

Asian Citrus Holdings Limited

Vertical expansion to mid-stream...

to summarize...

- The group reported interim result of FY2011/12. Revenue increased 67.2% YoY to RMB1,043.6m. Net profit decreased 26.7% YoY to RMB383.6m. Excluding the net gain on change in fair value of biological assets and share-based payments, net income for the period increased 51% YoY to RMB308.8m.
- Oranges accounted for 61.8% of sales compared to 84.2% in the previous period. Processed fruits accounted for 38.0%. In terms of sales channels, corporate customers accounted for 42.9%, supermarket chains accounted for 32% and wholesaler accounted for 24.6%.
- Gross margin declined 5 PCP to 38.9%, due to the effect of incorporation of Beihai BPG, a newly acquired business.
- Total production increased 19.4% YoY to 171,607 tonnes. Direct sales channels expanded to 22 supermarket chains. Beihai BPG sold a total of 38,418 tonnes.
- The counter is currently trading at 7.6x current year fwd P/E on consensus. The Hong Kong listed producers are currently trading at average 10.7x current-yr forward P/E and 7.8x 1-year forward P/E based on market consensus.

Latest reported results: The group reported interim result of FY2011/12. Revenue increased 67.2% YoY to RMB1,043.6m. Gross profit of the period increased 47.5% YoY to RMB406.3m. Net profit decreased 26.7% YoY to RMB383.6m. The decrease was due to the drop in net gain of the fair value of biological assets. Excluding the net gain on change in fair value of biological assets and share-based payments, the group's net earnings for the period increased 51% YoY to RMB308.8m.

Table 1. 1H 11/12 Result

6 months to Dec	Turnover (RMBm)	Gross Profit (RMBm)	Gross Margin (%)	Pre-tax profit (RMBm)	Net profit (RMBm)	Adjusted Net
1H FY11A	1,043.4	406.3	38.9	391.5	393.6	308.8
1H FY10A	624.0	275.4	44.1	526.4	523.4	204.7
YoY(%)	67.2	47.5		(25.6%)	(26.7%)	50.9

Source: Company data

Sales mix: Oranges accounted for 61.8% of sales compared to 84.2% in the previous period. Processed fruits accounted for 38%. In terms of sales channels, corporate customers accounted for 42.9%, supermarket chains accounted for 32% and wholesaler accounted for 24.6%.

Margins: The gross margin declined 5 PCP to 38.9%. This is due to the effect of incorporation of Beihai BPG, a newly acquired business. Beihai BPG has a lower profit margin due to the nature of the production facilities, with higher cost of goods sold (COGS). The COGS also increased due to warmer climate, which increased the need for pesticides to maintain crops healthy and infection free.

Production: Total production increased 19.4% YoY to 171,607 tonnes. The group's direct sales channels expanded to 22 supermarket chains versus 20 supermarket chains in 2010. Supply to supermarket chains also increased by 25.6% YoY to 48,447 tonnes of oranges. Beihai BPG sold a total of 14,604 tonnes of juice concentrates, 15,076 tonnes of fruit purees and 8,738 tonnes of frozen and dried fruits and vegetables for the period. The utilization rate of BPG's production facilities in Beihai city and Hepu county was approximately 92.2% and 93.4% respectively.

Please refer to important disclosures at the end of this report

Ticker	0073 HK
Rating	NR
Price (HK\$)	5.24
12m Price Range (HK\$)	2.71-9.41
Market cap. (US\$m)	825.0
Daily t/o (US\$m)	2.3
Free float (%)	61.2

Financial summary

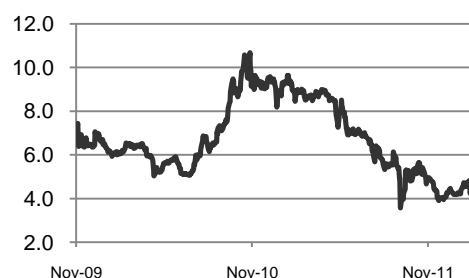
Year to June	09A	10A	11A
Turnover (RMB)	668.5	812.5	1,412.6
Net Profit (RMB)	440.1	585.5	1,110.0
EPS (RMB)	0.581	0.741	1.056
P/E (x)	11.1	8.7	6.1
P/B (x)	1.68	1.33	0.90
EV/EBITDA (x)	8.7	6.2	3.7
Yield (%)	11.1	14.0	20.0
ROE (%)	30.3	17.4	19.6
ROCE (%)	31.0	17.7	19.9
N. Gear. (%)	Cash	Cash	Cash

Source: SBI

	11F	12F	13F
Consensus EPS (HK\$)	0.561	0.562	-
Previous earnings (HK\$m)	-	-	-
Previous EPS (HK\$)	-	-	-

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	15.8	1.9	(33.2)
Actual price changes (%)	15.2	11.5	(41.1)



Source: Bloomberg

Research Team

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Plantation: Hepu Plantation was fully developed with approximately 1.3m orange trees, of which 1.0m are fruit-bearing trees. Xinfeng Plantation was fully planted with 1.6m winter orange trees, of which all are producing. Production at Xinfeng Plantation increased by approximately 36.0% to 126,701 tonnes. 707,000 summer orange trees have been planted at Hunan Plantation, another 343,000 summer orange trees are expected to be planted before March 2012.

Cost structure: Cost of sales for oranges consists of fertilizers, packaging materials, pesticides, as well as direct labor, depreciation and production overheads. In total the cost of sales of oranges increased 24.9% YoY to RMB355.4m. The increase in production costs was principally due to the increase in fertilizers and pesticides utilized for higher production volumes and during warmer weather.

Table 2. Cost of sales

Revenue by segment	2011 RMBm	%	2010 RMBm	%
Cost of sales oranges.				
Fertilizers	204.5	57.5	158.3	55.6
Package materials	14.4	4.1	16.6	5.8
Pesticides	34.4	9.7	25.1	8.8
Direct labor	32.5	9.1	26.9	9.5
Depreciation	44.1	12.4	41.5	14.6
Others	25.5	7.2	16.1	5.7
Total	355.4	100	284.6	100

Source: Company data

Company Background

Description: Asian Citrus engages in planting, cultivation and selling of agricultural produce, and manufacturing and selling of fruit juice concentrates, fruit purees and frozen fruits and vegetables. It owned and operated three orange plantations and two processing plants in the People's Republic of China. It operates in three segments: agricultural produce, processed fruits and others. Agricultural produce include planting, cultivation and sale of agricultural produce. Processed fruits include manufacturing and selling of fruit juice concentrates, fruit purees, frozen fruits and vegetables.

Table 3. Revenue breakdown

Revenue by segment	1H 2011/12 (%)	1H 2010/11 (%)	Revenue by channel	1H 2011/12 (%)	1H 2010/11 (%)
Oranges	61.8	84.2	Corporate customers	42.9	40.3
Processed fruits	38.0	11.1	Supermarket chains	32.0	31.4
Self-bred saplings	0.2	0.5	Wholesale customers	24.6	27.6
Properties	0	4.2	Others	0.5	0.7
<i>Total</i>	<i>100</i>	<i>100</i>	<i>Total</i>	<i>100</i>	<i>100</i>

Source: Company data

Products: The Group cultivates and sells two types of oranges: winter (the varieties grown being Navel, Hamlin, Pineapple and Hong Jiang) and summer (principally Valencia). The company sells these oranges to supermarket chains, corporate customers, wholesalers and sole proprietors in China.

Newly acquired Beihai BPG: In October 2010 the company acquired of 92.94% equity interest in Beihai Perfuming Garden Juice Company Limited ("Beihai BPG"). Beihai BPG is a leading producer and wholesaler of tropical fruit juice concentrates in China and processes over ten different varieties of tropical fruits, the most significant types of which include pineapples, passion fruits, lychees, mangoes and papayas. Its current annual output production capacity is estimated to be over 60,000 tonnes. Revenue from the sale of processed fruits increased by 471.9% YoY to RMB396.9m. It is mainly attributable by consolidation of six months of financial into the Group's results, compared to only one month results from the previous period. The group is developing new production facilities for BPG in Baise City.

Table 4. Sales of processed food

Revenue by segment	2012/11		2011/10	
	Production Volume (Tonnes)	Revenue (RMBm)	Production Volume (Tonnes)	Revenue (RMBm)
Pineapple juice concentrates	9,421	114,129	2,475	30,707
Other fruit juice concentrates	5,183	79,668	443	11,710
Mango purees	7,966	57,187	91	683
Papayas purees	6,825	48,970	771	5,233
Other fruit purees	285	3,566	-	-
Frozen and dried fruits and vegetables	8,738	62,970	265	5,201
	38,418	366,490	4,045	53,534
Fruit juice trading	-	30,413	-	15,876
Total	38,418	396,903	4,045	69,410

Source: Company data

Hepu plantation: The Hepu Plantation is situated in the Guangxi Zhuang Autonomous Region with a size of 30.9 km². This plantation is fully developed with approximately 1.3m orange trees, of which 1.0m is bearing fruit. Production decreased by approx. 11.1% to 44,905 tonnes. This reduction came as a natural result of a reduction in the winter orange trees. Thus the Group initiated a replanting program in the Hepu Plantation to replace existing winter orange trees with new species of summer orange trees that have stronger resistance to disease and produce a higher yield

Xinfeng plantation: The Xinfeng Plantation in the Jiangxi province with a size of 37.1 km² is fully planted with 1.6m winter orange trees, which are all fruit bearing. Production increased 36% YoY to 126,701 tonnes. The plantation contributes with approx. 44.5% of the total revenue for the group.

Table 5. Plantations

Name	Location	Status	Planted Orange Trees	2012/11	2011/10	2012/11	2011/10	2012/11	2011/10
				Production (tonnes)	Production (tonnes)	ASP (per tonne)	ASP (per tonne)	GP Margin (%)	GP Margin (%)
Hepu Plantation	Guangxi	In Operation	1.3 million	44,906	50,517	4,085	3,922	55.4	40.2
Xinfeng Plantation	Jiangxi	In Operation	1.6 million	126,701	93,181	3,770	3,660	56.2	40.4
Hunan Plantation	Dao County	In progress	707 thousands	-	-	-	-	-	-
Total				171,607	143,698				

Source: Company data

Hunan plantation: The Hunan Plantation in Dao County has a size of 30.7 km². By the end of December 2011 the group had planted 707,000 summer orange trees and is expecting to have another 343,000 summer trees planted by March 2012. Investments of RMB375.6m have been used for land clearing, land cultivation, planting cost etc. in connection with this plantation.

Biological asset: The gain on change in fair value of the biological assets decreased 70.5% YoY to RMB100.6m from RMB338.2m. The decrease is a natural result of the development in the biological assets, which works in 3 steps. At the first stage the self-bred saplings are immature and not ready to be planted. They are kept in greenhouses and stated at cost in the accounts with a value of approx. RMB6-8 each. At stage two the infant, small trees have been planted in the plantation, but will not bear fruit and start production before the age of 4 year, thus they are stated at cost in the accounts at approx. RMB10 per tree. When the tree become fruit bearing at the age of four, they will be transferred to the category of orange trees where their fair value are based on the net present value of expected net cash flow from the orange trees discounted at a current market determined pre-tax rate. This means that there will be a large gain on change in fair value of biological assets when the trees turns into a four year old, orange producing tree compared to the previous year, where only cost were stated in the accounts. It is important to note that the gain on change in fair value of biological assets will not have any effect on the cash flow.

Table 6. Changes in fair value of biological assets

	1H 2011/12 (RMBm)	1H 2010/11 (RMBm)
Gain due to transfer of infant trees to oranges trees	-	151.9
Gain due to price change	37.4	140.1
Decrease due to replanting program	(70.2)	(64.2)
Gain due to yield, maturity, cost and other changes	133.4	1140.4
Total	100.6	338.2

Source: Company data

Valuation and our view: The counter is currently trading at 7.6x current year fwd P/E on consensus. The Hong Kong listed producers are currently trading at average 10.7x current-yr forward P/E and 7.8x 1-year forward P/E based on market consensus. The demand for fresh fruit may continue to enjoy support from China's emerging middle class, which has a taste for various Western lifestyle products. There appears to be a social trend towards drinking fresh orange juice, which Asian Citrus is benefitting of through their acquisition of Beihai BPG,

Table 7. Valuation comparison

Company name	Ticker	Mkt cap (US\$m)	Last Price (Local)	His P/E (x)	Curr-Yr P/E (x)	1-Yr P/E (x)	PB (x)	Est. ROE (%)
HK listed								
Asian Citrus	73 HK	825.0	5.24	5.4	7.6	6.0	0.7	19.6
China Huiyuan	1886 HK	540.0	2.85	8.1	24.9	17.4	0.7	4.0
China Tianyi	756 HK	250.2	1.62	8.8	5.7	4.6	1.7	21.6
Yantai North	2218 HK	155.9	0.29	20.1	11.6	-	0.8	4.2
China Haisheng	359 HK	117.9	0.73	8.0	3.7	3.1	0.7	5.8
<i>Average</i>				<i>10.1</i>	<i>10.7</i>	<i>7.8</i>		

Source: Bloomberg

Table 8. Historical P & L

Year to Dec (RMBm)	2009A	2010A	2011A
Revenue	668.5	812.5	1,412.6
Cost of sales	(222.9)	(344.1)	(674.0)
Gross profit	445.6	468.4	738.6
Other revenue	-	1.8	9.8
Net gain on biological asset	210.6	306.0	598.0
Selling and distribution costs	(49.4)	(45.5)	(63.3)
Administrative expenses	(164.4)	(143.3)	(161.6)
Profit from operation	(442.4)	587.4	1,121.5
Finance cost	0.1	(0.1)	(0.2)
Profit before tax	(442.3)	587.3	1,121.3
Income tax	(2.2)	(1.9)	(1.8)
Profit and total comprehensive income	440.1	585.5	1,119.5
Attribute to			
Owners of the company	440.1	585.5	1,109.9
Non-controlling interest	-	-	9.5

Source: Company data, SBI E2-Capital

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BUY : absolute upside of >10% over the next six months

HOLD : absolute return of -10% YoY to +10% over the next six months

SELL : absolute downside of >10% over the next six months

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