

---

**THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION**

---

**If you are in any doubt** about this circular or as to the action to be taken, you should consult your stockbroker or other registered dealer in securities, bank manager, solicitor, professional accountant or other professional advisor.

**If you have sold or transferred** all your shares in Guangzhou Pharmaceutical Company Limited (the “Company”), you should at once hand this circular to the purchaser or transferee or to the bank, stockbroker or other agent through whom the sale or transfer was effected for transmission to the purchaser or transferee.

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



**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**

**Financial adviser to the Company**

**CAOH**

**Celestial Capital Limited**

**Joint independent financial advisers to the Independent Board Committee**



**Karl Thomson Financial Advisory Limited**



**Barits Securities (Hong Kong) Limited**

---

A letter from the Independent Board Committee is set out on page 14 of this circular.

A letter from Karl Thomson and Barits containing their advice to the Independent Board Committee is set out on pages 15 to 22 of this circular.

1 September 2003

---

## CONTENTS

---

	<i>Page</i>
<b>DEFINITIONS .....</b>	1
 <b>LETTER FROM THE BOARD</b>	
1. Introduction .....	4
2. Subscription Agreement .....	5
3. Shareholding Structure of Guangzhou Hanfang .....	9
4. Information on the Group and Guangzhou Hanfang .....	10
5. Information on the Subscribers .....	11
6. Reasons for the Subscription .....	11
7. Connected Transaction .....	12
8. Recommendation .....	13
9. Further Information .....	13
<b>LETTER FROM THE INDEPENDENT BOARD COMMITTEE .....</b>	14
<b>LETTER FROM KARL THOMSON AND BARITS .....</b>	15
<b>APPENDIX I - VALUATION REPORTS .....</b>	23
<b>APPENDIX II - GENERAL INFORMATION .....</b>	37

---

## DEFINITIONS

---

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

“A Share(s)”	Renminbi-donominated domestic share(s) in the ordinary share capital of the Company, with a nominal value of RMB1.00 each
“associates”	has the meaning ascribed to it under the Listing Rules
“Barits”	Barits Securities (Hong Kong) Limited, the joint independent financial adviser to the Independent Board Committee and a deemed licenced corporation under the SFO.
“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 and the Shanghai Stock Exchange
“Directors”	the directors of the Company
“GH Executive Directors”	all the executive directors of Guangzhou Hanfang, namely Ms. Liu Ju Yan, Mr. Mo Shang Zhi and Mr. Cai Xing Chun
“GH Share(s)”	a unit (units) of RMB1 in the registered capital of Guangzhou Hanfang
“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 an approximately 97.44% owned subsidiary of the Company before the completion of the Subscription and an approximately 58.49% owned subsidiary of the Company after the completion of the Subscription

---

## DEFINITIONS

---

“H Share(s)”	overseas listed foreign share(s) in the ordinary share capital of the Company, with a nominal value of RMB1.00 each, which are listed on the Stock Exchange.
“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 Board Committee”	the independent board committee of the Board comprising Mr. Chu Youlin, David, Mr. Zhang Bohua, Mr. Liu Jinxiang, Mr. Wu Zhang and Mr. Huang Buren who are the independent non-executive Directors
“Independent Shareholders”	Shareholders other than GPHL and their associates
“Independent Third Party”	a person or entity who/which is not a connected person of the Company or its subsidiaries as defined in the Listing Rules
“Karl Thomson”	Karl Thomson Financial Advisory Limited, the joint independent financial adviser to the Independent Board Committee and a deemed licensed corporation under the SFO
“Latest Practicable Date”	27 August 2003, being the latest practicable date prior to the printing of this circular for ascertaining certain information herein
“Listing Rules”	Rules Governing the Listing of Securities on the Stock Exchange
“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
“SFO”	the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong)

---

## DEFINITIONS

---

“Stock Exchange”	The Stock Exchange of Hong Kong Limited
“Shareholders”	shareholders of the Company
“Share(s)”	share(s) of RMB1 each in the capital of the Company
“Subscribers”	GPHL, Huadong Chinese Medicine, the GH 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 GH 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.

---

LETTER FROM THE BOARD

---



**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)*

*Executive Directors*

Mr. CAI Zhixiang  
Mr. LI Yimin  
Mr. FENG Zansheng  
Mr. ZHOU Yuejin

*Independent non-executive Directors*

Mr. CHU Youlin, David  
Mr. ZHANG Bohua  
Mr. LIU Jinxiang  
Mr. WU Zhang  
Mr. HUANG Buren

*Supervisors*

Mr. CHEN Canying  
Mr. TAN Sima  
Mr. LUO Jidong

*Registered office and*

*principal place of business*

45 Sha Mian North Street,  
Guangzhou City,  
Guangdong Province, PRC

*Place of business in Hong Kong*

Room 2005, 20th Floor  
Tower Two, Lippo Center  
89 Queensway  
Hong Kong

1 September 2003

*To the Shareholders*

Dear Sir or Madam,

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

**1. INTRODUCTION**

The Board announced on 11 August 2003 that the Original Shareholders and the Subscribers entered into the Subscription Agreement on 28 February 2003 whereby the Subscribers agreed to subscribe for 33,284,300 new GH Shares at RMB1 per GH Share.

---

## LETTER FROM THE BOARD

---

The consideration of RMB1 per Subscription Share represented a premium of approximately 18.9% over the net assets per GH 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 GPLH and the GH Executive Directors, each being one of the Subscribers, were connected persons of the Company, the Subscription Agreement constituted a connected transaction of the Company under the Listing Rules.

The purpose of this circular is (i) to provide you with the details of the Subscription Agreement; and (ii) to set out the advice of the Independent Board Committee and the joint independent financial advisers with respect to the terms of the Subscription Agreement.

## 2. 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 GH Shares, in Guangzhou Hanfang, an approximately 97.44% owned subsidiary of the Company as at the date of the Subscription Agreement.

### **Subscribers**

GPLH (*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*)

---

## LETTER FROM THE BOARD

---

*Notes:*

1. GPLH 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, 2 senior staff members of Guangzhou Hanfang, namely Mr. Zhao Xiang Yong and Mr. Ge Fa Huan, are also involved in the active management of Guangzhou Hanfang. Thus, all the members of the active management of Guangzhou Hanfang have subscribed for Subscription 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 holds shares in the Company.

As GPLH and the GH Executive Directors were connected persons of the Company, the Subscription constituted a connected transaction under the Listing Rules.

### **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:

<b>Subscriber</b>	<b>Total consideration paid (RMB)</b>	<b>Number of Subscription Shares received</b>
GPLH	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
	<u>33,284,300</u>	<u>33,284,300</u>



---

## LETTER FROM THE BOARD

---

The consideration payable by GPLH for its Subscription shares was settled by the Tangible Assets comprising the land use rights of a piece of land (the “Land”) with a total area of approximately 61,700 square meters situated at 從化市桃園鎮雲星大道268號(No.268, Yun Xing Da Road, Tao Yuan Town, Cong Hua City, Guangdong Province, the PRC) (formerly known as 中國廣東省從化市城郊鎮塘下村「園仔嶺」 (“Yuan Zai-Ling” Tang Xia Village, Cheng Jiao Town, Cong Hua City, Guangdong Province, the PRC)), six buildings (collectively, the “Buildings”), ancillary structures, machinery and equipment. The Buildings in aggregate have a gross floor area of approximately 5,800 square meters and are situated on the Land. For details of the Tangible Assets, please refer to the valuation reports of Greater China Appraisal Limited set out in Appendix I of this circular.

The original owner of the Tangible Assets was 廣州市電力總公司 (Guangzhou Electricity Corporation). 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 were allocated to GPLH at zero consideration. GPLH, in turn, transferred the Tangible Assets to Guangzhou Hanfang as consideration for its Subscription Shares. Guangzhou Hanfang has obtained a State-owned Land Use Right Certificate and six Real Estate Ownership Certificates with respect to the Land and Buildings as follows:

<b>Certificates</b>	<b>Date of issue</b>	<b>Issuing Authority</b>	<b>Expiry date</b>
State-owned Land Use Right Certificate	26 August 2003	People’s Government of Cong Hua City	21 December 2043
6 Real Estate Ownership Certificates	27 August 2003	People’s Government of Guangdong Province	21 December 2043

According to the PRC legal opinion dated 29 August 2003 issued by Z & T Law Firm, the above certificates entitle Guangzhou Hanfang to freely transfer, lease, and mortgage the Land and Buildings during their unexpired terms without paying any additional land premium to the relevant government authorities.

For the purpose of determining the consideration for the Subscription shares, the value of the Tangible Assets was based on the valuation of Guangzhou Yangcheng Certified Public Accountants in the amount of RMB25,634,300 as at 31 December 2002. For the purpose of this circular, Greater China Appraisal Limited, was appointed by the Company as an independent valuer to issue an updated valuation of the Tangible Assets. The Tangible Assets were valued by Greater China Appraisal Limited at the aggregate amount of RMB25,980,000 as at 30 June 2003. The valuation reports of Greater China Appraisal Limited are set out in Appendix I to this circular.

---

## LETTER FROM THE BOARD

---

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 66.57% of the registered capital of Guangzhou Hanfang as at the date of the Subscription Agreement and approximately 39.96% 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 GH 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. The Board consider that the terms of the Subscription Agreement were fair and reasonable and were in the interests of the Company and the Shareholders as a whole.

### **Rights of the Subscription Shares**

The Subscription Shares impart the same rights in all respects as the GH 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 GH 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 GH 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).

---

**LETTER FROM THE BOARD**

---

### 3. SHAREHOLDING STRUCTURE OF GUANGZHOU HANFANG

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 GH Shares	Approximate %	No. of GH 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>

---

## LETTER FROM THE BOARD

---

Notes:

1. 廣州陳李濟藥廠 (Guangzhou Chen Li Ji Chinese Medicine Factory) is a wholly owned subsidiary of the Company.
2. 廣州中一藥業有限公司 (Guangzhou First Chinese Medicine Co., Ltd.) is an approximately 97.02% owned subsidiary of the Company.
3. 廣州敬修堂(藥業)股份有限公司 (Guangzhou Jing Xiu Tang Pharmaceutical Co., Ltd.) is an approximately 88.40% owned subsidiary of the Company.
4. 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.

#### 4. 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. 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 an unaudited net loss of 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.

## **5. 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 Latest Practicable Date. It is a state-owned enterprise in the PRC. Since its establishment in 1983, it has principally 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 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 GH 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 are involved in the research and development operations of Guangzhou Hanfang.

## **6. 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.

---

## LETTER FROM THE BOARD

---

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 have 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.

### 7. CONNECTED TRANSACTION

Since GPLH and the GH Executive Directors were connected persons of the Company, the Subscription Agreement constituted a connected transaction of the Company under the respective listing rules of the Stock Exchange and the Shanghai Stock Exchange.

Under the Listing Rules, the Subscription Agreement should have been 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.

Given that the Subscription was completed on 17 April 2003 and is irrevocable, the Board does not propose to convene a general meeting to seek ratification of the Subscription. Instead, the Board has formed the Independent Board Committee, comprising Mr. Chu Youlin, David, Mr. Zhang Bohua, Mr. Liu Jinxiang, Mr. Wu Zhang and Mr. Huang Buren, who are the independent non-executive Directors, to advise the Independent Shareholders as to whether the terms of the Subscription Agreement were fair and reasonable and in the interests of the Company and the Shareholders as a whole. Furthermore, the Board has appointed Karl Thomson and Barits to advise the Independent Board Committee.

---

## LETTER FROM THE BOARD

---

### 8. RECOMMENDATION

Your attention is drawn to the “Letter from the Independent Board Committee” set out on page 14 of this circular which contains advice from the Independent Board Committee to the Independent Shareholders and the “Letter from Karl Thomson and Barits ” set out on pages 15 to 22 of this circular which contains the advice from Karl Thomson and Barits to the Independent Board Committee.

### 9. FURTHER INFORMATION

Your attention is drawn to the additional information set out in the appendices to this circular.

For and on behalf of the Board

**Cai Zhixiang**

*Chairman*

---

LETTER FROM THE INDEPENDENT BOARD COMMITTEE

---



**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)*

1 September 2003

*To the Independent Shareholders*

Dear Sir or Madam,

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

We refer to the circular of the Company dated 1 September 2003 (the "Circular"), of which this letter forms part. The terms used in the Circular shall have the same meanings when used in this letter, unless the context requires otherwise.

We, being the independent non-executive Directors constituting the Independent Board Committee, have been appointed by the Board to advise you as to whether the terms of the Subscription Agreement were fair and reasonable so far as the Independent Shareholders were concerned and the Subscription was in the interests of the Company and the Shareholders as a whole. Karl Thomson and Barits have been appointed as the joint independent financial advisers to advise us regarding the Subscription Agreement. Details of their advice, together with the principal factors and reasons taken into consideration in arriving at such advice, are set out in their letter on pages 15 to 22 of the Circular. Your attention is also drawn to the "Letter from the Board" set out on pages 4 to 13 and the additional information set out in the appendices to the Circular.

Having considered the principal factors, reasons and the opinion mentioned in the letter of advice from Karl Thomson and Barits, we consider the terms of the Subscription Agreement were fair and reasonable so far as the Independent Shareholders were concerned and that the Subscription was in the interests of the Company and the Shareholders as a whole. Accordingly, we would have recommended the Independent Shareholders to vote in favour of the Subscription Agreement had a general meeting been held.

Yours faithfully,

For and on behalf of

**Independent Board Committee**

**Chu Youlin, David**

Independent  
non-executive  
Director

**Zhang Bohua**

Independent  
non-executive  
Director

**Liu Jinxiang**

Independent  
non-executive  
Director

**Wu Zhang**

Independent  
non-executive  
Director

**Huang Buren**

Independent  
non-executive  
Director



---

## LETTER FROM KARL THOMSON AND BARITS

---

*The following is the text of a letter of advice to the Independent Board Committee from Karl Thomson and Barits in connection with the Subscription Agreement, which has been prepared for the purpose of inclusion in this circular.*



**Karl Thomson Financial Advisory Limited**

Room 801, Tower One  
Lippo Centre  
89 Queensway  
Central  
Hong Kong



**Barits Securities (Hong Kong) Limited**

Room 3406, 34/F  
Edinburgh Tower, The Landmark  
15 Queen's Road Central  
Hong Kong

1 September 2003

*To The Independent Board Committee  
Guangzhou Pharmaceutical Company Limited*

Dear Sirs,

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

**INTRODUCTION**

We, Karl Thomson and Barits, refer to our appointment as the joint independent financial advisers to advise the Independent Board Committee as regards the fairness and reasonableness of the terms of the Subscription Agreement. Details of the Subscription Agreement are set out in the "Letter from the Board" contained in this circular, of which this letter forms part. Unless otherwise defined, capitalised terms used in this letter shall have the same meanings as defined in this circular.

---

## LETTER FROM KARL THOMSON AND BARITS

---

On 11 August 2003 the Company announced that the Original Shareholders and the Subscribers entered into the Subscription Agreement on 28 February 2003 whereby the Subscribers agreed to subscribe for 33,284,300 new GH Shares for a total consideration of RMB33,284,300 (equivalent to RMB1 per GH Share). The Subscription Shares represented approximately 66.57% of the registered capital of Guangzhou Hanfang immediately before the Subscription and approximately 39.96% of the registered capital of Guangzhou Hanfang as enlarged by the Subscription. As a result of the Subscription, the registered capital of Guangzhou Hanfang increased from 50,000,000 shares to 83,284,300 shares whereas the Company's interests (including direct and indirect) in the registered capital of Guangzhou Hanfang reduced from approximately 97.44% to approximately 58.49%. Of those Subscribers, GPLH and the GH Executive Directors are connected persons of the Company, the Subscription Agreement therefore constituted a connected transaction of the Company under the respective listing rules of the Stock Exchange and the Shanghai Stock Exchange, and should have been conditional on the approval of the Independent Shareholders under the Listing Rules.

However, due to an inadvertent oversight in the reporting procedures by Guangzhou Hanfang, the Subscription Agreement was not made conditional on the approval by the Independent Shareholders before it was signed. The Subscription, therefore, constituted a breach of rule 14.26 of the Listing Rules and the Stock Exchange has stated that it reserves the right to take action against the Company and/or the Directors in respect of this breach of the Listing Rules. Shareholders should note that as the Subscription under the Subscription Agreement was completed on 17 April 2003, being the date on which the new business licence reflecting the new registered capital and the new shareholding structure of Guangzhou Hanfang was issued by 廣州市工商行政管理局 (Guangzhou Industrial and Commerce Administration Bureau), the Subscription is not revocable.

In formulating our opinion and advice, we have relied on the accuracy of the information and facts supplied, and the representations expressed, by the Directors and have assumed that all information, facts and representations made to us are true and accurate at the time they were made and will continue to be true at the date of this circular. The Directors have also confirmed that the information and facts supplied to us are completed, and that no material facts have been omitted from the information supplied and representations expressed. We have no reason to doubt the truth, accuracy and completeness of the information provided, and representations made, to us by the Directors. We have relied on such information and consider that the information that we have received is sufficient for us to reach an informed view on the terms of the Subscription Agreement and provide us with a reasonable basis for our recommendation. We have not, however, conducted an independent investigation into the business affairs, financial position or future prospects of the Group nor have we carried out any independent verification of the information supplied.

---

## LETTER FROM KARL THOMSON AND BARITS

---

### PRINCIPAL FACTORS AND REASONS TAKEN INTO ACCOUNT

In arriving at our opinion in respect of the Subscription Agreement, we have taken into account the following principal factors:

**1. Businesses and background of the Group, Guangzhou Hanfang and the Subscribers**

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, one of the Company's subsidiaries which accounted for approximately 1.7% of the audited net assets of the Group as at 31 December 2002, is principally engaged in (i) the development of new Chinese medicine; and (ii) research and development in new production methods for Chinese medicine. Guangzhou Hanfang is the main research and development arm of the Group. As at 31 December 2002 and 31 March 2003, Guangzhou Hanfang had audited and unaudited net assets of approximately RMB42.1 million and approximately RMB40.5 million respectively. For the year ended 31 December 2002 and the three months ended 31 March 2003, Guangzhou Hanfang incurred audited and unaudited net loss of approximately RMB7.1 million and approximately RMB1.5 million respectively.

Among the seven Subscribers to the Subscription Agreement, two are PRC enterprises and five are individuals. GPLH is a PRC state-owned enterprise which has almost 20 years of history in the business of development, manufacture and trading of western pharmaceutical products while Huadong Chinese Medicine is a PRC enterprise that has since 1990 been principally engaged in the research, development and manufacture of production equipment for Chinese medicine. The individual Subscribers are the GH Executive Directors and Mr. Zhao Xiang Yong and Mr. Ge Fa Huan. We are advised by the Directors that all of the individual Subscribers are currently the senior management of Guangzhou Hanfang and, in particular, Mr. Zhao Xiang Yong and Mr. Ge Fa Huan are the Assistant General Managers involving in Guangzhou Hanfang's research and development operations.

---

## LETTER FROM KARL THOMSON AND BARITS

---

### 2. Reasons for the Subscription

The reasons for entering into the Subscription Agreement are set out in the paragraph headed "Reasons for the Subscription" in the "Letter from the Board" in this circular.

We are informed by the Directors that they consider the future for the pharmaceutical and medicine businesses in the PRC are full of challenges and opportunities as a result of the PRC's accession into the World Trade Organisation and the rapid development of natural medicine in the global market. With an aim to capture these opportunities, the Group will continue to put more effort on the research and development of new products. The Directors are of the view that given Guangzhou Hanfang is the main research and development arm of the Group, its successfulness in fulfilling its duties is of great importance to the Group. In addition, the function of Guangzhou Hanfang in the Group before the Subscription was limited to research and development only and without the ability to generate revenue. The Directors expected that through the Subscription, by introducing the Subscribers as new additional shareholders who are all experienced with expertise in the medicine and pharmaceutical businesses to Guangzhou Hanfang, the Subscribers would strengthen Guangzhou Hanfang's ability in (i) exploring new products; and (ii) realizing its business plan regarding the Project as mentioned under the paragraph headed "Reason for the Subscription" set out in the "Letter from the Board". The Subscription in return will enable Guangzhou Hanfang to generate revenue as more new products will be developed and produced, thereby enhancing the Group's competitiveness in the pharmaceutical and medicine markets in the PRC .

Having taken into consideration (i) the principal business activities of the Group and that of the corporate Subscribers, being GPLH and Huadong Chinese Medicine; (ii) the expertise and experience of the individual Subscribers, being the GH Executive Directors, Mr. Zhao Xiang Yong and Mr. Ge Fa Huan; (iii) the loss making history of Guangzhou Hanfang, we consider that the reason for entering into the Subscription Agreement between the Original Shareholders and the Subscribers is justified.

---

## LETTER FROM KARL THOMSON AND BARITS

---

### 3. Consideration

The consideration of RMB1 per Subscription Share, which had been arrived after arm's length negotiation between the Original Shareholders and the Subscribers, represented a premium of approximately 18.9% over the net asset per GH Share of approximately RMB0.841 based on the audited net assets of Guangzhou Hanfang as at 31 December, 2002. Having taken into account that Guangzhou Hanfang is a loss making company and that the consideration per Subscription Share is at a premium over the net assets per GH Share as at 31 December 2002, we consider the consideration of RMB1 per Subscription Share is in the interests of the Company and its Shareholders as a whole.

#### *Form of consideration*

The total consideration under the Subscription Agreement was satisfied as to approximately 77.02% (equivalent to RMB25,634,300) by Tangible Assets and as to approximately 22.98% (equivalent to RMB7,650,000) by cash. As advised by Z & T Law Firm (廣東正平天成律師事務所), the Company's legal advisers as to PRC laws (the "PRC Legal Advisers"), the cash consideration was fully settled based on a copy of the Investment Verification Report (驗資報告) issued by Guangzhou Yangcheng Certificated Public Accountants Company Limited (廣州羊城會計師事務所有限公司) provided by the Company.

As set out in the sub-paragraph headed under "Consideration" in the "Letter from the Board", the composition of Tangible Assets comprising the Land, Buildings, ancillary structures, machinery and equipment.

---

## LETTER FROM KARL THOMSON AND BARITS

---

The land use right certificate and real estate ownership certificates with respect to the Land and the Building were issued to 廣州市電力總公司 (Guangzhou Electricity Corporation), the previous owner of the Land and the Buildings. Both the land use right certificate and the real estate ownership certificates are valid until 21 December 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 the Buildings) were allocated to GPLH at zero consideration. In mid-April 2003, following 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 the real estate ownership certificates under the name of Guangzhou Hanfang. We are advised by the Directors that on 26 August 2003 and 27 August 2003, Guangzhou Hanfang has successfully obtained the respective new land use rights certificate and the new real estate ownership certificates under its own name. In this regards, we have been provided with a legal opinion on, among others, the title to the Land and the Buildings issued by the PRC Legal Advisers dated 29 August 2003, confirming that, in their opinion, (i) Guangzhou Hanfang has successfully obtained the new land use rights certificate and the new real estate ownership certificates in its own name and the Land, Buildings and its ancillary structures as set out in the valuation reports in Appendix I to this circular are therefore legally owned by Guangzhou Hanfang; (ii) Guangzhou Hanfang has the entire ownership of the machinery and equipment as set out in the valuation report in Appendix I to this circular. The PRC Legal advisers are also of the view that effective from the respective date of the new land use rights certificate and the new real estate ownership certificates up to 21 December 2043, being the date of expiry of the terms of the new land use rights certificate and the new real estate ownership certificates, the Land and the Buildings owned by Guangzhou Hanfang can be freely transferred, leased or mortgaged to third parties without paying any additional land premium to the relevant government authorities.

The Company has engaged Greater China Appraisal Limited ("Greater China") to perform a valuation on the Tangible Assets. Details of the valuation reports are set out in Appendix I to this circular.

In assessing the consideration, we have reviewed and discussed with Greater China the methodology of, and the basis and assumptions adopted in performing the valuation. According to Greater China, as there is no readily identifiable market comparable for (i) the Buildings and the ancillary structures; and (ii) the machinery and equipment, they have adopted the depreciated replacement cost method. Under the principle of the depreciated replacement cost method, the valuation for the Land, Buildings and the ancillary structures requires an estimate of the market value of the existing use of the land, plus the current gross replacement (reproduction) costs of the improvement, less allowances for physical deterioration and all relevant forms of obsolescence and optimization. As regards the machinery and equipment, the depreciated replacement cost method establishes value based on the cost of reproducing or replacing the assets, less depreciation from physical deterioration, and functional and economic/external obsolescence.

---

## LETTER FROM KARL THOMSON AND BARITS

---

We are advised by Greater China that they are of the view that the depreciated replacement cost method generally furnishes the most reliable indication of value for property/assets in the absence of a known market based on market comparable. As regards the Land, the valuation performed by Greater China was based on comparison method where land comparables were analysed and adjusted for application. In the absence of readily identifiable market comparable as represented by Greater China, we consider the methodology adopted by Greater China in performing the valuation is fair and reasonable.

The Tangible Assets have been valued by Greater China at an aggregate value of RMB25,980,000 as at 30th June, 2003. The consideration under the Subscription Agreement, which was settled by the Tangible Assets amounting to RMB25,634,300, represents a discount of approximately 1.33% to Greater China's valuation, which we consider to be acceptable to the Company and its Shareholders as a whole.

Having taken into account the reasons for the Subscription as set out on pages 11 to 12 in the "Letter from the Board", we consider that by using Tangible Assets as part of the consideration for the Subscription Shares could assist Guangzhou Hanfang to implement the Project. In addition, we are of the opinion that the payment of cash consideration provides additional working capital to finance Guangzhou Hanfang's operation in the future.

#### **4. Other factors to consider**

##### *Effect on shareholding*

Immediately following the completion of the Subscription, the Company's effective interests in the registered capital of Guangzhou Hanfang was reduced from approximately 97.44% to approximately 58.49%. Taking into account that the dilution is the result of introducing the Subscribers as new additional shareholders in Guangzhou Hanfang which would result in strengthening the research and development function of the Group, but without the need to draw a significant amount of the Group's financial resources, we consider such dilution to be acceptable and fair and reasonable to Independent Shareholders.

---

## LETTER FROM KARL THOMSON AND BARITS

---

### *Restriction on the transfer of the Subscription Shares*

Pursuant to the Subscription Agreement, both the Company and Huadong Chinese Medicine are subject to a lock up period of three years from the date of the Subscription Agreement, being 28 February 2003, during which they are not allowed to dispose of, transfer or pledge their GH Shares. We are informed by the Directors that since the experience and expertise possessed by Huadong Chinese Medicine are of great importance to the implementation of the Project, the terms for restricting Huadong Chinese Medicine to transfer its ownership in the Subscription Shares helps secure its commitment to Guangzhou Hanfang and the Project. In return, by agreeing to such a lock up, Huadong Chinese requested the Company to be subject to the same lock up. The Directors are of the view that by agreeing to restrict the Company from disposing of its shareholding in Guangzhou Hanfang, the Company can demonstrate to Huadong Chinese Medicine its commitment in Guangzhou Hanfang. On an assessment of the overall benefits of the Subscription to the Company as discussed in this letter, we consider that the restriction is acceptable to the Company and its Shareholders as a whole.

### **OPINION**

Having considered the above principal factors and reasons, we are of the opinion that the terms of the Subscription Agreement were fair and reasonable so far as the Independent Shareholders were concerned and that the Subscription was in the interests of the Company and the Shareholders as a whole. Accordingly, we would advise the Independent Board Committee to recommend the Independent Shareholders to vote in favour of the resolution in relation to the Subscription Agreement had a general meeting of the Independent Shareholders been held for considering and passing such a resolution.

Yours faithfully,

For and on behalf of

**Karl Thomson Financial Advisory Limited**

**Alex Chow**

*Director*

Yours faithfully,

For and on behalf of

**Barits Securities (Hong Kong) Limited**

**Terence Hong/ Alfred Wong**

*Executive Director/ Director*



*The following is an extract from the valuation reports prepared for the purpose of incorporation in this circular received from Greater China Appraisal Limited, an independent valuer, in connection with their valuations as at 30 June 2003 of the Tangible Assets, comprising (i) land, buildings and ancillary structures; and (ii) machinery and equipment.*

## **1. LAND, BUILDINGS AND ANCILLARY STRUCTURES**

### **GREATER CHINA APPRAISAL LIMITED**

**漢華 評 值 有 限 公 司**

---

2407 Shui On Centre  
6-8 Harbour Road  
Wanchai  
Hong Kong

1 September, 2003

The Directors  
Guangzhou Pharmaceutical Company Limited  
No. 45 Sha Mian Bei Street  
Liwan District  
Guangzhou  
Guangdong Province  
The People's Republic of China

Dear Sirs,

In accordance with the instructions from Guangzhou Pharmaceutical Company Limited (the "Company") to value the property interest in the People's Republic of China (referred to as the "PRC"), we confirm that we have carried out inspection, made relevant enquiries and obtained such further information as we consider necessary for the purposes of providing you with our opinion of the value of such interest as at 30 June, 2003 (referred to as the "valuation date").

This letter which forms parts of our valuation report explains the basis and methodology of valuation, and clarifies our assumptions made, titleship of properties and the limiting conditions.

### **BASIS OF VALUATION**

The valuation of the property interest is our opinion of the market value which we would define as intended to mean:

"The estimated amount for which an asset should exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion."

In the course of our valuation, we have valued the property interest in its designed uses with the understanding that the property will be used as such (hereafter referred to as “continued use”).

## **VALUATION METHODOLOGY**

Due to the nature of buildings and structures constructed, there are no readily identifiable market comparable for them. Therefore, we have applied the depreciated replacement cost method in assessing the property. It is a method of using current replacement costs to arrive at the value to the business in occupation of the property as existing at the valuation date.

This method of valuation requires an estimate of the market value of the existing use of the land, plus the current gross replacement (reproduction) costs of the improvement, less allowances for physical deterioration and all relevant forms of obsolescence and optimization. The depreciated replacement cost approach generally furnishes the most reliable indication of value for property in the absence of a known market based on market comparable.

Valuation of land is made by comparison method where land comparables were analysed and adjusted for application in the valuation.

Physical deterioration is the loss in value resulting from wear and tear in operation and exposure to the elements.

Functional obsolescence is the loss in value caused by conditions within the assets such as changes in design, materials, or process that result in inadequacy, overcapacity, lack of utility, or excess operating costs.

Economic/external obsolescence is an incurable loss in value caused by unfavorable conditions external to the asset such as the local economy, economics of the industry, availability of financing, encroachment of objectionable enterprises, loss of material and labour sources, lack of efficient transportation, shifting of business centers, passage of new legislation and changes in ordinances.

## **ASSUMPTIONS**

Our valuation has been made on the assumption that the owner sells the relevant property interest in its continued use on the market without the benefit of deferred term contracts, leaseback, joint ventures, management agreements or any similar arrangements which would serve to increase the value of such interest. In addition, no forced sale situation in any manner is assumed in our valuation.

For the property interests which has been assessed by reference to the ‘Depreciated Replacement Cost’ approach, our opinion of values are subject of the fact that prospective earnings would provide a reasonable return on the appraised property, plus the value of any assets not included in the appraisal, and adequate net working capital.

Continued use assumes the property will be used for the purposes for which the property is designed and built, or to which it is currently adapted. The valuation on the property in continued use does not represent the amount that might be realized from piecemeal disposition of the property on the open market.

For the property which is held under long term land use rights, we have assumed that the owner of the property interests has free and uninterrupted rights to use the property for the whole of the unexpired term of its respective land use rights. Furthermore, we have valued it on the assumption that it can be freely disposable and transferable for its existing use to third parties in the open market without paying any premium to the PRC government. Unless stated as otherwise, vacant possession is assumed for the property concerned.

We have assumed that all consents, approvals and licenses from relevant government authorities for the buildings and structures erected thereon have been granted. Also, we have assumed that all buildings and structures fall within the site are held by the owner or permitted to be occupied by the owner.

It is assumed that all applicable zoning and use regulations and restrictions have been complied with unless nonconformity has been stated, defined, and considered in the appraisal report. Moreover, it is assumed that the utilization of the land and improvements is within the boundaries of the property described and that no encroachment or trespass exists, unless noted in the report.

No environmental impact study has been ordered or made. Full compliance with applicable national, provincial and local environmental regulations and laws is assumed unless otherwise stated, defined, and considered in the report. It is also assumed that all required licenses, consents, or other legislative or administrative authority from any local, provincial, or national government or private entity or organization either have been or can be obtained or renewed for any use which the report covers.

We believed that the assumptions so made by us are reasonable in the circumstances. We have also assumed that all consents, approvals and licenses from relevant government authorities for the properties have been granted without any onerous conditions or undue time delay which might affect the value.

Other special assumptions of each property, if any, have been stated out in the footnotes of the valuation certificate for the respective properties.

## **TITLE INVESTIGATION**

For the property interests located in the PRC, we have been provided with copy of title documents regarding the properties under valuation. However, due to the current registration system of the PRC, no investigations have been made for the legal title or any liabilities attached to the properties.

As far as the land and buildings in the PRC are concerned, we have relied upon the legal opinion (the “Legal Opinion”) dated 29 August, 2003 given by 廣東正平天成律師事務所 (Z&T Law Firm) (referred to as the “PRC Legal Advisers”) in relation to the legal title to and the nature of the interest in the Land and the Buildings (as defined in the valuation certificate) concerned. Summary of the Legal Opinion is listed in footnote no. 3 of the valuation certificate.

All legal documents disclosed in this report are for reference only and no responsibility is assumed for any legal matters concerning the legal title to the property described in this report.

## **LIMITING CONDITIONS**

We have not carried out detailed site measurement to verify the correctness of the site areas in respect of the relevant properties but have assumed that the site areas shown on the documents and official site plans handed to us are correct. Based on our experience of valuation of similar properties in the PRC, we consider the assumptions so made to be reasonable. All documents and contracts have been used as reference only and all dimensions, measurements and areas are approximations.

We have inspected the exterior and, where possible, the interior of the property. However, no structural survey has been made and we are therefore unable to report as to whether the properties are or are not free of rot, infestation or any other structural defects. No tests were carried out in any of the services.

No site investigations have been carried out to determine the suitability of the ground conditions or the services for any property development. Our valuation is made on the basis that these aspects are satisfactory and that no extraordinary expenses or delays will be incurred during the construction period.

No soil analysis or geological studies were order or made in conjunction with this report, nor were any water, oil, gas or other subsurface mineral use rights or conditions investigated.

Substance such as asbestos, urea-formaldehyde foam insulation, other chemicals, toxic waste or other potentially hazardous materials could, if present, adversely affect the value of the property. Unless otherwise stated in this report, its existence on the property was not considered by the appraiser in the development of the conclusion of market value. The stated value estimate is predicated on the assumption that there is no material on or in the property that would cause such a loss in value. No responsibility is assumed for any such conditions, and the client has been advised that the appraiser is not qualified to detect such substances, quantify their impact on values, or develop the remedial cost.

We do not investigate any industrial safety environmental and health related regulations in association any particular manufacturing process. It is assumed that all necessary licenses, procedures, and measures were implemented in accordance with Government legislation and guidance.

No allowance has been made in our valuation for any charges, mortgages or amounts owing on any of the properties valued nor for any expenses or taxation which may be incurred in effecting a sale. Unless otherwise stated, it is assumed that all the interests are free of encumbrances, restrictions and outgoings of an onerous nature which could affect their values.

The valuation contained in this report specifically excludes the impact of structural damage or environmental contamination resulting from earthquakes or other causes. It is recommended that the reader of this report consult a qualified structural engineer and/or environmental auditor for the evaluation of possible structural/environmental defects, the existence of which could have a material impact on market value.

Having examined all relevant documentation, we have relied to a very considerable extent on the information provided by the Company and has accepted advice given to us on such matters as planning approvals, statutory notices, easements, tenure, occupation, lettings, construction costs, rentals, site and floor areas and in the identification of the property in which the Company have valid interests. We have had no reason to doubt the truth and accuracy of the information. We were also advised that no material factors have been omitted from the information to reach an informed view, and have no reason to suspect that any material information has been withheld.

**OPINION OF VALUE**

In view of all relevant circumstances, we are of the opinion that the market value of the subject property in its existing state as at 30 June, 2003, with the assumption of free of all encumbrances, is in the region of **RENMINBI YUANS TWENTY ONE MILLION ONLY (RMB21,000,000)**.

We enclose herewith the valuation certificate.

We hereby certify that we have neither present nor prospective interest in the appraised assets or the value reported.

Yours faithfully,

For and on behalf of

**GREATER CHINA APPRAISAL LIMITED**

**K. K. Ip**

*BLE, MRICS, AHKIS, RPS(GP)*

*Managing Director*

Notes: Mr. K. K. Ip, who is a Chartered Valuation Surveyor and a Registered Professional Surveyor, has substantial experience in valuation of properties in the PRC since 1992.

## VALUATION CERTIFICATE

Property	Description and tenure	Particulars of Occupancy	Market value in Existing state as at 30 June, 2003
Land, buildings and structures located at No.268 Yun Xing Da Road Tao Yuan Town Cong Hua Guangzhou Guangdong Province The PRC	<p>The property comprises a parcel of land (the “Land”), 6 blocks of 1 to 4-storey industrial buildings (the “Buildings”) and ancillary structures (the “Structures”) erected upon the Land. The Buildings were completed in 1999.</p> <p>The land area of the Land is approximately 61,619.00 square metres and the total construction floor area of the Buildings is approximately 5,779.07 square metres. Structures consist of boundary walls, bridge, internal road and civil works within the Land.</p> <p>The property is held under a State-owned Land Use Right Certificate and 6 Real Estate Ownership Certificates for a term expiring on 21 December, 2043 for industrial use.</p>	As at the date of inspection, the Land, Buildings and Structures were occupied by 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) (referred to as “Guangzhou Hanfang”) as a research center.	RMB21,000,000

Notes:

1. In April 2003, the property was injected into Guangzhou Hanfang by 廣州醫藥集團有限公司 (Guangzhou Pharmaceutical Holdings Limited) (referred to as “GPHL”) as consideration for its subscription in the shares in Guangzhou Hanfang. After completion of the subscription by GPHL, together with other subscribers, Guangzhou Hanfang becomes an approximately 58.49% owned subsidiary of the Company.
2. According to a State-owned Land Use Right Certificate dated 26 August, 2003 and 6 Real Estate Ownership Certificates all dated 27 August, 2003 issued by People's Government of Cong Hua City and People's Government of Guangdong Province respectively, the Land and the Buildings, with a total land area of approximately 61,619.00 square metres and a total construction floor area of approximately 5,779.07 square metres, are held by Guangzhou Hanfang for a term expiring on 21 December, 2043 for industrial use.
3. It is stated in the Legal Opinion given by the PRC Legal Advisers, inter alia, that:
  - (a) The Land and the Buildings were held by Guangzhou Hanfang under the following title documents:

Title Documents	Document No.	No. of Storey	Land Area	Construction Floor Area	Term Expiry Date
State-owned Land Use Right Certificate	Cong Fu Guo Yong (2003) Zi Di No. 00212	/	59,017.00 sq.m.	/	21 December, 2043
Real Estate Ownership Certificate (Block 2)	Yue Fang Di Zheng Zi Di No. C1547961	4	914.00 sq.m.	3,456.00 sq.m.	21 December, 2043
Real Estate Ownership Certificate (Block 5)	Yue Fang Di Zheng Zi Di No. C1547964	1	129.00 sq.m.	130.56 sq.m.	21 December, 2043
Real Estate Ownership Certificate (Block 4)	Yue Fang Di Zheng Zi Di No. C1547963	2	935.00 sq.m.	1,472.00 sq.m.	21 December, 2043
Real Estate Ownership Certificate (Block 6)	Yue Fang Di Zheng Zi Di No. C1547965	1	163.00 sq.m.	161.92 sq.m.	21 December, 2043
Real Estate Ownership Certificate (Block 1)	Yue Fang Di Zheng Zi Di No. C1547960	1	286.00 sq.m.	300.05 sq.m.	21 December, 2043
Real Estate Ownership Certificate (Block 3)	Yue Fang Di Zheng Zi Di No. C1547962	1	175.00 sq.m.	258.54 sq.m.	21 December, 2043
			Total:	61,619.00 sq.m.	5,779.07 sq.m.

- (b) Guangzhou Hanfang has legally obtained ownership of the Land and the Buildings by means of asset injection from GPHL. In the course of obtaining ownership, Guangzhou Hanfang was not required to pay any land premium, fees or taxes.
- (c) Guangzhou Hanfang has the right to transfer, lease and mortgage the Land and the Buildings during the unexpired term of the use without paying any additional land premium to the relevant government authorities.



## 2. MACHINERY AND EQUIPMENT

### GREATER CHINA APPRAISAL LIMITED 漢華評值有限公司

---

2407 Shui On Centre  
6-8 Harbour Road  
Wanchai  
Hong Kong

1 September 2003

The Directors  
Guangzhou Pharmaceutical Company Limited  
No. 45 Sha Mian Bei Street  
Liwan District  
Guangzhou  
Guangdong Province  
The People's Republic of China

Dear Sirs,

In accordance with the instructions from Guangzhou Pharmaceutical Company Limited (referred to as the "Company"), we have completed the appraisal of certain machinery and equipment (the "Equipment") exhibited to us as those located at research centre of 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) (referred to as "Guangzhou Hanfang") in Cong Hua, Guangdong Province, the People's Republic of China (the "PRC") and submit our findings in this report.

We confirm that we have carried out inspection, made relevant enquiries and obtained such further information as we considered necessary for the purpose of providing you with our opinion of the market value of the Equipment as of 30 June, 2003. It is understood that this appraisal is being used for a connected transaction.

### INTRODUCTION

Guangzhou Hanfang is currently an approximately 58.49% owned subsidiary of the Company. It is principally engaged in the development of new Chinese medicine and research and development in new production methods for Chinese medicine.

## **DESCRIPTION OF THE EQUIPMENT**

As instructed by the Company, we have appraised the machinery and equipment as included in the valuation report prepared by Guangzhou Yangcheng Certified Public Accountants as at 31 December, 2002 for the purpose of determining the consideration for the subscription in the shares in Guangzhou Hanfang by 廣州醫藥集團有限公司 (Guangzhou Pharmaceutical Holdings Limited).

The appraised Equipment comprises various production equipment including extraction tanks, recovery tanks, distill boiler, reaction tanks, storage tanks, vacuum dryer, spray dryer, steam boiler, motors, filters, water softener, pumps, water purifier, electrical distribution system, water supply system and supported with ancillary equipment.

The Equipment is located in the research center of Guangzhou Hanfang at No.268 Yun Xing Da Road, Tao Yuan Town, Cong Hua, Guangdong Province, the PRC.

Excluded from this investigation are land improvements, improvements to leased property, real estate property, buildings, spare parts, supplies, inventories, materials on hand and all other tangible assets of current nature and intangible assets that might exist.

## **BASIS OF VALUATION**

The valuation is our opinion of the “Value of Plant & Machinery to the Business” which we would define as intended to mean “an option of the price at which an interest in the plant and machinery utilized in a business would have been transferred at the date of valuation assuming:

- (a) that the plant and machinery will continue in its present use in the business;
- (b) adequate potential profitability of the business, or continuing viability of the undertaking, both having due regard to the value of the total assets employed and the nature of the operation;
- (c) that the transfer is part of an arm’s length sale of the business wherein both parties acted knowledgeably, prudently and without compulsion.”

## **VALUATION METHODOLOGY**

Before arriving at our opinion of value, we personally inspected the Equipment and studied market conditions. To develop our opinion of value, we considered the three generally accepted approaches to value: the depreciated replacement cost, market comparable and income capitalization. The theory of these approaches is outlined as follows:

**The depreciated replacement cost approach**

The depreciated replacement cost approach establishes value based on the cost of reproducing or replacing the assets, less depreciation from physical deterioration, and functional and economic/external obsolescence.

Reproduction Cost, New is defined as the estimated current cost of reproducing a new replica of an asset with the same or closely similar materials.

Replacement Cost, New is defined as the estimated current cost of the new asset having the nearest equivalent utility as the asset being appraised.

Physical Deterioration is the loss in value of an asset from wear and tear of asset in operation and exposure to various elements.

Functional Obsolescence is the loss in value is due to factors inherent in the asset itself and changes in design, materials, or process that result in inadequacy, over capacity, excess construction, lack of functional utility or excess operating costs, etc.

Economic Obsolescence is an incurable loss in value caused by unfavorable external conditions.

When market transactions of comparable assets are not available, when data cannot be extrapolated from larger transactions, or when transactions are non-existent, under premise of continued use, assuming adequate earnings the depreciated replacement cost approach is the preferred valuation procedure.

**The market comparable approach**

The market comparable approach involves the collection of market data pertaining to the subject assets being appraised. The primary intent of the market comparable approach is to determine the desirability of the assets through recent sales or offerings of similar assets currently on the market in order to arrive at an indication of the most probable selling price for the assets being appraised.

If the comparable sales are not exactly similar to the asset being appraised, adjustments must be made to bring them as closely in line as possible with the subject asset.

Under the premise of continued use assuming adequate earnings, consideration is given to the cost to acquire similar equipment in the used-equipment market; an allowance then is made to reflect the costs for freight and installation.

**The income capitalization approach**

In the income capitalization approach considers value in relation to the present worth of future benefits derived from ownership and is usually measured through the capitalization of a specific level of income. This approach is most applicable to investment and general-use properties where there is an established and identifiable rental market.

In any appraisal study, all three approaches to value must be considered, as one or more may be applicable to the subject Equipment. In some situations, elements of two or three approaches may be combined to reach an opinion of value.

**INVESTIGATION AND ANALYSIS**

In valuing the Equipment, since there is no identified active used-equipment market in China that provides information on recent transactions of comparable items, the market comparable approach was not applied. On the other hand, since no identifiable income stream can be attributed to a specific piece of equipment or a group of equipment, the income capitalization approach to value was not applied. Therefore, we conclude that the depreciated replacement cost approach is deemed to be the most appropriate method of valuing the Equipment under premise of continued use.

For the Equipment of standard manufacture, we used current manufacturers' price lists, price quotations and price catalogs to determine the cost of replacement new. Allowances for freight and installation were sometimes required.

For the Equipment of special design or fabrication, we used current market price for labor, current market price for materials, manufactured components, design fees, engineering fees and contractors' overhead, profit and fee to determine the cost of replacement new. Allowances for freight and installation were sometimes required.

Also, we adopted the index factor to estimate the cost of reproduction new of special design or fabrication Equipment, an index factor is applied to the historical cost of an appraised equipment in order to estimate the current cost of the Equipment.

The deductions for physical deterioration, functional obsolescence, and economic / external obsolescence reflected observed condition; past maintenance and rebuilding history, if any; current use; and planned future utilization.

**VALUATION COMMENTS**

We have inspected the Equipment on 18 August, 2003. At the time of our inspection, the appraised Equipment was under test run and was found to be in good condition. We have assumed that the Equipment can perform efficiently according to the purposes for which they were designed and built.

According to the legal opinion dated 29 August, 2003 given by 廣東正平天成律師事務所 (Z&T Law Firm), the Equipment is owned by Guangzhou Hanfang, and Guangzhou Company has the right to use and dispose of the Equipment.

In the course of our investigation, we have not investigated the title or any liabilities against the Equipment.

We did not investigate any financial data pertaining to the present or prospective earning capacity of the operation in which the appraised assets are used. It was assumed that prospective earnings would provide a reasonable return on the market value of the appraised assets, plus the value of any assets not included in the appraisal, and adequate net working capital.

We accepted Equipment records furnished by the Company as properly describing the assets to be appraised, their original costs and their acquisition dates. We have relied to a very considerable extent on such records, listings, specifications and documents in arriving at our opinion of value. We visited the location to verify the existence of the assets and to gather information relating to the condition and utility of these assets.

Any deferred maintenance, physical wear and tear, operating malfunctions, lack of utility, or other observable conditions distinguishing the appraised equipment from equipment of like kind in new condition were noted and made part of our judgment in arriving at the value.

We do not investigate any industrial safety environmental and health related regulations in association with this particular manufacturing process. It is assumed that all-necessary license, procedures, and measures were implemented in accordance with the Government legislation and guidance.

It is assumed that there are no hidden or unapparent conditions of the equipment which would render it more or less valuable.

**OPINION OF VALUE**

After a thorough analysis of the Equipment and review of the information made available to us, it is our opinion that as at 30 June, 2003, the Value of Plant & Machinery to the Business of the Equipment is reasonably represented by the amount of **RENMINBI YUANS FOUR MILLION NINE HUNDRED AND EIGHTY THOUSAND ONLY (RMB4,980,000)**.

We hereby certify that we have neither present nor prospective interest in the appraised assets or the value reported.

Yours faithfully,

For and on behalf of

**GREATER CHINA APPRAISAL LIMITED**

K. K. Ip

*BLE, MRICS, AHKIS, RPS(GP)*

*Managing Director*

Investigation and report by

Andy H.F. Chu

Senior Manager

## 1. RESPONSIBILITY STATEMENT

This circular includes particulars given in compliance with the Listing Rules for the purpose of giving information with regard to the Company. The Directors collectively and individually accept full responsibility for the accuracy of the information contained in this circular and confirm, having made all reasonable enquiries, that to the best of their knowledge and belief, there are no other facts the omission of which would make any statement herein misleading.

## 2. DISCLOSURE OF INTERESTS

### (a) Interests of Directors, Chief Executive and Supervisors

- (i) As at the Latest Practicable Date, the interests and short positions of the Directors, chief executive and supervisors of the Company in the Shares, underlying Shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) (a) which were notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which the Directors, the chief executive or the supervisors were taken or deemed to have under such provisions of the SFO); or (b) which were required, pursuant to section 352 of the SFO, to be entered in the register referred to therein; or (c) which were notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies contained in the Listing Rules were as follows:

**Directors:**

<b>Name</b>	<b>Type of interest</b>	<b>Company</b>	<b>Number of Shares</b>
Cai Zhixiang	Personal	The Company (A Shares)	14,700
	Family	Guangzhou Xing Qun Pharmaceutical Co., Ltd. (“Xing Qun”)	1,900
	Family	Guangzhou Pan Gao Shou Pharmaceutical Co., Ltd. (“Pan Gao Shou”)	1,670
	Family	Guangzhou Yang Cheng Pharmaceutical Co., Ltd. (“Yang Cheng”)	1,960
	Family	Guangzhou Jing Xiu Tang Pharmaceutical Co., Ltd (“Jing Xiu Tang”)	2,240
	Family	Guangzhou Guang Hua Pharmaceutical Co., Ltd. (“ Guang Hua”)	1,670
	Family	Guangzhou Tian Xin Pharmaceutical Co., Ltd. (“ Tian Xin”)	1,670
	Trust *	Po Lian Development Company Limited (“Po Lian”)	200,000
Li Yimin	Personal	The Company (A Shares)	14,700
	Family	Xing Qun	1,900
	Family	Pan Gao Shou	1,670
	Family	Yang Cheng	1,960
	Family	Jing Xiu Tang	2,240
	Family	Tian Xin	1,670



Name	Type of interest	Company	Number of Shares
	Family	Guang Hua	1,670
	Trust *	Po Lian	200,000
Zhou Yuejin	Personal	The Company (A Shares)	3,700
	Trust*	Po Lian	200,000
<b>Supervisors:</b>			
Chen Canying	Personal	The Company (A Shares)	9,800
	Personal	Yang Cheng	22,150

\* Messrs. Cai Zhixiang, Li Yimin and Zhou Yuejin were holding the said shares in Po Lian as trustees only.

Save as disclosed above, as at the Latest Practicable Date, none of the Directors, the chief executive or supervisors of the Company or their respective associates had any personal, family, corporate or other interest in the Shares, underlying Shares or debentures of the Company or any of its associated corporations (within the meaning of part XV of the SFO) (a) which were notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which the Directors, the chief executive and the supervisors were taken or deemed to have under such provisions of the SFO); or (b) which were required, pursuant to section 352 of the SFO, to be entered in the register referred to therein; or (c) which were notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies contained in the Listing Rules.

**(b) Interests of substantial Shareholders**

So far as is known to any Director, chief executive or supervisor of the Company, as at the Latest Practicable Date, the persons or companies (not being a Director, chief executive or supervisor of the Company) who had interests or short positions in the Shares or underlying Shares of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO were as follows:-

<b>Name</b>	<b>Type of Shares</b>	<b>Number of Shares held</b>	<b>Approximate percentage of the total share capital</b>
GPHL (Note 1)	A Shares	513,000,000	63.26%
HKSCC Nominees Limited (Note 2)	H Shares	218,020,999	26.89%

Note 1: Such A Shares were state-owned non-listed shares. GPHL has pledged 152,600,000 of its A Shares as collateral for the debt restructuring of 廣州白雲山製藥股份有限公司 (Guangzhou Baiyunshan Pharmaceutical Co., Ltd. (“Baiyunshan”)), an associated company of GPHL, to various creditors of Baiyunshan.

Note 2: The register of substantial Shareholders maintained under section 336 of the SFO recorded the following substantial Shareholders’ interests, being 5% or more of the Company’s issued H Shares as at the Latest Practicable Date:

<b>Name</b>	<b>Number of H Shares held</b>	<b>the total number of H Shares</b>	<b>Approximate percentage of the total share capital</b>
The Hongkong and Shanghai Banking Corporation Limited	48,442,950	22.03%	5.97%
Guotai Junan Securities (Hong Kong) Limited	17,378,000	7.90%	2.14%
Bank of China (Hong Kong) Limited	16,137,000	7.34%	1.99%
Citibank N.A.	12,736,000	5.79%	1.57%
Hang Seng Bank Limited	11,166,000	5.08%	1.38%

So far as is known to any Director, chief executive or supervisor of the Company, as at the Latest Practicable Date, the following persons were interested in 10% or more of the equity interests of the subsidiaries of the Company:

Name of subsidiaries	Name of shareholders	Approximate percentage of the total share capital
Guangzhou Qi Xing Pharmaceutical Co.,Ltd.	Guang Rong Finance Company Limited	25%
Guangzhou Medicine Commodities Exhibition Centre	China Medicine Group Company Limited	20%
Guangzhou Huanye Pharmaceutical Co.,Ltd. (“GZ Huanye”)	Feng Jinling	11.34% (Note 1)
Guangzhou Hanfang	GPHL	30.78% (Note 2)

Note 1: Such shareholding includes 9.77% of the share capital of GZ Huanye which was held by Feng Jinling as trustee only.

Note 2: Upon completion of the Subscription, GPHL was also taken to be interested in approximately 58.49% of the registered capital of Guangzhou Hanfang by virtue of its shareholding in the Company.

Save as disclosed above, as at the Latest Practicable Date, the Directors are not aware of any other person who had an interest or short position in the Shares or underlying Shares which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO, or who was, directly or indirectly, interested in 10% or more of the nominal value of any class of share capital, or options in respect of such capital, carrying rights to vote in all circumstances at general meetings of any other member of the Group.

### 3. MATERIAL CONTRACTS

There is no contract or arrangement subsisting at the date of this circular in which a current Director is materially interested and which is significant in relation to the business of the Group.

### 4. QUALIFICATION

The following is the qualification of the experts who have given an opinion or advice which is contained in this circular:-

<b>Name</b>	<b>Qualification</b>
Karl Thomson	A deemed licensed corporation under the SFO
Barits	A deemed licensed corporation under the SFO
Greater China Appraisal Limited	Registered professional surveyors

### 5. CONSENTS

Each of Karl Thomson and Barits, being the joint independent financial advisors to the Independent Board Committee and Greater China Appraisal Limited, being the independent valuer, has given and has not withdrawn its written consent to the issue of this circular with the inclusion herein of a copy of its letter in the form and context in which it appears.

As at the Latest Practicable Date, none of Karl Thomson, Barits and Greater China Appraisal Limited had any shareholding in any member of the Group or the right (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for securities in any member of the Group nor did they have any interest, either direct or indirect, in any assets which had been, since the date to which the latest published audited financial statements of the Company were made up, acquired or disposed of by or leased to or were proposed to be acquired or disposed of by or leased to any member of the Group.

## 6. MATERIAL CHANGES

The Directors are not aware of any material adverse change in the financial or trading position of the Group since 31st December, 2002, the date to which the latest published audited accounts of the Company have been made up.

## 7. GENERAL

- (i) Each of the executive Directors entered into service contract with the Company and the term will expire on the date of election of the 3rd term of the Board in the 2003 annual general meeting of the Company. Save as disclosed, none of the Directors has entered into, or proposed to enter into, any service contracts with any member of the Group which will not expire or is not determinable by the Company or any of the member of the Group within one year without payment of compensation;
- (ii) as at the Latest Practicable Date, none of the Directors had any direct or indirect interest in any assets which had been, since the date to which the latest audited accounts of the Company were made up, acquired or disposed of by or leased to any member of the Group or were proposed to be acquired or disposed of by or leased to any member of the Group;
- (iii) the Company's branch share registrar is Hong Kong Registrars Limited at Shops 1712-1716, 17/F, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong;
- (iv) the secretary of the Company is He Shuhua; and
- (v) the English text of this circular shall prevail over the Chinese text.

## 8. LITIGATION

As at the Latest Practicable Date, none of the members of the Group was engaged in any litigation or arbitration of material importance and no litigation or claim of material importance was known to the Directors to be pending or threatened against any member of the Group.

**9. DOCUMENTS AVAILABLE FOR INSPECTION**

Copies of the following documents will be available for inspection at the registered office of the Company at 45 Sha Mian North Street, Guangzhou City, Guangdong Province, PRC during normal business hours up to and including 15 September 2003:

- (a) the Memorandum and Articles of Association of the Company;
- (b) the Subscription Agreement;
- (c) the annual reports of the Group for the two financial years ended 31st December, 2001 and 2002;
- (d) the interim report of the Company for the 6 months ended 30th June, 2003;
- (e) the valuation reports on the Tangible Assets prepared by Greater China Appraisal Limited, the text of which is set out in Appendix I to this circular;
- (f) the letter from the Independent Board Committee, the dated 1 September 2003, the text of which is set out on page 14 of this circular;
- (g) the letter from Karl Thomson and Barits to the Independent Board Committee, the text of which is set out on pages 15 to 22 of this circular; and
- (h) the written consents from Karl Thomson, Barits and Greater China Appraisal Limited referred to in paragraph 5 of this appendix
- (i) the service contracts referred to in paragraph 7(i) of this appendix.