



## MANAGEMENT DISCUSSION AND ANALYSIS

### FINANCIAL RESULTS

For the year ended 31 March 2004, the Group recorded turnover of HK\$60,569,000 (2003: HK\$91,195,000), representing a decrease of 33.6% as compared with that of last year. Net profit from ordinary activities attributable to shareholders was reported at HK\$3,312,000 (2003: HK\$15,551,000) whilst the basic earnings per share was HK0.55 cent (2003: HK2.9 cents).

### BUSINESS REVIEW

The Group's operating results for the year mirrored the impact of SARS on local consumer spending especially in the first half of the year, and during its aftermath which lingered in the second half of the year. Despite a gradual lift of health awareness after the health scare, the consumer market has yet to reap any real benefits of recovery. The Group's sales in the second half of the year also reflected the seasonal factor of health food products in general. The initial costs associated with the acquisition of Yunnan Long Far also created pressure on the Group's profit during the year.

On the product front, the Group's flagship product Beauty and Healthy「排毒美顏寶」accounted for 82.0% of the Group's turnover, compared to 95.3% in the previous financial year. Sales of B&H-24's「輕盈版排毒美顏寶」, Female Essence「補氣養血寶」and Super Vitality「填精生力寶」, which were introduced in the previous financial year were satisfactory. Therefore, the Group launched other eight new products during the year. Superior Lingzhi「極品靈芝」, Flu Reliever「感冒靈丹」, Vasopure「血之清」, Kidney Essence「補腎良方」, Lung Essence「清肺良方」, and Slim Factor「餐餐1/2」were introduced to the market in the first half of the year whilst Detox Tea「排毒美顏茶」and Stimulean Tea「秀身花果茶」were introduced in the second half of the year. These products have made satisfactory contributions in broadening our customer profile, helping us to target wider market segments. During the year, the above products generated total sales of HK\$4,675,000, accounting for 7.7% of the Group's turnover.

Hong Kong continued to be the Group's largest market, accounting for 77.4% of total turnover. In view of the situation of the local market, the Group reorganized its distribution network and expanded the product variety for the Southeast Asian market, resulting in a 48.1% rise in sales to HK\$12,547,000 and accounting for 20.7% of the Group's turnover. No turnover was recorded in the Japanese market as the Group has temporarily withdrawn from this market awaiting other opportunities pending the improvement of the market environment in Japan. During the year, the Group also made an initial market appearance in Canada and Germany. The Group regards the penetration of these markets as an encouraging step in tapping further opportunities within the European and American markets.

With the acquisition of Yunnan Long Far, the Group has formally completed its goal of vertical integration. Yunnan Long Far is engaged mainly in the research, development, manufacture and distribution of pharmaceutical products in China under the brand name「雁塔牌」(Yanta Pai). It possesses a total of 156 pharmaceutical production permits, which are important assets for the Group in broadening its product mix in the future. In February 2004, the Group successfully obtained the GMP Certificate for the plant. Production at Yunnan Long Far began in February 2004. In addition to producing the products under "Yanta Pai" for sales in China, the Group will gradually assign more of the Group's products to be manufactured at the plant. The Group is expected to reap more cost saving benefits from it in the years ahead.



## MANAGEMENT DISCUSSION AND ANALYSIS

### BUSINESS REVIEW *(Continued)*

In May 2003, the Group entered into an agreement to cooperate with the CUCAMed Company Limited to research and develop an effective Chinese medicinal formula for relieving symptoms of allergic rhinitis. The clinical tests returned satisfactory progress. Pushing forward in this area, the Group will introduce to the market the new product, SBL. The University of Hong Kong has conducted a survey which showed that among the 2,000 individuals interviewed, 47% of the interviewees believed they have allergic rhinitis. Academics responsible for the survey estimate that about 20% of the Hong Kong population (approximately 1.3 million people) are suffering from allergic rhinitis. If it is not treated early, it may develop into asthma, which can be fatal. Given its huge potential and the result of the above survey, the Group is confident of the prospects of the new product.

### PROSPECTS

CMCHK implemented a registration system for proprietary Chinese medicines since 19 December 2003. All proprietary Chinese medicines manufactured, processed, imported, re-exported or sold in Hong Kong should apply for registration with the CMB. Through the registration system, the safety, quality and efficacy of proprietary Chinese medicines can be assured. All registered proprietary Chinese medicines are recognized as containing the above elements and can be sold freely, while unregistered proprietary Chinese medicines will be prohibited to sale in Hong Kong market. The Group has submitted the necessary documents to register its products and is expecting a positive reply from the CMB. The Directors believe that the registration system will enhance customers' confidence in using proprietary Chinese medicines and guide the healthy development of the industry as poor quality products will be eliminated from the market.

The recent inflow of tourists, especially those from the Mainland China is expected to lend support to consumer spending in the local market. As for the health food product market, competition is expected to remain intense.

The Group is determined to maintain its position as the mainstay in the industry. To achieve this goal, the Group will continue the strategy of expanding its product portfolio and markets. The sales performance of new products, particularly Slim Factor「餐餐1/2」, Detox Tea「排毒美顏茶」and Stimulean Tea「秀身花果茶」, has been promising. The Group will also step up efforts in extending and strengthening its presence in overseas markets.

The Group also expects to enjoy higher cost advantages as the production scale of Yunnan Long Far enlarges. More substantial contribution in terms of sales as well as profit is also anticipated from the facility. In the longer run, given its extensive distribution network and established brand name, Yunnan Long Far will become an important base for business growth of the Group in China.

## MANAGEMENT DISCUSSION AND ANALYSIS

### PROSPECTS *(Continued)*

To effectively boost sales, the Group will adopt a cautious and flexible approach in branding. The recent accreditation of “Super Brands Awards” again by a worldwide organisation in May 2004 is testimony to the Group’s achievement in this area. In addition to heightening consumer awareness locally of the brand name「龍發製藥」(Long Far), the Group will also identify opportunities to promote the brand name「龍發製藥」(Long Far) in other potential markets including China to pave way for future business development.

With a solid presence in the health food product market, the management remains positive about the prospects of the Group.

### EMPLOYEES

As at 31 March 2004, the Group had 189 employees (2003: 50 employees).

The remuneration policy and package for the Group’s employees are reviewed and approved by the Directors on a periodical basis. The Group remunerates its employees based on industry practice and performance of individual employees. The Group also offers discretionary bonuses to and makes available a share option scheme for its employees.

### USE OF PROCEEDS

Up to 31 March 2004, the net proceeds (after deducting related expenses) from the Share Offer (as defined in the prospectus of the Company dated 27 August 2004 (the “Prospectus”)) (“Net Proceeds”) of HK\$38,751,000 had been utilised in line with the terms stipulated in the Prospectus, particulars of which are set out as follows:

	Proposed application of the Net Proceeds HK\$’000	Actual amount used up to 31 March 2004 HK\$’000
Research and development	10,000	6,683
Expansion of distribution network	2,751	– (Note 1)
Establishment of a Chinese herbal raw material production base in China	4,000	– (Note 1)
Establishment of a Chinese medicinal service centre in Hong Kong	4,000	4,000 (Note 2)
Expansion of the business of the Group through merger, acquisitions, cooperative arrangements, strategic alliance and joint ventures	18,000	18,000 (Note 3)

As at 31 March 2004, the unused amount of Net Proceeds of approximately HK\$10,068,000 was deposited in various licensed banks in Hong Kong.



## MANAGEMENT DISCUSSION AND ANALYSIS

### USE OF PROCEEDS *(Continued)*

#### Notes:

- (1) The Company has not yet utilised the Net Proceeds as mentioned in the Prospectus regarding expansion of distribution network and establishment of a Chinese herbal raw material production base in China. Notwithstanding this, the Company still intends to utilise the Net Proceeds in accordance with the plan as described in the Prospectus.
- (2) The total cost for the establishment of a Chinese medicinal service centre in Hong Kong was HK\$4,800,000 of which HK\$4,000,000 was from the Net Proceeds as mentioned in the Prospectus and the remaining HK\$800,000 was from internal resources of the Group.
- (3) The total cost for the expansion of the business of the Group was HK\$39,167,000 of which HK\$18,000,000 was from the Net Proceeds as mentioned in the Prospectus and the remaining HK\$21,167,000 was from internal resources of the Group.

### LIQUIDITY AND FINANCIAL RESOURCES

The Group has consistently maintained sufficient working capital. As at 31 March 2004, the Group had current assets of HK\$57,903,000 (2003: HK\$90,422,000) and cash and bank balances of HK\$26,608,000 (2003: HK\$58,332,000). The Group's current liabilities as at 31 March 2004 was HK\$14,905,000 (2003: HK\$7,581,000).

As at 31 March 2004, shareholders' funds was HK\$86,697,000 (2003: HK\$85,240,000). The Group had no outstanding borrowings as at 31 March 2004 (2003: Nil). The gearing ratio, being the ratio of total liabilities to shareholders' funds, was 18.0% (2003: 8.9%).

### CONTINGENT LIABILITIES

As at 31 March 2004, the Group had 348,151 (2003: 459,030) outstanding coupons issued to the members of the International Health Association, established by a subsidiary of the Group, which entitle the coupon holders to purchase products of the Group from certain retailing outlets in Hong Kong at a discounted price for a period up to 31 October 2005. These retailing outlets would be entitled to recoup from the Group for the amount of discounts given to the coupon holders upon the presentation of the coupons received. As at 31 March 2004, the maximum value of these outstanding coupons, subject to recoup by these retailing outlets, amounted to approximately HK\$9,226,000 (2003: HK\$13,771,000).

### EXCHANGE RISK

The Board is of the opinion that the impact of foreign exchange exposure on the Group is minimal because its sales and purchases are mainly conducted in Hong Kong dollars. The Group does not engage in any hedging contracts.

### CHARGE ON GROUP'S ASSETS

As at 31 March 2004, certain of the Group's time deposits totalling HK\$4,388,000 were pledged to the banks as security for the banking facilities granted to the Group. An amount of HK\$480,000 (2003: Nil) of these banking facilities was utilized by the Group as at 31 March 2004.