

DEAR SHAREHOLDERS,

On behalf of the board of directors (the "Board") of Dawnrays Pharmaceutical (Holdings) Limited (the "Company") and its subsidiaries (collectively referred to as the "Group"), I am pleased to present the results of the Group for the year ended 31 December 2004.

RESULTS

The Group recorded a turnover of approximately RMB584,758,000 (2003: RMB491,388,000) for the year ended 31 December 2004, which was increased by 19.0% from that of 2003. Net profit from ordinary activities attributable to shareholders was approximately RMB80,171,000 (2003: RMB108,022,000), which was decreased by 25.8% from that of 2003. The growth in turnover was mainly attributable to the significant increase in the production and sales volume of cephalosporin powder for injection form and bulk medicine, as well as new types of generic drugs (system specific medicine) which successfully tapped into the market as planned (with an average gross profit margin over 70%). The decrease in profit was principally attributable to the following reasons:

1. On 7 June 2004, the National Development and Reform Commission of the PRC ordered a reduction in the retail price of antibiotics. The average rate of reduction in price for 24 species of antibiotics was about 30%. The Group took the initiative to reduce the ex-factory price of cephalosporin powder for injection form so as to expand its market share. In 2004, the sales volume of cephalosporin powder for injection form was increased by 51.4%, whilst the gross profit margin was 42.0% (2003: 54.6%), representing a decrease of 12.6%. The turnover of cephalosporin powder for injection form was RMB216,979,000 (2003: RMB230,976,000), representing a decrease of RMB13,997,000;
2. In 2004, the Group established an effective mechanism for optimizing technologies, marketing, research and development, as well as determining remuneration so as to motivate management. Experts in high-end technologies and marketing were recruited from competitors for the development of generic drugs (system specific medicine). Bonuses given during the year amounted to RMB7,422,000 (2003: Nil);
3. As the Group was listed on 11 July 2003, no expense was incurred in the head office in Hong Kong for the first half of 2003. In 2004, administrative expenses incurred in the head office in Hong Kong amounted to RMB9,979,000 (2003: RMB5,155,000), representing an increase of RMB4,824,000; and
4. In 2004, the Group devoted more efforts to the research and development of new products. Expenses on research and development amounted to RMB12,309,000 (2003: RMB10,305,000), representing an increase of RMB2,004,000.

FINAL DIVIDEND

The Board has declared a final dividend of HK\$0.023 per share for the year ended 31 December 2004, amounting to a total sum of HK\$18,400,000 (equivalent to RMB19,543,000).

Together with the interim dividend of HK\$0.015 per share, this will bring the total dividend distribution for the year to HK\$0.038 per share, representing a dividend payout of approximately 40%.

BUSINESS OUTLOOK

I. ANALYSIS ON MARKET POSITIONING OF CEPHALOSPORIN

According to the "China Medical Statistical Year Book 2002" 《二零零二年中國藥業統計年報》, the market scale for finished preparations of cephalosporin in the PRC as a whole exceeded RMB10 billion in 2002. As indicated by such analysis, the growth in the consumption of cephalosporin per annum was increased by more than 20% in the recent five years.

The Group is principally engaged in the PRC in the manufacture and sale of non-patented chemical medicine, including cephalosporin bulk medicine and powder for injection form. It is one of the few third generation cephalosporin manufacturers in the PRC which has adopted a comprehensive vertically integrated production process. The Group plans to launch the fourth generation cephalosporin bulk medicine and powder for injection form into the market in 2005. Currently, the Group's solvent crystallisation techniques for Cefoperazone is a leading technology employed in the PRC, having a market share of about 60% in the PRC. The market share of Ceftriaxone was about 30%.

As the market prospects of the production of cephalosporin is highly attractive, large pharmaceutical enterprises in the PRC, including State owned enterprises, foreign invested enterprises and private owned enterprises, are gradually starting to increase their investments in this industry. However, the PRC government is expected to further reduce the retail price of cephalosporin so that more people will be able to afford to use cephalosporin. Therefore, we consider that enterprises with adequate capital, technical process advantages and strong sales capabilities will have a competitive advantage in the cephalosporin pharmaceutical industry. Competition among such enterprises, in particular with respect to price, will also increase.

II. ANALYSIS ON MARKET POSITIONING OF GENERIC DRUGS (SYSTEM SPECIFIC MEDICINE)

In an article titled "Game theory" of The Lex Column on page 14 of the Financial Times of UK published on 22 February 2005, it was stated that *"It is a testament to the woes of the pharmaceuticals sector that off-patent drugs have become its sexiest segment. In the US alone, some \$60bn of prescription medicines will lose legal protection over the next four years, slowing industry revenue growth to 7-8 per cent per annum. By contrast, generics are winning market share, as cost pressures on healthcare providers increase, and should grow by more than 10 per cent a year"*, and also in another article titled "Generics bring potent ingredient to drug mix" on page 16, it was stated that *"Novartis¹ predicts the generics market will be worth about \$100bn by 2010, by which time it expects to have a 10 per cent share"*. With doubts in the medical sector on the safety of the new drugs launched recently by major prescription drugs manufacturers resulting in some cases of suspension of production, as well as increasing concerns over the deficit incurred by the medical welfare funds of governments around the world, and the increase in pressure on reimbursement by private medical insurance arising from aging problems in the population, generic drugs (system specific medicine) are expected to be warmly received by communities.

Meanwhile, it is expected that the development of generic drugs will draw the attention of the pharmaceutical manufacturers to the distinct predictability in the market, lower costs in the development techniques, shorter product development cycle, higher gross profit margin, and longer cycle for profitability.

¹ Novartis Group, the largest Swiss pharmaceutical company with operations covering more than 140 countries and regions around the world.

III. OUR STRATEGIES

Under such circumstances, the Group has formulated and implemented the following strategies:

1. Establishment of an expert network

In 2004, the Group successfully established an expert network which was formed by well known experts, such as Professor Zhong Nan Shan and Professor Mei Hua, who are very influential in the medical sector, as representatives. Such network provided support to the decision on the marketing strategies of the Group in the medical and pharmaceutical sectors.

2. Enhancement of research and development capabilities with integrated models of research and development, and launch generic drugs (system specific medicine) with huge market potential and business value

In 2004, the Group received 45 approvals on clinical testing and production from the State Food and Drug Administration of the PRC in total, which increased by 12 approvals as compared with the total of 33 approvals received in 2003. In 2005, it is prudently estimated that the Group will receive more than 40 approvals on clinical testing and production, which will include the fourth generation cephalosporin and several generic drugs (system specific medicine).

For cephalosporin, the Group will conduct further research so as to improve its technique and technologies, thereby reducing costs and enhancing yield rate.

As to generic drugs (system specific medicine), the Group will adopt various models for cooperation, which will facilitate knowledge exchange with various research institutes and multinational technology companies for determination on the academic orientation. Finasteride Tablet and Metformin Hydrochloride & Glibenclamide Tablet which commenced production in bulk in 2004 complemented the generic drugs (system specific medicine) portfolio of the Group that was previously made up of Amlodipine Besylate Tablet, Compound Ranitidine Capsule, Cetirizine Hydrochloride Tablet and Bismuth Potassium Citrate Capsule etc. Such portfolio will be developed to a greater extent in 2005 and 2006.

3. Pool of resources and central coordination for marketing of generic drugs (system specific medicine)

In 2004, the Group devoted more efforts to the establishment of a new sales team for the marketing and sales of generic drugs (system specific medicine). A team dedicated to serve the medical sector was also established. Finasteride tablet which commenced production in 2004 and Amlodipine Besylate tablet which commenced production in 2002 were centrally coordinated by the new drug sales department. As at year end, the new drug sales department has about 30 offices across the PRC, and actively engaged in academic promotion activities in the medical sector.

4. Scale of development and economies of scale

In 2004, the production capacity for the workshop of cephalosporin powder for injection form was upgraded to 240 million vials. As the average gross profit margin for cephalosporin is demonstrating a downward trend, the Group is expected to expand its output significantly in 2005 in order to expand the market share and cultivate the brand. At the same time, in June 2005, a workshop of 450 tonnes for cephalosporin bulk medicine will commence operation. Hence, the production capacity of the Group's third generation cephalosporin bulk medicine will exceed 800 tonnes, and account for about 30% of the total market share in the third generation cephalosporin bulk medicine in the PRC.

5. Tapping into international market and actively seeking strategic partners for cooperation

Sales to overseas increased by four times compared with that in 2003, and amounted to RMB22,088,000. It is expected that, as a powerful sales strategy, through devoting more efforts to expand the international market for cephalosporin, the Group will be able to set off the effect of the government price reduction policy. Meanwhile, it will also solidify a foundation for expanding the sales of generic drugs (system specific medicine) in the international market.

Under the premises of globalized economy and China's accession to World Trade Organisation, the Group has been actively seeking partners for strategic cooperation so as to expand its capital operation and provide opportunities for business development.

6. Tightening cost control

The Group constructed and operated a system for the recycling of solvents, which is in the capacity to recycle 15,500 tonnes of chemical solvents per year, thereby reducing the production costs on the purchases of solvents.

IV. CORPORATE GOVERNANCE

The Board has established an Audit Committee and a Remuneration Committee, which contributed to the development of the Group into a more professional and international corporation, with respect to investment direction, product creation, officers' appointment and removal and remuneration structure. The Board will continue to improve the capabilities of the Group in the area of corporate governance, so as to enhance the flexibility and the science of the management platform. Effective internal control mechanism on financial management was also established, so as to maintain sustainable and healthy development of the enterprise. This will further solidify the foundation for the Group's growth in capital operations.

V. THE CREATION OF FUTURE JOINTLY BY THE ENTERPRISE AND ITS STAFF

After the Group was listed, the Board increased its pace in the training and recruitment of expertise with international perspectives and good knowledge of the national situation of the PRC, so as to meet with the needs for the rapid development in the enterprise professionalization and internationalization. In 2004, share options to subscribe for about 3.5% (2003: 5%) of the Company's shares as at 31 December 2004 were granted to the senior management. The Group has always treated its management team as well as its staff nationwide as the most valuable intangible assets of the Group, which have been the greatest driving force behind the further development of the Group. I would like to take this opportunity to express my deepest gratitude to the members of the Board, and to the staff of the Group's subsidiary companies and various departments who have used their best endeavours at work and dedicatedly served the Group in the past year.

Li Kei Ling

Chairman

Hong Kong , 7 March 2005