
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 20-F

(Mark One)

- ☐ REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 12(g) OF THE SECURITIES EXCHANGE ACT OF 1934
OR
☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2014
OR
☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____
OR
☐ SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Date of event requiring this shell company report _____

Commission file number 001-33751

China Nepstar Chain Drugstore Ltd.
(Exact Name of Registrant as Specified in Its Charter)

Cayman Islands
(Jurisdiction of Incorporation or Organization)

**25F, Neptunus Yinhe Keji Building
No.1, Kejizhong 3rd Road
Nanshan District, Shenzhen
Guangdong Province 518057
People's Republic of China (Address of Principal Executive Offices)**

**Zixin Shao
Chief Financial Officer
Telephone: (86 755) 2641-4065
E-mail: shaolz@nepstar.cn
Fax: (86 755) 2643-0889**

**At the address of the Company set forth above
(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)**

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Ordinary Shares, par value US\$0.0001 per share.	
American Depositary Shares, each representing two Ordinary Shares	New York Stock Exchange

Securities registered or to be registered pursuant to Section 12(g) of the Act: None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None

Indicate the number of outstanding shares of each of the Issuer's classes of capital or common stock as of the close of the period covered by the annual report.
197,446,940 Ordinary Shares

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes ☐ No ☒

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and

large accelerated filer” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer ☒

Indicate by check mark which basis of accounting the registration has used to prepare the financial statements included in this filing:

U.S. GAAP ☒

International Financial Reporting Standards as issued
by the International Accounting Standards Board

Other

If “Other” has been checked in response to the previous question, indicate by check mark which consolidated financial statement item the registrant has elected to follow. Item 17 ☐ Item 18 ☐

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).
Yes ☐ No ☒

(APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PAST FIVE YEARS)

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12,13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes ☐ No ☐

**CHINA NEPSTAR CHAIN DRUGSTORE LTD.
ANNUAL REPORT ON FORM 20-F**

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CONVENTIONS THAT APPLY TO THIS ANNUAL REPORT ON FORM 20-F

Unless otherwise indicated, references in this annual report on Form 20-F to:

- “ADRs” is to the American depositary receipts, which evidence our ADSs;
- “ADSs” is 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., which operates drugstores in Yunnan province under the trade name Jianzhijia. We disposed of our 40% ownership in JZJ on December 28, 2012;
- “Nepstar E-Commerce” is to Shenzhen Nepstar E-Commerce Co., Ltd., a PRC-incorporated company;
- “Shenzhen Nepstar” is to Shenzhen Nepstar Chain Co., Ltd., a PRC-incorporated company that operates Nepstar drugstores under the trade name Nepstar and 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” is to our ordinary shares, par value US\$0.0001 per share;
- “regional Nepstar companies” is to the PRC-incorporated companies, including Shenzhen Nepstar, 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 on Form 20-F includes our audited consolidated financial statements for the years ended December 31, 2012, 2013 and 2014 and as of December 31, 2013 and 2014.

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.”

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. Selected Financial Data

The following selected consolidated statement of comprehensive income data for the years ended December 31, 2012, 2013 and 2014 and selected consolidated balance sheet data as of December 31, 2013 and 2014 have been derived from our audited consolidated financial statements included elsewhere in this annual report. The following selected consolidated statement of comprehensive income data for the years ended December 31, 2010 and 2011 and selected consolidated balance sheet data as of December 31, 2010, 2011 and 2012 have been derived from our 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 “Item 5. 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,					
	2010	2011	2012	2013	2014	
	RMB	RMB	RMB	RMB	RMB	US\$
(in thousands, except share and per share data)						
Consolidated Statement of Comprehensive Income Data						
Revenue	2,356,604	2,491,290	2,549,856	2,699,103	2,953,314	475,988
Gross profit	1,163,939	1,188,637	1,180,544	1,178,307	1,230,522	198,324
Sales, marketing and other operating expenses	(985,510)	(1,015,165)	(1,011,695)	(1,026,798)	(1,098,000)	(176,965)
General and administrative expenses ⁽¹⁾	(128,196)	(120,671)	(115,734)	(121,542)	(125,577)	(20,239)
Income/(loss) from operations	21,270	38,637	46,946	22,983	(2,932)	(472)
Gain on disposal of an equity method investee ⁽²⁾	—	—	68,440	—	—	—
Net income/(loss) attributable to China Nepstar Chain Drugstore Ltd.	16,508	35,933	90,092	11,828	(13,771)	(2,219)
Earnings/(loss) per share						
Basic	0.08	0.17	0.45	0.06	(0.07)	(0.01)
Diluted	0.08	0.17	0.45	0.06	(0.07)	(0.01)
Shares used in computation						
Basic	209,550,935	206,127,305	199,198,962	197,446,940	197,446,940	197,446,940
Diluted	210,406,560	206,377,682	199,263,363	197,446,940	197,446,940	197,446,940

(1) General and administrative expenses included share-based compensation expenses of RMB5.8 million in 2010, nil in 2012, nil in 2013 and nil in 2014. 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 was credited to general and administrative expenses for 2011.

(2) On December 28, 2012, we disposed of our 40.0% ownership in JZJ which had been accounted for under the equity method.

	As of December 31,					
	2010	2011	2012	2013	2014	
	RMB	RMB	RMB	RMB	RMB	US\$
(in thousands)						
Consolidated Balance Sheet Data						
Cash, cash equivalents and other bank deposits	1,139,796	810,885	608,356	545,586	279,430	45,036
Restricted cash	5,000	—	36,000	37,000	37,423	6,031
Inventories	433,265	437,058	478,483	551,783	546,312	88,050
Accounts receivable, net of allowance for doubtful accounts	83,722	102,937	114,601	131,984	136,568	22,011
Total current assets	1,805,442	1,480,369	1,394,650	1,442,272	1,250,791	201,591
Property and equipment, net	192,019	141,817	120,237	123,183	137,750	22,201
Long-term bank time deposits	—	169,000	20,000	40,256	—	—
Total assets	2,153,109	1,942,197	1,644,011	1,727,115	1,514,104	244,029
Accounts payable	313,773	352,386	356,095	403,558	409,428	65,988
Amounts due to related parties	24,461	18,169	18,381	29,247	25,636	4,132
Total current liabilities	548,186	527,818	555,807	808,494	608,758	98,114
Total non-current liabilities	35,716	60,125	62,101	73,095	73,714	11,881
Total shareholders' equity	1,569,207	1,354,254	1,026,103	845,526	831,632	134,034

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 RMB6.2046 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 31, 2014. 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 “Item 3. Key Information — D. 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 17, 2015, the exchange rate as published by the Federal Reserve Board of the United States was RMB6.1976 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)			
2010	6.6000	6.7696	6.8330	6.6000
2011	6.2939	6.4630	6.6364	6.2939
2012	6.2301	6.2990	6.3879	6.2221
2013	6.0537	6.1412	6.2438	6.0537
2014	6.2046	6.1620	6.2591	6.0402
October	6.1124	6.1251	6.1385	6.1107
November	6.1429	6.1249	6.1429	6.1117
December	6.2046	6.1886	6.2256	6.1490
2015				
January	6.2495	6.2181	6.2535	6.1870
February	6.2695	6.2518	6.2695	6.2399
March	6.1990	6.2386	6.2741	6.1955
April (through April 17)	6.1976	6.2010	6.2152	6.1930

(1) For all periods 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.

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

Risks Related to Our Business

We may not be able to timely identify or otherwise effectively respond to changing customer preferences, and we may fail to optimize our product offering and inventory position.

The retail industry, particularly the retail drugstore industry, in China is rapidly evolving and is subject to rapidly changing customer preferences that are difficult to predict. Our success depends on our ability to anticipate and identify customer preferences and adapt our product selection to these preferences. In particular, we must optimize our product selection and inventory positions based on sales trends. We cannot assure you that our product selection, especially the mix of our private label products and third-party branded products and our selections of non-pharmaceutical products, will accurately reflect customer preferences at any given time. If we fail to accurately anticipate either the market for our products or purchasing habits of our customers, or fail to respond to customers' changing preferences promptly and effectively, we may not be able to effectively adapt our product selection to customer preferences or make appropriate adjustments to our inventory positions, which could reduce customer traffic and our sales significantly and have a material adverse effect on our business, financial condition and results of operations.

Our success depends on our ability to establish effective advertising, marketing and promotional programs.

Our success depends on our ability to establish effective advertising, marketing and promotional programs, including pricing strategies implemented in response to competitive pressures and/or to drive demand for our products. Our advertisements are designed to promote our brand, our corporate image and the prices of products available for sale in our stores. Our pricing strategies and value proposition must be appropriate for our target customers. If we are not able to maintain and increase awareness of our brand, products and services, we may not be able to attract and retain customers and our reputation may also suffer. We expect to incur substantial expenses in our marketing and promotional efforts to both attract and retain customers. However, our marketing and promotional activities may be less successful than we anticipate, and may not be effective at building our brand awareness and customer base. We also cannot assure you that our current and planned spending on marketing activities will be adequate to support our future growth. Failure to successfully execute our advertising, marketing and promotional programs may result in material decreases in our revenue and profitability.

If we are unable to optimize management of our distribution centers, we may be unable to meet customer demand.

We distribute substantially all of our products to our stores through our national distribution center located near our headquarters in Shenzhen and 15 regional distribution centers located in various regions in China, and we deliver merchandise from these distribution centers to our stores partly using our own vehicles and partly by third party logistics services. Our ability to meet customer demand may be significantly disrupted if we do not successfully operate our distribution centers and efficiently conduct our distribution activities, or if one or more of our distribution centers are destroyed or forced to shut down for any reason, including as the result of a natural disaster. Any disruption in the operation of our distribution centers could result in higher costs or longer lead times associated with distributing our products. In addition, as it is difficult to predict accurate sales volume in our industry, we may be unable to optimize our distribution activities, which may result in excess or insufficient inventory, warehousing, fulfillment or distribution capacity. Furthermore, failure to effectively control damage to products during distribution could decrease our operating margins and reduce our profitability.

Failure to maintain optimal inventory levels could increase our inventory holding costs or cause us to lose sales, either of which could have a material adverse effect on our business, financial condition and results of operations.

We need to maintain sufficient inventory levels to operate our business successfully as well as meet our customers' expectations, and this exposes us to the risk of accumulating excess inventory. In addition, our exposure to inventory accumulation risks have increased as a result of our private label and non-pharmaceutical product expansion, rapid changes in product life cycles, customers' changing preferences, uncertainty of success of product launches, seasonality, manufacturer backorders and other vendor-related problems. We cannot assure you that we can accurately predict these trends and events and avoid over-stocking or under-stocking products that customers prefer. In addition, demand for products could change significantly between the time product inventory is ordered and the time it is available for sale. When we begin selling a new product, it is particularly difficult to forecast product demand accurately. The purchase of certain types of inventory may require significant lead-time. As we carry a broad selection of products and maintain significant inventory levels for a substantial portion of our merchandise, we may be unable to sell such inventory in sufficient quantities or during the relevant selling seasons. Carrying excess inventory would increase our inventory holding costs, and failure to have a product in our inventory when a customer orders or purchases it could cause us to lose that order or customer, either of which could have a material adverse effect on our business, financial condition and results of operations.

Our product offering expansion into non-pharmaceutical categories may not achieve or maintain broad market acceptance.

We have been expanding our product offerings since May 2010 by introducing more non-pharmaceutical products to address the wider needs of our customers for a healthy and convenient lifestyle and to reduce downside risks in terms of unfavorable government policies in price control over pharmaceutical products. However, we may be less successful than anticipated in boosting store traffic and increasing profitability. In addition, the expansion of our product offerings can be costly due to intensive promotional activities and excessive logistics charges in inventory maintenance and delivery. Also, due to build-up of new product inventory, our cash flow from operations may be stretched. If we cannot successfully achieve and maintain customer acceptance and control our expenses in execution of our product offering expansion, our profitability and prospects may be materially and adversely affected.

Our private label products may not achieve or maintain broad market acceptance.

We began introducing private label products in September 2005, and sales of private label products accounted for 17.5% of our revenue and 24.8% of our gross profit in 2014. These products generally have higher profit margins than our other similar products. We believe that our success in gaining and maintaining broad market acceptance of our private label products depends on many factors, including:

- our product pricing;
- our ability to maintain the cost competitiveness of our private label products;
- the effectiveness of our sales and marketing efforts;
- our ability to provide consistent and high quality customer experiences;
- publicity or public perception concerning our company, our brand, our products or our competitors or competing products;
- whether or not customers develop habits of routinely purchasing and using our private label products; and
- our ability to anticipate, identify and respond to changing customer preferences.

We may not achieve or maintain broad market acceptance for our private label products, products introduced by our competitors may be more favorably received than our private label products, or we may fail to respond to customers' changing preferences promptly and effectively, all of which may result in decreased customer traffic to our stores or increased inventory costs. As a result, our business, financial condition, results of operations and prospects may be materially and adversely affected.

We depend on the continued service of, and on the ability to attract, motivate and retain a sufficient number of qualified and skilled staff.

Our ability to continue expanding our retail drugstore chain and deliver high quality products and customer service depends on our ability to attract and retain qualified and skilled staff, particularly regional managers and in-store pharmacists for our stores. In particular, the applicable PRC regulations require at least one qualified pharmacist to be stationed in every drugstore to instruct or advise customers on prescription drugs. Over the years, a significant shortage of pharmacists has developed due to increasing demand within the drugstore industry as well as demand from other businesses in the healthcare industry. We cannot assure you that we will be able to attract, hire and retain sufficient numbers of skilled regional managers and in-store pharmacists necessary to continue to develop and grow our business. The inability to attract and retain a sufficient number of skilled regional managers and in-store pharmacists could limit our ability to open additional stores, increase revenue or deliver high quality customer service. In addition, competition for these individuals could cause us to offer higher compensation and other benefits in order to attract and retain them, which could have a material adverse effect on our financial condition and results of operations.

The centralization of procurement may not help us achieve anticipated savings and may place additional burdens on the management of our supply chain.

We plan to continue to increase the centralization of merchandise procurement and replenishment operations and expect to reduce cost of goods sold as a result of volume purchase benefits. However, we may be less successful than anticipated in achieving these volume purchase benefits. In addition, the centralization of merchandise procurement is expected to increase the complexity of tracking inventory, create additional inventory handling and transportation costs and place additional burdens on the management of our supply chain. Furthermore, we may not be successful in achieving the cost savings expected from the renegotiation of certain supplier contracts due to the nature of the products covered by those contracts and the market position of the related suppliers. If we cannot successfully reduce our costs through centralizing procurement, our profitability and prospects would be materially and adversely affected.

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.

As sales of our private label products continue to account for a substantial portion of our revenue, we consider our brand name, trade names and trademarks to be valuable assets. Under PRC law, we have the exclusive right to use a trademark for products or services for which such trademark has been registered with the PRC Trademark Office of the State Administration for Industry and Commerce, or the SAIC. We cannot assure you, however, that we will be able to secure the trademark registrations for which we apply. In addition, our efforts to defend our trademarks against competitors or other violating entities may be unsuccessful and we may not have adequate remedies for any such violation. Moreover, we may be unable to prevent third parties from using our brand name or trademarks without authorization. Unauthorized use of our brand name or trademarks by third parties may adversely affect our business and reputation, including the perceived quality and reliability of our products.

We also rely on trade secrets to protect our know-how and other proprietary information, including pricing, purchasing, promotional strategies, customer lists and/or supplier lists, which may be difficult to protect. While we use reasonable efforts to protect our trade secrets, our employees, consultants, contractors or advisors may unintentionally or willfully disclose our information to competitors. In addition, confidentiality agreements, if any, executed by the foregoing persons may not be enforceable or may not otherwise provide meaningful protection for our trade secrets or other proprietary information in the event of unauthorized use or disclosure. If we were to enforce a claim that a third party had illegally obtained and was using our trade secrets, our enforcement efforts could be expensive and time-consuming, and the outcome is unpredictable. In addition, if our competitors independently develop information that is equivalent to our trade secrets or other proprietary information, it would be even more difficult for us to enforce our rights and our business and prospects could be harmed.

Litigation may be necessary in the future to enforce our intellectual property rights or to determine the validity and scope of the intellectual property rights of others. As the validity, enforceability and scope of protection of intellectual property rights in China are uncertain and still evolving, we may not be successful in prosecuting these cases. In addition, any litigation or proceeding or other efforts to protect our intellectual property rights could result in substantial costs and diversion of our resources and could materially harm our business and operating results. Furthermore, the degree of future protection of our intellectual property rights is uncertain and may not adequately protect our rights or permit us to gain or keep our competitive advantage. If we are unable to protect our trade names, trademarks, trade secrets and other propriety information from infringement, our business, financial condition and results of operations may be materially and adversely affected.

We rely on licensing arrangements with our affiliated companies to use the trademark “Neptunus” and a number of other trademarks. Any improper use of these trademarks by our licensor or any other third parties could materially and adversely affect our business, financial condition and results of operations.

Our rights to our trade names and trademarks are the most important factor in marketing our stores and private label products. The trademark “Neptunus,” or “海王” in Chinese, is owned by Shenzhen Neptunus Group Co., Ltd., or the Neptunus Group, and we have obtained, under a license agreement, the non-exclusive right to use this trademark so long as the trademark is valid. The trademark “Neptunus,” or “Haiwang,” is also used by the Neptunus Group, its subsidiaries and affiliated entities, which are controlled by Simin Zhang, our founder, the chairman of our board of directors and the sole beneficial owner of our controlling shareholder, China Neptunus Drugstore Holding Ltd., or Neptunus BVI. We have also obtained rights to use an aggregate of 618 additional trademarks, including 101 trademarks that are registered under Nepstar Pharmaceutical, 251 registered trademarks that we have obtained exclusive rights to use, 248 registered trademarks that we have obtained non-exclusive rights to use and 18 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, 2014, we have developed 2,156 private label products with these licensed trademarks. If the Neptunus Group, any of its subsidiaries or affiliated entities, or any third party uses the trade name “Neptunus,” or trademarks we use to develop our private labels in ways that adversely affect such trade name or trademark, our reputation could suffer damage, which in turn could have a material adverse effect on our business, financial condition and results of operations.

We may be exposed to intellectual property infringement and other claims by third parties which, if successful, could disrupt our business and have a material adverse effect on our financial condition and results of operations.

Our success depends, in large part, on our ability to use our proprietary information and know-how without infringing third party intellectual property rights. Despite the decrease in our revenue of private label products from RMB635.5 million in 2013 to RMB516.7 million in 2014, representing 23.5% and 17.5% of our total revenue, respectively, sales of our private label products still constitute an important component of our business. As litigation becomes more common in China, we continue to face risks of being the subject of claims for intellectual property infringement, invalidity or indemnification relating to other parties’ proprietary rights. As of December 31, 2014, we were not involved in any disputes that were related to intellectual properties involving our private label products, but we cannot guarantee that such disputes will not implicate us in the future. Our current or potential competitors, many of which have substantial resources, may have or may obtain intellectual property protection that will prevent, limit or interfere with our ability to make, use or sell our products in China. Moreover, the defense of intellectual property suits, including trademark infringement suits, and related legal and administrative proceedings can be both costly and time consuming and may significantly divert the efforts and resources of our management personnel. Furthermore, an adverse determination in any such litigation or proceedings to which we may become a party could cause us to:

- pay damage awards;
- seek licenses from third parties;
- pay ongoing royalties;
- redesign our product offerings; or

- be restricted by injunctions,

each of which could effectively prevent us from pursuing some or all of our business and result in our customers or potential customers deferring or limiting their purchase of our products, which could have a material adverse effect on our financial condition and results of operations.

We do not possess clear leasehold titles or written agreements providing for usage rights in respect of some of our occupied properties.

As of December 31, 2014, we had 2,013 leased properties with an aggregate gross floor area of 311,401 square meters, of which 230,188 square meters were used as drugstores. 249 or approximately 12.4% of these leased properties had defects in their legal titles. Of all of the properties with defects in legal titles, 25,750 square meters were used as drugstores, equivalent to approximately 11.1% 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 24,314 square meters, or approximately 10.5% of the total gross floor area of our drugstores, and with the latter type of defects in title was 3,179 square meters, or approximately 1.4% of the total gross floor area of our drugstores. In the absence of proper title documents, the relevant leasing contracts may not be valid or enforceable. We have been working to cure, or cause to be cured, defects in property titles and the related costs have been immaterial. We do not expect to incur material costs to cure outstanding defects in property titles in the future. Although we believe that failure to cure these defects would not result in the loss of a significant number of these leases, if any of such defects of title for these occupied properties is not cured, we may lose our rights to use some of these properties, and our business and operations may be severely disrupted. In addition, 109,868 square meters, or approximately 35.3% of our leased properties, including properties with defects in title, have not been registered as required by applicable PRC regulations. We do not believe that the failure of registration will affect the validity or performance of these leases. We are making efforts to urge our landlords to cooperate with us to complete the required registrations as tenants alone cannot effect registrations under the applicable PRC regulations. However, if the required registrations are not effected, the relevant government authorities have the right to request both our landlords and us to complete the registrations and we could be subject to fines, the amount of which differs in various regions in China.

We have experienced, and may continue to experience, increasing rental costs as to the lease of our stores.

We have been experiencing increases in rental costs for the leasing of our stores in the past few years. In particular, the average rental expense for existing stores with renewal leases in 2013 and 2014, which were 585 and 498 stores, respectively, increased by approximately 19% and 10%, respectively, upon renewal of the existing leases of such stores. A majority of our leases have a five-year term. We expect rental costs for our stores to continue to increase in the future as China's economy continues to grow and competition for desirable rental locations intensifies. Increase in rental costs may have a material adverse effect as to our financial condition and results of operations if we are unable to offset such higher costs through higher prices and/or increasing operational efficiency at our existing stores. In addition, higher rental costs may increase the amount of time required before our new stores would achieve profitability and affect our ability to expand our network of stores, which could materially and adversely impact our business and prospects.

We rely on computer software and hardware systems in managing our operations, the capacity of which may restrict our growth and the failure of which could adversely affect our business, financial condition and results of operations.

We are dependent upon our enterprise resource planning, or ERP, system to monitor daily operations of our drugstores and to maintain accurate and up-to-date operating and financial data for compilation of management information. In addition, we rely on our computer hardware and network for the storage, delivery and transmission of our retail system data. Any system failure which causes interruptions to the input, retrieval and transmission of data or increases in service time could disrupt our normal operation. Although we believe we have a disaster recovery plan, which can handle the failure of our computer software and hardware systems, we cannot assure you that we can effectively carry out this disaster recovery plan and that we will be able to restore our operation within a sufficiently short time frame to avoid disruption to our business. Any failure in our computer software and/or hardware systems could have a material adverse effect on our business, financial condition and results of operations. In addition, if the capacity of our computer software and hardware systems fails to meet the increasing needs of our expanding operations, our ability to grow may be constrained.

As a retailer of pharmaceutical and other healthcare products, we are exposed to inherent risks relating to product liability and personal injury claims.

Pharmacies are exposed to risks inherent in the packaging and distribution of pharmaceutical and other healthcare products, such as with respect to improper filling of prescriptions, labeling of prescriptions, adequacy of warnings, and unintentional distribution of counterfeit drugs. Furthermore, the applicable laws, rules and regulations require our in-store pharmacists to offer counseling, without additional charge, to our customers about medication, dosage, delivery systems, common side effects and other information the in-store pharmacists deem significant. Our in-store pharmacists may also have a duty to warn customers regarding any potential adverse effects of a prescription drug if the warning could reduce or negate these effects and we may be liable for claims arising from advice given by our in-store pharmacists. In addition, product liability claims may be asserted against us with respect to any of the products we sell and, as a retailer, we are required to pay for damages for any successful product liability claim against us, although we may have the right under applicable PRC laws, rules and regulations to recover from the relevant manufacturer for compensation we paid to our customers in connection with a product liability claim. We may also be obligated to recall affected products. Any product liability claim or product recall may result in adverse publicity regarding us and the products we sell, which would harm our reputation. If we are found liable for product liability claims, we could be required to pay substantial monetary damages. Furthermore, even if we successfully defend ourselves against this type of claim, we could be required to spend significant management, financial and other resources, which could disrupt our business, and our reputation as well as our brand name may also suffer. We, like many other similar companies in China, do not carry product liability insurance. As a result, any imposition of product liability could materially harm our business, financial condition and results of operations. In addition, we do not have any business interruption insurance due to the limited coverage of any business interruption insurance in China, and as a result, any business disruption or natural disaster could severely disrupt our business and operations and significantly decrease our revenue and profitability.

Our operating results are difficult to predict, and we may experience significant fluctuations in our operating results.

Our operating results may fluctuate significantly. As a result, you may not be able to rely on period to period comparisons of our operating results as an indication of our future performance. Factors causing these fluctuations include, among others:

- the frequency of customer visits to our drugstores and the quantity and mix of products our customers purchase;
- our ability to maintain and increase sales to existing customers, attract new customers and satisfy our customers' demands;
- the price we charge for our products or changes in our pricing strategies or the pricing strategies of our competitors;
- timing and costs of marketing and promotional programs organized by us and/or our suppliers, including the extent to which we or our suppliers offer promotional discounts to our customers;
- our ability to acquire merchandise, manage inventory and fulfill orders;
- technical difficulties, system downtime or interruptions of our ERP system, which we use for product selection, procurement, pricing, distribution and retail management processes;
- the introduction by our competitors of new products or services;

- the effects of strategic alliances, potential acquisitions and other business combinations, and our ability to successfully and timely integrate such transactions into our business;
- changes in government regulations with respect to pharmaceutical and retail industries; and
- current economic and geopolitical conditions in China and elsewhere.

In addition, a significant percentage of our operating expenses are fixed in the short term. As a result, a delay in generating revenue for any reason could result in substantial operating losses.

Moreover, our business is subject to seasonal variations in demand. In particular, traditional retail seasonality affects the sales of certain pharmaceuticals and other non-pharmaceutical products. In particular, sales of our pharmaceutical products benefit in the fourth quarter from the winter cold and flu season, and are lower in the first quarter of each year because the Chinese New Year holiday is in the first quarter of each year and our customers generally visit drugstores less frequently during this period. In addition, sales of some health and beauty products are driven, to some extent, by seasonal purchasing patterns and seasonal product changes and sales of our pharmaceutical products and nutritional supplements are driven to some extent by the occurrence of epidemics such as H1N1 and H7N9. Failure to effectively manage increased sales in the high sale season, and increases in inventory in anticipation of increases in sales, could have a material adverse effect on our financial condition, results of operations and cash flow.

Many of the factors discussed above are beyond our control, making our quarterly results difficult to predict, which could cause the trading price of our ADSs to decline below investor expectations. You should not rely on our operating results for prior periods as an indication of our future results.

Failure to manage our operations effectively could strain our management, operational and other resources, which could materially and adversely affect our business and future growth.

We are a leading retail drugstore chain in China, with a network of 1,980 directly operated drugstores spanning 74 cities across 14 provinces and direct-controlled municipalities in China as of December 31, 2014. The effective management of our business has resulted in, and may continue to result in, substantial demands on our management, operational and other resources. In particular, the management of our growth will require, among other things:

- our ability to continue to identify new store locations and lease new store facilities at acceptable prices;
- our ability to optimize product offerings and increase sales of private label products;
- our ability to successfully expand our product offerings in non-pharmaceutical categories;
- our ability to control procurement cost and optimize product pricing;
- information technology system enhancement, including further improvement of our ERP system;
- strengthening of financial and management controls;
- our ability to control operating expenses and achieve a high level of efficiency, including, in particular, our ability to manage the amount of time required to open new stores and for stores to become profitable, to maintain sufficient inventory levels and to manage warehousing, buying and distribution costs;
- increased marketing, sales and sales support activities; and
- hiring and training of new personnel, including in-store pharmacists and regional managers.

If we are not able to manage our growth successfully, our business and prospects could be materially and adversely affected.

Acquisitions have been and are expected to continue to be a part of our long-term growth strategy, and could expose us to significant business risks.

One of our long-term growth strategies is to grow our business through selective acquisitions, especially in cities where local regulations prohibit the opening of new drugstores within certain distances of an existing drugstore, and in cities that are close to our distribution centers in order to gain operational efficiencies in distribution and leverage our information technology infrastructure over a broader store base. We constantly examine suitable targets for acquisition.

We cannot assure you that the expected synergies from completed and future acquisitions will actually materialize. Completed and future acquisitions may also expose us to potential risks, including risks associated with:

- the integration of new operations, services and personnel;
- unforeseen or hidden liabilities;
- potential unfamiliarity or dissatisfaction with our brand or the merchandise carried in our stores;
- the diversion of financial or other resources from our existing businesses;
- our inability to generate sufficient revenue to recover costs and expenses of the acquisitions; and
- potential loss of, or harm to, relationships with employees or customers.

Any of the above could significantly disrupt our ability to manage our business and have a material and adverse effect on our business, financial condition, results of operations and prospects.

We also cannot assure you that we will be able to identify and secure suitable acquisition opportunities. Our ability to consummate and integrate effectively any future acquisitions on terms that are favorable to us may be limited by the number of attractive acquisition targets, internal demands on our resources and, to the extent necessary for larger acquisitions, our ability to obtain financing on satisfactory terms, if at all. Moreover, if an acquisition target is identified, the third parties with whom we seek to cooperate may not select us as a potential partner or we may not be able to enter into arrangements on commercially reasonable terms or at all. The negotiation and completion of potential acquisitions, whether or not ultimately consummated, could also require significant diversion of management's time and resources and cause potential disruption of our existing business. Future acquisitions could also result in the incurrence of additional indebtedness, costs, and contingent liabilities.

Our online business has a short operating history, as a result, it may be difficult to evaluate its performance and prospects.

In November 2010, we launched a pilot version of our e-commerce website and in January 2011 launched our official e-commerce website, www.star365.com. However, we did not sell any pharmaceutical products through the website until October 1, 2011. Currently, we sell both pharmaceutical and non-pharmaceutical products mainly through our own website and an e-commerce store we set up with a third-party sales channel website, www.tmall.com. Revenue generated from our online sales increased from RMB65.8 million in 2013 to RMB126.5 million (US\$20.4 million) in 2014, primarily due to our strategically developed product portfolio for online sales and marketing and promotion efforts.

Despite the increase in revenue from online sales, our ability to generate a profit from online sales from our own website and from any potential revenue-sharing with portal partners or collection of advertising fees remains unproven. Our online business strategy has not been tested over time and we cannot be certain that we will be able to successfully manage or grow our online business. We may incur significant costs as we continue to implement and improve our e-commerce platform. Given the limited operating history of our online business, it may be difficult for you to evaluate its performance and prospects.

Uncertainties regarding the growth and sustained profitability of e-commerce in China could adversely affect our online business prospects.

While e-commerce has existed in China since the 1990s, only recently have certain e-commerce companies in China become profitable. Thus, the long-term viability and prospects of various e-commerce business models, and e-commerce generally, in China remain relatively untested. Our future operating results from our online business, will depend on numerous factors affecting the development of e-commerce in China, which may be beyond our control. These factors include:

- the growth of personal computer, Internet and broadband usage and penetration in China, and the rate of any such growth;
- the trust and confidence level of consumers in online shopping in China, as well as changes in customer demographics and consumers' tastes and preferences;
- the selection, price and popularity of products that we and our competitors offer on websites;
- the emergence of alternative retail channels or business models that better address the needs of consumers in China;
- the development of fulfillment, payment and other ancillary services associated with online purchases; and
- general economic conditions, particularly economic conditions affecting discretionary consumer spending.

A decline in online shopping in general, or failure by us to improve the online shopping experience of our customers in response to trends and consumer needs, may adversely affect our online business prospects.

We depend substantially on the continuing efforts of our executive officers, and our business and prospects may be severely disrupted if we lose their services.

Our future success is dependent on the continued services of the key members of our management team. The implementation of our business strategy and our future success depend in large part on our continued ability to attract and retain highly qualified management personnel. We face competition for personnel from other drugstore chains, retail chains, supermarkets, convenience stores, pharmaceutical companies and other organizations. Competition for these individuals could cause us to offer higher compensation and other benefits in order to attract and retain them, which could significantly increase our operating expenses. In addition, we may be unable to attract or retain the personnel required to achieve our business objectives and failure to do so could severely disrupt our business and prospects. The process of hiring suitably qualified personnel is also often lengthy. If our recruitment and retention efforts are unsuccessful in the future, it may be more difficult for us to execute our business strategy.

We do not maintain key-man insurance for members of our management team. If we lose the services of any senior management, we may not be able to locate suitable or qualified replacements, and may incur additional expenses to recruit and train new personnel, which could severely disrupt our business and prospects. Furthermore, as we expect to continue to expand our operations, we will need to continue attracting and retaining experienced management. Each of our executive officers has entered into a confidentiality and non-competition agreement with us regarding these agreements. However, if any disputes arise between our executive officers and us, we cannot assure you, in light of uncertainties associated with the PRC legal system, that any of these agreements could be enforced in China, where the majority of our executive officers reside and hold some of their assets. See “— Risks Related to Doing Business in China — Uncertainties with respect to the PRC legal system could limit the protections available to you and us.”

Our controlling shareholder has substantial influence over our company and its interests may not be aligned with your interests, and we are exempt from some of the corporate governance requirements of the New York Stock Exchange.

As of December 31, 2014, Simin Zhang, our founder and chairman of our board of directors, through Neptunus BVI, beneficially owned 54.2% of our outstanding share capital. As such, Mr. Zhang has substantial influence over our business, including decisions regarding mergers, consolidations and the sale of all or substantially all of our assets, election of directors, declaration of dividends and other significant corporate actions. This concentration of ownership may discourage, delay or prevent a change in control of our company, which could deprive you of an opportunity to receive a premium for your ADSs as part of a sale of our company and may also cause the price of our ADSs to decline significantly.

If we grant additional share options, restricted shares or other share-based compensation in the future, our operating results could be materially adversely affected.

. We may issue options and other share-based awards according to the terms of China Nepstar Chain Drugstore Ltd. 2007 Share Incentive Plan, or our 2007 Share Incentive Plan, adopted on June 30, 2007. We recognize as an expense, the fair value of share options and other share-based compensation based on the fair value of equity-classified awards on the date of the grant, with the compensation expense recognized generally over the period in which the recipient is required to provide service in exchange for the equity award. If we grant additional options, restricted shares and other equity incentives to our employees in the future, we could incur significant compensation expenses which could materially reduce our net income, and your investment in our ADSs could be significantly diluted. As of December 31, 2014, we did not have any share options outstanding that had not been exercised.

We may need additional capital and may not be able to obtain it at acceptable terms or at all.

As of December 31, 2014, our total cash, cash equivalents, bank deposits and restricted cash amounted to RMB316.9 million (US\$51.1 million). Based on our current operating plans, we expect our existing resources, including our current cash and cash flows from operations, to be sufficient to fund our anticipated cash needs, including for working capital, repayment to borrowings and capital expenditures for at least the next 12 months. We may, however, need to raise additional funds if our expenditures exceed our current expectations due to changed business conditions or other future developments. Our future liquidity needs and other business reasons could require us to sell additional equity or debt securities or obtain a credit facility. The sale of additional equity securities or securities convertible into or exchangeable for our equity securities would result in additional dilution to you. The incurrence of additional indebtedness would result in increased debt service obligations and could result in operating and financing covenants that restrict our operational flexibility. Our ability to raise additional funds in the future is subject to a variety of uncertainties, including:

- our future financial condition, results of operations and cash flows;
- general market conditions for capital-raising activities by pharmaceutical companies; and
- economic, political and other conditions in China and elsewhere.

We may be unable to obtain additional capital in a timely manner or on commercially acceptable terms or at all. Furthermore, the terms and amount of any additional capital raised through issuances of equity securities may result in significant shareholder dilution.

Risks Related to Our Industry

We face significant competition, and if we do not compete successfully against existing and new competitors, our revenue and profitability could decrease materially.

The retail industry, particularly the retail drugstore industry, in China is intensely competitive, rapidly evolving and highly fragmented. We primarily compete with other retail drugstore chains or independent drugstores. As a retailer of general merchandise, we also compete with other convenience stores, grocery stores, supermarkets, discount merchandisers and mass merchants. We compete for customers primarily on the basis of our brand name, store location, merchandise selection, prices, and the pharmacy 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 drugstore 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 from existing stores, 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.

Moreover, we may be subject to additional competition from new entrants to the drugstore industry in China. If the PRC government removes or reduces the barriers for foreign companies to operate majority-owned retail drugstore businesses in China, we could face increased competition from foreign companies. Some of our larger competitors may enjoy competitive advantages, such as:

- greater financial and other resources;
- a larger variety of products;
- more extensive and advanced supply chain management systems;
- greater pricing flexibility;
- larger economies of scale and purchasing power;
- more extensive advertising and marketing efforts;
- greater knowledge of local market conditions;
- stronger brand recognition; and
- larger sales and distribution networks.

As a result, we may be unable to offer products similar to, or more desirable than, those offered by our competitors, market our products as effectively as our competitors or otherwise respond successfully to competitive pressures. In addition, our competitors may be able to offer larger discounts on competing products, and we may not be able to profitably match those discounts. Furthermore, our competitors may offer products that are more attractive to our customers or that render our products uncompetitive. The timing of the introduction of competing products into the market could also affect the market acceptance and market share of our products. Our failure to compete successfully could materially and adversely affect our business, financial condition, results of operation and prospects.

Changes in economic conditions and consumer confidence in China may influence the retail industry, consumer preferences and spending patterns.

Our business growth primarily depends on the size of the retail market of pharmaceutical products in China. As a result, our revenue and profitability may be negatively affected by changes in national, regional or local economic conditions and consumer confidence in China. In particular, as our stores are typically located in metropolitan markets, where living standards and consumer purchasing power are higher than rural areas, we are especially susceptible to changes in economic conditions, consumer confidence and customer preferences of the urban Chinese population. External factors beyond our control that affect consumer confidence include unemployment rates, levels of personal disposable income, national, regional or local economic conditions and acts of war or terrorism. Changes in economic conditions and consumer confidence could adversely affect consumer preferences, purchasing power and spending patterns. Although we have taken steps to close unproductive stores in affected areas, our ability to reduce costs to offset the results of a prolonged or severe economic downturn is limited given our fixed costs associated with our operations. In addition, we cannot assure you that market conditions will continue to improve in the near future or that our results will not continue to be materially and adversely affected. Furthermore, acts of war or terrorism may cause damage to our facilities, disrupt the supply of the products and services we offer in our stores or adversely impact consumer demand. Any of these factors could have a material adverse effect on our business, financial condition and results of operations.

PRC government regulations on the price of pharmaceutical products may have a material adverse effect on our revenue and profitability.

A substantial portion of our pharmaceutical products, primarily those included in the national and provincial medical insurance catalogs or in the national essential drug list, which are collectively referred to in this annual report as Essential Drug and Reimbursement Lists, are subject to price controls in the form of fixed retail prices or retail price ceilings. See “Item 4. Information on the Company — B. Business Overview — Regulation — Price Controls.” In addition, the retail prices of these products are also subject to periodic downward adjustments as PRC government authorities seek to make pharmaceutical products more affordable to the general public. Since May 1998, the relevant PRC government authorities have ordered price reductions of thousands of pharmaceutical products. In 2012, 2013 and 2014, approximately 30.4%, 31.0% and 30.6% of our revenue was derived from sales of pharmaceutical products that were subject to price controls, respectively. As of December 31, 2014, the National Development and Reform Commission, or the NDRC, implemented price ceilings on 12,192 types of drugs, mainly commonly-used antibiotics and circulatory system medications, including 6,425 pharmaceutical products carried by our stores. Furthermore, the relevant PRC government authorities may impose ceilings on the gross margin that retailers may earn for products included in the Essential Drug and Reimbursement Lists, which may have a negative impact on our gross margin. On September 1, 2010, the Price Bureau of Guangdong Province implemented guidelines relating to the control of maximum retail prices, maximum wholesale prices, and the maximum spread between the retail and wholesale prices of generic pharmaceutical products subject to government-guided pricing. In November, 2013, the Price Bureau of Yuexiu District in Guangzhou City of Guangdong Province imposed a penalty of RMB5.7 million on us for noncompliance with the foregoing pricing guidelines, of which we settled RMB2.8 million in November 2013 and we settled the remaining penalty amount in April 2014. In October 2014, NDRC issued a consultation paper to local state bureaus of commodity prices, indicating that the existing price controls over pharmaceuticals may be relaxed. However, we do not know whether any enforceable regulations or rules will be stipulated and implemented, and the time such regulations or rules will be stipulated and implemented, and we cannot guarantee such consultation paper will result in any relaxation of price controls. 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.

Our retail operations require a number of permits and licenses in order to carry on their business.

Drugstores in China are required to obtain certain permits and licenses from various PRC government authorities, including good supply practice, or GSP, certification. On January 22, 2013, the Ministry of Health (now China National Health and Family Planning Commission or the “NHFPC”) promulgated a new GSP, or the New GSP, which became effective on June 1, 2013. Compared with the previous GSP, the New GSP raised various standards to obtain certifications thereunder. For example, the New GSP requires drugstores to be equipped with (1) automatic temperature and humidity monitors and cold chain belt lines, as well as (2) remote prescription-review systems and low-temperature storage facilities in some cases, and to be staffed with licensed apothecaries. In accordance with the regulation, all the drugstores in China should obtain the new GSP certification by the end of 2015, and we have proceeded to renew our GSP certification in our subsidiaries. In addition to GSP certifications, we are also required to obtain food hygiene certificates for the distribution of non-pharmaceutical products.

We cannot assure you that we have obtained or maintained all required licenses, permits and certifications to carry on our business at all times, and from time to time we may have not been in compliance with all such required licenses, permits and certifications. Moreover, these licenses, permits and certifications are subject to periodic renewal and/or reassessment by the relevant PRC government authorities and the standards of such renewal or reassessment may change from time to time. We intend to apply for the renewal of these licenses, permits and certifications when required by applicable laws and regulations. Any failure by us to obtain and maintain all licenses permits and certifications necessary to carry on our business at any time could have a material adverse effect on our business, financial condition and results of operations. In addition, any inability to renew these licenses, permits and certifications could severely disrupt our business, and prevent us from continuing to carry on our business. Any changes in the standards used by government authorities in considering whether to renew or reassess our business licenses, permits and certifications, as well as any enactment of new regulations that may restrict the conduct of our business, may also decrease our revenue and/or increase our costs and materially reduce our profitability and prospects. Furthermore, if the interpretation or implementation of existing laws and regulations changes or new regulations comes into effect requiring us to obtain any additional licenses, permits or certifications that were previously not required to operate our existing businesses, we cannot assure you that we would successfully obtain such licenses, permits or certifications.

The continued penetration of counterfeit products into the retail market in China, incidents caused by low quality pharmaceutical and nutritional products and the resulting negative media coverage on such incidents may harm consumer confidence in the pharmaceutical and nutritional products we carry in our drugstores, damage our brand and reputation and significantly harm our business and prospects.

There has been continued penetration of counterfeit products into the pharmaceutical retail market in China. Counterfeit products are generally sold at lower prices than the authentic products due to their low production costs, and in some cases are very similar in appearance to the authentic products. Counterfeit pharmaceuticals may or may not have the same chemical content as their authentic counterparts, and are typically manufactured without proper licenses or approvals as well as fraudulently mislabeled with respect to their content and/or manufacturer. Although the PRC government has been increasingly active in combating counterfeit pharmaceutical and other products, there is not yet an effective counterfeit pharmaceutical product regulation control and enforcement system in China. Moreover, while we have implemented a series of quality control procedures in our procurement process, we cannot assure you that we would not be selling counterfeit pharmaceutical products inadvertently. Any unintentional sale of counterfeit products may subject us to negative publicity, fines and other administrative penalties or result in litigation against us. Furthermore, the continued proliferation of counterfeit products and other products in recent years may reinforce the negative image of retailers among consumers in China, and may severely harm the reputation and brand name of companies like us. The continued proliferation of counterfeit products in China could significantly harm our business and prospects as well as have a material adverse effect on our financial condition and results of operations. In addition, any negative media coverage on incidents caused by low quality pharmaceutical and nutritional products could harm consumer confidence in the pharmaceutical and nutritional products we carry in our drugstores, damage our reputation and significantly harm our business and prospects. For example, the negative media coverage of chromium tainted capsules made by certain producers in mainland China in early 2012 had a negative impact on overall consumer confidence in pharmaceutical and nutritional products in capsule form. Our sales for the second quarter of 2012 were negatively impacted as a result of the incident and related negative media coverage.

Our business and growth may be materially and adversely affected by ongoing healthcare reforms in China.

Ongoing healthcare reforms in the PRC aim to make healthcare more affordable as one of their primary goals. In January 2009, the PRC government approved in principle a healthcare reform plan to address the affordability of healthcare services, the rural healthcare system and healthcare service quality in China. In March 2009, the Chinese government published the healthcare reform plan, which broadly addressed medical insurance coverage, essential medicines, provision of basic healthcare services and reform of public hospitals. The implementation plan also called for additional government spending on healthcare totaling RMB850.0 billion over a three-year period from 2009 to support the reform plan. According to the Implementation Plan for the Recent Priorities of the Health Care System Reform (2009-2011), which was issued by the State Council on March 18, 2009, the PRC government is aiming to construct a large number of community clinics in urban areas that will dispense pharmaceutical products at a very low margin, which may result in a decrease in the number of customers visiting our stores. According to the Implementation Plan for the Reform of Medicine and Healthcare as part of the Twelfth Five-Year Plan announced by the State Council on March 14, 2012, the PRC government decided to step up its reform of the pharmaceutical and healthcare sectors. In February 2013, the State Council issued an official guidance setting forth how to improve the management and prescription system of essential drugs and the new operating system of basic healthcare services at grassroots clinics, including measures to (i) monitor the prices of essential drugs and set flat national rates for selected products, and (ii) mandate support for the delivery of essential drugs to rural areas. These reform measures may result in continued downward adjustment as to the pricing of pharmaceutical products listed on the Essential Drug and Reimbursement Lists, the expansion of the pharmaceutical products that are covered by the Essential Drug and Reimbursement Lists or other measures that could adversely affect our business. See “—The retail prices of some of our products are subject to control, including periodic downward adjustment, by PRC government authorities.” We cannot assure you that any reform of the healthcare sector in China would not have a material adverse effect on our business and prospects.

We may be subject to fines and penalties if we fail to comply with the applicable PRC laws, rules and regulations governing sales of medicines under the PRC National Medical Insurance Program.

Eligible participants in the PRC national medical insurance program, mainly consisting of urban residents in China, are entitled to buy medicines using their medical insurance cards in an authorized pharmacy, provided that the medicines they purchase have been included in the Essential Drug and Reimbursement Lists. The pharmacy in turn obtains reimbursement from the relevant government social security bureaus. Moreover, the applicable PRC laws, rules and regulations prohibit pharmacies from selling goods other than pre-approved medicines when purchases are made with medical insurance cards. We have established procedures to prohibit our drugstores from selling unauthorized goods to customers who make purchases with medical insurance cards. However, we cannot assure you that those procedures will be strictly followed by all of our employees in all of our stores. In the past, there have been incidents involving our store staff selling products other than pre-approved medicines to customers who make payment with medical insurance cards, and we have been subject to negative publicity, fines and other administrative penalties. If any of our drugstores or sales personnel is found to have sold products other than pre-approved medicines to customers who make payment with medical insurance cards, we would be subject to fines or other penalties. In addition, if we are deemed by the relevant local authorities to have violated such regulations, we may be subject to fines or other penalties. Any of these occurrences could damage our reputation as well as have a material adverse effect on our business, financial condition and results of operations. In 2013 and 2014, certain regions in China, such as Chengdu, Dalian, Xinjiang, Jilin, Shijiazhuang, Guangzhou, among others, adopted local regulations and some other regions have begun to promulgate local regulations that prohibit the sale of certain non-pharmaceutical products in pharmacies where medical insurance cards are accepted. In 2014, the Legislative Office of the People's Government of Guangzhou issued a consultation paper for a proposed implementation rule of Guangzhou Social and Public Health Insurance Ordinance, indicating that the People's Government may restrict certain pharmacies from selling non-pharmaceutical products. Such regulations have had and, in the case of those still in the legislative process, when they become effective, are expected to continue to have adverse impact to our business in these cities.

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.

Current PRC laws, rules and regulations 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. Substantially all of our operations are conducted through Shenzhen Nepstar Pharmaceutical Company Ltd., or Nepstar Pharmaceutical, our wholly owned subsidiary in China, and through its contractual arrangements with several of our consolidated entities in China, including the regional Nepstar companies, in each of which Nepstar Pharmaceutical owns a 49.0% of the equity interest, and Shenzhen Nepstar Information and Technology Service Co., Ltd., or Nepstar IT Service, and Shenzhen Nepstar Management Consulting Co., Ltd., or Nepstar Management Consulting, collectively own the remaining 51.0% of equity interests. The respective sole beneficial owners of Nepstar IT Service and Nepstar Management Consulting, Liping Zhou and Feng Tu, are two long-time employees of our company who are PRC citizens. We depend on the regional Nepstar companies to operate substantially all of our retail drugstores and generate a substantial portion of our revenue. We have entered into contractual arrangements with the regional Nepstar companies, Nepstar IT Service and Nepstar Management Consulting and their respective shareholders, which provide us with the ability to retain financial and operating control over these companies and substantially all of the economic risks and rewards of ownership of these companies.

In addition, 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, foreign investors are generally 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, subject to limited exceptions such as in the Shanghai Pilot Free Trade Zone where the equity interest cap imposed by foreign investors was moved by the Ministry of Commerce, or the MOFCOM in January 2015. We depend on Shenzhen Nepstar to operate our online business and generate revenue from online sales. Because we are a Cayman Islands company and our wholly owned PRC subsidiary Nepstar Pharmaceutical is considered a foreign-invested enterprise, Nepstar Pharmaceutical has entered into contractual arrangements with Nepstar IT Service, Nepstar Management Consulting and their shareholders to retain control over Shenzhen Nepstar. Nepstar IT Service and Nepstar Management Consulting each own 41% and 10% of the equity interest in Shenzhen Nepstar, respectively.

There are uncertainties regarding the interpretation and application of PRC laws, rules and regulations, including but not limited to the laws, rules and regulations governing the validity and enforcement of our contractual arrangements. 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 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. In addition, new PRC laws, rules and regulations may be introduced from time to time to impose additional requirements that may be applicable to our contractual arrangements.

If we, Nepstar Pharmaceutical, Nepstar IT Service, Nepstar Management Consulting or the regional Nepstar companies are determined to be in violation of any existing or future PRC laws, rules or regulations or fail to obtain or maintain any of the required governmental permits or approvals, the relevant PRC regulatory authorities would have broad discretion in dealing with such violations, including:

- revoking the business and operating licenses of our PRC consolidated entities;
- discontinuing or restricting the operations of our PRC consolidated entities;
- shutting down our servers or blocking our websites;
- confiscating illegal income in connection with operating a non-compliant Internet-based business;
- imposing conditions or requirements with which we or our PRC consolidated entities may not be able to comply;
- requiring us or our PRC consolidated entities to restructure the relevant ownership structure or operations;
- restricting or prohibiting our use of the remaining proceeds from our initial public offering to finance our business and operations in China; or
- imposing fines.

The imposition of any of these penalties would severely disrupt our ability to conduct business and have a material adverse effect on our financial condition, results of operations and prospects.

We rely on contractual arrangements with the regional Nepstar companies, Nepstar IT Service and Nepstar Management Consulting and their respective shareholders to operate a substantial portion of our businesses, which may not be as effective as exercising operational control through a majority ownership of equity interests.

We rely on contractual arrangements with the regional Nepstar companies, Nepstar IT Service and Nepstar Management Consulting and their respective shareholders to operate a substantial portion of our business in China and to provide us with legal and unilateral control over these entities. For a description of these contractual arrangements, see “Item 4. Information on the Company — C. Organizational Structure” and “Item 7. Major Shareholders and Related Party Transactions — B. Related Party Transactions.” These contractual arrangements may not be as effective as exercising control through direct ownership of majority equity interests. Although we do not have a majority ownership interest in the regional Nepstar companies, under the relevant contractual arrangements, we are able to effect changes in the board of directors of these companies, which in turn could effect changes, subject to any applicable fiduciary obligations, at the management level. However, as a legal matter, if any of the regional Nepstar companies, Nepstar IT Service, Nepstar Management Consulting or any of their respective shareholders fails to perform its, his or her respective obligations under these contractual arrangements, we may have to incur substantial costs and resources to enforce these arrangements, and rely on legal remedies under PRC law, including seeking specific performance or injunctive relief and claiming damages, which we cannot assure you would be effective. For example, if Nepstar IT Service or Nepstar Management Consulting were to refuse to transfer its equity interest in the regional Nepstar companies to us or our designated persons when we exercise the purchase option pursuant to these contractual arrangements, we may have to take legal action to compel them to fulfill their contractual obligations.

Moreover, these contractual arrangements are governed by PRC law and provide for the resolution of disputes through either arbitration or litigation in the PRC. Accordingly, these contracts would be interpreted in accordance with PRC law and any disputes would be resolved in accordance with PRC legal procedures. The legal environment in the PRC is not as developed as in other jurisdictions, such as the United States. As a result, uncertainties in the PRC legal system could limit our ability to enforce these contractual arrangements. In the event a dispute arises under these contracts, our ability to conduct our business effectively may be materially compromised.

Contractual arrangements we have entered into among our consolidated entities may be subject to scrutiny by the PRC tax authorities and a finding that we or any of our consolidated entities owe additional taxes could have a material adverse impact on our net income and the value of your investment.

Under PRC law, arrangements and transactions among related parties may be subject to audit or challenge by the PRC tax authorities. If any of the transactions we have entered into with our consolidated entities are challenged by the PRC tax authorities as not being on an arm’s length basis, or as resulting in an unreasonable reduction in our PRC tax obligations, the PRC tax authorities have the authority to disallow our tax deduction claims, adjust the profits and losses of our respective PRC consolidated entities for PRC tax law purposes and assess late payment fees and other penalties. Our net income may be materially reduced if our tax liabilities increase or if we are otherwise assessed late payment fees or other penalties.

The shareholders of Nepstar IT Service and Nepstar Management Consulting may have conflicts of interest with us, which may materially and adversely affect our business, financial condition and results of operations.

The shareholders of Nepstar IT Service and Nepstar Management Consulting are long-time employees of our company. Conflicts of interests between their dual roles as sole shareholders of Nepstar IT Service and Nepstar Management Consulting, respectively, and as employees of our company may arise. We have entered into a supplemental agreement with each of Liping Zhou and Feng Tu, the respective sole beneficial owners of Nepstar IT Services and Nepstar Management Consulting, under which Ms. Zhou and Mr. Tu have warranted that they will not, so long as they remain the shareholders of Nepstar IT Service and Nepstar Management Consulting, serve, invest or assist in any business that may compete with our business or otherwise conduct any business activity that may compete with our business. However, we cannot assure you that when conflicts of interest arise, any or both of these individuals will act in the best interests of our company or that conflict of interests will be resolved in our favor. Any such conflicts of interest may have a material adverse effect on our business, financial condition and results of operations.

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.

We conduct all of our business through our consolidated subsidiaries incorporated in China. We rely on dividends paid by these consolidated subsidiaries for our cash needs, including the funds necessary to pay any dividends and other cash distributions to our shareholders, to service any debt we may incur and to pay our operating expenses. The payment of dividends by entities established in the PRC is subject to limitations. Regulations in the PRC currently permit payment of dividends by our consolidated PRC entities only out of accumulated profits as determined in accordance with accounting standards and regulations in the PRC. Each of our PRC subsidiaries, including wholly foreign-owned enterprises, or WFOEs, and joint venture enterprises 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 aggregate amount of such reserves reaches 50% of its respective registered capital. As of December 31, 2014, the accumulated balance of our statutory reserve funds totaled RMB98.9 million (US\$15.9 million). Our statutory reserves are not distributable as loans, advances or cash dividends. We anticipate that in the foreseeable future, some of our PRC subsidiaries will need to continue to set aside 10% of their respective after-tax profits to their statutory reserves. In addition, if any of our PRC subsidiaries incurs debt on its own behalf in the future, the instruments governing the debt may restrict its ability to pay dividends or make other distributions to us. Any limitations on the ability of our PRC subsidiaries to transfer funds to us could materially restrict our ability to grow, make investments or acquisitions that could be beneficial to our business, pay dividends and otherwise fund and conduct our business.

The application for conversion of Nepstar Commerce and Nepstar Electronic from domestic enterprises to foreign investment enterprises in connection with our restructuring in 2004 was not in full compliance with applicable PRC laws, rules and regulations, which could subject those companies to fines and other penalties and result in a material disruption of our business.

Shenzhen Nepstar Commerce Development Ltd., or Nepstar Commerce, and Shenzhen Nepstar Pharmaceutical Electronic Technologies Ltd., or Nepstar Electronic, were converted from domestic enterprises into wholly foreign-owned enterprises under PRC law in connection with our restructuring in 2004. In their applications for the approval for such conversion that were made to Shenzhen Nanshan Economic and Trade Bureau, Nepstar Commerce and Nepstar Electronic did not disclose that they owned regional Nepstar companies that engage in the drugstore business in various provinces of China. Furthermore, when Nepstar Commerce and Nepstar Electronic became wholly foreign-owned enterprises, foreign investment in drugstore retail business was prohibited under PRC law. As a result, the application by Nepstar Commerce and Nepstar Electronic was not made in full compliance with applicable PRC laws, rules and regulations. Although these defects have been corrected in connection with our restructuring in 2007, PRC regulators have the authority to impose fines or other penalties based on past violations by Nepstar Commerce and Nepstar Electronic. In some cases, these regulatory bodies may require the disgorgement of profits or revoke their prior approval. We do not believe these past violations will have a material adverse effect on our business, financial condition and results of operations, but due to the uncertainty of regulatory enforcements in the PRC, we cannot assure you that Nepstar Commerce or Nepstar Electronic will not be subject to such fines or penalties, including the disgorgement of profits or revocation of the approval previously issued to them, or that such fines or penalties will not have a material adverse effect on our business, financial condition or results of operations.

Risks Related to Doing Business in China

Adverse changes in political and economic policies of the PRC government could have a material adverse effect on the overall economic growth of China, which could reduce the demand for our products and materially and adversely affect our competitive position.

All of our business operations are conducted in China and all of our sales are made in China. Accordingly, our business, financial condition, results of operations and prospects are affected significantly by economic, political and legal developments in China. The Chinese economy differs from the economies of most developed countries in many respects, including:

- the degree of government involvement;

- the level of development;
- the growth rate;
- the control of foreign exchange;
- access to financing; and
- the allocation of resources.

While the Chinese economy has grown significantly in the past 30 years, the growth has been uneven, both geographically and among various sectors of the economy. The PRC government has implemented various measures to encourage economic growth and guide the allocation of resources. Some of these measures benefit the overall Chinese economy, but may also have a negative effect on us. In particular, changes in government regulations affecting the drugstore industry in China could affect our financial results. For example, reimbursements under the national medical insurance program became available for purchases of medicines from designated retail pharmacies in 1998, which indirectly benefited our business. 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. However, 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 any event, our financial condition and results of operations may be materially and adversely affected by government control over capital investments or changes in tax regulations that are applicable to us.

The Chinese economy has been transitioning from a planned economy to a more market-oriented economy. Although the PRC government has in recent years implemented measures emphasizing the utilization of market forces for economic reform, the reduction of state ownership of productive assets and the establishment of sound corporate governance in business enterprises, a substantial portion of the productive assets in China is still owned by the PRC government. The continued control of these assets and other aspects of the national economy by the PRC government could materially and adversely affect our business. The PRC government also exercises significant control over China's economic growth through the allocation of resources, controlling payment of foreign currency-denominated obligations, setting monetary policy and providing preferential treatment to particular industries or companies. These actions, as well as future actions and policies of the PRC government, could materially affect our liquidity and access to capital and our ability to operate our business.

Uncertainties with respect to the PRC legal system could limit the protections available to you and us.

The PRC legal system is a civil law system based on written statutes. Unlike in the common law system, prior court decisions may be cited for reference but have limited presidential value. Since 1979, PRC legislation and regulations have significantly enhanced the protections afforded to various forms of foreign investments in China. We conduct all of our business through our consolidated entities established in China. These entities are generally subject to laws and regulations applicable to foreign investment in China and, in particular, laws applicable to wholly foreign-owned enterprises. However, since many laws, rules and regulations are relatively new and the PRC legal system continues to rapidly evolve, the interpretations of many laws, regulations and rules are not always uniform and enforcement of these laws, regulations and rules involve uncertainties, which may limit legal protections available to us. For example, we may have to resort to administrative and court proceedings to enforce the legal protection that we enjoy either by law or contract. Since PRC administrative and court authorities have significant discretion in interpreting and implementing statutory and contractual terms, it may be more difficult to evaluate the outcome of Chinese administrative and court proceedings and the level of legal protection we enjoy in China than in more developed legal systems. These uncertainties may impede our ability to enforce the contracts we have entered into with our business partners, customers and suppliers. In addition, such uncertainties, including the inability to enforce our contracts, could materially and adversely affect our business and operations. Furthermore, intellectual property rights and confidentiality protections in China may not be as effective as in the United States or other countries. Accordingly, we cannot predict the effect of future developments in the PRC legal system, particularly with regard to the Chinese pharmaceutical industry and retail industry, including the promulgation of new laws, changes to existing laws or the interpretation or enforcement thereof, or the preemption of local regulations by national laws. These uncertainties could limit the legal protections available to us and other foreign investors, including you. In addition, any litigation in China may be protracted and result in substantial costs and diversion of our resources and management attention.

Our auditor's Chinese member firm of the KPMG network, like other independent registered public accounting firms operating in China, is not permitted to be subject to inspection by the Public Company Accounting Oversight Board, and as such, investors may be deprived of the benefits of such inspection.

Our independent registered public accounting firm that issues the audit report for our annual report on this Form 20-F, as an auditor of companies that are traded publicly in the United States and a firm registered with the Public Company Accounting Oversight Board (United States), or PCAOB, is required by the laws of the United States to undergo regular inspections by PCAOB to assess its compliance with the laws of the United States and professional standards. Because our auditor, KPMG, currently relies on its Chinese member firm of the KPMG network for assistance in completing the audit work associated with our operations in China, a jurisdiction where the PCAOB is currently unable to conduct inspections without the approval of the PRC authorities, our auditor's Chinese member firm, like other independent registered public accounting firms operating in China, is currently not inspected by PCAOB. On May 24, 2013, PCAOB announced that it had entered into a memorandum of understanding on enforcement cooperation with the China Securities Regulatory Commission, or the CSRC, and the Ministry of Finance that establishes a cooperative framework between the parties for the production and exchange of audit documents relevant to investigations in the United States and China. PCAOB continues to engage in discussions with the CSRC and Ministry of Finance to permit joint inspections in China of audit firms that are registered with PCAOB and audit Chinese companies that trade on U.S. exchanges. However, direct PCAOB inspections of independent registered public accounting firms in China are still not permitted by Chinese authorities.

The inability of PCAOB to conduct inspections of independent registered public accounting firms operating in China makes it more difficult to evaluate the effectiveness of our auditor's Chinese member firm's audit procedures or quality control procedures. As a result, investors may be deprived of the benefits of PCAOB inspections.

Proceedings instituted by the SEC against Big Four PRC-based accounting firms, including our independent registered public accounting firm's Chinese member firm of the KPMG network, could result in financial statements being determined to not be in compliance with the requirements of the Exchange Act.

On January 22, 2014, Judge Cameron Elliot, an SEC administrative law judge, issued an initial decision suspending the Chinese member firms of the "Big Four" accounting firms, including KPMG network, from, among others, practicing before the SEC for six months. In February 2014, the initial decision was appealed. While under appeal and in February 2015, the Chinese member firms of "Big Four" accounting firms reached a settlement with the SEC. As part of the settlement, each of the Chinese member firms of "Big Four" accounting firms agreed to settlement terms that include a censure, undertakings to make a payment to the SEC, procedures and undertakings as to future requests for documents by the US SEC and possible additional proceedings and remedies should those undertakings not be adhered to.

Our independent registered public accounting firm currently relies on the Chinese member firm of the KPMG network for assistance in completing the audit work associated with our operations in China. If the settlement terms are not adhered to, Chinese member firms of "Big Four" accounting firms may be suspended from practicing before the SEC which could in turn delay the timely filing of our financial statements with the SEC. In addition, it could be difficult for us to timely identify and engage another qualified independent auditor to replace KPMG. A delinquency in our filings with the SEC may result in NYSE initiating delisting procedures or deregistration from the SEC, which could effectively terminate the trading of our ADSs in the United States, adversely harm our reputation and have other material adverse effects on our overall growth and prospect.

We may need to obtain additional governmental approvals to open new drugstores. Our inability to obtain such approvals will have a material adverse effect on our business and growth.

According to the Measures on the Administration of Foreign Investment in the Commercial Sector promulgated by the PRC Ministry of Commerce, which became effective on June 1, 2004, a company that is directly owned by a foreign invested enterprise needs to obtain relevant governmental approvals before it opens new retail stores. However, there are no specific laws, rules or regulations with respect to whether it is necessary for a company established by a subsidiary of a foreign invested enterprise to obtain approvals to open new retail stores. We have consulted with the Shenzhen Bureau of Trade and Industry, which was of the view that companies established by a subsidiary of a foreign invested enterprise are not required to acquire governmental approvals to open new retail stores. In addition, our PRC legal counsel also advises us that such approval is not required based on their interpretations of current PRC laws, rules and regulations. However, we cannot assure you that the PRC Ministry of Commerce will not require that such approvals to be obtained. If additional governmental approval is deemed to be necessary and we are not able to obtain such approvals on a timely basis or at all, our business, financial condition, results of operations and prospects, as well as the trading price of our ADSs, may be materially and adversely affected.

The enforcement of the Social Insurance Law and other social insurance-related regulations in the PRC may adversely affect our business and our results of operations.

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 the range specified by the respective local government authorities where we operate our businesses. The total amount of contributions to pensions we incurred for these employee benefit plans in 2012, 2013 and 2014, was RMB37.8 million, RMB39.2 million and RMB40.6 million (US\$6.5 million), respectively.

On October 28, 2010, the Standing Committee of the National People's Congress of China promulgated a new social security act, namely, the Social Insurance Law of the PRC, which took effect on July 1, 2011. The Social Insurance Law regulates five basic social security insurance schemes: pension, medical insurance, work-related injury insurance, unemployment insurance and maternity insurance. The Social Insurance Law covers all employing entities within China and all individuals, including city residents, flexible employment individuals, migrant workers and foreigners working in China, and provides for new mandatory means to collect social insurance premiums where an employer fails to pay the social insurance contributions in full and on time. Further, an employer who fails to pay the social insurance contributions in full and on time may be penalized with late payment surcharges and face administrative fines up to three times the amount of the social insurance premiums outstanding. Under the Social Insurance Law, the amount of our statutory social insurance contributions has increased which increases our operating expenses and adversely affects our business and results of operations.

The interpretation and implementation of the Social Insurance Law remains uncertain. For instance, the new law has not provided for national uniform social insurance contribution rates. Employers still need to refer to local regulations for contribution rates of the social insurance schemes. We cannot assure you that our employment practice will at all times be deemed in full compliance with the new regulations. We may face administrative proceedings and substantial penalties if the relevant authorities determine that we have not complied with the applicable statutory social security schemes. If we are subject to severe penalties or incur significant liabilities in connection with administrative investigations and proceedings, our business and results of operations may be adversely affected.

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.

The State Administration of Foreign Exchange, or the SAFE, issued a public notice in October 2005, or the SAFE Circular No. 75, requiring PRC residents to register with the local SAFE branch before establishing or controlling any company outside of China for the purpose of capital financing with assets or equities of PRC companies, referred to in the notice as an “offshore special purpose company.” PRC residents that are shareholders of offshore special purpose companies established before November 1, 2005 were required to register with the local SAFE branch. In addition, relevant SAFE rules also require any share option plan adopted by the offshore special purpose company to be filed with the local SAFE branch when the offshore special purpose company is registered with the local SAFE branch, and such registration must be amended when option holders exercise their share options offshore. In July 2014, SAFE promulgated SAFE Circular No. 37, which replaced SAFE Circular No. 75. SAFE Circular No. 37 requires PRC residents, including PRC institutions and individuals, to register with the local SAFE branch in connection with their direct establishment or indirect control of an offshore entity, referred to in SAFE Circular No. 37 as a “special purpose vehicle,” for the purpose of holding domestic or offshore assets or interests. PRC residents must also file amendments to their registrations in the event of any significant changes with respect to the special purpose vehicle, such as increase or decrease of capital contributed by PRC individuals, share transfer or exchange, merger, division or other material event. Under these regulations, PRC residents’ failure to comply with specified registration procedures may result in restrictions being imposed on the foreign exchange activities of the relevant PRC entity, including the payment of dividends and other distributions to its offshore parent, as well as restrictions on capital inflows from the offshore entity to the PRC entity, including restrictions on the ability to contribute additional capital to the PRC entity. Simin Zhang, a PRC resident and the beneficial owner of our current controlling shareholder, has registered with the local SAFE branch as required by the SAFE Circular No. 37, and we are in the process of filing our equity incentive plan with the local SAFE branch.

It is unclear how these regulations will be interpreted and implemented as SAFE Circular No. 37 is newly issued and it is possible that some or all of our shareholders who are PRC residents will not comply with all the requirements required by SAFE Circular No. 37 or related rules. The failure of our company, Simin Zhang or future beneficial owners of our company who are PRC residents to comply with the registration or filing procedures set forth in the SAFE rules may subject such beneficial owners to fines and legal sanctions and may also limit our ability to contribute additional capital into our consolidated PRC entities, limit our consolidated PRC entities’ ability to distribute dividends to our company or otherwise materially and adversely affect our business.

In addition, on January 5, 2007, the SAFE promulgated the Implementing Rules of Measures for the Administration of Individual Foreign Exchange, or the Implementation Rules. Under the Implementation Rules, PRC citizens who are granted share options by an overseas publicly-listed company are required, through a qualified PRC agent or the PRC subsidiary of such overseas publicly-listed company, to register with the SAFE and complete certain other procedures related to the share options. We and our PRC citizen employees, who have been granted share options, or PRC option holders, are subject to the Implementation Rules.

If our PRC resident shareholders and our PRC share option holders fail to comply with these rules and regulations, we or our PRC resident shareholders and share option holders may be subject to fines and legal or administrative sanctions.

Dividends we receive from our operating subsidiaries located in the PRC may be subject to PRC withholding tax.

The PRC Corporate Income Tax Law, or 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 an establishment or place of business in the PRC 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. Therefore, dividends paid to us by our subsidiaries in China are subject to withholding of income tax if we are considered a “non-resident enterprise” under the CIT Law. If under the CIT Law and its implementation regulations any dividends we receive from our subsidiaries are subject to withholding of income tax, it may materially reduce our net income and the amount of dividends, if any, that we may pay to our shareholders and ADS holders.

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 became 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 withholding tax at a reduced 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 may be determined under an applicable tax treaty between the PRC and the jurisdiction in which the holder of the relevant PRC subsidiary is tax resident. Although we are a Cayman Islands incorporated company, in 2009 we received from the relevant tax authorities in Hong Kong a certification of resident status and were considered as a Hong Kong tax resident and subject to Hong Kong Profits Tax on income arising in or derived from Hong Kong. In February 2014, our company was denied its Hong Kong tax residency that applied to the year ended December 31, 2013 by the Hong Kong Inland Revenue Department. Our company is therefore now subject to a standard withholding tax rate of 10%, rather than a reduced tax rate of 5% under the tax treaty previously applied by us, for dividends to be paid or appropriated from our PRC subsidiaries. We continue to actively monitor the level of withholding tax in which we may be subject and are continuing to evaluate appropriate organizational changes, if any, to minimize the corresponding tax impact.

We may be deemed a PRC resident enterprise under the CIT Law and be subject to PRC taxation on our worldwide income.

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, it is unclear whether PRC tax authorities would treat us as a PRC resident enterprise. If we are treated as a resident enterprise for PRC tax purposes, we will be subject to PRC tax on our worldwide income at the 25% uniform tax rate, which could have an impact on our effective tax rate and an adverse effect on our net income and profitability, although dividends distributed from our PRC subsidiaries to us could be exempt from PRC dividend withholding tax, since such income is exempt under the CIT Law when paid to a PRC resident recipient.

Dividends payable by us to our shareholders and ADS holders and gain on the sale of our ADSs or ordinary shares may become subject to taxes under PRC tax laws.

Under the CIT Law and implementation regulations, PRC income tax at the rate of 10%, or the lower applicable rate if specified in an income 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 in the PRC but the relevant income is not effectively connected with such establishment or place of business, to the extent such dividends are derived from sources within the PRC. Similarly, any gain realized on the transfer of ADSs or shares by such investors is also subject to a 10% PRC income tax rate, or the lower applicable rate if specified in an income tax treaty, if such gain is regarded as income derived from sources within the PRC. If we are considered a PRC “resident enterprise,” it is unclear whether dividends we pay with respect to our ordinary shares or ADSs, or the gain you may realize from the transfer of our ordinary shares or ADSs, would be treated as income derived from sources within the PRC and be subject to PRC income tax. If we are required under the CIT Law to withhold PRC income tax on dividends payable to our non-PRC investors that are “non-resident enterprises,” or if you are required to pay PRC income tax on the capital gain derived from the transfer of our ordinary shares or ADSs, the value of your investment in our ordinary shares or ADSs could decrease materially.

We face uncertainties with respect to the application of the Circular on Strengthening the Administration of Enterprise Income Tax for Share Transfers by Non-PRC Resident Enterprises.

Pursuant to the Circular on Strengthening the Administration of Enterprise Income Tax for Share Transfers by Non-PRC Resident Enterprises, known as SAT Circular 698, issued by the State Administration of Taxation in 2009 with retroactive effect from 2008, and guidance subsequently issued in 2011 and 2015, where a non-resident enterprise transfers the equity interests of a PRC resident enterprise, or properties of establishments of a foreign enterprise in the PRC, indirectly by disposing of the equity interests of an overseas holding company, or an Indirect Transfer, such Indirect Transfer may be subject to tax in the PRC. Using a “substance over form” principle, the PRC tax authorities may disregard the existence of the overseas holding company if it lacks a reasonable commercial purpose and was established for the purpose of reducing, avoiding or deferring PRC tax. As a result, gains derived from such Indirect Transfer may be subject to PRC withholding tax at a rate of up to 10% under certain circumstances. In the case of an Indirect Transfer of property of establishments of a foreign enterprise in the PRC, the applicable tax rate would be 25%. SAT Circular 698 also provides that where a non-PRC resident enterprise transfers its equity interests in a PRC resident enterprise to its related parties at a price lower than the fair market value, the relevant tax authority has the power to make a reasonable adjustment to the taxable income of the transaction. Both parties to an Indirect Transfer may be required to report the Indirect Transfer to the relevant tax authority of the PRC resident enterprise. In addition, the PRC resident enterprise may be required to provide necessary assistance to support the enforcement of SAT Circular 698, including making tax filings regarding such transfer.

There is uncertainty as to the application of SAT Circular 698 and the subsequent guidance and related rules. For example, it may be difficult to evaluate whether or not a particular transaction has a reasonable commercial purpose, and such evaluation may be based on ambiguous criteria which have not yet been formally declared or stated by tax authorities. While such rules do not apply to transfers of our stock traded on a public capital market, SAT Circular 698 may be determined by the tax authorities to be applicable to any offshore restructuring transactions where non-resident investors are involved. The PRC tax authorities may pursue offshore shareholders to conduct a filing regarding the transactions and request that our PRC subsidiaries assist with such filing or be subject to certain penalties. As a result, we and our non-resident investors may become at risk of being subject to tax and penalties under SAT Circular 698 and may be required to expend valuable resources to comply with SAT Circular 698 or to establish that we and our non-resident enterprise investors should not be taxed under SAT Circular 698 for our previous and future restructuring, which may have a material adverse effect on our financial condition and results of operations.

Fluctuations in the exchange rates of the Renminbi may have a material adverse effect on your investment.

The exchange rates between the Renminbi and the U.S. dollar, Euro and other foreign currencies is affected by, among other things, changes in China’s political and economic conditions. On July 21, 2005, the PRC government changed its decade-old policy of pegging the value of the Renminbi to the U.S. dollar. This change in policy permitted the Renminbi to fluctuate within a narrow and managed band against a basket of foreign currencies. However, on June 19, 2010, the PRC government announced the adoption of measures to allow broader fluctuation of the Renminbi. In addition, the PRC government has allowed international transactions to be settled in Renminbi in 20 provinces, autonomous regions and municipalities in China. In April 2012, the People’s Bank of China announced that it would expand the floating range of the trading price of the Renminbi against the U.S. dollar from 0.5% to 1.0%, beginning on April 16, 2012. In 2014, the Renminbi depreciated 2.5% against the U.S. dollar. On March 15, 2014, the People’s Bank of China further expanded the floating range of the trading price of the Renminbi against the U.S. dollar from 1.0% to 2.0%.

There remains significant international pressure on the PRC government to adopt a more flexible currency policy, which could result in further and more significant appreciation of the Renminbi against the U.S. dollar. As we rely on dividends paid to us by our PRC subsidiaries, any significant revaluation of the Renminbi may have a material adverse effect on the value of, and dividends payable on, our ADSs in foreign currency terms. To the extent that we need to convert U.S. dollars we received from our initial public offering into Renminbi for our operations, appreciation of the Renminbi against the U.S. dollar would have an adverse effect on the Renminbi amount we would receive from the conversion. Conversely, if we decide to convert our Renminbi into U.S. dollars for the purpose of making payments for dividends on our ordinary shares or ADSs or for other business purposes, appreciation of the U.S. dollar against the Renminbi would have a negative effect on the U.S. dollar amount available to us. In addition, appreciation or depreciation in the value of the Renminbi relative to the U.S. dollar would affect our financial results reported in U.S. dollar terms without giving effect to any underlying change in our business, financial condition and results of operations.

Governmental control of currency conversion may affect the value of your investment.

The PRC government imposes controls on the convertibility of the Renminbi into foreign currencies and, in certain cases, the remittance of currency out of China. We receive all our revenues in Renminbi. Under our current corporate structure, our income is primarily derived from dividend payments from our PRC subsidiaries. Shortages in the availability of foreign currency may restrict the ability of our PRC subsidiaries to remit sufficient foreign currency to pay dividends or other payments to us, or otherwise satisfy their foreign currency-denominated obligations. Under existing PRC foreign exchange regulations, payments of current account items, including profit distributions, interest payments and expenditures from trade related transactions, can be made in foreign currencies without prior approval from the SAFE by complying with certain procedural requirements. However, approval from the SAFE or its local branch is required where Renminbi is to be converted into foreign currency and remitted out of China to pay capital expenses such as the repayment of loans denominated in foreign currencies. Similarly, approval from the SAFE is required where foreign currency, in the form of capital investment, is to be converted into Renminbi, and penalties may be imposed for failure to comply with related requirements, including use of such funds to be within the business scope approved by the applicable governmental authority and may not be used for equity investments in the PRC unless otherwise provided by laws and regulations, pursuant to Circular 142 promulgated by SAFE on August 29, 2008. The PRC government may also at its discretion restrict access in the future to foreign currencies for current account transactions.

We converted approximately US\$350.0 million net proceeds from our initial public offering into Renminbi in December 2007 and January 2008. However, in July 2010, SAFE assessed a one-time non-recurring penalty of approximately RMB25.5 million against us for failing to comply with relevant procedures, citing that the purposes for the conversion of the net proceeds as stated at the time of conversion were not entirely consistent with our subsequent use of such proceeds. We recognized the expense of approximately RMB25.5 million in the second quarter of 2010. We fully paid the penalty in July 2010.

On November 9, 2010, the SAFE promulgated a notice on relevant issues concerning strengthening the administration of foreign exchange business, which requires the authenticity of the settlement of net proceeds from an offshore offering to be closely examined and the net proceeds to be settled in the manner described in the offering documents. Furthermore, in November 2012, SAFE promulgated the Circular of Further Improving and Adjusting Foreign Exchange Administration Policies on Foreign Direct Investment which substantially amends and simplifies the current foreign exchange procedure. Pursuant to this circular, the opening of various special purpose foreign exchange accounts (e.g. pre-establishment expenses account, foreign exchange capital account, guarantee account), the reinvestment of Renminbi proceeds by foreign investors in the PRC, and remittance of foreign exchange profits and dividends by a foreign-invested enterprise to its foreign shareholders no longer require the approval or verification of SAFE, and multiple capital accounts for the same entity may be opened in different provinces, which was not possible before. In addition, SAFE promulgated the Circular on Printing and Distributing the Provisions on Foreign Exchange Administration over Domestic Direct Investment by Foreign Investors and the Supporting Documents in May 2013, which specifies that the administration by SAFE or its local branches over direct investment by foreign investors in the PRC shall be conducted by way of registration and banks shall process foreign exchange business relating to the direct investment in the PRC based on the registration information provided by SAFE and its branches.

We closely monitor any update in the relevant PRC laws and regulations with respect to currency conversions, as well as our compliance with such laws and regulations. If the foreign exchange control system prevents us from obtaining sufficient foreign currency to satisfy our currency demands, we may not be able to pay dividends in foreign currencies to our shareholders, including holders of our ADSs.

The approval of the Chinese Securities Regulatory Commission, or the CSRC, might have been required in connection with our initial public offering, and, if required, we could be subject to sanction, fines and other penalties.

On August 8, 2006, six PRC regulatory agencies, including the CSRC, promulgated a regulation, which became effective on September 8, 2006, and was amended on June 22, 2009, that purports to require an offshore special purpose vehicle, or SPV, formed for listing purposes and controlled directly or indirectly by PRC companies or individuals to obtain the approval of the CSRC prior to the listing and trading of such SPV's securities on an overseas stock exchange. On September 21, 2006, the CSRC issued a clarification that sets forth the criteria and process for obtaining any required approval from the CSRC. We've been advised by our PRC counsel that:

- the CSRC approval requirement applies to SPVs that acquired equity interests in PRC companies through share exchanges and using cash; and
- based on their understanding of the current PRC laws, rules and regulations and the new regulation, unless there are new PRC laws, rules and regulations or clear requirements from the CSRC in any form that require the prior approval of the CSRC for the listing and trading of any SPV's securities on an overseas stock exchange, the new regulation does not require that we obtain prior CSRC approval for the listing and trading of our ADSs on the New York Stock Exchange, because we completed our reorganization under which the equity interests in our consolidated PRC entities were transferred to China Nepstar, an overseas SPV, prior to September 8, 2006, the effective date of the new regulation.

The interpretation and application of this regulation remains unclear, and we cannot assure you that our initial public offering did not require approval from the CSRC. If the CSRC or other PRC regulatory body subsequently determines that the CSRC's approval was required for our initial public offering, we may face sanctions by the CSRC or other PRC regulatory agencies. In that case, these regulatory agencies may impose fines and penalties on our operations in the PRC, limit our operating privileges in the PRC, restrict or prohibit payment or remittance of dividends, or take other actions that could have a material adverse effect on our business, financial condition, results of operations, reputation and prospects, as well as the trading price of our ADSs.

The regulations also established additional procedures and requirements that could make merger and acquisition activities by foreign investors more time-consuming and complex, including requirements in some instances that the MOFCOM, be notified in advance of any change-of-control transaction in which a foreign investor takes control of a PRC domestic enterprise in which any of the following situations exists: (i) the transaction involves an important industry in China; (ii) the transaction may affect national "economic security"; or (iii) the PRC domestic enterprise has a well-known trademark or historical Chinese trade name in China. As we may grow our business in part by acquiring complementary businesses in the future, complying with the requirements of the new regulations to complete such transactions could be time-consuming, and any required approval processes, including obtaining approval from the MOFCOM, may delay or inhibit our ability to complete such transactions. Any such delay or inability to obtain applicable approvals to complete our potential future acquisitions could affect our ability to expand our business or maintain our market share.

Risks Related to Our Ordinary Shares and ADSs

The market price for our ADSs may be volatile, which could result in substantial loss to you.

The market price for our ADSs is likely to be highly volatile and subject to wide fluctuations in response to factors, including the following:

- actual or anticipated fluctuations in our quarterly operating results;
- changes in financial estimates by securities research analysts;
- changes in the economic performance or market valuations of other drugstore chain companies;
- announcements of competitive developments;
- regulatory developments in China affecting us, our customers or our competitors;
- announcements regarding litigation or administrative proceedings involving us;
- additions or departures of our executive officers; and
- sales or perceived sales of additional ordinary shares or ADSs.

In addition, the U.S. capital markets have from time to time experienced significant price and volume fluctuations that are not related to the operating performance of particular companies. These market fluctuations may also have a material adverse effect on the market price of our ADSs.

Substantial future sales or perceived sales of our ADSs in the public market could cause the price of our ADSs to decline.

If our existing shareholders sell, indicate an intention to sell, or are perceived to intend to sell, substantial amounts of our ordinary shares in the public market and other legal restrictions on resale lapse, the trading price of our ADSs could decline. We cannot predict what effect, if any, market sales of securities held by our significant shareholders or any other shareholder or the availability of these securities for future sale will have on the market price of our ADSs.

In addition, certain of our shareholders or their transferees and assignees will have the right to cause us to register the sale of their shares under the Securities Act upon the occurrence of certain circumstances. Registration of these shares under the Securities Act would result in these shares becoming freely tradable without restriction under the Securities Act immediately upon the effectiveness of the registration. Sales of these registered shares in the public market could cause the price of our ADSs to decline.

Our articles of association contain anti-takeover provisions that could discourage a third party from acquiring us, which could limit our shareholders' opportunity to sell their shares, including ordinary shares represented by our ADSs, at a premium.

Our articles of association limit the ability of others to acquire control of our company or cause us to engage in change-of-control transactions. These provisions could have the effect of depriving our shareholders of an opportunity to sell their shares at a premium over prevailing market prices by discouraging third parties from seeking to obtain control of our company in a tender offer or similar transaction. For example, our board of directors has the authority, without further action by our shareholders, to issue preferred shares. These preferred shares may have better voting rights than our ordinary shares, in the form of ADSs or otherwise, and could be issued quickly with terms calculated to delay or prevent a change in control of our company or make removal of management more difficult. If our board of directors decides to issue preferred shares, the price of our ADSs may fall and the voting and other rights of the holders of our ordinary shares and ADSs may be materially and adversely affected.

In addition, certain actions require the approval of a super majority of at least two-thirds of our board of directors which, among other things, would allow our non-independent directors to block a variety of actions or transactions, such as a merger, asset sale or other change of control, even if all of our independent directors unanimously voted in favor of such action, thereby further depriving our shareholders of an opportunity to sell their shares at a premium.

Holders of ADSs have fewer rights than shareholders and must act through the depositary to exercise their rights.

Holders of our ADSs do not have the same rights of our shareholders and may only exercise the voting rights with respect to the underlying ordinary shares in accordance with the provisions of the deposit agreement. Under our second amended and restated memorandum and articles of association, the minimum notice period required to convene a general meeting is seven days. When a general meeting is convened, you may not receive sufficient notice of a shareholders' meeting to permit you to withdraw your ordinary shares to allow you to cast your vote with respect to any specific matter. In addition, the depositary and its agents may not be able to send voting instructions to you or carry out your voting instructions in a timely manner. We will make all reasonable efforts to cause the depositary to extend voting rights to you in a timely manner, but we cannot assure you that you will receive the voting materials in time to ensure that you can instruct the depositary to vote your ADSs. Furthermore, the depositary and its agents will not be responsible for any failure to carry out any instructions to vote, for the manner in which any vote is cast or for the effect of any such vote. As a result, you may not be able to exercise your right to vote and you may lack recourse if your ADSs are not voted as you requested. In addition, in your capacity as an ADS holder, you will not be able to call a shareholders' meeting.

You may be subject to limitations on transfers of your ADSs.

Your ADSs are transferable on the books of the depositary. However, the depositary may close its transfer books at any time or from time to time when it deems expedient in connection with the performance of its duties. In addition, the depositary may refuse to deliver, transfer or register transfers of ADSs generally when our books or the books of the depositary are closed, or at any time if we or the depositary deems it advisable to do so because of any requirement of law or of any government or governmental body, or under any provision of the deposit agreement, or for any other reason.

Your right to participate in any future rights offerings may be limited, which may cause dilution to your holdings and you may not receive cash dividends if it is impractical to make them available to you.

We may from time to time distribute rights to our shareholders, including rights to acquire our securities. However, we cannot make rights available to you in the United States unless we register the rights and the securities to which the rights relate under the Securities Act or an exemption from the registration requirements is available. Also, under the deposit agreement, the depositary bank will not make rights available to you unless either both the rights and any related securities are registered under the Securities Act, or the distribution of them to ADS holders is exempted from registration under the Securities Act. We are under no obligation to file a registration statement with respect to any such rights or securities or to endeavor to cause such a registration statement to be declared effective. Moreover, we may not be able to establish an exemption from registration under the Securities Act. Accordingly, you may be unable to participate in our rights offerings and may experience dilution in your holdings.

In addition, the depositary of our ADSs has agreed to pay to you the cash dividends or other distributions it or the custodian receives on our ordinary shares or other deposited securities after deducting its fees and expenses. You will receive these distributions in proportion to the number of ordinary shares your ADSs represent. However, the depositary may, at its discretion, decide that it is inequitable or impractical to make a distribution available to any holders of ADSs. For example, the depositary may determine that it is not practicable to distribute certain property through the mail, or that the value of certain distributions may be less than the cost of mailing them. In these cases, the depositary may decide not to distribute such property and you will not receive such distribution.

We are a Cayman Islands company and, because judicial precedent regarding the rights of shareholders is more limited under Cayman Islands law, you may have less protection than if you were a shareholder of a Delaware corporation.

Our corporate affairs are governed by our second amended and restated memorandum and articles of association, the Cayman Islands Companies Law (as amended) and the common law of the Cayman Islands. The rights of shareholders to take action against the directors, actions by minority shareholders and the fiduciary responsibilities of our directors to us under Cayman Islands law are to a large extent governed by the common law of the Cayman Islands. The common law of the Cayman Islands is derived in part from comparatively limited judicial precedent in the Cayman Islands as well as that from English common law, which has persuasive, but not binding, authority on a court in the Cayman Islands. The rights of our shareholders and the fiduciary responsibilities of our directors under Cayman Islands law are not as clearly established as they would be under statutes or judicial precedent in some jurisdictions in the United States. In particular, the Cayman Islands has a less developed body of securities laws than the United States. In addition, some U.S. states, such as Delaware, have more fully developed and judicially interpreted bodies of corporate law than the Cayman Islands. Furthermore, Cayman Islands companies may not have standing to initiate a shareholder derivative action in a federal court of the United States. As a result, public shareholders may have more difficulties in protecting their interests in the face of actions taken by management, members of the board of directors or controlling shareholders than they would as shareholders of a Delaware company.

If a poll is not demanded at our shareholder meetings, voting will be by show of hands and shares will not be proportionately represented. Shareholder resolutions may be passed without the presence of holders of a majority of our shares in person or by proxy.

Voting at any of our shareholder meetings is by show of hands unless a poll is demanded. A poll may be demanded by the chairman of the meeting or by any shareholder present in person or by proxy. If a poll is demanded, each shareholder present in person or by proxy will have one vote for each ordinary share registered in his or her name. If a poll is not demanded, voting will be by show of hands and each shareholder present in person or by proxy will have one vote regardless of the number of shares registered in his or her name. In the absence of a poll, shares will therefore not be proportionately represented in the voting. In addition, the quorum required for our shareholder meetings consists of shareholders who hold at least one-third of our ordinary shares being present at a meeting in person or by proxy. As a result, subject to the requisite majorities, shareholder resolutions may be passed at our shareholder meetings without the presence of holders of a majority of our shares in person or by proxy.

We may be or become a passive foreign investment company, or PFIC, for U.S. federal income tax purposes, which could result in adverse U.S. federal income tax consequences to U.S. investors.

Based on the quarterly average valuation of our assets, including goodwill for the taxable year ended on December, 31, 2014, we do not believe that we were a PFIC for our taxable year ended on December 31, 2014, although there can be no certainty in this regard due to the complex nature of the applicable rules. Under the U.S. Internal Revenue Code of 1986, as amended, the determination of whether we are a PFIC is made annually after the close of the taxable year. 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 based on the market price of our ADSs and ordinary shares, which is likely to fluctuate. 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 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 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, such characterization could result in adverse U.S. federal income tax consequences to you if you are a U.S. investor, unless you make a timely “mark-to-market” election to mitigate these consequences. For example, if we are or become a PFIC, our U.S. investors may become subject to increased tax liabilities under U.S. federal income tax laws and regulations, and will become subject to burdensome reporting requirements. Moreover, non-corporate U.S. investors will not be eligible for reduced rates of taxation on any dividends received from us if we are a PFIC in the taxable year in which such dividends are paid or in the preceding taxable year. You are urged to consult your tax advisor regarding the application of the PFIC rules in your particular circumstances and the advisability of making a mark-to-market election.

ITEM 4. INFORMATION ON THE COMPANY

A. History and Development of the Company

China Nepstar is incorporated in the Cayman Islands. Our principal executive offices are located at 25F, Neptunus Yinhe Keji Building, No.1, Kejizhong 3rd Road, Nanshan District, Shenzhen, Guangdong Province 518057, People's Republic of China. Our telephone number is (86) 755-2643-5319 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. We disposed of our 40% ownership in JZJ on December 28, 2012. As a result, during the period from the first quarter of 2009 to the time of disposal of our ownership in JZJ, JZJ had not been our consolidated subsidiary and had been accounted for under the equity method.

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 with the intention 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 January 28, 2013, Shenzhen Nepstar obtained all the licenses which are 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.

In July 2013, we established Shenzhen Nepstar Group Siping Northeast Co., Ltd. in Siping City, solely owned by Shenzhen Nepstar.

In October 2014, we established Wuhan Nepstar Chain Co., Ltd. in Wuhan City, solely owned by Shenzhen Nepstar.

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, as well as to retain the economic risks and rewards of these entities. See “Item 4. Information on the Company — C. Organizational Structure.”

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 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 “Item 3. Key Information — D. 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 2012, 2013 and 2014, our capital expenditures totaled RMB35.0 million, RMB47.2 million and RMB60.0 million (US\$9.6 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 2015 will range from approximately RMB60.0 million to RMB100.0 million, which we plan to use for setting up new stores and distribution centers as well as upgrading our information management system.

B. Business Overview

We are a leading retail drugstore chain in China, with a network of 1,980 directly operated drugstores spanning 74 cities across 14 provinces and direct-controlled municipalities in China as of December 31, 2014. 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 Guangzhou, 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 2,156 private label products as of December 31, 2014. Sales of our private label products accounted for 17.5% of our revenue and 24.8% of our gross profit in 2014.

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 4.3% of our revenue and 2.1% of gross profit in 2014.

Our Store Network

We are a leading retail drugstore chain in China based on the number of directly operated stores, with a store network comprising 1,980 directly operated stores as of December 31, 2014. 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 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, 2014:

City	As of December 31,		
	2012	2013	2014
Shenzhen	344	329	314
Dalian	197	203	220
Hangzhou	158	145	139
Ningbo	141	126	121
Guangzhou	132	120	111
Suzhou	78	82	89
Qingdao	104	93	83
Chengdu	77	79	82
Weifang	82	84	75
Tianjin	78	74	72
Others	741	731	674
Total	2,132	2,066	1,980

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

	As of December 31,		
	2012	2013	2014
Number of stores at the beginning of the period	2,395	2,132	2,066
Stores closed/disposed of during the period	319	188	216
New stores opened during the period	56	122	130
Number of stores at the end of the period	2,132	2,066	1,980

Our stores are typically between 80 and 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 2,100 to 2,700 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 3,733 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 22.3% of our revenue in 2014.

Over-the-Counter Drugs. We offer approximately 3,470 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 40.1% of our revenue in 2014.

Nutritional Supplements. We offer approximately 476 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 13.3% of our revenue in 2014.

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 4.2% of our revenue in 2014.

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 20.1% of our revenue in 2014.

Private Label Products

We launched our first private label product in September 2005, and since then our private label portfolio has increased to 2,156 products marketed under 171 private labels, covering all categories of products we offer. In 2014, private label products accounted for approximately 17.5% of our revenue and 24.8% 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. For our member customers, we offer free samples of selected merchandise periodically to promote sales and introduce new products.

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" program in 1999. As of December 31, 2014, this program had more than 10.8 million members, approximately 4.4 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. We also award VIP memberships to those member customers who make purchases of at least RMB2,000 from our stores annually. As of December 31, 2014, the number of our VIP members accounted for approximately 1.6% 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 an additional two loyalty points for every RMB10.0 spent on our products. Loyalty points may be used as discounts for future purchase and also to exchange for gifts. At the end of calendar year, unutilized loyalty points are forfeited.

We maintain a database of our loyalty scheme membership, including customer profiles and purchasing records, which help us to tailor our promotional programs to meet our customers' specific needs. On average, members of our loyalty scheme spend approximately 2.4 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 65.8% of our revenue in 2014.

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

	As of December 31,		
	2012	2013	2014 ⁽¹⁾
	(in thousands)		
Members	10,261	12,285	10,759
Active members	4,376	4,891	4,379

(1) In 2014, we terminated the membership of approximately 1.9 million inactive members.

In 2010, we began to 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 2014, our stores served an average of approximately 75 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, which help us 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 2012, 2013 and 2014.

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, 2014, 1,146, or 57.9% of our stores are designated stores under the PRC national medical insurance program.

Procurement

We currently source our merchandise from 1,689 suppliers, including 652 manufacturers and 1,037 wholesalers. In 2014, 74.0% 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 8.0% of our total purchases in 2014. The transaction value of purchases from our largest five suppliers accounted for 24.6% of our total purchases in 2014.

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 continue to centralize our merchandise procurement, our greater sourcing capabilities make 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 15 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, partly using our own vehicles and partly using third party logistics services. 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 433 manufacturers out of a large number of manufacturers as suppliers of our private label products after reviewing their good manufacturing practice, or GMP, compliance status, product selection, quality and manufacturing, packaging, transportation and storage capabilities as well as cost competitiveness.

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 brand name, store location, merchandise selection, prices, and services offered. 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 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 2014, our total insurance coverage totaled approximately RMB880.8 million (US\$142.0 million) and we paid approximately RMB0.6 million (US\$0.1 million) in insurance premiums. 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 and medical devices, we are subject to regulation and oversight by different levels of the food and drug administration in China, and in particular China Food and Drug Administration, or the CFDA, which was established in 2013 as the successor to 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 Essential Drugs and Reimbursement Lists.”

On April 18, 2009, the Ministry of Health (now NHFPC) and other eight PRC ministries and commissions issued the Provisional Administrative Measures of the National List of Essential Drugs, stipulating the criteria and procedures to determine the items included in the Essential Drugs and Reimbursement Lists. In principle, the Essential Drugs and Reimbursement Lists are subject to review every three years. The latest list (2012 Version) was published on March 13, 2013 and came into effect on May 1, 2013.

Regulations on Distribution of Medical Devices

Some of our medical devices are subject to regulatory controls governing medical devices. As a distributor of medical devices, we are subject to regulation and oversight by the CFDA, and its relevant local branches. CFDA requirements include obtaining production permits, product registrations and export registrations, and compliance with clinical testing standards, manufacturing practices, pricing practices, quality standards, applicable industry standards, adverse event reporting, and advertising and packaging standards.

In China, medical devices are classified into three different categories, Class I, Class II and Class III, depending on the degree of risk associated with each medical device and the extent of control needed to ensure safety and effectiveness. Classification of a medical device is important because the class to which a medical device is assigned determines, among other things, whether a distributor needs to obtain a distribution permit or notify municipal level food and drug administration and file for record, and the level of regulatory authority involved in granting permit or maintaining record.

Class I devices are those with low risk to the human body and are subject to “general controls.” Class I devices require product registration and are regulated by the city level food and drug administration where the manufacturer is located. Class II devices impose medium risk to the human body and are subject to “strict controls.” Class II devices require product registration by their manufacturers, usually through a quality system assessment, and are regulated by the provincial level food and drug administration where the manufacturer is located. Class III devices, subject to “special controls,” impose high risk to the human body, such as life-sustaining, life-supporting and implantable devices. Class III devices also require product registration by manufacturers and are regulated by the CFDA under the strictest regulatory control. Our medical devices for distribution cover all the three categories of medical devices as described above.

We must have a distribution license to engage in sales and distribution of Class III medical devices in China. The distribution license is valid for five years and is renewable upon expiration. The distributor does not need the distribution license in connection with the sale and distribution of Class I and Class II medical devices, but must notify the municipal level food and drug administration and file for record with it.

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.

Regulations 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 and amended on January 8, 2011;
- 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. See "Item 4. Information on the Company — C. Organizational Structure."

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. See "Item 4. Information on the Company — C. Organizational Structure."

Good Supply Practice Standards

GSP standards regulate wholesale and retail pharmaceutical product distributors to ensure the quality of distribution of pharmaceutical products in China. On January 22, 2013, the Ministry of Health (now NHFPC) promulgated the New GSP, which became effective on June 1, 2013. The New GSP strengthens the previous GSP's requirements for pharmaceutical product distributors to implement strict controls on the distribution of medicine 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. In accordance with the New GSP, all the drugstores in China should obtain the new GSP certification by the end of 2015, and we have proceeded to renew our GSP certification in our subsidiaries.

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 Ministry of Health (now NHFPC), 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.

The Tort Law of the PRC was promulgated in December 2009, which stipulates that if damages to consumers are caused by defective products as a result of the fault of a third party such as a transportation carrier or a warehouse, the producers and the sellers of the products have the right to recover their respective losses from such third party. If defective products are identified after they have been put into distribution, the producers or the sellers are required to take remedial measures in a timely manner, such as issuance of warning, recall of products, etc., or otherwise will be subject to liabilities. If the products are produced and sold with known defects, causing death or severe damage to the health of others, the consumers suffering from damages have the right to claim punitive damages in addition to compensatory damages.

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 and 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 that of 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 government authorities have ordered price reductions of thousands of pharmaceutical products. In 2012, 2013 and 2014, approximately 30.4%, 31.0% and 30.6% of our revenue was derived from sales of pharmaceutical products that were subject to price controls, respectively. In October 2014, NDRC issued a consultation paper to local state bureaus of commodity prices, indicating that the existing price controls over pharmaceuticals may be relaxed. However, we do not know whether any enforceable regulations or rules will be stipulated and implemented and the time such regulations or rules become effective if they are stipulated, and we cannot guarantee that such consultation paper will result in any relaxation of price controls. 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 “Item 3. Key Information — D. 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 government 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 is on 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.

Medicines included in the Essential Drug and Reimbursement Lists are 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 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, have the power to determine every two years which medicines are included in the national medical insurance catalog and each of the two-tiers, as well as 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 reduce or increase 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 by no more than 15%. 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 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 (now NHFPC) 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 took 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.

Seasonality of Our Business

See “Item 5. Operating and financial Review and Prospects – Seasonality.”

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 compensatory damages not exceeding RMB500,000 according to the currently effective PRC Trademark Law and not exceeding RMB3 million according to the newly promulgated Third Amendment to PRC Trademark Law to be effective on May 1, 2014.

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

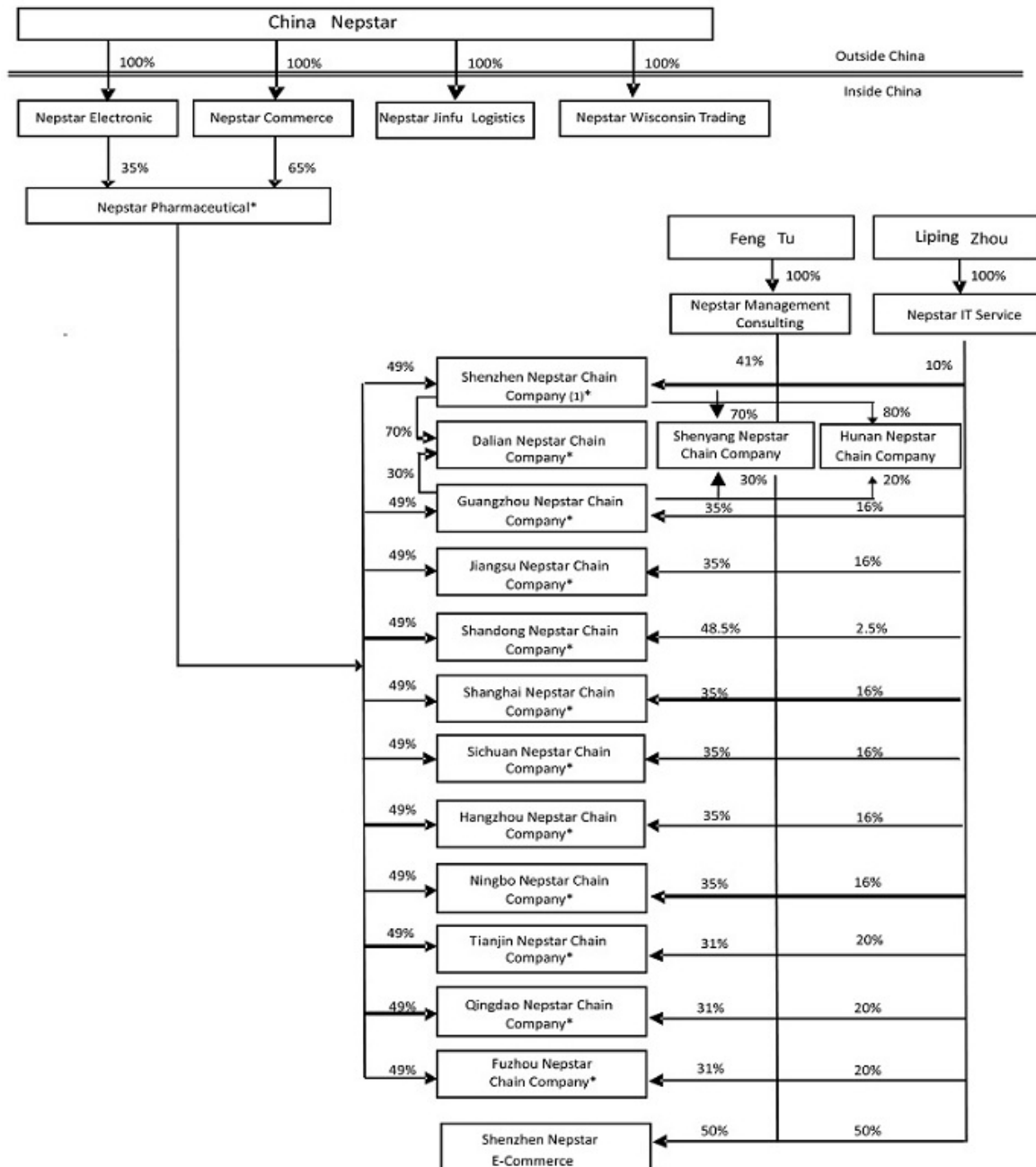
The principal laws, rules and regulations governing dividends paid by our PRC operating subsidiaries include the Company Law of the PRC (1993), as amended in October 2005 and December 2013, Wholly Foreign Owned Enterprise Law (1986), as amended in 2000, and Wholly Foreign Owned Enterprise Law Implementation 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, 2014, the accumulated balance of our statutory reserve funds totaled RMB98.9 million (US\$15.9 million).

Tax

See “Item 10. Additional Information — E. Taxation.”

C. Organizational Structure

The following diagram illustrates our corporate structure as of the date of this annual report. Except China Nepstar, which is incorporated under the law of Cayman Islands, each of the other companies within our corporate structure is incorporated under PRC law.



(1) Shenzhen Nepstar Chain Co., Ltd. owns 100% of the equity interest in each of the following subsidiaries: Beijing Nepstar Huashi Drugstore Co., Ltd.; Beijing Nepstar Guangqumen Drugstore Co., Ltd.; Beijing Nepstar Tiyyuguanlu Drugstore Co., Ltd.; Beijing Nepstar Shuangjing Drugstore Co., Ltd.; Beijing Nepstar Tongda Drugstore Co., Ltd.; Beijing Nepstar Hongda Drugstore Co., Ltd.; Beijing Nepstar Xingda Drugstore Co., Ltd.; Hubei Nepstar Pharmaceutical Co., Ltd.; Wuhan Nepstar Drugstore Co., Ltd.; Shenzhen Nepstar Group Siping Northeast Co., Ltd. and Wuhan Nepstar Chain Co., Ltd.

* Significant subsidiaries

D. Property and Equipment

Our corporate headquarters are located in Shenzhen, where we lease an aggregate of 1,671 square meters of office space. As of the date of this annual report, we operated one national distribution center located near our headquarters and 15 regional distribution centers with a combined total of approximately 58,132 square meters of space.

Substantially all of our store space is leased from third parties. Our leases generally have a five-year term. As of December 31, 2014, 1,295 leases (covering an aggregate gross floor area of approximately 121,184 square meters, equivalent to approximately 38.9% of the total gross floor area of properties we occupied) will terminate within two years. We must negotiate with the lessors for extensions to the old leases or enter into new leases upon their termination. The lessors 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, 2014, we had 2,013 leased properties with an aggregate gross floor area of 311,401 square meters, of which 230,188 square meters were used as drugstores. 249 or approximately 12.4% of these leased properties had defects in their legal titles. Of the properties with defects in legal titles, 25,750 square meters were used as drugstores, equivalent to approximately 11.1% 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 corresponding lessors; and (ii) the identity of the lessor 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 defect in title was 24,312 square meters, or approximately 10.5% of the total gross floor area of our drugstores, and with the latter type of defect in title was 3,179 square meters, or approximately 1.4% of the total gross floor area of our drugstores. In addition, 109,868 square meters, or approximately 35.3% of our leased properties, including properties with defects in title, have not been registered as required by applicable PRC regulations. See “Item 3. Key Information — D. Risk Factors — Risks Related to Our Business — We do not possess clear leasehold titles or written agreements providing for usage rights in respect of some of our occupied properties.”

ITEM 4A. UNRESOLVED STAFF COMMENTS

None.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

You should read the following discussion and analysis of our financial condition and results of operations in conjunction with our consolidated financial statements included elsewhere in this annual report on Form 20-F. 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 “Item 3. Key Information — D. Risk Factors” or in other parts of this annual report on Form 20-F.

A. 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 RenRenHao 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. In 2012, we disposed the eight stores we acquired from Wenzhou RenRenHao Chain Drugstore Co., Ltd. In 2014, we disposed one store we acquired from Beijing Zeruntang Medical Ltd. and 18 stores we opened in Zao Zhuang, Shandong Province. We also close stores that do not perform well. Taking into account the 19 stores we disposed, we closed 216 stores and opened 130 new stores in 2014. As of December 31, 2014, we had a total of 1,980 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 Guangzhou, in terms of store count. Our total revenue was RMB2,549.9 million and RMB2,699.1 million and our net income was RMB90.1 million and RMB11.8 million in 2012 and 2013, respectively. In 2014, our revenue increased to RMB2,953.3 million (US\$476.0 million) and we incurred a net loss of RMB13.8 million (US\$2.2 million), primarily due to increases in our cost of goods sold and operating expenses that outpaced revenue growth.

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-term 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 the 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 basic drugs to patients at or near cost. While we believe that these community health clinics primarily target lower income and more price-sensitive customers compared to our typical clientele, 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 Ministry of Health (now NHFPC) established the Essential Drug List, which contains 205 types of chemical drugs and 102 types of 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 to the implementation of these price ceilings, our gross margins experienced downward pressure in 2010 as compared to 2009 and continued to experience downward pressure in 2011. In March 2013, NHFPC updated the Essential Drug List, which contains 317 types of chemical drugs and 203 types of traditional Chinese herbal medicines. As of December 31, 2014, 2,643 pharmaceutical products carried by our stores were on the List. 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 April 2014, the NHFPC, NDRC together with other government authorities issued an opinion to ensure the supply of regular low-price medicines. 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 if such price control goes into effect.

We believe that our extensive store network and operational expertise, strong brand name and development 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,		
	2012	2013	2014
Number of stores at the beginning of the year	2,395	2,132	2,066
Number of stores at the end of the year	2,132	2,066	1,980

During 2014, our stores served an average of approximately 75 customers per day per store. Our customer visits in 2014 slightly decreased as compared with 77 customers per day per store in 2013, primarily because of the termination of certain marketing and promotion programs in which free samples were given to customers.

We believe that store location is an important factor in driving our store sales. Our goal is to establish clusters of stores in well-developed cities in China. Within each major city, we aim to locate our stores in well-established residential communities. In 2014, in order to manage our stores more effectively and to improve the overall quality of store sales performance, we closed 216 stores, most of which were performing below our expectations. The number of closed stores in 2014 increased from 188 in 2013 to 216 in 2014, due to our more stringent performance reviews. We also sped up the pace of new store openings, adding 130 new stores in 2014 as compared to 122 new stores in 2013, as a result of the improvement in the sales performance of our stores generally, despite the fact that new stores may incur high initial costs.

For our drugstores that were opened prior to December 31, 2012, the average daily revenue per store increased from RMB3,541 in 2013 to RMB3,861 in 2014. The increase was mainly due to our effort in closing poorly performing stores, expanding product offerings into non-pharmaceutical categories of higher price points, as well as streamlining our store operations.

	2013		2014	
	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, 2011	1,893	3,554	1,701	3,860
Opened in 2012	54	3,072	49	3,887
Opened prior to December 31, 2012	1,947	3,541	1,750	3,861

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,							
	2012		2013		2014			
	RMB'000	% of Revenue	RMB'000	% of Revenue	RMB'000	US\$'000	% of Revenue	
Prescription drugs	519,557	20.4	601,934	22.3	658,031	106,055	22.3	
Over-the-counter drugs	997,997	39.1	1,059,154	39.2	1,183,665	190,772	40.1	
Nutritional supplements	399,397	15.7	392,009	14.5	393,466	63,415	13.3	
Herbal products	100,419	3.9	109,284	4.1	124,810	20,116	4.2	
Other products ⁽¹⁾	532,486	20.9	536,722	19.9	593,342	95,630	20.1	
Total	2,549,856	100.0	2,699,103	100.0	2,953,314	475,988	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, which affects our results of operations. It is essential for us to balance brand name products, which are popular among customers, with private label products, which generate higher margins. We also need to balance our pharmaceutical 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 22.3% of our revenue in 2014, sales of over-the-counter drugs accounted for 40.1% of our revenue in 2014 while sales of nutritional supplements accounted for 13.3% of our revenue in 2014.

In 2014, we expanded our product offerings and introduced 146 new non-pharmaceutical products, of which 15 are private label products. Sales of food, household, personal care and other products accounted for 20.1% of our revenue in 2014. 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. We believe that our extensive store network, operational expertise, strong brand name and focus on average store revenue growth provide us with a competitive platform to capture growth opportunities in China's retail market for convenience products.

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 2,156 products marketed under 171 private labels as of December 31, 2014, 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 618 additional trademarks, including 101 trademarks that are registered under Nepstar Pharmaceutical, 251 registered trademarks that we have obtained exclusive rights to use, 248 registered trademarks that we have obtained non-exclusive rights to use and 18 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, 2014, we have developed 2,156 private label products with these licensed trademarks. Private label products accounted for approximately 23.5% and 17.5% of our revenue, and 31.8% and 24.8% of our gross profit in 2013 and 2014, 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, 2014:

	Private Label Revenue as a Percentage of Revenue of the Category
Prescription drugs	7.2%
Over-the-counter drugs	11.7%
Nutritional supplements	41.7%
Herbal products	27.1%
Others ⁽¹⁾	22.3%
Total ⁽²⁾	17.5%

(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 consists primarily of 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 negligible. 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 1,689 suppliers, including 652 manufacturers and 1,037 wholesalers. In 2014, 74.0% 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 8.0% of our total purchases in 2014. The transaction value of purchases from our largest five suppliers accounted for 24.6% of our total purchases in 2014.

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 under our suppliers' brands. 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 2012, 2013 and 2014, we purchased merchandise from the Neptunus Group and its affiliates totaling RMB92.9 million, RMB138.8 million and RMB57.4 million (US\$9.2 million), respectively, and sold merchandise to the Neptunus Group and its affiliates totaling RMB5.5 million, RMB2.5 million and RMB2.6 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 effect 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 government authorities have ordered price reductions on thousands of pharmaceutical products. In 2012, 2013 and 2014, approximately 30.4%, 31.0% and 30.6%, 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,		
	2012	2013	2014
Sales, marketing and other operating expenses	39.7%	38.0%	37.2%
General and administrative expenses	4.5%	4.5%	4.3%
Impairment losses of property and equipment	0.3%	0.3%	0.3%
Total operating expenses	44.5%	42.8%	41.8%

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 decreased from 39.7% in 2012, 38.0% in 2013 and 37.2% in 2014 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 for 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 2012, 2013 and 2014, our inventory turnover days, calculated as the average of inventory at the beginning of the year and inventory at each quarter end of the year, divided by cost of goods sold for the year and then multiplied by 365, was 120 days, 119 days and 118 days, respectively.
- **Costs associated with closing underperforming stores.** We closed 319,188 and 216 underperforming stores during 2012, 2013 and 2014, respectively. The cost associated with closing underperforming stores were RMB8.9 million, RMB5.7 million and RMB5.8 million (US\$0.9 million) for 2012, 2013 and 2014, 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, increased from an average of 36 days in 2012, 45 days in 2013 to 46 in 2014. 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 of the Chinese New Year holidays, which results in our customers generally paying 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, the PRC income tax rate of 10%, or 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 had 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% were subject to tax rates of 22%, 24%, 25%, 25% and 25% in 2010, 2011, 2012, 2013 and 2014 onwards, respectively. Accordingly, our operating subsidiaries and retail store entities in Shenzhen and Zhuhai were subject to 25% income tax rates in 2012, 2013 and 2014 onwards, respectively. Our subsidiaries outside of Shenzhen and Zhuhai have been subject to the 25% statutory income tax rate since January 1, 2008.

In addition, in February 2014, our company was denied its Hong Kong tax residency that applied to the year ended December 31, 2013 by the Hong Kong Inland Revenue Department. Our company is therefore now subject to a standard withholding tax rate of 10%, rather than a reduced tax rate of 5% under the tax treaty previously applied by us, for dividends to be paid or appropriated from our PRC subsidiaries. We continue to actively monitor the level of withholding tax to which we may be subject and are continuing to evaluate appropriate organizational changes, if any, to achieve tax optimization.

Impact of Foreign Currency Fluctuation

See “Item 11. ITEM 11. Quantitative and Qualitative Disclosures about Market Risk – Foreign Exchange Risk.”

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. Together, these factors 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 consolidated statements of comprehensive 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 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 as well as tax planning strategies 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 RMB40.8 million (US\$6.6 million) was provided for as of December 31, 2014. 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.

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 2012, 2013 and 2014.

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 recognized impairment losses of RMB7.6 million, RMB7.0 million and RMB9.9 million (US\$1.6 million) in 2012, 2013 and 2014, respectively, with respect to leasehold improvements and store fixtures of certain underperforming 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 2012, 2013 or 2014.

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 2012, 2013 and 2014 were RMB9.1 million, RMB11.9 million and RMB2.8 million (US\$0.4 million), respectively.

Results of Operations

The following table sets forth a summary of our consolidated statements of comprehensive 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,					
	2012		2013		2014	
	RMB	% of Revenue	RMB	% of Revenue	RMB	US\$ % of Revenue
(In thousands, except percentage and per share data)						
Revenue	2,549,856	100.0	2,699,103	100.0	2,953,314	475,988 100.0
Cost of goods sold	(1,369,312)	(53.7)	(1,520,796)	(56.3)	(1,722,792)	(277,664) (58.3)
Gross profit	1,180,544	46.3	1,178,307	43.7	1,230,522	198,324 41.7
Operating expenses:						
Sales, marketing and other operating expenses	(1,011,695)	(39.7)	(1,026,798)	(38.0)	(1,098,000)	(176,965) (37.2)
General and administrative expenses	(115,734)	(4.5)	(121,542)	(4.5)	(125,577)	(20,239) (4.3)
Impairment losses of property and equipment	(7,649)	(0.3)	(6,984)	(0.3)	(9,877)	(1,592) (0.3)
Other income	1,480	0.1	—	—	—	— —
Income / (loss) from operations	46,946	1.8	22,983	0.9	(2,932)	(472) (0.1)
Net interest income ⁽¹⁾	16,435	0.6	15,713	0.6	7,234	1,166 0.2
Dividend income from cost method investments	4,528	0.2	5,232	0.2	5,852	943 0.2
Equity in income of an equity method investee	1,337	0.1	—	—	—	— —
Gain on disposal of an equity method investee ⁽²⁾	68,440	2.7	—	—	—	— —
Other income	—	—	—	—	3,082	497 0.1
Other loss	—	—	—	—	(535)	(86) (0.0)
Income tax expense	(47,594)	(1.9)	(32,100)	(1.2)	(26,472)	(4,267) (0.9)
Net income / (loss) attributable to China Nepstar Chain Drugstore Ltd.	90,092	3.5	11,828	0.4	(13,771)	(2,219) (0.5)
Earnings / (loss) per ordinary share						
Basic	0.45		0.06		(0.07)	(0.01)
Diluted	0.45		0.06		(0.07)	(0.01)

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

(2) Gain on disposal of an equity method investee in 2012 represents the gain from the disposal of our 40% equity interest in JZJ. On December 28, 2012 we completed the sales of its 40% equity interests in JZJ to Yunnan Jianzhijia Holding Co., Ltd. (“JZJ Holding”) for a total cash consideration of RMB81.5 million. A gain of RMB68.4 million was recognized in income upon completion of the sales.

Comparison of Years Ended December 31, 2013 and December 31, 2014

Revenue. Our revenue was RMB2,953.3 million (US\$476.0 million) in 2014 compared to RMB2,699.1 million in 2013. The same store sales (for 1,750 operating stores opened prior to December 31, 2012) increased by 9.0% from RMB3,541 in 2013 to RMB3,861 (US\$622.3 million) in 2014. The increase in revenue as well as same store sales was driven by continued optimization of our merchandise portfolio, the closure of underperforming stores and more intensive sales promotion initiatives. Sales of over-the-counter drugs accounted for 39.2% and 40.1% of our revenue in 2013 and 2014, respectively; sales of prescription drugs accounted for 22.3% and 22.3% of our revenue in 2013 and 2014, respectively; and sales of nutritional supplements accounted for 14.5% and 13.3% of our revenue in 2013 and 2014, respectively.

Gross Profit. Our gross profit was RMB1,230.5 million (US\$198.3 million) in 2014 compared to RMB1,178.3 million in 2013. Our gross margin was 41.7% in 2014 compared to 43.7% in 2013. This decrease in gross margin was primarily due to downward pressure on sales price as a result of sales promotion initiatives to increase our market share.

Operating Expenses. Our operating expenses were RMB1,233.5 million (US\$198.8 million) in 2014 compared to RMB1,155.3 million in 2013. Operating expenses as a percentage of our revenue was 41.8% in 2014 compared to 42.8% in 2013.

- **Sales, Marketing and Other Operating Expenses.** Our sales, marketing and other operating expenses increased by 6.9% from RMB1,026.8 million in 2013 to RMB1,098.0 million (US\$177.0 million) in 2014, primarily due to increases in labor costs and rental expenditures.
- **General and Administrative Expenses.** Our general and administrative expenses increased by 3.4% from RMB121.5 million in 2013 to RMB125.6 million (US\$20.2 million) in 2014.
- **Impairment Losses.** We recognized impairment losses of RMB7.0 million and RMB9.9 million (US\$1.6 million) in 2013 and 2014, respectively, representing the reduction of the carrying amount of the property and equipment of certain underperforming stores.

Income/Loss from Operations. As a result of the foregoing, we recorded loss from operations of RMB2.9 million (US\$0.5 million) in 2014 compared to income from operations RMB23.0 million we generated in 2013. Our operating margin was negative 0.1% in 2014 compared to 0.9% in 2013.

Net Interest Income. Our net interest income was RMB7.2 million (US\$1.2 million) in 2014 compared to RMB15.7 million in 2013.

Dividend Income from Cost Method Investments. Dividends received from our investments in companies accounted for under the cost method were RMB5.9 million (US\$0.9 million) in 2014 compared to RMB5.2 million in 2013.

Other Income. Other income increased from nil in 2013 to RMB3.1 million (US\$0.5 million) in 2014, due to the disposal gains from the sales of one PRC subsidiary that operates drugstores and another PRC subsidiary that operates regional distribution center.

Other Loss. Other loss increased from nil in 2013 to RMB0.5 million (US\$0.1 million) in 2014, due to the disposal loss arising from disposal of one underperforming PRC subsidiary.

Income Tax Expense. Our income tax expense decreased from RMB32.1 million in 2013 to RMB26.5 million (US\$4.3 million) in 2014. Our effective tax rate increased to 208.4% in 2014 from 73.1% in 2013. The difference in effective income tax rate was primarily attributable to high operating losses sustained by certain loss-making subsidiaries in 2014, for which full valuation allowances were made on their deferred tax assets, and the tax effect from the waiver of intra-group liabilities. Pursuant to the Chinese Taxation Law, loss from the waiver of liabilities with related parties could be deducted from taxable income only after obtaining the respective approval from the tax authority. In the PRC, losses in companies which are part of a group are not allowed to be off-set against profits of other companies in the same group.

Net Income/Loss. As a result of the foregoing, we recorded a net loss of RMB13.8 million (US\$2.2 million) in 2014 compared to net income of RMB11.8 million we generated in 2013.

Comparison of Years Ended December 31, 2012 and December 31, 2013

Revenue. Our revenue was RMB2,699.1 million in 2013 compared to RMB2,549.9 million in 2012. The same store sales (for 1,893 operating stores opened prior to December 31, 2011) increased by 10.3% from RMB3,167 in 2012 to RMB3,492 in 2013. The increase in revenue as well as same store sales was driven by continued optimization of our merchandise portfolio through diversification into non-pharmaceutical categories, the closure of underperforming stores and more intensive sales promotion initiatives. Sales of over-the-counter drugs accounted for 39.1% and 39.2% of our revenue in 2012 and 2013, respectively; sales of prescription drugs accounted for 20.4% and 22.3% of our revenue in 2012 and 2013, respectively; and sales of nutritional supplements accounted for 15.7% and 14.5% of our revenue in 2012 and 2013, respectively.

Gross Profit. Our gross profit was RMB1,178.3 million in 2013 compared to RMB1,180.5 million in 2012. Our gross margin was 43.7% in 2013 compared to 46.3% in 2012. This decrease in gross margin was primarily due to downward pressure on sales price as a result of the implementation of more sales promotion initiatives to increase our market share.

Operating Expenses. Our operating expenses were RMB1,155.3 million in 2013 compared to RMB1,135.1 million in 2012. Operating expenses as a percentage of our revenue was 42.8% in 2013, compared to 44.5% in 2012.

- **Sales, Marketing and Other Operating Expenses.** Our sales, marketing and other operating expenses increased by 1.5% from RMB1,011.7 million in 2012 to RMB1,026.8 million in 2013, primarily due to the implementation of more sales promotion initiatives.
- **General and Administrative Expenses.** Our general and administrative expenses increased by 5.0% from RMB115.7 million in 2012 to RMB121.5 million in 2013.
- **Impairment Losses.** We recognized impairment losses of RMB7.6 million and RMB7.0 million in 2012 and 2013, respectively, representing the reduction of the carrying amount of the property and equipment of certain underperforming stores.

Income from Operations. As a result of the foregoing, our income from operations was RMB23.0 million in 2013 compared to RMB46.9 million in 2012. Our operating margin was 0.9% in 2013 compared to 1.8% in 2012.

Net Interest Income. Our net interest income was RMB15.7 million in 2013, compared to RMB16.4 million in 2012.

Dividend Income from Cost Method Investments. Dividends received from our investments in companies accounted for under the cost method were RMB5.2 million in 2013 compared to RMB4.5 million in 2012.

Equity in income of an equity method investee. Equity in income of an equity method investee was nil in 2013, compared to that of RMB1.3 million in 2012. The decrease was due to the disposal of our 40% interest in JZJ in 2012.

Gain on Disposal of an Equity Method Investee. Gain on disposal of an equity method investee decreased from RMB68.4 million in 2012 to nil in 2013, due to the disposal of our 40% interest in JZJ in 2012.

Income Tax Expense. Our income tax expense decreased from RMB47.6 million in 2012 to RMB32.1 million in 2013. Our effective tax rate increased to 73.1% in 2013 as compared to 34.6% in 2012, primarily due to non-deductible expenses and the relatively high operating losses from loss-making subsidiaries, for which full valuation allowances were made on their deferred tax assets as compared to the overall results of our company. In the PRC, losses in companies which are part of a group are not allowed to be off-set against profits of other companies in the same group. In addition, in February 2014, our company was denied its Hong Kong tax residency that applied to the year ended December 31, 2013 by the Hong Kong Inland Revenue Department. We are therefore now subject to a standard withholding tax rate of 10%, rather than a reduced tax rate of 5% under the tax treaty previously applied by us, for dividends to be paid or appropriated from our PRC subsidiaries.

Net Income. As a result of the foregoing, our net income was RMB11.8 million in 2013 compared to RMB90.1 million in 2012.

B. Liquidity and Capital Resources

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,			
	2012	2013	2014	
	RMB	RMB	RMB	US\$
	(In thousands)			
Net cash provided by / (used in) operating activities	41,376	6,883	(58,672)	(9,456)
Net cash provided by/(used in) investing activities	(19,589)	(15,257)	140,600	22,660
Net cash used in financing activities	(417,688)	—	(191,246)	(30,823)
Net decrease in cash	(396,629)	(10,110)	(108,972)	(17,563)
Cash and cash equivalents at end of the year	371,256	361,146	252,174	40,643

As of December 31, 2014, we had RMB252,174 million (US\$40,643 million) in cash and cash equivalents. As of December 31, 2014, no held-to-maturity securities were on our balance sheet. As of December 31, 2014, our total cash, cash equivalents, bank deposits and restricted cash amounted to RMB316.9 million (US\$51.1 million). As of December 31, 2014, we had no short-term bank loan balances.

We expect to generate positive operating cash flow in 2015. 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 “Item 3. Key Information — D. 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 used in operating activities was RMB58.7 million (US\$9.5 million) in 2014 compared to net cash provided by operating activities of RMB6.9 million in 2013, primarily due to more prepayments made to suppliers.

Net cash provided by operating activities was RMB6.9 million in 2013 compared to RMB41.4 million in 2012, primarily due to our increased purchases of merchandise in line with the increase in our sales in 2013.

Investing Activities

Net cash provided by investing activities in 2014 was RMB140.6 million (US\$22.7 million) compared to net cash used in investing activities of RMB15.3 million in 2013, primarily as a result of our decreased investment in time deposits with original maturity over three months.

Net cash used in investing activities was RMB15.3 million in 2013 compared to net cash used in investing activities of RMB19.6 million in 2012, primarily due to the increase of our cash proceeds from withdrawal of time deposits with original maturity over three months in 2013.

Financing Activities

Net cash used in financing activities was RMB191.2 million (US\$30.8 million) in 2014, which primarily consisted of dividend payments. The dividend was declared on November 26, 2013 and paid to our shareholders in January 2014.

There were minimal financing activities in 2013, net cash provided by or used in financing activities was nil.

Net cash used in financing activities was RMB417.7 million in 2012, which primarily consisted of dividend payments in 2012 totaling RMB378.5 million.

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 “Item 3. Key Information — D. 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,” “Item 3. Key Information — D. 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 “Item 3. Key Information — D. 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 2012, 2013 and 2014, our capital expenditures totaled RMB35.0 million, RMB47.2 million and RMB60.0 million (US\$9.6 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 our capital expenditures in 2015 to range from approximately RMB60.0 million to RMB100.0 million, which we plan to use to open new stores, remodel existing stores and upgrade our integrated information management system.

Borrowings

As of December 31, 2014, we had no outstanding short-term borrowings.

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 2.6% in 2012, 2.6% in 2013 and 2.0% in 2014.

Recently Issued Accounting Pronouncements

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

C. Research and Development, Patents and Licenses, etc.

Research and Development

We have not made, and do not expect to make significant expenditures on research and development.

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 618 additional trademarks, including 101 trademarks that are registered under Nepstar Pharmaceutical, 251 registered trademarks that we have obtained exclusive rights to use, 248 registered trademarks that we have obtained non-exclusive rights to use and 18 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, 2014, we have developed 2,156 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 “Item 3. Key Information — D. 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.”

D. 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, 2014 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 cause the disclosed financial information to be not necessarily indicative of future operating results or financial conditions.

E. 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.

F. Tabular Disclosure of Contractual Obligations

The following table sets forth our contractual obligations as of December 31, 2014:

Contractual Obligations	Payment due by period				Total
	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years	
	(In thousands of RMB)				
Operating lease commitments	222,908	402,757	161,851	33,512	821,028
Total	222,908	402,757	161,851	33,512	821,028

G. 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 the sections entitled “Item 3. Key Information — D. Risk Factors,” “Item 4. Information on the Company” and “Item 5. 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.

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

A. 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	53	Chairman of the Board of Directors
Barry J. Buttifant	70	Independent Director ⁽¹⁾⁽²⁾⁽³⁾
Henry Lu	49	Director
Alistair Eric MacCallum Laband	63	Independent Director ⁽¹⁾⁽²⁾⁽³⁾
Alan Au	43	Independent Director ⁽¹⁾⁽²⁾
Fuxiang Zhang	43	Chief Executive Officer

Name	Age	Position/Title*
Zixin Shao	46	Chief Financial Officer
Yingnan (Rebecca) Zhang	47	Chief Operating 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. Mr. Zhang was also the president of Shenzhen General Chamber of Commerce from 2005 to 2014. 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, all of which are publicly listed companies in Hong Kong. Dr. Buttifant also serves as a non-executive director of Global-Tech Advanced Innovations Inc., a NASDAQ listed company.

Dr. Buttifant is currently an independent adviser to MCL Financial Group Ltd. From 2011 to 2014, he was an executive director of Hsin Chong Construction Group Ltd ("HCCG") and a non-executive director of Synergis Holdings Limited ("Synergis"), both of which are listed on the Stock Exchange of Hong Kong. Prior to that, he was group chief executive officer of IDT International Limited. In October 2009, Dr. Buttifant became a director for corporate finance of Mission Hills Group ("MHG"). Prior to this appointment, he was a consultant to the MHG since December 2008. Prior to joining MHG, he served as a principal to KLC Kennic Lui & Company ("KLC"), a professional accounting firm, and managing director of KLC Transactions Limited. Prior joining KLC, Dr. Buttifant was the executive director for finance, of MHG. In 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). Dr. Buttifant was also an alternate director to both HCCG and Synergis. Dr. Buttifant was an operating partner of Barings Private Equity Asia Limited. He was also the managing director of Wo Kee Hong (Holdings) Limited ("WKH") from 2001 to 2002 and was the advisor to the Board of Directors of WKH from 2002 to 2004. Prior to joining WKH, he was the managing director of IDT International Limited for over eight years, as well as working for Polly Peck Group and Sime Darby Hong Kong Limited for more than 11 years in the capacity of finance director and managing director. Dr. Buttifant is a fellow member of the Association of Chartered Certified Accountants (UK); the Hong Kong Institute of Certified Public Accountants; the Chartered Management Institute (UK); the Hong Kong Management Association and the Hong Kong Institute of Directors. He was awarded an honorary doctorate of Business Administration (honoris causa) by Edinburgh Napier University, United Kingdom in 2013.

Henry Lu has been a director of our company since June 2014. Mr. Lu has been Director of Capital Eagle Global Limited since May 2014 and Managing Director of China Merchants Capital since February 2014. Mr. Lu was Partner of SVC China from 2012 to 2014 and Chief Representative of William Blair & Company, L.L.C., Shanghai Representative Office from 2006 to 2011. Prior to that, Mr. Lu was with McKinsey & Company advising global and domestic companies on their growth and financial strategies. Mr. Lu received a PhD from Columbia University in 1997 and an MBA from University of Chicago Business School in 2000.

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. Since August 2013, Mr. Laband has been an Independent Non-Executive Director of The Tom Lee Music Company Ltd. 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.

Alan Au has been a director of our company since May 2013. He is a member of our audit committee and compensation committee. Mr. Au is currently an adviser to Sincere Pharmaceutical Group, a China-based pharmaceutical company that used to be listed on the New York Stock Exchange, and a venture partner of Ally Bridge Group, a biotech-focused investment fund headquartered in Hong Kong. He is also a member of the board, audit committee and compensation committee for Cellular Biomedicine Group (Nasdaq: CBMG), a biomedicine company engaged in the development of treatments for degenerative and cancerous diseases utilizing proprietary cell therapy technologies, and an assessment panel member of the Small Entrepreneur Research Assistance Program (SERAP) for the Innovation and Technology Commission of the Hong Kong SAR Government.

Mr. Au has over 15 years of experience across healthcare investment banking, private equity and venture capital investments in Asia with a focus on China. He was Head of Asia Healthcare Investment Banking of Deutsche Bank Group, advising healthcare initial public offerings and mergers and acquisitions ("M&A") in the region between 2011 and 2012. Prior to that, he was Executive Director at JAFCO Asia Investment Group, responsible for healthcare investments in China from 2008 to 2010, and Investment Director at Morningside Group, responsible for healthcare investments in Asia from 2000 to 2005. From 1995 to 1999, Mr. Au worked at KPMG and KPMG Corporate Finance Ltd., responsible for regional M&A transactions and financial advisory services.

Mr. Au is a Certified Public Accountant in the U.S. and holds the Chartered Financial Analyst (CFA) designation. He is an associate member of the Hong Kong Institute of Financial Analysts and member of the American Institute of Certified Public Accountants. Mr. Au received his Bachelor's degree in Psychology from the Chinese University of Hong Kong in 1995, and a Master's degree in Management from Columbia Business School in New York in 2007.

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.

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.

Yingnan (Rebecca) Zhang was appointed by our board of directors as our chief operation officer in November 2014. Ms. Zhang joined Nepstar in March 1999 and served as executive vice president in charge of procurement, merchandising, logistics and quality departments starting from April 2014. She was the Company's vice president of procurement and merchandising from January 2009 to April 2014. Prior to that Ms. Zhang served as head of procurement department. Ms. Zhang received a bachelor's degree in microbiological pharmaceutical in 1991 from Shenyang Pharmaceutical University.

The address of our directors and executive officers is 25F, Neptunus Yinhe Keji Building, No.1, Kejizhong 3rd Road, Nanshan District, Shenzhen, Guangdong Province 518057, People's Republic of China. No family relationship exists between any of our directors and executive officers.

B. Compensation of Directors and Executive Officers

Cash Compensation

In 2014, the aggregate cash compensation to our executive officers, including all the directors, was RMB4.6 million (US\$0.7 million). 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, to 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. The remaining options under the Pre-IPO Share Option Scheme expired on November 10, 2012.

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 options to purchase 200,000 shares 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 options to purchase 600,000 shares 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 options to purchase another 200,000 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 became 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 options to purchase an aggregate of 800,000 shares 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 fully vested options to purchase an aggregate of 150,000 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.

As of December 31, 2014, we did not have any share options outstanding that had not been exercised.

C. Board Practices

Committees of the Board of Directors

Audit Committee

Our audit committee consists of Alistair Eric MacCallum Laband, Barry J. Buttifant and Alan Au. 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 Alan Au. 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 and Alistair Eric MacCallum Laband. 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 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 14,500, 14,017 and 13,050 employees as of December 31, 2012, 2013 and 2014, 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, 2014:

	As of December 31, 2014	
	Number of Employees	Percentage of Total
Non-pharmacist store staff	7,825	60.0%
Pharmacists	3,607	27.6%
Management	1,017	7.8%
Logistics	601	4.6%
Total	13,050	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 contribution to pensions we incurred for these employee benefit plans in 2012, 2013 and 2014 was RMB37.8 million, RMB39.2 million and RMB40.6 million (US\$6.5 million), respectively.

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

E. Share Ownership

The following table sets forth information with respect to the beneficial ownership of our ordinary shares as of March 31, 2015 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	54.2
Barry J. Buttifant	—	—
Alistair Eric MacCallum Laband	*	*
Henry Lu ⁽³⁾	50,000,000	25.3
Alan Au	—	—
Fuxiang Zhang	*	*
Zixin Shao	—	—
Yingnan (Rebecca) Zhang	—	—
Principal Shareholders		
China Neptunus Drugstore Holding Ltd.	107,000,000	54.2
Capital Eagle Global ⁽³⁾	50,000,000	25.3

* 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 197,446,940 ordinary shares outstanding as of March 31, 2015.
- (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 Capital Eagle Global Limited. Mr. Henry Lu, a director of Capital Eagle Global Limited and managing director of China Merchants Capital, disclaims beneficial ownership of shares held by the Capital Eagle Global except to the extent of his pecuniary interest in these shares.

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 “—B. Compensation of Directors and Executive Officers—2007 Share Incentive Plan.”

None of our shareholders have 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, 2015, of the 197,446,940 issued and outstanding ordinary shares, 40,446,940 ordinary shares were registered in the name of a nominee of JPMorgan Chase Bank, N.A., the depository of our ADSs. Approximately 20.5% of our ordinary shares, representing our ordinary shares held by the depository, were held in the United States.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

A. Major Shareholders

Please refer to “Item 6. Directors, Senior Management and Employees — Share Ownership.”

B. 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 2012, 2013 and 2014, we purchased merchandise from the Neptunus Group and its affiliates totaling RMB92.9 million, RMB138.8 million and RMB57.4 million (US\$9.2 million), respectively, and sold merchandise to the Neptunus Group and its affiliates totaling RMB5.5 million, RMB2.5 million and RMB2.6 million (US\$0.4 million), respectively. The payment terms offered by the Neptunus Group for the purchase of merchandise ranged from 15 to 90 days. As of December 31, 2013 and 2014, the amounts due to the Neptunus Group and its affiliates in connection with our purchase of merchandise totaled RMB29.2 million and RMB25.6 million (US\$4.1 million), respectively.

As of December 31, 2013 and 2014, the amounts due from the Neptunus Group and its affiliates totaled RMB0.4 million and RMB3.4 million (US\$0.5 million), respectively, related to the sale of merchandise. As of December 31, 2013 and 2014, amounts related to value added tax for the foregoing sales of merchandise due from Neptunus Group and its affiliates were RMB44,000 and RMB387,000 (US\$62,400), respectively.

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 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, and Nepstar IT Service and Nepstar Management Consulting collectively own the remaining 51.0% equity interest in each of the regional Nepstar companies. In addition, each of Nepstar IT Service and Nepstar Management Consulting owns 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. See “Item 4. Information on the Company — C. Organizational Structure.”

The following is a summary of the material provisions of these arrangements. For more complete information, you should read these agreements in their entirety, which are filed with the SEC.

Loan Agreements

Under applicable PRC law, a company that is not a licensed financial institution is not permitted to extend loans directly to another company in China. As a result, a financial institution, such as a commercial bank, is typically involved in loan arrangements between companies that are not financial institutions by acting as an intermediary, whereby the financial institution receives the funds from the lending company and disburses the funds to the borrowing company. These types of loan arrangements are commonly referred to in China as “entrustment loans.” Through an intermediary bank, Nepstar Pharmaceutical provided interest-free entrustment loans to Nepstar IT Service and Nepstar Management Consulting in accordance with loan agreements dated June 13, 2007 in the aggregate principal amounts of RMB10.0 million and RMB26.0 million, respectively. In 2010, Nepstar Pharmaceutical renewed the interest-free entrustment loans to Nepstar IT Service and Nepstar Management Consulting in accordance with loan agreements dated June 25, 2010 in the aggregate principal amounts of RMB8.0 million and RMB22.8 million, respectively, and loan agreements dated December 1, 2010 in the aggregate principal amounts of RMB5.9 million and RMB6.3 million, respectively. In 2012, Nepstar Pharmaceutical renewed the interest-free entrustment loans to Nepstar IT Service and Nepstar Management Consulting in accordance with the loan agreements dated June 28, 2012 in the aggregate principal amounts of RMB14.1 million and RMB29.3 million, respectively, which were renewed again on August 28, 2013 and September 3, 2014, respectively. As consideration for the loans, Nepstar IT Service, Nepstar Management Consulting and their respective shareholders entered into a series of contractual arrangements that allow us to retain, through Nepstar Pharmaceutical, substantially all the economic risks and rewards of the regional Nepstar companies, as well as provide us with effective unilateral control over Nepstar IT Service, Nepstar Management Consulting, the regional Nepstar companies.

Logistics Service and Information Technology Support Agreements

Under the logistics service and information technology support agreements dated May 28, 2007 between Nepstar Pharmaceutical and each of the regional Nepstar companies and the logistics service and information technology support agreement dated August 18, 2009 between Nepstar Pharmaceutical and Fuzhou Nepstar, and the logistics service and information technology support agreement dated May 28, 2010 between Nepstar Pharmaceutical and Nepstar E-Commerce, Nepstar Pharmaceutical will provide logistics services, information technology support and consulting services in exchange for an annual service fee calculated based on the respective Nepstar company's gross profit for the corresponding year. The term of each logistics service and information technology support agreement is ten years from the effective date thereof, renewable by agreement between the parties. The logistics service and information technology support agreements will be automatically renewed for additional one-year terms on an annual basis unless Nepstar Pharmaceutical gives prior written notice regarding its decision not to renew the agreements.

Trade Name License Agreements

Under the trade name license agreements dated May 28, 2007 between Nepstar Pharmaceutical and each of the regional Nepstar companies and the trade name license agreement dated August 18, 2009 between Nepstar Pharmaceutical and Fuzhou Nepstar, and the trade name license agreement dated May 28, 2010 between Nepstar Pharmaceutical and Nepstar E-Commerce, Nepstar Pharmaceutical has granted a non-exclusive license to use its trade names and brand names in exchange for an annual license fee calculated based on the respective Nepstar company's gross profit for the corresponding year. The term of each trade name license agreement is ten years from the date thereof, renewable by agreement between the parties. The trade name license agreements will be automatically renewed for additional one-year terms on an annual basis unless Nepstar Pharmaceutical gives prior written notice regarding its decision not to renew the agreements.

Supply Agreements

Under the supply agreements dated May 28, 2007 between Nepstar Pharmaceutical and each of the regional Nepstar companies and the supply agreement dated August 18, 2009 between Nepstar Pharmaceutical and Fuzhou Nepstar, and the supply agreement dated May 28, 2010 between Nepstar Pharmaceutical and Nepstar E-Commerce, Nepstar Pharmaceutical is the exclusive supplier of all products sold by each of the respective Nepstar companies and the businesses they operate. The purchase price to be paid by the respective Nepstar company will be determined by Nepstar Pharmaceutical monthly based on the prevailing market conditions. In each month, Nepstar Pharmaceutical will notify the respective Nepstar company of the applicable purchase price for the following month. Nepstar Pharmaceutical also has the right to adjust the purchase price for any current month in its sole discretion. As a result, Nepstar Pharmaceutical has effective control over the price the respective Nepstar company pays for its merchandise. The term of each supply agreement is ten years from the effective date thereof, renewable by agreement between the parties. The supply agreements will be automatically renewed for additional one-year terms on an annual basis unless Nepstar Pharmaceutical gives prior written notice regarding its decision not to renew the agreements.

Shareholders Agreements

Under the shareholders agreements dated April 28, 2007 among Nepstar Pharmaceutical, Nepstar IT Service and Nepstar Management Consulting with respect to each of the regional Nepstar companies:

- Neither Nepstar IT Service nor Nepstar Management Consulting is allowed to transfer its equity interests in the regional Nepstar companies to a third party, nor is it allowed to pledge, dispose of or create any encumbrance on such equity interest, without the prior written consent of Nepstar Pharmaceutical;
- Each of Nepstar IT Service and Nepstar Management Consulting agrees to delegate all the rights to exercise their voting power as shareholders of the regional Nepstar companies to persons designated by Nepstar Pharmaceutical. In addition, each of Nepstar IT Service and Nepstar Management Consulting agrees to delegate the voting rights of the directors representing it on the board of directors of the regional Nepstar companies to the directors representing Nepstar Pharmaceutical, to the extent permitted by applicable PRC laws, rules and regulations. The same provision is also contained in the equity pledge agreements described below;
- Unanimous approval of the shareholders must be obtained before a regional Nepstar company may distribute dividends and with such approval, dividends may be distributed in accordance with the shareholders' respective equity interests or as otherwise agreed to by the shareholders;

- Nepstar Pharmaceutical, in its sole discretion, has an exclusive option to require each of Nepstar IT Service and Nepstar Management Consulting to sell to Nepstar Pharmaceutical or its designated persons all or part of their equity interests in the regional Nepstar companies, when and to the extent permitted by PRC law, at a price equal to the respective purchase price initially paid by Nepstar IT Service and Nepstar Management Consulting, subject to any requirements under applicable PRC laws, rules and regulations. The same provision is also contained in the equity pledge agreements described below; and
- Nepstar Pharmaceutical, in its sole discretion, has an exclusive option to require the respective shareholders of Nepstar IT Service and Nepstar Management Consulting to sell to Nepstar Pharmaceutical or its designated persons all or part of the equity interests in Nepstar IT Service and Nepstar Management Consulting owned by such shareholders, when and to the extent permitted by PRC law, at a price equal to the registered capital of Nepstar IT Service and Nepstar Management Consulting, respectively, as represented by the purchased equity interest, subject to any requirements under applicable PRC laws, rules and regulations. The same provision is also contained in the equity pledge agreements described below.

Equity Pledge Agreements

Under the equity pledge agreement dated June 22, 2007 among Nepstar Pharmaceutical, Liping Zhou and Feng Tu, each of Liping Zhou and Feng Tu has pledged his or her respective equity interest in Nepstar IT Service and Nepstar Management Consulting to Nepstar Pharmaceutical to secure: (i) the obligations of Nepstar IT Service and Nepstar Management Consulting under the loan agreements, and (ii) the obligations of each regional Nepstar company under the logistics service and information technology support agreements, the trade name license agreements and the supply agreements described above. In addition, neither Liping Zhou nor Feng Tu will transfer, sell, pledge, dispose of or create any encumbrance on their respective equity interest in Nepstar IT Service and Nepstar Management Consulting.

Under the equity pledge agreement dated June 22, 2007 among Nepstar Pharmaceutical, Nepstar IT Service and Nepstar Management Consulting, each of Nepstar IT Service and Nepstar Management Consulting has pledged its respective equity interest in each of the regional Nepstar companies to Nepstar Pharmaceutical to secure: (i) the obligations of Nepstar IT Service and Nepstar Management Consulting under the loan agreements; and (ii) the obligations of each regional Nepstar company under the logistics service and information technology support agreements, the trade name license agreements and the supply agreements described above. In addition, neither Nepstar IT Service nor Nepstar Management Consulting may transfer, sell, pledge, dispose of or create any encumbrance on their equity interests in the regional Nepstar companies, or engage in any business or operations other than holding equity interests in the regional Nepstar companies. All amounts received by Nepstar IT Service and Nepstar Management Consulting from the regional Nepstar companies, including dividends and other distributions on equity interests, shall be deemed as security for the loans and be deposited in a designated bank account, payable to Nepstar Pharmaceutical upon its request in respect of the outstanding loans. Without prior consent of Nepstar Pharmaceutical, these amounts may not be distributed.

Under the two supplemental agreements dated August 18, 2009 and May 28, 2010, respectively, we amended the equity pledge agreement dated June 22, 2007 among Nepstar Pharmaceutical, Liping Zhou and Feng Tu to include Fuzhou Nepstar and Nepstar E-Commerce, respectively, in the appendix of regional Nepstar companies, in order to secure in accordance with the terms of the equity pledge agreement dated June 22, 2007: (i) the obligations of Nepstar IT Service and Nepstar Management Consulting under the loan agreements; and (ii) the obligations of Fuzhou Nepstar and Nepstar E-Commerce, respectively, under the logistics service and information technology support agreements, the trade name license agreements and the supply agreements described above.

All the above equity pledge agreements have been registered with the relevant government authorities to render the security interests under such agreements effective. The equity pledge agreements will expire after the regional Nepstar companies, Nepstar IT Service, Nepstar Management Consulting and their respective shareholders, as the case may be, have fully performed their respective obligations under the logistics service and information technology support agreements, the trade name license agreements, the supply agreements and the loan agreements described above.

Equity Incentive Plan

See “Item 6. Directors, Senior Management and Employees — B. Compensation of Directors and Executive Officers — Pre-IPO Share Option Scheme” and “— 2007 Share Incentive Plan.”

C. Interests of Experts and Counsel

Not applicable.

ITEM 8. FINANCIAL INFORMATION

A. Consolidated Statements and Other Financial Information

See “Item 18. Financial Statements.”

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 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. On April 27, 2012, our Board of Directors declared a special cash dividend of US\$0.60 per ADS. The special dividend was paid on or around May 24, 2012 to shareholders of record as of the close of business on May 7, 2012. On November 26, 2013, our Board of Directors declared a cash dividend of US\$0.32 per ADS. The dividend was paid on or around January 24, 2014 to shareholders of record as of the close of business on December 20, 2013. We did not make any other dividend payment or declare cash dividend in 2014.

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, 2014, the accumulated balance of our statutory reserve funds totaled RMB98.9 million (US\$15.9 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.

B. Significant Changes

Except as disclosed elsewhere in this annual report, we have not experienced any significant changes since the date of our audited consolidated financial statements included elsewhere in this annual report.

ITEM 9. THE OFFER AND LISTING

A. Offer and Listing Details

Our ADSs, each representing two of our ordinary shares, have been listed on the New York Stock Exchange since November 9, 2007 under the symbol “NPD.” The table below shows, for the periods indicated, the high and low closing prices on the New York Stock Exchange for our ADSs. The closing price for our ADSs on the New York Stock Exchange on April 22, 2015 was US\$2.87per ADS.

	Market Price Per ADS	
	High	Low
	US\$	US\$
2010	7.49	2.55
2011	4.65	1.51
2012	3.21	1.52
2013	2.46	1.50
2014	3.28	1.33
Quarterly Highs and Lows		
First quarter 2013	1.98	1.55
Second quarter 2013	1.99	1.51
Third quarter 2013	1.65	1.50
Fourth quarter 2013	2.46	1.56
First quarter 2014	3.28	1.88
Second quarter 2014	2.66	2.23
Third quarter 2014	2.50	2.03
Fourth quarter 2014	2.09	1.33
Monthly Highs and Lows		
October 2014	2.09	1.74
November 2014	1.85	1.65
December 2014	1.68	1.33
January 2015	1.70	1.40
February 2015	1.65	1.42
March 2015	1.84	1.54
April 2015 (through April 22)	2.87	1.68

B. Plan of Distribution

Not applicable.

C. Markets

Our ADSs, each representing two of our ordinary shares, have been listed on the New York Stock Exchange since November 9, 2007 under the symbol “NPD.”

D. Selling Shareholders

Not applicable.

E. Dilution

Not applicable.

F. Expenses of the Issue

Not applicable.

ITEM 10. ADDITIONAL INFORMATION

A. Share Capital

Not applicable.

B. Memorandum and Articles of Association

We incorporate by reference into this annual report the description of our second amended and restated memorandum of association contained in our registration statement on Form F-1 (File No. 333-146767), as amended, initially filed with the SEC on October 17, 2007.

C. Material Contracts

We have not entered into any material contracts other than in the ordinary course of business and other than those described in “Item 4. Information on the Company” or elsewhere in this annual report.

D. 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.

In July 2014, SAFE promulgated SAFE Circular No. 37, which replaced SAFE Circular No. 75. SAFE Circular No. 37 requires PRC residents, including PRC institutions and individuals, to register with the local SAFE branch in connection with their direct establishment or indirect control of an offshore entity, referred to in SAFE Circular No. 37 as a “special purpose vehicle,” for the purpose of holding domestic or offshore assets or interests. PRC residents must also file amendments to their registrations in the event of any significant changes with respect to the special purpose vehicle, such as increase or decrease of capital contributed by PRC individuals, share transfer or exchange, merger, division or other material event. Under these regulations, PRC residents’ failure to comply with specified registration procedures may result in restrictions being imposed on the foreign exchange activities of the relevant PRC entity, including the payment of dividends and other distributions to its offshore parent, as well as restrictions on capital inflows from the offshore entity to the PRC entity, including restrictions on the ability to contribute additional capital to the PRC entity.

Our beneficial owners who are PRC citizens or residents have registered with the local branch of the SAFE as required under SAFE Circular No. 37.

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.

E. Taxation

Cayman Islands Taxation

The Cayman Islands currently levies 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 with respect to the issue or transfer of shares in our company or on an instrument of transfer in respect of our shares, or on any transaction document to which our company is a party unless such transaction document is executed in, brought to, or produced before a court of the Cayman Islands. The Cayman Islands is not a party to any double tax treaties which are applicable to any payments made by or to our company. 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 thereafter enacted in the Cayman Islands imposing any tax to be levied on profits, income, gains or appreciations shall apply to us or our operations; and
- no tax to be levied on profits, income, gains or appreciations or any tax in the nature of estate duty or inheritance tax shall be payable on our shares, debentures or other obligations, or by way of the withholding in whole or in part of any relevant payment as defined in Section 6(3) of the Tax Concessions Law (1999 revision).

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 continued to enjoy the lower rate and gradually transitioned 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 of PRC companies 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 withholding tax at a reduced 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 may be determined under an applicable income tax treaty between the PRC and the jurisdiction of which the holder of the relevant PRC subsidiary is tax resident. Although we are a Cayman Islands company, in 2009 we received from the relevant tax authorities in Hong Kong a certification of resident status and were considered as a Hong Kong tax resident and subject to Hong Kong Profits Tax on income arising in or derived from Hong Kong. In February 2014, the Company was denied its Hong Kong tax residency that applied to the year ended December 31, 2013 by the Hong Kong Inland Revenue Department. The Company is therefore now subject to a standard withholding tax rate of 10%, rather than a reduced tax rate of 5% under the tax treaty previously applied by the Company, for dividends to be paid or appropriated from the Company’s PRC subsidiaries.

Furthermore, we may be affected if any of our non-resident shareholders fails to comply with the relevant rules of SAT Circular 698 and be liable for taxes imposed by the PRC tax authorities. See “Item 3. Key Information — D. Risk Factors — Risks Related to Doing Business in China — We face uncertainties with respect to the application of the Circular on Strengthening the Administration of Enterprise Income Tax for Share Transfers by Non-PRC Resident Enterprises.”

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 U.S. 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” refers to any beneficial owner 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 depository, 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 with respect to dividends received from other U.S. corporations.

With respect to non-corporate U.S. Holders (including individuals), certain dividends received 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 considered readily tradable on an established securities market in the United States for this purpose. 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 these rules 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 if we are a PFIC in the taxable year in which such dividends are paid or in the preceding taxable year.

In the event that we are deemed to be a PRC “resident enterprise”, under PRC tax law you may be subject to PRC withholding taxes on dividends paid to you with respect to the ADSs or ordinary shares if the dividends paid by us are deemed to be derived from sources within the PRC. 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 recognized by a U.S. Holder that is eligible for the benefits of the treaty 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, 2014, we do not believe that we were a PFIC for our taxable year ended on December 31, 2014, 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 after the close of the taxable year. 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. 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 have treated 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 (including individuals) will not be eligible for reduced rates of taxation on any dividends received from us, 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) on an annual basis if you hold our ADSs or ordinary shares in any year in which we are classified as a PFIC, subject to certain exceptions based on the value of PFIC stock held.

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. federal income 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.

If you held our ADSs or ordinary shares in any taxable year in which we were a PFIC and did not make a timely mark-to-market election, you will generally continue to be treated as owning an interest in a PFIC even if we are no longer a PFIC in the current or a future taxable year unless you make a “deemed sale” election to recognize any gain in your ADSs or ordinary Shares as of the last day of the last taxable year in which we were a PFIC. You are urged to consult your tax advisor concerning the availability and advisability of making a deemed sale election in your particular circumstances.

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.

F. Dividends and Paying Agents

Not applicable.

G. Statement by Experts

Not applicable.

H. Documents on Display

We have filed this annual report on Form 20-F, including exhibits, with the SEC. As permitted by the SEC, in Item 19 of this annual report, we incorporate by reference certain information we have filed with the SEC. This means that we can disclose important information to you by referring you to another document filed separately with the SEC. The information incorporated by reference is considered to be part of this annual report.

You may read and copy this annual report, including the exhibits incorporated by reference in this annual report, at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549 and at the SEC's regional offices in New York, New York and Chicago, Illinois. You can also request copies of this annual report, including the exhibits incorporated by reference in this annual report, upon payment of a duplicating fee, by writing information on the operation of the SEC's Public Reference Room.

The SEC also maintains a website at www.sec.gov that contains reports, proxy statements and other information regarding registrants that file electronically with the SEC. Our annual report and some of the other information submitted by us to the SEC may be accessed through this web site.

As a foreign private issuer, we are exempt from the rules under the Exchange Act prescribing the furnishing and content of quarterly reports and proxy statements, and officers, directors and principal shareholders are exempt from the reporting and short-swing profit recovery provisions contained in Section 16 of the Exchange Act.

Our financial statements have been prepared in accordance with U.S. GAAP.

We will furnish our shareholders with annual reports, which will include a review of operations and annual audited consolidated financial statements prepared in conformity with U.S. GAAP.

I. Subsidiary Information

For a listing of our subsidiaries, see “Item 4. Information on the Company — C. Organizational Structure.”

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Exchange Risk

Substantially all of our revenues, costs and expenses are denominated in Renminbi. As a result, fluctuations in the value of the Renminbi may affect the price competitiveness of our products as compared to competing products from multinational pharmaceutical companies. Although the conversion of the Renminbi is highly regulated in China, the value of the Renminbi against the value of the U.S. dollar or any other currency nonetheless may fluctuate and be affected by, among other things, changes in China’s political and economic conditions. Under the currency policy in effect in China today, the Renminbi is permitted to fluctuate in value within a narrow band against a basket of certain foreign currencies. China is currently under significant international pressures to liberalize this government currency policy, and if such liberalization were to occur, the value of the Renminbi could appreciate or depreciate against the U.S. dollar.

We use the Renminbi as the reporting currency for our financial statements. Our company’s functional currency is the U.S. dollar and the functional currency of our subsidiaries is the Renminbi. All of our subsidiaries’ transactions in currencies other than the Renminbi during the year are recorded at the exchange rates prevailing on the relevant dates of such transactions. Monetary assets and liabilities of our subsidiaries existing at the balance sheet date denominated in currencies other than the Renminbi are re-measured at the exchange rates prevailing on such date. Exchange differences are recorded in our consolidated statements of comprehensive income. The values of our company’s assets and liabilities are translated into Renminbi using the exchange rate on the balance sheet date. Revenues and expenses of our company are translated at average rates prevailing during the year. Gains and losses resulting from translation of our financial statements from U.S. dollars into Renminbi are recorded in other comprehensive loss within equity. Fluctuations in exchange rates may also affect our consolidated financial statements and operations. For example, to the extent that we need to convert U.S. dollars into Renminbi for our operations, appreciation of Renminbi against the U.S. dollar would have an adverse effect on the amount of Renminbi that we receive from the conversion. Conversely, if we decide to convert Renminbi into U.S. dollars for the purpose of making payments for dividends on our ordinary shares or ADSs or for other business purposes, appreciation of the U.S. dollar against the Renminbi would have a negative effect on the U.S. dollar amounts available to us. As of December 31, 2014, we had U.S. dollar-denominated bank deposits of US\$2.5 million. If there was a further 1.0% appreciation of Renminbi against the U.S. dollar, our cash balance would have been decreased by RMB156,000 (US\$25,000), which would have resulted in an increase in the accumulated other comprehensive loss by such amount.

We do not believe that we currently have any significant direct foreign exchange risk and have not used any derivative financial instruments to hedge exposure in foreign exchange risk.

Interest Rate Risk

We have not been, nor do we anticipate being, exposed to material risks due to changes in interest rates. Our risk exposure to changes in interest rates relates primarily to the interest income generated by cash deposited in interest-bearing savings accounts. As of December 31, 2014, we had no interest-bearing bank loan balances. We have not used, and do not expect to use in the future, any derivative financial instruments to hedge any interest risk exposure.

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

A. Debt Securities

Not applicable.

B. Warrants and Rights

Not applicable.

C. Other Securities

Not applicable.

D. American Depositary Shares

As set forth in the Deposit Agreement dated November 17, 2007 among us, JPMorgan Chase Bank, N.A., as depositary, and the holders from time to time of the ADRs, the depositary collects its fees for issuance and cancellation of ADSs directly from investors depositing shares or surrendering ADSs for the purpose of withdrawal or from intermediaries acting for them. The depositary collects fees for making distributions to investors by deducting those fees from the amounts distributed or by selling a portion of distributable property to pay the fees. The depositary may collect its annual fee for depositary services by deduction from cash distributions, or by directly billing investors, or by charging the book-entry system accounts of participants acting for them. The depositary may generally refuse to provide fee-attracting services until its fees for those services are paid.

ADR holders will be charged a fee for each issuance of ADSs, including issuances resulting from distributions of shares, rights and other property, and for each surrender of ADSs in exchange for deposited securities. The fee in each case is US\$5.00 for each 100 ADSs (or any portion thereof) issued or surrendered.

The following additional charges shall be incurred by the ADR holders, by any party depositing or withdrawing shares or by any party surrendering ADSs or to whom ADSs are issued (including, without limitation, issuance pursuant to a share dividend or share split declared by us or an exchange of share regarding the ADSs or the deposited securities or a distribution of ADSs), whichever is applicable:

- a fee of US\$0.02 or less per ADS (or portion thereof) for any cash distribution made pursuant to the deposit agreement;
- a fee of US\$0.02 per ADS (or portion thereof) per calendar year for services performed by the depositary in administering our ADR program (which fee may be charged on a periodic basis during each calendar year (with the aggregate of such fees not to exceed the amount set forth above) and shall be assessed against holders of ADRs as of the record date or record dates set by the depositary during each calendar year and shall be payable in the manner described in the next succeeding provision); provided that the depositary may adjust this fee with our consent, such consent not to be unreasonably withheld;
- any other charge payable by any of the depositary, any of the depositary's agents, including, without limitation, the custodian, or the agents of the depositary's agents in connection with the servicing of our shares or other deposited securities (which charge shall be assessed against registered holders of our ADRs as of the record date or dates set by the depositary and shall be payable at the sole discretion of the depositary by billing such registered holders or by deducting such charge from one or more cash dividends or other cash distributions);
- a fee for the distribution of securities (or the sale of securities in connection with a distribution), such fee being in an amount equal to the fee for the execution and delivery of ADSs which would have been charged as a result of the deposit of such securities (treating all such securities as if they were shares) but which securities or the net cash proceeds from the sale thereof are instead distributed by the depositary to those holders entitled thereto;
- share transfer or other taxes and other governmental charges;
- cable, telex and facsimile transmission and delivery charges incurred;
- transfer or registration fees for the registration of transfer of deposited securities on any applicable register in connection with the deposit or withdrawal of deposited securities;
- expenses of the depositary in connection with the conversion of foreign currency into U.S. dollars; and

- such fees and expenses as are incurred by the depositary (including without limitation expenses incurred in connection with compliance with foreign exchange control regulations or any law or regulation relating to foreign investment) in delivery of deposited securities or otherwise in connection with the depositary's or its custodian's compliance with applicable laws, rules or regulations.

We will pay all other charges and expenses of the depositary and any agent of the depositary (except the custodian) pursuant to agreements from time to time between us and the depositary. The fees described above may be amended from time to time.

Our depositary has agreed to reimburse us for certain expenses we incur that are related to establishment and maintenance of the ADR program, including investor relations expenses and the New York Stock Exchange application and listing fees. There are limits on the amount of expenses for which the depositary will reimburse us, but the amount of reimbursement available to us is not related to the amounts of fees the depositary collects from investors. As set forth in the Deposit Agreement dated November 17, 2007 among us, JPMorgan Chase Bank, N.A., as depositary, and the holders from time to time of the ADRs, the depositary collects its fees for issuance and cancellation of ADSs directly from investors depositing shares or surrendering ADSs for the purpose of withdrawal or from intermediaries acting for them. The depositary collects fees for making distributions to investors by deducting those fees from the amounts distributed or by selling a portion of distributable property to pay the fees. The depositary may collect its annual fee for depositary services by deduction from cash distributions, or by directly billing investors, or by charging the book-entry system accounts of participants acting for them. The depositary may generally refuse to provide fee-attracting services until its fees for those services are paid. In 2014, we received the following reimbursement from the depositary:

Category of Reimbursement	Amount (in US\$)
Listing fees	29,394
Investor relations related expenses	75,757
Legal fees	82,111
Audit fees	103,231
Total	290,493

The depositary further agreed to waive other ADR program-related expenses amounting to US\$25,000 associated with the administration of the ADR program in 2014.

PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

None of these events occurred in 2012, 2013 or 2014.

ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

See "Item 10. Additional Information" for a description of the rights of holders of our ordinary shares, which remain unchanged.

We completed our initial public offering of 47,437,500 ordinary shares, in the form of ADSs, at US\$16.20 per ADS in November 2007, after our ordinary shares and American Depositary Receipts were registered under the Securities Act. The aggregate price of the offering amount registered and sold was US\$384.2 million, of which we received net proceeds of US\$357.3 million. The effective date of our registration statement on Form F-1 (File number: 333-146767) was November 8, 2007.

In 2012, we used approximately RMB419.4 million (US\$67.3 million) from the net proceeds received from our initial public offering for the repurchase of our ordinary shares and dividends payment. In 2013, we used approximately RMB191.2 million (US\$31.6 million) from the net proceeds received from our initial public offering for dividends payment. In 2014, we did not use any proceeds from our initial public offering to repurchase our ordinary shares or to pay dividends.

As of December 31, 2014, we had total cash, cash equivalents, bank deposits and restricted cash in the amount of RMB316.9 million (US\$51.1 million).

ITEM 15. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in reports filed by the Company under the Securities Exchange Act of 1934 (“the Exchange Act”), as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms and that such information is accumulated and communicated to our management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. Under the supervision and with the participation of our management, including our chief executive officer and our chief financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) and Rule 15d-15(e) promulgated under the Exchange Act. Based on that evaluation, our chief executive officer and chief financial officer have concluded that our disclosure controls and procedures were effective as of the end of the period covered by this annual report.

Management’s Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) under the Exchange Act, for our company. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements in accordance with U.S. GAAP and 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 a company’s assets, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of consolidated financial statements in accordance with generally accepted accounting principles, and that a company’s receipts and expenditures are being made only in accordance with authorizations of a company’s management and directors, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of a company’s assets that could have a material effect on the consolidated financial statements.

Due to its inherent limitations, a system of internal control over financial reporting can provide only reasonable assurance with respect to consolidated financial statement preparation and presentation and 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.

As required by Section 404 of the Sarbanes-Oxley Act of 2002 and related rules as promulgated by the SEC, management assessed the effectiveness of our internal control over financial reporting as of December 31, 2014 using criteria established in Internal Control-Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Based on this assessment, management concluded that our internal control over financial reporting was effective as of December 31, 2014 based on the criteria established in Internal Control-Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Attestation Report of Independent Registered Public Accounting Firm

The effectiveness of our internal control over financial reporting as of December 31, 2014 has been audited by KPMG, an independent registered public accounting firm, as stated in their report dated April 23, 2015 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, 2014, based on criteria established in *Internal Control – Integrated Framework (1992)* 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, 2014, based on criteria established in *Internal Control – Integrated Framework (1992)* 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, 2013 and 2014, and the related consolidated statements of comprehensive income, shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2014, and our report dated April 23, 2015 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG
Hong Kong, China
April 23, 2015

ITEM 16. 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, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our Board of Directors has determined that Alistair Eric MacCallum Laband qualifies as “audit committee financial expert” as defined in Item 16A of Form 20-F. Each of the members of the Audit Committee is an “independent director” within the meaning of NYSE Manual Section 303A(2) and meet the criteria for independent set forth in Section 10A(m)(3) of the Exchange Act.

ITEM 16B. CODE OF ETHICS

Our board of directors has adopted a code of ethics that applies to our directors, officers, employees and agents, including certain provisions that specifically apply to our chief executive officers, chief financial officer, chief operating officer, chief technology officer, vice presidents and any other persons who perform similar functions for us. We have filed our code of business conduct and ethics as an exhibit to our registration statement on Form F-1 (File No. 333-146767). We hereby undertake to provide to any person without charge, a copy of our code of business conduct and ethics within ten working days after we receive such person’s written request.

ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The following table sets forth the aggregate fees by categories specified below in connection with certain professional services rendered by KPMG, our independent registered public accounting firm, for the periods indicated. We did not pay any other fees to KPMG during the periods indicated below.

	For the Year Ended December 31,		
	2012	2013	2014
	(in millions of RMB)		
Audit Fees	5.9	5.7	5.6
Audit-related Fees	—	—	—
Tax Fees	—	—	—

The policy of our audit committee is to pre-approve all audit and non-audit services provided by our independent registered public accounting firm, including audit services, audit-related services, tax services and all other services as described above. During 2014, all services rendered by KPMG were approved by our audit committee.

ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES

Not applicable.

ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

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 December 31, 2012, we have purchased 8,215,142 of our ordinary shares in the form of ADSs for a total purchase price of approximately US\$9.6 million. We did not purchase any of our ordinary shares during 2013. 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. On December 30, 2014, our board of directors approved another share repurchase program, under which we were authorized to repurchase up to US\$5.0 million of our issued and outstanding ADSs from the open market from time to time over the next 12 months. As of the date of this annual report, we haven't made any purchases under the 2014 repurchase program. The following table sets forth certain information related to purchases made by us of our ADSs under our programs:

Period	Total number of ADSs purchased	Average price paid per ADS⁽¹⁾ US\$	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\$
August 2011	152,223	2.4661	152,223	19,624,603.97
September 2011	362,880	2.5467	515,103	18,700,453.39
October 2011	321,378	2.2640	836,481	17,972,868.04
November 2011	276,956	2.4016	1,113,437	17,307,741.26
December 2011	308,978	1.8822	1,422,415	16,726,170.70
January 2012	463,056	2.3800	1,885,471	15,624,103.17
February 2012	280,318	2.5169	2,165,789	14,918,564.68
March 2012	275,688	2.2905	2,441,477	14,287,103.62
April 2012	229,813	2.2870	2,671,290	13,761,528.31
May 2012	570,721	2.4751	3,242,011	12,348,925.62
June 2012	481,005	2.3299	3,732,016	11,228,251.00
July 2012	212,528	2.1845	3,935,544	10,763,985.96
August 2012	172,027	2.0441	4,107,571	10,412,346.07

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

ITEM 16F. CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT

None.

ITEM 16G. CORPORATE GOVERNANCE

We are a "foreign private issuer" (as such term is defined in Rule 3b-4 under the Exchange Act), and our ADSs, each representing two ordinary shares, are listed on the New York Stock Exchange, or NYSE. Under Section 303A of the NYSE Listed Company Manual, NYSE-listed companies that are foreign private issuers are permitted to follow home country practice in lieu of the corporate governance provisions specified by the NYSE with limited exceptions. The following summarizes some significant ways in which our corporate governance practices differ from those followed by domestic companies under the listing standards of the NYSE.

- The NYSE standards for domestic companies require that non-management directors meet at regularly scheduled executive sessions without management. We are not subject to this requirement under the Cayman Islands law and have decided to follow Cayman Islands practice on this matter.

- The NYSE standards for domestic companies require that the audit committee of the board of directors must have a minimum of three members. As a foreign private issuer, we are not required to comply with such requirement. As of the date of this annual report, our audit committee consists of three members, each of whom satisfies the “independence” requirements of Section 303A of the NYSE Listed Company Manual and Rule 10A-3 under the Exchange Act, and one such member qualifies as an “audit committee financial expert” under applicable SEC rules.

ITEM 16H. MINE SAFETY DISCLOSURE

Not applicable.

PART III

ITEM 17. FINANCIAL STATEMENTS

We have elected to provide financial statements pursuant to Item 18.

ITEM 18. FINANCIAL STATEMENTS

The following financial statements are filed as part of this annual report together with the report of the independent registered public accounting firm:

- Consolidated Balance Sheets as of December 31, 2013 and 2014
- Consolidated Statements of Comprehensive Income for the years ended December 31, 2012, 2013 and 2014
- Consolidated Statements of Shareholders’ Equity for the years ended December 31, 2012, 2013 and 2014
- Consolidated Statements of Cash Flows for the years ended December 31, 2012, 2013 and 2014
- Notes to the Consolidated Financial Statements

ITEM 19. EXHIBITS

Exhibit Number	Description of Document
1.1	Second Amended and Restated Memorandum and Articles of Association of China Nepstar Chain Drugstore Ltd. (incorporated by reference to Exhibit 3.2 from our F-1 registration statement (File No. 333-146767), as amended, initially filed with the Commission on October 17, 2007)
2.1	Specimen Certificate for Ordinary Shares of China Nepstar Chain Drugstore Ltd. (incorporated by reference to Exhibit 4.2 from our F-1 registration statement (File No. 333-146767), as amended, initially filed with the Commission on October 17, 2007)
2.2	Form of American Depositary Receipt of China Nepstar Chain Drugstore Ltd. (incorporated by reference to Exhibit 4.1 from our F-1 registration statement (File No. 333-146767), as amended, initially filed with the Commission on October 17, 2007)
2.3	Form of Deposit Agreement among China Nepstar Chain Drugstore Ltd., the depositary and Owners and Beneficial Owners of the American Depositary Receipts (incorporated by reference to Exhibit 4.3 from our F-1 registration statement (File No. 333-146767), as amended, initially filed with the Commission on October 17, 2007)
4.1	Form of Indemnification Agreement with the directors of China Nepstar Chain Drugstore Ltd. (incorporated by reference to Exhibit 10.1 from our F-1 registration statement (File No. 333-146767), as amended, initially filed with the Commission on October 17, 2007)
4.2.1	Form of Logistics Service and Information Technology Support Agreements dated as of May 28, 2007 between Shenzhen Nepstar Pharmaceutical Co., Ltd. and each of the regional Nepstar companies (Translation) (incorporated by reference to Exhibit 10.4 from our F-1 registration statement (File No. 333-146767), as amended, initially filed with the Commission on October 17, 2007)

Exhibit Number	Description of Document
4.2.2	Logistics Service and Information Technology Support Agreement dated as of August 18, 2009 between Shenzhen Nepstar Pharmaceutical Co., Ltd. and Fuzhou Nepstar Chain Co., Ltd. (Translation) (incorporated by reference to Exhibit 4.2.2 from our annual report on Form 20-F (File No. 001-33751) filed with the Commission on April 20, 2011)
4.2.3	Logistics Service and Information Technology Support Agreement dated as of May 28, 2010 between Shenzhen Nepstar Pharmaceutical Co., Ltd. and Shenzhen Nepstar E-Commerce Co., Ltd. (Translation) (incorporated by reference to Exhibit 4.2.3 from our annual report on Form 20-F (File No. 001-33751) filed with the Commission on April 20, 2011)
4.3.1	Form of Trade Name License Agreements dated as of May 28, 2007 between Shenzhen Nepstar Pharmaceutical Co., Ltd. and each of the regional Nepstar companies (Translation) (incorporated by reference to Exhibit 10.5 from our F-1 registration statement (File No. 333-146767), as amended, initially filed with the Commission on October 17, 2007)
4.3.2	Trade Name License Agreement dated as of August 18, 2009 between Shenzhen Nepstar Pharmaceutical Co., Ltd. and Fuzhou Nepstar Chain Co., Ltd. (Translation) (incorporated by reference to Exhibit 4.3.2 from our annual report on Form 20-F (File No. 001-33751) filed with the Commission on April 20, 2011)
4.3.3	Trade Name License Agreement dated as of May 28, 2010 between Shenzhen Nepstar Pharmaceutical Co., Ltd. and Shenzhen Nepstar E-Commerce Co., Ltd. (Translation) (incorporated by reference to Exhibit 4.3.3 from our annual report on Form 20-F (File No. 001-33751) filed with the Commission on April 20, 2011)
4.4.1	Form of Supply Agreements dated as of May 28, 2007 between Shenzhen Nepstar Pharmaceutical Co., Ltd. and each of the regional Nepstar companies (Translation) (incorporated by reference to Exhibit 10.6 from our F-1 registration statement (File No. 333-146767), as amended, initially filed with the Commission on October 17, 2007)
4.4.2	Supply Agreement dated as of August 18, 2009 between Shenzhen Nepstar Pharmaceutical Co., Ltd. and Fuzhou Nepstar Chain Co., Ltd. (Translation) (incorporated by reference to Exhibit 4.4.2 from our annual report on Form 20-F (File No. 001-33751) filed with the Commission on April 20, 2011)
4.4.3	Supply Agreement dated as of May 28, 2010 between Shenzhen Nepstar Pharmaceutical Co., Ltd. and Shenzhen Nepstar E-Commerce Co., Ltd. (Translation) (incorporated by reference to Exhibit 4.4.3 from our annual report on Form 20-F (File No. 001-33751) filed with the Commission on April 20, 2011)
4.5.1	Loan Agreement dated as of June 28, 2012 among Shenzhen Nepstar Pharmaceutical Co., Ltd., Industrial Bank Co., Ltd. and Shenzhen Nepstar Information and Technology Service Co., Ltd. (Translation) (incorporated by reference to Exhibit 4.5.9 from our annual report on Form 20-F (File No. 001-33751) filed with the Commission on April 26, 2013)
4.5.2	Loan Agreement dated as of June 28, 2012 among Shenzhen Nepstar Pharmaceutical Co., Ltd., Industrial Bank Co., Ltd. and Shenzhen Nepstar Management Consulting Co., Ltd. (Translation) (incorporated by reference to Exhibit 4.5.10 from our annual report on Form 20-F (File No. 001-33751) filed with the Commission on April 26, 2013)
4.5.3	Loan Agreement dated as of August 28, 2013 among Shenzhen Nepstar Pharmaceutical Co., Ltd., Industrial Bank Co., Ltd. and Shenzhen Nepstar Information and Technology Service Co., Ltd. (Translation) (incorporated by reference to Exhibit 4.5.1 from our annual report on Form 20-F (File No. 001-33751) filed with the Commission on April 22, 2014)
4.5.4	Loan Agreement dated as of August 28, 2013 among Shenzhen Nepstar Pharmaceutical Co., Ltd., Industrial Bank Co., Ltd. and Shenzhen Nepstar Management Consulting Co., Ltd. (Translation) (incorporated by reference to Exhibit 4.5.2 from our annual report on Form 20-F (File No. 001-33751) filed with the Commission on April 22, 2014)
4.5.5*	Loan Agreement dated as of September 3, 2014 among Shenzhen Nepstar Pharmaceutical Co., Ltd., Industrial Bank Co., Ltd. and Shenzhen Nepstar Information and Technology Service Co., Ltd. (Translation)
4.5.6*	Loan Agreement dated as of September 3, 2014 among Shenzhen Nepstar Pharmaceutical Co., Ltd., Industrial Bank Co., Ltd. and Shenzhen Nepstar Management Consulting Co., Ltd. (Translation)

Exhibit Number	Description of Document
4.6.1	Form of Shareholders Agreement dated as of April 28, 2007 among Shenzhen Nepstar Pharmaceutical Co., Ltd. and Nepstar Information and Technology Service Co., Ltd. and Shenzhen Nepstar Management Consulting Co., Ltd. with respect to each of the regional Nepstar companies (Translation) (incorporated by reference to Exhibit 10.8.1 from our F-1 registration statement (File No. 333-146767), as amended, initially filed with the Commission on October 17, 2007)
4.6.2	Commitment Letter dated as of August 21, 2007 from Feng Tu and Shenzhen Nepstar Management Consulting Co., Ltd. to Shenzhen Nepstar Pharmaceutical Co., Ltd. (incorporated by reference to Exhibit 10.8.2 from our F-1 registration statement (File No. 333-146767), as amended, initially filed with the Commission on October 17, 2007)
4.6.3	Commitment Letter dated as of August 21, 2007 from Liping Zhou and Shenzhen Nepstar Information and Technology Co., Ltd. to Shenzhen Nepstar Pharmaceutical Co., Ltd. (incorporated by reference to Exhibit 10.8.3 from our F-1 registration statement (File No. 333-146767), as amended, initially filed with the Commission on October 17, 2007)
4.7.1	Equity Pledge Agreement dated as of June 22, 2007 among Shenzhen Nepstar Pharmaceutical Co., Ltd., Nepstar Information and Technology Service Co., Ltd. and Shenzhen Nepstar Management Consulting Co., Ltd. (Translation) (incorporated by reference to Exhibit 10.9.1 from our F-1 registration statement (File No. 333-146767), as amended, initially filed with the Commission on October 17, 2007)
4.7.2	Equity Pledge Agreement dated as of June 22, 2007 among Shenzhen Nepstar Pharmaceutical Co., Ltd., Liping Zhou and Feng Tu (Translation) (incorporated by reference to Exhibit 10.9.2 from our F-1 registration statement (File No. 333-146767), as amended, initially filed with the Commission on October 17, 2007)
4.8	Trademark License Agreement dated as of April 20, 2000 between Shenzhen Neptunus Group Co., Ltd. and Shenzhen Nepstar Pharmaceutical Co., Ltd. regarding “Neptunus” (Translation) (incorporated by reference to Exhibit 10.13 from our F-1 registration statement (File No. 333-146767), as amended, initially filed with the Commission on October 17, 2007)
4.9	Trademark License Agreement dated as of July 7, 2000 between Shenzhen Neptunus Group Co., Ltd. and Shenzhen Nepstar Pharmaceutical Co., Ltd. regarding 499 trademarks (Translation) (incorporated by reference to Exhibit 10.14 from our F-1 registration statement (File No. 333-146767), as amended, initially filed with the Commission on October 17, 2007)
4.10	Trademark License Agreement dated as of July 7, 2006 between Shenzhen Neptunus Tong’ai Pharmaceutical Manufacturing Co., Ltd. and Shenzhen Nepstar Pharmaceutical Co., Ltd. regarding “Tong’ai” and “Jindian” (Translation) (incorporated by reference to Exhibit 10.15 from our F-1 registration statement (File No. 333-146767), as amended, initially filed with the Commission on October 17, 2007)
4.11	Trademark License Agreement dated as of July 7, 2006 between Shenzhen Neptunus Pharmaceutical Co., Ltd. and Shenzhen Nepstar Pharmaceutical Co., Ltd. regarding 42 trademarks (Translation) (incorporated by reference to Exhibit 10.16 from our F-1 registration statement (File No. 333-146767), as amended, initially filed with the Commission on October 17, 2007)
4.12	Trademark License Agreement dated as of June 28, 2007 between Shenzhen Neptunus Pharmaceutical Co., Ltd. and Shenzhen Nepstar Pharmaceutical Co., Ltd. regarding 14 trademarks (Translation) (incorporated by reference to Exhibit 10.17 from our F-1 registration statement (File No. 333-146767), as amended, initially filed with the Commission on October 17, 2007)
4.13	Trademark License Agreement dated as of June 28, 2007 between Shenzhen Neptunus Tong’ai Pharmaceutical Management Co., Ltd. and Shenzhen Nepstar Pharmaceutical Co., Ltd. regarding “Tong’ai” (Translation) (incorporated by reference to Exhibit 10.18 from our F-1 registration statement (File No. 333-146767), as amended, initially filed with the Commission on October 17, 2007)
4.14	Supplemental Agreement dated August 18, 2009 to the Equity Pledge Agreement dated as of June 22, 2007 among Shenzhen Nepstar Pharmaceutical Co., Ltd., Liping Zhou and Feng Tu (Translation) (incorporated by reference to Exhibit 4.17 from our annual report on Form 20-F (File No. 001-33751) filed with the Commission on April 30, 2010)
4.15	Supplemental Agreement dated May 28, 2010 to the Equity Pledge Agreement dated as of June 22, 2007 among Shenzhen Nepstar Pharmaceutical Co., Ltd., Liping Zhou and Feng Tu (Translation) (incorporated by reference to Exhibit 4.18 from our annual report on Form 20-F (File No. 001-33751) filed with the Commission on April 20, 2011)

Exhibit Number	Description of Document
8.1*	List of Subsidiaries
11.1	Code of Business Conduct and Ethics (incorporated by reference to Exhibit 99.1 from our F-1 registration statement (File No. 333-146767), as amended, initially filed with the Commission on October 17, 2007)
12.1*	Certification by the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
12.2*	Certification by the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
13.1*	Certification by the Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
13.2*	Certification by the Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
23.1*	Consent of Independent Registered Public Accounting Firm
23.2*	Consent of Beijing Kang Da Law Firm
101.INS*	XBRL Instance Document.
101.SCH*	XBRL Taxonomy Extension Schema Document.
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document.

* Filed with this annual report on Form 20-F

SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing its annual report on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

CHINA NEPSTAR CHAIN DRUGSTORE LTD.

By /s/ Fuxiang Zhang

Name: Fuxiang Zhang

Title: Chief Executive Officer

Date: April 23, 2015

CHINA NEPSTAR CHAIN DRUGSTORE LTD.
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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 its subsidiaries, as of December 31, 2013 and 2014, and the related consolidated statements of comprehensive income, shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2014. 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 its subsidiaries as of December 31, 2013 and 2014, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2014 in conformity with U.S. generally accepted accounting principles.

The accompanying consolidated financial statements as of and for the year ended December 31, 2014 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, 2014, based on criteria established in *Internal Control – Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated April 23, 2015 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG
Hong Kong, China
April 23, 2015

CHINA NEPSTAR CHAIN DRUGSTORE LTD. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2013 AND 2014
(Amounts in thousands, except per share data)

	Note	2013 RMB	2014 RMB	2014 USD (Note 2(c))
ASSETS				
Current assets:				
Cash and cash equivalents	3	361,146	252,174	40,643
Short-term bank time deposits	3	184,440	24,000	3,868
Long-term bank time deposits due within one year	3	-	3,256	525
Restricted cash	2(e)	37,000	37,423	6,031
Accounts receivable, net of allowance for doubtful accounts	4	131,984	136,568	22,011
Bills receivable		-	400	64
Amounts due from related parties	22	379	3,366	543
Prepaid expenses, deposits and other current assets	5	169,210	245,254	39,528
Inventories	6	551,783	546,312	88,050
Deferred tax assets	12	6,330	2,038	328
Total current assets		1,442,272	1,250,791	201,591
Property and equipment, net	7	123,183	137,750	22,201
Long-term bank time deposits	3	40,256	-	-
Rental deposits		41,946	42,257	6,811
Cost method investments		12,638	12,638	2,037
Intangible assets, net	8	2,509	2,509	404
Goodwill	8	51,819	51,819	8,352
Deferred tax assets	12	11,723	16,340	2,633
Accrued interest income		769	-	-
TOTAL ASSETS		1,727,115	1,514,104	244,029
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current liabilities:				
Accounts payable		403,558	409,428	65,988
Bills payable		4,334	-	-
Amounts due to related parties	22	29,247	25,636	4,132
Accrued expenses and other payables	13	123,065	122,236	19,700
Deferred income	14	22,477	25,715	4,145
Income tax payable		34,567	25,743	4,149
Dividend payable	17	191,246	-	-
Total current liabilities		808,494	608,758	98,114
Deferred income	14	17,391	15,677	2,527
Deferred tax liabilities	12	16,541	14,711	2,371
Other non-current liabilities	12	39,163	43,326	6,983
Total liabilities		881,589	682,472	109,995
Shareholders' equity:				
Share capital – ordinary shares USD 0.0001 par value:				
360,000,000 shares authorized; 197,446,940 shares issued and outstanding as of December 31, 2013 and 2014	15	158	158	25
Additional paid-in capital		640,341	640,341	103,204
Accumulated other comprehensive loss		(41,623)	(41,746)	(6,728)
Retained earnings	16	246,650	232,879	37,533
Total shareholders' equity		845,526	831,632	134,034
Commitments and contingencies	2(u)	-	-	-
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		1,727,115	1,514,104	244,029

See accompanying notes to consolidated financial statements.

CHINA NEPSTAR CHAIN DRUGSTORE LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(Amounts in thousands, except per share data)

	Note	2012 RMB	2013 RMB	2014 RMB	2014 USD (Note 2(c))
Revenue	18,22	2,549,856	2,699,103	2,953,314	475,988
Cost of goods sold		(1,369,312)	(1,520,796)	(1,722,792)	(277,664)
Gross profit		1,180,544	1,178,307	1,230,522	198,324
Sales, marketing and other operating expenses		(1,011,695)	(1,026,798)	(1,098,000)	(176,965)
General and administrative expenses		(115,734)	(121,542)	(125,577)	(20,239)
Impairment losses of property and equipment	7	(7,649)	(6,984)	(9,877)	(1,592)
Other income		1,480	-	-	-
Income / (loss) from operations		46,946	22,983	(2,932)	(472)
Interest income		16,435	15,713	7,234	1,166
Dividend income from cost method investments		4,528	5,232	5,852	943
Equity in income of an equity method investee	9	1,337	-	-	-
Gain on disposal of an equity method investee	9	68,440	-	-	-
Other income	10	-	-	3,082	497
Other loss	11	-	-	(535)	(86)
Income before income tax expense		137,686	43,928	12,701	2,048
Income tax expense	12	(47,594)	(32,100)	(26,472)	(4,267)
Net income / (loss) attributable to China Nepstar Chain Drugstore Ltd.		90,092	11,828	(13,771)	(2,219)
Earnings / (loss) per ordinary share:					
Basic	21	0.45	0.06	(0.07)	(0.01)
Diluted	21	0.45	0.06	(0.07)	(0.01)
Other comprehensive income, net of tax:					
Foreign currency translation adjustments		(555)	65	(123)	(20)
Comprehensive income / (loss) attributable to China Nepstar Chain Drugstore Ltd.		89,537	11,893	(13,894)	(2,239)

See accompanying notes to consolidated financial statements.

CHINA NEPSTAR CHAIN DRUGSTORE LTD AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(Amounts in thousands, except per share data)

	Ordinary shares		Treasury Stock at Cost	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Total Shareholders' Equity
	Number of Shares	Par Value Amount					
		RMB	RMB	RMB	RMB	RMB	RMB
Balance as of January 1, 2012	202,783,480	161	(1,736)	1,252,232	(41,133)	144,730	1,354,254
Net income	-	-	-	-	-	90,092	90,092
Other comprehensive loss	-	-	-	-	(555)	-	(555)
Repurchase of ordinary shares (Note 15)	-	-	(40,899)	-	-	-	(40,899)
Retirement of ordinary shares (Note 15)	(5,704,700)	(3)	42,635	(42,632)	-	-	-
Issuance of ordinary shares upon exercise of employee share options (Note 15)	368,160	-	-	1,683	-	-	1,683
Dividends (Note 17)	-	-	-	(378,472)	-	-	(378,472)
Balance as of December 31, 2012	<u>197,446,940</u>	<u>158</u>	<u>-</u>	<u>832,811</u>	<u>(41,688)</u>	<u>234,822</u>	<u>1,026,103</u>

See accompanying notes to consolidated financial statements.

CHINA NEPSTAR CHAIN DRUGSTORE LTD AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(Amounts in thousands, except per share data)

	Ordinary shares		Treasury Stock at Cost	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Total Shareholders' Equity
	Number of Shares	Par Value Amount					
		RMB	RMB	RMB	RMB	RMB	RMB
Balance as of January 1, 2013	197,446,940	158	-	832,811	(41,688)	234,822	1,026,103
Net income	-	-	-	-	-	11,828	11,828
Other comprehensive income	-	-	-	-	65	-	65
Dividends (Note 17)	-	-	-	(192,470)	-	-	(192,470)
Balance as of December 31, 2013	<u>197,446,940</u>	<u>158</u>	<u>-</u>	<u>640,341</u>	<u>(41,623)</u>	<u>246,650</u>	<u>845,526</u>

See accompanying notes to consolidated financial statements.

CHINA NEPSTAR CHAIN DRUGSTORE LTD AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(Amounts in thousands, except per share data)

	Ordinary shares				Accumulated			
	Number of	Par Value	Treasury	Additional	Other			Total
	Shares	Amount	Stock at Cost	Paid-in	Comprehensive	Retained Earnings	Shareholders' Equity	
		RMB	RMB	RMB	Loss	RMB	RMB	RMB
Balance as of January 1, 2014	197,446,940	158	-	640,341	(41,623)	246,650		845,526
Net loss	-	-	-	-	-	(13,771)		(13,771)
Other comprehensive loss	-	-	-	-	(123)	-		(123)
Balance as of December 31, 2014	197,446,940	158	-	640,341	(41,746)	232,879		831,632
Balance as of December 31, 2014 (USD)		25	-	103,204	(6,728)	37,533		134,034

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, 2012, 2013 AND 2014
(Amounts in thousands)

	Year ended December 31,			
	2012 RMB	2013 RMB	2014 RMB	2014 USD
Cash flows from operating activities:				
Net income / (loss)	90,092	11,828	(13,771)	(2,219)
Adjustments to reconcile net income / (loss) to net cash provided by operating activities:				
Depreciation and amortization	45,135	36,711	36,679	5,912
Allowance for doubtful accounts	2,276	140	365	59
(Gain) / loss on disposal of property and equipment	(268)	1,028	2,393	386
Loss on disposal of intangible asset	-	359	-	-
Gain on disposal of an equity method investee	(68,440)	-	-	-
Equity in income of an equity method investee	(1,337)	-	-	-
Dividend income from an equity method investee	13,825	-	-	-
Gain on disposal of subsidiaries	-	-	(3,082)	(497)
Loss on disposal of a subsidiary	-	-	535	86
Deferred income tax benefit	(2,022)	(4,251)	(2,298)	(370)
Inventory write-downs	9,072	11,926	2,756	444
Impairment losses of property and equipment	7,649	6,984	9,877	1,592
Changes in operating assets and liabilities:				
Accounts receivable	(13,940)	(17,523)	(4,949)	(798)
Bills receivable	-	-	(400)	(64)
Amounts due from related parties	(3,605)	7,875	(2,987)	(481)
Prepaid expenses, deposits and other current assets	(20,551)	(25,930)	(75,586)	(12,182)
Inventories	(50,497)	(85,226)	2,715	438
Deferred income	2,841	7,176	1,524	246
Accounts payable	3,709	47,463	5,870	946
Bills payable	20,534	(16,200)	(4,334)	(699)
Amounts due to related parties	212	10,866	(3,611)	(582)
Accrued expenses and other payables	(11,018)	17,131	(5,833)	(942)
Income tax payable and other non-current liabilities	17,709	(3,474)	(4,535)	(731)
Net cash provided by / (used in) operating activities	41,376	6,883	(58,672)	(9,456)
Cash flows from investing activities:				
Placement of restricted cash	(36,000)	(1,000)	(423)	(68)
Purchase of property and equipment	(35,014)	(47,197)	(59,558)	(9,599)
Proceeds from disposal of property and equipment	2,870	536	667	108
Proceeds from disposal of an equity method investee	81,480	-	-	-
Dividend income from an equity method investee	11,175	-	-	-
Investment in time deposits with original maturity over three months	(88,100)	(325,696)	(83,000)	(13,377)
Proceeds from maturity of time deposits with original maturity over three months	43,000	358,100	280,440	45,197
Proceeds from disposal of subsidiaries*	-	-	2,474	399
Refund of acquisition deposit	1,000	-	-	-
Net cash (used in) / provided by investing activities	(19,589)	(15,257)	140,600	22,660
Cash flows from financing activities:				
Proceeds from issuance of ordinary shares upon exercise of employee share options	1,683	-	-	-
Payment for repurchase of ordinary shares	(40,899)	-	-	-
Dividends paid	(378,472)	-	(191,246)	(30,823)
Net cash used in financing activities	(417,688)	-	(191,246)	(30,823)

* Proceeds from disposal of subsidiaries in 2014 represented the cash considerations of RMB13,901 received less cash balance transferred to the acquirers amounting to RMB11,427.

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, 2012, 2013 AND 2014
(Amounts in thousands)

	Year ended December 31,			
	2012	2013	2014	2014
	RMB	RMB	RMB	USD
Effect of foreign currency exchange rates on cash	(728)	(1,736)	346	56
Net decrease in cash	(396,629)	(10,110)	(108,972)	(17,563)
Cash and cash equivalents at beginning of the year	767,885	371,256	361,146	58,206
Cash and cash equivalents at end of the year	371,256	361,146	252,174	40,643
Supplemental disclosure of cash flow information:				
Income taxes paid	(36,144)	(44,725)	(25,900)	(4,174)
Accounts payable for purchase of property and equipment	3,664	4,593	6,696	1,079

See accompanying notes to consolidated financial statements.

CHINA NEPSTAR CHAIN DRUGSTORE LTD. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(Amounts in thousands, except per share data)

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, 2014, the Company, through its subsidiaries, was the owner and operator of 1,980 retail drugstores in 74 cities in Guangdong, Jiangsu, Zhejiang, Liaoning, Shandong, Hunan, Fujian, Sichuan, Hubei, Anhui and Jilin 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 which principally affected 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,		
		2012	2013	2014
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 (Note 1(a)(i))	100%	100%	-
Shenzhen Nepstar Group Siping Northeast Co., Ltd. (“Siping Nepstar”)	Procurement of merchandise for the Group	-	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%

1 PRINCIPAL ACTIVITIES, ORGANIZATION AND BASIS OF PRESENTATION - CONTINUED

(a) Principal activities - continued

Name of subsidiary/investee	Principal activities	Percentage of controlling interest as of December 31,		
		2012	2013	2014
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%
Fuzhou Nepstar Chain Co., Ltd. ("Fuzhou Nepstar")	Operation of retail drugstores	100%	100%	100%
Hubei Nepstar Pharmaceutical Co., Ltd. ("Hubei Nepstar")	Operation of retail drugstores	100%	100%	100%
Beijing Nepstar Chain Co., Ltd. ("Beijing Nepstar")	Operation of retail drugstores (Note 1(a)(i))	100%	100%	-
Beijing Hongda Nepstar Chain Co., Ltd. ("Beijing Hongda")	Operation of retail drugstores	100%	100%	100%
Beijing Shuangjing Nepstar Co., Ltd. ("Beijing Shuangjing")	Operation of retail drugstores	100%	100%	100%
Beijing Tongda Nepstar Chain Co., Ltd. ("Beijing Tongda")	Operation of retail drugstores	100%	100%	100%
Beijing Xingda Nepstar Chain Co., Ltd. ("Beijing Xingda")	Operation of retail drugstores	100%	100%	100%
Beijing Guang QuMen Nepstar Chain Co., Ltd. ("Beijing Guang QuMen")	Operation of retail drugstores	100%	100%	100%
Beijing Hua Shi Nepstar Chain Co., Ltd. ("Beijing Hua Shi")	Operation of retail drugstores	100%	100%	100%
Beijing Ti Yu Guan Lu Nepstar Chain Co., Ltd. ("Beijing Ti Yu Guan Lu")	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%

CHINA NEPSTAR CHAIN DRUGSTORE LTD. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2012, 2013 AND 2014
(Amounts in thousands, except per share data)

1 PRINCIPAL ACTIVITIES, ORGANIZATION AND BASIS OF PRESENTATION - CONTINUED

(a) Principal activities - continued

Name of subsidiary/investee	Principal activities	Percentage of controlling interest as of December 31,		
		2012	2013	2014
Zaozhuang Nepstar Chain Co., Ltd. ("Zaozhuang Nepstar")	Operation of retail drugstores (Note 1(a)(i))	100%	100%	-
Wenzhou Nepstar Chain Co., Ltd. ("Wenzhou Nepstar")	Operation of retail drugstores (Note 1(a)(i))	100%	-	-
Hunan Nepstar Health Chain Co., Ltd. ("Hunan Nepstar")	Operation of retail drugstores	100%	100%	100%
Wuhan Nepstar Drugstore Co., Ltd. ("Wuhan Nepstar")	Operation of retail drugstores	100%	100%	100%
Wuhan Nepstar Chain Co., Ltd. ("Wuhan Chain")	Operation of retail drugstores	-	-	100%

Note (i)

On December 20, 2013, Wenzhou Nepstar was dissolved.

Beijing Nepstar was 100% owned by Shenzhen Nepstar. In June 2014, the Group completed the sales of its 100% equity ownership in Beijing Nepstar to Mr. Zhao Shi, an individual and a third party to the Group. In accordance with the agreement entered into by Shenzhen Nepstar and Zhao Shi in connection with the transaction, Shenzhen Nepstar transferred its 100% equity interest in Beijing Nepstar to Zhaoshi for a cash consideration of RMB100. As of December 31, 2014, Beijing Nepstar was no longer a subsidiary of the Group. See Note 10.

Weifang Nepstar was 100% owned by Nepstar Pharmaceutical. In September 2014, the Group completed the sales of its 100% equity ownership in Weifang Nepstar to Yantai Rongchang Pharmacy Co., Ltd. ("Rongchang"), a third party to the Group. In accordance with the agreement entered into by Nepstar Pharmaceutical and Rongchang in connection with the transaction, Nepstar Pharmaceutical transferred its 100% equity interests in Weifang Nepstar to Rongchang for a cash consideration of RMB13,801. As of December 31, 2014, Weifang Nepstar was no longer a subsidiary of the Group. See Note 10.

Zaozhuang Nepstar was 100% owned by Shenzhen Nepstar. In December 2014, the Group completed the sales of its 100% equity ownership in Zaozhuang Nepstar to Shenzhen Maidexin Medical Investment Co., Ltd. ("MDX Investment"), a third party to the Group. In accordance with the agreements entered into by the Shenzhen Nepstar and MDX Investment in connection with the transaction, Shenzhen Nepstar transferred its 100% equity interests in Zaozhuang Nepstar to MDX Investment for a cash consideration of RMB one yuan. As of December 31, 2014, Zaozhuang Nepstar was no longer a subsidiary of the Group. See Note 11.

1 PRINCIPAL ACTIVITIES, ORGANIZATION AND BASIS OF PRESENTATION - CONTINUED

(b) Significant concentrations and risks

As of December 31, 2013 and 2014, the Group held US dollar denominated bank deposits of USD9,745 and USD2,536 (equivalent to RMB58,996 and RMB15,733) respectively, which were placed with financial institutions in the Hong Kong Special Administrative Region ("HK SAR") of the PRC. Apart from the bank deposits in HK SAR, all of the Group's bank deposits were placed 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 Nepstar Pharmaceutical. 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. ("Nepstar 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:

1 PRINCIPAL ACTIVITIES, ORGANIZATION AND BASIS OF PRESENTATION - CONTINUED

(c) Organization - continued

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.

1 PRINCIPAL ACTIVITIES, ORGANIZATION AND BASIS OF PRESENTATION - CONTINUED

(c) *Organization - continued*

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 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 subsidiary 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 dates.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

(c) Foreign currency transactions and translation - continued

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 income / (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, 2014 RMB amounts included in the accompanying consolidated financial statements have been translated into US dollars at the rate of US\$1.00=RMB 6.2046, being the noon buying rate for US dollars in effect on December 31, 2014 for cable transfers in RMB per US 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 US dollars at that rate or at any other rate on December 31, 2014 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 RMB37,000 (USD5,963) as of December 31, 2014 represented short-term pledged bank deposits placed with a bank, which were designated as security for bank acceptance bills granted by the financial institution, and will be released upon termination of the agreement with the financial institution. The remaining restricted cash of RMB423 (USD68) represented the government grant deposited at the designated bank account. The usage of the amount in this designated bank account requires the respective governmental bureaus' approval.

(f) 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 governmental 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.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

(g) *Inventories*

Inventories are stated at the lower of cost or market. Cost is determined using the weighted average cost method for all inventories. 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, 2012, 2013 and 2014 were RMB9,072, RMB11,926, and RMB2,756 respectively, and are included in cost of goods sold.

(h) *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, other than leasehold improvements, are as follows:

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 operating rights acquired in business combinations. 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-lived 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 RMB7,649, RMB6,984 and RMB9,877 was recognized for the years ended December 31, 2012, 2013 and 2014 respectively (see Note 7).

Goodwill is reviewed for impairment at least annually. In September 2011, the FASB issued ASU 2011-08, Testing Goodwill for Impairment, which provides an entity the option to perform a qualitative assessment to determine whether it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount prior to performing the two-step goodwill impairment test. If this is the case, the two-step goodwill impairment test is required. If it is more-likely-than-not that the fair value of a reporting unit is greater than its carrying amount, the two-step goodwill impairment test is not required. The Company adopted ASC 2011-08 from 2012 and did not elect to use the qualitative assessment option.

If the two-step goodwill impairment test is required, first, the fair value of the reporting unit is compared with its carrying amount (including goodwill). If the fair value of the reporting unit is less than its carrying amount, 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

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

(h) *Long-lived assets – continued*

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 amount, step two does not need to be performed.

The Group performs annual impairment review of goodwill at December 31, and when a triggering event occurs between annual impairment tests. No impairment of goodwill was recognized for the years ended December 31, 2012, 2013 and 2014.

(i) *Cost and equity method investments*

Investments in the stock of an investee where the fair value of the equity security is not readily determinable and 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 comprehensive 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.

Sales of investment in an investee is accounted for as gains or losses equal to the difference at the time of sale between selling price and carrying amount of the investment sold.

(j) *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.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

(k) 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 comprehensive income.

(l) 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 fair value of the free products to be redeemed by customers and the fair value of the cash coupon are both recorded as deferred income and recognized as revenue upon redemption or usage. For all the years presented, the total amount of the free products and cash coupons recognized in the consolidated statements of comprehensive income was immaterial.

(m) Advertising and promotion costs

Advertising and promotion costs are expensed as incurred. Advertising and promotion costs amounted to RMB14,504, RMB14,142 and RMB10,932 for the years ended December 31, 2012, 2013 and 2014, respectively and are included in sales, marketing and other operating expenses in the consolidated statements of comprehensive income.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

(n) Store opening costs

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

(o) 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, 2012, 2013 and 2014, the Company recognized vendor allowances of RMB87,338 , RMB104,714 and RMB100,772 in cost of goods sold, and RMB13,131, RMB16,759 and RMB18,171 as a reduction of advertising and promotion costs, respectively.

(p) 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 RMB37,757, RMB39,172 and RMB40,181 and distribution costs amounted to RMB11,208, RMB11,042 and RMB12,001 for the years ended December 31, 2012, 2013 and 2014, respectively.

(q) 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.

(r) Retirement and other postretirement benefits

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

(s) 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.

(t) 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.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

(u) 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.

(v) 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.

(w) 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:

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

(w) Fair value measurements - continued

- 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 liabilities that are measured at fair value on a recurring or nonrecurring basis as of December 31, 2013 and 2014.

The following table presents fair value measurements of assets that are measured at fair value on a nonrecurring basis at December 31, 2014:

Description	Year ended December 31, 2014	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total losses
	RMB	RMB	RMB	RMB	RMB
Property and equipment	137,750	-	137,750	-	(9,877)

(x) Recently issued accounting standards

In April 2014, the FASB issued ASU No. 2014-08, *Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*. ASU 2014-08 change the requirements for reporting discontinued operations. This ASU limits discontinued operations reporting to disposals of components of an entity that represent strategic shifts that have a major effect on an entity's operations and financial results. As a result, the Company expects to report fewer discontinued operations under the new standard than would otherwise be reported under previous requirements. The new standard is effective for any disposals of components of the Company in annual reporting periods beginning after December 15, 2014. Early adoption is permitted. The Company will implement the provisions of ASU 2014-08 as of January 1, 2015. The Company expects that the adoption of ASU 2014-08 will not have a material impact on its consolidated financial statements.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

(x) *Recently issued accounting standards - continued*

The FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers*, in May 2014. ASU 2014-09 requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. An entity should also disclose sufficient quantitative and qualitative information to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The new standard is effective for annual reporting periods beginning after December 15, 2016. Early application is not permitted. The Company will implement the provisions of ASU 2014-09 as of January 1, 2017. The Company has not yet determined the impact of the new standard on its current policies for revenue recognition.

In June 2014, the FASB issued ASU No. 2014-12, *Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period*. ASU 2014-12 provides explicit guidance on how to account for those share-based payments awards that require a specific performance target to be achieved in order for employees to become eligible to vest in the awards. The new standard is effective for annual reporting periods beginning after December 15, 2015. Earlier adoption is permitted. The new standard is to be applied prospectively but retrospective application is permitted. The Company will implement the provisions of ASU 2014-12 as of January 1, 2016. The Company expects that the adoption of ASU 2014-12 will not have a material impact on its consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*. In connection with preparing financial statements for each annual and interim reporting period, an entity's management should evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued when applicable). The new standard is effective for reporting periods beginning after December 15, 2016. Earlier application is permitted. The Company will implement the provisions of ASU 2014-15 as of January 1, 2017. The Company expects that the adoption of ASU 2014-15 will not have a material impact on its consolidated financial statements.

3 CASH, CASH EQUIVALENTS AND BANK DEPOSITS

As of December 31, 2013 and 2014, the amount of cash and cash equivalents and bank deposits by original maturity was as follows:

	December 31,	
	2013	2014
	RMB	RMB
Cash and cash equivalents	361,146	252,174
Short-term time deposits with maturity over three months but within one year	184,440	24,000
Long-term time deposits due within one year	-	3,256
Long-term time deposits with maturity between one and two years	40,256	-

As of December 31, 2013 and 2014, cash and cash equivalents include US Dollar denominated bank deposits of USD9,745 and USD2,536 (equivalent to RMB58,996 and RMB15,733), respectively.

As of December 31, 2014, the interest rate of time deposits range from 2.82% to 4.40% per annum with a weighted average original maturity of 11.2 months. The Group places its cash in financial institutions with sound credit rating.

4 ACCOUNTS RECEIVABLE, NET OF ALLOWANCE FOR DOUBTFUL ACCOUNTS

Accounts receivable consist of the following:

	December 31,	
	2013	2014
	RMB	RMB
Accounts receivable due from:		
Banks	1,182	2,052
Social security bureau	112,884	115,247
Non-retail customers	18,105	19,543
	132,171	136,842
Less: allowance for doubtful accounts	(187)	(274)
Accounts receivable, net	131,984	136,568

The following table presents the movement of allowance for doubtful accounts for the years ended December 31, 2012, 2013 and 2014.

	December 31,		
	2012	2013	2014
	RMB	RMB	RMB
Balance at the beginning of the year	-	647	187
Provision for the year	2,276	140	365
Write-off of accounts receivable	(1,629)	(600)	(278)
Balance at the end of the year	647	187	274

5 PREPAID EXPENSES, DEPOSITS AND OTHER CURRENT ASSETS

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

	December 31,	
	2013	2014
	RMB	RMB
Prepaid rental	101,337	107,382
Rental deposits	244	1,681
Prepayments for purchases of merchandise	25,359	98,501
Advances to employees	3,077	3,395
Deferred tax charge on unrealized profits on inter-company sales	16,337	8,805
Store consumables and supplies	12,235	11,684
Accrued interest income	4,445	2,921
Dividend receivable from cost method investee	-	4,262
Other prepaid expenses and deposits	6,176	6,623
	<u>169,210</u>	<u>245,254</u>

6 INVENTORIES

Inventories consist of the following:

	December 31,	
	2013	2014
	RMB	RMB
Merchandise in stores	408,216	369,756
Merchandise in warehouses	143,567	176,556
	<u>551,783</u>	<u>546,312</u>

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7 PROPERTY AND EQUIPMENT, NET

Property and equipment consist of the following:

	December 31,	
	2013	2014
	RMB	RMB
Buildings	18,087	18,087
Leasehold improvements	184,419	187,317
Store fixture and equipment	146,106	157,446
Software	36,714	37,445
Motor vehicles	14,572	15,169
	399,898	415,464
Less: Accumulated depreciation and amortization	(276,715)	(277,714)
	<u>123,183</u>	<u>137,750</u>

Total depreciation and amortization expense of property and equipment for the years ended December 31, 2012, 2013 and 2014 was RMB44,916, RMB36,711 and RMB36,679, respectively, of which RMB34,526, RMB27,063 and RMB27,731 was recorded in sales, marketing and other operating expenses and RMB10,390, RMB9,648 and RMB8,948 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 RMB7,649 ,RMB6,984 and RMB9,877 for the years ended December 31, 2012, 2013 and 2014 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 be generated from the use and eventual disposal of these assets.

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8 GOODWILL AND OTHER INTANGIBLE ASSETS

(a) Intangible assets, net

	December 31,	
	2013	2014
	RMB	RMB
Unamortized intangible assets		
Operating rights	2,509	2,509
Total intangible assets	<u>2,509</u>	<u>2,509</u>

Operating right represents the legal right acquired in business combination to operate drugstores in certain areas 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, 2013 and 2014 were as follows:

	December 31,	
	2013	2014
	RMB	RMB
Gross goodwill as of January 1	51,819	51,819
Accumulated impairment losses	-	-
Net goodwill as of December 31	<u>51,819</u>	<u>51,819</u>

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9 EQUITY METHOD INVESTMENT

The equity in income of the equity method investee in 2012 of RMB1,337 was the equity income recognized for the 40% equity investment in Yunnan Jian Zhijia Chain Drugstore Ltd. (“Yunnan Nepstar”). In 2012, Yunnan Nepstar declared and paid a cash dividend of RMB25,000 to Nepstar Pharmaceutical. For the purposes of the consolidated statement of cash flows, the amount of dividend received in 2012 of RMB11,175 that represents returns of the Company’s investment has been reported as cash flows from investing activities.

In 2012, the Company’s Board of Director approved the sale of the Group’s 40% equity ownership in Yunnan Nepstar to Yunan Jianzhijia Holding Co. Ltd., a company 100% beneficially owned by a director of Yunnan Nepstar, for a total cash consideration of RMB81,480. A gain of RMB68,440 was recognized from disposal of an equity method investee upon completion of the sale. The gain was measured as the difference between cash consideration received and the carrying amount of the investment at the time of completion of the sales. The cash consideration of the transaction was received by the Company on December 28, 2012.

10 OTHER INCOME

In June 2014, the Company completed the sales of 100% equity ownership in Beijing Nepstar to a third party individual Mr. Zhao Shi for a total cash consideration of RMB100. A gain of RMB226 was recognized in other income upon completion of the sales. The gain was measured as the difference between cash consideration received and the carrying amount of net assets at the time of completion of the sales.

In September 2014, the Company completed the sales of 100% equity ownership in Weifang Nepstar to Rongchang for a total cash consideration of RMB13,801. A gain of RMB2,856 was recognized in other income upon completion of the sales. The gain was measured as the difference between cash consideration received and the carrying amount of net assets at the time of completion of the sales.

11 OTHER LOSS

In December 2014, the Company completed the sales of 100% equity ownership in Zaozhuang Nepstar to MDX Investment for a total cash consideration of RMB one yuan. A loss of RMB535 was recognized in other loss upon completion of the sales. The loss was measured as the difference between cash consideration received and the carrying amount of net assets at the time of completion of the sales.

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.

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.

For the years ended December 31, 2012, 2013 and 2014, the Company’s PRC subsidiaries are subject to income tax at the statutory income tax rate of 25% under the Corporate Income Tax Law of the PRC (“CIT”).

12 INCOME TAXES - CONTINUED

Under the CIT 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 has qualified for the 5% withholding tax rate for the years ended December 31, 2012. The Company ceased to maintain its Hong Kong tax residency for the years ended December 31, 2013 and 2014 and is therefore subject to a standard withholding tax rate of 10% for the years then ended.

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

	Year ended December 31,		
	2012	2013	2014
	RMB	RMB	RMB
PRC	138,755	44,129	9,512
Non-PRC	(1,069)	(201)	3,189
Income before income tax expense	<u>137,686</u>	<u>43,928</u>	<u>12,701</u>

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

	Year ended December 31,		
	2012	2013	2014
	RMB	RMB	RMB
Current tax expense	49,616	36,351	28,770
Deferred tax benefit	(2,022)	(4,251)	(2,298)
Income tax expense	<u>47,594</u>	<u>32,100</u>	<u>26,472</u>

12 INCOME TAXES - CONTINUED

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, 2012, 2013 and 2014, to income before income tax expense is as follows:

	Year ended December 31,		
	2012	2013	2014
	RMB	RMB	RMB
Computed "expected" tax expense	34,422	10,982	3,175
Effect of tax rate differential	(33)	50	(797)
PRC dividend withholding tax	4,598	2,351	(1,830)
Change in tax rate	-	8,659	-
Non-deductible expenses:			
- Disallowed rental expenses	14,190	13,333	13,960
- Penalty charged by the governmental authority	-	1,419	949
- Bad debt write-off	569	194	72
- Disallowed entertainment expense	441	457	435
- Deemed profit method differential	396	328	442
- Withholding taxes on rebate income	367	440	605
- Others	275	115	153
Tax effect from the waiver of intra-group debts subject to tax bureau's approval	-	-	7,666
Reversal of deferred tax liabilities on equity method investment	(6,250)	-	-
Non-taxable income	(1,132)	(1,308)	(1,463)
Provision / (reversal) of unrealized tax credit from intra-group transaction	-	1,601	(1,601)
Investment loss on the dissolution / disposal of PRC subsidiaries	-	(1,250)	(487)
Release of unrecognized tax benefits due to expiration of the statute of limitations	(2,785)	(4,584)	(4,648)
Change in valuation allowance	2,536	(687)	9,841
Actual income tax expense	<u>47,594</u>	<u>32,100</u>	<u>26,472</u>

In 2012, dividends of RMB25,000 was received from Yunnan Nepstar, an equity method investee (see Note 9). Consequently, deferred tax liabilities of RMB6,250 arising from the recognition of the equity method investment was reversed.

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12 INCOME TAXES – CONTINUED

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, 2013 and 2014 are presented below.

	December 31,		
	2013	2014	
	RMB	RMB	
Deferred tax assets:			
- Tax loss carryforwards	40,621	50,696	
- Inventories	3,971	2,958	
- Impairment of property and equipment	2,625	3,072	
- Accrual for membership reward program	411	-	
-Accrual for government grant	250	229	
- Accrued expenses	53	-	
- Others	2,016	2,230	
Total gross deferred tax assets	49,947	59,185	
Valuation allowance	(31,894)	(40,807)	
Total deferred tax assets	18,053	18,378	
Deferred tax liabilities:			
- PRC dividend withholding taxes	(15,914)	(14,084)	
- Intangible assets	(627)	(627)	
Total deferred tax liabilities	(16,541)	(14,711)	
Net deferred tax assets	1,512	3,667	
Classification on consolidated balance sheets:			
Deferred tax assets:			
- Current	6,330	2,038	
- Non-current	11,723	16,340	
Deferred tax liabilities:			
- Non-current	(16,541)	(14,711)	
	Year ended December 31,		
	2012	2013	2014
	RMB	RMB	RMB
Valuation allowance:			
Balance as of January 1	37,405	37,264	31,894
Addition	10,115	9,893	16,848
Deduction	(7,579)	(10,580)	(7,611)
Reversal on expiration of tax loss	(2,677)	(4,683)	(324)
Balance as of December 31	37,264	31,894	40,807

12 INCOME TAXES - CONTINUED

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, 2013 and 2014. As of December 31, 2014, the Group recognized net deferred tax assets of RMB18,378, of which RMB14,203 relates to a subsidiary that is in cumulative loss position as of December 31, 2014. The net deferred tax assets recognized by this subsidiary include RMB12,034 relating to RMB48,135 tax loss carryforwards which expire in varying amounts between 2018 and 2019. The realization of these tax benefits is dependent on the generation of projected future taxable income and tax planning strategies prior to expiration of the tax loss carryforwards. Although realization is not assured, management believes it is more likely than not that all of the net deferred tax asset will be realized. The amounts 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, 2014, the tax loss carryforwards of the Group amounted to RMB202,784 of which RMB12,399, RMB16,084, RMB23,201, RMB74,393 and RMB76,707 will expire, if unused, by end of 2015, 2016, 2017, 2018 and 2019 respectively.

A reconciliation of the beginning and ending amount of unrecognized tax benefits in the PRC for the years ended December 31, 2012, 2013 and 2014 is as follows:

	Year ended December 31,		
	2012	2013	2014
	RMB	RMB	RMB
Balance as at January 1	31,015	36,237	45,843
Additions based on tax positions related to current year	8,007	14,190	20,998
Expiration of the statute of limitations	(2,785)	(4,584)	(4,649)
Balance as at December 31	<u>36,237</u>	<u>45,843</u>	<u>62,192</u>

The unrecognized tax benefits as of December 31, 2012, 2013 and 2014 are the potential benefits that, if recognized, would affect the effective tax rate. The unrecognized tax benefits mainly represent rental expenses and loss from waiver of intra-group debts taken on the tax returns in which the deductibility of such expenses does not meet the more likely than not threshold. Pursuant to the Chinese Taxation Law, loss from the waiver of debts with related parties could be deducted from taxable income only after obtaining the respective approval from the tax authority. As of December 31, 2014, the unrecognized tax benefits of RMB 11,555 was presented as a reduction of the deferred tax asset for tax loss carryforwards of certain subsidiaries since the uncertain tax position would reduce the tax loss carryforwards under the tax law. 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, 2012, 2013 and 2014.

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 2008 are subject to examination by the relevant tax authorities.

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13 ACCRUED EXPENSES AND OTHER PAYABLES

Accrued expenses and other payables consist of the following:

	December 31,	
	2013	2014
	RMB	RMB
Accrued payroll and employee benefits	67,824	62,285
Other accrued expenses (Note (a))	26,258	26,240
Payable for purchases of property and equipment	4,593	6,696
Deposits received (Note (b))	2,801	3,169
VAT and other taxes payable	21,589	23,846
	<u>123,065</u>	<u>122,236</u>

Notes:

- (a) Amounts represent primarily accrued rental, utilities, advertising and other sundry expenses.
(b) Amounts represent primarily guarantee deposits from constructors for renovation and construction projects.

14 DEFERRED INCOME

Deferred income consists of the following:

	December 31,	
	2013	2014
	RMB	RMB
Deferred revenue arising from Shopper's Card Program (Note 2(l)) and others	22,477	25,715
Deferred rebate income	17,391	15,677
	<u>39,868</u>	<u>41,392</u>

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, 2012, 2013 and 2014, the Company issued 368,160, nil and nil ordinary shares, respectively, to employees upon the exercise of vested share options.

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 of its outstanding ordinary shares in the form of ADS from the open market. On December 30, 2014, the Board of Directors of the Company authorized a share repurchase program ("The 2014 Program"). The 2014 Program allows the Company, from time to time and during a 12-month period starting from December 30, 2014, to purchase up to USD5,000 of its outstanding ordinary shares in the form of ADS from the open market. During the years ended December 31, 2012, 2013 and 2014, the Company repurchased 5,370,312, nil and nil of its ordinary shares for a total purchase price of USD6,565 (equivalent to RMB40,899), nil and nil, respectively. As of December 31, 2012, all of shares repurchased under The 2011 Program had been retired.

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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.

The Company's PRC subsidiaries made appropriations to the statutory surplus reserve of RMB4,178 for the years ended December 31, 2012, reversed RMB23 for the year ended December 31, 2013, and made appropriations to the statutory surplus reserve of RMB80 and wrote-off RMB571 in relation of the disposal of Weifang Nepstar for the year ended December 31, 2014. The accumulated balance of the statutory surplus reserve as of December 31, 2013 and 2014 was RMB99,354 and RMB98,863, respectively. No equivalent amounts were appropriated by the Company.

17 DIVIDEND

On April 27, 2012, the Board of Directors of the Company declared a special cash dividend of USD0.3 per ordinary share, totaling USD59,986 (equivalent to RMB378,472 at the exchange rate on April 27, 2012), to the ordinary shareholders on record as of close of business on April 26, 2012. 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, 2012.

On November 26, 2013, the Company's Board of Directors declared a cash dividend of USD0.16 per ordinary share, totaling USD31,591 (equivalent to RMB192,470 at the exchange rate on November 26, 2013), to the ordinary shareholders on record as of close of business on December 20, 2013, which was fully paid in January 2014.

18 REVENUE

Revenue by each major product categories is analyzed as follows:

	Year ended December 31,		
	2012	2013	2014
	RMB	RMB	RMB
Prescription drugs	519,557	601,934	658,031
Over-the-counter drugs	997,997	1,059,154	1,183,665
Nutritional supplements	399,397	392,009	393,466
Herbal products	100,419	109,284	124,810
Other product sales	532,486	536,722	593,342
	<u>2,549,856</u>	<u>2,699,103</u>	<u>2,953,314</u>

18 REVENUE - CONTINUED

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, 2012, 2013 and 2014, approximately 30%, 31% and 31%, 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, 2012, 2013 and 2014.

19 SHARE-BASED PAYMENTS

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 USD3.725 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 USD3.725 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.

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19 SHARE-BASED PAYMENTS - CONTINUED

On March 2, 2010, the Company granted an aggregate of 150,000 fully vested ordinary shares with a grant date fair value of 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 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.

The fair value of options granted under the 2007 Plan was estimated on the date of the grant using the Binomial option pricing model. The Binomial model takes into account variables such as volatility, dividend yield rate, and risk free interest rate. In addition, 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.

The fair value of the above share options granted under the 2007 Plan was estimated based on following assumptions at the date of grant:

	<i>Share options granted on November 9, 2007</i>	<i>Share options granted on January 5, 2009</i>	<i>Share options granted on January 5, 2010</i>
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.

All share options and ordinary shares granted under 2007 Plan were vested or forfeited before December 31, 2012. No share-based compensation expense was recognized or reversed during the year ended December 31, 2012, 2013 and 2014.

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19 SHARE-BASED PAYMENTS - CONTINUED

A summary of the Company's option activities for the years ended December 31, 2012, 2013 and 2014 is presented below:

	<i>Number of options</i>	<i>Weighted Average exercise price</i>
Outstanding as of January 1, 2012	609,750	USD 1.71
Exercised	(368,160)	USD 0.72
Forfeited	(241,590)	USD 3.21
Outstanding as of December 31, 2012, 2013 and 2014	<u>-</u>	<u>-</u>
Exercisable as of December 31, 2014	<u>-</u>	<u>-</u>

The total intrinsic value of share options exercised during the year ended December 31, 2012 was USD122. 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.

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 expenses and sales, marketing and other operating expenses in the consolidated statements of comprehensive income was RMB37,824, RMB39,152 and RMB40,550 for the years ended December 31, 2012, 2013 and 2014, respectively.

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

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21 EARNINGS PER SHARE

	Year ended December 31,		
	2012	2013	2014
	RMB	RMB	RMB
Numerator:			
Net income / (loss) attributable to China Nepstar Chain Drugstore Ltd. ordinary shareholders	90,092	11,828	(13,771)
Denominator:			
Basic weighted average number of ordinary shares	199,198,962	197,446,940	197,446,940
Dilutive effect of outstanding share options and non-vested shares	64,402	-	-
Dilutive weighted average number of ordinary shares	199,263,364	197,446,940	197,446,940
Basic earnings / (loss) per ordinary share	0.45	0.06	(0.07)
Diluted earnings / (loss) per ordinary share	0.45	0.06	(0.07)

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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,		
	2012	2013	2014
	RMB	RMB	RMB
Purchases from related parties (Notes 22(a))	92,906	138,835	57,367
Sales to related parties (Note 22(b))	5,454	2,490	2,644
Lease of property from a related party (Note 22(d))	1,082	1,082	1,082
	December 31,		
	2013	2014	
	RMB	RMB	
Amounts due from related parties (Note 22(c))	379	3,366	
Amounts due to related parties (Note 22(e))	29,247	25,636	

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 15 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,		
	2012	2013	2014
	RMB	RMB	RMB
Neptunus Group and its affiliates	5,454	2,490	2,644
	<u>5,454</u>	<u>2,490</u>	<u>2,644</u>

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22 RELATED PARTY BALANCES AND TRANSACTIONS - CONTINUED

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

	December 31,	
	2013	2014
	RMB	RMB
Amount due from Neptunus Group and its affiliates related to:		
Sales of merchandise (Note 22(b))	335	2,979
VAT for the above sales of merchandise	44	387
	<u>379</u>	<u>3,366</u>

- (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 was renewed in November 1, 2013 and will expire in October 2015.
- (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.

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23 COMMITMENTS AND CONTINGENCIES

Operating lease commitments

Future minimum lease payments under non-cancelable operating lease agreements as of December 31, 2014 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
2015	203,105	19,803	222,908
2016	218,115	16,293	234,408
2017	153,501	14,848	168,349
2018	93,790	14,738	108,528
2019	40,148	13,175	53,323
Thereafter	18,159	15,353	33,512
Total	<u>726,818</u>	<u>94,210</u>	<u>821,028</u>

The Group's rental expenses under operating leases amounted to RMB370,292, RMB375,999 and RMB399,079 for the years ended December 31, 2012, 2013 and 2014, 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.

English translation of Chinese original

ENTRUSTMENT LOAN AGREEMENT
(For Corporate Business)

Serial No.: Xing Yin Shen Tian An Wei Jie Zi (2014) No. 0020

Entrustor: **Shenzhen Nepstar Pharmaceutical Co., Ltd.** (affixed with the corporate seal)

Domicile: A-15B, Shenzhen Nanshan District Haiwang Building

Legal Representative/Principal Officer: Zhang Simin

Contact Person: _____ Title: _____

Mailing Address: Shenzhen Nanshan District Haiwang Building A-15B

Postal Code: 518000 Telex: _____

Telephone Number: 26430133 Facsimile: _____

Lender: **Shenzhen Tian'an Branch of Industrial Bank Co., Ltd. (the "Bank")**

Domicile: Suite 101, Tower 1, Phase 1, Tian An Innovation Technology Square

Legal Representative/Principal Officer: Zhang Pengfeng

Contact Person: Lin Beixiang Title: _____

Mailing Address: Suite 101, Tower 1, Phase 1, Tian An Innovation Technology Square

Postal Code: 518000 Telex: _____

Telephone Number: 83432045 Facsimile: _____

Borrower: **Shenzhen Nepstar Information and Technology Service Co., Ltd.** (affixed with the corporate seal)

Domicile: 15D, Haiwang Building, Shenzhen Nanshan District Nanyou Avenue

Legal Representative/Principal Officer: Zhou Liping

Contact Person: _____ Title: _____

Mailing Address: 15D, Haiwang Building, Shenzhen Nanshan District Nanyou Avenue

Postal Code: 518000 Telex: _____

Telephone Number: _____ Facsimile: _____

Place of Execution: Shenzhen Branch of Industrial Bank Co., Ltd.
Industrial Bank Building, Futian District, Shenzhen

Important Reminder for Agreement Signing

In order to protect your interest, please read through carefully, examine and confirm each of the following items prior to your signing of this agreement:

- I. You have the right to sign this agreement, and you have obtained all the authorizations necessary for your signing hereof to the extent any such authorization of any person is required under any law;**
- II. You have carefully read and fully understood the provisions in this agreement and have paid special attention to those provisions concerning the imposition of liabilities, or release of or limitations on the liabilities of the Bank, and the contents of those sections highlighted in bold;**
- III. Both your company and you yourself have fully understood the meaning of, the corresponding legal consequences that may arise from, and are willing to be bound by, the provisions in this agreement;**
- IV. The draft of this agreement provided by the Bank is a form only. In this draft, there is a blank left after each relevant article, and at the end of the agreement, an article under the heading of “Supplementary Provisions” is inserted for the parties to this agreement to make any amendments, additions or deletions; and**
- V. Where you have any question about this agreement, please promptly consult the Bank.**

Pursuant to the Entrusted Loan Entrustment Agreement by and between the Entrustor and the Lender dated September 3, 2014 numbered as Xing Yin Shen Tian An Wei Tuo Zi (2014) No. 0020, the Lender is entrusted by the Entrustor to disburse the Entrusted Loan (as defined below) to the Borrower. With a view to specifying the responsibilities and to acting in good faith, in accordance with relevant laws and regulations of the People's Republic of China (the "PRC") and after negotiations on an equal footing, the parties hereto hereby enter into this Entrustment Loan Agreement (this "Agreement") for mutual observance.

Article 1 Definitions and Interpretation

Unless otherwise agreed in writing among the parties hereto, when used in this Agreement, the following terms shall be defined and interpreted as follows:

1. **"Entrusted Loan"** means a loan that shall be disbursed by the Lender (i.e., the Entrustee) for and on behalf of the Entrustor to a specific person, for specific purposes, in a specific amount, for a specific tenor and at a specific interest rate determined by the Entrustor from the funds provided by the Entrustor to the Lender, and shall be recovered with the assistance of the Lender. In connection with each Entrusted Loan, the Lender shall receive the charges only and not take any risks in any form.

A "Loan" means a monetary amount disbursed to the Borrower by the Lender hereunder upon the entrustment of the Entrustor.

A "Borrowing" means a monetary amount received by the Borrower from the Lender after the Borrower's request to the Lender for Borrowing is reviewed and approved by the Lender, in each case in accordance with this Agreement.

Each party hereto agrees and acknowledges that the monetary amount disbursed to the Borrower by the Lender hereunder shall be consistent to the monetary amount received by the Borrower from the Lender hereunder.

2. **"Loan Risks"** includes without limitation, legal and policy risks, credit risks, market risks, operational risks, force majeure risks and any other risks.

"Legal and Policy Risks" means the risks that any Entrusted Loan is rendered unable to be recovered on time or both on time and in full as a result of any modification of or change in applicable laws or regulations of the People's Republic of China.

"Credit Risks" means the risks arising from any failure of the Borrower to satisfy its obligations for repayment under this Agreement.

"Market Risks" means the risks that any Entrusted Loan is rendered unable to be recovered on time or both in full and on time as a result of any change in macro policies, economic cycle, market price or any other similar factors.

"Operational Risks" means the risks that any Entrusted Loan is rendered unable to be recovered on time or both in full and on time as a result of any incomplete or problematic procedures or improper management actions in the course of the disbursement and management of such Entrusted Loan.

“Force Majeure Risks” means the risks that any Entrusted Loan is rendered unable to be recovered on time or both in full and on time as a result of the occurrence of any objective circumstances that are unforeseeable, unavoidable or insurmountable by either the Entrustor or the Entrustee.

“Other Risks” means any other risks that may render any Entrusted Loan unable to be recovered on time or both in full and on time, excluding those described above.

3. **“Obligations”** or **“Master Obligations”** means the RMB obligations generated from the disbursement of any Loan to the Borrower (the debtor) by the Lender (the creditor) after having reviewed and approved the applicable request from the Borrower, including the principal amounts, interest, default interest, compound interest, liquidated damages, indemnities and the Expenses for the Enforcement of the Obligations incurred by the Lender.

Each of the parties hereto agrees and acknowledges that the Obligations of the Borrower towards the Lender under this Agreement shall be consistent to the debts of the Borrower owed to the Lender under this Agreement.

4. **“Expenses for the Enforcement of Obligations”** includes without limitation, costs and expenses for litigations, arbitrations, property preservation, applications for enforcement, attorney fees and expenses, public announcements, appraisals, verifications, auctions, realizations, telecommunications, travels and disposals.

5. **“Workday”** used herein means a business day of the Lender; where in the course of the performance of this Agreement, any drawdown date or repayment date falls on a date that is not a business day of the Lender, the drawdown or repayment shall be put off till the immediately following business day of the Lender.

6. For purposes of this Agreement, the following terms shall be defined and interpreted as follows:

“PBOC RMB Loan Benchmark Rate” means the benchmark interest rate for RMB loans published by the People’s Republic of China (“PBOC”) that is effective from time to time.

“PBOC RMB Deposit Benchmark Rate” means the benchmark interest rate for RMB deposits published by the People’s Republic of China (“PBOC”) that is effective from time to time.

“LPR” means the loan prime rate calculated and published by the National Interbank Funding Center based on the best loan interest rates offered by quoting banks that is effective from time to time.

“SHIBOR” means the Shanghai Interbank Offered Rate calculated and published by the National Interbank Funding Center that is effective from time to time.

“LIBOR” means the T-2 Day London Interbank Offered Rate prevailing on London financial market, which covers such currencies as USD, Euro Dollar, and Japanese Yen. Of which, T means the date on which the loan is actually disbursed; T-2 means the second Workday prior to the date on which the loan is actually disbursed. The definition of T and T-2 shall be applicable to all sections below.

“HIBOR” means the T-2 Day Hongkong Interbank Offered Rate prevailing on Hong Kong financial market.

Article 2 Amount of the Borrowing

The Borrowing under this Agreement shall be in an amount of RMB Fourteen Million and Seventy Thousand only.

Article 3 Purposes of the Borrowing

The Borrowing received hereunder shall be applied towards the funding of working capital requirements. Without prior written consent of the Entrustor, the Borrower may not apply any part of the Borrowing towards any other purpose.

Article 4 Tenor of the Borrowing

1. The tenor of the Borrowing hereunder shall be 12 months, starting on September 3, 2014 and ending on September 3, 2015 (the "Tenor").
2. Where the Loan is to be disbursed in a lump-sum, the date of actual disbursement as recorded on the receipt of borrowing and/or certificate of borrowing shall be deemed as the disbursement date. Where the date of actual disbursement is later than the disbursement date so recorded, the Tenor shall be extended accordingly.

[N/A 3. Pursuant to the instructions of the Entrustor, the Borrowing shall be disbursed by installments in accordance with the following schedule:

On ____ [insert the applicable date], RMB ____ [insert the applicable amount]; On ____ [insert the applicable date], RMB ____ [insert the applicable amount];

On ____ [insert the applicable date], RMB ____ [insert the applicable amount]; On ____ [insert the applicable date], RMB ____ [insert the applicable amount];

On ____ [insert the applicable date], RMB ____ [insert the applicable amount]; On ____ [insert the applicable date], RMB ____ [insert the applicable amount];

The Lender shall transfer each of the relevant amounts as specified above to the account of the Borrower on each of the dates as specified above.]

4. Where the Loan is to be utilized by installments, all the installments shall expire on the same day, or in other words, all the installments disbursed separately shall expire simultaneously on the expiration date specified on the receipt of borrowing and/the certificate of borrowing for the first installment.
5. In the event that the Lender accelerates the Loan under the circumstances set forth herein or in accordance with the instructions of the Entrustor, it shall be deemed that expiration date of the Tenor is accelerated accordingly.

Article 5 Interest Rate and Payment of Interest

As agreed between the Entrustor and the Borrower, interest shall accrue on the Borrowing at the interest rate as follows (the "Interest Rate"):

1. Interest Rate

(1) The pricing benchmark rate shall be the one set forth in Item N/A below:

- (i) PBOC RMB Loan Benchmark Rate for N/A tenor.
- (ii) PBOC RMB Deposit Benchmark Rate for N/A tenor.
- (iii) LPR for N/A tenor.
- (iv) SHIBOR for N/A tenor.
- (v) LIBOR for N/A tenor.
- (vi) HIBOR for N/A tenor.

(2) The Interest Rate shall be determined at the pricing formula set forth in Item N/A below:

- (i) Interest Rate = pricing benchmark rate + N/A %.
- (ii) Interest Rate = pricing benchmark rate × N/A %.

(3) The Interest Rate (meaning a rate per annum, which is applicable to all sections below) shall be determined in accordance with the provisions set forth in Item N/A below:

- (i) a fixed rate, which shall be determined based on the pricing benchmark rate effective on the date of actual disbursement of the Borrowing and the pricing formula, and shall remain unchanged during the Tenor.
- (ii) a floating rate, which shall be determined based on the pricing benchmark rate and the pricing formula effective on the date of actual disbursement of the Borrowing and the date of adjustment of interest rate (the "Date of Interest Rate Adjustment"). The Date of Interest Rate Adjustment shall be determined in accordance with the provisions set forth in Item N/A below:

A. The Interest Rate hereunder shall be adjusted on a(an) N/A [monthly/quarterly/semi-annual/ yearly/other time period] basis, and on each [monthly/quarterly/semi-annual/ yearly/other time period] anniversary of the date of actual disbursement of the Borrowing, which shall be an Interest Rate Adjustment Date; and for any month that does not have a date correspond to such anniversary, the last day of such month shall be deemed an Interest Rate Adjustment Date.

B. N/A.

In case of any adjustment to the benchmark rate during the Tenor, no notice will be given to the Borrower.

(iii) any other interest rate: [N/A].

(4) Where the Borrowing is disbursed by installments, the interest rate applicable to each installment shall be determined based on the benchmark rate effective on the date of actual disbursement of such installment (or the applicable Date of Interest Rate Adjustment).

(5) In the event that the benchmark rate is canceled by the PRC government or is not available any more on the market, the Entrustor hereby authorizes the Lender to redetermine the Interest Rate in accordance with the applicable PRC policies concerning interest rate, by adhering to the principal of fairness and good faith and by reference to the industrial practice, the status of the interest rate and any other similar factor. In case the Borrower has any disagreement thereon, it shall consult with the Entrustor. Where such disagreement fails to be resolved through such consultation, the Entrustor shall have the right to accelerate the Loan and the Borrower shall immediately pay any and all the principal and accrued interest then outstanding.

2. Manners of Payment of Interest

(1) Calculation of Interest. Interest shall accrue on the principal of the Borrowing, whether in RMB or foreign currency, starting from the date on which the Borrowing is transferred into an account of the Borrower by the Lender under this Agreement. The interest to accrue on the Borrowing per day = amount outstanding under the Borrowing that day \times daily interest rate. The conversion between daily rate and annual rate shall be conducted in accordance with the applicable PBOC regulations and international practice.

(2) The interest accrued on the Borrowing shall be paid in the manners set forth in Item N/A below:

(i) it is agreed hereunder that the 20th day of each calendar month/the last month of each calendar quarter/the last month of each half year/the last month of each calendar year/other time period shall be an interest settlement date (an Interest Settlement Date”), and the Borrower shall pay the Lender the accrued interest for the current Interest Period on the day immediately after the current Interest Settlement Date; provided, however, any and all the principal and interest outstanding under the Borrowing shall be paid on the expiration date of the Tenor.

(ii) The date that falls on the day immediately preceding the _____ monthly/quarterly/semi-annual/ yearly/other time period anniversary of the date of actual disbursement of the Borrowing (or for any month that does not have a date corresponding to such anniversary, the last day of such month shall be deemed an anniversary) shall be an interest settlement date (an “Interest Settlement Date”). The Borrower shall pay the Lender the accrued interest for the current Interest Period on the day immediately after the current Interest Settlement Date; provided, however, that the interest for the last Interest Period shall be paid on the expiration date of the Tenor.

(iii) any alternative manners for the payment of interest _____.

3. Default Interest and Compound Interest

(1) In the event that the Borrower misappropriates any amount of the Borrowing for any purpose other than those specified herein, the Entrustor hereby authorizes the Lender to charge compound interest on such amount so misappropriated at a default interest rate equal to the Interest Rate plus its 50%. In the event that the Borrower fails to repay any amount of the Loan and fails to reach agreement with the Entrustor on the extension of the Tenor, and as result, such amount becomes delinquent, the Entrustor hereby authorizes the Lender to charge default interest on such delinquent amount at a default interest rate equal to the Interest Rate plus its 50%. In the event that any interest accrued on the Loan fails to be paid on time, the Entrustor hereby authorizes the Lender to charge compound interest at the default interest rate applicable to the delinquent amount specified above.

(2) Where the Interest Rate is a fixed rate, the default interest rate shall also be a fixed one; and accordingly, where the Interest Rate is a floating rate, the default interest rate shall also be a floating one. The floating period of the default interest shall be consistent to that of the Interest Rate.

(3) The default interest and the compound interest shall be calculated and collected in the same way as the regular interest on the Loan set forth herein.

Article 6 Repayment of the Principal

1. The principal of the Borrowing hereunder shall be repaid in the manners set forth in Item (A) below:

(A) The principal of the Borrowing shall be repaid in a lump-sum on the expiration date of the Tenor.

(B) The principal of the Borrowing shall be repaid by installments in accordance with the following repayment schedule:

On ____*[insert the applicable date]*, RMB ____*[insert the applicable amount]*; On ____*[insert the applicable date]*, RMB ____*[insert the applicable amount]*;

On ____*[insert the applicable date]*, RMB ____*[insert the applicable amount]*; On ____*[insert the applicable date]*, RMB ____*[insert the applicable amount]*;

On ____*[insert the applicable date]*, RMB ____*[insert the applicable amount]*; On ____*[insert the applicable date]*, RMB ____*[insert the applicable amount]*;

(C) Any alternative manners for the repayment of the principal: _____.

2. On each repayment date and Interest Settlement Date specified in this Agreement, the Borrower shall punctually and in full, repay the principal of and the accrued interest on any amount of the Borrowing received hereunder. In the event that the Borrower fails to repay punctually any principal of or interest on any amount of the Borrowing, the Lender shall have the right to debit from any account of the Borrower maintained with the Lender or any organization within the system of the Lender the necessary amount in satisfaction of the fees, expenses, principal and interest due from the Borrower in accordance with the applicable regulations concerning banking accounting and in the order stipulated in the internal rules of the Lender.

3. Where a repayment date falls on a date that is not a business day of the Lender, the repayment shall be put off till the immediately following business day of the Lender; provided, however, that such date that is not a business day shall be included into the number of days during which the Loan is actually occupied. At the repayment of the last amount of the principal of the Borrowing, any and all the accrued interest that remains outstanding by then shall be paid simultaneously, regardless of the provisions concerning the Interest Settlement Date set forth in Article 5 above.

4. Subject to the review and consent of the Entrustor, the Borrower may prepay the whole or any part of the principal of the Entrusted Loan.

Article 7 Handling Charges

1. The Lender shall receive handling charges equal to 1‰ of the amount of the Entrusted Loan. The handling charges shall be paid by the Entrustor in a lump-sum prior to the disbursement of the Borrowing. The Entrustee shall be entitled to debit the handling charges directly from any account of the Entrustor.

Article 8 Security

[N/A 1. The borrowing contemplated hereunder shall be secured by the security interest to be provided by the guarantors acceptable to the Entrustor under the following security agreement(s):

(1) the _____ [insert name of the security agreement] numbered as _____, under which the security is provided in the form of _____, and the guarantor is _____;

(2) the _____ [insert name of the security agreement] numbered as _____, under which the security is provided in the form of _____, and the guarantor is _____; and

(3) the _____ [insert name of the security agreement] numbered as _____, under which the security is provided in the form of _____, and the guarantor is _____.]

2. Until the execution and effectiveness of each and all the security agreements hereunder and the completion of all the required procedures for the perfection of the security created thereunder, the Lender shall have the right to withhold the performance of such obligations as for the disbursement of the Loan.

Article 9 Representations and Undertakings of the Borrower

The Borrower hereby voluntarily makes the following representations and undertakings and will assume the legal liabilities for the truth thereof:

1. The Borrower is a legal entity established and validly existing under the laws of the PRC, and has the full capacity for civil conduct. The Borrower undertakes that it will, at the request of the Entrustor or the Lender, provide the relevant certificates, permits and licenses as well as any other documents as requested by the Entrustor or the Lender from time to time.

2. The Borrower has the full power to perform all its obligations and responsibilities under this Agreement, and its liabilities for repayment hereunder will not be relieved or released as a result of any order, any change of its financial status, or any agreement with any person.

3. The Borrower has the full power, authorization and legal right to execute this Agreement, and has obtained or completed (i) any and all the internal corporate approvals, authorizations and any other relevant procedures, and (ii) any and all the approvals, registrations, authorizations, consents, permits and any other relevant procedures from or with any required governmental or regulatory authorities necessary for its execution and performance of this Agreement, and all such approvals, registrations, authorizations, consents, permits and any other relevant procedures are in full legal force and effect.

4. The execution of this Agreement by the Borrower fully complies with the relevant articles of association, internal decisions, or shareholder or board resolutions of the Borrower. This Agreement does not conflict with or violate any of the articles of association, internal decisions, shareholder or board resolutions or policies of the Borrower.
5. The execution and performance of this Agreement are based on the expression of the real intentions of the Borrower. The execution and the performance of this Agreement do not violate any provision of any law, regulation, rule or contract by which the Borrower is bound. This Agreement is legal, valid and enforceable. The Borrower shall, promptly and on an unconditional basis, indemnify the Entrustor and the Lender against any and all the losses arising from the invalidity of this Agreement due to any flaw in the right of the Borrower to the execution and performance of this Agreement.
6. Any and all the documents, financial statements and other materials provided by the Borrower to the Entrustor or the Lender hereunder are true, complete, accurate and effective, and the Borrower will maintain all the financial indices required by the Entrustor of the Lender.
7. The Borrower agrees that the borrowing contemplated hereunder shall be bound by the rules and customary practice of the Lender, which shall be subject to the interpretation of the Lender.
8. In the event that the Borrower fails to perform any of the Obligations hereunder, it hereby authorizes the Lender to debit directly the corresponding amount from any account of the Borrower maintained with the Lender or any organization within the system of the Lender.
9. No matter at what stage of the transaction after the execution of this Agreement, where the Borrower submits to the Lender for review and approval of any document relating to any specific transaction, the Borrower shall ensure the truth of all such documents. The Lender will make a decision on the apparent truth of any transaction documents, not participate in or know the substance of any specific transaction conducted by the Borrower, and not assume any liabilities therefor.
10. The Borrower hereby acknowledges that other than those disclosed to the Entrustor or the Lender, the Borrower does not know any of the following circumstances, whether pending or threatened, which may result in the Entrustor or the Lender refusing to disburse the Borrowing hereunder:
- (1) any obligations or contingent liabilities to which the Borrower is subject, including without limitation, any mortgage, pledge, lien or any other encumbrance created on any assets or income of the Borrower that has not been disclosed to the Lender;
 - (2) any material noncompliance of discipline, violation of law, or claim involving the Borrower or any of its senior officers;

- (3) any default by the Borrower under any agreement between the Borrower and any of its other creditors relating to obligations or creditor rights;
- (4) there has not occurred and does not exist any litigation, arbitration or administrative proceedings pending, or to the knowledge of the Borrower threatened, against the Borrower or any of its assets, and the Borrower is not subject to any liquidation or winding-up or any other similar proceedings by or against the Borrower; or
- (5) Any other circumstances which may have an adverse effect on the Borrower's financial status or ability to repay debts.

11. The Borrower hereby undertakes that it will apply the Borrowing towards the purposes specified herein, not misappropriate nor will it allow any amount of the Borrowing to be applied towards any purpose in violation of the intent of this Agreement. The Borrower shall subject itself to and cooperate with the Entrustor or the Lender in the supervision, inspection and check by the Entrustor or the Lender from time to time on the utilization of the Borrowing, the operational and financial activities, inventory, assets and liabilities, bank deposits and cash on hand of the Borrower, or any other requirement deemed necessary or advisable by the Entrustor or the Lender.

12. The Borrower shall provide adequate and valid security or any other security deemed appropriate or acceptable by the Entrustor.

13. The Borrower may not allow its registered capital to be reduced in any way. Without prior written consent of the Entrustor, the Borrower may not transfer its obligations hereunder to any third party, whether in whole or in part. Prior to the full satisfaction of all its obligations hereunder, the Borrower may not satisfy any of its obligations owed to any of its creditors prior to the same falling due.

14. In the event that the Lender is involved in any dispute between the Borrower and any third party as a result of any litigation or arbitration or any other dispute between the Lender and the Borrower or any third party related to the Borrower due to the Lender's performance of its obligations hereunder, the Borrower shall indemnify the Lender against any and all the litigation or arbitration costs and expenses, attorney fees, and any other costs and expenses paid by the Lender in connection therewith.

15. The Borrower shall conduct all the settlement business arising under this Agreement through a settlement account opened by it with the Lender.

16. In the event that the security interest granted hereunder is in the form of mortgage on building(s), the Borrower shall have the obligation to promptly notify both the Entrustor and the Lender upon being aware of any information that the mortgaged building(s) may be demolished. Where the mortgaged building(s) is/are demolished, if compensation is paid in the form of property in consideration of such demolition, the Entrustor or the Lender shall have the right to request the Borrower to prepay the indebtedness owed hereunder or create a new mortgage and enter into a new mortgage agreement. During the period after the original mortgaged building(s) is/are extinguished and before the registration of new mortgage is completed, security interest granted by a person who is qualified to do so shall be provided. If compensation is paid in the form of cash in consideration of such demolition, the Borrower shall be obligated to cause the mortgagor to deposit the cash compensation into a special deposit account or certificate of deposit, which account or certificate shall be used to secure the Master Obligations.

Article 10 Other Rights and Obligations

1. The Entrustor shall transfer the entrusted funds into its account for entrusted loans on a timely basis. The Lender will not commence disbursement procedures in accordance with the entrustment loan agreement and the loan contract etc. until the entrusted funds of the Entrustor have been deposited into its account for entrusted loans.
2. The funds for Entrusted Loan shall be obtained from legitimate sources and may not be credit-extending fund obtained from the Lender; otherwise the Entrustor shall bear legal liability correspondingly.
3. The Entrustor and the Borrower shall provide true materials, including, without limitation, documents, statements and certificates, required by the Lender.
4. The Borrower shall repay the principal of the Entrusted Loan and interest accrued thereon in the same currency as that of the Borrowing, unless otherwise agreed by the Entrustor and the Borrower.
5. The Entrustor shall be responsible for any pre-loan-extending investigation on the Borrower, the surety or the collaterals and make determination upon the Borrower and the surety or the collaterals after necessary analysis and evaluation. The scope of investigation shall include, without limitation, the purpose of the loan, basic information, credit standing, financial condition of the Borrower and the surety and any other things required to be investigated.
6. The Entrustor shall review the conditions for disbursement of the Entrusted Loan. Once the Loan is disbursed by the Lender, it shall be deemed that the Borrowing shall have satisfied all the conditions for disbursement required by the Entrustor.
7. The Entrustor shall be responsible for the collection of the Entrusted Loan, inspection of the use of the Entrusted Loan, understanding the operating activities and financial condition of the Borrower as well as any disputes and security in relation to any indebtedness of the Borrower.
8. Each of the Entrustor and the Lender shall have the right to monitor the use of the Borrowing by the Borrower.
9. The Entrustor shall be entitled to take measures, such as litigation or arbitration, in accordance with applicable law or this Agreement, to recover the principal and interest of the Loan, and the Lender shall give any assistance required for therefor.
10. The Borrower hereby irrevocably authorizes the Lender to debit from the bank account of the Borrower the necessary amount in repayment of the principal of the Entrusted Loan and the interest accrued thereon.

11. If the Borrower fails to repay any principal of the Loan or any interest accrued thereon as agreed under this Agreement, the Entrustor shall assume any Loan Risks in relation to the Entrusted Loan, and shall not require the Lender to assume any liability for reasons that the Lender fails to perform appropriate supervision, fails to promptly notify the Entrustor of any delay in repayment or any other reasons. Any dispute between the Entrustor and the Borrower shall be irrelevant to the Lender.
12. Unless otherwise agreed by the parties hereto, neither the Entrustor nor the Borrower may require the Lender to assume any other obligations or risks.
13. Where the Entrustor authorizes the Lender to initiate a lawsuit or arbitration on its behalf, it shall advance to the Lender the Expenses for the Enforcement of Obligations, including, without limitation, fees in relation to litigation, arbitration, asset preservation, application for enforcement, announcement, appraisal, evaluation, auction, sale, communication, travel and accommodation and disposal, as well as attorney's fee.

Article 11 Acceleration of Loan

1. During the Tenor of the Borrowing, if the Borrower or the surety (i.e., the guarantor or the mortgagor under this Agreement) commits any of the following, the Entrustor shall have the right to cease any disbursement of any amount under this Agreement that has not been disbursed, and accelerate all or portion of the principal and interest of the Loan. Where the Borrowing is repaid in installments and the Entrustor accelerates any one of the installments in accordance with this Agreement, all the other installments that have not become due may be deemed due and payable:

- (1) It provides any false materials or conceals any material operating or financial matters, or any certificate or document submitted to the Entrustor or the Lender or any representations or warranties under Article 9 of this Agreement is proved to be untrue, inaccurate, incomplete or willful misleading;
- (2) It changes the intended purpose of the Borrowing without consent of the Entrustor, or misappropriates any Borrowing or use any Borrowing in any illegal or non-compliant transactions;
- (3) It refuses to accept any supervision or inspection of the Entrustor or the Lender on its use of the loan proceeds and the relevant operating or financial activities;
- (4) It carries out any significant merger, acquisition or restructuring, which, in the view of the Entrustor, may affect the repayment of the Borrowing;
- (5) It intentionally evades from or invalidating any debt through related party transactions;
- (6) Its credit standing deteriorates and its ability to repay any indebtedness, including any contingent liability, apparently weakens;
- (7) The Borrower fails to repay any principals and interest of or any expenses relating to any Borrowing when they become due and payable;
- (8) The Borrower ceases repayment of its indebtedness or is unable to or indicate that it is unable to repay any indebtedness due and payable;

(9) The Borrower stops production, ceases its business, is declared bankrupt, dissolves, is cancelled, is involved in any material economic dispute or its financial condition deteriorates or its business license is revoked;

(10) The Borrower fails to perform any of its obligations under Article 10 or any other obligations under this Agreement, or the surety fails to perform its obligations under the security agreement;

(11) The value of any assets subject to mortgage or pledge decreases or potentially decreases, or the right of pledge requires to be enforced prior to the date the Borrowing becomes due and payable; and

(12) any other events that adversely affect or damage or potentially adversely affect or damage any rights or interests of the Entrustor or the Lender.

2. In the event of acceleration of the Loan, the Entrustor shall be entitled to take appropriate measures under Article 12.1 and Article 12.5.

Article 12 Default Liability

1. If the Borrower is in breach of any provision under this Agreement or the Lender is unable to perform its obligation due to any reason attributable to the Borrower, the Borrower shall bear the following liability for its breach of Agreement to the Entrustor:

(1) if the Entrusted Loan has not been disbursed, the Entrustor shall have the right to terminate this Agreement and cease disbursement of the Entrusted Loan;

(2) if the Entrusted Loan has not become due, the Entrustor shall have the right to terminate this Agreement and accelerate the principal and interest of the Entrusted Loan;

(3) if the Entrusted Loan has become overdue, the Entrustor shall have be entitled to overdue penalty interest;

(4) if the Borrower misappropriates the Entrusted Loan, the Entrustor shall be entitled to penalty interest for the misappropriation;

(5) the Entrustor shall be entitled to take actions to enforce the obligations of the Borrower hereunder, and any fees and expenses in connection with such enforcement shall be born by the Borrower; and

(6) the Entrustor shall have the right to require the Borrower to indemnify it against any other economic loss.

2. If the Entrustor breaches this Agreement or the Lender is unable to perform its obligation due to any reason attributable to the Entrustor, the Entrustor shall bear the following liability to the Borrower:

(1) if the Entrusted Loan fails to be disbursed on time, the Entrustor shall disburse the Entrusted Loan as soon as possible; and

(2) the Entrustor shall indemnify the Borrower against any economic losses.

3. If the Lender breaches this Agreement, the Lender shall indemnify the Entrustor or the Borrower, as the case may be, against its economic losses in accordance with law.

4. If the Entrustor/the Borrower fails to timely pay any handling charge, the Lender shall be entitled to liquidated damages on a daily basis in an amount equal to 1 % of any unpaid handling charge.

The Entrustee shall be entitled to debit the necessary amount from the account of the Entrustor in satisfaction of any liquidated damages required to be paid by the Entrustor. The Entrustor shall be responsible for procuring the Borrower to pay any liquidated damages owed by the Borrower. If the Borrower fails to duly pay the liquidated damages, the Entrustor agrees to make such payment on behalf of the Borrower, and the Entrustee shall be entitled to debit the corresponding amount from the account of the Entrustor.

5. In the event that the surety under this Agreement (i.e., the guarantor, mortgagor or pledgor) incurs any of the following events, the Entrustor shall have the right to take measures under 12.1:

(1) The guarantor fails to perform its obligations under the applicable guarantee agreement, or its credit standing deteriorates, or it incurs any other events that weaken its ability of guarantee;

(2) The mortgagor fails to perform its obligations under the applicable mortgage agreement, or intentionally damages or destroys the mortgaged assets, or the value of the mortgaged assets apparently decreases or may decrease, or it incurs any other events that prejudice the mortgage rights of the Lender; or

(3) The pledgor fails to perform its obligations under the applicable pledge agreement, or the value of the pledged assets apparently decreases or may decrease, or the right of pledge has to be enforced prior to the satisfaction of the Borrowing, or it incurs any other events that prejudice the right of pledge of the Lender.

Article 13 Continuity of Obligations

All obligations of the Borrower under this Agreement shall be continuous and shall have full and equal binding effect on its successor, agent, receiver, assigns and surviving entity.

Article 14 Right to Set Off

In case the Borrower or the surety fails to perform its liabilities or breaches its obligations under this Agreement which results in acceleration of its liabilities hereunder, the Lender shall have the right to debit the necessary amount from any account of the Borrower opened with the Lender for repayment. If the currency under such account of the Borrower is different from the currency of the Master Obligations, it shall be converted at the buying rate published by the Lender on the date of debiting.

Article 15 Extension of the Tenor

1. The Borrower may request for extension of the Tenor upon the expiration of the Entrusted Loan.
2. The Borrower shall submit written application for extension to the Lender _____ Workdays prior to the expiration of the Entrusted Loan, provided that the application shall be approved by the Entrustor and the surety in writing.
3. If the Entrustor approves the extension, the Lender shall enter into a supplemental agreement for the extension of the Entrusted Loan with the Borrower, the Entrustor and the surety. If the Entrustor refuses to approve the extension, the Borrower shall perform its obligations hereunder in accordance with this Agreement.

Article 16 Governing Law, Jurisdiction and Dispute Resolution

1. This Agreement shall be governed by and construed in accordance with the PRC law, and any dispute in connection with this Agreement shall be resolved in accordance with the PRC law.
2. In case of any controversy or dispute in connection with this Agreement arising from the performance of this Agreement, such controversy or dispute may be resolved through negotiation. If such negotiation fails, such controversy or dispute shall be resolved in accordance with the method set forth in Item (2) below:
 - (1) to institute legal proceedings before the court at the place of execution of this Agreement;
 - (2) to refer the controversy or dispute to Shenzhen Arbitration Commission for arbitration under its then effective arbitration rules (in Shenzhen). An arbitral award by Shenzhen Arbitration Commission shall be final and binding on all the parties involved in arbitration; or
 - (3) any other ways of dispute resolution: _____.
3. During the period when a controversy or dispute is pending hereunder, the terms that are not in dispute shall continue to be performed, and the Borrower shall not refuse to perform any obligations under this Agreement on the grounds that any controversy or dispute is pending for resolution.

Article 17 Correspondence, Communications and Notification

1. Any correspondence, communications and notification under this Agreement shall be made in writing and sent to the other party at the address or telex number listed on the cover page of this Agreement, or by other means.
2. If any of the contact information of any party changes, such party shall promptly notify the other parties without any delay. If such party fails to promptly notify the other parties and the other parties send any document, communications or notifications in accordance with the original contact information, any consequences resulting therefrom shall be borne by the party who fails to make such prompt notification.
3. If any document, communication or notification is sent at the above address, it shall be deemed served:

- (1) if sent by mail (including by courier, regular mail or registered mail), five Workdays after it is deposited with a post office;
- (2) if sent by fax or any other electronic means, the day on which it is transmitted; or
- (3) if delivered in person, the day on which the intended recipient signs the acknowledgement of receipt.

Where the Entrustee gives a notice by publishing it on its own website, through its online bank or telephone bank or at its business site, such notice shall be deemed served on the day on which such notice is so published. In no event, may the Entrustee be held liable for any failure, omission or delay in the transmission by any postal service, fax, telephone or any other communication system.

4. The parties agree that the corporate seal, office seal, finance specific seal, contract specific seal, sending and receiving acknowledgement seal and the loan specific seal of the Lender shall be valid seals for the correspondence, communication and notification among the parties. All the staff of the Entrustor and the Borrower shall be the authorized persons to sign on and receive the correspondence, communication and notification sent to and from the Entrustor and the Borrower.

Article 18 Effectiveness and Miscellaneous

1. This Agreement shall become effective upon execution by or affixation with the seal of each party hereto.
2. **During the term of this Agreement, any grace or extension granted by the Entrustor or the Lender to the Borrower or the surety or any delay of the Entrustor or the Lender in the exercise of its rights or interests under this Agreement shall neither prejudice, affect or limit any and all rights or interests of the Entrustor or the Lender under applicable law and this Agreement, nor be deemed a waiver by the Entrustor or the Lender of any rights or interests under this Agreement, nor affect any obligations of the Borrower under this Agreement.**
3. **In response to its business or management needs, the Lender shall have the right to authorize or delegate any other branch of the Bank to exercise its rights and perform its obligations hereunder, including the execution of any relevant contracts, or to transfer the management of a Loan hereunder to any other branch of the Bank, in each case, without consent from the Borrower/Entrustor. The Borrower/Entrustor hereby acknowledges the foregoing.**
4. If, at any time, any term of this Agreement becomes illegal, invalid or unenforceable in any respect, the legality, validity or enforceability of any other terms of this Agreement shall not be affected or prejudiced.
5. Headings are inserted for convenience only and shall not be used for the construction of any provision of this Agreement or any other purposes.
6. The exhibits hereto shall be an integral part of this Agreement and shall have the same legal effect as this Agreement.

7. This Agreement shall be executed in four counterparts, with the Entrustor to hold one, the Lender to hold two and the Borrower to hold one, and each counterpart shall have the same legal effect.

Article 19 Notarization and Voluntary Submission to Enforcement

1. If the Entrustor or the Lender requires this Agreement to be notarized, this Agreement shall be notarized by a notary public authorized by the relevant authority.

2. This Agreement after being notarized shall be enforceable. Where the Borrower fails to perform its liabilities hereunder or in the case of any circumstances agreed hereunder that entitle the Entrustor or the Lender to enforce its rights, the Entrustor or the Lender shall have the right to apply for enforcement to the court with jurisdiction.

Article 20 Supplementary Provisions

Entrustor	Shenzhen Nepstar Pharmaceutical Co., Ltd. (affixed with the corporate seal) Legal representative or agent <u>/s/</u> : Dated September 3, 2014
Lender	Shenzhen Tian'an Branch of Industrial Bank Co., Ltd. (affixed with the corporate seal) Legal representative or agent <u>/s/</u> : Dated September 3, 2014
Borrower	Shenzhen Nepstar Information and Technology Service Co., Ltd. (affixed with the corporate seal) Legal representative or agent <u>/s/</u> : Dated September 3, 2014

ENTRUSTMENT LOAN AGREEMENT
(For Corporate Business)

Serial No.: Xing Yin Shen Tian An Wei Jie Zi (2014) No. 0019

Entrustor: **Shenzhen Nepstar Pharmaceutical Co., Ltd.** (affixed with the corporate seal)

Domicile: A-15B, Shenzhen Nanshan District Haiwang Building

Legal Representative/Principal Officer: Zhang Simin

Contact Person: _____ Title: _____

Mailing Address: Shenzhen Nanshan District Haiwang Building A-15B

Postal Code: 518000 Telex: _____

Telephone Number: 26430133 Facsimile: _____

Lender: **Shenzhen Tian'an Branch of Industrial Bank Co., Ltd. (the "Bank")**

Domicile: Suite 101, Tower 1, Phase 1, Tian An Innovation Technology Square

Legal Representative/Principal Officer: Zhang Pengfeng

Contact Person: Lin Beixiang Title: _____

Mailing Address: Suite 101, Tower 1, Phase 1, Tian An Innovation Technology Square

Postal Code: 518000 Telex: _____

Telephone Number: 83432045 Facsimile: _____

Borrower: **Shenzhen Nepstar Management Consulting Co., Ltd.** (affixed with the corporate seal)

Domicile: 15C, Haiwang Building, Shenzhen Nanshan District Nanyou Avenue

Legal Representative/Principal Officer: Tu Feng

Contact Person: _____ Title: _____

Mailing Address: 15C, Haiwang Building, Shenzhen Nanshan District Nanyou Avenue

Postal Code: 518000 Telex: _____

Telephone Number: _____ Facsimile: _____

Place of Execution: Shenzhen Branch of Industrial Bank Co., Ltd.
Industrial Bank Building, Futian District, Shenzhen

Important Reminder for Agreement Signing

In order to protect your interest, please read through carefully, examine and confirm each of the following items prior to your signing of this agreement:

- I. You have the right to sign this agreement, and you have obtained all the authorizations necessary for your signing hereof to the extent any such authorization of any person is required under any law;**
- II. You have carefully read and fully understood the provisions in this agreement and have paid special attention to those provisions concerning the imposition of liabilities, or release of or limitations on the liabilities of the Bank, and the contents of those sections highlighted in bold;**
- III. Both your company and you yourself have fully understood the meaning of, the corresponding legal consequences that may arise from, and are willing to be bound by, the provisions in this agreement;**
- IV. The draft of this agreement provided by the Bank is a form only. In this draft, there is a blank left after each relevant article, and at the end of the agreement, an article under the heading of “Supplementary Provisions” is inserted for the parties to this agreement to make any amendments, additions or deletions; and**
- V. Where you have any question about this agreement, please promptly consult the Bank.**

Pursuant to the Entrusted Loan Entrustment Agreement by and between the Entrustor and the Lender dated September 3, 2014 numbered as Xing Yin Shen Tian An Wei Tuo Zi (2014) No. 0019, the Lender is entrusted by the Entrustor to disburse the Entrusted Loan (as defined below) to the Borrower. With a view to specifying the responsibilities and to acting in good faith, in accordance with relevant laws and regulations of the People's Republic of China (the "PRC") and after negotiations on an equal footing, the parties hereto hereby enter into this Entrustment Loan Agreement (this "Agreement") for mutual observance.

Article 1 Definitions and Interpretation

Unless otherwise agreed in writing among the parties hereto, when used in this Agreement, the following terms shall be defined and interpreted as follows:

1. **"Entrusted Loan"** means a loan that shall be disbursed by the Lender (i.e., the Trustee) for and on behalf of the Entrustor to a specific person, for specific purposes, in a specific amount, for a specific tenor and at a specific interest rate determined by the Entrustor from the funds provided by the Entrustor to the Lender, and shall be recovered with the assistance of the Lender. In connection with each Entrusted Loan, the Lender shall receive the charges only and not take any risks in any form.

A "Loan" means a monetary amount disbursed to the Borrower by the Lender hereunder upon the entrustment of the Entrustor.

A "Borrowing" means a monetary amount received by the Borrower from the Lender after the Borrower's request to the Lender for Borrowing is reviewed and approved by the Lender, in each case in accordance with this Agreement.

Each party hereto agrees and acknowledges that the monetary amount disbursed to the Borrower by the Lender hereunder shall be consistent to the monetary amount received by the Borrower from the Lender hereunder.

2. **"Loan Risks"** includes without limitation, legal and policy risks, credit risks, market risks, operational risks, force majeure risks and any other risks.

"Legal and Policy Risks" means the risks that any Entrusted Loan is rendered unable to be recovered on time or both on time and in full as a result of any modification of or change in applicable laws or regulations of the People's Republic of China.

"Credit Risks" means the risks arising from any failure of the Borrower to satisfy its obligations for repayment under this Agreement.

"Market Risks" means the risks that any Entrusted Loan is rendered unable to be recovered on time or both in full and on time as a result of any change in macro policies, economic cycle, market price or any other similar factors.

"Operational Risks" means the risks that any Entrusted Loan is rendered unable to be recovered on time or both in full and on time as a result of any incomplete or problematic procedures or improper management actions in the course of the disbursement and management of such Entrusted Loan.

“Force Majeure Risks” means the risks that any Entrusted Loan is rendered unable to be recovered on time or both in full and on time as a result of the occurrence of any objective circumstances that are unforeseeable, unavoidable or insurmountable by either the Entrustor or the Entrustee.

“Other Risks” means any other risks that may render any Entrusted Loan unable to be recovered on time or both in full and on time, excluding those described above.

3. **“Obligations”** or **“Master Obligations”** means the RMB obligations generated from the disbursement of any Loan to the Borrower (the debtor) by the Lender (the creditor) after having reviewed and approved the applicable request from the Borrower, including the principal amounts, interest, default interest, compound interest, liquidated damages, indemnities and the Expenses for the Enforcement of the Obligations incurred by the Lender.

Each of the parties hereto agrees and acknowledges that the Obligations of the Borrower towards the Lender under this Agreement shall be consistent to the debts of the Borrower owed to the Lender under this Agreement.

4. **“Expenses for the Enforcement of Obligations”** includes without limitation, costs and expenses for litigations, arbitrations, property preservation, applications for enforcement, attorney fees and expenses, public announcements, appraisals, verifications, auctions, realizations, telecommunications, travels and disposals.

5. **“Workday”** used herein means a business day of the Lender; where in the course of the performance of this Agreement, any drawdown date or repayment date falls on a date that is not a business day of the Lender, the drawdown or repayment shall be put off till the immediately following business day of the Lender.

6. For purposes of this Agreement, the following terms shall be defined and interpreted as follows:

“PBOC RMB Loan Benchmark Rate” means the benchmark interest rate for RMB loans published by the People’s Republic of China (“PBOC”) that is effective from time to time.

“PBOC RMB Deposit Benchmark Rate” means the benchmark interest rate for RMB deposits published by the People’s Republic of China (“PBOC”) that is effective from time to time.

“LPR” means the loan prime rate calculated and published by the National Interbank Funding Center based on the best loan interest rates offered by quoting banks that is effective from time to time.

“SHIBOR” means the Shanghai Interbank Offered Rate calculated and published by the National Interbank Funding Center that is effective from time to time.

“LIBOR” means the T-2 Day London Interbank Offered Rate prevailing on London financial market, which covers such currencies as USD, Euro Dollar, and Japanese Yen. Of which, T means the date on which the loan is actually disbursed; T-2 means the second Workday prior to the date on which the loan is actually disbursed. The definition of T and T-2 shall be applicable to all sections below.

“HIBOR” means the T-2 Day Hongkong Interbank Offered Rate prevailing on Hong Kong financial market.

Article 2 Amount of the Borrowing

The Borrowing under this Agreement shall be in an amount of RMB Twenty-Nine Million, Two Hundred and Sixty Thousand only.

Article 3 Purposes of the Borrowing

The Borrowing received hereunder shall be applied towards the funding of working capital requirements. Without prior written consent of the Entrustor, the Borrower may not apply any part of the Borrowing towards any other purpose.

Article 4 Tenor of the Borrowing

1. The tenor of the Borrowing hereunder shall be 12 months, starting on September 3, 2014 and ending on September 3, 2015 (the "Tenor").
2. Where the Loan is to be disbursed in a lump-sum, the date of actual disbursement as recorded on the receipt of borrowing and/or certificate of borrowing shall be deemed as the disbursement date. Where the date of actual disbursement is later than the disbursement date so recorded, the Tenor shall be extended accordingly.

[N/A 3. Pursuant to the instructions of the Entrustor, the Borrowing shall be disbursed by installments in accordance with the following schedule:

On ____*[insert the applicable date]*, RMB ____*[insert the applicable amount]*; On ____*[insert the applicable date]*, RMB ____*[insert the applicable amount]*;

On ____*[insert the applicable date]*, RMB ____*[insert the applicable amount]*; On ____*[insert the applicable date]*, RMB ____*[insert the applicable amount]*;

On ____*[insert the applicable date]*, RMB ____*[insert the applicable amount]*; On ____*[insert the applicable date]*, RMB ____*[insert the applicable amount]*;

The Lender shall transfer each of the relevant amounts as specified above to the account of the Borrower on each of the dates as specified above.]

4. Where the Loan is to be utilized by installments, all the installments shall expire on the same day, or in other words, all the installments disbursed separately shall expire simultaneously on the expiration date specified on the receipt of borrowing and/the certificate of borrowing for the first installment.
5. In the event that the Lender accelerates the Loan under the circumstances set forth herein or in accordance with the instructions of the Entrustor, it shall be deemed that expiration date of the Tenor is accelerated accordingly.

Article 5 Interest Rate and Payment of Interest

As agreed between the Entrustor and the Borrower, interest shall accrue on the Borrowing at the interest rate as follows (the "Interest Rate"):

1. Interest Rate

(1) The pricing benchmark rate shall be the one set forth in Item N/A below:

- (i) PBOC RMB Loan Benchmark Rate for N/A tenor.
- (ii) PBOC RMB Deposit Benchmark Rate for N/A tenor.
- (iii) LPR for N/A tenor.
- (iv) SHIBOR for N/A tenor.
- (v) LIBOR for N/A tenor.
- (vi) HIBOR for N/A tenor.

(2) The Interest Rate shall be determined at the pricing formula set forth in Item N/A below:

- (i) Interest Rate = pricing benchmark rate + N/A %.
- (ii) Interest Rate = pricing benchmark rate × N/A %.

(3) The Interest Rate (meaning a rate per annum, which is applicable to all sections below) shall be determined in accordance with the provisions set forth in Item N/A below:

- (i) a fixed rate, which shall be determined based on the pricing benchmark rate effective on the date of actual disbursement of the Borrowing and the pricing formula, and shall remain unchanged during the Tenor.
- (ii) a floating rate, which shall be determined based on the pricing benchmark rate and the pricing formula effective on the date of actual disbursement of the Borrowing and the date of adjustment of interest rate (the "Date of Interest Rate Adjustment"). The Date of Interest Rate Adjustment shall be determined in accordance with the provisions set forth in Item N/A below:

A. The Interest Rate hereunder shall be adjusted on a(an) N/A [monthly/quarterly/semi-annual/ yearly/other time period] basis, and on each [monthly/quarterly/semi-annual/ yearly/other time period] anniversary of the date of actual disbursement of the Borrowing, which shall be an Interest Rate Adjustment Date; and for any month that does not have a date correspond to such anniversary, the last day of such month shall be deemed an Interest Rate Adjustment Date.

B. N/A.

In case of any adjustment to the benchmark rate during the Tenor, no notice will be given to the Borrower.

(iii) any other interest rate: [N/A].

(4) Where the Borrowing is disbursed by installments, the interest rate applicable to each installment shall be determined based on the benchmark rate effective on the date of actual disbursement of such installment (or the applicable Date of Interest Rate Adjustment).

(5) In the event that the benchmark rate is canceled by the PRC government or is not available any more on the market, the Entrustor hereby authorizes the Lender to redetermine the Interest Rate in accordance with the applicable PRC policies concerning interest rate, by adhering to the principal of fairness and good faith and by reference to the industrial practice, the status of the interest rate and any other similar factor. In case the Borrower has any disagreement thereon, it shall consult with the Entrustor. Where such disagreement fails to be resolved through such consultation, the Entrustor shall have the right to accelerate the Loan and the Borrower shall immediately pay any and all the principal and accrued interest then outstanding.

2. Manners of Payment of Interest

(1) Calculation of Interest. Interest shall accrue on the principal of the Borrowing, whether in RMB or foreign currency, starting from the date on which the Borrowing is transferred into an account of the Borrower by the Lender under this Agreement. The interest to accrue on the Borrowing per day = amount outstanding under the Borrowing that day \times daily interest rate. The conversion between daily rate and annual rate shall be conducted in accordance with the applicable PBOC regulations and international practice.

(2) The interest accrued on the Borrowing shall be paid in the manners set forth in Item N/A below:

(i) it is agreed hereunder that the 20th day of each calendar month/the last month of each calendar quarter/the last month of each half year/the last month of each calendar year/other time period shall be an interest settlement date (an "Interest Settlement Date"), and the Borrower shall pay the Lender the accrued interest for the current Interest Period on the day immediately after the current Interest Settlement Date; provided, however, any and all the principal and interest outstanding under the Borrowing shall be paid on the expiration date of the Tenor.

(ii) The date that falls on the day immediately preceding the _____ monthly/quarterly/semi-annual/ yearly/other time period anniversary of the date of actual disbursement of the Borrowing (or for any month that does not have a date corresponding to such anniversary, the last day of such month shall be deemed an anniversary) shall be an interest settlement date (an "Interest Settlement Date"). The Borrower shall pay the Lender the accrued interest for the current Interest Period on the day immediately after the current Interest Settlement Date; provided, however, that the interest for the last Interest Period shall be paid on the expiration date of the Tenor.

(iii) any alternative manners for the payment of interest _____.

3. Default Interest and Compound Interest

(1) In the event that the Borrower misappropriates any amount of the Borrowing for any purpose other than those specified herein, the Entrustor hereby authorizes the Lender to charge compound interest on such amount so misappropriated at a default interest rate equal to the Interest Rate plus its 50%. In the event that the Borrower fails to repay any amount of the Loan and fails to reach agreement with the Entrustor on the extension of the Tenor, and as result, such amount becomes delinquent, the Entrustor hereby authorizes the Lender to charge default interest on such delinquent amount at a default interest rate equal to the Interest Rate plus its 50%. In the event that any interest accrued on the Loan fails to be paid on time, the Entrustor hereby authorizes the Lender to charge compound interest at the default interest rate applicable to the delinquent amount specified above.

(2) Where the Interest Rate is a fixed rate, the default interest rate shall also be a fixed one; and accordingly, where the Interest Rate is a floating rate, the default interest rate shall also be a floating one. The floating period of the default interest shall be consistent to that of the Interest Rate.

(3) The default interest and the compound interest shall be calculated and collected in the same way as the regular interest on the Loan set forth herein.

Article 6 Repayment of the Principal

1. The principal of the Borrowing hereunder shall be repaid in the manners set forth in Item (A) below:

(A) The principal of the Borrowing shall be repaid in a lump-sum on the expiration date of the Tenor.

(B) The principal of the Borrowing shall be repaid by installments in accordance with the following repayment schedule:

On ____[insert the applicable date], RMB ____[insert the applicable amount]; On ____[insert the applicable date], RMB ____[insert the applicable amount];

On ____[insert the applicable date], RMB ____[insert the applicable amount]; On ____[insert the applicable date], RMB ____[insert the applicable amount];

On ____[insert the applicable date], RMB ____[insert the applicable amount]; On ____[insert the applicable date], RMB ____[insert the applicable amount];

(C) Any alternative manners for the repayment of the principal: _____.

2. On each repayment date and Interest Settlement Date specified in this Agreement, the Borrower shall punctually and in full, repay the principal of and the accrued interest on any amount of the Borrowing received hereunder. In the event that the Borrower fails to repay punctually any principal of or interest on any amount of the Borrowing, the Lender shall have the right to debit from any account of the Borrower maintained with the Lender or any organization within the system of the Lender the necessary amount in satisfaction of the fees, expenses, principal and interest due from the Borrower in accordance with the applicable regulations concerning banking accounting and in the order stipulated in the internal rules of the Lender.

3. Where a repayment date falls on a date that is not a business day of the Lender, the repayment shall be put off till the immediately following business day of the Lender; provided, however, that such date that is not a business day shall be included into the number of days during which the Loan is actually occupied. At the repayment of the last amount of the principal of the Borrowing, any and all the accrued interest that remains outstanding by then shall be paid simultaneously, regardless of the provisions concerning the Interest Settlement Date set forth in Article 5 above.

4. Subject to the review and consent of the Entrustor, the Borrower may prepay the whole or any part of the principal of the Entrusted Loan.

Article 7 Handling Charges

1. The Lender shall receive handling charges equal to 1‰ of the amount of the Entrusted Loan. The handling charges shall be paid by the Entrustor in a lump-sum prior to the disbursement of the Borrowing. The Entrustee shall be entitled to debit the handling charges directly from any account of the Entrustor.

Article 8 Security

[N/A 1. The borrowing contemplated hereunder shall be secured by the security interest to be provided by the guarantors acceptable to the Entrustor under the following security agreement(s):

(1) the _____ [insert name of the security agreement] numbered as _____, under which the security is provided in the form of _____, and the guarantor is _____;

(2) the _____ [insert name of the security agreement] numbered as _____, under which the security is provided in the form of _____, and the guarantor is _____; and

(3) the _____ [insert name of the security agreement] numbered as _____, under which the security is provided in the form of _____, and the guarantor is _____.]

2. Until the execution and effectiveness of each and all the security agreements hereunder and the completion of all the required procedures for the perfection of the security created thereunder, the Lender shall have the right to withhold the performance of such obligations as for the disbursement of the Loan.

Article 9 Representations and Undertakings of the Borrower

The Borrower hereby voluntarily makes the following representations and undertakings and will assume the legal liabilities for the truth thereof:

1. The Borrower is a legal entity established and validly existing under the laws of the PRC, and has the full capacity for civil conduct. The Borrower undertakes that it will, at the request of the Entrustor or the Lender, provide the relevant certificates, permits and licenses as well as any other documents as requested by the Entrustor or the Lender from time to time.

2. The Borrower has the full power to perform all its obligations and responsibilities under this Agreement, and its liabilities for repayment hereunder will not be relieved or released as a result of any order, any change of its financial status, or any agreement with any person.

3. The Borrower has the full power, authorization and legal right to execute this Agreement, and has obtained or completed (i) any and all the internal corporate approvals, authorizations and any other relevant procedures, and (ii) any and all the approvals, registrations, authorizations, consents, permits and any other relevant procedures from or with any required governmental or regulatory authorities necessary for its execution and performance of this Agreement, and all such approvals, registrations, authorizations, consents, permits and any other relevant procedures are in full legal force and effect.

4. The execution of this Agreement by the Borrower fully complies with the relevant articles of association, internal decisions, or shareholder or board resolutions of the Borrower. This Agreement does not conflict with or violate any of the articles of association, internal decisions, shareholder or board resolutions or policies of the Borrower.
5. The execution and performance of this Agreement are based on the expression of the real intentions of the Borrower. The execution and the performance of this Agreement do not violate any provision of any law, regulation, rule or contract by which the Borrower is bound. This Agreement is legal, valid and enforceable. The Borrower shall, promptly and on an unconditional basis, indemnify the Entrustor and the Lender against any and all the losses arising from the invalidity of this Agreement due to any flaw in the right of the Borrower to the execution and performance of this Agreement.
6. Any and all the documents, financial statements and other materials provided by the Borrower to the Entrustor or the Lender hereunder are true, complete, accurate and effective, and the Borrower will maintain all the financial indices required by the Entrustor of the Lender.
7. The Borrower agrees that the borrowing contemplated hereunder shall be bound by the rules and customary practice of the Lender, which shall be subject to the interpretation of the Lender.
8. In the event that the Borrower fails to perform any of the Obligations hereunder, it hereby authorizes the Lender to debit directly the corresponding amount from any account of the Borrower maintained with the Lender or any organization within the system of the Lender.
9. No matter at what stage of the transaction after the execution of this Agreement, where the Borrower submits to the Lender for review and approval of any document relating to any specific transaction, the Borrower shall ensure the truth of all such documents. The Lender will make a decision on the apparent truth of any transaction documents, not participate in or know the substance of any specific transaction conducted by the Borrower, and not assume any liabilities therefor.
10. The Borrower hereby acknowledges that other than those disclosed to the Entrustor or the Lender, the Borrower does not know any of the following circumstances, whether pending or threatened, which may result in the Entrustor or the Lender refusing to disburse the Borrowing hereunder:
- (1) any obligations or contingent liabilities to which the Borrower is subject, including without limitation, any mortgage, pledge, lien or any other encumbrance created on any assets or income of the Borrower that has not been disclosed to the Lender;
 - (2) any material noncompliance of discipline, violation of law, or claim involving the Borrower or any of its senior officers;

- (3) any default by the Borrower under any agreement between the Borrower and any of its other creditors relating to obligations or creditor rights;
- (4) there has not occurred and does not exist any litigation, arbitration or administrative proceedings pending, or to the knowledge of the Borrower threatened, against the Borrower or any of its assets, and the Borrower is not subject to any liquidation or winding-up or any other similar proceedings by or against the Borrower; or
- (5) Any other circumstances which may have an adverse effect on the Borrower's financial status or ability to repay debts.
11. The Borrower hereby undertakes that it will apply the Borrowing towards the purposes specified herein, not misappropriate nor will it allow any amount of the Borrowing to be applied towards any purpose in violation of the intent of this Agreement. The Borrower shall subject itself to and cooperate with the Entrustor or the Lender in the supervision, inspection and check by the Entrustor or the Lender from time to time on the utilization of the Borrowing, the operational and financial activities, inventory, assets and liabilities, bank deposits and cash on hand of the Borrower, or any other requirement deemed necessary or advisable by the Entrustor or the Lender.
12. The Borrower shall provide adequate and valid security or any other security deemed appropriate or acceptable by the Entrustor.
13. The Borrower may not allow its registered capital to be reduced in any way. Without prior written consent of the Entrustor, the Borrower may not transfer its obligations hereunder to any third party, whether in whole or in part. Prior to the full satisfaction of all its obligations hereunder, the Borrower may not satisfy any of its obligations owed to any of its creditors prior to the same falling due.
14. In the event that the Lender is involved in any dispute between the Borrower and any third party as a result of any litigation or arbitration or any other dispute between the Lender and the Borrower or any third party related to the Borrower due to the Lender's performance of its obligations hereunder, the Borrower shall indemnify the Lender against any and all the litigation or arbitration costs and expenses, attorney fees, and any other costs and expenses paid by the Lender in connection therewith.
15. The Borrower shall conduct all the settlement business arising under this Agreement through a settlement account opened by it with the Lender.
16. In the event that the security interest granted hereunder is in the form of mortgage on building(s), the Borrower shall have the obligation to promptly notify both the Entrustor and the Lender upon being aware of any information that the mortgaged building(s) may be demolished. Where the mortgaged building(s) is/are demolished, if compensation is paid in the form of property in consideration of such demolition, the Entrustor or the Lender shall have the right to request the Borrower to prepay the indebtedness owed hereunder or create a new mortgage and enter into a new mortgage agreement. During the period after the original mortgaged building(s) is/are extinguished and before the registration of new mortgage is completed, security interest granted by a person who is qualified to do so shall be provided. If compensation is paid in the form of cash in consideration of such demolition, the Borrower shall be obligated to cause the mortgagor to deposit the cash compensation into a special deposit account or certificate of deposit, which account or certificate shall be used to secure the Master Obligations.

Article 10 Other Rights and Obligations

1. The Entrustor shall transfer the entrusted funds into its account for entrusted loans on a timely basis. The Lender will not commence disbursement procedures in accordance with the entrustment loan agreement and the loan contract etc. until the entrusted funds of the Entrustor have been deposited into its account for entrusted loans.
2. The funds for Entrusted Loan shall be obtained from legitimate sources and may not be credit-extending fund obtained from the Lender; otherwise the Entrustor shall bear legal liability correspondingly.
3. The Entrustor and the Borrower shall provide true materials, including, without limitation, documents, statements and certificates, required by the Lender.
4. The Borrower shall repay the principal of the Entrusted Loan and interest accrued thereon in the same currency as that of the Borrowing, unless otherwise agreed by the Entrustor and the Borrower.
5. The Entrustor shall be responsible for any pre-loan-extending investigation on the Borrower, the surety or the collaterals and make determination upon the Borrower and the surety or the collaterals after necessary analysis and evaluation. The scope of investigation shall include, without limitation, the purpose of the loan, basic information, credit standing, financial condition of the Borrower and the surety and any other things required to be investigated.
6. The Entrustor shall review the conditions for disbursement of the Entrusted Loan. Once the Loan is disbursed by the Lender, it shall be deemed that the Borrowing shall have satisfied all the conditions for disbursement required by the Entrustor.
7. The Entrustor shall be responsible for the collection of the Entrusted Loan, inspection of the use of the Entrusted Loan, understanding the operating activities and financial condition of the Borrower as well as any disputes and security in relation to any indebtedness of the Borrower.
8. Each of the Entrustor and the Lender shall have the right to monitor the use of the Borrowing by the Borrower.
9. The Entrustor shall be entitled to take measures, such as litigation or arbitration, in accordance with applicable law or this Agreement, to recover the principal and interest of the Loan, and the Lender shall give any assistance required for therefor.
10. The Borrower hereby irrevocably authorizes the Lender to debit from the bank account of the Borrower the necessary amount in repayment of the principal of the Entrusted Loan and the interest accrued thereon.

11. If the Borrower fails to repay any principal of the Loan or any interest accrued thereon as agreed under this Agreement, the Entrustor shall assume any Loan Risks in relation to the Entrusted Loan, and shall not require the Lender to assume any liability for reasons that the Lender fails to perform appropriate supervision, fails to promptly notify the Entrustor of any delay in repayment or any other reasons. Any dispute between the Entrustor and the Borrower shall be irrelevant to the Lender.
12. Unless otherwise agreed by the parties hereto, neither the Entrustor nor the Borrower may require the Lender to assume any other obligations or risks.
13. Where the Entrustor authorizes the Lender to initiate a lawsuit or arbitration on its behalf, it shall advance to the Lender the Expenses for the Enforcement of Obligations, including, without limitation, fees in relation to litigation, arbitration, asset preservation, application for enforcement, announcement, appraisal, evaluation, auction, sale, communication, travel and accommodation and disposal, as well as attorney's fee.

Article 11 Acceleration of Loan

1. During the Tenor of the Borrowing, if the Borrower or the surety (i.e., the guarantor or the mortgagor under this Agreement) commits any of the following, the Entrustor shall have the right to cease any disbursement of any amount under this Agreement that has not been disbursed, and accelerate all or portion of the principal and interest of the Loan. Where the Borrowing is repaid in installments and the Entrustor accelerates any one of the installments in accordance with this Agreement, all the other installments that have not become due may be deemed due and payable:

- (1) It provides any false materials or conceals any material operating or financial matters, or any certificate or document submitted to the Entrustor or the Lender or any representations or warranties under Article 9 of this Agreement is proved to be untrue, inaccurate, incomplete or willful misleading;
- (2) It changes the intended purpose of the Borrowing without consent of the Entrustor, or misappropriates any Borrowing or use any Borrowing in any illegal or non-compliant transactions;
- (3) It refuses to accept any supervision or inspection of the Entrustor or the Lender on its use of the loan proceeds and the relevant operating or financial activities;
- (4) It carries out any significant merger, acquisition or restructuring, which, in the view of the Entrustor, may affect the repayment of the Borrowing;
- (5) It intentionally evades from or invalidating any debt through related party transactions;
- (6) Its credit standing deteriorates and its ability to repay any indebtedness, including any contingent liability, apparently weakens;
- (7) The Borrower fails to repay any principals and interest of or any expenses relating to any Borrowing when they become due and payable;
- (8) The Borrower ceases repayment of its indebtedness or is unable to or indicate that it is unable to repay any indebtedness due and payable;

(9) The Borrower stops production, ceases its business, is declared bankrupt, dissolves, is cancelled, is involved in any material economic dispute or its financial condition deteriorates or its business license is revoked;

(10) The Borrower fails to perform any of its obligations under Article 10 or any other obligations under this Agreement, or the surety fails to perform its obligations under the security agreement;

(11) The value of any assets subject to mortgage or pledge decreases or potentially decreases, or the right of pledge requires to be enforced prior to the date the Borrowing becomes due and payable; and

(12) any other events that adversely affect or damage or potentially adversely affect or damage any rights or interests of the Entrustor or the Lender.

2. In the event of acceleration of the Loan, the Entrustor shall be entitled to take appropriate measures under Article 12.1 and Article 12.5.

Article 12 Default Liability

1. If the Borrower is in breach of any provision under this Agreement or the Lender is unable to perform its obligation due to any reason attributable to the Borrower, the Borrower shall bear the following liability for its breach of Agreement to the Entrustor:

(1) if the Entrusted Loan has not been disbursed, the Entrustor shall have the right to terminate this Agreement and cease disbursement of the Entrusted Loan;

(2) if the Entrusted Loan has not become due, the Entrustor shall have the right to terminate this Agreement and accelerate the principal and interest of the Entrusted Loan;

(3) if the Entrusted Loan has become overdue, the Entrustor shall have be entitled to overdue penalty interest;

(4) if the Borrower misappropriates the Entrusted Loan, the Entrustor shall be entitled to penalty interest for the misappropriation;

(5) the Entrustor shall be entitled to take actions to enforce the obligations of the Borrower hereunder, and any fees and expenses in connection with such enforcement shall be born by the Borrower; and

(6) the Entrustor shall have the right to require the Borrower to indemnify it against any other economic loss.

2. If the Entrustor breaches this Agreement or the Lender is unable to perform its obligation due to any reason attributable to the Entrustor, the Entrustor shall bear the following liability to the Borrower:

(1) if the Entrusted Loan fails to be disbursed on time, the Entrustor shall disburse the Entrusted Loan as soon as possible; and

(2) the Entrustor shall indemnify the Borrower against any economic losses.

3. If the Lender breaches this Agreement, the Lender shall indemnify the Entrustor or the Borrower, as the case may be, against its economic losses in accordance with law.

4. If the Entrustor/the Borrower fails to timely pay any handling charge, the Lender shall be entitled to liquidated damages on a daily basis in an amount equal to 1 % of any unpaid handling charge.

The Entrustee shall be entitled to debit the necessary amount from the account of the Entrustor in satisfaction of any liquidated damages required to be paid by the Entrustor. The Entrustor shall be responsible for procuring the Borrower to pay any liquidated damages owed by the Borrower. If the Borrower fails to duly pay the liquidated damages, the Entrustor agrees to make such payment on behalf of the Borrower, and the Entrustee shall be entitled to debit the corresponding amount from the account of the Entrustor.

5. In the event that the surety under this Agreement (i.e., the guarantor, mortgagor or pledgor) incurs any of the following events, the Entrustor shall have the right to take measures under 12.1:

(1) The guarantor fails to perform its obligations under the applicable guarantee agreement, or its credit standing deteriorates, or it incurs any other events that weaken its ability of guarantee;

(2) The mortgagor fails to perform its obligations under the applicable mortgage agreement, or intentionally damages or destroys the mortgaged assets, or the value of the mortgaged assets apparently decreases or may decrease, or it incurs any other events that prejudice the mortgage rights of the Lender; or

(3) The pledgor fails to perform its obligations under the applicable pledge agreement, or the value of the pledged assets apparently decreases or may decrease, or the right of pledge has to be enforced prior to the satisfaction of the Borrowing, or it incurs any other events that prejudice the right of pledge of the Lender.

Article 13 Continuity of Obligations

All obligations of the Borrower under this Agreement shall be continuous and shall have full and equal binding effect on its successor, agent, receiver, assigns and surviving entity.

Article 14 Right to Set Off

In case the Borrower or the surety fails to perform its liabilities or breaches its obligations under this Agreement which results in acceleration of its liabilities hereunder, the Lender shall have the right to debit the necessary amount from any account of the Borrower opened with the Lender for repayment. If the currency under such account of the Borrower is different from the currency of the Master Obligations, it shall be converted at the buying rate published by the Lender on the date of debiting.

Article 15 Extension of the Tenor

1. The Borrower may request for extension of the Tenor upon the expiration of the Entrusted Loan.
2. The Borrower shall submit written application for extension to the Lender 30 Workdays prior to the expiration of the Entrusted Loan, provided that the application shall be approved by the Entrustor and the surety in writing.
3. If the Entrustor approves the extension, the Lender shall enter into a supplemental agreement for the extension of the Entrusted Loan with the Borrower, the Entrustor and the surety. If the Entrustor refuses to approve the extension, the Borrower shall perform its obligations hereunder in accordance with this Agreement.

Article 16 Governing Law, Jurisdiction and Dispute Resolution

1. This Agreement shall be governed by and construed in accordance with the PRC law, and any dispute in connection with this Agreement shall be resolved in accordance with the PRC law.
2. In case of any controversy or dispute in connection with this Agreement arising from the performance of this Agreement, such controversy or dispute may be resolved through negotiation. If such negotiation fails, such controversy or dispute shall be resolved in accordance with the method set forth in Item (2) below:
 - (1) to institute legal proceedings before the court at the place of execution of this Agreement;
 - (2) to refer the controversy or dispute to Shenzhen Arbitration Commission for arbitration under its then effective arbitration rules (in Shenzhen). An arbitral award by Shenzhen Arbitration Commission shall be final and binding on all the parties involved in arbitration; or
 - (3) any other ways of dispute resolution: _____.
3. During the period when a controversy or dispute is pending hereunder, the terms that are not in dispute shall continue to be performed, and the Borrower shall not refuse to perform any obligations under this Agreement on the grounds that any controversy or dispute is pending for resolution.

Article 17 Correspondence, Communications and Notification

1. Any correspondence, communications and notification under this Agreement shall be made in writing and sent to the other party at the address or telex number listed on the cover page of this Agreement, or by other means.
2. If any of the contact information of any party changes, such party shall promptly notify the other parties without any delay. If such party fails to promptly notify the other parties and the other parties send any document, communications or notifications in accordance with the original contact information, any consequences resulting therefrom shall be borne by the party who fails to make such prompt notification.
3. If any document, communication or notification is sent at the above address, it shall be deemed served:

- (1) if sent by mail (including by courier, regular mail or registered mail), five Workdays after it is deposited with a post office;
- (2) if sent by fax or any other electronic means, the day on which it is transmitted; or
- (3) if delivered in person, the day on which the intended recipient signs the acknowledgement of receipt.

Where the Entrustee gives a notice by publishing it on its own website, through its online bank or telephone bank or at its business site, such notice shall be deemed served on the day on which such notice is so published. In no event, may the Entrustee be held liable for any failure, omission or delay in the transmission by any postal service, fax, telephone or any other communication system.

4. The parties agree that the corporate seal, office seal, finance specific seal, contract specific seal, sending and receiving acknowledgement seal and the loan specific seal of the Lender shall be valid seals for the correspondence, communication and notification among the parties. All the staff of the Entrustor and the Borrower shall be the authorized persons to sign on and receive the correspondence, communication and notification sent to and from the Entrustor and the Borrower.

Article 18 Effectiveness and Miscellaneous

- 1. This Agreement shall become effective upon execution by or affixation with the seal of each party hereto.
- 2. **During the term of this Agreement, any grace or extension granted by the Entrustor or the Lender to the Borrower or the surety or any delay of the Entrustor or the Lender in the exercise of its rights or interests under this Agreement shall neither prejudice, affect or limit any and all rights or interests of the Entrustor or the Lender under applicable law and this Agreement, nor be deemed a waiver by the Entrustor or the Lender of any rights or interests under this Agreement, nor affect any obligations of the Borrower under this Agreement.**
- 3. **In response to its business or management needs, the Lender shall have the right to authorize or delegate any other branch of the Bank to exercise its rights and perform its obligations hereunder, including the execution of any relevant contracts, or to transfer the management of a Loan hereunder to any other branch of the Bank, in each case, without consent from the Borrower/Entrustor. The Borrower/Entrustor hereby acknowledges the foregoing.**
- 4. If, at any time, any term of this Agreement becomes illegal, invalid or unenforceable in any respect, the legality, validity or enforceability of any other terms of this Agreement shall not be affected or prejudiced.
- 5. Headings are inserted for convenience only and shall not be used for the construction of any provision of this Agreement or any other purposes.
- 6. The exhibits hereto shall be an integral part of this Agreement and shall have the same legal effect as this Agreement.

7. This Agreement shall be executed in four counterparts, with the Entrustor to hold one, the Lender to hold two and the Borrower to hold one, and each counterpart shall have the same legal effect.

Article 19 Notarization and Voluntary Submission to Enforcement

1. If the Entrustor or the Lender requires this Agreement to be notarized, this Agreement shall be notarized by a notary public authorized by the relevant authority.

2. This Agreement after being notarized shall be enforceable. Where the Borrower fails to perform its liabilities hereunder or in the case of any circumstances agreed hereunder that entitle the Entrustor or the Lender to enforce its rights, the Entrustor or the Lender shall have the right to apply for enforcement to the court with jurisdiction.

Article 20 Supplementary Provisions

Entrustor	Shenzhen Nepstar Pharmaceutical Co., Ltd. (affixed with the corporate seal) Legal representative or agent <u>/s/</u> : Dated September 3, 2014
Lender	Shenzhen Tian'an Branch of Industrial Bank Co., Ltd. (affixed with the corporate seal) Legal representative or agent <u>/s/</u> : Dated September 3, 2014
Borrower	Shenzhen Nepstar Management Consulting Co., Ltd. (affixed with the corporate seal) Legal representative or agent <u>/s/</u> : Dated September 3, 2014

SUBSIDIARIES OF THE COMPANY

Wholly-owned subsidiaries, each of which is duly incorporated in the PRC:

- Shenzhen Nepstar Pharmaceutical Electronic Technologies Ltd.
- Shenzhen Nepstar Commerce Development Ltd.
- Shenzhen Jinfu Logistics Service Co., Ltd.
- Shenzhen Wisconsin Trading Development Co., Ltd.
- Shenzhen Nepstar Pharmaceutical Co., Ltd.

Consolidated entities, each of which is duly incorporated in the PRC:

- Shenzhen Nepstar Chain Co., Ltd.
 - Beijing Nepstar Huashi Drugstore Co., Ltd.
 - Beijing Nepstar Guangqumen Drugstore Co., Ltd.
 - Beijing Nepstar Tiyyuguanlu Drugstore Co., Ltd.
 - Beijing Nepstar Shuangjing Drugstore Co., Ltd.
 - Beijing Nepstar Tongda Drugstore Co., Ltd.
 - Beijing Nepstar Hongda Drugstore Co., Ltd.
 - Beijing Nepstar Xingda Drugstore Co., Ltd.
 - Hubei Nepstar Pharmaceutical Co., Ltd.
 - Wuhan Nepstar Drugstore Co., Ltd.
 - Shenzhen Nepstar Group Siping Northeast Co., Ltd.
 - Wuhan Nepstar Chain Co., Ltd.
 - Dalian Nepstar Chain Co., Ltd.
 - Shenyang Nepstar Chain Co., Ltd.
 - Hunan Nepstar Health Chain Co., Ltd.
 - Guangzhou Nepstar Chain Co., Ltd.
 - Jiangsu Nepstar Chain Co., Ltd.
 - Shandong Nepstar Chain Co., Ltd.
 - Shanghai Nepstar Chain Co., Ltd.
 - Sichuan Nepstar Chain Co., Ltd.
 - Hangzhou Nepstar Chain Co., Ltd.
 - Ningbo Nepstar Chain Co., Ltd.
 - Tianjin Nepstar Chain Co., Ltd.
 - Qingdao Nepstar Chain Co., Ltd.
 - Fuzhou Nepstar Chain Co., Ltd.
 - Shenzhen Nepstar E-Commerce Co., Ltd.
 - Shenzhen Nepstar Information and Technology Service Co., Ltd.
 - Shenzhen Nepstar Management Consulting Co., Ltd.
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Certification by the Chief Executive Officer**Pursuant to Section 302 of the****Sarbanes-Oxley Act of 2002**

I, Fuxiang Zhang, certify that:

1. I have reviewed this annual report on Form 20-F of China Nepstar Chain Drugstore Ltd.;
 2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
 3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
 4. The company's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the company and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - (c) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and
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5. The company's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of the company's board of directors (or persons performing the equivalent functions):

- (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
- (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: April 23, 2015

/s/ Fuxiang Zhang

Fuxiang Zhang
Chief Executive Officer

Certification by the Chief Financial Officer**Pursuant to Section 302 of the****Sarbanes-Oxley Act of 2002**

I, Zixin Shao, certify that:

1. I have reviewed this annual report on Form 20-F of China Nepstar Chain Drugstore Ltd.;
 2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
 3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
 4. The company's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the company and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - (c) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and
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5. The company's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of the company's board of directors (or persons performing the equivalent functions):

- (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
- (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: April 23, 2015

/s/ Zixin Shao

Zixin Shao
Chief Financial Officer

Certification by the Chief Executive Officer

Pursuant to Section 906 of the

Sarbanes-Oxley Act of 2002

In connection with the Annual Report of China Nepstar Chain Drugstore Ltd. (the “Company”) on Form 20-F for the year ended December 31, 2014 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Fuxiang Zhang, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: April 23, 2015

/s/ Fuxiang Zhang

Fuxiang Zhang
Chief Executive Officer

Certification by the Chief Financial Officer

Pursuant to Section 906 of the

Sarbanes-Oxley Act of 2002

In connection with the Annual Report of China Nepstar Chain Drugstore Ltd. (the “Company”) on Form 20-F for the year ended December 31, 2014 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Zixin Shao, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: April 23, 2015

/s/ Zixin Shao

Zixin Shao
Chief Financial Officer

Consent of Independent Registered Public Accounting Firm

**To the Board of Directors
China Nepstar Chain Drugstore Ltd.:**

We consent to the incorporation by reference in the registration statement (No. 333-147702) on Form S-8 of China Nepstar Chain Drugstore Ltd. of our reports dated April 23, 2015, with respect to the consolidated balance sheets of China Nepstar Chain Drugstore Ltd. and subsidiaries as of December 31, 2013 and 2014, and the related consolidated statements of comprehensive income, consolidated statements of changes in equity and consolidated statements of cash flows for each of the years in the three-year period ended December 31, 2014, and the effectiveness of internal control over financial reporting as of December 31, 2014, which reports appear in the December 31, 2014 annual report on Form 20-F of China Nepstar Chain Drugstore Ltd.

/s/ KPMG

Hong Kong, China
April 23, 2015

April 23, 2015

China Nepstar Chain Drugstore Ltd.
25F, Neptunus Yinhe Keji Building
No.1, Kejizhong 3rd Road
Nanshan District, Shenzhen
Guangdong Province 518057
People's Republic of China

Dear Sir/Madam:

We hereby consent to the reference of our name and inclusion of the summary and quotation of our opinion under the headings “ITEM 1A. RISK FACTORS” and “ITEM 4. INFORMATION ON THE COMPANY” in China Nepstar Chain Drugstore Ltd.’s Annual Report on Form 20-F for the fiscal year ended December 31, 2014 (the “**Annual Report**”), which will be filed with the Securities and Exchange Commission (the “**SEC**”) on April 23, 2015. We also consent to the filing with the SEC of this consent letter as an exhibit to the Annual Report.

In giving such consent, we do not thereby admit that we come within the category of persons whose consent is required under Section 7 of the Securities Act of 1933, or under the Securities Exchange Act of 1934, in each case, as amended, or the regulations promulgated thereunder.

Very truly yours,

/s/ Beijing Kang Da Law Firm
Beijing Kang Da Law Firm
