

董事長報告

CHAIRMAN'S STATEMENT

致各位股東：

本人謹此提呈山東新華製藥股份有限公司（本公司）截至二零零五年十二月三十一日止年度報告書，敬請各位股東省覽。

業績與股息

本公司及其附屬公司（簡稱「本集團」）截至二零零五年十二月三十一日止年度按中國會計準則編制的主營業務收入為人民幣1,696,515千元，較二零零四年度增長12.26%；淨利潤為人民幣5,416千元，本集團本年度實現扭虧為盈。

按香港普遍採納之會計原則編制的營業額為人民幣1,712,102千元，較二零零四年度增長12.31%；股東應佔盈利為人民幣1,229千元。

董事會建議按307,312,830股A股及150,000,000股H股，派發截至二零零五年十二月三十一日止年度末期股息每股人民幣0.05元（約折合每股港幣0.0482元，A股含稅）。建議派發的股息已計入本公司賬項，有待於截至二零零五年十二月三十一日止年度的週年股東大會上批准。

業務回顧

二零零五年本集團仍遇到諸多不利因素，原材料、動力能源價格仍在高價位運行，國家持續降低藥品價格，人民幣升值。雖然本集團主要原料藥暢銷，但藥品供大於求局面未從根本上得到改觀，本集團仍處於微利狀態。

本集團認真分析外部形勢，針對內部突出問題，按照年初提出的「三二一」發展思路，圍繞提高企業經濟效益，採取切實有效應對措施，銷售收入繼續保持兩位數增長，成品資金佔用較年初大幅下降，產銷率、回款率穩步提高，經營活動產生的現金流量大幅度上升，二零零五年經濟運行質量有了明顯改善。

Dear Shareholders,

I hereby present for your review the annual report of the Company for the year ended 31 December 2005.

Results and Dividends

In the fiscal year ended 31 December 2005, the income from principal operations of the Company and its subsidiaries ("Group") prepared under PRC accounting standards was RMB1,696,515,000 representing an increase of 12.26%, as compared with that of year 2004. The Group recorded its profit of RMB5,416,000 for the first time.

The Group's sales prepared under HKGAAP were RMB1,712,102,000, representing an increase of 12.31%, as compared with that of year 2004. A profit attributable to shareholders of RMB1,229,000 was recorded.

The Board of Directors has proposed a final dividend for year 2005 of RMB0.05 per share (approximately HK\$0.0482 per share, including income tax of A shares) on 307,312,830 A Shares and 150,000,000 H Shares. The proposed dividend has been included as a dividend reserve in the the financial statements of the Company for the year ended 31 December 2005 and is subject to approval by shareholders at the annual general meeting of the Company for the year 2005.

Review of Operations

In 2005, the Group experienced a number of difficulties such as high prices of raw materials and power, the falling medicine prices instructed by the State together with Renminbi appreciation. Despite its readily marketable major bulk pharmaceuticals, profit of the Group remained minimal due to the oversupply of medicine products without a fundamental improvement.

During the year, the Group made a prudent analysis of the external environment to tackle the pressing internal problems in line with the gradual development strategy put forward at the beginning of the year. A number of practicable and efficient measures were taken to maximise the economic efficiency. As a result, sales revenue of the Group read another two-digit growth and capital used for finished products decreased significantly from that at the beginning of the year. A stable growth was also seen for both sales-output ratio and receivables collection ratio in addition to the considerably increased cash flows from operating activities. The overall operation of the Group has markedly improved during the year.

業務回顧 (續)

1. 積極開拓市場，保持銷售規模兩位數增長

二零零五年本集團抓住主要原料藥旺銷機遇，大力開拓市場，原料藥銷售額(按中國會計準則計算)較上年增長17.43%。出口創匯完成90,340千美元，增幅達13.0%，其中有9個品種出口創匯過百萬美元，有4個品種出口創匯過千萬美元，主導原料藥國際市場份額明顯增加。

製劑普藥在鞏固原有市場的基礎上，積極開闢第三終端市場，銷售額增長14.3%；製劑新藥逐步完善了代理制，初步建立了終端網絡；OTC銷售也邁出了可喜的一步。

山東新華醫藥貿易有限公司銷售額達到人民幣321,149千元，較上年增長32.29%，成為本集團所在地最大的醫藥商業企業；山東淄博新華大藥店連鎖有限公司銷售額實現人民幣29,633千元，較上年增長18.22%。

2. 加快研發速度，培育新的經濟增長點

二零零五年本集團獲得國家食品藥品監督管理局頒發的生產批准文號17個，獲得臨床批件等19個，三個新的原料藥陸續投產。新產品成功開發和順利投產，將為本集團實現快速發展增添新的經濟增長點。

Review of Operations (continued)

1. Proactive market expansion to maintain a two-digit growth in sales

During the year, the Group leveraged on the opportunities in booming sale of major bulk pharmaceuticals to expand its market, resulting in a 17.43% increase in its sales revenue under PRC accounting standards as compared with last year. Revenue generated from the exports was approximately US\$90,340,000, representing a year-on-year increase of 13.0%, including nine products recorded over US\$1 million of revenue generated from the exports and four products over US\$10 million. The Group's international market share of major bulk pharmaceuticals was noticeably enlarged.

Based on the consolidated existing market, the Group took initiatives in development of the tertiary terminal market for ordinary preparation medicines, sales revenue of which increased by 14.3%. As for new preparation medicines, the Group gradually improved the agency system and has set up a basic terminal network. Desirable improvement was also seen in sale of OTC.

With its sales revenue increasing by 32.29% from 2004 to approximately RMB321,149,000, Shandong Xinhua Medical Trade Co., Ltd. became the largest medical commercial enterprise in the Group's headquarter area. Shandong Zibo Xinhua Pharmacy Chain Company Limited recorded sales revenue of approximately RMB29,633,000, representing an increase of 18.22% over 2004.

2. Faster pace in research and development for the operation of new profit

In 2005, the Group obtained 17 certifications of production and 19 approvals for clinic application by the State Food and Drugs Administration of the PRC. Three new bulk pharmaceuticals have been put into production in succession. The development and smooth production of new products will bring about new profit sources for the Group's fast growth.

業務回顧 (續)

3. 採取切實措施，確保盈利水平提升

發揮本集團原料藥市場主導地位作用，及時調整產品價格，實現主要產品價格提高大於採購成本上升的預期目標。本集團通過實施一系列節能降耗、產品技術攻關、控制費用支出等措施，二零零五年本集團實現產品毛利率(按中國會計準則計算)達到17.78%，較上年度提高1.59個百分點，三項費用佔銷售額的比例(按中國會計準則計算)較上年度下降1.21個百分點。

4. 提高效率、控制風險，促使經濟運行質量提高

圍繞提高資金利用效率目標，二零零五年本集團堅持以市場為導向，努力壓縮成品資金佔用，加大風險管理力度，積極應對經營及匯率風險，二零零五年底本集團成品資金佔用(按中國會計準則計算)較年初降低人民幣36,219千元，本年度產銷率、回款率均超過100%，經營活動產生現金流量(按中國會計準則計算)達到人民幣178,859千元，較上年增加人民幣119,734千元，本集團二零零五年經濟運行質量明顯提高。

Review of Operations (continued)

3. Practicable measures for enhanced profitability

Capitalising on its leading position in bulk pharmaceuticals, the Group timely adjusted product prices and ensured the outrunning of its major product prices over procurement cost. As a result of series of measures such as energy saving, consumption reduction, key technology deployment and cost control, the Group's gross profit margin for 2005 under PRC accounting standards was 17.78%, increased by 1.59% as in 2004, and the ratio of the financial cost, management expense and operating expense over the revenue under PRC accounting standards was decreased by 1.21% as in 2004.

4. Improvement in efficiency and risk control to enhance the efficiency of the overall operation

To improve utilisation of working capital, the Group cut down the capital used for finished products while putting more efforts in risk management to cope with operating and exchange rate risks on a market-oriented basis. At the end of year, the Group's capital used for finished products under PRC accounting standards decreased by approximately RMB36,219,000 from that at the beginning of the year. Both the sales-output ratio and receivables collection ratio for year 2005 exceeded 100%. Cash flows from operating activities under PRC accounting standards amounted to approximately RMB178,859,000, representing a year-on-year increase of approximately RMB119,734,000. All such has demonstrated a significant improvement for the overall operation of the Group in 2005.

未來展望

二零零六年國際國內經濟形勢繼續向好，隨著國家加快醫療保障體系建設、農村「兩網」建設及新型合作醫療制度的建立，為醫藥經濟持續發展創造了條件。而原油價格的高企、匯率變化、供過於求造成的市場競爭，政府進一步降低藥品價格的心理預期，給國內醫藥企業發展帶來了諸多不確定性。

二零零六年是「十一五」規劃實施的第一年，本集團將積極研究並採取切實可行策略和措施，力爭二零零六年銷售收入繼續保持兩位數增長，三項費用率進一步下降，經營業績取得恢復性增長。

1. 抓技術，促創新，增添發展後勁

建立健全科研人員激勵約束機制，研究修訂相關考核辦法，激發科研人員主動性、積極性和創造性，以提升人才素質，提高創新能力。

加大科研投入力度，加快國家級企業技術中心改造項目施工建設，為企業長遠發展創造良好的技術創新平台。預計二零零六年本集團將會取得6個以上新產品生產批文。

Prospects

The pharmaceutical industry in 2006 is looking to a host of opportunities for its rapid growth brought from accelerating progress in the national medical insurance framework, the rural drug monitoring and supply networks as well as a new collaborative medical system of the PRC in favourable domestic and international economic environments. Notwithstanding, domestic pharmaceutical enterprises are faced with uncertainties arising from high oil price, changes in exchange rate, market competitions from oversupply and expected reduction in the price of pharmaceutical products by the government.

In 2006, the first year of the 11th Five-year Plan, the Group will introduce practical strategies and measures based on in-depth study to aim to achieve resilient business results for 2006, including a two-digit growth in sales revenue and further decrease in financial cost, management expense and operating expense as percentages of revenue.

1. Promoting technology-based innovation to fuel progresses

The Group will establish an incentive and constraining system for research and development, where assessment methods will be developed to stimulate initiative, mobility and creativity of research specialists, aiming to enhance talents and sharpen their innovation edge.

More efforts will be put in research and development. The Group will speed up renovation projects in its state-level enterprise technology centre, building it into a technological innovation platform for growth in the long run. The Group expects to obtain at least 6 certifications of production for its new products in 2006.

未來展望 (續)

2. 抓生產，降成本，提高企業盈利水平

- (1) 繼續狠抓成本領先工程，強化產品技術攻關活動，着力降低產品成本，提高企業效益。
- (2) 大力推進「四新」技術應用，深入開展節能降耗工作，確保全年節能降耗工作取得新的成效。
- (3) 研究新工藝、採用新技術，提高環保水平；堅持推進循環式生產，強化點源治理，加強程序控制，走清潔生產道路。

3. 抓市場，突破製劑，提高企業地位和影響力

- (1) 鞏固、發展原料藥傳統市場，積極開拓新市場，特別是出口業務最終用戶，繼續保持原料藥優勢地位。
- (2) 狠抓製劑銷售，聚焦重點品種，努力打造銷售額過億元（人民幣）製劑產品；切實抓好 OTC 重點市場銷售，加大終端開發力度，為後續產品投放市場打好基礎。努力擴大製劑產品出口。

Prospects (continued)

2. Cutting down production cost to widen profit margin

- (1) With commitment to its cost-oriented programme, the Group will put effort to strengthen key technology projects to cut down product cost and widen profit margin.
- (2) The Group will advance energy saving and consumption reduction by promoting new technologies to ensure another progress for the whole year.
- (3) The Group expects to improve environment protection based on new work process and technologies, adhering to recycling production with treatments to both pollution outlets and source coupled with process control. The Group is in light of clean production.

3. Further penetrating into the market to enhance the Group's position and influence in the industry

- (1) While securing the traditional market of bulk pharmaceuticals, the Group will ambitiously tap into new markets, especially to end users of export, to maintain its leading position in bulk pharmaceuticals.
- (2) By strengthening preparation distribution focusing key varieties, the Group will reinforce preparations with over RMB100 million of sales for a single product. Meanwhile, the Group will penetrate to major OTC markets with more investment in terminal construction, laying a solid ground for launching of subsequent products in line with the effort to expand preparation export.

未來展望 (續)

4. 抓管理，重實效，夯實企業基礎

- (1) 繼續狠抓產品銷售產、銷、回動態平衡，控制經營風險。強化「對外壓欠」工作，加大外欠貨款清理力度。確保二零零六年本集團產銷率、回款率均在100%以上。
- (2) 進一步完善快速反應機制，提高企業市場應變能力，努力做好「對內壓佔」工作，提高資金利用效率。
- (3) 全面預算管理剛性化，強化對過程及結果的控制、監督、檢查和考核，力爭二零零六年本集團三項費用率較二零零五年再降低1個百分點。
- (4) 以年初新組建的採購物控部為契機，建立健全規範、高效招標比價採購體系，強化過程監督控制，努力降低採購成本。

Prospects (continued)

4. Laying down a cornerstone of management efficiency

- (1) Efforts will be continued in achieving a dynamic balance among production, sales and receivables collection with a view to control operating risks. The Group will strive to minimise receivables with a view to ensure that both sales-output ratio and receivables collection ratio remain more than 100% in 2006.
- (2) The Group will further improve its fast reacting mechanism and enhance mobility to address market change. For internal management, the Group will give efforts in minimising inventory for better utilisation of working capital.
- (3) Upholding rigid comprehensive budget scheme, the Group will strengthen control, supervision, examination and assessment on both processes and results, aiming to reduce the ratio of financial cost, management expense and operating expense by 1% from year 2005.
- (4) Capitalising on its newly established Procurement and Controlling Department in early 2006, the Group will build up a procurement system based on standard and efficient bidding invitation and price comparison, with rigorous supervision and control over processes to minimise procurement cost.

董事長報告 (續)

CHAIRMAN'S STATEMENT (continued)

未來展望 (續)

5. 抓機遇，促外經，提升企業國際化水平

二零零六年本集團將充分利用新片劑車間、新針劑車間產能擴大，以及本集團在開發區預留待開發土地諸多優勢，大力開展對外招商引資工作，抓好新的醫藥中間體、製劑等合作項目，提高本集團國際化水平。

過去的一年，是本集團歷史上不平凡的一年，全體員工齊心協力，克服了種種困難，實現了扭虧為盈。在新的一年裡，本董事會將竭盡全力，努力工作，相信在董事會的帶領下2006年新華製藥效益將會取得恢復性增長，並為今後企業大發展奠定堅實基礎。

賀端湜
董事長

中國•山東•淄博
二零零六年三月二十四日

Prospects (continued)

5. Leveraging opportunities in foreign investment to broaden the global vision

The Group invite foreign investment in 2006 by taking full advantages of capacity expansions of new tablet workshop and new injection workshop as well as its land reserve in the development zone, focusing on new medical intermediates and preparation projects to broaden its global vision.

The year was an uncommon year in the history of the Group, through the mutual effort of the whole staff and overcoming uncountable difficulties in the operation, the Group realised a turnaround from loss to profit in 2005. In the coming year, the Board of Directors will endeavor to work and is confident to have a profitable year ahead to lay down a solid foundation for the future development.

He Duanshi
Chairman

24 March 2006
Zibo, Shandong, PRC