

# MANAGEMENT DISCUSSION AND ANALYSIS

## RESULTS

By disposing one of its subsidiaries, Sino Concept Technology Limited (whose sole asset is its 55% equity interests in Shandong Chia Tai Freda Pharmaceutical Co. Ltd. and Shandong Chia Tai Freda New Packaging Resources Co. Ltd. respectively) at a consideration of USD200 million on 26 September, 2005, the Group disposed of its ophthalmic and osteoarthritis operations. Though the two businesses were excluded, the Group's other continuing operations still reported notable growth. For the year ended 31 December, 2005, turnover from the Group's continuing operations was approximately HK\$756.07 million (fig.1.2), approximately 13.8% higher than that in last year. Profit attributable to the Group from continuing operations (before fair value adjustment) amounted to approximately HK\$108.96 million, about 28.1% more than that in last year. Basic earnings per share from continuing operations (before fair value adjustment) were HK4.93 cents. Profit attributable to the Group from the discontinued operations was approximately HK\$1,490.28 million. Profit attributable to the Group was approximately HK\$1,532.93 million. Earnings per share were HK69.39 cents, around 723.1% higher than last year. Cash and cash equivalents and bank balances on the balance sheet date were approximately HK\$1,696.01 million (fig.1.6). Return on equity was 77.6%.

## BUSINESS REVIEW

In spite of the challenging conditions in the pharmaceutical industry, the Group reported outstanding performance and it was mainly attributable to its persistence in executing the proven business and human resources policies.

In 2005, the pharmaceutical industry experienced fluctuation because of government policy changes, in particular the pricing control policy that squeezed the industry's profitability; the expiration of patents and the release of encouraged replication of products that intensified competition; and the promulgation of the new pharmacopoeia to raise product quality that led to higher production costs. Other factors aggravating competition included regulation on direct selling, stringent pharmaceutical categorization and more medicine wholesale companies entering the market. Pharmaceutical organizations purchasing through centralized tendering also lowered profit.

The Group adjusted its sales and marketing strategy to cope with the changing market conditions. Riding on its established sales network and thorough understanding of regional markets, the Group conducted more academic promotions to reinforce its professional image and brandings. In addition, the Group stepped up marketing to hospitals and pharmaceutical retailers and also actively developed third-tier end markets. Currently, the Group employed over 1,358 sales staff and its products are sold in 30 provinces, cities and autonomous regions in the PRC.

The Group adheres to a dual emphasis management concept of "achieving results and containing crisis". Besides, the Group's employees are its most important asset and one of its core competitive advantages. As such, the Group adopts an effective staff incentive mechanism that links staff rewards and personal advancement with the Group's performance.



JCTT R&D Centre



Beijing Tide's new plant

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The Group committed strong efforts towards research and development (“R&D”) to strengthen its edges for future development. The R&D expenses contributed approximately 7.1% of the sales of the Group. The Group undertakes self-development and co-development of innovative drugs, and self-development of generic drugs. To enhance its R&D capabilities, the Group fully utilizes the society’s R&D resources and power and conducts joint development projects with domestic and international R&D institutes.

The Group emphasizes on intellectual property rights to new drugs. The year of 2005 was a rewarding year for the Group in terms of filing and securing patent for its products and technology. During the year, it filed 212 invention patents applications and obtained 17 patents. The Group has an accumulation of 322 patents applications, of which 21 secured patents included 12 invention patents, 2 utility models patent and 7 apparel design patents. The announced product invention patents are 247. One patent that is worth mentioning is that of a new chiral compound extracted from Licorice and then chiral restructured and purified, used for treating severe hepatitis and protecting liver by lowering enzyme level. The compound is used to produce Tianqingganmei injections, and that of a new anti-viral drug for hepatitis with a new crystal of Adefovir Dipivoxil tablets. It has laid the foundation for the Group to expand its business and extend its share in the hepatitis drug market.

The Group has been focusing on developing specialty treatment, product series and specialty brands. After years of effort, the Group has successfully developed its own line of hepatitis medicines and cardio-cerebral medicines; and has begun to actively develop its own analgesic medicines, oncology medicines, and respiratory system and anti-diabetic drugs, etc.

### Cardio-cerebral medicines

Cardio-cerebral medicines are mainly manufactured and sold by Beijing Tide and NJCTT, representing 24.5% of the Group’s turnover from continuing operations (fig.1.7). Cardio-cerebral disease is the No. 1 killer in the world, as such, the type of medicines are the best seller worldwide and the second best seller in the PRC market. The Kaishi injections produced by Beijing Tide is one of the cardio-cerebral medicines and the first Prostaglandin E1 target sustained release medicine in the PRC. This product has adopted an internationally-advanced target preparation of PGEI invented by, and patent technology of which was transferred from, Professor Mizushima Yataka, a renowned medical scientist in Japan. With exclusive R&D technologies, Beijing Tide’s products yield much better therapeutic effects than other similar products in the country. This medicine is thus well received by medical practitioners and patients, and currently enjoys a substantial market share. In February 2005, the Beijing Municipal People’s Government awarded Beijing Tide the “Beijing Science & Technology Second Honor Award”, in recognition of its scientific development efforts; its achievement in the production technology of the Alprostadil injections and its contribution to economic and social development in Beijing. With the SFDA’s approval for its



Beijing Tide’s production workshop



NJCTT’s production workshop



Tianqingganmei injections



Kaishi injections



Spring injections

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Tianqinggan injections

use to treat hepatitis indications in 2005, the product's market potential was further boosted. Its sales grew 12.8% to HK\$318.67 million when compared with last year (fig.1.4).

Designed to serve different patients' needs, the Spring PVC-free soft bags for intravenous injections and the Spring injections manufactured by NJCTT and JCTT recorded with total sales of HK\$50.47 million, in spite of pricing pressure.

NJCTT launched its Tianqinggan injections in April 2004 and received positive market response. The new product will become a new driver for the development of cardio-cerebral medicines.

### Hepatitis medicines

JCTT is responsible for the R&D and manufacture of hepatitis medicines, one of the Group's major treatment areas, which recorded a total sales of approximately HK\$558.85 million this year, accounting for 73.9% of the Group's turnover from continuing operations (fig.1.7). Hepatitis is one of the most common diseases in the PRC. Currently, hepatitis medicines are mainly for protecting the liver, combating hepatitis virus, and boosting the body's immunity, out of which the liver protecting medicine has shown the most encouraging development in recent years and boasts great prospects. As more anti-hepatitis measures are introduced by the PRC authority, fewer new viral hepatitis cases are expected to surface. However, the number of patients with fatty liver and alcohol liver has been rising year on year and these conditions are best treated by medicine for protecting the liver. JCTT's hepatitis medicines are consistently among the five best sellers in the market. Tianqingfuxin, which is used to combat the hepatitis virus, also ranks one of the five best sellers two years after being launched in the market.

Hepatitis medicines made with ingredient extracted from Licorice are commonly used in the industry. It also has the best therapeutic effects in protecting the liver and lowering enzyme levels. JCTT is the largest Licorice R&D unit and is the largest manufacturer of the type of medicine. Its major products Ganlixin injections and capsules and Tianqingganpin enteric capsules (launched in May 2004) are all made with extracts from Licorice.

The Tianqinganmei injection, a hepatitis drug (protecting the liver by lowering enzyme level) produced by the Group for treating severe hepatitis, uses a new chemical compound extracted and separated from Licorice. The product received a patent certificate of independent intellectual property right. It was launched in November 2005 and drew immediate industry attention. It is expected to soon become another "blockbuster drug" of the Group, with total sales exceeding HK\$100 million.



Ganlixin injections



Ganlixin capsules



Tianqingfuxin capsules



Tianqingfuxin injections

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Since the patent of Ganlixin expired, many replica products emerged in the market, which affected its sales performance. The Group took combative measures and turned the sales around but its overall growth slowed down last year at approximately 5.2%, reaching approximately HK\$319.67 million (fig.1.4). As for Tianqinganping enteric capsules, its expedient dosage and proven therapeutic effects pushed up sales to HK\$41.21 million this year.



Tianqinganping  
enteric capsules

Affected by the intense market competition in the segment of combating hepatitis virus, a major product, Tianqingfuxin injections and capsules, made with extract and separate from the Chinese Herb called Sophora Alpecuroides L, reported a drop in sales of HK\$129.06 million this year (fig.1.4).

JCTT has built a foundation in hepatitis treatment with the core focus on protecting the liver and fighting hepatitis virus.



Carnet injections

### Oncology medicines

Tumor is the No. 2 killer in the world and the mortality rate is rising every year. oncology medicines have thus shown the highest growth among various products. Currently, their sales rank third in the country and are rising continuously. Tianqinyitai injections, the new oncology medicines launched by JCTT in January 2005, is used for easing the pain caused by osteolytic bone metastasis. Supported by its established sales network, strong sales team, abundant marketing experience, and the product's remarkable therapeutic effects, the new medicine immediately attracted the attention of medical practitioners and recorded total sales amounted to HK\$26.53 million. The Group believes its other oncology medicines Renyi injections, which is manufactured by NJCTT, will also see encouraging performance.



Tianqinyitai injections

### Analgesic medicines

Beijing Tide's new Flurbiprofen micro-sphere target sustained release analgesic injection or Kaifen injections, using advanced production technology, has notable effect in alleviating pain with minimal side effects. In addition to receiving a RMB1 million R&D grant from Beijing Municipal Bureau of Industrial Development and State Administration of Foreign Experts Affairs, the product also received the certificate of the "National New Product" jointly awarded from the PRC's Ministry of Science and Technology, the PRC's Ministry of Commerce, the PRC's General Administration of Quality Supervision, Inspection and Quarantine, and the State Environmental Protection Administration of China. The medicine boasts tremendous growth potential as the Group believes that it will take up a certain share of the traditional analgesic medicine market.

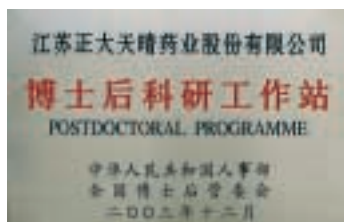


Renyi injections



Kaifen injections

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Postdoctoral Programme



R &amp; D laboratory



R &amp; D laboratory



R &amp; D laboratory



Tianqingzhengshu tablets

## RESEARCH AND DEVELOPMENT

The Group focuses on the R&D of therapeutic medicines for cardio-cerebral diseases, hepatitis, oncology, analgesia, respiratory system and diabetes. During the year, the Group received a total of 17 production approvals and 31 clinical research approvals from the SFDA. A total of 56 cases had completed clinical research, under clinical trial or applying for production approval. The Group received R&D subsidies from the PRC Government totalling RMB7.15 million, of which RMB5.61 million was secured for JCTT and RMB1.54 million for Beijing Tide.

The Group received research funding from the Innovation and Technology Commission of the Hong Kong Special Administrative Region in November 2003 for cooperating with the Hong Kong Polytechnic University on a joint pharmaceutical research project by using biotechnology in genetic engineering in hepatitis treatment. This project progressed smoothly and the result report was submitted at the end of the year.

## CTGC

CTGC is principally engaged in the R&D of medicines used to treat cardio-cerebral diseases, respiratory system, diabetes and digestive system. It specializes in the research of sustained release and controlled release of the drop pills for Chinese medicines and chemical medicines. The size of the drop pills can also be adjusted according to the effect desired and market requirements. CTGC has 5 SFDA approvals for clinical research and has signed product transfer contracts for 39 drugs. Boasting low development cost, outstanding therapeutic effects and convenient application, the product fits in with the direction of the pharmaceutical industry in the PRC and is expected to attract strong demand from the third-tier end markets in the country. We see promising prospects for the product and it is expected to broaden the Group's product mix, prolong its product life spans and expand its market.

## JCTT

During the year, JCTT received 24 approvals for clinical research from the SFDA. A total of 36 cases received approval for clinical research, under clinical trial or had completed clinical trial, and applying for production approval. These products are used to treat hepatitis, oncology, cardio-cerebral diseases, respiratory system, bacteria and inflammation as well as diabetes. The Group will obtain the necessary production approvals and launch the products to the market.

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The newly patented drug Adefovir Dipivoxil, a new anti-viral drug for hepatitis, has completed the clinical stage and is applying for production approval from the SFDA. The Group expects to launch the product in the first half of 2006. The Group has also applied to the SFDA for the production approval of Tianqingsule (Tiotropium Bromide) spray, a drug for treating respiratory ailments, targeting to launch in the first half of 2006. It is expected that the two mentioned products will become the blockbuster products of the Group in the future.

### NJCTT

2 approvals were received for clinical research this year. A total of 9 cases were in clinical research, or had completed clinical trials, or are applying for production approval from the SFDA. One of them is the plasma volume expander, which is expected to obtain the production approval in first half of 2006 and will become another blockbuster product of the Group.

### Beijing Tide

A total of 6 products were in clinical trial, or had completed clinical trial and applying for production approval from the SFDA. Three of them are drugs for treating cardio-cerebral diseases, two are for reducing blood glucose level (treating diabetes) and one new drug for treating digestive diseases. These products, which are expected to be launched in 2006 and 2007, will help to consolidate the Group's position in the area of cardio-cerebral disease treatment, enlarging its corresponding market shares, and also expanding in the area of diabetes and digestive diseases treatment.

## CORPORATE GOVERNANCE

### Investors' Relations

The Group strongly believes that its commitment to good corporate governance has increased its transparency. During the period under review, the Group actively arranged three media conferences and four investor presentations to enhance analysts' and fund managers' understanding about the latest business development of the Group. The senior management also met with the analysts and fund managers regularly to provide them updated information and corporate development of the Group.

To further strengthen its investor relations, the Group participated in various large-scale investor roadshows during the period. These roadshows include:

- CLSA China Forum;
- CLSA Hong Kong Forum;
- Goldman Sachs' China Investment Frontier;
- 2005 BOCI Investors Conference;
- DBS' roadshow/corporate presentation events in Japan and New York.

The Group's high level of transparency has allowed it to gain the trust of international conglomerates, facilitating potential future merger and restructuring. In the past year, the Group was awarded by various renowned organizations for its remarkable performance, which revealed the extensive recognition and support it had from the investment community. The Group is committed to putting more resources in enhancing transparency.

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### Code on Corporate Governance Practices

In the opinion of the directors, the Company had complied with all Code Provisions set out in the Code on Corporate Governance Practices as set out in Appendix 14 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") for the year ended 31 December, 2005, except for the following deviation from Code Provision A.2.1 and that Code Provision B.1 is complied in the second half of the year:—

1. Code Provision A.2.1 – The Code Provision stipulates that the roles of chairman and chief executive officer should be separate and should not be performed by the same individual. Mr. Tse Ping is the chairman and chief executive officer of the Company. The Board considers that Mr. Tse Ping's substantial experience in the pharmaceutical business and management will enhance the Company's decision making and operational efficiency. To help achieve better balance of power and authority, the chairman discusses important issues and decisions relating to the Group's business with other executive directors.
2. Code Provision B.1 – The Company has established a remuneration committee on 6th October, 2005 with specific terms of reference in compliance with this Code Provision.

The Company has adopted a code of conduct regarding securities transactions by directors set out in Appendix 10 of the Listing Rules. All directors have complied with the required standard set out in the Model Code and the code of conduct regarding securities transactions by directors adopted by the Company.

### CAPITAL STRUCTURE

On 11 April, 2005, 71,760,000 ordinary shares of HK\$0.025 each have been issued on the exercise of the share options. On 13 April, 2005, 60,202,807 new ordinary shares of HK\$0.025 each have been issued on the exercise of the conversion rights of convertible bonds held by Jian Kang Limited. On 29 April, 2005, 240,000 ordinary shares of HK\$0.025 each have been issued on the exercise of the share options. On 31 May, 2005, 754,656,245 bonus shares have been issued and an amount of HK\$18,866,406.13, being part of the Company's share premium account, has been capitalised. Such sum has been applied accordingly in paying up in full at par of the 754,656,245 bonus shares.

### LIQUIDITY AND FINANCIAL RESOURCES

The Group's liquidity remains strong. During the year, the Group's primary source of funds was cash derived from operating activities and the disposal of Sino Concept Technology Limited. As at 31 December, 2005, the Group's bank balance and cash in hand was approximately HK\$1,696.01 million (2004: approximately HK\$344.48 million).

### CAPITAL COMMITMENT

The Group's capital expenditure commitments amounted to approximately HK\$23.83 million as at 31 December, 2005 (2004: approximately HK\$60.37 million). The Group has adequate financial resources to fund its capital expenditure commitment from existing cash resources and cash flows generated from its operations.

### CHARGE ON ASSETS

The Group did not have any charges on assets as at 31 December, 2005 (2004: Nil).

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### CONTINGENT LIABILITIES

As at the balance sheet date, the Group had contingent liabilities of HK\$4,970,000 (2004: Nil).

### ASSETS AND GEARING RATIO

As at 31 December, 2005, total assets of the Group amounted to approximately HK\$2,140.22 million (2004: approximately HK\$950.54 million) whereas total liabilities amounted to approximately HK\$164.98 million (2004: approximately HK\$282.75 million). The gearing ratio (total liabilities over total assets) was approximately 7.7% (2004: approximately 29.7%).

### EMPLOYEE AND REMUNERATION POLICIES

As at 31 December, 2005, the Group had about 2,546 employees (2004: 3,008). The Group remunerates its employees based on their performance, experience and the prevailing market rates. Other employee benefits include mandatory provident fund, insurance and medical coverage, subsidized training programmes as well as a share option scheme.

Total staff costs (including Directors' remuneration) of continuing operations for the year were HK\$154,312,000 (2004: HK\$94,055,000).

### EXPOSURE TO FLUCTUATIONS IN EXCHANGE RATES

Most of the assets and liabilities of the Group were denominated in Renminbi, US dollars and Hong Kong dollars. In Mainland China, foreign investment enterprises are authorized to convert Renminbi to foreign currency in respect of current account items (including payment of dividend and profit to the foreign joint venture partner). The exchange rate between Hong Kong dollars and US dollars has been pledged under a fixed linked system over a long period of time. The Directors consider that the Group is not significantly exposed to foreign currency risk and no hedging or other alternatives have been implemented.