- (2) the Company, in accordance with law, prepares and delivers those reports and documents required by authorities entitled thereto; and
- (3) the Company's registers of shareholders are properly maintained, and that persons entitled to the Company's records and documents are furnished with such records and documents without delay.

*(iii) Supervisory committee*

The Company shall have a supervisory committee. The Directors, general manager, deputy and financial controller shall not act concurrently as supervisors. The supervisory committee shall be composed of three Supervisors. The term of office of Supervisors shall be three years, renewable upon re-election and re-appointment.

The supervisory committee shall have one chairman who shall be elected or removed with the consent of two-thirds or more of the members of the supervisory committee. The term of office of the general manager shall be three years, renewable upon re-election and re-appointment. The supervisory committee shall comprise two representatives of shareholders who shall be elected or removed by the shareholders in general meeting and one representative of staff and workers of the Company who shall be elected or removed democratically by the staff and workers. External Supervisors shall constitute half of the members of the Supervisory committee and it shall have two independent Supervisors. "External Supervisors" means those Supervisors who take up no position in the Company. External Supervisors shall have power to report to the shareholders in general meeting any matter in relation to the good faith, diligence and other performance of the managerial officers of the Company.

The supervisory committee shall be accountable to the shareholders' general meeting and exercise the following powers in accordance with law:

- (1) to examine the Company's financial situation;
- (2) to examine whether the Directors, general manager and other officers act in contradiction with the laws, administrative regulations and the Articles of Association;
- (3) to demand rectification from a Director, the manager or any other officer when the acts of such persons are harmful to the Company's interest;
- (4) to verify the financial information such as the financial report, business report and plans for distribution of profits to be submitted by the Board to the shareholders' general meetings and, should any queries arise, to authorize, in the name of the Company, a re-examination by the certified public accountants and practising auditors of the Company for the time being;

- (5) to propose to convene a shareholders' extraordinary general meeting;
- (6) to represent the Company in negotiation with or bringing an action against a Director; and
- (7) to exercise other powers specified in the Articles of Association.

Members of the supervisory committee shall be present at meetings of the Board.

*(iv) General manager of the Company*

The Company shall have one general manager, who shall be appointed and dismissed by the Board.

The general manager shall be accountable to the Board and exercise the following powers:

- (1) to be in charge of the Company's production, operation and management and to organize the implementation of the resolutions of the Board;
- (2) to organize the implementation of the Company's annual business plan and investment plan;
- (3) to draft plans for the establishment of the Company's internal management structure;
- (4) to draft the Company's basic management system;
- (5) to formulate basic rules and regulations for the Company;
- (6) to propose the appointment or dismissal of the Company's deputy manager(s) and the financial controller;
- (7) to appoint or dismiss management personnel other than those required to be appointed or dismissed by the Board;
- (8) to determine rewards and punishments, promotion and demotion, increase and decrease of salaries, recruitment, appointment, termination of employment and dismissal of the staff and workers of the Company;

- (9) to, as authorized by the Board, represent the Company in important external business transaction; and
- (10) to exercise other powers conferred by the Articles of Association and the Board.

The general manager and deputy general manager shall be present at meetings of the Board. However, the general manager or the deputy general manager has no voting rights at the meetings unless he is also a Director.

The general manager in performing his functions and powers, shall act honestly and diligently and in accordance with laws, administrative regulations and the Articles of Association.

*(v) Board*

The Board is responsible to the shareholders' general meeting and exercises the following powers:

- (1) to be responsible for the convening of the shareholders' general meeting and to report on its work to the shareholders' general meeting;
- (2) to implement the resolutions of the shareholders' general meetings;
- (3) to decide on the Company's business plans and investment plans;
- (4) to formulate the Company's proposed annual preliminary and final financial budget;
- (5) to formulate the Company's profit distribution plan and plan for recovery of losses;
- (6) to formulate proposals for increases or reductions of the Company's registered share capital and the issue of corporate debentures;
- (7) to draw up plans for the merger, division or dissolution of the Company;
- (8) to decide on the establishment of the Company's internal management structure;
- (9) to appoint or dismiss the Company's general manager, and pursuant to the general manager's nominations to appoint or dismiss deputy general manager(s) and financial controller of the Company and decide on their remuneration;

(10) to formulate the Company's basic management system;

(11) to formulate proposals for any amendments of the Company's Articles of Association; and

(12) to determine the setting up of ad-hoc committee(s) and the appointment and dismissal of the person(s) in charge.

Except Board's resolutions in respect of the matters specified in the above paragraphs (6), (7) and (11), which shall be passed by two-thirds or more of the Directors, Board resolutions in respect of all other matters may be passed by more than one half of the Directors.

Meetings of the Board shall be held at least twice every year and convened by the chairman of the Board. Notice of the meeting shall be served on all of the Directors ten (10) days before the date of the meeting. In case of any urgent matters, upon requisition by three (3) Directors or by the general manager, an extraordinary meeting of the Board may be held.

Meetings of the Board shall be held only if more than half of the Directors are present. Each Director shall have one vote. Where the number of votes cast for and against a resolution are equal, the chairman of the Board shall have a casting vote.

*(vi) Accounts and audit*

(1) Appointment of accountants' firm

The Company shall appoint an independent firm of certified public accountants which is qualified under the relevant regulations of the State to audit the Company's annual report and review the Company's other financial reports. The first certified public accountants' firm of the Company may be appointed by the inaugural meeting of the Company before the first annual general meeting and the certified public accountants' firm so appointed shall hold office until the conclusion of the first annual general meeting. If the inaugural meeting fails to exercise its powers under the preceding paragraph, those powers shall be exercised by the Board.

The certified public accountants' firm appointed by the Company shall hold office from the conclusion of the annual general meeting of shareholders at which the appointment is made until the conclusion of the next annual general meeting of shareholders.

Before the convening of the shareholders' general meeting, the Board may fill any casual vacancy in the office of the certified public accountants' firm, but while any such vacancy continues, the surviving or continuing firm, if any, may act.

The shareholders in general meeting may, by ordinary resolution, remove a certified public accountants' firm before the expiration of its term of office, notwithstanding the stipulations in the contract between the Company and the firm, but without prejudice to the firm's right to claim, if any, for damages in respect of such removal.

The remuneration of a certified public accountants' firm or the manner in which such firm is to be remunerated shall be determined by the shareholders in general meeting. The remuneration of a certified public accountants' firm appointed by the Board shall be determined by the Board.

(2) Change and removal of accountants' firm

The Company's appointment of, removal of and non-reappointment of a certified public accountants' firm shall be resolved by shareholders in general meeting. The resolution of the shareholders' general meeting shall be filed with the securities governing authority of the State Council.

Where it is proposed that any resolution be passed at a shareholders' general meeting concerning the appointment of a certified public accountants' firm which is not an incumbent firm to fill a casual vacancy in the office of the certified public accountants' firm re-appointment of a retiring certified public accountants' firm which was appointed by the Board to fill a casual vacancy, or removal of the certified public accountants' firm before the expiration of its term of office, the following provisions shall apply:

- (1) A copy of the proposal shall be sent before notice of meeting is given to the shareholders to the firm proposed to be appointed or proposing to leave its post or the firm which has left its post (leaving includes leaving by removal, resignation and retirement).

- (2) If the firm leaving its post makes representations in writing and requests the Company to notify such representations to the shareholders, the Company shall (unless the representations are received too late):
  - (i) in any notice of the resolution given to shareholders, state the fact of the representations having been made; and
  - (ii) attach a copy of the representations to the notice and deliver it to the shareholders in the manner stipulated in the Articles of Association.
- (3) If the firm's representations are not sent in accordance with the preceding paragraph, the relevant firm may require that the representations be read out at the meeting and may lodge further complaints.
- (4) A certified public accountants' firm which is leaving its post shall be entitled to attend:
  - (i) the shareholders' general meeting at which its term of office would otherwise have expired;
  - (ii) any shareholders' general meeting at which it is proposed to fill the vacancy caused by its removal; and
  - (iii) any shareholders' general meeting convened on its resignation;

and to receive all notices of, and other communications relating to, any such meetings, and to speak at any such meeting in relation to matters concerning its role as the former certified public accountants' firm of the Company.

(3) Resignation of accountants' firm

Where the certified public accountants' firm resigns its post, it shall make clear to the shareholders' general meeting whether there has been any impropriety on the part of the Company.

Any certified public accountants' firm may resign its office by depositing at the Company's legal residence a resignation notice which shall become effective on the date of such deposit or on such later date as may be stipulated in such notice. Such notice shall include the following:

- (1) a statement to the effect that there are no circumstances connected with its resignation which it considers should be brought to the notice of the shareholders or creditors of the Company; or
- (2) a statement of any such circumstances.

Where a notice is deposited under the preceding paragraph, the Company shall within fourteen (14) days send a copy of the notice to the relevant governing authority. If the notice contains a statement under the preceding paragraph (2), a copy of such statement shall be placed at the Company's residence for shareholders' inspection. The Company shall also send a copy of such statement by prepaid mail to every holder of H Shares at the address registered in the register of shareholders.

Where the certified public accountants' firm's notice of resignation contains a statement of any circumstance which should be brought to the notice of the shareholders or creditors of the Company, it may require the board of directors to convene a shareholders' extraordinary general meeting for the purpose of receiving an explanation of the circumstances connected with its resignation.

*(vii) Dispute resolution*

Whenever any disputes or claims arising between holders of the overseas-listed foreign-invested Shares and the Company, holders of the overseas-listed foreign-invested Shares and the Company's directors, supervisors, general manager or other senior administrative officers, or holders of the overseas-listed foreign-invested Shares and holders of domestic-invested Shares, based on the Articles of Association or any rights or obligations conferred or imposed by the Company Law or any other relevant laws and administrative regulations concerning the affairs of the Company, such disputes or claims shall be referred by the relevant parties to arbitration.

A claimant may elect arbitration at either the China International Economic and Trade Arbitration Commission in accordance with its rules or the Hong Kong International Arbitration Centre in accordance with its Securities Arbitration Rules. Once a claimant refers a dispute or claim to arbitration, the other party must submit to the arbitral body elected by the claimant.

If a claimant elects arbitration at Hong Kong International Arbitration Centre, any party to the dispute or claim may apply for a hearing to take place in Shenzhen in accordance with the Securities Arbitration Rules of the Hong Kong International Arbitration Centre.

If any disputes or claims of rights mentioned in paragraph (1) are referred to arbitration, the laws of the PRC shall apply, save as otherwise provided in laws and administrative regulations.

Where a dispute or claim of rights is referred to arbitration, the entire claim or dispute must be referred to arbitration, and all persons who have a cause of action based on the same facts giving rise to the dispute or claim or whose participation is necessary for the resolution of such dispute or claim, shall abide by the arbitration provided that such person is the Company or the Company's shareholder, director, supervisor, general manager or other officer. Disputes in relation to the identification of shareholders and disputes in relation to the share register need not be referred to arbitration.

The award of an arbitration body shall be final and conclusive and binding on all parties.

**1. FURTHER INFORMATION ABOUT THE COMPANY****Incorporation**

The Company was established in the PRC under the Company Law as a joint stock limited company with limited liability on 22 March 2000 with Tongrentang Ltd., Tongrentang Holdings, Yin Shun Hai, Wang Zhao Qi, Mei Qun, Tian Rui Hua, Tian Da Fang and Zhao Bing Xian as promoters. At the time of its establishment, the Company had a registered capital of RMB110,000,000, divided into 110,000,000 Domestic Shares of RMB1.00 each. The Company has established a place of business in Hong Kong and has submitted an application to the Registrar of Companies in Hong Kong to be registered as an overseas company in Hong Kong under Part XI of the Companies Ordinance. Such application contains a notice of appointment of Ms. Yang Qiong of Flat D, 9th Floor, Friendship Building, 12 Blue Pool Road, Happy Valley, Hong Kong as the agent of the Company for the acceptance of service of process in Hong Kong.

Since the Company was established in the PRC, it is required to comply with the laws and regulations of the PRC. A summary of the relevant laws and regulations of the PRC, and a summary of Articles of Association are set out in Appendices V and VI to this prospectus, respectively.

The establishment of the Company involved, amongst other matters, the following procedures and approvals:

- (1) convening of a board meeting of Tongrentang Ltd. on 13 January 2000 at which, amongst other matters, a provisional general meeting of Tongrentang Ltd. was proposed to be convened;
- (2) convening of a general meeting of Tongrentang Ltd. on 22 February 2000 at which, amongst other matters, the establishment of the Company was approved;
- (3) convening of an inaugural general meeting of the Company on 9 March 2000 at which, amongst other matters, the following resolutions were passed:
  - (i) the report of the promoters in relation to the establishment of the Company was approved;
  - (ii) the initial articles of association of the Company which were subsequently superseded by the Articles of Association were adopted;

- (iii) the report of Tongrentang Ltd. in relation to its asset injection into the Company as consideration for its Domestic Shares was approved;
  - (iv) the appointment of Yin Shun Hai, Wang Zhao Qi, Mei Qun, Tian Rui Hua and Zhao Bing Xian as Directors and Tian Da Fang, Yang Liang and Sun Feng Sheng as Supervisors; and
  - (v) the Board was authorized to, amongst other matters, arrange for the Placing and listing of the Placing Shares on GEM;
- (4) an approval (證監發行字[2000]78號) dated 19 June 2000 by the CSRC authorizing the Company to apply for listing on GEM;
- (5) convening of the Company's board meeting on 11 October 2000 at which, amongst other things, the following resolutions were passed:
- (i) the Articles of Association of the Company were adopted;
  - (ii) granting of Over-allotment Option;
  - (iii) conditional upon (1) the GEM Listing Committee granting listing of and permission to deal in the Placing Shares; and (2) the obligations of the Placing Underwriters under the Underwriting and Placing Agreement as referred to in the section headed "Underwriting" in this prospectus becoming unconditional and not being terminated according to the terms of the Underwriting and Placing Agreement or otherwise, in each case on or before 23 November 2000, that the Placing was approved and the Directors were authorized to allot and issue the Shares pursuant thereto.

Immediately following completion of the Placing and assuming the Over-allotment Option is not exercised, the issued share capital of the Company will be RMB182,800,000, divided into 110,000,000 Domestic Shares and up to 72,800,000 H Shares. The Domestic Shares are held by Tongrentang Ltd., Tongrentang Holdings, Yin Shun Hai, Wang Zhao Qi, Mei Qun, Tian Rui Hua, Tian Da Fang and Zhao Bing Xian, representing 54.705%, 1.586%, 0.274%, 0.274%, 0.274%, 0.055%, 0.274%, and 2.735%, of the issued share capital of the Company, respectively, and all of which were fully paid up or credited as fully paid up. Immediately following completion of the Placing and assuming that the Over-allotment Option is exercised in full, the issued share capital of the Company will increase to RMB190,000,000, divided into 110,000,000 Domestic Shares and 80,000,000 H Shares and all of which are or will be fully paid up or credited as fully paid up. Save as the above, there has been no change in the share capital of the Company since the date of its establishment.

For the preparation of the Placing, the Company was established by way of promotion on 22 March 2000, with Tongrentang Ltd. as the major promoter and controlling shareholder together with Tongrentang Holdings and six natural persons as other promoters. For the establishment of the Company, Tongrentang Ltd. contributed its assets comprising Factory No. 2, Chinese Medicine Refinery, Import and Export Department and Research and Development Centre into the Company. Other promoters contributed capital into the Company and their respective amount of contribution is stated in the table in the sub-section headed “Restrictions on Disposal of Domestic Shares” on page 15 of this prospectus under the section headed “Summary of this prospectus”.

Pursuant to an indemnity given by Tongrentang Ltd. in favour of the Company contained in the restructuring agreement referred to in paragraph 4(a)(i) below, Tongrentang Ltd. has undertaken, among other things, to indemnify the Company for any loss in relation to all claims, damages and charges suffered or incurred from Tongrentang Ltd.’s contributed assets as aforesaid and for all demands, claims, losses, liabilities, indemnities, litigation, arbitration, payments and expenses related to the assets, businesses, rights, liabilities and obligations retained by Tongrentang Ltd. or arising from legal actions against the Company or suffered therefor.

## **2. SUBSIDIARIES**

At the date of this prospectus, the Company does not have any subsidiaries (as defined in the Companies Ordinance).

## **3. FURTHER INFORMATION ABOUT DIRECTORS, SUPERVISORS, MANAGEMENT, STAFF AND SUBSTANTIAL SHAREHOLDER**

### **(a) Particulars of service contracts and remuneration of Directors and Supervisors**

Each of the executive Directors and Supervisors has entered into a service contract with the Company. Particulars of these contracts, except as indicated, are in all material respects identical and are set out below:

- (i) each service contract is for an initial term of three years commencing on 9 March 2000 and shall continue until the conclusion of the annual general meeting of the Company on 2003 and thereafter subject to the approval of the shareholders’ meeting of the Company, each service contract may be renewed each time for three years;
- (ii) subject to resolution passed at shareholders’ meeting of the Company, the remuneration of each of the executive Directors and Supervisors may be changed;

(iii) the annual salary and allowance of each of the Directors and Supervisors for the three years ending 9 March 2003 are as follows:

**Directors**

(aa) Yin Shun Hai	Nil
(bb) Wang Zhao Qi	HK\$420,000
(cc) Mei Qun	Nil
(dd) Tian Rui Hua	RMB48,000 (HK\$45,223.29)
(ee) Zhao Bing Xian	Nil
(ff) Jin Shi Yuan	RMB24,000 (HK\$22,611.64)
(gg) Tam Wai Chu, Maria	HK\$120,000
(hh) Ting Leung Huel, Stephen	HK\$120,000

**Supervisors**

(ii) Tian Da Fang	Nil
(jj) Yang Liang	RMB48,000 (HK\$45,223.29)
(kk) Sun Feng Sheng	RMB48,000 (HK\$45,223.29)

(iv) Each of the executive Directors and Supervisors is entitled to out-of-pocket expenses reasonably incurred during his/her term of office;

(v) The Directors and Supervisors are not entitled to any bonus.

The aggregate of annual remunerations of all executive Directors and non-executive Directors are HK\$420,000 and HK\$307,834.93, respectively, for an initial term of three years.

**(b) Disclosure of the Directors' and Supervisors' interests in the issued share capital of the Company**

Immediately following completion of the Placing, the beneficial interests of the Directors and Supervisors in the Shares and the share capital of any associated corporation (within the meaning of the SDI Ordinance), which will have to be notified to the Company and the Stock Exchange pursuant to section 28 of the SDI Ordinance (including interests which they are deemed or taken to have under section 31 of, or Part I of the Schedule to the SDI Ordinance), or which will be required, pursuant to section 29 of the SDI Ordinance, to be entered in the register referred to therein or which will be required, pursuant to rules 5.40 to 5.59 of the GEM

Listing Rules, to be notified to the Company and the Stock Exchange once the H Shares are listed, will be as follows:

Name	Personal interests/ No. of shares	Family interests	Corporate interests	Other interests	Approximate percentage of holdings immediately following the Placing
Mr Yin Shun Hai	500,000 ( <i>Note</i> )	–	–	–	0.274%
Mr Wang Zhao Qi	500,000 ( <i>Note</i> )	–	–	–	0.274%
Mr Tian Rui Hua	100,000 ( <i>Note</i> )	–	–	–	0.055%
Mr Mei Qun	500,000 ( <i>Note</i> )	–	–	–	0.274%
Mr Zhao Bing Xian	5,000,000 ( <i>Note</i> )	–	–	–	2.735%
Mr Tian Da Fang	500,000 ( <i>Note</i> )	–	–	–	0.274%

*Note:* Domestic Shares only.

**(c) Substantial shareholder**

So far as the Directors are aware, immediately following the Placing, the holder of 10% or more of Shares then in issue will be:

Name	Number of Shares	Approximate percentage of holding immediately following the Placing
Tongrentang Ltd. ( <i>Note</i> )	100,000,000 ( <i>Domestic Shares</i> )	54.705%

*Note:* Tongrentang Ltd. is owned as to 75% by Tongrentang Holdings.

**(d) Connected transactions and related party transactions**

The Company had entered into certain connected transactions and related party transactions within the two years immediately preceding the date of this prospectus as described in the sub-section headed “Connected transactions” under the section headed “Relationship with Tongrentang Holdings and Tongrentang Ltd.” of this prospectus, and note (f) headed “Related party transactions” in paragraph 5 of the accountants’ report set out in Appendix I to this prospectus.

**(e) Disclaimers**

Save as disclosed herein:

- (i) none of the Directors, chief executive nor Supervisors has any interest in the equity or debt securities of the Company or any of its associated corporation (if any) (within the meaning of the SDI Ordinance) which once the H Shares are listed, will be required to be notified to the Company and the Stock Exchange pursuant to section 28 of the SDI Ordinance (including interests which they are deemed or taken to have under section 31 of, or Part I of the Schedule to the SDI Ordinance), or which will be required, pursuant to section 29 of the SDI Ordinance, to be entered into the register referred to therein or which will be required, pursuant to rules 5.40 to 5.59 of the GEM Listing Rules relating to securities transactions by director to be notified to the Company and the Stock Exchange once the H Shares are listed and in case of Supervisors, which will be required to be notified as described above if they had been Directors;
- (ii) so far as is known to any of the Directors or Supervisors, there is no person who will, immediately following the completion of the Placing, be directly or indirectly interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of the Company;
- (iii) none of the Directors nor Supervisors has entered or has proposed to enter into any service contracts with the Company (other than contracts expiring or determinable by the employer within one year without payment of compensation other than statutory compensation);
- (iv) none of the Directors nor Supervisors nor any of the experts whose names are listed in the paragraph headed “Consent of experts” in this appendix has any direct or indirect interest in the promotion of, or in any assets which have been acquired or disposed of by or leased to the Company within the two years immediately preceding the date of this prospectus, or which are proposed to be acquired or disposed of by or leased to the Company;
- (v) none of the Directors nor Supervisors nor any of the experts whose names are listed in the paragraph headed “Consents of experts” in this appendix is materially interested in any contract or arrangement subsisting at the date of this prospectus which is significant in relation to the business of the Company;
- (vi) none of the experts whose names are listed in the paragraph headed “Consents of experts” in this appendix has any shareholding in the Company or the right (whether legally enforceable or not) to subscribe for or to nominate other persons to subscribe for securities in the Company.

#### 4. FURTHER INFORMATION ABOUT THE BUSINESS

##### (a) Summary of material contracts

The following contracts (not being contracts in the ordinary course of business) have been entered into by the Company within the two years preceding the date of this prospectus and are or may be material:

###### (i) *Restructuring agreement*

(aa) a restructuring agreement was entered into by the Company and Tongrentang Ltd. on 22 March 2000 whereby Tongrentang Ltd. transferred certain assets and liabilities of the business units comprising Factory No. 2, the Chinese Medicine Refinery, Import and Export Department and the Research and Development Centre to the Company in exchange for 100,000,000 Domestic Shares;

(bb) an agreement supplemental to the above restructuring agreement was entered into by the Company and Tongrentang Ltd. on 20 October 2000 which the parties thereto agreed to expand the definition of “taxation” in clause 9 of the restructuring agreement to include all forms of taxation whether of the PRC or elsewhere in the world;

###### (ii) *Distribution agent agreements*

(aa) a distribution agent agreement was entered into by the Company and Tongrentang Ltd. on 6 October 2000 whereby Tongrentang Ltd. would act as sales agent of the products of the Company in the PRC; and

(bb) a distribution agent agreement was entered into by the Company and Tongrentang Ltd. on 6 October 2000 whereby the Company would act as sale agent of the products of Tongrentang Ltd. in countries and territories outside the PRC;

###### (iii) *Contract for permission to use trademark*

A contract for permission to use trademark was entered into by the Company and Tongrentang Holdings on 6 October 2000 whereby Tongrentang Holdings agreed to permit the Company to use certain trademarks of Tongrentang Holdings;

*(iv) Undertaking for permission to use tradename*

An undertaking dated 28 February 2000 as supplemented by an undertaking dated 17 October 2000 was issued by Tongrentang Holdings in favour of the Company whereby the Company is permitted to use the words “同仁堂” as its tradename free of charge, including the usage of the names “同仁堂” “北京同仁堂”, “TONG REN TANG” and “創建於一六六九年”, together or separately, in the prospectus and the share certificate of the Company in whatever form, style or manner of representation.

*(v) Underwriting and Placing agreement*

The Underwriting and Placing Agreement was entered into by, among other parties, the Company and the Placing Underwriters on 21 October 2000 relating to the Placing;

*(vi) Deed of undertaking*

A deed of undertaking was signed by Zhao Bing Xian, Tian Rui Hua and Tian Da Fang in favour of the Company, the Sponsor and the Placing Underwriters on 21 October 2000 in respect of certain undertakings (including non-disposal undertakings) contained therein;

*(vii) Raw material supply agreement*

A raw material supply agreement was entered into by the Company and Tongrentang Holdings on 6 October 2000 whereby Tongrentang Holdings agreed to supply raw material to the Company;

*(viii) Joint venture agreement with Beijing Holdings and Hutchison Chinese Medicine*

A joint venture agreement was entered into by the Company, Hutchison Chinese Medicine and Beijing Holdings on 7 October 2000 whereby a joint venture company will be formed in Hong Kong to engage in the research, development and sale of Chinese medicine in Hong Kong;

*(ix) Property leasing agreement*

Supplemental Agreement dated 6 October 2000 referred to in page 35 of this prospectus;

(x) *Land use right leasing agreement*

A land use right leasing agreement was entered into by the Company and Tongrentang Holdings on 6 October 2000 in respect of the properties referred to in paragraph (C)(1) in the sub-section headed “Connected transactions” under the section headed “Relationship with Tongrentang Holdings and Tongrentang Ltd.”

(xi) *Undertaking dated 19 October 2000 referred to in page 133;*

(xii) *The Subscription Agreements; and*

(xiii) *Joint venture agreement with WM Dianorm Biotech*

A joint venture agreement was entered into between the Company and WM Dianorm Biotech on 10 May 2000 whereby a joint venture company was incorporated in the PRC to engage in the development of bio-pharmaceutical technologies.

**(b) Summary of joint venture agreements**

The joint venture companies to which the Company is a party include Tong Ren Tang Hutchison Pharmaceutical Development and Tong Ren Tang WM Dianorm Biotech.

The following is a summary of the terms of the relevant joint venture agreements:

*I. Tong Ren Tang Hutchison Pharmaceutical Development*

Joint venture partners	:	The Company Beijing Holdings Hutchison Chinese Medicine
Operative term	:	20 years from the date of incorporation. This agreement will take effect upon all requisite PRC governmental or other approvals for the consummation of the transaction contemplated thereby being obtained.

Total investment	:	HK\$200,000,000
		HK\$100,000,000 to be invested within one year from the date of incorporation of the joint venture company and as to the balance of HK\$100,000,000 to be invested within three to four years from the date of incorporation of the joint venture company in the discretion of the board of directors of the joint venture company. The parties to the joint venture agreement have agreed to subscribe for shares of the joint venture company or increase their respective amounts of investment in the ratio of 40% (the Company), 10% (Beijing Holdings) and 50% (Hutchison Chinese Medicine)
Authorized share capital	:	HK\$15,000,000
Capital contribution	:	The Company: HK\$6,000,000 Beijing Holdings: HK\$1,500,000 Hutchison Chinese Medicine: HK\$7,500,000
		Upon application for respective share interests of 40%, 10% and 50%, of the joint venture company, the Company will pay its share of investment of the joint venture of HK\$6,000,000 by telegraphic transfer whereas Beijing Holdings and Hutchison Chinese Medicine will pay their respective investment by cashier's order of HK\$1,500,000 and HK\$7,500,000, respectively

In all circumstances, the Company enjoys the first right of refusal at the first time of transfer of shares by Beijing Holdings, under the same transfer consideration. After the first time of transfer, the Company and Hutchison Chinese Medicine shall exercise their respective first right of refusal according to their respective shareholdings in the joint venture company.

Equity interests	:	The Company: 40% Beijing Holdings: 10% Hutchison Chinese Medicine: 50%
Board of directors	:	Six members <ul style="list-style-type: none"><li>• Two of them to be appointed by the Company</li><li>• One of them to be appointed by Beijing Holdings</li><li>• Three of them appointed by Hutchison Chinese Medicine</li></ul>
Sharing of profits and losses	:	The Company: 40% Beijing Holdings: 10% Hutchison Chinese Medicine: 50%

*II. Tong Ren Tang WM Dianorm Biotech*

Joint venture partners	:	The Company WM Dianorm Biotech
Operative term	:	20 years from the date of incorporation
Total investment	:	US\$5,000,000
Registered capital	:	US\$3,000,000
Capital contribution	:	The Company: US\$1,800,000 WM Dianorm Biotech: US\$1,200,000




60% of the registered capital, which equals to US\$1,800,000 will be paid up by the Company in cash. 10% of the registered capital, which equals to US\$300,000 will be paid up by WM Dianorm Biotech in cash. WM Dianorm Biotech will also contribute technology of patented liposome and relevant products with total value of US\$900,000 to the joint venture, representing the remaining 30% of the registered capital



Equity interests	:	The Company: 60% WM Dianorm Biotech: 40%
Board of directors	:	Five members <ul style="list-style-type: none"><li>• Three of them to be appointed by the Company including the chairman of the board</li><li>• Two of them to be appointed by WM Dianorm Biotech</li></ul>

**(c) Intellectual property rights**

*Trademark (and service trademark)*

Pursuant to the contract for permission to use trademark dated 6 October 2000 between the Company and Tongrentang Holdings, the Company has been granted various permits to use and apply the following trademark (and service trademarks) until the expiry (if shorter) of the trademark registration period. Trademarks (and service trademarks) registered in the PRC are governed and protected by and subject to the PRC Trademark Act for an initial term of ten years from the date of registration renewable for a further term of ten years upon expiry.

Trademark/service trademark	Jurisdiction	Class	Registration number	Registered owner	Expiry date
1. 	PRC	31	171188	Tongrentang Holdings	28 February 2003
2. 	PRC	5	924656	Tongrentang Holdings	6 January 2007
3. 	PRC	35	771060	Tongrentang Holdings	6 November 2004
	PRC	36	770582	Tongrentang Holdings	27 October 2004
	PRC	37	769845	Tongrentang Holdings	13 October 2004
	PRC	38	770633	Tongrentang Holdings	27 October 2004
	PRC	39	769343	Tongrentang Holdings	6 October 2004
	PRC	40	770619	Tongrentang Holdings	27 October 2004
	PRC	41	769220	Tongrentang Holdings	6 October 2004
	PRC	42	779239	Tongrentang Holdings	6 October 2005

Trademark/service trademark	Jurisdiction	Class	Registration number	Registered owner	Expiry date
4. 	PRC	31	143697	Tongrentang Holdings	28 February 2003
5. 	PRC	31	136321	Tongrentang Holdings	28 February 2003

## 5. OTHER INFORMATION

### (a) Estate duty and other tax indemnity

The Directors have been advised that no material liability for estate duty is likely to fall on the Company under PRC law.

Pursuant to the restructuring agreement dated 22 March 2000 and the agreement supplemental to the restructuring agreement dated 20 October 2000 referred to in paragraph 4(a)(i) above, Tongrentang Ltd. has undertaken to pay (i) all forms of taxation arising from the business in relation to the assets and rights transferred to the Company prior to the establishment of the Company, regardless as to whether the taxes are due prior to or after the establishment of the Company; (ii) relevant forms of taxation arising either before or after the establishment of the Company from the assets, rights, liabilities or obligations of the relevant business owned by it but not reflected in the asset valuation report and the accountants' report on the Company prior to or after the establishment of the Company; and (iii) all forms of taxation arising as a result of the relevant rights or other assets or liabilities which should otherwise have been but not yet transferred to the Company after the establishment of the Company. Taxation shall include all forms of taxation whether of the PRC or elsewhere in the world whenever imposed and all statutory, governmental, state, provincial, local government or municipal impositions, duties and levies and all penalties, charges, costs and interest relating thereto.

### (b) Litigation

As at the Latest Practicable Date, the Company is not engaged in any litigation or arbitration of material importance and, so far as the Directors are aware, no litigation, arbitration or claim of material importance is pending or threatened against the Company.

**(c) Sponsor, global coordinator and lead manager**

BOCI Asia has made an application on behalf of the Company to the GEM Listing Committee for the listing of, and permission to deal in, any of the H Shares to be issued under the Placing and to be allotted and issued pursuant to the exercise of the rights of over allotment. All necessary arrangements have been made to enable the H Shares to be admitted into CCASS.

BOCI Asia is the sponsor, global coordinator and lead manager in relation to the Placing.

**(d) Preliminary expenses**

The preliminary expenses of the Company are estimated to be approximately RMB23.4 million (HK\$22 million) and are payable by the Company.

**(e) Promoters**

The promoters of the Company are Tongrentang Ltd., Tongrentang Holdings, Yin Shun Hai, Tian Da Fang, Wang Zhao Qi, Mei Qun, Tian Rui Hua and Zhao Bing Xian. Save as disclosed in this prospectus, within the two years preceding the date of this prospectus, no cash amount or security or other benefit has been paid, allotted or given or proposed to be paid, allotted or given to the promoters in connection with the Placing or the related transactions described in this prospectus.

**(f) No material adverse change**

Save as disclosed in this prospectus, the Directors believe that there has been no material adverse change in the financial or trading position or prospect of the Company since 30 April 2000.

**(g) Binding effect**

This prospectus shall have the effect, if an application is made in pursuance hereof, of rendering all persons concerned bound by all of the provisions (other than the penal provisions) of sections 44A and 44B of the Companies Ordinance insofar as applicable.

**(h) Taxation of holders of the H Shares**

Dealing in the H Shares is subject to Hong Kong stamp duty.

**(i) Miscellaneous**

(i) Save as disclosed in this prospectus:

(aa) within the two years preceding the date of this prospectus, no share or loan capital of the Company has been issued or agreed to be issued fully or partly paid either for cash or for a consideration other than cash;

(bb) no share or loan capital of the Company is under any option or is agreed conditionally or unconditionally to be put under option;

(cc) within the two years preceding the date of this prospectus, no commissions, discounts, brokerages or other special terms have been granted in connection with the issue or sale of any share or loan capital of the Company;

(dd) the Company has no founders or management or deferred shares.

(ii) The Company is not subject to the Sino-Foreign Joint Venture Law of the PRC, and is not expected to be subject to such law unless and until it is granted foreign invested enterprise status.

(iii) None of the equity and debt securities of the Company is listed or dealt in any other stock exchange nor is any listing or permission to deal being or proposed to be sought.

(iv) The Company does not have any outstanding convertible debt securities.

**6. QUALIFICATIONS OF THE EXPERTS**

<b>Name</b>	<b>Qualification</b>
BOCI Asia	Registered securities dealer under the Securities Ordinance
LCH (Asia-Pacific) Surveyors Limited	Registered professional surveyors and independent valuers
Zhong Yin Law Firm	Licensed legal advisers on PRC law
Arthur Andersen & Co.	Certified public accountants

**7. CONSENTS OF EXPERTS**

Each of BOCI Asia, LCH (Asia-Pacific) Surveyors Limited, Zhong Yin Law Firm and Arthur Andersen & Co. has given and has not withdrawn its respective written consent to the issue of this prospectus with the inclusion of its report and/or letter and/or advice and/or valuation certificate and/or the references to its name in the form and context in which they are respectively included.

**1. DOCUMENTS DELIVERED TO THE REGISTRAR OF COMPANIES**

The documents attached to the copy of this prospectus delivered to the Registrar of Companies in Hong Kong for registration were copies of the written consents referred to in the section headed “Consents of experts” in Appendix VII to this prospectus and copies of the material contracts referred to in the section headed “Material contracts” in Appendix VII to this prospectus.

**2. DOCUMENTS AVAILABLE FOR INSPECTION**

Copies of the following documents will be available for inspection at the offices of Kwok & Yih in association with Blake Dawson Waldron, 37th Floor, Gloucester Tower, The Landmark, Central, Hong Kong during normal business hours up to and including 6 November 2000.

- (a) the Articles of Association of the Company;
- (b) the accountants’ report on the Company prepared by Arthur Anderson & Co., the text of which is set out in Appendix I to this prospectus;
- (c) the letter, summary of valuation and valuation certificate relating to the property, machinery and facilities of the Company prepared by LCH (Asia-Pacific) Surveyors Limited, the texts of which are set out in Appendices III and IV to this prospectus;
- (d) the legal opinion dated 24 October 2000 issued by Zhong Yin Law Firm confirming that in their opinion the summary of the PRC laws and principal regulatory provisions as referred to in Appendix V to this prospectus is a correct summary of the relevant PRC laws and regulatory provisions;
- (e) the material contracts referred to in paragraph 4(a) in Appendix VII to this prospectus;
- (f) the service contracts referred to in paragraph 3(a) in the section headed “Further information about Directors, Supervisors, management staff and substantial shareholder” in Appendix VII to this prospectus;

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**APPENDIX VIII      DOCUMENTS DELIVERED AND AVAILABLE FOR INSPECTION**

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- (g) the written consents referred to in paragraph 7 in Appendix VII to this prospectus;
- (h) the Company Law; and
- (i) the board minutes and shareholders resolutions of the Company both dated 11 October 2000.