

**CHINA MEDICAL SCIENCE LIMITED**

**中華藥業有限公司\***

*(Incorporated in the Cayman Islands with limited liability)*

**INTERIM 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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## HIGHLIGHTS

- Turnover of the Group for the six months ended 31 January 2005 amounted to approximately HK\$83,653,000, representing a decrease of approximately 12.6% as compared with that in the preceding year.
- Loss attributable to shareholders for the six months ended 31 January 2005 amounted to approximately HK\$27,208,000, after a provision of HK\$19,479,000 for loss on disposal of discontinuing operations.
- Basic loss per share amounted to approximately 5.44 cents for the six months ended 31 January 2005.
- The Directors do not recommend the payment of any interim dividend for the six months ended 31 January 2005.

## 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 and six months ended 31 January 2005, together with the comparative unaudited figures for the corresponding period of the previous financial year are as follows:

### Consolidated Income Statement – Unaudited

	Note	For the three months ended 31 January		For the six months ended 31 January	
		2005 HK\$'000	2004 HK\$'000 (Restated)	2005 HK\$'000	2004 HK\$'000 (Restated)
Turnover					
Continuing operations	2	35,872	40,119	79,322	85,906
Discontinuing operation	2	1,657	3,281	4,331	9,770
		<u>37,529</u>	<u>43,400</u>	<u>83,653</u>	<u>95,676</u>
Cost of sales		<u>(31,119)</u>	<u>(35,487)</u>	<u>(65,110)</u>	<u>(76,675)</u>
Gross profit		6,410	7,913	18,543	19,001
Other revenue & gains	2	557	340	1,364	1,046
Selling and distribution costs		(1,458)	(2,855)	(7,540)	(6,348)
General and administrative expenses		(4,608)	(3,763)	(10,893)	(7,725)
Other operating expenses		(2,211)	(2,465)	(3,679)	(4,177)
Loss on disposal of discontinuing operations	4	(19,479)	–	(19,479)	–
<b>(LOSS)/PROFIT FROM OPERATING ACTIVITIES</b>	5	<b>(20,789)</b>	<b>(830)</b>	<b>(21,684)</b>	<b>1,797</b>
Finance costs		(4,541)	(4,128)	(9,119)	(8,150)
Share of result of an associate		1,332	246	1,914	592
<b>LOSS BEFORE TAX</b>		<b>2,168</b>	<b>(2,902)</b>	<b>(1,103)</b>	<b>(3,326)</b>
Continuing operations		2,168	(2,902)	(1,103)	(3,326)
Discontinuing operation		(26,166)	(1,810)	(27,786)	(2,435)
Tax expense	6				
Continuing operations		(17)	–	(101)	–
Discontinuing operation		–	–	–	–
<b>LOSS BEFORE MINORITY INTERESTS</b>		<b>(24,015)</b>	<b>(4,712)</b>	<b>(28,990)</b>	<b>(5,761)</b>
Minority interests		1,654	136	1,782	(471)
<b>NET LOSS ATTRIBUTABLE TO SHAREHOLDERS</b>		<b><u>(22,361)</u></b>	<b><u>(4,576)</u></b>	<b><u>(27,208)</u></b>	<b><u>(6,232)</u></b>
<b>LOSS PER SHARE</b>	7				
– Basic		<u>(4.47) cents</u>	<u>(0.92) cents</u>	<u>(5.44) cents</u>	<u>(1.25) cents</u>
– Diluted		<u>N/A</u>	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>

## Consolidated Balance Sheet

		As at 31 January 2005 <i>HK\$'000</i> (Unaudited)	As at 31 July 2004 <i>HK\$'000</i> (Audited)
<b>NON-CURRENT ASSETS</b>			
Fixed assets	8	197,978	200,902
Intangible assets		10,577	12,428
Goodwill:			
Goodwill		19,558	20,088
Negative goodwill		(5,092)	(5,440)
Interest in an associate		11,496	9,583
Long term investments		4,420	4,420
Deferred tax asset		251	257
		<u>239,188</u>	<u>242,238</u>
<b>CURRENT ASSETS</b>			
Inventories		22,383	21,470
Trade receivables	9	172,886	169,036
Deposits, prepayment and other receivables	9	56,160	42,178
Pledged deposits		55,981	65,649
Cash and cash equivalents		13,098	43,569
		<u>320,508</u>	<u>341,902</u>
<b>CURRENT LIABILITIES</b>			
Bank and other borrowings		178,517	191,417
Notes payable	10	97,026	124,937
Trade payables	10	69,673	82,090
Other payables and accruals	10	100,341	67,034
Deferred income		973	973
Amounts due to directors		28,507	4,222
Tax payable		1,977	1,977
		<u>477,014</u>	<u>472,650</u>
<b>NET CURRENT LIABILITIES</b>		<u>(156,506)</u>	<u>(130,748)</u>
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>		<u>82,682</u>	<u>111,490</u>
<b>NON-CURRENT LIABILITIES</b>			
Bank and other borrowings		20,649	20,649
Deferred income		3,054	3,540
Deferred tax liability		311	320
		<u>24,014</u>	<u>24,509</u>
<b>NET ASSETS BEFORE MINORITY INTERESTS</b>		<u>58,668</u>	<u>86,981</u>
Minority interests		9,931	11,036
		<u>48,737</u>	<u>75,945</u>
<b>CAPITAL AND RESERVES</b>			
Issued capital	11	25,000	25,000
Reserves		23,737	50,945
		<u>48,737</u>	<u>75,945</u>

## Condensed Consolidated Cash Flow Statement – Unaudited

	<b>For the six months ended 31 January 2005 HK\$'000</b>	For the six months ended 31 January 2004 HK\$'000 (Restated)
<b>NET CASH (OUTFLOW)/INFLOW FROM OPERATING ACTIVITIES</b>		
Continuing operations	(12,983)	35,617
Discontinuing operation	(8,828)	(8,427)
Total	(21,811)	27,190
<b>NET CASH INFLOW/(OUTFLOW) FROM INVESTING ACTIVITIES</b>		
Continuing operations	8,201	(6,032)
Discontinuing operation	(3,778)	(145)
Total	4,423	(6,177)
<b>NET CASH (OUTFLOW)/INFLOW FROM FINANCING</b>		
Continuing operations	(27,872)	(15,739)
Discontinuing operation	14,789	4,710
Total	(13,083)	(11,029)
<b>(DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(30,471)</b>	<b>9,984</b>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF THE PERIOD</b>	<b>43,569</b>	<b>45,754</b>
<b>CASH AND CASH EQUIVALENTS AT END OF THE PERIOD</b>	<b>13,098</b>	<b>55,738</b>
<b>ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS</b>		
Non-pledged cash and bank balances	4,598	19,319
Non-pledged time deposits with original maturity of less than three months when acquired	8,500	36,419
	<b>13,098</b>	<b>55,738</b>

## Consolidated Statement of Change in Equity – Unaudited

	Share capital	Share premium	Capital reserve	Exchange fluctuation reserve	Retained profits	Total
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
At 1 August 2003	25,000	17,992	27,104	25	49,615	119,736
Net loss for the period	–	–	–	–	(6,232)	(6,232)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
At 31 January 2004	<u>25,000</u>	<u>17,992</u>	<u>27,104</u>	<u>25</u>	<u>43,383</u>	<u>113,504</u>
At 1 August 2004	25,000	17,992	27,104	25	5,824	75,945
Net loss for the period	–	–	–	–	(27,208)	(27,208)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
At 31 January 2005	<u>25,000</u>	<u>17,992</u>	<u>27,104</u>	<u>25</u>	<u>(21,384)</u>	<u>48,737</u>

Notes:

## 1. Basis of presentation

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, other revenue and gains

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

An analysis of turnover, other revenue and gains is as follows:

	For the three months ended 31 January		For the six months ended 31 January	
	2005	2004	2005	2004
	HK\$’000	HK\$’000	HK\$’000	HK\$’000
<b>Turnover</b>				
Continuing operations				
Sale of human drugs	27,993	35,044	63,880	74,891
Sale of veterinary drugs	7,879	5,075	15,442	11,015
	<u>35,872</u>	<u>40,119</u>	<u>79,322</u>	<u>85,906</u>
Discontinuing operation				
Sale of packaging materials	1,657	3,281	4,331	9,770
	<u>1,657</u>	<u>3,281</u>	<u>4,331</u>	<u>9,770</u>
	<u>37,529</u>	<u>43,400</u>	<u>83,653</u>	<u>95,676</u>
<b>Other revenue and gains</b>				
Interest income	25	26	428	532
Sundry income	359	140	589	165
Negative goodwill recognized	173	174	347	349
	<u>557</u>	<u>340</u>	<u>1,364</u>	<u>1,046</u>

### 3. Segment information

An analysis of the Group's turnover and contribution to operating results by business segments is as follows:

	Continuing operations						Discontinuing operation Packaging Materials				Consolidated	
	Human Drugs		Veterinary Drugs		Corporate		Materials		Elimination			
	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004
	HK\$000	HK\$000	HK\$000	HK\$000	HK\$000	HK\$000	HK\$000	HK\$000	HK\$000	HK\$000	HK\$000	HK\$000
Segment revenue:												
Sales to external customers	63,880	74,891	15,442	11,015	-	-	4,331	9,770	-	-	83,653	95,676
Intersegment sales	7,524	3,668	-	-	-	-	710	637	(8,234)	(4,305)	-	-
Other revenue	553	153	36	12	703	1,140	-	-	(356)	(791)	936	514
<b>Total</b>	<b>71,957</b>	<b>78,712</b>	<b>15,478</b>	<b>11,027</b>	<b>703</b>	<b>1,140</b>	<b>5,041</b>	<b>10,407</b>	<b>(8,590)</b>	<b>(5,096)</b>	<b>84,589</b>	<b>96,190</b>
Segment results	9,216	4,015	1,546	(236)	(7,817)	(1,828)	(25,057)	(686)	-	-	(22,112)	1,265
Interest income											428	532
(Loss)/profit from operating activities											(21,684)	1,797
Finance costs											(9,119)	(8,150)
Share of result of an associate	1,914	592									1,914	592
Loss before tax											(28,889)	(5,761)
Tax expenses	(101)	-									(101)	-
Loss before minority interests											(28,990)	(5,761)
Minority interests											1,782	(471)
Net loss attributable to shareholders											(27,208)	(6,232)

### 4. Discontinuing operations

During the period under review, the Group decided to focus its operations on the development, production, sales and distribution of a range of biotechnology and pharmaceutical products, principally infusion and injection medicine for human and domestic animals consumption. Seechain Investments Limited ("Seechain"), an indirectly wholly-owned subsidiary of the Company, has entered into the Equity Interest Transfer Agreement with Sichuan Taishan Real Estate Development Co., Ltd. ("Sichuan Taishan") on 24 December 2004, for the disposal of a 91% equity interest in each of Chengdu Mt. Green and Sichuan Future for a cash consideration of RMB1.00. Upon completion of the disposal of Chengdu Mt. Green and Sichuan Future, the Group will discontinue its development, production, sales and distribution of a series of aluminium-plastic caps for use in the packaging of biotechnology and pharmaceutical products. The estimated loss on disposal of the business of Chengdu Mt. Green and Sichuan Future was approximately HK\$19,479,000. There was no tax arising from the disposal.

The turnover, other revenue, expenses and results of the segment of packaging materials, included in the Group's unaudited consolidated income statement for the six months ended 31 January 2005 and 31 January 2004 respectively are as follows:

	<b>Packaging Materials</b>		<b>Total</b>	
	<b>2005</b>	2004	<b>2005</b>	2004
	<b>HK\$'000</b>	HK\$'000	<b>HK\$'000</b>	HK\$'000
Turnover:	<b>4,331</b>	9,770	<b>4,331</b>	9,770
Cost of sales	<b>(3,841)</b>	(8,390)	<b>(3,841)</b>	(8,390)
Gross profit	<b>490</b>	1,380	<b>490</b>	1,380
Selling and distribution costs	<b>(312)</b>	(477)	<b>(312)</b>	(477)
General and administrative expenses	<b>(1,127)</b>	(1,262)	<b>(1,127)</b>	(1,262)
Other operating expenses	<b>(335)</b>	(327)	<b>(335)</b>	(327)
Loss on disposal of discontinuing operation	<b>(23,773)</b>	–	<b>(23,773)</b>	–
Segment result	<b><u>(25,057)</u></b>	<b><u>(686)</u></b>	<b><u>(25,057)</u></b>	<b><u>(686)</u></b>
Interest and unallocated income			<b>129</b>	88
Loss from operating activities			<b>(24,928)</b>	(598)
Finance costs			<b>(2,858)</b>	(1,837)
Loss before tax			<b>(27,786)</b>	(2,435)
Tax expense			–	–
Loss before minority interests			<b>(27,786)</b>	(2,435)
Minority interests			<b>2,501</b>	219
Net loss attributable to shareholders			<b><u>(25,285)</u></b>	<b><u>(2,216)</u></b>

The carrying amounts of the total assets and liabilities relating to the discontinuing operation is as follows:

	Packaging Materials		Total	
	2005	2004	2005	2004
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Segment assets	<u>127,775</u>	<u>119,748</u>	<u>127,775</u>	<u>119,748</u>
Total assets	<u>127,775</u>	<u>119,748</u>	<u>127,775</u>	<u>119,748</u>
Segment liabilities	<u>127,725</u>	<u>76,985</u>	<u>127,725</u>	<u>76,985</u>
Total liabilities	<u>127,725</u>	<u>76,985</u>	<u>127,725</u>	<u>76,985</u>

#### 5. (Loss)/Profit from operating activities

The Group's (loss)/profit from operating activities is arrived at after charging/(crediting):

	For the three months ended 31 January		For the six months ended 31 January	
	2005	2004	2005	2004
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Cost of inventories sold	<b>31,119</b>	35,487	<b>65,110</b>	76,675
Depreciation of fixed assets	<b>3,561</b>	3,978	<b>7,724</b>	8,120
Amortisation of intangible assets	<b>834</b>	1,046	<b>1,851</b>	2,012
Interest income	<u>(25)</u>	<u>(26)</u>	<u>(428)</u>	<u>(532)</u>

#### 6. 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 six months ended 31 January 2005 (2004: 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 and approximately HK\$2,000 recognised for the three months and six months ended 31 January 2005 respectively (three months and six months ended 31 January 2004: approximately HK\$4,000 and approximately HK\$8,000 respectively) represents the movement for temporary difference arising from the acquisition of subsidiaries.

## 7. Loss per share

The calculation of basic loss per share for the three months and six months ended 31 January 2005 was based on the unaudited net loss attributable to shareholders of approximately HK\$22,361,000 and approximately HK\$27,208,000 respectively (three months and six months ended 31 January 2004: approximately HK\$4,576,000 and approximately HK\$6,232,000 respectively) and the weighted average number of 500,000,000 for the three months and six months ended 31 January 2005 (three months and six months ended 31 January 2004:500,000,000) ordinary shares in issue during the period.

No diluted loss per share are presented for the three months and six months ended 31 January 2005 and the three months and six months ended 31 January 2004 respectively as the convertible note outstanding during the period and the potential ordinary share issuable under the Company's share option scheme had an anti-dilutive effect on the basic loss per share for the period.

## 8. Fixed assets

During the period from 1 August 2004 to 31 January 2005, the Group had additions to buildings, plant and equipment and motor vehicles in the amount of approximately HK\$5,467,000.

## 9. Trade and other receivables

	<b>31 January 2005 HK\$'000 (Unaudited)</b>	31 July 2004 HK\$'000 (Audited)
Trade receivables	<b>172,886</b>	169,036
Other receivables	<b>56,160</b>	42,178
	<b><u>229,046</u></b>	<u>211,214</u>

The Group's trading terms with its customers are mainly on credit, except for new customers, where payment in advance is normally required. The credit period is generally for a period of three months and on discretion for major customers. Each customer has a maximum credit limit. The Group seeks to maintain strict control over its outstanding receivables and the management regularly reviews the overdue balances.

An aged analysis of the trade receivables based on payment due date and net of provision, is as follows:

	<b>31 January 2005 HK\$'000 (Unaudited)</b>	31 July 2004 HK\$'000 (Audited)
Within 3 months	44,382	59,394
3 to 6 months	49,743	43,759
6 to 12 months	19,031	38,052
Over 1 year	59,730	27,831
	<u><b>172,886</b></u>	<u>169,036</u>

#### 10. Trade payables, notes payable and accruals

	<b>31 January 2005 HK\$'000 (Unaudited)</b>	31 July 2004 HK\$'000 (Audited)
Trade payables	69,673	82,090
Notes payable	97,026	124,937
Other payables and accruals	100,341	67,034
	<u><b>267,040</b></u>	<u>274,061</u>

An aged analysis of the trade payables based on payment due date, is as follows:

	<b>31 January 2005 HK\$'000 (Unaudited)</b>	31 July 2004 HK\$'000 (Audited)
Within 3 months	13,419	26,831
3 to 6 months	18,138	27,979
6 to 12 months	19,535	10,683
Over 1 year	18,581	16,597
	<u><b>69,673</b></u>	<u>82,090</u>

## 11. Share capital

	No. of shares		Nominal value	
	At 31 January 2005 '000	At 31 July 2004 '000	At 31 January 2005 HK\$'000	At 31 July 2004 HK\$'000
Authorised:				
Ordinary share of HK\$0.05 each	<u>1,000,000</u>	<u>1,000,000</u>	<u>50,000</u>	<u>50,000</u>
Issued and fully paid:				
Ordinary share of HK\$0.05 each	<u>500,000</u>	<u>500,000</u>	<u>25,000</u>	<u>25,000</u>

## **DIVIDEND**

The Directors do not recommend the payment of any interim dividend for the six months ended 31 January 2005. (2004: Nil)

## **BUSINESS REVIEW AND OUTLOOK**

### **FINANCIAL REVIEW**

For the six months ended 31 January 2005, the Group recorded an unaudited consolidated turnover of approximately HK\$83,653,000, representing a decrease of approximately 12.6%, as compared with that of the corresponding period in 2004. The group's unaudited consolidated loss attributable to shareholders for the period was approximately HK\$27,208,000 (2004: approximately HK\$6,232,000). This was mainly attributable to the provision for loss on disposal of operations of approximately HK\$19,479,000 made during the period under review. The price competition in current infusion medicine market becomes increasingly fierce and also in packaging materials market was and is still the key factors for impairing the business performance of the Group for the period under review. Also the changes in price caps enacted by State Food and Drug Administration (the "SFDA") of the People's Republic of China (the "PRC") have unfavourable impact on the turnover of the Group. The sale of infusion medicine by Chengdu Mt. Green and packaging material by Sichuan Future decreased by 86.1% and 55.7% respectively when compared with the corresponding quarter last year.

The increase in expenditure from 19.1% to 26.4% of turnover for the six months ended 31 January 2005 and from 20.9% to 22.1% of turnover for the second quarter when compared to 2004 was mainly due to increase in transportation cost, increase of sales incentive and customer rebate as a result of pursuing a more comprehensive sales network and also amortization of guaranteed return for polypropylene bottle production line.

## **Segment information**

The Group was previously engaged in the development, production, sales and distribution of a series of aluminium-plastic caps for use in the packaging of biotechnology and pharmaceutical products as well as a range of biotechnology and pharmaceutical products, principally infusion and injection medicine in the PRC for human and domestic animals consumption. Seechain, an indirectly wholly-owned subsidiary of the Company, has entered into the Equity Interest Transfer Agreement with Sichuan Taishan on 24 December 2004, for the disposal of a 91% equity interest in each of Chengdu Mt. Green and Sichuan Future. Upon completion of the disposal, the Group will continue to carry on the business of the development, production, sales and distribution of human drugs and veterinary drugs. The Group presented its segment information based on nature of its operations and the products it provided.

## **Liquidity, financial resources and capital structure**

The Group generally financed its operation through internally generated cashflows and banking facilities provided by its principal bankers in the PRC. As at 31 January 2005, the aggregate borrowings were approximately HK\$199,166,000 (31 July 2004: approximately HK\$212,066,000) of which approximately HK\$129,044,000 (31 July 2004: approximately HK\$112,843,000) were partially secured by pledged bank deposits or by assets of certain subsidiaries. As at 31 January 2005, the amount of banking facilities available and utilized was approximately HK\$287,112,000 (31 July 2004: approximately \$300,894,000). The Group's bank and other loans bear interest at the prevailing market rate.

The convertible note in the principal amount of HK\$26,740,760 issued by the Company to Concord Pharmaceutical Technology (Holdings) Ltd ("CPT" hereinafter) on 23 March 2001 (the "Convertible Note") has been repaid by the Company to CPT in full by 22 December 2004. The Convertible Note was repaid using the Company's internal resources and the Company believes that the repayment does not have any material adverse impact on the working capital of the Company.

The Group continues to adopt a conservative approach towards its treasury policy with all bank deposits in either Hong Kong Dollars, or in the local currencies of the operating subsidiaries, keeping a minimum exposure to foreign exchange risks.

## **Gearing ratio**

As at 31 January 2005, the gearing ratio (total borrowing, including notes payable, less cash and cash equivalents and pledged bank deposits to total assets) was approximately 40.6% (31 July 2004: approximately 39.0%)

## **Foreign exchange exposure**

The Group mainly earns revenue and incurs cost in Renminbi. The Directors consider that the impact of foreign exchange exposure of the Group is minimal, and therefore, no hedging against foreign currency exposure is considered necessary.

## **Charges on group asset**

As at 31 January 2005, leasehold land and buildings situated in the PRC, plant and machinery with net book values of approximately HK\$100,962,000 (31 July 2004: approximately HK\$64,413,000), and HK\$39,256,000 (31 July 2004: approximately HK\$29,290,000) respectively and bank and time deposits of approximately HK\$55,981,000 (31 July 2004: approximately HK\$65,649,000) were pledged to secure general banking facilities granted to the Group.

## **Contingent liabilities**

As at 31 January 2005, the Group did not have any significant contingent liabilities. (31 July 2004: nil)

## **Commitments and significant investment**

At 31 January 2005, the Group had outstanding capital commitment of approximately HK\$13,532,000 (31 July 2004: approximately HK\$14,804,000) and the Group did not have any significant investments during the period.

## **Future plan for investment**

Except as disclosed in the financial statements, as at 31 January 2005, the Group did not have future plan for material investment and capital assets. However, as will be stipulated in the Outlook Section of this report, in the event that a strategic alliance partner and/or one or more investors decide to join force with the Group, investment will be made in the construction of a GMP-compliant vaccine factory.

## **Material acquisitions/disposals**

Except for those set out in the paragraph of “Operation Review”, the group had no other material acquisitions or disposals of subsidiaries and affiliated companies for the period under review.

## **Employee Information**

As at 31 January 2005, the Group had 929 employees (2004: 1,046) in Hong Kong and PRC. The total remuneration to employees, including director’s emoluments amounted to approximately HK\$6,953,000 (2004: approximately HK\$6,401,000). The Group remunerates its employees based on their performance, qualification, experience and the prevailing industry practice. Other benefits include contributions to statutory mandatory provident fund scheme and medical coverage to its employees in Hong Kong and the statutory central pension schemes to its employees in the PRC.

## **OPERATION REVIEW**

In view of the adverse operation results of Chengdu Mt. Green and Sichuan Future and the negative impact on the profitability of the Group, Seechain, an indirectly wholly-owned subsidiary of the Company has entered into the Equity Interest Transfer Agreement with Sichuan Taishan on 24 December 2004, for the disposal of 91% equity interest in each of Chengdu Mt. Green and Sichuan Future, for a cash consideration of RMB1.00. Details of the transaction in respect of disposal of Chengdu Mt. Green and Sichuan Future were set out in the circular issued by the Company dated 31 January 2005. The legal procedures for the transfer of the interest of Chengdu Mt. Green in Chengdu Mt. Green Li Kong Medical Technology Co. Limited (“Chengdu Mt. Green Li Kong”) and Sichuan Shule Pharmaceutical Joint Stock Company Limited to Leshan Seechain Technology Development Limited (“Leshan Seechain”) (or other member of the Group) is currently under the way.

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

For the six-months period ended 31 January 2005, the sales of Sichuan Shule increased from approximately HK\$58,780,000 last year to approximately HK\$61,642,000 for the corresponding period this year, representing an increase of approximately 4.9%. The improvement in turnover was mainly attributed to the persistent effort made by the management to increase competitiveness and sustained stable growth in the turnover with improved operational efficiency by way of stringent cost controls, enhanced management system and strict controls over operation processes.

In order to enhance the competitiveness of its products in increasingly competitive market, Sichuan Shule during the period under review continued to accelerate its steps towards the development of new products. This not only could help the company to generate incremental sales for the period under review but also further reinforce Sichuan Shule's position as leading manufacturers of nutritional infusion medicines.

To pursue a more persistent growth in product quality, the company continues to strictly enforce quality control measures. Refinement of operation process, timely adjustment of the composition of quality control specialists amongst the workshops, whose skills and standards are constantly upgraded through ongoing training are the measures adopted during the period under review. This is to ensure consistent improvement in profitability and enable the company to achieve a refined margin mix of product offerings.

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

During the six-months period under review, the sale of Chengdu Yuan Heng increased from approximately HK\$10,092,000 last year to approximately HK\$15,165,000 for the corresponding period this year, representing an increase of approximately 50.3%. The business performance of the company was affected in the corresponding period of the last year by the new regulatory policies implemented by the Ministry of Agriculture, but 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 results in more effective promotion on higher margin products and also an absolute increase in sales revenue.

To pursue a more comprehensive sales network, the company adjusted its overall sales and marketing strategies by adopting a regional sales management system. The effect of the regional sales management system is to ensure the company to more pragmatically and effectively promote and drive penetration of the products to medium to small scale farm. Consistent with the new sales management system, the company also adjusted the composition of sales team by recruiting of local sales persons in certain regions that more effectively enhanced overall talent resources and their adaptability to market.

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

Chengdu Mt. Green recorded a turnover of approximately HK\$2,238,000 for the six months ended 31 January 2005, representing a decrease of 86.1% 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 is subject to the review by SFDA, 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 weighted down.

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

During the six-months period under review, the turnover of Sichuan Future decreased from approximately HK\$9,770,000 last year to approximately HK\$4,331,000 for the corresponding period this year, representing a decrease of approximately 55.7%. 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.

### **Research and Development**

#### ***Human drug:***

Currently Sichuan Shule has a variety of infusion medicine in the research and development pipeline. During the period under review, two products have obtained the production permit from SFDA, namely Matrine 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**

Upon completion of disposal of Chengdu Mt. Green and Sichuan Future, the directors believe the Group will be better positioned in the two thriving markets in the PRC, infusion medicine and veterinary drug industry. The company will also focus its resources exclusively to the more profitable businesses and keep ahead of the competition at all times.

Following the completion of modification of workshop and upgrading of production facilities, the productivity of Sichuan Shule further improves. This will provide a solid foundation for Sichuan Shule to diversify and transform its products towards more value-added products under the categories of Fat Emulsion, Propofol and Bambuterol Hydrochloride Capsules. In light of the pharmaceutical market being increasingly competitive, research and development of new products become the prime tasks for the Group in the year of 2005, thereby providing a solid platform for its growth in the future and create best long-term value for the company.

As non-GMP certified veterinary drug manufacturers will be forced to close down by the end of 2005, the directors anticipate that fierce price competition in the veterinary drug industry in the PRC will continue to affect the performance of Yuen Heng in the year of 2005. Yuen Heng will endeavour its efforts to enhance its cost control to reduce overall cost and continually intensify its marketing efforts for the existing products in the PRC by expanding its sales team and distribution network, thereby maintaining sustained growth in its business.

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 believes 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 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 January 2005, 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
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 CPT, a wholly-owned subsidiary of Concord Business Management Limited (“CBM” hereinafter). As at 31 January 2005, 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) Convertible Note in the Principal amount of HK\$26,740,760 issued by the Company to CPT on 23 March 2001 has been repaid by the Company to CPT in full by 22 December 2004.

Save as disclosed herein, as at 31 January 2005, 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 January 2005, 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 six months ended 31 January 2005, 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 January 2005, 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**

<b>Name</b>	<b>Capacity and nature of interest</b>	<b>Shares/equity derivatives</b>	<b>Number/amount of shares/equity derivatives held</b>	<b>Percentage of the Company's issued share capital</b>	<i>Note</i>
CPT	Corporation	Ordinary shares	400,000,000 shares	80%	a and b
CBM	Through controlled corporation	Ordinary shares	400,000,000 shares	80%	a and b

#### *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) Convertible Note in the Principal amount of HK\$26,740,760 issued by the Company to CPT on 23 March 2001 has been repaid by the Company to CPT in full by 22 December 2004.

Save as disclosed above, as at 31 January 2005, 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**

During the period under review, the Company was in compliance with the Board Practices and Procedures as set out in Rules 5.34 to 5.45 of the GEM Listing Rules, which applied before the amendment of the GEM Listing Rules relating to the Code on Corporate Governance Practices and Rules on Corporate Governance Report on 1 January 2005. The Code has become effective for accounting periods commencing on or after 1 January 2005. The Company will prepare a Corporate Governance Report in accordance with Rule 18.44 of the GEM Listing Rules for the financial year ended 31 July 2006.

## **PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S SHARES**

During the six months ended 31 January 2005, 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, 16 March, 2005

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.