REPORT OF THE BOARD OF DIRECTORS

The Board of Directors (the "Board") of the Company is pleased to submit to the shareholders the report of the Board of Directors and the audited accounts of the Company and the Group for the year ended 31 December 2001

MANAGEMENT DISCUSSION AND ANALYSIS

I. THE BUSINESS SCOPE AND THE OPERATING RESULTS OF THE COMPANY

The Company is mainly engaged in the business of developing, manufacturing and selling bulk pharmaceuticals, preparations, chemical products and other products. The profit of the Company and its subsidiaries (the "Group") is mainly attributable to its principal operations.

Sales Analysis

Under PRC accounting standards, the Group achieved a turnover of RMB1,099,258,000 for the year ended 31 December 2001, in which sales of bulk pharmaceuticals accounted for 61.74% of the total sales of the Group, representing a decrease of 2.17% as compared to last year. Sales of preparations and chemical and other products accounted for 36.28% and 1.98% respectively of the total sales of the Group, and representing increases of 1.9% and 0.27% respectively as compared to 2000. The Company produced a remarkable effect in the adjustment to its product mix.

Sales of bulk pharmaceutical were increased by 1.7% to RMB678,666,000. Sales of preparations and sales of chemical and other products were RMB398,774,000 and RMB21,818,000, increased by 11.09% and 22.55% respectively. The increase of sales of chemical and other products was mainly attributable to the increase of turnover of Shandong Zibo Xinhua Pharmacy Company Limited, a subsidiary of the Company.

Results Analysis

The Group's profits attributable to shareholders for the year ended 31 December 2001 calculated in accordance with HKGAAP was RMB81,746,000 and the profit after taxation calculated in accordance with PRC accounting standards was RMB80,896,000, representing increases of 20.52% and 17.04% as compared to last year, respectively. The main reasons for the increases were mainly attributable to the following reasons that:

1. The Group continued to introduce activities for the purpose of reducing costs,

improving revenues as well as improving the production technologies for its different products. Besides reducing cost of production and improving the yield, the Group also reduced its costs of procurement by inviting public tenders.

2. Improvement of the Group's gross margin is contributed by the continuous adjustment in product mix and enlargement of sales of major products especially the export of bulk pharmaceuticals and sales of new drugs.

Major Products and corresponding market share in the PRC

Major Products		**As % of total sales in 2001**	**Market share of the domestic market**
A.	Bulk Pharmaceuticals		
	Analgin	17.91	51.68
	Caffeine	7.6	23.37
	Aminopyrine	5.66	94.44
	Aspirin	4.98	46.28
	Hydrocortisone	5.25	53.50
	Pipemidic acid	2.33	100.00
	Ibuprofen	1.47	30.77
	Theophylline	0.97	18.37
	Aminophylline	0.28	23.89
B.	Preparations		
	寧 Pipemidic acid tablets	3.94	不詳
	Co-SMZ tablets	1.91	13.64
	Co-liquorice tablets	1.38	5.73
	Nimodipine tablets	1.21	11.35
	Ibuprofen tablets	0.92	35.45

Financial and Results Analysis in accordance with PRC accounting standards

Total assets of the Company as at 31 December 2001 amounted to RMB1,836,720,000, representing an increase of RMB473,993,000 or 34.78%, as compared to that of last year. The increase was mainly attributable to the proceeds raised from the Issue, the increase of funds and the profit realised in 2001. The total long-term liabilities of the Company were increased by RMB 150,000,000 to RMB153,562,000 as at 31 December 2001, which was mainly due to the increase of loans borrowed during the year. Shareholders' equity of the Company as at 31 December 2001 increased by RMB414,828,000 or 44.81% to RMB1,340,524,000, as compared to that of last year. The increase was mainly attributable to the increase of share capital and capital surplus following the issue of new A Shares in 2001.

Profit from principal operations and profit after taxation for 2001 amounted to RMB325,896,000 and RMB80,896,000 respectively, representing increases of 7.83% and 17.04% respectively, as compared to that of last year. The main reasons for such increases are mainly attributable to:

1. The Group continuing to initiate activities for the purpose of reducing costs, improving revenues as well as improving the production technologies for different products. Besides reducing costs of production and improving the yield, the Group also reduced the costs of procurement by inviting public tenders.

2. Improvement of the Group's gross margin contributed by the continuous adjustment in product mix and enlargement of sales of the Company's major products especially the export of bulk pharmaceuticals and sales of new drugs.

   A broad analysis of the main products, which accounted for over 10% of the total sales of the Company for 2001, is as follows:

Product	**Turnover**	**Cost of goods sold**	**Rate of gross margin**
	RMB'000	*RMB'000*	*%*
Analgin	196,849	126,854	35

Analysis of the Group's performance under HKGAAP

As at 31 December 2001, the current ratio and the quick ratio of the Group were 395.22% and 330.07% respectively, and the rate of receivables turnover and rate of stock turnover for the year were 470.36% and 431.23% respectively. The cash on hand and in bank was RMB617,231,000 and the bank loans was RMB332,100,000. The Group maintained a good flow of funds and has the ability to repay its debts as they fall due.

The Group's demand for funding was constant throughout the year.

The funds of the Group were comprised mainly of three sources, namely the profit achieved during the year, the proceeds raised from the Issue and the loans borrowed from financial institutions. As at 31 December 2001, the total amount of the bank loans is RMB332,100,000 at a fixed interest rate and the cash on hand and in bank amounted to

RMB617,231,000, among which RMB551,501,000 was deposited in different banks. The Company will invest the proceeds raised from the Issue in the projects disclosed in the prospectus and use other funds reasonably.

As at 31 December 2001, the total amount of investment of the Company was RMB55,277,000, including equity investments of RMB30,000,000 in Tiantong Securities Company Limited, RMB13,577,000 in The Bank of Communication and RMB7,000,000 in The Pacific Insurance Corporation. The Company is confident of the above investments given the good results shown by these companies so far.

In 2001, the Company purchased the land use right from its controlling shareholder, SXPGC. The area of the property is 35,885.1 square meters and the total consideration paid for the acquisition was RMB7,914,000. The consideration was based on the valuation of the property interests conducted by the Zibo Land Appraisal Firm in its Land Appraisal Report No. Zitujia(gu)zi 20011030.

As at 31 December 2001, there was no charge on the Group's assets.

In the coming year, the material investment will be focused on the projects using the proceeds from the issue of new A Shares.

The gearing ratio of the Group was 24.63% as at 31 December 2001.

The existing loans of the Company will be mainly used in the production, sales and research. To avoid the exchange risk, half of the funds were deposited in U.S. Dollars and the remaining funds were deposited in Renminbi with different banks.

As at 31 December 2001, the Company had no contingent liabilities.

II. OPERATION AND RESULTS OF SUBSIDIARY OF THE COMPANY

Shandong Zibo Xinhua Pharmacy Company Limited (the "Xinhua Pharmacy"), in which the Company holds 88% of the total equity interest, was approved for incorporation by the Zibo Municipal Industrial and Commercial Administration on 19 November 1999. The main operations of the subsidiary involves the sale of traditional Chinese medicines, prepared herbal medicines for decoction, preparations, drugs for birth control, medical appliances, health foods and cosmetics.

In addition to the existing 5 drugstores, 6 new drugstores were opened in 2001 in both Zibo City and other cities situated along the railway in Shandong Province. The total turnover of the subsidiary was RMB12, 658,000, and the profit after taxation was RMB461,000, representing an increase of 43.80% and a decrease of 16.33% respectively as compared to 2000, respectively. The decrease in profit after taxation was mainly due to the higher start-up costs of new drugstores.

III. COMPLETION OF THE PROFIT FORECAST

The forecast of profit for the year 2001 was listed in the prospectus for the Issue which was published on the domestic newspapers, China Securities and Securities Time, and the Hong Kong newspapers, Wen Wei Po and Hong Kong iMail, on 24 August 2001. As required by the CSRC, information regarding completion of the forecast of profit for the year 2001 is as follows:

In 2001, the export of the Company was in a downward trend affected by many negative factors, such as recession of the economy of the United States, the downturn of the economy in European Union and Japan and the September 11 terrorist attack on America. In contrast with the increase of 13% in the first half of the year as compared to the same period last year, the export for the whole year increased by only 8% as compared to last year and left a lag behind the goal set at the beginning of the year. Affected by the export, the prices of products exported dropped in varying degrees, which resulted in the decline in profit before taxation and profit after taxation by 16.15% and 17.20% respectively compared to the data in the report of profit forecast.

IV. USE OF PROCEEDS

On 3 September 2001, the Company raised an amount of RMB370,517,000 from the Issue, being an issue and offer of 33,000,000 A Shares (including the offer of 3,000,000 State-owned shares). As at 31 December 2001, a total of RMB37,556,000 was used in the following projects:

Name of project	**Total investment** *RMB'000*	**Actual investment in 2001** *RMB'000*	**% of the total investment**	**Remark**
Caffeine technical renovation	160,000	3,619.7	2.26%	construction of factory building
L-350 technical renovation	29,980	12,137.9	40.09%	basically finished
Analgin GMP renovation	39,800	21,798.6	54.77%	completion of factory building

Total	37,556.2

Note:

1. As it was half a year behind the schedule set by the Company to issue A Shares, the constructions of most projects were postponed except for the Caffeine renovation, the L-350 renovation and the Analgin GMP renovation which have been under construction as at 31 December 2001.

2. The remaining proceeds were deposited with banks and will be used in accordance with the prospectus.

WORKING REPORT OF THE BOARD

1. During the year, the Board of Directors convened five meetings at the Company's registered office:

A. On 9 March 2001, the first meeting was convened at the Company's registered office, during which the following resolutions were passed:

i. To approve the report of the Directors of the Company for the year 2000;

ii. To approve the audited accounts of the Company for the year 2000;

iii. To approve the profit appropriation of the Company for the year 2000;

iv. To approve the profit appropriation budget plan of the Company for the year 2001;

v. To approve the re-appointment of the international and domestic auditors respectively for year 2001 and authorise the Directors to fix their remuneration;

vi. To approve the remuneration of the Directors and the Supervisors for the year 2001;

vii. To approve the connected transactions for the year 2000;

viii. To approve the written report on the provisions for diminution in value of assets and treatment of related losses submitted by the general manager of the Company;

ix. To approve the resignation of Mr. Li Zhi as director of the Company;

x. To grant the Directors a conditional general mandate to purchase H Shares with an aggregate nominal value of not more than 10% of the aggregate nominal value of the total H Shares in issue as at the date of the passing of such resolution.

xi. To approve and authorise the Board of Directors to have a discretion to make any investments whatsoever without prior approval from the shareholders provided that the aggregate amount of such investments does not exceed 10% of the total asset value of the Company as specified in the latest audited financial report subject to all practicable laws, rules and regulations. This resolution is subject to the approval in the general meeting for the year 2000; and

xii. To approve amendments to the Articles of Association of Association of the Company, that is a new Article 93a was added following the Article 93 to Chapter 10 of the Articles of Association, that "The Board of Directors of the Company be authorised to have a discretion to make any investments whatsoever without prior approval from the shareholders provided that the aggregate amount of such investments does not exceed 10% of the total asset value of the Company as specified in the latest audited financial report subject to all practicable laws, rules and regulations". This resolution is subject to the approval in the general meetings for the year 2000.

B. On 19 April 2001, the second meeting was convened at the Company's registered office, during which the Board of Directors passed a resolution that the Company was satisfied with conditions required for the issue of new A Shares in accordance with "The Rules on the Issue of New A Shares by Listed Companies" and "The Notice regarding to the Issue of New A Shares by Listed Companies".

C. On 20 July 2001, the third meeting was convened at the Company's registered office, during which the following resolutions were passed:

i. To approve the interim report of the Company for the six months ended 30 June 2001;

ii. To recommend neither the distribution of an interim dividend, nor any transfer from the Company's capital reserve into its share capital.

iii. To approve and authorise the Chairman to have a discretion to make any investments provided that the aggregate amount of such investments does not exceed 1 percent of the total asset value of the Company as specified in the latest audited financial report, subject to all practicable laws, rules and regulations.

D. On 29 September 2001, the fourth meeting was convened at the Company's registered office, during which the Board of Directors passed a resolution to approve the establishment of a contractual sino-foreign joint venture with the JC COMPANY, Inc. (the "JC"), towards which the Company will invest USD700,000 by means of plant and equipment and hold 70% of the total equity interest. On the other hand, the JC will invest USD300,000 in cash and its own intellectual properties toward the joint venture.

E. On 14 December 2001, the fifth meeting was convened at the Company's registered office, during which the following resolutions were passed:

i. To approve the change of the registered address of the Company;

ii. To approve the acquisition of land use right from SXPGC.

iii. To approve the resignation of some Senior Officers and appoint new Senior Officers;

iv. To approve the increase of investment in Shandong Zibo Xinhua Pharmacy Company Limited;

v. To approve and authorise the general manager of the Company to have a discretion to make minor investments; and

vi. To approve the report of self-examination in respect of the corporate governance to the Jinan Office of the CSRC. The Board confirmed in the said report that the Company is in conformity with the requirements of CSRC.

vii. To approve the adjustments made to the Company's internal departments and the adjustments of the directors of these departments.

2. The dividends for 2000 were fully paid in early July 2001. The Issue, which was approved at the first extraordinary general meeting in 2000 was completed.

BRIEF INTRODUCTION OF DIRECTORS, SUPERVISORS AND SENIOR OFFICERS

Brief introduction of the Directors, Supervisors and Senior Officers are listed in the above section headed "DIRECTORS, SUPERVISORS, SENIOR OFFICERS AND STAFF".

DIRECTORS', SUPERVISORS' AND SENIOR OFFICERS' INTERESTS IN SHARES

The shareholding of the Directors, Supervisors and Senior Officers, according to the register of shareholders maintained by the Company in accordance with section 29 of the Securities (Disclosure of Interests) Ordinance or to the best knowledge of the Company, the shareholding of each of the Directors, Supervisors and Senior Officers are listed in the above section headed "DIRECTORS, SUPERVISORS, SENIOR OFFICERS AND STAFF".

REMUNERATION OF DIRECTORS AND SUPERVISORS

Details of the remuneration of the Directors and the Supervisors are set out in note 9 to the Accounts prepared under HKGAPP.

INDIVIDUALS WITH THE HIGHEST REMUNERATION

All the five individuals with the highest salaries paid by the Group and the Company during the year 2001 were Directors.

DIRECTORS' AND SUPERVISORS' RIGHTS TO ACQUIRE SHARES

At no time during the year was the Company, its holding company or its fellow subsidiaries a party to any arrangements to enable any of the Company's Directors, Supervisors, or their spouses or children under 18 years of age to acquire shares in, or debentures of, the Company or any other body corporate mentioned above.

SERVICE CONTRACTS OF DIRECTORS AND SUPERVISORS

Each of the Directors and Supervisors entered into a service contract with the Company for a period of three years which commence on 1 July 1999. The terms of the service contracts may be renewed by both parties pursuant to the terms thereof.

No existing Directors or Supervisors have a service contract with the Company which is not terminable by the Company within one year without payment of compensation (other than statutory compensation).

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.

DIRECTORS' AND SUPERVISORS' INTERESTS IN CONTRACTS

Ms. Julia Frances Charlton, an independent non-executive director of the Company, is currently the principal of the law firm, Charltons, the legal advisor of the Company on Hong Kong law, which receives and will receive legal fees in connection with its representation of the Company's affairs.

Except as stated above, no contracts of significance in relation to the Company's business to which the Company, its holding companies and its fellow subsidiaries and in which any Directors or Supervisors had a material interest, whether directly or indirectly, existed at the end of the reporting year or at any time during the year.

ACCOUNTS

The Group's results for the year ended 31 December 2001 and the financial position of the Group and the Company as at 31 December 2001 prepared in accordance with HKGAAP and PRC accounting standards are set out in section headed "Financial Reports".

FINANCIAL SUMMARY

A summary of the results, assets and liabilities of the Group prepared in accordance with HKGAAP and PRC accounting standards for the last five financial years is set out in section headed "Summary of Financial and Operating Results".

PROFIT APPROPRIATION FOR THE YEAR 2001

In accordance with PRC accounting standards, the Group realised a net profit of RMB80,896,000, of which 10% is appropriated to the statutory surplus reserve, 5% is appropriated to the welfare reserve, and 10% is appropriated to the discretionary surplus reserve. These reserves amounted to RMB8,200,000, RMB4,100,000 and RMB8,090,000, respectively. After taking into account the proposed final dividend for 2001 of RMB0.08 per share (approximately HK$0.0754), which represents a total final dividend payable of RMB36,585,000, the undistributed profit of the Group for the reporting period is increased by RMB23,921,000 as compared to the previous year.

The Board of Directors declares and proposes the final dividend for the year ended 31 December 2001 as follows:

To declare a final dividend for the year 2001 of RMB0.08 per share (approximately HK$0.754), including income tax for A Shares, based on 307,312,830 A Shares and 150,000,000 H Shares in issue.

Profit appropriation policy for the year 2002 will be as follows:

(1) the profit for the year 2002 will only be distributed once;

(2) the dividend for the year 2002 will be 35% to 45% of the net profit of 2002;

(3) the undistributed profit for the year 2001 will not be distributed; and

(4) the profit distribution will be paid in the form of cash in 2002.

It is anticipated that no transfer from capital reserve to share capital will be recommended in 2002.

Principal Activities and Geographical Analysis of Operations

The principal activities of the Group are the development, production and sales of bulk pharmaceuticals, preparations (e.g. injections and tablets), chemicals and other products.

An analysis of the Group's turnover in various geographical locations is as follows:

	Total Turnover (RMB'000)		
	2001	**2000**	**Change (%)**
Geographical location			
PRC (including Hong Kong)	751,043	697,815	7.63
Europe	148,347	158,357	(6.32)
America	138,495	129,401	7.03
Other	61,404	58,500	4.96
Total	1,099,289	1,044,073	5.29

There is no major disparity in the ratios between turnover and profit in relation to the above geographical locations, hence no analysis was performed on profit contributions from the above geographical locations.

CHANGES IN SHARE CAPITAL AND SHAREHOLDERS

Changes in share capital and shareholders are set out in the above section headed "CHANGES IN SHARE CAPITAL AND SHAREHOLDERS"

RESERVES

Movements in the reserves of the Group and the Company during the year 2001 are set out in note 19 to the Accounts prepared in accordance with the HKGAAP, and note 25 and 26 to the Accounts prepared in accordance with PRC accounting standards, respectively.

FIXED ASSETS

Details of the movement in the fixed assets of the Group and the Company during the year 2001 are set out in note 10 to the Accounts prepared in accordance with the HKGAAP, and note 12 to the Accounts prepared in accordance with PRC accounting standards.

BANK LOANS AND OTHER BORROWINGS

Particulars of bank loans and other borrowings of the Group and the Company as at 31 December 2001 are set out in note 20 to the Accounts prepared in accordance with the HKGAAP, and note 15 to the Accounts prepared in accordance with the PRC accounting standards.

INTEREST CAPITALISED

During the year, no interest was capitalised in respect of loans borrowed by the Group and the Company for financing its construction-in-progress.

STAFF QUARTERS

All staff quarters of the Group were owned by SXPGC. The Group did not sell any staff quarters to its employees during the year ended 31 December 2001. For the year ended 31 December 2001, contributions made by the Group to an employees' accommodation scheme amounted to RMB2,512,000.

PREFERENTIAL TAX TREATMENT

Pursuant to approval documents from the People's Government of the Shandong Province and the Shandong Province Zibo Municipal Finance Bureau, the Company is entitled to a preferential enterprise income tax refund treatment from the Shandong Province Zibo Municipal Finance Bureau for the year 2001. The refund is equal to 18% of their taxable income in respect of the enterprise income tax paid to the taxation bureau.

On 30 January 2002, Shandong Province Zibo Municipal Local Taxation Bureau Development Zone Sub-Division confirmed in its document Zi Di Shui Kai Zi [2002]No.5 that the rate of the income tax for the Company would be reduced to 15% for the year ending 31 December 2002. However, there can be no assurance that the preferential tax treatment would be maintained for financial years beyond 2002.

DESIGNATED DEPOSITS

For the year ended 31 December 2001, the Group had neither placed any deposits with any non-banking financial institutions, nor had it placed any designated deposits. The Group does not have any overdue time-deposits.

EFFECTS OF THE PRC’S ENTRY INTO THE WORLD TRADE ORGANISATION ("WTO")

It is expected that the Group will be affected only slightly in the short term following the PRC's accession into WTO due to its competitive advantages in respect of technologies in chemical synthetic, management, production and research and development. The Company's procurement of raw materials will benefit from the drop of custom tariff rates. In the longer term, however, the Group will be confronted with more intense competition in terms of capital, technology, staff, products and sales network by the PRC's entry into WTO. The Company's research model will have to be modified in order to invent its own new products rather than the imitation of products belonging to others. The Group has been and is considering strategies to minimize any adverse effects arising from the PRC's entry into WTO and to ensure the continued development of the Group's business.

STAFF

The staff remuneration plan of the Group was worked out based on the Company's profit realised in the corresponding period and the average revenue of local residents in accordance with State policies.

The number of staff of the Group as at 31 December 2001 was 5,039, and their total amount of salaries and wages payable for the year ended 31 December 2001 was RMB83,795,000.

COMPLIANCE WITH THE CODE OF BEST PRACTICE

For the year ended 31 December 2001, in the opinion of the Directors, the Company has complied with the Code of Best Practice set out in Appendix 14 of the Listing Rules during the year.

AUDIT COMMITTEE

Pursuant to the Listing Rules, an audit committee, comprising three non-executive directors, namely Mr. Qi Moujia, Ms. Julia Frances Charlton and Mr. Xiao Yu, was established on 1 July 1999.

By reference to "A Guide for the Formation of An Audit Committee" published by the Hong Kong Society of Accountants, written terms of reference which describe the authority and duties of the Audit Committee were prepared and adopted by the Board.

IMPORTANT ISSUES

Important issues of the Company for the year 2001 are set out in the section headed "IMPORTANT ISSUES".

MAJOR CUSTOMERS AND SUPPLIERS

The aggregate percentages of purchases and sales attributable to the Group's five largest suppliers and five largest customers were 17.05% and 15.23% of the Group's total purchases and total sales values, respectively, for the year ended 31 December 2001.

PURCHASE, SALE AND REDEMPTION OF THE COMPANY'S LISTED SECURITIES

The Company did not redeem any of its listed shares during the year. Neither the Company nor any of its subsidiaries has purchase any of the Company's shares during the year. The issue of shares during the year are listed in section headed "Changes in Share Capital and Shareholders".

PRE-EMPTIVE RIGHTS

According to the Articles of Association and the laws of the PRC, there is no provision for pre-emptive rights.

RETIREMENT SCHEME ARRANGEMENTS

The Group participates in the State Social Retirement Scheme (the "Scheme") and pays the insurance premium in accordance with the particular regulation issued by the local municipal government whereby it is required to make an annual contribution of 25% of the total salaries and bonuses paid to staff. In turn, the local municipal government undertakes to assume the retirement benefit obligations of all existing and future retirees of the Group. Contributions to the Scheme are charged to the profit and loss account as and when they are incurred. For the year ended 31 December 2001, the total contribution of the Group to the Scheme was RMB18,860,000.

CONNECTED TRANSACTIONS

During the year 2001, the Group entered into the following connected transactions.

	2001	**2000**
	RMB'000	*RMB'000*
With SXPGC, the controlling shareholder		
- Purchase of land use right in Zibo City, the PRC	7,914	-
With SXPGC's subsidiaries		
- Sale of finished goods and raw materials	18,196	13,942
- Purchase of raw materials	55,787	54,281
- Rental income	1,760	465
- Payment of labour and other services	12,156	12,156

In the opinion of the Directors, the above transactions were carried out on normal commercial terms and in the ordinary course of the Company's business. The independent non-executive directors have reviewed the above connected transactions and are of the opinion that the transactions are in the ordinary course of business of the Group and that the agreements governing the transactions were entered into on normal commercial terms.

AUDITORS

The accounts of the Company and the Group for the year 2001 prepared in accordance with HKGAAP and the PRC accounting standards have been audited by PricewaterhouseCoopers, Certified Public Accountants, Hong Kong ("PricewaterhouseCoopers") and Shine Wing, Certified Public Accountants, PRC ("Shine Wing") respectively. In the preceding 3 years, the Company did not change its auditors.

The Company intends to re-appoint PricewaterhouseCoopers and Shine Wing as international auditors and PRC auditors of the Company for the year ending 31 December 2002, respectively, at the Annual General Meeting for the year 2001.

By order of the Board
He Duanshi
Chairman

Zibo, Shandong, PRC
22 March 2002