Dairy Products China News

Guaranteed Exclusive Analysis

Vol. 14 Issue 12 2021

Welcome to the December issue of Dairy Products China News.

2022 could prove a very interesting year for China. The country's economic growth is expected to slow to somewhere between 5-5.5% – still impressive but quite a comedown from the estimated 8%+ achieved last year and lower than most expect to see in India and many other parts of Asia.

As a positive, China is currently preparing for two high profile international sporting events – the Winter Olympics in Beijing, scheduled to take place from 4 to 20 February, and the Winter Paralympic Games from 4 to 13 March – with Yili still the exclusive supplier of dairy products to these two events, despite the Coca-Cola and Mengniu Dairy joint worldwide Olympic Partnership from 2020 to 2032. It is to be hoped that Omicron will not disrupt these too much of course, but who knows? Already, even without this late emerging curve ball, China's zero-tolerance protocols and developments such as this month's Zhenhai lockdown affecting Ningbo port have led to significant supply chain congestion.

But even if COVID is contained, there are several areas of obvious risk. Most seriously, the US-China relationship tops the list of geopolitical uncertainties. But simply in terms of the domestic economy, the property market situation suggests more limited economic growth in the coming years, given that it accounts for roughly a third of the country's GDP. This is especially the case after the long-expected default on 9 December of China's second biggest (and the world's most heavily indebted) developer, Evergrande, with debts exceeding USD300 billion. It has been suggested by some economists that a 20% decline in real-estate activity, even without a banking crisis, could take as much as 10% out of the country's GDP.

The dairy sector poses questions of its own of course – import demand has remained strong on most key products but how much will this be affected by the rising local milk supply capabilities, and how well-placed are international suppliers to continue servicing what is expected to continue to be an increasing import requirement? Especially when the ocean carriers are now so powerful – witness this month's Maersk/LF Logistics deal.

We've had a busy year looking at prospects for dairy ingredients and dairy inputs into foodservice chains in particular in China and around Asia, as well as working on other food categories in China where political imperatives and market trends combine to make the future as hard to gauge as ever. For now, a big thank you to our customers and subscribers and we wish you a safe, enjoyable and prosperous year of the tiger!

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

UK Head Office

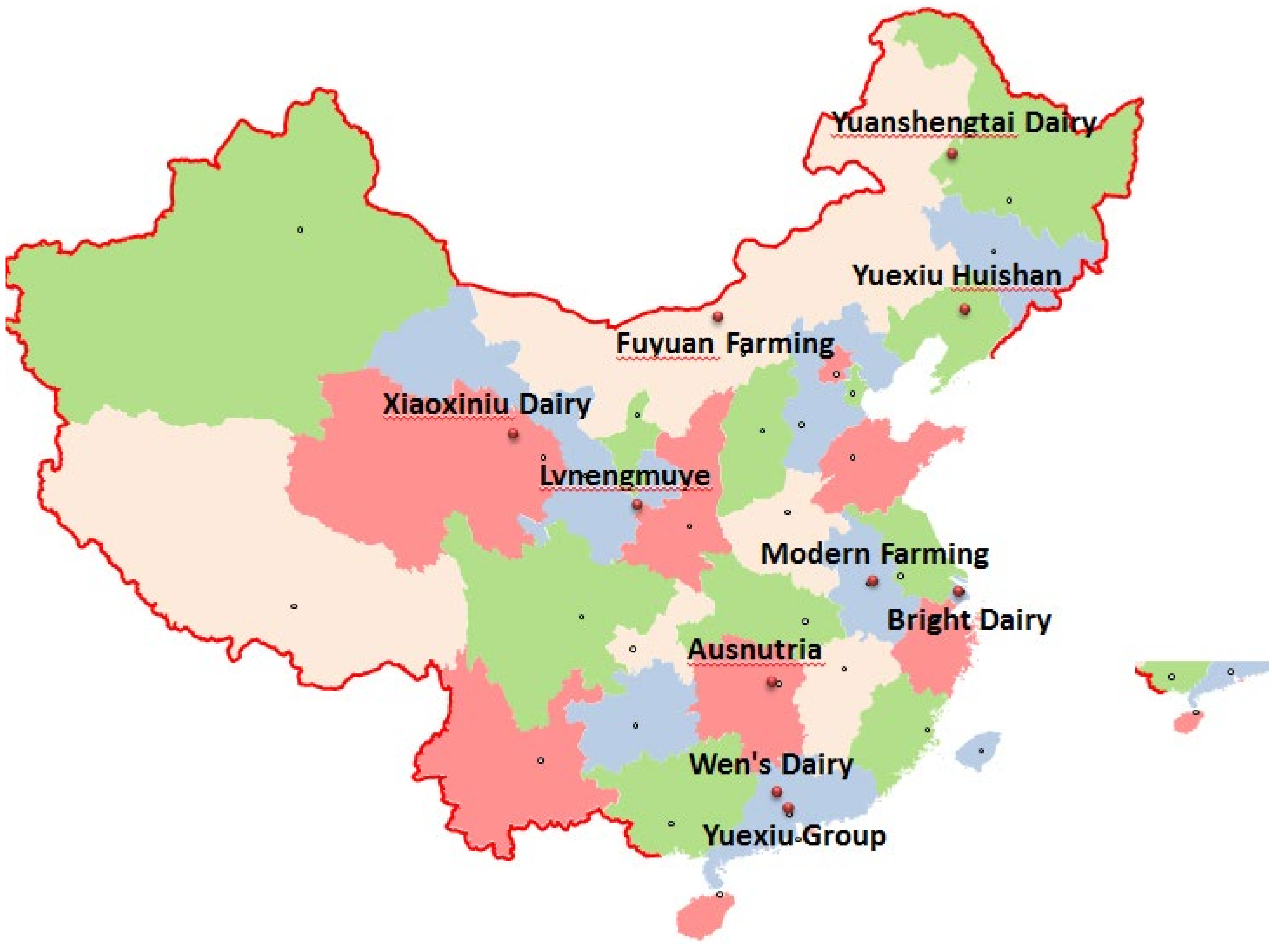
Orrani Consulting
12 Lower Camden Place
Bath, BA1 5JJ, United Kingdom
Tel: +44 (0) 1225 318 222
Fax: +44 (0) 1225 430240

Contents

Headlines

- On 24 Nov., Wen's Dairy signed up for Xinxing County Efficient Ecological Dairy Farming Project and completed the project investment agreement; on 26 Nov., Yuexiu Group initiated the construction work of the Yuexiu Fengxing Ecological Pastoral Complex Project
- New food import legislation (GACC Decree No. 249) becomes effective from 1 Jan., 2022, with new rules for imported foods for special dietary uses (FSDU).
- On 3 Dec., SAMR released a notice on a system change from "licensing" to "filing" for FSMPs and IMF.
- Yuanshengtai Dairy issued a USD20.57 million (RMB131 million) acquisition proposal for Lvnengmuye, a Shaanxi-based goat milk producer, a deal set to boost China Feihe's goat milk business significantly.
- Modern Farming announced that it has completed the acquisition of Fuyuan Farming on 29 Nov.
- A notice on Dec. has confirmed that Bright Dairy has completed the acquisition of a 60% stake in Xiaoxiniu Dairy.
- On 6 Dec., 2021, Liaoning Yuexiu Huishan Dairy Holding Co., Ltd. emerged formally as the successor to Huishan Dairy.
- On 10 Dec., Yili highlighted that it had received a green light from SAMR in regard to its investment in Ausnutria.
- December data has seen China's milk price remain high, still mainly driven by growing cost of feed.

Major Companies and Sites Mentioned in This Issue



Market Dynamics

Two Dairy Farming Projects Settled in Guangdong

Summary: *On 24 Nov., Wen's Dairy signed up for Xinxing County Efficient Ecological Dairy Farming Project and completed the project investment agreement; on 26 Nov., Yuexiu Group initiated the construction work of the Yuexiu Fengxing Ecological Pastoral Complex Project.*

On 24 Nov., the signing ceremony of Xinxing County Efficient Ecological Dairy Farming Project was held in Yunfu City, Guangdong Province, concluding an investment agreement between the local government and Guangdong Wen's Dairy Co., Ltd. (Wen's Dairy) and an Efficient Agriculture Cooperation Programme between Wen's Dairy and Guangdong Huanong Wens Animal Husbandry Co.,Ltd. (Huanong Wens).

Details of the Xinxing Project are as follows:

- Location: Xinxing County, Yunfu City, Guangdong Province
- Total investment: USD39.25 million (RMB250 million)
- Size: 22.84 ha including 5.8 ha of building area
- Scheduled stock: 3,500 dairy cows
- Projected economic benefit: Milk production to reach 20,000 t/a worth USD18.8 million (RMB120 million)

Meanwhile, under the farmer-owner model (where the farmers contract forage supplies from local producers) the project will bring income of USD1.6 million (RMB10.0 million) to local forage growers.

Wens Foodstuff Group Co., Ltd. (Stock Code: 300498) holds 78% of Wen's Dairy and 93.3% of Huanong Wens.

The biggest milk supplier in South China, Wen's Dairy runs 6 modern large-scale dairy farms with 27,000 imported dairy cows which produce 150,000 t/a. It also processes dairy products, selling mainly in the south.

Huanong Wens, registered with USD150.7 million (RMB960 million) in 2002, specialises in the production and sales of boars, boar semen, piglets, pigs for pork and feeds.

On 26 Nov., the groundbreaking ceremony of the state-level Yuexiu Fengxing Ecological Pastoral Complex Project along with the signing ceremony of the investment agreement between Yuexiu Enterprise (Holdings) Ltd (Yuexiu Group) and the central government, took place in Conghua District, Guangzhou. This project, partly invested with USD56.5 million (RMB360 million) by Yuxiu Group, is the only Guangdong Province listing in the National Pastoral Complex Pilot Programme and will receive governmental support totalling USD23.6 million (RMB150 million) over 3 years.

Details of Yuexiu Fengxing Ecological Pastoral Complex Project

- Location: No.1 Qinglong Base (dairy farming base of Guangzhou Huamei Milk Company), Hengjiang County, Aotou Town, Conghua District, Guangzhou
- Total investment: USD135.6 million (RMB863.95 million)
- Investment in tourism: USD56.5 million (RMB360 million)
- Scheduled stock: to increase to 6,000 from the current size of 3,500
- Construction period: Two years
- General scheme: The currently farm will be expanded and the neighbouring villages (Longtan, Hengjiang, Wushi, etc.) will be transformed into ecological tour sites.

It is being reported that if the project progresses as scheduled it will become the No.1 demonstration farm in South China in terms of farming scale and automation level. Further construction plans will be launched for a dairy breeding centre (focusing on breeds of high-yielding dairy cows that adapt to the subtropical climate in South China), a pastoral tourism zone, grass-planting area, etc.

Founded in 1987 with a registered capital of USD1.1 million (RMB7.1 million), Guangzhou Huamei Milk Company is 100% owned by Guangzhou Fengxing Milk Co., Ltd. with operations covering dairy breeding and farming, wholesale and retailing of dairy products.

Governmental Direction

New Rules on China Imports of FSDU

Summary: *New food import legislation (GACC Decree No. 249) becomes effective from 1 Jan., 2022, with new rules for imported foods for special dietary uses (FSDU).*

The *Measures of the People's Republic of China for the Administration of Import and Export Food Safety (Decree No. 249)*, which were adopted at the executive meeting of the General Administration of Customs of China (GACC) on 12 March, 2021 will come into force as of 1 Jan., 2022.

New Requirements for Overseas Authorities

In accordance with article 18 of Decree No. 249, GACC will control registrations of overseas food manufacturers exporting to China, publishing a list of those registered. Particularly, *"the overseas producers of the following food categories need to be recommended by their country's competent authority for registration with GACC: meat and meat products, sausage casings, aquatic products, dairy products, bird nest products, bee products, eggs and egg products, edible oils and fats, oilseeds, stuffed wheat products, edible grains, milled grain industry products and malt, fresh and dehydrated vegetables, dried beans, condiments, nuts and seeds, dried fruits, unroasted coffee and cocoa beans, foods for special dietary uses (FSDU), and health foods"* – this was stipulated by Administrative Regulations on Registration of Overseas Producers of Imported Food (Degree No. 248) – which we covered in the October issue, and which is also effective from 1 Jan., 2022.

An exporter's local competent authority should submit the following application materials to GACC:

- Recommendation letter
- List of applicants and their application letters
- Identification documents of the applicants, such as their national business licenses
- Confirmation that the recommended applicants are qualified to register.
- Review reports on the applicants

GACC requires records on food safety and health control, and food safety protection including floor plans of plant areas, workshops and refrigerated storage areas, and production flowcharts, if necessary.

New Requirements for Overseas FSDU Producers

Article 22 of Decree No. 249 focuses on imported foods for special dietary uses (FSDU), a local terminology which includes formulae and FSMPs, other baby foods (cereal-based and other cans/jars), complementary food supplements, sports nutrition products, and other foods for special dietary uses such as dietary supplements for lactating mothers.

FSDU product labels must be both in original languages and Chinese:

- The Chinese version must be printed on the smallest sales packs before entry, and shall not be added after (article 30)
- Inner and outer packaging shall include the Chinese registration number and the authorised registration number in the original country (region). More detailed requirements for labels in Chinese can be found in the *National Food Safety Standard Food Labeling of Prepackaged Special Diet (GB 13432-2013)*

Article 21 of Decree No. 249 also requires food importers to set up importation and domestic sales record systems and keep related documents showing product name, net content/ specification, volume, production date, production/import batch number, shelf life, contact information of overseas exporters and domestic buyers, delivery date, etc. Records are to be retained for at least 6 months after the product's expiration date, or at least 2 years after its launch in the market if there is no expiration date.

Licensing System Simplified for FSMP and IMF

Summary: *On 3 Dec., SAMR released a notice on a system change from "licensing" to "filing" for FSMPs and IMF.*

On 3 Dec., the State Administration for Market Regulation (SAMR) posted the *Notice on Issues Concerning Recording of Sales of Pre-packaged Foods Only*, indicating that IMF, healthcare products and FSMP can now go on sale once their producers have finishing filing their details online, and without waiting for food business licenses to be approved, something which has proven very slow and difficult.

Previously businesses had to register with the authority before operation (potentially for multiple food products, not just pre-packaged products) and get a business operation license before selling the registered food products – this was termed the *"licensing system"*. This policy change provides a more efficient system and is an important part of the central government strategy to promote businesses' *"classification and grading administration"*. It is expected to:

- Accelerate the time needed for checking / approval and streamline legal procedures to reduce administrative burdens on businesses
- Enable faster launches of new IMF products

This certainly doesn't mean less regulatory scrutiny but is aimed at the overall improvement of China's IMF industry, being meant to expedite innovation and market development.

Company Development

Yuanshengtai Dairy to buy Lvnengmuye

Summary: *Yuanshengtai Dairy issued a USD20.57 million (RMB131 million) acquisition proposal for Lvnengmuye, a Shaanxi-based goat milk producer, a deal set to boost China Feihe's goat milk business significantly.*

On 19 Nov., **Yuanshengtai Dairy Farm Ltd** (Yuanshengtai Dairy, Stock Code: 01431) notified its acquisition proposal for Shaanxi Lvnengmuye Co., Ltd. (Lvnengmuye). Later on 29 Nov., it disclosed details of the plan that involves investing USD20.57million (RMB131 million) in the goat milk production lines, other equipment and rights to the dairy farming land of Lvnengmuye, which is located in the main pasture area in Guanshan Grassland, Shaanxi Province. When the acquisition will complete remains unclear, however the acquired business is expected to operate as part of Yuanshengtai Dairy's wholly-owned subsidiary, Shaanxi Ruixiang Chengda Animal Husbandry Co., Ltd.

A 71.26% stake in Yuanshengtai Dairy was acquired in Dec. 2020 by China Feihe Ltd (China Feihe, Stock Code: HK.06186). China Feihe has benefited from this significantly as Yuanshengtai Dairy is close to its plants – in 2020, 92.4% of China Feihe's raw milk requirements were sourced from Yuanshengtai Dairy, and the percentage was 89.6% over Q1-Q3 2021.

Likewise, unsurprisngy, China Feihe has remained Yuanshengtai Dairy's top customer – in 2020, taking approximately 83.6% of its milk. This has been even more the case this year, this proprtion rising to 89.3% during Q1-Q3 2021.

In this case, Yuanshengtai Dairy's new investment underpins and promotes China Feihe's goat milk business which has been a subject of high focus for the firm since this July when it acquired Shaanxi Xiaoyang Milk Co., Ltd. to secure leading place in the segment. – which is also supplied by Lvnengmuye. For now, therefore, China Feihe owns 3 goat milk formula/powder brands: *"Xiaoyao Milk"*, *"Ruijia Milk"* and *"+ Love"*.

TABLE 1: Trends in Yuanshengtai Dairy's Milk Sales

Year	From the 2 initial farms (tonnes)*	Total (tonnes)	%
2018	62,722	282,261	22.2%
2019	67,685	334,424	20.2%
2020	87,967	355,599	24.7%
Jan.-June 2021	53,451	179,824	29.7%

Source: Yuanshengtai Dairy's Annual Report 2020 on Related Party Transactions (China Feihe) and Cninfo (cninfo.cn, a stock market website)

*Note: * These farms – Gannan Pasture and Kedong Heping Pasture – were acquired by Yuanshengtai Dairy from China Feihe in 2011.*

Yuanshengtai Dairy sees strong potential in China's goat dairy market and this purchase will consolidate its position and diversify its product mix to meet the expanding market.

Its acquisition proposal shows that in 2019, Shaanxi Province had 2.4 million dairy goats (the largest number amongst all China's provinces) and produced 700,000 tonnes of milk, equivalent to 129,000 tonnes of powdered goat milk products. The local goat milk industry was worth USD 4.47 billion (RMB28.5 billion). In 2020, China's goat IMF segment was assessed by the China Baby and Child Network (cnkids.com.cn) at USD1.56 billion (RMB10 billion), and forecast to reach between USD3.12 billion (RMB20 billion) – USD4.67 billion (RMB30 billion) within 3 to 5 years.

Established in 2014 with a registered capital of USD 3.14 million (RMB20 million), Lvnengmuye runs dairy goat farms and goat milk processing plants in Shaanxi Province and the deal suggests China Feihe will be in a very strong position in this market sector.

Modern Farming Closes Acquisition of Fuyuan Farming

Summary: Modern Farming announced that it has completed the acquisition of Fuyuan Farming on 29 Nov.

On 29 Nov., Modern Farming (Group) Co., Ltd. (Modern Farming, Stock Code: HK.01117) stated that Inner Mongolia Fuyuan Farming Co., Ltd. (Fuyuan Farming) has become its subsidiary after the withdrawal on 25 Nov. of China Mengniu Dairy Company Ltd (Mengniu, Stock Code: HK.02319), which until then had held a 43.35% stake in the firm.

Fuyuan Farming

Set up in Feb. 2021 with a registered capital of USD239.02 million (RMB1522.4 million), Fuyuan Farming mainly engages in forage growing, dairying, feed processing and sales, and providing technical assistance on dairying.

Its 14 operational large-scale farms span 6 major dairying areas – Inner Mongolia, Hebei, Shandong, Ningxia, Jiangsu and Sichuan – and involve some 60,000 dairy cows producing 900 tonnes of milk per day.

Back in July 2016, Fuyuan Farming acquired a 65% stake in HayKingdom, the US West Coast industry forage products giant which has 5 forage farms and is best known for its alfalfa.

Three strengths of Fuyuan Farming:

- High-yielding dairy operations: Currently, each of its milking cows can produce 11.7 tonnes annually vs. 11.1 tonnes in Modern Farming
- Strong profitability: The company's profits after tax were USD9.69 million (RMB61.7 million) in 2018, USD22.45 million (RMB143 million) in 2019 and USD54.64 million (RMB348million) over the first 9 months of 2020
- Strong cash flow: Fuyuan Farming reports cash flow amounting to USD141.30 million (RMB900 million) while Modern Farming holds USD172.7 million (RMB1.1 billion) of cash and USD188.4 million (RMB1.2 billion) of financing at hand – so Modern Farming's asset-liability ratio will stay stable and the target asset will not impair its consolidated results for 2021.

Acquisition Purpose

Three key benefits of the acquisition for Modern Farming are:

- Improving the quality and stability of its feed supply, whilst lowering its costs of feed purchasing
- Increasing its dairy farming scale to achieve economies and greater profitability
- Securing supply of safe and quality milk, particularly for Mengniu, strengthening its bargaining power

As of 31 June, 2021, Modern Farming owned 26 dairy farms with 250,000+ dairy cows producing 1.5 million t/a; this deal takes its herd up to 310,000 head, in line with its *"Five-year Top Leader Programme"* which plans to double its herd to 500,000 by 2025 and raise its milk production to 3.6 million t/a.

Back on 27 Feb., 2014, Fuyuan Farming signed a milk supply with Mengniu running up to 28 Feb., 2034. Modern Farming can now integrate Fuyuan Farming's feed resources into its own to optimize synergies where possible.

Bright Dairy Invests in Xiaoxiniu Dairy

Summary: A notice on Dec. has confirmed that Bright Dairy has completed the acquisition of a 60% stake in Xiaoxiniu Dairy.

On 7 Dec., Bright Dairy & Food Co., Ltd. (Bright Dairy, Stock Code: 600597) announced that it had become the lead shareholder in Qinghai Xiaoxiniu Biological Dairy Industry Co., Ltd. (Xiaoxiniu Dairy). This came after it proposed to purchase a 60% interest in the firm for an estimated USD95.8 million (RMB610 million) back on 19 Nov.

The deal entails a 3-year performance commitment by Xiaoxiniu Dairy to achieve consolidated net profits excluding extraordinary gains and losses above USD13.3 million (RMB 84.56 million) in 2022, USD15.1 million (RMB 95.97 million) in 2023 and USD17.1 million (RMB108.93 million) in 2024. Bright Dairy is to become actively involved in the administration of Xiaoxiniu Dairy to help boost its overall operations, from production and marketing to distribution.

Objectives of this acquisition:

- Bright Dairy plans to raise the production and market share of Xiaoxiniu Dairy's flagship *"old yoghurt"* product, which has several very marketable differentiating local characteristics — it is a set yoghurt produced with milk from farms in southwest China; the range of varieties is limited but the products are rich in taste
- Secondarily, Bright Dairy intends to expand its dairy farming in the southwest region which has been targeted by just a few majors, notably Yili, Mengniu and Zhuangyuan Pasture, etc.) — this fits its plan to create more local specialty products with nationwide potential
- After the 3-year commitment is fulfilled, Bright Dairy will have the option to buy the last 40% of Xiaoxiniu Dairy at a favourable price.

Bright Dairy's heritage is very based on eastern China but it has targeted the west region for some time now. Last year, it started a strategic cooperation with the Government of Zhongwei (a prefecture-level city in the Ningxia Hui Autonomous Region) and Ningxia Agriculture Investment Group Co., Ltd. to establish dairying and feed production there, even air-freighting milk from there to its Shanghai plants.

At the moment, it is constructing large-scale dairy farms (+100 cows) in Anhui, Ningxia and Heilongjiang provinces, all scheduled to start up next year. These will bring its dairy herd to 31,000 head in line with its strategic plan for 2021–2025 laid out on 30 March, 2021.

Founded on 13 Sept., 2002 with registered capital of USD5.1 million (RMB32.5 million), Xiaoxiniu Dairy has focused on dairying as well as dairy processing. Its dairying operations include 1,128 cows in Wuling City and 4,012 in Wuzhong City, Ningxia. Its overall product portfolio comprises 45 products covering 3 categories: liquid milk, yoghurt and milk beverages. These sell under 8 brands – *"Qinghai Old Yoghurt", "Yoghurt of Tibetan People", "Mula Granny's Yoghurt", "Snow Land Shengyuan Pure Milk", "Zangzhibao Pure Milk", "Xiaoxiniu Pure Milk", "Tuolunbao Pure Milk"*, and *"Highland Barley Zangzhibao Yoghurt"*.

TABLE 2: Key Data of Xiaoxiniu Dairy, 2020-2021, USD million

Year	Revenue	Net profit	Net profit attributable to equity holders of the parent company	Net profit excl. extraordinary gains/losses
2020	90.2	10.9	11.0	10.1
Jan.-April 2021	37.8	4.0	4.0	4.1

Source: Bright Dairy's notice of acquisition of Xiaoxiniu Dairy

In its targeting of western dairying operations, this acquisition is reminiscent of the purchase by New Hope Dairy Holdings Co., Ltd. (New Hope Dairy, Stock Code: 002946) of Ningxia Huanmei Dairy Development Co., Ltd. (Huanmei Dairy) in May 2020 and taking control of Ningxia Xiajin Dairy Industry Group Co., Ltd.'s *"Xiajin Dairy"* range including UHT milk, functional *"healthy"* flavoured milks (e.g. containing Lycium chinense or boxthorn, the source of goji berries), yoghurt, milk powder and cheese products. This Sept., New Hope Dairy kicked off a 5-year plan designed to make Xiajin Dairy the showcase regional dairy brand for Ningxia.

Fierce competition in the west between Bright Dairy and New Hope Dairy seems a certainty going forward.

Yuexiu Group Reorganises Huishan Dairy

Summary: *On 6 Dec., 2021, Liaoning Yuexiu Huishan Dairy Holding Co., Ltd. emerged formally as the successor to Huishan Dairy.*

An inauguration ceremony was held for Liaoning Yuexiu Huishan Dairy Holding Co., Ltd. (Yuexiu Huishan) on 6 Dec., marking the completion of the reorganisation of Huishan Dairy Holding Co., Ltd. (Huishan Dairy) by Yuexiu Enterprise (Holdings) Ltd (Yuexiu Group) – and thus a reboot for Huishan Dairy.

"Our target is for Yuexiu Huishan to achieve an annual turnover of USD1.57 billion (RMB10 billion) by 2025, to increase its herd to 200,000-230,000 head and raise its annual milk production to 1-1.3 million tonnes, of which 0.45-0.5 million tonnes will be used in our own dairy production. Going public is contingent upon business performance and market opportunity" Yuexiu Group explained.

Registered with capital of USD31.4 million (RMB200 million) in March 2009, Huishan Dairy was involved in dairying with Holsteins and Jerseys and was also procuring milk for its own product range (IMF, milk powders for adults, UHT and fresh milks, fermented dairy products, milk beverages etc.) As was widely publicised, it had a famously chequered history though:

- Sept. 2013: Listing in Hong Kong
- March 2017: A debt crisis caused its value to plummet from USD4.13 billion (HKD32.2 billion, USD1=HKD7.79625, dated 1 Dec., Hexun.com) to USD0.73 billion (HKD5.66 billion)
- 25 June, 2018: The administrators' preliminary financial review of the firm and its 83 subsidiaries showed it was in debt to the tune of USD3.66 billion (RMB23.33 billion)
- Dec. 2019: Delisting from the Hong Kong Stock Exchange.

Now, as Yuexiu Huishan, it owns 161,883 ha of forage and feed production growing area, feed plants with a production capacity up to 600,00 t/a, 78 of its own modern dairy farms – holding around 130,000 imported purebred dairy cows – 4 dairy processing plants.

According to the reorganisation plan, Yuexiu Group has invested up to USD0.47 billion (RMB3 billion) in the business – including USD0.31 billion (RMB2 billion) for a 67% stake and USD0.16 billion (RMB1 billion) of loans to pay off debts incurred during Huishan Dairy's liquidation and to supplement its operational cash flow.

As Guangzhou's largest SOE and the parent company of five listed companies, Yuexiu Group is valued at over USD109.9 billion (RMB700 billion). Two of its notable dairy businesses are Fengxing Milk (Guangzhou Fengxing Milk Co., Ltd.) and Great Wall Dairy (The Great Wall Dairy of Zhangjiakou Co., Ltd.). Over the period Jan.-Oct., 2021, it achieved revenues of USD10.17 billion (RMB64.8 billion) and gross profit USD2.04 billion (RMB13 billion).

Core Business – IMF

This is key to the development plan of Yuexiu Huishan. The company's products are differentiated by using milk from Jerseys (with a milk fat percentage 1.5 X that of Holsteins' milk and a protein content of 3.8%+). Since 2010, Huishan Dairy has started to import Jerseys and it operates China's largest farms for this breed.

Liquid Dairy

Yuexiu Huishan's chilled milk range has built up a strong customer base in the northeast, and is complemented by its *"Great Wall Dairy"* in the north and *"Fengxing Milk"* in the south, signifying its nationwide aspirations.

On 30 Nov.-2 Dec., it held liquid milk distributor conferences in Yingkou City and Shenyang City, Liaoning Province, and in Changchun City, Jilin Province respectively. At these several new products were launched– *"Huishan A2β-Casein Pure Milk"* (UHT milk), *"Huishan 3.7% Fresh Milk (chilled)"*, *"LuxeJersey Cheese Milk"(flavoured fermented milk)*, *"Coffeelatte Milk"*, *"Huishan Jiexi (translated from English "Jersey" by pronunciation) Yoghurt"* and other fermented milk products in multiple flavours.

Updates on Yili's Investment in Ausnutria

Summary: *On 10 Dec., Yili highlighted that it had received a green light from SAMR in regard to its investment in Ausnutria.*

On 10 Dec., Inner Mongolia Yili Industrial Group Co., Ltd. (Yili, Stock Code: 600887) revealed Decision Letter (No. 734) from the State Administration for Market Regulation (SAMR) on 8 Dec. which confirmed that no further anti-monopoly review is to be conducted on Yili's acquisition of Ausnutria, and so should speed up the conclusion of this deal.

Yili also mentioned that Ausnutria will not see major changes in its business structure, and that its new subsidiary will remain operationally independent and listed in the Hong Kong Stock Exchange after the acquisition completes.

Cooperation between Yili and Ausnutria looks set to focus on 4 main areas:

- Cooperative development of high quality and innovative products
- Production coordination to improve utilisation and efficiency of production facilities
- Purchasing of raw materials such as base powders and other dairy materials
- Joint efforts in product marketing to boost Ausnutria's brand awareness amongst Chinese customers and its competitiveness

This deal means Ausnutria will benefit from a cash injection of USD116.1 million (HKD905.4 million, USD1=HKD7.79625, dated 1 Dec., Hexun.com). The plan is for the proceeds to be split into 4 parts:

- 30% (=USD34.8 million (HKD271.5 million) to establish production facilities for raw materials. Ausnutria's annual report of 2019 showed an investment of around USD171.9 million (RMB1.1 billion) in the construction of production equipment and facilities for drying base powders from goat milk/whey. The 1st phase of this project will commence in Q2 of 2022
- 30% (=USD34.8 million (HKD271.5 million) will be reserved for future acquisitions of dairy or nutritionals businesses. Reportedly, Ausnutria is negotiating with an undisclosed nutrition and functional food company over such a deal, which if positive would likely be implemented in the first half of 2022
- 20% (=USD23.2 million (HKD181million) for upgrading its processing capacity and logistics functions in China, adding logistics and inventory facilities in its 3rd plant in Changsha City, Hunan Province (which has a site of 23,000 m^2)
- 10% (=USD11.6 million (HKD90.5 million) for brand building and business development projects
- 10% (=USD11.6 million (HKD90.5 million) to pay off debts to banks in Hong Kong / Netherlands, lowering the overall debt burden of the company

It is notable that nutrition and healthcare products are prioritised in both Yili's and Ausnutria's business planning activities:

- In 2019, Ausnutria took over Aunulife, an Australian probiotics brand
- In H1 2021, its nutrition division reported sales of USD10.7 million, up 3.5% YoY
- To ease the supply disruption it has faced over the pandemic period, Ausnutria decided to move a portion of Nutrition Care's manufacture of nutrition and herbal formulae to China this year

Ausnutria's expertise spans healthcare products, probiotics and FSMPs, outflanking most of its direct competitors and providing ample synergistic opportunities – this is surely what most attracted Yili to finalise this deal.

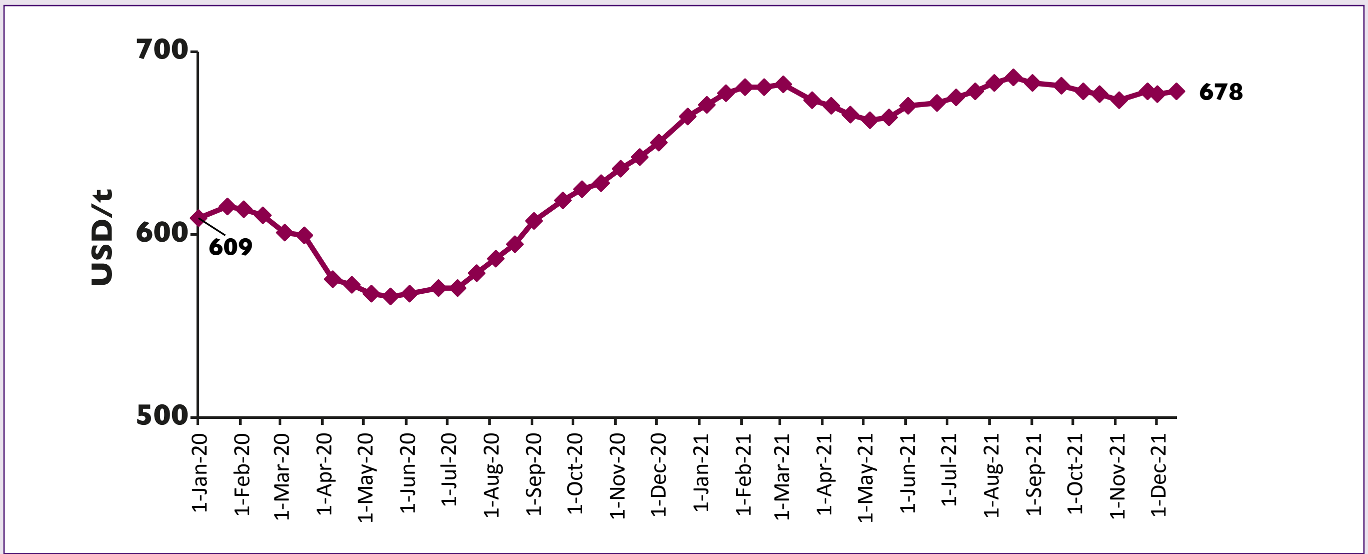
Raw Milk Supply

2021 Milk Prices End High

Summary: *In Nov., China's raw milk price started to pick up in the latter two weeks after a flat early period. Rising farming costs and market demand for dairy products are the drivers, expected to exert this effect until the end of year.*

The average milk price in 10 major dairy provinces was USD678/t (RMB4,320/t) in Dec., up by 1.2% vs. USD 670/t (RMB4,270/t) back at the start of the year in Jan. and up by 4.6% MoM. The increasing feed costs are regarded as the main driver for this situation.

FIGURE 1: National Average Raw Milk Price, Jan. 2020–Nov. 2021



Source: MARA (based on data from 500 county markets and milk collection stations)

Rising transport costs

Data collected in the 3rd week of Dec. reveals the national price of corn averaged at USD455/t (RMB2,900/t), up by 11.1% YoY; the price of soya bean meal was USD590/t (RMB3760/t), up by 9.0% YoY.

Due to series of traffic restrictions and control measures against the pandemic, provinces such as Jiangsu, Henan and Hunan faced difficulties in transporting raw materials for feed production and feed products, pushing up the logistics costs.

The results of this situation were waves of price hikes —two in May, one in June and one in Aug. — the biggest single increase of price over the year was the rise of USD68 /t (RMB435/t) seen in early Aug.

In the early Oct., Jiangxi New Hope Liuhe Feed Co., Ltd., Jiujiang Dabeinong Feed Technology Co., Ltd. and Alpha Feeds have raised their feed prices. For instance, the first of these lifted its price for pellet feed by USD23.6/t (RMB150/t) and for expanded feed by USD18.8/t (RMB120/t).

At present it seems that the price of raw materials for feeds will continue to rise, and more feed growers will increase their prices as a result of the overall tight supply.

Forage costs rise

The quality and quantity of silage corn was seriously affected by heavy rainfalls during the harvest period this year, especially in major growing provinces like Beijing, Hebei, Henan, Shandong, Shanxi. This led to tight supply and high prices, and even to panic buying in some regions. Conversely, the higher farmgate milk price has undermined supply contracts in many cases, making it difficult for some dairying businesses to survive.

- Silage corn: Inventories have been very inadequate. Only about one third of pastures met their harvest target and priced their corn silage at USD86/t-USD97/t (RMB550/t-RMB620/t) during the collection period. Soon after this, the prices shot up to USD110/t-USD126 (RMB700/t-RMB800/t), up roughly 50%-80% YoY
- Imported alfalfa surged to USD487/t (RMB3,100/t) this month from USD396/t (RMB2,520/t) last Dec
- Imported oat hay is now USD424/t-USD455/t (RMB2,700/t-RMB2,900/t) compared with USD323/t (RMB2,060/t) in Dec. 2020, up by 23%-31%

- Corn: This is now USD471/t (RMB3,000/t), up 25%-30% from USD424/t (RMB2,700/t) during the same period last year

Company Responses

The general response of large dairy farms to higher costs and feed shortages has been either to cut back on expenditures in other areas or seek better supply options.

- Modern Farming (Group) Co., Ltd. (Modern Farming) has worked on optimizing its farm management, including adjusting purchasing plans and feeding formulae as well as fortifying feeds
- China Shengmu Organic Milk Ltd. (China Shengmu, Stock Code: 01432) has started to import feed products directly from the supply chain centre in Tianjin where it can speed up feed purchasing by paying on shorter terms

The overall situation has put pressure on producers' profitability and the higher milk prices and production have not delivered the bottom line growth that might have been expected for many. Nevertheless, it remains the case that these 2 major producers did surprisingly well – in H1, Modern Farming and China Shengmu registered growths in net profits of 123% and 81.4% YoY respectively. Continued rises in the milk price must surely impact the main dairy processors in 2022, it would seem.

News in Brief

Dairy Imports in November 2021

China's dairy imports in November showed continued strong demand for WMP vs. last year, interesting in the context of WMP's drop by -3.3% at the latest GDT event. Volumes for SMP and cheese were also up, and YTD volumes for each of these segments are much increased.

Volumes for butter were surprisingly down last month after a continued strong run, though, with AMF also down. As anticipated demand for permeate from China's pig sector has eased, however, so whey volumes fell (even for WPC80 and WPI), and infant formula imports continued to fall away.

Local stocks are reportedly at reasonable levels but that doesn't seem to have taken away too much demand so far, but is a drop around the corner? We have been here before of course.

It's notable that some of these volumes these could have been higher still without the persistent shipping problems which have been hampering US supply into the market. This will be critical as whilst the US milk production increases continue, most of the European dairy industry looks to a future with less milk and New Zealand's milk production is down by about 3% at present – demand there for oil mixes used in IMF and lecithin for instantisation are reportedly low, whilst the typical move to do more custom products after the peak trading period doesn't seem to be happening.

TABLE 3: November Dairy Imports, tonnes

HS code	Product	202110	202011	202111	MOM	YOY
04011000	Milk & cream, fat ≤1%, not concentrated or sweetened	8,862.2	16,600.2	8,078.9	-8.8%	-51.3%
04012000	Milk & cream of >1% but ≤6% fat, not concentrated or sweetened	67,828.0	68,887.7	70,094.2	3.3%	1.8%
04014000	Milk & cream, 6%	16.8	5.3	7.5	-55.3%	41.8%
04015000	Milk & cream, fat >10%, not concentrated or sweetened	18,935.0	18,849.8	26,075.5	37.7%	38.3%
04021000	SMP	32,656.9	29,422.2	31,017.9	-5.0%	5.4%
04022100	WMP, unsweetened	32,634.0	44,504.5	64,429.5	97.4%	44.8%
04022900	WMP, sweetened	431.0	1,781.1	189.6	-56.0%	-89.4%
04041000	Whey and modified whey	49,956.1	60,952.9	48,679.4	-2.6%	-20.1%
04049000	Products consisting of natural milk constituents, nes	510.2	358.5	464.1	-9.0%	29.5%
04051000	Butter	5,313.2	9,206.3	4,829.5	-9.1%	-47.5%
04059000	AMF	1,064.9	1,771.2	1,445.1	35.7%	-18.4%
04061000	Fresh cheese, incl. whey cheese, curd	3,634.7	4,259.1	7,379.8	103.0%	73.3%
04062000	Grated or powdered cheese	1,390.6	3,729.9	4,352.0	213.0%	16.7%
04063000	Processed cheese	1,287.4	1,822.0	1,726.2	34.1%	-5.3%
04064000	Blue cheese	5.8	4.1	9.8	68.4%	137.8%
04069000	Cheese, nes	1,624.3	1,875.2	2,567.1	58.0%	36.9%
17021100	Anhydrous lactose, lactose wt.≥99%	9,833.8	7,797.1	9,637.7	-2.0%	23.6%
17021900	Lactose syrup & other lactose	158.9	1,095.8	823.7	418.5%	-24.8%
19011010	Infant formula	19,961.3	29,223.3	25,062.6	25.6%	-14.2%
35011000	Casein	1,199.5	858.8	982.8	-18.1%	14.4%
35019000	Caseinates	1,918.4	1,967.3	2,396.5	24.9%	21.8%
35022000	WPC80/WPI	2,371.5	3,455.4	3,180.5	34.1%	-8.0%

Source: China Customs

Zhuangyuan Pasture's "Old Lanzhou Yoghurt" Found with Excessive Mould

On 10 Dec., the Gansu Provincial Administration of Market Regulation identified 43 batches of foods found to be non-confirming to regulations. These included beverages, condiments, honey products, dairy products, foods in catering service, vegetable products, starch / starch-based products, instant foods, stir-frying foods, nut products and edible agricultural products.

One such product was *"Old Lanzhou Yoghurt"* (a flavoured product in 140 g cups, production date: 10 April, 2021) produced by Lanzhou Zhuangyuan Pasture Co., Ltd. (Zhuangyuan Pasture, Stock Code: HK.01533). The product was found to have a mould count at 90 CFU (colony forming units)/g – which exceeds the standard limit of 30 CFU/g.

The aerobic plate count in foods is an indicator for bacterial populations on a sample and in principle reflects the sanitary status in the production of foods. However, in this product's case, the high mould count was caused by incorrect storage by its distributors.

Milkfly: Meeting Daisy Natural Cheese Stick Launches

On 28 Nov., Miaofei Jiangsu Food & Technology Co., Ltd. (Milkfly) launched a *"Meeting Daisy Natural Cheese Stick"* to expand its cheese range.

On 22 Nov., the revised *National Food Safety Standards — Cheese (GB 5420-2021)* entered into effect, requiring the whey protein/casein ratio in cheese products (except whey cheese) to be the same as in cow milk, and laying out terms/conditions for hardness and fat content indicators.

In line with the latest requirements, the *"Meeting Daisy Natural Cheese Stick"* contains milk (≥78%), concentrated milk protein (≥13%), whipping cream (≥1%) — dairy content makes up 92%+ of the product, with each 100g providing 750 mg of calcium and 12.2 g of protein.

Established in July 2019 and with registered capital of USD11.5million (RMB73.5 million), Milkfly mainly engages in the development, production and sale of cheese products especially for children. The range comprises 3 series – *"0 Sucrose Cheese Stick", "Milkfly Growing-up Cheese"* and *"Milkfly Mozzarella"*, and this launch shows its confidence in the cheese stick segment's prospects.

China Imports Milk Powders from Brazil

On 5 Nov., the first small batch of milk powder manufactured by Brazil's Central Cooperativa Gaúcha Ltda (CCGL) arrived in China. Currently CCGL has 3,500 farmer members.

This shipment included WMP, SMP and lactose-free milk powder, with 2 further containers scheduled to ship to China in the near future according to CCGL.

China began discussions over Brazilian dairy supply back in 2007, but only authorised market access for 24 Brazilian dairy firms in July 2019 – the list of authorised exporters now comprises 33 firms cleared as tuberculosis-free and brucellosis-free and able to offer export documentation showing product traceability from production to processing.

The Brazilian dairy association is encouraging exports to both China and Russia. But historically Brazil has proven an inconsistent dairy exporter all round, and supply to China has been negligible – will this be any different?

FrieslandCampina's Friso IMF Promotion Penalised

In early Dec., Friesland Campina Trading (Shanghai) Co., Ltd. was fined USD314,000 (RMB200,000) by the Administration for Market Regulation of Huangpu District, Shanghai for illegally advertising its IMF as a complete or partial substitute for breast milk, leading to the ad's prompt removal.

The Administration received a report back on 16 July, 2020 on this ad for Friso Prestige Stage 1, a product imported from the Netherlands in 800g cans and selling on the Friso Prestige Flagship Store on Tmall.com. After an investigation, promotional claims such as *"naturally contains Milk Fat Globule Membrane (MFGM), structured lipid OPO, natural lactoferrin", "decoding rare nutrition in breast milk"* and *"(formulation) close to the composition of breast milk"* were in breach of the article 21 of the Advertisement Law: *"Advertising in the mass media or in public places of dairy products, beverages and other foods for infants that claim to be wholly or partly a substitute for breast milk is prohibited"*.

This requirement was underscored in June 2019 in the *Action Plan for Promotion of the Domestic Infant Milk Powder Formulae* published by the State Administration for Market Regulation (SAMR), and remains a key part of the national *Action Plan for Promotion of Breastfeeding (2021-2025)* issued on 23 Nov., 2021.

Jialihe Animal Husbandry Sets Up in Gansu

On 2 Dec., Tianjin Jialihe Animal Husbandry Co., Ltd. (Jialihe Animal Husbandry) moved the 1st batch of 5,000 dairy cows from its existing farms to its new farm in Gansu Province in line with its agreement with the local government in July to develop a High-quality Dairying Program there.

Farm details are as follows:

- Total investment: USD 157 million (RMB1 billion)
- Location: Dengmaying Lake Area, Nanhu Village, Liangzhou District, Wuwei City, Gansu Province
- Area: 45.18 ha
- Herd size: scheduled to reach 16,000 dairy cows in total
- Production: 101,200 tonnes of milk worth USD 72.2 million (RMB460 million) per year
- Feed consumption: Corn feed will be sourced from the 3,333 ha of local growing area

Set up in 2007 by the state-owned Tianjin Food Group with registered capital of USD 61.2 million (RMB390 million), Jialihe Animal Husbandry runs 17 large-scale dairy farms, and owns Tianjin Jialihe Feeds Co., Ltd. To date it has 38,000 dairy cows and sells approximately 221,000 tonnes of milk annually.

Lesson Dairy Starts Farm Construction

On 3 Dec., Yunnan Royal Lesson Dairy Co., Ltd. (Lesson Dairy) signed an investment agreement with the provincial Government to set up a 10,000+ dairy demonstration farm. Scheduled to break ground this month, this smart farm is to be an integrated business combining feed/forage growing and dairy farming, agriculture and tourism.

Farm details are as follows:

- Total investment: USD78.5 million (RMB500 million) — USD39.3 million (RMB250 million) in fixed assets and USD39.3 million (RMB250 million) in livestock and other biological assets
- Location: Dacang Town, Weishan Yi and Hui Autonomous County, Yunnan Province
- Scale: 1,533 ha
- Projected herd size: A total of 10,000 dairy cows will be introduced by the end of 2025
- Construction period: The construction work is set to start this month, and to complete by end-June 2023

Founded in May 2018 and with registered capital of USD8.4 million (RMB53.8 million), Lesson Dairy is an integrated dairy business with activities ranging from dairy farming to R&D, production and sales of 80+ dairy products spread across 6 categories — yoghurt, fresh milk, UHT milk, milk beverages, cheese and plant-based protein drinks.

3 Batches of Goat Milk Products Fail Packaging Inspection

On 6 Dec., Shanghai Municipal Administration for Market Regulation identified 3 non-conforming batches of goat milk powder and dairy products in a Sample Check on (Excessive) Packaging of Dairy Products 2021.

80 batches of dairy products were sampled, and 3 failed to meet the packaging standard – *"Caprilac Instant Goat WMP"*, *"Caprilac Goat Milk Formula for the Middle-aged and Elderly"* (both imported from France) and *"Anmu Goat Milk"* (UHT milk – this is a brand of Shandong Anmu Dairy Co., Ltd., a goat milk company in Shandong Province with a range of powdered goat milk products, goat milk/milk beverage, goat milk cheeses etc).

The three were identified as not confirming with the *Requirements of Restricting Excessive Package – Foods and Cosmetics (GB 23350-2009)* and the *Food and Cosmetics Packaging Measurement and Inspection Rules (JJF 1244-2010)* in respect of their *"interspace ratio"* – this term refers to the ratio of unnecessary space within the final pack compared with the pack's total volume. The standard for interspace ratio for dairy products is ≤45%, whereas these were each higher than 45%.

Tianrun Dairy to Set Up Tianrun Qiyuan Dairy

On 8 Dec., Xinjiang Tianrun Dairy Co., Ltd. (Tianrun Dairy, Stock Code: 600419) announced plans to set up Tianrun Qituan Dairy Co., Ltd. (Tianrun Qituan) as a JV with the state-owned company, Shandong Qiyuan Development Group Co., Ltd. This is based on a cooperation agreement with the Qihe County Government signed earlier on 8 Sept., and aims to take advantage of Qihe County's strong milk supply capabilities.

Key data:

- Registered location: Qihe County, Dezhou City, Shandong Province
- Registered capital: USD47.1 million (RMB300 million) — USD24 million (RMB153 million = 51% stake) from Tianrun Dairy and USD23.1million (RMB147 million = 49% stake) from Shandong Qiyuan
- Business scope: Dairy farming and dairy processing
- Scale: A phase I project is proposed with an investment of USD62.8 million (RMB400 million) to build a plant capable of producing 100,000 t/a of dairy products

Tianrun Dairy indicated that this strategic investment aligns well with its plans to develop its business outside Xinjiang Uygur Autonomous Region.

Wei-Chuan O'Baby IMF Found to Contain Prohibited Substance

On 16 Dec., the Zhejiang Provincial Administration for Market Regulation published the *Food Safety Supervision Sampling Inspection Information Announcement (Issue 46, 2021)*. This showed that Wei-Chuan O'Baby IMF (stage 1, 108 g/can, production date: 9 Aug., 2021) manufactured by Hangzhou Wei-Chuan Biotechnology Foods Co., Ltd. (Wei-Chuan Biotech), was detected as containing 103.5 μg/kg of ethyl vanillin, a synthetic flavour. According to the National Food Safety Standard — Standards for Uses of Food Additives (GB 2760–2014), stage 1 formula must not contain flavours.

The regulators required immediate actions by the manufacturer to limit any risks, including thorough investigation and correction of the production steps and recall of non-conforming batches. Retailers are also urged to remove the product from their shelves.

Wei-Chuan Biotech was founded in 2005 with registered capital of USD10 million. It is a subsidiary of Taiwan's Ting Hsin International Group and competes in IMF with 3 core brands ("Wei-Chuan Aisijia", *"Wei-Chuan O'Baby"* and *"Meiruier"*), as well as marketing its range of powdered beverages (powdered beverages (fruit / protein / instant coffee, etc.).

PRIORITY ORDER FORM

Choose Type of Subscription

Single user PDF:	☐ 1 year US$2,915	☐ 2 years US$4,960	☐ 3 years US$6,560
Enterprise-wide license:	☐ 1 year US$7,290	☐ 2 years US$12,395	☐ 3 years US$16,405

Note: All subscriptions are invoiced in full on commencement of each subscription period

Your Details

Name:

Position:

Company:

Address:

Tel No:

E-Mail:

Fax:

Vat No. (EU only):

Signature:

Date:

To Order, Please Send Confirmation To:

Richard Field, Director, Orrani Consulting

E-mail: **richard.field@orrani.com**

Fax: +44-1225-430240