

# China Pork Sector

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DBS Group Research . Equity

28 Jun 2022

## Price recovery is key

- Latest demand uptrend against contracting sow inventories should infer further hog price recovery in China towards >RMB18/kg by 2H22
- Rising prices should also favour domestic and imported frozen meats across China
- Easing cost pressures and ongoing market consolidation to improve operating efficiency and margins ahead
- Our top pick is [WH Group](#); we also like [COFCO Joycome](#) and [New Hope Liuhe](#) as they should benefit from the price recovery in China along with cost efficiency improvements

**Hog prices are recovering.** Sow inventory reduction in the industry was well on track, while hog prices have started to recover since April 2022. With tighter market supply amid ongoing sow inventory reduction, we believe hog prices should continue to rise in 2H22 to above RMB18/kg. The average finished weight of hog production could also decline further in 2H22. Overall, we expect the major hog farmers to stage a turnaround in 2H22 and achieve better profit margins. Ongoing expansion of their production scale could also improve efficiency in the industry and accelerate market consolidation.

### Downstream players to leverage on the price uptrend.

Downstream players like WH Group have taken advantage of the lower pork prices in 1H22 to build up their frozen pork inventory, and should achieve better profitability in 2H22 as pork prices head higher. The pork import businesses of companies like WH Group and COFCO Joycome should also improve riding on the pork price uptrend in China.

**Cost pressure should ease in 2H22.** While feed cost pressure may linger in the near term, normalising global supply and the Chinese government's determination to stabilise feed prices should lessen the impact on the industry by 2H22. In addition, major hog producers will continue to improve production efficiencies through feed-mix adjustment and sow quality control. We believe they should aim at a production cost of RMB16/kg or below at the end of this year, while leading player Muyuan may further target at a RMB14.5/kg production cost ahead for better profitability.

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### Recommendation & valuation

Company Name	Currency	Price Local\$	Target Price Local\$	Rec	Mkt Cap US\$m	PE 23F x
<a href="#">Wh Group*</a> (288 HK)	HKD	5.78	6.72	BUY	9,448	6.0
<a href="#">COFCO Joycome Foods*</a> (1610 HK)	HKD	3.93	4.19	BUY	1,954	7.4
<a href="#">New Hope Liuhe 'A'*</a> (000876 CH)	CNY	16.30	19.27	BUY	10,977	14.4
Muyuan Foods 'A' (002714 CH)	CNY	58.58	n.a.	NR	46,603	10.8
Wens Foodstuff Group 'A' (300498 CH)	CNY	23.20	n.a.	NR	22,393	13.0

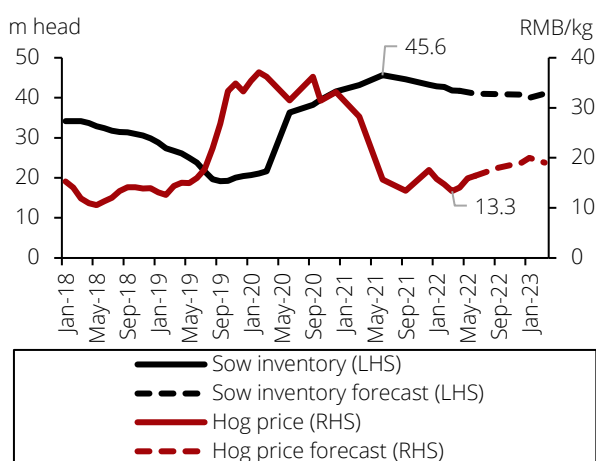
Source: Thomson Reuters, \*DBS Bank (Hong Kong) Limited ("DBS HK")



Live more, Bank less

**Sow reduction well on track.** Sow inventory volume has been on a steady decline since June 2021 from c.46m heads to <42m heads as of April 2022, and we expect further dips in 2H22. With the declining sow inventory volume in the industry, hog supply in the market may have peaked in April this year, considering the time lag between hog production and sow inventory volume given the 10-12 month breeding and rearing cycle. We also tracked the monthly hog production volume of top market players, and have seen m-o-m declines since April. Hog prices have also started to recover since April 2022, which corresponded to our previous estimate.

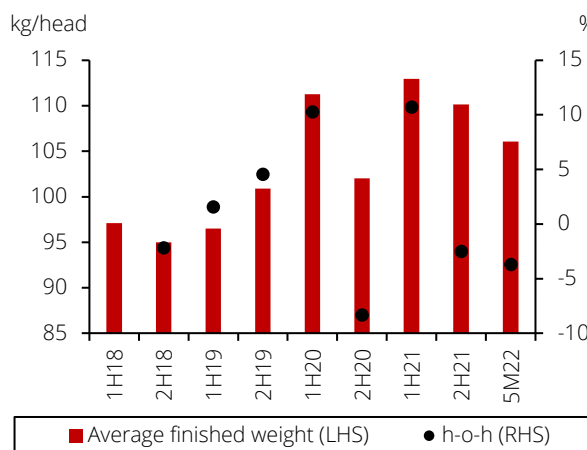
**Sow inventory vs. live hog prices**



Source: NDRC, MARA, Wind, DBS HK

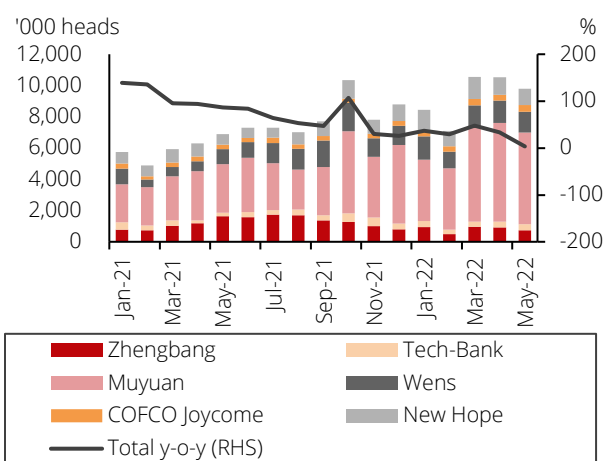
**Will supply continue to decline in 2H22?** The latest sow inventory level in the industry is still 2%/13% higher than the recommended/minimum volume suggested by the Ministry of Agriculture and Rural Affairs (MARA), while some small-scale players are likely to continue to be loss-making. We believe the industry sow inventory may continue to fall to below 41m heads in 2H22. In the meantime, the average hog finished weight of the top-five companies that we tracked has also seen h-o-h declines since 1H21 due to shorter delays in hog deliveries by these players. As there is now less room for market supply to increase vs. 1H21, while the average finished weight in 2H22 should continue to normalise towards a lower level, we believe the supply of hog production in China should continue to tighten in 2H22.

**Average hog finished weight of top-5 companies**



Source: Company data, DBS HK

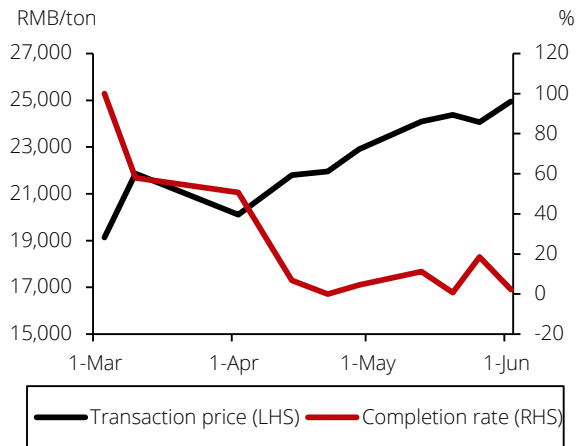
**Monthly hog production by selected companies**



Source: Company data, DBS HK

**Government purchases to boost market confidence.** The Chinese government has been purchasing frozen pork from the market since March 2022, to support the low pork prices and eventually stabilise the industry production capacity. While the transaction price has trended higher since the first batch of stockpiling in early-March, the actual purchase over the government's target has been declining as the government's offering price is getting less attractive along with the recovery in hog prices in the market. Although the total purchased volume of c.0.1m tons so far is relatively small, this shows the Chinese government's determination to support the hog and pork prices, therefore lifting market confidence on the near-term pork price uptrend.

State reserve purchase in 2022

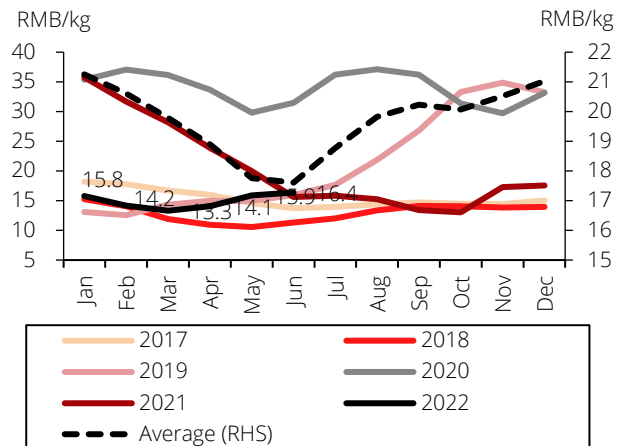


Source: Merchandise Reserve Management Centre, news reports, DBS HK

**Market demand to stay strong.** While hog production should continue to contract in 2H22, near-term demand is expected to stay strong as we move towards the Mid-Autumn Festival and National Day celebrations in China. Hog prices have risen during June to September in the past years. We believe such seasonality should also support hog and pork prices to rise above RMB18/kg in 2H22.

The fading impact from COVID-19 resurgence should support downstream consumption (i.e., fresh pork and packaged meats), as social restrictions ease in cities such as Shanghai and Beijing. We expect to see a gradual recovery in the restaurant and catering channels in 2H22, while over the medium-term, pork consumption per capita in China could also grow by c.5% CAGR according to OECD's forecasts, supporting the demand for hog production and processed pork products.

Hog price seasonality



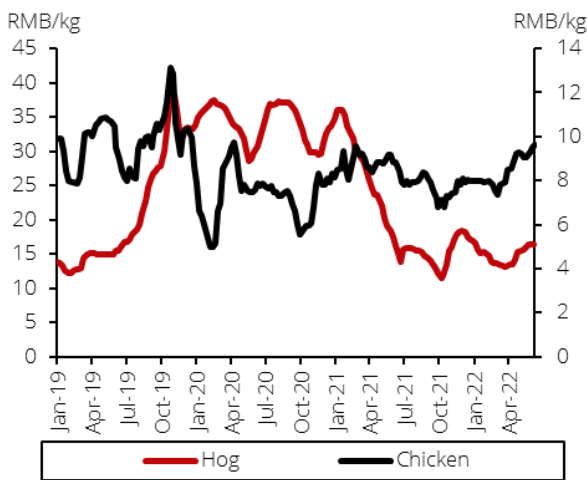
Source: NDRC, Wind, DBS HK

Given the expected price uptrend in 2H22, downstream players like WH Group could also leverage on the lower pork prices in 1H22 to stockpile frozen pork, and obtain better margins in 2H22 when pork price recovers further. We believe WH Group should be able to generate a profit of RMB50-70/head in its pork segment for FY22/23. Package meat sales could also benefit from the lower raw material costs. As such, WH Group should be able to achieve a unit profit of RMB4,000/ton in FY22, which should be maintained going forward, while product-mix enhancement driven by normalising market conditions could also help to deliver higher profit margins.

Leading market players in China have also entered into hog futures contracts to partially mitigate the risks of movements in hog and pork prices. Although the expected pork price uptrend in 2H22 should reduce this practise in the near term, we believe these companies will continue to expand their exposure to hog futures hedging to help to stabilise their profits in a longer horizon. We could also take the futures contract prices as a reference for hog price outlook. The Jan'23 contract is currently trading above RMB20/kg, while the Sep'22 and Nov'22 contracts are both trading at c.RMB19/kg. In our view, hog price could reach above RMB18/kg in 2H22 and further up to RMB20+/kg in 1Q23.

**Substitution effect from poultry.** Poultry farmers in China have recorded losses in 2021 due to unfavourable prices of chicken and duck meats, along with the lingering feed cost pressure. We believe the continuing losses could have led to a contraction in the supply of poultry meats in the market, thus driving up poultry prices since March 2022. We believe the substitutional effect between poultry and pork would further support hog price recovery ahead.

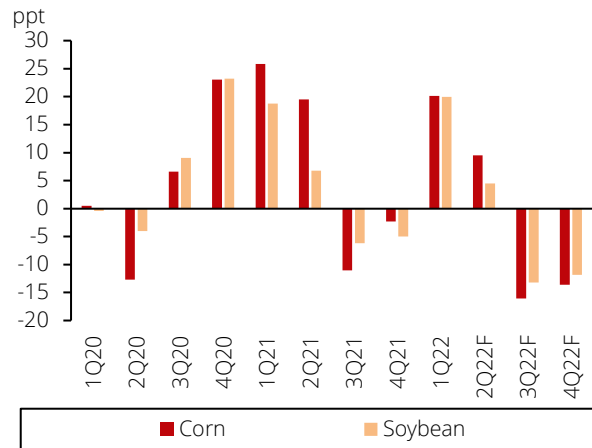
**Hog price vs. chicken price**



Source: NDRC, Wind, DBS HK

**Cost pressures to ease.** YTD, feed cost (mainly corn and soybean meal) for hog production remains high while mixed feed cost was up c.6% y-o-y. With the global supply normalising, we expect to see sequential decline in corn and soybean meal prices in 2H22. Given the Chinese government's determination to stabilise the prices, feed cost in China should see less volatility vs. global prices. We believe cost pressure should ease for hog farming companies in 2H22.

**Global feed price forecast (q-o-q)**

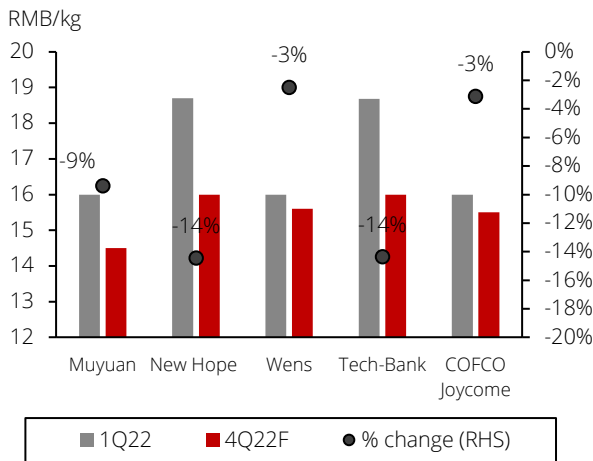


Source: World Bank, Euromonitor, DBS HK

To cope with feed cost pressure, leading market players continue to adjust the feed composition with effective substitutes (e.g., wheat and paddy) to partially mitigate the price volatility. For example, Wens was able to limit the respective consumptions of corn and soybean meal to <10% of total feeds during 1Q22, while maintaining the hog production efficiency. As such, we believe the feed cost per unit of hog production of leading players is likely to see low-single digit increase in 2022, followed by a mild decline in 2023. Moreover, companies like Muyuan and New Hope should see greater potentials for feed cost improvement as they could benefit from vertical integration of their feed production operations.

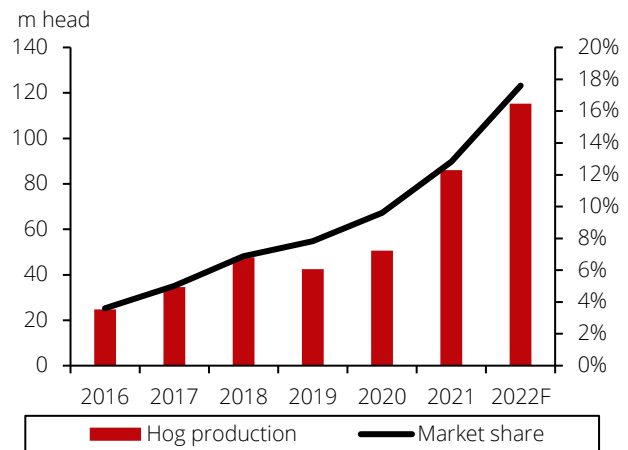
Leading market players should continue to improve their hog production efficiency. Since 2021, major hog farmers have been reducing their sow inventory of low breeding efficiency to a good extent. For example, New Hope was able to limit the proportion of three-way-crossbred sows to a single-digit level so far, while Muyuan and COFCO Joycome have already ceased the use of this sow category. In general, PSY (pigs per sow per year) levels of major hog farmers have recovered to 21+ so far (vs. c.20 in 2021). In the meantime, large hog farmers are outsourcing less of their piglets and focusing more on self-bred ones, which could potentially provide them with cost savings of RMB40-50/head of hog production. Overall, we believe the major hog farmers intend to achieve production cost of RMB16/kg or below by the end of 2022, leading to profit margin improvements.

Production cost targets of selected companies



Source: Company, DBS HK

Market share of top 6 players



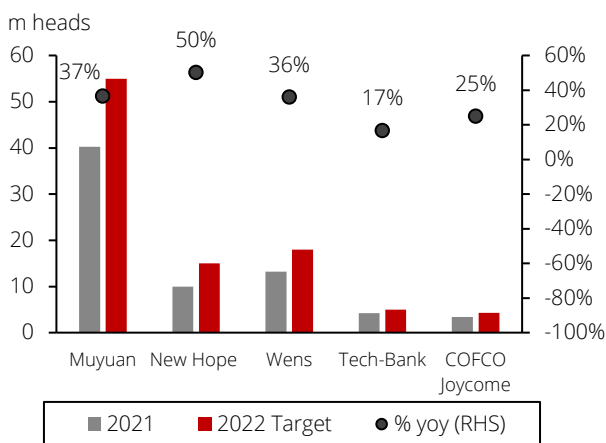
Source: Company, MARA, DBS HK

**Industrialisation remains the key theme.** The significant decline in hog prices in 2H21 may have sped up the elimination of small-scale hog farmers. The Chinese government’s tightening regulatory requirements should allow large-scale hog farmers to capture more market share with their production expansion plans, supported by sufficient land resources and expertise in hog farming. We believe the industry will continue to consolidate and the top 6 players could achieve an aggregate market share of c.18% by 2022 (2021: 12.8%), in our view. The ongoing consolidation should also provide the sector with scale-efficiency while stabilising the hog price cycle in China.

Global players to leverage on normalising markets.

Downstream players like WH Group continue to see favourable demand in both retail and food service channels in the US. While the raw material prices (mainly feeds and pork) have been trending higher, WH Group should be able to moderate the pressure, as it partially mitigates the risks through its successful formula-based pricing and negotiation for packaged meat sales, as well as strong pricing power. With the market recovery in Europe, WH Group should also be able to stage a turnaround from loss to profit starting from 2Q22 and improve its profit margins in 2H22, led by price adjustments and ongoing cost management. Furthermore, the uptrend in hog and pork prices in China should offer companies like WH Group and COFCO Joycome better opportunities in their pork import business. While the total pork import volume in China has substantially declined y-o-y so far in 2022, we also noticed a decline in average import prices. We believe both WH Group and COFCO Joycome should be able to see a more favourable price spread in 2H22 and increase their import volume h-o-h.

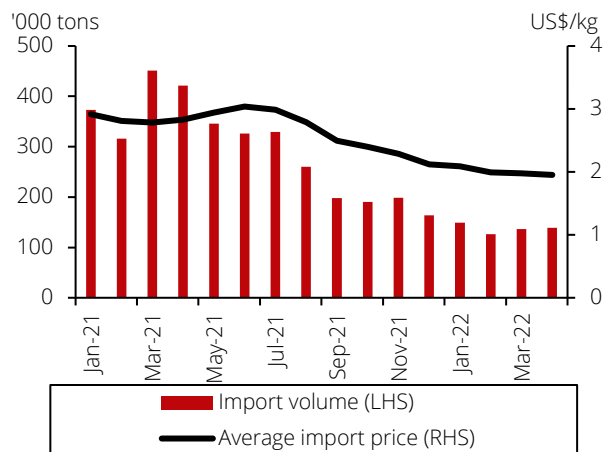
Target production volumes of selected companies



Source: Company, DBS HK

China Pork Sector

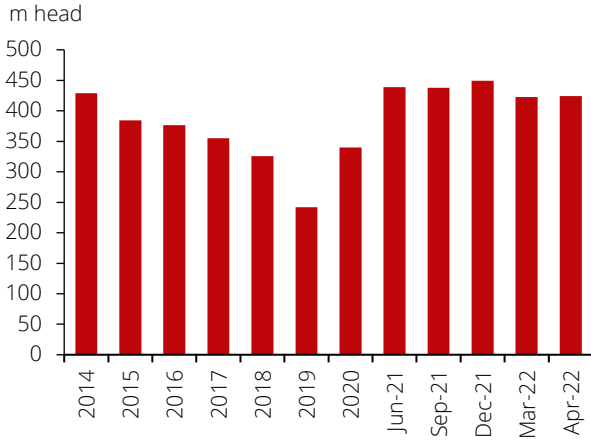
Pork imports in China



Source: China Custom, DBS HK

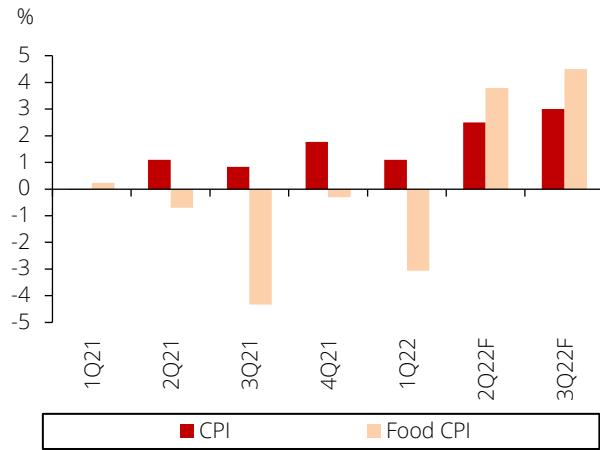
Our sector top pick is **WH Group (288 HK; BUY; TP HK\$6.72)** considering its undemanding valuation (currently trading at c.7x FY22 P/E). Moreover, we believe WH Group should be able to leverage on the pork price uptrend in China and score better profit margins in both domestic and imported frozen pork sales, while the cost for packaged meat business should still be manageable with its proactive inventory build-up strategies. WH Group could also benefit from the strong demand in the US as well as the market recovery in Europe. We also like **COFCO Joycome (1610 HK; BUY; TP HK\$4.19)** and **New Hope (000876 CH; BUY; TP RMB19.27)**, as they should continue to enjoy the hog/pork price recovery in China, along with ongoing efforts in cost efficiency improvement in their hog production.

Hog inventory trend in China



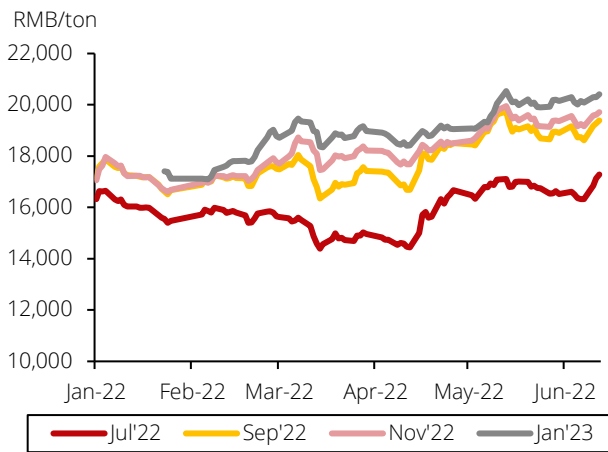
Source: NBS, Wind, DBS HK

CPI inflation in China



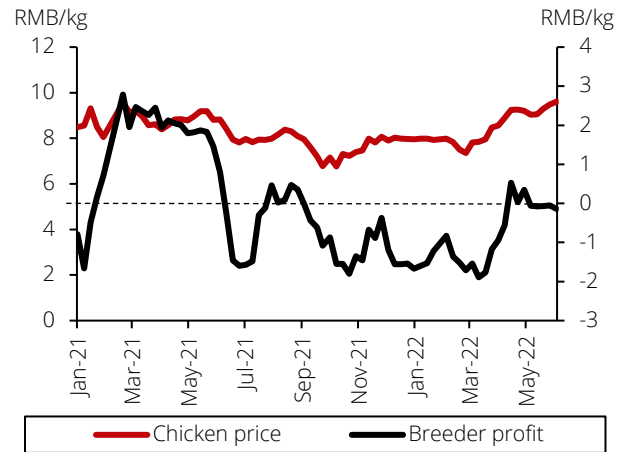
Source: NBS, Trading Economics, DBS HK

Live hog futures prices



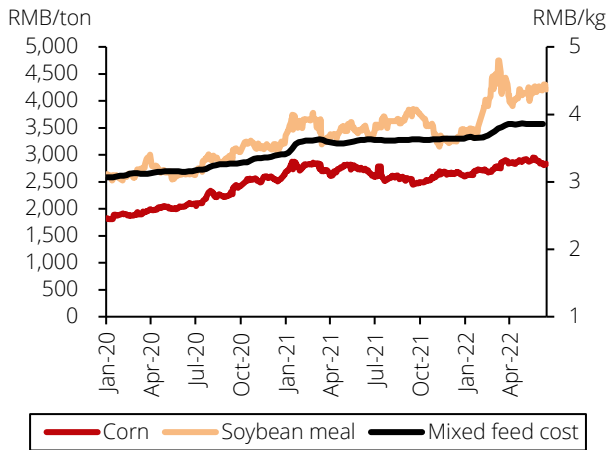
Source: Dalian Commodity Exchange, Wind, DBS HK

Chicken price and breeder profit



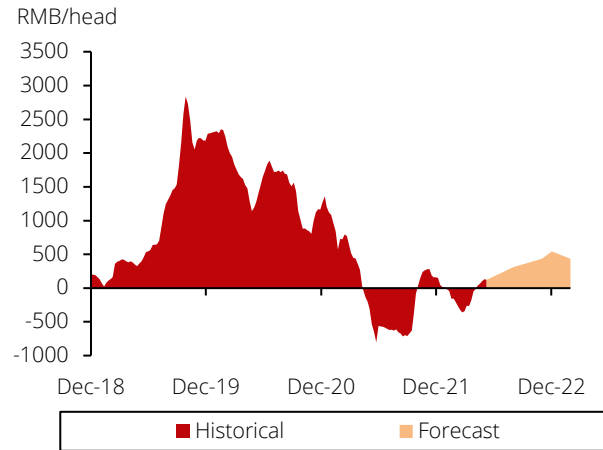
Source: Wind, DBS HK

Feed price trends



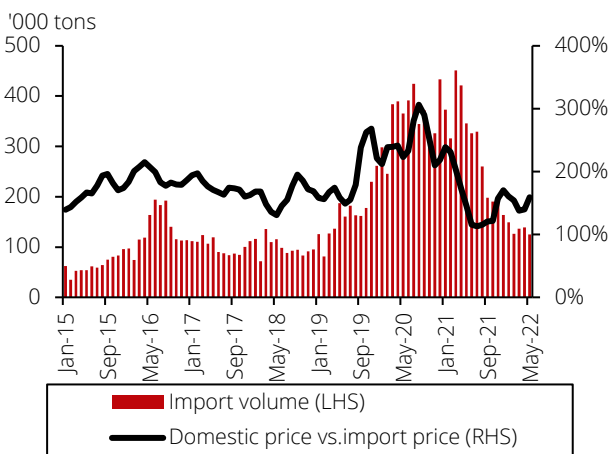
Source: Dalian Commodity Exchange, NDRC, Wind, DBS HK

Estimated profit per head of hog production



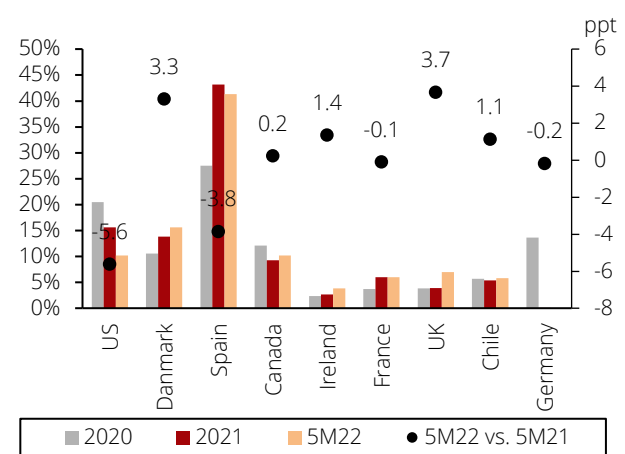
Source: NDRC, DBS HK

Import volume vs. relative prices of pork



Source: MARA, China Custom, DBS HK

Import volume breakdown by country (%)



Source: China Custom, DBS HK



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