

# Management Report, Discussion and Analysis



*Newly-acquired facility:  
Pharmaceutical workshop refrigeration system*

## BUSINESS PERFORMANCE CONDITIONS

### BUSINESS REVIEW

Sales turnover of health care products in China in 2001 declined by 43% compared with 2000. This trend continued in 2002. According to information disclosed in a website known as Zhong Guo Bao Jian Shi Pin Wang [中國保健食品網], sales turnover of health care products in 2002 declined by about 30% over the same period of previous year. Turnover of health care products in China for 2002 was approximately HK\$19 billion, representing a decline of about 60% when compared with the peak season in 2000. In face of this unfavourable market condition, the Group modified its operation strategy by curtailing a large part of its advertising expenses and adopting flexible marketing of offering free gifts to customers. As a result, sales turnover of health care products only declined by 23.5% when compared with that in the corresponding period of the previous year, and HK\$18 million was saved in terms of marketing expenses compared with the previous year. Therefore, although sales turnover decreased, profit from operation did not decline significantly. While continuing to strengthen the markets we had developed last year in Beijing, Chengdu, Chongqing and Wuhan, the Group also developed two new markets this year in Fujian and Shenzhen so as to compensate for contraction of the existing markets. Sales income of HK\$5.5 million had been generated in these new markets. Moreover, after the introduction of its new pharmaceutical product "Mei Nuo Ping" [美樂平] to the market in the second half of 2002, the Group had earned an extra income of HK\$9.4 million from the sale of this product.

### PRODUCT DEVELOPMENT

Technology transfer fees of HK\$1.8 million and HK\$0.6 million had been paid for acquisition of the new products, namely Piglyketone and Azithromycin Granules respectively. The obtaining of production approval of the new products was delayed due to clinical testings and the formality of reporting. It is anticipated that production approval can be obtained in the period of July - August of 2003.



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In order to gain further development in the production of pharmaceutical products, the Group signed a technology transfer contract with Shen Yang Zhonghai Sheng Wu Ji Shu Kai Fu You Xian Gong Si (瀋陽中海生物技術開發有限公司) in early 2002 in respect of the new State Category 2 virus-resistant medicine “Yan Shuan a Bi Duo er” [鹽酸阿比朵爾]. The total amount of the technology transfer fee was HK\$3.8 million. A payment of HK\$0.5 million has already been made.

Production approval of the new product “Mei Nuo Ping” [美樂平] was granted in the second half of 2002. This new product is good for pimples treatment and can either be taken orally or used externally. An income of HK\$9.4 million from the sale of this product was realized that year. There are very good prospects for its development.

Production approval of the new product “Xiang Fei Jiao Nang pill” [香妃膠囊] was granted on 20 March 2002. This new product is developed by the Company itself and is treated as a reserved product which has not yet been put into production. “Nuclein” is still under review.

As revealed by market survey, the market of health care products will continue to slacken while sale of traditional tonic medicine will be stable with slight increase. A member of the Group for pharmaceutical products has invested HK\$2.8 million in the acquisition of the production technology of “Korean Ginseng” [高麗蔘] together with the production approval. The Group has already acquired the raw “Korean Ginseng” with a value of HK\$14.1 million, which will bring steady income upon commercialisation in May, 2003.

After improvement of the production technology of the Longevity Ginseng of the Group, its registration ref. Liao Wei Jian Zi (1996) No. 0136, has been changed to Guo Yao Zhan Zi No. B20021010 as approved by the State Pharmaceutical Supervision and Administration Bureau of the PRC in December, 2002.

Moreover, the Company is now developing its own health care products such as “Zhuang Gu Fan” [壯骨粉], “Bing Tong Yan Wo Kou Fu Yie” [冰糖燕窩口服液] and “Wu Ji Jing” [烏雞精]. These new products are now under application for approval.



*Newly-acquired facility:  
Pharmaceutical purified water treatment system*

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*Newly-acquired facility:  
High efficiency thin sugar-coating machine*

## REGIONAL DEVELOPMENT

While maintaining sales turnover in the original markets, the Group also developed two new markets in Fujian and Shenzhen in the second half of 2002, and these new markets had brought a turnover of HK\$5.5 million to the Group. Our new product “Mei Nuo Ping” 「美樂平」, though its sales coverage at present is restricted to the north-eastern part of China, had been able to bring a turnover of HK\$9.4 million to the Company.

## PROSPECTS FOR THE YEAR 2003

Facing with the current market situation, the Group is also confronting with challenging months ahead so as to gain a turnaround for recovery. The Group will continue to focus on consolidation of its existing products and markets. At the same time, The Group believes that with the growing potential of the pharmaceutical market, we are enhancing the strength of its future development with injection of significant resources.

The management of the Group strongly believes that by leveraging our technological know-how and the existing marketing networks in the PRC, pharmaceutical market will bring fruitful returns and profits to our investors in near future.

## LIQUIDITY AND FINANCIAL ANALYSIS

As at 31 December, 2002, applications of the net proceeds from the listing were as follows:

Plant renovation and replacement of equipment to meet the high standard of GMP: totally HK\$5.5 million was spent for the completion of the entire project, exceeding the planned expenditure of HK\$2.5 million by HK\$3.0 million.

An amount of HK\$1.7 million was paid as technology transfer fee for acquisition of new medicine “Piglyketone” 「匹格列酮」. A further HK\$0.4 million shall be paid under the contract. This is in line with HK\$2.1 million as contemplated in the prospectus of the Company.

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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 contemplated in the prospectus of the Company.

An amount of HK\$0.5 million was paid on projects of expanding production facilities and production volumes.

An amount of HK\$23.0 million, exceeding the original plan by HK\$5.0 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, 2002, bank loans of the Group at fixed rate amounted to HK\$84.2 million, representing an increase of HK\$37.0 million as compared to the outstanding loans at 31 December 2001, all of which were short-term loans due within one year and partial in Renminbi loans. Since movements of Renminbi against other currencies, in particular the Hong Kong dollar were more stable, the Directors do not anticipate to face any major currency exposures, therefore the Group has not arranged any currency hedge. The Group has also secured short-term floating rate loan of HK\$17.8 million for working capital. During the year, an amount of HK\$5.2 million was paid as aggregate interest of bank loans. The Group did not use property as securities for such bank facilities, nor was there the use of any financial instruments for hedging purposes.

Gearing ratio of the Group rose from approximately 24.0% at 31 December, 2001 to approximately 50.8% at 31 December, 2002. This calculation is based on net borrowings of approximately HK\$102.0 million (2001: HK\$47.2 million) and shareholders fund of approximately HK\$201.7 million (2001: HK\$196.3 million).

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As at 31 December 2002, the balance of the inventories amounted to HK\$117.8 million, representing an increase of HK\$81.7 million when compared with the corresponding period of the previous year, of which:

- (a) an amount of HK\$57.3 million was attributed to raw material, representing an increase of HK\$45.6 million when compared with the corresponding period of the previous year, as the commencement of production of Shenyang Jinlong Pharmaceutical Co. Ltd. (瀋陽金龍藥業公司) required a raw material reserve for the new product “Korean Ginseng” [高麗蔘] amounting to HK\$14.1 million. The major raw material for Longevity Ginseng is an agricultural by-product the growing period of which is 4-5 years. Its production volume and price are entirely controlled by market forces. As a result of the supply and demand, its price in 2002 had declined to its lowest level within the past five years. It is anticipated that the production volume of ginseng next year will become less and its price accordingly might rise sharply. In order to reduce the purchasing cost, we have reserved a large quantity of raw ginseng this year, causing our inventory to rise to approximately HK\$31.5 million when compared with the corresponding period of the previous year; and
- (b) an amount of HK\$48.6 million was attributed to the finished product, representing an increase of HK\$30.4 million when compared with the corresponding period of the previous year, as past experience in the development of new markets showed that sales turnover will usually rise significantly in the second year of its development. The Company had thus produced a large quantity of the products for the new market. As the growth of sales in the new market had not been as good as expected, the inventory of the finished product thus rose.

## CHARGE OF ASSETS

As at 31 December, 2002, the Group's bank deposits of approximately HK\$27.4 million (2001: HK\$12.0 million) were pledged to banks to secure general banking facilities granted to its subsidiaries.



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## CONTINGENT LIABILITIES

As at 31 December, 2002, the Group did not provide any form of guarantees for any other company and was not liable to any legal proceedings. Therefore, the Group has no significant contingent liabilities.

## SHORT AND LONG TERM BUSINESS PROSPECTS AND DEVELOPMENT PLANS

Since the market for health care products remains sluggish and the sale for traditional health care products is expected to be satisfactory, the Group therefore will increase the production of “Korean Ginseng” in 2003. It is anticipated that the turnover of “Korean Ginseng” in 2003 will amount to HK\$14 million and will even reach HK\$45 million in three years.

The Group will step up promotion of the product “Mei Nuo Ping” [美樂平] and develop new markets in addition to the existing one in the north-eastern part of China. The Group will tap the market in eastern China in 2003 and also other parts of China with market potential in 2004.

In order to cope with its strategy of producing a great variety of pharmaceutical products and enhancing their therapeutic effect, the Group will promote the sale of the new medicine for curing diabetes – “Piplyketone” [匹格列酮], and the antibiotic – “Azithromycin” [阿奇霉素] in 2003. The virus-resistant product “Yan Shuan a Bi Duo er” [鹽酸阿比朵爾] will go into production in 2005.

Following increase in sales turnover of the pharmaceutical products, the Group will have stable growth of its business.

The Group will commence production of the “Longevity Ginseng” [保齡蔘] with approval ref. “Guo Yao Zhen Zi Hao” [國藥准字號] in the second half of 2003. It will be sold in pharmacies and hospitals so as to avoid keen competition in the market for health care products and reduce the sales expenses to a large extent with a view to increasing profit ability.



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In order to improve the situation of limited choice of products and seasonal fluctuation in sales, the Group is planning to adopt a multiple mode of operations so as to gain a larger share of the market and avoid the decline in sales. We will introduce to the market the products of “Zhuang Gu Fan”「壯骨粉」, “Bing Tong Yan Wo Kou Fu Yie”「冰糖燕窩口服液」 and “Wu Ji Jing”「烏雞精」to compensate for the loss of sales in the non-peak season. We will also increase the utilization rate of the speciality outlets and significantly reduce the cost of production and sale.

The progress of the property development project in Guangzhou is on schedule. The approval procedure has been completed. It is now at the stage of arranging tender for the project. The total investment of the Group in the project will remain at HK\$20 million and funded from its internal resources.

## **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.

Our production division implements performance appraisal morale for all employees. Those who fail to meet the appraisal are subject to dismissal. In order to boost the staff morale and enable them to give full play to their professional knowledge and skill, monthly as well as annual appraisals are conducted, those with remarkable performance upon appraisal are rewarded whereas those who fail in the appraisal standards are dismissed.

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An output target for each product is formulated for various job postings. The Company uses 20% of the savings to award those staff (or job postings) who have exceeded the output target. A quota system is implemented in respect of the production task of various job postings. Those who fail to achieve their production quota have their salary reduced in accordance with the One Hundred Points Appraisal System and in proportion to the quantity of work being not completed. Those who have worked exceeding the production quota are awarded in accordance with the One Hundred Points Appraisal System.

Our marketing division has linked the wage of the marketing personnel with the selling expenses and sales income. They only receive a basic monthly salary. At the end of the year, those who are able to achieve the sales target are awarded bonus with regard to the percentage of the selling expenses in relation to the sales income.

## SHARE OPTION SCHEME

The Company adopted its existing share option scheme on 6 April 2001 which will expire on 6 April 2011 (the “Existing Scheme”). There is no option granted under the Existing Scheme. In view of the changes introduced to chapter 17 of the Listing Rules with effect from 1 September 2001, the Board considers that it is in the interest of the Company to adopt a new share option scheme in compliance with the Listing Rules (the “New Scheme”) and to terminate the Existing Scheme. A summary of the principal terms of the rules of the New Scheme has been set out in the circular (the “Circular”) dispatched to the shareholders of the Company together with this Annual Report. The Existing Scheme will be terminated upon the New Scheme coming into effect which in turn will be subject to the fulfilment of certain conditions set out in the Circular.





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## **CLOSURE OF REGISTER OF MEMBERS**

The register of members of the Company will be closed from Tuesday, 27 May, 2003 to Friday, 30 May, 2003 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, Computershare Hong Kong Investor Services Limited at Shops 1901-5, 19th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong no later than 4:00p.m. on Monday 26 May, 2003.

## **AUDIT COMMITTEE**

The audit committee of the Company 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, 2002.