

# Dairy Products China News

## Guaranteed Exclusive Analysis

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Welcome to the November issue of Dairy Products China News.

This month's National Health Commission plan plans an easing of the government's COVID restrictions, but the local dairy businesses are still facing a difficult environment. This context makes the very mixed recent results of dairy sector businesses in China very easy to sympathise with. The Junlebao/ Yinqiao deal has definite logic to it. Few have emulated New Hope Dairy's figures, for instance. Likewise, few are in a position to raise their international profiles at present of course – except for the two majors which are yet to be seriously challenged, as Yili's position as the official dairy supplier at this month's G20 summit in Bali and Mengniu's similar role at the World Cup in Qatar emphasise.

Faltering demand coupled with the continued rapid growth in the country's milk production look increasingly problematic for exporters of commodities which the local industry can produce for itself. Infant formula is having a moment for reasons of channel mix, but in terms of ingredients once more we look to the whey complex where permeate and protein continue to benefit from relevance to local applications and from lack of domestic competitors. And in the B2C context, we are seeing increased level of innovation coming from the dairy and nutritionals industry in China – for instance, Danone has been filing a number of patents for products which it has developed in China. China's role in the world dairy market will become increasingly two-way in the future.

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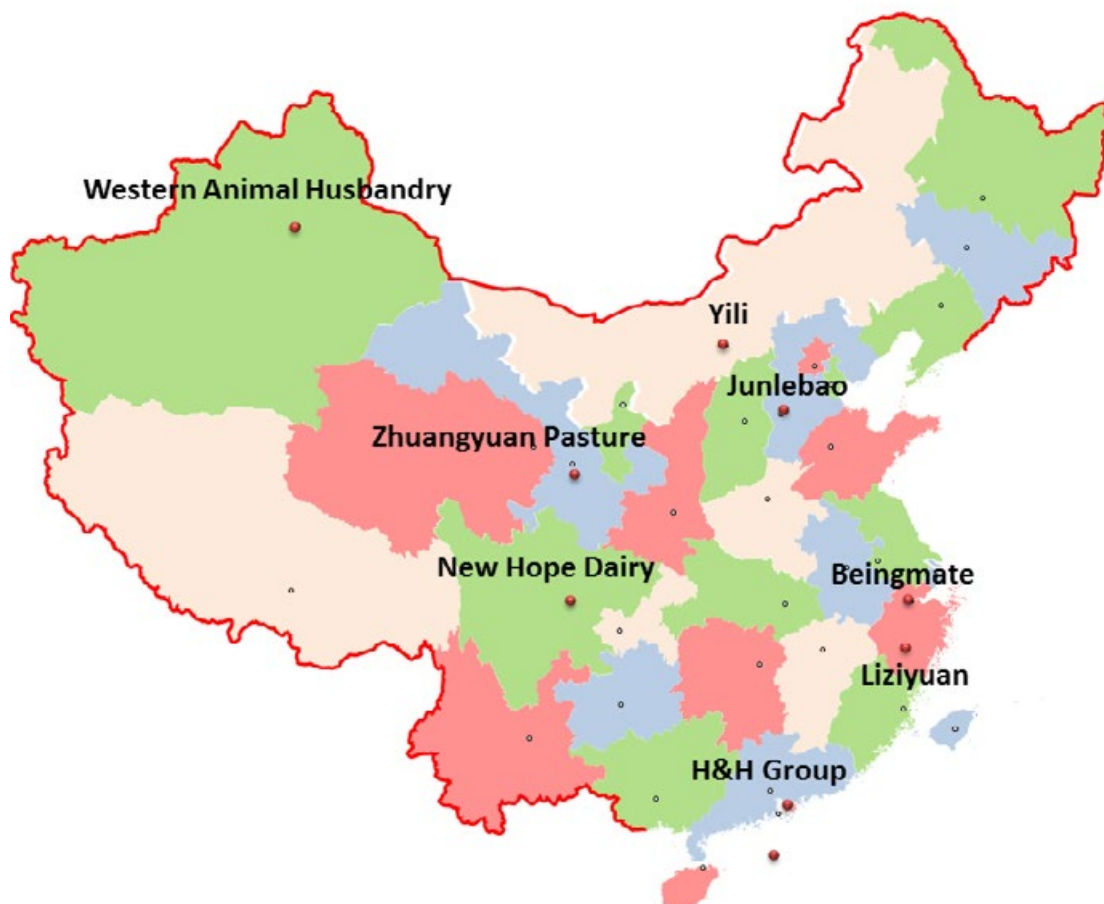
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## Headlines

- Two new large dairy farms have recently started operation in Hohhot City and Ulanqab City of Inner Mongolia.
- New Hope Dairy achieved double-digit growth in both revenue and net profits in Q3, with rising chilled dairy product sales highlighted in its "Fresh Cube" Strategy.
- In Q3, two regionally-focused dairy firms, Zhuangyuan Pasture and Western Animal Husbandry, reaped bumper profits, both up by over 50%.
- China's State Administration for Market Regulation (SAMR) has issued a consultation paper on the Labeling of Food for Special Medical Purpose (FSMP), and a ban on celebrity endorsements for FSMP.
- On 18 Nov., SAMR published the Detailed Rules for the Review of Production Licensing of Infant Formula Milk Powder.
- Yili's Q3 net profits dived but its overall Q1-Q3 earnings grew despite this.
- Milk beverage company Liziyuan reported Q3 net profit down over 20% and is planning to raise USD83.2 million (RMB600 million) for new capacity construction.
- On 4 Nov., SAMR disclosed details of Junlebao's acquisition of the core operating assets of Yinqiao Dairy, a move which will expand its position in the Shaanxi Province market.
- H&H Group reported total revenue of USD1.27 billion (RMB9.18 billion) in the first 3 quarters, with like-for-like growth of 13.4%. China accounted for 74.0% of the total. The company's core BNC segment continued to slide, however.
- China's milk price slipped in Nov., a combined result of oversupply and low demand that was partly linked with the record daily COVID-19 cases in some regions. However the coming Spring Holiday sales season and China's plan for easing epidemic restrictions step by step may spur demand in the future.

## Major Companies and Sites Mentioned in This Issue



## Market Analysis

### Two New Dairy Farms Start Up in Inner Mongolia

**Summary:** *Two new large dairy farms have recently started operation in Hohhot City and Ulanqab City of Inner Mongolia.*

Inner Mongolia Autonomous Region is the country's largest dairying region. According to the local department of agriculture and animal husbandry, there were 1.621 million dairy cows in the region, up 9.8% YoY in Q1-Q3 2022, with milk output of 4.32 million tonnes, up 11.3%. It is estimated that by the end of this year, the dairy herd will be over 1.63 million, and the milk output will be 7.2 million tonnes, an increase of 196,000 head and 470,000 tonnes respectively over 2021.

The region's "Nine policy steps for the revitalization of the dairy industry" issued in March targets a dairy products output of up to 10 million tonnes by 2025, giving an output value for the whole dairy supply chain of over USD41.62 billion (RMB300 billion).

In line with this, in late Oct., a 15,000-head dairy farm in Togtoh County of Hohhot City started operation, reportedly supplying all its milk to Yili.

#### Farm Profile

- Location: Togtoh County, Hohhot City, Inner Mongolia Autonomous Region
- Investor: Inner Mongolia Lixing Ecological Agriculture and Animal Husbandry Co., Ltd.
- Total investment: USD69.4 million (RMB500.0 million), 1% (USD0.69 million/RMB5.0 million) of which is for environmental protection
- Site area: 136.01 ha, including 8.70 ha for silage growing
- Scale: 15,000 head – 7,500 milking cows and 7,500 replacement cattle

- Capacity:
  - Raw milk – 80,000 tonnes
  - Sale of calves – 1,500 head
  - Elimination of replacement cattle – 186 head
- Construction period: April 2021 – April 2023
- Achievements to date:
  - Since Oct. 2021, this farm has imported 5,425 calves from Australia, and 2,000 dairy cattle embryos and 6,000 doses of frozen sex-sorted semen from the US
  - At the end of 2021, breeding took place and the first batch of heifer calves was born in Sept. this year with a survival rate of 95%
  - It is expected that the farm will have produced 60 tonnes of raw milk in the period from start-up in late Oct. to the end of the year, by when it should have 7,500 head; and will reach full operation with 15,000 head, producing 300 t/d of raw milk and revenue of around USD69.36 million (RMB500 million) by the end of 2024.

Inner Mongolia Lixing Ecological Agriculture and Animal Husbandry Co., Ltd. was founded on 28 Oct., 2020 with registered capital of USD4.2 million (RMB30.0 million). It mainly engages in dairy farming and breeding, forage planting, raw milk supply, and organic fertiliser processing and sale.

In early Nov., Liangcheng County Zhoujialing Town Gaonong Agriculture and Animal Husbandry Co., Ltd. began operation. It is a dairy farm wholly-owned by Liangcheng County Gaonong Animal Husbandry Co., Ltd.. It was founded

in April 2022 with registered capital of USD6.9 million (RMB50.0 million). Its parent is a largescale animal husbandry firm integrating dairy and fattening cattle farming, forage planting and processing, as well as agricultural tourism.

#### Farm Profile

- Location: Liangcheng County, Ulanqab City, Inner Mongolia Autonomous Region
- Investor: Liangcheng County Zhoujialing Town Gaonong Agriculture and Animal Husbandry Co., Ltd.
- Total investment: USD91.0 million (RMB655.8 million), 5.17% (USD4.7 million/RMB33.9 million) of which is for environmental protection
- Site & building area: 102.4 ha & 24.3 ha
- Designed full herd size and production: 25,000 dairy cows and raw milk output of 480 t/d or 175,000 t/a
  - The 1st phase construction includes introduction of 12,000 cattle (7,200 milking cows, 1,500 dry cows, 1,800 heifers, 1,440 calves) and the construction work has started this May, scheduled to complete in 3 years
- So far this farm has built 3 cow sheds holding 3,096 cows and purchased over 15,000 tonnes of silage corn.

Up to now, there are 35,000+ dairy cattle in Liangcheng County with daily output of raw milk at about 450 tonnes. This county is a quality milk source for both Yili and Mengniu and it is speeding up modernization of the local dairy industry, aiming to reach 100,000 head and a milk output over 1,500 t/d by 2025.

## New Hope Dairy: "Fresh Cube" Strategy Continues to Drive Sales in Q3

**Summary:** *New Hope Dairy achieved double-digit growth in both revenue and net profits in Q3, with rising chilled dairy product sales highlighted in its "Fresh Cube" Strategy.*

Despite the regional outbreak of COVID compounded by external pressures on dairy businesses, New Hope Dairy Holdings Co., Ltd. (New Hope Dairy, Stock Code: 002946) reports outstanding business performance in Q3 with revenue and net profit growing by double digits, in contrast to Yili, Bright Dairy, Sanyuan Foods, Milkground Food which saw their net profits down by 26.46%, 52.18%, 82.15%, 63.03% YoY, respectively.

In Q3, New Hope Dairy believes its "Fresh Cube" Strategy has driven sales of fresh milk and yoghurt, alongside some growth from new product launches. It also indicates that its move to digitalization has further lifted internal management efficiencies and helped offset external hits. For example, the high temperatures, power rationing and stricter epidemic control in July and August which initially disrupted its subsidiary Sichuan Xinhua Dairy Co., Ltd., were brought under control by an emergency plan and adjustment of its sales strategy, according to the group.

### Upbeat Category Performance in Q1-Q3

#### Fresh milk:

- Sales grew by 20%
- Its leading market share in the fresh dairy product category increased by 1.3%
- New launches such as "24-hour Fresh Milk", "Today Fresh Milk Shop" with pack designs featuring various Chinese cultural elements have done well, and also the new premium line "Black Gold 24-hour Jersey Milk"

launched in Sept. (China has many dairy firms producing Jersey milk like Huishan Dairy, Yili, Bright Dairy; this new product is New Hope Dairy's first ultra-premium product in its "24-hour Fresh Milk" range, marketed as having a better source of Jersey milk and only being on sale within 24 hours of production)

#### Fresh yoghurt:

- Quarterly sales have remained positive YTD
- Innovations launched including "Crystal Ball Yoghurt" (containing probiotics bubbles offering a distinctive chewing taste experience), frozen yoghurt and cheese-like yoghurt have boosted the category growth to certain degree
- New products are becoming the main performance drivers in New Hope Dairy; the company said it would keep pushing product R&D based on three fronts: functional health (with the "Crystal Ball Yoghurt" as a case in point), simple formulation (represented by "Chuxin Zero-sugar Yoghurt" line) and casual snacks (such as "Angry Yoghurt (fermented soda with probiotics)")

#### Company's outlook

New Hope Dairy said it would carry the "Fresh Cube" Strategy further in gearing up chilled products sales; on market expansion, it is facilitating distribution of its fresh brand Weipin Dairy in the southern markets of Guangdong, Guangxi, Hainan, Hongkong and Macau. On top of that, it mentioned a plan to increase its control of milk sourcing by investing further in dairying. To date, about 50% of New Hope Dairy's raw milk comes from its own 13 farms and those of Modern Dairy and AustAsia.

**TABLE I: Key Financial Indicators of New Hope Dairy, Q1-Q3 2022, USD million**

Item	Q1-Q3 2021	Q1-Q3 2022	YoY change	Q3 2021	Q3 2022	YoY change
Revenue	922.54	1,037.71	12.48%	323.8	374.56	15.68%
Net profit attributable to equity shareholders of the listed company	35.52	43.04	21.16%	15.25	16.8	10.19%
Net profit attributable to equity shareholders of the listed company excl. extraordinary gains/losses	30.61	34.33	12.13%	14.17	14.52	2.49%

Source: New Hope Dairy's report for Q3



## Two Regional Dairy Firms Mark Bumper Profits in Q3

**Summary:** In Q3, two regionally-focused dairy firms, Zhuangyuan Pasture and Western Animal Husbandry, reaped bumper profits, both up by over 50%.

Lanzhou Zhuangyuan Pasture Co., Ltd. (Zhuangyuan Pasture, Stock Code: 002910.SZ, 01533.HK) and Xinjiang Western Animal Husbandry Co., Ltd. (Western Animal Husbandry, Stock Code: 300106) are two regionally-focused dairy firms. In Q3 reports, they marked net profits up by 125.46% and 53.07% YoY, respectively.

### Zhuangyuan Pasture's Q1-Q3 results

#### Q3:

- Revenue: USD38.9 million (RMB280.4 million), up 10.12% YoY
- Net profit attributable to the shareholders of the listed company: USD3.0 million (RMB21.3 million), up 125.46% YoY
  - The growth in net profit is attributed to dairy product sales, as from this year the company's farms have supplied only its internal requirements
  - In H2 2022, its UHT dairy products accounted for 47.63% of the total revenue, up 91.52% YoY
- On 30 August, Zhuangyuan Pasture withdrew from the Hong Kong Exchanges (HKEX), after having been China's first A+H listed dairy company (both listed in Shanghai Stock Exchange (SSE) and HKEX). The company stated that it now plans to concentrate resources on enhancing the overall operation on the A share platform

#### Q1-Q3:

- Revenue: USD107.8 million (RMB776.8 million), up 5.63% YoY

- Net profit attributable to the shareholders of the listed company: USD4.2 million (RMB30.3 million), down 6.05% YoY

Zhuangyuan Pasture was established in 2000 and currently owns 8 dairy farms and 3 dairy brands "Zhuangyuan Pasture" (UHT/fresh milk, modified milk and chilled yoghurt), "Shenghu" (pure milk from Tibet Plateau) and "Dongdang Duoxian Pasture" (UHT milk and flavoured yoghurt aimed at school pupils). The company has been working on product differentiation and marketing in the northwest region, especially in Gansu, Qinghai and Shannxi – these regional markets contributed over 80% of its total revenue in H1 2022.

### Western Animal Husbandry's Q1-Q3 results

#### Q3:

- Revenue: USD48.8 million (RMB351.7 million), up 17.54% YoY
- Net profit attributable to the parent company: USD344,400 (RMB2.5 million), up 53.07% YoY

#### Q1-Q3:

- Revenue: USD135.0 million (RMB973.4 million), up 18.37% YoY
- Net profit attributable to the parent company: USD2.0 million (RMB14.6 million), 0.93% YoY
  - In H1 2022, dairy products comprised 82.77% of the company's total revenue, sales of which increased by 30.88%; other operations (feed processing, raw milk and beef sale) showed a 17.58% drop in revenue YoY
- Western Animal Husbandry explained that at present sales of dairy products produced from Xinjiang milk are better than two years ago: although the raw milk

prices in China overall are falling, the price of local milk has stayed relatively high, allowing double-digit growth in sales of dairy products; however, the net profit growth did slow down as a result of rising feed costs (compared with the 126.41% net profit growth in Q1-Q3 2021)

Established in 2003, Western Animal Husbandry is an integrated dairy firm with operations ranging from dairy farming to dairy product processing, feed production, livestock breeding, slaughtering and processing. Its dairy product processing is mainly handled by two companies in Xinjiang – Xinjiang Shihezi Garden Dairy Co., Ltd (a 60% owned subsidiary, acquired in 2011) and Xinjiang Tianshan Yunmu Dairy Co., Ltd. (a wholly owned subsidiary), both able to produce UHT milk, chilled yoghurt and milk formulae for adults and infants. Currently over 70% of Western Animal Husbandry's revenue comes from markets outside of Xinjiang, as the company is increasing investment in New Retailing formats such as group purchases outside Xinjiang to boost overall sales, in addition to the traditional sales channels – its own physical stores and sales agents).

In 2021, Yili and Mengniu had market shares of about 25% and 22% respectively across the full dairy/IMF market, close to half of China's dairy market. In recent years, they have pushed strongly into regional markets, eroding the profitability of regional dairy businesses in the process. However, those regional companies can differentiate themselves from national brands by leveraging their structural cost advantages and market knowledge to develop and marketing products meeting local consumers' needs – like Zhuangyuan Pasture; or they can push into other markets by making the best of their products with regional flavours – like Western Animal Husbandry.

**TABLE 2: Key Indicators of Zhuangyuan Pasture and Western Animal Husbandry in Q3 2022**

Company	Revenue, million USD	YoY change	Net Profit Attributable to the Parent Company, million USD	YoY change
Zhuangyuan Pasture	38.90	10.12%	2.95	125.46%
Western Animal Husbandry	48.80	17.54%	0.34	53.07%

Source: Financial Reports for Q3 2022 of Zhuangyuan Pasture and Western Animal Husbandry

## Governmental Direction

### New Regulations for FSMP Labelling

**Summary:** China's State Administration for Market Regulation (SAMR) has issued a consultation paper on the Labelling of Food for Special Medical Purpose (FSMP), and a ban on celebrity endorsements for FSMP.

Foods for special medical purposes or FSMPs are formulated to meet the special dietary requirements of people with restricted feeding, digestive and absorption disorders, metabolic disorders or specific diseases or conditions. In order to better regulate and supervise the category, the General Administration of Market Supervision and other relevant departments have released a draft Guidance for the Labeling of FSMP on 7 Nov. This requires feedback by 25 Nov., and comes after a new ban on the use of celebrity endorsers in FSMP advertising (see further below).

One FSMP segment is made up of formulae for special medical purposes. In China's IMF market, these account for around 20%-30% of sales. The essential nature of what they provide for infants with special physical conditions offers high profitability for brands, alongside high repurchase rates and customer loyalty – coupled with the advantages of the significant barriers to entry which characterise the category.

In recent years, Feihe Dairy, Yili, Synutra, Ausnutria, Yeeper Dairy, Yashili, Beingmate, AusNuotore, Wissun and others are focusing on the category, where the proportion of domestic products amongst those newly registered is rising.

#### Guidance for the Labeling of FSMP

The draft has made refinements in 13 areas: product name, product category, ingredient list, nutrition information, formula characteristics/nutritional characteristics, clinical trial, organization status, suitable people, consumption method and dosage, net content and specification, production date and shelf life, storage conditions, warning notes and cautions. In addition, it stresses that FSMP labelling should be true and standardised, scientifically accurate, clear and easy to understand, and should not contain false, exaggerated or absolutist language.

#### Basic Requirements and Content Requirements for Labelling FSMP for Infants

- **Prohibitions**

- Use of words of falsehood, exaggeration, violation of scientific principles, such as "special effects", "full effects", "superior effects"

- Use of words relating to healthcare functions, such as "strong"; expressing or implying functional uses that help improve intelligence, immunity, and intestinal conditions
- Use of words that mislead consumers, e.g. the use of homophones or similar words that may cause misunderstandings among consumers, such as "parental", "maternal", "bionic", etc.
- Use of images of babies or patients in label designs, and expressions such as "humanised milk", "breast milk" etc.

- **Other requirements**

- For FSMP for premature/low birth weight infants, the osmolality (the concentration of a solution expressed as the total number of solute particles per kg) of the product should be indicated on the product label and under the "Warning Notes and Cautions" in the instruction manual; and the label should include expressions of "For infants of 0-6 month age, the preferred diet is breast milk. This product should be consumed by premature/low birth weight infants when breast milk is unavailable, under the guidance of a doctor or clinical nutritionist" or similar statements
- FSMP for infants above 6 months should be labelled with the statement "This product should be consumed with complementary foods for infants over 6 months of age with special medical conditions".
- For imported FSMP for Infants the Chinese label needs to be directly added to each pack unit before entering the country.

#### Ban on the Use of Celebrity Endorsement in FSMP Advertising

On 31 Oct., the General Administration of Market Regulation issued the Guideline on Further Regulating Celebrity Advertising Endorsement Activities, prohibiting the use of celebrities to endorse FSMP (and also healthcare foods, medicines and medical devices) – a move coming after increasing advertisements making false claims. For the household-name dairy brands, this will likely have only a limited impact, but it is likely to affect some new brands looking to gain quick traction amongst consumers.

## Detailed Rules for the Review of Production Licensing of Infant Formula Milk Powder (2022 version)

**Summary:** On 18 Nov., SAMR published the Detailed Rules for the Review of Production Licensing of Infant Formula Milk Powder.

On 18 Nov., the State Administration for Market Regulation (SAMR) published *Detailed Rules for the Review of Production Licensing of Infant Formula Milk Powder (2022 version)*. These came into effect immediately, replacing the former version issued on 16 Dec., 2013 by the China Food and Drug Administration under the State Council. Any review of renewal/change/new application of IMF production licenses is now subject to the 2022 version.

The new rules include requirements on the production site, equipment and facilities, process flow, stuff management and management system in IMF production, stress food safety accountability linked to enterprises (IMF producers), and specify raw material control, production and processing risk prevention and control and traceability management – raising the bar to market entry and without doubt, the production costs as well.

### Major changes in 2022 version from the 2013 version

- Control of raw materials: Specified requirements are set for raw milk source, temperatures and times for storage and transport of milk, strain identification and traceability, etc.
- Traceability: A traceability system with strict monitoring measures is required throughout production, so

that products can be recalled and causes can be identified in the event of quality and safety problems

- Production equipment and facilities: Fluidised beds should use clean air after filtration, purification and dehumidification. Producers should introduce corresponding measures for self-inspection before production suspension and resumption
- Risk control: Producers are required to step up checks on substances in raw and auxiliary materials and production water that may affect product quality and endanger human health, formulating detailed prevention and control plans and conducting the required tests or checks
- Process and cleaning validation: Producers are required to develop plans for prospective, simultaneous or retrospective validation of key processes and realistic process parameters, generating corresponding validation reports.

### New Rules for raw material control

- Producers are required to have their own dairy farms (wholly-or part-owned) or contracted farms which they can supervise and audit regularly
- Raw milk should be stored at a temperature of no more than 7°C and for no more than 24 hours
- Producers should carry out safety monitoring and assess indicators of toxic and harmful substances (pesticide

and veterinary drug residues, heavy metals, etc.), pathogenic parasites and microorganisms, and biotoxins in raw milk, to comply with the provisions of the relevant national food safety standards and requirements

- When using base powders, producers are subject to requirements for safe transport and storage, and required to carry out full inspections of each batch of products and to set a reasonable period of use after the inspection

### Tightening regulations on production

- Producers that have packaging facilities but lack full production capabilities will not be granted production permits
- The definition of base powder is revised to being a "compound ingredient" rather than a "semi-finished product"; the base powder is "mainly made from cow or goat/sheep milk or the related milk protein products", changed from "mainly made from cow or goat/sheep milk or the related processed products"; the text now refers to adding nutrients and/or other excipients, changed from "with a portion of or without nutrients and/or other excipients"
- Producers are not allowed to produce or use base powders that meet the national standards for IMF, meaning they cannot repack from bulk milk powders that are qualified as IMF and then sell them as IMF products.

## Company Dynamics

### Yili Announces Steady Growth in Q1-Q3

**Summary:** Yili's Q3 net profits dived but its overall Q1-Q3 earnings grew despite this.

On 27 Oct., Inner Mongolia Yili Industrial Group Co., Ltd. (Yili, Stock Code: 600887) reported a much lower net profit for Q3 but steady growth in both revenue and net profit in Q1–Q3. Key financial data are as follows:

#### Q3 2022:

- Revenue: USD4.2 billion (RMB30.3 billion), up 6.72 YoY
- Net profit attributable to the parent company: USD267.6 million (RMB1.9 billion), down 26.46% YoY
- Net profit attributable to the parent after excl. extraordinary gains/losses: USD234.9 million (RMB1.7 billion), down 33.27% YoY
- The company attributed the drops in profit to the increased marketing expense compared with the same period of last year amid the current elevated market competition, and a reduction in financial assets held for trading.

### Q1–Q3 2022:

- Revenue: USD13.0 billion (RMB93.5 billion), up 10.42 YoY
- Net profit: USD1.1 billion (RMB8.1 billion), up 1.47% YoY
- Yili has grown for 29 years consecutively now, building and maintaining resiliency in its USD1 billion plus business through a diverse product portfolio which has allowed it to withstand the short-term hit to profits which has in part stemmed from the COVID-induced market uncertainties.

### Q1-Q3 Category Performance

#### Liquid dairy

- Sales were down 0.95% YoY over the period, but down 4.7% YoY in Q3
- This reflected China's sharp increase in COVID-19 cases and strict regional control measures, especially in the 3rd and 4th tier cities which are the new high-focus markets for the dairy industry. These factors dampened the liquid milk operation to a certain extent, even though Yili still topped the category

#### Powdered milk products and other dairy products:

- Sales grew 60.50% YoY with growth in IMF as well as formulae for adults outpacing their respective categories
- IMF: Although the industry continues to experience a decline due to the low birth rate and consumers delaying having children, Yili said it would focus

on becoming more integrated in its approach to this business, where it is confident it can continue to increase its market share

- Adult formula: It expects to maintain good growth here, given China's increasingly aging population

#### Cheese:

- Its sales here increased by more than 30% YoY, and its retail market share overtook Milkana to move into 2nd place, behind only Milkground Food
- Next year, on the basis of increasing the market share, Yili noted it will prioritise improved margins on its cheese products

#### Ice cream and popsicles:

- Sales rose 32.43% YoY
- Its main ice cream range "Yili Qiaolezi" achieved sales of almost USD69.4 million (RMB5.0 billion), accounting for over 50% of its total sales from this category.

Yili remains positive over prospects for Q4, in terms of both demand (with dealers currently actively purchasing in preparation for the Spring Festival seasonal sale) and cost control (with relatively stable raw milk prices and likewise a stable competitive landscape). It intends to persist in its efforts to build up its sales channels. Its overall estimate for Q4 is to achieve double-digit growth in revenue along with higher profit margins, enabling positive annual results overall.

**TABLE 3: Yili's Revenue Split by Main Business, Q1–Q3 2022**

Product category	Revenue, USD billion
Liquid dairy (UHT/fresh milk, modified milk, chilled and ambient yoghurt, etc.)	8.89
Powdered milk products and other dairy products (cheese, cream, etc.)	2.60
Frozen drinks (ice cream/popsicles)	1.28
Others (bottled water, plant-based dairy substitutes, functional dairy, new business e.g. beef)	0.04
<b>Total</b>	<b>12.81</b>

Source: Yili's Report for Q3 2022



## Liziyuan's Q3 Net Profit Slides by 20%+

**Summary:** Milk beverage company Liziyuan reported Q3 net profit down over 20% and is planning to raise USD83.2 million (RMB600 million) for new capacity construction.

On 28 Oct., milk beverage producer Zhejiang Liziyuan Food Co., Ltd. (Liziyuan) announced its Q3 2022 revenue and net profits down by 3.77% and 21.10% respectively. It is the 4<sup>th</sup> consecutive quarterly decline in

net profit after -4.35% in Q4 2021, -23.59% in Q1 2022 and -17.62% in Q2 2022. The company also proposed to raise USD83.2 million (RMB600 million) for building new capacity in milk beverages.

Liziyuan was founded in 1994 and listed on the Shanghai Stock Exchange (SSE) in Feb. 2021. According to the China Food Industry Association, in 2018, it ranked 7<sup>th</sup> in the dairy drinks market,

after Yili, Mengniu, Hangzhou Wahaha Group, Yakult, Xiaoyangren Biological Dairy and Juneyao Dairy – and led the sweet milk drinks segment. It now has 5 production plants (Jinhua City and Longyou County in Zhejiang Province, Shanggao County in Jiangxi Province, Qujing City in Yunnan Province and Hebi City in Henan Province) with 30+ production lines providing 400,000 t/a capacity for milk beverages and other drinks.

**TABLE 4: Key Quarterly Data of Liziyuan in 2022**

Item	Q1-Q3 2022		Q3 2022	
	Amount, USD million	YoY change	Amount, USD million	YoY change
Revenue	147.26	0.59%	50.08	-3.77%
Net profit attributable to equity shareholders of the parent	21.52	-20.44%	7.23	-21.10%
Net profit attributable to equity shareholders of the parent excl. extraordinary gains/losses	18.31	-26.89%	6.75	-25.23%

Source: Liziyuan's Financial report for Q3 2022

### Slow Growth in Core Category and Failure in NPD

Liziyuan shows heavy reliance on the sweet milk drinks which dominate its total revenue, supplemented by its other series such as formulated milk beverages, fermented milk beverages and mixed protein beverages.

In July, it raised prices for 90% of its products by 6%-9% to offset the increases in raw materials and energy

prices. However this failed to achieve the growth intended, despite Q3 being a key season for beverage sales.

In Q1–Q3, Liziyuan's milk beverages sales were USD142.8 million (RMB1.0 billion), up slightly by 0.34% YoY, making up 96.91% of its total revenue. In Q3 alone, the sales revenue from milk beverages was USD48.4 million (RMB349 million).

The company has been launching new products over recent years, such as 0-fat LAB drinks, "Stinky Milk" (durian flavoured), fruit and vegetable yoghurt, and coffee latte, trying to find new areas of growth, yet it has seen poor market results. In Q1–Q3, its sales of products than milk beverages were just USD4.0 million (RMB28.6 million), up by 9.21% YoY but much lower than the growth of 90.29% it saw in Q1.

**TABLE 5: Liziyuan Revenue by Category, USD million**

Category	Q1-Q3 2021	Q1-Q3 2022	YoY change
Milk beverages	142.24	142.72	0.34%
Others (mixed protein beverages, plant protein beverages, fruit and vegetable juice drinks, etc.)	3.63	3.97	9.21%
<b>Total</b>	<b>145.87</b>	<b>146.68</b>	<b>0.56%</b>

Source: Liziyuan's Financial report for Q3 2022

## Continuous capacity expansion

Meanwhile, it plans to issue convertible bonds to raise USD83.2 million (RMB600 million), 80.93% (=USD67.4 million/RMB486 million) of which will be for a 150,000 t/a milk beverage capacity expansion and technology transformation project in Jinhua City, Zhejiang Province.

Details of the 150,000 t/a milk beverages project

- Construction schedule: The work divides into a 1<sup>st</sup> phase of 2 years and a 2<sup>nd</sup> phase of 1.5 years

- Construction content:
  - To add 3 new 450mL/bottle milk beverage production lines with a combined capacity of 80,000 t/a, and a new end-product warehouse
  - To transform 3 existing outmoded production lines into 2 upgraded 450mL/bottle milk beverage lines and a 225mL/bottle milk beverage line, giving a rebuilt capacity of 70,000 t/a in all
  - To add digital software and hardware for plant digitalisation,

and photovoltaic panels and other supporting facilities like electricity infrastructure, heating, ventilation and air conditioning (HVAC).

As the first production plant of Liziyuan, this plant supplies the company's key markets in East China and has been under great production pressure with capacity utilisation exceeding 125%. However its equipment and facilities are outmoded and suffer high energy consumption, so the proposed project aims to cut back on labour costs and improve overall production efficiency.

## Junlebao to Buy Core Operations of Yinqiao Dairy

**Summary:** On 4 Nov., SAMR disclosed details of Junlebao's acquisition of the core operating assets of Yinqiao Dairy, a move which will expand its position in the Shaanxi Province market.

On 4 Nov., the State Administration for Market Regulation (SAMR) published details of the acquisition by Junlebao Dairy Group Co., Ltd. (Junlebao) of the core assets of Xi'an Yinqiao Dairy (Group) Co., Ltd. (Yinqiao Dairy). The publicity is from November 4, 2022 to November 13, 2022.

According to the disclosure, the acquisition comprises Yinqiao Dairy's operational assets related to UHT/fresh milk, ambient/chilled yoghurt, ambient/chilled lactobacillus drinks, modified milk and milk beverages, formulae for infants and adults, and processed cheese.

Xi'an is unique with both dairy cow and goat milk supply – the city held 24,000 dairy cattle and 177,000 dairy goats by the end of 2021. As one of the two main local processors alongside Xi'an Baiyue Sheep Milk Group Co., Ltd., Yinqiao Dairy has a very strong sales network with Shaanxi Province (north-central China) as the pivot point and spreading across the Northwest.

As a result, this deal looks set to exert a considerable impact on the national dairy industry. Statistics from the official publicity include both parties' market shares in China mainland by the end of 2021.

- Chilled yoghurt: Junlebao: 10-15%, Yinqiao Dairy: 0-5%, combined share: 10-15%
- IMF: Junlebao: 5-10%, Yinqiao Dairy: 0-5%, combined share: 5-10%

- Other dairy products (UHT/fresh milk, ambient/chilled yoghurt, ambient/chilled lactobacillus drinks, modified milk and milk beverages, formulae for adults, processed cheese, etc.): Junlebao: 0-5%, Yinqiao Dairy: 0-5%, combined share: 0-5%

At present, Junlebao owns 21 dairy plants and 17 largescale farms with a product portfolio encompassing IMF, chilled yoghurt, fresh milk and UHT liquid milk. In 2020, its revenue and net profit were USD2.1 billion (RMB14.5 billion) and USD77.7 million (RMB538 million) respectively. In 2021, the annual revenue jumped nearly 40% to USD3.1 billion (RMB20.3 billion) YoY, and its sales volume of powdered milks and formulae for infants and adults exceeded 100,000 tonnes.

Ranked amongst the country's dairy industry top 4, this July Junlebao launched an IPO process to list on the Hong Kong Stock Exchange by 2025, targeting sales of USD6.9 billion (RMB50.0 billion). This acquisition is a critical move for it to scale up its goat milk powders operation and expand its liquid dairy business in Shaanxi and other regions in the Northwest.

Founded in 1978, Yinqiao Dairy owns major brands: "Yinqiao" (liquid milk, a household name locally), "Qinyong" (cow and goat milk formulae and sweetened WMP), "Sunshine Baby" (cow formula) and "Aibaorui" (pure goat milk formula). It was the first Chinese dairy company to go public overseas when it brought a shell company TSM Resources listed on Singapore exchange in 2003, later delisting in 2016. It ranked 60th in the "2021 Top 100 Enterprises in Xi'an" list with a revenue of USD499 million (RMB3.5 billion) in 2020.

## H&H Group's Revenue from China Remains Stable in Q1-Q3

**Summary:** H&H Group reported total revenue of USD1.27 billion (RMB9.18 billion) in the first 3 quarters, with like-for-like growth of 13.4%. China accounted for 74.0% of the total. The company's core BNC segment continued to slide, however.

H&H Group (Stock Code: HK. 01112) reported its Q1-Q3 results on 15 Nov., with revenue up 13.4% YoY to USD1.27 billion (RMB9.18 billion), driven by growths in its Baby Nutrition and Care and Adult Nutrition and Care segments in and by the Australia and New Zealand markets, as well as by the especially the strong performance of Pet Nutrition and Care worldwide. China remains the group's key market though, accounting for 74.0% of its total revenue for the period and up 5.7%.

### Segment Performance for 3Q 2022

- **Baby Nutrition and Care (BNC)** = 51.7% of total revenue, sales down 1.4% YoY

- IMF: 3Q sales slipped by 2.2% (vs. -3.1% in H1); channel inventory level has stayed stable
- Cow and goat milk formulae sales were down by 2.0% and 4.5% YoY respectively
- **Biostime:** it achieved market shares of 5.6% of China's IMF market overall, and 4.2% in goat IMF; it has been achieving single-digit growth in the ultra-premium segment
- **Probiotic supplements'** sales increased by 14.2%, supporting its leading position in the market
- **Adult Nutrition and Care (ANC)** = 36.7% of total revenue, with sales up 20.8% YoY
  - Swisse in China continued to rise by 22.8% YoY and represented 62.8% of ANC sales; the brand topped China's online healthcare market with a 7.2% market share

- Its sales in the Australia and New Zealand market maintained growth, achieving a 12.2% market share
- **Pet Nutrition and Care (PNC)** = 11.6% of total revenue, with sales up 26.1% YoY (+52.3% in China and +20.6% in North America)

H&H Group stated it will continue to deepen its focus on family nutrition and healthcare. In line with the coming implementation on 22 Feb. 2023 of the new standards – Infant Formula Foods (GB 10765-2021), Formula Foods for Older Infants (GB 10766-2021) and Formula Foods for Young Children (GB 10767-2021) – and to offset the impact of the slowing birth rate, the company is prioritising channel strategy and consumer education in a bid to reinforce its position in the market. To boost probiotics sales, it aims to develop new markets, improve offline distribution and build up the Biostime brand in the sector.

**TABLE 6: H&H Group Revenue Split by Segment & Geography, Q1-Q3 2022, USD million**

By segment	Q1-Q3 2021	Q1-Q3 2022	Change	Q3 2021	Q3 2022	Change
Baby Nutrition and Care (BNC)	668.32	658.8	-1.40%	210.58	217.09	3.10%
IMF	515.67	504.27	-2.20%	163.11	162.68	-0.30%
Probiotic supplements	96.57	110.13	14.00%	32.14	41.55	29.30%
Other infant products	56.08	44.41	-20.80%	15.33	12.86	-16.10%
Adult Nutrition and Care (ANC)	407.01	467.28	14.80%	142.52	183.36	28.70%
Pet Nutrition and Care (PNC)	47.9	148.1	209.10%	17.59	47.5	170.00%
By region	Q1-Q3 2021	Q1-Q3 2022	Change	Q3 2021	Q3 2022	Change
Mainland China	890.98	941.54	5.70%	289.81	331.85	14.50%
Australia and New Zealand	131.5	150.96	14.80%	48.56	54.88	13.00%
North America	30.94	120.14	288.40%	9.92	40.93	312.50%
Other regions	69.81	61.54	-11.80%	22.41	20.3	-9.40%
<b>Total</b>	<b>1,123.24</b>	<b>1,274.18</b>	<b>13.40%</b>	<b>370.69</b>	<b>447.95</b>	<b>20.80%</b>

Source: H&H Group's Q1-Q3 Report

## Raw Milk Price

### November Milk Price on a Slight Decline

**Summary:** China's milk price slipped in Nov., a combined result of oversupply and low demand that was partly linked with the record daily COVID-19 cases in some regions. However the coming Spring Holiday sales season and China's plan for easing epidemic restrictions step by step may spur demand in the future.

In the week ended 9 Nov., China's raw milk price averaged USD572.97/t (RMB4,130/t), down by 0.5% MoM and by 3.7% YoY. This comes after the short-term recovery seen since Aug. From the January average of USD591.70/t (RMB4,265/t) – the highest price point YTD – the November milk price was down by USD18.73/t (RMB135/t).

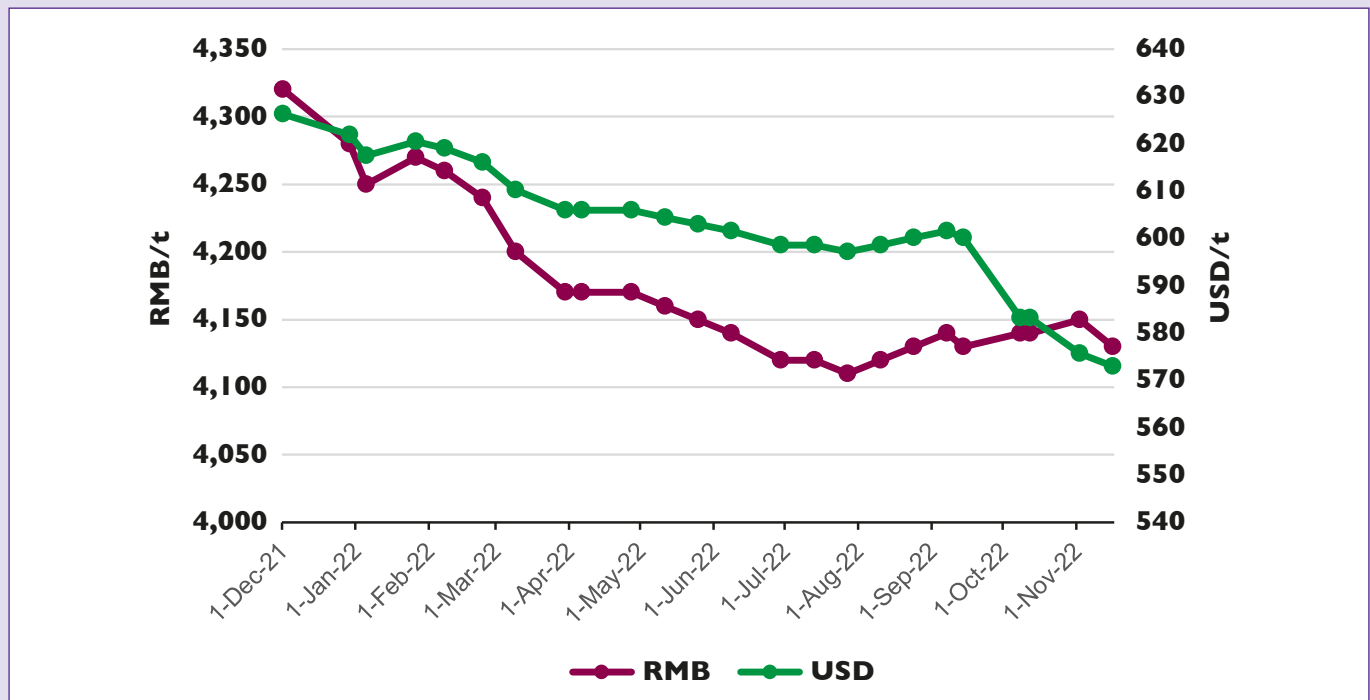
So no real relief here for China's milk producers, despite being in what is normally a period of strong demand.

- On the supply side, national milk production in Q3 grew by 6.8% YoY to 10.4 million tonnes, contributing

to the recent oversupply – this with still more new dairy farms due to start operations

- On the demand side, some regional consumer markets were hit by the recurring epidemics – a record number of new daily cases was reported in populous cities Zhengzhou, Guangzhou and Beijing this month. Nonetheless, the dairy consumer market may well recover gradually after the State Council released 20 Measures to Optimise Epidemic Prevention and Control on 11 Nov. – these stressed strong efforts to minimise the impact of the epidemic on economic and social development
- According to the National Bureau of Statistics, the national dairy product production in Oct. was 2.757 million tonnes, up 5.2% YoY; while preparations for the Chinese New Year starting rather earlier than usual on 22 Jan. 2023 provide some optimism for the dairy market in Q4

**FIGURE 1: Trends in China's Raw Milk Price, Dec. 2021–Nov. 2022**



Source: Ministry of Agriculture and Rural Affairs (MARA)

### Feeds market

Data released on 9 Oct. by the Ministry of Agriculture and Rural Affairs (MARA) show:

- The national price of corn averaged USD 421.75/t

(RMB3,040/t), leveling off from the first week of the month but up 5.2% YoY

- The national price of soybean meal averaged USD771.35/t(RMB5,560/t), up 1.3% from the first week of the month and jumping 46.3% YoY

- Forage import: YTD September China imported alfalfa at an average CIF price of USD492.31/t, up 33.1% YoY; prices of imports from the US, Spain and South Africa have increased to varying degrees; the majority of China's oat hay imports were from Australia, at an average CIF price of USD423.64/t, up 27.3% YoY

In addition to feed costs, which have remained high, the overall operating costs of dairy farms have risen under the epidemic, along with increases in costs of labour, epidemic prevention, energy, transports and other raw materials.

#### Farm operators

To stay in profit, farm operators introduce adopted varied measures to reduce costs and increase efficiency.

- China Shengmu:
  - Raw milk price reportedly averaged to USD457.82/t (RMB3,300/t) in H1, and its feed cost was up 6.6% YoY to USD374.58/t (RMB2,700/t); gross profit margin dropped by

6.3% to USD71.14 million (RMB512.8 million), and gross profit ratio was also down, by 4% to 33.1% YoY. The company said it is expanding procurement channels to reduce procurement costs

- Youran Dairy:
  - Feed costs were reported to be USD337.12/t (RMB2,430/t) in H1 on average, up 14.6% YoY. The gross margin of its raw milk business was under pressure due to the significant increase in bulk raw material prices. Youran Dairy indicated that it would increase its feed production to ensure internal supply
- Modern Dairy:
  - Raw milk costs went up from USD382.90/t (RMB2,760/t) to USD402.33/t (RMB2,900/t) in H1. The company said it would optimise dairy rations while continuing to improve cow health and yields, and make use of centralised purchase platforms to limit surging feed prices.



## News in Brief

### Dairy Imports in October 2022

The October import volumes remained disappointing in most cases. Some exceptions are whipping cream and AMF, believed to reflect growth in the bakery sector and concerns over future availability from New Zealand. Infant nutritionals also continued their increased seen from July, reflecting improved logistics into the market from overseas as pandemic-related problems have eased. This also derives from the failure to control COVID-19 effectively in China – this has affected offline sales of infant formulae, meaning that some demand has shifted to E-commerce channels where international brands are stronger as well as more diverse distribution channels like Daigou (purchasing agents) and cross-border online shopping app/platforms.

**TABLE 7: 2022 October Imports, tonnes**

HS code	Product	202110	202209	202210	MOM	YOY
04011000	Milk & cream, fat ≤1%, not concentrated or sweetened	8,862.2	6,942.6	7,764.9	11.8%	-12.4%
04012000	Milk & cream of >1% but ≤6% fat, not concentrated or sweetened	67,828.0	51,015.8	37,137.7	-27.2%	-45.2%
04014000	Milk & cream, 6%	16.8	0.0	3.2	/	-81.1%
04015000	Milk & cream, fat >10%, not concentrated or sweetened	18,935.0	20,947.3	25,569.9	22.1%	35.0%
04021000	Milk & cream in solid forms, fat ≤1.5%, concentrated/sweetened	32,656.9	25,090.9	22,295.5	-11.1%	-31.7%
04022100	Milk & cream in solid forms of >1.5% fat, concentrated, unsweetened	32,608.8	30,092.1	27,123.5	-9.9%	-16.8%
04022900	Milk & cream in solid forms of >1.5% fat, concentrated, sweetened	431.0	169.4	307.5	81.5%	-28.7%
04041000	Whey and modified whey	49,956.1	62,617.3	55,916.3	-10.7%	11.9%
04049000	Products consisting of natural milk constituents, nes	510.2	869.5	240.0	-72.4%	-53.0%
04051000	Butter	5,313.2	6,245.5	6,194.6	-0.8%	16.6%
04059000	Other fats & oils derived from milk	1,064.9	3,101.0	3,961.3	27.7%	272.0%
04061000	Fresh cheese, incl. whey cheese, curd	3,634.7	4,981.4	4,527.1	-9.1%	24.6%
04062000	Grated or powdered cheese	1,390.6	1,924.3	2,442.1	26.9%	75.6%
04063000	Processed cheese, not grated or powdered	1,287.4	2,030.1	1,459.6	-28.1%	13.4%
04064000	Blue-veined cheese, other-veined cheese prod. by penicillium roqueforti	5.8	11.8	10.3	-12.2%	77.0%
04069000	Cheese, nes	1,624.3	1,387.8	1,346.3	-3.0%	-17.1%
17021100	Anhydrous lactose, lactose wt.≥99%	9,833.8	10,188.5	11,343.4	11.3%	15.4%
17021900	Lactose syrup & other lactose	158.9	100.6	25.9	-74.3%	-83.7%
19011010	For infant food retail packaging formula, the defatted cocoa content < 5%	19,962.2	22,614.7	24,223.8	7.1%	21.3%
35011000	Casein	1,199.5	1,103.4	1,209.3	9.6%	0.8%
35019000	Caseinates	1,918.4	1,723.2	1,764.5	2.4%	-8.0%
35022000	WPC80/WPI	2,371.5	3,113.6	2,563.2	-17.7%	8.1%

Source: China Customs

## Dr. Cheese's First Super Factory Begins Production

On 1 Nov., Dr. Cheese (Shanghai) Food Technology Co., Ltd. (Dr. Cheese) announced the opening of its "Super Cheese Factory" in Langya District of Chuzhou City. Dr. Cheese is a startup company founded by Jason Chan, previously the General Manager of the Germany's DMK/Oldenburger consumer dairy business in China (cheese, butter, milk etc). Dr. Cheese started its business with "Round Cheese", produced by Vergeer Holland in the Netherlands. It grew with products made in China, mainly outsourced to Shandong Junjun Cheese Co., Ltd., which also produces as an OEM for many well-known names like Mengniu, Bright Dairy and Genki Forest.

This is Dr. Cheese's first factory and China's first cheese factory producing both natural and processed cheese, on a site of over 80,000 m<sup>2</sup>. According to the construction plan, the intention is to build 48 production lines for cheese, yoghurt, supplementary foods for infants, snacks and other dairy products with an investment estimated at USD138.73 million (RMB1 billion). So far 45 lines are operational, providing capacity of 43,000 t/a; the investment to date is given as USD59.66 million (RMB430 million).

At present, the company is planning to launch a new range of ambient yoghurt and supplementary foods for infants and snacks, to be produced in this new factory (with imported dairy ingredients) next year. It also plans to transfer the production of "Round Cheese" (100% natural cheese) from the Netherlands to this new site.

Meanwhile, it is segmenting its product range into 3 sub-ranges – "Growing up" (for babies), "High Nutrition" (high calcium and milk fat) and "Food Serving".

In Aug., the company launched 3 products in the "Food Serving" sub-range (as shown in the picture):

- One Piece for Each Meal (每餐一片™) High-nutrient Cheese (81% cheese)
- Cheese Fall (浓香瀑布™) Grated Mozzarella (100% natural (recombined) cheese)
- Cloud-like (轻盈云朵™) Whipping Cream (35% milk fat).

Founded in 2019, the emerging brand Dr. Cheese entered the cheese market by selling "Round Cheese" and has raised over USD13.87 million (RMB100 million) in three rounds of financing. It expects to achieve a 25-fold growth of GMV (gross merchandise volume) in omnichannel retailing operations in 2022 vs. 2021. In Q1-Q3 2022, its cumulative sales volume on online mainstream platforms such as Douyin and Kuaishou exceeded RMB200 million, up 224% YoY.

**PICTURE 1: Dr. Cheese's Food Serving Range**



Source: Dr. Cheese

## 70 New GB-Conforming IMF Products Approved in Q1-Q3

Since last year, Chinese dairy firms have been rushing to register formulations to conform with the new national standards for IMF – Infant Formula Foods (GB 10765-2021), Formula Foods for Older Infants (GB 10766-2021) and Formula Foods for Young Children (GB 10767-2021) – all of which become effective as of 22 Feb., 2023.

In Q1-Q3 this year, the Centre for Food Evaluation of the State Administration for Market Regulation has approved 603 IMF registrations. Only 70 are qualified under the new national standards for IMF, however, the others having been applied for before the new standard came out: this sub-group (12% of the total) comprises applications from Feihe Dairy, Wyeth, Yili, Eurbest, Junlebao, Wissun, Mead Johnson, Beingmate, Nestle, etc., The others are expected to reapply, renew or cancel their registrations due to the regulatory change now underway.

In addition, there are an estimated further 1,000 applications currently awaiting IMF registration approval, so Q4 may well see a surge in registrations.

From the approved registrations:

- The first approved batch of IMF products (0-36 months) under the new national standards were from Inner Mongolia Jinhai Yili Dairy Co., Ltd. and Banner Infant Dairy Products Co., Ltd.
- Nestlé's products included some made in Switzerland and others made in China
- Feihe Dairy achieved the highest number with 24 registrations approved, to be produced in 4 plants in Heilongjiang (3) and Jilin (1)
- YTD, 6 goat milk formula have been registered under the new standards: Eurbest's "Zhuoyang" and "Nuoyou Goat", Feihe Dairy's "Xingfeifan Zhuoshu" and "Yangyang Feifan", Yili's "Uitstekend Geitenmelk" and Yeeper Dairy's "Yeeper Baby Goat"

## Beingmate Reports Double-digit Growth in Q1-Q3 Earnings

Recently, Beingmate Co., Ltd. (Beingmate, Stock Code: 002570) released its quarterly report showing improving Q1-Q3 data as follows:

- Revenue: USD335.3 million (RMB2,417 million), up 45.8% YoY, including USD111.4 million (RMB802.9 million) for Q3, up 49.62% YoY
- Net profit attributable to parent company: USD6.1 million (RMB44.3 million), up 14.2% YoY, including USD185,200 (RMB1.3 million) for Q3, down 74.46% YoY
- Net profit after excl. extraordinary gains/losses: USD2.6 million (RMB18.8 million), up 335.52% YoY, a return to positive growth from the like-for-like figures
- Net cash flows from operating activities: USD42.2 million (RMB304.0 million), up 231.36% YoY

Challenged by the fierce competition in the formula market and the falling number of newborns in China, Beingmate had experienced years of loss. In early 2021, the founder Xie Hong returned to company after resigning his post as chairman for personal health reasons in 2011, and initiated a series of reform measures to increase efficiency and reduce costs.

According to the recent report, the company's primary business (particularly the infant range "Keruixin" and formulae for children and FSMP), and ancillary manufacturing activities and brand licensing, are all growing.

Additionally, the company is confident in the New Retail model based on online and offline data integration and allows closer sales management via digitization, artificial intelligence and other advanced technologies to target consumers and their needs more precisely – it indicates that this has facilitated half of its YTD sales, and cites "Keruixin" as a successful example, with growing number of New Retail distributors and sales results.

During 2022 China's Double 11 festival, the country's most important online shopping spree, Beingmate's GMV (gross merchandise volume) in online marketplaces rose by over 20% YOY – sales on emerging platforms like Pinduoduo enjoyed 200%+ growth, while sales on the key established platforms like Tmall.com and JD.com also did well.

## Tibetan Plateau to Build its Biggest Yak Dairy Industrial Park

On 4 Nov., work began on Kangding Yak Dairy Industrial Park in Kangding City of Ganzi Tibetan Autonomous Prefecture, Sichuan Province.

The park's construction is led by Ganzi Tibetan Autonomous Prefecture Kangding Lanyi Plateau Food Co., Ltd. (Lanyi Food) and will be the biggest such site in the Tibetan Plateau area, a site of 3.33 ha with a projected investment of USD18.0 million (RMB130 million). The project includes building a research institute for traditional food in the region, a product exhibition and sampling area, a yak culture exhibition area and a processing plant, to be completed by June 2024. The plan is for the plant to have a milk processing capacity of 10,000 t/a and annual production worth USD69.4 million (RMB500 million).

Ganzi is one of China's major yak farming areas with around 1.73 million head of yak, representing 41.07% of Sichuan's total yak number by the end of 2021. However it faces serious constraints like altitude and transportation infrastructure which make it hard to deliver quality yak milk to inland consumer markets; it is hoped that this park may help counter these challenges.

Lanyi Food was founded in Oct. 2012 with a registered capital of USD4.6 million (RMB33.5 million) and is the leading yak dairy firm in Ganzi. It has 70+ patents on processing technology and innovation and the application of yak milk as a food ingredient, and has developed 30+ yak milk products including ice cream, UHT milk and a yak cheese snack (a traditional food in Ganzi).

## Maiquer Faces Large Q3 Loss

Maiquer was hit by the detection of propylene glycol in its pure milk in the summer – caused by insufficient cleaning of modified milk tank lines during the production switching process (see article in July issue).

After this drew a fine of USD10.1 million (RMB73.2 million) in June, Maiquer Group Co., Ltd. (Maiquer, Stock Code: 002719) has incurred serious losses:

### Q1-Q3:

- Revenue: USD117.8 million (RMB849.0 million), up 3.13% YoY
- Net Loss: USD43.8 million (RMB315.9 million) vs. a profit of USD2.4 million (RMB17.6 million) in the same period last year – the biggest loss YTD among the A-share listed companies in the dairy sector

### Q3:

- Revenue: USD19.6 million (RMB141.5 million), down 58.66% YoY
- Net loss attributable to equity shareholders of the listed company: USD19.5 million (RMB140.7 billion)

The company indicates that the propylene glycol incident has caused an estimated loss of USD26.4 million (RMB190 million) in its H1 performance will seriously affect its full year figures, as pure milk makes up some 50% of its turnover.

The situation is not helped by the involvement on 6 Nov. of its parent company Xinjiang Maiquer Group Co., Ltd. in a debt dispute with Orient Securities Co., Ltd. over USD66.7 million (RMB481 million).

Maiquer was founded in Dec. 2002 and went public on the SZSE in 2014. It has formed two core businesses in bakery and dairy, the latter comprising UHT milk, modified milk, milk beverages and fermented dairy products and providing almost 70% of its turnover for H1 2022. In recent 2 years, its pure milk has become very successful with online consumers buying into its image as a quality milk from Xinjiang's prime dairying region or "golden milk source belt".

## Yili's Jindian Organic Milk Limited Edition

On 24 Oct., Yili launched "Jindian Hulunbuir Organic (UHT) Pure Milk Limited Edition" exclusively on Tmall Mart, an online supermarket run by Alibaba. According to Yili, users of Tmall Mart have higher internet penetration rates, purchasing power and repeat purchase rates vs. those using other online distribution channels.

This product has a protein content shown as 3.8g/100ml and is produced on the 4 production lines operational since 19 Oct. at the company's Hulunbuir Yili High-end Green & Smart Organic Dairy Product Project, one of its key production sites for high-end products.

### Details of the Hulunbuir Yili High-end Green & Smart Organic Dairy Product Project

Phase I construction:

- Total investment: USD208.1 million (RMB1.5 billion)
- Capacity: 530,000 t/a
- Annual output value of liquid milk: USD693.7 million (RMB5.0 billion)
- 9 lines are operating, producing 660 t/d of liquid milk; 7 of these are producing 400 t/d of organic pure milk. These have driven construction of 13 largescale dairy farms in Arun Banner, Hulunbuir City

Phase II construction:

- Yili will soon proceed with the 2nd phase of construction to add 13 more liquid milk production lines, ultimately giving a total raw milk processing capacity of 1,800 t/d
- Yili is also planning a construction project for a large scale dairy farm at this location integrating dairy farming and dairy processing, targeting a dairy herd of 300,000 head and milk production of 4,000 t/d.

## Probiotic License Agreement between Scitop Bio-Tech and CSL

On 28 Oct., Beijing Scitop Bio-tech Co., Ltd. (Scitop Bio-tech, Stock Code: 300858.SZ) announced its entry into a License Agreement with Italy's Centro Sperimentale del Latte (CSL), authorising CSL to manufacture and distribute Scitop Bio-tech's patented Lactobacillus Plantarum P-8 in Europe and North America exclusively, paying a fixed license fee for the use of intellectual property and 10% of net sales as royalty fees.

Lactobacillus Plantarum P-8 is a probiotic isolated from Inner Mongolian traditional yoghurt, claimed to reduce stress and anxiety and to improve memory and cognitive functions. According to CSL, it will be used to produce probiotic powder for dairy products, medical foods and dietary supplements, helping it build its probiotics business outside Italy.

Since its establishment in 2003, Scitop Bio-tech has been dedicated to the R&D, production and sale of probiotic lactic acid bacteria (LAB) and related products. It has a microbial resource centre storing a collection of 20,000+ strains of LABs including probiotics, and possesses whole-process production techniques for probiotics isolation, screening, evaluation, cultivation, freeze drying and storage. On 27 July, 2020, Scitop Bio-tech debuted on ChiNext Market, making it the first listed stock in China's probiotics industry. Its key customers include dairy, animal husbandry and pharmaceutical firms, such as Mengniu, Bright Dairy, Wondersun Dairy, New Hope Dairy, Shengmu High-tech, Modern Dairy and Jiangzhong Pharmaceutical (Stock Code: 600750).

Founded in 1948, CSL is the biggest probiotics manufacturer in Italy and part of Sacco System, a producer of starter cultures for food fermentation (in particular dairy). It specialises in R&D and production of natural probiotics for pharmaceutical, nutritional, dairy, food and agriculture departments and institutions across the world.

## Mengniu Launches Probiotic Strains Grown in Space

On 27 Oct., Mengniu and the China Space Foundation hosted a launch event for 2 space-grown probiotics, "2016 Guoren No.1 Strain" and "2016 Guoren No.0 Strain", presenting these as symbolising collaborative innovation between the aerospace and food industries.

These probiotics, developed by Mengniu, were sent back to Earth via China's Shenzhou-11 spacecraft after 33 days in space since 17 Oct., 2016. Having gone through drastic temperature change, high-intensity space radiation, microgravity and other unique space conditions, the strains have developed higher tolerance to extreme environments and are claimed to show outstanding application potential to balance intestinal bacteria and to achieve improve metabolisms. To date, Mengniu has published 7 papers and applied for 10 patents on for the 2 space strains.

The company has worked with the China Space Foundation since 2003 and is the first dairy firm working with the aerospace sector. In 2017, it became a strategic partner of the China Space Foundation and started scientific cooperation aimed at developing "space quality" dairy products.

## China Shengmu and Mengniu Sign Milk Supply Framework Agreement

On 18 Nov., China Shengmu Organic Milk Ltd (China Shengmu, Stock Code: HK.01432) and China Mengniu Dairy Company Ltd (Mengniu, Stock Code: HK. 02319) signed a Milk Supply Framework Agreement with a 3-year term from 1 Jan. 2023 to 31 Dec. 2025. The deal has ceiling spends of USD471.7 million (RMB3.4 billion), USD596.6 million (RMB4.3 billion), USD693.7 million (RMB5.0 billion) over the three years, and key terms as follows:

- Under the agreed monthly milk supply plan, China Shengmu sells raw milk to China Mengniu Group on a daily basis that meets its procurement standards and quality requirements, and will ensure that it sells on average more than 80% of the raw milk it produces to Mengniu each year
- The specific purchase volume is to be determined by both companies
- The daily delivery volume will be based on the volume ordered by Mengniu
- In terms of pricing mechanism, the benchmark price of the framework agreement refers to the market price, while the corresponding subsidy and price adjustment are negotiated based on the current logistics costs and the quality and grade of raw milk.

China Shengmu said that the cooperation with Mengniu will help stabilise raw milk prices and sales volume, generating stable incomes and cash flow. In addition, China Shengmu's farms are mainly located in the Hohhot and Bayannur regions, where China Mengniu has significant processing capacity. The short transportation distance ensure the freshness of the raw milk and minimises logistics/refrigeration costs, making China Shengmu's milk competitive vs. other suppliers.

China Shengmu is one of the leading organic raw milk producers in China. As of June 2022, it had 33 farms, including 20 organic certified farms and 3 farms producing DHA milk; its herd of 130,802 cows included 86,578 cows under organic management with an average daily production of 1,364 tonnes of organic milk. In H1 2022, it sold 311,565 tonnes of raw milk, an increase of 8.2% YoY, 71.5% (=223,000 tonnes) of which were organic, representing an increase of 20.9% YoY.

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