

Management Discussion and Analysis



BUSINESS AND OPERATIONS REVIEW

Business Review

During the year under review, the Group focused on distribution of pharmaceutical products in China and has set product diversification as a business priority. We are committed to the distribution of overseas agency products along with our house products.

Sales of Product

The consolidated sales turnover of the Group was approximately HK\$343 million which has resulted in a growth rate of over 20% as compared with approximately HK\$281 million as recorded in last year. We have maintained a steady growth momentum on the operation of "Osteoform". The sales turnover of Osteoform was approximately HK\$310 million. On a year-on-year basis, the growth of Osteoform was over 20%. In the 3rd quarter of 2004, we launched our new 60 capsule package and have contributed a sales income of approximately HK\$7 million.

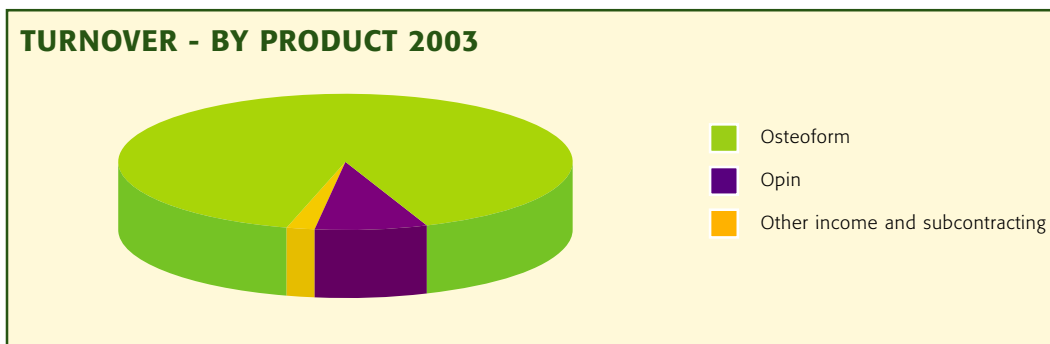
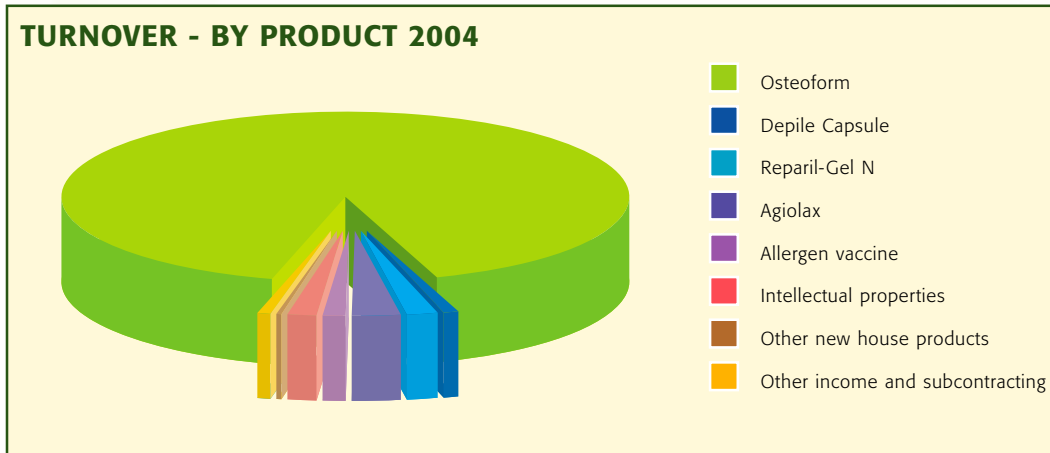


The production of "Opin" was suspended in 2004. Last year, the sales turnover was approximately HK\$23 million.

The Group has launched several new house products including "Depile Capsule", "Fenofibrate Tablet", "Aceclofenac Tablet" and 2 antibiotic products which generated a total sales income of approximately HK\$4 million. In addition, the Group has commenced distribution of 3 pharmaceutical products imported from Europe, namely Reparil-Gel N and Agiolax Granule from Madaus AG, Germany, and a vaccine for treatment of allergies produced by a Danish pharmaceutical company. The 3 imported products generated a sales income of approximately HK\$20 million. Nevertheless, the distribution agreement of the Danish vaccine project was terminated by the end of the year because of unsatisfactory sales performance.

"Osteoform", a Compound Calcium Amino Acid Chelate Capsule for treatment of Osteoporosis and Calcium Deficiency
In early 2004, the Group was granted a new packaging permit together with an additional requirement of adding the extra word "Compound" to the product name on the label. Additional product descriptions have been added onto the product insert which have facilitated the promotion of the product. In the 2nd quarter, the new fully automated production line in Chengdu City, Sichuan Province was commissioned. This has upgraded the production quality and ensured a steady product supply. Moreover, the Chengdu City Export Bonded Warehouse that the Group has invested RMB0.8 million and at a 40% equity interest, has commenced operation. The bonded warehouse that is situated in the same city as our "Osteoform" workshop has provided convenient logistic facilities which has saved our transportation costs and shortened the logistics lead time. All the aforesaid factors and effective marketing policy have fueled a steady growth pace for the product.

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“Depile Capsule”, an oral herbal drug that relieves symptoms of Haemorrhoids

The product was launched in early 2004 and sold approximately 0.2 million boxes which accounted for a sales income of about HK\$3 million. The Group is working to improve in the operation of the product.

Other house products

“Fenofibrate Tablet” a drug that regulates blood lipid level, “Aceclofenac Tablet”, a drug that relieves soft tissue pain and inflammation and 2 antibiotic products, namely Clarithromycin Capsule and Azithromycin Capsule were launched in 2004.

Fenofibrate Tablet was launched in mid 2004, Aceclofenac Tablet was launched in the 3rd quarter whereas the 2 antibiotics were launched towards the year end. The annual sales income for these products was only approximately HK\$1 million. For these products, competition in the market is relatively keen.

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"Opin" an interferon suppository for the treatment of chronic viral cervicitis and vaginitis

The production technique of Opin has to be modified according to the newly enacted "Drug Registration Administration Procedure" in China, therefore its production was suspended in 2004. In the 4th quarter of 2004, the State Food and Drug Administration Authority ("SFDA") of China approved the new supplemental production technique of Opin. The Group passed the pilot production in December 2004 and expects to re-launch Opin into the market in mid 2005.

The Production Base in Chengdu City, Sichuan Province, China

The newly built No. 1 solid dosage workshop was commissioned in the 2nd quarter of 2004 and it has been designed exclusively to manufacture Osteoform. The outer packaging procedures have been upgraded to automation in order to enhance efficiency and a steady supply. The former No. 2 multiple solid dosage workshop was re-scheduled for other new products. In addition, the new "Aceclofenac" raw material GMP workshop has been put into operation.

The Production Base in Wuhan City, Hubei Province, China

At present, the factory has 5 GMP production lines, including the suppository line for Opin and the 4 lines namely granule, capsule, gel and tablet dosage forms which were built for the packaging of import products from Madaus AG, Germany. During the year, we have obtained the import product packaging permit for Agliolax Granule, a drug to relieve acute and chronic constipation and have begun the packaging process of the product.

The Group shall apply to the SFDA in 2005 for the import product packaging permit for Reparil-Gel N, another product of Madaus AG.



四川維奧三江制藥有限公司("Sichuan Vital San Jiang Pharmaceutical Co Ltd")

During the year, the Board resolved to participate in a 60% equity interests in this company. The objective of the project is to build a GMP compliant plant for injection products. The construction phase of the project is expected to be completed by late 2005. The total investments budget for the project is set at RMB50 million.

The development of Skin Drug Delivery System ("SDDS")

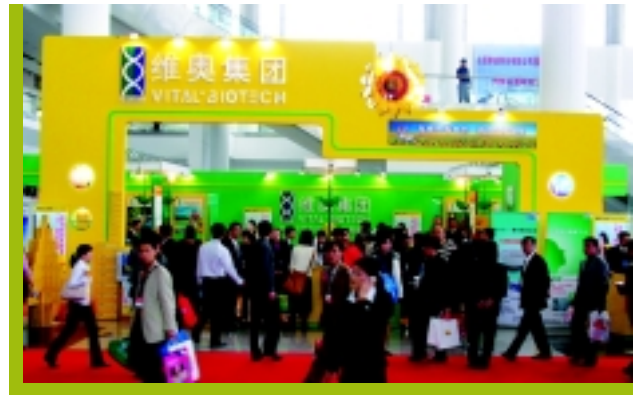
Last year, the Group joined with Qingdao Growful Pharmaceutical Group to form a Sino-foreign joint venture company: Qingdao Growful Vital Pharmaceutical Company Limited ("Growful Vital"), to whom the Group has transferred the China patent rights of SDDS technology and several products. By late 2004, the workshops of Growful Vital passed the GMP inspection. Some product registration processes were at the clinical trial stages. Marketing activities are expected to commence in 2005. The objectives of the Group are to commercialize the SDDS technology by promoting product developed with SDDS through the extensive chain store network of Qingdao Growful Pharmaceutical Group.

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Business Prospect

The Group will pursue its current strategies on distribution and promotion of pharmaceutical products. Diversification of products is still a priority. Through the agency business of marketing prominent overseas labels, the Group's objective is to extend further its cooperation with these prominent pharmaceutical companies. The Group will consider implementing other business models notwithstanding introducing more agency products into China.



New Product in the pipeline

"AOTIANPING™" [Miglitol Tablet] is a third generation alpha-glucosidase inhibitors. This is a drug used in the control of blood sugar level in conjunction with dietary management for type 2 diabetes. The Group has received the China production permit and expects to commence production and sales in 2005.



Vital Fast "維快™" is a slow release flu medication formulated with loratadine, pseudoephedrine sulphate and paracetamol. We acquired this new formulation in 2004 and clinical trials were completed in October 2004. The production permit is pending the approval from SFDA. The new drug certificate and the production permit are both expected to be released in 2005.

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FINANCIAL REVIEW

Capital structure

As of 31 December 2004, the Company had in issue 1,521,198,380 ordinary shares (31 December 2003: 1,314,876,127 shares). During the year 2004, total 206,322,253 new ordinary shares were issued, in which 3,043,640 new shares issued as scrip shares for the 2003 final dividend of HK1.5 cent each and 2004 interim dividend of HK0.5 cent each; and 170,000,000 new shares placed to institutional investors at HK\$0.72 each; another 20,508,613 new shares issued per minimum issue price at HK\$0.46 each to Harvest Time (H.K.) Limited ("Harvest Time") as per the signed agreement for acquisition of the shares of Vital Pharmaceuticals (Sichuan) Co. Ltd. (the "Acquisition Agreement") in 2003; and last, 12,770,000 new shares issued for share option exercised.

In January 2005, the Company further issued 20,508,613 new shares per minimum issue price at HK\$0.46 each to Harvest Time as consideration. As at the date of this annual report, the Company had issued a total of 1,541,706,993 ordinary shares.

The market capitalization of the Company as of 31 December 2004 was approximately HK\$426 million (31 December 2003: HK\$1,038 million).

Liquidity and financial resources

As of 31 December 2004, the Group has bank loans of approximately HK\$122.8 million (31 December 2003: approximately HK\$90.5 million), comprising long-term portion of HK\$6.6 million (31 December 2003: HK\$11.7 million), short-term portion of HK\$116.2 million (31 December 2003: HK\$78.8 million). Bank balances and cash amounted to approximately HK\$110.1 million (31 December 2003: approximately HK\$71.7 million).

As of 31 December 2004, the Group has obtained banking facilities of approximately HK\$150 million from banks in HK and China. Unutilised banking facilities amounted to approximately HK\$30 million. The cost of financing was around 4% per annum. The Group has maintained sufficient financial resources for business operation purpose.

Currency policy

The sales receipts of the Group were mainly denominated in RMB. Purchases were denominated as to approximately 57% in USD, 3% in EURO and 40% in RMB. Operating expenditures including selling and distribution expenses and administrative expenses were denominated as to approximately 33% in HK\$, 64% in RMB and 3% in AUD. For the year 2004, the Group was required to settle the purchase in EURO and entered into forward contracts to hedge against foreign currency fluctuation. Moving forward, the Group will increase its purchases denominated in EURO and will be exposed to a higher foreign currency risk. Cautiously, the Group will enter into forward contract to hedge against foreign currency fluctuation.

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Key financial figures and ratios

In the year 2004, several profit and loss items and ratios were worsened by a higher level of selling and distribution expenses. As compared with last year, turnover and product range has been increased and widened respectively, production costs have been stable and the overall gross profit margin was comparable to last year. Since both gross profit margin after selling and distribution expenses and net profit margin were dropped by 15% and 12% respectively. The Group has increased its marketing expenditure to gain market share of its existing and newly expanded range of house products and agency products. Selling and distribution expenses amounted to 39% (2003: 26%) of sales turnover and in return, Osteoform was among the top selling products in the market and the market for newly expanded range of house products and agency products was developed.

In addition, due to the suspension of Opin's production, the Group has made provision for bad and doubtful debt, written-off the patent and development costs, and written-off the inventories amounting to HK\$0.91 million, HK\$3.96 million and HK\$0.29 million respectively.

	Year 2004	Year 2003
<i>Profit and loss item:</i>		
Turnover (HK\$' million)	343.4	280.8
Gross profit margin	70%	72%
Selling and distribution expenses (HK\$' million)	134.8	73.0
Gross profit margin after selling and distribution expenses	31%	46%
Net profit margin	10%	22%
EBITDA (HK\$' million)	58.4	86.0
EBITDA/Turnover	17%	31%

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Balance sheet item: Gross debt equity ratio was controlled below 40% and net debt equity ratio (which represents bank loans net of bank balances and cash divided by net tangible assets) was below 5%. The average trade receivable turnover day was maintained at about 3 months. Inventory (excluding goods in transit) average turnover day increased to about 3.4 months. The longer inventory turnover day was mainly attributable to the relative slow sales momentum of Agiolax Granules since the launch of the product in mid 2004. As of 31 December 2004, the total costs of Agiolax Granules raw material and finished goods amounted to HK\$16 million (2003: Agiolax Granules raw material in transit amounted to HK\$17.6 million) which represented about 37% of the total inventory values of HK\$43 million as of 31 December 2004. Should the sales of Agiolax Granules gather momentum in 2005, its overstock situation will improve and the overall inventory turnover day will be softened.

	As at 31 December 2004 HK\$ million	As at 31 December 2003 HK\$ million
<i>Balance sheet item:</i>		
Short-term bank loans	116.2	78.8
Long-term bank loans	6.6	11.7
Bank balances and cash	110.1	71.7
Bank loans net of bank balances and cash	12.7	18.7
Net tangible assets	334.2	194.2
Debt equity ratio (gross)	36.7%	46.6%
Debt equity ratio (net)	3.8%	9.6%
Average trade receivable turnover day	91 days	76 days
Average inventory turnover day	102 days	84 days

As at 31 December 2004, the Group had HK\$17.9 million in bank balances and cash, HK\$5.6 million in investment securities and HK\$25.9 million in fixed assets pledged as collateral to banks.

For year 2004, return on equity was on average 9%. In conclusion, the Group has maintained a healthy financial position and has provided a reasonable return to the shareholders.

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The usage of proceed from placement

In February 2004, 170 million ordinary shares of the Company having an aggregate nominal value of HK\$1.7 million were placed to institutional investors at HK\$0.72 each and a net proceed of HK\$119 million was raised in order to enhance the capital base of the Company, thereby giving it greater flexibility in its funding and to increase the shareholders' base of the Company. The market closing price of the share on 12 February 2004 was HK\$0.79. The usage of proceed was as follows:

Projects	Usage as announced HK\$ million	Actual progress HK\$ million
2 projects of sale and distribution of products of European pharmaceutical companies	48	44
1 project of sale and distribution of health supplements of an Australian company	22	10
Research and development of Erythropoietin (EPO) sublingual tablet	18	1
Installation of production lines in Wuhan City	16	16
Working capital	15	48
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Total	119	119

EMPLOYEE INFORMATION

As at 31 December 2004, the Group had 1,334 employees, comprising 41 in research and development, 247 in production, 883 in sales and distribution, and 163 in general administration and finance. 1,303 of these employees were located in China, 7 in Australia, 24 in Hong Kong and Macau.

The policy of employee remuneration, bonus, share option scheme and training are commensurate with performance and comparable to market rate. The Group encourages employees to participate in external training programmes to develop themselves on a continuous basis, so as to improve staff quality to meet future challenges and gain a competitive edge. Total staff costs for the year 2004 amounted to approximately HK\$40.2 million.