



February 2006

New report



3A Business Consulting



China – dairy opportunities unlimited

- dairy production, consumption & trade, trends, players and outlook 2008

China – dairy opportunities unlimited

- dairy production, consumption & trade, trends, players and outlook 2008

A new report on China's dairy industry reveals the enormous changes that are taking place in milk production and dairy consumption in that country with milk production expanding faster than is experienced in any other country in the world, and dairy imports escalating. These changes are driven by remarkable growth in milk and dairy food demand experienced throughout China.

The report provides a detailed review of China's milk production, dairy trade and milk utilization. Trend data is augmented with future projections. Profiles of the major Chinese dairy companies are provided along with their partnerships with foreign dairy and food companies. *"Our analysis shows there is little let-up expected in the foreseeable future in terms of milk production growth or trends in milk demand"*, says Wayne Whiting, co-author of the report. *"Indeed, a renewed interest by foreign companies in securing a base in China suggests some of the leading world players share this view, investing at this early stage of industry development in order to secure a long-term position in China's dairy industry."*

The report discusses issues such as:

- China's socio-economic profile – and how factors such as the changing population profile, continuing strong GDP growth through to 2008 Beijing Olympics, changing consumer preferences, and the dairy sector overcoming a lag in terms of the East Asian development model, is fuelling exponential growth in China dairy consumption
- Trends in domestic milk utilization – a comprehensive review is undertaken of on-farm and off-farm milk use, unprocessed and processed milk utilization, and local manufactured volume across all product categories, including a review of key user segments such as infant formula manufacture & whey utilization by end market
- The balance of trade in key dairy commodities – few recognize that despite dependence on dairy imports, China accounts for almost 100,000 mt p.a. of dairy exports
- Dairy trade analysis – this looks at key commodities and important categories within this trade, based on source/destination, trends, value and pricing
- The regulatory environment – highlights of China's WTA accession are given, along with current tariff rates and packaging regulations
- The activities of the major Chinese dairy companies
- Foreign investment in China's dairy industry – this section of the report includes a detailed commentary on Fonterra's and other dairy companies' interest in China

"Opportunities abound in the China dairy industry", comments Tage Affertsholt, co-author of the report'. Firstly we see domestic industry players taking the initiative and driving development in their own industry. Secondly, some very strong global players have revisited their 'China strategy', and undertaking various approaches to secure a strong competitive position."

The report contains 163 pages and can be purchased at a cost of US\$ 5,500. For further information:

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1. Scope and objectives of the report

Understanding the changes occurring in China's dairy industry industry

The dairy industry in China is undergoing change. Fundamental to this is a number of issues, including:

- A rapid growth in national milk production, outstripping the rate of growth in any other country in the world and catapulting China to the position as the world's 8th largest milk producer
- Remarkable growth in milk and dairy food consumption. This is being driven by various factors, including increasing household discretionary income, changing dietary preferences, improved sales and distribution infrastructure, locally-sourced and affordable dairy products, ready acceptance of products that are quite specific to Asia (e.g. lactic acid bacteria drinks), new channels of distribution, geographic expansion in consumption patterns
- Strong growth in dairy commodity trade – whilst most industry observers relate to the growth in dairy imports experienced by China, few realize that China exports almost 100,000 mt of dairy products per annum in its own right
- Renewed interest by foreign players in the China market, including a recent string of equity investments by major global dairy companies
- Local dairy companies progressing with increased confidence, investing in manufacturing, extending market reach, and improving product quality

Country coverage & key points of analysis

- Country overview Socio-economic factors, food industry, food consumption patterns
- Milk production Volume trends, production by species, regional review, new initiatives
- Milk utilization Detailed review of milk utilization, including category forecasts
- Dairy trade Volume/value analysis, exports & imports, balance of trade, pricing
- Foreign investment A Fonterra perspective, initiatives by other companies, outlook
- Company profiles Activities of the major Chinese dairy companies

Time frame

- Historical and current 2004 data
- Future projections to 2007 (three scenarios)

Price and timing

- US\$ 5,500
- Report available February 2006

2. Report content

Abbreviations	X				
Executive summary	1				
1. China – country profile	8				
1.1. Official name	8				
1.2. Physical geography	8				
1.3. Population	9				
1.4. Economic	12				
1.5. Religions	12				
1.6. Other factors	12				
1.7. The food industry in China	13				
1.8. Food consumption in China	14				
2. Milk production in China – situation review	16				
2.1. China's position in world milk production	16				
2.2. Historical overview	18				
2.3. Long-term trends in China national milk production	19				
2.4. Short-term trends in China national milk production	20				
2.5. China milk production by species	21				
3. Milk production in China – current features	22				
3.1. Milk production in China – a priority emphasis	22				
3.2. Key industry development drivers	22				
3.3. The 'Livestock Revolution' – China sets the pace	23				
3.4. Constraints to further increases in milk production	23				
3.4.1. Background	23				
3.4.2. Small-scale producers	24				
3.4.3. Low livestock yields	24				
3.4.4. Retention of milk on-farm	24				
3.4.5. Livestock feed	24				
3.5. The regional nature of milk production	25				
3.5.1. Pastoral milk production	25				
3.5.2. Milk production in the cropping regions	25				
3.5.3. Peri-urban milk production	26				
3.6. The pattern of regional milk production	27				
3.7. Tibet – an example of a research-based approach to improving milk production	28				
3.7.1. Background	28				
3.7.2. Increasing milk production from cattle	28				
3.7.3. Intensifying production of grain and fodder in Central Tibet farming practices	29				
4. Milk utilization in China	30				
4.1. On-farm and processing	30				
4.1.1. Milk production and on-farm retention	30				
4.1.2. On-farm utilization of milk	30				
4.1.3. Milk utilization by the processing sector	31				
4.1.4. China infant formula manufacturers	33				
4.2. Key product categories	34				
4.2.1. Value-added milk sector	34				
4.2.2. China milk powder production	35				
4.2.3. China milk powder usage	36				
4.2.4. Whey product usage	36				
4.3. Milk consumption in China	37				
4.3.1. Constraints to milk consumption	37				
4.3.2. Regional patterns of milk consumption in China	39				
4.3.3. Milk consumption relative to household income levels	39				
4.3.4. Dairy industry development – the issue of market proximity	40				
4.3.5. Factors underpinning growth in dairy demand in China	43				
5. China dairy imports – trade analysis	46				
5.1. Volume analysis	46	5.10. Cheese and curd products	69	6.9.6. Casein exports – volume trends by country of destination	117
5.2. Total value of dairy imports	48	5.11. Lactose products	73	6.9.7. Casein exports - price trend analysis	118
5.3. Major dairy product suppliers – value shares and trends	49	5.12. Ice cream and edible ice products	76	6.10. Ice cream and edible ice products	120
5.4. Share and value of dairy imports by key product sector	50	5.13. Casein and casein derivative products	78	6.10.1. Recent trends – export value	120
5.5. Fluid milk and cream products	52	5.14. Whey derivative products	81	6.10.2. Recent trends – export volume	121
5.6. Concentrated milk and cream products	55	5.15. China – analysis of key competitive import suppliers	84	6.10.3. Export sales volume by key destination	122
5.7. Buttermilk and cultured dairy products	60	5.15.1. Value trends – overview of key dairy import suppliers	84	6.10.4. Export price analysis	123
5.8. Whey products	62	5.15.2. New Zealand – value trends and current share of dairy imports	85	6.10.5. China ice cream & edible ice product exports – business split by district of origin	124
5.9. Milk fat products	66	5.15.3. Australia – value trends and current share of dairy imports	86	7. Regulatory and milk supply issues	125
		5.15.4. The United States – value trends and current share of dairy imports	87	7.1. Market regulations	125
		5.15.5. Finland – value trends and current share of dairy imports	88	7.1.1. Food legislation	125
		5.15.6. Ireland – value trends and current share of dairy imports	88	7.1.2. Food labeling & packaging regulations	125
		5.15.7. The Netherlands – value trends and current share of dairy imports	89	7.1.3. Documentation	126
				7.1.4. Import tariffs	126
				7.1.5. China's commitments under WTO	127
				7.2. Future milk production and utilization – a projection	129
				7.2.1. Three forecast scenarios	129
				7.2.2. On-farm versus off-farm utilization of milk	130
				7.2.3. Trends in liquid milk production	131
				7.2.4. Trends in manufactured products	131
				7.3. Dairy cattle imports	132
				8. Profiling of major Chinese dairy companies	135
				8.1. Beijing Sanyuan Food Co Ltd - PR China	135
				8.2. Canton American Flower Lounge Livestock Company Limited – PR China	137
				8.3. Guangdong Yangtang Dairy Company – PR China	138
				8.4. China Mengniu Dairy Co Ltd – PR China	139
				8.5. Jinwei Beverage & Food Company Limited – PR China	141
				8.6. Heilongjiang Longdan Dairy Science Technology Co Ltd – PR China	143
				8.7. Shanghai Yue Chang Industrial Company Limited – PR China	145
				8.8. Shijiazhuang Sanlu Group Holding Co Ltd – PR China	146
				8.9. Tianjin Dairy Group Co Limited- PR China	148
				8.10. Heilongjiang Wondersun Harbin Dairy Industry Company Limited – PR China	149
				9. Foreign investment in China	152
				9.1. A Fonterra perspective	152
				9.1.1. Bi-lateral/regional FTAs – a Fonterra viewpoint	152
				9.1.2. The dairy market in China – Fonterra's view	155
				9.1.3. Investing in China – the Fonterra business model	156
				9.1.4. Fonterra secures Shijiazhuang Sanlu Group deal	157
				9.2. Groupe Danone - recent initiatives in China	158
				9.3. Arla's initiatives in China	159
				9.4. Indian aspirations to supply into China	159
				9.5. Valio granted Green Food label in China	159
				9.6. Nestle concentrates on range extension in ice cream industry	160
				9.7. Infant formula quality issue	160
				9.8. China exports milk products to Australia	160
				9.9. American Dairy contracts to establish new milk processing venture in China	160
				9.10. Fraser & Neave Group moves into China	161
				9.11. Industry outlook	161

List of figures

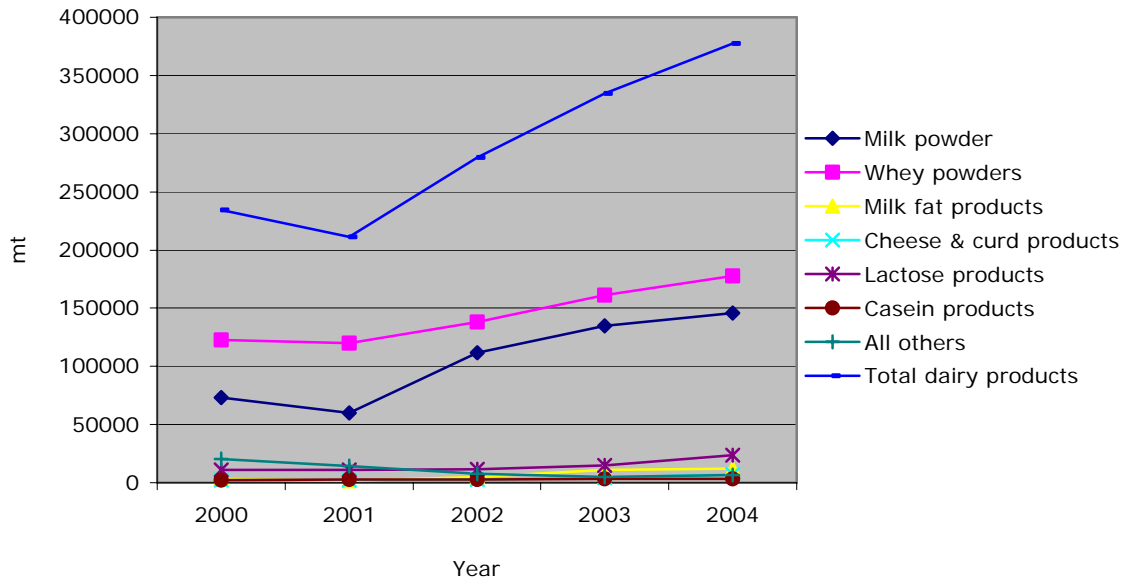
- Figure 1: Dairy product consumption – an example of products with specific target age groups
- Figure 2: China – annual GDP real growth trends (%)
- Figure 3: China – per capita GDP growth trends (1985-2004)
- Figure 4: Projected growth in PR China milk consumption 2002-2030 – a Fonterra perspective
- Figure 5: China's position in world milk production, recent trends (million mt, 1991 vs. 2004)
- Figure 6: Recent trends in off-farm milk utilization ('000 mt)
- Figure 7: Forecast domestic milk utilization – on-farm & processing sector ('000 mt)
- Figure 8: China - Balance of trade for dairy products by key category (mt, 2004)
- Figure 9: Recent volume trends in China dairy imports – key categories (mt)
- Figure 10: Dairy supply into China market – value share of major players (2000 vs. 2004, US\$ millions)
- Figure 11: A map of China
- Figure 12: China – Estimates of population to 2030
- Figure 13: PR China age & sex distribution (2003)
- Figure 14: PR China age & sex distribution (2050)
- Figure 15: The food processing industry in China
- Figure 16: Regional distribution of China food processing
- Figure 17: Urban per capita consumption trends – key food groups (includes dairy commodities - kg, per annum)
- Figure 18: Urban per capita food consumption by income group (kg per year)
- Figure 19: Comparative output and rankings of twenty leading milk producing nations – million mt, 1991 vs. 2004
- Figure 20: Long-term volume growth in China domestic milk production, 1961-2005
- Figure 21: Short-term volume growth in China domestic milk production
- Figure 22: Changes in milk production in China by species
- Figure 23: Regional milk production – volume shares (%)
- Figure 24: Milk production in China – recent trends by species
- Figure 25: Recent trends in on-farm utilization of milk by usage application
- Figure 26: Recent trends in off-farm milk utilization by key product category
- Figure 27: China's major infant formula companies – volume estimates
- Figure 28: Major milk processors in China – national off-farm milk intake volume share estimates (2002, %)
- Figure 29: Major players in key value-added branded milk product categories
- Figure 30: Summary of key features in China's milk processing sector
- Figure 31: Milk powder production – share of output (2002)
- Figure 32: China milk powder production – share of usage (2002)
- Figure 33: Whey products marketed in China
- Figure 34: Usage of whey products in China – volume share (%)
- Figure 35: WPC 35 usage in China – volume share (%)
- Figure 36: Patterns of milk consumption in China – rural versus urban (2000)
- Figure 37: Comparative analysis of urban milk product consumption in China based on income (1999 vs. 2000)
- Figure 38: Current trends in China dairy imports (tonnes, 2000-2004)
- Figure 39: Share of China dairy imports by key categories (2004)
- Figure 40: Recent volume trends in China dairy imports – key categories
- Figure 41: Current trends in China dairy imports (US\$ millions, 2000-2004)
- Figure 42: Trends in dairy product supply by country of origin – top six suppliers (US\$ millions, 2000-2004)
- Figure 43: Share of dairy imports by key product sector (% value, 2004)
- Figure 44: Trends in China dairy imports (US\$ millions, 2000-2004)
- Figure 45: Current trends in China fluid milk & cream imports (tonnes, 2000-2004)
- Figure 46: Trends in imports of fluid milk & cream products by country of origin (mt)
- Figure 47: Fluid milk & cream products – market size and recent growth trends (US\$ millions, 2000-2004)
- Figure 48: Market share, fluid milk & cream products – key suppliers (2004)
- Figure 49: Value supply trends by key supplier – fluid milk & cream products (US\$ millions, 2000-2004)
- Figure 50: Current trends in concentrated milk imports (tonnes, 2000-2004)
- Figure 51: Trends in imports of milk powder by country of origin (mt)
- Figure 52: Trends in imports of non-fat milk powder by country of origin (mt)
- Figure 53: Trends in imports of wholemilk powder by country of origin (mt)
- Figure 54: Concentrated milk & cream products – market size and recent growth trends (US\$ millions, 2000-2004)
- Figure 55: Market share, concentrated milk & cream products – key suppliers (2004)
- Figure 56: Value supply trends by key supplier – concentrated milk & cream products (US\$ millions, 2000-2004)
- Figure 57: Current trends in buttermilk and cultured dairy imports (tonnes, 2000-2004)
- Figure 58: Trends in imports of cultured milk products by country of origin (mt)
- Figure 59: Buttermilk & cultured dairy products – market size and recent growth trends (US\$ millions, 2000-2004)
- Figure 60: Market share, buttermilk & cultured dairy products – key suppliers (2004)
- Figure 61: Value supply trends by key supplier – buttermilk & cultured dairy products (US\$ millions, 2000-2004)
- Figure 62: Current trends in whey powder imports (tonnes, 2000-2004)
- Figure 63: Trends in imports of whey powders by country of origin (mt)
- Figure 64: Whey products – market size and recent growth trends (US\$ millions, 2000-2004)
- Figure 65: Market share, whey products – key suppliers (2004)
- Figure 66: Value supply trends by key supplier – whey products (US\$ millions, 2000-2004)
- Figure 67: Current trends in milk fat product imports (tonnes, 2000-2004)
- Figure 68: Trends in imports of milk fat products by country of origin (mt)
- Figure 69: Trends in imports of butter by country of origin (mt)
- Figure 70: Trends in imports of other milk fat products by country of origin (mt)
- Figure 71: Milk fat products – market size and recent growth trends (US\$ millions, 2000-2004)
- Figure 72: Market share, milk fat products – key suppliers (2004)
- Figure 73: Value supply trends by key supplier – milk fat products (US\$ millions, 2000-2004)
- Figure 74: Current trends in cheese & curd product imports (tonnes, 2000-2004)
- Figure 75: Trends in imports of cheese & curd products by country of origin (mt)
- Figure 76: Cheese & curd products – market size and recent growth trends (US\$ millions, 2000-2004)
- Figure 77: Market share, cheese & curd products – key suppliers (2004)
- Figure 78: Value supply trends by key supplier – cheese & curd products (US\$ millions, 2000-2004)
- Figure 79: Current trends in lactose product imports (tonnes, 2000-2004)
- Figure 80: Trends in imports of lactose products by country of origin (mt)
- Figure 81: Lactose products – market size and recent growth trends (US\$ millions, 2000-2004)
- Figure 82: Market share, lactose products – key suppliers (2004)
- Figure 83: Value supply trends by key supplier – lactose products (US\$ millions, 2000-2004)
- Figure 84: Current trends in ice cream product imports (tonnes, 2000-2004)
- Figure 85: Trends in imports of ice cream products by country of origin (mt)
- Figure 86: Ice cream & edible ice products – market size and recent growth trends (US\$ millions, 2000-2004)
- Figure 87: Market share, ice cream & edible ice products – key suppliers (2004)
- Figure 88: Value supply trends by key supplier – ice cream & edible ice products (US\$ millions, 2000-2004)
- Figure 89: Current trends in casein and related product imports (tonnes, 2000-2004)
- Figure 90: Trends in imports of casein & caseinate products by country of origin (mt)
- Figure 91: Casein & casein derivative products – market size and recent growth trends (US\$ millions, 2000-2004)
- Figure 92: Market share, casein & casein derivative products – key suppliers (2004)
- Figure 93: Value supply trends by key supplier – casein & casein derivative products (US\$ millions, 2000-2004)
- Figure 94: Current trends in whey derivative product imports (tonnes, 2000-2004)
- Figure 95: Trends in imports of whey derivatives by country of origin (mt)
- Figure 96: Whey derivative products – market size and recent growth trends (US\$ millions, 2000-2004)
- Figure 97: Market share, whey derivative products – key suppliers (2004)
- Figure 98: Value supply trends by key supplier – whey derivative products (US\$ millions, 2000-2004)
- Figure 99: Trends in supply by key import suppliers (US\$ million, 1999-2004)
- Figure 100: Value supply and share trends – New Zealand
- Figure 101: Value supply and share trends – Australia
- Figure 102: Value supply and share trends – United States
- Figure 103: Value supply and share trends – Finland
- Figure 104: Value supply and share trends – Ireland
- Figure 105: Value supply and share trends – the Netherlands
- Figure 106: Recent trends in China dairy export performance
- Figure 107: China – recent export trends (volume & value)
- Figure 108: China – dairy export share by major commodity (volume share, 2004)
- Figure 109: China – dairy export share by major commodity (value share, 2004)
- Figure 110: Overview of recent trends in Chinese exports – concentrated milk & cream products (US\$ millions)
- Figure 111: Current product mix
- Figure 112: Trends in export value by key categories – concentrated milk & cream products
- Figure 113: Export trends – concentrated milk & cream products (tonnes)
- Figure 114: Current product mix – concentrated milk & cream products
- Figure 115: Trends in concentrated milk & cream product volume exports by category (tonnes)
- Figure 116: Trends in China concentrated milk & cream prices (US\$/kg)
- Figure 117: China wholemilk powder exports – 2004 share by destination
- Figure 118: China wholemilk powder exports – recent trends
- Figure 119: China wholemilk powder exports – price analysis by destination
- Figure 120: China sweetened condensed milk exports – 2004 share by destination
- Figure 121: China sweetened condensed milk exports – recent trends
- Figure 122: China sweetened condensed milk exports – price analysis by destination
- Figure 123: China sweetened milk powder exports – 2004 share by destination
- Figure 124: China sweetened milk powder exports – recent trends
- Figure 125: China sweetened milk powder exports – price analysis by destination
- Figure 126: China evaporated milk exports – 2004 share by destination
- Figure 127: China evaporated milk exports – recent trends
- Figure 128: China evaporated milk exports – price analysis by destination (US\$/kg)
- Figure 129: China skim milk powder exports – 2004 share by destination
- Figure 130: China skim milk powder exports – recent trends
- Figure 131: China skim milk powder exports – price analysis by destination
- Figure 132: Overview of recent trends in China exports – fluid milk & cream products by key category (US\$ millions)
- Figure 133: Trends in regular milk exports
- Figure 134: Trends in China's regular milk export prices
- Figure 135: China regular milk exports – 2004 share by destination
- Figure 136: China regular milk exports – volume (tonnes) by key destinations
- Figure 137: Regular milk price trends – key destinations
- Figure 138: Overview of recent trends in China exports – casein & whey protein derivative products by key category (US\$ millions)
- Figure 139: Casein & whey protein derivative product exports – trends in key category share of trade
- Figure 140: Trends in casein exports
- Figure 141: Trends in China casein export prices – average price
- Figure 142: China casein exports – 2004 share by destination
- Figure 143: China casein exports – volume (tonnes) by top four destinations
- Figure 144: Casein price trends – key destinations
- Figure 145: Casein prices – current review major markets – 2004
- Figure 146: China casein exports – recent prices by country of destination
- Figure 147: Overview of recent value trends in China exports – ice cream & edible ice products
- Figure 148: Overview of recent volume trends in China exports – ice cream & edible ice products
- Figure 149: Geographic sales mix – ice cream & edible ice exports (2004)
- Figure 150: Recent trends in geographic sales mix – ice cream & edible ice exports
- Figure 151: Price trend – average price all destinations
- Figure 152: Price trend – average price by destination
- Figure 153: Exports of ice cream & edible ice by district of origin – 2004
- Figure 154: Trends in exports of ice cream & edible ice by district of origin
- Figure 155: Chinese import tariffs
- Figure 156: Short-term forecast scenarios milk utilization in China – on-farm & processing sector
- Figure 157: Top-line trends in China's milk production and utilization – on-farm vs. off-farm
- Figure 158: Milk beverage volume trends and projections
- Figure 159: Manufactured dairy product volume trends and projections
- Figure 160: Imports of dairy livestock from Oceania
- Figure 161: Value of dairy cattle imports (US\$ millions)
- Figure 162: Average value of dairy cattle imports (US\$)

3. Sample from report

Dairy import

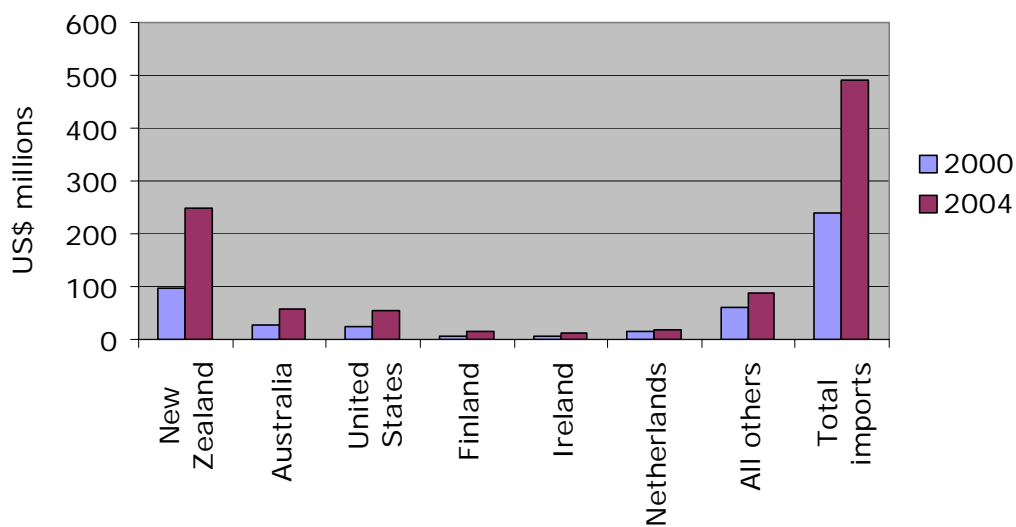
International trade in dairy products is important to China. Key aspects of this trade are summarized in the following table.

Recent volume trends in China dairy imports – key categories (mt)



Source: China Customs

Dairy supply into China market – value share of major players (2000 vs. 2004, US\$ millions)



Source: China Customs

Foreign investment in China

Fonterra secures Shijazhuang Sanlu Group deal

In late 2005 it was announced that Fonterra Co-operative Group had secured agreement to acquire 43% of the equity in Hebei-based Shijazhuang Sanlu Group. It has been reported that Fonterra paid US\$107 million for this stake, and is claimed to be one of the largest single investments by any foreign company in the Chinese dairy sector. Sanlu expects its sales for the year to achieve US\$900 million

Key features arising from this position include:

- Initial discussions were entered into by the two organizations in 2002
- Sanlu sees this as a first step in becoming a global dairy business in its own right
- Fonterra plans to use this as a key platform for driving growth in the highly attractive and fastest expanding dairy sector in China – fresh milk and milk products
-
-

Groupe Danone's recent initiatives in China

French-based multi-national, Danone-Groupe, has recently undertaken two concurrent activities:

- Establishment of its first dairy research and development centre in Asia located in Shanghai. The facility is located on a 1,600 square meter site in Zhijiang Semiconductor Industrial Park in Pudong New Area. It cost around US\$2 million to construct and outfit. Research initiatives will concentrate largely on fresh dairy foods; and
- Raising its equity interest in China's Bright Dairy & Food Company to almost 12%. This cost the company US\$8.9 million, and represents the second boost to equity stake in the company in 2005 (in March Groupe Danone lifted its stake from 3.85% to 9.7%). The earlier acquisition follows the buy-out of interest from Shanghai State-owned Assets Operation, and the latter transaction involved buying interest from Dazhong Transportation Group. This leaves the two largest shareholders in the company as Shanghai Dairy (Group) Co Ltd and S.I. Food Products Holding – both with 30.78% share. Groupe Danone becomes the third largest shareholder in the company.

Arla's initiatives in China

Arla signed an agreement with China's Mengniu Dairy Company during 2005 to supply milk powder into the China market. More specifically, the joint venture initiatives are based on Arla supplying milk powder in bulk, which in turn is re-packaged into retail consumer packs within the market.

Key aspects of this venture include:

- Commencement of the joint venture was 01 October 2005
- The venture will be involved in the import, re-packing and domestic sales and distribution of milk powder
- The China partner, Mengniu Dairy Company, was founded in 1999
-
-

Outlook 2008

Thus, the outlook is for a continuing positive phase through the short to medium term for the China dairy industry. Key aspects of this will include:

- Continuing growth in demand for milk and dairy foods
- Continuing growth in domestic milk production – with improvements in feeding regimes and genetics contributing towards higher productivity
- Continuing national economic prosperity through the foreseeable future – underwriting consumption growth and investment in all aspects of the dairy sector
- Possible pressure coming on milk supply – this will ensure milk prices remain buoyant
- Heightening competitive market pressure – this could see price pressure, and processing margins will inevitably suffer
- Continuing growth of foreign investment in the Chinese dairy industry

4. Authors' biographies – “credentials”

3A Business Consulting

3A Business Consulting is a Danish food & drink industry strategic business and marketing consultancy working with all elements in the value chain. 3A is involved in strategy and business development projects with Scandinavian and international companies as clients. 3A is a network based consultancy working together with major European contract research organisations and associated consultants.

Examples of 3A projects include:

- Strategy platform for value-added dairy ingredients for major food and dairy company
- Strategy development for nutraceutical ingredients for global food ingredients company
- Survey of European dairy industry for US-based dairy and food equipment manufacturer
- Benchmarking study of dairy and meat industries
- Feasibility study for a new dairy company in South America
- Global marketing and production of whey products – report 2003

Shainwright Consulting and Research Group Pty Ltd

Shainwright Consulting and Research Group Pty Ltd is an Australian company that specialises in agribusiness consulting and research. With a strong background in the international dairy industry, the company has completed numerous global and regional strategic industry studies, market analyses, and business planning assignments. An overwhelming majority of these have been in the Asian theatre, and have included leading edge marketing and business development projects in such areas as:

- Dairy nutraceuticals
- Dairy cosmeceuticals
- Opportunities for developing a bioactive cheese positioning
- Whey derivatives and market applications
- Longitudinal dairy pricing studies
- Dairy company case studies

Key project personnel

Tage Affertsholt, M.Sc.

Since establishing 3A Business Consulting in 1994 and as Managing Partner, Tage Affertsholt has mainly been engaged in strategy and business development issues in the food and drink industries including market assessment opportunities for food and dairy businesses. Tage Affertsholt has held a number of management positions including directorships in a number of Danish and European companies including Arla Foods, Express Foods and Norsk Hydro. In Singapore he has also held regional responsibility for the Far East on behalf of Express Foods.

Wayne Whiting MPhil, MBus, BAgEc, BCA, FRGS

Wayne Whiting is Managing Director of Shainwright Consulting and Research Group, an organization founded in 1999. He is an international dairy marketing and business development specialist with experience in the dairy ingredients, consumer and food service sectors. Based in Australia, he has over 25 years involvement in the food industry. Much of this was with large trans-national dairy organizations, rising to Divisional General Manager of a large Asian dairy company. Wayne Whiting's experience includes residential assignments in New Zealand, Australia, Bahrain and Malaysia, and numerous successfully completed projects through Asia.

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