

May 12, 2011

Market Outperform / Speculative Risk

FEED: 1Q11 Update

MARKET DATA 5/12/2011

Price	\$1.28
Exchange	NASDAQ
Target Price	\$3.50
52 Wk Hi - Low	\$3.77 - \$1.21
EV(MM)	\$140.1
Market Cap(MM)	\$74.2
Shares Out (MM)	58.0
Public Mkt Float (MM)	26.8
Avg. Daily Vol	689,689

BALANCE SHEET METRICS

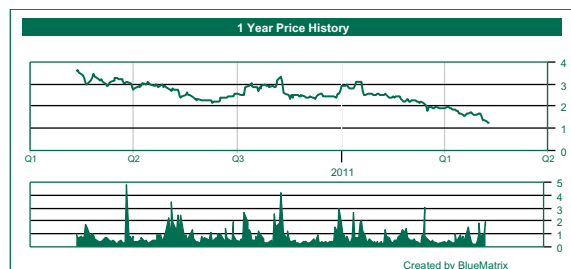
Cash (MM)	\$9.2
LTD (MM)	\$14.3
Total Debt/Total Equity	NA
Debt/Capital	NA
Price/Book Value	0.5x
Book Value/Share	\$2.37

EARNINGS DATA (\$)

FY - Dec	2009A	2010A	2011E
Q1 (Mar)	0.08	0.02	(0.03)A
Q2 (Jun)	0.03	(0.07)	(0.01)
Q3 (Sep)	0.07	(0.43)	0.05
Q4 (Dec)	0.08	(0.42)	0.06
Full Year EPS	0.26	(0.90)	0.08

INDICES

DJIA	12,695.9
SP-500	1,348.6
NASDAQ	2,407.9
Russell 2000	847.5



FEED reported 1Q11 revenue, GAAP net loss and diluted EPS of \$93.0 million, (\$1.6) million and (\$0.03) versus our estimates of \$96.5 million, (\$3.2 million) and (\$0.06), respectively. Top line grew by 75.9% YoY from \$52.9 million in 1Q11, but declined 6.5% sequentially from \$99.5 million in 4Q10 on higher than expected contribution from the company's U.S. operations offset by disappointing performance of animal nutrition and China hog operation segments. Gross profit of \$7.8 million represented a 24.7% YoY increase and an 8.5% gross margin, compared to \$6.3 million or 12.0% margin in 1Q10 and \$1.5 million or 1.5% margin in 4Q10. SG&A expenses were up 56.8% YoY from \$4.7 million in 1Q10 to \$7.4 million, accounting for 7.9% of the total revenues compared to 8.9% in 1Q11. The company reported a net loss of (\$1.6) million or (\$0.03) per share compared to a net income of \$1.1 million or \$0.02 per share in 1Q11. We expect the company to return to profitability in 2H11 and reiterate our Market Outperform/Speculative Risk rating. We are, however, reducing our price target from \$4.00 to \$3.50 on higher share count. Our 12-month price target is based on the shares attaining a P/E level of 8x our FY12 EPS estimate of \$0.43.

Discussion

- M2P2 Saves the Day:** M2P2, a U.S.- based hog production company and a key supplier to Hormel (HRL, Not Rated), was acquired in September 2010. The subsidiary contributed \$57.9 million and \$4.4 million towards the company's revenues and gross profit in 1Q11, equivalent to 62.3% and 55.6% of the total revenues and gross profit, respectively. During 1Q11, M2P2 sold 334,000 hogs versus 84,275 hogs sold by AgFeed in China, earning an average gross profit of \$13 per hog (~7.6% gross margin). These results significantly exceeded our 1Q11 revenue and gross profit estimates of \$50.0 million and \$2.3 million (~4.5% gross margin). We are consequently increasing our full year projections for the U.S. hog segment to \$219.9 million in revenues and \$13.7 million in gross profit from the previous forecasts of \$200.0 million and \$9.5 million, respectively.
- Weak Quarter for the Animal Nutrition Segment:** Animal nutrition segment revenues increased by less than 1% YoY to \$28.2 million (inclusive of \$4.0 million in intercompany sales). Sequentially, revenues declined 17.3% QoQ on lower volume and selling prices. During 1Q11, the company sold 43,926 MT of feed versus 49,614 MT sold in the previous quarter. Average selling prices declined by 3.0% YoY and 6.5% QoQ to \$643/MT despite higher input costs. Overall feed segment gross margin declined from 15.9% in 1Q10 and 13.4% in 4Q10 to 8.6% in 1Q11 as the company struggled to absorb higher corn costs without losing its market share.

- **A Glimmer of Hope:** AgFeed earned a gross profit of \$13/hog sold in China during 1Q11, compared to \$10/hog in 1Q10 and a loss of (\$8)/hog in 4Q10 despite higher feed costs. While average selling prices per hog declined to \$136, per kilogram prices increased from \$1.81/kg in 1Q10 to \$2.45/kg in 1Q11 as the company sold younger feeder pigs at lower weights to maximize profits. We believe this is a plausible strategy given that younger pigs gain weight faster while bringing finisher pigs to market weights requires proportionately higher amounts of feed per kilogram of weight gained in the later stages of a pig's life. So in certain market conditions, lower prices received for younger, lighter pigs can be more than offset by savings on feed costs. While this may be a temporary market phenomenon, nonetheless, we believe the shift from gross loss to gross profit signals an impending return to profitability in the hog segment in China.
- **Half Way There:** We remind that at the end of FY10 the company had decided to dispose of eight consistently loss-making farms, including all commercial farms in Jiangxi, the Tuanxi farm in Shanghai and some of the facilities at the multifarm sites in Guangxi and Fujian. As of the end of 1Q11, the company closed four of the eight farms. The remaining farms are expected to be closed by the end of August 2011.
- **Western-style farms to start generating revenues in 1Q12:** The first of the western-style farms located in Dahua, Guangxi province has entered production mode in February 2011 with initial stocks of 5,000 sows. We expect the farm to start generating revenues from the sales of meat hogs in 1Q12. Dahua production pod is the first of six western-style farms to be built in southern China over the next couple of years.
- **Dilution by 1,000 Cuts** During the quarter, AgFeed sold 3.4 million shares pursuant to an equity credit agreement with Southridge Partners. An additional 5.2 million shares were issued to Southridge during 2Q11 to finance the construction of new western-style hog farms in China. Consequently, we are increasing weighted average fully diluted share count to 58.7 million shares for FY11 and 63.1 million shares for FY12. As of May 11, 2011, AgFeed could sell additional shares to Southridge for aggregate gross proceeds of up to \$21.6 million.

Adjusting our Model: We are slightly tweaking our quarterly forecasts for 2011, expecting the company to return to profitability in 3Q11. For 2Q11, we expect revenues and net loss of 92.7 million and (\$0.5) million or (\$0.01) per fully diluted share. For the full FY11, we are projecting revenues of \$384.5 million and GAAP net income of \$4.9 million or \$0.08 per fully diluted share. FY12 revenues and GAAP net income are expected to come in at \$544.7 million and \$27.3 million or \$0.43 per fully diluted share, respectively.

Valuation: AgFeed is currently trading at 16x our FY11 fully diluted EPS forecast of \$0.08 and 3x our FY12 fully diluted EPS forecast of \$0.43 compared to 12x and 11.5x multiples for the U.S.-listed protein and animal feed peer group and 29x and 21x for the China-listed protein and animal feed comparables. We believe the company will continue to face headwinds for the remainder of 1H11, with performance gradually improving over the 2H11 as the company continues to implement multiple efficiency initiatives. Consequently, we are valuing the stock at a substantial discount to its U.S. peers. Our reduced price target of \$3.50 is based on the shares attaining a P/E level of 8x our FY12 EPS estimate.

Risks: (1) High feed costs (2) Hog prices (3) Weak consumer demand for pork (4) Swine disease (5) Execution risk (6) Regulatory risk (7) Commodity hedging (8) Client concentration (9) Nonrenewal of M2P2 long term hog procurement agreements.

AgFeed Industries, Inc. (FEED)																		
Income Statement	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11 E	3Q11 E	4Q11 E	FY07	FY08	FY09	FY10	FY11 E	FY12 E
(In USD, '000, except EPS)																		
Revenues	33,429	38,528	45,115	56,131	52,859	37,662	53,606	99,487	92,987	92,659	100,129	98,756	36,163	143,661	173,203	243,614	384,531	544,675
Cost of goods sold	(27,626)	(33,306)	(37,554)	48,082	(46,540)	(35,103)	(49,284)	(98,016)	(85,107)	(84,341)	(88,482)	(87,261)	(25,763)	(109,225)	(146,568)	(228,943)	(345,190)	(468,464)
Gross Profit	5,803	5,222	7,561	8,049	6,319	2,559	4,322	1,471	7,880	8,318	11,647	11,495	10,400	34,437	26,635	14,671	39,341	76,211
Selling expenses	(864)	(999)	(961)	(1,110)	(1,031)	(983)	(1,063)	(1,309)	(987)	(1,205)	(1,302)	(1,284)	(2,694)	(3,941)	(3,934)	(4,386)	(4,777)	(6,766)
G&A Expenses	(1,757)	(1,961)	(2,889)	(3,502)	(3,664)	(3,509)	(5,021)	(7,894)	(6,375)	(6,023)	(5,507)	(4,938)	(1,385)	(5,755)	(10,109)	(20,087)	(22,843)	(31,046)
Impairment of intangible assets	0	0	0	0	0	0	(16,752)	(4,860)	0	0	0	0	0	0	0	(21,612)	0	0
Impairment of long-term assets	0	0	0	0	0	0	0	(9,022)	0	0	0	0	0	0	0	(9,022)	0	0
Total Operating Expenses	(2,621)	(2,960)	(3,849)	(4,613)	(4,695)	(4,492)	(22,836)	(23,085)	(7,362)	(7,227)	(6,809)	(6,222)	(4,079)	(9,696)	(14,043)	(55,108)	(27,620)	(37,813)
Income from Operations	3,182	2,262	3,712	3,436	1,624	(1,933)	(18,514)	(21,614)	518	1,091	4,838	5,274	6,321	24,741	12,592	(40,436)	11,721	38,398
Other income (expense)	193	(189)	(388)	(58)	(96)	(355)	(193)	568	(3)	0	0	0	160	(711)	(443)	(76)	(3)	0
Interest income	61	53	75	25	48	38	55	(24)	15	30	30	30	142	191	213	117	105	46
Interest and financing costs	(153)	(625)	(193)	(52)	(125)	(140)	(291)	(809)	(915)	(1,000)	(1,000)	(1,000)	(154)	(5,704)	(1,023)	(1,365)	(3,915)	(4,862)
Foreign currency transaction loss	(2)	5	(18)	(3)	14	(34)	(35)	51	(10)	0	0	0	0	(559)	(18)	(5)	(10)	0
Total Non-operating Income (Expense)	98	(756)	(524)	(89)	(159)	(491)	(464)	(214)	(913)	(970)	(970)	(970)	149	(6,783)	(1,270)	(1,328)	(3,823)	(3,823)
Pre-tax Income	3,281	1,506	3,188	3,347	1,465	(2,424)	(18,978)	(21,827)	(395)	121	3,868	4,304	6,470	17,958	11,322	(41,764)	7,898	34,575
Income Tax	(216)	(286)	(293)	(348)	(454)	(641)	(1,759)	1,619	(539)	(16)	(484)	(516)	193	(587)	(1,142)	(1,235)	(1,554)	(6,805)
Net income (Loss) from Cont. Operations	3,065	1,220	2,895	2,999	1,011	(3,065)	(20,737)	(20,209)	(934)	105	3,385	3,787	6,663	17,370	10,180	(42,999)	6,343	27,770
Net income (Loss) from Discont. Operatic	0	0	0	0	0	0	0	0	(681)	(700)	0	0	0	0	0	0	(1,381)	0
Less: Net inc. attr. to noncont. Int.	(46)	6	1	(208)	56	110	101	28	(64)	(61)	(85)	(83)	0	(422)	169	295	(293)	(500)
Net income attributed to AgFeed	3,019	1,226	2,896	3,207	1,067	(2,955)	(20,636)	(20,181)	(1,551)	(533)	3,300	3,705	6,663	16,949	10,348	(42,704)	4,920	27,270
Weighted Avr. S/O - Basic	37,933	39,550	42,421	42,921	44,869	45,015	48,487	48,069	53,388	57,200	59,450	60,950	26,093	31,558	40,978	47,458	57,747	61,950
Weighted Avr. S/O - Diluted	37,933	41,446	43,329	43,829	45,213	45,015	48,487	48,069	53,388	57,200	61,434	62,934	26,175	31,714	41,214	47,458	58,739	63,109
Basic EPS (GAAP)	\$ 0.08	\$ 0.03	\$ 0.07	\$ 0.07	\$ 0.02	\$ (0.07)	\$ (0.43)	\$ (0.42)	\$ (0.03)	\$ (0.01)	\$ 0.06	\$ 0.06	\$ 0.26	\$ 0.54	\$ 0.25	\$ (0.90)	\$ 0.09	\$ 0.44
Diluted EPS (GAAP)	\$ 0.08	\$ 0.03	\$ 0.07	\$ 0.07	\$ 0.02	\$ (0.07)	\$ (0.43)	\$ (0.42)	\$ (0.03)	\$ (0.01)	\$ 0.05	\$ 0.06	\$ 0.25	\$ 0.53	\$ 0.25	\$ (0.90)	\$ 0.08	\$ 0.43
Margins (% of revenue)																		
Cost of goods sold	(82.6%)	(86.4%)	(83.2%)	85.7%	(88.0%)	(93.2%)	(91.9%)	(98.5%)	(91.5%)	(91.0%)	(88.4%)	(88.4%)	(71.2%)	(76.0%)	(84.6%)	(94.0%)	(89.8%)	(86.0%)
Gross profit	17.4%	13.6%	16.8%	14.3%	12.0%	6.8%	8.1%	1.5%	8.5%	9.0%	11.6%	11.6%	28.8%	24.0%	15.4%	6.0%	10.2%	14.0%
Selling Expenses	(2.6%)	(2.6%)	(2.1%)	(2.0%)	(1.9%)	(2.6%)	(2.0%)	(1.3%)	(1.1%)	(1.3%)	(1.3%)	(1.3%)	(7.4%)	(2.7%)	(2.3%)	(1.8%)	(1.2%)	(1.2%)
General & Administrative	(5.3%)	(5.1%)	(6.4%)	(6.2%)	(6.9%)	(9.3%)	(9.4%)	(7.9%)	(6.9%)	(6.5%)	(5.5%)	(5.0%)	(3.8%)	(4.0%)	(5.8%)	(8.2%)	(5.9%)	(5.7%)
Operating margin	9.5%	5.9%	8.2%	6.1%	3.1%	(5.1%)	(34.5%)	(21.7%)	0.6%	1.2%	4.8%	5.3%	17.5%	17.2%	7.3%	(16.6%)	3.0%	7.0%
Tax rate	(6.6%)	(19.0%)	(9.2%)	(10.4%)	(31.0%)	(26.5%)	(9.3%)	7.4%	(136.4%)	(13.0%)	(12.5%)	(12.0%)	3.0%	(3.3%)	(10.1%)	3.0%	(19.7%)	(19.7%)
Net margin	9.0%	3.2%	6.4%	5.7%	2.0%	(7.8%)	(38.5%)	(20.3%)	(1.7%)	(0.6%)	3.3%	3.8%	18.4%	11.8%	6.0%	(17.5%)	1.3%	5.0%

Source: Company Filings, Rodman & Renshaw Research

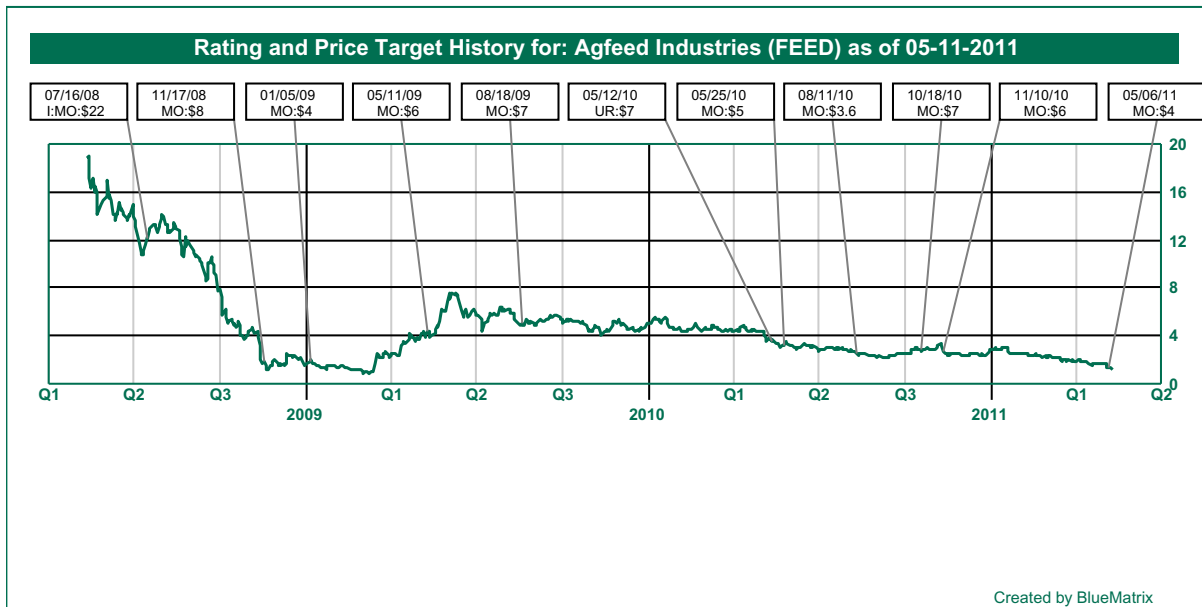
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- Market Outperform (Buy): The common stock of the company is expected to outperform a passive index comprised of all the common stock of companies within the same sector, as defined by First Call.
- Market Perform (Hold): The common stock of the company 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)	147	59.80%	37	25.17%
Market Perform(MP)	41	16.70%	4	9.76%
Market Underperform(MU)	8	3.30%	0	0.00%
Under Review(UR)	50	20.30%	14	28.00%
Total	246	100%	55	100%

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