NOTES TO FINANCIAL STATEMENTS

31 May 2002

1. CORPORATE INFORMATION

During the year, the Group was involved in the following principal activities in the People's Republic of China, excluding Hong Kong (the "PRC"):

– 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;

– the wholesale and retail of Chinese and Western pharmaceutical products and healthcare products; and

– the operation of Taiyuan City Rheumatoid Hospital (the "Taiyuan Hospital") which provides diagnosis and clinical treatment for patients with symptoms associated with rheumatism and/or arthritis.

In the opinion of the directors the ultimate holding company of the Company as at 31 May 2002 is Healthlink International Inc., which is incorporated in the British Virgin Islands.

2. IMPACT OF NEW AND REVISED HONG KONG STATEMENTS OF STANDARD ACCOUNTING PRACTICE

The following new and revised Hong Kong Statements of Standard Accounting Practice ("SSAPs") and related Interpretations are effective for the first time for the current year's financial statements:

- SSAP 9 (Revised): "Events after the balance sheet date"
- SSAP 14 (Revised): "Leases"
- SSAP 18 (Revised): "Revenue"
- SSAP 26: "Segment reporting"
- SSAP 28: "Provisions, contingent liabilities and contingent assets"
- SSAP 29: "Intangible assets"
- SSAP 30: "Business combinations"
- SSAP 31: "Impairment of assets"
- SSAP 32: "Consolidated financial statements and accounting for investments in subsidiaries"
- Interpretation 12: "Business combinations – subsequent adjustment of fair values and goodwill initially reported"
- Interpretation 13: "Goodwill – continuing requirements for goodwill and negative goodwill previously eliminated against/credited to reserves"

These SSAPs prescribe new accounting measurement and disclosure practices. The major effects on the Group's accounting policies and on the amounts disclosed in these financial statements of those SSAPs and Interpretations which have had a significant effect on the financial statements, are summarised as follows:

NOTES TO FINANCIAL STATEMENTS

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2. IMPACT OF NEW AND REVISED HONG KONG STATEMENTS OF STANDARD ACCOUNTING PRACTICE (continued)

SSAP 14 (Revised) prescribes the basis for lessor and lessee accounting for finance and operating leases, and the required disclosures in respect thereof. Certain amendments have been made to the previous accounting measurement treatments, which may be accounted for retrospectively or prospectively, in accordance with the requirements of this revised SSAP. The revised requirements have not had a material effect on the amounts previously recorded in the financial statements and therefore, no prior year adjustment has been required. The disclosure changes under this SSAP have resulted in changes to the detailed information disclosed for operating leases, which are further detailed in note 27 to the financial statements.

SSAP 26 prescribes the principles to be applied for reporting financial information by segment. It requires that management assesses whether the Group's predominant risks or returns are based on business segments or geographical segments and determines one of these bases to be the primary segment information reporting format, with the other as the secondary segment information reporting format. The impact of this SSAP is the inclusion of significant additional segment reporting disclosures which are set out in note 4 to the financial statements.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of preparation

These financial statements have been prepared in accordance with SSAPs, accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. They have been prepared under the historical cost convention, except for the periodic remeasurement of certain fixed assets as further explained below.

Basis of presentation and consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year ended 31 May 2002. The results of subsidiaries acquired or disposed of during the year are consolidated from or to their effective dates of acquisition or disposal, respectively.

The prior year comparative consolidated financial statements have been prepared using the merger basis of accounting. Under this basis, the Company has been treated as the holding company of its subsidiaries prior to the date of their acquisition pursuant to a group reorganisation implemented on 25 June 2000. Accordingly, the consolidated results of the Group for the year ended 31 May 2001 include the results of the Company and its subsidiaries with effect from 1 June 2000 or since their respective dates of incorporation/registration, where this is a shorter period, as if the current Group structure had been in existence throughout the year ended 31 May 2001.

In the opinion of the directors, the comparative consolidated financial statements prepared on the above basis present more fairly the results of the Group as a whole.

All significant intercompany transactions and balances within the Group are eliminated on consolidation.

NOTES TO FINANCIAL STATEMENTS

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Subsidiaries

A subsidiary is a company whose financial and operating policies the Company controls, directly or indirectly, so as to obtain benefits from its activities.

The Company's investments in subsidiaries are stated at cost less any impairment losses.

Joint venture companies

A joint venture company is a company set up by contractual arrangement, whereby the Group and other parties undertake an economic activity. The joint venture company operates as a separate entity in which the Group and the other parties have an interest.

The joint venture agreement between the venturers stipulates the capital contributions of the joint venture parties, the duration of the joint venture and the basis on which the assets are to be realised upon its dissolution. The profits and losses from the joint venture company's operations and any distributions of surplus assets are shared by the venturers, either in proportion to their respective capital contributions, or in accordance with the terms of the joint venture agreement.

A joint venture company is treated as a subsidiary if the Company has unilateral control over the joint venture company.

Related parties

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financing and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or corporate entities.

Impairment of assets

An assessment is made at each balance sheet date of whether there is any indication of impairment of any asset, or whether there is any indication that an impairment loss previously recognised for an asset in prior years may no longer exist or may have decreased. If any such indication exists, the asset's recoverable amount is estimated. An asset's recoverable amount is calculated as the higher of the asset's value in use or its net selling price.

An impairment loss is recognised only if the carrying amount of an asset exceeds its recoverable amount. An impairment loss is charged to the profit and loss account in the period in which it arises, unless the asset is carried at a revalued amount, when the impairment loss is accounted for in accordance with the relevant accounting policy for that revalued asset.

A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the recoverable amount of an asset, however not to an amount higher than the carrying amount that would have been determined (net of any depreciation/amortisation) had no impairment loss been recognised for the asset in prior years.

A reversal of an impairment loss is credited to the profit and loss account in the period in which it arises, unless the asset is carried at a revalued amount, when the reversal of the impairment loss is accounted for in accordance with the relevant accounting policy for that revalued asset.

NOTES TO FINANCIAL STATEMENTS

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Fixed assets and depreciation

Fixed assets are stated at cost or valuation less accumulated depreciation and any impairment losses.

The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after fixed assets have been put into operation, such as repairs and maintenance, is normally charged to the profit and loss account in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the fixed asset, the expenditure is capitalised as an additional cost of that asset.

Changes in the values of fixed assets are dealt with as movements in the asset revaluation reserve. If the total of this reserve is insufficient to cover a deficit, on an individual asset basis, the excess of the deficit is charged to the profit and loss account. Any subsequent revaluation surplus is credited to the profit and loss account to the extent of the deficit previously charged. On disposal of a revalued asset, the relevant portion of the asset revaluation reserve realised in respect of previous valuations is transferred to retained profits as a movement in reserves.

Depreciation is provided on the straight-line basis to write off the cost or valuation of each asset, less any estimated residual value, over the following estimated useful lives:

Short term leasehold land and buildings outside Hong Kong	Over the remaining lease terms
Plant and machinery	5 to 10 years
Leasehold improvements	Over the remaining lease terms
Furniture, fixtures, motor vehicles and other equipment	5 to 10 years

The gain or loss on disposal or retirement of a fixed asset recognised in the profit and loss account is the difference between the net sales proceeds and the carrying amount of the relevant asset.

Research and development costs

All research costs are charged to the profit and loss account as incurred.

Expenditure incurred on projects to develop new products is capitalised and deferred only when the projects are clearly defined; the expenditure is separately identifiable and can be measured reliably; there is reasonable certainty that the projects are technically feasible; and the products have commercial value. Product development expenditure which does not meet these criteria is expensed when incurred.

Deferred development costs are stated at cost less any impairment losses and are amortised using the straight-line basis over the expected useful lives of the related products subject to a maximum period of five years commencing from the date when the products are available for use.

Operating leases

Leases where substantially all the rewards and risks of ownership of assets remain with the lessor are accounted for as operating leases. Where the Group is the lessee, rentals payable under the operating leases are charged to the profit and loss account on the straight-line basis over the lease terms.

NOTES TO FINANCIAL STATEMENTS

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Long term investments

Investments in rheumatic treatment centres

The Group's investments in rheumatic treatment centres represent the costs incurred in relation to the establishment of rheumatic treatment centres for the treatment of rheumatoid and/or arthritic conditions (the "Rheumatic Treatment Centres") with certain hospitals in the PRC which are intended to be held on a long term basis.

Long term investments are stated at cost less any accumulated amortisation and any impairment losses. Such costs are amortised on the straight-line basis, over the terms of the contractual arrangements of twelve years commencing from the date when the Group is entitled to share the profits generated from the operation of the Rheumatic Treatment Centres.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined on the first-in, first-out basis and, in the case of work in progress and finished goods, comprises direct materials, direct labour and an appropriate proportion of overheads based on normal level of activity. Net realisable value is based on estimated selling prices less any estimated costs to be incurred to completion and disposal.

Accounts receivable

Trade debtors, which generally have credit terms of not more than 90 days, are recognised and carried at the original invoiced amount less an allowance for any uncollectible amounts. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off as incurred.

Cash equivalents

For the purpose of the consolidated cash flow statement, cash equivalents represent short term highly liquid investments which are readily convertible into known amounts of cash and which were within three months of maturity when acquired, less advances from bank repayable within three months from the date of the advance. For the purpose of balance sheet classification, cash equivalents represent assets similar in nature to cash, which are not restricted as to use.

Deferred tax

Deferred tax is provided, using the liability method, on all significant timing differences to the extent it is probable that the liability will crystallise in the foreseeable future. A deferred tax asset is not recognised until its realisation is assured beyond reasonable doubt.

Revenue recognition

Revenue is recognised when it is probable that the economic benefits will flow to the Group and when the revenue can be measured reliably, on the following bases:

(a) from the sale of goods, when the significant risks and rewards of ownership have been transferred to the buyer, provided that the Group maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold;

NOTES TO FINANCIAL STATEMENTS

31 May 2002

3. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (continued)

Revenue recognition (continued)

(b) the provision of clinical and medicinal services, and medicinal preparations, when the services are rendered; and

(c) interest income, on a time proportion basis taking into account the principal outstanding and the effective interest rate applicable.

Dividends

Final dividends proposed by the directors are classified as a separate allocation of retained profits within the capital and reserves section of the balance sheet, until they have been approved by the shareholders in a general meeting. When these dividends have been approved by the shareholders and declared, they are recognised as a liability.

Foreign currencies

Foreign currency transactions are recorded at the applicable rates of exchange ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the applicable rates of exchange ruling at that date. Exchange differences are dealt with in the profit and loss account.

On consolidation, the financial statements of overseas subsidiaries are translated into Hong Kong dollars at the applicable rates of exchange ruling at the balance sheet date. The resulting translation differences are included in the exchange fluctuation reserve.

Retirement benefits scheme

The Group operates a defined contribution Mandatory Provident Fund retirement benefits scheme (the "MPF Scheme") under the Mandatory Provident Fund Schemes Ordinance, for those employees who are eligible to participate in the MPF Scheme. The MPF Scheme has operated since 1 December 2000. Contributions are made based on a percentage of the employees' basic salaries and are charged to the profit and loss account as they become payable in accordance with the rules of the MPF Scheme. The assets of the MPF Scheme are held separately from those of the Group in an independently administered fund. The Group's employer contributions vest fully with the employees when contributed into the MPF Scheme.

NOTES TO FINANCIAL STATEMENTS

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4. SEGMENT INFORMATION

SSAP 26 was adopted during the year, as detailed in note 2 to the financial statements. Segment information is presented by way of two segment formats: (i) on a primary segment reporting basis, by business segment; and (ii) on a secondary segment reporting basis, by geographical segment.

The Group's operating businesses are structured and managed separately, according to the nature of their operations and the products and services they provide. Each of the Group's business segments represents a strategic business unit that offers products and services which are subject to risks and returns that are different from those of other business segments. Summary details of the business segments are as follows:

(a) the manufacturing segment engages in the development, manufacturing and provision of Chinese pharmaceutical products;

(b) the trading segment engages in the trading of Chinese and Western pharmaceutical products and healthcare products; and

(c) the hospital operation segment engages in the operation of the Taiyuan Hospital which provides diagnosis and clinical treatment for patients with symptoms associated with rheumatism and/or arthritis.

In determining the Group's geographical segments, revenues and results are attributed to the segments based on the location of the customers, and assets are attributed to the segments based on the location of the assets. No geographical segment information is presented as over 90% of the Group's revenue and results are derived from customers based in the PRC, and over 90% of the Group's assets are located in the PRC.

NOTES TO FINANCIAL STATEMENTS

31 May 2002

4. SEGMENT INFORMATION (continued)

The following tables present revenue, results and certain assets, liabilities and expenditure information for the Group's business segments.

Group	Manufacturing		Trading		Hospital operation		Consolidated	
	2002	2001	**2002**	2001	**2002**	2001	**2002**	2001
	HK$'000	HK$'000	**HK$'000**	HK$'000	**HK$'000**	HK$'000	**HK$'000**	HK$'000
Segment revenue:								
Sales to external customers	**249,252**	195,845	**24,620**	33,354	**6,194**	6,160	**280,066**	235,359
Segment results	**36,394**	54,460	**224**	973	**120**	(320)	**36,738**	55,113
Interest income							**639**	1,326
Net unallocated expenses							**(7,835)**	(6,772)
Profit from operating activities							**29,542**	49,667
Finance costs							**(387)**	–
Profit before tax							**29,155**	49,667
Tax							**(7,535)**	(9,132)
Profit before minority interests							**21,620**	40,535
Minority interests							**(293)**	(440)
Net profit from ordinary activities attributable to shareholders							**21,327**	40,095

NOTES TO FINANCIAL STATEMENTS

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4. SEGMENT INFORMATION (continued)

Group	Manufacturing		Trading		Hospital operation		Consolidated	
	2002	2001	**2002**	2001	**2002**	2001	**2002**	2001
	HK$'000	HK$'000	**HK$'000**	HK$'000	**HK$'000**	HK$'000	**HK$'000**	HK$'000
Segment assets	**307,341**	214,266	**11,214**	3,508	**5,492**	5,914	**324,047**	223,688
Unallocated assets							**2,031**	7,421
Total assets							**326,078**	231,109
Segment liabilities	**69,515**	41,721	**7,919**	7,697	**1,037**	1,331	**78,471**	50,749
Unallocated liabilities							**53,181**	4,860
Total liabilities							**131,652**	55,609
Other segment information:								
Depreciation and amortisation	**5,011**	2,431	**5**	3	**520**	392	**5,536**	2,826
Impairment losses recognised in the profit and loss account	**9,874**	–	**–**	–	**–**	–	**9,874**	–
Other non-cash expenses	**2,349**	35	**–**	–	**2**	–	**2,351**	35
Capital expenditure	**483**	13,440	**8**	21	**298**	106	**789**	13,567
Unallocated amounts							**17**	475

5. TURNOVER

Turnover represents the net invoiced value of goods sold, after allowance for returns and trade discounts, and services provided. All significant transactions among the companies comprising the Group have been eliminated on consolidation.

NOTES TO FINANCIAL STATEMENTS

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6. PROFIT FROM OPERATING ACTIVITIES

The Group's profit from operating activities is arrived at after charging/(crediting):

	2002 HK$'000	2001 HK$'000
Auditors' remuneration	**1,150**	850
Amortisation of deferred development costs*	**2,329**	1,464
Cost of inventories sold	**157,557**	118,518
Cost of services provided	**4,661**	4,974
Minimum lease payments under operating leases in respect of land and buildings	**1,544**	1,819
Depreciation	**3,207**	1,362
Provision for impairment of deferred development costs*	**5,277**	–
Loss on disposal of fixed assets	**77**	35
Provision for impairment of long term investments*	**4,597**	–
Provision for bad and doubtful debts*	**2,274**	–
Research and development expenses*	**–**	16,091
Staff costs (excluding directors' remuneration, note 8)		
Wages and salaries	**5,155**	9,538
Retirement benefits contributions	**17**	14
	5,172	9,552
Interest income on bank balances	**(639)**	(1,326)

* Included in "Other operating expenses" on the face of the consolidated profit and loss account.

Costs of inventories sold and services provided include HK$3,333,000 (2001: HK$1,950,000) relating to staff costs and depreciation, which are also included in the respective total amounts disclosed separately above for these types of expenses.

7. FINANCE COSTS

	Group 2002 HK$'000	Group 2001 HK$'000
Interest expense on bank borrowings wholly repayable within five years	**387**	–

NOTES TO FINANCIAL STATEMENTS

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8. REMUNERATION OF DIRECTORS AND FIVE HIGHEST PAID EMPLOYEES

Directors' remuneration

Details of the remuneration of the directors of the Company for the year disclosed pursuant to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited and Section 161 of the Hong Kong Companies Ordinance are as follows:

	2002 HK$'000	2001 HK$'000
Fees:		
Executive directors	–	–
Independent non-executive directors	400	640
	400	640
Other emoluments of executive directors:		
Basic salaries, housing benefits, other allowances and benefits in kind	1,596	1,500
	1,996	2,140

The remuneration of each director fell within the nil – HK$1,000,000 band.

There was no arrangement under which a director waived or agreed to waive any remuneration during the year (2001: Nil).

Five highest paid employees

The five highest paid employees during the year included four (2001: three) directors, details of whose remuneration are set out above. The details of the remuneration of the remaining non-director, highest paid employee (2001: two), which fell within the nil – HK$1,000,000 band are as follows:

	Group	
	2002 HK$'000	2001 HK$'000
Basic salaries, housing benefits, other allowances and benefits in kind	507	455
Retirement benefits contributions	12	6
	519	461

During the year, no emoluments were paid by the Group to the directors, or the non-director, highest paid employee as an inducement to join or upon joining the Group, or as compensation for loss of office (2001: Nil).

In the opinion of the directors of the Company, the Group had no significant obligations for long service payments to its employees pursuant to the requirements under the Employment Ordinance, Chapter 57 of the Laws of Hong Kong, at 31 May 2002 and 2001.

NOTES TO FINANCIAL STATEMENTS

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9. TAX

	Group	
	2002	2001
	HK$'000	HK$'000
Current year provision – outside Hong Kong	**7,535**	9,132

Hong Kong profits tax has not been provided (2001: Nil) as the Group had no assessable profits arising in Hong Kong during the year.

Taxes on profits assessable elsewhere have been calculated at the applicable rates of tax prevailing in the jurisdictions in which the subsidiaries operated during the year based on existing legislation, interpretations and practices in respect thereof.

PRC income tax for all of the subsidiaries operating in the PRC is calculated at a unified tax rate of 33% (2001: 33%) on their taxable profits unless waivers are granted by relevant tax authorities during the year.

Shanxi Zhengzhong Pharmaceutical Co., Ltd. ("Shanxi Zhengzhong") was exempted from PRC income tax for two years from its first profit-making year of operations, which was the year ended 31 December 1998, and thereafter is eligible for a 50% relief from PRC income tax for the following three years under the Income Tax Law of the PRC.

Deferred tax has not been provided (2001: Nil) because the Company and the Group had no significant timing differences at 31 May 2002.

10. NET LOSS FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS

The net loss from ordinary activities attributable to shareholders for the year ended 31 May 2002 dealt with in the financial statements of the Company is HK$1,000 (2001: net profit of HK$8,499,000).

11. EARNINGS PER SHARE

The calculation of basic earnings per share is based on the net profit from ordinary activities attributable to shareholders for the year of HK$21,327,000 (2001: HK$40,095,000), and the weighted average number of 2,100,000,000 (2001: 1,874,452,055) ordinary shares, as adjusted for the sub-division of one ordinary share of HK$0.10 each into five ordinary shares of HK$0.02 each (note 23), of the Company during the year.

Diluted earnings per share for the years ended 31 May 2002 and 2001 have not been calculated as no dilutive events existed during the two years ended 31 May 2002.

NOTES TO FINANCIAL STATEMENTS

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12. FIXED ASSETS

Group

	Short term leasehold land and buildings outside Hong Kong HK$'000	Plant and machinery HK$'000	Leasehold improvements, furniture, fixtures, motor vehicles and other equipment HK$'000	Total HK$'000
Cost or valuation:				
At 1 June 2001	16,890	2,754	7,968	27,612
Additions	–	403	403	806
Disposals	–	(16)	(82)	(98)
Deficit on revaluation	(5,137)	–	–	(5,137)
At 31 May 2002	**11,753**	**3,141**	**8,289**	**23,183**
Accumulated depreciation:				
At 1 June 2001	97	2,205	1,755	4,057
Provided during the year	2,255	275	677	3,207
Disposals	–	(7)	(14)	(21)
Reversal upon revaluation	(2,352)	–	–	(2,352)
At 31 May 2002	**–**	**2,473**	**2,418**	**4,891**
Net book value:				
At 31 May 2002	**11,753**	**668**	**5,871**	**18,292**
At 31 May 2001	16,793	549	6,213	23,555
Analysis of cost or valuation:				
At cost	–	3,141	8,289	11,430
At valuation	11,753	–	–	11,753
	11,753	3,141	8,289	23,183

The valuation of the leasehold land and buildings were carried out by Castores Magi Surveyors Limited, an independent firm of professional valuers, at depreciated replacement cost basis as at 31 May 2002. A revaluation deficit of HK$2,785,000, resulting from the above valuation, has been debited to the asset revaluation reserve (note 24).

Had these land and buildings been carried at historical cost less accumulated depreciation, their carrying values would have been approximately HK$6,005,000 (2001: HK$8,023,000) as at 31 May 2002.

NOTES TO FINANCIAL STATEMENTS

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13. DEFERRED DEVELOPMENT COSTS

	Group
	HK$'000
Cost:	
At 1 June 2001 and at 31 May 2002	14,635
Accumulated amortisation and impairment:	
At 1 June 2001	1,464
Provided during the year	2,329
Impairment during the year recognised in the profit and loss account	5,277
At 31 May 2002	**9,070**
Net book value:	
At 31 May 2002	**5,565**
At 31 May 2001	13,171

14. LONG TERM DEPOSIT

The balance at 31 May 2001 represented a deposit paid in respect of the acquisition of a factory located in the PRC (the "Factory Acquisition"). The agreement for the Factory Acquisition was terminated during the year. As a result, the deposit was refunded to the Group during the year ended 31 May 2002.

NOTES TO FINANCIAL STATEMENTS

31 May 2002

15. INVESTMENTS IN SUBSIDIARIES

	Company	
	2002	2001
	HK$'000	HK$'000
Unlisted investments, at cost	**84,347**	84,347

The amount due from a subsidiary is unsecured, interest-free and has no fixed terms of repayment.

Particulars of the principal subsidiaries are set out below:

Name	Place of incorporation/ registration and operations	Nominal value of paid-up share/ registered capital	Percentage of equity attributable to the Company 2002	2001	Principal activities
Directly held					
Central Pharmaceutical Holdings (BVI) Limited ("CBVI")	British Virgin Islands	Ordinary US$500,000	**100**	100	Investment holding
Indirectly held					
Shanxi Zhengzhong Pharmaceutical Co., Ltd.	People's Republic of China	RMB30,000,000 (2001: RMB20,000,000)	**99** note (a)	99	Provision of medicinal preparations and the sale of Chinese pharmaceutical products
Shanxi Taiyuan Kexing Pharmaceutical Technology Research Company Limited	People's Republic of China	RMB500,000	**100** note (b)	100	Development of new medicines, clinical research and medical information technology
Taiyuan City Rheumatoid Hospital	People's Republic of China	RMB3,000,000	**99.4**	99.4	Provision of therapy for patients with symptoms associated with rheumatoid and/or arthritic conditions

NOTES TO FINANCIAL STATEMENTS

31 May 2002

15. INVESTMENTS IN SUBSIDIARIES (continued)

Name	Place of incorporation/ registration and operations	Nominal value of paid-up share/ registered capital	Percentage of equity attributable to the Company 2002	2001	Principal activities
Beijing Zhengzhongyuan Pharmaceutical Technology Development Company Limited	People's Republic of China	RMB1,000,000	**99.2**	99.2	Development of medical technology and the provision of consultancy services
Beijing Zhengzhong Sante Medicine and Medicinal Materials Company Limited	People's Republic of China	RMB500,000	**79.4** note (c)	79.4	Wholesale and retail of Chinese and Western pharmaceutical products and healthcare products

The above table lists the subsidiaries of the Company which, in the opinion of the directors, principally affected the results for the year or formed a substantial portion of the net assets of the Group. To give details of other subsidiaries would, in the opinion of the directors, result in particulars of excessive length.

Notes:

(a) Shanxi Zhengzhong was established by Shanxi Taiyuan Kexing Pharmaceutical Technology Research Company Limited ("Kexing") and a foreign partner for an original period of 12 years commencing on 9 December 1993. In 1999, the tenure of Shanxi Zhengzhong was extended for a further eight years to 9 December 2013.

(b) In March 2000, Kexing became a wholly foreign owned enterprise with a tenure of five years commencing on 22 November 1999, the date of issuance of its business licence.

(c) Beijing Zhengzhong Sante Medicine and Medicinal Materials Company Limited ("Beijing Sante") is a limited liability company with a registered capital of RMB500,000.

Prior to the acquisition of 80% of its equity interest by the Group in September 1999, Beijing Sante was wholly-owned by an independent third party. Pursuant to the agreements dated 1 January 1996 and 25 July 1998, Shanxi Zhengzhong obtained the entire operational and management rights of Beijing Sante for a period of six years expiring on 31 December 2001. During the contracted period, an annual fee of RMB150,000 was payable by the Group to Beijing Sante, while all profits and losses derived from Beijing Sante's operations were to be vested in or borne by the Group.

Upon execution of an agreement entered into on 20 September 1999, the Group acquired an 80% equity interest in Beijing Sante which became an 80%-owned subsidiary of the Group thereafter. On 10 November 1999, the date that the business licence of Beijing Sante was granted, the agreement dated 25 July 1998 was replaced by another agreement with the same terms, except that the contracted period will now expire on 9 November 2009.

NOTES TO FINANCIAL STATEMENTS
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16. LONG TERM INVESTMENTS AND INVESTMENTS HELD FOR DISPOSAL

	Group	
	2002	2001
	HK$'000	HK$'000
Unlisted investments, at cost	**144,191**	–
Provision for impairment	**(4,597)**	–
	139,594	–
Investments held for disposal	**(77,882)**	–
Long term investments	**61,712**	–
Investments held for disposal	**77,882**	–
Portion classified as current assets	**(66,929)**	–
Long term portion	**10,953**	–

During the year, the Group signed various agreements (the "Agreements") with 94 hospitals in the PRC for the establishment of the Rheumatic Treatment Centres in these hospitals.

Pursuant to the Agreements, the hospitals are responsible for the establishment of the Rheumatic Treatment Centres within a time frame prescribed in the Agreements. The ownership and day to day responsibility for the operation of the Rheumatic Treatment Centres vest with the hospitals. The Group is responsible for the sourcing of appropriate medical equipment, supply of the necessary medicinal preparations and anti-rheumatoid capsules for the treatment of rheumatoid and/or arthritic conditions for the Rheumatic Treatment Centres. Pursuant to the purchase agreements entered into with the medical equipment supplier (the "Supplier"), the medical equipment can be returned to the Supplier should the medical equipment not meet the Group's requirements. The Group also funds part of the initial establishment costs of the Rheumatic Treatment Centres which are non-refundable. In return, the Group receives a participating right in the Rheumatic Treatment Centres' profits for the duration of the periods specified in the Agreements, generally 12 years. Pursuant to the Agreements, the Group can share 50% of the profit generated from the operation of the Rheumatic Treatment Centres, after a 10% appropriation reserved for future development of the Rheumatic Treatment Centres, commencing from 1 January 2003. The total original cost of investments in Rheumatic Treatment Centres, after taking into account the initial establishment costs of the Rheumatic Treatment Centres as further detailed below, amounted to approximately HK$164.6 million.

The remaining amortisation period of the investments in Rheumatic Treatment Centres, which will commence in January 2003, is approximately ten years and nine months.

During the year, the Group carried out continuous assessment of the setting up and operation of the Rheumatic Treatment Centres. In view of the locations of these Rheumatic Treatment Centres are widely dispersed in the PRC and the unsatisfactory performance of some of these centres, the Group decided either to terminate the cooperation with some of these hospitals or dispose of its rights of some of these centres.

NOTES TO FINANCIAL STATEMENTS

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16. **LONG TERM INVESTMENTS AND INVESTMENTS HELD FOR DISPOSAL** (continued)

Subsequent to the balance sheet date, in August and September 2002, the Group entered into various termination agreements (the "Termination Agreements") with 36 hospitals for the termination of its investments in the Rheumatic Treatment Centres (the "Terminated Centres") due to their unsatisfactory performance. Pursuant to the Termination Agreements, all the medical equipment delivered to the Terminated Centres were returned to the Group and the cooperation with these 36 hospitals were terminated. On the other hand, the Group entered into an agreement (the "Supplier Agreement") with the Supplier. Pursuant to the Supplier Agreement, the Supplier agreed to buy back those medical equipment returned from the Terminated Centres at aggregate consideration of approximately HK$41.4 million, representing 90% of the original cost, resulting in a loss of approximately HK$4.6 million, which was incorporated into these financial statements. The initial establishment costs of the Terminated Centres of a total of approximately HK$11.5 million are not refundable and hence were charged to the profit and loss account. Pursuant to the Supplier Agreement, the Group received approximately HK$21.8 million from the Supplier in September 2002. In accordance with the Supplier Agreement, the remaining balance will be settled as to approximately HK$5.5 million and approximately HK$14.1 million in November 2002 and January 2003, respectively.

In October 2002, the Group entered into sale and purchase agreements (the "Disposal Agreements") with two independent third parties (the "Purchasers") to dispose of its entire interests in the investments in the Rheumatic Treatment Centres with some other 28 hospitals (the "Disposed Centres") at aggregate consideration of approximately HK$36.5 million. The initial establishment costs of the Disposed Centres of a total of approximately HK$8.9 million were charged to the profit and loss account. The Group received non-refundable deposits of a total of approximately HK$18.2 million from the Purchasers in October 2002 in accordance with the Disposal Agreements. The remaining balance will be settled as to approximately HK$7.3 million and approximately HK$11.0 million by the Purchasers in April 2003 and December 2003, respectively, according to the Disposal Agreements.

The directors, after taking into account a valuation report performed by an independent professional valuer and the operations of the remaining 30 Rheumatic Treatment Centres, consider that there is no impairment in value on the investments in the Rheumatic Treatment Centres with the remaining 30 hospitals of approximately HK$61.7 million.

NOTES TO FINANCIAL STATEMENTS

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17. INVENTORIES

	Group	
	2002	2001
	HK$'000	HK$'000
Raw materials	**280**	398
Work in progress	**737**	519
Finished goods	**294**	2,452
	1,311	3,369

At 31 May 2002, no inventories were stated at net realisable value (2001: Nil).

18. ACCOUNTS RECEIVABLE

An aged analysis of the accounts receivable as at the balance sheet date, based on the date of goods delivered, is as follows:

	Group	
	2002	2001
	HK$'000	HK$'000
Less than 90 days	**54,356**	42,384
91 – 180 days	**40,252**	1,153
Over 180 days	**884**	236
	95,492	43,773

19. CASH AND CASH EQUIVALENTS

The cash and cash equivalents are mainly denominated in Renminbi. Renminbi is not freely convertible into foreign currencies. Under the PRC's Foreign Exchange Control Regulations and Administration of Settlement, Sales and Payment of Foreign Exchange Regulations, the Group is permitted to exchange Renminbi for foreign currencies through banks authorised to conduct foreign exchange business.

NOTES TO FINANCIAL STATEMENTS

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20. ACCOUNTS PAYABLE

An aged analysis of the accounts payable as at the balance sheet date, based on the date of goods received, is as follows:

	Group	
	2002	2001
	HK$'000	HK$'000
Less than 90 days	**27,472**	13,280
91 – 180 days	**8,593**	2,193
Over 180 days	**5,007**	6,708
	41,072	22,181

21. INTEREST-BEARING BANK BORROWINGS

	Group	
	2002	2001
	HK$'000	HK$'000
Trust receipt loan, unsecured	**7,031**	–
Unsecured bank loan repayable:		
Within one year	**12,000**	–
In the second year	**12,000**	–
In the third to fifth years, inclusive	**6,000**	–
	37,031	–
Portion classified as current liabilities	**(19,031)**	–
Long term portion	**18,000**	–

At 31 May 2002, the banking facilities of the Group were supported by:

(i) corporate guarantees executed by the Company and a subsidiary of the Company; and

(ii) personal guarantees executed by two directors of the Company.

NOTES TO FINANCIAL STATEMENTS

31 May 2002

22. DUE TO A DIRECTOR

The amount due to a director is unsecured, interest-free and not repayable within twelve months.

23. SHARE CAPITAL

	Company	
	2002	2001
	HK$'000	HK$'000
Authorised:		
10,000,000,000 ordinary shares of HK$0.02 each (2001: 2,000,000,000 ordinary shares of HK$0.10 each)	**200,000**	200,000
Issued and fully paid:		
2,100,000,000 ordinary shares of HK$0.02 each (2001: 420,000,000 ordinary shares of HK$0.10 each)	**42,000**	42,000

Pursuant to an ordinary resolution passed in a special general meeting of the Company held on 25 July 2001, each of the shares of HK$0.10 each in the issued and unissued share capital of the Company was sub-divided into 5 shares of HK$0.02 each. As a result, the Company's authorised share capital was changed from 2,000,000,000 shares of HK$0.10 each to 10,000,000,000 shares of HK$0.02 each, while the Company's issued share capital was changed from 420,000,000 shares of HK$0.10 each to 2,100,000,000 shares of HK$0.02 each. All the shares, after adjustment for the sub-division, rank pari passu with each other in all respect.

NOTES TO FINANCIAL STATEMENTS

31 May 2002

23. SHARE CAPITAL (continued)

A summary of the movements in the issued share capital of the Company is as follows:

	Number of shares in issue ('000)	Share capital HK$'000
Shares allotted and issued nil paid on incorporation	1,000	–
On acquisition of CBVI:		
Shares issued as consideration	1,000	100
Application of contributed surplus to pay up nil paid shares	–	100
Capitalisation issue credited as fully paid conditional on the share premium account of the Company being credited as a result of the issue of new shares to the public	343,000	–
Pro forma share capital as at 31 May and 1 June 2000	345,000	200
New issue on public listing	75,000	7,500
Capitalisation of the share premium account	–	34,300
Share capital as at 31 May and 1 June 2001	420,000	42,000
Sub-division of 1 ordinary share of HK$0.10 each into 5 ordinary shares of HK$0.02 each	1,680,000	–
Share capital as at 31 May 2002	**2,100,000**	**42,000**

Subsequent to the balance sheet date, in July 2002, the Company issued convertible debentures of HK$20,000,000 (the "Convertible Debentures"), bearing interest at 4.5% per annum, to an independent third party.

HK$9,750,000 of the Convertible Debentures were converted into 150,000,000 shares in September 2002 (note 30(a)). As a result, the issued share capital of the Company increased to HK$45,000,000 comprising 2,250,000,000 ordinary shares of HK$0.02 each.

Share options

The Company operates a share option scheme (the "Scheme"), details of which are set out under the heading "Share option scheme" in the Report of the Directors.

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

NOTES TO FINANCIAL STATEMENTS

31 May 2002

24. RESERVES

Group

	Share premium account HK$'000	Asset revaluation reserve HK$'000	Contributed surplus HK$'000	Retained profits HK$'000	Total HK$'000
At 1 June 2000	–	7,396	4,500	72,251	84,147
Issue of shares to public	56,250	–	–	–	56,250
Share issue expenses	(15,811)	–	–	–	(15,811)
Capitalisation issue of shares	(34,300)	–	–	–	(34,300)
Revaluation surplus	–	1,570	–	–	1,570
Net profit for the year	–	–	–	40,095	40,095
At 31 May and 1 June 2001	6,139	8,966	4,500	112,346	131,951
Revaluation deficit	–	(2,785)	–	–	(2,785)
Net profit for the year	–	–	–	21,327	21,327
At 31 May 2002	**6,139**	**6,181**	**4,500**	**133,673**	**150,493**

The contributed surplus arose as a result of the Group reorganisation in 2000 and represents the difference between the nominal value of the Company's shares issued under the reorganisation scheme and the nominal value of the aggregate share/registered capital of the subsidiaries acquired.

Company

	Share premium account HK$'000	Contributed surplus HK$'000	Retained profits HK$'000	Total HK$'000
Arising on acquisition of CBVI	–	84,247	–	84,247
Applied in payment of 1,000,000 ordinary shares allotted nil paid on incorporation	–	(100)	–	(100)
Issue of shares to public	56,250	–	–	56,250
Share issue expenses	(15,811)	–	–	(15,811)
Capitalisation issue of shares	(34,300)	–	–	(34,300)
Net profit for the year	–	–	8,499	8,499
2000 final dividend paid	–	–	(8,400)	(8,400)
At 31 May and 1 June 2001	6,139	84,147	99	90,385
Net loss for the year	–	–	(1)	(1)
At 31 May 2002	**6,139**	**84,147**	**98**	**90,384**

NOTES TO FINANCIAL STATEMENTS

31 May 2002

24. RESERVES (continued)

The contributed surplus of the Company arose as a result of the Group reorganisation in 2000 and represents the excess of the then combined net assets of the subsidiaries acquired pursuant to the same reorganisation, over the nominal value of the Company's shares issued in exchange therefor.

Under the Companies Act 1981 of Bermuda, the Company's contributed surplus is available for cash distribution and/or distribution in specie under certain circumstances.

25. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

(a) Reconciliation of profit from operating activities to net cash inflow from operating activities

	2002	2001
	HK$'000	HK$'000
Profit from operating activities	**29,542**	49,667
Interest income	**(639)**	(1,326)
Depreciation	**3,207**	1,362
Amortisation of deferred development costs	**2,329**	1,464
Provision for impairment of deferred development costs	**5,277**	–
Loss on disposal of fixed assets	**77**	35
Provision for impairment of long term investments	**4,597**	–
Provision for bad and doubtful debts	**2,274**	–
Decrease in inventories	**2,058**	277
Increase in accounts receivable	**(53,993)**	(7,503)
Decrease/(increase) in prepayments, deposits and other receivables	**(5,511)**	7,656
Increase in accounts payable	**18,891**	4,048
Increase/(decrease) in accrued liabilities and other payables	**17,049**	(11,348)
Net cash inflow from operating activities	**25,158**	44,332

NOTES TO FINANCIAL STATEMENTS

31 May 2002

25. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT (continued)

(b) Analysis of changes in financing during the year

	Issued capital and share premium account HK$'000	Bank loan HK$'000	Due to a director HK$'000	Minority interests HK$'000
Balance at 1 June 2000	200	–	–	1,050
Net cash inflow from financing	47,939	–	–	–
Capital contribution from the minority equity holder of a subsidiary	–	–	–	150
Share of profit for the year	–	–	–	440
Dividend distributed to a minority equity holder of a subsidiary	–	–	–	(91)
At 31 May and 1 June 2001	48,139	–	–	1,549
Net cash inflow from financing	–	30,000	8,500	–
Capital contribution from the minority equity holder of a subsidiary	–	–	–	91
Share of profit for the year	–	–	–	293
At 31 May 2002	**48,139**	**30,000**	**8,500**	**1,933**

26. CONTINGENT LIABILITIES

As at 31 May 2002, the Company had provided corporate guarantees for banking facilities utilised by certain subsidiaries of HK$37,031,000 (2001: Nil).

The Group had no significant contingent liabilities at the balance sheet date (2001: Nil).

NOTES TO FINANCIAL STATEMENTS

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27. OPERATING LEASE ARRANGEMENTS

The Group leases certain of its office properties under operating lease arrangements. Leases for these properties are negotiated for terms ranging from one to six years.

At 31 May 2002, the Group had total future minimum lease payments under non-cancellable operating leases falling due as follows:

	Group	
	2002	2001
	HK$'000	HK$'000
		(Restated)
Within one year	**1,302**	1,376
In the second to fifth years, inclusive	**783**	1,834
	2,085	3,210

The Company had no significant operating lease arrangements at the balance sheet date (2001: Nil).

SSAP 14 (Revised), which was adopted during the year, requires lessees under operating leases to disclose the total future minimum operating lease payments, rather than only the payments to be made during the next year as was previously required. Accordingly, the prior year comparative amounts for operating leases as lessee above, have been restated to accord with the current year's presentation.

28. COMMITMENTS

In addition to the operating lease commitments detailed in note 27 above, the Group had contracted for capital commitments of HK$455,000 (2001: HK$145,000) in respect of decoration work for the Group's premises in the PRC at the balance sheet date.

As at 31 May 2001, the Group had a capital commitment of HK$4,400,000 in respect of the Factory Acquisition. During the year, as a result of the termination of the Factory Acquisition, the deposit was refunded (note 14) to the Group. In addition, the Group was discharged with the outstanding contracted commitment of HK$4,400,000.

The Company had no significant commitments at the balance sheet date (2001: Nil).

29. RELATED PARTY AND CONNECTED TRANSACTIONS

Details of the amount due to a director and certain guarantees executed by two directors of the Company in respect of banking facilities granted to the Group are set out in notes 21 and 22 to the financial statements.

NOTES TO FINANCIAL STATEMENTS

31 May 2002

30. POST BALANCE SHEET EVENTS

(a) In July 2002, the Company issued Convertible Debentures, bearing interest at 4.5% per annum, to Honest Concord Enterprises Limited, an independent third party.

The Convertible Debentures are convertible into new shares of the Company at any time after 29 July 2002 and up to the maturity date of the Convertible Debentures of 29 July 2004. The conversion price of the debentures is determined based on the higher of (i) the fixed conversion price of HK$0.065 per share, subject to adjustment; and (ii) 93% of the average closing price of the shares of the Company during the 10 business days immediately prior to conversion of the Convertible Debentures.

Details in respect of the above Convertible Debentures have been included in an announcement of the Company dated 30 July 2002.

In September 2002, a portion of the Convertible Debentures were converted into 150,000,000 shares of the Company of HK$0.02 each at a conversion price of HK$0.065 per share (note 23).

(b) During the period from August 2002 to October 2002, the Group entered into various agreements for the termination and disposal of a portion of its investments in the Rheumatic Treatment Centres. Details of the arrangements are set out in note 16 to the financial statements.

(c) On 28 August 2002, the Group entered into an agreement with an independent third party for the acquisition of 11% equity interest in a PRC entity, which is also engaged in the pharmaceutical industry, for a consideration of HK$20,000,000 (the "Acquisition"). The Group had fully settled the consideration of HK$20,000,000 up to October 2002. At the date of these financial statements, the Acquisition remained conditional, subject to the satisfaction of certain conditions as set out in the agreement.

31. COMPARATIVE AMOUNTS

As further explained in notes 2 and 27 to the financial statements, due to the adoption of SSAP 14 (Revised) during the current year, the presentation of operating lease commitments in the financial statements has been revised to comply with the new requirements. Accordingly, the related comparative amounts have been revised to conform with the current year's presentation.

32. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the directors on 29 October 2002.