BUSINESS REVIEW AND PROSPECTS

(Unless otherwise stated, financial data contained herein is extracted from the accounts prepared by the Group in accordance with the PRC accounting rules and regulations)

SCOPE OF BUSINESS

The Company and its subsidiaries (the "Group") are principally engaged in (1) the manufacture and sale of Chinese patent medicine and (2) the wholesales, retail, import and export of Western and Chinese pharmaceutical products and various medical apparatus.

COMPANY'S OPERATION DURING THE REPORTING PERIOD

According to PRC accounting rules and regulations, the Group's consolidated turnover from principal activities for the six months ended 30 June 2001 was Rmb2,644,971,000, representing an increase of 22.67% over that of last year. Profit before taxation amounted to Rmb151,853,000 representing an increase of 34.00% over that of 2000. Net profit amounted to Rmb90,764,000, representing an increase of 11.56% over that of 2000.

According to HK GAAP, the Group's consolidated turnover from principal activities for the six months ended 30 June 2001 was Rmb2,644,971,000 representing an increase of 22.97%over that of last year. Profit before taxation amounted to Rmb107,579,000, representing a decrease of 3.76% over that of 2000. Net profits amounted to Rmb52,063,000, representing a decrease of 33.59% over that of 2000.

With the approval of the Board, effective 1 January 2001, the Group adopted the "Accounting Regulations for Enterprises" issued by the Ministry of Finance which contributed to certain changes in the Group's existing accounting policies, namely impairment of fixed assets and construction in progress. The total impairment charges for the six months ended 30 June 2001 amounted to Rmb50,277,000. Although such charges are qualified for prior year adjustments pursuant to Caihui [2001] 17 issued by the Ministry of Finance, they are not considered as change in accounting policies under HK GAAP. Accordingly, the impairment charges were charged to the profit and loss account prepared under HK GAAP for the six months ended 30 June 2001. This attributed to the decrease in profit before taxation and net profit prepared under HKGAAP.

Changes in the tax rate of enterprise income tax also attributed to the decrease in the net profit. Details of local tax privilege are set out in the section of "Disclosure of significant events".

During the first half of year 2001, the Group's manufacturing operations contributed to the Group's turnover and profit before taxation of 31.81% and 68.19%. The Group's trading operations contributed to the Group's turnover and profit before taxation of 74.62% and 25.38%.

CPM MANUFACTURING BUSINESS (THE "MANUFACTURING OPERATIONS")

According to PRC accounting rules and regulations, turnover of the Group's manufacturing operations in the first half of 2001 was Rmb841,457,000, representing an increase of 21.03% over that of 2000. Profit before taxation of the manufacturing operations was Rmb113,311,000, representing an increase of 38.08% over that of 2000. According to HK GAAP, turnover was Rmb841,457,000, representing an increase of 21.52% over that of 2000. Profit before taxation was Rmb82,168,000, representing an increase of 13.32% over that of 2000.

The manufacturing operations focused on expanding the market share within and outside Guangdong province by strengthening its advertising campaigns in hospitals and retailing stores, reorganising the distributors, developing a marketing information network and improving the market analysis work. Other than continuously developing markets for the Company's major products such as Xiao Ke Wan, Xiashangju, Huatuo Zaizao Pills, etc., the manufacturing operations also explored the potential of certain second-line products such as Qing Re Xiao Yan Ning, Biyan Qingdu Granule, etc. Furthermore, the Group has implemented procedures to allow co-operation between the manufacturing and trading operations. This helped the group to improve its resources utilisation rate and enhance the sales of Wu Ji Bai Feng Wan and Chuanbei Pipa Oral Liquid.

In the first half of 2001, there was a considerable increase in the sales of major products like Xiao Ke Wan, Huatuo Zaizao Pills, Xiashangju, Wu Ji Bai Feng Wan, Wang Lao Ji Heat-clearing Tea Granules and Zhui Feng Tou Gu Wan. The sales of Huatuo Zaizao Pills also increased considerably in the Eastern European market. This improvement contributed to the increase in the sales revenue of the manufacturing operations.

As a result of strengthening the cost controls of the manufacturing operations, during the reporting period, the unit cost of certain major products and the operating expenses ratio decreased by 3.24% and 4.25%, respectively, in comparison with last year. This led to an increase in the gross profit margin of the manufacturing operations.

In order to secure a sustainable development, the group has accelerated its technology upgrade and new products development. During this report period, the manufacturing operations have obtained approval to produce two new products, commenced commercial production of two new medicines, which are Shihu Yeguang Granule and Yifu Zhixue Pills, and in the process of devloping seventeen new products, which included Re Ke Qing Granules. The total sales of these new products for the first half of 2001 was Rmb45,000,000.

During this reporting period, the Group has completed certain technology upgrade projects. These included the completion of a high-speed automatic pills production line in Guangzhou Xing Qun Pharmaceutical Co., Ltd., a microwave drying line in Guangzhou Qi Xing Pharmaceutical Factory and a GMP certification implementation of an ointment production line in Guangzhou Pan Gao Shou Pharmaceutical Co Ltd. At present, in order to meet the increasing market demand of Xiao Ke Wan, the Kwang Chow First Chinese Medicine Factory is expanding its production capabilities and planning for a new factory relocation. Technological upgrades shall improve the group's production efficiency and capacities and further enhance the competitive edge of the Group's core business.

The Group has continued to implement an ERP management system for manufacturing operations in 2001. At present, the ERP management system is operating in four manufacturing subsidiaries of the Group. Other manufacturing subsidiaries are expected to implement the ERP management system in the first half of year 2002. The implementation of the ERP system has improved the overall efficiency and manufacturing quality of manufacturing operations.

During this reporting period, the turnover ratio of inventory and accounts receivable improved by 18.52% and 30.40%, respectively, in comparision with last year.

The merger of Kwang Chow First Chinese Medicine Factory and Guangzhou Zhong Sheng Pharmaceutical Factory has improved the Group's resources management and enhanced the competitive advantage of its brand-name products to ensure sustainable growth. The sales and profit before taxation of Kwang Chow First Chinese Medicine Factory for the report period increased by 18.32% and 88.31% respectively.

PHARMACEUTICAL TRADING BUSINESS INCLUDING WHOLESALING, RETAILING, IMPORT AND EXPORT (THE "TRADING OPERATIONS")

According to PRC accounting rules and regulations, turnover of the Group's trading operations in the first half of year 2001 was Rmb1,803,514,000, representing an increase of 23.46% over that of 2000. Profit before taxation of the trading operations was Rmb38,541,000, representing an increase of 23.30% over that of 2000. According to HK GAAP, turnover was Rmb1,803,514,000, representing an increase of 23.66% over that of 2000. Profit before taxation is Rmb 25,411,000, representing a drecrease of 35.29% over that of last year.

The State's medicine reform created severe competition in the pharmaceutical market and hence have, to a certain extent, affected the trading operations. Accordingly, the gross profit margin of trading operations for 2001 decreased by 1.22% in comparison with last year.

During the first half of 2001, the trading operations have successfully expanded its market share within and outside Guangdong province and other rural areas. During the report period, the trading operations have obtained distribution rights for more than 440 new products, of which 5 new products have national and regional exclusive distribution rights. The trading operations also expanded its customer base and increased by more than 430 new customers. Such measures contributed to the increase in turnover of the trading operations. During the reporting period, the trading operations have strengthened the controls of inventory re-ordering and accounts receivable recoverability and adjusted its product mix. Accordingly, turnover ratio of inventory and accounts receivable improved by 14.07% and 3.28% respectively in comparison with last year.

In order to expand market share and secure a steady growth of the trading operations, the Group has expanded its retail chain stores network during the first half of 2001. As of 30 June 2001, the Group's retailchain stores increased from 155 stores as at 1 January 2001 to 219 stores. The Group's retail chain stores included 127 Cai Zhi Lin chain stores, which mainly deal with CPM retailing, and 92 Jian Min chain stores, which deal with Western pharmaceutical products retailing.

THE COMPANY'S INVESTMENTS

Use of net proceeds from issue of H shares

The Company issued a total of 219,900,000 H shares in October 1997. The net proceeds of the issue amounted to HK$317,421,000 (approximately Rmb340,233,000). As at 30th June 2001. All the proceeds have been unutilised according to their proposed use.

Use of net proceeds from issue of A shares

With the approval from the China Securities Regulatory Commission, the company issued a total of 78,000,000 A shares on 10 January 2001. The net amount received from the issue totalled Rmb737,990,000. The A shares were listed on the Shanghai Stock Exchange on 6th February 2001. Details of the use of proceeds from the A shares issue up to 30th June, 2001 are as follows:

- Approximately Rmb75,000,000 for upgrading production technology for the Group's major products and developing the Group's new products;

- Approximately Rmb27,000,000 for expanding sales network, establishing logistic center and implementing ERP management information system;

- Approximately Rmb2,500,000 for establishing a biology pharmaceutical research center;

- Approximately Rmb79,690,000 as working capital; and

- For preparing the establishment of an innovation centre for new technology of Chinese medicine.

The balance of net proceeds from issue of A shares has temporarily been invested in government treasury bonds or placed in banks for the Group's daily operations. The Company will utilise the balance of net proceeds in accordance with the progress of the above projects.

Other investments

During the reporting period, with the approval of the second directors' meeting of the second term, the Company has subscribed 5,500,000 shares in Everbright Bank of China, which represents 0.093% of the total shares of Everbright Bank of China (5,891,000,000 shares) in issue. The total subscription price was Rmb10,725,000.

Financial Status

1. Change of major accounting itmes

Items	**30 June 2001**	**31 December 2000**	**Change**

	Rmb	Rmb	
Total assets	3,797,261,296.17	3,011,702,084.18	26.08%
Accounts receivable	624,465,487.93	465,904,603.69	34.03%
Other accounts receivble	197,110,428.87	174,653,322.34	12.86%
Inventories	713,433,819.68	790,462,500.78	-9.74%
Long-term investment	89,779,116.77	79,430,924.17	13.03%
Net fixed assets	605 376,280.44	621,379,486.26	-2.58%
Prepayments	26,881,468.71	4,638,122.33	479.58%
Other accounts payable	299,003,560.53	229,273,428.07	30.41%
Tax payable	51,192,759.95	35,519,653.23	44.13%
Long-term borrowings	40,000,000.00	65,000,000.00	-38.46%
Share capital	810,900,000.00	732,900,000.00	10.64%
Capital reserve	1,105,480,936.29	445,108,742.81	148.36%
Profit from principal operations	599,040,209.80	522,595,652.32	14.63%
Finance costs	4,525,182.18	16,793,097.22	-73.05%
Income tax	54,116,860.58	26,355,345.77	105.34%
Net profit	90,763,780.34	81,355,802.05	11.56%
Undistributed profit	58,427,180.83	-38,665,311.41	

2. Explanatory notes to the accounts regarding the items involving changes of 30% or above as compared with the corresponding items at the beginning of the year (or the same period of the previous year)

(1) Accounts receivable: Due to increase in sales for the six months ended 30 June 2001;

(2) Prepayments: Due to the prepayments for additional advertising fees;

(3) Other accounts payable: Due to increase in technological development fee and increase in the number of transactions with external units;

(4) Tax payable: Due to a rise in value added tax;

(5) Long-term borrowings: Due to partial repayments for long-term borrowings by the Company;

(6) Capital reserve: Due to premium on the issue of A shares by the Company in 2001;

(7) Finance cost: Due to decrease in net interest paid;

(8) Income tax: Due to the increase in income tax rate from 15% to 33%;

(9) Undistributed profit: Due to the charging of impairment losses which qualified for prior years adjustments as a result of adoption of new accounting policies.

PROSPECTS FOR THE 2ND HALF OF 2001

Through the use of proceeds from the issue of A shares and the gradual implementation of the projects as described above, the pace of improvements in technical standards and research and development will increase rapidly. It will help the Group to expand rapidly in the market and increase the competitive edge of its core business.

The Group's sales will sustain steady growth due to the expansion of the marketplace and the brand-name effect of major products. It is expected that there will be three products which 2001 annual sales will achieve over Rmb100 million each and seven products which 2001 annual sales will achieve over Rmb50 million each.

The Company will increase its investments in technology upgrade projects and enhance the Group's strength in developing Chinese medicines and biology medical products. This will help the Group to sustain operational growth.

The Group will enhance the utilisation of capital funds and focus on potential mergers and acquisitions.

To tackle the decrease of gross profit margin of the trading operations in the first half of 2001, the group will actively expand its market share to improve sales and work hard to maintain the increase in profit of the manufacturing operations.