

REPORT OF THE DIRECTORS

The directors present their report and the audited financial statements of the Company and the Group for the year ended 31 May 2002.

Principal activities

The principal activity of the Company is investment holding. The principal activities of the Company's 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 wholesale and retail of Chinese and Western pharmaceutical products and healthcare products in the People's Republic of China, excluding Hong Kong (the "PRC"); and (iii) the operation of Taiyuan City Rheumatoid Hospital.

There were no significant changes in the nature of the Group's principal activities during the year.

Segment information

An analysis of the Group's turnover and contribution to results by principal activity and geographical area of operations for the year ended 31 May 2002 is set out in note 4 to the financial statements.

Results and dividends

The Group's profit for the year ended 31 May 2002 and the state of affairs of the Company and of the Group at that date are set out in the financial statements on pages 16 to 47.

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 assets, liabilities and minority interests of the Group for the last five financial years, as extracted from the audited financial statements and reclassified as appropriate, is set out on pages 3 to 4 of the annual report. This summary does not form part of the audited financial statements.

Fixed assets

Details of movements in the fixed assets of the Group during the year are set out in note 12 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 23 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.

Purchase, redemption or sale of listed securities of the Company

Neither the Company, nor any of its subsidiaries purchased, redeemed or sold any of the Company's listed securities during the year.

Reserves

Details of movements in the reserves of the Company and the Group during the year are set out in note 24 to the financial statements.

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Distributable reserves

At 31 May 2002, the Company's reserves available for cash distribution and/or distribution in specie amounted to HK\$84,245,000. In addition, in accordance with the Companies Act 1981 of Bermuda, the Company's share premium account in the amount of HK\$6,139,000 as at 31 May 2002 may be distributed in the form of fully paid bonus shares.

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 34.1% of the Group's total sales for the year. The amount of sales to the Group's largest customer included therein represented approximately 8.0%.
- (2) The aggregate amount of purchases attributable to the Group's five largest suppliers accounted for approximately 86.5% of the Group's total purchases for the year. The amount of purchases from the Group's largest supplier included therein represented approximately 38.9%.

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

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

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, will offer himself for re-election at the forthcoming annual general meeting.

Directors' and senior management's biographies

Biographical details of the directors of the Company and the senior management of the Group are set out on pages 48 to 50 of the annual report.

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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.

Apart from the foregoing, 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 contracts

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

Directors' interests in shares

At 31 May 2002, the interests of the directors and their associates in the share capital of the Company or its associated corporations, as recorded in the register maintained by the Company pursuant to Section 29 of the Securities (Disclosure of Interests) Ordinance (the "SDI Ordinance"), were as follows:

1. Ordinary shares of the Company

Name	Type of interest	Number of issued ordinary shares of HK\$0.02 each in the Company
Mr. David Y. M. Shi ("Mr. Shi")	Corporate	1,394,228,344

These shares are held by Healthlink International Inc. ("Healthlink"), a company incorporated in the British Virgin Islands, the entire issued share capital of which is beneficially owned by Mr. Shi.

As at the date of this report, the interest of Mr. Shi in the share capital of the Company held by Healthlink, as recorded in the register maintained by the Company pursuant to Section 29 of the SDI, is 872,252,344 shares.

2. Associated corporations

Madam Hou Li Ping and Mr. Shi 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 equity or debt securities 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

Apart from as disclosed under the heading "Share option scheme" below, 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 benefits by means of the acquisition of shares in or debentures of the Company or any other body corporate.

Share option scheme

The principal purpose of the share option scheme (the "Scheme") is to recognise the significant contributions of the directors and employees of the Group to the growth of the Group, by rewarding them with opportunities to obtain an ownership interest in the Company and to further motivate and give an incentive to these persons to continue to contribute to the Group's long term success and prosperity.

Eligible participants of the Scheme include any full-time employees of the Company and its subsidiaries, including any executive directors but not non-executive directors. The Scheme became effective on 25 July 2000 and, unless otherwise cancelled or amended, will remain in force for 10 years from that date.

The maximum number of unexercised share options currently permitted to be granted under the Scheme is an amount equivalent, upon their exercise, to 10% of the shares of the Company in issue at any time. The maximum number of shares issuable under share options to each eligible participant in the Scheme within any 12-month period, is limited to 2.5% of the shares of the Company in issue at any time. Any further grant of share options in excess of this limit is subject to shareholders' approval in a general meeting.

The offer of a grant of share options may be accepted in writing within 21 days from the date of the offer, upon payment of a nominal consideration of HK\$1 in total by the grantee. The exercise period of the share options granted is determinable by the directors, and commences after a certain vesting period and ends on a date which is not later than ten years from the date of the commencement of the exercise period of the share options or the expiry date of the Scheme, if earlier.

The exercise price of the share options is determinable by the directors, but may not be less than 80% of the average closing price of the Company's shares on The Stock Exchange of Hong Kong Limited for the five trading days immediately preceding the date of the offer or the nominal value of the Company's shares, whichever is higher.

Pursuant to the amendments (the "New Rules") to Chapter 17 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules"), any options granted after 1 September 2001 must comply with the provision of the New Rules. If the Company wishes to grant options to its directors or other eligible participants in future, a new share option scheme in compliance with the New Rules should be approved and adopted by the shareholders of the Company in a general meeting. A new share option scheme in compliance with the New Rules is proposed to be adopted in the forthcoming annual general meeting.

Up to 31 May 2002, no share options have been granted under the Scheme.

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Substantial shareholders

At 31 May 2002, no person other than the directors of the Company whose interests are set out in the section "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 pursuant to Section 16(1) of the SDI Ordinance.

Connected transactions

Details of connected transactions of the Group are set out in note 29 to the financial statements.

Post balance sheet events

Details of the significant post balance sheet events of the Group are set out in notes 16 and 30 to the financial statements.

Code of Best Practice

In the opinion of the directors, the Company has complied with the Code of Best Practice (the "Code") as set out in Appendix 14 of the Listing Rules throughout the year covered by this report, except that the independent non-executive directors of the Company are not appointed for specific terms as required by paragraph 7 of the Code, but are subject to retirement by rotation at the annual general meeting in accordance with the Company's bye-laws.

Audit committee

The Company has established an Audit Committee (the "Committee") since 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 2002 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

29 October 2002
