

IV. CHAIRMAN'S STATEMENT

Dear shareholders,

I am pleased to report to you the operating results of Shandong Xinhua Pharmaceutical Company Limited (the "Company") for the six months ended 30 June 2001.

For the six months ended 30 June 2001, the revenue from principal operations of the Company and its subsidiary (the "Group") was RMB571,964,000, and profit after taxation was RMB50,063,000, under PRC accounting standards, representing increases of 3.39% and 15.21% respectively, as compared to the same period last year.

The Group achieved a turnover of RMB571,964,000, and profit attributable to shareholders of RMB50,523,000, for the six months ended 30 June 2001 under HKGAAP, representing increases of 3.39% and 16.66% respectively, as compared to the same period last year.

The Board of Directors of the Company does not recommend any payment of an interim dividend for the six months ended 30 June 2001.

A. Review of operation

Despite keen competition in the Group's market, the production and operations of the Group remained profitable. The profit after taxation of the Group under PRC accounting standards increased by 15.21% as compared to the same period last year.

1. *Improvement of profitability by adjusting to market changes and modifying the product mix*

In the first half of 2001, the Company focused on a strategy of modifying its product mix and continued to implement a policy for balancing production, sales and payments. With internal cooperation among departments, the Company overcame the negative external influences, secured a healthy cycle of production and sales; and achieved a 2.08% increase in gross margin as compared to the same period last year. The sales and marketing department focused on "three majors", mainly main region, main customers and main products, by improving the task of personal visits to clients, contracting clients by telecommunications, and enhancing after-sales services. The Company also built up a rapid-reaction mechanism, which involves the sales department, control department, research department and production department, to fulfil clients' needs faster. In the first half of 2001, the sales of new products and the amount of exports amounted to RMB60,400,000 and USD26,208,000 respectively, representing increases of 19.94% and 13% respectively, as compared to the same period last year.

The output of the Company, especially of antipyretic analgesic drugs such as Analgin and Ibuprofen, increased and the competitiveness of such products was consolidated. Meanwhile, the sales of some products such as Hydrocortisone, Trimethoprim and L-350 etc. increased. The Company also put more emphasis on the marketing of new products such as Baihongyou. Although the price of leading products dropped in the first half of the year, the Group still maintained a 3.39% increase in sales.

The research institute of the Company enhanced the development of new products, in particular the new preparations which form different drug series were enhanced for the purpose of improving the proportion of preparations in the total sales. In the first half of 2001, the Company obtained 3 certifications and production approval for new drugs, including nonsteroidal anti-inflammatory drug Meloxicam both in bulk form and preparations and Clindamycin Phosphate Glucose Injection. The clinical tests of Aspirin Enteric-Coated Sustained-release Tablets, Aspirin and Codeine Tablets, Famotidine Injection were finished. The clinical tests of State II new medicine oral hypoglycemic Glimpiride both in bulk form and tablets were approved and will be finished soon.



2. *Achievement of Targets by strict internal management*

By focusing on financial control, the Company further strengthened its basic management by way of strict cash control, implementation of public tendering throughout the whole of the company and intensive activities carried out for the purpose of increasing revenue and reducing costs. The reduction of costs in the first half of 2001 amounted to RMB940,000, as compared to the same period last year.

The Company enhanced quality management. By enhancing its management and control and modifying each of its quality standard and management systems, the Company implemented GMP. The quality of hardware was up-graded. The management of its software was enhanced. In the first half of 2001, the Company passed the re-examination of ISO9001 quality control certification. The pass rate of its product quality sampling is 100%. The one-tick pass rate for the Company's main bulk pharmaceuticals maintained its continuous increase. There was also a big increase in the rate of superior quality preparations compared to last year. In the first half of the year, there were altogether 15 foreign companies carrying out quality audits on the Company. The Company passed the quality audit assessed by reputable and international companies including GlaxoSmithKline (GSK) and received favourable comment. These have laid the foundation for the development of the Company in overseas market.

In respect of technological innovation, through persistent technological research of different products, the anticipated technical targets of the products such as Hydrocortisone, Isopropylantipyrine were realized. The production yield ratio of the Company's main products was improved and the cost of products was further reduced.

The Company was equally concerned with environmental protection. In the first half of 2001, the Company passed the re-examination of ISO14001 international environment certification.

3. *The analysis of the Group's liquidity and financial resources (under HKGAAP)*

(1) The analysis of the Group's liquidity

As at 30 June 2001, the current ratio of the Company was 186.21%, the quick ratio was 145.48%, the rate of accounts receivable turnover and stock turnover were 496.5% and 472% respectively. The data was a good financial indicator which showed that the Company's capital floating was in good cycle and the realizing and debt paying ability of the Company was adequate.

(2) The Analysis of the Group's financial resources

As at 30 June 2001, the Company had RMB299 million of short-term bank loans. Each loan is a serial bond which will be paid by instalment. The Company has no risk on the short-term bank loans. In the first half of 2001, net cash flow from the operating activities of the Company was RMB79,080,000, which was mainly attributable to the profit made by the Company.

The Company has no apparent seasonal capital requirement.



4. *The capital structure of the Group*

The capital of the Company was mainly attributable to the Company's profits, its bank loans and its issue of shares. Apart from the supervision of professional bodies and security authorities, the Company has formulated a rigorous financial control system to ensure the use of capital is effective and reasonable. For example, there is an overall and strict approval procedure in terms of receipts and payments according to the Standard of Capital Control. Under the requirements of the Standard of Investment, any investment should have a feasibility report prepared that includes the risks and return on investment and which is approved by the board and the general meeting of the Company.

For the time being, the short-term bank loans are at a fixed interest rate which is the same as the basic rate published by the People's Bank of China.

B. **Prospects for the Second Half of the Year**

Focusing on the profitability, the Company will continue to implement the strategy of adjusting the product mix, consolidating the competitiveness of its main products, accelerating its development of new products and increasing its investment in research and development in order to improve its economic results and achieve its target for the year. The Company will focus on the following work:

1. The Company will develop new sources of profit, in particular, developing the supplied material market, and explore markets of new products.
2. The Company will transform caffeine and L-350 etc, by using new methods, new technology and new equipment and will further improve the level of technical input of existing products to increase the competitiveness of the Company.
3. The Company will continue to make technical improvement of individual method for different product and more modifications in technologies to improve production yield ratio and qualities of various products and cut down production costs.
4. Through the additional issue of A Shares, the Company will further increase its investment in research and development in order to develop leading product intellectual property. The Company will speed up the establishment of Bio-Genetic Engineering Institute. The Company will endeavour to develop bio-drugs and genetic-engineering drugs and carry out research into Leuprorelin and L-Asparaginase to speed up the development of the Company.
5. The Company will continue to improve its sales network and accelerate the establishment of chain drugstores and offices. By the end of this year, it is intended that there will be four drug retail stores in operation to improve the Company's drugs retailing and wholesaling.
6. Relying on the competitive advantage of our drugs in the international market, the Company will seek local and international partners, opportunities for cooperation and opportunities for joint ventures in order to build up long term strategic cooperative relationships.

By order of the Board
He Duanshi
Chairman

25 July 2001

