

The Stock Exchange of Hong Kong Limited takes no responsibility for the contents of this announcement, makes no representation as to its accuracy or completeness and expressly disclaims any liability whatsoever for any loss howsoever arising from or in reliance upon the whole or any part of the contents of this announcement.



廣州藥業股份有限公司

Guangzhou Pharmaceutical Company Limited

(a joint stock company with limited liability established in the People's Republic of China)

**CONNECTED TRANSACTION
SUBSCRIPTION OF NEW SHARES IN A
SUBSIDIARY BY CONNECTED PERSONS**

On 28 February 2003, the Original Shareholders and the Subscribers entered into the Subscription Agreement whereby the Subscribers agreed to subscribe for 33,284,300 new Shares in Guangzhou Hanfang at RMB1 per Share.

As a result of the Subscription, the registered capital of Guangzhou Hanfang increased from 50,000,000 Shares to 83,284,300 Shares. The Subscription Shares represented approximately 67% of the registered capital of Guangzhou Hanfang immediately before the Subscription and approximately 40% of the registered capital of Guangzhou Hanfang as enlarged by the Subscription.

The consideration of RMB1 per Subscription Share represented a premium of approximately 18.9% over the net assets per Share of approximately RMB0.841 based on the audited net assets of Guangzhou Hanfang as at 31 December 2002. The total consideration for the Subscription Shares amounted to RMB33,284,300 and was settled as to approximately 77% by the Tangible Assets while the remaining approximately 23% was settled by cash.

Since GPHL and the Executive Directors of Guangzhou Hanfang were connected persons of the Company, the Subscription Agreement constituted a connected transaction of the Company as defined in the respective listing rules of The Stock Exchange of Hong Kong Limited and the Shanghai Stock Exchange.

Under the Listing Rules, the Subscription Agreement should be conditional on the approval by the Independent Shareholders in general meeting. Due to an inadvertent oversight in reporting procedures by Guangzhou Hanfang, the Subscription Agreement was not made conditional on the approval by the Independent Shareholders before it was signed. Therefore, the Subscription constituted a breach of rule 14.26 of the Listing Rules. The Stock Exchange of Hong Kong Limited reserves the right to take action against the Company and/or the Directors in respect of this breach of the Listing Rules.

Given that the Subscription was completed on 17 April 2003, the Company does not propose to convene a shareholders' meeting to seek approval of the Subscription. Instead, the Company will form an independent board committee comprising the independent non-executive Directors to advise the Independent Shareholders on the terms of the Subscription Agreement and will appoint an independent financial adviser to advise the independent board committee. A circular containing, among other things, details of the Subscription Agreement, a letter containing the advice of the independent board committee to the Independent Shareholders and a letter of advice from an independent financial adviser to the independent board committee will be despatched to the shareholders of the Company on or before 1 September 2003.

SUBSCRIPTION AGREEMENT

Date

28 February 2003

Subscription

Pursuant to the Subscription Agreement, the Subscribers agreed to subscribe for the Subscription Shares, being 33,284,300 new Shares in Guangzhou Hanfang, a 97.44% owned subsidiary of the Company as at the date of the Subscription Agreement.

Subscribers

GPHL (*Note 1*)

Huadong Chinese Medicine (*Note 2*)

Ms. Liu Ju Yan (*Note 3*)

Mr. Mo Shang Zhi (*Note 3*)

Mr. Cai Xing Chun (*Note 3*)

Mr. Zhao Xiang Yong (*Note 3,4*)

Mr. Ge Fa Huan (*Note 3,4*)

Notes:

1. GPHL is interested in approximately 63.26% of the issued share capital of the Company and is the controlling shareholder of the Company.
2. Huadong Chinese Medicine is an Independent Third Party.
3. The board of Guangzhou Hanfang comprises 3 Executive Directors, namely Ms. Liu Ju Yan, Mr. Mo Shang Zhi and Mr. Cai Xing Chun, and 4 non-executive directors. In addition to the Executive Directors, there are 2 senior staff members, namely Mr. Zhao Xiang Yong and Mr. Ge Fa Huan, who are involved in the active management of Guangzhou Hanfang. Thus, all the members of the active management of Guangzhou Hanfang have subscribed for Shares.
4. Mr. Zhao Xiang Yong and Mr. Ge Fa Huan are not connected with the Directors, chief executive or substantial shareholders of the Company or any of their respective associates. Neither of them hold shares in the Company.

As GPHL and the Executive Directors are connected persons of the Company, the Subscription constituted a connected transaction as defined in the respective listing rules of The Stock Exchange of Hong Kong Limited and the Shanghai Stock Exchange.

Consideration

The consideration for the Subscription Shares was RMB1 per Subscription Share. The total consideration paid by and the number of Subscription Shares received by each of the Subscribers were as follows:

Subscriber	Total consideration paid (RMB)	Number of Subscription Shares received
GPHL	25,634,300	25,634,300
Huadong Chinese Medicine	5,000,000	5,000,000
Ms. Liu Ju Yan	600,000	600,000
Mr. Mo Shang Zhi	550,000	550,000
Mr. Cai Xing Chun	500,000	500,000
Mr. Zhao Xiang Yong	500,000	500,000
Mr. Ge Fa Huan	500,000	500,000
	33,284,300	33,284,300

The consideration payable by GPHL was settled by Tangible Assets comprising the land use right of a piece of land (the “Land”) with an area of approximately 61,700 square meters situated at 中國廣東省從化市成郊鎮塘下村「園仔嶺」(“Yuan Zai-Ling” Tang Xia Village, Cheng Jiao Town, Cong Hua City, Guangdong Province, the PRC), six buildings (collectively, the “Buildings”), plant, machinery and other facilities. The Buildings in aggregate have a gross floor area of approximately 5,800 square meters and are situated on the Land. As at 31 December 2002, the Tangible Assets in aggregate were valued at RMB25,634,300 according to the “Asset Valuation Report Yang Ping Zhi No. 191 (2003)” issued by Guangzhou Yangcheng Certified Public Accountants. The details of the Tangible Assets including their respective valuation and book value as contained in the valuation report are set out below:

Class of assets	Book value (RMB)	Valuation (RMB)
1. land use right of the Land	7,188,700	11,126,000
2. Buildings, plant, machinery and others	18,336,100	14,508,300
Total	25,524,800	25,634,300

Save as being the auditor of the Company, Guangzhou Yangcheng Certified Public Accountants has no relationship with the Company, its directors, chief executive, substantial shareholders or their respective associates.

The land use right certificate and building certificates with respect to the Land and the Buildings respectively were issued to 廣州市電力總公司 (Guangzhou Electricity Corporation), the previous owner of the Land and the Buildings. The land use right certificate is valid until 2043. Pursuant to 廣州市財政局文件[2002] 583號 (Document no. [2002] 583 of Guangzhou Finance Bureau) dated 10 May 2002, the Tangible Assets (including the Land and Buildings) were allocated to GPLH at zero consideration. However, as at the date of this announcement, the land use right certificate and building certificates are still registered under the name of 廣州市電力總公司 (Guangzhou Electricity Corporation). In mid-April 2002, following the completion of the Subscription, both 廣州市電力總公司 (Guangzhou Electricity Corporation) and GPLH applied to 從化市國土資源和房屋管理局 (The Land Bureau of Cong Hua City) for the registration of the land use right certificate and building certificates under the name of Guangzhou Hanfang. Guangzhou Hanfang expects that it will obtain the land use right certificate and building certificates within two months from the date of this announcement.

The consideration payable by the remaining Subscribers, namely Huadong Chinese Medicine, Ms. Liu Ju Yan, Mr. Mo Shang Zhi and Mr. Cai Xing Chun, Mr. Zhao Xiang Yong and Mr. Ge Fa Huan was fully settled by cash by 15 April 2003.

Basis for determining the consideration

The Subscription Shares represented approximately 67% of the registered capital of Guangzhou Hanfang as at the date of the Subscription Agreement and approximately 40% of the registered capital of Guangzhou Hanfang as enlarged by the Subscription.

The consideration of RMB1 per Subscription Share represented a premium of approximately 18.9% over the net asset per Share of approximately RMB0.841 based on the audited net assets of Guangzhou Hanfang as at 31 December 2002.

The consideration had been arrived after arm's length negotiation between the Original Shareholders and the Subscribers. Given that Guangzhou Hanfang is a loss making company and the consideration per Subscription Share is at a premium over the net assets per Share of Guangzhou Hanfang as at 31 December 2002, the Directors consider that the terms of the Subscription Agreement were fair and reasonable and in the interests of the shareholders of the Company as a whole.

Rights of the Subscription Shares

The Subscription Shares impart the same rights in all respects as the Shares in existence before the completion of the Subscription Agreement, including the right to receive distributions made after 17 April 2003, being the date of the completion of the Subscription as set out below.

Restriction on the transfer of the Subscription Shares

The Company and Huadong Chinese Medicine, which are interested in approximately 54.03% and approximately 6.00% of the registered capital of Guangzhou Hanfang respectively following the completion of the Subscription Agreement, will not be allowed to dispose of, transfer or pledge the Shares owned by them within 3 years from the date of the Subscription Agreement, being 28 February 2003, unless otherwise agreed by all the shareholders of Guangzhou Hanfang. The remaining Subscribers are not subject to the above restrictions on the transfer of their shares.

Completion

The Subscription was completed on 17 April 2003, being the date on which the new business licence of Guanzhou Hanfang (reflecting its new registered capital and its new shareholding structure) was issued by 廣州市工商行政管理局(Guangzhou Industrial and Commerce Administration Bureau).

SHAREHOLDING STRUCTURE OF GUANGZHOU HANFANG IMMEDIATELY BEFORE AND AFTER THE SUBSCRIPTION

The Subscription introduced the Subscribers as new shareholders to Guangzhou Hanfang. Following the completion of the Subscription, the Company's interests (including direct and indirect interests) in the registered capital of Guangzhou Hanfang reduced from approximately 97.44% to approximately 58.49%. Set out below is the shareholding structure of Guangzhou Hanfang immediately before and after the completion of the Subscription:

Shareholders	Immediately before the completion of the Subscription		Immediately after the completion of the Subscription	
	No. of Shares	Approximate %	No. of Shares	Approximate %
<i>Original Shareholders</i>				
The Company	45,000,000	90.00	45,000,000	54.03
廣州陳李濟藥廠 (Guangzhou Chen Li Ji Chinese Medicine Factory) (Note 1)	2,000,000	4.00	2,000,000	2.40
廣州中一藥業有限公司 (Guangzhou First Chinese Medicine Co., Ltd.) (Note 2)	1,000,000	2.00	1,000,000	1.20
廣州敬修堂(藥業)股份有限公司 (Guangzhou Jing Xiu Tang Pharmaceutical Co., Ltd.) (Note 3)	850,000	1.70	850,000	1.02
廣州市醫藥工業研究所 (Guangzhou Pharmaceutical Industrial Research Institute)(Note 4)	1,150,000	2.30	1,150,000	1.39
<i>Subscribers</i>				
GPHL	—	—	25,634,300	30.78
Huadong Chinese Medicine	—	—	5,000,000	6.00
Ms. Liu Ju Yan	—	—	600,000	0.72
Mr. Mo Shang Zhi	—	—	550,000	0.66
Mr. Cai Xing Chun	—	—	500,000	0.60
Mr. Zhao Xiang Yong	—	—	500,000	0.60
Mr. Ge Fa Huan	—	—	500,000	0.60
Total	<u>50,000,000</u>	<u>100.00</u>	<u>83,284,300</u>	<u>100.00</u>

Notes:

- 廣州陳李濟藥廠 (Guangzhou Chen Li Ji Chinese Medicine Factory) is a wholly owned subsidiary of the Company.
- 廣州中一藥業有限公司 (Guangzhou First Chinese Medicine Co., Ltd.) is a 97.02% owned subsidiary of the Company.
- 廣州敬修堂(藥業)股份有限公司 (Guangzhou Jing Xiu Tang Pharmaceutical Co., Ltd.) is a 88.40% owned subsidiary of the Company.
- 廣州市醫藥工業研究所 (Guangzhou Pharmaceutical Industrial Research Institute) is a state-owned enterprise in the PRC. Its senior management, which is equivalent to the board of directors, consists of four members. All of them were directly or indirectly nominated by GPHL. Therefore, 廣州市醫藥工業研究所 (Guangzhou Pharmaceutical Industrial Research Institute) is under the management control of GPHL and is therefore regarded as an associate of GPHL and a connected person of the Company.

INFORMATION ON THE GROUP AND GUANGZHOU HANFANG

The Group

The Group is principally engaged in (i) the manufacture and sale of Chinese patent medicine and (ii) the wholesale, retail, import and export of western and Chinese pharmaceutical products and various medical apparatus.

Guangzhou Hanfang

Guangzhou Hanfang is a subsidiary of the Company, and the main research and development arm of the Group. It is principally engaged in (i) the development of new Chinese medicine; and (ii) research and development in new production methods for Chinese medicine. The Group is principally a manufacturer, rather than researcher, of pharmaceutical products, and Guangzhou Hanfang is only a small subsidiary when compared to the overall size of the Group. As at 31 December 2002 and 31 March 2003, it had audited net assets of approximately RMB42.1 million and unaudited net assets of approximately RMB40.5 million, both representing approximately 1.7% of the Group's net assets as at such dates respectively. In addition, as a research and development company, Guangzhou Hanfang does not generate revenue and therefore does not contribute to the profit of the Group. For the year ended 31 December 2002 and the three months ended 31 March 2003, Guangzhou Hanfang had an audited net loss of approximately RMB7.1 million and approximately RMB1.5 million, respectively. During the same periods, the Group had an audited net profit of approximately RMB94.6 million and an unaudited net profit of approximately RMB52.4 million, respectively.

INFORMATION ON THE SUBSCRIBERS

GPHL

GPHL is the controlling shareholder of the Company holding 513,000,000 shares, representing approximately 63.26% of the issued share capital of the Company as at the date of the Subscription Agreement and the date of this announcement. It is a state-owned enterprise in the PRC. Since its establishment in 1983, it has principally been engaged in the development, manufacture and trading of western pharmaceutical products.

Huadong Chinese Medicine

Huadong Chinese Medicine is an Independent Third Party. Since its establishment in 1990, it has principally been engaged in the research, development and manufacture of production equipment for Chinese medicine. It was accredited by 安徽省科學技術委員會 (The Science & Technology Committee of Anhui Province) in 1994 as an Advanced Technology Enterprise (高新技術企業) in the PRC. "Advanced Technology Enterprise" is a recognition for enterprises with valuable achievement in the development of technology. Advanced Technology Enterprises normally enjoy tax benefits in the PRC.

Management of Guangzhou Hanfang

The management of Guangzhou Hanfang consists of the Executive Directors, namely Ms. Liu Ju Yan, Mr. Mo Shang Zhi and Mr. Cai Xing Chun, and 2 senior management staff, namely Mr. Zhao Xiang Yong and Mr. Ge Fa Huan. Mr. Zhao Xiang Yong and Mr. Ge Fa Huan are Assistant General Managers and involved in the research and development operations of Guangzhou Hanfang.

REASONS FOR THE SUBSCRIPTION

The Directors consider the existing research and development in Chinese medicine and their production methods conducted by Guangzhou Hanfang are of strategic importance to the Group since it will help the Group to maintain its long term competitiveness in the market where new technology and new products are emerging every day.

Guangzhou Hanfang intends to set up a research and development center for conducting research in “modernized methods for extracting the useful ingredients of Chinese medicine” (中藥提取分離過程現代化) (the “Project”). At present, the production of Chinese medicine is largely based on traditional methods, such as boiling and grinding of herbs. The drawback of the traditional methods is that it produces medicine with redundant ingredients which are naturally present in the herbs. The quality of the medicine also tends to be inconsistent, since the traditional methods cannot control the proportion of useful and redundant ingredients. The aim of the Project is to develop new production methods which can extract the useful ingredients from the herbs without the redundant ingredients such that the medicine produced will have higher and more consistent quality.

Pursuant to the Subscription Agreement, GPLH and Huadong Chinese Medicine will become new shareholders of Guangzhou Hanfang. The Directors consider that the experience and expertise of GPLH and Huadong Chinese Medicine in the medical and pharmaceutical industry will be conducive to the Project. The Directors also consider the subscription of the Subscription Shares by the management of Guangzhou Hanfang will provide an incentive to the management and will be beneficial to the long term development of the Group.

In addition, the Tangible Assets will provide the facilities for Guangzhou Hanfang to implement the Project and to produce the medicine developed by it.

GENERAL

Guangzhou Hanfang is a relatively small subsidiary of the Group, the net assets of which represented only approximately 1.7% of the net assets of the Group as at 31 December 2002. However, since GPHL and the Executive Directors were connected persons of the Company, the Subscription Agreement constituted a connected transaction of the Company as defined in the respective listing rules of The Stock Exchange of Hong Kong Limited and the Shanghai Stock Exchange.

Under the Listing Rules, the Subscription Agreement should be conditional on the approval by the Independent Shareholders in general meeting. Due to an inadvertent oversight in reporting procedures by Guangzhou Hanfang, the Subscription Agreement was not made conditional on the approval by the Independent Shareholders before it was signed. Therefore, the Subscription constituted a breach of rule 14.26 of the Listing Rules. The Stock Exchange of Hong Kong Limited reserves the right to take action against the Company and/or the Directors in respect of this breach of the Listing Rules. In order to prevent recurrence of similar mistakes in the future, the Board intends to take the following remedial actions: (i) circulating a memorandum to the management of the subsidiaries of the Company to remind them of the obligations of the Listing Rules and to advise them to contact the Company Secretary Office in case of doubts; (ii) tightening the reporting procedure within the Group so that similar transactions will receive the attention of the Board; and (iii) providing training to the management of subsidiaries to enhance their awareness of the Listing Rules. The company secretary of the Company will be primarily responsible for overseeing the implementation of the above measures.

Given that the Subscription was completed on 17 April 2003, the Company does not propose to convene a shareholders' meeting to seek approval of the Subscription. Instead, the Company will form an independent board committee comprising the independent non-executive Directors to advise the Independent Shareholders on the terms of the Subscription Agreement and will appoint an independent financial adviser to advise the independent board committee. A circular containing, among other things, details of the Subscription Agreement, a letter containing the advice of the independent board committee to the Independent Shareholders and a letter of advice from an independent financial adviser to the independent board committee will be despatched to the shareholders of the Company on or before 1 September 2003.

DEFINITIONS

In this announcement, unless the context otherwise requires, the following expressions have the following meanings:

“Board”	the board of Directors
“Company”	廣州藥業股份有限公司 (Guangzhou Pharmaceutical Company Limited), a company incorporated in the PRC the securities of which are listed on The Stock Exchange of Hong Kong Limited and the Shanghai Stock Exchange

“Directors”	the directors of the Company
“Executive Directors”	the executor directors of Guangzhou Hanfang, namely Ms. Liu Ju Yan, Mr. Mo Shang Zhi and Mr. Cai Xing Chun
“Group”	the Company and its subsidiaries
“GPHL”	廣州醫藥集團有限公司 (Guangzhou Pharmaceutical Holdings Limited), a company incorporated in the PRC. It is interested in approximately 63.26% of the issued share capital of the Company and is the controlling shareholder of the Company
“Guangzhou Hanfang”	廣州漢方現代中藥研究開發有限公司 (Guangzhou Hanfang Modern Chinese Medicine Research and Development Limited), a company incorporated in the PRC and a 97.44% owned subsidiary of the Company before the completion of the Subscription and a 58.49% owned subsidiary of the Company after the completion of the Subscription
“Huadong Chinese Medicine”	華東中藥工程集團有限公司 (Huadong Chinese Medicine Engineering Group Limited), a company incorporated in the PRC and an Independent Third Party
“Independent Shareholders”	shareholders of the Company other than GPHL
“Independent Third Party”	a person or entity who/which is not a connected person of the Company as defined in the Listing Rules
“Listing Rules”	Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited
“Original Shareholders”	the shareholders of Guangzhou Hanfang prior to the completion of the Subscription Agreement, namely the Company, 廣州陳李濟藥廠 (Guangzhou Chen Li Ji Chinese Medicine Factory), 廣州中一藥業有限公司 (Guangzhou First Chinese Medicine Co., Ltd.), 廣州敬修堂 (藥業) 股份有限公司 (Guangzhou Jing Xiu Tang Pharmaceutical Co., Ltd.), and 廣州市醫藥工業研究所 (Guangzhou Pharmaceutical Industrial Research Institute)
“PRC”	the People’s Republic of China

“RMB”	Renminbi, the official currency of the PRC
“Share(s)”	a unit (units) of RMB1 in the registered capital of Guangzhou Hanfang
“Subscribers”	GPHL, Huadong Chinese Medicine, the Executive Directors, Mr. Zhao Xiang Yong and Mr. Ge Fa Huan
“Subscription”	the subscription of the Subscription Shares by the Subscribers pursuant to the Subscription Agreement
“Subscription Agreement”	the unconditional subscription agreement dated 28 February 2003 entered into among the Original Shareholders and the Subscribers
“Subscription Shares”	33,284,300 new Shares subscribed by the Subscribers pursuant to the Subscription Agreement
“Tangible Assets”	the tangible assets injected into the Guangzhou Hanfang as the consideration for the Subscription Shares subscribed by GPHL
“%”	per cent.

By order of the Board
He Shuhua
Company Secretary

Guangzhou, the PRC, 11 August 2003

Please also refer to the published version of this announcement in The Standard / Hong Kong Economic Times.