

### China Agriculture Industry (NEUTRAL) – Policy upside may lead to a further rebound in share prices of agricultural stocks

- ❖ New policy essentially in line with our expectations. The Central Doc. No.1 for 2012 consists of six parts with 23 articles. Future efforts called for include: (i) increased investment and accelerated efforts to realize further and steady growth in agriculture; (ii) guide and support the construction of a modern agricultural system based on new technology and industry innovation; (iii) promote agricultural R&D and expand social services in rural areas; (iv) strengthen education and training to foster a rural force of modern agricultural specialists; (v) improve agricultural facilities and equipment, constantly consolidating the material foundation for the advancement of the agricultural industry; and (vi) improve market efficiency and secure a steady and balanced supply of agricultural products.
- ❖ Government spending on agriculture over the next three years is tipped to multiply; seed R&D will be given priority. According to our statistics, China's fiscal spending on agricultural technology came to ~Rmb67bn over the past few years, with ~Rmb24bn on R&D and the rest on the promotion and extension of agricultural technology. Given the requirements set in the Central Doc. No. 1 and that developed countries typically spend ~2.5% of agricultural GDP on R&D, based on China's agricultural GDP of Rmb6-7trn we estimate that it will spend at least Rmb200bn on R&D in this area. As the prices of raw and deep-processed agricultural products rise, the scale of Mainland agricultural GDP will also rise rapidly. This will result in a rise in fiscal spending on industry R&D.
- ❖ Improvement in the cultivation model will boost demand for harvesting and drip irrigation equipment. As a key area in agricultural technology, the improvement in cultivation methods will lead to the building of high-quality fields and further mechanization of farm production, boosting demand for farm equipment. Should Central Doc. No. 1 for 2012 include specific objectives in this area, a high-growth period is in the offing for the farm equipment sector, benefiting manufacturers of equipment (including corn harvesters, rice planters, cotton harvesters, sugar cane harvesters and drip irrigation equipment).
- ❖ An improving system for the application of technology will benefit leading players. We believe in the system for the promotion of farm technology, extension and service is the "last mile" in the journey of transforming R&D into real means of production. We expect to see further improvement in this respect going forward. An improved extension system will promote the efficient transformation of R&D into real capacity. Additionally, it will minimize waste in government spending on R&D and boost farm production efficiency. At the same time, appropriate technologies will significantly enhance the impact of application (such as the use of quality seeds). As a result, clients' brand loyalty will be reinforced.
- ❖ Reiterate our NEUTRAL rating on the agricultural industry, with focus on the seed and equipment sub-sectors. We are of the view that the decline in sector valuation in Jan 2012 was more a case of playing "catch-up" following a decline in the broad market than a correction following a market peak. In the short-term, the correction in share prices is basically over. Given a favorable Central Doc. No. 1 and the posting of strong 2011E results by some companies, we remain upbeat on listed seed and feed producers. Due to the recent excessive decline in some plays, the livestock and poultry sub-sectors may also present investment opportunities. We maintain our NEUTRAL rating on the sector and recommend following seed and equipment makers as they are potentially the primary beneficiaries of the new policy.

## 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				
<b>Hong Kong - average</b>		<b>12.7</b>	<b>8.0</b>	<b>7.0</b>	<b>0.5</b>	<b>0.9</b>	<b>4.4</b>	<b>14</b>
Chaoda Modern (00682.HK)*	1.10	0.8	NA	NA	NA	NA	NA	NA
China Green (00904.HK)*	2.25	3.2	3.0	2.7	0.3	0.5	10.4	17
Mengniu Dairy (02319.HK)	22.15	25.3	19.4	17.5	1.3	2.5	1.3	15
Yurun Food (01068.HK)	12.96	8.3	7.6	6.9	0.9	1.3	3.1	20
Xiwang Sugar (02088.HK)	1.14	4.4	4.3	3.9	0.8	0.4	NA	10
Global Bio-Chem (00809.HK)	1.86	15.4	5.4	6.0	0.3	0.5	4.8	8
Global Sweeteners (03889.HK)	0.93	11.8	5.2	5.0	0.2	0.4	NA	9
China Agri-Industries (00606.HK)	6.40	14.8	9.1	7.9	0.4	1.1	3.3	14
Andre Juice (02218.HK)	0.26	18.4	10.6	NA	NA	NA	NA	NA
Haisheng Juice (00359.HK)	0.77	14.3	3.2	2.7	0.1	0.6	6.4	23
Sinofert (00297.HK)	2.22	23.6	11.9	10.4	0.5	0.9	1.5	9

Source: Respective companies, Bloomberg, CSI

\*Annualized figures

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## Investment rating system

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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