
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 TRANSACTIONS

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



A letter from the Board is set out on pages 1 to 8 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 9 to 10 of this circular. A letter from Get Nice Capital Limited, the independent financial adviser, containing its advice to the Independent Board Committee and the Independent Shareholders is set out on pages 11 to 19 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 Friday, 10 October 2008 at 9:00 a.m. is set out on pages 25 to 27 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 No. 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.

22 August 2008

CONTENTS

	<i>Page</i>
DEFINITIONS	ii
LETTER FROM THE BOARD	1
LETTER FROM THE INDEPENDENT BOARD COMMITTEE	9
LETTER FROM GET NICE CAPITAL LIMITED	11
APPENDIX — GENERAL INFORMATION	20
NOTICE OF EXTRAORDINARY GENERAL MEETING	25

DEFINITIONS

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

“2006 Agreement”	means the agreement entered into between the Company and SXPGC on 23 October 2006 in relation to, among other things, SXPGC’s supply of chemical raw materials to the Company and the Company’s supply of water, electricity and steam to SXPGC;
“2006 Circular”	means the circular dated 13 November 2006 issued by the Company in relation to, among other things, the 2006 Agreement and the Trademark Licence Agreement;
“Board”	means the board of Directors of the Company;
“Company”	means 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”	means the directors of the Company;
“EGM”	means the extraordinary general meeting of the Company to be held on 10 October 2008 for the purpose of approving, among other things, the ratification of the actual amount incurred in 2007 under the 2006 Agreement and the Revised Caps;
“Hong Kong”	means Hong Kong Special Administrative Region of the PRC;
“HK\$”	means Hong Kong dollars, the lawful currency of Hong Kong;
“Independent Board Committee”	means the independent board committee of the Company constituted for the purpose of considering the ratification of the actual amount incurred in 2007 under the 2006 Agreement and the Revised Caps, comprising three independent non-executive Directors;
“Independent Shareholders”	means shareholders of the Company other than SXPGC and its associates (as defined in the Listing Rules);
“Latest Practicable Date”	18 August 2008, being the latest practicable date prior to the printing of this circular for ascertaining certain information contained herein;
“Listing Rules”	means the Rules Governing the Listing of Securities on the Stock Exchange;

DEFINITIONS

“PRC”	means the People’s Republic of China;
“Revised Caps”	means the revised annual caps for the continuing connected transactions under the 2006 Agreement for each of 2008 and 2009;
“RMB”	means Renminbi, the lawful currency of the PRC for the time being;
“SFO”	means The Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong);
“Shareholders”	means the shareholders of the Company;
“Stock Exchange”	means The Stock Exchange of Hong Kong Limited;
“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;
“Trademark Licence Agreement”	means the trademark licence agreement entered into between the Company and SXPGC on 7 December 1996.

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)

Directors:

Ms. Guo Qin (*Chairman*)
Mr. Liu Zhenwen
Mr. Ren Fulong
Mr. Zhao Songguo
Mr. Li Tianzhong

Registered Address:

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

Independent Non-executive Directors:

Mr. Dai Qingjun
Mr. Xu Guojun
Mr. Sun Minggao

22 August 2008

To the Shareholders

Dear Sir or Madam,

CONTINUING CONNECTED TRANSACTIONS

1. BACKGROUND INFORMATION

Reference is made to announcement dated 1 August 2008 in relation to exceeding and revision to the original annual caps for the continuing connected transactions, and the announcement dated 24 October 2006 and the 2006 Circular.

As disclosed in the announcement dated 24 October 2006 and the 2006 Circular, the Company proposed to enter into continuing connected transactions under two Agreements with SXPGC, namely, the 2006 Agreement and Trademark Licence Agreement. In this connection, independent shareholders' approval was obtained by the Company pursuant to Rule 14A.35 of the Listing Rules in respect of the continuing connected transactions and the proposed annual caps of the continuing connected transactions.

LETTER FROM THE BOARD

In accordance with Rule 14A.36(1) of the Listing Rules, if an annual cap is exceeded, the Company must re-comply with the provisions of Chapter 14A of the Listing Rules in relation to such connected transactions. Further, if the applicable percentage ratios in relation to the actual amount incurred in 2007 under the 2006 Agreement exceeds 2.5%, the Company must re-comply with the reporting, announcement and independent shareholders' approval requirements under the Listing Rules.

2. EXCEEDING THE ORIGINAL ANNUAL CAP

During the course of auditing the Company's financial statements for the year ended 31 December 2007, the auditors of the Company determined that the 2007 cap for the value of the transactions under the 2006 Agreement had been exceeded. This was due to an unexpected increase in the market prices of chemical raw materials under the 2006 Agreement.

The Company has now designated certain persons to monitor all continuing connected transactions and report to management the amount of those transactions on a monthly basis, and notify each member of the Board if any of those transactions reach 75% of the agreed annual cap prior to the end of September in any year.

3. CONNECTED RELATIONSHIP

SXPGC currently holds 35.70% equity interest of the Company and is therefore a connected person under the Listing Rules.

4. THE 2006 AGREEMENT

Date of agreement

23 October 2006

Parties to agreement

SXPGC and the Company

Principal terms and conditions

The 2006 Agreement entered into between the Company and SXPGC on 23 October 2006 contains the following principal terms:

- (1) The Company shall purchase the following products and services from SXPGC at market price, 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;

LETTER FROM THE BOARD

- (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.

- (2) The Company shall sell the following products to SXPGC:
 - (a) supply of water, electricity and steam, at cost plus corresponding tax and 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) 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 or SXPGC from time to time.
- (4) The Company is 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 2006 Agreement commences from 1 January 2007 and ends on 31 December 2009, subject to extension for a further three years ending on 31 December 2012, such extension being subject to the Company's compliance with the reporting, announcement and independent shareholders' approval requirements under Rule 14A.35 of the Listing Rules. The Company will comply with the Listing Rules in respect of the above continuing connected transactions with SXPGC.

LETTER FROM THE BOARD

5. TRADEMARK LICENCE AGREEMENT

The announcement dated 24 October 2006 and the 2006 Circular also referred to the Trademark Licence Agreement entered into between the Company and SXPGC in 1996. The cap for the Trademark Licence Agreement was RMB1,100,000 which shall remain unchanged until the Trademark Licence Agreement is terminated and the Trademark Licence Agreement shall continue in effect as long as the trademark referred to in the Trademark Licence Agreement remains valid.

As the cap and the terms of the Trademark Licence Agreement were approved by the Independent Shareholders at the extraordinary general meeting held on 29 December 2006 and the Company did not exceed the cap in 2007, no further Independent Shareholders' approval is required for this agreement.

6. REASONS FOR AND BENEFITS OF THE CONTINUING CONNECTED TRANSACTIONS

The Directors (including the independent non-executive directors) consider that the entering into the 2006 Agreement is in the best interests of the Company and its Shareholders as a whole. They also consider that the transactions under the 2006 Agreement are on normal commercial terms and in the ordinary and usual course of business and that the terms of the transactions under the 2006 Agreement are fair and reasonable.

By virtue of the 2006 Agreement, the Company can continue to generate revenue from selling the respective products to SXPGC and to secure a steady supply of raw materials and/or sundry products from SXPGC without incurring extra costs by purchasing them through other parties.

7. CAPS

Original caps

The Independent Shareholders approved the caps as set out below in relation to the 2006 Agreement for 2007, 2008 and 2009 at the extraordinary general meeting on 29 December 2006.

	2007 <i>RMB'000</i>	2008 <i>RMB'000</i>	2009 <i>RMB'000</i>
1. Purchase of accessories, raw materials and packaging materials	73,600	84,640	97,340
2. Sale of waste materials, supply of water, electricity and steam	21,620	24,860	28,590

LETTER FROM THE BOARD

The actual amounts incurred under the 2006 Agreement for 2007 and 2008 in relation to purchase of accessories, raw materials and packaging materials and sale of waste materials, supply of water, electricity and steam are set out as below:

	2007	January to June 2008
	<i>RMB'000</i>	<i>RMB'000</i>
	(actual amount)	(actual amount)
1. Purchase of accessories, raw materials and packaging materials	96,730	68,450
2. Sale of waste materials, supply of water, electricity and steam	14,036	6,499

The 2007 cap in relation to the purchase of accessories, raw materials and packaging materials was exceeded due to an unexpected increase in the market prices of chemical raw materials.

8. REVISION TO THE ORIGINAL CAPS IN RELATION TO THE 2006 AGREEMENT FOR THE YEARS 2008 AND 2009

The Company has been monitoring all of the Company's continuing connected transactions. With the continued development in the business of the Company and the increase in the raw material prices, and also based on internal estimates of the demand for the Company's products, the Company expects that the original caps for the years 2008 and 2009 for the continuing connected transactions under the 2006 Agreement as set out in the 2006 Circular will not be sufficient for the Company's requirements. The Company therefore proposes that the caps for the purchase of accessories, raw materials and packaging materials under the 2006 Agreement for 2008 and 2009 be revised to RMB200,000,000 and RMB250,000,000 respectively and that the caps for sale of waste materials, and supply of water, electricity and steam for 2008 and 2009 under the 2006 Agreement remain unchanged.

Newly proposed caps

	2008	2009
	<i>RMB'000</i>	<i>RMB'000</i>
	(proposed cap)	(proposed cap)
Purchase of accessories, raw materials and packaging materials	200,000	250,000

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

- (a) the historical figures in 2007;
- (b) the actual increase (please see the table below) and the projected increase in the market prices of chemical raw materials; and

LETTER FROM THE BOARD

(c) the development in the business of the Company.

The Company has noted that the market prices of raw materials for the production of pharmaceutical products in June 2008 have doubled or tripled or more over the market prices in January 2007. A table showing the increase in the market prices of some of the chemical raw materials is set out below:

	January 2007	June 2008
Sulphuric acid	RMB370 per ton	approximately RMB1,700 per ton
Dimethyl sulphate	RMB2,500 per ton	RMB5,000 per ton
Reductant	RMB500 per ton	RMB1,500 per ton

In view of the huge increase in the market prices of the raw materials, the Company proposes to increase the caps under the 2006 Agreement for 2008 and 2009 considerably.

9. IMPLICATIONS UNDER THE LISTING RULES

Under the Listing Rules, when an existing cap in respect of continuing connected transactions is exceeded, the Company must re-comply with the relevant provisions of Chapter 14A of the Listing Rules. As the applicable percentage ratios in relation to the actual amount incurred in 2007 under the 2006 Agreement exceed 2.5%, the Company must re-comply with the reporting, announcement and independent shareholders' approval requirements under the Listing Rules.

In respect of each of the revised annual caps for the continuing connected transactions under the 2006 Agreement for the years 2008 and 2009, the applicable percentage ratios (as defined in the Listing Rules) exceed 2.5% on an annual basis and the consideration will exceed HK\$10,000,000. In accordance with Rule 14A.35(4) of the Listing Rules, the Company has to comply with the Independent Shareholders' approval requirements described in Rule 14A.48, in addition to the reporting and announcement requirements in rules 14A.45 to 14A.47 of the Listing Rules.

In this connection, the Company will seek Independent Shareholders' approval for the ratification of the actual amount incurred in 2007 and the Revised Caps for the continuing connected transactions under the 2006 Agreement at the EGM. As SXPGC is a substantial shareholder of the Company and holding 35.70% of the issued share capital of the Company, SXPGC and its associate(s), if any, are connected persons of the Company as defined in the Listing Rules and will abstain from voting on the relevant resolutions at the EGM.

The Company believes that the terms of the continuing connected transactions under the 2006 Agreement which are on normal commercial terms and are entered into in the ordinary and usual course of business of the Company, are fair and reasonable and in the interest of the Shareholders as a whole, and that all the Revised Caps mentioned above are fair and reasonable.

LETTER FROM THE BOARD

10. APPROVAL BY INDEPENDENT SHAREHOLDERS

An Independent Board Committee has been formed to advise the Independent Shareholders in connection with the proposed amendments to the original caps for the continuing connected transactions for the years 2008 and 2009, and an independent financial adviser has been appointed to advise the Independent Board Committee and the Independent Shareholders.

11. INFORMATION ABOUT THE COMPANY

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

12. INFORMATION ABOUT SXPGC

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.

13. EXTRAORDINARY GENERAL MEETING

The Directors have resolved to convene the EGM to consider and, if thought fit by the Independent Shareholders, to ratify the actual amount incurred in 2007 under 2006 Agreement and to approve the Revised Caps. Notice of the EGM is set out on pages 25 to 27 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's office of the Company at No. 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.

14. RECOMMENDATION

The Directors (including the independent non-executive Directors) consider that the ratification of the actual amount incurred in 2007 under 2006 Agreement and the Revised 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 ratification of the actual amount incurred in 2007 under 2006 Agreement and the Revised Caps. Get Nice Capital Limited has been appointed as independent financial adviser to advise the Independent Board Committee and the Independent Shareholders in respect of the same.

LETTER FROM THE BOARD

After taking into account the reasons for and benefits of the continuing connected transactions under the 2006 Agreement and the relevant terms of the 2006 Agreement, and the opinion of Get Nice Capital Limited, the Independent Board Committee considers that the ratification of the actual amount incurred in 2007 under 2006 Agreement and the Revised 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 resolutions to be proposed at the EGM to ratify the actual amount incurred in 2007 under 2006 Agreement and to approve the Revised Caps.

All connected persons or Shareholders with a material interest in the transaction and its associates shall abstain from voting in ratifying the actual amount incurred in 2007 under 2006 Agreement and approving the Revised 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 ratify the actual amount incurred in 2007 under 2006 Agreement and to approve the Revised Caps and all matters contemplated thereunder.

The Independent Shareholders will be asked to consider and, if thought fit, ratify and approve by poll the actual amount incurred in 2007 under 2006 Agreement and the Revised Caps at EGM.

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.

15. ADDITIONAL INFORMATION

Your attention is drawn to the letter from the Independent Board Committee and the letter of advice from Get Nice 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. Dai Qingjun
Mr. Xu Guojun
Mr. Sun Minggao

Registered Address:

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

22 August 2008

To the Independent Shareholders

Dear Sir or Madam,

**EXCEEDING AND REVISION TO THE ORIGINAL ANNUAL CAPS
FOR THE CONTINUING CONNECTED TRANSACTIONS**

We refer to this circular dated 22 August 2008 issued by the Company to its Shareholders, of which this letter forms part. Unless the context otherwise requires, terms defined in this 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 ratification of the actual amount incurred in 2007 under 2006 Agreement and the Revised 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 the continuing connected transactions under the 2006 Agreement. In addition, Get Nice Capital Limited has been appointed as independent financial adviser.

LETTER FROM THE INDEPENDENT BOARD COMMITTEE

We wish to draw your attention to (i) the letters of advice from Get Nice Capital Limited as set out on pages 11 to 19 of this circular; and (ii) the letter from the Board on pages 1 to 8 of this circular, which set out information relating to, and the reasons for and benefits of the ratification of the actual amount incurred in 2007 under 2006 Agreement and the Revised Caps.

As the Company's independent directors, we have discussed with the management of the Company the reasons for and benefits of the ratification of the actual amount incurred in 2007 under 2006 Agreement and the Revised Caps. We have considered the factors and reasons considered by, and the opinions and recommendations of, Get Nice Capital Limited as set out on pages 11 to 19 of this circular. We concur with the view of Get Nice Capital Limited that the percentage of the actual amount incurred in 2007 under 2006 Agreement exceeding the cap is moderate and acceptable and the Revised Caps are fair and reasonable. We also concur with the view of Get Nice Capital Limited that the underlying transactions in relation to the ratification of the actual amount incurred in 2007 under the 2006 Agreement and the Revised Caps are 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 ordinary resolutions ratifying the actual amount incurred in 2007 under 2006 Agreement and approving the Revised Caps to be proposed at the EGM.

Yours faithfully,

The Independent Board Committee of
Shandong Xinhua Pharmaceutical Company Limited
Dai Qingjun, Xu Guojun, Sun Minggao

LETTER FROM GET NICE CAPITAL LIMITED

The following is the full text of a letter from Get Nice Capital Limited for the purpose of incorporation in this circular, in connection with its advice to the Independent Board Committee and the Independent Shareholders in relation to the ratification of the actual amount incurred in 2007 under the 2006 Agreement and the Revised Caps:



10th Floor, Cosco Tower,
Grand Millennium Plaza,
183 Queen's Road Central
Hong Kong

22 August 2008

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

Dear Sirs,

CONTINUING CONNECTED TRANSACTIONS

We refer to our appointment as the independent financial adviser to advise the Independent Board Committee and the Independent Shareholders on whether the ratification of the actual amount incurred in 2007 under the 2006 Agreement and the Revised Caps, are on normal commercial terms, in ordinary and usual course of business of the Company and in the interests of the Company and the Shareholders as a whole and whether they are fair and reasonable, details of which are set out in the "Letter from the Board" (the "**Board Letter**") contained in the circular of the Company dated 22 August 2008 (the "**Circular**"), of which this letter forms part. Terms defined in the Circular shall have the same meanings in this letter unless the context of this letter otherwise requires.

As disclosed in the Company's announcement dated 24 October 2006 (the "**2006 Announcement**") and the 2006 Circular respectively, the Company proposed to enter into continuing connected transactions under the 2006 Agreement. In this connection, independent shareholders' approval was obtained by the Company pursuant to Rule 14A.35 of the Listing Rules in respect of the continuing connected transactions and the proposed annual caps of the continuing connected transactions under the 2006 Agreement.

LETTER FROM GET NICE CAPITAL LIMITED

During the course of auditing the Company's financial statements for the year ended 31 December 2007, the auditors of the Company determined that the 2007 cap for the value of the transactions under the 2006 Agreement had been exceeded. Under the Listing Rules, when an existing cap in respect of continuing connected transactions is exceeded, the Company must re-comply with the relevant provisions of Chapter 14A of the Listing Rules. As the applicable percentage ratios in relation to the actual amount incurred in 2007 under the 2006 Agreement exceed 2.5%, the Company must re-comply with the reporting, announcement and independent shareholders' approval requirements under the Listing Rules.

In respect of each of the revised annual caps for the continuing connected transactions under the 2006 Agreement for the years 2008 and 2009, the applicable percentage ratios (as defined in the Listing Rules) exceed 2.5% on an annual basis and the consideration will exceed HK\$10,000,000. In accordance with Rule 14A.35(4) of the Listing Rules, the Company has to comply with the Independent Shareholders' approval requirements described in Rule 14A.48, in addition to the reporting and announcement requirements in Rules 14A.45 to 14A.47 of the Listing Rules.

In this connection, the Company will seek Independent Shareholders' approval for the ratification of the actual amount incurred in 2007 and the revised caps for the continuing connected transactions under the 2006 Agreement at the EGM. As SXPGC is a substantial shareholder holding 35.7% equity interest of the Company, SXPGC and its associate(s), if any, are connected persons of the Company as defined in the Listing Rules and will abstain from voting on the relevant resolutions at the EGM.

The Independent Board Committee, comprising Mr. Dai Qingjun, Mr. Xu Guojun and Mr. Sun Minggao all being the independent non-executive Directors, has been formed to advise the Independent Shareholders as to whether the ratification of the actual amount incurred in 2007 under the 2006 Agreement and Revised Caps are in the interests of the Company and the Shareholders as a whole and they are fair and reasonable so far as the Independent Shareholders are concerned.

In formulating our recommendation, we have relied on the statements, information, opinions and representations contained in the Circular and the information, facts and representations provided to us by the Directors and management of the Company. We have assumed that all information, representations and opinions contained or referred to in the Circular and all information, representations and opinions which have been provided by the Directors or management of the Company for which they are solely responsible, are true and accurate at the time they were made and will continue to be accurate at the date of the despatch of the Circular. We are also not aware that any statements of belief, opinion and intention made by the Directors in the Circular were not reasonably made after due and careful enquiry and not based on honestly-held opinions. We have no reason to doubt the truth, accuracy and completeness of the information and representations provided to us by the Directors and we have been advised by the Directors that no material facts have been omitted from the information and representations provided in and referred in the Circular.

LETTER FROM GET NICE CAPITAL LIMITED

We consider that we have been provided with 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 opinion. We have not, however, carried out any independent verification of the information provided by the Directors and management of the Company, nor have we conducted an independent investigation into the business and affairs of the Company or any of its respective subsidiaries or associates.

PRINCIPAL FACTORS AND REASONS TAKEN INTO ACCOUNT

In arriving at our advice to the Independent Board Committee and the Independent Shareholders in respect of the ratification of the actual amount incurred in 2007 under the 2006 Agreement and the Revised Caps, we have taken the following principal factors and reasons into consideration:

I. Background of the continuing connected transactions under the 2006 Agreement

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.

As stated in the 2006 Announcement and the 2006 Circular, the 2006 Agreement was entered into between the Company and SXPGC on 23 October 2006 pursuant to which the Company proposed to (i) purchase accessories, raw materials and packaging materials from SXPGC (the “**Purchase Transactions**”); and (ii) sell waste materials, supply of water, electricity and steam to SXPGC (the “**Sale Transactions**”). The term of the 2006 Agreement commenced from 1 January 2007 and ends on 31 December 2009, subject to extension for a further three years ending on 31 December 2012. The Purchase Transactions and the Sale Transactions under the 2006 Agreement contemplated constituted continuing connected transactions under Chapter 14A of the Listing Rules and were subject to the then Independent Shareholders’ approval requirement pursuant to Rule 14A.35 of the Listing Rules.

LETTER FROM GET NICE CAPITAL LIMITED

Pursuant to the 2006 Agreement, (i) the prices for the products and services for the Purchase Transactions shall be determined in accordance with the market practice but all of the relevant prices shall not be higher than the selling price in respect of such items as offered by SXPGC to any independent third parties; and (ii) all of the relevant prices for the Sales Transaction shall not be lower than the selling price offered by the Company to SXPGC in respect of such items as offered to any independent third parties.

Also, the caps as set out below in relation to the Purchase Transactions and the Sale Transactions under the 2006 Agreement for 2007, 2008 and 2009 were proposed:

	2007	2008	2009
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
1. Purchase Transactions	73,600	84,640	97,340
2. Sale Transactions	21,620	24,860	28,590

As set out in the 2006 Announcement and the 2006 Circular, the Directors (including the independent non-executive Directors) considered that the entering into the 2006 Agreement was in the best interests of the Company and the Shareholders as a whole. They also considered that the transactions under the 2006 Agreement were on normal commercial terms and in the ordinary and usual course of business and that the terms of the transactions under the 2006 Agreement were fair and reasonable. By virtue of the 2006 Agreement, the Company could continue to generate revenue from selling the respective products to SXPGC and to secure a steady supply of raw materials and/or sundry products from SXPGC without incurring extra costs by purchasing them through other parties.

Independent shareholders' approval was obtained by the Company pursuant to Rule 14A.35 of the Listing Rules in respect of the continuing connected transactions and the above proposed annual caps of the continuing connected transactions under the 2006 Agreement at the extraordinary general meeting of the Company on 29 December 2006.

LETTER FROM GET NICE CAPITAL LIMITED

II. Annual caps and their revision

A. Annual cap for 2007

During the course of auditing the Company's financial statements for the year ended 31 December 2007, the auditors of the Company determined that the 2007 cap in relation to the Purchase Transactions under the 2006 Agreement had been exceeded.

The original caps and the actual amount for the value of the Purchase Transactions and the Sale Transactions under the 2006 Agreement for 2007, 2008 and 2009 are summarized as below:

	2007			2008			2009		
	Original cap <i>RMB'000</i>	Percentage of actual		Original cap <i>RMB'000</i>	Percentage of actual		Original cap <i>RMB'000</i>	Percentage of actual	
		Actual	amount to the		Actual	amount to the		Actual	amount to the
		amount	original cap		amount	original cap		amount	original cap
		<i>RMB'000</i>	%		<i>RMB'000</i>	%		<i>RMB'000</i>	%
Purchase									
Transactions	73,600	96,730	131.43	84,640	N/A	N/A	97,340	N/A	N/A
Sale Transactions	21,620	14,036	64.92	24,860	N/A	N/A	28,590	N/A	N/A

Table 1: Original annual caps and actual amounts of transactions under the 2006 Agreement

As can be seen from Table 1, the actual amount of the Purchase Transactions for 2007 was RMB96,730,000, exceeding the original cap for 2007 of RMB73,600,000 by approximately 31.43%. This was due to an unexpected increase in the market price of chemical raw materials.

A table showing the increase in the market prices of some of the chemical raw materials during the period from January 2007 to June 2008 is set out below:

	January 2007	December 2007	June 2008
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
	(per ton)	(per ton)	(per ton)
1. Sulphuric acid	370	1,053	approximately 1,700
2. Dimethyl sulphate	2,500	3,514	5,000
3. Reductant	500	1,077	1,500

Table 2: Market price of chemical raw materials

LETTER FROM GET NICE CAPITAL LIMITED

Referring to Table 2 above, during the year 2007, (i) the market price of sulphuric acid has increased by approximately 184.59% from RMB370 per ton in January to RMB1,053 per ton in December; (ii) the market price of Dimethyl sulphate has increased by approximately 40.56% from RMB2,500 per ton in January to RMB3,514 per ton in December; and (iii) the market price of Reductant has increased by approximately 115.4% from RMB500 per ton in January to RMB1,077 per ton in December.

In view of the above substantial and unexpected increase in the market prices of the chemical raw materials during year 2007, we believe that the situation in which the value of actual amount of the Purchase Transactions for 2007 exceeded the respective original cap for 2007 by approximately 31.43% under the 2006 Agreement is moderate and acceptable. Accordingly, we share the same view of the Directors that the ratification of the actual amount incurred in 2007 under the 2006 Agreement is in the best interests of the Company and the Shareholders as a whole and is fair and reasonable as far as the Independent Shareholders are concerned.

B. Revision to the original caps for the years 2008 and 2009

With the continued development in the business of the Company and the increase in the raw material prices, and also based on internal estimates of the demand for the Company's products, the Company expects that the original caps for the years 2008 and 2009 for the continuing connected transactions under the 2006 Agreement as set out in the 2006 Circular will not be sufficient for the Company's requirements. The Company therefore proposes that the caps for the Purchase Transactions under the 2006 Agreement for 2008 and 2009 be revised to RMB200,000,000 and RMB250,000,000 respectively as set out below and that the caps for Sale Transactions for 2008 and 2009 under the 2006 Agreement remain unchanged.

	2008	2009
	<i>RMB'000</i>	<i>RMB'000</i>
	(newly proposed cap)	(newly proposed cap)
Purchase Transactions	200,000	250,000

LETTER FROM GET NICE CAPITAL LIMITED

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

1. the historical figures in 2007;
2. the actual increase and the projected increase in the market prices of chemical raw materials; and
3. the development in the business of the Company.

The Directors (including the independent non-executive Directors) consider that the Revised Caps are in the best interests of the Company and the Shareholders as a whole and are fair and reasonable as far as the Independent Shareholders are concerned.

We have discussed with the management of the Company on the above factors for the revision of the annual caps for 2008 and 2009. We are advised that the Company has noted that the market prices of raw materials for the production of pharmaceutical products in June 2008 have doubled or tripled or more over the market prices in January 2007 as set out in Table 2 above. The Directors anticipate that with the increase in the general price level and in the prices of the fundamental raw materials in the PRC, the market prices of the above chemical raw materials for production of pharmaceutical products are still on the upward trend in the near future. In view of such situation, the Company proposes to increase the caps in relation to the Purchase Transactions under the 2006 Agreement for 2008 and 2009 considerably.

As disclosed in the Board Letter, the actual amounts incurred in relation of the Purchase Transactions under the 2006 Agreement during the first six months from January to June 2008 were RMB68,450,000, representing approximately 80.87% of the original cap of RMB84,640,000 for year 2008 and 34.23% of revised cap of RMB200,000,000 for year 2008 respectively. In anticipation of the increase in the market prices of the chemical raw materials and the expected increase in the trading volume of the Purchase Transactions to cope with the business plan of the Group in expanding its market share particularly that in the PRC and outside the PRC over the next few years, the Directors expect that more Purchase Transactions with SXPGC will be generated.

LETTER FROM GET NICE CAPITAL LIMITED

The revised annual caps for the Purchase Transactions under the 2006 Agreement for the two financial years ended 31 December 2009 of RMB200,000,000 and RMB250,000,000 will respectively account for approximately 12.73% and 15.92% of the audited consolidated cost of goods sold of the Company of RMB1,570,246,000 for the financial year ended 31 December 2007. We are of the view that the Company's risk of reliance on the business with SXPGC for the Purchase Transactions under the 2006 Agreement is acceptable.

In light of the above, we consider that the above factors for the determination of the revised caps in relation to the Purchase Transactions for 2008 and 2009 are fair and reasonable.

C. Monitoring on the revised annual caps

The Company has now designated certain persons to monitor all continuing connected transactions and report to management the amount of those transactions on a monthly basis, and notify each member of the Board if any of those transactions reach 75% of the agreed annual cap prior to the end of September in any year.

In light of the above and in view of the situation that the Purchase Transactions and the Sale Transactions for the two financial years ended 31 December 2009 shall be subject to compliance with the requirements of Chapter 14A of the Listing Rules, we consider that the Company has taken appropriate measures to monitor the revised annual caps for the years 2008 and 2009 under the 2006 Agreement and hence to safeguard the interests of the Company and the Shareholders as a whole.

D. Conclusion

Based on the above, we consider that the revised annual caps in relation to the Purchase Transactions under the 2006 Agreement for the years 2008 and 2009 are fair and reasonable and are in the interest of the Company and the Shareholders as a whole.

LETTER FROM GET NICE CAPITAL LIMITED

RECOMMENDATION

Based on the information and representations provided and opinions given by the Board and having taken into account the above principal factors and reasons, we are of the view that the underlying transactions in relation to the ratification of the actual amount incurred in 2007 under the 2006 Agreement and Revised Caps for the Purchase Transactions under the 2006 Agreement for 2008 and 2009 are 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 advise the Independent Board Committee to recommend the Independent Shareholders to vote in favour of the resolutions in connection with the ratification of the actual amount incurred in 2007 under the 2006 Agreement and the proposed amendments to the original caps for the Purchase Transactions under the 2006 Agreement for the years 2008 and 2009 at the EGM.

Yours faithfully,
For and on behalf of
Get Nice Capital Limited
Louis Yiu Gary Hung
Director 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 187,809,202 unlisted shares, 119,503,628 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 Securities and Futures Ordinance (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 and supervisors of the Company was materially interested in any contract or arrangement entered into by any member of the Group since 31 December 2007, 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 Get Nice Capital Limited had any direct or indirect interest in any assets which had since 31 December 2007, 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 interests 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	148,737,998	32.52

The SXPGC is a wholly-state owned company. Ms. Guo Qin being a 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 2007, 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
Get Nice 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. PROCEDURES FOR DEMANDING A POLL BY SHAREHOLDERS

Your right to demand a poll on the resolutions proposed at the EGM is set out below. The chairman of the EGM will exercise his power under Article 70 of the Articles of Association to put each of the resolutions proposed at the EGM to the vote by way of a poll. Article 70 of the Articles of Association sets out the procedure by which shareholders of the Company may demand a poll:

“At any general meeting a resolution put to the vote of the meeting shall be decided on a show of hands unless any of the following persons demand a poll before or after such resolution is decided by a show of hands:

- (i) the chairman of the meeting;
- (ii) at least two members with voting rights or two proxies for the time being entitled to vote at the meeting; and
- (iii) any member or members (including proxies) representing one-tenth or more of the total voting rights of all the members having the right to vote at the meeting.

Unless a poll be so demanded, a declaration by the chairman of the meeting that a resolution has on a show of hands been carried, and an entry in the minutes of the meeting shall be conclusive evidence of the fact without proof of the number or proportion of the votes recorded in favour or against such resolution.

The shareholder demanding a poll can withdraw such demand.”

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.

At present, the Company has no qualified accountant. With reference to the announcement of the Company dated 11 November 2005, the Stock Exchange has agreed to grant a three-year conditional waiver to the Company from strict compliance with Rule 3.24 of the Listing Rules regarding the employment of an individual with the qualifications set out under that rule as a qualified accountant on a full-time basis. The waiver commenced on 12 November 2005 and will cease on (i) 11 November 2008 or (ii) when the Company fails to fulfill any of the conditions to the waiver as set out in the said announcement, whichever is earlier. The Company is continuing to use its best endeavours to find a suitable candidate to fill the post of qualified accountant of the Company.

- (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 10th Floor, 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 8 September 2008 and at the EGM:

- (a) the 2006 Agreement;
- (b) the Trademark Licence Agreement;
- (c) the letter of recommendation from the Independent Board Committee of the Company to the Independent Shareholders as set out in this circular;
- (d) the letter of advice from Get Nice Capital Limited as set out in this circular;
- (e) the written consent from Get Nice 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 (“**EGM**”) 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 10 October 2008 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:

- (1) the actual amount incurred in 2007 under the 2006 Agreement, i.e. RMB96,730,000 being the purchase of accessories, raw materials and packaging materials by the Company from SXPGC be and is hereby ratified, approved and confirmed.
- (2) the revised caps in relation to the purchase of accessories, raw materials and packaging materials by the Company from SXPGC for each of the two years ending 31 December 2009 being RMB200,000,000 and RMB250,000,000 respectively be and are hereby approved.”

Shandong Xinhua Pharmaceutical Company Limited

The Board of Directors

22 August 2008

NOTICE OF EXTRAORDINARY GENERAL MEETING

Notes:

1. The register of members of the Company will be closed from 10 September 2008 to 10 October 2008 (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 before 4:00 p.m. on 9 September 2008 and on the register of members of the China Securities Registrar Company Limited Shenzhen Branch after the closing of Shenzhen Stock Exchange on 9 September 2008 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 22 August 2008 to the Company Secretary's office of the Company (see Note 7 below) on or before 19 September 2008, 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 22 August 2008 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 22 August 2008.
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:

No. 14 Dongyi Road, Zhangdian District, Zibo City, Shandong Province, The PRC

Postal Code : 255005

Telephone : 86 533 2196025

Facsimile : 86 533 2287508

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

Directors:

Ms. Guo Qin (*Chairman*)

Mr. Liu Zhenwen

Mr. Ren Fulong

Mr. Zhao Songguo

Mr. Li Tianzhong

Independent Non-executive Directors:

Mr. Dai Qingjun

Mr. Xu Guojun

Mr. Sun Minggao