

Research Report on Supply & Demand of Dairy and Products in China 2014/2015

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Abstracts

Introduction

2014 is another important turning point during the development history of dairy industry in China. Characterized in quickening the elimination of traditional free-ranging and rapid development of large scale farming, the entire industry accelerates the transition from extensive quantity growth form to intensive quality efficiency form and from hypernormal disorderly development to steady and orderly development. The Third Plenary Session of the Eighteenth Central Committee of the CPC has pulled open the prelude of comprehensively deepening the reform in China and also brought significant influence upon the dairy industry in China within predictable several years in the future. On the whole, the challenge with which the dairy industry of China is faced is intensifying, and the opportunity coexists in the meantime.

Seen from the challenge, it is mainly manifested in the following respects: I. China's CPI index kept on climbing in 2015, price rose. The price for feed, fuel and labor rose comprehensively, so the production cost of raw milk kept on surging, but raw milk price kept on falling during the same period, hence more and more smallholder farms (including small farms) had their cows slaughtered for beef. There was abnormal elimination of dairy cattle and small scale farming had to be abandoned. II. For a long time domestic dairy processing companies have been devoting effort to the fostering of top-end consuming groups, the companies explored the top-end dairy market and invested a lot for quality raw milk, then sell products at high price to consumers. This is the so-called "high input and high output" industrial development mode. So far the top-end marketing strategy of the processing companies has been successful. In recent years the growth of the domestic dairy market has been the growth of the top-end brands, and competition among processing companies is competition of the top-end

market. However alongside the signing of the FTA with New Zealand and Australia and the highly open dairy policy on the US and the EU, not only foreign milk powder is seeing enlargement of market share in China, but also UHT milk or even pasteurized milk is flowing into China constantly. Compared with the foreign brands, how is the competitiveness of the domestic top-end brands? We should wait and see. The top-end market, fostered by the domestic dairy companies, may be grabbed by the foreign brands. Also the “high input and high output” mode may have lost the comparative advantage in international competition. Therefore when the market is completely open, the domestic top-end brands are at an inferior position in international competition. III. Many dairy companies readjusted their product structure, reduced the production of medium/low-end products that are in line with the mainstream consumption demand. More high-priced products are made, but the high price restrains the consumption. IV. Dairy import especially whole and skim powder import broke another record in 2014. The large dairy import caused a huge pressure to the domestic counterpart and a serious impact to the market. Also the serious drought in New Zealand in the first half of the year led to a slip of raw milk production and considerable growth of price. At the same time the upsurge of raw milk price in Europe, North America and Latin America pushed higher dairy price, so the import price to China was substantially higher year on year, which raised the dairy processing cost based on imported raw materials. V. The frequent dairy quality and safety incidents continued to affect consumers’ confidence on domestic made products (especially infant/young child’s formula milk powder). Such negative impacts shall sustain in 2015. VI. There is more and more pressure from supervision. The dairy industry has always been in the center of public opinion in food safety, epidemic control and environmental pollution. Therefore Government’s supervision shall be more and more intensive and the media and the community would pay more and more attention as well.

Seen from the opportunity, it is mainly manifested in the following respects: I. Huge domestic consumption potential: currently the per capita dairy consumption of the residents is about 30 kg, less than 1/3 of the world average. This is not in line with the growth of per capita income. Meanwhile more and more residents cognize the nutrition value and health-care function of dairy products after two decades of education, but the quality and safety issues concerning dairy products and the too high price affect consumption. II. Apart from the existing supporting policies, the Government shall provide unprecedented support and regulation to the industry in 2015. Preferential policies on assistance to key enterprises including favorable taxation treatment, financial support from both the Central and local government, bank loans, financing at the capital market and land utilization. Meanwhile the threshold for dairy processing was heightened once again. The processing industry was gradually disciplined, competition

of the dairy market is being regulated and the margin of processing companies rose, which eased the pressure from the rising production cost to a certain extent. Additionally, The new population policy (two-child policy) in 2014 may help to enlarge the dairy market in the coming years. III. The “Decisions on Primary Issues Concerning Further Deepening the Reform from the CPC Central Committee” points out that if one of the two parents is from a single child family, the couple may have two kids. The peak of birth is foreseen to be postponed till the end of 2017, the number of babies between 0-3 years old shall be 13% more than that before the readjustment of the family planning policy. This shall increase the demand for infant/young child’s formula milk powder by 16 billion yuan. The policy would raise the market demand for infant/young child’s formula milk powder by 10-20%, which is not only favorable to domestic producers but also foreign dairy companies have increased investment in China. IV. Currently the shortage of raw milk supply and the huge dairy consumption potential attract the preference from domestic and foreign capitals. A number of international dairy giants wish to share the cake in the new round of expansion of the dairy industry, which would be favorable to the upgrading of the domestic dairy industry. V. The global economy in 2015 is projected to be better than in 2014 in spite of uncertainties and big disparities among different entities. The global dairy demand shall still be prosperous, especially China and India. Meanwhile the dairy production and supply shall be larger year on year, hence there shall be rising dependence on export. VI. The hardship faced by the developed dairy processing entities brings an opportunity to China’s dairy industry, especially the implementation of the “stepping out” strategy creates an opportunity.

Seen from the market prospect in 2015, domestically, the Third Plenary Session of the Eighteenth Central Committee of the CPC held in November 2013 has pulled open the prelude of comprehensively deepening the reform and also brought significant influence upon the dairy market and industry supervision in China: (1) The population policy of China will be adjusted, a couple having two children is permitted and the quantity of newborns will be increased in 2015 Although the growth rate is hard to be determined accurately, such policy is beneficial for the infant formula industry undoubtedly; (2) Safeguarding and improving people’s livelihood is regarded as one of the focuses concerned by the government, the safety problem of the food including dairy product is expected to be valued and solved unprecedentedly, and the confidence of consumers in domestic dairy product will be shored up hopefully; (3) The Decision of the Third Plenary Session explicitly proposes that the central government will establish the “National Security Council”, “spare no effort to solve the problem of crossing of power and responsibility and duplicate law enforcement, and set up the authoritative and efficient administrative law enforcement system with integration of power and

responsibility”, “based on formulating negative list, all kinds of market entities are able to equally enter into the field beyond the list according to law”, “clear and abolish various regulations and behaviors hindering national uniform market and fair competition, prohibit and punish sorts of conducts implementing preferential policy illegally”, etc.. Under this overall background, the original China dairy supervision and related policies are predicted to be adjusted and perfected correspondingly, and the raw milk, dairy industry and market in China will hopefully be further standardized and orderly. Seen globally, the hopeful growth of European and American economy during the adjustment; the promotion of regionalization and globalization, and the tension and conflict in global local area tending relieved, all benefit to inhibit the price of energy product and agricultural product going up too rapidly. The production of raw milk and dairy product in major economic entities is predicted to increase slightly, and the price of dairy product in international market is estimated to tend stable.

Competition of the dairy market shall witness new changes in 2015 alongside the implementation of new polices: (1) market competition shall be competition for integrated strength including brand influence, capital, R&D in new products, marketing, scaled economy and control over quality milk source. Brand is important, but its weight in competitiveness has been weakened. (2) The brand concentration level shall rise further. The new “threshold”, which shall be enforced from 1st May, shall lead to withdrawal from the dairy market at least 1/5 medium/small companies. Large processing companies shall devote effort to the whole industrial chain, especially to the control of quality raw milk supply and R&D on new products. Therefore the concentration level of brands shall climb further. (3) Regarding the utilization of both the domestic and foreign resource and market, processing companies are shifting from the mono “introduction” to both “introduction” and “stepping out”. More companies are foreseen to join in the “stepping out” team in 2015 due to the shortfall of raw milk supply in China. (4) More capital from outside the dairy industry shall enter into China’s dairy industry thanks to the huge demand potential, especially the demand for raw milk, infant/young child’s formula milk powder, cheese and butter.

This Report panoramically expounds the current situation of China dairy industry in 2014, including the production of raw milk and dairy product, dairy consumption, dairy trade, price tendency of raw milk and dairy product, operational condition of China dairy industry, competitive situation of China dairy market, business performance and investment situation of key dairy enterprise, world dairy market trend, production, consumption and trade status of major countries of dairy production and trade, influence of work dairy market environment upon China dairy industry, and the forecasting upon the development tendency of China dairy industry in 2015.

This Report is the crystallization of collective intelligence of dairy research group of Beijing Orient Agribusiness Consultants Limited. The senior dairy analysts of dairy research group of BOABC are the members of “thinking bank” in related government departments and associations, who keep good relationship with these departments and associations as well as national key dairy enterprise, correlative industry and enterprise. These resource superiorities provide particularly precious professional support for the composition of this Report, and also guarantee the accuracy, authority, scientificity and perspectiveness of the data cited herein. BOABC believes this Report will be the important reference material for strategic decision-making of domestic and overseas investment company, dairy enterprise, dairy burdening supplier, and related equipment supplier as well as such organizations as guild and research institution.

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