

Report of the Directors

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

MANAGEMENT DISCUSSION AND ANALYSIS

Business Scope and Analysis of operations

1. *Scope of business*

The Company and its subsidiaries (collectively the "Group") is principally engaged in (1) manufacture and sales of Chinese Patent Medicine ("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*

(1) Principal activities and geographical analysis of operations

As affected by the increasingly keen competition in the domestic pharmaceutical market, the implementation of the national pricing policy on pharmaceutical products and the restriction on sales of antibiotics, together with the direct impact arising from the emergence of a large number of cheap chain pharmacies and the significant operating loss recorded by Guangzhou Chinese Medicine Corporation ("Chinese Medicine Corporation") a subsidiary of the Company, the operating results of the Group declined significantly.

According to the Group's consolidated accounts for the year ended 31 December 2004 prepared under the PRC accounting standards and systems, the turnover of the Group was approximately RMB7,708,314,000, representing an increase of 10.56% over that of 2003. Total profit was approximately RMB167,642,000, representing a decrease of 41.13% over that of 2003 and net profit was approximately RMB55,292,000, representing a decrease of 60.45% over that of 2003. According to the Group's consolidated accounts for the Year prepared under HK GAAP, the Group's turnover amounted to approximately RMB7,709,565,000, representing an increase of 10.56% over that of 2003. Profit before taxation was approximately RMB161,675,000, representing a decrease of 47.48% over that of 2003, and profit attributable to shareholders was approximately RMB42,829,000, representing a decrease of 70.8% over that of 2003.

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An analysis of the Group's turnover and profit from principal activities for the Reporting Period is set out 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	1,918,980	1,920,231	986,998	1,004,786
Trading				
Wholesale	5,339,957	5,339,957	318,005	322,485
Retail	278,830	278,830	55,345	56,310
Import and export	170,547	170,547	12,141	12,351
Sub-total	5,789,334	5,789,334	385,491	391,146
Total	7,708,314	7,709,565	1,372,489	1,395,932

Geographical analysis of sales arising from the manufacturing operations ("Manufacturing Operations") and trading operations ("Trading Operations") is set out as follows:

Region	Manufacturing		Trading		Total (%)	Percentage of the total turnover
	Turnover <i>RMB'000</i>	Percentage of the manufacturing turnover (%) <i>RMB'000</i>	Turnover <i>RMB'000</i>	Percentage of the trading turnover (%)		
Southern China	1,183,878	61.69	4,918,798	84.96	6,102,676	79.17
Eastern China	257,945	13.44	279,111	4.82	537,056	6.97
Northern China	177,511	9.25	121,227	2.09	298,738	3.88
North-Eastern China	121,230	6.32	93,063	1.61	214,293	2.78
South-Western China	109,801	5.72	192,136	3.32	301,937	3.92
North-Western China	68,615	3.58	91,147	1.58	159,762	2.07
Exports			93,852	1.62	93,852	1.21
Total	1,918,980	100	5,789,334	100	7,708,314	100

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(2) Chinese Patent Medicine manufacturing business (the “Manufacturing Operations”)

During the year 2004, due to the implementation of the national policy regarding the administration on advertisement of pharmaceuticals and their price-restriction, the increased amortisation of fixed assets and higher operating cost upon completion of GMP renovation and the increase in the price of raw material all resulted in a decline of the operating results of the Company's certain manufacturing subsidiaries.

According to the Group's consolidated accounts prepared under the PRC accounting standards and systems, turnover of the Manufacturing Operations for the Year was RMB1,918,980,000, representing an increase of 1.58% over that of 2003. Total profit was RMB180,314,000, representing a decrease of 15.38% over that of 2003, and net profit was RMB94,211,000. According to the Group's consolidated accounts prepared under HK GAAP, turnover of the Manufacturing Operations for the Year was RMB1,920,231,000, representing an increase of 1.58% over that of 2003. Profit before taxation was RMB177,976,000, representing a decrease of 25.44% over that of 2003, and profit attributable to shareholders was RMB87,478,000.

In 2004, the Group has taken the following measures in its Manufacturing Operations: (i) it has endeavored to improve the promotion and marketing in its major products such as Xiao Ke Wan, Hua Tuo Zai Zao Wan, and the series of Wang Lao Ji Liao Cha, and Hua Zhi Shuan and further strengthened the marketing and promotion of products so as to expand the market share of its major products; (ii) it has strengthened the cooperation with large pharmaceutical companies in major cities, and enhanced the marketing and promotion in the retail market; (iii) it continued to strengthen the brand promotions to the academy and end-users market such as hospitals and medical institutions. During the Year, certain large promotions and academic exchange activities were conducted, by which the corporate identity and the brand popularity were improved; (iv) it has strengthened the contact and connection with major customers in marketing, and improved the credit management on customers and market control as well as accelerated the collection of the accounts receivable.

After the implementation of the aforesaid measures, there were 34 products whose sales income exceeded RMB10 million in 2004, of which annual sales income exceeding RMB100 million included Xiao Ke Wan, Hua Tuo Zai Zao Wan, Xia Shang Ju and the series of Wang Lao Ji Liang Cha, the annual sales income of 10 products ranged from RMB30 million to RMB100 million and the annual sales income of 20 products ranged from RMB10 million to RMB30 million. The sales income of certain key products such as Xiao Ke Wan, the series of Wang Lao Ji Liang Cha, Hua Zhi Shuan, Bao Ji Wan, Ru He San Jie Pian, Qing Re An Chuang Pian and An Shen Bu Nao Ye increased significantly by 11.88%, 73.20%, 18.21%, 17.32%, 24.86%, 20.60% and 53.46% respectively as compared with 2003.

As affected by the market environment, the turnover of the cough medicines decreased by 24.54% as compared with 2003, among which the series of She Dan Chuan Bei Pi Pa and Mi Lian Chuan Bei Pi Pa Gao decreased by 25.15% and 27.28% respectively as compared with 2003.

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Analysis of sales of major products is as follows:

Products	Turnover for 2004	Gross profit for 2004
	RMB'000	RMB'000
Heat clearing and anti-toxic	484,136	223,593
Diabetes curing	348,513	237,073
Cough and phlegm clearing	187,574	87,194
Arthritis curing	209,206	133,658
Gastric	91,671	39,875

In 2004, the Company made its best efforts to accelerate its subsidiaries to pass the GMP and GAP examination to obtain the certifications smoothly. Currently, the Company's nine manufacturing subsidiaries have all passed the GMP examination. In addition, the Company has also aggressively promoted the progress of GAP examination. Currently, astragalus root GAP base of Guangzhou Zhong Yi Pharmaceutical Co., Ltd ("Zhong Yi Pharmaceutical") and Jiu Jie Cha GAP base of Guangzhou Jing Xiu Tang Pharmaceutical Co., Ltd ("Jing Xiu Tang Pharmaceutical") have been put into operation, while Guangzhou Pan Gao Shou Pharmaceutical Co., Ltd ("Pan Gao Shou Pharmaceutical") and Wang Lao Ji have also started the construction of the GAP model base.

During the Year, the Group continued to accelerate the construction of technology platforms and to strengthen the research and development of new products. In 2004, there was one new medicine that obtained the new medicine certificates and production approval, four obtained the clinical research approvals and four under the clinical research, among which, Fu Li Tong Capsules (previously named as Feng Shi Ping Capsules), a new key product of the Group, has passed the third phase of clinical researches and the production of Ganoderma Lucidum Spore Oil, Gan Jin Pian and Yi Sheng Jun, etc. has been approved and started. Such items have established a solid foundation for the future development of the Group's principal business.

- (3) Pharmaceutical trading business, including wholesale, retail, import and export (the "Trading Operations")

According to the consolidated financial accounts prepared in accordance with PRC accounting standards and systems, turnover of the Group's Trading Operations for the Year was about RMB5,789,334,000, representing an increase of 13.90% over that of the previous year. Loss before taxation was about RMB12,672,000, representing a sharp decrease of 117.68% year-on-year, and net loss was RMB38,920,000. According to the consolidated accounts prepared in accordance with HK GAAP, the turnover of the Group's Trading Operations this year was about RMB5,789,334,000, representing an increase of 13.90% over that of the previous year. Loss before taxation was about RMB16,302,000, representing a decrease of 123.58% year-on-year, and loss for the year was RMB44,649,000.

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According to the market changes, the Trading Operations mainly focused on the following aspects: (i) they continued its active development as agent and distributor for prestigious pharmaceutical products, actively seeking and developing characteristic products with promising market prospect, and try to expand sales in the wholesale market. (ii) additional efforts were made to expand the sales market of hospitals by enhancing the capability of the hospital marketing teams. In addition, they also made an earnest effort in improving the bidding and supplying for hospitals with a wider range of medicines to increase the sales volume through hospital channels. (iii) they expedited the process of resource integration within the Group, and facilitated the purchases, supplies and services of traditional Chinese medicine and raw materials in large bulks. (iv) timely adjusted the development strategies on retail network with focus on the core retail business. (v) speeded up the construction of medicine logistics center to accelerate the delivery speed and inventory capital turnover. (vi) strengthened the credit management control of the clients and the monitoring on accounts receivable, and standardized the management flow of accounts receivable in order to reduce the risks of bad debts arising from accounts receivable. (vii) enhanced service consciousness, focused on all-rounded services for major customers and promoted the operation of our brand series products.

During the Reporting Period, the number of new customers of the Trading Operations increased by 633, products with distribution rights increased by 26 types and products with exclusive distribution rights grew by 24 types. During the Year, the Company has undertaken a re-structuring of its retail pharmacies and closed some retail outlets that operated at a loss. As at 31 December 2004, the Group had 163 chain pharmacies, including 89 "Cai Zhi Lin" which specialize in traditional chinese medicine and 73 "Jian Min" which specializes in chemical medicine.

The pharmaceutical logistics center of the Group has been put into operation in May 2004. During the Year, the GSP certification of the pharmaceutical products wholesale companies under the Group has also been completed as planned, and has passed the re-examination of the state pharmacy supervision authority.

In the year 2004, the operating results of the Trading Operations of the Group decreased. This was mainly due to the following reasons: (i) affected by the market entry of a large number of pharmacies offering lower selling prices and the implementation of the national pricing policy on pharmaceutical products and policy on restricting the sales of antibiotics, the gross profit margin of the Trading Operations continued to decline. In 2004, the gross profit margin of the Trading Operations was 6.76%, representing a decrease of 11.40% as compared with 7.63% in 2003. To a certain extent, this affected the increase of profit of the Trading Operations; (ii) the Company's trading subsidiary, Guangzhou Chinese Medicine Corporation recorded a significant loss due to provision for diminution in value of inventory it made and other extraordinary factors, which has a significant impact on the annual operation results of the Company for the Year.

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3. Details of operation and results of the Company's major subsidiaries

Name	Principal activities and major products	Total assets as at 31 December 2004	Net assets as at 31 December 2004	Net profit as at 31 December 2004
		RMB'000	RMB'000	RMB'000
Zhong Yi Pharmaceutical	Production and sales of CPM; major products are Xiao Ke Wan etc.	503,916	354,847	60,205
Guangzhou Chen Li Ji Pharmaceutical Factory	Production and sales of CPM; major products are Wu Ji Bai Feng Wan etc.	258,074	191,751	16,297
Guangzhou Qi Xing Pharmaceutical Factory	Production and sales of CPM; major products are Hua Tuo Zai Zhao Wan etc.	186,066	174,520	18,710
Guangzhou Xing Qun Pharmaceutical Co., Ltd	Production and sales of CPM; major products are Xia Shang Ju etc.	322,794	199,214	15,176
Jing Xiu Tang Pharmaceutical	Production and sales of CPM; major products are Qing Re Xiao Yan Ning, etc.	190,288	103,457	2,901
Pan Gao Shou Pharmaceutical	Production and sales of CPM; major products are Mi Lian Chuan Bei Pi Pa Gao, etc.	281,435	176,690	1,321
Wang Lao Ji	Production and sales of CPM; major products are Bao Ji Wan, etc.	188,686	145,413	15,755
Guangzhou Huan Ye Pharmaceutical Co., Ltd	Production and sales of phytochemical medicine	41,756	24,019	(134)
Guangxi Yingkang	Production and sales of CPM; major products include Hua Tuo Feng Tong Bao, etc.	47,511	39,148	(2,147)
Guangzhou Bai Di Bio-Technology Co., Ltd	Research and production of bio-tech medicine	68,757	55,018	(7,558)
Guangzhou Hanfang	Research and production of CPM	165,201	110,501	(5,185)
Guangzhou Pharmaceutical Corporation	Trading of chemical pharmaceutical products and medical apparatus	2,236,359	412,465	41,658
Guangzhou Chinese Medicine Corporation	Trading of CPM and Chinese raw medicine	252,694	8,994	(83,237)
Guangzhou Pharmaceutical Import & Export Corporation	Import and export of TCM and chemical medicine	103,821	21,293	1,472
Guangzhou Guangyao Ying Bang Marketing Co., Ltd	Trading of CPM, Chinese raw medicine and materials	32,080	6,084	247
Total		<u>4,879,438</u>	<u>2,023,413</u>	<u>75,482</u>

None of the Group's invested 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 RMB949,599,000, representing approximately 14.80% of the total purchases. The purchases from the largest supplier amounted to RMB273,258,000, representing 4.26% of the total purchases. Goods and services sold to the 5 largest customers amounted to RMB511,695,000, representing 6.64% of the total sales. Sales to the largest customer amounted to RMB148,693,000, representing 1.93% of the total sales of the Group.

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 implementation of the national regulations on the advertisements and pricing of pharmaceutical products, the increase in the manufacturing costs caused by GMP renovation, the continuing decrease in the profit margin of the Trading Operations of the Company and the significant losses in the operations of Guangzhou Chinese Medicine Corporation, a subsidiary of the Company, have a definite impact on the Group's results for the Year.

The Company's Investments

1. *Use of net proceeds from the issue of A shares during the Reporting Period*

The Company issued 78,000,000 A shares at the issue price of RMB9.80 per share in the PRC on 10 January 2001. The net proceeds raised from the issue of A shares was RMB737,990,000. As at 31 December 2004, an aggregate of RMB660,380,000 of the net proceeds from the issue of A shares were utilised. The remaining unused proceeds amounting to RMB77,610,000 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. As at 31 December 2004, the use of proceeds from the issue of A shares was in line with the undertakings made in the prospectus for the issue of A shares. Details of the application of the proceeds are set out as follows:

Category	Projects	Budgeted injection from the proceeds RMB'000	Accumulated Amount injected up to the end of the year RMB'000	Stage of completion %
Projects for the technology upgrade and industrialization of new products				
Pills	Xiao Ke Wan upgrade	29,800	29,800	100%
	Bao Ji Wan upgrade	11,000	11,000	100%
	Industrilisation of Wei Re Qing	29,000	23,780	82%
	Automation of pill production	11,000	11,000	100%
	Technology upgrade of Hua Tuo Zai Zao Wan	17,000	17,000	100%
	Technology upgrade of throat, spleen and intestine pills	29,100	18,430	80%
Syrup	Technology upgrade for syrup production	29,500	29,500	100%
	Industrialisation of Ke Gan Li Yan Syrup	19,600	19,600	100%
Granules	Technology upgrade of Xu Han Ting Granules	12,000	12,000	100%
	Automation of granules upgrade	29,900	29,900	100%
	Technology upgrade of flu granules for children	23,000	23,000	100%
Tablets	Industrilisation of Fu Yan Soluble Tablets	29,500	23,300	79%
	Technology upgrade of spleen, intestine and pimples tablets	17,800	17,800	100%
	Technology upgrade of syrup workshops	29,500	29,500	100%
	Technology upgrade of suppository workshops	12,000	12,000	100%
Industrialization foundations				
	Modernisation of extraction and purification technology	29,900	29,900	96%
	Critical purification of CO2 technology foundation	29,900	29,900	96%
Trading				
	Expansion of chained pharmacies			
	Jian Min	89,300	88,630	99%
	Cai Zhi Lin	59,500	24,880	63%
	Logistics centre upgrade	20,000	20,000	100%
	ERP upgrade for the Trading Operations	20,000	16,020	80%
	Bio-tech research centre	80,000	63,750	70%
	Additional working capital	50,000	79,690	100%
	Total	708,300	660,380	

Note:

The net proceeds from the issue of A shares were approximately RMB737,990,000. The portion exceeding the budgeted proceeds amounted to RMB29,690,000 was used as additional working capital.

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- (1) Explanatory note on return on projects and delay in completion of certain projects

During the Reporting Period, additional sales and gross profit from the completed projects mentioned above amounted to RMB1,354,540,000 and RMB309,690,000 respectively.

Among these, the expansion of chain pharmacies slowed down as a result of fierce competition in the domestic pharmaceutical market.

- (2) As at the end of the Reporting Period, there was no change in the actual application of the proceeds and the proposed use of the proceeds from the issue of A shares as disclosed in the undertakings made in the prospectus for the issue of A shares.

3. Other investments during the Reporting Period

- (1) Approved at the meeting of the Investment Management Committee of the Company held on 12 January 2004, the Company injected RMB90,000 to Guangzhou Jin Shen Pharmaceutical Co., Ltd ("GZ Jin Shen"). After that, the Company has invested a total of RMB765,000 in GZ Jin Shen, representing 38.25% of the equity interest thereof.
- (2) Approved at the meeting of the Investment Management Committee of the Company held on 18 February 2004, the Company injected an investment of RMB21,717,000 in cash into Guangxi Yingkang, representing 51% of the equity interest thereof.
- (3) Approved at the meeting of the Investment Management Committee of the Company held on 18 May 2004, Guangzhou Pharmaceutical Corporation, a subsidiary of the Company, invested RMB250,000 in Guangzhou Lian Jie Computer Technology Co., Ltd, representing 50% of the equity interest thereof.
- (4) Approved at the meeting of the Investment Management Committee of the Company held on 21 June 2004, the Company injected, in proportion to its 24% equity interest, an additional amount of RMB1,200,000 in its associated company, Guangzhou Jihua Medical Appliance Company Limited.
- (5) Approved at the meeting of the Investment Management Committee of the Company held on 7 July 2004, the Company agreed to inject RMB1,000,000 into Beijing Gugong Gongyuan Cultural Development Co., Ltd. Up to the date of this annual report, pursuant to the agreement entered into by the parties the Company has injected RMB200,000 into the aforementioned company, representing 10% of the equity interest thereof.
- (6) On 8 November 2004, Wao Lao Ji, a then subsidiary of the Company, entered into a Subscription Agreement with Golden Force. Under the Subscription Agreement, Golden Force agreed to subscribe for the newly issued shares of Wang Lao Ji at the consideration of RMB168,880,000, representing 48.0465% of equity interest of the Wang Lao Ji as enlarged by the subscription. The above transaction was considered and passed at the Third Extraordinary General Meeting of 2004, the Class Meeting of holders of domestic shares and the Class Meeting of overseas listed foreign shares all held on 30 December 2004. The new joint venture company of Wang Lao Ji was established on 2 February 2005.

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Financial Conditions

1. Financial conditions of the Group

Prepared in accordance with PRC accounting standards and systems

Items	2004 RMB'000	2003 RMB'000	Change (%)
Total assets	5,182,878	4,707,039	10.11
Shareholders' funds	2,440,230	2,429,476	0.44
Profit from principal activities	1,372,489	1,372,714	(0.02)
Net profit	55,292	139,795	(60.45)
Net increase/(decrease) in cash and cash equivalents	64,386	(201,038)	132.03

Prepared in accordance with HK GAAP

Items	2004 RMB'000	2003 RMB'000	Change (%)
Total assets	5,413,438	4,954,091	9.27
Shareholders' funds	2,545,592	2,551,417	(0.23)
Operating profit after finance costs	162,236	307,365	(47.22)
Profit attributable to shareholders	42,829	146,667	(70.80)
Net increase / (decrease) in cash and cash equivalents	65,496	(181,895)	136.01

Reason for changes:

Cash and cash equivalents of the Group for the Reporting Period recorded an increase of 132.03% as compared with 2003, which was mainly due to the significant increase in the net cash flows from operating activities during the Reporting Period.

2. Liquidity

As at 31 December 2004, the current ratio of the Company was 1.46, and its quick ratio was 0.97. Accounts receivable turnover rate was 9.77 times, representing a decrease of 4.48% as compared with that of 2003. Inventory turnover rate was 5.88 times, representing an increase of 1.11% as compared with last year.

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3. *Financial resources*

As at 31 December 2004, cash and cash equivalents of the Group amounted to RMB880,825,000, out of which 96.59% and 3.41% were denominated in Renminbi and foreign currencies, like Hong Kong dollars, respectively.

As at 31 December 2004, the Group had bank borrowings of RMB1,094,639,000 in total. The long-term borrowings of the Group amounted to RMB157,180,000 (31 December 2003: RMB137,180,000), which was fixed interest loans denominated in RMB (out of which RMB47,680,000 is due in 2005 and RMB109,500,000 will be due in 2006). The short-term borrowings of the Group was RMB937,459,000 (31 December 2003: RMB664,230,000).

4. *Capital structure*

As at 31 December 2004, the Group's current liabilities amounted to RMB2,398,058,000 (31 December 2004: RMB1,948,139,000), representing an increase of 23.09% over that of 2003, and its long-term liabilities was RMB148,330,000 (31 December 2003: RMB162,691,000), with a decrease of 8.83% as compared with 2003. The shareholders' funds of the Group as at 31 December 2004 amounted to RMB2,440,230,000 (31 December 2003: RMB2,429,476,000), with an increase of 0.44% as compared with 2003.

5. *Capital expenditure*

The Group expects the capital expenditure for 2005 to amount to approximately RMB258,000,000 (2004: RMB329,000,000), which will be mainly applied in GMP renovation and other technology upgrades. The Group has sufficient financial resources to meet the capital expenditure and daily working capital requirements.

6. *Gearing ratio*

As at 31 December 2004, the Group's gearing ratio (calculated according to the formula: total liabilities/total assets) was 49.13%, with an increase of 9.56% as compared with the year 2003.

7. *Exposure to fluctuations in exchange rates*

As majority of the revenue, expenses, assets and liabilities of the Group are denominated in RMB, the Group does not have significant risks in exposure to fluctuations in exchange rates.

8. *Cash flows and its application*

As at 31 December 2004, cash and cash equivalents of the Group amounted to RMB880,825,000, with an increase of RMB64,386,000 as compared with last year. The net increase in cash and cash equivalents of the Group from operating activities amounted to RMB200,542,000, with an increase of RMB207,373,000 as compared with last year, which was mainly attributable to the fact that the increment in aspect of cash income was higher than that of the cash expenses of principal activities.

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9. *Contingent liabilities*

As at 31 December 2004, the Group has no significant contingent liabilities.

10. *Charge on Group assets*

At 31 December 2004, part of the Group's bank loans were secured by fixed assets with a net book value of RMB130,344,000.

Impact caused by the changes in operation environment and macro economy on the Company

Factors such as the implementation of the national regulations on the pricing policy of pharmaceutical products and restriction on sales of antibiotics and the significant increase in the number of pharmacies offering lower selling price led to the increasingly fierce competition in the domestic pharmaceutical market have caused certain impact on the Group's results for the year 2004.

The accounts of the Group for the year ended 31 December 2004 have been audited by Guangdong Yangcheng Certified Public Accountants Co., Ltd, the domestic auditors, and PricewaterhouseCoopers, the international auditors. The Company's domestic and international auditors have both issued unqualified auditors' reports thereon.

Prospect and Plans for 2005

In the new year, the Group will adhere to its strategy of "To strengthen basic management, control cost and expenditure, expand product marketing and enhance profit-making capacity". While optimizing corporate governance and enhancing internal management and monitoring, the Company will make every effort to develop and make stronger the main business by sourcing and developing new profit-making points to achieve the operation targets set for 2005. The plans for 2005 mainly include:

- (1) To further strengthen market planning and monitoring of our pillar products such as Xiao Ke Wan and Hua Tuo Zai Zao Wan while at the same time make a good market planning of our key nurturing products such as Xu Han Ting, Hua Zhi Shuan, Wu Ji Bai Feng Wan and An Shen Su Nao Ye, with a view to developing several mainstay products with cutting edge in the shortest time. Meanwhile we need to do a good marketing on our key products like Fu Li Tong Capsule and Ganoderma Lucidum Spore Oil featured by high content of science and technology, high value-added and promising prospect so as to increase the profit of our principal business.
- (2) To continue strengthening the core business of Guangzhou Chinese Medicine Corporation and do our best to reverse the loss position of Guangzhou Chinese Medicine Corporate.
- (3) To strengthen fund attraction and continuously seek opportunities for cooperation with outstanding pharmaceutical enterprises at home and abroad and to strengthen our efforts in merging with appropriate domestic pharmaceutical enterprises.

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- (4) To continue to expedite integration of internal resources within the Group, to better the uniform purchase of traditional Chinese medicine, raw materials in large bulks, packing materials and import materials. At the same time, to enlarge the market share of the Group's products by leveraging on the advantages of wholesale and retail networks of the Group's Trading Operations.
- (5) To strengthen basic management and reasonable operating cost saving to increase the capital utilization rate, reduce operation risks by further strengthening management of account receivable.

The Company faces both new opportunities and challenges in 2005. We will continue to exercise the spirit of industry, progress, pragmatics and innovation so as to generate a better return for our shareholders.

DAILY OPERATIONS OF THE BOARD

Board Meetings

The Board has fulfilled their duties in strict compliance with the PRC Company Law and the Company's Articles of Association, and diligently executed the resolutions passed at the general shareholders' meetings. During the Reporting Period, 12 board meetings have been convened, details of which are set out as follows:

- (1) The 27th meeting of the Second Session of the Board was held on 6 February 2004, at which the following resolutions were considered and passed:
 - The resolution in relation to the connected transaction regarding the Company's acquisition of 51% equity interest of Guangzhou Yingbang held by GPLH;
 - The resolution in relation to the connected transactions regarding the lease of office space from GPLH by the Company and the renewal of the lease of the existing office and other premises;
 - The resolution in relation to the non-competition agreement entered into between the Company and Baiyunshan Pharmaceutical;
 - The resolution in relation to the amendments of the Articles of Association of the Company and the relevant articles of "Rules of Board Meetings" of the Company;
 - The recommendation of Mr. Cai Zhixiang, Mr. Li Yimin, Mr. Feng Zansheng and Mr. Zhou Yuejin as the candidates of Directors of the new session of the Board of the Company, and Mr. Wu Zhang, Mr. Wong Hin Wing and Mr. Zhang Heyong as the candidates of Independent Non-executive Directors of the next session of the Board of the Company;
 - The resolution to appoint Ms. Huang Xuezhen as the representative of the securities affairs of the Board of the Company; and
 - The resolution to propose the Company to hold the first EGM in 2004.

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- (2) The 28th meeting of the Second Session of the Board was held on 19 February 2004 by means of written resolution, by which the resignation of Mr. Li Decheng as Deputy General Manager of the Company was approved.
- (3) The 29th meeting of the Second Session of the Board was held on 26 March 2004, at which the following resolutions were considered and passed:
- the Directors' Report for the year 2003;
 - the Report of the Supervisory Committee for the year 2003;
 - the audited financial reports for the year 2003;
 - the auditors' reports for the year 2003;
 - the re-appointment of Guangzhou Yangcheng Certified Public Accountants Co., Ltd. and PricewaterhouseCoopers as domestic and international auditors respectively, and authorization of the Board to determine the auditors' remunerations;
 - the proposed profit distribution and dividend payment for the year 2003 ;
 - the projected profit distribution policy of the Company for the year 2004;
 - the remuneration of the Directors for 2004;
 - the remuneration of the Supervisors for 2004;
 - the agreement relating to the continuing connected transactions entered into between the Company and GPLH dated 26 March 2004 and the transaction contemplated thereunder;
 - the proposed amendments to the Articles of Associations of the Company;
 - the proposed amendments to the "Rules of Shareholders' General Meetings" of the Company;
 - the proposed amendments to the "Rules of Board Meetings" of the Company; and
 - the proposal for convening the 2003 AGM of the Company.
4. The 1st meeting of the Third Session of the Board was held on 28 April 2004, at which the following resolutions were considered and passed:
- the 2004 first quarterly report of the Company;
 - the election of Mr. Cai Zhixiang as Chairman of the Third Session of the Board of the Company;

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- the election of Mr. Li Yimin as Vice Chairman of the Third Session of the Board of the Company;
 - the appointment of Mr. He Shuhua as Company Secretary of the Company;
 - the appointment of Mr. Zhou Yuejin as the General Manager of the Company;
 - the appointment of Mr. He Shuhua as the Deputy General Manager of the Company;
 - the appointment of Mr. Gao Fang as the Financial Controller of the Company;
 - the appointment of Messrs. Wu Zhang, Wong Hin Wing and Zhang Heyong as members of the Third Audit Committee and Mr. Wong Hin Wing as the Head of the Audit Committee;
 - the appointment of Messrs. Cai Zhixiang, Li Yimin, Wu Zhang, Wong Hin Wing and Zhang Heyong as the members of the Second Remuneration and Evaluation Committee, and Mr. Wu Zhang as the Head of the Remuneration and Evaluation Committee;
 - the appointment of Messrs. Cai Zhixiang, Li Yimin and Zhou Yuejin as members of the Second Investment Management Committee, and Mr. Cai Zhixiang as the Head of the Investment Management Committee; and
 - the resolution regarding authorization of the Chairman of the Board to sign documents on behalf of the Board to guarantee credit facilities granted to the Company's direct wholly-owned subsidiaries or controlling subsidiaries.
5. The 2nd meeting of the Third Session of the Board was held on 22 June 2004 by means of written resolution, by which the resignation of Mr. Li Yimin as Director and Vice Chairman of the Company was approved.
6. The 3rd meeting of the Third Session of the Board was held on 27 August 2004, at which the following resolutions were considered and passed:
- the 2004 interim report of the Company;
 - the unaudited financial statements of the Company for the first half of 2004;
 - the opinion of the Audit Committee on the 2004 interim report of the Company;
 - the proposed subscription of newly issued shares of Guangzhou Hanfang by the Company;
 - the proposal for remuneration of the Independent Directors and external Supervisors for the year 2004; and
 - the proposal for convening the second EGM in 2004.

Report of the Directors

7. The 4th meeting of the Third Session of the Board was held on 9 September 2004, at which the following resolutions were considered and passed:
 - the election of Mr. Zhou Yuejin as Vice Chairman of the Third Session of the Board;
 - the resignation of Mr. Cai Zhixiang as Chairman and Director of the Company, and the appointment of Mr. Zhou Yuejin, the Vice Chairman, to act as acting Chairman until the date of the election of the new Chairman; and
 - the resolution in relation to the nomination of Mr. Yang Rongming and Mr. He Shuhua as candidates for appointment as Directors.
8. The 5th meeting of the Third Session of the Board was held on 19 October 2004, at which the following matters were discussed:
 - matters in relation to the proposed subscription of newly issued shares of Wang Lao Ji by Golden Force; and
 - matters in relation to the lease of Wang Lao Ji trademark.
9. The 6th meeting of the Third Session of the Board was held on 28 October 2004, at which the 2004 3rd quarterly report of the Company was considered and passed.
10. The 7th meeting of the Third Session of the Board was held on 1 November 2004, at which the following matters were considered and passed:
 - the election of Mr. Yang Rongming as the Chairman of the Third Session of the Board of the Company;
 - the resolution in relation to the amendment of Article 3 of the “Implementation Details of the Investment Management Committee of the Board”, in respect of the number of members constituting the Investment Management Committee, and the election of Mr. Yang Rongming, Mr. Feng Zansheng and Mr. He Shuhua as replacement members of the Investment Management committee; and
 - the resolution in relation to the election of Mr. Yang Rongming and Mr. Zhou Yuejin as replacement members of the Remuneration and Evaluation Committee.

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11. The 8th meeting of the Third Session of the Board was held on 5 November 2004, at which the following matters were considered and passed:
 - the proposed subscription of newly issued shares of Wang Lao Ji by Golden Force;
 - the proposed supplemental trademark licence agreement between GPLH and the Company;
 - the proposed trademark licence agreement between GPLH and Wang Lao Ji; and
 - the proposal for convening an EGM and separate class meetings of shareholders of the Company to consider the first resolution stated above.

12. The 9th meeting of the Third Session of the Board was held on 26 November 2004, at which the resignation of Mr. Zhou Yuejin as the General Manager of the Company was accepted, and Mr. Xie Bin was appointed as the General Manager of the Company, with a term of office commencing from the date of appointment until the date of election of the new session of Board.

The progress of Execution by the Directors in respect of the Resolutions passed at General Shareholders' Meetings

2003 final dividend

Pursuant to the resolution passed at the 2003 AGM, a final dividend of RMB0.06 per share (including withholding tax for A shares) for 2003 had been paid to the Company's shareholders by July 2004. The registration date for H Shares' shareholders for the final dividend was 11 May 2004, while the book closing date was 12 May 2004. The registration date for A Shares' shareholders for the final dividend was 24 June 2004 and the closing date was 25 June 2004.

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

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 RMB0.025 per share (including withholding tax for A Shares) for the year ended 31 December 2004 (2003: RMB0.06). The proposed final dividend will be submitted to the forthcoming 2004 AGM for consideration and approval (the notice to convene the 2004 AGM will be published separately).

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

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OTHER MATTERS

1. Accounts

The results of the Group for the year ended 31 December 2004 are set out in the consolidated profit and loss account prepared in accordance with PRC accounting standards and systems and HK GAAP on page 66 and page 129, respectively.

The financial conditions of the Group as at 31 December 2004 are set out in the consolidated balance sheet prepared in accordance with PRC accounting standards and systems and HK GAAP on page 64 and page 130, respectively.

The cash flows of the Group for the year ended 31 December 2004 is set out in the consolidated cash flow statement prepared in accordance with PRC accounting standards and systems and HK GAAP on page 69 and page 133, respectively.

The cash flows of the Company for the year ended 31 December 2004 is set out in the cash flow statement prepared in accordance with PRC accounting standards and systems on page 75.

2. 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 4.

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 4.

3. Reserves

Movements in the reserves of the Group during the year in accordance with PRC accounting standards and systems are set out on page 107 to 108.

Movements in the reserves of the Group and of the Company during the year in accordance with HK GAAP are set out on page 156 to 159.

4. Distributable Reserves

The profit available for distribution to shareholders is the lower of the amount determined in accordance with HK GAAP and the PRC accounting standards and systems. The distributable reserves of the Group as at 31 December 2004 amounted to RMB22,506,000, calculated under the PRC accounting standards and systems. The distributable reserves of the Company pursuant to Section 79B of the Hong Kong Companies Ordinance amounted to RMB51,869,000.

5. Fixed Assets

Details of the movements of fixed assets of the Group are set out on page 96 and page 150 to 151.

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6. Connected Transactions

Pursuant to the rules of China Securities Regulatory Commission, details of the connected transactions were set out on pages 115 to 121.

Pursuant to the rules of The Stock Exchange of Hong Kong Limited (the "Stock Exchange"), details of the connected transactions were set out as follows:

	2004
	RMB'000
Ultimate holding Company	
Licence fee expense	7,618
Service fee expense	910
Welfare facilities fee expense	480
Rental expense	3,971
Capital contribution to a subsidiary of the Company	48,369
Fellow subsidiaries	
Sales of finished goods and raw materials	6
Purchase of finished goods and raw materials	9,607

In addition, other transactions with jointly controlled entities, associated companies and Guangzhou Baiyunshan Pharmaceutical Co., Ltd and its subsidiaries which, pursuant to the rules of the Stock Exchange, do not constitute connected transactions, have been disclosed in notes to the accounts prepared in accordance with HK GAAP.

The Directors believe that the above-mentioned connected transactions have been conducted in full compliance with the relevant clauses stipulated in the Agreement in relation to the Sales and Purchase Connected Transactions entered into between the Company and GPLH on 26 March 2004.

The Independent 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 terms to the Group no less favourable than those available to or from independent third parties. In addition, the aggregate amount of the above connected transactions during the Year has not exceeded the annual caps as stated in the Agreement in relation to the Sales and Purchase Connected Transactions entered into between the Company and GPLH.

Report of the Directors

The international auditors have confirmed that continuing connection transactions out of the above transactions pursuant to the rules of the Stock Exchange:

- had been approved by the board of directors of the Company;
- were entered into in accordance with the relevant pricing policies;
- were entered into in accordance with the terms of the relevant agreements governing such transactions; and
- had not exceeded the cap as described in the agreement entered into between the Company and GPLH on 26 March 2004.

7. 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.

8. 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.

9. Audit Committee

The Audit Committee of the Company had reviewed the accounting policies, accounting regulations and methods adopted by the Company, and had discussed with the Company's management about the audit, internal controls and financial reporting. The Committee also reviewed the audited accounts for the year ended 31 December 2004.

10. 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.

11. 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 163 to 164 and page 145.

12. Staff quarters

Pursuant to the Accommodation Service Agreement entered into between the Company and GPLH, GPLH agreed to sell the staff quarters to the employees of the Group at a preferential price. The Company shall pay to GPLH the staff quarters reform costs, which represent the difference between the preferential price and the cost net of depreciation paid by GPLH on buildings acquired for such staff quarters. The total staff quarters reform costs, which are payable to GPLH, amounted to approximately RMB62,030,000 (2003: RMB62,030,000).

In addition, the Group has constructed or acquired certain staff quarters. As at 31 December 2004, the difference between the construction cost or acquisition cost and the revenue from disposal of the quarters totalled RMB42,437,000 (2003: RMB42,437,000).

The above mentioned staff quarters reform costs amounted to RMB104,467,000 as at 31 December 2004 (2003: 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 2004. 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 2004 was approximately RMB56,342,000, and the amortisation for 2004 was RMB10,446,000. As at 31 December 2004, the net carrying value of the deferred staff quarters reform costs was RMB48,125,000. 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 2004, the consolidated net assets of the Group as at 31 December 2004 would have been reduced by approximately RMB48,125,000. 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.

13. Project under Development and for Sale

During the Reporting Period, the Group did not hold any properties for the purpose of development and/or for investment purpose of which the net book value is above 15% of the net book value of tangible assets of the Group or the contribution to profit before tax from these properties is over 15% of the Group's total profit before tax.

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14. Bank Loans, Overdraft and Other Loans

Details of the bank loans, overdrafts, and other liabilities of the Group as at 31 December 2004 are set out on page 102 to 105 and page 106. In comparison to last year, there have been no material adverse changes in respect of the amounts of bank loans, overdrafts and total liabilities as at 31 December 2004.

15. Auditors

Guangdong Yangcheng Certified Public Accountants Co., Ltd. and PricewaterhouseCoopers were respectively appointed as domestic and international auditors of the Company for the year 2003, as approved at the 2003 AGM.

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

16. Change in the Newspapers Designated by the Company for Information Disclosure

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

17. Explanation of Certified Public Accountants in respect of Funds Used by Controlling Shareholder and Other Connected Parties of the Company

Guangdong Yangcheng Certified Public Accountants Co., Ltd., the domestic auditors of the Company, has made an explanation in respect of the flow of funds with the controlling shareholder and other parties of the Company.

Report of the Directors

In accordance with the requirements as set out in the Notice Concerning the Regulation on the Flow of Funds between Listed Companies and their Related Parties and the Provision of Guarantees by Listed Companies to External Parties (Zheng Jian Fa [2003] Directive No. 56) promulgated by the CSRC and the State Asset Management Commission under the State Council, the statement on the application of funds by the Company's controlling shareholder and other related parties for the year ended 31 December 2004 is set out below:

Connected parties	Relationship with the Company	Account	Balance as at 31 December 2004		Balance as at 1 January 2004		Transaction amount (debit)		Transaction amount (credit)		Nature
			RMB'000		RMB'000		RMB'000		RMB'000		
GPHL	Parent company	Other receivables	6,312	—	7,227	—	436	—	1,351	—	Deposits
Guangzhou Qiao Guang Pharmaceutical Factory	Under the same parent company	Accounts receivable	—	17,232	—	5,573	—	55,015	—	43,355	Purchase
Guangzhou Ming Xing Pharmaceutical Factory	Under the same parent company	Accounts receivable	—	739	—	288	—	1,903	—	1,452	Purchase
Guangzhou Tian Xin Pharmaceutical Co., Ltd	Under the same parent company	Accounts receivable	—	5,481	—	3,140	—	21,688	—	19,347	Purchase
Guangzhou He Ji Gong Pharmaceutical Factory	Under the same parent company	Accounts receivable	—	432	—	18	—	1,351	—	936	Purchase
Guangzhou He Ji Gong Pharmaceutical Factory	Under the same parent company	Other receivables	25	—	—	—	25	—	—	—	Borrowings
Guangzhou Guang Hua Pharmaceutical Co., Ltd	Under the same parent company	Accounts receivable	—	1,573	—	434	—	4,320	—	3,181	Purchase
Guangzhou Wei Cai Factory	Under the same parent company	Accounts receivable	—	—	—	329	—	5	—	334	Purchase
Guangzhou Hua Nan Medical Apparatus Co., Ltd	Under the same parent company	Other receivables	100	—	100	—	—	—	—	—	Borrowings
Po Lian	Under the same parent company	Other receivables	14,854	—	8,222	—	13,438	—	6,805	—	Temporary deposits of the deposit of acquisition
Guangzhou Zhong Fu Medical Co., Ltd	Affiliated company	Accounts receivable	—	—	—	188	—	—	—	188	Purchase
Guangzhou Zhong Fu Medical Co., Ltd	Affiliated company	Other receivables	—	—	3	—	—	—	3	—	Borrowings
Guangzhou Baiyunshan Pharmaceutical Factory	Under the same parent company	Accounts receivable	—	1,753	—	7,766	—	8,868	—	14,880	Purchase
Guangzhou Baiyunshan Chinese Medicine Factory	Under the same parent company	Accounts receivable	—	1,154	—	852	—	1,628	—	1,326	Purchase
Guangzhou Chemical Pharmaceutical Factory	Under the same parent company	Accounts receivable	—	423	—	—	—	3,665	—	3,242	Purchase
Shenzhen Qixing Lanzao Biological Co., Ltd	Under the same parent company		2,631	—	2,631	—	—	—	—	—	
Total			23,923	28,786	18,183	18,587	13,899	98,442	8,159	88,243	

Report of the Directors

18. Explanation and Independent Opinions of Independent Non-executive Directors in respect of Accumulated and Current External Guarantees Granted by the Company and the Funds Used by the Controlling Shareholders and Other Connected Parties of the Company

Pursuant to the principle as implied in the Notice Concerning the Regulation on the Flow of Funds between Listed Companies and their Related Parties and the Provision of Guarantees by Listed Companies to External Parties, the independent directors of the Company have conducted examination of the policies towards the guarantees provided to the external parties by the Company in a serious manner. The relevant details are as follows:

As at 31 December 2004, the Company has not provided any guarantee to its controlling shareholder or any other related parties.

19. Forecast on the Ordinary Connected Transactions in 2005

The Group and GPLH together with its associates have been selling certain pharmaceutical products, bulk pharmaceutical raw materials and medical equipment to each other. These transactions have been, and will continue to be carried out on normal commercial terms and on an arm's length basis. The forecasted amount of the connected transactions between the Group and GPLH together with its associates are set out as follows:

Connected transactions		Related parties	2005 forecasted amount	Amount in 2004
1. Purchases	Pharmaceutical products, bulk pharmaceutical raw materials, medical equipment and pharmaceutical packaging materials	GPLH and its associates	RMB482 million	Approximately RMB105 million
2. Sales	Pharmaceutical products, bulk pharmaceutical raw materials, medical apparatus and pharmaceutical packaging materials	GPLH and its associates	RMB270 million	Approximately RMB8.4 million

Because the estimated annual amount of sales or purchase connected transaction between the Company and GPLH together with its associates for the year 2005 exceeds the caps of annual caps of sales or purchase connected transactions between the Company and GPLH together with its associates as stipulated in the Sales and Purchase Connected Agreement entered into on 26 March 2006, the Company has negotiated with GPLH to re-define the annual caps for the sales or purchase connected transactions between both parties (please refer to the announcement relating to the continuing connected transaction of the Company dated 27 April 2005 for details), which will be submitted for consideration and approval at the 2004 AGM of the Company.

On behalf of the Board
Yang Rongming
Chairman

Guangzhou, the PRC, 27 April 2005