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China: Milky Way Ahead

Chinese growth in various industries in the last three decades has been well evidenced, talked and researched about. I want to look into the future for China and see where the next boom is going to come from and how various market participants can capture this growth opportunity. I believe we should look to China's milk sector. This sector has seen quite rapid growth over the last few years, and I believe that it could easily outperform most other agriculture sectors in China from a return-on-investment standpoint.

To provide some context, a high milk consuming country in Europe would have per capital milk consumption of about 150 kg/person/year. China currently is at less than one third of this number. In addition, in advanced nations milk (and milk products) provide about 9% of one's dietary supplement, 19% of one's protein, and 12% of one's fat. China currently lags behind in all of these numbers, which incidentally are sourced from FAO of the UN. Most importantly, I would argue that given the size of its population, changing dietary habits (which are incentivizing milk consumption), higher income levels, and a greater need for total calorific value, we should expect the demand for milk to be substantially higher in China in a decade's time than it is today.

What does this mean for the world? First, there are only few nations - such as New Zealand, the United States, and Australia - that have the capacity to export very large quantities of milk. Second, assuming that production can keep up with the increasing demand for milk, there will still be a need for higher yielding cows and greater feed to support their milk production. Third, feed can be pasture or corn, both of which are available in abundance only in a few countries, such as Argentina, the United States, and Australia. Fourth, milk is a perishable product, so if we are talking about imports into China, most of it will have to be evaporated milk in containers. These factors will lead to an increase in milk prices, very likely resulting in a struggle for fulfilling demand in other countries such as Venezuela, Algeria etc.

What does this mean for investments? The first phase of investments will be in producing milk elsewhere, such as in California or Kansas in the United States, and exporting this milk to China. Exporting the technology to produce milk in China itself would be the next step, so that the production and consumption centers are closer to each other. While China can make these capital investments in milk production, it should also make a conscious effort to invest in pastureland or production of corn for dairy feed. China currently doesn't enjoy either of these agricultural capabilities because it runs a tight ship on land usage given water constraints, and there is a vibrant feed demand for corn towards meat production. The opportunity not only lies in making the right investments in milk production but also in investing in technologies of feed production to achieve higher milk yielding cows.

Given the current scenario, I think the most prudent way to capture this expected growth trajectory would be for Chinese firms to make investments in milk producing nations. This will help them achieve the appropriate milk balance and also allow them to assimilate milk production technology into their own production process. The natural choices for these investments in my view are the United States for production and India for learning the successful tactics required in feeding milk to a billion plus population. It is clear China will be demanding more milk for domestic consumption, and to optimize its return on investment, it is time to capitalize on some of the lessons we have learned from the infrastructure boom in China and apply them to the milk sector.

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