

## **CHAIRMANS' STATEMENT**



**CHAIRMAN MR. HE DUANSHI**

Dear shareholders,

I am pleased to report to you the operating results of Shandong Xinhua Pharmaceutical Company Limited (the "Company") for the year ended 31 December 2001.

## **RESULTS AND DIVIDENDS**

For the year ended 31 December 2001, in accordance with PRC accounting standards, the total revenue of the Company and its subsidiaries (the "Group") from principal operations was RMB1,099,258,000, an increase of 5.29% from 2000. Reported profit after taxation was RMB80,896,000, an increase of 17.04% as compared to 2000, and the reported earnings per share ("EPS") was RMB0.177.

In accordance with HKGAAP, total turnover of 2001 was RMB1,099,289,000, an increase of 5.29% from 2000. Reported profit attributable to shareholders was RMB81,746,000, an increase of 20.52% as compared to 2000, and the reported EPS was RMB0.179.

The Board of Directors has proposed a final dividend for 2001 of RMB0.08 per share (approximately HK\$0.754 per share), including income tax for A Shares, to be paid in cash. The proposed dividend has been dealt with in the accounts of the Company and is subject to approval at the annual general meeting for the year 2001.

## **REVIEW OF OPERATION**

In 2001, due to various negative factors, including the recession of the economy of the United States, the downturn of the economy in the European Union and Japan and the September 11 terrorist attack on America, export of the Company were affected detrimentally. In contrast with the increase of 13% in the first half of the year as compared to the same period last year, export for the whole year only increased by 8% as compared to last year, leaving a lag behind the goal set at the beginning of the year. Competition has also become more intense within the domestic market, and the Company was confronted with more difficulties in sales as a result of changes in the PRC pharmaceutical industry and the drop in medicine prices as required by the Chinese government. Despite these unfavourable factors, the Company has adopted a series of measures, including enhancing its marketing activities, improving its operation effectiveness and strengthening its basic management, to maintain a good trend in production and operations in order to realise a double-digit increase in profit.

### **I. COMPLETION OF THE ISSUE AND OFFER OF NEW A SHARES**

It took over one year for the Company to issue its new A Shares (the "Issue") from the beginning of August 2000 to its listing in September 2001. Under the Issue, 30,000,000 A Shares were issued and 3,000,000 State-owned A Shares were offered, giving a net proceeds of RMB370,000,000. The net proceeds will be mainly used in the enlargement and technological improvement of the existing products of the Company, as well as for the renovation of the Company's State-class enterprise technological center. At the end of 2001, the Company completed its technological improvement of L-350 and constructed a building for its Analgin product. The Caffeine project, which is the largest investment from the proceeds of the Issue, reached the stage of construction. The completion of these projects will lay a solid foundation for the Company's development in its tenth Five-year plan and thereafter.

In 2001, the Company was recognized as a high-technology enterprise by the Shandong Province Science and Technology Bureau in its document Lu Ke Gao Zi [2001]No.647 after an appraisal by experts. On 30 January 2002, the Shandong Province Zibo Municipal Local Taxation Bureau Development Zone Sub-Division confirmed in its document Zi Di Shui Kai Zi [2002]No.5 that the rate of the income tax for the Company would be reduced to 15% for the financial year 2002.

## **II. IMPROVEMENT OF CORPORATE GOVERNANCE**

The improvement of the Company's corporate governance of the Company was regarded as one of the Company's major achievements in 2001. For the purpose of complying with the requirements of corporate governance, to improve its modern corporate system and differentiate the duties and responsibilities of the Directors and the managers, the Company replaced its general manager and three deputy general managers. At this point, the Company has 10 remaining directors, of which 3 are independent non-executive directors. The management of the Company comprises 6 members.

## **III. Improvement of Operating Results**

Through the implementation of various strategies for balancing production, sales and payments, and the tightened control of operating risks, the Company realised increases of 5.29% in turnover and 17.04% in profit after taxation in accordance with the PRC accounting standards.

In addition to consolidating its existing market share for preparations, the development and marketing of new preparation products were accelerated. In the reported year, the Company obtained certificates and approvals for production of 5 new medicines from the State Drug Administration. These medicines are meloxicam, in bulk and capsule form, clindamycin

phosphate injection and glimepiride, in bulk and tablet form. The Company was also approved to have its etofesalamide ointment placed into mass production. Theophylline Calcium Gluconate, a product of the Caffeine series, and Meloxicam capsule were also placed on trial and mass production respectively.

Owing to the Company's emphasis on increasing both production volume and profit, the marketing of the new preparation products was further strengthened. In 2001, the sales of new preparations were RMB111,750,000, an increase of 10.95% as compared to the same period last year.

#### **IV. STRENGTHENING OF BASIC MANAGEMENT**

The Company continued to encourage each of its staff to take part in activities that are conducive to increasing the Company's revenue, reducing its operating costs and promoting technical improvement of the different production methods for different products of the Company. The technical and economic indicators of the main targeted products of the Company, set at the beginning of the year, improved as compared to the same indicators of last year, and five of these products accomplished their targets set for the year 2001.

In order to enhance its quality control, the Company amended its quality control rules and regulations and established a "lifetime responsibility mechanism" for the Company's products. The "rapid reaction mechanism" was further improved to meet the different demands of the market. In 2001, the Company passed the examination by the Food and Drug Administration of the United States of America (the "FDA") and quality audits carried out by 18 foreign companies including multinational corporations such as GSK. The Company has also passed the ISO9001 and ISO14001 review carried out on the Company during the year.

By inviting public tenders and budget management, the Company further reduced its costs of production, expenses and its financing risk. Raw materials required by the Company were supplied in time and were of superior quality due to the quality audits carried out on its suppliers by the Company.

#### **FUTURE PROSPECTS**

As a consequence of economic globalization, the Company was confronted with complicated operating circumstances prompted by multinational companies' entry into the domestic PRC market after China's accession into the World Trade Organization (the "WTO"). There are numerous uncertainties in the world economy, but the Chinese national economy remains on an increase at the rate of approximately 7% in the coming year due to

the implementation of macro-economy policies for increasing domestic demand, development of regions in the northwestern provinces of China, and reduction in interest rate of loans and deposit rate in Renminbi currency. Medical consumption in the PRC is expected to maintain its growth as a result of the greater wealth of PRC nationals and the expansion of the medical care system of the PRC. The Company will benefit from the abovementioned factors and will make an effort to achieve the following major objectives determined for the coming year:

## **1. TO ENHANCE MARKETING AND EXPAND THE SCALE OF SALES**

The Company is beginning to formulate new models of sales. Although the Company has accumulated a wealth of experience and made considerable headway in the marketing of bulk pharmaceuticals. The Company is considering how to promote the sales of preparations. By analysing the nature and sales networks for different preparations, the Company restructured its sales department for sales of preparations by separating it into four departments for different products, namely generic preparations, oral preparations, injections and other preparations. This will effectively maximise staff's enthusiasm and improve the competitiveness of the marketing personnel for the Company by simplifying its administration structure. Meanwhile, the Company also plans to enhance its cooperation with the medical commercial companies in the wholesales and retail business in order to increase its sales volume.

In respect of the marketing of bulk pharmaceuticals, the Company will seek to further consolidate and promote its strategic relationships with its customers. By taking advantage of its advanced technologies, the Company will modify its production technologies and develop series of products with particular specifications to meet the quality requirements of individual clients. Also, the Company will place emphasis on the sales of its main products in the important markets as well as the marketing of its more profitable products and strategic products. In the international market, the Company is planning to promote its cooperation with famous multinational companies and increase the export of its products with particular specifications. It will be helpful for the Company to establish and maintain good strategic relationships with cooperative enterprises both domestically and abroad.

The Company will improve its incentive and retention mechanisms in the sales departments by implementing routine checks on the sales managers and will improve the Company's competitiveness in marketing by enhancing the training of its sales staff.

The Company, in addition to its marketing efforts, set up a division in charge of risk control and implemented a "lifetime responsibility" policy in respect of the payment for its goods. In order to reduce the operational risk and improve the operational results of the Company, a

series of rules and regulations will be promulgated to control such risks throughout the course of its sales.

## **2. TO BUILD A STUDY-ORIENTED ENTERPRISE AND PROMOTE CREATIVITY**

As the world economy comes into the age of information technology, and the theories, methods and measures in respect of management are developing rapidly. After China's accession into the WTO, the Company has to adapt itself to the significant change of business environment. Learning and utilising the rules of WTO and keeping in pace with the development of the economy will be one of the main focuses of the Company for the year 2002.

To meet the demands of development, the Company advocates a study-oriented enterprise by way of stimulating staff's enthusiasm in learning modern management theories and methods and improving their sense in respect of opportunities, reform, market, awareness and creativity. By enhancing the basic management and improving both software and hardware of the Company, the Company is well prepared for the certification of GMP, which are quality audits carried out by foreign companies, and the examination of the FDA.

As for the supply of raw materials, besides the massive purchase of chemical products, the Company will pursue the policy of inviting public tenders in all its procurements, including auxiliary materials, retail materials, instruments and apparatus. The Company will build up its centralised purchasing system to cut down on costs of procurement and carry out quality audits on its suppliers of raw materials.

Focused on financial and funding management, the Company will implement an overall budget management by taking into account all of its expenditures in its budget, place the results of its budget under periodic examination, and modify the appraisal mechanism of its budget to ensure that the production and operations of the Company remain in a good cycle.

By making full use of its existing intranet, the Company will improve its information collection by adopting ERP(Enterprise Resource Plan), CRM(Customer Relation Management) and SCM(Supply Chain Management) in its management progressively. Meanwhile, the Company also plans to develop its E-business by inviting public tenders and e-procurement on the website of the Company.

## **3. TO DEVELOP NEW PROFITABLE RESOURCES THROUGH PRODUCT MIX ADJUSTMENTS AND TECHNOLOGICAL INNOVATION**

The Company will develop at a greatly accelerated pace by bringing into play its

comparative advantages in respect of bulk pharmaceuticals. Applying the advanced facilities and technologies in the production of the Company's existing products, the Company will improve the scientific contents of its products and achieve economies of scale. The Company also plans to develop new production technologies and improve the adaptability of its production facilities to satisfy the demands of its different customers. Through independent and joint research of technologies for different products, which are focused on the main, strategic and high margin products in sales, the production yield of the Company will be further improved which will in turn improve the competitiveness of the Company.

The Company will fully utilise its strength in respect of self-produced bulk pharmaceuticals. The development of preparations will be expedited due to the economies of scale and its brand-name recognition.

The Company will continue to improve its level in scientific know-how research especially in respect of the Company's transformation from the imitation of products of others to the invention of its own new products. The Company will increase its investments in research and development, upgrade the equipment of its research institutes, and employ senior researchers. Meanwhile, the Company is paying more attention to its cooperation with universities and research institutions in order to quickly implement more scientific results achieved from experiments in its industrial production. It is anticipated that the Company will obtain more than three certificates for new drugs approved by the State Drug Administration in 2002.

#### **4. TO ESTABLISH JOINT VENTURES OR COOPERATIVE VENTURES WITH FOREIGN COMPANIES**

Presently, the world economy is undergoing a new cycle of structural adjustments, which provides the Company with a rare opportunity to engage in international cooperation. Capitalising on its strengths in bulk pharmaceuticals and fine chemicals, the Company will utilise its influence on the international market and the preferential policies promulgated by the local government to attract both domestic and overseas investment by way of processing contracts and joint ventures, especially the cooperation with renowned multinational companies. The Company will also take an active part in the mergers and acquisitions of the domestic pharmaceutical industry.

The Company will take advantage of opportunities arising from the reorganisation of the PRC pharmaceutical industry to accelerate its development.

In 2001, the Company made great effort to realise an increase of profit after taxation by 17.04% as compared to the year 2000 in accordance with PRC accounting standards, despite

the deteriorated conditions seen in the international market which exerted a tremendous detrimental effect on the export of the Company. However, the profit after taxation realised in the year 2001 decreased by 17.20% compared with the profit forecast for the corresponding period. In the coming year, the Board is confidence that, through the mutual effort of the management and the staff, the Company shall continue to make a sustained and prosperous growth.

By order of the Board

**He Duanshi**

*Chairman*

22 March 2002

Zibo, Shandong, PRC