

# Report of the Directors

(Unless otherwise stated, the financial data contained in this report is extracted from the Group's financial statements prepared in accordance with the PRC Accounting Standards and Systems.)

## MANAGEMENT DISCUSSION AND ANALYSIS

### (I) Business Scope and Analysis of Operations

#### 1. Scope of business

The Group is principally engaged in (1) the 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) Review of operating results

During the Reporting Period, the Group has taken the following measures: (i) it strengthened the monitoring and management of the operations of its subsidiaries and actively participated in their material decision-making process in relation to their operations to seek to improve the operations and efficiency of the subsidiaries; (ii) it focused on expanding the markets outside the province following the consolidation of the markets in southern China, expedited the construction of networks of end-markets by aggressively expanding the distribution networks outside the province and exploring end-markets such as key hospitals, retail pharmacies, communities and rural areas and increasingly built up professional reputation as well as improved the consolidation and integral influence of GPC in the market; (iii) it facilitated the process of resource integration and uniformity operation within the Group by focusing on a centralised purchasing of traditional Chinese medicine, raw materials in large bulks, packaging material, materials for import and advertisement and strengthening the business cooperation between the industrial and commercial businesses within the Group and enlarging the market share of the Group's products by leveraging on the advantages of wholesale and retail networks of the Group's Trading Operations; and (iv) it expedited the construction of technology platform of the Group, and facilitated the research and development of new products and application of new technologies. Through the implementation of these measures, the Group achieved a good result. During the Reporting Period, a significant growth was recorded in the operating results of the Group, and the highest record level since its establishment was achieved.

According to the Group's consolidated financial statements for the Year prepared under the PRC Accounting Standards and Systems, the turnover of the Group was approximately RMB 9,026,340,000, representing an increase of 17.10% over that of 2004. Profit before tax was approximately RMB 306,741,000, representing an increase of 82.97% over that of 2004. Net profit was approximately RMB 184,482,000, representing an increase of 233.65% over that of 2004. According to the Group's financial statements for the Year prepared under HK GAAP, the Group's turnover amounted to approximately RMB9,026,340,000, representing an increase of 17.07% over that of 2004. Profit before income tax was approximately RMB315,493,000, representing an increase of 95.14% over that of 2004, and profit attributable to equity holders of the Company was approximately RMB197,804,000, representing an increase of 361.84% over that of 2004.

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## MANAGEMENT DISCUSSION AND ANALYSIS (continued)

### (I) Business Scope and Analysis of Operations (continued)

#### 2. Analysis of operating results (continued)

##### (1) Review of operating results (continued)

An analysis of the Group's turnover and profit from principal activities for the Year is set out as follows:

	Turnover		Profit from principal activities	
	Under PRC Accounting Standards and Systems RMB'000	Under HK GAAP RMB'000	Under PRC Accounting Standards and Systems RMB'000	Under HK GAAP RMB'000
Principal activities:				
Manufacturing	2,141,675	2,141,675	1,098,097	1,116,452
Trading, including:				
Wholesale	6,345,288	6,345,288	352,402	357,617
Retail	318,669	318,669	63,185	64,197
Import and export	220,708	220,708	15,068	15,100
Sub-total	6,884,665	6,884,665	430,655	436,914
Total	9,026,340	9,026,340	1,528,752	1,553,366

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

Region	Manufacturing		Trading		Consolidated RMB'000	Percentage of the total turnover (%)
	Turnover RMB'000	Percentage of the manufacturing turnover (%)	Turnover RMB'000	Percentage of the trading turnover (%)		
Southern China	1,264,923	59.06	6,010,447	87.30	7,275,370	80.60
Eastern China	349,441	16.31	283,621	4.12	633,062	7.02
Northern China	202,533	9.46	123,615	1.80	326,148	3.61
North-Eastern China	127,986	5.98	70,564	1.02	198,550	2.20
South-Western China	122,516	5.72	226,351	3.29	348,867	3.86
North-Western China	70,275	3.28	68,008	0.99	138,283	1.53
Exports	4,001	0.19	102,059	1.48	106,060	1.18
Total	2,141,675	100.00	6,884,665	100.00	9,026,340	100.00

# Report of the Directors

## MANAGEMENT DISCUSSION AND ANALYSIS *(continued)*

### (I) Business Scope and Analysis of Operations *(continued)*

#### 2. Analysis of operating results *(continued)*

##### (2) Chinese Patent Medicine manufacturing business

According to the Group's consolidated financial statements for the Year prepared under the PRC Accounting Standards and Systems, turnover of the Manufacturing Operations for the Year was RMB2,141,675,000, representing an increase of 11.60% over that of 2004. Total profit was RMB216,380,000, representing an increase of 20.00% over that of 2004, and net profit was RMB120,209,000, representing an increase of 27.60% over that of 2004. According to the Group's financial statements for the Year prepared under HK GAAP, turnover of the Manufacturing Operations for the Year was RMB2,141,675,000, representing an increase of 11.60% over that of 2004. Profit before income tax was RMB230,502,000, representing an increase of 29.51% over that of 2004, and profit attributable to equity holders of the Company was RMB136,761,000, representing an increase of 56.34% year-on-year. Both sales income and profit before income tax for the Manufacturing Operations reached the highest record level.

During the Reporting Period, the Group has taken the following measures in its Manufacturing Operations:(i) it continued to improve the promotion and marketing in its major products such as Xiao Ke Wan, Hua Tuo Zai Zao Wan, Xia Sang Ju, the series of Wang Lao Ji Liang Cha and the series of Pan Gao Shou Cough and phlegm clearing and enhanced abilities of the sales team, as well as further strengthened the marketing and promotion of products so as to expand the market share of its products; (ii) it aggressively expanded distribution network and explored hospitals, communities and other retail markets and further developed the markets in rural and out of the province. During the Year, GPC and its subsidiaries have held several large meetings for association and products introduction in cities including Chengdu, Wuhan, Xi'an, Shenyang, Zhengzhou and Zhuhai, respectively, strengthening the connections and communications between companies and distributors, improving the corporate identity and brand popularity as well as expanding geographic coverage of sales of products.

Through the implementation of the aforesaid measures, there were 36 products whose sales income exceeded RMB10 million during the Year, of which annual sales income exceeding RMB100 million included Xiao Ke Wan, Hua Tuo Zai Zao Wan, Xia Sang Ju and the series of Wang Lao Ji Liang Cha, the annual sales income of 17 products ranged from RMB30 million to RMB100 million and the annual sales income of 15 products ranged from RMB10 million to RMB30 million. The sales income for the Year of certain key products such as Xia Sang Ju, Wang Lao Ji Liang Cha, Throat, spleen and intestine pills, She Dan Chuan Bei Pi Pa Gao and Zhi Ke Chuan Bei Pi Pa Lu increased significantly by 28.78%, 117.49%, 46.53%, 42.70% and 33.56% respectively as compared with 2004.

For the Reporting Period, sales of cough and phlegm clearing medicine, diabetes curing medicine, gastric medicine and arthritis curing medicine for the Manufacturing Operations increased by 35.51%, 16.64%, 8.18% and 16.63% as compared with the previous year, respectively.

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## MANAGEMENT DISCUSSION AND ANALYSIS (continued)

### (I) Business Scope and Analysis of Operations (continued)

2. Analysis of operating results (continued)
  - (2) Chinese Patent Medicine manufacturing business (continued)

Analysis of sales of major products is as follows:

Products	Turnover for 2005 RMB'000	Gross profit for 2005 RMB'000
Heat clearing and anti-toxic	496,761	240,223
Diabetes curing	406,503	269,337
Cough and phlegm clearing	254,180	144,198
Arthritis curing	244,004	152,540
Gastric	99,166	45,325
Others	641,061	264,811

During the Year, the Group continued to accelerate the construction of technology platforms and to strengthen the research and development of new products. In 2005, there was six new medicine that obtained approvals on production and five obtained the approvals on clinical research. Recently, the principal project of our national projects research centre for modernizing the process of extracting and separating Chinese medicine has officially been finalized and put into use. This will certainly become the research development platform for modern Chinese medicine and extraction technology of the Group.

- (3) Pharmaceutical trading business, including wholesale, retail, import and export

According to the consolidated financial statements prepared in accordance with PRC Accounting Standards and Systems, turnover of the Group's Trading Operations for the Year was about RMB6,884,665,000, representing an increase of 18.92% over that of the previous year. Gross profit was about RMB90,361,000, representing an increase of 813.10% year-on-year, and net profit was RMB64,273,000, representing an increase of 265.14% year-on-year. According to the consolidated financial statements prepared in accordance with HK GAAP, the turnover of the Group's Trading Operations this year was about RMB6,884,665,000, representing an increase of 18.92% over that of the previous year. Profit before income tax was about RMB84,991,000, representing an increase of 621.35% year-on-year, and profit attributable to equity holders of the Company was RMB61,043,000, representing an increase of 236.72% year-on-year.

During the Reporting Period, the Trading Operations mainly focused on the following aspects: (i) they actively sought and developed featured products with promising market prospect, and tried to expand sales of branded products in the market; (ii) they expedited the process of resource integration within the Group, and facilitated the purchases, supplies and services of traditional Chinese medicine, raw materials in large bulks and imported materials; (iii) they strengthened the business cooperation with the manufacturing subsidiaries of the Group and made full advantages of marketing networks of the Trading Operations in order to expand the sales of the products for the Group.

During the Reporting Period, the number of new customers of the Trading Operations increased by 694 and products with exclusive distribution rights grew by 22 types. As at 31 December 2005, the Group had 161 chain pharmacies, including 87 "Cai Zhi Lin" which specializes in traditional Chinese medicine and 73 "Jian Min" which specializes in chemical medicine as well as one pharmacy named Ying Bang.

# Report of the Directors

## MANAGEMENT DISCUSSION AND ANALYSIS (continued)

### (I) Business Scope and Analysis of Operations (continued)

#### 2. Analysis of operating results (continued)

#### (3) Pharmaceutical trading business, including wholesale, retail, import and export (continued)

Details of operation and results of the Company's subsidiaries

Name	Major products and business nature	Percentage of direct holding by the Company (%)	Sales income for the Year RMB'000	Profit for the Year RMB'000	Net profit for the Year RMB'000	Total assets as at the end of the Year RMB'000	Net assets as at the end of the Year RMB'000
Xing Qun Pharmaceutical	Manufacturing of CPM such as Xia Sang Ju	88.99	273,482	45,056	27,167	307,193	215,885
Zhong Yi Pharmaceutical	Manufacturing of CPM such as Xiao Ke Wan	90.36	569,932	103,266	68,728	519,303	384,622
Guangzhou Chen Li Ji Pharmaceutical Factory	Manufacturing of CPM such as Wu Ji Bai Feng Wan	100.00	222,418	38,098	24,040	277,709	222,749
Guangzhou Qi Xing Pharmaceutical Co., Ltd	Manufacturing of CPM such as Hua Tuo Zai Zhao Wan	75.00	352,632	47,501	34,056	279,548	143,258
Guangzhou Jing Xiu Tang Pharmaceutical Co., Ltd	Manufacturing of CPM such as Qing Re Xiao Yan Ning	88.40	159,438	2,094	1,967	164,891	105,802
Guangzhou Pan Gao Shou Pharmaceutical Co., Ltd	Manufacturing of CPM such as Mi Lian Chuan Bei Pi Pa Gao	87.77	240,918	12,623	6,605	271,481	182,370
Wanglaoji Pharmaceutical	Manufacturing of CPM such as Bao Ji Wan	48.0465	244,701	35,015	32,346	193,783	167,311
Huan Ye Pharmaceutical	Manufacturing of phytochemical medicine	59.70	34,515	469	252	42,944	24,270
Guangxi Yingkang	Manufacturing of CPM such as Hua Tuo Feng Tong Bao	51.00	17,868	(7,338)	(7,119)	44,908	31,880
Guangzhou Bai Di	Research and development and manufacturing of bio-tech medicine	95.69	1,316	(8,392)	(8,392)	66,765	60,126
Guangzhou Hanfang	Research and development and manufacturing of CPM	70.04	2,929	(13,252)	(13,252)	138,732	97,371
Guangzhou Pharmaceutical Corporation	Sales of chemical pharmaceutical products and medical apparatus	90.09	6,436,780	68,735	47,742	2,238,874	436,834
Guangzhou Chinese Medicine Corporation	Sales of Chinese raw medicine and CPM	100.00	789,797	6,602	5,799	353,704	20,122
Guangzhou Pharmaceutical Import & Export Corporation	Import and export of TCM and chemical medicine	100.00	305,427	3,055	1,603	122,968	23,070
Guangzhou Guangyao Ying Bang Marketing Co., Ltd	Sales of Chinese raw medicine, CPM and materials	51.00	204,540	2,592	1,574	36,805	7,658
Total			<u>9,856,693</u>	<u>336,124</u>	<u>223,116</u>	<u>5,059,608</u>	<u>2,123,328</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.

# Report of the Directors

## MANAGEMENT DISCUSSION AND ANALYSIS *(continued)*

### (I) Business Scope and Analysis of Operations *(continued)*

#### 2. Analysis of operating results *(continued)*

##### (4) Major customers and suppliers

During the Year, purchases of goods and services from the 5 largest suppliers amounted to RMB1,185,063,000 representing approximately 15.12% of the total purchases. The purchases from the largest supplier amounted to RMB315,546,000 representing 4.02% of the total purchases. Goods and services sold to the 5 largest customers amounted to RMB572,598,000, representing 6.34% of the total sales. Sales to the largest customer amounted to RMB181,446,000, representing 2.01% 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 5 largest suppliers or customers noted above.

### (II) The situation of 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 2005, an aggregate of RMB682,140,000 of the net proceeds from the issue of A shares were utilised. The remaining unused proceeds amounting to RMB55,850,000 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.

# Report of the Directors

## MANAGEMENT DISCUSSION AND ANALYSIS (continued)

### (II) The situation of the Company's Investments (continued)

2. As at 31 December 2005, 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 for the Year RMB'000	Stage of completion %
<b>Projects for the technology upgrade and industrialization of new products</b>				
<b>Pills</b>	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	24,580	88
	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	22,160	85
<b>Syrup</b>	Technology upgrade for syrup production	29,500	29,500	100
	Industrialisation of Ke Gan Li Yan Syrup	19,600	19,600	100
<b>Granules</b>	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
<b>Tablets</b>	Industrilisation of Fu Yan Xiao Soluble Tablets	29,500	23,790	84
	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
<b>Industrialization foundations</b>				
	Modernisation of extraction and purification technology	29,900	29,900	100
	Critical purification of CO2 technology foundation	29,900	29,900	100
<b>Trading</b>				
	Expansion of chained pharmacies			
	Jian Min	89,300	88,840	100
	Cai Zhi Lin	59,500	29,190	68
	Logistics centre upgrade	20,000	20,000	100
	ERP upgrade for the Trading Operations	20,000	16,220	85
<b>Bio-tech research centre</b>				
		80,000	75,770	95
<b>Additional working capital</b>				
		76,690	79,690	100
Total		<u>737,990</u>	<u>682,140</u>	

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.

# Report of the Directors

## MANAGEMENT DISCUSSION AND ANALYSIS (continued)

### (II) The situation of the Company's Investments (continued)

2. As at 31 December 2005, 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: (continued)

(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 RMB3,068,440,000 and RMB446,440,000 respectively.

Among these, the expansion of chain pharmacies had slowed down as a result of keen 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

On 1 August 2005, the Company and other shareholders of Guangzhou Bai Di, its subsidiary, entered into an Agreement for Increase in Capital, whereby the Company should increase its investment in Guangzhou Bai Di of RMB13,500,000. Upon the completion of such increase, the Company's equity interests in Guangzhou Bai Di increased to 95.69%.

### (III) Financial Conditions

1. Financial conditions of the Group

Prepared in accordance with PRC Accounting Standards and Systems

Items	2005 RMB'000	2004 RMB'000	Change (%)
Total assets	5,098,095	5,182,878	(1.64)
Shareholders' funds	2,621,437	2,440,230	7.43
Profit from principal activities	1,528,752	1,372,489	11.39
Net profit	184,482	55,292	233.65
Net increase / (decrease) in cash and cash equivalents	(263,842)	64,386	(509.78)

Prepared in accordance with HK GAAP

Items	2005 RMB'000	2004 RMB'000	Change (%)
Total assets	5,316,420	5,413,438	(1.79)
Capital and reserves attributable to the Company's equity holders	2,723,123	2,545,592	6.97
Operating profit after finance costs	316,705	162,236	95.21
Profit attributable to equity holders of the Company	197,804	42,829	361.84
Net increase / (decrease) in cash and cash equivalents	(263,804)	65,496	(502.78)



# Report of the Directors

## MANAGEMENT DISCUSSION AND ANALYSIS *(continued)*

### (III) Financial Conditions *(continued)*

#### 1. Financial conditions of the Group *(continued)*

Reasons for changes:

- (1) Net profit for the Year increased by 233.65% as compared with 2004 which is mainly caused by: A. The substantial increase in net profit of the Group during the Year. B. The Chinese Medicine Corporation, a subsidiary of the Company, recorded notable improvements in operating results.
- (2) Net cash and cash equivalent for the Year decreased by 509.78% over that of 2004 is mainly caused by the Group's repayment of bank borrowings during the Year.

#### 2. Liquidity

As at 31 December 2005, the current ratio of the Company was 1.55 (31 December 2004: 1.46), and its quick ratio was 0.98 (31 December 2004: 0.97). Accounts receivable turnover rate was 10.96 times, representing an increase of 12.16% as compared with that of 2004. Inventory turnover rate was 6.71 times, representing an increase of 14.16% as compared with last year.

#### 3. Financial resources

As at 31 December 2005, cash and cash equivalents of the Group amounted to RMB616,983,000 out of which 97.93% and 2.07% were denominated in Renminbi and foreign currencies, like Hong Kong dollars, respectively.

As at 31 December 2005, the Group had bank borrowings of RMB917,785,000 in total. The short-term borrowings of the Group amounted to RMB867,785,000 (31 December 2004: RMB937,459,000). The long-term borrowings of the Group to be due in one year time was RMB50,000,000 (31 December 2004: RMB47,680,000).

#### 4. Capital structure

As at 31 December 2005, the Group's current liabilities amounted to RMB2,236,332,000 (31 December 2004: RMB2,398,058,000), representing a decrease of 6.74% over that of 2004, and its long-term liabilities was RMB54,826,000 (31 December 2004: RMB148,330,000), with a decrease of 63.04% as compared with 2004. The shareholders' funds of the Group as at 31 December 2005 amounted to RMB2,621,437,000 (31 December 2004: RMB2,440,230,000), with an increase of 7.43% as compared with 2004.

#### 5. Capital expenditure

The Group expects the capital expenditure for 2006 to amount to approximately RMB245,000,000 (2004: RMB137,000,000), which will be mainly applied in acquisition of fixed assets and equity investment, etc. The Group has sufficient financial resources to meet the capital expenditure and daily working capital requirements.

# Report of the Directors

## MANAGEMENT DISCUSSION AND ANALYSIS *(continued)*

### (III) Financial Conditions *(continued)*

#### 6. Gearing ratio

As at 31 December 2005, the Group's gearing ratio (calculated according to the formula: total liabilities/total assets) was 44.94%, with a decrease of 8.53% as compared with the year 2004.

#### 7. Exposure to fluctuations in exchange rates

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

#### 8. Main cash resources and its application

As at 31 December 2005, cash and cash equivalents of the Group amounted to RMB616,983,000, with a decrease of RMB263,842,000 as compared with last year. The net increase in cash and cash equivalents of the Group delivered from operating activities amounted to RMB146,323,000, with a decrease of RMB54,220,000 as compared with last year, which was mainly attributable to the increase of purchasing expenditure for the year.

#### 9. Contingent liabilities

As at 31 December 2005, the Group has no significant contingent liabilities.

#### 10. Charge on Group assets

At 31 December 2005, part of the Group's bank loans were secured by fixed assets with a net book value of RMB93,511,000.

### (IV) Impact caused by the changes in operation environment and national macro economic policy on the Company

Factors such as the implementation of the national policy regarding the price-restriction of pharmaceutical products, the increased production cost resulting from GMP renovation of the Manufacturing Operations of the Group and lower gross profit margin of Trading Operations have caused certain impact on the Group's results.

### (V) The annual financial reports of the Group for the year of 2005 have been audited by Guangdong Yangcheng Certified Public Accountants Co., Ltd, the PRC auditors, and PricewaterhouseCoopers, the international auditors. The Company's PRC and international auditors have both issued unqualified auditors' reports thereon.

### (VI) Prospect and Plans for 2006

The facts that prospect for pharmaceutical markets both at home and abroad is positive, OTC medicines have evolved rapidly, CPM is modernized and internationalized more quickly and Guangdong Province and Guangzhou Municipal focus on the industry of traditional Chinese medicine and pharmaceuticals will provide more opportunities for the future development of the Group. On the other side, the regulation of national pricing policy on pharmaceutical products and the keen competition in the CPM market have also imposed certain influence on the operations of the Group.

# Report of the Directors

## MANAGEMENT DISCUSSION AND ANALYSIS *(continued)*

### (VI) Prospect and Plans for 2006 *(continued)*

In 2006, the Group will continue to optimize corporate governance and enhance internal management and control, while it will also make every effort to develop and strengthen the main business by developing new profit-making points to achieve the operation targets set for 2006.

The plans for 2006 mainly include:

1. With the focus on geographical expansion and end-market construction, to put more efforts in sales and marketing, increase the market share of the products and further strengthen the market subdivision and administration of our pillar products such as Xiao Ke Wan, Hua Tuo Zai Zao Wan, series products of Chuan Bei Pi Pa, series products of Wang Lao Ji and Xia Sang Ju to ensure a steady growth of their market shares, while at the same time, focus on the industrialisation of and make a sound market planning and promotion of our new nurturing products such as Feng Shi Ping capsule, Qing Hao Su and Ganoderma Lucidum Spore Oil, with a view to developing them into new growth points of the Company. Meanwhile, we also need to develop new Second or Third products and products featured by a promising prospect, high content of science and technology and high value-added so as to increase our market share in the near future.
2. With the focus on the research and development of products and the secondary development of branded products, to reinforce the technical cooperation with higher colleges and organizations for scientific research to expedite the technological innovation and construction of technological platform, and hence improve the market share of new and high-tech products and core competitiveness of the company.
3. With the focus on the professional development and brand- building, to aggressively explore specialized sales markets, improve the recognition and social influence of the products and develop and expand the product categories with a view to increasing the targeted market share.
4. To continue to expedite integration of internal resources within the Group and to centralise the purchase of traditional Chinese medicine, raw materials in large bulks, packing materials and import materials, as well as to enlarge the market share of the Group's products by increasingly strengthening the co-operation between its manufacturing and trading enterprises within the Group.
5. To strengthen fund attraction and aggressively seek opportunities for cooperation with outstanding and high-tech pharmaceutical enterprises at home and abroad to facilitate the development of our principal activities.
6. With the focus on the financial budgets and management of funds, to strengthen the basic management surveillances. We will further reinforce the management and control of our subsidiaries and play our emphasis on the financial budgeting for the purpose of a reasonable operating cost saving to increase the capital utilization rate and secure a sound capital base, as well as establish a risk protection mechanism against the business law exposure for the company so as to reduce operation risks.

The Company faces both new opportunities and challenges in 2006. We will continue to exercise the spirit of industry, progress, pragmatics and innovation so as to generate a better return for our shareholders.

# Report of the Directors

## DAILY OPERATIONS OF THE BOARD

### (I) Board Meetings

Meetings	Dates	Resolutions	Newspapers on which the resolution was published for information disclosure	Publication dates of the resolution
10th meeting of the Third Session	18 March 2005	Engagement of an independent financial advisor to prepare an evaluation report in respect of the Company's internal control procedures as proposed by the Audit Committee of the Company has been approved in writing.	/	/
11th meeting of the Third Session	27 April 2005	/	Shanghai Securities in the PRC, Hong Kong Economic Times and The Standard in Hong Kong	28 April 2005
12th meeting of the Third Session	30 June 2005	/	Shanghai Securities in the PRC, Hong Kong Economic Times and The Standard in Hong Kong	1 July 2005 and 4 July 2005
13th meeting of the Third Session	1 August 2005	/	Shanghai Securities in the PRC, Hong Kong Economic Times and The Standard in Hong Kong	2 August 2005
14th meeting of the Third Session	12 August 2005	/	Shanghai Securities in the PRC, Hong Kong Economic Times and The Standard in Hong Kong	15 August 2005
15th meeting of the Third Session	27 October 2005	/	Shanghai Securities in the PRC, Hong Kong Economic Times and The Standard in Hong Kong	28 October 2005

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## DAILY OPERATIONS OF THE BOARD *(continued)*

### (I) Board Meetings *(continued)*

Meetings	Dates	Resolutions	Newspapers on which the resolution was published for information disclosure	Publication dates of the resolution
16th meeting of the Third Session	11 November 2005	Regulations regarding Improving the Monitoring and Administration of Disclosable and Connected Transactions of Listed Issuers of Guangzhou Pharmaceutical Company Limited have been approved.	/	/
17th meeting of the Third Session	30 November 2005	Approved the ceasement of Mr. Gao Fang, the former Financial Controller of the Company, due to work relocation with effect from the same date.	/	/
18th meeting of the Third Session	13 December 2005	Approved the appointment of Mr Chen Binghua as the Financial Controller of the Company with the term of office effective from the date of appointment and expiring on the date on which a new Board is elected.	/	/

### (II) The progress of execution by the Directors in respect of the resolutions passed at General Shareholders' Meetings

#### Distribution of 2004 final dividend

Pursuant to the resolution passed at the 2004 AGM, a final dividend of RMB0.025 per share (including withholding tax for A shares) for 2004 had been paid to the Company's shareholders by July 2005. The registration date for the entitlement of holders of H shares to the final dividend was 30 May 2005, while the book closing date was 1 June 2005. The registration date for the entitlement of holders of A shares to the final dividend was 18 July 2005 and the book closing date was 19 July 2005.

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

The amount of retained profits available for the 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 RMB0.07 per share (including withholding tax for A shares) for the year ended 31 December 2005 (2004: RMB0.025). The proposed final dividend will be submitted to the forthcoming 2005 AGM for consideration and approval (the notice for convening the 2005 AGM will be published separately).

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

# Report of the Directors

## OTHER MATTERS

### (I) Financial Statements

The results of the Group for the year ended 31 December 2005 are set out in the consolidated income statement prepared in accordance with PRC Accounting Standards and Systems and HK GAAP on page 58 and page 134, respectively.

The financial conditions of the Group as at 31 December 2005 are set out in the consolidated balance sheet prepared in accordance with PRC Accounting Standards and Systems and HK GAAP on page 56 and page 131, respectively.

The cash flows of the Group for the year ended 31 December 2005 is set out in the consolidated cash flow statement prepared in accordance with PRC Accounting Standards and Systems and HK GAAP on page 61 and page 136, respectively.

The cash flows of the Company for the year ended 31 December 2005 is set out in the cash flow statement prepared in accordance with PRC Accounting Standards and Systems on page 70.

### (II) 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 7.

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 7.

### (III) Reserves

Movements in the reserves of the Group during the Year prepared in accordance with PRC Accounting Standards and Systems are set out on pages 107 to 108. Movements in the reserves of the Group during the Year prepared in accordance with HK GAAP are set out on pages 172 to 174.

### (IV) 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 2005 amounted to RMB93,840,000, calculated in accordance with the PRC Accounting Standards and Systems and amounted to RMB142,075,000, calculated in accordance with HK GAAP.

### (V) Fixed Assets

Details of the movements of fixed assets for the Year are set out on pages 90 to 91 and pages 160 to 162 herein.

# Report of the Directors

## OTHER MATTERS *(continued)*

### (VI) Connected Transactions

Pursuant to the regulations of CSRC, details of the connected transactions were set out on pages 116 to 125 .

Pursuant to the rules of HKEX, details of the connected transactions during the Year were set out as follows:

	<b>2005</b>
	<i>RMB'000</i>
Ultimate holding Company	
Licence fee expense	12,230
Service fee expense	860
Welfare facilities fee expense	310
Rental expense	3,450
Fellow subsidiaries	
Sales of finished goods and raw materials	167,089
Purchase of finished goods and raw materials	430,225

In addition, other transactions with jointly controlled entities and associated companies which, pursuant to the rules of HKEX, do not constitute connected transactions of the Listing Rules, 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 (as amended) entered into between the Company and GPHL on 27 April 2005.

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 (as amended) entered into between the Company and GPHL.

The international auditors have confirmed that continuing connection transactions out of the above transactions pursuant to the Listing Rules:

- had been approved by the Board of directors of the Company;
- were entered into in accordance with the relevant pricing policies;

# Report of the Directors

## OTHER MATTERS *(continued)*

### (VI) Connected Transactions *(continued)*

- were entered into in accordance with the terms of the relevant agreements governing such transactions; and
- had not exceeded the caps as described in the Agreement in relation to the Sales and Purchase Connected Transactions (as amended) entered into between the Company and GPLH on 27 April 2005.

### (VII) 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.

### (VIII) Compliance with the Code on Corporate Governance Practices

Throughout the Year, the Company was in compliance with the code provisions set out in the Code on Corporate Governance Practices contained in Appendix 14 to the Listing Rules.

### (IX) 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 of the Group and the Company for the Year ended 31 December 2005.

### (X) 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.

### (XI) 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 179 to page 181.



# Report of the Directors

## OTHER MATTERS *(continued)*

### (XII) Staff Quarters

Pursuant to the Accommodation Service Agreement entered into between the Company and GPHL, GPHL agreed to sell the staff quarters to the employees of the Group at a preferential price. The Company shall pay to GPHL the staff quarters reform costs, which represent the difference between the preferential price and the cost net of depreciation paid by GPHL on buildings acquired for such staff quarters. As at 31 December 2005, the total staff quarters reform costs, which are payable to GPHL, amounted to approximately RMB61,655,000 (31 December 2004: RMB62,030,000).

In addition, the Group has constructed or acquired certain staff quarters. As at 31 December 2005, the difference between the construction cost or acquisition cost and the revenue from disposal of the quarters totalled RMB42,437,000 (31 December 2004: RMB42,437,000).

Correspondingly, the above mentioned staff quarters reform costs amounted to RMB104,092,000 as at 31 December 2005 (2004: RMB104,467,000). According to the regulation in Caiqi [2000] No.29, the Notice on Accounting Treatment Method of Housing Reform Initiated in Enterprises, issued by the Ministry of Finance, the costs arising therefrom should be dealt with in retained earnings as at 1 January 2005. 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 financial statements prepared in accordance with the PRC Accounting Standards and Systems.

For the financial statements 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 2005 was approximately RMB66,725,000, and the amortisation for 2005 was RMB10,382,000. As at 31 December 2005, the net carrying value of the deferred staff quarters reform costs was RMB37,367,000. 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 2005, the consolidated net assets of the Group as at 31 December 2005 would have been reduced by approximately RMB37,367,000. 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.

### (XIII) 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.

# Report of the Directors

## **OTHER MATTERS** *(continued)*

### **(XIV) Bank Loans, Overdraft and Other Loans**

Details of the bank loans, overdrafts, and other liabilities of the Group as at 31 December 2005 are set out on pages 102 to 105. 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 2005.

### **(XV) Auditors**

Guangdong Yangcheng Certified Public Accountants Co., Ltd. and PricewaterhouseCoopers were respectively appointed as PRC and international auditors of the Company for the year 2005, as approved at the 2005 first EGM.

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

### **(XVI) 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.

### **(XVII) Explanation of Certified Public Accountants in respect of Funds Used by the Controlling Shareholder and Other Connected Parties of the Company**

Guangdong Yangcheng Certified Public Accountants Co., Ltd., the PRC 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.

In accordance with the requirements as set out in the Notice Concerning the Regulation on the Flow of Funds between Listed Companies and their Connected 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 Connected parties for the year ended 31 December 2005 is set out below:



# Report of the Directors

## OTHER MATTERS (continued)

### (XVII) Explanation of Certified Public Accountants in respect of Funds Used by the Controlling Shareholder and Other Connected Parties of the Company (continued)

Connected parties	Relationship with the Company	Account	Balance as at 31 December 2005 RMB'000	Balance as at 1 January 2005 RMB'000	Transaction amount (debit) RMB'000	Transaction amount (credit) RMB'000	Nature	Remarks
GPHL	Parent company	Other receivables	5,060	6,312	1	1,253	Prepayment & current account	Prepaid rental and daily current account
Guangzhou Baiyunshan Qiao Guang Pharmaceutical Co. Ltd	Under the same parent company	Accounts receivable	26,469	17,232	71,612	62,375	Sale	Production
Guangzhou Baiyunshan Ming Xing Pharmaceutical Co. Ltd	Under the same parent company	Accounts receivable	1,714	739	15,475	14,501	Sale	Production
Guangzhou Baiyunshan Tian Xin Pharmaceutical Co. Ltd	Under the same parent company	Accounts receivable	1,842	5,481	21,227	24,866	Sale	Production
Guangzhou Baiyunshan Tian Xin Pharmaceutical Co. Ltd	Under the same parent company	Prepayment	—	202	—	202	Purchase	Production
Guangzhou Baiyunshan He Ji Gong Pharmaceutical Co. Ltd	Under the same parent company	Other receivables	—	25	—	25	Current account	Production
Guangzhou Baiyunshan He Ji Gong Pharmaceutical Co. Ltd	Under the same parent company	Accounts receivable	238	432	1,739	1,933	Sale	Production
Guangzhou Baiyunshan Guang Hua Pharmaceutical Co. Ltd	Under the same parent company	Accounts receivable	2,895	1,573	50,168	48,845	Sale	Production
Guangzhou Hua Nan Medical Apparatus Co. Ltd.	Under the same parent company	Other receivables	100	100	—	—	Current account	Daily current account
Po Lian Development Co. Ltd	Under the same parent company	Other receivables	7,993	14,854	2,388	9,249	Current account	Daily current account
Guangzhou Pharmaceutical Industrial Research Institute	Under the same parent company	Accounts receivable	—	—	3	3	Sale	Production
Guangzhou Hutchison Whampoa Chinese Medicine Co., Ltd	Under the same parent company	Accounts receivable	1,777	1,154	20,726	20,104	Sale	Production
		Prepayment	197	—	618	421	Purchase	Production
Guangzhou Baiyunshan Pharmaceutical Factory	Under the same parent company	Accounts receivable	4,225	1,753	28,598	26,127	Sale	Production
Guangzhou Baiyunshan Chemical Pharmaceutical Factory	Under the same parent company	Accounts receivable	1,208	423	23,903	23,117	Sale	Production
Guangzhou Baiyunshan External Pharmaceutical Factory	Under the same parent company	Accounts receivable	170	—	2,063	1,894	Sale	Production
Wanglaoji	Jointly controlled entity	Accounts receivable	2,268	—	24,219	21,951	Sale	Production
Guangzhou Lian Jie Computer Technology Co., Ltd	Jointly controlled entity	Other receivables	520	520	—	—	Current account	Daily current account
Total		Other receivables	13,673	21,812	2,388	10,527		
		Accounts receivable	42,805	28,786	259,734	245,715		
		Prepayment	197	202	618	623		

# Report of the Directors

## OTHER MATTERS *(continued)*

### (XVII) Explanation of Certified Public Accountants in respect of Funds Used by the Controlling Shareholder and Other Connected Parties of the Company *(continued)*

#### Repayment schedule

Planned repayment date	Repayment method	Repayment amount RMB'000	Remarks
End of February 2006	Setoff against cash, rental and room service charge	7,554	An amount of RMB7,383,000 which was previously deposited in Po Lian Development Co., Ltd has been refunded
End of March 2006	Setoff against rental and room service charge	86	
End of April 2006	Setoff against rental and room service charge	86	
End of May 2006	Setoff against rental and room service charge	86	
End of June 2006	Setoff against rental and room service charge	86	
End of July 2006	Setoff against rental and room service charge	86	
End of August 2006	Setoff against rental and room service charge	86	
End of September 2006	Setoff against rental and room service charge	86	
End of October 2006	Setoff against rental and room service charge	86	
End of November 2006	Setoff against rental and room service charge	86	
End of December 2006	Setoff against rental and room service charge	86	
Total		<u>8,414</u>	

Note: Such outstanding amount does not include daily operational application fund.

### (XVIII) 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 Shareholder 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 Non-executive 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 the end of this Reporting Period, the Group has not provided any guarantee to its controlling shareholder or any other related parties.

On behalf of the Board  
**Yang Rongming**  
*Chairman*

Guangzhou, the PRC, 31 March 2006