



Management's discussion and analysis of the results of operations

Business Review

The following is a review of the performance of the Group for the six months ended 30 June 2001 (the "Relevant Period") by the directors of the Company (the "Directors").

The shares of the Company (the "Shares") have been listed on the main board (the "Main Board") of the Stock Exchange since 9 May 2001. The Directors consider that the successful listing of the Shares on the Main Board represents a milestone of the business development of the Group.

The unaudited consolidated turnover of the Group for the Review Period recorded approximately HK\$122,684,000, as compared with approximately HK\$136,856,000 for the corresponding period in 2000, representing a decrease of approximately 10.4%. During the Review Period, the unaudited consolidated profit attributable to shareholders of the Company was approximately HK\$31,155,000, whereas it was approximately HK\$43,108,000 in the corresponding period in 2000, representing a decrease of approximately 27.7%. The Directors consider that the decrease was primarily attributable to the decrease in the turnover of the Group and unexpected increase in the distribution costs of the Group, particulars of which are set forth below. As a result, the earnings per share of the Group for the Review Period was approximately HK\$6.11 cents (2000: approximately HK\$8.99 cents per share).

During the Review Period, the Directors consider that the PRC domestic market was generally affected by the slowdown of the global economic growth. Except for certain sectors in the PRC economy in which the demand remained strong, during the Review Period, the general consumption level in the PRC increased at an unexpectedly slower pace as compared with that for the corresponding period in 2000. Other than commodity housing, the general consumption level of the PRC was lowered significantly as compared with that for the corresponding period in 2000. In particular, the health care product market grew at a relatively low rate. In response to such market condition in the PRC, the Group timely adjusted the sales strategy of its products. Instead of launching massive advertisements to boost the customers' awareness as well as the sales of the products of the Group, the Group implemented a series of market-oriented sales approaches, such as,



setting up sale counters in various departmental stores. As a result of this strategy, the realised product sales revenue for the Review Period was approximately HK\$122,684,000, representing only a slight decrease of approximately 10.4% as compared with that for the corresponding period in 2000. Such prompt response and adjustment to the sales approach and strategy of the Group have been proved to be appropriate and successful in light of the weak market condition in the PRC during the Review Period. Meanwhile, the Group also expanded actively its presence in overseas markets in anticipation of a relatively large number of orders coming from North America.

1. Sales of the Group

During the Review Period, the sales revenue of the principal product of the Group, “Chenlong Baoling Longevity Ginseng”, recorded approximately HK\$94,000,000, which as compared with that for the corresponding period in 2000 represented only a slight decrease of approximately 0.7%. Besides, the sales revenue of its American Ginseng products was HK\$28,700,000 representing a decrease of approximately 32.0% as compared with the same for the corresponding period in 2000. The main reason was that there were unexpectedly increasing number of producers launching American ginseng products or similar products in the PRC during the Review Period by means of intensive advertising strategies, including lowering the selling prices and providing free gifts. In response to this competition, the Group started to launch American Ginseng products to other new markets with less competitors. Nonetheless, as the Group’s product of “Chenlong Baoling Longevity Ginseng” is produced under a patented technology exclusively granted to the Group, the sales of such products were not significantly affected by the increasing competition in the PRC market.

2. Development of new products by the Group

Because of the unexpectedly long time taken in obtaining the necessary approvals from the Ministry of Public Health of the PRC (MPH), the launching of “Chenlong Pill for Reducing Blood Sugar” was delayed until September 2001. The product was originally expected to be launched during the Review Period. As a result of the delay in the approval process, the Directors anticipate that the product will be launched in the PRC markets in October 2001. Development of new products of the Group, “Chenlong Pill for Prolonging Climacteric Age” and “Skin Care Pill”, gathered momentum following



the recruitment of some development and research staff in the first half of the year. These two new products together with Nuclein were submitted to the State MPH for approval.

As a result of the delays in the technology development and product research, application for approval in respect of the proposed new product, “Transgenosis γ -tpA” was pending. The Directors consider that such delays would not have material effects on the Group’s business. The Group acquired the products of “Piglyketone” and “Azithromycin Granules” in accordance with the expected schedule, and the Group will commence the production thereof in 2002. Currently, the transfer fees paid were approximately HK\$1,278,000 and HK\$591,000 respectively. It is anticipated that the production approval for “Piglyketone” and “Azithromycin Granules” will be obtained in January 2002.

3. *Development of new markets in the PRC*

During the Review Period, the markets of the Group mainly included Shanghai and the PRC provinces of Zhejiang, Jiangsu and Liaoning that are similar to that for the corresponding period in 2000. The Group devoted additional efforts and resources to conduct specific market research in Beijing, Wuhan and the PRC provinces of Guangdong, Sichun and Shangdong, and the Directors expect to launch the products of the Group in these areas in the last quarter of 2001 based on the findings of such research. As a preliminary plan, the Directors plan to develop new markets in Beijing, Sichun and Wuhan in the second half of this year. It is estimated that the aggregate size of these markets will be bigger than the aggregate of those in Jiangsu and Zhejiang.

Employee Policy of the Group and Implementation of New Staff Appraisal Scheme

As at 30 June 2001, the Group employed a total of approximately 1,000 employees in the PRC and Hong Kong, the number of which is approximately the same as compared with that for the corresponding period in 2000. During the Review Period, the Group implemented a management system for improving the efficiency in the production of its products. On the basis of cost auditing and adoption of cost adjustment commensurate with wages, the production department imposed an appraisal scheme with reference to those indicators such as consumption cost of raw materials, production capacity and



production costs. Additional wages will be awarded to the staff of the production department who can achieve the highest production efficiency in terms of the pre-determined indicators. As a result of the implementation of this appraisal scheme, the staff incentive was improved significantly and the production cost of “Chenlong Baoling Longevity Ginseng” was decreased by approximately 6.5% as compared with the same for the corresponding period in 2000. The Directors propose that the sales department of the Group will implement a similar scheme to increase its cost efficiency during the second half of this year.

Liquidity and Financial Resources

As stated above, the Shares have been listed on the Main Board since 9 May 2001, with net proceeds from the share offer of approximately HK\$70,000,000 for its business and new product development. It is expected that such new proceeds will be applied to business expansion in the second half of this year according to the future plans of the Group set forth in the prospectus issued by the Company dated 26 April 2001.

As at 30 June 2001, the Group had unsecured Renminbi loans from banks in the PRC amounting to approximately RMB45,000,000 (equivalent to approximately HK\$40,900,000) representing an increase of approximately RMB15,000,000 (equivalent to approximately HK\$13,600,000) as compared with the balance of the outstanding loan as at 31 December 2000. Total interest paid on such bank loans was approximately RMB1,500,000 (equivalent to approximately HK\$1,400,000) and no property of the Group was charged as security for such bank loans. In view of the relatively stable in the exchange rate between Renminbi and other currencies and, in particular, Hong Kong dollars, the Directors do not expect to face any material currency risks. As such, no hedges for exchange rates have been made by the Group.

The gearing ratio of the Group decreased from approximately 22.0% as at 31 December 2000 to approximately 20.1% as at 30 June 2001, which was calculated on the basis of net borrowings of approximately HK\$40,909,000 (31 December 2000: HK\$27,273,000) and shareholders funds of approximately HK\$203,095,000 (31 December 2000: HK\$123,900,000) as at 30 June 2001.



Business Outlook and Development Plans

The Group will continue to implement the future plans as stipulated in the Prospectus. As at the date of this report, the Directors do not envisage any circumstances that will materially affect the future plans of the Group as stated in the Prospectus. With the objective of increasing the existing sales volumes of products of the Group and tapping new markets to a full extent, the Directors have decided to launch the products of the Group in the three new markets in Beijing, Wuhan and Sichun. In this connection, the Group has designated 30 sales persons to explore these markets. The Group also proposes to launch intensive advertising campaigns in these new markets by holding promotional events in department stores, retail outlets and drug stores and launching new product design and packaging in order to stimulate the demand for the products of the Group as self consumption products or gifts. The Directors consider that the new markets will generate a stable revenue growth for the business of the Group.

In line with the business development of the Group and the compliance with the new medicine production capacity standard of GMP, a contract in connection with the air purification in medicine workshops was entered into with 金馬醫藥工程安裝公司在 Shenyang. Completion of such improvement works is expected to take place in November 2001. In 2002, the medicine production will commence while the improvement works will also be completed. The Group intends to manufacture traditional Chinese and modern medicines for further growth of the business of the Group.