

# MANAGEMENT DISCUSSION AND ANALYSIS

For the financial year ended 31 May 2002, the Group's turnover continued to grow. In order to gain long-term, continuous and sizeable growth, the Group has put into place a large investment scheme during the year. It formed Rheumatic Treatment Centres with 94 hospitals and invested approximately HK\$165 million in these centres. Due to certain unanticipated operating insufficiency of its co-operative hospitals during the period from August to October 2002, the Group terminated 36 centres and disposed of another 28 centres to two independent third parties. Because of the termination and disposal as mentioned, non-refundable initial establishment costs of HK\$20 million and impairment loss of HK\$5 million in respect of investments in those terminated/disposed centres were charged to the current year's profit and loss account. As a result, the Group's net profit for the financial year ended 31 May 2002 was down to HK\$21.3 million, from HK\$40.1 million in previous year. The Group's current year result has dropped; nonetheless, we still feel positive about having formed the Rheumatic Treatment Centres as they have created new business prospect for the Group.

## Operating Results

Consolidated turnover of the Group for the year ended 31 May 2002 amounted to HK\$280.1 million, representing an increase of 19.0% over HK\$235.4 million of previous year. The increase was attributable to the provision of anti-rheumatoid pharmaceutical products to the newly formed Rheumatic Treatment Centres.

The Group's gross profit was approximately HK\$117.8 million, representing a slight increase of approximately 5.3% over HK\$111.9 million of previous year. Change of product mix and price increases of raw and supplementary materials caused the profit margin to slide from 48% in previous year to 42% in this year.

## Manufacturing of Chinese Pharmaceutical Products

For the year ended 31 May 2002, the development, manufacturing and provision of medicinal preparations and anti-rheumatoid capsules for the treatment of rheumatoid and/or arthritic conditions continue to perform well and remain as the Group's major profit contributor. Turnover of the manufacturing business, an upsurge by 27.3% when compared to that of previous year, was in the amount of HK\$249.3 million. Revenue and operating result derived from the manufacturing of Chinese pharmaceutical products accounted for 89.0% and 99.1%, respectively, of the Group's turnover and segment results. The growth in revenue of the manufacturing business was primarily due to the increase in sales volume derived from the newly established hospital network.

## Trading Business

The Group's trading business is principally engaged in the wholesale and retail of Chinese and Western pharmaceutical products and health care products in the PRC. For the year ended 31 May 2002, the trading business accounted for 8.8% of the Group's turnover. Since the trading business is focused on the Beijing region, as a result of severe competition in the trading of pharmaceutical industry in the PRC this year, both of its turnover and operating result were lower than previous year.

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## Operation of Taiyuan Hospital

For the year ended 31 May 2002, the Group's turnover attributable to the provision of medical treatment, including clinical and medical fees and sales of medicines in the Taiyuan Hospital accounted for approximately 2.2% of the Group's total turnover. Due to the continued growth in the number of patients, the operation of the Taiyuan Hospital reported increase in both of its turnover and operating result over previous year.

## Employees

As of 31 May 2002, the Group has a workforce of approximately 280 in both the PRC and Hong Kong. Remuneration policies of the staffs are reviewed annually and certain staffs are entitled to commission and bonus. During the year, there was no significant change in the Company's employees remuneration policies.

## Liquidity and Financial Resources

The Group continues to maintain a strong financial position and is confident that it has sufficient funds to meet its daily business operation requirements and future expansion. As at 31 May 2002, the Group's cash and cash equivalents was HK\$53 million (2001: HK\$135 million) and its working capital was HK\$124 million (2001: HK\$134 million). The gearing ratio, defined as long-term liabilities to shareholders' fund, was 0.14 (2001: not applicable) as there was long-term bank loan drawn down during the first half of the year. The Group finances its operations with internally generated cash flow and banking facilities. The Group's cash balances at 31 May 2002, which accounted for approximately 23.1% of the total current assets, amounted to HK\$53 million.

The Group's bank borrowings amounted to HK\$37 million (2001: Nil) as at 31 May 2002 which are all charged at floating interest rate. The bank borrowings were repayable as to HK\$19 million, HK\$12 million and HK\$6 million within one year, in the second year and in the third year, respectively. The banking facilities of the Group were supported by corporate guarantees executed by the Company and a subsidiary of the Company together with personal guarantees executed by two executive directors of the Company.

Most of the Group's monetary assets and borrowings are denominated in Renminbi and Hong Kong dollar. The foreign exchange fluctuation between Hong Kong dollar and Renminbi is not material. Thus, the exchange rate risk of the Group is considered to be minimal.

As at 31 May 2002, the Group had no significant contingent liabilities (2001: Nil).

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## Subsequent Events

On 29 July 2002, the Company agreed to issue HK\$20 million unsecured convertible debentures to Honest Concord Enterprises Limited and the net proceeds amounted to approximately HK\$19.6 million. The details of the issuance of unsecured convertible debentures have been set out in the Company's press announcement dated 30 July 2002.

On 28 August 2002, the Group entered into a conditional agreement with an independent third party for the acquisition of 11% equity interest in a PRC pharmaceutical enterprise for a consideration of HK\$20 million. The transaction remains conditional upon certain conditions to be fulfilled as set out in the agreement. The Board believes that the acquisition will enhance the Group's production capacity.

## Use of Proceeds

To the date of this report, the net proceeds of approximately HK\$48 million raised in the Company's initial public offering in July 2000 have been applied as follows:

- approximately HK\$7 million for upgrading the existing production plant and acquisition of additional machinery;
- approximately HK\$3 million for marketing and advertising campaigns in the PRC;
- approximately HK\$2.8 million used for general working capital purposes; and
- the remaining balance was placed with banks if no requirement for immediate use.

## PROSPECTS

In our view, the intense competition in the PRC's pharmaceutical industry will last until the market is dominated by only a few giant companies. Each company in the market gropes for the way to become the last survivors. Based on our last few years' experience and study, we believe support from hospitals, medical institutions and universities form one of the predominant factors in determining the reputation, recognition and thus earning powers of a pharmaceutical company. To secure our influence and leadership in the treatment of rheumatism, the Group will strengthen its clinical and technological cooperation with hospitals, medical institutions and universities. To capitalise on the expanded sales network with co-operative hospitals, high recognition of "Hou's Therapy" and high curative effects of its manufactured anti-rheumatoid pharmaceutical products, the Group will focus, in the coming year, on providing training and technical assistance to the newly formed Rheumatic Treatment Centres so as to strengthen quality of their services and treatments. This, in turn, will create selling opportunities to the Group. The Board is confident in its policies and believes that the Group will achieve growth gradually and will in return enhance its profitability for the shareholders in the near future.