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MEDICAL CHINA LIMITED

神州醫療科技有限公司*

(Incorporated in Bermuda with limited liability)

**CHANGE IN GENERAL CHARACTER
OR NATURE OF BUSINESS**

Financial Advisers to Medical China Limited

CAOH

Celestial Capital Limited

VINCO 城高

Vinco Capital Limited

Independent Financial Adviser to the Independent Board Committee



道亨證券有限公司

DaoHengSecurities Ltd.

A letter from the Independent Board Committee is set out on page 20 of this circular.

A letter from Dao Heng Securities Limited containing its advice to the Independent Board Committee is set out on pages 21 to 36 of this circular.

A notice convening the Special General Meeting to be held at 8th Floor, Teda Building, 87 Wing Lok Street, Hong Kong at 9:30 a.m. on 25 July 2003 is set out on pages 43 and 44 of this circular. Whether or not you are able to attend the Special General Meeting, you are requested to complete and return the enclosed form of proxy in accordance with the instructions printed thereon as soon as possible and in any event not later than 48 hours before the time appointed for holding the Special General Meeting or any adjourned meeting. Completing and returning the form of proxy will not preclude you from attending and voting in person at the Special General Meeting should you so wish.

This circular will remain on the "Latest Company Announcements" page of the Growth Enterprise Market website at <http://www.hkgem.com> for at least seven days from the date of its posting.

* For identification only

7 July 2003

CHARACTERISTICS OF GEM

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

Given the emerging nature of companies listed on GEM, there is a risk that securities traded on GEM may be more susceptible to high market volatility than securities traded on the main board of the Stock Exchange and no assurance is given that there will be a liquid market in the securities traded on GEM.

The principal means of information dissemination on GEM is publication on the Internet website operated by the Stock Exchange. Listed companies are not generally required to issue paid announcements in gazetted newspapers. Accordingly, prospective investors should note that they need to have access to the GEM website at <http://www.hkgem.com> in order to obtain up-to-date information on GEM-listed issuers.

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DEFINITIONS

In this circular, the following expressions have the following meanings unless the context otherwise requires:

“Board”	the board of Directors
“Boston Scientific”	the holding company of Boston Scientific Asia Pacific and Radio Therapeutics
“Boston Scientific Asia Pacific”	Boston Scientific Asia Pacific Pte Ltd, a fellow subsidiary of Radio Therapeutics
“Directors”	the directors of the Company
“Company”	Medical China Limited, a company incorporated in Bermuda with limited liability, the shares of which are listed on GEM
“Contracted Hospitals”	the hospitals in the PRC which have entered into cooperation contracts with the Group in relation to the operation of the RFAS treatment centres
“Exclusive Distribution Agreement”	the exclusive distribution agreement dated 4 September 2001 between Tat Lung and Radio Therapeutics
“GEM”	The Growth Enterprise Market of the Stock Exchange
“GEM Listing Rules”	the Rules Governing the Listing of Securities on GEM
“Group”	the Company and its subsidiaries
“Independent Board Committee”	the independent board committee of the Board comprising Mr. Guo Guoqing and Mr. Fan Wan Tat who are independent non-executive Directors
“Independent Financial Adviser”	Dao Heng Securities Limited, the independent financial adviser to the Independent Board Committee and a deemed licensed corporation under the SFO
“Independent Shareholders”	the shareholders of the Company other than the Directors, chief executive, management shareholders of the Company (being Mr. Li Nga Kuk, James, Mr. Li Tai To, Titus, Mr. Li Wo Hing, Mr. Ng Kwai Sang, Mr. Chan Siu Sun and Mr. Li Yue Erh) and their respective associates

DEFINITIONS

“IPO”	the initial public offering of the Company in December 2001
“Latest Practicable Date”	4 July 2003, being the latest practicable date prior to the printing of this circular for the purpose of ascertaining certain information for inclusion in this circular
“Notice Letter”	the notice letter dated 19 March 2003 from Boston Scientific Asia Pacific to Tat Lung
“PRC”	the People’s Republic of China
“Radio Therapeutics”	Radio Therapeutics Corporation, the supplier of the RTC products and a subsidiary of Boston Scientific
“RFAS”	Radio Frequency Ablation System
“RTC products”	Radio Therapeutics radio frequency generators, LeVeen Electrodes and electric plates
“SFO”	the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong)
“Special General Meeting”	the special general meeting of the Company to be held at 9:30 a.m. on 25 July 2003
“Stock Exchange”	the Stock Exchange of Hong Kong Limited
“Tat Lung”	Tat Lung Medical Treatment Technology (Shenzhen) Limited (達隆醫療科技(深圳)有限公司), a wholly-owned subsidiary of the Company
“Top-up Placing”	the top-up placing of the Company’s shares set out in the Company’s circular dated 13 August 2002
“\$”	Hong Kong dollars

LETTER FROM THE BOARD



MEDICAL CHINA LIMITED

神州醫療科技有限公司*

(Incorporated in Bermuda with limited liability)

Directors:

Li Nga Kuk, James
Ng Kwai Sang
Li Wo Hing
Chan Shut Li, William
Chan Siu Sun
Li Tai To, Titus

Non-executive Director:

Chen Minshan

Independent non-executive Directors:

Guo Guoqing
Fan Wan Tat
Han K. Huang

Registered office:

Cedar House
41 Cedar Avenue
Hamilton HM 12
Bermuda

Head office and principal

place of business in Hong Kong:
Office B, 21st Floor
Teda Building
87 Wing Lok Street
Hong Kong

7 July 2003

To the Shareholders

Dear Sir or Madam,

CHANGE IN GENERAL CHARACTER OR NATURE OF BUSINESS

INTRODUCTION

It was announced by the Company on 7 April 2003 and 3 June 2003 that on 3 April 2003, Tat Lung received the Notice Letter from Boston Scientific Asia Pacific, a fellow subsidiary of Radio Therapeutics, which notified the Group that it would not supply the Group with the RTC products in the PRC but the hospitals which acquired RTC products through the Group in the past, being the Contracted Hospitals, may contact Boston Scientific directly. It was not mentioned in the Notice Letter, but the Directors have verbally confirmed with Boston Scientific that its new distribution policy will also apply to the Hong Kong market. The Notice Letter may constitute an anticipatory breach or an anticipatory repudiation

* For identification only

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of the Exclusive Distribution Agreement between Tat Lung and Radio Therapeutics, although Boston Scientific did not state explicitly in the Notice Letter that it was terminating the Exclusive Distribution Agreement.

As a result of the new distribution policy of Boston Scientific, the Directors has proposed to revise the business plans and use of proceeds from the IPO and the Top-up Placing. The revised business plans and use of proceeds from the IPO and the Top-up Placing will amount to a change to the general character or nature of the business of the Group under Rule 17.25 of the GEM Listing Rules and are therefore subject to the approval of the Independent Shareholders at a special general meeting.

The purpose of this circular is (i) to provide you with information in relation to the Notice Letter and details of the revised business plans and use of proceeds from the IPO and the Top-up Placing; (ii) to set out the advice of the Independent Financial Adviser to the Independent Board Committee and the recommendation of the Independent Board Committee in respect of the revised business plans and use of proceeds; (iii) to give you notice of the Special General Meeting and to seek Independent Shareholders' approval of the revised business plans and use of proceeds; and (iv) to give you other information on the Group.

THE GROUP'S COOPERATION WITH CONTRACTED HOSPITALS

The Group is principally engaged in the research, development and provision of medical devices for cancer treatment in the PRC. The Group is also engaged in the research, development and promotion of sales of anti-cancer drugs, ancillary anti-cancer drugs and other drugs (including 16 different types of drugs which are subject of 16 medical research projects that have been agreed to be purchased by the Group, as disclosed in the circular issued by the Company on 8 January 2003. The acquisition of such medical research projects by the Group has been completed).

Tat Lung has been appointed by Radio Therapeutics as its sole and exclusive distribution agent in the PRC and Hong Kong for the sale, distribution and marketing of Radio Therapeutics radio frequency generators, LeVeen Electrodes, electric plates and related products for a term of five years from 27 April 2001 pursuant to the Exclusive Distribution Agreement. The RFAS, which is the major product of the Group that consists of the Radio Therapeutics radio frequency generators, LeVeen Electrodes, electric plates, an ultrasonic scanner, a personal computer and the software for the system being developed by the Group, are used for cancer treatment by applying radio frequency ablation, which causes necrosis of targeted tissue by heating it to high temperatures in a procedure that yields few side effects. The LeVeen Electrode is positioned within the lesion (i.e. the tumour targeted to be destroyed), and is then connected to the Radio Therapeutics radio frequency generator and electrical current is delivered into the lesion. As the cells are heated, they are destroyed.

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The Group's existing business model

Based on the discussions between the Group and the hospitals in the PRC, the major difficulty in promoting sales of advanced medical devices in the PRC is that most hospitals in the PRC usually do not have sufficient funds to pay the purchase price of the medical devices. In order to promote the use of RFAS and related products, and increase the profitability of the Group, instead of selling RFAS to the hospitals, the Group has adopted from the outset of its establishment a business model under which the Group has entered into cooperation contracts with the Contracted Hospitals whereby the Group provides RFAS (which have been totally funded by the Group) to the Contracted Hospitals for the setting up of the RFAS treatment centers. Upon setting up of the RFAS treatment centers, the Contracted Hospitals use the RFAS for treatment of cancers and charge medical treatment fees to the patients. The Group then shares the profits of the RFAS treatment centers with the Contracted Hospitals as medical service fees according to the cooperation contracts.

Besides the provision of RFAS to set up the RFAS treatment center, the Group also provides other value-added services to the Contracted Hospitals/RFAS treatment centers. The Group has developed a computer system of RFAS which coordinates with imaging equipment such as ultrasound scanner and equipment measuring the impedance of the tissues and produces data for monitoring medical operations using RFAS and makes RFAS more easily to be used and adaptable to the PRC environment (the computer system of RFAS has been registered with 深圳市信息化辦公室 (The Information Management Office of Shenzhen) under the name of Tat Lung). In addition, the Group has also (i) organized conferences to demonstrate and promote the application of RFAS in curing various cancers; and (ii) provided training to doctors from the Contracted Hospitals.

The terms of the cooperation contracts range from four years to fifteen years. The terms of most of the contracts (more than 50 contracts) are six years and during such period the Group would share 80%, 70% and 60% of the profits of the RFAS treatment centers for the first two years, the third to fourth years, and the fifth to sixth years, respectively, from the date of the relevant contracts. The terms of the other contracts were determined by reference to either a fixed period or a fixed number of treatments completed by the relevant Contracted Hospitals. Based on the advice of the Company's PRC legal advisers, Jingtian & Gongcheng which was also the Company's legal advisers with regard to the Company's IPO, the Contracted Hospitals are not entitled to unilateral termination of the existing cooperation contracts without the Group's consent (if a Contracted Hospital terminates the relevant cooperation contract without the Group's consent, the Group may take legal actions against such Contracted Hospitals in order to protect the interest of the Group), hence the contracts will not be affected, as a result of the change in distribution policy of Boston Scientific. In addition, the Group has contacted 12 Contracted Hospitals and all of those 12 Contracted Hospitals have advised the Group that Boston Scientific's new distribution policy would not affect the Group's cooperation with them under the existing contracts. The 12 Contracted Hospitals were selected arbitrarily by the Group, and the RFAS treatment centers set up by the Group and those Contracted Hospitals accounted for about 30% of the total medical service fees received by the Group

LETTER FROM THE BOARD

during the year ended 31 December 2002 and 4 of the 12 Contracted Hospitals were among top 5 customers of the Group.

As mentioned in the Company's annual reports for the years ended 31 December 2001 and 2002, there were 59 and 65 Contracted Hospitals as at 31 December 2001 and 2002 (cooperation contracts between the Group with 5 out of the 65 Contracted Hospitals as at 31 December 2002 were terminated upon mutual agreements as a result of unsatisfactory performance of the cooperation or insufficient staff of these 5 Contracted Hospitals after 31 December 2002; accordingly, there are 60 Contracted Hospitals as at the Latest Practicable Date), respectively. The turnovers and gross profits of the Group during the two years ended 31 December 2001 and 2002 and for the three months ended 31 March 2003 were as follows:

	Year ended 31 December 2001 (Audited)		Year ended 31 December 2002 (Audited)		Three months ended 31 March 2003 (Unaudited) <i>(Note 1)</i>	
	\$'000	%	\$'000	%	\$'000	%
Turnover						
Medical service fees	28,921	75.07	33,620	67.44	3,818	59.47
Sales of LeVein Electrodes and electric plates <i>(Note 2)</i>	9,602	24.93	16,230	32.56	1,679	26.15
Sales of medical testing instruments <i>(Note 3)</i>	—	—	—	—	923	14.38
	<u>38,523</u>	<u>100.00</u>	<u>49,850</u>	<u>100.00</u>	<u>6,420</u>	<u>100.00</u>
Total turnover						
Gross profit						
Medical services	25,191	86.54	29,110	82.56	2,640	72.97
Sales of LeVein Electrodes and electric plates <i>(Note 2)</i>	3,917	13.46	6,148	17.44	621	17.16
Sales of medical testing instruments <i>(Note 3)</i>	—	—	—	—	357	9.87
	<u>29,108</u>	<u>100.00</u>	<u>35,258</u>	<u>100.00</u>	<u>3,618</u>	<u>100.00</u>
Total gross profit						

Notes:

1. The unaudited figures for the three months ended 31 March 2003 are extracted from the quarterly report of the Group for such three-month period.
2. LeVein Electrodes and electric plates were used as consumables during the course of RFAS treatments in the RFAS treatment centers from time to time.
3. Medical testing instruments consist of biochemical analyzers and coagulometers.

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As shown in the above table, medical service fees, being the Group's share of profits of the RFAS treatment centers jointly set up by the Group and the Contracted Hospitals, accounted for about 75.07% and 67.44% of the Group's total turnover and about 86.54% and 82.56% of the Group's gross profit for the years ended 31 December 2001 and 2002, respectively. As mentioned above, the Group's business model is that the Group provides RFAS to the RFAS treatment centers and shares profits of the RFAS treatment centers as medical service fees. Under its business model, the Group purchased Radio Therapeutics radio frequency generators, LeVeen Electrodes and electric plates itself and used them together with the software developed by the Group to set up the RFAS treatment centers with the Contracted Hospitals (except that two Radio Therapeutics radio frequency generators were not used for RFAS treatment centers but sold for profits of about Rmb346,000 (equivalent to about \$327,000) during the year ended 31 December 2002). The Directors believe that as (i) from the outset of its establishment, the Group has adopted the business model of providing the Contracted Hospitals with the RFAS to set up RFAS treatment centers, and the Group receives medical service fees from its provision of the RFAS by way of sharing profits of the RFAS treatment centers with the Contracted Hospitals (accordingly, the Group's business has not relied on sale or distribution of RFAS, LeVeen Electrodes, electric plates and other related products as distribution agent, and it only sold two Radio Therapeutics radio frequency generators during the year ended 31 December 2002); (ii) Boston Scientific stated in the Notice Letter that the hospitals which acquired RTC products (i.e. Radio Therapeutics radio frequency generators, LeVeen Electrodes, electric plates and other related products) through the Group in the past, being the Contracted Hospitals, may contact Boston Scientific directly, and the Group has verbally confirmed with Boston Scientific that Boston Scientific will continue to supply the RTC products to the Contracted Hospitals (in particular the Leveen Electrodes and electric plates which are consumables used during the course of RFAS treatments), and (iii) according to the advice of the Company's legal advisers in the PRC, the existing cooperation contracts with the Contracted Hospitals will not be affected as a result of the change in distribution policy of Boston Scientific on the basis that the Contracted Hospitals are not entitled to unilateral termination of the contracts without the consent of the Group, the operations of the existing RFAS treatment centers of the Group and the Contracted Hospitals in the PRC should be able to continue after Boston Scientific has implemented its new distribution policy. Accordingly, the Directors are of the view that the new distribution policy of Boston Scientific will not have direct effect on the Group's share of profits of the existing RFAS treatment centers which are operated under the existing cooperation contracts. **However, the new distribution policy of Boston Scientific will have adverse impacts on the Group's future plan to set up new RFAS treatment centers which in turn will have negative impact on the Group's financial results (including medical service fees to be received by the Group under any new cooperation contracts) as described in the following paragraph headed "Impact of Boston Scientific's new distribution policy on the Group". As detailed in the Notice Letter, Boston Scientific is no longer in a position to supply the Group with the RTC products (and accordingly the Group may encounter difficulties in obtaining RTC products in the future).**

LETTER FROM THE BOARD

IMPACT OF BOSTON SCIENTIFIC'S NEW DISTRIBUTION POLICY ON THE GROUP

Impact on the Group's future plan to set up new RFAS treatment centers

The Group will continue its existing business model as described above by entering into new cooperation contracts with insufficiently funded hospitals to set up new RFAS treatment centers and then sharing the profits of these treatment centers in the future. At present, the Group has only limited stock of Radio Therapeutics radio frequency generators. After the remaining stock of Radio Therapeutics radio frequency generators is depleted, the Group will provide funds to acquire, through those insufficiently funded hospitals, the RTC products and use the computer system developed by the Group together with the RTC products to set up new RFAS treatment centers. **However, there exists potential competition from other companies or sufficiently funded hospitals in the PRC as they may in the future obtain Radio Therapeutics radio frequency generator, LeVeen Electrodes and electric plates directly from Boston Scientific under Boston Scientific's new distribution policy and, to that extent, the future expansion of the network of Contracted Hospitals of the Group may be affected.** In addition, there is a possibility that Boston Scientific may directly distribute RTC products to the hospitals and finance those hospitals that are insufficiently funded, although the Directors are not aware of any plan of Boston Scientific to commence business using similar business model of the Group. The Company was only informed by Boston Scientific that it would supply all RTC products directly from its local trading company in the PRC.

Despite the risk of competition, the Directors consider the Group has competitive advantages over its potential competitors, due to the following reasons:

- (i) the Group is able to provide total solutions to the insufficiently funded hospitals in the PRC as the Group has developed its computer system of RFAS and other value-added services as mentioned in the above paragraph headed "The Group's cooperation with Contracted Hospitals to set up RFAS treatment centers", while the Group's competitors need more time to develop or procure the development of their own computer systems and other similar services;
- (ii) the management of the Group has extensive experience in promoting the use of RFAS since 1999 and managing RFAS treatment centers;
- (iii) the Group has established an extensive network of RFAS treatment centres in major cities in the PRC including Guangzhou, Shanxi, Tianjin, Fujian, Hangzhou, Henan, Zhejiang, Harbin, Guangxi, Sichuan, Shijiazhuang, Nanjing, Lanzhou, Jinan, Shenzhen, Shanghai, Beijing, Kunming, Guangdong, Kaifeng, Jiangsu, Changchun, Liaoning and Haikou);

LETTER FROM THE BOARD

- (iv) the Group has extensive connections with medical experts (including medical doctors at hospitals in the PRC including the Contracted Hospitals, and professors at medical schools (for examples, Medical School of Fudan University (復旦大學醫學院) and Sun Yat Sin Medical University Tumour Hospital (中山醫科大學腫瘤醫院)) in the PRC, while its competitors also need more time to gain these experience and set up networks and connections with hospitals and medical experts in the PRC that are comparable to those of the Group; and
- (v) the cooperation contracts with the Contracted Hospitals cannot be terminated unilaterally by the Contracted Hospitals (more than 50 contracts are for six years).

Accordingly, since the Group has established its business and geographical reach and penetration in the PRC, in the future it can concentrate on improving its products and services for further development of its business while its competitors need to invest time, effort and resources (in terms of funds and technical expertise) in starting up their business.

Impact on the Group's financial results

Despite the competitive advantages of the Group over its competitors, medical service fees to be received by the Group by sharing profits of the RFAS treatment centers in the future may decrease as (i) the Group may not be able to enter into new cooperation contracts with more hospitals in the future as a result of competition from competitors; (ii) the Group's share of profits from the existing RFAS treatment centers will decrease as the terms of most of the existing cooperation contracts are six years and during such period the Group would share 80%, 70% and 60% of the profits of the RFAS treatment centers for the first two years, the third to fourth years, and the fifth to sixth years, respectively, from the date of the relevant contracts; and (iii) the existing cooperation contracts may not be renewed upon their respective expiry.

During the year ended 31 December 2001, the total sales of LeVeen Electrodes and electric plates for use by the RFAS treatment centers, which were sourced by the Group from Radio Therapeutics, accounted for about 24.93% of the turnover of the Group. During the year ended 31 December 2002, the total sales of these two products accounted for about 32.56% of the turnover of the Group. The gross profits from the sales of LeVeen Electrodes and the electric plates for the years ended 31 December 2002 and 2001 amounted to about \$6.1 million and \$3.9 million respectively, representing about 17.44% and 13.46% respectively of the total gross profits of the Group for the years ended 31 December 2002 and 2001 respectively. **As a result of the new distribution policy of Boston Scientific, the Group will lose all the turnover and profits attributable to the sales of LeVeen Electrodes and the electric plates in the future, and the total turnover and profits of the Group will be materially affected.** However, the Group has been considering using other electrodes and electric plates available in the market which have similar functions and can be used to replace LeVeen Electrodes and electric plates for RFAS treatments. The Group has been discussing with suppliers of the other electrodes and electric plates. In addition, as set out in the paragraph headed "Proposed change in business plans and use of proceeds" below, the Group plans to

LETTER FROM THE BOARD

develop its own electrodes and electric plates. The Directors are of the opinion that if suitable electrodes and electric plates can be acquired, or developed, by the Group at competitive prices, the impact on the Group's turnover and profits caused by the new distribution policy of Boston Scientific in respect of LeVeen Electrodes and electric plates will be reduced. However, the Group may or may not be able to acquire, or develop, suitable electrodes and electric plates at competitive prices, hence it may or may not be possible for the Group to reduce the impact on the Group's turnover and profits caused by the new distribution policy of Boston Scientific in respect of LeVeen Electrodes and electric plates. As at the Latest Practicable Date, the Group has identified a supplier, which is an independent third party, in the PRC for electric plates which are comparable to the electric plates supplied by Boston Scientific (in terms of price) and are compatible with the RFAS, and the Group has decided to use the electric plates supplied by such supplier in the RFAS treatment centers. Other than that, as at the Latest Practicable Date, no conclusion has been made between the Company and any of the suppliers, and such conclusion may or may not be made in the future. In addition, the Group is also exploring the possibility of developing suitable electrodes and electric plates with a university in the PRC (namely Sun Yat Sin Medical University Tumour Hospital (中山醫科大學腫瘤醫院)) and should suitable electrodes and electric plates be developed and produced, the impact on the Group's turnover and profits will be further reduced. **However, the development and/or production of suitable electrodes and electric plates by the Group and the university may or may not be materialised.**

As set out above, as a result of the new distribution policy of Boston Scientific, the Group's share of profits of the RFAS treatment centers in the future may decrease and the Group will lose all the turnover and profits attributable to the sales of LeVeen Electrodes and the electric plates in the future, and the total turnover and profits of the Group will be materially affected.

POSSIBLE ACTIONS THAT MAY BE TAKEN BY THE GROUP

The Company has sought preliminary legal advice on the Company's position with respect to the Notice Letter and was advised that, assuming Boston Scientific was authorised to terminate the Exclusive Distribution Agreement, the Notice Letter may constitute an anticipatory breach or an anticipatory repudiation of the Exclusive Distribution Agreement which avails Tat Lung of the following legal remedies upon occurrence of actual breach, namely, to (i) seek a declaratory judgment against Radio Therapeutics from court to determine the rights of the parties under the Exclusive Distribution Agreement; (ii) make a claim against Radio Therapeutics to recover general damages to compensate Tat Lung for the alleged breach of Radio Therapeutics of the Exclusive Distribution Agreement; (iii) seek an order of specific performance from the court to compel Radio Therapeutics to continue to supply the RTC products to Tat Lung; and (iv) seek an order of injunction from the court to enjoin Radio Therapeutics from using another distributor other than Tat Lung. The Directors consider it may not be in the best interests of the Group to take legal actions against Radio Therapeutics and/or Boston Scientific at this stage, but reserves the right to do so. Before taking any legal action against Radio Therapeutics and/or Boston Scientific, the Group needs to consider various factors, including (i) the benefits and costs of taking any legal action, and (ii) the

LETTER FROM THE BOARD

possible impact on Boston Scientific's supply of LeVein Electrodes and electric plates to the Contracted Hospitals for the operation of the existing RFAS treatment centers, and its supply of the RTC products to those hospitals which may enter into new cooperation contracts with the Group in the future to set up new RFAS treatment centers. In the meantime, the Group will continue to discuss with Boston Scientific/Radio Therapeutics with regard to Boston Scientific's future supply of the RTC products, and as at the Latest Practicable Date, no concluded agreement or arrangement has been reached between the Group and Boston Scientific/Radio Therapeutics. The Group will make further announcement if there is any material development of the discussion.

SUFFICIENT LEVEL OF OPERATION

The Directors are of the view that Group is able to maintain a sufficient level of operations pursuant to Rule 17.26 of the GEM Listing Rules after Boston Scientific has implemented its new distribution policy because, as set out in this circular, the operation of the existing RFAS treatment centers set up by the Group and the Contracted Hospitals should be able to continue, hence the Group will continue to share profits of these existing RFAS treatment centers as medical service fees, which accounted for approximately 75.07% and 67.44% of the Group's total turnover and about 86.54% and 82.56% of the Group's gross profit for the years ended 31 December 2001 and 2002, respectively.

PROPOSED CHANGE IN BUSINESS PLANS AND USE OF PROCEEDS

The Directors consider that as a result of the new distribution policy of Boston Scientific, the Group has to shift its future business expansion focus from RFAS to other areas by reformulating the Group's business plans and changing the proposed use of proceeds from the IPO in December 2001 and the proceeds from the Top-up Placing. Accordingly, the Group will continue to develop the network of hospitals in the PRC for RFAS and at the same time it intends to allocate a substantial amount of the unused net proceeds from the IPO and the Top-up Placing to the development of drugs and medical testing instruments, which are also existing businesses of the Group. The Group has acquired 16 medical research projects in relation to 16 drugs (further details of which are set out in the Company's circular dated 8 January 2003). Out of these 16 drugs, 4 drugs are anti-cancer, 7 drugs are ancillary anti-cancer, and the remaining 5 drugs are used for curing asthma, lung diseases, throat diseases and fever and can be used by children after recovery from illness. As present, the 16 medicine research projects are in the research and development stage. Application for approval of pre-clinical trial have been submitted to 國家藥品監督管理局 (the State Drug Administration Bureau of the PRC) and 江蘇省藥品監督管理局 (the Drug Administration Bureau of Jiangsu the Province) for six of these medicine research projects. These six medicine research projects are now in the pre-clinical trial stage, and the Directors expect that two of these six medicine research projects will obtain approval for clinical trial by end of 2003. In addition, the Group plans to manufacture medical testing instruments including biochemistry analysers, coagulometers and immune analysers. These medical testing instruments are not related to, and are sold separately from, RTC products.

LETTER FROM THE BOARD

The Directors are of the view that the 16 drugs that may be developed from the medical research projects and the medical testing instruments are of great market potential. Most of the 16 drugs are anti-cancer and ancillary anti-cancer. Biochemistry analysers, coagulometers and immune analysers are basic examination devices applied in cancer diagnosis. As cancer is a serious illness which has a high death rate globally, the Directors believe that demand for such products can be huge.

As at the Latest Practicable Date, there are 60 Contracted Hospitals located in various parts of the PRC. The Board believes that the Group can leverage on this extensive network to effectively promote the sale of drugs and medical testing instruments, hence enhancing the total revenue and profitability of the Group. With respect to the medical research projects, the Group can also transfer the results of such medicine research projects at different stages of the research process to generate revenue.

As at the Latest Practicable Date, the Group has approximately 150 staff, out of which over 20 and 25 staff are engaged in the research and development of drugs and medical testing equipment, respectively. In addition, Ms. Guo Ping, who is the major shareholder of the company selling the 16 medical research projects, has over 20 years of experience in medicine research and will be a director of China Best Drugs Research (Nanjing) Limited, the Group's subsidiary which will be engaged in the further development of the 16 medical research projects. As such, the Directors believe that the Group will have enough personnel and expertise in pursuing the development of drugs and medical testing instruments. The Directors will also recruit new personnel in the future if considered necessary.

LETTER FROM THE BOARD

The Group plans to revise its business plans up to 31 December 2003 and apply the total unused net proceeds from the IPO and the Top-up Placing of approximately \$68.67 million as at 31 March 2003 as follows:

Business plans	Details	Three months ended	Three months ending	Three months ending	Proposed amount of investment \$ (million)	Total \$ (million)
		30 June 2003	30 September 2003	31 December 2003		
Continual development of the market and application of RFAS in the PRC	Entering into new cooperation contracts with 2 hospitals <i>(Notes 1 and 2)</i>	1.2	Entering into new cooperation contracts with 2 hospitals <i>(Notes 1 and 2)</i>	1.2	1.2	3.6
	Establishing 1 RFAS training center	0.5	Establishing 1 RFAS training center	0.5	0.5	1.5
	Hosting 2 conferences to demonstrate and promote the application of RFAS and providing training to doctors from 3 contracted hospitals	0.3	Hosting 2 conferences to demonstrate and promote the application of RFAS and providing training to doctors from 3 contracted hospitals	0.3	0.3	0.9
	Research and development of electrodes and electric plates	2.0	Continuing the research and development of electrodes and electric plates	2.0	2.0	6.0
Total		4.0		4.0	4.0	12.0

Note 1: The Directors have confirmed that the Group is currently negotiating with four hospitals in the PRC which may enter into cooperation contracts with the Group.

Note 2: The Group currently has 10 sets of Radio Therapeutics radio generators in stock which may be used to set up new RFAS treatment centres with a total of 6 hospitals during the period up to 31 December 2003.

LETTER FROM THE BOARD

Business plans	Details	Three months ended	Three months ending	Three months ending	Total		
		30 June 2003	30 September 2003	31 December 2003			
		Proposed amount of investment	Proposed amount of investment	Proposed amount of investment			
		\$ (million)	\$ (million)	\$ (million)	\$ (million)		
Research, development and sales of drugs	Continuing the research and development of 16 medical research projects in relation to 16 different drugs (the "Drugs") after completion of acquisition of those projects	0.5	Continuing the research and development of the Drugs	0.5	Commencing testing of 2 Drugs	1.0	2.0
					Continuing the research and development of the other Drugs		
	Continuing cooperation with the Medical School of Fudan University and identifying research and development topics	0.5	Continuing cooperation with the Medical School of Fudan University (and other university(ies) in the PRC, if applicable) by continuing the research and development topics	1.0	Continuing cooperation with the Medical School of Fudan University (and other university(ies) in the PRC, if applicable) by continuing the research and development topics	1.0	2.5
	Developing sales network of ancillary anti-cancer medicine (Note 3)	3.0	Continuing to sell ancillary anti-cancer medicine	3.0	Continuing to sell ancillary anti-cancer medicine	3.0	9.0
	Negotiating with relevant parties in relation to establishment of factory for production of drugs	0.5	Applying to relevant authorities in relation to the establishment of factory for production of drugs and commence construction of factory	6.0	Continuing construction of factory for production of drugs	6.0	12.5
Total		4.5		10.5		11.0	26.0

Note 3: The Directors have confirmed that the Group has signed sales agreement with approximately 60 pharmaceutical stores in Nanjing, the PRC. Approximately 40 of those pharmaceutical stores have commenced selling the Group's ancillary anti-cancer medicine at their own counters since the 2nd quarter of 2003.

LETTER FROM THE BOARD

Business plans	Details	Three months ended	Three months ending	Three months ending	Proposed amount of investment \$ (million)	Total \$ (million)
		30 June 2003	30 September 2003	31 December 2003		
Research and development of 3-dimensional laparoscope and software for medical devices	Completing prototype of 3-dimensional laparoscope	1.0	Testing and revising prototype of 3-dimensional laparoscope	1.0	Testing the revised prototype of the 3-dimensional laparoscope	3.0
	Developing software for medical devices	1.5	Continuing development of software for medical devices	1.5	Completing development of the software for medical devices	4.5
Total		2.5		2.5	2.5	7.5
Research, development and production of medical testing instruments	Producing Biochemistry Analyzer	1.5	Obtaining licence for production of Coagulometer and producing Biochemistry Analyzer and Coagulometer	1.5	Obtaining licence for production of Immune Analyzers and producing Biochemistry Analyzer, Coagulometer and Immune Analyzer	5.0
	Continuing to establish a new factory for manufacturing medical testing instruments	2.5	Completing establishment of the new factory for manufacturing medical testing instruments	2.5	Commencing production of medical testing instruments in the new factory	8.0
Total		4.0		4.0	5.0	13.0

The Group plans to utilize a total of about \$58.50 million to finance the above business plans. The balance of about \$10.17 million from the net proceeds from the IPO and Top-up Placing will be applied as general working capital of the Group.

LETTER FROM THE BOARD

Set out below is a comparison of the business plans as set out in the prospectus of the Company dated 19 December 2001 with the revised business plans:

Original business plans	Original target for the six months ended 30 June 2003	Original target for the six months ending 31 December 2003	Revised business plans up to 31 December 2003
Continual development of the network of hospitals in the PRC for RFAS	Entering into new cooperation contracts with 20 hospitals in Sichuan and Yuannan	Entering into new cooperation contracts with 10 hospitals in Fujian and east of the PRC	Entering into new cooperation contracts with 6 hospitals in the PRC
Promotion of application of RFAS and establishment of RFAS training centers	<ul style="list-style-type: none"> • Hosting 5 conferences to demonstrate and promote the application of RFAS • Providing training to doctors from 15 contracted hospitals 	<ul style="list-style-type: none"> • Hosting 5 conferences to demonstrate and promote the application of RFAS • Providing training to doctors from 20 contracted hospitals 	<ul style="list-style-type: none"> • Hosting 6 conferences to demonstrate and promote the application of RFAS • Providing training to doctors from 9 contracted hospitals
Development of the market for 3-dimensional laparoscope and assisting in the sales of anti-cancer drugs	<ul style="list-style-type: none"> • Commencing to provide assistance in relation to sale of new cancer-related drugs to the contracted hospitals in the PRC • Commencing sale of the 3-D laparoscopes to the contracted hospitals in the PRC 	<ul style="list-style-type: none"> • Continuing to provide assistance in relation to the sale of IP6 and Neustim to the contracted hospitals in the PRC • Continuing production by contractor(s) and sale of the 3-D laparoscopes to the contracted hospitals in the PRC 	<ul style="list-style-type: none"> • Suspended as IP6 failed to obtain the final approval from State Drug Administration of the PRC and the manufacturer of Neustim failed to supply Neustim at a price acceptable to the Group due to high production cost. However, the Group has acquired 16 medical research projects in relation to the 16 Drugs, some of which are expected to be used for cancer treatment • Development of 3-D laparoscopes has fallen behind schedule due to technical problems. Currently, testing of prototype will be done by end of 2003
Establishment of cancer treatment centers	Installation of medical devices to the second cancer treatment center	Commencing operation of the second cancer treatment center	Suspended due to new distribution policy of Boston Scientific and immense capital requirement not justifiable at this stage

LETTER FROM THE BOARD

Set out below is a comparison of the original proposed use of the proceeds from the IPO and the Top-up Placing and the proposed use of proceeds under the revised business plans:

Business plans	Proposed use	Proposed use	Total of amount from the IPO and the Top-up Placing	Actual amount	Original plan	Revised plan for
	of the proceeds from the IPO as set out in the prospectus dated 19 December 2001	of the proceeds from the Top-up Placing as set out in the announcement dated 24 July 2002		used during the period from 15 December 2001 to 31 March 2003	for the balance of the net proceeds from the IPO and the Top-up Placing	the balance of the net proceeds from the IPO and the Top-up Placing
	\$ (million)	\$ (million)	\$ (million)	\$ (million)	\$ (million)	\$ (million)
Continual development of the network of hospitals in the PRC for RFAS	21.00	4.35	25.35	8.00	17.35	3.60
Promotion of application of RFAS and establishment of RFAS training centers	4.50	–	4.50	0.80	3.70	2.40
Development of the market for 3-dimensional laparoscope and assisting in the sales of anti-cancer drugs	9.00	–	9.00	1.50	7.50	3.00
Establishment of cancer treatment centers	24.90	15.00	39.90	–	39.90	–
Working capital	0.22	–	0.22	–	0.22	10.17 <i>(Note)</i>
Remaining proceeds applied to other areas of the revised business plans (mainly for the Drugs and medical testing instruments businesses)	N/A	N/A	N/A	N/A	N/A	49.50
Total	59.62	19.35	78.97	10.30	68.67	68.67

Note: The \$10.17 million of working capital will be applied as to approximately \$2.17 million for the operations of new RFAS treatment centres, as to approximately \$4.00 million for the operations of the factories for the new drugs and medical testing instruments and as to approximately \$4.00 million for the commercialisation and promotion of the new drugs if the testing of the new drugs is successful.

The revised business plans and use of proceeds from the IPO and the Top-up Placing will amount to a change to the general character or nature of the business of the Group under Rule 17.25 of the GEM Listing Rules and are therefore subject to the approval of Independent Shareholders at the Special General Meeting.

LETTER FROM THE BOARD

SPECIAL GENERAL MEETING

In accordance with Rule 17.25 of the GEM Listing Rules, the Directors, chief executive, management shareholders of the Company (being Mr. Li Nga Kuk, James, Mr. Li Tai To, Titus, Mr. Li Wo Hing, Mr. Ng Kwai Sang, Mr. Chan Siu Sun and Mr. Li Yue Erh) and their respective associates, who in aggregate held 376,320,000 shares or approximately 45.1% of the issued share capital of the Company as at the Latest Practicable Date, shall abstain from voting at the Special General Meeting.

A notice convening the Special General Meeting to be held at 8th Floor, Teda Building, 87 Wing Lok Street, Hong Kong at 9:30 a.m. on 25 July 2003 for the purpose of considering and, if thought fit, passing the ordinary resolution in relation to the revised business plans and proposed change in the use of proceeds from the IPO and the Top-up Placing is set out on pages 43 and 44 of this circular.

A proxy form applicable to the Special General Meeting is herewith enclosed. In order to be valid, the proxy form, under which it is signed, must be deposited by hand or by post, for holders of shares of the Company at the share registrar of the Company in Hong Kong, Computershare Hong Kong Investor Services Limited, at Rooms 1901-5, 19th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong not later than 48 hours before the time appointed for holding the Special General Meeting or any adjourned meeting. If the proxy form is signed by a person under a power of attorney or other authority, a notarially certified copy of that power of attorney or authority shall be deposited at the same time as mentioned in the proxy form.

RECOMMENDATION

The Independent Board Committee, comprises Mr. Guo Guoqing and Mr. Fan Wan Tat, independent non-executive Directors, has been established (the other independent non-executive Director, Mr. Han K. Huang, has not been appointed as member of the Independent Board Committee as he has not been in Hong Kong during the course of preparation of this circular) to advise the Independent Shareholders as to whether the proposed changes in business plans and use of proceeds are in the interests of the Company and its shareholders as a whole. Furthermore, the Independent Financial Adviser has been appointed to advise the Independent Board Committee.

Your attention is drawn to (i) the letter from the Independent Board Committee set out on page 20 of this circular which contains its recommendation to the Independent Shareholders concerning the revised business plans and proposed change in the use of proceeds from the IPO and the Top-up Placing; and (ii) the letter from Dao Heng Securities Limited, the Independent Financial Adviser, set out on pages 21 to 36 of this circular which contains its recommendation to the Independent Board Committee in relation to the revised business plans and proposed change in the use of proceeds from the IPO and the Top-up Placing and the principal factors and reasons considered in arriving at its recommendation.

LETTER FROM THE BOARD

The Directors consider that the revised business plans and proposed change in use of proceeds from the IPO and Top-up Placing, which will lead to an expansion of the Group's business to research and development of drugs and medical testing instruments in addition to the operation of RFAS treatment centres and which will amount to a change to the general character or nature of the business of the Group under Rule 17.25 of the GEM Listing Rules, are in the interests of the Group and the shareholders of the Company as a whole. Accordingly, the Directors recommend all the Independent Shareholders to vote in favour of the ordinary resolution set out in the notice of the Special General Meeting.

FURTHER INFORMATION

Your attention is also drawn to the additional information set out in the appendix to this circular.

By order of the Board
Medical China Limited
Li Wo Hing
Director



MEDICAL CHINA LIMITED

神州醫療科技有限公司*

(Incorporated in Bermuda with limited liability)

7 July 2003

To the Independent Shareholders

Dear Sir or Madam,

**CHANGE IN GENERAL CHARACTER
OR NATURE OF BUSINESS**

We refer to the circular issued by the Company on 7 July 2003 (the “Circular”), of which this letter forms a part. Terms used in this letter shall have the same meanings as those defined in the Circular unless the context otherwise requires.

We have been appointed by the Board as the Independent Board Committee established to consider the revised business plans and proposed change in the use of proceeds from the IPO and the Top-up Placing and to advise you as to whether the revised business plans and proposed change in the use of proceeds from the IPO and the Top-up Placing are in the interests of the Company and its shareholders as a whole.

Dao Heng Securities Limited has been retained as the Independent Financial Adviser to advise us regarding the revised business plans and proposed change in the use of proceeds from the IPO and the Top-up Placing. Details of the advice of Dao Heng Securities Limited, together with the principal factors and reasons taken into consideration by it in arriving at such advice, are set out in its letter on pages 21 to 36 of the Circular. Your attention is also drawn to the letter from the Board in the Circular and the additional information set out in the appendix to the Circular.

Having reviewed the advice of Dao Heng Securities Limited, we concur with the views of Dao Heng Securities Limited and consider that the revised business plans and proposed change in the use of proceeds from the IPO and the Top-up Placing are in the interests of the Company and its shareholders as a whole and recommend Independent Shareholders to vote in favour of the ordinary resolution to be proposed at the Special General Meeting to approve the revised business plans and proposed change in the use of proceeds from the IPO and the Top-up Placing.

Yours faithfully,

For and on behalf of the Independent Board Committee

Guo Guoqing

Fan Wan Tat

Independent non-executive Directors

* For identification purpose only

LETTER FROM DAO HENG SECURITIES LIMITED

The following is the text of the letter of advice to the Independent Board Committee from Dao Heng Securities Limited in connection with the proposed changes in general character or nature of the Group's business, which has been prepared for the purpose of inclusion in this circular.



7 July 2003

To the Independent Board Committee

Dear Sirs,

CHANGE IN GENERAL CHARACTER OR NATURE OF BUSINESS

INTRODUCTION

We refer to our engagement by the Company as independent financial adviser to advise the Independent Board Committee with respect to the proposed changes in business plans and use of proceeds, which will amount to change in general character or nature of the Group's business (the "Proposed Changes"). Details of the Proposed Changes are contained in the letter from the Board in the circular dated 7 July 2003 to the shareholders of the Company (the "Circular"), of which this letter forms part. Terms defined in the Circular bear the same meanings herein unless the context otherwise requires.

On 3 April 2003, Tat Lung, a wholly-owned subsidiary of the Company, received the Notice Letter from Boston Scientific Asia Pacific, a fellow subsidiary of Radio Therapeutics, which stated, among other things, that Boston Scientific would not supply the Group with the RTC products in the PRC but the Contracted Hospitals may contact Boston Scientific directly. As a result of Boston Scientific's new distribution policy with respect to the RTC products, the Directors have proposed to revise the business plans and use of proceeds from the IPO and the Top-up Placing. Such revision of business plans and change in proposed use of proceeds will amount to a change to the general character or nature of the Group's business under Rule 17.25 of the GEM Listing Rules and are therefore subject to the approval of Independent Shareholders at the Special General Meeting. Mr. Fan Wan Tat and Mr. Guo Guoqing, being the independent non-executive Directors, have been appointed as the members of the Independent Board Committee to advise the Independent Shareholders in respect of the Proposed Changes. As stated in the letter from the Board, the Directors, chief executive, management shareholders of the Company (being Mr. Li Nga Kuk, James, Mr. Li Tai To, Titus, Mr. Li Wo Hing, Mr. Ng Kwai Sang, Mr. Chan Siu Sun and Mr. Li Yue Erh) and their respective associates, who in aggregate held 376,320,000 shares of the Company or approximately 45.1% of the issued share capital of the Company as at the Latest Practicable Date shall abstain from voting at the Special General Meeting.

LETTER FROM DAO HENG SECURITIES LIMITED

Our role as the independent financial adviser to the Independent Board Committee is to give our opinion as to whether the Proposed Changes are in the interests of the Company and its shareholders as a whole.

In formulating our recommendations, we have relied on the accuracy of the information and representations contained in the Circular, which have been provided by the Directors and have assumed that all information and representations made or referred to in the Circular are true and accurate in all material respects. We have no reason to doubt the truth, accuracy and completeness of the information and representations provided to us by the Directors and have been advised by the Directors that no material facts have been omitted from the information provided and referred to in the Circular. We consider that we have reviewed sufficient information to reach an informed view and to justify relying on the accuracy of the information contained in the Circular and to provide a reasonable basis for our advice. We have not, however, conducted any independent investigation into the business and affairs or the future prospects of the Group.

PRINCIPAL FACTORS AND REASONS CONSIDERED

A. Change in general character or nature of business

Existing business operation and performance

The Group is principally engaged in the research, development and provision of medical devices for cancer treatment in the PRC. The Group is also engaged in the research, development and promotion of sales of anti-cancer drugs, ancillary anti-cancer drugs and other drugs.

As stated in the letter from the Board, Tat Lung has been appointed by Radio Therapeutics as its sole and exclusive distribution agent in the PRC and Hong Kong for the sale, distribution and marketing of the RTC products for a term of five years from 27 April 2001 pursuant to the Exclusive Distribution Agreement. It is further stated in the letter from the Board that, under its current business model, the Group has entered into cooperation contracts with the Contracted Hospitals whereby the Group purchased RTC products and used them together with the software developed by the Group to set up the RFAS treatment centres with the Contracted Hospitals. The Contracted Hospitals use the RFAS in these RFAS treatment centres for treatment of cancers and charge medical treatment fees to the patients. The Group then shares the profits of the RFAS treatment centres with the Contracted Hospitals as medical service fees according to the cooperation contracts. As at the Latest Practicable Date, there were 60 RFAS treatment centres jointly established by the Contracted Hospitals and the Group in the PRC.

In addition to the operation of the RFAS treatment centres, the Group is also engaged in sale of LeVeen Electrodes and electric plates and sale of medical testing instruments. The LeVeen Electrodes and the electric plates, which were supplied by

LETTER FROM DAO HENG SECURITIES LIMITED

Radio Therapeutics, were used as consumables during the course of RFAS treatments in the RFAS treatment centres from time to time. Since the first quarter of 2003, the Group commenced sale of own-developed medical testing instruments, namely biochemical analysers and coagulometers. As stated in the letter from the Board, these medical testing instruments are not related to, and are sold separately from, the RTC products. The following table summarises the business performance of the Group during the financial year ended 31 December 2001 (“Year 2001”), 31 December 2002 (“Year 2002”) and the three months ended 31 March 2003 (the “Three-month Period”):

	Year 2001		Year 2002		Three-month Period	
	(Audited)		(Audited)		(Unaudited)	
	(HK\$m)	(%)	(HK\$m)	(%)	(HK\$m)	(%)
Turnover						
Medical service fees	28.92	75.07	33.62	67.44	3.82	59.47
Sales of LeVeen Electrodes and electric plates	9.6	24.93	16.23	32.56	1.68	26.15
Sales of medical testing instruments	—	—	—	—	0.92	14.38
Total turnover	<u>38.52</u>	<u>100.00</u>	<u>49.85</u>	<u>100.00</u>	<u>6.42</u>	<u>100.00</u>
Gross profit						
Medical service fees	25.19	86.54	29.11	82.56	2.64	72.97
Sales of LeVeen Electrodes and electric plates	3.92	13.46	6.15	17.44	0.62	17.16
Sales of medical testing instruments	—	—	—	—	0.36	9.87
Total gross profit	<u>29.11</u>	<u>100.00</u>	<u>35.26</u>	<u>100.00</u>	<u>3.62</u>	<u>100.00</u>

As shown in the above table, the medical service fees derived from the RFAS treatment centres served as a major income source to the Group which accounted for approximately 75.07%, 67.44% and 59.47% of the Group’s total turnover and approximately 86.54%, 82.56% and 72.97% of the Group’s total gross profit for Year 2001, Year 2002 and the Three-month Period respectively. The second largest income source of the Group is the sales of LeVeen Electrodes and electric plates which accounted for approximately 24.93%, 32.56% and 26.15% of the Group’s total turnover and approximately 13.46%, 17.44% and 17.16% of the Group’s total gross profit for Year 2001, Year 2002 and the Three-month Period respectively. During 2003, the Group commenced to manufacture and sell medical testing instruments. As advised by the Directors, since the medical testing instruments are newly launched products of the Group in the first quarter of 2003, it only accounted for approximately 14.38% and 9.87% of the Group’s total turnover and gross profit for the Three-month Period respectively.

LETTER FROM DAO HENG SECURITIES LIMITED

Notice Letter from Boston Scientific Asia Pacific

As stated in the letter from the Board, Tat Lung received the Notice Letter from Boston Scientific Asia Pacific, a fellow subsidiary of Radio Therapeutics, which notified the Group that it would not supply the Group with the RTC products in the PRC but the Contracted Hospitals may contact Boston Scientific directly. It is further stated in the letter from the Board that the Group has verbally confirmed with Boston Scientific that Boston Scientific will continue to supply the RTC products to the Contracted Hospital (in particular, the LeVein Electrodes and electric plates which are consumables used during the course of RFAS treatments). In addition, as stated in the letter from the Board, the Company's legal advisers in the PRC advised that, pursuant to the existing cooperation contracts with the Contracted Hospitals, the Contracted Hospitals are not entitled to unilateral termination of the contracts without the consent of the Group, the operations of the existing RFAS treatment centres of the Group and the Contracted Hospitals in the PRC should be able to continue after the implementation of the new distribution policy by Boston Scientific.

Based on the verbal confirmation by the Company with Boston Scientific that Boston Scientific will continue to supply the RTC products to the Contracted Hospitals and the abovementioned legal advice from the Company's legal advisers in the PRC, the Directors are of the view that the new distribution policy of Boston Scientific will not have direct effect on the Group's share of profits of the existing RFAS treatment centres which are operated under the existing cooperation contracts. Pursuant to the legal advice from the Company's legal advisers in the PRC as to the existing cooperation contracts with the Contracted Hospitals, we consider that the implementation of the new distribution policy by Boston Scientific may not have material effect on the operation of the RFAS treatment centres. However, in the event that Boston Scientific does not supply the Contracted Hospitals with the RTC products and the Group are unable to obtain the required RTC products from Boston Scientific, we consider that the operation of the existing RFAS treatment centres may be adversely affected and there may be potential deterioration in earnings from the RFAS treatment centres to the Group.

However, as stated in the letter from the Board, medical service fees to be received by the Group by sharing profits of the RFAS treatment centres in future may decrease as (i) the Group may not be able to enter into new cooperation contracts with more hospitals in future as a result of competition from competitors; (ii) the Group's share of profits from the existing RFAS treatment centres will decrease as the terms of most of the existing cooperation contracts are six years and during such period the Group would share 80%, 70% and 60% of the profits of the RFAS treatment centres for the first two years, the third to fourth years, and the fifth to sixth years, respectively, from the date of the relevant contracts; and (iii) the existing cooperation contracts may not be renewed upon their respective expiry.

LETTER FROM DAO HENG SECURITIES LIMITED

Being the second largest income source of the Group, the sales of LeVeen Electrodes and electric plates for use by the RFAS treatment centres accounted for approximately 24.93%, 32.56% and 26.15% of the total turnover of the Group, while the gross profits therefrom accounted for approximately 13.46%, 17.44% and 17.16% of the total gross profits of the Group for Year 2001, Year 2002 and the Three-month Period respectively. As a result of the new distribution policy of Boston Scientific, the Group will lose all the turnover and profits attributable to the sales of LeVeen Electrodes and the electric plates in future, and the total turnover and profits of the Group will be materially affected.

Acquisition of medicine research projects

We note that, on 6 December 2002, the Company entered into an acquisition agreement, pursuant to which, the Group has agreed to purchase 16 medicine research projects with a view that the drugs may be developed therefrom are of market potential and there has been increasing interest in efficacy of the Chinese medicines. According to the circular of the Company dated 8 January 2003, these 16 medicine research projects relate to 16 different types of drugs. Out of the 16 drugs, 4 drugs are anti-cancer while 7 drugs are ancillary anti-cancer. The remaining 5 drugs can be used for curing asthma, lung diseases, throat diseases and fever and can be used by children after recovery from illness. As stated in the letter from the Board, at present, the 16 medicine research projects are in the research and development stage. Application for approval of new drugs have been submitted to 國家藥品監督管理局 (the State Drug Administration Bureau of the PRC) and 江蘇省藥品監督管理局 (the Drug Administration Bureau of Jiangsu Province) for six of these medicine research projects. These six medicine research projects are now in the pre-clinical trial stage, and the Directors estimated that two of these six medicine research projects will obtain approval for clinical trial by end of 2003.

Since cancer is a serious illness which has a high death rate globally, the Directors believe that demand for such drugs can be huge and price of anti-cancer medicines in nature can be high. Coupled with the increasing interest in efficacy of Chinese medicines, the Directors are of the view that the drugs developed from the medicine research projects purchased by the Group are of great market potential. It was also stated in the letter from the Board that, with respect to the medicine research projects, the Group can also transfer the results of such research projects at different stages of the research process to generate revenue. Given that there are 60 Contracted Hospitals located in various parts of the PRC, including Guangzhou, Shanxi, Tianjin, Fujian, Hangzhou, Henan, Zhejiang, Harbin, Guangxi, Sichuan, Shijiazhuang, Nanjing, Lanzhou, Jinan, Shenzhen, Shanghai, Beijing, Kunming, Guangdong, Kaifeng, Jiangsu, Changchun, Liaoning and Haikou, we concur with the Directors' view that the Group can leverage on this extensive network to effectively promote the sale of drugs, hence enhancing the total revenue of the Group.

LETTER FROM DAO HENG SECURITIES LIMITED

Intention of the Group in response to the Notice Letter

We note that the Group has proposed to respond to this adverse change in business environment as a result of the Notice Letter by the following action plans:

(i) Provision of medical service by RFAS treatment centres

As stated in the letter from the Board, the Group will continue its existing business model by entering into new cooperation contracts with insufficiently funded hospitals to set up new RFAS treatment centres and then share the profits of the treatment centres in future. As stated in the letter from the Board, currently, the Group has around 10 Radio Therapeutics radio frequency generators in stock which may be used to set up new RFAS treatment centres with a total of six hospitals during the period up to 31 December 2003. After the remaining stock of Radio Therapeutics radio frequency generators is depleted, the Group will provide funds to acquire, through those insufficiently funded hospitals, the RTC products and use the computer system developed by the Group together with the RTC products to set up new RFAS treatment centres.

(ii) Sales of LeVeen Electrodes and electric plates

In respect of the sales of LeVeen Electrodes and electric plates for use by the RFAS treatment centres, as a remedial measure, the Group has been considering using other electrodes and electric plates available in the market which have similar functions and can be used to replace LeVeen Electrodes and electric plates for RFAS treatments. Moreover, it is stated in the letter from the Board that the Group plans to develop its own electrodes and electric plates. The Directors are of the opinion that if suitable electrodes and electric plates can be acquired, or developed, by the Group at competitive prices, the impact on the Group's turnover and profits caused by the new distribution policy of Boston Scientific in respect of LeVeen Electrodes and electric plates will be reduced.

(iii) Development of drugs and medical testing instruments

As a result of implementation of the new distribution policy by Boston Scientific, the Directors consider that the Group has to shift its future business expansion focus from RFAS to other areas by re-formulating the Group's business plans and changing the proposed use of proceeds from the IPO in December 2001 and the Top-up Placing set out in the Company's circular dated 13 August 2002. As stated in the letter from the Board, the Group intends to allocate approximately HK\$51.5 million of the unused net proceeds from the IPO and the Top-up Placing to the drugs (as mentioned in the paragraph headed "Acquisition of medicine research projects" above) and medical testing instruments businesses, which are existing businesses of the Group. As set out in the Company's circular dated 8

LETTER FROM DAO HENG SECURITIES LIMITED

January 2003, the Group has agreed to purchase 16 medicine research projects in relation to 16 drugs. Out of these 16 drugs, 4 drugs are anti-cancer, 7 drugs are ancillary anti-cancer, and the remaining 5 drugs are used for curing asthma, lung diseases, throat diseases and fever and can be used by children after recovery from illness. In addition, the Group plans to manufacture medical testing instruments including biochemistry analysers, coagulometers and immune analysers. These medical testing instruments are not related to, and are sold separately from, the RTC products.

We understand from the Directors that the Group's current strategy is to maintain its existing business, while deriving additional source of income from development of drugs and medical testing instruments. The Directors believe that this strategic move will enable the Group (i) to reduce reliance on Radio Therapeutics, (ii) to leverage on the existing business relationship, networks and experience for its drugs and medical testing instruments businesses, and (iii) to enhance the scope of business of the Group. Having said that, we consider that it is a logical move for the Group to shift its business focus from the RFAS treatment centres to other areas with growth potential and to reduce its reliance on Radio Therapeutics.

B. Proposed revised business plans

According to the Company's listing prospectus dated 19 December 2001 (the "Listing Prospectus"), in order to achieve the Group's business objective of becoming one of the leading providers of medical devices and a promoter to assist in the sales of drugs for cancer treatment in the PRC, the Group's original business strategies comprised (i) continual development of the network of hospitals in the PRC for RFAS; (ii) establishment of four RFAS training centres; (iii) development of the market for 3-dimensional laparoscope and assisting in sales of anti-cancer drugs in the PRC; and (iv) establishment of two cancer treatment centres. As a result of Boston Scientific's new distribution policy with respect to the RTC products, the Directors has proposed to revise the business plans and use of proceeds from the IPO and the Top-up Placing with a development focus on research of drugs and medical testing instruments businesses. We note that the major revisions to the original business objectives are related to reducing the reliance on, and exposure to the provision of medical services by RFAS treatment centres and sale of LeVeen Electrodes and electric plates. The proposed revised business plans are summarised as follows (further details of the revised business plans up to 31 December 2003 are set out in the letter from the Board in the Circular):

- (i) *Continual development of the market and application of RFAS in the PRC*

The Group plans to enter into new cooperation contracts with six hospitals (instead of entering into new cooperation contracts with 30 hospitals during the year ending 31 December 2003 ("Year 2003") as stated in the Listing Prospectus) and establish three

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RFAS training centres. The Group plans to host six conferences (instead of hosting 10 conferences during Year 2003 as stated in the Listing Prospectus) to demonstrate and promote the application of RFAS and provide training to doctors from six Contracted Hospitals (instead of providing training to doctors from 35 Contracted Hospitals during Year 2003 as stated in the Listing Prospectus). As a substitute to the RTC products provided by Radio Therapeutics, the Group plans to commence research and development of its own electrodes and electric plates. In light of the potential deterioration in the Group's share of earnings from operating the RFAS treatment centres as a result of the failure in the procurement of the RTC products from Radio Therapeutics due to the Notice Letter, we consider the decrease in reliance on Radio Therapeutics as well as the exposure in RFAS related business to be fair and reasonable so far as the Independent Shareholders are concerned and is in the interest of the Company and the Independent Shareholders as a whole.

(ii) Research, development and sale of drugs

Research, development and sales of drugs become the development focus upon the Proposed Changes. During the nine months ending 31 December 2003, the Group plans to continue the research and development of 16 medicine research projects acquired in relation to 16 different drugs with two drugs to be tested during the three months ending 31 December 2003. Through its cooperation with the Medical School of Fudan University, the Group plans to continue to identify research and development topics of drugs. The Group plans to develop sales network of ancillary anti-cancer medicine. As stated in the letter from the Board, the Group has signed sales agreements with approximately 60 pharmaceutical stores in Nanjing, the PRC and approximately 40 of these pharmaceutical stores have commenced selling the Group's ancillary anti-cancer medicine at their own counters since the second quarter of 2003. In order to complement its shift of business focus to research and development and sale of drugs, the Group also plans to establish its own production plant for drugs and commence construction during the third quarter of 2003 and the shareholders of the Company should note that no such plan had been stated in the section of "Business Objectives" contained in the listing prospectus of the Company.

As advised by the Directors, China Best Drugs Research (Nanjing) Limited, a wholly-owned subsidiary of the Company in Nanjing, the PRC, is responsible for the Group's research and development and sales of drugs business in the PRC. The Directors further advised us that a number of the directors and management members of China Best Drugs Research (Nanjing) Limited have over 10 years' experience in the areas of research and development and commercialisation of medicine and drugs.

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In view of the objective to reduce reliance on the business of operating RFAS treatment centres and to capitalise on the established business relationship, networks and experience of the Group and the signed sales agreements with approximately 60 pharmaceutical stores in Nanjing, the PRC and the acquisition of the 16 medicine research projects as disclosed in the Company's circular dated 8 January 2003, we consider the shift in the development focus to research, development and sales of drugs to be acceptable so far as the Independent Shareholders are concerned.

(iii) Research and development of 3-dimensional laparoscope and software for medical devices

According to the original business plans, the Group planned to provide assistance in relation to the sale of IP6 and Neustim to the Contracted Hospitals in the PRC during Year 2003, which, however, has been suspended since IP6 failed to obtain the final approval from 國家藥品監督管理局 (the State Drug Administration of the PRC) and the manufacturer of Neustim failed to supply Neustim at an acceptable price to the Group due to high production cost. Instead, the Group plans to commence the development of software for medical devices (such plan had not been stated in the Listing Prospectus) and continue to develop 3-dimensional laparoscope (such plan had been stated in the Listing Prospectus). As stated in the letter from the Board, the proceeds to be applied in this area will decrease from HK\$7.5 million to HK\$3.0 million. Given the fact that the continual sale of Neustim may adversely affect the Group's profit margin due to its high procurement cost and the failure of IP6 in obtaining the final approval from 國家藥品監督管理局 (the State Drug Administration of the PRC), we consider the termination of developing IP6 and Neustim, commencement of developing software for medical devices and the continuance of developing 3-dimensional laparoscope to be acceptable so far as the Independent Shareholders are concerned.

(iv) Research, development and production of medical testing instruments

Research and development of medical testing instruments is another new area of business focus of the Group under the revised business plans and is not stated in the original business plan in the Listing Prospectus. During the nine months ending 31 December 2003, the Group plans to continue to produce biochemistry analyser, to obtain license for production of and commence production of coagulometer and immune analysers. According to the revised business plans, the Group plans to establish a new factory for manufacturing medical testing instruments, and the production of medical testing instruments in the new factory is scheduled to be commenced by end of Year 2003. As advised by the Directors, the Company currently has four small production units located in Nanjing, the PRC for manufacturing of medical testing instruments. The Directors are of the view that the consolidation of these small production units and establishment of a new factory would enable the Group to enjoy economies of scale and reduce the logistic costs.

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As advised by the Directors, Sino-Innova Medical Science & Technology Company Limited, a subsidiary of the Company, is responsible for the Group's business of manufacturing and sales of medical equipment and most of the directors and management members of which have over 10 years' experience in the areas of manufacturing and sales of medical equipment.

Since the research and development of medical testing instruments, being the existing business of the Group, do not have significant impact by the new distribution policy of Boston Scientific, we consider that the continuance in developing medical testing instruments and, in long run, the establishment of a new factory for manufacturing medical testing instruments are in line with the principal business of the Group.

(v) *Establishment of cancer treatment centres*

The Directors advised us that, according to its original business plan, the Group intended to establish cancer treatment centres of small-to-medium size which required approximately RMB38.55 million for establishment of two cancer treatment centres as stated in the Listing Prospectus. However, as a result of the rapid growth of the medical industry in the PRC, the Directors envisaged that, in order to maintain its competitiveness, the Group has to establish cancer treatment centre in a medium-to-large scale, and therefore immense capital is required.

As stated in the annual report of the Company for the year ended 31 December 2002, after repeat assertion and investigation, the Group considered that it was not an appropriate time to inject a huge sum of money to establish this kind of treatment centre. It was also stated that the reason was because the Group had to invest an enormous amount of capital, acquire a considerable amount of equipment and fixed assets before the treatment centres could be established and from the findings of the said assertion and investigation, the amount required to be invested is much more than originally planned. The Group, on an overall basis, considered that the return from investment was not impressive and the project involved high risk. As a result, in order to be responsible to the shareholders of the Company, the Group suspended this project subject to further development in the future. As advised by the Directors, unlike the operation of the RFAS treatment centres which are functional units within the Contracted Hospitals, the cancer treatment centres are supposed to be independently operated like a specialised clinics/hospitals.

According to an article on the website of 中華工商時報 (www.cbt.com.cn), hospitals and medical clinics in the PRC have been expanding in terms of size. In addition, according to information stated in the articles on various websites, including 新華日報 (www.xhby.net), 市場信息報 (www.scxxb.com.cn) and 新華網 (www.xinhuanet.com), there were privately owned hospitals or foreign-owned hospitals in various areas/cities in the PRC, including Shanghai, Nanjing, Ningbo and Zhejiang

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Province, which require investment of over RMB100 million. Based on the above, the Directors estimated that the capital requirement for establishing medium-to-large scale cancer treatment centres would be well above the amount originally planned. Having discussed with the Directors and based on the above findings, we consider that, should the cancer treatment centres be established, the Group might be required to invest over RMB100 million for each cancer treatment centre in order to compete favourably in the market. Taking into account the immense capital requirement and the cash position of the Group (being cash and cash equivalent and deposits with banks, in aggregate, of approximately HK\$107.22 million as at 31 December 2002), we are of the view that the investment of over RMB200 million for establishing two cancer treatment centres will expose the Group to high business risk and it may not be justifiable for the Group to proceed with such plan.

Based on the fact that, as a result of the new distribution policy of Boston Scientific that it would not supply the RTC products to the Group and the possible direct purchase of the RTC products by the Contracted Hospital from Boston Scientific, (i) the largest income source of the Group, namely the medical service fees by sharing profit of the RFAS treatment centres, may decrease in future; (ii) the Group will lose all the turnover and profits attributable to the sales of LeVein Electrodes and the electric plates, being the second largest income source of the Group, in the future, and the total turnover and profits of the Group will be materially affected; (iii) despite the possible development of electrodes and electric plates for the RFAS treatment by the Group in future, there is no immediate substitute to the RTC products; (iv) the demand of anti-cancer or ancillary anti-cancer drugs can be huge and the 16 drugs which may be developed from the 16 medicine research projects acquired by the Group may have market potential (details of the market statistics regarding cancer cases in the PRC are set out in the sub-paragraph headed “(iv) Drugs and medical testing instruments businesses” under the paragraph headed “C. Revised use of proceeds from the IPO and the Top-Up Placing” in this letter), we concur with the Directors’ view that the expansion of the Group’s business to research and development and distribution of drugs and medical testing instruments in addition to the operation of RFAS treatment centres by re-formulating the Group’s business plans is in the interest of the Company and its shareholders as a whole.

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C. Revised use of proceeds from the IPO and the Top-up Placing

The following table summarises the change in the proposed use of proceeds from the IPO and the Top-up Placing under the revised business plans:

Business plans	Actual amount used during the period from 15 December 2001 to 31 March 2003 (HK\$ million)	Original plan for the balance of the net proceeds from the IPO and the Top-up Placing (HK\$ million)	Revised plan for the balance of the net proceeds from the IPO and the Top-up Placing (HK\$ million)
Continual development of the network of hospitals in the PRC for RFAS	8.00	17.35	3.60
Promotion of application of RFAS and establishment of RFAS training centres	0.80	3.70	2.40
Development of the market for 3-dimensional laparoscope and assisting in the sales of anti-cancer drugs	1.50	7.50	3.00
Establishment of cancer treatment centres	–	39.90	–
Working capital			
– RFAS related business	–	0.22	2.17
– factories of new drugs and medical testing instruments	–	–	4.00
Promotion of new drugs	–	–	4.00
Remaining proceeds applied to other areas of the revised business plans			
– electrodes and electric plates for use in RFAS related businesses	–	–	6.00
– distribution of ancillary anti-cancer medicine	–	–	9.00
– 16 drugs and related businesses			
1. research and development of drugs	–	–	4.50
2. establishment of factory for production of drugs	–	–	12.50
– medical testing instruments businesses			
1. development of software for medical devices	–	–	4.50
2. research and development of medical testing instruments	–	–	5.00
3. establishment of factory for production of medical testing instruments	–	–	5.00
4. production of medical testing instruments	–	–	3.00
Total	10.30	68.67	68.67

Further details of the comparison of the original proposed use of the proceeds from the IPO and the Top-up Placing and the proposed use of proceeds under the revised business plans are set out in the letter from the Board in the Circular.

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(i) *RFAS related business*

As stated in the Listing Prospectus, although the Contracted Hospitals have no right to terminate the cooperation contracts within the contracted period, the terms of the contracts with the Contracted Hospitals range from 4 to 15 years and will end at different times starting from 2004 in the event that the Contracted Hospitals do not extend the contracts. The Directors expect that the future operating income of the Group will be substantially dependent on the renewal of such contracts with the hospitals. We consider that, as a result of the new distribution policy of Boston Scientific that it would not supply the RTC products to the Group and the possible direct purchase of the RTC products by the Contracted Hospital from Boston Scientific, uncertainties arise as to whether the Group could renew the cooperation contracts or enter into new contracts with similar terms and conditions with the hospitals in the PRC and, accordingly, if the Group fails to do so, the medical service fees by sharing profit of the RFAS treatment, being the largest income source of the Group, may decrease in future.

Given the aforementioned limitations, we understand from the Directors that they would rather take a prudent approach with respect to RFAS related business by reducing the financing thereof from approximately HK\$21.27 million to HK\$14.17 million and shift its resources to develop other areas of business with growth potential, in this case the drugs and medical testing instruments businesses (further discussion in this regard are set out in the sub-paragraph headed “(iv) Drugs and medical instruments businesses” below).

(ii) *Development of the 3-dimensional laparoscope and sale of anti-cancer drugs*

As discussed with the Directors, due to the failure of IP6 to obtain the final approval from 國家藥品監督管理局 (the State Drug Administration of the PRC) and the failure of the manufacturer of Neustim to supply Neustim at a price acceptable to the Group, the proceeds for use in the development of the market for 3-dimensional laparoscope and assisting in the sales of anti-cancer drugs is proposed to be reduced. We consider that this is a logical move and corresponds to the actual development of the Group’s business.

(iii) *Establishment of cancer treatment centres*

We understand from the Directors that one of the major resources originally scheduled for the establishment of cancer treatment centres has been abolished since, after continuous feasibility studies held by the Company, the establishment of the cancer treatment centres is considered to be a capital intensive investment and of inherent high risk and such amount of proceeds have been shifted to mainly apply for the drugs and medical testing instruments businesses. Given that none of the proceeds from the IPO and the Top-up Placing have been applied for the establishment of cancer treatment centres thus far and the establishment of cancer treatment centres requires immense capital, we consider that it is justifiable for the Group to temporarily suspend the cancer treatment centres project and to shift the resources to finance other business opportunities.

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(iv) Drugs and medical testing instruments businesses

Having said that, we note that a substantial amount of the proceeds from the IPO and the Top-up Placing of approximately HK\$51.5 million will be mainly applied for the drugs and medical testing instruments businesses and we consider that this corresponds to the revised business plan and enables the Group to possibly derive a new source of income in future. The Directors advised us that no revenue has been derived from sale of drugs by the Group thus far but the Group recorded an unaudited turnover from sale of medical testing instruments of, according to the first quarterly report of the Company for the Three-month Period, approximately HK\$923,000 during the Three-Month Period and, according to its management accounts for the five months ended 31 May 2003, approximately RMB\$2.12 million (or approximately HK\$2 million) for the five months ended 31 May 2003. According to China Health Statistical Yearbook 2003 (2003年中國衛生統計提要) released by the Ministry of Health, the PRC, the number of various medical instruments in hospitals in the PRC, including electrocardiograph, ultrasound cardiograph, brightness modulation ultrasonoscope, color dopple ultrasonoscope, X-ray unit, CT, MRI, cardiac monitor, hemodialysis machine, ophthalmic unit, operating microscope, electric dental chair and delivery monitor, increased from 150,851 in 1996 to 229,952 in 2001. Based on the aforementioned figures, we consider that the market for the Group's medical testing instruments is of growth potential.

In respect of the demand for anti-cancer drugs in the PRC, we have looked up the statistics from the International Agency for Research on Cancer ("IARC"), part of the World Health Organisation, which showed number of deaths caused by cancer of all kinds in the PRC (including both urban and rural areas) during the years from 1988 to 1998. Based on the information available from IARC, the number of deaths caused by cancer in the PRC were 106,443, 133,001, 140,109 in 1988, 1993 and 1998 respectively. As stated in the article published by the World Health Organisation on 15 May 2003, the global burden of cancer was on the increase and ten million people developed a malignant tumour in 2000. It is further stated that with the unfortunate trends of increases in unhealthy lifestyles and tobacco use, the number of new cases will rise by half by 2020 to 15 million new cancer cases per year. It is stated that due to evidence collected through research, with existing tools and knowledge, one third of cancers can be prevented and when there are sufficient resources, one third can be detected and treated. Based on the above, we consider that, in light of the fact that the new cancer cases are on the increase, the market for anti-cancer drugs is of growth potential. As stated in the circular dated 8 January 2003 issued by the Company and the letter of recommendation from the Dean of School of Pharmacy of Fudan University, the Dean of School of Pharmacy of Fudan University of the PRC had reviewed the 16 medicine research projects and formed the view that such projects had good prospects because most of the drugs that may be developed from such projects were anti-cancer in nature and there appeared a significant growth in the interest in Chinese herbal medicine recently.

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As such, we consider that it is a logical move for the Group to diversify its businesses into anti-cancer drugs and medical testing instrument businesses before any possible deterioration of earnings from RFAS related business as a result of the Notice Letter.

D. Other areas for the attention of the Company's shareholders

We would like to draw the attention of the Company's shareholders that the development of the Group's drugs and medical testing instruments involves certain level of commercial risks, including:

- (i) *Unproven track record of the drugs and medical testing instruments to be developed by the Group*

The 16 drugs related to the 16 medicine research projects and the medical testing instruments to be developed by the Group are commercially unproven. Since none of the 16 drugs and only two of the medical testing instruments have been started commercial sales in the first quarter of 2003 (it recorded a turnover of HK\$923,000 during the Three-month Period), the Group cannot assure that the research and development of the 16 drugs and the development of medical testing instruments will succeed or can be commercialised in an efficient and timely manner. The development of Group's products is subject to the risks of failure inherent in the development of any products based on new technologies and any regulatory approvals to be obtained from the relevant authorities, and therefore, the successful development of the Group's products is uncertain.

- (ii) *Possible delay or failure in development of the Group's products resulting from lengthy and expensive testing process*

Most of the Group's products (in particular, the 16 drugs related to the 16 medicine research projects) are at an early stage of research and development. Proofs of efficacy and safety through pre-field trial testing and field trials are necessary before commencement of commercial sale of these products. As advised by the Directors, the clinical trial of a drug takes about 18 to 24 months (under an optimistic scenario) before it proceeds to commercialise for sale. The Directors also advised us that such length of time could be several years or more (under a pessimistic scenario) depending on the testing results, the prospects and the investment in the research project that the Company evaluates from time to time. Therefore, conducting field trials can be a lengthy, time-consuming and expensive process, particularly for pharmaceutical products. The length of time may vary substantially according to the degree of regulation, type, complexity, novelty and intended use of the products, and can often be several years or more. Additional and unbudgeted operating expenses may be incurred during delays in conduction of pre-field trial tests or field trials. The commencement and completion of field trials may be delayed by many factors, including inadequate or inconclusive results and government or regulatory delays or changes in policy or requirements.

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The Group may also, based on the results of the field trials, decide to discontinue the development of any products at any time and therefore, there is no assurance that the Group's products, which are under development, will proceed through their trial phase in a timely manner.

(iii) Uncertainty in the market acceptance for the Group's products

Even if the Group's products can demonstrate statistically sufficient levels of safety and efficacy and all regulatory approvals and patents have been obtained, the Group's products may not gain market acceptance, which may adversely affect their respective sales volumes and selling prices. The degree of market acceptance of the Group's products will depend on publicly establishing and demonstrating the efficacy and safety, especially as compared to other products with similar functions; cost effectiveness and the costs of switching products; competitive performance against alternative products or treatments; and marketing and distribution support for the Group's products.

(iv) Permit for manufacturing of the Group's medical testing instruments

The Directors advised us that as a pre-requisite for carrying on the manufacturing of medical testing instruments in the PRC, the Group is required to obtain a production permit (醫療器械生產企業許可証) from the relevant government authority. The production permit of the Group in this regard has been obtained on 24 December, 2002 and such permit will be expired on 24 December 2007. In the event that the Group could not renew such permit upon expiry, its operation will be adversely affected.

RECOMMENDATION

Despite the fact that the Proposed Changes will involve certain commercial risks as detailed in the above paragraph headed "D. Other areas for the attention of the Company's shareholders", we, having taken into account the above factors and reasons, consider that the Proposed Changes are in the interest of the Company and the shareholders of the Company as a whole. Accordingly, we recommend the Independent Board Committee to advise the Independent Shareholders to vote at the Special General Meeting in favour of the resolution being proposed to approve the Proposed Changes.

Yours faithfully,

For and on behalf of

Dao Heng Securities Limited

Stella Fung

Executive Director and General Manager

Venus Choi

Executive Director

1. RESPONSIBILITY STATEMENT

This circular, for which the Directors collectively and individually accept full responsibility, includes particulars given in compliance with the GEM Listing Rules for the purpose of giving information with regard to the Group. The Directors, having made all reasonable enquiries, confirm that, to the best of their knowledge and belief:

- (a) the information contained in this circular is accurate and complete in all material respects and is not misleading;
- (b) there are no other facts the omission of which would make any statement in this circular misleading; and
- (c) all opinions expressed in this circular have been arrived at after due and careful consideration and are founded on bases and assumptions that are fair and reasonable.

2. DISCLOSURE OF INTERESTS

As at the Latest Practicable Date, the relevant interests or short positions of the Directors and chief executive of the Company in the shares, underlying shares and debentures of the Company or its associated corporations (within the meaning of Part XV of the SFO) which:

- (a) are required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which he is taken or deemed to have under such provisions of the SFO); or
- (b) are required pursuant to section 352 of the SFO, to be entered in the register referred to therein; or

- (c) are required, pursuant to rules 5.40 to 5.58 of the GEM Listing Rules relating to securities transactions by Directors to be notified to the Company and the Stock Exchange;

are as follows:

Name	Number of Shares held	Nature of interests	Percentage of interest
Dr. Li Nga Kuk, James	32,800,000	Personal	3.93%
Mr. Li Wo Hing	32,800,000 212,320,000	Personal Corporate (<i>Note 1</i>)	3.93% 25.43%
Mr. Ng Kwai Sang	32,800,000 212,320,000	Personal Corporate (<i>Notes 1 & 2</i>)	3.93% 25.43%
Mr. Li Tai To, Titus	16,400,000	Personal	1.96%
Mr. Chan Siu Sun	32,800,000	Personal	3.93%

Notes:

1. By a letter of undertaking dated 14 December 2001, Mr. Ng Kwai Sang undertook to grant a right of first refusal to Mr. Li Wo Hing regarding his 5% shareholding in the share capital of People Market Management Limited (“PMM”), which is in turn owned as to 28.57% by Mr. Li Wo Hing. Therefore, Mr. Li Wo Hing is deemed to be interested in 212,320,000 Shares held directly by PMM.
2. 212,320,000 Shares are owned by PMM, which is in turn owned as to 35.71% by Mr. Ng Kwai Sang.

Save as disclosed above, as at the Latest Practicable Date, none of the Directors and chief executive of the Company had any other interests or short positions in the shares, underlying shares and debentures of the Company or its associated corporations (within the meaning of Part XV of the SFO) which are required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which he is taken or deemed to have under such provisions of the SFO) or were required pursuant to section 352 of the SFO, to be entered in the register referred to therein or were required, pursuant to rules 5.40 to 5.58 of the GEM Listing Rules relating to securities transactions by Directors to be notified to the Company and the Stock Exchange.

As at the Latest Practicable Date, so far as is known to any Director or chief executive of the Company, the following persons (other than a Director or chief executive of the Company) 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 expected, directly or indirectly, to be interested in 10 per cent. or

more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of any member of the Group, and set out below are also details of the amount of each of such person's interest in such securities, together with particulars of any options in respect of such capital:

(a) **Interest in the Company**

Name of shareholder	Number of Shares held	Percentage of interests
1. PMM (<i>Note</i>)	212,320,000	25.43%
2. China Equity Associates L.P.	116,720,000	13.98%

Note: As at the Latest Practicable Date, PMM owned 212,320,000 Shares, representing approximately 25.43% of the issued share capital of the Company. The issued share capital of PMM is owned as to 35.71% by Mr. Ng Kwai Sang, as to 28.57% by Mr. Li Wo Hing, as to 17.86% by Dr. Li Nga Kuk, James, as to 8.93% by Mr. Li Tai To, Titus and as to 8.93% by Mr. Li Yue Erh.

(b) **Interest in Believe Investments Limited (*Note*)**

Name of shareholder	Number of BVI Shares held	Percentage of interests
Guo Ping	1	100%

Note: After completion of the acquisition of the 16 medical technologies research and development projects and the results, interests, approvals and intellectual property rights relating to such projects ("Medical Research Projects") by the Group, the Company will enter into certain transactions ("Reorganisation"), upon completion of which Believe Investments Limited will become a subsidiary of the Company.

(c) **Interest in 南京神州佳美藥物研究有限公司 (China Best Drugs Research (Nanjing) Limited)**

Name of holders of equity interest of the registered capital	Percentage of interests
1. Believe Investments Limited (<i>Note 1</i>)	100%
2. Guo Ping (<i>Note 2</i>)	25%

Notes:

- On completion of the Reorganisation, Believe Investments Limited will hold 100% of the equity interest of the registered capital of the 南京神州佳美藥物研究有限公司 (China Best Drugs Research (Nanjing) Limited).

2. As Ms. Guo Ping will hold 25% interest in Believe Investments Limited after completion of the Reorganisation, she will then be indirectly interested in the equity interest of the registered capital of the 南京神州佳美藥物研究有限公司 (China Best Drugs Research (Nanjing) Limited).

Save as disclosed above, as at the Latest Practicable Date, so far as is known to any Director or chief executive of the Company, no other person (other than a Director or chief executive of the Company) 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 expected, directly or indirectly, to be interested in 10 per cent. or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of any member of the Group.

3. INTERESTS OF THE SPONSOR

Pursuant to the agreement dated 18 December 2001 entered into between the Company, and Celestial Capital Limited, Celestial Capital Limited has received and will receive a fee for acting as the sponsor of the Company for the period commencing from 31 December 2001 and ending on 31 December 2003.

As updated by Celestial Capital Limited, as at the Latest Practicable Date, neither Celestial Capital Limited nor its directors or employees or associates (as referred to in note 3 to Rule 6.35 of the GEM Listing Rules) has any interests in the Shares, including options or rights to subscribe for any Shares.

4. COMPETING INTERESTS

As at the Latest Practicable Date, so far as the Directors are aware of, none of themselves or the management shareholders of the Company or their respective associates had any interests in a business which competes or may compete with the business of the Group, or had any interests which conflicted with those of the Group.

5. LITIGATION

As at the Latest Practicable Date, no member of the Group was engaged in any litigation or claims of material importance and no litigation or claim of material importance is known to the Directors to be pending or threatened against any member of the Group.

6. SERVICE CONTRACTS

Each of Ng Kwai Sang, Li Wo Hing, Dr. Li Nga Kuk, James, Li Tai To, Titus, Chan Siu Sun and Chan Shut Li, William, being all the executive Directors, has entered into a service contract with the Group. Particulars of these agreements are set out below:

Each service contract is for an initial period of three years commencing on 1 December 2001, and will continue thereafter unless and until, after the expiry of the first year of service, terminated by either party by serving not less than three months' prior written notice or by payment of three months' salary in lieu of such notice. Each of the executive Directors shall be entitled to an annual salary of HK\$330,000 (subject to an annual increment at the discretion of the Directors of not more than 20% of his or her then monthly salary).

Moreover, each of the executive Directors, for each completed year of service, is entitled to (i) a fixed bonus of an amount equivalent to one month's salary and (ii) a discretionary bonus of such amount to be determined by the Board at its sole discretion, provided that the aggregate amount of such discretionary bonuses payable to all executive Directors in any financial year shall not exceed 8% of the consolidated net profits of the Group before taxation and minority interests and before exceptional and extraordinary items of the Company as shown in the consolidated audited accounts of the Company for such financial year.

An executive Director may not vote on any resolution regarding a review of his salary or the amount of any bonus payable to him.

Save as disclosed above, none of the Directors has or is proposed to have a service contract with any member of the Group (other than contracts expiring or determinable by the employer within one year without the payment of compensation other than statutory compensation).

7. CONSENTS

Dao Heng Securities Limited has given and has not withdrawn its written consent to the issue of this circular with the inclusion of its letter or reference to its name, as the case may be, in the form and context in which they respectively appear.

8. EXPERT

The following is the qualification of the expert who has given opinion or advice which are contained in this circular:

Name	Qualification
Dao Heng Securities Limited	a deemed licensed corporation under the SFO

As at the Latest Practicable Date, Dao Heng Securities Limited was not interested in the share capital of any member of the Group nor did it has any right (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for securities in any member of the Group.

9. GENERAL

- (a) The head office and principal place of business of the Company is at Office B on 21st Floor, Teda Building, 87 Wing Lok Street, Hong Kong. The registered office of the Company is at Cedar House, 41 Cedar Avenue, Hamilton HM 12, Bermuda. The Hong Kong branch share registrar and transfer office of the Company is Computershare Hong Kong Investor Services Limited at 17/F, Hopewell Centre, 183 Queen's Road East, Hong Kong.
- (b) The compliance officer of the Company is Mr. Li Wo Hing, MBA, an executive Director.
- (c) The company secretary of the Company is Mr. Wong Hon Sum. Mr. Wong is fellow member of the Hong Kong Society of Accountants.
- (d) The qualified accountant of the Company is Mr. Ling Chun Kwok, Alfred. Mr. Ling is an associate member of the Hong Kong Society of Accountants and a member of the Association of Chartered Certified Accountants.
- (e) The Company has established an audit committee on 14 December 2001 with written terms of reference in compliance with Rules 5.23 to 5.24 of the GEM Listing Rules. The primary duties of the audit committee are to review and supervise the financial reporting process and internal control systems of the Group. The audit committee has three members comprising Mr. Fan Wan Tat, Mr. Guo Guoqing and Mr. Han K. Huang. Mr. Fan Wan Tat is the chairman of the audit committee.

Mr. Han K. Huang is a professor of School of Medicine University of Southern California, the United States of America and the chair professor of Medical Informatics Department of Optometry and Radiography, The Hong Kong Polytechnic University.

Mr. Fan Wan Tat is a medical doctor in Hong Kong.

Mr. Guo Guoqing is the president of Commercial College, Zhongguo Renmin University.

- (f) The English text of this circular shall prevail over the Chinese text.

NOTICE OF SPECIAL GENERAL MEETING



MEDICAL CHINA LIMITED

神州醫療科技有限公司*

(Incorporated in Bermuda with limited liability)

NOTICE IS HEREBY GIVEN that the Special General Meeting (“SGM”) of Medical China Limited (the “Company”) will be held at 8th Floor, Teda Building, 87 Wing Lok Street, Hong Kong on 25 July 2003 at 9:30 a.m. for the purpose of considering and, if thought fit, passing the following resolution as an ordinary resolution:

ORDINARY RESOLUTION

“**THAT** the change in business plans and use of unused net proceeds from the initial public offering of the Company in December 2001 and the top-up placing of the Company’s shares set out in the Company’s circular dated 13 August 2002 (which change has been set out in the statement marked “Change in business plans and use of proceeds” and is tabled at the meeting and initiated by the Chairman of the meeting for the purpose of identification) proposed by the board of directors of the Company be and is hereby ratified, approved and confirmed.”

By order of the Board
Medical China Limited
Li Wo Hing
Director

Hong Kong, 7 July 2003

Registered office:
Cedar House
41 Cedar Avenue
Hamilton HM12
Bermuda

*Head office and Principal place
of business in Hong Kong:*
Office B, 21st Floor
Teda Building
87 Wing Lok Street
Hong Kong

* *For identification only*

NOTICE OF SPECIAL GENERAL MEETING

Notes:

1. A proxy form to be used for the meeting is enclosed.
2. Any member entitled to attend and vote at a meeting of the Company shall be entitled to appoint another person as his proxy to attend and vote instead of him. A member who is the holder of two or more shares may appoint more than one proxy to represent him and vote on his behalf at a general meeting of the Company or at a class meeting. A proxy need not be a member. In addition, a proxy or proxies representing either a member who is an individual or a member which is a corporation shall be entitled to exercise the same powers on behalf of the member which he or they represent as such member could exercise.
3. The instrument appointing a proxy shall be in writing under the hand of the appointor or of his attorney duly authorised in writing, or, if the appointor is a corporation, either under its seal or under the hand of an officer, attorney or other person authorised to sign the same. In the case of an instrument of proxy purporting to be signed on behalf of a corporation by an officer thereof it shall be assumed, unless the contrary appears, that such officer was duly authorised to sign such instrument of proxy on behalf of the corporation without further evidence of the facts.
4. The instrument appointing a proxy and (if required by the Board) the power of attorney or other authority (if any) under which it is signed, or a certified copy of such power or authority, shall be delivered to the Company's registrar in Hong Kong, Computershare Hong Kong Investor Services Limited, Rooms 1901-5, 19th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong not less than forty-eight (48) hours before the time appointed for holding the meeting.
5. Where there are joint holders of any share any one of such joint holder may vote, either in person or by proxy, in respect of such share as if he was solely entitled thereto, but if more than one of such joint holders be present at any meeting the vote of the senior who tenders a vote, whether in person or by proxy, shall be accepted to the exclusion of the votes of the other joint holders, and for this purpose seniority shall be determined by the order in which the names stand in the register in respect of the joint holding.