

Dear shareholders,

I am pleased to report the operating results of the Company and its subsidiaries (the "Group") for the six months ended 30 June 2004.

For the six months ended 30 June 2004, pursuant to PRC accounting standards, the revenue from principal operations of the Group was RMB802,136,000 and profit after taxation was RMB27,328,000, representing an increase of 18.42% and decrease of 36.96% respectively, as compared with the amounts achieved for the same period of last year.

The Group achieved a turnover of RMB806,803,000 and profit attributable to shareholders of RMB23,946,000 for the six months ended 30 June 2004 under HKGAAP, representing an increase of 19.11% and decrease of 45.55% respectively, as compared with the amounts achieved for the same period of last year.

The Board did not recommend the payment of an interim dividend for the six months ended 30 June 2004.

REVIEW OF OPERATION

In the first half of 2004, the prices of chemical materials and energy increased a number of times. In contrast, the prices of bulk pharmaceuticals sold by the Company experienced fluctuations, albeit, at low levels. All of these unfavourable factors resulted in an increase in costs and a decrease in gross margin of the Company's products. Meanwhile, the sales of some of the Company's new drugs declined due to the change in price caps on antibiotic medicines enacted by the PRC government. Although the total sales of the Group under PRC accounting standards increased by 18.42% as compared to the same period of last year, the gross margin of the Group was only 18.02%, a decrease of 6.55% as compared to the same period last year. The following sets out major activities and performance of the Group in the first half of 2004:

1. The Company increased its marketing in overseas markets. In the first half of 2004, the output of bulk pharmaceuticals of the Group increased by 12.1% as compared to same period of last year. The revenue generated from the exports was USD41,710,000, an increase of 34.2% as compared to the same period of the previous year and is a record high as compared to corresponding periods of preceding accounting years. The total quantity of bulk pharmaceuticals exported increased by 30.1%. Accordingly, the Company's market share of products in overseas bulk pharmaceuticals markets has increased.
2. The Company continued to improve its competitiveness. In the first half of 2004, the Company obtained the COS certifications of Analgin and Isopropylantipyrene. Except ointments, all other products had passed the GMP authentication. The Company also accomplished 19 foreign customers' quality audits. All of these provided the Company with edges in the marketing of products.
3. At the same time, the Company strengthened corporate management. The Company pursued public bidding for the purchase of raw materials, implemented the budgeted management and encouraged the technological renovation for achieving a higher level of technology. In the first half of 2004, the expenditure for raw materials and energy consumption decreased by RMB4,390,000.
4. The R&D works were picked up. In the first half of 2004, the Company acquired 8 production approvals for new products, such as Class I new drug, triphenyl diamidine, and other preparations from the State Food and Drug Administration. Other 7 new drugs were also approved to come into the stage of clinical research.
5. An analysis of the Group's liquidity, financial resource and capital structure (HKGAAP) is as follows:

As at 30 June 2004, the current ratio and the quick ratio of the Group were 195.97% and 159.16% respectively. The rate of accounts receivable turnover and the rate of stock turnover were 214.98% and 260.47% respectively. The Group maintained good liquidity and has the ability to repay its debts as they fall due.

The Group's demand for funding was not subjected to any seasonal fluctuation.

The capital of the Group comprises mainly of three sources namely, the Group's profits achieved, the proceeds raised from the issue of shares and the loans borrowed from financial institutions. As at 30 June 2004, the Company's total amount of fixed interest rate bank loans was RMB602,803,000 and all the loans could be duly repaid. The capital expenditure commitments of the Company as at 30 June 2004 was RMB68,952,000 and there was no funding requirement. Cash on hand and in bank as at 30 June 2004 amounted to RMB497,288,000. The borrowings, cash and cash equivalents are denominated in Renminbi yuan. The existing deposits of the Company mainly comprises of the proceeds from the issue of new A Shares, working capital and retained profit which will be mainly used in the production, sales, research and development for the Company's products. The Group has stringent internal control system for cash and fund management for purpose of strengthening financial management.

The future plan of material investments of the Company will be funded by proceeds from the issue of new A Shares in 2001.

As at 30 June 2004, the total amount of investments of the Company was RMB80,108,000, including equity investments of RMB30,000,000 in Tiantong Securities Company Limited, RMB24,831,000 in Xinhua-Perrigo Pharmaceutical Company Ltd., RMB13,577,000 in The Bank of Communication and RMB7,000,000 in the Pacific Insurance Corporation. At present, these companies are under normal operations.

As at 30 June 2004, no charge on the Group's assets was made.

The Group's assets and liabilities are denominated in Renminbi. Therefore, it is not necessary for the Group to undertake any hedge against risks associated with foreign exchange fluctuation.

6. Results and Financial Analysis under PRC accounting standards

The Group is mainly engaged in the development, manufacturing and sales of bulk pharmaceuticals, pharmaceutical preparations, chemical products and other products. The profit of the Group is mainly attributable to these businesses.

In the first half of 2004, the Group achieved a turnover of RMB802,136,000, representing an increase of 18.42% as compared to the same period of last year. The increase was mainly attributable to the development of the Group's overseas markets, which lead to the increase in exports volume of the Company's main products. Net cash and cash equivalents increased by RMB83,302,000 as compared to RMB-73,489,000 achieved in the same period of last year. The reason for the rise was mainly due to the increases of borrowings of the Group from financial institutions as compared to that of last year. Profit from principal operations and net profit for the first half of 2004 amounted to RMB143,422,000 and RMB27,328,000 respectively, representing decreases of 12.60% and 36.96% respectively. Such decrease was mainly attributable to the price increase of chemical materials and energy which resulted in increases of costs of products of the Company and a new price-cut policy on antibiotics medicines promulgated by the PRC government which reduced the gross profit of the Company's products.

Total assets of the Group as at 30 June 2004 amounted to RMB2,394,064,000, representing an increase of RMB308,683,000 or 14.80% as compared to that as at 1 January 2004. This increase was mainly due to the increase in the construction in progress and cash in the first half of 2004. The short-term liabilities of the Group as at 30 June 2004 were RMB352,803,000, representing an increase of RMB178,647,000 from the beginning of this year. The total long-term liabilities of the Group as at 30 June 2004 were RMB253,562,000, an increase of RMB50,000,000, from the beginning of this year. Such increase was attributable to demand for working capital arising from the increase in output and sales, the shift of sales pattern and necessity to guarantee the regular operation of the Company. Shareholders' equity of the Company as at 30 June 2004 increased by RMB8,864,000 or 0.63%, as compared to that as at 1 January 2004, to RMB1,422,168,000. This increase was mainly attributable to the profits of the Group achieved in the first half of 2004.

An analysis of the Group's turnover is as follows:

By geographical location of customers	First half of 2004		First half of 2003	
	Total turnover RMB'000	Costs RMB'000	Total turnover RMB'000	Costs RMB'000
PRC (incl. Hong Kong)	520,169	419,677	434,956	320,581
Europe	103,370	87,943	84,008	64,769
America	126,249	112,612	97,541	78,026
Others	52,348	37,367	60,846	47,525
Total	<u>802,136</u>	<u>657,599</u>	<u>677,351</u>	<u>510,901</u>

By products	Income from principal operations RMB'000	Costs of sales of principal operations RMB'000	Gross profit margin (%)
Bulk pharmaceuticals	490,542	409,963	16.43
Preparations	279,854	217,848	22.16
Chemical products and other products	31,740	29,788	6.14
Total	<u>802,136</u>	<u>657,599</u>	<u>18.02</u>

An analysis of the constitution of profit compared to last year is as follows:

Items	Amount(RMB'000)		% of total profit	
	Jan.—Jun. 2004	2003	Jan.—Jun. 2004	2003
Profit from principle business	143,422	292,631	443.34%	580.96%
Profit from other business	925	2,097	2.86%	4.16%
Expenses occurred	117,205	243,491	362.30%	483.40%
Investment income	7,921	781	24.49%	1.55%
Allowance	330	339	1.02%	0.67%
Profit/Loss from non-operation activities	-3,043	-1,986	-9.41%	-3.94%
Profit before taxation	<u>32,350</u>	<u>50,371</u>	<u>100.00%</u>	<u>100.00%</u>

CHAIRMAN'S STATEMENT

- (1) In the reporting period, the reduction in proportion of profit from principle operation to the profit before taxation was mainly attributable to the increase of investment income.
- (2) In the reporting period, the reduction in proportion of expenses to the profit before taxation was mainly attributable to the tightened budget management and expenditure control.
- (3) The reduction in proportion of profit from other business to the profit before taxation were mainly attributable to the decrease in prices of some of materials sold.
- (4) The increase in proportion of the investment income to profit before taxation was mainly attributable to the income of fund investment.

7. Use of Proceeds

On 3 September 2001, the Company raised an amount of RMB370,517,000 from the public offer and issue of 33,000,000 A Shares (including the sales of 3,000,000 State-owned shares). As at 30 June 2004, RMB291,132,000 was used in the following projects:

Name of project	Planned investment RMB'000	Actual investment in 2004 RMB'000	Accumulated amount of investment RMB'000	% of the investment	Remarks
State-level technical center renovation	74,500	—	10,123	13.59%	
Injection GMP renovation	80,000	27,722	57,767	72.21%	
Caffeine technical renovation	160,000	12,120	188,201	117.63%	Completed and invested RMB28,201,000 from internal resources
L-350 technical renovation	29,980	—	23,442	78.19%	Completed
Analgin GMP renovation	39,800	—	46,265	116.24%	Completed and invested RMB6,465,000 from internal resources
Total	<u>384,280</u>	<u>39,842</u>	<u>325,798</u>		

1. State-level technical center renovation project is in the stage of preparation.
2. The construction injection GMP renovation project has been finished and the project has come into the stage of equipment installation.
3. L-350 technical renovation project and Analgin (GMP) renovation project and Caffeine technical renovation has been completed.

The remaining proceeds were deposited with banks and will be used in accordance with the Company's project commitments.

PROSPECTS FOR THE SECOND HALF OF THE YEAR

The primary works of the Company for the second half of 2004 will be focused on the following aspects:

1. Capitalizing on its advantages in scale and techniques, the Company will promote its bulk pharmaceutical products. At the same time, the Company will pay more attention to the sales of new drugs and the establishment of sale channels. Based on enhanced marketing of some of preparations, the Company plans to develop a few of products with each of a turnover of over RMB100,000,000.
2. The Company will continue to strengthen the corporate management to improve profits. The Company will continue to adopt the system of public bidding for the purchase of raw materials to lower the costs of purchase, implement the budgeted management to control expenditure and expenses, encourage technological renovation to improve the technology used in products.
3. Capitalizing on its technical specialties in chemical synthesis, the Company is improving associations with multinational corporations with a view to seeking investment and cooperation on certain products. Through the cooperation with scientific institutions, research and development of the new products are being accelerated.

By order of the Board
He Duanshi
Chairman

28 July 2004
 Zibo, Shandong, PRC