

## DIRECTORS' REPORT

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### DIRECTORS' REPORT

The directors present their annual report and the audited financial statements for the year ended December 31, 2003.

### PRINCIPAL ACTIVITIES

The Company is an investment holding company. Details of the activities of its subsidiaries and a jointly controlled entity are set out in notes 34 and 16 to the financial statements, respectively.

### CHANGE OF COMPANY NAME

Pursuant to a special resolution passed at the special general meeting of the Company held on April 23, 2003, the name of the Company was changed from China Pharmaceutical Enterprise and Investment Corporation Limited 中國製藥企業投資有限公司 to China Pharmaceutical Group Limited 中國製藥集團有限公司. The new name became effective on May 7, 2003.

### MAJOR CUSTOMERS AND SUPPLIERS

The aggregate sales and purchases attributable to the Group's five largest customers and suppliers were less than 30% of the Group's total sales and purchases for the year, respectively.

### RESULTS AND APPROPRIATIONS

The results of the Group and appropriations of the Company for the year ended December 31, 2003 are set out in the consolidated income statement on page 19 of the annual report and the accompanying notes to the financial statements.

An interim dividend of HK7.0 cents per share amounting to HK\$107,669,000 was paid to the shareholders during the year. The directors now recommend a final dividend of HK7.0 cents per share to the shareholders on the register of members on May 14, 2004, amounting to HK\$107,669,000 and retention of the remaining profit of HK\$288,831,000.

### PROPERTY, PLANT AND EQUIPMENT

During the year, the Group continued to expand and upgrade its production facilities for bulk drug products and finished drug products. Details of these and other movements in the property, plant and equipment of the Group during the year are set out in note 11 to the financial statements.

### SHARE CAPITAL AND SHARE OPTIONS

Details of movements in the issued share capital and share options of the Company are set out in notes 24 and 25 to the financial statements, respectively.

**DIRECTORS AND DIRECTORS' SERVICE CONTRACTS**

The directors of the Company during the year and up to the date of this report were:

*Executive directors:*

Cai Dong Chen, *Chairman*

Ding Er Gang

Qu Ji Guang

Wei Fu Min

Yue Jin

Feng Zhen Ying (appointed on June 11, 2003)

Liu Yi (resigned on June 11, 2003)

*Independent non-executive directors:*

Huo Zhen Xing

Lee Ka Sze, Carmelo

Qi Mou Jia

Guo Shi Chang (appointed on February 5, 2004)

In accordance with Article 92 of the Company's Article of Association, the new directors, Messrs. Feng Zhen Ying and Guo Shi Chang retire at the forthcoming annual general meeting and being eligible, offer themselves for re-election.

In accordance with Article 101 of the Company's Articles of Association, Messrs. Qu Ji Guang, Yue Jin and Lee Ka Sze, Carmelo retire at the forthcoming annual general meeting by rotation and, being eligible, offer themselves for re-election.

None of the directors being proposed for re-election at the forthcoming annual general meeting has a service contract with the Company or any of its subsidiaries, which is not determinable by the Group within one year without payment of compensation, other than statutory compensation.

**BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT****CAI Dong Chen**

Appointed as a director of the Company in 1998. Mr. Cai, aged 50, senior engineer, is the Chairman of Shijiazhuang Pharmaceutical Group Company Limited ("SPG"). Mr. Cai graduated from Hebei Pharmaceutical Finance College, the People's Republic of China (the "PRC") in 1972. He joined Hebei Pharmaceutical Factory ("HPF"), the PRC in 1972 as a technician and was appointed as factory manager of HPF in 1984. Mr. Cai has over twenty years of management experience in the pharmaceutical industry.

**BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT – continued****DING Er Gang**

Appointed as a director of the Company in 1997. Mr. Ding, aged 43, is an economist. He graduated from Hebei College of Economic, the PRC and joined Hebei Province Municipal Planning Research Centre as an assistant researcher. Mr. Ding is responsible for the overall financial management and investor relations.

**QU Ji Guang**

Appointed as a director of the Company in 2001. Mr. Qu, aged 49, has over twenty years of marketing and management experience in the pharmaceutical industry.

**WEI Fu Min**

Appointed as a director of the Company in 1994. Mr. Wei, aged 57, is a senior engineer. He graduated from Tianjin Industrial College, the PRC in 1970. Mr. Wei has over twenty years of technical and management experience in the pharmaceutical industry.

**YUE Jin**

Appointed as a director of the Company in 2001. Mr. Yue, aged 40, graduated from Hebei University, the PRC in 1985. Mr. Yue has over fifteen years of product development and project management experience in the pharmaceutical industry.

**FENG Zhen Ying**

Appointed as a director of the Company in June 2003. Mr. Feng, aged 48, graduated from Hebei Chemical College, the PRC and is a senior engineer. Mr. Feng has over twenty years of technical and management experience in the pharmaceutical industry.

**HUO Zhen Xing**

Appointed as a non-executive director of the Company in 1994. Mr. Huo, aged 67, was the former head of Industrial and Commercial Bank of China, Hebei Province branch and Shijiazhuang sub-branch.

**LEE Ka Sze, Carmelo**

Appointed as a non-executive director of the Company in 1996. Mr. Lee, aged 44, is a solicitor by profession and is a partner of a law firm in Hong Kong.

**QI Mou Jia**

Appointed as a non-executive director of the Company in 1996. Mr. Qi, aged 70, is a senior engineer. He is a former director of State Drug Administration of China ("SDA"). He was the deputy chairman and chairman of SDA in 1978 and 1982-1994 respectively.

**BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT – continued**

**GUO Shi Chang**

Appointed as a non-executive director of the Company in February 2004. Mr. Guo, aged 62, is an engineer. He was the Vice Governor of Hebei Provincial People's Government, the PRC from 1993 to 2002.

**DIRECTORS' INTERESTS IN SHARES, UNDERLYING SHARES AND DEBENTURES**

As at December 31, 2003, the interests of the directors and their associates in the shares, underlying shares and debentures of the Company and its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")), as recorded in the register maintained by the Company pursuant to Section 352 of the SFO, or as otherwise notified to the Company and The Stock Exchange of Hong Kong Limited (the "Stock Exchange") pursuant to the Model Code for Securities Transactions by Directors of Listed Companies (the "Model Code") contained in the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules"), were as follows:

| Name of director | Capacity         | Number of issued<br>ordinary shares held | Percentage of the issued<br>share capital of the Company |
|------------------|------------------|--|--|
| Cai Dong Chen    | Beneficial owner | 2,000,000                                | 0.13%  |
| Ding Er Gang     | As a trustee     | 25,000,000 <i>(Note)</i>                 | 1.63%  |
|                  | Beneficial owner | 1,000,000                                | 0.07%  |
| Wei Fu Min       | Beneficial owner | 500,000                                  | 0.03%  |
| Yue Jin          | Beneficial owner | 500,000                                  | 0.03%  |

*Note:* The shares are held in trust for SPG, the Company's substantial shareholder.

Other than as disclosed above, none of the directors nor their associates had any interests or short positions in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) as at December 31, 2003, as required to be recorded in the register maintained by the Company pursuant to Section 352 of the SFO, or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code.

**SHARE OPTIONS**

Particulars of the Company's share option scheme are set out in note 25 to the financial statements.

The following table discloses movements in the Company's share options during the year:

| Name of director   | Date of grant | Exercisable period     | Exercise price | Outstanding at 1.1.2003  | Exercised during the year  | Lapsed during the year     | Outstanding at 12.31.2003 |
|--|---------------|------------------------|----------------|--------------------------|----------------------------|----------------------------|---------------------------|
| Cai Dong Chen  | 3.27.2000     | 9.28.2000 to 9.27.2003 | HK\$0.62       | 10,000,000               | (10,000,000)               | –                          | –                         |
|  | 8.15.2001     | 2.16.2002 to 5.26.2004 | HK\$0.61       | 5,000,000                | (5,000,000)                | –                          | –                         |
| Ding Er Gang   | 3.27.2000     | 9.28.2000 to 9.27.2003 | HK\$0.62       | 5,000,000                | (5,000,000)                | –                          | –                         |
|  | 8.15.2001     | 2.16.2002 to 5.26.2004 | HK\$0.61       | 3,000,000                | (3,000,000)                | –                          | –                         |
| Qu Ji Guang  | 2.19.2000     | 8.20.2000 to 8.19.2003 | HK\$0.67       | 1,304,000                | (1,304,000)                | –                          | –                         |
|  | 8.15.2001     | 2.16.2002 to 5.26.2004 | HK\$0.61       | 3,000,000                | (3,000,000)                | –                          | –                         |
| Wei Fu Min   | 8.15.2001     | 2.16.2002 to 5.26.2004 | HK\$0.61       | 4,304,000                | (4,304,000)                | –                          | –                         |
| Yue Jin  | 2.19.2000     | 8.20.2000 to 8.19.2003 | HK\$0.67       | 1,304,000                | (1,304,000)                | –                          | –                         |
|  | 8.15.2001     | 2.16.2002 to 5.26.2004 | HK\$0.61       | 3,000,000                | (3,000,000)                | –                          | –                         |
| Liu Yi<br>(former director,<br>resigned on<br>June 11, 2003)               | 2.19.2000     | 8.20.2000 to 8.19.2003 | HK\$0.67       | 1,306,000                | –                          | (1,306,000)                | –                         |
|  | 8.15.2001     | 2.16.2002 to 5.26.2004 | HK\$0.61       | 3,000,000                | –                          | (3,000,000)                | –                         |
| Wang Xian Jun<br>(former director,<br>resigned on<br>December 23,<br>2002) | 3.27.2000     | 9.28.2000 to 9.27.2003 | HK\$0.62       | 5,000,000                | –                          | (5,000,000)                | –                         |
|  | 8.15.2001     | 2.16.2002 to 5.26.2004 | HK\$0.61       | 3,000,000                | –                          | (3,000,000)                | –                         |
| Total directors  |               |                        |                | <u>48,218,000</u>        | <u>(35,912,000)</u>        | <u>(12,306,000)</u>        | –                         |
| Total employees  | 2.19.2000     | 8.20.2000 to 8.19.2003 | HK\$0.67       | 3,912,000                | –                          | (3,912,000)                | –                         |
| Grand total  |               |                        |                | <u><u>52,130,000</u></u> | <u><u>(35,912,000)</u></u> | <u><u>(16,218,000)</u></u> | <u>–</u>                  |

No options were granted or cancelled during the year.

**ARRANGEMENT TO PURCHASE SHARES OR DEBENTURES**

Other than as disclosed above, at no time during the year was the Company or any of its holding companies, or its fellow subsidiaries or its subsidiaries a party to any arrangement to enable the directors of the Company to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.

**DIRECTORS' INTERESTS IN CONTRACTS OF SIGNIFICANCE**

Woo, Kwan, Lee & Lo, a firm of solicitors of which Mr. Lee Ka Sze, Carmelo is a partner, rendered professional services to the Group for which it received normal remuneration.

Other than as disclosed above, no contracts of significance to which the Company, its holding companies, or any of its fellow subsidiaries or subsidiaries was a party and in which a director 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.

**SUBSTANTIAL SHAREHOLDER**

As at December 31, 2003, the register of substantial shareholders maintained by the Company pursuant to Section 336 of the SFO shows that the following shareholder had notified the Company of relevant interests in the share capital of the Company.

| <b>Number of substantial shareholder</b> | <b>Number of ordinary share of the Company held</b> | <b>Percentage of issued share capital</b> |
|--|---|---|
| SPG                                      | 783,316,161 ( <i>Note</i> )                         | 50.93%                                    |

*Note:* In respect of the 783,316,161 shares, 748,436,399 shares are held by SPG, 25,000,000 shares are held by Mr. Ding Er Gang, an executive director of the Company, as trustee for SPG and 9,879,762 shares are held by China Charmaine Pharmaceutical Company Limited, a wholly-owned subsidiary of SPG.

Other than as disclosed above, the Company has not been notified of any other relevant interests or short positions in the shares and underlying shares of the Company as at December 31, 2003 or any other interests representing 5% or more of the issued share capital of the Company as at December 31, 2003.

**CONNECTED TRANSACTIONS**

Details of the discloseable connected transactions during the year are set out in note 33 (I) to the financial statements. In the opinion of the independent non-executive directors, the above transactions were entered into by the Group:

- (i) in the ordinary and usual course of the Group's business;
- (ii) on normal commercial terms or on terms that are fair and reasonable so far as the shareholders of the Company are concerned;

**CONNECTED TRANSACTIONS – continued**

- (iii) in accordance with the terms of the agreements governing such transactions or on terms no less favourable than terms available to or from independent third parties; and
- (iv) within the relevant cap amounts as agreed by the Stock Exchange.

In addition, the Group entered into the following connected transactions during the year:

- (a) On February 19, 2003, the Company entered into an agreement with SPG and Shijiazhuang Pharmaceutical Group New Medicine Company Limited, a wholly-owned subsidiary of SPG, for the acquisition by the Company of the entire issued share capital of Zhongqi Pharmaceutical Technology (Shijiazhuang) Company Limited (“Zhongqi”, formerly known as Shijiazhuang Pharmaceutical Group Pharmaceutical Technology Development Company Limited) for a consideration of HK\$17,250,000. Zhongqi is a limited liability company established in the PRC and is engaged in research and development of pharmaceutical products. The acquisition was completed in June 2003. Details of this connected transaction were disclosed in a press announcement dated February 19, 2003.
- (b) On July 7, 2003, Zhongnuo Pharmaceutical (Shijiazhuang) Company Limited, a wholly owned subsidiary of the Group, entered into an agreement with Shijiazhuang Municipal Second Pharmaceutical Factory (“Second Pharmaceutical”) for the acquisition of production facilities including, among others, machinery and equipment for the purpose of manufacture of pharmaceutical preparation products and bulk pharmaceutical products for a consideration of HK\$15,241,000.

Second Pharmaceutical is an associate of SPG and is therefore a connected party to the Company under the Listing Rules. Completion of this transaction took place in July 2003. Details of this connected transaction were disclosed in a press announcement dated July 7, 2003.

- (c) During the year, a subsidiary of the Company obtained advance of HK\$93,545,000 from SPG. The amount is unsecured, interest-bearing at prevailing market rate and is repayable between one to two years from the balance sheet date.
- (d) During the year, a subsidiary of the Company obtained advance of HK\$8,045,000 from SPG. The amount is unsecured, interest free and will not be repaid within twelve months from the balance sheet date.

**PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S LISTED SECURITIES**

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

**DISCLOSURE UNDER PRACTICE NOTE 19 TO THE LISTING RULES**

Pursuant to two term loan agreements, it will be an event of default under the loan agreements if SPG owns less than 40% of the issued share capital of the Company. The outstanding principal of the term loans at December 31, 2003 was HK\$195,030,000 and the last instalment repayment is due in October 2005.

**DISCLOSURE UNDER PRACTICE NOTE 19 TO THE LISTING RULES – continued**

Save as disclosed above, there are no other events which are required to be disclosed by the Company under Practice Note 19 to the Listing Rules.

**CORPORATE GOVERNANCE**

In the opinion of the directors, the Company has complied throughout the year ended December 31, 2003 with the Code of Best Practice as set out in Appendix 14 of the Listing Rules. The Company has an audit committee consisting of the independent non-executive directors of the Company. The committee meets regularly with the external auditors and management to review the interim and yearly financial statements of the Group.

The term of office of each independent non-executive director of the Company is the period up to his retirement by rotation in accordance with the Company's Articles of Association.

**CHARITABLE DONATIONS**

During the year, the Group made charitable donations amounting to HK\$691,000.

**AUDITORS**

A resolution will be submitted to the annual general meeting of the Company to re-appoint Messrs. Deloitte Touche Tohmatsu as auditors of the Company.

On behalf of the Board

**Cai Dong Chen**

*Chairman*

Hong Kong, March 22, 2004