China Medical System Holdings Limited

Report of the Directors and Financial Statements

for the year ended 31 December 2009

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China Medical System Holdings Ltd.
("CMS" or "the Company")

Annual Report 2009

For the year ended 31 December 2009

China Medical System Holdings Ltd. (AIM: CMSH), a marketing and promotional service provider in China for prescription pharmaceutical products, is pleased to announce its annual results for the year ended 31 December 2009.

Results are reported in US dollar currency unless otherwise stated.

HIGLIGHTS

Financial Highlights:

- **Sales up 32.9% to $96.5M (2008: $72.6M)**
- **Gross Profit up 35.9% to $60.9M (2008: $44.8M)**
- **Net Profit up 38.4% to $20.8 million (2008: $15 .0 million)**
- **Basic EPS and Diluted EPS up 38.3% and 37.7% to $0.437 and $0.435 respectively (2008: $0.316 for both)**
- **Total dividend per share for the year up 33.3%, to $0.20 per share (2008: $0.15 per share)**

Operational Highlights

- **Exceptional sales increase of our in-licensed products:**

Deanxit	$44.5M	21.1% increase (2008:$36.7M)
Ursofalk	$28.3M	34.4% increase (2008:$21.1M)
Stulln	$6.1M	39.9% increase (2008:$4.4M)
GanFuLe	$4.8M	22.3% increase (2008:$3.9M)
XinHuoSu	$7.3M	155.5% increase (2008:$2.8M)
Salofalk	$1.8M	1,271.4% increase (2008: $0.1M)
Cystistat	$0.5M	680.3% increase (2008:$0.1M)

- **The Imported Drug License of Cystistat was renewed in March 2009**
- **Expanded sales & marketing network by employing over 250 new staff (total sales and marketing team of over 750)**
- **Forbes Magazine accreditation for 2010 Forbes China Up & Comers**

CMS AT A GLANCE

CMS -- founded in 1995, we are the leading provider of sales, marketing and promotional services in China for prescription pharmaceutical products manufactured overseas and domestic specialty pharmaceutical companies according to a report on the pharmaceutical sales and marketing service provider market in China prepared by Frost and Sullivan and commissioned by us (the "Frost Report").

Our Business

We primarily serve overseas and domestic specialty pharmaceutical companies by promoting their prescription products using our extensive professional marketing network. Through agency and distribution agreements, our suppliers grant us the medium to long-term exclusive rights to promote and sell our in-licensed pharmaceutical products in China.

Currently, our sales and marketing network covers products that span seven therapeutic areas, including: central nervous system (or CNS), hepatology, Gastrointestinal (or GI), urology, ophthalmology, cardiovascular, and oncology. Seven of our most profitable in-licensed pharmaceutical products come from our top six suppliers:

Supplier	**Product**	**Indication**
H Lundbeck A/S, Denmark	*Deanxit Tablet*	Mild to moderate depression and anxiety
Dr. Falk Pharma GmbH, Germany	*Ursofalk Capsules*	Dissolution of cholesterol gallstones, cholestatic liver disease and gastritis
	Salofalk	Ulcerative colitis and Crohn's disease
Pharma Stulln GmbH, Germany	*Augentropfen Stulln Mono Eye-drops*	Ocular asthenopia and Senile Macular Degeneration
Bioniche Teoranta, Ireland	*Cystistat*®	Interstitial Cystitis
China National Group Corp. of Traditional & Herbal Medicine	*GanFuLe*	Liver cancer, hepatitis B and cirrhosis
Tibet Rhodiola Pharmaceutical Holding Company	*XinHuoSu (Nesiritide)*	Acutely decompensated congestive heart failure (ADHF)

Our Strengths

Pharmaceutical Promotion Network
Our sales, marketing and promotion network comprises more than 750 staff covering over 5,000 hospitals (including about 150 Military hospitals) in over 1,100 PRC cities (including municipal and county – level cities) across 30 provinces. More than 78% of our sales team graduated from medical schools or have pharmaceutical backgrounds. Our hospital network (excluding Military hospitals) covers 80% of the class-three hospitals and 35% of the class-two hospitals in China. Our sales, marketing and promotion network gives our suppliers direct access to more than 38,000 physicians.

Product Screening Expertise
We focus on in-licensing prescription drugs from domestic or overseas manufacturers. Our product selection criteria includes: large market potential or unmet medical needs in China, and strong intellectual property rights or administrative protection in China, or features that can differentiate the drugs from other competitive products.

Our Strategies

To broaden the promotion network
We continue to recruit new medical representatives and expand our hospital customer base in order to strengthen our professional marketing and promotion network that is customized to the Chinese market, which in 2009 was the fastest growing pharmaceutical market in the world according to the Frost Report.

To expand the product portfolio
We plan to continue to expand our product portfolio and therapeutic focus by obtaining exclusive rights for new pharmaceutical products in China. Our goal is to add at least two high-quality pharmaceutical products every year to our portfolio for which we aim to obtain the exclusive agency and marketing rights in China so as to expand our market share and generate more profits for the Group.

CHAIRMAN & CEO'S STATEMENT

2009 was another exciting and successful year for CMS. We reached record sales of $96.5M, representing an increase of 32.9% from 2008 ($72.6M), and nearly doubled the sales of 2007 ($51.7M), which is the year of our AIM listing. In addition, net profit and net cash from operating activities also reached record levels in 2009 amounting to $20.8M and $15.5M respectively.

Having established our Group 15 years ago with the aim of introducing quality products to patients and healthcare practitioners in China, CMS has continued to look for in-licensing opportunities for prescription drugs with large market potential or unmet medical needs in China. We primarily target overseas and domestic pharmaceutical companies with limited promotion capability in China, and seek to promote and sell their products on an exclusive basis using our extensive professional marketing network.

During the year we delivered strong organic growth from our existing product portfolio. We benefit from economies of scale in relation to sales and promotional expenses for new products by leveraging our well-established sales and promotion network to add new products to our existing portfolio. At the time of releasing our 2009 interim results, we reported that we had put strong efforts into identifying potential products and were having ongoing discussions with potential suppliers. Although we did not bring in new products in the fiscal year of 2009, we were delighted to add Bioflor and Exacin to our portfolio in early 2010, and look forward to cooperating with Biocodex and Asahi Kasei Pharma Corporation, being the suppliers of Bioflor and Exacin respectively. The strong growth in sales and the addition of these products validate the strength of our business model and growth strategy.

In 2009, following a strategic review of our businesses, we decided to dispose both of our R&D operations (Healthlink Inc. and its subsidiaries) and medical devices business to focus solely on providing sales, marketing and promotional services to overseas or domestic specialty pharmaceutical companies. Both disposals were completed in December of 2009. We believe we will benefit further by focusing our resources on the sale and promotion of prescription pharmaceutical products.

The rate of growth we have achieved in the past year was helped by our dedicated and capable employees as well as our devoted and competent management team. We appreciate the efforts of our staff, and understand the importance of attracting and retaining high caliber employees. Therefore during the year we implemented the Key Employee Benefit Scheme, being a long term incentive plan under which awards may be granted to key employees of the Company and its subsidiaries, who have been actively involved in the business development of the Group.

Dividend Declaration

The Company paid an interim dividend of $0.1 per ordinary share for the first six months ended 30 June 2009. The Board is delighted to recommend a final dividend for the year of $0.1 per ordinary share, giving a total of $0.2 per ordinary share for the year. This represents a growth in dividends year-on-year of 33.3%. Payment of the final dividend is subject to the shareholder's approval at the Annual General Meeting ("AGM") on 4 May 2010.

The final dividend will be paid on 14 May 2010 to shareholders whose names appear on the Company's register of members on 16 April 2010, with an ex-dividend date of 14 April 2010.

The AGM is scheduled to be held on 4 May 2010 at 10:00am (Macau time) at Ballroom 3, Wynn Macau, rua cidade de sintra, Nape, Macau.

Operational Review

Marketing & Promotion

Pharmaceutical marketing and promotion is an important component of informing and educating healthcare practitioners about our pharmaceutical products, updating and raising their awareness of available treatments, and hence generating demand for such treatments.

Over the past 15 years, CMS has established a nationwide sales, marketing and promotion network that comprises more than 750 staff covering over 5,000 hospitals (including about 150 Military hospitals) in over 1,100 PRC cities (including municipal and county – level cities) across 30 provinces. More than 78% of our sales team graduated from medical schools or have pharmaceutical backgrounds. Our hospital network (excluding military hospitals) covers 80% of the class-three hospitals and 35% of the class-two hospitals in China. Our sales, marketing and promotion network gives our suppliers direct access to more than 38,000 physicians. Our professional medical representatives strengthen product recognition by targeting physicians on our network and through them generate demand for our products.

CMS maintains a centralised product training program to ensure that all our medical representatives are adequately informed and educated about each product's clinical use, benefits, side effects and other clinical aspects, so that they can employ an academic approach to promote the products to the targeted physicians and build up brand awareness.

In order to further expand our sales network's coverage, we recruited more than 250 new staff to our sales team in 2009. The new addition of our medical representatives will further add to our established sales team, and allow us to expand our sales network's geographic reach and broaden our therapeutic specialties.

For the full year ended 31 December 2009, total sales were $96.5M, representing an increase of 32.9% from 2008 (2008: $72.6M). We applied our experience from Deanxit and Ursofalk, our two best sellers, to our introductory stage products, and in 2009 we saw outstanding progress in sales of these introductory stage products. Sales of Stulln, GanFuLe, XinHuoSu, Cystistat and Salofalk amounted to $20.5M, representing an increase of 80.9% from 2008 (2008: $11.3M). Sales derived from our growth stage products (Deanxit and Ursofalk) amounted to $72.8M from $57.8M in 2008, representing an increase of 26.0%. This healthy development in the overall sales trend is in-line with our goal to diversify our revenue source and reduce dependence on a few products.

In 2009, we sponsored various medical conferences and medical symposia across the nation to enhance brand awareness of our products, which, we believe, is instrumental in helping us to further expand the market share of our products.

A brief review of the major products in our portfolio is as follows:

Growth Stage Products

Our proven track record in successfully promoting and selling prescription pharmaceutical products in China has led to the growth of our business. In particular, Deanxit and Ursofalk are two products which we have promoted exclusively in China for over 10 years. Sales of both of these products have been growing steadily, reaching an annual turnover of $44.5M and $28.3M respectively in 2009, which represent CAGRs (2007-2009) of 30.4% and 38.6% respectively. The success of these two products demonstrates our ability and proficiency in positioning and promoting pharmaceutical products to healthcare practitioners, and our ability to generate further demand for the products in the Chinese pharmaceutical market. During 2009, the total sales of these two products accounted for 75.5% of total revenue, representing a decrease of 4.1% from 2008 (2008: 79.6%).

Deanxit Tablet (Flupentixol and Melitracen Tablets)

Sales of Deanxit, our largest revenue contributor, increased by 21.1% to $44.5M in 2009 (2008:$36.7M) as we continued to expand our promotion activities in China. Deanxit is used for treatment of mild to moderate depression and anxiety. As of December 31, 2009, we sold Deanxit to over 4,100 hospitals (including Military hospitals) across 28 provinces in China. Deanxit has been included in the Class B Drug Catalogue of National Basic Medical Insurance since 2009, which significantly reduced the costs to patients.

Launched in 1997, Deanxit is currently one of the leading antidepressants in China. According to the Frost Report, Deanxit was ranked No.2 in terms of revenue in China in 2009. In 1997, Mr. Lam obtained an exclusive right to distribute Deanxit in China (excl. Hong Kong and Macau) and in 1999, we entered into a five-year exclusive agreement with A/S Lundbeck Overseas Ltd. of Denmark to promote and sell Deanxit in China. In 2008, we successfully renewed the agreement for another five years.

Sales of Deanxit have increased at a CAGR of 30.4% from 2007 to 2009, and we attributed the strong growth to our extensive promotion network and our focus on promoting the use of Deanxit for treatment of psychosomatic diseases.

Ursofalk Capsules (*Ursodesoxycholic Acid or "UCDA")*
Sales of Ursofalk, our second largest revenue contributor, increased by 34.4% to $28.3M in 2009 (2008: $21.1M). Ursofalk is primarily used in the dissolution of cholesterol gallstones, cholestatic liver disease and gastritis. As of December 31, 2009, we sold Ursofalk to over 2,200 hospitals (including Military hospitals) across 29 provinces in China. UCDA has been included in the Drug Catalogue of National Basic Medical Insurance, and added in the new National Essential Drug List in China released in 2009, which further increased customer demand.

We introduced Ursofalk to the Chinese market in 1998. According to the Frost Report, Ursofalk was the No.1 drug in China's Cholagogue market in 2009 accounting for 55.9% of market share. We entered into an exclusive agreement with Dr. Falk Pharma of Germany for the sales and marketing of Ursofalk in China in 1998. The contract was automatically renewed in 2009 and will expire in 2014 after fulfilling the annual minimum order quantities we agreed with Dr. Falk Pharma.

During the year, CMS hosted the meeting of clinical research on the treatment of Drug Induced Liver Injury to introduce the efficacy and safety of Ursofalk. Additionally, Ursofalk continued to take part in different academic activities, such as "Seminar of expert consensus on the diagnosis and treatment of cholestatic liver disease" and "Summit Forum of Fatty Liver Disease". With the continuous efforts from Dr. Falk and CMS, we believe Ursofalk will continue its healthy sales growth and maintain its market leading position.

Main Introductory Stage Products

CMS has held the exclusive rights in China to promote and sell Stulln since 2006 and GanFuLe since 2007, and further obtained the exclusive promotion and selling rights for XinHuoSu, Salofalk and Cystistat® in 2008. We are able to leverage our established sales network and promotion expertise to enhance the sales of our newly introduced products. Sales of Stulln increased at a CAGR of 42.9% from 2007-2009, while sales of GanFuLe increased at at a CAGR of 35.6 % from 2007 to 2009. Compared with 2008, sales of XinHuoSu, Salofalk and Cystistat® increased by 155.5%, 1,271.4% and 680.3% in 2009, respectively. Total revenue contributed from these five new products increased from 15.6% in 2008 to 21.3% in 2009.

Augentropfen Stulln Mono Eye-drops
Augentropfen Stulln Mono (ASM) is an imported eye-drop approved by SFDA for the treatment of senile macula degeneration (SMD). ASM is also approved as treatment for all forms of ocular asthenopia. Sales of ASM increased by 39.9% to $6.1M in 2009 (2008: $4.4M) as we continue to sell the product in more hospitals.

ASM is a product of Pharma Stulln GmbH, Germany. We first obtained the exclusive right to promote and sell ASM in China in 2006, and then acquired the exclusive agency right in China in 2008. Since 2007, we have sponsored many nationwide academic conferences and seminars to build up the brand awareness. In 2009, CMS achieved positive progress in promoting ASM for ocular asthenopia and we organized several different conferences, such as the conference on "Results discussion of national multi-center clinical study on the efficacy and safety of Stulln in the treatment of Asthenopia". As a result, we successfully expanded the number of hospitals that prescribe ASM from 200 in 2007 to over 1,000 hospitals in 2009.

GanFuLe ("GFL")

Sales of GanFuLe increased by 22.3% to $4.8M in 2009 (2008: $3.9M). GFL was introduced in 2007 and is a traditional Chinese medicine used to treat primary liver cancer, hepatitis B and cirrhosis with specified symptoms. GFL is included in the Drug Catalogue of National Basic Medical Insurance which helps to promote wider prescription in the market. In addition, the product was granted a seven-year National Second Grade Traditional Chinese Medicine Protection expiring in July 2013, during which time, other manufacturers are not allowed to produce the product.

We entered into an exclusive agreement with Huahe Pharmacy Lengshuijiang Pharmaceutical Co. Ltd for the sales and marketing of GFL in southern regions of China in 2007, which was renewed in 2010, and will expire in 2014.

As GFL receives more recognition from physicians, we are confident we will continue to gain market share.

XinHuoSu (Lyophilized Recombinant Human Brain Natriuretic Peptide "rhBNP"）

XinHuoSu was introduced in 2008. Sales of XinHuoSu increased by 155.5% to $7.3M in 2009 (2008: $2.8M). This product is used for acutely decompensated congestive heart failure ("ADHF") patients who have dyspnea at rest or with minimal activity. XinHuoSu is classified as a National Class One New Drug by the SFDA. We entered into an exclusive agreement with Tibet Rhodiola Co. Ltd, for the sales and marketing of XinHuoSu in China in 2008, which expires by 2010 and may be renewed for another 3 years if we meet the minimum order quantities.

As of December 31, 2009, we were able to expand the number of hospitals prescribing XinHuoSu from 249 to over 400, and sales in 2009 more than doubled that of 2008.

Cystistat®(Sodium Hyaluronate)

Cystistat® is used with a medical device for the temporary replacement of the glycosaminoglycan (GAG) layer in the bladder caused by Interstitial cystitis (IC). We entered into an exclusive agreement with Bioniche Teoranta to promote and sell Cystistat in China in 2008 and the term of the agreement is five years with automatic renewal if minimum order quantity is satisfied. Sales of Cystistat was $0.5M in 2009

Salofalk (Mesalazine)

Salofalk is prescribed for the treatment of Ulcerative Colitis and the acute exacerbations of Crohn's disease. This is the second product we in-licensed from Dr. Falk Pharma, and we entered into an exclusive agreement to market and sell the product in China in 2008 for a term of 5 years. Salofalk is included in the Class B Drug Catalogue of National Basic Medical Insurance.

In 2009, we sponsored many conferences to introduce the Company and the product to the market. We were able to leverage our existing relationship with doctors to build up the expert network for Salofalk, which assisted us in educating the physicians about the clinical benefits of the drug. We also co-sponsored Falk Symposium in Shanghai with support from Falk Foundation, which provided a platform for the local physicians to exchange experiences with the internationally renowned Professor G.Adler (Professor of internal medicine of University Ulm), and helped to establish brand awareness of Salofalk amongst the Chinese healthcare practitioners.

Sales in 2009 amounted to $1.8M, and we believe its sales will be further increased through our established network.

Outlook & Summary

According to reports prepared by IMS Health in 2009 on the state of the global pharmaceutical market (the "IMS Reports"), whilst the global pharmaceutical market is expecting single digit growth as it navigates through the current challenging economic climate, China's pharmaceutical sector grew by 26% in 2008 and is expected to drive $40 billion in growth through 2013. According to the IMS Reports, China was the sixth largest pharmaceutical market in 2009 and will become the third biggest by 2011. The strategic importance of China for many Western pharmaceutical companies has become increasingly apparent, but regulatory and cultural differences have made it difficult for overseas pharmaceutical companies to directly penetrate the China market. As the leading marketing and promotional service provider in China for prescription pharmaceutical products according to the Frost Report, we are confident that we can assist such companies in entering into the Chinese market.

We have rich experience in cooperating with overseas pharmaceutical companies and have a proven track record and devoted management team. We intend to continue to grow our existing products' market share, as well as expand our product portfolio to add at least two additional products each year to increase our revenue. We aim at continuously delivering satisfactory results to our in-licensing partners, and as our market and therapeutic reach expands, we believe we can continue to attract new suppliers of quality products.

We look forward to 2010 with confidence, we believe we have the team and strategy in place to deliver on our above goals. As supported by our strong cashflow and balance sheet, we are well positioned to capitalize on potential acquisition opportunities when they become available.

Post Balance Sheet Event

Bioflor

Bioflor (Saccharomyces boulardii), produced by Biocodex of France, is a probiotic antidiarrheal product mainly used in the prevention and treatment of diarrhea, found in adults and children. Biocodex, founded in 1953, is an independent, family-owned French pharmaceutical company specializing in Gastroenterology, Pain Treatment, Neurology and Psychiatry. We signed an agreement with Biocodex for the exclusive sales and promotion of Bioflor capsule and sachet in China in February 2010 for a duration of five years.

Exacin

Exacin (Isepamicin Sulfate) is an aminoglycoside antibiotic product developed and produced by Asahi Kasei Pharma. Corporation ("Asahi Kasei Pharma"), and it has been imported in China since 2004 and is approved by the SFDA for treatment of sensitive bacteria causing septicaemia, secondary infections arising from trauma, burns and surgery as well as chronic bronchitis, bronchiectasis, pneumonia, pyelonephritis, cystitis and peritonitis. Asahi Kasei Pharma has acquired a one–time import permit from the State Food and Drug Administration of the People's Republic of China (SFDA) for Exacin, while the Imported Drug License is under renewal. We recently contracted with Asahi Kasei Pharma Corporation who granted us the rights to promote the one-time imported Exacin in China (excluding Hong Kong and Macau).

Kong Lam
Chairman & CEO

FINANCIAL REVIEW

Highlights

- Turnover up 32.9% to $96.5M (2008: $72.6M)
- Gross profit up 35.9% to $60.9M (2008: $44.8M)
- Gross profit margin increased by 1.4% to 63.1% (2008: 61.7%)
- Profit up 38.4% to $20.8M (2008: $15.0M)
- Basic EPS and Diluted EPS up 38.3% and 37.7% to $0.437 and $0.435 respectively (2008: $0.316 for both)

Turnover

Turnover was up 32.9% to $96.5M (2008: $72.6M). Turnover generated from the growth of the existing products (Deanxit, Ursofalk) was up 26.0% to $72.8M (2008: $57.8M) and accounted for 75.5% of the total sales (2008: 79.6%). Turnover generated from newly in–licensed products (Stulln, GanFuLe, XinHuoSu, Cystistat, Salofalk) was up 80.9% to $20.5M (2008: $11.3M) and accounted for 21.3% of total sales (2008: 15.6%).

Gross profit margin

Gross profit margin increased by 1.4% to 63.1% (2008: 61.7%). This was mainly due to the change of our product mix, and the increase in sales of high gross margin products.

Other gains and losses

Other gains and losses was $0.7M (2008: $2.7M). The decrease was mainly due to the decrease of service income, and the exchange loss arising from the appreciation of the Euro.

Selling expenses

Selling expenses amounted to $24.8M (2008: $18.6M) and the expense ratio was 25.8% (2008: 25.7%). The selling expenses increased as we rolled out the marketing and promotion campaigns for the newly in-licensed products. However, the selling expenses, as a percentage of the turnover, remained flat over 2008 as we benefit from decrease of other selling expenses as a percentage of the turnover.

Administrative expenses

Administrative expenses amounted to $7.4M (2008: $6.9M) and the expense ratio was 7.7% (2008: 9.6%). The increase of the amount was mainly due to the launch of the Key Employee Benefit Scheme in 2009.

Research and development costs

Research and Development costs amounted to $2.0M, and the expense ratio was 2.1% (2008: $2.3M and expense ratio being 3.1%). The amount decreased by $0.2M, mainly due to the decrease in the expenditure on clinical trials.

Taxation

Taxation amounted to $6.1M (2008: $4.5M). The amount increased by $1.6M, mainly due to the increase of the PRC Enterprise Income Tax rate from 18% in 2008 to 20% in 2009 applicable to the Shenzhen city and the increase of our profit.

Inventories

Inventories increased by $5.1M to $11.1M (2008: $5.9M), mainly due to the increase of our sales and the addition of new products to our product portfolio.

Trade receivables

Trade receivables amounted to $21.0M (2008: $17.4M), and the average turnover was 73 days. (2008: 81 days). The improvement in receivable days was primarily due to our increased efforts in working with our distributors to tighten control over trade receivables, with the assistance of our information management system, which provides us with instant access to data on billing and outstanding receivables.

Cash resource

Cash resource (represented by bills receivables) was up 34.7% to $9.5M (2008: $7.1M).

Bank balances and cash, and cash flow

Bank balances and cash was down 24.8% to $15.1M (2008: $20.1M), mainly due to the final dividend paid for 2008 of $4.7M and the interim dividend paid for 2009 of $4.7M, and the additional investment of $10.0M in R&D operation before its disposal.

For the year ended 31 December 2009, net cash from operating activities was $15.5M, net cash used in investing activities was $16.6M and net cash used in financing activities was $4.0M.

Pledged bank deposits and bank borrowings

Pledged bank deposits was $17.6M (2008: $1.1M, which were deposits pledged to open Letters of Credit) and bank borrowings was $16.5M. The pledged bank deposits represent deposits to banks to secure short-term bank borrowings

Trade payables

Trade payables amounted to $6.1M (2008: $5.6M). The increase of the amount was due to the increase of inventories. The average trade payable days was 60 days. (2008: 105 days).

Derivative financial liabilities

Derivative financial liabilities amounted to $0.1M, being the fair value of interest rate swaps and forward currency forward contracts to hedge against our loans in USD, as at 31 December 2009.

Earnings per share

Basic earnings per share and diluted earnings per share were $0.437and $0.435 respectively (2008: $0.316 for both).

Yanling Chen
Chief Financial Officer

DIRECTORS & SENIOR MANAGEMENT

The CMS management team consists of members who are highly motivated, and have an enthusiastic and entrepreneurial spirit. The management team consists of members qualified in medicine, pharmacology and biochemistry. The Directors believe that the Board has valuable experience in product research, regulatory affairs, sales and marketing. The Directors further believe that the management team's familiarity with the rules and regulations of the PRC pharmaceutical sector and its understanding of the business culture of the PRC has allowed CMS to be competitive in the PRC pharmaceutical market.

The following sets out information regarding the Company's current Directors.

Mr. Kong Lam – Chairman and Chief Executive Officer (CEO)
Our Group was founded in 1995 when our Chairman and CEO, Mr. Kong Lam, acquired Kangzhe Shenzhen Pharmaceutical Company Limited. Mr. Lam built the business from a small pharmaceutical distribution company to a leading provider of pharmaceutical sales, marketing and promotion services. Mr Lam has since spearheaded all aspects of the creation, implementation and management of the Company's growth strategy.

Mr. Lam is also the co-inventor of the Group's peptide products. He received his bachelor's degree in medicine from Zhanjiang Medical College, the name of which was changed to Guangdong Medical College in 1992.

Mr. Hongbing Chen –Chief Operating Officer (COO)
Mr. Chen joined Kangzhe Shenzhen Pharmaceutical Company Limited in 1995 and is currently our COO responsible for the operation of the sales, marketing and promotion business of the Group. Prior to joining the Company, he was a resident doctor for four years. He graduated from Nanjing Medical College with a bachelor's degree in Clinical Medicine.

Ms. Yanling Chen – Chief Financial Officer (CFO)
Ms Chen joined Kangzhe Shenzhen Pharmaceutical Company Limited in 1995 and is currently our CFO. Ms. Chen has been involved in financial control, financial integration and the financial management of the Group's business. She received her accountancy qualification in 1997 and an EMBA from International East-West University in 1999.

Ms. Xiaoxuan Hou – Executive Director
Ms. Hou is currently the Executive Director of the Company. She joined Shenzhen Kangzhe Pharmaceutical Company Limited in 1995. Before joining the company, she was a teacher at Kunming Medical College. Ms. Hou received a bachelor's degree in clinical medicine from Kunming Medical College, a master's degree in accountancy from Renming University of China and an EMBA from the Guanghua School of Management of Peking University.

Mr. Ki Fat Hui – Executive Director
Mr. Hui is currently our Executive Director, responsible for the business of Sky United, which engages in the import and export of pharmaceutical products for the Group and has been a Director of Sky United Trading Ltd., being one of our subsidiaries since 1999. Prior to his career in Sky United, he was Director and General Manager of Jebsen & Company Ltd. in Tianjin, China. He is also an associate member of the Institute of Medical Laboratory Technology in the UK.

Mr. Stuart Hamilton Leckie – Independent Non-Executive Director
Mr. Leckie was the Chairman of the Hong Kong Retirement Schemes Association, and was the Chairman of the International Actuarial Association's China Committee. He has served as the Chairman of Watson Wyatt in Asia Pacific, Chairman of Fidelity Investments, Asia Pacific, Independent Director of Hong Kong Securities Clearing Company Limited, Director of Exchange Fund Investment Ltd. and President of the Actuarial Society of Hong Kong. Additionally, he has served on three committees of Hong Kong's Securities and Futures Commission. Mr. Leckie qualified as an Actuary in the United Kingdom in 1972.

Dr. Paul Bernard Harper – Independent Non-Executive Director
Dr. Harper is an experienced director and company chairman. He has served as director of Physiomics, and also served as R&D director at Johnson & Johnson. Dr. Harper is currently serving as non-executive director of ReNeuron Group, the chairman of the board of RegenTec Ltd. and the non-executive chairman of Sareum Holdings plc. Dr. Harper received a BSc in Bacteriology and a PhD from The University of Leeds.

In addition to the Directors, management responsibility for the operations of the Group rests with a senior management team of three persons. This team of senior managers has supervisory responsibility for the Group's business, dealing with operational and financial issues, capital expenditure decisions and the development, adoption and implementation of strategy across the Group.

The following sets out the information regarding our senior managers:

Dr. Jonathan Zheng Ma – Chief International Operations Officer (CIOO)
Dr. Ma joined Shenzhen Kangzhe Pharmaceutical in 2005 and was appointed vice president of the Group in international operations in 2007, and he is currently the CIOO. Earlier in his career, Dr. Ma served as associate director of biometrics within the clinical data operations department of Pfizer PPG and provided services to the Centre for Drug Evaluation and Research of the FDA in the division of Anaesthetics Critical Care, and Addiction Drug Products. Dr. Ma received his bachelor degree in mathematics from Peking University in 1988, a PhD from Yale University in 1995 and a master's degree in science from The University of Texas at El Paso in 1991.

Dr. Waiming Wong – Chief Technical Officer (CTO)
Dr. Wong was appointed as chief R&D officer in 2007, and he is currently the CTO, being responsible for introducing products and providing professional advice to the Group. He is also the co-inventor (along with Mr. Lam) of the Group's peptide products. Prior to this, Dr. Wong worked as manager of the pharma China department for Jebsen Co., Ltd. Dr. Wong received his BSc and PhD from the University of Hong Kong in 1983 and 1993 respectively.

Mr. Vincent Wing Sin Hui – Company Secretary and Chief Investor Relations Officer
Mr. Hui joined the Group in 2007 as the Company Secretary, and is currently also acting as the Chief Investor Relations Officer. Mr. Hui is a member of HKICPA (Hong Kong Institute of Certified Public Accountants) and AICPA (American Institute of Certified Public Accountants). Prior to joining the Group, he worked for Ernst & Young, Hong Kong. Mr. Hui received a bachelor's degree in biochemistry with nutrition and a master's degree in accounting and management science from the University of Southampton in the United Kingdom.

DIRECTORS' REPORT

The Directors present their report on the affairs of the Company, together with the audited financial statements for the year ended 31 December 2009.

Business Review

A detailed review of the performance, business activities and future development of the Company is set out in the Chairman's Statement and the Chief Financial Officer's Report.

Principal Risks and Uncertainties

The main risks associated with these factors are outlined below. Information on financial risk management is set out in note 34 to the financial statements.

Risk associated with success of products
The Company's revenue is, and will be, derived principally from the sale of its in-licensed products in China. There can be no assurance that current product revenue can be maintained or increased in the future. Products sales may be affected by adverse market conditions or other factors including influence of financial crisis on the Company, pricing pressures from government or other authorities and competition from other products.

Risk associated with changes in government policies
The pharmaceutical industry in the PRC is subject to laws, regulations and other policies which are implemented by the PRC government from time to time. Changes in these policies (e.g. Health Reform) may have a material impact on the entire or a certain part of the pharmaceutical industry and, in turn, on the Company. The PRC government's foreign investment policies could also influence the international aspects of our corporate structure.

Risk associated with product licences
We may not be able to obtain and renew the appropriate licences, permits or certifications required for the import, distribution, manufacture and sale of pharmaceutical products in China, which could materially and adversely affect our business, financial condition and results of operations.

Results

The Consolidated Statement of Comprehensive Income is set out on page 20 and shows the Company's results for the year ended 31 December 2009.

Dividends

Details of the dividend proposal are set out on page 4

Directors

During the year, the Directors of the Company who served during the year were as follows:

Executive Directors:
Mr. Kong Lam (Chairman and Chief Executive Officer)
Mr. Hongbing Chen (Chief Operating Officer)
Ms. Yanling Chen (Chief Financial Officer)
Ms. Xiaoxuan Hou (Executive Director)
Mr. Ki Fat Hui (Executive Director)

Independent Non-executive Directors:
Mr. Stuart Hamilton Leckie (Chairman of the Audit Committee and the Nomination Committee)
Dr. Paul Bernard Harper (Chairman of the Remuneration Committee)

Biographies of the current Directors are detailed on page 11-12.

Mr. Hongbing Chen, Ms. Yanling Chen and Ms. Xiaoxuan Hou will retire by rotation at the forthcoming Annual General Meeting, and being eligible, offer themselves for re-election. Details of the resolution to reappoint them are contained in the AGM notice.

Director's Interests

The interests of the Directors in the Company at 31 December 2009 and at the beginning of the financial year were as followed:

	No. of Shares (31-12-2009)	***No. of Shares (31-12-2008)***
Mr. Kong Lam	34,000,000	34,000,000
Mr. Hongbing Chen	2,709,791	2,709,791
Ms. Xiaoxuan Hou	2,080,000	2,080,000
Ms. Yanling Chen	246,500	246,500

As of 31 December 2009 Mr. Hongbing Chen, COO of the Company, held 708,695 options to subscribe for ordinary shares of US$0.1 each of the Company ("Ordinary Share") all at the exercise price of GBP 138 per share. The options will expire on 25 June 2012.

Substantial Shareholdings

As at 31 March 2010 the Company had been notified that the following shareholders hold 3% or more of the total issued share capital of the Company:

	Amount	***Holdings***
Mr. Kong Lam	34,000,000	71.72%
Martin Currie Investment	3,623,188	7.64%
Mr. Hongbing Chen	2,709,791	5.72%
Ms. Xiaoxuan Hou	2,080,000	4.39%

Directors and Officers Liability Insurance

During the year, we have maintained a third party directors and officers liability insurance for all Directors.

Auditors

Deloitte Touche Tohmatsu has expressed their willingness to continue in office as Auditors of the Company. A resolution to re-appoint Deloitte Touche Tohmatsu as Auditors of the Company will be proposed at the forthcoming Annual General Meeting.

Directors Remuneration

Details of our Directors' remuneration during the year are set out below (excluding the interests from the *Key Employee Benefit Scheme*).

	2009(US$)			
	Salary	Directors' Fee	Social Insurance	Total
Mr. Kong Lam	86,424	23,246	6,815	116,485
Mr. Hongbing Chen	89,176	23,246	3,074	115,496
Ms. Yanling Chen	66,881	23,246	3,074	93,201
Ms. Xiaoxuan Hou	49,622	23,246	2,000	74,868
Mr. Ki Fat Hui	46,437	23,246		69,683
Mr. Stuart Hamilton Leckie		23,246		23,246
Dr. Paul Bernard Harper		23,246		23,246

Key Employee Benefit Scheme

During 2009, the Shareholders of the Company approved the adoption of a Key Employee Benefit Scheme ("Scheme") which is a long term incentive plan under which, following the fulfillment of certain conditions, awards may be granted to key employee of the Company and its subsidiaries ("Group"), who have been actively involved in the business development of the Group ("Key Employee"). The reason for the introduction of the Scheme was not only to align the interests of the Key Employee and Shareholders with the long term growth and development of the Company but also to attract high quality staff in the future.

Three directors of the Company, Mr. Hongbing Chen, Ms. Yanling Chen and Ms. Xiaoxuan Hou, joined the Scheme as Key Employee and may acquire beneficial interests from the Scheme.

Annual General Meeting (AGM)

Accompanying this report is the Notice of the Annual General Meeting together with the notes on the proposed resolutions. The meeting will be held on 4 May 2010 at 10:00 a.m. (Macau time) at Ballroom 3, Wynn Macau, rua cidade de sintra, Nape, Macau.

By Order of the Board

Vincent Hui
Company Secretary
6 April 2010

CORPORATE GOVERNANCE

The Board of Directors is committed to maintaining high standards of corporate governance. In the admission document issued upon the admission of the Company's shares to trading on AIM, the Directors stated their intention that, wherever it is reasonably practicable taking into account the Company's size and nature, the Company will be managed according to the provisions of the Quoted Companies Alliance for AIM Companies published in 2005.

The Board of Directors

The Company is managed by the Board of Directors. The Board takes overall responsibility for the corporate governance, reinforcing business performance and overseeing shareholders' interests with appropriate operational strategies and financial consideration. At 31 December 2009 the Board comprised five Executive Directors and two Non-executives Directors; the company secretary is responsible for maintaining the board regulation and meeting procedures. The composition of the Board and the senior management team and biographies of each member are detailed on page 11-12.

The Board of Directors holds a meeting at least quarterly and has a defined schedule of matters reserved for its attention. The Board met 5 times during the year. Two important policies were discussed and resolved during the meetings in this year: Key Employee Benefit Scheme and The De-merger of Healthlink Consultancy Inc.

Audit Committee

The Audit Committee is composed entirely of two independent Non-Executive Directors and is chaired by Mr. Stuart Hamilton Leckie. The Committee's main responsibility is to consider and recommend the appointment or removal of external auditors, to agree with the external auditors the scope of their work and fees, to monitor the financial affairs of the Company, to review and discuss any reports from management and the auditors regarding the financial statements and to discuss the report's integrity before they are submitted to the Board, and to monitor and review the internal control systems implemented by the Company to be in line with the relevant UK professional and regulatory requirements, and taking into consideration of both the interim and annual financial statements.

Nomination Committee

The Nomination Committee is composed entirely of two independent Non-Executive Directors and one Executive Director Mr. Kong Lam. Mr. Stuart Hamilton Leckie acts as the Chairman of the Committee. The Committee's main responsibility is to make recommendations to the Directors on all new appointments of Directors and senior management, to interview nominees, to draw up the relevant role and capabilities for a particular appointment, to take up references and to consider the leadership needs of the Group and the composition, size and structure of the Board.

Remuneration Committee

The Remuneration Committee is composed of two independent Non-Executive Directors and Dr. Paul Bernard Harper acts as the Chairman of the Committee. The Committee's main responsibility is to determine and agree with the Board the framework for the remuneration of the Chief Executive Officer of the Company and review the specific remuneration of the Executive Directors, the Company Secretary and senior management.

Relations with Shareholders

We place great importance on maintaining good communications with both institutional and private investors and analysts. Regular communication is provided through our website www.chinamedicalsystem.com where all press releases are published. We also email all important press releases to its shareholders. The AGM also provides an opportunity to communicate with shareholders and we welcome the shareholders' and other investors' participation.

INDEPENDENT AUDITOR'S REPORT

TO THE MEMBERS OF CHINA MEDICAL SYSTEM HOLDINGS LIMITED
(incorporated in the Cayman Islands with limited liability)

We have audited the consolidated financial statements of China Medical System Holdings Limited (the "Company") and its subsidiaries (collectively referred to as the "Group") set out on pages 20 to 74, which comprise the consolidated statement of financial position as at 31 December 2009, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the consolidated financial statements

The directors of the Company are responsible for the preparation and the true and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit and to report our opinion solely to you, as a body, in accordance with our agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Group's preparation and the true and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by directors of the Company, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Group as at 31 December 2009 and of the Group's profit and cash flows for the year then ended in accordance with International Financial Reporting Standards.

Deloitte Touche Tohmatsu
Certified Public Accountants
Hong Kong
30 March 2010

CHINA MEDICAL SYSTEM HOLDINGS LIMITED

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2009

	NOTES	2009 US$'000	2008 US$'000
Turnover	5	96,454	72,600
Cost of goods sold		(35,596)	(27,835)
Gross profit		60,858	44,765
Other gains and losses	6	662	2,690
Selling expenses		(24,840)	(18,631)
Administrative expenses		(7,399)	(6,940)
Research and development costs		(2,038)	(2,275)
Finance costs	7	(390)	(226)
Share of results of associates		30	152
Share of result of a jointly controlled entity		43	-
Profit before taxation		26,926	19,535
Taxation	8	(6,096)	(4,487)
Profit for the year	9	20,830	15,048
Other comprehensive income			
Exchange differences from translation		70	2,880
Share of changes in reserve of an associate		(1)	36
Fair value changes on cash flow hedges		(145)	-
Total comprehensive income for the year		20,754	17,964
Profit for the year attributable to:			
Owners of the Company		20,684	14,946
Minority interests		146	102
		20,830	15,048
Total comprehensive income attributable to:			
Owners of the Company		20,608	17,877
Minority interests		146	87
		20,754	17,964
Earnings per share	12		
Basic		0.437	0.316
Diluted		0.435	0.316

CHINA MEDICAL SYSTEM HOLDINGS LIMITED

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AT 31 DECEMBER 2009

	NOTES	2009 US$'000	2008 US$'000
Non-current assets			
Property, plant and equipment	13	3,575	5,459
Prepaid lease payments	14	260	267
Interest in a jointly controlled entity	15	43	-
Interest in an associate	16	1,507	535
Intangible assets	17	6,461	7,575
Goodwill	18	379	581
Deferred tax assets	19	1,432	1,073
		13,657	15,490
Current assets			
Inventories	20	11,060	5,945
Trade and other receivables	21	32,794	27,684
Amount due from an associate	22	-	172
Amount due from a jointly controlled entity	22	481	-
Amounts due from a director	22	-	43
Held for trading investments	23	31	-
Pledged bank deposits	24	17,641	1,060
Bank balances and cash	24	15,113	20,100
		77,120	55,004
Current liabilities			
Trade and other payables	25	11,062	9,252
Dividends payable		-	5
Bank borrowings - secured	26	16,517	-
Deferred consideration payables	27	838	685
Derivative financial instruments	28	145	-
Tax payable		1,226	813
		29,788	10,755
Net current assets		47,332	44,249
Total assets less current liabilities		60,989	59,739

	NOTES	2009 US$'000	2008 US$'000
Capital and reserves			
Share capital	29	4,741	4,725
Reserves	31	48,992	48,065
Equity attributable to equity holders of the Company		53,733	52,790
Minority interests	32	201	(69)
		53,934	52,721
Non-current liabilities			
Deferred tax liabilities	19	1,764	839
Deferred consideration payables	27	5,291	6,179
		7,055	7,018
		60,989	59,739

The financial statements on pages 20 to 74 were approved and authorised for issue by the Board of Directors on 30 March 2010 and are signed on its behalf by:

Kong LAM
DIRECTOR

Yanling CHEN
DIRECTOR

CHINA MEDICAL SYSTEM HOLDINGS LIMITED

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2009

	Attributable to the equity holders of the Company											
	Share capital US$'000	Share premium US$'000	Capital reserve US$'000 (note 31)	Share option reserve US$'000	Surplus reserve fund US$'000 (note 31)	Translation reserve US$'000	Hedging reserve US$'000	Accumulated profits US$'000	Dividend reserve US$'000	Total US$'000	Minority interests US$'000	Total US$'000
Balance at 1 January 2008	4,725	17,147	4,911	570	4,255	2,730	-	2,937	4,725	42,000	(156)	41,844
Exchange differences arising from translation	-	-	-	-	-	2,895	-	-	-	2,895	(15)	2,880
Share of changes in reserve of an associate	-	-	-	-	-	36	-	-	-	36	-	36
Profit for the year	-	-	-	-	-	-		14,946	-	14,946	102	15,048
Total comprehensive income for the year	-	-	-	-	-	2,931	-	14,946	-	17,877	87	17,964
Dividends paid	-	-	-	-	-	-	-	(2,362)	(4,725)	(7,087)	-	(7,087)
Dividends proposed - 2008	-	-	-	-	-	-	-	(4,725)	4,725	-	-	-
Transfer of reserves	-	-	-	-	1,802	-	-	(1,802)	-	-	-	-
Balance at 31 December 2008	4,725	17,147	4,911	570	6,057	5,661	-	8,994	4,725	52,790	(69)	52,721
Exchange differences arising from translation	-	-	-	-	-	70	-	-	-	70	-	70
Share of changes in reserve of an associate	-	-	-	-	-	(1)	-	-	-	(1)	-	(1)
Fair value changes on cash flow hedges	-	-	-	-	-	-	(145)	-	-	(145)	-	(145)
Profit for the year	-	-	-	-	-	-	-	20,684	-	20,684	146	20,830
Total comprehensive income and expense for the year	-	-	-	-	-	69	(145)	20,684	-	20,608	146	20,754
Issue of shares	16	435	-	-	-	-	-	-	-	451	-	451
Release of translation reserve upon disposal of subsidiary	-	-	-	-	-	8	-	(8)	-	-	-	-
Release of translation reserve upon disposal of an associate	-	-	-	-	-	(36)	-	36	-	-	-	-
Dividends paid to a minority shareholder	-	-	-	-	-	-	-	-	-	-	(206)	(206)
Effect of distribution in specie	-	(11,503)	-	-	-	853	-	-	-	(10,650)	330	(10,320)
Dividends paid	-	-	-	-	-	-	-	(4,741)	(4,725)	(9,466)	-	(9,466)
Dividends proposed - 2009	-	-	-	-	-	-	-	(4,741)	4,741	-	-	-
Transfer of reserves	-	-	-	-	2,102	-	-	(2,102)	-	-	-	-
Balance at 31 December 2009	4,741	6,079	4,911	570	8,159	6,555	(145)	18,122	4,741	53,733	201	53,934

CHINA MEDICAL SYSTEM HOLDINGS LIMITED

CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2009

	NOTES	2009 US$'000	2008 US$'000
Operating activities			
Profit before taxation		26,926	19,535
Adjustments for:			
Share of results of associates		(30)	(152)
Share of result of a jointly controlled entity		(43)	-
Discount on acquisition of an associate		(647)	-
Amortisation of intangible assets	17	1,115	793
Depreciation of property, plant and equipment	13	898	772
Release of prepaid lease payments		7	7
Interest income		(329)	(221)
Imputed interest income on available-for-sale investment		-	(20)
Interest expenses		43	-
Imputed interest expense on deferred consideration payable		347	226
Gain on disposal of property, plant and equipment		(7)	(2)
Impairment loss recognised on property, plant and equipment		805	-
Gain on disposal of a subsidiary		(24)	-
Loss on disposal of an associate		70	-
Allowance for inventories		10	119
Allowance for bad and doubtful debts		57	23
Operating cash flows before movements in working capital		29,198	21,080
(Increase) decrease in inventories		(5,226)	5,347
Increase in trade and other receivables		(5,287)	(7,526)
Increase in held for trading investments		(31)	-
Decrease (increase) in amount due from an associate		172	(8)
Increase in amount due from a jointly controlled entity		(481)	-
Decrease (increase) in amounts due from directors		43	(23)
Increase (decrease) in trade and other payables		2,284	(5,011)
Cash generated from operations		20,672	13,859
PRC Enterprise Income Tax paid		(5,008)	(3,637)
Hong Kong Profits Tax paid		(115)	(47)
Net cash from operating activities		15,549	10,175

	NOTES	2009 US$'000	2008 US$'000
Investing activities			
Purchase of property, plant and equipment		(280)	(959)
Capital injected in an associate		-	(149)
Increase in pledged bank deposits		(16,581)	(1,060)
Interest received		329	221
Dividend received from an associate		235	-
Proceeds from disposal of available-for-sale investment		-	187
Proceeds from disposal of property, plant and equipment		120	16
Cash outflow from disposal of a subsidiary	35(b)	(1)	-
Proceeds from disposal of an associate		439	-
Acquisition of an associate		(877)	-
Net cash used in investing activities		(16,616)	(1,744)
Financing activities			
Dividends paid		(9,471)	(7,082)
Cash outflow from distribution in specie	35(a)	(10,068)	-
Repayment of deferred consideration payables		(1,245)	(137)
Proceeds from issue of shares		451	-
New bank borrowings raised		16,517	-
Dividends paid to a minority shareholder		(206)	-
Net cash used in financing activities		(4,022)	(7,219)
Net (decrease) increase in cash and cash equivalents		(5,089)	1,212
Cash and cash equivalent at beginning of the year		20,100	17,601
Effect of foreign exchange rate changes		102	1,287
Cash and cash equivalent at end of the year, represented by bank balances and cash		15,113	20,100

1. GENERAL

The Company was incorporated as an exempted company with limited liability in the Cayman Islands on 18 December 2006. On 26 June 2007, the Company was listed on the Alternative Investment Market ("AIM") operated by the London Stock Exchange plc. The Company's ultimate holding company and immediate holding company is Treasure Sea Limited, a company incorporated in the British Virgin Islands. The address of the Company's registered office is P.O. Box 309GT, Ugland House, South Church Street, George Town, Grand Cayman, Cayman Islands. The address of its principal place of business is 8/F., Block A, Tong Fong Information Centre, Long Shan Road, Nan Shan, Shenzhen, the People's Republic of China (the "PRC").

The Company is an investment holding company. The principal activities of its subsidiaries are production of medicines, distribution and import of drugs and medical devices and research and development on microbiology related drugs.

The functional currency of the Company is Renminbi as it is the currency in which the majority of the Group's transactions are denominated. The consolidated financial statements of the Group are presented in United States Dollars ("US$") as the directors consider this presentation to be more useful for its current and potential investors.

2. APPLICATION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRSs")

In the current year, the Group has applied, the following amendment and interpretations ("new IFRSs") issued by the International Financial Reporting Interpretations Committee ("IFRIC"), which are effective for the Group's financial year beginning 1 January 2009.

IAS 1 (Revised 2007)	Presentation of financial statements
IAS 23 (Revised 2007)	Borrowing costs
IAS 32 & 1 (Amendments)	Puttable financial instruments and obligations arising on liquidation
IFRS 1 & IAS 27(Amendments)	Cost of an investment in a subsidiary, jointly controlled entity or associate
IFRS 2 (Amendment)	Vesting conditions and cancellations
IFRS 7 (Amendment)	Improving disclosures about financial instruments
IFRS 8	Operating segments
IFRIC 9 & IAS 39 (Amendments)	Embedded derivatives
IFRIC 13	Customer loyalty programmes
IFRIC 15	Agreements for the construction of real estate
IFRIC 16	Hedges of a net investment in a foreign operation
IFRIC 18	Transfers of assets from customers
IFRSs (Amendments)	Improvements to IFRSs issued in 2008, except for the amendment to IFRS 5 that is effective for annual periods beginning or after 1 July 2009
IFRSs (Amendments)	Improvements to IFRSs issued in 2009 in relation to the amendment to paragraph 80 of IAS 39

Except as described below, the adoption of the new IFRSs had no material effect on the consolidated financial statements of the Group.

2. APPLICATION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRSs") - continued

New and revised IASs and IFRSs affecting presentation and disclosure only

IAS 1 (Revised 2007) Presentation of financial statements

IAS 1 (Revised 2007) has introduced terminology changes (including revised titles for the consolidated financial statements) and changes in the format and content of the consolidated financial statements.

IFRS 8 Operating segments

IFRS 8 is a disclosure standard that has resulted in a redesignation of the Group's reportable segments (see note 5) and changes in the basis of measurement of segment profit or loss, segment assets and segment liabilities.

Improving disclosures about financial instruments (amendments to IFRS 7 Financial instruments: Disclosures)

The amendments to IFRS 7 expand the disclosures required in relation to fair value measurements in respect of financial instruments which are measured at fair value. The amendments also expand and amend the disclosures required in relation to liquidity risk. The Group has not provided comparative information for the expanded disclosures in accordance with the transitional provision set out in the amendments.

The Group has not early applied the following new and revised standards, amendments and interpretations that have been issued but are not yet effective:

IFRSs (Amendments)	Amendment to IFRS 5 as part of improvements to IFRSs May 2008[1]
IFRSs (Amendments)	Improvements to IFRSs April 2009[2]
IAS 24 (Revised)	Related party disclosures[6]
IAS 27 (Revised 2008)	Consolidated and separate financial statements[1]
IAS 32 (Amendment)	Classification of rights issues[4]
IAS 39 (Amendment)	Eligible hedged items[1]
IFRS 1 (Amendment)	Additional exemptions for first-time adopters[3]
IFRS 1 (Amendment)	Limited exemption from comparative IFRS 7 disclosure for first-time adopters[5]
IFRS 2 (Amendment)	Group cash-settled share-based payment transactions[3]
IFRS 3 (Revised 2008)	Business combinations[1]
IFRS 9	Financial instruments[7]
IFRIC* 14 (Amendment)	Prepayments of a minimum funding requirement [6]
IFRIC 17	Distributions of non-cash assets to owners[1]
IFRIC 19	Extinguishing financial liabilities with equity instruments[5]

* IFRIC represents the International Financial Reporting Interpretations Committee.

2. APPLICATION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRSs") - continued

[1] Effective for annual periods beginning on or after 1 July 2009.
[2] Amendments that are effective for annual periods beginning on or after 1 July 2009 or 1 January 2010, as appropriate.
[3] Effective for annual periods beginning on or after 1 January 2010.
[4] Effective for annual periods beginning on or after 1 February 2010.
[5] Effective for annual periods beginning on or after 1 July 2010.
[6] Effective for annual periods beginning on or after 1 January 2011.
[7] Effective for annual periods beginning on or after 1 January 2013.

The adoption of IFRS 3 (Revised) may affect the Group's accounting for business combinations for which the acquisition date is on or after 1 January 2010. IAS 27 (Revised) will affect the accounting treatment for changes in the Group's ownership interest in a subsidiary.

The directors of the Company anticipate that the application of the other new and revised standards, amendments and interpretations will have no material impact on the results and the financial position of the Group.

3. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared on the historical cost basis, except for certain financial instruments, which are measured at fair value, and in accordance with IFRSs. The principal accounting policies are set out below.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries). Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

The results of subsidiaries acquired or disposed of during the year, other than those resulting from group reorganisation in 2006, are included in the consolidated statement of comprehensive income from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Minority interests in the net assets of consolidated subsidiaries are presented separately from the Group's equity therein. Minority interests in the net assets consist of the amount of those interests at the date of the original business combination and the minority's share of changes in equity since the date of the consolidation. Losses applicable to the minority in excess of the minority's interest in the subsidiary's equity are allocated against the interests of the Group except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Business combinations

The acquisition of businesses is accounted for using the purchase method. The cost of the acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree, plus any costs directly attributable to the business combination. The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3 "Business Combinations" are recognised at their fair values at the acquisition date.

Goodwill arising on acquisition is recognised as an asset and initially measured at cost, being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised. If, after reassessment, the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities exceeds the cost of the business combination, the excess is recognised immediately in profit or loss.

The interest of minority shareholders in the acquiree is initially measured at the minority's proportion of the net fair value of the assets, liabilities and contingent liabilities recognised.

Goodwill

Goodwill arising on an acquisition of a business is carried at cost less any accumulated impairment losses.

Capitalised goodwill arising on an acquisition of a business is presented separately in the consolidated statement of financial position.

For the purposes of impairment testing, goodwill arising from an acquisition is allocated to each of the relevant cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the acquisition. A cash-generating unit to which goodwill has been allocated is tested for impairment annually, and whenever there is an indication that the unit may be impaired. For goodwill arising on an acquisition in a financial year, the cash-generating unit to which goodwill has been allocated is tested for impairment before the end of that financial year. When the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated to reduce the carrying amount of any goodwill allocated to the unit first, and then to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit. Any impairment loss for goodwill is recognised directly in profit or loss. An impairment loss for goodwill is not reversed in subsequent periods.

On subsequent disposal of the relevant cash-generating unit, the attributable amount of goodwill capitalised is included in the determination of the amount of profit or loss on disposal.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Investment in an associate

An associate is an entity over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

The results and assets and liabilities of associates are incorporated in these consolidated financial statements using the equity method of accounting. Under the equity method, investments in associates are carried in the consolidated statement of financial position at cost as adjusted for post-acquisition changes in the Group's share of the net assets of the associate, less any identified impairment loss. When the Group's share of losses of an associate equals or exceeds its interest in that associate (which includes any long-term interests that, in substance, form part of the Group's net investment in the associate), the Group discontinues recognising its share of further losses. An additional share of losses is provided for and a liability is recognised only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of that associate.

Any excess of the cost of acquisition over the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities over the cost of acquisition, after reassessment, is recognised immediately on profit or loss.

Any excess of the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities over the cost of acquisition, after reassessment, is recognised immediately in profit or loss.

Where a group entity transacts with an associate of the Group, profits and losses are eliminated to the extent of the Group's interest in the relevant associate.

Investment in a jointly controlled entity

Joint venture arrangements that involve the establishment of a separate entity in which venturers have joint control over the economic activity of the entity are referred to as a jointly controlled entity.

The results and assets and liabilities of a jointly controlled entity are incorporated in the consolidated financial statements using the equity method of accounting. Under the equity method, investment in a jointly controlled entity is carried in the consolidated statement of financial position at cost as adjusted for post-acquisition changes in the Group's share of the net assets of the jointly controlled entity, less any identified impairment loss. When the Group's share of losses of a jointly controlled entity equals or exceeds its interest in that jointly controlled entity (which includes any long-term interests that, in substance, form part of the Group's net investment in the jointly controlled entity), the Group discontinues recognising its share of further losses. An additional share of losses is provided for and a liability is recognised only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of that jointly controlled entity.

Any excess of the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities over the cost of acquisition, after reassessment, is recognised immediately in profit or loss.

When a group entity transacts with a jointly controlled entity of the Group, profits or losses are eliminated to the extent of the Group's interest in the jointly controlled entity.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Intangible assets

Intangible assets acquired separately with finite useful lives are carried at cost less accumulated amortisation and any accumulated impairment losses. Amortisation for intangible assets with finite useful lives is provided on a straight line basis over their estimated useful lives.

Gains or losses arising from derecognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in profit or loss in the period when the asset is derecognised.

Research and development expenditure

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

An internally-generated intangible asset arising from development (or from the development phase of an internal project) is recognised if, and only if, all of the following have been demonstrated:

- the technical feasibility of completing the intangible asset so that it will be available for use or sale;
- the intention to complete the intangible asset and use or sell it;
- the ability to use or sell the intangible asset;
- how the intangible asset will generate probable future economic benefits;
- the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and
- the ability to measure reliably the expenditure attributable to the intangible asset during its development.

The amount initially recognised for internally-generated intangible asset is the sum of the expenditure incurred from the date when the intangible asset first meets the recognition criteria. Where no internally-generated intangible asset can be recognised, development expenditure is charged to profit or loss in the period in which it is incurred.

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for good sold in the normal course of business, net of customer returns, rebates, other similar allowances and sales related taxes.

Revenue from the sale of goods is recognised when goods are delivered and title has passed.

Service fee income is recognised as services are rendered.

Interest income from a financial asset is accrued on a time basis by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts the estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount on initial recognition.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Property, plant and equipment

Property, plant and equipment including buildings held for use in the production or supply of goods or services, or for administrative purposes are stated at cost less subsequent accumulated depreciation and accumulated impairment losses.

Depreciation is provided to write off the cost of items of property, plant and equipment over their estimated useful lives and after taking into account their estimated residual value, using the straight line method.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in profit or loss in the period in which the item is derecognised.

Impairment losses on tangible and intangible assets other than goodwill

At the end of each reporting period, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised as income immediately.

Prepaid lease payments

Prepaid lease payments represent the cost of land use rights paid to the local Land Bureau of the PRC Government.

Land use rights are stated at cost and are charged to the consolidated statement of comprehensive income over the period for which the relevant land use right has been granted to the Group.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is calculated using the weighted average method.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Financial instruments

Financial assets and financial liabilities are recognised in the consolidated statement of financial position when a group entity becomes a party to the contractual provisions of the instrument. Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognised immediately in profit or loss.

Financial assets

The Group's financial assets are mainly financial assets held for trading, loans and receivables and available-for-sale financial assets. All regular way purchases or sales of financial assets are recognised and derecognised on a trade date basis. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace. The accounting policies adopted in respect of each category of financial assets are set out below.

Effective interest method

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial asset or financial liability, or, where appropriate, a shorter period to the net carrying amount on initial recognition.

Interest income and interest expenses is recognised on an effective interest basis for debt instruments.

Financial assets held for trading

A financial asset is classified as held for trading if:

- it has been acquired principally for the purpose of selling in the near future; or
- it is a part of an identified portfolio of financial instruments that the Group manages together and has a recent actual pattern of short-term profit-taking; or
- it is a derivative that is not designated and effective as a hedging instrument.

At the end of the reporting period subsequent to initial recognition, financial assets held for trading are measured at fair value, with changes in fair value recognised directly in profit or loss in the period in which they arise. The net gain or loss recognised in profit or loss excludes any dividend or interest earned on the financial assets.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Financial instruments - continued

Financial assets - continued

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Subsequent to initial recognition, loans and receivables (including trade and other receivables, amount due from an associate, amount due from a jointly controlled entity, amounts due from directors, pledged bank deposits, bank balances and cash) are carried at amortised cost using the effective interest method, less any identified impairment losses (see accounting policy on impairment loss on financial assets below).

Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated or not classified as financial assets at fair value through profit or loss, loans and receivables or held-to-maturity investments.

Available-for-sale financial assets are measured at fair value at the end of the reporting period. Changes in fair value are recognised in other comprehensive income and accumulated in investment revaluation reserve, until the financial asset is disposed of or is determined to be impaired, at which time, the cumulative gain or loss previously accumulated in the investment revaluation reserve is reclassified to profit or loss (see accounting policy on impairment loss on financial assets below).

Impairment of financial assets

Financial assets are assessed for indicators of impairment at the end of the reporting period. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the financial assets have been affected.

For all financial assets, objective evidence of impairment could include:

- significant financial difficulty of the issuer or counterparty; or
- default or delinquency in interest or principal payments; or
- it becoming probable that the borrower will enter bankruptcy or financial re-organisation.

For certain categories of financial asset, such as trade receivables that are assessed not to be impaired individually are subsequently assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of receivables could include the Group's past experience of collecting payments, an increase in the number of delayed payments in the portfolio past the credit period granted, observable changes in national or local economic conditions that correlate with default on receivables.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Financial instruments - continued

Impairment of financial assets - continued

For financial assets carried at amortised cost, an impairment loss is recognised in profit or loss when there is objective evidence that the asset is impaired, and is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade and other receivables, where the carrying amount is reduced through the use of an allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss. When trade and other receivables are considered uncollectible, they are written off against the allowance account. Subsequent recoveries of amounts previously written off are credited to profit or loss.

For financial assets measured at amortised cost, if, in a subsequent period, the amount of impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment losses was recognised, the previously recognised impairment loss is reversed through profit or loss to the extent that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

Impairment losses on available-for-sale debt investment are subsequently reversed if an increase in the fair value of the investment can be objectively related to an event occurring after the recognition of the impairment loss.

Financial liabilities and equity

Financial liabilities and equity instruments issued by a group entity are classified according to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities.

The Group's financial liabilities, including trade and other payables and deferred consideration payables, are subsequently measured at amortised cost, using the effective interest method. Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

Derivative financial instruments and hedging

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently remeasured to their fair values at the end of the reporting period. The resulting gain or loss is recognised in profit or loss immediately unless the derivative is designated and effective as a hedging instrument, in which event the timing of the recognition in profit or loss depends on the nature of the hedge relationship.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Financial instruments - continued

Hedge accounting

The Group uses derivative financial instruments (primarily interest rate swaps and foreign currency forward contracts) to hedge its exposure against changes in interest rate and foreign currency exposure on bank borrowings. At the inception of the hedging relationship the entity documents the relationship between the hedging instrument and hedged item, along with its risk management objectives and its strategy for undertaking various hedge transactions. Furthermore, at the inception of the hedge and on an ongoing basis, the Group documents whether the hedging instrument that is used in a hedging relationship is highly effective in offsetting changes in cash flows of the hedged item.

Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised in other comprehensive income. The gain or loss relating to the ineffective portion is recognised immediately in profit or loss as other gain or losses.

Amounts previously recognised in other comprehensive income and accumulated in equity (hedging reserve) are reclassified to profit or loss in the periods when the hedged item is recognised in profit or loss.

Hedge accounting is discontinued when the Group revokes the hedging relationship, the hedging instrument expires or is sold, terminated, or exercised, or no longer qualifies for hedge accounting. Any cumulative gain or loss accumulated in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in profit or loss. When a forecast transaction is no longer expected to occur, the gain or loss accumulated in equity is recognised immediately in profit or loss.

Derecognition

Financial assets are derecognised when the contractual rights to receive cash flows from the assets expire or transferred and the Group has transferred substantially all the risks and rewards of ownership of the financial assets. On derecognition of a financial asset, the difference between the asset's carrying amount and the sum of the consideration received and receivable and any cumulative gain or loss that had been recognised in other comprehensive income is recognised in profit or loss.

Financial liabilities are derecognised when the obligation specified in the relevant contract is discharged, cancelled or expires. The difference between the carrying amount of the financial liability derecognised and the consideration paid or payable is recognised in profit or loss.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit for the year as reported in the consolidated statement of comprehensive income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The liability for current tax of the Group is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are recognised to the extent that it is probable that taxable profit will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and an associate, and interest in a jointly controlled entity, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at the end of the reporting period and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset is realised, based on tax rate (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Group expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities. Deferred tax is recognised in profit or loss, except when it relates to items that are recognised in other comprehensive income or directly in equity, in which case the deferred tax is also recognised in other comprehensive income or directly in equity respectively.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Foreign currencies

In preparing the financial statements of each individual group entity, transactions in currencies other than the functional currency of that entity (foreign currencies) are recorded in the respective functional currency (i.e. the currency of the primary economic environment in which the entity operates) at the rates of exchanges prevailing on the dates of the transactions. At the end of the reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items, and on the translation of monetary items, are recognised in profit or loss in the period in which they arise.

For the purposes of presenting the consolidated financial statements, the assets and liabilities of the Group's operations are translated from the functional currency of the respective companies into the presentation currency of the Group (i.e. US$) at the rate of exchange prevailing at the end of the reporting period, and their income and expenses are translated at the average exchange rates for the year, unless exchange rates fluctuate significantly during the period, in which case, the exchange rates prevailing at the dates of transactions are used. Exchange differences arising, if any, are recognised in other comprehensive income and accumulated in equity (the translation reserve). Such exchange differences are recognised in profit or loss in the period in which the foreign operation is disposed of.

Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The Group as lessee

Rentals payable under operating leases are charged to the profit or loss on a straight line basis over the period of the respective leases. Benefits received and receivable as an incentive to enter into an operating lease are recognised as a reduction of rental expense over the lease term on a straight line basis.

Leasehold land and building

The land and building elements of a lease of land and building are considered separately for the purpose of lease classification, leasehold land which title is not expected to pass to the lessee by the end of the lease term is classified as an operating lease unless the lease payments cannot be allocated reliably between the land and building elements, in which case, the entire lease is classified as a finance lease and accounted for as property, plant and equipment.

3. SIGNIFICANT ACCOUNTING POLICIES - continued

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, are capitalised as part of the cost of those assets. Capitalisation of such borrowing costs ceases when the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

All other borrowing costs are recognised in profit or loss in the period in which they are incurred.

Government grants

Government grants are recognised in profit or loss on a systematic basis over the periods in which the Group recognises as expenses the related costs for which the grants are intended to compensate. Government grants related to depreciable assets are recognised as a deduction from the carrying amount of the relevant asset in the consolidated statement of financial position and transferred to profit or loss over the useful lives of the related assets. Other government grants are recognised as revenue over the periods necessary to match them with the costs for which they are intended to compensate, on a systematic basis. Government grants that are receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the Group with no future related costs are recognised in profit or loss in the period in which they become receivable.

Retirement benefit costs

Payments to state-managed retirement benefit schemes, which are defined contribution schemes, are charged as an expense when employees have rendered service entitling them to the contributions.

Equity-settled share-based payment transactions

Share options granted to employees

A shareholder of the Company has granted shares to certain employees of the Group, for their services rendered at no consideration. The fair value of services received is determined by reference to the fair value of share at the respective grant dates because the fair value of services cannot be reliably measured. Such fair value is recognised as an expense in full at the grant date with a corresponding increase in other comprehensive income (capital reserve).

Share options granted to the underwriter

Share options issued in exchange for services in connection with the underwriting of the new shares of the Company by way of placing and public offer are measured at the fair values of the services received, unless that fair value cannot be reliably measured, in which case the services received are measured by reference to the fair value of the share option granted. The fair values of the services received in relation to issue of new shares are recognised as in other comprehensive income (share premium).

At the time when the share options are exercised, the amount previously recognised in share options reserve will be transferred to share premium. When the share options are forfeited after the vesting date or are still not exercised at the expiry date, the amount previously recognised in share options reserve will be transferred to share premium.

4. KEY SOURCES OF ESTIMATION UNCERTAINTY

The key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities, are described below.

Impairment of intangible assets

The impairment of the intangible assets is based on the valuation of the recoverable amount with reference to expected future cash flows on management's estimation. A considerable amount of judgement is required in estimating the expected future cash flows from the Group's distribution right and agency right in connection to two finished drug products under the trade name of Nesiritide and Augentropfen Stulln Mono respectively. If the actual future cash flows is less than expected, impairment may be required. The carrying amount of the intangible assets as at 31 December 2009 is US$6,461,000 (2008: US$7,575,000) (see note 17).

Deferred tax assets

As at 31 December 2009, a deferred tax asset of US$1,432,000 (2008: US$1,073,000) in relation to unrealised profits on inventories and impairment loss on property, plant and equipment has been recognised in the Group's consolidated statement of financial position. The recognition of the deferred tax asset mainly depends on whether sufficient future profits or taxable temporary differences will be available in the future. In cases where the actual future taxable profits generated are less than expected, a material reversal of deferred tax assets may arise, which would be recognised in the profit and loss account in the year in which such a reversal takes places.

Impairment of goodwill

Determining whether goodwill is impaired requires an estimation of the value in use of the cash-generating units to which goodwill has been allocated. The value in use calculation requires the Group to estimate the future cash flows expected to arise from the cash-generating unit and a suitable discount rate in order to calculate the present value. Where the actual future cash flows are less than expected, a material impairment loss may arise. As at 31 December 2009, the carrying amount of goodwill is US$379,000 (2008: US$581,000). Details of the recoverable amount calculation are disclosed in note 18.

Impairment of trade receivables

On assessing any impairment of the Group's trade receivables, the management regularly reviews the recoverability, creditworthiness of customers and ages of the trade receivables. Impairment on trade receivables is made on the estimation of the future cash flows discounted at an effective interest rate. If the financial condition of the customers of the Group were deteriorated, resulting in an impairment of their ability to make payments, additional impairment may be required. As at 31 December 2009, the carrying amount of trade receivables and allowance for bad and doubtful debts is US$20,746,000 (2008: US$17,220,000) and US$213,000 (2008: US$221,000) respectively.

5. TURNOVER AND SEGMENT INFORMATION

Turnover represents the net amount received and receivable for goods sold during the year.

The Group has adopted IFRS 8 "Operating segments" with effect from 1 January 2009. IFRS 8 is a disclosure standard that requires operating segments to be identified on the basis of internal reports about components of the Group that are regularly reviewed by the chief operating decision maker for the purpose of allocating resources to segments and assessing their performance. In contrast, the predecessor Standard (IAS 14 "Segment reporting") required an entity to identify two sets of segments (business and geographical) using a risks and returns approach. As a result of the adoption of IFRS 8, the identification of the Group's reportable segments has changed. In prior year, the Group's operation is regarded as a single segment, being an enterprise engaged in production of medicine, distribution and import of drugs and medical devices and research and development on microbiology related drugs. However, information reported to the chief operating decision maker for the purpose of resources allocation and assessment of performance focuses more specifically on the types of products sold. Therefore, on adoption of IFRS 8, management has identified the following reportable segments: promotion and sales of pharmaceutical products and others.

For the purpose of resources allocation and performance assessment, the chief operating decision maker reviews operating results of pharmaceutical products by product basis. Each product is identified as an operating segment in accordance with IFRS 8. When the pharmaceutical product is operating in similar business model with similar target group of customers, the Group's operating segments are aggregated into promotion and sales of pharmaceutical products.

The Group's reportable operating segments under IFRS 8 for the year ended 31 December 2008 were originally three operations: promotion and sales of pharmaceutical products, research and development and others. The Group changed the structure of its internal organisation in a manner that causes the composition of its reportable segments reduced to two operations: promotion and sales of pharmaceutical products and others. The composition of its reportable segments for the year ended 31 December 2008 was restated. The segment result for the year ended 31 December 2008 on the reportable segment of the research and development has been reclassified to other gains and losses, administrative expenses and research and development costs by US$3,000, US$280,000 and US$2,022,000 respectively.

No analysis of the Group's assets and liabilities by operating segments is disclosed as it is not regularly provided to the chief operating decision maker for review.

The Group's reportable operating segments under IFRS 8 are the following two operations:

(1) Promotion and sales of pharmaceutical products - promotion and sales of in-licensed medicine and pharmaceutical products from overseas and domestic pharmaceutical companies to wholesale customers across China, including distributors and hospitals; and

(2) Others – production and sales of other medicine and pharmaceutical products to wholesale customers across China, including distributors and hospitals and production and sales of medical instruments.

5. TURNOVER AND SEGMENT INFORMATION - continued

The segment information is as follows:

For the year ended 31 December 2009

	Promotion and sales of pharmaceutical products US$'000	Others US$'000	Elimination US$'000	Consolidated US$'000
External segment revenue	93,752	2,702	-	96,454
Inter-segment revenue	-	2,100	(2,100)	-
Revenue	93,752	4,802	(2,100)	96,454
Segment results	58,419	2,439	-	60,858
Other gains and losses				662
Selling expenses				(24,840)
Administrative expenses				(7,399)
Research and development costs				(2,038)
Finance costs				(390)
Share of results of associates				30
Share of result of a jointly controlled entity				43
Profit before taxation				26,926

For the year ended 31 December 2008

	Promotion and sales of pharmaceutical products US$'000	Others US$'000	Elimination US$'000	Consolidated US$'000
External segment revenue	69,595	3,005	-	72,600
Inter-segment revenue	-	4,496	(4,496)	-
Revenue	69,595	7,501	(4,496)	72,600
Segment results	42,237	2,528	-	44,765
Other gains and losses				2,690
Selling expenses				(18,631)
Administrative expenses				(6,940)
Research and development costs				(2,275)
Finance costs				(226)
Shares of result of an associate				152
Profit before taxation				19,535

5. TURNOVER AND SEGMENT INFORMATION - continued

Inter-segment revenue are conducted at prices and terms mutually agreed amongst those business segments.

The accounting policies of the reportable segments are the same as the Group's policies described in note 3. Segment results for the promotion and sales of pharmaceutical products and others reportable segments represented the gross profit of the relevant operations. This is the measure reported to the chief operating decision maker for the purpose allocation and performance assessment.

Other segment information

	Promotion and sales of pharmaceutical products US$'000	Others US$'000	Total US$'000
Amounts included in the measure of segment profit:			
2009			
Depreciation and amortisation	1,115	391	1,506
Allowance for inventories	-	10	10
2008			
Depreciation and amortisation	793	392	1,185
Allowance for inventories	-	119	119

The Group primarily operates in the PRC. All revenue for external customers are attributed to the PRC and all non-current assets of the Group are located in the PRC.

Revenue from major products

The following is an analysis of the Group's revenue from its major products:

	2009 US$'000	2008 US$'000
Deanxit	44,468	36,710
Ursofalk	28,327	21,074
Augentropfen Stulln Mono eye-drops	6,146	4,394
GanFuLe	4,780	3,910
XinHuoSu	7,253	2,839
Salofalk	1,824	133
Cystistat	515	66
Others	3,141	3,474
Total	96,454	72,600

6. OTHER GAINS AND LOSSES

	2009 US$'000	2008 US$'000
Service fee income	-	771
Net exchange (loss) gain	(405)	743
Government subsidies (Note)	801	623
Interest income	329	221
Gain on disposal of a subsidiary	24	-
Loss on disposal of an associate (Note 16)	(70)	-
Fair value change on investments held for trading	81	158
Imputed interest income on available-for-sale investment	-	20
Gain on disposal of property, plant and equipment	7	2
Impairment loss recognised on property, plant and equipment	(805)	-
Discount on acquisition of an associate (Note 16)	647	-
Others	53	152
	662	2,690

Note: The amount represents the incentive subsidies provided by the PRC local authorities to the Group to encourage performance of the research and development. There are no specific conditions attached to the grants, the Group recognised the grants upon receipts.

7. FINANCE COSTS

	2009 US$'000	2008 US$'000
Interest on bank loans wholly repayable within five years	43	-
Imputed interest on deferred consideration payable	347	226
	390	226

8. TAXATION

	2009 US$'000	2008 US$'000
Current tax:		
PRC Enterprise Income Tax	5,443	4,236
Hong Kong Profits Tax	97	63
Other jurisdictions	6	6
	5,546	4,305
Overprovision in prior years		
PRC Enterprise Income Tax	(11)	(21)
Deferred taxation (note 19):		
- Current year	561	203
Taxation charge for the year	6,096	4,487

The provision for PRC Enterprise Income Tax is based on the estimated taxable income for PRC taxation purposes at the rate of taxation applicable to each year.

On 16 March 2007, the PRC promulgated the Law of the PRC on Enterprise Income Tax (the "New Law") by Order No. 63 of the President of the PRC. On 6 December 2007, the State Council of the PRC issued Implementation Regulation of the New Law. Under the New Law and Implementation Regulation, the Enterprise Income Tax rate of the Company's subsidiaries in the PRC was increased from 15% to 25% progressively from 1 January 2008 onwards. The deferred tax has been adjusted to reflect the tax rates that are expected to apply to the respective periods when the assets are realized or the liabilities are settled.

For the year ended 31 December 2009, the Enterprise Income Tax rate of 深圳市康哲藥業有限公司 Shenzhen Kangzhe Pharmaceutical Company Limited ("Shenzhen Kangzhe") and 深圳市康哲醫藥科技開發有限公司 Shenzhen Kangzhe Medical Instrument Limited ("Kangzhe Medical") was increased from 18% to 20%.

Certain PRC subsidiaries are eligible for certain tax concession in the PRC. Pursuant to relevant laws and regulation, 康哲(湖南)制药有限公司 Kangzhe (Hunan) Medical Co. Ltd. ("Hunan Kangzhe") is entitled to a tax reduction to 15% for three years starting from 1 January 2006 granted by the Hunan Province Government. After year ended 31 December 2008, Hunan Kangzhe is entitled to such a tax concession under annual renewal basis. For year ended 31 December 2009, Hunan Kangzhe continued to entitle to a tax reduction to 15% (2008: 15%).

Pursuant to the Labuan Offshore Business Activity Tax Act 1990 ("Labuan Tax Act") in Malaysia, CMS Pharmaceutical Agency Co., Ltd. ("CMS Pharmaceutical") is eligible to elect to pay a lump sum taxation charge of MYR 20,000 (equivalent to approximately US$6,000) or 3% on net audited profits. CMS Pharmaceutical elected to pay a lump sum tax.

On 26 June 2008, the Hong Kong Legislative Council passed the Revenue Bill 2008 which reduced corporate profits tax rate from 17.5% to 16.5% effective from the year of assessment 2008/2009. Therefore, Hong Kong Profits Tax is calculated at 16.5% of the estimated assessable profit for both years.

8. TAXATION - continued

The taxation for the year can be reconciled to the profit before taxation per the consolidated statement of comprehensive income as follows:

	2009 US$'000	2008 US$'000
Profit before taxation	26,926	19,535
Tax at the applicable tax rate at 20% (2008: 18%) (Note)	5,385	3,516
Tax effect of share of result of a jointly controlled entity	(9)	-
Tax effect of share of results of associates	(6)	(27)
Tax effect of expenses that are not deductible in determining taxable profit	575	340
Tax effect of income that is not taxable in determining taxable profit	(52)	(122)
Tax effect of tax losses not recognised	223	438
Tax effect of tax concession	(28)	(78)
Effect on different applicable tax rates of subsidiaries	(280)	(265)
Effect of tax benefit arising from Labuan Tax Act	(629)	(133)
Overprovision in prior years	(11)	(21)
Utilisation of tax loss previously not recognised	-	(3)
Deferred tax arising from withholding tax on undistributed profit of a PRC subsidiary	925	839
Others	3	3
Taxation charge for the year	6,096	4,487

Note: The applicable PRC Enterprise Income Tax rate of 20% (2008: 18%) is the prevailing tax rate in Shenzhen, the PRC, where the operations of the Group are substantially based and the taxation charge mainly represents income tax of Shenzhen Kangzhe.

9. PROFIT FOR THE YEAR

	2009 US$'000	2008 US$'000
Profit for the year has been arrived at after charging:		
Directors' remuneration		
Fees	161	193
Other emoluments	340	328
Pension costs	15	12
	516	533
Other staff costs	13,082	10,668
Pension costs	674	626
Key employee benefit expense (note 39)	451	-
Total staff costs	14,723	11,827
Auditor's remuneration	150	135
Allowance for bad and doubtful debts	57	23
Allowance for inventories	10	119
Release of prepaid lease payments	7	7
Depreciation of property, plant and equipment	898	772
Amortisation of intangible assets (included in cost of goods sold)	1,115	793
Cost of inventories recognised as an expense	34,078	25,753
Minimum lease payment under operating lease in respect of property	621	591

10. DIVIDENDS

	2009 US$'000	2008 US$'000
Dividend paid		
Interim dividend for 2009 of US$0.10 (2008: US$0.05) per share on 47,408,904 (2008: 47,246,376) shares	4,741	2,362
Final dividend for 2008 of US$0.10 (2007: US$0.07) per share on 47,246,376 shares	4,725	3,307
Special dividend for 2008 of nil (2007: US$0.03) per share on 47,246,376 shares	-	1,418
	9,466	7,087
Dividends proposed		
Proposed final dividend for 2009 of US$0.10 (2008: US$0.10) per share on 47,408,904 shares (2008: 47,246,376 shares)	4,741	4,725

During the year ended 31 December 2009, the directors of the Company declared an interim dividend for 2009 of US$0.10 (2008: US$0.05) per share amounting to US4,741,000 (2008: US$2,362,000).

The directors of the Company propose to declare a final dividend of US$0.10 (2008: US$0.10). The proposed final dividend is subject to the approval by the shareholders of the Company in the forthcoming annual general meeting. As a result, an amount of US$4,741,000 (2008: US$4,725,000) has been transferred to the dividend reserve.

11. DISTRIBUTION

	2009 US$'000	2008 US$'000
Distribution of one Healthlink Consultancy Inc. ("Healthlink") share per one ordinary share of the Company in December 2009 (note 35 (a))	8,681	-
Cash dividend	1,969	-
	10,650	-

12. EARNINGS PER SHARE

The calculation of the basic and diluted earnings per share attributable to the owners of the Company is based on the following data:

	2009 US$'000	2008 US$'000
Earnings for the purposes of basic and diluted earnings per share (profit attributable to owners of the Company)	20,684	14,946

	Number of ordinary shares	
	2009	2008
Weighted average number of ordinary shares for the purpose of basic earnings per share	47,314,504	47,246,376
Effect of dilutive potential ordinary shares on share options	256,635	-
Weighted average number of ordinary shares for the purpose of diluted earnings per share	47,571,139	47,246,376

The computation of diluted earnings per share does not assume the exercise of the Company's outstanding share options for the year ended 31 December 2008 as the exercise price of those options is higher than the average market price of the Company's shares.

13. PROPERTY, PLANT AND EQUIPMENT

	Buildings	Leasehold improvement	Plant and machinery	Motor vehicles	Furniture, fixtures and equipment	Total
	US$'000	US$'000	US$'000	US$'000	US$'000	US$'000
COST						
At 1 January 2008	2,476	177	3,223	1,228	1,055	8,159
Currency realignment	170	12	227	102	78	589
Additions	-	-	112	614	233	959
Disposals	-	-	-	(108)	(32)	(140)
At 31 December 2008	2,646	189	3,562	1,836	1,334	9,567
Currency realignment	2	-	4	2	1	9
Additions	-	-	108	127	45	280
Disposals	-	-	(32)	(409)	(24)	(465)
Disposal of a subsidiary	-	-	-	-	(12)	(12)
Distribution of a subsidiary	-	-	(926)	-	(57)	(983)
At 31 December 2009	2,648	189	2,716	1,556	1,287	8,396
DEPRECIATION						
At 1 January 2008	835	28	1,183	572	601	3,219
Currency realignment	62	4	92	41	44	243
Provided for the year	142	62	300	156	112	772
Eliminated on disposals	-	-	-	(97)	(29)	(126)
At 31 December 2008	1,039	94	1,575	672	728	4,108
Currency realignment	1	-	2	1	1	5
Provided for the year	135	63	291	262	147	898
Eliminated on disposals	-	-	(30)	(305)	(17)	(352)
Disposal of a subsidiary	-	-	-	-	(6)	(6)
Distribution of a subsidiary	-	-	(600)	-	(37)	(637)
Impairment loss recognised	-	-	805	-	-	805
At 31 December 2009	1,175	157	2,043	630	816	4,821
CARRYING VALUES						
At 31 December 2009	1,473	32	673	926	471	3,575
At 31 December 2008	1,607	95	1,987	1,164	606	5,459

Note: During the year ended 31 December 2009, the directors conducted a review of the Group's property, plant and equipment and determined that certain of its plant and machinery were impaired. Impairment loss of US$805,000 (see note 6) was recognised in the consolidated statement of comprehensive income. The impairment was due to deteriorating demand in the medicines produced. The recoverable amount of the plant and machinery was determined based on a value-in-use calculation. For impairment test purpose, the calculation uses cash flow projections for the operation of production of medicines based on financial budgets approved by the management covering a five-year period at a discount rate of 15%.

The property, plant and equipment are depreciated over their estimated useful lives as follows:

Buildings	4.75%
Leasehold improvement	Over the lease term
Plant and machinery	18%
Motor vehicles	18%
Furniture, fixtures and equipment	18%

14. PREPAID LEASE PAYMENTS

	2009 US$'000	2008 US$'000
The Group's prepaid lease payments comprise:		
Leasehold land in PRC:		
Medium-term leases	267	274
Analysed for reporting purposes as:		
Current asset (included in trade and other receivables)	7	7
Non-current asset	260	267
	267	274

15. INTEREST IN A JOINTLY CONTROLLED ENTITY

	2009 US$'000	2008 US$'000
Cost of unlisted investment in a jointly controlled entity	-	-
Share of post-acquisition profits and other comprehensive income	43	-
	43	-

As at 31 December 2009 and 31 December 2008, the details of the jointly controlled entity are as follows:

Name of jointly controlled entity	Place of establishment and business	Attributable interest held by the Group	Principal activity
廣東蘭太康虹醫藥有限公司 Guangdong Lan Tai Kanghong Pharmaceutical Ltd. ("GDLT")	PRC	55% (Note)	Distribution of medicine

Note: In November 2007, the Group acquired a 55% equity interest in GDLT at nil consideration. The Group holds 55% of the registered share capital of GDLT and has the power to appoint three out of the five directors of GDLT. The remaining shareholding is held by one independent shareholder. However, under GDLT's memorandum and articles of association, the power to govern the financial and operating policies rests with the Board of Directors of GDLT and it requires two-third of the directors to approve the respective policies. The directors of the Company consider that the Group does not have control over GDLT and has classified GDLT as a jointly controlled entity.

15. INTEREST IN A JOINTLY CONTROLLED ENTITY - continued

The summarised financial information in respect of the Group's jointly controlled entity which is accounted for using equity method is set out below:

	2009 US$'000	2008 US$'000
Total assets	782	476
Total liabilities	(704)	(518)
Net assets (liabilities)	78	(42)
Group's share of net assets of a jointly controlled entity	43	-
Turnover	1,179	525
Profit (loss) for the year	121	(14)
Group's share of result of a jointly controlled entity	43	-

16. INTEREST IN AN ASSOCIATE

	2009 US$'000	2008 US$'000
Cost of unlisted investments in an associate	1,687	378
Share of post-acquisition profits and other comprehensive income, net of dividends received	(180)	157
	1,507	535

As at 31 December 2009 and 31 December 2008, the details of the associate are as follows:

Name of associate	Place of establishment/ incorporation	Attributable interest held by the Group 2009	 2008	Principal activities
深圳市深科醫療器械技術開發有限公司 Shenzhen Shenke Medical Instrument Technological Development Limited ("Shenzhen Shenke")	PRC	-	51% (Note 1)	Research and development, production and distribution of medical devices
Ophol Limited ("Ophol")	Hong Kong	24.49% (Note 2)	-	Investment holding and provision of agency service

16. INTEREST IN AN ASSOCIATE - continued

Notes:

(1) The Group held 51% of the registered share capital of Shenzhen Shenke and has the power to appoint four out of seven directors of Shenzhen Shenke. The other three shareholders of Shenzhen Shenke each has the power to appoint one director of Shenzhen Shenke. Pursuant to the shareholders' agreement, the power to govern the financial and operating policies rests with the Board of Directors of Shenzhen Shenke and it requires two-third of the directors to approve the respective policies. As a result, the Group does not have control over Shenzhen Shenke. The directors of the Company consider that the Group does exercise significant influence over Shenzhen Shenke and it is therefore classified as an associate of the Group.

The associate was disposed of to a related company and third parties at a consideration of RMB3,000,000 (equivalent to approximately US$439,000) during the year ended 31 December 2009 and loss on disposal of US$70,000 is recognised in profit or loss.

(2) On 20 February 2009, the Group entered into an agreement (the "Ophol Agreement") with the controlling shareholder of Ophol to acquire its equity interest of 73.47% in Ophol at a consideration of RMB22,500,000 (equivalent to approximately US$3,295,000). In which, RMB18,000,000 (equivalent to approximately US$2,636,000) was paid at initial and the rest RMB4,500,000 (equivalent to approximately US$659,000) would be paid over four years beginning from 2010. Before the completion of the transaction under the Ophol Agreement, on 15 March 2009, the Group entered into separate agreements (the "March Agreements") with each of the other two original shareholders of Ophol. Pursuant to the two March Agreements, the Group transferred 24.49% equity interest in Ophol to each of the other two original shareholders of Ophol at the consideration of RMB7,500,000 (equivalent to approximately US$1,098,000) each. Upon the completion of the March Agreements, the Group holds 24.49% equity interest in Ophol, while the other two original shareholders of Ophol hold equity interest of 38.78% and 36.73% respectively. On the same date, the Group entered into a supplementary agreement with the controlling shareholder of Ophol, the other two original shareholders of Ophol, Ophol and Qingdao League Pharmaceutical Co., Ltd. ("Qingdao League") for the purpose to ratify the terms of the Ophol Agreement and the March Agreements.

All the transactions mentioned above were completed in June 2009. As a result of all the agreements above, the Group in substance acquired 24.49% equity interest in Ophol at a consideration of RMB7,500,000 (equivalent to approximately US$1,098,000). In which, RMB6,000,000 (equivalent to approximately US$879,000) was paid at initial and the rest RMB1,500,000 (equivalent to approximately US$219,000) would be paid over four years beginning from 2011.

The holding of 24.49% equity interest in Ophol was classified as an associate of the Group and discount on acquisition of US$647,000 is recognised in the profit or loss.

16. INTEREST IN AN ASSOCIATE - continued

The summarised financial information in respect of the Group's associate is set out below:

	2009 US$'000	2008 US$'000
Total assets	6,154	1,211
Total liabilities	-	(161)
Net assets	6,154	1,050
Group's share of net assets of an associate	1,507	535
Turnover	2,170	1,654
Profit for the year	178	298
Other comprehensive (expense) income	(3)	71
Group's share of results of associates for the year	30	152
Group's share of other comprehensive income and expense of associates	(1)	36

17. INTANGIBLE ASSETS

	Exclusive distribution right US$'000 (Note a)	Exclusive agency right US$'000 (Note b)	Total US$'000
COST			
At 1 January 2008	671	-	671
Exchange adjustments	78	-	78
Additions	919	6,775	7,694
Transfer	(717)	628	(89)
At 31 December 2008	951	7,403	8,354
Exchange adjustments	1	-	1
At 31 December 2009	952	7,403	8,355
AMORTISATION			
At 1 January 2008	(61)	-	(61)
Exchange adjustments	(14)	-	(14)
Charge for the year	(302)	(491)	(793)
Transfer	89	-	89
At 31 December 2008	(288)	(491)	(779)
Charge for the year	(294)	(821)	(1,115)
At 31 December 2009	(582)	(1,312)	(1,894)
CARRYING VALUES			
At 31 December 2009	370	6,091	6,461
At 31 December 2008	663	6,912	7,575

17. INTANGIBLE ASSETS - continued

(a) Exclusive distribution right

(i) On 10 February 2007, the Group entered into a supplemental agreement with Qingdao League, which gave the Group exclusive distribution right of Augentropfen Stulln Mono ("Stulln"), which is a finished drug product under the trade name of Augentropfen Stulln Mono in the PRC for a term of ten years with effect from 1 January 2007 to 31 December 2016. In the opinion of the directors of the Company, the exclusive distribution right of Stulln was acquired by the Group in connection with the Operation Agreement. Accordingly, the cost of the intangible asset of exclusive distribution right amounting to US$644,000 obtained from Qingdao League was determined as the excess of the consideration paid of US$770,000 over the fair value of the investment in Qingdao League as at the date of acquisition of US$126,000. The expected useful life of the exclusive distribution right of Stulln was 10 years.

The exclusive distribution right of Stulln was early terminated when the Group entered into a supplementary agreement with Ophol and the supplier of Stulln in Germany in July 2008. The remaining unamortised carrying amount of this exclusive distribution right of Stulln qualified as a direct attributable cost in acquiring the exclusive agency right of Stulln, pursuant to the Group entered into such supplementary agreement with Ophol and the supplier of Stulln in Germany in July 2008 (see (b) below). Accordingly, the remaining unamortised carrying amount of the exclusive distribution right of Stulln amounting to US$628,000 was then transferred to the exclusive agency right of Stulln. The details are set out in (b) below.

(ii) On 9 March 2008, the Group entered into an exclusive distribution agreement and a supplementary agreement (the "Nesiritide Agreements") with 西藏諾迪康藥業服份有限公司 (Tibet Rhodiola Pharmaceutical Holding Co., Ltd.) ("Rhodiola") in connection to a finished drug product (Lyophilized Recombinant Human Brain Natriuretic Peptide) which is distributed in the PRC market since 2005 under the trade name of Nesiritide for a term of three years with effect from 1 July 2008 to 30 June 2011.

Pursuant to the Nesiritide Agreements, the Group has obtained the exclusive distribution right of Nesiritide at nil consideration and has committed to handle the Phase IV clinical trials of Nesiritide for 2,000 cases in the PRC to meet the drug safety standards set by the Food and Drug Administration in the PRC ("SFDA"). The drug, Nesiritide, to be used in the 2,000 case clinical trials will be provided by Rhodiola free of charge. All other costs of the 2,000 case clinical trials should be borne by the Group. The management of the Group estimates the total costs to be incurred for completion of the 2,000 case clinical trials would be approximately RMB6,500,000 (equivalent to approximately US$919,000).

In the opinion of the directors of the Company, the Group obtained the exclusive distribution right of Nesiritide on the basis that the Group should complete the clinical trials of Nesiritide and bear all the costs of the clinical trials. Therefore, the costs to be incurred in clinical trials of US$919,000 are capitalised as an intangible asset with corresponding liability recognised.

The expected useful life of the exclusive distribution right of Nesiritide is 3 years.

17. INTANGIBLE ASSETS - continued

(b) Exclusive agency right

On 26 April 2008, a transfer agreement was entered into between Ophol, Qingdao League and Pharma Stulln GmbH ("Pharma", the supplier of Stulln in Germany) in connection to the transfer of the exclusive agency right of Stulln in the PRC from Qingdao League to Ophol at nil consideration. After Ophol has obtained the exclusive agency right of Stulln in the PRC, Ophol agreed to transfer such exclusive agency right to the Group on condition that the 51% equity interest of Qingdao League owned by Shenzhen Kangzhe would be transferred to Qingdao Leatu Trading Ltd., a company which has common shareholder with Ophol under the sale and purchase agreement as described in note 16 above. On 15 July 2008, the Group entered into a supplementary agreement with Ophol and Pharma in connection to the transfer of exclusive agency right of Stulln, from Ophol to CMS Pharmaceutical, a wholly-owned subsidiary of the Company, at a consideration of RMB60,000,000 (equivalent to approximately US$8,779,000). CMS Pharmaceutical will pay annually of RMB6,000,000 (equivalent to approximately US$878,000) to Ophol over the next ten years to settle the consideration. The directors of the Group recognise the payable as a deferred consideration (see note 27) in the amount of US$6,775,000, which represents the present value of the consideration of US$878,000 over next 10 years discounted at 5%. CMS Pharmaceutical has replaced Qingdao League as the exclusive agent of Stulln for Pharma in the PRC from 1 August 2008 to 31 July 2018.

The expected useful life of the exclusive agency right is 10 years.

18. GOODWILL

	US$'000
At 1 January 2008 and 31 December 2008	581
Released on disposal of a subsidiary	(202)
At 31 December 2009	379

For the purposes of impairment testing, the entire amount of goodwill has been allocated to two cash generating units ("CGUs") representing two subsidiaries, one is engaged in distribution and import of drug and the other one is engaged in production of medical devices which amounted to US$379,000 (2008:US$379,000) and nil (2008: US$202,000) respectively. In December 2009, the Group disposed its equity interest in a subsidiary, 山東寶利好醫療器械有限公司 Boundless Horizon (Shan Dong) Medical Appliances Co. Ltd. ("Shandong Bao Li Hao"), which engaged in the production of medical devices.

Particulars regarding impairment testing on goodwill arising from acquisition of subsidiaries are disclosed as follows:

The recoverable amount of each of the CGUs are determined from value in use calculations. The key assumptions for the value in use calculations are those regarding the discount rates, growth rates and expected changes to selling prices and direct costs during the year. Management estimates discount rates using pre-tax rates that reflect current market assessments of the time value of money and the risks specific to the CGUs. The growth rates are based on industry growth forecasts. Changes in selling prices and direct costs are based on past performance and expectations of future changes in the market.

18. GOODWILL - continued

During the year, the Group performed impairment review for goodwill based on the cash flow projections which was derived from the financial budgets approved by the management covering a three-year period with discount rate of 15% (2008: 20%). For impairment review purpose, the cash flow projections was extrapolated for two years to a five-year period based on the assumption that no growth is expected after the third year. Another key assumption for the value in use calculation is the budgeted gross margin, which is determined based on the unit's past performance and management's expectation for the market development. The directors of the Company consider that no impairment loss on goodwill should be recognised.

19. DEFERRED TAX

The following are the deferred tax assets (liabilities) recognised and movements thereon during the current and prior years:

	Unrealised profits on inventories	Undistributed profits of PRC subsidiary	Others (note)	Total
	US$'000	US$'000	US$'000	US$'000
At 1 January 2008	412	-	17	429
Credit (charge) to profit or loss for the year (note 8)	653	(839)	(17)	(203)
Exchange differences	8	-	-	8
At 31 December 2008	1,073	(839)	-	234
Credit (charge) to profit or loss for the year (note 8)	244	(925)	120	(561)
Exchange differences	(5)	-	-	(5)
At 31 December 2009	1,312	(1,764)	120	(332)

Note: These mainly represent the deferred tax assets recognised in relation to impairment loss on plant and machinery of the segment of production of medicines for the year ended 31 December 2009.

The following is the analysis of the deferred tax balances for financial reporting purposes:

	2009	2008
	US$'000	US$'000
Deferred tax assets	1,432	1,073
Deferred tax liabilities	(1,764)	(839)
	(332)	234

19. DEFERRED TAX - continued

At 31 December 2009, the Group has unused tax losses of approximately US$2,178,000 (2008: US$6,659,000) available for offsetting against future profits. No deferred tax asset has been recognised in respect of such tax losses due to the unpredictability of future profit streams. Included in unrecognised tax losses at 31 December 2009 are tax losses of approximately US$1,378,000 (2008: US$5,859,000) that will expire within 5 years from the year of originating. Other tax losses may be carried forward indefinitely.

Under the EIT Law of PRC, withholding tax is imposed on dividends declared in respect of profits earned by PRC subsidiaries from 1 January 2008 onwards. Deferred taxation has been provided for in the consolidated financial statements in respect of temporary differences attributable to accumulated profits of the PRC subsidiary amounting to US$35,280,000 (2008: US$16,772,000).

20. INVENTORIES

	2009 US$'000	2008 US$'000
Raw materials	222	46
Work in progress	32	104
Finished goods	10,806	5,795
	11,060	5,945

21. TRADE AND OTHER RECEIVABLES

	2009 US$'000	2008 US$'000
Trade receivables	20,959	17,441
Less: Allowance for bad and doubtful debts	(213)	(221)
	20,746	17,220
Bills receivables	9,513	7,062
Other receivables	2,535	3,402
Total trade and other receivables	32,794	27,684

The Group normally allows a credit period of three months to its trade customers. Lengthened credit period up to four months was allowed to some selected customers.

An aging analysis of the trade receivables net of allowance for bad and doubtful debts at the respective reporting dates is as follows:

	2009 US$'000	2008 US$'000
0 - 90 days	17,879	14,811
91 - 365 days	2,839	2,316
Over 365 days	28	93
	20,746	17,220

21. TRADE AND OTHER RECEIVABLES - continued

The bills receivables of the Group are of the age within six months at the end of the reporting period.

Management closely monitors the credit quality of trade and other receivables and considers the trade and other receivables that are neither past due nor impaired to be of a good credit quality.

Included in the Group's trade receivable balance are debtors with aggregate carrying amount of US$4,476,000 (2008: US$4,291,000) which are past due at the reporting date for which the Group has not provided for impairment loss. Based on the historical experiences of the Group, trade receivables past due but not impaired are generally recoverable. The Group does not hold any collateral over these balances.

The following is an aging analysis of trade receivables which are past due but not impaired:

	2009 US$'000	2008 US$'000
0 - 90 days	2,274	2,127
91 - 365 days	2,174	2,071
Over 365 days	28	93
	4,476	4,291

The Group has provided fully for all receivables over 3 years because historical experience is such that receivables that are past due beyond 3 years are generally not recoverable.

Movement in the allowance for bad and doubtful debts:

	2009 US$'000	2008 US$'000
Balance at beginning of the reporting period	221	307
Impairment losses recognised on receivables	57	23
Amount written off as uncollectible	(65)	(127)
Currency realignment	-	18
Balance at end of the reporting period	213	221

Included in the allowance for bad and doubtful debts are individually impaired trade receivables with an aggregate balance of US$213,000 (2008: US$221,000) which have either been placed under liquidation or in severe financial difficulties. The Group does not hold any collateral over these balances.

22. OTHER FINANCIAL ASSETS

(a) The amount due from an associate and amounts due from directors were unsecured, non-interest-free and repayable on demand.

	2009 US$'000	2008 US$'000
Amounts due from a director		
Hui Ki Fat	-	43

(b) Included in amount due from a jointly controlled entity amounting to US$312,000 (2008: nil) is trade nature and is aged within three months. The Group allows a credit period of three months to its jointly controlled entity. The remaining amount is unsecured, non-interest-free and repayable on demand.

23. HELD FOR TRADING INVESTMENTS

	2009 US$'000	2008 US$'000
Held for trading investments include:		
- Equity securities listed in PRC	31	-

24. BANK BALANCES AND CASH/PLEDGED BANK DEPOSITS

The bank deposits and pledged bank deposits carry interest at the prevailing market rate of approximately 0.36% to 1.71% (2008: 0.36% to 5.00%) per annum.

Pledged bank deposits amounting to US$17,641,000 (2008: US$1,060,000) represent deposits pledged to banks to secure short-term bank borrowings (see note 26) and therefore classified as current assets.

25. TRADE AND OTHER PAYABLES

An aging analysis of the trade payables presented based on the invoice date at the end of the reporting period as follows:

	2009 US$'000	2008 US$'000
0 - 90 days	6,067	5,562
91 - 365 days	5	24
Over 365 days	7	7
	6,079	5,593

The average credit period on purchases of goods is 90 days.

26. BANK BORROWINGS - SECURED

	2009 US$'000	2008 US$'000
Import trade loans	7,557	-
Bank loans	8,960	-
	16,517	-
Carrying amount repayable within one year	16,517	-

The bank borrowings are discounted in US$. Import trade loans carried fixed interest at a range from 1.53% to 1.87% per annum. The remaining bank loans bears interest at LIBOR + 0.35% per annum. The range of effective interest rates (which are also equal to contracted interest rates) on the bank loans was from 0.58% to 1.62%.

27. DEFERRED CONSIDERATION PAYABLES

	2009 US$'000	2008 US$'000
Non-current	5,291	6,179
Current	838	685
	6,129	6,864

During the year ended 31 December 2008, the Group acquired an agency right from Ophol which has become the associate of the Group during the year ended 31 December 2009 for a consideration of RMB60,000,000 (equivalent to approximately US$8,779,000) (see note 17(b)). The consideration is payable annually of RMB6,000,000 (equivalent to approximately US$878,000) for 10 years commencing on 26 April 2008. The present value of the discounted consideration at an interest rate of 5% amounting to US$6,775,000 was accounted for by the Group as deferred consideration payable at initial recognition. As at 31 December 2009, the carrying value amounting to US$5,966,000 (2008: US$6,864,000) is included in deferred consideration payables.

The remaining deferred consideration payables represented consideration for the acquisition of an associate, Ophol (see note 16(2)).

28. DERIVATIVE FINANCIAL INSTRUMENTS

Derivative under hedge accounting

	2009 US$'000	2008 US$'000
Cash flow hedges		
- Interest rate swaps	74	-
- Foreign currency forward contracts	71	-
	145	-

28. DERIVATIVE FINANCIAL INSTRUMENTS - continued

Derivative under hedge accounting - continued

(i) Interest rate swaps

The Group uses interest rate swaps to minimise its exposure to interest expenses of certain of its floating-rate US dollar bank borrowings by swapping floating interest rates to fixed interest rates. The interest rate swaps and the corresponding bank borrowings have the same terms and the directors of the Company considered that the interest rate swaps are highly effective hedging instruments. Major terms of the interest rate swaps are set out below:

31 December 2009

Notional amount	Maturity	Swaps
US$3,765,000	28 September 2010	From 1-month LIBOR + 0.35% to 1.47%
US$1,470,000	29 November 2010	From 3-month LIBOR + 0.35% to 1.68%
US$1,617,000	14 December 2010	From 3-month LIBOR + 0.35% to 1.68%
US$2,108,000	30 December 2010	From 3-month LIBOR + 0.35% to 1.68%

(ii) Foreign currency forward contracts

At the end of the reporting period, the Group had the following foreign currency forward contracts designated as highly effective hedging instruments in order to manage the Group's foreign currency exposure in relation to US dollar interest and principal payments of its US dollar bank borrowings.

The terms of the foreign currency forward contracts have been negotiated to match the terms of the respective designated hedged items. Major terms of the foreign currency forward contracts are as follows:

31 December 2009

Notional amount	Maturity	Exchange rates
Buy US$2,140,000	23 August 2010	US$1: RMB 6.822
Buy US$3,821,000	28 September 2010	US$1: RMB 6.858
Buy US$1,470,000	2 December 2010	US$1: RMB 6.638
Buy US$1,620,000	14 December 2010	US$1: RMB 6.719
Buy US$2,140,000	30 December 2010	US$1: RMB 6.686

29. SHARE CAPITAL

	Number of shares '000	Amount US$'000
Authorised share capital with nominal value of US$0.1 each:		
At 31 December 2008 and 31 December 2009	1,000,000	100,000
Issued and fully paid:		
At 31 December 2007 and 31 December 2008	47,246	4,725
Issue of shares	162	16
At 31 December 2009	47,408	4,741

On 31 July 2009, 162,528 new ordinary shares of US$0.1 of the Company were issued at GBP1.68 per share (equivalent to US$2.78 per share) for cash to the trust under the Key Employee Benefit Scheme (the "Scheme") (see note 39).

All the shares which were issued by the Company during the year ended 31 December 2009 rank pari passu with each other in all respects.

30. SHARE OPTIONS

The Company granted share options of 708,695 shares with an exercise price of GBP1.38 per share on 26 June 2007. These options were granted to Evolution Securities China Limited ("Evolution"), the underwriters of the Company on the Company's initial public offering on AIM, in exchange for a payment of GBP1.00 from Evolution to the Company. These options are exercisable over a period of five years and vest on 26 June 2007. The share options will expire on 25 June 2012. The estimated fair value per share of these options is GBP0.4019 (equivalent to US$0.8046) with a total fair value of US$570,000. In addition to the share options granted to Evolution on successful basis, the Company paid an underwriting commission of US$1,151,000 (equivalent to GBP575,000) to Evolution representing 5.75% to the gross proceeds of the new issue. Such underwriting commission of US$1,151,000 settled in cash was recognised in the share premium account together with other initial public offering expenses allocated to the new issued shares.

On 9 March 2009, Mr. Chen Hong Bing, a director of the Company, acquired the share options of 708,695 shares from Evolution. There was no other movement in the share options for both years.

31. RESERVES

Capital reserve

Capital reserve resulted from transactions between the Group and its shareholders. It mainly represents 4.25% of equity shares of Shenzhen Kangzhe granted to employees in 2001, 2004, 2005 and 2006 pursuant to the Internal Management and Regulation on Employee Share holding dated 25 July 2001 (the "Phantom Shares") and certain shares granted to certain employees of Shenzhen Kangzhe for their services rendered by Dr. Lam Kong, during 2001 to 2006, waiver of an advance to the Company by Dr. Lam Kong in 2006, discount on acquisitions of additional interest in subsidiaries from Dr. Lam Kong in 2004 and 2005, the difference between the transfer of the entire interest in Shenzhen Kangzhe to Sino Talent Limited ("Sino Talent") pursuant to the group restructuring in 2005 and the nominal value of Shenzhen Kangzhe's share capital, and difference between the par value of shares issued by the Company for the entire interest in CMS International Investment Limited ("CMS International") and Healthlink pursuant to the Group Reorganisation and the nominal value of the issued share capital of CMS International and Healthlink in preparation for the listing of the Company's shares.

Surplus reserve fund

Articles of Association of the Group's subsidiaries established in the PRC require the appropriation of certain percentage of their profit after taxation each year to the surplus reserve fund until the balance reaches 50% of the registered capital of the relevant subsidiaries. In normal circumstances, the surplus reserve fund shall only be used for making up losses, capitalisation into registered capital and expansion of the subsidiaries' production and operation. For the capitalisation of surplus reserve fund into registered capital, the remaining amount of such reserve shall not be less than 25% of the registered capital.

32. MINORITY INTERESTS

The amounts as at 31 December 2008 represent the agreed share of net liabilities of subsidiaries by minority shareholders.

Pursuant to supplementary shareholders' agreements entered on 28 April 2004 and 2 January 2007, the minority shareholders of Hunan Pharmapep Zhong Nang Research and Development Ltd. ("Hunan R&D") and Crosspac Group Limited ("Crosspac") respectively, 70% subsidiaries of the Company, agreed to contribute additional capital to Hunan R&D and Crosspac to make good of the losses incurred.

33. CAPITAL RISK MANAGEMENT

The Group manages its capital to ensure that the group entities will be able to continue as a going concern while maximising the return to stakeholders through the optimisation of the debt and equity balance. The Group's overall strategy remains unchanged from prior year.

The capital structure of the Group consists of cash and cash equivalents, bank borrowings and equity attributable to equity holders of the Company, comprising issued share capital and reserves including accumulated profits.

The directors of the Company review the capital structure on a regular basis. As part of this review, the directors consider the cost of capital and the risks associated with each class of capital. Based on recommendations of the directors, the Group will balance its overall capital structure through the payment of dividends and new share issues.

34. FINANCIAL INSTRUMENTS

Categories of financial instruments

	2009 US$'000	2008 US$'000
Financial assets		
Loans and receivable (including cash and cash equivalents)	63,494	45,443
Held-for-trading financial assets	31	-
Financial liabilities		
Derivative instruments in designated hedge accounting relationship	(145)	-
Amortised cost	(29,771)	(16,116)

Financial risk management objectives and policies

The Group's major financial instruments include trade and other receivables, bank balances and cash, trade and other payables, bank borrowings and derivative financial instruments. Details of these financial instruments are disclosed in the respective notes. The risks associated with these financial instruments include market risk (interest rate risk, currency risk and other price risk), credit risk and liquidity risk. The policies on how to mitigate these risks are set out below. The management manages and monitors these exposures to ensure appropriate measures are implemented on a timely and effective manner.

34. FINANCIAL INSTRUMENTS - continued

Financial risk management objectives and policies - continued

Market risk

Interest rate risk

The Group's fair value interest rate risk is the risk that the fair value of a fixed rate financial instrument will fluctuate because of changes in market interest rates. Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. In order to keep borrowings at fixed rate and to minimise the cash flow interest rate risk, the Group uses floating to fixed interest rate swaps to manage the cash flow interest rate risk exposure associated with the bank borrowings amounting to US$8,960,000 issued at floating rates (see note 26 for details) and therefore no sensitivity analysis is provided. Interest rate swaps, fixed rate bank and bank borrowings expose the Group to fair value interest rate risk.

Currency risk

Some subsidiaries of the Company have foreign currency purchases and bank borrowings, which also expose the Group to foreign currency risk. Approximately 76.4% (2008: 70.1%) of the Group's purchases are denominated in currencies other than the functional currency of the group entities making the purchase. All sales of the Group are denominated in functional currency of the group entities making the sale.

The Group has entered into appropriate hedging instruments, mentioned in note 28(ii) to the financial statements, to hedge against the potential currency risk arising from US$ denominated bank borrowings. The Group reviews the continuing effectiveness of hedging instruments at least at the end of each reporting period and until the hedging instrument expires or is terminated or the hedge no longer meets the criteria for hedge accounting. It is the Group's policy to negotiate the terms of the hedge derivatives to match the terms of the lodged item to maximize hedge effectiveness (see note 28 for details).

The carrying amounts of the Group's foreign currency denominated monetary assets (representing bank balances) and monetary liabilities (representing trade and other payables and import trade loans of US$5,450,000 without any hedging instruments) at the reporting date are as follows:

		Assets		Liabilities	
	Currency	2009	2008	2009	2008
		US$'000	US$'000	US$'000	US$'000
US dollars	US$	595	245	9,628	4,935
Euro	EURO	316	16	1,719	2,243
Others		140	89	-	-

Management conducts periodic review of exposure and settlements of various currencies, and will consider hedging significant foreign currency exposures should the need arise.

34. FINANCIAL INSTRUMENTS - continued

Financial risk management objectives and policies - continued

Currency risk - continued

The Group is mainly exposed to currency risk of the Euro and the United States dollar. The following table details the Group's sensitivity to a 7% increase and decrease in the RMB against the relevant foreign currencies. The sensitivity analysis includes only outstanding foreign currency denominated monetary items and adjusts their translation at the year end for a 7% change in foreign currency rates. The sensitivity analysis includes bank balances, trade and other payables and import trade loans of US$5,450,000 without any hedging instruments. A positive number below indicates an increase in post-tax profit for the year where the RMB strengthens 7% against the relevant currency. If there is a 7% weakening in RMB against the relevant foreign currencies, there would be an equal and opposite impact on the result for the year:

	2009 US$'000	2008 US$'000
US dollars	632	328
Euro	98	156

Other price risk

The Group's held-for-trading investments in listed securities are measured at fair value at each reporting date with reference to the listed share prices. Therefore, the Group is exposed to equity price risk and the management will monitor the price movements and take appropriate actions when it is required. The exposure of the equity price risk is minimal and no sensitivity to equity price risk is provided.

The Group is also exposed to other price risk through its investments in derivative financial instruments. The Group's other price risk is mainly concentrated on the foreign exchange forward contracts entered during the year.

The sensitivity analyses have been determined based on the exposure to other price risks for derivative at the reporting date. If the forward rate of the foreign exchange forward contracts had been 5% higher/lower and all other variables were held constant, the fair value changes which deferred in equity as hedging reserve for the year ended 31 December 2009 would increase/decrease by US$558,000.

Credit risk

The Group's maximum exposure to credit risk in the event of the counterparties failure to perform their obligations as at 31 December 2009 in relation to each class of recognised financial assets is the carrying amount of those assets as stated in the consolidated statement of financial position. In order to minimise the credit risk, management of the Group has delegated a team responsible for determination of credit limits, credit approvals and other monitoring procedures to ensure that follow-up action is taken to recover overdue debts. In addition, the Group reviews the recoverable amount of each individual trade debt at the end of the reporting period to ensure that adequate impairment losses are made for irrecoverable amounts. In this regard, the directors of the Company consider that the Group's credit risk is significantly reduced.

34. FINANCIAL INSTRUMENTS - continued

Credit risk - continued

The credit risk on liquid funds is limited because the counterparties are banks with good reputation.

Other than concentration of credit risk on liquid funds which are deposited with several banks with good reputation, the Group has no significant concentration of credit risk on trade and other receivables, with exposure spread over a number of counterparties and customers and across diverse geographical areas.

Liquidity risk

In the management of the liquidity risk, the Group monitors and maintains a level of cash and cash equivalents deemed adequate by the management to finance the Group's operations and mitigate the effects of fluctuations in cash flows.

Ultimate responsibility for liquidity risk management rests with the board of directors, which has built an appropriate liquidity risk management framework for the management of the Group's short, medium and long-term funding and liquidity management requirements.

The following table details the Group's remaining contractual maturity for its financial liabilities based on the agreed repayment terms. The table has been drawn up based on the undiscounted cash flows of financial liabilities based on the earliest date on which the Group can be required to pay. The table includes both interest and principal cash flows. To the extent that interest flows are floating rate, the undiscounted amount is derived from current interest rate at the end of the reporting period.

In addition, the following table details the Group's liquidity analysis for its derivative financial instruments. The tables have been drawn up based on the undiscounted contractual net cash (inflows) and outflows on derivative instruments that settle on a net basis, and the undiscounted gross (inflows) and outflows on these derivatives that require gross settlement. When the amount payable is not fixed, the amount disclosed has been determined by reference to the projected interest rates as illustrated by the interest rate existing at the end of the reporting period. The liquidity analysis for the Group's derivative financial instruments are prepared based on the contractual maturities as the management consider that the contractual maturities are essential for an understanding of the timing of the cash flows of derivatives.

	Less than 1 year	1 to 5 years	Over 5 years	Total undiscounted cash flows	Carrying amount at 31.12.2009
	US$'000	US$'000	US$'000	US$'000	US$'000
As at 31 December 2009					
Trade and other payables	7,125	-	-	7,125	7,125
Deferred consideration payables	879	3,679	3,516	8,074	6,129
Fixed interest rate borrowings	7,682	-	-	7,682	7,557
Variable interest rate borrowings	9,014	-	-	9,014	8,960
	24,700	3,679	3,516	31,895	29,771
Derivatives - net settlement					
Foreign currency forward contracts	95	-	-	95	71
Derivatives - gross settlement					
Interest rate swaps					
- inflows	(53)	-	-	(53)	-
- outflows	142	-	-	142	74

34. FINANCIAL INSTRUMENTS - continued

Liquidity risk - continued

	Less than 1 year US$'000	1 to 5 years US$'000	Over 5 years US$'000	Total undiscounted cash flows US$'000	Carrying amount at 31.12.2008 US$'000
As at 31 December 2008					
Trade and other payables	9,252	-	-	9,252	9,252
Deferred consideration payables	741	3,512	4,389	8,642	6,864
	9,993	3,512	4,389	17,894	16,116

Fair value

The fair value of financial assets and financial liabilities are determined as follows:

- the fair value of financial assets with standard terms and conditions and traded on active liquid markets are determined with reference to quoted market bid prices; and

- the fair value of derivative instruments is calculated using discounted cash flow analysis using the applicable yield curve for the duration of the instruments for non-optional derivatives.

The carrying amounts of financial assets and liabilities carried at amortised cost approximate their respective fair values.

Fair value measurements recognised in the statement of financial position

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 2 based on the degree to which the fair value is observable.

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active market for identical assets or liabilities.

- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

	2009	
	Level 1 US$'000	Level 2 US$'000
Held-for-trading investments		
Listed equity securities	31	-
Derivative financial instruments	-	145

There were no transfers between Level 1 and 2 for both years.

35. DISPOSAL OF SUBSIDIARIES

(a) On 11 December 2009, the Board of Directors of the Company approved the payment of a dividend. The dividend is payable by way of a distribution in specie ("the Distribution") of the entire share capital of Healthlink on the basis of one Healthlink share for every one ordinary share of the Company of US$0.1 each in the capital of the Company, with cash dividend alternative. Healthlink and its subsidiaries ("Healthlink Group") are engaging in the research and development of medicine in PRC.

On 18 December 2009, 82.1% shareholders elected to receive shares in Healthlink and 17.9% shareholders elected for cash alternative. Under a repurchase agreement between the Company and Healthlink, the 17.9% remaining Healthlink share held by the Company is disposed to Healthlink for aggregate cash consideration of US$1,969,000.

On 23 December 2009, the Company has made the Distribution of US$8,681,000, which is equivalent to the net asset value of Healthlink Group on that date, in the form of distribution in specie of the 38,921,747 ordinary shares of US$0.01 each, representing entire share capital of Healthlink, and cash dividend of US$1,969,000. The Distribution was made to the shareholders on the register of members on 27 November 2009.

The net assets of Healthlink at the date of the Distribution were as follows:

	11 December 2009 US$'000
NET ASSETS DISTRIBUTED OF	
Property, plant and equipment	346
Other receivables	91
Bank balances and cash	8,099
Other payables	(185)
	8,351
Minority interests	330
	8,681
Satisfied by:	
Interim dividend in specie (note 11)	8,681
Cash outflow arising on the Distribution:	
Bank balances and cash distributed of	8,099
Cash dividend	1,969
	10,068

During the year ended, Healthlink has insignificant impact on the turnover and contributed loss which amounted to US$1,138,000 (2008: US$2,299,000) to the Group.

35. DISPOSAL OF SUBSIDIARIES - continued

(b) On 17 December 2009, the Group disposed of a subsidiary, Shandong Bao Li Hao, to the independent third parties. The net liabilities of Shandong Bao Li Hao at the date of disposal were as follows:

	17 December 2009 US$'000
NET LIABILITIES DISPOSED OF	
Property, plant and equipment	6
Inventories	107
Trade and other receivables	1
Bank balances and cash	1
Trade and other payables	(341)
	(226)
Attributable goodwill	202
	(24)
Gain on disposal	24
Total consideration	-
Cash outflow arising on disposal:	
Bank balances and cash disposed of	1

During the year ended, Shandong Bao Li Hao has contributed turnover amounting to US$15,000 (2008: US$5,000) and loss amounting to US$75,000 (2008: US$95,000) to the Group.

36. OPERATING LEASE

The Group as lessee

The Group's total future minimum lease payments under non-cancellable operating lease in respect of property which fall due as follows:

	2009 US$'000	2008 US$'000
Within one year	487	462
In the second to fifth years inclusive	390	631
	877	1,093

The lease is negotiated for a lease term of 1 to 5 years at fixed monthly rental.

37. RELATED PARTY TRANSACTIONS

(a) Apart from details of the balances with related parties disclosed in the consolidated statement of financial position, the Group entered into the following transactions with related parties during the year:

Name of related company	Relationship	Nature of transactions	2009 US$'000	2008 US$'000
Ophol	Associate	Finance cost	347	-
GDLT	Jointly controlled entity	Sales of goods	743	303
Sunpharma GmbH	Related company (note)	Purchases of goods	157	-
Shenzhen Kangzhe Industrial Investment Co. Ltd. 深圳市康哲實業投資有限公司	Related company (note)	Consideration received for disposal of interest in an associate	258	-

Note: Sunpharma GmbH and Shenzhen Kangzhe Industrial Investment Co. Ltd. 深圳市康哲實業投資有限公司 are companies in which Mr. Lam Kong, the director of the Company has beneficial interests.

(b) The key management personnel includes solely the directors of the Company and the compensation paid to them is disclosed in note 9.

(c) In the opinion of the directors of the Group, the related party transactions were carried out in the ordinary and usual course of the Group's business.

38. RETIREMENT BENEFITS SCHEMES

The employees employed in the PRC are members of the state-managed retirement benefit schemes operated by the PRC government. The PRC subsidiaries are required to contribute a certain percentage of their payroll to the retirement benefit schemes to fund the benefits. The only obligation of the Group with respect to the retirement benefit schemes is to make the required contributions under the schemes.

The employees employed in Hong Kong are required to join the Mandatory Provident Fund Scheme (the "MPF Scheme"). Contributions to the MPF Scheme are made in accordance with the statutory limits prescribed by the Mandatory Provident Fund Ordinance of Hong Kong.

During the year, the total expense recognised in the profit or loss for the above schemes amounted to US$689,000 (2008: US$638,000).

39. KEY EMPLOYEE BENEFIT SCHEME

The Scheme was adopted by the Board on 31 July 2009 ("Adoption Date"). Unless terminated earlier by the Board, the Scheme shall be valid and effective for a term of 20 years commencing on the Adoption Date. Pursuant to the rules of the Scheme, the Company set up a trust through a trustee (the "Trustee"), Fully Profit Management (PTC) Limited, for the purpose of administration the Scheme. A summary of some of the principal terms of the Scheme is set out in below.

(a) The purpose of the Scheme is to recognise the contributions by certain employees who have been actively involved in the business development of the Group and to establish and maintain a superannuation fund for the purpose of providing retiring allowances for certain employees (including without limitation employees who are also directors) of the Group, and to give incentive in order to retain them for the continual operation and development of the Group.

(b) Under the Scheme, the Board may, from time to time, at its absolute discretion and subject to such terms and conditions as it may think to select an employee (the "Member") who completed 10 years' services in the Group (subject to consent of the Board if the employee completed 5 year's services in the Group) for participation in the Scheme for 10 years after retirement (the "Payment Period") (subject to adjustment set out in (d) below).

(c) The Company will, on a yearly basis, contribute the sum equal to an amount not less than 0.5%, but no more than 3% of its after tax profits shown on the audited consolidated financial statements of the Group, or issue such number of shares of the Company to the Trustee in consideration of payment of such amount as the Board may determine with reference to the aforesaid contribution as against the then market value of the shares of the Company (the "Yearly Contributions"), subject to the Board's approval.

(d) The amount payable to the Members depends on the value of the assets held by the Trustee (the "Fund"). If the value of the Fund is less than the aggregate amount of contributions previously made by the Company, the amount payable to the Members and the Payment Period will be adjusted by a factor derived from the value of the Fund and the aggregate amount of contributions previously made by the Company. The only obligation of the Company is to make the Yearly Contributions to the Fund.

During the year ended 31 December 2009, the Company contributed cash amounting to US$451,000 to the Fund and which were recognised as key employee benefit expenses in the consolidated statement of comprehensive income. On the other hand, the Scheme subscribed 162,528 shares of the Company (see note 29).

40. EVENTS AFTER THE REPORTING PERIOD

(a) In February 2010, the Group, through its subsidiary, CMS Pharmaceutical, entered into an exclusive distribution agreement with a pharmaceutical company established in France ("Licensor"). Pursuant to this agreement, CMS Pharmaceutical obtained the exclusive distribution right of a drug in the PRC for a period of five years commencing from the effective date of the agreement. In addition, CMS Pharmaceutical has committed for a minimum purchase quantity for each contract year at the pre-determined prices based on the quantities purchased. The minimum purchase amount based on the minimum quantity for the first, second, third, fourth and fifth contract year are amounted to US$ 619,000, US$ 929,000, US$ 1,300,000, US$ 1,703,000 and US$ 2,064,000 respectively.

40. EVENTS AFTER THE REPORTING PERIOD – continued

The Licensor is entitled to terminate the agreement by giving six months' advance notice in writing if the Group cannot attain the minimum purchase quantity during 2 consecutive calendar years, unless the Group is willing to purchase the difference versus the minimum purchase quantity within January following the shortfall year.

(b) In March 2010, the Group, through its subsidiary, CMS Pharmaceutical, entered into an agreement with third parties for providing promotion services of a one-off importing drug in PRC (excluding Hong Kong, Macau and Taiwan). The service fee for the promotion activity is US$5.14 and US$8.78 per bottle for two kinds of packing at an aggregated amount of US$4,210,800 if all products are sold out in PRC.

41. SUBSIDIARIES OF THE COMPANY

As at 31 December 2009 and 2008, the details of the Company's subsidiaries are set as follows:

Name of subsidiaries	Place of incorporation/ establishment and operation	Issue and fully paid share capital/ registered capital		Equity interest held by the Group				Principal activities
		2009	2008	2009		2008		
				Directly	Indirectly	Directly	Indirectly	
CMS International (note 2)	British Virgin Islands	US$10,000	US$10,000	100%	-	100%	-	Investment holding
CMS Peptides Patent Holding Company Limited (note 3)	British Virgin Islands	US$100	US$100	-	-	-	70%	Holding of overseas registered patents
Healthlink (note 3)	British Virgin Islands	US$474,089	US$10,000	-	-	100%	-	Investment holding
Hunan Kangzhe (Sino-Foreign Equity Joint Venture)	PRC	RMB20,000,000	RMB20,000,000	-	100%	-	100%	Production of medicines
Hunan R&D (Sino-Foreign Equity Joint Venture) (note 3)	PRC	RMB3,660,000	RMB3,660,000	-	-	-	70% (Note 1)	Research and development of microbiology related drugs
Kangzhe Medical (Wholly-owned PRC Enterprise) (note 4)	PRC	RMB10,000,000	RMB10,000,000	-	100%	-	100%	Investment holding
Kangzhe Pharmaceutical Industrial Ltd. (note 2)	British Virgin Islands	RMB21,288,000	RMB21,288,000	-	100%	-	100%	Investment holding
Shandong Bao Li Hao (Wholly-owned PRC Enterprise) (note 4)	PRC	RMB1,300,000	RMB1,300,000	-	-	-	100%	Production of medical devices
Shenzhen Kangzhe (Wholly-owned Foreign Enterprise)	PRC	RMB150,000,000	RMB150,000,000	-	100%	-	100%	Distribution and import of drugs
Kangzhe Pharmaceutical Research and Development (Shenzhen) Limited (Wholly-owned Foreign Enterprise) (note 3)	PRC	RMB10,609,000	RMB10,609,000	-	-	-	100%	Research and development of peptide related drugs
Sino Talent	Hong Kong	HK$1	HK$1	-	100%	-	100%	Investment holding
Sky United Trading Limited	Hong Kong	HK$10	HK$10	-	60%	-	60%	Trading of drugs
Crosspac (note 3)	British Virgin Islands	US$10	US$10	-	-	-	70% (Note 1)	Research and development of drugs
常德康哲醫藥有限公司 (Wholly-owned PRC Enterprise)	PRC	RMB2,000,000	RMB2,000,000	-	100%	-	100%	Trading of drugs
CMS Pharmaceutical	Malaysia	US$1	US$1	-	100%	-	100%	Trading of drugs

Notes:

1. Pursuant to the shareholders' agreement entered, all the shareholders agree to share the accumulated losses and net deficit of the company.
2. Being inactive subsidiaries, the place of operation is also in British Virgin Islands.
3. The Group distributed of the entire equity interest of Healthlink during the year ended 31 December 2009. After completion of the Distribution, Healthlink Group is no longer the Group's subsidiaries.
4. The Group disposed of the entire equity interest of the subsidiary during the year ended 31 December 2009.
5. None of the subsidiaries had issued any debt securities at the end of the year.

CORPORATE INFORMATION

Board of Directors
Executive Directors
Mr. Kong Lam, Chairman and CEO
Mr. Hongbing Chen, COO
Ms. Yanling Chen, Chief Financial Officer
Ms. Xiaoxuan Hou, Executive Director
Mr. Ki Fat Hui, Executive Director

Non-executive Directors
Mr. Stuart Hamilton Leckie, Independent Non-Executive Director
Dr. Paul Bernard Harper, Independent Non-Executive Director

Senior Management
Dr. Jonathan Zheng Ma, Chief International Operations Officer
Dr. Waiming Wong, Chief Technical Officer
Mr. Vincent Wing Sin Hui, Company Secretary and Chief Investor Relations Officer

Audit Committee
Mr. Stuart Hamilton Leckie (Chairman)
Dr. Paul Bernard Harper

Remuneration Committee
Mr. Paul Bernard Harper (Chairman)
Dr. Stuart Hamilton Leckie

Nomination Committee
Mr. Stuart Hamilton Leckie (Chairman)
Mr. Lam Kong
Dr. Paul Bernard Harper

Nominated Adviser
Seymour Pierce Limited

Financial Advisers and Broker
Seymour Pierce Limited

Auditor
Deloitte Touche Tohmatsu

INFORMATION FOR SHAREHOLDERS

Listing
The Company's ordinary shares are listed on the Alternative Investment Market operated by London Stock Exchange plc

Ticker Symbol:
CMSH

Registered Offiice
Maples & Calder Corporate Service Limited
PO Box 309GT
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George Town, Grand Cayman

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Tongfang Information Harbor
No.11 Langshan Road,
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Nanshan District, Shenzhen, 518057
People's Republic of China

Share Registrar
Computershare Investor Services
(Jersey) Limited
P.O. Box 83, Ordnance House
31 Pier Road, St. Helier
Jersey, Channel Islands JE4 8PW

Depositary
Computershare Investor Services Plc
The Pavilions
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Investor Information
Corporate press release, financial reports and other investor information on the Company are available online at the Company's website: www.chinamedicalsystem.com

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