
THIS CIRCULAR IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION

If you are in any doubt about this circular or as to the action to be taken, you should consult your stockbroker, bank manager, solicitor, professional accountant or other professional adviser.

If you have sold or transferred all your shares in Shandong Xinhua Pharmaceutical Company Limited, you should at once hand this circular and the accompanying form of proxy to the purchaser or transferee or to the bank, stockbroker or other agent through whom the sale or transfer was effected for transmission to the purchaser or transferee.

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山東新華製藥股份有限公司 Shandong Xinhua Pharmaceutical Company Limited

(a joint stock limited company established in the People's Republic of China with limited liability)

(Stock Code: 0719)

CONTINUING CONNECTED TRANSACTION AND PROPOSED ANNUAL CAPS

**Independent Financial Adviser to the Independent Board Committee
and the Independent Shareholders**



文略融資有限公司
MENLO CAPITAL LIMITED

A letter from the Board is set out on pages 1 to 7 of this circular. A letter from the Independent Board Committee containing its recommendations in respect of the continuing connected transactions is set out on pages 8 to 9 of this circular. A letter from Menlo Capital Limited, the independent financial adviser, containing its advice to the Independent Board Committee and the independent Shareholders is set out on pages 10 to 18 of this circular.

A notice convening an extraordinary general meeting of the Company to be held at the Company's conference room at No. 14 Dongyi Road, Zhangdian District, Zibo City, Shandong Province, The People's Republic of China on Monday, 28 December 2009 at 9:00 a.m. is set out on pages 23 to 25 of this circular. Whether or not you are able to attend the meeting, we encourage you to complete and return the enclosed form of proxy in accordance with the instructions printed thereon, as soon as possible and in any event not less than 24 hours prior to the commencement of the extraordinary general meeting to the Company Secretary's office of the Company at 14 Dongyi Road, Zhangdian District, Zibo City, Shandong Province, The People's Republic of China.

Completion and return of the form of proxy will not preclude you from attending and voting at the meeting should you so wish.

11 November 2009

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DEFINITIONS

In this circular, the following expressions have the meanings set out below unless the context requires otherwise:

“Articles of Association”	the articles of association of the Company
“Board”	the board of Directors
“Company”	山東新華製藥股份有限公司 (Shandong Xinhua Pharmaceutical Company Limited), a joint stock company incorporated in the PRC with limited liability
“Directors”	the directors of the Company
“EGM”	The extraordinary general meeting of the Company to be held on 28 December 2009
“Group”	SXPGC and its subsidiaries, including the Company
“Hong Kong”	Hong Kong Special Administrative Region of the PRC
“HK\$”	Hong Kong dollars, the lawful currency of Hong Kong
“Independent Board Committee”	the independent board committee of the Company comprising three independent non-executive director which is constituted for the purpose of considering the SXPGC Agreement and the proposed caps
“Latest Practicable Date”	4 November 2009, being the last practicable date prior to printing of this circular for ascertaining certain information contained herein
“Listing Rules”	the Rules Governing the Listing of Securities on the Stock Exchange
“PRC”	the People’s Republic of China
“RMB”	Renminbi, the lawful currency of the PRC
“SFO”	the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong)
“Shareholders”	the shareholders of the Company
“Stock Exchange”	The Stock Exchange of Hong Kong Limited

DEFINITIONS

“Supervisor”	the supervisors of the Company
“SXPGC”	means 山東新華醫藥集團有限責任公司(Shandong Xinhua Pharmaceutical Group Company Limited), a wholly-state owned company which holds and owns 35.70% of the total issued share capital of the Company and is currently the largest shareholder of the Company
“SXPGC Agreement”	the written agreement entered into between the Company and SXPGC dated 28 October 2009
“Zibo”	Zibo City, situated in Shandong Province of the PRC

LETTER FROM THE BOARD



山東新華製藥股份有限公司
Shandong Xinhua Pharmaceutical Company Limited

(a joint stock limited company established in the People's Republic of China with limited liability)

(Stock Code: 0719)

Executive Directors:

Ms. Guo Qin (*Chairman*)
Mr. Ren Fulong
Mr. Zhao Songguo

Registered Address:

Chemical Industry Area of Zibo Hi-tech
Industry Development Zone, Zibo City,
Shandong Province, the PRC

Non-executive Directors:

Mr. Liu Zhenwen
Mr. Li Tianzhong
Mr. Zhao Bin

Independent Non-executive Directors:

Mr. Zhu Baoquan
Mr. Sun Minggao
Mr. Kwong Chi Kit, Victor

11 November 2009

To: the Shareholders

Dear Sir or Madam,

**CONTINUING CONNECTED TRANSACTION
AND PROPOSED ANNUAL CAPS**

A. BACKGROUND INFORMATION

On 23 October 2006, the Company entered into an agreement with SXPGC in relation to the Company and/or its subsidiaries purchasing and selling certain products and/or services from and to SXPGC and/or its subsidiaries for a period of three years from 1 January 2007 to 31 December 2009. An announcement was made on 24 October 2006.

LETTER FROM THE BOARD

As the above agreement will expire on 31 December 2009, the Company has entered into the SXPGC Agreement with SXPGC for a period of three years commencing from 1 January 2010.

B. SXPGC AGREEMENT

Date: 28 October 2009

Parties: (i) the Company
(ii) SXPGC

Principal terms and conditions

The SXPGC Agreement contains the following principal terms:

- (1) The Company and/or its subsidiaries shall purchase the following products and services from SXPGC and/or its subsidiaries at market prices, including but not limited, to the following:
 - (a) purchase of accessories in respect of the repairs and maintenance of equipment and tools, hardwares, valves, instruments and meters, bearings, pumps, chemical reagents, glass wares, and the repair and maintenance of the same;
 - (b) purchase of packaging materials including light plates, woodwork, packaging, blow molding, colour printing, paper tray and cardboard drums, bottles and other assorted packing materials; and
 - (c) purchase of trimethyl orthoformate, diethyl malonate, dimethyl malonate, chloroproionyl chloride, sodium methylate, chloroacetic acid, sulphuric acid, salicylic acid, dimethyl sulphate, sodium sulphate, reductant and other chemicals used primarily for the production of pharmaceutical products.

The prices for the products and services stated above shall be determined in accordance with the market practice. However, all of the relevant prices shall not be higher than the selling prices in respect of such items as offered by SXPGC to any independent third parties.

LETTER FROM THE BOARD

- (2) The Company shall sell the following products to SXPGC and/or its subsidiaries:
- (a) supply of water, electricity and steam, at cost plus corresponding tax and management fees; and
 - (b) sundry items of by-products during the manufacturing processes which can be recycled, e.g. waste water, waste gas and other solid wastage, at market prices.

In any event, all of the relevant prices stated above shall not be lower than the selling price in respect of such items as offered to any independent third parties.

- (3) Payment Term: each party shall pay to the other party for the products ordered or services provided in a timely manner as specified in each purchase order placed by the Company, the Company's subsidiaries, SXPGC and SXPGC's subsidiaries from time to time. Payment shall normally be made within 60 days after invoicing.
- (4) The Company and its subsidiaries are not restricted from conducting transactions with any third parties for the sale and purchase of the relevant products and the provisions of services.
- (5) The term of the SXPGC Agreement runs from 1 January 2010 to 31 December 2012.

Proposed annual caps for the SXPGC Agreement

The proposed annual caps for the Company selling products to SXPGC and/or its subsidiaries are as follows:-

	2010 (RMB'000)	2011 (RMB'000)	2012 (RMB'000)
Sale of waste materials,			
supply of water, electricity and steam	31,000	35,000	39,000

The proposed annual caps for the Company and/or its subsidiaries purchasing accessories, raw materials and packaging materials from SXPGC and/or its subsidiaries are as follows:

	2010 (RMB'000)	2011 (RMB'000)	2012 (RMB'000)
Purchase of accessories,			
raw materials and packaging materials	200,000	210,000	220,000

LETTER FROM THE BOARD

The Company has determined the above annual caps based on the following factors:-

- (a) the historical figures in 2007, 2008 and January to August 2009 for the transactions between the Company (and/or its subsidiaries) and SXPGC (and/or its subsidiaries) (see table 1 below);
- (b) the demand set out by SXPGC and/or its subsidiaries;
- (c) the demand set out by the Company and/or its subsidiaries;
- (d) the projected increase in the market prices of chemical raw materials; and
- (e) the development in the business of the Company and/or its subsidiaries.

The proposed annual caps are significantly higher than the respective actual transacted amounts in 2008 and 2009 because in 2008 and 2009 because the market prices of the products and/or services and the sales and purchases to and from SXPGC and/or its subsidiaries decreased considerably due to the worldwide financial turmoil. However, as the worldwide economy has resumed, the Company predicts that there will be a significant increase in the market prices of the products and/or services and in the sales and purchase of the products and/or services to and from SXPGC and its subsidiaries in 2010, 2011 and 2012.

Table 1 — Historical figures in 2007, 2008 and January to August 2009 for the transactions between the Company and/or its subsidiaries and SXPGC and/or its subsidiaries

	2007 <i>(RMB'000)</i>	2008 <i>(RMB'000)</i>	January to August 2009 <i>(RMB'000)</i>
1. Sale of waste materials, supply of water, electricity and steam to SXPGC and/or its subsidiaries	14,036	12,870	7,130
2. Purchase of accessories, raw materials and packaging materials from SXPGC and/or its subsidiaries	96,730	132,098	54,432

LETTER FROM THE BOARD

Reasons for and benefits of the continuing connected transactions between the Company and/or its subsidiaries and SXPGC and/or its subsidiaries under the SXPGC Agreement

By virtue of the SXPGC Agreement, the Company and/or its subsidiaries can continue to generate revenue from selling the respective products to SXPGC and/or its subsidiaries and to secure a steady supply of raw materials and/or sundry products from SXPGC and/or its subsidiaries without incurring extra costs by purchasing them through other parties.

Therefore, the Directors consider that the entering into the SXPGC Agreement is in the best interest of the Company and its Shareholders as a whole. They also consider that the transactions contemplated under the SXPGC Agreement are on normal commercial terms and in the ordinary and usual course of business and that the terms of the transactions under the SXPGC Agreement are fair and reasonable.

Implications under the Listing Rules

The highest annual cap for the Company selling the products to SXPGC and/or its subsidiaries for the years 2010, 2011 and 2012 under the SXPGC Agreement is RMB39,000,000. The applicable percentage ratios (as defined in the Listing Rules) exceed 2.5% on an annual basis and the total consideration exceeds HK\$10,000,000. In accordance with rules 14A.35(3) and (4) of the Listing Rules, the Company is required to obtain an independent Shareholders' approval as described in rule 14A.48, and must comply with the reporting and announcement requirements as described in rules 14A.45 to 14A.47 of the Listing Rules.

The highest annual cap for the Company and/or its subsidiaries purchasing accessories, raw materials and packaging materials from SXPGC and/or its subsidiaries for the years 2010, 2011 and 2012 under the SXPGC Agreement is RMB220,000,000. The applicable percentage ratios (as defined in the Listing Rules) exceed 2.5% on an annual basis and the total consideration exceeds HK\$10,000,000. In accordance with rules 14A.35(3) and (4) of the Listing Rules, the Company is required to obtain an independent Shareholders' approval as described in rule 14A.48, and must comply with the reporting and announcement requirements as described in rules 14A.45 to 14A.47 of the Listing Rules.

Connected Relationship

As at the Latest Practicable Date, SXPGC currently holds 35.70% equity interest of the Company and is therefore a connected person under the Listing Rules. The transactions contemplated under the SXPGC Agreement will constitute continuing connected transactions under the Listing Rules.

Information about the Company and SXPGC

The Company is principally engaged in the development, manufacture and sales of bulk pharmaceuticals, preparations and chemical products.

SXPGC is a state-owned enterprise established in the PRC specialising in investment in the pharmaceutical industry, and associated chemical production, packaging and supply of chemical engineering equipment.

LETTER FROM THE BOARD

C. INDEPENDENT BOARD COMMITTEE

An Independent Board Committee has been formed to advise the independent Shareholders in connection with the SXPGC Agreement and the proposed annual caps.

D. EXTRAORDINARY GENERAL MEETING

The Board have resolved to convene the EGM to consider and, if thought fit by the independent Shareholders, to approve the SXPGC Agreement and the proposed annual caps. Notice of the EGM is set out on pages 23 to 25 of this circular. Whether or not you are able to attend the EGM, we encourage you to complete and return the enclosed form of proxy in accordance with the instructions printed thereon, as soon as possible and in any event not less than 24 hours prior to the commencement of the EGM, to the company secretary at the Company at 14 Dongyi Road, Zhangdian District, Zibo City, Shandong Province, PRC. Completion and return of the form of proxy will not preclude you from attending and voting at the EGM should you so wish.

E. RECOMMENDATION

The Directors (including the independent non-executive Directors) consider that the approval of the SXPGC Agreement and the proposed annual caps are in the best interests of the Company and its Shareholders as a whole and are fair and reasonable as far as the independent Shareholders are concerned.

The Independent Board Committee comprising independent non-executive directors of the Company has been appointed to advise the independent Shareholders on the approval of the SXPGC Agreement and the proposed annual caps. Menlo Capital Limited has been appointed as independent financial adviser to advise the Independent Board Committee and the independent Shareholders in respect of the same.

After taking into account the reasons for and benefits of the SXPGC Agreement, the opinion of Menlo Capital Limited, the Independent Board Committee considers that the approval of the SXPGC Agreement and the proposed annual caps are fair and reasonable as far as the independent Shareholders are concerned. Accordingly, the Independent Board Committee recommends the independent Shareholders to vote in favour of the resolution to be proposed at the EGM to approve the SXPGC Agreement and the proposed annual caps.

All connected persons or Shareholders with a material interest in the transactions and its associates shall abstain from voting in approving the SXPGC Agreement, and the proposed annual caps.

SXPGC is the direct controlling shareholder of the Company and holding 35.70% of the issued share capital of the Company. Pursuant to the Listing Rules, SXPGC and its associates will abstain from voting in the EGM to approve the SXPGC Agreement and the proposed annual caps and all matters contemplated thereunder.

LETTER FROM THE BOARD

The independent Shareholders will be asked to consider and, if thought fit, approve by poll the SXPGC Agreement and the proposed annual caps.

The Company will publish an announcement on the results of the EGM on the business day following the EGM with respect to whether or not the resolutions set out in this circular has been passed by the independent Shareholders.

F. ADDITIONAL INFORMATION

Your attention is drawn to the letter from the Independent Board Committee and the letter of advice from Menlo Capital Limited and information set out in the appendix to this circular.

Yours faithfully,

By order of the Board of Directors

Shandong Xinhua Pharmaceutical Company Limited

Guo Qin

Chairman

LETTER FROM THE INDEPENDENT BOARD COMMITTEE



山東新華製藥股份有限公司
Shandong Xinhua Pharmaceutical Company Limited

(a joint stock limited company established in the People's Republic of China with limited liability)

(Stock Code: 0719)

Independent Non-executive Directors:

Mr. Zhu Baoquan

Mr. Sun Minggao

Mr. Kwong Chi Kit, Victor

Registered Address:

Chemical Industry Area of Zibo Hi-tech
Industry Development Zone, Zibo City,
Shandong Province, The PRC

11 November 2009

To the independent Shareholders

Dear Sir or Madam,

**CONTINUING CONNECTED TRANSACTION
AND PROPOSED ANNUAL CAPS**

We refer to this circular dated 11 November 2009 issued by the Company to its Shareholders, of which this letter forms part. Unless the context otherwise requires, terms defined in the circular shall have the same meanings when used in this letter.

As the Independent Board Committee, we have been appointed to advise the independent Shareholders as to whether, in our opinion, the approval of the SXPGC Agreement and the proposed annual caps, are in the interests of the Company and the Shareholders as a whole and whether they are fair and reasonable so far as the independent Shareholders are concerned. None of the members of the Independent Board Committee have any direct or indirect interest in any of the aforesaid continuing connected transactions. In addition, Menlo Capital Limited has been appointed as independent financial adviser to advise you and us on this matter.

We wish to draw your attention to (i) the letters of advice from Menlo Capital Limited as set out on pages 10 to 18 of this circular; and (ii) the letter from the Board on pages 1 to 7 of this circular, which set out information relating to, and the reasons for and benefits of the approval of the SXPGC Agreement and the proposed annual caps.

LETTER FROM THE INDEPENDENT BOARD COMMITTEE

As the Company's independent Directors, we have discussed with the management of the Company the reasons for and benefits of the approval of the SXPGC Agreement and the proposed annual caps. We have considered the factors and reasons considered by, and the opinions and recommendations of, Menlo Capital Limited as set out on pages 10 to 18 of this circular. We concur with the view of Menlo Capital Limited that the SXPGC Agreement and the annual caps are entered into in the ordinary and usual course of business of the Company, on normal commercial terms and fair and reasonable so far as the Shareholders are concerned and are in the interests of the Company and the Shareholders as a whole. Accordingly, we recommend the independent Shareholders to vote in favour of the approval of the SXPGC Agreement and the annual caps to be proposed at the EGM.

Yours faithfully,

The Independent Board Committee of

Shandong Xinhua Pharmaceutical Company Limited

Mr. Zhu Baoquan, Mr. Sun Minggao, Mr. Kwong Chi Kit, Victor

LETTER FROM MENLO CAPITAL LIMITED

The following is the letter of advice from Menlo Capital Limited in connection with the continuing connected transactions which has been prepared for the purpose of inclusion in this circular:



Menlo Capital Limited
17/F., Asia Standard Tower
59- 65 Queen's Road Central, Hong Kong

11 November 2009

*To the Independent Board Committee and the independent Shareholders of
Shandong Xinhua Pharmaceutical Company Limited*

Dear Sirs,

CONTINUING CONNECTED TRANSACTIONS

INTRODUCTION

We refer to our engagement as the independent financial adviser to advise the Independent Board Committee and the independent Shareholders of the Company (the "Independent Shareholders") on whether (i) the continuing connected transactions contemplated under the SXPGC Agreement are in the interest of the Company and the Shareholders as a whole; (ii) the SXPGC Agreement is within the ordinary and usual course of businesses of the Company and entered into on normal commercial terms; and (iii) the terms and the respective annual caps proposed under the SXPGC Agreement are fair and reasonable so far as the Company and the Independent Shareholders are concerned, details of which are set out in the "Letter from the Board" in this circular (the "Circular") issued by the Company to the Shareholders dated 11 November 2009 of which this letter forms part. Capitalised terms used in this letter shall have the same meanings ascribed to them in the Circular unless the context otherwise requires.

On 28 October 2009, the Company and SXPGC entered into the SXPGC Agreement in relation to the Company and/or its subsidiaries purchasing certain products and services from SXPGC and/or its subsidiaries and the Company selling certain products to SXPGC and/or its subsidiaries for a period of three years from 1 January 2010 to 31 December 2012.

As at the Latest Practicable Date, SXPGC holds and owns 35.70% of the total issued share capital of the Company is currently the largest shareholder of the Company. SXPGC is a connected person of the Company under the Listing Rules. As a result, the transactions contemplated under the SXPGC Agreement will constitute continuing connected transactions under the Listing Rules.

LETTER FROM MENLO CAPITAL LIMITED

The highest annual cap in relation to the Company and/or its subsidiaries purchasing accessories, raw materials and packaging materials from SXPGC and/or its subsidiaries for the years 2010, 2011 and 2012 under the SXPGC Agreement is RMB220,000,000. The applicable percentage ratios (as defined in the Listing Rules) exceed 2.5% on an annual basis and the total consideration exceeds HK\$10,000,000.

The highest annual cap for the Company selling the waste materials and supplying water, electricity and steam to SXPGC and/or its subsidiaries for the years 2010, 2011 and 2012 under the SXPGC Agreement is RMB39,000,000. The applicable percentage ratios (as defined in the Listing Rules) exceed 2.5% on an annual basis and the total consideration exceeds HK\$10,000,000. In accordance with the Listing Rules, the Company is required to obtain an Independent Shareholders approval for entering into the SXPGC Agreement.

In formulating our opinion, we have relied on the accuracy of the information and representations contained in the Circular which have been provided to us by the Directors and which the Directors consider to be complete and relevant, and have assumed that the statements made were true, accurate and complete at the time they were made and continue to be true on the date of the Circular.

We consider that we have received sufficient information to enable us to reach an informed view and to justify our reliance on the accuracy of the information and representations contained in the Circular and to provide a reasonable basis for our view and recommendation. We have taken all reasonable steps pursuant to rule 13.80 (including notes) of the Listing Rules which include the following:

- (a) obtaining the information and documents relevant to an assessment of the fairness and reasonableness of the terms of the SXPGC Agreement together with the proposed annual caps, including but not limited to the Board Letter, the terms of the SXPGC Agreement, the sample transactions executed by the Company in the 2007 and 2008 under the SXPGC Agreement and the annual reports of the Company for the years ended 31 December 2007 and 31 December 2008;
- (b) reviewing the sample transactions executed by the Company in the 2007 and 2008 with the relevant prices offered from and to SXPGC and from and to any independent third parties of the SXPGC Agreement;
- (c) reviewing the fairness, reasonableness and completeness of any assumptions or projections relevant to the SXPGC Agreement, the performance and financial situation of the Company as well as the reasons and background of entering into the SXPGC Agreement; and
- (d) confirming that no third party expert provides any opinion or valuation is relevant to the SXPGC Agreement.

LETTER FROM MENLO CAPITAL LIMITED

PRINCIPAL FACTORS AND REASONS CONSIDERED

In arriving at our opinion regarding whether (i) the continuing connected transactions contemplated under the SXPGC Agreement are in the interest of the Company and the Independent Shareholders as a whole; (ii) the SXPGC Agreement is entered into on normal commercial terms and within the ordinary and usual course of businesses of the Company; and (iii) the terms and the respective annual caps proposed under the SXPGC Agreement are fair and reasonable, we have considered the following principal factors and reasons:

BACKGROUND INFORMATION

The Company is principally engaged in the development, manufacture and sales of bulk pharmaceuticals, preparations and chemical products.

SXPGC is a connected person of the Company under the Listing Rules. As a result, the transactions contemplated between the connected person and the Company will constitute continuing connected transactions under the Listing Rules.

On 23 October 2006, the Company entered into an agreement with SXPGC in relation to the Company and/or its subsidiaries purchasing and selling certain products and/or services from and to SXPGC and/or its subsidiaries for a period of three years from 1 January 2007 to 31 December 2009. An announcement was made on 24 October 2006.

As the above agreement will expire on 31 December 2009, the Company has entered into a new agreement, that is, the SXPGC Agreement with SXPGC on 28 October 2009 for a period of three years commencing from 1 January 2010.

REASONS FOR AND BENEFITS OF ENTERING INTO THE SXPGC AGREEMENT

SXPGC is a state-owned enterprise established in the PRC specialising in investment in the pharmaceutical industry, and associated chemical production, packaging and supply of chemical engineering equipment. By virtue of the SXPGC Agreement, the Company and/or its subsidiaries can continue to generate revenue from selling the respective products to SXPGC and/or its subsidiaries and to secure a steady supply of raw materials and/or sundry products from SXPGC and/or its subsidiaries without incurring extra costs by purchasing them through other parties. Therefore, the Directors consider that the entering into the SXPGC Agreement is in the best interests of the Company and its Shareholders as a whole. The Directors also consider that the transactions contemplated under the SXPGC Agreement are on normal commercial terms and in the ordinary and usual course of business and that the terms of the transactions under the SXPGC Agreement are fair and reasonable.

LETTER FROM MENLO CAPITAL LIMITED

We have reviewed the nature of business of the Group set out in the annual reports of the Company for 2007 and 2008. We note that the Company has been starting the purchasing and selling certain products and/or services from and to SXPGC in previous years. Accordingly, we are of the view that the continuing connected transactions for the period from 1 January 2010 to 31 December 2012 are within the ordinary and usual course of businesses of the Company.

THE SXPGC AGREEMENT

Principal terms of the SXPGC Agreement

Date: 28 October 2009

Parties: (i) the Company
(ii) SXPGC

Principal terms and conditions

The SXPGC Agreement contains the following principal terms:

- (1) The Company and/or its subsidiaries shall purchase the following products and services from SXPGC and/or its subsidiaries at market prices, including but not limited, to the following:
 - (a) purchase of accessories in respect of the repairs and maintenance of equipment and tools, hardwares, valves, instruments and meters, bearings, pumps, chemical reagents, glass wares, and the repair and maintenance of the same;
 - (b) purchase of packaging materials including light plates, woodwork, packaging, blow molding, colour printing, paper tray and cardboard drums, bottles and other assorted packing materials; and
 - (c) purchase of trimethyl orthoformate, diethyl malonate, dimethyl malonate, chloroproionyl chloride, sodium methylate, chloroacetic acid, sulphuric acid, salicylic acid, dimethyl sulphate, sodium sulphate, reductant and other chemicals used primarily for the production of pharmaceutical products.

The prices for the products and services stated above shall be determined in accordance with the market practice. However, all of the relevant prices shall not be higher than the selling prices in respect of such items as offered by SXPGC to any independent third parties.

LETTER FROM MENLO CAPITAL LIMITED

We have reviewed the records of sample purchasing transactions relating to the purchases of the above mentioned products for the period from 1 January 2007 to the Latest Practicable Date and note that the relevant prices in respect of those items purchased from SXPGC were not higher as compared with the similar items purchased from the independent third parties which are fair and reasonable so far as the Company and the Independent Shareholders are concerned.

- (2) The Company shall sell the following products to SXPGC and/or its subsidiaries:
- (a) supply of water, electricity and steam, at cost plus corresponding tax and management fees; and
 - (b) sundry items of by-products during the manufacturing processes which can be recycled, e.g. waste water, waste gas and other solid wastage, at market prices.

In any event, all of the relevant prices stated above shall not be lower than the selling price in respect of such items as offered to any independent third parties.

We have also requested for the records of sales and sample invoices relating to the sales to any independent third parties of the above mentioned by-products for the period from 1 January 2007 to the Latest Practicable Date and note that there was no relevant transaction. The reason is that not many companies would buy waste materials for recycling. Therefore, we are unable to compare the sales to any independent third parties of the above mentioned by-products with any similar transaction of the Group.

- (3) Payment Term: each party shall pay to the other party for the products ordered or services provided in a timely manner as specified in each purchase order placed by the Company, the Company's subsidiaries, SXPGC and SXPGC's subsidiaries from time to time. Payment shall normally be made within 60 days after invoicing.
- (4) The Company and/or its subsidiaries are not restricted from conducting transactions with any third parties for the sale and purchase of the relevant products and the provisions of services.
- (5) The term of the SXPGC Agreement runs from 1 January 2010 to 31 December 2012.

We are of the view that the above terms are normal commercial terms without any extraordinary conditions.

Proposed annual caps for the SXPGC Agreement

The proposed annual caps for the Company selling products to SXPGC and/or its subsidiaries are as follows:-

	2010 (RMB'000)	2011 (RMB'000)	2012 (RMB'000)
1. Sale of waste materials, supply of water, electricity and steam	31,000	35,000	39,000

LETTER FROM MENLO CAPITAL LIMITED

The proposed annual caps for the Company and/or its subsidiaries purchasing accessories, raw materials and packaging materials from SXPGC and/or its subsidiaries are as follows:

	2010 <i>(RMB'000)</i>	2011 <i>(RMB'000)</i>	2012 <i>(RMB'000)</i>
Purchase of accessories, raw materials and packaging materials	200,000	210,000	220,000

The Company has determined the above annual caps based on the following factors:-

- (a) the historical figures in 2007, 2008 and January to August 2009 for the transactions between the Company (and/or its subsidiaries) and SXPGC (and/or its subsidiaries) (see table 1 below);
- (b) the demand set out by SXPGC and/or its subsidiaries;
- (c) the demand set out by the Company and/or its subsidiaries
- (d) the projected increase in the market prices of chemical raw materials; and
- (e) the development in the business of the Company and/or its subsidiaries.

Table 1 — Historical figures in 2007, 2008 and January to August 2009 for the transactions between the Company and/or its subsidiaries and SXPGC and/or its subsidiaries

	2007 <i>(RMB'000)</i>	2008 <i>(RMB'000)</i>	January to August 2009 <i>(RMB'000)</i>
1. Sale of waste materials, supply of water, electricity and steam to SXPGC and/or its subsidiaries	14,036	12,870	7,130
2. Purchase of accessories, raw materials and packaging materials from SXPGC and/or its subsidiaries	96,730	132,098	54,432

LETTER FROM MENLO CAPITAL LIMITED

In arriving at our advice to the Independent Board Committee and the Independent Shareholders on whether the proposed annual caps are sufficient as well as fair and reasonable, we have reviewed:

- (i) the historical figures in 2007, 2008 and January to August 2009 for the transactions between the Company (and/or its subsidiaries) and SXPGC (and/or its subsidiaries); together with the demand set out by SXPGC and/or its subsidiaries; and the demand set out by the Company and/or its subsidiaries.

We note that there was a sharp increase of the purchase of products from SXPGC by approximately 36.6% in 2008 compared with that in 2007, and that there was a significant drop of purchase in the first eight months in 2009 which is mainly due to the significant drop of the market prices of major raw materials purchased by the Company and/or its subsidiaries in 2009.

According to the World Economic Outlook published by the International Monetary Fund in October 2009, “advanced economies are projected to expand sluggishly through much of 2010, with unemployment continuing to rise until later in the year. Annual growth in 2010 is projected to be about 1 1/4 percent, following a contraction of 3 1/2 percent in 2009. The recovery of activity is more clearly evident on a fourth-quarter-over-fourth-quarter basis: from 2009:Q4 to 2010:Q4, real GDP is expected to rise by about 1 3/4 percent, up from an expansion of about 1/2 percent (annualized) during the second half of 2009 and a 2 percent contraction in the first half.”

The Company has stated in this Circular that the proposed annual caps are significantly higher than the respective actual transacted amounts in 2008 and 2009 because in 2008 and 2009, the market prices of the products and/or services and the sales and purchases to and from SXPGC and/or its subsidiaries decreased considerably due to the worldwide financial turmoil. However, as the Company is of the view that the worldwide economy has resumed, the Company predicts that there will be a significant increase in the market prices of the products and/or services and in the sales and purchase of the products and/or services to and from SXPGC and/or its subsidiaries in 2010, 2011 and 2012.

Based on the predictions of both the International Monetary Fund and the Company on the worldwide economy, we are of the view that the worldwide economy is recovering from the bottom as at the first half 2009, and that there will be a gradual increase in both the market prices of the products and/or services and in the sales and purchase of the products and/or services to and from SXPGC and/or its subsidiaries in the coming years.

We have also reviewed the demand set out by the Company and/or its subsidiaries which indicates that there will be a significant increase in the consumption of certain raw materials and an increase in their market prices.

The Directors advise that due to the expansion of the production capacity of several production plants of the SXPGC and/or its subsidiaries, the demand set out by SXPGC and/or its subsidiaries indicate that there will be a significant increase in the demand waste materials, supply of water, electricity and steam.

LETTER FROM MENLO CAPITAL LIMITED

- (ii) the projected increase in the market prices of chemical raw materials;

We have reviewed the market prices of five major raw materials purchased by the Company and/or its subsidiaries in 2008 and 2009 and noted that the highest prices in 2008 were in the range of approximately 74% to 631% with an average of approximately 226% higher than the lowest prices of the respective items in 2009.

As the worldwide economy has resumed, there will be a significant increase in the market prices of the products and/or services and in the sales and purchase of the products and/or services to and from SXPGC and/or its subsidiaries in 2010, 2011 and 2012.

- (iii) the development in the business of the Company and/or its subsidiaries;

According to the annual report of the Company for the year ended 31 December 2008, the Company is going to develop both the domestic market in the PRC and the international market, in particular, the USA market. Apparently, there is growth of bulk pharmaceuticals business of the Company in both domestic and international markets.

Based on (i) the historical figures in 2007, 2008 and January to August 2009 for the transactions between the Company (and/or its subsidiaries) and SXPGC (and/or its subsidiaries); (ii) the demand set out by SXPGC and/or its subsidiaries; (iii) the demand set out by the Company and/or its subsidiaries; (iv) the projected increase in the market prices of chemical raw materials; and (v) the development in the business of the Company and/or its subsidiaries prepared by the Company to arrive at the proposed annual caps, we are of the view that the assumptions adopted by the Company in preparing the forecast and the proposed annual caps are fair and reasonable.

The annual caps for the transactions under the SXPGC Agreement of RMB200,000,000, RMB210,000,000 and RMB220,000,000 for 2010, 2011 and 2012 will respectively account for approximately 14.6%, 15.3% and 16.0% of the audited consolidated purchase of the Company of approximately RMB1,371,000,000 for the financial year ended 31 December 2008. The Directors are of the view that the above portion of purchases of the Company from SXPGC and/or its subsidiaries is fair and sufficient. In case there is any necessary change in the annual caps, the Company will seek the approval of the Independent Shareholders in advance.

LETTER FROM MENLO CAPITAL LIMITED

OPINION

Having taken into consideration of the above principal factors and reasons, in particular:

1. the SXPGC Agreement is entered into in the ordinary and usual course of business of the Group;
2. the entering into the SXPGC Agreement enable the Group to secure a steady supply of raw materials and/or sundry products from SXPGC and/or its subsidiaries without incurring extra costs by purchasing them through other parties which is in the interest of the Company and Shareholders as a whole;
3. the SXPGC Agreement is on normal commercial terms and the terms of the SXPGC Agreement are fair and reasonable so far as the Company and the Independent Shareholders are concerned; and
4. the proposed annual caps are sufficient as well as fair and reasonable so far as the Independent Shareholders are concerned.

RECOMMENDATION

Having taken into account of the factors and reasons set out in the above sections, we are of the view that (i) the entering into the SXPGC Agreement and the continuing connected transactions contemplated thereunder relating to the purchase and the sales of the Products are in the interest of the Company and the Independent Shareholders as a whole; (ii) the SXPGC Agreement is entered into on normal commercial terms and within the Company's ordinary and usual course of business; and (iii) the terms of the Continuing Connected Transactions relating to the purchase and the sales of the products and the annual caps contemplated under the SXPGC Agreement are fair and reasonable so far as the Company and the Independent Shareholders are concerned.

Accordingly, we recommend the Independent Board Committee and the Independent Shareholders to vote in favour of the ordinary resolution to be proposed at the EGM to approve (i) the entering into the SXPGC Agreement and the Continuing Connected Transactions relating to the purchase and the sales of the products contemplated thereunder; and (ii) the proposed annual caps.

Yours faithfully,
For and on behalf of
Menlo Capital Limited

Michael Leung
Executive Director

1. RESPONSIBILITY STATEMENT

This circular includes particulars given in compliance with the Listing Rules for the purpose of giving information with regard to the Company. The Directors collectively and individually accept full responsibility for the accuracy of the information contained in this circular and confirm, having made all reasonable enquiries, that to the best of their knowledge and belief there are no other facts the omission of which would make any statement herein misleading.

2. SHARE CAPITAL

As at the Latest Practicable Date, the total number of issued shares of the Company is 457,312,830, comprising 187,808,632 unlisted shares, 119,504,198 A shares listed on the Shenzhen Stock Exchange and 150,000,000 H shares listed on the Stock Exchange.

3. DISCLOSURE OF INTEREST

As at the Latest Practicable Date, the following Directors hold shares in the Company:-

Name	Number of A Shares	Percentage of the total issued share capital of the Company (%)
Director:		
Ms. Guo Qin	12,639	0.00276
Supervisors:		
Mr. Yu Gongfu	6,075	0.00133
Mr. Gao Qinggang	4,370	0.00096
Mr. Liu Qiang	4,370	0.00096
Senior Officers:		
Mr. Cao Changqiu	2,278	0.00050

Save as disclosed above, as at the Latest Practicable Date:-

- (a) none of the Directors, Supervisors and chief executive of the Company was interested in the equity or debt securities of the Company or any associated corporations (within the meaning of the SFO) which (i) were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they are taken or deemed to have under such provisions of the SFO), (ii) were required, pursuant to section 352 of the SFO, to be entered in the register referred to therein or (iii) were required, pursuant to the Model Code for Securities Transactions by Directors of Listed Companies, to be notified to the Company and the Stock Exchange;
- (b) none of the Directors or Supervisors of the Company was materially interested in any contract or arrangement entered into by any member of the Group since 31 December 2008, being the date to which the latest published audited financial statements of the Company were made up, and which was significant in relation to the business of the Group;
- (c) none of the Directors, Supervisors of the Company and Menlo Capital Limited had any direct or indirect interest in any assets which had since 31 December 2008, being the date to which the latest published audited financial statements of the Company were made up, been acquired or disposed of by or leased to any member of the Group, or are proposed to be acquired or disposed of by or leased to any member of the Group; and
- (d) as at the Latest Practicable Date, none of the Directors or their respective associates has any interest in any company or business which competes or may compete with the businesses of the Group.

4. SUBSTANTIAL SHAREHOLDERS

As at the Latest Practicable Date, so far as was known to the Directors and chief executive of the Company, the persons, other than a Director or chief executive of the Company, who had an interest or a short position in the shares and underlying shares which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO or who is directly or indirectly, interested in ten per cent. or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of the Company were as follows:

No.	Name of Shareholder	Class of shares	Number of shares held	% of the total issued share capital
1.	Shandong Xinhua Pharmaceutical Group Company Limited ("SXPGC")	State-owned A Shares	163,258,735	35.70
2.	HKSCC (Nominees) Limited	Listed H Shares	148,759,998	32.53

SXPGC is a wholly-state owned company. Ms. Guo Qin being a director of the Company is also a director of SXPGC. Mr. Liu Zhenwen being a non-executive director of the Company is also a director of SXPGC. Mr. Ren Fulong being a director of the Company is also a director of SXPGC. Mr. Li Tianzhong being a non-executive director of the Company is also a director of SXPGC. Mr. Gao Qinggang being the Supervisor of the Company is also a director of SXPGC.

Save as disclosed above, the Directors and chief executive of the Company are not aware that there is any party who, as at the Latest Practicable Date, had an interest or a short position in the shares and underlying shares which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO, or who is, directly or indirectly, interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of any other member of the Group.

5. MATERIAL ADVERSE CHANGE

As at the Latest Practicable Date, the Directors are not aware of any material adverse change in the financial or trading position of the Group since 31 December 2008, the date to which the latest audited financial statements of the Group were made up.

6. LITIGATION

No member of the Group is engaged in any litigation or arbitration or claim of material importance and there is no litigation or arbitration or claim of material importance known to the Directors to be pending or threatened by or against any member of the Group.

7. CONSENTS OF EXPERT

The following expert has given and has not withdrawn its written consents to the issue of this circular with the inclusion of its letter and reference to its name in the form and context in which it appears:

Names	Qualifications
Menlo Capital Limited	Independent financial adviser and a licensed corporation to carry out type 6 regulated activities under the SFO

The above expert is not beneficially interested in the share capital of any member of the Group nor do they have any right, whether legally enforceable or not, to subscribe for or to nominate persons to subscribe for securities in any member of the Group.

8. SERVICE CONTRACTS

As at the Latest Practicable Date, none of the Directors and Supervisors of the Company had entered into, or proposed to enter into, a service contract with the Company or any member of the Group which does not expire or is not terminable by such member of the Group within one year without payment of compensation, other than statutory compensation.

9. VOTE BY POLL

Pursuant to Rule 13.39(4) of the Listing Rules, the vote of Shareholders of the Company at the EGM shall be taken by poll.

10. MISCELLANEOUS

- (a) The joint secretaries of the Company are Mr. Cao Changqiu, who graduated from Qingdao Ocean University, specialising in economic management in 1991 and Ms. Guo Lei, who graduated from Guangzhou Foreign Trade College, specialising in accounting in 1992.
- (b) The share registrar of the Company in Hong Kong is Hong Kong Registrar Limited, 17th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong.
- (c) In the case of any discrepancy, the English text of this circular and form of proxy shall prevail over the Chinese text.

11. DOCUMENTS FOR INSPECTION

Copies of the following documents will be available for inspection at the office of Charltons being the Hong Kong legal advisers to the Company, at 10/F, Hutchinson House, 10 Harcourt Road, Hong Kong during normal business hours on any weekday (except public holidays) from the date of this circular up to and including 26 November 2009 and at the EGM:

- (a) the SXPGC Agreement;
- (b) the letter of recommendation from the Independent Board Committee of the Company to the independent Shareholders as set out in this circular;
- (c) the letter of advice from Menlo Capital Limited as set out in this circular;
- (d) the written consent from Menlo Capital Limited referred to in paragraph 7 of this appendix.

NOTICE OF EXTRAORDINARY GENERAL MEETING



山東新華製藥股份有限公司 Shandong Xinhua Pharmaceutical Company Limited

(a joint stock limited company established in the People's Republic of China with limited liability)

(Stock Code: 0719)

NOTICE IS HEREBY GIVEN that an extraordinary general meeting of Shandong Xinhua Pharmaceutical Company Limited (the “**Company**”) will be held at the Company’s conference room at No. 14 Dongyi Road, Zhangdian District, Zibo City, Shandong Province, The People’s Republic of China (the “**PRC**”) on 28 December 2009 at 9:00 a.m. for the purpose of considering and, if thought fit, passing the following resolutions which will be proposed as ordinary resolutions:

ORDINARY RESOLUTIONS

“**THAT:**

the agreement entered into between the Company and Shandong Xinhua Pharmaceutical Group Limited (“SXPGC”) dated 28 October 2009 and the proposed annual caps in relation to the Company’s sale of waste materials, water, electricity and steam to SXPGC and/or its subsidiaries in the sum of RMB31,000,000, RMB35,000,000 and RMB39,000,000 for 2010, 2011 and 2012 respectively and the proposed annual caps in relation to the Company’s and/or its subsidiaries’ purchase of accessories, raw materials and packaging materials from SXPGC and/or its subsidiaries in the sum of RMB200,000,000, RMB210,000,000 and RMB220,000,000 for 2010, 2011 and 2012 respectively under such agreement are hereby approved and confirmed.

Shandong Xinhua Pharmaceutical Company Limited

The Board of Directors

11 November 2009

NOTICE OF EXTRAORDINARY GENERAL MEETING

Notes:

1. The register of members of the Company will be closed from 28 November 2009 to 28 December 2009 (both days inclusive), during which period no H share transfers will be effected. Shareholders of the Company whose names appear on the register of members of the Company in the Hong Kong Registrars Limited at 4:30 p.m. on 27 November 2009 and on the register of members of the China Securities Registrar Company Limited Shenzhen Branch after the closing of Shenzhen Stock Exchange on 27 November 2009 and the Directors, the Supervisors and the senior officers of the Company are entitled to attend the EGM or any adjournment thereof.
2. Shareholders of the Company who intend to attend the EGM are asked to send the completed and signed reply slip for attendance dispatched to the Company's Shareholders together with the circular dated 11 November 2009 to the Company Secretary's office of the Company (see Note 7 below) on or before 7 December 2009, by hand, by post or by facsimile. The written reply will not affect the right of the Shareholders (see Note 1 above) to attend and vote at the EGM. The completion and deposit of a form of proxy will not preclude any shareholder from attending and voting in person at the EGM or any adjournment thereof.
3. A shareholder of the Company entitled to attend and vote at the EGM may appoint one or more proxies (whether the person is a shareholder of the Company or not) to attend and vote on his/her behalf at the EGM. When a shareholder appoints more than one proxy, such proxies may only vote on a poll. Each holder of H shares (or his/her proxy or proxies) shall be entitled to one vote for each share held.
4. Shareholders of the Company must appoint a proxy or proxies in writing i.e. the original proxy form dispatched to the Company's Shareholders together with the circular dated 11 November 2009 or a copy of it, which shall be signed by the person appointing the proxy or proxies or by his/her duly authorised attorney. If the form of proxy is signed by an attorney, the document appointing the attorney must be certified by a notary public. If the appointing shareholder is a legal person, the legal person's seal or the signature of its director(s) or representative(s) duly authorised in writing is required. To be valid, a notarially certified power of attorney or other authority (if any) and the form of proxy must be received by the Company Secretary's office of the Company (see Note 7 below) 24 hours prior to the commencement of the EGM. A form of proxy for use at the EGM is dispatched to the Company's Shareholders together with the circular dated 11 November 2009.
5. Shareholders of the Company or their proxies shall present proof of identity upon attending the EGM. Should a proxy be appointed, the proxy shall also present his/her form of proxy.

NOTICE OF EXTRAORDINARY GENERAL MEETING

6. The EGM is expected to last half a day. Shareholders who attend the EGM shall bear their own traveling and accommodation expenses.

7. The address of the Company Secretary's office of the Company is as follows:

14 Dongyi Road, Zhangdian District, Zibo City, Shandong Province, PRC

Postal Code: 255005

Telephone: 86 533 2196025

Facsimile: 86 533 2287508

As at the date of this notice, the Board of Directors comprises:

Executive Directors:

Ms. Guo Qin (*Chairman*)

Mr. Ren Fulong

Mr. Zhao Songguo

Independent Non-executive Directors:

Mr. Zhu Baoquan

Mr. Sun Minggao

Mr. Kwong Chi Kit, Victor

Non-executive Directors:

Mr. Liu Zhenwen

Mr. Li Tianzhong

Mr. Zhao Bin