

Vol.1 Issue 01, 2012

Jan. 31, 2012

AgriChina Investor



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Welcome to AgriChina Investor 1201, the first issue of this newsletter.

2011 is a year worth celebrating for China's grain production, which hit 571.2 million tonnes in 2011, up 24.7 million tonnes, or 4.5% over 2010, representing the eighth consecutive year for increased grain production, as shown in the figures from the National Bureau of Statistics of China.

However, China still faces heavy tasks for food security. On one hand, The decreasing farmland is a major threat to the grain production in China. Statistics show that China's cultivated land decreased from 130 million ha. in 1995 to 121 million ha. in 2010.

On the other hand, the development of urbanization creates a huge potential market for food. Figure from the National Bureau of Statistics shows that China's urbanization rate reaches 51.27% in 2011. This is the first time that the rate has exceeded 50%. By the end of 2011, the number of urban population has increased to 690.79 million, while the number of rural population has decreased to 656.56 million.

Besides, in recent years, repeatedly emerging food safety incidents in domestic market have stimulated the demand for safe food.

It is a huge challenge to provide enough food with good quality for a country with over 1.3 billion people. However, this also provides good opportunities for the huge market. In fact, many investors have entered the agricultural industry and have gained harvest, and we believe that more will be attracted and involved in the future.

If there are any specific topics you would like us to cover or investigate any of the subjects covered in more details, please contact us by +86-20-3761 6606, or econtact@cnchemicals.com.

Headlines of AgriChina Investor 1201

The Catalogue for the Guidance of Foreign Investment Industries (2011 Amendment) will come into effect on Jan. 30th, 2012, which is beneficial to the development of China's agricultural industry.

China's first central document of 2012 mainly focuses on enhancing the development of agricultural science & technology, aiming to safeguard domestic food security.

Sinograin decides to enter the small package edible oil market, in a response to the Chinese government's macro control over domestic edible oil price.

Chinatea, one subsidiary of COFCO, reveals that it will invest about USD79.35 million to build or acquire large scale green tea processors in 2012, through raising funds by itself or cooperating with domestic or multinational companies.

Huaying Agriculture is to strengthen its business structure by raising USD92.83 million through non-public issuance.

Yingli Group held a conference on 5 Jan. 2012 to launch its own olive oil brand.

After getting USD10 million from Tsing Capital in 2010, Tony's Farm has got another USD28.48 million from 4 investors in late 2011.

Nowadays, Chinese agriculture has become a hot object for investors, including PE/VC.

China's pig price hit a record high in 2011. However, the high price brings not only excitement, but also cares.

The average price of farm milk in China keeps at a high level in 2011, along with the stricter governmental supervision, which attracts more and more domestic and multinational companies to enter the dairy farming industry.

Domestic cotton and soybean acreage will have the possibility to decrease in 2012.

Domestic sugar price will have the potential to rise in 2012 thanks to the policy support from the Chinese government.



Investment Environment

New Catalogue for the Guidance of Foreign Investment Industries to come into force

On Dec. 24th, 2011, the Ministry of Commerce of the P.R.C. and the National Development and Reform Commission jointly issued the Catalogue for the Guidance of Foreign Investment Industries (2011 Amendment) which will substitute the 2007 Amendment and come into effect on Jan. 30th, 2012.

The Catalogue divides foreign investment industries into encouraged, restricted and prohibited industries.

As compared with the 2007 Amendment, the 2011 Amendment cancels the improvement of low and medium yielding field as the encouraged industry in farming, forestry, animal husbandry and fishery sectors, while adds the planting of oil palm as the encouraged investment. This is aiming to protect domestic land resources and secure the soaring demand for raw materials of biofuel. In the manufacturing industry, the 2011 Amendment continues to encourage foreign investors to enter China's agro-food processing, food and beverage industries. Meanwhile, the 2011 Amendment still takes the development and production of new fertilizers, pesticides, bio-pesticides and biological control products as the encouraged industries. Take pesticides for example, the 2011 Amendment defines that the development and production of efficient, safe, environmentally friendly new pesticides and new formulations, special intermediates and additives are encouraged. Additionally, clean production processes and associated applications, including the methylene technique for acetochlor, the ammoniacal-cyanide (AC) process for paraquat, the aqueous phase method for chlorpyrifos, the method for recycling chloromethane during the production of glyphosate, the oriented synthesis method for chirality and stereochemical pesticides, the ethyl chloride synthesis, etc. are encouraged.

Regarding the restricted industries, the 2011 Amendment extends the restricted scale in manufacturing industry over the 2007 Amendment. Apart from the processing of soybean, rapeseed edible oil (China's holding), deep-processing of corn and manufacturing of biology liquid fuel, the 2011 Amendment increases the processing of peanut oil, cottonseed oil, tea seed oil, sunflower oil, palm oil and other edible oils and fats (China's holding), rice and flour processing, etc. as the restricted industries. This adjustment is based on the consideration of

the overcapacity which has been emerging in the processing industries of oil, flour and corn. Meanwhile, the government aims to secure food supply and keep food price stable. In 2011, China's CPI increased by 5.4% year on year, of which the food price was up by 9.1%, which thus drove 2.8% of CPI increase. Meanwhile, the 2011 Amendment cancels the restriction on carbonic acid beverage manufacturing, as compared with the 2007 Amendment. The same as the 2007 Amendment, the 2011 Amendment continues to restrict foreign investment in wholesale, retail and logistics distribution of grain, cotton, vegetable oil, sugar, medicine, tobacco, automobile, crude oil and capital goods for agricultural production.

As for the prohibited industries, cultivation of China's rare precious breeds (including fine genes in plant industry, husbandry and aquatic product industry) and production and development of genetically modified plants' seeds are prohibited in both the 2007 and 2011 Amendments.

Guided by the former Catalogues, China directly adopted USD426 billion foreign investment during the 11th Five-Year-Plan (2006-2010), with a CAGR of 11.9% during this period, of which, China's agriculture industry totally adopted USD4.6 billion foreign investment (statistics from the Ministry of Agriculture of the P.R.C.) in the same period.

Though it took up a relatively small share in the foreign investment in those past five years, the foreign investment in China's agriculture industry, especially in the produces' processing sector, has witnessed remarkable increase since 2011, aided by the continuous encouragement and support from the government.

In 2011, Nestle (China) Ltd., (Nestle), the largest food company of the world, invested USD240 million to acquire 60% shares of Yinlu Food Group Co., Ltd. (Yinlu) in September and spent USD1.7 billion to buy 60% shares of Hsu Fu Chi International Ltd. (Hsu Fu Chi) in July. Yinlu is a large producer of peanut milk and canned rice porridge and Hsu Fu Chi is a large candy producer in China.

China's urbanization rate exceeds 50% in 2011

According to the National Bureau of Statistics of China, China's urbanization rate reaches 51.27% in 2011. This is the first time that the rate has exceeded 50%. By the end of 2011, the number of urbanization population has increased by 21 million year on year to touch 690.79 million, while the number of rural population has decreased by 14.56 million to 656.56 million as compared with that in 2010.

The remarkable change brings both opportunities and risks to Chinese agricultural industry. For one thing, the increasing urbanization population creates a huge potential market in the cities; for another, the decline of rural population will cause a labor shortage in the agricultural industry, thus raising production cost.



Technology feeds China

Enhancing the development of agricultural science & technology is the major focus of China's first central document of 2012. The document reveals that China will accelerate the reform of agricultural science & technology system and enhance the innovation of agricultural science & technology, aiming to safeguard food security in China.

The first central document of the year, also known as the "No. 1 Document", is issued annually by the Central Committee of the Communist Party of China and the State Council, the Cabinet.

Before the release of the "No. 1 Document", the Ministry of Agriculture had issued the 12th Five-Year Plan (2011-2015) on Agricultural Science & Technology (the Plan) in late Dec. 2011. "The Plan" serves as the guideline for China's agricultural development in the next five years. According to the Plan, the major tasks in the coming years include innovation of the seed industry, transformation of achievements in scientific research, etc.

"The fund needed will be guaranteed. In the next ten years, China will invest over USD 475 billion (RMB 3 trillion) in agricultural science & technology." said an insider from the Ministry of Agriculture.

The aims of the "No. 1 Document" and "the Plan" are to safeguard domestic food security. China's grain output hit 571.21 million tonnes in 2011, up 24.73 million tonnes, or 4.5% over 2010, representing the eighth consecutive year for increased grain production, as shown in the figures from the National Bureau of Statistics of China. However, China faces heavy task for food security because of the decrease of farmland and the soaring food demand.

Statistics show that China's cultivated land decreased from 130 million ha. in 1995 to 121 million ha. in 2010.

With the limited sources, the effective way to safeguard domestic food security is to increase the per unit area yield through the investment in agricultural science & technology, especially in seed innovation.

China's grain per unit area yield has witnessed big increase in the past decades due to the application of improved seeds and the input of chemical fertilizers and pesticides. However, the grain per unit area yield is still very low compared with those in some developed countries. There is still big room for the increase of grain per unit area yield.

There is a saying in China, "Agriculture feeds the nation, and seed feeds agriculture". It is believed that the application of improved seed varieties is the best way to increase grain per unit area yield. Actually, before the "No. 1 Document" of 2012, China has already paid close attention to the seed industry and issued a series of policies in 2011.

On 18 April 2011, the State Council released the formal "Suggestions for Accelerating Development of Modern Crop Seed Industry" (the Suggestions) to enhance the development of domestic seed industry.

According to the Suggestions, research institutes and universities should focus on the basic researches in the future, such as the collection and conservation of crop germplasms, the breeding theory, the GM technology, etc. It also encourages the cooperation between research institutes and seed companies, and research institutes should share their germplasm resources and research achievements with seed companies.

At present, most of the crop varieties in China are developed by research institutes or universities. Most seed companies pay little attention to the breeding of new varieties. They usually try to buy variety patents from research institutes or universities, which is not good for the long-term development of seed companies. The Suggestions shows the intention of Chinese government to change this status.

As for GM crops, although there is much controversy over the commercialization of GM crops (China issued biosafety certificates for GM rice and GM corn in late 2009, but no staple crop has achieved commercialization yet), Chinese government attaches importance to GM technology and has invested a lot of funds in the development of GM technology.

At present, GM crops are mostly insect-resistant and herbicide-tolerant. It is expected that China will also focus on GM crops with high yield and quality. "China should enhance the development of GM crops, such as GM corn, to ease domestic supply pressure," according to an insider from the Ministry of Agriculture recently.

Besides the development of seed industry, "No. 1 Document" and "the Plan" also pay attention to the mechanization of agriculture. "The Plan" reveals that mechanization farming of major grain crops in China should increase to 60% by the end of 2015.

Chinese government has been continuing the trend which started from 2004 of tackling rural problems in its first annual document, and the first document of 2011 focused on water infrastructure construction.



China strengthens circulation system establishment of agricultural produces

On 6 January 2012, the Ministry of Commerce issued a notification, requiring its regional offices to perfect the circulation system for agricultural produces, which is on the heel of the State Council's related policy issued on 13 December 2011, suggesting that the government plans to strengthen the establishment of circulation system of fresh agricultural produces.

The Ministry of Commerce's notification is the specific supporting policy for the State Council's policy: according to the State Council's policy, the main goal of the government is to build a circulation system connecting production and selling, which can ensure the supply, decrease the transportation cost and maintain the stable price of fresh agricultural produces.

The government divides the goal into 8 key tasks, such as rationalizing the layout of the terminal market, strengthening the construction of circulation infrastructure and the information system, etc. And one task which is worth noting is that the government encourages the distributors to develop in the way of corporatization, scale development and brand building, as well as to merge, recombine or cooperate with other companies through investment in cross-regions.

In order to achieve its goal and fulfill its tasks, the government will take 7 measures, such as guaranteeing reasonable land use, strengthening supervision and providing transportation conveniences, etc. It's worth noting that the government

expressed that it will perfect the tax policy for the transportation of agricultural produces, such as the exemption of vegetable transportation and sales taxes. Besides, the government revealed that it will strengthen the financial support, like to encourage the financial institutions to loan or invest more in companies of agricultural production, processing and transportation, and to encourage insurance companies to launch insurance products for fresh agricultural produces.

The Ministry of Commerce's move suggests the start of the implementation of the State Council's policy, and it's estimated that the implementation is one main task for the government in 2012, as such a policy can further benefit the inflation control and boost domestic demand—still two main tasks for Chinese government in 2012.

Though the policy is expected to aid the establishment of the circulation system of fresh agricultural produces, many experts expressed that the government's efforts are not enough. For example, some experts questioned that the tax exemption only covers vegetables currently, instead of covering all agricultural produces. And some believed that the tax exemption can't reduce the price of agricultural produces or increase the farmers' income either, and the policy should focus on the farmers to encourage them to establish their own distribution channels.

Ministry of Agriculture to focus on development of livestock & poultry breeding

The Ministry of Agriculture of the People's Republic of China issued a document "The Twelfth Five-Year Plan of National Livestock and Poultry Genetic Resources Conservation and Utilization" on January 4, 2012. The document indicates that during the period of the Twelfth Five-Year Plan (2011-2015), crossbreeding systems for more than 50 new domestic varieties of livestock and poultry shall be established. Meanwhile, crossbreeding systems for local varieties of livestock and poultry shall account for 30% of the total crossbreeding systems for the new domestic varieties of livestock and poultry. It is aiming to foster a number of livestock and poultry breeding enterprises, so as to improve the development of high-quality domesticated animal products and the competitiveness of the livestock and poultry industry to a further step. Specifically, the document detailed that the livestock and poultry species such as pig, cow, chicken, etc., will be mainly involved in the animal genetic resource conservation in 2011-2015.

It is predicted that meat consumption will be more substantial with the improvement of farmers' income level in some regions of China. The document claims that the proportion of large-scale breeding of livestock and poultry in the whole nation will

increase by 10%-15% by 2015. Some insiders pointed out that although the demand for livestock grows at a fast speed, recently the key livestock species are mainly from abroad rather than from at home. The long breeding cycles and the weakness of the livestock and poultry breeding technology seriously impede the development of domestic livestock breeding industry.

The document also states that the Chinese government will establish a stable central and local guarantee mechanism of fund input to gradually formulate an animal genetic resource conservation system. In addition, the Chinese government will play a guiding role in the utilization of public finances, encouraging and supporting enterprises and individuals to get involved in the species protection. Moreover, the Chinese government will also guide the industrial & commercial funds and private capitals to participate in the conservation and development of livestock and poultry genetic resources.



China to encourage agricultural insurance businesses

Chinese Government will accelerate the development of agricultural insurance businesses and improve the subsidy policy of agricultural insurance, according to the 12th-Five-Year Plan (2011-2015) for Development of Agriculture and Rural Economy (The Plan).

Li Yong, Vice Minister of the Ministry of Finance, said that agricultural insurance is playing more and more important role in Chinese "agriculture, rural areas and farmers" plan, especially since the Central Government has carried out the policy of agricultural insurance premium subsidies for 5 years. Moreover, the government should make efforts to further improve the agricultural insurance continuously, said Li Yong.

From Jan. 2007 to Aug. 2011, agricultural insurance has turned the loss into profit and its capability for sustainable development was enhanced. During this period, agricultural insurance premiums added up to USD8.55 billion (RMB 54.6 billion), which increased from USD0.71 billion (RMB5.18 billion) in 2007 to USD2.05 billion (RMB13.58 billion) in 2010,

with an average annual growth rate of 37.8%, much higher than the growth level of the industrial insurance in the corresponding period. From Jan. 2011 to Aug. 2011, the total agricultural insurance premiums were USD2.22 billion (RMB14.19 billion), up 22.61% over the same period of 2010, and even overtook that in 2010.

For a big agricultural nation like China, agricultural insurance is an important tool of dispersing agricultural risks. It has provided effective supports for agricultural systemic reform and agricultural production. But the development of Chinese agricultural insurance still faces many problems recently. And the major contradiction exists between farmers' pressing need of the supports from agricultural insurance and the unwillingness of commercial insurance companies to enter this field.

Central Rural Work Conference to promote 2012 agricultural development

The Central Rural Work Conference, which not only sums up the rural development in 2011, but also maps out policies for next year's agricultural and rural development, was held on December 27, 2011.

Before the meeting, the Chinese government had highly commended the rural development in 2011 as domestic grain output has reached 571.2 million tonnes in 2011, 24.7 million tonnes more than that in 2010. It is the first time that Chinese grain's output has kept increasing for 8 consecutive years (2004-2011), which creates a new record since the establishment of the People's Republic of China. Besides, the Central Government has greatly increased the budget expenditures for agriculture, rural areas and peasants to USD158.5 billion in 2011 from USD41.6 billion in 2004, whose compound annual growth rate (CAGR) reached 21%.

However, at the meeting, the Chinese government also recognized the weaknesses existing in agricultural development. For example, recently domestic capacity of beef and mutton can not satisfy the increasing demand. Meanwhile, the short supply of some kinds of farm produces such as corn and soybean results in the large price fluctuation of agricultural produces. As a result, the Chinese government will implement some plans on grain production and non-staple food production in 2012. In

grain production, the Chinese government will further develop grain food through the following ways:

1. Continue to enhance the incentive and policy support for the large production provinces of grain food;
2. Encourage and support the regions where the conditions of creating a pilot area for the large-scale grain food production are satisfied;
3. Promote the development of crop pests and diseases preventing system in major grain food producing areas;
4. Raise the rice mechanical planting level and corn mechanical harvest level to 28% and 38% respectively in 2012, 3% and 5% higher over 2011.

On the other hand, the Chinese government will implement the "National Vegetable Industry Development Plan", in order to strengthen the construction of livestock & poultry production bases and vegetable greenhouses.

China resumes beef import from Argentina

At the end of Nov. 2011, China resumed the import of beef and its related products from Argentina. This is the first time for China to import beef and related products from Argentina after China suspended the beef import from Argentina in 2006 due to the aftosa in Argentina.

From Jan. to Nov. in 2011, China totally imported 17,973 tonnes of fresh and refrigerant beef and related products, with the value of USD84.98 million. The main origins are Australia, New

Zealand and Uruguay, etc.

China is Argentina's largest export destination for agricultural produces, and Argentina's main export products to China include soybeans, soybean oil, soybean meal, sunflower oil, chicken, tobacco and fruit juices, etc.

Investment Dynamic

Sinograin enters domestic edible oil market

On January 4, 2012, it was officially declared that China Grain Reserves Corporation (Sinograin) decides to enter the small package edible oil market, in a response to the Chinese government's macro control over domestic edible oil price. Sinograin is a state-owned enterprise which plays a key role in carrying out the Chinese government's initiatives to ensure China's food security and economic growth.

In December 2011, Sinograin launched two kinds of small-package edible oil with the volume of 5 liter and 1.8 liter separately under the new brand "Jinding" in Jiangsu, Shanghai, Zhejiang and Tianjin, hoping to enter about 20,000 supermarkets and retail terminals.

Sinograin Oils Co., Ltd., (Sinograin Oils), a wholly owned subsidiary of Sinograin, will play a key role in Sinograin's entering the small-package edible oil market. At the beginning, it is estimated that Sinograin will construct wide commercial

network with nearly 50,000 retail terminals in North and East China in 2012, with the large scale production capacity of 700,000t/a in 2012. The subsidiary plans to increase its edible oil production capacity to one million tonnes per year with annual revenue of USD1.6 billion and to seize 10%-15% share of domestic edible oil market in the coming five years. Also, some insiders declare that Sinograin's large amount of oil storage will greatly support its expansion in the future development. In fact, Sinograin has a lot of oil storage facilities in some major oil production regions.

As a new enterprise just entering domestic edible oil market, Sinograin will face some difficulties in its access to oil marketing channels, such as the lack of knowledge about the oil retail market. In order to resolve the problems as mentioned, Sinograin Oils will establish a new specialized sales company for Jinding edible oil's sales plans and sales management.

Sinograin will pay more attention to enhancing Jinding's brand reputation so as to formulate Jinding's product mix and brand system. Moreover, Sinograin Oils plans to efficiently expand its oil market sales channels through the integration of Sinograin's own oil inventory, marketing channels and logistics resources.

Some market watchers believe that Sinograin's involvement into small package oil market is meaningful, which will lower the enthusiasm of multinational enterprises to enter the market, and efficiently resolve the domestic food security problem to a certain extent.

Furthermore, Sinograin's activity will not only have its own oil resource superiority, but also receive the support from the new policy issued by the Chinese government. On January 12, 2012, the National Development and Reform Commission, cooperating with the Ministry of Industry and Information Technology of the People's Republic of China, issued a new policy--the "Twelfth Five-Year Plan for Domestic Food Industry".

PICTURE 1: Picture of Jinding's small-package edible oil



Source: China Grain Reserves Corporation (Sinograin)



In strict accordance with "the Catalogue of the Guidance for Foreign Investment Industries (2011 Amendment)" and relevant approved projects, the Chinese government should limit the access management of foreign investment in edible oil processing and corn processing industries. Foreign acquisition of domestic agricultural produces should be made an important enterprise security review, according to the use of anti-dumping, countervailing, safeguard measures and other trade remedy measures to protect the safety of domestic food industry.

In fact, the Chinese government attached more importance to the reserves of corn and wheat rather than that of soybean before 2008, leading to China's great dependency on foreign oil companies. Recently, multinational grain and oil companies have been engaged in or controlled 64 of the 97 domestic oil companies, dominating nearly 70% of domestic edible oil market. "In 2010, domestic soybean output only reached 15 million tonnes, much lower than the imported soybean with volume of 52.5 million tonnes. Foreign companies have

almost monopolized the domestic oil market attributed to their integrated operations from soybeans' import to oil's processing." said Mr. Liu, the general manager of Sinograin Oil.

Before "the Catalogue of the Guidance for Foreign Investment Industries (2011 Amendment)" is implemented, although Chinese grain and oil enterprises are improving their competitiveness and gradually increasing their shares in the domestic small-package edible oil market, the top 4 multinational oil companies still maintain two-thirds of the shares of domestic small package edible oil market, such as Bunge, Archer Daniels Midland Company (ADM), Cargill and Louis Dreyfus. Moreover, some multinational oil companies are taking advantage of the loopholes existing in the old "Catalogue of the Guidance for Foreign Investment Industries"; for example, they purchase domestic grain from domestic agents so as to control domestic grain resources.

COFCO eyes tea industry

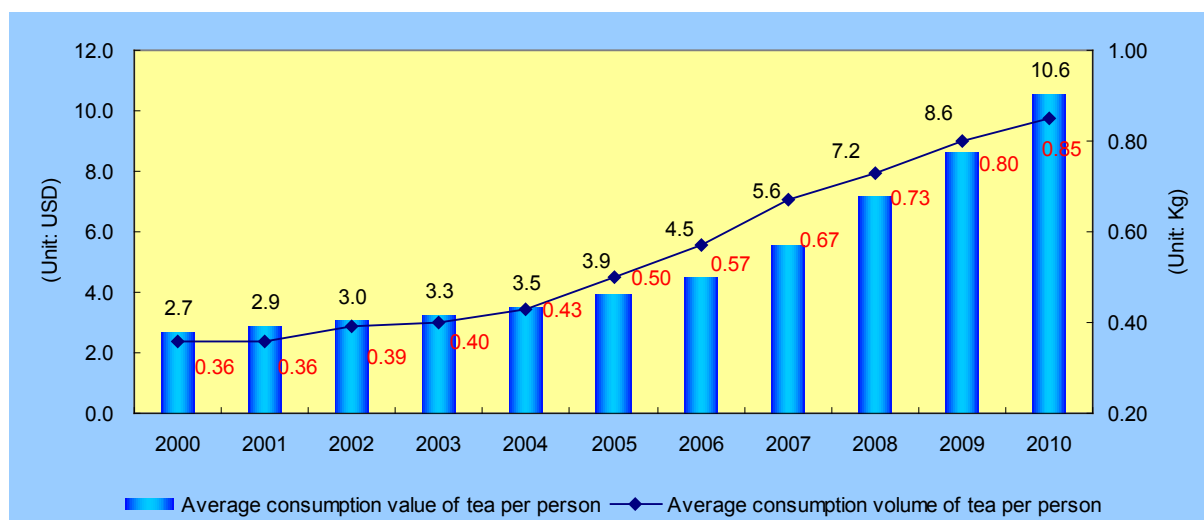
On 20 December 2011, Chinatea Co., Ltd. (Chinatea), a subsidiary company of China's leading agricultural company China National Cereals, Oils & Foodstuffs Corp (COFCO), revealed that the company will invest about USD79.35 million (RMB500 million) to build or acquire large scale green tea processors in 2012, through raising funds by itself or even by cooperating with domestic and multinational companies, aiming to quicken the integration in tea industry.

According to Mr. Wang, President of Chinatea, the company expects to increase its sales revenue to USD792.50 million (RMB5 billion) five years later from USD237.75 million (RMB1.50 billion) in 2011, and the company is likely to cooperate with domestic and multinational companies to realize this goal in the future.

Undoubtedly, it's a good occasion for Chinatea to quicken its expansion currently: according to Euromonitor International, the consumption of traditional Chinese tea was about 1.1 million tonnes in 2010, suggesting the consumption per person was 0.85 kg, compared with the figure of 0.80 kg in 2009. And green tea is the largest consumer species of traditional Chinese tea, which took up 66.5%, compared with the figure of 13.4% for oolong tea.

Meanwhile, the retail sales of Chinese tea enjoyed a rapid development, which increased to USD14.86 billion (RMB93.76 billion) in 2010 from USD4.51 billion (RMB28.44 billion) in 2000, with a compound annual growth rate (CAGR) of 12.7%. And the CAGR of the retail sales will reach 11.7% from 2011 to 2013 as estimated.

FIGURE 1: Average consumption volume & value of traditional Chinese tea per person in China, 2000 - 2010



Source: Euromonitor International



What's more, the concentration ratio of the industry is very low: for example, in 2010, one of China's largest tea brands Tenfu only captured 3.72% in the traditional Chinese tea market, compared with 3.61%, 2.38%, 1.63% and 1.95% for TAETA, Junshan Tea & Xiaoxiang Tea & Xiangyi Tea, Wuyutai Tea and Zhuyeqing Tea & Jasmine Tea respectively. And the remaining 86.71% are for other companies, suggesting that there are great opportunities for Chinatea.

Mr. Jia, General Manager of Chinatea, also expressed the company's optimism, and he revealed that though green tea is the largest consumer species of tea in China, with an annual output and output value of 700,000 tonnes and USD4.76 billion (RMB30 billion) respectively, there is no tea company with annual domestic sales revenue over USD31.7 million (RMB200 million). Meanwhile, there are about 200,000 tonnes of green tea for export annually, but the export price is low for the cut-throat competition. All these are estimated to drive Chinatea to grasp this opportunity in 2012.

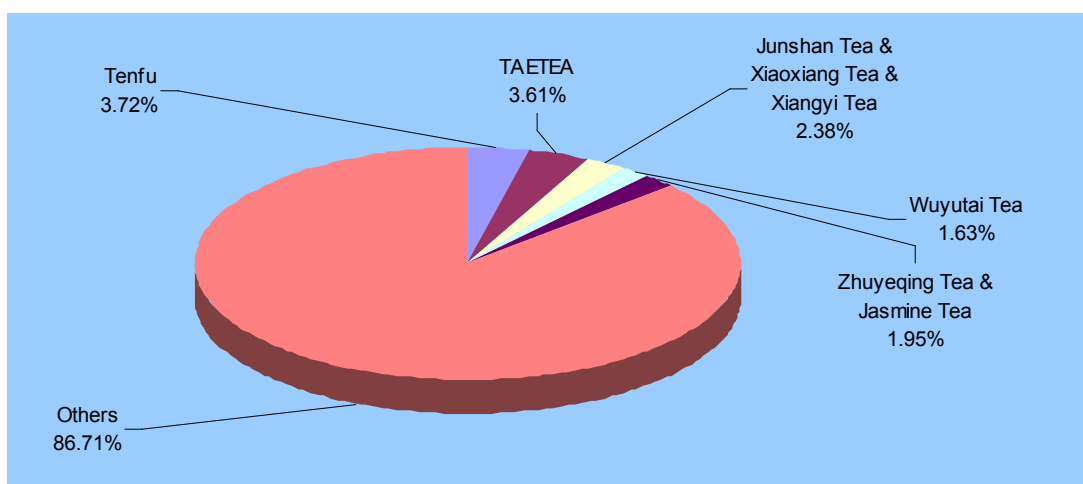
Actually, Chinatea has started its industrial integration earlier as Mr. Jia revealed, but in a low profile. The company has already acquired a plant in Anhua County, Hunan Province to develop its black tea business; besides, the company revealed that it will build a plant in Fujian to produce oolong tea in the near future.

Of course, Chinatea's case is not isolate, and many processors are also moving in the same direction as Chinatea is, and the competition amongst them is estimated to be direct and fierce. In August 2011, Beijing Wuyishan Laoji

Tea Co., Ltd. (Laoji Tea), a wholly-owned subsidiary of the largest tour retailer in Asia-- King Power Group (Hong Kong), announced that the company invested about USD6.34 million (RMB40 million) to acquire a tea plant and its tea garden of dahongpao tea in Fujian, aiming to support its expansion in China and overseas. And later in September, Tenfu (Cayman) Holdings Company Limited (Tenfu), a famous tea processor, successfully raised about USD144.09 million (HKD1.12 billion) to fund its expansion. All these suggest that the competition will be fierce in the future, which is estimated to be the reason for Chinatea's potential cooperation with domestic and multinational companies.

However, as a subsidiary company of COFCO, Chinatea has its own advantages: for example, the company can raise capital to fund its development more easily; besides, Chinatea can sell its products through COFCO's resources, such as selling in COFCO's franchise shops and selling together with COFCO's foods, thus decreasing the cost.

FIGURE 2: Market share by brands of traditional Chinese tea in China, 2010



Source: Euromonitor International

Huaying Agriculture enjoys bright future with expansion

On Jan. 6th, 2012, Henan Huaying Agricultural Development Co., Ltd. (Huaying Agriculture), one of the leading duck incubation, cultivation and processing companies in China, announced to raise USD92.83 million funds through non-public issuance, aiming to strengthen its business structure. The planned projects include chicken culturing, duckling breeding and duck processing.

These projects will certainly consolidate Huaying Agriculture's competitiveness with a complete business structure. Currently, Huaying Agriculture has its own feed production plants, duckling breeding and cultivation bases, duck and chicken

processing factories, and an eiderdown processing company. However, the ineffective poultry cultivation in local regions seriously restricts its production in Zhoukou City, Henan Province, and that is why Huaying Agriculture plans to build a new chicken culturing farm. Moreover, Huaying Agriculture has built a shambles with an annual capacity of slaughtering 40 million chickens in Zhoukou.

With the improvement of living standard, the consumption volume of duck and chicken sees fast increase, and the growth rate is higher than those of pork and beef in China. According to the statistics from the National Bureau of Statistics of the P.R.C.,



China totally consumed 78.03 million tonnes of meat in 2011, increasing by 0.3% year on year, while the pork consumption volume decreased by 0.4% to 50.53 million tonnes. According to the statistics from the National Meat Association, the consumption volume of poultry has exceeded 16.56 million tonnes in 2010, with a year-on-year growth of 3.8% which is higher than that of pork (3.7%), beef (2.7%) and mutton (2.4%). It is expected that the demand for poultry will keep an equal or even higher growth rate in the coming years.

Nowadays, the poultry cultivation scale of many companies is relatively small. Only a few companies, such as Guangdong Wens Foodstuffs Group Co., Ltd., Chia Tai Group, Liuhe Group

Co. Ltd. and DaChan Food (Asia) Limited, etc., enjoy poultry cultivation scale of over 100 million items per year. It is worth noting that these large poultry cultivation companies all have their own complete value chains.

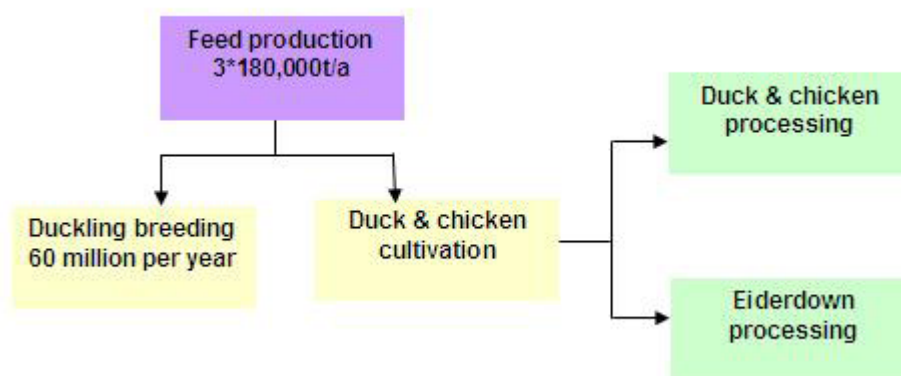
In a word, Huaying Agriculture is to see a bright future when the potential projects are launched.

TABLE 1: Huaying Agriculture's potential projects, Jan. 2012

No.	Subsidiary	Project	Investment, million USD	Remark
1	Henan Chenzhou Huaying Poultry Industry Co., Ltd.	Setting a farm for culturing 20 million chickens per year	28.02	To realize its cultivation scale to 36 million chickens per year, the new project will be launched within 12 months.
2	Henan Huaying Agricultural Development Co., Ltd.	Building a shambles with a capacity of slaughtering 20 million ducks per year	23.07	To expand its butchering capacity to 64 million ducks per year, the new project will be launched within 12 months.
3	Heze Huaying Poultry Industry Co., Ltd.	Setting a plant for breeding cherry valley duckling, with a capacity of breeding 40 million ducklings per year	18.48	The new project will be launched within 12 months.
4	Henan Huaying Agricultural Development Co., Ltd.	Reinforcing the floating capital	23.26	/

Source: Henan Huaying Agricultural Development Co., Ltd.

FIGURE 3: Huaying Agriculture's business structure, Jan. 2012



Source: CCM International

Yingli Group enters olive oil industry

Yingli Green Energy Holding Co., Ltd. (Yingli Group), one of the leading solar power energy companies in China, held a conference on 5 Jan. 2012 to launch its own olive oil brand, namely "Greens Food". The olive oil is repacked and marketed by Tianjin Greens Food Co., Ltd. (Tianjin Greens), a subsidiary of Yingli Group.

"We are building sales network at present and we plan to distribute the olive oil by e-business, team buyers and supermarkets. In the short term, we will mainly sell the product in North China cities, such as Beijing, Tianjin, Shijiazhuang, Baoding, etc." said Teng Xu, General Manager of Tianjin Greens.

In late 2011, Yingli Group has completed the construction of an olive oil factory in Tianjin with the capacity of 7,500t/a (the company has also planned to expand the capacity in the future). The company plans to import olive oil in bulk from Mediterranean region then repack it in its Tianjin factory. According to Yingli Group, the production line is also introduced from overseas to ensure the high quality of olive oil.

Besides, the company has invested USD316,455 (RMB 2 million) to build a world-class product quality inspection center. All the olive oil has to pass the inspection by the center before marketed to customers.

The price of the olive oil from Yingli Group will be very competitive, about 30% lower than those of the same kind of olive oil products on the market. The normal price for olive oil in domestic market is USD20.25/500ml while the price of Yingli Group's product is USD13.92/500ml.

"We aim to provide affordable olive oil products to domestic customers. We will cut price in the future rather than increase the price." said Miao Liansheng, chairman of the board of Yingli Group.

Although Yingli Group has just entered the olive oil industry, the company has attracted a lot of attention. "Yingli Group will be a major competitor for us in the future." said Ning Gaoning, chairman of the board of China National Cereals, Oils & Foodstuffs Corp (COFCO), a leading agricultural company in China and also a key olive oil player. Insiders reveal that Yingli Group's lower-price olive oil products will have a huge impact on the market.

Many people may be curious about Yingli Group's strategy to enter olive oil industry. However, for insiders familiar with the company, it is easy to understand.

Solar power energy business, the major business of the company, faces many challenges nowadays such as overcapacity, cut-throat competition, weak demand, etc. To disperse risks, the company has been expanding its business scope in recent years. Agribusiness is expected to play an important role in the company's future expansion. "The profit in agribusiness is lower compared with those in some other businesses, but its

development is more stable." said Miao Liansheng.

Besides, Yingli Group owns the advantage in olive oil import. Many clients of its solar power energy business are in Mediterranean region, the major olive oil production base in the world. Yingli Group reveals that many of its clients in the region are also olive oil producers. Yingli Group intended to enter the olive oil business years ago. At present, the company just imports and sells olive oil, but it may buy some olive farms in oversea countries in the future.

However, the most important factor that attracted Yingli Group is the strong demand for olive oil in domestic market. China consumes over 20 million tonnes of vegetable oil every year, most of which are soybean oil, rapeseed oil, peanut oil, etc. In recent years, the demand for olive oil in domestic market has witnessed huge increase although its price is quite high. Insiders reveal that the annual consumption of olive oil in China is over 10,000 tonnes at present and this figure may hit 100,000 tonnes in the near future.

Olive oil is a high-end oil in China and over 50% of it is imported from Spain, Italy, Greece, Turkey, etc. At present, there are many oil brands in China and the market is in a state of chaos which hinders the development of olive oil industry in China.

For instance, some domestic media has recently reported that four out of five bottles of Italian olive oil were mixed with lower quality oil from other Mediterranean countries, and most of these olive oil is exported to China. Italian is the second exporter of olive oil to China, only after Spain.

Insiders reveal that Yingli Group's entry into this industry may be good news, for big companies such as Yingli Group may enhance the health development of the domestic olive oil industry.

Besides olive industry, Yingli Group also gets a foot into industries such as real estate, logistics, planting, pig breeding, food processing, etc. However, the company reveals that solar power energy will still account for 70% of its business in the future.



COFCO strengthens support for Mengniu

On 30 December 2011, China National Cereals, Oils & Foodstuffs Corp (COFCO) increased its shares in Mengniu to 28.09% from 27.96% before Mengniu was involved in a quality scandal—one of its UHT milk produced on 18 October 2011 was found to have an Aflatoxin M1 (AFM1) level of 1.2 $\mu\text{g}/\text{kg}$, 140% higher above the national standard level of $\leq 0.5 \mu\text{g}/\text{kg}$ shown in the Hygiene Standard for Feeds which was published in 2001.

The currency amount involved in such move is about USD5.30 million, which suggests that COFCO plans to support Mengniu, especially when Mengniu's share price has decreased by 31.5% from the closing price of USD3.39 (HK26.30) on 23 December to the closing price of USD2.58 (HK20.00) on 28 December. And the price remained at about USD2.58 (HK20.00) on 10

Jan. 2012, which is estimated to be attributed by COFCO's move.

Besides, such a move also helps COFCO control Mengniu: after Mengniu's founder, Mr. Niu, has been replaced as Chairman of Mengniu by Mr. Ning—the president of COFCO in June 2011, COFCO increased its share in Mengniu from 19.9% to 28.04%, with a reported investment of USD462.24 million, suggesting that COFCO is intending to take full charge of Mengniu, and the new move can increase COFCO's influence further. But how to combine the advantages of the two companies seems to remain a key challenge for COFCO.

Market Watcher

Ecological agriculture attracting investors

Nowadays, investors and companies in other industries have been showing great vigor and enthusiasm for ecological agriculture. Shanghai Tony Agriculture Development Co., Ltd. (Tony's Farm), the largest organic produce supplier in Shanghai, got another USD28.48 million investment from 4 investors in late 2011, not long after the USD10 million investment it got from Tsing Capital in 2010.

The 4 investors are DT Capital Partners, Kleiner Perkins Caufield & Byers, Delta Capital and HTO Capital.

"Over 30 investors held investment talks with us, including some famous companies such as COFCO and Goldman Sachs. However, we only want to sell a few part of our stakes and we still remain the biggest shareholder of Tony's Farm." said Zhang Tonggui, General Manager of Tony's Farm.



It looks like a tendency of the day to invest in ecological agriculture. Since 2008, many investors and companies in other industries have set a foot in ecological agriculture or are planning to do so.

YMT Organic Farm Shanghai Co., Ltd., a smaller organic produce supplier in Shanghai, also got investment of over USD3.16 million (RMB20 million) recently. DT Capital Partners, one of the investors for Tony's Farm, just invested in Ecological Agriculture Co., Ltd. Beijing Century Chestnut, a leading ecological chicken farm in Beijing covering an area of 400 ha. The ecological chicken farm has totally got investment of USD20.57 million from investors.

Dalian Wanda Group, one of the leading real estate companies in China, has built an ecological farm with 400 ha. China Minsheng Banking Corp., Ltd., the first national joint-stock commercial bank in China, also has built an ecological farm taking up an area of 200 ha.

Besides, many IT companies are also trying to enter the agricultural industry, especially ecological agriculture. Ding Lei, founder and CEO of the leading China-based internet technology company NetEase.com, Inc., proposed his idea of pig breeding project in 2009. Now the pig breeding project is underway smoothly, and the first batch of products—10,000 pigs will be put on the market at the beginning of 2012.

Legend Holdings Ltd., China's top PC manufacturer, has established an agricultural business department in 2010 and initiated its strategic investments in agricultural industry in 2011. The company has achieved more than five cases of investment in agricultural projects including livestock breeding,



aquatic feeds, aquatic products and fruit planting, etc. Different from the government's original intention to provide enough food for the country, the target of investment in ecological agriculture is to provide high quality food. In recent years, repeatedly emerging food safety incidents in domestic market have stimulated the demand for safe food.

Insiders reveal that China consumes about USD1.58 billion of organic food every year, accounting for very small market share of the whole food market in China. However, after a series of food safety incidents, the consumption of high end food products, including organic food, has huge potential. Many investors are looking for investment opportunities in ecological agriculture, but high quality ecological agriculture companies are limited in the market at present. That's why so many investors show interest in Tony's Farm.

Founded in 2005, Tony's Farm is developing very quickly in recent years. It is the largest organic produce supplier in Shanghai, offering restaurants, corporate clients and individual

members a wide variety of quality organic vegetables, with customized orders and farm-to-door delivery. It was the sole exhibitor of organic produces at the 2010 Shanghai Expo.

Tony's Farm aims at high-end clients. Zhang Tonggui, General Manager of Tony's Farm, reveals that the company has informed its clients that its net profit is 30%. He said only in this way (high price of the company's products) can the company input more to ensure the safety and the high quality of the food products. Insiders reveal that Tony's Farm has over 9,000 membership clients and the normal membership fee is USD1,579 (RMB9,980) per year.

In order to ensure food production, Tony's Farm has built ecological farms in Shanghai, Zhejiang, Yunnan, Fujian, etc.

Chinese agriculture turns to hot object for PE/VC

Agriculture has played a predominant role in Chinese economy and will become increasingly important in the foreseeable future. The potential high growth of China's agriculture industry has attracted more and more investors, including private equity (PE) and venture capital (VC).

Agriculture industry becomes a hot object for PE/VC only in recent years. In 2006, PE's investment to Chinese agricultural projects was only USD56 million and the investment increased to USD396 million in 2007. PE's investment to Chinese agriculture industry hit USD1,489 million in 2010, more than the total value in 2006–2009.

PE's investment to Chinese agriculture industry was about USD600 million in 2011, less than that in 2010. However, this doesn't mean that PE/VC's enthusiasm begins to abate. 8 PE specially for agriculture industry were found in 2011, with the capital scale of over USD790 million, more than that in any single year in the past.

ShenZhen GTJA Investment Group Co., Ltd. (Shenzhen GTJA) and Agricultural Bank of China just found a PE specially for agriculture in Nov. 2011, with the capital scale of USD158 million. They also plan to expand the capital scale to USD790 million (RMB5 billion) in the future.

"Over 50% of the capital will be invested in modern agriculture, including biological breeding, food processing, ecological agriculture, bio-pesticides, agricultural machinery, etc." said Mr. Guo, a partner of Shenzhen GTJA.

Investment in agriculture has been known for the disadvantage of relatively long period of investment return and profiting. But

why have PE/VC exerted more passions on China's agriculture than ever before?

Most investors reveal that they are attracted by the high growth potential in Chinese agriculture industry and the small risks affected by the economic cycle.

First, the Chinese government is enhancing the support in agriculture and has spent much money in food security, farmers' income improvement and stability of rural society. Chinese government is making efforts to narrow the gap of income between urban residents and rural residents, and private capital has been encouraged to invest in China's agriculture industry.

Second, more requirements on food and other agricultural produces come out. On one hand, the increasing population in China demands more food in the future; on the other hand, with the improvement of living standards, people require safety food with more varieties and higher quality, and this is the greatest growth potential in China's agriculture industry.

Third, there are requirements of the improvement in productivity. The productivity in China's agriculture is relatively low, due to low industrial integration, low land integration, and low adoption of mechanization, etc. With the acceleration of urbanization, more and more peasants have shifted to other industries from agricultural industry. Thus, higher productivity is required to guarantee food supply.

Most PE/VC are very patient for the investment in agriculture industry. However, there are still some challenges that PE/VC should face besides the long period of investment return and profiting, such as scattered farmland, price fluctuations, lack of



high quality agricultural companies, etc.

There were 114 PE/VC investment cases in domestic agriculture industry from 2006 to H1 2011, as figure from Zero2IPO Group

shows. Among the total, 26 were in agricultural production means industry; 23 were in planting (mostly in ecological agriculture); the others were in animal husbandry, forestry, fishery, food processing, agricultural logistics, etc.

TABLE 2: Top ten PE&VC for agriculture industry in China, 2011

No.	PE/VC
1	Fortune Venture Capital Co. Ltd.
2	Temasek Holdings
3	Guigu Tiantang Venture Capital Co., Ltd.
4	Yellow River Delta Industry Investment
5	Kunwu Jiuding Capital Co., Ltd
6	Legend Capital
7	Olympus Capital
8	Bright Stone Investment&Management (Beijing) Co., Ltd.
9	Shenzhen Capital Group Co., Ltd.
10	PreIPO Capital Partners Limited

Source: China Venture Capital & Private Equity Annual Ranking 2011

High pig price: opportunity and risk co-exist

2011 is a year to celebrate for pig farmers in China. The pig price witnessed huge increase in the year and almost all pig producers made good money after hard years in 2009 and 2010. However, the high pig price brings not only excitement, but also cares. Will the pig price witness ups and downs in the future like it experienced in the past?

The average price of pig in 2011 was USD2.68/kg in China, up 48.16% over 2010. Domestic pig price started to rise from June 2010 and it hit a record high in June 2011 with the price of USD3.10/kg. The price stayed around the record high level till September 2011 and then began to decline. However, the price witnessed some rebound in December after hitting USD2.66/kg in November.

Most experts from the industry blame the price surge on the cyclical pig supply shortage, the rising production cost (such as feed costs and worker wages) and the strong demand caused by urbanization and higher income.

Although the high pig price was partly attributed to the increase of production cost, the profit for pig producers was very impressive in 2011. Insiders reveal that the profit of raising one pig soared from USD47 to USD110 in 2011.

The high price of pig and the fat profit have attracted lots of companies. Traditional pig farmers and meat processing companies are expanding their capacity. Besides, many investment banks, real estate developers, IT companies, etc, have been attracted by the pig industry.

For example, Yurun Group Co., Ltd., one of the leading meat processing companies in China, plans to build several modern pig farms in the near future to guarantee the quantity and

quality of pig supply. According to the company's plan, by 2020, all the pork processed by the company will come from the pigs raised by itself. Shuanghui Group, another leading meat processing company in China, is also planning to build pig farms.

This big pig market is also attractive to oversea investors. Some of the oversea investors entered this industry as early as 2007, a former bull market for pig industry in China. So far, these oversea investors include Deutsche Bank Group, Goldman Sachs, Mitsubishi, Itoham Foods Inc., Yonekyu Corporation, etc.

The latest news reported that Chia Tai Group, a well-known multinational company with over 80,000 employees in China, plans to invest USD1.15 billion to build modern pig farms and layer farms in Gansu Province, with production capacity of 1 million pigs and 3 million layers per year.

Besides, pork exporters also benefit from the high pig price in China. China imported 0.87 million tonnes of pork (including by-products of pork) in the first 9 months in 2011, up 44.60% year on year. The major pork exporters to China are America, Denmark and Canada. The total pork import is estimated to be over 1 million tonnes in 2011 (statistics have not been released yet), more over the record high in 2008 (0.91 million tonnes).

The import of breeding pigs also witnessed increase last year. Insiders reveal that China imported about 470,000kg of breeding pig (about 5,000 breeding pigs) in the first 9 months in 2011, much more than the volume in 2010 and 2009. These breeding pigs are mainly from England, France, America and Canada.



The high pig price is good news for pig producers in the industry, but not for the government. China aimed to control the inflation under 4% in 2011, but it failed to achieve the target, mainly due to the high food price, especially the record high pork price.

The consumer price index (CPI) in China rose by 5.4% in 2011, which even rose 6.4% in June 2011, when pig price hit a record high and pushed up the CPI.

Pork accounts for about 64% of the meat consumed in China and it has huge impact on the CPI. According to figure from the National Bureau of Statistics, China consumed 79.25 million tonnes of meat in 2010, including 50.70 million tonnes of pork.

To bring the CPI under control, the government has to take control of the pork price. In 2011, Chinese government embarked USD396 million (RMB2.5 billion) to subsidize pig farm expansion. Besides, Chinese government also released reserved frozen pork. The latest news revealed that the government is planning to introduce pork futures market to regulate pork price.

After maintaining around the record high for 4 months, the pig price started to decline in September 2011 and hit USD2.66/kg in November, which eased the inflation pressure, but it is not good news for pig producers. Will the pork price witness ups and downs in the future like it experienced in the past?

In China, pig prices have been in an about three-year cycle in the past years because most of the pigs are raised in small scale. Experts in the industry reveal that about 65% of the pigs are

raised by small pig farms (with the annual production capacity of less than 500 pigs). The production of these farms is easily impacted by pig price. They increase production when pig price is high, while reduce or even stop production when pig price is low, resulting in the cyclical pig oversupply and supply shortage in China.

Judging from the previous experience, pig price may witness sharp decline in 2012 after a price surge year in 2011. However, there are signs showing that this story may not happen again. Most insiders in the industry reveal that pig price will witness decrease in 2012, but the decline will be modest.

The number of small-scale pig farms, the major producers of pigs in China, is reducing in China. Besides, small-scale pig farmers are becoming more rational. "Although we can gain substantial profits from raising pigs, no one wants to raise more pigs since pig price may decline in the future." said a small-scale pig farmer.

Figure from the Ministry of Agriculture also shows that farmers' enthusiasm for raising more pigs is modest. The pig livestock in November 2011 was 476.25 million, only up 0.23% over the previous month and up 2.82% year on year. The breeding pig livestock in November 2011 was 49.05 million, up 0.51% over the previous month and up 2.01% year on year.

Besides, the rising feed costs, worker wages and the continuously increasing demand signify that pig price will not face a sharp decline like what happened in 2008. Pig price is expected to be around USD2.21/kg to USD2.69/kg in 2012.

Dairy farming attracts domestic & multinational companies

In 2011, the price of farm milk has kept at a high level; meanwhile, the government's supervision became stricter and its requirements became higher, which attracts more and more domestic and multinational companies to enter the dairy farming industry.

Due to many reasons, such as inflation, insufficient raw milk supply in China, etc., the price of farm milk remains at a high level in 2011: in mid December 2011, the price of farm milk was USD508/t (RMB3,220/t), up 6.3% over that of USD478/t (RMB3,150/t) in Dec. 2010 —the second highest point of farm milk price in 2010. Actually, the price of farm milk increased gradually in 2011, and each monthly price is higher than that in the same period of 2010.

The high level price of farm milk gives the incentive to many companies to expand their dairy farming business, especially under the stricter supervision and higher requirements from the government: the typical example of the government's policy is the Reconstruction and Promotion Planning Outline of Dairy Industry issued in November 2008 after the melamine scandal, according to which the government required dairy processors to source 70% of their milk supplies from their own farms or

through contracted large-scale suppliers by October 2011.

Under this situation, many dairy processors have to build their own farms: for example, Mengniu has previously declared that it will increase its investment in dairy farm construction to about USD520 million (RMB3,300 million) over the coming 5 years(2012-2016); it has invested USD109 million (RMB700 million) in H1 2011 on farms, almost 80% of the USD141 million (RMB900 million) allocated for this purpose in 2011, according to the company's financial report for H1. And the company's latest move is that in November 2011, it planned to invest about USD251 million (RMB1,600 million) in total to a dairy complex, including a plant with total capacity of 1,400 t/d and 4 farms with 6,000 cows in all in Yunnan.

Also in November 2011, Shanghai Dairy Group, one parent company of Bright Dairy and a subsidiary of Bright Foods, announced its cooperation with Wuhan Kailong Group (Kailong Group, a diverse business group based in Wuhan), aiming to build a dairy farm in Wuhan, with a total investment of USD15 million (RMB100 million) for the 1st stage construction which is expected to be completed at the end of 2012, providing milk



production of 10,000 tonnes per year.

However, to build farms is not an easy task for dairy processors, even for large scale dairy processors, especially when the competition is fierce and the cost is increasing, and they have to raise funds through their own ways. Yili's fund-raising plan adjustment in November and Bright Dairy's fund-raising plan in October are estimated to be the two primary examples (Please refer to Dairy Products China News Vol.4 December Issue, p7 Mengniu's Potential Expansion in Yunnan? & p12, Rapid Development of Milk Supply in Southern China & p6, Yili Adjusts Its Fund Raising Plan).

Obviously, it's hard for dairy processors to build all the farms needed, which was the original intention of the government in the past though: according to China's Dairy Industry Association, only 40% of the large-scale dairy processors have met the government requirements to source 70% of their milk supplies from their own farms or through contracted large-scale suppliers by October 2011.

However, it's good news for those farming companies and investment agencies: for example, on 15 November 2011, Wenshi Food announced its plan to build a dairy farm in Guangxi, with a total investment of USD31 million (RMB200 million) and 10,000 cows will be bred in the farm. This move just followed its recent dairy farm project with 10,000+ cows in Guangdong, suggesting the company is targeting the raw milk market in Guangdong and Guangxi, 2 difficult but nevertheless promising dairy regions.

Besides domestic companies, some multinational companies are also optimistic about the raw milk supply market in China—a promising market aided by the high level price and the insufficient raw milk supply situation in China: for example, Fonterra Co-operative Group (Fonterra) just appointed the general manager of its dairy farming business in China in November 2011, and revealed that the company will build a group of dairy farms in Hebei in the future five years. The company's goal is ambitious, and actually early on 19 July 2011, it had signed a contract with the government of Yutian County,

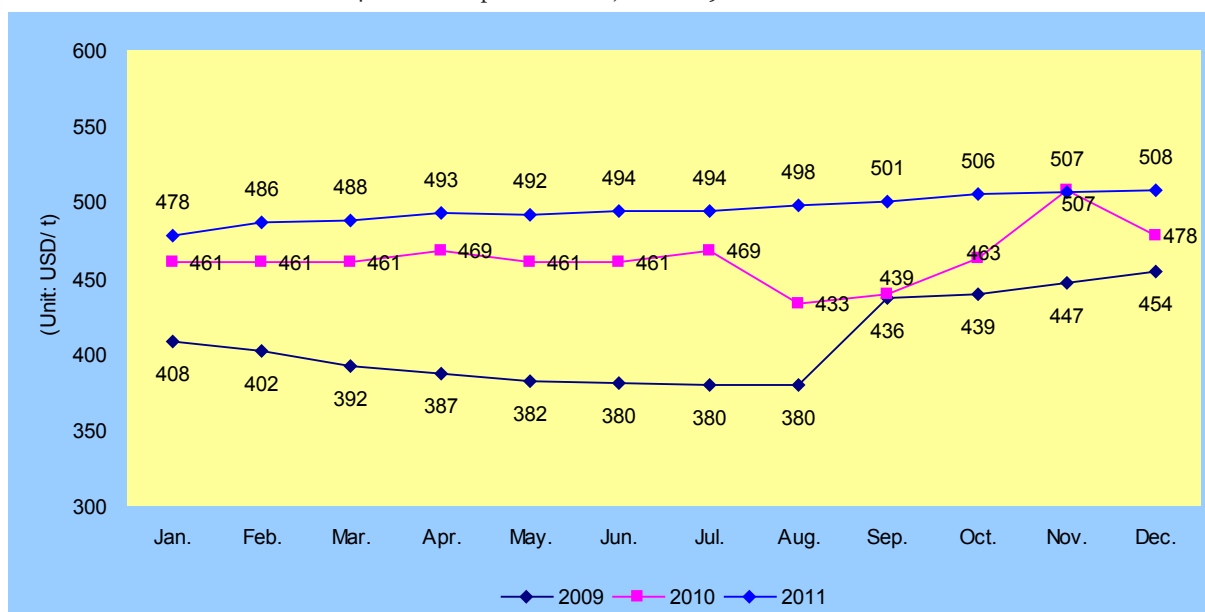
Hebei Province, aiming to invest about USD40.20 million (RMB260 million) to build its 3rd local dairy farm.

Fonterra is not an isolated case: also in July, Olympus Capital Holdings Asia (Olympus Capital) announced its investment of USD30 million in Huaxia Dairy Farm (Sanhe) Co., Ltd. (Huaxia Dairy), while the leading German dairy producer, Muller Milch would invest USD10 million and Huaxia Dairy's existing shareholder (believed to be California Technology Ventures) would inject USD5 million, aiming to expand business in China's dairy raw milk market.

Although the development of China's dairy farming is promising, investors will face a growing level of competition in milk supply, mainly from domestic companies, while more international investors will make the competition even more intense, especially for suppliers in the main milk production regions during the peak production season.

It is also the case that the competition has become more cut-throat than ever: Yili and Mengniu, the two largest dairy processors in China, had come up with some harsh terms for their suppliers since April 2011, on the heel of finishing the production license reapplication by the end of March. On this basis, many small dairy processors (often a key market for rural milk suppliers) have been squeezed out from the dairy market. Large-scale processors offered a low purchase price and even refused to purchase milk at that time, when is the peak season for raw milk production in China. A source from Huaxia Dairy revealed that their raw milk was refused by Mengniu, Yili and Beijing Sanyuan in one week for the reason of low fat content, but according to the test results from a 3rd party detection organization, the fat content of milk was actually in accordance with the national standard. This forces Huaxia Dairy to accept the tougher terms from the three processors. So how to fairly cooperate with large-scale dairy processors, especially in the peak season of milk production, will be a pressing and reasonable concern for many on the supply side that needs to be addressed.

FIGURE 4: Farm milk price in China, Jan. 2009 - Dec. 2011



Source: CCM International



Farmers gain low profit from high-priced Wuchang rice

The news about Wuchang (Heilongjiang Province) rice has caused public concern recently. The selling price of Wuchang rice goes as high as USD23/kg in the market. But its purchasing price from farmers is only USD0.60/kg to USD0.63/kg (RMB3.8/kg to RMB4/kg). So, how should people treat the phenomenon that farmers can't benefit from high market price of rice?

In fact, the purchasing price of Wuchang rice was higher than those in other parts of China. The purchasing price of Wuchang rice is USD0.60/kg to USD0.63/kg, while the rice purchase price in other regions in China is about USD0.41/kg. It means that Wuchang grain enterprises have made some compensation to Wuchang rice farmers for the premium price. However, compared with the high selling price, this compensation seems too low, which has aroused public concern.

In China, farmers are too weak to have a strong voice in the market. To solve this tough problem, farmers should establish

and improve professional cooperative organizations and professional agricultural associations. Only when farmers have the discourse power can they have the same power to negotiate with top enterprises and share risks and profits with them.

Wuchang rice, produced in Wuchang City, Heilongjiang Province, is well-known for its good quality. At present, there are many grain enterprises located in Wuchang City. These enterprises have absorbed almost 1.25 billion kilograms of rice which are all produced from the 0.12 million ha. paddy fields in Wuchang City. Aided by the high quality of rice, some domestic and internationally well-known corporations have set up factories there: not only have some domestic listed companies such as Heilongjiang Agriculture Co., Ltd., COFCO Corporation, Orient Group. Incorporation and so forth captured parts of the market, but also some foreign companies such as Yihai Grain and Oil Industry Co., Ltd. have set up bases in Wuchang City.

Special Report

Domestic cotton and soybean acreage to decrease in 2012

In the last third of November 2011, the National Cotton Market Monitoring System (NCMMS) conducted a survey among domestic growers about their intentions to plant cotton and the results show that domestic cotton planting areas in 2012 may decrease by 8.2% year on year, mainly due to the decreasing price of cotton and the increasing cotton planting costs in 2011. Domestic cotton acreage in 2012 may only reach 4.89 million ha., 433,800 ha. less than that in 2011.

According to the survey, Yellow River Basin cotton planting area may be the most affected, down by 10.3% year on year. Meanwhile, compared with the Yellow River Basin, although Northwest China cotton planting area may only decline by 6.5% year on year, the smallest decrease in China, growers' planting enthusiasm in the area has faded.

China reaped an overall harvest of cotton in 2011; however, the increasing labor cost and the depressed cotton downstream market resulted in cotton growers' low income from the bumper harvest. Compared with large scale mechanical cultivation of field crops such as wheat, corn, etc., the low machinery industrial level of cotton leads to the labors' high intensity. As the inflation has gone higher and higher, labor cost has effectively caused the high cotton planting cost and finally brought serious influence to cotton growers' earnings. In addition, the production and marketing situation of domestic cotton downstream industries has become worse and worse

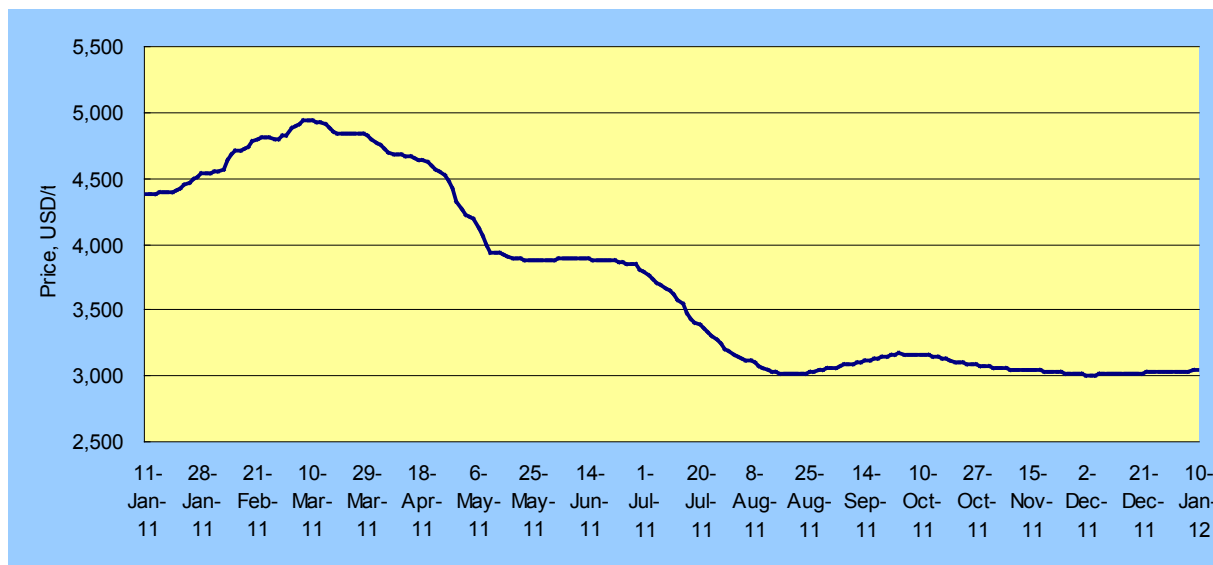
because of the low cotton demand and domestic tightened monetary policy in 2011, which raises the pressure on cotton's supply. Domestic cotton price has constantly declined, which made cotton purchasing price from the downstream enterprises decrease to a low level. According to the statistics from the NCMMS, domestic price of cotton decreased to USD3,039.5/t in November 2011 from USD3,116.4/t in October 2011.

However, actually, domestic cotton planting area has a close connection with cotton purchasing policy set by the government. According to the routine, the spring cotton sowing time will begin from the second half of March in 2012. Cotton growers can regulate their cotton planting based on cotton purchasing policy published by the Chinese government, which may be fixed before the cotton sowing time. In 2011, the temporary cotton purchasing and storage policy published by the Chinese government effectively supported domestic cotton price, alleviating the decreasing cotton price. This policy has not only efficiently stabilized domestic cotton market, but also protected growers' income. The National Cotton Teleconference has declared that the Chinese government will perfect the cotton purchasing and storage policy.

Besides, domestic soybean may face a same or even more severe situation as cotton does. As corn's selling price continues to rise, many soybean growers plan to transform their soybean acreages



FIGURE 5: Fluctuation of domestic cotton's market price, 2011



Source: CCM International

to corn acreages because of their similar planting environment, so as to increase their incomes, even though the Chinese government has decided to raise its soybean purchasing price from USD585.7/t in 2008 to USD633.2/t in 2012.

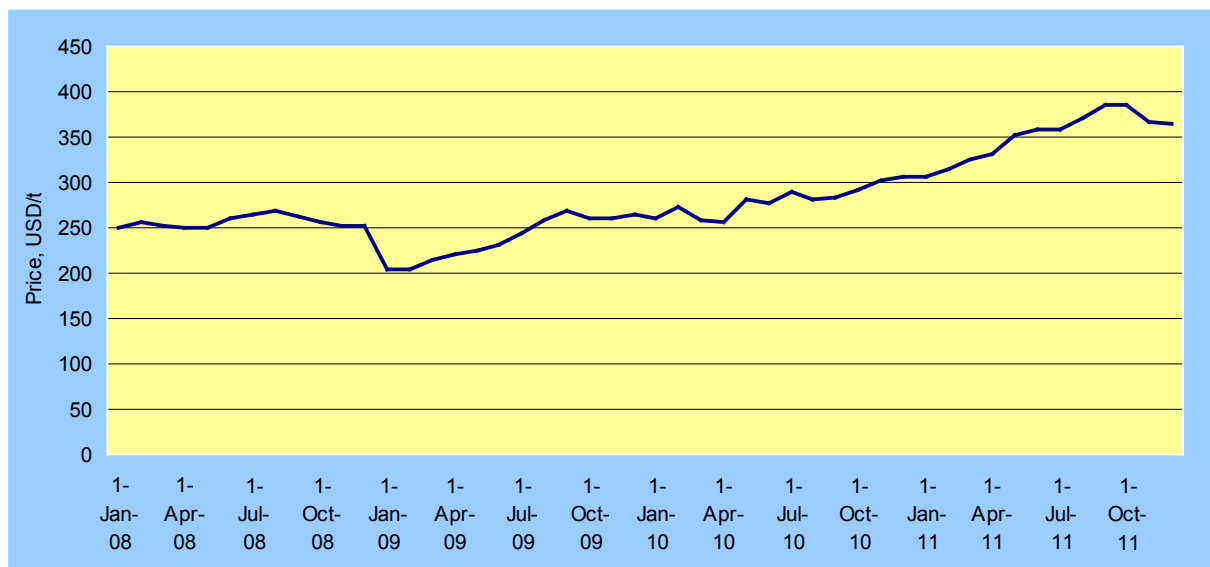
In fact, the State Administration of Grain issued a notice on November 28, 2011, which indicated that domestic soybean purchasing price is set as USD633.2/t, available from November 23, 2011 to April 30, 2012. The purpose of the policy is to maintain growers' soybean planting enthusiasm, in case of soybean acreage's sliding downward to a large extent. Moreover, the Chinese government can keep the initiative to regulate domestic grain and oil market supply and demand.

However, many soybean growers still prefer to plant corn rather than soybean, thanks to corn's higher output. For example, a farmer from Heilongjiang Province says that the planting cost

of soybean is USD475.1/t, compared with USD633.5/t of the planting cost of corn. But he can get USD1057.4/t of profit from corn planting, USD531.8/t higher than that of soybean. Recently, according to the purchasing price set by the Chinese government, the prices of soybean and corn are USD633.2/t and USD316.6/t separately. The output of soybean is just 0.83 tonne per ha., much lower than corn's 3.34 tonnes per ha.

In 2011, the corn planting area in China hit 33.43 million ha., up 2.9% year on year. The soybean planting area was 7.6 million ha. in 2011, down 0.93 million ha. over the previous year.

FIGURE 6: Fluctuation of domestic corn's market price, 2008-2011



Source: CCM International



Forecast for domestic sugar price in 2012

Domestic sugar price will have the potential to rise in 2012 thanks to Chinese government's policy support.

On January 4, 2012, the National Development and Reform Commission (NDRC) held a conference about the control and regulation of domestic sugar price. There's a buzz going round that at the meeting, Guangxi Zhuang Autonomous Region Sugar Association agreed on the sugar collection and storage policy with NDRC. The following items are involved:

1. Thorough investigation of the smuggling of sugar, in order to fight against the phenomenon of illegal sugar sales channels into domestic market;
2. Strict control over sugar import quotas according to dynamics of domestic sugar market, so as to stabilize domestic sugar price;
3. Out of the one million tonnes of the national sugar reserves in 2012, 600,000 tonnes will be from Guangxi;
4. Guangxi's squeezing cost of sugar is priced at USD982.7/t, while the domestically average purchasing price will be around USD1,014.4/t before the end of January 2012.

This news spreads out and greatly boosts domestic sluggish sugar market. On January 5, 2012, Zheng Sugar Futures highly opened at USD963.7/t, reached the highest of USD1001.6/t and finally closed at USD993.6/t, up over 3.95% compared with the opening price of the trading day. Also, domestic sugar price has risen from USD1,059/t to USD1,062/t from January 5, 2012 to January 9, 2012.

Although domestic sugar price is constantly rising in the first third of January, 2012, some analysts still have doubts about the authenticity of the hearsay. An insider assumes that two possible situations may occur in the near future: one is the

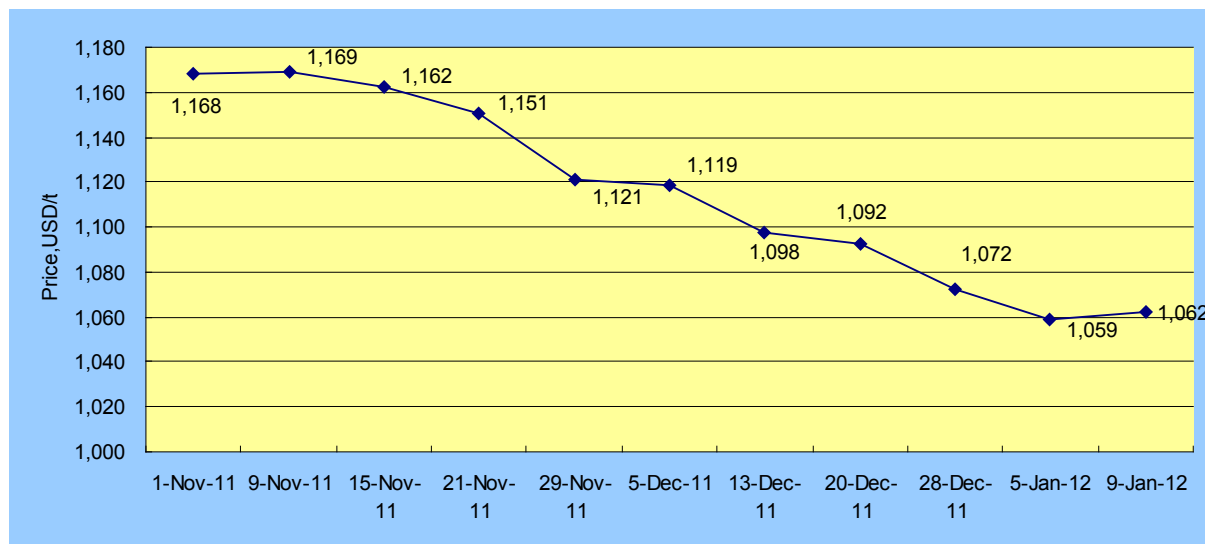
policy implementation in January 2012. Domestic sugar market will be in short supply and the product's price will go up because of the estimated consumption gap of 500,000 tonnes in 2012. Even though the sugar consumption prediction during 2011-2012 reaches 13 million tonnes, 200,000 tonnes higher than that during 2010-2011, domestic sugar supply will decrease to 12.5 million tonnes due to the one million tonnes of national procurement for reserves.

The other situation is that, if the rumor doesn't turn true, domestic sugar price will fall again and may finally maintain at around the cost line, which is about USD950.4/t now; however, it is possible that the Chinese government will launch temporary purchasing price then to stabilize the sugar price.

It is estimated that domestic sugar price is at least to flatten out and may be up after a period of fluctuation during January 2012-April 2012. Even if sugar price in 2012 may not reach USD1,226/t, the highest price in 2011, it is predicted that Chinese government is likely to stabilize and even raise domestic sugar price to a reasonable level, so as to effectively protect domestic sugar market, whether the rumored policies will be implemented or not. However, if the policies are implemented in the near future, it is concluded that the substantial impact of some measures, like thorough investigation of the smuggling of sugar, will not be notable in a short time, while others such as strict control over sugar import quotas will greatly affect domestic sugar market.

Specifically speaking, strict control over import quotas will result in the cost increase of sugar import, efficiently reducing sugar's import volume, which reflects Chinese government's resolution on the regulation of domestic sugar market. Recently, the import tax rate of non-quota sugar is 50%, 35% higher than that of quota sugar. According to the latest estimation of sugar's import price, sugar price from Thailand reaches nearly USD951.0/t, while that from Brazil is around USD982.7/t. The

FIGURE 7: Domestic sugar price fluctuation, 2011.11.01-2012.01.09



Source: CCM International



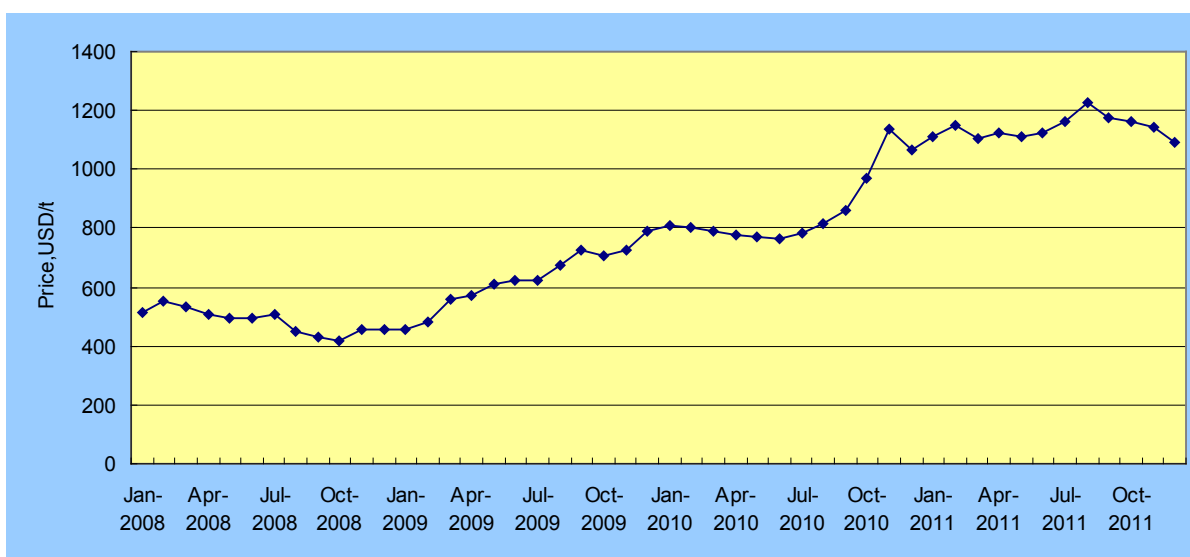
low price of import sugar makes the domestic sugar market flooded with large volume of import sugar and leads to the price decline of domestic sugar.

In addition, the high purchasing price set by the Chinese government will make the investors be bullish on the future of domestic sugar market. Meanwhile, the purchasing and storage volume of sugar, which the Chinese government drafts in the new policy, may probably result in the short supply of sugar in the market. The short supply will ultimately lead to price rise of sugar in 2012. Some insiders believe that the purchasing and storage of sugar in Guangxi Zhuang Autonomous Region will play an important role especially in the weak prospect of domestic sugar market. During 2009-2011, the output volume of domestic sugar industry saw continuous decline from 14.8

million tonnes in 2007-2008 to 10.5 million tonnes in 2010-2011. Although domestic sugar market still stays in the situation of increasing new sugar supply and sluggish demand, it is forecasted that the domestic sugar market will restore the increasing production in 2011-2012.

In fact, the price of domestic sugar more than doubled from USD514.7/t in January 2008 to USD1,226/t in August 2011 because of the international short supply of sugar and the rising sugar cost. Attributed to Chinese government's policies to stabilize the market price and fight against the market inflation, domestic sugar price has decreased from USD1,226/t in August 2011 to USD1,059/t at the beginning of January 2012, diminishing sugarcane growers' revenue and sugar mills' profit.

FIGURE 8: Domestic sugar price fluctuation, 2008-2011



Source: CCM International

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Publisher: CCM International Limited

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