

China Agriculture Industry (NEUTRAL) – Policy and results may drive up the sector

- ❖ Global: Food prices heading downwards again; China: stable grain prices, moderate adjustment of sugar and cotton prices, and a gradual decline of pork prices. In Jan 2012, persistent droughts in South American food producing areas pushed food prices up in international markets. Additionally, due to the downbeat USDA supply-demand report and quarterly grain inventory report, as well as macro negatives (including the EU debt crisis) and regional instability, commodity markets have remained under pressure. In Feb 2012E, given: (i) a recovering global grain supply, (ii) slowing growth in demand, and (iii) liquidity risks, we expect that global food prices will return to a downward path. In the post-holiday domestic market, grain prices should remain largely stable and pork prices may decline gradually. Given sluggish supply-demand coupled with policy support, prices of sugar and cotton could undergo moderate adjustment.
- ❖ The Central Doc. No.1 for 2012 is pending, with emphasis on agricultural technology. The Central Doc. No.1 for 2012 is expected to release soon. We believe the document will focus on: (i) securing food supply; (ii) promoting agricultural R&D and training relevant specialists; and (iii) consolidating the material foundation for the advancement of the Mainland agricultural industry. We believe that top priority will be given to R&D in the seed sector. Policy support to agriculture, rural areas, and farmers will be stepped up, with emphasis on promoting agricultural technology, especially in the seed and farm equipment sectors.
- ❖ Seed: Leading players are tipped to grow rapidly on favorable policies and strong seed reserves. In 2012E, the seed industry will also see major development opportunities. Supportive policies will aim at: (i) reinforcing the market status of companies engaged in seed breeding, multiplication, and promotion; (ii) enhancing companies' seed breeding capacity; (iii) expanding the scale and strengthening leading companies; and (iv) stepping up law enforcement regarding seed application. Currently, major companies are accelerating the pace of M&A activity and boosting investment in R&D. Quality new seeds have been secured by listed seed breeders and are being released to the market, signaling strong earnings growth ahead.
- ❖ Feed: Upbeat business climate in 1-3Q12E. Sample data show that sales of feed picked up in 4Q11. We forecast that a favorable business climate will be sustained till 3Q12E. In view of the promising market, leading companies have fixed plans to expand in scale. We remain optimistic about the structural shift in the feed industry and look to a strong market in 1-3Q12E.
- ❖ Potential risks associated with investing in the sector: (i) Plant/animal diseases and natural disasters; (ii) deflation; and (iii) food safety scares.
- ❖ Investment strategy for Feb 2012E: Sector valuation plunged in Jan 2012. The fall was partly a correction after peaking, but more a case of playing "catch-up" following a decline in the broad market. In the short-term, the correction in share prices is basically over. Additionally, given a favorable Central Doc. No. 1 and the posting of strong 2011E results posted by some companies, we remain upbeat on listed seed and feed producers. Given the recent excessive decline in some plays, the livestock and poultry sub-sectors may also present investment opportunities.

Peers' comparison - China Agriculture Industry (HK)

Company	Price (HK\$)	PER (x)			PEG (x) 10-12E	P/B (x) 12E	Yield (%) 12E	RoE (%) 12E
		10	11E	12E				
Hong Kong - average		12.4	7.7	6.8	0.5	0.9	4.5	14
Chaoda Modern (00682.HK)*	1.10	0.8	NA	NA	NA	NA	NA	NA
China Green (00904.HK)*	2.18	2.7	2.6	2.7	NA	0.5	10.7	17
Mengniu Dairy (02319.HK)	21.35	24.4	18.7	16.8	1.2	2.4	1.4	15
Yurun Food (01068.HK)	12.76	8.2	7.5	6.8	0.8	1.3	3.2	20
Xiwang Sugar (02088.HK)	1.14	4.4	4.3	3.9	0.8	0.4	NA	10
Global Bio-Chem (00809.HK)	1.77	14.6	5.1	5.7	0.2	0.4	5.1	8
Global Sweeteners (03889.HK)	0.90	11.4	5.0	4.9	0.2	0.4	NA	9
China Agri-Industries (00606.HK)	6.29	14.6	8.9	7.7	0.4	1.0	3.4	14
Andre Juice (02218.HK)	0.255	18.0	10.4	NA	NA	NA	NA	NA
Haisheng Juice (00359.HK)	0.80	14.9	3.3	2.8	0.1	0.6	6.1	23
Sinofert (00297.HK)	2.12	22.6	11.3	10.0	0.4	0.8	1.6	9

Source: Respective companies, Bloomberg, CSI

*Annualized figures

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Performance of stock or sector relative to MSCI-China 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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