

CHINA MEDICAL SCIENCE LIMITED

中華藥業有限公司*

(Incorporated in the Cayman Islands with limited liability)

FIRST QUARTERLY REPORT

2003

** For identification purposes only*

CHARACTERISTICS OF THE GROWTH ENTERPRISE MARKET (“GEM”) OF THE STOCK EXCHANGE OF HONG KONG LIMITED (THE “STOCK EXCHANGE”)

GEM has been established as a market designed to accommodate companies to which a high investment risk may be attached. In particular, companies may list on GEM with neither a track record of profitability nor any obligation to forecast future profitability. Furthermore, there may be risks arising out of the emerging nature of companies listed on GEM and the business sectors or countries in which the companies operate. Prospective investors should be aware of the potential risks of investing in such companies and should make the decision to invest only after due and careful consideration. The greater risk profile and other characteristics of GEM mean that it is a market more suited to professional and other sophisticated investors.

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This report, for which the directors of CHINA MEDICAL SCIENCE LIMITED collectively and individually accept full responsibility, includes particulars given in compliance with Rules Governing the Listing of Securities on the GEM for the purpose of giving information with regard to CHINA MEDICAL SCIENCE LIMITED. The directors of CHINA MEDICAL SCIENCE LIMITED, having made all reasonable enquiries, confirm that, to the best of their knowledge and belief: (i) the information contained in this report is accurate and complete in all material respects and not misleading; (ii) there are no other matters the omission of which would make any statement in this report misleading; and (iii) all opinions expressed in this report have been arrived at after due and careful consideration and are founded on bases and assumptions that are fair and reasonable.

HIGHLIGHTS

- Turnover of the Group for the three months ended 31 October 2002 amounted to approximately HK\$34,426,000, representing a decrease of approximately 20% as compared with that of the corresponding period in 2001.
- Profit attributable to shareholders for the three months ended 31 October 2002 amounted to approximately HK\$3,040,000, compared with a profit of approximately HK\$4,273,000 recorded by the Group for the corresponding period in 2001.
- Basic earnings per share amounted to approximately 0.61 cents for the three months ended 31 October 2002.
- The Directors do not recommend the payment of an interim dividend for the three months ended 31 October 2002.

RESULTS

The board of directors (the “Board”) of China Medical Science Limited (the “Company”) is pleased to announce that the unaudited consolidated results of the Company and its subsidiaries (collectively, the “Group”) for the three months ended 31 October 2002 together with the comparative unaudited figures for the corresponding period last year are as follows:

		For the three months ended 31 October	
		2002	2001
	<i>Note</i>	<i>HK\$'000</i>	<i>HK\$'000</i> <i>(Restated)</i>
Turnover	2	34,426	43,036
Cost of sales		(23,451)	(29,946)
Gross profit		10,975	13,090
Other revenue & gains		640	779
Selling and distribution costs		(513)	(2,717)
General and administrative expenses		(3,294)	(2,983)
Other operating expenses		(1,316)	(1,067)
PROFIT FROM OPERATING ACTIVITIES		6,492	7,102
Finance costs		(2,715)	(2,413)
Share of loss of an associate		(98)	—
PROFIT BEFORE TAX		3,679	4,689
Tax	3	(292)	—
PROFIT BEFORE MINORITY INTERESTS		3,387	4,689
Minority interests		(347)	(416)
NET PROFIT FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS		3,040	4,273
EARNINGS PER SHARE	4		
— Basic		0.61 cents	0.85 cents
— Diluted		0.59 cents	0.81 cents

Notes:

1. Group reorganisation and basis of presentation

The Company was incorporated in the Cayman Islands on 22 September 2000 as an exempted company with limited liability under the Companies Law (2000 Revision) of the Cayman Islands. Pursuant to a group reorganisation (the “Reorganisation”) to rationalise the Group’s structure in preparation for the listing of the shares on GEM, the Company became the holding company of the companies now comprising the Group. The Company’s shares have been listed on the GEM since 10 April 2001.

The principal accounting policies adopted in preparing the unaudited consolidated results conform with the Statements of Standard Accounting Practice (the “SSAPs”) and Interpretations issued by the Hong Kong Society of Accountants, the disclosure requirements of Hong Kong Companies Ordinance and the Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited (“GEM Listing Rules”).

The principal accounting policies adopted in preparing the unaudited consolidated results are consistent with those used in the annual financial statements for the year ended 31 July 2002 of the Group.

2. Turnover

The Group’s turnover represents the net invoiced value of goods sold and net of value added tax, after allowances for returns and trade discounts.

	For the three months ended 31 October	
	2002	2001
	<i>HK\$’000</i>	<i>HK\$’000</i>
Sale of human drugs — infusion medicine	14,818	23,694
Sale of veterinary drugs	7,478	5,335
Sale of packaging materials for infusion medicine	12,130	14,007
Turnover	<u>34,426</u>	<u>43,036</u>

3. Tax

No provision for Hong Kong profits tax has been made, as the Group had no assessable profits arising in Hong Kong for the three months ended 31 October 2002. (2001: Nil)

The subsidiaries of the Group in the PRC have been granted corporate income tax exemption for the first two profitable years of operation and are entitled to a 50% relief from corporate income tax for the following three years. Chengdu Viking Yuan Heng Pharmaceutical Co., Ltd, a 91% owned subsidiary established in Chengdu, Sichuan, was entitled to tax exemption up to 31 December 2001. As of 31 October 2002, Chengdu Viking Yuan Heng is subject to PRC corporate income tax at a concessionary rate of 15%. Other subsidiaries were still under the tax holiday.

The Group did not have any significant unprovided deferred tax liabilities for the three months ended 31 October 2002 (2001: Nil).

4. Earnings per share

The calculation of the basic earnings per share for the three months ended 31 October 2002 is based on the unaudited consolidated profit attributable to shareholders of approximately HK\$3,040,000 (2001: approximately HK\$4,273,000) and the weighted average number of 500,000,000 (2001: 500,000,000) ordinary shares in issue for the three months ended 31 October 2002.

The calculation of diluted earnings per share for the three months ended 31 October 2002 is based on the unaudited consolidated profit attributable to shareholders of approximately HK\$3,040,000 (2001: approximately HK\$4,273,000) after adjustment of interest saved upon deemed conversion of all convertible notes (the "Convertible Note") upon the listing, and the weighted average number of 500,000,000 (2001: 500,000,000) ordinary shares outstanding plus the respective weighted average number of 48,619,564 (2001: 48,619,564) ordinary shares deemed to be issued as if the Convertible Note had been converted and the exercise of Pre-IPO share option upon the listing.

5. Reserves

	Share premium HK\$'000	Capital reserve HK\$'000	Exchange fluctuation reserve HK\$'000	Retained profit HK\$'000	Total HK\$'000
At 1 August 2000					
As previously reported	—	8,968	25	637	9,630
Prior year adjustments:					
SSAP 30 — restatement to non-current assets section of consolidated balance sheet of goodwill and negative goodwill on acquisition of subsidiaries	—	(8,968)	—	38	(8,930)
As restated	—	—	25	675	700
Issue of shares	50,000	—	—	—	50,000
Capitalisation issue of shares	(20,000)	—	—	—	(20,000)
Share issue expenses	(12,008)	—	—	—	(12,008)
Arising on capitalisation of loan	—	27,104	—	—	27,104
Net profit for the year (as restated)	—	—	—	29,094	29,094
At 31 July 2001	<u>17,992</u>	<u>27,104</u>	<u>25</u>	<u>29,769</u>	<u>74,890</u>
At 1 August 2001					
As previously reported	17,992	27,728	25	29,403	75,148
Prior year adjustments:					
SSAP 30 — restatement to non-current assets section of consolidated balance sheet of goodwill and negative goodwill on acquisition of subsidiaries	—	(624)	—	366	(258)
As restated	17,992	27,104	25	29,769	74,890
Net profit for the period	—	—	—	4,273	4,273
At 31 October 2001	<u>17,992</u>	<u>27,104</u>	<u>25</u>	<u>34,042</u>	<u>79,163</u>
At 1 August 2002					
Profit for the period	17,992	27,104	25	50,267	95,388
	—	—	—	3,040	3,040
At 31 October 2002	<u>17,992</u>	<u>27,104</u>	<u>25</u>	<u>53,307</u>	<u>98,428</u>

DIVIDEND

The Directors do not recommend the payment of any interim dividend for the three months ended 31 October 2002. (2001: Nil)

BUSINESS REVIEW AND OUTLOOK

FINANCIAL REVIEW

For the three months ended 31 October 2002, the unaudited consolidated turnover of the Group amounted to approximately HK\$34,426,000, representing a decrease of approximately 20% as compared with the turnover of the corresponding period in 2001. The Group's profit from operations amounted to approximately HK\$6,492,000 (2001: approximately HK\$7,102,000) for the period under review. The drop was mainly due to 37.5% decrease in sales of infusion medicines over the same period the year before. Market competition amongst manufacturers of the infusion medicines has intensified since the early of 2002, resulting in the gradual decrease of the price of the infusion medicines. The average selling price of the infusion medicines have decreased by approximately between 20% and 30% for the period under review as compared to the corresponding period in 2001. Under fierce competition and adverse market conditions in the infusion medicine industry, Chengdu Mt. Green Pharmaceutical during the period under review endeavoured to restructure its sales and distribution system in response to the changes imposed by the State in the medical industry, resulting in the decline in the sale for the period under review.

Chengdu Mt. Green Pharmaceutical Co., Ltd. (“Chengdu Mt. Green”)

During the period under review, the sale of human drugs amounted to approximately HK\$14,818,000, representing a decrease of approximately 37.5% as compared with the corresponding period in 2001. The company experienced increasingly fierce competition during the period in the PRC medicine industry due to the following reasons: (1) With the gradual implementation of a series of State pharmaceutical reform policies, Chengdu Mt. Green implemented a number of measures on the sale and distribution system in response to changes in the market, which caused the turnover of the company temporarily slackened for the period under review. (2) The State’s pricing control policy on pharmaceutical products coupled with severe competition in the domestic pharmaceutical market have, to a certain extent, affected the business of the company. (3) The single series of product with low added-value was and is still one of major risk factors for Chengdu Mt. Green’s performance. During the period under review, Chengdu Mt. Green faced such risk to a much more material extent than other competitors with diversified business.

To maintain the market share and its competitive edge, Chengdu Mt. Green further upgraded its sales management strategy by adopting new marketing approaches. First, by replacing the regional manager system with larger regional agent system, more emphasis has been placed on effective cost control, minimizing the credit risk. Additionally, the company established contractual sale system in which appropriate pharmaceutical companies will be contracted as sole agents in restricted areas with favourable terms. This is helping to further increase the market share of the new products.

In response to the poor market conditions, Chengdu Mt. Green during the period under review endeavoured to accelerate the development of new products, and has enhanced its competitiveness through adjustment of its product mix, refinement of operational procedures and strengthening of quality management. These measures not only will expand the product range of the company, but also will build a solid base for Chengdu Mt. Green’s future development.

In addition, the construction of the main production complex for production of medical infusion medicine in PVC bags was basically completed, with the other auxiliary facilities having been installed. The preparation works for Good Manufacturing Practice (the “GMP”) certificate was in progress. The procedure of GMP certification is expected to be accomplished by the end of 2002. With the addition of infusion medicine in PVC bags, the market reach of the company will be significantly expanded and it will be greatly beneficial to the development of new products in the future.

Sichuan Future Industrial Co., Ltd. (“Sichuan Future”)

The sale of packaging materials for infusion medicine for the 3-months period amounted to approximately HK\$12,130,000, representing a decrease of approximately 13.4% with the sale recorded for the corresponding period in 2001. The reason for this decrease was mainly attributable to changes in sales strategy of the company so as to secure the market share.

During the period under review, the new multi-coloured transparent aluminium-plastic caps with new nano-technology, which were co-developed under the joint efforts with University of Sichuan, Sichuan High Molecule Material Institute and South-west Aluminium have been well recognized on the market since they were launched. The Directors believe that this new products will further strengthen the profitability and will bring about more potential product developments in the near future.

In order to maintain the fundamentals of a healthy growth and the development momentum, Sichuan Future implemented changes by adopting a regional sales management system, and strengthening market efforts through the implementation of new commission-based remuneration measure. The effect of the regional sales management system is to enable the company to more pragmatically and effectively promote and drive penetration of the products to hospitals and end markets. During the period under review, the sale network is further expanded to Guangxi Province, Jilin Province, Ningxia Province, Inner Mongolia, Harbin and Shanghai in the PRC.

Additionally, Sichuan Future during the period under review adopted a market-oriented approach by primarily focusing on high-end products, which were complemented by low-mid range products. Ultimately, all products ranges step toward high-end products. The Directors are confident that the new sale and marketing strategy will facilitate the company to maintain sustainable growth under increasingly competitive conditions.

Chengdu Viking Yuan Heng Pharmaceutical Co., Ltd. (“Chengdu Yuan Heng”)

Chengdu Yuan Heng recorded turnover of approximately HK\$7,478,000 for the 3-months period under review, representing an increase of approximately 40.2% as compared with the turnover for the corresponding period in 2001.

During the period under review, the acquisition of Sichuan Veterinary Medicine factory (name changed to Sichuan Bio-pharmaceutical Factory) (the “Sichuan Veterinary”) has basically completed. Currently, the company is in the process of obtaining the business license. The plant for Sichuan Bio-pharmaceutical Factory is scheduled for completion and production by 2003.

In relation to the powdered medicine workshop and the orally administrated liquid medicine workshop, air-purifying works and overall infrastructures have been completed, but the equipments are still under preparation. Both workshops are expected to operate in full capacity in the next quarter.

Research and Development

Infusion medicine:

The R&D projects undertaken by Chengdu Mt. Green are progressing well. Pentoxifylline and Glucose Injection and Isosorbide Mononitrate and Glucose Injection were submitted to the SDA for the application of medicine certificate and production approvals. However, with new measures imposed in the medical industry by the SDA, all applications for medicine certificate were delayed. The medicine certificate and production approvals for both medicines are expected to be obtained in next quarter. Also, there were various new products under research and development, namely Aminomethybenzoic Acid and Glucose Injection, Pazufloxacin Injection and Surgical Washing Solution. It is expected that the early phase of research and development will be completed by the end of 2002.

Veterinary drug:

During the period under review, 7 products had obtained the pharmaceutical registrations, namely Qingtianfenzhen, Jiaoyangenzhen, Genta-Micronomicinum Injection, Binghuozhizun Injection, Gongli Injection, New Tyclosone Injection and Clindamycinum Hydrochloride Injection. Qingtianfenzhen and Gongli Injection have been well received since their launch in the market.

OUTLOOK

With a series of reform policies gradually implemented by the State in the medicine market, the Directors anticipate that the Group will continue to face keen competition in the PRC pharmaceutical market. Despite this, the Directors are confident of a better performance in the second quarter following the implementation of the strategies to strengthen and expand the sales network. Also the Group will further improve the process of optimising the application of its internal resources and endeavour to lower costs. Efforts will also be made to maximise the utilisation of working capital and seek new investment opportunities such as through merger and acquisition. The Directors believe that the infusion medicine business will remain the Group's core operation; it also will seek other potential opportunities proactively in order to generate a new stream of revenue and profits for the Group in the long run.

COMPETING INTEREST

None of the directors, the management shareholders or substantial shareholders (as defined in the GEM Listing Rules) of the Company or any of their respective associates had any interest in any business, which competes or may compete with the business of the Group or has any other conflict of interest with the Group.

DIRECTORS' INTERESTS IN THE SHARES OF THE COMPANY

As at 31 October 2002, the interests of the directors and their associates in the share capital of the Company and its associated corporations, as recorded in the register maintained by the Company pursuant to Section 29 of the Securities (Disclosure of Interests) Ordinance ("SDI Ordinance") or as otherwise notified to the Company pursuant to the minimum standards of dealings by the directors as referred to Rule 5.40 of the GEM Listing Rules were as follows:

Name of Director	Nature of Interest	Number of shares in the Company
Mr. Wong Sai Chung (<i>Note a</i>)	Corporate	400,000,000

Note:

- (a) The shareholding interest attributable to Mr. Wong Sai Chung, an executive director, in the Company is held through Concord Pharmaceutical Technology (Holdings) Limited and Concord Business Management Limited. Concord Pharmaceutical Technology (Holdings) Limited and Concord Business Management Limited are investment holding companies and wholly-owned by Mr. Wong Sai Chung.

The interests of the directors in the share options of the Company are separately disclosed in the section "Share option schemes" in this report.

DIRECTORS' RIGHTS TO ACQUIRE SHARES OR DEBENTURES

Pursuant to the terms of the Company's Pre-IPO Share Option Scheme (the "Pre-IPO Plan") adopted by the Company on 23 March 2001, the Company has granted options to the following directors to subscribe for shares in the Company at any time from 10 October 2001 up to and including 9 April 2011 at an exercise price of HK\$0.55 per share. Summary details of these options which remain outstanding as at 31 October 2002 are as follows:

Name of Director	Number of underlying shares
Mr. Wong Sai Wa	3,200,000
Mr. Kwan Kai Cheong	3,000,000

The exercise period of the Pre-IPO Plan is set out under the paragraph headed "Share Option Schemes" below. Details of the Pre-IPO Plan are set out in the Prospectus.

Pursuant to the Convertible Note issued by the Company on 23 March 2001, the following director has personal interests in the Convertible Note convertible into shares of the Company:

Name of Director	Outstanding principal	Number of underlying shares
Mr. Wong Sai Chung (<i>Note</i>)	HK\$26,740,760.00	48,619,564

Note: The shareholding interest attributable to Mr. Wong Sai Chung in the Company is held through Concord Pharmaceutical Technology (Holdings) Limited and Concord Business Management Limited, each of Concord Pharmaceutical Technology (Holdings) Limited and Concord Business Management Limited is an investment holding company wholly-owned by Mr. Wong Sai Chung who is an executive director of the Company.

The principal terms of the Convertible Note are set out in the Prospectus.

Save as disclosed above, as at 31 October 2002, none of the directors or their associates had any personal, family, corporate or other interests in the equity or debt securities of the Company or any of its associated corporations (as defined in the SDI Ordinance).

Save as disclosed above, at no time during the year was the Company or any of its subsidiaries a party to any arrangements to enable the Company's directors, their respective spouse or children under 18 years of age to acquire benefits by means of acquisition of shares in or debentures of the Company or any other body corporate.

SHARE OPTION SCHEMES

On 23 March 2001, the Company conditionally adopted the Pre-IPO Plan and the Share Option Scheme, the principal terms of which are set out in the Prospectus.

Pursuant to the Pre-IPO Plan, five employees of the Group (including two executive Directors) were conditionally granted options on 23 March 2001 to subscribe for an aggregate of 7,400,000 shares, which upon exercise in full will result in issue of 7,400,000 additional ordinary shares of HK\$0.05 each for aggregate proceeds of HK\$4,070,000 before the related shares issue expense. All of these options have a duration of 10 years from the date of grant of the options, each is exercisable in accordance with their terms of issue after 6 months from the date of listing of the shares on GEM, but each shall lapse if the relevant grantee ceases to be employed by the relevant companies. The option of 400,000 shares granted to Ms Yip Yuk Lin, the former qualified accountant, was cancelled on 17 August 2001 due to her resignation from the Group. Therefore, as at 31 October 2002, the number of share options granted to the employees remains 7,000,000 shares. The aggregate amount of HK\$3,850,000 will be generated if all share options are fully exercised. As at 31 October 2002, none of the Directors or employees of the Company had exercised any share options and no allotment or issue of shares was made pursuant to the Pre-IPO Plan.

On 23 March 2001, the Company adopted a Share Option Scheme (the "Share Option Scheme") under which the Board of the Company may at their discretion, grant options to full time employees of the Group, including any executive directors of the Company and any of its subsidiaries, to subscribe for shares in the Company in accordance with the provisions in the Share Option Scheme. The Share Option Scheme became effective on 23 March 2001 for a period of ten years. Further details of the Share Option Scheme are set out in the Prospectus. No options were granted under the Share Option Scheme during the year.

Save as disclosed herein, no rights to acquire benefits by means of the acquisition of shares in or debentures of the Company were granted to any director, chief executive and substantial shareholder of the Company or their respective associates.

SUBSTANTIAL SHAREHOLDERS

As at 31 October 2002, save for interests of Directors disclosed above, the register of substantial shareholders maintained by the Company under Section 16(1) of the SDI Ordinance showed that the following interests, being 10% or more in the Company's issued share capital:

Name of shareholder	Number of shares held	Percentage of shareholding
Concord Pharmaceutical Technology (Holdings) Limited (<i>Note</i>)	400,000,000	80
Concord Business Management Limited (<i>Note</i>)	400,000,000	80
Mr. Wong Sai Chung (<i>Note</i>)	400,000,000	80

Note: Concord Pharmaceutical Technology (Holdings) Limited is a wholly-owned subsidiary of Concord Business Management Limited, the entire issued share capital of which is owned by Mr. Wong Sai Chung. Accordingly, each of Concord Business Management Limited and Mr. Wong Sai Chung is deemed to have an interest in the 400,000,000 shares of the Company held by Concord Pharmaceutical Technology (Holdings) Limited.

SPONSOR'S INTEREST

Yuanta Securities (Hong Kong) Company Limited (name changed to Core Pacific-Yamaichi (Hong Kong) Company Limited) ("Yuanta Securities") had entered into a sponsorship agreement with the Company on 27 March 2001, pursuant to which Yuanta Securities would act as the continuing sponsor to the Company for the period from the listing date (10 April 2001) to 31 July 2003 (the "Period"). On 4 May 2001, Yuanta Securities notified the Stock Exchange and the Company that Yuanta Securities would be merged with Core Pacific-Yamaichi Capital Limited ("CPY Capital"). Accordingly, the Company appointed CPY Capital as the continuing sponsor on 3 August 2001 for the balance of the Period in return for a fee.

As at 31 October 2002, CPY Capital, its directors, employees or associates, did not have any interest in the share capital of the Company or any member of the Group, or any right to subscribe for or to nominate persons to subscribe for the securities of the Company or any member of the Group.

AUDIT COMMITTEE

The Company set up an audit committee on 23 March 2001 with written terms of reference in compliance with the requirements as set out in Rules 5.23, 5.24 and 5.25 of the GEM Listing Rules. During the period under review, Professor Chiang Chiu Ping Raymond, being one of the independent non-executive director and a member of the audit committee of the Company, passed away. On 11 November 2002, Mr. Lo Chun Wing Albert was appointed as an independent non-executive director and a member of audit committee of the Company. Accordingly, as at the date of this report, the audit committee comprises two members, Mr. Tsim Tak-Lung and Mr. Lo Chun Wing Albert, both of them being independent non-executive directors of the Company.

The work undertaken by the audit committee was to review, in draft form, the Company's annual and interim financial reports and to provide advice and comments thereon to the Board. The audit committee will also be responsible for reviewing and providing supervision over the financial reporting process and internal control of the Group.

The Committee has reviewed the unaudited first quarter results for the three months ended 31 October 2002.

COMPLIANCE WITH BOARD PRACTICE AND PROCEDURES

The Company has complied with the board practices and procedures as set out in Rules 5.28 to 5.39 of the GEM Listing Rules for the period under review.

PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S SHARES

During the three months ended 31 October 2002, neither the Company nor any of its subsidiaries had purchased, sold or redeemed any of the Company's listed securities.

By Order of the Board
China Medical Science Limited
Wong Sai Chung
Chairman

Hong Kong, 12th December, 2002