

## **DIRECTORS' REPORT**

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The directors present their annual report and the audited financial statements for the year ended December 31, 2004.

### **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 35 and 16 to the financial statements, respectively.

### **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 for the year ended December 31, 2004 are set out in the consolidated income statement on page 16 of the annual report and the accompanying notes to the financial statements.

The directors do not recommend the payment of a dividend and propose the net profit for the year be retained.

### **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 25 and 26 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

Feng Zhen Ying

Wei Fu Min

Yue Jin

Ji Jian Ming

(appointed on February 28, 2005)

Yao Shi An

(appointed on February 28, 2005)

Qu Ji Guang

(resigned on September 17, 2004)

**DIRECTORS AND DIRECTORS' SERVICE CONTRACTS – continued**

*Non-executive director:*

Lee Ka Sze, Carmelo (re-designated on September 24, 2004)

*Independent non-executive directors:*

Huo Zhen Xing

Qi Mou Jia

Guo Shi Chang (appointed on February 5, 2004)

Chan Siu Keung, Leonard (appointed on September 24, 2004)

In accordance with Article 92 of the Company's Article of Association, the new directors, Messrs. Ji Jian Ming, Yao Shi An and Chan Siu Keung, Leonard 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. Cai Dong Chen, Ding Er Gang, Wei Fu Min and Qi Mou Jia 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**

Mr. CAI, aged 51, is the Chairman of the Company and was appointed as an executive director of the Company in 1998. He is also the Chairman of Shijiazhuang Pharmaceutical Group Company Limited ("SPG"), the Company's ultimate holding company. Mr. Cai graduated from Hebei Pharmaceutical Finance College in the People's Republic of China (the "PRC") and joined SPG in 1972. Mr. Cai has over thirty years of technical and management experience in the pharmaceutical industry.

**DING Er Gang**

Mr. Ding, aged 44, was appointed as an executive director of the Company in 1997. He graduated from Hebei College of Economics in the PRC and has over fifteen years of management experience in the pharmaceutical industry.

**FENG Zhen Ying**

Mr. Feng, aged 49, was appointed as an executive director of the Company in 2003. He graduated from Hebei Chemical College in the PRC and has over twenty years of technical and management experience in the pharmaceutical industry.

**WEI Fu Min**

Mr. Wei, aged 58, was appointed as an executive director of the Company in 1994. He graduated from Tianjin Industrial College in the PRC and has over thirty years of technical and management experience in the pharmaceutical industry.

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

Mr. Yue, aged 41, was appointed as an executive director of the Company in 2001. He graduated from Hebei University in the PRC and has over fifteen years of technical and management experience in the pharmaceutical industry.

**YAO Shi An**

Mr. Yao, aged 55, was appointed as an executive director of the Company in 2005. He graduated from Beijing Technology and Business University in the PRC and has over thirty years of technical and management experience in the pharmaceutical industry.

**JI Jian Ming**

Mr. Ji, aged 42, was appointed as an executive director of the Company in 2005. He graduated from Hebei University in the PRC and has more than twenty years of technical and management experience in the pharmaceutical industry.

**LEE Ka Sze, Carmelo**

Mr. Lee, aged 44, was appointed as an independent non-executive director of the Company in 1996 and re-designated as a non-executive director in 2004. He is a solicitor by profession and is a partner of a law firm in Hong Kong.

**HUO Zhen Xing**

Mr. Huo, aged 69, was appointed as an independent non-executive director of the Company in 1994. He was the former head of Industrial and Commercial Bank of China, Hebei Province branch and Shijiazhuang sub-branch.

**QI Mou Jia**

Mr. Qi, aged 72, was appointed as an independent non-executive director of the Company in 1996. He was the former director of State Drug Administration of China (“SDA”, now known as State Food and Drug Administration of China). He was the deputy chairman and chairman of SDA in 1978 and 1982-1994 respectively.

**GUO Shi Chang**

Mr. Guo, aged 63, was appointed as an independent non-executive director of the Company in 2004. He was the Vice Governor of Hebei Provincial People’s Government, the PRC from 1993 to 2002.

**CHAN Siu Keung, Leonard**

Mr. Chan, aged 47, was appointed as an independent non-executive director of the Company in 2004. He is a qualified accountant and a member of the Institute of Chartered Accountants of Ontario. He holds a Master of Business Administration degree from York University, Ontario, Canada and has extensive experience in finance and investment.

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

As at December 31, 2004, 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 ("Model code") contained in the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules"), were as follows:

<b>Name of director</b>	<b>Capacity</b>	<b>Number of issued ordinary shares held</b>	<b>Percentage of the issued share capital of the Company</b>
Mr. Cai Dong Chen	Beneficial owner	2,000,000	0.13%

Other than as disclosed above, as at December 31, 2004, 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 recorded in the register required to be kept under Section 352 of the SFO, or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code.

**ARRANGEMENTS TO PURCHASE SHARES OR DEBENTURES**

Other than the share option schemes of the Company as disclosed in note 26 to the financial statements, at no time during the year was the Company or any of its holding companies, fellow subsidiaries or 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 or any of its holding companies, 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, 2004, the register of substantial shareholders maintained by the Company pursuant to Section 336 of the SFO shows that the following shareholders had notified the Company of relevant interests in the share capital of the Company.

**SUBSTANTIAL SHAREHOLDER – continued**

Name of substantial shareholder	Capacity	Number of ordinary shares of the Company held	Percentage of issued share capital
SPG	Beneficial owner and controlled corporation	783,316,161 <i>(Note)</i>	50.93%
Templeton Investment Counsel, LLC	Investment Manager	77,078,246	5.01%

*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, 2004 or any other interests representing 5% or more of the issued share capital of the Company as at December 31, 2004.

**CONNECTED TRANSACTIONS**

Details of the discloseable connected transactions during the year are set out in note 34 (I) to the financial statements. In the opinion of the independent non-executive directors, those 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;
- (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 following connected transactions during the year:

- (a) On December 31, 2004, Shijiazhuang Pharma Group Zhonghe Pharmaceutical (Neimenggu) Co., Limited ("Neimenggu Zhonghe"), a wholly-owned subsidiary of the Company, entered into a purchase agreement with Hebei Hong Yuan Chemical Co., Limited ("Hong Yuan"), a 75% subsidiary of SPG, whereby Neimenggu Zhonghe shall purchase chemical products as raw materials for the production of amoxicillin from Hong Yuan for the period from January 1, 2005 to December 31, 2007.
- (b) On December 31, 2004, Shijiazhuang Pharma Group Zhongrun Pharmaceutical (Neimenggu) Co., Limited ("Neimenggu Zhongrun"), a wholly-owned subsidiary of the Company, entered into a purchase agreement with Shijiazhuang Pharma Group Neimenggu Zhongkang Sugar Co., Limited ("Zhongkang Sugar"), a 45% associate of SPG, whereby Neimenggu Zhongrun shall purchase liquid glucose and corn syrup as raw materials for the production of penicillin products from Zhongkang Sugar for the period from January 1, 2005 to December 31, 2007.

**CONNECTED TRANSACTIONS – continued**

- (c) On December 31, 2004, Shijiazhuang Pharma Group Hebei Zhongrun Pharmaceutical Co., Limited (“Hebei Zhongrun”), Weisheng Pharmaceutical (Shijiazhuang) Co., Ltd. (“Weisheng”) and Shijiazhuang Pharma Group Hebei Zhongnuo Pharmaceutical Co., Limited (“Hebei Zhongnuo”), all being subsidiaries of the Company, entered into separate agency agreements with Shijiazhuang Pharma Group Import and Export Trading Co., Ltd. (“SPG Import and Export Co.”), a wholly owned subsidiary of SPG, respectively, whereby Hebei Zhongrun, Weisheng and Hebei Zhongnuo will appoint SPG Import and Export Co. to act as its agent in securing overseas sales orders for the Group. The commission to be paid by each of Hebei Zhongrun, Weisheng and Hebei Zhongnuo to SPG Import and Export Co. is up to 4% of the sales amount. The term of each of the agency agreement is three years from January 1, 2005 to December 31, 2007.

The above connected transactions and their proposed annual caps were subsequently approved by an ordinary resolution in an extraordinary general meeting of the Company held on February 21, 2005. These transactions have commenced in 2005 and details of which were disclosed in a press announcement dated December 31, 2004 and a circular dated January 24, 2005.

**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 RULE 13.18 OF THE LISTING RULES**

Pursuant to three bank loan agreements, it will be an event of default under each of these loan agreements if SPG owns less than 40% of the issued share capital of the Company. The outstanding principal of these bank loans at December 31, 2004 was HK\$675,020,000 and the last instalment repayment is due in December 2008.

Save as disclosed above, there are no other events which are required to be disclosed by the Company under rule 13.18 of the Listing Rules.

**CORPORATE GOVERNANCE**

In the opinion of the directors, the Company has complied throughout the year ended December 31, 2004 with the Code of Best Practice as set out in Appendix 14 of the Listing Rules. The Company has an audit committee consisting of one non-executive director and two 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.

Each of the non-executive director and independent non-executive directors of the Company has entered into a service contract with the Company on December 31, 2004 for a term of two years.

The Company has adopted the Model Code set out in Appendix 10 to the Listing Rules as the code of conduct regarding securities transactions by the directors. Having made specific enquiry of all directors, the Company confirmed that all directors have complied with the required standard set out in the Model Code.

**PUBLIC FLOAT**

Based on the information that is publicly available to the Company and within the knowledge of the directors, as at the date of this report, there is sufficient public float of not less than 25% of the Company's issued shares as required under the Listing Rules.

**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, April 11, 2005