

Rosefinch Research | 2024 Series # 8

Three Main Themes in Agriculture



Agriculture is the foundation of all societies, and food is the basis for development. Agriculture is a domestic demand industry with huge market size, and it is a relatively inelastic field among consumer goods. Against the backdrop of macro trends, there have been some changes in both the demand side and supply side for agricultural products such as grains, vegetables, meat, and eggs. Animal feed, pesticides, and pig farming industries are still seeing rapid destocking, while genetic engineering is reshaping industry patterns. The pet economy is growing against the trend, and the scale of the pet food industry has rapidly surpassed 50 billion yuan. How should we view the changes in various fields?

In terms of demand, in recent years, the decline in birth rates, improvements in dietary structures and relative softness in catering consumption have had certain potential impacts on demand for subdivided fields of agriculture and animal husbandry. In terms of supply, the elimination of participants with weak cost control capabilities, financial pressures and lagging R&D has continued to improve the supply-side patterns of many subdivided fields, and in recent years there have also been cases of major agricultural and animal husbandry enterprises gradually withdrawing from the market. The speed of supply-side elimination is very fast in some fields.

In addition, technological breakthroughs are helping agricultural and animal husbandry enterprises improve efficiency, and R&D investment is an important means for advantage enterprises to continue shaping their own moats in response to industry impacts, which is also an important observation point for us.

Currently in the agricultural, forestry, animal husbandry and fishery sectors, we mainly focus on three themes: fields where demand continues to grow, such as pet food; fields with rapid supply-side elimination such as feed, pesticide, and pig farming; and fields of technological progress, such as genetically modified seeds and biological intelligent industries.

1. Double digit growth in pet food market

First, the pet food industry is currently one of the fields in agriculture where demand continues to grow rapidly. From 2010 to 2022, the market scale of the pet food industry has grown at a compound annual rate of 22%, making it a sector with very fast growth among consumer goods.



Domestically, the scale and growth rate of the pet food market data shows considerable potential for growth in per capita expenditure and penetration rates compared to European, American, and Japanese markets. Looking at overseas cases, the pet food industry is an industry that can outperform GDP growth in the long run. This year, the pet food industry is still maintaining relatively fast double-digit growth.

Industry insiders agree that growth is very fast, so valuations may not be particularly cheap for such an industry. We believe that on one hand, we need to find companies that have already established clear industry leadership and competitive advantages. On the other hand, we need to make objective assessments based on companies' potential for future growth, future industry status and changes in industry patterns.

For the pet food industry, we will focus on two dimensions:

The first dimension is domestic pet food companies that have the ability to operate premium brands and even capture market share from foreign brands. This is because premium brands correspond to customers with stronger bargaining power and stickiness downstream. From our observations, this customer group continues to grow in the current environment.

Companies with premium products usually have more complete product lineups, and their ability to increase prices for mid-to-low end products is also stronger. Pet food companies without premium brands are often trapped in homogeneous competition in the mid-to-low end products and find it difficult to form brand effects and occupy consumers' minds. Operating premium brands poses very high requirements for pet food companies' product differentiation, including new product R&D, marketing, personnel teams, supply chain management and brand promotion. Domestic pet food companies started relatively late, and they basically started as OEM manufacturers. Companies with the ability to operate premium products are very rare.

The second dimension is pet food companies that can bind young customer groups. Currently, the pet industry is showing a significant trend of youth-ization, with Generation Y and Z pet owners accounting for 46.3%. Their consumption concepts, habits and information channels differ significantly from older generations of pet owners. Young consumers have higher levels of specialization and obtain information through more innovative and unique channels. They also tend to personalize and endear pets more strongly, often requiring higher quality, more professional pet foods. Companies need to diversify marketing tools both online and offline to attract young consumers in the long run and gradually transform early marketing investments into long-term brand power.

2. Fast destocking in supply side

The first industry with supply-side logic is the pig farming industry. Currently, market attention is relatively high, but people are paying attention to the supply side rather than demand. In terms of demand, with the decline in birth rates and continuous optimization of dietary habits, overall demand for the pig farming industry may decline in the medium to long term. Looking at the supply side, capacity elimination is also occurring at a very fast pace. The pig farming industry has gone through what may have been the longest period of losses in history. Pig farmers who had blindly expanded previously are under tremendous pressure in financing, and we can even see leading companies actively reducing capacity and gradually exiting the industry.

We believe the supply-side logic of the pig farming industry is more important than the demand-side logic, because in the stage of price slump and capacity reduction, the speed of capacity reduction may be faster than the temporary reduction caused by sluggish demand.

Therefore, we will pay attention to two points in the future: first, pig farming enterprises with ample cash flow and better cost control capabilities have a higher chance of surviving until the next pig cycle. Second,

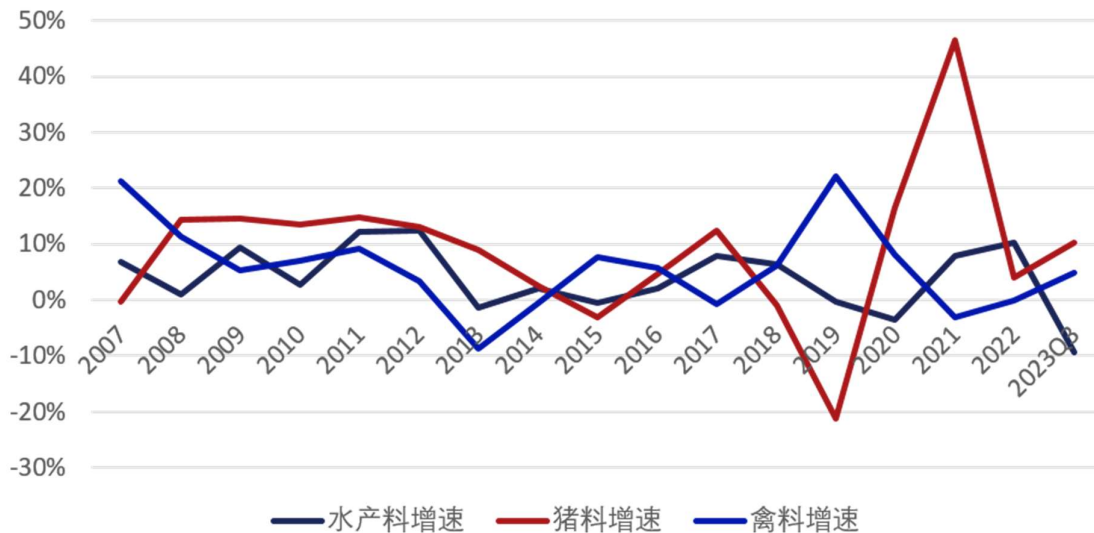
the progress of overall industry capacity reduction. Based on past pig cycles, the more thorough an industry's capacity reduction, the greater the probability of price rally in the next pig cycle.

Average pork price CNY/kg



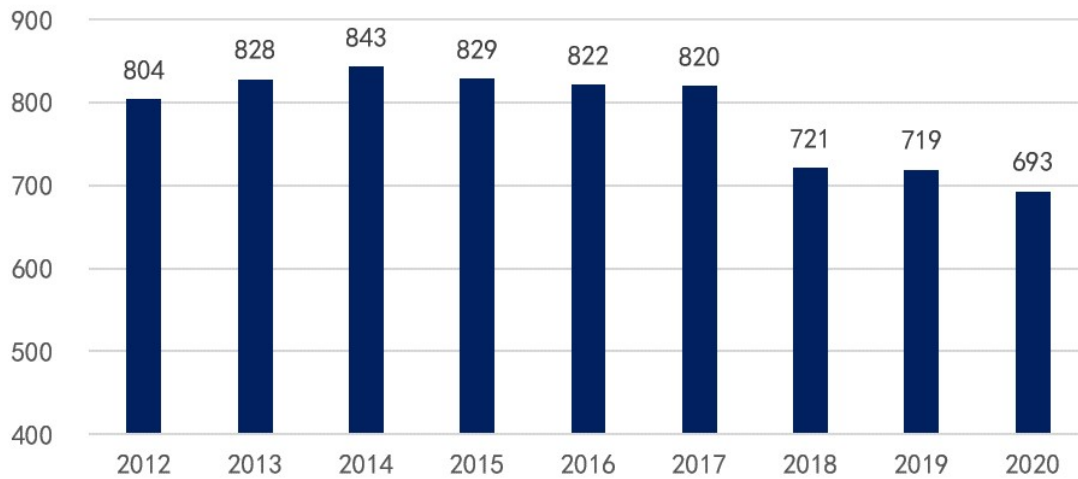
The second industry with supply-side logic is the feed industry. As one of the industries with larger market space currently in agriculture, forestry, animal husbandry and fishery, the global leading feed enterprises are mostly concentrated domestically. Affected by downstream breeding demand, industry growth has slowed as total volumes remain relatively stable, making changes in industry patterns particularly important. In recent years, many feed enterprises have fallen into losses and gradually withdrawn from the market amid huge fluctuations in raw material prices, downstream demand, and profit pressures from breeding operations.

Feed sub-sector growth rate



The third industry with supply-side logic is the agrochemical industry. Against the backdrop of deglobalization, major sovereign countries around the world pay increasing attention to food security issues. As a necessity for grain production, agrochemical demand is expected to remain at a high level over the long run. Structurally, some companies with strong R&D capabilities have made breakthroughs in innovative drugs and biological pesticides. From a growth perspective, there is more room for optimizing industry concentration and competitive patterns under tighter environmental policies.

Sizable agriculture enterprises



The three-year COVID-19 pandemic caused instability in overseas supply chains, with many overseas customers bulk purchasing over three years, directly pushing up API prices to historical highs and attracting significant new production capacity amid lucrative profits. As the pandemic ends and new capacities are released, agrochemical APIs have now returned to low price levels and continue to grind lower. Currently, industry is seeking balance between supply and demand. In terms of supply, we believe it is better to select varieties with small or no capacity increases, and those with absolute brand power.

In terms of demand, agrochemical inventory levels in Europe, Asia, Latin America have basically recovered to normal, while inventories in North America and Brazil are also gradually improving. Therefore, the core factor dominating agrochemical price trends is the recovery of orders in the first half of 2024. Currently, many plants are starting to lose money and reduce operating rates, and we are closely tracking the arrival of the inventory turning point.

3. Genetic engineering impacts the future of agriculture

Under the unprecedented major changes of the past century, agricultural security is extremely important, and to achieve high level self-reliance requires gains in technology. Currently, plant breeding technology represented by transgenic technology in China has matured, and industry transformation is underway via industry expansion and reshaping of the operating pattern.

Good traits and good varieties are key to the smooth promotion of transgenic crops. In terms of traits, the main ones approved so far are double gene varieties, with insect resistance and herbicide tolerance traits, and the herbicide tolerance should be higher than 4 times the usual dose. In terms of varieties, transgenic technology is just a means, and the more crucial aspects are the biological traits of traditional varieties, such as combined advantages in yield and resistance.

In the early stage, the variety industry sector presented more thematic opportunities. We believe that with the introduction and increasing penetration rate of transgenic varieties, the industry is expected to switch from thematic investment to growth tracks, and the switching speed is closely related to the penetration rate of transgenic crops. We will continue to monitor developments closely going forward.

In addition to transgenic technology, gene editing technology and synthetic biology technology are also developing rapidly. Gene editing is relatively simpler and more direct than transgenic technology, and policy regulation is also more lenient. It can improve many quality problems at present. For example, by using synthetic biology to express human serum albumin in rice, it can be used for patient's post-surgery recovery. These are also directions worth paying attention to in the future.

We hope that by sharing Rosefinch's views, we add value to your day.

We endeavor to provide timely English version of Rosefinch's publications. For any English translation of the original Chinese article, in case of any discrepancy, the Chinese version takes precedence.

Disclaimer

The information and data provided in this document is for informational purposes only and is not intended as an offer or solicitation for the purchase or sale of any financial products or services. This document is not intended for distribution to, or usage by, any person or entity in any jurisdiction or country where such distribution or usage are prohibited by local laws/regulations. The contents of this document are based upon sources of information believed to be reliable at the time of publication. Except to the extent required by applicable laws and regulations, there is no express or implied guarantee, warranty or representation to the accuracy or completeness of its contents. Investment returns are not guaranteed as all investments carry some risk. The value of an investment may rise or fall with changes in the market. Past performance is no guarantee of future performance. This statement relates to any claims made regarding past performance of any Rosefinch (or its associated companies') products. All rights are reserved by Rosefinch Fund Management Co. Ltd and its affiliates.