

MANAGEMENT DISCUSSION AND ANALYSIS

The Group is principally engaged in the research and development (“**R&D**”), manufacture and sale of gynecological medicine and medicinal healthcare products for women in the PRC. During the Year, the Group continued to achieve a positive return through its own and joint national distribution channels as well as extensive marketing network.

MARKET REVIEW

During the Year, the pharmaceutical industry was further reformed with expedited restructuring pace in a favourable national macro-economic environment. Production and sales of pharmaceutical products grew more rapidly and prospect of the export segment remained positive. Compared with last year, both Chinese medicines and bio-pharmaceutical medicines segments registered an increase in profit growth, thereby demonstrating sustainable prospect for the Chinese medicines segment. On the other hand, there was a drop in the profit growth in the chemical pharmaceutical medicines segment.

During the Year, intensive reform was introduced in the domestic pharmaceutical industry. A series of policies were implemented, such as medicines classification system, regulation on medicine names by prohibition of multiple naming of medicines and prescription system with non-proprietary names. With the increase in prices of upstream raw/auxiliary materials and utilities (water and electricity), coal and transportation charges, the pharmaceutical industry development was faced with unprecedented challenges. On the other hand, the Directors believe that new socialist reforms introduced in the rural regions would bring great potentials and expedited growth to the rural market. Meanwhile, merger and acquisition (“**M&A**”) activities continued to boom and consolidation progress proceeded further. Market competition was intensified with major foreign enterprises attempting to tap into the promising PRC pharmaceutical market.

BUSINESS REVIEW

Though the pharmaceutical market had generally become increasingly competitive, the Group achieved a steady growth during the Year. The Directors believed that the Group had managed to maintain satisfactory business performance during the Year, as a result of a number of factors, including the Group’s fundamental strategic mission of developing itself as a top player in the field of gynecological medicines and medicinal healthcare products for women; the Group’s quality hospital brand image over the years; the ownership of proprietary products and protected Chinese medicines with greater pricing autonomy; the Group’s prestigious market position; the successful commercial launch of “**Magic 美即**” branded medicinal healthcare products and a professional marketing team.

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FINANCIAL PERFORMANCE

During the Year, the Group's turnover was approximately HK\$627.9 million, of which approximately HK\$465.2 million (74.1% of the Group's turnover) was derived from sales of the Group's own products, representing an increase of 21.3% as compared with approximately HK\$383.6 million of last year. Prescription drugs contributed approximately HK\$293.6 million in sales during the Year, representing approximately 63.1% of the total sales of the Group's own products. Over-the-counter (“OTC”) drugs recorded approximately HK\$97.4 million in sales, accounting for 20.9% of the total turnover of the Group's own products and a 29.7% increase over last year. Feminine medicinal healthcare products recorded approximately HK\$74.2 million in sales, representing 16.0% of the total turnover of the Group's own products and a 97.3% increase over last year. In addition, approximately HK\$162.7 million of the Group's turnover for the Year was attributable to trading business.

CONSOLIDATION

During the Year, the marketing strategy of the Group has been focused on segmentation of target markets, improvement of sales network infrastructure and penetration into distribution channels. As for prescription drugs, the Group continued to build a strong professional sales team by recruiting high-caliber professionals. To further improve the Group's results, the Group endeavoured to devote more sales and marketing efforts to its key products through a number of means including academic and public welfare promotion.

Fuke Zaizaowan (婦科再造丸) is the Group's core branded product under the OTC drugs category. The main promotional strategy of this product line lies in product branding and enhancement of the Group's corporate image through brand promotion and point-of-sales promotion. The Group's integrated marketing plan had yielded good results in Guizhou, Yunnan, Sichuan, Chongqing, Shaanxi and Gansu provinces and had been extended to more than 10 other regions including Guangdong, Hubei and Beijing. The overall sales of this drug was encouraging.

During the Year, in line with the trend of commercial restructuring in the PRC and as part of the Group's strategies, a brand strategy and a differentiation strategy were introduced to the “**Magic 美即**” series products. Overwhelming responses were received from the market and customers, with product varieties under the “**Magic 美即**” series products increasing from 35 products last year to approximately 50 products at present, covering three main categories of products, namely, facial treatment, eye treatment and body treatment. Sales of this product series had been conducted through the Group's strategic partners, including Watsons, Carrefour, Wal-Mart, Jusco and other famous nation-wide retail channels whose sales channels cover most of the major cities throughout the PRC. Points of sales for this product series had grown significantly from approximately 350 last year to around 700 during the Year. The Directors believe that the “**Magic 美即**” product series has a promising sales prospect.

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AWARDS

During the Year, **Yeosure Natural Medicine Lotion (日舒安洗液)** was granted a number of awards for its reputed quality and outstanding sales history over the past 13 years in the domestic hospital market:

- I. It was recognized as “China’s renowned brand name (中國著名品牌)” by the Social Survey Institute of China (中國社會調查所) (“**SSIC**”), a renowned survey institute in China, in the “Product survey on market satisfaction and reputation (產品社會滿意度、信譽度公益性調查)” on gynecological medicinal products in 2005. It was awarded by SSIC a medal and an honourable certificate in December 2005.
- II. It was awarded the title of “Top Ten Most Influential Brands in Gynecological Medicines in China (中國婦科用藥十大影響力品牌)” during the Second Annual Conference on China Brands’ Influences (第二屆中國品牌影響力高峰論壇年會) held in Beijing.
- III. Together with **Fuke Zaizaowan (婦科再造丸)** – a major product of Guiyang De Chang Xiang Pharmaceutical Company Limited (貴陽德昌祥藥業有限公司) (“**DCX**”), it was granted the title of “Number 1 Brand in China Gynecological Medicines (中國婦科藥品第一品牌)” in the 2006 Top Brands Assessment in National Pharmaceutical Industry (2006年全國醫藥行業第一品牌評價工作).

In line with the Group’s strategic direction, consolidation effects of internal resources began to show on the hundred-year-old pharmaceutical firm, DCX. In 2006, the Group’s proprietary product **Fuke Zaizaowan (婦科再造丸)** was granted two second-class awards in Guizhou Province, including outstanding new product and outstanding technical innovation. It also, together with **Yeosure Natural Medicine Lotion (日舒安洗液)**, received the title of “Number 1 Brand in China Gynecological Medicines (中國婦科藥品第一品牌)”. The Group’s new product, **Fuke Zaizao capsules (婦科再造膠囊)**, was also granted a second-class honour in Guiyang City as an outstanding new product (environmental protection product).

In addition, the Good Manufacturing Practice (“**GMP**”) compliant production facility of DCX and the technological improvement of GMP compliant production facility of Guizhou Hanfang Medicine Manufacture Co., Ltd. (貴州漢方製藥有限公司) (“**GHMM**”) received an honour in Guiyang City on outstanding technological advancement (environmental protection category).

RESEARCH AND DEVELOPMENT

During the Year, the Group obtained production approval for **Jinbaka (金巴卡) – Paclitaxel Injection (紫杉醇注射液)**, a naturally-sourced anti-tumour medicine. The gynecological recuperation product **Fuke Zaizao capsules (婦科再造膠囊)** passed the technical assessment of the State Food and Drug Administration of the PRC (中國國家食品藥品監督管理局) (“**SFDA**”) and the Group was granted an exclusive right of production of this product. The Group has commenced the production and sales of these two products.

During the Year, the Group completed phase IIa of the clinical trials of **Fu Shu Le Tablets (婦舒樂片)**, a new Chinese medicine for curing gynecological atrophic vaginitis which is common in women at menopause. It is currently undergoing phase IIb of the clinical trials. The Directors expect that phase IIb of the clinical trials will be completed by the end of 2006 and an application for the new medicine certification with SFDA will then be made.

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Clinical trials of **Secmidazole Tablets and Capsules (塞克硝唑片及膠囊)**, a new product for curing gynecological trichomoniasis and anerobe, had been completed and reports on the clinical trials and other related information had been duly prepared. Application for production of this new medicine with SFDA will be made in the near future. The Directors expect that approval for sales of this product will be obtained in early 2007.

Other ongoing R&D projects mainly concern gynecological medicines and prescription drugs.

In order to meet market demand, the R&D on product features and functionality of several reserve products under the “**Magic 美即**” series were completed. The results are the fruits of modern technological researches. Around 50 products under the “**Magic 美即**” series have been launched to the market.

PRODUCTION FACILITIES

GHMM and DCX are equipped with a total of 15 and 11 GMP compliant production lines respectively. To date, the Group has a total of 26 production lines which have been accredited with GMP certification issued by SFDA of the PRC, covering most types of medication. The present average utilization rate is approximately 40% to 50%, indicating that there is plenty of production capacity readily available for future development. In addition, the production lines of the two production enterprises are complementary to each other. Upon preliminary consolidation, the Group can share internal resources, which will enable it to further explore its internal potentials as well as save energy and costs. It will also provide the Group with greater flexibility in production planning, thereby bringing about corporate synergy. This will strengthen the Group's bargaining power with upstream raw material suppliers and upgrade the Group's production management. With the accreditation of GMP certifications of all its production lines, the Directors believe the Group is equipped with sufficient production resources and is well positioned to become one of the leading pharmaceutical manufacturing enterprises in terms of scale of production facilities and products varieties in the southwestern region of the PRC.

PROSPECTS

During the Year, the pharmaceutical industry in China has been growing steadily. This has laid a cornerstone for the sustainable and rapid development of the pharmaceutical sector. The domestic pharmaceutical market is expected to post over a double-digit growth per annum for the coming three years. Compared with other pharmaceutical industry segments, the Chinese medicine segment remains a sector with stronger industry edges, more distinct core competitiveness and relatively stable growth prospect.

The Directors believe the focuses of the future pharmaceutical industry will be product varieties, distribution channels and enhancing corporate strength through rapid M&A. The Group will adhere to its strategic goal of becoming “a leading manufacturer of gynecological pharmaceutical products and feminine medicinal healthcare products”. In light of the prosperous developments in China, by identifying M&A opportunities with pharmaceutical enterprises possessing the potential to make significant contributions to the Group in terms of brand building, product varieties and marketing network and implementing effective integration, the Group will enhance its management quality, competitiveness, operation and efficiency.

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In the present year, the Group will continue to strengthen its internal consolidation through internal restructuring and asset reorganization in order to form an integrated operational platform. By constantly optimizing business flow and internal control systems, as well as tightening cost controls, the Group has improved its mode of operation and risk management ability in order to react promptly to the changing market conditions.

The Group has expedited the launch and sales of a category one new medicine, namely **Human Nerve Growing Factor (人神經生長因子)**, a product which has been granted an exclusive intellectual property right and a national patent right. **Human Nerve Growing Factor (人神經生長因子)** applies a biotechnological separation process to the Chinese medicine “Placenta (紫河車)”, thereby obtaining a high purity cell factor which could be used for replenishing nutrition to human nerve cells and re-conditioning damaged nerve cells. The Directors are confident that the sales and introduction of the **Human Nerve Growing Factor (人神經生長因子)** will definitely enhance the Group’s brand recognition in the prescription drugs market and strengthen its competitiveness, thus further improving its profitability in the field of prescription drugs. In addition, the separation process of “Placenta (紫河車)” will produce other products, which could be developed into various anti-ageing beauty products through further R&D. In that event, our medicinal healthcare product mix will certainly be enriched and our competitiveness will be further enhanced.

Being the most significantly growing business sector of the Group, medicinal healthcare products under “**Magic 美即**” series are becoming the focuses for the Group’s future development. The product series of “**Magic 美即**” has established a nationwide coverage of approximately 700 hyper-markets. The Group will keep abreast of the consumer market trend in order to rapidly respond to changing market demands. The Group will take great leaps in establishing closer connections with large chain hyper-markets and supermarkets with a view to broadening our geographical coverage. The Group will devote more promotional efforts on media advertisement in focused regions in order to further build up the competitive strengths of the “**Magic 美即**” brand. Moreover, in reaction to market changes, and by capitalizing on the fruits of modern scientific research, the “**Magic 美即**” series products will be diversified and refined in terms of product varieties and functions. Our product varieties have been extended to a variety of feminine skin care segments. To consolidate our sales performance and network in Eastern China, Southern China and Northern China, we will also tap into cities in these regions in order to build up brand influence and boost sales of our “**Magic 美即**” series of products in the national market. To cope with the robust growth of the “**Magic 美即**” brand, the Group is planning to invest in the construction of a new plant in Guangzhou.

Furthermore, the Group will take great steps in flourishing high-margin agency business through acquiring exclusive operational rights. Meanwhile, with the development of new rural infrastructure and the implementation of new rural cooperative medical systems, the rural pharmaceutical market is expected to have tremendous growing potentials in the foreseeable future. The rural pharmaceutical market is expected to become a driving momentum for the pharmaceutical industry. With over a hundred types of medicines, pharmaceutical companies within the Group, namely DCX and GHMM, will both become the Group’s gateway to its rapid expansion into the rural pharmaceutical market. The Group will take advantage of the expanding rural pharmaceutical market to sharply increase the Group’s sales in the rural market and enlarge the Group’s sales in order to yield higher profit return.

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The Group is confident of the future outlook. In the present year, as before, the Group will continue to actively carry out product R&D, enhance production quality management and explore new business opportunities. Meanwhile, the Group will implement marketing and channel penetration strategies with a view to consolidating and reinforcing its prominent position in the market.

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. As at 30 June 2006, the Group had unpledged cash and bank balances of approximately HK\$523.9 million (30 June 2005: approximately HK\$474.0 million). Its gearing ratio calculated as a ratio of total debt to equity attributable to equity holders of the Company was approximately 18.8% (30 June 2005: approximately 29.6% (restated)). Net current assets was approximately HK\$649.4 million (30 June 2005: approximately HK\$554.4 million) and the current ratio was maintained at the healthy level of approximately 3.7 (30 June 2005: approximately 3.4) as at 30 June 2006.

The finance costs of the Group for the Year amounted to approximately HK\$11.3 million (2005: approximately HK\$7.9 million), representing approximately 1.8% (2005: approximately 1.3%) of the Group's total turnover and an increase of approximately HK\$3.4 million over last year. The increase in finance costs was principally due to increase in bank interest rates.

POST BALANCE SHEET EVENTS

The Group had the following significant post balance sheet events:

- (a) Subsequent to the balance sheet date, the Group drew down a new bank loan of HK\$445 million pursuant to a loan facility agreement entered into by the Group with certain financial institutions in Hong Kong and overseas on 30 June 2006. The loan facility is for a term of 3 years commencing from the date of the loan facility agreement and with an option at the end of the third year to extend the loan for an additional 2 years. A portion of the amount drawn was utilised to repay the entire bank loan of the Company outstanding as at 30 June 2006. The remaining portion is intended to provide additional working capital to the Group.
- (b) Subsequent to the balance sheet date, the Group purchased a technical knowhow and the related exclusive intellectual property right and national patent right of a category one new medicine namely Human Nerve Growing Factor (人神經生長因子), and in turn established a bio-technological company with paid up capital of HK\$100 million in Mainland China for the manufacture and sale of the said medicine.
- (c) Subsequent to the balance sheet date, the Group entered into a sale and purchase agreement with an independent third party for the disposal of the Group's entire available-for-sale equity investment.

CONTINGENT LIABILITIES

As at 30 June 2006, the Group did not have any material contingent liabilities (30 June 2005: Nil).

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BANK BORROWINGS

As at 30 June 2006, the Group had outstanding bank loans of approximately HK\$157.6 million from the banks in the PRC and Hong Kong (30 June 2005: approximately HK\$197.0 million), approximately 75.7% (30 June 2005: approximately 59.8%) 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 2006, the Group's bank borrowings were secured by (i) certain plant and machinery of the Group; (ii) certain land and buildings of the Group; (iii) pledge of equity interests of certain subsidiaries of the Company; and (iv) corporate guarantees given by certain subsidiaries 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 generated 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 2006, the Group had contracted commitments of HK\$13.2 million (30 June 2005: HK\$3.7 million) and HK\$34.0 million (30 June 2005: HK\$1.8 million) in respect of purchases of technical knowhow and construction on property, plant and equipment.

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EMPLOYEES, TRAINING AND REMUNERATION POLICIES

As at 30 June 2006, the Group had a total of 1,304 employees (2005: 1,224), of whom 1,297 were based in the PRC, with the rest stationed in Hong Kong. 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\$25,010,000 (2005: approximately HK\$18,482,000). Staff costs accounted for 4.0% of the Group's turnover during the Year (2005: 3.1%). 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 recommended the payment of a final dividend of HK2 cents per share of the Company for the Year (2005: HK2 cents per share).

CLOSURE OF REGISTER OF MEMBERS

The register of members will be closed from Monday, 18 December 2006 to Thursday, 21 December 2006 (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 26th Floor, Tesbury Centre, 28 Queen's Road East, Wanchai, Hong Kong not later than 4:00 pm on Friday, 15 December 2006 for registration.