

FINANCIAL REPORT PREPARED IN CONFORMITY WITH PRC ACCOUNTING STANDARDS FOR THE SIX MONTHS ENDED 30 JUNE 2006 (UNAUDITED)

Balance Sheet

Unit: RMB

Item	NOTES	Consolidated		Company	
		2006.6.30	2005.12.31	2006.6.30	2005.12.31
CURRENT ASSETS					
Cash	7.1	229,945,463.82	363,190,821.79	200,245,720.18	347,545,287.09
Short-term investments		—	—	—	—
Notes receivable	7.2	38,078,768.13	38,055,566.10	35,706,270.98	37,308,366.10
Dividend receivable		—	—	—	—
Interest receivable		1,387,327.50	1,404,455.00	1,387,327.50	1,404,455.00
Accounts receivable	7.3	266,784,233.95	254,455,977.93	243,958,856.21	235,190,011.51
Other receivables	7.4	100,478,561.49	95,626,833.62	122,159,446.82	115,601,420.89
Accounts Prepaid	7.5	11,689,237.42	13,550,818.93	4,888,242.06	6,658,886.86
Inventories	7.6	242,799,093.73	274,764,676.15	210,150,797.16	245,111,762.49
Deferred and prepaid expenses		—	—	—	—
Long-term debt investment due within a year		—	—	—	—
Other current assets		—	—	—	—
Total current assets		891,162,686.04	1,041,049,149.52	818,496,660.91	988,820,189.94
LONG-TERM INVESTMENTS					
Long-term equity investment	7.7	53,343,568.07	54,056,357.79	114,226,863.91	106,076,412.99
Long-term debt investment	7.7	117,075,500.00	117,075,500.00	117,075,500.00	117,075,500.00
Total long-term investments		170,419,068.07	171,131,857.79	231,302,363.91	223,151,912.99
FIXED ASSETS					
Fixed assets - cost	7.8	1,612,425,681.76	1,599,263,587.11	1,589,047,413.33	1,576,496,267.39
Less: accumulated depreciation	7.8	839,610,056.76	791,869,783.86	836,057,799.78	789,039,368.69
Fixed assets net	7.8	772,815,625.00	807,393,803.25	752,989,613.55	787,456,898.70
Less: Provision for impairment fixed assets	7.8	—	—	—	—
Fixed assets net	7.8	772,815,625.00	807,393,803.25	752,989,613.55	787,456,898.70
Construction materials		8,552,717.13	8,552,717.13	8,552,717.13	8,552,717.13
Construction-in-progress	7.9	109,630,696.33	81,614,955.97	109,630,696.33	81,614,955.97
Total fixed assets		890,999,038.46	897,561,476.35	871,173,027.01	877,624,571.80
INTANGIBLE ASSETS AND OTHER ASSETS					
Intangible assets	7.10	95,274,743.48	97,310,967.48	95,274,743.48	97,310,967.48
Long-term prepayments		—	—	—	—
Other long-term assets		—	—	—	—
Total intangible assets and other assets		95,274,743.48	97,310,967.48	95,274,743.48	97,310,967.48
DEFERRED TAX					
Deferred tax debit		—	—	—	—
TOTAL ASSETS		2,047,855,536.05	2,207,053,451.14	2,016,246,795.31	2,186,907,642.21



FINANCIAL REPORT

(PREPARED UNDER PRC ACCOUNTING STANDARDS)

Item	NOTES	Consolidated		Company	
		2006.6.30	2005.12.31	2006.6.30	2005.12.31
LIABILITIES AND CAPITAL					
CURRENT LIABILITIES					
Short-term loans	7.11	352,225,000.00	418,969,306.90	352,225,000.00	418,969,306.90
Notes payable	7.12	176,829,120.00	233,154,906.11	176,829,120.00	233,154,906.11
Accounts payable	7.13	87,712,616.47	120,334,178.91	60,287,805.60	96,762,486.09
Advances from customers	7.14	12,084,123.57	11,662,298.82	10,645,687.88	11,274,685.18
Accrued payroll		—	—	—	—
Welfare & benefit payable		15,297,220.79	15,297,220.79	15,297,220.79	15,297,220.79
Dividends payable	7.15	6,278,715.75	5,516,030.54	6,278,715.75	5,516,030.54
Taxes payable	7.16	711,527.64	(4,017,420.94)	1,869,963.44	(3,135,608.38)
Other payments		—	—	—	—
Other payables	7.17	45,201,542.04	54,045,416.09	44,954,009.54	57,488,161.35
Accrued expenses	7.18	10,722,865.68	3,945,468.73	10,722,865.68	3,945,468.73
Estimated liabilities		—	—	—	—
Long term liabilities					
due within one year		—	—	—	—
Other current liabilities		—	—	—	—
Total current liabilities		707,062,731.94	858,907,405.95	679,110,388.68	839,272,657.31
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
DEFERRED TAXES					
Deferred tax credit		—	—	—	—
Total liabilities		710,624,231.94	862,468,905.95	682,671,888.68	842,834,157.31
MINORITY EQUITY					
Minority Equity		4,030,083.42	1,091,928.47	—	—
OWNERS' EQUITY					
Paid-in stock	7.19	457,312,830.00	457,312,830.00	457,312,830.00	457,312,830.00
Capital surplus	7.20	558,919,077.15	558,919,077.15	558,919,077.15	558,919,077.15
Surplus reserve	7.21	160,207,660.67	160,207,660.67	159,980,492.82	159,980,492.82
Undistributed profit	7.22	157,132,752.28	167,636,170.49	157,362,506.66	167,861,084.93
Including: Dividend in cash to be distributed		—	22,865,641.50	—	22,865,641.50
Unconfirmed investment loss	7.23	(1,027,247.49)	(1,027,247.49)	—	—
Foreign currency statement translation difference	7.24	656,148.08	444,125.90	—	—
Total share capital equity		1,333,201,220.69	1,343,492,616.72	1,333,574,906.63	1,344,073,484.90
Total liabilities & stockholders equity					
		2,047,855,536.05	2,207,053,451.14	2,016,246,795.31	2,186,907,642.21

Profit and loss account and profit distribution (Unaudited)

Unit: RMB

Items	NOTES	Consolidated		Company	
		First half of 2006	First half of 2005	First half of 2006	First half of 2005
1. Revenue from main operations	7.25	861,634,017.50	871,680,519.30	684,807,454.37	741,496,995.87
Less: Cost of main operations	7.25	702,675,966.55	713,149,027.81	530,673,591.44	586,502,541.48
Tax and surcharges for main operations	7.26	4,158,250.22	4,033,027.95	4,036,359.63	3,888,831.39
2. Profit from main operations		154,799,800.73	154,498,463.54	150,097,503.30	151,105,623.00
Add: Profit from other operations	7.27	1,098,536.09	1,097,489.84	(1,049,063.96)	1,097,489.84
Less: Operating expenses		74,963,019.33	74,315,157.29	70,684,610.87	71,639,549.11
General and administrative expenses		56,434,143.18	53,509,586.99	53,919,095.98	52,180,364.87
Financial expenses	7.28	10,313,528.72	9,377,589.34	10,064,158.86	9,385,297.65
3. Operating profit		14,187,645.59	18,393,619.76	14,380,573.63	18,997,901.21
Add: Investment income	7.29	2,387,287.78	1,185,181.79	2,242,315.92	332,341.67
Revenue from subsidiaries		—	214,926.08	—	214,926.08
Non-operating revenue	7.30	499,338.04	1,126,875.20	499,223.80	1,126,875.20
Less: Non-operating expenditures	7.31	1,645,757.92	552,189.34	1,644,914.89	552,189.34
4. Income before tax		15,428,513.49	20,368,413.49	15,477,198.46	20,119,854.82
Less: Income tax		3,130,872.75	4,918,107.50	3,110,135.23	4,817,850.62
Minority profit		(64,582.55)	(170,705.63)	—	—
Add: Unconfirmed investment loss		—	—	—	—
5. Net income		12,362,223.29	15,621,011.62	12,367,063.23	15,302,004.20
Add: Undistributed profit at the beginning of the year		167,636,170.49	163,003,055.71	167,861,084.93	163,534,149.59
6. Profit to be distributed		179,998,393.78	178,624,067.33	180,228,148.16	178,836,153.79
Less: Appropriation of statutory surplus reserve		—	—	—	—
Appropriation of statutory public welfare fund		—	—	—	—
7. Profit to be distributed to investors		179,998,393.78	178,624,067.33	180,228,148.16	178,836,153.79
Less: Appropriation of discretionary surplus reserve		—	—	—	—
Dividend payable on common stock		22,865,641.50	—	22,865,641.50	—
8. Undistributed profit		157,132,752.28	178,624,067.33	157,362,506.66	178,836,153.79

ANNOTATIONS

1. Gain on sale and disposal of a department or an invested enterprise	—	—	—	—
2. Losses arising from natural disasters	—	—	—	—
3. Increase / decrease in income before tax due to a change in accounting policy	—	—	—	—
4. Increase / decrease in income before tax due to a change in accounting estimate	—	—	—	—
5. Losses arising from debt restructurings	—	—	—	—
6. Others	—	—	—	—



FINANCIAL REPORT

(PREPARED UNDER PRC ACCOUNTING STANDARDS)

Statement of Cash flow

Unit: RMB

	First half of 2006	
	Consolidated	Company
1. CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from the sales of goods or rendering of services	673,730,563.51	601,850,545.10
Refund of taxes	11,541,682.78	11,541,682.78
Other cash receipts relating to other operating activities	4,892,710.99	2,315,842.56
SUB-TOTAL OF CASH INFLOWS	690,164,957.28	615,708,070.44
Cash paid for goods and services	527,800,037.40	462,288,423.32
Cash paid to and on behalf of employees	63,641,492.23	61,898,581.28
Payments of all types of taxes	24,153,792.75	23,219,354.87
Other cash payments relating to operating activities	68,317,520.02	64,442,119.03
SUB-TOTAL OF CASH OUTFLOWS	683,912,842.40	611,848,478.50
NET CASH FLOWS FROM OPERATING ACTIVITIES	6,252,114.88	3,859,591.94
2. CASH FLOWS FROM INVESTING ACTIVITIES:		
Cash received from return on investment	—	—
Cash received from distribution of investment profit	3,117,205.00	3,117,205.00
Net cash received from the sales of fixed assets, intangible assets and other long-term assets	702,100.00	702,100.00
Other cash receipts relating to investing activities	—	—
SUB-TOTAL OF CASH INFLOWS	3,819,305.00	3,819,305.00
Cash paid to acquire fixed assets, intangible assets and other long-term assets	59,829,541.79	59,480,277.79
Cash paid to investments	—	9,008,212.50
Other cash payments relating to investing activities	—	—
SUB-TOTAL OF CASH OUTFLOWS	59,829,541.79	68,488,490.29
NET CASH FLOWS FROM INVESTING ACTIVITIES	(56,010,236.79)	(64,669,185.29)
3. CASH FLOWS FROM FINANCING ACTIVITIES		
Cash received from investments by others	3,002,737.50	—
Including: Cash received by the subsidiaries by absorbing the minorities' equity investment	3,002,737.50	—
Cash received from borrowings	—	—
Other cash receipts relating to financing activities	13,237,408.32	13,237,408.32
SUB-TOTAL OF CASH INFLOWS	16,240,145.82	13,237,408.32
Cash repayments of amounts borrowed	65,822,706.90	65,822,706.90
Cash paid for distribution of dividends profits and for interest expenses	22,376,057.65	22,376,057.65
Other cash payments relating to financing activities	—	—
SUB-TOTAL OF CASH OUTFLOWS	88,198,764.55	88,198,764.55
NET CASH FLOWS FROM FINANCING ACTIVITIES	(71,958,618.73)	(74,961,356.23)
4. EFFECT OF CHANGES IN FOREIGN EXCHANGE RATE ON CASH		
5. NET INCREASE IN CASH AND CASH EQUIVALENTS	(121,716,740.64)	(135,770,949.58)

ANNOTATIONS

	First half of 2006	
	Consolidated	Company
1. RECONCILIATION OF NET INCOME TO CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	12,362,223.29	12,367,063.23
Less: Unconfirmed investment loss	—	—
Add: Minority profit	(64,582.55)	—
Provisions for impairment of assets	—	—
Depreciation of fixed assets	49,643,471.56	48,615,363.80
Amortization of intangible assets	2,036,224.00	2,036,224.00
Amortization of long-term prepayments	—	—
Decrease (increase) in expenses to be apportioned	—	—
Increase (decrease) in drawing expenses in advance	6,777,396.95	6,777,396.95
Losses on disposal of fixed assets, intangible assets and other long-term assets (or deduct: gains)	(49,875.71)	(49,875.71)
Losses on scrapping of fixed assets	—	—
Financial expenses	10,313,528.72	10,064,158.86
Investments losses (or deduct: gains)	(2,387,287.78)	(2,242,315.92)
Deferred tax credit (or deduct: debit)	—	—
Decrease in inventories (or deduct: increase)	31,965,582.42	34,960,965.33
Decrease in operating receivables (or deduct: increase)	(15,341,604.41)	(8,911,684.28)
Increase in operating payables (or deduct: decrease)	(89,002,961.61)	(99,757,704.32)
Others	—	—
NET CASH FLOWS FROM OPERATING ACTIVITIES	6,252,114.88	3,859,591.94
2. INVESTING AND FINANCING ACTIVITIES THAT DO NOT INVOLVE CASH RECEIPTS AND PAYMENTS:		
Conversion of debt into capital	—	—
Convertible bonds to be expired within one year	—	—
Fixed assets under finance lease	—	—
3. NET INCREASE IN CASH AND CASH EQUIVALENTS		
Cash and cash equivalents at the end of the period	176,324,677.82	146,624,934.18
Less: Cash and cash equivalents at beginning of the period	298,041,418.46	282,395,883.76
NET INCREASE IN CASH AND CASH EQUIVALENTS	(121,716,740.64)	(135,770,949.58)



FINANCIAL REPORT

(PREPARED UNDER PRC ACCOUNTING STANDARDS)

STATEMENT OF PROVISION FOR THE PERIOD FROM 1 JANUARY TO 30 JUNE 2006 (CONSOLIDATED)

Unit: RMB

Items	2005.12.31	Addition for current period	Reversal for current period	Transferred out	2006.6.30
1. Total amount of bad debts provided	13,293,346.47	—	48,000.00	—	13,341,346.47
Including: Accounts Receivable	10,769,833.80	—	48,000.00	—	10,817,833.80
Other Receivables	2,523,512.67	—	—	—	2,523,512.67
2. Total amount of short-term investments write-down provided	—	—	—	—	—
Including: Stock investment	—	—	—	—	—
Bond investment	—	—	—	—	—
3. Total amount of inventory write-down provided	2,506,110.99	—	—	—	2,506,110.99
Including: Goods on hand	2,506,110.99	—	—	—	2,506,110.99
Raw materials	—	—	—	—	—
4. Total amount provided for impairment of long-term investments	30,000,000.00	—	—	—	30,000,000.00
Including: Long-term equity investment	30,000,000.00	—	—	—	30,000,000.00
Long-term debt investment	—	—	—	—	—
5. Total amount provided for impairment of fixed assets	—	—	—	—	—
Including: Buildings and structures	—	—	—	—	—
Equipment and machinery	—	—	—	—	—
6. Provision for impairment of intangible assets	—	—	—	—	—
Including: Patents	—	—	—	—	—
Trade marks	—	—	—	—	—
7. Provision for impairment of construction in progress	—	—	—	—	—
8. Provision for impairment of designated loan receivable	—	—	—	—	—
9. Total	45,799,457.46	—	48,000.00	—	45,847,457.46

STATEMENT OF PROVISION FOR THE PERIOD FROM 1 JANUARY TO 30 JUNE 2006 (COMPANY)

Unit: RMB

Items	2005.12.31	Addition for current period	Reversal for current period	Transferred out	2006.6.30
1. Total amount of bad debts provided	13,154,358.49	—	48,000.00	—	13,202,358.49
Including: Accounts Receivable	10,630,845.82	—	48,000.00	—	10,678,845.82
Other Receivables	2,523,512.67	—	—	—	2,523,512.67
2. Total amount of short-term investments write-down provided	—	—	—	—	—
Including: Stock investment	—	—	—	—	—
Bond investment	—	—	—	—	—
3. Total amount of inventory write-down provided	2,506,110.99	—	—	—	2,506,110.99
Including: Goods on hand	2,506,110.99	—	—	—	2,506,110.99
Raw materials	—	—	—	—	—
4. Total amount provided for impairment of long-term investments	30,000,000.00	—	—	—	30,000,000.00
Including: Long-term equity investment	30,000,000.00	—	—	—	30,000,000.00
Long-term debt investment	—	—	—	—	—
5. Total amount provided for impairment of fixed assets	—	—	—	—	—
Including: Buildings and structures	—	—	—	—	—
Equipment and machinery	—	—	—	—	—
6. Provision for impairment of intangible assets	—	—	—	—	—
Including: Patents	—	—	—	—	—
Trade marks	—	—	—	—	—
7. Provision for impairment of construction in progress	—	—	—	—	—
8. Provision for impairment of designated loan receivable	—	—	—	—	—
9. Total	45,660,469.48	—	48,000.00	—	45,708,469.48

Appendix to the Profit and Loss Account

Reported Profit	Rate of return on equity (%)				EPS (RMB)			
	Fully diluted		Weighted average		Fully diluted		Weighted average	
	First half of 2006	First half of 2005	First half of 2006	First half of 2005	First half of 2006	First half of 2005	First half of 2006	First half of 2005
Profit from principal operations	11.61	11.40	11.57	11.46	0.338	0.338	0.338	0.338
Operating profit	1.06	1.36	1.06	1.36	0.031	0.040	0.031	0.040
Profit after taxation	0.93	1.15	0.92	1.16	0.027	0.034	0.027	0.034
Profit after taxation and extraordinary items	0.82	0.94	0.82	0.95	0.024	0.028	0.024	0.028



FINANCIAL REPORT

(PREPARED UNDER PRC ACCOUNTING STANDARDS)

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

1. BACKGROUND OF THE COMPANY

Shandong Xinhua Pharmaceutical Company Limited (hereinafter referred to as the “Company”) was established in 1993 pursuant to the reorganization of Shandong Xinhua Pharmaceutical Factory. The Company issued its H Shares in the Hong Kong Stock Exchange in December 1996 and listed its A Shares in the 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 the PRC. The Company issued an additional 30 million ordinary A shares as approved and decreased 3 million state-owned shares in September 2001. In accordance with the revised share reform of the Company for the conversion of non-tradable A shares to tradable A shares (the “Revised Share Reform”) the holder of the non-tradable A shares, Shandong Xinhua Pharmaceutical Group Company Limited (“SXPGC”), which was also an immediate holding company of the Company, offered as consideration, 3.5 shares of non-tradable A shares of the Company for every 10 tradable A Shares held by A share shareholders as registered on the registration date in respect of the implementation of the Revised Share Reform. Upon the completion of the proposal, SXPGC offered 26,653,665 non-tradable A shares as condition to have trading rights in the A share market.

The registered capital of the Company as of 30 June 2006 is RMB457.31 million and its share capital as of 30 June 2006 consists of the following:

	No. of Shares	Amount	Ratio
State-owned shares	187,786	187,786	41.06%
Legal person shares	16,720	16,720	3.66%
Publicly held H shares	150,000	150,000	32.80%
Publicly held A shares	102,807	102,807	22.48%
Total	<u>457,313</u>	<u>457,313</u>	<u>100%</u>

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

According to the circular “Lu Ke Gao Zi (2001) No. 647” issued by the 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

- 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 of the PRC (“MOF”).
- 2 Methods of preparing consolidated financial statements
 - 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 has substantial control over them.
 - 2.2 Consolidated financial statements have been prepared in accordance with the Provisional Regulations on Consolidated Financial Statements and relevant supplementary regulations issued by the 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

1 Accounting year

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

2 Principles of Accounting and basis of valuation

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

3 Reporting currency

The Company's reporting currency is Renminbi ("RMB").

4 Foreign currency translation

Foreign currency transactions for the year are translated into RMB at the exchange rate as 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 prevailing exchange rate as 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.

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 change in value.

6 Short-term investments

- 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.
- 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.
- 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 an item-by-item basis.

7 Bad Debts Provision

- 7.1 Accounts receivable are recognized as bad debts when: (a) the debtor is dissolved or declared bankrupt or becomes insolvent or is badly short of cash flows, or it ceases production due to the occurrence of a severe natural disaster and therefore cannot repay its debts 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 unlikely to be recovered.
- 7.2 Bad debt losses are accounted for using the allowance method. Provision for doubtful accounts is made on an aging basis at the end of the period, and reported in the income statement of the period. Accounts receivable that cannot be recovered has been written off as bad debt losses after approval at a board meeting or shareholders' meeting, and reported as reductions of provision for doubtful accounts.

Provision for bad debts losses are made as follows:

Aging	Bad debts percentage
Less than 1 year	0.5%
1 to 2 years	20%
2 to 3 years	60%
Over 3 years	100%

Provision for bad debts losses of other receivables (other than those from related parties) is made in the same way as for accounts receivable. Provision for special receivables is made after assessing their collectibility.



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8 Inventories

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

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

9 Long-term investments

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

9.1 Long-term equity investments

- 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 investee company.
- 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.

9.2 Long-term debt investments

- 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.
 - 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 value 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.
- 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.

10 Fixed assets and construction-in-progress**10.1 Fixed assets**

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 of over RMB2,000 and useful life of over 2 years.

10.1.2 Fixed assets are recorded at the cost of acquisition. The cost of fixed assets purchased include the purchasing price, value added tax ("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.

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:

Items	Useful 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%

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, significant 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 the following events:

- 1) The market value of fixed assets has declined significantly more than expected as a result of passage of time or normal use and the declined value is not expected to be recovered in the near future;
- 2) Fixed assets have become obsolete or physically damaged;
- 3) Significant adverse changes in 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.



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10.2 Construction in progress

- 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.
- 10.2.2 Construction in progress is transferred to fixed assets at the date of reaching its usable conditions at 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.
- 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 an 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.

11 Borrowing costs

- 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 from the acquisition or construction of a fixed asset, is charged directly as financial expenses in the period incurred. Special borrowing costs incurred from 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.
- 11.2 The borrowing costs 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.

12 Valuation and amortization of intangible assets

- 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.
- 12.2 The cost of 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 by 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.

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) A 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 has expired but can still be used to a certain extent; and
- 4) Other circumstances indicating the impairment of intangible asset.

13 Revenue Recognition

The Company's operating revenue is mainly derived from sale of goods revenue. Revenue is 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 evidence of payment, and 4) the relevant costs can be measured reliably.

14 Accounting for Income Tax

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

4. TAXES

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

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 the 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 has put on records in the local department of revenue.

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

2 Value added tax

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

For the purchase of raw materials, the input VAT is deductible against output VAT at the rate of 17%.

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

3 Urban maintenance and construction tax and education surcharges

Urban maintenance and construction tax and education surcharges are based on the sum of VAT payable and sales tax payable, at the rates of 7%, 3% and 1% respectively.

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.



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5. CHANGES IN ACCOUNTING PRINCIPLES AND ESTIMATES

According to the “Notice in relation to Financial Treatment of Enterprises Following the Implementation of Company Law” (CaiQi [2006] No.67) promulgated by the MOF, the Company transferred the balance of the Public Welfare Fund as at 31 December 2005 to Arbitrary Surplus Reserve. The Company has adopted retrospective adjustment method to reflect the change in accounting policy and eliminated the balance of the Public Welfare Fund as at 31 December 2005 by RMB26,552,898.89.

6. MAJORITY-OWNED SUBSIDIARIES AND ASSOCIATES

1 As of 30 June 2006, the detailed list of the majority-owned subsidiaries and associates of the Company is as follows:

Company name	Registered capital	Amount	Ratio	Principal operations	Consolidated or not
Zibo Xinhua Drug Store Chain Company Limited	RMB2,000,000	RMB1,760,000	88%	Retail of pharmaceuticals	Y
Zibo Xinhua Sanhe Chemical & Industrial Company Limited	USD500,000	USD350,000	70%	Research, production & sale of pharmaceuticals & chemicals	Y
Zibo Xinhua Pharmaceutical Design Institute	RMB2,000,000	RMB1,800,000	90%	Pharmaceutical project design	Y
Dongying Xinhua Pharm. Company Limited	RMB900,000	RMB477,000	53%	Retail of pharmaceuticals	Y
Shandong Xinhua Pharmaceutical (European) GmbH	EUR650,000	EUR500,000	76.9%	Bulk pharmaceutical and intermediates operation	Y
Zibo Xinhua – Perrigo Pharmaceutical Company Limited	USD6,000,000	USD3,000,000	50%	Production & sale of Ibuprofen materials	N
Shandong Xinhua Pharmaceutical Trade Company Limited	RMB48,498,900	RMB47,528,900	98%	Drug sale	Y
Zibo Xinhua-Eastwest Pharmaceutical Company Limited	USD1,500,000	USD1,125,000	75%	Production and sale of calcium polycarbophil materials	Y
Shandong Xinhua Pharmaceutical Import & Export Company Limited	RMB3,000,000	RMB660,000	99.52%	Import & export of cargos and technologies	Y

- 1) Zibo Xinhua Drug Store Chain Company Limited (originally called “Zibo Xinhua Pharmaceutical Company Limited” and the current name has been adopted since December 2003) was incorporated in July 1999, with the registered capital contributed by the Company and SXPGC, 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. In September 2005, Beijing Santian Chemical Tech. Company Limited and Japan Gonghe Pharmaceutical Company Limited signed the equity transfer agreement in which Beijing Santian Tech. Company Limited transferred 5% of the registered capital of Zibo Xinhua Sanhe Chemical & Industrial Company Limited to Japan Gonghe Pharmaceutical Company Limited. The equity transfer agreement the board was approved by the board meeting of Beijing Santian Chemical Tech. Company Limited held on 8 December 2005. So, the shareholders of Zibo Xinhua Sanhe Chemical & Industrial Company Limited are constituted by the Company and Japan Gonghe Pharmaceutical Company Limited, which hold 70% and 30% of the registered capital 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 RMB900,000, Dongying Xinhua Pharmaceutical Company Limited was formed in March 2002 by Zibo Xinhua Drug Store Chain Company Limited (a majority-owned subsidiary of the Company) and Dongying Lanjing Tech. Company Limited, which hold 53% and 47% of equity interests respectively.

- 5) ShanDong Xinhua Pharmaceutical (European) GmbH was established on 25 November 2003. It was jointly invested by the Company and Mr. LI PENG from Germany. The registered capital was 1 million Euros. The Company holds 70% of equity interests, while Mr. LI PENG owns 30%. This company was incorporated in Hamburg, Germany. This company's reporting currency is Euro. In March 2005, the registered capital of this company was changed to EUR650,000 pursuant to the resolution of a board meeting of this company, and the share of equity interest held by the Company and Mr. LI PENG was changed to 76.90% and 23.10% respectively.
- 6) Zibo Xinhua-Perrigo Pharmaceutical Company Limited (hereinafter referred to as "Xinhua-Perrigo"), a foreign invested joint venture company, was established by the Company and the US Perrigo International Company on 11 September 2003. With a registered capital of USD6 million, each party holds 50% of equity interests. The registered address of this company is the Chemical Area in Zibo New and High Technology Industrial Development Zone, Shandong Province. This company's reporting currency is RMB. Since Xinhua-Perrigo is a joint venture, and the Company has no substantial control over this company, and hence is not required to consolidate its financial statement.
- 7) With a registered capital of RMB5 million, Shandong Xinhua Pharmaceutical Trade Company Limited was established on 30 August 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. In March 2005, the registered capital increased by RMB43,498,900, among which, RMB42,628,900 was contributed by the Company in tangible assets, and RMB870,000 was contributed by Zibo Xinhua Drug Store Chain Company Limited in cash. The share of equity interest held by each shareholder remains unchanged.
- 8) With a registered capital of USD1,500,000, Zibo Xinhua Eastwest Pharmaceutical Company Limited was formed on 15 November 2005 by the Company and Eastwest Inc. of United States, which hold 75% and 25% of the registered capital respectively. The registered address of this company is 14 Dongyi Road, Zhangdian, Zibo City, Shandong Province.
- 9) With a registered capital of RMB3,000,000, Shandong Xinhua Pharmaceutical Import & Export Company Limited was formed on 15 May 2006 by Shandong Xinhua Pharmaceutical Trade Company Limited and Zibo Xinhua Drug Store Chain Company Limited (both are majority-owned subsidiaries of the Company), which hold 98% and 2% of the registered capital respectively. In the first period, the registered capital contributed by RMB660,000 in April 2006, among which, RMB600,000 was contributed by Shandong Xinhua Pharmaceutical Trade Company Limited in cash, and RMB60,000 was contributed by Zibo Xinhua Drug Store Chain Company Limited in cash.

2 Change in scope of consolidation

As compared to the same period last year, Zibo Xinhua-Eastwest Pharmaceutical Company Limited and Shandong Xinhua Pharmaceutical Import & Export company Limited were added and included in the Company's consolidated financial statement. The details of the two Companies are set out in the "MAJORITY-OWNED SUBSIDIARIES AND ASSOCIATES".

7. NOTES TO THE CONSOLIDATED ACCOUNT

1 Cash and Cash Equivalents

	2006.6.30	2005.12.31
Cash	67	48
Bank deposits	82,257	280,414
Other funds	147,621	82,729
Total	<u>229,945</u>	<u>363,191</u>
Including: Cash and cash equivalents	176,324	298,042

The end balance of other funds includes a sum of RMB53,621,000 (at the beginning of the year: RMB64,702,000) as bank acceptance deposit, according to the acceptance agreements and acceptance contracts between the Company and banks, the Company should deposit 20% - 30% of the face value of bank acceptance in the relevant banks.



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2. Notes Receivable

	2006.6.30	2005.12.31
Bank acceptance	<u>38,079</u>	<u>38,056</u>

The maturity date of notes receivable will be after June 2006. In the end balance there are no mortgaged, discounted or overdue notes receivable.

3. Accounts Receivable

	2006.6.30	Ratio %	Bad debts provision	2005.12.31	Ratio %	Bad debts provision
Less than 1 year	253,859	91.44	965	242,153	91.30	1,222
1 to 2 years	12,605	4.54	2,521	12,140	4.58	2,444
2 to 3 years	9,514	3.43	5,708	9,389	3.54	5,560
Over 3 years	1,624	0.59	1,624	1,544	0.58	1,544
Total	<u>277,602</u>	<u>100.00</u>	<u>10,818</u>	<u>265,226</u>	<u>100.00</u>	<u>10,770</u>

In the end balance, there are no accounts receivable due from shareholders who hold 5% or more of the Company's voting rights.

4. Other Receivables

	2006.6.30	Ratio %	Bad debts provision	2005.12.31	Ratio %	Bad debts provision
Less than 1 year	82,966	80.55	38	78,979	80.47	32
1 to 2 years	7,119	6.91	116	6,494	6.62	308
2 to 3 years	4,590	4.46	238	4,465	4.55	132
Over 3 years	8,327	8.08	2,131	8,212	8.36	2,051
Total	<u>103,002</u>	<u>100</u>	<u>2,523</u>	<u>98,150</u>	<u>100</u>	<u>2,523</u>

5. Advances to Suppliers

	2006.6.30	Ratio %	2005.12.31	Ratio %
Less than 1 year	11,547	98.79	13,498	99.61
1 to 2 years	142	1.21	53	0.39
Total	<u>11,689</u>	<u>100.00</u>	<u>13,551</u>	<u>100.00</u>

The end balance of advance payments does not have any advance payment due from shareholders who hold 5% or more of the Company's voting rights.

6. Inventories

	2006.6.30	Provision for Impairment	2005.12.31	Provision for Impairment
Raw materials	38,569	—	49,439	—
Work-in-progress	70,098	—	92,973	—
Finished products	91,037	2,506	91,961	2,506
Goods in stock	32,648	—	29,653	—
Low-value consumables	11,131	—	11,423	—
Special materials for Government	1,822	—	1,822	—
Total	<u>245,305</u>	<u>2,506</u>	<u>277,271</u>	<u>2,506</u>

Inventories at the end of the period are not impaired except for finished products.

7. Long-Term Investments

	2005.12.31	Additions	Deductions	2006.6.30
Long-term equity investment	84,056	—	713	83,343
Long-term debt investments	117,076	—	—	117,076
Total	<u>201,132</u>	<u>—</u>	<u>713</u>	<u>200,419</u>
Provision for impairment	30,000	—	—	30,000
Net value of long-term investments	<u>171,132</u>	<u>—</u>	<u>713</u>	<u>170,419</u>

Long-term equity investments

Name of investee companies	Period of investment	Proportion of equity interest in investee company	Initial cost	Current equity adjustment	Accumulated equity adjustment	Deductions of disposal	Ending balance	Ending impairment	Provision for impairment at beginning of year
Tianton Securities Company Limited*	Long-term	1.23%	30,000	—	—	—	30,000	30,000	30,000
Pacific Insurance Company Limited	Long-term	0.25%	7,000	—	—	—	7,000	—	—
Ruiheng Pharm & Technology Investment Company Limited	50 years	2.91%	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	(1,128)	(6,464)	—	18,367	—	—
Shandong Xinhua Longxin Chemical & Industrial Company Limited	15 years	40%	10,000	415	1,199	—	11,199	—	—
Total			<u>88,608</u>	<u>(713)</u>	<u>(5,265)</u>	<u>—</u>	<u>83,343</u>	<u>30,000</u>	<u>30,000</u>

Long-term debt investment

Type of bonds	Par value	Annual interest rate	Initial cost	Maturity date	Interest for current period	Accumulated interest	2006.6.30
Electric Power Construction Bond	60	—	60	Matured	—	16	76
Qingdao Hisyn Trust & Investment Company Limited	—	5.27% - 5.54%	130,000	2007.7	3,100	12,670	117,000
Total	<u>—</u>	<u>—</u>	<u>130,060</u>	<u>—</u>	<u>3,100</u>	<u>12,686</u>	<u>117,076</u>



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8. Fixed Assets

	Houses & Buildings	Machinery & Equipment	Transportation Equipment	Electronic Apparatus	Total
Original cost at beginning of year	461,567	1,092,762	18,557	26,378	1,599,264
Add: Increases in the year	—	12,575	1,894	645	15,114
Including: Construction-in-progress transferred in	—	—	—	—	—
Less: Decreases in the year	—	768	1,184	—	1,952
Cost at the end of the period	461,567	1,104,569	19,267	27,023	1,612,426
Accumulated depreciation at beginning of year	191,424	567,255	14,289	18,902	791,870
Add: Increases in the year	7,857	39,658	927	1,200	49,642
Less: Decrease in the year	306	574	1,022	—	1,902
Accumulated depreciation at the end of the period	198,975	606,339	14,194	20,102	839,610
Net value at 31 Dec 2005	270,143	525,507	4,268	7,476	807,394
Net value at 30 June 2006	262,592	498,230	5,073	6,921	772,816

No provision for impairment is made and there is no evidence indicating any impairment of fixed assets at the end of the period.

9. Construction-in-progress

	2006.6.30	2005.12.31
Capital construction projects	109,631	81,615

List of construction projects:

Project	Beginning balance	Additions	Transfer to fixed assets	Other deduction	End balance	Source of funds	Project budget	Project progress	Estimated date of completion
Project for freezing building	2,094	176	—	—	2,270	—	—	—	—
Xinhua (West) int'l industrial Park	5,078	(200)	—	—	4,878	—	—	—	—
Xinhua (East) int'l industrial Park	720	64	—	—	784	—	—	—	—
9-Workshop DK production expansion	2,074	—	—	—	2,074	Self-owned	0	30%	2006.12
Xinhua (East) water supply system	3,710	—	—	—	3,710	Self-owned	5,000	85%	2006.10
Troche expansion project (3-Workshop)	—	5,148	—	—	5,148	Self-owned	30,000	90%	2006.12
Tramadol HCL project	4,009	112	—	—	4,121	Self-owned	3,050	95%	2006.11
Supply and marking warehouse renovation project	8,080	3,002	—	—	11,082	Self-owned	6,000	90%	2006.12
2005 DK production expansion	1,368	177	—	—	1,545	Self-owned	5,000	60%	2006.12
05 high concentration waste water treatment shop renovation project	1,813	2,744	—	—	4,557	Self-owned	6,000	50%	2006.12
Repair Workshop movement project	—	2,179	—	—	2,179	—	—	—	—
Tablet Workshop make up	—	492	—	—	492	—	—	—	—
Injection Workshop make up	—	1,332	—	—	1,332	—	—	—	—
Methyl Process of Theophylline Sodium	—	2,498	—	—	2,498	—	—	—	—
Non-separation from Reaction Solution	—	783	—	—	783	—	—	—	—
105-Workshop nitration mother liquor thickly repair	—	—	—	—	—	—	—	—	—
Others	52,669	9,509	—	—	62,178	Self-owned	—	—	—
Total	81,615	28,016	—	—	109,631				

- 1) Interest capitalization does not apply to construction in progress because no specially-borrowed funds are used.
- 2) There is no impaired construction-in-progress at year-end, and thus no provision for impairment is made.

10. Intangible Assets

	Land use Right	Software use right	Non-patented technology	Total
Cost	110,234	2,728	6,550	119,512
Cost on 1 January 2006	91,456	1,673	4,182	97,311
Accumulated amortization on 1 January 2006	15,436	1,055	2,368	18,859
Increase for the year	—	—	—	—
Amortization for the year	1,212	259	565	2,036
Accumulated amortization on 30 June 2006	16,648	1,314	2,933	20,895
Amount transferred out for the year	—	—	—	—
Cost on 30 June 2006	<u>90,244</u>	<u>1,414</u>	<u>3,617</u>	<u>95,275</u>
Remaining amortization period (Year)	12 - 50	1 - 5	3 - 5	

- 1) The Company purchased the land use right at the price of RMB4,360,000 from its controlling shareholder - SXPGC. The procedure for change of the land use rights certificate has not been completed as of 30 June 2006.
- 2) The Company purchased the land use right at the price of RMB27,595,000 from the government of Zibo New and High-Technology Industrial Development Zone. The procedure for change of the land use rights certificate has not been completed as of 30 June 2006.
- 3) There are no intangible assets impaired at year-end, and no provision for impairment is thus made.

11. Short-term Loans

	2006.6.30	2005.12.31	Annual interest rate (%)
Pledged loans	—	1,691	—
Credit loans	132,225	173,068	—
Secured borrowing	<u>220,000</u>	<u>244,210</u>	3.78 - 5.22
Total	<u>352,225</u>	<u>418,969</u>	

- 1) The secured borrowing is guaranteed by SXPGC.
- 2) The Company does not have any short-term loan due yet not paid off.



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12. Notes Payable

	2006.6.30	2005.12.31
Bank acceptance	<u>176,829</u>	<u>233,155</u>

In the end balance, there are no notes payable due from shareholders who hold 5% and more of the Company's voting power.

13. Accounts Payable

	2006.6.30	2005.12.31
Accounts payable	<u>87,713</u>	<u>120,334</u>

In the end balance, there are no accounts payable due from shareholders who hold 5% and more of the Company's voting power.

14. Advances from Customers

	2006.6.30	2005.12.31
Advances from customers	<u>12,084</u>	<u>11,662</u>

- 1) Most of the advances from customers aged over one year are unsettled small residual payments.
- 2) In the end balance, there are no advances from customers due from shareholders who hold 5% and more of the Company's voting rights.

15. Dividends Payable

	2006.6.30	2005.12.31	Delay Reason
State-owned shares	—	—	
Legal person shares	—	—	
Publicly held A-share	—	—	
Publicly held H-share	—	—	
Others	<u>6,279</u>	<u>5,516</u>	Normal delay
Total	<u>6,279</u>	<u>5,516</u>	

16 Taxes Payable

	2006.6.30	2005.12.31	Applicable
Income tax payable	603	3,877	15%, 33%
VAT payable	(2,413)	(10,979)	—
Sales tax payable	13	942	3%, 5%
Urban maintenance & construction tax payable	415	119	7%
Education surcharges payable	178	96	3%
Local education surcharges payable	59	115	1%
Payroll tax payable	183	402	—
Land-use tax payable	800	(8)	—
Property tax payable	819	19	1.2%
Land VAT payable	—	1,215	30%
Stamp tax payable	55	185	—
Total	<u>712</u>	<u>(4,017)</u>	

17 Other Payables

	2006.6.30	2005.12.31
Other payables	<u>45,202</u>	<u>54,045</u>

In the end balance, there are no other payables due from the shareholders who hold 5% and more of the Company's voting rights.

18 Accrued Expenses

	2006.6.30	2005.12.31
Directors' emoluments	500	—
Audit fees	500	1,000
Financial expenses	1,228	630
Trademark use fees	—	200
Year-end bonus	—	1,960
Technical development spends	1,500	—
Export freight & insurance charges	5,554	155
Others	1,441	—
Total	<u>10,723</u>	<u>3,945</u>



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19 Share Capital

	2006.6.30	2005.12.31
I. Non-tradable shares		
1. Founders' shares:	187,786	214,440
Including: State-owned shares (non-tradable)	187,786	214,440
Domestic legal person held shares	—	—
Foreign-funded legal person held shares	—	—
2. Fund raising legal person shares (non-tradable)	16,720	16,720
3. Transferred and allotted shares	—	—
4. Employee shares	—	—
5. Preferred stock and others	—	—
Sub-total	204,506	231,160
II. Listed shares		
1. Domestically listed RMB ordinary shares (A shares)	102,807	76,153
2. Domestically listed foreign invested shares	—	—
3. Overseas listed foreign invested shares (H shares)	150,000	150,000
4. Others	—	—
Sub-total	252,807	226,153
III. Total stock	457,313	457,313

20 Capital Surplus

	2005.12.31	Additions	Deductions	2006.6.30
Upward revaluation of assets	60,910	—	—	60,910
Premium on stock	496,851	—	—	496,851
Receipt of donation	1,158	—	—	1,158
Total	558,919	—	—	558,919

21 Surplus Reserves

	2005.12.31	Additions	Deductions	2006.6.30
Statutory surplus reserve	68,859	—	—	68,859
Discretionary surplus reserve	91,349	—	—	91,349
Total	160,208	—	—	160,208

22 Profit Distribution

	2006.6.30	2005.12.31
Net income	12,362	5,416
Add: Undistributed profit at beginning of the year	167,636	163,003
Profit available for the year	179,998	168,419
Less: Appropriation of statutory surplus reserve (10%)	—	522
Appropriation of statutory public welfare fund (5%)	—	261
Undistributed profit available for the year	179,998	167,636
Less: Appropriation of discretionary surplus reserve (10%)	—	—
Dividend payable on common stock	22,866	—
Undistributed profit at the end of the year	<u>157,132</u>	<u>167,636</u>
Including: Dividend in cash to be distributed	—	22,866

23 Unconfirmed investment losses

Name	Investment	Initial cost ratio	Amount of shareholder equity of investee company	2006.6.30
Zibo Xinhua Sanhe Chemical & Industrial Company Limited	2,897	70%	(1,467)	(1,027)

24 Foreign Currency Statement Translation Difference

	2006.6.30	2005.12.31
Foreign-currency statement translation difference	<u>656</u>	<u>444</u>

These results are from translating the EUR financial statements of Shandong Xinhua Pharmaceutical (European) GmbH (the overseas subsidiary of the Company) into RMB.

25 Revenue and Costs from Main Operations

	Revenue		Costs	
	2006.1 - 6	2005.1 - 6	2006.1 - 6	2005.1 - 6
Bulk pharmaceuticals	502,943	515,740	393,782	419,868
Including: Export sales	384,899	361,267	306,108	299,308
Preparations	132,823	153,590	87,261	93,418
Commerce circulations	216,321	194,768	211,958	190,676
Chemicals and others	9,547	7,583	9,675	9,187
Total	<u>861,634</u>	<u>871,681</u>	<u>702,676</u>	<u>713,149</u>



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(PREPARED UNDER PRC ACCOUNTING STANDARDS)

26 Taxes and Surcharges for Main Operations

Items	Base of Computation	Tax Rate	2006.1 - 6	2005.1 - 6
City Construction Tax	VAT payable	7%	2,605	2,753
Education surcharges	VAT payable	3%	1,117	1,201
Local education surcharges	VAT payable	1%	372	—
Sales tax	Design revenue	5%	64	79
Total			<u>4,158</u>	<u>4,033</u>

27 Profit from Other Operations

	2006.1 - 6			2005.1 - 6		
	Revenue	Expenditure	Profit	Revenue	Expenditure	Profit
Sales of materials	13,452	15,308	(1,856)	13,241	13,092	149
Sales of water, power and gas	4,918	4,938	(20)	5,938	5,954	(16)
Leasing	1,002	176	826	1,155	191	964
Others	2,149	—	2,149	—	—	—
Total	<u>21,521</u>	<u>20,422</u>	<u>1,099</u>	<u>20,334</u>	<u>19,237</u>	<u>1,097</u>

28 Financial Expenses

	2006.1 - 6	2005.1 - 6
Interest expenses	10,260	10,545
Banking charge	772	607
Less: Interest income	2,242	1,797
Exchange losses / gains	1,081	274
Others	443	(251)
Total	<u>10,314</u>	<u>9,378</u>

29 Investment Income

	2006.1 - 6	2005.1 - 6
Bond investment income	3,100	3,250
Fund investment income	—	(512)
Share of investee company's net income under the equity method	(713)	(1,553)
Total	<u>2,387</u>	<u>1,185</u>

30 Non-Operating Income

	2006.1 - 6	2005.1 - 6
Proceeds from disposal of fixed assets	480	1,078
Income from penalties	19	48
Others	—	1
Total	<u>499</u>	<u>1,127</u>

31 Non-Operating Expenses

	2006.1 - 6	2005.1 - 6
Loss from disposal of fixed assets	430	121
Overdue fines, penalties, excessive sewage discharge charges etc.	270	8
Others	946	423
Total	<u>1,646</u>	<u>552</u>

8 NOTES TO THE FINANCIAL STATEMENTS OF THE COMPANY
1 Accounts Receivable

	2006.6.30	Bad Debts Ratio %	Provision	2005.12.31	Bad Debts Ratio %	Provision
Less than 1 year	231,473	90.90	1,058	222,914	90.68	1,108
1 to 2 years	12,317	4.84	2,463	12,096	4.92	2,419
2 to 3 years	9,224	3.62	5,534	9,267	3.77	5,560
Over 3 years	1,624	0.64	1,624	1,544	0.63	1,544
Total	<u>254,638</u>	<u>100</u>	<u>10,679</u>	<u>245,821</u>	<u>100</u>	<u>10,631</u>

In the end balance, there are no accounts receivable due from shareholders who hold 5% and more of the Company's voting rights.

2 Other Receivables

	2006.6.30	Bad Debts Ratio %	Provision	2005.12.31	Bad Debts Ratio %	Provision
Less than 1 year	104,647	83.93	38	98,977	83.79	32
1 to 2 years	7,118	5.71	116	6,470	5.48	308
2 to 3 years	4,590	3.68	238	4,465	3.78	132
Over 3 years	8,327	6.68	2,131	8,212	6.95	2,051
Total	<u>124,682</u>	<u>100</u>	<u>2,523</u>	<u>118,124</u>	<u>100</u>	<u>2,523</u>



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3 Long-Term Investments

	2005.12.31	Additions	Deductions	2006.6.30
Long-term equity investments	136,076	8,150	—	144,226
Long-term debt investments	117,076	—	—	117,076
Total	<u>253,152</u>	<u>8,150</u>	<u>—</u>	<u>261,302</u>
Provision for impairment	<u>30,000</u>	<u>—</u>	<u>—</u>	<u>30,000</u>
Net value of long-term investments	<u>223,152</u>	<u>8,150</u>	<u>—</u>	<u>231,302</u>

Including: Long-term equity investments

Name of investee companies	Period of investment	Proportion of equity interest in investee company	Initially cost	Current equity adjustment	Accumulated equity adjustment	Deductions of disposal	End balance	Ending impairment	Provision for impairment at beginning of year
Tiantong Securities Company Limited	Long-term	1.23%	30,000	—	—	—	30,000	30,000	30,000
Pacific Insurance Company Limited	Long-term	0.25%	7,000	—	—	—	7,000	—	—
Ruiheng Pharm & Technology Investment Company Limited	50 years	2.91%	3,200	—	—	—	3,200	—	—
Bank of Communications	Long-term	—	13,577	—	—	—	13,577	—	—
Zibo Xinhua-Perrigo Pharm. Company Limited	Long-term	50%	24,831	(1,128)	(6,464)	—	18,367	—	—
Shandong Xinhua Pharmaceutical (Europe) GmbH	Long-term	76.9%	4,597	(92)	(2,309)	—	2,288	—	—
Zibo Xinhua Drug Store Chain Company Limited	Long-term	88%	1,760	146	132	—	1,892	—	—
Zibo Xinhua Pharm. Design Institute Company Limited	Long-term	90%	1,800	70	(1,490)	—	310	—	—
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	(269)	(144)	—	47,385	—	—
Shandong Xinhua Longxin Chemical & Industrial Company Limited	15 years	40%	10,000	415	1,199	—	11,199	—	—
Zibo Xinhua-Eastwest Pharmaceutical Company Limited	10 years	75%	9,008	—	—	—	9,008	—	—
Total			<u>156,199</u>	<u>(858)</u>	<u>(11,973)</u>	<u>—</u>	<u>144,226</u>	<u>30,000</u>	<u>30,000</u>

4 Revenue and Costs from Main Operations

	Revenue		Costs	
	2006.1 - 6	2005.1 - 6	2006.1 - 6	2005.1 - 6
Bulk pharmaceuticals	505,447	513,157	396,287	417,604
Including: Export sales	387,403	358,685	308,611	297,044
Preparations	143,257	167,395	97,695	107,223
Commerce circulations	27,868	53,834	27,017	52,489
Chemicals and others	8,235	7,111	9,675	9,187
Total	<u>684,807</u>	<u>741,497</u>	<u>530,674</u>	<u>586,503</u>

5 Investment Income

	2006.1 - 6	2005.1 - 6
Bond investment income	3,100	3,250
Fund investment income	—	(512)
Share of investee company's net income under the equity method	(858)	(2,406)
Total	<u>2,242</u>	<u>332</u>

9. RELATED PARTY RELATIONSHIP AND TRANSACTIONS**1 Related Party Relationship****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.	Immediate holding company of the Company	Wholly state-owned	Guo Qin
Xinhua Lukang 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	Liu Congde

1.2 Registered capital (and changes thereof) of related parties under a control relationship

Related Party Name	2005.12.31	Increase for the period	Decrease for the period	2006.6.30
Shadong Xinhua Pharmaceutical Group Company Limited	298,500	—	—	298,500
Xinhua Lukang Pharmaceutical Group Company Limited	495,490	—	—	495,490



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1.3 Shareholdings (and change thereof) of related parties under a control relationship

Related Party Name	Amount of shares		Ratio	
	2006.6.30	2005.12.31	2006.6.30	2005.12.31
Shandong Xinhua Pharmaceutical Group Company Limited	187,786	214,440	41.06%	46.89%

1.4 Nature of related parties not under control relationships

Related Party Name	The relationships with the company	Main businesses	Related Transactions with the Company
Shandong Xinhua Industry & Trade Company Limited	Controlled by the same holding shareholder	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	Controlled by the same holding shareholder	Kindergarten education, etc.	Purchase of services and sale of power
Shandong Zibo XinCat Pharmaceutical Company Limited	Controlled by the same holding shareholder	Production and operation of Western medicine preparation, and chemical materials medicine and intermediates	Sale of power, leasing houses
Shandong Zibo Xinhua-Chemferm Pharmaceutical Company Limited	The same senior management officer	Production and sale of cephal-product series	Sale of power and Purchase of materials
Zibo Packing & Decoration Company Limited of Shandong Xinhua Pharmaceutical Group	Controlled by the same holding shareholder	Packaging & decoration products, printing, packaging & decoration design, and furniture	Sale of power and purchase of packaging materials
Shandong Xinhua Bobang Chemical & Industrial Company Limited	Controlled by the same holding shareholder	Production and sale of chemical production & materials, etc.	Purchase of materials
Zibo Xinhua-Perrigo Pharmaceutical Company Limited	Joint venture	Production and sale of ibuprofen product series	Sale of power
Shandong Xinhua Longxin Chemical & Industrial Company Limited	Associated company	Production and sale of salicylic acid product series	Purchase of materials

2 Related Transactions

2.1 Sale of merchandise

Related Party Name	2006.1 - 6 Amount	2005.1 - 6 Amount	Remark
Shandong Xinhua Industry & Trade Company Limited	6,650	8,714	Sale of power and waste materials
Shandong Zibo XinCat Pharmaceutical Company Limited	411	610	Sale of power
Shandong Zibo Xinhua – Chemferm Pharmaceutical Company Limited	1,897	1,590	Sale of power
Zibo Packing & Decoration Company Limited of Shandong Xinhua Pharmaceutical Group	70	343	Sale of power
Zibo Xinhua – Perrigo Pharmaceutical Company Limited	1,285	117	Sale of power
Zibo All – purpose Service Company Limited of Shandong Xinhua Pharmaceutical Group	—	24	Sale of power
Total	<u>10,313</u>	<u>11,398</u>	

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

2.2 Purchase of materials

Related Party Name	2006.1 - 6 Amount	2005.1 - 6 Amount
Shandong Xinhua Industry & Trade Company	4,933	15,134
Shandong Xinhua Longxin Chemical & Industrial Company Limited	2,723	—
Zibo Packaging & Decoration Company Limited of Shandong Xinhua Pharmaceutical Group	6,613	8,734
Shandong Zibo Xinhua – Chemferm Pharmaceutical Company Limited	4,967	—
Shandong Xinhua Bobang Chemical & Industrial Company Limited	1,388	—
Zibo Xinhua-Perrigo Pharmaceutical Company Limited	4,731	2,710
Total	<u>25,355</u>	<u>26,578</u>

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



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2.3 Trademark usage fees

Related Party Name	Items	2006.1 - 6 Amount	2005.1 - 6 Amount
Shandong Xinhua Pharmaceutical Group Company Limited	Trademark usage fees	<u>1,000</u>	<u>—</u>

2.4 Lease of assets

Related Party Name	Nature of deal	Time of deal	2006.1 - 6 Amount	2005.1 - 6 Amount
Shandong Xinhua Zibo Xincat Pharmaceutical Company Limited	House leasing	1 - 6 months	<u>700</u>	<u>800</u>

The Company lets out assets to related parties at an agreed price.

2.5 Assets purchase

Related Party Name	Nature of deal	Time of deal	2006.1 - 6 Amount	2005.1 - 6 Amount
Shandong Xinhua Pharmaceutical Group Company Limited	Assets purchase	1 - 6 months	<u>1,499</u>	<u>—</u>

The Company purchased assets from related parties at the market price.

2.6 Interest income

Related Party Name	Items	2006.1 - 6 Amount	2005.1 - 6 Amount
Zibo Xinhua-Perrigo Pharmaceutical Company Limited	Interest income	<u>135</u>	<u>—</u>

2.7 Guarantee secured

- 1) On 26 September 2005, the Company signed an export bargainor credit contract with China Import & Export Bank for a contractual amount of RMB200,000,000 and for a period of 12 months. SXPGC provided joint and several guarantee for the liabilities of the Company under the above contract. As at the end of 30 June 2006, the Company received RMB200,000,000 under the contract.
- 2) On 19 December 2005, the Company signed a secured loan contract with the Zibo Zhangdian District branch of Industrial & Commercial Bank of China for a contractual amount of RMB20,000,000 for a period of 12 months. SXPGC provided joint and several guarantee for the liabilities of the Company under the above contract. As at the end of 30 June 2006, the Company received RMB20,000,000 under the contract.

2.8 Fund transactions between related parties

Related Party Name	Funds 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 ¹	—	(6)	—	—
Zibo Xinhua-Perrigo Pharmaceutical Company Limited ²	—	7,136	—	—

1) By the end of 30 June 2006, SXPGC has repaid the non-business capital by way of cash. SXPGC guaranteed not to occupy any capital of the Company starting from 1 January 2006 for non-business reasons.

2) The Company provided a fund of RMB6,921,000 to Zibo Xinhua-Perrigo Pharmaceutical Company Limited, including RMB2,481,000 at the rate of 2.2675% per year for a period of 2 years, starting from 29 July 2004; RMB4,440,000 at the rate of 4.81% per year for a period of 1.5 years, starting from 28 December 2005. The interest due from Zibo Xinhua-Perrigo Pharmaceutical Company Limited incurred in 2005 is RMB135,000.

3 Related Party Current Account Balances

Related Party Name	A/C title	2006.6.30	2005.12.31
Shandong Xinhua Pharmaceutical Group Company Limited	Other receivables	(6)	9,507
Shandong Xinhua Industry & Trade Company	Other receivables	39,811	26,828
Shandong Zibo Xinhua – Chemferm Pharmaceutical Company Limited	Other receivables	1,094	722
Shandong Xinhua Zibo XinCat Pharmaceutical Company Limited	Other receivables	8,192	7,746
Zibo Packing & Decoration Company Limited of Shandong Xinhua Pharmaceutical Group	Other receivables	(1,134)	(59)
Zibo All-purpose Service Company Limited of Shandong Xinhua Pharmaceutical Group	Other receivables	1,374	1,478
Zibo Xinhua – Perrigo Pharmaceutical Company Limited	Other receivables	7,914	7,475
Shandong Zibo Xinhua – Chemferm Pharmaceutical Company Limited	Notes payable	1,921	4,000
Zibo Packing & Decoration Company Limited of Shandong Xinhua Pharmaceutical Group	Notes payable	1,840	2,979
Shandong Xinhua Bobang Chemical & Industrial Company Limited	Account payable	292	344
Shandong Xinhua Bobang Chemical & Industrial Company Limited	Notes payable	761	400
Shandong Xinhua Longxin Chemical & Industrial Company Limited	Account payable	—	145
Shandong Xinhua Longxin Chemical & Industrial Company Limited	Advances to suppliers	732	—

10. CONTINGENCIES

None

11. OTHER EVENTS

None