

CHINA MEDICAL SCIENCE LIMITED

中華藥業有限公司*

(Incorporated in the Cayman Islands with limited liability)

THIRD QUARTERLY REPORT

2005/2006

** 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 nine months ended 30 April 2006 amounted to approximately HK\$51,190,000, representing a decrease of approximately 50.8% as compared with that in the preceding year, mainly attributable to the disposal of medical cap and human drugs businesses.
- Loss attributable to shareholders for the nine months ended 30 April 2006 amounted to approximately HK\$10,375,000.
- Loss per share amounted to approximately HK2.08 cents for the nine months ended 30 April 2006.
- The Directors do not recommend the payment of any interim dividend for the nine months ended 30 April 2006.

RESULTS

The board of directors (the “Board”) of China Medical Science Limited (the “Company”) presents the unaudited consolidated results of the Company and its subsidiaries (collectively, the “Group”) for the nine months ended 30 April 2006, together with the comparative unaudited figures for the corresponding period of the preceding year are as follows:

Consolidated Income Statement – Unaudited

	Note	For the three months ended 30 April		For the nine months ended 30 April	
		2006 HK\$'000	2005 HK\$'000 (Restated)	2006 HK\$'000	2005 HK\$'000 (Restated)
Turnover					
Continuing operations	2	3,558	5,492	13,990	20,934
Discontinued operations	2	–	14,932	37,200	83,143
		<u>3,558</u>	<u>20,424</u>	<u>51,190</u>	<u>104,077</u>
Cost of sales		(2,436)	(13,925)	(35,163)	(79,035)
Gross profit		<u>1,122</u>	<u>6,499</u>	<u>16,027</u>	<u>25,042</u>
Other revenue		1	1,077	790	2,441
Selling and distribution costs		(1,395)	(4,272)	(8,468)	(11,812)
General and administrative expenses		(1,366)	(4,912)	(8,801)	(15,806)
Other operating expenses		(4,718)	(292)	(8,381)	(3,970)
Profit/(loss) on disposal of subsidiaries	3	–	(26,019)	1,032	(45,499)
LOSS FROM OPERATING ACTIVITIES		<u>(6,356)</u>	<u>(27,919)</u>	<u>(7,801)</u>	<u>(49,604)</u>
Finance costs		(262)	(1,865)	(4,113)	(10,984)
Share of result of an associate		–	–	–	1,914
LOSS BEFORE TAX		<u>(6,618)</u>	<u>(28,784)</u>	<u>(11,657)</u>	<u>(58,674)</u>
Continuing operations		(6,618)	(2,879)	(11,657)	(2,593)
Discontinued operations		–	(26,905)	(257)	(56,081)
		<u>(6,618)</u>	<u>(29,784)</u>	<u>(11,914)</u>	<u>(58,674)</u>
Tax expense	4				
Continuing operations		–	–	–	–
Discontinued operations		–	–	(170)	(101)
		<u>–</u>	<u>–</u>	<u>(170)</u>	<u>(101)</u>
LOSS AFTER TAX		<u>(6,618)</u>	<u>(29,784)</u>	<u>(12,084)</u>	<u>(58,775)</u>
Attributable to:					
Equity holders of the Company		(5,807)	(30,100)	(10,375)	(57,309)
Minority interests		(811)	316	(1,709)	(1,466)
		<u>(6,618)</u>	<u>(29,784)</u>	<u>(12,084)</u>	<u>(58,775)</u>
LOSS PER SHARE	5				
– Basic		<u>1.16 cents</u>	<u>6.02 cents</u>	<u>2.08 cents</u>	<u>11.46 cents</u>
– Diluted		<u>N/A</u>	<u>N/A</u>	<u>N/A</u>	<u>N/A</u>

Notes:

1. Basis of presentation

The principal accounting policies adopted in preparing the unaudited consolidated results conform with the new and revised Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards (collectively referred to as “HKFRSs”) issued by the Hong Kong Institute of Certified Public Accountants, which are effective for accounting periods beginning on or after 1 January 2005. The adoption of the new HKFRSs has resulted in changes to the Group’s accounting policies in the following areas that have an effect on how the results for current or prior accounting periods are prepared and presented.

HKAS 1 Presentation of Financial Statements and HKAS 27 Consolidated and Separate Financial Statements

The adoption of HKAS 1 and HKAS 27 affects certain presentation and disclosure of the accounts. According to HKAS 1 and HKAS 27, minority interests at the balance sheet are presented in the consolidated balance sheet within equity, separately from the equity attributable to the equity holders of the Company, and minority interests in the results of the Group for the period are presented on the face of the consolidated income statement as an allocation of the total profit and loss for the period between minority interests and the equity holders of the Company.

HKFRS 3 Business Combinations

The adoption of HKFRS 3 has resulted in a change in accounting policy for goodwill and negative goodwill. In prior years, goodwill was amortised on a straight line basis over a period of not exceeding 20 years and assessed for the impairment at each balance sheet date. Negative goodwill was presented as a deduction from assets and released to income based on an analysis of the circumstances from which the balance resulted.

In accordance with the provision of HKFRS 3, the Group ceased amortisation of goodwill from 1 August 2005 onwards and goodwill will be tested for impairment at least annually or in the financial year in which the acquisition takes place. The Group has derecognised all negative goodwill previously presented as a deduction from assets with a corresponding increase to retained earnings.

HKFRS 5 Non-current Assets Held for Sale and Discontinued Operations

The adoption of HKFRS 5 affects certain presentation and disclosure of the accounts. The HKFRS 5 changes the timing of the classification of an operation as discontinued. In accordance with HKFRS 5, the Company classifies an operation as discontinued at the date as the Group has disposed of the operation.

2. Turnover

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

An analysis of turnover is as follows:

	For the three months ended 30 April		For the nine months ended 30 April	
	2006	2005	2006	2005
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Turnover				
Continuing operations				
Sale of veterinary drugs	<u>3,558</u>	<u>5,492</u>	<u>13,990</u>	<u>20,934</u>
	<u>3,558</u>	<u>5,492</u>	<u>13,990</u>	<u>20,934</u>
Discontinued operations				
Sale of human drugs	–	14,932	37,200	78,812
Sale of packaging materials	<u>–</u>	<u>–</u>	<u>–</u>	<u>4,331</u>
	<u>–</u>	<u>14,932</u>	<u>37,200</u>	<u>83,143</u>
	<u>3,558</u>	<u>20,424</u>	<u>51,190</u>	<u>104,077</u>

3. Discontinued operations

In May 2005, Chengdu Viking Yuen Heng, an indirectly 91% owned subsidiary of the Company has entered into the Equity Interest Transfer Agreement with an independent third party for the disposal of the 51.05% equity interest in Sichuan Shule together with its subsidiary for a consideration of RMB1.00. The transfer of the entire interest of the Company in Sichuan Shule to the independent third party was completed in 2005 and the Group disposed of the remaining portion of human drugs business.

The turnover, other revenue, expenses and result of the human drugs segment, included in the Group's unaudited consolidated income statement for the nine months ended 30 April 2006 and 30 April 2005 respectively are as follows:

	Human Drugs	
	2006 HK\$000	2005 HK\$000
Turnover	37,200	78,812
Cost of sales	(26,001)	(61,040)
Gross profit	11,199	17,772
Other revenue	380	1,218
Selling and distribution costs	(4,816)	(7,865)
General and administrative expenses	(4,633)	(9,276)
Other operating expenses	(130)	(2,008)
Profit/(loss) on disposal of discontinued operations	1,032	(22,390)
Profit/(loss) from operating activities	3,032	(22,549)
Finance costs	(3,289)	(7,573)
Share of result of an associate	–	1,914
Loss before tax	(257)	(28,208)
Tax expense	(170)	(101)
Loss before minority interests	(427)	(28,309)
Minority interests	730	1,052
Net profit/(loss) attributable to shareholders	303	(27,257)

4. Tax expenses

No provision for Hong Kong profits tax has been made, as the Group had no assessable profits arising in Hong Kong for the nine months ended 30 April 2006 (2005: 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.

There is no material deferred tax credit recognised for the nine months ended 30 April 2006 and 2005.

5. Loss per share

The calculation of basic loss per share for the three months and nine months ended 30 April 2006 was based on the unaudited net loss attributable to shareholders of approximately HK\$5,807,000 and approximately HK\$10,375,000 respectively (three months and nine months ended 30 April 2005: approximately HK\$30,100,000 and approximately HK\$57,309,000) and the weighted average number of 500,000,000 for the three months and nine months ended 30 April 2006 (three months and six months ended 30 April 2005: 500,000,000) ordinary shares in issue during the period.

No diluted loss per share are presented for the three months and nine months ended 30 April 2006 and 2005 respectively as there were no dilutive potential shares.

6. Reserves

	Share premium HK\$'000	Capital reserve HK\$'000	Exchange fluctuation reserve HK\$'000	Retained profits/ (accumulated losses) HK\$'000	Total HK\$'000
At 1 August 2004	17,992	27,104	25	5,824	50,945
Net loss for the period	—	—	—	(57,309)	(57,309)
At 30 April 2005	<u>17,992</u>	<u>27,104</u>	<u>25</u>	<u>(51,485)</u>	<u>(6,364)</u>
At 1 August 2005	17,992	27,104	828	(57,736)	(11,812)
Effects of change in accounting policies	—	—	—	4,746	4,746
As restated	<u>17,992</u>	<u>27,104</u>	<u>828</u>	<u>(52,990)</u>	<u>(7,066)</u>
Exchange difference arising on translation of financial statements of PRC subsidiaries	—	—	436	—	436
Net loss for the period	—	—	—	(10,375)	(10,375)
At 30 April 2006	<u>17,992</u>	<u>27,104</u>	<u>1,264</u>	<u>(63,365)</u>	<u>(17,005)</u>

DIVIDEND

The Directors do not recommend the payment of any interim dividend for the nine months ended 30 April 2006 (2005: Nil).

BUSINESS REVIEW AND OUTLOOK

FINANCIAL REVIEW

The Group recorded a turnover of approximately HK\$51,190,000 for the nine months ended 30 April 2006, representing a decrease of approximately 50.8% as compared to approximately HK\$104,077,000 for the corresponding period in the previous financial year. The decrease in turnover was mainly attributable to the disposal of medical cap and human drugs businesses during the year ended 31 July 2005. Together with the additional provision for bad and doubtful debt and provision for diminution in value for the inventories, loss after tax attributable to the equity holders of the Company for the period under review was approximately HK\$10,375,000 (nine months ended 30 April 2005: approximately HK\$57,309,000). The loss for the corresponding period last year mainly included substantial provision of approximately HK\$45,499,000 for the loss on the disposal of medical cap and human drugs businesses, which was a one-off event.

OPERATION REVIEW

With the completion of the disposal of the human drugs business during the period under review, the Group maintained its focus exclusively on the veterinary drugs and vaccines businesses. Results from the sale of veterinary drugs for the nine months period under review were adversely affected by the price competition from the non-GMP compliance manufacturers that severally affected the performance of Chengdu Viking Yuen Heng for the nine-months period under review. Turnover from the sale of veterinary drugs declined by 32.4% to approximately HK\$13,561,000 from approximately HK\$20,052,000 that recorded for the corresponding period in the preceding year. Chengdu Viking Yuen Heng has taken a number of steps during the period under review to consolidate its performance including enhancing its market intelligence and products distribution system across the principal livestock producing counties in PRC, continuously upgrading and enhancing the technical know-how of the sales force to serve the market, and also implementing stringent cost control measures.

Research and Development

During the nine months period under review, Chengdu Viking Yuen Heng continued to focus its efforts to develop new veterinary drugs jointly with Sichuan Agriculture University and Southwestern Agriculture University.

For the veterinary drug, about 9 products in 18 specifications had obtained pharmaceutical registration during the period under review, namely Antondini Injection, Dexamethason Sodium Phosphate Injection, Streptomycin Sulfate for Injection, Procaine Benzylpenicillin for Injection, Tetracycline Hydrochloride for Injection, Kanamycin Sulfate for Injection, Lincomycin Hydrochloride Injection, Compound Sulfamethoxydiazine Sodium Injection and Ciprofloxacin Hydrochloride Injection.

OUTLOOK

Following the completion of the group restructuring during the period under review, the Group employs its resources in the more promising veterinary pharmaceutical and vaccines businesses. Apart from enhancing its market intelligence, products distribution system, and the technical know-how of the sales force, as well as implementing stringent cost control measures, our veterinary vaccines operation is taking steps to comply with the Good Manufacturing Practice. Via implementing the above, the Group is aiming to deliver more competitive products in order to improve its performances. In addition, the Group will develop its business through strategic alliance and joint ventures in order to enrich the portfolio of the Group and sustain the development of the Group in the long term.

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 30 April 2006, 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 5.68 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 of shares/equity derivatives held	Percentage of the Company's issued share capital	Note
Mr. Wong Sai Wa	Directly beneficially owned	Share options	3,200,000 share options	0.64%	(a)
Mr. Kwan Kai Cheong	Directly beneficially owned	Share options	3,000,000 share options	0.60%	(a)

Notes:

- (a) 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.

Save as disclosed herein, as at 30 April 2006, 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.

The following share options were outstanding under the Pre-IPO Plan during the period under review:

Name or category of participant	At 1.08.2005	Granted during the period	Exercised during the period	Lapsed during the period	Cancelled during the period	At 30.04.2006	Date of grant of	Exercise period of	Exercise price of
							share options <i>(Note a)</i>	share options <i>(Note b)</i>	share options <i>(Note b)</i> HK\$
Directors									
Mr. Wong Sai Wa	3,200,000	-	-	-	-	3,200,000	23.3.2001	10.10.2001 to 22.3.2011	0.55
Mr. Kwan Kai Cheong	3,000,000	-	-	-	-	3,000,000	23.3.2001	10.10.2001 to 22.3.2011	0.55
	<u>6,200,000</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>6,200,000</u>			
Other employees	400,000	-	-	-	-	400,000	23.3.2001	10.10.2001 to 22.3.2011	0.55
	<u>6,600,000</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>6,600,000</u>			

Notes:

- (a) The vesting period of the share options is from the date of the grant until the commencement of the exercise period.
- (b) The exercise price of the share options is subject to adjustment in the case of rights or bonus issues, or other similar changes in the Company's share capital.

The exercise of the above 6,600,000 outstanding share options as at 30 April 2006, would under the present capital structure of the Company, result in the issue of 6,600,000 additional share capitals of HK\$330,000 and share premium of HK\$3,300,000 (before issue expenses). During the period ended 30 April 2006, 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 30 April 2006, 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 of shares/equity derivatives held	Percentage of the Company's issued share capital	<i>Note</i>
Concord Pharmaceutical Technology (Holdings) Limited ("CPT")	Corporation	Ordinary shares	400,000,000 shares	80%	(a)
Concord Business Management Limited ("CBM")	Through controlled corporation	Ordinary shares	400,000,000 shares	80%	(a)
Mr. Wong Sai Chung	Through controlled corporation	Ordinary shares	400,000,000 shares	80%	(a)

Notes:

- (a) CPT is a wholly-owned subsidiary of CBM. As at 30 April 2006, the entire issued share capital of CBM was owned by Mr. Wong Sai Chung. Accordingly, CBM and Mr. Wong Sai Chung is deemed to have interests in the 400,000,000 shares of the Company held by CPT.

Save as disclosed above, as at 30 April 2006, 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 5.33 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 ending 31 July 2006.

PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S SHARES

During the nine months ended 30 April 2006, 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 Wa
Chairman

Hong Kong, 14 June 2006

As at the date of this report, the Board comprises three executive directors, namely Mr. Wong Sai Wa, Mr. Kwan Kai Cheong 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.