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THE CHINA MEAT MARKET

SECTOR OVERVIEW 2010

New Zealand TRADE & ENTERPRISE

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CHINA MEAT MARKET OVERVIEW- BEEF AND LAMB

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1. MARKET OVERVIEW

China is self-sufficient in meat. However, unlike European countries and the United States, China has not been traditionally a red meat consuming country. In 2009, pork accounted for 64% of total meat consumption while beef and lamb together accounted for 13%; the remaining 23% was poultry.

Beef and lamb have not been commonly available to Chinese consumers; the reasons for this include:

- China has no tradition of differentiating between lamb and mutton (mature sheep) or valuing high-quality lamb.
- In the Chinese language, lamb, mutton and goat meat are all referred to as “yang rou” and lamb and mutton are both referred to as “sheep meat”.
- Cows have been traditionally used as a workhorse to plough fields, not for edible purposes.
- China may be home to the largest flock of “sheep” in the world, though more than half of these are in fact goats and most sheep are bred for wool, with little available for the dining room table, especially lamb.
- Consequently, the domestic price for beef and lamb remains almost double that of pork and chicken.

Despite the relatively high volumes of product in the market, consumers are unfamiliar with beef and lamb as a main menu item. Instead most of today’s low-value domestic and imported beef and lamb find their way into complex dishes, which often hide rather than highlight them as a standalone cuisine.

Goat meat is more popular than sheep and widely consumed in China’s southern provinces. In the country’s cuisine culture, older meat is perceived as being more nutritious and delicious. Sheep meat soup, with the meat attached to the bone, is a popular winter dish. Generally speaking, the major consumption of sheep meat is found in western China where large Muslim populations exist and it is a traditional food of ethnic minorities such the Hui, Mongolian’s and Uighur group.

1.1. MARKET SIZE AND PER CAPITA CONSUMPTION

China’s beef and lamb consumption has been stable in recent years, however per capita consumption is on the increase. With the rise in incomes and sophistication of agriculture, the value of beef has been recognised and appreciated in recent years, resulting in a notable increase of beef consumption. According to WTA, from 2007 to 2009:

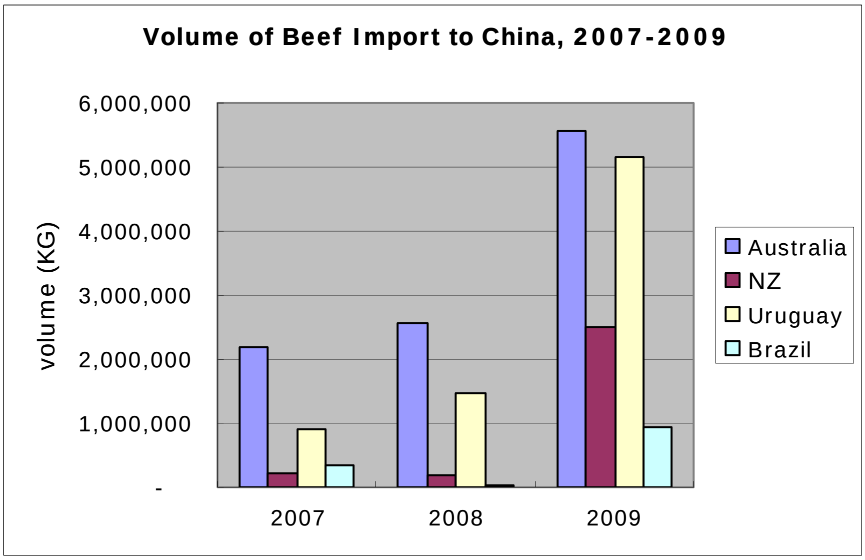
- The volume of imported beef and lamb has risen 289% and 44% respectively.
- The volume of beef and lamb for export has fallen 53% and 69% respectively.
- According to the National Bureau of Statistics of China, between 1998 and 2008 per capita consumption of beef rose approximately 172% and lamb climbed approximately 56% , while pork consumption only saw a 10% increase.

Market Size of China Beef and Sheep Meat Market (2009) Unit KG

	Domestic Production	Import	Export	Consumption	Per Capita Consumption
Beef	6,360,000,000	14,158,442	13,395,335	6,360,763,107	4.81
Sheep meat	3,890,000,000	66,251,796	4,108,834	3,952,142,962	2.99

Source: National Bureau of Statistics of China, China Customs, WTA

1.2. BEEF AND LAMB IMPORT ANALYSIS



China has strict quarantine regulations on meat importation. Prior to March 2010, only five countries had signed bilateral agreements allowing them to export beef and lamb to China. These countries are Australia, New Zealand and Uruguay, who can export beef, sheep meat and offal; Argentina fresh and chilled boneless beef, cooked beef and offal, and Brazil only boneless beef.

Australia remains the leading supplier of beef into China, though decreasing from 59.70% to 39.26% in last three years.

New Zealand's exports of beef to China are growing exponentially. In the year ended March 2010, New Zealand's exports of frozen beef were worth NZD11.9 million – increase from NZD3.3 million in the year ended March 2009.

For 2009, 93.36% of imported beef was boneless with an average price slightly higher than that for boned product. New Zealand's boned beef volume has increased 310% since 2007, but remains low grade.

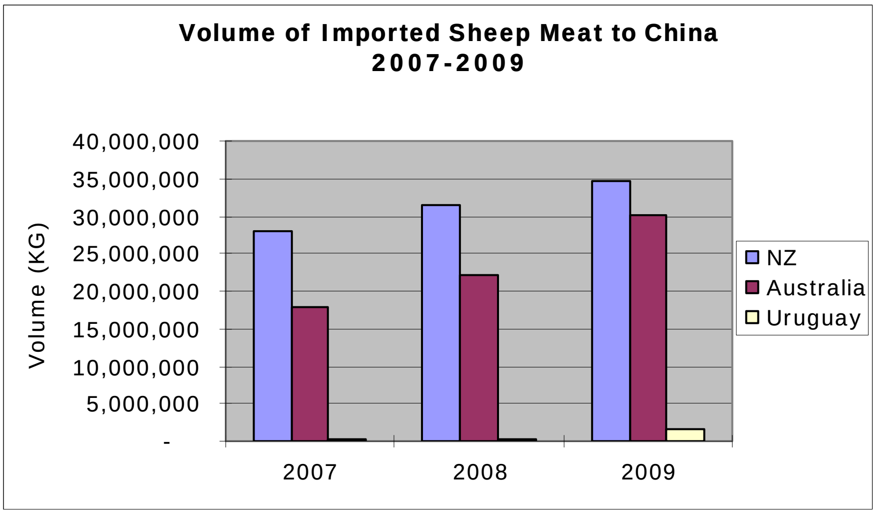
Currently there is little high value beef product from New Zealand in the HRI sector. Australian grain fed beef dominates the premium end of the market and New Zealand faces strong competition from South America and local product in the remaining segment.

Chilled beef, which in 2009 accounted for only 4% of imports, is dominated by Australia supply.

New Zealand is China's largest import source of sheepmeat. In the year ended March 2010, New Zealand exported NZD116 million worth of sheepmeat to China. This was an increase of 5% on the previous year.

The majority of our sheepmeat exports to China are destined for reprocessing into lamb rolls and other products which are sold to local hotpot restaurants and retail outlets. The largest market is in the north part of China.

Again in the premium chilled lamb market, which amounts to only 0.06% of imports, Australia accounts for 99.40% of supply.



2. CHANNEL ANALYSIS AND SEGMENTATION

2.1. DISTRIBUTION

Distribution and sales of imported meat continues to be focused on the demand from relatively affluent first-tier and major cities on the eastern coast. North-eastern cities, such as Dalian and Harbin where low-end beef and lamb cuts are popular, are traditional ports of entry and remain the hubs for large-volume importation.

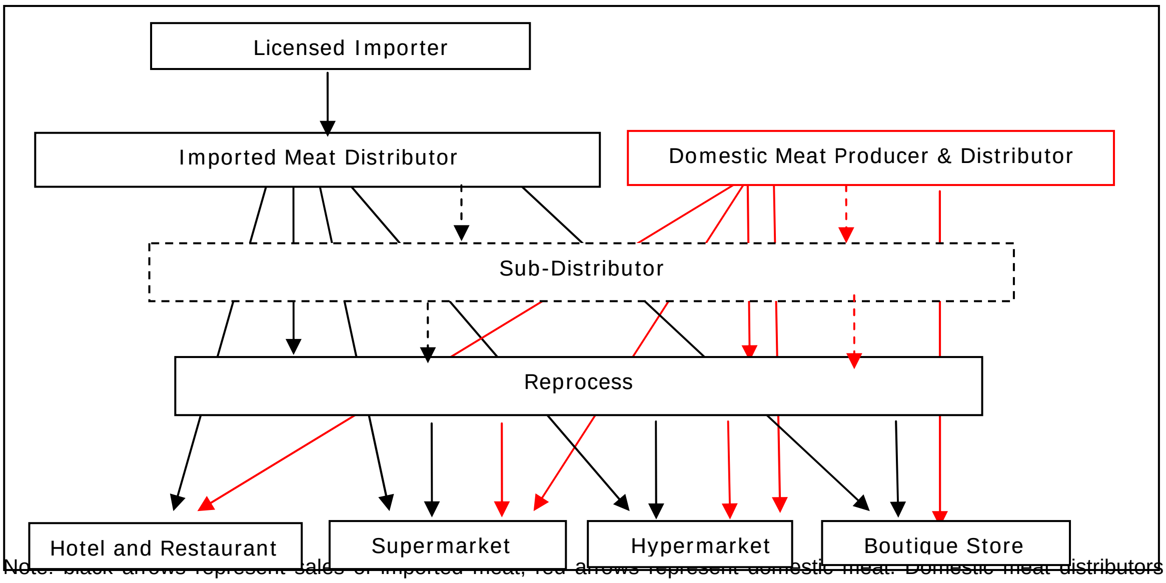
Many distributors in China also act as importers. Effective distribution, especially outside of the main centres, is still an industry in which foreign suppliers struggle to compete and more often than not choose to partner with local entities for geographical coverage. The further afield a product travels, the more steps there are in the value chain, in which numerous sub distributors with local relationships become key. Ownership of product may change hands many times before it reaches the final client.

A number of distributors opt to supply retailers, hotels and restaurants directly in major cities and wholesale via sub-distributors to less developed regions. Few distributors have genuine national coverage, though many increasingly sophisticated operators service the major centres and a growing umber of second- and third-tier cities and provinces.

China's fragmented logistics industry has hindered cold-chain development for high-value temperature sensitive product, meaning the vast majority of Chinese people still buy fresh meat from traditional local markets.

Few food companies own or operate their own truck fleets, and most still tend to outsource this service to specialist providers with regional distribution centres. However, some food companies now have increasing investment and capability in cold stores and, in some cases, world class refrigeration.

Beef and Lamb Distribution Diagram



Note: black arrows represent sales of imported meat, red arrows represent domestic meat. Domestic meat distributors may wholesale to many different sub-distributors in inland cities.

2.2. RETAIL CHANNELS

Retail in China is developing rapidly as the economy relies more on domestic consumption. Significant foreign and local investment in retail has resulted in a change of consumer buying habits and a retail boom led by supermarkets, hypermarkets, convenient stores and boutique stores, which has been accompanied by an increase in the range of SKU's and higher-value products being offered.

While domestic retailers still exceed their international counterparts in number and coverage of stores, many have fallen behind in store management, purchasing and food health and safety standards. Thus Chinese domestic retailers have become increasingly less popular amongst affluent shoppers and residents of first-tier cities, such as Shanghai, Beijing, Guangzhou and Shenzhen. Prohibitive listing fees, credit terms and price requirements of the large retail groups have, to date, limited participation in hypermarkets by foreign food companies to those with large promotional budgets and low-cost large-scale production capability.

Beef and Lamb in Retail Supermarket

		Carrefour	Metro	City Shop	Wal-Mart
Beef	**Tenderloin**	China	China Australia	China Australia	China Australia
	Rib	China Australia	China Australia	China Australia	China
	Shank	China	China Australia	Australia	China Australia NZ
Lamb	**French Lamb Rack**	Australia	China Australia	Australia	China
	Bone-in Lamb leg	Australia	China	Australia	China NZ

Source: site visits in Shanghai, 2010. Note: most of domestic beef and lamb sold in these high-end stores are from Qingdao, however, other high-end beef and lamb brands from Beijing and Inner Mongolia also featured.

Over 80% of imported premium meat sold in retail outlets is beef (mainly from Australia). However with improving quality, and prices at around half those of imported product, domestic beef dominates the retail sector.

Lamb volumes are small but increasing – again Australia is the main suppliers. There is currently some New Zealand and domestic lamb available in selected retail outlets.

2.3. HORECA CHANNELS

Foreign restaurants, including popular French, American, Italian, Spanish, Japanese, Five-Star hotels and an increasing number of Steakhouses, all use premium and expensive beef cuts. However New Zealand does not feature prominently and this premium end of the market is served almost exclusively by Australian grain feed beef.

Some mid and low-end western restaurants use domestic beef or product from South America due to competitive prices.

Chinese restaurants use mainly domestic beef (driven by price), although there are a small number buying Wagyu beef and other imported products.

Lamb is rarely available – whereas mutton is popular in Hot Pot restaurants especially in the northern part of China. As noted, much of New Zealand sheepmeat exports end up in these outlets.

High end lamb cuts are available in upscale western and 5 star hotel restaurants although this segment remains relatively small.

3. VALUE CHAIN

Beef and Lamb Value Chain								
	Beef Tenderloin in Supermarket (1kg)		Beef Tenderloin Steak Restaurant (350gm)		Lamb Rack in Supermarket (1kg)		Lamb Rack in Restaurant (250gm)	
USD to RMB 6.8	**USD**	**RMB**	**USD**	**RMB**	**USD**	**RMB**	**USD**	**RMB**
Retail Price	US$58.23	￥395.98	US$61.76	￥420.00	US$66.18	￥450.00	US$24.71	￥168.00
Retailer Gross Margin	44.42%		81.67%		62.75%		75.03%	
Distributor selling price	US$32.36	￥220.08	US$11.32	￥76.99	US$24.65	￥167.63	US$6.16	￥41.91
Distributor Gross Margin	30.00%		30.00%		30.00%		30.00%	
Distributor Purchase Price	US$22.66	￥154.06	US$7.93	￥53.89	US$17.26	￥117.34	US$4.31	￥29.34
Duty Clearance	1.00%		1.00%		1.00%		1.00%	
Total Import Tax	22.04%		22.04%		22.04%		22.04%	
CIF Price	US$18.38		US$6.43		US$14.00		US$3.50	
Air Freight Cost	US$2.00		US$0.70		US$2.00		US$0.50	
FOB Price	US$16.38		US$5.73		US$12.00		US$3.00	

Source: Site visits and interviews

ASSUMPTIONS

1. The data collected from the supermarket is measured per kg, while restaurants refer to a dish price.
2. All site visits and interviews were conducted in March 2010, Shanghai.
3. The air freight cost and duty clearance fee is approximately quoted and the storage cost is not calculated for the purpose of simplifying. The total import tax is a compounded calculation of tariff and VAT, where the tariff rate is based on New Zealand - China FTA rate reduction in 2010.
4. Cuts quoted in the table are both sold in high-end supermarkets and restaurants. Low-end cuts are usually supplied to distributors at a lower 10%-20% margin, and to retailers a 30% margin.
5. Sub-distributors may exist in different areas, but are not quoted in this table for the purpose of simplifying.
6. Based on interview, there is a norm in the HORECA channel (hotel, restaurant and cafe), that the cost of beef and lamb contained in one dish does not exceed 20%-30% of the dish’s selling price. This means that hotels and restaurants earn at least 50% margin on average in imported beef and lamb products.
7. All the retail price of beef quoted is referring Australia. All the retail price of lamb quoted is referring New Zealand. The FOB price is a mixture from all sources by interviews.

4. CHINA-NZ FREE TRADE AGREEMENT

The New Zealand China Free Trade Agreement came into effect on 1st October 2008 and consequently many New Zealand products have seen a drop in their respective tariff rates. Therefore, the FTA is increasing New Zealand exports to China, providing a huge opportunity for New Zealand beef and lamb companies to seize more and more market share through power marketing and promotion.

New Zealand companies can now offer a relatively competitive price, given that Australia, whose product quality is comparable to New Zealand's, hasn't yet signed FTA with China, but did begin negotiations in 2005.

Tariff of beef and lamb will come to a halt by 2016. Detailed data on tariffs can be found on the website at WWW.CHINAFTA.GOVT.NZ and in the appendix of this report.

Aside from tariffs, beef and lamb importation to China is also subject to 13% VAT. Rather than calculating the sum of these percentages to reveal the applicable costs, total import tax is determined using a compound formula, described below.

Take frozen unboned meat of sheep (HS Code 02044200) as example:

$$\text{Total Import Tax rate} = \frac{\text{ICD} + \text{VAT} + \text{CT} + \text{ICD} \times \text{VAT}}{1 - \text{CT}}$$

In 2010, the import tax rate (ICD) is 8%, VAT is 13%, so in 2010, the total import taxes for frozen unboned sheep meat is 22.04%.

Under the China-New Zealand free trade agreement, a New Zealand company needs to provide a FTA certificate of origin to benefit from duty reduction. In the case of beef and lamb shipment, FTA certificate of origin is either issued by independent bodies in New Zealand or by New Zealand chambers of commerce.

It should be noted that an e-vision certificate of origin sometimes does not work in china customs and New Zealand companies must provide a hard copy for their importer. It is important to ensure all details on the certificate are correct, such as HS Code, product price and value. Any mistake could cause tremendous trouble for importers in claiming the tariff reduction.

If an export consignment misses out on a preferential tariff because of failure to present a FTA certificate or declaration of origin, the importer in China can claim a refund within 12 months of the product being imported.

Also, indirect shipment from New Zealand to China via a third country port has sometimes resulted in failure to receive duty reduction. In this case, the carrier should be asked for documentary evidence from the third country customs bureau or China Inspection Company Limited in Hong Kong to prove the origin of the products. Companies stay hopeful of a logical resolution for these issues over time.

5. IMPORTATION PROCESS

China utilises a strict animal product quarantine system and license management for beef and lamb importation. The General Administration for Quality Supervision, Inspection and Quarantine (AQSIQ) takes charge of administration of quarantine management.

5.1. EXPORT QUALIFICATION

New Zealand has signed a beef and lamb importation agreement with China. A supplier must become registered at AQSIQ and the Certification and Accreditation Administration of People's Republic of China (CNCA) through submitting documents to the local government for qualification for exportation. CNCA takes charge of the registration and supervision of all beef and lamb exporters. Qualification is valid for four years, and renewal must take place one year before the expiration, otherwise qualification will be cancelled. A list of registered plants is publicised on the AQSIQ website and sporadically updated.

5.2. IMPORT DOCUMENTATION

To import any beef or lamb product to China, a company must apply for a meat quarantine import permit (MQIP) to cover the contractual amount. Before applying for MQIP, a company must submit the necessary documents and register at AQSIQ. The importer must then submit documents regarding the volume of the shipment to AQSIQ for the MQIP application.

The following documents need to be prepared for importation clearance:

1. Bill of Landing / Airway Bill
2. Invoice
3. Packing list
4. Sales contract
5. Health Certificate
6. Certificate of Origin Certificate
7. Import License
8. Certificate of Non-Interference for transhipment via third country.

IMPORTATION PATHWAY

STEP 1: Arrival in Pudong Airport and load to transit station

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STEP 2: Notice to the consignee to clear this shipment and delivery to assigned warehouse

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STEP 3: Quarantine Claim to CIQ

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STEP 4: Issue Imported Goods Clearance (入境货物通关单) Sheet for Customs

↓

STEP 5: CIQ Clearance label check and on-site physical check (Random laboratory examination also might be applied from case to case). Issue Imported Goods Quarantine Certificate (入境货物检验检疫证明) (if quota qualified) or Imported Goods Disposal Notice 《检验检疫处理通知书》 if does not meet the quarantine criteria.

↓

STEP 6: Customs Clearance on-site check, consignee pays Tariff and VAT (Random laboratory examination also might be applied from case to case)

↓

Deliver to distributors

6. REGULATORY, LABELLING AND LICENSING RESTRICTIONS

The New Zealand government negotiated protocols for sheep and beef imports in 2003. At the time, it was understood that these protocols included both frozen and chilled meat. However, AQSIQ is now referring to a clause that lists the temperature at which frozen meat should be stored, and suggesting that the protocols therefore only include frozen meat (no similar temperature is listed for chilled meat). The New Zealand government is currently undergoing meetings with AQSIQ, hoping to address this issue.

In recent years, the Chinese government has enforced regulations, supervising standards and labelling for foods. It is critical for New Zealand exporters to understand the relevant rules if they are looking at a long-term position in China. There are numerous laws and regulations relating to imported food and beverage products in China, which are being continuously updated and revised. There are also documentation requirements that must be fulfilled in order for New Zealand exporters to reap FTA tariff advantages.

When negotiating supply contracts, and before beginning the export process, companies are advised to meticulously consult with their importer or distributor.

6.1. CERTIFICATES OF ORIGIN

To benefit from the Free Trade Agreement, you need to:

- Determine whether your goods qualify for access under the agreement
- Obtain a certificate of origin to verify your goods are legitimately made in New Zealand

The New Zealand and China Customs administrations have signed an exchange of letters that rectify a number of issues with the certificate of origin format under the Free Trade Agreement (FTA). These changes, which came into effect on 1st July 2009, should assist the entry of New Zealand goods into China.

6.2. CERTIFICATES OF NON-MANIPULATION

Shipments from all FTA nations have had difficulties with identification and claiming reductions upon entry. When New Zealand goods are exported to China via intermediary countries, a number of New Zealand traders have encountered requirements for Certificates of Non-Manipulation or Non-Interference. New Zealand Customs understands that China Customs is developing guidelines on administering the transhipment of goods through intermediate countries. Until those guidelines are formalised, exporters should consider contacting the following agencies about obtaining Certificates of Non-Manipulation/Non-Interference.

- China Inspection Company Limited (CIC) in Hong Kong can issue Certificates of Non-Manipulation for goods transhipped though Hong Kong to China. Please refer to the website http://www.cichk.com.hk/index-e.htm.
- Singapore Customs can issue Certificates of Non-Manipulation for goods transhipped though Singapore to China. Please refer to the website http://www.customs.gov.sg/leftnav/trad/certificates+of+origin.htm.

Under other FTA, which China is party to, China Customs has indicated that certificates of non-manipulation issued by these entities in Hong Kong and Singapore are suitable forms of evidence that no further manufacturing has occurred. However, there is no guarantee that certificates of non-manipulation issued by these entities will meet the needs of China Customs under the NZ-China FTA. China FTA Certificate of Origin applicants should ask their client or importer to approach China Customs at the point of import to see if these certificates will facilitate the release of goods at NZ-China FTA preferential rates.

6.3. IMPORT LICENSES

Not many food products have import limitations by quota, except grains and sugar. However, an import license is required for the import of a range of products such as meat and edible offal, horticultural products, fish and other aquatic products. The following provides some details about the license application process for importers:

- Approval Organisation: The applicant should lodge the application to China Inspection and Quarantine (CIQ), through which it will be delivered to AQSIQ for assessment. The result of application will be made known through CIQ.
- Main documents and information required for the application of an import license:
  - Qualification of legal representative of applicant (copy)
  - Production/processing/storage agreement with the companies certified by AQSIQ for imported products, i.e. meat, gut, casein, aquatic products, etc.
  - Country of Origin Certificate (There is no limit on C/O as long as the supply plant has passed through the inspection from Chinese government authority.)
  - Total quantity and value to be imported (There is no limit on import quantity and value; however the applicant should seek to utilise at least 70% of the quantity approved. Otherwise, subsequent applications may be difficult.)
  - For the second application by the same applicant, the previous import license (including Verification Sheet) can be cancelled after verification
- Validity: six months for one single consignment
- Cost: no cost on application of import licensing
- Time frame: the standard application procedure takes 30 working days

Currently, full import licenses are only available to large state-owned and domestic private companies. Private Chinese companies must meet certain criteria (import levels, annual revenue, and number of employees) before qualifying for an import license. Full import licenses allow companies to sell directly to the public, act as an agent for smaller Chinese or foreign distributors who do not possess a license, import goods for internal manufacturing, and import materials for manufacturing.

A MQIP can cover multiple containers or shipments and is valid for six months. Unless a company has imported 75% or more of the quantity allocated in the permit, it can not apply for a new MQIP. It takes one month for importers to receive the final feedback from the AQSIQ before knowing whether a new MQIP will be issued.

When beef and lamb is imported to the China port, each shipment is subject to a site check. At the same time, imported beef and lamb is required to be stored in refrigerators managed by the bureau. Once passing all checks and quarantine tests, a sanitary certificate is issued by the CIQ and the beef and lamb product may enter its distribution channels.

Technically, a beef and lamb distributor does not necessarily need to apply for MQIP because there are some agents in the port city that provide importation services to distributors. These agents register themselves at AQSIQ, apply for MQIP, and conduct the duty clearance for their clients. The fee for this service is usually approximately 1% of the total value of imported products and the service can save meat distributors a lot of time and energy, thus allowing the distributors to focus on the meat distribution channel development and marketing.

6.4. CHINESE LABELLING REGULATION

In April 2006, responsibility for the inspection of imported food product labels was transferred from China’s General Administration for Quality Supervision, Inspection and Quarantine (AQSIQ) to the provincial level China Inspection and Quality (CIQ) offices at the port of entry. Prior to a packaged product being imported to or distributed in China, labelling verification must be sought from CIQ. This process takes one to two weeks and is normally handled in conjunction with the importer or distributor, due to language issues and the need for an on-the-ground liaison with CIQ. When going through this procedure, exporters should carefully consider specifying who will retain ownership of the label after approval in their contract with the importer or distributor. This will make it easier to work with other distributors in the future, should the need arise.

Exported beef and lamb are required to clearly state the following information outside of the package:

• Name & brand	• Registration number of plant
• Packaging, Net Weight, Date of Production	• Name of the producer
• Temperature requirements & Shelf Life	• Country of Origin, Destination (PRC)

APPENDIX: CHINA-NZ FTA TARIFF RATE REDUCTIONS

China-NZ FTA Tariff Rate Reductions in %

HSCODE	Description	Basic Rate	2010	2011	2012	2013	2014	2015	2016
02011000	Fresh or chilled bovine carcasses & half carcasses	20	13.3	11.1	8.9	6.7	4.4	4.4	0
02012000	Fresh or chilled unboned bovine meat (excl. carcasses)	12	8	6.7	5.3	4	2.7	1.3	0
02013000	Fresh or chilled boneless bovine meat (excl. carcasses)	12	8	6.7	5.3	4	2.7	1.3	0
02021000	Frozen bovine carcasses & half carcasses	25	16.7	13.9	11.1	8.3	5.6	2.8	0
02022000	Frozen unboned bovine meat (excl. carcasses)	12	8	6.7	5.3	4	2.7	1.3	0
02023000	Frozen boneless bovine meat (excl. carcasses)	12	8	6.7	5.3	4	2.7	1.3	0
02041000	Fresh or chilled lamb carcasses & half carcasses	15	10	8.3	6.7	5	3.3	1.7	0
02042100	Fresh or chilled sheep carcasses & half carcasses (excl. lamb)	23	15.3	12.8	10.2	7.7	5.1	2.6	0
02042200	Fresh or chilled unboned meat of sheep (excl. carcasses)	15	10	8.3	6.7	5	3.3	1.7	0
02042300	Fresh or chilled boneless meat of sheep (excl. carcasses)	15	10	8.3	6.7	5	3.3	1.7	0
02043000	Frozen lamb carcasses & half carcasses	15	10	8.3	6.7	5	3.3	1.7	0
02044100	Frozen sheep carcasses & half carcasses (excl lamb)	23	15.3	12.8	10.2	7.7	5.1	2.6	0
02044200	Frozen unboned meat of sheep (excl. carcasses)	12	8	6.7	5.3	4	2.7	1.3	0
02044300	Frozen boned meat of sheep (excl. carcasses)	15	10	8.3	6.7	5	3.3	1.7	0
02045000	Fresh, chilled or frozen goat meat	20	13.3	11.1	8.9	6.7	4.4	2.2	0

Source: China Customs

APPENDIX: CHINA MAP

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