

# Management Discussion and Analysis

## BUSINESS REVIEW

### 1. PRODUCTION & SALES OPERATION

Each of the Group's products in terms of production volume and sales volume recorded growth over the previous year. During the year, 371.4 tonnes of bulk medicine were produced, which was increased by 66.5% over the previous year. Sales of bulk medicine were 301.0 tonnes, which was increased by 66.5% over the previous year. 85,766,000 vials of cephalosporin powder for injection form were produced, which was increased by 35.9% over the previous year. Sales of cephalosporin powder for injection form were 85,736,000 vials, which was increased by 51.4% over the previous year. 8,915,000 boxes of generic drugs (system specific medicine) were produced, which was increased by 32.9% over the previous year. Sales of generic drugs (system specific medicine) were 8,396,000 boxes, which was increased by 28.1% over the previous year. Overseas export sales of medicine increased rapidly by about four times over the previous year to more than ten countries over Europe, South America and Asia.

### 2. PRODUCTS IN THE PIPELINE

In 2004, the Group obtained 22 production permits from the State Food and Drug Administration of the PRC. Of which, there were five new medicines, namely Cefuroxime Sodium Sterile bulk medicine, Cefixime bulk medicine, Finasteride bulk medicine, Finasteride tablet, Metformin Hydrochloride & Glibenclamide tablet. The Group was also awarded 23 permits for clinical testing. 16 projects for pre-clinical testing and 10 projects for clinical testing were completed. The Group's research and development team, completed a survey covering the local and global market, trend of frequent illness, trend of overall adjustment of medicine development and analysis of the outlook for all kinds of medicine markets, and incorporated the Group's special features and the direction of research and development, and completed the preliminary report on the development of products. A total of 20 projects were embarked in 2004.

### 3. RECOGNITIONS OBTAINED IN 2004

On 5 February 2004, Ceftriaxone Sodium Sterile bulk medicine and powder for injection form, and Amlodipine Besylate bulk medicine and its tablet were classified as projects under the Torch Plan in Jiangsu Province by the Department of Science and Technology of Jiangsu Province;

On 18 February 2004, the Company's research and development centre was endorsed by the Department of Science and Technology of Jiangsu Province as the first batch of foreign research and development entities in Jiangsu Province;

On 28 May 2004, Amlodipine Besylate bulk medicine and its tablet, products of the Company, were endorsed by the Department of Science and Technology of Jiangsu Province as a high tech product of Jiangsu Province;

On 7 July 2004, Amlodipine Besylate bulk medicine and its tablet, products of the Company, were endorsed by the Ministry of Science and Technology as a project under the State Torch Plan; and

On 12 August 2004, Xi Ke Wei (Cetirizine Hydrochloride Tablet), a product of the Company, was endorsed by the Department of Science and Technology of Jiangsu Province as a high tech product of Jiangsu Province.

## 4. CONSTRUCTION PROJECTS FOR THE EXPANSION OF PRODUCTION FACILITIES

The construction of engineering projects for the Group in 2004 proceeded as scheduled:

85% of the overall construction work of the new workshop of Suzhou Dawnrays Pharmaceuticals Co., Ltd. for the cephalosporin bulk medicine was completed. It is expected to commence operation in June 2005. After the construction is completed, it is expected that the output of cephalosporin will be increased by 450 tonnes. The Group's products will become more comprehensive and enjoy comparative advantage in terms of costs. It will also solidify the Group's leading position in third generation cephalosporin.

The project for the output expansion of Ceftriaxone Crude for Suzhou Dawnrays Chemical Co., Ltd. proceeded smoothly. After the construction is completed, it is expected to increase the output of Ceftriaxone Crude from 200 tonnes to 400 tonnes.

Expansion in the workshop of Suzhou Dawnrays Chemical Co., Ltd. for the recycling of solvents was completed successfully. The capability in recycling is now expanded to 15,500 tonnes per annum, and will provide enormous support as to cost savings for cephalosporin products.

As at the end of 2004, the projects of the pilot production workshop, upgrade of environmental protection facilities, and quality assurance for the Group established and commenced smoothly. It is expected to complete within the first half of 2005, which will optimize the infrastructure facilities and enhance the overall competitiveness of the Group.

## PROSPECTS

The Group's principal product, third generation cephalosporin, has been the most popular medicine within its category in the PRC. It is anticipated that the demand of cephalosporin will increase in 2005. Various cephalosporin products of the Group have adopted our core technology. The potential growth of sales remains high. Sales of cephalosporin powder for injection form in 2005 will not be limited by the production capacity. With the 450 tonnes workshop for cephalosporin bulk medicine commencing operation in June 2005, it is expected that production capabilities and sales of cephalosporin bulk medicine will exceed 800 tonnes per annum. In 2005, the Group will also launch the fourth generation cephalosporin products into the market so as to assure its competitive edge. However, followed by the increasing keen competition in the cephalosporin medicine market, the market will be driven by the integrated and consolidated pharmaceutical business model of "Intermediate - Bulk medicine - Preparation medicine". Price competition will soon emerge. The Group will continue to devote efforts in strengthening antibiotics as a foundation for stable cashflow.

The Group has devoted a lot of efforts and resources to develop the business of generic drugs (system specific medicine) in 2004, which now accounts for about 9% of the total sales. The Group has improved its market expansion capability for system specific medicine and is now well positioned to grow. It is believed that satisfactory results will be achieved by strengthening marketing efforts and network building.

The Group has been implementing a standard system of corporate governance, which forms the basis for the conduct of globalization strategy. The Group will actively develop international trade and cooperation projects, and seek strategic cooperation in the international capital market so as to optimize the Group's capital structure, absorb premium resources and state-of-the-art management philosophies in the coming year.

# Management Discussion and Analysis

## FINANCIAL REVIEW

### SALES AND GROSS PROFIT

During the year, the Group recorded a turnover of approximately RMB584,758,000, representing an increase of 19.0% as compared with the previous year. Gross profit was approximately RMB192,677,000, representing a decrease of 6.4% as compared with the previous year. Gross profit margin was 32.9% (2003: 41.9%). The main reasons for the decrease in gross profit margin are as follows: firstly, the Group took the initiative in reducing prices of cephalosporin powder for injection form to gain higher market share; secondly, the Group increased sales proportion of bulk medicine which has relatively lower gross profit margin.

During the year, sales of bulk medicine amounted to RMB311,457,000, representing an increase of 48.3% as compared with RMB209,950,000 of the previous year. Sales of bulk medicine accounted for 53.2% of total sales (2003: 42.7%). Gross margin of bulk medicine was approximately 19.3% (2003: 20.2%).

Sales of powder for injection form amounted to RMB216,979,000, representing a decrease of 6.1% as compared with RMB230,976,000 of the previous year. Sales of powder for injection form accounted for 37.1% of total sales (2003: 47.0%). Gross margin of powder for injection form was approximately 42.0% (2003: 54.6%).

Sales of generic drugs (system specific medicine) amounted to RMB51,554,000, representing an increase of 5.9% as compared with RMB48,681,000 of the previous year. The proportion of generic drugs (system specific medicine) to total sales was 8.8% (2003: 9.9%). Gross profit margin for generic drugs (system specific medicine) was approximately 73.6% (2003: 77.5%).

During the year, overseas export sales increased rapidly as compared with the previous year, which was mainly attributable to the increased overseas export sales of bulk medicine from RMB3,769,000 of the previous year to RMB21,086,000 of this year, representing an increase of 459%.

### EXPENSES

Total expenses incurred during the year amounted to approximately RMB108,221,000, representing an increase of 14.7% over the previous year. Total expenses as a percentage of turnover was 18.5% (2003: 19.2%).

Of which, selling and distribution costs amounted to RMB58,987,000, representing an increase of 3.9% over the previous year. Selling and distribution costs as a percentage of turnover was 10.1% (2003: 11.6%).

Administrative expenses and other operating expenses amounted to RMB49,234,000, representing an increase of 34.0% over the previous year. The increase was due to the full year operation of the head office in Hong Kong, increase in research and development expenditure, and the giving of bonuses to attract experts and attractive remuneration to motivate core members with technology expertise.

## NET PROFIT FROM OPERATING ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS

During the year, net profit from operating activities attributable to shareholders amounted to RMB80,171,000, representing a decrease of approximately 25.8% as compared with the previous year.

## ANALYSIS ON RETURN OF ASSETS

As at 31 December 2004, net assets of the Group were about RMB411,471,000. Net return on assets, which is defined as the net profit from operating activities attributable to shareholders divided by net assets, was 19.5%. The turnover days for account receivables on bulk medicine (including notes receivables) was about 135 days. The turnover days for the account receivables on cephalosporin powder for injection form and generic drugs (system specific medicine) was about 100 days, whilst the inventory turnover was about 65 days.

## CASHFLOW

As at 31 December 2004:

1. Net cash inflows from operating activities were RMB73,740,000;
2. Expenditures on construction projects and purchases of fixed assets amounted to RMB63,964,000; and
3. Profit distributions (including dividend paid to minority shareholders) amounted to RMB42,889,000.

As at 31 December 2004, the Group has RMB98,382,000 cash and cash equivalents, and no bank loans.

## LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE

As at 31 December 2004, the Group's current assets amounted to approximately RMB435,900,000, whilst current liabilities was approximately RMB274,896,000. Net current assets were approximately RMB161,004,000.

As at 31 December 2004, the Group has aggregate bank facilities of approximately RMB387,000,000, with no asset being pledged to banks.

As at 31 December 2004, the Group's capital commitments amounted to approximately RMB91,989,000 which will be funded by proceeds from listing and by internal resources.

# Management Discussion and Analysis

## FINANCIAL MANAGEMENT, FINANCIAL INSTRUMENTS AND EXCHANGE RATE RISK

The Group implements a steady and prudent financial strategy. Exposure incurred during its course of financial management are managed in accordance with policies approved by the Board.

Substantially all of the Group's operations are normally transacted in Renminbi, which is not freely convertible into foreign currencies.

The Group's monetary assets and liabilities are normally denominated in Hong Kong Dollars, Renminbi and US Dollars.

The carrying amount of the Group's cash and cash equivalents, trade receivables and payables, other receivables and payables, borrowings and balances with related parties approximate their values because of the short maturity of these instruments.

The Group did not enter into any foreign exchange forward contracts or other hedging instruments to hedge against fluctuations, and the Group did not use any financial instruments.

## STAFF

Human resources is the most valuable assets of the Group. A professional, pragmatic, and highly efficient management team together with the staff as a whole is the Company's most valuable competitive advantage. The Group provides a competitive remuneration policy.

As at 31 December 2004, the Group employed approximately 1,200 employees (31 December 2003: approximately 749 employees) with attractive remuneration and employee benefits such as defined contribution retirement schemes, share option scheme and medical coverage. The Group provides certain of its employees in PRC with dormitory accommodation, and makes monthly contribution to State unemployment insurance funds and State housing fund for the employees in the PRC. During the year, staff costs amounted to RMB39,682,000 (31 December 2003: RMB27,537,000).

The Company has adopted a share option scheme. Under the share option scheme, the Eligible Persons (including the executive and independent non-executive directors and employees of the Group (whether full time or part time)) may be granted options which enable them to subscribe for shares in the Company, up to a maximum of 10% of the shares of the Company in issue upon listing.

Options in respect of about 3.5% of shares in the Company as at 31 December 2004 has been granted by the Company to Eligible Persons during the year.

## CHARGE ON ASSETS

As at 31 December 2004, no asset of the Company was pledged to banks to obtain credit facilities.

## PLANS FOR SIGNIFICANT INVESTMENTS AND EXPECTED SOURCE OF FUNDING

Details of the Group's future plans for significant investments and their expected source of funding have been stated in the Company's prospectus dated 30 June 2003 under the section headed "Future Plans and Use of Proceeds".

In order to further expand the Group's production facilities, the Group plans to invest RMB38,823,000 to construct five infrastructure projects commencing from 2005:

1. A multi-function pilot production workshop for Suzhou Dawnrays Pharmaceuticals Co., Ltd. of around RMB4,575,000;
2. A workshop of cephalosporin in solid dosage form for Suzhou Dawnrays Pharmaceuticals Co., Ltd. of around RMB15,570,000;
3. An integrated warehouse for Suzhou Dawnrays Pharmaceuticals Co., Ltd. of around RMB10,000,000;
4. Upgrade of auxiliary utilities facilities for the whole plant of Suzhou Dawnrays Chemical Co., Ltd. of around RMB7,112,000; and
5. Expansion of the workshop for the intermediates of cephalosporin for Suzhou Dawnrays Chemical Co., Ltd. of around RMB1,566,000.

Other than those disclosed above, the Group did not have any plan for material investments or acquisition of capital assets.

## CONTINGENT LIABILITIES

As at 31 December 2004, the Group had no material contingent liabilities (31 December 2003: Nil).