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Ten winners from the free trade agreement

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The historic free trade agreement (FTA) between China and Australia in the main hasn’t prompted analysts to make wide sweeping changes to forecasts or recommendations. But there is plenty of upside if you look in the right places.

The reason enthusiasm has been tempered is because most of the tariff reductions are long dated in their commencement and will be phased out gradually.

Furthermore, as Damian Boey from Credit Suisse pointed out, most of Australia's exports to China are resource-based and investors are currently more focused on deteriorating commodity prices.

Nikko Asset Management portfolio manager Malcolm Whitten summed the situation up well saying: "The immediate impact on share prices will be limited because the market is too short-term focused". But that's no reason for readers and long-term investors to think the same way.

While price action in resource stocks has all been to the downside, there were some noticeable spikes in share prices of companies in the soft commodities sector. And while this is definitely a fragmented industry, with a number of players having multi-layered businesses, *Smart Investor* has identified 10 stocks worth adding to your watch lists.

Beef and Dairy

The beef and dairy industries were two of the biggest winners with removal of all tariffs of up to 20 per cent and 25 per cent respectively to commence in four years and be fully abolished by 2025.

Australian Agricultural Company(AAC) is a standout player in the beef industry for a number of reasons. Firstly it is Australia's largest cattle and beef producer with an asset base comprising a herd of 540,000 head of cattle as at June 30, 2014 and property portfolio in the order of 6.5 million hectares.

Strategically though it could be argued its most important asset looking to the future is the recently established beef processing facility near Darwin, Livingston Beef, which began commercial operations on October 31.

Following delivery of the FTA, managing director Jason Strong said the company welcomed the recent announcements of liberalised trade arrangements with key markets such as Japan, South Korea and China.

AAC estimates continuing population growth and rising living standards especially in Asia will see global food demand grow by up to 70 per cent in the next 30 years, leaving the group well positioned to take advantage of this trend, particularly having established a major processing and distribution facility with optimum proximity to Asian markets.

AAC's shares spiked approximately 8 per cent at the start of the week, but it was outdone by **Elders (ELD)** with its share price hitting a two year high of 23.5¢ on Tuesday, up 40 per cent since the start of the month.

This surge occurred under record volumes as investors embraced the revitalised diversified rural services group after a rocky few years. Of note were chief executive Mark Allison comments, highlighting the improved fiscal 2014 result announced on

November 17 was substantially driven by a recovery in livestock prices and volumes, as well as increased supply to international markets.

He said the group's live export services benefited from strong demand from Asian markets, underlining the long-term benefits of the FTA. Elders provides food and processing services as well as handling export logistics with Elders Indonesia and Elders China, two of its key divisions.

Bell Potter is forecasting earnings per share growth of 67 per cent in fiscal 2015 with average growth of about 30 per cent per annum in 2016 and 2017. Bell's analyst said, "With tailwinds in cattle and the benefits of a strengthened balance sheet, Elders looks on track to lift underlying earnings before interest and tax towards $60 million by fiscal 2017".

Ruralco Holdings (RHL) is a similar style of operation in that its diversified business provides exposure to a wide range of agricultural commodities. However, what is likely to come into focus is its recently established Frontier International operation, a live export business which shipped more than 40,000 cattle in the second half of fiscal 2014.

Managing director, John Maher, highlighted when delivering the annual result which featured a 78 per cent increase in underlying profit, "Frontier International continues to grow its order pipeline across both feedlot and breed cattle categories with potential to increase its dedicated shipping space to meet demand". This area of its business while immature is certainly shaping up as a growth engine.

Bega Cheese (BGA) is engaged in the processing, manufacturing and distribution of dairy and associated products to Australian and international markets, holding a leading position in the domestic cheese industry, but more importantly, in terms of recent developments it has strong exposure to growing infant formula demand in Asia.

Executive Chairman, Barry Irvin described the FTA as "One of the most important initiatives of the last decade and a particularly excellent outcome for the Australian dairy industry".

While he didn't point to specific areas of the business most affected, the recent signing of a supply and distribution agreement with one of China's leading retail group's Chongqing General Trading Group for the supply of UHT milk suggests it will be a big winner.

On a similar note, **Freedom Foods Group (FNP)** took advantage of the G20, with it and Perich Group signing a Memorandum of Understanding with China's New Hope Group aimed at long-term dairy milk supply through the establishment of new large-scale intensive dairy farms in south-east Australia for supply to Freedom Food Group's UHT operations.

Perich Group is the largest shareholder in Freedom Foods and operates one of the most prominent dairy farming activities in New South Wales. New Hope is the largest private company in China with diversified operations in agriculture, financial services and real estate.

As the largest supplier of meat, egg and dairy products in China this represents a highly strategic partnership, and not surprisingly Freedom's shares bounced approximately 15 per cent when the deal was announced.

Wine

Wine tariffs of between 14 per cent and 20 per cent will be phased out over a period of four years. Citi analyst, Gino Rossi, noted China represented approximately 5 per cent of Australian exports by volume, but 12 per cent by value, highlighting the trend towards premium wines.

Treasury Wine Estate (TWE) benefits from premium pricing in Asia resulting in earnings before interest and tax margins of 35 per cent compared to group margins of 11 per cent. While Rossi believes the reduction in tariff should stimulate volumes and lift overall margins for the group, the benefit may be modest since a significant proportion of its premium wine already enters China through Hong Kong which has zero tariffs.

Another potential beneficiary is **Australian Vintage (AVG)**, particularly given it is only a matter of months since the group signed a long-term strategic China wide distribution agreement with COFCO Wine & Spirits, part of China's largest food processing, manufacturer and trader, COFCO.

Under the agreement, Australian Vintage through its core brand McGuigan Wines has become the strategic partner for Australian wine throughout China within the newly established international wine division of COFCO.

Chief financial officer, Mike Noack said, "The agreement between Australia and China gives us confidence Australian Vintage is well placed for long-term success in this important emerging market, and importantly the agreement with China will create a level playing field with Chile and New Zealand.

Analysts at Bell Potter recently noted Australian Vintage continues to transition from a bulk wine play to a branded wine group with a growing presence in the UK and Australia likely to be complemented by an emergence in China.

Horticulture

All trade tariffs on most horticultural products exported to China will be eliminated over the next four years, with the only exception being citrus fruits which will be phased out over eight years. Among ASX listed companies, nut producers are the big winners with the elimination of the 10 per cent to 25 per cent tariffs by 2018.

Almond Board of Australia chief executive, Ross Skinner, said with the elimination of almond tariffs there was potential for Australia to increase the tonnage sold into the Chinese market, which had been rapidly expanding as Chinese income had risen.

California is the dominant global almond producer with a market share of 80 per cent, but this will assist Australian producers, notably **Select Harvests (SHV)** which has already been taking advantage of lower production in the US.

Management expects to have doubled its acreage by 2018 with a view to expanding output and increasing its focus on South-East Asian markets, suggesting this is a timely development which will offer improved pricing power.

As the largest vertically integrated walnut business in the southern hemisphere, **Webster (WBA)** is also in a strong position to take advantage of better pricing.

With Bell Potter forecasting production to increase from about 7000 tonnes in fiscal 2014 to 10,500 tonnes in fiscal 2017 and management targeting 16,000 tonnes by 2025, the removal of tariffs will help the company compete with the US and achieve better than previously expected earnings growth.

Pearls and Perfumes

The pearl industry may not have received the headlines, but the abolishment of a 21 per cent tariff is a significant development for **Atlas Pearls and Perfumes (ATP)**. While the group doesn't traditionally sell its highly sought-after South Sea pearls directly into China, it expects this will open doors for future trade relations.

A more immediate beneficiary is likely to be its pearl extract perfume and cosmetics business, as well as the Essential Oils of Tasmania (EOT) operations. In the course of President Xi Jinping's visit to Tasmania, Atlas Pearl conducted site visits with Chinese enterprises discussing a potential deal in relation to its Lavender and Tasmanian Native Pepper business.

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