

## MANAGEMENT DISCUSSION AND ANALYSIS

### MARKET REVIEW

The pharmaceutical industry has set itself into a growing path. The pharmaceutical industry has maintained growth in sales revenue and has recorded a growth of 24.6% in the first half of 2005 as compared with the corresponding period in 2004. According to market segment analysis, the Chinese medicines have shown better performance as compared with the average industry level in terms of sales revenue, net asset yield ratio and sales-to-profit ratio, manifesting a strong potential of growth.

The pharmaceutical market was also underpinned by higher concentration of product sales and higher economic efficiency. The corporate merger and acquisition and reorganization have expedited the pace of consolidation and instigation of resources in the pharmaceutical industry and it is also noteworthy that the fierce market competition in the pharmaceutical retail market, coupled with the impact of the new set of standards in the research and development of pharmaceutical products adopted by the State and the price control measures, have exerted pressure on the profit margin of the chemical pharmaceutical manufacturers. The sino-foreign co-operation in the industry has already speeded up foreign investment in entering the market of medicines distribution in China. The emerging features for the industry of Chinese medicines are that it has basically evolved into a modernized industry and that with its rapid development, it has turned into the second pillar of the pharmaceutical industry, coming only after chemical pharmaceutical industry. The perfecting of the mechanism in the protection of intellectual properties rights and the unparallel emphasis placed by the State. With the favourable underlying factors, the Directors believe that the market potential for Chinese medicines is enormous.

### BUSINESS REVIEW

Despite challenges resulted from severe market competition in the pharmaceutical industry, Hua Han managed to achieve satisfactory results and its underlying strategy of focusing its development on becoming the leading pharmaceutical enterprise in the field of gynecological medicines and medicinal healthcare products for women was further realized by its competitive product lines and attractive product mix, extensive marketing network and nationwide distribution channel as well as our strategy of **“Prestigious Brand Name Building”**, **“Legend Products”** and **“Nationwide Sales Network”**.

### FINANCIAL PERFORMANCE

The Group has achieved continuing growth in annual turnover and net profit for the three-year period from 2002 to 2005, at an annual compound growth rate of 30.4% and 10.4% in turnover and net profit of the Group's products respectively. For the Year, the Group recorded a total turnover of approximately HK\$601.9 million, approximately HK\$383.6 million (2004: approximately HK\$273.2 million) of which was attributable to the turnover of the Group's products, representing a growth of 40.4% over last year, and approximately HK\$218.3 million of which was revenue from the trading activities.

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Gross profit of the Group's products for the Year was approximately HK\$211.4 million, representing a growth of 43.8% over that for last year of approximately HK\$147.0 million. The gross profit of trading products for the Year was approximately HK\$14.0 million. Profit attributable to shareholders for the Year was approximately HK\$102.1 million (2004: approximately HK\$95.0 million), representing an increase of 7.5% from that of last year.

Approximately HK\$78.3 million of turnover was attributable to the products of Guiyang De Chang Xiang Pharmaceutical Company Limited (貴陽德昌祥藥業有限公司) and Guangdong Qunhe Pharmaceutical Company Limited (廣東群禾藥業有限公司) since they became members of the Group during the Year.

### PRESCRIPTION DRUGS

#### Gynecological Anti-inflammatory Products

The **Yeosure Series (日舒安系列)** product line, which offers a comprehensive range of products with different therapeutic functions targeted at women of all ages, retained its major contributory position to the Group's proprietary products turnover. Amongst the popular Yeosure products are **Yeosure Natural Medicine Lotion (日舒安洗液)** and **Yeosure Moistened Toilet Towel (日舒安濕巾)**, gynecological anti-inflammatory products. The **Yeosure Series** gynecological anti-inflammatory product line recorded sales of approximately HK\$105.8 million, representing 27.6% of total turnover of the Group's products.

#### Gynecological Endocrine Products

**Yeosure Puerperant's Health Drink (日舒安婦康沖劑)**, a gynecological endocrine product, produced total sales of approximately HK\$20.6 million, representing 5.4% of the total turnover of the Group's products.

#### Gynecological Anti-tumour Products

**Jin Xi Su (金喜素)** and **Qiang Xi (強喜)**, **Camptothecine Series (喜樹碱系列)**, all of which are naturally sourced gynecological anti-tumour injection medicines, brought in total sales of approximately HK\$81.5 million, representing about 21.2% of the Group's total products turnover. Gross profit margin of the Camptothecine Series of products for the Year was 66.7%.

#### Medicine for Children

**Cefadroxil Granules (毅達顆粒)**, an antibiotic for children, produced total sales of approximately HK\$32.0 million, representing 8.3% of the total turnover of the Group's products and an increase of 12.7% from that of last year.

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### OVER-THE-COUNTER (“OTC”) DRUGS

#### Gynecological Endocrine Products

Sales of **Huangqi Granules (黃芪顆粒)**, a gynecological endocrine product, was approximately HK\$34.5 million, representing 9.0% of total sales of the Group's products and an increase by 21.6% compared to that of last year.

Sales of **Fuke Zaizaowan (婦科再造丸)**, a gynecological endocrine proprietary product from a subsidiary acquired during the Year, Guiyang De Chang Xiang Pharmaceutical Company Limited (貴陽德昌祥藥業有限公司) (“**DCX**”), was approximately HK\$23.0 million, representing 6.0% of total sales of the Group's products. This is the flagship product of DCX that has been sold in the market for nearly 70 years, with a solid reputation particularly in Southwestern China. The Group will further develop this product as a leading gynecological Chinese medicine in China through brand-building and introduce it to unexplored provinces in China.

Sales of medicinal healthcare products under the brand series of “**Magic 美即**”, women's medicinal healthcare products from another subsidiary acquired during the Year, Guangdong Qunhe Pharmaceutical Company Limited (廣東群禾藥業有限公司), was approximately HK\$37.6 million, representing 9.8% of total sales of the Group's products. This is another major series of products that the Group will strongly develop, first to the whole of China through Watsons' channel and intensive marketing campaigns, then possibly to overseas market in the coming years.

### MERGERS & ACQUISITIONS

During the Year, the Group acquired 92.91% equity interest in DCX from Shenzhen Shi Dong Si Long Enterprise Management Consultancy Limited Liability Company (深圳市東斯隆企業管理顧問有限責任公司) and Guiyang De Chang Xiang Pharmaceutical Company Limited Labour Union (貴陽德昌祥藥業有限公司工會). DCX possesses over 120 approved pharmaceutical numbers (藥品批准文號), 21 of which are gynecological and obstetrical medicines and approximately 40 of which are proprietary protected medicines. DCX had an aggregate of approximately 267 employees as at 30 June 2005 and DCX, as a continued entity of its predecessor, has a history of over 100 years.

Five established production lines of DCX had successfully been granted Good Manufacturing Practice (“**GMP**”) certification issued by the State Food and Drug Administration of the PRC (中國國家食品藥品監督管理局) (“**SFDA**”) at December 2004. DCX then became the largest manufacturer in Guizhou producing traditional Chinese medicine and such certification laid a foundation that allows the Group to fully manifest the strength of various gynecological products as held by DCX. The strategic guidance of the Group has set its goal of development of, and the corporate strategy for, becoming the leading pharmaceutical manufacturer of classic Chinese gynecological medicines in China and is determined to expand steadily in the direction of turning “**Fuke Zaizaowan 婦科再造丸**” that has been sold in the market for nearly 70 years to be its core product and making the OTC sales to be its major market by means of brand name promotion and consolidation and integration of distribution channels. DCX is expected to develop “**Fuke Zaizaowan 婦科再造丸**”, a gynecological Chinese medicine renowned in Southwestern China region, into a renowned product in the whole country in about three years.

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The Group also successfully acquired 70% equity interest in Guangdong Qunhe Pharmaceutical Company Limited (廣東群禾藥業有限公司) (“**Guangdong Qunhe**”) during the Year. Guangdong Qunhe under our Group has expanded the medicinal healthcare product lines of “**Magic 美即**”, from originally 4 products to now 29 products under 3 main product series in the Year, covering facial treatment, eye treatment and body treatment. The products are sold in more than 10 cities, including Beijing, Guangzhou, Shenzhen, Wuhan, Chengdu, Chongqing, Tianjin, Urumqi and Dalin and such network has laid the foundation for establishing a nationwide distribution network in the coming two years. It is expected that an addition of 5 to 10 self-developed new products would be brought to the market this year.

Guangdong Qunhe has undertaken a strategy of all-round marketing promotion for the consumer products under the “**Magic 美即**” Series, and is committed to, under the corporate direction on marketing and publicity, entering the consumer market and quickly promoting the product awareness by placing advertisements on the internet, TV and magazines as well as in out-door areas and terminuses. During the Year, Guangdong Qunhe entered into a contract with the well-known chain store, Watsons, for its PRC market and has formally become the supplier of Watsons. Such arrangement allows the medicinal healthcare products of “**Magic 美即**” to be sold in 170 chain stores under Watsons in the PRC. The product series of “**Magic 美即**” was awarded the Golden Award of “New Product with Strongest Potential” by Watsons in 2004. Our “**Magic 美即**” Series was also awarded “The Most Favorite International Cosmetic Brand of Shenzhen Citizens (深圳市民最喜愛的國際化妝品品牌)” by China Cosmetics Association (Shenzhen Branch) and “深圳晶報” jointly.

These acquisitions allowed the Group to expand its product lines of gynecological products and to set foot in the market of medicinal healthcare products for women which manifests a strong potential of growth. This is an initiative of significance for the Group to improve its overall efficiency and competitiveness.

### DISPOSAL OF INTEREST IN A PRC COMPANY

During the Year, the Group sold 10% equity interest in Hubei Kanglai Medicine Company Limited (湖北康萊醫藥有限公司) (“**Kanglai Medicine**”) (“**Disposal**”) to Wuhan San Tian Trading Company Limited (武漢三田商貿有限公司) (“**San Tian**”). The Group has an unconditional right to require San Tian to acquire from it any of its remaining 41.72% equity interest in Kanglai Medicine within two years from 20 October 2004.

Through the Disposal, the Group aims to take advantage of the expertise of the owners of San Tian to expand the Group’s sales and distribution network of its pharmaceutical products in the Hubei Province.

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### RESEARCH AND DEVELOPMENT

To broaden the Group's product mix and to sustain the persistent growth of operations, the Group will continue to put a strong emphasis and commit resources for the development of new products. The Company has injected approximately HK\$3.9 million in research and development during the Year.

The Group has obtained the production approval of **Paclitaxel Injection (紫杉醇注射液)**, an anti-tumour medicine, and is intended to launch the product in the market by the end of 2005.

The Group engaged Beijing Venture-Sunshine Pharmaceutical Technology Company Limited (北京萬全陽光醫藥科技有限公司) to undertake the second and the third phases of clinical trials of **Fu Shu Le Tablets (婦舒樂片)**, a new Chinese medicine for curing gynecological atrophic vaginitis, which is common for women at menopause. It is expected that the clinical trials will be completed in 2006.

The Group has also undertaken the second and third phases for clinical trials for **Zhitong Jiangu Capsules (止痛健骨膠囊)**, a Chinese medicine for curing pain associated with osteoarthritis of elderly and the trials are expected to be completed in 2006.

The Group has formulated the manufacturing process and completed the quality studies of **Omeprazole Sodium (奧美拉唑鈉)** and **Levofloxacin Lactate Injection 乳酸左氧氟沙星注射液** during the Year. The Group has also compiled all the relevant production information for registration with SFDA and an application has been made for the production approval. It is expected that the product will be approved for sales in 2006.

It is expected that **Secnidazole Tablets and Capsules (塞克硝唑片及膠囊)**, products curing gynecological trichomoniasis and anaerobe, will obtain approval for sales from SFDA and be launched in the market in 2006.

The technical evaluation procedure with respect to "**Fuke Zaizaowan capsules 婦科再造丸膠囊**", a proprietary product, has been completed and it is expected that we will obtain the exclusive rights for production in China.

The research and development of a total of 51 products under 9 categories of the "**Magic 美即**" Series has been completed and such products will involve more sophisticated technology and novel packaging design.

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### PRODUCTION FACILITIES

To satisfy the requirements of SFDA that medicine production enterprises must obtain Good Manufacturing Practice (“GMP”) certification, and to allow the Group to be more competitive in the pharmaceutical industry, Guizhou Hanfang Medicine Manufacture Co., Ltd., (貴州漢方製藥有限公司) a subsidiary of Hua Han, has a total of 7 production lines in the existing production complex for the production of capsules (**Cephalosporins 頭孢菌素**), granules (**Cephalosporins 頭孢菌素**), tablets, powders, suppository, and raw medicines **Hydroxycamptothecine (羥喜樹碱)** and **Topotecan Hydrochloride (鹽酸拓撲替康)**, all of which have commenced operation upon obtaining the GMP certification during the Year. DCX has newly established a total of 6 production lines in the production complex for the production of vials, tinctures, mixture, syrup, mastic and aerosol after its existing 5 production lines, namely pills, capsules, tablets, granules and powder, have received the GMP certification. To date, we have a total of 26 production lines which have been accredited the GMP certification issued by SFDA. Such awards help improve the Group’s standards of technology and management, allowing the Group to become the leading pharmaceuticals manufacturing enterprise (in terms of the scale of production facilities and the products types available) in Southwestern region of the PRC.

### PROSPECTS

Hua Han, as in the past, will endeavour in the strategic planning of establishing itself as the leading enterprise in the manufacture and sales of gynecological pharmaceuticals products and feminine medicinal healthcare products. The Group will put emphasis on the effective integration of its existing products, brand and sales network resources, optimization of internal resources allocation and manifestation of synergy of its products, production, sales and distribution management.

#### 1. Three-year Target

We are devoted to turn Hua Han into the leading enterprise of gynecological pharmaceuticals products and feminine medicinal healthcare products in China within three years.

#### 2. The general direction for operation and management

The effective integration of the Group’s existing resources on operation and the improvement on the standard of the Group’s operation and assets management will contribute to the maximization of the Company’s value and shareholders’ return.

The Group has perfected the development plan of prescription drugs, OTC medicines and medicinal healthcare products under its corporate strategy. The Group is determined to reinforce its edges and competitiveness of its products, to enlarge its scale of turnover and to raise its profitability.

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The Group will spare no efforts in building up the popularity of our products. Apart from further consolidating the market share of “**Yeosure 日安舒**” Series in the prescription drugs market, the Group also strives to promote “**Fuke Zaizaowan 婦科再造丸**” and “**Magic 美即**” Series of products in OTC market and the facial treatment products market respectively. Such strategy would allow the Group to have a significant improvement in results and attain a higher growth.

### 3. Principle for operation

To further improve the Group’s operation management system and corporate management structure that incorporates risk control measures, effective mode of operation and check-and-balance.

The Group also develops business strategies that can lead it to become a market leader.

### 4. Principle for assets management

To further improve the Group’s mechanism on corporate financial management that ensures the security of assets, improves the efficiency on the application of resources and reduces operating costs.

### 5. Operation strategy

#### 1) *Prestigious Brand Name Building*

To maintain the steady growth of the prescription drugs in the hospital market and to build up the professional image of our prescription drugs in the hospital market. Meanwhile, with the full support of the Group’s resources, we are determined to enter the OTC market with “**Fuke Zaizaowan 婦科再造丸**” and the medicinal healthcare products market with the “**Magic 美即**” Series of products in order to give an impetus to the products sales.

#### 2) *Legend Products*

This refer to the Group’s concerted efforts in raising the turnover and market share of “**Yeosure Series 日安舒系列**”, “**Fuke Zaizaowan 婦科再造丸**”, “**Magic 美即**” Series of products and “**Camptothecine Series 喜樹碱系列**”, making such products the major contributors to the Group’s profit and the brand name prestige as well as to the success of the subsequent products launched.

In terms of research and development, the Group will put stronger emphasis on gynecological prescription drugs and OTC medicinal products that have the strongest market potential in the hospital and retail markets.

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With respect to non-major products, the Group will undertake co-operation with pharmaceuticals agents through various ways with an objective of turning such products into the Group's major products that offer contribution to our profit.

### 3) *Nationwide Sales Network*

Building on the existing clinical network and our team of prescription drugs, such as gynecological anti-inflammatory products and anti-tumour products, we are determined to perfect the sales and distribution network on the basis of our knowledge-based marketing skills and with a focus on hospital clients. We will build up our sales network and marketing team for retail market as well as the sales and distribution platform for gynecological OTC products and medicinal healthcare products on the basis of “**Fuke Zaizaowan**” (婦科再造丸) and “**Magic 美即**” Series products.

The integration of the existing sales and distribution resources allow the medicine distribution entity under the Group to become a distribution enterprise which focuses on value-added agency services, enjoys competitive edges within the region and manifests the synergy effects with the Group's medicinal and healthcare products.

## 6. Strategy for the operation of our core business

Guizhou Hanfang Medicine Manufacture Co., Ltd. (貴州漢方製藥有限公司)

This company will concentrate itself on the production and promotion of the Group's high-tech gynecological prescription drugs with strong medical effects, including gynecological anti-tumour products. The Group's mission is to consolidate the Group's marketing network on prescription drugs and build up the Group's professional image.

Guiyang De Chang Xiang Pharmaceutical Company Limited (貴陽德昌祥藥業有限公司)

This company will focus itself on the production and promotion of classic gynecological Chinese medicines with the mission of becoming the leading enterprise in the retail market of gynecological products with the support of the Group's OTC marketing network and brand name prestige built with “**Fuke Zaizaowan 婦科再造丸**”.

Guangdong Qunhe Pharmaceutical Company Limited (廣東群禾藥業有限公司)

This company will put an emphasis on the production and marketing of products “**Magic 美即**” Series as trendy and healthy products and strive to become the leading enterprise in the skincare product market by establishing the marketing network of medicinal healthcare products and brand name prestige of “**Magic 美即**” Series.



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Chengdu Hechuang Pharmacy Company Limited (成都禾創藥業有限公司)

This company is determined to become a medicine distribution enterprise which focuses on value-added agency services and enjoys competitive edges within the region and manifests the synergy effects with the Group's medicinal and healthcare products.

### STRATEGIC ALLIANCE WITH HAW PAR

Haw Par Corporation Ltd. ("**Haw Par**") which is a company listed on the Singapore Exchange, has formed a strategic alliance with the Group by acquiring 21.08% shareholding in the Company on 10 June 2005 through Haw Par's wholly-owned subsidiary.

Haw Par is a long-established, renowned multinational enterprise with a business focus on healthcare and leisure. Its OTC pharmaceutical products such as "**Tiger Balm**" and "**Kwan Loong**" are household brandnames in many markets and convey positive image. Tiger Balm, for instance, is being sold in about 100 countries in the world. Forming a strategic alliance with Haw Par will be conducive to faster and healthier growth and development of the Group in the future.

### LIQUIDITY AND FINANCIAL RESOURCES

The Group generally finances its operations with internally generated cash flows and banking facilities provided by banks in the PRC and Hong Kong. Haw Par subscribed 133,232,400 new shares on 10 June 2005 and injected a total cash inflow of approximately HK\$114.6 million into Hua Han. As at 30 June 2005, the Group had cash and bank balances of approximately HK\$474.0 million (30 June 2004: approximately HK\$271.4 million). Its gearing ratio calculated as a ratio of total debt to equity was approximately 29.4% (30 June 2004: approximately 34.3%). Net current asset value was approximately HK\$552.1 million (30 June 2004: approximately HK\$402.4 million) and the current ratio was maintained at the healthy level of approximately 3.40 (30 June 2004: approximately 3.08) as at 30 June 2005.

The finance costs of the Group for the Year amounted to approximately HK\$7.9 million (2004: approximately HK\$5.7 million), representing approximately 1.3% (2004: approximately 1.1%) of the Group's total turnover and an increase of approximately HK\$2.2 million over last year. The increase in finance costs was principally due to new bank loans obtained.

## **MANAGEMENT DISCUSSION AND ANALYSIS**

### **CONTINGENT LIABILITIES**

As at 30 June 2005, the Group did not have any material contingent liabilities (30 June 2004: Nil).

### **BANK BORROWINGS**

As at 30 June 2005, the Group had outstanding bank loans of approximately HK\$197.0 million from the banks in the PRC and Hong Kong (30 June 2004: approximately HK\$143.0 million), approximately 60% (30 June 2004: approximately 60%) of which were short term bank loans with maturity within one year. All the bank loans of the Group were denominated in Renminbi and Hong Kong Dollar.

As at 30 June 2005, the Group's bank borrowings were secured by (i) certain plant and machinery of the Group; (ii) buildings of the Group; (iii) personal guarantees; (iv) pledge of equity interests of certain subsidiaries of the Group and (v) corporate guarantees executed by a subsidiary of the Company.

### **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 purpose.

### **TREASURY POLICIES**

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

### **COMMITMENTS**

As at 30 June 2005, the Group had contracted commitments of HK\$3.7 million (30 June 2004: HK\$3.0 million) and HK\$1.8 million (30 June 2004: nil) in respect of purchases of technical knowhow and construction-in-progress.

## **MANAGEMENT DISCUSSION AND ANALYSIS**

### **EMPLOYEES, TRAINING AND REMUNERATION POLICIES**

As at 30 June 2005, the Group had a total of 1,224 employees (2004: 1,024), of whom 1,217 were based in the PRC, with the rest working in Hong Kong. The substantial growth in the number of employees was mainly contributed from the newly acquired subsidiaries. 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 Directors' remunerations) amounted to approximately HK\$22,022,000 (2004: approximately HK\$13,630,000). Staff costs accounted for 3.7% of the Group turnover (2004: 2.7%) during the Year. The Group participated in retirement benefit schemes for its staff both in 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.

### **FINAL DIVIDEND**

The Directors recommend the payment of a final dividend of HK2 cents per share of the Company for the Year (2004: HK2 cents).

### **CLOSURE OF REGISTER OF MEMBERS**

The register of members will be closed from Monday, 21 November 2005 to Wednesday, 23 November 2005 (both days inclusive) during which period no transfer of shares of the Company will be effected. In order to qualify for the proposed final dividend, all transfers accompanied by the relevant share certificate must be lodged with the Company's Hong Kong branch share registrar, Tengis Limited at Ground Floor, Bank of East Asia Harbour View Centre, 56 Gloucester Road, Wanchai, Hong Kong not later than 4:00 pm on Friday, 18 November 2005 for registration.