



中國製藥集團有限公司
China Pharmaceutical
Group Limited

INTERIM REPORT
2006

CONTENTS

| | PAGE |
|---|------|
| CORPORATE INFORMATION | 2 |
| MANAGEMENT DISCUSSION AND ANALYSIS | 3 |
| INDEPENDENT REVIEW REPORT | 6 |
| CONDENSED CONSOLIDATED INCOME STATEMENT | 7 |
| CONDENSED CONSOLIDATED BALANCE SHEET | 8 |
| CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY | 9 |
| CONDENSED CONSOLIDATED CASH FLOW STATEMENT | 10 |
| NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS | 11 |
| OTHER INFORMATION | 20 |

DIRECTORS*Executive:*

CAI Dong Chen (*Chairman*)

WEI Fu Min

YUE Jin

JI Jian Ming

FENG Zhen Ying

CHAK Kin Man

Non-executive:

LEE Ka Sze, Carmelo

Independent Non-executive:

HUO Zhen Xing

QI Mou Jia

GUO Shi Chang

CHAN Siu Keung, Leonard

SOLICITORS

Woo, Kwan, Lee & Lo

27th Floor, Jardine House

1 Connaught Place

Hong Kong

AUDITORS

Deloitte Touche Tohmatsu

Certified Public Accountants

35/F One Pacific Place

88 Queensway

Hong Kong

COMPANY SECRETARY

LEE Ka Sze, Carmelo

AUTHORISED REPRESENTATIVES

WEI Fu Min

CHAK Kin Man

REGISTERED OFFICE

Room 3805

38th Floor

Central Plaza

18 Harbour Road

Wanchai

Hong Kong

SHARE REGISTRAR**AND TRANSFER OFFICE**

Secretaries Limited

26/F Tesbury Centre

28 Queen's Road East

Hong Kong

STOCK EXCHANGE

The Stock Exchange of Hong Kong Limited

STOCK CODE

1093

WEBSITE

www.cpg.hk

MANAGEMENT DISCUSSION AND ANALYSIS

BUSINESS REVIEW AND OUTLOOK

Results

For the first half of 2006, the Group's turnover and profit attributable to shareholders of the Company amounted to HK\$1,749,634,000 and HK\$16,642,000, representing an increase of 21% and a decrease of 81% over the same period of last year respectively.

Vitamin C Series

The total output of this series for the period amounted to 11,807 tonnes, a decrease of 20% over the same period of last year. Product prices continued to decline during the period. For the first and second quarters of the year, the average prices of vitamin C were US\$2.91 and US\$2.79 per kg respectively. The gross profit margin of the entire series decreased from 31.3% in the same period of last year to 15.9% in the current period. Under the current relatively low price level, the output of the manufacturers has decreased accordingly. It is expected that product prices would become stable.

Penicillin Series

The total output of this series for the period amounted to 4,388 tonnes, an increase of 71% over the same period of last year. Product prices were relatively stable during the current period. For the first half of the year, the average prices of penicillin industrial salt, amoxicillin and 6-APA were US\$9.15, US\$20.93 and US\$20.04 per kg respectively. Production costs were decreased due to the increasing utilization rate of the production lines in Inner Mongolia. The gross profit margin of the entire series increased from 9.4% in the same period of last year to 12.4% in the current period. It is expected that market condition will improve gradually and product prices would be able to rebound.

Cephalosporin Series

The total output of this series for the period amounted to 634 tonnes, approximately the same level of the corresponding period of last year. Being affected by the significant increase in market supply, product prices dropped sharply during the period. The average prices of 7-ACA in the first and second quarters of the year were US\$84.01 and US\$74.37 per kg respectively. With the reduction of production costs, the gross profit margin of the entire series only decreased from 20.5% in the same period of last year to 20.0% in the current period. It is expected that product prices would continue to be under pressure.

Finished Drugs

Though market competition remained fierce, the revenue of this business managed to grow by 19% as compared with the same period of last year. Gross profit margin decreased from 24.7% in the same period of last year to 22.6% in the current period. However, the significant increase in distribution costs has brought down the operating profit as compared with the same period of last year. Market competition is expected to remain fierce and the profitability of this business may further decline.

Patent Drug

The patent drug, butylphthalide, which was launched to the market last year, achieved a desirable growth in sales during the period. However, as market build-up work was still in its early stage, this business recorded a loss in the current period.

In order to speed up the development of butylphthalide in overseas markets, the Group entered into a license agreement with an overseas pharmaceutical company during the period. Pursuant to the agreement, the overseas pharmaceutical company is responsible for applying overseas accreditation for the patent drug and developing markets in America and Europe. The Group will receive milestone payments and royalties according to the progress of the overseas accreditation application and future sales.

FINANCIAL REVIEW

Liquidity and Financial Position

Certain long-term bank loans will be due for repayment starting from current year, so parts of the loans were classified as current liabilities at the balance sheet date. As a result, the Group's current ratio fell to 0.94 at June 30, 2006. The Group will seek to improve its liquidity position by arranging new banking facilities. Debtor turnover period (ratio of the total of trade receivables and bills receivable balance to sales, inclusive of value added tax for sales in PRC) increased to 61 days as compared to 51 days in 2005. Inventory turnover period (ratio of inventories balance to cost of goods sold) decreased from 110 days in 2005 to 83 days in current period. For the first half of 2006, the capital expenditure of the Group was HK\$66,489,000.

At June 30, 2006, the Group had total borrowings of HK\$1,505,531,000 (comprising bank loans of HK\$1,449,904,000 and loans from ultimate holding company of HK\$55,627,000). The maturity profile of the total borrowings spreads over a period of three years with HK\$767,024,000 repayable within one year. Net gearing ratio was 45%, which was calculated on the basis of the Group's total borrowings net of bank deposits, bank balances and cash of HK\$379,261,000 over equity at the balance sheet date.

45% of the Group's borrowings is denominated in Hong Kong dollars and the remaining 55% in Renminbi. The Group's revenues are mainly either in Renminbi or in US dollars. The Group is of the view that its exposure to foreign exchange rate risk is limited.

Pledge of Assets

At June 30, 2006, bank deposits of HK\$9,264,000 (December 31, 2005: bank deposits of HK\$2,428,000 and bills receivable of HK\$3,828,000) were pledged to banks to secure banking facilities granted to the Group.

Contingent Liabilities

- (i) The Company and one of its subsidiary are named as, among others, defendants in a number of antitrust complaints filed in The United States of America. The details of the antitrust complaints have been set out in the financial statements of the Company for the year ended December 31, 2005. As at June 30, 2006, three of the antitrust complaints have been served on the Company and the subsidiary.

The directors of the Company are of the view that the allegations in the antitrust complaints are without merit and the directors of the Company intend to contest the claims set out in the antitrust complaints vigorously. The Group has appointed legal advisors to advise them in the legal proceedings and the outcome of the antitrust complaints cannot be estimated with certainty at this stage.

- (ii) At the beginning of 2006, an anti-dumping investigation of Penicillin-G was initiated by the Department of Commerce, Government of India. Two subsidiaries of the Company were invited to provide information for the investigation so as to determine the existence, degree and effect of alleged dumping of the above-mentioned product. On April 28, 2006, the investigation was withdrawn by the Department of Commerce, Government of India. In the opinion of the directors, there is no contingent liability on this investigation as at June 30, 2006.

Employees

At the balance sheet date, the Group has about 12,338 employees, the majority of them are employed in the PRC. The Group continues to offer competitive remuneration packages, discretionary share options and bonuses to staff based on the performance of the Group and the individual employee.

INDEPENDENT REVIEW REPORT

Deloitte.

德勤

TO THE BOARD OF DIRECTORS OF CHINA PHARMACEUTICAL GROUP LIMITED

(incorporated in Hong Kong with limited liability)

Introduction

We have been instructed by the Company to review the interim financial report set out on pages 7 to 19.

Directors' responsibilities

The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited require the preparation of an interim financial report to be in compliance with Hong Kong Accounting Standard 34 "Interim Financial Reporting" issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and the relevant provisions thereof. The interim financial report is the responsibility of, and has been approved by, the directors.

It is our responsibility to form an independent conclusion, based on our review, on the interim financial report, and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

Review work performed

We conducted our review in accordance with Statement of Auditing Standards 700 "Engagements to Review Interim Financial Reports" issued by the HKICPA. A review consists principally of making enquiries of management and applying analytical procedures to the interim financial report and, based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit and therefore provides a lower level of assurance than an audit. Accordingly we do not express an audit opinion on the interim financial report.

Review conclusion

On the basis of our review which does not constitute an audit, we are not aware of any material modifications that should be made to the interim financial report for the six months ended June 30, 2006.

Deloitte Touche Tohmatsu
Certified Public Accountants
Hong Kong
September 7, 2006

CONDENSED CONSOLIDATED INCOME STATEMENT
FOR THE SIX MONTHS ENDED JUNE 30, 2006

| | NOTES | For the six months ended June 30, | |
|---|-------|-----------------------------------|---------------------------------|
| | | 2006 HK\$'000 (Unaudited) | 2005 HK\$'000 (Unaudited) |
| Revenue | 3 | 1,749,634 | 1,442,643 |
| Cost of sales | | (1,427,681) | (1,102,790) |
| Gross profit | | <u>321,953</u> | <u>339,853</u> |
| Other income | | 17,336 | 5,982 |
| Distribution costs | | (111,253) | (71,106) |
| Administrative expenses | | (156,279) | (141,406) |
| Other expenses | | (4,757) | (14,078) |
| Share of results of a jointly controlled entity | | 783 | (438) |
| Finance costs | | (48,115) | (25,575) |
| Profit before tax | 4 | <u>19,668</u> | <u>93,232</u> |
| Income tax expense | 5 | (3,068) | (7,665) |
| Profit for the period | | <u><u>16,600</u></u> | <u><u>85,567</u></u> |
| Attributable to: | | | |
| Equity holders of the Company | | 16,642 | 85,571 |
| Minority interests | | (42) | (4) |
| | | <u><u>16,600</u></u> | <u><u>85,567</u></u> |
| Earnings per share – Basic | 7 | <u><u>HK1.08 cents</u></u> | <u><u>HK5.56 cents</u></u> |

CONDENSED CONSOLIDATED BALANCE SHEET

AT JUNE 30, 2006

| | NOTES | June 30, 2006 HK\$'000 (Unaudited) | December 31, 2005 HK\$'000 (Audited) |
|--|-------|--|--|
| Non-current assets | | | |
| Property, plant and equipment | 8 | 3,084,132 | 3,176,949 |
| Prepaid lease payments | | 137,871 | 154,612 |
| Intangible assets | | 55,580 | 61,233 |
| Goodwill | | 55,764 | 55,764 |
| Interest in a jointly controlled entity | | 24,869 | 24,086 |
| Pledged bank deposits | 9 | 3,746 | 2,428 |
| | | <u>3,361,962</u> | <u>3,475,072</u> |
| Current assets | | | |
| Inventories | | 656,253 | 756,053 |
| Trade and other receivables | 10 | 705,415 | 512,987 |
| Bills receivable | 10 | 145,421 | 118,281 |
| Prepaid lease payments | | 4,174 | 4,474 |
| Loan receivable | | 670 | 670 |
| Tax recoverable | | 176 | 8,096 |
| Trade receivables due from related companies | 11 | 62 | 14,393 |
| Amount due from a jointly controlled entity | 11 | 17,817 | 17,047 |
| Pledged bank deposits | 9 | 5,518 | – |
| Bank balances and cash | | 369,997 | 472,706 |
| | | <u>1,905,503</u> | <u>1,904,707</u> |
| Current liabilities | | | |
| Trade and other payables | 12 | 892,860 | 974,756 |
| Bills payable | 12 | 333,805 | 403,876 |
| Amounts due to related companies | 11 | 8,128 | 4,146 |
| Trade payable due to a jointly controlled entity | 11 | – | 3,107 |
| Tax liabilities | | 16,607 | 7,328 |
| Bank loans – due within one year | 13 | 767,024 | 344,804 |
| | | <u>2,018,424</u> | <u>1,738,017</u> |
| Net current (liabilities) assets | | <u>(112,921)</u> | <u>166,690</u> |
| Total assets less current liabilities | | <u>3,249,041</u> | <u>3,641,762</u> |
| Non-current liabilities | | | |
| Loans from ultimate holding company | 11 | 55,627 | 55,488 |
| Bank loans – due after one year | 13 | 682,880 | 1,090,746 |
| | | <u>738,507</u> | <u>1,146,234</u> |
| | | <u>2,510,534</u> | <u>2,495,528</u> |
| Capital and reserves | | | |
| Share capital | | 153,812 | 153,812 |
| Reserves | | 2,347,662 | 2,331,020 |
| Equity attributable to equity holders of the Company | | <u>2,501,474</u> | <u>2,484,832</u> |
| Minority interests | | 9,060 | 10,696 |
| | | <u>2,510,534</u> | <u>2,495,528</u> |

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE SIX MONTHS ENDED JUNE 30, 2006

Equity attributable to equity holders of the Company

| | Share capital HK\$'000 | Share premium HK\$'000 | Capital contribution HK\$'000 | Goodwill reserve HK\$'000 | Translation reserve HK\$'000 | Non- distributable reserves HK\$'000 | Retained profits HK\$'000 | Total HK\$'000 | Minority interests HK\$'000 | Total HK\$'000 |
|---|------------------------------|------------------------------|-------------------------------------|---------------------------------|------------------------------------|---|---------------------------------|-------------------|-----------------------------------|-------------------|
| At January 1, 2005 | 153,812 | 1,116,727 | 1,362 | (167,254) | 2,692 | 276,334 | 876,213 | 2,259,886 | 10,058 | 2,269,944 |
| Profit for the period | - | - | - | - | - | - | 85,571 | 85,571 | (4) | 85,567 |
| Capital contributions by minority shareholders of a subsidiary | - | - | - | - | - | - | - | - | 1,330 | 1,330 |
| At June 30, 2005 | 153,812 | 1,116,727 | 1,362 | (167,254) | 2,692 | 276,334 | 961,784 | 2,345,457 | 11,384 | 2,356,841 |
| Exchange differences arising on translation of foreign operations recognised directly in equity | - | - | - | - | 68,428 | - | - | 68,428 | 218 | 68,646 |
| Profit for the period | - | - | - | - | - | - | 70,947 | 70,947 | (221) | 70,726 |
| Total recognised income and expense for the period | - | - | - | - | 68,428 | - | 70,947 | 139,375 | (3) | 139,372 |
| Transfers | - | - | - | - | - | 79,190 | (79,190) | - | - | - |
| Capital contributions by minority shareholders of a subsidiary | - | - | - | - | - | - | - | - | 1 | 1 |
| Dividends paid to minority shareholders of a subsidiary | - | - | - | - | - | - | - | - | (686) | (686) |
| At December 31, 2005 | 153,812 | 1,116,727 | 1,362 | (167,254) | 71,120 | 355,524 | 953,541 | 2,484,832 | 10,696 | 2,495,528 |
| Profit for the period | - | - | - | - | - | - | 16,642 | 16,642 | (42) | 16,600 |
| Transfers | - | - | - | - | - | 9,353 | (9,353) | - | - | - |
| Release upon dissolution of subsidiaries | - | - | - | - | - | - | - | - | (1,594) | (1,594) |
| At June 30, 2006 | 153,812 | 1,116,727 | 1,362 | (167,254) | 71,120 | 364,877 | 960,830 | 2,501,474 | 9,060 | 2,510,534 |
| Attributed to: | | | | | | | | | | |
| The Company and its subsidiaries | 153,812 | 1,116,727 | 1,362 | (160,130) | 70,481 | 358,384 | 955,955 | 2,496,591 | 9,060 | 2,505,651 |
| Jointly controlled entity | - | - | - | (7,124) | 639 | 6,493 | 4,875 | 4,883 | - | 4,883 |
| | 153,812 | 1,116,727 | 1,362 | (167,254) | 71,120 | 364,877 | 960,830 | 2,501,474 | 9,060 | 2,510,534 |

Note: The non-distributable reserves represent statutory reserves appropriated from the profit after tax of the Company's subsidiaries and a jointly controlled entity in the People's Republic of China (the "PRC") under the laws and regulations of the PRC.

CONDENSED CONSOLIDATED CASH FLOW STATEMENT
FOR THE SIX MONTHS ENDED JUNE 30, 2006

| | For the six months ended June 30, | |
|---|--|-------------|
| | 2006 | 2005 |
| | HK\$'000 | HK\$'000 |
| | (Unaudited) | (Unaudited) |
| Net cash from (used in) operating activities | 68,830 | (81,584) |
| Net cash used in investing activities: | | |
| Proceeds from disposal of property, plant and equipment | 6 | 2,978 |
| Acquisition of property, plant and equipment | (126,304) | (322,863) |
| Acquisition of leasehold land | – | (18,043) |
| Other investing cash flows | (11,480) | 13,465 |
| | (137,778) | (324,463) |
| Net cash (used in) from financing activities: | | |
| New bank loans raised | 272,727 | 896,147 |
| Repayments of bank loans | (258,373) | (565,020) |
| Other financing cash flows | (48,115) | (25,575) |
| | (33,761) | 305,552 |
| Net decrease in cash and cash equivalents | (102,709) | (100,495) |
| Cash and cash equivalents brought forward | 472,706 | 501,346 |
| Cash and cash equivalents carried forward, represented by bank balances and cash | 369,997 | 400,851 |

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED JUNE 30, 2006

1. BASIS OF PREPARATION

The condensed consolidated financial statements have been prepared in accordance with the applicable disclosure requirements of Appendix 16 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (“Listing Rules”) and Hong Kong Accounting Standard 34 “Interim Financial Reporting” issued by the Hong Kong Institute of Certified Public Accountants (the “HKICPA”).

2. PRINCIPAL ACCOUNTING POLICIES

The condensed consolidated financial statements have been prepared under the historical cost basis.

The accounting policies used in the condensed consolidated financial statements are consistent with those followed in the preparation of the annual financial statements of the Company and its subsidiaries (the “Group”) for the year ended December 31, 2005, except as described below.

In the current period, the Group has applied, for the first time, a number of new Hong Kong Financial Reporting Standards (“HKFRS(s)”), amendments to Hong Kong Accounting Standards (“HKAS (Amendment(s))”) and Interpretations (“HK(IFRIC) – INT(s)”) (hereinafter collectively referred to as the “new HKFRSs”) issued by the HKICPA that are either effective for accounting periods beginning on or after December 1, 2005 or January 1, 2006. The application of the new HKFRSs has had no material effect on how the results for the current or prior accounting periods are prepared and presented. Accordingly, no prior period adjustment has been required.

The Group has not early applied the following new HKFRSs that have been issued but are not yet effective. The directors of the Company anticipate that the application of these new HKFRSs will have no material impact on the results and financial position of the Group.

| | |
|--------------------|--|
| HKAS 1 (Amendment) | Capital disclosures ¹ |
| HKFRS 7 | Financial instruments: Disclosures ¹ |
| HK(IFRIC) – INT 7 | Applying the restatement approach under HKAS 29 Financial Reporting in Hyperinflationary Economies ² |
| HK(IFRIC) – INT 8 | Scope of HKFRS 2 “Share-based Payments” ³ |
| HK(IFRIC) – INT 9 | Reassessment of embedded derivatives ⁴ |

¹ Effective for annual periods beginning on or after January 1, 2007.

² Effective for annual periods beginning on or after March 1, 2006.

³ Effective for annual periods beginning on or after May 1, 2006.

⁴ Effective for annual periods beginning on or after June 1, 2006.

3. REVENUE AND SEGMENT INFORMATION

Business segments

The Group reports its primary segment information by products which are bulk drugs, including penicillin series, cephalosporin series, vitamin C series, finished drugs and others. Segment information about these products is presented below:

For the six months ended June 30, 2006

| | Bulk Drugs | | | Finished Drugs HK\$'000 | Others HK\$'000 | Eliminations HK\$'000 | Consolidated HK\$'000 |
|---|----------------------------------|-------------------------------------|---------------------------------|-------------------------------|--------------------|--------------------------|--------------------------|
| | Penicillin series HK\$'000 | Cephalosporin series HK\$'000 | Vitamin C series HK\$'000 | | | | |
| REVENUE | | | | | | | |
| External sales | 442,370 | 361,006 | 303,111 | 636,057 | 7,090 | – | 1,749,634 |
| Inter-segment sales | 104,552 | 57,217 | 319 | – | – | (162,088) | – |
| TOTAL REVENUE | 546,922 | 418,223 | 303,430 | 636,057 | 7,090 | (162,088) | 1,749,634 |
| Inter-segment sales are charged at prevailing market rates. | | | | | | | |
| SEGMENT RESULTS | 24,196 | 33,570 | 2,581 | 26,972 | (12,176) | | 75,143 |
| Unallocated corporate expenses | | | | | | | (8,143) |
| Share of results of a jointly controlled entity | | | | | 783 | | 783 |
| Finance costs | | | | | | | (48,115) |
| Profit before tax | | | | | | | 19,668 |
| Income tax expenses | | | | | | | (3,068) |
| Profit for the period | | | | | | | 16,600 |

For the six months ended June 30, 2005

| | Bulk Drugs | | | Finished Drugs HK\$'000 | Others HK\$'000 | Eliminations HK\$'000 | Consolidated HK\$'000 |
|---|----------------------------------|-------------------------------------|---------------------------------|-------------------------------|--------------------|--------------------------|--------------------------|
| | Penicillin series HK\$'000 | Cephalosporin series HK\$'000 | Vitamin C series HK\$'000 | | | | |
| REVENUE | | | | | | | |
| External sales | 158,960 | 376,431 | 370,174 | 533,768 | 3,310 | – | 1,442,643 |
| Inter-segment sales | 115,811 | 72,916 | – | – | – | (188,727) | – |
| TOTAL REVENUE | 274,771 | 449,347 | 370,174 | 533,768 | 3,310 | (188,727) | 1,442,643 |
| Inter-segment sales are charged at prevailing market rates. | | | | | | | |
| SEGMENT RESULTS | (12,227) | 33,900 | 71,902 | 44,887 | (8,395) | | 130,067 |
| Unallocated corporate expenses | | | | | | | (10,822) |
| Share of results of a jointly controlled entity | | | | | (438) | | (438) |
| Finance costs | | | | | | | (25,575) |
| Profit before tax | | | | | | | 93,232 |
| Income tax expenses | | | | | | | (7,665) |
| Profit for the period | | | | | | | 85,567 |

Geographical segments

Segment information about the Group's operations by geographical market is presented below:

| | For the six months ended June 30, | |
|--|--|-------------------------|
| | 2006 | 2005 |
| | HK\$'000 | HK\$'000 |
| REVENUE | | |
| The People's Republic of China (the "PRC") | 1,226,593 | 1,001,769 |
| Asia other than the PRC | 284,474 | 214,842 |
| Europe | 125,573 | 128,002 |
| America | 103,136 | 84,772 |
| Others | 9,858 | 13,258 |
| | <u>1,749,634</u> | <u>1,442,643</u> |

4. PROFIT BEFORE TAX

| | For the six months ended June 30, | |
|---|--|-----------------------|
| | 2006 | 2005 |
| | HK\$'000 | HK\$'000 |
| Profit before tax has been arrived at after charging (crediting): | | |
| Amortisation of intangible assets | 10,297 | 7,418 |
| Amortisation of prepaid lease payments | 2,087 | 1,748 |
| Depreciation of property, plant and equipment | 153,297 | 106,762 |
| | <u>165,681</u> | <u>115,928</u> |
| Total depreciation and amortisation | | |
| Loss on disposal of property, plant and equipment | 29 | 12,620 |
| Research and development expenses | 3,626 | 5,039 |
| Share of tax of a jointly controlled entity (included in share of results of a jointly controlled entity) | 187 | 22 |
| Interest income | <u>(1,517)</u> | <u>(1,390)</u> |

5. INCOME TAX EXPENSE

The charge comprises PRC Enterprise Income Tax for both periods.

No Hong Kong Profits Tax is payable by the Company nor its Hong Kong subsidiaries since they either had no assessable profits or incurred tax losses for both periods. Taxation arising in other jurisdictions is calculated at the rates prevailing in the relevant jurisdictions.

Pursuant to the relevant laws and regulations in the PRC, certain PRC subsidiaries of the Company are entitled to exemption and relief from PRC income tax starting from their first profit-making years. The income tax expense for both periods represent income tax provision which has taken into account of the tax incentive.

There was no other significant unprovided deferred tax for the period or at the balance sheet date.

6. DIVIDEND

No dividends were paid during the period. The directors do not recommend the payment of an interim dividend.

7. EARNINGS PER SHARE

The calculation of the basic earnings per share attributable to the equity holders of the Company for the six months ended June 30, 2006 is based on the following data:

| | For the six months ended June 30, | |
|--|--|------------------------------|
| | 2006 | 2005 |
| Profit for the period attributable to equity holders of the Company | <u>HK\$16,642,000</u> | <u>HK\$85,571,000</u> |
| Number of ordinary shares for the purposes of basic earnings per share | <u>1,538,124,661</u> | <u>1,538,124,661</u> |

No diluted earnings per share has been presented for the six months ended June 30, 2006 and 2005 as there was no potential ordinary shares in issue during both periods.

8. PROPERTY, PLANT AND EQUIPMENT

During the period, the Group spent HK\$61,845,000 (January 1, 2005 to June 30, 2005: HK\$322,863,000) on acquisition of property, plant and equipment.

In addition, the Group disposed of certain property, plant and equipment with a carrying amount of HK\$1,364,000 (January 1, 2005 to June 30, 2005: HK\$15,598,000), resulting in a loss on disposal of HK\$29,000 (January 1, 2005 to June 30, 2005: HK\$12,620,000).

9. PLEDGED BANK DEPOSITS

Included in pledged bank deposits were deposits pledged to banks to secure banking facilities granted to the Group for acquisition of property, plant and equipment of HK\$3,746,000 (December 31, 2005: HK\$2,428,000), which were classified in the balance sheet as non-current. The remaining balance of HK\$5,518,000 (December 31, 2005: Nil) represented deposits pledged to banks to secure short-term banking facilities granted to the Group and was classified as current asset.

10. TRADE AND OTHER RECEIVABLES/BILLS RECEIVABLE

The Group allows a credit period from 30 days to 90 days to its trade customers. An aged analysis of trade receivables net of allowances is as follows:

| | June 30, 2006 HK\$'000 | December 31, 2005 HK\$'000 |
|-------------------|---------------------------------------|----------------------------------|
| 0 to 90 days | 457,059 | 353,927 |
| 91 to 180 days | 51,074 | 24,436 |
| 181 to 365 days | 6,968 | 829 |
| | 515,101 | 379,192 |
| Other receivables | 190,314 | 133,795 |
| | 705,415 | 512,987 |

At balance sheet date, the amount of the Group's bills receivable was aged within one year.

11. CONNECTED AND RELATED PARTY DISCLOSURES

During the period, the Group had significant transactions and balances with related parties, some of which are also deemed to be connected parties pursuant to the Listing Rules. The significant transactions with these companies during the period, and balances with them at the balance sheet date, are as follows:

(I) CONNECTED PARTIES

| Name of company | Nature of transactions/ balances | For the six months ended June 30, | |
|--|---|---------------------------------------|----------------------------------|
| | | 2006 HK\$'000 | 2005 HK\$'000 |
| Shijiazhuang Pharmaceutical Group Company Limited ("SPG", the ultimate holding company of the Company) and its subsidiaries excluding the Group (the "SPG Group") | Sale of steam | 633 | – |
| | Purchase of raw materials | 132,391 | 39,811 |
| | Rental expense | 2,877 | 519 |
| | Interest expense on loans from ultimate holding company (note a) | 904 | 820 |
| | Bank guarantee to the Group | 57,416 | – |
| | | June 30, 2006 HK\$'000 | December 31, 2005 HK\$'000 |
| Balance due from (to) the SPG Group | | | |
| – trade receivables (note b) | | 62 | 14,393 |
| – trade payable (note b) | | (3,893) | – |
| – other payables (note b) | | (4,235) | (4,146) |
| | | (8,128) | (4,146) |
| – long-term loans (note a) | | (55,627) | (55,488) |

(II) RELATED PARTIES, OTHER THAN CONNECTED PARTIES

| Name of company | Nature of transactions/ balances | For the six months ended June 30, | |
|--|---|--|---|
| | | 2006 HK\$'000 | 2005 HK\$'000 |
| Hebei Huarong Pharmaceutical Co., Ltd. ("Huarong"), a jointly controlled entity of the Group | Purchase of raw materials | 13,211 | 18,502 |
| | Provision of utility services by the Group (note c) | 4,649 | 3,554 |
| | | June 30, 2006 HK\$'000 | December 31, 2005 HK\$'000 |
| | Balance due from (to) Huarong | | |
| | – dividend receivable | 6,122 | 6,122 |
| | – other receivables (note b) | 11,695 | 10,925 |
| | | 17,817 | 17,047 |
| | – trade payables (note b) | – | (3,107) |
| | | For the six months ended June 30, 2006 HK\$'000 | 2005 HK\$'000 |
| Ouyi Pharmaceutical Co., Ltd. ("Ouyi"), a former associate of SPG (note d) | Sale of finished goods | – | 1,248 |
| | Purchase of raw materials | – | 6,319 |
| | Rental income | – | 150 |
| | Service charges relating to administrative, selling, utility, energy, community, land use rights and other supporting services and facilities | – | 131 |
| | Income from provision of technology consultancy services | – | 388 |

(III) OTHER STATE-OWNED ENTITIES IN THE PRC

The Group operates in an economic regime currently predominated by entities directly or indirectly owned by the PRC government through its government authorities, agencies, affiliations and other organisations ("state-owned entities"). Transactions with other state-owned entities include but are not limited to the followings:

- lending and deposit taking;
- taking and placing of inter-bank balances;
- purchase, sale and lease of property and other assets; and
- rendering and receiving of utilities and other services.

These transactions are conducted in the ordinary course of the Group's business on terms similar to those that would have been entered into with non-state-owned entities. The Group has also established its pricing strategy and approval processes for major products and services, such as loans, deposits and commission income. Such pricing strategy and approval processes do not depend on whether the customers are state-owned entities or not. Having due regard to the substance of the relationship, the directors of the Company are of the opinion that none of these transactions are material related party transactions that require separate disclosure.

(IV) COMPENSATION OF KEY MANAGEMENT PERSONNEL

The remuneration of key management of the Group during the period was as follows:

| | For the six months ended June 30, | |
|--------------------------|--|--------------|
| | 2006 | 2005 |
| | HK\$'000 | HK\$'000 |
| Short-term benefits | 3,803 | 3,781 |
| Post-employment benefits | 283 | 283 |
| | <u>4,086</u> | <u>4,064</u> |

The above remuneration is determined by the remuneration committee having regard to the performance of individuals and market trends.

Notes:

- (a) Included in loans from ultimate holding company is an amount of HK\$47,847,000 which is interest bearing at prevailing market rates, the remaining balance is interest-free.
- (b) At the balance sheet date, the amount was aged within one year.
- (c) The transactions were based on the actual costs incurred.
- (d) Ouyi was a former associate company of SPG and the relationship ceased on July 31, 2005. Only the transactions with Ouyi prior to July 31, 2005 were considered as related party transactions.

12. TRADE AND OTHER PAYABLES/BILLS PAYABLE

An aged analysis of trade payables is as follows:

| | June 30, 2006 HK\$'000 | December 31, 2005 HK\$'000 |
|--------------------|---------------------------------------|----------------------------------|
| 0 to 90 days | 344,798 | 383,495 |
| 91 to 180 days | 89,646 | 69,611 |
| 181 to 365 days | 28,637 | 26,432 |
| More than 365 days | 19,201 | 19,395 |
| | <hr/> | <hr/> |
| | 482,282 | 498,933 |
| Other payables | 410,578 | 475,823 |
| | <hr/> | <hr/> |
| | 892,860 | 974,756 |
| | <hr/> <hr/> | <hr/> <hr/> |

At balance sheet date, the amount of the Group's bills payable was aged within one year.

13. BANK LOANS

During the period, the Group obtained new bank loans amounted to approximately HK\$272,727,000. The loans bear interest at prevailing market rates and were used to finance the general operations of the Group. In addition, the Group repaid bank loans of approximately HK\$258,373,000 during the period.

14. CAPITAL COMMITMENTS

At the balance sheet date, the Group had the following capital commitments:

| | June 30, 2006 HK\$'000 | December 31, 2005 HK\$'000 |
|--|---------------------------------------|----------------------------------|
| Capital expenditure contracted for but not provided in the financial statements in respect of acquisition of | | |
| – property, plant and equipment | 21,260 | 7,867 |
| – intangible assets | 4,978 | 3,568 |
| | <hr/> | <hr/> |
| | 26,238 | 11,435 |
| | <hr/> <hr/> | <hr/> <hr/> |
| Capital expenditure authorised but not contracted for in respect of acquisition of property, plant and equipment | 23,598 | 40,450 |
| | <hr/> <hr/> | <hr/> <hr/> |

15. CONTINGENT LIABILITIES

- (i) As disclosed in the financial statements of the Company for the year ended December 31, 2005, the Company and one of its subsidiaries are named as, among others, defendants in a number of antitrust complaints filed in The United States of America (the “United States”). These antitrust complaints have alleged that certain manufacturers of vitamin C in the PRC have since at least December 2001 conspired to control prices and volumes of exports of vitamin C to the United States and elsewhere in the world and that as such have been in violation of the antitrust laws of the United States. It is alleged in the antitrust complaints that the purchasers of vitamin C in the United States paid more for vitamin C than they would have paid in the absence of the alleged conspiracy and, therefore, suffered losses. The plaintiffs (purportedly as representatives of classes of similar plaintiffs) seek treble unspecified damages and other relief. Up to the date of this report, three of the antitrust complaints have been served on the Company and the subsidiary.

The directors of the Company are of the view that the allegations in the antitrust complaints are without merit and, the directors of the Company intend to contest the claims set out in the antitrust complaints vigorously. The Group has appointed legal advisors to advise them in the legal proceedings and the outcome of the antitrust complaints cannot be estimated with certainty at this stage.

- (ii) At the beginning of 2006, an anti-dumping investigation of Penicillin-G was initiated by the Department of Commerce, Government of India. Two subsidiaries of the Company were informed to provide information for the investigation so as to determine the existence, degree and effect of alleged dumping of the above-mentioned product. On April 28, 2006, the investigation was withdrawn by the Department of Commerce, Government of India. In the opinion of directors, there is no contingent liabilities on this investigation as at June 30, 2006.

OTHER INFORMATION

Directors' Interests in Shares, Underlying Shares and Debentures

As at June 30, 2006, the interests of the directors and their associates in the shares, underlying shares and debentures of the Company and its associated corporations (within the meaning of Part XV of the Securities and Future Ordinance (“SFO”)), as recorded in the register maintained by the Company pursuant to Section 352 of the SFO or as otherwise notified to the Company and The Stock Exchange of Hong Kong Limited (the “Stock Exchange”) pursuant to the Model Code for Securities Transactions by Directors of Listed Companies (the “Model Code”) contained in the Rules Governing the Listing of Securities on the Stock Exchange (the “Listing Rules”), were as follows:

| Name of director | Capacity | Number of issued ordinary shares held | Percentage of the issued share of the Company |
|------------------|------------------|---------------------------------------|---|
| Cai Dong Chen | Beneficial owner | 2,000,000 | 0.13% |
| Chak Kin Man | Beneficial owner | 4,000 | 0.00026% |

Other than as disclosed above, as at June 30, 2006, none of the directors nor their associates had any interests or short positions in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) as recorded in the register required to be kept under Section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code.

Arrangements to Purchase Shares or Debentures

Other than the share option scheme of the Company, at no time during the period was the Company, its holding company, or any of its fellow subsidiaries or subsidiaries, a party to any arrangements to enable the directors of the Company to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.

Share Option Scheme

The Company's share option scheme was adopted on July 6, 2004 for the purpose of providing incentive to directors (or any persons proposed to be appointed as such, whether executive or non-executive) and employees (whether full-time or part-time) of each member of the Group, eligible business consultants, professionals and other advisers who have rendered services or will render service to the Group as determined by the board of directors.

No option had been granted or agreed to be granted under the share option scheme since its adoption.

Substantial Shareholders

As at June 30, 2006, the register of substantial shareholders maintained by the Company pursuant to Section 336 of the SFO shows that the following shareholders had notified the Company of relevant interests in the share capital of the Company.

| Name of substantial shareholder | Capacity | Number of ordinary shares of the Company held | Percentage of issued share capital |
|---|---|--|---|
| Shijiazhuang Pharmaceutical Group Company Limited (“SPG”) | Beneficial owner and controlled corporation | 783,316,161 <i>(Note)</i> | 50.93% |
| Templeton Investment Counsel, LLC | Investment Manager | 77,078,246 | 5.01% |

Note: In respect of the 783,316,161 shares, 773,436,399 shares are held by SPG and 9,879,762 shares are held by China Charmaine Pharmaceutical Company Limited, a wholly-owned subsidiary of SPG

Other than as disclosed above, the Company has not been notified of any other relevant interests or short positions in the issued share capital of the Company or any other interests representing 5% or more of the issued share capital of the Company as at June 30, 2006.

Corporate Governance

The Company has complied with the code provisions in the Code on Corporate Governance Practices contained in Appendix 14 of the Listing Rules during the six months ended June 30, 2006 with certain deviations as set out below.

Code provision A.2.1 stipulates that the roles of the chairman and managing director should be separate and should not be performed by the same individual. As disclosed in the 2005 annual report of the Company, Mr. Cai Dong Chen has assumed both roles as the chairman and managing director of the Company. The Company believes that vesting both roles in Mr. Cai will allow for more effective planning and execution of business strategies. As all major decisions are made in consultation with members of the Board, the Company believes that there is adequate balance of power and authority in place.

Directors’ Securities Transactions

The Company has adopted the Model Code as set out in Appendix 10 of the Listing Rules. Have made specific enquiry, all directors have complied with the required standard set out in the Model Code throughout the six months ended June 30, 2006.

Purchase, Sale or Redemption of the Company’s Listed Securities

There was no purchase, sale or redemption by the Company or any of its subsidiaries of the Company’s listed securities during the six months ended June 30, 2006.

Disclosure under Rule 13.18 of the Listing Rules

Pursuant to two bank loan agreements, it will be an event of default under each of the loan agreement if SPG owns less than 40% of the issued share capital of the Company. The outstanding principal of these bank loans at June 30, 2006 was HK\$670,000,000 and the last instalment repayment is due in April 2009.

By order of the Board
CAI DONG CHEN
Chairman

Hong Kong, September 7, 2006