

China Agriculture Industry (OUTPERFORM): Continue to recommend seed, sugar, live pig and aquaculture sub-sectors

- ❖ Sep 2010E strategic views. The Mainland seed industry is our top pick for Sep 2010E, given: (i) increasing sales of new varieties such as Xianyu 335 and 'super-maize'; (ii) better-than-expected earnings of certain old varieties; (iii) imminent rollout of supportive policies; and (iv) earnings of major seed companies will likely be better than expected. Sub-sectors such as sugar processing, high-end breeding (aquaculture + animal breeding) and animal vaccines are our key recommendations.
- ❖ Prices of agricultural products: USDA's Aug 2010 supply and demand report provided the backdrop for a bullish international market for agricultural products. Affected by floods and droughts, wheat and corn yields continued to fall and some countries restricted grain exports. Future weather uncertainties and a gradual pickup in demand will underpin the uptrend of international grain prices. In China, due to reduced yields of summer grain and early rice which are expected to extend into autumn, the State stepped up efforts to control and suppress the excessive rise in food and grain prices. However, taking into account all factors including expectations of reduced yield, State reserve and inventories, grain prices will likely rise 15% YoY for full-year 2010E (+11.8% YoY in 1H10). Due to the increased likelihood of reduced sugar cane production coupled with rising international sugar prices, we forecast that the Mainland's sugar prices will rise to over Rmb6,000/tonne in 2H10E. Inventory stocking for the festive seasons ahead and the upcoming high season for consumption will boost pork prices amid volatility.
- ❖ Operational efficiency of listed counters continued to improve. During Jan-Jun 2010, the Mainland agricultural sector posted: (i) turnover of Rmb57.63bn (+21.59% YoY); (ii) operating costs of Rmb46.92bn (+22.66% YoY); and (iii) consolidated net profit of Rmb2.14bn (+13.94% YoY, excluding investment gains). On the whole, the sugar, wood processing, seed and aquaculture industries reported the fastest YoY growth in net profit after deducting investment gains. Operational efficiency of companies continued to improve sector-wide, while cost/income ratios trended down during the period.
- ❖ Seed industry will continue to lead others, while the sugar industry presents outstanding opportunities for trend investment. While 1H10 results of some companies were affected somewhat by natural disasters and wild swing in prices of agricultural products, with the upcoming rollout of supportive policies and improving management and operating standards of listed plays, we believe the sector's profit growth will rise continually. On the back of an upbeat sector climate, the increasing contribution of new products to sector earnings and the anticipation of rising prices of related agricultural products, we project that earnings growth of sub-sectors such as seed, sugar, high-end breeding, animal vaccines and furniture making will be sustainable.
- ❖ Maintain OUTPERFORM sector rating. We maintain our OUTPERFORM sector rating and fundamental view that the seed industry will outrun other sub-sectors. Market sentiment will remain upbeat given: (i) better-than-expected earnings growth of listed seed, sugar and high-end breeding counters; (ii) rising prices of agricultural products; and (iii) anticipated rollout of seed policy. Our recommended portfolio for Sep 2010E is comprised of Denghai Seed, Fengle Seed, Long Ping High-Tech, Dunhuang Seed, Nanning Sugar, Shunxin Agriculture, China Animal Husbandry, Yihua Timber, Sunner Development, Zhengbang Technology and Zhangzidao. On the Hong Kong bourse, investors may follow Sinofert (00297.HK), Xiwang Sugar (02088.HK) and Yurun (01068.HK).
- ❖ Risks associated with investing in the sector. (i) Extreme weather; (ii) pandemic outbreaks; and (iii) serious pests and diseases of crops.

Peers' comparisons – China Agriculture Industry

Company	Price (HK\$)	PER (x)			PEG (x) 09-11E	P/B (x) 10E	Yield (%) 10E	RoE (%) 10E
		09	10E	11E				
Hong Kong - average		16	13	10	2.7	1.7	1.7	15
Chaoda Modern (00682.HK)	6.10	4	4	4	19.4	0.8	1.6	21
China Green (00904.HK)	7.59	12	10	9	0.9	2.0	2.4	20
Mengniu Dairy (02319.HK)	23.15	26	25	20	NA	3.9	0.8	16
Yurun Food (01068.HK)	28.95	27	20	18	1.3	4.5	1.3	25
Xiwang Sugar (02088.HK)	2.11	15	8	6	0.3	1.0	4.2	13
Global Bio-Chem (00809.HK)	1.18	10	7	7	0.4	0.4	1.2	6
Global Sweeteners (03889.HK)	1.36	12	9	6	0.3	0.8	0.0	10
China Agri-Industries (00606.HK)	9.71	19	14	12	0.7	2.0	1.7	15
Andre Juice (08259.HK)	0.38	22	14	9	0.4	1.2	2.1	8
Haisheng Juice (00359.HK)	0.89	10	5	6	0.4	0.9	2.2	18
Sinofert (00297.HK)	4.06	NA	22	16	NA	1.9	0.7	9

Source: Respective companies, Bloomberg, CSI

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Investment rating system

Performance of stock or sector relative to MSCI-China Index over next 6 months after research publications

	Rating	Remark
Stock rating	Buy	Relative performance over MSCI-China Index >20%
	Overweight	Relative performance over MSCI-China Index 5% ~ 20%
	Hold	Relative performance over MSCI-China Index -10% ~ 5%
	Sell	Relative performance over MSCI-China Index > -10%
	NR	Not rated
Sector rating	Outperform	Relative performance over MSCI-China Index >10%
	Neutral	Relative performance over MSCI-China Index -10% ~10%
	Underperform	Relative performance over MSCI-China Index > -10%

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