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Global Agricultural Information Network

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China - Peoples Republic of

DAIRY AND PRODUCTS ANNUAL

2009 Annual Report

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Report Highlights:

FAS/Beijing forecasts China's 2010 milk production will rise 10 percent to 32.5 million metric tons (MMT), rebounding from sharply lower production in 2009. The production gains will be fueled by rising consumer demand for local milk, which is gradually recovering from the effects of the 2008 melamine scandal. After rising threefold in 2009 to more than 160,000 metric tons, Chinese imports of whole milk powder are expected lower next year as higher international milk prices and increasing domestic production combine to limit import demand. China's imports of U.S. whey in 2009 are estimated at nearly 180,000 metric tons, roughly double the levels the year before, boosted by strong demand in both food and feed channels.

Executive Summary:

FAS/Beijing estimates China's raw milk production in 2009 will fall below 30 million metric tons (MMT), down 16 percent from last year. Lower production in response to weak consumer demand in the first half of 2009 following the September 2008 melamine contamination, will be partially offset by rapidly improving market conditions in the latter half of the year. The current rebound in production will continue through 2010, with total production estimated to rise 10 percent to nearly 33 MMT. Chinese whole milk powder (WMP) production in 2010 is forecast at 1.03 million metric tons, up five percent from the year before. Modest growth is also forecast for nonfat dry milk (NFDM) production, up two percent to 56,000 metric tons (MT).

Chinese imports of WMP in 2010 are forecast at 120,000 MT, down by one-fourth compared to 2009 levels. WMP imports in 2009 are estimated at more than 160,000 MT, up threefold from the year before fueled by strong demand for alternatives to local dairy ingredients. An expected rise in international milk prices and higher domestic production will combine to limit WMP imports next year. Meanwhile, China's imports of NFDM in 2010 will continue rising to nearly 70,000 MT as limited Chinese NFDM production will fall short of rising Chinese NFDM demand. While representing a small fraction of total Chinese milk consumption, fluid milk imports are forecast to will continue higher, rising by one-fourth in 2010 to 15,000 MT, in response to continued strong demand from high-end consumers.

Chinese imports of whey are expected to exceed 300,000 tons in 2009, up almost 50 percent from 2008. Low whey prices and strong demand in both the animal feed and processed food channels are fueling sales this year. The United States is the top supplier, accounting for roughly half of total shipments in 2009, valued at more than \$80 million. Whey products remain the most important U.S. dairy export to China.

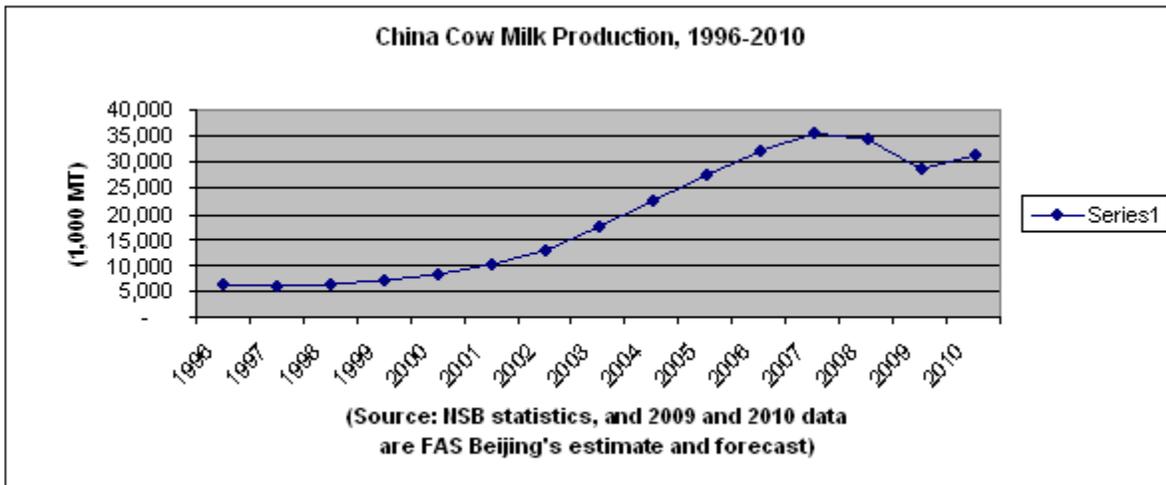
Meanwhile, Chinese exports of dairy products will continue to slide in 2010, with fluid milk falling 32 percent to 13,000 tons. Overseas consumer perceptions about Chinese dairy product safety are hampering recovery in sales through export channels.

Commodities:

Select

Production:

Raw Milk Production to Rebound in 2010 to Nearly 33 MMT



After posting steady gains for 10 straight years, Chinese milk production is estimated to drop 16 percent to 29.6 MMT as consumer demand continued weak following the widespread melamine contamination of Chinese dairy products in

September 2008. Small backyard farmers bore the brunt of the reduced demand as processors eliminated or sharply reduced purchases from milk collectors, the primary distribution channel for small-scale operators. Post estimates that nearly 15 percent of China's dairy herd was eliminated through slaughter or dry-up. A sharp rise in imported milk powder, reaching 220,000 metric tons in the year ending September 2009, up from less than 90,000 MT in the same period the year before, also impacted demand for domestic milk. In response to weak demand for local milk, the Chinese government extended its milk processor loan subsidy until April to enable processing plants to collect unsold milk from dairy farmers. The government also announced purchases of 50,000 MT of milk powder for state reserves. Overall, milk powder stocks exceeded an estimated 300,000 MT by May 2009.

As small-scale farmers exit the business or combine into larger operations, China's dairy industry is emerging from the melamine crisis with more efficient operations that are better capitalized at the farm level and well-positioned to meet projected future strong demand growth in Chinese dairy demand. Traders report the long-awaited rebound in demand has already begun as international milk prices began rising in September. The ramp up in local demand has pushed Chinese fluid milk prices up toward 3 yuan (\$.44) per kilogram, up from 2.2 yuan (\$.33) per kilogram in early 2009, and the highest level since early 2008. The strong upward price pressure is expected to continue through early 2010 as Chinese operators gradually respond with increased supplies. The strong production gains are expected through 2010, with total volumes projected to rise 10 percent to almost 33 MMT.

To encourage dairy industry restructuring, the National Development and Reform Commission (NDRC) and the Ministry of Industry and Information Technology jointly announced the "China Dairy Industry Policy" (Revision 2009) on June 26, 2009. The policy directs firms building new dairy processing facilities to source at least 40 percent of its raw milk from its own herd, up from 30 percent previously. Furthermore, companies that improve or expand existing facilities must control no less than 75 percent of its raw milk source sent to the improved plants. In addition, the policy directs fluid milk processors (including pasteurized and UHT) to use raw milk for all fluid milk sales. In the past processors were allowed to use reconstituted product for sales of UHT fluid milk.

The government is also undertaking a broad revision of China's dairy product standards geared to better ensure safety and quality, and improve consumer confidence. In late October 2009, the Ministry of Health (MOH) issued draft updated standards for a number of products including fluid milk, milk powder, whey, and infant formula. The revisions include new microbiological standards and guidelines for storage and transportation.

In response to the need for stepped up modernization and industry restructuring in the wake melamine, several major dairy companies have launched new investments in raw milk and processing. Yili Dairy Group, China's largest dairy company based in Inner Mongolia, reports that 75 percent of its raw milk is now under the company's control. Yili continues to build new production facilities, including a 12,000 head operation scheduled to open later this year. In July 2009, China Oil and Foodstuffs Corporation (COFCO) bought 20 percent of stock shares from Mengniu, the second largest Chinese dairy company, to help bolster Mengniu's production capacity. New Hope Co. has just invested RMB100 million (\$11.6 million) in dairy farm construction.

Subsidies for Breeding Dairy Cows on the Rise

According to the Ministry of Agriculture (MOA), the Chinese central government provided RMB990 million (\$114.7 million) in breeding animal subsidies in 2009. The amount is double the total amount of the previous two years. Subsidies for breeding cows include more than 7 million head of Holstein and Jersey cows, in addition to minor breeds, including 430,000 dairy buffalos in nine provinces including Guangxi and Yunnan, 270,000 Simmental cows in eight provinces including Inner Mongolia and Jilin, 260,000 head of brown cows in Xinjiang, and 50,000 head of Sanhe (Wagyo) cows in Inner Mongolia. Each productive Holstein or Jersey cow is subsidized with RMB30 (\$4.4) for two straws of frozen bull semen (for artificial insemination) a year, while other breeds get RMB20 (\$2.93) for two straws of frozen bull semen a year. China's urgent need for improvement in genetics will translate into rising animal genetic imports in 2009 and 2010. While a small fraction of Chinese bovine genetics sales, bull semen imports from the United States have recently made inroads in the Chinese market. 2009 sales through September exceeded \$2 million.

Both Non-Fat Dry Milk and Whole Milk Powder Production Increasing

Post forecasts China's whole-fat milk powder (WMP) production in 2010 to increase five percent to 1.03 MMT, following a 13 percent decrease in 2009. In 2009, processors reported weak demand for WMP for a range of products, including retail packets of milk powder, infant formula, and reconstituted milk products as processors shifted to imported ingredients.

Chinese imports of preparations for infant use are forecast to top 60,000 metric tons in 2009, up from 42,000 metric tons in 2008. However, dairy processors are reporting rising demand for local WMP in late 2009 as consumer confidence slowly rebounds. Post forecasts China's 2010 NFDM production to increase two percent to 55,000 MT from the previous year boosted by comparatively stable sales in specialty products targeted for adults.

Consumption:

Strong Gains in Dairy Consumption Expected in 2010

Fluid Milk: China's fluid consumption in 2010 is expected to rise 12 percent to 13.2 MMT following a 19 percent decrease in the previous year. UHT milk accounts for 90 percent of Chinese consumption as cold-chain constraints limit sales growth in pasteurized milk. Yili and Mengniu, both based in Inner Mongolia, are the largest UHT producers, with a huge presence as each operate over 500,000 sales stations across China. Industry is increasingly focusing on consumers outside of urban areas where growth potential is considered greatest. Government initiatives to encourage milk consumption are also on the rise. These include a "One Glass of Milk a Day" (UHT) project aimed at expecting mothers in poor rural areas.

Non-fat Dry Milk (NFDM): China's NFDM consumption growth has been robust in recent years with imported NFDM accounting for nearly all the gains. Post forecasts China's NFDM consumption in 2010 to increase five percent to 125,000 MT, up from an 11 percent increase in 2009. NFDM is mainly for products geared to specific consumer groups such as older people or dieting adults. With China's aging population, NFDM demand is expected to continue strong.

Whole-fat Milk Powder (WMP): Post forecasts China's WMP consumption in 2010 to increase 11 percent to 1.17 MMT. WMP consumption is expected higher in both the retail milk powder and dairy foods markets.

Trade:

WMP Imports to Decline But Will Remain High

Post forecasts China's imports of WMP in 2010 will decline by one-fourth to 120,000 metric tons. A combination of rising international milk prices, higher domestic production, and release of state reserves should lower imports. In late 2009, traders are already witnessing rising purchases of domestic WMP due mainly to rising prices for imported WMP. New Zealand is the largest supplier of Chinese WMP imports accounting for 86 percent of 2009 shipments (through September).

Total NFD Milk Imports to Increase, While U.S. Shipments Shrink

Fueled by strong demand and limited Chinese production, Post forecasts China's NFDM imports in 2010 will continue higher, rising eight percent to 70,000 MT, following an 18 percent increase in the previous year. Imports from the United States have fallen dramatically in 2009 following record sales of more than 15,600 tons in 2008, as low prices this year have dropped below support prices.

Fresh Milk Imports Surge Higher

While still a niche market, Chinese fluid milk imports have tripled in recent years, up from just over 4,000 tons in 2007 to an estimated 12,000 tons in 2009. The strong demand is fueled by sales to wealthier Chinese and expats who are willing to pay up to 18 rmb (\$2.64) per liter of imported milk at retail. New Zealand, Australia and France account for almost 90 percent of sales. Fluid milk imports are expected to approach 15,000 metric tons in 2010.

U.S. Whey Exports to China Continue to Surge Higher

2009 Chinese imports of whey are expected to rise by half from the year before to more than 300,000 metric tons. The United States accounts for roughly half of Chinese whey imports. Low whey prices in the first half of 2009 encouraged Chinese food processors to replace domestic milk powder with cheaper dried whey or whey protein concentrate. Strong sales are also due to robust feed demand from China's 500 million head hog sector. Other major whey suppliers to China include France, Ireland, the Netherlands, and Germany.

Nearly Eighty Percent of Chinese Dairy Export Market Lost

Chinese milk product exports continue to slump, with fluid milk exports falling from nearly 46,000 MT in 2007 to an estimated 19,000 MT in 2009, and whole milk powder exports falling from more than 62,000 MT to an estimated 12,000 MT this year. Following the melamine incident, China faced product bans and buyer resistance in most markets and weak demand has continued through 2009. Former key markets with little or no sales so far in 2009 include Taiwan, Thailand, Singapore, and the Philippines. Continued weak sales are forecast in 2010, with fluid milk exports expected to fall by one-third to 13,000 MT and WMP exports dropping 17 percent to 10,000 MT.

Policy:

Fresh Milk, Milk Powder, and Whey Imports under ARF Management

On July 16, 2009, the Chinese Ministry of Commerce (MOFCOM) and the General Customs Administration (GCA) jointly announced that as of August 1, 2009 imported fresh milk, milk powder, and whey are included in the list of major agricultural commodities subject to import monitoring. Importers must complete an Automatic Registration Form (ARF) to receive a permit from the China Chamber of Commerce for Import and Export Foodstuffs, Native Produce and Animal Byproducts (CCFNA) under MOFCOM prior to importation. While the purpose of the ARF is to monitor imports, there can be business disruptions to the importer. Importers of U.S. products subject to the ARF have reported occasional delays in MOFCOM processing applications and issuing import permits.

China Tightens Enforcement of Benzoic Acid and Nitrite Standards in Imported Dairy Products

In 2009, AQSIQ (General Administration of Quality Supervision, Inspection and Quarantine) stepped up enforcement of China's zero tolerance for benzoic acid, a commonly used substance found in U.S. whey and many other products worldwide. Several U.S. whey powder shipments have been detained due to detections of benzoic acid upon arrival in China.

USDA and the U.S. Dairy Export Council have petitioned the Ministry of Health to approve benzyl peroxide and benzoic acid for use in whey production. An application and safety data were presented to the MOH Bureau of Food Safety Integrated Coordination and Health Supervision of MOH. It is not known how long the review will take nor the expected outcome.

Meanwhile, China has also increased its inspection of imported dairy products for nitrite residues. China's 2 ppm maximum residue level (MRL) for nitrite in milk powder, infant formula, and whey, is significantly lower than international standards. In the past, the different standards have resulted in stopped shipments during periods of heightened enforcement.

Marketing:

(Reported by Hongyu Zhang at ATO Shanghai)

1.1 Market Size

Overall the dairy industry in China has been sustaining a high speed growth over the past ten years. More and more Chinese consumers believe in milk and milk products as an excellent source of protein and calcium. The rise in disposable income, increasing health consciousness among the growing middle class, and fast expanding retail outlets all attributed to the rapid growth of dairy industry. The positive attributes of dairy products are also recognized by the Chinese government, which actively supports development of the industry.

Despite the melamine scandal took place just one year ago, the Chinese dairy industry is still one sector of the food industry that enjoys the best growing momentum. According to Euromonitor statistics, total dairy sales in China reached RMB 143.8 billion (USD 21.1 billion) in 2008, representing a 4% increase from 2007, and 78% growth over five years ago. According to China Ministry of Industry and Information Technology (MIIT), dairy industry turnover accounted for 20% of the whole food industry in China in 2008. China's dairy industry showed a surprising resilience – by July 2009, the dairy market has recovered to 90% of the pre-scandal consumption level, according to relevant industry associations. The dairy production during January-August this year reached 12.52 million metric tons, nearly up to the same level one year ago. August 2009 even saw a production growth of 9.4% over same period in 2008, among which the milk powder production reached 660,000 metric tons, a 9.5% increase over August 2008. In the first half of 2009, the four dairy giants Yili, Mengniu, Bright and San Yuan achieved a total profit of around RMB 1billion (\$ 147 million), representing a 16.6% growth over same period in 2008.

The per capita consumption of dairy products in China's urban area is around 29 kg, but in rural areas, the per capita consumption is only around one tenth of that figure. Compared with the average per capita consumption of 268 kg in developed countries, and 51 kg in developing countries in the world, there is a big room for growth for China's dairy market. That also explains why China's dairy market, facing so many challenges, can bounce back quickly after serious setbacks and still show considerable potential for future development.

Retail Value of Dairy Markets (million \$)

	2004	2005	2006	2007	2008
Dairy Products	11,822	14,716.7	17,451.6	20,161.9	21,057.3
Drinking milk products	9,753.4	12,277.2	14,433.6	16,536.8	17,077.6
Cheese	49.9	58.9	69.7	81.9	97.9
Yoghurt & sour milk drinks	1,867.6	2,220.2	2,778.3	3,362.1	3,688.9
Other dairy products	151.1	160.2	170	181	192.9

Source: Euromonitor (Exchange rate between USD and RMB: 1vs 6.83)

1.2 Distribution Channels and Marketing Tools

In China, more than 78% of the dairy products go to consumers via retailers, many of whom have significantly consolidated during the past five years. Supermarkets/ hypermarkets have been evolving into the major outlets for all varieties of dairy products. For cheese products, yogurt and take-home ice cream, the supermarkets' role is even more important due to consumer's confidence in their comparatively better cold chain facilities. Improved availability of supermarkets and convenience stores in rural areas also contributed to their increasing share in the distribution channel, while small independent food stores, which used to be the main retail force in rural areas, have become less important.

Dairy Products Distribution Channel % Breakdown in 2008

Dairy product categories	Supermarkets/ hypermarkets	Independent food stores	Convenience stores	Others
Drinking Milk Products*	32.0	28.0	14.0	26.0
Cheese	93.0	5.0	-	2.0
Yogurt/sour milk drinks	78.0	3.0	14.0	6.0
Other dairy products	77.0	3.0	14.0	6.0

*Drinking milk products include fluid milk and milk powder etc.

Source: Euromonitor

Statistics show that dairy product sales growth is in direct proportion to their investment in advertising. Hence major players invest hugely in branding and advertising. TV commercials are the most important promotion approaches for dairy products targeted at retail channels, and the most frequently advertised dairy products currently in China are fluid milk, infant formula or fortified milk powder with minerals, yogurt, ice cream and dairy drinks.

Some manufacturers have also raised awareness tremendously and strengthened the reputation of their dairy products by sponsoring certain political or entertaining projects with wide public attention. For example, Yili sponsored the Beijing

Olympic Games in 2008, Mengniu sponsored NBA program “More Milk, More Exercises” in China in 2009, and Bright Dairy also kicked off a program to sponsor the Chinese Academy of Sciences (CAS) and the Chinese Academy of Engineering (CAE) academicians living in Shanghai with Bright Dairy’s milk through Aug 1, 2009 to Aug 1, 2010.

Some dairy products, particularly fluid milk, reach consumers through special channels, and a “school milk program” which began in November 2000, is one of them. Under this program, milk is delivered to school students directly by the government-designated manufacturers who have good reputation on product quality and safety. Hui Bei Jia Dairy, a Sino-US dairy joint venture located in Harbin, bid for the dairy products sourcing project by UN High Commissioner for Refugees (UNHCR), the UN’s refugee agency, and by end of 2008, it has received orders of 15,000 metric tons from UNHCR.

Compared with the retail channel, there are fewer brands competing at the food service channel. The strong competition in retail markets and shrinking profits resulting from price wars are forcing some major players to explore the food service segment as well. Brands such as Angli from Sanyuan, Yiran from Yili, LOOK from Bright Dairy, and Muge from Mengniu are designed to target the food service channel. However, although the profit in food service channels may be double or even triple the profit achieved from retail channels, manufacturers face many challenges, such as: 1) the entrance fees are determined by hotels and restaurants individually and therefore could be very high; 2) most of the profit margin goes to restaurants and hotels, and the high price of the dairy products constrains the sales volume; 3) many hotels and restaurants pay the manufacturers or distributors after the products are sold, therefore influencing the cash flow of the latter. It is predicted that eventually competition will result in a lower price and profit for dairy products in the food service sector in the near future.

Major Product Categories

2.1 Fluid Milk: UHT milk vs. Pasteurized milk

Fluid milk has been the fastest-growing segment during the past five years. Fluid milk has become a feature of the middle class’ daily diet. For manufacturers, the fluid milk market has a lower price entry point compared with other dairy products which have higher processing technical requirements. There are currently more than 2,000 companies in China involved in fluid milk manufacturing. Fierce competition has forced the profit of fluid milk to hit historically low levels. Unit price of fluid milk increased slowly due to rising production cost and feed cost. The Chinese government, however, tries to maintain a stable price level in the fluid milk sector, and those leading dairy manufacturers must submit applications to the National Development and Reform Commission (NDRC) before they increase their prices.

UHT milk greatly improved the availability of fluid milk for consumers in urban areas, and it has quickly come to the fore and gained a larger market share during the past five years. At the national level, UHT milk has about 78% of the market share in 2008, but in big cities, e.g. Shanghai, pasteurized milk occupies more than 70% of the market share.

Behind the fiercest competition between UHT milk and pasteurized milk is the battle between the resource-oriented manufacturers, represented by Yili and Mengniu from Inner Mongolia and market-oriented manufacturers, represented by Bright Dairy from Shanghai and San Yuan from Beijing. China’s “cow belt” is located in northern China, although the major consumption market is mainly in the coastal provinces in eastern and southern China, where consumers are more affluent.

The higher cold chain logistics costs of pasteurized milk have resulted in a 20% higher retail price over UHT milk, and in a price-sensitive market, this makes a difference.

In addition, sales of pasteurized milk rely heavily on cold chain logistics, which requires huge investments in infrastructure and human resources. The burgeoning market demand cannot wait for this, so it is not surprising that the UHT milk is quickly filling the gap. UHT milk will likely continue to have a leading role in new market development into remote areas, which have comparatively lower average milk consumption and poor cold chain infrastructure.

The pasteurized milk industry, led by Bright Dairy, has been using the “freshness” as the biggest selling point. However, since 2007, Bright Dairy realized it could not afford to give up the UHT milk market, and strengthened its investment in this sector. Bright Dairy achieved sales of \$ 250 million for its UHT milk in 2007, a 20% growth from 2006. In 2008, although disturbed by the melamine scandal, its sales on UHT milk still amounted to \$ 332.4 million, an increment of 31.4% over 2007. By end of 2008, Bright Dairy ranked No.1 in pasteurized milk with 26% of the market share, and also increased its UHT milk market share from 6% to 9%.

2.2 Cheese

Not a traditional food in the Chinese diet, the cheese market is small, but one with great growth potential. The concept that cheese is a good source of protein and calcium for supposedly lactose-intolerant Asian people has found its way in the middle class consumers’ mind. From 2003 to 2008, China topped the emerging markets in the world with total volume sales growth of 114%. According to Euromonitor, retail value sales of cheese grew by 16% in 2008 to \$ 97.9 million.

Starting in China only ten years ago, the pizza restaurants have increased to over 4,000 by 2008. While food service remains the important channel of cheese consumption, e.g. mozzarella cheese from Europe, New Zealand and United States are widely used in pizza and fast food making, retail channel sales growth outperformed foodservice in 2008. In the retail channel, processed spreadable cheese, which is frequently used as a complement for breakfast toast, was the highest growth sub-sector in 2008, with an increase in value of 17%. Cream cheese is widely used for making cakes and other bakery products, and contributed 71% of the retail value sales in 2008.

Currently the key consumers of cheese are foreigners living or traveling in China and returnees from abroad. Manufacturers have continued to develop products with flavor or fortified with vitamins and minerals that appeal to Chinese health-conscious consumers.

Almost all cheese available in the China market are imported and processed. In 2008 China imported 13,904 metric tons of cheese, mostly from Australia, New Zealand and the U.S. Domestic leading dairy companies including Bright Dairy, Sanyuan and Yili launched their cheese processing lines, and began their consumer education programs. Bright Dairy leads the cheese sales with 50% of the market share, and Anchor, the New Zealand brand, and Pikoufu, a French brand tailored to Chinese tastes, ranks No.2 and No.3 respectively in the cheese sector. The top three brands occupy over 60% of the market share.

Cheese Brand Market Share by Retail Value (2004-2008)

Brand	Company name	2004	2005	2006	2007	2008
Bright	Bright Food (Group) Co Ltd	31.9	33.4	33	30.2	49.8
Anchor	Fonterra Co-operative Group	17.4	18.4	17.9	17.7	18.4
Pikifou	Bongrain SA	5.8	6.3	6.4	6.6	6.7

Sanyuan	Beijing San Yuan Foods Co Ltd	5.4	5.1	4.8	4.4	5
Suki	Shanghai Gaofu Longhui Foods Co Ltd	4.4	4.8	4.7	4.6	3.6
Mainland	Fonterra Co-operative Group	1.9	2	1.8	1.7	1.4

Source: Euromonitor

The lack of an integral and unbroken cold chain is the No.1 factor that holds back cheese sales in China. In addition, the high prices of cheese make it a luxury food item for mass consumers in China. With locally produced or packaged cheese products gaining more of a presence in retail channels, the average unit price of cheese is expected to decline.

2.3 Yoghurt and sour drinks

Yogurt is another fast growing dairy product in China. It has been growing at an average annual rate of over 20% since 2000. In 2008, the sales growth of yoghurt and sour milk drinks slowed down to 9.7%. Yogurt is a comparatively mature product for Chinese consumers, and reduced competition has resulted in higher profitability. Compared with fluid milk however, the yogurt market is more difficult to enter due to the higher production technologies required. Bright Dairy, Mengniu, and Yili are domestic leaders in this sector. In 2008, Bright Dairy raised its market share from 44% to 47% and maintained its No. 1 rank in the yoghurt market. Wahaha, a Hangzhou brand and Mengniu rank No. 1 and No. 2 in sour drinks.

Milk Powder

The milk powder sales growth is slowing, and most of its growth has been in underdeveloped areas in west and central China.

In the first half of 2009, China still found it difficult to export any milk powders to overseas markets. Meanwhile, due to staggering dairy prices in international markets, large quantities of low-priced milk powder are imported into China, making the inventory crisis of domestic manufacturers even worse. According to industry associations, milk powder inventory reached 350,000 metric tons during January to May 2009.

The high value-added infant formula milk powder market is nearly monopolized by multinational giants from Europe, United States, and Australia. Apart from the advantages in technology, foreign companies also enjoy a competitive edge in branding and channel management. The infant formula melamine contamination crisis provided huge opportunities for imported dairy products, especially infant formula, which gained enormous trust among more affluent Chinese consumers. Foreign infant formula brands raised prices several times during the past year, but the concerns on food safety made the young parents in China less price sensitive.

2.4 Niche market and new products

The supply squeeze has been driving dairy manufacturers to explore markets in second and third tier cities and even rural areas. Meanwhile, the giants as well as small and medium-sized companies are exploring niche markets for higher profitability, striving to achieve unique values created through innovation in products, branding and marketing.

Momchilovtsi, the high-end yoghurt with a shelf life of 90 days was launched by Bright Dairy in January 2009 and proved a huge success. It is the first shelf-stable yoghurt without need for cold chain ever launched in the China market, and realized sales of nearly \$ 6 million in the first quarter of 2009, four times of Bright Dairy's historical sales record of newly launched product.

The concerns about food safety are driving the more affluent consumers in urban areas to pick up organic milk, either imported or produced domestically. In addition to import brands, Yili and Mengniu launched organic milk brands in 2008. However, constrained by the strict certification process and high technology requirements as well as high price, the organic milk market is unlikely to grow rapidly in the near future.

Coffee whiteners enjoy strong growth in 2008 thanks to growing demand for coffee in China. Its sales rose 8% in value and 7% in volume over 2007.

Flavored milk drinks with fruit were the fastest growing sub-sector among drinking milk in 2008. By targeting teenage consumers who favor taste more than health benefits, flavored milk drinks marketed effectively among younger consumers by positioning themselves as unique and trendy. Some flavored drinks also added DHA, calcium or multivitamins and successfully attracted the attention of children's parents.

Key Players

There are a total of about 2,000 milk processors in China, and the domestic major players can be roughly divided into two groups: resource-oriented manufacturers and market-oriented manufacturers. The representatives of the former are Yili and Mengniu from Inner Mongolia, Wandashan from Heilongjiang, and Yinqiao from Shan'xi, while Bright Dairy from Shanghai, Sanyuan from Beijing, Nanjing Dairy Group from Nanjing and Jiabao Dairy from Jinan are the major players in the latter group. Geographically, the resource-oriented manufacturers are located in the north, and urban-oriented dairy manufacturers are closer to the major markets in the more populated east and south.

Yili, Mengniu and Bright Dairy rank among the top three manufacturers in terms of annual output, and the three together have more than 50% market share countrywide. Although all the three giants suffered huge losses in 2008, they still keep the top three positions till now. Mengniu has the highest market share in fluid milk, while Bright Dairy ranks No. 1 in yoghurt and cheese. Yili is more focusing on milk powder production, and its ice cream sales increased very fast in recent years.

Strong competition in the marketplace has been forcing the major players to seek to build up raw milk bases and production facilities nationwide, and has resulted in industry consolidation. The Chinese government has been also pumping money to larger companies helping them to expand significantly. Two of Yili's new milk powder production base, commissioned in second quarter of 2009, greatly enhanced its leading position in this sector. In July 2009, Mengniu claimed that China National Oils, Foodstuffs and Cereal Corp (COFCO), the largest oils and food importer and exporter as well as a leading food manufacturer acquired 20% of its shares, and became its biggest stakeholder. The deal has for the first time converted Mengniu into a state-owned company. Mengniu then announced their plan to build up 20 new large scale farms with the new investment. In June 2009, Bright Dairy finished its Haifeng Dairy Farm phase I project in Jiangsu Province, and received the first 6,000 cows from Australia. This new farm is expected to supply 200,000 tons of milk annually to Shanghai market. Meanwhile, Heilongjiang, Tianjin, Shanxi, Xining respectively announced their plans to build up large scale farms of over 10,000 cows in first half of 2009.

Major foreign dairy brands competing in the marketplace are mainly from Europe, the United States, Australia and New Zealand. Nestle, Wyeth, Dumex, Frisocare, and Mead Johnson are trustworthy brands of infant formula in the China market.

TS=TD 0 0 0

(This is not USDA official data. Please refer to USDA on-line PS&D for official data.)

No-Fat-Dry Milk PS&D Table

Dairy, Milk, Nonfat Dry China	2008 2008 Market Year Begin: Oct 2008			2009 2009 Market Year Begin: Oct 2009		2010 2010 Market Year Begin: Oct 2010		
	USDA Official Data	New Post Data	USDA Official Data	New Post Data	USDA Official Data	Jan Data		
Beginning Stocks	0	0	0	0	0	0	(1000 MT)	
Production	60	65	53	63	54	55	(1000 MT)	
Other Imports	54	39	55	65	65	70	(1000 MT)	
Total Imports	54	39	55	65	65	70	(1000 MT)	
Total Supply	114	104	108	128	119	125	(1000 MT)	
Other Exports	2	5	1	1	0	0	(1000 MT)	
Total Exports	2	5	1	1	0	0	(1000 MT)	
Human Dom. Consumption	112	99	107	127	119	125	(1000 MT)	
Other Use, Losses	0	0	0	0	0	0	(1000 MT)	
Total Dom. Consumption	112	99	107	127	119	125	(1000 MT)	
Total Use	114	104	108	128	119	125	(1000 MT)	
Ending Stocks	0	0	0	0	0	0	(1000 MT)	
Total Distribution	114	104	108	128	119	125	(1000 MT)	
CY Imp. from U.S.	21	4	16	25	6	5	(1000 MT)	
CY. Exp. to U.S.	0	0	0	0	0	0	(1000 MT)	
TS=TD			0		0	0		

(This is not USDA official data. Please refer to USDA on-line PS&D for official data.)

Whole-Fat Milk Powder PS&D Table

Dairy, Dry Whole Milk Powder China	2008 2008 Market Year Begin: Jan 2008		2009 2009 Market Year Begin: Jan 2009		2010 2010 Market Year Begin: Jan 2010		
	USDA Official Data	New Post Data	USDA Official Data	New Post Data	USDA Official Data	Jan Data	

Beginning Stocks	0	0	0	0	120	110	(1000 MT)
Production	1,200	1,200	1,120	1,270	977	1,030	(1000 MT)
Other Imports	35	35	46	38	165	150	(1000 MT)
Total Imports	35	35	46	38	165	120	(1000 MT)
Total Supply	1,235	1,235	1,166	1,308	1,262	1,260	(1000 MT)
Other Exports	54	54	62	30	12	10	(1000 MT)
Total Exports	54	54	62	30	12	10	(1000 MT)
Human Dom. Consumption	1,146	1,146	954	1,278	1,050	1,170	(1000 MT)
Other Use, Losses	35	35	30	0	90	10	(1000 MT)
Total Dom. Consumption	1,181	1,181	984	1,278	1,140	1,180	(1000 MT)
Total Use	1,235	1,235	1,046	1,308	1,152	1,190	(1000 MT)
Ending Stocks	0	0	120	0	110	70	(1000 MT)
Total Distribution	1,235	1,235	1,166	1,308	1,262	1,260	(1000 MT)
CY Imp. from U.S.	1	1	1	2	1	1	(1000 MT)
CY. Exp. to U.S.	0	0	0	0	0	0	(1000 MT)
TS=TD			0		0	0	

(This is not USDA official data. Please refer to USDA on-line PS&D for official data.)

Author Defined:

Dairy Products Trade Matrices

China Fluid Milk Imports, 2007-2009 (Year-To-Date) (Metric Tons)					
	Jan-Dec	Jan-Dec	Jan-Aug		Jan-Aug
	Quantity	Quantity	Quantity Comparison		% Change
Origin	2007	2008	2008	2009	2009/08
World	4,109	7,565	4,000	7,701	92.53
New Zealand	2,236	3,567	2,176	3,515	61.53
France	785	1,320	744	1,311	76.21
Australia	594	1,719	659	989	50.08
Germany	227	429	189	832	340.21
United States	3	12	9	33	266.67
Other	264	518	223	1,021	357.85
HS Codes: 0401.1000, 0401.2000, and 0401.3000					
Source: GTA China Customs Statistics					

China Non-Fat Milk Powder Imports, 2007-2009 (Year-To-Date) (Metric Tons)					
	Jan-Dec	Jan-Dec	Jan-Aug		Jan-Aug
	Quantity	Quantity	Quantity Comparison		% Change
Origin	2007	2008	2008	2009	2009/08
World	40,416	54,965	38,008	45,761	20.40
New Zealand	19,302	18,122	11,331	31,380	176.94
Australia	8,671	14,455	7,548	7,150	-5.27
United States	6,520	15,601	13,850	3,072	-77.82

Germany	2	1	1	1,301	130000.00
Netherlands	72	122	72	1,052	1361.11
France	1,179	1,249	985	349	-64.57
Canada	1,220	1,278	827	300	-63.72
Ireland	434	758	225	272	20.89
Belgium	0	475	475	1	-99.79
India	635	2,652	2,448	0	-100.00
Other	2,381	252	246	884	259.35
HS Codes: 0402.1000					
Source: GTA China Customs Statistics					

China Whole-Fat Milk Powder Imports, 2007-2009 (Year-To-Date) (Metric Tons)					
	Jan-Dec	Jan-Dec	Jan-Aug		Jan-Aug
	Quantity	Quantity	Quantity Comparison		% Change
Origin	2007	2008	2008	2009	2009/08
World	57,755	45,965	19,878	117,355	490.38
New Zealand	52,220	32,471	15,414	101,122	556.04
France	639	2,102	722	5,819	705.96
Australia	3,733	9,974	2,492	5,664	127.29
Netherlands	127	78	2	2,201	109950.00
Denmark	711	4	2	1,617	80750.00
Poland	0	50	50	500	900.00
Germany	0	68	45	125	177.78
United States	24	885	861	14	-98.37
Other	301	333	290	293	1.03
HS Codes: 0402.2100, 0402.2900, 0402.9100, and 0402.9900					
Source: GTA China Customs Statistics					

China Whey Imports, 2007-2009 (Year-To-Date) (Metric Tons)					
	Jan-Dec	Jan-Dec	Jan-Aug		Jan-Aug
	Quantity	Quantity	Quantity Comparison		% Change
Origin	2007	2008	2008	2009	2009/08
World	166,733	211,796	127,083	192,217	51.25
United States	49,723	90,478	51,603	95,488	85.04
France	47,168	50,672	32,214	31,813	-1.24
Germany	7,992	9,747	6,518	10,522	61.43
Finland	12,260	9,936	5,673	9,473	66.98
Netherlands	10,387	12,184	7,538	9,287	23.20
Ireland	6,021	8,630	3,200	8,637	169.91
Australia	6368	8,609	5,689	6,300	10.74
Canada	1410	3,880	2,699	4,879	80.77
Poland	2,954	1,807	1,775	4,161	134.42
Argentina	5,046	2,817	1,709	3,435	100.99
New Zealand	4,786	6,734	4,939	3,160	-36.02
Ukraine	2,200	1,875	600	1,950	225.00
Spain	0	96	0	864	0.00
Austria	579	308	185	800	332.43
Belgium	494	435	98	432	340.82
India	4,319	2,258	1,922	336	-82.52
Italy	1,104	443	147	222	51.02

Uruguay	580	0	0	150	0.00
Other	3,342	887	574	308	-46.34
HS Codes: 0404.1000 and 0404.9000					
Source: GTA China Customs Statistics					

China Cheese Imports, 2007-2009 (Year-To-Date) (Metric Tons)					
	Jan-Dec	Jan-Dec	Jan-Aug		Jan-Aug
	Quantity	Quantity	Quantity Comparison		% Change
Origin	2007	2008	2008	2009	2009/08
World	13,191	13,904	9,600	9,473	-1.32
New Zealand	5,425	6,233	4,124	4,610	11.78
Australia	4,417	3,432	2,606	2,588	-0.69
United States	1,193	1,998	1,310	1,049	-19.92
Netherlands	111	119	51	237	364.71
France	293	445	290	219	-24.48
Italy	171	216	146	164	12.33
Germany	530	401	316	70	-77.85
Other	1,051	1,060	757	536	-29.19
HS Codes: 0406.1000, 0406.2000, 0406.3000, 0406.4000, and 0406.9000					
Source: GTA China Customs Statistics					

China Fluid Milk Exports, 2007-2009 (Year-To-Date) (Metric Tons)					
	Jan-Dec	Jan-Dec	Jan-Aug		Jan-Aug
	Quantity	Quantity	Quantity Comparison		% Change
Origin	2007	2008	2008	2009	2009/08
World	45,559	38,428	31,531	12,724	-59.65
Hong Kong	37,284	28,114	22,076	12,614	-42.86
Macau	1,944	1,860	1,620	110	-93.21
Philippines	1,450	2,496	2,416	0	-100.00
Singapore	2,701	1,983	1,844	0	-100.00
Mongolia	1,105	1,897	1,716	0	-100.00
Libya	0	1,290	1,091	0	-100.00
Other	1,075	788	768	0	-100.00
HS Codes: 0401.1000, 0401.2000, and 0401.3000					
Source: GTA China Customs Statistics					

China Whole-Fat Milk Powder Exports, 2007-2009 (Year-To-Date) (Metric Tons)					
	Jan-Dec	Jan-Dec	Jan-Aug		Jan-Aug
	Quantity	Quantity	Quantity Comparison		% Change
Origin	2007	2008	2008	2009	2009/2008
World	57,629	62,387	41,000	8,251	-79.88
Venezuela	0	35,530	16,460	5,250	-68.10
Nigeria	980	3,027	2,347	1,683	-28.29
Myanmar	4,839	2,773	2,563	1,100	-57.08
Thailand	7,429	3,126	2,951	58	-98.03
United Arab Emirates	2,686	799	724	46	-93.65
Hong Kong	2,993	2,006	1,950	35	-98.21
Taiwan	14,959	7,732	7,016	12	-99.83
Singapore	1,532	280	280	2	-99.29
Sudan	225	944	944	0	-100.00

Mongolia	282	682	670	0	-100.00
Saudi Arabia	1,164	609	593	0	-100.00
Mauritania	816	515	515	0	-100.00
Vietnam	1,697	332	26	0	-100.00
Lebanon	1,064	389	349	0	-100.00
Philippines	275	0	0	0	0.00
Bangladesh	4,274	220	220	0	-100.00
Israel	1,598	0	0	0	0.00
Iraq	677	128	128	0	-100.00
Turkey	1,026	185	174	0	-100.00
Other	9,113	3,110	3,090	65	-97.90
HS Codes: 0402.2100, 0402.2900, 0402.9100, and 0402.9900					
Source: GTA China Customs Statistics					

Dairy Products Import Tariff Table

Import Tariffs on Dairy Products Effective on Jan-Dec, 2009 (Unit: Kilogram)					
		General	MFN	V.A.T	Effective Rate (MFN & VAT)
Fluid Milk	0401.10	40.0%	15.0%	17.0%	34.9%
	0401.20	40.0%	15.0%	17.0%	34.9%
	0401.30	40.0%	15.0%	17.0%	34.9%
Powdered Milk	0402.10	40.0%	10.0%	17.0%	29.9%
	0402.21	40.0%	10.0%	17.0%	29.9%
	0402.29	40.0%	10.0%	17.0%	29.9%
	0402.91	90.0%	10.0%	17.0%	29.9%
	0402.99	90.0%	10.0%	17.0%	29.9%
Yogurt	0403.10	90.0%	10.0%	17.0%	29.9%
	0403.90	90.0%	20.0%	17.0%	39.9%
Whey	0404.10	30.0%	2.0%	17.0%	21.9%
	0404.90	90.0%	20.0%	17.0%	39.9%
Butter & Dairy Spreads	0405.10	90.0%	10.0%	17.0%	29.9%
	0405.20	90.0%	10.0%	17.0%	29.9%
	0405.90	90.0%	10.0%	17.0%	29.9%
Cheese	0406.10	90.0%	12.0%	17.0%	31.9%
	0406.20	90.0%	12.0%	17.0%	31.9%
	0406.30	90.0%	12.0%	17.0%	31.9%
	0406.40	90.0%	15.0%	17.0%	34.9%
	0406.90	90.0%	12.0%	17.0%	31.9%
Source: China Customs					

(End of whole report)

