

Recovery in 2007

China Agriculture

Ko Yo (8042 HK, HK\$0.57)

HOLD (downgraded from BUY)

Target price: HK\$0.58 (+2%)

9M06 results review. Sales grew 2.3% to RMB489m for the first nine months of 2006 while net profit was down 8% to RMB35m (3Q09 net profit dropped 47% to RMB6.9m). The results were below expectations.

- Overall sales volume increased 3.5% to 369,000t during the period. Sales volume of BB and complex fertilizers grew 3.5% to 131,911t but turnover decreased 4.4% to RMB216m.
- 3Q06 results were lower than expected as sales were hammered by severe drought in Sichuan, Chongqing and eastern Jiangnan and typhoons in the coastal areas. The company also experienced electricity stoppage during the period. As a result, sales volume of BB and compound fertilizers was down 15% to 28,716t in 3Q06.
- Going forward, the company will initiate a 450,000t urea project in Dazhou, Sichuan to take advantage of the abundant supply of natural gas there.

No turnaround in 4Q06 yet. We expect 4Q06 results will be no better than 3Q06 as the company encountered some electricity and natural gas supply disruption in the past few months and these were only rectified on Nov 11. ASP of Ko Yo's products has come down by about 10% YoY to RMB1,600 per tonne. Due to Ko Yo's lack of production scale, it will be more prone to external factors such as supply shortage and price fluctuations.

Outlook expected to improve in 2007. Nonetheless, we do expect profitability will improve in 2007 as the company has received a 150,000t complex fertilizer export order from Indonesia for next year while the re-vamping and technological upgrading of machinery will be done in 2Q07, which will further enhance efficiency. Note that the ASP for the export order will be around RMB1,300 per tonne while the gross margin will be around 8-10% compared with the overall gross margin of 16.8% for the first nine months of 2006.

Downgrades. We have scaled down our earnings forecast by 22% and 21% for FY12/06 and FY12/07 respectively. Our new target price is HK\$0.58 (was HK\$1.21) based on 6x FY12/07F P/E. Downgrade from BUY to HOLD as there will not be any major catalyst until 2Q07.

Disclosure of interests: SBI E2-Capital Securities Ltd. acted as the Sole Bookrunner and Placing Agent for the Ko Yo top-up placement (84m shares at HK\$0.78 each) on May 4, 2006.

Table 1: Financial summary

Year to Dec	Net profit RMBm	EPS RMB	EPS Δ %	P/E x	P/B x	EV/EBITDA x	Yield %	ROE %	ROCE %	N. Gearing %
04A	32.7	0.078	18.2	7.6	1.6	6.3	2.5	23.9	16.1	47.2
05A	46.8	0.111	42.3	5.3	1.2	3.8	3.5	26.4	18.8	15.9
06F	40.0	0.084	(24.3)	7.0	1.0	4.0	3.9	16.0	13.5	Cash
07F	50.5	0.100	18.8	5.9	0.9	3.6	3.5	15.9	14.4	Cash
08F	61.0	0.121	20.9	4.9	0.8	3.0	4.2	16.8	15.5	Cash

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