

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 2005.

For the six months ended 30 June 2005, pursuant to PRC accounting standards, the revenue from principal operations of the Group was RMB871,681,000 and profit after taxation was RMB15,621,000, representing an increase of 8.67% and decrease of 42.84% respectively, as compared with the amounts achieved for the same period of last year.

The Group achieved a turnover of RMB878,716,000 and profit attributable to shareholders of RMB13,522,000 for the six months ended 30 June 2005 under HKGAAP, representing an increase of 8.91% and decrease of 43.53% 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 2005.

REVIEW OF OPERATION

In the first half of 2005, the prices of chemical materials, energy and transportation of the PRC still fluctuated at high levels. Despite improvement in market orders to certain extent resulting from the mandatory GMP authentication for pharmaceutical enterprises of the PRC in 2004, the cut throat competition in pharmaceutical market has yet to be improved fundamentally. Certain preparation products of the Group recorded underperformed sales, mainly due to a further decrease in prices of certain medicines proposed by the State Development and Reform Commission which in turn leads to pharmaceutical distributors' view that "to purchase in the case of expected increase in price and not to purchase in the case of expected decreases in price". Encountered with such unfavourable factors, the Group took initiatives to expand its market shares and achieved a further growth in sales. The strengthened corporate management led to improved technical-economic indicators of products. The Group's net profit for the first half of 2005 prepared under the PRC accounting standards and the HKGAAP amounted to RMB15,621,000 and RMB13,522,000 respectively, representing a turnaround in the Group's performance from loss last year.

The following sets out major activities and performance of the Group in the first half of 2005:

1. The Group took advantage of the opportunities in bulk pharmaceuticals market to increase sales and profitability. During the first half of 2005, the Group's sales (prepared under the PRC accounting standards) amounted to RMB871,681,000, representing a year-on-year increase of 8.67%, of which the revenue generated from the exports was USD47,040,000, representing a year-on-year increase of 12.8% and another two-digit growth.

According to market analysis, the Group made timely adjustments to prices of bulk pharmaceuticals. As a result, the Group recorded a gross margin of 18.19% for the first half of 2005, representing a slight increase over 18.02% for the same period last year or 2% increase over 16.19% for 2004. Thus, the gross margin has stopped decreasing further from last year.

2. By strengthening corporate management, the Group has lowered the costs and made operating risks under control. With the progress in key technology projects, approximately RMB11,550,000 was saved in raw material consumption and energy power of the Group for the first half of 2005 as compared with the same period last year. Through promoting efficient utilisation of financial resources, the Group achieved a desirable progress in minimising the occupation of funds in closing inventories which decreased by RMB61,000,000 or approximately 20% from that at the end of last year.

Furthermore, the Group has endeavoured to promote control of operating risks and efficient sales. In the first half of 2005, the Group insisted on the balanced strategy for sales and output. The sales/output ratio amounted to 109.5%, while the cash recovery ratio reached 98%, representing increases of 8% and 5.4% respectively over the corresponding period last year. Net cash flows from operating activities amounted to RMB60,602,000, demonstrating improvement in overall operation of the Group.

3. The Group speeded up its new product development on the market-oriented basis. During the first half of 2005, the Group was granted 4 production approvals for new drugs by the State Food and Drugs Administration of the PRC, as well as the acceptance approvals for Tramadol Hydrochloride Sustained-release Tablets and Paracetamol Dispersible Tablets for compliance with the state standards. In addition, the Group completed a number of development projects of refined chemical products and drugs according to domestic and overseas customer demands. Both the introduction of new drugs and the cooperative production of refined chemical products will become new sources for profits of the Group.
4. The Group has proactively adjusted sales strategy of new finished pharmaceutical products so as to lay foundations for breakthrough of sales volume for finished pharmaceuticals. For the first half of 2005, the strategy of "walking with two legs" for agent and terminal sales was implemented. Reclassification was carried out for new products. For instance, agency system was implemented for those finished pharmaceuticals new products with developed market, while the method of terminal sales was carried out for newly launched products and implement the method of taking delivery of goods against cash payment so as to control operating risk. Also, it is possible to implement consolidation of agent and terminal sales, laying solid foundations for the expansion of sales of finished pharmaceutical products.

5. Liquidity and analysis of financial resources and capital structure (prepared under HKGAAP)

As of 30 June 2005, the liquidity ratio was 119.24%, quick ratio was 95.87%, the annual turnover ratio of account receivables was 255.81% (annual turnover ratio of account receivables = turnover/average account receivables and net value of bills x 100%) and annual turnover ratio of inventory was 264.73% (annual inventory turnover ratio = cost of sales/average net value of inventory x 100%)

There were no significant seasonal effects on the capital demand of the Group.

The sources of capital of the Group mainly included inflow of capital arising from the Group's operation and loans from financial institutions. As at 30 June 2005, the total borrowings of the Group amounted to RMB650,816,000. Apart from loans in the sum of RMB33,929,000 secured by export documentary bills, other outstanding loans were unsecured. As at 30 June 2005, the Company's total amount of fixed interest rate bank loans was RMB390,000,000 and all the loans were being duly repaid in accordance with the terms of the contracts. The capital expenditure commitments of the Company as at 30 June 2005 was RMB53,602,000 and there was no funding requirement. Cash on hand and in bank of the Group as at 30 June 2005 amounted to RMB430,538,000. The main use of the bank deposits of the Company was reserved for the capital requirement of production operation and scientific research and development. The borrowings, cash and cash equivalents are denominated in Renminbi.

The Group has stringent internal control system for cash and fund management for purpose of strengthening financial management. The Group has a sound liquidity and repayment ability.

The Group has introduced or planned to introduce certain new products during the first half of 2005. The details of which are set out in paragraph 3 under the heading "Review of Operation".

For the six months ended 30 June 2005, the Company made an investment of RMB10,000,000 to establish a joint venture company, of which the Company owned 40% of its registered capital. We are confident on the prospects of the above company. Apart from the above transaction, the Group has not made material investments, acquisitions or disposals during this reporting period.

The segmental results of the Group can be referred to paragraph 6 "Results and Financial Analysis" set out in this section.

As at 30 June 2005, the number of employees of the Group amounted to 4,701. The total salaries for employees in the first half of 2005 amounted to RMB41,652,000.

As of 30 June 2005, except the export documentary bills pledged to banks for loans in the sum of RMB33,929,000 as disclosed in paragraph 5, no other assets of the Group were pledged or charged.

There was no significant investment projects in the future plans of the Company.

The capital debt ratio of the Group was 47.06%. (capital debt ratio = total loans/share capital and total reserve x 100%).

The assets and debts of the Group were mainly denominated in Renminbi. Therefore, the Group was not subject to significant foreign exchange fluctuation. No financial instruments are used for hedging purposes.

As of 30 June 2005, the Company has no contingent liabilities.

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 2005, the Group achieved a turnover of RMB871,681,000, representing an increase of 8.67% as compared to the same period of last year. The increase in revenue from principal operations was mainly attributable to the Group's ability in grasping the market opportunities of raw medicine by timely adjustment in product prices and expansion of their sales. Net cash and cash equivalents increased by RMB92,605,000 as compared to RMB83,302,000 achieved in the same period of last year. The reason for the rise was mainly due to the increase in borrowings of the Group from financial institutions as compared to that of last year. Profit from principal operations for the first half of 2005 amounted to RMB154,498,000, representing an increase of 7.72%. The main reasons for the increase were that the Group made accurate decisions according to market situation and adjusted product prices as well as expanded their sales. Net profit for the first half of 2005 amounted to RMB15,621,000 representing a decrease of 42.84%. The main reasons for the decrease was the expansion of the sales of finished pharmaceuticals and the injection of capital into advertisement and market development and the decrease of investment income as compared with the corresponding period last year.

Total assets of the Group as at 30 June 2005 amounted to RMB2,406,771,000, representing an increase of RMB108,301,000 or 4.71% as compared to that as at 1 January 2005. This increase was mainly due to the increase in cash in the first half of 2005. The short-term liabilities of the Group as at 30 June 2005 were RMB400,816,000, representing an increase of RMB94,531,000 from the beginning of this year. Such increase was attributable to demand for working capital and necessity to guarantee the regular operation of the Company. Shareholders' equity of the Company as at 30 June 2005 increased by RMB15,621,000 or 1.17%, as compared to that as at 1 January 2005, to RMB1,355,626,000. This increase was mainly attributable to the profits of the Group achieved in the first half of 2005.

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

By geographical location of customers	First half of 2005		First half of 2004	
	Total turnover RMB'000	Costs RMB'000	Total turnover RMB'000	Costs RMB'000
PRC (incl. Hong Kong)	618,773	505,383	520,169	419,677
Europe	123,210	105,089	103,370	87,943
America	78,074	69,431	126,249	112,612
Others	51,624	33,246	52,348	37,367
Total	871,681	713,149	802,136	657,599
By products	Income from principal operations RMB'000		Costs of sales of principal operations RMB'000	
			Gross profit margin (%)	
Bulk pharmaceuticals	515,740		419,868	
Preparations	153,590		93,418	
Medical commercial logistics	194,768		190,676	
Chemical products and other products	7,583		9,187	
Total	871,681		713,149	

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

Items	Amount (RMB'000)		% of total profit	
	Jan. – Jun. 2005	2004	Jan. – Jun. 2005	2004
Profit from principle business	154,498	234,801	758.53	(458.20)
Profit from other business	1,097	3,068	5.39	(5.99)
Expenses occurred	137,202	273,869	673.62	(534.43)
Investment income	1,185	(15,721)	5.82	30.68
Allowance	215	1,099	1.06	(2.14)
Profit/Loss from non-operation activities	575	(623)	2.82	1.22
Profit before taxation	20,368	(51,245)	100.00	100.00

The significant change in proportion of revenue and expense over total profit is mainly attributable to the conversion of losses to profits in the first half of 2005.

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 2005, RMB320,056,000 has been used in the following projects:

Name of project	Planned investment RMB'000	Actual investment in 2005 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	2,348	80,227	100.28%	completed
Caffeine technical renovation	160,000	—	188,201	117.63%	completed
L-350 technical renovation	29,980	—	23,442	78.19%	completed
Analgin GMP renovation	39,800	—	46,265	116.24%	completed
Total	<u>384,280</u>	<u>2,348</u>	<u>348,258</u>		

- (1) Analgin (GMP) renovation project, L-350 technical renovation project and Caffeine technical renovation has been completed. According to keen market competition, the decrease in product prices and the significant increase in prices of chemical materials technical renovation was not able to reach the profit forecast.
- (2) The construction injection GMP renovation project has been finished and the project has come into the stage of equipment installation.
- (3) State-level technical center renovation project is in the stage of preparation.

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 trend of pharmaceutical market of the second half of the 2005 is not optimistic. The expenses on raw materials, transportation and energy price will remain at high levels. The development of pharmaceutical enterprise will be hindered since there was adverse impact such as prediction of price decrease of pharmaceutical products. The principle plans for the second half of the year are as follows:

1. The Group will conduct research on the trend of pharmaceutical market in order to adjust its sales strategy timely. The Group will consolidate and enhance the leading position of chemical raw pharmaceutical market; the Group will secure the co-operative relations with strategic partners; the Group will expand the domestic and overseas sales scale of raw medicines; the Group will promote sales of newly finished pharmaceutical products; the Group will maintain stable relationship with agents and develop sales strategy of terminal network. The Group will endeavor to realize sales of newly finished pharmaceutical products to achieve a breakthrough.
2. The Group will continue to maintain strict internal management and enhance quality and efficiency. Grasping the chance of various types of checking and quality measurement so as to reinforce internal management and upgrade the level of software and hardware and to increase the quality of staff as a whole. Technological research and development will be accelerated to cater to the needs of the market. Internal auditing will be strengthened and expenses and risks will be strictly controlled.
3. The Group will proactively communicate and interact with foreign investors in order to seek for opportunity of joint-venture and cooperation and further pave for international development.
4. The Group will concentrate manpower and resources to prepare the eleventh five-year plan of the Group in order to figure out a blueprint for the coming five years for further development.

By order of the Board
He Duanshi
 Chairman

28 July 2005
 Zibo, Shandong, PRC