

Report of The Directors

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

MANAGEMENT DISCUSSION AND ANALYSIS

Business scope and analysis of operations

1. Scope of business

The Group is principally engaged in (1) manufacture and sales of CPM; (2) wholesale, retail, import and export of Western and Chinese pharmaceutical products and medical apparatus; and (3) research and development of natural medicine and biological medicine.

2. Analysis of operating results

(1) Principal activities and geographical analysis of operations

During the year, great impact had been caused to the domestic pharmaceutical market owing to the following reasons: (i) due to the outbreak of SARS, demand for certain pharmaceutical products changed significantly and purchases from medical institutions dropped tremendously in some areas due to the decrease in the number of inpatients; (ii) the implementation of the State regulations on pharmaceutical products has caused the reduction in the price of certain pharmaceutical products; (iii) gross profit margin of the pharmaceutical manufacturing operations decreased as a result of the increase in cost of certain raw materials; (iv) the increasingly fierce competition in the pharmaceutical market in certain large cities of the country as a result of the springing up of cheap chain pharmacies has brought direct impact on the pharmaceutical trading business. Facing severe market conditions, the Group analyzed the changes in the pharmaceutical market, adjusted its marketing strategies on a timely basis and strengthened market expansion, so as to increase its sales and ensure the stable growth of the Group's results.

According to the Group's consolidated accounts for the year ended 31 December 2003, turnover of the Group under PRC accounting standards and systems was RMB6,971,963,000, representing an increase of 17.30% over that of 2002. Turnover under HK GAAP amounted to RMB6,973,113,000, representing an increase of 17.32% over that of 2002. Profit before taxation under PRC accounting standards and systems amounted to RMB284,773,000, representing a decrease of 0.95% over that of 2002. Profit before taxation under HK GAAP amounted to RMB307,829,000, representing an increase of 56.77% over that of 2002.

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An analysis of the Group's turnover and profit from principal activities for the year by segment 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	1,889,215	1,890,364	990,842	1,009,308
Trading				
Wholesale	4,544,134	4,544,134	288,774	293,271
Retail	354,438	354,438	82,913	84,144
Import and export	184,177	184,177	10,185	10,226
Sub-total	5,082,749	5,082,749	381,872	387,641
Total	6,971,963	6,973,113	1,372,714	1,396,949

Geographical analysis of sales of manufacturing and trading operations is set out as follows:

Region	Manufacturing		Trading		Total turnover	% of the turnover
	Turnover	% of the manufacturing turnover	Turnover	% of the trading turnover		
Southern China	1,192,253	63.11	4,322,167	85.04	5,514,420	79.09
Eastern China	243,940	12.91	225,862	4.44	469,802	6.74
Northern China	140,232	7.42	129,146	2.54	269,378	3.86
North-eastern China	110,342	5.84	75,014	1.48	185,356	2.66
South-western China	101,433	5.37	171,321	3.37	272,754	3.91
North-western China	61,693	3.27	80,926	1.59	142,619	2.05
Exports	39,322	2.08	78,312	1.54	117,634	1.69
Total	1,889,215	100.00	5,082,749	100.00	6,971,963	100.00

(2) CPM manufacturing business (the "Manufacturing Operations")

Turnover of the Manufacturing Operations in 2003 under PRC accounting standards and systems was RMB1,889,215,000, representing an increase of 8.36% over that of 2002. Turnover of the Manufacturing Operations in 2003 under HK GAAP was RMB1,890,364,000, representing an increase of 8.43% over that of 2002. Profit before taxation of the Manufacturing Operations under PRC accounting standards and systems was RMB213,086,000, representing a decrease of 0.23% over that of 2002. Profit before taxation of the Manufacturing Operations under HK GAAP was RMB238,690,000, representing an increase of 61.82% over that of 2002.

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In 2003, the Group has taken the following measures in its Manufacturing Operations: (i) it has strengthened the connection and cooperation with large pharmaceutical enterprises. During the year, several large exhibitions and technical promotion meetings were conducted, which has effectively improved the brand image of the Group and increased its sales. (ii) it has done its best to improve the promotion and marketing in some major products such as Xiao Ke Wan and Hua Tuo Zai Zao Wan, set up manager responsibility system for major products and strengthened its market control and management on certain major products; (iii) it has further improved the marketing of some major products with high market potential such as Hua Zhi Quan, Xu Han Ting, Mi Lian Chuan Bei Pi Pa Gao and Wu Ji Bai Feng Wan, striving to explore new profit source for the Group; (iv) it further strengthened promotions of pharmaceutical products to end-users such as hospitals and medical institutions, endeavouring to make up for the loss caused by the decrease in sales to hospitals.

The implementation of the aforementioned strategies have good impact. In 2003, the sales of certain key products such as Mi Lian Chuan Bei Pi Pa Gao, the series of Wang Lao Ji Liang Cha, Hua Zhi Quan and Xu Han Ting increased significantly by 59.95%, 33.25%, 54.67% and 51.08% respectively as compared with 2002.

As affected by SARS, the turnover of the Company's diabetes curing medicine decreased by 14.58% as compared with 2002.

Sales analysis of major products is as follows:

Products	Turnover	Gross profit
	2003	2003
	RMB'000	RMB'000
Heat clearing and antitoxic	475,617	236,707
Diabetes curing	311,501	207,160
Cough and phlegm clearing	248,569	121,894
Arthritis curing	210,935	123,204
Gastric	102,690	47,796

The Group emphasizes on accelerating the process of the technology upgrades. During the year, twelve projects which utilised proceeds from issue of A shares have been completed, including the technology upgrade of Xiao Ke Wan, technology upgrade for syrup production, automation of pill production and syrup workshop upgrade. During the Reporting Period, Guangzhou Qi Xing Pharmaceutical Co., Ltd, Guangzhou Jing Xiu Tang, Guangzhou Huan Ye Pharmaceutical Co., Ltd, Guangzhou Xing Qun, Guangzhou Chen Li Ji Pharmaceutical Factory and Guangzhou Yang Cheng have been granted the GMP certification for their completed renovation. Currently, all of the Company's eight manufacturing subsidiaries, except Guangzhou Zhong Yi Pharmaceutical Co., Ltd due to relocation of production plant, have passed GMP examination (Guangzhou Pan Gao Shou has passed the GMP examination, but has not been granted with GMP certification yet).

During the year, inventory turnover days of the Manufacturing Operations decreased by 5.77 days, while accounts receivable turnover days increased by 1.07 days as compared with 2002.

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The Group continued to push the research and development of new products and the redevelopment of certain major products. In 2003, two new drugs applied for approval of clinical research, one product was approved for clinical research, one product applied for new drug certification, one product was under clinical research and 18 products such as Zhi Yan Xiao Granules (sugar free), Compound Tui Re Quan for Children and Ke Gan Li Yan Syrup were granted with production approvals.

In 2003, the implementation of the ERP system in the Company's seven manufacturing subsidiaries has been completed. The Company's ERP project in the Manufacturing Operations passed the examination by the assessment team organized by Guangzhou Economic Commission and gained the recognition by the experts. Currently, the Company is in the progress of implementing the ERP system in the Trading Operations.

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

Turnover of the Group's Trading Operations in 2003 under both PRC accounting standards and systems and HK GAAP was RMB5,082,749,000, representing an increase of 20.01% over that of 2002. According to the accounts prepared in accordance with PRC accounting standards and systems, profit before taxation of the Trading Operations amounted to RMB71,687,000, with a decrease of 3.02% over that of 2002. According to the accounts prepared in accordance with HK GAAP, profit before taxation was RMB69,139,000, representing an increase of 41.51% over that of 2002.

In 2003, due to the impact caused by changes in the pricing policy for pharmaceutical products and the tendering system adopted by hospitals, gross profit margin of the Trading Operations continued to decline and accounts receivable as at the end of the Reporting Period climbed. The trading subsidiaries of the Company carried out effective measures to react to the above market conditions. Firstly, they made timely adjustments to its marketing strategies according to market changes, focused on the logistics management for the SARS related medicine and tried to maintain their market share. They also strengthened the promotion on the SARS related medicine, especially to end-users such as hospitals and retail pharmacies, so as to ensure a continuous sales growth. Secondly, they continued to seek and develop new famous pharmaceutical products and their agency and distribution rights, and tap up the market in major cities and rural areas outside Guangdong Province. Thirdly, they strengthened its wholesale business and tried to maintain its rapid growth. Fourthly, they made timely adjustments to their development strategies in the retail business according to the market changes. Fifthly, they made efforts to accelerate the construction of the pharmaceutical logistics center, further streamlined their business, accelerated delivery speed and shortened inventory turnover days.

As at 31 December 2003, the Group had 224 chain pharmacies, including 124 "Cai Zhi Lin" Traditional Chinese Medicine (TCM) chain pharmacies and 100 "Jian Min" chemical medicine chain pharmacies. The number of the clients of the Trading Operations increased by 2,103, products with distribution rights increased by 2,077 types and products with exclusive distribution rights grew by 36 types. That has been crucial to the sales growth of the Trading Operations of the Group.

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

Name	Principal activities and major products	Total assets as at 31 December 2003 RMB'000	Net assets as at 31 December 2003 RMB'000	Net profit for the year RMB'000
Guangzhou Zhong Yi Pharmaceutical Co., Ltd	Production and sales of CPM; major products are Xiao Ke Wan etc.	469,808	332,680	56,999
Guangzhou Chen Li Ji Pharmaceutical Factory	Production and sales of CPM; major products are Wu Ji Bai Feng Wan etc.	265,364	189,545	20,130
Guangzhou Qi Xing Pharmaceutical Factory	Production and sales of CPM; major products are Hua Tuo Zai Zhao Wan etc.	178,517	166,969	12,906
Guangzhou Xing Qun Pharmaceutical Co., Ltd	Production and sales of CPM; major products are Xia Shang Ju etc.	304,468	202,840	27,202
Guangzhou Jing Xiu Tang Pharmaceutical Co., Ltd	Production and sales of CPM; major products are Qing Re Xiao Yan Ning, etc.	183,939	100,467	5,270
Guangzhou Pan Gao Shou Pharmaceutical Co., Ltd	Production and sales of CPM; major products are Mi Lian Chuan Bei Pi Pa Gao, etc.	299,628	177,489	3,029
Guangzhou Yang Cheng Pharmaceutical Co., Ltd	Production and sales of CPM; major products are Bao Ji Wan, etc.	178,657	141,373	18,810
Guangzhou Huan Ye Pharmaceutical Co., Ltd	Production and sales of phytochemical medicine	34,303	24,152	253
Guangzhou Bai Di Bio-Technology Pharmaceutical Co., Ltd	Research and production of bio-tech medicine	67,831	62,575	(4,704)
Guangzhou Han Fang Contemporary Medicine Research & Development Co., Ltd	Research and production of CPM	85,382	71,205	(4,131)
Guangzhou Pharmaceutical Corporation	Trading of chemical pharmaceutical products and medical apparatus	1,824,061	391,118	40,173
Guangzhou Chinese Medicine Corporation	Trading of CPM and Chinese raw medicine	351,949	92,231	(1,126)
Guangzhou Pharmaceutical Import & Export Corporation	Import and export of TCM and chemical medicine	121,144	19,821	848

None of the Company's subsidiaries investment income account for more than 10% of the Group's net profit for the year.

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4. *Major customers and suppliers*

During the year, purchases of goods and services by the Group from the 5 largest suppliers amounted to RMB972,248,000, representing approximately 16.51% of the total purchases. The purchases from the largest supplier amounted to RMB255,763,000, representing 4.34% of the total purchases. Goods and services sold to the 5 largest customers amounted to RMB388,693,000, representing 5.58% of the total sales. Sales to the largest customer amounted to RMB145,646,000, representing 2.09% of the total sales of the Group.

Acknowledged by the Board, none of the Directors, their associates or shareholders holding more than 5% of the Company's total issued share capital had any interest in any of the major suppliers or customers noted above.

5. *Issues arising from operations and solutions*

The changes in the pricing policy for pharmaceutical products, the increase in the price of certain raw medicine and the springing up of cheap chain pharmacies have brought certain impact on the Group's operation. In response to the severe market conditions, the Group made timely adjustment to its marketing on the basis of prudent analysis of market changes, made greater efforts in market expansion and endeavor to improve the sales of the Group, so as to ensure the steady growth of the Group's results.

The Company's investments

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

Upon the approval from the CSRC, 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 2003, an aggregate of RMB583,770,000 of the net proceeds from the issue of A shares were utilised. The remaining unused proceeds amounting to RMB154,220,000 are currently placed as bank deposits or used as working capital. The Company will gradually utilise the funds according to the requirement of the projects.

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2. As at 31 December 2003, the use of the 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	Amount injected during the year RMB'000	Stage of completion (%)
Projects for the technology upgrade and industrialisation of new products				
Pills	Xiao Ke Wan upgrade	29,800	29,800	100
	Bao Ji Wan upgrade	11,000	11,000	100
	Industrialisation of Wei Re Qing Capsules	29,000	7,990	80
	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	17,580	70
Syrup	Technology upgrade for syrup production	29,500	29,500	100
	Industrialisation of Ke Gan Li Yan Syrup	19,600	19,600	100
Granules	Technology upgrade of Xu Han Ting Granules	12,000	12,000	100
	Automation of granules upgrade	29,900	29,900	100
	Technology upgrade of flu granules for children	23,000	23,000	100
Tablets	Industrialisation of Fu Yan Xiao Soluble Tablets	29,500	8,640	45
	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
Industrialisation foundations			29,900	30,920
	Modernisation of extraction and purification technology	29,900	23,720	83
	Critical purification of CO ₂ technology foundation	29,900	13,180	80
Trading				
Expansion of chain pharmacies				
	Jian Min	89,300	84,230	94
	Cai Zhi Lin	59,500	20,840	60
	Logistics centre upgrade	20,000	20,000	81
	ERP upgrade for the Trading Operations	20,000	15,620	80
	Bio-tech research centre	80,000	50,180	63
	Additional working capital	50,000	79,690 (Note)	—
Total		<u>708,300</u>	<u>583,770</u>	

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

(1) Explanatory note on returns on projects and the stage of completion

During the Reporting Period, additional sales and gross profit from the completed projects amounted to RMB437,590,000 and RMB246,250,000, respectively.

Among the above projects, the completion of industrialisation of Fu Yan Xiao Soluble Tablets and industrialisation of Wei Re Qing Capsules were delayed till the end of 2004 due to the relocation of production plants, while the expansion of chain pharmacies slowed as a result of fierce competition in the domestic pharmaceutical market.

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- (2) At end of the Reporting Period, there was no change in the proposed use of the proceeds from the issue of A shares as disclosed in the prospectus for the issue of A shares.
3. Investments with the funds generated from the Group's operations during the Reporting Period
- (1) As approved at the meeting of the Investment Management Committee of the Company held on 3 January 2003, the Company invested RMB1.2 million in the construction of the Financial Information Control Platform of Guangzhou Pharmaceutical Company Limited. The investment proposal has been considered and approved by the experts delegated by Guangzhou Economic Commission. Guangzhou Economic Commission has agreed to provide grants for the project.
- (2) As approved at the meeting of the Investment Management Committee of the Company held on 26 May 2003, the Company entered into a joint venture agreement with Guangzhou New Oasis Life Technology Co., Ltd and the Traditional Chinese Medicine Hospital of Guangdong Province to establish Guangzhou Jin Shen Pharmaceutical Technology Co., Ltd, in which the Company injected RMB675,000, representing 45% of the equity interest thereof. The Company is the largest shareholder of Guangzhou Jin Shen Pharmaceutical Technology Co., Ltd. Guangzhou Jin Shen Pharmaceutical Co., Ltd is principally engaged in the research, development and operation of TCM and TCM related healthcare products.
- (3) As approved at the meeting of the Investment Management Committee of the Company held on 28 August 2003, Guangzhou Bai Di Bio-Technology Pharmaceutical Co., Ltd ("Guangzhou Bai Di"), one of the Company's major subsidiaries, invested RMB1 million in the establishment of Guangzhou Hua Yin Bio-Technology Co., Ltd, in cooperation with Guangzhou Han Shi Bio-Technology Co., Ltd and Guangzhou Bio-Technology Centre. The registered capital of Guangzhou Hua Yin Bio-Technology Co., Ltd was RMB1 million, out of which RMB150,000 was contributed by Guangzhou Bai Di, representing 15% of the registered capital thereof. In addition, Guangzhou Bai Di provides Guangzhou Hua Yin Bio-Technology Co., Ltd a plant with an area of 500 m² which is in compliance with GMP for a period of 5 years without any charges.
- (4) As approved at the meeting of the Investment Management Committee of the Company held on 28 August 2003, Guangzhou Pharmaceutical Corporation ("Guangzhou Pharmaceutical"), one of the Company's major subsidiaries, set up Guangyao An Kang Pharmaceutical Company Limited in Hubei Province in association with two individual shareholders of Hubeiren Fu An Kang Pharmaceutical Materials Company. The registered capital of the joint venture amounted to RMB6 million, out of which RMB3.06 million was contributed by Guangzhou Pharmaceutical, representing 51% of the registered capital thereof. The establishment of the joint venture is expected to facilitate Guangzhou Pharmaceutical to expand the retail market in Hubei Province, improve its service to end-users, and greatly increase the sales of its products outside Guangdong Province.
- (5) As approved at the meeting of the Investment Management Committee of the Company held on 10 September 2003, the Company injected RMB20.1 million into Guangzhou Bai Di which is a subsidiary of the Company.

The above investments provide more investment channels for the Company.

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Financial conditions

1. Financial conditions

Prepared in accordance with PRC accounting standards and systems

Item	2003 RMB'000	2002		Change %
		Before adjustment RMB'000	After adjustment RMB'000	
Total assets	4,707,039	4,173,194	4,173,194	12.79
Shareholders' equity	2,429,476	2,286,929	2,335,583	4.02
Profit from principal activities	1,372,714	1,289,409	1,289,409	6.46
Net profit	139,795	158,478	158,478	(11.79)
Net increase in cash and cash equivalents	(201,038)	126,211	126,211	(259.29)

Prepared in accordance with HK GAAP

Items	2003 RMB'000	2002 RMB'000	Change %
Total assets	4,954,091	4,410,210	12.33
Shareholders' equity	2,551,417	2,454,080	3.97
Operating profit	307,365	219,485	40.03
Net profit	146,667	101,155	44.99
Net increase in cash and cash equivalents	(181,895)	104,988	(273.25)

Reason for changes:

Cash and cash equivalents of the Group for the Reporting Period decreased by of 259.29% as compared with 2002 due to the significant increase of capital expenditure into GMP renovation.

2. Liquidity, financial resources and capital structure

As at 31 December 2003, long-term borrowings of the Group amounted to RMB107,180,000 (at 31 December 2002: RMB89,680,000). These borrowings were fixed interest loans denominated in RMB and repayable within two to three years. As at 31 December 2003, the cash and cash equivalents of the Group amounted to RMB816,440,000 (at 31 December 2002: RMB1,019,900,000), out of which approximately 95.66% was denominated in RMB and 4.34% was denominated in Hong Kong dollars.

3. Capital expenditure

The Group's capital expenditure for 2004 is around RMB367,000,000 (2003: RMB363,000,000). The Group has sufficient financial resources to meet the capital expenditure and daily working capital requirements.

4. Exposure to fluctuations in exchange rates

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

5. Contingent liabilities

Up to 31 December 2003, the Group has no significant contingent liabilities.

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6. Charge on Group assets

As at 31 December 2003, the net book value of fixed assets pledged as collateral for the Group's bank loans amounted to RMB118,400,000 (at 31 December 2002: RMB118,030,000).

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

The implementation of GMP in the Manufacturing Operations will lead to the increase in the costs of the Group. In addition, the gross profit margin of the Trading Operations will keep decreasing due to keen competition in the domestic pharmaceutical market. It is expected that the above factors will cause certain impact on the Group's operating results.

The accounts of the Group and the Company for the year ended 31 December 2003 have been audited by Guangzhou Yangcheng Certified Public Accountants Co., Ltd, the domestic auditors, and PricewaterhouseCoopers, the international auditors. The Company's domestic and international auditors have both issued unqualified auditors' reports thereon, respectively.

Operation plans for 2004

Year 2004 is a year full of challenges. Following the opening of the domestic pharmaceutical market, especially the pharmaceutical trading market, competition in the domestic pharmaceutical market is expected to be increasingly severe, and the Company will be encountered with new challenges and opportunities. In strict adherence to its development strategy, the Company will further enhance its corporate governance, strengthen its management and internal control, expand its core business and explore new profitable business.

The Company's operation plans for 2004 include:

1. To further strengthen the marketing and promotion of certain major products and products with high market potential, and to explore more major products with great competitiveness, seeking to increase the Group's turnover and profit to a higher level;
2. To accelerate the construction of technology platforms, and to push the production and marketing of new products such as Feng Shi Ping Capsules. In addition, it will continue to make great efforts to enhance its competitiveness in technology.
3. To further regulate and perfect the SAP system of the Company and to accomplish the upgrading of SAP system in the Manufacturing Operations in the first half of 2004, at the same time to accelerate the implementation and training of the ERP system in the Trading Operations;
4. To continue seeking opportunities for cooperations with quality domestic pharmaceutical enterprises through acquisition and merger, with a view to broadening the profit base of the Group; and
5. To gradually improve its existing evaluation mechanism and long-term incentive scheme so as to enhance the activity and creativity of the key staff.

In 2004, the Company will continue to strive generating favourable returns for its shareholders.

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DAILY OPERATIONS OF THE BOARD

Board meetings

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

1. The 21st meeting of the Second Section of the Board was held on 23 January 2003, at which the following resolution was passed:
 - The adoption of HK GAAP in the accounting treatment in relation to the medical insurance taken out by the Group for its retired and retiring employees within 10 years as required by circular No. 17 Provisional Rules of Basic Medical Insurance for Employees in Guangzhou City promulgated by the Guangzhou People's Municipal Government.
2. The first extraordinary board meeting of 2003 was held on 12 March 2003 by means of written resolution:
 - To authorize HKEX to submit the announcements and relevant information disclosed by the Company to the Hong Kong Securities and Futures Commission for records on behalf of the Company, and to appoint Mr. Zhou Yuejin to sign on such authorization.
3. The 22nd meeting of the Second Section of the Board was held on 21 March 2003, at which the following resolutions were passed:
 - the 2002 Directors' Report;
 - the 2002 audited accounts;
 - the 2002 auditors' reports;
 - to re-appoint Guangzhou Yangcheng Certified Public Accountants Co., Ltd. and PricewaterhouseCoopers, as domestic and international auditors respectively, and to recommend the 2002 AGM to authorise the Board to determine the auditors' remuneration;
 - the scheme of profit distribution and dividend payment for 2002;
 - the projected profit distribution policy of the Company for 2003;
 - the aggregate amount of emoluments to be paid to the Directors and Supervisors;
 - to recommend the 2002 AGM to authorize the Board to allot and issue new shares; and
 - to convene the 2002 AGM.
4. The 23rd meeting of the Second Section of the Board was held on 25 April 2003, at which the following resolution was passed:
 - the 2003 1st quarterly report of the Company.
5. The 24th meeting of the Second Section of the Board was held on 7 August 2003, at which the following resolution was passed:
 - the connected transaction in relation to the increase in the registered capital of Guangzhou Han Fang, one of the Company's subsidiaries, with contributions by the Company's controlling shareholder namely GPHL and five other individual shareholders such as Mr. Liu Ju Yan.

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6. The 25th meeting of the Second Section of the Board was held on 15 August 2003, at which the following resolutions were passed:
 - the 2003 interim report of the Company; and
 - the unaudited financial report and profit distribution scheme for the first half of 2003.
7. The 26th meeting of the Second Section of the Board was held on 28 October 2003, at which the following resolutions were passed:
 - the 2003 3rd quarterly report of the Company;
 - to purchase the liabilities insurance for the Company's Directors and Senior Management, which was proposed to be submitted to the Company's shareholders' meeting for consideration and approval;
 - the Working Rules of the Audit Committee under the Board of the Company;
 - the Working Rules of the Remuneration & Evaluation Committee under the Board of the Company; and
 - the Working Rules of the Investment Management Committee under the Board of the Company.

The progress of execution in respect of the resolution passed at the general shareholders' meetings

2002 final dividend

Pursuant to the resolutions passed at the 2002 AGM, a final dividend of RMB0.06 per share for 2002 had been paid to the Company's shareholders in June 2003. The registration date for H Shares' shareholders for the final dividend was 24 April 2003, while the closing date was 25 April 2003. The registration date for A Shares' shareholders for the final dividend was 29 May 2003 and the closing date was 30 May 2003.

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

According to the Company's Articles of Association, the amount of retained profits available for distribution to shareholders of the Company is the lower of the amount determined in accordance with PRC accounting standards and systems and the amount determined in accordance with HK GAAP. The Board recommended a final dividend of RMB0.06 per share (including withholding tax for A Shares) (2002: RMB0.06) for the year ended 31 December 2003. The proposed final dividend will be submitted to the forthcoming 2003 AGM for consideration and approval (the notice to convene the 2003 AGM will be published separately).

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

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CHANGE IN THE NEWSPAPERS DESIGNATED BY THE COMPANY FOR INFORMATION DISCLOSURE

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

OTHER MATTERS

1. Accounts

The results of the Group for the year ended 31 December 2003 are set out in the consolidated profit and loss account prepared in accordance with PRC accounting standards and systems and HK GAAP on pages 47 and 109.

The financial conditions of the Group as at 31 December 2003 are set out in the consolidated balance sheet prepared in accordance with PRC accounting standards and systems and HK GAAP on page 45 and page 110, respectively.

The cash flows of the Group for the year ended 31 December 2003 is set out in the consolidated cash flow statement prepared in accordance with PRC accounting standards and systems and HK GAAP on page 50 and page 113, respectively.

The cash flows of the Company for the year ended 31 December 2003 is set out in the cash flow statement prepared in accordance with PRC accounting standards and systems on page 56.

2. Financial summary

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

3. Reserves

Movements in the reserves of the Group and the Company during the year prepared in accordance with PRC accounting standards and systems and HK GAAP are set out on page 88 and pages 140 to 141.

4. Distributable reserves

In accordance with the Company's Articles of Associations, the profit available for distribution to shareholders is the lower between the amount determined in accordance with HK GAAP and the PRC accounting standards and systems. The distributable reserves of the Company as at 31 December 2003 amounted to RMB76,050,000, calculated under HK GAAP.

5. Fixed assets

Details of fixed assets movement of the Group in accordance with PRC accounting standards and systems and HK GAAP are set out on pages 73 to 74 and pages 132 to 133.

6. Directors' and Supervisors' interests in contracts

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

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7. Connected transactions

Details of the connected transactions were set out on pages 95 to 103 and pages 153 to 154.

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

The Directors believe that the above-mentioned connected transactions fully comply with the waivers granted by HKEX.

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 at least no more favourable than the preferential terms offered to third parties.

8. 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.

9. Compliance with the code of best practice

Throughout the year, the Company was in compliance with the Code of Best Practice as set out in Appendix 14 to the Listing Rules.

10. Audit Committee

The Audit Committee had reviewed the accounting policies, accounting regulations and methods adopted by the Group and discussed with the Company's management about the audit, internal controls and financial reporting. The Committee also reviewed the audited accounts for the year ended 31 December 2003.

11. 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.

12. 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 120 and page 126.

Report of The Directors

13. 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. The total staff quarters reform costs, which are payable to GPHL, amounted to approximately RMB62,030,000 (2002: RMB62,030,000).

In addition, the Group has constructed or acquired certain staff quarters. As at 31 December 2003, the difference between the construction cost or acquisition cost and the revenue from disposal of the quarters totalled RMB42,437,000 (2002: RMB42,437,000).

The above mentioned staff quarters reform costs amounted to RMB104,467,000 as at 31 December 2003 (2002: 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 there from should be dealt with in retained earnings as at 1 January 2003. 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 amortised 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 amortisation as at 31 December 2003 was approximately RMB45,896,000, and the amortisation for 2003 was RMB10,446,000. As at 31 December 2003, the net carrying value of the deferred staff quarters reform costs was RMB58,571,000. In the opinion of the Board of the Company, if the aforesaid deferred staff quarter reform cost had been completely written off in 2003, the consolidated net assets of the Group as at 31 December 2003 would have been reduced by approximately RMB58,571,000. With respect to the document (Suifu [2000] 18) issued by the Guangzhou People's Municipal Government 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. From 2001 onwards, the Group has formulated its own cash accommodation allowance policy to employees based on the Group's situation.

14. Project under development and for sales

During the Reporting Period, the Group did not hold any properties for the purpose of development and /or sale 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

15. Bank loans, overdraft and other loans

As at 31 December 2003, the details of the bank loans, overdrafts, and other liabilities of the Group are set out on pages 83 and 86, and payes 138 and 144. Company with 2002, there have been no material adverse changes in respect of the amounts of bank loans, short-term borrowings and total liabilities as at 31 December 2003.

16. Gearing ratio

Up to 31 December 2003, there has been no material adverse change in the gearing ratio of the Group.

17. Auditors

Guangzhou Yangcheng Certified Public Accountants Co., Ltd. and PricewaterhouseCoopers were respectively appointed as domestic and international auditors of the Company for the year 2003, as approved at the 2002 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 year 2004 is to be proposed at the forthcoming 2003 AGM.

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

EXPLANATION OF CERTIFIED PUBLIC ACCOUNTANTS IN RESPECT OF FUNDS USED BY THE CONTROLLING SHAREHOLDER AND OTHER CONNECTED PARTIES OF THE COMPANY

Guangzhou Yang Cheng Certified Public Accountants Co., Ltd, the domestic auditors of the Company, has made an explanation in respect of the flow of funds with the controlling shareholder and other connected 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 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 2003 was set out below:

Report of The Directors

Connected parties	Relationship with the Company	Account	Balance	Balance	Transaction	Transaction	Nature
			as at 31 December 2003	as at 1 January 2003	amount (Debit)	amount (Credit)	
			RMB'000	RMB'000	RMB'000	RMB'000	
GPHL	Parent company	Other receivables	7,226.8	8,130.3	—	903.5	Deposits
Guangzhou Qiao Guang Pharmaceutical Factory	Under the same parent company	Accounts receivable	5,572.5	7,236.5	35,815.7	37,479.7	Trade
		Other receivables	—	197.1	—	197.1	Deposits
Guangzhou Ming Xing Pharmaceutical Factory	Under the same parent company	Accounts receivable	288.4	2	1,666.1	1,379.7	Trade
Guangzhou Tian Xin Pharmaceutical Co., Ltd	Under the same parent company	Accounts receivable	3,140	917.6	17,527.8	15,305.4	Trade
Guangzhou He Ji Gong Pharmaceutical Factory	Under the same parent company	Accounts receivable	17.6	17.1	120.5	120	Trade
Guangzhou Guang Hua Pharmaceutical Co., Ltd	Under the same parent company	Accounts receivable	433.8	336.9	3,237.8	3,140.9	Trade
Guangzhou Pharmaceutical Mechanics Factory	Under the same parent company	Other receivables	—	33.3	—	33.3	Deposits
Guangzhou Wei Cai Factory	Under the same parent company	Accounts receivable	329.3	1,141.7	1,806.5	2,618.9	Trade
Guangzhou Hua Nan Medical Apparatus Co., Ltd	Under the same parent company	Other receivables	100	100	—	—	Deposits
Guangzhou Pharmaceutical Ying Bang Marketing Co., Ltd	Under the same parent company	Accounts receivable	1,763.3	3,507	22,498.9	24,242.6	Trade
		Other receivables	5,000	5,029.6	—	29.6	Borrowings
Guangzhou Pharmaceutical Economic Development Company	Under the same parent company	Accounts receivable	25.8	—	25.8	—	Trade
Po Lian Development Co., Ltd	Under the same parent company	Other receivables	8,221.6	5,796.2	4,088.6	1,663.2	Deposits
Guangzhou Zhong Fu Medical Co., Ltd	Affiliated company	Accounts receivable	187.6	477.3	1,416	1,705.7	Trade
		Other receivables	3.4	—	227.2	223.8	Deposits
Guangzhou Pharmaceutical Industrial Institute	Under the same parent company	Other receivables	—	2,000	—	2,000	Borrowings
Guangzhou Baiyunshan Enterprise Group	Under the same parent company	Accounts receivable	—	6,413.6	—	6,413.6	Trade
Guangzhou Baiyunshan Pharmaceutical Factory	Under the same parent company	Accounts receivable	7,765.6	—	22,742.7	14,977.1	Trade
Guangzhou Baiyunshan Chinese Medicine Factory	Under the same parent company	Accounts receivable	851.9	370.4	1,581.5	1,100	Trade
Total		Other receivables	20,551.8	21,286.5	4,315.8	5,050.5	
		Accounts receivables	20,375.8	20,420.1	108,439.3	108,483.6	

Report of The Directors

EXPLANATION AND INDEPENDENT OPINIONS OF INDEPENDENT NON-EXECUTIVE DIRECTORS IN RESPECT OF ACCUMULATED AND CURRENT EXTERNAL GUARANTEES GRANTED BY THE COMPANY AND 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 Connected Parties and the Provision of Guarantees by Listed Companies to External Parties (Zheng Jian Fa [2003] Directive No. 56), the Independent Non-executive Directors of the Company have conducted examination of policies towards the guarantees provided to the external parties by the Company in a serious manner. The relevant details are as follows:

As at 31 December 2003, the Company has not provided any guarantee to its controlling shareholder or any other connected parties.

On behalf of the Board
Cai Zhixiang
Chairman

Guangzhou, the PRC
26 March 2004