

A new pesticide giant is rising

14 Jun. 2018

Investment Highlights:

- ❖ **Adama and Sanonda merged.** Sanonda is one of China's largest organophosphorus pesticide producers, and it boasts some advantages against the environmental inspections. In China, the environmental inspections in 2017 inhibited expansion of the pesticide production capacity and shored up the business climate. We believe the buoyant business climate for the pesticide market will continue going ahead. Adama is a leading transnational generic pesticide producer and the world's sixth largest pesticide producer, logging sales revenue of US\$2,877mn in 2016. Over recent years, Adama gained fast development across the major developed and emerging markets. The Adama-Sanonda combination is tipped to drive the Company into a new development stage.
- ❖ **Sanonda launched construction of new projects after the merger.** The Company maintained stable operation during 3Q/4Q2017 after the M&A deal was completed in Aug 2017. In Jan 2018, the Company raised Rmb1.66bn through a private placement, and planned to spend the proceeds on four major projects, including the Huai'an pesticide preparation center, construction of the domestic distribution platform, product R&D and registration, and FAI in Adama. These new projects are expected to further optimize the Company's global presence, increase its production capacity, strengthen the marketing channels and upgrade the supply chain quality.
- ❖ **Sanonda implements a Polestar strategy to drive ahead growth in major foreign markets.** The new company divides the global market into five areas, namely Europe/North America/Latin America/India, Middle East & Africa/Asia Pacific, and represents an 8%/6%/5%/12.6%/3.6% share in respective areas (size of these five markets is estimated at US\$13bn/10.7bn/15bn/4bn/14bn, respectively). In order to effectively develop global business, the new company implements a Polestar strategy (setting foot in continual development in the Chinese market, enriching the product offerings and serving the mass demand). Considering that construction of the China production base effectively shortens the global supply chain and given Sanonda's advantages in original pesticide R&D and production, we expect the new company to record a sales growth rate of 6%/8%/10%/10%/10% in the Europe/North America/Latin America/India, Middle East & Africa/Asia Pacific (ex-China) markets.
- ❖ **Sales in emerging markets (including China) are tipped to pick up.** Emerging markets bear critical significance to the growth of global pesticide companies: by growth rate, 9 of the top 10 pesticide markets are from emerging countries; and by market share, emerging markets account for 53.47% of the total sales of the world's top 20 pesticide



BUY (Initiation)

Current price: Rmb16.76

Target price: Rmb20.50

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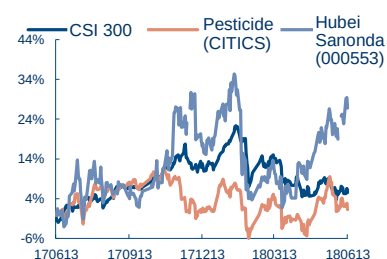
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Performance relative to the index



Source: CITICS Quantitative Investment Analysis System

Main data

CSI 300	3788.34
Total equity/shares o/s (mn)	2446.6/363.9
LTM High/low (Rmb)	17.9/12.82
1-month absolute gain	4.03%
6-month absolute gain	6.88%
YTD Absolute gain	5.74%
LTM Average daily turnover (Rmb mn)	103.2

producers. Currently, emerging markets contribute over 50% of the new company's total sales revenue. Given Adama's sales experience in India as well as the new company's channel/product/service advantages, we expect the new company to deliver robust growth in emerging markets such as China.

- ❖ **Risks:** 1) Extreme weather and natural disaster reduce the use of pesticide; 2) discrepant business culture between Adama and Sanonda weakens the new company's operating efficiency; 3) exchange rate swings.
- ❖ **Earnings forecast, valuation and investment rating:** Excluding the Rmb2bn asset disposal income posted in 1Q18, we project the Company's 2018/19/20E net profit at Rmb1,675mn/1,887mn/2,154mn, implying EPS of Rmb0.68/0.77/0.88. Considering i) the smooth integration of Adama and Sanonda as well as implementation of the Polestart strategy, ii) the Company is expected to take advantage of its product, service and technology strength to gain robust development in the pesticide preparation market, and iii) the new company's premium and fast growth potential, and referring to valuation of the comparable companies, we apply 30x 2018E PE on the Company, yielding a target price of Rmb20.50/share. Initiate BUY.

Item/Year	2016A	2017A	2018E	2019E	2020E
Turnover (Rmb mn)	1,855	23,820	25,994	28,387	31,023
Growth rate (YoY, %)	-14.53	1184.26	9.13	9.21	9.28
Net profit (Rmb mn)	-74	1,546	3,675	1,887	2,154
Growth rate (YoY, %)	-152.52	-2175.28	137.73	-48.65	14.16
EPS (Rmb, fully diluted)	-0.03	0.63	1.50	0.77	0.88
Gross margin (%)	13.67	35.33	35.31	35.03	35.13
ROE (%)	-3.72	8.23	16.64	7.93	8.37
PE (x)	-550	27	11	22	19
PB (x)	5.0	2.2	1.9	1.7	1.6

Source: CITICS Quantitative Investment Analysis System

Note: Closing price as of 13 Jun. 2018

Income Statement (Rmb mn)					
Indicator	2016	2017	2018E	2019E	2020E
Turnover	1,855	23,820	25,994	28,387	31,023
Operating cost	1,601	15,404	16,815	18,442	20,125
Gross margin	14%	35%	35%	35%	35%
Business tax & surcharge	15	75	82	89	97
Operating expense	224	1,402	1,530	1,671	1,826
Operating expense ratio	12%	6%	6%	6%	6%
Administrative expense	224	1,402	1,530	1,671	1,826
Administrative expense ratio	12%	6%	6%	6%	6%
Financial expense	-4	1,205	1,019	1,131	1,153
Financial expense ratio	0%	5%	4%	4%	4%
Investment revenue	4	74	50	50	50
Operating profit	-120	1,679	3,976	2,047	2,335
Operating profit margin	-6%	7%	15%	7%	8%
Non-operating income	23	34	34	34	34
Non-operating expenditure	0	45	45	45	45
Total profit	-97	1,668	3,965	2,036	2,324
Income tax	-22	122	290	149	170
Income tax rate	23%	7%	7%	7%	7%
Minority interests	0	0	0	0	0
Net profit attributable to shareholders	-74	1,546	3,675	1,887	2,154
Net margin	-4%	6%	14%	7%	7%
EPS (Rmb, diluted)	-0.03	0.63	1.50	0.77	0.88

Cash Flow Statement (Rmb mn)					
Indicator	2016	2017	2018E	2019E	2020E
Net profit	-74	1,546	3,675	1,887	2,154
Minority interests	0	0	0	0	0
Depreciation & amortization	238	1,668	2,324	2,444	2,565
Change in working capital	365	254	-1,430	-1,531	-1,600
Others	-260	490	294	411	438
Operating cash flow	268	3,958	4,863	3,211	3,557
CAPEX	-131	-1,503	-2,160	-2,160	-2,160
Investment revenue	1	0	50	50	50
Disposal of assets	1	2	0	0	0
Others	23	214	-95	-95	-95
Investing cash flow	-105	-1,288	-2,205	-2,205	-2,205
Stock issuance	0	1,532	0	0	0
Change in liabilities	-264	965	-6,542	551	278
Dividend paid	0	-154	-366	-188	-215
Others	223	-707	-1,019	-1,131	-1,153
Financing cash flow	-41	1,636	-7,928	-767	-1,089
Net increase in cash and equivalent	122	4,307	-5,269	239	264

Balance Sheet (Rmb mn)					
Indicator	2016	2017	2018E	2019E	2020E
Cash and cash equivalent	547	7,869	2,599	2,839	3,102
Inventory	174	7,488	8,174	8,965	9,783
Accounts receivable	209	5,057	5,518	6,027	6,586
Other current assets	162	2,916	3,646	4,389	5,145
Current assets	1,092	23,330	19,937	22,219	24,617
Fixed assets	1,604	6,141	6,219	6,176	6,012
Long-term equity investment	0	102	102	102	102
Intangible assets	208	4,037	3,724	3,412	3,099
Other long-term assets	81	6,003	7,120	8,238	9,355
Non-current assets	1,893	16,284	17,166	17,927	18,569
Total assets	2,985	39,614	37,103	40,147	43,185
Short-term borrowing	0	2,281	3,516	4,068	4,346
Accounts payable	169	3,906	4,264	4,677	5,104
Other current liabilities	420	5,108	5,248	5,404	5,573
Current liabilities	589	11,295	13,029	14,149	15,023
long-term liabilities	197	514	514	514	514
Other long-term liabilities	194	9,026	1,473	1,698	1,923
Non-current liabilities	391	9,540	1,988	2,212	2,437
Total liabilities	980	20,836	15,017	16,361	17,460
Share capital	594	2,447	2,447	2,447	2,447
Capital reserve	263	12,982	12,982	12,982	12,982
Owner's equity	2,005	18,778	22,087	23,786	25,725
Minority interests	0	0	0	0	0
Liabilities & owner's equity	2,985	39,614	37,103	40,147	43,185

Major financial indicators

Indicator	2016	2017	2018E	2019E	2020E
Growth rate (%)					
Turnover	-15%	1184%	9%	9%	9%
Operating profit	-166%	-1494%	137%	-49%	14%
Net profit	-153%	-2175%	138%	-49%	14%
Margin (%)					
Gross margin	14%	35%	35%	35%	35%
EBIT Margin	-5%	12%	19%	11%	11%
EBITDA Margin	7%	19%	28%	20%	19%
Net margin	-4%	6%	14%	7%	7%
Return (%)					
ROE	-4%	8%	17%	8%	8%
ROA	-2%	4%	10%	5%	5%
Others (%)					
Liability/asset ratio	33%	53%	40%	41%	40%
Income tax rate	23%	7%	7%	7%	7%
Dividend payout ratio	0%	10%	10%	10%	10%

Source: CITICS Quantitative Investment Analysis System

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		HOLD	Increase relative to market representative index between -10% and 5%
		SELL	Decrease relative to market representative index over 10%
	Industry ratings	OUTPERFORM	Increase relative to market representative index over 10%
		NEUTRAL	Increase relative to market representative index between -10% and 10%
		UNDERPERFORM	Decrease relative to market representative index over 10%

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