Dairy Products China News

Guaranteed Exclusive Analysis

Welcome to the February issue of Dairy Products China News. Vol. 16 Issue 2 2023

The much hoped for resurgence in demand for dairy amongst Chinese consumers remains in question, with even the online channel rather quiet over the first months of the year. The government is expected to release national retail sales for January and February on March 15, so those numbers should prove revealing. Food inflation continues as a severe problem for many worldwide, and China is no exception. In January, food prices in Beijing rose by 6.6%, meeting the conditions for starting the price-linked subsidy program, local pressed quoted an official as saying. With this in mind, the city's government is to give out a cash payment of 40 yuan (about $6) monthly to low-income residents to cushion the impact of rising food prices – this is expected to go to more than 300,000 people on low incomes for an unspecified period of time.

Although clearly focusing on a higher spending demographic altogether, it's an interesting time for Nestlé to push into high priced fresh milks, a move which will have required a good deal of preparation you'd think. A recent, global analysis of 44,000 brands measured by Kantar BrandZ found that 34% of brands failed to justify their prices in consumers' eyes, and the agency points out that in times of inflation, those brands are the ones most at risk when people consider where best to spend their money.

This month we cover the establishment of the country's latest largest dairy farm, and in this context it is unsurprising that signs of a significant recovery in Chinese dairy demand remain missing – purchases by local buyers have been noticeably absent over the December and January auctions. While we are forced to await the most recent Chinese dairy import data, though, it's interesting to read that Iran expects to earn some $2 billon from exports of dairy products to China in the next two years under a new agreement finalized this month. It's clear that Iran has achieved strong growth in its overall exports of cheese and milk powders over recent years, but we should not hold our breath for this wave of milk products heading to China – Iran's total dairy exports worldwide were worth only around $400 million in 2021. But it's not the first case of politicians being overcome by the compulsion to announce big numbers on such missions!

Richard Field, Editor
richard.field@orrani.com

Publishers

Guangzhou CCM Information Science & Technology Co., Ltd
17th Floor,
Huihua Commercial & Trade Building,
No.80 Xianlie Zhong Road,
Guangzhou, 510070, P.R.China
Tel: :+86-20-3761 6606
Fax: +86 20 3761 6968
E-mail: econtact@cnchemicals.com

orrani consulting

UK Head Office
Orrani Consulting
12 Lower Camden Place
Bath, BA1 5JJ, United Kingdom
Tel: +44 (0) 1225 318 222
Fax: +44 (0) 1225 430240

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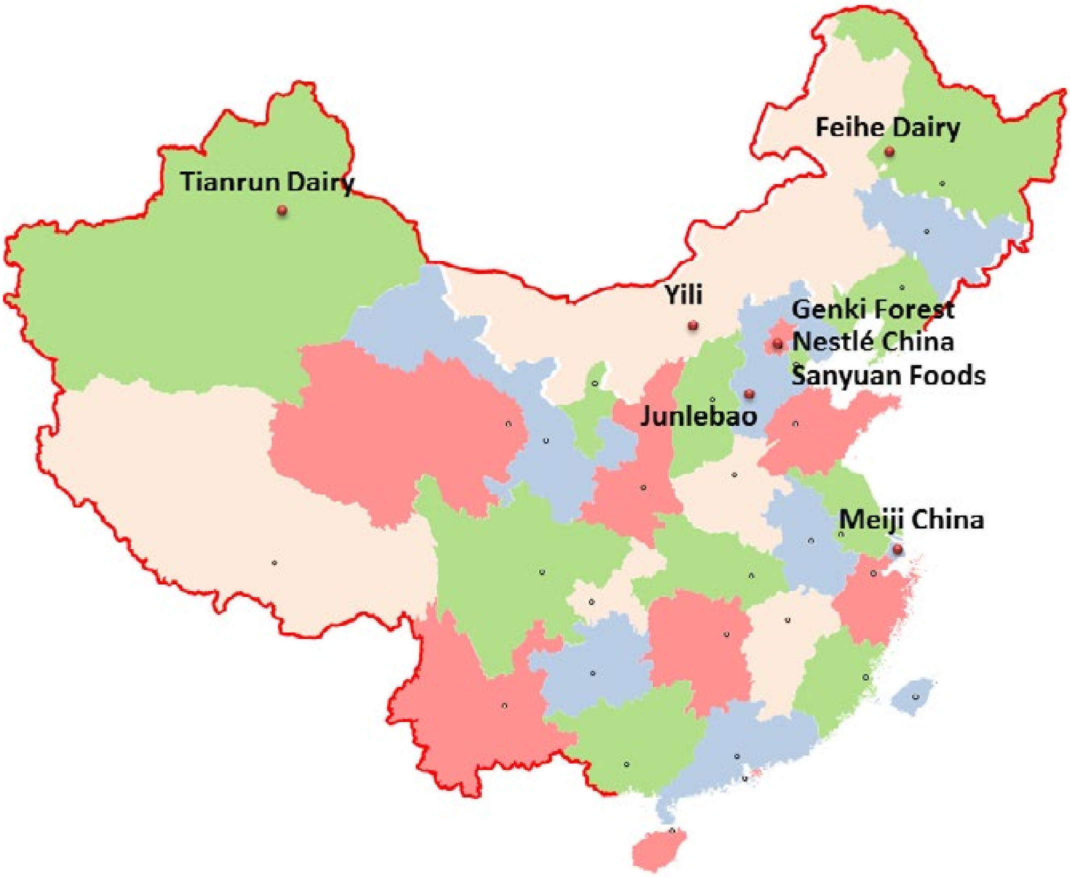
Major Companies and Sites Mentioned in This Issue



Market Analysis

IMF Manufacturers Focusing on the Children's Formula Segment

Summary: *Fewer newborns and increasingly intense competition are pushing dairy companies into the children's formula segment in search of new growth and trying to extend their product life circles.*

China's population declined for the first time in decades with a natural population growth rate of -0.60% in 2022; and the number of newborns fell from 18.83 million in 2016 to 9.56 million in 2022 (or 6.77 births for every 1,000 people). China's IMF market has weakened over the years and may continue to shrink, taking a toll on producers and retailers, despite 2023 being projected to see consumer spending revival with the country's reopening.

Key Players' Initiatives in the Children's Formulae Segment

As China's new national standard for infant formula sets a higher bar for competitors, more and investments have been directed to formulae for older children, with well-known formula brands like Yili, Danone, Nestlé and Mead Johnsom launching differentiated products with functional ingredients to increase their brand awareness and extend their product life cycle. For some, children's formulae are becoming the mainstay of their businesses:

- Nestlé: It launched an ultra-premium A2 formula *"FortiGrow"* in China in mid-Feb., designed for school-age children (6-15 year old). Wang Lei, senior vice president of Nestlé Greater China region, is optimistic about the sales of its formula for school-age children in China, which have achieved a cumulative increase of about 1.5 times in the last few years, whilst the penetration rate of school-age children's formulae remains just 6%, much lower than the 44% for adult formulae
- FrieslandCampina: Yang Guochao, senior vice-president of FrieslandCampina China, said in recent interview that the company is planning to add formulae for a wider range of ages in children, in addition to IMF
- China Feihe: The company stated in the financial presentations in 2021 that sales of its stage 4 formulae that year were USD284 million (RMB1.92 billion), up 63%; it aims to raise the share of its sales accounted for by formulae for children and adults to 50% by 2028, second to IMF

Category Challenges

However, there are some challenges. At present, many brands produce children's formulae of varying quality levels, in the absence of national standards for the category, creating a relatively low entry threshold. The effective National Food Safety Standard–Milk Powders (GB19644-2010) stipulates the upper levels of proteins, microorganisms, etc. in such formulae, but much less strictly than for IMF products, in terms of production processes, marketing etc. This has allowed some clear over-hyping of children formulae products by some manufacturers.

This shows how crucial it will be for the government to formulate more comprehensive and systematic rules for children's formulae if the segment is to fulfil its potential.

Dairy Companies Announce 2022 Earnings Forecasts

Summary: *In late Jan., Panda Dairy, Yiming Food, Royal Group and Beingmate all published their earnings forecasts for 2022.*

In late Jan., Panda Dairy, Yiming Food, Royal Group and Beingmate published their earnings forecasts for 2022, Panda Dairy expecting a profit slump and the others even showing losses.

Panda Dairy Corporation (Panda Dairy, Stock Code: SZ.300898) projects its profits to fall:

- Net profit attributable to equity shareholders of the listed company: USD6.22 million (RMB42 million)–USD7.85 million (RMB53 million), down 31.48%–46.70%
- Net profit attributable to equity shareholders excl. extraordinary gains/losses: USD5.19 million (RMB35 million)–USD6.67 million (RMB45 million), down 33.39%–48.20%

It indicated that waves of COVID infections have driven up raw material costs, depressing its earnings for the year.

Zhejiang Yiming Food Co., Ltd. (Yiming Food, Stock Code: 605179) projects revenue up by 4.47%–7.93% to USD358.56 million (RMB2.42 billion)–USD370.41 million (RMB2.50 billion), but foresees losses nevertheless:

- Net loss attributable to equity shareholders of the listed company: USD16.30 million (RMB110 million)–USD20.00 million (RMB135 million)
- Net loss excl. extraordinary gains/losses: USD13.33 million (RMB90 million)–USD17.78 million (RMB120 million)

The company explained that its business has been eroded by various factors such as COVID restrictions, marketing and raw material costs, despite the steady revenue growth.

Royal Group Co., Ltd. (Royal Group, Stock Code: 002329)'s forecast is as follows:

- Net profit attributable to equity shareholders of the listed company: USD1.48 million (RMB10 million)–USD2.22 million (RMB15 million), reversing its previous loss

- Net loss attributable to equity shareholders excl. extraordinary gains/losses: USD15.65 million (RMB105.66 million)–USD16.40 million (RMB110.66 million), continuing its previous losses

The group's achievements in marketing, standardisation of cultivation and transplant of water buffalo embryos and farm construction at home and abroad all contributed to growth in revenue. However, rising costs for raw materials and logistics have lowered its expectations on profitability.

Beingmate Co., Ltd. (Beingmate, Stock Code: 002570) also predicts a loss:

- Net loss attributable to equity shareholders of the listed company: USD17.78 million (RMB120 million) –USD26.69 million (RMB180 million)
- Net loss attributable to equity shareholders excl. extraordinary gains/losses: USD23.71 million (RMB160 million–USD32.60 million (RMB 220 million)

It attributed this to the falling number of newborns, fiercer market competition and upgraded pandemic control measures last year.

Genki Forest and Guanmu Dairy to Add Milk Beverage Capacities

Summary: In early Feb., environmental impact reports were published for 2 new milk beverage projects by Genki Forest and Guanmu Dairy.

On 10 Feb., an environmental impact report for Genki Forest's new milk beverage project was published on the official website of the Ecology and Environment Bureau of Suzhou City. The company already has 5 beverage factories in China (Zhaoqing City, Guangdong Province; Xiqing District of Tianjin; Chuzhou City, Anhui Province; Xianning City, Hubei Province; Dujiangyan City, Sichuan Province).

Project info:

- Construction nature: New construction
- Executive entity: Genki Forest (Jiangsu) Beverage Co., Ltd.
- Location: Hi-Tech Industrial Development Zone of Taicang City, Jiangsu Province
- Total investment: USD177.80 million (RMB1.20 billion), of which USD177.80 million (RMB1.20 billion) for building construction, USD112.61million (RMB760 million) for new equipment, and USD7.41 million (RMB50 million) for environmental protection
- Construction period: 24 months, estimated to complete by the end of 2024
- Site & floor areas: 79,978.9 m^2
- Construction content: a 2-storey combination workshop, a wastewater treatment station, 8 automatic filling lines and 4 injection moulding machines for the production of plastic bottles
- Product plan: An aggregate 900 million bottles of carbonated drinks, juice, tea-based beverages — 225 million (500ml & 1.25L) bottles for milk beverages
- Main process in milk beverage production: Milk powder preparation — Blending — Sterilization — Fermentation — Stiring — Cooling and homogenizing
- Working system: 300 workers in two 12-hour shifts for 365 days a year

Genki Forest (Jiangsu) Beverage Co., Ltd. was founded on 15 Jan., 2022 with a registered capital of USD56 million, and is fully owned by Genki Forest Group Holdings HK Ltd. Its main business is the production of food and beverages.

TABLE 1: Planned Use of Materials in Genki Forest Jiangsu

Product	Raw materials:	Annual Consumption, t/a
Milk beverage	SMP	4,072.5
	WMP	20,000
	Powdered Lactobacillus	15
	Whipping cream	50
	Emulsifier	10

Source: Genki Forest (Jiangsu) Beverage Co., Ltd.

On 13 Feb., the Ecology and Environment Bureau of Deyang City published the approved environmental impact report for the dairy and drinks project of Sichuan Guanmu Dairy Co., Ltd. (Guanmu Dairy, previously known as Sichuan Miaomiaolong Drinks Co., Ltd). This project is to develop the currently idle plant and warehouse built by the company in 2014.

Project info:

- Construction nature: Upgrade + expansion
- Location: Nanfeng Town, Guanghan City (county-level), Deyang City, Sichuan Province
- Total investment: USD7.41 million (RMB50 million), of which USD146,684.05 (RMB990,000) for environmental protection
- Construction period: 5 months
- Site & floor areas: 39,966.62 m^2 & 25,000 m^2
- Construction plan: upgrade of the existing facilities and equipment, add new production equipment and wastewater treatment, set up office buildings, etc.

Product plan:

- Fresh milk and fermented dairy products – 480 t/a
- Mixed protein beverages – 1,680 t/a
- Plant-based protein drinks – 1,680 t/a
- Flavoured alcoholic drinks – 1,680 t/a
- Working system: 80 workers in one 8-hour shift for 300 days a year

Guanmu Dairy was founded on 23 Oct., 2013 with registered capital of USD296,331.42 (RMB2 million), mainly focused on dairy products, beverages and instant foods.

TABLE 2: Planned Use of Materials in Guanmu Dairy's New Project

Product	Raw and auxiliary materials:	Annual Consumption, t/a
Fresh milk and fermented dairy products	Raw milk	324.44
	Milk powders	10.08
	White sugar	9.60
Mixed protein beverages	Peanuts	30.96
	Milk powders	33.60

Source: Sichuan Guanmu Dairy Co., Ltd.

Ningxia Wuzhong Commits to Largescale Dairying

Summary: *Latest data show Wuzhong City in Ningxia Hui Autonomous Region, has 149 largescale dairy farms with 334,000 cows, producing 4,100 tonnes of raw milk per day, with clear commitment to grow further.*

By the end of 2022, there were 837,000 dairy cows in Ningxia Hui Autonomous Region, an increase of 19.2% YoY, the fastest growing region or province nationwide for the 4th consecutive year; the region's output of raw milk was up 22.1% YoY to 3.425 million tonnes last year. 25 new large-scale dairy farms opened in the main dairying areas, taking farms with 1,000 cows to 90% of all farms in the region. This concentration of activities is reportedly bringing growing benefits.

Wuzhong City, in the centre of Ningxia, has promoted this trend and helped transform and upgrade scattered, small farms over the last few years. Currently there are 149 largescale dairy farms with a total of 334,000 cows producing 4,100 t/d of milk in the city; the gross output from these farms is valued up to USD4.1 billion (RMB28 billion).

Three core areas around the city are involved — Wuzhong National Agricultural Science and Technology Park, Litong Wulipo Dairy Breeding and Farming Base, and Qingtongxia Niushou Mountain Milk Source Base.

The Wuzhong National Agricultural Science and Technology Park contains 45 largescale farms holding 91,000 cows and the park's milk production was 1,310 t/d or 471,800 tonnes in 2022.

Two more are now being built:

- Ningxia State Farm Group (also known as Ningxia Nongken Enterprise Group Co., Ltd) is working on the Mahuanggou Dairy Farming Park Project, accelerating work across an area of 397 ha (5950 mu), based on an investment of USD346.3 billion (RMB2.3 billion). The plan is for this to be single largest dairy farm in China with 50,000 dairy cows producing 330,000 t/a of milk worth around USD178 million (RMB1.2 billion). *(Note: currently, Modern Dairy's subsidiary Modern Farming (Wuhe) Co., Ltd. Is operating a 40,000 cow* *farm in Bengbu in Anhui Province)*. With the preliminary works completed including receipt of the government's approval for startup, registration, field investigation and environmental impact assessment, the farm will be ready to operate in March, with only water and power supply engineering to schedule

- Ningxia New Hope Saishang Animal Husbandry Co., Ltd. is investing USD59.3 million (RMB400 million) in a 10,000 cow farm expected to turn operational in mid-2023. The main office buildings and living quarters and procurement of 2,000 pure Holsteins, robotic rotary milking parlour, automated waste cleaning machine and other key equipment have been completed, and facilities like cattle sheds, silage silo, milking room are under construction
- Other new/continuing construction projects of largescale farms in Wuzhong for 2023:
  - State Farm Group Wuzhong Dairy Co., Ltd: Sunjiatan No.1 Farm, 25,000 cows
  - Ningxia State Farm Dairy Co., Ltd. (formerly known as Ningxia Nongken Helanshan Dairy Co., Ltd): Hongyazi No.3 Farm, 25,000 cows
  - Ningxia Tianhong Animal Husbandry Technology Co., Ltd: Zhongken Tianong Modern Agricultural Farming Demonstration Park, 10,000+ cows; wholly owned by Zhongken Dairy Co., Ltd.
  - Ningxia Duoxiya Agriculture & Animal Husbandry Co., Ltd: 5,000 cows
  - Wuzhong City Huitai Animal Husbandry Co., Ltd: 3,000 cows

According to the Wuzhong Municipal Plan for Agriculture during 14th Five-year Development Plan Period (2021-2025) and the Vision to Build a Modern Agricultural Industrial System by 2035, the city pledges to expand the local herd size to 430,000 head that can produce 2.15 million t/a of milk, and to achieve gross output value of USD5.9 billion (RMB40 billion) from largescale dairy farms by 2025.

Governmental Direction

China CDC Publishes Infant Diet Survey Data

Summary: *The Chinese Center for Disease Control and Prevention (CDC) disclosed data from its infant diet survey for the first time in late Jan., with key focuses on the breastmilk intakes of infants aged 0–5 months and the dietary energy and nutrient intakes of infants aged 6–23 months.*

For the first time, the National Institute of Nutrition and Health (part of the Chinese Center for Disease Control and Prevention – China CDC) has reported on the systematic study of the nutrition and health of Chinese children aged 0–18 years old over the 13th Five-year Plan period (2016–2020). The data provided in the January issue of the Journal of Hygiene Research, sponsored by the National Health Commission, focus on the breastmilk intakes of infants aged 0–5 months and the dietary energy and nutrient intakes of infants aged 6–23 months. The data are broken down across 7 regions – North China, Northeast China, East China, South China, Central China, Southwest China and Northwest China.

This survey provides key up-to-date data for managing the diets of modern Chinese infants, improving upon weaknesses in past such studies on the topic, in terms of geographic span, sample size, timeframe etc. It helps healthcare professionals identify deficiencies in infant diets at an earlier stage and suggest optimised diet plans on a scientific basis. Meanwhile, the CDC is encouraging further research into the Chinese infants' intakes of breastmilk and food supplements, to push innovation and development of evaluation techniques.

Here are the key takeaways:

Breastmilk Intake of Infants Aged 0–5 Months

- The average daily amount of breastmilk for infants aged 0–5 month on all-breast-milk diets is 800.1g, based on 8 feeds per 24 hours, each of 103.4g–150.3g
- The breastmilk intake rises over the 5 months, peaking around the 4th month before a dip, then stabilising at the 5th month
- The intakes are very similar across regions / by gender
- The survey also points out that the introduction of infant formulae or food supplements in all-breastmilk diets will affect the breastmilk intake of these infants, given that breastmilk naturally provides all of the nutritional needs of most such infants

Dietary Energy and Nutrient Intake of Infants Aged 6–23 Months

- Comparing vs. the WHO and UNICEF (United Nations Children's Fund)'s report on global food supplement for infant feeding, China's dietary energy intakes among infants aged 6–23 months are lower than those in developed countries and higher than those in other developing countries.
  - Intakes by infants aged 6–23 months through food supplements
    > Of protein, range from 2.6g–3.8g/100kcal, higher than the WHO's reference of 0.9g–1.0g/100kcal
    > Of iron, range between 0.9mg–1.0mg/100kcal, far lower than the

- WHO's reference of 4.5mg/100kcal for 6–8 month olds and 3.0mg/100kcal for 9–11 month olds (however intakes by the 12–36 month olds are close to WHO's reference of 1.0mg/100kcal)

  > Of zinc, average 0.5mg/100kcal, also way below WHO's reference of 1.6mg/kcal for 6–8 month olds and 1.1mg/100kcal for 9–11 month olds (the surveyed level for 12–36 month olds is close to the WHO's reference of 0.6mg/100kcal)

- There are no significant differences in dietary energy and nutrient intake between urban and rural areas and between southern and northern areas as a whole.
  - However, diets of babies of 9 months or above living in the eastern and western regions contain more energy and nutrients than those of this age range in other regions; the lowest levels are seen in the central region
- In particular, there is a wide gap in dietary energy and nutrient intakes of babies of 12–23 months between the central region and the other 6 regions
- It is recommended that governments act according to local conditions to educate people about dietary supplements and scientific measures for feeding infants.

Company Dynamics

Nestlé's First Fresh Milk in China

Summary: *On 3 Feb., Nestlé launched its first fresh milk product in China, an A2 milk at a very high price.*

Nestlé launched its first fresh milk in China on 3 Feb., an A2 milk exclusively selling via WeChat's mini-program platform at the moment.

The new product contains microorganisms at ≤5,000 CFU/ml, much lower than the national standard of 2,000,000 CFU/ml, and a protein level of 3.4g/100ml, compared with the national standard of 2.8g–3.3g/100ml. It has an extended shelf life of 14 days, and is labelled as whole pasteurised milk sourced from the company's own dairy farm in Shuangcheng District of Harbin, Heilongjiang.

Targeting the premium segment, it is priced at USD28.21 (RMB190.4) for a 4-bottle pack, equivalent to USD7.059 (RMB47.6) per 650ml bottle, or at USD14.94 (RMB100.8) for a 6-bottle pack, equivalent to USD2.49 (RMB16.8) per 236ml bottle. While the average price of A2 milk is below USD4.44/L (RMB30/L), Nestlé's A2 milk at USD10.85/L (RMB73.2)/L is 1.5-2 times higher.

High Pricing Strategy Behind Premiumisation

Zhang Xiqiang, Chairman of Nestlé China, expects revenue of USD14.82 billion (RMB100 billion) in China by 2030, citing premium products as key to achieving this. For the first nine months of 2022, Nestlé reported sales of USD75.16 billion (RMB507.30 billion), with organic growth of 8.5% YoY, 7.5 percentage points coming from price rises. In China its sales grew by 7.2%, but price rises accounted for only 2.6 percentage points.

However, many similar A2 milk products have been launched, leading to the question as to whether Nestlé's evidently overpriced A2 milk could win consumers over its rivals, especially as the launch has come at a time of weak raw milk sales and stores streamlining their stocks of dairy products.

Crowded Fresh Milk Market

In 2018, leading dairy brands Mengniu, Bright Dairy and New Hope Dairy announced increasing investments in fresh milk business. In 2019, Junlebao launched its first fresh milk product *"Yuexianhuo"* with a long shelf life of 19 days, selling across the country. In 2021, high-end yoghurt brands CLASSY KISS and Simple Love proposed development plans in the fresh milk category to build their overall sales. Moreover, foreign brands like a2 Milk Company, Meiji, Fonterra and Yoplait have also launched fresh milks in recent years.

However, according to the 2022 List of Top 10 Chinese Dairy Brands (by total retail sales) released by Euromonitor, almost 40% of China's fresh milk market was held by Bright Dairy (about 20%), Mengniu (over 10%) and New Hope Dairy (about 8%), followed by Yili, Sanyuan Foods, Nanjing Weigang Dairy Co., Ltd., Jinan Jiabao Dairy Co., Ltd.

In the last two years of Covid-19, many dairy companies have faced profit declines in their fresh milk businesses, and have resorted to a range of strategies to cut costs and increase efficiency. It is notable that the foreign brands tend to prioritise targeting high-end consumers with mainly ultra-pasteurised milk with a relatively longer shelf life – this has limited their penetration in the overall fresh milk market.

Tianrun Dairy Targets Capacity Expansion

Summary: *On 8 Feb., Tianrun Dairy issued convertible bonds, planning to raise USD146.68 million (RMB990 million) to help it develop a 200,000 t/a dairy processing project.*

On 8 Feb., Xinjiang Tianrun Dairy Co., Ltd. (Tianrun Dairy, Stock Code: 600419) issued convertible bonds to common A-shares, planning to raise funds of up to USD146.68 million (RMB990 million), the proceeds of which will be used in the construction of its 200,000 t/a dairy products processing project and to replenish working capital.

Plans for the New 200,000 t/a Dairy Products Project:

- Executive entity: Xinjiang Tianrun Biotechnology Co., Ltd.
- Proposed investment: USD126.31 million (RMB852.50 million)
- Construction period (estimated): 24 months
- Capacity: 200,000 t/a of ambient dairy products (no disclosure of specific items/categories)
- Construction content: New factories and related production equipment
- Location: Wuyi Farm of the 12th Division of Xinjiang Production and Construction Corps, Urumqi, Xinjiang
- Operational plan & economic returns: Plant utilisation is set at 50% in the first year, 70% in the second year, 100% thereafter; payback period is estimated at 7.31 years, with a net internal rate of return of 15.80% and annual net profit of USD24.22 million (RMB163.46 million) once operational

Potential

Demand and Capacity Gap

- Per capita dairy consumption in China remains relatively low compared to other countries worldwide, just 1/3 of the global level or ½ of that in developing countries. In April 2022, the Chinese Nutrition Society released the Dietary Guidelines for Chinese Residents (2022), encouraging Chinese to increase their dairy consumption to 300g-500g per day from 300g or less
- Tianrun Dairy's flagship stores on Tmall.com and JD.com recorded 1,050,000+ visits during the *"Double 11 Shopping Festival"* last year during which on Tmall:
  - Tianrun Yoghurt Tub ranked as the 5th best-selling chilled yoghurt with sales of 46,000kg
  - Tianrun Pure Milk ranked 8th in the most repurchased pure milks, making sales of 150,000 bottles (125g each)
- The company owns 18 dairy farms, 37,600 dairy cows in total, each producing 10.5 t/a of milk. In 2021, the company's milk self-sufficiency was 67%, a high level in terms of the dairy industry nationwide
- In processing, its established 270,000 t/a capacity for pure milk, yoghurt and *"Milk Beer"*, to rise to 490,000 t/a after adding the new and expansion projects currently under construction. Those include the Tang King Plant (southern Xinjiang) and Qihe Plant (northwest Shandong); however that upper level still falls short of the full-year dairy sales of 589,253 tonnes in 2022 — part of the reason why Tianrun Dairy is seeking the new 200,000 t/a ambient capacity, to boost overall capacity to 690,000 t/a

Expansion Plan

China's current dairy industry is dominated by national operators prioritising ambient dairy products and regional producers focusing on chilled products. Tianrun Dairy is a case in point, with its business development constrained by supply chain issues and distribution radius. Since 2020, it has looked for markets outside Xinjiang, drafting plans to build up its online and offline distribution networks both in and beyond Xinjiang region. Financial reports show its sales revenues grew by 27.01% in 2021 and 35.17% YoY in Q1-Q3 2022. Upon the completion of the new capacity, it is intended that Tianrun Dairy's increased production of ambient dairy products will facilitate an improved product mix and allow wider distribution coverage, allowing the business to grow as a result.

Meiji Increasing Investments in China's Dairy Market

Summary: *On 31 Jan., Meiji started up its second dairy plant in China, part of its strategic expansion plan in the country over recent years.*

The leading Japanese dairy company Meiji Holdings Co., Ltd. (Meiji) entered China back in 1989 and has 5 local factories – 2 in Guangzhou producing ice cream/chocolate biscuits, one in Shanghai producing chocolate biscuits, one in Suzhou producing dairy products including milk and yoghurt, milk beverages and whipping cream mainly for supply to Shanghai, and one dairy plant in Tianjin.

The last of these opened on 31 Jan. as the company's 2nd dairy plant in China and its first in the north. It will produce ESL (extended shelf life) milk, yoghurt, milk beverages and cream products for Tianjin and other northern markets.

Construction Details of Meiji's Tianjin Dairy Plant

- Construction nature: New construction
- Total investment: USD275.6 million (RMB1.9 billion), 1.01% (=USD2.8 million/RMB18.8 million) of which for environmental protection
- Construction unit: Meiji Dairies (Tianjin) Co., Ltd. (established in Sept. 2019)
- Site & floor areas: 53,768.9 m^2 & 31,495.63 m^2
- Main construction items: 3 production lines for milk (118,100 t/a) and milk beverages (6,561 t/a), yoghurt (in total 11,326 t/a, comprising 7,114 t/a for bottled sweetened yoghurt and 4,212 t/a for fruit yoghurt cups), whipping cream products (in total 80,608t/a, comprising 67,486t/a for bag-in-box formats and 13,122 t/a for cartons)

- Project development: Construction work commenced in July 2020, completing in Dec. 2021. The plant was certified for production in Nov. 2022 and formally started operations on 31 Jan., 2023.

Business Integration and Expansion

From the start of 2022, Meiji began integrating its 4 major segments in China – dairy products, chocolate biscuits, ice cream and SAVAS whey protein powders. It appointed Meiji (China) Investment Co., Ltd. (Meiji China) to build synergy between the categories, seeking more cross-category collaboration, faster market responsiveness and decision making, and improved operational efficiency.

Expanding in China is key to Meiji's overseas business development. For 2023 the group's budgeted overseas sales are USD637.7 million (JPY82.0 billion), including 43% (=USD272.2 million/JPY35.0 billion) from China, +36% over what it achieved in FY2022 USD169.5 million (JPY21.8 billion). It expects to triple its 2022 results by 2026, so it has been accelerating capacity expansion and ramping up investment in raw milk supply.

Major Investments in 3 Areas

- Production capacity: In addition to the new Tianjin Dairy Plant, Meiji is building another factory in Guangzhou to add capacity in dairy products and chocolate biscuits, scheduled to start operations this year. Its Shanghai chocolate biscuit plant is adding new ice cream capacity, turning operational in 2024, and will include a new R&D centre focused on delivering innovations for the local market. As a result, China will account for the majority of Meiji's 6 overseas manufacturing plants
- Milk supply: In April 2020, Meiji secured its first milk source in China by acquiring a 25% stake in Austasia Investment Holdings Pte. Ltd., Japfa's dairy unit in China. As of Dec. 2022, Austasia owns 110,000+ dairy cows in the country, capable of providing all Meiji's raw milk demand for future development
- Strategic products: Meiji has indicated that probiotic yoghurts and protein products are its main focuses in China. Last year Meiji SAVAS, the leading protein powder brand in Japan, was launched in China. Its top sellers *"Meiji Probio Yoghurt R-1"* and *"Meiji Probio Yoghurt LG21"* were launched in China in 2021

Sanyuan Foods in Deep Debt

Summary: In Feb., Sanyuan Foods forecast a net profit slump in 2022, as it struggled with lower sales and heavy debts.

On 1 Feb., Beijing Sanyuan Foods Co., Ltd. (Sanyuan Foods, Stock Code: 600429) released its Forecast on 2022 Annual Performance, advising of a drastic drop in net profit.

Highlights:

- Total revenue of USD1.19 billion (RMB8.06 billion) including its main business (dairy products), increased after deduction of incomes from Beijing Sunlon Livestock Development Co., Ltd. and HCo Lux S.à.r.l (SPV);
- Net profit attributable to the parent: USD4.30 million (RMB29 million) – USD 6.07 million (RMB41 million), down by 86%–90% or USD38.15million (RMB257.51 million) – USD39.93 million (RMB269.51 million) YoY after adjustment
- Net profit excl. extraordinary gains/losses to the parent: USD3.56 million (RMB24 million) – USD5.33 million (RMB36 million), down by 89%–93% or USD42.36 million (RMB285.92 million) – USD44.14 million (RMB297.92 million) YoY after adjustment
- At present, a goodwill impairment test is being carried out which may cause a further cut of about USD29.63 million (RMB200 million) to the net profit to the parent and mean a loss, warned in the statement.
- Sanyuan Foods cited rising costs and depressed demand in retail and foodservice during the pandemic as the drivers of these declines in profits

(Note: Beijing Sunlon Livestock Development Co., Ltd's financial statement was consolidated into Sanyuan Foods's adjusted 2021 data and 2022 estimates. HCo Lux S.à.r.l (SPV) is no longer consolidated in this way, but counted as an asset of 49% acquired shares since May 2022)

Sanyuan Foods' latest projection of USD1.19 billion (RMB8.06 billion) for 2022 revenue falls short of the USD1.26 billion (RMB8.5 billion) target for the year set in its 2021 financial report. In early 2022, it indicated a revenue target of USD1.80 billion (RMB12.17 billion) for 2023 when launching the restricted stock plan as a kind of ownership incentive.

Although Sanyuan Foods has remained profitable since 2014, 2022 could change this, and 2023 looks to be tough for the company as well.

Accumulating Acquisition Debts

- In 2018, Sanyuan Foods acquired the French margarine maker St Hubert with a loan of around USD740.83 million (RMB5 billion) loan, but the profit from St Hubert has not covered the interests on the loan
- In 2020, it purchased an additional 5% stake in ice cream producer Beijing Allied Faxi Food Co., Ltd, taking its total stake to 95%
- In 2021, it became the holding company of Beijing Sunlon Livestock Development Co., Ltd, but the subsidiary has faced cost pressures and weak dairy demand the pandemic
- In 2022, it obtained full ownership of Hunan Taizinai Biological Technology Co., Ltd., a company that has been making losses for years

This series of largescale acquisitions has put Sanyuan Foods in deep debt. Its short-term loans jumped to USD193.36 million (RMB1,305 million) by the end of Q3 2022 from the USD14.82 million (RMB100 million) in 2017. Adding the non-current debts of USD23.85 million (RMB161 million), its short-term liabilities came to USD217.21 million (RMB1.47 million) as of Q3 2023, which could not be repaid with the cash or cash equivalents totalling USD148.17 million (RMB1 billion) in the corresponding period. Sanyuan Foods is, therefore, exposed to increased insolvency risk for the year to come.

Raw Milk Price

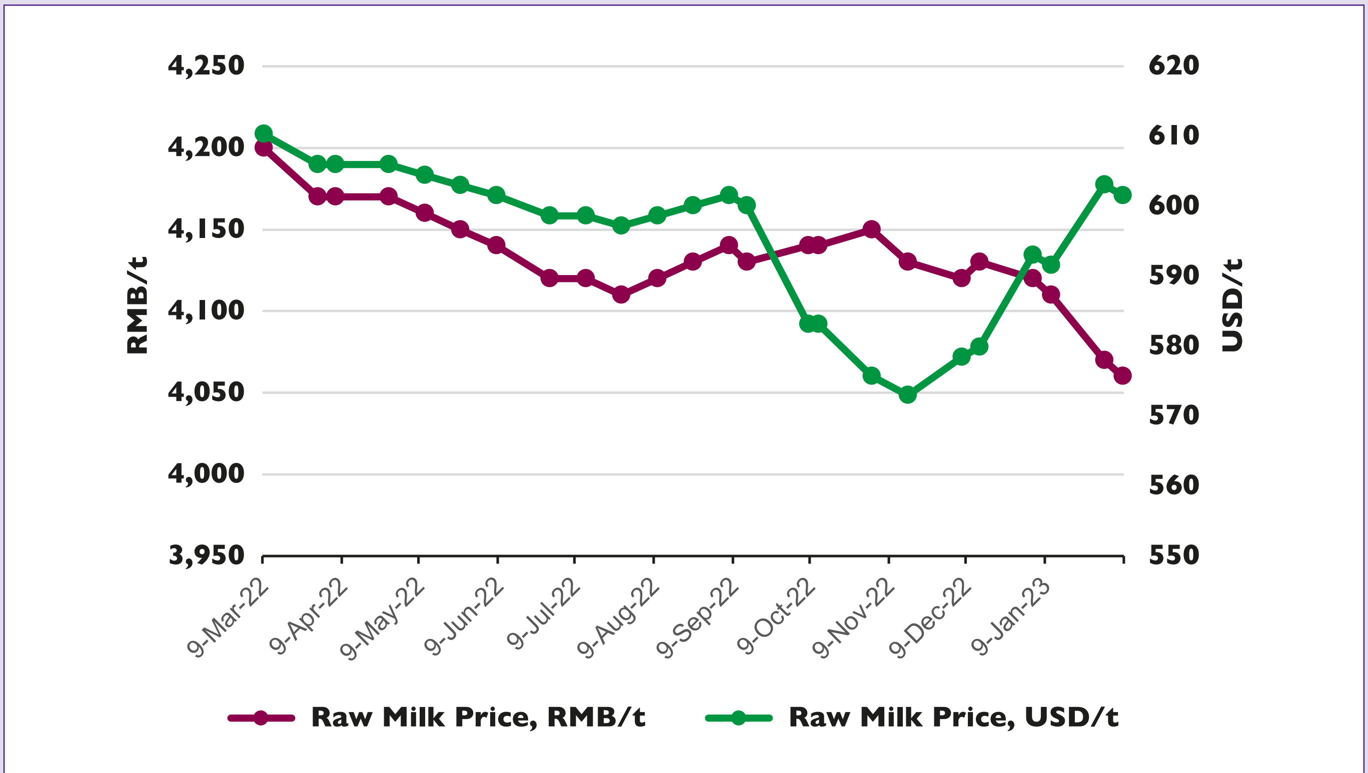
Milk Price Slides to 2 Year Low

***Summary:** After the recent demand-supply imbalance, China's raw milk price hit the lowest point in 2 years this month. However, demand for dairy products has shown a gradual recovery after the Spring Festival.*

In the week ending 8 Feb., China's raw milk price averaged USD601.55/t (RMB4,060/t), down only 0.2% from the preceding week but down 4.9% YoY. It is the lowest price point in two years, largely due to the recent demand-supply imbalance. Spray drying by processors has continued, although at a lower level than seen in Jan.

The gradual reopening of China since mid-Jan., plus the holiday-related demand, has encouraged more retail purchasing of dairy products, especially high-end pure milk. In the mid-to-long term perspective, there is scope for improvements in the dairy market with premiumisation and product diversification, as the nation is accentuating public health awareness and striving to restore consumer confidence.

FIGURE 1: Trends in China's Raw Milk Price, March 2022–Feb. 2023



Source: Ministry of Agriculture and Rural Affairs (MARA)

Feed market

- Domestic:
  - The national price of corn averaged USD447.46/t (RMB3,020/t), down 0.3% from the first week and up 5.2% YoY, based on data published on 8 Feb. by the Ministry of Agriculture and Rural Affairs (MARA); the average price in major production regions (Heilongjiang, Jilin and Liaoning) was down 0.4% to USD410.42/t (RMB2,770/t) compared with the first week; and the price in the main demand area (Guangdong) stayed at USD463.76/t (RMB3,130/t)
  - The national price of soybean meal averaged USD731.94/t (RMB4,940/t), down 0.2% from the first week of the month and up 25.7% YoY.
- Imported: The CIF price of imported alfalfa averaged USD517.88/t, up 35.5% YoY, and the CIF price of imported oat hay averaged USD429.06/t, up 25.2% YoY, based on data from China Customs

The *"No 1 Central Document"* for 2023 issued on 13 Feb., pledges to advance the national strategy of rural revitalization and accelerate the modernization process in rural regions, in the hope that this may prevent further rises in domestic feed prices.

Reference trading prices for raw milk among major provinces for Q1/H1 2023:

- Heilongjiang Province (for Q1): USD607.48/t (RMB4,100/t), with a minimum price of USD585.25/t (RMB3,950/t)
- Shandong Province (for Q1): USD570.44/t–USD607.48/t (RMB3,850/t–RMB4,100/t)
- Hebei Province (for Q1): USD607.48/t (RMB4,100/t), with a minimum price of USD585.29/t (RMB3,930/t)
- Shaanxi Province (for Q1): USD577.85/t–USD607.48/t (RMB3,900/t–RMB4,100/t)
- Guangdong Province (for H1): no less than USD770.46/t (RMB5,200/t)
- Sichuan Province (for H1): USD773.42/t (RMB5,220/t), with a minimum price of USD736.38/t (RMB4,970/t)

News in Brief

Dairy Imports in January 2023

The import data for this month are not yet released by China Customs, but will be issued in March.

28 Batches of Dutch Lady Milk Denied Entry

On 16 Jan., the General Administration of Customs (GACC) released the list of food and cosmetics products barred from entering the country in December 2022. These included 15 batches of Dutch Lady Milk (Original Flavour), 130,274.26 kg in all, and 13 batches of Dutch Lady Milk (Strawberry Flavour), 59,932.24 kg in all. These were stopped due to non-conforming product labels and lack of proper certificates or required documents – all were produced by the group's subsidiary in Vietnam.

This followed similar problems for the company for its products from Vietnam in 2021, when 16,038 kg of Dutch Lady Milk (Original Flavour) were barred for deficient labels in May and several batches of products were barred for excessive choline levels in Aug., Sept. and Nov.

FrieslandCampina's China office has indicated that it was unaware of the recent hold-up, pointing out that these products may be handled by dealers unfamiliar with China's imports regulations and national food standards.

Pinlive Foods Expects Sharp Drop in 2022 Profits

On 31 Jan., the well-known dairy importer and distributor Pinlive Foods Co., Ltd. (Pinlive Foods, Stock Code: 300892) released a severely reduced earnings forecast for 2022:

- Net profit attributable to equity shareholders of the listed company: USD1.48 million (RMB10.00 million)–USD2.07 million (RMB 14.00 million), down 85.34%–89.53%
- Net profit attributable to equity shareholders excl. extraordinary gains/losses: USD0.40 million (RMB 2.70 million)–USD0.59 million (RMB 4.00 million), down 94.71%–96.43%

The slash in profits was attributed to the weakened demand and increasing costs in procurement, transport and marketing during the pandemic.

China's Clones of Super Cows Born

On 31 Jan., the Science and Technology Department of Ningxia announced the births of 3 cloned *"super cows"* in Lingwu City (county-level). It was the first successful effort by Chinese scientists to clone dairy cows from ear tissue from mature, reproductive and highly productive Holstein cows on different farms with technologies involving collection, restoration and conservation of germplasm and quality breed cultivation.

In 2021, the Northwest Agriculture and Forestry University (NWAFU) initiated this project, supported by the Science and Technology Department of Ningxia. In October 2022, NWAFU reported a success in ovum pick-up and in-vitro embryo production (OPU-IVP) technology – this lay a foundation for the births of the 3 cloned calves using the somatic cell nuclear transfer or SCNT method, with the first calf born on 30 Dec. 2022. It is reported that from the 1st batch of 120 cloned embryos transplanted into recipient females, 42% achieved pregnancy, with subsequent failures taking this success rate down to 17.5% after 200 days. Each of the selected cell donors has given birth 4 times or more and is capable of producing over 18 tonnes of milk annually, or over 100 tonnes in lifetime, compared with the average national milk yield of core breed groups at 13 tonnes per cow / year.

This project now has the technological capability in cloning (somatic cell nuclear transfer), OPU-IVP and embryo transfer, operational in its 4 in-vitro embryo production centres. These hold 300 adult cattle and 300 heifers in total, all selected from superior varieties as a live gene bank. So far, 2,991 good embryos have been cultivated via OPU-IVP and 10 replacement bulls have been raised in the centres.

This year, Lingwu City plans to conduct 1,000 OPU-IVP embryo transfers with an expected 50% birth rate (=500), to transplant 300 cloned embryos with a 10% birth rate (=30), and obtain 100 sexing embryos from the cloned cattle for larger-scale breeding of high yielding cows.

In China, fewer than 0.005% of dairy cows are capable of producing over 100 tonnes of milk in a lifetime, and deficiencies in home growing and fast reproduction of good cattle breeds have meant most of its current quality cows are imported. In order to address this heavy dependency on cattle imports the *China Dairy Herd Genetic Improvement Program for 2021–2025* published by the Ministry of Agriculture and Rural Affairs set a goal of 70%+ self-sufficiency of cattle breeds – a target which these breakthroughs in dairy breeding may help achieve.

Inner Mongolia Yijiahao to Expand Cheese Capacity

On 17 Feb., the Ecology and Environment Bureau of Hohhot City, Inner Mongolia Autonomous Region approved and publicised the environmental impact assessment document of the capacity expansion project proposed by Inner Mongolia Yijiahao Cheese Co., Ltd., a wholly-owned subsidiary of Inner Mongolia Yili Industrial Group Co., Ltd. (Yili, Stock Code: 600887) This business was founded in June 2021 with a registered capital of USD2.96 million (RMB20 million) and is located in the Yili Future Intelligence and Health Valley.

This Valley is a high-quality developing complex integrating production of milk powders, liquid dairy (milk, yoghurt, drinks, etc.) and cheese. Upon the completion of this expansion, the subsidiary will possess 34 production lines with gross capacity up to 119.97 t/d for ambient and chilled cheese products.

Expansion Plan:

- Location: Jiashan Economic and Technological Development Zone, Hohhot City, Inner Mongolia Autonomous Region
- Total investment: USD42.11 million (RMB284.23 million, 0.23% (=USD97,789.37 or RMB660,000) of which for environmental protection
- Construction period: 2 months
- Site area: 287,997.12 m^2
- Additions: 14 production lines in total
  - 5 lines for ambient kid's cheese sticks (16.20 t/a)
  - 4 lines for chilled kids' cheese sticks (12.96 t/a)
  - 2 lines for chilled drinkable cheese (7.68 t/a)
  - 2 lines for kids' cheese snacks (6.04 t/a)
  - 1 line for cheese slices (7.97 t/a)
- Raw materials usage:
  - Cream cheese – 6,780 t/a
  - MPC – 1,357 t/a
  - Butter – 4,747 t/a
- Working system: 127 people working for 20h/d, for 300 days a year

Yili Starts Operation of 4 Premium Dairy Lines in Hinggan League

On 29 Jan., Yili's wholly-owned subsidiary Inner Mongolia Hinggan Yili Dairy Co., Ltd. put 4 new production lines into operation as part of the 1st phase construction of its New Intelligent Manufacturing Technology Demonstration Project, involving *"5G Industrial Internet Platform"*.

Details of the project's 1st phase:

- Investment: USD164.8 million (RMB1.1 billion)
- Location: Hinggan League, Inner Mongolia Autonomous Region
- Site & floor area: 31.96 ha (479.33 mu) & 9 ha
- Construction plan: A total of 8 production lines for high-end products in the Ambrosial Yoghurt and Jindian Milk ranges, produced with new technologies such as industrial 5G, AR (augmented reality) and BIM (building information modeling)
- Estimated benefits: The 1st phase is projected to achieve over 100,000 tonnes of dairy output, drive development of 7 nearby large dairy farms, and deliver annual revenues of at least USD74.1 million (RMB500 million) this year

This overall project is being built over 2 phases: the 2nd stage of the 1st phase (another 4 lines) remains under construction, after which the 2nd phase will commence. The aim is to achieve overall capacity of 1,500 t/a of liquid dairy, and annual production value of USD222.2 million (RMB1.5 billion). It is Yili's 3rd such project in Inner Mongolia Autonomous Region, following the first Hulunbuir Yili High-end Green & Smart Organic Dairy Product Project, and then its Global Smart Manufacturing Industrial Park in Yili Future Intelligence and Health Valley in Hohhot City. The project is expected to stimulate local businesses in planting, farming, feed processing, logistics and packaging, and generate revenues of at least USD26.7 billion (RMB180 billion) across the full supply chain.

Junlebao to Build Base in Yangtze River Delta Area

On 29 Jan., Junlebao Dairy Group Co., Ltd. announced its plan to build its first integrated production base in the Yangtze River Delta area, including 3 largescale dairy farms and a *"digital and intelligent dairy processing plant"* in Chuzhou City, Anhui Province, with an investment of USD444.5 million (RMB3.0 billion). This project, to start construction work in March this year, will support the implementation of the National School Milk Programme in the region.

On Dec. 2022, Junlebao signed an investment agreement with Tianchang Municipal (county-level) Government in the province to establish a largescale dairy farming base at a cost of USD66.7 million (RMB450 million). The terms for the 1st phase include building a 66.67 ha farm with 10,000 dairy cows and taking on 1,333.33 ha of land for alfalfa and silage corn planting; the target annual milk production is 80,000 tonnes. The Tianchang Municipal Government also appointed Junlebao as the main school milk supplier for local primary and middle schools. The school milk products will have special labels showing that they are sourced from designated dairy farms to ensure quality and safety.

As of 2021, China had certified 123 school milk producers and 346 dairy farms registered for school milk. In addition to Tianchang, Junlebao has been appointed by governments of Hebei, Henan, Jiangsu and others for school milk supply.

Genki Forest Sells Off Beihai Ranch

On 18 Jan., full ownership of Beihai Ranch (Beijing) Dairy Co., Ltd. changed from Genki Forest (Beijing) Food Technology Group Co., Ltd. to Land of Promise Group Holdings HK Limited, a private company registered in Hong Kong on 19 Aug., 2022.

Although Genki Forest downplayed the significance of the change, saying the brand and its business operations would remain as usual, this move has stimulated industry-wide discussion about whether Genki Forest is to leave the yoghurt market. The company has been one of China's fastest growing beverage brands since its establishment in April 2016, with a product range encompassing sugar-free tea, sparkling water, yoghurt, milk tea, juice and energy drinks. Beihai Ranch was a high-end yoghurt brand of Genki Forest, producing products with selling points such as *"sugar free"* and *"high quality"* inherited from its parent's wider portfolio, and remains popular with young consumers. It has also launched other dairy products like *"Extra Thick Milk"* (high in protein and calcium) and *"Extra Thick Milk Tea"*.

In China's high-end yoghurt market, top brands like CLASSY KISS, Simple Love (owned by Guangzhou Honest Dairy (Group) Co., Ltd) and big names like Yili, Mengniu, Bright Dairy, New Hope Dairy have marketed quite similar products, typically sugar-free, high protein and with no additives. The recent few years have seen little growth in the chilled yoghurt segment, so sales of Genki Forest's high-priced yoghurt have proven slow as it has been hard to differentiate the products from its competitors.

Innovation in High-performance Packaging Materials for Ambient Dairy

In Feb. the National Centre of Technology Innovation for Dairy, which operates in the Yili Future Intelligence and Health Valley in Hohhot City, Inner Mongolia Autonomous Region, showcased an Innovation of High-performance Package Material for Dairy Products Using Phase Separation Technique for Light Blocking. It is claimed as a milestone in resolving a technical problem in using PET packaging materials, breaking the foreign monopoly in the field.

This is a breakthrough applicable to plastic packs with enhanced protection for UHT dairy products, in which photosensitive ingredients such as unsaturated fatty acids and vitamin B will affect products' taste and texture if exposed to strong light that triggers photosensitive responses and oxidation. This makes it important to add light-resistant and oxygen-absorbing additives to packaging to ensure a long shelf-life and the quality of dairy products in ambient storage conditions – such additives are mainly imported at a significant cost.

The centre's R&D team has developed a PET material that gives superior performance when blended with regular resin to that provided by the light blocking additives, the usage of which could reduce by 40%+.

The team has completed technical development of a series of materials including high-efficacy light blocking masterbatch, high-efficacy light blocking labels, and high-efficacy light-resistant and oxygen-absorbing masterbatch, and is now preparing to commercialise these results, starting in PET labels and bottles.

Feihe Dairy to Add Lines for Lactoferrin and Whipping Cream

On 13 Feb., Heilongjiang Feihe Dairy Co., Ltd. (Feihe Dairy; subsidiary of China Feihe Ltd. (Stock Code: HK. 06186)) held a signing ceremony for a lactoferrin and whipping cream processing project with Government of Kedong County, Qiqihar of Heilongjiang.

A total of USD19.3 million (RMB130 million) is to be assigned:

- Lactoferrin line: USD11.9 million (RMB80 million) in a 15-month construction for 180,000 t/a raw milk processing capacity and 12.6 t/a lactoferrin production capacity, providing an estimated annual output value of USD11.6 million (RMB78 million)
- Whipping cream line: USD7.4 million (RMB50 million) in a 15-month construction for 90,000 t/a raw milk processing capacity and 9,000 t/a whipping cream production capacity, with an estimated annual output value of USD35.3 million (RMB238 million).

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