

Management Report, Discussion and Analysis



*Year 2001 New Purchased Equipment
DXDK660 Fully Auto Filing Packing Machine*

The Directors consider that listing of the shares of the Company on the main board of the Stock Exchange on 9 May, 2001 represents a new milestone of business development of the Group.

REVIEW OF MARKET CONDITIONS

The pace of economic growth slowed down substantially in 2001, particularly after the terrorist attacks in the United States of America on 11 September, 2001 which severely affected the domestic markets in China, resulting in a substantial drop in share prices of A shares in the stock markets in China. The domestic consumption level showed extensive decline when compared with that in the corresponding period of the previous year. The hardest hit segment was internal consumption such as health care products industry. To cope with the domestic market conditions in China, the Company adjusted its product marketing strategy in time: apart from launching massive advertising and promotional campaigns in the newly developed markets, marketing approach in existing markets is shifted to taking up points of sales from the previous sales approach mainly based on advertising. Over a thousand exclusive sales counters were leased and approximately 1,200 temporary marketing staff hired to meet the needs of the consumers over the counters. They marketed products by conducting product introductions on functions and therapeutic effects and distributing promotional leaflets. In order to expand product sales, new markets in Beijing, Chengdu, Chongqing and Wuhan were developed in the second half of 2001. Sales revenue generated from the new markets for the year amounted to approximately HK\$40 million, of which about HK\$5 million sales revenue was generated by the new product “Yan Ling Shu Ke” (延齡舒可).

BUSINESS PERFORMANCE CONDITIONS

The following is the business review of the year ended 31 December, 2001 presented to the Group by the Board of the Company.

As a result of the occurrence of the “trade mark dispute”, substantial quantity of sold goods, amounting to over HK\$50 million, had been returned since the end of September 2001. After deducting the goods returned, the realised turnover of the Group for the whole year amounted to HK\$209,413,000, representing a decrease of 15.7% over the same period of previous year, of which turnover of HK\$158 million was realized by Baoling Ginseng, HK\$46 million by American Ginseng products and HK\$5 million by the new product “Yan Ling Shu Ke” (延齡舒可).

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PRODUCT DEVELOPMENT

The new product “Pill for Reducing Blood Sugar” (降糖膠囊), which was originally planned to launch in the first half of the year, did not obtain “production approval” until October 2001 due to the new product naming rules adopted by the Ministry of Public Health. The product was renamed “Yan Ling Shu Ke” (延齡舒可) and launched to the market in December 2001, generating a turnover of HK\$5 million for the year.

The proposed new products to be acquired or jointly developed, namely “Transgenosis γ -tpA” (轉基因 γ -tpA) and the anti early-aged senile “Fu Gan Ning” (服肝寧), were postponed because of obstacles of research and development technology on the part of the transferring (developing party) which results in project application not having been completed. On the other hand, “Piglyketone” (匹格列酮) and “Azithromycin Granules” (阿奇霉素微囊細粒劑) were underway pursuant to a contracted schedule. Transfer fees of HK\$1.3 million and HK\$0.6 million have been paid to date. According to the schedule, it is expected that “Piglyketone” (匹格列酮) will obtain new medicine production approval by August 2002 and production will commence in September 2002. Currently, biological utilization rate tests have been conducted for “Azithromycin” (阿奇霉素), and it is anticipated that production approval will be obtained in December 2002. Production will commence in 2003.

To speed up the progress of product development, the Company recruited a number of product research and development staff this year. “Mei Nuo Ping” (美諾平) is a pure herbal medicine product which can be orally taken and also for external use. It has been successfully developed and used for treating pimples. Application for approval has been submitted to the state medicine regulatory bureau. It is expected that product approval will be obtained in August 2002 and production will commence in September 2002.

The “Skin care pill” (換膚丹) under original application was renamed “Xiang Fei Jiao Nang pill” (香妃膠囊) and obtaining the production approval, whereas “Nuclein” (核能元) was still being reviewed.

REGIONAL DEVELOPMENT

During the first half of this year, sales markets in Shanghai city and provinces of Zhejiang and Jiangsu were basically unchanged when compared with last year. The Company successfully developed four new markets in Beijing, Chengdu, Chongqing and Wuhan, bringing a turnover of approximately HK\$40 million to the Group.



*Year 2001 New Purchased Equipment
CFM800 Fully Auto Capsule Filling Machine*

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*Year 2001 New Purchased Equipment
Control Board of Electricity Allocation*

EMPLOYEE POLICY, PERFORMANCE AND SALARY PROCEDURES

The Group has a total of over one thousand employees in the PRC and Hong Kong, about the same level as last year. Based on the successful experience of the Production Division in implementing One Hundred Points Appraisal Scheme in the first half of 2001, the Sales Division used, with the experience of the Production Division as the basis, appraisal methods that determine and confirm job position and the relevant salary according to the comprehensive results. Initiatives of the marketing staff in the Sales Division had been largely motivated. Areas of appraisal include indicators like sales volume, refund rates, market share, brand name recognition and proportion of marketing expenditure. At the same time, the control of sales work activities was strengthened. Taking in the above information, the Company was able to adjust its work objectives and marketing strategies. Sales costs were reduced to the largest possible level. According to the comprehensive appraisal indicators, excellent staff were promoted to higher positions whereas demotion and reduced salary given to those who failed to meet the comprehensive appraisal indicators.

CAPITAL STRUCTURE

At 31 December, 2001, the share capital of the Group was approximately HK\$58.4 million, compared with HK\$47.9 million at 31 December, 2000. At 31 December, 2001, shareholders' funds (before distribution of dividends) were approximately HK\$196.3 million, compared with HK\$123.9 million at end-2000.

LIQUIDITY AND FINANCIAL RESOURCES

As at 31 December, 2001, bank loans of the Group in China amounted to HK\$47,170,000, representing an increase of HK\$19,897,000 over the same period of the previous year, all of which were current fund loans due within one year. The Group did not use property as securities for such bank loans. Since movements of the Hong Kong dollar against RMB were more stable than against other currencies, the Directors do not anticipate to face any major currency exposures, therefore the Group has not arranged any currency hedge.

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Gearing ratio of the Group rose slightly from approximately 22.0% at 31 December, 2000 to approximately 24.0% at 31 December, 2001. This calculation is based on net borrowings of HK\$47,170,000 (2000: HK\$27,273,000) and shareholders fund of HK\$196,305,000 (2000: HK\$123,900,000).

CHARGE OF ASSETS

As at 31 December, 2001, the Group's bank deposits of approximately HK\$11,981,000 (2000: HK\$2,727,000) were pledged to banks to secure general banking facilities granted to subsidiaries.

CONTINGENT LIABILITIES

As at 31 December, 2001, the Group did not provide any from of guarantees for any other company and was not liable to any legal proceedings. Therefore, the Group was no significant contingent liabilities.

APPLICATION OF PROCEEDS FROM THE LISTING

On 9 May, 2001, the shares of the Company was listed on the main board of the Stock Exchange. Net proceeds of about HK\$70,000,000 raised from the share offer were used on business expansions and new product development.

As at 31 December, 2001, applications of the proceeds were as follows:

Plant renovation and replacement of equipment to meet the high standard of GMP: totally HK\$3.5 million was spent, exceeding the planned expenditure of HK\$2.5 million by HK\$1 million. It is expected that HK\$1.8 million will be paid for the completion of the entire project.

An amount of HK\$1.3 million was paid as technology transfer fee for acquisition of new medicine "Piglyketone" (匹格列酮). A further HK\$0.8 million shall be paid under the contract. This is in line with HK\$2.1 million as planned in the Prospectus.

An amount of HK\$0.6 million was paid as technology transfer fee for acquisition of "Azithromycin Granules" (阿奇霉素微囊細粒劑). A further HK\$0.1 million shall be paid under the contract. This is largely in line with HK\$0.7 million as planned in the Prospectus.

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An amount of HK\$0.31 million was paid on projects of expanding production facilities and production volumes.

An amount of HK\$23 million, exceeding the originally plan by HK\$5 million, was spent for new market expansions and market promotions for existing products of the Group. The objective is to develop new markets more effectively.

As at 31 December, 2001, the above investment projects had a total actual expenditure of HK\$28 million.

SHORT AND LONG TERM BUSINESS PROSPECTS AND DEVELOPMENT PLANS

The Group will continue to develop new sales markets including Guangdong scheduled for 2002. As far as the newly developed markets of Beijing, Chengdu, Chongqing and Wuhan are concerned, the Group will increase its penetration power by actively developing those neighboring regional markets of such newly developed markets. The Group is able to increase sales volume on the basis of 2001. New markets will bring steady business growth to the Group.

The construction work of medicine production plants is largely completed to cope with the business development of the Group and bring the quality of medicine products more in line with the new production standard. The plants have applied to the pharmaceutical regulatory authority for inspection and approval and are expected to commence production in June 2002. Production of Chinese products such as “Kang Gu Zeng Sheng Pian” (抗骨增生片), “Tong Mai Ke Li” (通脈顆粒), “Du Zhong Jiang Ya Pian” (杜仲降壓片) and “Mei Nuo Ping” (美諾平) will commence in the second half of the next year. Production of the diabetes treatment product “Piglyketone” (匹格列酮) will commence in August 2002. With the completion of medicine production facilities, the Group is combining both the traditional Chinese medicines production and the modern pharmaceutical manufacturing, bringing new growth areas for the business of the Group.

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CLOSURE OF REGISTER OF MEMBERS

The register of members of the Company will be closed from Tuesday, 28 May, 2002 to Friday, 31 May, 2002 both days inclusive, during which period no transfer of Shares will be registered. In order to qualify for attending the forthcoming Annual General Meeting, all completed transfer forms accompanied by the relevant share certificates must be lodged with the Company's branch share registrar in Hong Kong, Central Registration Hong Kong Limited at Shops 1901-5, 19th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong no later than 4:00 p.m. on Monday, 27 May, 2002.

AUDIT COMMITTEE

The audit committee of the Company (the "Audit Committee") and the management of the Company have reviewed the accounting principles and practices adopted by the Group and have discussed the matters related to auditing, financial reporting procedures and internal control, including the review of the final results for the year ended 31 December, 2001.

CODE OF BEST PRACTICE

Since the listing of the Company's shares on the Stock Exchange on 9 May, 2001, the Company has complied with the Code of Best Practice as established in Appendix 14 of the Rules Governing the Listing of Securities (the "Listing Rules") on the Stock Exchange.

PURCHASE, SALE OR REDEMPTION OF COMPANY'S LISTED SHARES

During the period, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's listed shares.

PUBLICATION OF RESULTS ANNOUNCEMENT ON THE EXCHANGE'S WEBSITE

A detailed results announcement containing all the information required by paragraphs 45(1) to 45(3) of Appendix 16 of the Listing Rules will be published on the website of the Stock Exchange in due course.