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## SHANXI CENTRAL PHARMACEUTICAL INTERNATIONAL LIMITED

正中藥業國際有限公司\*

*(incorporated in Bermuda with limited liability)*

### ANNOUNCEMENT

This announcement is made to clarify certain issues in respect of the Company's investments in 94 hospitals in the PRC.

The directors (the “**Directors**”) of Shanxi Central Pharmaceutical International Limited (the “**Company**”) noticed certain articles appearing in some newspapers on 31 October, 2002 and 1 November, 2002 mentioning the Company's investments in 94 hospitals (the “**Hospital Investments**”) in the People's Republic of China (the “**PRC**”). The Directors would like to clarify certain issues in the Hospital Investments and this announcement is made for such purpose.

In view of the high incidence of rheumatoid disease in the PRC and leveraging on the remarkable curative effects of the Group's anti-rheumatoid capsules and medicinal preparations and the famous therapeutic treatment, Hou's Therapy, the Company and its subsidiaries (the “**Group**”) commenced market research in respect of the possibility of the establishment of centers for the treatment of rheumatic and/or arthritic conditions (the “**Rheumatic Treatment Centres**”) and liaised with around 100 hospitals in the PRC from February 2001 to late 2001 and entered into cooperation agreements (the “**Cooperation Agreements**”) with 94 hospitals separately in late 2001 to establish the Rheumatic Treatment Centres in these hospitals. These hospitals are dispersed in different provinces of the PRC including Hubei Province, Shanxi Province, Shandong Province, Henan Province, Guangdong Province, Hunan Province, Anhui Province, Fujian Province, Gansu Province, Jilin Province, Zhejiang Province, Liaoning Province, Xinjiang Autonomous Region, Neimonggo, etc.. Before entering into the Cooperation Agreements, the Company had carried out feasibility studies on the possible cooperation with these hospitals and they were chosen on the basis that the Group had already established certain clinical and technological cooperative relationship with them in the past and where there is a high population of patients/potential patients suffering from rheumatoid and/or arthritic condition. Based on the feasibility studies, the Directors consider that the Hospital Investments will lead to an increase in demand for the Group's products and thus increase the Group's profitability. The manufacturing revenue of the Group's products for the year ended 31 May, 2002 had increased 27% from last year. Each of these hospitals are independent third parties and are not connected with any of the directors, chief executives and substantial shareholders of the Company or any of its subsidiaries or any of their respective associates.

The Directors have carefully considered the Hospital Investments and are of the view that the establishment of additional sales networks for the Group's products through the Rheumatic Treatment Centres in these hospitals is an important factor in determining the reputation, recognition and earning power of a

pharmaceutical company in the current competitive market in the PRC. The Directors have made site visits to these hospitals and convened internal meetings among board members of the Company to study the possible investments on numerous occasions before formally entering into the Cooperation Agreements with these hospitals. The independent non-executive Directors have been informed and updated on the progress of the Hospital Investments and raised no objections as they consider that the Hospital Investments is an important breakthrough in demand for the Group's products and will increase the Group's profit in the long term.

Pursuant to the Cooperation Agreements, these hospitals are responsible for the establishment of the Rheumatic Treatment Centres within a time frame prescribed in the Cooperation Agreements. The ownership and day to day responsibility for the management and operation of the Rheumatic Treatment Centres vest with these hospitals. The Group is responsible for the sourcing of appropriate medical equipment and provision of the necessary anti-rheumatoid capsules and medicinal preparations for the treatment of rheumatoid and/or arthritic conditions for the Rheumatic Treatment Centres. The Group also funds part of the initial establishment costs of the Rheumatic Treatment Centres which are non-refundable. In return, the Group receives a participating right in the Rheumatic Treatment Centres' profits for the duration of the periods specified in the Cooperation Agreements, generally 12 years. According to the Cooperation Agreements, the Group can share 50% of the profit generated from the operation of the Rheumatic Treatment Centres, after a 10% appropriation reserved for future development of the Rheumatic Treatment Centres, commencing from 1 January, 2003. The total original cost of investments in the Rheumatic Treatment Centres amounts to approximately HK\$164.6 million within which the initial establishment costs of the Rheumatic Treatment Centres are HK\$29.9 million and the remaining HK\$134.7 million are the costs of purchasing the appropriate medical equipment.

During the year, the Group carried out continuous assessment of the setting up and operation of the Rheumatic Treatment Centres. In view of the locations of these Rheumatic Treatment Centres being widely dispersed in the PRC and the unsatisfactory performances of some of these centres due to limited human and financial resources actually offered by the relevant hospitals as none of such hospitals can afford any promoting expenses to bring the patients' awareness of the existence of the Rheumatic Treatment Centres whereas 36 hospitals cannot spare proper and adequate staff to manage these centres as stipulated in the Cooperation Agreements, the Group had separately entered into the termination agreement to terminate the cooperations with 36 Rheumatic Treatment Centres and dispose of its rights in 28 Rheumatic Treatment Centres to independent third parties when the performance of these centres could not be improved at the end of May, 2002, which is approximately six months after the date of the relevant Cooperation Agreement. The Directors have carefully devised the exit plans beforehand, pursuant to the two separate purchase agreements entered into with an independent medical equipment supplier, Bozhou City Medicinal Materials General Company of Anhui Province (安徽省亳州市藥材總公司) (the "Supplier") on different dates earlier, the Supplier agreed to buy back those medical equipment if the Hospital Investments were not successful. As a result of the termination of 36 Rheumatic Treatment Centres, the Group only incurs a loss of HK\$4.6 million for the return of the medical equipment in 36 Rheumatic Treatment Centres to the Supplier while the loss for the initial establishment costs of 64 Rheumatic Treatment Centres amounts to HK\$20.4 million. Out of approximately HK\$41.4 million as the aggregate consideration of returning medical equipment for the 36 Rheumatic Treatment Centres, the Group received approximately HK\$21.8 million from the Supplier in September 2002. The remaining balance will be settled as to approximately HK\$5.5 million and approximately HK\$14.1 million in November 2002 and January 2003 respectively. The original costs of establishing 64 Rheumatic Treatment Centres and purchasing medical equipment are HK\$20.4 million and HK\$82.5 million respectively.

The Directors would like to point out that when the Group commenced negotiations with these hospitals, they are conducted on a separate basis. The Cooperation Agreements are also executed on different dates. Each investing amount of the Hospital Investments constitutes less than 3% of the net tangible assets of the Company of HK\$160.8 million with reference to the then latest published annual report of 2001. Therefore, each of the Hospital Investments should be treated as a separate and individual transaction and not a notifiable transaction. In addition, the 94 hospitals are all independent third parties and the Hospital Investments are entered into on normal commercial terms in the ordinary and usual course of business of the Company at arm's length to expand its sales networks into hospitals. The Directors do not consider that the Hospital Investments constitute notifiable transaction under the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules"). Besides, the Company's independent non-executive Directors have been verbally informed of the above arrangements and have verbally agreed to such arrangements and they will be kept informed about this matter in the future.

However, the Stock Exchange considers that as all the medical equipment for the 94 Rheumatic Treatment Centres were purchased from one Supplier within a short period of time, the value of purchasing these medical equipment should be added together and it will then constitute a major transaction under the Listing Rules. Therefore, the Stock Exchange is of the view that the Company has breached the Listing Rules and reserves its rights against the Company and its Directors in respect of the Company's breach of the Listing Rules. Further announcement will be made as and when appropriate.

The Directors notice that the unaudited net profit from ordinary activities attributable to shareholders published on the press announcement dated 2 October, 2002 amounted to HK\$28.7 million while the audited net profit from ordinary activities attributable to shareholders published on 30 October, 2002 was HK\$21.3 million. The reason for the decrease of HK\$7.4 million is because at the time when the Company released the unaudited final results, the Company's plan for the disposal of a portion of the Rheumatic Treatment Centres has not yet completed and the Company has not yet entered into any sale and purchase agreements (the "**Disposal Agreements**") with two independent third parties (the "**Purchasers**") to dispose of its entire interests in the Rheumatic Treatment Centres of the 28 hospitals. In October 2002, the Group entered into two separate Disposal Agreements with two Purchasers, namely Bozhou City Medicinal Materials General Company of Anhui Province (安徽省亳州市藥材總公司) and Dayinpan Wholesale Department of Taiyuan Medical and Medicinal Materials Company (太原醫藥藥材公司大營盤批發部), to dispose of its entire interests in 16 and 12 Rheumatic Treatment Centres (collectively, the "Disposed Centres") respectively. The considerations for the disposal of 16 and 12 Rheumatic Treatment Centres are HK\$19.1 million and HK\$17.4 million respectively. The initial establishment costs, after adjusting for the tax effect, of the Disposed Centres of a total of approximately HK\$7.4 million, which has been included in the initial establishment costs of HK\$20.4 million, were then charged to the current year's profit and loss account. The two Purchasers are independent third parties not connected with any of the directors, chief executives and substantial shareholders of the Company or any of its subsidiaries or any of their respective associates. The two transactions relating to the Disposed Centres are conducted on a separate basis and the two Disposal Agreements are also executed on different dates. In addition, they are entered into on normal commercial terms in the ordinary and usual course of business of the Company at arm's length. Therefore, the transactions relating to the two Disposal Agreements do not constitute notifiable transaction under the Listing Rules with reference to the net tangible assets of the Company in the then latest published annual report of 2001.

The Stock Exchange has indicated that it may request the Company to and the Company if so requested will provide further information on the Hospital Investments in the future.

By Order of the Board  
**Shanxi Central Pharmaceutical International Limited**  
**David Y.M. Shi**  
*Deputy Chairman and Managing Director*

Hong Kong, 4 November, 2002

\* *for identification only*

“Please also refer to the published version of this announcement in The Standard”.