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REPORT OF THE DIRECTORS

The directors herein present their report and the audited financial statements of the Company and the Group for the year ended 31 May 2001.

Group reorganisation, subsidiaries and basis of presentation

The Company was incorporated in Bermuda as an exempted company with limited liability under the Companies Act 1981 of Bermuda on 4 November 1999. Pursuant to a reorganisation scheme ("Group Reorganisation") to rationalise the Group structure in preparation for the listing of the Company's shares on The Stock Exchange of Hong Kong Limited (the "Stock Exchange"), the Company became the holding company of other companies comprising the Group on 25 June 2000. Further details of the Group Reorganisation and the subsidiaries acquired pursuant thereto as well as the basis of presentation of the financial statements are set out in notes 1, 14 and 19 to the financial statements.

The Company's shares were listed on the Stock Exchange on 25 July 2000.

Principal activities

The principal activity of the Company is investment holding. The principal activities of the subsidiaries consisted of (i) the development, manufacturing and provision of Chinese pharmaceutical products, which are predominantly medicinal preparations and anti-rheumatoid capsules primarily for the treatment of rheumatoid and/or arthritic conditions; (ii) the operation of Taiyuan City Rheumatoid Hospital; and (iii) the wholesale and retail of Chinese and Western pharmaceutical products and healthcare products in the PRC.

The nature of the Group's principal activities has not changed during the year.

Segmental information

An analysis of the Group's turnover and contribution to profit before tax by principal activity for the year ended 31 May 2001 is as follows:

	Turnover		Contribution to profit before tax	
	2001 HK\$'000	2000 HK\$'000	2001 HK\$'000	2000 HK\$'000
By principal activity:				
Manufacturing of Chinese pharmaceutical products	195,845	141,469	48,513	68,434
Trading business	33,354	29,342	973	2,769
Operation of Taiyuan Hospital	6,160	5,432	181	230
	<u>235,359</u>	<u>176,243</u>	<u>49,667</u>	<u>71,433</u>

The Group's turnover and contribution to profit before tax for the years ended 31 May 2001 and 2000 were principally derived from its operations in the PRC.



Results and dividends

The Group's profit for the year ended 31 May 2001 and the state of affairs of the Company and the Group at that date are set out in the financial statements on pages 17 to 44.

The directors do not recommend the payment of any dividend in respect of the year.

Summary financial information

A summary of the published results and of the assets and liabilities of the Group for the last five financial years as extracted from the audited financial statements and reclassified as appropriate, is set out on page 4 of this report. This summary is not part of the audited financial statements.

Fixed assets

Details of movements in the fixed assets of the Group are set out in note 11 to the financial statements.

Subsidiaries

Particulars of the Company's subsidiaries are set out in note 14 to the financial statements.

Share capital and share options

Details of movements in the Company's share capital, together with the reasons therefor, and details of the Company's share option scheme are set out in note 19 to the financial statements.

Reserves

Details of movements in the reserves of the Company and the Group during the year are set out in note 20 to the financial statements.

Pre-emptive rights

There are no provisions for pre-emptive rights under the bye-laws of the Company or the Laws of Bermuda, being the jurisdiction in which the Company was incorporated, which would oblige the Company to offer new shares on a pro rata basis to existing shareholders.

Distributable reserves

As at 31 May 2001, the Company's reserves available for cash distribution and/or distribution in specie amounted to HK\$84,246,000. Under the Companies Act 1981 of Bermuda, the Company's contributed surplus, amounting to HK\$84,147,000 as at 31 May 2001, is distributable under certain circumstances. The Company's share premium account with a balance of HK\$6,139,000 as at 31 May 2001 may be distributed in the form of fully paid bonus shares.

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Major customers and suppliers

In the year under review, the percentages of sales and purchases attributable to the Group's major customers and suppliers were as follows:

- (1) The aggregate amount of sales attributable to the Group's five largest customers accounted for approximately 50.4% of the Group's total sales for the year. The amount of sales to the Group's largest customer included therein represented approximately 20.4%.
- (2) The aggregate amount of purchases attributable to the Group's five largest suppliers accounted for approximately 75.5% of the Group's total purchases for the year. The amount of purchases from the Group's largest supplier included therein represented approximately 32.7%.

As far as the directors are aware, neither the directors, their associates nor shareholders (which, to the best knowledge of the directors, own more than 5% of the Company's issued share capital) had any beneficial interests in the Group's five largest customers or five largest suppliers during the year.

Directors

The directors of the Company during the year were as follows:

Executive directors:

Madam Hou Li Ping

Mr. David Y. M. Shi

Mr. Luo Jian Xiang

Independent non-executive directors:

Mr. Chan Bo Ching

Dr. Ko Siu Shing, Patrick

Madam Hung Ying Yu

(retired on 22 November 2000)

Madam Wan Hiu Shan

(retired on 22 November 2000)

In accordance with the bye-laws of the Company, the directors of the Company, including the independent non-executive directors, are subject to retirement by rotation and re-election at the forthcoming annual general meeting of the Company. In accordance with bye-law 111(A) of the Company's bye-laws, Mr. Luo Jian Xiang will retire by rotation and, being eligible, offer himself for re-election at the forthcoming annual general meeting.



Directors' service contracts

Each of the executive directors has entered into a service agreement with the Company for an initial term of five years commencing on 1 June 2000 and will continue thereafter until terminated by not less than three months' written notice served by either party on the other.

No director proposed for re-election at the forthcoming annual general meeting has a service contract with the Company which is not determinable by the Company within one year without payment of compensation other than statutory obligation.

Directors' interests in shares

As at 31 May 2001, the interests of the directors and their associates in the share capital of the Company and its associated corporations as recorded in the register maintained by the Company pursuant to Section 29 of the Securities (Disclosure of Interests) Ordinance ("SDI Ordinance") were as follows:

1. The Company

Name	Type of interest	Number of issued ordinary shares of HK\$0.10 each in the Company
Mr. David Y.M. Shi	Corporate	315,000,000*

- * These shares, which after share sub-division subsequent to 31 May 2001 were equivalent to 1,575,000,000 shares of HK\$0.02 each, are held by Healthlink International Inc., a company incorporated in the British Virgin Islands. The entire issued share capital of this company is owned beneficially by Mr. David Y. M. Shi.

2. Associated corporations

Mr. David Y.M. Shi and Madam Hou Li Ping have beneficial interests in a company named Shanxi Zhengzhong Enterprise Group Company Limited, which beneficially owns 1% of the equity interest in the registered capital of Shanxi Zhengzhong Pharmaceutical Co., Ltd., a 99% owned subsidiary of the Company.

Save as disclosed above, none of the directors, chief executives or their associates, had any personal, family, corporate or other beneficial interests in the issued share capital of the Company or any of its associated corporations as defined in the SDI Ordinance.

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Directors' rights to acquire shares or debentures

Under the terms of a share option scheme (the "Scheme") adopted by the Company on 8 July 2000, the directors are authorised, at their absolute discretion, to grant options to employees, including executive directors, of the Company or any of its subsidiaries to subscribe for the Company's shares. Further details of the Scheme are set out in note 19 to the financial statements. The Scheme became effective upon the listing of the Company's shares on the Main Board of the Stock Exchange on 25 July 2000. As at the date of this report, no options have been granted to any director or employee under the Scheme.

Apart from the foregoing and the Group Reorganisation, at no time during the year was the Company, its holding company or any of its subsidiaries a party to any arrangement to enable the Company's directors, their respective spouse, or children under 18 years of age to acquire the Company's shares or debentures.

Directors' interests in contracts

Apart from the Group Reorganisation, no director had a significant beneficial interest, either direct or indirect, in any contract of significance to the business of the Company to which the Company, its holding company or any of its subsidiaries was a party at any time during the year.

Directors' remuneration and five highest paid employees

Details of the remuneration of the directors of the Company and of the five highest paid employees of the Group during the year ended 31 May 2001 are set out in note 6 to the financial statements.

Pension scheme

Details of the pension scheme of the Group are set out in notes 2 and 5 to the financial statements.

Substantial shareholders

No person, other than the directors of the Company whose interests are set out in the section headed "Directors' interests in shares" above, had registered an interest of 10% or more of the issued share capital of the Company that was required to be recorded under Section 16(1) of the SDI Ordinance as at 31 May 2001.

Post balance sheet event

Details of the significant post balance sheet event of the Group are set out in note 23 to the financial statements.

Connected transactions

During the year, neither the Company, nor any of its subsidiaries conducted any transactions which are required to be disclosed under Chapter 14 of the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules").



Purchase, redemption or sale of the Company's listed securities

Other than in connection with the Company's initial public offering and placing of shares as detailed in note 19 to the financial statements, neither the Company, nor any of its subsidiaries purchased, redeemed or sold any of the Company's listed securities during the year.

Compliance with the Code of Best Practice

In the opinion of the directors, the Company has complied with the Code of Best Practice as set out in Appendix 14 of the Listing Rules throughout the year covered by this report, save that the independent non-executive directors of the Company are not appointed for specific terms, but are subject to retirement by rotation at the annual general meeting in accordance with the Company's bye-laws.

Audit committee

To comply with the Code of Best Practice as set out in Appendix 14 of the Listing Rules, the Company established an Audit Committee (the "Committee") on 8 July 2000 with written terms of reference, for the purpose of reviewing and providing supervision over the Group's financial reporting process and internal control system of the Group. The Committee comprises two independent non-executive directors, namely Dr. Ko Siu Shing, Patrick and Mr. Chan Bo Ching. The Group's financial statements for the year ended 31 May 2001 have been reviewed by the Committee, which was of the opinion that such statements complied with the applicable accounting standards, and stock exchange and legal requirements, and that adequate disclosures had been made.

Auditors

Ernst & Young retire and a resolution for their reappointment as auditors of the Company will be proposed at the forthcoming annual general meeting.

ON BEHALF OF THE BOARD

Hou Li Ping

Chairman

Hong Kong, 24 September 2001