

CHINA MEDICAL SCIENCE LIMITED
中華藥業有限公司*

(Incorporated in the Cayman Islands with limited liability)

FIRST QUARTERLY REPORT

2005

** For identification purposes only*

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

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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 2004 amounted to approximately HK\$46,124,000, representing a decrease of approximately 11.8% as compared with that in the preceding year.
- Loss attributable to shareholders for the three months ended 31 October 2004 amounted to approximately HK\$4,848,000.
- Basic loss per share amounted to approximately 0.97 cents for the three months ended 31 October 2004.
- The Directors do not recommend the payment of any interim dividend for the three months ended 31 October 2004.

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 2004, together with the comparative unaudited figures for the corresponding period of the previous financial year are as follows:

		For the three months ended 31 October	
		2004	2003
	<i>Note</i>	HK\$'000	<i>HK\$'000</i>
Turnover	2	46,124	52,276
Cost of sales		(33,991)	(41,188)
Gross profit		12,133	11,088
Other revenue & gains		807	707
Selling and distribution costs		(6,083)	(3,493)
General and administrative expenses		(6,285)	(4,220)
Other operating expenses		(1,468)	(1,454)
(LOSS)/PROFIT FROM OPERATING ACTIVITIES		(896)	2,628
Finance costs		(4,578)	(4,022)
Share of result of an associate		582	346
LOSS BEFORE TAX		(4,892)	(1,048)
Tax expense	3	(83)	–
LOSS BEFORE MINORITY INTERESTS		(4,975)	(1,048)
Minority interests		127	(607)
NET LOSS ATTRIBUTABLE TO SHAREHOLDERS		(4,848)	(1,655)
LOSS PER SHARE	4		
– Basic		(0.97) cents	(0.33) cents
– Diluted		N/A	N/A

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 Institute of Certified Public Accountants ("HKICPA"), 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 2004 of the Group.

2. Turnover

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

	For the three months ended 31 October	
	2004	2003
	HK\$'000	HK\$'000
Sale of human drugs	35,887	39,847
Sale of veterinary drugs	7,563	5,939
Sale of packaging materials	2,674	6,490
	<u>46,124</u>	<u>52,276</u>

3. Tax expense

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 2004 (2003: Nil). Taxes on profits assessable elsewhere have been calculated at the rates of tax prevailing in the countries in which the Group operates, based on existing legislation, interpretations and practices in respect thereof.

The deferred tax credit of approximately HK\$1,000 recognised for the three months ended 31 October 2004 (2003: approximately HK\$4,000) represents the movement for temporary difference arising from the acquisition of subsidiaries.

4. Loss per share

The calculation of basic loss per share for the three months ended 31 October 2004 was based on the unaudited net loss attributable to shareholders of approximately HK\$4,848,000 (2003: approximately HK\$1,655,000) and the weighted average number of 500,000,000 (2003:500,000,000) ordinary shares in issue during the period.

No diluted loss per share are presented for the three months ended 31 October 2004 and 31 October 2003 respectively as the convertible note outstanding during the period had an anti-dilutive effect on the basic loss per share for both periods, thus there were no dilutive potential ordinary shares.

5. Reserves

	Share premium <i>HK\$'000</i>	Capital reserve <i>HK\$'000</i>	Exchange fluctuation reserve <i>HK\$'000</i>	Retained profits <i>HK\$'000</i>	Total <i>HK\$'000</i>
At 1 August 2003	17,992	27,104	25	49,615	94,736
Net loss for the period	—	—	—	(1,655)	(1,655)
At 31 October 2003	17,992	27,104	25	47,960	93,081
At 1 August 2004	17,992	27,104	25	5,824	50,945
Net loss for the period	—	—	—	(4,848)	(4,848)
At 31 October 2004	<u>17,992</u>	<u>27,104</u>	<u>25</u>	<u>976</u>	<u>46,097</u>

DIVIDEND

The Directors do not recommend the payment of any interim dividend for the three months ended 31 October 2004 (2003: Nil).

BUSINESS REVIEW AND OUTLOOK

FINANCIAL REVIEW

For the three months period ended 31 October 2004, the Group recorded an unaudited consolidated turnover of approximately HK\$46,124,000, representing a decrease of approximately 11.8% from HK\$52,276,000 for the corresponding period in 2003. The group's unaudited consolidated loss attributable to shareholders for the period was approximately HK\$4,848,000 (2003: approximately HK\$1,655,000). Intensified price competition in the infusion medicine industry and also the packaging materials industry was and is still the key factors impairing the business performance of the Group for the period under review. The sale of infusion medicine by Chengdu Mt. Green and packaging material by Sichuan Future decreased by 93.1% and 58.8% respectively when compared with the corresponding quarter in the preceding year. On the other hand, the performance of Sichuan Shule Pharmaceutical Joint Stock Company Limited improved. Details of these are set out in the following paragraph. The total expenses of the Group for the three months ended 31 October 2004 were approximately HK\$13,836,000, compared with approximately HK\$9,167,000 for the corresponding period in 2003. The extra expenditure over that of last year was primarily attributable to the increase of marketing and promotional activities, increase of sales incentive and customer rebate, increase of transportation cost and also amortisation of guaranteed return for polypropylene bottle production line.

Sichuan Shule Pharmaceutical Joint Stock Company Limited (“Sichuan Shule”)

Sichuan Shule recorded a turnover of approximately of HK\$35,214,000 for the 3-months period under review, representing an increase of approximately 16.9% as compared with the turnover for the corresponding period in the preceding year. The improvement in Sichuan Shule's performance was largely attributable to the efforts made by the management and the staff that have helped to expedite the pace of business development. Moreover, timely adjustment to marketing strategies and product mix was made to cope with the changes of pharmaceutical market.

In view of the competition in the pharmaceutical market being increasingly intensified, Sichuan Shule during the period under review continued to push on the research and development of new products. The company also strengthened the quality control procedures and continuously optimised and rationalized its production processes, while production technology were reviewed, with an aim to achieving overall cost saving and providing a solid platform for its future growth.

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

Chengdu Mt. Green recorded a turnover of approximately HK\$673,000 for the three months ended 31 October 2004, representing a decrease of 93.1% as compared with that for the corresponding period in the previous year. The decrease was mainly due to the following factors: (1) The GMP certification of Chengdu Mt. Green will be subject to the review by the State Food Drug Administration of China (“SFDA”) by the end of the year 2004, resulting in the modification to the production facilities being undertaken by Chengdu Mt. Green during the period under review, and that production almost coming to a halt for the period. (2) Competition in current infusion medicine market was still fierce and product prices remained at lower level, which caused the absolute amount of sales to be weighed down. In view of the decreasing profit margins of low end infusion medicine, Chengdu Mt. Green reduced its overall production during the period under review and redirected its focus and resources on research and development of products with more growth potential and long-term prospect.

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

During the three-months period under review, the turnover of Sichuan Future decreased from approximately HK\$6,490,000 last year to approximately HK\$2,674,000 for the corresponding period this year, representing a decrease of approximately 58.8%. The decrease was mainly due to the following factors: (1) The price competition in the infusion medicine market became increasingly fierce, which put greater pressure on the demand of medical cap, and also its selling price. (2) 28f series of medical cap with low profit margin was and still is one of major risk factors for Sichuan Future’s performance. (3) A large increase in the plastic and aluminium costs on the manufacture of medical cap and increase in transportation cost during the period under review also caused the overall profit margin to be weighed down. Facing the increasing competition in the packaging material industry and unpredictable rises in costs, Sichuan Future gradually reduced its production of low end products and reallocated its resources to develop high end products in order to reduce its reliance currently placed on the infusion medicine market.

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

During the three-months period under review, the sale of Chengdu Yuan Heng increased from approximately HK\$5,939,000 last year to approximately HK\$7,607,000 for the corresponding period this year, representing an increase of approximately 28.1%. The business performance of the company was affected in the first quarter of last year by the new regulatory policies implemented by the Ministry of Agriculture, but the situation now gradually returned to the normal. The increase in profit as compared with the rise in turnover for the period under review was mainly the result of a change in sales mix in favour of new products with higher profit margin and also contribution from the original equipment manufacturer (“OEM”) products. During the period under review, the company placed more efforts to increase its distribution network but also enhanced the professional standard of its sales force. This resulted in more effective promotion on higher margin products and also an absolute increase in sales revenue.

Research and Development

Human drug:

Research and development on new medicines continued smoothly. During the period under review, two products have obtained the production permit from SFDA, namely Matriline and Sodium Chloride Injection and Zedoary Turmeric Oil Injection. The result in respect of pre-clinical test for certain new drugs under categories I and III were also reported to SFDA for drug supervision. Sichuan Shule will continue the selection of new product development projects in order to widen production range.

Veterinary drug:

During the period under review, 7 products had obtained pharmaceutical registration, namely Macleayae Injection, Compound Sulfamonomethoxine Sodium LongActing Injection, Compound Enrofloxacin Injection, Benzylpenicillin Potassium for Injection 1.0g, Gentamycin Sulfate Injection 5ml : 0.2g, Enrofloxacin and Sulfamonomethoxine Injection and Compound Apramycin Sulfate Injection.

OUTLOOK

The directors anticipate that fierce competition in the pharmaceutical industry in the PRC will continue to affect the prospects of the Group and also its future earnings. In order to improve the market share of the Group's products, the research and development of new products will be the key tasks for the Group. The directors believe that capitalizing on Sichuan Shule's inherent experience in the manufacturing of nutritional infusion medicines and non-addictive anesthetics in the PRC, the Group will further enlarge its production scale of more new human drugs under the categories of Fat Emulsion, Propofol and Bambuterol Hydrochloride Capsules, thereby strengthening the company's favourable position in the market.

As for the loss making Chengdu Mt. Green and Sichuan Future businesses, the directors are currently negotiating with certain potential purchasers for the disposal of the businesses.

As the development of modernized agriculture and husbandry industry becomes one of the prime directives of the PRC government, it is evident that demand for modern vaccine products of international standards is growing in intensity. Chengdu Yuan Heng holds one of the 28 vaccine production licenses in the PRC. The directors believe in the huge potential of this business and is in discussion with potential strategic partners in the industry and investors with the view of investing together on the construction of a new GMP-compliant vaccine factory to take advantage of this huge and potentially highly profitable segment of the market.

COMPETING INTEREST

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

DIRECTORS' AND CHIEF EXECUTIVES' INTEREST IN THE SHARES OF THE COMPANY

As at 31 October 2004, the interests or short positions of the directors and chief executives in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (“SFO”)) which were notified to the Company and The Stock Exchange of Hong Kong Limited (the “Stock Exchange”) pursuant to Division 7 and 8 of Part XV of the SFO (including interests or short positions which they were taken or deemed to have under such provisions of the SFO), or which were required, pursuant to Section 352 of the SFO, to be entered in the register referred to therein, or which were required, pursuant to Rules 5.46 to 5.67 of the GEM Listing Rules, to be notified to the Company and the Stock Exchange, were as follows:

Long positions in ordinary shares and underlying shares of the Company

Name of Director	Capacity and nature of interest	Shares/equity derivatives	Number/ amount of shares/equity derivatives held	Percentage of the Company's issued share capital	Note
Mr. Wong Sai Chung	Through controlled corporation	Ordinary shares	400,000,000 shares	80%	a
	Through controlled corporation	Convertible note	HK\$26,740,760	9.7%	c
Mr. Wong Sai Wa	Directly beneficially owned	Share options	3,200,000 share options	0.64%	b
Mr. Kwan Kai Cheong	Directly beneficially owned	Share options	3,000,000 share options	0.60%	b

Notes:

- (a) These shares are registered in the name of Concord Pharmaceutical Technology (Holdings) Limited (“CPT” hereinafter), a wholly-owned subsidiary of Concord Business Management Limited (“CBM” hereinafter). As at 31 October 2004, the entire issued share capital of CBM was owned by Mr. Wong Sai Chung. Accordingly, Mr. Wong Sai Chung is deemed to have an interest in the 400,000,000 shares of the Company held by CPT.
- (b) 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 the above options to the directors to subscribe for shares in the Company at any time from 10 October 2001 up to and including 22 March 2011 at an exercise price of HK\$0.55 per share. 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.
- (c) As at 31 October 2004, CPT held a convertible note (the “Convertible Note”) with outstanding principal amount of HK\$26,740,760. The Convertible Note confers the right on CPT to convert such note into approximately 48,619,564 of the Company’s new shares at an issue price of HK\$0.55 per share, representing approximately 9.7% of the issued share capital of the Company and approximately 8.9% of the issued share capital of the Company as enlarged by the shares which may fall to be issued on conversion. Mr. Wong Sai Chung has a beneficial interest in CPT as set out in note (a) above. The principal terms of the Convertible Note are set out in the Prospectus.

Save as disclosed herein, as at 31 October 2004, none of the directors or chief executives of the Company has short positions in the shares or underlying shares of equity derivatives of the Company.

Save as disclosed above, at no time during the period 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 a Share Option Scheme (the “Share Option Scheme”), the principal terms of both 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, and each option is exercisable in accordance with the 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 options of 400,000 shares granted to Ms Yip Yuk Lin and Dr. Chan Ka Keung respectively were cancelled due to their resignation from the Group. Accordingly, as at 31 October 2004, the number of share options granted to the employees remained at 6,600,000 shares. An aggregate amount of HK\$3,630,000 will be generated if all share options are fully exercised. During the three months ended 31 October 2004, 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 under which the board of directors 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 period under review.

SUBSTANTIAL SHAREHOLDERS' INTERESTS

As at 31 October 2004, the following persons (not being the directors and chief executives of the Company) had interests or short positions in the shares, underlying shares or debentures of the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO, or which were recorded in the register required to be kept under Section 336 of the SFO as follows:

Long positions in ordinary shares and underlying shares of the Company

Name	Capacity and nature of interest	Shares/equity derivatives	Number/amount of shares/equity derivatives held	Percentage of the Company's issued share capital	Note
CPT	Corporation	Ordinary shares	400,000,000 shares	80%	a and b
	Corporation	Convertible note	HK\$26,740,760	9.7%	a and c
CBM	Through controlled corporation	Ordinary shares	400,000,000 shares	80%	a and b
	Through controlled corporation	Convertible note	HK\$26,740,760	9.7%	a and c

Notes:

- (a) CPT is a wholly-owned subsidiary of CBM. Accordingly, CBM is deemed to have interests in the 400,000,000 shares and convertible note of the Company held by CPT.
- (b) The shares held in the name of CPT are duplication of the shares held by the director, Mr. Wong Sai Chung.
- (c) The convertible note held by CPT is a duplication of the convertible note held by the director, Mr. Wong Sai Chung. Details of the convertible note are disclosed under the section headed "Directors' and Chief Executives' Interests in Shares of the Company" above.

Save as disclosed above, as at 31 October 2004, the directors or chief executives of the Company were not aware of any other person (other than directors or chief executives of the Company) who had an interest or short position in the shares or underlying shares of the Company 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 was interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meeting of any other 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 5.28, 5.29 and 5.30 of the GEM Listing Rules. The audit committee has 3 members, namely Mr. Chow Wai Ming, Mr. Garry Alides Willinge and Mr. Lai Chik Fan. The work undertaken by the audit committee are to review the Company's annual report and financial statements, half-yearly report and quarterly reports and to provide advice and comment thereon to the board of directors. The audit committee will also be responsible for reviewing and supervising the financial reporting process and internal control procedures of the Group.

COMPLIANCE WITH BOARD PRACTICE AND PROCEDURES

The Company has complied with the board practices and procedures as set out in Rules 5.34 to 5.45 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 2004, 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
Yu Ling Ling
Company Secretary

Hong Kong, 14 December, 2004

As at the date of this report, the Board comprises five executive directors, namely Mr. Wong Sai Chung, Mr. Wong Sai Wa, Mr. Kwan Kai Cheong, Dr. Tang Gang and Mr. Wong Fei Fei; and three independent non-executive directors, namely Mr. Chow Wai Ming, Mr. Lai Chik Fan and Mr. Garry Alides Willinge.