

---

## INDUSTRY OVERVIEW

---

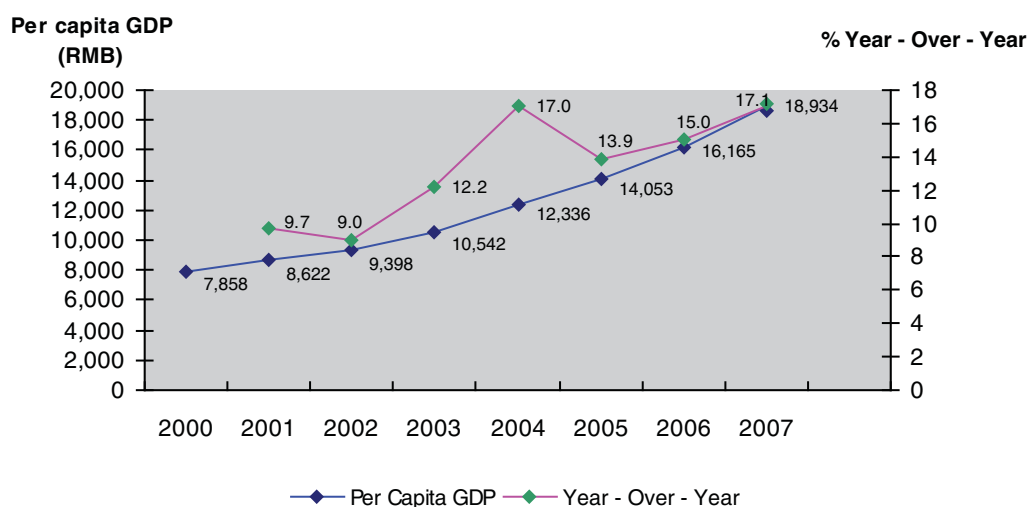
### OVERVIEW OF THE PRC HEALTHCARE MARKET

We operate in the large and rapidly growing healthcare industry in China. The healthcare industry in China is supported by a combination of favorable socioeconomic factors such as the growth of China's economy, size of its overall population and the proportion of its population over the age of 60, improvement of living standards, increased health consciousness, an increase in lifestyle related disorders and active PRC Government support.

#### Primary Growth Drivers of the Healthcare Industry

##### *Increasing disposable income and spending on healthcare*

According to the China Statistical Yearbook 2008 (the "Yearbook"), from 2003 to 2007, the average per capita annual disposable income of China's urban residents increased from approximately RMB8,472.1 to RMB13,785.8, representing a CAGR of approximately 12.9%. According to the Yearbook, China's GDP grew at a CAGR of 16.4% from 2003 to 2007, and its per capita GDP grew from RMB10,542 in 2003 to approximately RMB18,934 in 2007, representing a CAGR of 15.8%. During this period, national income and disposable income levels increased significantly. The following chart illustrates the growth of China's per capita GDP in the periods indicated:



Source: China Statistical Yearbook

---

## INDUSTRY OVERVIEW

---

With rising living standards and increasing disposable income, people in China have become more health conscious. These developments have resulted in both Chinese urban and rural residents spending more on healthcare. According to the PRC National Bureau of Statistics, consumer expenditures on healthcare in China's urban and rural areas increased from approximately RMB476.0 and RMB117.8 per person in 2003, respectively, to approximately RMB699.0 and RMB210.2 per person in 2007, respectively.

### *Population growth and increased life expectancy*

The significant growth of China's population aged 60 or above is expected to drive demand for healthcare in China. According to the PRC National Bureau of Statistics, the proportion of the population aged 60 or above in China has increased from 11.9% in 2003, or approximately 150.0 million people to 13.6%, or approximately 162.2 million people in 2007. Rising life expectancy is also expected to contribute to the growth of China's aging population, both as an absolute number and as a percentage of the total population. We believe that the aging population in China, which historically spends the most on healthcare, will drive the growth of the PRC healthcare industry. The prevalence of chronic health problems, such as arthritis, cardiovascular diseases and cancer, is expected to increase with the growth of China's population aged 60 or above. In addition, as living standards continue to improve and health consciousness grows in China, many lifestyle-related diseases are also increasing and becoming more widespread. For example, Business Monitor International estimates that sales of prescription cardiovascular medicines increased by 87% from US\$2,765 million in 2003 to US\$5,177 million in 2007, primarily as a result of the rising prevalence of heart disease in an aging population and increasingly unhealthy lifestyles in the population at large.

### *Active PRC Government support*

As part of its Eleventh Five-Year Plan (2006-2010), the PRC Government has actively supported the PRC healthcare industry by providing a number of incentives and enacting programs, including increased funding for building additional hospitals, research centers and other healthcare facilities, enacting healthcare reforms and standards and subsidizing healthcare services for its citizens. The PRC Government has announced it will spend an additional RMB850 billion on healthcare programs from 2009 to 2011, which will significantly bolster the PRC healthcare market.

### *Increasing coverage of social medical insurance in China*

The National Medical Insurance Program ("National Program"), which was introduced in 1999, is the largest medical insurance program in China. The National Program is funded with varying levels of contributions from the PRC Government, individual program participants and their employers.

In 1999, the National Program was originally launched as the Urban Worker Basic Medical Insurance Program ("Urban Worker Program") (城鎮職工基本醫療保險), a mandatory scheme covering urban workers and their minor children. In 2007, a voluntary component called the Urban Resident Basic Medical Insurance Program ("Urban Resident Program") (城鎮居民基本醫療保險) was further implemented as part of the National Program, to cover the rest of the urban residents that are not covered by the Urban Workers Program. The National Program provides guidance on which prescription and over-the-counter medicines are included in the program and to what extent the purchases of these medicines are reimbursable. See the section headed "Regulation — Reimbursement Under the National Medical Insurance Program" in this document for further information.

---

## INDUSTRY OVERVIEW

---

We believe that only a small percentage of the Chinese population can afford commercial insurance plans. Therefore, the National Program coverage is expected to expand in the future. According to the PRC National Bureau of Statistics, the percentage of PRC urban residents grew from approximately 37.7% of the total population to 44.9% from 2001 to 2007. The number of people covered by the National Program increased from approximately 37.9 million in 2000 to 180.2 million in 2007, representing an CAGR of 25%. This trend is anticipated to continue as the Eleventh Five-Year Plan projects that the PRC urban population will increase from 45% to 47% of China's total population between 2007 to 2010. Furthermore, the provincial and municipal authorities who are responsible for administering social medical insurance funds to cover such reimbursements have been gradually increasing funding in recent years. According to the PRC Ministry of Labor and Social Security, total funding under the national insurance program reached RMB225.7 billion (approximately US\$28.9 billion) in 2008, representing an increase of 29.2% from 2007. The availability of funding is expected to increase significantly in the near future, primarily as a result of increased financial and policy support from various levels of the PRC Government.

### *Increasing access to healthcare in rural areas*

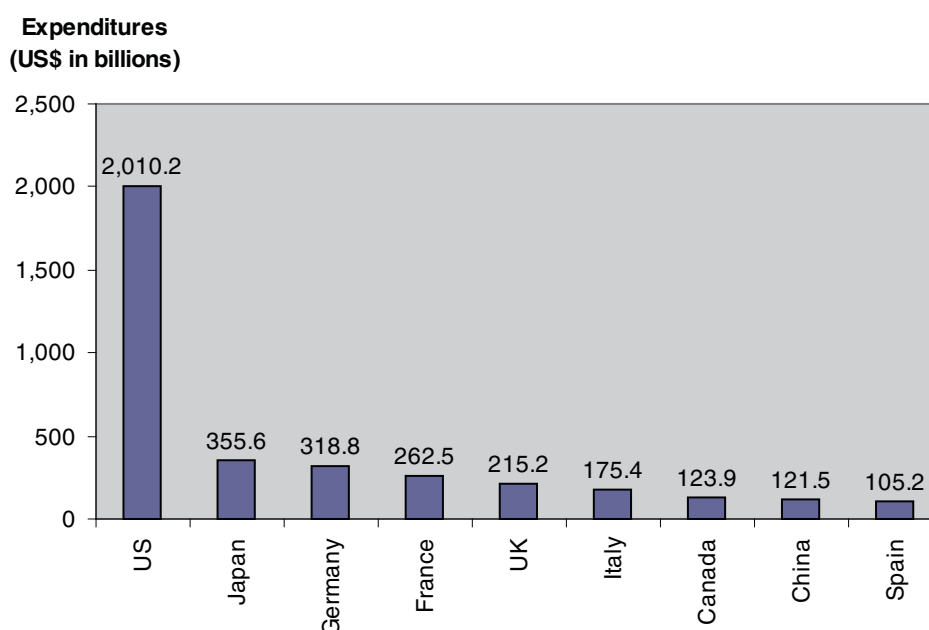
At the fifth meeting of the tenth National People's Congress held in March 2007, the PRC Government announced its goal to accelerate the reform and development of healthcare services in the PRC and focus on building a basic healthcare system that covers both rural and urban areas. The PRC Government's plans include providing expanded healthcare services for its rural citizens and establishing comprehensive community healthcare service centers that would provide basic medical treatment and pharmaceutical services, as well as upgrading existing class-two hospitals and state-owned medical facilities. The public health service centers would be allocated based on demand and population.

In addition, the PRC Government has actively promoted the implementation of the New Rural Cooperative Medical Insurance Scheme ("New Rural Insurance Scheme") (新型農村合作醫療保險), which seeks to provide healthcare services to the vast rural areas of China. The program extends to cover approximately 2,729 counties in the PRC, which account for 95.4% of the total number of counties in the PRC. In addition, the program covers approximately 814 million rural residents, which accounts for approximately 91.5% of the total population engaged in the agricultural industry in China as of 31 December 2008.

## INDUSTRY OVERVIEW

### Healthcare Spending and Development

According to information jointly provided by the World Health Organization and Ministry of Health, China ranked eighth among the World Health Organization's member nations in terms of healthcare spending in 2006. Compared to the United States, which is currently the world's largest healthcare market, China spends a relatively small amount on healthcare. In 2006, China spent US\$121.5 billion (approximately RMB947.7 billion) on healthcare, compared to US\$2,010.2 billion (approximately RMB15,684.2 billion) spent by the U.S. in the same year. Nonetheless, the PRC healthcare spending has grown significantly, increasing from RMB502.6 billion in 2001 to RMB947.7 billion in 2006, representing a CAGR of 13.5%. The following chart sets forth the total expenditures of the largest healthcare markets in 2006:



Source: World Health Organization

According to the World Health Organization, China has approximately one-fifth of the world's population and a per capita expenditure on healthcare is relatively low compared to other World Health Organization member nations, ranking only 101st among all member nations in 2006. China's per capita total expenditure on healthcare grew from approximately US\$50 per person (approximately RMB390) in 2001 to approximately US\$92 per person (approximately RMB718) in 2006, representing a CAGR of approximately 13.0%. The following table sets forth healthcare expenditure information for the ten largest markets during the periods indicated:

Country	Total expenditures		Per capita total expenditure on healthcare		CAGR of per capita total expenditure on healthcare from 2001 to 2006
	2006	2006	2001	2006	
	(US\$ in billions)		US\$	US\$	%
United States of America	2,010.2		4,915.0	6,714.0	6.4
Japan	335.6		2,609.0	2,626.0	0.1
Germany	318.8		3,537.0	3,870.0	1.8
France	262.5		3,227.0	4,278.0	5.8
United Kingdom	215.2		2,478.0	3,552.0	7.5
Italy	175.4		2,358.0	3,002.0	4.9
Canada	123.9		2,853.0	3,799.0	5.9
<b>China</b>	<b>121.5</b>		<b>50.0</b>	<b>92.0</b>	<b>13.0</b>
Spain	105.2		1,596.0	2,387.0	8.4

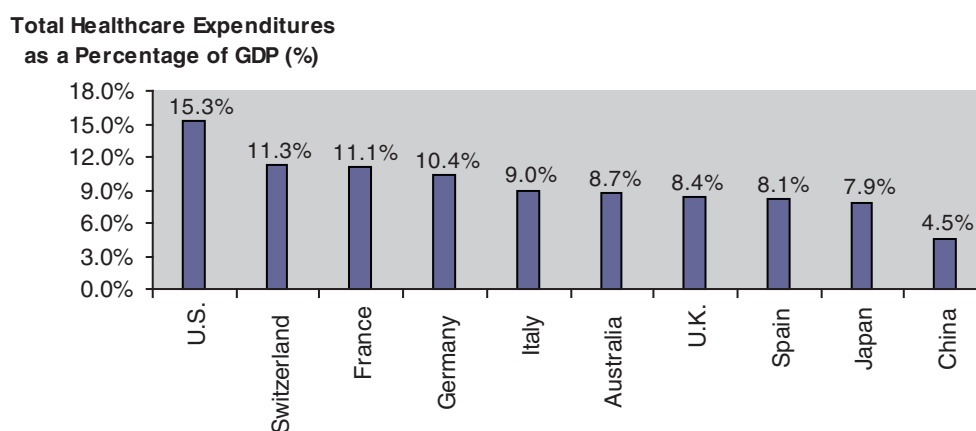
Source: World Health Organization

---

## INDUSTRY OVERVIEW

---

As a percentage of GDP, China's expenditures on healthcare were also low compared to those of industrialized nations, amounting to approximately 4.5% in 2006, compared to 11.1% for France and 15.3% for the United States. According to the World Health Organization the healthcare spending of most developed countries accounts for 7% to 9% of GDP. We predict that China's healthcare spending will rise significantly in relation to its rapidly growing GDP and become more aligned with international standards. In addition, we believe industry growth factors such as the rapidly growing economy of China, which has fueled rising living standards and increasing health consciousness, as well as China's aging population and corresponding increase of lifestyle-related disorders and active PRC Government support, will positively affect China's healthcare spending. The following chart sets forth the total healthcare spending of selected countries in 2006 as a percentage of their GDP:



Source: World Health Organization

### Latest Healthcare Reform Plan

In September 2008, the State Council published a draft plan to ease the difficulties and minimize the costs for PRC citizens to obtain proper healthcare treatment. On 17 March 2009, the PRC Government issued the Opinion on Deepening the Healthcare System Reform (中共中央國務院關於深化醫藥衛生體制改革的意見) (the "Opinion"). The State Council subsequently released the Notice on Important Implementing Plans for the Healthcare System Reform 2009-2011 (國務院關於印發醫藥衛生體制改革近期重點實施方案 (2009-2011) 的通知) (the "Implementing Plan"). The goal of the healthcare reform plan is to establish a basic, universal healthcare framework to provide Chinese citizens with safe, efficient, convenient and affordable healthcare. The Opinion calls for healthcare reform to be carried out in two steps:

- Step One, which will be completed by 2011, aims to increase the accessibility while reducing the cost of healthcare. During this phase, the PRC Government will build up a network of basic healthcare facilities, expand the coverage of the public medical insurance system to cover 90% or more the population, as well as reform the drug supply and public hospital system.
- Step Two, which will take place between 2011 and 2020, envisions the establishment of a universal healthcare system. The entire population should be covered by public medical insurance; drugs and medical services should be accessible and affordable to citizens in all public healthcare facilities.

While the PRC Government has neither provided a concrete timetable nor steps to implement certain tasks, such as the public hospital reform, it has released execution guidance for other tasks. Most notably, the PRC Government has announced it will spend an additional RMB850 billion from

---

## INDUSTRY OVERVIEW

---

2009 to 2011 on the healthcare industry. A significant portion will be expended to establish a basic healthcare medical insurance regime, which aims to cover over 90% of the national population by 2011, mainly through the Urban Worker Program, Urban Resident Program and the New Rural Insurance Scheme. The PRC Government further announced that the annual subsidy for each participant will be increased from RMB40 to RMB120 for Urban Resident Program participants, and from RMB80 to RMB120 for New Rural Insurance Scheme participants, starting from 2010. The reform plan will also raise the cap on claim payments from four times the local average annual income to six times such income. Another significant part of the spending plan focuses on healthcare facilities. The PRC Government plans to build 29,000 rural clinics in 2009. In the next three years, it plans to build an additional 5,000 rural clinics, 2,000 county-level hospitals and 2,400 urban community clinics in under-developed areas. This substantial increase in healthcare spending is expected to expedite the growth of the healthcare industry in China.

Under the healthcare reform plan, the additional funding for the healthcare industry will primarily target four fundamental healthcare systems in China:

- *The public health services system.* This system focuses on preventing disease and promoting health as a complementary alternative to medical treatment. The public health services system will provide services such as immunizations, regular physical check-ups (for senior citizens over 65 years of age and children under three years of age), pre-natal and post-natal check-ups for women, prevention of infectious or chronic diseases and other preventative and fitness activities.
- *The public medical insurance system.* This system covers drugs and medical treatments for the majority of the population. The healthcare reform plan will retain the framework of the current public medical insurance schemes under the National Program, but will expand them to cover more of the population and increase the scope of treatments, raise the cap on claim payments and cover more claims at higher percentages.
- *The public healthcare delivery system.* One of the primary goals of the Implementing Plan is to build more healthcare facilities and to improve the training of healthcare professionals. Beyond additional public wellness centers, the reform plan aims to place a medical clinic in every village and a hospital in every county by 2011. In addition, the PRC Government will encourage private investors to establish public non-profit hospitals.
- *The drug supply system.* This system regulates pricing and how drugs will be procured, prescribed and dispensed in healthcare facilities. The healthcare reform plan will focus on pricing, procurement, prescription and dispensing of essential drugs.

The Opinion and the Implementing Plan direct relevant governmental authorities, including the Ministry of Health, SFDA and the National Development Reform Commission, or NDRC, to adopt implementing regulations for the reforms outlined in the healthcare reform plan.

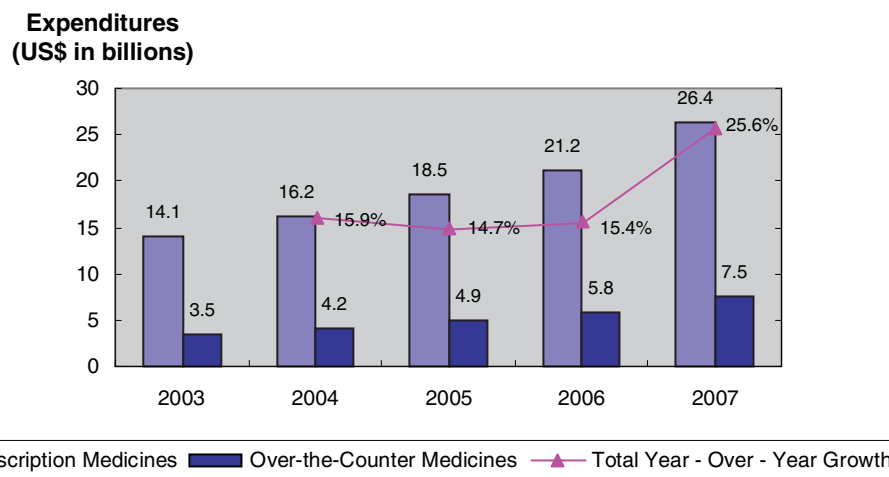
Although the healthcare reform plan is expected to benefit our pharmaceutical distribution, retail pharmacy and other business operations and improve our competitive position, the full effect of the healthcare reform plan on our operations is as yet unclear.

### Pharmaceutical Sales in China

The pharmaceutical market in China has grown rapidly in recent years. According to Business Monitor International, the total sales of medicines in China, including prescription and

## INDUSTRY OVERVIEW

over-the-counter medicines, was US\$33.9 billion (approximately RMB257 billion) in 2007, representing an increase of 25.6% from 2006 and a 2003-2007 CAGR of 17.8%. Business Monitor International estimates that the Chinese market became the eighth largest pharmaceutical market in the world in 2007 from ninth in 2006. The following chart sets forth the trend of PRC expenditures for prescription and over-the-counter medicines in the periods indicated:



Source: Business Monitor International

Sales of prescription medicines are the principal component of pharmaceutical expenditures in China and are mostly made in hospitals. According to Business Monitor International, sales of prescription medicines grew from US\$14.1 billion in 2003 to US\$26.4 billion in 2007, representing a CAGR of 17.0%. In 2007, total sales of prescription medicines represented 77.9% of China's total expenditures on medicine sales. The remaining expenditures were spent on over-the-counter medicines. In 2007, sales of over-the-counter medicines amounted to US\$7.5 billion, representing a CAGR of 21.0% from 2003 to 2007. In addition to the primary growth drivers of healthcare spending in China described above, another factor expected to increase the amount of healthcare spending in China is the growing trend of PRC consumers to purchase non-prescription, over-the-counter medicines in non-hospital retail pharmacies.

---

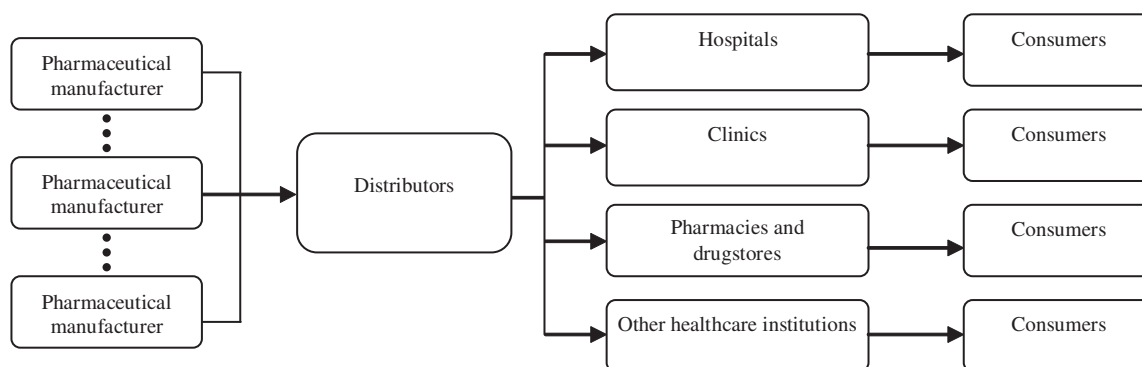
## INDUSTRY OVERVIEW

---

### PHARMACEUTICAL DISTRIBUTION IN CHINA

#### Overview of the Pharmaceutical Supply Value Chain

The pharmaceutical distribution market connects pharmaceutical manufacturers with pharmaceutical retailers, including hospital pharmacies, drugstore chains and independent community drugstores, community clinics and other points of sale retail outlets. Distributors play an important role in the pharmaceutical supply value chain by leveraging their economies of scale and operating expertise to purchase, store, resell and transport pharmaceutical products. In doing so, distributors ensure the prompt and efficient delivery of a wide range of products from thousands of manufacturers to numerous and dispersed points of sale, help reduce supply chain distribution costs and allow more cost-savings to be passed to consumers. Distributors can increase the operating efficiencies of manufacturers by acting as the latter’s direct customers and relieving them from the burden of delivery to, and collecting payment from, numerous retailers. On the other hand, by using distributors as suppliers, retailers benefit from reduced transaction costs and administrative burdens as well as improved confidence in their product supply. The chart below illustrates the distribution value chain of pharmaceutical products in China:



Typically, pharmaceutical distributors enter into agreements to purchase pharmaceutical products from manufacturers. In many cases, distributors also seek from manufacturers the right to be an exclusive distributor of a particular medicine or groups of medicines. They generate revenue by reselling these pharmaceutical products downstream and providing relevant services to customers in the retail market. In general, pharmaceutical distributors do not hire pharmaceutical sales representatives to promote medicines and healthcare products to physicians, pharmacists and other healthcare professionals. Promotional efforts are generally undertaken by the manufacturers or companies providing outsourced promotion services. However, sales teams of a distributor work with sales representatives of manufacturers to ensure that product demands are met.

In addition, large pharmaceutical distributors in China offer complementary logistics and value-added services to manufacturers and retailers. In the PRC market, the ability to provide these services is highly valued and increasingly required by many larger customers, such as hospitals. As a result, a distributor’s ability to provide services constitutes a competitive advantage and enhances its relationships with customers and suppliers. These logistics and value-added services include electronic purchase orders confirmation, tailored packaging, repackaging and reprocessing services, product insurance brokerage, payment collection on behalf of manufacturers, product return, replacement or recall mechanisms, inventory tracking and management, delivery of specialty pharmaceutical products, technical support and sales assistance, import agency, customs clearance, free trade zone warehousing and other services.



---

## INDUSTRY OVERVIEW

---

### **Hospitals and Retail Pharmacies**

#### *Hospitals*

Traditionally, out-patients in China typically filled their prescriptions at hospital pharmacies, unlike in the United States and in other developed countries, where patients typically fill their prescriptions at pharmacies unaffiliated with hospitals. Although the latest healthcare reform plan aims to reduce hospitals' reliance on sales from hospital pharmacies, out-patients still primarily fill their prescriptions at hospital pharmacies.

Most hospitals in China are owned and operated by the PRC Government. In addition, the vast majority of hospitals in China are located in urban areas, with rural areas suffering from both a lack of hospitals and clinics as well as qualified medical staff and resources at the facilities they do have. Hospitals in China are classified under the Ministry of Health-administered hospital classification system into three classes based upon a number of factors, including reputation, the number of doctors and nurses, total number of in-patient beds, equipment and expertise. The best and largest hospitals are designated as "Class-three" hospitals, and the second and third tiers as "Class-two" and "Class-one", respectively. In 2008, 1,192, 6,780 and 4,989 were designated as "Class-three", "Class-two", and "Class-one" hospitals, respectively, according to Ministry of Health statistics.

#### *Retail pharmacies*

While out-patients in China generally fill their prescriptions at hospital pharmacies, they primarily purchase over-the-counter medicines from retail pharmacies. To the extent that a medical condition can be treated with an over-the-counter medicine, many Chinese people choose to purchase an over-the-counter medicine instead of seeing a doctor in a hospital for a prescription medicine.

The retail pharmacy sector in China is highly fragmented. Retail pharmacies in China include pharmacy chain stores, individual stores, retail chain stores with over-the-counter medicine counters, and over-the-counter medicine counters in supermarkets. While they are expanding quickly, neither pharmacy chain stores nor retail chain stores with over-the-counter medicine counters have developed a nationwide presence in China.

A small portion of retail pharmacies in China is authorized under the National Program. A program participant may be reimbursed for the cost of a medicine included in the provincial medicine catalog only if he or she purchases that medicine from an authorized retail pharmacy. We refer to these pharmacies as authorized pharmacies.

### **Development of Pharmaceutical Distribution in China**

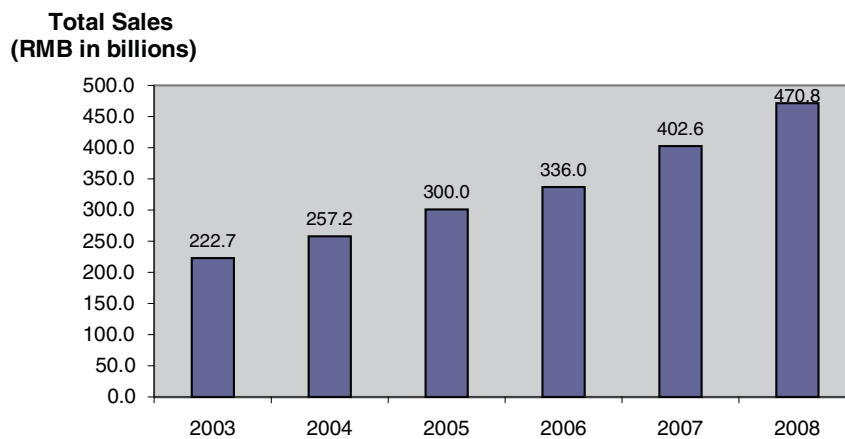
The PRC pharmaceutical distribution market has evolved in the past 30 years from a complex, multi-tiered system that was subject to strict control at every governmental level to a competitive and increasingly market-oriented industry. From 1950 to 1979, all Chinese pharmaceutical distributors were state-owned and categorized into national, provincial and municipal-level distributors. The price markup at each level, from pharmaceutical manufacturer to end-consumer, was subject to a total markup cap of 28%. During the 1980s, the rigid three-level distribution system gave way to a more open and decentralized network. Driven by increasing demand for pharmaceutical products in the past three decades, the PRC pharmaceutical industry has experienced rapid growth. The numbers of pharmaceutical manufacturers and distributors have also increased significantly until recent years, when competition and government regulations and policies started to drive consolidation in the industry. As a result of these developments, the market volume of the PRC pharmaceutical distribution

---

## INDUSTRY OVERVIEW

---

market has steadily increased. The following chart shows the development of the PRC pharmaceutical distribution sector in terms of total sales:



*Source: China Association of Pharmaceutical Commerce*

Mostly due to the market's historical roots in the multi-tiered system and the large number of pharmaceutical distributors in China, the direct channel to a particular point-of-sale, such as a hospital or a drug store, is often controlled by a few distributors with strong local presence. Therefore, distributors, especially the larger ones, typically make part of their sales through other distributors. In order to increase their profitability, we believe all the leading distributors aim to expand their control of these direct channels to the points-of-sale.

### **Fragmentation of the Pharmaceutical Distribution Industry and the Trend Toward Consolidation**

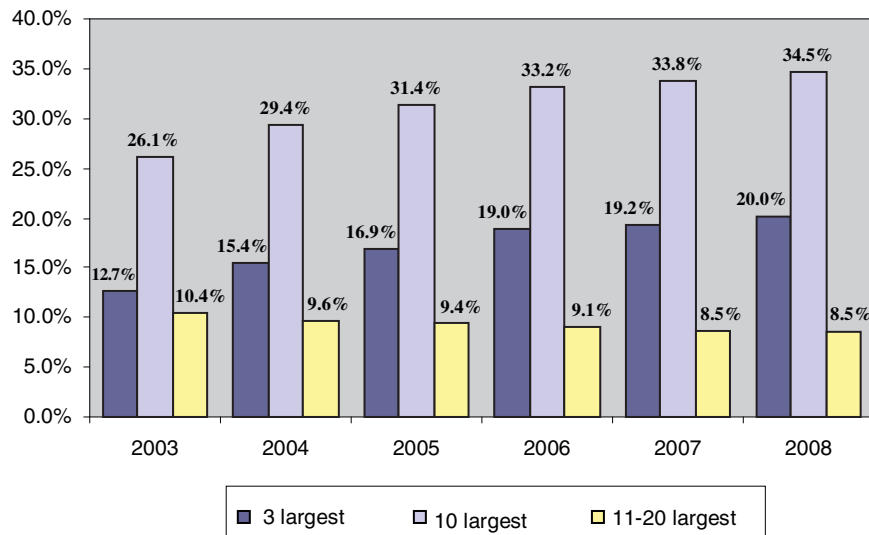
The pharmaceutical distribution industry in China is currently highly fragmented. There were more than 9,000 GSP-certified pharmaceutical distributors as of 2007 according to the South Medicine Economics Research Institute, an affiliate of the SFDA. According to CAPC, the three largest pharmaceutical distributors in China accounted for only approximately 20.0% of the PRC pharmaceutical distribution industry in 2008, in terms of their share of the total revenues of the pharmaceutical distribution industry in China. This fragmentation of the pharmaceutical industry has resulted in an inefficient supply chain for the distribution of most pharmaceutical products without the advanced logistics services featured in more developed markets. Given the level of fragmentation in the pharmaceutical distribution industry, we believe that only large distributors with effective nationwide distribution capabilities, value-added supply chain services and large-scale operations will thrive.

Due to competitive pressures caused by the fragmentation of the industry, the introduction of GSP requirements and other increased PRC regulatory requirements, as well as continuing price controls imposed by the PRC Government and the centralization of tender and bidding processes among public hospitals, there has been a trend towards consolidation of the pharmaceutical distribution industry in recent years. According to CAPC, the combined market share of the top three pharmaceutical distributors in China increased from 12.7% in 2003 to approximately 20.0% in 2008. The market share of the top 20 pharmaceutical distributors in the industry increased from 36.5% to 43.0% in the same period. Furthermore, the data suggest that the largest distributors benefit more from consolidation. The total market share of the ten largest distributors grew from 26.1% in 2003 to 34.5% in 2008, while that of the 11 to 20 largest companies decreased from 10.4% to 8.5% over the same period. The following chart

## INDUSTRY OVERVIEW

shows the market share of the three largest, ten largest and 11 to 20 largest distributors in China's pharmaceutical distribution industry in the periods indicated:

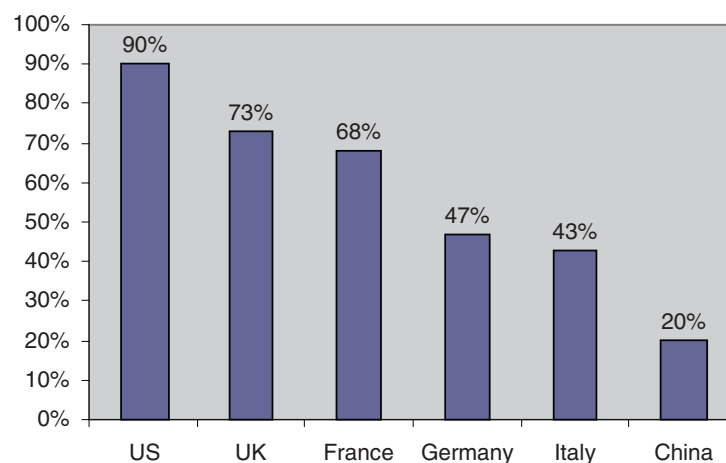
**Market Share (%)**



Source: China Association of Pharmaceutical Commerce

Consolidation has also occurred in the pharmaceutical distribution industries of other countries as a natural part of their evolution and development into a mature market. According to the Kaiser Foundation, a non-profit private foundation focusing on healthcare issues, between 1975 and 2000, the number of pharmaceutical distributors in the United States declined from approximately 200 to fewer than 50. Similarly, according to Booz Allen Hamilton, an international consulting firm, between 1979 and 2005, the number of pharmaceutical distributors decreased from 25 to 10 in France, from 32 to 12 in the United Kingdom, from 41 to 16 in Germany, and from 279 to 138 in Italy. The three largest pharmaceutical distributors in the U.S. held 90% of the U.S. market in terms of their share of total revenues in 2005, and the three largest European pharmaceutical distributors had 73%, 68%, 47% and 43% of the market in the United Kingdom, France, Germany, and Italy, respectively, in 2005. Overall, these three leading European pharmaceutical distributors held a market share of 64% of the pharmaceutical distribution industry in Europe in 2005. The following chart sets forth the market share of the top three largest distributors in each country in the years indicated:

**Market Share (%)**



Sources: US: 2005 data from Kaiser Foundation; UK, France, Germany, Italy: 2005 data from Booz Allen Hamilton; and China: 2008 data from China Association of Pharmaceutical Commerce

THIS INFORMATION PACK IS IN DRAFT FORM. The information contained in it is incomplete and is subject to change. This Information Pack must be read in conjunction with the section headed "Warning" on the cover of this Information Pack.

---

## INDUSTRY OVERVIEW

---

We expect that, over time, the PRC pharmaceutical distribution industry will experience consolidation in the manner experienced in North America and Europe, as distributors seek to achieve economies of scale and optimize their resources. The trend towards consolidation in the PRC pharmaceutical industry has also been intensified by increased regulatory requirements and policies imposed by the PRC Government on market participants in order to implement uniform quality control criteria for the distribution of pharmaceuticals and ensure a stable supply of safe, effective medicines throughout the country. For example, in 2003 the SFDA adopted and strictly enforced GSP certification as the relevant standard for quality control in pharmaceutical distribution. A number of smaller distributors were forced to exit the market due to the associated higher compliance costs following the adoption of GSP certification and other regulatory standards. We believe that the more rigorous regulatory standards and policies imposed by the PRC Government will accelerate the trend towards consolidation in the pharmaceutical industry, and favor the continued growth of pharmaceutical distributors with large-scale, nationwide pharmaceutical distribution operations and effective quality controls that are positioned to benefit from the changes in PRC regulatory requirements and policies. In addition, the imposition of price controls imposed by the PRC Government, the centralization of tender and bidding processes among public hospitals and consolidation among drug manufacturers are additional factors that will also contribute to the trend towards consolidation in the industry.

### *Major pharmaceutical distributors in China*

In 2008, the aggregate revenues of the ten largest distributors of pharmaceutical products in China accounted for approximately 35% of the total revenues of the PRC pharmaceutical distribution industry. The following table sets forth the market share of the ten largest pharmaceutical distributors in China for 2008:

Distributors	Percentage of total distributors' market share (%)
<b>China National Pharmaceutical Group Corporation<sup>(1)</sup></b> .....	<b>11.3</b>
Shanghai Pharmaceutical Co., Ltd. ....	4.8
Jointown Group Co., Ltd. ....	4.0
Nanjing Medical Co., Ltd. ....	3.1
Guangzhou Pharmaceutical Corporation. ....	2.7
Anhui Huayuan Pharmaceutical Co., Ltd. ....	2.6
Beijing Pharmaceutical Co., Ltd. ....	1.7
Chongqing Medicine Co., Ltd. ....	1.7
Chongqing Tongjunge Ltd. ....	1.5
Sichuan Kelun Medicine & Trade Co., Ltd. ....	1.2

*Source: China Association of Pharmaceutical Commerce*

(1) We contributed over 90% to the revenue of our parent company, CNPGC.

### *Increased cooperation with international pharmaceutical distributors and manufacturers*

To expedite the expansion and enhance the competitiveness of the PRC pharmaceutical industry, and adhere to its World Trade Organization obligations, China has opened up certain segments of the manufacture, distribution and sale of pharmaceutical products to selected foreign investors since 2005. Encouraged by incentives offered by the PRC Government and the PRC market's potential, foreign pharmaceutical manufacturers increasingly view China as a place to conduct drug discovery, clinical trial research and sell their products. A number of foreign-invested distributors have entered the market, bringing with them advanced logistics and management systems. The first domestic joint venture with an international pharmaceutical distributor, China Zuellig Xinxing

---

## INDUSTRY OVERVIEW

---

Pharmaceutical Co., Ltd., was established by a Swiss company, Zuellig Pharma Group, and the China Xinxing Group in December 2003. In January 2007, the large British pharmaceutical supply chain service provider Alliance Boots PLC formed a joint venture with Guangzhou Pharma to engage in the distribution of pharmaceutical products. At the same time, PRC distributors seek to cooperate with global pharmaceutical companies in order to improve their operational technologies and information management systems. Although the number of foreign distributors has increased and foreign investment in China has intensified the level of competition in the PRC market, further market development and trends with respect to foreign participation in the PRC pharmaceutical industry are difficult to predict.

### Competition in the PRC Pharmaceutical Distribution Industry

Given the fragmentation in the Chinese pharmaceutical distribution industry, distributors are under intense pressure to compete for business and maintain their profits, and must focus on a number of competitive issues, including:

- *Scale.* Given the low margins of the distribution business, achieving economies of scale is crucial for distributors to maintain a sustainable and profitable business.
- *Quality and range of services.* Customers and suppliers of pharmaceutical distributors increasingly value pharmaceutical distributors that are able to deliver one-stop shop pharmaceutical distribution services, which comprise high-quality traditional distribution services and logistics and other value-added services.
- *Geographic coverage.* China's vast territory presents significant geographical challenges that require manufacturers and distributors to develop their distribution networks and penetrate as many local markets as possible to take advantage of the growth of the Chinese market.
- *Product portfolio.* The breadth of products that distributors offer is an important factor for their customers. For example, a large hospital typically needs thousands of different types of prescribed drugs. As such, distributors with an extensive portfolio are generally preferred.
- *Creditworthiness and financial stability.* To minimize supply disruptions and bad debt, customers and suppliers generally select pharmaceutical distributors that are reliable commercial partners with strong financial capabilities and proven track records.
- *Price.* Price competition is intense in the pharmaceutical distribution industry. However, customers and suppliers generally do not make purchasing decisions solely based on price, as they will consider the foregoing factors as well. As a result, the leading and established distributors are able to leverage their strengths to obtain better pricing terms than their weaker competitors.

### Regulatory Regime

The PRC Government has increased its regulation of the pharmaceutical industry in China with a series of initiatives, including promoting equal opportunity for non-hospital drugstores, actively cracking down on corruption and increasing its enforcement of existing laws and regulations, and implementation of new laws and regulations, with respect to intellectual property. This intensified regulation has greatly altered the market and competitive landscape. Drugstores and pharmacies that are not associated with hospitals are predicted to benefit from anti-corruption regulations that encourage the separation of a hospital's pharmaceutical dispensing function from its provision of medical services.

---

## INDUSTRY OVERVIEW

---

### *Equal opportunity for non-hospital drugstores*

On 14 February 2007, the Ministry of Health promulgated *Measures for the Administration of Prescriptions* (處方管理辦法) requiring hospitals to allow prescriptions to be filled at non-hospital drugstores. The implementation of this regulation is expected to increase drug sales, especially prescription drug sales, in drugstore chains and independent drugstores that are not affiliated with hospitals. According to a 2009 report by Frost & Sullivan, of the total drug expenditures in China in 2008, hospital pharmacies and non-hospital drugstores accounted for 84.9% and 15.1%, respectively.

### *Commercial anti-corruption measures*

Most hospitals in China are owned and operated by the PRC Government, and revenue from its hospital pharmacies constitute a significant portion of the total revenue of the hospitals. Hospitals procure their supplies of pharmaceutical products in bulk from manufacturers or distributors of pharmaceutical products, and generally decide whether to include a particular medicine in their pharmacy based upon a number of factors, including doctors' preferences in prescribing the medicine, the cost of the medicine, the perceived efficacy of the medicine and the hospital's budget. Decisions by hospitals regarding whether to include a particular medicine in their pharmacies may be affected by corrupt practices. These practices generally include illegal kickbacks and other benefits offered by manufacturers or distributors of pharmaceutical products, and are primarily utilized by smaller manufacturers and distribution companies. These corrupt practices may also affect doctors' decisions regarding which types of medicine to prescribe.

The PRC Government has strengthened its anti-corruption measures and has organized a series of government-sponsored anti-corruption campaigns in recent years. In particular, the Standing Committee of NPC amended the Criminal Law of PRC in 2006, increasing the penalties for corrupt business practices. The amendment of the Criminal Law of the PRC enhances regulation of pharmaceutical product suppliers to ensure they conduct business on fair and equal terms and, as a result, is expected to result in the standardization of the competitive market, increase consumer confidence and promote the further development of the pharmaceutical industry.

### *Protection of intellectual property*

China has recently passed amendments to its patent laws in order to promote protection of intellectual property, including stricter standards of novelty and implementation of the WTO compulsory license regime. However, counterfeit pharmaceutical products remain an issue in China. In addition to financial losses, counterfeit drugs also pose public health concerns as well. In recent years, the Chinese government has tightened regulation and monitoring aimed to prevent piracy or counterfeiting activities. China has created a comprehensive regulatory and legal structure to better deal with the counterfeit drug issue, and also has joined the International Medicinal Products Anti-Counterfeiting Taskforce, a global partnership created by the World Health Organization. However, as the PRC Government is still building up its experience in dealing with the issue, clearer interpretation of the relevant laws and regulations as well as more effective enforcement are still needed.

## SOURCE OF INFORMATION

The information and statistics set out in this section have been extracted or derived from public and private publications of information providers, including CAPC, Business Monitor International, South Medicine Economics Research Institute, Kaiser Foundation, Booz Allen Hamilton and Frost & Sullivan. All of these information providers are independent third parties and the reports and sources used by such information providers have not been commissioned by us.