1. GENERAL

The Company is a listed public limited company incorporated in Hong Kong and its shares are listed on The Stock Exchange of Hong Kong Limited (the ''Stock Exchange'').

The Company's ultimate holding company is Shijiazhuang Pharmaceutical Group Company Limited (''SPG''), a state-owned enterprise established under the laws of The People's Republic of China (the ''PRC''). SPG, together with the companies under its control, other than members of the Group, will hereinafter be referred to as the ''SPG Group''.

The Company's subsidiaries are principally engaged in the manufacture and sale of pharmaceutical products.

2. ADOPTION OF HONG KONG FINANCIAL REPORTING STANDARDS

In the current year, the Group has adopted, for the first time, the following revised Hong Kong Financial Reporting Standard (''HKFRS'') issued by the Hong Kong Society of Accountants (''HKSA''), the term of HKFRS is inclusive of Statements of Standard Accounting Practice (''SSAP(s)'') and Interpretations approved by the HKSA.

Income Taxes

In the current year, the Group has adopted SSAP 12 (Revised) ''Income Taxes'' (''SSAP 12 (Revised)''). The principal effect of the implementation of SSAP 12 (Revised) is in relation to deferred tax. In previous years, partial provision was made for deferred tax using the income statement liability method, i.e. a liability was recognised in respect of timing differences arising, except where those timing differences were not expected to reverse in the foreseeable future. SSAP 12 (Revised) requires the adoption of a balance sheet liability method, whereby deferred tax is recognised in respect of all temporary differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, with limited exceptions. The adoption of this standard has had no material effect on the results for the current or prior accounting periods. Accordingly, no prior period adjustment has been required.

3. SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared under the historical cost convention and in accordance with accounting principles generally accepted in Hong Kong. The principal accounting policies adopted are as follows:

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries made up to December 31 each year.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

3. **SIGNIFICANT ACCOUNTING POLICIES – continued**

Goodwill

Goodwill arising on consolidation represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets and liabilities of a subsidiary at the date of acquisition.

Goodwill arising on acquisitions prior to January 1, 2001 continues to be held in reserves, and will be charged to the income statement at the time of disposal of the relevant subsidiary or at such time as the goodwill is determined to be impaired.

Goodwill arising on acquisitions on or after January 1, 2001 is capitalised and amortised on a straight-line basis over its estimated useful economic life. Goodwill arising on the acquisition of subsidiaries is presented separately in the balance sheet.

Revenue recognition

Sales of goods are recognised when goods are delivered and title has passed.

Interest income is accrued on a time basis, by reference to the principal outstanding and at the interest rate applicable.

Service income is recognised when services are rendered.

Dividend income from investments is recognised when the shareholders' rights to receive payment have been established.

Investments in subsidiaries

Investments in subsidiaries are included in the Company's balance sheet at cost less any identified impairment losses.

Jointly controlled entities

Joint venture arrangements which involve the establishment of a separate entity in which each venturer has an interest are referred to as jointly controlled entities.

The Group's interests in jointly controlled entities are included in the consolidated balance sheet at the Group's share of the net assets of the relevant jointly controlled entities less any identified impairment loss. The Group's share of post-acquisition results of jointly controlled entities is included in the consolidated income statement.

3. SIGNIFICANT ACCOUNTING POLICIES – continued

Property, plant and equipment

Construction in progress is stated at cost which includes all construction costs and other direct costs, including borrowing costs capitalised, attributable to such projects. Construction in progress is not depreciated until completion of construction. Costs on completed construction works are transferred to the relevant category of property, plant and equipment.

Property, plant and equipment other than construction in progress are stated at cost less accumulated depreciation and amortisation and accumulated impairment losses.

Depreciation and amortisation are provided to write off the cost of items of property, plant and equipment other than construction in progress over their estimated useful lives, and after taking into account their estimated residual value, using the straight-line method, at the following rates per annum:

Buildings in the PRC	3.3% – 5%
Plant and machinery	5% – 10%
Furniture, fixtures and office equipment	20%
Motor vehicles	20%

The cost of land use rights is amortised on a straight-line basis over the period of the rights.

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in the income statement.

Intangible assets

The cost of technical know-how is measured initially at cost and amortised on a straight-line basis over its estimated useful life.

The cost of rights to use utilities is measured initially at cost and amortised on a straight-line basis over their estimated useful lives.

Research and development expenditure

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

An internally-generated intangible asset arising from development expenditure is recognised only if it is anticipated that the development costs incurred on a clearly defined project will be recovered through future commercial activity. The resultant asset is amortised on a straight-line basis over its estimated useful life.

Where no internally-generated intangible asset can be recognised, development expenditure is recognised as an expense in the period in which it incurred.

3. SIGNIFICANT ACCOUNTING POLICIES – continued

Impairment

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. Impairment losses are recognised as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, such that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised as income immediately.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is calculated using the weighted average method.

Foreign currencies

Transactions in foreign currencies are initially recorded at the rates of exchange prevailing on the dates of the transactions or at the contracted settlement rate. Monetary assets and liabilities denominated in foreign currencies are re-translated at the rates prevailing on the balance sheet date. Profits and losses arising on exchange are included in net profit or loss for the year.

On consolidation, the assets and liabilities of the Group's PRC subsidiaries and jointly controlled entity are translated at exchange rates prevailing on the balance sheet date. Income and expenses items are translated at the average exchange rates for the year as quoted by the People's Bank of China, the PRC. Exchange differences arising, if any, are classified as equity and transferred to the Group's translation reserve. Such translation differences are recognised as income or as expenses in the period in which the operation is disposed of.

Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years, and it further excludes income statement items that are never taxable or deductible.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are

3. SIGNIFICANT ACCOUNTING POLICIES – continued

Taxation – continued

generally recognised for all taxable temporary differences, and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset realised. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are capitalised as part of the cost of those assets. Capitalisation of such borrowing costs ceases when the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs capitalised.

All other borrowing costs are recognised as an expense in the period in which they are incurred.

Retirement benefits scheme contributions

Payments to Mandatory Provident Fund Scheme and state-managed retirement benefit scheme are charged as an expense as they fall due.

Operating leases

Rentals payable under operating leases are charged to the income statement on a straight-line basis over the period of the relevant leases.

4. TURNOVER AND SEGMENT INFORMATION

Turnover represents the net amounts received and receivable for goods sold by the Group to outside customers, and is stated net of value-added tax and sales returns during the year.

In accordance with the Group's internal financial reporting, the Group has determined business segments are its primary reporting format and geographical segments are its secondary reporting format.

Business segments

The Group reports its primary segment information by products which are bulk drugs, including penicillin series, cephalosporin series and vitamin C series, finished drugs and others. Segment information about these products is presented below:

2003

	Bulk Drugs						
	Penicillin series	Cephalosporin series	Vitamin C series	Finished Drugs	Others	Eliminations	Consolidated
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
TURNOVER							
External sales	548,955	455,948	684,139	786,164	3,220	–	2,478,426
Inter-segment sales	193,327	84,835	–	–	–	(278,162)	–
TOTAL TURNOVER	742,282	540,783	684,139	786,164	3,220	(278,162)	2,478,426

Inter-segment sales are charged at prevailing market rates.

	Penicillin series	Cephalosporin series	Vitamin C series	Finished Drugs	Others	Eliminations	Consolidated
SEGMENT RESULT	118,011	47,987	349,271	124,033	(3,677)		635,625
Unallocated corporate expenses							(17,336)
Profit from operations							618,289
Finance costs							(25,361)
Share of profit of a jointly controlled entity					7,610		7,610
Profit before taxation							600,538
Taxation							(94,978)
Profit before minority interests							505,560
Minority interests							(1,391)
Net profit for the year							504,169

4. TURNOVER AND SEGMENT INFORMATION – continued

Business segments – continued

The following is an analysis of the carrying amount of segment assets and segment liabilities, analysed by products:

2003 – continued

	Bulk Drugs					
	Penicillin series	**Cephalosporin series**	**Vitamin C series**	**Finished Drugs**	**Others**	**Consolidated**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
ASSETS						
Segment assets	610,855	801,229	771,996	525,243	71,738	2,781,061
Interest in a jointly controlled entity					21,235	21,235
Unallocated corporate assets						559,328
Consolidated total assets						3,361,624
LIABILITIES						
Segment liabilities	285,236	263,185	105,829	128,432	6,412	789,094
Unallocated corporate liabilities						442,561
Consolidated total liabilities						1,231,655

	Bulk Drugs						
	Penicillin series	**Cephalosporin series**	**Vitamin C series**	**Finished Drugs**	**Others**	**Corporate**	**Consolidated**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
OTHER INFORMATION							
Capital expenditure	28,529	32,170	213,826	43,148	5,488	2,030	325,191
Depreciation and amortisation	43,087	53,955	27,295	20,345	859	421	145,962
Impairment of intangible assets	–	10,878	–	–	–	–	10,878

4. TURNOVER AND SEGMENT INFORMATION – continued

Business segments – continued

2002

	Bulk Drugs						
	Penicillin series	**Cephalosporin series**	**Vitamin C series**	**Finished Drugs**	**Others**	**Eliminations**	**Consolidated**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
TURNOVER							
External sales	524,284	498,797	362,093	234,796	5,160	–	1,625,130
Inter-segment sales	59,726	25,722	–	–	–	(85,448)	–
TOTAL TURNOVER	584,010	524,519	362,093	234,796	5,160	(85,448)	1,625,130

Inter-segment sales are charged at prevailing market rates.

SEGMENT RESULT	105,007	106,158	68,403	31,403	90		311,061
Unallocated corporate expenses							(13,170)
Profit from operations							297,891
Finance costs							(26,682)
Share of profit of a jointly controlled entity					7,916		7,916
Profit before taxation							279,125
Taxation							(49,550)
Profit before minority interests							229,575
Minority interests							(1,433)
Net profit for the year							228,142

4. TURNOVER AND SEGMENT INFORMATION – continued

Business segments – continued

The following is an analysis of the carrying amount of segment assets and segment liabilities, analysed by products:

2002 – continued

	Bulk Drugs					
	Penicillin series	Cephalosporin series	Vitamin C series	Finished Drugs	Others	Consolidated
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
ASSETS						
Segment assets	715,148	820,365	625,270	415,732	25,794	2,602,309
Interest in a jointly controlled entity					20,809	20,809
Unallocated corporate assets						325,679
Consolidated total assets						2,948,797
LIABILITIES						
Segment liabilities	133,980	129,478	94,853	132,553	44	490,908
Unallocated corporate liabilities						654,943
Consolidated total liabilities						1,145,851

	Bulk Drugs						
	Penicillin series	Cephalosporin series	Vitamin C series	Finished Drugs	Others	Corporate	Consolidated
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
OTHER INFORMATION							
Capital expenditure	82,363	187,555	28,216	5,120	9,014	16	312,284
Depreciation and amortisation	48,088	35,907	28,493	6,812	22	345	119,667
Allowance for doubtful debts	–	–	14,276	–	–	–	14,276

4. TURNOVER AND SEGMENT INFORMATION – continued

Geographical segments

The Group's operations are located in the PRC, Asia other than the PRC, Europe, America and others. Segment information about the Group's operations is presented below:

	Turnover	
	2003	2002
	HK$'000	*HK$'000*
The PRC	**1,801,751**	1,247,647
Asia other than the PRC	**278,619**	130,108
Europe	**178,656**	105,659
America	**130,881**	95,058
Others	**88,519**	46,658
	2,478,426	1,625,130

Contribution to profit by geographical market has not been presented as the contributions to profit from each market is substantially in line with the overall Group ratio of profit to turnover.

Analysis of carrying amounts of segment assets and capital expenditure are not presented as over 90% of amounts involved are in the PRC.

5. PROFIT FROM OPERATIONS

	2003	2002
	HK$'000	*HK$'000*
Profit from operations has been arrived at after charging:		
Staff costs including directors' remuneration	**170,555**	121,874
Retirement benefit scheme contributions	**27,317**	18,101
Total staff costs	**197,872**	139,975
Amortisation (included in administrative expenses) of:		
– intangible assets	**13,770**	14,303
– goodwill	**3,168**	1,546
Depreciation and amortisation of property, plant and equipment	**129,024**	103,818
Total depreciation and amortisation	**145,962**	119,667
Auditors' remuneration	**1,350**	1,200
Loss on disposal of property, plant and equipment	**9,030**	7,587
Research and development expenses	**1,870**	2,290
Impairment of intangible assets (included in administrative expenses)	**10,878**	–
and after crediting:		
Bank interest income	**1,589**	1,737
Interest income from loan receivables fully provided for in prior year	**–**	504

6. FINANCE COSTS

	2003	2002
	HK$'000	*HK$'000*
Bank loan arrangement fee	**333**	–
Interest on:		
– bank loans wholly repayable within five years	**17,853**	24,384
– other loans from connected parties wholly repayable within five years *(note 33 (I))*	**980**	3,158
– bills receivable discounted without recourse	**6,195**	–
Total borrowing costs	**25,361**	27,542
Less: interest capitalised in construction in progress	**–**	(860)
	25,361	26,682

7. DIRECTORS' EMOLUMENTS AND EMPLOYEES' EMOLUMENTS

	2003	2002
	HK$'000	*HK$'000*
DIRECTORS		
Directors' fees:	**380**	180
Executive	**360**	140
Independent non-executive		
	740	320
Other emoluments of executive directors:		
Salaries and other benefits	**4,520**	4,054
Performance related incentive payments	**2,755**	189
Retirement benefits scheme contributions	**24**	34
	8,039	4,597

The directors' emoluments were within the following bands:

	2003 Number of directors	2002 Number of directors
Nil to HK$1,000,000	**7**	9
HK$1,000,001 to HK$2,000,000	**1**	2
HK$2,000,001 to HK$3,000,000	**2**	–

7. DIRECTORS' EMOLUMENTS AND EMPLOYEES' EMOLUMENTS – continued

EMPLOYEES

Of the six (2002: six) highest paid individuals in the Group, four (2002: four) were directors of the Company whose emoluments are set out above. The aggregate emoluments of the remaining two (2002: two) highest paid individuals are as follows:

	2003	2002
	HK$'000	*HK$'000*
Salaries and other benefits	**897**	805
Performance related incentive payments	**450**	165
Retirement benefit scheme contributions	**22**	12
	1,369	982

	2003	2002
	No. of individuals	No. of individuals
Emoluments of the two highest paid employees were within the following bands:		
Nil to HK$1,000,000	**1**	2
HK$1,000,001 to HK$2,000,000	**1**	–
	2	2

During the year, no emoluments were paid by the Group to the six highest paid individuals, including directors, as an inducement to join or upon joining the Group or as compensation for loss of office. None of the directors has waived any emoluments during the year.

8. TAXATION

	2003	2002
	HK$'000	*HK$'000*
The charge comprises:		
PRC income tax		
– current year	**102,862**	48,276
– (over)underprovision in prior years	**(3,249)**	296
– tax credits	**(5,697)**	–
Taxation attributable to the Company and its subsidiaries	**93,916**	48,572
Share of taxation of a jointly controlled entity	**1,062**	978
	94,978	49,550

8. TAXATION – continued

No Hong Kong Profits Tax is payable by the Company or its Hong Kong subsidiaries since they had no assessable profit for the year.

Taxation arising in other jurisdictions is calculated at the prevailing rate in the relevant jurisdictions.

The tax charge for the year can be reconciled to the profit per the consolidated income statement as follows:

	2003		2002	
	HK$'000	**%**	*HK$'000*	%
Profit before taxation	**600,538**		279,125	
Tax at the average income tax rate of 22.1% (2002: 25.9%)	**132,855**	**22.1**	72,264	25.9
Tax effect of income not taxable for tax purpose	**(1,859)**	**(0.3)**	(2,246)	(0.8)
Tax effect of expenses not deductible for tax purpose	**11,930**	**2.0**	16,533	5.9
Tax effect of tax losses not recognised	**119**	**0.0**	346	0.2
Effect of tax exemptions granted to PRC subsidiaries and a jointly controlled entity	**(39,121)**	**(6.5)**	(37,643)	(13.5)
Tax credits granted to the PRC subsidiaries	**(5,697)**	**(0.9)**	–	–
(Over)underprovision in respect of prior year	**(3,249)**	**(0.5)**	296	0.1
Tax effect and effective tax rate for the year	**94,978**	**15.9**	49,550	17.8

Note: The average income tax for the years ended December 31, 2003 and 2002 represent the weighted average tax rate of the operations in different regions and industries in the PRC on the basis of the relative amounts of net profit before taxation and the relevant statutory rates.

Pursuant to the relevant laws and regulations in the PRC, certain of the Group's PRC subsidiaries are entitled to an exemption from PRC income tax for the two years starting from their first profit– making year, followed by a 50% reduction for the next three years (the ''PRC Tax Relief''). Certain of the Group's subsidiaries are also entitled to tax credits which can be offset against the PRC income tax (''Tax Credits''). The relevant Tax Credits are calculated with reference to the cost of plant and equipment that were manufactured in the PRC and acquired by the Group's subsidiaries. The taxation charge for the year represents provision for taxation which has taken into account of these tax incentives.

The jointly controlled entity, which was established in the PRC, is also entitled to similar PRC Tax Relief as the above subsidiaries.

There was no significant unprovided deferred taxation for the year or at the balance sheet date.

9. DIVIDENDS

	2003	2002
	HK$'000	*HK$'000*
Interim dividend paid HK7.0 cents (2002: nil) per share	**107,669**	–
Final dividend proposed HK7.0 cents (2002: HK6.0 cents) per share	**107,669**	90,133
	215,338	90,133

A final dividend of HK7.0 cents (2002: HK6.0 cents) per share has been proposed by the directors and is subject to approval by the shareholders in general meeting.

10. EARNINGS PER SHARE

The calculation of the basic and diluted earnings per share is based on the following data:

	2003	2002
Profit attributable to shareholders	**HK$504,169,000**	HK$228,142,000
Weighted average number of ordinary shares for the purposes of basic earnings per share	**1,515,192,387**	1,373,033,290
Effect of dilutive potential ordinary shares in respect of share options	**20,501,401**	22,612,855
Weighted average number of ordinary shares for the purposes of diluted earnings per share	**1,535,693,788**	1,395,646,145

11. PROPERTY, PLANT AND EQUIPMENT

	Land use rights in the PRC	Buildings in the PRC	Plant and machinery	Furniture, fixtures and office equipment	Motor vehicles	Construction in progress	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
THE GROUP							
COST							
At January 1, 2003	96,028	338,116	1,315,534	1,665	10,545	181,899	1,943,787
Additions	17,008	86	53,046	2,399	1,971	249,092	323,602
Acquisition on acquisition of a subsidiary	–	6,948	4,340	918	84	–	12,290
Transfers	–	8,487	62,684	–	–	(71,171)	–
Disposals	–	(2,748)	(21,476)	(671)	(1,367)	–	(26,262)
At December 31, 2003	113,036	350,889	1,414,128	4,311	11,233	359,820	2,253,417
DEPRECIATION AND AMORTISATION							
At January 1, 2003	5,037	33,942	352,877	1,061	5,461	–	398,378
Provided for the year	5,043	16,345	105,279	529	1,828	–	129,024
Eliminated on disposals	–	(487)	(11,829)	(481)	(352)	–	(13,149)
At December 31, 2003	10,080	49,800	446,327	1,109	6,937	–	514,253
NET BOOK VALUE							
At December 31, 2003	102,956	301,089	967,801	3,202	4,296	359,820	1,739,164
At December 31, 2002	90,991	304,174	962,657	604	5,084	181,899	1,545,409

No interest was capitalised in construction in progress at December 31, 2003. At December 31, 2002, interest cost of HK$860,000 was capitalised and included in construction in progress.

At the balance sheet date, the Group's land use rights and buildings in the PRC are held under medium-term leases.