

Chemical-free additives**Biotech – F&B****China Medical Science (8120 HK, HK\$0.156)****Not Rated**

Placement. China Medical Science Ltd (CMSL) announced on 19 January 2007 that it issued a top up placement of 260m shares at HK\$0.148 each, representing a 5.13% discount to its last closing price of HK\$0.156. The shares represent 52.00% of its existing capital and 20.97% of its enlarged share capital. The issue is expected to raise HK\$37.00m in net proceeds, which will be used mainly for the expansion of its production facilities.

New major shareholder. JBC Bio-Tech (JBCBT), which holds 70.00% of JBC Bio Products (JBCBP), has acquired 38.13% of CMSL becoming its largest major shareholder. CMSL, through JBCBT, will focus on the development, production, sales and distribution of feed supplements developed from lactobacillus fermentum. JBCBT will nominate a majority of the directors to the board and the chairman is to be elected from among the directors later.

Table 1: Post top-up placement shareholder structure

	No. of shares
JBC Bio-Tech	480,000,000
CPT* and its associates	400,000,000
Directors of CPT*	6,600,000
Public shareholders	
- Placees	260,000,000
- Public	112,400,000
Total	1,259,000,000

* Concord Pharmaceutical Technology (CPT) used to be the largest single shareholder.

Source: Company data

JBC Bio-Tech. JBCBT acquired 70.00% in JBCBP for a consideration of 480m new shares in December 2006. Currently, JBCBT is 90.00% owned by Ms. Liu Yang. Incorporated in November 2002 and based in Zhongshan, Guangdong, JBC Group comprises JBCBP, which wholly owns JBC China. JBC China wholly owns Zhongshan JBC Bio-Technology, which was set up in November 2003 and is principally engaged in the development and manufacture of animal feed supplements developed mainly from lactobacillus fermentum. Its current annual production capacity is estimated at around 80 tonnes sufficient to feed about 220,000 piglets a year.

Professional verification. JBCBP has developed a series of bio products for livestock and poultry using lactobacillus fermentum. Its lactobacillus additives are used in the production of pork known as “Sakura” pork. On 6 November 2003, Southern China Agricultural University issued a certificate strongly endorsing JBCBP’s products for livestock feeding. In an experiment conducted by the university, the weight growth rate of pigs fed with JBCBP’s products was 17.25% higher than that in the control group, and the feedstuff yield growth rate in the test group was 14.57% higher than in the control group. The products are chemical-free. No side effects were noted. China’s Ministry of Agriculture evaluated and certified JBCBP’s “Sakura” pork and special cultivation techniques in 10 April 2004.

Key management of JBCBT. Liu Yang is the founder of JBC Group and Chairwoman of JBCBT. She holds a law degree from China Politics and Law University. Other senior executives include: Dr. Jiang Zhi Guang – Director of Product, has with around 20 years of experience in photo-electronics and biotechnology; Professor Jin Feng - Director of Research and Development, holds a Doctorate in Anthropology and Human Genetics from the Department of Anthropology, Faculty of Science, the University of Tokyo, Japan.

We believe the growth outlook for JBCBP's feed supplement business is strong because of:

- ❑ Preference for antibiotic substitutes. Concerns about food safety and the quality of animal feeds are on the rise. Sweden banned the use of antibiotics as animal growth promoters in 1986, Denmark in 1999 and the European Union in 2006. JBCBP's feed supplements are developed mainly from *Lactobacillus fermentum*, which is one of the most commonly used pro-biotics (friendly bacteria). Pro-biotics inhabit intestines of humans and all animals and prevent the entrance and proliferation of organisms, which cause disease.
- ❑ Wide range of applications. JBCBP's products can also be used in poultry, fishery product cultivation and preservation of fresh fruit and vegetables. After encouraging results in piglets, the feed supplements were used in two poultry farms and one aquatic farm in late 2005. They improved the quality of chicken and shrimp, completely replacing the use of antibiotics and other chemical growth promoters, resulting in safer food and preventing infectious diseases. In the longer term, the company aims to extent its medical research to humans, focusing on diabetes, cancer, respiratory infections and contagious diseases.
- ❑ Patented technology. JBCBP's patented technology platforms provide a gateway for future business development and product diversification. In China, the company patented its feed supplements manufacturing methods under the name of "*Methods of manufacture domestic animal feeds*" on 28 December 2005 for 20 years from 8 March 2004 and such patent is held by the guarantor (Ms. Liu). The registration of the assignment of the PRC patent will be completed by February 2007. The company's proprietary intellectual property rights to its *Lactobacillus* and fermentation methodology have enhanced its competitiveness in the biological industry
- ❑ Proven track record. JBCBP's licensed "Sakura Meat" series is now sold in Singapore's supermarkets, after two-year commercial scale trials in China. JBCBP plans to further penetrate the Malaysian market after introducing its feed additives to one pig farm and one chicken farm. JBCBP has also got approval from the Australian government to export bio additives to the country and will begin its first stage trial in one farm this March. We expect CMSL to adopt JBCBP's business model that proved successful in Southeast Asian countries to penetrate more markets, including China.
- ❑ Committed management team. Ms. Liu's commitment and the group's strong scientific advisory board, which comprises members from leading universities and research institutes in Japan, the US and China, has enhanced the group's technological research capabilities in the biological field and its ability to respond quickly to customers' needs and the challenges of the global biological industry.
- ❑ Government support in China. According to an official work report, the Chinese government planned to spend RMB339.70b on agriculture, farming villages and farmers in 2006. It also earmarked funds for the reform of the country's veterinary medicine management system, development of the animal disease prevention and control system and structural adjustments to promote the development of the livestock and poultry industry.
- ❑ Strong growth prospects. China is the world's largest producer and consumer of pork. According to a report issued by Agriculture and Agri-Food Canada in March 2006, China was expected to account for 53.35% of the world's pork production of 97.20m tones in 2006. By 2010, a 0.10% increase in the use of bio feed supplements will boost demand for probiotic bacteria feed supplements by 200,000 tons, from 1,000 tons in 2000, according to China's National Development and Reform Commission in 2001.

Valuation. There is no direct comparable listed peer in Hong Kong. The most relevant comparable listed peer is Japan's Yakult Honsha Co (2267 JP, JPY 3310, NR), which is currently trading at FY03/06A P/E of 86.4x and 66.7x for FY03/07F.

Disclosure of Interest: SBI E2-Capital Securities Ltd. acted as the sole book runner and placement agent for the China Medical Science's top up placement on 16 January 2007.