

Outlook intact

China Agriculture

Pacific Andes (1174 HK, HK\$1.95)

BUY (unchanged)

Target price: HK\$3.55 (+82.1%)

- Better-than-expected operation in processing & distribution division during 1H FY03/08F.
- Improved management of working capital.
- A potential beneficiary of inflation in the PRC.
- Maintain BUY recommendation with target price unchanged at HK\$3.55.

Interim results review. Revenue went up 34.2% YoY to HK\$5,085.0m in 1H FY03/08A and net profit increased 6.5% YoY to HK\$187.5m. EPS declined from HK0.139 one year ago to HK\$0.115 due to dilution from 600.9m new shares issued in Jun 2007 at HK\$1.55 each. We think the results are generally in line with our previous estimates, though actual net profit beat our forecast soundly. The main difference came from processing & distribution segment. As discussed in our previous report, Chinese government stepped up on controls of food export to US, Europe and Japan during the period, which adversely affected the company's delivery schedule. We have expected a 31.6% decline in the segmental turnover, versus the actual 11.7%.

Table 1: Interim results summary

Six months to Sep (HK\$m)	1H FY08A	1H FY07A	YoY change (%)	1H FY08F	Difference (%)
Industrial fishing	1,606.7	565.5	184.1	1,606.6	(0.0)
Frozen fish SCM	2,118.2	1,682.7	25.9	2,118.6	0.0
Fish fillets processing and distribution	1,354.8	1,533.5	(11.7)	1,048.3	(22.6)
Total revenue	5,085.0	3,789.8	34.2	4,780.7	(6.0)
Gross profit	903.6	611.1	47.9	824.8	(8.7)
Selling and distribution expenses	(119.4)	(46.2)	158.5	(117.4)	(1.7)
Administrative expenses	(174.8)	(115.0)	52.0	(160.6)	(8.1)
Operating profit	698.9	493.8	41.5	633.0	(9.4)
Finance costs	(255.6)	(111.9)	128.4	(265.1)	3.7
Taxation	(21.6)	(12.0)	80.0	(27.3)	26.1
Minority interests	(234.8)	(194.7)	20.6	(267.1)	13.7
Net profit	187.5	176.1	6.5	74.3	(60.3)

Source: Company data, SBI E2-Capital

Table 2: Financial summary

Year to	Net profit	EPS	EPS	P/E	P/B	EV/EBITDA	Yield	ROE	ROCE	N. Gearing
Mar	HK\$m	HK\$	Δ %	x	x	x	%	%	%	%
06A	183.1	0.183	12.3	10.7	1.3	10.8	2.7	12.3	10.2	144.6
07A	310.8	0.270	47.5	7.2	1.1	7.4	2.1	16.7	12.0	147.4
08F	432.1	0.258	(4.3)	7.5	0.7	4.9	2.1	11.8	12.9	92.8
09F	655.9	0.359	38.8	5.4	0.6	3.6	4.1	11.9	13.9	60.3
10F	767.0	0.420	16.9	4.6	0.6	2.9	5.1	12.6	14.6	39.7

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Better cash management. A major improvement in 1H FY03/08A was working capital management. The company managed to accelerate its inventory turnover and receivable turnover during the period, which, in our view, could also be partly attributed to strong demand for fish product. As we expect high-inflation environment to persist in the PRC in 2008, demand will likely remain robust.

Table 3: Working capital

(HK\$m)	Sep 07A	Dec 06A
Inventory	1,769.5	1,927.6
Receivables	2,646.1	3,378.3
Payables	863.1	776.0
Working capital	3,552.5	4,529.9

Source: Company data

Benefit from inflation. The Industrial fishing business contributed 31.6% of total turnover and 71.0% of operating profit in 1H FY03/08A. As an upstream food producer, we think the company could be a major beneficiary of inflation. In addition, fish trades more or less like commodity, which gives PAIH flexibility in seizing market opportunities by shifting sales geographically. According to the management, the average selling prices of its fish products rose around 10% during 1H FY03/08A.

Margin enhancement. Blended gross margin improved 1.6pcp in 1H FY03/08A due to more sales from higher-margin industrial fishing business in overall revenue mix. Separately, margin squeeze was observed in industrial fishing and processing & distribution segments. Gross margin narrowed in fishing division was mainly due to increased charter hired expenses in the 4th vessel operating agreement (VOA), according to which, PAIH has to pay a daily fee of US\$12,000 per vessel instead of a lump sum payment. We estimate this arrangement resulted in 3.4pcp of total 3.9pcp decline in the segmental gross margin. Based on this new fee structure, we expect gross margin to rebound in 2H FY03/08F, given rising fish selling prices. For distribution & processing division, the reduction in gross margin could be contributed to: (1) slow-down in delivery; (2) increasing raw material costs (i.e. fish prices). Nevertheless, the newly launched Hongdao plant will likely help margin by improving operation efficiency and raw material utilization rate, according to the management.

Table 4: Gross margins

Six months to Sep (%)	1H FY08A	1H FY07A	YoY change (pcp)
Industrial fishing	33.3	37.2	(3.9)
Frozen fish SCM	9.2	9.2	0.0
Fish fillets processing and distribution	12.8	16.0	(3.2)
Blended	17.8	16.1	1.6

Source: Company data, SBI E2-Capital

Table 5: Vessel operating agreements

	1st VOA	2nd VOA	3rd VOA	4th VOA
Date of signing	Jan-04	Feb-06	Jan-07	Jan-07
Employment period	10 years (renewable for 10 years on expiry)	10 years (renewable for 10 years on expiry)	18 years	5 years
Est. catch quantity (based on 2007 TACs)	70,000 tonnes	70,000 tonnes	70,000 tonnes	60,000 tonnes
Number of Supertrawlers	7	7	3	6
Fee structure	Prepaid fee US\$56m, 20% operating profit (before amortization of prepaid fee)	Prepaid fee US\$82m, 20% operating profit (before amortization of prepaid fee)	Prepaid fee US\$150m, 20% operating profit (before amortization of prepaid fee)	Daily fee US\$12,000 per vessel, 20% operating profit (after deduction of daily fee)

Source: Company data

BUY call unchanged. As we have assumed catch-up in the processing and distribution division in 2H, we will only fine tune full-year estimates to better reflect the interim results. We forecast the company will have HK\$11,407.1m in top line for FY03/08F. Net profit will increase 38.8% YoY to HK\$432.1m, versus previous estimate of HK\$404.9m. The up-adjustment is mainly due to lesser finance costs, thanks to a better working capital management. We maintain our target price at HK\$3.55, representing 13.8x FY03/08F P/E, which will further reduce to 9.9x in FY03/09F.

Table 6: P&L

Year to Mar (HK\$m)	06A	07A	08F	09F	10F
Industrial fishing	620.2	1,789.3	3,499.8	4,401.4	4,715.8
Frozen fish SCM	2,981.9	3,496.7	4,398.7	5,059.0	5,463.7
Fish fillets processing and distribution	2,537.2	3,176.7	3,494.3	4,076.7	4,199.0
Others	17.7	15.8	14.2	12.8	11.5
Total revenue	6,157.0	8,478.6	11,407.1	13,550.0	14,390.1
Cost of sales	(5,226.5)	(7,156.5)	(9,339.5)	(10,824.1)	(11,460.4)
Gross profit	930.5	1,322.0	2,067.6	2,725.8	2,929.8
Other income	50.0	132.4	190.5	193.5	196.3
Selling and distribution expenses	(145.8)	(138.3)	(261.8)	(355.6)	(377.1)
Administrative expenses	(240.0)	(321.2)	(416.9)	(563.7)	(594.9)
Other expenses	(32.9)	(10.5)	(43.5)	(17.4)	(19.2)
Gain on dilution of interest in a subsidiary	220.0	385.1	24.7	0.0	0.0
Loss on deemed disposal of interest in a subsidiary	(12.7)	0.0	0.0	0.0	0.0
Finance costs	(204.2)	(357.3)	(536.1)	(521.1)	(441.1)
Share of results of associates	(0.4)	0.4	0.8	0.9	1.0
Profit before taxation	564.5	1,012.6	1,025.1	1,462.3	1,694.9
Taxation	(14.3)	(19.3)	(55.0)	(80.3)	(87.0)
Profit for the period	550.2	993.3	970.1	1,382.1	1,607.9
Attributable to:					
Shareholders of the company	183.1	310.8	432.1	655.9	767.0
Minority interest	367.1	682.5	538.0	726.2	840.9
Dividend proposed	55.9	73.9	73.1	146.3	182.8
DPS (HK\$)	0.052	0.041	0.040	0.080	0.100
EPS – Basic	0.183	0.270	0.258	0.359	0.420

Source: Company data, SBI E2-Capital