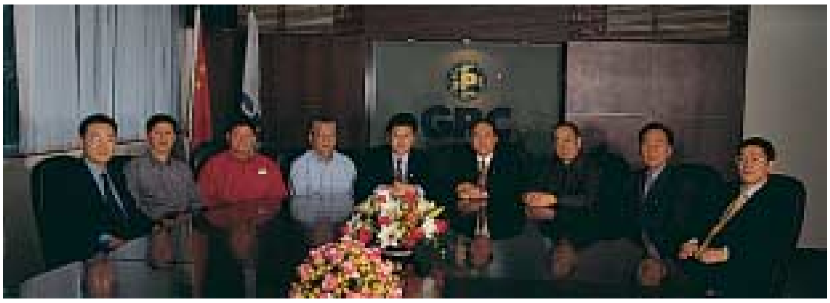

The members of the second Board of Directors of the Company:
(Left) Zhou Yuejin, Feng Zansheung, Zhang Bohua, Huang Buren,
Li Yimin, Cai Zhixiang, Liu Jinxiang, Chu Youlin, Wu Zhang.

DISCUSSION AND ANALYSIS OF THE COMPANY'S OPERATIONS

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

Analysis of operations

1. *The Company's industry and position*

   The Company operates in the pharmaceutical industry. On the basis of turnover generated, the Company is the largest manufacturer of CPM, and one of the three largest pharmaceutical products trading enterprises within China.

2. *Operation status*

   (a) Principal activities and geographical analysis of operations

   Year 2001 is the fourth financial year since the Company listed its H shares on the HKSE in 1997 and the first financial year since the Company listed its A shares on SSE. During the year, China has successfully become a member of WTO and the domestic pharmaceutical market has substantial adjustments in light of the State's implementation of reforms to the national medical system, the setting-up of a classification system for prescription medicine, the formulation of a pharmaceutical pricing policy, and the implementation of employees' medical care insurance. The Group implemented a number of measures in response to severe market competition and has maintained sustainable growth evident from its operating results.

According to the Group's consolidated accounts for the year ended 31 December 2001, turnover of the Group under both HK GAAP and PRC accounting standards and systems was Rmb5,334,029,000, representing an increase of 26.31% over that of last year. Profit before taxation amounted to Rmb260,137,000, representing an increase of 20.92% over that of 2000. Profit before taxation under HK GAAP amounted to Rmb205,987,000, representing an increase of 0.69% over that of 2000. An analysis of the Group's turnover and profit from principal activities for the reporting period by principal activities is as follows:

	Turnover (under PRC accounting standards and systems and HK GAAP)	**Profit from principal activities**
	Rmb'000	*Rmb'000*
Principal activities:		
Manufacturing	1,634,887	826,180
Trading:		
Wholesale	3,281,570	235,566
Retail	357,170	80,156
Import and export	60,402	6,123
	3,699,142	321,845
Total	5,334,029	1,148,025

Geographical analysis for sales arising from manufacturing and trading operations is as follows:

Area	**Manufacturing**		**Trading**		
	Turnover	**% to the manufacturing turnover**	**Turnover**	**% to the trading turnover**	**Total**
	Rmb'000		*Rmb'000*		*Rmb'000*
South China	1,108,068	67.78	3,147,133	85.08	4,255,201
East China	202,029	12.36	184,398	4.98	386,427
North China	103,216	6.31	100,964	2.73	204,180
North East China	97,970	5.99	55,030	1.49	153,000
South West China	62,487	3.82	90,606	2.45	153,093
North West China	36,807	2.25	60,609	1.64	97,416
Exporting	24,310	1.49	60,402	1.63	84,712
Total	1,634,887	100.00	3,699,142	100.00	5,334,029

Sales analysis of major products is as follows:

Product	**Turnover 2001**	**Gross profit 2001**
	Rmb'000	*Rmb'000*
Heat Clearing and Anti Toxic	364,880	169,391
Diabetes Curing	310,932	190,374
Cough and phlegm Clearing	177,653	85,320
Arthritis Curing	164,176	95,920
Gastric	83,736	38,615

(b) *CPM manufacturing business (the "manufacturing operations")*

Turnover of the manufacturing operations in 2001 under both HK GAAP and PRC accounting standards and systems was Rmb1,634,887,000, representing an increase of 26.23% over that of 2000. Profit before taxation of the manufacturing operations was Rmb186,582,000, representing an increase of 17.78% over that of 2000. Profit before taxation of the manufacturing operations under HK GAAP was Rmb150,716,000, representing an decrease of 5.64% over that of 2000.Both the manufacturing operations' turnover and profit before taxation have reached record high levels.

In 2001, manufacturing operations focused on expanding the market share of its major products by strengthening its technology promotions and advertising campaigns in certain major cities and end-user markets. The purpose of these events is to explore and develop potential markets and customers. An information system for sales and market analysis was also implemented to monitor the market conditions so as to adjust the marketing strategy on a timely basis. This contributed an increase in the sales of the key products.

In 2001, the manufacturing operations had 30 major products for which annual sales of each exceeded Rmb10 million. Of these products, 5 products individually achieved annual sales of Rmb50 million and 3 products individually achieved annual sales of Rmb100 million. This attributed to the increase in the operating profit of the manufacturing operations.

The manufacturing operations placed emphasis on manufacturing costs and expenses controls. In 2001, the average unit cost of major products decreased by 4.57 % and the operating expenses decreased by 2.67 % in comparison to last year. The decrease in these costs made significant contributions to the growth in profit of the manufacturing operations.

In 2001, the manufacturing operations have completed a number of technology upgrade projects and GMP certification implementations. These included: technology upgrade of Xiao He Pill of Kwang Chow First Factory Chinese Medicine Factory ("Kwang Chow First Factory"); microwave drying line of Guangzhou Qi Xing Pharmaceutical Factory ("GZ Qi Xing"); GMP certification of a pill production line of GZ Yangcheng. The in-progress upgrade projects and GMP certificate implementations included: new factory technology upgrade of Kwong Chow First Factory and GZ Xing Qun; GMP certification procedures implementation of GZ Pan Gao Shau; technology upgrade of certain production lines of GZ Jing Xiu Tang. These technology development projects have enhanced the manufactured operations' production capacity and product quality and improved the competitiveness of the Group.

In 2001, the Group adjusted its operational structure to optimize its available resources. On 21 February 2001, with a resolution passed at the 3rd meeting of the second term of the Board, Kwang Chow First Factory merged with Guangzhou Zhongsheng Pharmaceutical Factory ("GZ Zhongsheng"). The merger further optimized the allocation of resources and enhanced the Group's ability to continue developing into the future and to minimise risks. After the merger, the turnover and profit before taxation of Kwang Chow First Factory increased by 29.08 % and 38.53% respectively, in comparison to those former individual factories.

During the year, Beijing Chinese Medicine University transferred 30% equity in Guangjing Chinese Medicine Innovation Center to Guangzhou Medical and Industrial Research Department. Guangjing Chinese Medicine Innovation Center has been renamed as Guangzhou Han Fang Natural Medicine Research & Development Co., Ltd ("GZ Han Fang"). GZ Han Feng has commenced its research and development activities for 4 new Chinese medicines.

In order to expedite the process of securing new products and technology, the Group established a new company, Guangzhou BaiDi Biological Pharmaceutical Company Limited ("GZ BaiDI"). GZ BaiDi is currently working on research of 4 new products related to anti-hepatitis B vaccine and activity seeking for co-operation projects with market potentials.

In 2001, the Group has commenced commercial production of three new products, which are "Shi Zuo Ye Guang Keli", "Yi Fu Zhi Xue Wan" and "Wei Re Qing. The manufacturing operations have also completed the clinical research for another three new products with PHY ingredients. The Group is developing certain new products, including "Si Yi Huan Si Ji", "Jie Yuan Jiao Nang", "Re Ke Qing Ke Li", "Kang Yi Gan DNA Yimiao", "Zhiwu Xueqiu Ningji Xu", etc.

The Group has successfully implemented ERP system for the manufacturing operations. Five manufacturing entities have completed the ERP system implementation. For the time being, implementation of ERP for Kwang Chow First Factory and GZ Yangzheng is in progress. The Group has commenced study on the implementation of ERP for the trading operations. The implementation of computerized network system and the ERP system has improved the overall efficiency and manufacturing quality of the manufacturing operations.

During the reporting period, inventory turnover days and accounts receivable turnover days were reduced by 37 days and 24 days respectively, in comparison to last year.

(c) *Pharmaceutical trading business, including wholesaling, retailing, import and export (the "trading operations")*

Turnover of the Group's trading operations in 2001, under both HK GAAP and PRC accounting standards and systems, was Rmb3,699,142,000, representing an increase of 26.35% over that of 2000. Profit before taxation of the trading operations was Rmb73,555,000, representing an increase of 29.68 % over that of 2000. Profit before taxation under HK GAAP was Rmb55,271,000, representing an increase of 23.24% over that of 2000.

In 2001, a series of State pharmaceutical reform policies have been gradually implemented. By taking advantage of these development opportunities and adopting new market strategies on a timely basis, the trading operations were able to follow changes in the market. The trading operations have fully utilized the distributors strategy to develop new medicines for special diseases to meet market demand. The trading operations have obtained distribution rights for more than 477 new products in 2001. The trading operations, through the result of co-operation with the manufacturing operations, developed a competitive sales network. Control of logistics procedures has also been strengthened to help maximize the effectiveness of the sales network.

In 2001, the Guangzhou government fully opened the pharmaceutical market by adopting the policy that hospitals can invite tenders. These new practices directly stimulated competition in the end-user markets. This market change has driven the manufacturing operations to increase its wholesale trading strength and expand retail networks by adjusting the location of the retail shops. Jin Min Chain Store, on the strength of its large-scale operations, good reputation and extensive network, has a strong reputation in the pharmaceutical market of Guangzhou and other nearby large cities. The Group currently has 11 stores, which have been deemed as the first batch of retail pharmaceutical stores under the basic insurance scheme of Guangzhou City and Sushan employees, representing 37% of the retail Pharmaceutical stores of this kind. During the year, the Group opened 100 new retail chain stores, of which 11 stores were owned by the Company and the other 89 were operated under franchising arrangements. As at 31 December 2001, the Group's retail network has 273 chain stores, included 173 Cai Zhi Lin chain stores, which mainly carry CPM, and 100 Jian Min chain stores, which mainly carry Western pharmaceutical products. Jin Mia chain stores and Cai Zhi Lin chain stores ranked the fourth and the seventh respectively of the national largest eight pharmaceutical chain stores in term of turnover in 2001.

In 2001, the State's pricing control policy on pharmaceutical products coupled with severe competition in the domestic pharmaceutical market have, to a certain extent, affected the business of the trading operations, and led to a decrease in gross profit margin by 1.46%, compared with 2000. In order to maintain profitability, the trading operations have aggressively expanded its sales network and exercised stringent control over operational overheads. In addition, the trading operations have successfully improved the inventory by reviewing stock level and sales statistics. Furthermore, management has paid attention to its credit control and customer scanning policy. The decrease in operational overheads and increase in sales as well as the improvement on operational cash flows attributed to a sustained growth of the trading operations' profit.

3. *Results and details of the Company's major subsidiaries*

Enterprise name	Principal activities and major products	Total assets *Rmb'000*	Net Assets *Rmb'000*	Net Profit *Rmb'000*
Kwang Chow First Factory	Production and sales of Chinese patent medicine; major products are Xiao Ke Wan etc.	335,669	248,400	44,449
Guangzhou Chen Li Ji Pharmacentical Co.. Ltd. ("GZ Chen Li Ji")	Production and sales of Chinese patent medicine; major products are Wu Ji Bai Feng Wan etc.	296,112	167,891	17,101
GZ Qi Xing	Production and sales of Chinese medicine; major products are Hua Tuo Zai Zhao Wan etc.	171,356	152,669	13,532
Guangzhou Pharmaceutical Corporation ("GPC")	Trading of Western Pharmaceutical products and medical apparatus	1,227,991	329,492	30,763
Guangzhou Chinese Medicine Corporation ("GCMC")	Trading of Chinese patent medicine and Chinese raw medicine	320,292	86,233	3,815
Guangzhou Pharmaceutical Import & Export Corporation ("GPIE")	Chinese and Western medicine, medical apparatus, package and medical consumables	71,548	18,398	313
GZ Xing Qun	Production and sales of Chinese patent medicine and chemical preparation; major products are Xia Shang Ju etc.	277,538	177,356	15,047
GZ Jing Xiu Tang	Production and sales of Chinese medicine; major products are Qing Re Xiao Yan Ning etc.	157,992	85,674	1,187
GZ Pan Gao Shou	Production and sales of Chinese medicine; major products are Mi Lian Chun Bei Pi Pa Gao etc.	279,186	175,359	13,860
GZ Yangcheng	1Production and sales of Chinese medicine; major products are Bao Ji Wan etc.	151,181	124,809	13,743
GZ Bai Di	Research and manufacturing of biology medicine	20,022	20,000	0
GZ Han Fang	Research and manufacturing of Chinese medicine	11,234	11,099	(391)

Note :

(i) Kwang Chow First Factory was reformed to become a limited liability company 1 January 2002, now known as Guangzhou First Chinese Medicine Company Limited.

(ii) GPC was reformed to become a limited liability company on 21 December 2001, now known as Guangzhou Pharmaceutical Company Limited

None of the Group 's investee companies derived to the Group any investment income which equals to 10% or more of the Group's net profit.

4. *Major customers and suppliers*

During the year, the Group purchased its goods and services from its 5 largest suppliers amounting to Rmb766,081,000, represented approximately 18% of the total purchase. The purchases from the largest supplier amounted to Rmb213,262,000, represented 5.12% of the total purchases. The Group sold its goods and services to its 5 largest customers, amounting to Rmb368,857,000, represented 6.92% of the total sales. Sales to the largest customer amounted to Rmb140,525,000, represented 2.63% of the total sales.

To the knowledge of the Board, none of the directors, their associates or any shareholder owns more than 5% of the Company's share capital had an interest in the major suppliers or customers noted above.

5. *Issues arising from operations and solutions*

The State further expanded it's pharmaceutical reform and implemented a series of measures included reducing the prices of 383 pharmaceutical products and implementing a tendering system for hospitals. These new practices had negative impacts on the manufacturing operations and the trading operations, which lead to a decrease in the gross margin of the trading operations. As remedial actions, the Company adopted the following strategies: 1.increasing the share of the pharmaceutical market by expanding the wholesale network; 2. increasing the retail market and playing an active role in opening new retail shops to increase coverage of the end-user market; 3. actively participating in the tendering system of hospitals to increase the share of prescription drugs market. The above strategies have secured a significant increase in the operating income of the Company.

6. *Comparison between the net profit for the year and the profit forecast as disclosed in the prospectus for public offering of A shares*

The Group's net profit for the 2001 year prepared under PRC accounting standards and systems was Rmb 146,133,000 , which exceeded the profit forecast of Rmb 130,445,000 as disclosed in the prospectus for public offering of A shares.

The Company's investments

1. *Use of net proceeds from the issue of H shares*

The company issued a total of 219,900,000 H shares in October 1997. The residual proceeds of Rmb9,040,000 was utilised in the project of a modern technology center in current year. The company has co-operated with the Beijing Chinese Medicine University to set up Guangjin Chinese Medicine Innovation Centre in 1998. In February 2001 Beijing Chinese Medicine University transferred 30% equity in Guangjin Chinese Medicine Innovation Centre to the Guangzhou Pharmaceutical Industrial Research Department and Guangjin Chinese Medicine Innovation Centre was renamed as Guanzhou Hanfang. Up to 30 June 2001, the residual proceed of Rmb9,040,000 was fully utilised according to the business plan of the prospectus for H shares public offerings. As a technology platform of new medicine and new technology, the project has improved the Group's ability in research and development of new products.

2. *Use of net proceeds from the issue of A shares*

Upon the approval from CSRC, the Company issued 78,000,000 A shares at the subscription price of Rmb9.80 per share in the PRC on 10 January 2001. The net proceed received from the issue was Rmb737,990,000. During the reporting period, Rmb286,610,000 of the net proceeds from the issue of A shares were utilised. The remaining proceeds are currently placed as bank deposits or utilised as working capital. The Company will gradually put the funds in their budgeted use, according to the actual stage of completion.

Details of use of the proceeds are as follows:

Category	Projects	Budgeted injection from proceeds of issue	Funds injected during reporting period	Stage of completion
		Rmb'000	*Rmb'000*	
Project for the technology upgrade and industrialisation of new products				
Pills	Xiaokewan upgrade	29,800	14,630	70%
	Baogiwan upgrade	11,000	8,720	80%
	Commercialisation of Weierqian	29,000	2,330	30%
	Automation of pill production	11,000	1,940	30%
	Technolgy upgrade of Wahtao pills	17,000	3,500	40%
	Throat, spleen and intestine pills echnology upgrade	29,100	8,200	30%
Syrup	Import of the technolgy for syrup production	29,500	630	20%
	Commercialisation of Keli syrup	19,600	860	30%
Granules	Anti- presipriation granules upgrade	12,000	2,370	30%
	Automation of granules upgrade	29,900	20,300	70%
	Flu granules for children upgrade	23,000	18,000	70%
Tablets	Commercialisation of Xiaoyin tablets	29,500	3,050	30%
	Spleen, intestine and pimples tablets upgrade	17,800	960	30%
	Gaolu upgrade	29,500	10,630	40%
	Tablets workshop upgrade	12,000	4,310	50%

	Budgeted injection from proceeds of issue	Funds injected during reporting period	Stage of completion
	Rmb'000	*Rmb'000*	
Industrialisation foundation			
Modernisation of extraction and purification technology	29,900	200	1%
Critcal purification of CO2 technology foundation	29,900	—	0%
Trading			
Expansion of retail chain			
Jian Min	89,300	61,080	60%
Cai Zhi Lin	59,500	16,210	50%
Logistic centre upgrade	20,000	1,000	20%
ERP for trading section upgrade	20,000	5,000	30%
Bio- medicine research centre	80,000	23,000	20%
Additional working capital	50,000	79,690 Note	100%
Total	708,300	286,610	—

Note: The proceeds from issue of A shares were approximately Rmb737,990,000. The portion exceeding the budgeted proceeds at Rmb29,690,000 was used as additional working capital.

(a) Project for the technology upgrade and industrialization of new products:

The investment amount of the project involving workshops of pills, syrup, granules tablets mull and suppository estimated to be Rmb329,700,000. During the reporting period, the total amount invested was Rmb100,430,000, which mainly used for new construction and purchases of production lines and equipment in accordance with GMP requirements. Most technical improvement for Xiu He pill has been completed. During the year, sales increased by Rmb43,010,000 and gross profit increased by Rmb23,670,000, compared with last year. Other projects are still in progress. The timely implementation of these projects will ensure that the subsidiaries can meet the GMP requirements time table set by the State. This enhanced the production capability and competitive edge in the market shares.

(b) Modernised Chinese medicine industrial base:

The project included modernized Chinese medicine Industrial base for extraction and purification of Chinese herb especially with CO2 technology. The total investment amount estimated to be Rmb59,800,000. Site selection has been completed. Construction work and invitation for tender is in progress.

(c) Project for expansion of sales network

Total investment estimated to be Rmb148,800,000. Rmb77,290,000 has been used for increase of 43 new chain stores, which increased in sales by Rmb64,050,000.

(d) Technical improvement project for modernized business logistic center in Huanjingwei:

This investment amount estimated to be Rmb20,000,000. As at year-end, Rmb1,000,000 has been used for purchases of necessary equipment.

(e) Technical improvement project for business ERP system:

The investment amount of this project estimated to be Rmb20,000,000. Rmb5,000,000 has been used for establishment of two servers and some equipment during the reporting period. At present, both the software and hardware is being upgraded to improve the internet and workstation ability.

(f) Construction project for biological research and development center:

In August 2001, GZ BaiDi was established. The Company invested an amount of Rmb23,000,000 to purchase land for the project. The registered capital of GZ BaiDi is Rmb20,000,000. The Company owned 82% of its share capital. At present, a 3,000 square meter research and development center is being constructed.

3. *Major investments through use of funds generated from the Group's operations*

With the approval of the Company's second meeting of the 2nd term of the Board, the Company acquired 5,500,000 shares in Everbright Bank of China with a total consideration of Rmb10,725,000. The shares acquired represents 0.093% of the total shares of 5,891 million of the Everbright Bank of China.

Financials

1 *Financial States*

Extracted from the accounts prepared in accordance with PRC accounting standards and systems

	2001	2000	
	Rmb'000	*Rmb'000*	*Changes (%)*
Total assets	**3,697,239**	3,017,797	22.51%
Long term liabilities	**23,854**	84,573	-71.79%
Shareholders' equity	**2,172,910**	1,326,404	63.82%
Profit from principal activities	**1,148,025**	1,001,733	14.60%
Net profit	**146,134**	141,214	3.48%

Extracted from the accounts prepared in accordance with HK GAPP

	2001	2000	
	Rmb'000	*Rmb'000*	*Changes (%)*
Total assets	**3,877,969**	3,256,426	19.09%
Long term liabilities	**10,000**	65,000	-84.62%
Shareholders' equity	**2,408,430**	1,598,817	50.64%
Profit from principal activities	**215,384**	208,670	3.22%
Net profit	**95,868**	135,250	-29.12%

Reasons for changes:

(a) Total assets: During the reporting period, the total assets of the Company increased from Rmb3,018 million to Rmb3,697 million. The major reason for the increase of the net assets was the proceeds from issue of A shares at Rmb737.99 million.

(b) Total liabilities: During the year, the long term liabilities of the Company decreased from Rmb84.57 million to Rmb23.85 million. The major reason was that the Group had repaid the long term loans on time.

(c) Shareholders' equity: During the year, the shareholders' equity increased from Rmb1,326 million to Rmb2,173 million. The major reason of the increase was due to proceeds from the issue of A shares and the increase in profit after tax.

(d) Profit from principal activities: During the year, the increase of profit from principal activities was due to significant growth in turnover.

(e) Net profit: Under PRC accounting standards, the net profit for the reporting period was Rmb146 million, representing 3.48% increase from 2000. Due to the changes in tax rate and part of the tax refund has not been received yet, the increase in net profit is less than the increase in profit before tax. Net profit prepared under HK GAAP is Rmb95.87 million and it is less than the net profit prepared under PRC accounting standards by Rmb50.26 million. The major reason for the difference is that the Group has adopted a new accounting policy under the PRC accounting rules and regulation, which required that a provision for impairment charge of Rmb50.12 million to be made. This provision was charged to retained profits according to the relevant PRC regulations. However, this provision was charged in the current year's profit and loss account under HKGAAP.

2 *Liquidity, financial resources and capital structure*

As at 31 December 2001, the long-term borrowings of the Group amounted to Rmb10 million. These borrowings are fixed interest loans denominated in Rmb and repayable within 2003. As at 31 December 2001, the cash and cash equivalents of the Group amounted to Rmb867.41 million of which approximately 87% is denominated in Rmb and 13% is denominated in Hong Kong dollars.

3 *Capital asset/expenditure*

The Group expected that the capital expenditure during 2002 would be approximately Rmb340 million. The Group has sufficient financial resources to meet the capital expenditure demand and daily working capital requirements.

4 *Exposure to fluctuations in exchange rate*

As the majority of the revenue, expenses, assets and liabilities of the Group are denominated in Rmb. Therefore, the Group does not have significant risk in exposure to fluctuations in exchange rate.

5 *Contingent liabilities*

Up to 31 December 2001, the Group has no significant contingent liabilitiy.

6 *Charge on Group assets*

At 31 December 2001, the net book value of fixed assets pledged as security for the Group's bank loans amounted Rmb137,606,000.

Impact of the changes in production environment and macro economy on the company

According to the relevant regulations issued by the State, preferential tax treatment applicable to listed companies in China, was terminated on 31 December 2001. During the reporting period, the Group and the Company was taxed at 33% first, and a refund of 10.8% was made locally (effective tax rate: 22.2%). The tax refund received during the first half of 2001 amounted to approximately Rmb13 million. The refund entitlement estimated at Rmb18 million for the second half of the year will be received during 2002 after the statutory audited accounts are completed and approved. The Group will be taxed at an effective tax rate of 33% from 2002, which will affect the net profit after tax of the Group to a certain extent.

New business plan

In 2002, the planned increase in sales revenue is 10 % over that of 2001.

In 2002, the Group will give priority to those investments utilising the capital raised from the issue of A shares. The Company will continue to take a market-oriented approach and place emphasis on the expansion of market share associated with major products. Emphasis will also be placed on promoting the sales of major products outside Guangdong province. The Company will strengthen its research and development capabilities by expediting the technical development of the Company and upgrading the standards of its manufacturing operations. Increased efforts will be made to develop the Company. The Company will further improve the process of optimising the application of its internal resources and endeavour to lower costs. Efforts will also be made to maximise the utilisation of working capital and seek new investment opportunities, such as through merger and acquisition. The Company will also endeavour to generate new business that can sustain profits in order to strengthen the core competitiveness of the Company. The specific strategies are as follows:

1 *Implementing a brand marketing strategy and expansion of the end-user market network*

To maintain sustainable development of the manufacturing and trading operations, the Group will adopt a market-oriented approach by focusing on key products and strengthening efforts to expand the sales network through brand advertising. Additionally, the Group will specifically develop a series of products to meet market demand. Through actively promoting the sales of brand name products the Company will ultimately expand the market share of its core products.

2 *Utilising the advanced technology to strengthen the development of new product research.*

The key factor in research and development is to enhance the process of the modernization of Chinese medicine and the development of bio-chemical products. Its purpose is to further strengthen the Company's core competitiveness and capabilities for continuous development. In 2002, the Company will actively apply for the establishment of the Chinese Medicine Manufacturing Engineering and research and development center of the State. The Company will speed up the progress of the following Chinese medicine projects: Mao Dong Qing Fu Zhi Na, Si Yi Huan Xi Pian, Jie Yuan Jiao Nang, and accelerate the experimental study on bio-medicines such as DNA hepatitis vaccine and cellular protein. Moreover, there will be a transfer of those projects involving bio-chemical and new products, which were in the experimental stage or have already been granted certification as new products to the production stage. These projects are expected to be produced commercially and bring economic benefits for the Company in the near future.

3 *Accelerating the progress of technological enhancement and GMP certification procedures*

In 2002, the Company will place emphasis on technological enhancement projects undertaken by Kwang Chow First Factory and GZ Xing Qun, and strive to accomplish the procedures of GMP certification before 2003.

4 *Strengthening the Company's management and accelerating the implementation of the ERP system.*

In 2002, the company will firstly accomplish the overall implementation of the ERP system of the manufacturing operations. Secondly, the Company will accelerate the implementation of the ERP system of the trading operations. The Company will strive to complete the implementation of the ERP system in the major departments of GCMC and improve the ERP system of GPC. Thirdly, the Company will set up a data analysis system and ERP data interface. Moreover, the information network will undergo further construction and improvement. Furthermore, the Company will establish its e-commerce platform and actively promote the utilization of e-commerce technology. Finally,the company will strive to obtain certification for its SAP system.

5 *Enhancing the corporate structural reform to fully utilise the advantage of management team.*

The Company will continue encouraging the optimal allocation of its internal resources by furthering structural reforms, gradually implementing an incentive system of equity base and optimising the use of modern managerial techniques. In 2002, the Company plans to implement changes in the current wholly-owned enterprise structure by undertaking management to hold shares in the Group. In the meantime, the Group will take advantage of the long-range incentive scheme to cultivate and to attract a number of specialised technical and managerial personnel so as to improve the overall quality of the Company.

6 *Improving the use of funds to facilitate the progress of development*

The Group will engage professionals from the capital market to improve on using of funds.

By involving strategic investors from both the PRC and overseas, the shareholding of the Company will be diversified. In addition, the Group will explore further opportunities for merger and acquisition and potential investments and to explore new profitable businesses to create a foundation for future development.

In 2002, the Group will continue to strive generating favourable returns for its shareholders.

DAILY OPERATION OF THE BOARD

Board meetings

All directors of the Company have complied with the PRC Company Law, fulfilled their responsibilities as set forth in the Company's articles of association, diligently executed the resolutions of the general meetings of shareholders, and have endeavoured to maintain and maximise shareholders' wealth.

In 2001, the Board held 8 meetings. Major points and resolutions of those meetings are as follows:

1 The 3rd meeting of the Board of the 2nd term was held on 21 February 2001. The following resolutions were passed:

- resolved that Kwang Chow First Factory merge with GZ Zhongsheng and for Kwang Chow First Chinese Medicine Factory to carry out the merger in accordance with the relevant laws and regulations;
- agreed to the transfer of 30% of the equity of Guangjing Chinese Medicine Innovation Centre held by Beijing Chinese Medicine University to the Guangzhou Pharmaceutical Industrial Research Department and rename as Guangjin Chinese Medicine Innovation Center. The Company gave up its pre-emptive rights to the shares.
- resolved to establish an investment management committee under the Board and authorised the committee to a) review the overall investment plan and projects of the Company, b) review and supervise the investment plan and projects of the subsidiaries, c) review and approve external investment projects whose individual investment amount is less than 3% of the Company's net assets and whose accumulated investment amount for the whole year is less than 10% of the Company's net assets (including acquisition and merger), d) review and approve short-term investment projects (only referring to those whose individual investment amount is less than 3% of the Company's net assets and whose accumulated investment amount is less than 10% of the Company's net assets), e) review, approve and manage other investment projects entrusted by the Board. The members of the Investment Management Committee are as follows: Supervisor, Cai Zhixiang; Deputy Supervisor, Li Yiming; committee members, Chen Xiangzhi, Xiao Cheng, Jiang Shijie, He Shuhua, Xiang Zhixing.

2 The 4th meeting of the Board of the 2nd term was held on 20 April 2001. The following resolutions were passed:

- approved the 2000 Directors' Report;
- approved the 2000 Report of the Supervisory Committee;
- approved the audited accounts for the year ended 31 December 2000;
- approved the Auditors' Report for the year 2000;
- approved the re-appointment of the retiring auditors and international auditors, Guangzhou Yangcheng Certified Public Accountants Co Ltd and PricewaterhouseCoopers, respectively, and to authorised the Board to determine their remuneration;

- approved the 2001 scheme for profits distributions and dividend;
- approved the aggregate amount of emoluments to be paid to the Directors and Supervisors in 2001; and
- authorised the Board to allot and issue new shares in accordance with the relevant regulations during the relevant period and authorised the Board to make any appropriate and necessary amendments to the Company's articles of association and to register such amendments with the relevant authority.

3 The 5th meeting of the Board of the 2nd term was held on 25 July 2001. The following resolutions were passed:

- the Company entrusted Southern Securities Co., Ltd to invest in State bonds and securities with its own fund. The total entrusted amount is Rmb 30 million. The entrusted period is from 26 July 2001 to 31 December 2001. If the earning ratio of the entrusted assets is less than 5%, no asset management fee would be charged by the entrustee. Otherwise, the entrustee would collect 2.5% against the investment's net value as an annual management fee.
- GZ Chen Li Ji entrusted Northeast Security Company Limited to manage its investment. The amount entrusted is up to Rmb 20 million. The entrusted period is from 26 July 2001 to 26 July 2002. If the earning ratio of the entrusted assets were less than 10%, no performance bonus would be collected by the entrustee; otherwise all income above 10% of the entrusted investment value would be kept by the entrustee as a performance bonus.
- GZ Yang Cheng and GZ Pan Gaou Shou, entrusts Dapeng Security Co., Ltd to invest in government bonds. The entrusted amount is Rmb 20 million and Rmb 25 million respectively. The entrusted period is from 26 July 2001 to 26 July 2002. If the earning ratio of the current year were higher than 3.2%, 50% of the amount exceeding 3.2% of the entrusted investment value would be paid to the entrustee as a performance bonus.

4 The 6th meeting of the Board of the 2nd term was held on 17 August 2001. The following resolutions were passed:

- approved 2001 interim announcement
- approved 2001 unaudited interim accounts and scheme of profit distribution
- approved the resolution to make provisions for impairment losses on assets in accordance with the Accounting Standards for Business Enterprises and formulating the related internal control policies
- approved the implementation of the long-range incentive scheme
- approved the proposal to convene the first EGM shareholders of 2001

5 the 7th meeting of the Board of the 2nd term was held on 6 September 2001. The following resolutions were passed:

- approved the appointment of He Shuha who was nominated by the General Manager, as the Company's deputy general manager. His appointment would be until the end of the 2nd term of the Board . In the mean time, the board approved the resignation of Mr. Xiao Cheng upon his retirement.

6 the 8th meeting of the Board of the 2nd term was held on 27 September 2001. The following resolutions were passed:

- approved the proposal of a connected party transaction involving the purchase of the Suikang Building by GPC, from Guangzhou Pharmaceutical Resources Supplying Company, a wholly-owned subsidiary of GZPHL.
- approved the establishment of the Independent Directors Committee
- approved to convene the 1st EGM of 2001.

7 the 9th meeting of the Board of the 2nd term was held on 19 October 2001. The following resolution was passed:

- The Company signed the contract with an independent third party, Opalmind International Holdings Limited ("Opaimind") on 19 October 2001, to incorporate Guangzhou Pharmaceutical (England) Co., Ltd ("GZP England")., in London, England

8 the 10th meeting of the Board of Directors of the 2nd term was held on 18 December 2001. The following resolutions were passed:

- approved the proposal for the Company to entrust New York Bank for issuing American Depositary Receipts ("ADR")
- approved Mr. Chen Xiangzhi, Director and General Manager to resign from the position of General Manager and approved the appointment of Mr. Zhou Yuejin as General Manager
- approved the proposal for reforming GPC and Kwang Chow First Factory to limited liability company.

The progress of execution by the directors in respect of the resolution of the general meetings

2000 year-end profits distribution

Pursuant to the resolutions passed in the 2000 AGM, the 2000 final dividend of Rmb0.03 per share has been paid to the shareholders in 2001. The registration date for H Shares' shareholders for the final dividend was 23 May 2001. The closing date was 24 May 2001. The registration date for A Shares' shareholders for the final dividend was 22 June 2001. The closing date was 25 June 2001.

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

Proposed scheme

In accordance with PRC accounting standards and systems, net profit of the Group for 2001 is Rmb146,134,000. After deduction of the negative opening retained earning of Rmb27,438,000,profit available for distribution is Rmb118,696,000. The Board recommended a final dividend of Rmb 0.06 per share (including withholding tax for A Shares) for the year ended 31 December 2001.

The proposed final dividend, if passed at the AGM on 7 June 2002, will be paid on or before 21 June 2002 to H share shareholders who appear on the Company's register of members before 4:00 pm on 13 May 2002 (Monday). The registration day of the A share shareholders, date of payment of the dividend, and the method of payment will be announced separately.

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

Explanation of the difference between current year profit distribution and 2000 annual report's distribution scheme.

The Company was expected to make two profits distributions in 2001, but only distributed once in 2001. The reason is that under CSRC rules, the financial statements should be audited by local and oversea auditors before making any profit distribution. As the Company expected that the audit would not be finished before the scheduled time, thus there was no interim dividend purposed in 2001.

Expected distribution of the year 2002

In 2002, the Company is expected to make one profit distribution. The distribution ratio would not be less than 30% of the net profit. The distribution would be in form of cash. The Company has no plan to transfer from capital reserve to share capital in 2002. The Board retains the right to adjust the above expected distribution scheme.

OTHER MATTERS

1. In order to further establish the modernised enterprise system, the Company will continue to reform its subsidiaries. On 21 January 2002, Kwang Chow First Factory has been restructured into Guangzhou First Chinese medicine Co., Ltd. On 21 December 2001 GPC had been reformed into Guangzhou Pharmaceutical Corporation Co., Ltd.. The charge in structure of these two companies involving shares allocated to management will effectively enhance their continuous development.

2. The Company signed a contract with Opalmind on 19 October 2001 to incorporate GZP England. The Company holds 20% of GZP England's total share through contribution of the exclusive rights for use of the brands, "Guangzhou Pharmaceutical" and "Cai Chi Lin" in UK and the European Union. Opalmind injected cash and holds 80% of GZP England's total share. The authorised capital of GZP England is GBP 1.5 million. GZP England's is a limited liability company. The business scope includes the sale of Chinese Patent Medicine, natural health and nutritional revitalising products, and the opening of chain stores. Up to 31 December 2001, the required legal procedures relating to the establishment of the new company are still in program.

3. The Company established Guangzhou BaiDi on 27 August 2001. The Company holds 82% of total share equity, the Guangzhou Pharmaceutical Industrial Research Department holds 10% and the management of the company hold 8%. The registered capital of the company is Rmb20,000,000. The company is a limited liability company. Its business scope is focused on research and development of new medicine and the medicine on abstaining from drugs and providing service on the methodology research of the new medicine, retail sales and wholesales.

4. In 2002 the Company plans to issue ADR in the USA. Approval from the CSRC has been granted to the Company on 27 February. The Company signed an agreement with the New York Bank on 7 March 2002 and designated the bank as the entrusted bank of the ADR.

5. *Accounts*

   The results of the Group for the year ended 31 December 2001 are set out in the consolidated profit and loss accounts prepared in accordance with PRC accounting standards and systems and HK GAAP on page 49 and page 100 respectively.

   The state of affairs of the Group and the Company as at 31 December 2001 are set out in the consolidated balance sheet prepared in accordance with PRC accounting standards and systems and HK GAAP on page 47 and page 101 respectively.

The cash flow of the Group for the year ended 31 December 2001 is set out in the consolidated cash flow statement prepared in accordance with PRC accounting standards and systems and HK GAAP on page 52 and page 103 respectively. The cash flow of the Company for the year ended 31 December 2001 is set out in the cash flow statement prepared in accordance with PRC accounting standards and systems on page 58.

6. *Financial summary*

A summary of the results and of the asset and liabilities of the Group for the last five financial years prepared in accordance with HK GAAP is set out on page 6.

A summary of the results and of the assets and liabilities of the Group for the last three financial years prepared in accordance with the PRC accounting standards and systems is set out on page 5.

7. *Reserves*

Movements in the reserves of the Group and the Company during the year in accordance with HK GAAP are set out on pages 123 to 127.

Movements in the reserves of the Group and the Company during the year in accordance with PRC accounting standards and systems are set out on pages 87 to 88.

8. *Distributable reserves*

In accordance with the Company's articles of association, the profit available for distribution to shareholders is the lower of the amount determined in accordance with HK GAAP and the amount determined in accordance with PRC accounting standards and systems. The distributable reserve of the Company as at 31 December 2001 amounted to Rmb63,448,000, which is calculated under HK GAAP.

9. *Fixed assets*

Details of movements in fixed assets during the year are set out on pages 77 to 78 and 118 to 119.

10. *Directors' and Supervisors' interest in contracts*

No contracts of significance in relation of the Group's business to which the Company, its fellow subsidiaries or its holding company was a party to, and in which a director or supervisor of the Company had a material interest, whether directly or indirectly, existed at the end of the year or at any time during the year.

11. *Connected transactions*

Details of the connected party transaction were set out on pages 130 to 131.

Other transactions with jointly controlled entities and associated companies as disclosed do not constitute connected transactions under the Listing Rules.

The Directors believe that the above-mentioned connected party transactions fully comply with the waivers granted by the HKSE to the Company.

The non-executive Directors have reviewed the connected party transaction and regard the transaction as being carried out within the Company's ordinary operations and under ordinary business terms. The relative terms were considered normal business terms or at least no more favorable than the preferential terms offered to third parties. According to the Company, the terms were fair and reasonable.

12. *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.

13. *Compliance with the code of best practice*

The Company has throughout the year of 2001 complied with the Code of Best Practice as set out in Appendix 14 to the Listing Rules.

14. *Audit Committee*

The Audit Committee had reviewed the accounting policy, accounting regulation and methods adopted by the Company, and discussed with management about the audit, internal control and financial reporting. The Committee also reviewed the audited accounts for the year ended 31 December 2001.

15. *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 111 and 115.

16. *Staff quarters*

Pursuant to the Accommodation Service Agreement entered into between the Company and GZPHL on 1 September 1997, GZPHL agreed to sell the staff quarters to the employees of the Group at a preferential price. The Company shall pay to GZPHL the staff quarters reform costs, which represent the difference between the preferential price and the cost net of depreciation paid by GZPHL on buildings acquired for such staff quarters. For the year ended 31 December 2001, the staff quarters reform costs brought forward from last year, which are payable to GZPHL, amounted to approximately Rmb62,030,000. (2000: Rmb62,030,000)

In addition, the Group has constructed or acquired certain staff quarters in the years before 2000. As at 31 December 2001, the difference between the construction cost or acquisition cost and the revenue from disposal of the quarters totaled Rmb42,437,000. (2000: Rmb42,437,000)

The above mentioned staff quarters reform costs amounted to Rmb 104,467,000 as at 31 December 2001 (2000: 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 therefrom *have been* dealt with in retained earnings as at 1 January 2000. Subject to the approval by the Board, 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 2001 was approximately Rmb25,004,000 (2000: Rmb14,558,000). As at 31 December 2001, the net carrying value of the deferred staff quarters reform costs was Rmb79,463,000 (2000: Rmb89,909,000). In the opinion of the Board, if the aforesaid deferred staff quarter reform cost had been completely written off in 2000, the consolidated net assets of the Group as 31 December 2001 would have been reduced by approximately Rmb79,463,000 (2000: Rmb89,909,000). With respect to the document (Suifu (2000) 18) issued by the Guangzhou Municipal Government on 18 May 2000 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. The Group will formulate their own cash accommodation allowance policy to employees based on the Group's situation.

17. *Project under development and for Sales*

    Details of the properties of the Group held for the purpose of development and/or sale 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 is set out on Page 118.

18. *Purchase, sale or redemption of shares*

    The Company has not redeemed any of its shares during the year. Neither the Company nor any of its subsidiaries has purchased or sold any of the Company's shares during the year.

19. *Bank loans, overdraft and other loans*

    As at 31 December 2001, details of bank loans and overdrafts and other loans are set out on page 84 and 86, and, pages 122 and 128. In comparison to the previous year, there are no material adverse changes in respect of the amounts of bank loans, short term loans and total liabilities as at 31 December 2001.

20. *Gearing ratio*

    Up to 31 December 2001, there have been no material adverse changes in the gearing ratio of the Group.

21. *Auditors*

    Guangzhou Yangcheng Certified Public Accountants Co Ltd and PricewaterhouseCoopers were appointed as domestic and international auditors of the Company for the year 2001, as approved at the 2000 AGM.

    A resolution for the re-appointment of Guangzhou Yangcheng Certified Public Accountants Co Ltd and PricewaterhouseCoopers as domestic and international auditors respectively of the Company for the 2002 year is to be proposed at the forthcoming AGM.

On behalf of the Board
Cai Zhixiang
Chairman

4 April 2002