

CHINA MEDICAL SCIENCE LIMITED

中華藥業有限公司*

(Incorporated in the Cayman Islands with limited liability)

FIRST QUARTERLY REPORT

2006/2007

** 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 2006 amounted to approximately HK\$3,493,000, representing a decrease of approximately 90.3% as compared with that in the preceding year. The decrease was mainly attributable to the disposal of Sichuan Shule and its subsidiary during the year ended 31 July 2006 of which contributed more than 80% of the total turnover for the three months ended 31 October 2005 (2006: Nil).
- Loss attributable to shareholders of the Company for the three months ended 31 October 2006 amounted to approximately HK\$2,286,000.
- Loss per share amounted to approximately HK0.46 cents for the three months ended 31 October 2006.
- The Directors do not recommend the payment of any interim dividend for the three months ended 31 October 2006.
- The Company entered into an agreement to acquire 70% equity interest of a feed supplements business for a consideration of 480 million new shares of the Company on 31 July 2006. An announcement on the said proposed acquisition was made on 6 September 2006. Further information to be included in a circular for the said proposed acquisition will be distributed as soon as possible.

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 three months ended 31 October 2006, together with the comparative unaudited figures for the corresponding period in 2005 are as follows:

		For the three months ended 31 October	
	<i>Note</i>	2006 <i>HK\$'000</i>	2005 <i>HK\$'000</i> (Restated)
Turnover			
Continuing operations	2	3,493	6,743
Discontinued operations	2	–	29,065
		<u>3,493</u>	<u>35,808</u>
Cost of sales		(2,433)	(23,285)
Gross profit		1,060	12,523
Other revenue		–	810
Selling and distribution costs		(592)	(5,339)
General and administrative expenses		(1,858)	(5,735)
Other operating expenses		(724)	(726)
(Loss)/profit from operating activities		<u>(2,114)</u>	<u>1,533</u>
Finance costs		(380)	(3,335)
Loss before tax			
Continuing operations		(2,494)	(1,085)
Discontinued operations		–	(717)
		<u>(2,494)</u>	<u>(1,802)</u>
Tax expense	4		
Continuing operations		(3)	–
Discontinued operations		–	(120)
		<u>(3)</u>	<u>(120)</u>
Loss for the period			
Continuing operations		(2,497)	(1,085)
Discontinued operations		–	(837)
		<u>(2,497)</u>	<u>(1,922)</u>
Loss attributable to:			
Shareholders of the Company		(2,286)	(1,434)
Minority interests		(211)	(488)
		<u>(2,497)</u>	<u>(1,922)</u>
Loss per share attributable to Shareholders of the Company (in cents)	5		
Basic			
Continuing operations		0.46	0.20
Discontinued operations		–	0.09
		<u>0.46</u>	<u>0.29</u>
Diluted			
Continuing operations		N/A	N/A
Discontinued operations		N/A	N/A

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 and have been prepared under the historical cost convention.

The accounting policies adopted in preparing the unaudited consolidated financial statements for the three months ended 31 October 2006 are consistent with those followed in the annual report of the Company for the year ended 31 July 2006.

2. Turnover

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

An analysis of turnover is as follows:

	For the three months ended 31 October	
	2006 HK\$’000	2005 HK\$’000 (Restated)
Turnover		
Continuing operations		
Sale of veterinary drugs	3,493	6,743
Discontinued operations		
Sale of human drugs	–	29,065
	<u>3,493</u>	<u>35,808</u>

3. Discontinued operations

On 20 May 2005, Chengdu Viking Yuen Heng Pharmaceutical Co., Ltd., an indirectly 91% owned subsidiary of the Company entered into an equity interest transfer agreement with an independent third party for the disposal of the 51.05% equity interest in Sichuan Shule for a consideration of RMB1. Upon completion of the disposal of Sichuan Shule and its subsidiary, the Group discontinued its development, production, sales and distribution of human drugs business.

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 three months ended 31 October 2006 (2005: Nil). Current tax represents PRC enterprise income tax charged on the estimated taxable profits of certain subsidiaries operating in the PRC and is calculated at the prevailing tax rate.

The deferred tax charge of approximately HK\$3,000 for the three months ended 31 October 2006 (2005: Nil) represents the movement in temporary difference arising from decelerated depreciation allowances.

5. Loss per share attributable to Shareholders of the Company

The calculation of basic loss per share attributable to shareholders of the Company from continuing operations is based on the loss attributable to shareholders of the Company from continuing operations for the three months ended 31 October 2006 of approximately HK\$2,286,000 (2005: approximately HK\$1,002,000) and the weighted average number of 500,000,000 (2005: 500,000,000) ordinary shares in issue during the period under the review.

The calculation of basic loss per share attributable to shareholders of the Company from discontinued operations is based on the loss attributable to shareholders of the Company from discontinued operations for the three months ended 31 October 2005 of approximately HK\$432,000 and the weighted average number of 500,000,000 ordinary shares in issue during the period.

No diluted loss per share from continuing and discontinued operations is shown as there were no dilutive potential shares.

6. Reserves

	Share premium <i>HK\$'000</i>	Capital reserve <i>HK\$'000</i>	Exchange fluctuation reserve <i>HK\$'000</i>	Accumulated losses <i>HK\$'000</i>	Total <i>HK\$'000</i>
At 1 August 2005	17,992	27,104	828	(57,736)	(11,812)
Effects of adopting new financial reporting standards	—	—	—	4,745	4,745
As restated	17,992	27,104	828	(52,991)	(7,067)
Exchange difference arising on translation of financial statements of PRC subsidiaries	—	—	55	—	55
Net loss for the period	—	—	—	(1,434)	(1,434)
At 31 October 2005	<u>17,992</u>	<u>27,104</u>	<u>883</u>	<u>(54,425)</u>	<u>(8,446)</u>
At 1 August 2006	17,992	27,104	1,446	(58,764)	(12,222)
Exchange difference arising on translation of financial statements of PRC subsidiaries	—	—	439	—	439
Net loss for the period	—	—	—	(2,286)	(2,286)
At 31 October 2006	<u>17,992</u>	<u>27,104</u>	<u>1,885</u>	<u>(61,050)</u>	<u>(14,069)</u>

DIVIDEND

The Directors do not recommend the payment of any interim dividend for the three months ended 31 October 2006 (2005: Nil).

BUSINESS REVIEW AND OUTLOOK

FINANCIAL REVIEW

For the three months ended 31 October 2006, the Group recorded a turnover of approximately HK\$3,493,000. A decrease of approximately 90.3% as compared to approximately HK\$35,808,000 that was recorded in the preceding year. The Group also recorded a loss of approximately HK\$2,286,000 for the three months ended 31 October 2006 attributable to the shareholders of the Company (2005: approximately loss of HK\$1,434,000). The deterioration of the performance was mainly attributable to (a) disposal of Sichuan Shule which contributed more than 80% of the Group's turnover for the three months ended 31 October 2005 (2006: Nil); (b) severe price competition from non-Good Manufacturing Practice ("GMP") compliant manufacturers which affected the performance of the veterinary drugs business; and (c) delegation of resources for the preparation of GMP recognition.

OPERATION REVIEW

Continuing operations

Veterinary drug

During the period under review, the sale of veterinary drugs was decreased from approximately HK\$6,558,000 for the three months ended 31 October 2005 to approximately HK\$3,493,000 for the three months ended 31 October 2006, representing a decrease of approximately 46.7%. The decrease was mainly the result of severe price competition from the non-GMP compliant manufacturers and unstable contributions from the original equipment manufacturer business. In addition, the performance was also impacted by the preparation of GMP recognition as certain resources were delegated to upgrade the production facilities.

Discontinued operations

The Group has completed the restructuring in the preceding year after the disposal of Sichuan Shule which operated human drug business.

Research and Development

In addition to a variety of veterinary drugs in the pipeline, the Group continues to work in conjunction with Sichuan Agriculture University and Southwestern Agriculture University for the development of new products.

OUTLOOK

On 31 July 2006, the Company entered into an agreement with JBC Bio Technology Company Limited, (the “Vendor”), in relation to the acquisition of 70% of the issued share capital of JBC Bio Products Company Limited for a consideration of 480 million new shares of the Company to be allotted and issued to the Vendor or its nominee at par credited as fully paid upon completion (the “Possible Acquisition”). JBC Bio Products through its subsidiary in Zhongshan, the PRC (together “JBC Group”), is principally engaged in the manufacture of the feed supplements (the “Feed Supplements”). Details of the Possible Acquisition to be included in a circular will be distributed as soon as possible.

The infusion and injection medicine produced by the Group are primarily used on poultry, and the Group’s customers are largely the poultry farms in the PRC. Given the Vendor intends to expand the application of the Feed Supplements to poultry such as chicken, the Directors believe that the Feed Supplements business of the JBC Group may capitalize on the sales and distribution network and customer base of the Group’s veterinary business and there may be cross-selling opportunities between the customers of the Feed Supplements business of the JBC Group and of the veterinary drug business of the Group in the future.

Both the veterinary and the Feed Supplements business will benefit from the policy of The Central People’s Government of the PRC (the “Central Government”) in rural reform. According to Report on the Work of the Government (2006) (2006年政府工作報告), the Central Government will implement the policy of getting industry to support agriculture and cities to support countryside, strengthen support for agriculture, rural areas and farmers (i.e. 三農－農業, 農村, 農民), and continue to reform the rural systems and innovations in rural institutions as well as prepares to spend RMB339.7 billion on agricultural industry, farming villages and farmers in 2006. In addition, there are growing concerns on the quality of animal feeds and the ban of using antibiotics in animal feeds due to bacterial resistance and allergenic effects in humans. The market potential for the existing veterinary business and the Feed Supplements business in the PRC and other regions outside the PRC are encouraging.

The completion of the Possible Acquisition is subject to the fulfillment of a number of conditions precedent. Details of which will be disclosed further in a circular to be distributed.

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 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 31 October 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 1.08.2006	Granted during the period	Exercised during the period	Lapsed during the period	Cancelled during the period	At 31.10.2006	Date of grant of share options (Note a)	Exercise period of share options	Exercise price of share options (Note b) 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:

- The vesting period of the share options is from the date of the grant until the commencement of the exercise period.
- 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 31 October 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 31 October 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 31 October 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	Note
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 31 October 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 31 October 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.

CODE ON CONDUCT REGARDING SECURITIES TRANSACTIONS BY DIRECTORS

The Company has adopted the code of conduct for securities transactions by directors on terms no less exacting than the required standard of dealings set out in Rules 5.48 to 5.67 of the GEM Listing Rules. Throughout the period under the review, the Company was not aware of any non-compliance with the required standard of dealings and its code of conduct regarding securities transactions.

CODE ON CORPORATE GOVERNANCE PRACTICES

The Company has adopted the code provisions set out in the Code on Corporate Governance Practices (the “Code”) as set out in Appendix 15 of the GEM Listing Rules. The Company has applied the principles in the Code and complied with the code provisions set out in the Code for the three-months period ended 31 October 2006 except for Code Provisions A.2.1, and A.4.1. The Board will keep these matters under review on a periodical basis.

PURCHASE, SALE OR REDEMPTION OF THE COMPANY’S SHARES

During the three-months period ended 31 October 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
Wong Sai Wa
Chairman

Hong Kong, 14 December 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. Garry Alides Willinge and Mr. Lai Chik Fan.