

Determined to excel

Integrating advanced production facilities with strong production know-how, Shineway strives to provide high quality products and services with the aim of broadening brand recognition. Shineway adopts a stringent quality management system throughout the entire production process from R&D to procurement, production and sales and marketing. Its goal is to deliver the highest quality modern Chinese medicines to its customers and the market.



Management discussion and analysis

Industry Overview

During 2004, the PRC economy achieved fast growth with GDP and the pharmaceutical industry maintained a faster growth pace. While the growth rate of Chinese medicines sector surpasses the growth rate of the pharmaceutical industry. Last year, the State enforced the GMP and GSP certification system. Manufacturing enterprises which fail to obtain the certification could not continue to carry out production or sales of medicines. At the same time, the PRC starts implementing the classification of medicines management system to ensure safe and effective usage of medicine by customers. Since all the Group's production facilities have obtained GMP certification in 2003, Shineway Sales has obtained GSP certification in the middle of the year. Stricter regulation on medicines provide a healthier development environment for the Group and other large enterprises. After the SARS outbreak in 2003, raw material prices have restored to a more reasonable level and was relatively stable in 2004. The PRC has reduced selling prices of medicines, mainly western medicines drastically. Prices of the Chinese pharmaceutical products are relatively stable, with no adverse effect on the Group's sales.

Results

The Group's consolidated turnover for the year ended 31 December 2004 was RMB703,575,000, representing an increase of 16.5% over the amount of RMB604,042,000 for last year. The turnover generated from the sale of injections, soft capsules, granules and other product forms amounted to RMB361,600,000, RMB229,300,000, RMB102,000,000 and RMB10,675,000, accounting for 51.4%, 32.6%, 14.5% and 1.5%, respectively. The proportion of sale of injection products increased notably. Profit after taxation was RMB260,793,000, up 72.3% than 2003. Gross profit margin was 64.2%, higher than 47.9% for last year primarily due to an increase in economies of scale, lower purchasing cost after the adoption of central purchasing system and a shift in product mix towards higher margin products.

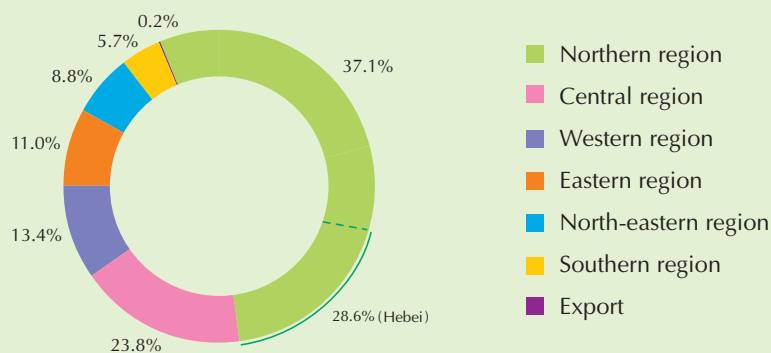
Product sales

The Group produced both prescription and OTC medicines in 2004. It offers a range of 45 pharmaceutical products, most of which are sold in the PRC, with exports accounting for only a small portion of sale. Our customers are mainly licensed pharmaceutical distributors, hospitals and medical institutions, pharmacies and other retail outlets. The Group's seven main products, including Xin Nao Qing soft capsules, Qing Kai Ling injection, Shen Mai injection, Fu Fang San Wei Ya You Suan I soft capsules, Huo Xiang Zheng Qi soft capsules, Paediatric Hua Tan Zhi Ke granules and Paediatric An Fen Huang Na Min granules, account for approximately 82.8% of the total turnover.

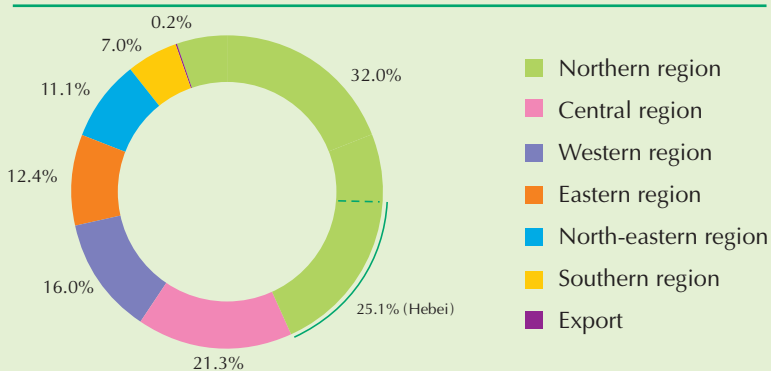
A breakdown of turnover by geographic location

	Northern region						Central region		Western region		Eastern region		North-eastern region		Southern region		Export		Total	
	Hebei		Others		Total		RMB		RMB		RMB		RMB		RMB		RMB		RMB	
	million	%	million	%	million	%	million	%	million	%	million	%	million	%	million	%	million	%	million	%
2001	122.5	28.4	38.2	8.9	160.7	37.3	106.9	24.8	54.3	12.6	45.0	10.4	41.3	9.6	22.1	5.1	0.6	0.2	430.9	100
2002	128.1	26.8	50.2	10.5	178.3	37.3	117.0	24.5	56.9	11.9	49.0	10.3	45.9	9.6	29.9	6.2	0.9	0.2	477.9	100
2003	173.0	28.6	51.0	8.5	224.0	37.1	144.0	23.8	81.0	13.4	66.3	11.0	53.0	8.8	34.8	5.7	0.9	0.2	604.0	100
2004	176.7	25.1	48.7	6.9	225.4	32.0	149.8	21.3	112.8	16.0	87.1	12.4	77.9	11.1	49.3	7.0	1.2	0.2	703.5	100

2003



2004



Notes:

- Other regions include Beijing, Shanxi Province, Tianjin and Inner Mongolia.
- Central region includes Henan Province, Anhui Province, Hubei Province, Hunan Province and Jiangxi Province.
- Western region includes Sichuan Province, Yunnan Province, Gansu Province, Chongqing, Xinjiang Uygur Autonomous Region, Guizhou Province, Qinghai Province, Ningxia Autonomous Region and Shaanxi Province.
- Eastern region includes Shandong Province, Zhejiang Province, Jiangsu Province and Shanghai.
- North-eastern region includes Heilongjiang Province, Jilin Province and Liaoning Province.
- Southern region includes Guangdong Province, Fujian Province, Guangxi Zhuangzu Autonomous Region and Hainan.

The breakdown of sales by geographical location showed that the sales to the Northern and Central China increased by RMB7,301,000 in 2004, and the percentage accounting for the total sales reduced from 60.9% in 2003 to 53.4%. It was because the Group not only consolidated its existing marketing sales effort but also enhanced its sales effort in other regional markets. As a result, the Eastern and Western markets recorded faster growth pace.

A breakdown of turnover by product types

Items	For the year ended 31 December					
	2002		2003		2004	
	RMB million	%	RMB million	%	RMB million	%
Prescription						
Modern Chinese medicines	321.7	67.3	431.8	71.5	533.1	75.8
Western Pharmaceuticals	77.2	16.2	79.3	13.1	66.9	9.5
Subtotal	198.9	83.5	511.1	84.6	600.0	85.3
OTC						
Modern Chinese medicines	51.8	10.8	68.4	11.3	66.0	9.4
Western Pharmaceuticals	27.2	5.7	24.5	4.1	37.5	5.3
Subtotal	79.0	16.5	92.9	15.4	103.5	14.7
Total	477.9	100	604.0	100	703.5	100

The Group's turnover derived from prescription medicines was RMB600 million in 2004. The proportion in turnover increased to 85.3%. The turnover derived from modern Chinese medicines was RMB533 million, accounting for 75.8% of the Group's turnover.

During 2004, the Group kept focus on the sale of higher margin injection products by product form, the turnover from injections products was RMB362 million, accounting for 51.4% of the Group's turnover and representing an increase of 36.8% over 2003. Turnover from soft capsules was RMB229 million, accounting for 32.6% of the Group's turnover and representing an increase of 6.5% over 2003. The turnover of granules was RMB102 million, accounting for 14.5% of the Group's turnover and representing an increase of 13.0% over 2003.

Regarding the Group's three major products, the turnover from Wu Fu Xing Nao Qing soft capsules was RMB156,341,000, grew by 10.3% from 2003. The turnover from Shen Mai injection was RMB179,467,000, grew by 47.4% from 2003. The turnover from Qing Kai Ling injection was RMB 149,731,000, grew by 26.6% from 2003.

Turnover from emerging products, Qing Kai Ling soft capsule, Huang Qi injection and Paediatric Qing Fei Hua Tan granules, was RMB9,571,000, RMB19,179,000, and RMB23,608,000, respectively up by 94%, 60% and 110% respectively from that of 2003.

Cost of sales

The Group's cost of sales amounted to RMB251,998,000 in 2004. Direct materials, direct labor and other production cost accounted for approximately 72.7%, 3.9% and 23.4% of the cost of sales.

Gross profit

The Group's gross profit was RMB451,577,000 in 2004 (2003: RMB289,040,000), representing an increase of 56.2% from that of 2003. The gross profit margin increased to 64.2% (2003: 47.9%), mainly attributable to the reduction in cost of sales resulting from: (1) the fall in market prices of raw materials and adoption of central procurement policy by the Group which resulted in a reduction of the purchase prices of raw materials; (2) the enhancement of production efficiency and the economies of scales; (3) the strengthening of selling effort for the high margin injection products. The sales proportion of injection

products increased from 43.8% in 2003 to 51.4% in 2004; and (4) the 100% self-production of extracts concentrates. From August 2002 to November 2003, the Group's extraction workshop carried out automation technological modification. During the period, the Group purchased extraction fluids from independent third parties. After completion of the automation modification, the Group produce all extraction fluids by itself. By product form, the gross profit margin of injection, soft capsules and granules were 71.4%, 63.3% and 42.5%, respectively.

Profit before taxation

The Group's profit before taxation was approximately RMB280,809,000 in 2004, an increase of 51.7% over 2003. During the year, the Group recorded total operating expenses of RMB171,627,000, comprising approximately RMB116,510,000 distribution costs and RMB55,117,000 administrative expenses. Distribution cost comprised RMB85,545,000 advertising and promotion expenses, RMB13,455,000 salaries and allowances, and RMB5,610,000 travelling expenses. The distribution cost amounted to 16.6% of turnover, compared with 11.6% in 2003. A higher distribution cost was primarily due to the increased efforts in developing markets at other regions, thereby increasing advertising and promotion expenses.

During 2004, the Group recorded administrative expenses of approximately RMB55,117,000, comprised approximately RMB8,367,000 research and development expenses. Research and development expenses accounted for approximately 1.2% of the total turnover in 2004, or an increase of RMB4,960,000 from 2003. The Group's administrative expenses accounted for 7.8% of the total sales in 2004, a growth of RMB20,389,000 from 2003.

Taxation

During 2004, the taxation of the Group was approximately RMB10,659,000.

Net profit attributable to shareholders in ordinary activities

The Group minority interests was RMB9,357,000 in 2004. The Group's net profit for the year was RMB260,793,000. The profit margin was approximately 37.0%, increased from 25.0% in 2003.

Financial information

The cash and bank balances of the Group was RMB1,146,592,000 as at 31 December 2004 (2003: RMB294,989,000), comprising RMB1,025,748,000 of cash and bank balance denominated in Hong Kong dollars, and the balance of RMB120,844,000 of cash and bank balance denominated in RMB. The increase in cash and bank balance was mainly come from the proceeds of the initial public offering and the better results from operations during the year.

As at 31 December 2004, the Group has no outstanding bank loans, and no contingent liabilities (2003: Nil). The current ratio and liquid ratio also improved to 10.4 times and 10.2 times from 3.6 times and 3.3 times respectively in 2003.

For 2004, the turnover period of trade receivables was 65 days (2003: 45 days). The increase of turnover period of trade receivables was attributable to the increase in bills receivable from distributors issued by banks as at 31 December 2004.

During the year under review, the inventory turnover period was relatively stable at 30 days (2003: 34 days).

The turnover period of trade payables was 53 days (2003: 88 days). The shortening of the turnover period of trade payables was attributable to the management's effort in speeding up payment to raw material suppliers for getting favorable purchase terms.

On the whole, the Group strictly monitored its capital and liquidity to ensure an optimal capital structure. As a result, the financial position of the Group was healthy, laying a solid foundation for future development.

Commitments

As at 31 December 2004, the Group had the following commitments:

	RMB'000
Operating lease	2,763
Capital commitments	41,196

The operating lease commitment represents obligations of the Group in respect of the lease of an office premises and staff quarters in Hong Kong and the capital commitment represents the estimated obligations of the Group under its engagement of Shineway Medical for construction of the extraction workshop.

Interest rate and foreign exchange risks

The Group is debt free as at 31 December 2004. Most of the Group's businesses were operated in the PRC and denominated in RMB. There is only small settlement denominated in US dollars or Hong Kong dollars. There is no significant interest rate and foreign exchange risks.

Contingent liabilities

As at 31 December 2004, the Group had no contingent liabilities.

Capital expenditures

Capital expenditures are comprised of purchase of property, plant and equipment, increase in construction in progress and additions to land use rights. For the year ended 31 December 2004, the Group's capital expenditures were approximately RMB22 million. The increase in capital expenditures was the result of the Group's continued efforts in upgrading and expanding its production facilities.

Proceeds from the initial public offer

The net proceeds of the initial public offer, after deducting the relevant expenses, was approximately HK\$950 million. During the year under review, the Group has not applied substantial amount of the proceeds from the initial public offer as it only listed on the Main Board of the Stock Exchange on 2 December 2004. The proceeds were deposited into a bank account in Hong Kong at 31 December 2004. The Group is applying for an increase in capital contribution to 神威藥業有限公司 (Shineway Pharmaceutical Limited) ("Shineway Pharmaceutical") and 河北神威藥業有限公司 (Hebei Shineway Pharmaceutical Limited) ("Hebei Shineway").

Material acquisition and sale activities

Apart from the Group's reorganization in preparation for the listing of the Company's shares on the Main Board of the Stock Exchange, the Group has not acquired or sold any of its subsidiaries.

Staff and remuneration policies

As at 31 December 2004, the Group had 1,607 employees (2003: 1,456), an increase of 151 employees over last year. Total staff cost accounted for 5.6% of the total turnover (2003:4.0%). The increase in staff number was due to the additional number of employees in the Sales Department in line with the Group's business development. The employee salary was determined and reviewed based on fair principles with reference to market conditions and individual performance. The Group also provides other benefits for its employees, including medical insurance and retirement benefits. During the year, the Group also granted bonuses to employees based on the Group's operating results and staff individual performance. The staff in Hong Kong also participated in the mandatory provident fund scheme.

Share Option Scheme

Under the Share Option Scheme adopted by the Company on 10 November 2004, the Board may, at its discretion, grant to eligible persons under the scheme (including full-time or part-time employees and directors of the Group, consultants and advisors) for subscribing shares of the Company not exceeding 30% of the total number of Shares in issue from time to time. Unless otherwise further approved by shareholders, the total number of shares which may be issued under the exercise of options to be granted under this Share Option Scheme and any other share option schemes shall not exceed 10% of the share capital in issue by the Company on the date of commencement of dealings in the shares on the Stock Exchange. The total number of shares issued and to be issued upon exercise of all options granted or to be granted to such participants (including the options being exercised, cancelled and outstanding) in the 12-month period up to and including the date of such grant shall not exceed 0.1% of the number of shares in issue or having an aggregate value, based on the closing price of shares at the date of grant, in excess of HKD5,000,000; the total number of shares issued and to be issued upon exercise of the options granted to each participant (including exercised and outstanding options) shall not exceed 1% of the total number of shares in issue. The purpose of the Share Option Scheme is to provide the Company with a flexible means of giving incentive to rewarding, remunerating, compensating and/or providing benefits to the participants and for such other purposes as the Board may approve from time to time. The Share Option Scheme is effective from the date of adoption and will expire on 9 November 2014. The subscription price of the Share Option Scheme shall be determined by the Board and shall at least be the highest of: (i) the closing price of the shares as stated in the Stock Exchange's daily quotation sheet on the date on which an option is granted, which date must be a business day; (ii) a price being the average of the

closing prices of the shares of the Company as stated in the Stock Exchange's daily quotation sheet for 5 business days immediately preceding the date on which an option is granted; and (iii) the nominal vale of a share. An option may be exercised at any time during the option period after the option has been granted by the Board, but in any event, not longer than 10 years from the date of grant, subject to early termination of such Share Option Scheme.

None of the options was granted, exercised, cancelled or lapsed during the year and as at the date of this report.

Outlook

After the implementation of GMP and GSP standard on 30 June 2004 and 31 December 2004 by the PRC government, pharmaceutical manufacturers that are unable to comply with GMP standards and pharmaceutical distribution enterprises that are unable to comply with GSP standards will be phased out. It is expected that pharmaceuticals market in the PRC will eventually be dominated by a few market leaders with nationwide brandnames, large-scale production, technologically advanced products and an extensive sales and marketing network.

Geographical expansion

The Group has a good track record in the industry. We will capitalize on our reputable "SHINEWAY" brand, the market status in Northern and Central regions of the PRC and our extensive distribution network to promote our products to other regions of the PRC. In the short to medium terms, we expect to further expand our market share to Southern and Eastern regions of the PRC.

Production

As at 20 November 2004, the Group and Shineway Medical entered into a purchase agreement. In January 2005, the Group completed the acquisition of the new extraction workshop constructed by Shineway Medical upon completion. The workshop is among the first batch of commercialized special high technology projects name by the National Development and Reform Bureau. In January, the workshop commenced production, increasing the Group's annual extraction capacity from 1,800 tonnes to 5,400 tonnes and released the existing production bottleneck.

New products

In respect of further enhancement of research and development capability, the Group will continue to strengthen strategic alliance with various research institutions, universities and hospitals. Before conducting the research work, the Group will carefully assess cost efficiency and analyze the market trend thoroughly. The Group intends to continue focusing on medicines for curing diseases affecting middle and old aged people and/or children, and anti-viral medicines to satisfy customers' demand and increase their loyalty. It is expected that three Certificates of New Medicine will be obtained in 2005. Two medicines will obtain certification as State Protected Chinese Medicines. We will develop two new medicine products and expedite the progress of research and development.

Systems

In order to improve efficiency in handling customer orders and delivery of products, streamlining inventory procurement and enhancing customer services, the Group invests and installs an Enterprise Resource Planning system and an office control system to control inventory purchase and management. We also plan to build a logistics centre with an area of 15,000 sq.m. to increase operational efficiency.

Suppliers relationship

The Group has adopted a strategy to establish a long term cooperative relationship with major medicine suppliers which can fulfill its stringent requirements. We entered into long term cooperative agreements with various herb and plant (including Red Ginseng, Honeysuckle and Indigowoad Root) cultivators. We will provide technological support and guidance for the cultivators to ensure supply of raw materials of high quality so as to furtherly enhance our market competitiveness.