

# Food for Thought

## China Channel Checks

**GUY HOOPER**

guy.hooper@forsythbarr.co.nz  
+64 4 495 5255

**CHELSEA LEADBETTER CFA**

chelsea.leadbetter@forsythbarr.co.nz  
+64 4 495 5262

**MATT MONTGOMERIE**

matt.montgomerie@forsythbarr.co.nz  
+64 9 368 0124

China is a key market for a number of New Zealand exporters and with activity in China recovering post peak COVID-19 impact it will continue to provide evolving insights on consumer preferences and behaviours. Early insights show sales channel mix and consumer behaviour trends have evolved and changes are likely to be enduring, in our view. Our recent industry discussions provide positive read through for the listed New Zealand food and beverage companies, with growing attraction for 'Brand NZ' and any products with perceived health benefits, although materiality differs depending on China exposure. Within our coverage **a2 Milk** (ATM), **Scales** (SCL), and **Comvita** (CVT) are best positioned to benefit.

**Activity returning in China, with Government support for the consumer**

Anecdotal feedback suggests that consumer activity is beginning to return in China and supply channels (outside of air freight) are now operating at 80%–90% capacity. Domestic last mile challenges still exist (not helped by some sub-distributor business failures from COVID-19), although the Chinese Government has signalled the intent to continue supporting food supply lines. Consumption represents c. 56% of China's GDP and we are already seeing an emphasis from policymakers on incentivising consumer spending, as illustrated by the lengthening of China's May Holiday.

**Consumer behaviour and channel realignment**

Lockdown policies have accelerated channel realignment trends, in particular towards online. Through January and February, online sales penetration lifted to 22% (from 17% prior). Digital brand interaction is vital for companies to maintain share gains, with a growing importance placed on live streaming and short videos. The food service channel was, unsurprisingly, the hardest hit through China's lockdown, and remains under material pressure post re-opening as consumers remain cautious. This channel is expected to be subdued for an extended period. From a New Zealand listed company context, China food service represents a very small portion of total global revenue exposure. Companies most exposed are Fonterra (FSF) and NZ King Salmon (NZK), although for NZK product re-alignment (to frozen and smoked) and redeployment of volumes to other markets likely lowers any sustained impact.

**Brand New Zealand well placed in the eyes of the Chinese consumer**

New Zealand's primary industry is well regarded globally for producing high quality exports and this is particularly true in China. Our recent channel checking suggests the positive perception by Chinese consumers remains strong and may be growing, helped by:

- New Zealand's management of COVID-19: New Zealand has seen positive media on the ground in China for our strict lockdown and general handling of COVID-19, particularly relative to other nations. This has received a positive reception and further supports New Zealand's existing strong reputation for food quality.
- Heightened awareness of health: Chinese consumer demand for health products is increasing with heightened emphasis on nutritional benefits of products, which supports a number of our export categories including dairy, fruit, honey and supplements.

Channel checking points to healthy demand from Chinese consumers for a number of our key export products including pet food, dairy, infant formula, skincare, vitamins/supplements, seafood, wine, fruit and Manuka honey.

**Window of opportunity, but competition is coming**

A window of opportunity exists for New Zealand food and beverage companies to gain additional market share in the near-term, with supply chains of fresh produce from other international markets (Europe and North America) highly disrupted. However, it is likely all global exporters will be looking to increase volume to China as its consumers are less restricted vs other markets which are in earlier stages of managing COVID-19. Inventory levels, particularly in fruit, wine and beef are already showing signs of rising which may put pressure on prices in future.

## NZ listed agri sector – China exposure

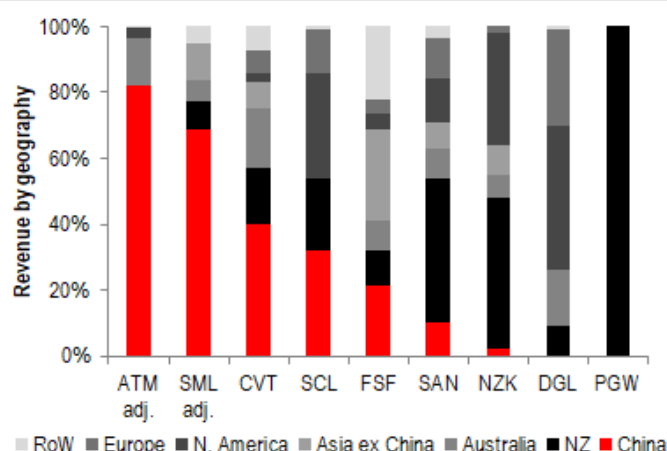
Recent anecdotes and feedback from China, a key market for a number of NZ exporters, suggests activity is recovering and demand is healthy for high quality necessity products with growing attraction for 'Brand NZ' and any products with perceived health related benefits. Within the NZ listed Food, Beverage & Agriculture sector The a2 Milk Company (ATM), Scales (SCL) and Comvita (CVT) are best positioned to benefit from these trends given material exposure to China, and their product offerings and channel mix. Other companies with a smaller foothold in China that may benefit from opportunities arising out of COVID-19 to grow (and redeploy volume from more affected markets) include Sanford (SAN) and New Zealand King Salmon (NZK).

**Figure 1. Estimated company specific exposure and demand/supply changes in China through CY20**

Company name	Ticker	China exposure (0 no exposure, 10 only market)	Supply chain (0 halted, 10 no disruption)	Demand change (0 negative impact, 10 positive impact)	Channel exposure pre-COVID			
					Wholesale	Retail	Online	Foodservice
a2 Milk	ATM	8	8	7	✓	✓	✓	x
Fonterra	FSF	3	7	5	✓	✓	✓	✓
Synlait	SML	7	8	7	✓	x	x	x
NZ King Salmon	NZK	0	1	2	x	x	x	✓
Sanford	SAN	1	7	5	✓	x	x	✓
Scales	SCL	3	8	7	x	✓	✓	x
Delegat	DGL	0	8	5	x	✓	x	x
Comvita	CVT	4	8	9	x	✓	✓	x

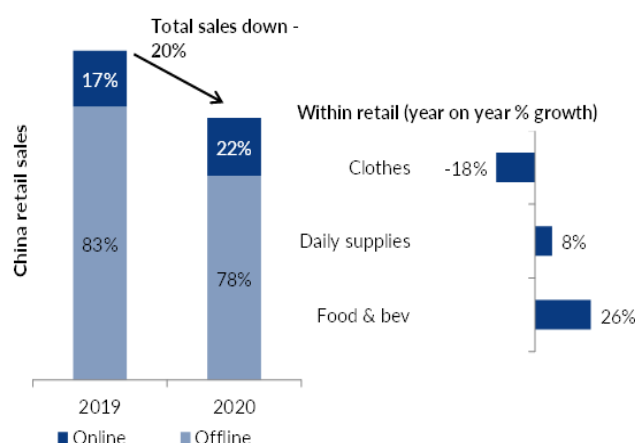
Source: Forsyth Barr analysis

**Figure 2. Revenue exposure by geography\***



Source: Company reports, Forsyth Barr analysis, \*where China not explicitly disclosed, it is our estimate

**Figure 3. China retail sales of Consumer Goods in Jan–Feb 2020**



Source: Alibaba, Forsyth Barr analysis

## Company specific comments

### Dairy

- a2 Milk (OUTPERFORM)** – Highly exposed to Chinese consumption of its infant formula (IF) products. Recent channel checking suggests demand remains strong, particularly through online channels, while anecdotes suggest minimal supply chain disruption of note. ATM is well placed to capitalise on any growing preference for high quality imported product, shift in desirability of NZ sourced product and/or any production disruption for other imported IF brands.
- Fonterra (Not Rated)** – Key exposures are China sales within its Consumer & Foodservice segment and commodity prices which are influenced by global supply/demand dynamics. We expect Consumer sales have been good, while the collapse of Foodservice through lockdown would have materially impacted sales in that channel. Anecdotes suggest demand is returning for the latter as China re-opens more restaurants, although consumers remain cautious. Dairy prices have been relatively resilient to date vs other commodities.
- Synlait Milk (NEUTRAL)** – SML's fortunes in the China market are predominantly driven by that of key customer, ATM, discussed above. SML is also looking to secure new customers, to support its recent capacity expansion, and the favourable (and growing positive) perception of the quality of NZ sourced products and manufacturing is likely beneficial to discussions.

### Seafood

- **New Zealand King Salmon (OUTPERFORM)** — During lock down sales fell to zero, with the collapse of food service; however, China only represents ~2% of sales and the company was able to successfully redeploy volume into other markets. NZK is currently working on channel re-alignment into retail (in particular online), which will involve new product formats for the China market (more suitable for retail and able to sea freighted). China remains a significant opportunity for NZK, supported by shareholder China Resources, over the medium to long term.
- **Sanford (OUTPERFORM)** — China is a relatively small market for SAN with limited fresh product exposure, and therefore limited supply chain disruption compared to other seafood exporters. Anecdotal feedback suggests seafood demand through the retail channel is robust, however, food service demand remains subdued and could be for prolonged period.

### Horticulture & viticulture

- **Delegat (Not Rated)** — DGL sells minimal product in China (too small to be disclosed). China could present a long term opportunity, although the company remains focused on North America growth. With limited on-premise exposure in North America, those growth plans remain intact.
- **Scales (NEUTRAL)** — SCL should be benefiting from current trends in China. The first shipment of apples arrived in China mid-March and initial feedback on new varieties (first commercial season of the Posy variety) is positive. Port congestion has eased, with the imported fruit volume through Shanghai port in March 2020 only down -10% on the prior comparable period and is expected to improve over coming months. It is worth noting it is early in the selling season and some price risk exists in the coming months as inventory from other global exporters builds.

### Other

- **Comvita (Not Rated)** — Recent commentary from CVT confirms strong demand from Chinese consumers across its product range, particularly Manuka honey, Propolis and Olive Leaf Extract. Online sales have seen a material uplift in China, which materially offset lower sales through traditional retail stores.
- **PGG Wrightson (Not Rated)** — No direct exposure to China. The combined impact of COVID-19 and drought has likely weighed on PGW performance in recent months. Strong demand and robust pricing for New Zealand fruit and protein in China should be supportive of on farm activity in New Zealand and provide an offset to the weak economic outlook, in our opinion.

**Analyst certification:** The research analyst(s) primarily responsible for the preparation and content of this publication ("Analysts") are named on the first page of this publication. Each such Analyst certifies (other than in relation to content or views expressly attributed to another analyst) that (i) the views expressed in this publication accurately reflect their personal views about each issuer and financial product referenced and were prepared in an independent manner, including with respect to Forsyth Barr Limited and its related companies; and (ii) no part of the Analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that Analyst in this report.

**Analyst holdings:** For information about analyst holdings in a particular financial product referred to in this publication, please refer to the most recent research report for that financial product.

**Ratings distributions:** As at 16 Apr 2020, Forsyth Barr's research ratings were distributed as follows:

OUTPERFORM	NEUTRAL	UNDERPERFORM
42.0%	44.0%	14.0%

Forsyth Barr's research ratings are OUTPERFORM, NEUTRAL, and UNDERPERFORM. The ratings are relative to our other equity security recommendations across our New Zealand market coverage and are based on risk-adjusted Estimated Total Returns for the securities in question. Risk-adjusted Estimated Total Returns are calculated from our assessment of the risk profile, expected dividends and target price for the relevant security.

**Disclosure:** Forsyth Barr Limited and its related companies (and their respective directors, officers, agents and employees) ("Forsyth Barr") may have long or short positions or otherwise have interests in the financial products referred to in this publication, and may be directors or officers of, and/or provide (or be intending to provide) investment banking or other services to, the issuer of those financial products (and may receive fees for so acting). Forsyth Barr is not a registered bank within the meaning of the Reserve Bank of New Zealand Act 1989. Forsyth Barr may buy or sell financial products as principal or agent, and in doing so may undertake transactions that are not consistent with any recommendations contained in this publication. Other Forsyth Barr business units may hold views different from those in this publication; any such views will generally not be brought to your attention. Forsyth Barr confirms no inducement has been accepted from the issuer(s) that are the subject of this publication, whether pecuniary or otherwise, in connection with making any recommendation contained in this publication. In preparing this publication, non-financial assistance (for example, access to staff or information) may have been provided by the issuer(s) being researched.

**Investment banking engagements:** For information about whether Forsyth Barr has within the past 12 months been engaged to provide investment banking services to an issuer that is the subject of this publication, please refer to the most recent research report for that issuer's financial products.

**Not personalised financial advice:** The recommendations and opinions in this publication do not take into account your personal financial situation or investment goals. The financial products referred to in this publication may not be suitable for you. If you wish to receive personalised financial advice, please contact your Forsyth Barr Investment Adviser. The value of financial products may go up and down and investors may not get back the full (or any) amount invested. Past performance is not necessarily indicative of future performance. Disclosure statements for Forsyth Barr Investment Advisers are available on request and free of charge.

**Disclaimer:** This publication has been prepared in good faith based on information obtained from sources believed to be reliable and accurate. However, that information has not been independently verified or investigated by Forsyth Barr. Forsyth Barr does not make any representation or warranty (express or implied) that the information in this publication is accurate or complete, and, to the maximum extent permitted by law, excludes and disclaims any liability (including in negligence) for any loss which may be incurred by any person acting or relying upon any information, analysis, opinion or recommendation in this publication. Forsyth Barr does not undertake to keep current this publication; any opinions or recommendations may change without notice to you. Any analyses or valuations will typically be based on numerous assumptions; different assumptions may yield materially different results. Nothing in this publication should be construed as a solicitation to buy or sell any financial product, or to engage in or refrain from doing so, or to engage in any other transaction. This publication is not intended to be distributed or made available to any person in any jurisdiction where doing so would constitute a breach of any applicable laws or regulations or would subject Forsyth Barr to any registration or licensing requirement within such jurisdiction.

**Terms of use:** Copyright Forsyth Barr Limited. You may not redistribute, copy, revise, amend, create a derivative work from, extract data from, or otherwise commercially exploit this publication in any way. By accessing this publication via an electronic platform, you agree that the platform provider may provide Forsyth Barr with information on your readership of the publications available through that platform.