

# C HAIRMAN'S STATEMENT

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On behalf of the board of directors (the "Board"), I am pleased to submit the third annual report of Shanxi Central Pharmaceutical International Limited (the "Company") and its subsidiaries (collectively the "Group") for the year ended 31 May 2002.

The Group achieved a consolidated turnover of HK\$280.1 million for the financial year ended 31 May 2002, representing an increase of 19.0% over that of last year. Gross profit slightly rose by 5.3% and amounted to HK\$117.8 million, while gross profit margin for the year was approximately 42.1%. The net profit from ordinary activities attributable to shareholders amounted to HK\$21.3 million. It is acknowledged that this represented 46.8% lower than that of last year. The decline in net profit was mainly due to initial establishment costs and impairment loss in respect of the Group's investments in a portion of centres for the treatment of rheumatic and/or arthritic conditions (the "Rheumatic Treatment Centres") were charged to the profit and loss account this year. For the detailed year-to-year comparison of other financial data, I would like to leave it to the "Management Discussion And Analysis" section. Year 2002 has been considered a challenging and eventful year for the Group. Here, I would like to address only on those events that, in my view, have significant impacts on the Group.

In the summer of 2001, we have reviewed our sales results and benchmarked the effectiveness of sales through different channels. In view of that our major products are used primarily for the treatment of rheumatism and arthritis which need to be diagnosed and treated by specialists in hospitals since private practice is still yet to be popular in the People's Republic of China (the "PRC"), we found that the most cost beneficial way to channel our products to consumers remains via alliance with hospitals in the PRC. Also, we believed that imported pharmaceutical products still have to take years to penetrate into hospitals in the PRC. On these premises, we have entered into agreements with 94 hospitals across the PRC for the formation of "Rheumatic Treatment Centres" on a co-operative basis in these hospitals. In our plan, the co-operative hospitals are vested with the ownership and management of the Rheumatic Treatment Centres while the Group is responsible for funding certain of its initial establishment costs, the sourcing of necessary medical equipment and providing training about application of Hou's Therapy. In return, the Group will supply its medicinal preparations and anti-rheumatoid capsules to the Rheumatic Treatment Centres and share the profit of the Rheumatic Treatment Centres equally with the co-operative hospitals commencing from 2003, for twelve years from the date of agreements with the 94 hospitals.

The Group hopes the plan go well but has prepared that it may not achieve a total success since it involves a large number of co-operative hospitals, which, in many aspects, could react beyond our expectations. However, we still believe it is worth to explore the potential of such co-operation as it can create immense market and business opportunities for the Group's products as well as generate enormous income to the Group. We have also constructed certain protective measures in the arrangements so as to allow ourselves to exit those under-perform investments, if any. Firstly, we have obtained consent from the supplier of the medical equipment for the Rheumatic Treatment Centres to return equipment that do not meet our requirement. Secondly, we have the permission from the co-operative hospitals to terminate the arrangement upon reaching mutual agreement without any legal or financial consequences. Lastly, we are also allowed to sell our investment in the Rheumatic Treatment Centres to independent third parties.

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# C CHAIRMAN'S STATEMENT

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The establishment and operation of the Rheumatic Treatment Centres were under the Group's close monitor in the last several months. Based on our continuous and cautious evaluation, the result of some of these centres were not performing satisfactorily. One of the most common reasons is that the financial resources of the co-operative hospitals are too restricted. None of these hospitals can afford any promoting expenses to bring the patients' awareness of the existence of the Rheumatic Treatment Centres whereas quite a few of these hospitals cannot spare proper human resources to the Rheumatic Treatment Centres. This means that the centres, if serviced, can only operate on short and irregular hours. The other problems include discrepancy in management style and financial reporting system between the Group and the co-operative hospitals. Having made all necessary careful calculations, the Group found it is sensible to exercise its exit plans since the Group can recover, even not all, but a substantial portion of its investments in the under-performing Rheumatic Treatment Centres. During the period from August to October 2002, the Group terminated the co-operations with 36 hospitals and disposed of its investments in 28 Rheumatic Treatment Centres to two independent third parties. The Group will continue its investments in the remaining 30 hospitals. As a result of the exit, the non-refundable initial establishment costs of HK\$20.4 million and impairment loss of HK\$4.6 million in respect of investments in those terminated/disposed centres were charged to the current year's profit and loss account. We are still confident that the remaining Rheumatic Treatment Centres will contribute sizeable future income to the Group. The execution of this large-scale investment plan has also brought into invaluable experience to our management. We have gained an insight into devising future expansion plans.

In addition to the investments in the Rheumatic Treatment Centres, Shanxi Zhengzhong Pharmaceutical Co., Ltd., the profit-making entity of the Group, has passed the GMP certification of its factory renovation plan and the construction work will be carried out soon.

## Appreciation

Last but not least, I would like to take this opportunity to express my appreciation to all management and staff members of the Group for their contributions, dedications and hard work throughout the year.

BY ORDER OF THE BOARD

**Hou Li Ping**  
*Chairman*

Hong Kong  
29 October 2002

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