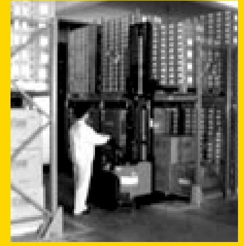
CHINDEX

# 2001 Annual Report

CHINDEX

Chindex International, Inc.
U.S.-China Industrial Exchange,Inc.

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## Mission Statement

**Prosper As A Cross Cultural Company By Providing Leading Edge Healthcare Technologies, Products and Services to the Greater Chinese Marketplace With Pride.**

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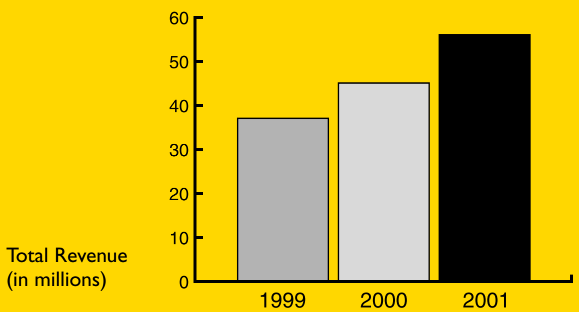
## 20th Year Commemoration

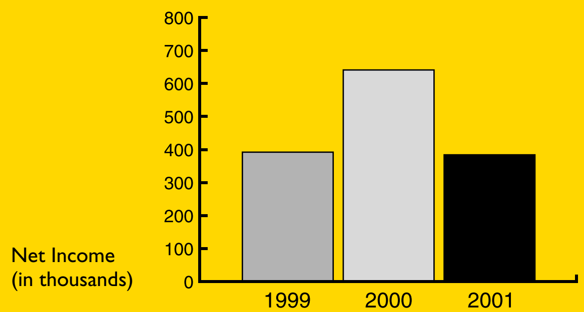
**1981 - 2001 Twenty Years of Success In China**

We are very proud of the accomplishments made in the 20 years of operations at Chindex. In that time we have seen the company grow from two people to almost five hundred; from our first sale of diagnostic medical instruments at a hospital in Beijing to a nationwide distribution company serving over 2,000 institutions; from a small, private company to a $56 million public healthcare concern with multiple business platforms. In these 20 years we have succeeded where many others have not. The name "Chindex" in China is a nationally recognized brand in healthcare.

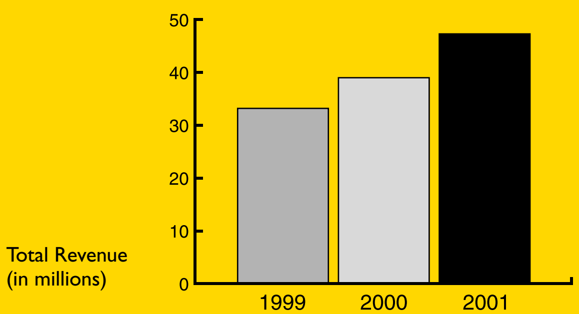
## Summary Financial Results

### Consolidated Revenues and Earnings

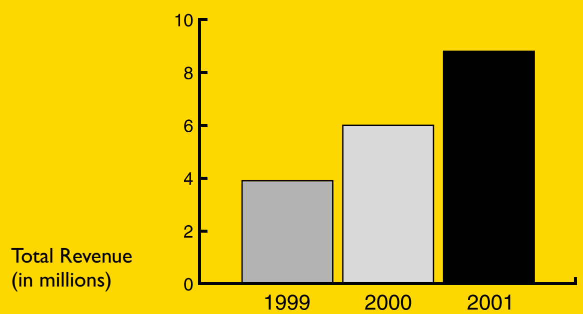



### Healthcare Products Revenue




### Healthcare Services Revenue




**We were pleased to again post profitable results for the year based on continued double-digit revenue growth rates in both segments of the business.**

**The name "Chindex" in China is a nationally respected brand in high quality healthcare.**

**Dear Shareholder:**

In 2001 we celebrated our 20th year of operations in China. It was both a successful and challenging year. We were pleased to again post profitable results for the year based on continued double-digit revenue growth rates in both segments of the business. Healthcare Products reported top line growth of 21% for the year. Healthcare Services reported 31% growth. With China's accession to the WTO at the end of the year, we find the company well-positioned with a unique expertise in China trade and a dominant competitive position in the healthcare markets we serve.

For the year ended December 31, 2001, we reported a net profit of $384,000 or $0.42 per share. This compares to a net profit of $641,000, or $0.76 per share in 2000. Total revenues were $56.1 million for the year, compared to $45.1 million in 2000. Our Balance Sheet at year end showed cash and cash equivalents of approximately $5.4 million, total assets of $33.3 million, a current ratio of 1.4:1 and shareholders equity of $13.6 million.

The foundation of our company has been built over a 20 year period by the Capital Medical Equipment Division ("CME") of the Healthcare Products segment. Once again in 2001 this department led the company in total revenues with sales of over $25 million. Our traditional areas of market leadership have been in diagnostic ultrasound, clinical chemistry, radiology, critical care cardiology and infection control. Our revenue distribution throughout the year was strong in each of these sectors. Chindex CME distributes premier healthcare technologies from such prominent suppliers as Siemens Medical Systems, Johnson & Johnson, Hologic, Bard, and Steris. Since the mid -1990s Chindex has been highly successful in developing innovative, government-backed loan financing programs for its Chinese customers. Once again in 2001 sales funded by such financing packages were an important component of our revenue picture. During the year we fulfilled $4.2 million in contracts under our current loan authorizations. We were disappointed when final approvals from the Chinese government for an additional $2.1 million were not received by year-end. These shipments were delivered in early 2002 and we are already working on execution of the next loan package.

The Products Distribution Division ("PD") of the Healthcare Products segment grew rapidly again this year. Its revenues were up 72% over 2000 to $21 million. This wholly owned logistics and distribution network provides a comprehensive range of distribution and related services to the healthcare industry based on a sophisticated core competency in marketing, logistics and supply chain management. PD has earned recognition as an "industry leader" in China for these services and is proud to count among its clients Guidant, BD (Becton Dickinson), Johnson & Johnson, and Tyco Healthcare. Our Hospital Products department under PD now supplies over 500 subdealers throughout China who directly serve all the 500+ bed hospitals in the country, representing coverage of over 80% of the market for imported medical devices. We have pioneered the model of in-hospital inventories for high priced interventional cardiology consumables in our distribution partnership with Guidant Corporation. Our ability to monitor stocks and usage in each hospital nationwide on a daily basis is unique and a critical element of our sucess. Our Retail Pharmacy department under PD has served L'Oreal for three years in the development of a distribution pipeline to pharmacies in the top 30 cities in China. We currently count approximately 250 pharmacies in 20 cities as our valued business partners and expect to continue this expansion to reach about 350 top-selling pharmacies in about 25 cities by the end of 2002. We experienced delays in 2001 of final registration approval from the Chinese government for the Summer's Eve brand of feminine hygiene products, however we expect to launch this product along with an

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upscale hair care and deodorant product line targeted at China's rapidly growing middle class in 2002. Chindex is leading the way in retail pharmacy distribution by bringing modern merchandising to these traditional outlets. Personal care products with a select pharmacy distribution offer Chindex an important niche. When China's OTC drug distribution system opens to foreign participation under its WTO commitments, Chindex will already be entrenched as a major player.

The Healthcare Services segment reported an extraordinary year in 2001. Revenue for Beijing United Family Hospital ("BJU") increased 46% to $8.8 million from $6.0 million. Even more impressive, profits for the year more than doubled to $476,000 from $218,000. These highly successful indicators of financial performance reflected a variety of accomplishments at the hospital during the year. It was a year in which the institution made giant strides towards its goal of being a full-service community hospital serving not only the expatriate community of Beijing but the local Chinese community as well. Every measure of performance increased significantly during the year - Patient Days up 68%, Clinic Visits up an aggregate 55%, Dental Clinic Visits up 88%, Lab Procedures up 61%, Surgical Procedures up 40%, Imaging Procedures up 27%, Deliveries up 17%. Several organizational milestones were reached that will provide for continued growth into the future. These included the establishment of a professional department of Critical Care and Emergency Medicine in conjunction with the opening of a 24-hour/7 day Emergency Room at BJU in September and the establishment of a department of Radiology in conjunction with the addition of digital x-ray, mammography, CT and endoscopy imaging systems. BJU has set a goal of achieving JCIA accreditation in 2002. This ambitious goal, if achieved, would make BJU the first such accredited institution in North Asia. In 2002 BJU will also continue the expansion of its physical facilities to a 50 bed capacity and will begin operations of its first satellite clinic.

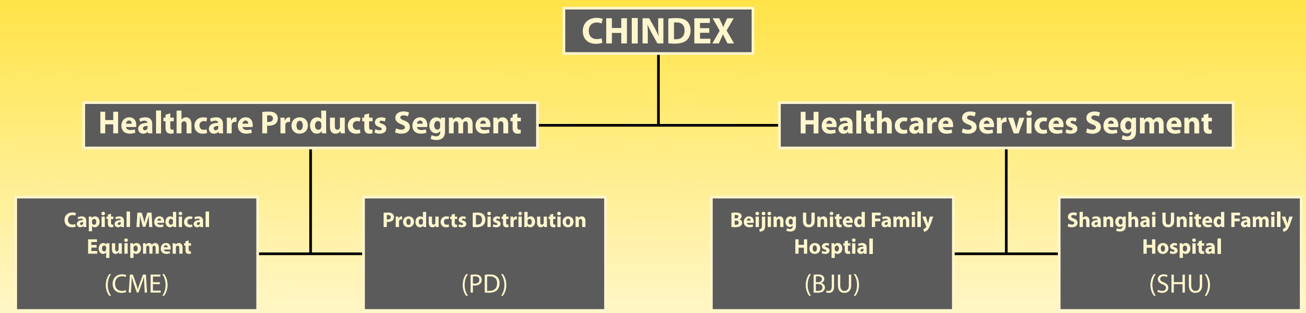
After four years of operations at BJU we believe we have proven the business model for private healthcare services in China, and we are now ready to proceed with the next phase of the Chindex Healthcare Network. Late in 2001, we announced the approval of our next hospital - Shanghai United Family Hospital ("SHU"). We expect to finalize funding for the facility early in 2002 and open its doors as early as the first quarter of 2003. At SHU and our future United Family Hospitals, we will capitalize on all the experience gained at BJU to maximize operating performance. This is another Chinese market with huge potential growth in which Chindex has a unique business platform that we will continue to build upon.

The name "Chindex" in China is a nationally respected brand in high quality healthcare. Our excellent reputation in the marketplace has been earned through hard work over these 20 years. It is built on a philosophy of strategic long term positioning, unwavering dedication to customer service and commitment to day-to-day flexibility in the marketplace.

As China enters the post-WTO and pre-Olympic phase of its development, and as Chindex enters its next phase of strategic growth, the value of the existing Chindex business is extraordinary. The work ahead of us is to continue to translate that potential into increased shareholder value over time. On behalf of the Board of Directors and management, I would like to express our appreciation to all of our shareholders, employees, principals and partners for their ongoing support.

Roberta Lipson
President and Chief Executive Officer






## Healthcare Products - Capital Medical Equipment Division

**For over 20 years Chindex has been a leading supplier of cutting-edge Western medical technology to the Chinese healthcare system. Our direct sales, marketing and technical support personnel operate nationwide to service Chindex-supplied medical instrumentation to a customer base of over 2,000 hospitals. The Chindex portfolio of products targets the key technology needs for developing Chinese healthcare facilities.**

### Diagnostic Imaging

As the exclusive representative for the Acuson (a Siemens company) brand of color doppler ultrasound scanners since 1987, Chindex has held the leading market share in this high end market for over a decade. In 2001 Chindex became the exclusive distributor of the full Siemens family of color ultrasound products.

### Clinical Laboratory

As the distributor for the clinical laboratory systems of Ortho-Clinical Diagnostics (a Johnson & Johnson company) and critical care laboratory products from Nova Biomedical, Chindex has established a quickly growing business in instrumentation and follow-on sales of proprietary consumables products. The logistics service provided by the Products Distribution division highlights the cross-departmental synergies of the Chindex approach.

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### Interventional Cardiology

The electrophysiology monitoring systems of Bard Labsystems and the specialized cardiac laser surgery systems of PLC Medical highlight the Chindex product offerings in interventional cardiology instrumentation. This complements the distribution of consumable products to the cardiac cath labs by the Products Distribution division.

### Radiology

Hologic is a leading supplier of bone densitometers and mammographic X-ray systems. Chindex has been the dominant supplier of bone densitometers in China for many years and the mammography market is an expanding new market segment in Chinese healthcare. Chindex is the exclusive distributor of these Hologic products in China.


### Infection Control and Operating Theater

In partnership with Steris Corporation, Chindex offers one of the world's leading lines of central sterile supply and operating theater equipment. Chindex begins working with customers for the sale of these products from the hospital design phase.

**Using its logistics base, Chindex has pioneered retail pharmacy merchandizing. The network now serves approximately 250 pharmacies in the top 20 cities in China.**

**The Hospital Sales business unit manages 500 local area dealers around the country.**

## Healthcare Products - Products Distribution Division

**The Chindex Products Distribution ("PD") Division is a wholly-owned logistics network providing unique pipeline distribution services to the healthcare and health related industries. It has been recognized as an industry leader. We have invested heavily in the PD infrastructure to access the untapped retail pharmacy markets for branded Western healthcare and personal care products. In the future Chindex will be extraordinarily well-positioned to take advantage of the emerging OTC and ethical drug markets. The division also provides logistics and supply channel management services to foreign medical device manufacturers expanding their presence in the Chinese hospital market.**

### Logistics Services

Through its two established distribution centers in Tianjin and Shanghai, Chindex PD offers custom logistics services to principals in the healthcare device industry as well as other Chindex divisions. This business unit provides services to BD (Becton Dickinson), Pari, and Whitney International, among others. Future growth in this business unit will target additional multinational medical device manufacturers as well as scientific instrument and pharmaceutical manufacturers.

### Retail Pharmacy Sales

Chindex is paving the way into retail pharmacy distribution through a partnership with L'Oreal, the world's largest producer of cosmetic products. Chindex's unique ability to closely control both the inventory and the distribution channels in China has proven successful and its distribution network has grown to approximately 250 pharmacies in 20 cities. As Chindex adds additional personal care and health related products to the pipeline, this network will expand to cover the 30 top cities in China which will account for over 80% of the emerging demand.

### Hospital Sales

Capitalizing on the 20 year reputation of Chindex in the hospital industry in China, the PD division taps the substantial and growing market for high-quality imported medical consumables and low-priced instrumentation. The Chindex expertise focuses on distribution through a network of more than 500 local area dealers throughout the country who supply the vast majority of all hospitals in China. The product portfolio complements the Capital Medical Equipment division in many areas including Interventional Cardiology (Guidant Corporation), Critical Care products (Hudson RCI, Tyco Healthcare), and Diagnostic Imaging (miniaturized and popularly priced ultrasound scanners).

## Healthcare Services - The Expanding Chindex Healthcare Network

**The unique Chindex Healthcare Network is bringing comprehensive, international standard, private healthcare services to China for the first time. The backbone of the Chindex Healthcare Network will be three United Family Hospitals with associated clinics in the three top metropolitan markets of China - Beijing, Shanghai and Guangzhou.**

### Beijing United Family Hosptial and Clinics ("BJU")

Since 1997, BJU has set the standard for private healthcare services in Beijing. BJU addresses the demand for comprehensive acute care services for the growing segment of prosperous families in China's capital city. It is still the only private, international-standard hospital in China, and its competition is limited to smaller foreign-invested clinics that do not provide the full scope of services available at BJU.

The hospital and its associated clinics provide consultation and treatment in all major disciplines including Family Medicine, Internal Medicine, Emergency Medicine, Radiology, Psychology, Psychiatry, Pediatrics, Obstetrics and Gynecology, General Surgery, Orthopedic Surgery, Urology, Anesthesia, Dermatology, Family Dentistry and Orthodontics.





### Shunyi Clinic (Operating as part of BJU)

Anticipated to open in the Spring of 2002, the Shunyi Clinic will be the only outpatient clinic located in the densely expatriate populated suburb of Shunyi County. As a satellite clinic of BJU, this first concept clinic will provide a solid referral base to BJU and a model for future clinics in the network.

### Shanghai United Family Hospital and Clinics ("SHU")

Anticipated to open in 2003, SHU will be the second private hospital in the Chindex Healthcare Network. It will open with the full range of services currently available at BJU. With the same mission and business model as BJU, SHU will continue to expand the availability of Chindex's international-standard, patient-centered care in China.

### Guangzhou United Family Hospital and Clinics ("GZU")

In the early stages of development now, Chindex is currently anticipating that GZU will be established and operational in 2004. It will be the third full-service United Family Hospital in the network. All United Family Hospitals will share a common senior management team and share resources on a network basis.

**Product synergy between the Capital Medical Equipment and Products Distribution divisions provides a comprehensive supply solution for Chinese hospitals across a broad spectrum of medical products. Chindex's expertise in hospital design and product selection is demonstrated to potential customers when they see our products in use at Beijing United Family Hospital.**

# ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

## General

The Company's revenues continued their growth in 2001, with increases occurring in both segments of the Company's business. In 2001 the Company, continuing its loan program efforts, was able to arrange a commercial bank financing for a total of approximately $4.3 million for its customers in China, although only slightly more than half of this total was able to be shipped in 2001 due to approval delays for one major customer in China. The remainder is expected to ship in the first part of 2002. In 2001, the Company's net income suffered a decrease of 40% from the prior year,as discussed in more detail below.

During the year the Company expanded its Beijing United Hospital (BJU) by adding a 24 hour emergency room as well as completing additional expansion of the first floor of the hospital. This expansion undertaking will continue in 2002 as work begins on the upper floors of the hospital building that previously had been subleased to a tenant through December 31, 2001. In addition to expansion efforts at BJU, the Company completed negotiations for its new hospital in Shanghai and, in March of 2002, entered into a joint venture agreement with Shanghai Changning Central District Hospital (a 70-30 equity joint venture, with the Company holding 70%) for the establishment of Shanghai United Family Hospital. The Company has also entered into an 18-year lease for a stand-alone four story building on the campus of the Changning Hospital. The Company has been engaged in extensive discussions related to the financing for the Shanghai hospital project but as of March 26, 2002, has not entered into any agreements on financing.

Also in 2001 the Company entered into a five-year exclusive distribution agreement with Siemens AG for the distribution of Acuson and Siemens color doppler ultrasound machines in China. In the Products Distribution Department of the Healthcare Products segment, the Company continued to expand its reach into the Chinese pharmacy market and is currently operating retail pharmacy business in 20 Chinese cities. In 2001 the Company reached agreement with Nesh Cosmetics Ltd. of Israel for the establishment of a joint venture company in Hong Kong owned by the Company (40%), Nesh (40%) and another Israeli company (20%). Utilizing this joint venture, assuming final registration approval, the Company will begin marketing Nesh products in Chinese pharmacies in 2002.

In 2001 the Company also undertook a global restructuring in which it has reorganized its structure and has modified inter-company relationships to better accommodate its predominantly Chinese operations. This restructuring entailed the creation of three subsidiaries in the Republic of Mauritius, one in the British Virgin Islands (BVI), and one in China. In the new structure, for U.S. federal income tax purposes, the wholly owned foreign subsidiaries in China are treated as divisions or branches of an offshore holding company located in the BVI. The Chinese subsidiaries are in the process of being transferred to the ownership of a Mauritius company, which is also treated as a division of BVI for U.S. federal income tax purposes.

## Fiscal year 2001 compared to 2000

The Company's revenues for 2001 were $56,118,000, up 25% from 2000 revenues of $45,064,000. These numbers include bulk medical equipment sales of $4,196,000 in 2001 and $9,396,000 in 2000, -due to sales attributable to shipments made under the Company's loan financing transactions. The Company believes that this type of financing is important to its customers and the Company and will continue to try to offer such financings in the future. These financings can be very complex and their impact and timing on the Company's results are difficult to predict (see "Timing of Revenues"). In fact, the timing of the financing arranged in 2001, was such that only half of the goods were shipped and recognized as revenue in 2001 for reasons beyond the Company's control.

The Company recorded net income in 2001 of $384,000 or a 40% decrease from 2000 net income of $641,000. Had the complete 2001 loan project shipped in 2001, as planned, the Company's 2001 net income would likely have exceeded that of 2000.

### Healthcare Products

The healthcare products segment, consisting of medical equipment, medical consumables and personal healthcare products, had revenue growth of 21% to $47,339,000 in 2001 from 2000 revenues of $39,049,000. The 2001 revenues included $25,817,000 in sales of medical equipment (55%) and $21,522,000 in sales of medical consumables and personal healthcare products (45%). In 2000, the sales of medical equipment constituted 68% of the total for healthcare product sales, while the sales of medical consumables and personal healthcare products constituted 32% of the total. The sales of medical equipment are U.S. Dollar-based export sales often contingent on financing (see "Timing of Revenues"). The sales of medical consumables and personal healthcare products are local currency-based sales made from inventories maintained locally in China (see "Foreign Currency Exchange and Impact of Inflation") to a network of sub-dealers and pharmacies.

Gross profit in 2001 rose to $10,293,000 from $9,529,000 in 2000. As a percentage of revenue, gross profit from the healthcare products segment declined in 2001 to 22% from 24% in 2000. This decrease in gross profit is related to the increase in local currency sales of medical consumables and personal healthcare products since these sales are made at a lower average gross profit than U.S. dollar capital equipment sales.

Expenses for the healthcare products segment in 2001 increased to $11,170,000 (24% of revenue) from $9,595,000 in 2000 (25% of revenue). Salaries increased $587,000 (salaries were 13% of revenue in 2001 and 14% in 2000), primarily due to increased hires. In addition, travel and entertainment expense increased $174,000 (travel and entertainment was 4% of revenue in 2001 and 5% in 2000) as a result of increased marketing efforts and other costs increased $597,000.

### Healthcare Services

The healthcare services segment consists of a Western style primary care hospital and outpatient facility. In 2001, the revenues from this segment increased to $8,779,000 or 46% over 2000 revenues of $6,015,000. During 2001, the hospital has continued the expansion of its service offerings and the revenue increases for the year reflect increased patient visits taking advantage of these services. Healthcare services costs increased in 2001 to $8,303,000 or 43% over 2000 costs of $5,797,000. This increase is due to the costs associated with increases in services. Also, in September 2001 the Company completed first floor renovations and added a full time emergency room. The hospital is currently expanding its present facility and continues to explore the possibility of additional satellite clinics to serve as referral sites to its hospital.

Salaries increased by $1,727,000 (salaries were 46% of revenue in 2001 versus 39% in 2000), with all other costs increasing $996,000.

### Other Income and Expenses

Interest income in 2001 declined to $161,000 from $200,000 in 2000. In addition, the Company incurred $13,000 in interest expense in 2001 and had $94,000 in interest expense in 2000 (see "Liquidity and Capital Resources").

Other income (other than interest) increased slightly in 2001 to $578,000 from $558,000 in 2000. This other income is primarily from the net sublease income. This sublease ended December 31, 2001 and this part of the building is now being renovated as part of the hospital expansion. The Company does not anticipate any significant revenue in this category in 2002.

### Taxes

The Company has undertaken a global restructuring in which it has reorganized its structure and is modifying inter-company relationships to better accommodate its predominantly Chinese operations. This restructuring was motivated, in part, by the Company's desire to "incorporate" various functions previously operated as a division or branch of the U.S. parent and, in part, due to its intent to expand its presence in the direct health care market by opening an additional hospital.

This restructuring provides the flexibility to structure operations in the People's Republic of China to comply with the various legal and regulatory restrictions and encourages cash flow among the foreign subsidiaries to new investments without triggering U.S. federal income tax. This flexibility further permits the Company to aggressively pursue Chinese and other tax incentives, rebates, and holidays without triggering U.S. federal income tax. In addition, the new legal structure creates a desirable environment should the Company wish to attract third party investment in a new Chinese Hospital or the Chinese Hospitals as a whole. As such, this reorganization aligns the U.S. tax result with the Company's overall business plan and facilitates the free flow of cash among the Company's foreign subsidiaries.

As a result of this restructuring the Company expects to make use of a portion of its U.S. federal net operating losses and accordingly, recorded a $232,000 deferred tax valuation adjustment on previously fully reserved tax losses. The Company expects these net operating losses to be recognizable in 2002 or 2003.

## Fiscal year 2000 compared to 1999

The Company's revenues for 2000 were $45,064,000, up 21% from 1999 revenues of $37,128,000. The largest single component in 2000 and 1999 was $9,396,000 and $11,723,000, respectively, due to sales attributable to shipments made under the Company's loan financing transactions.

The Company recorded net income in 2000 of $641,000 or 64% increase over 1999 net income of $392,000.

### Healthcare Products

The healthcare products segment, consisting of medical equipment, medical consumables and personal healthcare products, had revenue growth of 18% to $39,049,000 in 2000 from 1999 revenues of $33,182,000. The 2000 revenues included $26,554,000 in sales of medical equipment (68%) and $12,495,000 in sales of medical consumables and personal healthcare products (32%). The sales of medical equipment are U.S. Dollar-based export sales often contingent on financing (see "Timing of Revenues"). The sales of medical consumables and personal healthcare products are local currency-based sales made from inventories maintained locally in China (see "Foreign Currency Exchange and Impact of Inflation") to a network of sub-dealers and pharmacies.

Gross profit in 2000 rose to $9,529,000 from $8,234,000 in 1999. As a percentage of revenue, gross profit from the healthcare products segment declined in 2000 to 24% from 25% in 1999.

Expenses for the healthcare products segment in 2000 increased to $9,595,000 (25% of revenue) from $7,991,000 in 1999 (24% of revenue). Salaries increased $873,000 (salaries were 14% of revenue in 2000 and 1999), primarily due to increased hires. In addition, travel and entertainment expense increased $238,000 (travel and entertainment was 5% of revenue in 2000 and 1999) as a result of increased marketing efforts and other costs increased $493,000.

### Healthcare Services

The healthcare services segment consists of a Western style primary care hospital and outpatient facility. In 2000, the revenues from this segment increased to $6,015,000 or 52% over 1999 revenues of $3,946,000. During 2000, the Company expanded the dental clinic and continued to offer services providing obstetrics, gynecology, pediatrics, birthing services and executive health care. All of these practice areas experienced continued growth. The Company is exploring the possibility of additional satellite clinics to serve as referral sites to its hospital.

Healthcare services costs increased in 2000 to $5,797,000 or 31% over 1999 costs of $4,410,000. This increase is due to the costs associated with increases in services. Salaries increased by $555,000 (salaries were 39% of revenue in 2000 versus 46% in 1999), with all other costs increasing $832,000.

### Other Income and Expenses

Interest income in 2000 declined to $200,000 from $308,000 in 1999. In addition, the Company incurred $94,000 in interest expense in 2000 and had no interest expense in 1999 (see "Liquidity and Capital Resources").

Other income decreased slightly in 2000 to $558,000 from $588,000 in 1999.

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## LIQUIDITY AND CAPITAL RESOURCES

As of December 31, 2001, total accounts receivable decreased by $4,264,000 as compared to December 31, 2000. This was due to the large Ex-Im Bank transaction shipping at the end of the year ended December 31, 2000 while no large Ex-Im Bank or other loan transaction shipped during the last half of the year ended December 31, 2001.

Substantially all of the $3,615,000 decrease as of December 31, 2001 in accounts payable and accrued expenses was related to vendor payments for the Ex-Im Bank transaction shipped at the end 2000. Payments related to this shipment were paid upon collection of the receivable in 2001.

As of December 31, 2001, inventories were $7,365,000, decreasing $1,755,000 from the December 31, 2000 balance of $9,120,000. This decrease was mainly attributable to liquidation of inventory as a result of the expiration of the logistics agreement with Tyco Corporation.

As of December 31, 2001 the Company capitalized $1,798,000 of improvements and equipment, primarily for a full service emergency room for BJU as well as certain other improvements to the first floor. This is substantially over the $720,000 improvements for the year ended December 31, 2000. The Company has plans during 2002 to continue to renovate expanded additional floors at BJU. It is estimated this will cost around $1,300,000 and will be primarily financed through internal cash flows, bank borrowings and vendor financing.

The Company's hospital has completed short term financing arrangements in China with Hongkong Shanghai Banking Corp. ("HSBC") for up to $300,000 in revolving loans or standby credit. Terms of the agreement are customary, with the interest rate being 1.75% over the 3 month Singapore Interbank Money Market Offer Rate ("SIBOR"). The hospital has agreed to utilize HSBC for a certain portion of its credit card settlement business. As of December 31, 2001 this line of credit had $200,000 outstanding.

The Company continues to consider various financing alternatives to satisfy its future expansion, capital improvements and equipment requirements. The Company has made commitments for a total of $5.7 million for its new hospital in Shanghai in connection with an 18-year lease for the hospital building. As of March 18, 2002, the Company had not yet located the financing necessary to fulfill these future commitments.

As of December 31, 2001, the sublease of the top two floors of the Company's BJU hospital building expired and the tenant has moved out of the building. In 2001, income attributable to this sublease was approximately $550,000. The Company anticipates that once the space has been renovated and put into service for use for the BJU hospital, the Company will recognize additional revenue to make up for some or all of this sublease income.

**The following table sets forth the Company's contractual cash obligations at December 31, 2001:**

| | Total | 2002 | 2003 | 2004 | 2005 | 2006 | Thereafter |
|---|---|---|---|---|---|---|---|
| **Line of credit** | $ 200,000 | $ 200,000 | $ 0 | $ 0 | $ 0 | $ 0 | $ 0 |
| **Operating leases** | 10,524,000 | 1,037,000 | 1,003,000 | 831,000 | 715,000 | 715,000 | 6,223,000 |
| **Total contractual cash obligations** | $10,724,000 | $1,237,000 | $1,003,000 | $831,000 | $715,000 | $715,000 | $6,223,000 |

For information about these contractual cash obligations, see Notes 7 and 8 to the consolidated financial statements appearing elsewhere in this report.



## TIMING OF REVENUES

The timing of the Company's revenues is affected by several significant factors. Many end-users of the capital equipment products sold by the Company depend to a certain extent upon the allocation of funds in the budgeting processes of the Chinese government and the availability of credit from the Chinese banking system. These processes and the availability of credit are based on policy determinations by the Chinese government and are not necessarily subject to fixed time schedules.

In addition, the sales of certain products often require protracted sales efforts, long lead times and other time-consuming steps. Further, in light of the dependence by purchasers of capital equipment on the availability of credit, the timing of sales may depend upon the timing of the Company's or its purchasers' abilities to arrange for credit sources, including Ex-Im Bank or other loan financing. As a result, the Company's operating results have varied and are expected to continue to vary from period to period and year to year. In addition, a relatively limited number of orders and shipments may constitute a meaningful percentage of the Company's revenue in any one period. As a result, a relatively small reduction in the number of orders can have a material impact on the Company's revenues in any year. Further, because the Company recognizes revenues and expenses as products are shipped, the timing of shipments could affect the Company's operating results for a particular period. At the same time, a growing percentage of the Company's revenues are attributable to hospital services and local currency sales through the Products Distribution Division, both of which have more even revenue streams.

## FOREIGN CURRENCY EXCHANGE AND IMPACT OF INFLATION

The results of operations of the Company for the periods discussed have not been significantly affected by inflation or foreign currency fluctuation. Since the Company sells goods and services in local Chinese currency as well as U.S. dollars, the Company has some foreign currency risk. Changes in the valuation of the Chinese Renminbi or Hong Kong Dollar may have an impact on the Company's results of operations in the future. The Company's subsidiaries, Chindex Tianjin, Chindex Shanghai and Beijing United, sell products and services in Renminbi.

Also, the Company has purchased and will continue to purchase some products in Western currencies other than U.S. dollars and has sold and will continue to sell such products in China for U.S. dollars. To the extent that the value of the U.S. dollar declines against such a currency, the Company could experience a negative impact on profitability. The Company anticipates hedging transactions wherever possible to minimize such negative impacts. Currently there are no such hedges.

## FORWARD-LOOKING STATEMENTS

With the exception of historical information, the matters discussed or incorporated by reference in this 2001 Annual Report to Stockholders are forward-looking statements that involve risks and uncertainties. These forward-looking statements include, but are not limited to, statements about the Company's (i) performance goals, including successful conclusion of efforts to secure government-backed financing, (ii) future revenues and earnings, including revenues from the Company's developmental businesses such as the health services segment, (iii) markets, including growth in demand in China for the Company's products and services, and (iv) proposed new operations, including expansion of its health services business. Actual results could differ materially from such forward-looking statements because of, among other things, the following factors: developments relating to conducting business in China (including political, economic and legal matters), the timing of the Company's revenues, risks relating to commencement and early operation of healthcare services, dependence on certain suppliers, and extension of credit terms.

# ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MATERIAL RISK

## MARKET RISKS

The Company is exposed to market risks in a variety of ways. The principal market risk has to do with the nature of the Chinese economy and political system. Since the Company generates all of its revenues from China, any risk having to do with the environment in China for a foreign business operating there can have a significant impact on the Company.

The Chindex growth plan includes continuing expansion of the capital medical equipment and instrumentation business, rapid expansion of the Products Distribution product portfolio, with an emphasis on increasing the number and variety of products that are sold directly to retail pharmacies, and the development of a network of private family hospitals, based on the Beijing United Family Hospital model, to serve China's growing middle class. Management continues to develop this growth plan, the implementation of which will be contingent on a number of factors, including requisite financing.

Although the Company remains optimistic about the marketplace, there are some continuing uncertainties as to the direction of China's on-going political and economic reforms, the possibility for future devaluation of the Chinese or Hong Kong currencies, as well as China's relationship with the United States. These uncertainties may influence the budgeting and purchasing process in China. Any of the foregoing circumstances may impede trade with China, thus impairing the ability of the Company's customers to purchase the Company's products. In the Company's view, China's entry into the World Trade Organization (WTO) in 2001 has made the dangers from these uncertainties less significant. Other possibly adverse circumstances include decreased funds available to Chinese end-users as a result of a general economic slowdown and increased competition from other American and European companies.

### Internal Political Risk

The Company's interests may be adversely affected by the political environment in China. China is a socialist state which since 1949 has been, and is expected to continue to be, controlled by the Communist Party of China. Changes in the top political leadership of the Chinese government and/or the Communist Party, may have a significant impact on policy and the political and economic environment in China. Moreover, economic reforms and growth have been more successful in certain sections of the country than others, and the continuation or increase of such disparities could affect political or social stability.

### Government Control Over Economy

The government of China has exercised and continues to exercise substantial control over virtually every section of the Chinese economy through regulation and state ownership. China's continued commitment to reform and the development of a vital private sector in that country have, to some extent, limited the practical effects of the control currently exercised by the government over individual business enterprises. However, the economy continues to be subject to significant government controls which, if directed towards business activities of the Company could have a significant adverse impact on the Company. For example, if the government were to limit the number of foreign personnel who could work in the country or were to substantially increase taxes on foreign businesses or were to impose any number of other possible types of limitations on the Company's operations the impact would be significantly adverse.

### Legal System

China's legal system is a civil law system, which is based on written statutes and in which decided legal cases have little precedential value. Moreover, China's legal system is still in the early stage of development and there are not sufficient numbers of trained judges or other legal professionals to manage disputes that may arise. As a result, the administration of laws and regulations by government agencies in China may be subject to considerable discretion.

### Foreign Trade Corporations

In the sale of its capital equipment to China, the Company must make most of its sales through foreign trade corporations ("FTCs"). Although purchasing decisions are made by the end-user, which is obligated to pay the applicable purchase prices, the Company enters into a formal purchase contract with only the FTC. By virtue of its direct contractual relationship with the FTC, rather than the end-user, the Company is to some extent dependent upon the continuing existence of and contractual compliance by the FTC until the particular transaction has been completed.

### Financing for Shanghai Hospital

The Company has made commitments for the lease of the building for its Shanghai hospital. Fulfillment of this commitment is dependent upon the Company locating a source of financing for the hospital. The Company believes that arranging the financing will be accomplished within early 2002. However, should this prove not to be the case, the Company will have the risk associated with renegotiation of its lease commitments in Shanghai.

### Critical Accounting Policies

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The Company's estimates, judgments and assumptions are continually evaluated based on available information and experience. Because of the use of estimates inherent in the financial reporting process, actual results could differ from those estimates.

Certain of the Company's accounting policies require higher degrees of judgment than others in their application. These include revenue recognition on long-term service contracts, impairments and estimation of useful lives of long-term assets, income tax recognition of deferred tax items and accruals for loss contracts and contingencies. Our policy and related procedures for revenue recognition on long-term service contracts are summarized below. In addition, Note 1 to the Consolidated Financial Statements includes further discussion of the Company's significant accounting policies.

### Revenue Recognition

Sales and most commissions are recognized upon product shipment. Costs associated with shipping, handling, installation, after-sale servicing and warranty are not significant and are recognized in cost of sales as they are incurred. Revenues related to services provided by Beijing United Family Hospital are recognized in the period services are provided. Costs associated with such services are recognized in the period incurred.

# ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

**Report of Ernst & Young LLP, Independent Auditors**
The Board of Directors and Stockholders
U.S.-China Industrial Exchange, Inc.

We have audited the accompanying consolidated balance sheets of U.S.-China Industrial Exchange, Inc. as of December 31, 2001 and 2000, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2001. Our audits also included the financial statement schedule listed in the Index at Item 14(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of U.S.-China Industrial Exchange, Inc. at December 31, 2001 and 2000, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2001 in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the financial statements taken as a whole, present fairly in all material respects the information set forth therein.

/s/ Ernst & Young, LLP

McLean, Virginia
March 18, 2002



# U.S. -CHINA INDUSTRIAL EXCHANGE, INC.
## CONSOLIDATED BALANCE SHEETS

| | December 31, 2001 | December 31, 2000 |
|---|---|---|
| **ASSETS** | | |
| **Current Assets:** | | |
| Cash and cash equivalents | $5,459,000 | $3,785,000 |
| Trade receivables less allowance for doubtful accounts of $604,000 (2001 and 2000) | 12,932,000 | 17,196,000 |
| Inventories | 7,365,000 | 9,120,000 |
| Income taxes receivable | 165,000 | 277,000 |
| Deferred tax | 232,000 | 0 |
| Other current assets | 1,668,000 | 1,315,000 |
| Total current assets | 27,821,000 | 31,693,000 |
| Property & equipment, net | 4,751,000 | 3,726,000 |
| Other assets | 797,000 | 1,079,000 |
| Total assets | $33,369,000 | $36,498,000 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| **Current Liabilities:** | | |
| Accounts payable and accrued expenses | $18,643,000 | $22,065,000 |
| Accrued contract training | 915,000 | 1,108,000 |
| Short term loan payable | 200,000 | 0 |
| Income taxes payable | 0 | 90,000 |
| Total liabilities | 19,758,000 | 23,263,000 |
| **Stockholders' Equity:** | | |
| Preferred stock, $.01 par value, 5,000,000 shares authorized, none issued | | |
| Common stock, $.01 par value, 30,000,000 shares authorized, including 2,000,000 designated Class B): | | |
| Common stock - 657,319 shares issued and outstanding in 2001 and 2000 | 7,000 | 7,000 |
| Class B stock - 193,750 shares issued and outstanding in 2001 and 2000 | 2,000 | 2,000 |
| Additional capital | 17,303,000 | 17,303,000 |
| Foreign currency equity translation adjustment | (8,000) | 0 |
| Accumulated deficit | (3,693,000) | (4,077,000) |
| Total stockholders' equity | 13,611,000 | 13,235,000 |
| Total liabilities and stockholders' equity | $33,369,000 | $36,498,000 |

See accompanying notes

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## U.S. -CHINA INDUSTRIAL EXCHANGE, INC.
### CONSOLIDATED STATEMENTS OF OPERATIONS

| | For the year ended December 31, | | |
|---|---|---|---|
| | 2001 | 2000 | 1999 |
| **Total sales and service revenue** | $56,118,000 | $45,064,000 | $37,128,000 |
| **Cost and expenses** | | | |
| Cost of goods and services sold | 38,426,000 | 30,529,000 | 25,561,000 |
| Salaries and payroll taxes | 10,091,000 | 7,777,000 | 6,349,000 |
| Travel and entertainment | 2,139,000 | 1,897,000 | 1,560,000 |
| Other | 5,863,000 | 4,709,000 | 3,879,000 |
| **(Loss) income from operations** | (401,000) | 152,000 | (221,000) |
| **Minority interest** | (18,000) | (36,000) | (18,000) |
| **Other income and (expenses)** | | | |
| Interest expense | (13,000) | (94,000) | 0 |
| Interest income | 161,000 | 200,000 | 308,000 |
| Miscellaneous income, net | 578,000 | 558,000 | 588,000 |
| Total other income | 726,000 | 664,000 | 896,000 |
| **Income before income taxes** | 307,000 | 780,000 | 657,000 |
| **(Benefit from) Provision for income taxes** | (77,000) | 139,000 | 265,000 |
| **Net income** | $384,000 | $641,000 | $392,000 |
| **Net income per common share - basic** | $ .45 | $ .79 | $ .50 |
| **Weighted average shares outstanding - basic** | 851,069 | 808,722 | 790,313 |
| **Net income per common share - diluted** | $ .42 | $ .76 | $ .49 |
| **Weighted average shares outstanding - diluted** | 921,927 | 838,716 | 794,527 |

See accompanying notes



## U.S. -CHINA INDUSTRIAL EXCHANGE, INC.
### CONSOLIDATED STATEMENTS OF CASH FLOWS

| | For the year ended December 31, | | |
|---|---|---|---|
| | 2001 | 2000 | 1999 |
| **OPERATING ACTIVITIES** | | | |
| Net income | $384,000 | $641,000 | $392,000 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | | |
| Depreciation | 773,000 | 750,000 | 672,000 |
| Inventory write-down | 147,000 | 154,000 | 164,000 |
| Deferred taxes | (232,000) | 0 | 0 |
| Changes in operating assets and liabilities: | | | |
| Trade receivables | 4,264,000 | (9,229,000) | 4,683,000 |
| Inventories | 1,608,000 | (3,393,000) | (274,000) |
| Income taxes receivable | 112,000 | (161,000) | 0 |
| Other current assets | (353,000) | (418,000) | (316,000) |
| Other assets | 282,000 | (260,000) | (21,000) |
| Accounts payable and accrued expenses | (3,615,000) | 11,481,000 | (4,609,000) |
| Income taxes payable | (90,000) | (15,000) | 48,000 |
| Net cash provided by (used in) operating activities | 3,280,000 | (450,000) | 739,000 |
| **INVESTING ACTIVITIES** | | | |
| Purchases of property and equipment | (1,798,000) | (720,000) | (514,000) |
| Net cash used in investing activities | (1,798,000) | (720,000) | (514,000) |
| **FINANCING ACTIVITIES** | | | |
| Proceeds from short term loan payable | 200,000 | 0 | 0 |
| Exercise of stock options | 0 | 9,000 | 0 |
| Net cash provided by financing activities | 200,000 | 9,000 | 0 |
| Effect of foreign exchange rate changes on cash and cash equivalents | (8,000) | (2,000) | 0 |
| Net increase/(decrease) in cash and cash equivalents | 1,674,000 | (1,163,000) | 225,000 |
| Cash and cash equivalents at beginning of year | 3,785,000 | 4,948,000 | 4,723,000 |
| Cash and cash equivalents at end of year | $5,459,000 | $3,785,000 | $4,948,000 |
| Cash paid for interest | $13,000 | $10,000 | $0 |
| Cash paid for taxes | $518,000 | $368,000 | $257,000 |

See accompanying notes

# U.S. -CHINA INDUSTRIAL EXCHANGE, INC.

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITYFOR THE YEARS ENDED DECEMBER 31, 1999, 2000 AND 2001

| | Common Stock | | Common Stock -Class B | | Additional | Accumulated | Accumulated other comprehensive income | |
|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Amount | Capital | Deficit | | Total |
| Balance at Dec 31, 1998 | 596,563 | $6,000 | 250,000 | $3,000 | $17,294,000 | ($5,109,000) | $2,000 | $12,196,000 |
| Forfeit of escrow shares | | | (56,250) | (1,000) | | | | (1,000) |
| Net income for 1999 | | | | | | 392,000 | | 392,000 |
| Balance at Dec 31, 1999 | 596,563 | 6,000 | 193,750 | 2,000 | 17,294,000 | (4,717,000) | 2,000 | 12,587,000 |
| September stock dividend | 59,756 | 1,000 | | | | (1,000) | | 0 |
| Option exercise | 1,000 | 0 | | | 9,000 | | | 9,000 |
| Foreign currency translation adjustment | | | | | | | (2,000) | (2,000) |
| Net income 2000 | | | | | | 641,000 | | 641,000 |
| Balance at Dec 31, 2000 | 657,319 | 7,000 | 193,750 | 2,000 | 17,303,000 | (4,077,000) | 0 | 13,235,000 |
| Foreign currency translation adjustment | | | | | | | (8,000) | (8,000) |
| Net income 2001 | | | | | | 384,000 | | 384,000 |
| Balance at Dec 31, 2001 | 657,319 | 7,000 | 193,750 | 2,000 | 17,303,000 | (3,693,000) | (8,000) | 13,611,000 |

See accompanying notes



# U.S.-CHINA INDUSTRIAL EXCHANGE, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## 1. ACCOUNTING POLICIES

### ORGANIZATION AND DESCRIPTION OF BUSINESS

U.S.-China Industrial Exchange, Inc., doing business as Chindex International (the Company) is a leading American company in the healthcare sectors of the Chinese marketplace, including Hong Kong. The Company conducts business in two segments. First, in its health care products segment, it markets and sells high-technology medical equipment and consumables and other healthcare products acquired from several major U.S., European, and other manufacturers. The Company markets and sells these products in China and Hong Kong, and provides marketing, sales and technical services for the products. Substantially all direct sales, commissions and purchases of these products are denominated in U.S. dollars. In this segment the Company also provides logistics services to other companies doing business in the Chinese market. Sales of consumables and low value healthcare products are undertaken through subsidiaries.

Two of the Company's subsidiaries, Chindex Holdings International Trade (Tianjin) Ltd., and Chindex Shanghai International Trading Co., Ltd., sell goods and receive payment in local Chinese currency and use the currency to pay for local expenses and U.S. dollar imported goods. Payments are generally required to be made in advance for consumable products.

Second, in its healthcare services segment, the Company operates a hospital in Beijing. In 1996 the Company established the Beijing United Family Hospital, a contractual joint venture between the Company and a Company controlled by the Chinese Academy of Medical Sciences. This Hospital provides complete western standard primary care health services including family practice, pediatrics, dental care, physical therapy, obstetrics, gynecology, neonatology and men's health care. Operations commenced in late 1997. Full-time operation began in March 1998. While Beijing United does denominate its revenue and expenses in local Chinese currency it can receive payments in U.S. dollars.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company, its wholly-owned subsidiaries, Chindex, Inc., Chindex Holdings International Trade (Tianjin) Ltd., Chindex Shanghai International Trading Co., Ltd., Chindex Hong Kong and its 100% balance sheet interest and 90% earnings interest in the Beijing United Family Hospital. Significant intercompany accounts and transactions have been eliminated in consolidation.

### Revenue Recognition

Sales and most commissions are recognized upon product shipment. Costs associated with shipping, handling, installation, after-sale servicing and warranty are not significant and are recognized in cost of sales as they are incurred.

Revenues related to services provided by Beijing United Family Hospital are recognized in the period services are provided. Costs associated with such services are recognized in the period incurred.

## Inventories

Inventory purchased to fill signed sales contracts and purchase orders that remain undelivered at year-end (merchandise inventory), service parts and inventory of peripheral components are stated at the lower of cost or market using the specific identification method. In addition, two wholly foreign owned subsidiaries maintain merchandise inventory based on expected sales targets.

Certain items are purchased for demonstration purposes and subsequent sale (demonstration inventory). Management monitors the salability of such demonstration inventory and reduces the carrying amount to net realizable value when there is any impairment in value.

Inventory items held by Beijing United Family Hospital are stated at the lower of cost or market using the average cost method.

## Property and Equipment

Property and equipment, including such assets held by Beijing United Family Hospital, are stated at historical cost. The costs of additions and improvements are capitalized, while maintenance and repairs are charged to expense as incurred. Depreciation is computed on the straight line method over the estimated useful lives of the related assets. Useful lives for office equipment, vehicles and furniture and fixtures range from 5 to 7 years. Leasehold improvements are amortized by the straight-line method over the shorter of the estimated useful lives of the improvements or the lease term. Certain medical equipment is depreciated over three years.

The Company assesses the impairment of long-lived assets including intangible assets in accordance with Statement of Financial Standards No. 121, 'Accounting for the Impairment of Long Lived Assets and for Long Lived Assets to be Disposed of ' (Statement 121). Statement 121 requires impairment losses to be recognized for long-lived assets when indicators of impairment are present and the undiscounted cash flows are not sufficient to recover the assets' carrying amounts. Intangibles are also evaluated for recoverability by estimating the projected undiscounted cash flows, excluding interest, of the related business activities. The impairment loss of these assets, including goodwill, is measured by comparing the carrying amount of the assets to its fair value with any excess of carrying value over fair value written off. Fair value is based on market prices where available, an estimate of market value, or determined by various valuation techniques including discounted cash flows.

## Income Taxes

The Company's U.S. entities are on a June 30 fiscal year and beginning in 2001, they filed a consolidated U.S. federal tax return. The U.S. provision for income taxes is computed for each entity in the U.S. consolidated group at the statutory rate based upon each entity's income or loss, giving effect to permanent difference. The Company's foreign subsidiaries file separate income tax returns on a December 31 fiscal year.

Provisions for income taxes are based upon earnings reported for financial statement purposes and may differ from amounts currently payable or receivable because certain amounts may be recognized for financial reporting purposes in different periods than they are for income tax purposes. Deferred income taxes result from temporary differences between the financial statement amounts of assets and liabilities and their respective tax bases. A valuation allowance reduces the deferred tax assets when it is more likely than not that some portion or all of the deferred tax assets will not be realized.

## Cash Equivalents

The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

## Fair Value of Financial Instruments

The Company considers the recorded value of its financial instruments, which consist of cash and cash equivalents, trade receivables, commissions receivable and accounts payable, to approximate the fair value of the respective assets and liabilities at December 31, 2001 and 2000.

## Earnings Per Share

The Company follows Statement of Financial Accounting Standards No. 128, 'Earnings per Share' (Statement 128) whereby basic earnings per share excludes any dilutive effects of options, warrants and convertible securities and diluted earnings per share includes such effects. The Company does not include the effects of stock option, warrants and convertible securities for periods when the Company reports a net loss as such effects would be antidilutive.

## Stock Based Compensation

The Company follows Statement of Financial Accounting Standards No. 123, 'Accounting for Stock-Based Compensation,' (Statement 123) which allows companies to either account for stock-based compensation under the provisions of Statement 123 or under the provisions of Accounting Principles Board Opinion No. 25 'Accounting for Stock Issued to Employees' (Opinion 25), but requires pro forma disclosure in the footnotes to the financial statements as if the measurement provisions of Statement 123 had been adopted. The Company has elected to account for its stock-based compensation to employees pursuant to the provisions of Opinion 25.

## Dividends

The Company has not paid cash dividends to the stockholders of its common stock and any cash dividends that may be paid in the future will depend upon the financial requirements of the Company and other relevant factors. On August 25, 2000 the Company declared a 10% stock dividend to holders of record on September 13, 2000.

## Reclassifications

Certain balances in the 2000 and 1999 financial statements have been reclassified to conform to the 2001 presentation.

## New Accounting Standards

In July 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 141, Business Combinations, and SFAS No. 142, Goodwill and Other Intangible Assets. SFAS No. 141 requires that the purchase method of accounting be used and establishes new standards on the recognition of certain identifiable intangible assets separate from goodwill for all business combinations initiated after June 30, 2001. SFAS No. 142 will require that goodwill and intangible assets with indefinite useful lives no longer be amortized but instead tested for impairment at least annually. SFAS No. 142 will also require that intangible assets with definite useful lives be amortized over their respective estimated useful lives to their estimated residual values. The Company is currently evaluating the requirements and impact of this Standard, but its adoption is not expected to have a material impact on our results of operations and financial position.

Under SFAS No. 142, the Company is required to perform transitional impairment tests for our goodwill and certain intangible assets as of the date of adoption. The transitional impairment test for these intangible assets will be completed by March 31, 2002. Step one of the transitional goodwill impairment test, which compares the fair values of our reporting units to their respective carrying values, will be completed by June 30, 2002. Transitional impairment losses for goodwill and these certain intangibles, if any, will be recognized as the cumulative effect of a change in accounting principle in our consolidated statement of income. The Company is currently evaluating the requirements and impact of this Standard, but its adoption is not expected to have a material impact on the Company's results of operations and financial position.

In June 2001, the FASB issued SFAS No. 143, Accounting for Asset Retirement Obligations. SFAS No. 143 requires that the fair value of the liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. SFAS No. 143 is effective for fiscal years beginning after June 15, 2002. The Company is currently evaluating the requirements and impact of this Standard, but its adoption is not expected to have a material impact on the Company's results of operations and financial position.

In August 2001, the FASB issued SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. SFAS No. 144 establishes one accounting model to be used for long-lived assets to be disposed of by sale and broadens the presentation requirements of discontinued operations to include more disposal transactions. SFAS No. 144 supersedes SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of, and the accounting and reporting provisions of Accounting Principles Board Opinion No. 30, Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions, relative to discontinued operations. SFAS No. 144 is effective for fiscal years beginning after December 15, 2001. The Company is currently evaluating the requirements of this Standard, but the impact of its adoption, if any, is not expected to have a material impact on the Company's results of operations and financial position.

## 2. INVENTORIES

| Inventories consist of the following: | December 31. | |
|---|---|---|
| | 2001 | 2000 |
| Merchandise inventory | $4,805,000 | $6,960,000 |
| Healthcare services inventory | 234,000 | 149,000 |
| Demonstration inventory, net | 597,000 | 489,000 |
| Parts and peripherals | 1,729,000 | 1,522,000 |
| | **$7,365,000** | **$9,120,000** |



## 3. PROPERTY AND EQUIPMENT, NET

| Property and equipment, net consists of the following: | December 31. | |
|---|---|---|
| | 2001 | 2000 |
| Furniture and equipment | $4,594,000 | $3,312,000 |
| Vehicles | 109,000 | 109,000 |
| Leasehold improvements | 3,610,000 | 3,094,000 |
| | 8,313,000 | 6,515,000 |
| Less: accumulated depreciation and amortization | (3,562,000) | (2,789,000) |
| | **$4,751,000** | **$3,726,000** |

## 4. STOCKHOLDERS' EQUITY

### Common Stock

The Class B common stock and the common stock are substantially identical on a share-for-share basis, except that the holders of Class B common stock have six votes per share on each matter considered by stockholders and the holders of common stock have one vote per share on each matter considered by stockholders. Each share of Class B common stock will convert at any time at the option of the original holder thereof into one share of common stock and is automatically converted into one share of common stock upon (i) the death of the original holder thereof, or, if such stocks are subject to a stockholders agreement or voting trust granting the power to vote such shares to another original holder of Class B common stock, then upon the death of such original holder, or (ii) the sale or transfer to any person other than specified transferees.

### Stock Option Plan

The Company's 1994 Stock Option Plan (the Plan) provides for the grant, at the discretion of the Board of Directors, of (i) options that are intended to qualify as incentive stock options (Incentive Stock Options) within the meaning of Section 422A of the Internal Revenue Code to certain employees, consultants and directors, and (ii) options not intended to so qualify (Nonqualified Stock Options) to employees, consultants and directors. At the Company's 2001 annual meeting the stockholders approved a 200,000 increase in the amount of stock authorized for issuance. The total number of shares of common stock for which options may be granted under the Plan is currently 262,500.

The Plan is administered by the Board of Directors, which determines the terms of options, including the exercise price, the number of shares subject to the options and the terms and conditions of exercise. No option granted under the Plan is transferable by the optionee other than by will or the laws of descent and distribution and each option is exercisable during the lifetime of the optionee only by such optionee.

The exercise price of options granted under the Plan must be at least equal to the fair market value of such shares on the date of grant. With respect to any participant who owns stock possessing more than 10% of the voting rights of the Company's outstanding capital stock, the exercise price of any Incentive Stock Option may be not less than 110% of the fair market value on the date of grant. With respect to any Incentive Stock Option granted to a participant who owns stock possessing more than 10% of the total combined voting power of all classes of the Company's outstanding capital stock, the maximum term is five years.

The following is a summary of stock option activity during the years ended December 31, 2001, 2000 and 1999:

| | | 2001 | 2000 | 1999 | Exercise Price Range |
|---|---|---|---|---|---|
| Options outstanding, beginning of year: | | 210,021 | 46,318 | 38,856 | $7.56 - $36.36 |
| | Granted | 28,060 | 171,498 | 10,000 | $8.21 - $36.88 |
| | Exercised | 0 | (1,000) | 0 | $9.13 |
| | Canceled | (28,480) | (6,795) | (34,106) | $8.21 - $36.36 |
| | Repriced and Reissued | 0 | 0 | 31,568 | $8.21 |
| Options outstanding, end of year | | 209,601 | 210,021 | 46,318 | $7.56 – $36.36 |

The Company has not provided disclosures under FAS 123 for proforma net income and proforma earnings per share, as such amounts are not materially different from reported amounts. The weighted average exercise price of options outstanding is $9.27, $9.95 and $12.00 and the weighted average remaining contractual life of such options is 8.6 years, 9.4 years and 9.2 years respectively as of December 31, 2001, 2000 and 1999.

The Company has adopted the disclosure-only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation." Accordingly, no compensation expense has been recognized for the Company's stock option plans. If the Company had elected to recognize compensation based on fair value of the options granted at grant date as prescribed by SFAS No. 123, net income and earnings per share would have been as follows:

| (in thousands except per share data) | | 2001 | 2000 | 1999 |
|---|---|---|---|---|
| Pro forma net income | | $226 | $127 | $366 |
| Pro forma earnings per share | | | | |
| | Basic | $.27 | $.16 | $.46 |
| | Assuming dilution | $.25 | $.15 | $.46 |

The effects of applying SFAS No. 123 on pro forma net income are not indicative of future amounts until the new rules are applied to all outstanding non-vested awards. The fair value of each option is estimated at the date of grant using a modified Black-Scholes option pricing model, with the following weighted-average assumptions for 2001, 2000 and 1999: dividend yield 0.00%; expected volatility of 62.3%; risk-free interest rate of 3.00%; and expected life of 7.0 years.

### Shares of Common Stock Reserved

At December 31, 2001 the Company has reserved 456,250 shares of common stock for issuance upon exercise of stock options and Class B common stock convertibility.

## 5. EARNINGS PER SHARE

The following is a reconciliation of the numerators and denominators of the basic and diluted Earnings per Share (EPS) computations for net income and other related disclosures:

| | | For the year ended December 31, 2001 | | |
|---|---|---|---|---|
| | | Income (Numerator) | Shares (Denominator) | Per-Share Amount |
| Net income/Basic EPS | | $384,000 | 851,069 | $ .45 |
| Effect of dilutive securities: | | | | |
| | Warrants and options | | 70,858 | (0.03) |
| Net income/Diluted EPS | | $384,000 | 921,927 | $ .42 |

| | | For the year ended December 31, 2000 | | |
|---|---|---|---|---|
| | | Income (Numerator) | Shares (Denominator) | Per-Share Amount |
| Net income/Basic EPS | | $641,000 | 808,722 | $ .79 |
| Effect of dilutive securities: | | | | |
| | Warrants and options | | 29,994 | (0.03) |
| Net income/Diluted EPS | | $641,000 | 838,716 | $ .76 |

| | | For the year ended December 31, 1999 | | |
|---|---|---|---|---|
| | | Income (Numerator) | Shares (Denominator) | Per-Share Amount |
| Net income/Basic EPS | | $392,000 | 790,313 | $.49 |
| Effect of dilutive securities: | | | | |
| | Warrants and options | | 4,214 | -- |
| Net income/Diluted EPS | | $392,000 | 794,527 | $.49 |

Options to purchase 209,601, 210,021 and 46,318 of common stock between $7.56 and $36.36 were outstanding during most of 2001, 2000 and 1999 respectively. See note 4.

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## 6. INCOME TAXES

The Company's provision for (benefit from) income taxes consists of the following for the year ended December 31:

| | 2001 | 2000 | 1999 |
|---|---|---|---|
| **Current:** | | | |
| Federal | $-- | $-- | $-- |
| Foreign | 249,000 | 220,000 | 265,000 |
| State | 34,000 | -- | -- |
| | 283,000 | 220,000 | 265,000 |
| **Deferred:** | | | |
| Federal | (190,000) | -- | -- |
| State | (42,000) | -- | -- |
| Foreign | (128,000) | (81,000) | -- |
| | (360,000) | (81,000) | -- |
| | **$(77,000)** | **$139,000** | **$265,000** |

Significant components of the Company's deferred tax liabilities and assets are as follows as of December 31:

| | 2001 | 2000 |
|---|---|---|
| **Deferred tax liabilities:** | | |
| Rate differential on Chinese and Hong Kong earnings | $(1,054,000) | $(146,000) |
| | | |
| **Deferred tax assets:** | | |
| Allowance for doubtful accounts | 233,000 | 225,000 |
| Inventory writedowns | 295,000 | 295,000 |
| Net operating loss carryforwards | 1,991,000 | 2,494,000 |
| Foreign tax credit | 210,000 | 210,000 |
| Other | 3,000 | 3,000 |
| Subtotal | 1,678,000 | 3,081,000 |
| Less valuation allowance | $(1,446,000) | $(3,081,000) |
| **Net deferred tax asset** | $232,000 | $-- |

The Company's effective income tax rate varied from the statutory federal income tax rate for the year ended December 31 as follows:

| | 2001 | 2000 | 1999 |
|---|---|---|---|
| **Statutory federal income tax rate** | 34.0% | 34.0% | 34.0% |
| **Adjustments:** | | | |
| State income taxes, net of federal benefit | (22.0) | 3.5 | 3.5 |
| Foreign tax rate differential | (188.0) | (31.5) | (33.5) |
| Use of foreign net operating losses | (42.0) | (20.7) | -- |
| Change in valuation allowance | 181.0 | 34.0 | 27.4 |
| Other, including permanent differences | 12.0 | (1.5) | 9.0 |
| | **(25.0)%** | **17.8%** | **40.4%** |

Due to the Company's global restructuring plan, it expects to be able to make use of a portion of its U.S. federal net operating losses, and accordingly, recorded a $232,000 reduction in its deferred tax valuation allowance on previously fully reserved tax losses. The Company expects these net operating losses will be recognizable in 2002 or 2003. The remaining net deferred tax assets have been fully reserved.

The Company has U.S. Federal net operating losses of approximately $4.8 million that expire in 2012 through 2019. The Company also has foreign losses from China of approximately $358,000 that expire in 2002 and 2003.

## 7. COMMITMENTS

### Leases

The Company leases office space, warehouse space, and space for the Beijing United Family Health Center under operating leases. Future minimum payments under these noncancelable operating leases consist of the following:

| **Year ending December 31:** | |
|---|---|
| 2002 | $1,037,000 |
| 2003 | 1,003,000 |
| 2004 | 831,000 |
| 2005 | 715,000 |
| 2006 | 715,000 |
| Thereafter | 6,223,000 |
| Net minimum rental commitments | $10,524,000 |

The above leases require the Company to pay certain pass through operating expenses and rental increases based on inflation.

Rental expense was approximately $1,026,000, $953,000 and $850,000 for the years ended December 31, 2001, 2000 and 1999, respectively.

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## 8. CONCENTRATIONS OF CREDIT RISK

Financial instruments which potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents, trade receivables and commission receivables. Substantially all of the Company's cash and cash equivalents at December 31, 2001 and 2000 were held by two U.S. financial institutions.All of the Company's sales during the years were to end-users located in China or Hong Kong. Most of the Company's sales are accompanied by down payments of either cash or letters of credit with one Chinese financial institution. Sales on extended payment terms usually have down payments in the form of a letter of credit and additional payments are secured through several methods. The Company generally does not grant extended payment terms for greater than 20% of a contract value unless there are exceptional circumstances. Before extended payment terms are provided, the Company performs a thorough review of the local operation, secures a guarantee from higher authorities than the end-user, and performs other steps as needed.All of the Company's medical services provided by Beijing United Family Hospital were performed in China for patients residing in China. Substantially all of the payments received for such services were denominated in local currency; however, the Company is authorized to accept payment in other currencies.

Extended payment term transactions are entered into in the context of the Company's sales activities in China and, as such, the risks attendant to doing business in China apply to such transactions as well.The absence of a comprehensive and effective legal system in China, among other concerns, requires alternative arrangements in order to reduce the Company's credit risks. Guarantees from higher governmental authorities, for example, usually involve requiring customers to have a provincial or municipal governmental organization sign a statement that the payment obligations will be satisfied.This political commitment is, in the Company's experience, an effective method in helping ensure payment of obligations in China. These commitments, however, are different from traditional commercial guarantees in the United States, which guarantees are not available in China for transactions of the type engaged in by the Company.

The Company has a $1,750,000 credit facility with First National Bank of Maryland for short-term working capital needs, standby letters of credit, and spot and forward foreign exchange transactions. Balances outstanding under the facilities are payable on demand, fully secured and collateralized by government securities acceptable to the Bank having an aggregate fair market value of not less than $1,945,000.As of December 31, 2001, letters of credit issued by the bank amounted to approximately $725,000 and no amounts were outstanding under the line of credit facility. Borrowings under the credit facility bear interest at 1% over three month London Interbank Offered Rate ("LIBOR").

The Company's hospital has recently completed short term financing arrangements in China with Hongkong Shanghai Banking Corp. ("HSBC") for up to $300,000 in revolving loans or standby credit. Terms of the agreement are customary, with the interest rate being 1.75% over the 3 month Singapore Interbank Money Market Offer Rate ("SIBOR"). The hospital has agreed to utilize HSBC for a certain portion of its credit card settlement business. As of December 31, 2001 this line of credit had $200,000 outstanding.

The Company conducts its marketing and sales and provides its services exclusively to buyers located in China and Hong Kong.The medical services and products provided by Beijing United Family Hospital and the marketing of such services are performed exclusively for/to patients in China.The Company's results of operations and its ability to obtain financing could be adversely affected if there was a deterioration in trade relations between the United States and China. Of the Company's net assets at December 31, 2001 and 2000, approximately $15,660,000 and $12,022,000, respectively, of such assets are located in China, consisting principally of cash, inventories, property improvements and equipment.

See Note 9 also.

## 9. SIGNIFICANT CUSTOMERS/SUPPLIERS

Substantially all China purchases of the Company's U.S.-dollar sales of products, regardless of the end-user, are made through Chinese foreign trade corporations (FTCs).Although the purchasing decision is made by the end-user, which may be an individual or a group having the required approvals from their administrative organizations, the Company enters into formal purchase contracts with FTCs.The FTCs make purchases on behalf of the end-users and are authorized by the Chinese government to conduct import business. FTCs are chartered and regulated by the government and are formed to facilitate foreign trade. The Company markets its products directly to end-users, but in consummating a sale the Company must also interact with the particular FTC representing the end-user. By virtue of its direct contractual relationship with the FTC, rather than the end user, the Company is to some extent dependent on the continuing existence of and contractual compliance by the FTC until a particular transaction has been completed.

Purchases from three suppliers were each over 10% of total cost of goods. These were Acuson, a Siemens Company, $9,330,000, Becton-Dickenson $4,949,000 and Tyco $5,356,000 for the year ended December 31, 2001. In 2000 and 1999 only Acuson, $9,616,000 and $4,251,000, respectively, was over 10% of cost of goods. The Company has entered into a security arrangement to ensure the payment of Acuson's accounts payable. As of December 31, 2001 the Company no longer represents the Davis & Geck products, manufactured by Tyco.

## 10. SEGMENT REPORTING

The Company has two reportable segments: Healthcare Products and Healthcare Services. The Healthcare Products segment consists of medical equipment, medical consumables, and personal healthcare products. The Healthcare Services segment consists of a Western style primary care hospital and outpatient facility services.

The Company evaluates performance and allocates resources based on profit or loss from operations before income taxes. The accounting policies of the reportable segments are the same as those disclosed in the summary of significant accounting policies. The Company's reportable segments are business units that offer different products and services. The reportable segments are each managed separately because the nature of the business activities in each of the two segments are totally distinct from each other in terms of the operations performed, the customer base and the nature of revenue generation.

The following segment information has been provided per Statement of Financial Accounting Standards No. 131, 'Disclosures about Segments of an Enterprise and Related Information':

For the year ended December 31, 2001:

| | Healthcare Products | Healthcare Services | Total |
|---|---|---|---|
| **Assets** | $26,455,000 | $6,871,000 | $33,326,000 |
| Sales and service revenue | $47,339,000 | $8,779,000 | $56,118,000 |
| Gross profit | 10,293,000 | n/a | n/a |
| Gross profit % | 22% | n/a | n/a |
| Expenses | 11,170,000 | 8,303,000 | 56,519,000 |
| (Loss) income from operations | (877,000) | 476,000 | (401,000) |
| Other income/expense, net | | | 726,000 |
| Minority interest | | | (18,000) |
| Income before taxes | | | $307,000 |

For the year ended December 31, 2000:

| | Healthcare Products | Healthcare Services | Total |
|---|---|---|---|
| **Assets** | $30,847,000 | $5,651,000 | $36,498,000 |
| Sales and service revenue | $39,049,000 | $6,015,000 | $45,064,000 |
| Gross profit | 9,529,000 | n/a | n/a |
| Gross profit % | 24% | n/a | n/a |
| Expenses | 9,595,000 | 5,797,000 | 44,912,000 |
| (Loss) income from operations | (66,000) | 218,000 | 152,000 |
| Other income/expense, net | | | 664,000 |
| Minority interest | | | (36,000) |
| Income before taxes | | | $780,000 |

For the year ended December 31, 1999:

| | Healthcare Products | Healthcare Services | Total |
|---|---|---|---|
| **Assets** | $19,708,000 | $4,676,000 | $24,384,000 |
| Sales and service revenue | $33,182,000 | $3,946,000 | $37,128,000 |
| Gross profit | 8,234,000 | n/a | n/a |
| Gross profit % | 25% | n/a | n/a |
| Expenses | 7,991,000 | 4,410,000 | 37,349,000 |
| (Loss) income from operations | 243,000 | (464,000) | (221,000) |
| Other income/expense, net | | | 896,000 |
| Minority interest | | | (18,000) |
| Income before taxes | | | $657,000 |

Intersegment transactions were eliminated for the years ended December 31, 2001, 2000 and 1999.

## 11. SELECTED QUARTERLY DATA (UNAUDITED)

(thousands except per share data)

| For the year ended December 31, 2001: | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
|---|---|---|---|---|
| Revenues | $10,606 | $13,201 | $13,447 | $18,864 |
| Gross profit from operations | 3,657 | 4,215 | 4,407 | 5,413 |
| Income (loss) before income taxes | 129 | (140) | 178 | 139 |
| Net income (loss) | 25 | (225) | 109 | 475 |
| Basic earnings (loss) per share of common stock | .03 | (.26) | .13 | .55 |
| Diluted earnings (loss) per share of common stock | .03 | (.26) | .12 | .52 |
| Cash dividends per share of common stock | .00 | .00 | .00 | .00 |

| For the year ended December 31, 2000: | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
|---|---|---|---|---|
| Revenues | $7,040 | $9,462 | $9,430 | $19,132 |
| Gross profit from operations | 2,436 | 3,245 | 3,302 | 5,552 |
| Income (loss) before income taxes | (267) | 72 | (221) | 1,196 |
| Net income (loss) | (349) | 116 | (302) | 1,176 |
| Basic earnings (loss) per share of common stock | (.44) | .15 | (.38) | 1.37 |
| Diluted earnings (loss) per share of common stock | (.44) | .15 | (.38) | .1.34 |
| Cash dividends per share of common stock | .00 | .00 | .00 | .00 |



# Corporate Directory

### BOARD OF DIRECTORS

Roberta Lipson
Chairperson of the Board of Directors
Chief Executive Officer and President
Chindex International, Inc.

Elyse Beth Silverberg
Executive Vice President and Secretary
Chindex International, Inc.

Lawrence Pemble
Executive Vice President Finance and
Business Development
Chindex International, Inc.

Robert C. Goodwin, Jr.
Executive Vice President Operations,
Treasurer and General Counsel
Chindex International, Inc.

A. Kenneth Nilsson
Chairman and Chief Executive Officer
Eureka Group, Inc.

Julius Y. Oestreicher, Esq.
Partner
Oestreicher and Ennis

Carol R. Kaufman
Vice President and
Chief Administrative Officer
The Cooper Companies, Inc.

### EXECUTIVE OFFICERS

Roberta Lipson
President and Chief Executive Officer

Elyse Beth Silverberg
Executive Vice President and Secretary

Lawrence Pemble
Executive Vice President Finance and
Business Development

Robert C. Goodwin, Jr.
Executive Vice President Operations,
Treasurer and General Counsel

### SENIOR MANAGEMENT

Ronald Zilkowski
Senior Vice President Finance
and Corporate Controller

James H. Spear, Jr.
Senior Vice President
Products Distribution

Walter Stryker, Jr.
Senior Vice President
China Administration

Patrick Yim
Vice President Finance
and China Operations

Guo-Dong Sheng
Vice President
Medical Equipment Division

David J. Hofmann
Vice President and
General Manager- Hong Kong

David Wood
General Manager
Beijing United Family Hospital

### GENERAL INFORMATION

Form 10-K Availability:
The Company will provide to
any beneficial owner of its stock,
without charge, a copy of its
annual report on SEC
form 10-K upon written
request to the Corporate Offices.

Listing:
Nasdaq symbol: "CHDX"

Company Information:
To obtain materials about our
Company please contact the
Corporate Offices or check
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