

final report

Project code: P.PIP.0558
Prepared by: Simon Stahl
Date published: 10th Nov 2018

PUBLISHED BY
Meat and Livestock Australia Limited
Locked Bag 991
NORTH SYDNEY NSW 2059

China value chain design, partner and feasibility model development

Meat & Livestock Australia acknowledges the matching funds provided by the Australian Government to support the research and development detailed in this publication.

This publication is published by Meat & Livestock Australia Limited ABN 39 081 678 364 (MLA). Care is taken to ensure the accuracy of the information contained in this publication. However MLA cannot accept responsibility for the accuracy or completeness of the information or opinions contained in the publication. You should make your own enquiries before making decisions concerning your interests. Reproduction in whole or in part of this publication is prohibited without prior written consent of MLA.

Executive Summary

One of the largest economies in the world, China has grown at the fastest pace over the past thirty years. Increasing market liberalisation has generated significant growth in disposable income and with that demand for improved goods and services. Whilst the rewards of owning and operating a business internationally can be great, in particular China, unique challenges in this developing and maturing market require significant due diligence.

Value added processing of Australian exported boxed chilled and frozen beef in China has enormous potential. Many existing supply chain controls and processing facilities do not meet world best standard. Chinese legislators acknowledge partnerships with appropriately qualified western processing experts will greatly improve the supply chain, particularly with regard to lowering cost and improving quality. The benefit to the Australian red meat industry is clearly increasing demand in China, based on cost competitiveness and quality.

This report articulates the necessary considerations and de-risking activities required when evaluating an in-market joint venture partner to further manufacture and distribute red meat product in China, along with in market production facility development and optimisation with the objective of undertaking further manufacturing and distribution of Australian red meat in China.

Table of Contents

1. Background	4
2. Project objectives	5
2.1. Before we get started	5
2.1.1. Language barriers and understanding the cultural difference	5
2.1.2. The need for 2 levels of partners	5
2.2. Identification of an appropriate partner selection framework	6
2.2.1. Legal requirements of conducting business in China	6
2.2.2. Dealing with state owned entities (SOE)	6
2.2.3. Compatability of co operative business structure in a joint venture	6
2.2.4. Strategic business overview	6
2.2.5. Operational and Import / Export licences	7
2.2.6. Finance and Capital	7
2.2.7. Human Resources	7
2.2.8. JV partner financial due diligence	7
2.2.9. Insurence	8
3. Project management, design and delivery of assets and facilities	8
3.1.1. Risk Management	8
3.1.2. Production facility design	9
3.1.3. Production facility equipment	10
4. Conclusion and recommendations	11
5 Appendices	12

1 Background

The lack of contemporary and innovative business models within the agri-food sector has reinforced adversarial, transactional behaviour and loss of trust within these supply chains.

It is now well regarded within contemporary business management 'thought leadership' that business model innovation can create a more significant and defensible competitive advantage than the tradition forms of innovation being product or process in creating a sustainable competitive advantage.

Sophisticated and well-integrated business model and value chains and targeted growth strategies must become the norm if agri-business enterprises are to be successful at both creating value for customers, and capturing value for their businesses and their supply chain partners.

In arriving at innovative value chain designs which create and capture increased value for the Australian red meat industry, the current level of understanding of alternative models whereby Australian red meat is further processing in-market under the infrastructure and quality systems managed by an Australian company or a JV partner is largely unknown and once understood creates opportunities for innovative value chain designs from a both a manufacturing efficiency and capital attraction viewpoint

This project undertook to develop both due diligence frameworks and processing efficiency models to investigate and evaluate specific commercial opportunities for value adding red meat in China. This will be achieved by developing frameworks to conduct partner due diligence on identified in market partners and the development of a dynamic processing feasibility model to assess the commercial viability of in-market manufacturing opportunities through in market joint venturing activity.

This project represents phase 1 of what is anticipated broader program of work which will further explore the application of all 7 design considerations identified below within new value chain pilots in the Chinese market place. This project has been identified as a flagship chain value chain demonstration project within the Rural Research and Development Insights to Innovation program.

The design considerations and capabilities developments identified through previous research include;

- Partner selection
- Channel partner support program
- Industry standards
- Surveillance mechanism
- Data and Analytics
- Cold chain logistics
- Local resource development

The aspects covered within this project was the development of a partner selection due diligence framework for selecting an in-market Chinese JV partner and in-market production facility development and optimisation with the objective of undertaking further manufacturing and distribution of Australian red meat throughout China.

2 Projective Objectives

The development of both due diligence frameworks and processing efficiency models to investigate and evaluate specific commercial opportunities for value adding red meat in China, including;

- Partner selection due diligence frameworks around identifying an appropriate in market JV partner to conduct further manufacturing of Australian red meat in China (a deeper dive than the model we currently have developed as part of the insights to innovation foundation research activity enabling a more forensic due diligence investigation into a specific partner once a suitable partner has been identified)
- Development of a dynamic processing feasibility model for an Australian red meat exporter to develop and operate a retail ready red meat processing facility in China

2.1 Before we get started

2.1.1 Language barriers and understanding the cultural differences

By collaborating with an Australian based Chinese expat, the project participants worked together for over twelve months to develop concepts and potential business structures. The initial priority was to find a resource fluent in Mandarin & Cantonese and experienced with commercial transactions in China. In reality the consultant soon became a collaborative partner or co-partner, albeit in a different business. Importantly this co-partner had other business interests in China and it was a matter of keeping the two roles separated and appropriate salary established.

Due diligence in selecting this partner included a review of his company and associated business owners and business acumen in running his/her own business in Australia and/or in China. This partner also had strong ties and existing family relationships in China and relations that directly owned and operated non-competing businesses (but within the meat industry) in China (in particular in the province where we targeted our business). Critical legal documents were translated by independent third party and less critical documents are translated by the project participant Co-partner.

2.1.2 The need for 2 levels of Partners

Having confidence in understanding language and cultural barriers or at least having them explained to our organisation, we determined two partnerships were required for this project, being

1. Project “co-partner” with Chinese language, commercial skills and experience (assisting the Australian investor) [Refer to section 2.1.1] ; and
2. Partnership with Chinese company with relevant in-market processing, warehousing and distribution capability. The JV partner relied upon NCMC processing expertise and hence the JV, but had the land, buildings, warehousing and distribution networks.

It was concluded that it is not even possible to approach the correct level of in-market Chinese partner without proper research and understanding of the markets and an understanding of the meat industry in China. Our co-partner was able to perform this research and we were able to proceed with further developing the framework for selection of an appropriate in-market Chinese business partner.

2.2 Identification of an Appropriate Partner selection Framework

2.2.1 Legal requirements of conducting business in China

Given the project proponents limited knowledge of legal requirements in China, “tier 1” legal firm King Wood Malleson were engaged to advise. The Firm is multi-national and their branch offices in Shanghai, Hong Kong and Brisbane were utilised. The Firm offered appropriate skills and support for the China project, including translation services, understanding of legal and commercial possibilities for structure, entry, operations and exiting the China-based business venture.

The brief was to assist with Structure after consideration of our priorities being:

1. ensuring the investment and parent entities were protected;
2. ensuring an ability to grow and fund future expansion plans;
3. ensuring that taxes are minimised; and
4. ability to limit future liabilities/commitments and access to profits, dividends and excess cash requirements.

Refer to **APPENDIX 1** for a diagrammatic of the proposed structure.

2.2.2 Dealing with a State-Owned Entity “SOE”

Having a choice of dealing with a private enterprise or a state-owned enterprise. When the China Government announced its policy to improve the quality and cold-chain product traceability, partnering with a Chinese state-owned entity was an obvious choice. Whilst the amount of red-tape and government oversight might be seen as an impost on progress, The project participants saw it as a positive in terms of there being less room for corruption or an increased level of trust. In dealing with a SOE, as the due diligence proved, it has access to significant capital, working capital finance, assets, cashflow, etc.

The SOE chosen to deal with already has a significant cold-chain vertical integration and distribution in food products other than red-meat. As such the vertical integration of red meat product was made easier. Significantly the SOE was looking for a red meat supplier sourced from a quality assured, sustainable, country for its distribution network.

2.2.3. Compatibility of co operative business structure

Culturally, the China people understand and appreciate the concept of farmer owned organisations and co-operative farming, which is the exact nature of project proponents business structure, being a producer/operator-based co-operative. That is not to say that this is a requirement for doing business in China, however it was seen as an intangible benefit during the partnership negotiations.

2.2.4. Strategic Business Overview

Ownership of the red-meat integration was documented by the SOE in their Strategic Overview document for the Project and demonstrated the integration of the skills, knowledge and expertise of both partners.

2.2.5. Operational and Import/Export Licences

NCMC has export licence to supply chilled and frozen red meat into China. Import licences in China are controlled by Government and an appropriately licenced importer is required to facilitate business into China.

In market certification for further processing is required. Below is a list of the licence / certifications required to manufacture and process edible food products in China.

ENTITY	LICENSE	PERIOD FOR APPLICATION	REMARK
Company	Business License	In application	Business scope should be including <i>Food Distribution</i>
	Food Business License	1 to 1.5 months	Business scope should be including <i>Prepackaged Food Sales</i>
Company's Processing Facility	EIA (Environmental Impact Assessment)	No specific period	The specific period depends on Environmental Protection Agency
	Food Production License	Around 2 months	The license application requirement documents: a) EIA and Fire Security Report b) Workshop layout, production line info and labor info etc.

2.2.6. Finance / Capital

A high-level multiyear operational budgets were established as a part of the development of the venture, including the creation of a marketing strategy section for the business plan. The working capital funding can be sourced from the SOE due to its extensive cash reserves and free operating cashflow. These high-level budgets are subject to JV Board review and approval including an analysis of expenditure items including marketing and entertainment. Culturally, there is a fundamental difference in the way that business is done in China resulting in high entertainment and similar costs compared to Western countries, however this may change slowly over time.

2.2.7. Human Resources

In order to simplify management of Human Resources, it was determined the JV will directly employ only those required to manage the trading business. Labour required for technical production, including value adding and distribution will be sourced from in market partner on a user pay basis.

2.2.8. JV Partner Financial Due Diligence

Third due diligence provided confirmation that we were dealing with a State-Owned Enterprise and any work around the quantity and validation of the size of revenues, expenses, assets and liabilities. The latest audited financial statements for the SOE Group on issue were downloaded from the Group web-site and indicated a substantial business enterprise and as such a review of the top 10 customers and top 10 suppliers due diligence was not deemed necessary.

2.2.9 JV Partner Legal Due Diligence

Third party advisor King Wood Malleson Hong Kong confirmed the existence of the SOE and the size and scale of the business enterprise indicates that whilst legal issues may arise, there is nothing to indicate that legal matters may exist that may financial materially impact the SOE.

That being said, many business transactions, laws and regulations differ substantially to the Western or Australian environment, and as such if a transaction or verbal explanation was provided of a material financial nature, then the matter was referred to King Wood Malleson for confirmation.

2.2.10 Insurance

Insurances are not required until the exact nature and structure is established. Advice is sought in each jurisdiction, prior to signing any documents.

3 Project management, design and delivery of assets and facilities in China

3.1.1. Risk Management

The risk management strategy for delivering processing and food manufacturing facility will need to reflect the cultural and commercial environment in China. The design, construction and operational phases of the project will require assessment and management to ensure that all relevant risks are controlled in a manner suitable for all parties of the JV. At a high level the project should consider the following:

- Facility Construction and operational OH&S – Delivering projects in China will require careful assessment of the associated risk and safety of Chinese and Foreign workers in both the construction and operational phases of the project. The maturity of workplace safety systems, construction methodologies and workplace health and safety procedures and policies in China appear to be of a lower standard than in western countries. The utilisation of, Western design, or equivalent, construction techniques and principles should be utilised for the proposed manufacturing facility including process design and materials handling systems.
- Quality assurance and product integrity – The integrity of the product and the subsequent shelf life of the finished goods in China may currently not be of the same standard as that that as manufactured in Australia or other western countries. The quality of imported products into China can be reduced due to inefficient cold chain logistics. In the case of imported meat products, the Chinese regulators, are attempting to address the issue by banning the importation of chilled product. This however reduces the quality of the finished product, particularly for high end high quality Grain fed cuts including F1 and Wagyu bred products. Long term strategies should include improved control of the “Cold Chain” from import to processing and distribution of the finished goods to retail customers and the consumer.
- The processing plant should be configured with building construction details, plant and processes that are equivalent to International Export standards including refrigeration systems.

Cold storage, refrigerated transport and supply chain logistics systems should also be configured to reflect International good practice.

- IP protection. - The production processes that are utilised in the proposed manufacturing facility are of specific value to the Australian entities and will generally provide specific brand and quality attributes to the finished product. Consideration should be given to how the intellectual property of the process including recipe and process trade secrets (if applicable) are managed to ensure brand and product integrity is maintained
- Traceability and product substitution – There are many reports of product substitution in the Chinese consumer market. Consideration as to how product traceability, and integrity is maintained throughout the process should be controlled within the proposed manufacturing plant. Key point for consideration include, Country of origin Labelling (COOL), and cut and brand substitution.

3.1.2 Production Facility design

Finding the right balance between production throughput and developing a full range of products during the early start-up phase of the project will be challenging. The products and process to be housed in the facility are still under discussion and will possibly start on a smaller footprint processing a select range of products. Initial production capability could focus on two or three key product lines that are then configured to achieve the standard and throughput required with the efficiency the project will have on completion.

All parties are cognizant of the need to develop a plant that produces products that are tailored to the tastes and consumer trends of initially the Shanghainese, and then ultimately the greater Chinese consumer. It is expected that the products processed will be of a premium quality and may include high quality organic, grain fed and high-end Wagyu products.

Key facility and process design inputs that will be required to develop the design will include;

- Building and services design – The building design and services that will be required for the new process facility will need to be assessed and, if not currently available, additional functionality will need to be provided to adequately support the new production plant. Key design information will include overall layout, building structure, refrigeration plant, thermal insulation, water supply, drainage, power and other key services design information including 3D Building Model (BIM) and 2D plan and elevation drawings where available.
- Process design – although the final process design deliverables and throughput are yet to be decided, a whole of facility concept should be developed to allow planning for the initial and future stages of work. The development of an overall process concept will assist in identifying the quantum of building services required for the initial process but will estimate the building's longer term needs for services and infrastructure during later stages of the project development.
- Supply of future services - the ability to expand will be contingent on the availability of adequate infrastructure to support the expansion when required. It is recommended that the obligation to

supply adequate infrastructure and services for the project through all stages of the project is clearly understood by the building owners and the JV partners

Design information required - Key process information that will be required during the concept and stage one design of the project will include where possible:

- Estimated Short, medium and long term production throughputs
- Possible products to be processed and finished goods produced
- Destination of finished goods (Country, Province, City)
- Preferred equipment and suppliers, if known
- Finished goods packaging formats
- Raw materials availability and format (chilled, frozen, box, bulk, etc.)
- Local authority requirements and any other special Chinese or if applicable export market requirements

This data will also provide information necessary to design raw material receipt, equipment layout and finished goods dispatch functionality required to meet production demands. This information will allow for a basic mass balance of the raw materials, products to be manufactured, the processes required and depending on the quality of information, the sales patterns and volumes expected during the project stages.

3.1.3 Production facility equipment procurement and operational support

The success of the project will be a function of the reliability of plant and equipment in production, whilst maintaining product integrity and quality. During the process design phase of the project it was recommended that technology and equipment selections are based on Australian, European, or US suppliers that have a strong presence in China, particularly in the Shanghai region. Partnering with these suppliers will provide production and on-going operational support on completion of the project

When developing a project in China, it will be an imperative to partner with an organisation currently operating in, and have a strong track record of success in the region that the project will be delivered. These organisations should beyond commercial sales and marketing capability, include; equipment supply, process design, spare parts, equipment maintenance and service support. Other Key points that should be considered include:

- Developing a production facility design and associated cold chain logistics consistent with international good practice
- Conducting a master planning and high level evaluation of the potential final production process and required throughput to ascertain the limits of the existing building structure and services
- Defining clearly the initial stage of the facility's development including production throughput and products to be processed. This should then, where possible, extend to subsequent future stages of the project.
- Establish the long-term capacity requirements of services and building design to support the process and ensuring these will be available as the facility expands to the expected final configuration

- Locating and having available all possible building structure and services engineering design information to ensure adequate to support the proposed facility
- Evaluating fully the Occupational and workplace health and safety system and culture that will be required to operate facility under the proposed Joint venture to ensure all parties are protected and subsequently their executive and shareholder members.
- Assessment and identification of control and mitigation measures as required to ensure product quality, integrity and product and process IP is protected at all times.

4. Conclusion and Recommendations

When developing a JV in China, it is imperative to partner with organisations that are currently operating in and have a strong track record of success in the region that the project will be delivered. These organisations should include evidence of strong market presence, growth in target market sales channels, market insight, and high quality operational capabilities and capacity.

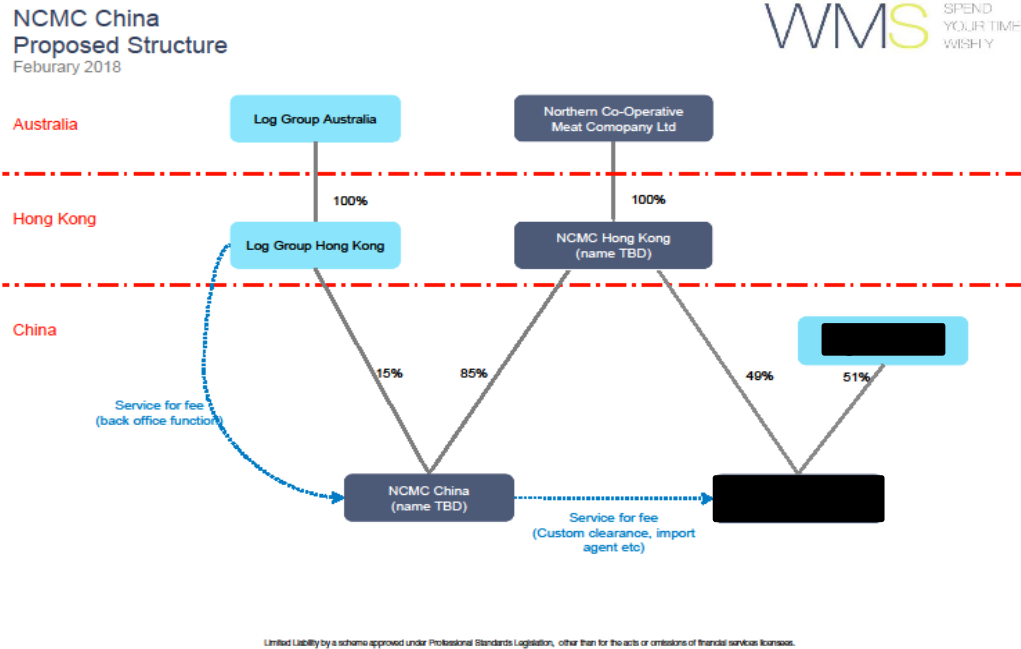
For this particular initiative it was determined that a multilevel partnership would be required to provide the necessary expertise and context in understanding the language and cultural barriers in navigating the design of the potential China JV structure. Specifically a two tier partnership was deployed, consisting of; a project “co-partner” with Chinese language, commercial skills and experience (assisting the Australian investor and a partnership with Chinese company with relevant in-market processing, warehousing and distribution capability.

Other Key design considerations that should be accounted for when determining JV opportunities within China;

- Developing a production facility design and associated cold chain logistics consistent with international good practice
- Conducting a master planning and high level evaluation of the potential final production process and required throughput to ascertain the limits of the existing building structure and services
- Defining clearly the initial stage of the facility’s development including production throughput and products to be processed. This should then, where possible, extend to subsequent future stages of the project.
- Establish the long-term capacity requirements of services and building design to support the process and ensuring these will be available as the facility expands to the expected final configuration
- Locating and having available all possible building structure and services engineering design information to ensure adequate to support the proposed facility
- Evaluating fully the Occupational and workplace health and safety system and culture that will be required to operate facility under the proposed Joint venture to ensure all parties are protected and subsequently their executive and shareholder members
- Assessment and identification of control and mitigation measures as required to ensure product quality, integrity and product and process IP is protected at all times.

5. Appendices

1. Proposed business structure



2. Media statement of JV

5/29/2017

Bright real estate building bright new life

May 17, Guangming Real Estate Haibo Logistics Group and the Australian Northern Joint Meat Company on the "West Hongqiao cold chain logistics park" cooperation matters in the bright real estate building signed a meeting minutes. Australian Consul General in Shanghai Graeme Meehan, Vice President, Bright Food Group Ma Yongjian, Australian Business Consulate in China Christina Goodman, Chairman of Bright Real Estate, President Shen Hongze, Chairman of the Board of Australian Northern Joint Meat Co., Ltd. John Seccombe, Chief Executive Officer Simon Stahl, Bright real estate vice president, Haibo logistics executive director of this and Haibo logistics general manager Zhou Yi and other leaders attended the signing ceremony.

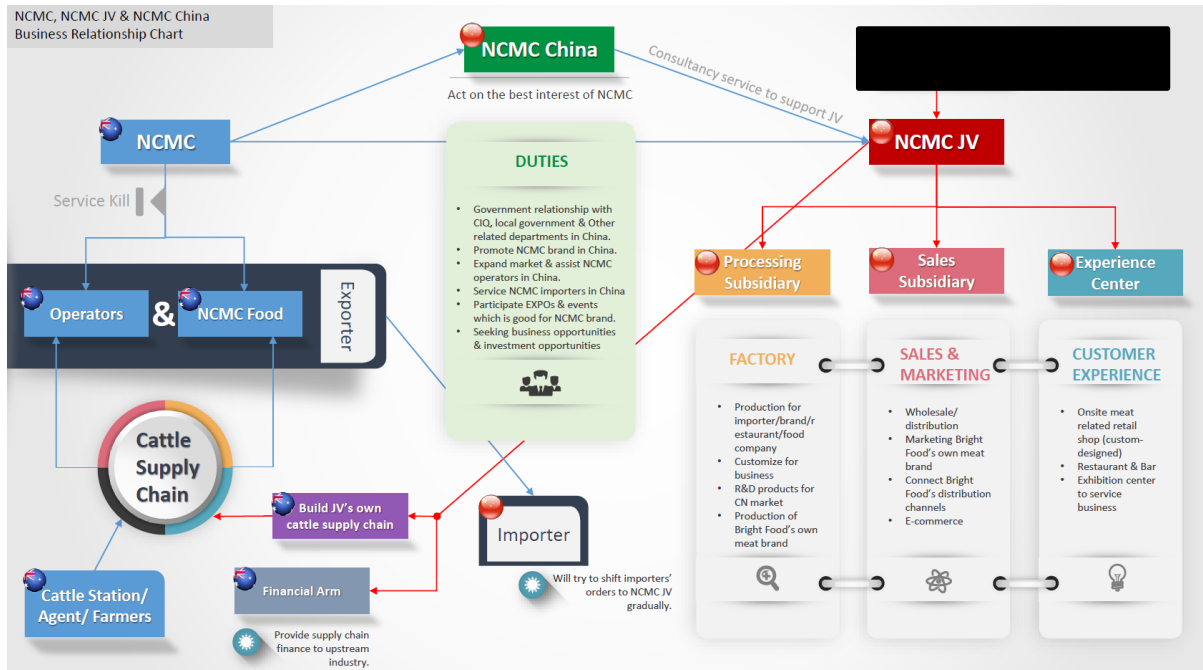
Signing ceremony, Ma Yongjian affirmed the cooperation between the two companies and negotiations, hope to rely on the strong support of the bright food group, meat-related business in the Group's main business in the important position, as well as Australian beef in the Chinese market Solid foundation for this cooperation to lay the foundation. At the same time pointed out that the two sides in the project the focus of future cooperation: First, play both the advantages of resources, establish a platform; Second, from the source of the industry chain to ensure food quality and safety; Third, do a good job of products, together to build the industry chain terminal channels. In the Chinese market a new benchmark, the real sense to achieve from the source to the terminal of the whole industry chain sharing platform. If Australia is able to cooperate with Haibo Logistics Group, it will have the opportunity to cooperate extensively with Guangming Food Group on more platforms.

Shen Hongze said that in the context of the successful end of the International Cooperation Summit Forum in 2017, the cooperation between the Australian Northern Joint Meat Company and Haibo Logistics Group conforms to the national strategic direction and conforms to the Bright Food Group and the bright real estate group transformation and upgrading Requirements, far-reaching. He detailed the bright real estate group's existing business and future development strategy. He stressed that logistics as a bright real estate development of one of the new business, with the real estate business can form a variety of new industrial model, Haibo logistics in the future logistics + real estate, logistics + finance, logistics + business, logistics + exhibition sales, logistics + Information technology and other formats on the full expansion of the "platform + park" to drive the shape of Haibo Logistics Group, the overall transformation and development of the industry. "West Hongqiao cold chain logistics park" is the logistics industry transformation and upgrading of the driving platform, bright real estate to actively encourage and promote Haibo logistics to cultivate a new format, the formation of a new round of bright real estate development and economic growth point.

At the meeting, John Seccombe, Zhou Yi, Simon Stahl, respectively, as the two sides of the enterprise representatives, has signed the "Shanghai Haibo Logistics (Group) Co., Ltd. and the Australian Northern Joint Meat Co., Ltd. on the cooperation of the two ministers meeting."

Founded in 1933, the Australian Northern Union Meat Co., Ltd. is a comprehensive industrial chain food processing service complex located in the northern coast of New South Wales. It has a skilled production, processing and segmentation technology. Through decades of continuous development and growth, the company has a number of Australian beef high-end brands, a number of intellectual property and beef pork export qualification, has now become the global meat processing industry leader. (Wang Ze Rui Wen / Shen Min Dong photo)

3. Business relationship chart



4. Observations / insights around conducting Business in China

- JV Agreement and Articles of Association need to be submitted to local Administration of Industry and Commerce for approval.
- Any exclusivity at least in China Eastern District (Shanghai plus a few nearby provinces) to prevent any party to carry out similar JV arrangement with outside 3rd party which may compete with the JV business.
- Every PRC entity must have a Legal Representative, who is authorized to execute major contracts and legal transactions on behalf of the Company, the appointment and removal of top management including the General Manager, opening of bank accounts etc. Hence it is paramount to set the limit and authority of the Legal Representative in the JV's articles of association and related documents filed with local Administration of Industry and Commerce
- In China, every company is required to have its own Company Seal or Chop which is normally in the custody of the Legal Representative. Most, if not all the binding contracts and opening of bank accounts require the use of Chop (signature is not required). Hence the Chop must always be kept in a safe and locked place, with proper records being kept on its use
- Valuation of contribution of capital in kind or intellectual property rights or land use – it is quite common in JV that parties contribute their share of registered capital (in China all registered capital need to be paid up) by way of building, plant or equipment, land use right, intellectual property rights or in combination with cash. The question is how to value these non-cash capital contributions, to be fair and equitable to the other JV party.
- Securities and guarantees – no securities, bank guarantees or bonds are to be provided to any client without the unanimous approval by the JV Board. Any litigations or claim exceeding a certain amount must be brought to the attention of the JV Board, and followed the directives given by the JV Board in handling and/or settlement.

- Frequency of JV Board meetings (monthly or quarterly) is to be spelt out in the Shareholders Agreement. Another option is the formation of a management committee which consists of the GM (or CEO), Deputy GM (or COO), Financial Controller (or CFO) plus a representative from each party.
- Annual Budgets and business plan need to be tabled and approved by the JV Board. Monthly cash flow forecast and management accounts (with budget variance and analysis) need to be presented and discussed in the monthly performance review by management committee.
- All meeting minutes need to be prepared in both English and Chinese, written correspondence between parties must be in English.
- Bank accounts – any cheques or e-transfer exceeding a certain limit must be authorized by both parties (signing authority or holding of dongles).
- Distribution of profit – unless the surplus has been earmarked for a major capital expenditure, at least 75% of net profit must be distributed to the parties by way of dividend.
- Related party transactions – need to obtain consent by the other party in advance, with reasons given for not procuring from 3rd party.
- Arbitration on disputes between parties – in accordance with UNCITRAL in an independent country such as Singapore.
- Intellectual Property – belongs to the party which created, developed or acquired.
- Exit Clause – time period for remedy and smooth transition, first right of refusal in sale of shares, fair valuation of shares (or follow a certain formula).