**THIS CIRCULAR IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION**

**If you are in any doubt** as to any aspect of this circular or as to the action to be taken, you should consult your stockbroker or other registered dealer in securities, bank manager, solicitor, professional accountant or other professional adviser.

**If you have sold or transferred** all your shares in **China Pharmaceutical Group Limited**, you should at once hand this circular to the purchaser or the transferee or to the bank, stockbroker or other agent through whom the sale was effected for transmission to the purchaser or the transferee.



中國製藥集團有限公司
**China Pharmaceutical Group Limited**

*(Incorporated in Hong Kong under the Companies Ordinance)*

**(Stock Code: 1093)**

# CONNECTED TRANSACTION IN RELATION TO THE ASSET SWAP

**Independent Financial Adviser to**
**the Independent Board Committee and the Independent Shareholders**

Quam Financial Services Group

**Quam Capital Limited**

A letter from the Board is set out on pages 5 to 13 of this circular. A letter from the Independent Board Committee is set out on pages 14 to 15 of this circular. A letter from Quam Capital Limited, the independent financial adviser, containing its advice to the Independent Board Committee and the Independent Shareholders is set out on pages 16 to 34 of this circular.

A notice convening the Extraordinary General Meeting of China Pharmaceutical Group Limited to be held at Suite 3206, 32nd Floor, Central Plaza, 18 Harbour Road, Wanchai, Hong Kong on Friday, 3 July 2009 at 10:00 a.m. is set out on pages 40 to 41 of this circular. Whether or not you propose to attend the meeting, you are requested to complete the accompanying proxy form in accordance with the instructions printed thereon and return the same to the registered office of the Company at Suite 3206, 32nd Floor, Central Plaza, 18 Harbour Road, Wanchai, Hong Kong as soon as possible and in any event not less than 48 hours before the time appointed for the holding of the meeting or any adjournment thereof.

Hong Kong, 12 June 2009

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# DEFINITIONS

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

| | |
|---|---|
| "Acquisition" | the acquisition of 100% equity interest in Hong Yuan by the Company pursuant to the Asset Swap Agreement |
| "Announcement" | the announcement of the Company dated 22 May 2009 relating to the Asset Swap Agreement |
| "Asset Swap" | the Disposal and the Acquisition |
| "Asset Swap Agreement" | the agreement dated 22 May 2009 entered into by the Parties in relation to the Asset Swap |
| "associate(s)" | has the meaning ascribed thereto under the Listing Rules |
| "Board" | the board of Directors |
| "Business Day(s)" | day(s) (other than Saturday and Sunday) on which banks in Hong Kong are open for business |
| "China Charmaine" | China Charmaine Pharmaceutical Company Limited, a company incorporated in Hong Kong with limited liability |
| "Company" | China Pharmaceutical Group Limited, a company incorporated in Hong Kong with limited liability and the shares of which are listed on the main board of the Stock Exchange |
| "Completion" | completion of the Asset Swap |
| "Completion Date" | the 30th Business Day following the date on which the last of the conditions precedent to Completion have been fulfilled or such other date as the Parties to the Asset Swap Agreement may agree in writing on which the Asset Swap Agreement shall be completed |
| "connected person(s)" | has the meaning ascribed to it under the Listing Rules |

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|---|---|
| "Director(s)" | director(s) of the Company |
| "Disposal" | the disposal of 100% equity interest in NBP by the Company pursuant to the Asset Swap Agreement |
| "EGM" | an extraordinary general meeting of the Company to be convened for the purpose of considering, and if thought fit, approving, among other things, the Asset Swap Agreement and the transactions contemplated thereunder by the Independent Shareholders |
| "Group" | collectively, the Company and its subsidiaries from time to time |
| "Hong Kong" | the Hong Kong Special Administrative Region of the People's Republic of China |
| "Hong Yuan" | 河北宏源化工有限公司 (Hebei Hong Yuan Chemical Company Limited*), a company established in the PRC and wholly-owned by China Charmaine |
| "Independent Board Committee" | an independent committee of the Board comprising Mr. Huo Zhenxing, Mr. Qi Moujia, Mr. Guo Shichang and Mr. Chan Siu Keung, Leonard |
| "Independent Financial Adviser" | Quam Capital Limited, a licensed corporation to carry out type 6 (advising on corporate finance) regulated activities under the SFO, the independent financial adviser appointed to advise the Independent Board Committee and the Independent Shareholders on the Asset Swap |
| "Independent Shareholder(s)" | Shareholder(s) other than MGGL and its associates |
| "Latest Practicable Date" | 9 June 2009, being the latest practicable date prior to the printing of this circular for ascertaining certain information contained herein |

| | |
|---|---|
| "Legend Holdings" | 聯想控股有限公司 (Legend Holdings Limited*), an investment holding company established in the PRC, being a party acting in concert with MGGL pursuant to a concert party agreement dated 31 May 2007 entered into between Legend Holdings and MGGL, details of which are set out in the composite document dated 19 July 2007 jointly issued by the Company, Legend Holdings and MGGL |
| "Listing Rules" | the Rules Governing the Listing of Securities on the Stock Exchange |
| "MGGL" | Massive Giant Group Limited, a controlling Shareholder and a company established under the laws of the British Virgin Islands |
| "NBP" | 石藥集團恩必普藥業有限公司 (Shijiazhuang Pharma Group NBP Pharmaceutical Company Limited*), a foreign investment company established in the PRC and a wholly-owned subsidiary of the Company |
| "Parties" | the parties to the Asset Swap Agreement, namely China Charmaine and the Company; and "Party" means any one of them |
| "PRC" | the People's Republic of China which for the purpose of this circular, excluding Hong Kong, Macau Special Administrative Region and Taiwan |
| "SFO" | Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) |
| "Share(s)" | ordinary share(s) of HK$0.10 each in the issued share capital of the Company |
| "Shareholder(s)" | holder(s) of Shares |
| "SPG" | 石藥集團有限公司 (Shijiazhuang Pharmaceutical Group Company Limited*), a company established in the PRC and wholly-owned by Legend Holdings |

| | |
|---|---|
| "Stock Exchange" | The Stock Exchange of Hong Kong Limited |
| "subsidiaries" | has the meaning ascribed to it in the Companies Ordinance (Chapter 32 of the Laws of Hong Kong) |
| "HK$" | Hong Kong dollars, the lawful currency of Hong Kong |
| "RMB" | Renminbi, the lawful currency of the PRC |
| "%" | per cent. |

*For the purpose of this circular, amounts denominated in RMB have been translated into HK$ at the rate of RMB1 = HK$1.13636. Such translation should not be construed as a representation that the amounts quoted could have been or could be or will be converted at the stated rate or at any other rates at all.*

* *For identification purpose only*

中國製藥集團有限公司
**China Pharmaceutical Group Limited**
*(Incorporated in Hong Kong under the Companies Ordinance)*
**(Stock Code: 1093)**

*Executive Directors:*
CAI Dongchen *(Chairman)*
YUE Jin
FENG Zhenying
CHAK Kin Man
PAN Weidong
ZHAO John Huan
WANG Shunlong

*Non-executive Director:*
LEE Ka Sze, Carmelo

*Independent Non-executive Directors:*
HUO Zhenxing
QI Moujia
GUO Shichang
CHAN Siu Keung, Leonard

*Registered Office:*
Suite 3206
32nd Floor
Central Plaza
18 Harbour Road
Wanchai
Hong Kong

Hong Kong, 12 June 2009

*To the Shareholders*

Dear Sir or Madam,

## CONNECTED TRANSACTION IN RELATION TO THE ASSET SWAP

### 1. INTRODUCTION

On 22 May 2009, the Company entered into the Asset Swap Agreement with China Charmaine pursuant to which the Company agreed to transfer its 100% equity interest in NBP to China Charmaine and China Charmaine agreed to transfer its 100% equity interest in Hong Yuan to the Company at a consideration of HK$125,000,000. China Charmaine is beneficially wholly-owned by SPG.

The consideration of the Asset Swap of HK$125,000,000 was determined after arm's length negotiations between the Parties with reference to (i) the prevailing price to earnings multiples of comparable companies engaged in similar business of Hong Yuan; and (ii) the unaudited net asset value of NBP of RMB99.77 million (equivalent to approximately HK$113.37 million) as at 30 April 2009. The consideration of HK$125,000,000 represents a price to earnings multiple of approximately 3.17 times of Hong Yuan based on the audited net profit after tax of Hong Yuan of RMB34.70 million (equivalent to approximately HK$39.43 million) for the year ended 31 December 2008. Moreover, according to the terms of the Asset Swap Agreement, China Charmaine has agreed to procure the repayment by NBP on or before Completion of the outstanding amounts of approximately RMB60.81 million (equivalent to approximately HK$69.10 million) owed to the Group with such repayment expected to be financed by borrowings of NBP. Upon Completion, Hong Yuan will become a direct wholly-owned subsidiary of the Company and NBP will be wholly-owned by China Charmaine and will no longer be a subsidiary of the Company.

The Board appointed the Independent Board Committee to consider and advise the Independent Shareholders on the terms of the Asset Swap, and the Independent Financial Adviser to advise the Independent Board Committee and the Independent Shareholders on whether the terms of the Asset Swap are fair and reasonable and in the interest of the Company and the Shareholders as a whole.

The purpose of this circular is (i) to provide the Shareholders with further details on the Asset Swap; (ii) to set out the letter from the Independent Board Committee and the letter of advice from the Independent Financial Adviser to the Independent Board Committee and the Independent Shareholders on the terms of the Asset Swap; and (iii) to give other information on the Company as required by the Listing Rules.

## 2. THE ASSET SWAP AGREEMENT

**Date:**

22 May 2009

**Parties:**

(1) The Company

(2) China Charmaine

**Subject matter of the Asset Swap Agreement**

Pursuant to the Asset Swap Agreement, the Company agreed to transfer its 100% equity interest in NBP to China Charmaine and China Charmaine agreed to transfer its 100% equity interest in Hong Yuan to the Company at a consideration of HK$125,000,000. China Charmaine is beneficially wholly-owned by SPG.

To the best knowledge of the Directors, the Company has not entered into any prior transactions with China Charmaine and its ultimate beneficial owners which require aggregation under Rule 14A.25 of the Listing Rules.

China Charmaine is an investment holding company incorporated in Hong Kong.

**Consideration**

The consideration of the Asset Swap of HK$125,000,000 was determined after arm's length negotiations between the Parties with reference to (i) the prevailing price to earnings multiples of comparable companies engaged in similar business of Hong Yuan; and (ii) the unaudited net asset value of NBP of RMB99.77 million (equivalent to approximately HK$113.37 million) as at 30 April 2009. The consideration of HK$125,000,000 represents a price to earnings multiple of approximately 3.17 times of Hong Yuan based on the audited net profit after tax of Hong Yuan of RMB34.70 million (equivalent to approximately HK$39.43 million) for the year ended 31 December 2008.

Pursuant to the Asset Swap Agreement, the consideration of the Asset Swap shall be satisfied by the Company transferring its entire equity interest in NBP to China Charmaine in exchange for China Charmaine's entire equity interest in Hong Yuan.

The Directors (including the independent non-executive Directors) are of the opinion that the terms of the Asset Swap Agreement are fair and reasonable and on normal commercial terms and the Asset Swap is in the interests of the Company and the Shareholders as a whole.

**Conditions precedent of the Asset Swap Agreement**

(a) the Company having conducted a due diligence investigation in respect of Hong Yuan including but not limited to its business, legal aspects, properties and accounts and the Company being satisfied with the results of its due diligence investigation;

(b) the Company having obtained the approval by the Independent Shareholders at the EGM in respect of the Asset Swap Agreement and the transactions contemplated thereunder in accordance with the Listing Rules;

(c) if applicable, all relevant approvals from governmental or regulatory authorities (including but not limited to the commerce department of the PRC government) in respect of the Asset Swap Agreement and all transactions contemplated thereunder being obtained and the share transfer registration procedures in respect of the Asset Swap being completed in accordance with the requirements under the PRC laws; and

(d) if applicable, the obtaining of consents to the Asset Swap from the relevant bank financiers of the Parties.

Neither Party can waive conditions (b), (c) and (d) above whereas condition (a) can be waived by the Company. As at the date of this circular, none of the above conditions have been fulfilled. If the above conditions are not fulfilled within 6 months immediately after the date of the Asset Swap Agreement, unless the Parties otherwise agree in writing, the Asset Swap Agreement will lapse.

**Completion**

Completion shall take place on the Completion Date at or before 5:00 p.m. (or such other time as the Parties may agree in writing).

According to the terms of the Asset Swap Agreement, China Charmaine has agreed to procure the repayment by NBP on or before Completion of the outstanding amounts of approximately RMB60.81 million (equivalent to approximately HK$69.10 million) owed to the Group.

## 3. INFORMATION OF HONG YUAN

Hong Yuan is a company established in the PRC in 1997 and wholly-owned by China Charmaine. Hong Yuan is principally engaged in the manufacture and sale of chemical products, including mainly D(-) parahydroxy phenylglycine dane salt and D(-) phenylglycine dane salt.

The aggregate original purchase cost paid by China Charmaine for 100% interest in Hong Yuan was approximately RMB67 million (equivalent to approximately HK$76.14 million). Set out below are the audited results of Hong Yuan prepared in accordance with the Generally Accepted Accounting Principles in the PRC for the two years ended 31 December 2008:

| | For the year ended | |
|---|---|---|
| | **31 December 2008** | **31 December 2007** |
| | *(audited)* | *(audited)* |
| | *RMB million* | *RMB million* |
| Revenue | 276.79 | 168.10 |
| Profit/(loss) before taxation | 37.55 | 20.90 |
| Profit/(loss) after taxation | 34.70 | 18.40 |

As at 31 December 2008, the audited net asset value of Hong Yuan was approximately RMB63.69 million (equivalent to approximately HK$72.37 million).

As at 30 April 2009, the unaudited net asset value of Hong Yuan was approximately RMB78.56 million (equivalent to approximately HK$89.27 million).

## 4. INFORMATION OF NBP

NBP is a foreign investment company wholly-owned and established by the Company in the PRC in 2003. NBP is principally engaged in the manufacture and sale of pharmaceutical products, including mainly butylphthalide soft capsule, a medicine for treating ischemic stroke.

Set out below are the audited results of NBP prepared in accordance with the Generally Accepted Accounting Principles in the PRC for the two years ended 31 December 2008:

| | For the year ended | |
|---|---|---|
| | **31 December 2008** | **31 December 2007** |
| | *(audited)* | *(audited)* |
| | *RMB million* | *RMB million* |
| Revenue | 60.37 | 37.99 |
| Profit/(loss) before taxation | (20.49) | (21.70) |
| Profit/(loss) after taxation | (20.49) | (21.70) |

The loss of NBP was mainly due to the loss generated from its operations.

As at 31 December 2008, the audited net asset value of NBP was approximately RMB107.03 million (equivalent to approximately HK$121.62 million).

As at 30 April 2009, the unaudited net asset value of NBP was approximately RMB99.77 million (equivalent to approximately HK$113.37 million).

As at 30 April 2009, the amounts due from NBP to certain subsidiaries of the Company was approximately RMB60.81 million (equivalent to approximately HK$69.10 million). Pursuant to the Asset Swap Agreement, China Charmaine has agreed to procure the repayment by NBP on or before Completion of the outstanding amounts of approximately RMB60.81 million (equivalent to approximately HK$69.10 million) owed to the Group with such repayment expected to be financed by borrowings of NBP. The amount repaid is intended to be used as the general working capital of the Group.

## 5. FINANCIAL EFFECTS OF THE ASSET SWAP

Upon Completion, (i) Hong Yuan will become a direct wholly-owned subsidiary of the Company and its financial results will be consolidated into the financial statements of the Company; and (ii) NBP will be wholly-owned by China Charmaine and the Company will cease to have any interests in NBP and its results, assets and liabilities will no longer be included in the consolidated financial statements of the Company.

As at 31 December 2008, the Group's audited total assets and total liabilities were approximately HK$7,903.4 million and HK$3,320.2 million respectively. It is expected that the Asset Swap would have decreased the total assets and total liabilities of the Group by approximately HK$36.0 million and HK$29.4 million respectively assuming that Completion had taken place on 30 April 2009. It is expected that the Group will not record any material gain or loss as a result of the disposal of NBP but will record a gain of approximately HK$15.0 million, being the difference of the estimated fair value of NBP and its net asset value, as a result of change in fair value of NBP.

Given the profitable track record of Hong Yuan, the Directors consider that the contribution from Hong Yuan will have a positive impact on the earnings of the Group in the future following completion of the Asset Swap.

The aforesaid financial effect of the Asset Swap is for illustrative purposes only. The actual financial effect is subject to the fair values of Hong Yuan and NBP upon Completion.

## 6. REASONS FOR AND BENEFITS OF THE ASSET SWAP

The Company is an investment holding company with its subsidiaries principally engaged in the manufacture and sale of pharmaceutical products.

The Group has been purchasing chemical products from Hong Yuan during the previous years for the production of pharmaceutical products. The chemical products purchased from Hong Yuan including but not limited to D(-) parahydroxy phenylglycine dane salt and D(-) phenylglycine dane salt are used as raw materials for the production of antibiotics, including but not limited to amoxicillin, ampicillin and ampicillin sodium. As disclosed in the announcement of the Company dated 29 November 2007 and the circular of the Company dated 11 December 2007, the Group entered into continuing connected transactions with Hong Yuan in relation to the purchase of chemical products for a period of 3 years from 1 January 2008 to 31 December 2010. The transactions were approved by the then independent Shareholders at the extraordinary general meeting of the Company held on 28 December 2007.

The Directors consider the Acquisition is a natural business growth of the Company. In addition, the Acquisition, which in effect is a vertical integration, will ensure a reliable supply of raw materials for the manufacture of pharmaceutical products of the Group at lower cost. Accordingly, the Directors (including the independent non-executive Directors) are of the view that the Acquisition is in the interests of the Company and the Shareholders as a whole.

Upon Completion, the transactions between the Group and Hong Yuan will cease to be continuing connected transactions for the Company under Chapter 14A of the Listing Rules.

Given the unsatisfactory financial performance of NBP for the past few years, the Directors consider that the future prospect of NBP is rather uncertain. In addition, the Company will be relieved from the financial burden to finance the operations of NBP after Completion. The Directors (including the independent non-executive Directors) are of the view that the Disposal is in the interests of the Company and the Shareholders as a whole.

Moreover, the Directors are of the view that the Asset Swap will not require any cash outlay by the Group.

## 7. IMPLICATIONS UNDER THE LISTING RULES

By virtue of the arrangement as disclosed in the circular jointly issued by the Company, Legend Holdings and MGGL dated 19 July 2007, Legend Holdings is entitled to exercise or control the exercise all the Shares held by MGGL in the Company, representing approximately 51.04% of the issued share capital of the Company as at the date of this circular. Therefore, Legend Holdings is regarded as a controlling Shareholder. Legend Holdings indirectly holds the entire interest in China Charmaine through SPG. As such, China Charmaine, being an indirect wholly-owned subsidiary of Legend Holdings, is an associate of the Legend Holdings and thus, a connected person of the Company within the meaning of the Listing Rules. Therefore, the Asset Swap constitutes a connected transaction of the Company under Chapter 14A of the Listing Rules. Given the applicable percentage ratios (other than the profit ratio) exceed 2.5% and the total consideration is more than HK$10,000,000, the Asset Swap is subject to the requirements of reporting, announcement and Independent Shareholders' approval by way of poll at the EGM pursuant to Chapter 14A of the Listing Rules.

## 8. EGM

Set out on pages 40 to 41 of this circular is the notice convening the EGM to be held at Suite 3206, 32nd Floor, Central Plaza, 18 Harbour Road, Wanchai, Hong Kong on Friday, 3 July 2009 at 10:00 a.m. for the purposes of considering and, if thought fit, passing the resolution to approve the Asset Swap Agreement and the transactions contemplated thereunder. Whether or not you propose to attend the meeting, you are requested to complete the accompanying proxy form in accordance with the instructions printed thereon and return the same to the registered office of the Company at Suite 3206, 32nd Floor, Central Plaza, 18 Harbour Road, Wanchai, Hong Kong as soon as possible and in any event not less than 48 hours before the time appointed for the holding of the meeting or any adjournment thereof. Completion and return of the form of proxy will not preclude you from attending and voting in person at the EGM or any adjourned meeting should you so wish.

MGGL, Legend Holdings and their respective associates, with material interest in the Asset Swap Agreement, will be required to abstain from voting in relation to the resolution to approve, among other things, the Asset Swap Agreement and the transactions contemplated thereunder at the EGM.

The votes to be taken at the EGM will be taken by poll, an announcement of the results of which will be published on the Business Day following the EGM.

## 9. RECOMMENDATION

The Directors (including the independent non-executive Directors) consider that the terms of the Asset Swap Agreement are fair and reasonable and in the best interests of the Company and the Shareholders as a whole. The Directors recommend that the Shareholders vote in favour of the resolution for approving the Asset Swap Agreement and the transactions contemplated thereunder.

The Independent Board Committee, having taken into account the advice of the Independent Financial Adviser, considers that the Asset Swap Agreement and the transactions contemplated thereunder are on normal commercial terms, fair and reasonable so far as the Independent Shareholders are concerned and are in the interests of the Company and the Shareholders as a whole. Accordingly, the Independent Board Committee recommends the Independent Shareholders to vote in favour of the ordinary resolutions to be proposed at the EGM to approve the Asset Swap Agreement and the transactions contemplated thereunder.

## 10. ADDITIONAL INFORMATION

Your attention is drawn to: (i) the letter from the Independent Board Committee set out in this circular which contains its recommendation to the Independent Shareholders; (ii) the letter of advice from the Independent Financial Adviser set out in this circular which contains its recommendations to the Independent Board Committee and the Independent Shareholders in respect of the terms of the Asset Swap and transactions contemplated thereunder; and (iii) the information set out in the appendix to this circular as required under the Listing Rules.

By order of the Board
**CAI Dongchen**
*Chairman*

*The following is the text of a letter of recommendation from the Independent Board Committee which has been prepared for the purpose of inclusion in this circular.*

中國製藥集團有限公司
**China Pharmaceutical Group Limited**
*(Incorporated in Hong Kong under the Companies Ordinance)*
**(Stock Code: 1093)**

12 June 2009

*To the Independent Shareholders*

Dear Sir and Madam,

## CONNECTED TRANSACTION IN RELATION TO THE ASSET SWAP

We refer to the circular of the Company dated 12 June 2009 (the "Circular"), of which this letter forms part. Unless specified otherwise, capitalised terms used herein shall have the same meanings as those defined in the Circular.

We have been appointed as members of the Independent Board Committee to advise the Independent Shareholders in connection with the Asset Swap and the transaction contemplated under the Asset Swap Agreement. Quam Capital Limited has been appointed as the independent financial adviser of the Company to advise us and the Independent Shareholders in relation to the Asset Swap and the transaction contemplated under the Asset Swap Agreement.

We wish to draw your attention to the letter from the Board as set out on pages 5 to 13 of the Circular and the letter from the Independent Financial Adviser as set out on pages 16 to 34 of the Circular respectively.

Having considered the principal factors and reasons considered by, and the advice of Quam Capital Limited as set out in its letter of advice, we consider that the Asset Swap and the transaction contemplated under the Asset Swap Agreement are on normal commercial terms, fair and reasonable so far as the Independent Shareholders are concerned and are in the interests of the Company and the Shareholders as a whole. Accordingly, we recommend the Independent Shareholders to vote in favour of the resolution to be proposed at the EGM to approve the Asset Swap and the transactions contemplated under the Asset Swap Agreement.

Yours faithfully,
Independent Board Committee

| | | | |
|---|---|---|---|
| **HUO Zhenxing** | **QI Moujia** | **GUO Shichang** | **CHAN Siu Keung, Leonard** |

*Independent Non-executive Directors of*
**China Pharmaceutical Group Limited**

*The following is the text of a letter of advice from Quam Capital Limited, the independent financial adviser to the Independent Board Committee and the Independent Shareholders, which has been prepared for the purpose of incorporation into this circular, setting out its advice to the Independent Board Committee and the Independent Shareholders in respect of the terms of the Asset Swap Agreement.*

Quam Financial Services Group
Quam Capital Limited 華富嘉洛企業融資有限公司
A Member of The Quam Group

12 June 2009

*To the Independent Board Committee and*
*the Independent Shareholders*

Suite 3206
32nd Floor
Central Plaza
18 Harbour Road
Wan Chai
Hong Kong

Dear Sir/Madam,

## CONNECTED TRANSACTION IN RELATION TO THE ASSET SWAP

We refer to our appointment as the independent financial adviser to the Independent Board Committee and the Independent Shareholders in relation to the Asset Swap. Details of the Asset Swap are set out in the "Letter from the Board" contained in the circular issued by the Company to the Shareholders dated 12 June 2009 (the "Circular"). Terms used in this letter shall have the same meanings as defined in the Circular unless the context otherwise requires.

On 22 May 2009, the Company entered into the Asset Swap Agreement with China Charmaine. Pursuant to the Asset Swap Agreement, the Company agreed to transfer its 100% equity interest in NBP to China Charmaine; and China Charmaine agreed to transfer its 100% equity interest in Hong Yuan to the Company at a consideration of HK$125,000,000.

By virtue of the arrangement as disclosed in the composite document jointly issued by the Company, Legend Holdings and MGGL dated 19 July 2007, Legend Holdings is entitled to exercise or control the exercise of all the Shares held by MGGL, representing approximately 51.0% of the issued share capital of the Company as at the Latest Practicable Date. Therefore, Legend Holdings is regarded as a controlling Shareholder. Legend Holdings indirectly holds the entire interest of China Charmaine through SPG. As such, China Charmaine, being an indirectly wholly-owned subsidiary of Legend Holdings, is an associate of Legend Holdings and thus, a connected person of the Company within the meanings of the Listing Rules. Therefore, the Asset Swap constitutes a connected transaction of the Company under Chapter 14A of the Listing Rules and is subject to the Independent Shareholders' approval by way of a poll at the EGM.

Messrs. Huo Zhenxing, Qi Moujia, Guo Shichang and Chan Siu Keung, Leonard, all being the independent non-executive Directors, have been appointed as members of the Independent Board Committee to advise the Independent Shareholders as to whether the terms of the Asset Swap Agreement are on normal commercial terms and fair and reasonable and in the interests of the Company and the Shareholders as a whole; and to advise the Independent Shareholders as to whether to vote in favour of the Asset Swap. As the independent financial adviser, our role is to give an independent opinion to the Independent Board Committee and the Independent Shareholders in respect of the Asset Swap.

Quam is independent of and not connected with any members of the Group or any of their substantial shareholders, directors or chief executives, or any of their respective associates, and is accordingly qualified to give an independent advice in respect of the Asset Swap.

In formulating our recommendation, we have relied on the information and facts supplied by the Company and its advisers, and the opinions expressed by and the representations of the Directors and management of the Company. We have assumed that all the information and representations contained or referred to in the Circular are true and accurate in all respects at the date thereof and may be relied upon. We have also assumed that all statements contained and representations made or referred to in the Circular are true at the time they are made and continue to be true at the date thereof. We have no reason to doubt the truth, accuracy and completeness of the information and representations provided to us by the Directors and the Directors have confirmed to us that no material facts have been withheld or omitted from the information provided and referred to in the Circular, which would make any statements therein misleading.

We consider that we have reviewed sufficient information currently available to reach an informed view and to justify our reliance on the accuracy of the information contained in the Circular so as to provide a reasonable basis for our recommendation. We have not, however, carried out any independent verification of the information, nor have we conducted any form of in-depth investigation into the business, affairs, operations, financial position or future prospects of any member of the Group (including NBP), Hung Yuan or any of their respective subsidiaries or associates.

## PRINCIPAL FACTORS AND REASONS CONSIDERED

In arriving at our recommendation in respect of the Asset Swap, we have taken into consideration the following principal factors and reasons:

### 1. Background of and reasons for the Asset Swap

#### *(a) Principal business and business strategies of the Group*

The Group is principally engaged in the manufacture and sale of pharmaceutical products. Its business segments are principally categorised into four major product lines, namely the bulk vitamin C series, the bulk penicillin series, the bulk cephalosporin series and the finished drugs which accounted for approximately 31.6%, 27.4%, 10.8% and 29.1% of the Group's total revenue for the year ended 31 December 2008 respectively.

According to the Company's annual report for the year ended 31 December 2008 (the "2008 Annual Report"), the Group recorded revenue and profit attributable to shareholders of approximately HK$6,830.0 million and HK$940.56 million respectively for the year ended 31 December 2008, representing increases of approximately 37.0% and 97.0% respectively as compared to the previous year. It is noted that the growth was mainly driven by the significant increase in the gross profit margin of the bulk vitamin C business and the strong growth of the finished drugs business.

As stated in the 2008 Annual Report, it is the Company's overall business expansion strategy that the Group will actively explore suitable acquisition opportunities with a view to expand its product portfolio and product types. In particular, with the aim of developing the finished drugs business into its leading business segment and further establishing itself as the leader in the PRC finished drugs market, the Group will endeavour to re-position the sales and marketing strategies in 2009 to ensure its finished drugs business segment become the main growth driver of the Group. It will also actively explore overseas markets for its bulk penicillin series business.

*(b)* ***Financial performance of the Group's bulk penicillin series business and finished drugs business***

As noted in the Company's financial statements for the three years ended 31 December 2008, revenue derived from the bulk penicillin series business continued to account for a significant portion of the total revenue of the Group. For each of the three years ended 31 December 2006, 2007 and 2008, sales generated from the bulk penicillin series business accounted for approximately 28.7%, 32.4% and 27.4% of the Group's total revenue respectively. Particularly, for the year ended 31 December 2008, the total sales volume of this segment business increased by approximately 36.4% with revenue growing by approximately 15.7% to approximately HK$1,870.80 million as compared to the previous financial year. However, the gross profit margin decreased from approximately 37.5% in 2007 to 23.3% in 2008 mainly due to higher production costs and lower product prices in the second half of 2008 as a result of the reduction of purchase orders from certain overseas customers following the outbreak of the financial turmoil. It is disclosed in the 2008 Annual Report that abundant market supply and capacity expansion of certain manufacturers are expected to continue to exert pressure on the selling prices of the Group's bulk penicillin series products. Under such market environment, the Group will strengthen its control over production cost and actively explore overseas markets.

As disclosed in the 2008 Annual Report, the expanding medical insurance system and vast investment in the establishment of medical infrastructure in the PRC have made medical services more accessible to people residing in rural and urban areas, which directly drives growth in the demand for pharmaceutical products. As a major finished drugs manufacturer in the PRC with a strong distributing network across urban and rural areas, the Group has benefited directly from the rapid growth of the PRC pharmaceutical market. As a result, revenue derived from the Group's finished drugs business for the year ended 31 December 2008 reached approximately HK$1,988.68 million, representing an increase of approximately 32.8% as compared to that of the previous financial year.

***(c) The Acquisition***

*(i) Information of Hong Yuan*

Hong Yuan is a company established in the PRC in 1997. We were advised that prior to a corporate restructuring of Hong Yuan completed in April 2009, Hong Yuan was owned as to 25% by China Charmaine and 75% by 石藥集團新諾威制藥有限公司 (Shijiazhuang Pharma Group Xin Nuo Wei Pharmaceutical Company Limited), a wholly-owned subsidiary of SPG. Following the corporate restructuring of Hong Yuan, it became a wholly-owned subsidiary of China Charmaine. As stated in the "Letter from the Board" in the Circular, the aggregate original acquisition cost paid by China Charmaine for 100% interest of Hong Yuan was approximately RMB67 million (equivalent to approximately HK$76.14 million).

Hong Yuan is principally engaged in the manufacture and sale of chemical products mainly including D(-) parahydroxy phenylglycine dane salt and D(-) phenylglycine dane salt which are raw materials for the production of antibiotics such as amoxicillin, ampicillin and ampicillin sodium. Set out below are the results of Hong Yuan prepared in accordance with PRC accounting standards for the two years ended 31 December 2008 and the four months ended 30 April 2009:

**Table 1 — Financial information of Hong Yuan**

| | **For the year ended 31 December** | | **For the four months ended 30 April** |
|---|---|---|---|
| | **2007** | **2008** | **2009** |
| *(RMB million)* | *(Audited)* | *(Audited)* | *(Unaudited)* |
| Revenue | 168.10 | 276.79 | 90.31 |
| Profit before taxation | 20.90 | 37.55 | 17.14 |
| Profit after taxation | 18.40 | 34.70 | 14.88 |

As set out in Table 1 above, the audited revenue and profit after taxation of Hong Yuan for the year ended 31 December 2008 amounted to approximately RMB276.79 million (equivalent to approximately HK$314.53 million) and RMB34.70 million (equivalent to approximately HK$39.43 million) respectively, representing increases of approximately 64.7% and 88.6% as compared to those for the previous financial year. The management of the Company advised that such growth was mainly due to the expanded production capacity of Hong Yuan, increased demand for antibiotics and amoxicillin, higher selling prices of D(-) parahydroxy phenylglycine dane salt and the growth of the D(-) phenylglycine dane salt business.

Based on the PRC unaudited accounts of Hong Yuan, the net asset value of Hong Yuan as at 30 April 2009 was approximately RMB78.56 million (equivalent to approximately HK$89.27 million). The unaudited revenue and profit after taxation of Hong Yuan for the four months ended 30 April 2009 amounted to approximately RMB90.31 million (equivalent to approximately HK$102.62 million) and RMB14.88 million (equivalent to approximately HK$16.91 million) respectively, representing increases of approximately 4.4% and 63.8% from the corresponding period in 2008.

*(ii) Reasons for and benefits of the Acquisition*

As advised by the Directors, the Group has been procuring certain chemical products (including D(-) parahydroxy phenylglycine dane salt and D(-) phenylglycine dane salt) from Hong Yuan for use in its manufacturing of antibiotics such as amoxicillin, ampicillin and ampicillin sodium under its bulk penicillin series business since 1999. Details of such continuing connected transactions (i) from August 1999 to 31 December 2001 were set out in the Company's announcement and circular dated 30 April and 21 May 1999 respectively; (ii) for a period of three years from 1 January 2002 to 31 December 2004 were set out in the Company's announcement and circular dated 16 January and 6 February 2002 respectively; (iii) for a period of three years from 1 January 2005 to 31 December 2007 are set out in the Company's announcement and circular dated 31 December 2004 and 24 January 2005 respectively; and (iv) for a period of three years from 1 January 2008 to 31 December 2010 are set out in the Company's announcement and circular dated 29 November and 11 December 2007 respectively. We were also advised that it is the current intention of the Company to continue to maintain Hong Yuan as a major supplier of the required chemical products to the Group for its pharmaceutical production.

It is noted from the 2008 Annual Report, the Group had purchased approximately HK$212.90 million of chemical products from Hong Yuan during the year ended 31 December 2008, which accounted for over 65% of Hong Yuan's total revenue of the relevant year. As advised by the Company, hitherto, the sales of the chemical products manufactured by Hong Yuan have been geographically concentrated in the PRC with the Group being its key customer. We were also advised that save for the PRC pharmaceutical manufacturers, Hong Yuan also conducts export sales with those pharmaceutical manufacturers located in India and the Islamic Republic of Pakistan.

As stated in the "Letter from the Board" in the Circular, the Directors consider that the Acquisition will contribute to the natural business growth of the Company and will ensure a reliable supply of raw materials for the manufacture of pharmaceutical products of the Group at lower costs. Furthermore, we were advised that the Acquisition forms part of the Group's overall strategy to tackle the threats of the increasingly competitive market conditions to the Group's bulk penicillin series business as discussed in sub-section (b) above.

In view of the long-term business relationship between the Group and Hong Yuan and the stated business strategy and policy of the Group in relation to its bulk penicillin series business as discussed in sub-sections (a) and (b) above, we concur with the view of the Directors that it is in the interest of the Group to effect the Acquisition and continue the aforesaid procurement arrangement thereafter, as this will provide the Group with a new source of additional income and at the same time ensure it can secure a reliable source of supply of the required chemical products at a competitive price, which in turn would help facilitate the smooth operation and future development of the Group's business.

***(d) The Disposal***

*(i) Information of NBP*

NBP is a foreign investment company established in the PRC and wholly-owned by the Company. Within the Group's finished drugs business, NBP is principally engaged in the manufacture and sale of pharmaceutical products with butylphthalide soft capsule (a medicine for treating ischemic stroke) being its major product which accounts for over 80% of its total sales for the year ended 31 December 2008. Set out below are the results of NBP prepared in accordance with PRC accounting standards for the two years ended 31 December 2008 and the four months ended 30 April 2009:

**Table 2 — Financial information of NBP**

| | **For the year ended 31 December** | | **For the four months ended 30 April** |
|---|---|---|---|
| | **2007** | **2008** | **2009** |
| *(RMB million)* | *(Audited)* | *(Audited)* | *(Unaudited)* |
| Revenue | 37.99 | 60.37 | 27.40 |
| (Loss) before taxation | (21.70) | (20.49) | (6.90) |
| (Loss) after taxation | (21.70) | (20.49) | (6.90) |

As set out in Table 2 above, the audited revenue of NBP amounted to approximately RMB37.99 million (equivalent to approximately HK$43.17 million) and RMB60.37 million (equivalent to approximately HK$68.60 million) for the two years ended 31 December 2007 and 2008 respectively, representing an increase of approximately 58.91%. We were advised that such significant increase was mainly attributable to the increased marketing efforts of the management of NBP. Nonetheless, NBP has been making losses since its inception. Net loss after taxation amounted to approximately RMB21.70 million (equivalent to approximately HK$24.66 million) and RMB20.49 million (equivalent to approximately HK$23.28 million) for the two years ended 31 December 2007 and 2008 respectively. We have discussed the underlying reasons for the unsatisfactory financial performance of NBP with the Company's management. We noted that the continued loss incurred by NBP was mainly due to low sales volume, high marketing costs, intense market competition and ineffective marketing and sales strategies. Although the sale of butylphthalide soft capsules has grown steadily since it was launched in 2005, it has been lagging behind its competitors and has failed to gain market share mainly due to ineffective marketing and sales strategy and its inability to be listed in 國家基本醫療保險和工傷保險藥品目錄 (the PRC National Medicine Catalogue). The management of the Company expects the prospect of butylphthalide soft capsule to continue to be challenging mainly due to factors such as intense competition, the lack of a sound sales and marketing strategy, and poor market positioning.

Based on the PRC unaudited accounts of NBP, the net asset value of NBP as at 30 April 2009 was approximately RMB99.77 million (equivalent to approximately HK$113.37 million). The unaudited revenue and loss after taxation of NBP for the four months ended 30 April 2009 amounted to approximately RMB27.40 million (equivalent to approximately HK$31.14 million) and RMB6.90 million (equivalent to approximately HK$7.84 million) respectively, representing increases of approximately 89.9% and 9.9% from the corresponding period in 2008.

*(ii) Reasons for and benefits of the Disposal*

We were advised that the continued unsatisfactory financial performance of NBP since its establishment has placed a considerable financial burden on the Group. Furthermore, as at 30 April 2009, NBP had total amounts owed to the Group of approximately RMB60.81 million (equivalent to approximately HK$69.10 million). Pursuant to the Asset Swap Agreement, China Charmaine has agreed to procure the repayment by NBP on or before Completion of the aforesaid outstanding amounts owed to the Group with such repayment expected to be financed by borrowings of NBP. We noted that the amount repaid is currently intended to be used as the general working capital of the Group. While the management of the Company consider the finished drugs business of the Group to have an enormous growth potential, the challenges that NBP faces as discussed above cause the future prospect of NBP to be uncertain.

Given the above and after taking into account the historical financial performance of and the challenging prospect for NBP, we concur with the Directors' view that the Disposal is in the interests of the Company and the Shareholders as a whole as it would allow the Group to dispose of a loss making company under its finished drugs business and be relieved from the burden to finance the operations of NBP after Completion. This in turn is expected to have a positive impact on the overall financial performance of the Group's finished drugs business.

***(e) Conclusion***

In light of the above, and particularly taking into consideration (i) the respective principal business activities and historical financial performances of Hong Yuan and NBP; (ii) the potential benefits to be derived from the Asset Swap on the development of the Group's bulk penicillin series and finished drugs businesses; and (iii) the Group's stated business objectives and strategies, we are of the view that the Asset Swap will help expedite the implementation of the stated business objectives and development strategies in respect of the Group's bulk penicillin series and finished drugs businesses and have a positive impact on the Group's overall financial performance. As such, we consider that the entering into of the Asset Swap Agreement by the Group is within its usual and ordinary course of business and in the interests of the Company and the Shareholders as a whole in this respect.

**2. The consideration of the Asset Swap Agreement**

***(a) Basis of determination***

The consideration of the Asset Swap is HK$125,000,000 (the "Consideration"). We noted that the Consideration was arrived at after arm's length negotiations between the Parties with reference to (i) the prevailing price to earnings multiples of comparable companies engaged in similar businesses as those of Hong Yuan; and (ii) the unaudited net asset value of NBP of approximately RMB99.77 million (equivalent to approximately HK$113.37 million) as at 30 April 2009.

*(i) The Acquisition*

The Consideration represents a price to earnings multiple of approximately 3.17 times in respect of the Acquisition based on Hong Yuan's audited net profit after tax (based on PRC accounting standards) of approximately RMB34.70 million (equivalent to approximately HK$39.43 million) for the year ended 31 December 2008.

In assessing the fairness and reasonableness of the Consideration in respect of the Acquisition, we have, to our best efforts, identified and made references to five comparable companies listed on the Stock Exchange whose principal businesses are similar to those of Hong Yuan (the "Hong Yuan Comparables"). When performing our analysis, we have excluded the companies which recorded losses in their respective latest financial years. We have examined the respective price to earnings multiples and price to net asset multiples of the Hong Yuan Comparables and made a comparison on this basis with the Consideration in respect of the Acquisition in our analysis as detailed in Table 3 below:

**Table 3 — Hong Yuan Comparables**

| **Company name** | **Principal activities** | **Price to earnings multiple** *(Note 1)* *(times)* | **Price to net asset multiple** *(Note 2)* *(times)* |
|---|---|---|---|
| Tiande Chemical Holdings Ltd. | Production, trading and sale of fine chemical products | 5.75 | 0.41 |
| Shandong Xinhua Pharmaceutical Co. Ltd. | Development, production and sales of pharmaceutical raw materials, preparations and chemical products | 24.40 | 0.50 |

| Company name | Principal activities | Price to earnings multiple *(Note 1)* *(times)* | Price to net asset multiple *(Note 2)* *(times)* |
|---|---|---|---|
| EcoGreen Fine Chemicals Group Ltd. | Production and trading of fine chemicals from natural resources for use in aroma chemicals and pharmaceutical products | 5.91 | 0.90 |
| Dawnrays Pharmaceutical (Holdings) Ltd. | Development, manufacture and sale of non-patented chemical medicines | 5.46 | 0.89 |
| Changmao Biochemical Engineering Co. Ltd. | Production and sale of organic acids used in pharmaceutical products and other products | 15.63 | 1.86 |
| **Hong Yuan** | | **3.17** | **1.40** |
| **Minimum** | | **5.46** | **0.41** |
| **Maximum** | | **24.40** | **1.86** |
| **Average** | | **11.43** | **0.91** |

*Source: Website of the Stock Exchange*

*Notes:*

1. The price to earnings multiples of the Hong Yuan Comparables were calculated based on the basic earnings per share as per their respective latest published annual results and the closing prices of such companies as quoted on the Stock Exchange on 22 May 2009, being the date of the Asset Swap Agreement.

2. The price to net asset multiples of the Hong Yuan Comparables were calculated based on the basic net asset value after minority interest (if any) per share as per their respective latest published annual results and the closing prices of such companies as quoted on the Stock Exchange on 22 May 2009, being the date of the Asset Swap Agreement.

As shown in Table 3 above, the price to earnings multiples of the Hong Yuan Comparables are in the range of approximately 5.46 times to 24.40 times; while the mean of the price to earnings multiples of the Hong Yuan Comparables is approximately 11.43 times. The Consideration represents a price to earnings multiple of approximately 3.17 times in respect of the Acquisition based on Hong Yuan's audited net profit after tax (based on PRC accounting standards) of approximately RMB34.70 million (equivalent to approximately HK$39.43 million) for the year ended 31 December 2008, which falls below the range of the Hong Yuan Comparables' price to earning multiples.

Given that Hong Yuan has established a proven track record and is not an asset-based company, we consider the price to earnings multiple is a fair and reasonable basis for the determination of the Consideration in respect of the Acquisition.

As a supplemental reference, we note that the Consideration also represents a price to net asset multiple of approximately 1.40 times in respect of the Acquisition based on the unaudited net asset value of Hong Yuan as at 30 April 2009 (based on PRC accounting standards) of approximately RMB78.56 million (equivalent to approximately HK$89.27 million). We note that the price to net asset multiple as implied under the Consideration in respect of the Acquisition also falls within the range of the price to net asset multiples of the Hong Yuan Comparables of approximately 0.41 times to 1.86 times as at the date of the Asset Swap Agreement.

*(ii) The Disposal*

To assess the reasonableness and fairness of the Consideration in respect of the Disposal, we have, to the best of our efforts, identified and made references to the respective price to net asset multiples of the listed companies in Hong Kong which are principally engaged in businesses similar to those of NBP (the "NBP Comparables"). Since NBP has been recording losses, when performing our analysis, we have not been able to analyse the price to earnings multiple of NBP as represented by the Consideration in respect of the Disposal.

**Table 4 — NBP Comparables**

| **Company name** | **Principal activities** | **Price to net asset multiple** *(Note 1)* *(times)* |
|---|---|---|
| Broad Intelligence International Pharmaceutical Holdings Ltd. | Manufacture, sale, research and development of injection solution pharmaceutical products | 0.28 |
| Everpride Biopharmaceutical Co. Ltd. | Manufacturing and sales of medicines | 10.93 |
| Jilin Province Huinan Changlong Bio-pharmacy Co. Ltd. | Manufacture and distribution of biochemical medicines | 0.55 |
| Jiwa Bio-Pharm Holdings Ltd. | Research, development, manufacture and sale of pharmaceutical products | 1.01 |
| Lee's Pharmaceutical Holdings Ltd. | Manufacture and sale of self-developed pharmaceutical products and trading of license-in pharmaceutical products | 2.48 |
| Long Far Pharmaceutical Holdings Ltd. *(Note 2)* | Trading, manufacture and distribution of pharmaceutical products | 5.43 |
| Shandong Luoxin Pharmacy Stock Co. Ltd. | Manufacturing and selling of pharmaceutical products | 3.71 |

| Company name | Principal activities | Price to net asset multiple *(Note 1)* *(times)* |
|---|---|---|
| Vital Pharmaceutical Holdings Ltd. | Research and development, selling and manufacturing of pharmaceutical products | 0.44 |
| **NBP** | | **1.10** |
| **Minimum** | | **0.28** |
| **Maximum** | | **10.93** |
| **Average** | | **3.10** |

*Source: Website of the Stock Exchange*

*Notes:*

1. The price to net asset multiples of the NBP Comparables were calculated based on the basic net asset value after minority interest (if any) per share as per their respective latest published annual or interim results and the closing prices of such companies as quoted on the Stock Exchange on 22 May 2009, being the date of the Asset Swap Agreement, save for as detailed in note 2 below.

2. The price to net asset multiple of Long Far Pharmaceutical Holdings Ltd. was calculated based on the basic net asset value per share as per its latest published annual results and the closing price of its shares as quoted on the Stock Exchange on 15 May 2009, being the last trading day of its shares before they were suspended from 18 May 2009 to 25 May 2009.

3. Hua Han Bio-Pharmaceutical Holdings Ltd. ("Hua Han") is a company principally engaged in research, development, manufacture and sale of gynecological medicine and medicinal healthcare products for women, which we consider to be a suitable comparable company for NBP. However, according to the announcement and prospectus issued by Hua Han on 14 and 29 May 2009 respectively, it is in the process of conducting an open offer which will have an impact on its issued share capital and net asset value. Since such impact is uncertain, we consider it inappropriate to include Hua Han's price to net asset multiple to our comparison analysis.

As shown in Table 4 above, the price to net asset multiples of the NBP Comparables are in the range of approximately 0.28 times to 10.93 times; while the mean of the price to net asset multiples of the NBP Comparables is approximately 3.10 times. The Consideration represents a price to net asset multiple of approximately 1.10 times in respect of the Disposal based on NBP's unaudited net asset value (based on PRC accounting standards) of approximately RMB99.77 million (equivalent to approximately HK$113.37 million) as at 30 April 2009, which falls within the range of the NBP Comparables' price to net asset multiples.

Having considered the above, we are of the view that the basis of determination of the Consideration is appropriate and that the Consideration is fair and reasonable so far as the Independent Shareholders are concerned.

***(b) The Asset Swap arrangement***

Pursuant to the Asset Swap Agreement, the Company shall transfer the entire equity interest in NBP to China Charmaine in exchange for the entire equity interest in Hong Yuan. Given that the Asset Swap arrangement allows the Group to dispose of a loss making subsidiary in exchange for a profitable company without any cash outlay by the Group, we consider the Asset Swap arrangement is in the interests of the Company and the Shareholders as a whole.

Based on the foregoing, we are of the opinion that the terms of the Asset Swap Agreement are fair and reasonable, on normal commercial terms, and in the interests of the Company and the Shareholders as a whole.

**3. Financial impacts of the Asset Swap on the Group**

***(a) Net asset value***

According to the 2008 Annual Report, as at 31 December 2008, the Group's audited total assets, total liabilities and net asset value after minority interest were approximately HK$7,903.41 million, HK$3,320.21 million and HK$4,497.38 million respectively. As stated in the section headed "Financial effect of the Asset Swap" in the "Letter from the Board" in the Circular, upon Completion, it is expected that the total assets and total liabilities of the Group would have been decreased by approximately HK$36.0 million and HK$29.4 million respectively assuming that Completion had taken place on 30 April 2009. Shareholders should note that the aforesaid figures are for indicative purposes only and may not be the same as those figures to be presented on the Company's financial statements which will be prepared in accordance with Hong Kong Financial Reporting Standards. Based on our review on the latest management accounts of the Company as at 31 March 2009 (the "Management Accounts") and the Directors' confirmation regarding the Company's financial position as at 30 April 2009, we noted that there is no material change to the total assets, total liabilities and net asset value of the Group since 31 December 2008 and up to 30 April 2009.

Having considered the above, the Asset Swap is expected to have no material adverse effect to the net asset value of the Group.

***(b) Earnings***

As discussed in sections 1(c) and (d) above, Hong Yuan had achieved a profitable track record with strong growth in both revenue and profit in the year ended 31 December 2008; while NBP has been making losses since its inception and incurred losses of over RMB20 million (equivalent to approximately HK$22.73 million) for each of the two years ended 31 December 2008. Upon Completion, Hong Yuan will become a wholly-owned subsidiary of the Company, and hence, the financial results of Hong Yuan will be consolidated into the Company's financial statements; while the Company will cease to have any interests in NBP's financial results.

As stated in the section headed "Financial effect of the Asset Swap" in the "Letter from the Board" in the Circular, it is expected that the Group will not record any material gain or loss as a result of the Disposal but will record a gain on change in fair value of NBP in the amount of approximately HK$15.0 million, being the difference of the estimated fair value of NBP and its net asset value as at 30 April 2009. The gain on change in fair value of NBP will be reflected in the consolidated income statement of the Group.

In view of the above, we consider that it is reasonable for the Directors to expect that the Asset Swap will have a favourable impact on the earnings of the Group.

***(c) Working capital position***

Pursuant to the Asset Swap Agreement, China Charmaine has agreed to procure the repayment by NBP on or before Completion of the outstanding amounts owed to the Group of approximately RMB60.81 million (equivalent to approximately HK$69.10 million) as at 30 April 2009 with such repayment expected to be financed by borrowings of NBP. It is noted that such amount repaid is currently intended to be used as the general working capital of the Group. Furthermore, based on the audited cash flow statements of Hong Yuan prepared in accordance with the PRC accounting standards, Hong Yuan had generated positive operating cash flow for each of the two years ended 31 December 2007 and 2008.

Given the above and that the Asset Swap does not require a cash outlay by the Group, the Asset Swap is not expected to have any adverse impact on the working capital position of the Group in this respect.

***(d) Gearing ratio***

We noted from the 2008 Annual Report, the Group's gearing ratio (defined as total borrowings divided by total assets) as at 31 December 2008 was approximately 18.8%. Based on the Management Accounts and as confirmed by the Directors, there is no material change to the gearing ratio of the Company since 31 December 2008. We are advised by the Directors that the gearing ratio of the Group will not have any material adverse change as a result of the Asset Swap.

In view of the foregoing, we are of the opinion that the Asset Swap will not have any material adverse impact on the Group's financial position upon Completion in this regard.

**RECOMMENDATION**

Having considered the principal factors and reasons discussed above, in particular the following (which should be read in conjunction with and interpreted in the full context of this letter):

- the respective historical financial performance of the Group's bulk penicillin series and finished drugs businesses, Hong Yuan and NBP;

- that the Acquisition will provide the Group with a new source of additional income and at the same time ensure it can secure a reliable source of supply of the required chemical products at a competitive price for its bulk penicillin series business;

- that the Disposal will help relieve the Group from the financial burden likely to be continuously caused by NBP, which in turn is expected to have a positive impact on the overall financial performance of the Group's finished drug business;

- that the Asset Swap will help expedite the implementation of the stated business objectives and development strategies in respect of the Group's bulk penicillin series and finished drugs businesses;

- that the terms of the Asset Swap Agreement are fair and reasonable, on normal commercial terms, and in the interests of the Company and the Shareholders as a whole; and

- that there will not be any material adverse impact on the financial position of the Group as a result of the Asset Swap,

we are of the view that the Asset Swap Agreement has been entered into by the Group within its ordinary and usual course of business based on normal commercial terms, and the terms thereof are fair and reasonable and in the interests of both the Company and the Shareholders as a whole.

Accordingly, we advise the Independent Shareholders, and the Independent Board Committee to recommend the Independent Shareholders to vote in favour of the ordinary resolution to be proposed at the EGM to approve the Asset Swap Agreement.

Yours faithfully,
For and on behalf of
**Quam Capital Limited**
**Richard D. Winter**
*Managing Director*

## 1. RESPONSIBILITY STATEMENT

This circular includes particulars given in compliance with the Listing Rules for the purpose of giving information with regard to the Company. The Directors collectively and individually accept full responsibility for the accuracy of the information contained in this circular and confirm, having made all reasonable enquiries, that to the best of their knowledge and belief there are no other facts the omission of which would make any statement contained herein misleading.

## 2. DISCLOSURE OF INTEREST

### (a) Interests of Directors

As at the Latest Practicable Date, the interests and short positions of the Directors and the chief executive of the Company in the shares, underlying shares of the Company or its associated corporations (within the meaning of Part XV of the SFO) which (i) were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they were taken or deemed to have under such provisions of the SFO); or (ii) were required to be entered in the register maintained by the Company pursuant to section 352 of the SFO; or (iii) were required to be notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers as contained in the Listing Rules, were as follows:-

***Interests in Shares***

| Name of Director | Capacity | Number of issued ordinary shares held | Approximate percentage of the issued share capital of the Company |
|---|---|---:|---:|
| Chak Kin Man | Beneficial Owner | 4,000 | 0.00026% |

Save as disclosed above, as at the Latest Practicable Date, none of the Directors and chief executive of the Company had any interests or short positions in the Shares or underlying Shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which were required (a) to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they were taken or deemed to have under such provisions of the SFO); or (b) to be entered in the register required to be kept by the Company pursuant to section 352 of the SFO; or (c) to be notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers as contained in the Listing Rules.

**(b) Interests of substantial Shareholders**

As at the Latest Practicable Date, so far as is known to the Directors and chief executive of the Company, the following persons or corporations (not being Directors or chief executive of the Company), had an interest in the Shares which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO were as follows:

| **Name of substantial Shareholder** | **Capacity** | **Number of issued ordinary shares held** | **Approximate percentage of the issued share capital of the Company** |
|---|---|---|---|
| MGGL | Beneficial owner | 783,482,393 | 51.04% |
| Legend Holdings | Interest to an agreement | 783,482,393 *(Note 1)* | 51.04% |
| 聯想控股有限公司職工持股會 Employees' Shareholding Society of Legend Holdings Limited ("Employees' Society") | Interest held by a controlled corporation | 783,482,393 *(Note 2)* | 51.04% |

*Notes:*

(1) Legend Holdings and MGGL are parties to an agreement to which Section 317(1)(a) of the SFO applies. Legend Holdings is deemed to be interested in the 783,482,393 Shares held by MGGL.

(2) Employees' Society owns 35% interest in Legend Holdings. Employees' Society is deemed to be interested in the 783,482,393 Shares held by MGGL.

Save as disclosed above, as at the Latest Practicable Date, the Directors were not aware of any other person who had an interest or short position in the shares or underlying shares of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO, or who was directly or indirectly, interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of any other member of the Group or had any options in respect of such capital.

## 3. DIRECTORS' INTERESTS IN CONTRACTS

(a) Each of the Non-executive Director and the Independent Non-executive Directors has entered into a service contract for a term of two years from 1 January 2009.

Save as disclosed above, as at the Latest Practicable Date, none of the Directors had entered, or proposed to enter into a service contract with any member of the Group (excluding contracts expiring or determinable by the employer within one year without payment of compensation (other than statutory compensation).

(b) As at the Latest Practicable Date, none of the Directors had any interest, direct or indirect, in any assets which had been, since 31 December 2008, being the latest published audited accounts of the Company were made up, acquired or disposed of by or leased to any member of the Group, or are proposed to be acquired or disposed of by or leased to any member of the Group.

(c) Save as disclosed herein, the Directors confirm that there is no contract or arrangement subsisting as at the Latest Practicable Date in which a Director was materially interested which was significant in relation to the business of the Group.

## 4. MATERIAL ADVERSE CHANGE

As at the Latest Practicable Date, the Directors are not aware of any material adverse change in the financial or trading position of the Company since 31 December 2008 (being the date to which the latest published audited consolidated financial statements of the Company were made up).

## 5. DIRECTORS' INTEREST IN COMPETING BUSINESS

As at the Latest Practicable Date, none of the Directors or their respective associates had any interest in any business which competes or may compete, either directly or indirectly with any business of the Group.

## 6. EXPERT AND CONSENT

(a) The following is the qualification of the expert which has given opinion or advice which are contained in this circular:

| **Name** | **Qualification** |
|---|---|
| Quam Capital Limited | A licensed corporation to carry out type 6 (advising on corporate finance) regulated activities under the SFO |

(b) As at the Latest Practicable Date, the Independent Financial Adviser was not beneficially interested in the share capital of any member of the Group nor has any right, whether legally enforceable or not, to subscribe for or nominate persons to subscribe for securities in any member of the Group, nor did it have any interest, direct or indirect, in any assets which have been acquired or disposed of or leased to any member of the Group since 31 December 2008, the date to which the latest published audited accounts of the Group were made up.

(c) The Independent Financial Adviser has given and has not withdrawn its written consent to the issue of this circular with the inclusion of the text of its letter and references to its name, in the form and context in which they respectively appear.

## 7. RIGHT TO DEMAND A POLL

Pursuant to Article 73 of the Articles of Association, at any general meeting resolutions put to the vote of the meeting shall be decided on a show of hands unless a poll is taken as may from time to time be required under the Listing Rules or any other applicable laws, rules or regulations or unless a poll is (before or on the declaration of the result of the show of hands) demanded:-

(a) by the Chairman; or

(b) by at least three members present in person or by proxy for the time being entitled to vote at the meeting; or

(c) by any member or members present in person or by proxy and representing not less than one-tenth of the total voting rights of all the members having the right to vote at the meeting; or

(d) by any member or members present in person or by proxy and holding shares in the Company conferring a right to vote at the meeting being shares on which an aggregate sum has been paid up equal to not less than one-tenth of the total sum paid up on all the shares conferring that right.

## 8. GENERAL

(a) The share registrar and transfer office of the Company is Tricor Secretaries Limited, 26th Floor, Tesbury Centre, 28 Queen's Road East, Hong Kong.

(b) Mr. Lee Ka Sze, Carmelo, a Non-executive Director, is a partner of Woo, Kwan, Lee & Lo, the legal advisers of the Company with respect to Hong Kong law in connection with the Asset Swap, which firm will receive normal professional fees.

(c) The English text of this circular shall prevail over the Chinese text.

## 9. DOCUMENTS FOR INSPECTION

Copies of the following documents will be available for inspection at Suite 3206, 32nd Floor, Central Plaza, 18 Harbour Road, Wanchai, Hong Kong during normal business hours up to and including the date of the EGM:

(a) the Asset Swap Agreement;

(b) the letter of recommendation from the Independent Board Committee, the text of which is set out on pages 14 to 15 of this circular;

(c) the letter from the Independent Financial Adviser, the text of which is set out on pages 16 to 34 of this circular; and

(d) the written consent referred to in paragraph 6 of this appendix.

中國製藥集團有限公司
**China Pharmaceutical Group Limited**
*(Incorporated in Hong Kong under the Companies Ordinance)*
**(Stock Code: 1093)**

# NOTICE OF EXTRAORDINARY GENERAL MEETING

**NOTICE IS HEREBY GIVEN** that an extraordinary general meeting of the shareholders of CHINA PHARMACEUTICAL GROUP LIMITED (the "**Company**") will be held at Suite 3206, 32nd Floor, Central Plaza, 18 Harbour Road, Wanchai, Hong Kong on Friday, 3 July, 2009 at 10:00 a.m. for the purpose of considering and, if thought fit, passing (with or without modifications) the following resolution as an ordinary resolution of the Company:

## ORDINARY RESOLUTION

"**THAT**:

(a) an agreement dated 22 May 2009 entered into between China Charmaine Pharmaceutical Company Limited and the Company (the "Asset Swap Agreement", a copy of which has been produced to the meeting and marked "A" and signed by the Chairman of the meeting for the purpose of identification) in relation to the disposal of 100% equity interest in 石藥集團恩必普藥業有限公司 (Shijiazhuang Pharma Group NBP Pharmaceutical Company Limited) by the Company and the acquisition of 100% equity interest in 河北宏源化工有限公司 (Hebei Hong Yuan Chemical Company Limited) by the Company and the transactions contemplated thereunder be and are hereby approved, confirmed and ratified; and

(b) the directors of the Company be and are hereby authorised for and on behalf of the Company to sign, seal, execute all such other documents and agreements and do all such acts or things as they may in their absolute discretion consider to be necessary, desirable, appropriate or expedient to implement or give effect to the Asset Swap Agreement and the transactions contemplated thereunder."

By order of the Board
**Cai Dongshen**
*Chairman*

Hong Kong, 12 June 2009

*Notes:*

(1) Any member entitled to attend and vote at the meeting is entitled to appoint more than one proxy to attend and, on a poll, to vote instead of him. A proxy need not be a member of the Company.

(2) Where there are joint registered holders of any share, any one of such persons may vote at the meeting, either personally or by proxy, in respect of such share as if he were solely entitled thereto, but if more than one of such joint holders be present at the meeting personally or by proxy, that one of the said persons so present whose name stands first on the register in respect of such share, shall alone be entitled to vote in respect thereof.

(3) A form of proxy for use at the meeting is enclosed.

(4) To be valid, the form of proxy, together with the power of attorney or other authority, if any, under which it is signed or a certified copy of such power or authority, must be deposited at the registered office of the Company at Suite 3206, 32nd Floor, Central Plaza, 18 Harbour Road, Wanchai, Hong Kong not less than 48 hours before the time appointed for holding the meeting or adjourned meeting. Completion and return of the form of proxy will not preclude members from attending and voting in person at the meeting.

(5) The Ordinary Resolution as set out above will be determined by way of a poll.