

November 10, 2010

Market Outperform / Speculative Risk

Putting the House in Order: AgFeed Reports 3Q10 Results.

MARKET DATA	11/10/2010
Price	\$2.63
Exchange	NASDAQ
Target Price	\$6.00
52 Wk Hi - Low	\$5.70 - \$2.12
EV(MM)	\$116.4
Market Cap(MM)	\$135.1
Shares Out (MM)	51.4
Public Mkt Float (MM)	26.8
Avg. Daily Vol	875,328.0

BALANCE SHEET METRICS	
Cash (MM)	\$19.1
LTD (MM)	\$0.0
Total Debt/Total Equity	3.61%
Debt/Capital	NA
Price/Book Value	0.8x
Book Value/Share	\$3.25

EARNINGS DATA (\$)			
FY - Dec	2009E	2010E	2011E
Q1 (Mar)	0.08	0.02A	0.11
Q2 (Jun)	0.03	(0.07)A	0.12
Q3 (Sep)	0.07	(0.43)A	0.13
Q4 (Dec)	0.08	0.03	0.14
Full Year EPS	0.26	(0.44)	0.50

INDICES	
DJIA	11,346.8
SP-500	1,213.4
NASDAQ	2,176.9
Russell 2000	726.0



AgFeed posted a 3Q10 miss versus our estimates, primarily due to a \$16.8 million (non-cash) impairment charge, a one-time tax charge of \$1.3 million relating to the corporate reorganization taken to facilitate the planned animal nutrition carve-out, one-time professional fees and expenses of \$1.1 million relating to the M2P2 acquisition, a 13% increase in corn prices compared to 3Q09 and weaker hog sales volume offset by strong feed segment performance and contribution from the M2P2 acquisition. We are reducing our 4Q10 forecasts due to the potentially lingering effects from the summer floods and heat that had negatively impacted hog inventory. While the quarterly results were below our expectations, we believe the company is taking the right strategic steps that will ensure long-term growth and profitability. We are maintaining our revenue and net income FY11 outlook. We are reducing our price target from \$7 to \$6 based on higher share count. Our 12-month price target is based on the shares attaining a P/E level of 12x our FY11 EPS estimate of \$0.50. With over 100% upside from current price levels, we suggest that long-term investors take advantage of the pullback to accumulate positions.

Discussion

- 3Q10 Results** The company reported revenues of \$53.6 million (~up 18.8% YoY) considerably above our forecast of \$37.4 million. The variance from our estimate was a result of \$10.3 million contribution to the quarterly results from the M2P2 that we assumed would not contribute significantly to this quarter's results and higher than estimated revenues from the hog segment. The company reported a gross profit of \$4.3 million translating into 8.1% gross profit margin compared to \$7.6 million gross profit and 16.8% gross margin in the 3Q09. The decrease was attributable primarily to 13.0% increase in corn costs and lower hog selling prices during the quarter compared to the same period last year. The company reported GAAP net loss of \$20.6 million or (\$0.43) per share. Excluding the effect of a non-cash impairment charge (~ (\$0.35) per share) and non-recurring charges amounting to a total of \$2.4 million, the company lost (\$0.03) per share.
- Impairment Charge and Other Non-recurring Charges** A review of the legacy farms in China for goodwill impairment has revealed that while the farms can be operated profitably, they cannot sustain a high enough level of profitability to support the original acquisition values and resulting goodwill. Consequently, the management decided that an intangible asset write down of \$16.8 million was necessary. We remind that most of the farms were acquired in 2008 when hog prices were at the historically high levels. Additionally, the company booked two significant non-recurring charges totaling \$2.4 million relating to the planned animal nutrition carve-out and professional and consulting fees associated with the acquisition of M2P2.

- **We view the announced management changes as a positive** Mr. Selina Jin was relieved of her duties as a CFO, effective immediately. Per company's press release, Ms. Jin will be reassigned to another position. She is being replaced by Mr. Edward Pazdro, the current CFO of the company's animal nutrition business and the joint venture AgFeed International Protein Technologies Corp. We believe the change is driven by the company's recent expansion into the U.S. hog market through the acquisition of M2P2. Mr. Pazdro's previous experience with the agricultural companies includes working as a controller for PIC (PIC US and PIC Canada) and animal feed subdivision of Tate & Lyle. Mr. Pazdro, who is a CPA, brings to the company over 30 years of accounting experience, in depth understanding of GAAP accounting and international financial reporting practices. Given Mr. Pazdro experience, we believe he makes a better choice of CFO to oversee the successful business integration of the company's. U.S. and China operations. Additionally, Mr. Gerry Daignault, the company's COO has been named President and CEO of the animal nutrition business.
- **Additional Color on M2P2 Acquisition** M2P2 acquisition that was closed on September, 13th, 2010 contributed \$10.3 million, \$0.5 million and \$0.14 million toward the 3Q10 revenues, gross profit and net income. AgFeed has not previously disclosed any information regarding the acquisition's potential contribution to the company's gross profit and net income. Reported 4.9% gross margin and 1.4% net profit margin for the two week period may be indicative of the M2P2's future contribution to AgFeed's profits. M2P2 owns 10 sow farms in Colorado, Oklahoma and North Carolina and operates a finishing system of over 200 farms in Iowa.
- **Feed Segment Continues to Impress** Animal feed segment has contributed \$27.3 million towards the 3Q10 revenues, in line with our forecasts. Sales volumes increased 46% to 43,000 metric tons. The growth was primarily driven by the strong sales of complete (also called blended) and condensed (also called concentrate) feeds that increased by 70% YoY and 58% YoY to 26,154 MT and 8,434 MT, respectively. The Increase was offset by a slight decline in the premix sales of 126 MT.
- **What's Up with the Skinny Pigs?** Revenues from Chinese hog farms declined by \$11.4 million compared to 3Q09, reflecting a decline of \$2.1 million attributable to lower prices and \$9.3 million due to 65,000 fewer marketed hogs during the 3Q10. We anticipated the decline in the number of pigs sold due to two factors. First, in 2009 AgFeed used to purchase hogs from outside the system for finishing to market weights. The company has discontinued such purchases partially due to the high biosecurity risks associated with the practice. Second, during 2Q10, AgFeed lost 16,000 live hogs and 3,000 sows due to flooding. We expect it will take the company at least two quarters to rebuild the sow base resulting in lower hog sales volumes during 3Q10 and 4Q10. What we did not anticipate was the impact of extreme heat during the 3Q10 that lead to higher incidence of disease resulting in lower weight gain rates and hence lower average selling prices per hog (\$143/hog). We are slightly reducing our 4Q10 hog sales volumes to adjust for the potentially lingering effects of these health issues into the 4Q10.
- **Dilution** In September, 2009 AgFeed entered into an equity credit agreement with Southridge Partners II, LP pursuant to which the company could issue the fund common stock during the two years following the agreement for gross proceeds of up to \$50,000,000. During the 3Q10, the company issued Southridge 5,029,762 shares of common stock for the proceeds of \$13 million (~\$2.58 per share). We understand the capital was used for the acquisition of M2P2.

Outlook

Despite the challenging quarter, we remain positive on the company and hog raising industry in China. The company continues to strive for long-term efficiency gains through better genetics, breeding, nutrition, introduction of western data-based farm management practices and the construction of western style farms. M2P2, the U.S. hog raising business acquired in September 2010, has started to contribute to the company's top and bottom line. We estimate M2P2 will contribute approximately \$45 million towards the company's revenues in the 4Q10 and approximately \$180 million in FY11. The company is also on schedule with the construction of western style hog farms in Dahua and Xinyu that will have considerably higher yields per sow (in the 22-24 piglet per sow annually compared to the average sow productivity in China of about 16 piglets per sow annually). Initial stocking of these farms is expected to take place in the next two months. The addition of western style farms should increase hog production at AgFeed's China operations to 1.2 million heads in FY12. Given the vast long-term opportunity associated with the commercialization and modernization of pork production in China, combined with the improving hog pricing environment in China, we believe there is a significant upside potential for AgFeed shares.

We are making slight adjustments to our model, reducing 4Q10 revenues and net income to \$88 million and \$1.4 million or \$0.03 per fully diluted share, respectively. We are maintaining our forecasts for FY11 at \$419.0 million in revenues and \$28 million in net income. However, we are reducing our fully diluted EPS forecast to \$0.50 on a higher share count.

Valuation

AgFeed is currently trading at 6x our FY11 our EPS estimate of \$0.50. We continue to view AgFeed's valuation as attractive. Given the company's genetics program, adoption of western production practices and improving pricing environment for hogs, we believe the company warrants higher valuation. We reiterate our Market Outperform/Speculative Risk rating. However, we are reducing our price target to \$6 on a higher share count. Our price target is based on the shares attaining a P/E level of 12x our FY11 EPS estimate.

Risks

(1) High feed costs (2) Persistently low hog prices (3) Weak consumer demand for pork (4) Swine disease (5) Execution risk (6) Regulatory Risk

AgFeed Industries, Inc. (FEED)																			
Income Statement	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10 E	1Q11 E	2Q11 E	3Q11 E	4Q11 E	FY07	FY08	FY09	FY10 E	FY11 E	FY12 E	
(In USD, '000, except EPS)																			
Revenues	33,429	38,528	45,115	56,131	52,859	37,662	53,606	88,192	99,275	101,973	106,920	110,798	36,163	143,661	173,203	232,319	418,966	649,822	
Cost of goods sold	(27,626)	(33,306)	(37,554)	48,082	(46,540)	(35,103)	(49,284)	(78,905)	(84,391)	(86,017)	(89,740)	(92,728)	(25,763)	(109,225)	(146,568)	(209,832)	(352,876)	(535,926)	
Gross Profit	5,803	5,222	7,561	8,049	6,319	2,559	4,322	9,288	14,884	15,956	17,180	18,071	10,400	34,437	26,635	22,488	66,090	113,896	
Selling expenses	(864)	(999)	(961)	(1,110)	(1,031)	(983)	(1,063)	(1,764)	(1,985)	(2,039)	(2,138)	(2,216)	(2,694)	(3,941)	(3,934)	(4,841)	(8,379)	(16,246)	
G&A Expenses	(1,757)	(1,961)	(2,889)	(3,502)	(3,664)	(3,509)	(5,021)	(5,292)	(5,460)	(5,609)	(5,881)	(6,094)	(1,385)	(5,755)	(10,109)	(17,485)	(23,043)	(38,989)	
Impairment of intangible assets	0	0	0	0	0	0	(16,752)	0	0	0	0	0	0	0	0	(16,752)	0	0	
Total Operating Expenses	(2,621)	(2,960)	(3,849)	(4,613)	(4,695)	(4,492)	(22,836)	(7,055)	(7,446)	(7,648)	(8,019)	(8,310)	(4,079)	(9,696)	(14,043)	(39,078)	(31,422)	(55,235)	
Income from Operations	3,182	2,262	3,712	3,436	1,624	(1,933)	(18,514)	2,232	7,438	8,308	9,161	9,761	6,321	24,741	12,592	(16,590)	34,668	58,661	
Total Non-operating Income (Expense)	98	(756)	(524)	(89)	(159)	(491)	(464)	(500)	(500)	(500)	(500)	(500)	149	(6,783)	(1,270)	(1,615)	(2,000)	(2,000)	
Pre-tax Income	3,281	1,506	3,188	3,347	1,465	(2,424)	(18,978)	1,732	6,938	7,808	8,661	9,261	6,470	17,958	11,322	(18,205)	32,668	56,661	
Income Tax	(216)	(286)	(293)	(348)	(454)	(641)	(1,759)	(234)	(923)	(1,015)	(1,083)	(1,111)	193	(587)	(1,142)	(3,087)	(4,132)	(7,166)	
Net income incl. noncontrolling interest	3,065	1,220	2,895	2,999	1,011	(3,065)	(20,737)	1,498	6,015	6,793	7,578	8,150	6,663	17,370	10,180	(21,292)	28,536	49,495	
Less: Net inc. attr. to noncont. Int.	(46)	6	1	(208)	56	110	(101)	76	124	128	139	144	0	(422)	169	141	534	500	
Net income attributed to AgFeed	3,019	1,226	2,896	3,207	1,067	(2,955)	(20,636)	1,423	5,891	6,665	7,440	8,006	6,663	16,949	10,348	(21,100)	28,002	48,995	
Weighted Avr. S/O - Basic	37,933	39,550	42,421	42,921	44,869	45,015	48,487	51,350	51,465	51,747	52,029	52,311	26,093	31,558	40,978	47,430	51,888	47,429	
Weighted Avr. S/O - Diluted	37,933	41,446	43,329	43,829	45,213	45,015	48,487	53,365	55,779	55,779	55,779	55,779	26,175	31,714	41,214	48,020	55,779	47,429	
Basic EPS (GAAP)	\$ 0.08	\$ 0.03	\$ 0.07	\$ 0.07	\$ 0.02	\$ (0.07)	\$ (0.43)	\$ 0.03	\$ 0.11	\$ 0.13	\$ 0.14	\$ 0.15	\$ 0.26	\$ 0.54	\$ 0.25	\$ (0.44)	\$ 0.54	\$ 1.03	
Diluted EPS (GAAP)	\$ 0.08	\$ 0.03	\$ 0.07	\$ 0.07	\$ 0.02	\$ (0.07)	\$ (0.43)	\$ 0.03	\$ 0.11	\$ 0.12	\$ 0.13	\$ 0.14	\$ 0.25	\$ 0.53	\$ 0.25	\$ (0.44)	\$ 0.50	\$ 1.03	
% Growth Rates																			
Revenue (Y/Y)	175.2%	8.1%	(8.7%)	20.8%	58.1%	(2.2%)	18.8%	57.1%	87.8%	170.8%	99.5%	25.6%	--	297.3%	20.6%	34.1%	80.3%	55.1%	
Revenue (Q/Q)	(28.0%)	15.3%	17.1%	24.4%	(5.8%)	(28.8%)	42.3%	64.5%	12.6%	2.7%	4.9%	3.6%	--	--	--	--	--	--	
Operating Income (Y/Y)	84.5%	(74.2%)	(60.1%)	(30.3%)	(49.0%)	(185.5%)	(598.8%)	(35.0%)	357.9%	529.9%	(149.5%)	337.3%	--	291.4%	(49.1%)	(231.8%)	(309.0%)	69.2%	
Net Income (Y/Y)	228.4%	(68.7%)	(64.7%)	(17.6%)	(64.6%)	(341.0%)	(812.5%)	(55.6%)	451.9%	325.6%	136.1%	462.7%	--	154.4%	(38.9%)	(303.9%)	(232.7%)	75.0%	
Diluted EPS (Y/Y)	166.7%	(75.0%)	(70.8%)	(36.0%)	(75.0%)	(333.3%)	(714.3%)	(61.9%)	428.1%	270.7%	131.0%	438.4%	--	112.0%	(52.8%)	(275.8%)	(214.2%)	105.8%	
Margins (% of revenue)																			
Cost of goods sold	(82.6%)	(86.4%)	(83.2%)	85.7%	(88.0%)	(93.2%)	(91.9%)	(89.5%)	(85.0%)	(84.4%)	(83.9%)	(83.7%)	(71.2%)	(76.0%)	(84.6%)	(90.3%)	(84.2%)	(82.5%)	
Gross profit	17.4%	13.6%	16.8%	14.3%	12.0%	6.8%	8.1%	10.5%	15.0%	15.6%	16.1%	16.3%	28.8%	24.0%	15.4%	9.7%	15.8%	17.5%	
Selling Expenses	(2.6%)	(2.6%)	(2.1%)	(2.0%)	(1.9%)	(2.6%)	(2.6%)	(2.0%)	(2.0%)	(2.0%)	(2.0%)	(2.0%)	(7.4%)	(2.7%)	(2.3%)	(2.1%)	(2.0%)	(2.5%)	
General & Administrative	(5.3%)	(5.1%)	(6.4%)	(6.2%)	(6.9%)	(9.3%)	(8.5%)	(6.0%)	(5.5%)	(5.5%)	(5.5%)	(5.5%)	(3.8%)	(4.0%)	(5.8%)	(7.5%)	(5.5%)	(6.0%)	
Operating margin	9.5%	5.9%	8.2%	6.1%	3.1%	(5.1%)	(34.5%)	2.5%	7.5%	8.1%	8.6%	8.8%	17.5%	17.2%	7.3%	(7.1%)	8.3%	9.0%	
Tax rate	(6.6%)	(19.0%)	(9.2%)	(10.4%)	(31.0%)	(26.5%)	(25.0%)	(13.5%)	(13.3%)	(13.0%)	(12.5%)	(12.0%)	3.0%	(3.3%)	(10.1%)	17.0%	(12.6%)	(12.6%)	
Net margin	9.0%	3.2%	6.4%	5.7%	2.0%	(7.8%)	(38.5%)	1.6%	5.9%	6.5%	7.0%	7.2%	18.4%	11.8%	6.0%	(9.1%)	6.7%	7.5%	

Source: Company Filings, Rodman & Renshaw Research

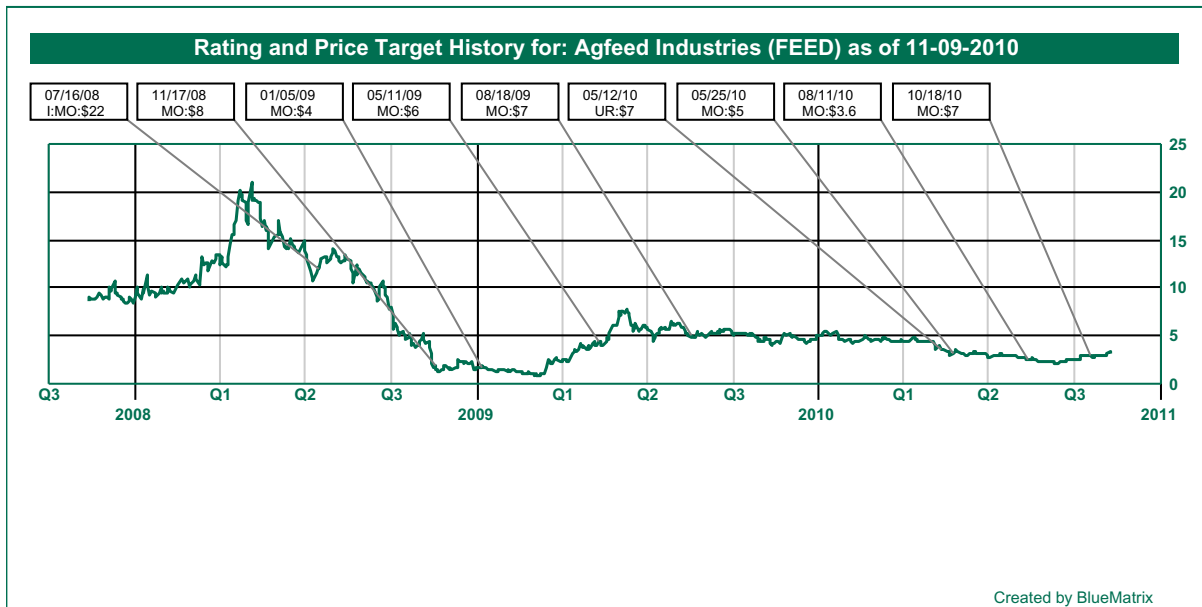
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- Market Outperform (Buy): The common stock of the company is expected to outperform a passive index comprised of all the common stock of companies within the same sector, as defined by First Call.
- Market Perform (Hold): The common stock of the company is expected to mimic the performance of a passive index comprised of all the common stock of companies within the same sector, as defined by First Call.
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- Speculative - The common stock risk level is significantly greater than market risk. The stock price of these equities is exceptionally volatile.
- Aggressive - The common stock risk level is materially higher than market level risk. The stock price is typically more volatile than the general market.
- Moderate - The common stock is moderately risky, or equivalent to stock market risk. The stock price volatility is typically in-line with movements in the general market.



RATING SUMMARY

Distribution of Ratings Table				
Rating	Count	Percent	IB Serv./Past 12 Mos	
			Count	Percent
Market Outperform(MO)	172	75.80%	49	28.49%
Market Perform(MP)	45	19.80%	4	8.89%
Market Underperform(MU)	5	2.20%	0	0.00%
Under Review(UR)	5	2.20%	0	0.00%
Total	227	100%	53	100%

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