MANAGEMENT DISCUSSION AND ANALYSIS

BUSINESS REVIEW

Engaged principally in the research and development, manufacture, distribution and sales of Chinese pharmaceutical products for women and the elderly, naturally-sourced anti-tumour medicine and western pharmaceutical products in the PRC, the Group has been putting in continuous efforts in further capitalizing in the market of naturally-sourced anti-tumour medicines in the Year. Under the rapid growth in the PRC pharmaceutical industry and the promotion of general health protection and social medical insurance by the PRC government, notwithstanding the competition from different domestic and international pharmaceutical manufacturers, the Group has achieved remarkable success over the years leveraging on its competitive edges including its well-established brand name, good reputation, strong research and development capabilities and extensive sales and marketing network. The Company's listing on the Main Board of The Stock Exchange of Hong Kong Limited ("**Stock Exchange**") marks an important milestone for the Group and paves the way for further business expansion. The Group will endeavour to tap into various business opportunities in the pharmaceutical industry in order to increase its market share and net profit.

FINANCIAL PERFORMANCE

The results of the Group for the Year were very encouraging. The Group recorded turnover of approximately HK$219,043,000 during the Year, representing a growth of approximately 26% as compared to that of last year. Gross profit margin remained stable at approximately 64% during the year under review due to the stable and ample supply of medicinal herbs in Guizhou where the Group's production complex is located and enhanced production efficiency. Gross profit for the Year amounted to approximately HK$141,044,000, representing an increase of approximately 27% from that of last year. Profit attributable to shareholders for the Year was approximately HK$85,883,000, with an increase of approximately 13% from that of last year.

CHINESE PHARMACEUTICAL PRODUCTS

The turnover of the Group's Chinese pharmaceutical products increased by approximately 24%, from approximately HK$105,134,000 for last year to approximately HK$130,221,000 for the Year, accounting for approximately 60% of the total turnover of the Group. The gross profit margin of this product line was maintained at a relatively high level of approximately 64%. The major products under this category are products under the ***Yeosure***（日舒安）brand name, which generated sales of approximately HK$110,162,000 during the Year with a growth of approximately 12% compared with that of last year and contributed greatly to the fruitful results of the Group for the Year. The ***Yeosure***（日舒安）product line comprises a comprehensive range of products with different therapeutic functions for women of all ages. The ***Yeosure***（日舒安）brand name is well established in the market through the Group's extensive sales network all over the PRC as well as its well-recognized therapeutic functions. In view of the increasing awareness of the importance of health by women, the Group has been capturing opportunities to extend this product line to meet market demand.

With the outbreak of SARS in early 2003, the sales of ***Huangqi Granules***（黃芪顆粒）, a Chinese pharmaceutical health drink for strengthening human immune system which targets at the OTC market, has surged tremendously. Its turnover amounted to approximately HK$14,729,000 during the Year, accounting for approximately 7% of the total turnover of the Group, with a significant increase of approximately 695% from that of last year.

NATURALLY-SOURCED ANTI-TUMOUR MEDICINE

The Group has been exerting continuous efforts in further capitalising on the growth of the naturally-sourced anti-tumour medicine during the Year. Another growth driver for the Group in the Year was the naturally-sourced anti-tumour injection medicine, of which ***Jin Xi Su***（金喜素）and ***Qiang Xi***（強喜）are the major products. The entire product category contributed approximately HK$64,233,000 to the total turnover of the Group, representing approximately 29% of the total turnover of the Group for the Year and an increase of approximately 27% from approximately HK$50,635,000 for last year. The turnover of ***Jin Xi Su***（金喜素）and ***Qiang Xi***（強喜）were approximately HK$54,950,000 and HK$6,539,000 respectively for the Year. Gross profit of the product in this category for the Year was approximately 67%. The main ingredient of naturally-sourced anti-tumour injection medicine is extracted from the fruit of ***camptotheca acuminata***（喜樹）which is in abundant supply in Guizhou where the Group's production complex is situated. Hence, costs of the materials of such products have been maintained at a low level. ***Jin Xi Su***（金喜素）injection was approved by the State Food and Drug Adminstration of the PRC ("**SFDA**") in 2000 as a Second category new chemical medicine entitled to a protection period of eight years, guaranteeing a positive prospect of this product in the coming future.

WESTERN PHARMACEUTICAL PRODUCTS

The turnover of the western pharmaceutical products recorded approximately HK$24,589,000 during the Year, representing approximately 11% of the Group's total turnover, with an increase of approximately 41% as compared to that of last year. Gross profit of the products in this category for the Year was approximately 56%. The Group has established strategic alliances with a few renowned pharmaceutical research institutes and universities, so as to utilise the cutting-edge technologies and the latest discoveries in the pharmaceutical industry. This facilitates the Group to catch up with the latest pharmaceutical products. Apart from the Chinese pharmaceutical product of the Group, ***Huangqi Granules***（黃芪顆粒）, a western pharmaceutical product, ***Cefadroxil Granules***（毅達顆粒）, an antibiotic for children, achieved favourable sales during the period of the SARS outbreak. Its turnover amounted to approximately HK$22,794,000 or approximately 10% of the total turnover of the Group during the Year, representing an increase of approximately 42% from that of last year.

PROSPECTS

Looking ahead, the Directors are confident that the Group will achieve impressive results by continually implementing business plans and strategies adopted in the Year. The momentum for the Group's growth and development will come from its efforts in new product development and expansion of sales network as well as vertical integration through acquisition of pharmaceutical distribution enterprises and manufacturing enterprises.

The Group emphasizes on the importance of new product development. Through strengthening its research and development capabilities, the Group is able to further expand its product mix and sources of revenue. The Group's ***Zhitong Jiangu Capsules***（止痛健骨膠囊）, a Chinese pharmaceutical product for the treatment of arthritis that has passed the pre-clinical research review by the SFDA and obtained approval to conduct phases II and III of the clinical trial, is expected to be classified as a Third category new medicine and complete the clinical trials by the end of 2004 and obtain new medicine certificate by mid 2005. Meanwhile, the Group is continuing its research and development of new medicines through strategic alliances with different pharmaceutical research institutes and universities. Such research institutes and universities include the China Pharmaceutical University（中國藥科大學）, the Institute of Materia Medica of the Chinese Academy of Medical Sciences（中國醫學科學院藥物研究所）and the Chinese University of Hong Kong（香港中文大學）. The Group also plans to establish a research and development centre in the PRC. With the consistent launch of three to five new pharmaceutical products into the market every year, the Directors are of the view that the Group's business will achieve continuous growth.

Arousing brand awareness and intensifying marketing activities of its products remain important to the Group. Given the satisfactory results of the promotional campaigns for the expansion into the OTC markets for the Group's products in 2003, the Group will reinforce its efforts to arouse brand awareness in the provinces of Guizhou, Hubei, Sichuan, Guangxi and Guangdong and to enter into the markets in the provinces of Heilongjiang, Jilin, Liaoning, Henan and Yunnan. Currently, the Group has 10 sales offices in the PRC and the Group plan to establish additional sales offices in major municipalities of the PRC such as Beijing, Tianjin, Xian, Lanzhou, Chongqing, Kunming and Changsha, etc, resulting in a total number of 20 sales offices in the PRC to further extend its sales network in these new target markets.

Facing the structural reform in the pharmaceutical industry in the PRC after the PRC's accession into WTO and the requirement by the PRC government for all domestic pharmaceutical manufacturers to be accredited with Good Manufacturing Practice ("**GMP**") certification by June 2004, the Directors consider that prompt expansion of the Group's business is of utmost importance. In order to capture the market share of its products, the Group will strategically expand its sales points and distribution channels by way of vertical integration through acquiring pharmaceutical distribution enterprises in the PRC. The southwestern region of the PRC will be one of the focused markets of the Group in the future. During the Year, the Group has successfully acquired a state-owned pharmaceutical distribution enterprise in the southwestern region of the PRC which was accredited a Good Service Practice ("**GSP**") certification in February 2003. Such enterprise has an extensive sales network covering not only hospitals but also retail clients. Through such acquisition, the Group will be able to enlarge its client base in a short period of time and further explore the business opportunities in the southwestern region of the PRC, which accounted for only approximately 13% of the Group's total turnover for the year under review. In addition, the distribution enterprise that the Group has acquired owns a well-equipped warehouse. The warehouse will not only be used as storage facility, but also as the Group's logistic centre in the southwestern region of the PRC. Furthermore, the warehouse is well linked with a railway platform that facilitates mass transportation of pharmaceutical products from different via the railway. Pharmaceutical products can be temporarily stored in the warehouse and then delivered to other wholesalers or retailers in the region. With this strategic move, the operational efficiencies of the distributional process will also be further enhanced. Through the above downstream integration, the Group will be able to lower its operating costs and achieve economies of scale, resulting in higher profitability and better use of resources. The distribution enterprise also provides the Group with business opportunities to cooperate with domestic or multi-national pharmaceutical enterprises for the manufacture and distribution of pharmaceutical products in the PRC.

By June 2004, the accreditation of GMP certificates would be the prerequisite for all domestic pharmaceutical manufacturers in the PRC to sustain in the industry. Lying ahead of competitors with GMP certification obtained for the production of eight forms of pharmaceutical products, the Group is also benefiting from this competitive edge as the accreditation process of GMP certificate is time-consuming, which would take approximately 6 to 9 months to complete. At the same time, the scattered PRC pharmaceutical industry is expected to consolidate and this would create abundant opportunities for the Group to acquire small-scale or state-owned pharmaceutical manufacturers which may face significant financial difficulties in meeting the new requirement. Providing its own platform for further business growth, the potential acquisitions would empower the Group's sales and distribution network while facing the challenges arising from the PRC's accession of WTO. Capitalising on horizontal integration and development, the Group will expeditiously expand its product range and manufacturing capabilities and hence maintain its market position in the PRC pharmaceutical industry and increase profit levels.

The Group is committed to developing new product, strengthening research and development capabilities, expanding its sales and marketing network, enhancing production efficiency and product quality, and executing capital investments in pharmaceutical distribution and manufacturing enterprises to capture the opportunities arising from the reform of pharmaceutical industry in the PRC. By increasing the number of production lines and acquiring pharmaceutical distribution and manufacturing enterprises, the Group will keep on enlarging the interface with end-users of nation-wide hospitals as well as OTC counterparts. The Group is confident to increase profitability with the adoption of current business plans and strategies.

LIQUIDITY AND FINANCIAL RESOURCES

For the Year, the Group generally financed its operations with internally generated cash flows and banking facilities provided by banks in the PRC. As at 30 June 2003, the Group had cash and bank balances of approximately HK$105,019,000 (2002: approximately HK$59,652,000). The gearing ratio (calculated as a ratio of bank loans to shareholders' equity) of the Group as at 30 June 2003 was approximately 27.5%. Net current assets value was approximately HK$190,179,000 (2002: approximately HK$74,575,000) and the current ratio was maintained at the healthy level of approximately 2.78 (2002: approximately 2.18) as at 30 June 2003.

The finance costs of the Group for the Year amounted to approximately HK$3,563,000, representing approximately 1.6% of the Group's total turnover and an increase of approximately HK$721,000 over last year. The increase in finance costs was principally due to new bank loans obtained.

CONTINGENT LIABILITIES

As at 30 June 2003, the Group did not have any material contingent liabilities (2002: Nil).

BANK BORROWINGS

As at 30 June 2003, the Group had outstanding bank loans of approximately HK$70,861,000 (2002: approximately HK$46,803,000) and approximately 74% (2002: approximately 66%) of which were short term bank loans from the banks in the PRC with maturity within one year. All the bank loans of the Group were denominated in Renminbi.

As at 30 June 2003, the Group's bank loans were secured by (i) plant and machinery of the Group; (ii) land and buildings of the Group; and (iii) corporate guarantee from a subsidiary of the Company.

ACQUISITION OF SUBSIDIARIES

In June 2003, the Group acquired the entire equity interest in 貴州禾創投資有限公司(“禾創投資”), which holds the entire equity interest in 成都禾創藥業有限公司(formerly 成都醫藥採購供應站)(“禾創藥業”), from certain independent third parties. 禾創投資 is an investment holding company established in the PRC. 禾創藥業 is engaged in the trading of pharmaceutical products, healthcare products, and medical appliances and equipment. The results of the subsidiaries acquired during the Year had no significant impact on the Group's consolidated turnover or profit after tax as they were acquired in June 2003.

SEASONAL OR CYCLICAL FACTORS

During the Year, the Group's business operations were not significantly affected by any seasonal and cyclical factors.

FOREIGN EXCHANGE EXPOSURE

During the Year, the Group mainly earned revenue and incurred costs in Renminbi. Renminbi was relatively stable during the Year. The Directors considered that the Group's exposure to fluctuation in foreign exchange rate was minimal, and, accordingly, the Group did not employ any financial instruments for hedging purposes.

TREASURY POLICIES

During the Year, the Group generally financed its operations with internally generated resources and credit facilities provided by banks in the PRC. Interest rates of most of these were calculated by reference to the PRC bank rates. Both bank deposits and borrowings were mainly denominated in Renminbi.

COMMITMENTS

The Group had the following commitments as at 30 June 2003:

(a) contracted commitments of HK$3,099,000 (2002: HK$4,626,000) in respect of purchases of technical knowhow; and

(b) contracted commitments of HK$2,467,000 (2002: Nil) in respect of purchases of plant and machinery.

FINAL DIVIDEND

The Board recommends the payment of a final dividend of HK2 cents per share by the Company for the Year.

EMPLOYEES TRAINING AND REMUNERATION POLICIES

As at 30 June 2003, the Group had a total of 671 (2002: 422) employees (禾創藥業 staff not included as it was acquired in June 2003), of whom 664 were based in the PRC, with the rest in Hong Kong. The employees of the Group were remunerated based on their experience, qualifications, the Group's performance as well as market conditions. During the Year, staff costs (including director's emoluments) amounted to approximately HK$7,126,000 (2002: HK$6,136,000). Staff costs remained stable at 3.3% of the Group's turnover. The Group participated in retirement benefit schemes for its staff in both Hong Kong and the PRC.

The Group has developed its training programmes in a structured and systematic manner for its management and employees. The Group provided regular management and technical related courses to its employees during the Year.

SHARE OPTION SCHEME

The Company operates a share option scheme ("**Scheme**") for the purpose of providing incentives and/or rewards to eligible participants who contribute to the success of the Group's operations. The Scheme became effective on 25 November 2002, and unless otherwise cancelled or amended, will remain in force for a period of 10 years from that day.

During the Year, options carrying the rights to subscribe for a total of 56,600,000 shares in the Company were granted under the Scheme, which are exercisable at the exercise price of HK$1.19 per share during the period from 16 May 2003 to 15 May 2005. No option lapsed or was cancelled during the Year. As at 30 June 2003, options carrying the rights to subscribe for 56,600,000 shares in the Company were outstanding.

USE OF NET PROCEEDS FROM NEW ISSUE

The net proceeds from the placing and public offer of new shares by the Company in December 2002 ("**New Issue**") amounted to approximately HK$54.8 million. These proceeds were partly applied during the Year and up to the date of this report, the Group had utilised the net proceeds as follows:

Comparison of the use of net proceeds from the New Issue disclosed in the prospectus of the Company dated 28 November 2002 ("**Prospectus**") with actual application.

	Net proceeds from the New Issue approximately, HK$'m	**Actual amount used up to the date of this report approximately, HK$'m**
Research, development and acquisition of technological knowhow of new pharmaceutical products	9.0	9.0
Establishment of the Group's research and development centre and relocation of the Group's head office in the PRC	6.0	4.7
Extension of the Group's production facilities and equipment	2.0	2.0
Promotional expenses of the Group's Chinese pharmaceutical products, anti-tumour medicines and new medicines	5.5	5.5
Establishment of 10 sales offices in the PRC to expand the Group's sales and distribution network and an international sales centre in Hong Kong for the promotion of the Group's products overseas	7.5	4.5
Investing in a joint venture with a pharmaceutical company in Hong Kong for the manufacture and sale of products developed by the Company in the PRC	2.0	—
Repayment of bank borrowings	22.8	22.8
Total	54.8	48.5

Notes:

The allocation of the net proceeds from the New Issue as disclosed in the Prospectus was based on the assumption that the new shares in the Company were offered at an offer price of HK$0.80 per share, being the mid-point of the indicative offer price range of HK$0.74 to HK$0.87.

The actual allocation of the net proceeds from the New Issue as stated in the column headed "Net proceeds from the New Issue" in the above table is based on the actual offer price of HK$0.77 per share.

To the extent that the proceeds from the New Issue are not applied, they are currently placed at licensed banks in Hong Kong as short term deposits. The Directors are of the opinion that the remaining proceeds will be applied in the coming year for their intended use as set out in the Prospectus.