The Group is mainly engaged in the development, manufacturing and sale of bulk pharmaceuticals, pharmaceutical preparations, chemical and other products. The profit of the Group is mainly attributable to these businesses.

1. LIQUIDITY AND ANALYSIS OF FINANCIAL RESOURCES AND CAPITAL STRUCTURE UNDER HKGAAP

As of 30 June 2006, the liquidity ratio of the Group was 129.90%, quick ratio was 94.43%, the turnover ratio of account receivables was 296.41% (turnover ratio of account receivables = turnover / average account receivables and net value of bills x 100%) and turnover ratio of inventory was 273.22% (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 main source of funds of the Group was loans from financial institutions. As at 30 June 2006, the total amount of bank loans was approximately RMB352,225,000, which were unsecured. As at 30 June 2006, cash on hand and in bank amounted to approximately RMB229,945,000 (including the pledged deposits for acceptance of bills of exchange by banks amounted to approximately RMB53,621,000).

The Group has stringent internal control systems for cash and fund management in order to strengthen financial management. The Group has sound liquidity and repayment ability.

For the six months ended 30 June 2006, the Company made an investment of RMB9,008,000 to establish Zibo Xinhua - Eastwest Pharmaceutical Company Limited（淄博新華－中西製藥有限責任公司）with Eastwest Inc. of United States, of which the Company owns 75% of its registered share capital. The Company is confident of the future development of the joint venture company. Apart from the above transaction, the Group did not have any significant investment, takeovers, asset acquisitions or disposals during this reporting period.

The clarification of the performance results of the Group is referred to in the section headed "Results and Financial Analysis under PRC accounting standards".

As at 30 June 2006, the number of employees of the Group amounted to 4,672. The total salaries for employees in the first half of 2006 amounted to RMB45,825,000.

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

The capital debt ratio of the Group was 25.92%. (capital debt ratio = total loans / share capital and total reserve x 100%)

The cash and bank balances of the Company will mainly be used as working capital for production, sales and research.

As at 30 June 2006, the Company has no contingent liabilities.

The assets and debts of the Group were mainly denominated in Renminbi. However, the Group achieved USD51,397,000 in its export for the first half of 2006. Therefore, there was a foreign exchange risk. The Group adopted the following measures to minimize the foreign exchange fluctuation risk: 1. raising the export price in order to minimize foreign exchange risk; and 2. when the Group enters into an export contract involving large quantities of products with other parties, the Group shall seek prior consent from the other party that both parties will bear the foreign exchange fluctuation risk should the foreign exchange fluctuation exceed the contractual limit as agreed by both parties.

2. RESULTS AND FINANCIAL ANALYSIS UNDER PRC ACCOUNTING STANDARDS

In the first half of 2006, the Group achieved a turnover of RMB861,634,000 from its principal business, representing a decrease of 1.15% as compared to the same period last year. The decrease in revenue from principal business was mainly attributable to decrease in the sale of bulk pharmaceuticals due to a downturn in the domestic bulk pharmaceuticals market. Net cash and cash equivalents decreased by RMB121,717,000 as compared to an increase of RMB92,605,000 achieved in the same period last year. The reason for the change was mainly due to repayment of certain bank loans and distribution of cash dividend for the year 2005. Profit from principal business for the first half of 2006 amounted to RMB154,800,000, representing an increase of 0.20%, thus retaining the level as achieved in the same period last year.

Total assets of the Group as at 30 June 2006 amounted to RMB2,047,856,000, representing a decrease of RMB159,197,000 or 7.21% as compared to that as at 1 January 2006. This decrease was mainly due to repayment of certain bank loans and distribution of cash dividend for the year 2005. The short-term loan of the Group as at 30 June 2006 were RMB352,225,000, representing a decrease of RMB66,744,000 from the beginning of this year. Such decrease was attributable to the Company's adjustment of the loan structure, strengthening of the fund dispatch and a decrease in the fund costs. Shareholders' equity of the Company as at 30 June 2006 decreased by RMB10,292,000 or 0.77%, as compared to that as at 1 January 2006, to RMB1,333,201,000. This decrease was mainly attributable to distribution of cash dividend amounting to RMB22,866,000 for the year 2005 in the first half of 2006.

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

By geographical location of customers	**First half of 2006**		First half of 2005	
	Total turnover	**Costs**	Total turnover	Costs
	RMB'000	***RMB'000***	*RMB'000*	*RMB'000*
PRC (incl. Hong Kong)	**516,260**	**416,630**	618,773	505,383
Europe	**127,604**	**106,358**	123,210	105,089
America	**164,974**	**143,208**	78,074	69,431
Others	**52,796**	**36,480**	51,624	33,246
Total	**861,634**	**702,676**	871,681	713,149

By industry and By product	**Income from principal operations**	**Costs of sales of principal operations**	**Gross profit margin**
	RMB'000	*RMB'000*	*(%)*
Bulk pharmaceuticals	502,943	393,782	21.70
Preparations	132,823	87,261	34.30
Medical commercial logistics	216,321	211,958	2.02
Chemical products and other products	9,547	9,675	(1.34)
Total	861,634	702,676	18.45

An analysis of the constitution of profit as compared to 2005 is as follows:

Items	**Amount (RMB'000)**		**% of total profit**	
	Jan. – Jun. 2006	2005	**Jan. – Jun. 2006**	2005
Profit from principal business	**154,800**	296,077	**1,003.31**	2,376.21
Profit from other business	**1,099**	2,622	**7.12**	21.04
Expenses incurred	**(141,711)**	(286,806)	**(918.47)**	(2,301.81)
Investment income	**2,387**	(13,998)	**15.47**	(112.34)
Allowance	**—**	215	**—**	1.73
Profit/Loss from non-operation activities	**(1,146)**	14,350	**(7.43)**	115.17
Profit before taxation	**15,429**	12,460	**100.00**	100.00

Analysis of reasons for changes:

The provision for devaluation of long-term investment of approximately RMB18,000,000 was made in 2005 and had a significant influence on the gross profit for the year 2005. This resulted in greater changes in proportion of constituent items to the profit as compared to that of the same period last year.

3. 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 sale of 3,000,000 State-owned shares). As at 30 June 2006, RMB320,056,000 has been used in the following projects:

Name of project	**Planned investment** *RMB'000*	**Actual investment Jan. - Jun. 2006** *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	—	80,226	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	384,280	—	348,257		RMB28,201,000 financed by the Company

(1) Analgin (GMP) renovation project, L-350 technical renovation project and caffeine technical renovation has been completed. Except for the fact that profit forecast of the caffeine technical renovation project has yet to be realised because of the effects of keen market competition, decrease in product prices and significant increase in prices of chemical materials, other projects have reached their profit forecast.

(2) The preparation stage of the state-level technical center renovation project has been completed and construction will soon begin.

The remaining proceeds were deposited with banks and will be used in accordance with the Company's project commitments.