



# Management Discussion and Analysis

## BUSINESS PERFORMANCE CONDITIONS

### Business Review

2003 was an arduous year for enterprises in Asia. The outbreak of the Severe Acute Respiratory Syndrome ("SARS") epidemic in the Asian region had a serious strike and impact on the retail market and consumer spending, halting economic growth in most countries in Asia. The business performance of the Group showed a notable decline during the first half of 2003. In coping with the situation, the management of the Group drastically reduced the costs of sales and temporarily suspended the exploration of the market for new health care products while at the same time strengthened the sales effort on pharmaceuticals. On the other hand, the Group had successfully opened up the markets in northern and eastern China in the second half of 2003, and as such the sales volume of pharmaceutical products recorded a satisfactory growth of 100% over that of 2002.

In October 2003, the Group entered into an agreement with an international investor for the acquisition and development of a nasal spray insulin project. A subsidiary of our Group agreed to issue a total of 7,000,000 preference shares to the investor and would raise an aggregate of US\$7 million for the acquisition and development of the nasal spray insulin project. The first stage of 4,000,000 preference shares were issued and the funds raised were received in November 2003, which is currently placed as reserve fund pending approval of new medicine certificate by the State Pharmaceutical Supervision and Administration Bureau of the People's Republic of China (the "PRC"), and thereafter production activity and sales campaign will be launched.

In view of the unstable conditions of the property market, the Group decided in 2003 to pull out from its real estate development project in Guangzhou. The Group withdrew all its investments from the said project and there was no profit or loss incurred therefrom.

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## Product Development

Our "Azithromycin Granules" [阿奇霉素微囊細粒劑] was granted the production approval in September 2003 and launched in the market in October 2003. The product contributed to the Group's sales income of approximately HK\$2,000,000. In addition, the production approval of another new product "Piglyketone" [匹格列酮] was also granted in December 2003. The product is scheduled to put into production and market in 2004.

In January 2003, the Group signed a technology transfer contract with Shenyang 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) ("Shenyang Zhonghai") in respect of the new State Category 2 virus-resistant medicine "Yan Shuan a Bi Duo er" [鹽酸阿比朵爾]. As Shenyang Zhonghai could not obtain the approval of clinical test, the contract was subsequently terminated.

The new product "Mei Nuo Ping" [美諾平], which is good for pimples treatment and can be taken orally together with ointment for external use, achieved a sales income of approximately HK\$14 million, representing a 45% increase over that of the previous year. It is expected that there will be ample room for the development of this product.

Production approval of the new product "Xiang Fei Jiao Nang Pill" [香妃膠囊], developed by the Group itself, was granted in March 2002. The product is treated as a reserved product which has not yet been put into production. The approval of "Nuclein" [核能元] is still being under processed.

Taking advantage of the satisfactory sales performance of traditional health care products, a member of the Group for pharmaceutical products invested approximately HK\$2.8 million in the acquisition of the production technology of "Korean Ginseng" [高麗蔘] together with the production approval. The product was launched into market in August 2003 and recorded a sales income of approximately HK\$1.7 million.

Following the improvement of the Group's production technology of the Longevity Ginseng, the products registration reference 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. The product is treated as a reserved product and expected to be launched into the market in the second half of 2004.

Moreover, the Group is now developing its own health care products such as "Zhuang Gu Fan" [壯骨粉], "Bing Tong Yan Wo Kou Fu Ye" [冰糖燕窩口服液], "Wu Ji Jing" [烏雞精] and "Qi Cai Zhen Zhu Ye" [七彩珍珠液]. The product "Qi Cai Zhen Zhu Ye" [七彩珍珠液] was granted the approval already, while other products are still under applications.

The application of another new product of the Group "Luo Hong Mei Su" [羅紅霉素] for approval has been accepted by the State Pharmaceutical Supervision and Administration Bureau of the PRC. The product is now undergoing clinical test.

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## Regional Development

The sales of the health care products of the Group were basically maintained at their original markets in 2003. The Group's new product "Mei Nuo Ping" [美諾平] expanded its sales coverage from the original north-eastern part of China to eastern China, and by capitalizing on its original sales network, the sales expenses of the new product was effectively reduced. On the other hand, the new antibiotic product "Azithromycin" [阿奇霉素] was launched in the market and available for sale in October 2003. At present, its market coverage is confined to the north-eastern part of China, bringing a turnover of approximately HK\$2 million to the Group. The Group plans to expand into the market in eastern China in the second half of 2004.

## PROSPECTS FOR THE YEAR 2004

The government of the PRC aims to introduce reform measures in the near future to regulate the management system on all pharmaceuticals and health care products in the country, including the Good Manufacturing Practice ("GMP") accreditation towards the manufacturers and the Good Service Practice ("GSP") requirements towards the sales channels. The ultimate objective of the reform is to ensure a healthy development of the health care industry.

Through the reform measures, it is expected that all the poor-quality or faked products will be expelled from the market whilst those quality health care products can be protected and supported for development. On the other hand, in the wake of the outbreak of the SARS epidemic, consumer's demand towards disease-immune medicines has been enhanced. The sales for health care products is optimistic. With the steady growth of the national economy and the betterment of national income, people would pay more attention to health and improve their quality of life, all of which are attributable to healthy development for the market of health care products.

The Group believes that, amid the recovery of the market for health care products and supported by all the positive factors in 2004, it could capitalize on the market opportunities and reap a stable return for the year.

The robust sales network of the health care products in the PRC developed by the Group had laid a strong foundation for its further exploration of the pharmaceuticals market. Under the circumstances, the management of the Group believes that the Group will experience further development in 2004 and beyond, its pharmaceuticals business will bring fruitful returns and provide room for revenue growth.

## LIQUIDITY AND FINANCIAL ANALYSIS

The issue of the first stage of 4,000,000 preference shares by a subsidiary of the Company raised US\$4 million which was placed as reserve fund, and will be used for investment once the new medicine certificate for nasal spray insulin is obtained. As at 31 December 2003, bank loans of the Group at fixed rate amounted to HK\$81.2 million, representing a decrease of HK\$20.8 million as compared to the total outstanding loans at 31 December 2002, 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. During the year, an amount of HK\$6.3 million was paid as aggregate interest of bank loans (2002: HK\$5.2 million). The Group did not use property as securities for such bank facilities, nor was there the use of any financial instruments for hedging purposes.



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Gearing ratio of the Group reduced from approximately 50.8% at 31 December 2002 to approximately 38.9% at 31 December 2003. This calculation is based on net borrowings of approximately HK\$81.2 million (2002: HK\$102.0 million) and shareholders fund of approximately HK\$208.9 million (2002: HK\$200.7 million).

As at 31 December 2003, the balance of the inventories amounted to HK\$108.0 million, representing a decrease of HK\$9.7 million when compared with the corresponding period of the previous year, of which:

- (a) an amount of HK\$56.7 million was attributed to raw material, representing a decrease of HK\$0.6 million when compared with the corresponding period of the previous year; and
- (b) an amount of HK\$51.4 million was attributed to the work in progress and finished products, representing a decrease of HK\$9.1 million when compared with the corresponding period of the previous year. There was a higher inventory level in 2002 due to piling up of finished goods, however, the Group managed to reduce its inventory of finished goods in 2003.

### CHARGE OF ASSETS

As at 31 December 2003, the Group's bank deposits of approximately HK\$20.6 million (2002: HK\$27.4 million) were pledged to banks to secure general banking facilities granted to its subsidiaries.

### CONTINGENT LIABILITIES

As at 31 December 2003, the Group did not provide any form of guarantees for any outside companies and was not liable to any material legal proceedings of which provision for contingent liabilities was required.

### SHORT AND LONG TERM BUSINESS PROSPECTS AND DEVELOPMENT PLANS

To capture the arising opportunities from the traditional health care products' market, the Group has successfully launched the product "Korean Ginseng" [高麗蔘] in the market in the second half of 2003. The sales coverage for the product is merely confined to the eastern China region, and sales in 2003 reached HK\$1.7 million. In 2004, the product will also be sold to other potential and valuable markets such as Beijing and Wuhan, and it is expected to bring promising sales revenue to the Group.

The Group will step up promotion and sales of the product "Mei Nuo Ping" [美諾平] and the antibiotic "Azithromycin" [阿奇霉素], and further develop new markets in addition to the existing markets in northern and eastern China.



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In order to cope with its marketing strategy of producing a great variety of pharmaceutical products and enhancing their therapeutic effects, the Group will promote the production of the new medicine for curing diabetes – “Piglyketone” [匹格列酮]. With the increase in the sales of new products, it is expected that the Group will ride on the steady growth track.

In view of the keen competition in the market for health care products, the Group has significantly reduced sales expenses and retained the existing mode of sales by increasing the utilization rate of the “specialty outlets”. It is anticipated that 1,000 shops will be opened within the nation to expand its profit base.

### EMPLOYEE POLICY, PERFORMANCE AND SALARY PROCEDURES

The Group has a total of over one thousand employees in the PRC and Hong Kong (remains at the same level of last year).

The Group has implemented a comprehensive staff policy together with the reward/penalty system so as to enhance the overall operational efficiency. The Group put much emphasis on staff’s performance and their contribution to the Company. The production division implements performance appraisal standards for all employees of various levels and departments. Those who fail to meet the appraisal standards are subject to dismissal. On the other hand, the Group conducts monthly and annual appraisal towards employees on a regular basis, those with remarkable performance upon appraisal are rewarded whereas those who fail are dismissed.

For employees engaged in production, output targets for various products are formulated for various postings. The Company offers 20% of its savings to reward those staff (or job postings) who have exceeded the output target. On the other hand, a quota system is implemented by the Group in respect of the production task of various job postings. According to the 100 Points Appraisal System implemented by the Group, those who fail to achieve their production quota are subjects to salary reduction in proportion to the quantity of work not being completed and bonus cancellation. However, those who have work exceeded the production quota are rewarded.

In respect of the marketing division, the Group adopts a performance-based salary system which links the salary of the marketing officers with the selling expenses and the sales income, in order to encourage the officers to excel in their sales performance. The marketing officers receive only a monthly basic salary, and by the end of the year, bonus will be granted to those who are able to achieve their sales target, which based on the calculation with regards to the selling expense as a percentage to the sales income.