Rabobank

Moving Globally

What Role Will China Play in the Global Beef Market?

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Food & Agribusiness Research and Advisory

Chenjun Pan
Chenjun.Pan@rabobank.com
+852 2103 2430

far.rabobank.com

Contents

Rabobank sees great potential in China's beef market over the next decade. Although market growth will slow down, emerging consumer segmentation and retail channels will create new demand for value-added and branded beef products. In addition to trading opportunities, international players are well positioned to take advantage of the new market trends and to enter into further processing. Chinese companies are also expected to integrate into the global market by actively making outbound investments in selected regions.

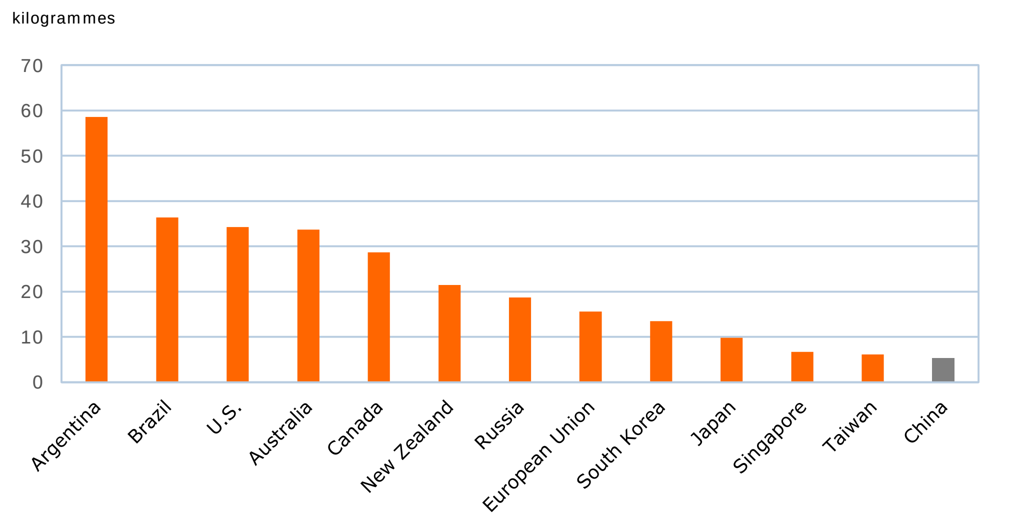
Introduction

Over the next decade, the Chinese market is expected to consume an additional 2.2 million tonnes of beef each year, taking the total demand from the current 8 million tonnes to 10.2 million tonnes by 2025. Local production will likely meet 80 percent of demand, with the remaining 20 percent met by imports. While the mass market remains commodity-based and price-driven, the emergence of niche markets demonstrates differentiated demand and consumers' ability to pay a premium for value-added. The new dynamics in the consumer market will offer global beef companies—typically suppliers of bulk beef to China—opportunities to focus on value creation and branding. In the meantime, Chinese beef companies will move globally to seek consistent supply and learn from their western counterparts. This trend will enable China's beef players and global companies to actively work together and consolidate global resources and markets.

Chinese consumers eat more beef than we thought

Beef is not a traditional meat in China; therefore, it isn't surprising to see that beef consumption is under 6 kilogrammes per capita, far behind pork and poultry consumption, at 40 kilogrammes and 13 kilogrammes, respectively. However, China's beef market has seen very impressive growth, with a 4.8 percent CAGR from 1996 to 2014 in terms of market volume and an estimated value of around USD 60 billion each year. This compares with a 3.5 percent CAGR for pork and a 3.4 percent CAGR for poultry over the same period. While the westernisation of diets, rising income, and demand for higher-value nutrition and health are driving the growth in China's beef consumption, per capita consumption is still low compared with other countries (*see Figure 1*).

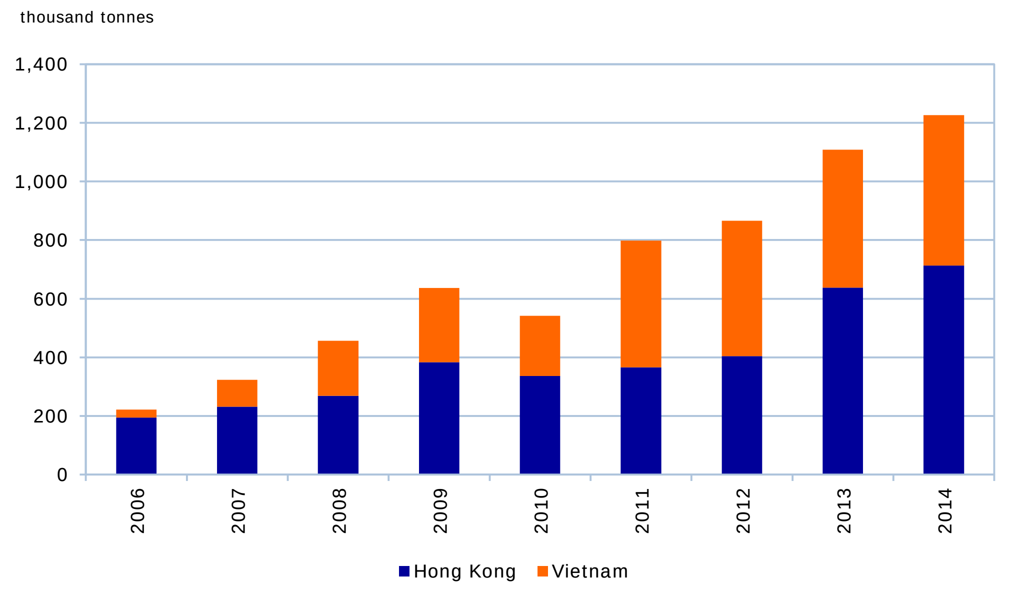
Figure 1: Comparison of beef consumption on a per capita basis, 2014



Source: OCED, USDA, Rabobank, 2015

In determining just how much beef Chinese consumers eat, imports via the grey channels need to be factored in. Based on the assumption that the grey channels are mainly via Vietnam and Hong Kong, we estimate that around 1 million tonnes of beef are imported to China via these channels. Imports for domestic consumption in Vietnam and Hong Kong have been stable at 0.2 million tonnes—and with slightly more than 1.2 million tonnes imported in 2014, the additional 1 million tonnes is available for shipping into mainland China (*see Figure 2*). The shipment via the grey channels can be translated into 0.75 kilogrammes on a per capita basis, or 12 percent of the total supply, which was estimated at 8 million tonnes in 2014.

Figure 2: Hong Kong and Vietnam beef imports, 2006-2014



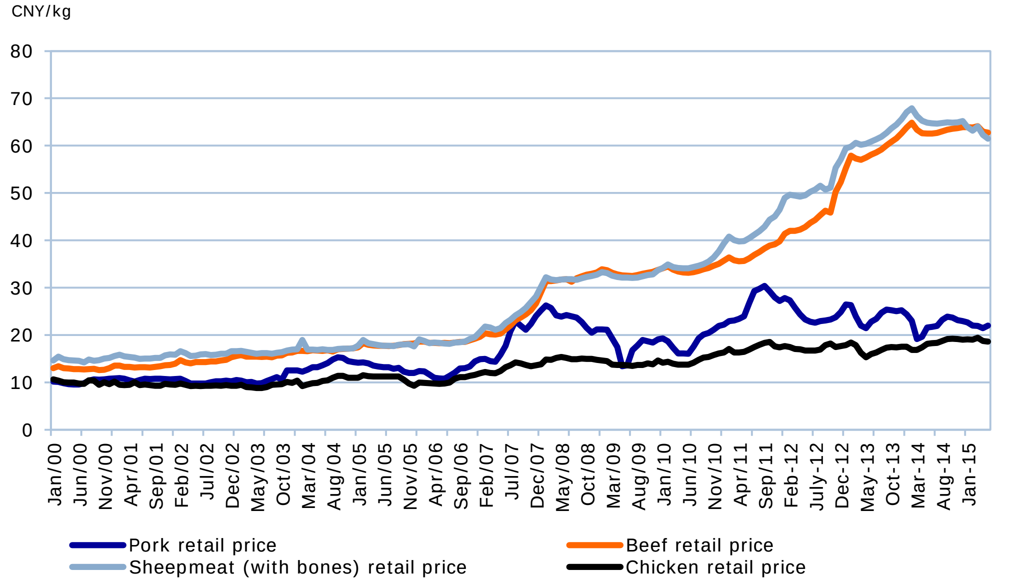
Source: USDA, OECD, 2015

Consumers tolerate high beef prices

Beef prices in China have been increasing and are now more than four times higher than in 2000, while pork prices have doubled, and poultry prices increased 1.8 times during the same period (*see Figure 3*). Given the faster growth of beef consumption, this reflects consumers' higher tolerance for soaring beef prices versus other meats. The average beef price has been around USD 10/kilogramme at the retail market, among the highest beef prices in the world. The current supply issue means there is limited room for the beef price to go down. Instead, there is a high possibility that beef prices will continue to go up periodically, driven by the supply shortage.

As the growth rate of China's economy is expected to slow to around 6 percent by 2025, beef consumption growth will also decelerate. We project that beef demand growth will decrease to a CAGR of 2.2 percent in the next decade, versus the 4.8 percent seen between 1996 and 2014. But even with a slightly lower growth rate in economy, we predict a similar beef demand due to the ongoing premiumisation. This is a bit more optimistic than the Ministry of Agriculture's projection, which is 2 percent for the next decade.

Figure 3: Beef prices are now more than four times higher than in 2000, Jan 2000-Jan 2015



Source: MOA, Rabobank, 2015

Emerging channels indicate new growth opportunities

Market growth potential differs by channel

The sales channel structure for beef in China has evolved, along with the market dynamics. Today, there are three key channels where beef products can be purchased by consumers. They are the foodservice sector, institutional buyers (such as canteens in the workplace and food processors) and the retail market. Under each major channel, there are several sub-channels, and each represents demand for different products. While the data of channel breakdown is not available, the foodservice channel is estimated to account for the largest proportion of beef, with institutional buyers being the next most important consumers in volume terms. The retail market, which is the largest channel for other meats, is believed to be the least important for beef consumption. This is attributed to the fact that beef consumption has been driven by foodservice and dining away from home in the past decades. Compared with pork and poultry, home cooking of beef is not common or frequent.

Each of the three channels demonstrates different market potential. While stable demand is expected for institutional buyers, foodservice and the retail market will witness a lot more dynamics in the coming years.

New channels bring product differentiation

The sub-channels of the retail market mainly include the traditional agricultural market, modern retail (i.e. supermarket/hypermarket) and online shopping. The traditional agricultural market—or so-called 'wet market'—remains the dominant channel, offering a wide variety of beef products: from ready-to-eat beef prepared using Chinese cooking methods to frozen, chilled and fresh beef cuts. This market is mainly commodity-based and price-driven, with limited branding and packaging. Products are mainly in carcass form, and consumers can pick the part they want and have the seller cut it. Despite having convenient locations and providing freshness, the growth of this sub-channel faces great challenges due to frequently reported food safety issues, along with inconsistent supply due to shortages in recent years.

The modern retail sub-channel mainly includes supermarkets and hypermarkets, offering branded and packaged beef with specific cuts, rolls and ready-to-cook steak. The prices in this sub-channel are usually 20 percent to 50 percent higher than the agricultural market. This channel mainly targets a small group of consumers who have great concern over food safety and prefer to pay a premium for safer, quality products. Local brands sold in this channel include Kerchin, Kingbull, Hengdu and Haoyue, who are leading players in pastoral regions, while foreign products are mainly packaged beef cuts sold under local brands, but labelled with the originating countries. However, due to the high marketing expenses involved in modern retail stores, many beef companies consider this a niche market, as they cannot make money by distributing beef via this channel. In addition, beef is not a must-have item for many supermarkets, and so it is not given a lot of consideration. All of these factors hardly make it possible for modern retail to maintain sustainable growth in beef sales.

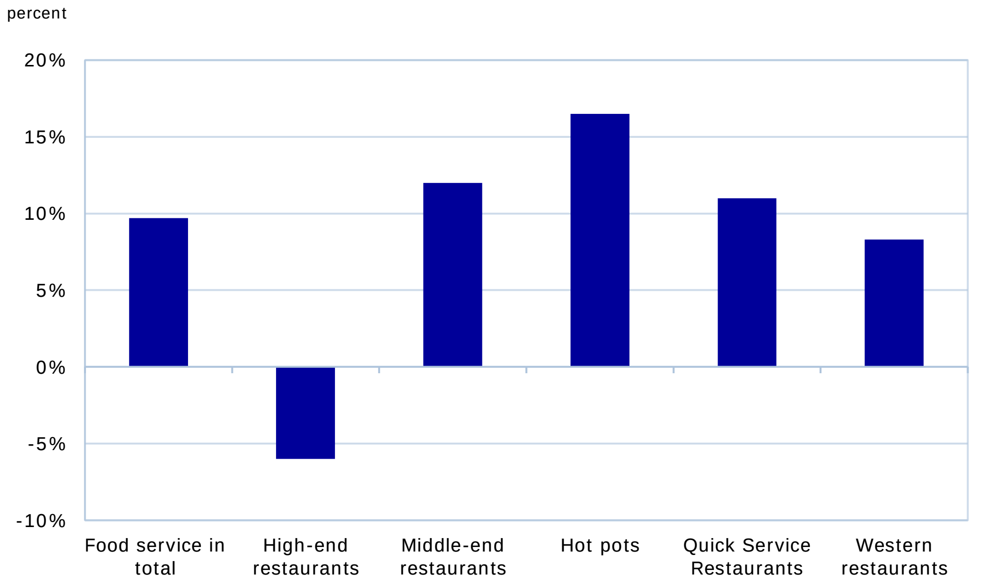
The food safety and high-cost marketing challenges faced by the agricultural market and modern retail sub-channels represent opportunities to e-commerce players in the online shopping sub-channel. Led by 1haodian, Womai and SF, after achieving rapid growth in non-perishable sales, these e-commerce players have just begun looking at offering a selection of perishable foods. Items including beef, sheepmeat, imported seafood and imported fruits, which share issues with conventional channels, have been chosen to be the focus for online perishable food sales. Online shops currently offer much more variety of beef products than supermarkets and hypermarkets. The majority of the products are well packaged and branded with competitive pricing, due to far lower marketing expenses. The freshness is well recognized, as the cold chain logistics are highly emphasised by e-commerce players. In addition, online shopping enables consumers to start cooking steak at home, as the steak products are offered at more affordable prices, come with cooking instructions and ready-to-cook preparation. However, it needs to be stressed that online shoppers are still a niche market, and steak-at-home cooking is just at beginning to take off in urban areas. The beef cooking and eating habit is far from mature, and consumers need more education to know how to cook and eat beef. There is a potentially big market to be unlocked in the coming decades.

The rapidly emerging online shopping channel suggests that beef companies need to pay more attention to the new retail channels by offering small packaged, convenient and value-added products. Foreign companies should look for partners who have the access to the new retail channels. This is probably the most challenging part for foreign players.

Foodservice is driven by hot pot and middle-end restaurants

Foodservice remains the major channel for beef consumption in China, although the foodservice sector has been negatively impacted by economic slow-down and the anti-corruption campaign. Steakhouses, hot pots and some quick service restaurants (QSR) are the specific types of restaurants that offer beef as a main cuisine. These food service types have maintained strong growth in recent years, against the overall slowdown of the foodservice sector (*see Figure 4*). The strong performance is attributed to a westernised lifestyle, a rising affluent class, and the pursuit of value-for-money and variety. The steakhouse, which has been popular in China for less than two decades, is only targeted at a niche group of the affluent class. But this niche market has been growing rapidly. Take Wowprime as an example: Owning more than 200 steakhouses across mainland China via the brands of Wang Steak and Tasty, Wowprime has seen its revenue rise more than 30 percent annually in recent years. This compares with the 6 percent decline for high-end restaurants in 2014, resulting from the sharp decrease in corporate consumers after the anti-corruption campaign. As restaurants like Wowprime mainly serve private consumers, such contrast suggests that the purchasing power of the affluent class remains strong despite the economic slowdown. Going forward, steakhouses and QSRs will continue to have great growth potential, while hot pots, which are already well developed in China, will witness steady growth.

Figure 4: Revenue change by different type of food service in 2014



Source: China Food Service Report, 2015

New investment in further processing

Beef players need to understand the rising sophistication of the Chinese consumer market and the emergence of new distribution channels. While supply issues continue to be the major theme for the whole market, the emergence of 'niche' markets and channels provides more value-creation opportunities. Beef companies face the challenge of where to source consistent beef supply, but they also need to develop, and even create, new markets by delivering new products and addressing the needs for convenience, tailor-made value-added products.

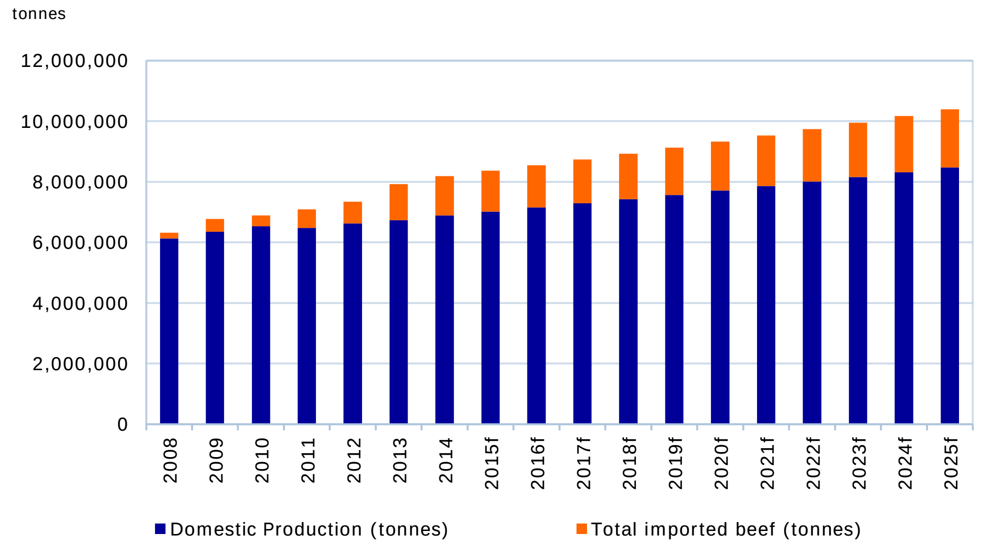
The existing production capacity in China cannot meet the needs mentioned above. There is overcapacity in slaughtering, but lack of capacity in professional cutting and further processing, as the traditional market is primarily raw meat. Some beef companies have already started to invest in further processing facilities, which are mainly used to process imported beef. As the market for value-added products is a niche market and regionally based, such investment tends to be small and serves multiple purposes for both the retail market and foodservice clients, with marinated beef or ready-to-cook beef products. While domestic companies have the advantage of knowing the market and owning sales channels, foreign companies have overseas sourcing capacity, as well as further processing technology and are also well positioned to seize the market opportunity. Foreign companies could either partner with local players or set up wholly owned foreign enterprises if the sales channels could be well established. There is no need to have sizeable investment, but the development of sales channels is the key factor for making a positive investment return.

Imports will contribute 20 percent by 2025

Since 2007, China's domestic beef production has entered into stagnation. Despite the continuously rising prices in the following years, Chinese farmers failed to expand beef production. According to official statistics, the cattle inventory has decreased, from approximately 119 million cattle in 2005 to roughly 105 million cattle in 2015. Due to limited additional investment and longer production cycles, the beef supply chain has much slower development than pork and poultry. In 2014, in a paper issued by China State Council, more beef imports would be allowed in order to meet the domestic supply gap. This is a clear signal that the government can tolerate a lower self-sufficiency for beef, and imports are considered an important sourcing channel beyond domestic production. In 2013 and 2014, a large amount of cheaper beef products was imported from both the official import channel and the grey channel, making domestic production in an increasingly difficult situation and leaving limited room for domestic beef production to recover in the coming years. While domestic beef production is greatly challenged, it will continue to exist in the long term, due to local demand for fresh meat. Beef production will have regional concentration, driven by the regional favourable policy in selected provinces.

In the coming decade, we expect domestic production to grow at a CAGR of 1.9 percent, to 8.4 million tonnes by 2025. As consumption is forecast to grow at 2.2 percent, the supply gap will be 2 million tonnes each year, which will need to be met by imports, including official imports and the shipments via the grey channels. While total imported beef currently accounts for 15 percent of supply, it is expected to contribute 20 percent by 2025 (*see Figure 5*). The rising imports will not only be driven by the domestic production limitation, but also meet the demand for higher-value, quality, premium foreign products.

Figure 5: Beef imports and domestic production by 2025, 2008-2025f



Source: Rabobank, 2015

Moving globally

While we see limited investment in China's domestic cattle production, we expect to see more outbound investment in the coming years. Chinese beef companies aim to participate in the whole supply chain—from farming to processing—in order to not only secure resources such as grassland, but also to take a strategic step to integrate the whole value chain. During the process, both big companies and medium-sized companies will be actively participating in cross-border investments. Driven by the weak domestic production, but with strong demand, the beef sector will likely become the first agricultural sector where China has high integration with the rest of the world. This will differentiate beef from other meat sectors, which are largely independent. Chinese investors are expected to play an influential role in the global beef market.

Although such outbound investment is just at the beginning stage, as only a few small transactions have been completed in the last two years, we expect more investments to take place in the coming decade. In addition to lacking consistent supply, China lacks technology and product innovation in meeting the emerging needs, and therefore urgently needs to learn from counterparts in other major beef markets. Australia remains the top consideration, due to its well established supply and value chains, stable social and political environment, export experience and many years of cooperation with Chinese players. However, its attractiveness is decreasing to some extent, due to the rising doubt on consistent supply in the future. South America is becoming a new interesting area to Chinese companies, as the potential for cattle production growth is more obvious. As a handful of Chinese companies have already entered into the upstream sector in the region, it makes more sense if they could extend the value chain into the beef business. The US market remains uncertain. Future investment opportunities in the US will depend on the discussions beyond BSE or other technical issues between two countries.

For foreign companies, the robust demand in China's beef market provides inbound investment opportunities as described above, though the size of the upside market remains small at the current stage. Foreign companies are not recommended to participate in the whole supply chain. The sectors from farming to slaughtering are not well developed and will be driven by policies, so they may have hidden risks for foreign players. However, downstream—from processing to the retail sector—will benefit from the strong consumer demand and the emerging sales channels, and demonstrate growth potential. Foreign companies could take the chance on low competition and the rising demand.

Conclusion

Rabobank believes that China's beef demand will continue strong growth in the coming decade. An additional 2.2 million tonnes will be needed by 2025, and imports will play an important role in filling in the supply gap. In addition to the volume gap, China's beef market also demonstrates potential for value-added products. Strong demand from the foodservice and retail market channels provides opportunities for both Chinese and foreign companies in the further processing sector. In the meantime, Chinese companies will play an increasingly important role in the world beef market by making more outbound investments in the coming decade.