

MANAGEMENT DISCUSSION AND ANALYSIS

SALES

Benefited from the increase in sales of key products, i.e. Lijunsha, and non-antibiotics finished medicines, the Group's total sales increased from RMB433,092,000 for the corresponding period last year by 3.3% to RMB447,581,000 for the six months ended 30 June 2006.

For the six months ended 30 June					
	2006		2005		
	Sales	Percentage	Sales	Percentage	Change
	<i>RMB'000</i>	<i>of sales</i>	<i>RMB'000</i>	<i>of sales</i>	<i>%</i>
		<i>%</i>		<i>%</i>	
Antibiotics					
— Lijunsha	212,086	47.4	203,352	47.0	4.3
— Paiqi	44,615	10.0	43,594	10.1	2.3
— Erythromycin tablets	31,011	6.9	28,688	6.6	8.1
— Cephalosporin	20,969	4.7	27,949	6.5	-25.0
— Limaixian	7,422	1.7	8,609	2.0	-13.8
— Other antibiotics	10,902	2.4	12,331	2.8	-11.6
Total sales of antibiotics	327,005	73.1	324,523	75.0	0.8
Dobesilate	18,596	4.2	13,007	3.0	43.0
Other finished medicines	59,233	13.2	52,953	12.2	11.9
Total sales of other finished medicines	77,829	17.4	65,960	15.2	18.0
Sales of bulk pharmaceuticals	39,445	8.8	35,614	8.2	10.8
Sales of Chinese medicines	1,856	0.4	4,447	1.0	-58.3
Others	1,446	0.3	2,548	0.6	-43.3
Group's total sales	447,581	100	433,092	100	3.3

ANTIBIOTICS

The sales of antibiotics for the period amounted to RMB327,005,000, which is similar to that of the corresponding period last year.

The sales of Lijunsha, the major product of the Group, accounted for 47.4% of the Group's total sales and amounted to RMB212,086,000, representing an increase of 4.3% as compared to the corresponding period last year. In 2005, the Group reinforced its efforts in market exploration for Lijunsha in small- and medium-sized cities and villages. The sales of Lijunsha have been growing with the increasing marketing initiatives launched in these regions.

In respect of Paiqi, the new generation antibiotics product, the Group is currently focusing its efforts on promoting the product to the first-tier cities. For the six months ended 30 June 2006, sales of Paiqi amounted to RMB44,615,000, representing an increase of 2.3% from RMB43,594,000 for the corresponding period last year.

Subject to market conditions, the Group's sales of Cephalosporins antibiotics products decreased.

OTHER FINISHED MEDICINES

Sales of other finished medicines amounted to RMB77,829,000 for the period, representing an increase of 18.0% as compared to the corresponding period last year. The increase was mainly attributable to the introduction of new products and the increase in the sales of fever relief products. Among other finished medicines, the sales of "Dobesilate", the focal non-antibiotics product under the Group's marketing initiatives, reached RMB18,596,000, representing an increase of 43.0% as compared to RMB13,007,000 for the corresponding period last year. It is the plan of the Group to launch more advertising and promotion activities for Dobesilate in the second half of 2006 in order to speed up its growth.

BULK PHARMACEUTICALS

The growing market demand of bulk pharmaceuticals and the improvement in export environment increased the Group's sales of bulk pharmaceuticals by 10.8% to RMB39,445,000.

COST OF GOODS SOLD AND GROSS PROFIT

The total cost of goods sold amounted to RMB213,403,000 for the six months ended 30 June 2006. The cost of direct materials, direct labour and overhead represented 75.9%, 8.1% and 16.0% of the total cost of goods sold respectively.

For the six months ended 30 June 2006, the Group recorded a total gross profit of RMB234,178,000. The increase in the Group's sales of products with higher gross profit such as Lijunsha, Paiqi and Dobesilate during the period, coupled with the improvement in production efficiency, contributed to the rise of overall gross profit by 2.8 percentage points, from 49.5% for the corresponding period last year to 52.3%.

SELLING AND MARKETING EXPENSES

For the six months ended 30 June 2006, selling and marketing expenses amounted to approximately RMB121,996,000, which mainly comprised advertising expenses of approximately RMB34,580,000, marketing expenses of approximately RMB63,932,000 and sales office and staff expenses of approximately RMB23,484,000.

The increase of 18.8% in selling and marketing expenses for the six months ended 30 June 2006 as compared with that of the corresponding period in 2005 was mainly attributable to the Group's reinforced advertising efforts in promoting products such as Lijunsha, Paiqi and Dobesilate, in addition to increased marketing exploration and sales expenses arising from the adjustment of sales policies.

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses amounted to approximately RMB61,215,000 for the six months ended 30 June 2006, which mainly comprised salaries of approximately RMB19,767,000, depreciation of approximately RMB4,909,000, office and rental expenses of approximately RMB4,723,000, sharing of administrative costs of Shaanxi Xi'an Pharmaceutical Factory of approximately RMB6,500,000, impairment provision for receivables of RMB4,963,000 and research and development expenses of approximately RMB3,561,000.

The increase of 25.5% in general and administrative expenses for the six months ended 30 June 2006 as compared to that of the corresponding period last year was mainly attributable to the increase in the cost of salaries, impairment provision for receivables and other administrative expenses.

OPERATING PROFIT

For the six months ended 30 June 2006, the increase in sales and gross profit has led to a rise of gross profit by 9.3%. However, operating expenses has increased as well, leading to a decrease in the Group's operating profit to RMB54,325,000, representing a drop of 12.3% as compared to that of the corresponding period last year, whereas operating profit margin (defined as operating profit divided by total sales) also dropped from 14.3% to 12.1%.

FINANCE COSTS

The Group's finance costs for the period amounted to RMB3,294,000, which remained similar as compared to that of the corresponding period last year.

INCOME TAX EXPENSE AND PROFIT ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY FOR THE PERIOD

During the period, Xi'an Lijun, the Group's major subsidiary, continued to enjoy the exemption from the enterprise income tax. With the substantial reduction in the amount of deferred tax, the profit attributable to equity holders of the Company for the period increased by 10.8% to RMB41,615,000 while net profit margin (profit attributable to equity holders of the Company for the period divided by total sales) increased to 9.3% from 8.7% for the corresponding period last year.

LIQUIDITY AND FINANCIAL RESOURCES

The Group primarily finances its working capital and other capital requirements by net cash generated from operating activities and resorts to external financing including both long-term and short-term loans from time to time in case the operating cashflow is insufficient to meet the capital requirements.

As at 30 June 2006, the cash and bank balance aggregated to RMB254,873,000 (31 December 2005: RMB275,122,000), comprising RMB148,724,000 of cash and bank balances denominated in Hong Kong dollars, and RMB106,149,000 in RMB.

Bank loans amounted to RMB245,940,000 as at 30 June 2006 (31 December 2005: RMB113,000,000), comprising RMB102,940,000 of bank loan denominated in Hong Kong dollars and RMB143,000,000 in RMB. The increase was mainly due to bank loan obtained for acquisition of 20% interest in Xi'an Lijun on 23 June 2006.

Gearing ratio (defined as total liabilities divided by total assets) of the Group increased from 36.6% as at 31 December 2005 to 48.4% as at 30 June 2006.

Current ratio (defined as current assets divided by current liabilities) of the Group decreased from 1.79 as at 31 December 2005 to 1.32 as at 30 June 2006.

EXCHANGE EXPOSURE

The Group's principal assets, liabilities, revenue and payments are denominated in HKD and RMB. Despite the recent mild appreciation of the RMB exchange rate, the directors believe that the RMB exchange rate will only appreciate by a small percentage in the foreseeable future. In this regard, the directors believe that exposure to exchange rate fluctuations will not have material adverse effect to the Group.

PLEDGE OF ASSETS

As at 30 June 2006, bank deposits of HK\$100,000,000 and the Group's land use rights with the net book amount of approximately RMB6,980,000 was pledged as collateral for the Group's bank borrowings.

CONTINGENT LIABILITIES

As at 30 June 2006, the Group did not have any contingent liabilities.

PROCEEDS FROM INITIAL PUBLIC OFFERING

Proceeds from initial public offering amounted to approximately HK\$145,557,000, net of relevant expenses. Most of the proceeds from initial public offering had not been utilized as at 30 June 2006 and such proceeds were mainly deposited in the bank accounts of the Group.

Application of Proceeds from initial public offering:

	Planned use of net proceeds HK\$'000	Actual use of net proceeds as at 30 June 2006 HK\$'000
Setting up of the new production line of spray form products	3,800	—
Setting up of the new production line of oral solution products	43,300	3,021
Setting up of the new production line of soft capsule form products	21,200	67
Expansion of production capacities of lyophilized powder for injection	17,300	8,688
Improvement of existing products and production technology of Chinese medicines, improvement and expansion of the Group's existing production facilities of Chinese medicines, development of new forms of Chinese medicines, and promotion of the brand name of the Group's Chinese medicines	19,200	—
Enhancement and expansion of the Group's distribution network	9,200	—
Setting up of centralised information and management systems for sales networks	5,800	—
Enhancement of the research and development capability to improve existing and develop new pharmaceutical technology	21,400	3,561
Group's Working capital	4,357	4,357
Total	145,557	19,694

INTERIM DIVIDEND

The Directors resolved to pay on 29 September 2006 an interim dividend of HK\$0.07 per share (amounting to a total of approximately RMB20,933,000) for the six months ended 30 June 2006 to the shareholders named in the register of members of the Company on 21 September 2006. The interim dividend represents a payout rate of 50.3% of net profit attributable to the equity holders of the Company for the six months ended 30 June 2006.

PURCHASE, SALE OR REDEMPTION OF SECURITIES

The Company has not redeemed any of its Shares during the year. Neither the Company nor any of its subsidiaries has purchased or sold any of the Company's listed securities during the year.

SUBSTANTIAL INVESTMENT AND ACQUISITION

On 23 June 2006, the Group completed the acquisition of 20% interest of Xi'an Lijun from Rejoy Group Limited Liability Company for a consideration of RMB102,556,452. Xi'an Lijun became a wholly-owned subsidiary of the Group after the acquisition. Details of the acquisition had been set out in the circular to the shareholders dated 5 June 2006.

SHARE OPTION SCHEME

Pursuant to a share option scheme approved by a written resolution of all shareholders of the Company on 16 October 2005 ("Scheme"), the Company may grant options to, amongst others, the directors or employees of the Company or its subsidiaries, for the recognition of their contributions to the Group, to subscribe for the Shares. The offer for grant of options ("Offer") must be taken up within 28 days from the date of Offer, with a payment of HK\$1.00 as consideration for the grant. The exercise price of the share option will be determined at the higher of (i) the average closing prices of Shares as stated in the Stock Exchange's daily quotations sheets for the five trading days immediately preceding the date of Offer; (ii) the closing price of Shares as stated in the Stock Exchange's daily quotations sheet on the date of Offer; and (iii) the nominal value of the Shares. The share options are exercisable at any time during a period of not more than 10 years from the date of Offer, subject to the terms and conditions of the Scheme and any conditions of grant as may be stipulated by the Board. Unless terminated by the Company by resolution in general meeting, the Scheme shall be valid and effective for a period of 10 years commencing on the date on which the Scheme becomes unconditional.

The maximum number of Shares which may be issued upon exercise of all outstanding options granted and yet to be exercised under the Scheme and any other schemes shall not exceed 30% of the issued share capital of the Company from time to time. The total number of Shares which may be issued upon exercise of all options to be granted under the Scheme and any other schemes must not, in aggregate, exceed 10% of the number of Shares in issue as at the date dealings in the Shares first commence on the Stock Exchange unless further shareholders' approval has been obtained pursuant to the conditions set out in the Scheme. The total number of Shares issued and to be issued upon exercise of all options granted under the Scheme and any other schemes (including both exercised or outstanding options) to each participant in any 12-month period shall not exceed 1% of the issued share capital of the Company.

No option has been granted by the Company under the Scheme since its adoption.

EMPLOYEES AND REMUNERATION POLICY

As at 30 June 2006, the Group had approximately 2,550 employees, most of whom were members of the Group's production team based in the PRC. The number of workers employed by the Group varies from time to time depending on its needs and the emolument policy of employees is based on industry practice.

The remuneration policy of the Group's employees are periodically reviewed. Apart from social insurance and in-house training programmes, discretionary bonuses and share options may be awarded to employees according to the assessment of individual performance.

The total remuneration cost incurred by the Group for the six months ended 30 June 2006 was RMB45,518,000.

DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS IN THE SHARES

As at 30 June 2006, the following Directors had interests or short positions in the Shares, underlying shares or debentures of the Company and its associated corporations (within the meaning of Part XV of the SFO) which are required (a) to be notified to the Company or the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which he is taken or deemed to have under such provisions of the SFO); (b) pursuant to section 352 of the SFO, to be entered in the register referred to therein, or (c) pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers to be notified to the Company and the Stock Exchange.

Long positions in the Shares

Name of Director	Capacity	Number of shares held	% of the issued share capital of the Company
Mr. Wu Qin	Interest in a controlled corporation (<i>Note</i>)	22,344,000	7.69%

Note: These Shares were registered in the name of and beneficially owned by Success Manage International Limited ("Success Manage"), the issued share capital of which is held as to approximately 37.88% by Mr. Wu Qin. Pursuant to Part XV of the SFO, Mr. Wu Qin is deemed to be interested in all the Shares held by Success Manage.

Save as disclosed above, as at 30 June 2006, none of the Directors or chief executives had an interest or short position in the Shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which were required (a) to be notified to the Company or the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which he is taken or deemed to have under such provisions of the SFO); (b) pursuant to section 352 of the SFO, to be entered in the register referred to therein, or (c) pursuant to Model Code for Securities Transactions by Directors of Listed Issuers to be notified to the Company and the Stock Exchange.

SUBSTANTIAL SHAREHOLDERS' AND OTHER PERSON'S INTERESTS IN THE SHARES

As at 30 June 2006, the following persons, other than a Director or chief executive of the Company, have an interest or short position in the shares and underlying shares of the Company which would fall to be disclosed to the Company under S336 of the SFO.

Long positions in the Shares

Name of Shareholder	Capacity	Number of Shares	% of the issued share capital of the Company
Prime United Industries Limited (Note 1)	Beneficial owner	123,984,000	42.68%
Victory Rainbow Investment Limited	Beneficial owner	58,300,000	20.07%
Grand Ocean Shipping Company Ltd. (Note 2)	Interest of controlled corporation	58,300,000	20.07%
Ms. Chen Lin-Dong (Note 2)	Interest of controlled corporation	58,300,000	20.07%
Mr. Xu Ming (Note 2)	Interest of controlled corporation	58,300,000	20.07%
Success Manage	Beneficial owner	22,344,000	7.69%
Ms. Zhang Minfang (Note 3)	Interest of spouse	22,344,000	7.69%
Japan Trustee Services Bank, Ltd.	Trustee	15,016,000	5.17%

Notes:

1. Prime United Industries Limited is held as to 2.43% by Mr. Wu Qin, an executive Director, as to approximately 2.43% by Mr. Wu Zhihong, an executive Director, as to approximately 2.41% by Mr. Huang Chao, an executive Director, as to approximately 4% by Mr. Xie Yunfeng, an executive Director, as to approximately 4% by Ms. Han Yamei, a member of the management of Xi'an Lijun, and as to approximately 84.73% by Mr. Wu Qin, Mr. Wu Zhihong, Mr. Huang Chao, Mr. Xie Yunfeng and Ms. Han Yamei who jointly hold such shares on trust for 4,965 individuals who are present and former employees or their respective estates of Xi'an Lijun and Rejoy Group. Mr. Wu Qin, Mr. Wu Zhihong, Mr. Huang Chao and Mr. Xie Yunfeng, the executive Directors, are also directors of the Prime United Industries Limited.
2. Victory Rainbow Investment Limited is wholly-owned by Grand Ocean Shipping Company Ltd., a company incorporated in the Republic of Liberia, which in turn is owned as to 50% by Ms. Chen Lin-Dong and 50% by Mr. Xu Ming. By virtue of Part XV of the SFO, each of Grand Ocean Shipping Company Ltd., Ms. Chen Lin-Dong and Mr. Xu Ming is deemed to be interested in the Shares held by Victory Rainbow Investment Limited.
3. Success Manage is held as to approximately 37.88% by Mr. Wu Qin. Pursuant to Part XV of the SFO, the spouse of Mr. Wu Qin, Ms. Zhang Minfang, are deemed to be interested in all the Shares held by Success Manage. Mr. Wu Qin, Mr. Wu Zhihong and Mr. Huang Chao, the executive Directors, are also directors of Success Manage International Limited.

COMPLIANCE WITH THE CODE ON CORPORATE GOVERNANCE PRACTICES AND MODEL CODE

The Company has complied with the requirements of the Code on Corporate Governance Practices as set out in Appendix 14 of the Listing Rules of the Stock Exchange during the period.

The Company has adopted the Model Code as set out in Appendix 10 of the Listing Rules as the code for securities transactions by directors. The Company, having made specific enquiry, confirms that all directors have complied with the required standards set out in Model Code throughout the six months period ended 30 June 2006.

INDEPENDENT REVIEW OF AUDITORS

The Interim Financial Report for the six months ended 30 June 2006 has been reviewed by the auditors of the Company, PricewaterhouseCoopers.

AUDIT COMMITTEE

The Audit Committee has reviewed and approved the Interim Financial Report for the six months ended 30 June 2006.

CLOSURE OF REGISTER OF MEMBERS

The register of members of the Company will be closed from Tuesday, 19 September 2006 to Thursday, 21 September 2006 (both day inclusive) during which period no transfer of shares will be effected. In order to qualify for the interim dividend, all transfer documents, accompanied by the relevant share certificate(s), must be lodged with the Company's branch share registrar and transfer office in Hong Kong, Computershare Hong Kong Investor Services Limited, at Shops 1712-16, 17th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong not later than 4:00 p.m. on 18 September 2006.

On behalf of the Board

Wu Qin

Chairman

Hong Kong, 1 September 2006