Corporate Snippet

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Better-than-expected interim results — China Agriculture

China Green (904 HK, HK$7.31) — BUY (unchanged)

Target price: HK$11.29 (+54%)

Overview. Revenue rose 37.8% YoY to RMB533.7m in 1H FY04/08A, comprising RMB140.4m from the fresh produce segment (up 25.4% YoY), RMB208.9m from processed products (up 36.4% YoY), and RMB184.4m from branded food and beverage products (up 51.0% YoY). Thanks to improved operating margins, net profit rose 53.6% to RMB207.8m. EPS increased 26.3% to RMB0.24 or 16.7% to RMB0.21 on a diluted basis (the company issued RMB1,000.0m worth of convertible bonds in Oct 2007). The company declared an interim dividend of RMB0.063 per share.

Margin expansion. The blended gross margin widened 0.6pcp to 51.6% in 1H FY04/08A mainly due to sales mix changes in the period, especially growth in higher-margin processed and beverage products (gross margin 57.1% and 58.6%, respectively, in 1H FY04/08A). The operating margin widened 2.7pcp to 40.9% as a result of the company's economies of scale and better control of operating expenses.

Major growth drivers. 1) Robust domestic consumption and strong food demand, especially for green food, worldwide; 2) popularity of the company's branded products (beverages and newly-launched instant noodles). Beverage sales up 66.5% YoY in 1H FY04/08A at RMB89.3m; 3) expanding processing capacity (total 10 plants with an annual processing capacity of 440,000 tonnes at end-Oct 2007).

Inflation benefits. We believe CG will benefit from inflation, particularly food price hikes, given its upstream production capability. The company acquired 14,000 mu (933.3 hectares) of cultivation land in 1H FY04/08A, increasing its total cultivation area to 66,100 mu (13,220 hectares) covering 30 vegetable bases, five fruit bases and one organic rice base, which together can generate an annual crops output of around 273,000 tonnes. One of the company's upstream products is soya bean, accounting for 4.0% of its total turnover in 1H FY04/08A. Soya bean's price surged from below US$900/bushel in Sep 2007 to more than US$1,200. We expect the company to benefit from this price movement.

New food policy. The Chinese government released new food pricing measures to curb inflation, including:

- 14 Dec 2007 – the Ministry of Finance together with State Administration of Taxation announced the abolishment of export tax rebates for 84 types of grains and grain products starting from 20 Dec 2007. The old tax rebate rates were 5-13%.
- 4 Jan 2008 – China's Customs imposed export duties of 5-25% on 57 types of grains and grain products, effective from 1 Jan to 31 Dec 2008.
- 15 Jan 2008 – the National Development and Reform Commission said it would require sizable food producers to obtain approval before rising prices. Wholesalers and retailers will have to justify their price

Table 1: Financial summary

Year to Dec	Net profit HK$m	EPS HK$	EPS Δ%	P/E x	P/B x	EV/EBITDA x	Yield %	ROE %	ROCE %	N. Gearing %
05A	271.3	0.373	35.6	21.2	5.1	21.0	1.3	26.9	17.0	Cash
06A	346.0	0.400	7.4	19.7	3.9	15.6	1.5	25.7	16.5	Cash
07F	435.3	0.473	18.3	16.7	4.5	11.4	1.9	27.3	17.5	Cash
08F	586.6	0.607	28.2	13.0	3.4	7.8	2.6	30.0	17.5	Cash
09F	723.9	0.749	23.4	10.6	3.2	5.7	3.2	31.1	21.3	Cash

adjustments.

We understand that the company has yet to confirm whether its products will be affected be new export duties (45.0% of CG’s total sales came from overseas markets in 1H FY04/08A). However, its FY04/08F outlook should be intact, based on signed contracts. Despite the potential negative impact of China's food export policy, we believe CG will maintain its earnings growth, given: 1) strong food demand; 2) its expanding upstream production capacity; 3) cost advantages against overseas peers even after considering potential export duties.

BUY unchanged. The results are slightly better than we expected. We will review our forecast after meeting the management tomorrow. For the time being, we maintain our full-year net profit growth forecast of 25.8% YoY to RMB435.3m. Our target price is unchanged at HK$11.29.