2011 Annual Report

China Nepstar Chain Drugstore

Neighbourhood drugstore with one-stop convenience for day to day needs

海王星辰 NEPSTAR DRUGSTORE

海王星辰
NEPSTAR DRUGSTORE

NPD
LISTED
NYSE

Quality Assurance
Professional Service
Customer Satisfaction

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LETTER FROM CHAIRMAN

Dear Shareholders,

2011 marked another eventful year of ongoing healthcare reform in China. We are proud to have achieved increases in same store sales, revenue and net income in an turbulent environment characterized by mandated price cuts on essential drugs and various government initiatives to curb medication costs. Also, our business has continued to generate steady cash-flows from operating activities.

Our efforts to constantly streamline store operations and optimize product offerings enabled us to balance the adverse effects of contracting gross margins and increasing labor and rental costs. We continue to broaden our offerings in the convenience and consumable categories, where we have successfully selected excellent quality products with best value for our customers. Our product strategy drove a 5.7% increase in revenues and an 8.7% increase in same store sales for the year.

In 2011, we opened 76 new stores and closed 228 stores. As of December 31, 2011, Nepstar had a total of 2,395 stores in operation. After closely tracking and measuring the performance of each store, we made some difficult decisions by closing stores with no prospects for turnaround. However, we believe this is the right approach to maintain store quality, strengthen the foundation of our store network and improve our operating margin.

In 2012, we aim to balance the challenges and opportunities presented by the ongoing healthcare reform and uncertain macroeconomic climate. We are strengthening management at underperforming stores and are improving employee training and incentive programs to help drive sales. We also plan to enhance the image of existing stores and improve overall customer experience with display optimization. We will open new stores cautiously and only consider quality locations for our new stores.

Assuming the continuation of pricing controls on key pharmaceuticals, we plan to further strengthen our healthcare related non-pharmaceutical product categories including nutritional supplements, Traditional Chinese Medicines herbs, and household medical devices. We will also continue to develop product offerings to include competitively priced, high quality personal care products and daily consumables which we believe will further differentiate our stores from those of our competitors.

We thank our shareholders for your ongoing support and we remain optimistic about the long-term prospects of our company and the consumer healthcare market in China.

Sincerely,

Simin Zhang
Chairman
China Nepstar Chain Drugstore

CONVENTIONS THAT APPLY TO THIS ANNUAL REPORT

Unless otherwise indicated, references in this annual report to:

- "ADRs" are to the American depositary receipts, which evidence our ADSs;
- "ADSs" are to our American depositary shares, each of which represents two ordinary shares;
- "China" and the "PRC" are to the People's Republic of China, excluding, for the purposes of this annual report only, Taiwan and the special administrative regions of Hong Kong and Macau;
- "China Nepstar" is to China Nepstar Chain Drugstore Ltd.;
- "JZJ" is to Yunnan Jianzhijia Chain Drugstore Ltd., our 40.0% owned affiliate that operates drugstores in Yunnan province under the trade name Jianzhijia, which since the first quarter of 2009 has not been our consolidated subsidiary and has been accounted for under the equity method;
- "Nepstar E-Commerce" is to Shenzhen Nepstar E-Commerce Co., Ltd., a PRC-incorporated company that operates our online retail business and whose operating results are consolidated with our operating results;
- "Nepstar group companies," "we," "us," "our company" and "our" are to China Nepstar, its predecessor entities and its consolidated entities;
- "ordinary shares" are to our ordinary shares, par value US$0.0001 per share;
- "regional Nepstar companies" are to the PRC-incorporated companies that operate Nepstar drugstores in their respective regions under the trade name Nepstar and whose operating results are consolidated with our operating results;
- "RMB" and "Renminbi" are to the legal currency of China; and
- "US$" and "U.S. dollars" are to the legal currency of the United States.

Names of certain companies provided in this annual report are translated from their original Chinese legal names.

Discrepancies in any table between the amounts identified as total amounts and the sum of the amounts listed therein are due to rounding.

This annual report includes our audited consolidated financial statements for the years ended December 31, 2008, 2009 and 2010 and as of December 31, 2009 and 2010.

We completed the initial public offering of 23,718,750 ADSs, each representing two ordinary shares, in November 2007. On November 9, 2007, we listed our ADSs on the New York Stock Exchange under the symbol "NPD."

You should read the following discussion and analysis of our corporate background, competition landscape, financial condition and results of operations in conjunction with our consolidated financial statements included elsewhere in the annual report on Form 20-F filed with Securities and Exchange Commission. This discussion may contain forward-looking statements based upon current expectations that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth under "Risk Factors" or in other parts of the Form 20-F.

INTRODUCTION

This annual report on Form 20-F includes our audited consolidated financial statements for the years ended December 31, 2009, 2010 and 2011 and as of December 31, 2010 and 2011.

We completed the initial public offering of 23,718,750 ADSs, each representing two ordinary shares, in November 2007. On November 9, 2007, we listed our ADSs on the New York Stock Exchange under the symbol "NPD."

SELECTED FINANCIAL DATA

The following selected consolidated statement of income data for the years ended December 31, 2009, 2010 and 2011 and selected consolidated balance sheet data as of December 31, 2010 and 2011 have been derived from our audited consolidated financial statements included elsewhere in this annual report. The following selected consolidated statement of income data for the years ended December 31, 2007 and 2008 and selected consolidated balance sheet data as of December 31, 2007, 2008 and 2009 have been derived from audited consolidated financial statements not included in this annual report. You should read the selected consolidated financial data in conjunction with our consolidated financial statements included in this annual report and "Operating and Financial Review and Prospects." Our consolidated financial statements are prepared and presented in accordance with United States generally accepted accounting principles, or U.S. GAAP. Our historical results are not necessarily indicative of our results expected for any future periods.

	Year Ended December 31,					
	2007	2008	2009 [1]	2010	2011	
	RMB	RMB	RMB	RMB	RMB	US$
	(in thousands, except share and per share data)					
Consolidated Statement of Income Data						
Revenue	1,954,683	2,396,642	2,217,613	2,356,604	2,491,290	395,826
Gross profit	862,672	1,138,890	1,074,215	1,163,939	1,188,637	188,855
Sales, marketing and other operating expenses (2)	(606,340)	(898,019)	(858,072)	(985,510)	(1,015,165)	(161,294)
General and administrative expenses (3)	(75,514)	(99,495)	(105,652)	(128,196)	(120,671)	(19,173)
Income from operations	180,818	141,376	110,491	21,270	38,637	6,138
Net income attributable to China Nepstar Chain Drugstore Ltd.	148,165	192,746	139,976	16,508	35,933	5,709
Accretion to Series A redeemable convertible preferred shares redemption value	(15,135)	—	—	—	—	—
Net income attributable to China Nepstar Chain Drugstore Ltd. ordinary shareholders	133,030	192,746	139,976	16,508	35,933	5,709
Net earnings per share						
Basic	0.80	0.90	0.67	0.08	0.17	0.03
Diluted	0.80	0.88	0.66	0.08	0.17	0.03
Shares used in computation						
Basic	128,976,023	212,984,310	208,215,802	209,550,935	206,127,305	206,127,305
Diluted	130,091,840	218,286,251	210,655,820	210,406,560	206,377,682	206,377,682

(1) In January 2009, our board of directors approved the termination of the voting rights agreement that assigned to us an additional 30.0% of the total voting rights of Yunnan Jianzhijia Chain Drugstore Ltd., or JZJ, our 40.0% owned affiliate. As a result, since the first quarter of 2009, JZJ has not been our consolidated subsidiary and its financial results have been accounted for under the equity method.

(2) Sales, marketing and other operating expenses included share-based compensation expenses of RMB1.8 million in 2007, RMB0.5 million in 2008, RMB73,000 in 2009, RMB18,000 in 2010 and nil in 2011.

(3) General and administrative expenses included share-based compensation expenses of RMB6.9 million in 2007, RMB3.7 million in 2008, RMB2.9 million in 2009 and RMB5.8 million in 2010. In 2011, 600,000 unvested share options granted to a former executive officer were forfeited. As a result, the corresponding share-based compensation costs recognized in previous year for the unvested share options were reversed and an amount of RMB1.2 million (US$0.2 million) was credited to general and administrative expenses for 2011.

	As of December 31,					
	2007	2008	2009	2010	2011	
	RMB	RMB	RMB	RMB	RMB	US$
			(in thousands)			
Consolidated Balance Sheet Data						
Cash, cash equivalents and other bank deposits	2,168,911	1,197,884	666,012	1,139,796	810,885	128,837
Restricted cash	—	—	765,000	5,000	—	—
Held-to-maturity investment securities	600,000	641,000	400,000	—	—	—
Inventories	285,307	373,689	369,775	433,265	437,058	69,442
Accounts receivable, net of allowance for doubtful accounts	54,753	88,136	72,561	83,722	102,937	16,355
Prepayments for purchase of merchandise paid to related parties	4,452	70,306	38,102	—	—	—
Total current assets	3,225,051	2,572,476	2,469,817	1,805,442	1,480,369	235,208
Property and equipment, net	172,171	240,396	204,710	192,019	141,817	22,532
Long-term bank time deposits	—	—	—	—	169,000	26,851
Total assets	3,438,541	3,498,773	2,820,576	2,153,109	1,942,197	308,585
Accounts payable	233,425	267,250	313,794	313,773	352,386	55,988
Amounts due to related parties	50,544	64,200	12,533	24,461	18,169	2,887
Total current liabilities	464,432	490,699	995,202	548,186	527,818	83,862
Total non-current liabilities	—	25,435	47,642	35,716	60,125	9,553
Total shareholders' equity	2,955,145	2,959,474	1,777,732	1,569,207	1,354,254	215,170

Exchange Rate Information

This annual report on Form 20-F contains translations of certain Renminbi amounts into U.S. dollar amounts at specified rates. Unless otherwise noted, all translations from Renminbi to U.S. dollars and from U.S. dollars to Renminbi in this annual report were made at the rate of RMB6.2939 to US$1.00, the exchange rate as set forth in the weekly H.10 statistical release of the Federal Reserve Board of the United States as of December 30, 2011. We make no representation that the RMB or U.S. dollar amounts referred to in this annual report could have been or could be converted into U.S. dollars or RMB, as the case may be, at any particular rate or at all. See 20F section "Risk Factors — Risks Related to Doing Business in China — Fluctuations in the exchange rates of the Renminbi may have a material adverse effect on your investment" and "— Governmental control of currency conversion may affect the value of your investment" for discussions of the effects of fluctuating exchange rates and currency control on the value of our ADSs. On April 20, 2012, the exchange rate as published by the Federal Reserve Board of the United States was RMB6.3080 to US$1.00.

The following table sets forth information concerning exchange rates between the RMB and the U.S. dollar for the periods indicated.

Period	RMB per U.S. Dollar Exchange Rate [1]			
	Period End	Average [2]	Low	High
	(RMB per US$1.00)			
2007	7.2946	7.6072	7.8127	7.2946
2008	6.8225	6.9477	7.2946	6.7800
2009	6.8259	6.8307	6.8470	6.8176
2010	6.6000	6.7696	6.8330	6.6000
2011	6.2939	6.4630	6.6364	6.2939
October	6.3547	6.3710	6.3825	6.3534
November	6.3765	6.3564	6.3839	6.3400
December	6.2939	6.3482	6.3733	6.2939
2012				
January	6.3080	6.3172	6.3330	6.2940
February	6.2935	6.2997	6.3120	6.2935
March	6.2975	6.3125	6.3315	6.2975
April (through April 20)	6.3080	6.3052	6.3150	6.2975

(1) For all periods prior to January 1, 2009, the exchange rate refers to the noon buying rate as reported by the Federal Reserve Bank of New York. For periods beginning on or after January 1, 2009, the exchange rate refers to the rate as set forth in the weekly H.10 statistical release of the Federal Reserve Board of the United States.

(2) Annual averages are calculated from month-end rates. Monthly averages are calculated using the average of the daily rates during the relevant period.

HISTORY AND DEVELOPMENT OF THE COMPANY

China Nepstar is incorporated in the Cayman Islands. Our principal executive offices are located at 6th Floor, Tower B, Xinnengyuan Building, Nanhai Road, Nanshan District, Shenzhen, Guangdong Province 518054, People's Republic of China. Our telephone number is (86) 755-2643-3366 and our website is www.nepstar.cn. The information contained on our website is not a part of this annual report. Our agent for service of process in the United States is CT Corporation System, located at 111 Eighth Avenue, New York, New York 10011.

Our predecessor, Nepstar Pharmaceutical, was founded in June 1995 by the Neptunus Group, a PRC company established and controlled by Simin Zhang, the chairman of our board of directors. In January 1998, the Neptunus Group established Shenzhen Nepstar Health Chain Stores Ltd., or Nepstar Health, as a holding company for Neptunus Group's equity interests in Nepstar Pharmaceutical with the aim of building a nationwide drugstore chain in China. Prior to the restructuring in 2004, Nepstar Health was 93.0% owned by the Neptunus Group and 7.0% owned by the management team of Nepstar Health, and Nepstar Pharmaceutical was 85.0% owned by Nepstar Health and 15.0% owned by the management team of Nepstar Health.

In connection with a restructuring of the Nepstar group companies in 2004 as part of an effort to raise capital from investors outside of China, Nepstar Health and the management team of Nepstar Health established Nepstar Commerce and Nepstar Electronic in August 2004, and transferred their entire equity interests in Nepstar Pharmaceutical to Nepstar Commerce and Nepstar Electronic, respectively. After this transfer, Nepstar Pharmaceutical became 65.0% owned by Nepstar Commerce and 35.0% owned by Nepstar Electronic. Concurrently, Nepstar Health also transferred the equity interests it held in the regional Nepstar companies to Nepstar Commerce and Nepstar Electronic.

On August 13, 2004, Mr. Simin Zhang incorporated China Neptunus Drugstore Holding Ltd. in the British Virgin Islands, or Neptunus BVI, and on August 20, 2004, Neptunus BVI incorporated China Nepstar in the Cayman Islands. Upon incorporation, China Nepstar issued 115 million ordinary shares, of which 107.8 million shares, or 93.7%, were issued to Neptunus BVI. The remaining shares were issued to China Star Chain Ltd., or China Star Chain, a British Virgin Islands company beneficially owned by management team of Nepstar Health. China Nepstar became the holding company of the Nepstar group companies after it acquired all outstanding equity interests in Nepstar Commerce and Nepstar Electronic from their respective shareholders in September 2004.

On October 6, 2004, China Nepstar entered into an agreement with five institutional investors affiliated with The Goldman Sachs Group, Inc., or the GS Funds, pursuant to which China Nepstar issued an aggregate of 30,000,000 and 20,000,000 of Series A redeemable convertible preferred shares to the GS Funds on October 6, 2004 and December 1, 2005 for cash consideration of US$15.0 million and US$10.0 million, respectively. Immediately upon the completion of the Series A private placement, the GS Funds, Neptunus BVI and China Star Chain owned 30.3%, 66.06% and 3.64% equity interest in China Nepstar, respectively, on an as-converted basis.

Since our inception, we have conducted our operations in China primarily through Nepstar Pharmaceutical, which became a wholly foreign-owned enterprise in China in August 2004 as the result of our restructuring in 2004. As applicable PRC laws, rules and regulations effectively limit any foreign investor's ownership of drugstores to 49.0% if the investor owns interests in more than 30 drugstores in China that sell a variety of branded pharmaceutical products sourced from different suppliers, we undertook another restructuring in May 2007. In connection with the May 2007 restructuring, Nepstar Commerce, Nepstar Electronic and Nepstar Pharmaceutical transferred all or part of their equity interests in regional Nepstar companies to two newly established PRC companies, Shenzhen Nepstar Information & Technology Service Co., Ltd., or Nepstar IT Service, and Shenzhen Nepstar Management Consulting Co., Ltd., or Nepstar Management Consulting, which are wholly owned by Liping Zhou and Feng Tu, respectively. Liping Zhou and Feng Tu are both employees of our company and PRC citizens. After we completed our restructuring in May 2007, neither Nepstar Commerce nor Nepstar Electronic retained any direct ownership interest in any of the regional Nepstar companies.

On November 9, 2007, our ADSs were listed on the New York Stock Exchange.

On May 19, 2008, Nepstar Pharmaceutical entered into a Transfer Agreement with Pacific Gateway Capital Company Ltd. to sell the 51.0% of equity interest it owns in Medicine Shoppe for RMB2.5 million in cash. The carrying value of our share of Medicine Shoppe's net assets was RMB2.3 million as of March 31, 2008.

In January 2009, our board of directors approved the termination of a voting rights agreement which had assigned 30% of the total voting rights of JZJ to us. JZJ's other shareholders have expressed an intention to pursue the listing of the portion of the equity interest they hold in JZJ on the Shenzhen Stock Exchange in three years through a holding company. As of December 31, 2008, JZJ had 355 drugstore outlets, all of which were located in Yunnan province in southwestern China. As a result of the termination of the voting rights agreement, beginning in the first quarter of 2009, JZJ is no longer a consolidated subsidiary of China Nepstar and is accounted for under the equity method of accounting. See note 10 to our audited consolidated financial statements included in this annual report.

In August 2009, we established Fuzhou Nepstar Chain Co., Ltd., or Fuzhou Nepstar, with Nepstar Pharmaceutical holding 49.0% and Nepstar IT Service and Nepstar Management Consulting holding the remaining 51.0% of the equity interest.

In December 2009, we formed Nepstar E-Commerce as a subsidiary of Nepstar Pharmaceutical to operate our e-commerce business. On May 20, 2010, Nepstar Pharmaceutical entered into transfer agreements with Nepstar IT Service and Nepstar Management Consulting, respectively, to transfer to each a 50.0% equity interest in Nepstar E-Commerce. In August 2011, we changed the operator of our e-commerce business from Nepstar E-Commerce to Shenzhen Nepstar. As of December 31, 2011, Shenzhen Nepstar was in the process of applying for the value-added telecommunications service license which is required for the operation of our e-commerce business. We launched a pilot version of our e-commerce website in November 2010. In January 2011, we launched our official e-commerce website, www.star365.com. On October 1, 2011, we began selling over-the-counter drugs through the website.

In August 2011, we transferred our 100% equity interest in Shenzhen Nepstar Industrial Co., Ltd., or Nepstar Industrial, to the Neptunus Group, for cash consideration of RMB20.0 million (US$3.2 million). Such divestment simplified our corporate structure with no impact on our financial position or business, as we had not conducted any operations under Nepstar Industrial since its establishment in 2009.

We currently operate our drugstore business in China through a series of contractual arrangements Nepstar Pharmaceutical entered into with Nepstar IT Service, Nepstar Management Consulting and their shareholders to retain control over the regional Nepstar companies, including Fuzhou Nepstar, and Nepstar E-Commerce, as well as to retain the economic risks and rewards of these entities.

Although we have been advised by our PRC counsel, Beijing Kang Da Law Firm, that based on their understanding of the current PRC laws, rules and regulations, the structure for operating our business in China (including our corporate structure and contractual arrangements with the regional Nepstar companies, Nepstar E-Commerce, Nepstar IT Service and Nepstar Management Consulting and their respective shareholders) complies with all applicable PRC laws, rules and regulations, and does not violate, breach, contravene or otherwise conflict with any applicable PRC laws, rules or regulations, we cannot assure you that the PRC regulatory authorities will not determine that our corporate structure and contractual arrangements violate PRC laws, rules or regulations. If the PRC regulatory authorities determine that our contractual arrangements are in violation of applicable PRC laws, rules and regulations, our contractual arrangements will become invalid or unenforceable. See 20F section “Risk Factors — Risks Related to Our Corporate Structure — If the PRC regulatory bodies determine that the agreements that establish the structure for operating our business in China do not comply with applicable PRC regulatory restrictions on foreign investment, we could be subject to severe penalties.”

In 2009, 2010 and 2011, our capital expenditures totaled RMB81.7 million, RMB58.2 million and RMB32.8 million (US$5.2 million), respectively. In the past, our capital expenditures were used primarily to open drugstores, acquire drugstores through business combinations, set up distribution centers and install and upgrade our integrated information management system. We estimate that our capital expenditures in 2012 will range from approximately RMB40.0 million to RMB60.0 million, which we plan to use to open new stores and refurbish existing stores in China.

Business Overview

We are the largest retail drugstore chain in China, with a network of 2,395 directly operated drugstores spanning 74 cities across 14 provinces and direct-controlled municipalities in China as of December 31, 2011. We believe we have succeeded in building a national retail drugstore chain with an extensive footprint in China and we have the leading market position in a number of the most developed cities in China, including Shenzhen, Dalian, Hangzhou, Ningbo, and Suzhou, in terms of store count.

We provide our customers with high-quality, professional and convenient pharmacy services and a wide variety of other merchandise, including over-the-counter drugs, nutritional supplements, herbal products, personal care products, family care products, as well as convenience products including consumable, seasonal and promotional items. Unlike most other drugstores and retail drugstore chains in China, we also offer private label products, which we believe distinguishes our company from our key competitors. We launched our first private label products in September 2005 and offered 1,885 private label products as of December 31, 2011. Sales of our private label products accounted for 30.0% of our revenue and 41.3% of our gross profit in 2011.

We also operate an Internet website, www.star365.com, where online shoppers can purchase over-the-counter drugs, nutritional supplements, herbal products, personal care products, reproductive health products and household convenience products, among other products. Online sales accounted for less than 1% of our revenue and gross profit in 2011.

Our Store Network

We are the largest retail drugstore chain in China based on the number of directly operated stores, with a store network comprised of 2,395 directly operated stores as of December 31, 2011. We operate all of our stores directly, which we believe is critical in building a strong brand name and offering a more consistent customer experience across our store network. Moreover, we believe direct operation of our drugstores is very important to our success in the retail drugstore chain business in China, given the highly fragmented market, the relatively small size of other retail drugstore chains and their short operating histories. Through a decade of direct operating experience, we have developed standards among various aspects of drugstore operations in order to provide a high quality of services in all of our stores. Direct operation also enables us to better select store locations that meet the consumer traffic requirements, target new neighborhoods and allows us to leverage our existing distribution centers. In addition, our direct operation business model allows us to operate a relatively centralized and streamlined organizational structure, which enables us to expedite decision making and thus deploy our financial, operational and management resources more effectively. Furthermore, our business model also allows us to address local demand for specific products and services more accurately, to control our corporate overhead expenses and to provide uniform and high-quality training for our employees.

We carefully select our store sites to maximize consumer traffic, store visibility and convenience for our customers. Substantially all of our stores are located in well-established urban residential communities in 74 cities in China, where living standards and consumer purchasing power are generally higher than in rural areas. The following table sets forth the number of stores we owned and operated as of the dates indicated in the following top ten cities that we operated in as of December 31, 2011:

	As of December 31,		
City	2009	2010	2011
Shenzhen	428	441	387
Dalian	192	192	196
Hangzhou	195	182	173
Ningbo	186	188	170
Guangzhou	171	171	145
Qingdao	105	127	119
Tianjin	114	123	108
Dongguan	138	128	107
Suzhou	92	84	91
Weifang	83	91	89
Others	775	820	810
Total	2,479	2,547	2,395

The following table provides a history of our store openings and acquisitions as of the dates indicated:

	As of December 31,		
	2009	2010	2011
Number of stores at the beginning of the period	2,709	2,479	2,547
Effect of deconsolidation of JZJ	355*	—	—
Acquired stores during the period	7	17	1
Stores closed during the period	113	168	228
New stores opened during the period	231	219	75
Number of stores at the end of the period	2,479	2,547	2,395

* Effective January 5, 2009, we terminated a voting rights agreement, which assigned 30% of the total voting rights of JZJ to us. As a result, JZJ is no longer our consolidated subsidiary and has been accounted for under the equity method of accounting since January 2009.

Our stores are typically between 80 to 120 square meters in floor area, and conduct business from 8:30 a.m. to 10:30 p.m., seven days a week. Our stores are generally staffed with three employees per shift, including an in-store pharmacist, who in many cases also functions as the store manager, and two healthcare consultants. Our in-store pharmacists assist with the sales of prescription drugs, and each member of our store staff has received training regarding our products as well as how best to interact with customers. In addition, we regularly carry out training programs on medicinal information, nutritional information, selling skills for our store staff and pharmacists, as well as management training for our regional managers and senior management officers at our headquarters.

We are the first retail drugstore chain in China to sell over-the-counter drugs on open shelves. Consumers have easy access to all products we sell except prescription drugs, and we aim to provide them with a relaxing, clean and bright shopping environment to improve their shopping experience. We have also developed a uniform and distinctive layout, color scheme and design specification for our drugstores. We believe that the use of a uniform layout, color scheme and design promotes our corporate image and enhances the public perception of our brand.

Our Products and Services

We provide our customers with high-quality, professional and convenient pharmacy services and a wide variety of other merchandise, including over-the-counter drugs, nutritional supplements, herbal products, personal care products, family care products, as well as convenience products including consumable, seasonal and promotional items. We have rigorously analyzed a large number of drugs available for sale in China, and have concluded that a much smaller quantity of active ingredients are present in a significant majority of drugs purchased by our consumers. Accordingly, we have selected a diverse range of medicines based upon these ingredients which we believe drive consumer demand. Our typical store carries approximately 1,900 to 2,500 different products. We constantly review and refine our product selection in order to respond to changing demographics, lifestyles, habits and product preferences of our customers. Our product selection is designed to offer choices and convenience to our customers and to achieve high gross margins for us.

Product Offerings

Our merchandise can be broadly classified into the following categories:

Prescription Drugs. We offer approximately 1,996 prescription drugs. We accept prescriptions only from licensed health care providers and do not prescribe medications or otherwise practice medicine. Our in-store pharmacists verify the validity, accuracy and completeness of all prescription drug orders. We request that all prescription drug customers provide us with information regarding drug allergies, current medical conditions and current medications. Our in-store pharmacists also perform a drug utilization review in which they cross-check every prescription against the customer's submitted information for drug, disease and allergy interactions. Sales of prescription drugs accounted for 19.9% of our revenue in 2011.

Over-the-Counter Drugs. We offer approximately 2,082 over-the-counter drugs, including western medicines and traditional Chinese medicines, for the treatment of common diseases. Sales of over-the-counter drugs accounted for 36.6% of our revenue in 2011.

Nutritional Supplements. We offer approximately 473 nutritional supplements, including a variety of healthcare supplements, vitamins, minerals and dietary products. Nutritional supplements normally generate higher gross margins than prescription and over-the-counter drugs. Sales of nutritional supplements accounted for 18.1% of our revenue in 2011.

Herbal Products. We offer various types of drinkable herbal remedies and packages of assorted herbs for making soup, which are used by consumers as health supplements. Herbal products typically have higher gross margins than prescription and over-the-counter drugs. Sales of herbal products accounted for 4.0% of our revenue in 2011.

Other Products. Our other products include personal care products such as skin care, hair care and beauty products, family care products such as portable medical devices for family use, birth control and early pregnancy test products, and convenience products, including soft drinks, packaged snacks, cleaning agents and stationery. Our other products also include seasonal and promotional items tailored to local consumer demand for convenience and quality. In May 2010, we began to further expand our product offerings by introducing general merchandise and consumables, primarily in the following categories: convenience foods, produce, household cleaning and laundry products, and mother and baby products. We believe that offering these products and consumables increases the amount that customers spend per visit by meeting growing demand for one-stop shopping convenience, and helps mitigate the negative impact of ongoing healthcare reform and government policies, which have caused price reductions to pharmaceutical products on the national Essential Drug and Reimbursement Lists. Sales of other products accounted for 21.4% of our revenue in 2011.

Private Label Products

We launched our first private label product in September 2005, and since then our private label portfolio has increased to 1,885 products marketed under 148 private labels, covering all categories of products we offer. In 2011, private label products accounted for approximately 30.0% of our revenue and 41.3% of our gross profit. We believe private label branding gives us more freedom and flexibility in pricing and more control over product attributes and quality.

As the sourcing of private label products eliminates much of manufacturers' promotional costs and distributors' profit margin in the traditional merchandise supply chain, we are able to price our private label products at competitive prices while

maintaining favorable margins. In addition, we believe our private label products are particularly attractive to customers because our brand name and reputation command customer confidence. We believe that the quality of our private label products has won trust from our customers, and we operate rigorous quality control to retain that trust. We intend to continue to focus significant marketing efforts to enhance the reputation of the private label products available in our stores to drive their sales because they generally generate higher gross margins than branded products.

Marketing and Promotion

Our marketing and promotion strategy is to build brand recognition, increase customer traffic to our stores, attract new customers, build strong customer loyalty, maximize repeat customer visits and develop incremental revenue opportunities.

Our marketing department designs our nationwide marketing efforts while our regional Nepstar companies design regional promotions based on local demographics and market conditions. We also launch single store promotional campaigns and community activities in connection with the opening of new stores. Our store managers and staff are also encouraged to propose their own advertising and promotion plans, including holiday promotions, posters and billboards. In addition, we offer special discounts and gift promotions for selected merchandise periodically in conjunction with our suppliers' marketing programs. We also provide ancillary services such as providing free blood pressure measurements in our stores.

Many of our promotion programs are designed to encourage manufacturers to invest resources to market their brands within our stores. We typically receive from the manufacturers certain fees that offset part of our promotional costs to promote such manufacturers' products. We believe that manufacturer promotions improve our customers' shopping experience because manufacturers provide purchasing incentives and information to help customers to make informed purchase decisions. We work to maintain strong inventory positions for merchandise featured in our promotions, as we believe this increases the effectiveness of our spending on promotion activities.

As part of our marketing efforts and in order to build customer loyalty, we launched our "Loyal Customer" scheme in 1999. As of December 31, 2011, this program had more than 9.1 million members, approximately 4.7 million of whom were active members, which are defined as customers who make purchases from our stores at least once a year and whose contact information is available in our database. The numbers of our member and active member are lower when compared with those in 2010 mainly due to the fact that we terminated the memberships of approximately 7.5 million inactive members in 2011. We also award VIP memberships to those member customers who make purchases of at least RMB2,000 from our stores annually. As of March 31, 2012, the number of our VIP members accounted for approximately 1.3% of our total members. Under the loyalty points collection program we implemented in 2011, our member customers are entitled to receive free healthcare circulars published by our stores and gain one loyalty point for every RMB10.0 spent on our products and our VIP members are entitled to receive additional two loyalty points for every RMB10.0 spent on our products. Loyalty points may be used to exchange for gifts. At the end of calendar year, except for the loyalty points earned by our VIP members, which will never be forfeited, unutilized loyalty points are forfeited or carried forward for a very short period.

We maintain a database of our loyalty scheme membership, including customer profiles and purchasing records, which helps us to tailor our promotional programs to meet our customers' specific needs. On average, members of our loyalty scheme spend approximately 1.5 times more per sales transaction than non-member customers, and our member customers purchase more frequently from our stores than non-member customers. Sales to our member customers accounted for 55.0% of our revenue in 2011.

The following table sets forth the approximate number of our loyalty scheme members as of the dates indicated:

	As of December 31,		
	2009	2010	2011*
		(In thousands)	
Members	11,988	14,888	9,197
Active members	4,980	5,497	4,748

* In 2011, we terminated the memberships of approximately 7.5 million inactive members in our loyalty scheme membership database.

Beginning in 2010, we began to selectively introduce the Nepstar Shopper's Card program, which we implemented in all of our stores by September 2010. The Nepstar Shopper's Card is a prepaid card, bearing a face value of RMB100, RMB300, RMB500 or RMB1,000. During the launch stage, customers were encouraged to use their Nepstar Shopper's Cards to purchase certain beverage, convenience food, household and personal care products at certain Nepstar stores and accumulate bonus credits, which could then be used to purchase pharmaceutical and nutritional products in those stores. Currently, customers may use their Nepstar Shopper's Cards to purchase any products at any of our stores.

Customers

During 2011, our stores served an average of approximately 64 customers per day per store. Our typical customers are urban residents in major Chinese cities. We periodically conduct qualitative customer surveys in cities in which we operate more than 100 drugstores, helping us to build a stronger understanding of our market position and our customers' purchasing habits. In addition, we sell prescription and over-the-counter drugs to non-retail customers who choose to purchase from us rather than from manufacturers and distributors of pharmaceutical products directly, as these non-retail customers believe they can leverage the economies of scale realized by our greater purchasing power and obtain better pricing terms from us than directly purchasing the same products from the manufacturers and distributors. Sales to these non-retail customers accounted for less than 1.0% of our revenue in each of 2009, 2010 and 2011.

Our sales to retail customers are paid in cash or by debit or credit cards, or by medical insurance cards under the national medical insurance program. We obtain payments from the relevant government social security bureaus, for sales made to eligible participants in the national medical insurance program every one to three months. See "— Regulation — Reimbursement under the National Medical Insurance Program." As of December 31, 2011, 1,107 or 46.2% of our stores are designated stores under the PRC national medical insurance program.

Procurement

We currently source our merchandise from 1,440 suppliers, including 625 manufacturers and 815 wholesalers. In 2011, 62.5% of our total purchases were from wholesalers, with the remainder purchased directly from manufacturers. The transaction value of purchases from our largest supplier accounted for 5.3% of our total purchases in 2011. The transaction value of purchases from our largest five suppliers accounted for 17.5% of our total purchases in 2011. We believe that competitive sources are readily available for substantially all of the merchandise we carry in our stores, and our strategy is to consolidate our procurement through centralized purchasing from fewer suppliers.

While our selection of suppliers is currently centralized, supplier negotiations and placing of purchase orders are to a large degree handled by the regional Nepstar companies, partly reflecting the dominance of regional wholesalers in China's drug supply chain. We are in the process of centralizing our merchandise procurement and replenishment operations. We believe a more centralized and controlled procurement strategy not only benefits us by reducing our cost of purchase, but also benefits the manufacturers from whom we source our products. This is because drug manufacturers have historically relied on wholesalers to sell their products due to the relative small size of drug retailers, and manufacturers incur significant marketing expense to promote their brands and products. As we grow our revenue and as we continue to centralize our merchandise procurement, our greater sourcing capability makes us a more attractive distribution channel for many drug manufacturers. In addition, as our customers choose to purchase drugs from our stores due to their trust in our brand name and reputation, manufacturers can reduce their marketing expenses while increasing their sales volume by selling directly to us.

We conduct in-depth research of the characteristics of the merchandise under each of the categories, make on-site visits to the places of origin of the merchandise to conduct a thorough analysis of the cost structure of the merchandise in order to increase cost-effectiveness, and for those merchandise labeled as our private label products, we procure supplies from famous brands and major manufacturers to meet quality control standards.

Distribution

Our stores are supported by our national distribution center located near our headquarters in Shenzhen and 16 regional distribution centers serving our drugstores located in 74 cities across China.

Our suppliers normally deliver merchandise to our regional distribution centers, but we arrange for the transportation of merchandise to our national distribution center if a particular supplier cannot deliver regionally, and in these cases we levy a fee on the supplier for reimbursement of the transportation costs we incur. Merchandise is delivered from our national distribution center to the regional distribution centers which in turn serve our stores in the region, normally using our own vehicles. At each distribution center, we maintain a small fleet of trucks to deliver products to our stores and we replenish merchandise for each of our stores twice every week.

The operations of all of our distribution centers, including inventory management and deliveries, are integrated and coordinated by our ERP system, which is our integrated information management system. This system provides us with up-to-date product availability information so as to optimize our inventory management.

Information Management and Inventory Control

Each of our drugstores is equipped with computer terminals that are connected with our ERP system via real time broadband Internet links. Each merchandise item offered by our stores is coded with a unique bar-coded item number for its

identification in the store point-of-sale system which, in turn, is linked to our ERP system in real time. Cashiers scan the merchandise being sold and the data are recorded instantly. This integrated information management system generates a daily sales report, which enables us to quickly collect sales information, track and analyze inventory levels and sales trends, and enable us to optimize merchandise levels and product mix. Sales reports can also be produced at more frequent intervals, for example to monitor sales generated by a new product or by a promotional event. We also use this system to facilitate our category management decisions, fine-tune product selection, pricing, shelf space allocation, store replenishment triggers and distribution center replenishment triggers.

We manage our inventory carefully in order to minimize inventory holding cost, ensure timely delivery of merchandise and maintain the variety of merchandise available in our stores. We perform quarterly and ad hoc inventory counts in our stores and distribution centers, and perform daily inventory counts in stores for expensive merchandise and products that are vulnerable to pilferage. We require our store managers to follow up on any inventory discrepancies discovered during each inventory count and report the results to the relevant regional Nepstar company management.

Cash Control

A substantial portion of our sales are made in cash, and we have adopted strict cash control procedures in all of our stores. In particular, the details of each sales event are recorded in our integrated information management system, and the cash generated at our stores is collected and deposited daily in designated bank accounts, which are controlled by our headquarters. On a daily basis, staff working in our stores reconcile the sales record with the cash received, and staff in our finance department reconcile the sales record with the amounts deposited. Our finance department then reviews the monthly reconciliation of sales data collected on our information management system with cash receipts as confirmed by the banks. The cash needs of each regional Nepstar company are dispatched centrally on a weekly basis based on budgeted amounts.

Quality Control

We have selected 313 manufacturers as suppliers of our private label products after reviewing product selection, quality and manufacturing, packaging, transportation and storage capabilities as well as cost competitiveness. We had selected these vendors out of a large number of manufacturers after reviewing these manufacturers' GMP compliance status and their product quality, manufacturing facilities and technology, packaging, transportation and storage capabilities as well as the cost competitiveness of their products.

We conduct random quality inspections of each batch of products we procure. We replace our suppliers if they fail to pass our quality inspections. Since there is a significant manufacturing capability surplus within the Chinese pharmaceutical industry, it is possible for us to change suppliers without a material interruption to our business. We have established a quality control department at our headquarters and we maintain quality inspectors at each of our regional Nepstar companies. We regularly dispatch quality inspectors to our stores to monitor the service quality of our staff. We take into account the feedback received during these inspections when determining the bonus portion of our store employee's salaries.

Competition

The drugstore industry in China is intensely competitive, rapidly evolving and highly fragmented. We primarily compete with other retail drugstore chains or independent drugstores. We compete for customers primarily on the basis of our brand name, store location, merchandise selection, prices, and services that we offer. We believe that continued consolidation of the drugstore industry and continued new store openings by chain store operators will further increase competitive pressures in the industry. In addition, in certain of our targeted cities, such as Beijing and Shanghai, where local regulations prohibit the opening of new drugstores within certain distances of an existing store, and where other retail drugstore chains and independent drugstores have occupied many prime locations, we expect to face additional competition in terms of finding suitable new store locations if we expand into these cities.

Our primary competitors vary from region to region as most other retail drugstore chains in China operate on a regional basis. We do not consider independent drugstores as our major competitors, although we compete with them on an aggregate basis. There are significant differences between regions in the PRC due to distinctive demographics, local regulations and shopping habits, among other factors. Over the past decade, we have gained valuable and extensive expertise in operating a cross-region retail drugstore chain, which we believe will continue to give us advantages in competing with other drugstore chains.

Insurance

We maintain property insurance policies covering our distribution centers, stores and vehicles for losses due to fire, flood and a wide range of other disasters. In 2011, our total insurance coverage totaled approximately RMB699.2 million (US$111.1 million) and we paid approximately RMB0.5 million (US$0.1 million) in insurance premiums for the coverage. In addition, like other similar companies in China, we do not carry product liability insurance, and we do not have any business interruption insurance due to the limited coverage of any business interruption insurance in China. We consider our current insurance coverage to be adequate.

However, successful product liability and personal injury claims and uninsured damages to any of our distribution centers and our stores could have a material adverse effect on our financial condition and results of operations.

Regulation

As a distributor and retailer of pharmaceutical products, we are subject to regulation and oversight by different levels of the food and drug administration in China, in particular, the State Food and Drug Administration, or the SFDA. In November 2009, the PRC Ministry of Commerce and the SFDA jointly issued a notice to strengthen the PRC Ministry of Commerce's regulation of drugstores.

The Law of the PRC on the Administration of Pharmaceutical Products, as amended, provides the basic legal framework for the administration of the production and sale of pharmaceutical products in China and governs the manufacturing, distributing, packaging, pricing and advertising of pharmaceutical products in China. The corresponding implementation regulations set out detailed rules with respect to the administration of pharmaceuticals in China. We are also subject to other PRC laws, rules and regulations that are applicable to business operators, retailers and foreign-invested companies.

Distribution of Pharmaceutical Products

A distributor of pharmaceutical products must obtain a distribution permit from the relevant provincial- or designated municipal- or county-level food and drug administration. The grant of such permit is subject to an inspection of the distributor's facilities, warehouses, hygienic environment, quality control systems, personnel and equipment. The distribution permit is valid for five years, and the holder must apply for renewal of the permit within six months prior to its expiration. In addition, a pharmaceutical product distributor needs to obtain a business license from the relevant administration for industry and commerce prior to commencing its business. All of our consolidated entities that engage in the retail pharmaceutical business have obtained necessary pharmaceutical distribution permits, and we do not expect any difficulties for us to renew these permits and/or certifications.

In addition, under the Supervision and Administration Rules on Pharmaceutical Product Distribution promulgated by the SFDA on January 31, 2007, and effective May 1, 2007, a pharmaceutical product distributor is responsible for its procurement and sales activities and is liable for the actions of its employees or agents in connection with their conduct of distribution on behalf of the distributor. A retail distributor of pharmaceutical products is not allowed to sell prescription pharmaceutical products, or Tier A over-the-counter pharmaceutical products, listed in the Essential Drug and Reimbursement Lists without the presence of a certified in-store pharmacist. See "Reimbursement under the National Medical Insurance Program."

Regulations on Value-Added Telecommunications Services

On September 25, 2000, the State Council promulgated the Telecommunications Regulations, or the Telecom Regulations. The Telecom Regulations draw a distinction between "basic telecommunications services" and "value-added telecommunications services." Internet information service, or ICP service, is a subcategory of value-added telecommunications services. Under the Telecom Regulations, commercial operators of value-added telecommunications services must first obtain an operating license from the Ministry of Industry and Information Technology, or the MIIT, or its provincial level counterparts.

On September 25, 2000, the State Council issued the Administrative Measures on Internet Information Services, or the Internet Measures, which in particular regulate ICP services. According to the Internet Measures, commercial ICP service operators must obtain an ICP license from the relevant government authorities before engaging in any commercial ICP operations within the PRC.

The Internet Measures further specify that the Internet information services regarding, among others, news, publication, education, medical and health care, pharmacy and medical appliances are required to be examined, approved and regulated by the relevant authorities. ICP service providers are prohibited from providing services beyond that included in the scope of their ICP license or the registration information. Furthermore, the Internet Measures clearly specify a list of prohibited content. ICP service providers must monitor and control the information posted on their websites. If any prohibited content is found, they must cease dissemination of the offending content immediately, keep a record and report to the relevant authorities.

On December 26, 2001, the MIIT promulgated the Administrative Measures on Telecommunications Business Operating Licenses, or the Telecom License Measures. On March 1, 2009, the MIIT issued revised Telecom License Measures, which took effect on April 10, 2009. The Telecom License Measures set forth the types of licenses required to operate value-added telecommunications services and the qualifications and procedures for obtaining such licenses. For example, an information services operator providing value-added services in multiple provinces is required to obtain an inter-provincial license, whereas an information services operator providing the same services in a single province is required to obtain a local license.

On December 12, 2001, Beijing Telecommunications Administration issued the Preliminary Administrative Measures on Mobile Network Value-added Telecommunications Business in Beijing, which specifically set forth certain rules and requirements on mobile information provision services through service platforms connected via a mobile network. Among other things, the mobile information services operators in Beijing must obtain mobile network value-added telecommunication licenses.

Regulations on Internet Information Services

National security considerations are an important factor in the regulation of Internet information in China.

ICP service operators are required to monitor their websites in accordance with relevant PRC laws and regulations, including but not limited to the Internet Measures. They may not produce duplicate, post or disseminate any content that falls within the prohibited categories and must remove any such content from their websites, including any content that:

- opposes the fundamental principles stated in the PRC constitution;
- compromises national security, divulges state secrets, subverts state power or damages national unity;
- harms the dignity or interests of the state;
- incites ethnic hatred or racial discrimination or damages inter-ethnic unity;
- undermines the PRC's religious policy or propagates heretical teachings or feudal superstitions;
- disseminates rumors, disturbs social order or disrupts social stability;
- disseminates obscenity or pornography, gambling, violence, murder or terror or incites the commission of a crime;
- insults or slanders a third party or infringes upon the lawful rights and interests of a third party; or is otherwise prohibited by law or administrative regulations.

To the extent that PRC regulatory authorities find any content displayed on or through our website objectionable, they may require us to limit or eliminate the dissemination or availability of such content on our website or impose penalties, including the revocation of our operating licenses or the suspension or shutdown of our online operations. In addition, the costs of compliance with these regulations may increase as the volume of content and users on our website increases.

Regulation on Information Security and Censorship

Regulations governing information security and censorship include:

- Law of the People's Republic of China on the Preservation of State Secrets promulgated by the Standing Committee of the National People's Congress on September 5, 1988 and amended on April 29, 2010, which became effective from October 1, 2010, together with its Implementing Rules (1990);
- Rules of the People's Republic of China for Protecting the Security of Computer Information Systems promulgated by the State Council on February 18, 1994, as amended in January 2011;
- Provisional Regulations of the People's Republic of China on the Administration of International Networking of Computer Information Networks promulgated by the State Council on February 1, 1996 and amended on May 20, 1997, together with its Implementing Rules (1998);
- Administrative Measure for the Security Protection of International Connections to Computer Information Network promulgated by the Ministry of Public Security on December 16, 1997;
- Provisional Regulations for the Secrecy Protection of Computer Information Systems promulgated by the State Secrecy Bureau on February 26, 1998;
- Notice Regarding Issues Relating to the Implementation of the Administrative Measures for the Security Protection of International Connections to Computer Information Networks promulgated by the Ministry of Public Security on February 13, 2000;
- Decision Regarding the Safeguarding of Internet Security promulgated by the Standing Committee of the National People's Congress on December 28, 2000 and amended on August 27, 2009;
- Measures for the Administration of IP Address Archiving promulgated by the MIIT on February 8, 2005;
- Provision on Technical Measures for Internet Security Protection promulgated by the Ministry of Public Security on December 13, 2005; and
- Administrative Measures for the Graded Protection of Information Security promulgated by the Ministry of Public Security, the State Secrecy Bureau, the State Cipher Code Administration and the Information Office of the State Council on June 22, 2007.

These legislations specifically prohibit the use of Internet infrastructure where it may breach public security, provide content harmful to the stability of society or disclose state secrets. According to these legislations, it is mandatory for Internet information service providers, or the ICP service providers, in the PRC to complete security-filing procedures and regularly update information security and censorship systems for their websites with the local public security bureau. In addition, the newly amended Law on Preservation of State Secrets, which became effective on October 1, 2010, provides that whenever an Internet information service provider detects any leakage of state secrets in the distribution of online information, it should stop the distribution of such information and report to the authorities of state security, public security and secrecy protection. As per a request from the state security, public security or state secrecy authorities, the Internet information service provider should delete any content on its website that may lead to disclosure of state secrets. Failure to do so on a timely and adequate basis may subject the Internet information service provider to liability and certain penalties applied by the State Secrecy Bureau, the Ministry of Public Security, the authority of state security and/or the MIIT or their respective local counterparts.

Restrictions on Foreign Ownership of Wholesale or Retail Pharmaceutical Businesses in China

PRC regulations on foreign investment currently permit foreign companies to establish or invest in wholly foreign-owned enterprises or joint ventures that engage in wholesale or retail sales of pharmaceuticals in China. For retail sales, these regulations restrict the number and size of retail pharmacy stores that a foreign investor may establish. If a foreign investor owns more than 30 stores that sell a variety of branded pharmaceutical products sourced from different suppliers, the foreign investor's ownership interests in the stores are limited to 49.0%.

Our wholly owned subsidiary Nepstar Pharmaceutical currently owns 49.0% of the equity interest in each regional Nepstar company and has entered into contractual arrangements with each of these entities, including Nepstar IT Service, Nepstar Management Consulting and their shareholders.

Restrictions on Foreign Ownership of Online Businesses in China

Foreign ownership of Internet-based businesses is subject to significant restrictions under current PRC laws and regulations. The PRC government regulates Internet access, the distribution of online information and the conduct of online commerce through strict business licensing requirements and other government regulations. Specifically, investors are not allowed to own more than 50.0% of the equity interests in any "value-added telecommunications services" provider, or an entity conducting an Internet content distribution business such as Shenzhen Nepstar in its operation of www.star365.com.

Our wholly owned subsidiary Nepstar Pharmaceutical has entered into contractual arrangements with Nepstar IT Service, Nepstar Management Consulting and their shareholders to retain control over Shenzhen Nepstar.

Good Supply Practice Standards

GSP standards regulate wholesale and retail pharmaceutical product distributors to ensure the quality of distribution of pharmaceutical products in China. The current applicable GSP standards require pharmaceutical product distributors to implement strict controls on the distribution of medicinal products, including standards regarding staff qualifications, distribution premises, warehouses, inspection equipment and facilities, management and quality control. The GSP certificate is usually valid for five years.

All of our consolidated entities that engage in the retail pharmaceutical business, including the regional Nepstar companies, have obtained their GSP certificates. These GSP certificates currently have expiration dates varying from one to four years. We do not expect any difficulties in renewing these certifications upon their expiration.

Prescription Administration

Under the Rules on Administration of Prescriptions promulgated by the SFDA, effective May 1, 2007, doctors are required to include the chemical ingredients of the medicine they prescribe in their prescription and are not allowed to include brand names in their prescription. This regulation is designed to provide consumers with choices among different pharmaceutical products that contain the same chemical ingredients.

Advertisement of Pharmaceutical Products

In order to prevent misleading advertising of pharmaceutical products, the PRC Ministry of Health, the SAIC and the SFDA jointly promulgated the Standards for Examination and Publication of Advertisements of Pharmaceutical Products and Rules for Examination of Advertisement of Pharmaceutical Products in March 2007. Under these regulations, the advertising of certain pharmaceutical products is prohibited, and the advertising of prescription pharmaceutical products may only be made in authorized medical magazines. In addition, an approval must be obtained from the provincial level of the food and drug administration before a pharmaceutical product may be advertised. Such approval, once obtained, is valid for one year.

Product Liability and Consumers Protection

Product liability claims may arise if the products sold have any harmful effect on the consumers. The injured party may claim for damages or compensation. The General Principles of the Civil Law of the PRC, which became effective in January 1987, state that manufacturers and sellers of defective products causing property damage or injury shall incur civil liabilities for such damage or injuries.

The Product Quality Law of the PRC was enacted in 1993 and amended in 2000 to strengthen the quality control of products and protect consumers' rights and interests. Under this law, manufacturers and distributors who produce or sell defective products may be subject to confiscation of earnings from such sales, revocation of business licenses and imposition of fines, and in severe circumstances, may be subject to criminal liability.

The Law of the PRC on the Protection of the Rights and Interests of Consumers was promulgated on October 31, 1993 and became effective on January 1, 1994 to protect consumers when they purchase or use goods or services. All business operators must comply with this law when they manufacture or sell goods and/or provide services to customers. In extreme situations, pharmaceutical product manufacturers and distributors may be subject to criminal liability if their goods or services lead to the death or injuries of customers or other third parties.

Price Controls

The retail prices of some pharmaceutical products sold in China, primarily those included in the Essential Drug and Reimbursement Lists and those pharmaceutical products whose production or distribution are deemed to constitute monopolies, are subject to price controls in the form of fixed prices or price ceilings. In particular, manufacturers or distributors cannot freely set or change the retail price for any price-controlled product above the applicable price ceiling or deviate from the applicable fixed price imposed by the PRC government. The prices of medicines that are not subject to price controls are determined freely at the discretion of the respective pharmaceutical companies, subject to notification to the provincial pricing authorities. The National Development and Reform Commission, or the NDRC, may grant premium pricing status to certain pharmaceutical products that are subject to price controls, and may set the price-ceiling of pharmaceutical products that have obtained such status at a level that is significantly higher than comparable products.

The retail prices of medicines that are subject to price controls are administered by the Price Control Office of the PRC National Development and Reform Commission, or the NDRC, and provincial and regional price control authorities. The retail price,

once set, also effectively determines the wholesale price of that medicine. From time to time, the NDRC publishes and updates a list of medicines that are subject to price controls. Fixed prices and price ceilings on medicines are determined based on profit margins that the relevant government authorities deem reasonable, the type and quality of the medicine, its production costs, the prices of substitute medicine and the extent of the manufacturer's compliance with the applicable GMP standards. The NDRC directly regulates the pricing of a portion of the medicine on the list, and delegates to provincial and regional price control authorities the authority to regulate the pricing of the rest of the medicine on the list. Provincial and regional price control authorities have discretion to authorize price adjustments based on the local conditions and the level of local economic development.

Only the manufacturer of a medicine may apply for an increase in the retail price of the medicine, and it must either apply to the provincial price control authorities in the province where it is incorporated, if the medicine is provincially regulated, or to the NDRC, if the medicine is regulated by the NDRC. For a provincially regulated medicine, in cases where provincial price control authorities approve an application, manufacturers must file the newly approved price with the NDRC for record and thereafter the newly approved price will become binding and enforceable across China.

Since May 1998, the relevant PRC governmental authorities have ordered price reductions of thousands of pharmaceutical products. In 2009, 2010 and 2011, approximately 7.7%, 31.1% and 30.0% of our revenue was derived from sales of pharmaceutical products that were subject to price controls, respectively. Any future price controls or government mandated price reductions may have a material adverse effect on our financial condition and results of operations, including significantly reducing our revenue and profitability. See 20F section "Risk Factors — Risks Related to Our Industry — The retail prices of some of our products are subject to control, including period downward adjustment, by PRC governmental authorities."

Reimbursement under the National Medical Insurance Program

Eligible participants in the national medical insurance program, mainly consisting of urban residents, are entitled to purchase medicine when presenting their medical insurance cards in an authorized pharmacy, provided that the medicine they purchase have been included in the Essential Drug and Reimbursement Lists. Depending on relevant local regulations, authorized pharmacies either sell medicine on credit and obtain reimbursement from relevant government social security bureaus on a monthly basis, or receive payments from the participants at the time of their purchases, and the participants in turn obtain reimbursement from relevant government social security bureaus.

Medicine included in the Essential Drug and Reimbursement Lists is divided into two tiers. Purchases of Tier A pharmaceutical products are generally fully reimbursable, except that certain Tier A pharmaceutical products are only reimbursable to the extent the medicine is used for purposes specifically stated in the Essential Drug and Reimbursement Lists. Purchasers of Tier B pharmaceutical products, which are generally more expensive than Tier A pharmaceutical products, are required to make a certain percentage of co-payments, with the remaining amount being reimbursable. The percentage of reimbursement for Tier B over-the-counter pharmaceutical products varies in different regions in the PRC. Factors that affect the inclusion of medicine in the Essential Drug and Reimbursement Lists include whether the medicine is consumed in large volumes and commonly prescribed for clinical use in China and whether it is considered to be important in meeting the basic healthcare needs of the general public.

The PRC Ministry of Labor and Social Security, together with other government authorities, has the power to determine every two years which medicines are included in the national medical insurance catalog, under which of the two tiers the included medicine falls, and whether an included medicine should be removed from the catalog. Provincial governments are required to include all Tier A medicines listed on the national medical insurance catalog in their respective provincial Essential Drug and Reimbursement Lists. For Tier B medicines listed in the national medical insurance catalog, provincial governments have the discretion to adjust upwards or downwards by no more than 15% from the number of Tier B medicine listed in the national medical insurance catalog that is to be included in their respective provincial Essential Drug and Reimbursement Lists. The amount in a participant's individual account under the program varies, depending on the amount of contributions from the participant and his or her employer. Generally, participants under the national medical insurance program who are from relatively wealthier parts of China and metropolitan centers have greater amounts in their individual accounts than those from other parts of the country. Different regions in China have different requirements regarding the limitations on reimbursements in excess of the amounts in the individual accounts.

Sales of Nutritional Supplements and Other Food Products

According to the PRC Food Safety Law that took effect on June 1, 2009 and the Rules on Food Safety Certificate that took effect on July 30, 2009, a distributor of nutritional supplements and other food products must obtain the relevant license for food distribution from relevant local regulatory authorities. The license holder is responsible for establishing and improving its internal rules and management for the food to be distributed, such as establishing internal safety management rules and health examination system, establishing and maintaining employees' health records and keeping records of food inspection and distribution. The license for food distribution is valid for three years, and the holder must apply for renewal of the license within 30 days prior to its expiration.

On October 20, 2010, the Ministry of Health of the PRC published *Administrative Measures for National Food Safety Standards* to promote and supervise the formulation of national standards for food safety in China. Since then, various national food safety standards have been proposed, including *General Rules for Prepackaged Food Labels*, which is expected to take effect on April 20, 2012. These rules apply to all prepackaged food products sold in China and set forth standards and specifications for the labeling of prepackaged food, which would help consumers better understand relevant nutritional and safety information.

Trademarks

The PRC Trademark Law and the PRC Trademark Implementing Regulations provide the basic legal framework for the regulation of trademarks in China, and the SAIC is responsible for the registration and administration of trademarks throughout the country. The PRC has adopted a "first-to-file" principle with respect to trademarks.

PRC law provides that each of the following acts constitutes infringement of the exclusive right to use a registered trademark:

- use of a trademark that is identical with or similar to a registered trademark in respect of the same or similar commodities without the authorization of the trademark registrant;
- sale of commodities infringing upon the exclusive right to use the trademark;
- counterfeiting or making, without authorization, representations of a registered trademark of another person, or sale of such representations of a registered trademark;
- changing a registered trademark and selling products on which the altered registered trademark is used without the consent of the trademark registrant; and
- otherwise infringing upon the exclusive right of another person to use a registered trademark.

In the PRC, a trademark owner who believes the trademark is being infringed can provide his trademark registration certificate and other relevant evidence to the state or local Administration for Industry and Commerce, or AIC, which can, in its discretion, launch an investigation. The AIC may take actions such as ordering the infringer to immediately cease the infringing behavior, seizing and destroying any infringing products and representations of the trademark in question, closing the facilities used to manufacture the infringing products or imposing a fine. If the trademark owner is dissatisfied with the AIC's decision, he may institute civil proceedings against the infringer in court.

The trademark owner may also institute civil proceedings directly in court. Civil remedies for trademark infringement include:

- injunctions;
- requiring the infringer to take steps to mitigate the damage, such as publishing notices in newspapers; and
- damages, such as compensation for the economic loss and injury to reputation as a result of trademark infringement suffered by the trademark owner.

The amount of compensation is calculated according to either the gains acquired by the infringer from the infringement, or the losses suffered by the trademark owner, including expenses incurred by the trademark owner to claim and litigate such infringement. If it is difficult to determine the gains acquired by the infringer from the infringement, or the losses suffered by the trademark owner, the court may elect to award compensation of not exceeding RMB500,000.

If the trademark infringement is so serious as to constitute a crime, the trademark owner may file a complaint with the police and the infringer would be subject to investigation for criminal liability in accordance with PRC law.

Dividend Distribution

The principal laws, rules and regulations governing dividends paid by our PRC operating subsidiaries include the Company Law of the PRC (1993), as amended in October 2005, Wholly Foreign Owned Enterprise Law (1986), as amended in 2000, and Wholly Foreign Owned Enterprise Law Implementation Rules (1990), as amended in 2001. Under these laws and regulations, each of our consolidated PRC entities, including wholly foreign-owned enterprises, or WFOEs, and domestic companies in China may pay dividends only out of their accumulated profits, if any, determined in accordance with PRC accounting standards and regulations. In addition, each of our consolidated PRC entities, including WFOEs and domestic companies, is required to set aside at least 10% of its after-tax profit based on PRC accounting standards each year to its statutory surplus reserve fund until the accumulated amount of such reserve reaches 50% of its respective registered capital. These reserves are not distributable as cash dividends. As of December 31, 2011, the accumulated balance of our statutory reserve funds totaled RMB95.2 million (US$15.1 million).

Property and Equipment

Our corporate headquarters are located in Shenzhen, where we lease an aggregate of 1,533 square meters of office space. As of the date of this annual report, we operated one national distribution center located near our headquarters and 16 regional distribution centers with a combined total of approximately 55,784 square meters of space.

Substantially all of our store space is leased from third parties. Our leases in respect of those properties generally have a five-year term. As of December 31, 2011, 1,259 leases (covering an aggregate gross floor area of approximately 139,076 square meters, equivalent to approximately 53.9% of the total gross floor area of properties we occupied) will terminate within two years. We must negotiate with the landlords for an extension of the old leases or enter into new leases upon their termination, and our landlords may request a rent increase. Under applicable PRC law, we have priority over other potential lessees with respect to the leased store space on the same terms. Our community stores are normally relatively small in size and the facilities inside the store are easily movable. As a result, we do not expect our drugstore operations to be materially and adversely affected by any failure to renew or enter into new leases.

As of December 31, 2011, we had 2,435 leased properties with an aggregate gross floor area of 330,329 square meters, of which 258,144 square meters were used as drugstores. 255 or approximately 10.5% of these leased properties had defects in their legal titles, which as a percentage of leased properties is lower than in 2010. This decrease was largely due to the closure of some of the older stores with legal title defects and the correction of legal title defects when we renewed leases for our stores. Of all of the properties with defects in legal titles, 27,048 square meters were used as drugstores, equivalent to approximately 10.5% of the total gross floor area of our drugstores. The defects in title with respect to these properties generally fall into two categories: (i) the proper property title deeds cannot be obtained from the relevant landlord; and (ii) the identity of the landlord as it appears on the relevant leasing contract does not match the identity of the registered owner as it appears on the property title deeds and a formal approval by the registered owner as noted on the property title deeds for the lease of the property to us cannot be obtained by the relevant parties. The total floor area of properties with the former type of defects in title was 18,897 square meters, or approximately 7.3% of the total gross floor area of our drugstores, and with the latter type of defects in title was 8,151 square meters, or approximately 3.2% of the total gross floor area of our drugstores. In addition, 102,310 square meters, or approximately 31.0% of our leased properties, including properties with defects in title, have not been registered as required by applicable PRC regulations.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Operating Results

Overview

Since our inception in 1995, we have expanded our operations through organic growth and selective acquisitions of drugstores in China. In 2009, we acquired a total of seven stores, consisting of five stores in Beijing from Beijing Zeruntang Medical Ltd. and two stores in Shanghai from Shanghai Riye Chain Co., Ltd. In 2010, we acquired three other stores from Shanghai Riye Chain Co., Ltd., six stores from Beijing Xiang Yun Kang Drugstore and eight stores from Wenzhou Ren Ren Hao Chain Drugstore Co., Ltd. In 2011, we completed the acquisition of another store from Shanghai Riye Chain Co., Ltd. We accounted for these acquisitions using the acquisition method of accounting under FASB ASC Topic 805, *Business Combinations*. See note 8 to our audited consolidated financial statements included in this annual report. We also close stores that do not perform well. As of December 31, 2011, we had a total of 2,395 directly operated drugstores.

We believe that we have the leading market position in a number of the most developed cities in China, including Shenzhen, Dalian, Hangzhou, Ningbo and Suzhou, in terms of store count. Our total revenue was RMB2,217.6 million, RMB2,356.6 million and RMB2,491.3 million (US$395.8 million) and our net income was RMB140.0 million, RMB16.5 million and RMB35.9 million (US$5.7 million) in 2009, 2010 and 2011, respectively.

The major financial performance indicators that our management uses to manage and assess our business include our revenue, average daily revenue per store, sales per customer visit, gross profit and gross margin, operating income, private label product revenue as a percentage of total revenue, inventory turnover days and cash flow from operating activities. The major non-financial performance indicators that our management uses to manage and assess our business include number of stores, number of customer visits per store per day and the average time required for us to open a new store.

Factors Affecting Our Results of Operations

We believe that the most significant factors that affect our results of operations are:

- the size of the retail market of pharmaceutical products in China and changes in government regulations affecting the drugstore industry;
- our ability to manage our drugstore network;
- our ability to optimize product offerings and increase sales, including the sales of private label products;
- our ability to control procurement cost and optimize product pricing; and
- our ability to control operating expenses and achieve a high level of operating efficiency.

The Size of the Retail Market of Pharmaceutical Products in China and Changes in Government Regulations Affecting the Drugstore Industry

Our business and revenue growth depend on the size of the retail market of pharmaceutical products in China. Retail sales of pharmaceutical products in China have grown significantly in recent years. In the medium-to long-term, we believe that future growth in the Chinese drugstore industry will be driven by compelling industry fundamentals and favorable demographics. In particular, the increasing wealth and disposable income of Chinese people, an aging and more health conscious population and continued urbanization will contribute to the continued growth of the drugstore industry in China in the foreseeable future.

In particular, regulatory changes in China are expected to affect the growth of drug sales at retail drugstores. On one hand, beginning in 1998, reimbursements under the national medical insurance program have become available for purchases of medicines from designated retail pharmacies. In addition, the PRC government authorities have imposed additional restrictions on the advertisement of drugs in recent years, which we expect to increase drug manufacturers' reliance on retail drugstores to build brand familiarity among the general public. Furthermore, regulations were passed in 2005 to encourage the separation of pharmacy functions from the medical services offered by hospitals. On the other hand, in 2008, the enforcement of a PRC regulation restricting drugstores from selling products with certain steroid ingredients had a negative impact on our revenue growth.

In March 2009, the State Council announced plans to establish community health clinics in urban areas, which would provide essential drugs to patients at or near cost. While we believe that these community health clinics will primarily serve lower income, more price sensitive customers, compared to those primarily served by our stores, these community health clinics may attract customers who would otherwise purchase drugs from our stores, alter foot traffic into our stores or otherwise directly or indirectly compete with us, which could have a material adverse effect on our financial condition, results of operations and prospects.

In August 2009, the PRC Ministry of Health established the Essential Drug List, which contains 205 chemical drugs and 102 traditional Chinese medicines. In October 2009, the NDRC implemented price ceilings on 2,349 pharmaceutical products, including drugs or medicines on the Essential Drug and Reimbursement Lists, which included 1,728 pharmaceutical products carried by our stores. Due in part of the implementation of these price ceilings, our gross margins experienced downward pressure in 2009 as compared to 2008 and continued to experience downward pressure in 2010. In March 2011, the NDRC implemented price ceilings on 1,265 types of drugs, mainly commonly-used antibiotics and circulatory system medications, including 460 pharmaceutical products carried by our stores. If more pharmaceutical products carried by our stores become subject to price ceilings or if any reductions in existing price ceilings are implemented, our gross margins could be further reduced and our net income and profitability could be materially reduced. In addition, effective July 1, 2012, pursuant to the Interim Measures on the Price Control of Drugs, enacted by the NDRC, the selling price in not-for-profit hospitals and other not-for-profit healthcare institutions for any pharmaceutical product that is subject to price control cannot exceed the higher of 25% of the sourcing price or an additional RMB69. Since a substantial number of drugs carried in our stores are also available for distribution through hospitals, such price control may have a material adverse effect on our revenue and profitability.

We believe that our extensive store network and operational expertise, strong brand name and expansion plan provide us with a strong platform and we are well-positioned to capture growth opportunities in China's drugstore industry.

Our Ability to Manage Our Drugstore Network

We earn our revenue primarily from the sale of products carried by our drugstores, and our ability to increase revenue is directly affected by the number of drugstores in our network and our revenue per drugstore. Historically, we have expanded our retail network through both organic growth and acquisitions of stores. The following table sets forth certain information with respect to our stores for the periods indicated:

	Year Ended December 31,		
	2009	2010	2011
Number of stores at the beginning of the year	2,709*	2,479	2,547
Number of stores at the end of the year	2,479	2,547	2,395

* Includes stores operated by JZJ, which was deconsolidated from our financial results in 2009.

During 2011, our stores served an average of approximately 64 customers per day per store. Our customer visits in 2011 decreased as compared with 70 customers per day per store in 2010, primarily because ongoing healthcare reform has led to diversion of customers who might otherwise purchase drugs from our stores but instead visit community health clinics to purchase drugs or medicines on the Essential Drug and Reimbursement Lists at or near cost. In addition, increased competition from other retail drugstore chains, independent drugstores, convenience stores, grocery stores, supermarkets, discount merchandisers and mass merchants further reduced our customer visits in 2011.

We believe that store location is an important factor driving our store sales. Our goal is to establish stores in clusters in well-developed cities in China. Within each major city, we aim to locate our stores in well-established residential communities. We plan to focus our near term expansion in our existing markets where we can leverage our existing distribution centers and other infrastructure. In 2011, in order to manage our stores more effectively and to improve the overall quality of store sales performance, we closed 228 stores, most of which were performing below our expectations. We also slowed the pace of new store openings, as new stores generally incur high initial costs, but generate lower revenues during their first two years of operations.

For our drugstores that had been opened prior to December 31, 2009, the average daily revenue per store increased from RMB2,612 in 2010 to RMB2,838 in 2011. The increase was mainly due to our effort in expanding product offerings into non-pharmaceutical categories, streamlining our store operations, as well as closing poorly performing stores.

	2010		2011	
	Number of drugstores as of year end	Daily Average Revenue per Store	Number of drugstores as of year end	Daily Average Revenue per Store
Opened prior to December 31, 2008	2,078	2,701	1,883	2,955
Opened in 2009	235	1,479	217	1,841
Opened prior to December 31, 2009	2,313	2,612	2,100	2,838

Our Ability to Optimize Product Offerings and Increase Sales, including Sales of Private Label Products

The following table sets out a breakdown of our revenue by product categories for the periods indicated:

	Year Ended December 31,						
	2009		2010		2011		
	RMB	% of Revenue	RMB	% of Revenue	RMB	US$	% of Revenue
Prescription drugs	515,472	23.2	503,403	21.4	495,352	78,704	19.9
Over-the-counter drugs	818,919	36.9	866,634	36.8	911,412	144,809	36.6
Nutritional supplements	455,343	20.6	452,642	19.2	450,714	71,611	18.1
Herbal products	80,549	3.6	86,873	3.7	99,627	15,829	4.0
Other products (1)	347,330	15.7	447,052	18.9	534,185	84,873	21.4
Total	2,217,613	100.0	2,356,604	100.0	2,491,290	395,826	100.0

(1) Includes personal care, family care and convenience products.

Our ability to optimize product offerings is an important factor affecting customer visits, store traffic, sales volume, and margins thus affecting our results of operations. It is essential for us to balance the brand name products, which are popular among customers, and private label products, which generate higher margin. In addition, we also need to balance our offering of pharmaceutical products and non-pharmaceutical products to achieve the right balance of store traffic, sales volume and margins. As a result, we continuously review and refine our product offerings to respond to changing demographics, lifestyles, habits and preferences of customers. We aim to improve our product range to increase sales volume and revenue in a competitive market.

We generate a substantial portion of our revenue from sales of prescription drugs, over-the-counter drugs and nutritional supplements. In particular, sales of prescription drugs accounted for 19.9% of our revenue in 2011, sales of over-the-counter drugs accounted for 36.6% of our revenue in 2011 while sales of nutritional supplements accounted for 18.1% of our revenue in 2011.

In 2011, we expanded our product offerings and introduced 208 new non-pharmaceutical products, of which 48 are private label products. Sales of food, household, personal care and other products accounted for 21.4% of our revenue in 2011. We plan to continue to expand our offering of personal care, family care and convenience products, which we believe will increase expenditure per customer visit by providing greater one-stop shopping convenience for our customers. We believe that our extensive store network and operational expertise, strong brand name and expansion plan provide us with a strong platform to capture growth opportunities in China's retail market for convenience products and we expect revenue from non-pharmaceutical products to increase at a faster pace compared to those of our pharmaceutical products in future periods.

Our private label products generally have higher margins than our other products, because we are able to eliminate much of the manufacturers' promotional costs in the sourcing of our private label products and the distributors' profit margin in the traditional merchandise supply chain. We launched our first private label product in September 2005, and since then our private label portfolio has increased to 1,885 products marketed under 148 private labels as of December 31, 2011, covering all categories of products we offer. The increase in private label product sales was a significant factor contributing to the increases in our gross margin since late 2005.

To develop our private label products, we have also obtained rights to use an aggregate of 512 additional trademarks, including 251 registered trademarks that we have obtained exclusive rights to use, 248 registered trademarks that we have obtained non-exclusive rights to use, and 13 trademarks that are in the process of being registered by subsidiaries of the Neptunus Group. We use these licensed trademarks to develop our private label products. As of December 31, 2011, we have developed 1,885 private label products with these licensed trademarks. Private label products accounted for approximately 29.4% and 30.0% of our revenue, and 41.1% and 41.3% of our gross profit in 2010 and 2011, respectively. Private label branding also gives us more freedom and flexibility in pricing and more control over product attributes and quality.

The following tables set forth certain information with respect to our private label products for the year ended December 31, 2011:

	Private Label Revenue as a Percentage of Revenue of the Category
Prescription drugs	16.7%
Over-the-counter drugs	19.7%
Nutritional supplements	61.7%
Herbal products	29.6%
Others (1)	33.2%

	Private Label Revenue as a Percentage of Revenue of the Category
Total [2]	30.0%

(1) Includes personal care, family care and convenience products.
(2) Certain private labels are used in multiple categories of products.

Our Ability to Control Procurement Cost and Optimize Product Pricing

Our cost of goods sold represents primarily our purchase cost of merchandise. No depreciation or amortization is included in our cost of goods sold because our business does not involve manufacturing, and the amount of property and equipment we use in acquiring, warehousing and transporting merchandise to our stores is limited and hence the related depreciation and amortization is immaterial. We have been consolidating our procurement through centralized purchases from fewer suppliers, which we believe will enable us to procure goods on more favorable terms due to our enhanced bargaining position with our suppliers. We do not expect, however, to be dependent on any particular supplier, and expect to continue purchasing merchandise from a large number of suppliers in the foreseeable future. We currently source our merchandise from 1,440 suppliers, including 625 manufacturers and 815 wholesalers. In 2011, 62.5% of our total purchases were from wholesalers, with the remainder purchased directly from manufacturers. The transaction value of purchases from our largest supplier accounted for 5.3% of our total purchases in 2011. The transaction value of purchases from our largest five suppliers accounted for 17.5% of our total purchases in 2011. We believe that competitive sources are readily available for substantially all of the merchandise we carry in our stores, and our strategy is to consolidate our procurement through centralized purchases from fewer suppliers.

We source the majority of our merchandise from regional manufacturers and wholesalers of drug and non-drug products, and we make pricing decisions for these products, including all of our private label products. We set the retail prices of these products based on various factors, including our procurement costs, our agreements with suppliers, government policy and regulation, competition, customer preference and regional market considerations. In determining prices, we seek to maximize our gross margin as well as remain competitive in the market. For example, we set prices for some of our private label products lower than those of equivalent products. We are able to do so while commanding higher gross margins for our private label products as we are able to eliminate much of the manufacturers' promotional costs in the sourcing of our private label products and distributors' profit margin in the traditional merchandise supply chain. In addition, we source a portion of our drugs from large manufacturers, and the pricing decisions for these products are usually made by the manufacturers based on factors such as the prices of competitive drugs and the expected marketing expenditures.

We purchase and sell certain merchandise from and to the Neptunus Group and its affiliates. In 2009, 2010 and 2011, we purchased merchandise from the Neptunus Group and its affiliates totaling RMB89.6 million, RMB121.4 million and RMB105.2 million (US$16.7 million), respectively, and sold merchandise to the Neptunus Group and its affiliates totaling RMB3.9 million, RMB3.2 million and RMB2.2 million (US$0.4 million), respectively. See "Item 7. Major Shareholders and Related Party Transactions — B. Related Party Transactions — Transactions with Companies in Which a Major Shareholder Had Equity Interests."

A portion of the medicines sold in our stores, primarily those included in the Essential Drug and Reimbursement Lists are subject to price controls in the form of fixed prices or price ceilings. From time to time, the PRC government publishes a list of medicines that are subject to price controls either at the national level or the provincial or regional level. Fixed prices and price ceilings on medicines are determined based on profit margins that the relevant government authorities deem reasonable, the type and quality of the medicine, its production costs and the prices of substitute medicines. Any future price controls or government mandated price reductions may have a material adverse affect on our financial condition and results of operations, including significantly reducing our revenue and profitability.

While carrying medicines subject to price controls generally increases customer traffic and sales of other products, these medicines also generally have lower margins compared to our other products. Since May 1998, the relevant PRC governmental authorities have ordered price reductions of thousands of pharmaceutical products. In 2009, 2010 and 2011, approximately 7.7%, 31.1% and 30.0%, respectively, of our revenue was derived from sales of pharmaceutical products that were subject to price controls. The increase in the number of pharmaceutical products we offered that were subject to price controls from the level of 2009 reflected the inclusion of more pharmaceutical products, especially popular pharmaceutical products, in China's national medical insurance catalog. We expect that sales of pharmaceutical products that are subject to price controls as a percentage of our total revenue to further increase in the future, which we expect to have a negative effect on our gross margin.

Our Ability to Control Operating Expenses and Achieve a High Level of Operating Efficiency

Our ability to control operating expenses and achieve a high level of operating efficiency is a key factor driving our results of operations. The following table sets forth our operating expenses as a percentage of our revenue for the periods indicated:

	Year Ended December 31,		
	2009	2010	2011
Sales, marketing and other operating expenses	38.7%	41.8%	40.7%
General and administrative expenses	4.8%	5.4%	4.8%
Impairment losses of property and equipment	—	0.1%	0.6%
Other expense	—	1.1%	—
Total operating expenses	43.5%	48.4%	46.1%

Our sales, marketing and other operating expenses primarily consist of salaries and benefits of our in-store pharmacists and other store and distribution center staff as well as rental and utility expenses of our stores and distribution centers. Sales, marketing and other operating expenses also include depreciation of leasehold improvements of our stores, distribution centers and store equipment as well as costs associated with organizing promotional and marketing activities. Sales, marketing and other operating expenses as a percentage of our revenue increased from 38.7% in 2009 to 41.8% in 2010 due to increased salary, rental and distribution costs which were related to the expansion of our product offering into non-pharmaceutical categories. Sales, marketing and other operating expenses as a percentage of our revenue decreased from 41.8% in 2010 to 40.7% in 2011 due to the growth of revenue and closure of underperforming stores. We expect our total sales, marketing and other operating expenses to increase as a result of inflation as well as future growth of our business.

Our general and administrative expenses primarily consist of salaries and benefits for our management and administrative personnel, rental and utility expenses of premises used for administrative purposes, depreciation of our administrative equipment, fees and expenses of legal, accounting and other professional services, office consumables and other expenses associated with our administrative offices. We expect general and administrative expenses to increase as we recruit additional professionals and incur additional costs as a result of inflation as well as future growth of our business.

Other key factors affecting our operating expenses include the following:

- ***Inventory levels.*** We must maintain sufficient inventory levels to meet our customers' needs while balancing the risk of accumulating excess inventory. Carrying excess inventory would increase our inventory holding costs, and failure to have sufficient inventory could cause us to lose customers, either of which could reduce our revenue and profitability. In 2009, 2010 and 2011, our inventory turnover days, calculated as the average of inventory at the beginning of the year and inventory at the end of the year, divided by cost of goods sold for the year and then multiplied by 365, was 111 days, 123 days and 120 days, respectively. The increase in inventory turnover days from 2009 to 2010 was primarily caused by build-up of inventory due to the expansion of our product offerings to include convenience and other non-pharmaceutical products. The decrease in inventory turnover days from 2010 to 2011 was due to the fact that we tightened our inventory control.
- ***Costs associated with closing underperforming stores***. We closed 113, 168 and 228 underperforming stores during 2009, 2010 and 2011 respectively. The cost associated with closing underperforming stores are RMB6.3 million, RMB5.7 million and RMB8.6 million (US$1.4 million) for 2009, 2010 and 2011 respectively.
- ***The amount of time required to open new stores.*** The amount of time required for us to open new stores, measured from date of initial occupation to commencement date of operations, shortened from an average of 39 days in 2009 to 38 days in 2010 and further to 36 days in 2011. The amount of time required for us to open new stores is primarily determined by the amount of time the relevant local government authority takes to grant license for us to open our new stores. As part of our efforts to continue to reduce the amount of time for new stores to become profitable, we have developed uniform standards and streamlined our store operations through centralized management.

Seasonality

Our business is subject to seasonal variations in demand. In particular, traditional retail seasonality affects the sales of nutritional supplements, herbal products, personal and family care products, convenience products and certain drugs. Sales of our pharmaceutical products typically benefit in the fourth quarter from the winter cold season, and are lower in the first quarter of each year because the Chinese New Year holidays are in the first quarter of each year, which result in our customers generally pay fewer visits to drugstores during this period. Sales of some health and beauty products are also driven, to some extent, by seasonal purchasing patterns and seasonal product changes.

Taxation

The CIT Law provides that enterprises established outside of China whose "de facto management bodies" are located in China are considered "resident enterprises" and are generally subject to the uniform 25% enterprise income tax rate as to their worldwide income. Under the implementation regulations for the CIT Law, "de facto management body" is defined as a body that has material and overall management and control over the manufacturing and business operations, personnel and human resources, finances and treasury, and acquisition and disposition of properties and other assets of an enterprise. Although substantially all of our operational management is currently based in the PRC, our listed entity itself does not have a place of business in the PRC. We cannot assure you that PRC tax authorities would agree to treat us as a non-resident enterprise for PRC tax purposes.

Under the CIT Law and implementation regulations, PRC income tax at the rate of 10%, or the lower applicable tax rate if specified in a tax treaty, is applicable to dividends payable to investors that are "non-resident enterprises," which do not have an establishment or place of business in the PRC, or which have such establishment or place of business but the relevant income is not effectively connected with the establishment or place of business, to the extent such dividends are derived from sources within the PRC. As we derive substantially all of our revenue and income from our operations in China, if we are considered to be a "non-resident enterprise" for PRC tax purposes, dividends to be paid by our PRC subsidiaries to us will be subject to PRC income tax.

All of our operating subsidiaries, including the regional Nepstar companies, were incorporated in the PRC. Prior to January 1, 2008, certain subsidiaries and tax paying retail store entities located and conducting operations in the Shenzhen Special Economic Zones, Zhuhai Special Economic Zones and the Yunnan Province in the PRC were subject to a preferential tax rate of 15%. Under the implementation rules of the CIT Law, companies that enjoyed preferential income tax rates prior to January 1, 2008 have a five-year period to transition to the 25% statutory income tax rate. In particular, companies that were subject to a tax rate of 15% would be subject to tax rates of 18%, 20%, 22%, 24% and 25% in 2008, 2009, 2010, 2011 and 2012 onwards, respectively. Accordingly, our operating subsidiaries and retail store entities in Shenzhen and Zhuhai were subject to 20%, 22% and 24% income tax rates in 2009, 2010 and 2011, respectively, and are subject to a 25% income tax rate in 2012 and onwards. Our subsidiaries outside of Shenzhen and Zhuhai have been subject to the 25% statutory income tax rate since January 1, 2008.

Critical Accounting Policies

We prepare our consolidated financial statements in accordance with U.S. GAAP, which requires us to make judgments, estimates and assumptions that affect: (i) the reported amounts of our assets and liabilities; (ii) the disclosure of our contingent assets and liabilities at the end of each reporting period; and (iii) the reported amounts of revenue and expenses during each reporting period. We continually evaluate these estimates based on our own historical experience, knowledge and assessment of current business and other conditions, our expectations regarding the future based on available information and reasonable assumptions, which together form our basis for making judgments about matters that are not readily apparent from other sources. Since the use of estimates is an integral component of the financial reporting process, our actual results could differ from those estimates.

We believe that any reasonable deviation from those judgments and estimates would not have a material impact on our financial condition or results of operations. To the extent that the estimates used differ from actual results, however, adjustments to the statements of income and corresponding balance sheet accounts would be necessary. These adjustments would be made in future financial statements.

When reading our financial statements, you should consider: (i) our critical accounting policies; (ii) the judgment and other uncertainties affecting the application of such policies; and (iii) the sensitivity of reported results to changes in conditions and assumptions. We believe the following accounting policies involve the most significant judgment and estimates used in the preparation of our financial statements.

Realization of Deferred Tax Assets

We account for deferred income taxes using the asset and liability method required by FASB ASC Topic 740, *Income Taxes*. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and tax loss carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

At each balance sheet date, we assess the need to establish a valuation allowance that reduces deferred tax assets when it is more likely than not that all, or some portion, of the deferred tax assets will not be realized. A valuation allowance would be based on all available information including but not limited to our projections of future taxable income, which take into account the market environment for each of the tax-paying entities within the period during which temporary differences reverse or before our tax loss carry-forwards expire, and any available tax planning strategies. Sufficient negative evidence, such as cumulative net losses during a three-year period that includes the current year and the prior two years, may require that a valuation allowance be established with respect to the deferred tax assets. The deferred tax assets balance is analyzed regularly by management. Based on our historical operating results and projections for our future taxable income over the periods during which the tax loss can be utilized, we believe it

is more likely than not we will not realize some portion of our deferred tax assets and, as a result, a valuation allowance of RMB37.4 million was provided for as of December 31, 2011. Projections of future taxable income incorporate several assumptions of future business and operations that may differ from actual experience. If, in the future, our assumptions and estimates that resulted in our projections for future taxable income for each tax-paying component prove to be incorrect, the valuation allowance against our deferred tax assets may be adjusted.

Share-Based Compensation

We account for share-based compensation in accordance with FASB ASC Topic 718, *Compensation — Stock Compensation*, or ASC Topic 718, under which we are required to measure the fair value of employee share options on the date of the option grant, and recognize shared-based compensation expense in our consolidated statements of income over the period during which an employee is required to provide services in exchange for the award, which is generally the vesting period. In connection with the Pre-IPO Share Option Scheme, we granted 1,000,000 options, 6,680,000 options, and 1,000,000 options on August 30, 2005, March 20, 2006, and September 1, 2006, respectively. The exercise price was US$0.075 per share for options granted on August 30, 2005 and US$0.75 per share for options granted on March 20, 2006 and September 1, 2006. With respect to such options granted on August 30, 2005, 25.0% of such options vested immediately on the date of grant and the remaining 75.0% of the options vest over a three year period in 12 equal three-monthly installments. With respect to the options granted on March 20, 2006 and September 1, 2006, 25.0% of such options vested immediately on the respective dates of grant and the remaining 75.0% of such options vest over a four year period in eight equal six-monthly installments.

In 2009, we recognized share-based compensation expenses allocated to sales, marketing and other operating expenses and general administrative expenses in the amounts of RMB73,000 and RMB13,000, respectively. In 2010, we recognized share-based compensation expenses allocated to sales, marketing and other operating expenses and general administrative expenses in the amounts of RMB18,000 and RMB51,000 , respectively. As of December 31, 2011, all of the share options under the Pre-IPO Scheme have been vested and we did not have any unrecognized share-based compensation expense related to unvested options issued under the Pre-IPO Scheme.

We determined the fair value of employee share options granted under the Pre-IPO Share Option Scheme using the Black-Scholes option pricing model based on the assumptions shown in the table below. Under this option pricing model, certain assumptions, including the risk-free interest rate, the expected term of the options, the expected dividends on the underlying ordinary shares, and the expected volatility of the price of the underlying shares for the expected term of the options, are required in order to determine the fair value of the options. In addition, our ordinary share price on the date of the option grant affects the fair value of the options. Changes in these assumptions could significantly affect the option fair value and hence the amount of compensation expense we recognize in our consolidated financial statements.

	Awards granted on August 30, 2005	Award granted on March 20, 2006	Awards granted on September 1, 2006
Expected dividend yield	0%	0%	0%
Expected volatility	39.17%	36.80%	35.19%
Risk-free interest rate	4.69%	5.26%	5.27%
Expected life (in years)	4.85	4.59	4.30
Estimated fair value of underlying ordinary shares (US$ per share)	0.46	0.49	0.57

On June 30, 2007, our shareholders adopted the 2007 Share Incentive Plan, or the 2007 Plan. The 2007 Plan authorizes us to issue up to 8,680,000 shares of our ordinary shares in the form of share options, share appreciation rights and other share-based awards to its employees, directors or consultants. Under the 2007 Plan, the exercise price of the option shall not be less than the fair market value of our ordinary share on the date of grant.

In connection with the 2007 Plan, we granted 200,000 options, 600,000 options, 1,000,000 options and 50,000 non-vested ordinary shares to management on November 9, 2007, January 5, 2009, January 5, 2010 and March 2, 2010, respectively. On March 2, 2010, we also granted an aggregate of 150,000 fully vested ordinary shares to our three independent directors in exchange for their forfeiture of 150,000 options granted on November 9, 2007. On January 5, 2010, we granted an aggregate of 800,000 options to Mr. Jason Xinghua Wu, our former chief executive officer. Upon Mr. Wu's resignation in August 2011, 600,000 unvested options of the 800,000 options granted to him were forfeited immediately and the remaining 200,000 vested options were forfeited in February 2012.

In connection with the share options granted under the 2007 Plan, we recorded share-based compensation expense of RMB2.9 million and RMB5.7 million in 2009 and 2010, respectively. In 2011, 600,000 unvested share options granted to a former chief executive officer were forfeited. As a result, the corresponding share-based compensation costs recognized in previous years for

the unvested share options were reversed and an amount of RMB1.2 million (US$0.2 million) was credited to general and administrative expenses.

The fair value of the options granted under the 2007 Plan was determined using the binomial option pricing model based on following assumptions at the date of grant:

	Awards Granted On		
	November 9, 2007	January 5, 2009	January 5, 2010
Expected dividend yield	1.67%	2.54%	6.43%
Expected volatility	40.74%	41.76%	35.67%
Risk-free interest rate	4.23%	2.54%	3.86%
Option life (in years)	10	10	10
Forfeiture rate	0%	0%	0%
Suboptimal exercise factor	1.5	1.5	1.5

Depreciation and Amortization

Our long-lived assets include property and equipment and intangible assets. We amortize our long-lived assets using the straight-line method over the estimated useful lives of the assets. We make estimates of the useful lives of property and equipment (including the salvage values), and intangibles, in order to determine the amount of depreciation and amortization expenses to be recorded during any reporting period. We amortize leasehold improvements of our retail drugstores and other business premises over the shorter of five years or the lease term. A majority of our leases have a five-year term. We estimate the useful lives of our other property and equipment at the time we acquire the assets based on our historical experience with similar assets as well as anticipated technological and other changes. If technological changes were to occur more rapidly than anticipated or in a different form than anticipated, we may shorten the useful lives assigned to these assets as appropriate, which will result in the recognition of increased depreciation and amortization expense in future periods. There was no change to the estimated useful lives and salvage values in 2009, 2010 and 2011.

Impairment of Long-Lived Assets

We evaluate long-lived assets, including property and equipment and intangible assets, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. We assess recoverability by comparing the carrying amount of an asset to the estimated undiscounted future cash flow expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated undiscounted future cash flows, we recognize an impairment charge based on the amount by which the carrying amount of the asset exceeds the fair value of the asset. We estimate the fair value of the asset based on the best information available, including prices for similar assets and in the absence of an observable market price, the results of using a present value technique to estimate the fair value of the asset. We did not recognize any impairment charges on our long-lived assets in 2009. We recognized impairment losses of RMB3.4 million and RMB14.2 million (US$2.3 million) in 2010 and 2011, respectively, with respect to leasehold improvements and store fixtures of certain loss-making stores.

Impairment of Goodwill

Our goodwill represents the excess of the purchase price over the fair value of the identifiable net assets acquired in business combinations. We evaluate goodwill at least annually for impairment, and more frequently if events and circumstances indicate that it might be impaired. We evaluate the recoverability of goodwill using a two-step impairment test approach at the reporting unit level at the end of each year. The first step of the impairment test involves comparing the fair value of our reporting unit with the reporting unit's carrying amount, including goodwill. Next, if the carrying amount of the reporting unit exceeds its fair value, we then recognize an impairment loss for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. We determine the implied fair value by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation, in accordance with FASB ASC Topic 805, *Business Combinations*. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill. We did not recognize any goodwill impairment loss in 2009, 2010 or 2011.

Inventories

Our inventories are stated at the lower of cost, determined under the weighted average cost method, or market value. Our inventories are not subject to significant risk of obsolescence. We manage our inventory level based on historical sales trends, forecasted customer demand and lead time in supplier delivery. We identify inventories of medicine products which have remaining shelf life of six months or less, which under the terms of our purchase agreements, may be returned to the suppliers in exchange for new batches of products. Our inventory write-downs due to shrinkage losses and damaged merchandise in 2009, 2010 and 2011 were RMB8.7 million, RMB9.4 million and RMB9.4 million (US$1.5 million), respectively.

Results of Operations

The following table sets forth a summary of our statements of income for the periods indicated. Our historical results presented below are not necessarily indicative of the results that may be expected for any other future period.

	Year Ended December 31,						
	2009		2010		2011		
	RMB	% of Revenue	RMB	% of Revenue	RMB	US$	% of Revenue
	(In thousands, except percentages and per share data)						
Revenue	2,217,613	100.0	2,356,604	100.0	2,491,290	395,826	100.0
Cost of goods sold	(1,143,398)	(51.6)	(1,192,665)	(50.6)	(1,302,653)	(206,971)	(52.3)
Gross profit	1,074,215	48.4	1,163,939	49.4	1,188,637	188,855	47.7
Operating expenses:							
Sales, marketing and other operating expenses (1)	(858,072)	(38.7)	(985,510)	(41.8)	(1,015,165)	(161,294)	(40.7)
General and administrative expenses (2)	(105,652)	(4.8)	(128,196)	(5.4)	(120,671)	(19,173)	(4.9)
Impairment losses of property and equipment	—	—	(3,423)	(0.1)	(14,164)	(2,250)	(0.6)
Other expense (3)	—	—	(25,540)	(1.1)	—	—	—
Income from operations	110,491	5.0	21,270	0.9	38,637	6,138	1.5
Net interest income (4)	72,828	3.3	22,723	1.0	23,154	3,679	0.9
Dividend income from cost method investments	3,776	0.2	3,028	0.1	3,616	575	0.1
Equity in income of an equity method investee	5,128	0.2	5,808	0.2	1,552	247	0.1
Other income	8,927	0.4	—	—	—	—	—
Income tax expense	(61,174)	(2.8)	(36,321)	(1.5)	(31,026)	(4,930)	(1.2)
Net income attributable to noncontrolling interest	—	—	—	—	—	—	—
Net income attributable to China Nepstar Chain Drugstore Ltd.	139,976	6.3	16,508	0.7	35,933	5,709	1.4
Earnings per ordinary share							
Basic	0.67		0.08		0.17	0.03	
Diluted	0.66		0.08		0.17	0.03	

(1) Sales, marketing and other operating expenses included share-based compensation expenses of RMB73,000 in 2009, RMB18,000 in 2010 and nil in 2011.

(2) General and administrative expenses included share-based compensation expenses of RMB2.9 million in 2009 and RMB5.8 million in 2010, and reversal of expense of RMB1.2 million (US$0.2 million) in 2011.

(3) Other expense in 2010 consists of a one-time non-recurring penalty of RMB25.5 million, which SAFE assessed against us for failing to comply with relevant procedures, citing that the purposes for the conversion of net proceeds from our initial public offering as stated at the time of conversion were not entirely consistent with our subsequent use of such proceeds. We fully paid the penalty in July 2010.

(4) Net interest income includes "interest income" and "interest expense" set forth in our consolidated financial statements included elsewhere in this annual report.

Comparison of Years Ended December 31, 2010 and December 31, 2011

Revenue. Our revenue was RMB2,491.3 million (US$395.8 million) in 2011 compared to RMB2,356.6 million in 2010. This increase in revenue was principally the result of an increase of approximately 8.7% in same store sales in 2011 compared to 2010. The average daily revenue per store for stores opened prior to December 31, 2009 increased from RMB2,612 in 2010 to RMB2,838 (US$451) in 2011. The increases in revenue as well as same store sales are attributable to the efforts in constant optimization of the merchandise mix through diversification into non-pharmaceutical categories and effective execution of marketing programs in the fourth quarter of the year. Sales of over-the-counter drugs accounted for 36.8% and 36.6% of our revenue in 2010 and 2011,

respectively; sales of prescription drugs accounted for 21.4% and 19.9% of our revenue in 2010 and 2011, respectively; and sales of nutritional supplements accounted for 19.2% and 18.1% of our revenue in 2010 and 2011, respectively.

Gross Profit. Our gross profit was RMB1,188.6 million (US$188.9 million) in 2011 compared to RMB1,163.9 million in 2010. Our gross margin was 47.7% in 2011 compared to 49.4% in 2010. The decrease in gross margin was primarily due to our changes in product mix by introducing more non-pharmaceutical products and negative impact from the mandatory price controls on pharmaceuticals by the PRC government authorities. We expect our gross margin to decline gradually in the near to mid term as we anticipate further price reductions on pharmaceutical products mandated by the PRC governmental authorities. Also, we will continue to increase our offerings of non-pharmaceutical products, which is expected to generate lower gross margins compared to pharmaceutical products.

Operating Expenses. Our operating expenses were RMB1,150.0 million (US$182.7 million) in 2011 compared to RMB1,142.7 million in 2010. Operating expenses as a percentage of our revenue was 46.1% in 2011 compared to 48.4% in 2010.

- ***Sales, Marketing and Other Operating Expenses.*** Our sales, marketing and other operating expenses increased by 3.0% to RMB1,015.2 million (US$161.3 million) in 2011 from RMB985.5 million in 2010. This increase was primarily due to increased salaries in connection with minimum wage adjustments and higher rental costs in the inflationary property-for-rent market. Sales, marketing and other operating expenses as a percentage of our revenue was 40.7% in 2011 compared to 41.8% in 2010.
- ***General and Administrative Expenses.*** Our general and administrative expenses decreased by 5.9% to RMB120.7 million (US$19.2 million) in 2011 from RMB128.2 million in 2010. The decrease was primarily due to various cost control measures taken by management, including control over our headcount. General and administrative expenses as a percentage of our revenue was 4.8% in 2011 compared to 5.4% in 2010.
- ***Impairment Losses***. We recognized impairment losses of RMB 3.4 million and RMB14.2 million (US$2.3 million) in 2010 and 2011, respectively, in respect of leasehold improvements and store fixture of certain loss-making drugstores. The increase in impairment loss in 2011 reflects assessment conducted by the management during the year on certain underperforming stores, some of which will be closed in 2012. Management will carry on the practice of assessment regularly and when appropriate, which may result in future impairment losses.

Income from Operations. As a result of the foregoing, our income from operations was RMB38.6 million (US$6.1 million) in 2011 compared to RMB21.3 million in 2010. Our operating margin was 1.6% in 2011 compared to 0.9% in 2010.

Net Interest Income. Our net interest income increased to RMB23.2 million (US$3.7 million) in 2011 compared to RMB22.7 million in 2010. This increase was principally a result of an increase in deposit interest rates by the PRC government, offset partially by a decrease in balance of cash, cash equivalents and bank deposits due to dividend payment. We paid a special cash dividend of US$0.30 per ADS on or around February 28, 2011 totaling RMB205.2 million (US$32.6 million) to shareholders of record as of the close of business on January 31, 2011.

Dividend Income from Cost Method Investments. Dividends received from our investments in companies accounted for under the cost method were RMB3.6 million (US$0.6 million) in 2011 compared to RMB3.0 million in 2010.

Equity income of an equity method investee. Equity income of an equity method investee was RMB1.6 million (US$0.2 million), compared to that of RMB5.8 million in 2010. The decrease in equity income of an equity method investee was mainly due to the lower net income reported by Yunnan JianZhiJia Chain Drugstore Ltd. in 2011.

Income Tax Expense. Our income tax expense decreased to RMB31.0 million (US$4.9 million) in 2011 from RMB36.3 million in 2010. Our effective tax rate decreased from 68.8% in 2010 to 46.3% in 2011. The decrease in our effective tax rate was primarily due to the fact that 2010 non-deductible one-time non-recurring SAFE penalty did not recur in 2011.

Net Income. As a result of the foregoing, our net income was RMB35.9 million (US$5.7 million) in 2011 compared with RMB16.5 million in 2010.

Comparison of Years Ended December 31, 2009 and December 31, 2010

Revenue. Our revenue was RMB2,356.6 million in 2010 compared to RMB2,217.6 million in 2009. This increase in revenue was principally the result of the increase in the number of our stores from 2,479 in 2009 to 2,547 in 2010 as well as an increase of approximately 2.0% in same store sales in 2010 compared to 2009, due to our strategic expansion of convenience product offerings. The average daily revenue per store for stores opened prior to December 31, 2008 increased from RMB2,649 in 2009 to RMB2,701 in 2010. The increase was mainly due to a series of measures we undertook beginning in the second quarter of 2010, including expanding product offerings, adjusting price ranges, streamlining store operations and enhancing marketing campaigns.

Sales of over-the-counter drugs accounted for 36.9% and 36.8% of our revenue in 2009 and 2010, respectively; sales of prescription drugs accounted for 23.2% and 21.4% of our revenue in 2009 and 2010, respectively; and sales of nutritional supplements accounted for 20.6% and 19.2% of our revenue in 2009 and 2010, respectively.

Gross Profit. Our gross profit was RMB1,163.9 million in 2010 compared to RMB1,074.2 million in 2009. Our gross margin was 49.4% in 2010 compared to 48.4% in 2009. The increase in gross margin was primarily due to adjustment of our product mix as we further refine our product selection to include a greater percentage of high gross margin products, such as centrally procured products and private label products.

Operating Expenses. Our operating expenses were RMB1,142.7 million in 2010 as compared to RMB963.7 million in 2009. Operating expenses as a percentage of our revenue was 48.4% in 2010 compared to 43.5% in 2009.

- ***Sales, Marketing and Other Operating Expenses.*** Our sales, marketing and other operating expenses increased by 14.8% to RMB985.5 million in 2010 from RMB858.1 million in 2009. This increase was primarily due to increased salaries in connection with increased headcount, minimum wage adjustments and higher rental costs in the inflationary property-for-rent market. Sales, marketing and other operating expenses as a percentage of our revenue was 41.8% in 2010 compared to 38.7% in 2009.
- ***General and Administrative Expenses.*** Our general and administrative expenses increased by 21.4% to RMB128.2 million in 2010 from RMB105.6 million in 2009. The increase was primarily due to salary raises for middle and senior management personnel mainly at the branch level. General and administrative expenses as a percentage of our revenue was 5.4% in 2010 compared to 4.8% in 2009.
- ***Impairment Losses***. In 2010, we recognized impairment losses of RMB3.4 million with respect to leasehold improvements and store fixtures of certain loss-making stores. We did not recognize any impairment losses for property and equipment in 2009.
- ***Other Expense.*** In 2010, SAFE assessed a one-time non-recurring penalty of RMB25.5 million against us for failing to comply with relevant procedures, citing that the purposes for the conversion of net proceeds from our initial public offering as stated at the time of conversion were not entirely consistent with our subsequent use of such proceeds. We fully paid the penalty in July 2010.

Income from Operations. As a result of the foregoing, our income from operations was RMB21.3 million in 2010 compared to RMB110.5 million in 2009. Our operating margin was 0.9% in 2010 compared to 5.0% in 2009.

Net Interest Income. Our net interest income decreased significantly to RMB22.7 million in 2010 from RMB72.8 million in 2009. This decrease was principally a result of the decrease in cash, cash equivalents, bank deposits and held-to-maturity securities resulting from our payment of cash dividends, as well as lowered interest rates. We paid a cash dividend of US$0.28 per ADS on or around May 3, 2010 to shareholders of record as of the close of business on April 2, 2010.

Dividend Income from Cost Method Investments. Dividends received from our investments in companies accounted for under the cost method were RMB3.0 million in 2010 as compared to RMB3.8 million in 2009.

Income Tax Expense. Our income tax expense decreased to RMB36.3 million in 2010 from RMB61.2 million in 2009. Our effective tax rate increased from 30.4% in 2009 to 68.8% in 2010. The increase in our effective tax rate was primarily due to the increased valuation allowance recorded against deferred tax assets for tax loss carry-forwards, an increase in non-deductible rental expenses and the non-deductible one-time non-recurring penalty imposed by SAFE.

Net Income. As a result of the foregoing, our net income was RMB16.5 million in 2010 compared with RMB140.0 million in 2009.

Liquidity and Capital Resources

The following table sets forth a summary of our net cash flow information for the periods indicated:

	Year Ended December 31,			
	2009	2010	2011	
	RMB	RMB	RMB	US$
	(In thousands)			
Net cash provided by operating activities	295,280	110,685	108,152	17,183
Net cash provided by investing activities	652,720	769,544	287,647	45,704
Net cash used in financing activities	(814,891)	(736,367)	(250,140)	(39,744)

	Year Ended December 31,			
	2009	2010	2011	
	RMB	RMB	RMB	US$
		(In thousands)		
Net increase in cash	133,128	140,784	141,089	22,417
Cash and cash equivalents at end of the year	486,012	626,796	767,885	122,005

In 2009, 2010 and 2011, we were able to finance a significant portion of our operations and capital investments from our cash flows from operations. As of December 31, 2011, we had RMB767.9 million (US$122.0 million) in cash and cash equivalents. Before 2010, we deposited significant amount of proceeds from our initial public offering with various domestic banks, enrolling in their various wealth management programs, which guarantee principal amounts and provide higher returns compared to ordinary bank deposits. Such deposits were carried as held-to-maturity investment securities in our financial statements and matured in 2010. As of December 31, 2011, no held-to-maturity securities on our balance sheet. As of December 31, 2011, our total cash, cash equivalents and other bank deposits (including long-term bank time deposits) amounted to RMB979.9 million (US$155.7 million). As of December 31, 2011, we had no short-term bank loan balances, as all outstanding short-term bank loans as at December 31, 2009 were repaid in 2010.

We expect to continue to generate positive operating cash flow in 2012. We believe that our current levels of cash and cash flows from operations will be sufficient to meet our anticipated cash needs for at least the next 12 months.

We are a Cayman Islands holding company and substantially all of our income is derived from the operations of our operating subsidiaries located in the PRC. Therefore, dividends paid to us by our subsidiaries in China are subject to income tax if we are considered a "non-resident enterprise" under the PRC Corporate Income Tax Law. See 20F section "Risk Factors — Risks Related to Doing Business in China — Dividends we receive from our operating subsidiaries located in the PRC may be subject to PRC withholding tax."

We plan to further refine our product selection to include more convenience products with lower gross profit margin. We may need additional cash resources in the future if we experience changed business conditions or other developments. We may also need additional cash resources in the future if we find and wish to pursue opportunities for investment, acquisition, strategic cooperation or other similar actions.

If we determine that our cash requirements exceed the amounts of cash on hand, we may seek to issue debt or equity securities or obtain short-term or long-term bank financing, or we may postpone or downsize our investment plan. Any issuance of equity securities could cause dilution for our shareholders. Any incurrence of indebtedness could increase our debt service obligations and cause us to be subject to restrictive operating and financial covenants. It is possible that, when we need additional cash resources, financing will only be available to us in amounts or on terms that would not be acceptable to us or financing will not be available at all.

Operating Activities

Net cash provided by operating activities was RMB108.2 million (US$17.2 million) in 2011 compared to RMB110.7 million in 2010.

Net cash provided by operating activities was RMB110.7 million in 2010 compared to RMB295.3 million in 2009. Net cash provided by operating activities in 2010 was lower by comparison to 2009 primarily as a result of our payment of a one-time non-recurring penalty imposed by SAFE of approximately RMB25.5 million, as well as slower inventory turnover and build-up of inventory due to the change in our merchandising strategy.

Investing Activities

Net cash provided by investing activities was RMB287.6 million (US$45.7 million) in 2011 compared to net cash provided by investing activities of RMB769.5 million in 2010, primarily as the result of a decrease in the proceeds from maturity of held-to-maturity investment securities.

Net cash provided by investing activities was RMB769.5 million in 2010 compared to net cash provided by investing activities of RMB652.7 million in 2009, primarily as a result of an increase in proceeds from maturity of time deposits.

Financing Activities

Net cash used in financing activities was RMB250.1 million (US$39.7 million) in 2011, which primarily consisted of dividends payments in 2011 totaling RMB205.2 million (US$32.6 million).

Net cash used in financing activities was RMB736.4 million in 2010, which primarily consisted of repayment of our short-term bank loans totaling RMB470.0 million and dividend payments in 2010 totaling RMB239.9 million.

Net cash used in financing activities was RMB814.9 million in 2009, which mainly consisted of dividends payments declared in March 2009 and August 2009 totaling RMB1,281.1 million, which was partially offset by an increase of RMB470.0 million in short-term bank loans.

Restrictions on Cash Dividends

For a discussion on the ability of our subsidiaries to transfer funds to our company, and the impact this has on our ability to meet our cash obligations, see 20F section "Risk Factors — Risks Related to Our Corporate Structure — We rely on dividends paid by our consolidated operating subsidiaries to fund any cash and financing requirements we may have, and any limitation on the ability of our consolidated PRC entities to pay dividends to us could have a material adverse effect on our ability to conduct our business," "Risk Factors — Risks Related to Doing Business in China — PRC rules and regulations may subject our PRC resident shareholders and our PRC share option holders to personal liability, limit our ability to inject capital into our consolidated PRC entities, limit the ability of our consolidated PRC entities to distribute profits to us, or otherwise adversely affect us" and "Risk Factors — Risks Related to Doing Business in China — Dividends we receive from our operating subsidiaries located in the PRC may be subject to PRC withholding tax."

Capital Expenditures

In 2009, 2010 and 2011, our capital expenditures totaled RMB81.7 million, RMB58.2 million and RMB32.8 million (US$5.2 million), respectively. In the past, our capital expenditures were used primarily to open drugstores, acquire drugstores through business combinations, set up distribution centers and install and upgrade our integrated information management system. We estimate that our capital expenditures in 2012 will range from approximately RMB40.0 million to RMB60.0 million, which we plan to use to open new stores, remodel existing stores and build new distribution centers in China.

Borrowings

During November 2009, certain financial institutions in the PRC provided us with short-term bank loans in the aggregate amount of RMB410.0 million and credit facilities in the aggregate amount of RMB250.0 million. Time deposits that we had placed with such financial institutions in the amount of RMB500.0 million and RMB250.0 million were pledged as security interests for the short-term bank loan and credit facilities, respectively. The security interests for the short-term bank loans are released upon repayment and the security interests for the credit facilities are released upon the expiration of such facilities, which was three months from the date such credit facilities became available to us. The short-term borrowings were primarily obtained for general working capital purposes, including dividend payments. All outstanding short-term borrowings were repaid in January 2010 and the security deposits were released accordingly. As of December 31, 2011, no short-term borrowings were outstanding.

Inflation

According to the National Bureau of Statistics of China, China's overall national inflation rate, as represented by the general consumer price index, was approximately -0.7% in 2009, 3.3% in 2010 and 5.4% in 2011.

Recently Issued Accounting Pronouncements

For a detailed discussion of recently issued accounting standards, see note 2 to our audited consolidated financial statements included in this annual report.

Intellectual Property

Our rights to our trade names and trademarks are the most important factor in marketing our stores and private label products. Our company's name, Nepstar, means "Neptunus & Star" in Chinese. The trademark "Neptunus," or "Haiwang," is owned by the Neptunus Group, and we have obtained the non-exclusive right to use "Neptunus" for free so long as the trademark is valid through a licensing agreement with the Neptunus Group. The "Haiwang" trademark was designated as a "China Well-Known Trademark" by the SAIC in 2004, and the Neptunus Group may apply to the relevant administrative authority for an injunction prohibiting a third party's use of the "Haiwang" name as well as to compel the third party to cancel any other registration of the "Haiwang" name under certain circumstances. In addition, we have registered four trademarks in China, and are in the process of applying for five additional trademarks. Our trademarks include the Chinese characters for "Star" and related logos.

In addition to "Neptunus," we have also obtained rights to use an aggregate of 512 additional trademarks, including 251 registered trademarks that we have obtained exclusive rights to use, 248 registered trademarks that we have obtained non-exclusive rights to use, and 13 trademarks that are in the process of being registered by subsidiaries of the Neptunus Group. We use these licensed trademarks to develop our private label products. As of December 31, 2011, we have developed 1,885 private label products with these licensed trademarks.

Under PRC law, we have the exclusive right to use a trademark for products and services for which the trademark has been registered with the SAIC. Trademark registration is valid for 10 years, starting from the day the registration is approved. If we believe that a third party has infringed upon our exclusive rights with respect to any of our registered or licensed trademarks, we may, through appropriate administrative and civil procedures, institute proceedings to request the relevant authority for an injunction. The relevant authority also has power to impose fines, confiscate or destroy the infringing products or equipment used to manufacture the infringing products. As our brand names and trademarks become more recognized in the drug market in China, we are devoting additional resources to increasing and enforcing our trademark rights, which is critical to our overall branding strategy and reputation.

We also rely on trade secrets to protect our know-how and other proprietary information. Similar to other retailers, we generate proprietary information in connection with our operations, such as pricing, purchasing, promotional strategies, customer lists and supplier lists. We believe this proprietary information is essential to the operations of our business and the success of our competition strategies, and we strive to protect such information. For example, the key members of our management team have signed a confidentiality agreement with us pursuant to which they have committed not to disclose the confidential information acquired during their employment with us and not to compete with us for three years after their employment terminates.

If our trademarks are challenged, our brand name is damaged and/or our trade secrets become known by our competitors, there could be an adverse effect on our business. See 20F section "Risk Factors — Risks Related to Our Business — Our brand name, trade names, trademarks, trade secrets and other intellectual property are valuable assets. If we are unable to protect them from infringement, our business and prospects may be harmed."

Trend Information

Other than as disclosed elsewhere in this annual report, we are not aware of any trends, uncertainties, demands, commitments or events for the period from January 1, 2011 to the date of this annual report that are reasonably likely to have a material effect on our revenue, net income, profitability, liquidity or capital resources, or that would caused the disclosed financial information to be not necessarily indicative of future operating results or financial conditions.

Off-Balance Sheet Arrangements

We have not entered into, nor do we expect to enter into, any off-balance sheet arrangements. We also have not entered into any financial guarantees or other commitments to guarantee the payment obligations of third parties. In addition, we have not entered into any derivative contracts that are indexed to our equity interests and classified as shareholders' equity. Furthermore, we do not have any retained or contingent interest in assets transferred to an unconsolidated entity that serves as credit, liquidity or market risk support to such entity. We do not have any variable interest in any unconsolidated entity that provides financing, liquidity, market risk or credit support to us or that engages in leasing, hedging or research and development services with us.

Tabular Disclosure of Contractual Obligations

The following table sets forth our contractual obligations as of December 31, 2011:

	Payment due by period				
Contractual Obligations	**Less Than 1 Year**	**1-3 Years**	**3-5 Years**	**More Than 5 Years**	**Total**
	(In thousands of RMB)				
Operating lease commitments	209,840	316,592	84,235	19,575	630,242
Total	209,840	316,592	84,235	19,575	630,242

Safe Harbor

This annual report contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended that relate to our current expectations and views of future events. The forward-looking statements are contained principally in 20F under the sections entitled "Risk Factors," "Information on the Company" and "Operating and Financial Review and Prospects." These statements relate to events that involve known and unknown risks, uncertainties and other factors, including those listed under "Risk Factors," which may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements.

In some cases, these forward-looking statements can be identified by words or phrases such as “aim,” “anticipate,” “believe,” “continue,” “estimate,” “expect,” “intend,” “is/are likely to,” “may,” “plan,” “potential,” “will” or other similar expressions. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, results of operations, business strategy and financial needs. These forward-looking statements include, among other things, statements relating to:

- our growth strategies;
- our future business development, financial condition and results of operations;
- market acceptance of the merchandise we carry in our stores, especially our private label products;
- our ability to identify and respond to changing customer preferences;
- our ability to enhance and maintain our brand names;
- our ability to achieve anticipated volume purchasing benefits;
- our ability to establish effective advertising, marketing and promotional programs;
- our ability to manage our supply chain and our distribution centers;
- our ability to attract and retain a sufficient number of pharmacists for our stores;
- our ability to manage our operations;
- competition from other drugstore chains and independently operated drugstores;
- the expected growth of the drugstore industry in China;
- our ability to obtain permits and licenses to carry on our business; and
- fluctuations in general economic and business conditions in China.

The forward-looking statements made in this annual report relate only to events or information as of the date on which the statements are made in this annual report. We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise, after the date on which the statements are made or to reflect the occurrence of unanticipated events. You should read this annual report and the documents that we reference in this annual report and have filed as exhibits to this annual report with the understanding that our actual future results may be materially different from what we expect.

This annual report also contains data related to the pharmaceutical market in China, and we have derived such data from *China Drugstore* magazine. These market data include projections that are based on a number of assumptions. Unlike in the United States, there are limited authoritative data in China on the pharmaceutical market, particularly on a nationwide basis. In addition, any data that is available may not be current. Moreover, the pharmaceutical retail market in China may not grow at the rates projected by the market data, or at all. The failure of the market to grow at the projected rates may have a material adverse effect on our business, financial condition, results of operations and the market price of our ADSs. In addition, the rapidly changing nature of the pharmaceutical market subjects any projections or estimates relating to the growth prospects or future condition of our market to significant uncertainties. Further, if any one or more of the assumptions underlying the market data turns out to be incorrect, actual results may differ from the projections based on these assumptions. You should not place undue reliance on these forward-looking statements.

DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

Directors and Senior Management

The following table sets forth information regarding our directors and executive officers as of the date of this annual report on Form 20-F.

Name	Age	Position/Title
Simin Zhang	50	Chairman of the Board of Directors
Barry J. Buttifant	67	Independent Director (1)(2)(3)
Stephanie Hui	39	Director
Alistair Eric MacCallum Laband	60	Independent Director (1)(2)(3)
Gary Siu Kwan Sik	44	Independent Director (1)(2)(3)
Fuxiang Zhang	39	Chief Executive Officer
Zixin Shao	43	Chief Financial Officer

(1) Members of the audit committee
(2) Members of the compensation committee
(3) Members of the corporate governance and nominating committee

Simin Zhang is our founder and has served as chairman of our board of directors since June 1995. Mr. Zhang is also the chairman of the board of directors of the Neptunus Group. Prior to founding the Neptunus Group in July 1989, he was an employee in CITIC Group from 1986 to 1989. From 1983 to 1986, he was an employee in the PRC Space Administration. He is currently a guest professor at the Harbin Institute of Technology and Jilin University, an executive director of China Enterprise Confederation and China Enterprise Directors Association and the president of Shenzhen General Chamber of Commerce. Mr. Zhang received a bachelor's degree in precision instruments from Harbin Institute of Technology in 1983, an honorary doctorate from University of Newcastle in Australia in 1997 and a Ph.D. degree in economics from Nan Kai University in 2001.

Barry J. Buttifant has been a director of our company since November 2007. He is a member of our audit committee, compensation committee, corporate governance and nominating committee. He is an independent non-executive director of Daiwa Associate Holdings Limited and Giordano International Limited, and a non-executive director of Synergis Holdings Limited ("Synergis"), all of which are publicly listed companies in Hong Kong. Mr. Buttifant also serves as a non-executive director of Global-Tech Advanced Innovations Inc., a NASDAQ listed company. Mr. Buttifant is currently an executive director of Hsin Chong Construction Group Ltd ('HCCG'). Prior to that, he was group chief executive officer of IDT International Limited. In October 2009, Mr. Buttifant rejoined Mission Hills Group, or MHG, as a Director — Corporate Finance, and prior to this appointment, he had been a consultant to the MHG since December 2008. Prior to joining MHG, he served as a Principal to KLC Kennic Lui & Company, or KLC, a professional accounting firm and Managing Director of KLC Transactions Limited. Prior joining KLC, Mr. Buttifant was the Executive Director — Finance of the MHG from February 2008 till November 2008. Since December 2004, he was the managing director of Hsin Chong International Holdings Limited, a controlling shareholder of HCCG (which was acquired by MHG in November 2007) and Synergis (which was acquired by HCCG in September 2008). Mr. Buttifant was also an alternate director to both HCCG and Synergis. Mr. Buttifant was an operating partner of Barings Private Equity Asia Limited. He was also the managing director of Wo Kee Hong (Holdings) Limited, or WKH, from 2001 to 2002 and was the advisor to the board of directors of WKH from November 2002 to April 2004. Prior to joining WKH, he was the managing director of IDT International Limited for over eight years and had worked for Polly Peck Group and Sime Darby Hong Kong Limited for more than 11 years in the capacity of finance director and managing director. Mr. Buttifant is a fellow member of the Association of Chartered Certified Accountants; the Hong Kong Institute of Certified Public Accountants; the Chartered Management Institute; the Hong Kong Management Association and the Hong Kong Institute of Directors.

Stephanie Hui has served as a director of our company since October 2004. She is a managing director of Goldman Sachs (Asia) L.L.C. Ms. Hui was with Goldman Sachs & Co. in New York from 1995 to 1997 and Goldman Sachs (Asia) L.L.C. in 1998. Ms. Hui rejoined Goldman Sachs (Asia) L.L.C. in 2000 after obtaining an MBA degree from Harvard Business School in 2000. Ms. Hui received a bachelor's degree in biology from Harvard University in 1995. Ms. Hui currently serves on the board of directors of NVC Lighting Holding Ltd. and Shenzhen Hepalink Pharmaceutical Co., Ltd.

Alistair Eric MacCallum Laband has been a director of our company since November 2007. Mr. Laband is a member of our audit committee, our compensation committee and corporate governance and nominating committee. From November 2008 until the end of March 2011 Mr. Laband was a financial consultant to CITIC Pacific Ltd., a company listed on the Hong Kong Stock Exchange. From 2003 to June 2007, he was a partner of PricewaterhouseCoopers, or PwC, Hong Kong/China and until March 2007, secretary of the PwC Asia Region Board. From 2001 to 2002, he was a partner in charge of the Company Secretarial Services Group of PwC's Hong Kong office. From 1997 to 2001, he was finance/operations partner and a management board member of the Hong Kong office of Price Waterhouse, or PW, and subsequently, the Hong Kong office of PwC. From 1997 to 1998, he was also in charge of the company secretarial and legal services group of PW's Hong Kong office. Mr. Laband obtained a bachelor's degree in law from

the University of Cambridge in 1973 and a diploma in accountancy from the University of Strathclyde in 1976. Mr. Laband is a Chartered Accountant of the Institute of Chartered Accountants of Scotland and a Fellow of the Institute of Certified Public Accountants of Hong Kong.

Gary Siu Kwan Sik has been a director of our company since November 2007. Mr. Sik is a member of our audit committee and our compensation committee. Mr. Sik has more than 20 years of experience in investment banking and finance. He has held senior positions with a number of major international investment banks, as well as the Hong Kong operations of the securities and investment banking division of a state-owned PRC bank, responsible for business development and regional business operations. Mr. Sik achieved his bachelor's degree in engineering science and master's degree in arts from Oxford University in 1989 and 2006, respectively. Mr. Sik is a member of The Institute of Chartered Accountants in England and Wales and a fellow member of Hong Kong Institute of Certified Public Accountants. He is an executive director of C Y Foundation Group Limited and independent non-executive director of China Glass Holdings Limited, both companies listed on the Stock Exchange of Hong Kong Limited. Mr. Sik is also an independent non-executive director of Simcere Pharmaceutical Group, a company listed on the New York Stock Exchange that manufactures and supplies branded generic pharmaceutical products for the China market.

Mr. Fuxiang Zhang was appointed by our board of directors as our chief executive officer in August 2011. Mr. Zhang joined our company in 1997 and served as our vice president from 2006 to 2011 and then as our chief operating officer from March 2011 until his promotion in August 2011. From 2003 to 2006, Mr. Zhang served as the general manager of Shenzhen Nepstar Group Co., Ltd., one of our regional Nepstar companies. From 1999 to 2003, he was the vice general manager and then promoted to general manager of Nepstar Dalian. Mr. Zhang received a bachelor's degree in international economics in 1997 and a master's degree in industrial engineering in 2010 from the Harbin Institute of Technology.

Mr. Zixin Shao was appointed by our board of directors as our chief financial officer in November 2010. Mr. Shao joined our company in 2003 and has served as financial controller for our company since then. Prior to joining our company, he worked as a director, vice general manager and chief financial officer in China Resources Supermarket (Suzhou) Co., Ltd. from 1999 to 2001. From 1992 to 2002, he also held financial management position at China Resources Supermarket (HK) Co., Ltd. Mr. Shao received a bachelor's degree in accounting from the University of International Business and Economics in China in 1992. Mr. Shao is a PRC certified accountant.

The address of our directors and executive officers is c/o China Nepstar Chain Drugstore Ltd., 6th Floor, Tower B, Xinnengyuan Building, Nanhai Road, Nanshan District, Shenzhen, Guangdong Province 518054, People's Republic of China. No family relationship exists between any of our directors and executive officers.

Compensation of Directors and Executive Officers

Cash Compensation

In 2011, the aggregate cash compensation to our executive officers, including all the directors, was RMB3.68 million (US$584,808). For options granted to officers and directors, see "— Pre-IPO Share Option Scheme" and "— 2007 Share Incentive Plan."

Pre-IPO Share Option Scheme

Our Pre-IPO Share Option Scheme was adopted by our shareholders on August 30, 2005 and amended and restated on March 20, 2006. The purpose of the scheme was to aid us in recruiting and retaining key employees, directors or consultants of outstanding ability and to motivate such employees, directors or consultants to exert their best efforts on behalf of our company by providing incentives through the granting of options. Our board of directors believed that our company's long-term success is dependent upon our ability to attract and retain superior individuals who, by virtue of their ability, experience and qualifications, make important contributions to our business.

Termination of Options. Options granted under the scheme must have specified terms set forth in an option agreement. The board of directors determines, in its absolute discretion, the period during which an option may be exercised, provided that such period shall not commence before the listing date on which dealings in our shares first commence on an approved stock exchange, including the New York Stock Exchange, nor be it longer than five years from the date on which our ADSs are first listed on the New York Stock Exchange, or the listing date. If the options are not exercised or purchased on the last day of the period of exercise, they will terminate.

Duration and Administration. Subject to earlier termination, our Pre-IPO Share Option Scheme was valid and effective until the day immediately prior to the listing date. Thereafter, no further options may be granted under the scheme, but the scheme will remain in full force with respect to the options granted before the listing date. Our Pre-IPO Share Option Scheme is administered by our board of directors. Subject to the terms of the scheme, our board of directors has the right to interpret the scheme, determine the

persons who will be awarded options under the scheme and the number of shares to be issued under the scheme, to make such appropriate and equitable adjustments to the terms of options granted under the scheme, and to make any other decisions, determinations or regulations that it deems appropriate for the administration of the scheme. Our board of directors will determine the provisions, terms and conditions of each option in accordance with the scheme, including, but not limited to, the exercise price for an option, vesting schedule of options, forfeiture provisions, form of payment of exercise price and other applicable terms.

Option Exercise. The term during which options granted under our Pre-IPO Share Option Scheme may be exercised shall not commence before our listing date nor be longer than five years from our listing date. The consideration to be paid for our ordinary shares upon exercise of an option or purchase of shares underlying the option may include cash, electronic funds transfer, or certified or cashier's check subject to such specific procedures or discretions of our board of directors.

Amendment and Termination. The provisions of the scheme may be amended or altered in any respect by resolution of our board of directors, provided that such resolution includes the affirmative votes of at least one of the two directors appointed by the GS Funds, or by resolution in writing by all members of our board of directors, except that the certain provisions of the scheme may not be altered to the advantage of the potential participants in the scheme except with the prior approval of our shareholders in general meeting, provided that such approval includes the affirmative votes of members holding more than 50.0% in voting power of the issued and outstanding Series A redeemable convertible preferred shares, or by resolution in writing by all of our shareholders.

Lock-up. Under the option agreements, holders of our options (and permitted transferees) have agreed that they will not, directly or indirectly, offer, sell or transfer or dispose of any of the shares subscribed upon exercise of their options during the period commencing as of 14 days prior to and ending one year after the effective date of the registration statement or prospectus covering any public offering of our securities, or such lesser period of time the underwriters may permit. Holders of our options are permitted to participate in a registered offering with respect to any shares they hold, subject to the discretion of our board of directors.

Our board of directors and shareholders authorized the issuance of up to 8,680,000 ordinary shares upon exercise of options granted under our Pre-IPO Share Option Scheme. On August 30, 2005, we granted options to purchase 1,000,000 ordinary shares to 296 of our staff, including senior management, key employees and other employees, with an exercise price of US$0.075 per share. On March 20, 2006, we granted options to purchase 6,680,000 ordinary shares to 456 of our staff, including senior management, key employees and other employees, with an exercise price of US$0.75 per share. On September 1, 2006, we granted options to purchase 1,000,000 ordinary shares to an executive officer with an exercise price of US$0.75 per share. The Pre-IPO Share Option Scheme terminated after the completion of our initial public offering in November 2007. As of December 31, 2011, all of the ordinary share options granted under the Pre-IPO Share Option Scheme have been vested.

2007 Share Incentive Plan

The 2007 share incentive plan was adopted by our shareholders on June 30, 2007. The 2007 share incentive plan provides for the grant of options, limited share appreciation rights, and other share-based awards such as restricted shares, referred to hereafter as "awards." The purpose of the plan is to aid us in recruiting and retaining key employees, directors or consultants of outstanding ability and to motivate such employees, directors or consultants to exert their best efforts on behalf of our company through the granting of awards. Our board of directors believes that our company's long-term success is dependent upon our ability to attract and retain talented individuals who, by virtue of their ability, experience and qualifications, make important contributions to our business.

Termination of Awards. Options and restricted shares will have specified terms set forth in an award agreement. The compensation committee will determine in the relevant award agreement whether options granted under the award agreement will be exercisable following the recipient's termination of services with us. If the options are not exercised or purchased on the last day of the period of exercise, they will terminate.

Administration. The 2007 share incentive plan is administered by the compensation committee of our board of directors. The committee is authorized to interpret the plan, to establish, amend and rescind any rules and regulations relating to the plan, and to make any other determinations that it deems necessary or desirable for the administration of the plan. The committee will determine the provisions, terms and conditions of each award, including, but not limited to, the exercise price for an option, vesting schedule of options and restricted shares, forfeiture provisions, form of payment of exercise price and other applicable terms.

Option Exercise. The term of options granted under the 2007 share incentive plan may not exceed five years from the date of grant. The consideration to be paid for our ordinary shares upon exercise of an option or purchase of shares underlying the option may include cash, check or other cash-equivalent, ordinary shares, consideration received by us in a cashless exercise, or any combination of the foregoing methods of payment.

Third Party Acquisition. If a third party acquires us through the purchase of all or substantially all of our assets, a merger or other business combination, the compensation committee may decide that all outstanding awards that are unexercisable or otherwise unvested or subject to lapse restrictions will automatically be deemed exercisable or otherwise vested or no longer subject to lapse restrictions, as the case may be, as of immediately prior to such acquisition. The compensation committee may also, in its sole

discretion, decide to cancel such awards for fair value, provide for the issuance of substitute awards that will substantially preserve the otherwise applicable terms of any affected awards previously granted, or provide that affected options will be exercisable for a period of at least 15 days prior to the acquisition but not thereafter.

Amendment and Termination of Plan. Our board of directors may at any time amend, alter or discontinue our 2007 share incentive plan. Amendments or alterations to our 2007 share incentive plan are subject to shareholder approval if they increase the total number of shares reserved for the purposes of the plan or change the maximum number of shares for which awards may be granted to any participant, or if shareholder approval is required by law or by stock exchange rules or regulations. Any amendment, alteration or termination of our 2007 share incentive plan must not adversely affect awards already granted without written consent of the recipient of such awards. Unless terminated earlier, our 2007 share incentive plan shall continue in effect for a term of ten years from the date of adoption.

On November 9, 2007, we granted 200,000 shares options with a grant date fair value of approximately US$2.86 per option or US$0.6 million (RMB4.3 million) in the aggregate, to four newly appointed independent directors. The exercise price of such options is US$8.10 per share, which was equal to the initial public offering price of our ordinary shares. The share options vest and become exercisable in three equal annual installments on the first, second and third of the anniversaries of the date of grant, and expire on the tenth anniversary of the date of grant.

On January 5, 2009, we granted 600,000 options with a grant date fair value of approximately US$0.78 per option or RMB3.2 million in aggregate, to our chief financial officer at the time, William Weili Dai. The exercise price of such options is US$2.40 per share. The share options vest and become exercisable in three equal annual installments on the first, second and third of the anniversaries of the date of grant, and expire on the tenth anniversary of the date of grant. On January 5, 2010, we granted another 200,000 options with a grant day fair value of approximately US$0.92 per option to Mr. Dai. The exercise price of such options is US$3.725 per share. The options vest and become exercisable on January 5, 2013, and expire on the tenth anniversary of the date of grant. Upon Mr. Dai's resignation in November, 2010, 600,000 of the share options granted to him were forfeited.

On January 5, 2010, we granted an aggregate of 800,000 options with a grant day fair value of approximately US$0.91 per option to Jason Xinghua Wu, our former chief executive officer. The exercise price of such options is US$3.725 per share. Upon Mr. Wu's resignation in August 2011, 600,000 unvested options of the 800,000 options granted to him were forfeited immediately and the remaining 200,000 vested options were forfeited in February 2012.

On March 2, 2010, we granted an aggregate of 150,000 fully vested ordinary shares to our three current independent directors, and 50,000 non-vested ordinary shares to Jason Xinghua Wu, our former chief executive officer. The grant of the fully vested ordinary shares to our independent directors was made in exchange for their forfeiture of 150,000 options granted in November 2007. All of the 50,000 ordinary shares granted to Mr. Wu were fully vested before his resignation in August 2011.

Board Practices

Committees of the Board of Directors

Audit Committee

Our audit committee consists of Alistair Eric MacCallum Laband, Barry J. Buttifant and Gary Siu Kwan Sik. Mr. Laband is the chairman of our audit committee and meets the criteria of an audit committee financial expert as set forth under the applicable rules of the SEC. Our board of directors has determined that all members of our audit committee are "independent directors" within the meaning of NYSE Manual Section 303A(2) and will meet the criteria for independence set forth in Section 10A(m)(3) of the Securities Exchange Act of 1934, as amended, or the Exchange Act. The audit committee oversees our accounting and financial reporting processes and the audits of the financial statements of our company. The audit committee is responsible for, among other things:

- selecting our independent registered public accounting firm and pre-approving all auditing and non-auditing services permitted to be performed by our independent registered public accounting firm;
- reviewing with our independent registered public accounting firm any audit issues or difficulties and management's response;
- reviewing and approving all proposed related party transactions;
- discussing the annual audited financial statements with management and our independent registered public accounting firm;
- reviewing major issues as to the adequacy of our internal controls and any special audit steps adopted in light of significant control deficiencies;
- annually reviewing and reassessing the adequacy of our audit committee charter;

- such other matters that are specifically delegated to our audit committee by our board of directors from time to time; and
- meeting separately and periodically with management, our internal auditor and independent registered public accounting firm.

Compensation Committee

Our compensation committee consists of Alistair Eric MacCallum Laband, Barry J. Buttifant and Gary Siu Kwan Sik. Our board of directors has determined that each member of the compensation committee is an "independent director" within the meaning of NYSE Manual Section 303A(2). Our compensation committee assists our board of directors in reviewing and approving the compensation structure of our directors and executive officers, including all forms of compensation to be provided to our directors and executive officers. Members of the compensation committee are not prohibited from direct involvement in determining their own compensation. A chief executive officer may not be present at any committee meeting during which his compensation is deliberated. The compensation committee is responsible for, among other things:

- approving and overseeing the compensation package for our executive officers;
- reviewing and making recommendations to our board of directors with respect to our compensation policies and the compensation of our directors; and
- reviewing periodically and making recommendations to our board of directors regarding any long-term incentive compensation or equity plans, programs or similar arrangements, annual bonuses, employee pension and welfare benefit plans.

Corporate Governance and Nominating Committee

Our corporate governance and nominating committee consists of Barry J. Buttifant, Alistair Eric MacCallum Laband and Gary Siu Kwan Sik. Our board of directors has determined that each member of the corporate governance and nominating committee is an "independent director" within the meaning of NYSE Manual Section 303A(2). The corporate governance and nominating committee assists our board of directors of directors in identifying individuals qualified to become our directors and in determining the composition of our board of directors and its committees. The corporate governance and nominating committee is responsible for, among other things:

- identifying and recommending to our board of directors nominees for election or re-election to our board of directors, or for appointment to fill any vacancy of our board of directors;
- reviewing annually with our board of directors the current composition of our board of directors in light of the characteristics of independence, age, skills, experience and availability of service to us;
- advising our board of directors periodically with respect to significant developments in the law and practice of corporate governance as well as our compliance with applicable laws and regulations, and making recommendations to our board of directors on all matters of corporate governance and on any corrective action to be taken; and
- monitoring compliance with our code of business conduct and ethics, including reviewing the adequacy and effectiveness of our procedures to ensure proper compliance.

Our board of directors has adopted a code of business conduct and ethics, which is applicable to our senior executive and financial officers. Our code of business conduct and ethics has been filed as exhibits to our registration statement on Form F-1 (File No. 333-146767), as amended, initially filed with the SEC on October 17, 2007.

In addition, our board of directors has adopted a set of corporate governance guidelines. The guidelines will reflect certain guiding principles with respect to the structure of our board of directors, procedures and committees. These guidelines are not intended to change or interpret any law, or our second amended and restated memorandum and articles of association.

Duties of Directors

Under Cayman Islands law, our directors have a fiduciary duty to act honestly, in good faith and with a view to our best interests. Our directors also have a duty to exercise the skills they actually possess and such care and diligence that a reasonably prudent person would exercise in comparable circumstances. In fulfilling their duty of care to us, our directors must ensure compliance with our memorandum and articles of association, as amended and restated from time to time. A shareholder has the right to seek damages if a duty owed by our directors is breached.

The functions and powers of our board of directors include, among others:

- convening shareholders' annual general meetings and reporting its work to shareholders at such meetings;

- issuing authorized but unissued shares and redeeming or purchasing outstanding shares of our company;
- declaring dividends and other distributions;
- appointing officers and determining the term of office of officers;
- exercising the borrowing powers of our company and mortgaging the property of our company; and
- approving the transfer of shares of our company, including the registering of such shares in our share register.

Terms of Directors and Executive Officers

Our executive officers are elected by and serve at the discretion of our board of directors. Our directors are not subject to a term of office and hold office until such time as they resign or are removed from office without cause by special resolution or the unanimous written resolution of all shareholders or with cause by ordinary resolution or the unanimous written resolution of all shareholders. A director will be removed from office automatically if, among other things, the director: (i) becomes bankrupt or makes any arrangement or composition with his creditors; or (ii) dies or is found by our company to be or becomes of unsound mind.

Employment Agreements

We have entered into employment agreements with all of our executive officers. Under these agreements, each of our executive officers is employed for a specified time period. We may terminate his or her employment for cause at any time, with prior written notice, for certain acts of the employee, including but not limited to a felony conviction, or willful gross misconduct by the employee in connection with his employment, and in each case if such acts have resulted in material and demonstrable financial harm to us. An executive officer may, with prior written notice, terminate his or her employment at any time for any material breach of the employment agreement by us that is not remedied promptly after receiving the remedy request from the employee. Furthermore, either party may terminate the employment agreement at any time without cause upon advance written notice to the other party. Upon termination, the employee is generally entitled to a severance pay of at least one month's salary.

Each executive officer has agreed to hold, both during and subsequent to the terms of his or her agreement, in confidence and not to use, except in pursuance of his or her duties in connection with employment by us, any of our confidential information, technological secrets, commercial secrets and know-how. Each of our executive officers has also agreed to disclose to us all inventions, designs and techniques resulted from work performed by him or her, and to assign us all right, title and interest of such inventions, designs and techniques. Moreover, each of our executive officers has agreed that during the term of his or her employment with us and three years thereafter: (i) not to serve, invest or assist in any business that competes with our business; and (ii) not to solicit any of our officers, directors, employees or agents.

D. Employees

We had 16,015, 15,974 and 15,189 employees as of December 31, 2009, 2010 and 2011, respectively. The following table sets forth the number of our employees for each of our areas of operations and as a percentage of our total workforce as of December 31, 2011:

	As of December 31, 2011	
	Employees	Percentage of Total
Non-pharmacist store staff	10,048	66.2%
Pharmacists	3,173	20.9%
Management	1,230	8.1%
Logistics	738	4.8%
Total	15,189	100%

We place strong emphasis on the quality of our employees at all levels, including in-store pharmacists and store staff who directly interact with our customers. We provide extensive training for newly recruited employees in the first three months of their employment. The training is designed to encompass a number of areas, such as knowledge about our products and how best to interact with our customers. In addition, we regularly carry out training programs on medicine information, nutritional information, selling skills for our store staff and in-store pharmacists, as well as management training for our regional managers and senior management officers at the headquarters. We have also established the Nepstar School of Drugstore Management, with the cooperation and faculty support from Shenzhen Vocational College of Technology, and through this facility we offer training to our senior management and regional managers on store management, procurement and distribution. We believe these programs have played an important role in strengthening the capabilities of our management team.

We are required under PRC law to make contributions to our employee benefit plans including pension, medical insurance, work-related injury insurance, unemployment insurance and maternity insurance. Our contributions are made based on salaries, bonuses and certain allowances of our employees, in amounts within a range specified by the respective local government authorities where we operate our businesses. The total amount of contributions we incurred for these employee benefit plans in 2009, 2010 and 2011 was RMB28.7 million, RMB31.3 million and RMB34.4 million (US$5.5 million), respectively.

Our employees are not covered by any collective bargaining agreement. We believe that we have a good relationship with our employees.

Share Ownership

The following table sets forth information with respect to the beneficial ownership of our ordinary shares as of March 31, 2012 by:

- each of our directors and executive officers; and
- each person known to us to own beneficially more than 5.0% of our ordinary shares.

	Shares Beneficially Owned [1]	
	Number	%
Directors and Executive Officers:		
Simin Zhang [2]	107,000,000	53.3
Barry J. Buttifant	—	—
Alistair Eric MacCallum Laband	*	*
Gary Siu Kwan Sik	*	*
Stephanie Hui [3]	50,000,000	24.9
Fuxiang Zhang	—	—
Zixin Shao	—	—
Principal Shareholders		
China Neptunus Drugstore Holding Ltd.	107,000,000	53.3
GS Funds [4]	50,000,000	24.9

* Beneficially own less than 1.0% of our outstanding ordinary shares.

(1) Beneficial ownership is determined in accordance with Rule 13d-3 under the Exchange Act, and includes voting or investment power with respect to the securities. In computing the number of shares beneficially owned by a person and the percentage ownership of that person, we have included shares that the person has the right to acquire within 60 days. Percentage of beneficial ownership of each listed person is based on 200,665,782 ordinary shares outstanding as of March 31, 2012.

(2) Represents the beneficial ownership of 107,000,000 ordinary shares held by China Neptunus Drugstore Holding Ltd. Simin Zhang is the chairman of the board of directors and owns 100.0% of the equity interest in China Neptunus Drugstore Holding Ltd. China Neptunus Drugstore Holding Ltd. is a BVI company and its address is P.O. Box 3140, Road Town, Tortola, British Virgin Islands.

(3) Represents 50,000,000 ordinary shares held by the GS Funds. Ms. Stephanie Hui, a managing director of Goldman Sachs (Asia) L.L.C., disclaims beneficial ownership of shares held by the GS Funds except to the extent of her pecuniary interest in these shares.

(4) Includes a total of 50,000,000 shares owned by (i) GS Capital Partners 2000, L.P., GS Capital Partners 2000 Employee Fund, L.P. and Goldman Sachs Direct Investment Fund 2000, L.P., each of which is a limited partnership organized under the laws of the State of Delaware, (ii) GS Capital Partners 2000 Offshore, L.P., a Cayman Islands exempted limited partnership, and (iii) GS Capital Partners 2000 GmbH & Co. Beteiligungs KG, a German KG. Each of the GS Funds has a mailing address of c/o Goldman, Sachs & Co., 85 Broad Street, 10th Floor, New York, NY 10004. Affiliates of The Goldman Sachs Group, Inc. are the general partner, managing general partner or investment manager of each of the GS Funds, and each of the GS Funds shares voting and investment power with certain of its respective affiliates. Each of the GS Funds is affiliated with or managed by Goldman, Sachs & Co., a wholly owned subsidiary of The Goldman Sachs Group, Inc. Each of The Goldman Sachs Group, Inc., Goldman, Sachs & Co. and Goldman Sachs (Asia) L.L.C. disclaims beneficial ownership of the shares owned by each of the GS Funds, except to the extent of their pecuniary interest therein.

For details of the options granted to our directors and executive officers, including the title and amount of securities covered by the options, the exercise price, the purchase price and the expiration date of the options, see 20F section “Compensation of Directors and Executive Officers—2007 Share Incentive Plan.”

None of our shareholders has different voting rights from other shareholders. We are not aware of any arrangement that may, at a subsequent date, result in a change of control of our company. As of March 31, 2012, of the 200,665,782 issued and outstanding ordinary shares, 44,254,830 ordinary shares were registered in the name of a nominee of JPMorgan Chase Bank, N.A., the depositary of our ADSs. Approximately 22.1% of our ordinary shares, representing our ordinary shares held by the depositary, were held in the United States.

MISCELLANEOUS

MISCELLANEOUS

MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

Related Party Transactions

After the completion of our initial public offering on November 9, 2007, we adopted an audit committee charter, which requires that the audit committee review all related party transactions on an ongoing basis and all such transactions be approved by the committee. Set forth below is a description of all of our material related party transactions since the beginning of 2007 up to the date of this annual report.

Transactions with Companies in Which a Major Shareholder Had Equity Interests

Simin Zhang, our founder, the chairman of our board of directors and the sole beneficial owner of our controlling shareholder, Neptunus BVI, is the chairman of the board of directors and the controlling person of the Neptunus Group. In 2009, 2010 and 2011, we purchased merchandise from the Neptunus Group and its affiliates totaling RMB89.6 million, RMB121.4 million and RMB105.2 million (US$16.7 million), respectively, and sold merchandise to the Neptunus Group and its affiliates totaling RMB3.9 million, RMB3.2 million and RMB2.2 million (US$0.3 million), respectively. During 2009 and 2010, we fully utilized prepayments of RMB132.9 million made in April 2008 to the Neptunus Group. These prepayments were made in exchange for an 8% to 10% discount of procurement value on more than 100 types of national branded products procured from several companies under the Neptunus Group, namely Shandong Neptunus Galaxy Medicine Co. Ltd. and Shenzhen Neptunus Changjian Pharmaceutical Co. Ltd. and its affiliates. In 2009 and 2010, we purchased merchandise totaling RMB32.2 million and RMB38.1 million, respectively, from these companies under the Neptunus Group. The payment terms offered by the Neptunus Group for the purchase of merchandise ranged from 60 to 90 days. As of December 31, 2011, RMB18.2 million (US$2.9 million) was due to the Neptunus Group in connection with our purchase of merchandise.

As of December 31, 2010 and 2011, the amounts due from the Neptunus Group and its affiliates totaled RMB3.2 million and RMB2.2 million (US$0.3 million), respectively, related to the sale of merchandise. As of December 31, 2010 and 2011, amounts related to expenses we paid on behalf of the Neptunus Group and its affiliates were RMB7.0 million and RMB0.3 million (US$0.05 million), respectively. The amounts due from the Neptunus Group and its affiliates were partially settled in 2012 as of the date of this Annual Report.

Transactions with an Affiliated Entity of JZJ

We sold merchandise to Yunnan Jianzhijia Medical Ltd., an affiliated entity of our former consolidated subsidiary JZJ, in 2010 totaling RMB1.6 million. We did not purchase any merchandise from Yunnan Jianzhijia Medical Ltd. in 2009, 2010 or 2011.

As of December 31, 2009, no amount was due from or to Yunnan Jianzhijia Medical Ltd. As of December 31, 2010, RMB1.6 million were due from Yunnan Jianzhijia Medical Ltd. in connection with its purchases of merchandise from us and additional RMB0.6 million were due from it in connection with expenses we paid on its behalf. As of December 31, 2011, RMB1.6 million (US$0.3 million) were due from Yunnan Jianzhijia Medical Ltd. in connection with its purchases of merchandise from us in 2010 and additional RMB0.6 million (US$0.1 million) were due from it in connection with expenses we paid on its behalf in 2010. Collection of the amount due from JZJ is in process and management expects full amount to be collected in the near future.

Transaction related to the Disposal of Our 100% Equity Interest in Nepstar Industrial

In August 2011, we disposed of our 100% equity interest in Nepstar Industrial to Neptunus Group at a total cash consideration of RMB 20 million. The difference between consideration received and the carrying amount of the net assets of the subsidiary amounting to RMB19 was recognized in additional paid-in capital. We have not conducted any operations under Nepstar Industrial since its establishment in 2009. The purpose of the transaction is to simplify corporate structure and the divestment has not adversely affected our financial position or business operation.

Transactions Related to Our Regional PRC Companies

We, through our PRC operating subsidiary, Nepstar Pharmaceutical, have entered into a series of contractual arrangements with Nepstar IT Service, Nepstar Management Consulting, their respective shareholders, the regional Nepstar companies, including Fuzhou Nepstar, and Nepstar E-Commerce, including contracts relating to the provision of services and certain shareholder rights and corporate governance matters. Nepstar Pharmaceutical owns a 49.0% equity interest in each of the regional Nepstar companies, including Fuzhou Nepstar, and Nepstar IT Service and Nepstar Management Consulting collectively own the remaining 51.0% equity interest in each of the regional Nepstar companies, including Fuzhou Nepstar. In addition, Nepstar IT Service and Nepstar Management Consulting each own a 50.0% equity interest in Nepstar E-Commerce. Each of these contractual arrangements may only be amended with the approval of our audit committee or another independent body of our board of directors. The details of these contractual arrangements have been filed with the SEC.

Legal and Administrative Proceedings

We are currently not a party to any material legal or administrative proceedings, and we are not aware of threatened material legal or administrative proceedings against us. We may from time to time become a party to various legal or administrative proceedings arising in the ordinary course of our business.

Dividend Policy

Our board of directors has complete discretion on whether to pay dividends. On March 13, 2009, our board of directors approved a cash dividend of US$0.35 per ADS. The cash dividend was paid in May 2009 to shareholders of record as of the close of business on April 16, 2009. On August 24, 2009, our board of directors declared a special cash dividend of US$1.50 per ADS. In November and December 2009, approximately RMB1,038 million was paid out to shareholders of record as of the close of business on September 25, 2009. On March 3, 2010, our Board of Directors declared a cash dividend of US$0.28 per ADS. The cash dividend was paid on or around May 3, 2010 to shareholders of record as of the close of business on April 2, 2010. On January 18, 2011, our Board of Directors declared a special cash dividend of US$0.30 per ADS. The special dividend was paid on or around February 28, 2011 to shareholders of record as of the close of business on January 31, 2011.

Our ability to pay dividends depends substantially on the payment of dividends to us by our consolidated PRC entities. In particular, each of our consolidated PRC entities may pay dividends only out of its accumulated distributable profits, if any, determined in accordance with its articles of association, and the accounting standards and regulations in China. Moreover, pursuant to applicable PRC laws, rules and regulations, 10% of after-tax profits of each of our consolidated PRC entities are required to be set aside in a statutory surplus reserve fund annually until the reserve balance reaches 50% of such PRC entity's registered capital. As of December 31, 2011, the accumulated balance of our statutory reserve funds totaled RMB95.2 million (US$15.1 million). Our restricted reserves are not distributable as cash dividends. Allocations to these statutory reserves may only be used for specific purposes and are not distributable to us in the form of loans, advances, or cash dividends. Furthermore, if any of our subsidiaries and controlled affiliates incurs debt on its own behalf in the future, the instruments governing the debt may restrict its ability to pay dividends or make other payments to us.

If we pay any dividends, we will pay our ADS holders to the same extent as holders of our ordinary shares, subject to the terms of the deposit agreement, including the fees and expenses payable thereunder. Cash dividends on our ordinary shares, if any, will be paid in U.S. dollars.

Exchange Controls

Pursuant to the Foreign Currency Administration Rules promulgated in 1996, as amended, and various regulations issued by the SAFE and other relevant PRC government authorities, the Renminbi is convertible without prior approval from SAFE only to the extent of current account items, such as trade-related receipts and payments, interest and dividends and after complying with certain procedural requirements. Capital account items, such as direct equity investments, loans and repatriation of investments, require the prior approval from the SAFE or its local counterpart for conversion of Renminbi into a foreign currency, such as U.S. dollars, and remittance of the foreign currency outside the PRC.

Payments for transactions that take place within the PRC must be made in Renminbi. Foreign-invested enterprises may retain foreign exchange in accounts with designated foreign exchange banks subject to limitations set by the SAFE or its local counterpart. Unless otherwise approved, domestic enterprises must convert all of their foreign currency receipts into Renminbi.

Pursuant to the SAFE's Notice on Relevant Issues Concerning Foreign Exchange Administration for PRC Residents to Engage in Financing and Inbound Investment via Overseas Special Purpose Vehicles, or the SAFE Circular No. 75, issued on October 21, 2005: (i) a PRC citizen or resident shall register with the local branch of the SAFE before it establishes or controls an overseas special purpose vehicle, or overseas SPV, for the purpose of overseas equity financing (including convertible debt financing); (ii) when a PRC citizen or resident contributes the assets of or its equity interests in a domestic enterprise into an overseas SPV, or engages in overseas financing after contributing assets or equity interests to an overseas SPV, such PRC citizen or resident shall register his or her interest in the overseas SPV and the change thereof with the local branch of the SAFE; and (iii) when the overseas SPV undergoes a material event outside of China, such as change in share capital or merger and acquisition, the PRC resident shall, within 30 days from the occurrence of such event, register such change with the local branch of the SAFE. On May 29, 2007, the SAFE issued relevant guidance to its local branches for the implementation of the SAFE Circular No. 75. This guidance standardizes more specific and stringent supervision on the registration requirement relating to the SAFE Circular No. 75, and further requires PRC residents holding any equity interests or options in SPVs, directly or indirectly, controlling or nominal, to register with the SAFE.

Our beneficial owners who are PRC citizens or residents have registered with the local branch of the SAFE as required under SAFE Circular No. 75.

Under the Implementing Rules of Measures for the Administration of Individual Foreign Exchange, or the Implementation Rules, issued by the SAFE on January 5, 2007, PRC citizens who are granted shares or share options by an overseas listed company according to its share incentive plan are required, through a qualified PRC agent or the PRC subsidiary of such overseas listed company, to register with the SAFE and complete certain other procedures related to the share incentive plan. Foreign exchange income received from the sale of shares or dividends distributed by the overseas listed company must be remitted into a foreign currency account of such PRC citizen or be exchanged into Renminbi. Our PRC citizen employees who have been granted share options, or PRC option holders, have been subject to the Implementation Rules upon the listing of our ADSs on the New York Stock Exchange. If we or our PRC citizen employees fail to comply with these rules and regulations, we or our PRC option holders may be subject to fines and legal or administrative sanctions.

Taxation

Cayman Islands Taxation

The Cayman Islands currently levy no taxes on individuals or corporations based upon profits, income, gains or appreciation and there is no taxation in the nature of inheritance tax or estate duty. No Cayman Islands stamp duty will be payable unless an instrument is executed in, brought to, or produced before a court of the Cayman Islands. The Cayman Islands are not parties to any double tax treaties. There are no exchange control regulations or currency restrictions in the Cayman Islands.

We have, pursuant to Section 6 of the Tax Concessions Law (1999 Revision) of the Cayman Islands, obtained an undertaking from the Governor-in-Council that, for 20 years from September 7, 2004:

- no law which is enacted in the Cayman Islands imposing any tax to be levied on profits, income or gains or appreciations shall apply to us or our operations; and
- the aforesaid tax or any tax in the nature of estate duty or inheritance tax shall not be payable on our ordinary shares, debentures or other obligations.

People's Republic of China Taxation

Our PRC subsidiaries are incorporated in the PRC and are governed by applicable PRC income tax laws and regulations. The CIT Law was enacted on March 16, 2007 and became effective on January 1, 2008. The implementation regulations under the CIT Law issued by the PRC State Council became effective January 1, 2008. Under the CIT Law and the implementation regulations, the PRC has adopted a uniform tax rate of 25% for all enterprises (including foreign-invested enterprises) and has revoked the previous tax exemption, reduction and preferential treatments applicable to foreign-invested enterprises. However, there is a transition period for certain enterprises, whether foreign-invested or domestic, that were registered on or before March 16, 2007 and received preferential tax treatments granted by relevant tax authorities prior to January 1, 2008. Some enterprises that were subject to an enterprise income tax rate lower than 25% prior to January 1, 2008 have continued to enjoy the lower rate and are gradually transitioning to the new tax rate during the five-year period after the effective date of the CIT Law.

The CIT Law provides that enterprises established outside of China whose "de facto management bodies" are located in China are considered "resident enterprises" and are generally subject to the uniform 25% enterprise income tax rate on their worldwide income. In addition, a circular issued by the State Administration of Taxation on April 22, 2009 regarding the standards used to classify certain Chinese-invested enterprises controlled by Chinese enterprises or Chinese group enterprises and established outside of China as "resident enterprises" clarified that dividends and other income paid by such "resident enterprises" will be considered to be PRC source income, subject to PRC withholding tax, generally at a rate of 10%, when recognized by non-PRC enterprise shareholders. This circular also subjects such "resident enterprises" to various reporting requirements with the PRC tax authorities. Under the implementation regulations to the CIT Law, a "de facto management body" is defined as a body that has material and overall management and control over the manufacturing and business operations, personnel and human resources, finances and properties of an enterprise. In addition, the circular mentioned above details that certain Chinese-invested enterprises controlled by Chinese enterprises or Chinese group enterprises will be classified as "resident enterprises" if all of the following are located or resident in China: senior management personnel and departments that are responsible for daily production, operation and management; financial and personnel decision making bodies; key properties, accounting books, company seal, and minutes of board meetings and shareholders' meetings; and half or more of the directors with voting rights or senior management. However, as this circular only applies to enterprises established outside of China that are controlled by PRC enterprises or groups of PRC enterprises, it remains unclear how the tax authorities will determine the location of "de facto management bodies" for overseas incorporated enterprises that are controlled by individual PRC residents like us and some of our subsidiaries. As a result, although substantially all of our management is currently located in the PRC, it remains unclear whether the PRC tax authorities would require or permit our overseas registered entities to be treated as PRC resident enterprises. If the PRC tax authorities determine that we are a "resident enterprise," we may be subject to enterprise income tax at a rate of 25% on our worldwide income.

The CIT Law provides that a maximum income tax rate of 10% is applicable to dividends payable to non-PRC investors that are "non-resident enterprises," which do not have an establishment or place of business in the PRC, or which have such establishment or place of business but the relevant income is not effectively connected with the establishment or place of business, to

the extent such dividends are derived from sources within the PRC. We are a Cayman Islands holding company and substantially all of our income is derived from the operations of our operating subsidiaries located in the PRC. In addition, under the CIT Law, the Notice of the State Administration of Taxation on Overview of Treaty Dividends Withholding Tax Rates, or Notice 112, which was issued on January 29, 2008, the Arrangement between the PRC and the Hong Kong Special Administrative Region on the Avoidance of Double Taxation and Prevention of Fiscal Evasion, or the Double Taxation Arrangement (Hong Kong), which was effective on January 1, 2007 in the PRC, and the Notice of the State Administration of Taxation Regarding Interpretation and Recognition of Beneficial Owners under Tax Treaties, which was issued on October 27, 2009, dividends from our PRC subsidiaries paid to us may be subject to a withholding tax at a rate of 10%, or at a rate of 5% if we are considered as a "beneficial owner" that is generally engaged in substantial business activities and entitled to treaty benefits under the Double Taxation Arrangement (Hong Kong). Furthermore, the ultimate tax rate will be determined by treaty between the PRC and the tax residence of the holder of the PRC subsidiary. Although we are a Cayman Islands incorporated Company, we are considered as a Hong Kong tax resident as we are primarily managed and controlled in Hong Kong and subject to Hong Kong Profits Tax on income arising in or derived from Hong Kong and may qualify under the Double Taxation Arrangement (Hong Kong). We have determined that we have qualified for the 5% withholding tax rate pursuant to the Double Taxation Arrangement (Hong Kong).

Certain U.S. Federal Income Tax Consequences

The following summary describes certain U.S. federal income tax consequences of the ownership of our ordinary shares and ADSs as of the date hereof. This summary applies only to U.S. Holders (defined below) that are beneficial owners of ADSs or ordinary shares, that hold the ADSs or ordinary shares as capital assets and that have U.S. dollars as their functional currency. This discussion is based on the provisions of the Internal Revenue Code of 1986, as amended, or the Code, as in effect on the date of this annual report and on U.S. Treasury regulations in effect or, in some cases, proposed, as of the date of this annual report, as well as judicial and administrative interpretations thereof available on or before such date. All of the foregoing authorities are subject to change, which change could apply retroactively and could affect the tax consequences described below.

The following discussion does not deal with the tax consequences to any particular investor or to persons in special tax situations such as:

- dealers in securities or currencies;
- financial institutions;
- insurance companies;
- a regulated investment company;
- a real estate investment trust;
- broker dealers;
- U.S. expatriates;
- traders that elect to mark to market;
- tax-exempt entities;
- persons liable for alternative minimum tax;
- persons holding ADSs or ordinary shares as part of a constructive sale, straddle, hedging, conversion or integrated transaction;
- persons that actually or constructively own 10.0% or more of our voting stock; or
- persons holding ADSs or ordinary shares through partnerships or other pass-through entities for U.S. federal income tax purposes.

For the purpose of this discussion, "U.S. Holders" refer to any holder of our ordinary shares or ADSs that is, for U.S. federal income tax purposes:

- an individual citizen or resident of the United States;
- a corporation (or other entity taxable as a corporation for U.S. federal income tax purposes) created or organized in or under the laws of the United States, any state thereof or the District of Columbia;
- an estate whose income is subject to U.S. federal income taxation regardless of its source; or
- a trust that (1) is subject to the primary supervision of a court within the United States and one or more U.S. persons have the authority to control all substantial decisions of the trust or (2) has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person.

If you are a partner in a partnership or other entity taxable as a partnership that holds ADSs or ordinary shares, your tax treatment generally will depend on your status and the activities of the partnership. If you are a partner in a partnership or other entity taxable as a partnership that holds ADSs or ordinary shares, you should consult your own tax advisors.

The discussion below assumes that the representations contained in the deposit agreement are true and that the obligations in the deposit agreement and any related agreement will be complied with in accordance with their terms. If you hold ADSs, you generally will be treated as the holder of the underlying ordinary shares represented by those ADSs for U.S. federal income tax purposes. Exchanges of ordinary shares for ADSs and ADSs for ordinary shares generally will not be subject to U.S. federal income tax.

Taxation of Dividends and Other Distributions on the ADSs or Ordinary Shares

Subject to the discussion under "—Passive Foreign Investment Company" below, the gross amount of all our distributions to you (including amounts withheld to reflect any PRC withholding taxes) with respect to the ADSs or ordinary shares generally will be included in your gross income as foreign source dividend income on the date of actual or constructive receipt by the depositary, in the case of ADSs, or by you, in the case of ordinary shares, but only to the extent that the distribution is paid out of our current or accumulated earnings and profits (as determined under U.S. federal income tax principles). The dividends will not be eligible for the dividends-received deduction allowed to corporations under the Code in respect of dividends received from other U.S. corporations.

With respect to non-corporate U.S. Holders, certain dividends received in taxable years beginning before January 1, 2013 from a qualified foreign corporation may be subject to reduced rates of taxation. A foreign corporation is treated as a qualified foreign corporation with respect to dividends paid by that corporation on shares (or ADSs represented by such shares) that are readily tradable on an established securities market in the United States. U.S. Treasury Department guidance indicates that our ADSs (which are listed on the New York Stock Exchange), but not our ordinary shares, are readily tradable on an established securities market in the United States. Thus, we believe that dividends we pay on our ordinary shares that are represented by ADSs, but not on our ordinary shares that are not represented by ADSs, currently meet the readily tradable requirement for the reduced tax rates. There can be no assurance that our ADSs will be considered readily tradable on an established securities market in later years. A qualified foreign corporation also includes a foreign corporation that is eligible for the benefits of certain income tax treaties with the United States. In the event that we are deemed to be a PRC "resident enterprise" under PRC tax law (see discussion under "Taxation — People's Republic of China Taxation"), we may be eligible for the benefits of the income tax treaty between the United States and the PRC, and, if we are eligible for such benefits, dividends we pay on our ordinary shares, regardless of whether such ordinary shares are represented by ADSs, would be subject to the reduced rates of taxation if we are not a PFIC in the applicable years, as discussed below. Non-corporate U.S. Holders that do not meet a minimum holding period requirement during which they are not protected from the risk of loss or that elect to treat the dividend income as "investment income" pursuant to Section 163(d)(4) of the Code will not be eligible for the reduced rates of taxation regardless of our status as a qualified foreign corporation. In addition, the rate reduction will not apply to dividends if the recipient of a dividend is obligated to make related payments with respect to positions in substantially similar or related property. This disallowance applies even if the minimum holding period has been met. You should consult your own tax advisors regarding the application of this legislation to your particular circumstances.

Non-corporate U.S. Holders will not be eligible for the reduced rates of taxation on any dividends received from us in taxable years beginning prior to January 1, 2013, if we are a passive foreign investment company, or PFIC, in the taxable year in which such dividends are paid or in the preceding taxable year.

Under PRC tax law, if the dividends paid by us are deemed to be derived from sources within the PRC, you may be subject to PRC withholding taxes on dividends paid to you with respect to the ADSs or ordinary shares. In that case, subject to certain conditions and limitations, PRC withholding taxes on dividends, if any, may be treated as foreign taxes eligible for credit against your U.S. federal income tax liability. For purposes of calculating the foreign tax credit, dividends paid on the ADSs or ordinary shares will be treated as income from sources outside the United States and will generally constitute passive category income, but could, in certain circumstances, be general category income. The rules governing the foreign tax credit are complex. You are urged to consult your tax advisors regarding the availability of the foreign tax credit under your particular circumstances.

To the extent that the amount of the distribution exceeds our current and accumulated earnings and profits for a taxable year, as determined under U.S. federal income tax principles, it will be treated first as a tax-free return of your tax basis in your ADSs or ordinary shares, and to the extent the amount of the distribution exceeds your tax basis, the excess will be taxed as capital gain. However, we do not intend to calculate our earnings and profits in accordance with U.S. federal income tax principles. Therefore, a U.S. Holder should expect that a distribution will generally be treated as a dividend (as discussed above).

Taxation of Disposition of ADSs or Ordinary Shares

For U.S. federal income tax purposes, and subject to the discussion under "Passive Foreign Investment Company" below, you will recognize taxable gain or loss on any sale, exchange or other taxable disposition of each ADS or ordinary share equal to the

difference between the amount realized for the ADS or ordinary share and your tax basis in the ADS or ordinary share. The gain or loss generally will be capital gain or loss. If you are a non-corporate U.S. Holder, including an individual U.S. Holder, who has held the ADS or ordinary share for more than one year, you will be eligible for reduced tax rates. The deductibility of capital losses is subject to limitations. Any such gain or loss that you recognize will generally be treated as U.S. source income or loss for foreign tax credit limitation purposes. However, in the event that we are deemed to be a PRC "resident enterprise" under PRC tax law, we may be eligible for the benefits of the income tax treaty between the United States and the PRC. Under that treaty, if any PRC tax were to be imposed on any gain from the disposition of the ADSs or shares, the gain may be treated as PRC-source income. You are urged to consult your tax advisors regarding the tax consequences if a foreign withholding tax is imposed on a disposition of ADSs or ordinary shares, including the availability of the foreign tax credit under your particular circumstances.

Passive Foreign Investment Company

Based on the quarterly average valuation of our assets, including goodwill for the taxable year ended on December, 31, 2011, we may have been a PFIC for our taxable year ended on December 31, 2011, although there can be no certainty in this regard due to the complex nature of the applicable rules. Under the Code, the determination of whether we are a PFIC is made annually. Accordingly, our PFIC status for any taxable year cannot be determined until after the close of such taxable year. In particular, our PFIC status may be determined in large part based on the market price of our ADSs and ordinary shares, which is likely to fluctuate. Accordingly, fluctuations in the market price of the ADSs and ordinary shares may result in our being a PFIC in the current or any future taxable year. In addition, although the law in this regard is unclear, we treat the regional Nepstar companies and Nepstar E-Commerce as being owned by us for U.S. federal income tax purposes, not only because we retain control over their management decisions but also because we retain the economic risks and rewards of these entities. If it were determined, however, that we are not the owner of the regional Nepstar companies and Nepstar E-Commerce for U.S. federal income tax purposes, we would be more likely to be treated as a PFIC for any taxable year. If we are a PFIC for any taxable year during which you hold our ADSs or ordinary shares, you will be subject to special tax rules discussed below.

In general, we will be a PFIC for any taxable year in which:

- at least 75% of our gross income for the taxable year is passive income, or
- at least 50% of the value (determined based on a quarterly average) of our assets held during the taxable year is attributable to assets that produce or are held for the production of passive income.

For this purpose, passive income generally includes dividends, interest, royalties and rents (other than royalties and rents derived in the active conduct of a trade or business and not derived from a related person). If we, directly or indirectly, own at least 25% (by value) of the stock of another corporation, we will be treated, for purposes of the PFIC tests, as owning our proportionate share of the other corporation's assets and receiving our proportionate share of the other corporation's income.

If we are a PFIC for any taxable year during which you hold our ADSs or ordinary shares and unless you make a mark-to-market election as discussed below, you will be subject to special tax rules with respect to any "excess distribution" received and any gain realized from a sale or other disposition, including a pledge, of our ADSs or ordinary shares. Distributions received in a taxable year that are greater than 125% of the average annual distributions received during the shorter of the three preceding taxable years or your holding period for the ADSs or ordinary shares will be treated as excess distributions. Under these special tax rules:

- the excess distribution or gain will be allocated ratably over your holding period for the ADSs or ordinary shares;
- the amount allocated to the current taxable year, and any taxable year prior to the first taxable year in which we were a PFIC, will be treated as ordinary income; and
- the amount allocated to each other year will be subject to tax at the highest tax rate in effect for that year and the interest charge generally applicable to underpayments of tax will be imposed on the resulting tax attributable to each such year.

In addition, non-corporate U.S. Holders will not be eligible for reduced rates of taxation on any dividends received from us prior to January 1, 2013, if we are a PFIC in the taxable year in which such dividends are paid or in the preceding taxable year. You generally will be required to file Internal Revenue Service Form 8621 (or any other form subsequently specified by the U.S. Treasury) if you hold our ADSs or ordinary shares in any year in which we are classified as a PFIC.

If we are a PFIC for any taxable year during which you hold our ADSs or ordinary shares and any of our non-U.S. subsidiaries is also a PFIC, a U.S. Holder would be treated as owning a proportionate amount (by value) of the shares of the lower-tier PFIC for purposes of the application of these rules. You are urged to consult your tax advisors about the application of the PFIC rules to any of our subsidiaries.

In certain circumstances, in lieu of being subject to the excess distribution rules discussed above, you may make an election to include gain on the stock of a PFIC as ordinary income under a mark-to-market method, provided that such stock is regularly traded on a qualified exchange. Under current U.S. tax law, the mark-to-market election may be available to holders of

ADSs because the ADSs are listed on the New York Stock Exchange, which constitutes a qualified exchange, although there can be no assurance that the ADSs will be "regularly traded" for purposes of the mark-to-market election. It should also be noted that only our ADSs and not our ordinary shares are listed on the New York Stock Exchange. Consequently, if you are a holder of ordinary shares that are not represented by the ADSs, you generally will not be eligible to make a mark-to-market election. If you make an effective mark-to-market election, the excess distribution rules describe above would not apply to you. Instead, you will include in each year as ordinary income the excess of the fair market value of your ADSs at the end of the year over your adjusted tax basis in the ADSs. You will be entitled to deduct as an ordinary loss each year the excess of your adjusted tax basis in the ADSs over their fair market value at the end of the year, but only to the extent of the net amount previously included in your income as a result of the mark-to-market election. If you make an effective mark-to-market election, any gain you recognize upon the sale or other disposition of your ADSs will be treated as ordinary income and any loss will be treated as ordinary loss, but only to the extent of the net amount previously included in income as a result of the mark-to-market election.

Your adjusted tax basis in the ADSs will be increased by the amount of any income inclusion and decreased by the amount of any deductions under the mark-to-market rules. If you make a mark-to-market election, it will be effective for the taxable year for which the election is made and all subsequent taxable years unless the ADSs are no longer regularly traded on a qualified exchange or the Internal Revenue Service consents to the revocation of the election. A mark-to-market election generally must be made for the first taxable year in which a U.S. Holder holds stock in a PFIC, and is made by filing Internal Revenue Service Form 8621 with such U.S. Holder's original or amended U.S. federal income tax return on or before the due date (including extensions) of the return. You are urged to consult your tax advisor about the availability of the mark-to-market election, and whether making the election would be advisable in your particular circumstances.

Alternatively, a U.S. investor can avoid the rules described above with respect to the stock of a PFIC by electing to treat such PFIC as a "qualified electing fund" under Section 1295 of the Code. This option is not available to you because we do not intend to comply with the requirements necessary to permit you to make this election. You are urged to consult your tax advisors concerning the U.S. federal income tax consequences of holding ADSs or ordinary shares if we are considered a PFIC in any taxable year.

Information Reporting and Backup Withholding

Dividend payments with respect to ADSs or ordinary shares and proceeds from the sale, exchange or redemption of ADSs or ordinary shares paid to you within the United States (and in certain cases, outside the United States) may be subject to information reporting to the Internal Revenue Service, unless you are an exempt recipient. However, backup withholding will not apply to a U.S. Holder who furnishes a correct taxpayer identification number and makes any other required certification or who is otherwise exempt from backup withholding. U.S. Holders who are required to establish their exempt status generally must provide such certification on Internal Revenue Service Form W-9. You are urged to consult your tax advisors regarding the application of the U.S. information reporting and backup withholding rules.

Backup withholding is not an additional tax. Amounts withheld as backup withholding may be credited against your U.S. federal income tax liability, and you may obtain a refund of any excess amounts withheld under the backup withholding rules by filing the appropriate claim for refund with the Internal Revenue Service and furnishing any required information.

U.S. Holders that hold certain foreign financial assets (which may include our ADSs or ordinary shares) are required to report information related to such assets, subject to certain exceptions. You are urged to consult your tax advisor regarding the effect, if any, of this requirement on your ownership and disposition of our ADSs or ordinary shares.

Attestation Report of Independent Registered Public Accounting Firm

The effectiveness of our internal control over financial reporting as of December 31, 2011 has been audited by KPMG, an independent registered public accounting firm, as stated in their report dated April 24, 2012 appearing herein.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
China Nepstar Chain Drugstore Ltd.:

We have audited China Nepstar Chain Drugstore Ltd.'s internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). China Nepstar Chain Drugstore Ltd.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, China Nepstar Chain Drugstore Ltd. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control — Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of China Nepstar Chain Drugstore Ltd. and subsidiaries as of December 31, 2010 and 2011, and the related consolidated statements of income, shareholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2011, and our report dated April 24, 2012 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG

Hong Kong, China
April 24, 2012

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the year ended December 31, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

On August 13, 2010, our board of directors approved a share repurchase program, under which we were authorized to repurchase up to US$20.0 million worth of our issued and outstanding ADSs from the open market from time to time and before August 13, 2011. During the duration of this program, we purchased 6,458,742 of our ordinary shares in the form of ADSs for a total purchase price of approximately US$9.0 million. All of the repurchased ordinary shares have been retired. The repurchases were made on the open market at prevailing market prices or in block trades and subject to restrictions relating to volume, price and timing. The following table sets forth certain information related to purchases made by us of our ADSs under the program:

Period	Total number of ADSs purchased	Average price paid per ADS [1]		Total number of ADSs purchased as part of publicly announced program	Approximate dollar value of ADSs that may yet be purchased under the program	
		US$	RMB [2]		US$	RMB [2]
August 2010	1,581,773	2.7499	18.1493	1,581,773	15,650,282.43	103,291,864.00
September 2010	331,768	2.9971	19.7809	1,913,541	14,655,940.56	96,729,207.69
June 2011	358,319	2.6993	16.9892	2,271,860	13,688,727.10	86,155,479.49
July 2011	599,864	2.8720	18.0758	2,871,724	11,965,942.59	75,312,446.07
August 2011	357,647	2.6012	16.3717	3,229,371	11,035,625.38	69,457,122.58

(1) The average price paid per ADS is calculated using the execution price for each repurchase excluding commissions paid to brokers.

(2) The translations of U.S. dollar amounts into Renminbi amounts have been made at the exchange rate in effect on December 31, 2011, which was US$1.00 to RMB6.2939. See "Selected Financial Data — Exchange Rate Information."

On August 19, 2011, our board of directors approved a share repurchase program, under which we were authorized to repurchase up to US$20.0 million worth of our issued and outstanding ADSs from the open market from time to time and before August 23, 2012. As of March 31, 2012, we have purchased 4,882,954 of our ordinary shares in the form of ADSs for a total purchase price of approximately US$5.7 million. All of the repurchased ordinary shares have been retired. The repurchases were made on the open market at prevailing market prices or in block trades and subject to restrictions relating to volume, price and timing. The following table sets forth certain information related to purchases made by us of our ADSs under the program:

Period	Total number of ADSs purchased	Average price paid per ADS [1]		Total number of ADSs purchased as part of publicly announced program	Approximate dollar value of ADSs that may yet be purchased under the program	
		US$	RMB [2]		US$	RMB [2]
August 2011	152,223	2.4661	15.5214	152,223	19,624,603.97	123,515,294.93
September 2011	362,880	2.5467	16.0287	515,103	18,700,453.39	117,698,783.59
October 2011	321,378	2.2640	14.2494	836,481	17,972,868.04	113,119,434.16
November 2011	276,956	2.4016	15.1154	1,113,437	17,307,741.26	108,933,192.72
December 2011	308,978	1.8822	11.8464	1,422,415	16,726,170.70	105,272,845.77
January 2012	463,056	2.3800	14.9795	1,885,471	15,624,103.17	98,336,542.94
February 2012	280,318	2.5169	15.8411	2,165,789	14,918,564.68	93,895,954.24
March 2012	275,688	2.2905	14.4162	2,441,477	14,287,103.62	89,921,601.47

(1) The average price paid per ADS is calculated using the execution price for each repurchase excluding commissions paid to brokers.

(2) The translations of U.S. dollar amounts into Renminbi amounts have been made at the exchange rate in effect on December 31, 2011, which was US$1.00 to RMB6.2939. See "Part I. — Item 3. Key Information — Selected Financial Data — Exchange Rate Information."

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of
China Nepstar Chain Drugstore Ltd.

We have audited the accompanying consolidated balance sheets of China Nepstar Chain Drugstore Ltd. and subsidiaries as of December 31, 2010 and 2011, and the related consolidated statements of income, shareholders' equity and comprehensive income and cash flows for each of the years in the three-year period ended December 31, 2011. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of China Nepstar Chain Drugstore Ltd. and subsidiaries as of December 31, 2010 and 2011, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2011 in conformity with U.S. generally accepted accounting principles.

The accompanying consolidated financial statements as of and for the year ended December 31, 2011 have been translated into United States dollars solely for the convenience of the reader. We have audited the translation and, in our opinion, such consolidated financial statements expressed in Renminbi have been translated into United States dollars on the basis set forth in Note 2(c) to the consolidated financial statements.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), China Nepstar Chain Drugstore Ltd.'s internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated April 24, 2012 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG
Hong Kong, China
April 24, 2012

CHINA NEPSTAR CHAIN DRUGSTORE LTD. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2010 AND 2011

(Amounts in thousands, except share data)

	Note	December 31, 2010 RMB	2011 RMB	2011 USD
ASSETS				
Current assets:				
Cash and cash equivalents	3	626,796	767,885	122,005
Short-term bank time deposits	3	513,000	43,000	6,832
Restricted cash		5,000	—	—
Accounts receivable, net of allowance for doubtful accounts	4	83,722	102,937	16,355
Amounts due from related parties	22	12,358	4,649	739
Prepaid expenses, deposits and other current assets	5	127,750	122,831	19,516
Inventories	6	433,265	437,058	69,442
Deferred tax assets	12	3,551	2,009	319
Total current assets		1,805,442	1,480,369	235,208
Property and equipment, net	7	192,019	141,817	22,532
Long-term bank time deposits	3	—	169,000	26,851
Rental deposits		41,811	39,559	6,286
Cost method investments		12,638	12,638	2,008
Equity method investment	10	35,151	36,703	5,832
Land use right		8,227	—	—
Intangible assets, net	9	2,919	3,087	490
Goodwill	8,9	51,089	51,819	8,233
Deferred tax assets	12	1,813	3,151	501
Deposits for acquisition	8	2,000	1,000	159
Accrued interest income		—	3,054	485
TOTAL ASSETS		2,153,109	1,942,197	308,585
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current liabilities:				
Accounts payable		313,773	352,386	55,988
Amounts due to related parties	22	24,461	18,169	2,887
Accrued expenses and other payables	13	131,330	118,121	18,768
Deferred income	14	26,102	10,662	1,694
Income tax payable		52,520	28,480	4,525
Total current liabilities		548,186	527,818	83,862
Deferred income	14	18,794	17,078	2,713
Deferred tax liabilities	12	16,922	12,032	1,912
Other non-current liabilities	12	—	31,015	4,928
Total liabilities		583,902	587,943	93,415
Shareholders' equity:				
Share capital – ordinary shares USD0.0001 par value:				
360,000,000 shares authorized; 207,785,938 shares issued and outstanding as of December 31, 2010; 360,000,000 shares authorized; 202,783,480 shares issued and outstanding as of December 31, 2011	15	164	161	26
Treasury stock				
Nil as of December 31, 2010; 334,388 shares as of December 31, 2011	15	—	(1,736)	(276)
Additional paid-in capital		1,501,809	1,252,232	198,960
Accumulated other comprehensive loss		(41,563)	(41,133)	(6,535)
Retained earnings	16	108,797	144,730	22,995
Total shareholders' equity		1,569,207	1,354,254	215,170
Commitments and contingencies		—	—	—
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		2,153,109	1,942,197	308,585

See accompanying notes to consolidated financial statements.

CHINA NEPSTAR CHAIN DRUGSTORE LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 2009, 2010 AND 2011

(Amounts in thousands, except per share data)

	Note	Year ended December 31, 2009	2010	2011	2011
		RMB	RMB	RMB	USD
Revenue	18,22	2,217,613	2,356,604	2,491,290	395,826
Cost of goods sold		(1,143,398)	(1,192,665)	(1,302,653)	(206,971)
Gross profit		1,074,215	1,163,939	1,188,637	188,855
Sales, marketing and other operating expenses		(858,072)	(985,510)	(1,015,165)	(161,294)
General and administrative expenses		(105,652)	(128,196)	(120,671)	(19,173)
Impairment losses of property and equipment	7	—	(3,423)	(14,164)	(2,250)
Other expense	11	—	(25,540)	—	—
Income from operations		110,491	21,270	38,637	6,138
Interest income		75,335	23,923	23,154	3,679
Interest expense		(2,507)	(1,200)	—	—
Dividend income from cost method investments		3,776	3,028	3,616	575
Equity in income of an equity method investee	10	5,128	5,808	1,552	247
Other income	10	8,927	—	—	—
Income before income tax expense		201,150	52,829	66,959	10,639
Income tax expense	12	(61,174)	(36,321)	(31,026)	(4,930)
Net income attributable to China Nepstar Chain Drugstore Ltd.		139,976	16,508	35,933	5,709
Earnings per ordinary share:					
Basic	21	0.67	0.08	0.17	0.03
Diluted	21	0.66	0.08	0.17	0.03

See accompanying notes to consolidated financial statements.

CHINA NEPSTAR CHAIN DRUGSTORE LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 2009, 2010 AND 2011

(Amounts in thousands, except share data)

	Ordinary shares		Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Total Equity attributable to China Nepstar Chain Drugstore Ltd.	Noncontrolling Interest	Total Shareholders' Equity
	Number of Shares	Par Value Amount						
		RMB	RMB	RMB	RMB	RMB	RMB	RMB
Balance as of January 1, 2009	208,293,136	165	2,823,668	(38,009)	173,650	2,959,474	23,165	2,982,639
Net income	—	—	—	—	139,976	139,976	—	139,976
Foreign currency translation adjustment net of tax effect of nil	—	—	—	(476)	—	(476)	—	(476)
Comprehensive income						139,500	—	139,500
Repurchase and retirement of ordinary shares (Note 15)	(1,128,400)	(1)	(16,081)	—	—	(16,082)	—	(16,082)
Issuance of ordinary shares upon exercise of employee share options (Note 15)	2,708,412	2	13,300	—	—	13,302	—	13,302
Share-based compensation expense (Note 19)	—	—	3,003	—	—	3,003	—	3,003
Dividend (Note 17)	—	—	(1,218,128)	—	(103,337)	(1,321,465)	—	(1,321,465)
Deconsolidation of Yunnan Nepstar	—	—	—	—	—	—	(23,165)	(23,165)
Balance as of December 31, 2009	209,873,148	166	1,605,762	(38,485)	210,289	1,777,732	—	1,777,732

See accompanying notes to consolidated financial statements.

CHINA NEPSTAR CHAIN DRUGSTORE LTD AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 2009, 2010 AND 2011

(Amounts in thousands, except share data)

	Ordinary shares		Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Total Equity attributable to China Nepstar Chain Drugstore Ltd.	Noncontrolling Interest	Total Shareholders' Equity
	Number of Shares	Par Value Amount						
		RMB	RMB	RMB	RMB	RMB	RMB	RMB
Balance as of January 1, 2010	209,873,148	166	1,605,762	(38,485)	210,289	1,777,732	—	1,777,732
Net income	—	—	—	—	16,508	16,508	—	16,508
Foreign currency translation adjustment net of tax effect of nil	—	—	—	(3,078)	—	(3,078)	—	(3,078)
Comprehensive income						13,430	—	13,430
Repurchase and retirement of ordinary shares (Note 15)	(3,827,082)	(3)	(36,581)	—	—	(36,584)	—	(36,584)
Issuance of ordinary shares upon exercise of employee share options and ordinary shares granted to employees (Note 15)	1,739,872	1	10,148	—	—	10,149	—	10,149
Share-based compensation expense (Note 19)	—	—	5,781	—	—	5,781	—	5,781
Dividend (Note 17)	—	—	(83,301)	—	(118,000)	(201,301)	—	(201,301)
Balance as of December 31, 2010	207,785,938	164	1,501,809	(41,563)	108,797	1,569,207	—	1,569,207

See accompanying notes to consolidated financial statements.

CHINA NEPSTAR CHAIN DRUGSTORE LTD AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 2009, 2010 AND 2011

(Amounts in thousands, except share data)

	Ordinary shares								
	Number of Shares	Par Value Amount	Treasury Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Total Equity attributable to China Nepstar Chain Drugstore Ltd.	Noncontrolling Interest	Total Shareholders' Equity
		RMB	RMB	RMB	RMB	RMB	RMB	RMB	RMB
Balance as of January 1, 2011	207,785,938	164	—	1,501,809	(41,563)	108,797	1,569,207	—	1,569,207
Net income	—	—	—	—	—	35,933	35,933	—	35,933
Foreign currency translation adjustment net of tax effect of nil	—	—	—	—	430	—	430	—	430
Comprehensive income							36,363	—	36,363
Repurchase of ordinary share (Note 15)	—	—	(45,522)	—	—	—	(45,522)	—	(45,522)
Retirement of ordinary share (Note 15)	(5,142,102)	(3)	43,786	(43,783)	—	—	—	—	—
Issuance of ordinary shares upon exercise of employee share options and ordinary shares granted to employees (Note 15)	139,644	—	—	554	—	—	554	—	554
Share-based compensation expense reversal (Note 19)	—	—	—	(1,195)	—	—	(1,195)	—	(1,195)
Dividend (Note 17)	—	—	—	(205,172)	—	—	(205,172)	—	(205,172)
Income from disposal of subsidiary to parent company (Note 22(f))	—	—	—	19	—	—	19	—	19
Balance as of December 31, 2011	202,783,480	161	(1,736)	1,252,232	(41,133)	144,730	1,354,254	—	1,354,254
Balance as of December 31, 2011 (USD)		26	(276)	198,960	(6,535)	22,995	215,170	—	215,170

See accompanying notes to consolidated financial statements.

CHINA NEPSTAR CHAIN DRUGSTORE LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2009, 2010 AND 2011

(Amounts in thousands)

	Year ended December 31,			
	2009	2010	2011	2011
	RMB	RMB	RMB	USD
Cash flows from operating activities:				
Net income	139,976	16,508	35,933	5,709
Adjustments to reconcile net income to net cash provided by operating activities:				
Share-based compensation expense / (expense reversal)	3,003	5,781	(1,195)	(190)
Depreciation and amortization	63,144	66,755	58,913	9,360
Loss on disposal of property and equipment	3,728	3,531	3,605	573
Gain on deconsolidation of Yunnan Nepstar	(8,927)	—	—	—
Equity in income of an equity method investee	(5,128)	(5,808)	(1,552)	(247)
Deferred income taxes	19,519	112	(4,776)	(759)
Inventory write-downs	8,702	9,424	9,379	1,490
Impairment losses of property and equipment	—	3,423	14,164	2,250
Changes in operating assets and liabilities (net of effect of acquisitions, disposal and deconsolidation of subsidiaries):				
Accounts receivable	(12,793)	(11,161)	(19,215)	(3,053)
Prepayment for purchase of inventory from related parties	32,204	38,102	—	—
Amounts due from related parties	(2,198)	(5,052)	7,709	1,225
Prepaid expenses, deposits and other current assets	8,604	13,544	4,063	646
Inventories	(52,727)	(72,914)	(13,173)	(2,093)
Deferred income	12,009	17,894	(17,156)	(2,726)
Accounts payable	46,759	(21)	38,613	6,135
Amounts due to related parties	8,476	11,928	(6,292)	(1,000)
Accrued expenses and other payables	25,490	4,718	(7,843)	(1,245)
Income tax payable	5,439	13,921	6,975	1,108
Net cash provided by operating activities	295,280	110,685	108,152	17,183
Cash flows from investing activities:				
(Placement)/release of restricted cash	(15,000)	10,000	5,000	794
Purchase of property and equipment	(53,982)	(56,195)	(28,089)	(4,463)
Proceeds from disposal of property and equipment, and land use right	413	718	9,717	1,544
Proceeds from maturity of held-to-maturity investment securities	641,000	400,000	—	—
Payment for acquisitions	(19,078)	(1,979)	—	—
Payment for land use right	(8,622)	—	—	—
Investment in time deposits with original maturity over three months	(690,000)	(537,000)	(708,000)	(112,490)
Proceeds from maturity of time deposits with original maturity over three months	805,000	954,000	1,009,000	160,316
Effect of deconsolidation of subsidiaries	(7,011)	—	19	3
Net cash provided by investing activities	652,720	769,544	287,647	45,704
Cash flows from financing activities:				
Proceeds from issuance of ordinary shares upon exercise of employee share options	13,302	10,149	554	88
Payment for repurchase of ordinary shares	(16,082)	(36,584)	(45,522)	(7,233)
Proceeds from short-term bank loans	610,000	—	—	—
Repayment of short-term bank loans	(140,000)	(470,000)	—	—
Dividends paid	(1,282,111)	(239,932)	(205,172)	(32,599)
Net cash used in financing activities	(814,891)	(736,367)	(250,140)	(39,744)

See accompanying notes to consolidated financial statements.

CHINA NEPSTAR CHAIN DRUGSTORE LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2009, 2010 AND 2011

(Amounts in thousands)

	Year ended December 31,			
	2009	2010	2011	2011
	RMB	RMB	RMB	USD
Effect of foreign currency exchange rates on cash	19	(3,078)	(4,570)	(726)
Net increase in cash	133,128	140,784	141,089	22,417
Cash and cash equivalents at beginning of the year	352,884	486,012	626,796	99,588
Cash and cash equivalents at end of the year	486,012	626,796	767,885	122,005
Supplemental disclosure of cash flow information:				
Interest paid	(2,068)	(1,639)	—	—
Income taxes paid	(31,960)	(19,642)	(30,141)	(4,789)
Accounts payable for purchase of property and equipment	8,112	4,968	4,720	750

See accompanying notes to consolidated financial statements.

1 PRINCIPAL ACTIVITIES, ORGANIZATION AND BASIS OF PRESENTATION

(a) Principal activities

China Nepstar Chain Drugstore Ltd. (the "Company") and its subsidiaries (collectively with the Company, the "Group") are principally engaged in the business of operating retail drugstores in the People's Republic of China (the "PRC"). The Group's drugstores provide pharmacy services and sell prescription drugs, non-prescription or over-the-counter drugs, nutritional supplements, herbal products, personal and family care products and convenience products such as snack food and beverages. As of December 31, 2011, the Company, through its subsidiaries, was the owner and operator of 2,395 retail drugstores in 74 cities in Guangdong, Jiangsu, Zhejiang, Liaoning, Shandong, Hunan, Fujian, Sichuan, and Hubei provinces and Shanghai, Tianjin and Beijing municipalities of the PRC under the name of "China Nepstar". All of the Group's operations and customers are located in the PRC.

The following list contains the particulars of subsidiaries and an equity method investee which principally affect the consolidated results of operations and financial position of the Company.

Name of subsidiary/investee	Principal activities	Percentage of controlling interest as of December 31,		
		2009	2010	2011
Shenzhen Nepstar Pharmaceutical Co., Ltd. ("Nepstar Pharmaceutical")	Procurement of merchandise for the Group	100%	100%	100%
Weifang Nepstar Pharmaceutical Co., Ltd. ("Weifang Nepstar")	Procurement of merchandise for the Group	100%	100%	100%
Shanghai Nepstar Chain Co., Ltd. ("Shanghai Nepstar")	Operation of retail drugstores	100%	100%	100%
Guangzhou Nepstar Chain Co., Ltd. ("Guangzhou Nepstar")	Operation of retail drugstores	100%	100%	100%
Ningbo Nepstar Chain Co., Ltd. ("Ningbo Nepstar")	Operation of retail drugstores	100%	100%	100%
Sichuan Nepstar Chain Co., Ltd. ("Sichuan Nepstar")	Operation of retail drugstores	100%	100%	100%
Jiangsu Nepstar Chain Co., Ltd. ("Jiangsu Nepstar")	Operation of retail drugstores	100%	100%	100%
Dalian Nepstar Chain Co., Ltd. ("Dalian Nepstar")	Operation of retail drugstores	100%	100%	100%
Hangzhou Nepstar Chain Co., Ltd. ("Hangzhou Nepstar")	Operation of retail drugstores	100%	100%	100%
Shandong Minkang Nepstar Chain Co., Ltd. ("Shandong Nepstar")	Operation of retail drugstores	100%	100%	100%
Shenzhen Nepstar Chain Co., Ltd. ("Shenzhen Nepstar")	Operation of retail drugstores	100%	100%	100%

Name of subsidiary/investee	Principal activities	Percentage of controlling interest as of December 31,		
		2009	2010	2011
Qingdao Nepstar Chain Co., Ltd. (“Qingdao Nepstar”)	Operation of retail drugstores	100%	100%	100%
Tianjin Nepstar Chain Co., Ltd. (“Tianjin Nepstar”)	Operation of retail drugstores	100%	100%	100%
Yunnan Jian Zhijia Chain Drugstore Ltd. (“Yunnan Nepstar”)	Operation of retail drugstores (Note 1(a)(i))	40%	40%	40%
Fuzhou Nepstar Chain Co., Ltd. (“Fuzhou Nepstar”)	Operation of retail drugstores	100%	100%	100%
Hubei Nepstar Chain Co., Ltd. (“Hubei Nepstar”)	Operation of retail drugstores	100%	100%	100%
Beijing Nepstar Chain Co., Ltd. (“Beijing Nepstar”)	Operation of retail drugstores	100%	100%	100%
Shenyang Nepstar Chain Co., Ltd. (“Shenyang Nepstar”)	Operation of retail drugstores	100%	100%	100%
Shenzhen Nepstar E-commerce Co., Ltd. (“Nepstar E-commerce”)	Online retail sales of merchandise	100%	100%	100%
Zaozhuang Nepstar Chain Co., Ltd. (“Zaozhuang Nepstar”)	Operation of retail drugstores	—	100%	100%

Note (i)

Yunnan Nepstar is 40% owned by Nepstar Pharmaceutical, 30% owned by Yunnan Qunxiang Industrial Trading Co., Ltd. (“Qunxiang”), a company 100% beneficially owned by a director of Yunnan Nepstar, and 30% owned by Yunnan Hengyu Industrial Trading Co., Ltd. (“Yunnan Hengyu”), a third party investor. In 1999, Qunxiang assigned Nepstar Pharmaceutical its 30% voting interest right with respect to the corporate, financial and operating actions of Yunnan Nepstar, including the approvals for the appointment of directors, business operating and capital investment plans, financial budgets, and dividends or profit distributions. Under the Articles of Association of Yunnan Nepstar, the approval and resolution of these corporate, financial and operating actions require a majority vote by the shareholders. The assignment of the voting interest right to Nepstar Pharmaceutical was legally binding and irrevocable as long as Nepstar Pharmaceutical remained a 40% shareholder of Yunnan Nepstar. Also, Qunxiang agreed not to dispose its 30% equity interest in Yunnan Nepstar to any parties other than Nepstar Pharmaceutical without receiving Nepstar Pharmaceutical’s prior consent. Since Nepstar Pharmaceutical had legal and unilateral control of the operations of Yunnan Nepstar by virtue of ownership of a majority voting interest held directly (40%) and indirectly through the voting interest right assignment (30%), Yunnan Nepstar was accounted for as a 40%-owned consolidated subsidiary of the Group with 60% noncontrolling interest during the year ended December 31, 2008. On January 5, 2009, the Company announced that its Board of Directors approved the termination of the voting interest right assignment agreement between Qunxiang and Nepstar Pharmaceutical. The termination of the voting interest right assignment was considered by the Board of Directors to be in the long term interest of the Company’s shareholders. Upon the termination of the voting interest right assignment in January 2009, Yunnan Nepstar is no longer a consolidated subsidiary of the Company and instead accounted for under the equity method of accounting. Upon deconsolidation, management remeasured the retained noncontrolling interest in Yunnan Nepstar to its fair value. See Note 10.

(b) Significant concentrations and risks

As of December 31, 2010 and 2011, the Group held US dollar denominated bank deposits of USD2,947 and USD12,899 (equivalent to RMB19,447 and RMB81,186) respectively, which were placed with financial institutions in the Hong Kong Special Administrative Region (“HKSAR”) of the PRC. Apart from the bank deposits in HKSAR, all of the Group’s bank deposits are with financial institutions in the mainland of the PRC.

(c) Organization

The Company was incorporated in the Cayman Islands in August 2004 as part of the reorganization of Shenzhen Nepstar Health Chain Drugstore Co., Ltd., a PRC company that operated the retail drugstore business of Shenzhen Neptunus Group Co., Ltd. ("Neptunus Group"), to facilitate the raising of capital from investors outside of the PRC and the Company's initial public offering (the "Reorganization"). On November 9, 2007, the Company completed its initial public offering of shares in the form of American Depositary Shares ("ADSs"). The Company's ADSs are traded on New York Stock Exchange under the symbol "NPD".

In May 2007, the Company carried out a group reorganization whereby it transferred 51% equity interest in each of Shanghai Nepstar, Guangzhou Nepstar, Ningbo Nepstar, Sichuan Nepstar, Jiangsu Nepstar, Dalian Nepstar, Hangzhou Nepstar, Shandong Nepstar, Shenzhen Nepstar, Qingdao Nepstar and Tianjin Nepstar (collectively the "Pre-2009 Regional Companies") to two PRC companies (the "Transferee Companies"). The Transferee Companies are legally held under the name of the Group's employees in order to comply with certain PRC rules and regulations in relation to foreign ownership of companies in the PRC engaging in the retail drugstore businesses. The Transferee Companies paid an aggregate consideration of RMB31,794 to the Company for the 51% equity interest in the Pre-2009 Regional Companies, which was financed by loans provided by the Company. In August 2009, Nepstar Pharmaceutical and the Transferee Companies established Fuzhou Nepstar, each holding 49% and 51% equity interests, respectively. The Transferee Companies paid the initial capital contribution of RMB1,530 with the loans provided by Nepstar Pharmaceutical.

In December 2009, Shenzhen Nepstar E-commerce Co., Ltd. ("Nespstar E-commerce") was set up with 100% of equity interest owned by Nepstar Pharmaceutical to operate the online retail sales of merchandise. Under the PRC regulations, foreign investors are not allowed to own more than 50% of the equity interest in any "value-added telecommunications services" provider, or an entity conducting an internet content distribution business. As a result, in May 2010, Nepstar Pharmaceutical transferred its entire equity interest in Nepstar E-commerce to the two Transferee Companies. In return for the equity transfer, the Transferee Companies paid a total consideration of RMB10,000 (equal to the initial investment by Nepstar Pharmaceutical) to Nepstar Pharmaceutical. The cash of RMB10,000 was financed by a loan from Nepstar Pharmaceutical.

In order to have the same unilateral control and economic risks and rewards as direct legal ownership of the Pre-2009 Regional Companies, Fuzhou Nepstar and Nepstar E-commerce (collectively referred to as "Regional Companies" hereafter), Nepstar Pharmaceutical entered into certain contractual arrangements (the "Contractual Agreements") with the Regional Companies, the Transferee Companies and their individual legal owners. The terms of the Contractual Agreements are summarized as follows:

Agreements that Retain Control over the Regional Companies

Under the shareholders agreements (namely the Shareholders Agreements and Equity Pledge Agreements) among Nepstar Pharmaceutical and the Transferee Companies, the Transferee Companies are not allowed to transfer their equity interests in the Regional Companies to a third party, nor are the Transferee Companies allowed to pledge, dispose of or create any encumbrance on such equity interests, without the prior written consent of Nepstar Pharmaceutical. In addition, the Transferee Companies agree to delegate all voting power rights as legal shareholders of the Regional Companies to persons designated by Nepstar Pharmaceutical, and agree to delegate their voting rights in the Board of Directors of the Regional Companies to Nepstar Pharmaceutical. The terms of these agreements are indefinite. Further, in accordance with the PRC Property Rights Law, the Equity Pledge Agreements are required to be registered with the relevant government authority. The Company completed the registration of the Equity Pledge Agreements in July 2007.

Agreements that Retain Economic Risks and Rewards of the Regional Companies

Under the Logistics Service and Information Technology Support Agreements, the Trade Name License Agreements entered into between Nepstar Pharmaceutical and each of the Regional Companies, Nepstar Pharmaceutical provides logistic, information technology support and consulting services to the Regional Companies, and allows these companies to use the trade names and trademarks for their operations, in exchange for annual service fees and license fees calculated based on each Regional Company's gross profit. Under the Supply Agreements entered into between Nepstar Pharmaceutical and each of the Regional Companies, Nepstar Pharmaceutical is a supplier of products sold by these companies' retail drugstores and the use of other suppliers of products sold by these companies' retail drugstores requires authorization and approval by Nepstar Pharmaceutical. Nepstar Pharmaceutical has the right to adjust the purchase price at its sole discretion. These agreements will expire on May 27, 2017, and are automatically renewed for additional one-year term on an annual basis unless Nepstar Pharmaceutical gives prior written notice to the respective Regional Companies regarding its decision not to renew these agreements. These agreements allow the Regional Companies' profits to be transferred to the Company through Nepstar Pharmaceutical.

The respective shareholders agreements referred to above stipulate that unanimous approval of shareholders must be obtained before each of the Regional Companies may distribute dividends and with such approval, dividends may be distributed in accordance with the shareholders' respective equity interest or in a ratio as otherwise agreed to by the shareholders. In addition, any amounts received by the Transferee Companies from the Regional Companies, including dividends and other distributions on equity interest, shall be deposited in a designated bank account managed by Nepstar Pharmaceutical as security for the loans by Nepstar Pharmaceutical to the two Transferee Companies. The loans have an initial term of one year and are renewable indefinitely at the option of Nepstar Pharmaceutical. Without prior consent of Nepstar Pharmaceutical, these amounts cannot be distributed to the Transferee Companies' shareholders. Further, Nepstar Pharmaceutical has an exclusive option to acquire all or part of the Transferee Companies' equity interest in the Regional Companies at a price equal to the respective purchase price initially paid by the Transferee Companies. Nepstar Pharmaceutical also has an exclusive option to acquire all or part of the equity interests in the Transferee Companies from their shareholders at a price equal to the registered capital of these companies.

In the opinion of management, based on consultation with the Company's PRC legal counsel, the above contractual arrangements are legally binding and enforceable and do not violate current PRC laws and regulations.

According to the Contractual Agreements, the Transferee Companies agree to delegate all the rights to exercise their voting power as shareholders of the Regional Companies to Nepstar Pharmaceutical, and thus the Company has a unilateral controlling financial interest in the Regional Companies. Furthermore, the transfer of 51% legal ownership in the Regional Companies lacked substance for accounting purpose, as the purpose of the transfer was to allow the Company to comply with certain PRC rules and regulations in relation to foreign ownership of companies in the PRC engaging in retail drugstore business. Through the Contractual Agreements, the Company has exclusive authority over all decision-making related to the Regional Company's major operations and employee compensation and has 100% financial interest (either through dividend distribution or provision of logistic, information technology support and consulting services) in the Regional Companies. As a result, the Regional Companies are consolidated by the Company.

(d) Basis of presentation

The accompanying consolidated financial statements have been prepared in accordance with US generally accepted accounting principles ("US GAAP").

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Principles of consolidation

The accompanying consolidated financial statements include the financial statements of the Company and its subsidiaries. All significant inter-company balances and transactions have been eliminated in consolidation.

The Contractual Agreements provide the Company with the legal and unilateral financial control of the Regional Companies and allow the Company to share in all economic risks and rewards of ownership as though the Regional Companies were held through direct legal ownership. Accordingly, the Company has consolidated the Regional Companies as though the entities were wholly-owned subsidiaries. The loans and advance to the Transferee Companies are fully eliminated in consolidation.

(b) Use of estimates

The preparation of the consolidated financial statements in conformity with US GAAP requires management of the Company to make a number of estimates and assumptions relating to the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the year. Significant items subject to such estimates and assumptions include the realizability of inventories, the useful lives and salvage values of property and equipment and intangible assets, the recoverability of the carrying amount of property and equipment, goodwill, intangible assets and investments, the realization of deferred tax assets, the collectability of accounts receivable, the fair values of employee share-based payment arrangements and financial instruments, and accruals of contingencies. These estimates are often based on complex judgments and assumptions that management believes to be reasonable but are inherently uncertain and unpredictable. Actual results may differ from those estimates.

(c) Foreign currency transactions and translation

The Group's reporting currency is the Renminbi ("RMB"). The functional currency of the Company is the US dollar ("USD"), whereas the functional currency of the Company's subsidiaries in the PRC is the RMB since the PRC is the primary economic environment in which the PRC subsidiaries entities operate. Transactions denominated in currencies other than the functional currency are converted into the functional currency at the exchange rates prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are converted into the functional currency using the applicable exchange rates at the balance sheet date.

Assets and liabilities of the Company are translated into RMB using the exchange rate on the balance sheet date. Revenues and expenses of the Company are translated at average rates prevailing during the year. Gains and losses resulting from translation of the Company's financial statements are recorded as a separate component of accumulated other comprehensive loss within shareholders' equity. In addition, gains and losses on inter-company foreign currency transactions that are of a long-term investment nature are reported as other comprehensive income or loss in the same manner as translation adjustments.

For the convenience of the readers, the December 31, 2011 RMB amounts included in the accompanying consolidated financial statements have been translated into U.S. dollars at the rate of US$1.00=RMB6.2939, being the noon buying rate for U.S. dollars in effect on December 30, 2011 for cable transfers in RMB per U.S. dollar as certified for custom purposes by the Federal Reserve Bank of New York. No representation is made that the RMB amounts could have been, or could be, converted into U.S. dollars at that rate or at any other rate on December 31, 2011 or at any other date.

Since RMB is not a fully convertible currency, all foreign exchange transactions involving RMB must take place either through the People's Bank of China (the "PBOC") or other institutions authorized to buy and sell foreign exchange. The exchange rates adopted for the foreign exchange transactions are the rates of exchange quoted by the PBOC, which are determined largely by supply and demand.

(d) Cash and cash equivalents

Cash and cash equivalents, include interest-bearing time deposits at banks with original maturity within three months.

(e) Restricted cash

Cash that is restricted as to withdrawal or usage is reported as restricted cash in the consolidated balance sheets and is not included in the beginning or ending balance of cash and cash equivalents in the consolidated statements of cash flows.

Restricted cash of RMB5,000 as of December 31, 2010 represented cash with restrictions imposed by the Administration for Industry & Commerce. There was no restricted cash balance as of December 31, 2011.

(f) Held-to-maturity investment securities

Investments in debt securities in which the Group has the intent and ability to hold the securities until maturity are classified as held-to-maturity investment securities. Held-to-maturity investment securities are recorded at amortized cost, adjusted for the amortization or accretion of premiums or discounts. Interest income from the held-to-maturity investment securities is recognized when earned. Premiums and discounts, if any, are amortized or accreted over the life of the related security as an adjustment to interest income using the effective-interest method.

(g) Accounts receivable

Accounts receivable are recorded at the invoiced amount and do not bear interest. Accounts receivable represent amounts due from banks relating to retail sales that are paid or settled by the customers' debit or credit cards, amounts due from government social security bureaus relating to retail sales of drugs and prescription medicine that are paid or settled by the customers' medical insurance cards, and amounts due from non-retail customers for sales of merchandise. Accounts receivable are stated net of an allowance for doubtful accounts. The Group maintains and records an allowance for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. The allowance for doubtful accounts is based on a review of specifically identified accounts and aging data. Judgments are made with respect to the collectability of accounts receivable based on customer specific facts and current economic conditions. Accounts receivable are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. The Group does not have any off-balance sheet credit exposure related to its customers.

(h) Inventories

Inventories are stated at the lower of cost or market. Cost is determined using the weighted average cost method. The Group carries out physical inventory counts on a quarterly basis at each store and warehouse location and records write-downs to inventories for shrinkage losses and damaged merchandise that are identified during the inventory counts. Write-downs due to shrinkage losses and damaged merchandise for the years ended December 31, 2009, 2010 and 2011 were RMB8,702, RMB9,424 and RMB9,379, respectively, and are included in cost of goods sold.

(i) Long-lived assets

Property and equipment

Property and equipment are stated at cost, net of accumulated depreciation or amortization. Depreciation is calculated on the straight-line method over the estimated useful lives of the assets, taking into consideration the assets' estimated salvage value. Leasehold improvements are amortized over the shorter of the original lease term or the estimated useful life of the assets. The estimated useful lives of the Group's property and equipment are as follows:

Store buildings	20 years
Store fixture and equipment	5 years
Motor vehicles	5 years
Software	10 years

Goodwill

Goodwill represents the excess of the aggregate purchase price over the fair value of the net assets acquired in business combinations, which are not individually identified and separately recognized.

Intangible assets

The Group's intangible assets represent favorable lease contracts and operating rights acquired in business combinations (see Note 8). The favorable lease contracts are amortized over the remaining lease term. Operating rights are indefinite-lived intangible assets, which are not amortized but are reviewed for impairment annually or when events or circumstances indicate that the asset may be impaired.

Impairment of long-1ived assets

Long-lived assets, including property and equipment and intangible assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset group may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset group to estimated undiscounted future cash flows expected to be generated by the asset group. If the carrying amount of an asset group exceeds its estimated undiscounted future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset group exceeds the fair value of the asset group. Impairment of long-lived assets of nil, RMB3,423 and RMB14,164 was recognized for the years ended December 31, 2009, 2010 and 2011 respectively (see Note 7).

Goodwill is reviewed for impairment at least annually. The goodwill impairment test is a two-step test. Under the first step, the fair value of the reporting unit is compared with its carrying value (including goodwill). If the fair value of the reporting unit is less than its carrying value, an indication of goodwill impairment exists for the reporting unit and the enterprise must perform step two of the impairment test (measurement). Under step two, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation and the residual fair value after this allocation is the implied fair value of the reporting unit goodwill. If the fair value of the reporting unit exceeds its carrying value, step two does not need to be performed.

The Group performs annual impairment test of goodwill as of December 31, and when a triggering event occurs between annual impairment tests. No impairment of goodwill was recognized for the years ended December 31, 2009, 2010 and 2011.

(j) Cost and equity method investments

Investments in the stock of an investee where the Group does not have the ability to exercise significant influence over the operating and financial policies of the investees are accounted for under the cost method. Under the cost method of accounting, the Group records an investment in the equity of an investee at cost, and recognizes in income the amount of dividends received or receivable that are distributed from net accumulated earnings of the investee since the date of acquisition.

Investments in the stock of an investee, where the Group does not have a controlling financial interest, but has the ability to exercise significant influence over the operating and financial policies of the investee, are accounted for using the equity method of accounting. Under the equity method of accounting, the Group's share of the investee's results of operations is reported as equity in income (loss) of an equity method investee in the consolidated statements of income.

The Group recognizes an impairment loss when a series of operating losses of an investee or other factors may indicate that a decline in value below the carrying amount of the investment has occurred which is other than temporary. The process of assessing and determining whether impairment on a particular equity investment is other-than-temporary requires significant judgment. To determine whether an impairment is other-than-temporary, management considers whether the Group has the

ability and intent to hold the investment until recovery and considers whether evidence indicating the carrying value of the investment is recoverable outweighs evidence to the contrary. Evidence considered in this assessment includes the reasons for the impairment, the severity and duration of the decline in value, any change in value subsequent to year end, and forecasted performance of the investee. Based on management's evaluation, no impairment charges related to the Group's investments were recognized for any of the periods presented.

(k) Land use right

Land use right represents the cost of the right to use land in the PRC. The land use right is carried at cost and charged to expense on a straight-line basis over a period of the right of 50 years.

(l) Income taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and tax loss and tax credit carryforwards. Deferred tax assets are reduced by a valuation allowance to the extent management concludes it is more likely than not that the deferred tax assets will not be realized. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

The Group recognizes in the consolidated financial statements the impact of a tax position if, based on the technical merits of the position, that position is more likely than not of being sustained upon examination. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. The Group's accounting policy is to accrue interest and penalties related to unrecognized tax benefits as interest expense and a component of general and administrative expenses, respectively, in the consolidated statements of income.

(m) Revenue recognition

Revenue from sales of prescription medicine at the drugstores is recognized when the prescription is filled and the customer picks up and pays for the prescription. Revenue from sales of other merchandise at the drugstores is recognized at the point of sale, which is when the customer pays for and receives the merchandise. Revenue from sales of merchandise to non-retail customers is recognized when the following conditions are met: 1) persuasive evidence of an arrangement exists (sales agreements and customer purchase orders are used to determine the existence of an arrangement); 2) delivery of goods has occurred and risks and benefits of ownership have been transferred, which is when the goods are received by the customer at its designated location in accordance with the sales terms (Customer acceptance notes provide evidence of delivery); 3) the sales price is fixed or determinable; and 4) collectability is reasonably assured. Historically, sales returns were immaterial.

The Group's revenue is recognized net of value added tax ("VAT") collected on behalf of tax authorities in respect of the sale of merchandise. VAT collected from customers, net of VAT paid for purchases, is recorded as a liability in the balance sheet until it is paid to the tax authorities.

The Group has introduced a Nepstar shopper's card program (the "Program"). Under the Program, the Group's retail customers deposit certain amount of cash into the pre-paid cards issued by the Group for future purchases of merchandise at the Group's drugstores, and receive free products (which are in the form of low-value products sold at the Group's stores) or a cash coupon to be used as a credit for a future purchase. The unused portion of the pre-paid cards as of the balance sheet date is recorded as deferred income, and recognized as revenue when a customer uses the card for subsequent purchase of merchandise. At the point of sale of the pre-paid cards, the cost of the free product is recognized as an expense. The amount attributable to the cash coupon is deferred as a liability and recognized in the income statement upon usage. For all the years presented, the total amount of the free products and cash coupons recognized in the consolidated statements of income was immaterial.

(n) Government grants

Government grants are initially recognized in balance sheet when there is reasonable assurance that the grants will be received and the Group will comply with the relevant conditions attaching to them. Grants that compensate the Group for expenses to be incurred are recognized in other income on a systematic basis in the same periods in which the expenses are incurred.

For the years ended December 31, 2009, 2010 and 2011, government grants of RMB1,078, nil and nil, respectively, was recognized as a credit to general and administrative expenses in the consolidated statements of income.

(o) Advertising and promotion costs

Advertising and promotion costs are expensed as incurred. Advertising and promotion costs amounted to RMB7,941, RMB10,284 and RMB9,904, for the years ended December 31, 2009, 2010 and 2011, respectively and are included in sales, marketing and other operating expenses in the consolidated statements of income.

(p) Store opening costs

Expenditures related to the opening of new drugstores, other than expenditures for property and equipment, are expensed when incurred.

(q) Vendor allowances

Vendor allowances are recorded as a reduction to the carrying value of inventories and subsequently recognized in cost of goods sold when the inventories are sold, unless the allowances are specifically identified as reimbursements for advertising, promotion and other services, in which case the allowances are recognized as a reduction of the related advertising and promotion costs.

For the years ended December 31, 2009, 2010 and 2011, the Company recognized vendor allowances of RMB41,072, RMB55,667 and RMB76,067 in cost of goods sold, and RMB9,753, RMB11,952 and RMB10,387 as a reduction of advertising and promotion costs, respectively.

(r) Warehouse, buying and distribution costs

Warehouse and buying costs represent primarily rental expenses for warehouses, staff cost and other expenses incurred in warehousing and purchasing activities. Distribution costs represent the costs of transporting the merchandise from warehouses to stores. Warehouse, buying and distribution costs are expensed as incurred and are included in sales, marketing and other operating expenses. Warehouse and buying costs amounted to RMB28,175, RMB30,132 and RMB36,225 and distribution costs amounted to RMB8,224, RMB12,730 and RMB11,707 for the years ended December 31, 2009, 2010 and 2011, respectively.

(s) Operating leases

The Group leases premises for retail drugstores, warehouses and offices under non-cancelable operating leases. Operating lease payments are expensed on a straight-line basis over the term of lease. A majority of the Group's retail drugstore leases have a 5-year term with a renewal option upon the expiry of the lease. The Group has historically been able to renew a majority of its drugstores leases. Under the terms of the lease agreements, the Group has no legal or contractual asset retirement obligations at the end of the lease.

(t) Retirement and other postretirement benefits

Contributions to defined contribution retirement plans are charged to the consolidated statements of income as and when the related employee service is provided. The Group does not have any defined benefit retirement plans.

(u) Share-based payments

The Group measures the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award and recognizes that cost over the period the employee is required to provide service in exchange for the award, which generally is the vesting period.

(v) Earnings per share

Basic earnings per share is computed by dividing net income attributable to the Group by the weighted average number of ordinary shares outstanding during the period.

Diluted earnings per share reflects the potential dilution that would occur upon the exercise of outstanding options and the vesting of non-vested shares granted. Ordinary share equivalents are excluded from the computation of the diluted earnings per share when their effect would be anti-dilutive.

(w) Commitments and contingencies

Liabilities for loss contingencies arising from claims, assessments, litigation, fines and other sources are recorded when it is probable that a liability has been incurred and the amount can be reasonably estimated. Historically, the Group has experienced no product liability claims.

(x) Segment reporting

The Group's chief operating decision maker has been identified as its Chief Executive Officer. The Group has one reportable operating segment, which is the retail drugstore business. Geographic information is not presented because all of the Group's operations and customers are located in the PRC.

(y) Fair value measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, the Group considers the principal or most advantageous market in which it would transact and the assumptions that market participants would use when pricing the asset or liability.

The Group applies a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

Fair value is an exit price, defined as a market-based measurement that represents the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Fair value measurements are based on one or more of the following three valuation techniques:

Market

This approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.

Income

This approach uses valuation techniques to convert future amounts to a single present value amount based on current market expectations.

Cost

This approach is based on the amount that would be required to replace the service capacity of an asset

FASB ASC Subtopic 820 establishes three levels of inputs that may be used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Group has the ability to access at the measurement date.
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 inputs are unobservable inputs for the asset or liability.

The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

The Group did not have any financial assets and liabilities or nonfinancial assets and liabilities that are measured at fair value on a recurring or nonrecurring basis as of December 31, 2010 and 2011.

(z) Recently issued accounting standards

In December 2011, the FASB issued ASU No. 2011-11, *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities*. ASU 2011-11 requires an entity to disclose information about offsetting and related arrangements to enable users of financial statements to understand the effect of those arrangements on its financial position, and to allow investors to better compare financial statements prepared under U.S. GAAP with financial statements prepared under International Financial Reporting Standards (IFRS). The new standard is effective for annual periods beginning January 1, 2013, and interim periods within those annual periods. Retrospective application is required. The Company expects that the adoption of ASU 2011-11 in 2013 will not have a material impact on its consolidated financial statements.

In September 2011, the FASB issued ASU 2011-08, *Intangibles—Goodwill and Other (Topic 350): Testing Goodwill for Impairment*. This ASU permits an entity to make a qualitative assessment of whether it is more likely than not that a reporting unit's fair value is less than its carrying amount before applying the two-step goodwill impairment test. If an entity concludes it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, it need not perform the two-step impairment test. The ASU is effective for annual and interim goodwill impairment tests performed for fiscal years beginning

after December 15, 2011. Early adoption is permitted. The Company implemented the provisions of ASU 2011-08 as of January 1, 2012.

In June 2011, the FASB issued ASU 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income.* Under this ASU, an entity will have the option to present the components of net income and comprehensive income in either one or two consecutive financial statements. The ASU eliminates the option in U.S. GAAP to present other comprehensive income in the statement of changes in equity. An entity should apply the ASU retrospectively. For a public entity, the ASU is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Early adoption is permitted. In December 2011, the FASB decided to defer the effective date of those changes in ASU 2011-05 that relate only to the presentation of reclassification adjustments in the statement of income by issuing ASU 2011-12, *Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive income in Accounting Standards Update 2011-05.* The Company plans to implement the provisions of ASU 2011-05 by presenting a single continuous statement of comprehensive income in 2012.

In May 2011, the FASB issued ASU 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs.* The new standard does not extend the use of fair value but, rather, provide guidance about how fair value should be applied where it already is required or permitted under IFRS or U.S. GAAP. For U.S. GAAP, most of the changes are clarifications of existing guidance or wording changes to align with IFRS. A public entity is required to apply the ASU prospectively during interim and annual periods beginning after December 15, 2011. Management believes the adoption of ASU 2011-04 is not expected to have a significant impact on its consolidated financial statements.

3 CASH, CASH EQUIVALENTS AND BANK DEPOSITS

As of December 31, 2010 and 2011, the amount of cash and cash equivalents and bank deposits by original maturity was as follows:

	December 31,	
	2010	2011
	RMB	RMB
Cash and cash equivalents	626,796	767,885
Short-term time deposits with original maturity over three months but within one year	513,000	43,000
Long-term time deposits with original maturity between one and two years	—	169,000

As of December 31, 2010 and 2011, cash and cash equivalents include US Dollar denominated bank deposits of USD16,957 and USD12,899 (equivalent to RMB111,916 and RMB81,186), respectively.

As of December 31, 2011, the interest rate of time deposits range from 3.3% to 4.4% per annum with a weighted average original maturity of 16.5 months. The Group places its cash in financial institutions with sound credit rating.

Short-term time deposits with original maturity over three months but within one year has been reclassified to conform with the current year presentation.

4 ACCOUNTS RECEIVABLE, NET OF ALLOWANCE FOR DOUBTFUL ACCOUNTS

Accounts receivable consist of the following:

	December 31,	
	2010	2011
	RMB	RMB
Accounts receivable due from:		
Banks	787	1,176
Social security bureaux	66,268	84,185
Non-retail customers	16,823	17,576
	83,878	102,937
Less: allowance for doubtful accounts	(156)	—
Accounts receivable, net	83,722	102,937

The following table presents the movement of allowance for doubtful accounts for the years ended December 31, 2009, 2010 and 2011.

	December 31,		
	2009	2010	2011
	RMB	RMB	RMB
Balance at the beginning of the year	966	596	156
Reversal of bad debt expense	—	(377)	—
Write-off of accounts receivable	(370)	(63)	(156)
Balance at the end of the year	596	156	—

Historically, the amount of write-offs of accounts receivable has been immaterial and the Group has been able to collect substantially all amounts due from customers.

5 PREPAID EXPENSES, DEPOSITS AND OTHER CURRENT ASSETS

Prepaid expenses, deposits and other current assets consist of the following:

	December 31,	
	2010	2011
	RMB	RMB
Prepaid rental	88,993	93,975
Rental deposits	365	461
Prepayments for purchases of merchandise	11,104	2,532
Advances to employees	2,257	2,528
Deferred tax charge on unrealized profits on inter-company sales	5,886	7,200
Store consumables and supplies	10,707	9,724
Accrued interest income	4,608	1,381
Other prepaid expenses and deposits	3,830	5,030
	127,750	122,831

6 INVENTORIES

Inventories consist of the following:

	December 31,	
	2010	2011
	RMB	RMB
Merchandise in stores	255,219	283,282
Merchandise in warehouses	178,046	153,776
	433,265	437,058

7 PROPERTY AND EQUIPMENT, NET

Property and equipment consist of the following:

	December 31,	
	2010	2011
	RMB	RMB
Store buildings	14,617	14,617
Leasehold improvements	248,471	192,902
Store fixture and equipment	155,995	145,511
Software	31,882	33,596
Motor vehicles	14,855	14,827
	465,820	401,453
Less: Accumulated depreciation and amortization	(273,801)	(259,636)
	192,019	141,817

Total depreciation and amortization expense of property and equipment for the years ended December 31, 2009, 2010 and 2011 was RMB61,480, RMB66,440 and RMB58,722, respectively, of which RMB55,802, RMB56,998 and RMB48,665 was recorded in sales, marketing and other operating expenses and RMB5,678, RMB9,442 and RMB10,057 was recorded in general and administrative expenses. No depreciation and amortization expense was included in cost of goods sold for the years presented because the Company's business does not involve manufacturing of merchandise and the amount of depreciation and amortization of property and equipment relating to warehousing and transporting the merchandise to store locations is not material.

The Group recognized impairment losses of nil, RMB3,423 and RMB14,164 for the years ended December 31, 2009, 2010 and 2011 respectively in respect of leasehold improvements and store fixture of certain loss-making drugstores. The Group determined that the carrying amounts of these leasehold improvements and store fixture would not be recoverable through future cash flows. The fair value of the property and equipment was based on the discounted estimated cash flows expected to generated from the use and eventual disposal of these assets.

8 ACQUISITIONS

During the year ended December 31, 2009, the Group entered into definite agreements with Beijing Xiang Yun Kang Drugstore, Wenzhou Ren Ren Hao Chain Drugstore Co., Ltd. and Shanghai Riye Chain Co., Ltd. ("Shanghai Riye") to acquire six, eight and five stores, respectively in order to expand its retail store network. These acquisitions were approved by the investment committee of the Company. During the year ended December 31, 2010, the Group completed three business combinations in which it acquired six stores from Beijing Xiang Yun Kang Drugstore, eight stores from Wenzhou Ren Ren Hao Chain Drugstore Co., Ltd., and three stores from Shanghai Riye. The Group accounted for these business combinations using the acquisition method of accounting. The total aggregate purchase price of RMB12,775 was allocated to the identifiable assets acquired and liabilities assumed based on their fair value as of the respective acquisition dates with the amount of RMB10,627 being recognized as goodwill. Acquisition related costs were expensed as incurred and included in general and administrative expenses in the consolidated statements of income.

As of December 31, 2010, acquisition deposits of RMB2,000 related to the amount paid to Shanghai Riye for the proposed acquisition of the remaining two stores. The proposed acquisition of one store from Shanghai Riye was completed in the first quarter of 2011. The proposed acquisition of the other store is not expected to be executed according to the terms of acquisition agreement. The related deposit of RMB 1,000 has been received in full in March 2012.

The Group accounted for the above business combination using the acquisition method of accounting. The purchase price of RMB1,000 was allocated to the identifiable assets acquired and liabilities assumed based on their fair value as of the respective acquisition dates with an amount of RMB730 being recognized as goodwill. Acquisition related costs were expensed as incurred and included in general and administrative expenses in the consolidated statements of income.

The primary purpose of these acquisitions was to gain presence in new geographic areas or increase market share in existing geographic areas so as to gain regional operational synergy in drugstore operations.

A summary of the identifiable assets acquired and liabilities assumed in connection with these acquisitions are as follows:

	Year ended December 31,	
	2010	2011
	RMB	RMB
Total aggregate purchase price	12,775	1,000
Property and equipment	266	—
Operating rights (Note 9(a))	2,509	359
Deferred tax liability	(627)	(89)
Net assets acquired and liabilities assumed	2,148	270
Goodwill	10,627	730

Goodwill arising from these business combinations is not deductible for income tax purpose. No pro forma financial information as if the acquisitions had occurred on January 1, 2010 or 2011 has been provided since the effect would not be material to the Group's consolidated financial condition or results of operations.

9 GOODWILL AND OTHER INTANGIBLE ASSETS

(a) Intangible assets, net

	December 31,	
	2010	2011
	RMB	RMB
Amortized intangible assets		
Favorable lease contracts		
Cost	3,692	3,692
Less: Accumulated amortization	(3,282)	(3,473)
	410	219
Unamortized intangible assets		
Operating rights (Note 8)	2,509	2,868
Total intangible assets	2,919	3,087

As of December 31, 2010 and 2011, the Group's amortized intangible assets represented favorable lease contracts acquired in business combinations. The Group amortizes these favorable lease contracts on a straight-line basis over the remaining lease term ranging from 2 to 6 years from the date of acquisition.

Amortization expense for intangible assets was RMB1,664, RMB315 and RMB191 for the years ended December 31, 2009, 2010 and 2011, respectively and was included in general and administrative expenses.

Operating right represents the legal right acquired in business combination to operate drugstores in certain area where only one drugstore is permitted to operate according to governmental regulations. Management believes there is no foreseeable limit on the period of time over which the operating right is expected to contribute to the cash flow of the Group. As a result, the operating right is considered to have an indefinite life.

(b) Goodwill

The changes in the carrying amount of goodwill for the years ended December 31, 2010 and 2011 were as follows:

	December 31,	
	2010	2011
	RMB	RMB
Gross goodwill as of January 1	40,462	51,089
Goodwill acquired during the year (Note 8)	10,627	730
Gross goodwill as of December 31	51,089	51,819
Accumulated impairment losses	—	—
Net goodwill as of December 31	51,089	51,819

10 EQUITY METHOD INVESTMENT

The equity method investment represents the 40% equity interest in Yunnan Nepstar, a non-public retail drugstore operating company. Upon the approval by the Company's Board of Directors on the termination of the voting interest right assignment in January 2009 (see Note 1(a)), the investment in Yunnan Nepstar was deconsolidated and accounted for under the equity method of accounting. Upon deconsolidation, a gain of RMB8,927 was recognized in other income in 2009. The gain was measured as the difference between a) the aggregate of the fair value of the Company's retained 40% equity interest and the carrying amount of the former 60% noncontrolling interest in Yunnan Nepstar, and b) the carrying amount of Yunnan Nepstar's assets and liabilities. The fair value of the Company's retained 40% equity interest in Yunnan Nepstar was determined using a market approach by reference to the market observable earning multiples of other comparable companies in the same industry and applying an appropriate marketability discount for illiquidity.

The excess of carrying amount of equity method investment over the Company's share of net assets of Yunnan Nepstar was RMB8,927 at both December 31, 2010 and 2011. In accordance with ASC Topic 350, this equity-method goodwill is not amortized; however, the investment is analyzed for impairment. No impairment was recognized for the equity method investment during the years ended December 31, 2009, 2010 and 2011.

11 OTHER EXPENSE

The Company converted the net US dollar proceeds received from the initial public offering into Renminbi in 2007 and 2008. During the year ended December 31, 2010, the Company was notified by the State Administration of Foreign Exchange ("SAFE") that, as the purposes for the conversion of the net proceeds as stated at the time of the conversion was not entirely consistent with the subsequent use of such proceeds, the SAFE imposed a monetary penalty of RMB25,540 against the Company. The penalty was paid in July 2010.

12 INCOME TAXES

Cayman Islands Tax

Under the current law of the Cayman Islands, the Company is not subject to tax on its income or capital gains.

Hong Kong Tax

Although not incorporated in Hong Kong, the Company is considered as a Hong Kong tax resident since it is a company primarily managed and controlled in Hong Kong. The Company is subject to Hong Kong profits tax on income arising in or derived from Hong Kong. No provision for Hong Kong profits tax was made in the consolidated financial statements as the Company derived no taxable income from Hong Kong for the years ended December 31, 2009, 2010 and 2011. The payments of dividends by Hong Kong tax residents are not subject to any Hong Kong withholding tax.

PRC Corporate Income Tax

Each of the Company's PRC subsidiaries files stand-alone tax returns and the Group does not file a consolidated tax return.

Effective from January 1, 2008, the Company's PRC subsidiaries are subject to income tax at the statutory income tax rate of 25% under the new Corporate Income Tax Law of the PRC ("new tax law"), unless otherwise specified.

The new tax law and its relevant regulations provide transitional rates for entities operating in the Shenzhen and Zhuhai Special Economic Zones, which are 20%, 22%, 24%, and 25%, for 2009, 2010, 2011 and 2012 onwards, respectively. The Company's PRC subsidiaries operating in the Shenzhen and Zhuhai Special Economic Zones are subject to these transitional rates.

Under the new tax law and its implementation rules, a withholding tax at 10%, unless reduced by a tax treaty or arrangement, is applied on dividends received by non-PRC-resident corporate investors from PRC-resident enterprises, such as the Company's PRC subsidiaries. Undistributed earnings prior to January 1, 2008 are exempt from such withholding tax. Under the China-HK Tax Arrangement and the relevant regulations, a qualified Hong Kong tax resident which is the "beneficial owner" and holds 25% equity interests or more of a PRC enterprise is entitled to a reduced withholding rate of 5%. The Company has determined that it qualifies for the 5% withholding tax rate.

The Group's earnings before income tax expense consist of:

	Year ended December 31,		
	2009	2010	2011
	RMB	RMB	RMB
PRC	209,105	60,456	67,004
Non-PRC	(7,955)	(7,627)	(45)
Earnings before income tax expense	201,150	52,829	66,959

Income tax expense in the consolidated statements of income consists of:

	Year ended December 31,		
	2009	2010	2011
	RMB	RMB	RMB
Current tax expense	41,655	36,209	35,802
Deferred tax expense/(benefit)	19,519	112	(4,776)
Income tax expense	61,174	36,321	31,026

The reconciliation between actual income tax expense and the amount that results by applying the PRC statutory tax rate of 25% for the years ended December 31, 2009, 2010 and 2011, to earnings before income taxes is as follows:

	Year ended December 31,		
	2009	2010	2011
	RMB	RMB	RMB
Computed "expected" tax expense	50,288	13,207	16,740
Effect of tax rate differential	(7,108)	(1,797)	(1,345)
PRC dividend withholding tax	7,696	(1,263)	680
Effect of deferred income tax recognized upon deconsolidation of Yunnan Nepstar	3,722	—	—
Non-deductible expenses:			
- Disallowed rental expenses	7,215	10,010	8,527
- Penalty imposed by SAFE	—	5,951	—
- Others	2,255	272	430
Non-taxable income	(751)	(667)	(872)
Effect of deemed interest income	—	—	624
Release of unrecognized tax benefits due to expiration of the statute of limitations	—	—	(2,421)
Change in valuation allowance	(2,143)	10,608	8,663
Actual income tax expense	61,174	36,321	31,026

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities as of December 31, 2010 and 2011 are presented below.

	December 31,	
	2010	2011
	RMB	RMB
Deferred tax assets:		
- Tax loss carryforwards	32,017	36,722
- Inventories	2,005	1,487
- Accrued expenses	1,736	501
- Accrual for membership reward program	769	141
- Impairment of property and equipment	852	3,714
Total gross deferred tax assets	37,379	42,565
Valuation allowance	(32,015)	(37,405)
Total deferred tax assets	5,364	5,160
Deferred tax liabilities:		
- PRC dividend withholding taxes	(7,504)	(2,184)
- Equity method investment	(8,688)	(9,076)
- Intangible assets	(730)	(772)
Total deferred tax liabilities	(16,922)	(12,032)
Net deferred tax liabilities	(11,558)	(6,872)
Classification on consolidated balance sheet:		
Deferred tax assets:		
- Current	3,551	2,009
- Non-current	1,813	3,151
Deferred tax liabilities:		
- Non-current	(16,922)	(12,032)

For the years ended December 31, 2009, 2010 and 2011, the change in valuation allowance was a decrease of RMB2,509, an increase of RMB9,941 and an increase of RMB5,390, respectively. The change in valuation allowance for the year ended December 31, 2011 was primarily due to the net effect of (i) the additional valuation allowance of RMB10,774 recorded against the deferred tax assets of subsidiaries which were at cumulative losses, (ii) the utilization of tax loss carryforwards of which valuation allowance of RMB809 was previously provided and the reduction in valuation allowance amounting to RMB1,302 in respect of a subsidiary which turned into cumulative profit during the year, and (iii) the derecognition of deferred tax assets and the related valuation allowance of RMB3,273 upon expiration of unutilized tax loss carryforwards.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not that the Group will realize the benefits of the deferred tax assets, net of the existing valuation allowance as of December 31, 2010 and 2011. The amount of the deferred tax assets considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carryforward period are reduced.

As of December 31, 2011, the tax loss carryforwards of the Group amounted to RMB146,886, of which RMB11,311, RMB44,028, RMB10,773, RMB44,620 and RMB36,154 will expire, if unused, by end of 2012, 2013, 2014, 2015 and 2016, respectively.

A reconciliation of the beginning and ending amount of unrecognized tax benefits in the PRC for the years ended December 31, 2009, 2010 and 2011 is as follows:

	Year ended December 31,		
	2009	2010	2011
	RMB	RMB	RMB
Balance as at January 1	12,899	17,547	25,194
Additions based on tax positions related to current year	4,648	7,647	8,242
Expiration of the statute of limitations	—	—	(2,421)
Balance as at December 31	17,547	25,194	31,015

The unrecognized tax benefits as of December 31, 2009, 2010 and 2011 are the potential benefits that, if recognized, would affect the effective tax rate. The unrecognized tax benefits mainly represent rental expenses taken on the tax returns in which the deductibility of such expenses does not meet the more likely than not threshold. As of December 31, 2010, the amount of unrecognized tax benefits was included in income tax payable of RMB52,520. The Company does not expect that the amount of unrecognized tax benefits will change significantly within the next 12 months. No interest and penalty expenses were recorded for the years ended December 31, 2009, 2010 and 2011.

According to the PRC Tax Administration and Collection Law, the statute of limitations is three years if the underpayment of taxes is due to computational errors made by the taxpayer or the withholding agent. The statute of limitations is extended to five years under special circumstances where the underpayment of taxes is more than RMB100 (USD15). In the case of transfer pricing issues, the statute of limitations is ten years. There is no statute of limitations in the case of tax evasion. The tax returns of the Company's PRC subsidiaries for the tax years beginning in 2006 are subject to examination by the relevant tax authorities.

13 ACCRUED EXPENSES AND OTHER PAYABLES

Accrued expenses and other payables consist of the following:

	December 31,	
	2010	2011
	RMB	RMB
Accrued payroll and employee benefits	58,838	59,778
Other accrued expenses (Note (a))	40,020	19,658
Payable for purchases of property and equipment	4,968	4,720
Deposits received (Note (b))	2,540	2,582
VAT and other taxes payable	24,964	31,383
	131,330	118,121

Notes:

(a) Amounts represent primarily accrued rental, utilities, advertising and other sundry expenses.
(b) Amounts represent primarily deposits from non-retail customers for purchase of inventory.

14 DEFERRED INCOME

Deferred income consists of the following:

	December 31,	
	2010	2011
	RMB	RMB
Deferred revenue arising from Shopper's Card Program (Note 2(m))	26,102	10,662
Deferred rebate income	18,794	17,078
	44,896	27,740

15 ORDINARY SHARES

The Company's Memorandum and Articles of Association, as amended, authorizes the Company to issue 360,000,000 shares with a par value of USD0.0001 per share.

For the years ended December 31, 2009, 2010 and 2011, the Company issued 2,708,412, 1,559,872 and 119,644 ordinary shares, respectively, to employees upon the exercise of vested share options.

On March 2, 2010, the Company granted and issued an aggregate of 150,000 fully vested ordinary shares to its three independent directors. The grant of the shares to the independent directors was made in exchange for their forfeiture of 150,000 options granted in November 2007 (See Note 19). The Company also issued 30,000 and 20,000 ordinary shares, respectively, in the years ended December 31, 2010 and 2011 upon vesting of non-vested ordinary shares granted to an executive officer on March 2, 2010 (see Note 19). The non-vested shares vest in five equal installments on each of the first, second, third, fourth and fifth quarters after the date of grant, which was on March 2, 2010.

On August 26, 2008, the Board of Directors of the Company authorized a share repurchase program ("The 2008 Program"). The 2008 Program allowed the Company, from time to time and before December 27, 2009, to purchase up to 40,000,000 of its outstanding ordinary shares in the form of ADS from the open market. On August 13, 2010, the Board of Directors of the Company authorized another share repurchase program ("The 2010 Program"). The 2010 Program allows the Company, from time to time and during a 12-month period starting from August 13, 2010, to purchase up to USD20,000,000 of its outstanding ordinary shares in the form of ADS from the open market. On August 19, 2011, the Board of Directors of the Company authorized another share repurchase program ("The 2011 Program"). The 2011 Program allows the Company, from time to time and during a 12-month period starting from August 19, 2011, to purchase up to USD20,000,000 of its outstanding ordinary shares in the form of ADS from the open market. During the years ended December 31, 2009, 2010 and 2011, the Company repurchased 1,128,400, 3,827,082 and 5,476,490 of its ordinary shares for a total purchase price of USD2,356 (equivalent to RMB16,082), USD5,371 (equivalent to RMB36,584), and USD7,233 (equivalent to RMB45,522), respectively. As of December 31, 2009 and 2010, all of the repurchased shares had been retired. As of December 31, 2011, 334,388 of the total 5,476,490 ordinary shares repurchased in 2011 has not been retired and is presented as treasury stock in the consolidated balance sheet.

16 STATUTORY RESERVES

Under the PRC rules and regulations, the Company's PRC subsidiaries are required to transfer 10% of the net profit, as determined in accordance with the relevant PRC laws and regulations, to a statutory surplus reserve until the reserve balance reaches 50% of the subsidiary's registered capital. The transfer to this reserve must be made before distribution of dividends to shareholders can be made. The statutory surplus reserve can be used to make good previous years' losses, if any, and may be converted into share capital by issuance of new shares to shareholders in proportion to their existing shareholdings or by increasing the par value of the shares currently held by the shareholders, provided that the balance after such issuance is not less than 25% of the registered capital.

For the years ended December 31, 2009, 2010 and 2011, the Company's PRC subsidiaries made appropriations to the statutory surplus reserve of RMB9,257, RMB29,383 and RMB23,062 respectively. The accumulated balance of the statutory surplus reserve as of December 31, 2010 and 2011 was RMB72,137 and RMB95,199 respectively. No equivalent amounts were appropriated by the Company.

17 DIVIDEND

On March 13, 2009, the Board of Directors of the Company approved the payment of a cash dividend of USD0.175 per ordinary share, totaling USD36,254 (equivalent to RMB247,908 at the exchange rate on March 13, 2009), to the ordinary shareholders on record as of close of business on April 16, 2009. As approved by the Board of Directors of the Company, RMB144,571 of the dividends was paid out of additional paid-in capital. The cash dividends were fully paid during the year ended December 31, 2009.

On August 24, 2009, the Board of Directors of the Company declared a special cash dividend of USD0.75 per ordinary share, totaling USD157,164 (equivalent to RMB1,073,557 at the exchange rate on August 24, 2009), to the ordinary shareholders on record as of close of business on September 25, 2009. As approved by the Board of Directors of the Company, the entire amount of the special dividend was paid out of additional paid-in capital. USD152,027 was paid as of December 31, 2009, and the remaining balance was paid in April 2010.

On March 3, 2010, the Company's Board of Directors approved the payment of a cash dividend of USD0.14 per ordinary share, totaling USD29,491 (equivalent to RMB201,301 at the exchange rate on March 3, 2010), to the ordinary shareholders on record as of close of business on April 2, 2010. As approved by the Board of Directors of the Company, USD12,621 of the dividends was paid out of additional paid-in capital. The cash dividends were fully paid during the year ended December 31, 2010.

On January 18, 2011, the Board of Directors of the Company declared a special cash dividend of USD0.15 per ordinary share, totaling USD31,168 (equivalent to RMB205,172 at the exchange rate on January 18, 2011), to the ordinary shareholders on record as of close of business on January 31, 2011. As approved by the Board of Directors of the Company, the entire amount of

the special dividends was paid out of additional paid-in capital. The special dividends were fully paid during the year ended December 31, 2011.

18 REVENUE

Revenue by each major product categories is analyzed as follows:

	Year ended December 31,		
	2009	2010	2011
	RMB	RMB	RMB
Prescription drugs	515,472	503,403	495,352
Over-the-counter drugs	818,919	866,634	911,412
Nutritional supplements	455,343	452,642	450,714
Herbal products	80,549	86,873	99,627
Other product sales	347,330	447,052	534,185
	2,217,613	2,356,604	2,491,290

Certain pharmaceuticals sold in the PRC, primarily those included in the PRC's published Medical Insurance Catalogue and those pharmaceuticals whose production or trading are deemed to constitute monopolies by the PRC government, are subject to retail price controls in the form of fixed prices or price ceilings. The fixed prices or the price ceilings of such pharmaceuticals are published by the national and provincial price administration authorities from time to time. The controls over retail prices could have a corresponding effect on Group's pricing strategy. The prices of pharmaceuticals that are not subject to price controls are determined freely at the Group's discretion, and in certain cases subject to notification to the provincial pricing authorities. Certain of the Group's pharmaceutical merchandise are subject to price controls and accordingly, the price of such products could not be increased at the Group's discretion above the relevant controlled price ceiling without prior governmental approval. In addition, the price of such products may also be adjusted downward by the relevant government authorities in the future. Such price controls, especially downward price adjustment, may negatively affect the Group's revenue and profitability. For the years ended December 31, 2009, 2010 and 2011, approximately 8% and 31% and 30% respectively of the Group's revenue was generated from products that are subject to government pricing controls.

None of the Group's customers contributed 10% or more of the Group's revenue for the years ended December 31, 2009, 2010 and 2011.

19 SHARE-BASED PAYMENTS

Pre-IPO Option Scheme

On August 30, 2005, the Company's Board of Directors ("Board") and shareholders approved and adopted a share option plan, which was subsequently amended and restated on March 20, 2006 (the "Pre-IPO Option Scheme"). Under such scheme, the directors may, at their discretion, grant options to the directors and employees of the Group (each a "Grantee") to subscribe for ordinary shares of the Company. The Pre-IPO Option Scheme shall be valid and effective for a period commencing on August 30, 2005 and ending on the day immediately prior to the listing date on which trading in the Company's shares first commence on a stock exchange approved by the Board (the "Listing Date").

Under the Pre-IPO Option Scheme, the Grantee shall not in any way sell, transfer, charge, mortgage, encumber or create any interest (whether legal or beneficial) in favor of any third party over or in relation to the options or enter into any agreement to do so, except for transfer solely for tax planning purpose. Any breach of the foregoing by a Grantee shall render all outstanding options of such Grantee be automatically cancelled. In the event that on or before the Listing Date, a Grantee ceases to be employed by a member of the Group for any reason, the options granted to such Grantee shall be forfeited on the date of cessation and will not be exercisable, unless the Board otherwise determines that the options will remain exercisable for an additional period which shall not extend beyond the expiration of the original option period.

Pursuant to the Pre-IPO Option Scheme, in addition to meeting the service or vesting criterion as discussed below, the exercise of the options is conditional upon meeting a performance criterion, which is the initial public offering of the Company's ordinary shares on a stock exchange internationally recognized and duly approved by the Company's Board of Directors and such offering meets a Qualified IPO. A Qualified IPO is defined as a firm commitment underwritten initial public offering of the Company's ordinary shares on a stock exchange internationally recognized and duly approved by the Company's Board of Directors, that values the Company at no less than USD250,000 immediately prior to the IPO and that results in aggregate proceeds to the Company of USD50,000, net of offering costs. The exercise period and life of the options expire five years after a Qualified IPO.

On August 30, 2005, the Board granted 1,000,000 options with a grant-date fair value of approximately USD0.40 per option, or USD400 (RMB3,245) in aggregate, to certain directors, officers and employees to acquire ordinary shares of the Company. Each of these options allows the Grantee to acquire one ordinary share of the Company at an exercise price of USD0.075 per

share. 25% of the options granted on August 30, 2005 vested immediately on the date of grant. The remaining 75% of the options vested over a three year period in twelve equal three-monthly installments.

On March 20, 2006, the Board granted 6,680,000 options with a grant-date fair value of approximately USD0.11 per option, or USD735 (RMB6,063) in aggregate, to certain directors, officers and employees to acquire ordinary shares of the Company. On September 1, 2006, the Board granted 1,000,000 options with a grant-date fair value of approximately USD0.14 per option, or USD140 (RMB1,144) in aggregate, to a senior officer to acquire ordinary shares of the Company. Each of the options granted in 2006 allowed the Grantee to acquire one ordinary share of the Company at an exercise price of USD0.75 per share. 25% of the options granted in 2006 vested immediately on the respective dates of the grant. The remaining 75% of the options vested over a four year period in eight equal six-monthly installments.

The fair value of the share options granted under the Pre-IPO Option Scheme was estimated using the Black-Scholes option pricing model based on following assumptions at the date of grant:

	Awards granted on August 30, 2005	*Awards granted on March 20, 2006*	*Awards granted on September 1, 2006*
Expected dividend yield	0%	0%	0%
Expected volatility	39.17%	36.80%	35.19%
Risk-free interest rate	4.69%	5.26%	5.27%
Expected life (in years)	4.85	4.59	4.30
Estimated fair value of underlying ordinary shares (USD per share)	0.46	0.49	0.57

The expected volatility of the Company's ordinary shares was based on the average volatility of seven comparable companies in the drugstore industry. At the time these options were issued, the Company's ordinary shares were not listed in any exchange and therefore did not have a trading history. The Company estimated the volatility of its ordinary share price by referring to the average volatility of these comparable companies as management believed that the average volatility of such companies was a reasonable benchmark to use in estimating the expected volatility of the Company's ordinary shares.

The share-based compensation expense of pre-IPO option scheme is allocated as follows:

	December 31,		
	2009	2010	2011
	RMB	RMB	RMB
Sales, marketing and other operating expenses	73	18	—
General and administrative expenses	13	51	—
Total share-based compensation expense	86	69	—

As of December 31, 2011, all of the share options under the Pre-IPO Scheme have been vested and the Company did not have any unrecognized share-based compensation expense related to unvested options issued under the Pre-IPO Scheme.

2007 Share Incentive Plan

On June 30, 2007, the Company's shareholders adopted the 2007 Share Incentive Plan (the "2007 Plan"). The 2007 Plan authorizes the Company to issue up to 8,680,000 shares of the Company's ordinary shares in the form of share options, share appreciation rights and other share-based awards to its employees, directors or consultants. Under the 2007 Plan, the exercise price of the option shall not be less than the fair market value of Company's ordinary share on the date of grant.

On November 9, 2007, the Company granted 200,000 share options with a grant date fair value of approximately USD2.86 per option or USD573 (RMB4,250) in aggregate, to four newly appointed independent directors. The exercise price of such options is USD8.10 per share, which was equal to the IPO price of the Company's ordinary shares. The share options vest and become exercisable in three equal annual installments on the first, second and third anniversaries of the date of grant. The share options shall expire on the tenth anniversary of the date of grant.

On January 5, 2009, the Company granted 600,000 share options with a grant date fair value of approximately USD0.78 per option or USD469 (RMB3,203) in aggregate, to a newly appointed senior management employee. The exercise price of such options is USD2.40 per share. The share options vest and become exercisable in three equal annual installments on the first, second and third anniversaries of the date of grant. The share options shall expire on the tenth anniversary of the date of grant.

On January 5, 2010, the Company granted 800,000 share options with a grant date fair value of approximately USD0.91 per option or USD728 (RMB4,976) in aggregate, to an executive officer. The exercise price of such options is US$3.725 per share.

The options vest and become exercisable in four equal annual installments on the first, second, third and fourth anniversaries of the date of grant. The share options shall expire on the tenth anniversary of the date of grant.

On January 5, 2010, the Company granted 200,000 share options with a grant date fair value of approximately USD0.92 per option or USD184 (RMB1,256) in aggregate, to an executive officer. The exercise price of such options is US$3.725 per share. The options vest and become exercisable on the third anniversaries of the date of grant. The share options shall expire on the tenth anniversary of the date of grant.

On March 2, 2010, the Company granted an aggregate of 150,000 fully vested ordinary shares with a grant date fair value of approximately USD3.63 per ordinary share or USD545 (RMB3,188) in aggregate, to its three independent directors. The grant of the shares to the independent directors was made in exchange for their forfeiture of 150,000 options granted in November 2007 ("modification"). In connection with the modification, the Company recorded incremental share-based compensation expense resulting from the modification amounting to RMB3,436 in general and administrative expenses for the year ended December 31, 2010.

On March 2, 2010, the Company granted 50,000 non-vested ordinary shares with a grant date fair value of approximately USD3.49 per ordinary share or USD174 (RMB1,191) in aggregate, to an executive officer. The non-vested shares will vest in five equal installments on each of the first, second, third, fourth and fifth quarters after the date of grant.

For share options granted prior to November 9, 2007, the fair value for options was estimated at the date of the grant using the Black-Scholes option pricing model. For share options granted subsequent to November 9, 2007, the fair value of each award granted was estimated on the date of the grant using the Binomial option pricing model. The Binomial model considers characteristics of fair value option pricing that are not available under the Black-Scholes model. Both models take into account variables such as volatility, dividend yield rate, and risk free interest rate. However, the Binomial model considers the contractual term of the option, the probability that the option will be exercised prior to the end of its contractual life, and the probability of termination or retirement of the option holder in computing the value of the option which are not accounted for under the Black-Scholes model. For these reasons, the Company believes that the Binomial model provides a fair value that is more representative of actual experience and future expected experience after the Company's listing in November 2007.

The fair value of the above share options was estimated using the Binomial option pricing model based on following assumptions at the date of grant:

	Share options granted on November 9, 2007	*Share options granted on January 5, 2009*	*Share options granted on January 5, 2010*
Expected dividend yield	1.67%	2.54%	6.43%
Expected volatility	40.74%	41.76%	35.67%
Risk-free interest rate	4.23%	2.54%	3.86%
Option life (in years)	10	10	10
Forfeiture rate	0	0	0
Suboptimal exercise factor	1.5	1.5	1.5

For share options granted on November 9, 2007 and January 5, 2009, since the Company's ordinary shares have a limited trading history, the Company estimated the volatility of its ordinary shares at the date of grant based on the historical volatility of four comparable companies in the drugstore industry for a period equal to the option life for the share options. The suboptimal exercise factors applied in the valuations of share options granted were estimated based on the early exercise behavior of employees with share options. The risk-free rates applied in the valuations of the share options were based on the 10-year U.S. Treasury yield curve rates as of the grant dates on November 9, 2007 and January 5, 2009, respectively.

For share options granted during 2010, the Company estimated the historical volatility of its ordinary shares at the date of grant based on the historical volatility of the Company from the date the Company was listed to the valuation date and the historical volatility of the other four comparable companies in the drugstore industry for a period equal to the option life for the share options. The risk-free rate applied in the valuations of the share options was based on the 10-year U.S. Treasury yield curve rates as of the grant date in 2010. The suboptimal exercise factors applied in the valuations of share options granted were estimated based on the early exercise behavior of employees with share options.

The fair value of the fully vested and non-vested ordinary shares granted to the employee was determined by management based on the closing trading stock price of the Company on the date of grant.

In connection with the share options and ordinary shares granted under the 2007 Incentive Plan during the years ended December 31, 2009 and 2010, the Company recorded share-based compensation expense of RMB2,917 and RMB5,712 in general and administrative expenses for years ended December 31, 2009 and 2010, respectively. During the year ended December 31, 2011, 600,000 unvested share options granted to an executive officer were forfeited. Consequently, the corresponding share-based compensation costs recognized in previous years for the unvested share options were reversed and an amount of RMB1,195 was credited to general and administrative expenses for the year ended December 31, 2011.

A summary of the Company's option activities for the years ended December 31, 2009, 2010 and 2011 is presented below:

	Number of options	*Weighted average exercise price*	*Weighted average remaining contractual term*	*Aggregate intrinsic value (USD millions)*
Outstanding as of January 1, 2009	4,903,178	USD 1.03		
Granted	600,000	USD 2.40		
Exercised	(2,708,412)	USD 0.72		
Forfeited	(63,200)	USD 0.74		
Outstanding as of December 31, 2009	2,731,566	USD 1.64		
Granted	1,000,000	USD 3.73		
Exercised	(1,559,872)	USD 0.95		
Forfeited	(681,944)	USD 3.13		
Cancelled	(150,000)	USD 8.10		
Outstanding as of December 31, 2010	1,339,750	USD 2.51		
Exercised	(119,644)	USD 0.71		
Forfeited	(610,356)	USD 3.67		
Outstanding as of December 31, 2011	609,750	USD 1.71	0.6 year	0.02
Exercisable as of December 31, 2011	609,750	USD 1.71	0.6 year	0.02

The total intrinsic value of share options exercised during the years ended December 31, 2009, 2010 and 2011 was USD6,356, USD2,458 and USD98, respectively. The intrinsic value is calculated as the difference between the market value of shares on the date of exercise and the exercise price of the shares.

The intrinsic value of share options outstanding and options exercisable is calculated as the difference between the market value of the shares as of December 31, 2011 and the exercise price of the shares.

A summary of the status of the Company's non-vested ordinary shares granted to employees as of December 31, 2011, and changes during the year then ended are presented below:

	Number of shares	*Weighted average grant date fair value*
Outstanding as of January 1, 2010	—	—
Granted	50,000	USD3.49
Vested	(30,000)	USD3.49
Outstanding as of December 31, 2010	20,000	USD3.49
Granted	—	—
Vested	(20,000)	USD3.49
Outstanding as of December 31, 2011	—	—

20 PENSION AND OTHER POST RETIREMENT BENEFITS

Pursuant to the relevant PRC regulations, the Company's PRC subsidiaries are required to make contributions at rates ranging from 10% to 22% of their employees' salaries and wages to a defined contribution retirement scheme organized by the local social security bureaus. The amount of contributions charged to general and administrative expense and sales, marketing and other operating expenses in the consolidated statements of income was RMB28,652, RMB31,321 and RMB34,422 for the years ended December 31, 2009, 2010 and 2011, respectively.

The Group has no other obligation to make payments in respect of retirement benefits of the employees.

21 EARNINGS PER SHARE

	Year ended December 31,		
	2009	2010	2011
	RMB	RMB	RMB
Numerator:			
Net income attributable to China Nepstar Chain Drugstore Ltd. ordinary shareholders	139,976	16,508	35,933
Denominator:			
Basic weighted average number of ordinary shares	208,215,802	209,550,935	206,127,305
Dilutive effect of outstanding share options and non-vested shares	2,440,018	855,625	250,377
Dilutive weighted average number of ordinary shares	210,655,820	210,406,560	206,377,682
Basic earnings per ordinary share:	0.67	0.08	0.17
Diluted earnings per ordinary share	0.66	0.08	0.17

In the calculation of diluted earnings per share, the Company excluded 800,000, 800,000 and 200,000 potential ordinary shares issuable upon exercise of employee share options for the year ended December 31, 2009, 2010 and 2011, respectively, as their effect would be anti-dilutive.

22 RELATED PARTY BALANCES AND TRANSACTIONS

For the periods presented, the principal related party transactions and amounts due from and due to related parties are summarized as follows:

	Year ended December 31,		
	2009	2010	2011
	RMB	RMB	RMB
Purchases from related parties (Notes 22(a))	89,560	121,439	105,154
Sales to related parties (Note 22(b))	3,936	4,817	2,207
Lease of property from a related party (Note 22(d))	1,082	1,082	1,082
Disposal of a subsidiary to a related party (Note 22(f))	—	—	20,000

	December 31,	
	2010	2011
	RMB	RMB
Amounts due from related parties (Note 22(c))	12,358	4,649
Amounts due to related parties (Note 22(e))	24,461	18,169

Notes:

(a) The Group purchased merchandise from Neptunus Group and its affiliates in the normal course of business.

The payment terms offered by the related parties to the Group for purchase of merchandise ranged from 60 to 90 days. For the periods presented, none of the Group's suppliers accounted for 10% or more of the Group's purchases of merchandise.

(b) In the normal course of business, the Group sold merchandise to the following related parties as follows:

	Year ended December 31,		
	2009	2010	2011
	RMB	RMB	RMB
Yunnan Jianzhijia Health Chain Co., Ltd. (an affiliated entity of Yunnan Nepstar)	—	1,607	—
Neptunus Group and its affiliates	3,936	3,210	2,207
	3,936	4,817	2,207

(c) The amounts due from related parties represent the following:

	December 31,	
	2010	2011
	RMB	RMB
Amount due from Neptunus Group and its affiliates related to:		
Sales of merchandise (Note 22(b))	3,210	2,207
Expenses paid on behalf of related parties	6,993	287
	10,203	2,494
Amount due from Yunnan Jianzhijia Health Chain Co., Ltd. related to:		
Sales of merchandise (Note 22(b))	1,607	1,607
Expenses paid on behalf of related parties	548	548
	2,155	2,155

Expenses paid on behalf of related parties related to miscellaneous expenses paid by the Group on behalf of Neptunus Group and its affiliates and Yunnan Jianzhijia Health Chain Co., Ltd. respectively. The amounts are expected to be settled within one year.

(d) The Group rented a property from Neptunus Group under an operating lease arrangement that was entered in November 2008. The monthly rental is approximately RMB90 and the lease agreement will expire in October 2013.

(e) The balances represent amounts due to Neptunus Group and its affiliates in connection with the purchase of merchandise as described in Note 22(a) above.

(f) In August 2011, the Group disposed of its 100% equity interest in a subsidiary, Nepstar Industrial Co., Ltd., to Neptunus Group at a total cash consideration of RMB 20 million. The difference between consideration received and the carrying amount of the net assets of the subsidiary amounting to RMB19 was recognised in additional paid-in capital. As Neptunus Group held over 50% of the Company's equity interests, the transaction is considered a transaction with entity under common control. Nepstar Industrial Co., Ltd. has not conducted any operations since its establishment in 2009. The purpose of the transaction is to simplify corporate structure and the divestment has not adversely affected the Group's financial position or business operation.

23 COMMITMENTS AND CONTINGENCIES

Operating lease commitments

Future minimum lease payments under non-cancelable operating lease agreements as of December 31, 2011 are as follows. The Group's leases do not contain any contingent rental payments terms.

Years ending December 31,	*Store premises* RMB	*Warehouses and office premises* RMB	*Total* RMB
2012	198,579	11,261	209,840
2013	187,750	7,939	195,689
2014	117,228	3,675	120,903
2015	59,264	1,948	61,212
2016	21,917	1,106	23,023
Thereafter	17,103	2,472	19,575
Total	601,841	28,401	630,242

The Group's rental expenses under operating leases amounted to RMB323,548, RMB367,603 and RMB375,626 for the years ended December 31, 2009, 2010 and 2011, respectively.

24 FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties. The carrying amounts of the Group's financial assets and liabilities, such as cash, bank deposits, long-term bank time deposits, accounts and other receivables, amounts due from/to related parties and accounts and other payables, approximate their fair values because of the nature or the short maturity of these instruments. The fair value of cost method equity investments and equity method investment cannot be reasonably estimated without incurring excessive cost. However in the opinion of management, the estimated fair values of these investments are not significantly different from their current carrying values.

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