5. INDUSTRY OVERVIEW AND FUTURE PROSPECTS

The following discussion on the world and Malaysian economy and the industry in which the Y.S.P.SAH Group operates is not intended to be exhaustive but reflects some of the factors which are considered relevant to understanding the business and profitability of the Y.S.P.SAH Group based on prevailing regulations, economic trends and developments.

5.1 ECONOMIC OVERVIEW

The Group's growth and level of profitability are linked to the economic conditions in Malaysia and other countries which serve as markets for the Group's products, mainly the ASEAN region and in particularly countries such as Singapore, the Philippines and Vietnam.

5.1.1 The world economy

The world economy performance in the first half of 2003 retreated on account of the war in Iraq and the outbreak of Severe Acute Respiratory Syndrome ("SARS"). With the end of the Iraq war and containment of SARS, global performance in the second half of 2003 is expected to improve, supported by indications of an upturn in the major economies towards the end of the second quarter.

For 2004, world growth trade are expected to improve with most economic activities returning to normalcy. Business confidence and sentiment will, however, be cautiously optimistic against the backdrop of threats from terrorist attacks. World growth is still hinged on the modest performance of the USA economy with the Euro area still marked by relative weakness although Japan is showing signs of positive growth.

Overall, indications point towards an improved outlook and higher optimism for 2004, despite the downside risks. Upbeat stock market activities across major bourses in the second half of 2003 should bolster optimism for a firmer economic recovery. Thus, the world economy is expected to post a higher growth of 4%.

For the ASEAN region, with the containment of SARS and the positive impact following the implementation of various economic relief packages introduced by SARS-affected countries, the regional growth is envisaged to further accelerate in 2004.

(Source: Economic Report 2003/2004)

5.1.2 The Malaysian economy

During the second quarter of 2003, consumer and business sentiments in regional economics were particularly affected by the anxiety of a probably prolonged and widespread SARS epidemic that curtailed transport and tourism-related activities besides trade and investment flows.

Against this adverse global environment and concerns of further weakening of the already sluggish global economy, the Malaysian Government has put in place a package of broad-base pro-growth measures in May 2003. The Government's proactive stimulus package, apart from providing immediate relief for the SARS-affected sectors, was to address structural and organisational issues towards sustaining economic growth in the medium and longer term. The strategic measures introduced boosted confidence necessary to stimulate domestic consumption and investment.

Malaysia's sound economic fundamentals and expansionary fiscal and accommodative monetary policies, supplemented by the Government's proactive stimulus package, have helped to sustain high growth in the real gross domestic product ("GDP"). After expanding 4.5% in the first half of 2003 and with prospects of sustained growth in the second half of 2003, the economy is set to achieve its targeted growth of 4.5% in 2003, higher than the 4.1% in 2002.

The economy outlook for 2004 is envisaged to be favourable. Real GDP is expected to gain momentum and register a higher rate of 5.5% to 6% in 2004. Growth is expected to emanate from higher exports on account of continuing improvement in world economic prospects while domestic demand will continue to be driven by pro-growth fiscal and monetary measures.

(Source: Economic Report 2003/2004)

5.2 OVERVIEW OF THE MALAYSIAN PHARMACEUTICAL INDUSTRY

Pharmaceutical industry is becoming increasingly important as an export earner, particularly to other ASEAN countries as well as Africa and the Middle East. The export of pharmaceutical grew more than 5% in 2003. Local pharmaceutical manufacturers are intensifying their R&D efforts, particularly in the area of product innovation and improvement in herbal and traditional medicines. These growing developments have attracted foreign investment in R&D of pharmaceutical products and establishment of regional R&D centres in Malaysia.

(Source: Economic Report 2003/2004)

The generic pharmaceutical market in Malaysia is at a growth stage. In 2001, the market grew at a considerably good rate of 8.0%. This growth has been supported by the population's increasing awareness regarding choices in medications. Further, awareness about the importance of healthcare leads to regular check-ups and preventive measures, which ensures growing demand for drugs.

However, future growth of the industry in Malaysia would nevertheless be constrained by the small population base of 23 million people. In order to overcome this problem, local manufacturers are also looking beyond Malaysia for other countries with potential to be developed into new markets. Malaysia's membership in PICS is an indication that the Government is committed in improving the pharmaceutical industry in order to improve the overall healthcare standards to Malaysian public at affordable prices. This move is expected to aid Malaysian pharmaceutical manufacturers when competing against foreign manufacturers.

Generic drug manufacturers are expected to invest more in R&D and marketing activities in order to capture the market share from MNCs that have established a strong base in the country. With the admission of Malaysia into PICS, more awareness campaigns are expected to be launched by the MoH to encourage the use of generic drug manufactured locally.

The generic pharmaceutical market in Malaysia recorded revenues of USD102.6 million in 2001, representing a growth rate of 8% from USD94.7 million recorded in 2000. The CAGR is estimated to be 12.5% throughout 2002 to 2007, with potential revenues reaching USD207.7 million by 2007.

(Source: Frost & Sullivan)

5.2.1 Market drivers

Rising Healthcare Costs

Improved education levels have led to an increasing awareness of healthcare. Consequently, demand for drugs and medical services have increased, which led to a rise in healthcare costs. Patients are finding it expensive to maintain or improve personal health and are expected to take steps to reduce their healthcare costs, including the use of cheaper generic drugs over high priced patented drugs.

(Source: Frost & Sullivan)

Ageing Population

According to the 2000 census, the aging population in Malaysia (aged 65 years and above) accounted for 3.9 percent of the total population. This is slightly higher than the composition in 1991 of about 3.7 percent. The growing number of elderly people requiring medical care facilities provides opportunities for the healthcare industry in the near future as ailments and pains that often accompany ageing would require treatment. For example, demand for drugs for hypertension and cardiovascular ailments is high amongst the elderly Malaysian community. Whilst doctors are sought for medical advice, most elderly people purchase OTC products to tackle a particular problem, especially when they experience minor illnesses that can be easily cured.

(Source: Frost & Sullivan)

Demand from Neighbouring Countries

Apart from the domestic market which is constrained by a small population base, other ASEAN countries such as Thailand and Indonesia with their large population present opportunities for further market penetration. Other countries such as Vietnam and Myanmar could also provide opportunities due to their largely undeveloped pharmaceutical industries, in addition to their relatively large population size.

(Source: Frost & Sullivan)

Government Support for Local Manufacturers

The local pharmaceutical manufacturers have vast support from the Malaysia Government. One of the Government's efforts is to purchase pharmaceutical products from local manufacturers at their higher prices, up to a maximum of 20% price advantage. The Government is also committed to purchasing generic drugs, except in instances where patented drugs have proven to be more effective.

(Source: Frost & Sullivan)

5.2.2 Government regulations

There are two main regulations governing the pharmaceutical industry in Malaysia, namely the product registration process and implementation of PICS. Under the product registration process, market participants have to undergo online registration where the company is required to prepare and submit the necessary registration dossier to DCA *via* the official website. A drug sample will only be submitted to DCA for further testing upon request. The product registration process would usually take between 6 to 12 months.

As a member of the PICS, Malaysia is committed to support the PICS scheme. This includes improving the standards of public health through frequent plant inspections, development of GMP, and co-ordination of training for market participants. It is expected that more stringent checks will be carried out by the local authorities on pharmaceutical manufacturing plants, in order to ensure that the manufacturing facilities meet the minimum standards of hygiene and safety. Local pharmaceutical manufacturers are, hence, expected to consistently increase its capital investment to upgrade their manufacturing facilities.

(Source: Frost & Sullivan)

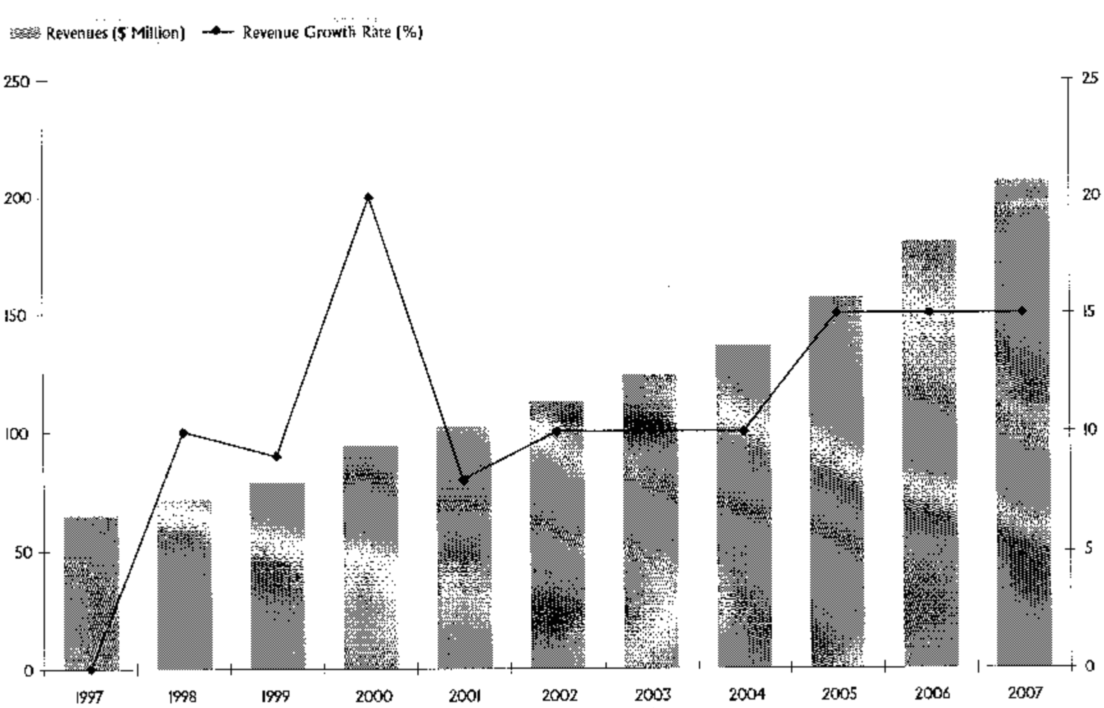
5.2.3 Market growth forecast

Set out below is a projection of the Malaysian generic pharmaceutical market from 1997 to 2007:

Year	Revenues (USD 'million)	Revenue Growth Rate (%)
1997	65.4	—
1998	72.6	10.0
1999	78.9	9.0
2000	94.7	20.0
2001	102.6	8.0
2002	112.9	10.0
2003	124.2	10.0
2004	136.6	10.0
2005	157.1	15.0
2006	180.6	15.0
2007	207.7	15.0
CAGR (2001-2007): 12.5%		

Note: All figures are rounded; the base year is 2001. Source: Frost & Sullivan

Generic Pharmaceutical Market: Historical and Projected Revenues (Malaysia), 1997-2007



Source: Frost & Sullivan

The generic pharmaceutical market stood at USD102.6 million in 2001, which reflected an 8.0% growth from the previous year. The single digit growth rate can be mainly attributed to the economic downturn, which made GPs and hospitals cautious in terms of spending. However, with the economy showing signs of recovery, revenue growth is expected to jump to 10.0%, bringing revenues to USD112.9 million in 2002. Growth in subsequent years is expected to be flat at around 10%, with a slight increase to 15% per annum from 2005. The rather stable growth reflects the condition of the pharmaceutical market. While there may be cuts in spending, patients would still need to consume drugs to treat illnesses, the only difference during an economic downturn is that they may wait longer before they treat their illnesses.

The higher forecast growth in later years is a reflection of increasing awareness about healthcare and more importantly, on the advantages of generic drugs. The CAGR during the forecast period is estimated at 12.5% and revenues are likely to reach USD207.7 million by 2007.

(Source: Frost & Sullivan)

5.2.4 Distribution trends

Set out below are the distribution trends of the Malaysian generic pharmaceutical market in 2001.

Distribution Channel	Percent of Revenues
Government Hospitals	40.0
Clinics/GPs	25.0
Private Hospitals	20.0
Retail Pharmacies	15.0
Total	100.0

Note: All figures are rounded; the base year is 2001. Source: Frost & Sullivan

Government hospitals account for the largest share of generic drugs at 40% with the largest patient base. This is partly due to the fact that patients who cannot afford the services of private hospitals and clinics would visit government hospitals which charge lower consultation and medication fees. Government hospitals would in turn purchase generic drugs in order to keep their costs low.

Clinics/GPs are the next largest distribution channel and contribute approximately 25% of the revenue from the sale of generic drugs. There are approximately 8,000 clinics in Malaysia compared to approximately 1,100 pharmacies. The remaining 20% and 15% of generic drug sales are generated by private hospitals and retail pharmacies respectively.

(Source: Frost & Sullivan)

5.2.5 Pricing trends

Prices for pharmaceutical products have generally been on a gradual downward trend as more companies enter the market. As differentiation is generally difficult in the generic pharmaceutical market, price is at times one of the key factors considered by customers. The Y.S.P.SAH Group has consistently adopted a stringent cost control for both of its productions and operations in order to ensure that the profit margin of the Y.S.P.SAH Group is maintained at a consistent level.

5.2.6 Competitive structure

Approximately 40 companies exist in the generic pharmaceutical market in Malaysia, out of which 10 are actively competing. Manufacturers in Malaysia are either Asian multinationals or local manufacturers. These manufacturers have their own distribution channel as it is difficult to go through well-established distributors such as Zuellig Pharma Sdn. Bhd. and Diethelm (Malaysia) Sdn. Bhd., that focus only on patented drugs. The competitive structure of the Malaysian pharmaceutical industry is divided into three tiers based on market share. The top 30% is controlled by UPHA Corporation (M) Sdn. Bhd. ("UPHA") while another 40.5% is shared by Raza Pharmaceuticals Sdn. Bhd. ("Raza"), Xepa Soul Pattinson (M) Sdn. Bhd. ("Xepa Soul") and the Y.S.P.SAH Group. Market participants belonging to the third tier include Duopharma Biotech Bhd ("Duopharma"), Hovid Sdn. Bhd. ("Hovid"), Ranbaxy (M) Sdn. Bhd. ("Ranbaxy") and Kotra Pharma (M) Sdn. Bhd. ("Kotra").

(Source: Frost & Sullivan)

Market Share Analysis

UPHA is the market leader with 30% share in the generic pharmaceutical market in Malaysia. It is the largest manufacturer in the country with a wide range of products. UPHA is a wholly owned subsidiary of Chemical Companies of Malaysia Berhad, a company listed on the Main Board of the KLSE. Its investments in R&D and initiatives in technology transfer from countries with more developed pharmaceutical industries and scientific research are the key success factors for UPHA to maintain its lead position ahead of the other market participants.

Raza holds the next largest market share at 18%. Raza is a wholly owned subsidiary of Raza Manufacturing Berhad, which in turn is a wholly owned subsidiary of Pharmaniaga Berhad, a company listed on the Main Board of the KLSE. Raza is one of the main suppliers to the Malaysian Government, which makes up a sizeable demand for its pharmaceutical products.

Xepa Soul (a wholly owned subsidiary of Apex Healthcare Berhad, a company listed on the Main Board of the KLSE) and the Y.S.P.SAH Group command 12% and 10.5% of the market respectively. The Y.S.P.SAH Group's market share is expected to increase as the Group is broadening its product range by expanding its production facilities to manufacture new drugs in eye-drop and injection forms.

The remaining 29.5% of the market is shared by the rest of the participants like Duopharma, Hovid, Ranbaxy and Kotra, to name a few.

(Source: Frost & Sullivan)

5.2.7 Eighth Malaysia Plan 2001 – 2005

Malaysia's current healthcare investments are guided by the Eighth Malaysia Plan which focuses on the improvement of health services to ensure that Malaysians enjoy a higher quality of life. A budget of RM5.5 billion has been allocated for the continued expansion of the healthcare sector, including healthcare services, medical equipment and pharmaceuticals from 2001 to 2005.

The Eighth Malaysia Plan emphasises on improving accessibility, affordability and quality of healthcare, expanding the wellness program, increasing the supply of trained and allied health professionals and enhancing the research capability of the health sector.

5.3 PROSPECTS AND PLANS OF THE Y.S.P.SAH GROUP

The Y.S.P.SAH Group has continuously upgraded its existing manufacturing plant located in Kawasan Perindustrian Bandar Baru Bangi, which was awarded the GMP status by the DCA for the manufacturing of pharmaceutical products and veterinary products. The Y.S.P.SAH Group intends to further expand its manufacturing facilities to enable the production of 3 new product lines, namely eye drops, injectable drugs and cephalosporin (antibiotics), by constructing 2 additional manufacturing plants as follows:

(i) extension of existing Bangi plant for the production of eye drops and injectable drugs and the accommodation of R&D facilities; and

(ii) construction of a new warehouse and manufacturing plant for the production of cephalosporin on the industrial land newly acquired by the Y.S.P.SAH Group, which are approximately 13,939 square meters in size and located approximately 5 kilometres from its existing factory site.

The Directors of Y.S.P.SAH expect the productions of eye-drops and injectable drugs to commence in the second half of 2004, whilst the production of cephalosporin is expected to commence in the last quarter of 2004.

The Directors of Y.S.P.SAH believe that the Group's broad spectrum of products covering the pharmaceutical, veterinary, aquatic and OTC products is a key competitive advantage for the Y.S.P.SAH Group. It allows the Y.S.P.SAH Group to cater for the various demands from its diversified customer base comprising clinics, hospitals, pharmacists, veterinaries, livestock farms and aquatic farms. Following the completion of the new manufacturing facilities as mentioned above, the Y.S.P.SAH Group will be able to broaden its range of products further and thereby allowing them to create new market segments for its products.

The Y.S.P.SAH Group has in the past years expanded its market coverage in the ASEAN region by establishing numerous subsidiary companies and resident representative office in countries such as Singapore, Philippines, Myanmar, Cambodia and Vietnam. The Directors of Y.S.P.SAH envisage that the Group will continue to enhance its market presence in the aforesaid countries and these overseas markets are expected to contribute positively to the Group's earnings for the next few financial years.

For the FYE 31 December 2004, the Y.S.P.SAH Group plans to expand its reach to other countries such as Bangladesh and Sri Lanka. The large population size and affordability of the generic drugs would provide the Y.S.P.SAH Group with an opportunity to penetrate these markets. Steps will also be taken for the Y.S.P.SAH Group to branch out to other new markets in the Middle East countries at a later stage, which are perceived to be a sizeable market for the Group's products in view of their populace's high spending power.

In order to support the Group's future market expansion plans, the Directors of Y.S.P.SAH have also embarked on plans to enhance its operational efficiencies as well as R&D activities, some of which are set out as follow:

Commitment in R&D

As highlighted in Section 6.4.6 of this Prospectus, the Y.S.P.SAH Group has a R&D team of 15 full-time personnel, which is based in Bangi facility and is mainly responsible for the development of off-patent products, new drug formulations, product registrations and improvement of existing drug formulations to enhance the quality and marketability of the Group's products. The R&D team is supported by YSP(TW) which provides technical assistance to the Y.S.P.SAH Group *via* the TTA. To date, the Y.S.P.SAH Group has successfully launched 33 pharmaceutical and veterinary products which are developed by the local R&D team.

The Y.S.P.SAH Group intends to further recruit new R&D personnel and upgrade its R&D facilities, as well as holding talks with a local university to consider a joint working agreement on R&D collaboration.

Centralised Warehouse

The Directors of Y.S.P.SAH intend to construct a new centralised warehouse for all its finished goods to alleviate the shortage of space at its current premises, which has forced the Group to store finished goods at different locations (at its Bangi manufacturing plant as well as a warehouse in Taman Industri Selaman, Bandar Baru Bangi, 43650 Kajang).

At present, the finished products or inventory of the Group are being monitored on a manual basis where physical stock counts are conducted on a weekly basis for fast moving products. With a centralised warehouse facility, the Y.S.P.SAH Group envisages that it would be able to semi-automate its stock tracking system *via* a bar-coding and digital marking system to better control its inventory levels and working capital requirements.

Implementation of ERP system

As part of the Group's plans to enhance its information technology, the Group's initial step is to implement the JDE One World Solution Explorer, an ERP system which is presently in the final stage of implementation and is expected to be fully implemented by January 2004. The ERP system provides system integration for all business units including manufacturing module, distribution module and finance module and enable data consolidation within the entire Y.S.P.SAH Group in the future. This ERP system is expected to enhance the information flow to the Y.S.P.SAH Group's senior management and to provide the management with more accurate sales data and forecasts which will further assist them in improving the order processes, goods delivery management, production and raw materials requirement planning.

The Y.S.P.SAH Group also plans to implement a virtual private network through internal data communications amongst its distribution centres, which will enable all its employees to have access to the office's network, including customers' database, inventory database and personal files. This facility is expected to further enhance the Y.S.P.SAH Group's services to clients.

Continuous Marketing Training and Updates to Customers

The Group has a sales team of around 120 representatives who are given regular product training to ensure that they are familiar with the Y.S.P.SAH Group's products as well as training on salesmanship. External speakers are also invited to conduct seminars for sales representatives. To support its marketing activities, the Y.S.P.SAH Group also distributes its in-house newsletter, the "YSP Bulletin", to all its customers to consistently keep them informed of the latest products available. In addition to the information on the Group's products, the bulletin also includes extracts of articles from related medical journals.

The Directors of Y.S.P.SAH believe that the Y.S.P.SAH Group is well positioned in the regional generic pharmaceutical market. The Directors also believe that the Y.S.P.SAH Group's competitive advantage lies in its comprehensive product portfolio, GMP accredited manufacturing plant, established in-house marketing and distribution network, sound R&D capabilities with strong support from YSP(TW) and experienced management team.