

(Unless otherwise stated, financial data contained in this report is extracted from the accounts prepared in accordance with PRC accounting standards and systems.)

MANAGEMENT DISCUSSION AND ANALYSIS

Analysis of operations

1. Scope of business

The Group is principally engaged in (1) manufacture and sales of CPM; (2) wholesale, retail, import and export of western and Chinese pharmaceutical products and medical apparatus and (3) research and development of natural medicine and biological medicine.

2. Analysis of operating results

(a) Principal activities and geographical analysis of operations

During the year, due to the implementation of the State regulations on pharmaceutical products, the adoption of tendering system by the hospitals and the implementation of employees' medical care insurance, the competition in the domestic pharmaceutical market became severe. Confronted with a market full of challenges and opportunities, the Group implemented a number of measures and maintained a stable growth evident from its operating results.

According to the Group's consolidated accounts for the year ended 31 December 2002, turnover of the Group under both HK GAAP and PRC accounting standards and systems was Rmb5,943,823,000, representing an increase of 11.43% over that of 2001. Profit before taxation amounted to Rmb287,506,000, representing an increase of 10.54% over that of 2001. Profit before taxation under HK GAAP amounted to Rmb196,360,000, representing a decrease of 4.67% over that of 2001. An analysis of the Group's turnover and profit from principal activities for the reporting period by principal activities is as follows:

	Turnover		Profit from principal activities	
	Under PRC accounting standards and systems <i>Rmb'000</i>	Under HK GAAP <i>Rmb'000</i>	Under PRC accounting standards and systems <i>Rmb'000</i>	Under HK GAAP <i>Rmb'000</i>
Principal activities:				
Manufacturing	<u>1,743,449</u>	<u>1,743,449</u>	<u>936,815</u>	<u>954,083</u>
Trading				
Wholesale	3,794,686	3,794,686	265,374	270,636
Retail	307,501	307,501	78,916	80,259
Import and export	<u>98,187</u>	<u>98,187</u>	<u>8,304</u>	<u>8,402</u>
Subtotal	<u>4,200,374</u>	<u>4,200,374</u>	<u>352,594</u>	<u>359,297</u>
Total	<u><u>5,943,823</u></u>	<u><u>5,943,823</u></u>	<u><u>1,289,409</u></u>	<u><u>1,313,380</u></u>

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Geographical analysis of sales arising from manufacturing and trading operations is as follows:

Area	Manufacturing		Trading		Total Rmb'000	% to the total turnover
	Turnover Rmb'000	% to the manufacturing turnover	Turnover Rmb'000	% to the trading turnover		
Southern China	1,064,693	61.06	3,488,255	83.05	4,552,948	76.60
Eastern China	237,249	13.61	212,676	5.06	449,925	7.57
Northern China	138,774	7.96	117,620	2.80	256,394	4.31
North-East China	114,869	6.59	90,788	2.16	205,657	3.46
South-West China	96,963	5.56	129,053	3.07	226,016	3.80
North-West China	43,030	2.47	63,795	1.52	106,825	1.80
Exporting	47,871	2.75	98,187	2.34	146,058	2.46
Total	1,743,449	100.00	4,200,374	100.00	5,943,823	100.00

(b) CPM manufacturing business (the “manufacturing operations”)

Turnover of the manufacturing operations in 2002 under both HK GAAP and PRC accounting standards and systems was Rmb1,743,449,000, representing an increase of 6.64% over that of 2001. Profit before taxation of the manufacturing operations was Rmb213,587,000, representing an increase of 14.51% over that of 2001. Profit before taxation of the manufacturing operations under HK GAAP was Rmb147,502,000, representing a decrease of 2.13% over that of 2001.

In 2002, the manufacturing operations had the following achievements. Firstly, the manufacturing operations endeavored to introduce modern marketing mechanisms and attract marketing experts to push the sales of major products. Secondly, the manufacturing operations conducted a number of product promotion campaigns in certain major cities to enhance the marketing of special techniques to the end-user market. By these means, the Company is fully exposed to hospitals, retail and consumer markets. Thirdly, the manufacturing operations integrated the present sales network and strived to develop new distributors in the second and third level of the market and in rural areas. Fourthly, the manufacturing operations continued to expand its sales network in Eastern Europe. Fifthly, the Company adjusted its promotion campaign strategy timely after the issuance of State's regulations on advertisement of pharmaceutical products. All of these measures contributed to the increase in sales of key products.

The aforementioned strategies were formulated successfully. In 2002, the sales of the certain key products, e.g. Xiao Ke Wan, Hua Tuo Zai Zao Wan, the series of Wang Lao Ji Liang Cha and Xu Han Ting, significantly increased by 17.28%, 24.57%, 21.07% and 63.71% respectively over that of 2001.

Sales analysis of major products is as follows:

Product	Turnover 2002 Rmb	Gross profit 2002 Rmb
Heat clearing and anti-toxic	408,546,400	205,509,300
Diabetes curing	364,659,600	228,709,200
Cough and phlegm clearing	198,364,500	98,154,300
Arthritis curing	190,280,600	118,142,800
Gastric	82,937,000	36,990,900

The manufacturing operations placed emphasis on manufacturing costs and expenses controls and technology innovation and strengthened purchase management. In 2002, the average unit cost of major products decreased by 2.66% and the operating expenses decreased by 0.06% in comparison with 2001. The decrease in these costs made significant contributions to the growth in profit of the manufacturing operations.

The Group accelerated the process of the technology upgrade in 2002. Some projects which utilised proceeds from issue of A shares have been completed, including the upgrading of Xiao Ke Wan, Bao Ji Wan, automation of granules, the granules for children and tablets workshop. Guangzhou Qi Xing Pharmaceutical Factory (“Qi Xing”) was granted GMP certification in December 2002. Xing Qun completed relocation and construction of new factory plants. New factory plants for Guangzhou First Chinese Medicine Company Limited (“First Medicine”) is under construction. These technological reforms upgraded the manufacturing capacity and strengthened the market competitive ability.

During the year, inventory turnover days and accounts receivable turnover days were reduced by 4 days and 3 days respectively, in comparison with 2001.

The Group continued to strengthen the efforts in the 2nd phase research and re-development for major products. In 2002, one product passed the research stage and in the process of applying for production approval from government. Two products were granted production approvals and 17 projects were under research, such as “Feng shi Ping Jiao Nang” and “Yi Zhi Jiao Nang”. Besides, the research on the “Feng Shi Ping Jiao Nang” has passed the second clinical testing stage.

Guangzhou Hanfang Contemporary Chinese Medicine Research and Development Co., Ltd. (“Hanfang”) has obtained the approval from the State Development Planning Commission to build its modernised laboratory, which should be used as a testing and industrialisation base for the research and development of Chinese medicine and study of extraction and purification technology. Hanfang has completed the first stage of construction for the project of “Demonstration of the State’s Contemporary Chinese Medicine Technology”. The Company is currently conducting research projects, including one new category 1 medicine, Mao Dong Qing Fu Zhi Na, and one new category 2 and one new category 3 medicines such as Si Ni Huan Xi Pian, medicine for compound hypertension and Ji Yuan Jiao Nang.

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Guangzhou Baidi Biological Pharmaceutical Company Limited (“Baidi”) put great effort on researching and has been actively seeking projects for cooperation. Baidi is currently working on certain biological medicine projects such as DNA hepatitis vaccine, category 1 medicine, impediment anemia PHA project. Two self-researching projects, namely, nitric alkaline protein testing of brain and thymus element restructuring have been launched. In particular, the DNA hepatitis vaccine project has been granted the recognition from the SETC and appointed as one of the national core innovative projects in 2002.

In 2002, the Group has accelerated the implementation of computerised networking system. The ERP system has been implemented in all the 7 manufacturing subsidiaries. At present, the Group is in the process of implementing the ERP system for the trading operations.

- (c) Pharmaceutical trading business, including wholesaling, retailing, import and export (the “trading operations”)

Turnover of the Group’s trading operations in 2002, under both PRC accounting standards and systems and HK GAAP, was Rmb4,200,374,000, representing an increase of 13.55 % over that of 2001. Profit before taxation of the trading operations was Rmb73,919,000, representing an increase of 0.49% over that of 2001. Profit before taxation under HK GAAP was Rmb48,858,000, representing a decrease of 11.60% over that of 2001.

In 2002, due to the impact of the tendering system adopted by hospitals and changes in the pricing policy for pharmaceutical products, gross profit margin of the trading operations decreased by 0.33% over that of 2001. The trading operations made all efforts to maintain its core competitive advantage in order to face the severe market competition. Firstly, the trading operations set up a new department responsible for hospitals’ tendering system; Secondly, the trading operations continued to seek and develop new famous pharmaceutical products and their distribution rights in order to maintain the market share. Thirdly, the trading operations put more promotion efforts on markets outside of Guangdong Province and strengthened its monitoring of the end-user markets and chained pharmacies within Guangdong Province. Fourthly, the trading operations, through the result of co-operating with the manufacturing operations, adopted a win-win strategy for the Group’s famous brand name products.

Because of the severe market competition in the retailing sector, the Group adjusted its business development strategy for chained pharmacies. As at 31 December 2002, the Group has 268 chained pharmacies, including 163 Cai Zhi Lin shops, which mainly carry CPM, and 105 Jian Min shops, which mainly carry western pharmaceutical products.

In order to ensure improvement on profitability, the trading operations also worked on the controls over operating overheads. In addition, the trading operations have successfully improved its inventory control through sales statistic study. Furthermore, management has paid attention to the credit control and customer scanning policy. The decrease in operating overheads and increase in sales as well as the improvement on operating cash flows contributed to a sustained growth of the trading operations’ profit.

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3. Results and details of the Company's major subsidiaries

Enterprise name	Principal activities and major products	Total assets Rmb'000	Net assets Rmb'000	Net profit Rmb'000
First Medicine	Production and sales of CPM; major products are Xiao Ke Wan etc.	416,506	314,011	69,811
Guangzhou Chen Li Ji Pharmaceutical Co., Ltd. ("Chen Li Ji")	Production and sales of CPM; major products are Wu Ji Bai Feng Wan etc.	254,465	183,324	20,155
Qi Xing	Production and sales of CPM; major products are Hua Tuo Zai Zhao Wan etc.	178,512	162,133	14,267
Guangzhou Pharmaceutical Corporation Limited ("GPC")	Trading of western pharmaceutical products and medical apparatus	1,467,655	375,690	47,997
Guangzhou Chinese Medicine Corporation ("GCMC")	Trading of CPM and Chinese raw medicine	368,976	93,357	2,424
Guangzhou Pharmaceutical Import & Export Corporation ("GPIE")	Chinese and western medicine, medical apparatus, package and medical consumables	94,165	18,973	576
Xing Qun	Production and sales of CPM and chemical preparation; major products are Xia Shang Ju etc.	265,336	183,825	11,696
Jing Xiu Tang	Production and sales of CPM ; major products are Qing Re Xiao Yan Ning etc.	169,786	94,214	7,313
Pan Gao Shou	Production and sales of CPM ; major products are Mi Lian Chun Bei Pi Pa Gao etc.	261,717	183,917	13,509
Yang Cheng	Production and sales of CPM ; major products are Bao Ji Wan etc.	168,651	133,511	15,639
Guangzhou Huanye Pharmaceutical Co., Ltd. ("Huanye")	Production and sales of phytochemical medicine	35,610	25,026	568
Baidi	Research and manufacture of biological medicine	77,729	47,179	(2,821)
Hanfang	Research and manufacture of Chinese medicine	49,704	42,052	(7,545)

None of the Group's investee companies derived to the Group of any investment income, which equals to 10% or more of the Group's net profit.

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4. *Major customers and suppliers*

During the year, purchases of goods and services from the 5 largest suppliers amounted to Rmb833,534,000, representing approximately 19.63% of the total purchases. The purchases from the largest supplier amounted to Rmb197,518,000, representing 4.65% of the total purchases. Goods and services sold to the 5 largest customers amounted to Rmb304,964,000, representing 5.13% of the total sales. Sales to the largest customer amounted to Rmb135,313,000, representing 2.28% of the total sales.

To the knowledge of the Board, none of the Directors, their associates or shareholders holding more than 5% of the Company's total issued share capital had any interest in any of the major suppliers or customers noted above.

5. *Issues arising from operations and solutions*

The launching of hospital tendering system and new medicine pricing policy and the prohibition on the advertising of prescribed medicines in accordance with the newly enacted "Medicine Law" had negative impacts on both the manufacturing operations and the trading operations and led to the decrease in the gross profit margin of the trading operations. As remedial actions, the Company formulated the following strategies: 1. active participation in the tendering system of hospitals and expansion of the wholesale network to increase the share of prescription drugs market; and 2. strengthening on the promotion in end-user market and holding disease-prevention activities to secure an increase in the operating income of the Group.

The Company's investments

1 *Use of net proceeds from the issue of A shares*

Upon the approval from the CSRC, the Company issued 78,000,000 A shares at the subscription price of Rmb9.80 per share in the PRC on 10 January 2001. The net proceeds received from the issue was Rmb737,990,000. Up to 31 December 2002, Rmb417,800,000 of the net proceeds from the issue of A shares were utilised. The remaining proceeds are currently placed as bank deposits or used as working capital. The Company will gradually utilise the funds according to the requirement of the projects.

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- 2 At the end of the reporting period, the use of proceeds from the issue of A shares was in line with the prospectus for issue of A shares.

Details of use of the proceeds are as follows:

Category	Projects	Budgeted injection from the proceeds <i>Rmb'000</i>	Funds injected during the reporting period <i>Rmb'000</i>	Stage of completion %
Project for the technology upgrade and industrialisation of new products				
Pills	Xiao Ke Wan upgrade	29,800	29,800	100
	Bao Ji Wan upgrade	11,000	11,000	100
	Commercialisation of Wei Re Qing	29,000	4,780	80
	Automation of pill production	11,000	10,770	90
	Technology upgrade of Hua Tuo pills	17,000	14,130	90
	Throat, spleen and intestine pills technology upgrade	29,100	14,170	60
Syrup	Technology upgrade for syrup production	29,500	1,540	30
	Commercialisation of Keli syrup	19,600	4,320	55
Granules	Anti- perspiration granules upgrade	12,000	10,350	100
	Automation of granules upgrade	29,900	29,900	100
	Flu granules for children upgrade	23,000	23,000	100
Tablets	Commercialisation of Xiao Yin tablets	29,500	5,160	45
	Spleen, intestine and pimples tablets upgrade	17,800	7,050	50
	Gaolu upgrade	29,500	12,760	50
	Tablets workshop upgrade	12,000	12,000	100

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	Budgeted injection from proceeds of issue <i>Rmb'000</i>	Funds injected during reporting period <i>Rmb'000</i>	Stage of completion %
Industrialisation foundation			
Modernisation of extraction and purification technology	29,900	9,960	40
Critical purification of CO2 technology foundation	29,900	—	—
Trading			
Expansion of chain pharmacies			
Jian Min	89,300	62,910	65
Cai Zhi Lin	59,500	19,000	60
Logistic centre upgrade	20,000	9,290	40
ERP for trading section upgrade	20,000	10,220	50
Bio-chemical research centre	80,000	36,000	40
Additional working capital	50,000	79,690(note)	—
Total	708,300	417,800	—

Note: The proceeds from the issue of A shares were approximately Rmb737,990,000. The portion exceeded the budgeted proceeds amounted to Rmb29,690,000 was used as additional working capital.

(a) Explanatory note on returns on projects and the stage of completion

During the reporting period, additional sales and net profit from the completed projects amounted to Rmb345,090,000 and Rmb175,320,000 respectively.

Due to plant relocation, technology upgrade for syrup production was delayed. Expansion of chained pharmacies was also slowed down because of the severe competition in the retailing sector. The traffic re-construction in the Guangzhou City led to the delay of the logistic centre project but related stages of sourcing the materials for the logistic center are in progress.

(b) At the end of the reporting period, there was no change in the proposed use of the proceeds from issuing A share as disclosed in the prospectus for issue of A shares.

3. Major investments through use of funds generated from the Group's operations

- (a) With the approval from the Investment Management Committee of the Company on 16 May 2002, Guoyao Group Industry Co., Ltd. (“Guoyao”) was established on 30 December 2002 by the Company and Chinese Pharmaceutical Industry Co., Ltd. for the purpose of producing raw medicine for Ah Pian powder and Yan Suan Ma Huang Su. The registered capital is Rmb80,000,000. The total investment made by the Company is Rmb8,000,000, representing 10% of the equity of Guoyao.
- (b) With the approval from the Investment Management Committee of the Company in October 2002, the Company made an investment of Rmb15,331,200 in the equity of Huanye. The registered capital of Huanye is Rmb6,000,000. The Company holds 59.7% of the registered capital. Huanye is principally engaged in chemical raw medicine production and medical research and development. The investment helps the Group improve its ability on research and production of phytochemical medicine.
- (c) With the approval from the Investment Management Committee of the Company on 21 January 2002, the Company entered into a joint venture agreement with Guangzhou Security Co., Ltd., Sichuan Nanfang Xiwan Co., Ltd. and Media Co., Ltd. to establish a fund management company, namely Guangzhou Jin Ying Fund Management Company (“Jin Ying”). Jin Ying is established on 6 November 2002 with registered capital of Rmb100,000,000. The Company’s investment therein is Rmb20,000,000, representing 20% of the total equity. Meanwhile, the Company is contemplating to subscribe 8,000,000 units of the “Jin Ying” unit trust issued by Jin Ying at a total price of Rmb8,000,000.

The above-mentioned investments further enriched and diversified the Company’s investment portfolio.

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Financials

1 Financial Status

Extracted from the accounts prepared in accordance with PRC accounting standards and systems

	2002	2001	2001	Change
	<i>Rmb'000</i>	<i>Rmb'000</i>	Restated <i>Rmb'000</i>	%
Total assets	4,173,194	3,697,239	3,702,113	12.72
Shareholders' equity	2,286,929	2,172,910	2,172,916	5.25
Profit from principal activities	1,289,409	1,148,025	1,148,025	12.32
Net profit	158,478	146,134	146,134	8.45
Increase in cash and cash equivalents	126,211	379,067	379,067	(66.70)

Extracted from the accounts prepared in accordance with HK GAPP

	2002	2001	Change
	<i>Rmb'000</i>	<i>Rmb'000</i>	%
Total assets	4,361,135	3,877,969	12.46
Shareholders' equity	2,455,066	2,408,430	1.94
Profit from principal activities	219,485	215,384	1.90
Net profit	94,561	95,868	(1.36)
Increase in cash and cash equivalents	104,988	405,463	(74.11)

Reasons for changes:

- (i) Total assets increased by 12.72%. The major reasons for the increase were: (1) increase in accounts receivable by Rmb169,300,000, representing an increase of 30.94% over that of 2001; (2) increase in prepayments by Rmb39,534,000, representing an increase of 96.03% over that of 2001; (3) increase in long-term investments by Rmb28,750,000, representing an increase of 31.73% over that of 2001; (4) increase in short-term loans by Rmb167,660,000, representing an increase of 43% over that of 2001; (5) increase in welfare benefits payable by Rmb14,552,000, representing an increase of 34% over that of 2001; (6) increase in long-term loans by Rmb79,680,000, representing an increase in 797% over that of 2001; and (7) increase in net profit by Rmb12,344,000, representing an increase of 8.45% over that of 2001.
- (ii) Shareholders' funds increased by 5.25%. The increase was mainly contributed by net profit of Rmb158,478,000 of the year.

- (iii) Profit from principal activities and net profit increased by 12.32% and 8.45% respectively. The major reasons were the increase in revenue by Rmb609,795,000, representing an increase in 11.43% over that of 2001 and increase in gross profit margin by 0.16% over that of 2001.
- (iv) Cash and cash equivalents decreased by 66.7%. The major reasons were (1) the proceeds of Rmb73,799,000 from the issue of A shares in 2001; (2) the increase in accounts receivable by Rmb169,300,000 leading to the significant decrease in the operating cash inflows.

2. *Liquidity, financial resources and capital structure*

As at 31 December 2002, long-term borrowings of the Group amounted to Rmb89,680,000. These borrowings were fixed interest loans denominated in Rmb and repayable in the third to fifth year. As at 31 December 2002, the cash and cash equivalents of the Group amounted to Rmb1,019,900,000, of which approximately 89.46% was denominated in Rmb and 10.54% was denominated in Hong Kong dollars.

3. *Capital expenditure*

The Group expects that capital expenditure during 2003 would be approximately Rmb 291 million. The Group has sufficient financial resources to meet the demand for capital expenditure and daily working capital requirement.

4. *Exposure to fluctuations in exchange rate*

As majority of the revenue, expenses, assets and liabilities of the Group are denominated in Rmb, the Group does not have significant risk in exposure to fluctuations in exchange rate.

5. *Contingent liabilities*

Up to 31 December 2002, the Group has no significant contingent liabilities.

6. *Charge on Group assets*

At 31 December 2002, the net book value of fixed assets pledged as collateral for the Group's bank loans amounted to Rmb118,030,000.

Impact of the changes in production environment and macro economy on the Company

As required by the Provisional Rules of Medical Insurance issued by the Guangzhou People's Municipal Government effective on 1 December 2001, it is mandatory for the enterprises in Guangzhou City to participate in the medical scheme for all retired and retiring employees.

In accordance with the requirement of HK GAAP, the contributions accrued by the Group for retired employees and past service of retiring employees were expensed in 2002. Financial result of the Group shown in the accounts prepared in accordance with HK GAAP for the year ended 31 December 2002 was affected by such expense recognition. Detail information is shown in Other Matters on page 37.

New business plan

2003 is a year full of challenges and opportunities. The PRC's entry into the WTO and the rapid development of natural medicine in global market will have great impact on domestic pharmaceutical business. With the support of its advanced technologies and adequate funds, the Company will endeavor to expand its share in domestic and overseas markets.

The Group will emphasise on promotion and advertisement to cultivate certain brand name products. Additionally, the Group will engage professional marketing consultants to assist the Company in formulating and implementing certain modern marketing strategies. Meanwhile, the Company will form alliance with other enterprises to share advantages and resources.

The Group will put more effort on research and development by co-operating with certain advanced research institutions. In addition, the Group will accelerate the commercialisation of certain products with market potential and increase its economic scale.

The Group will accelerate the construction of the new factory plant for First Medicine and put more efforts on the GMP re-engineering for Xing Qun and Pan Gao Shou in order to have the full scale GMP re-engineering completed in 2003.

In addition to the core business, the Group will actively seek promising business related investment projects, such as bio-chemical projects, medicine commercialisation projects, etc and attract domestic and overseas strategic investors. Through merger, acquisition and restructuring, the Company will diversify its business and explore new profitable business.

In 2003, the Company will continue to strive generating favourable returns for the Company's shareholders.

DAILY OPERATION OF THE BOARD

Board meetings

All Directors of the Company have complied with the PRC Company Law, fulfilled their responsibilities as set forth in the Company's Articles of Association, and diligently executed the resolutions of the general meetings of shareholders.

During the reporting period, the Board held 11 meetings. Major points and resolutions of those meetings are as follows:

- 1 The 11th meeting of the Board of the 2nd term was held on 7 February 2002. The following resolutions were passed:
 - Mr. Chen Xiangzhi's resignation from his position as Director and the nomination of Mr. Zhou Yuejin as successor;
 - the establishment of a Remuneration & Evaluation Committee;
 - the implementation of a long-term incentive scheme;
 - to convene the 1st 2002 EGM for the discussion of the resolutions mentioned above.
- 2 The 12th meeting of the Board of the 2nd term was held on 7 February 2002. The following resolution was passed by poll ballot:
 - appointed Hanfang to apply and construct the national modernised Chinese medicine production centre.
- 3 The 13th meeting of the Board of the 2nd term was held on 4 April 2002. The following resolutions were passed:
 - the 2001 Directors' Report;
 - the 2001 audited accounts;
 - the 2001 auditors' reports;

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- the re-appointment of Guangzhou Yangcheng Certified Public Accountants Co., Ltd. and PricewaterhouseCoopers, as domestic and international auditors respectively, and to recommend at the AGM to authorise to the Board to determine auditors' remuneration;
- the scheme of profit distribution and dividend payment for 2001;
- the aggregate amount of emoluments to be paid to the Directors and Supervisors in 2002;
- the Rules for Shareholders' Meeting;
- the Rules for Directors' Meeting;
- the Rules for Information Disclosure;
- the General Manager Working Guidelines;
- the amendments to the Articles of Association;
- the 2002 long-term incentive scheme for 2002;
- to recommend at the AGM to authorise to the Board to allot and issue new shares;
- to convene the 2001 AGM.

4 The 14th meeting of the Board of the 2nd term was held on 26 April 2002. The following resolution was passed by poll ballot:

- the 2001 1st quarter announcement.

5 The 15th meeting of the Board of the 2nd term was held on 17 May 2002. The following resolution was passed by poll ballot:

- the changes in the composition of the members of the Investment Management Committee of the Company in compliance with the "Regulations of Managing Listed Companies".

6 The 16th meeting of the Board of the 2nd term was held on 19 June 2002. The following resolutions were passed:

- the resignation of Mr. Jiang Shijie from his Financial Controller position of the Company due to retirement ;
- the appointment of Mr. Gao Fang as Financial Controller of the Company, the contract term is up to the expiration of the Board of of the 2nd term.

- 7 The 2002 ad-hoc directors' meeting was held on 20 June 2002. The following resolutions was passed:
- the Self-examination Report on Modernised Corporate System for Listed Companies.
- 8 The 17th meeting of the Board of the 2nd term was held on 16 July 2002. The following resolution was passed:
- the connected transactions between Guangzhou Pharmaceutical Industrial Research Institution ("GPIRI") and Baidi in respect of the acquisition of properties from GPIRI.
- 9 The 18th meeting of the Board of the 2nd term was held on 16 August 2002. The following resolution were passed:
- the 2002 interim announcement;
 - the 2002 unaudited interim accounts and profit distribution scheme;
 - the provisional scheme on the employees' housing subsidies.
- 10 The 19th meeting of the Board of the 2nd term was held on 25 October 2002. The following resolution was passed:
- the 2002 3rd quarter announcement.
- 11 The 20th meeting of the Board of the 2nd term was held on 27 December 2002. The following resolutions were passed:
- the implementation of the Internal Financial Management System;
 - the policies formulated in response to the queries raised by the CSRC;
 - to authorise the Chairman to sign the letter of consent to guarantee the loan credit facility granted to the Group.

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The progress of execution by the Directors in respect of the resolution of the general meetings

2001 final dividend

Pursuant to the resolutions passed at the 2001 AGM, the 2001 final dividend of Rmb0.06 per share had been paid to the shareholders in July 2002. The registration date for H Shares' shareholders for the final dividend was on 13 May 2002. The closing date was on 14 May 2002. The registration date for A Shares' shareholders for the final dividend was on 20 June 2002. The closing date was on 21 June 2002.

PROPOSED SCHEME OF PROFIT DISTRIBUTION AND INCREASE IN SHARE CAPITAL FROM CAPITAL RESERVE

According to the Company's Articles of Association, the amount of retained profits available for distribution to shareholders of the Company is the lower of the amount determined in accordance with RPC accounting standards and systems and the amount determined in accordance with HK GAAP. The Board recommended a final dividend of Rmb0.06 per share (including withholding tax for A Shares) for the year ended 31 December 2002.

The proposed final dividend, if passed at the AGM on 16 May 2003, will be paid on or before 30 May 2003 to H shares' shareholders whose names appear on the Company's register of members at the close of business on 24 April 2003 (Thursday). The registration day of the A shares shareholders, date of payment of the dividend, and the method of payment will be announced separately.

During the year, there was no increase in share capital from the capital reserve.

CHANGE IN THE NEWSPAPERS DESIGNATED BY THE COMPANY FOR INFORMATION DISCLOSURE

During the reporting period, there was no change in the newspapers designated by the Company for information disclosure.

OTHER MATTERS

1 *Employees' medical insurance*

As required by the Provisional Rules of Medical Insurance issued by the Guangzhou People's Municipal Government effective on 1 December 2001, it is mandatory for enterprises of Guangzhou City to participate in a medical insurance for their retired and retiring employees. Accordingly, the 21st meeting of the 2nd term of the Board on 23 January 2003 approved a resolution to adopt accounting treatment under HK GAAP in relation to the medical insurance for its retired and retiring employees on an accrual basis.

According to the accounting treatment under HK GAAP, payment to be made by the Group in relation to medical insurance for past services of its retired and retiring employees should be recognised as an expense in 2002. Based on the estimation by the Company, the net present value of the aggregate payments for medical insurance in 2002 and the next nine years is approximately Rmb 78.9 million, representing about 3.34% of the Group's net tangible asset as at 31 December 2002.

2. The Company's Level One American Depository Receipts ("ADRs") Program became effective on 21 June 2002. The ADRs are publicly traded in the over-the-counter markets in the United States. The stock code is 40066D108, and the ADRs code is "GZPGY". Each ADR represents 20 H shares. The nominal value of each H share is Rmb1. The registered quantity of ADRs is 10,000,000.

3. *Accounts*

The results of the Group for the year ended 31 December 2002 are set out in the consolidated profit and loss account prepared in accordance with PRC accounting standards and systems and HK GAAP on page 50 and page 110 respectively.

The state of affairs of the Group as at 31 December 2002 is set out in the consolidated balance sheet prepared in accordance with PRC accounting standards and systems and HK GAAP on page 48 and page 111 respectively.

The cash flows of the Group for the year ended 31 December 2002 is set out in the consolidated cash flow statement prepared in accordance with PRC accounting standards and systems and HK GAAP on page 53 and page 114 respectively.

The cash flows of the Company for the year ended 31 December 2002 is set out in the cash flow statement prepared in accordance with PRC accounting standards and systems on page 59.

REPORT OF THE DIRECTORS

4. *Financial summary*

A summary of the results and of the assets and liabilities of the Group for the last five financial years prepared in accordance with HK GAAP is set out on page 6.

A summary of the results and of the assets and liabilities of the Group for the last three financial years prepared in accordance with PRC accounting standards and systems is set out on page 6.

5. *Reserves*

Movements in the reserves of the Group during the year in accordance with PRC accounting standards and systems are set out on page 93 to 94.

Movements in the reserves of the Group and of the Company during the year in accordance with HK GAAP are set out on page 137 and 138.

6. *Distributable reserves*

In accordance with the Company's Articles of Associations, the profit available for distribution to shareholders is the lower between the amount determined in accordance with HK GAAP and the PRC accounting standards and systems. The distributable reserves of the Company as at 31 December 2002 amounted to Rmb57,704,000, calculated under HK GAAP.

7. *Fixed assets*

Details of the movements of fixed assets of the Group in accordance with PRC accounting standards and systems are set out on page 78.

Details of the movements of fixed assets of the Group and of the Company in accordance with HK GAAP are set out on page 130 to 131.

8. *Directors' and Supervisors' interest in contracts*

No contracts of significance in relation to the Group's business to which the Company, its fellow subsidiaries or its holding company was a party and in which a Director or Supervisor of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

9. *Connected transactions*

Details of the connected transactions were set out on page 100 to 107, and, page 146 to 147.

Other transactions with jointly controlled entities and associated companies as disclosed on notes to the accounts which do not constitute connected transactions under the Listing Rules.

The Directors believe that the above-mentioned connected transactions fully comply with the waivers granted by HKSE.

The Non-Executive Directors have reviewed the connected transactions and regarded the transactions as being carried out within the Company's ordinary operations and under ordinary business terms. The relative terms were considered normal business terms or at least no more favourable than the preferential terms offered to third parties.

10. *Management contracts*

No contracts concerning the management and administration of the whole or any substantial part of the business of the Company were entered into or existed during the year.

11. *Compliance with the code of best practice*

Throughout the year, the Company was in compliance with the Code of Best Practice as set out in Appendix 14 to the Listing Rules.

12. *Audit Committee*

The Audit Committee had reviewed the accounting policies, accounting regulations and methods adopted by the Company, and discussed with management about the audit, internal controls and financial reporting. The Committee also reviewed the audited accounts for the year ended 31 December 2002.

13. *Tax exemption*

Pursuant to circular No. 45 of the Taxation Law of the PRC issued in 1993, companies established in the PRC and expatriates working in the PRC are exempt from income tax on dividend income derived from holdings shares in companies listed on overseas stock exchange. Except for the above, there is no other tax preferential scheme.

REPORT OF THE DIRECTORS

14. Retirement scheme

Details of the retirement scheme and amounts of contributions charged to the profit and loss account for the year are set out on page 120 and page 126.

15. Staff quarters

Pursuant to the Accommodation Service Agreement entered into between the Company and GZPHL, GZPHL agreed to sell the staff quarters to the employees of the Group at a preferential price. The Company shall pay to GZPHL the staff quarters reform costs, which represent the difference between the preferential price and the cost net of depreciation paid by GZPHL on buildings acquired for such staff quarters. The total staff quarters reform costs, which are payable to GZPHL, amounted to approximately Rmb62,030,000 (2001: RMB62,030,000).

In addition, the Group has constructed or acquired certain staff quarters. As at 31 December 2002, the difference between the construction cost or acquisition cost and the revenue from disposal of the quarters totalled Rmb42,437,000. (2001: Rmb42,437,000)

The above mentioned staff quarters reform costs amounted to Rmb104,467,000 as at 31 December 2002 (2001: Rmb104,467,000).

According to the regulation in Caiqi [2000] No.295, the Notice on accounting Treatment Method of Housing Reform Initiated in Enterprises, issued by the Ministry of Finance, the costs arising there from should be dealt with in retained earnings as at 1 January 2002. Subject to the approval by the Board of Directors, any deficit balance should be appropriated to the statutory public welfare fund, statutory surplus reserve fund, and capital reserve. This accounting treatment has been adopted in the accounts prepared in accordance with PRC accounting standards and systems.

For the accounts prepared in accordance with HK GAAP, the staff quarters reform costs have been deferred and amortized on a straight-line basis to the profit and loss account over a period of 10 years, which is the estimated remaining average service life of the employees. The total accumulated amortization as at 31 December 2002 was approximately Rmb35,450,000. As at 31 December 2002, the net carrying value of the deferred staff quarters reform costs was Rmb69,017,000. In the opinion of the board of directors of the Company, if the aforesaid deferred staff quarter reform cost had been completely written off in 2002, the consolidated net assets of the Group as at 31 December 2002 would have been reduced by approximately Rmb69,017,000.

With respect to the document (Suifu [2000] 18) issued by the Guangzhou People's Municipal Government on concerning the one-time cash accommodation allowance to (i) those employees to whom the Group has not allocated staff quarters and (ii) those aged employees whose allocated staff quarters do not meet required standards, the Directors consider that the said document is not legally binding on the Group. In 2001, the Group has formulated its own cash accommodation allowance policy to employees based on the Group's situation.

16. *Purchase, sale or redemption of shares*

The Company has not redeemed any of its shares during the year. Neither the Company nor any of its subsidiaries has purchased or sold any of the Company's shares during the year.

17. *Bank loans, overdraft and other loans*

As at 31 December 2002, the details of the bank loans, overdrafts, and other liabilities are set out on page 89, 91, 92, and, page 135 and 140. In comparison to the prior year, there have been no material adverse changes in respect of the amounts of bank loans, overdrafts and total liabilities as at 31 December 2002.

18. *Gearing ratio*

Up to 31 December 2002, there have been no material adverse change in the gearing ratio of the Group.

19. *Auditors*

Guangzhou Yangcheng Certified Public Accountants Co., Ltd. and PricewaterhouseCoopers were respectively appointed as domestic and international auditors of the Company for the year 2002, as approved at the 2001 AGM.

A resolution for the re-appointment of Guangzhou Yangcheng Certified Public Accountants Co., Ltd. and PricewaterhouseCoopers as domestic and international auditors respectively of the Company for the year 2003 is to be proposed at the forthcoming AGM.

There was no change in auditors in the past 3 years.

On behalf of the Board
Cai Zhixiang
Chairman

21 March 2003