> *"Things that look too good to be true usually are."*
>
> ***— Old Proverb***

THIS RESEARCH REPORT EXPRESSES SOLELY OUR OPINIONS. We are short sellers. We are biased. So are long investors. So is CMS. So are the banks that raised money for the Company. If you are invested (either long or short) in CMS, so are you. Just because we are biased does not mean that we are wrong. Use BOC Texas, LLC's research opinions at your own risk. This report and its contents are not intended to be and do not constitute or contain any financial product advice. Investors should seek their own financial, legal and tax advice in respect of any decision regarding any securities discussed herein. You should do your own research and due diligence before making any investment decisions, including with respect to the securities discussed herein. We have a short interest in CMS' stock and therefore stand to realize significant gains in the event that the price of such instrument declines. Please refer to our full disclaimer located on the last page of this report.

COMPANY: China Medical System Holdings Ltd. | HK: 867
INDUSTRY: Pharmaceutical Promotion and Distribution

PRICE (AS OF CLOSE 02/05/2020)
HKD 10.40

MARKET CAP
HKD 26 BILLION

30 DAY AVG VOLUME
7 MM SHARES

BLUE ORCA VALUATION
HKD 3.95

China Medical System Holdings Ltd. (HK: 867) ("CMS" or the "Company") is a Hong Kong-listed pharmaceutical contract sales organization (CSO) in China. Sandwiched on the value chain between foreign drug companies which develop valuable intellectual property and Chinese distributors which sell directly to hospitals; CMS generates revenues primarily from in-licensing drugs for re-sale to distributors, and also from related promotional activities.

Despite a precarious position on the value chain and strong headwinds from policy changes in China to suppress drug prices, CMS has reported unusually robust and improving profitability (70%+ gross margins in 2018). **We think such profitability is an illusion.**

Our extensive investigation found CMS disclosures to A-share securities regulators in China which indicate that the Company's net profit is significantly less than reported to investors. We believe, in order to conceal such fake profitability, that CMS has concocted a phantom Malaysian tax benefit despite almost no evidence of any material assets in, or shipments through, Malaysia.

We also found a rotten pattern of undisclosed self-dealing. Chinese FDA records indicate that contrary to the Company's claims, CMS appears to be secretly funding research expenses for the chairman's private companies. Evidence shows that the chairman's private businesses are co-located at CMS facilities, use CMS staff, use CMS email addresses, and use Company resources to invest for his personal benefit in biotechnology startups. We believe that through this rotten self-dealing, the chairman siphons ever-shrinking profits away from the struggling business.

In our opinion, the evidence suggests that the Company exaggerates its financial performance, inflates profits and conceals that dwindling Company profits are used to privately enrich its chairman. If we value the Company on the profits CMS discloses to Chinese authorities and apply a modest 25% corporate governance discount to its P/E multiple, we value CMS at HKD 3.95 per share, a 62% downside from its current price. Yet given overwhelming evidence suggesting that CMS misleads investors, we believe that CMS is simply uninvestable.

1. **CMS' Filings in China Indicate Net Profit is 49% Less than Reported**. According to two independent data points reported by CMS to Chinese authorities, the Company is significantly less profitable than it claims to investors. First, in an A-share circular submitted to Chinese securities regulators in connection with a recent acquisition, CMS disclosed audited financials of its PRC subsidiaries which showed that the Company's net profits were 41% less than reported to investors in 2016. Since then, evidence indicates that the profit exaggeration has only gotten worse. SAIC filings corroborate the A-share disclosure and show that aggregate net profits at CMS' subsidiaries in the PRC were **49% less than reported from 2016-2018**. Based on CMS' disclosures, the Company does not generate remotely sufficient offshore revenue or profits outside of China to explain the discrepancy. Rather, in our opinion, such evidence indicates unambiguously that CMS is much less profitable than it claims.

2. **Phantom Malaysian Tax Benefit**. Much like China Metal Recycling (HK: 773), delisted for misrepresenting its financial performance after we alerted the market to its fraud, CMS claims an unusually low effective tax rate (~8%); supposedly because of a massive tax benefit which the Company claims to earn in Malaysia. According to CMS disclosures, it saved RMB 299 million in taxes in 2018 through its Malaysian subsidiary, CMS Pharma. For its claimed tax benefit to be true, CMS had to generate RMB 1.2 billion in pretax profit in Malaysia in 2018, 60% of the aggregate pre-tax profit generated by the whole Company that year. Yet evidence suggests that the Company's purported Malaysian tax benefit is likely bogus and, in our opinion, fabricated to conceal fake reported profits.

    a. **Malaysia Doesn't Ship Enough Drugs**. Befuddled by CMS' financials, sell side analysts have meekly suggested that perhaps the Company ships drugs through its lone Malaysian subsidiary. But according to UN export data, Malaysia **as a country does not ship enough drugs to China for this to be true**. Between 2016 and 2018, Malaysia as a country only exported USD 122 million (RMB 842 million) in drugs to China. This includes re-exports of drugs shipped through Malaysia from Europe to China. During the same period, CMS reported almost RMB 3 billion in pretax profit in Malaysia, which supposedly came from drug exports to China. Put simply, the total amount of Malaysian drug exports to China are not nearly large enough, even if all of them were shipped by CMS and generated 100% margin, to even remotely generate the profit necessary to justify CMS' mysterious Malaysian tax benefit. Moreover, customs records for shipments of CMS' primary drugs indicate that they are imported directly from European suppliers into China and not routed through Malaysia.

    b. **Malaysian IP Royalty is Also Insufficient**. Nor can intellectual property rights or royalties account for the tax benefit. In its Hong Kong filings, CMS disclosed the transfer of IP rights for only one drug to its Malaysian subsidiary, which accounted for just 4% of its 2018 revenues. This is not remotely large enough to generate profits sufficient to justify the claimed tax benefit. **More importantly, CMS admits that 99% of the Company's non-current assets, including intangible assets such as intellectual property rights, are held in China**. With 99% of its intellectual property assets located in the PRC, the Company cannot now claim that it parked any such IP in Malaysia.

Investors should ask themselves a simple question. If it were possible for Chinese drug distributors to save hundreds of millions in taxes each year by incorporating a lone Malaysian subsidiary, wouldn't this practice be widespread? CMS is a public company, meaning its tax strategies are widely known and available to its competitors. Any investor who believes CMS' disclosures should ask themselves why other Chinese drug distributors did not copy its tax structure, given that a simple incorporation could save hundreds of millions of yuan and 60% of its tax bill?

We think the evidence indicates, persuasively, that the Company has exaggerated its Malaysian tax benefit to conceal fake profits from PRC tax authorities. Further, such analysis also shows that CMS generates nowhere near enough profits offshore to resolve the discrepancy between the Company's claims and the lower profits reported in its A-share and SAIC filings.

3. **Chinese FDA Records Indicate that CMS Secretly Funds R&D Expenses for Chairman's Private Company**. CMS claims to have appointed the chairman's private research company, Kangzhe R&D, to conduct research (including clinical trials) on its compound CMS024. Yet records from China's drug trial database show that it is CMS, not Kangzhe R&D, which is conducting two of the three clinical trials for the drug. This indicates that contrary to Company claims, CMS is secretly funding research costs for the chairman's private entity. This is corroborated by local filings, which show that the **chairman's Kangzhe R&D had only one employee and zero operating expenses in 2018 –** confirming that this entity is not conducting research, but secretly passing such costs to the Company. This would be easy to do, as corporate records indicate that Kangzhe R&D is co-located at CMS facilities, employs CMS staff and even uses a CMS email address in registration documents. Ultimately, we believe there is overwhelming evidence that the Company secretly funds research supposedly conducted by the chairman's private business. Not only would this make CMS' disclosures false but is another example of many in which the chairman unjustly enriches himself at the expense of shareholders.

4. **Drug Development Pipeline: Rotten Conduit for Self-Dealing Transactions with Chairman**. In our opinion, CMS' drug development pipeline is a rotten conduit for undisclosed related party dealings with the chairman and

his privately-owned business, A&B (HK) Company Limited ("A&B Holdings"). Rather than engage in legitimate drug innovation, we believe that the chairman is using Company resources to support personal investments. We discovered at least **seven transactions or investments by A&B Holdings**, which is deeply problematic because:

- In multiple examples, the chairman inserted himself as a **middleman** in the Company's purchase of territorial distribution rights from drug companies, buying the rights himself only to sell them to CMS. As an unnecessary middleman, he presumably enriches himself at the Company's expense.
- In other instances, we discovered that drug developers partnering with CMS also **secretly issued equity to chairman**, suggesting that he is inappropriately leveraging CMS to invest privately in biotech startups.
- In many instances, **biotech startups** list CMS, not A&B Holdings, as the investor or counterparty, indicating that they believe to be partnering with the public Company, not the chairman's private vehicle. Yet, in many such cases, it is the chairman's A&B Holdings which receives the **valuable intellectual property**, board rights and shares.
- A&B Holdings is co-located at CMS facilities, lists CMS headquarters as its mailing address and even uses CMS' phone number and email address in its securities filings.
- Local filings show that A&B Holdings' lone Chinese subsidiary only has **one employee** and reported less than RMB 100,000 in operating expenses from 2016 through 2018. Without expenses or employees, there is no chance it conducts any research on its own. Rather, this suggests that its activities are conducted through CMS staff and likely funded, secretly, by the public Company.
- CMS executives are listed as the contact persons for A&B Holdings in investment contracts with biotech startups, indicating that Company employees are used by the chairman for his private benefit.
- In many instances, the drugs have failed, all but wiping out CMS' investment.

The following are just a few examples of this rotten pattern of self-dealing involving the chairman's A&B Holdings.

a. **Helius: Chairman Secretly Uses Company Resources to Support Failed Investment**. In October 2015, US listed biotech startup Helius Medical Technologies Group (Nasdaq: HSDT) ("Helius") announced a strategic investment by the chairman's A&B Holdings. In the contract disclosed by Helius in its SEC filings, A&B Holdings listed two CMS executives as its representatives and CMS' headquarters as its contact address. A&B Holdings even used an @cms email address in its notice provision. Obviously, if the chairman was investing on behalf of his private entity, CMS resources should not be used in the deal. In 2016, Helius **announced** that it transferred critical intellectual property rights to CMS, but the Company never reported the transfer, suggesting that such IP was transferred instead to the chairman's A&B Holdings. The investment in **Helius proved to be a disaster**. Yet before Helius' stock collapsed, the chairman sold his IP rights to the Company for an undisclosed sum, making it appear, in our opinion, that CMS was simply used to bail the chairman out of a failing investment.

b. **Faron: Chairman the Middleman in IP Rights Sale for Another Failed Investment**. In 2015, the chairman's A&B Holdings acquired 16% of the equity in Faron Pharmaceuticals, Ltd ("Faron"), a Finnish biotechnology company listed in London (LON: FARN), along with territorial distributions rights for Faron's drug in China. **11 days later, the chairman sold these rights to CMS for an undisclosed sum**. The Company claimed the deal was fair because the chairman would continue to bear research and development costs for the commercialization of the drug in China, but on Faron's website, it states that CMS (not the chairman's A&B Holdings) will bear further research costs, suggesting CMS **misled investors about this arrangement**. Faron's stock subsequently collapsed. In our opinion, the evidence clearly shows that CMS misled investors, and that the chairman unjustly enriched himself as an unnecessary middleman in the sale of distribution rights to the Company.

c. **Destiny Pharma**: **CMS Announcements Designed to Pump Chairman's Private Investment**. In 2017, CMS announced an equity investment and a distribution rights deal with Destiny Pharma, a biotech startup publicly trading on the AIM exchange in London (LN: DEST). Undisclosed by CMS, the chairman had previously invested in Destiny, and the Company's announcement of the deal looks like it was designed to pump Destiny's share price on the day of its IPO. Not only did the chairman front run CMS' investment, but the Company's investment was disastrous as Destiny's stock subsequently collapsed.

d. **The List Goes On and On…** We could fill a short novel of examples of inappropriate self-dealing. Other examples include Neurelis, in which the chairman front ran the Company's investment and was again an unnecessary middleman in the transfer of IP rights from the American biotech startup to the Company. In addition, CMS recently invested in three biotech startups (Acticor, Midatech, Blueberry), which undisclosed to CMS shareholders, also issued shares to the chairman's private entity, A&B Holdings. We think that the chairman, using a private entity staffed by CMS, is clearly leveraging the Company and its resources to unjustly enrich himself as a middleman and to extract equity from proposed Company partners.

VALUATION

In this report, we present evidence indicating that CMS substantially exaggerates its reported profits. Our due diligence of CMS disclosures in China, including local regulatory filings and financials filed with A-share securities regulators, indicates that the Company's net profit is 49% less than reported to investors.

Rather than supporting the Company's claims of rising profitability, which make no sense in the context of the government's efforts to suppress drug prices by removing middlemen like CMS from the distribution chain, the independent evidence indicates that the Company's profit overstatement is only increasing as it struggles under the weight of policy changes designed to undermine its business.

Source: CMS Annual Reports compared to A-share Filings and SAIC Filings

Help is not coming. Despite recent announcements hyping the purchase of licensing rights in China for certain generic drugs, CMS has rarely been successful in introducing new drugs to China which had not previously been granted approval. Since 2010, CMS has initiated import drug license (IDL) registration for a total of 13 drugs. As of December 31, 2018, none of the drugs have received their IDL approval and CMS has terminated the registration applications for 10 of the drugs.

A History of Failure: CMS IDL Applications Status

Drug/Product	Year Acquired	Current Status
Budenofalk (capsule)	2010	Undergoing application process for IDL
Budenofalk (foam aerosol)	2010	IDL registration terminated in 2017
L-lysine Aescinat	2011	IDL registration terminated in 2015*
Thiotriazolin	2011	IDL registration terminated in 2015*
Maltofer (Syrup)	2012	IDL registration terminated in 2018
Maltofer (Chewable Tablets)	2012	IDL registration terminated in 2018
Uro-Vaxom	2012	IDL registration terminated in 2016
Stimol	2013	IDL registration terminated in 2016
Ze 339	2013	Undergoing application process for IDL
Ze 450	2013	IDL registration terminated in 2017
Ze 440	2013	IDL registration terminated in 2017
Succinylated Gelatin Injection	2014	Undergoing application process for IDL
Succinylated Gelatin Electrolyte Injection	2014	IDL registration terminated in 2017

**CMS stopped disclosing the status update for L-lysine Asecinat and Thirotriazoline beginning in 2015.*
China FDA database did not show these two drugs have obtained IDL approvals
Source: CMS Annual Reports

The independent evidence indicates that the business is struggling and only getting worse. There is also a troubling pattern of undisclosed self-dealing. Chinese FDA records indicate that contrary to the Company's claims, CMS bears research and development costs for the chairman's private companies. We also found numerous instances in which the chairman uses CMS staff and resources to invest for personal benefit in biotech startups, acquiring rights which he then re-sells to CMS.

It is critical to note that local filings for the chairman's private entities show almost no employees and almost no operating expenses, meaning that the research and investment undertaken by these privately owned entities is likely done using CMS, Company employees and Company resources. Through this rotten self-dealing, we believe that the chairman siphons ever-shrinking profits away from the struggling business.

If we value the Company on the profits CMS discloses to Chinese authorities and apply a modest 25% corporate governance discount to its P/E multiple, we value CMS at HKD 3.95 per share, a 62% downside from its current price.

	1H 19 LTM
Reported net profit (RMB M)	2,062
% Adjustment	-49%
Adjusted net profit (RMB M)	1,044
Diluted EPS (RMB)	0.42
Diluted EPS (HKD)	0.47
P/E	11.3x
Corporate governance discount	25%
Adjusted P/E	8.5x
Blue Orca Valuation (HKD)	3.95
Last Traded Price (HKD)	10.40
Downside	**-62%**

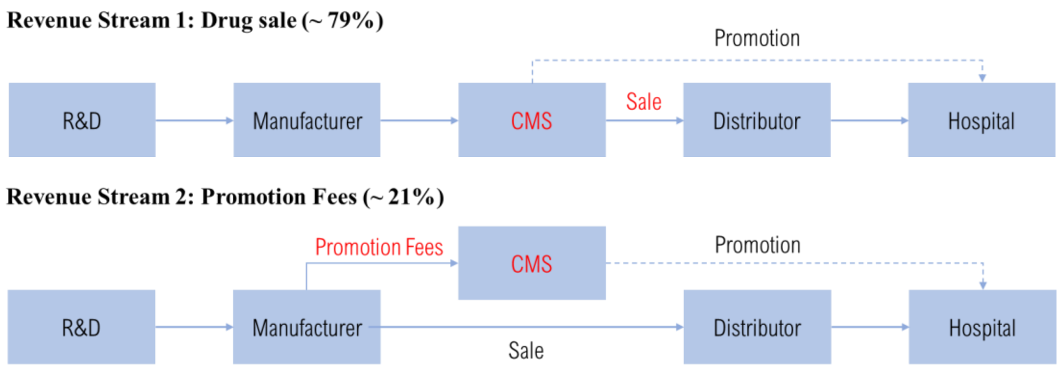
Source: Blue Orca Calculation

But even this valuation is likely far too charitable. In our opinion, the evidence suggests that the Company exaggerates its financial performance, inflates profits and conceals that dwindling Company profits are used to privately enrich its chairman. Given the overwhelming evidence suggesting that CMS misleads investors, we believe that CMS is simply uninvestable.

FAR DOWN THE VALUE CHAIN

China Medical System Holdings Ltd. (HK: 867) ("CMS" or the "Company") is a Hong Kong-listed pharmaceutical contract sales organization (CSO) in China. Sandwiched on the value chain between foreign drug companies which develop valuable intellectual property and Chinese distributors which sell directly to hospitals; CMS generates revenues primarily from in-licensing drugs for re-sale to distributors, and also from related promotional activities.

CMS Generates Revenue From Drug Re-sales and Promotion fees

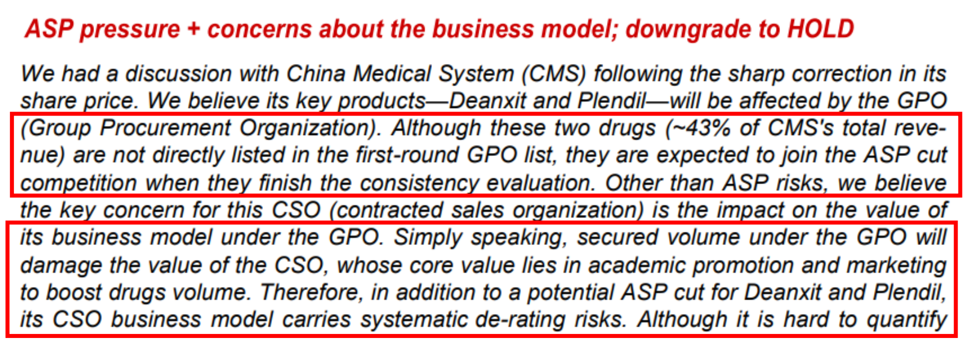


Source: CMS Public Filings

Two policy changes in China have negatively impacted the outlook for CMS' business. In 2017, China officially implemented the 2-invoice system, which allows only a single level of distributors for the sale of pharmaceutical products from manufacturers to hospitals. The purpose of this policy change was to eliminate multiple layers of drug distributors which provide little value but add cost. This directly targets CMS, as the Company sits between drug companies and distributors which sell directly to hospitals.

In 2018, to make matters worse, China launched a Group Purchasing Organization (GPO) in 11 cities, which aims to reduce drug costs via centralized procurement and to replace drugs on expired patents with generics. The first round of GPO reforms in December 2018 saw 70% - 90% ASP cuts for certain drugs.[1]

According to sell side analysts, two of CMS' key drugs – Deanxit and Plendil (combined 39% of 2018 total revenue) are expected to be directly impacted by this policy. Even normally sycophantic sell side analysts have noted the declining value of the Company's CSO business model: under the system of guaranteed purchase volume, there is less need for academic promotion and marketing to increase drug sales.



ASP pressure + concerns about the business model; downgrade to HOLD

We had a discussion with China Medical System (CMS) following the sharp correction in its share price. We believe its key products—Deanxit and Plendil—will be affected by the GPO (Group Procurement Organization). Although these two drugs (~43% of CMS's total revenue) are not directly listed in the first-round GPO list, they are expected to join the ASP cut competition when they finish the consistency evaluation. Other than ASP risks, we believe the key concern for this CSO (contracted sales organization) is the impact on the value of its business model under the GPO. Simply speaking, secured volume under the GPO will damage the value of the CSO, whose core value lies in academic promotion and marketing to boost drugs volume. Therefore, in addition to a potential ASP cut for Deanxit and Plendil, its CSO business model carries systematic de-rating risks. Although it is hard to quantify

Source: http://pdf.dfcfw.com/pdf/H3_AP201809171196647039_1.pdf

[1] China Galaxy International Research Report, December 2018
http://www.chinastock.com.hk/ewebeditor/uploadfile/20181208184240488.pdf

In addition to the two-invoice system and GPO, analysts expect further price cuts for CMS drugs. For example, a Credit Suisse research report noted that a 50% price cut for Xinhuosu (~ 6% of 2018 revenue) from the National Reimbursement Drug List (NRDL) re-negotiation, which will also negatively affect CMS' revenue.

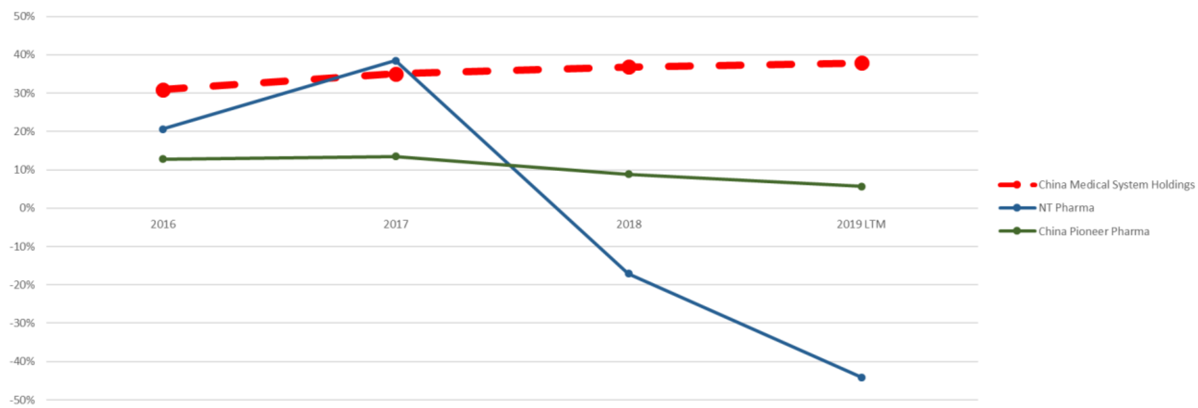
> On the other hand, further significant price cut from NRDL re-negotiation could be neutral or even negative to future sales because volume increase after a one-year NRDL inclusion would slow down and would not compensate for such a big price loss in our view. Therefore we think the ~50% price cut for Puyouke (Tasly) and XinHuoSu (CMS) during NRDL re-negotiation could drag down their 2020 sales.

Source: Credit Suisse Research Report, Jan 14, 2020

Yet despite its precarious position in the value chain and policy changes that negatively affect its business model, CMS has reported fantastic ***and increasing profitability***. According to the Company, its reported EBIT margin increased from 31% in 2016, to 38% in 2018.

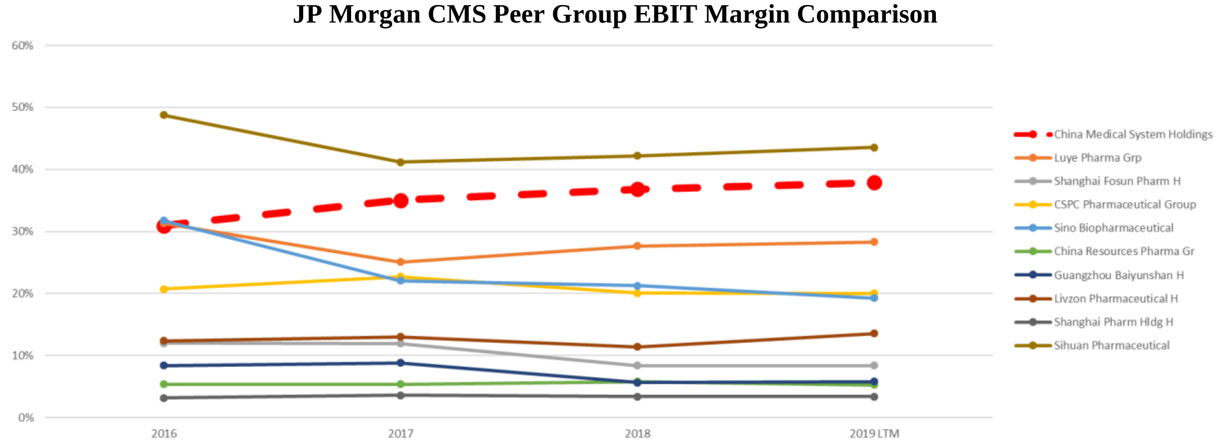
This presents a mystery. How can CMS' profits **increase** when policy changes in China are directly suppressing prices and undercutting the value of its promotional networks through the use of group purchasing orders? Other drug distributors and promoters have seen profits decline – why don't the laws of gravity apply to CMS?

Chinese CSO Companies EBIT Margin Comparison



Source: FactSet

JP Morgan CMS Peer Group EBIT Margin Comparison



Source: FactSet, JP Morgan Research Note

We think CMS' financial performance appears too good to be true because it is. Our extensive investigation indicates not only that things are bad, but they are getting worse; and that the Company's profit overstatement is only increasing as it struggles under the weight of policy changes designed to undermine its business.

CMS' FILINGS IN CHINA INDICATE NET PROFIT 49% LESS THAN REPORTED

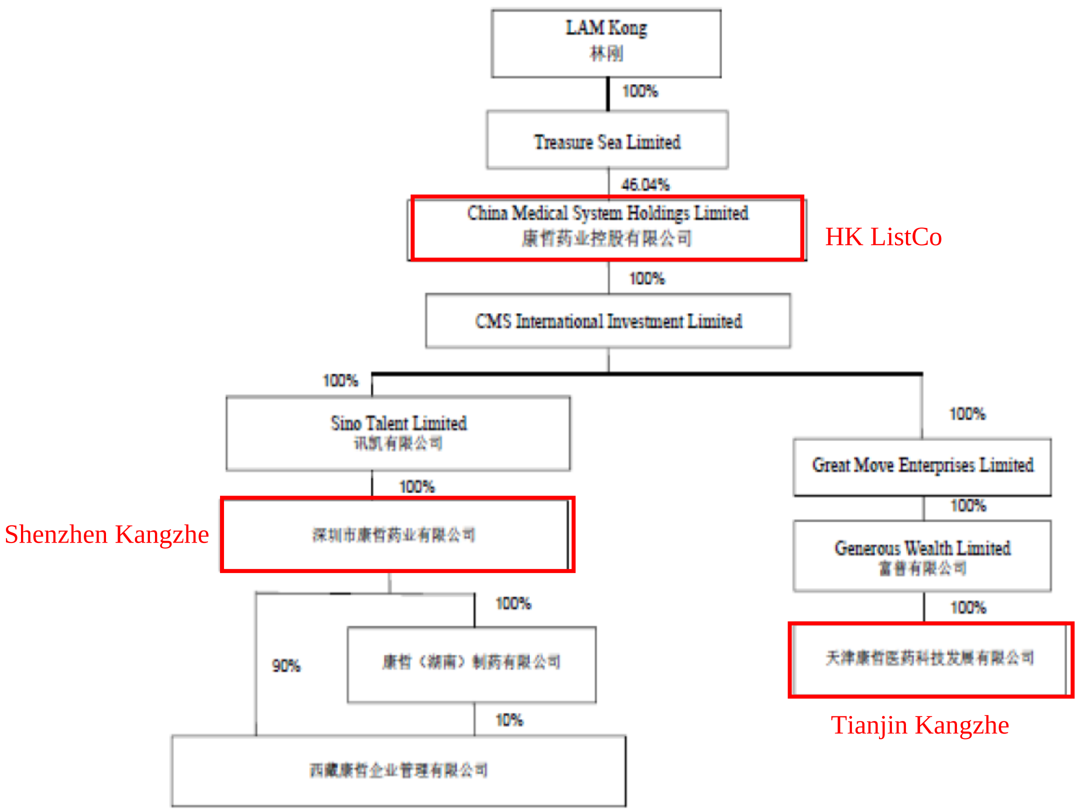
According to two independent data points reported by CMS to Chinese authorities, the Company is significantly less profitable than it purports to investors.

1) A-Share Disclosures Show Net Profits Substantially Less than Reported

First, in A-share disclosures to Chinese securities regulators filed in connection with a recent acquisition, CMS disclosed audited financials of its PRC operating subsidiaries which showed that the Company's net profits were substantially less than reported to investors.

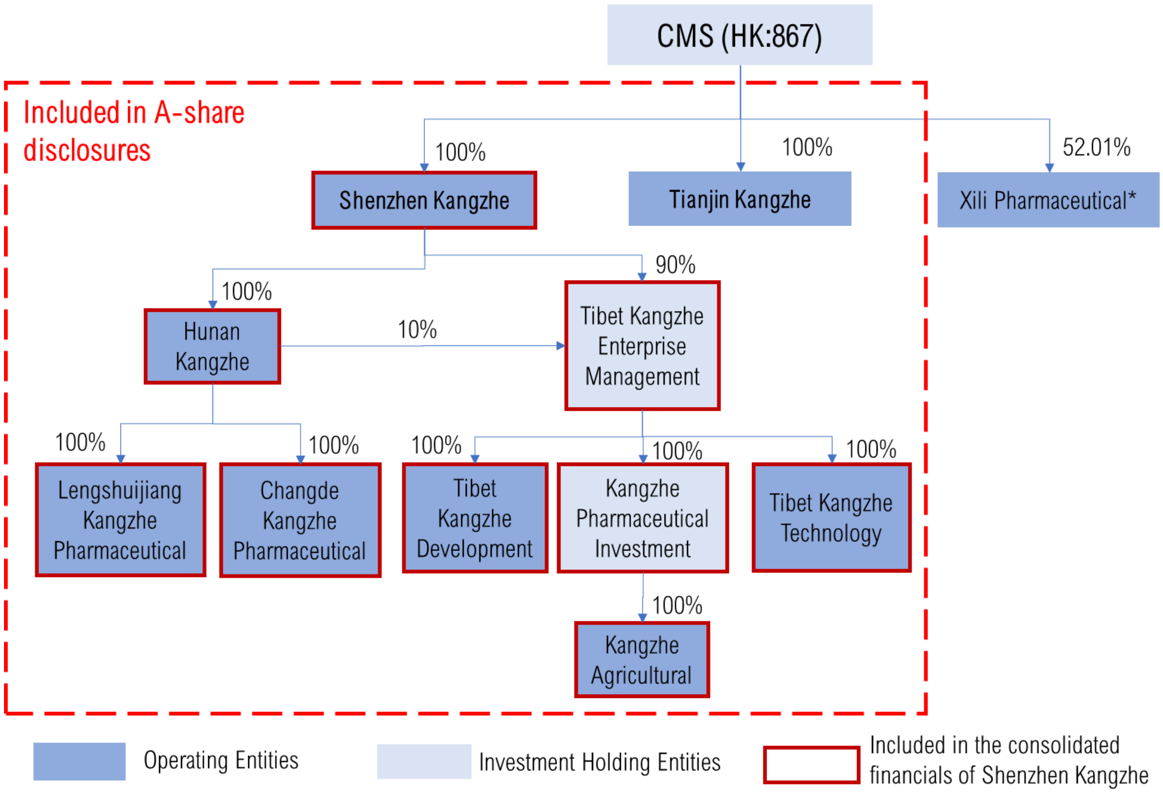
In May 2017, CMS acquired additional shares in Tibet Rhodiola Pharmaceutical Holdings Co., Ltd ("Tibet Pharmaceutical") (600211-SH), a publicly listed company trading on the Shanghai stock exchange, through a private placement. In connection with the share purchase, CMS was obligated to disclose the financials of its subsidiaries to Chinese investors and regulatory authorities.

In the circular, CMS disclosed that its corporate structure was organized under two primary PRC operating subsidiaries: Shenzhen Kangzhe Pharmaceuticals Co., Ltd ("Shenzhen Kangzhe") and Tianjin Kangzhe Pharmaceutical Technology Co., Ltd ("Tianjin Kangzhe").



Source: Tibet Pharmaceutical A-share Circular

According to the circular, the financials of Shenzhen Kangzhe and Tianjin Kangzhe consolidated the results of all of CMS' material PRC subsidiaries.



CMS PRC Subsidiaries	Principal activities	Consolidated in the A-share filings
Shenzhen Kangzhe	Marketing, promotion and sale of drugs	✓
Tibet Kangzhe Enterprise Management (a)	Investment holding	✓
Tibet Kangzhe Technology	Marketing and promotion of drugs	✓
Tibet Kangzhe Development	Trading of drugs	✓
Kangzhe Pharmaceutical Investment	Investment holding	✓
Kangzhe Agricultural	Agriculture	✓
Changde Kangzhe Pharmaceutical	Marketing and promotion of drugs	✓
Kangzhe Hunan	Production of medicines	✓
Kangzhe Lengshuijiang (b)	Production of medicines	✓
Tianjing Kangzhe	Marketing, promotion and sale of drugs	✓
Xili Pharmaceutical *	Production of medicines	2016 SAIC filings show RMB 10 million in net profit

Note: (a) Tibet Kangzhe Enterprise Management is formerly known as Kangzhe Pharmaceutical Technology
(b) Kangzhe Lengshuijiang was deregistered on 21 January 2016
** The only PRC subsidiary not consolidated in the A-share filing was Xili Pharmaceuticals, which reported only RMB 10 million in net profit in 2016. To give the Company the benefit of the doubt and to create an apple-to-apples comparison, we gave the Company credit for the profits from this entity in the A-share profit calculation.*

Source: CMS 2016 annual report, Qichacha.com

Notably, the A-share circular also stated that the financial results of CMS' subsidiaries were **audited**,[2] enhancing the credibility of the disclosures.

Audited consolidated financial information of Shenzhen Kangzhe (plus its consolidated subsidiaries)

2、合并利润表 Consolidated Income Statement

单位：元

	项目	2016 年度	2015 年度	2014 年度
Revenue (in RMB)	**一、业务收入**	5,416,705,034.29	3,729,143,152.18	2,892,419,262.10
	加：其他业务利润			
	减：主营业务成本	3,453,975,922.12	2,542,387,795.90	1,998,564,038.23
	主营业务税金及附加	21,914,774.57	36,108,586.88	31,112,703.76
	销售费用	1,050,988,167.39	792,135,750.65	565,514,081.96
	管理费用	100,217,515.33	98,591,471.08	89,813,432.45
	二、营业利润	846,781,156.44	284,870,767.34	216,407,915.86
	加：营业外收入	11,781,683.06	16,709,366.05	25,767,783.04
	减：营业外支出	4,091,450.95	6,777,628.59	7,781,697.94
	其中：非流动资产处置损失			
	利润总额	854,471,388.55	294,802,504.80	234,394,000.96
	减：所得税费用	121,639,779.67	45,461,657.58	62,127,372.19
Net Profit (in RMB)	**净利润**	732,831,608.88	249,340,847.22	172,266,628.77

Audited financial information of Tianjin Kangzhe

天津康哲通过代理商网络专业在中国营销、推广和销售国内制药企业生产的处方药品。最近 3 年财务状况如下：

单位：元

	项目	2016 年 12 月 31 日 /2016 年	2015 年 12 月 31 日 /2015 年	2014 年 12 月 31 日 /2014 年
	资产总额	1,363,122,005.32	1,328,921,902.99	1,044,176,554.67
	净资产	1,263,772,987.20	1,178,951,055.64	968,148,852.75
Revenue (RMB)	营业收入	592,394,433.61	523,971,915.76	604,203,883.94
	主营业务收入	592,394,433.61	523,971,915.76	604,203,883.94
Net Profit (RMB)	净利润	84,923,308.08	98,213,598.01	140,324,627.02
	净资产收益率	6.9%	9.1%	18.5%
	资产负债率	7.3%	11.3%	7.3%

Source: Tibet Pharmaceutical A-share Circular

All of CMS' revenues are generated in China. As we will discuss in detail in the next section, the financial performance of CMS' PRC operating subsidiaries should be consistent with the financial performance which CMS reports to investors. It is not.

[2] Only 2016 financials for Tianjin Kangzhe were not audited.

Although the reported revenues appear consistent, the A-share circular filed with Chinese authorities revealed that the **net profits of CMS' PRC operating subsidiaries were 40% less than CMS reported to Hong Kong investors in 2016**. CMS claimed that in 2016, its net profits were RMB 1.38 billion. Yet the A-share circular revealed that CMS' PRC subsidiaries only generated a combined RMB 827 million in net profits that year.

RMB M	2016 Revenue	2016 Net Profit
Shenzhen Kangzhe (consolidated)	5,417	733
Tianjing Kangzhe	592	85
Hebei Xili	159	10
Total: A-share Disclosure	6,169	827
Reported by Hong Kong Filings	4,901	1,378
Difference	**1,268**	**(551)**
Difference %	**26%**	**-40%**

Source: Tibet Pharmaceutical A-share Circular, Hebei Xili SAIC Filing

It is important to note that the A-share circular consolidated the financial performance of all of CMS' material PRC subsidiaries, so the dramatic shortfall in profitability cannot be explained by any missing entities.[3]

Rather, the A-share disclosures, in our opinion, unambiguously indicate that CMS is materially less profitable than it reports to Hong Kong investors. Other independent data points indicate that this exaggeration has only gotten worse with time.

2) SAIC Filings Show Increasing Exaggeration: Net Profit 49% Less than Reported (2016-2018)

In order to corroborate the financial data in the A-share circular, we reviewed the SAIC filings for CMS' PRC subsidiaries.

According to SAIC filings, the net profits generated by CMS' PRC operating subsidiaries were 49% less than reported to Hong Kong investors from 2016-2018.

RMB M	Principal Business	Revenue 2016	Revenue 2017	Revenue 2018	Revenue Cumulative	Net Profit 2016	Net Profit 2017	Net Profit 2018	Net Profit Cumulative
Shenzhen Kangzhe	Marketing, promotion and sale of drugs	3,823	3,597	3,837	11,256	157	372	396	925
Tibet Kangzhe Development	Trading of drugs	967	1,146	800	2,913	236	166	261	662
Tianjin Kangzhe	Marketing, promotion and sale of drugs	592	324	329	1,246	86	46	51	184
Tibet Kangzhe Technology	Marketing and promotion of drugs	387	262	-	650	246	74	(6)	313
Kangzhe Hunan	Production of medicines	238	220	237	695	124	140	136	400
Xili Pharmaceutical	Production of medicines	159	140	115	414	10	4	(8)	5
Kangzhe Agricultural	Agricultural	4	4	4	11	(1)	(3)	(3)	(8)
Changde Kangzhe Pharmaceutical	Marketing and promotion of drugs	2	-	n/a (a)	2	(1)	(4)	n/a (a)	(5)
Lengshuijiang Kangzhe Pharmaceutical	Production of medicines	n/a (b)	-	-	-	n/a (b)	-	-	-
SAIC Filings Total		6,173	5,693	5,321	17,186	856	794	827	2,477
HK Filings		4,901	5,349	5,433	15,683	1,378	1,670	1,845	4,892
Difference		**1,272**	**344**	**(112)**	**1,503**	**(522)**	**(876)**	**(1,018)**	**(2,416)**
Difference %		**26%**	**6%**	**-2%**	**10%**	**-38%**	**-52%**	**-55%**	**-49%**

Note: (a) Changde Kangzhe Pharmaceutical was deregistered in Jan 2019 and did not file 2018 annual account
(b) Lengshuijiang Kangzhe Pharmaceutical was established in July 2017

Source: SAIC Filings, CMS Annual Reports

Notably, SAIC filings for Shenzhen Kangzhe and Tianjin Kangzhe match the financial disclosures in the A-share circular. This consistency between filings indicates that the A-share disclosures and SAIC filings are accurate and credible.

[3] The only PRC subsidiary not consolidated in the A-share filing was Xili Pharmaceuticals, which reported only RMB 10 million in net profit in 2016. To give the Company the benefit of the doubt and to create an apple-to-apples comparison, we gave the Company credit for the profits from this entity in the A-share profit calculation.

SAIC filings of Shenzhen Kangzhe (standalone) matches with A-share disclosure for Shenzhen Kangzhe (standalone, not including consolidated subsidiaries)

Income Statement (UNIT: CNY 1,000)

Year	2016-12-31
Operating Income	3,822,630
Operating Costs	2,796,017
Tax and Associate Charge	12,705
Operating Gross Profit	1,013,908
Operating Expenses	732,701
Administrative Expenses	64,780
Financial Expenses	4,816
Investment Income	6,554
Operating Profit	218,165
Non-operating Income	1,032
Non-operating Expenses	-1,644
Total Profit	220,841
Income Tax	63,887
Net Profit	156,954

MATCH

深圳康哲通过直接学术推广模式

产的处方药品。最近 3 年财务状况如

项目	2016 年 12 月 31 日 /2016 年
资产总额	3,363,389,923.10
净资产	999,616,660.52
营业收入	3,822,629,598.67
主营业务收入	3,822,629,598.67
净利润	156,955,102.67

Revenue (RMB)

Net Profit (RMB)

Source: SAIC filings of Shenzhen Kangzhe, Tibet Pharmaceutical A-share Circular

SAIC filings of Tianjin Kangzhe matches with A-share disclosure

Income Statement (UNIT: CNY 1,000)

Year	2016-12-31
Operating Income	592,394
Operating Costs	445,603
Tax and Associate Charge	2,572
Operating Gross Profit	144,219
Operating Expenses	9,443
Administrative Expenses	49,907
Financial Expenses	-405
Investment Income	909
Exchange Earning	-
Operating Profit	86,183
Non-operating Income	13,726
Non-operating Expenses	-
Total Profit	99,909
Income Tax	13,651
Net Profit	86,258

MATCH

天津康哲通过代理商网络专业在

处方药品。最近 3 年财务状况如下：

项目	2016 年 12 月 31 日 /2016 年
资产总额	1,363,122,005.32
净资产	1,263,772,987.20
营业收入	592,394,433.61
主营业务收入	592,394,433.61
净利润	84,923,308.08

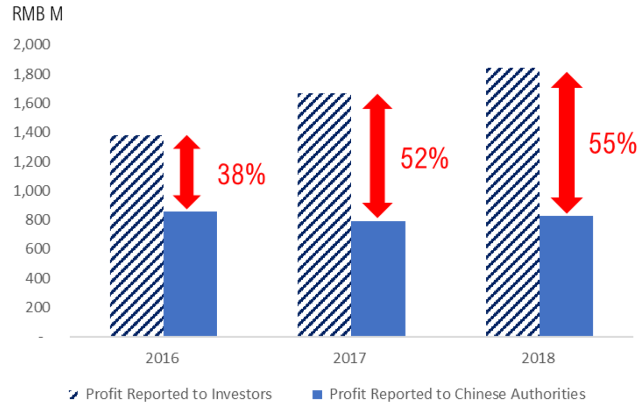
Revenue (RMB)

Net Profit (RMB)

Source: SAIC filings of Tianjin Kangzhe, Tibet Pharmaceutical A-share Circular

SAIC filings, just like the Company's A-share disclosures, show that CMS is substantially less profitable than it claims.

Shrinking Profitability and Increasing Profit Overstatement



Source: CMS Annual Reports compared to A-share Filings and SAIC Filings

Such filings also show that the Company's misrepresentations are getting worse with time, likely in order to mask the deteriorating profitability of a business struggling under the weight of policy changes in China designed to target drug middlemen and promoters like CMS.

3) Neither Offshore Income nor Transfer Pricing can Bridge the Gap

Both CMS' A-share disclosures and its SAIC filings indicate, in our opinion, that CMS' actual net profit was 49% less than reported to Hong Kong Investors from 2016 through 2018. Nor can foreign income or transfer pricing explain the difference.

CMS discloses in its annual report that all of its revenue comes from China and that 99% of its non-current assets (including intellectual property) are located in the PRC.

The Group primarily operates in the PRC. All revenue from external customers is attributed to the PRC and 99% of non-current assets excluding AFS investments and derivative financial instruments and deferred taxes of the Group are located in the PRC.

Source: CMS 2018 Annual Report

CMS lists only two non-PRC companies that are engaged in trading of drugs. One of them is the Hong Kong based Sky United. However, as evidenced by CMS' income tax breakdown, the Company generated limited profit in Hong Kong. At a flat tax rate of 16.5%, CMS' 2018 profit in Hong Kong amounted to a mere RMB 30 million, which is not remotely large enough to account for the shortfall of profitability at CMS' PRC subsidiaries.

	2018 RMB'000	2017 RMB'000
Current tax:		
The PRC Enterprise Income Tax	153,939	134,328
Hong Kong Profits Tax	5,002	3,208
Malaysia Corporate Income Tax	33	37
	158,974	137,573

The directors of the Company considered the amount involved upon implementation of the two-tiered profits tax rates regime as insignificant to the consolidated financial statements. Hong Kong Profits Tax is calculated at 16.5% of the estimated assessable profit for both years.

Source: CMS 2018 Annual Report

The only remaining possibility is Malaysia, where CMS has a subsidiary and where the Company claims a large tax benefit. Yet a close inspection of the Company's operations and assets in Malaysia indicate that CMS could not be generating sufficient profits in Malaysia to explain the discrepancy in profitability evident in the A-share and SAIC filings.

PHANTOM MALAYSIAN TAX BENEFIT

Prior to its Hong Kong IPO in 2010, CMS' effective tax rate was ~20%, which was in line with then prevailing PRC enterprise income tax rates of 18-20%. However, starting in 2010, CMS began to report an unusually low effective tax rate (~8%), supposedly because of a mysterious tax benefit earned in Malaysia.

RMB M	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Tax Expense	31	42	27	37	59	50	87	68	123	138	162
Profit before tax	136	184	235	440	596	681	1,130	1,064	1,500	1,808	2,006
Effective tax rate	**23%**	**23%**	**11%**	**8%**	**10%**	**7%**	**8%**	**6%**	**8%**	**8%**	**8%**

Source: CMS Annual Reports

Following its Hong Kong IPO, CMS began reporting massive tax breaks, which the Company claimed were attributable to a subsidiary set up in a tax zone in Labuan, Malaysia. According to the Labuan Offshore Business Activity Tax Act 1990, Labuan-incorporated entities have an option to pay either a lump sum tax charge of MYR 20,000 (RMB 33,000) or 3% of audited net profits.

> Pursuant to the Labuan Offshore Business Activity Tax Act 1990 ("Labuan Tax Act") in Malaysia, CMS Pharma Co., Ltd ("CMS Pharma") (formerly known as CMS Pharmaceutical Agency Co., Ltd.) is eligible to elect to pay a lump sum taxation charge of MYR20,000 or 3% on net audited profits. For the years ended 31 December 2018 and 2017, CMS Pharma elected to pay a lump sum tax of MYR20,000 (equivalent to approximately RMB33,000 and RMB37,000, respectively).

Source: CMS 2018 Annual Report

As CMS' profits supposedly grew, so did this purported tax benefit. In 2009, the Malaysian tax benefit made up only 12% of CMS' tax at applicable rates. However, by 2018, the benefit accounted for **60% of CMS' reported tax**. The purported Malaysian tax benefit grew supposedly so large that if CMS' disclosures are to be believed; the Company saved RMB 299 million in 2018 taxes by incorporating one lone subsidiary in Malaysia.

	2018 RMB'000	2017 RMB'000
Profit before tax	2,006,374	1,808,433
Tax at the applicable tax rate (Note)	501,594	452,108
Tax effect of share of results of associates	(20,714)	(19,431)
Tax effect of expenses that are not deductible in determining taxable profit	39,595	24,056
Tax effect of income that is not taxable in determining taxable profit	(247)	(3,932)
Tax effect of tax losses not recognised	4,685	1,261
Tax effect of deductible temporary differences not recognised	10,307	-
Tax effect of tax concession	(74,982)	(73,672)
Effect on different applicable tax rates of subsidiaries	(2,462)	(2,225)
Effect of tax benefit arising from Labuan Tax Act	(299,051)	(234,754)
Underprovision in prior years	399	308
Utilisation of deducible temporary differences previously not recognised	-	(7,301)
Others	2,652	2,076
Income tax expense for the year	161,776	138,494

Source: CMS 2018 Annual Report

RMB M	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total CMS tax at the applicable rate	24	37	52	106	149	170	282	266	375	452	502
Tax benefit from Labuan Tax Act	1	4	32	53	75	128	160	219	169	235	299
Malaysian tax benefit %	**4%**	**12%**	**62%**	**50%**	**50%**	**75%**	**57%**	**82%**	**45%**	**52%**	**60%**

Source: CMS Annual Reports

To save RMB 299 million in taxes, CMS must have generated over RMB 1.2 billion in pretax profits ***in Malaysia*** in 2018. In other words, 60% of CMS' total pretax profits must have been earned in Malaysia for its financials to be true.

RMB M	2013	2014	2015	2016	2017	2018
Malaysia corporate income tax	0.04	0.04	0.03	0.04	0.04	0.03
Tax benefit from Labuan Tax Act	128	160	219	169	235	299
Malaysian tax w/o benefit	128	160	219	169	235	299
Applicable tax rate	25%	25%	25%	25%	25%	25%
Estimated Malaysian profit before tax	511	641	875	675	939	1,196
Reported group level profit before tax	685	1,130	1,064	1,500	1,808	2,006
Malaysian profit before tax %	**75%**	**57%**	**82%**	**45%**	**52%**	**60%**

Source: CMS Annual Reports, Blue Orca Calculation

There is reason to be skeptical. CMS' own disclosures show that most of its cash balance is denominated in Renminbi. If the Company earns 60% of its pretax profit overseas, we would expect a much higher proportion of its bank balance to be denominated in foreign currencies. Certainly more than 3-6%.

> As at 31 December 2018, the cash and cash equivalents of the Group were mainly denominated in RMB, with small amount denominated in United States Dollar ("US$"), Euro ("EUR"), Great Britain Pound ("GBP"), Swiss Franc("CHF") and Hong Kong Dollars ("HK$").

> As at 31 December 2017, the cash and cash equivalents of the Group were mainly denominated in RMB, with small amount denominated in United States Dollar ("US$"), Euro ("EURO") and Hong Kong Dollars ("HK$").

RMB M	2016	2017	2018
Great British Pound		1	35
US Dollar	18	2	5
Euro	10	20	4
Swiss Franc		1	3
Hong Kong Dollar	1	2	2
Total disclosed foreign currrencies	29	26	49
Cash balance	482	856	815
% of foreign currencies	**6%**	**3%**	**6%**

Source: CMS Annual Report

Our investigation confirms this suspicion and indicates that CMS' Malaysian business appears virtually non-existent.

We believe, based on our research, that CMS generates nowhere near the amount of profits in Malaysia to justify its reported tax benefits or to make up for the reported shortfall in onshore profits in the PRC. Rather, we believe that CMS simply exaggerates the scale of its purported Malaysian tax benefit in order to conceal fake profits from Chinese tax authorities.

1. Malaysia Doesn't Ship Enough Drugs

Befuddled by CMS' unusual financials, sell side analysts have meekly suggested that CMS may ship the drugs through Malaysia first before shipping them to China in order to generate the large Malaysian tax benefit. However, we could find no evidence of any real operating business in Malaysia, and customs records indicate that Malaysia as a country does not ship nearly enough drugs for that to be true.

According to its 2018 annual report, CMS has two Malaysian subsidiaries. CMS Medical Limited was established on May 16, 2018, as an investment holding company, and thus could not account for the tax benefits earned from 2012 through 2018.

The Company's other Malaysia-based subsidiary, CMS Pharma Co. Ltd ("CMS Pharma"), supposedly engages in the trading of drugs.

Name of subsidiaries (Note i)	Place of incorporation/ establishment and operation	Issue and fully paid share capital/ registered capital		Equity interest held by the Group				Principal activities
		31 December 2018	31 December 2017	31 December 2018		31 December 2017		
				Directly	Indirectly	Directly	Indirectly	
CMS Pharma	Malaysia	US$1	US$1	-	100%	-	100%	Trading of drugs

Source: CMS 2018 Annual Report

According to the Malaysian corporate registrar, CMS Pharma's address is Level 15 (A1), Main Office Tower, Financial Park Labuan.

Company No :	LL06592
Company Name :	CMS Pharma Co., Ltd
Company Address :	Level 15(A1), Main Office Tower Financial Park Labuan Jalan Merdeka, 87000 Federal Territory of Labuan Malaysia
Trust Company Name :	Tricor Trustco (Labuan) Ltd.

Source: https://www.labuanibfc.com/areas-of-business/labuan-structures/labuan-companies/labuan-company-search?name=CMS%20pharma%20co.%2C%20ltd&refno=

But this is not a real office, just a mailbox. CMS Pharma's registered address is in fact occupied by Tricor Trustco (Labuan) Ltd, which provides incorporation and registration services.

Tricor Trustco (Labuan) Ltd - Operation Office

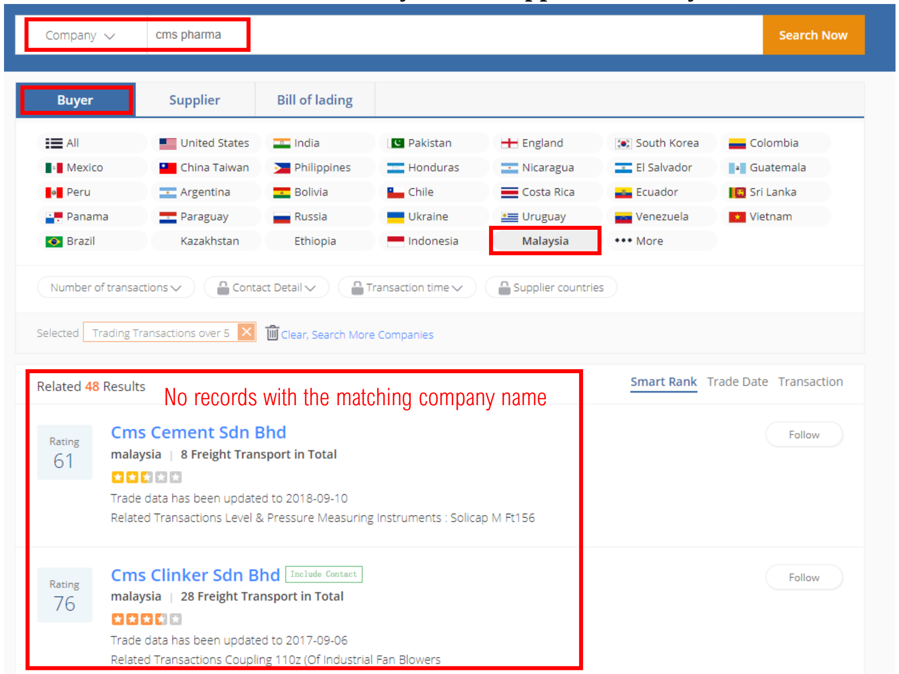
Level 15(A1), Main Office Tower,
Financial Park Labuan, Jalan Merdeka,
87000 Labuan F.T., Malaysia

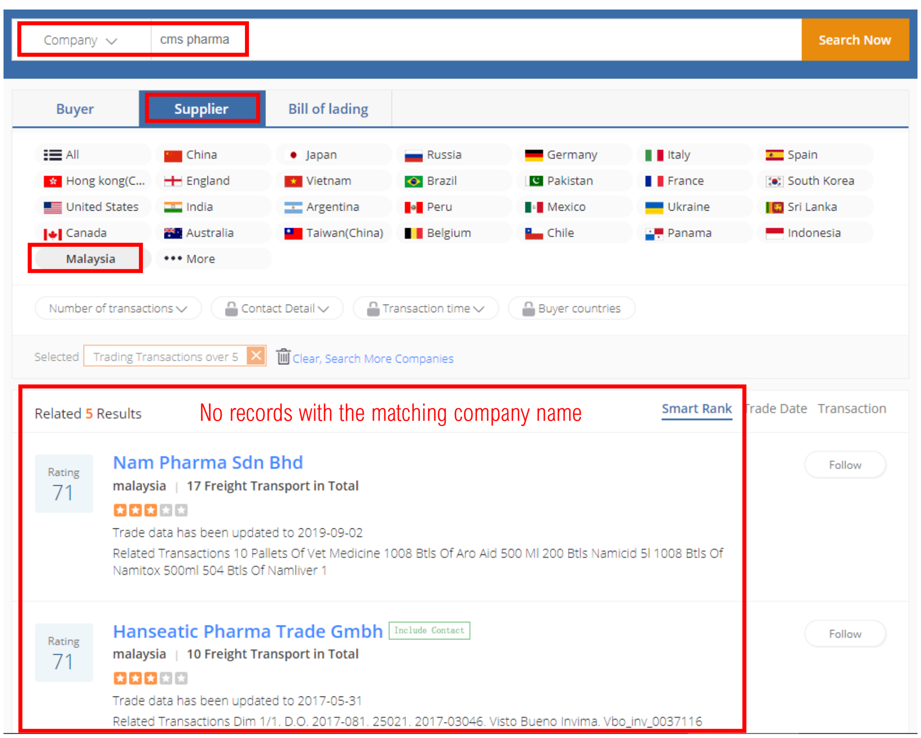
Source: https://www.tricorglobal.com/locations/labuan

We were unable, despite diligent effort, to locate any proper office or place of business in Malaysia for CMS Pharma. Unable to locate any evidence of an operating business with a real physical office, we believe that CMS Pharma is essentially a shell company. Although it is still possible (however unlikely) that an empty shell entity could still be used as an importer/re-exporter of drugs between Europe and China, **customs records indicate that this is not the case**.

First, customs and shipping databases show no records indicating that CMS Pharma exported drugs to China.

CMS Pharma Is Not Shown as Either a Buyer or a Supplier in Malaysia, China or Hong Kong





Source: *https://en.52wmb.com/*

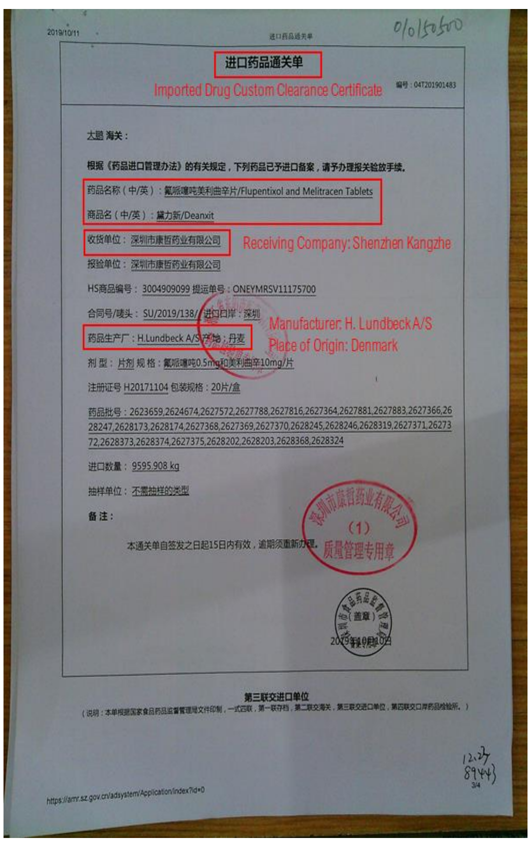
If CMS is shipping drugs through Malaysia, then CMS Pharma, its Malaysian subsidiary, should appear on customs records. It doesn't.

Rather, customs data clearly shows that Shenzhen Kangzhe, CMS' main PRC subsidiary, imports directly from Europe and did not receive any shipments from Malaysia.

Source: https://panjiva.com/Shen-Zhen-Kangzhe-Pharmaceutical-Co-Ltd/15706450

We also reviewed records for CMS' main drugs, which show that they are imported directly by CMS' Chinese subsidiaries from European suppliers.

For example, clearance certificates show that Deanxit, which contributed 19% of CMS revenue in 2018, was directly imported by CMS' PRC subsidiary from Denmark. We would expect, if Deanxit was imported via Malaysia, that CMS' Malaysian subsidiary would appear somewhere on the certificate. Yet customs records maintained and published online by drug distributors show that CMS' drugs are imported directly from Europe to China. Similarly, records show that Ursofalk, which accounted for 21% of CMS' 2018 revenue, was imported directly from Germany.



2019/10/11 进口药品通关单

进口药品通关单

Imported Drug Custom Clearance Certificate

编号：04T201901483

太臆 海关：

根据《药品进口管理办法》的有关规定，下列药品已予进口备案，请予办理报关验放手续。

药品名称（中/英）：氟哌噻吨美利曲辛片/Flupentixol and Melitracen Tablets

商品名（中/英）：黛力新/Deanxit

收货单位：深圳市康哲药业有限公司

Receiving Company: Shenzhen Kangzhe

报验单位：深圳市康哲药业有限公司

HS商品编号：3004909099 提运单号：ONEYMRSV11175700

合同号/唛头：SU/2019/138// 进口口岸：深圳

药品生产厂：H.Lundbeck A/S 产地：丹麦

Manufacturer: H. Lundbeck A/S
Place of Origin: Denmark

剂 型：片剂 规 格：氟哌噻吨0.5mg和美利曲辛10mg/片

注册证号 H20171104 包装规格：20片/盒

药品批号：2623659,2624674,2627572,2627788,2627816,2627364,2627881,2627883,2627366,2628247,2628173,2628174,2627368,2627369,2627370,2628245,2628246,2628319,2627371,2627372,2628373,2628374,2627375,2628202,2628203,2628368,2628324

进口数量：9595.908 kg

抽样单位：不需抽样的类型

备 注：

本通关单自签发之日起15日内有效，逾期须重新办理。

深圳市康哲药业有限公司 (1) 质量管理专用章

（盖章）

2019年10月10日

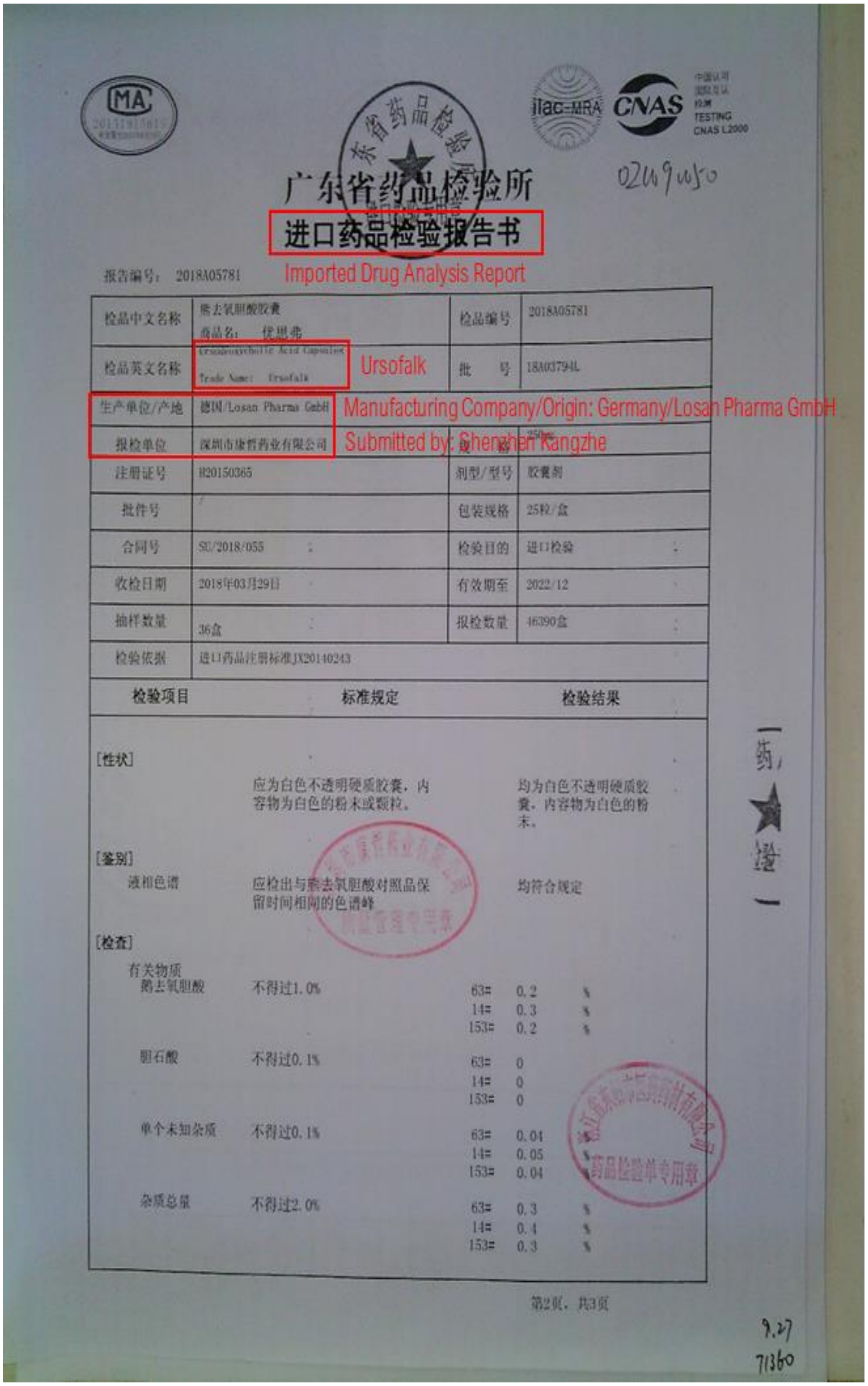
第三联交进口单位

（说明：本单根据国家食品药品监督管理局文件印制，一式四联，第一联存档，第二联交海关，第三联交进口单位，第四联交口岸药品检验所。）

https://amr.sz.gov.cn/adsystem/Application/index?id=0

3/4

Source: http://www.dyyyyc.com/Manager/Edit/uploadfile/20180928092601563.jpg



广东省药品检验所

进口药品检验报告书

报告编号：2018A05781

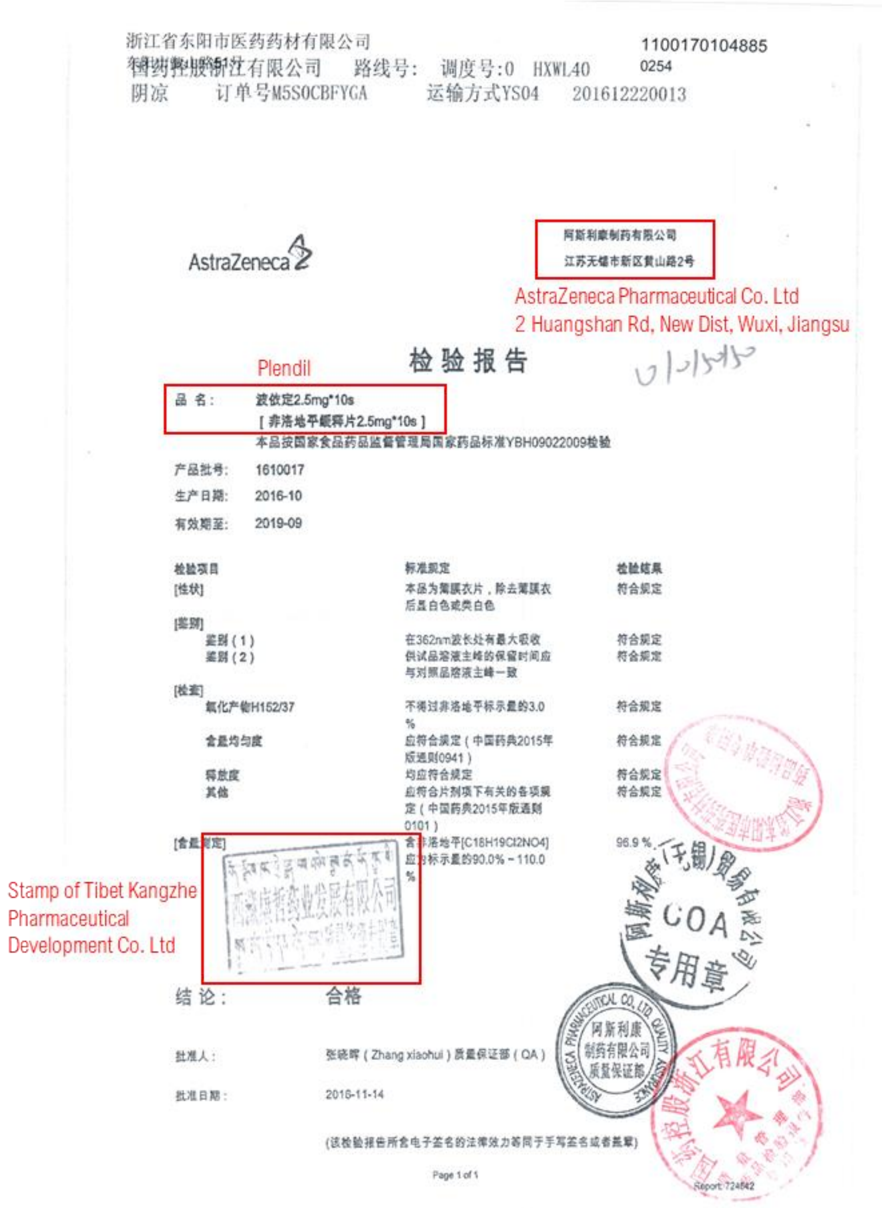
检品中文名称	熊去氧胆酸胶囊 商品名：优思弗	检品编号	2018A05781
检品英文名称	Ursodeoxycholic Acid Capsules Trade Name: Ursofalk	批 号	18A03794L
生产单位/产地	德国/Losan Pharma GmbH		
报检单位	深圳市康哲药业有限公司		
注册证号	H20150365	剂型/型号	胶囊剂
批件号	/	包装规格	25粒/盒
合同号	SU/2018/055	检验目的	进口检验
收检日期	2018年03月29日	有效期至	2022/12
抽样数量	36盒	报检数量	46390盒
检验依据	进口药品注册标准JX20140243		

检验项目	标准规定	检验结果
[性状]	应为白色不透明硬质胶囊，内容物为白色的粉末或颗粒。	均为白色不透明硬质胶囊，内容物为白色的粉末。
[鉴别] 液相色谱	应检出与熊去氧胆酸对照品保留时间相同的色谱峰	均符合规定
[检查] 有关物质 鹅去氧胆酸	不得过1.0%	63# 0.2 %; 14# 0.3 %; 153# 0.2 %
胆石酸	不得过0.1%	63# 0; 14# 0; 153# 0
单个未知杂质	不得过0.1%	63# 0.04 %; 14# 0.05 %; 153# 0.04 %
杂质总量	不得过2.0%	63# 0.3 %; 14# 0.4 %; 153# 0.3 %

第2页，共3页

Source: http://www.dyyyyc.com/Manager/Edit/uploadfile/20180928092601563.jpg

Plendil, the Company's largest revenue contributor (~21% of 2018 revenue), was not imported but came from AstraZeneca's manufacturing facility in Jiangsu, China.



浙江省东阳市医药药材有限公司 1100170104885
国药控股浙江有限公司 路线号: 调度号:0 HXWL40 0254
阴凉 订单号M5SOCBFYGA 运输方式YS04 201612220013

AstraZeneca

阿斯利康制药有限公司
江苏无锡市新区黄山路2号

AstraZeneca Pharmaceutical Co. Ltd
2 Huangshan Rd, New Dist, Wuxi, Jiangsu

Plendil

检验报告

品 名: 波依定2.5mg*10s
[非洛地平缓释片2.5mg*10s]
本品按国家食品药品监督管理局国家药品标准YBH09022009检验

产品批号: 1610017
生产日期: 2016-10
有效期至: 2019-09

检验项目	标准规定	检验结果
[性状]	本品为薄膜衣片，除去薄膜衣后显白色或类白色	符合规定
[鉴别]		
鉴别（1）	在362nm波长处有最大吸收	符合规定
鉴别（2）	供试品溶液主峰的保留时间应与对照品溶液主峰一致	符合规定
[检查]		
氧化产物H152/37	不得过非洛地平标示量的3.0%	符合规定
含量均匀度	应符合规定（中国药典2015年版通则0941）	符合规定
释放度	均应符合规定	符合规定
其他	应符合片剂项下有关的各项规定（中国药典2015年版通则0101）	符合规定
[含量测定]	含非洛地平[C18H19Cl2NO4]应为标示量的90.0% ~ 110.0%	96.9 %

Stamp of Tibet Kangzhe Pharmaceutical Development Co. Ltd

结 论: 合格

批准人: 张晓晖 (Zhang xiaohui) 质量保证部 (QA)

批准日期: 2016-11-14

(该检验报告所含电子签名的法律效力等同于手写签名或者盖章)

Page 1 of 1

Source: http://www.dyyyyc.com/Manager/Edit/uploadfile/201711793723125.jpg

Based on the Malaysian tax benefit reported by the Company, CMS should have generated RMB 1.2 billion pretax profit in Malaysia in 2018. However, customs records confirm that CMS' drugs are either manufactured in China or imported directly by Chinese subsidiaries from European suppliers. Such records indicate, in our opinion, that CMS' reported profitability in Malaysia is likely fabricated.

Moreover, according to United Nations Conference on Trade and Development database, **Malaysia as a country only exported a total of USD 51 million, or RMB 351 million in drugs to China (including Hong Kong) in 2018**. The UN data includes re-exports, which would capture drugs routed through Malaysia on their way from Europe to China.

Exports of a country can be distinguished as exports of domestic goods and exports of foreign goods. The second class is generally referred to as re-exports. The exports shown in our database contain both the exports of domestic and foreign goods.

Re-exports are exports of foreign goods in the same state as previously imported; they are to be included in the country exports. It is recommended that they be recorded separately for

Source: https://unstats.un.org/unsd/tradekb/Knowledgebase/50128/Reexports-and-Reimports

Merchandise trade matrix – product groups, exports in thousands of United States dollars, annual

Other: PRODUCT ▼ Medicinal and pharmaceutical products | PARTNER ▼ China

YEAR / ECONOMY	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Malaysia	1 511	2 471	4 240	6 632	8 782	11 177	13 329	9 635	15 831	29 398

Other: PRODUCT ▼ Medicinal and pharmaceutical products | PARTNER - China, Hong Kong SAR

YEAR / ECONOMY	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Malaysia	11 822	14 447	15 089	17 334	19 915	27 496	23 427	21 746	23 983	21 454

Source: https://unctadstat.unctad.org/

Put simply, the total amount of Malaysian drug exports to China are not nearly large enough, even if all of them were shipped by CMS, to even remotely generate the profit necessary to justify CMS' mysterious Malaysian tax benefit.

Between 2016 and 2018, CMS reported almost RMB 3 billion in pretax profit in Malaysia, which supposedly came from drug exports to China. Yet during this period, Malaysia as a country only exported USD 122 million (RMB 842 million) in drugs to China. How could CMS' profits from shipping drugs through Malaysia be 3x greater **than the total value of all drugs shipped or re-exported from Malaysia to China over that period?**

Even if we assume that CMS Pharma is responsible for all drug exports from Malaysia to China and that all such drugs are sold at 100% margin, both of which are unlikely, the export value of all drugs shipped by Malaysia to China still falls far short of the amount required to justify CMS' reported Malaysian tax benefit or make up for the profit gap between CMS' Chinese filings and its Hong Kong disclosures. Rather, such data suggests that the Company's purported Malaysian tax benefit is likely bogus and, in our opinion, fabricated to conceal fake reported profits.

2. Malaysian intellectual property royalty, if any, is also insignificant

If CMS Pharma receives any income from the intellectual property rights, such income is likewise insufficient to justify such a large tax benefit or to bridge the profit shortfall in the Company's disclosures.

According to the Company, its Malaysian subsidiary CMS Pharma holds the exclusive rights to **only one of its drugs**,[4] Augentropfen Stulln Mono Eye Drops ("Stulln Eyedrop"), which it held from 2008 to July 31, 2018.

shareholder with Ophol under the sale and purchase agreement. On 15 July 2008, the Group entered into a supplementary agreement with Ophol and Pharma in connection with the transfer of exclusive agency right of Stulln, from Ophol to CMS Pharma, a wholly-owned subsidiary of the Company, at a consideration of RMB60,000,000. CMS Pharma will pay annually of RMB6,000,000 to Ophol over the next ten years to settle the consideration. The directors of the Group recognised the payable as a deferred consideration (see note 27) in the amount of RMB46,330,000, which represents the present value of the annual consideration of RMB6,000,000 over next 10 years discounted at 5%. CMS Pharma has replaced Qingdao League as the exclusive agent of Stulln for Pharma in the PRC from 1 August 2008 to 31 July 2018.

Source: CMS 2015 Annual Report

Revenues from Stulln Eyedrops made up only 4% of CMS' total revenue from 2014-2018, meaning it accounts for only a small fraction of its sales. Even if the eyedrops are sold by CMS Pharma to the Company's onshore entities at 100% margin, it would not be remotely sufficient to account for the Malaysian tax benefit or bridge the shortfall in the Company's reported net profits in those years.

[4] CMS Pharma also acquired the assets related to Traumakine in 2015, but this drug has yet to be commercialized and thus would not generate any profit or revenue.

RMB M	2014	2015	2016	2017	2018
Stulln eyedrop revenue	133	159	181	218	225
CMS total revenue	2,945	3,553	4,901	5,349	5,433
% of total revenue	**5%**	**4%**	**4%**	**4%**	**4%**

Source: CMS Annual Reports

According to Company disclosures, CMS Pharma does not hold any other revenue-generating intellectual property rights in Malaysia. By its own admission, CMS claims that 99% of the Company's non-current assets, including intangible assets such as intellectual property, are held in China.

The Group primarily operates in the PRC. All revenue from external customers is attributed to the PRC and 99% of non-current assets excluding AFS investments and derivative financial instruments and deferred taxes of the Group are located in the PRC.

Source: CMS 2018 Annual Report

With 99% of its intellectual property assets located in the PRC, the Company cannot now claim that it parked any such IP in Malaysia.

Investors should ask themselves a simple question. If it were possible for Chinese drug distributors to save hundreds of millions in taxes each year by incorporating a lone Malaysian subsidiary, wouldn't this practice be widespread? CMS is a public company, meaning its tax strategies are widely known and available to its competitors. Any investor who believes CMS' disclosures should ask themselves why other Chinese drug distributors did not copy its tax structure, given that a simple incorporation could save hundreds of millions of yuan and 60% of its tax bill? We think the answer is obvious. It appears too good to be true because it is. Other Chinese drug distributors did not copy the structure because the tax benefit is likely bogus.

Ultimately, we could find no evidence of material Malaysian operations, and customs records indicate that nowhere near enough drugs are shipped from Malaysia to China to generate enough profits to justify the tax benefit or to make up the shortfall in the Company's onshore profits. Furthermore, CMS claims that its intangible assets such as intellectual property are located in China, meaning licensing royalties are not able to generate profit offshore.

We think the evidence indicates, persuasively, that the Company has exaggerated its Malaysian tax benefit to conceal fake profits from PRC tax authorities.

CHINESE FDA RECORDS INDICATE THAT CMS SECRETLY FUNDS R&D FOR CHAIRMAN

Chinese corporate and FDA records indicate that CMS secretly funds research expenses on behalf of a private entity owned by the chairman. Records show that the chairman's entity is co-located at CMS facilities, employs CMS staff and even uses a CMS email address in registration documents. Filings also show that the chairman's entity had **only one employee and reported zero operating expenses in 2018**, corroborating our thesis that this entity is not conducting any research, but secretly shifting its costs and expenses to the Company.

In its Hong Kong filings, CMS claims to have one in-house R&D project: a compound in development to potentially treat liver cancer called CMS024.

According to its annual report, CMS appointed Kangzhe Pharmaceutical Research and Development (Shenzhen) Limited ("Kangzhe R&D"), a research and development company owned by its chairman, to conduct clinical research on CMS024.

Under the unusual arrangement, the chairman's Kangzhe R&D agreed to bear the research costs for the clinical trials for the drug. In exchange, CMS agreed to pay 13% of the product's revenue to Kangzhe R&D as a royalty fee in the event the compound is successfully commercialized. CMS confusingly refers to this arrangement in its annual report as "in-house R&D," even though the R&D should in theory be outsourced to the chairman.

In- house R&D

CMS024 (Tyroserleutide)

The Group has taken the first step towards In-house R&D since 1998. CMS024 (Tyroserleutide), used to treat primary liver cancer, is a National Class One New Drug researched and developed by the Group. Though the Phase III clinical trial unblinded on February 2014 failed to achieve the expected results, the subgroup with "no tumor thrombosis" in the hepatic portal vein branches demonstrated a favorable trend during the clinical trial, the Group conducted a half-year "follow-up study" and achieved significant results. According to statistical data from the study, a statistical significance in survival time between the treatment group and the placebo group of the subgroup had been observed, indicating that CMS024 could prolong the survival time of liver cancer patients with "no tumor thrombosis" in the hepatic portal vein branches. Based on these positive results, the Group has decided to carry out a new extended phase III clinical trial for CMS024. During the Reporting Period, the extended phase III clinical trial of Tyroserleutide was still in the patient recruitment process. The costs of this clinical trial will continue to be borne by Kangzhe Pharmaceutical Research and Development (Shenzhen) Limited ("Kangzhe R&D"), and the Group will pay 13% of the product's revenue to Kangzhe R&D as royalty fees after the successful commercialization of the product. If Tyroserleutide is successfully launched into the market, it will not only have great market potential in China, but also have a significant impact on human health.

Source: CMS 2018 Annual Report

CMS states unambiguously in its annual report that Kangzhe R&D will "**continue**" to bear the costs of clinical trials for CMS024.

However, independent evidence indicates not only that CMS is bearing the R&D costs supposedly shifted to the chairman's company, but that Kangzhe R&D is secretly run using Company resources.

First, an online drug trial database maintained by China's National Medical Products Administration (NMPA), a division of the Chinese FDA, shows that two CMS subsidiaries are conducting clinical trials on CMS024. This of course, is in direct contradiction to the Company's disclosures, in which it claims that the chairman's Kangzhe R&D will bear the costs associated with the trials.

The database shows that there are currently three clinical trials in progress for CMS024.

查询词：酪丝； Search Word: Tyroserleutide

按登记号升序排序 按登记号降序排序 按试验状态升序排序 按试验状态降序排序 下载 订阅RSS 打印

序号	登记号	试验状态 (Status)	药物名称 (Drug Name)	适应症	试验通俗题目
1	CTR20150871	进行中 招募中 (In Progress Recuiting)	注射用酪丝亮肽	Tyroserleutide for injection	注射用酪丝亮肽治疗肝细胞癌的III期扩大临床研究
2	CTR20131722	进行中 招募中	注射用酪丝缬肽	Tyroservatide for injection	酪丝缬肽治疗晚期非小细胞肺癌安全性和有效性临床研究
3	CTR20131695	进行中 招募完成 (In Progress; Recuitment Completed)	注射用酪丝亮肽	Tyroserleutide for injection	酪丝亮肽治疗肝细胞癌的安全性、有效性III期临床试验

Source: http://www.chinadrugtrials.org.cn/eap/clinicaltrials.searchlist

Only one of them is conducted by Kangzhe R&D.

登记号：CTR20131722
试验状态：进行中
Status: In process
申办者联系人：崔安雷
首次公示信息日期：2014-05-07
First published: 2014-05-07
申办者名称：康哲医药研究（深圳）有限公司/
Applicant: Kangzhe Pharmaceutical Research and Development (Shenzhen) Limited

Source: http://www.chinadrugtrials.org.cn/eap/clinicaltrials.searchlist

The other two trials are conducted by CMS subsidiaries Kangzhe Hunan and Shenzhen Hunan.

登记号：CTR20131695
Status: In process
试验状态：进行中
申办者联系人：殷远洲
首次公示信息日期：2014-03-06
First published: 2014-03-06
申办者名称：益侨（湖南）制药有限公司/ 深圳市康哲药业有限公司/
Applicant: Yiqiao (Hunan) Pharmaceutical Co., Ltd/ Shenzhen Kangzhe Pharmaceutical Co., Ltd

登记号：CTR20150871
Status: In process
试验状态：进行中
申办者联系人：殷远洲
首次公示信息日期：2015-12-31
First published: 2015-12-31
申办者名称：益侨（湖南）制药有限公司/ 深圳市康哲药业有限公司/
Applicant: Yiqiao (Hunan) Pharmaceutical Co., Ltd/ Shenzhen Kangzhe Pharmaceutical Co., Ltd

Source: http://www.chinadrugtrials.org.cn/eap/clinicaltrials.searchlist

The clinical trials undertaken by CMS subsidiaries are much larger in scope compared to the one conducted by Kangzhe R&D. CMS clearly bears most, if not all, of the R&D expenses associated with the CMS024 compound.

Registration No.	Target Enrollment	Progress	Applicant
CTR20131695	300	Recruitment Completed	CMS Subsidiaries
CTR20150871	352	Recruiting	CMS Subsidiaries
CTR20131722	32	Recruiting	Kangzhe R&D

Source: http://www.chinadrugtrials.org.cn/eap/clinicaltrials.searchlist

SAIC files confirm that the Company is most likely secretly funding **ALL** research and development expenses which are supposed to be paid by the chairman.

We reviewed the 2016-2018 SAIC filings for Kangzhe R&D, which show almost no economic activity. In 2017, Kangzhe R&D reported only RMB 1 million in operating expenses. In 2018, Kangzhe R&D reported **zero operating expenses**.

SAIC Filings of Kangzhe R&D

RMB M	2016	2017	2018
Total Revenue	-	-	-
Total Operating Profit	(4)	(1)	-
Total Tax Expense	0	0	-
Total Net Profit	(4)	(1)	-
Total Assets	14	14	-
Total Liabilities	112	113	-
Total Equity	(98)	(99)	-

Source: Kangzhe R&D SAIC filings

In 2018, Kangzhe R&D was supposed to be conducting research on CMS024, including clinical trials for the drug. But its SAIC records show zero operating expenses, making it obvious, in our opinion, that such costs were being born by the Company.

We question if Kangzhe R&D ever conducted any research on its own. For many years, Chinese corporate filings show that the chairman's private entity **had only one employee on its payroll**.

社保信息 Social Security Information

城镇职工基本养老保险 City Employee Basic Pension	1人	Employee Basic Medical Insurance 职工基本医疗保险	1人
生育保险 Maternity Insurance	1人	Unemployement Insurance 失业保险	1人
工伤保险 Work-related Injury Insurance	1人		

Source: https://www.qichacha.com/firm_265ea18efa593c7e4ee219b517597458.html#report

With one employee and minimal to zero operating expenses, we doubt that Kangzhe R&D could conduct any material operations.

Rather, it appears to be a vehicle to secretly enrich the chairman. Chinese corporate registry filings show not only that Kangzhe R&D occupies the same office space as CMS' Shenzhen headquarters, but also that the chairman's private business uses an @CMS email and the Company's phone number in its registration documents.

2018 SAIC Filing of Kangzhe R&D

企业基本信息 2019-06-17 公布

注册号	440301503350560	统一社会信用代码	91440300746619539Y
企业经营状态	开业	企业联系电话 Contact No.	075582416868
从业人数	企业选择不公示	邮政编码	518052
有限责任公司本年度是否发生股东股权转让	否	企业是否有投资信息或购买其他公司股权	否
电子邮箱 Email	cms.legal@cms.net.cn		
企业通讯地址 Corporate Address	深圳市南山区大新路198号创新大厦B座6楼	Building B, Fl 6, Innovation Building, 198 Daxin Rd, Nanshang Dist, Shenzhen,	

2018 SAIC Filing of Shenzhen Kangzhe, CMS' Main Subsidiary

企业基本信息 2019-06-17 公布

注册号	440301503252172	统一社会信用代码	91440300192191146L
企业经营状态	开业	企业联系电话 Contact No.	0755-82416868
从业人数	企业选择不公示	邮政编码	518052
有限责任公司本年度是否发生股东股权转让	否	企业是否有投资信息或购买其他公司股权	否
电子邮箱 Email	cms.legal@cms.net.cn		
企业通讯地址 Corporate Address	深圳市南山区南头街道大新路198号马家龙创新大厦B座6-8楼	Building B, Fl 6-8, Innovation Building, 198 Daxin Rd, Nanshang Dist, Shenzhen,	

Source: Qichacha.com

Even more problematic, corporate records show that Kangzhe R&D's leadership team is composed of senior CMS executives.

序号	姓名 Name		职务 Position
1	林 林刚 Lam Kong	他关联 3 家企业 >	董事长,总经理 Chairman, General Manager
2	王 王伟明 Wong Wai MIng	他关联 1 家企业 >	副董事长 Vice Chairman
3	陈 陈洪兵 Chen Hongbing	他关联 5 家企业 >	董事 Director
4	吴 吴三燕 Wu Sanyan	他关联 13 家企业 >	监事 Supervisor

Name	Position at Kanghze R&D	Position at CMS
Lam Kong	Chairrman, General Manager	Chairman, Chief Executive Officer, President
Wong Wai Ming	Vice Chairman	Chief Technical Officer
Chen Hongbing	Director	Chief Operating Officer, Vice President
Wu Sanyan	Supervisor	Company Secretary

Source: Qichacha.com, CMS Annual Report

Kangzhe R&D also uses a CMS employee for its regulatory submissions. In the NMPA database, Kangzhe R&D has one clinical trial in progress and lists Cui Anlei as its contact person. However, Cui Anlei is clearly a CMS employee, as he uses @cms.net.cn email and a CMS phone number in the clinical trial database.

Applicant: Kangzhe Pharmaceutical Research and Development (Shenzhen) Limited

申办者名称:	1 康哲医药研究（深圳）有限公司/		
联系人姓名:	崔安雷 Contact Person: Cui Anlei		
联系人电话: Phone:	0755-82416868-270	联系人Email:	anfy_cui@cms.net.cn
联系人邮政地址:	深圳市南山区高新区北区朗山路11号同方信息港A栋8楼	联系人邮编:	518057
试验项目经费来源:	完全自筹		

Source: http://www.chinadrugtrials.org.cn/eap/clinicaltrials.searchlistdetail

No wonder Kangzhe R&D had to use a CMS employee for clinical trial registration; because the chairman's private entity simply does not have any staff of its own. Rather, the costs are secretly shifted to the public Company.

Ultimately, we believe there is overwhelming evidence that the Company secretly funds research supposedly conducted by the chairman's private business. Not only would this make CMS' disclosures false but is another example of many in which the chairman unjustly enriches himself at the expense of shareholders.

DRUG PIPELINE: ROTTEN CONDUIT FOR SELF-DEALING TRANSACTIONS WITH CHAIRMAN

Because of recent policy changes in the PRC aimed at significantly lowering drug prices, the outlook for CMS' core specialty drug licensing business is dim. In order to stimulate growth, CMS has ostensibly turned to investing in biotech startups, which the Company misleadingly refers to as its drug development business.

Our due diligence reveals that CMS' drug development pipeline is a rotten conduit for questionable dealings with the chairman and his privately-owned businesses. Rather than engage in legitimate drug innovation, we believe that the chairman is using company resources for personal gain.

It is critical to note that according to Company disclosures, A&B (HK) Company Limited ("A&B Holdings") is an independent company privately owned by its chairman. But all the evidence, including the disclosures of the biotech startups supposedly partnering with CMS, indicate that A&B Holdings is secretly run by CMS employees using CMS resources for the chairman's private benefit. Through this rotten self-dealing, we believe that the chairman siphons ever-shrinking profits away from the struggling business.

- In multiple examples, the chairman inserted himself as a **middleman** in the Company's purchase of territorial distribution rights from drug companies, buying the rights himself only to sell them to CMS. Although these transactions are disclosed, the consideration is not. As an unnecessary middleman, he presumably enriches himself at the Company's expense.

- In other instances, we discovered that drug developers partnering with CMS also **secretly issued equity to the chairman**, suggesting that he is inappropriately leveraging CMS to invest privately in biotech startups.

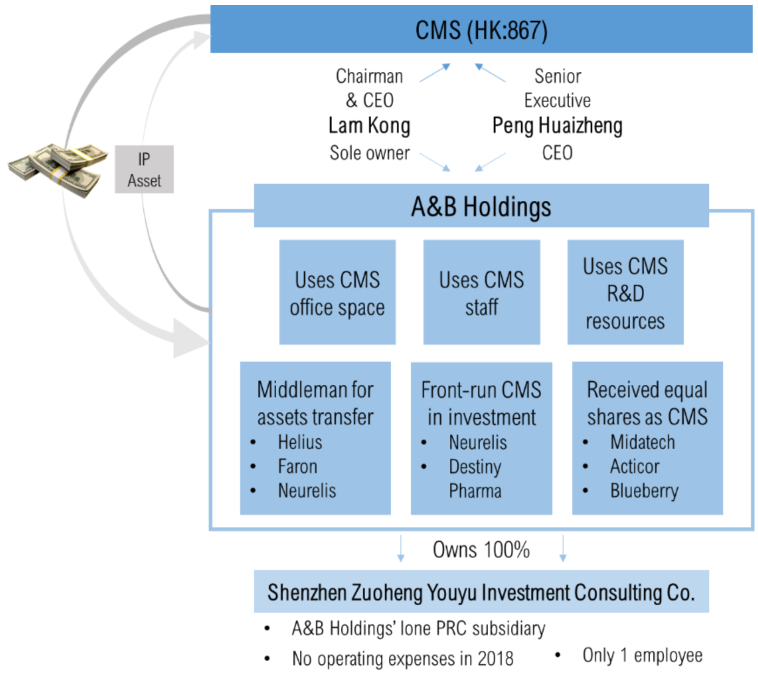
- In many instances, **biotech startups** list CMS, not A&B Holdings, as the investor or counterparty, indicating that potential partners believe they are partnering with the public Company, not the chairman's private vehicle. Yet, in many such cases, it is the chairman's A&B Holdings which receives the **valuable intellectual property**, board rights and shares.

- A&B Holdings is co-located at CMS facilities, lists CMS headquarters as its mailing address and even uses CMS' phone number and @cms email address in its securities filings.

- Local filings show that A&B Holdings' lone Chinese subsidiary only has **one employee** and reported less than RMB 100,000 in operating expenses from 2016 through 2018. Without expenses or employees, there is no chance it conducts any research on its own. Rather, this suggests that its activities are conducted through CMS staff and likely funded, secretly, by the public Company.

- CMS executives are listed as the contact persons for A&B Holdings in investment contracts with biotech startups, indicating that Company employees are used by the chairman for his private benefit.

- In many instances, the drugs have failed, all but wiping out CMS' investment.



Source: Blue Orca

Not only does this pattern merit a considerable corporate governance discount, but in our opinion, suggests that the chairman siphons ever-shrinking profits away from the struggling business.

1) Helius: Chairman Secretly Uses Company Resources in Failed Investment

The first example is emblematic of this egregious pattern of undisclosed self-dealing. The chairman, using Company employees and resources, invested in an US listed biotech startup. Only when the investment appeared on the brink of failure did the chairman then transfer the territorial distribution rights and related IP to CMS. To us, it looks like the chairman inappropriately siphoned Company resources for personal gain, and when his gambit failed, arranged for CMS to bail him out.

On October 13, 2015, publicly listed biotechnology startup Helius Medical Technologies Group (Nasdaq: HSDT) ("Helius") announced a strategic agreement with A&B Holdings, a company wholly owned by Mr. Lam Kong, the chairman and CEO of CMS.

Under this agreement, A&B Holdings acquired certain exclusive distribution rights in Asia for Helius' portable neurostimulation devices ("PoNS Devices") if the product made it to market. In exchange, A&B Holdings provided Helius a USD 7 million credit facility, convertible into Helius shares and warrants.

A&B (HK) Ltd Provides US $7.0M Funding Commitment to Helius Medical Technologies Inc.

NEWTOWN, Pa. & *HONG KONG*--(BUSINESS WIRE)-- **Helius Medical Technologies Inc.** (CSE:HSM; OTCQB:HSDT) ("Helius" or the "Company") announced today that it has entered into strategic agreements with **A&B Company Limited** ("A&B") for the development and commercialization of the Portable Neuromodulation Stimulator ("PoNS™") Therapy in *China*, *Hong Kong*, *Macao*, *Taiwan* and *Singapore* (the "Territories"). A&B is an investment and development company based in *Hong Kong* owned by **Dr. Kong Lam**.

Source: http://www.businesswire.com/news/home/20151013006150/en/

On the surface, it appeared that the chairman was investing exclusively through A&B Holdings, his private vehicle. Yet subsequent disclosures from Helius make clear that the chairman was using CMS resources to facilitate the transaction.

In a Helius 8-K filed on October 16, 2015, two CMS executives, Zhang Lingyan and Peng Huaizheng, were listed as the contact persons for the chairman's private company, A&B Holdings.

24. Notices. All notices, communications and deliveries hereunder shall be made in writing signed by or on behalf of the party making the same and shall be delivered personally or by fax, electronic mail or sent by registered or certified mail (return receipt requested) or by any national overnight courier service (with postage and other fees prepaid) as follows:

If to A&B to:

Zhang Lingyan
Director of Strategic Development and Investment
8/F, Bldg. A, Tongfang Information Harbor, No. 11
Langshan Road, Shenzhen Hi-tech Industrial Park
North, Nanshan District, Shenzhen 518057, P. R.
China
1ingyan@cms.net.cn

with a copy to:

Peng Huaizheng
Director
Tudor House, 62St John's Road, Petts Wood,
Orpington, UK.
huaizhengpeng@cms.net.cn

Source: Helius 8K, October 16, 2015

Notably, both CMS executives listed **@cms.net.cn** as their email address in the Helius contract. If the chairman were privately investing in Helius as he claimed and not using company resources, then CMS executives would not be the contact point for A&B Holdings.

Both individuals were working for CMS at that time. Zhang Lingyan was CMS Company Secretary and "Director of Strategy Development and Investment Affairs."

Company Secretary

Ms. Zhang Lingyan, aged 44, joined the Group in 2000 and currently holds the positions of Company Secretary, Director of Strategy Development and Investment Affairs of the Group and Director of the CEO's office. Ms. Zhang is primarily responsible for overseeing the legal and investment affairs of the Group, assisting Chief Executive Officer in the strategy development work, including compliance with the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited ("Listing Rules"). Ms. Zhang obtained a bachelor's degree in management majored in

Source: CMS 2015 Annual Report

In December 2015, A&B Holdings nominated Peng Huaizheng to the board of Helius. In the accompanying announcement, Helius described Peng as the "*General Manager and non-executive Director of **CMS** and in charge of international operations*."

Additional Directors

Pursuant to the terms of the agreement with A&B, the Company has granted A&B the right to nominate one director to the Board of the **Company and A&B** has appointed Dr. Huaizheng Peng.

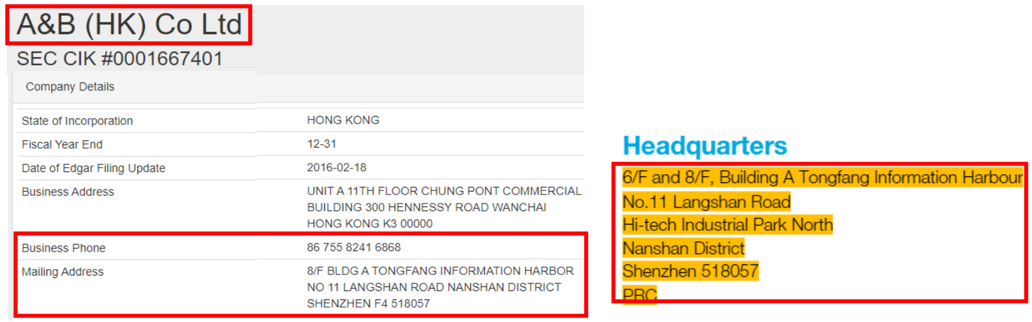
Dr. Peng is a General Manager, and non-executive Director of China Medical System Holdings ("CMS") and in charge of international operations. Prior to joining CMS, **Dr. Peng** was a private equity firm partner at **Northland Bancorp**, head of life sciences and as a director of corporate finance at Seymour Pierce and served as a non-executive Director of China Medstar, an AIM listed medical device company.

Source: http://www.businesswire.com/news/home/20151231005299/en/

Peng Huaizheng's current LinkedIn profile shows that he still works for CMS, as a Managing Director of CMS Medical Venture Investment Ltd, a wholly owned subsidiary of the Company.

Source: LinkedIn

In connection with its Helius investment, A&B Holdings was required to file with the SEC in America. Notably, A&B Holdings listed CMS' headquarters as its mailing address and even used a CMS phone number as its registered business number.


A&B (HK) Co Ltd

SEC CIK #0001667401

Company Details

State of Incorporation	HONG KONG
Fiscal Year End	12-31
Date of Edgar Filing Update	2016-02-18
Business Address	UNIT A 11TH FLOOR CHUNG PONT COMMERCIAL BUILDING 300 HENNESSY ROAD WANCHAI HONG KONG K3 00000
Business Phone	86 755 8241 6868
Mailing Address	8/F BLDG A TONGFANG INFORMATION HARBOR NO 11 LANGSHAN ROAD NANSHAN DISTRICT SHENZHEN F4 518057

Headquarters

6/F and 8/F, Building A Tongfang Information Harbour
No.11 Langshan Road
Hi-tech Industrial Park North
Nanshan District
Shenzhen 518057
PRC

Source: https://sec.report/CIK/0001667401, CMS 2015 Annual Report

Such disclosures make clear that A&B Holdings was co-located at CMS headquarters, it used the Company's phone number in its SEC registration documents, and it used two senior CMS executives as its representatives in the deal. Yet notably, **CMS never revealed any connected party transactions with the chairman's A&B Holdings at this time regarding Helius**. Despite its senior employee serving on the board of the American biotech startup, CMS never mentioned Helius until years later.

The investment proved to be a disaster. From 2015 to 2018, securities filings reveal that the CMS chairman invested USD 9 million in Helius, acquiring convertible promissory notes and warrants which A&B Holdings converted into 2.7 million Helius shares. Helius then failed to obtain clearance from the U.S. Food and Drug Administration, causing its stock to collapse from a high of $17 to its current price of $1.

Helius (Nasdaq: HSDT) Stock Chart

Source: Factset

But when the going got rough, the chairman sold his rights to the Company. Helius was burning cash and clearly experiencing grave headwinds as a business. Yet on August 20, 2018, CMS announced that it was purchasing territorial IP rights for Helius' devices from the chairman's A&B Holdings.

China Medical System Holdings Limited (the "**Company**", together with its subsidiaries, the "**Group**") is pleased to announce that the Group through its wholly-owned subsidiary (the "**CMS Subsidiary**") entered into a framework asset transfer agreement (the "**Agreement**") with A&B (HK) Company Limited ("**A&B**") relating to the portable neurostimulation devices developed by or for the Helius Medical Technologies group ("**Helius**") (the "**Products**"). A&B is a company wholly owned by Mr. Lam Kong, a controlling shareholder (as such term

Source: https://www1.hkexnews.hk/listedco/listconews/sehk/2018/0820/ltn20180820690.pdf

The terms of the deal were not disclosed to investors. Nor did the Company disclose how much it paid the chairman for such rights. However, given that Helius was on the precipice of disaster, we question whether the chairman used CMS to bail him out of a failed investment.

We also question why the Company was purchasing the Helius IP rights from the chairman in 2018, when according to its SEC filings, Helius transferred the applicable patents to CMS in 2016. In a Helius 8-K filed on January 14, 2016, the US biotech startup disclosed that it assigned three patent applications filed in China to CMS.

Additionally, Helius has filed 14 foreign design applications, seven in Canada, three in China, three in Russia, and one community design in Europe. The following three applications filed in China, which have been assigned to China Medical Systems Holdings LTD. pursuant to an asset purchase agreement (the "Strategic Agreement") dated effective October 9, 2015 with A&B (HK) Limited ("A&B") have been allowed:

Chinese Patent Application No.	Application Filing Date	Status	Chinese Patent No.	Issue Date	Subject Matter
201530177804.4	6/3/2015	Allowed	TBD	TBD	design application covering the system design currently used in the PoNS 4.0 device
201530178171.9	6/3/2015	Allowed	TBD	TBD	design application covering the mouthpiece design currently used in the PoNS 4.0 device
201530177398.1	6/3/2015	Allowed	TBD	TBD	design application covering the controller design currently used in the PoNS 4.0 device

Source: Helius 8K, January 14, 2016

Helius claimed in January 2016 that it had assigned the patent applications for its PoNS devices to CMS. But CMS never disclosed any such transactions or reported receiving such assets. Indeed, CMS would not even mention Helius in its Hong Kong filings for another two years.

How could CMS purchase IP rights from the chairman in 2018 when it supposedly acquired the applicable patents from Helius in 2016? Why didn't CMS disclose the transactions with Helius when they happened, if not to conceal the chairman's self-dealing?

We believe, based on the evidence and this pattern of events, that the chairman acquired Helius' IP and distribution rights using Company executives and resources, and when his investment appeared doomed, sold the rights to the Company.

2) Faron: Chairman the Middleman in IP Rights Sale for Another Failed Investment.

On May 8, 2015, chairman Lam's A&B Holdings acquired a 15.72% equity interest in Faron Pharmaceuticals, Ltd ("Faron"), a Finnish biotechnology company listed on London Stock Exchange (LON: FARN). As part of the deal, A&B Holdings also acquired the rights to develop, market and distribute Traumakine in China should the drug make it to commercialization. Faron's public filings show that the equity investment was €5.1 million (RMB 35 million).

- €5.1 million pre-IPO funding from A&B (HK) Company Limited in May 2015, in conjunction with Traumakine ® agreement for Greater China.

Source: Faron 2015 Annual Report

11 days later, on May 19, 2015, the chairman sold his recently acquired Traumakine distribution rights to CMS. Although CMS disclosed the existence of the deal, important details such as the consideration were never revealed to investors. What was the purpose of the chairman acquiring the IP rights for 11 days before he sold them to the Company, if not to unjustly enrich himself as an unnecessary middleman in the deal?

On 8 May 2015, a private company 100% owned by Dr. Lam Kong (the controlling shareholder (as defined in the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules")) of the Company) (the "private company") entered into agreements (the "Faron Agreements") with Faron Pharmaceuticals Ltd. ("Faron"). In accordance with the Faron Agreements, the private company acquired 15.72% of the shares of Faron and acquired assets related to Traumakine® in China, Hong Kong, Macau and Taiwan (the "Territory"), as well as certain intellectual properties related to the product. On 19 May 2015, a wholly-owned subsidiary of the Company (the "CMS Subsidiary"), entered into agreements with the private company and/or Faron ("Transfer Agreements"). Pursuant to the Transfer Agreements, the private company shall transfer the product assets in the Territory to the CMS Subsidiary. The

Source: CMS 2015 Annual Report

We also question if A&B Holdings has truly transferred the intellectual property assets to CMS. In its annual report published in May 2019, Faron still lists A&B Holdings as the license holder in Greater China, suggesting CMS never received the territorial rights.

The Company's existing license agreements with Maruishi in Japan, with A&B in Greater China and with Pharmbio in Republic of Korea each include only one performance obligation, which is the grant of the license to use of its intellectual property ("IP"). After the Company has granted the license, it

Source: Faron 2019 Annual Report

Other disclosures regarding the deal were also highly misleading. CMS claimed that the chairman's A&B Holdings will "continue to invest in the development of the Product" and that the Company will pay royalty fees to the chairman's private entity **<u>only after</u>** the successful commercialization of the product.

sales of the product in the Territory. The private company will continue to invest in the development of Traumakine® within the Territory so that the Group does not need to pay any R&D costs during the late stage of development, and should only pay the private company royalty fees representing a certain percentage of sales of the product after it is successfully commercialized.

Source: CMS 2015 Annual Report

Yet this claim appears to be directly contradicted by Faron's filings. Faron's annual report clearly suggested that CMS is responsible for the costs and risks related to the commercialization of Traumakine in China.

A&B (HK) Company Limited and CMS Pharma Co. Ltd - In May 2015, Faron entered into a licence and asset transfer agreement with A&B (HK) for the commercialisation of Traumakine in the *Greater China* Area. It is intended that A&B (HK)'s commercialisation activities of Traumakine will be conducted by a member of the **CMS Group**, a rapidly growing pharmaceutical group listed on the **Hong Kong Stock Exchange**. Alongside this agreement, A&B (HK) provided equity funding of €5.1 million in aggregate. **CMS Pharma Co. Ltd** owns the right to import, register, market, distribute, promote and sell Traumakine in the *Greater China* Area.

Source: Faron 2015 Annual Report

Even today, Faron's official website ***currently*** states that "the CMS Group covers all territorial development costs."

康哲药业控股有限公司
CHINA MEDICAL SYSTEM HOLDINGS LTD.

The China Medical System Holdings Ltd. (CMS) collaboration in Greater China is based on strategic agreements, according to which the Group (CMS and closely related development company A&B) has assets with Traumakine® rights in Mainland China, Hong Kong, Macao and Taiwan. The CMS Group also covers all territorial development costs. Faron is entitled to a profit per treatment and low double digit royalties above a certain minimum treatment price. A&B is a shareholder of Faron.

Source: https://www.faron.com/about-us/commercial-partnerships

Furthermore, our due diligence shows that A&B Holdings hardly appears to have any R&D capability on its own. Its lone PRC subsidiary, Shenzhen Zuoheng Youyu Investment Consulting Co., ("Shenzhen ZHYY"), is co-located at CMS facilities and uses an @cms email address in its registration documents.

企业基本信息 2019-06-21 公布

注册号	440301503513051	统一社会信用代码	91440300357851131L
企业经营状态	开业	企业联系电话 Contact No.	0755-82416868
从业人数	企业选择不公示	邮政编码	518052
有限责任公司本年度是否发生股东股权转让	否	企业是否有投资信息或购买其他公司股权	否
电子邮箱 Email	cms.legal@cms.net.cn		
企业通讯地址	深圳市坪山区坑梓街道办事处金沙社区锦绣东路16号康哲药业7号105		

Corporate Address: CMS Building 7, Room 105, 16 Jinxiu E. Rd, Pingshan Dist, Shenzhen

股东（发起人）出资信息 企查查

序号	发起人 Shareholder	认缴出资额(万元)	认缴出资日期	认缴出资方式	实缴出资额(万元)	实缴出资日期	实缴出资方式
1	佐佑（香港）有限公司 A&B (HK) Company Limited	500	2015-09-10	货币	500	2015-09-10	货币

Source: https://www.qichacha.com/firm_b0f263360d5b92e01d0764e2de0e937f.html#report

Local filings show that Shenzhen ZHYY only has **one employee** of its own, meaning its activities are conducted through CMS staff and likely funded, secretly, by the public Company. We doubt the chairman's entity can accomplish any meaningful research or product development with one person sitting in a CMS office.

社保信息 Social Security Information

城镇职工基本养老保险 City Employee Basic Pension	1人	Employee Basic Medical Insurance 职工基本医疗保险	1人
生育保险 Maternity Insurance	1人	Unemployement Insurance 失业保险	1人
工伤保险 Work-related Injury Insurance	1人		

Source: https://www.qichacha.com/firm_b0f263360d5b92e01d0764e2de0e937f.html#report

Furthermore, we reviewed the 2016-2018 SAIC filings for Shenzhen ZHYY, which show almost no economic activity.

RMB M	2016	2017	2018
Total Revenue	-	-	-
Total Operating Profit	-	(0.10)	-
Total Tax Expense	-	0.01	-
Total Net Profit	-	(0.10)	-
Total Assets	-	0.00	-
Total Liabilities	-	0.10	-
Total Equity	-	(0.00)	-

Source: SAIC Filings

This suggests that Shenzhen ZHYY was always secretly offloading research expenses to the Company. We believe the Company has intentionally misled investors – A&B Holdings is unlikely to be covering territorial development costs on Faron IP rights without any operating expenses and one employee sitting in a CMS office.

This investment was also a disaster. In May 2018, Faron announced that Traumakine's Phase III trial failed, sending its stock price crashing.

Traumakine® (the "**Product**"). As disclosed in the Announcement, the INTEREST study in Europe did not meet the Day 28 (D28) primary efficacy composite endpoint of ventilator free days and survival with Traumakine® treatment.

The Company believes that, under the current circumstances, the Product will not be able to obtain the necessary regulatory approval for it to be marketed based on the above results.

Source: https://www1.hkexnews.hk/listedco/listconews/sehk/2018/0508/ltn20180508909.pdf

Faron (LON: FARN) Stock Chart

Source: Factset

This is yet another example of a failed investment, but also an instance where CMS purchased IP rights to a drug or device not from the developer, but through the chairman. The terms of the deal were never disclosed, but we believe the only logical explanation to acquire such rights through the chairman (**which he held for only 11 days**) was to unjustly enrich the chairman at the expense of the public Company. It is also notable that CMS claimed it did not bear any development costs, yet at least according to Faron, CMS continues to be responsible for development costs in

China. Which makes sense given the chairman's A&B Holdings has one employee and zero operating expenses, meaning it could not be conducting any such research and development.

CMS and A&B Holdings, the chairman's private investment vehicle, are clearly acting as one, meaning the chairman is inappropriately using Company resources for his personal enrichment. Such rotten related party dealings merit a material corporate governance discount and should undermine any investor confidence in the integrity of CMS' disclosures to the market.

3) Destiny Pharma

On September 4, 2017, CMS announced a framework agreement with Destiny Pharma plc ("Destiny"), through which it acquired the rights to develop, manufacture, sell and commercialize certain Destiny products in China. At the same time, CMS promised to make an equity investment in Destiny, a biotech startup publicly trading on the AIM exchange in London (AIM: DEST).

> The Board of Directors (the "**Board**") of China Medical System Holdings Limited (the "**Company**", together with its subsidiaries, the "**Group**") is pleased to announce that the Group, through a wholly-owned subsidiary of the Company, has entered into a binding investment, development and commercialisation framework agreement ("**Framework Agreement**") with Destiny Pharma plc ("**Destiny Pharma**").

> and product data or documentations; and (ii) on reaching the above agreement, the Group will make an equity investment in Destiny Pharma.

Source: https://www1.hkexnews.hk/listedco/listconews/sehk/2017/0904/ltn20170904789.pdf

The timing of the announcement is significant: it was Destiny's first day of trading on the AIM stock exchange. The announcement appears clearly timed to juice the fledgling biotech's stock price, but why?

What CMS failed to disclose was that A&B Holdings, chairman Lam's private investment company, made a pre-IPO £3 million investment in Destiny. This creates two problems. First, it appears that CMS' announcement was timed to boost the stock price of a firm in which the chairman was secretly invested.

Second, the Company failed to disclose that the chairman had a prior equity investment in the target. This matters because we know from other deals that his so-called private entity is run using CMS staff and resources. It also increases the risk that the chairman leveraged CMS to invest at favorable terms.

> **Brighton, United Kingdom – 4 September 2017** – Destiny Pharma (AIM: DEST), a clinical stage biotechnology company focused on the development of novel anti-microbial drugs, which address the global problem of anti-microbial resistance (AMR) , is pleased to announce it has entered into a framework development and commercialisation collaboration agreement with China Medical System Holdings Ltd (**"CMS"**) (867:HK).

> manufacturing margin on any product Destiny Pharma supplies. In addition, A&B (HK) Company Ltd (**"A&B"**), a company with a controlling shareholder in common with CMS, has invested £3 million in a placing of new ordinary shares in Destiny Pharma, announced today, that raised gross proceeds of £15.3m (see separate announcement).

Source: https://www.destinypharma.com/2017/09/04/framework-agreement-with-china-medical-systems/

The chairman secretly front ran the Company's investment through a private entity which uses Company resources. He then had CMS announce a deal with the target on its first day of trading, presumably to his personal benefit. We believe that if revealed to the market, investors should take a dim view of such transactions, as it appears that the chairman is secretly benefiting at the expense of the public Company.

Predictably, this was yet another disastrous investment. CMS invested another £3 million in Destiny in December 2017. At the closing price of £0.38 per share as of February 4, 2020, the current holdings of CMS and A&B in Destiny are worth less £1 million, a 76% decline from their original investment.

Like other early stage biotech investments in Helius and Faron, CMS' dealings with the chairman appear to be disastrous.

Destiny Pharma (AIM: DEST) Stock Chart

Source: Factset

4) The List Goes On and On…

We could fill a short novel of examples of inappropriate self-dealing.

a. Neurelis: Chairman again the Middleman. In 2018, the Company announced the acquisition of territorial distribution rights from a private US biotech startup, Neurelis. Yet rather than purchase such IP from Neurelis, the Company bought it from its chairman, who front ran the Company's involvement. Few details were revealed regarding this transaction, but in our opinion, it is reasonable to assume that the chairman is inappropriately benefited as an unnecessary middleman in the sale of the distribution rights, and we question whether he is leveraging CMS and Company resources to negotiate better terms for his private investments in potential partners such as Neurelis.

b. Midatech: Chairman's Secret Co-Investment into Another Failed Biotech Startup. In January 2019, CMS announced a licensing agreement with and equity investment into Midatech Pharma PLC ("Midatech"), a biotech startup publicly traded on the AIM exchange in London (AIM: MTPH). CMS failed to disclose that at the same time, Midatech also issued an equal amount of shares to the chairman's A&B Holdings.

Subscription Agreements. In connection with the License Agreement, on January 29, 2019, the Company entered into a subscription agreement (the "**Subscription Agreement**") with each of A&B HK and CMS HK to subscribe for units ("**Units**") consisting of the Company's Ordinary Shares (the "**New Shares**") and warrants to purchase the New Shares at an exercise price of 50 pence per share (the "**Warrants**"). Pursuant to the terms of the subscription agreements, the Company agreed to issue 103,896,103 Units to each of A&B HK and CMS HK, with each Unit comprising one New Share and one Warrant, for an aggregate of approximately £4.0 million each (approximately £8.0 million total), subject to admission on AIM. The New Shares were admitted to trading on AIM on February 26, 2019.

Source: Midatech SC13D Filing, April 4, 2019

Despite an equal co-investment, the chairman's private entity, according to Midatech's filings, even received a board seat, suggesting that chairman's A&B Holdings was given priority over CMS and its shareholders.

Proposed non-executive Director

Pursuant to the Subscription, A&B is entitled to nominate a non-executive director to the Board of the Company and a Board observer for so long as A&B shall hold in excess of 10 per cent. of the issued share capital of the Company. It is intended that Dr. Huaizheng Peng (a director of CMS Venture and the Chief Executive Officer of A&B) will be appointed as a non-executive director of the Company following completion of the Proposed Subscription.

Source: Midatech 6K Filing, January 28, 2019

Given that A&B Holdings appears to be just a shell using CMS staff, offices and resources, such undisclosed related party transactions are, in our opinion, an obvious example of the chairman unjustly enriching himself by using CMS resources for his private benefit.

c. Acticor and Blueberry: More Undisclosed Co-Investments. In 2018, CMS announced equity investments in two European biotech startups, Acticor Biotech ("Acticor") and Blueberry Therapeutics Limited ("Blueberry

Therapeutics”). What CMS did not tell the market is that at the same time, the targets also issued an equal number of shares to the chairman.

RAPPEL PREALABLE

Le Président rappelle qu'aux termes des Décisions des Associés, ces derniers ont notamment décidé d'augmenter le capital social de la Société d'un montant nominal de 59.260 euros par l'émission de 59.260 actions ordinaires d'une valeur nominale d'un (1) euro, au prix unitaire de 135 euros (prime d'émission de 134 euros incluse), soit un prix de souscription total de 8.000.100 euros et une prime d'émission totale de 7.940.840 euros (l' « **Augmentation de Capital** »), avec suppression du droit préférentiel de souscription des associés au profit des bénéficiaires et dans les proportions suivantes :

- A&B (HK) Company Limited .... à hauteur de 29.630 actions ordinaires
- CMS Medical Venture (HK) Investment Limited .... à hauteur de 29.630 actions ordinaires

(les « **Souscripteurs** »).

Souscripteur	Nombre d'actions ordinaires	Montant de la souscription
A&B (HK) Company Limited	29.630	4.000.050 €
CMS Medical Venture (HK) Investment Limited	29.630	4.000.050 €
TOTAL	**59.260**	**8.000.100 €**

Translation: The chairman recalls that under the decisions of the shareholders, the latter decided to increase the capital of the company by a nominal amount of 59,260 euros by the issue of 59,260 ordinary shares with a nominal value of one (1) euro, at a unit price of 135 euros (issue premium of 134 euros included), i.e. a total subscription price of 8,000,100 and a total issue premium of 7,940,840 euros (capital increase)…

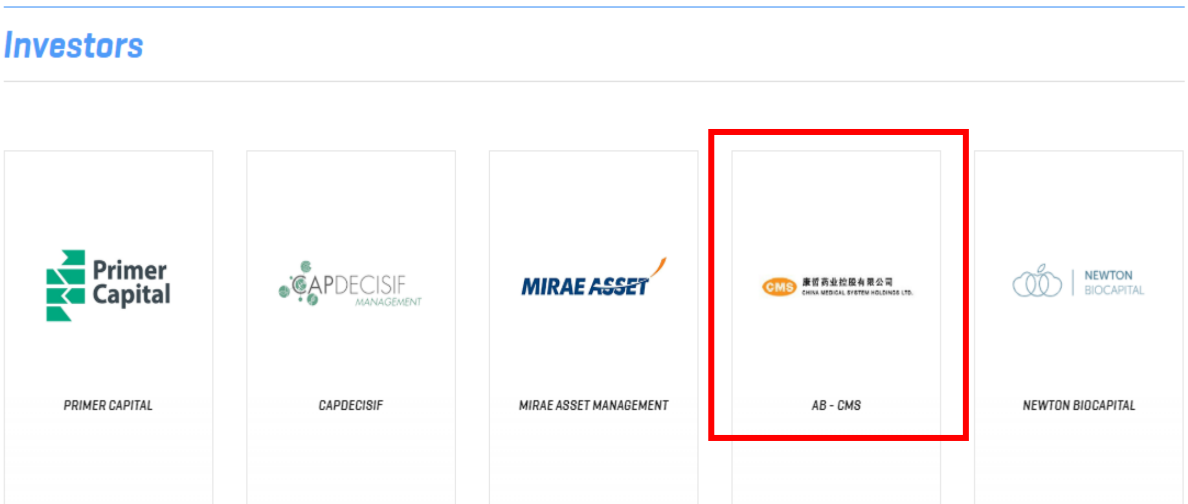
Source: French Regulatory Filings of Acitcor, dated September 18, 2018

Shareholding 26:	**418410 ORDINARY shares held as at the date of this confirmation statement**
Name:	**CMS MEDICAL VENTURE INVESTMENTS (HK) LIMITED**
Shareholding 27:	**418410 ORDINARY shares held as at the date of this confirmation statement**
Name:	**A&B (HK) COMPANY LIMITED**

Source: Blueberry Therapeutics UK Filing

It is not a stretch to conclude that the chairman is inappropriately leveraging the public Company and its resources to invest at favorable terms.

Indeed, Acticor’s website suggests the French biotech startup views CMS and the chairman’s private firm interchangeably. Acticor proudly displays its investors and partners on its website but refers to A&B Holdings-CMS as the same firm.



Source: https://acticor-biotech.com/partners-investors-new/

Furthermore, in Acticor's list of directors, it lists Huaizheng Peng's company as A&B Holdings, but describes him as the general manager of international investment and operations for CMS.

Source: https://acticor-biotech.com/about-us/board-of-directors/

This is critical because CMS discloses **zero connected party transactions with A&B Holdings** in its Hong Kong filings regarding Acticor. Yet Acticor's website clearly shows that CMS senior officers are also working at the same time for the chairman's private company (A&B Holdings), whose subsidiary is co-located in CMS' headquarters. We believe that Acticor, like other examples, shows that the chairman is inappropriately enriching himself at the expense of shareholders by secretly using CMS' managers, employees and resources and to his private benefit.

VALUATION

In this report, we present evidence, including local regulatory filings and financials filed with A-share securities regulators, indicating that the Company's net profit is 49% less than reported to investors.

Rather than supporting the Company's claims of rising profitability, which make no sense in the context of the government's efforts to suppress drug prices by removing middlemen like CMS from the distribution chain, the independent evidence indicates that the Company's profit overstatement is only increasing as it struggles under the weight of policy changes designed to undermine its business.

Source: CMS Annual Reports compared to A-share Filings and SAIC Filings

Help is not coming. Despite recent announcements hyping the purchase of licensing rights in China for certain generic drugs, CMS has rarely been successful in introducing new drugs to China which had not previously been granted approval. Since 2010, CMS has initiated import drug license (IDL) registration for a total of 13 drugs. As of December 31, 2018, none of the drugs have received their IDL approval and CMS has terminated the registration applications for 10 of the drugs.

A History of Failure: CMS IDL Applications Status

Drug/Product	Year Acquired	Current Status
Budenofalk (capsule)	2010	Undergoing application process for IDL
Budenofalk (foam aerosol)	2010	IDL registration terminated in 2017
L-lysine Aescinat	2011	IDL registration terminated in 2015*
Thiotriazolin	2011	IDL registration terminated in 2015*
Maltofer (Syrup)	2012	IDL registration terminated in 2018
Maltofer (Chewable Tablets)	2012	IDL registration terminated in 2018
Uro-Vaxom	2012	IDL registration terminated in 2016
Stimol	2013	IDL registration terminated in 2016
Ze 339	2013	Undergoing application process for IDL
Ze 450	2013	IDL registration terminated in 2017
Ze 440	2013	IDL registration terminated in 2017
Succinylated Gelatin Injection	2014	Undergoing application process for IDL
Succinylated Gelatin Electrolyte Injection	2014	IDL registration terminated in 2017

**CMS stopped disclosing the status update for L-lysine Asecinat and Thirotriazoline beginning in 2015. China FDA database did not show these two drugs have obtained IDL approvals*

Source: CMS Annual Reports

The independent evidence indicates that the business is struggling and only getting worse. There is also a troubling pattern of undisclosed self-dealing. Chinese FDA records indicate that contrary to the Company's claims, CMS bears research and development costs for the chairman's private companies. We also found numerous instances in which the chairman uses CMS staff and resources to invest for personal benefit in biotech startups, acquiring rights which he then re-sells to CMS.

It is critical to note that local filings for the chairman's private entities show almost no employees and almost no operating expenses, meaning that the research and investment undertaken by these privately owned entities is likely done using CMS, Company employees and Company resources. Through this rotten self-dealing, we believe that the chairman siphons ever-shrinking profits away from the struggling business.

If we value the Company on the profits CMS discloses to Chinese authorities and apply a modest 25% corporate governance discount to its P/E multiple, we value CMS at HKD 3.95 per share, a 62% downside from its current price.

	1H 19 LTM
Reported net profit (RMB M)	2,062
% Adjustment	-49%
Adjusted net profit (RMB M)	1,044
Diluted EPS (RMB)	0.42
Diluted EPS (HKD)	0.47
P/E	11.3x
Corporate governance discount	25%
Adjusted P/E	8.5x
Blue Orca Valuation (HKD)	3.95
Last Traded Price (HKD)	10.40
Downside	**-62%**

Source: Blue Orca Calculation

But even this valuation is likely far too charitable. In our opinion, the evidence suggests that the Company exaggerates its financial performance, inflates profits and conceals that dwindling Company profits are used to privately enrich its chairman. Given the overwhelming evidence suggesting that CMS misleads investors, we believe that CMS is simply uninvestable.

DISCLAIMER

We are short sellers. We are biased. So are long investors. So is CMS. So are the banks that raised money for the Company. If you are invested (either long or short) in CMS, so are you. Just because we are biased does not mean that we are wrong. We, like everyone else, are entitled to our opinions and to the right to express such opinions in a public forum. We believe that the publication of our opinions about the public companies we research is in the public interest.

You are reading a short-biased opinion piece. Obviously, we will make money if the price of CMS stock declines. This report and all statements contained herein are solely the opinion of BOC Texas, LLC, and are not statements of fact. Our opinions are held in good faith, and we have based them upon publicly available evidence, which we set out in our research report to support our opinions. We conducted research and analysis based on public information in a manner that any person could have done if they had been interested in doing so. You can publicly access any piece of evidence cited in this report or that we relied on to write this report. Think critically about our report and do your own homework before making any investment decisions. We are prepared to support everything we say, if necessary, in a court of law.

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This report should only be considered in its entirety. Each section should be read in the context of the entire report, and no section, paragraph, sentence or phrase is intended to stand alone or to be interpreted in isolation without reference to the rest of the report. The section headings contained in this report are for reference purposes only and may only be considered in conjunction with the detailed statements of opinion in their respective sections.

For convenience purposes only, we have provided a Chinese translation of this report. In case of any discrepancy or inconsistency between the Chinese and the English versions of this report, the English version is the original and should prevail. In case of any legal dispute, reference shall be made only to the English version.

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