



山東羅欣藥業股份有限公司
Shandong Luoxin Pharmacy Stock Co., Ltd.*

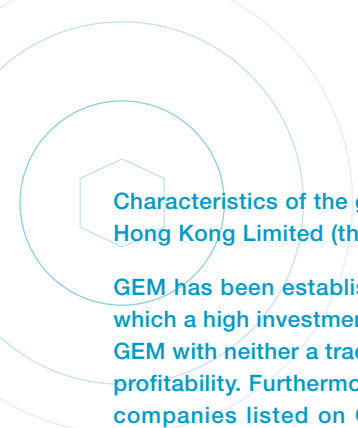
(a joint stock limited company incorporated in the People's Republic of China with limited liability)

Stock Code : 8058



INTERIM REPORT 2006

* For identification purposes only



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This report, for which the directors (the “Directors”) of Shandong Luoxin Pharmacy Stock Co., Ltd. (the “Company”) collectively and individually accept full responsibility, includes particulars given in compliance with the Rules Governing the Listing of Securities on GEM of the Stock Exchange (the “GEM Listing Rules”) for the purpose of giving information with regard to the Company. The Directors, having made all reasonable enquiries, confirm that, to the best of their knowledge and belief, (1) the information contained in this report is accurate and complete in all material respects and is not misleading; (2) there are no other matters the omission of which would make any statement in this report misleading; and (3) all opinions expressed in this report have been arrived at after due and careful consideration and are founded on bases and assumptions that are fair and reasonable.



SUMMARY

- The Company's sales for the six months ended 30 June 2006 was RMB147,058,000, representing an increase of 35.58% when compared with that of the corresponding period of last year.
- The Company's profit attributable to shareholders for the six months ended 30 June 2006 was RMB25,865,000, representing an increase of 72.87% when compared with that of the corresponding period of last year.
- The Board does not recommend the payment of any dividend for the six months ended 30 June 2006.

UNAUDITED INTERIM RESULTS

The board of Directors (the “Board”) of the Company is pleased to announce the unaudited interim results of the Company for the six months ended 30 June 2006 (the “Period”) and the comparative figures of the corresponding period of 2005 as follows:

INCOME STATEMENT

For the six months ended 30 June 2006

	Notes	Unaudited Three months ended 30 June		Unaudited Six months ended 30 June	
		2006 RMB'000	2005 RMB'000	2006 RMB'000	2005 RMB'000
Turnover	3	72,876	57,012	147,058	108,468
Cost of sales		(40,218)	(36,940)	(85,246)	(66,985)
Gross profit		32,658	20,072	61,812	41,483
Other revenue	3	661	442	688	507
Other operating income		643	199	2,362	540
Selling and distribution expenses		(7,137)	(6,083)	(12,096)	(9,712)
General and administration expenses		(4,590)	(3,393)	(10,154)	(7,652)
Operating profit	4	22,235	11,237	42,612	25,166
Finance costs	5	(2,211)	(1,971)	(3,998)	(3,173)
Profit before taxation		20,024	9,266	38,614	21,993
Taxation	6	(6,614)	(2,831)	(12,749)	(7,031)
Profit attributable to shareholders		13,410	6,435	25,865	14,962
Dividends	7	—	—	—	—
Earnings per share (RMB)	8	2.20 cents	1.40 cents	4.24 cents	3.25 cents

BALANCE SHEET

As at 30 June 2006

	Notes	Unaudited 30 June 2006 RMB'000	Audited 31 December 2005 RMB'000
Non-current assets			
Purchased technical know-how	9	2,355	2,908
Prepayments to acquire technical know-how	10	8,155	8,155
Property, plant and equipment	11	67,581	67,025
Construction-in-progress	12	34,899	16,064
Land use rights	13	1,832	1,852
Deferred tax assets		4,594	4,594
		119,416	100,598
Current assets			
Inventories		32,021	38,803
Trade and bills receivables	14	34,174	27,550
Other receivables, deposits and prepayments		13,284	23,278
Pledged bank deposits		—	7,478
Cash and cash equivalents		168,811	155,503
		248,290	252,612
Current liabilities			
Trade and bills payables	15	17,643	19,948
Other payables and accruals		40,077	41,924
Taxation payable		3,800	1,734
Dividend payable		8,909	—
Short-term bank loans		99,700	105,700
		170,129	169,306
Net current assets		78,161	83,306
Total asset less current liabilities		197,577	183,904
Non-current liabilities			
Deferred income	16	20,380	20,380
Net assets		177,197	163,524
Financed by:			
Share capital	17	60,960	60,960
Reserves		116,237	102,564
Shareholders' funds		177,197	163,524

STATEMENTS OF CHANGES IN EQUITY

For the six months ended 30 June 2006

	Attributable to shareholders of the Company					
	Share capital RMB'000	Share premium RMB'000	Statutory surplus reserve fund RMB'000	Statutory public welfare fund RMB'000	Retained earnings RMB'000	Total RMB'000
At 1 January 2005	46,000	13,340	8,373	4,187	21,935	93,835
Profit attributable to shareholders	—	—	—	—	14,962	14,962
At 30 June 2005	<u>46,000</u>	<u>13,340</u>	<u>8,373</u>	<u>4,187</u>	<u>36,897</u>	<u>108,797</u>
At 1 January 2006	60,960	31,139	12,066	6,033	53,326	163,524
Profit attributable to shareholders	—	—	—	—	25,865	25,865
Dividend declared	—	—	—	—	(12,192)	(12,192)
At 30 June 2006	<u>60,960</u>	<u>31,139</u>	<u>12,066</u>	<u>6,033</u>	<u>66,999</u>	<u>177,197</u>

CASH FLOW STATEMENTS

For the six months ended 30 June 2006

	Unaudited Six months ended 30 June	
	2006 RMB'000	2005 RMB'000
Net cash inflow/(outflow) from operating activities	38,528	(7,571)
Net cash (outflow)/inflow from investing activities	(15,937)	37,958
Net cash (outflow)/inflow from financing activities	(9,283)	1,510
Increase in cash and cash equivalents	13,308	31,897
Cash and cash equivalents at beginning of period	155,503	108,960
Cash and cash equivalents at end of period	168,811	140,857
Analysis of the balances of cash and cash equivalents		
Cash and bank balances	168,811	140,857



NOTES TO FINANCIAL STATEMENTS

For the six months ended 30 June 2006

1. GENERAL INFORMATION

The Company was established as a collectively-owned enterprise under the name of Shandong Luoxin Factory in the People's Republic of China (the "PRC") on 14 December 1995 and was converted into a joint stock co-operative enterprise on 12 July 1997. On 19 November 2001, Shandong Luoxin Factory underwent a corporate reorganization and was transformed into a joint stock limited liabilities company with a registered capital of RMB46 million by way of promotion. Subsequent to the above reorganisation, the name of the Company was changed to Shandong Luoxin Pharmacy Stock Co., Ltd. The H shares of the Company have been listed on the Growth Enterprise Market (the "GEM") of The Stock Exchange of Hong Kong Limited since 9 December 2005.

The Company's registered office is located at Luoqi Road, High and New Technology Experimental Zone, Linyi City, Shandong Province, the PRC.

The principal activities of the Company are manufacturing and selling of pharmaceutical products.

The accounts are presented in thousands of units of Renminbi (RMB'000), unless otherwise stated. These accounts have been approved for issue by the Board of Directors on 8 August 2006.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The unaudited condensed interim financial statements have been prepared in accordance with the Hong Kong Accounting Standard ("HKAS") 34 "Interim Financial Reporting" issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and the disclosure requirements set out in Chapter 18 of the Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited. The accounting policies adopted are consistent with those followed in the preparation of the Company's audited financial statements for the year ended 31 December 2005.

The accounts have been prepared under historical cost convention.

3. TURNOVER AND REVENUE

The principal activities of the Company are manufacturing and selling of pharmaceutical products. No business or geographical segment analysis is presented as all operations, assets and liabilities of the Company during the period are related to manufacturing and selling of pharmaceutical products, and all assets and customers are located in the PRC.

Revenues recognised are as follows:

	Unaudited	
	Six months ended 30 June	
	2006	2005
	RMB'000	RMB'000
Turnover		
Sales of manufactured goods	147,058	108,468
Other revenue		
Interest income on bank deposits	688	507
Total revenue	147,746	108,975

4. EXPENSES BY NATURE

	Unaudited	
	Six months ended 30 June	
	2006	2005
	RMB'000	RMB'000
Directors' and supervisors' emoluments	304	271
Depreciation	3,527	2,192
Loss on disposal of property, plant and equipment	497	—
Amortisation of prepaid lease payment	20	20
Amortisation of purchased technical know-how (included in cost of sales)	553	416
Provision for impairment of trade receivables	96	—
Employee benefit expense	14,888	10,463
Research and development costs	1,765	1,735
Advertising costs	1,969	1,914



5. FINANCE COSTS

	Unaudited Six months ended 30 June	
	2006 RMB'000	2005 RMB'000
Interest on short-term bank loan	<u>3,998</u>	<u>3,173</u>

6. TAXATION

	Unaudited Six months ended 30 June	
	2006 RMB'000	2005 RMB'000
PRC income tax	<u>12,749</u>	<u>7,031</u>

No provision for Hong Kong profits tax has been made as the Company did not carry out any business in Hong Kong during the period.

7. DIVIDENDS

The board does not recommend the payment of an interim dividend for the six months ended 30 June 2006 (2005: Nil).

8. EARNINGS PER SHARE

The calculation of basic earnings per share for the six months ended 30 June 2006 is based on the unaudited net profit of approximately RMB25,865,000, and the weighted average number of approximately 609,600,000 ordinary shares in issue during the period.

Diluted earnings per share has not been presented as there were no dilutive potential ordinary shares outstanding during the six months ended 30 June 2006.

The calculation of basic earnings per share for the six months ended 30 June 2005 is based on the unaudited net profit of approximately RMB14,962,000, and the weighted average number of approximately 460,000,000 ordinary shares in issue during the period.

9. PURCHASED TECHNICAL KNOW-HOW

RMB'000

Cost

At 1 January 2005, audited	12,850
Additions	<u>1,500</u>

At 31 December 2005, audited	14,350
Additions	<u>—</u>

At 30 June 2006, unaudited **14,350**

Accumulated amortisation and impairment losses

At 1 January 2005, audited	10,560
Charge for the year	<u>882</u>

At 31 December 2005, audited	11,442
Charge for the period	<u>553</u>

At 30 June 2006, unaudited **11,995**

Net book value

At 31 December 2005, audited	<u>2,908</u>
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At 30 June 2006, unaudited **2,355**

10. PREPAYMENTS TO ACQUIRE TECHNICAL KNOW-HOW

As at 30 June 2006, included in prepayments to acquire technical know-how were amounts prepaid to a shareholder and a related company and details are as follows:

	At 30 June 2006 RMB'000 (Unaudited)	At 31 December 2005 RMB'000 (Audited)
— Shenyang Pharmacy University, a shareholder	4,500	4,500
— Shenyang Bohong Pharmaceutical Technology Development Co., Ltd., a company owned by a shareholder	1,700	1,700
	<u>6,200</u>	<u>6,200</u>

As at 30 June 2006, the Company entered into agreements with Shenyang Pharmacy University, a shareholder, and Shenyang Bohong Pharmaceutical Technology Development Co., Ltd., a company owned by a shareholder, to purchase technical know-how in relation to production of pharmaceutical products at a total consideration of RMB9,300,000 (as at 31 December 2005: RMB9,300,000).

11. PROPERTY, PLANT AND EQUIPMENT

The changes in the net book value of property, plant and equipment for the six months ended 30 June 2006 are analysed as follows:

	RMB'000
At 1 January 2005	
Cost	52,771
Accumulated depreciation	<u>(9,853)</u>
Net book amount	<u>42,918</u>
Year ended 31 December 2005	
Opening net book amount	42,918
Additions	9,008
Transfer from construction-in-progress	20,652
Disposals	(526)
Depreciation	<u>(5,027)</u>
Closing net book amount	<u>67,025</u>
At 31 December 2005	
Cost	81,686
Accumulated depreciation	<u>(14,661)</u>
Net book amount	<u>67,025</u>
Period ended 30 June 2006	
Opening net book amount	67,025
Additions	3,505
Transfer from construction-in-progress	1,075
Disposals	(497)
Depreciation	<u>(3,527)</u>
Closing net book amount	<u>67,581</u>
At 30 June 2006	
Cost	85,722
Accumulated depreciation	<u>(18,141)</u>
Net book amount	<u>67,581</u>

11. PROPERTY, PLANT AND EQUIPMENT *(Continued)*

Plant and machinery with net book value of approximately RMB29,723,000 (as at 31 December 2005: RMB33,166,000) were pledged as collateral to secure bank loans.

12. CONSTRUCTION-IN-PROGRESS

	RMB'000
At 1 January 2005, audited	—
Additions	36,716
Transfer to property, plant and equipment	<u>(20,652)</u>
At 31 December 2005, audited	16,064
Additions	19,910
Transfer to property, plant and equipment	<u>(1,075)</u>
At 30 June 2006, unaudited	<u>34,899</u>

Analysis of construction-in-progress:

	At 30 June 2006 RMB'000 (Unaudited)	At 31 December 2005 RMB'000 (Audited)
Construction cost of buildings	29,417	15,979
Cost of plant and machinery	<u>5,482</u>	<u>85</u>
	<u>34,899</u>	<u>16,064</u>

13. LAND USE RIGHTS

Land use rights represent 50-year land use rights in the PRC expiring from March 2052 to May 2055. This payment is recognised as an expense over the leasehold period.

	RMB'000
At 1 January 2005, audited	1,892
Amortisation of prepaid operating lease payments	<u>(40)</u>
At 31 December 2005, audited	1,852
Amortisation of prepaid operating lease payments	<u>(20)</u>
At 30 June 2006, unaudited	<u>1,832</u>

14. TRADE AND BILLS RECEIVABLES

Details of the ageing analysis are as follows:

	At 30 June 2006 RMB'000 (Unaudited)	At 31 December 2005 RMB'000 (Audited)
1 to 90 days	26,532	20,196
91 to 180 days	5,109	4,721
181 to 365 days	3,039	2,882
Over 365 days	<u>2,507</u>	<u>2,668</u>
	37,187	30,467
Less: Provision for impairment of receivables	<u>(3,013)</u>	<u>(2,917)</u>
	<u>34,174</u>	<u>27,550</u>

Customers are generally granted with credit terms ranging from 30 to 180 days.

Trade and bills receivables as at 30 June 2006 are denominated in Renminbi.

15. TRADE AND BILLS PAYABLES

Details of the ageing analysis are as follows:

	At 30 June 2006 RMB'000 (Unaudited)	At 31 December 2005 RMB'000 (Audited)
1 to 90 days	12,176	10,026
91 to 180 days	3,200	7,851
181 to 365 days	715	374
Over 365 days	1,552	1,697
	<u>17,643</u>	<u>19,948</u>

Trade and bills payables as at 30 June 2006 are denominated in Renminbi.

16. DEFERRED INCOME

During the years ended 31 December 2002 and 2003, the Company received government subsidies in cash of RMB20,380,000 pursuant to an approval obtained from the local government authority. The grants were to enable the Company to construct new manufacturing plant to produce Chinese medicines. As at 30 June 2006, the Company has not commenced the construction of the new manufacturing plant.

17. SHARE CAPITAL

	Number of shares '000	Nominal value		Total RMB'000
		Domestic shares RMB'000	H shares RMB'000	
Registered, issued and fully paid				
At 1 January 2005, (nominal value of RMB0.10 each)	460,000	46,000	—	46,000
Domestic shares converted into H shares (Note (i))	—	(1,496)	1,496	—
Issue of new shares upon listing (Note (ii))	149,600	—	14,960	14,960
At 31 December 2005, audited	<u>609,600</u>	<u>44,504</u>	<u>16,456</u>	<u>60,960</u>
At 30 June 2006, unaudited	<u>609,600</u>	<u>44,504</u>	<u>16,456</u>	<u>60,960</u>

- (i) The 14,960,000 H Shares to be converted from Domestic Shares ("Sale H Shares") are being offered for sale by the Vendors under the Placing in compliance with the Temporary Administrative Measures for Reduction of State-owned Shares. Pursuant to the Temporary Administration Measures for Reduction of State-owned Shares, holders of State-owned shares of a joint stock limited company in the PRC shall offer for sale such number of its State-owned shares equivalent to 10% of the funds to be raised under the initial public offering of the joint stock limited company. Accordingly, an aggregate of 14,960,000 Sale H Shares (to be converted from Domestic Shares) are offered for sale at the Placing price by the Vendors under the Placing. These Sale H Shares rank pari passu with the new H Shares in all respects to be offered for subscription. The net proceeds arising from the sale of the Sale H Shares by the Vendors will be remitted to the National Social Security Fund.
- (ii) The Company's H shares were listed on the GEM Board on 9 December 2005 and 164,560,000 H shares, consisting of 149,600,000 new shares and 14,960,000 shares converted from Domestic shares, with a nominal value of RMB0.10 each were sold to the public by way of placing at HK\$0.26 (equivalent to RMB0.27) each.

The Company raised net proceeds of approximately RMB32,759,000 from the sales of 149,690,000 new shares, of which paid-up share capital was approximately RMB14,960,000 and share premium was approximately RMB17,799,000.

The net proceeds from the sales of 14,960,000 H shares converted from Domestic shares were approximately RMB3,277,000, after deducting the relevant portion of share issuing expenses of approximately RMB768,000 which were borne by the National Social Security Funds in connection with the sales of these shares. Such net proceeds were payable to the National Social Security Funds as at 31 December 2005.

18. BANKING FACILITIES

The Company had aggregate banking facilities of RMB99,700,000 (as at 31 December 2005: RMB113,123,000) which were utilised as at 30 June 2006.

As at 30 June 2006, approximately RMB99,700,000 (as at 31 December 2005: RMB93,123,000) of the banking facilities were secured by:

- (i) pledge of the Company's property, plant and equipment with net book value of approximately RMB29,723,000 (as at 31 December 2005: RMB33,166,000); and
- (ii) pledge of bank deposits of RMB Nil (as at 31 December 2005: RMB7,478,000).

19. COMMITMENTS

The Company had the following significant capital commitments:

	At 30 June 2006 RMB'000 (Unaudited)	At 31 December 2005 RMB'000 (Audited)
Contracted but not provided for:		
— Purchase of technical know-how	3,700	4,115
— Property, plant and machinery	<u>10,608</u>	<u>12,331</u>

As at 30 June 2006, approximately RMB3,100,000 (as at December 2005: RMB3,100,000) of the above commitments are related to acquisition of technical know-how from a shareholder and a company owned by a shareholder.

20. RELATED PARTY TRANSACTIONS

Key management compensation for the period ended 30 June 2006 and 30 June 2005 were disclosed in Note 4.

Apart from those disclosed under Notes 10 and 19, the Company had no material transactions with related parties during the period.

21. APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved by the board of Directors on 8 August 2006.



INTERIM DIVIDENDS

On 22 March 2006, the Board recommended the payment of a final dividend of RMB0.02 per share in respect of the year ended 31 December 2005 to shareholders whose names appear in the register of members of the Company on 26 May 2006. This proposed final dividend was approved by the shareholders of the Company at the annual general meeting held on 26 May 2006.

The Board does not recommend the payment of dividend for the six months ended 30 June 2006.

MANAGEMENT DISCUSSION AND ANALYSIS

Business Review

During the period under review, profits attributable to the shareholders of the Company recorded a tremendous increase over the same period last year, and achieved satisfactory results. The company has carried on its sustainable development strategy and attained distinguished advancement and progress in various aspects.

The Company expanded its market and immensely attracted its customers by taking advantage of its competitive edges gained from its large selection and diversification of products. As the company offered both low-end and high-end products, the brand name of “Luoxin” was strengthened and its sales volume increased rapidly. The Company enlarged its sales team and upgraded the quality of its sales staff. The Company also enlarged its sales networks to cover 27 provinces and 4 municipalities throughout the country. Smooth sales channels for merchandising, logistics, hospitals, and OTC and bulk medicines have been established. The Company strived to offer a wide and comprehensive range of products. The Company has also continuously held more promotional and marketing activities and increased the Company’s advertising budget. Currently, marketing network of the Company is becoming mature and is constantly under consolidation and expansion.



The Company's rapid and persistent growth depended largely on the procurement of scientific exploration. The strengthening of antibiotics products, the speeding up of the research and development of new antibiotics and the exploration of various specialized medicines all contributed to the rapid enhancement of the Company's results. In 2006, the Company continued to make sustained effort in research and development. For the six months ended 30 June 2006, 48 new products with various specifications mainly for use in respiratory system, digestive system, circulatory system, anti-neoplastic and anti-anaerobic drug were approved for production by the National Food and Drugs Authority. As a result, our products structure is optimize and our competitiveness on product diversity was obviously enhanced, this laid a solid foundation for the substantial development of our company. In March 2006, the Company's product, Gatifloxacin for Injection, was awarded the certificate of Technological Advancement Awards Runner-up by the Science and Technology Reward Committee of Shandong Province (山東省科學技術獎勵委員會), which further recognized the technology development capability of the R&D team of the Company.

While focusing on the development of new products, the Company has also made sustained effort in optimizing its production technology, improving the quality of its products and saving more production costs. The employment of vertical integration into the production of bulk medicines and preparation medicines has created competitive edges arising from product diversity for the continuous development of the Company. Meanwhile the Company expanded its production line and enhanced the productivity of its products. The newly established lyophilized powder production line is currently at its final stage of installation and will be put into use during the later half of this year, which will significantly enhance the productivity of the lyophilized powder production line. The newly established science and technology building is also at the very edge of completion, which, by that time, will further enhance the Company's capacity in scientific research.

Upon the parallel progression of various aspects of the Company, the overall reputation of the brand was effectively boosted. The Company, accompanied by a growing reputation within the pharmaceutical industry of China, is gradually evolving into a renowned top-brand corporate.



Financial Review

For the six months ended 30 June 2006, the Company's unaudited turnover was approximately RMB147,058,000, representing an increase of 35.58% when compared with approximately RMB108,468,000 for the corresponding period of last year.

For the six months ended 30 June 2006, the Company's unaudited cost of sales was approximately RMB85,246,000, representing an increase of 27.26% when compared with approximately RMB66,985,000 for the corresponding period of last year.

For the six months ended 30 June 2006, the Company's unaudited gross profit margin was 42.03%, representing an increase of 9.91% when compared with approximately 38.24% for the corresponding period of last year.


For the six months ended 30 June 2006, the Company's unaudited operating expenditure amounted to approximately RMB22,250,000, representing an increase of 28.14% compared with approximately RMB17,364,000 for the corresponding period of last year. This represented a usual growth in operating expenditure driven by the turnover growth of the Company.

For the six months ended 30 June 2006, the Company's unaudited profits attributable to the shareholders was RMB25,865,000, representing an increase of 72.87% compared with approximately RMB14,962,000 for the corresponding period of last year. Weighted average earnings per share were RMB0.042.

Liquidity and Financial Resources

The Company's working capital is generally financed by its internally generated cash flow.

As at 30 June 2006, the Company's cash and cash equivalents amounted to approximately RMB168,811,000 (as at 30 June 2005: RMB155,503,000). As at 30 June 2006, its short term loan amounted to RMB99,700,000 (as at 30 June 2005: RMB105,700,000).



The Company's gearing ratio as at 30 June 2006 was 27.11% (as at 30 June 2005: 29.93%), as calculated by dividing the amount of bank borrowings as at 30 June 2006 by total assets as at 30 June 2006 and then multiplied by 100%.

Pledged Property, Plant and Equipment

As at 30 June 2006, the Company's property, plant and equipment of RMB29,723,000 were pledged to secure the banking facilities of the Company.

Major Acquisition and Disposal

For the six months ended 30 June 2006, the Company did not make any major acquisition or disposal.

Significant Investments

For the six months ended 30 June 2006, the Company did not have any significant investment.

Contingent Liabilities

As at 30 June 2006, the Company did not have any substantial contingent liabilities.

Exchange Risk

The Company operates and conducts business in PRC and all the Company's transactions, assets and liabilities are denominated in Renminbi. Therefore, the Company's exposure to exchange risk is minimal.

Employees and Remuneration Policies

There is no significant change in the Group's employees and remuneration policies compared to that disclosed in the annual report for the year ended 31 December 2005.



Prospects

The Company shall continue to specialize in the scientific research, production and sales of pharmaceutical products. The Company will implement the strategy of sustained development and stick with its objective of becoming a “Technology-driven corporate”, constantly exploring new exclusive franchised products, uncovering new areas of potential growth, establishing more established market networks, enhancing its brand name and eventually elevating its core competitiveness so as to persistently bring about more revenue to the Company.

The Company shall continue to strengthen the cooperation with its research and development partners and increase the capacity of its own research team and keep on launching new products with high science and technology content, high quality and high added value. In 2006, the Company seeks to launch the Rhodiola for Injection, an exclusive franchised traditional Chinese medicine product for injection and thirty odd other new products to the market. Through employing the process of vertical integration into the production of bulk material and preparation medicines, we will capitalize and strengthen our competitiveness on product differentiation and low cost which in turn provides drives and assurance to the sustained development of the Company.

The Directors believe that the pharmaceutical industry will grow even faster in 2006 as the population in the PRC is increasing together with the accelerating pace of urbanization and industrial modernization in the PRC, and under the influence of globalization. The Company submits itself to the concept of value of “benefiting the shareholders, rewarding the staff, consolidating the corporate”. With the persistent growth of the pharmaceutical industry, the Company will also achieve substantial and rapid advancement which generates substantial profit and returns. As a result, the Company is focused on realizing the business objectives as stated in the prospectus issued by the Company.



COMPARISON BETWEEN BUSINESS OBJECTIVES AND ACTUAL BUSINESS PROGRESS

The net proceeds raised from the placing of the company's H Shares on GEM on 9 December 2005 were approximately HK\$31.5 million. The planned usage of proceeds stated in prospectus were based on placing price of HK\$0.35 with 164,560,000 H shares issued of which 14,960,000 H shares were converted from domestic shares of the Company. The final placing price of the H Shares was determined at HK\$0.26. Therefore, the proceeds from the placing was reduced.

The revised total cost of implementation of business plan was RMB32.76 million (or HK\$31.5 million at exchange rate of 1.04 with RMB). With this total, RMB25.42 million will be spent on the enhancement and upgrading of production facilities; RMB4.59 million will be spent on increasing the coverage of its marketing and sales network and its customer base in the PRC; and RMB2.75 million will be spent on the broadening its product range. Insufficient funds will be supported with the Company's internal resources. The Directors are of the view that the current retained earnings level and support from the banks will provide sufficient resources to pay the said deficient funds.

For the six months ended 30 June 2006, the revised spending on the enhancement and upgrading of production facilities was RMB21.97 million; spending on increasing the coverage of its marketing and sales network and its customer base in the PRC was RMB3.77 million; spending on the broadening its product range was RMB2.33 million.



Set out below is a summary of comparison between business objectives and actual business progress:

Business objectives as stated in the Prospectus for the Period

Actual business progress as at 30 June 2006

Enhance and upgrade production facilities

1. Complete the construction and submit the application of GMP accreditation for the new extraction workshop for herbal medicines

Not yet commenced, due to stricter steps and longer time to obtain production permit from the relevant authorities

2. Install new production equipment utilizing the solvent crystallisation technology in its bulk medicines workshop

In final stage of installation and will commence operation in the second half of 2006

3. Expand the production capacity of the powder for injection workshop through the installation of a new production line and ancillary production equipment

Not yet commenced, due to stricter steps and longer time to obtain production permit from the relevant authorities

Increase the coverage of its marketing and sales network and its customer base in the PRC

1. Enlarge sales and marketing team by employing additional 50 sales and marketing staff from different cities in the PRC

50 sales and marketing staff were recruited and are currently receiving training from the Company. They are expected to perform sales and marketing functions in the second half of 2006

2. Participate in National Pharmacy Exchange Fairs (國家藥品交流會) in the first quarter of 2006

Participated National Pharmacy Exchange Fairs (國家藥品交流會) in Zhengzhou, Henan, PRC.



Business objectives as stated in the Prospectus

3. Promote the Company's medicine products in different cities in the PRC through advertising in multi-media channels and participating in some target customer oriented promotion activities, including trade fairs, seminars, exhibitions for medicine products and press conferences
4. Provide training seminars to sales and marketing staff to enhance their knowledge on the Company's new medicine products and latest market information
5. Employ marketing experts to help promote the Company's medicine products

Broaden its product range

1. Commence the clinical research for Rhodiola for Injection and submit the application for the production approval of Rhodiola for Injection

Actual business progress as at 30 June 2006

Promoted the Company's medicine products in different cities in the PRC through advertising in multi-media channels and participating in some target customer oriented promotion activities, including trade fairs, seminars, exhibitions for medicine products and press conferences

Provided training seminars to sales and marketing staff to enhance their knowledge on the Company's new medicine products and latest market information

Recruited two marketing managers with extensive knowledge in medicines in PRC

Patent in respect of Rhodiola for Injection was obtained by the Group on 10 May 2006. The Company is in the process of obtaining the production approval for Rhodiola for Injection

USE OF PROCEEDS

	Costs for the implementation of business plan as at 30 June 2006 as set out in the Prospectus	Amount of net proceeds to be used as at 30 June 2006 as revised	Actual amount of net proceeds spent as at 30 June 2006	Company's contribution on the implementation of business plan
	<i>HK\$' million/ RMB million</i>	<i>RMB million</i>	<i>RMB million</i>	<i>RMB million</i>
1. Enhance and upgrade production facilities	26.80/ 27.87	21.97	4.6	9.39
2. Increase the coverage of its marketing and sales network and its customer base in the PRC	4.6/ 4.78	3.77	1.92	—
3. Broaden its product range	2.8/ 2.9	2.33	—	—

The delay in use of proceeds as shown above would not affect the profit earnings level and cashflow of the Company and the Directors are taking very prudent policies and procedures to apply the proceeds. The unused funds will be placed in the interest bearing accounts in a bank in PRC.

DIRECTORS' AND SUPERVISORS' INTERESTS IN THE SHARES, UNDERLYING SHARES AND DEBENTURES OF THE COMPANY

As at 30 June 2006, the interests and short positions of each Directors and supervisors of the Company in the shares, underlying shares and debentures of the Company, as recorded in the register required to be kept by the Company under Section 352 of Part XV of the Securities and Futures Ordinance (the "SFO"), or as otherwise notified to the Company and the Stock Exchange pursuant to Rule 5.46 of the GEM Listing Rules were as follows:

Long position of domestic shares of the Company as at 30 June 2006

Name of Director	Capacity/ Nature of Interest	Number of domestic shares	% of total domestic shares	% of the Company's issued share capital
Liu Baoqi (劉保起) (Note)	Interest of controlled corporation	230,000,000	51.68%	37.73%
Liu Zhenhai (劉振海)	Beneficial Owner	35,000,000	7.86%	5.74%

Note: These 230,000,000 domestic shares are registered in the name of Linyi Luoxin Pharmacy Company Limited ("Linyi Luoxin"). Liu Baoqi (劉保起) is interested in 51.72% of the registered share capital of Linyi Luoxin. As Liu Baoqi (劉保起) is entitled to exercise or control the exercise of one-third or more of the voting power at the general meeting of Linyi Luoxin. For the purpose of the SFO, Liu Baoqi (劉保起) is deemed to be interested in the entire 230,000,000 domestic shares held by Linyi Luoxin.

SUBSTANTIAL SHAREHOLDERS' INTERESTS AND/OR SHORT POSITIONS IN THE SHARES, UNDERLYING SHARES OF THE COMPANY

The register of substantial shareholders (not being a Director or supervisor of the Company) required to be kept under section 336 of Part XV of the SFO shows that as at 30 June 2006, the Company had been notified of the following substantial shareholders' interests and short positions, being 5% or more of the Company's issued share capital. These interests are in addition to those disclosed above in respect of the Directors and supervisors.

Long position of domestic shares of the Company as at 30 June 2006

Name	Capacity/ Nature of Interest	Number of domestic shares	% of total domestic shares	% of the Company's issued share capital
Linyi Luoxin	Beneficial Owner	230,000,000	51.68%	37.73%
Zuo Hongmei (左洪梅)	Family interest (Note 1)	230,000,000	51.68%	37.73%
Cao Tingting (曹婷婷)	Family interest (Notes 2&4)	35,000,000	7.86%	5.74%
Liu Zhendong (劉振東)	Beneficial Owner (Note 4)	35,000,000	7.86%	5.74%
Chen Weiwei (陳偉偉)	Family interest (Notes 3&4)	35,000,000	7.86%	5.74%
Linyi City People's Hospital	Beneficial Owner (Note 4)	34,560,000	7.77%	5.67%
Pinyi County People's Hospital	Beneficial Owner (Note 4)	34,560,000	7.77%	5.67%

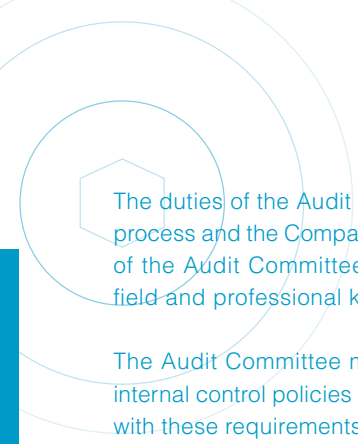


Notes:

1. These 230,000,000 domestic shares are registered in the name of Linyi Luoxin. Linyi Luoxin is owned as to approximately 51.72% by Liu Baoqi (劉保起). As Liu Baoqi (劉保起) is entitled to exercise or control the exercise of one-third or more of the voting power at the general meeting of Linyi Luoxin, for the purpose of the SFO, Liu Baoqi (劉保起) is deemed to be interested in the entire 230,000,000 domestic shares held by Linyi Luoxin. Zuo Hongmei (左洪梅), as wife of Liu Baoqi (劉保起), is taken to be interested in the entire 230,000,000 domestic shares held by Liu Baoqi (劉保起).
2. These 35,000,000 domestic shares are registered in the name of Liu Zhenhai (劉振海), for the purpose of the SFO, Cao Tingting (曹婷婷), as wife of Liu Zhenhai (劉振海), is taken to be interested in the entire 35,000,000 domestic shares held by Liu Zhenhai (劉振海).
3. These 35,000,000 domestic shares are registered in the name of Liu Zhendong (劉振東), for the purpose of the SFO, Chen Weiwei (陳偉偉), as wife of Liu Zhendong (劉振東), is taken to be interested in the entire 35,000,000 domestic shares held by Liu Zhendong (劉振東).
4. Each of Cao Tingting (曹婷婷), Liu Zhendong (劉振東), Chen Weiwei (陳偉偉), Linyi City People's Hospital and Pinyi County People's Hospital are not considered to be a substantial shareholder for the purpose of the GEM Listing Rules as each of them is only interested in less than 10% of the total issued share capital of the Company.

AUDIT COMMITTEE

The Company has established an audit committee (the "Audit Committee") with written terms of reference in compliance with paragraph C.3 of the Code on Corporate Governance Practices as set out in Appendix 15 of the GEM Listing Rules. The audit committee consists of three members, comprising Mr. Foo Tin Chung, Victor, Mr. Fu Hongzheng and Ms. Shao Youmei, all of whom independent non-executive Directors. The chairman of the audit committee is Mr. Foo Tin Chung, Victor.



The duties of the Audit Committee are to review and supervise the financial reporting process and the Company's internal control policies and procedures. The appointments of the Audit Committee members are based on their broad experience in medical field and professional knowledge on financial reporting and management.

The Audit Committee meets regularly to review the financial reporting matters and internal control policies and procedures issues; and see how the Company can comply with these requirements. The Audit Committee also acts as the communication bridge between the Board and the auditors in relation to the planning and scope of audit work. The unaudited interim results of the Company for the Period have been reviewed by the Audit Committee.

CODE ON CORPORATE GOVERNANCE PRACTICES

The Board has reviewed the Company's corporate governance practices and its satisfied that the Company has complied with the Code on Corporate Governance Practices (the "Code") as set out in Appendix 15 of the GEM Listing Rules for the six-months period ended 30 June 2006 save as the deviation disclosed as follows:

Under A.2.1 of the Code, "the roles of chairman and chief executive officer should be separate and should not be performed by the same individual". Mr. Liu Baoqi concurrently takes up the posts of chairman and chief executive officer of the Company. Such deviation is due to the fact that Mr. Liu is the controlling shareholder of the Linyi Luoxin, a promoter and controlling shareholder of the Company. Mr. Liu is one of the most important initial management shareholder of the company. He has extensive professional knowledge and experience in PRC pharmaceutical industry. As the Company has a short history and is still in its development and expansion stage, after careful consideration of the Board, it is of the view that the chairman and chief executive officer should be performed by the same individual.



PURCHASE, SALE OR REDEMPTION OF LISTED SECURITIES

The Company has not redeemed any of its listed securities during the Period. The Company has not purchased or disposed any of the Company's listed securities during the Period.

DIRECTORS' SECURITIES TRANSACTIONS

The Company has adopted a model code of conduct for securities dealings by Directors on terms no less exacting than the required standard of dealings as set out in Rules 5.48 to 5.67 of the GEM Listing Rules. The Company has confirmed, after making specific enquiries with the Directors, the Directors have complied with the required standard of dealings and such code of conduct in relation to securities dealings by Directors for the Period.

COMPETING BUSINESS

Set out below is information disclosed pursuant to paragraph 11.04 of the GEM Listing Rules:

Linyi Luoxin

Liu Baoqi is an executive director and chairman of Linyi Luoxin and a controlling shareholder holding 37.73% of the registered capital of Linyi Luoxin.

Before non-competition undertaking in favour of the Company was signed by Linyi Luoxin on 7 November 2002, Linyi Luoxin was engaged in the sales of chemical medicines, Chinese medicines, medical equipment, health and beauty products. Since the execution of the non-competition undertaking, Linyi Luoxin has undertaken to cease its chemical medicine business. In June 2005, Linyi Luoxin signed a supplementary non-competition undertaking whereby it has undertaken to carry out its sales activities in Linyi City only and confirmed that its customers are small and mid-sized medical institutions which are below county-level hospital. The Company will receive from Linyi Luoxin an annual confirmation in respect of the compliance of these undertakings.



Qingdao Guofeng Group Jiaozhou Pharmacy Limited (“Qingdao Guofeng Jiaozhou”)

Qingdao Guofeng Jiaozhou is a company established in the PRC with limited liability, holding 3.28% of the issued share capital of the Company. It is principally engaged in the sales of Chinese medicines, medical medicines, bio-chemical medicines, medical equipment and health products. To the best knowledge of the Directors, Qingdao Guofeng Jiaozhou has not engaged in the development and manufacture of medicine products and it has no research and development and production capabilities for medicine manufacturing in the PRC.

Qingdao Guofeng Jiaozhou serves as a regional distributor in Qingdao city and Jiaozhou district and procures medicine products from other suppliers in the PRC.

The Directors advised that some of the medicine products sold by Qingdao Guofeng Jiaozhou which have same or similar curative effects with those of the Company may be in competition with the products of Company.

Lijun Group Limited Liability Company (“Lijun Group”)

Lijun Group is a company established in the PRC with limited liability, holding approximately 1.42% of the issued share capital of the Company. Its scope of business mainly includes development, production and sales of Chinese medicines, chemical medicines and medical equipment.

The Directors advised that some of the medicine products sold by Lijun Group which have same or similar curative effects with those of the Company may be in competition with the Company's products.



Linyi Municipal Pharmacy Group Company (“Linyi Municipal Pharmacy”)

Linyi Municipal Pharmacy is a State-owned enterprise established in the PRC, holding approximately 1.42% of the issued share capital of the Company. Linyi Municipal Pharmacy is principally engaged in the sale of Chinese and chemical medicines, medical equipment and health products in Linyi City and nearby districts. To the best knowledge of the Directors, Linyi Municipal Pharmacy has not and will not engage in the development and manufacture of medicine products and it has no research and development and production capabilities for medicine manufacturing in the PRC.

Linyi Municipal Pharmacy serves as a regional distributor in Linyi city and nearby districts, and procures medicine products from other suppliers in the PRC. The Directors advised that some of the medicine products sold by Linyi Municipal Pharmacy which have same or similar curative effects with those of the Company may be in competition with the products of the Company.

Save as disclosed above, none of the Directors, the substantial shareholders of the Company or their respective associates (as defined in the GEM Listing Rules) had any interest in a business which competes or is likely to compete, either directly or indirectly, with the business of the Company.

COMPLIANCE ADVISER’S INTERESTS

As at 30 June 2006, as notified by the Company’s compliance adviser, Kingsway Capital Limited (the “Compliance Adviser”), neither the Compliance Adviser nor any of its directors, employees or associates (as referred to in Note 3 to Rule 6.35 of the GEM Listing Rules) had any interest in the securities of the Company, or any right to subscribe for or to nominate persons to subscribe for the securities of the Company.



Pursuant to the compliance adviser agreement dated 28 November 2005 entered into between the Company and the Compliance Adviser, the Compliance Adviser shall receive a fee for acting as the Company's compliance adviser for the period from 9 December 2005 to 31 March 2008.

By Order of the Board
Shandong Luoxin Pharmacy Stock Co., Ltd.
Liu Baoqi
Chairman

Hong Kong, 8 August 2006