

Food for Thought

China Flexes its Mussels

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China's suspension of imports from two seafood processing plants highlights existing market risk, however, at face value can be addressed through implementation of stricter COVID-19 protocols. Imports from Sanford's (SAN) Havelock mussel factory and a Sealord finfish processing plant have been suspended following scheduled video audits of the plants. The key takeaways for the listed New Zealand Food & Beverage sector, in our view, are (1) the use of virtual audits lowers risk that Chinese registration lapses given border restrictions, and (2) advanced warning for food exporters of China's expectations and increasing scrutiny on quality and safety. We understand the companies under our coverage are able to adapt to stronger COVID-19 protocols relatively quickly, if required, albeit this likely brings some productivity and/or cost ramifications.

Global expectations – stricter COVID-19 protocols required by China

Our understanding is that the current import restrictions have arisen due to China's global expectation of more stringent COVID-19 protocols, akin to those that were in place under New Zealand's Alert Level 3 and 4. SAN, and most other New Zealand exporters we have spoken to, are operating under protocols consistent with New Zealand's Alert Level 1, given the country's community COVID-19 free status. We understand exporters are geared to adapt to stricter protocols quickly if required, however, depending on the automation of supply chains there could be productivity and cost ramifications. SAN has previously indicated that it can run at c. 80% capacity at its on-land processing facilities under Alert Level 3. Companies that have less labour intensive processing, such as Synlait (SML), are likely to be less impacted.

Processing plant audits taking place virtually

China has been conducting its scheduled GACC (Chinese authority responsible for Chinese customs) audits of New Zealand processing plants virtually, with various seafood plants the most recent focus. We view virtual audits as taking risk off in terms of possible registration lapses, given earlier uncertainty over how/if China would conduct audits with borders closed.

Recent step forward in NZ-China trade relationship

New Zealand and China upgraded their free trade agreement in January 2021, with the agreement designed to ease trade flows by reducing administration red tape, lowering/removing tariffs on certain goods, and reducing handling requirements for perishable goods (e.g. seafood). The agreement illustrates a step forward in the trading relationship between China and New Zealand, against a backdrop of strained trade relationships between China and other countries.

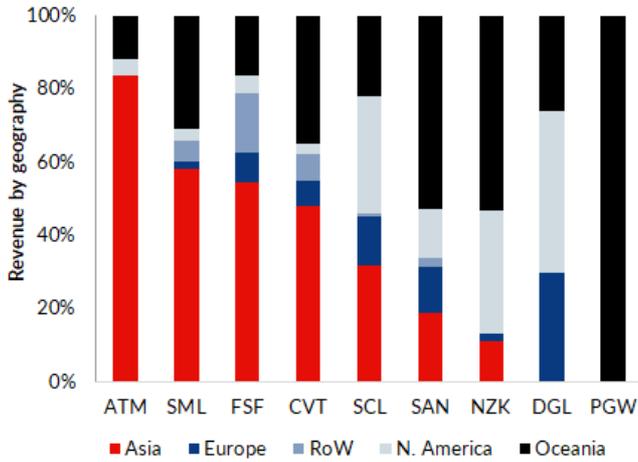
Takeaways for key stocks

- **SAN:** In recent months China has exhibited reasonable demand for mussels, making up 25% of export value (17% over the same time period 12 months prior). We estimate SAN's China mussel revenue is c. 6% of total revenue. We expect to see a resolution to the import restrictions, however, time frames are uncertain at this stage in the process. In the interim SAN has some mitigation avenues, with scope to re-route products given its geographic diversity, although note the demand backdrop remains tough.
- **SML, a2 Milk (ATM):** SML is coming into its audit cycle – SAMR registration for a2 is coming up for renewal in September 2022 (for ATM's China label product, ~34% of revenue), with GACC registration for SML's Dunsandel facility up for renewal prior to this. More specific timing isn't clear but there is time to work through any additional changes should they be required. Quality of protocols, processes and product is a key strength of SML, in our view. While there is risk inherent in re-registration and increasing scrutiny on quality & safety, we see SML/ATM as well positioned to navigate this – our forecasts assume re-registration is achieved. We expect this process (~950 Infant Formula, IF, product registrations up for renewal in 2022) may also see a further round of industry consolidation, with the IF industry still highly fragmented, with a long tail of smaller brands.

NZ listed agri sector – China and channel exposure

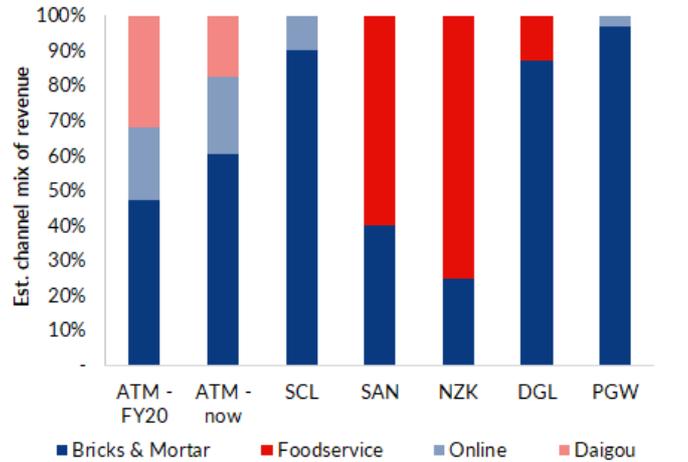
Within the New Zealand listed Food, Beverage & Agriculture sector ATM, SML, Fonterra (FSF), Scales (SCL) and Comvita (CVT) are most exposed to China and reliant on various regulatory registrations for market access, particularly in offline channels.

Figure 1. Geographic mix of companies



Source: Forsyth Barr analysis

Figure 2. Estimated channel exposure for key companies



Source: Forsyth Barr analysis

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