

FINANCIAL REPORT

(PREPARED UNDER PRC ACCOUNTING STANDARDS)

FINANCIAL REPORT PREPARED IN CONFORMITY WITH PRC ACCOUNTING STANDARDS FOR THE SIX MONTHS ENDED 30 JUNE 2005 (UNAUDITED)

Balance Sheet

Unit: RMB

	NOTES	Consolidated 2005.6.30	2004.12.31	Parent company 2005.6.30	2004.12.31
ASSETS					
CURRENT ASSETS					
Monetary Fund	5	430,538,051.84	337,932,575.24	419,492,937.30	323,545,736.94
Short-term investments	6	58,038,949.76	58,551,045.76	58,038,949.76	58,551,045.76
Notes receivable	7	32,294,554.33	28,870,092.76	31,899,554.33	28,660,092.76
Dividend receivable		—	—	—	—
Interest receivable		1,462,500.00	1,444,444.00	1,462,500.00	1,444,444.00
Accounts receivable	8	330,580,114.59	296,192,621.26	316,650,367.97	283,943,132.74
Other receivables	9	114,223,068.38	77,671,056.92	117,186,540.01	108,793,599.17
Accounts Prepaid	10	13,426,903.19	12,825,964.23	8,680,857.55	8,957,899.72
Inventories	11	238,677,068.65	300,253,329.37	207,235,914.46	277,128,704.51
Deferred and prepaid expenses		—	—	—	—
Long-term debt investment due within a year		—	—	—	—
Other current assets		—	—	—	—
Total current assets		1,219,241,210.74	1,113,741,129.54	1,160,647,621.38	1,091,024,655.60
LONG-TERM INVESTMENTS					
Long-term equity investment	12	73,513,102.23	64,726,261.98	127,497,231.40	77,273,887.97
Long-term debt investment	12	130,075,500.00	130,075,500.00	130,075,500.00	130,075,500.00
Total long-term investments		203,588,602.23	194,801,761.98	257,572,731.40	207,349,387.97
FIXED ASSETS					
Fixed assets - cost	13	1,522,879,390.90	1,421,114,352.36	1,503,460,519.49	1,418,170,280.95
Less: accumulated depreciation	13	769,497,472.78	724,520,511.74	767,531,540.22	723,112,871.35
Fixed assets net	13	753,381,918.12	696,593,840.62	735,928,979.27	695,057,409.60
Less: Provision for impairment fixed assets		—	—	—	—
Fixed assets net	13	753,381,918.12	696,593,840.62	735,928,979.27	695,057,409.60
Construction materials		14,293,547.60	14,293,547.60	14,293,547.60	14,293,547.60
Construction-in-progress	14	118,091,092.40	206,870,058.53	118,091,092.40	206,870,058.53
Total fixed assets		885,766,558.12	917,757,446.75	868,313,619.27	916,221,015.73
INTANGIBLE ASSETS AND OTHER ASSETS					
Intangible assets	15	98,174,399.78	72,169,207.78	98,174,399.78	72,169,207.78
Long-term prepayments		—	—	—	—
Other long-term assets		—	—	—	—
Total intangible assets and other assets		98,174,399.78	72,169,207.78	98,174,399.78	72,169,207.78
DEFERED TAX					
Deferred tax debit		—	—	—	—
TOTAL ASSETS		2,406,770,770.87	2,298,469,546.05	2,384,708,371.83	2,286,764,267.08

		Consolidated		Parent company	
	NOTES	2005.6.30	2004.12.31	2005.6.30	2004.12.31
LIABILITIES AND CAPITAL					
CURRENT LIABILITIES					
Short-term loans	16	400,815,773.32	306,285,118.06	400,815,773.32	306,285,118.06
Notes payable	17	189,192,735.50	144,460,492.70	189,192,735.50	144,460,492.70
Accounts payable	18	116,423,528.33	163,308,798.87	97,348,810.94	156,581,861.49
Deposits from customers	19	10,150,354.26	11,126,030.12	9,539,696.16	11,077,943.20
Accrued payroll		—	—	—	—
Welfare & benefit payable		17,258,692.63	15,297,220.79	17,258,692.63	15,297,220.79
Dividends payable	20	5,795,230.54	6,073,630.54	5,795,230.54	6,073,630.54
Taxes payable	21	5,012,342.79	(5,579,213.68)	6,689,831.05	(6,379,216.56)
Other payments		—	—	—	—
Other payables	22	45,448,609.43	57,825,185.31	45,242,594.62	57,621,504.00
Accrued expenses	23	4,978,530.14	3,201,240.13	4,978,530.14	3,201,240.13
Estimated liabilities		—	—	—	—
Long term liabilities		—	—	—	—
due within one year	24	250,000,000.00	250,000,000.00	250,000,000.00	250,000,000.00
Other current liabilities		—	—	—	—
Total current liabilities		1,045,075,796.94	951,998,502.84	1,026,861,894.90	944,219,794.35
LONG-TERM LIABILITIES					
Long-term borrowings		—	—	—	—
Bonds payable		—	—	—	—
Long-term payable		—	—	—	—
Other long-term liabilities		3,561,500.00	3,561,500.00	3,561,500.00	3,561,500.00
Total long term liabilities		3,561,500.00	3,561,500.00	3,561,500.00	3,561,500.00
DEFERED TAX					
Deferred tax credit		—	—	—	—
Total liabilities		1,048,637,296.94	955,560,002.84	1,030,423,394.90	947,781,294.35
MINORITY SHAREHOLDERS' EQUITY					
Minority Shareholders' Equity		2,507,657.82	2,904,738.72	—	—
SHARE CAPITAL EQUITY					
Share capital	25	457,312,830.00	457,312,830.00	457,312,830.00	457,312,830.00
Capital surplus	26	558,919,077.15	558,919,077.15	558,919,077.15	558,919,077.15
Surplus reserve	27	159,424,924.74	159,424,924.74	159,216,915.99	159,216,915.99
Including: welfare fund	27	26,291,986.91	26,291,986.91	26,222,650.66	26,222,650.66
Undistributed profit	28	178,624,067.33	163,003,055.71	178,836,153.79	163,534,149.59
Including: Dividend in cash to be distributed		—	—	—	—
Foreign currency statement translation difference		1,344,916.89	1,344,916.89	—	—
Total share capital equity		1,355,625,816.11	1,340,004,804.49	1,354,284,976.93	1,338,982,972.73
TOTAL LIABILITIES & STOCKHOLDERS EQUITY		2,406,770,770.87	2,298,469,546.05	2,384,708,371.83	2,286,764,267.08

FINANCIAL REPORT

(PREPARED UNDER PRC ACCOUNTING STANDARDS)

Profit and loss account and profit distribution

Unit: RMB

Items	NOTES	Consolidated		Parent company	
		First half of 2005	First half of 2004	First half of 2005	First half of 2004
1. Revenue from main operations	29	871,680,519.30	802,135,952.14	741,496,995.87	793,136,879.49
Less: Cost of main operations	29	713,149,027.81	657,599,222.75	586,502,541.48	650,696,394.50
Tax and surcharges for main operations	30	4,033,027.95	1,114,858.70	3,888,831.39	1,051,788.30
2. Sales gross profit		154,498,463.54	143,421,870.69	151,105,623.00	141,388,696.69
Add: Profit on other operations	31	1,097,489.84	925,007.40	1,097,489.84	925,007.40
Less: Operating expenses		74,315,157.29	61,696,743.26	71,639,549.11	59,683,583.67
General and administrative expenses		53,509,586.99	50,508,252.83	52,180,364.87	49,864,425.65
Financial expenses	32	9,377,589.34	4,999,548.94	9,385,297.65	5,008,049.27
3. Operating profit		18,393,619.76	27,142,333.06	18,997,901.21	27,757,645.50
Add: Investment income	33	1,185,181.79	7,920,965.43	332,341.67	7,384,357.54
Revenue from subsidies		214,926.08	330,057.11	214,926.08	330,057.11
Non-operating income	34	1,126,875.20	1,408,762.00	1,126,875.20	1,408,762.00
Less: Non-operating expenses	35	552,189.34	4,452,144.19	552,189.34	4,450,244.19
4. Profit before income tax		20,368,413.49	32,349,973.41	20,119,854.82	32,430,577.96
Less: Income tax		4,918,107.50	5,109,369.33	4,817,850.62	5,102,471.00
Minority profit		(170,705.63)	(87,502.88)	—	—
5. Profit after tax		15,621,011.62	27,328,106.96	15,302,004.20	27,328,106.96
Add: Undistributed profit at beginning of the year		163,003,055.71	236,903,608.28	163,534,149.59	237,111,617.03
Other transfer		—	—	—	—
6. Distributable profit		178,624,067.33	264,231,715.24	178,836,153.79	264,439,723.99
Less: Appropriation of statutory surplus reserve		—	—	—	—
Appropriation of statutory welfare fund		—	—	—	—
7. Profit available for distribution to shareholders		178,624,067.33	264,231,715.24	178,836,153.79	264,439,723.99
Less: Appropriation of discretionary surplus reserve		—	—	—	—
General dividend payable		—	18,292,513.20	—	18,292,513.20
8. Undistributed profit at the end of the period	28	178,624,067.33	245,939,202.04	178,836,153.79	246,147,210.79

ANNOTATIONS

1. Income from selling / disposing departments or companies that received investment	—	—	—	—
2. Loss from natural disaster	—	—	—	—
3. Increase (decrease) of the total profit due to changes of accounting policy	—	—	—	—
4. Increase (decrease) of the total profit due to changes of accounting estimation	—	—	—	—
5. Loss from recombining of debts	—	—	—	—
6. Others	—	—	—	—

Statement of Cash flow
Unit: RMB

Items	First half of 2005	
	Consolidated	Parent company
1. CASH FLOW FROM OPERATING ACTIVITIES		
Cash received from sales of goods or rendering of services	654,450,880.61	582,119,438.75
Refund of taxes and levies	9,606,081.61	9,606,081.61
Cash received from other operating activities	3,894,831.57	4,829,655.50
SUB-TOTAL OF CASH INFLOWS	667,951,793.79	596,555,175.86
Cash paid for goods and services	430,192,703.89	359,865,306.09
Cash paid to and on behalf of employees	58,892,182.11	58,238,906.74
Taxes paid	25,052,747.06	23,040,249.48
Cash paid relating to other operating activities	93,211,937.95	91,538,067.01
SUB-TOTAL OF CASH OUTFLOWS	607,349,571.01	532,682,529.32
NET CASH FLOWS FROM OPERATING ACTIVITIES	60,602,222.78	63,872,646.54
2. CASH FLOWS FROM INVESTING ACTIVITIES		
Cash received from return of investment	—	—
Cash received from distribution of investment profit	3,231,944.44	3,231,944.44
Net cash received from disposal of fixed assets, intangible assets and other long-term assets	747,940.00	747,940.00
Other cash received relating to investing activities	—	—
SUB-TOTAL OF CASH INFLOWS	3,979,884.44	3,979,884.44
Cash paid to acquire fixed assets, intangible assets and other long-term assets	47,106,655.05	47,035,355.05
Cash paid to investment	10,000,000.00	10,000,000.00
Other cash paid relating to investing activities	—	—
SUB-TOTAL OF CASH OUTFLOWS	57,106,655.05	57,035,355.05
NET CASH FLOWS FROM INVESTING ACTIVITIES	(53,126,770.61)	(53,055,470.61)
3. CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issuing shares and issuing bonds Including: cash received by the subsidiaries by absorbing the minorities' equity investment	—	—
Proceeds from borrowings	217,184,530.67	217,184,530.67
Cash received from other financing activities	825,646.63	825,646.63
SUB-TOTAL OF CASH INFLOWS	218,010,177.30	218,010,177.30
Repayment of borrowings	122,745,246.30	122,745,246.30
Distribution of dividends or profits and interest expenses	10,134,906.57	10,134,906.57
Payment of expenses on financing activities	—	—
SUB-TOTAL OF CASH OUTFLOWS	132,880,152.87	132,880,152.87
NET CASH FLOWS FROM FINANCING ACTIVITIES	85,130,024.43	85,130,024.43
4. EFFECT OF FOREIGN EXCHANGE RATE CHANGES ON CASH	—	—
5. NET INCREASE IN CASH AND CASH EQUIVALENTS	92,605,476.60	95,947,200.36

ANNOTATIONS

Items	First half of 2005	
	Consolidated	Parent company
1. RECONCILIATION OF NET PROFIT TO CASH FLOWS FROM OPERATING ACTIVITIES		
Net profit	15,621,011.62	15,302,004.20
Add: Minority profit	(170,705.63)	—
Provisions for impairment of assets	—	—
Depreciation of fixed assets	46,356,244.16	45,797,951.99
Amortization of intangible assets	1,770,833.00	1,770,833.00
Increase / (decrease) in accrued expenses	1,777,290.01	1,777,290.01
Loss / (gain) on disposal of fixed assets intangible assets and other long-term assets	(956,842.89)	(956,842.89)
Loss of fixed asset written off	—	—
Financial expenses	9,377,589.34	9,385,297.65
Loss / (gain) arising from investments	(1,185,181.79)	(332,341.67)
Deferred tax credits (or deduct: debit)	—	—
Decrease / (increase) in inventories	61,576,260.72	69,892,790.05
Decrease / (increase) in receivables	(76,516,526.93)	(82,151,780.52)
Increase / (decrease) in payables	2,952,251.17	3,387,444.72
Others	—	—
Net cash flows from operating activities	60,602,222.78	63,872,646.54
2. INVESTING AND FINANCING ACTIVITIES THAT DO NOT INVOLVE CASH RECEIPTS AND PAYMENTS		
Conversion of debt into capital	—	—
Convertible bonds expiring within one year	—	—
Fixed assets under finance lease	—	—
3. NET INCREASE IN CASH AND CASH EQUIVALENTS		
Cash at end of the period	430,538,051.84	419,492,937.30
Less: cash at beginning of the period	337,932,575.24	323,545,736.94
Add: cash equivalents at end of the period	—	—
Less: cash equivalents at beginning of the period	—	—
Net increase in cash and cash equivalents	92,605,476.60	95,947,200.36

Appendix to the Profit and Loss Account prepared in conformity

Reported Profit	Return on equity (%)				Earnings per share (RMB)			
	Fully diluted		Weighted average		Fully diluted		Weighted average	
	First half of 2005	First half of 2004	First half of 2005	First half of 2004	First half of 2005	First half of 2004	First half of 2005	First half of 2004
Profit from principal operations	11.40	10.08	11.46	10.05	0.338	0.314	0.338	0.314
Operating profit	1.36	1.91	1.36	1.90	0.040	0.059	0.040	0.059
Profit after taxation	1.15	1.92	1.16	1.92	0.034	0.060	0.034	0.060
Profit after taxation and extraordinary items	0.94	1.65	0.95	1.64	0.028	0.051	0.028	0.051

STATEMENT OF PROVISION FOR THE PERIOD FROM 1 JANUARY TO 30 JUNE 2005 (CONSOLIDATED).
Unit: RMB

Items	2004.12.31	Addition for current period	Reversal for current period	Transferred out	2005.6.30
1. Provision for bad debts	25,593,193.70	—	156,965.72	—	25,750,159.42
Including: Account Receivable	21,832,587.35	—	156,965.72	—	21,989,553.07
Other Receivable	3,760,606.35	—	—	—	3,760,606.35
2. Provision for loss on short-term investment	11,448,954.24	—	—	1,884,980.13	9,563,974.11
Including: Stock investment	—	—	—	—	—
Bond investment	11,448,954.24	—	—	1,884,980.13	9,563,974.11
3. Provision for loss on realisation of inventories	2,506,110.99	—	—	—	2,506,110.99
Including: Goods on hand	2,506,110.99	—	—	—	2,506,110.99
Raw materials	—	—	—	—	—
4. Provision for impairment on long-term investment	12,000,000.00	—	—	—	12,000,000.00
Including: Investment in equity	12,000,000.00	—	—	—	12,000,000.00
Investment in bonds	—	—	—	—	—
5. Provision for loss of fixed assets	—	—	—	—	—
Including: Plant & building	—	—	—	—	—
Equipment & others	—	—	—	—	—
6. Provision for impairment of intangible assets	—	—	—	—	—
Including: Patents	—	—	—	—	—
Trademark	—	—	—	—	—
7. Provision for impairment of construction in progress	—	—	—	—	—
8. Provision for impairment of designated loan receivable	—	—	—	—	—
9. Total	51,548,258.93	—	156,965.72	1,884,980.13	49,820,244.52

FINANCIAL REPORT

(PREPARED UNDER PRC ACCOUNTING STANDARDS)

STATEMENT OF PROVISION FOR THE PERIOD FROM 1 JANUARY TO 30 JUNE 2005 (Parent company)

Unit: RMB

Items	2004.12.31	Addition for current period	Reversal for current period	Transferred out	2005.6.30
1. Provision for bad debts	25,519,509.55	—	156,965.72	—	25,676,475.27
Including: Account Receivable	21,758,903.20	—	156,965.72	—	21,915,868.92
Other Receivable	3,760,606.35	—	—	—	3,760,606.35
2. Provision for loss on short-term investment	11,448,954.24	—	—	1,884,980.13	9,563,974.11
Including: Stock investments	—	—	—	—	—
Bond investments	11,448,954.24	—	—	1,884,980.13	9,563,974.11
3. Provision for loss on realisation of inventories	2,506,110.99	—	—	—	2,506,110.99
Including: Goods on hand	2,506,110.99	—	—	—	2,506,110.99
Raw materials	—	—	—	—	—
4. Provision for loss on long-term investment	12,000,000.00	—	—	—	12,000,000.00
Including: Long-term equity investment	12,000,000.00	—	—	—	12,000,000.00
Long-term debit investment	—	—	—	—	—
5. Total amounts provided for impairment of fixed assets	—	—	—	—	—
Including: Plant & building	—	—	—	—	—
Equipment & others	—	—	—	—	—
6. Provision for impairment of intangible assets	—	—	—	—	—
Including: Patents	—	—	—	—	—
Trademark	—	—	—	—	—
7. Provision for impairment of construction in progress	—	—	—	—	—
8. Provision for impairment of designated loan receivable	—	—	—	—	—
9. Total	51,474,574.78	—	156,965.72	1,884,980.13	49,746,560.37

NOTES TO THE ACCOUNTS (UNLESS OTHERWISE INDICATED, ALL FIGURES ARE STATED IN RMB'000)

1. Status of The Company

Shandong Xinhua Pharmaceutical Company Limited (hereinafter referred to as the “Company”) was established in 1993 as the result of the reorganization of Shandong Xinhua Pharmaceutical Factory. The Company issued its H Shares at Hong Kong Stock Exchange in December 1996 and listed its A Shares at Shenzhen Stock Exchange in July 1997. The Company became a foreign invested joint stock company in November 1998 upon approval by the Ministry of Foreign Trade and Economic Cooperation of P.R. China. The Company issued additional 30 million ordinary A shares as approved and decreased 3 million state-held shares in September 2001.

The registered capital of the Company as of 30 June 2005 was RMB457.31 million and its share capital as of 30 June 2005 consists of the following:

	No. of shares	Amount	Ratio
State held shares	214,440,000	214,440	46.89%
Legal-person shares	16,720,000	16,720	3.66%
Publicly-held H shares	150,000,000	150,000	32.80%
Publicly-held A shares	76,153,000	76,153	16.65%
Total	<u>457,313,000</u>	<u>457,313</u>	<u>100%</u>

The Company is mainly engaged in developing, manufacturing and selling bulk pharmaceuticals, preparations and chemicals products.

According to the Circular “Lu Ke Gao Zi (2001) No. 647” issued by Shandong Provincial Bureau of Science & Technology, the Company has been recognized as a new and high-tech company.

The Company’s place of registration is the Chemical Area in Zibo New and High Technology Industrial Development Zone, Shandong Province.

2. Basis of Presentation

2.1 Financial statements have been prepared in conformity with the Accounting Principles for Business Enterprises and the Accounting System for Business Enterprises promulgated by the Ministry of Finance.

2.2 Methods of preparing consolidated financial statements

2.2.1 Scope of consolidation: The consolidated financial statements include the financial statements of the Company and its subsidiaries in which the Company holds 50% or more of the voting capital, or holds less than 50% of the voting capital but exercises control over them.

2.2.2 Consolidated financial statements have been prepared in accordance with the Provisional Regulations on Consolidated Financial Statements and relevant supplementary regulations issued by MOF. All significant transactions and balances between the Company and its subsidiaries are eliminated for the purpose of consolidation.

3 Significant Accounting Policies and Accounting Estimates

3.1 Accounting period

The accounting period of the Company is from 1 January to 31 December of the Gregorian calendar year.

3.2 Principles of Accounting and basis of valuation

Financial statements have been prepared on an accrual basis and all the assets are stated at historical cost unless otherwise indicated.

3.3 Reporting currency

The Company uses RMB as its reporting currency.

3.4 Foreign currency translation

Foreign currency transactions for the year are translated into RMB at the rate of exchange quoted by the People's Bank of China on the first day of the month in which the transactions occurred. Foreign currency monetary assets and liabilities are translated into RMB at the rate of exchange prevailing at the balance sheet date. The resulting exchange differences are accounted for as exchange gains or losses of the period, the differences arising from the organization period are accounted for as long-term prepaid expenses, and the difference arising from borrowings related to the acquisition or construction of a fixed asset are treated according to the Principle of Capitalization of Borrowing Costs.

3.5 Cash equivalents

Cash equivalents are short-term (usually due within three months from the date of purchase), highly liquid investments that are readily convertible to known amounts of cash and subject to an insignificant risk of changes in value.

3.6 Short-term investments

3.6.1 Short-term investments are recorded at the cost of acquisition. The cost of a short-term investment acquired in cash is determined based on the total amount paid after deductions of cash dividends that are declared but not received or interest on bonds. The cost of a short-term investment made by investors is determined based on the amount as agreed by all the investors concerned.

3.6.2 Dividends and interests on short-term investments during the holding period are reported as reductions of the cost of investments when received, and not recognized as investment income. Proceeds from sale of short-term investments net of their carrying amount and dividends and interests accrued but not received are recorded as investment income or loss for the period.

3.6.3 Short-term investments are stated at the lower of cost or market value at the end of the accounting period. A provision for short-term investment impairment is made on any difference between the cost and lower market value at the end of the period usually on the item-by-item basis.

3.7 Accounting for bad debt losses

3.7.1 Allowance for doubtful accounts is made when: (a) the debtor is dissolved or declared bankruptcy or becomes insolvent or is badly in short of cash flows, or it ceases production due to the occurrence of a severe natural disaster and therefore cannot repay its debt in the foreseeable future; (b) the debtor has not serviced its debts due for over 3 years; and (c) there is other absolute proof that the debts cannot be recovered or are least likely to be recovered.

3.7.2 Bad debt losses are accounted for using the allowance method. Allowance for doubtful accounts is made on the aging basis at the end of the period, and reported in the income statement of the period. Accounts receivables that cannot be recovered has been written off as bad debt losses after approval at the board of directors' or stockholders' meeting, and reported as reductions of allowance for doubtful accounts.

Allowance for doubtful accounts is made as follows:

Aging of accounts	Ratio
Less than 1 year	0.5%
1 to 2 years	20%
2 to 3 years	60%
Over 3 years	100%

Allowance for doubtful accounts for miscellaneous receivables (other than those from related parties) is made in the same way as for accounts receivables. Allowance for special receivables is made after assessing their collectibility.

3.8 Inventories

Inventories mainly include raw materials, work-in-process, finished products, goods in stock, low-value consumables and packaging materials.

3.8.1 Raw materials are stated at the cost of purchase price plus freight, loading and unloading charges, and insurance premiums. The cost of self-made semi-products and finished products include various expenditures actually incurred during production.

3.8.2 The valuation of raw materials, self-made semi-products and finished products is made on a weighted-average basis when they are shipped and sold.

3.8.3 Low-value-consumables and packaging materials are expensed as incurred.

3.8.4 Inventories are stated at the lower of cost or market value at the end of the period. When the cost of inventories is higher than their recoverable amount because they are damaged, completely or partially obsolescent, or with a selling price lower than the cost, a provision for inventory write-down is made after a thorough examination of inventories at the end of the period. The provision is made on the difference between the cost of inventory items and their lower net realizable value on an item-by-item basis. Net realizable value refers to the amount of an estimated selling price less the estimated costs of completion and estimated selling expenses and taxes.

3.9 Long-term investments

Long-term investments include long-term equity investments and long-term debt investments.

3.9.1 Long-term equity investments

3.9.1.1 The initial cost of long-term equity investments is the total amount paid or determined on acquisition. The Company applies the cost method for long-term investments when it holds less than 20% of the voting capital of the investee company, or it holds 20% or more but does not have significant influence over the investee company. The equity method applies when the Company holds 20% or more of the voting capital of the investee company, or it holds less than 20% but exercises significant influence over the invested company.

3.9.1.2 The difference between the initial investment cost and the Company's share of shareholder's equity of the investee company is treated as excess cost over book value acquired, and accounted for as follows: If the initial investment cost is greater than the Company's share of the shareholder's equity of the investee company, the difference is amortized and reported in the income statement over a defined period. If the investment period is specified in the contract, the difference is amortized evenly over the period. If the investment period is not specified in the contract, the difference is amortized evenly over a period of no more than 10 years. If the initial investment cost is less than the Company's share of the shareholder's equity of the investee company, the difference is recognized in the capital reserve account.

3.9.2 Long-term debt investments

3.9.2.1 The initial cost of long-term debt investment is the total amount paid on acquisition. The initial cost of long-term debt investment acquired in cash is the total amount paid less interest on bonds accrued yet not received. Interest on bonds is accrued and included in investment income on the accrual basis.

3.9.2.2 The difference between 1) the initial cost of a long-term bond investment less related expenses and interest due but not received and interest accrued yet not due, and 2) the face amount of bonds is treated by the Company as premium or discount on the bond investment. The premium or discount is amortized on a straight-line basis over the period in which the investment is held when interest revenue is recognized.

3.9.3 If the recoverable amount of the investment is lower than its carrying amount as a result of a continuing decline in market value or changes in operating conditions of the investee company and is irrecoverable in the foreseeable future, the Company provides for the impairment of long-term investments for the difference between the recoverable amount and the carrying amount of the investment.

3.10 Fixed assets and construction-in-progress

3.10.1 Fixed assets

3.10.1.1 Fixed assets include buildings, machinery equipment, and transportation equipment. Fixed assets are assets with a useful life over one year, such as buildings and other major equipment used in production, and those that are not major equipment used in production but with a unit value over RMB2,000 and useful live over 2 years.

3.10.1.2 Fixed assets are recorded at the cost of acquisition. The cost of fixed assets purchased include the purchasing price, VAT, import duty, and other expenditures necessary to bring the fixed assets into their usable conditions. Fixed assets invested by investors are recorded at an amount as agreed upon by all the investors concerned.

- 3.10.1.3 Fixed assets (excluding those fully depreciated yet still used in operation) are depreciated on a straight-line basis with the estimated net residual value at 5%. The life and rate of depreciation for different classes of fixed assets are as follows:

Type of fixed assets	Depreciation life	Annual depreciation rate
Buildings & constructions	20 Years	4.75%
Machinery & equipment	10 Years	9.5%
Electronic apparatus	5 Years	19%
Office equipment and vehicles	5 Years	19%

- 3.10.1.4 The Company provides for impairment of the fixed assets that are actually impaired (e.g., because of excessive capacity, longtime inefficient utilization, significantly decrease in replacement value, return on fixed assets much lower than the normal return of funds), based on the excess of the carrying amount of the assets over their realizable value. Provision for impairment of fixed assets is made in full amount on occurrence of any of the following events:

- (1) The market value of fixed assets has declined significantly more than expected as a result of the passage of time or normal use and the declined value is not expected to be recovered in the near future;
- (2) Fixed assets has become obsolete or physically damaged;
- (3) Significant adverse changes in the the expected utilization of fixed assets with a negative effect on the Company, including the Company's plans to discontinue or restructure the operation to which the fixed assets belong, or to dispose of the fixed assets before the originally expected dates;
- (4) Significant changes with an adverse effect on the Company have taken place or will take place in the near future in the technological, market, economic or legal environments in which the Company operates, or in the market to which the products are dedicated;
- (5) Market interest rates have increased significantly in the period and the increases are likely to affect the discount rate used in calculating the assets' recoverable amount and therefore decrease the fixed assets' recoverable amount to a material extent;
- (6) Other situations that indicate the impairment of fixed assets.

3.10.2 Construction in progress

- 3.10.2.1 The cost of construction-in-progress is determined according to expenditures actually incurred. The cost of construction work undertaken by the Company itself is determined according to direct materials cost, direct labor cost, and direct construction expenses; the cost of construction work undertaken by a third party is determined according to amount paid to the contractor; and the cost of equipment installation construction is determined according to the cost of equipment, installation charges and test run expenses.

- 3.10.2.2 Construction in progress is transferred to fixed assets at the date of reaching its usable conditions for an estimated amount based on the budget price, the amount paid to the contractor or actual cost of construction. The asset will be depreciated from the second month after it is put into use. The estimated value of the asset and its accumulated depreciation is adjusted after going through the procedures for the final accounts of project completion.

- 3.10.2.3 The Company conducts a thorough inspection of construction-in-progress at the year-end and makes a provision for impairment on any excess of the carrying amount of construction-in-progress over its recoverable amount on the item-by-item basis on occurrence of one or several of the following situations:

- (1) Construction-in-progress suspended for quite a long time and not to be resumed within 3 years;
- (2) Construction-in-progress is obsolete in terms of function and technology, and there is great uncertainty of bringing economic benefits to the Company;
- (3) Other situations indicating the impairment of construction-in-progress.

3.11 Borrowing costs

- 3.11.1 Borrowing costs include interests incurred by the Company in connection with the borrowings, amortization of premium or discount -plus auxiliary expenses, and foreign exchange translation differences from foreign currency borrowings. Other borrowing costs, except for special borrowing costs incurred for the acquisition or construction of a fixed asset, is charged directly as financial expenses in the period incurred. Special borrowing costs incurred for acquisition or construction of a fixed asset are capitalized when the following three conditions are fully satisfied:

- (1) Expenditures for the asset are being incurred;
- (2) Borrowing costs are being incurred; and
- (3) Acquisition and construction that are necessary to enable the asset reach its expected usable condition have commenced.

3.11.2 The borrowing cost incurred for an asset acquired or constructed in compliance with the above conditions is capitalized before the asset has reached its expected usable condition and is charged as financial expenses after the asset has reached its expected usable condition.

3.12 Valuation and amortization of intangible assets

3.12.1 Intangible assets are recorded at the actual cost of acquisition. Intangible assets purchased are recorded at the amount actually paid; intangible assets contributed by an investor are recorded at an amount agreed by all the investors; and intangible assets developed by the Company itself with the legal title obtained (i.e., patent) are recorded at the amount of registration fees and legal fees incurred at the time of acquisition. Expenses incurred during the process of research and development such as materials, labor and others are expensed as incurred in the relevant period.

3.12.2 The cost of an intangible assets of the Company is amortized evenly over the amortization period not longer than the shortest of the expected useful life, the beneficial period as specified in the contract or the useful life specified in the law, and is charged as gains or losses of the period. Intangible assets are amortized from the month of acquisition. The amortization period shall not exceed 10 years given the lack of any specification in the contract or law. The Company's intangible assets include land use rights, patents, non-proprietary technologies, and trademarks etc. The land use right is amortized over a period of 50 years, and the software use right is amortized over a beneficial period of 5 years.

3.12.3 The Company provides for impairment of intangible assets impairment for the excess of the carrying amount of the asset over its recoverable amount on occurrence of one or several of the following circumstances:

- (1) An intangible asset has been replaced by a new technology and its ability to bring economic benefits to the Company has been adversely affected;
- (2) The drastic decline in the market value of an intangible asset occurred during the period is not likely to be recovered during the remaining amortization period;
- (3) An intangible asset whose legal protection period expires but can still be used to a certain extent; and
- (4) Other circumstances indicating the impairment of intangible asset.

3.13 Revenue Recognition

The Company's operating revenues are mainly revenues from sale of goods. Revenues are recognized when the Company 1) has transferred to the buyer the substantial risks and rewards of ownership of the goods, 2) neither retains continuing managerial involvement nor exercises control over the goods sold, 3) has received or obtained the evidence of payment, and 4) the relevant costs can be measured reliably.

3.14 Accounting for Income Tax

The Company applies the taxes payable method in accounting for income tax.

3.15 Taxes

Major taxes and tax rates applicable to the Company are as follows:

3.15.1 Income tax

According to the document (State Revenue Issue [1994] No. 151 "The notice of applying favourable tax policies for the new and high technology companies") issued by State Bureau of Revenue, the Company is subject to an income tax rate of 15% starting from 2002 because its place of registration is the chemical zone in Zibo Municipal New and High Technology Industrial Development Zone, Shandong Province, and approved by the local department of revenue. The Company is subject to 15% income tax for operating income generated from the development zone and 33% income tax for operating income generated outside the development zone from 2004 and this has put on records in the local department of revenue.

Zibo Xinhua Sanhe Chemical Industry Co. Ltd, a company in which the Company holds controlling interests, is subject to 15% income tax, while the other subsidiaries of the Company are subject to 33% income tax.

3.15.2 Value added tax

The Company is subject to value added tax for its sales revenues At a VAT rate of 17% or 13% for domestic sales and 0% for export sales.

In purchasing raw materials, the input VAT is deductible against out put VAT at the rate of 17%.

The VAT payable for the period is the amount of output VAT less input VAT.

3.15.3 Urban maintenance & construction tax and education surcharges

Urban maintenance & construction tax and education surcharges are based on the sum of VAT payable and sales tax payable, at the rates of 7% and 3% respectively.

3.15.4 Property tax

Property tax is levied based on 70% of the original cost of the building property of the Company at a rate of 1.2%. The Company is subject to a 12% tax rate for rental income from leasing its building property.

4. Majority-owned Subsidiaries and Associates

The following is a detailed list of the majority-owned subsidiaries and associates of the Company:

Company Name	Registered Capital	Amount	Ratio	Main operations	Consolidated or not
1. Zibo Xinhua Drug Store Chain Company Limited	RMB2,000,000	RMB1,760,000	88%	Retail of pharmaceutical	Y
2. Zibo Xinhua Sanhe Chemical & Industrial Company Limited	USD500,000	USD350,000	70%	Research, production and sales pharmaceutical & Chemical	Y
3. Zibo Xinhua Pharmaceutical Design Institute	RMB2,000,000	RMB1,800,000	90%	Pharmaceutical project design	Y
4. Dezhou Xinhua Taikang Pharmaceutical Company Limited	RMB600,000	RMB360,000	60%	Retail of pharmaceutical	N
5. Dongying Xinhua Pharmacy Company Limited	RMB900,000	RMB477,000	53%	Retail of pharmaceutical	Y
6. Weifang Xinhua Pharmacy Company Limited	RMB300,000	RMB165,000	55%	Retail of pharmaceutical	N
7. Shandong Xinhua Pharmaceutical (European) GmbH	650,000 Euro	500,000 Euro	76.9%	Retail of pharmaceutical	Y
8. Sino-USA Zibo Xinhua Perrigo Pharmaceutical Company Limited	USD6,000,000	USD3,000,000	50%	Making & sale of Ibuprofen materials	N
9. Shandong Xinhua Pharmaceutical Trade Company Limited	RMB48,498,900	RMB47,529,000	98%	Drug sales	Y
10. Shandong Xinhua Longxin Chemical & Industrial Company Limited	RMB25,000,000	RMB10,000,000	40%	Making & sales of Salicylic Acid Serial Products	N

- 1) Zibo Xinhua Drug Store Chain Company Limited (called originally “Zibo Xinhua Pharmacy Company Limited”) was incorporated on July, 1999 with the registered capital contributed by the Company and Xinhua Pharmaceutical Group Co., Ltd, which hold 88% and 12% of the registered capital, respectively. The original registered capital was RMB1,000,000 and it was increased to RMB2,000,000 in September 2002.
- 2) With a registered capital of USD500,000, Zibo Xinhua Sanhe Chemical & Industrial Company Limited was formed in October 2002 by the Company, Japan Gonghe Pharmaceutical Company Limited and Beijing Santian Chemical Tech. Company Limited, which hold 70%, 25% and 5% of equity interests respectively.
- 3) With a registered capital of RMB2,000,000, Zibo Xinhua Pharmaceutical Design Institute was formed in March 2002 by the Company and Xinhua Pharmaceutical Group Company Limited, which hold 90% and 10% of the registered capital, respectively.
- 4) With a registered capital of RMB600,000, Dezhou Xinhua Taikang Pharmaceutical Company Limited was set up in August 2001 by Zibo Xinhua Pharmaceutical Company Limited (a majority owned subsidiary of the Company) and Sangdong Dezhou Pharmaceutical Company Limited, which hold 60% and 40% of equity interests respectively. The Company is not included in the scope of consolidation because it was closed for liquidation as of June 30, 2005.
- 5) With a registered capital of RMB900,000, Dongying Xinhua Pharmaceutical Company Limited was formed in March 2002 by Zibo Xinhua Pharmaceutical Company Limited (a majority owned subsidiary of the Company) and Dongying Lanjing Tech. Company Limited, which hold 53% and 47% of equity interests respectively.
- 6) With a registered capital of RMB300,000, Weifang Xinhua Pharmaceutical Company Limited was formed in December, 2002 by Zibo Xinhua Pharmaceutical Company Limited (a majority-owned subsidiary of the Company) and Shandong Kangda Pharmaceutical Company Limited, which hold 55% and 45% of the registered capital, respectively. The company is not included in the scope of consolidation because it was closed for liquidation as of June 30, 2005.

- 7) ShanDong Xinhua Pharmaceutical (European) GmbH was established on 25 Nov. 2003. It was jointly invested by the Company and Mr. LI PENG from Germany. The original registered capital was 1 million Euros and it was decreased to 650,000 Euros in 2005. The Company holds 76.9% of equity interests, while Mr. LIPENG owns 23.1%. This company was incorporated in Hamburg, Germany. Euro is the reporting currency.
- 8) Sino-USA Zibo Xinhua-Perrigo Pharmaceutical Company Limited(hereinafter referred to as the Xinhua-Perrigo) was established between the Company and American Perrigo International Company on September 11, 2003, a foreign invested joint company. With a registered capital of USD 6 million, each party hold 50% of equity interests. This joint venture was incorporated in the Chemical Area in Zibo New and High Technology Industrial Development Zone, Shandong Province. The reporting currency is RMB.
- 9) Shandong Xinhua Pharmaceutical Trade Company Limited was formed on August 30, 2004 by the Company and Zibo Xinhua Drug Store Chain Company Limited(a majority owned subsidiary of the Company), which hold 98% and 2% of the registered capital, respectively. The original registered capital was RMB5 million and it was increased to RMB48,498,900 in April 2005. The statutory place of registration of the JV company is No.1 Lutai Street, Zibo New and High Technology Industrial Development Zone, Shandong Province. The recording currency is RMB.
- 10) Shandong Xinhua Langxin Chemical & Industrial Company Limited was formed on 17 June, 2005 by the Company and Shandong Longxin Chemical & Industrial Company Limited. The registered capital was RMB25,000,000, among them the Company provides fund of RMB10,000,000 with cash and holds 40% of equity interests, while the partner provides fund of RMB15,000,000 with factory buildings, equipments and holds 60% equity interests. This joint venture was incorporated in No.299 Yixi Road, Linzi Zone, Zibo City. The recording currency is RMB.

5. Monetary Fund

	2005.6.30	2004.12.31
Cash	59	56
Bank deposits	430,479	337,877
Total	430,538	337,933

6. Short-term Investments

	2005.6.30		2004.12.31	
Items	Amounts	Provision for write-down	Amounts	Provision for write-down
Equity investments	—	—	—	—
Fund investments	67,603	9,564	70,000	11,449
Total	67,603	9,564	70,000	11,449

7. Notes Receivable

	2005.6.30	2004.12.31
Bank acceptance	32,295	28,870
Total	32,295	28,870

The maturity date of notes receivable will be after June 2005. There are no mortgaged, discounted or overdue bills.

8. Accounts receivable

The aging analysis of accounts receivable as follows:

	2005.6.30	Proportion %	Provision for bad debts	2004.12.31	Proportion %	Provision for bad debts
Within 1 year	313,290	88.86	1,523	277,021	87.11	1,367
1 year to 2 years	18,615	5.28	6,328	22,498	7.07	6,328
2 years to 3 years	13,431	3.81	6,905	10,941	3.44	6,573
Over 3 Years	7,233	2.05	7,233	7,565	2.38	7,565
Total	352,569	100.00	21,989	318,025	100.00	21,833

There was no accounts receivable due from shareholders who hold 5% or more of the Company's shares.

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9. Other receivable

	2005.6.30	Proportion %	Provision for bad debts	2004.12.31	Proportion %	Provision for bad debts
Within 1 year	103,134	87.41	400	65,051	79.88	400
1 year to 2 years	5,082	4.31	106	4,982	6.12	106
2 years to 3 years	7,729	6.55	1,382	9,526	11.70	1,382
Over 3 Years	2,039	1.73	1,873	1,873	2.30	1,873
Total	<u>117,984</u>	<u>100.00</u>	<u>3,761</u>	<u>81,432</u>	<u>100.00</u>	<u>3,761</u>

10. Accounts Prepaid

	2005.6.30	Proportion %	2004.12.31	Proportion %
Within 1 year	13,370	99.58	12,734	99.28
1 year to 2 years	6	0.04	68	0.53
2 years to 3 years	51	0.38	24	0.19
Over 3 years	—	—	—	—
Total	<u>13,427</u>	<u>100.00</u>	<u>12,826</u>	<u>100.00</u>

There are no prepaid accounts due from shareholders who hold 5% or more of the Company's voting capital.

11. Inventories

	2005.6.30	Reserve against declining in price	2004.12.31	Reserve against declining in price
Raw materials	44,614	—	43,875	—
Work in progress	69,120	—	88,884	—
Finished goods	83,424	2,506	128,180	2,506
Goods in stock	32,895	—	30,586	—
Low value articles	9,308	—	9,412	—
Special materials for Government	1,822	—	1,822	—
Total	<u>241,183</u>	<u>2,506</u>	<u>302,759</u>	<u>2,506</u>

Impairment of inventory value was provided for on the basis of the difference between the carrying value of the finished products and the market value as at 30 June 2005.

12. Long-term investments

	2004.12.31	Increases for the year	Decreases for the year	2005.06.30
Long-term equity investment	76,725	10,304	1,516	85,513
Long-term debt investment	130,076	—	—	130,076
Total	<u>206,801</u>	<u>10,304</u>	<u>1,516</u>	<u>215,589</u>
Provision for impairment	12,000	—	—	12,000
Net value of long-term investments	<u>194,801</u>	<u>10,304</u>	<u>1,516</u>	<u>203,589</u>

Long-term equity investments

Name of investee companies	Period of investment	% of registered capital in investee company	Amount initially invested	Current equity adjustment	Accumulated equity adjustment	Ending balance	Ending impairment	Provision for impairment at beginning of year
Tiantong Securities Company Limited	Long-term	1.23%	30,000	—	—	30,000	12,000	12,000
Pacific insurance Company Limited	Long-term	0.25%	7,000	—	—	7,000	—	—
Ruiheng Pharm & Technology Investment Company Limited	50 years	6%	3,200	—	—	3,200	—	—
Bank of Communications	Long-term	—	13,577	—	—	13,577	—	—
Sino-USA Zibo Xinhua-Perrigo Pharmaceutical Company Limited	Long-term	50%	24,831	(1,516)	(3,454)	21,377	—	—
Shandong Xinhua Longxin Chemical & Industrial Company Limited	Long-term	40%	10,000	—	—	10,000	—	—
Weifang Xinhua Pharmaceutical Company Limited		55%	165	—	(110)	55	—	—
Dezhou Xinhua Tai Kang Drug Store Company Limited		60%	360	(36)	(56)	304	—	—
Total			<u>89,133</u>	<u>(1,552)</u>	<u>(3,620)</u>	<u>85,513</u>	<u>12,000</u>	<u>12,000</u>

Long-term debt investment

Item	Annual interest rate	Par value	Original cost	Due date	Interest for current period	Accumulated interest	2005.6.30
Electric power construction bond	60	—	60	Matured	—	16	76
Qingdao Hisyn Trust & Investment Co., Ltd	—	5%	130,000	July 2007	3,250	6,067	130,000
Total	—	—	<u>130,060</u>	—	<u>3,250</u>	<u>6,083</u>	<u>130,076</u>

13. Fixed assets

	Building & construction	Machinery equipment	Motor Vehicle	Apparatus	Total
At 31 December 2004	396,547	977,432	22,680	24,455	1,421,114
Additions	44,985	57,194	522	769	103,470
Include: transferred from CIP	44,985	51,517	—	—	96,502
Disposal	—	1,422	75	208	1,705
At 30 June 2005	<u>441,532</u>	<u>1,033,204</u>	<u>23,127</u>	<u>25,016</u>	<u>1,522,879</u>
Accumulated depreciation					
At 31 December 2004	<u>186,458</u>	<u>503,783</u>	<u>16,937</u>	<u>17,342</u>	<u>724,520</u>
Additions	6,892	37,116	1,244	1,176	46,428
Disposal	—	1,304	75	72	1,451
At 30 June 2005	<u>193,350</u>	<u>539,595</u>	<u>18,106</u>	<u>18,446</u>	<u>769,497</u>
Net value at 31 December 2004	<u>210,089</u>	<u>473,649</u>	<u>5,743</u>	<u>7,113</u>	<u>696,594</u>
Net value at 30 June 2005	<u>248,182</u>	<u>493,609</u>	<u>5,021</u>	<u>6,570</u>	<u>753,382</u>

At the end of the accounting period there is no devaluation for the fixed assets and no provision had been withdrawn.

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14. Construction in progress

	2005.6.30	2004.12.31
Construction projects	206,870	118,091
Total	206,870	118,091

14.1. Detailed list of construction projects

The list of construction projects	Beginning balance	Addition	Transferred to FA	Transferred to IA	Other decreases	Ending balance	Capital resources	Project budget	Project progress	Estimated date of completion
1. Caffeine Project	709	6,970	—	—	—	7,679	Raised	160,000	Completed	
2. Xinhua (West) Int'l Industrial Park	12,720	2,641	—	10,383	—	4,978	—	—	—	
3. Xinhua (East) Int'l Industrial Park	9,554	—	—	6,853	2,147	554	—	—	—	
4. Injection GMP Revamping	74,767	6,326	80,000	7,767	—	(6,674)	Raised	80,000	100%	
5. Xiyuan Logistics project	16,283	—	16,493	—	—	(210)	Self-owned	17,000	100%	
6. Xinhua (East) Water-supply system	3,710	—	—	—	—	3,710	Self-owned	5,000	70%	
7. Troche expansion project	26,396	5,334	—	—	—	31,730	Self-owned	30,000	100%	
8. Tramadol HCL project	1,404	2,018	—	—	—	3,422	Self-owned	—	—	
9. Propyphenazone project	3,931	8,861	—	—	—	12,792	Self-owned	12,500	—	
10. Calcium Polycarbophil project	3,300	3,911	—	—	—	7,211	Self-owned	6,000	—	
11. Warehouse in S&S Dept.	—	3,117	—	—	—	3,117	Self-owned	6,000	—	
12. Others	54,096	705	2,427	2,592	—	49,782	Self-owned	—	—	
Total	206,870	39,883	98,920	27,595	2,147	118,091	—	—	—	

- No specially-borrowed fund is used in construction-in-progress and there are no items to be capitalized
- The amount of RMB27,595,000 transferred to Intangible Assets in this reporting period is the acquirement costs of land use rights recorded in Construction in progress.
- There is no impaired construction-in-progress at year-end and no provision for impairment is thus made.

15. Intangible assets

Items	Land use rights	Software use rights	Non-Patented technology	Total
Cost	108,544	1,648	5,000	115,192
The original cost at 1 January 2005	67,984	744	3,441	72,169
Accumulated amortization at 1 January 2005	12,965	723	1,559	15,247
Addition	27,595	181	—	27,776
Amortization	1,232	149	390	1,771
Accumulated amortization at 30 June 2005	14,197	872	1,949	17,018
Charge for the year	—	—	—	—
Net value at 30 June 2005	94,347	776	3,051	98,174
The last of the year of the amortization	13-41	1-5	3	—

At the end of the period there is no devaluation for Intangible assets and no provision had been withdrawn.

16. Short-term loans

	2005.6.30	2004.12.31	Annual interest rate (%)
Pledged loans	33,929	21,358	
Credit loans	366,887	284,927	5.08 - 5.58
Total	400,816	306,285	

17. Notes payables

	2005.6.30	2004.12.31
Bankers' notes payable	<u>189,193</u>	<u>144,460</u>
Total	<u><u>189,193</u></u>	<u><u>144,460</u></u>

The ending balance of notes payable does not have any amount due from shareholders who hold 5% or more of the Company's Voting Capital.

18. Accounts payable

	2005.6.30	2004.12.31
Accounts payable	<u>116,424</u>	<u>163,309</u>

There was no account payable due from shareholders who hold 5% or more of the Company's shares.

19. Deposits from customers

	2005.6.30	2004.12.31
Deposits from customers	<u>10,150</u>	<u>11,126</u>

Deposits aging over 1 year that had not been carried forward were mainly balance due settled with clients.

There was no deposits from customers due from shareholders who hold 5% or more of the Company's shares.

20. Dividend payable

Class of Shareholders	2005.6.30	2004.12.31	Reasons
State shares	—	—	
Listed Stock A-share	—	—	
Listed Stock H-share	—	—	
Others	<u>5,795</u>	<u>6,074</u>	Normal Delay
Total	<u><u>5,795</u></u>	<u><u>6,074</u></u>	

21. Tax payables

	2005.6.30	2004.12.31	Taxed ratio
Income tax	1,841	(538)	15%, 33%
VAT	(455)	(10,546)	—
Operating tax	13	204	3% - 5%
Urban maintenance construction tax	2,377	2,768	7%
Additional Education Expenses	1,019	1,186	3%
IIT Payable	2	1,216	—
Land Use Tax Payable	128	131	1.2%
Real Estate Tax Payable	<u>87</u>	<u>—</u>	—
Total	<u><u>5,012</u></u>	<u><u>(5,579)</u></u>	

22. Other payable

	2005.6.30	2004.12.31
Other payable	<u>45,449</u>	<u>57,825</u>

There was no other payable due from shareholders who hold 5% or more of the Company's shares.

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23. Accrued expenses

	2005.6.30	2004.12.31
Directors' emoluments	1,186	2,000
Audit fees	860	1,200
Export freight & Insurance	1,463	1
Others	1,470	—
Total	<u>4,979</u>	<u>3,201</u>

24. Long-term Borrowings

Terms of Loan	2005.6.30	2004.12.31	Annual rate
Guaranteed borrowing*	<u>250,000</u>	<u>250,000</u>	3.51%

* The guaranty is provided by Shandong Xinhua Pharmaceutical Group Co., Ltd.

25. Share capital

	2005.6.30	2004.12.31
I. Unlisted shares:		
1. Founder's shares:	214,440	214,440
Including: State shares (unlisted)	214,440	214,440
Legal persons shares	—	—
2. Fund raising legal-person shares (unlisted)	16,720	16,720
3. Transferred and allotted shares	—	—
4. Employee shares	—	—
5. Preferred stock and others	—	—
Sub-total	<u>231,160</u>	<u>231,160</u>
II. Listed shares		
1. Domestically listed RMB A shares	76,153	76,153
2. H shares (Listed shares)	150,000	150,000
3. Foreign-capital shares in domestic listing	—	—
4. Others	—	—
Sub-total	<u>226,153</u>	<u>226,153</u>
III. Total stock	<u>457,313</u>	<u>457,313</u>

26. Capital surplus

	2004.12.31	Increased	Decreased	2005.6.30
Upward revaluation of assets	60,910	—	—	60,910
Premium on stock	496,851	—	—	496,851
Receipt of donation	1,158	—	—	1,158
Total	<u>558,919</u>	<u>—</u>	<u>—</u>	<u>558,919</u>

27. Surplus reserve

	2004.12.31	Increased	Decreased	2005.06.30
Statutory surplus reserve	68,337	—	—	68,337
Discretionary surplus reserve	64,797	—	—	64,797
Public welfare fund	26,291	—	—	26,291
Total	<u>159,425</u>	<u>—</u>	<u>—</u>	<u>159,425</u>

28. Profit Distribution

	2005.6.30	2004.12.31
Profit after tax	15,621	(55,608)
Add: Undistributed profit at beginning of the year	163,003	236,903
Profit available for the year	178,624	181,295
Less: Appropriation of statutory surplus reserve (10%)	—	—
Appropriation of statutory employees welfare reserve (5%)	—	—
Undistributed profit available for the year	178,624	181,295
Less: Appropriation of discretionary surplus reserve (10%)	—	—
Dividends distribution	—	18,292
Undistributed profit, at 31 December 2004	—	—
Undistributed profit, at 30 June 2005	<u>178,624</u>	<u>163,003</u>

29. Revenues & Costs from Main Operations

	Sales		Cost	
	2005.1-6	2004.1-6	2005.1-6	2004.1-6
Bulk pharmaceuticals	515,740	433,203	419,868	352,007
Include: export sales	361,267	326,679	299,308	273,153
Preparations	153,590	168,844	93,418	106,675
Commerce Circulations	194,768	179,466	190,676	176,091
Chemicals and other products	7,583	20,623	9,187	22,826
Total	<u>871,681</u>	<u>802,136</u>	<u>713,149</u>	<u>657,599</u>

30. Taxes and Surcharges for Main Operations

	Standard	2005.1-6	2004.1-6
City Construction Tax	7% of VAT payables of this year	2,753	736
Education Expenses Additional	3% of VAT payables of this year	1,201	316
Operating tax	5% of design fee	79	63
Total		<u>4,033</u>	<u>1,115</u>

31. Profit from other operations

	Other operating revenue RMB'000	2005.1-6 Other operating cost RMB'000	Other operating profit RMB'000	Other operating revenue RMB'000	2004.1-6 Other operating cost RMB'000	Other operating profit RMB'000
Sales of materials	13,241	13,092	149	9,302	9,475	(173)
Sales of water, power and gas	5,938	5,954	(16)	5,420	5,285	135
Leasing	1,155	191	964	963	—	963
Total	<u>20,334</u>	<u>19,237</u>	<u>1,097</u>	<u>15,685</u>	<u>14,760</u>	<u>925</u>

32. Financial expenses

	2005.1-6	2004.1-6
Interest expenses	10,545	6,827
Banking charge	607	839
Less: Interest income	1,797	2,873
Exchange loss	274	204
Others	(251)	3
Total	<u>9,378</u>	<u>5,000</u>

33. Investment income

	2005.1-6	2004.1-6
Short-term investment income	(512)	7,921
Bond investment income	3,250	—
Equity investment income	(1,553)	—
Total	<u>1,185</u>	<u>7,921</u>

34. Non-operating income

	2005.1-6	2004.1-6
Proceeds from disposal of fixed assets	1,078	1,198
Income from penalties	48	9
Others	1	202
Total	<u>1,127</u>	<u>1,409</u>

35. Non-operating expenses

	2005.1-6	2004.1-6
Loss on disposal of fixed assets	121	308
Overdue payment, fines, etc.	8	2
Others	423	4,142
Total	<u>552</u>	<u>4,452</u>

36. Notes to the parent company

36.1 Accounts receivable

The aging analysis for receivables is as follows:

	2005.6.30	Ratio %	Provision for bad debt	2004.12.31	Ratio %	Provision for bad debt
Within 1 year	299,287	88.40	1,450	264,698	86.59	1,293
1 year to 2 years	18,615	5.50	6,328	22,498	7.36	6,328
2 years to 3 years	13,431	3.97	6,905	10,941	3.58	6,573
Over 3 years	7,233	2.13	7,233	7,565	2.47	7,565
Total	<u>338,566</u>	<u>100.00</u>	<u>21,916</u>	<u>305,702</u>	<u>100.00</u>	<u>21,759</u>

There was no account receivables due from shareholders who hold 5% or more of the Company's shares.

36.2 Other receivables

	2005.6.30	Ratio %	Provision for bad debt	2004.12.31	Ratio %	Provision for bad debt
Within 1 year	106,097	87.72	400	94,475	83.94	400
1 year to 2 years	5,082	4.20	106	6,180	5.49	106
2 years to 3 years	7,729	6.39	1,382	10,026	8.91	1,382
Over 3 years	2,039	1.69	1,873	1,873	1.66	1,873
Total	<u>120,947</u>	<u>100.00</u>	<u>3,761</u>	<u>112,554</u>	<u>100.00</u>	<u>3,761</u>

36.3 Long-term investments

	2004.12.31	Increased	Decreased	2005.6.30
Long-term equity investment	89,274	52,652	2,429	139,497
Long-term debt investment	130,076	—	—	130,076
Total	219,350	52,652	2,429	269,573
Provision for impairment	12,000	—	—	12,000
Net value of Long-term investment	207,350	52,652	2,429	257,573

Including: Long-term equity investment

Name of investee companies	Investment period	% of registered capital of investee company	Initial amount invested	Current equity adjustments	Accumulated equity adjustments	Provision for Ending balance	Provision for impairment at end of year	impairment at beginning of year
Tiantong Securities Company Limited	Long-term	1.23%	30,000	—	—	30,000	12,000	12,000
Pacific Insurance Company Limited	Long-term	0.25%	7,000	—	—	7,000	—	—
Ruiheng Pharm & Technology Investment Company Limited	50 years	6%	3,200	—	—	3,200	—	—
Bank of Communications	Long-term	—	13,577	—	—	13,577	—	—
Sino-USA Zibo Xinhua-Perrigo Pharm. Company Limited	Long-term	50%	24,831	(1,516)	(3,454)	21,377	—	—
Shandong Xinhua Pharmaceutical (Europe) GmbH	Long-term	76.9%	4,597	(373)	(1,957)	2,640	—	—
Zibo Xinhua Drug Store Chain Company Limited	Long-term	88%	1,760	(12)	198	1,958	—	—
Zibo Xinhua Pharm. Design Institute Company Limited	Long-term	90%	1,800	(528)	(2,254)	(454)	—	—
Zibo Xinhua Sanhe Chemical & Industrial Company Limited	Long-term	70%	2,897	—	—	2,897	—	—
Shandong Xinhua Medicine Commerce Company Limited	20 years	98%	47,529	23	(227)	47,302	—	—
Shandong Xinhua Longxin Chemical & Industrial Company Limited	Long-term	40%	10,000	—	—	10,000	—	—
Total			147,191	(2,406)	(7,694)	139,497	12,000	12,000

36.4 Revenues & costs from main operations

	Revenue 2005.1-6	2004.1-6	Cost 2005.1-6	2004.1-6
Bulk pharmaceuticals	513,157	433,203	417,604	352,007
Include: export sales	358,685	319,808	297,044	261,859
Preparations	167,395	168,844	107,223	106,675
Commerce circulations	53,834	170,937	52,489	169,188
Chemicals and other products	7,111	20,153	9,187	22,826
Total	741,497	793,137	586,503	650,696

36.5 Investment income

	2005.1-6	2004.1-6
Short-term investment income	(512)	7,921
Bond investment income	3,250	—
Equity investment income	(2,406)	(537)
Total	<u>332</u>	<u>7,384</u>

37. Related Party Relationship and Transactions

37.1 Related Party Relationship

37.1.1 Related Parties under a control relationship

Related Party Name	Place of registration	Main operations	Relation with the Company	Nature	Legal representative
Shadong Xinhua Pharmaceutical Group Company Limited	No. 14, East 1st Road, Zhangdian Dist., Zibo, Shandong Province.	Investment in the design of construction projects, property development and food and beverage, etc.	Parent company of the Company	State-owned	He Duanshi
XinhuaLukang Pharmaceutical Group Company Limited	No. 109, XinCun West Road, Zhangdian Dist., Zibo, Shandong Province.	Investment in manufacturers of pharmaceuticals.	The ultimate holding company	Wholly state-owned	He Duanshi

37.1.2 Registered capital and its changes of related parties under a control relationship

Related Party Name	2004.12.31	Increase for the period	Decrease for the period	2005.06.30
Shadong Xinhua Pharmaceutical Group Company Limited	298,500	—	—	298,500
Xinhua Lukang Pharmaceutical Group Company Limited	495,490	—	—	495,490

37.1.3 Share holdings and their changes of related parties under a control relationship

Related Party Name	Amount of shares 2005.06.30	2004.12.31	Ratio 2005.06.30	2004.12.31
Shandong Xinhua Pharmaceutical Group Company Limited	214,440	214,440	46.89%	46.89%

37.1.4 Nature of related parties under no control relationships

37.1.4.1 Related parties controlled by the Company's parent Company

Related Party Name	Shares Held by parent company	Main businesses	Related Transactions with the Company
Shandong Xinhua Industry & Trade Company Limited	16,340	Production and sale of chemical raw materials, etc	Sale of power and waste materials, and purchase of raw materials
Zibo All-purpose Service Company Limited of Shandong Xinhua Pharmaceutical Group	19,600	Kindergarten education, etc.	Acquisition of services and sale of power
Shandong Zibo XinCat Pharmaceutical Company Limited	USD 1,725,000	Production and operation of Western medicine preparation, and chemical materials medicine and midway articles.	Sale of power and Lease of house properties
Shandong Zibo Xinhua-Chemferm Pharmaceutical Company Limited	46,256	Production and sale of cephal-product series.	Sale of power and raw materials
Zibo Packing & Decoration Company Limited of Shandong Xinhua Pharmaceutical Group	12,591	Packaging & decoration products, printing, packaging & decoration design, and furniture.	Sale of power and purchase of packaging materials

37.1.4.2 Joint venture of the Company

Related Party Name	Shares Held by the Company	Main business	Related Transaction with the Company
Sino-USA Zibo Xinhua-Perrigo Pharm. Company Limited	USD3,000,000	Making & Sale of Ibuprofen	Sale of water, power and gas

37.2 Related Transactions:

37.2.1 Sale of merchandise

Related Party Name	2005.1-6 Amount	2004.1-6 Amount	Remark
Shandong Xinhua Industry & Trade Company Limited	8,714	12,100	Sale of power and waste materials
Shandong Zibo XinCat Pharmaceutical Company Limited	610	520	Sale of power
Shandong Zibo Xinhua-Chemferm Pharmaceutical Company Limited	1,590	1,800	Sale of power
Shandong Xinhua Zibo Packaging & decoration Company Limited	343	420	Sale of power
Zibo All-purpose Service Company Limited of Shandong Xinhua Pharmaceutical Group	24	210	Sale of power
Sino-USA Zibo Xinhua-Perrigo Pharmaceutical Company Limited	117	—	Sale of power
Total	<u>11,398</u>	<u>15,050</u>	

The Company sells materials to related parties at the market price and sells power at an agreed-upon price.

37.2.2 Purchase of materials

Related Party Name	2005.1-6 Amount	2004.1-6 Amount
Shandong Xinhua Industry & Trade Company	15,134	22,050
Zibo Packaging & Decoration Company Limited of Shandong Xinhua Pharmaceutical Group	8,734	9,640
Shandong Zibo Xinhua-Chemferm Pharmaceutical Company Limited	2,710	—
Zichuan Chemical Company Limited of Shandong Xinhua Pharmaceutical Group	—	3,180
Total	<u>26,578</u>	<u>34,870</u>

The Company purchases goods from related parties at the market price.

37.2.3 Leasing Assets

Related Party Name	Nature of deal	Time of deal	2005.1-6 Amount	2004.1-6 Amount
Shandong Xinhua Zibo XinCat Pharmaceutical Company Limited	House leasing	First half of the year	800	750

The Company lets out assets to related parties at the market price.

37.2.4 Guaranty secured

On September 25, 2003, the Company signed an export bargainor credit contract with China Import & Export Bank with a contracted amount of RMB250,000,000 and for a period of 24 months. Shandong Xinhua Pharmaceutical Group provided joint and several guaranty for the liabilities of the Company under the above borrowing contract. By the end of 30 June 2005, the Company received RMB250,000,000 under the borrowing contract.

37.2.5 Fund transactions between related parties

Related Party Name	Fund provided to the related party		Fund provided to the public company by the related party	
	Additions	Balance	Additions	Balance
Shandong Xinhua Pharmaceutical Group Company Limited	11,666	25,619	—	—

Fund transactions between related parties are free of charge and no repayment date has been settled.

37.3 Related Party Current Account Balances

Related Party Name	A/C title	2005.06.30	2004.12.31
Shandong Xinhua Pharmaceutical Group Company Limited	Other receivables	25,619	13,953
Shandong Xinhua Industry & Trade Company	Other receivables	26,499	25,044
Shandong Zibo Xinhua -Chemferm Pharmaceutical Company Limited	Other receivables	2,538	(2,091)
Shandong Xinhua Zibo XinCat Pharmaceutical Company Limited	Other receivables	6,926	6,383
Zibo Packing & Decoration Company Limited of Shandong Xinhua Pharmaceutical Group	Other receivables	(1,938)	(3,021)
Zibo All-purpose Service Company Limited of Shandong Xinhua Pharmaceutical Group	Other receivables	1,247	1,309
Sino-USA Zibo Xinhua-Perrigo Pharmaceutical Company Limited	Other receivables	2,741	2,563

38. Contingent events

None

39. Other matters

None