



Management Discussion and Analysis

BUSINESS PERFORMANCE CONDITIONS

Business Review

The health care products market in PRC experienced a considerable recovery in 2004 in spite of increasing competition. The overall sales of the health care products in China increased by 13.3% over the previous year, among which the products for immunity system adjustment, detoxication and beautifying, blood-fat control and plant hormone and newly developed compound products with high technological content accounted for most of such increase, while the sales of existing products like traditional Chinese medicine retreated, reflecting the keen competition in the market. The management of the Group spent more on the marketing, especially in the smaller towns in Eastern China and the rural area so that sales could be maintained at basically same level as the previous year. “Azithromycin Granules”「阿奇霉素」began its sales in South Western and Southern regions of China, increasing its sales by nearly twofold the year-on-year; another new product “Electronic Cigarettes Component”「霧化電子煙彈」generated sales income of HK\$16,330,000. Thus, the Group sales turnover has an increase of 10.8% in comparison with the previous year.

Product Development

“Azithromycin Granules”「阿奇霉素微囊細粒劑」was launched in 2003 and generated sales income of approximately HK\$2,000,000. It was promoted to all over the country in the year 2004 with sales income increasing to about HK\$6,000,000, nearly two times the figure in the previous year.

The production approval of another new product “Piglyketone”「匹格列酮」was also granted in December 2003. This product was launched in December 2004 and has just begun to generate sales income due to the reasons like approvals for product and instruction on package, etc.

The product “Mei Nuo Ping”「美諾平」is good for pimples treatment and composed of pills that can be taken orally together with ointment for external use, however, its sale was affected by the new stipulation that “External use medicine and orally-taken medicine shall not be packed in one single package” promulgated by the Food and Drug Administration of the PRC, and achieved sales income of only approximately HK\$11,000,000, a decrease of 20.5% year-on-year.

The Group spent approximately HK\$4,700,000 to buy a nicotia liquid formula during the year for improving the oral taste of the new product “Electronic Cigarettes Component”「霧化電子煙彈」developed by the Group on its own. The sale performance of this product was satisfactory during the year with sales income of HK\$16,330,000. The directors are optimistic for the potential of this product and believe it will contribute more to operating results.

Regional Development

Market shares of the health care products of the Group were basically maintained during the year 2004. The Group explored the potential in the traditional market in large and medium-sized cities and began to promote in smaller cities and towns around and the rural area. The strategy bore satisfactory result, e.g. “Azithromycin Granules” which was initially promoted in some parts of Northern, North Western and Southern regions of China, achieved sales income of approximately HK\$6,000,000, increasing by twofold from the previous year.



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PROSPECTS FOR THE YEAR 2005 AND DEVELOPMENT PLAN

As the health care product market is recovering, new products are launched at a faster pace. The Group plans to launch more newly-developed products into the market in 2005. Besides the promotion in the medium and small-sized cities, town and rural areas, the Company plans to make use of direct distribution for our health care products in some selected regions, and will extend the mode to all over the country if it proves successful. It is estimated that the sales income of direct distribution will make up approximately 30% of the market shares in five years.

The Group will stress on the pharmaceutical product market. The marketing of “Azithromycin Granules” in 2004 has set a sound foundation for the coming year. Thanks to the existing sales network of “Azithromycin Granules”, “Piglyketone” has great potential. The pharmaceutical business may provide a more stable development to the Group.

“Electronic Cigarettes” will replace the traditional cigarettes gradually as more and more people become conscious about health. The directors are optimistic for the potential of its component and believe it will bring satisfactory return to the Group.

LIQUIDITY AND FINANCIAL ANALYSIS

The issue of 4,000,000 preference shares by a subsidiary of the Company in the first phase raised US\$4 million which was placed as reserve fund, and will be used for investment once the new medicine certificate for nasal spray insulin is obtained. As at 31 December 2004, bank loans of the Group at fixed interest rate amounted to HK\$75.01 million, representing a decrease of HK\$6.72 million as compared to the total outstanding loans at 31 December 2003, all of which were short-term loans due within one year and partial in Renminbi loans. Since movements of Renminbi against other currencies, in particular the Hong Kong dollar were more stable, the Directors do not anticipate to face any major currency exposures, therefore the Group has not arranged any currency hedge. During the year, an amount of HK\$4.36 million was paid as aggregate interest of bank loans (2003: HK\$6.36 million). The Group did not use property as securities for such bank facilities, nor was there the use of any financial instruments for hedging purposes.

Gearing ratio of the Group reduced from approximately 39.1% at 31 December 2003 to approximately 34.5% at 31 December 2004. This calculation is based on net borrowings of approximately HK\$75.01 million (2003: HK\$81.73 million) and shareholders fund of approximately HK\$217.18 million (2003: HK\$208.88 million).

As at 31 December 2004, the balance of the inventories amounted to HK\$88.63 million, representing a decrease of HK\$19.43 million when compared with the corresponding period of the previous year, of which:

- (a) an amount of HK\$56.50 million was attributed to raw material, representing a decrease of HK\$0.19 million when compared with the corresponding period of the previous year; and
- (b) an amount of HK\$32.13 million was attributed to the work in progress and finished products, representing a decrease of HK\$19.24 million when compared with the corresponding period of the previous year. There was a higher inventory level in 2003 due to piling up of finished goods, however, the Group managed to reduce its inventory of finished goods in 2004.



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ACQUISITION

During the year, the Group has entirely acquired the 20% of the equity interest in its subsidiary, Shenyang Jinlong Health Care Products Co., Ltd. (瀋陽金龍保健品有限公司), such interest is originally the minority interest, and accordingly, it became the wholly-owned subsidiary of the Group. The Group believes that the profitability of the Group would be effectively enhanced through such acquisition.

CHARGE OF ASSETS

As at 31 December 2004, the Group's bank deposits of approximately HK\$10.20 million (2003: HK\$20.63 million) were pledged to banks to secure general banking facilities granted to its subsidiaries.

CONTINGENT LIABILITIES

As at 31 December 2004, the Group did not provide any form of guarantees for any outside companies and was not liable to any material legal proceedings of which provision for contingent liabilities was required.

EMPLOYEE POLICY

In addition to maintaining a stable employee policy, the Group also set down minimum sales quotas for various pharmaceutical products for the sales staff working in pharmaceutical products sales division: those achieved only the minimum sales quota could just receive the basic salary, the portion exceeding the minimum sales quota will be taken in calculating bonus at different proportion corresponding to the extra sales amount achieved, the more the sales amount, the higher proportion of bonus will be rewarded. Such a performance-based salary system aims to encourage the employees to excel in their sales performance.