

Dairy Ingredients China 2009/10

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Business Review
Dairy Ingredients in China
 Producers, Products, Supply and Demand
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INTRODUCTION Asia is by far the fastest growing region within the global food sector. Liberal policies for setting up new dairy processing facilities has led to higher private investment in this sector and has increased consumption of processed dairy products. For example, the dairy industry is one of the fastest developing sectors in China while India boasts of the largest milk production in the world. In particular, milk consumption in China is relatively low at present but it is expected to grow very rapidly. The increase in modern distribution, the active school milk programmes and the increasingly dynamic co-operatives have all contributed to this growth.

Three important sources of change, especially in urban China, that are said to have played an integral role in shaping dairy demand are (a) changes in consumer perceptions of dairy products, (b) food purchasing behavior, and (c) dairy product marketing. Historically, the majority of Chinese have viewed milk as a nutritious food supplement, particularly for infants and the elderly, but milk has not been perceived as a food for regular consumption by the general population. These traditional perceptions are being challenged on several fronts. For example, current government guidelines for food and nutrition include regular milk consumption in their dietary recommendations.

As a key player or a company wishing to find new opportunities in China, this report enables you to consider your response in charting the strategy of your organization.

- OBJECTIVES**
- To examine the impact of socio-economic factors on milk production
 - To estimate total production/trends and production shares of key dairy ingredients in each of the selected countries
 - To describe the structure of the important end-product sectors in each country
 - To identify the major local dairy/ingredient producers and to provide a summary of their operations
 - To estimate current demand for dairy ingredients across sectors by country
 - To provide current information on import duties for the various dairy ingredients and any relevant legal information in each country.

PRODUCTS **Ingredients:** Skimmed milk powder/whole milk powder/milk protein, whey products, lactose, casein/caseinates, and any speciality fractions, where relevant

End-product sectors: Dairy (reconstituted milk, flavored milk, yogurt/fermented milk), infant formula, ice cream, bakery, cheese, powdered beverages, chocolate

MARKETS China

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2. SOCIO ECONOMIC SCENARIO

Geographic

Today, the People's Republic of China represents all of mainland China. The country is split up into 23 provinces, 5 autonomous regions, 4 municipalities and 2 special administrative regions.

Population

China is the biggest developing country in the world, and also has the largest population. Population in 2009 is recorded at 1.33 billion, or around 20% of world population. In order to ease the population burden, China adopted a one-child policy in the 1970s, leading to a drop in the population growth rate. From 2002 to 2009, the population rose from 1.28 billion to 1.33 billion, showing a decline in the annual growth rate from 0.65% to 0.42%.

In 2008, over 25% of the population were considered to be middle-class consumers. 775 million people are considered to constitute the Chinese labor force, of whom almost 1.42% are in the services sector. Approximately 50% of women are now employed outside the home. The official unemployment rate in urban areas in 2008 was in around 3.8%.

Population, 2008

Age range	Proportion of total population %	Male	Female
0-14	19.00	127 767 782	123 892 218
15-64	72.70	490 844 360	475 955 640
Above 65	8.30	55 623 612	53 936 388

Source: State Statistics Bureau

Regional analysis

In order to provide a clearer insight into the Chinese market, it is important to consider the regional dimension of this country. For the purpose of this study, China has been broken down into six broad regions:

3.2. GOVERNMENT SUPERVISION

A central factor behind the melamine incident is the government's poor supervision of the dairy industry. Since then, the government has made great efforts to improve the supervision system, aiming to achieve better food safety control.

The highlight is the implementation of the first Food Safety Law on June 1st 2009, aiming to guarantee more intensive and regular control on safety in the food industry. It is also expected to strengthen the dairy industry by raising requirements for new entrants. In addition, many preferential policies, such as purchases of milk powder and low interest subsidy loans to dairy processors were implemented in 2009. In addition, China's first Quality Safety Standard for Dairy Products was launched formally on June 1st 2010.

However, the government still needs to improve the safety and quality control system and strengthen supervision, as many incidents still occurred in 2009, reflecting continuing deficiencies in how the country tackles the task of achieving a safe food industry.

Such laws, regulations and standards will raise the costs for dairy producers, exerting even more pressure, whilst also attempting to boost the reorganisation of the overall dairy industry in China which began in September 2008.

Key food industry regulations, June 2009 - October 2010

No.	Publication	Regulation
1	June 2009	Food Safety Law (FSL)
2	March 2010	Dairy Safety Standard (DSS)
3	June 2009	Dairy Industry Policy (DIP)
4	October 2010	Detailed Rules for Infant Formula Producers' Approval Conditions 2010 (Draft Version)

Source: Giract

Food safety law (FSL)

The FSL is the first and fundamental food safety law launched on June 1st 2009 in China, aiming to guarantee food safety and standardise the Chinese food market. The government has formulated other supporting regulations and detailed sector-specific regulations based on the FSL.

6. DAIRY INGREDIENTS

6.1. SMP/WMP

6.1.1. SUPPLY

Over the past 4–5 years, domestic WMP/SMP production has gone through sharp highs and lows, the latter due mainly to the incident of melamine addition in infant formula.

In 2006 and 2007, annual capacity and output of domestic WMP/SMP continued to rise to respond to increasing demands from infant formula, milk beverage and fermented milk segments in particular. During this period, exports of domestic WMP/SMP also continued to grow in view of their competitive prices.

WMP/SMP capacity and output 2006-9 kt

	WMP		SMP	
	Capacity	Output	Capacity	Output
2006	#numbers edited out of this table			
2007				
2008				
2009				

Under normal circumstances, domestic WMP/SMP production should have kept the same upward trend during 2008 and 2009, however, the melamine incident and its huge repercussions meant that there was no capacity changes during this period and output dropped sharply in 2008, but then showed signs of slight recovery in 2009.

SMP is estimated to account for around #% of China's total milk powder production during 2008 and 2009.

The major reasons for the drop in production of WMP/SMP in 2008/9 are seen to be:

- Loss of consumer confidence in the domestic products. This left the door open for products from international manufacturers, e.g. Nestlé China. The Chinese companies implicated or related to the melamine incident, e.g. Shijiazhuang Sanlu Group, Inner Mongolia Yili Industrial Group and China Mengniu Dairy, had to stop their production lines and stockpiles of up to 300kt of milk powders were reported during the first half of 2009
- The melamine incident also had a very negative impact on exports of domestic WMP/SMP. According to statistics of China Customs, export volume of WMP increased by about 36% year-on-year and reached about #kt in the first eight months of 2008, but sharply reduced to only # tons in October 2008
- The global financial crisis and diminished purchasing power of domestic and overseas consumers further reduced demand for WMP/SMP

Price quotations by key SMP/WMP manufacturers in China, October 2010

Company	USD/t	
	SMP	WMP
Yili	N/A	N/A
Feihe	N/A	N/A
Beiru	# some numbers edited out of this table	
Yeeper	-	
Bright Dairy	-	
Yashili	N/A	N/A
Wondersun	-	
Reward Group	N/A	
Rodobo	-	
Ningxia Xuequan	N/A	
Mengniu	N/A	N/A.
Sanyuan Foods	N/A	

Source: Giract

6.1.5.

DEMAND

#####are the ingredients having the largest demand. Consumption of WMP/SMP is concentrated in ##### text edited out

SMP/WMP demand in selected end-use sectors in China, 2009 (tons)

End-use sectors	Demand
Milk beverages ## numbers edited out of this table	
Infant formula	
Yogurt/fermented milk	
Biscuits & bakery	
Ice cream	
Sweetened condensed milk	
Chocolate	
Processed Cheese	
Others	
Total	

Source: Giract

7.1. UHT/LONG LIFE PRODUCTS

Ultra heat treated (UHT) milk is one of the most popular dairy products in China.

UHT milk production 2005-2009

	Output mio tons
2005	## Numbers edited out of this table
2006	
2007	
2008	
2009	

*Although some sources indicate 5.7 mio tons

Source: Giract

- During the 2005 –2007 period , the implementation of relevant policies stimulating domestic UHT milk production as well as the rising living standards of the population helped to invigorate this sector
- In 2008, the melamine incident and the ensuing bad reputation attached to Chinese dairy products as well as the global financial crisis led to a decline in production
- In 2008, China’s school milk programme, launched in 2000, began to show signs of declining support from dairy producers in view of the lack of profit and government subsidies. The only incentive to dairy companies to continue to provide milk for this programme is social responsibility and the possibility of brand building
- 2009 registered an increase in production as the government put in place strict supervision measures on domestic dairy products in order to recover China’s reputation in this sector
- The international events held in China during 2008– 2010 – the Olympic Games in Beijing in 2008, Shanghai World Expo in 2010, etc. – increased the demand for UHT milk

As consolidation advances in the dairy industry, for example Inner Mongolia Yili Industrial Group and China Mengniu Dairy acquiring regional milk manufacturers, the range of drinking milk product brands is narrowing. On the other hand, consolidation has widened distribution networks, especially in smaller urban and rural areas.

7.2.3. DEMAND FOR DAIRY INGREDIENTS IN SWEETENED CONDENSED MILK

SMP/WMP are the main dairy ingredients used in the sweetened condensed milk segment. In 2009, an estimated 1,100,000 tons of SMP/WMP were consumed in sweetened condensed milk. SMP/WMP are usually added in original flavor sweetened condensed milk to enhance the taste and is seldom added in flavored sweetened condensed milk.

Nestlé (China) and Zhejiang Panda Dairy are the two leading sweetened condensed milk producers in China in 2009, with a total output of 1,100,000 tons or 100% of total output. However, at the beginning of 2010, products of Zhejiang Panda Dairy have been reported as not being up to safety standards which may affect sweetened condensed milk production.

Sweetened condensed milk - production by key players, 2009 tons

Company	Output
Nestlé (China) Co., Ltd.	1,100,000
Zhejiang Panda Dairy Co., Ltd.	0
Guangdong Fengxing Dairy Co., Ltd.	0
Guangdong Dongtai Dairy Co., Ltd.	0
Subtotal	1,100,000
Others	0
Total	1,100,000

Source: Giract

Demand for dairy ingredients by key sweetened condensed milk producers, 2009 tons

	Consumption
	SMP/WMP
Nestlé (China) Co., Ltd.	1,100,000
Zhejiang Panda Dairy Co., Ltd.	0
Guangdong Fengxing Dairy Co., Ltd.	0
Guangdong Dongtai Dairy Co., Ltd.	0
Subtotal	1,100,000
Others	0
Total	1,100,000

Source: Giract

In December 2009, Wondersun Xingkai Co., Ltd. was launched in Mudanjiang City, Heilongjiang Province, with a planned capacity of 20 000tpa. Total investment is USD 190.62 million.

In October 2009, Wondersun's first phase of 30 000tpa canned formula processing project was launched in Shuangcheng Economic Development Zone. The first phase of construction began in April 2009.

On September 8th, 2009, Wondersun successfully purchased Baoquanling -based assets of Synutra for USD 38.12 million, which included Synutra's dairy plants and farms in Baoquanling.

On June 26th, 2009, Wondersun signed a joint venture with Hebei Beland Dairy Co., Ltd. called Hebei Wondersun Beland Dairy Co., Ltd. (Hebei Beland), aiming to explore the liquid milk market in North China. Wondersun and Hebei Beland hold respectively 51% and 49% share of the new company.

Production situation

Infant formula output of Wondersun was estimated at 15 000 tons in 2009, and in H1 2010, the output volume was 8 000 tons.

8.7. GUANGDONG YASHILI GROUP CO., LTD.

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Website: www.yashili.com

Company background

Established in 1983, with a history of more than 20 years, Guangdong Yashili Group Co., Ltd. (Yashili) has grown to be a world famous modern large-scale enterprise having started from a small workshop.

Yashili now is composed of seven companies —food products, dairy, nutrition health care, packaging and printing, etc. also has production facilities for milk & soybean milk powders in Heilongjiang, Shanxi, Henan, etc.

Yashili has three major production sites in China which are Chaozhou in Guangdong, Heilongjiang and Shanxi. The plant in Shanxi is mainly for handling 'return products'.

The major production site in Guangzhou is a study and research centre. Further, a new plant is under construction in Henan which will be for the production of products other than powder formula. The new plant will be put into operation in 2011.