

December, 2013

China's Dairy Industry

I. Introduction

I.1 Introduction by Data

I.2 International Cooperation of Chinese Dairy Industry

I.3 Dynamics of Chinese Dairy Industry

II. Foreign Trade

II.1 Foreign Trade by Products

II.2 Foreign Trade by Countries

III. Domestic Dairy Consuming Market

IV. Dairy Companies in China

IV.1 Chinese Dairy Companies

IV.2 International Cooperation

V. 2011 Chinese dairy industry statements compared with other countries

MEMBER OF THE CONFEDERATION OF EUROPEAN BUSINESS (BUSINESSEUROPE)

Headquarters: Meşrutiyet Cad. No: 46 Tepebaşı 34420 İstanbul – Turkey
Ankara: İran Cad. No: 39/4 Gaziosmanpaşa 06700 Ankara – Turkey
Brussels: 13, Avenue des Gaulois, 1040 Brussels – Belgium
Washington D.C. : 1250 24th Street, N.W., Suite Nr. 300, Washington D.C. 20037 - USA
Berlin: Märkisches Ufer, 28 Berlin 10179 Germany
Paris: 33, Rue de Galilée 75116 Paris – France
Beijing: Beijing Lufthansa Centre, Office C-319, Beijing 100025, P. R. China

Phone: +90 (212) 249 19 29 **Fax:** +90 (212) 249 13 50
Phone: +90 (312) 468 10 11 **Fax:** +90 (312) 428 86 76
Phone: +32 (2) 736 40 47 **Fax:** +32 (2) 736 3993
Phone: +1 (202) 776 77 70 **Fax:** +1 (202) 776 77 71
Phone: +49 (30) 288 786 300 **Fax:** +49(30) 288 786 399
Phone: +33 (1) 44 43 55 35 **Fax:** +33 (1) 44 43 55 46
Phone: +86 (10) 6462 2066 **Fax:** +86 (10) 6462 3206

e-mail: tusiad@tusiad.org
e-mail: ankoffice@tusiad.org
e-mail: bxloffice@tusiad.org
e-mail: usoffice@tusiad.us
e-mail: berlinoffice@tusiad.org
e-mail: parisoffice@tusiad.org
e-mail: tusiad.china@euccc.com.cn

I. Introduction

Before 1978, the dairy industry development in China was really slow. After the release of the opening market policy, from 1977 to 1996, the national GDP per capital increased 12.5% annually, the Compound Annual Growth Rate (CAGR) of raw milk production was up by 11.2%. The fastest growth period of China's dairy industry was from 1997 to 2007. In this period, the dairy industry in China trended to be large-scaled, intensive and standardized. From 2008 to present, Chinese dairy industry has kept stable growth. After the milk quality issue of Melamine occurred in China, the consumption confidence on domestic dairy products was damaged badly. From 2008 to 2012, the CAGR(?) of raw milk production output was only 0.6%. However, the dairy products import growth rapidly, while the import growth rate in 2009 and 2010 was 117% and 27%. From 2008 to 2012, the national average income growth kept 10.7% annually,

and the sales volume average annual growth was 17%. The stable growth of national average income stimulates dairy product consumption growth in China.

I.1. Brief Introduction by Data

In 2012, there were total of 694 industrial enterprises above designated size (Main business revenue is above 20 million RMB) on dairy industry. The total dairy products output was 254.236 billion RMB (41.41 billion USD), up by 18.1%, which was 2.84% of total industry output on food industry. In China, the total milk output was 38.7 million tons.

According to accumulative dairy output in 2012 by province, the top 10 dairy producing provinces in order were Inner Mongolia, Shandong, Hebei, Heilongjiang, Henan, Shanxi, Jiangsu, Liaoning, Sichuan and Anhui, accounting for 72.25% of total China dairy output.

Item	2012 Data
Livestock volume of cow	14.939 million
Total milk output	38.686 million ton
Dairy processing	
- Total liquid milk output	21.5 million ton
- Total dry milk products output	3.99 million ton

Annual milk production by adult cow	5500 kg per cow
Average dairy consumption in major cities	
- Annual consumption value	347.5 RMB per person
- Annual consumption volume	26.79 kg per person

Source: 2013 China Dairy Statistical Summary

Top 10 Provinces of Dairy Production Output

	Province	Annual Output (10,000 Ton)	Percentage %
1	Inner Mongolia	325.67	12.80
2	Shandong	320.72	12.60
3	Hebei	272.48	10.71
4	Heilongjiang	185.74	7.3
5	Henan	175.36	6.89
6	Shanxi	172.10	6.76
7	Jiangsu	128.32	5.04
8	Liaoning	106.04	4.17
9	Sichuan	77.22	3.03
10	Anhui	75.23	2.96
Total of the ten provinces		1838.88	72.25
Total of China		2,545.19	

1.2. International Cooperation of Chinese Dairy Industry

With the rapid growth of domestic dairy industry, China's communication and cooperation with developed countries have also increased. China signed Dairy industry cooperation memorandums with New Zealand and Argentina to cooperate on dairy science, supervision on quality and safety, fresh milk test, and genetic

materials import. China also holds regular talks with New Zealand and Australia on dairy industry development, trade on dairy products, propagation and breeding, and test technology of dairy products. China has jointly cooperated with Canada on cow breeding technology training and holding the international conference on the nutrition of cow. Moreover, China organized front-line farm staffs to do breeding trainings in Sweden

and Holland. The United States and Ireland is also seeking for cooperation opportunities with China's dairy industry.

I.3 Dynamics of Chinese Dairy Industry

Technology innovation is the major dynamic for dairy industry development. In China, the rate of contribution by science and technology on dairy industry is below 50 percent, far behind the level of 70 – 80 percent in Europe and America. For future development, China has to raise the contribution rate on science and technology, and speed up dairy industry transformation by technological innovation in order to insure the supply of dairy products, improve the quality and safety level of dairy products, increase incomes of dairy farmers, enhance industrial competition capability and realize sustainable growth,.

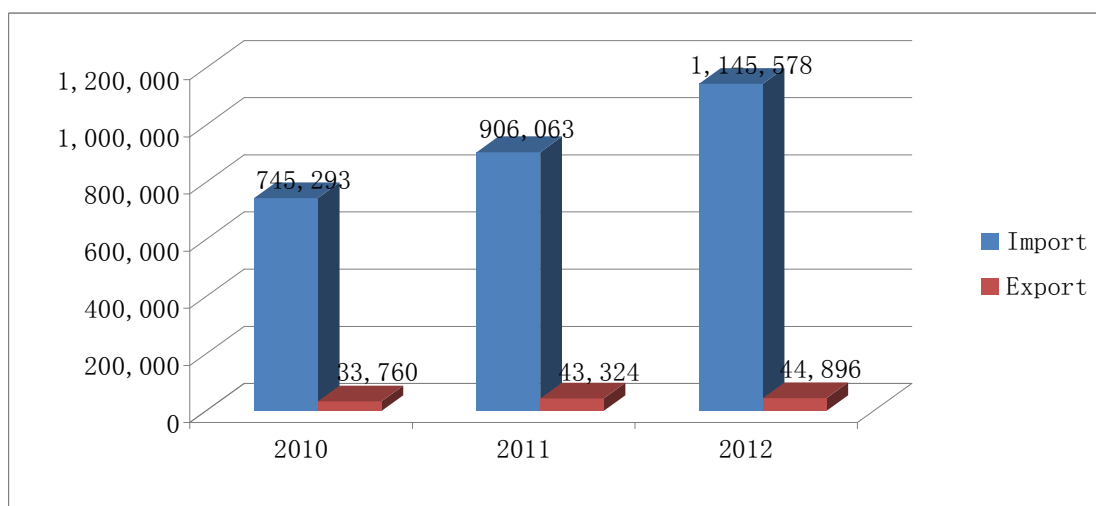
In order to improve and support the technology innovation development, there are five factors that need to be concerned:

1. Promoting genetic improvement of cow, and raising the comprehensive productivity of dairy industry.
2. Speeding up standardized scale farming of cows and promoting the transformation of production mode.
3. Strengthening the fresh milk safety supervision and ensuring the safety of dairy products.
4. Improving the quality of dairy products fundamentally from revitalizing development of dairy alfalfa.
5. Establishing comprehensive social services system of dairy industry, and making the association to be a platform of industrial technological innovation for dairy industry.

II. Foreign Trade

According to 2013 China Dairy Statistical Summary, in 2012, the total value and volume of imported dairy product was 3,213 million USD and 1.15 million ton, up by 22% and 20%. However, the total value and volume of exported dairy product was 82.4 million USD and 44.9 million ton. The dairy trade deficit was about 3,133 million USD.

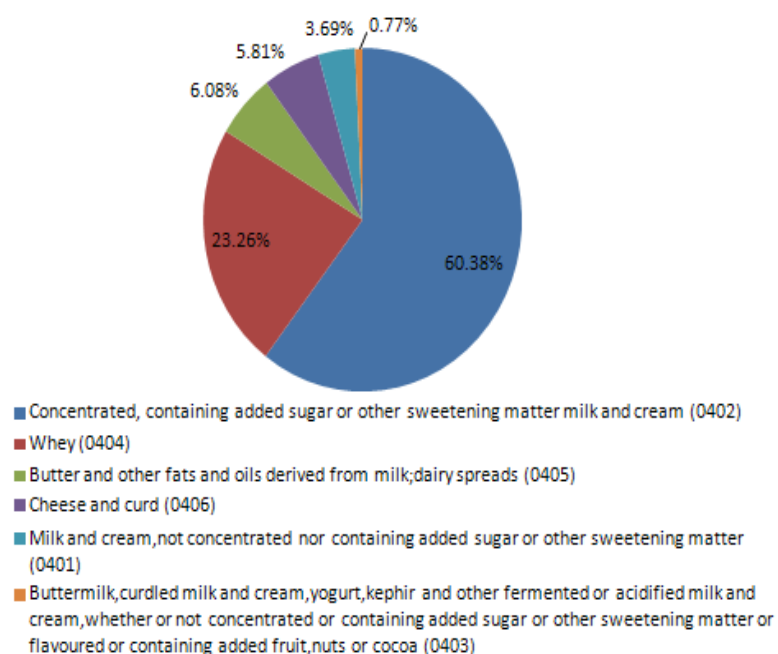
Unit: tons



II.1 Foreign Trade by Products

According to the Chinese customs statistics, in terms of imported products, the top 3 imported dairy products to China are: 1. Concentrated, containing added sugar or other sweetening matter milk and cream (custom code: 0412) accounted 60.4%, 2. Whey (0404) accounted 23.3%, 3. Butter and other fats and oils derived from milk, dairy spreads accounted 6.1% of total imported dairy products.

China Dairy Import by Products 2012



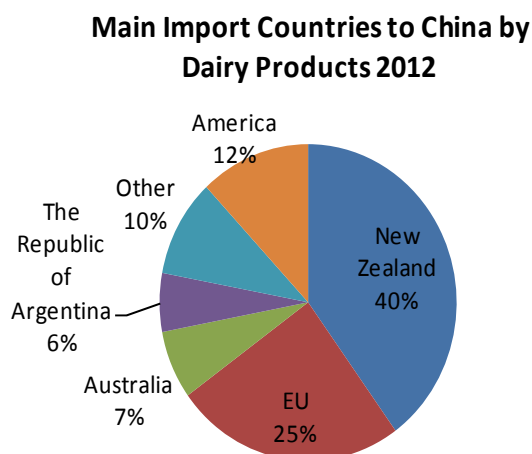
The demand of imported dairy product in China, especially the demand on imported milk powder is expanding and will still continue for a long term in the future, because of the increasing population of new birth. Additionally, through the requirement and concern on milk safe and milk quality, more and more middle and high level consumers choose imported milk products. On the other hand, 80% of China's total imported formula milk is from New Zealand. However, because of the milk powder quality issue that happened in Fonterra – New Zealand largest milk company, China temporary stopped NZ milk powder imports in August 2013, which provide more opportunity to other dairy importing countries. In September 2013, the New Zealand Infant Formula Exporters Association (NZIFEA)

signed a memorandum of understanding with the China Certification and Inspection Group in order to protect the country of origin and ensure formula quality. Michael Barnett, chairman of the NZIFEA released that in the future, New Zealand milk will be authorized to export to China again after passing the Legal examination and inspection procedures with China.

II.2 Foreign Trade by Countries

According to the custom statistics, China imports dairy products from over 60 countries and regions. New Zealand, America, France and Australia are major source countries, which accounted 84.31% of China's total imported dairy products in 2011. Germany, Denmark, Sweden, Netherlands, Argentina and Singapore are also in the top list. Since the Free Trade Agreement was signed by China and New Zealand in 2008, the growth of dairy products import from NZ increase rapidly. In 2011, the dairy product import from NZ accounted 62.67% of China's total imported dairy products in 2011 and it is the top dairy importing country to China. After the milk powder quality issue happened, milk powder imports from Netherlands and Germany increased rapidly, and their products sales price in China

increased about 30%.



III. Domestic Dairy Consuming Market

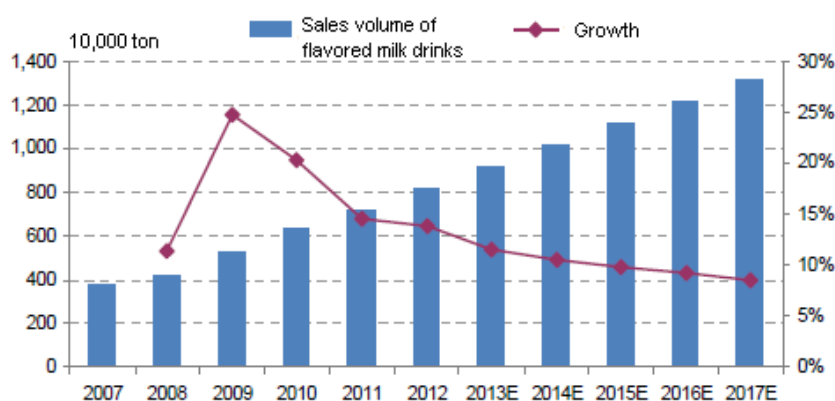
According to the research from China International Capital Corporation Limited (CICC), in 2013, the total raw milk demand in China will be 50.2 million tons and the total raw milk production output in China will be 41.18 million tons, the tight supply situation is intensifying. The price of raw milk product will increase by 5.3% y-o-y to 3.35 – 3.65 RMB/kg in 2013. By relatively, the price of dairy product will increase about 10% because of the raw milk price increase.

According to CICC, from 2012 to 2018, the growth of raw milk demand in Chinese market will be 47%. There are two main reasons that stimulate the growth of China's dairy consuming market:

1. The continuing growth of income drives the upgrade of consuming capability. In the past 5 years, the Compound Annual Growth Rate of national average income in China was 10.7%. At the moment, the average dairy product consumption in urban and rural areas is 25 kg and 12.3 kg per person per year, by comparing with developed countries, it still has rooms of 35% in urban and 170% in

rural to rise in the future.

2. The rapid growth of new dairy products sales expanded the demand of raw milk. In the past 5 years, the Compound Annual Growth Rate of milk drinks was 17%. The graph below shows the predicted sales volume of flavored milk drinks from 2007 to 2017.



IV. Dairy Companies in China

IV.1 Chinese Dairy Companies

There are about more than 1500 dairy enterprises in China, while the number of enterprises with operation revenue above 5 million RMB is more than 400. The famous national brand companies are Inner Mongolia Yili Industrial Group Co., Ltd., China Mengniu Dairy

Co., Ltd., Shanghai Bright Dairy & Food Co., Ltd., Hebei Sanyuan foods Corporation and so on; moreover, some foreign dairy brands own large part of the Chinese dairy market, such as Danone from France and Nestlé from Switzerland.

In 2012 the top 4 Chinese dairy companies are also listed on stock exchange board:

(Unit: 100 Million)

Company	Total Assets		Operation Revenue		Main Operating Income		Net Profit	
	RMB	USD	RMB	US	RMB	USD	RM	USD

				D			B	
Inner Mongolia Yili Industrial Group Co., Ltd.	198.1	32.3	419.9	68.4	417.4	68.0	17.4	2.8
China Mengniu Dairy Co., Ltd.	209.9	34.2	363.4	59.2	360.8	58.8	14.4	2.4
Shanghai Bright Dairy & Food Co., Ltd.	93.4	15.2	137.8	22.4	136.3	22.20	3.4	0.6
Hebei Sanyuan foods Corporation	36.5	5.9	35.5	5.8	35.2	5.7	0.1	0.02

In 2012 the dairy industry reported sales revenue of 246.54 billion RMB, among which the top 4 dairy companies merely accounted for almost 40% market share, while foreign dairy companies made up more than half of the market.

Market Share of the Top 4 China Dairy Companies



1. Inner Mongolia Yili Industrial Group Co., Ltd. (Yili)

In 2012, Inner Mongolia Yili Industrial Group Co., Ltd. reported total assets of 19.815 billion RMB and operation revenue of 41.991 billion RMB, up by more than 12% year on year. Yili Group enjoyed annual sales of more than 15 billion bags in 2012 and exclusively dominated the three advanced milk sources areas: Hulun Buir Grassland in Inner Mongolia, Xilin Gol Grassland in Inner Mongolia and Xinjiang Tianshan Mountain.

Their major products are liquid milk, ice cream, cheese and milk powder, and mixed feed. They have more than 1000 types of dairy products.

Yili had operation revenue of RMB 32.271 on liquid milk sector which accounted 77% of their total operation revenue. Shuhua Milk (low lactose

milk) and Satine are star products and major profit sources of Yili Group.

Moreover, Yili Group outperformed other Chinese dairy companies in the ice cream sector. In 2012, the operation revenue from ice cream sector was RMB 4.294 billion, accounted 44.84% of total operation revenue, which had ranked the 1st in China for 19 years.

2. China Mengniu Dairy Co., Ltd. (Mengniu)

In 2012, China Mengniu Dairy Co., Ltd. reported total assets of 20.99 billion RMB and operation revenue of 36.08 billion RMB. With the development of its nationwide market in 2012, the production output capability of Mengniu reached 7.58 million ton and Mengniu owned 30 production bases in 17 provinces.

Their major products are liquid milk, ice cream, cheese and milk powder, which had revenue of 32.337 billion RMB, 3.171 billion RMB and 0.572 billion RMB in 2012. The revenue from liquid milk dominated their profit source, occupying nearly 90% of their total operation revenue. Their liquid milk products include UHT milk, milk beverage, and yogurt. As one series of UHT milk, which is Mengniu's core

product, Milk Deluxe series is the most profitable product.

3. Shanghai Bright Dairy & Food Co., Ltd. (Bright Dairy)

Shanghai Bright Dairy & Food Co., Ltd. reported total assets of 9.339 billion RMB and operation revenue of 13.775 billion RMB in 2012.

Their major products are liquid milk, cheese, milk powder and other, with revenues of 9.888 billion RMB, 3.164 billion RMB and 0.579 billion RMB in 2012. The high quality liquid milk product almost dominated 3 quarter of their total operation revenue.

4. Hebei Sanyuan foods Corporation (Sanyuan)

Hebei Sanyuan foods Corporation reported total assets of 36.46 billion RMB and operation revenue of 35.53 billion RMB in 2012. Sanyuan has already built 16 major production bases throughout China and is capable of dealing with more than 1000 tons fresh milk every day. Mainly focusing on the Beijing market, Sanyuan has also extended its market to more than 50 regions and cities in China.

Their main products are liquid milk

and solid milk (cheese, milk powder and other) including more than 100 kinds of products, with revenues of 2.871 billion RMB and 0.643 billion RMB respectively.

IV.2 International Cooperations

Chinese dairy companies with overseas investments:

Inner Mongolia Yili Industrial Group (Yili)

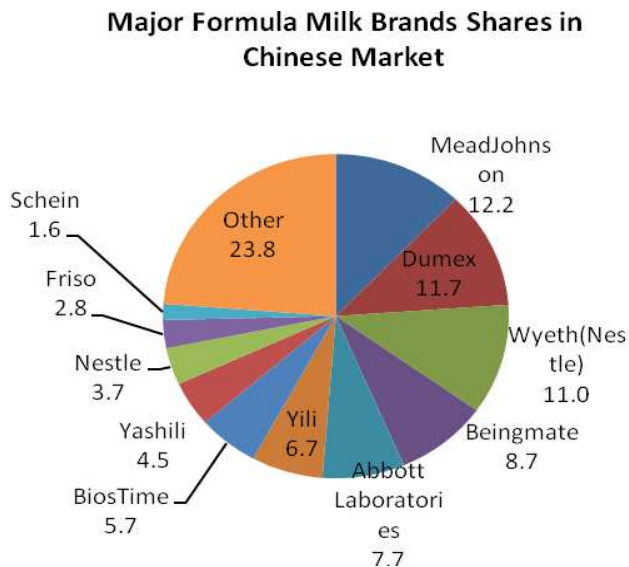
- In December 2012, Yili spent 214 million USD building an infant formula milk product plant in South Canterbury, New Zealand. The plant is scheduled to be completed by June 2014 operating at 60 percent capacity, with annual full capacity of 47,000 tons expected in the 2016/17 year;
- In July 2013, Yili signed a memorandum of understanding (MOU) to build a long-term strategic partnership on milk purchases and farm services with Dairy Farmers of America Inc. (DFA), which represents about 30 percent of the US raw milk producers.

Bright Dairy & Food co., Ltd (Bright Dairy)

- At the end of 2010, Bright Dairy acquired a 51% stake in the New Zealand-based dairy producer Synlait for \$58 million, which used the money to lift exports of milk powder and infant formula to China and help Bright Dairy establish a market leading position in the infant formula and milk powder category;
- In August 2011, Bright Dairy acquired 75% of stakes in Manassen Foods at an Value of 30 million AUD (554 million USD)thus entered into the Australian market;
- In November 2012, Bright Dairy spent about 700 million pounds (7 billion yuan/\$1.14 billion) in purchasing 60% of the shares in Weetabix, the second-largest maker of breakfast cereals in the United Kingdom and has about 14.5 percent of the UK market share and exports its products to over 80 countries;
- Since September 2013, Bright Dairy the second-largest food manufacturer in China has been in touch with Israel's largest food producer Tnuva Food Industries

Ltd., over a potential acquisition, which is valued at \$1.29 billion.

- **Foreign dairy companies in China:**



Foreign brands own over 70% shares of Chinese high level milk market. Additionally, the proportion of imported milk powder in Chinese market increased from 30% to over 50% from 2008 to 2012 as the data released from China Chamber of Commerce of Foodstuffs and Native Produce in 2012; moreover, in high level milk powder market, foreign brand accounted about 70% market share.

From another statistic by AC Nielson (Markey analyze company from Netherlands), in 2012, among the Top 10 Formula Milk brands in China, 6 of them are foreign brands that accounted 52.1% of Chinese formula milk market share. While Mead Johnson, Dumex, Wyeth and Abbott

Laboratories are the top 4 which accounted 12.3%, 11.7%, 11% and 7.7% market share.

Wyeth Pharmaceuticals Inc.

- In March 2008, Wyeth invested \$280 million to build a state-of-the-art nutritional manufacturing facility in Suzhou Industrial Park. This investment reflects Wyeth's long-term commitment to pediatric nutrition, as well as the recognition that China is now the fastest-growing market.

Danone Group

- Danone from France established a new Joint-Venture company with China Agri-Industries Holdings Limited. Through the new JV company, Danone will own 4% shares of Mengniu, moreover, Danone will merge their yogurt business with Mengniu to expand their yogurt business in China;
- Danone purchased Guangdong Miaoshi Dairy Corporation, and cooperated with New Hope Group to expand their dairy business in China;
- In May 2013, Danone has agreed to invest 325 million EUR (417

million USD) in Mengniu to expand Chinese dairy market. Additionally, Mengniu can expand its European market through Danone's platform.

- In June 2013, Danone Group has invested in two joint projects with Mengniu, which helped to improve the French food giant's sliding market share in China.
- Dumex, a milk powder producer subsidiary of Danone, invested 800 million RMB on increasing production capability of its Shanghai plant.

Nestle Corporation

- In January 2012, Nestle started to build a new dairy farming institution in Heilongjiang, China, which will strive to be China's leading dairy training centre for exports both in the country and globally.

Abbott Laboratories

- In August 2011, Abbott has invested \$230 million to build a new nutrition manufacturing facility in Jiangxi province, China to produce premium milk powder products.

Arla Foods

In June 2012, the European dairy giant Arla Foods purchased 5.9% shares from China Mengniu Dairy Company Limited with investment of 2.2 billion HKD to become the 2nd largest strategic investor in Mengniu. Arla Foods will introduce advanced Danish milk sources control, milk business management system and dairy product process technology to Mengniu. This cooperation promoted the dairy cooperation between China and Danish to establish a dairy technology cooperation center in China, which will further improve the construction and quality management level of milk source bases to international standard.

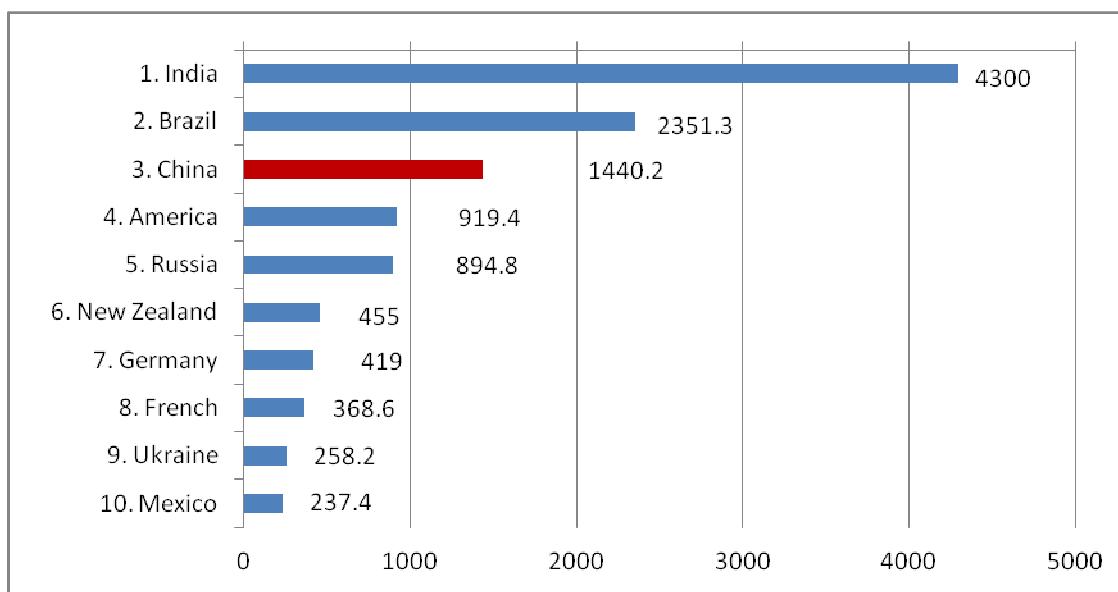
- In April 2006, Mengniu established MENGNIU ARLA brand with the premier Denmark dairy manufacturer Arla Foods, jointly developing high quality milk powder products;
- In June 2012, a strategic cooperation agreement was signed between Mengniu and Arla Foods, a European dairy industry leader. Arla Foods injected 2.2 billion HK dollars in Mengniu and obtained 5.9% of total shares in Mengniu.

Others

- Synlait Milk from New Zealand was merged by Bridgt Dairy. After the M&A, they established a factory together to produce high level infant formula milk products in New Zealand and export products to China;
- ASAHI from Japan produces ASAHI brand formula milk products in Shandong province and entering into Chinese high level milk consuming market;
- MAEIL Dairies from Korea is selling their formula milk products in China
- Success Dairy is a Joint-Venture company by New York-based private equity firm KKR & Co LP and Chinese private equity firm CDH Investment. Success Dairy and China Modern Dairy Holdings Ltd established a JV company to build two, 10,000-cow farms in Shandong province in the future 2 years with the investment of 140 million USD. The JV farms will operate cow feeding and selling, as well as dairy products producing, processing and selling businesses.

V. 2011 Chinese dairy industry statements compared with other countries

Top 10 livestock Holding Volume of Cows by Countries (10,000 cows)



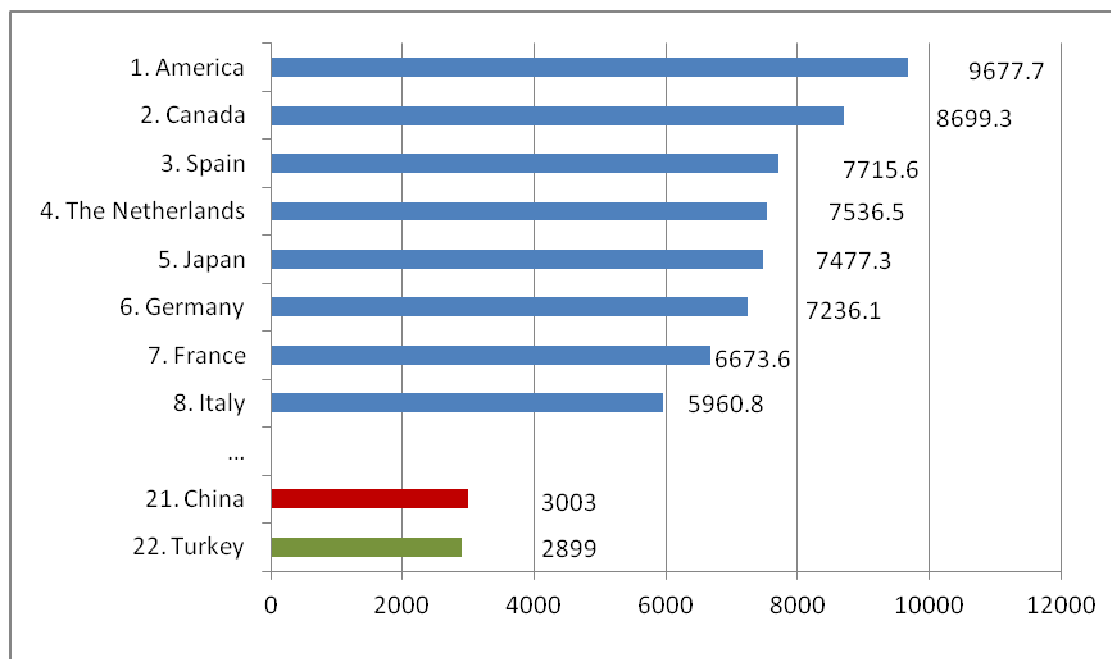
Source: 2013 China Dairy Statistical Summary

Top 10 Milk Production Volume by Countries			
	Country	Volume (mil. tons)	Proportion of the World %

	World	620.66	
1	America	89.01	14.3
2	India	57.7	9.3
3	China	36.58	5.9
4	Brazil	32.9	5.3
5	Russia	31.65	5.1
6	Germany	30.34	4.9
7	France	25.12	4.0
8	New Zealand	18.97	3.1
9	UK	14.08	2.3
10	Turkey	13.8	2.2

Source: 2013 China Dairy Statistical Summary

Top Average Milk Production Volume per Cow by Countries (kg/cow/year)



Source: 2013 China Dairy Statistical Summary