



Insights on today's global dairy business from the Hoogwegt companies

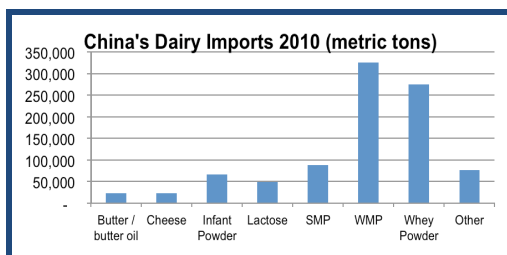
MARKET MATTERS

China: Stable Player or Country in Transition?

China has a major impact on the world's food commodity markets, and its influence on the global dairy market has grown in the past year. The country is now the world's largest dairy product importer.

Last year's fast growth in China's dairy product imports—especially whole milk powder—has underpinned firm world prices, effectively soaking up milk that might otherwise have burdened the market given the production recoveries in the second half of the year in the United States and Europe.

Total raw milk collections from Chinese farms have slowed as milk processors and product manufacturers strive to “reinvent” their supply chains and implement stringent quality and food-safety standards following the melamine problems in 2008. This recovery has included a rebuilding in cow milk production, which suffered due to the significant cow slaughter that occurred after the steep drop in demand for domestically produced products.



Recovery will be achieved through modernization of dairy farms and processing plants, which will help the industry address the volumes of lost production and the rapid rate of growth in consumer demand.

Consumer preference in China for imported products in foreign brands has been a major driver of imports. Brand reputation is a critical issue for local manufacturers, with the toughest challenges in the infant formula market, where imported brands have gained a large market share. Brand reputation is far less an issue in milk drinks.

The recent high-profile “shake-up” in the processing

sector regarding the large number of smaller processors that failed to obtain license renewals in April 2011 is not expected to have as much of an impact as originally anticipated. Many of these companies may attempt compliance, and the larger, more professional processors will be able to absorb lost capacity and available market share and be able to offer a more diverse product range to the market.

The stress placed on natural water resources and the risks associated with volatile climate will limit China's ability to consistently meet its 95% food self-sufficiency targets. The big question for world trade is whether the restructuring of the Chinese supply chain is in a transition phase or whether there will be permanent dependence on a significant volume of imported ingredients.

Future considerations

The Chinese government's major consideration for managing its food security priorities is which products to import to meet consumer demand for nutritional dairy foods. The government would prefer to have an industry better equipped to sustain local demand, but local production has ironically been outpaced by the demand for nutritional foods created through strong economic growth, which has given people better livelihoods.

It seems more likely that in the coming years China will require sustained volumes of imported dairy ingredients and products, as well as sustained volumes of feed inputs for an expanding dairy herd.

Dairy market opportunities in China aren't solely about milk powders. The increasing affluence of China's urban population also supports an expanding market for consumer products such as cheese and other fresh dairy products including cream, which has seen recent strong growth in demand.

Whole milk powder imports are therefore expected to stabilize at lower than current levels over a two- to four-year period, but there is expected to be a continued growing need for whey powder and its derivatives, given the lack of cheese manufacturing and increasing sophistication of the use of these ingredients in a range of products.

HOOGWEGT FORECAST

	U.S. Average Prices			EU Average Prices			Oceania Average Prices		
	\$/ton	\$/lb	Trend	\$/ton	\$/lb	Trend	\$/ton	\$/lb	Trend
SMP	3.625	1,64	Stable	3.500	1,59	Firm	3.800	1,72	Stable
FCMP / WMP	4.400	2,00	Stable	4.300	1,95	Stable	4.000	1,81	Stable
Butter	4.850	2,20	Stable	5.700	2,59	Firm	5.050	2,29	Stable
Cheddar*	3.750	1,70	Stable	4.850	2,20	Stable	4.425	2,01	Stable
SWP	1.325	0,60	Stable	1.325	0,60	Firm			
Lactose	1.100	0,50	Firm	1.450	0,66	Firm			

U.S. prices stated ex-works / incl. expected CWT subsidy where applicable; world prices stated FOB main port; EUR/USD: this week 1,435 (*CWT subsidy is included for US origin)

WORLD COMMENT

Last week dairy markets showed healthy demand, resulting a slightly higher prices in some cases. The European food processors seemed to have decided it was time to cover the balance of the year for milk powder and butterfat. The rather dry weather conditions in Northwestern Europe lowered the fat and protein content in the raw milk, leading to a less of a peak this Spring season. The US dairy product markets are proving to be stable, even with significantly more milk output. US (export) spot offerings remain limited; producers appear comfortable with their stock positions. The Southern hemisphere is now in its low season, though South America continues to offer more full cream for export than usual. Butterfat around the globe remains in tight supply. There are only some 30,700 MT of butter in Private Storage in the EU, which is a low number in comparison with recent years. Cheese markets are showing good demand and supply resulting in stable prices. The US continues to present attractive prices for cheddar and mozzarella compared to the EU and oceanic region. Whey is selling well; both the US and EU are exporting good volumes. Lactose firmed all around.

BRINGING IT HOME

Expect bigger export numbers in 2011

Given China's influence, the prospect for sustained import demand for dairy ingredients is an issue relevant to anyone trading dairy commodities.

Economic growth in the country is expected to fall slightly in 2011, but remain in excess of 9.5%, and a strong economy will continue to drive improving livelihoods, and therefore higher demand for nutritional foods.

China's economic miracle is not without headaches. China will aim to manage the political and social fallout from rising food price inflation while at the same time strive to feed its people.

The country will also attempt to keep trade and investment stable, quelling asset bubbles from the massive investment in housing and infrastructure. China has the financial reserves to successfully navigate these challenges and will invest and regulate where it sees fit to maintain stability.

The restructuring of the processing sector will change the composition of the industry for the better as larger firms gain a stronger commercial foothold and become more diverse in products and capabilities. State-controlled

Bright Dairy & Food's recently announced major plant investment is a sign of what is to come, and many others are building new and expanded facilities. A number of Chinese processors also have made and seek investments in overseas markets and production regions to improve access to product and brand presence.

Dairy demand will continue to grow strongly and deepen across the range of dairy products. The increased investment in full-service supermarkets and food-service outlets by local and international retailers will bring dairy products closer and more readily available to more urban consumers.

In 2011, local whole milk powder output will struggle to rise by 5%, after growing just 2% in 2010. To meet demand, China's imports of whole milk powder and whey products will expand further.

Chinese imports started the year with a burst. Year-over-year whole milk powder imports in January and February were up 47%, the result of a first quarter low-tariff window under a free trade agreement with New Zealand. Monthly export volumes are expected to slow after March but are anticipated to grow by about 20% for the year.

Did you know?

- Local infant formula production in China fell 12% in 2010—the first year-over-year decline ever.
- Chinese whey powder imports fell 8% last year (against trend), compared with 2009 levels, but in the first two months of 2011, whey powder imports are 30% ahead of last year.
- Bright Dairy & Food is building a 60,000 metric ton processing plant, claimed to be the largest in Asia. Half the plant's output will be yogurt.
- Farmgate milk prices in China are about 48 to 50 cents (U.S) per liter.

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