

Dabeinong Technology (002385)

# The first to benefit from improving industry climate



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**High-end feedstuff to benefit first from the rise in hog price, DBN's sales volume already improving as of end-Jun 2015.** Improving profitability for the breeding industry combined with falling stock of hogs will result in: (i) accelerated cash turnover in the distribution channels; and (ii) diverging sales performance between different types of feedstuff. As such, grassroots research on different brands of feedstuff from different regions will generate different feedbacks. Meanwhile, DBN's sales volume is already showing signs of improvement as of end-Jun 2015. As the population of breeding sows is expected to bottom out during Jun-Jul 2015, we anticipate the stock of commercial hogs to theoretically reach its nadir around Oct-Nov. As such, profitability for hog breeding will increase rapidly, stoking expenditure on a per head (of hog) basis as well. As high-end early stage feedstuff accounts for the majority of DBN's product line-up, the Company will become one of the first to benefit from improving industry climate. Hence, we believe 1H15 marks the trough of DBN's earnings and sales volume growth, which are both expected to improve gradually over the coming 18 months or so.

**Accelerating the coverage of breeding sows under management for its "zhuweb"** ([www.zhuweb.com.cn](http://www.zhuweb.com.cn), an integrated online platform launched in 2014, which provides solutions including hog farm management, breeding consultancy, online product ordering, small loans and online settlement for its partners). We have outlined previously that zhuweb is the "make or break" for DBN's internet business model, as the platform: (i) dictates traffic for DBN's online business; (ii) diverts customer traffic towards its online business (product sales); (iii) collects a huge amount of data (facilitating DBN's provision of financial services). As of end-2014, the number of breeding sows and hogs under management via this platform total 320,000 and 6mn respectively. After launching the upgraded version of the zhuweb in late-May 2015, its number of sows (active) under management surged to over 700,000 heads. We forecast this number could breach the 1.8mn mark by end-2015E.

**Perfecting its online and financial services with hog trading and third party payment businesses.** DBN did not set up its online agricultural platform for the sake of simply turning it into one of the hot topics in the market. Instead, it is a fruit of extensive accumulation of resources, business evolution and development. DBN also partnered up with a number of farmhouses and abattoirs since May, in order to gradually set up its hog trading business. In addition, DBN established an online payment company in Jul, as a part of creating a closed-loop model for its online businesses.

**Testing waters with the "free-roaming" approach of hog breeding, enhancing its organisational capability along the industry chain.** DBN has always strived to become China's largest integrated agricultural and farming services provider. Meanwhile, DBN has already switched its point of focus from the initial "feedstuff" to "feedstuff + technical services" and ultimate transitioning into "agricultural products + comprehensive services". In other words, apart from breeding (forte for hog farmers), DBN also provides a

comprehensive range of services throughout the entire breeding process for farmers (including trading, agricultural products, funding and management).

**Long-term investment rationale remains intact: four major revenue drivers starting to take shape, market cap expected to reach hundreds of billions of RMB.** In terms of foreseeable earnings of its respective business units, net profit from its feedstuff/seeds/supply chain and rural finance businesses are forecast to reach Rmb2.5bn, Rmb500mn and Rmb2.0bn-plus after 2020E. As such, DBN's total net profit is expected to exceed Rmb5.0bn. Over the past 4-5 years, thanks to its edge in marketing (product positioning), DBN has enjoyed a valuation premium of 10-15% over its comparables. Given its first-mover advantage in developing an online platform, we believe this valuation premium will widen further to 20-30% over the coming 5-8 years. Assuming a forward PER in the range of 15-20x, DBN's market cap could reach Rmb80-100bn in the future.

Risks associated with investing in the Company:

(i) Wild swings in raw material prices; (ii) sale volume falling short of expectations; (iii) excessive increase in expenses.

Investment advice:

We believe the Company will embrace rapid growth over the coming 2-3 years and its market cap is forecast to reach Rmb100bn. The Company is likely to become the first to benefit from the improving sector climate over the near-term given its advantages in product mix and services. Given our prediction that its earnings bottomed out in 1H15, we forecast its 2015-17E EPS to be Rmb0.36/0.57/0.75, reiterate BUY rating with a target price of Rmb20.

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	SELL	Decrease relative to market representative index over 10%
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