

Dear shareholders,

I am pleased to report the operating results of the Company for the six months ended 30 June 2006.

For the six months ended 30 June 2006, pursuant to PRC accounting standards, the revenue from the principal business of the Company and its subsidiaries (collectively referred to as “the Group”) was RMB861,634,000 and profit after taxation was RMB12,362,000, representing a decrease of 1.15% and decrease of 20.86% respectively, as compared with the amounts achieved for the same period last year.

The Group achieved a turnover of RMB869,353,000 and profit attributable to shareholders of RMB12,439,000 for the six months ended 30 June 2006 under HKGAAP, representing a decrease of 1.07% and decrease of 8.01% respectively, as compared with the amounts achieved for the same period last year.

The Board did not recommend the payment of an interim dividend for the six months ended 30 June 2006.

## **REVIEW OF OPERATION**

During the first half of 2006, as a result of unfavorable factors including a downturn in demand in the domestic bulk pharmaceuticals market, continuing increase in energy prices and continuing decline in prices of medicine products, the Company recorded sales (prepared under the PRC accounting standards) of approximately RMB861,634,000, a decrease of 1.15%, compared with that for the same period last year. However, in the face of the adverse impact from such unfavorable environment, the Company took initiatives in reducing products cost as well as organising sale of bestselling products to further bring its advantageous market position of key products into play. The Company's sale profit margin (prepared under the PRC accounting standards) was 18.45%, 0.26 percentage point up compared with that for the same period last year.

The following is an overall review of the main businesses of the Group in the first half of 2006.

### **1. Exploring global pharmaceutical markets and enhancing economic cooperation**

During the first half of 2006, the domestic bulk pharmaceutical market experienced a downturn. Therefore, adhering to its principle of avoiding Renminbi exchange risks and development of ultimate customers, the Company went all out in the exploration for overseas bulk pharmaceuticals markets and hence recorded income from exports of approximately US\$51,397,000, representing an increase of 9.26% from that for the same period last year. Sales results in the global market were also remarkable, with a favourable momentum.

Satisfactory results were also achieved from foreign cooperation. After a half year's preparation, Zibo Xinhua - Eastwest Pharmaceutical Company Limited (淄博新華—中西製藥有限責任公司), the joint venture jointly established by the Company and Eastwest Inc. of the United States, is now equipped for bulk production. The Company also enhanced cooperative relations with globally renowned pharmaceutical enterprises. Relevant cooperation projects or proposals are currently in negotiation and discussion.

### **2. Integrating procurement departments to cut down procurement costs**

At the beginning of the year, the Company integrated procurement functions of different departments and established a procurement control department to fully exert advantages in sharing internal resources and extend the scope of tender procurement. During the past half year, the Company also integrated the procurement processes and introduced advanced management methodology to further improve managerial methods and systems for inviting public bidding in procurement. As a result, procurement became more efficient and procurement costs were eventually minimized. In the first half of 2006, the Company's procurement costs for raw materials decreased by approximately RMB17,730,000 as compared with that of the same period last year, which effectively guaranteed the reduction of product cost.

### **3. Speeding up technical improvement and energy efficiency to promote cyclic economy**

The Company continued to put great effort in technology updating and technical improvement as well as reduction of consumption of raw materials to improve product yield ratio with minimized product costs. The Company took feasible measures in economizing on energy and reducing wastage of raw materials in the Company's production, and also put effort in ensuring comprehensive resource utilization developing cyclic economy and cleaner production. For the first half of 2006, the Company saved approximately RMB1,320,000 in consumption of raw materials and approximately RMB5,500,000 in energy consumption.



## CHAIRMAN'S STATEMENT

### 4. Deepening internal reform and improving promotion system to inspire the staff

At the beginning of the year, the Company implemented an experimental reform of competing for appointment for heads in four key departments including the human resources department. Based on this, the Company formulated and improved such rules as "Provisional Methods for Internal Recruitment (Competing for Appointment)", "Provisional Methods for "Position Alternation (Job Rotation)"" and "Management Methods for Transfer of Internal Employees" to rationalize the employment system and to lead to friendly competition among staff. These have greatly inspired the employees' working attitude and enthusiasm and helped to enhance cohesive forces in the enterprise and increased corporate vitality.

## PROSPECTS FOR THE SECOND HALF OF THE YEAR 2006

During the second half of 2006, the state will further rectify the pharmaceutical market and reduce drug prices. Tender procurement of drugs will be reinforced in all local areas. Meanwhile, the anticipated rise in prices of raw materials and energy is becoming reality. Facing such adverse factors, the Group will proactively take a number of practicable measures to integrate preparations and marketing resources for breakthroughs in sale of preparations. Furthermore, it will speed up product mix adjustment, strengthen foreign trade and foster new profit sources.

### 1. Integrating preparations marketing resources for a breakthrough in sale of preparations

Although the enhancement and continuous improvement of the Company's market share of bulk pharmaceuticals has become the basis of its development, the Company realized that its continuing development may be hindered without a breakthrough in preparations. It is both important and urgent work for the Company to accelerate the adjustment to product mix and break through in preparations for the time being. Therefore, the Company will integrate outlets of preparations, staff, brands and sales network of preparations, and ascertain the marketing strategy of preparation in the second half of the year. To implement preparations management, rapid market-oriented reaction system will be set up to improve efficiency in decision-making and execution. The establishment of strict punishment and reward system and elimination system will enhance the vitality of the marketing teams and enable the Company to compete in the domestic preparation market and lay down a basis for the Company's further development.

### 2 Strengthening foreign trade and cooperation to increase profitability

Focusing on adjustment to product mix in the increment of sales, the Group will put greater effort in the development and marketing of new bulk pharmaceutical products based on the development of traditional bulk pharmaceuticals. With its various advantages, the Group seeks to establish "win-win" cooperative partnerships based on mutual trust with global pharmaceutical enterprises. At the same time when the Company will be focused on obtaining more pharmaceutical intermediates processing projects, the Company will also strive for co-operation with internationally renowned pharmaceutical enterprises so as to increase profitability.

### 3. Implementing high standards and stringent requirements to improve management

The Company will bring into full play initiatives in preparations for EDQM's quality audits in the first half year to ensure all staff members' awareness of the "three Firsts", namely, Safety First, Environmental Protection First and Quality First. The Company will also strengthen basic management, technique improvement and tender procurement in order to lead management towards a new stage and facilitate smooth production and operation through strict management.

By order of the Board

**Guo Qin**  
Chairman

28 July 2006  
Zibo, Shandong, PRC