
INDUSTRY OVERVIEW

This section contains information, forecasts and statistics relating to the economy in China and the industry in which we operate. We believe that the sources of the information are appropriate sources for such information. We have no reason to believe that such information is false or misleading or that any fact has been omitted that would render such information false or misleading in any material respect. We have derived such information and data partly from publicly available government and official sources as well as a report we commissioned from Euromonitor International, an Independent Third Party, and a report we purchased from the Dairy Association of China (中國奶業協會), an Independent Third Party, which have not been independently verified by us, nor any of our directors, affiliates or advisers. Furthermore, the information provided by PRC Government sources may not be consistent with the information compiled within or outside China by third parties. We make no representation as to the correctness or accuracy of government or official information contained in this document. Accordingly, such information should not be unduly relied upon. We have, however, taken such care as we consider reasonable in the reproduction and extraction of such information.

EUROMONITOR INTERNATIONAL REPORT

We commissioned Euromonitor International to conduct an analysis of the Milk Powder market in China and prepare the Euromonitor International Report at a fixed fee of US\$13,500. The Euromonitor International Report includes information on the Milk Powder market in China such as sales value, sales volume, market share of leading players of foreign and local brands, and the outlook of the Milk Powder market in China, which have been quoted in this document.

Euromonitor International’s independent analysis was undertaken through primary and secondary research obtained from various sources. Primary research includes interviewing milk powder manufacturers, distributors, retailers and other third parties for fresh data, opinions and insights as well as national or regional dairy industry associations, government, semi-official and other segment observers. Secondary research involves gathering, refining and confirming information from multiple and relevant published data sources. Projected market size by retail sales value and retail sales volume were obtained based on a comprehensive and in-depth review over the historical market development, and a cross check with established government/industry figures or trade interviews, and statistical tools, where possible.

Euromonitor International made the following major assumptions in the preparation of the Euromonitor International Report:

- the research conducted covers the sale of Milk Powder through all retail channels in China and does not include the sale of Milk Powder for industrial use;
- the economy in China is expected to recover from 2010; and
- all sales values are based on retail sales prices.

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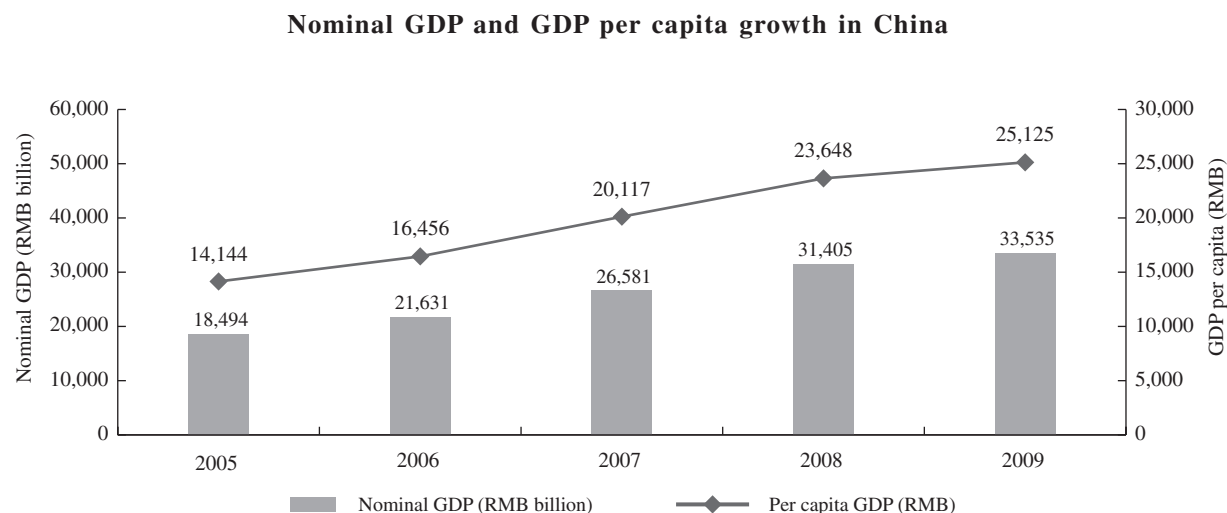
CHINA DAIRY STATISTICAL REPORT

The Dairy Association of China (中國奶業協會), an Independent Third Party, is a non-profit trade organisation set up by dairy farms, individual dairy farm operators and dairy product processing enterprises in the PRC, and is under the supervision of the Ministry of Agriculture of the PRC. The China Dairy Statistical Report was prepared by the Dairy Association of China (中國奶業協會). We did not commission the preparation of the China Dairy Statistical Report, which we purchased from the Dairy Association of China (中國奶業協會).

THE PRC ECONOMY

Economic growth and urbanisation

The economy in China is one of the world’s fastest growing economies. According to the National Bureau of Statistics, the nominal GDP of China in 2009 was RMB33,535 billion, representing a CAGR of 16.0% and annual growth of 6.8% from 2005 to 2009. From 2005 to 2009, the GDP per capita in China also increased from RMB14,144 to RMB25,125, representing a CAGR of 15.5%. The following chart illustrates the nominal GDP and the GDP per capita growth in China from 2005 to 2009.

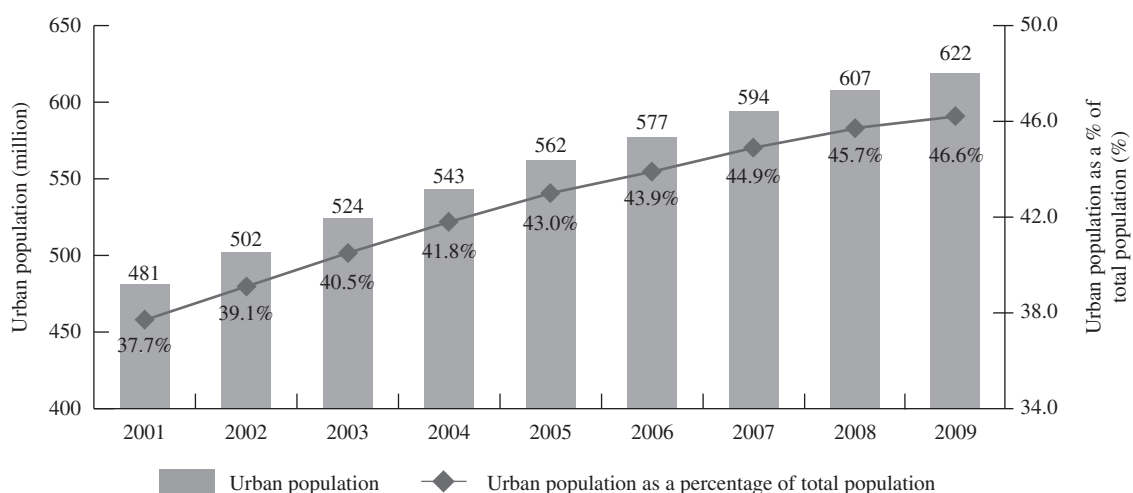


Source: National Bureau of Statistics

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The economic growth in China has been accompanied by rapid urbanisation. The total urban population in China increased from 481 million as at the end of 2001 to 622 million as at the end of 2009, representing an increase of 29.3% between 2001 and 2009. During the same period, the urban population as a percentage of the total population increased from 37.7% to 46.6%. The chart below illustrates the total urban population and the urban population as a percentage of the total population in China as at the end of the periods indicated.

Absolute and Relative Growth of Urban Population in China



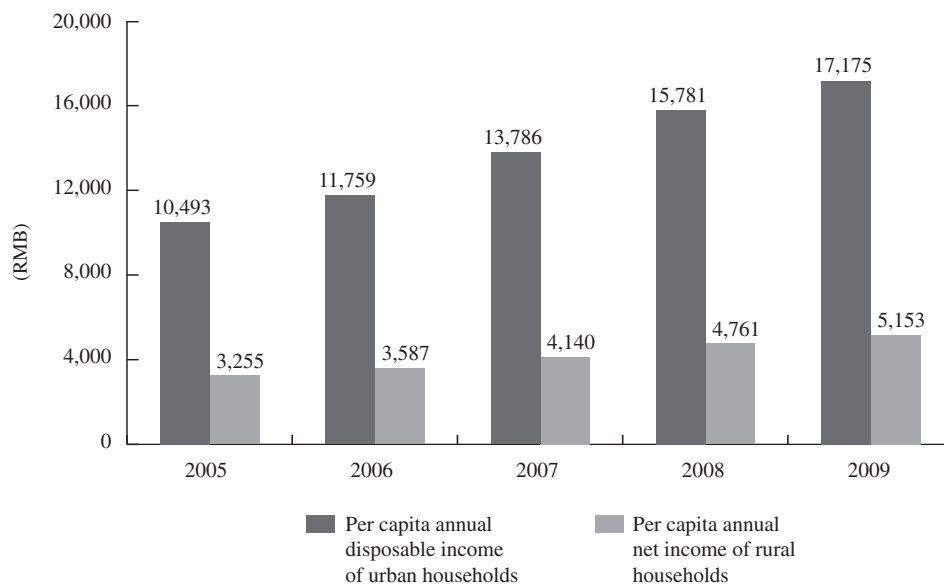
Source: National Bureau of Statistics

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Growth in disposable income of urban households and net income of rural households

Per capita income from urban and rural households in China has been increasing along with economic growth and increasing urbanisation. According to the National Bureau of Statistics, from 2005 to 2009, the per capita annual disposable income of urban households in China increased from RMB10,493 to RMB17,175, representing a CAGR of 13.1%. During the same period, the per capita annual net income of rural households in China increased from RMB3,255 to RMB5,153, representing a CAGR of 12.2%. These increases indicate that the purchasing power of Chinese consumers is increasing, and as a result Chinese consumers are more capable of purchasing high quality products for their babies and children. The following chart sets out the per capita annual disposable income of urban households and the per capita annual net income of rural households in China from 2005 to 2009.

**Per capita annual disposable income of urban households in China
and per capita annual net income of rural households in China**

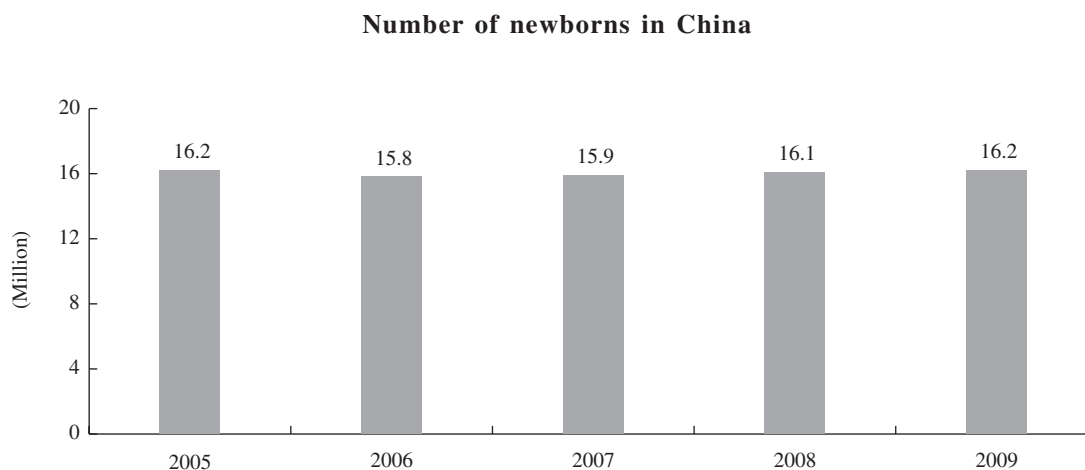


Source: National Bureau of Statistics

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Number of newborns in China

From 2005 to 2009, the number of newborns in China was relatively stable, at around 16 million births each year. Our Directors believe that the number of newborns in China will continue at a relatively consistent level in the near future. The following chart illustrates the number of newborns in China from 2005 to 2009, which is calculated based on the birth rate and population in China during the same period.



Source: National Bureau of Statistics

THE MILK POWDER INDUSTRY IN CHINA

The Milk Powder industry in China has experienced significant changes in recent years. In particular, the Milk Powder market in China recorded a slow-down in growth from 2008 to 2009, due to the melamine scandal in September 2008.

In September 2008, the milk products of a number of large domestic dairy products manufacturers in China were found to contain melamine, which can cause infants to develop kidney stones, and affected the health of several thousands of children. The melamine scandal undermined consumers' confidence in paediatric milk formula produced by milk powder sourced domestically, which was reflected in the significant drop in such purchases and resulted in a decrease in production volume.

According to the Euromonitor International Report, the retail sales volume of the Milk Powder market in China dropped by 3.2% in 2008 from 678,580 tonnes in 2007 to 656,600 tonnes in 2008, and the retail sales value of the Milk Powder market in China reached RMB39,794.1 million in 2008, an increase of 7.1% over 2007.

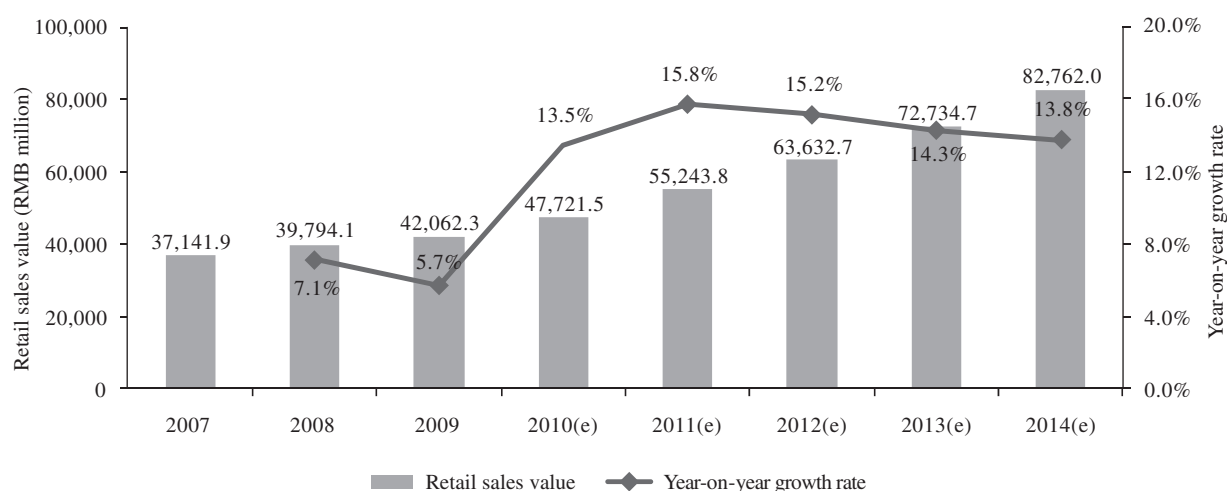
However, supported by the strong demands for milk formula, Euromonitor International believes that the growth of the Milk Powder market in China is expected to recover partly during the period between 2009 and 2014 with an estimated value CAGR of 14.5% from 2009 to 2014. According to data

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produced by Euromonitor International, the retail sales volume of Milk Powder in China is expected to increase by 4.9% from 640,400 tonnes in 2009 to 671,700 tonnes in 2010. Furthermore, the market scale of the Milk Powder market in China is estimated to achieve RMB82,762.0 million in retail sales value in 2014.

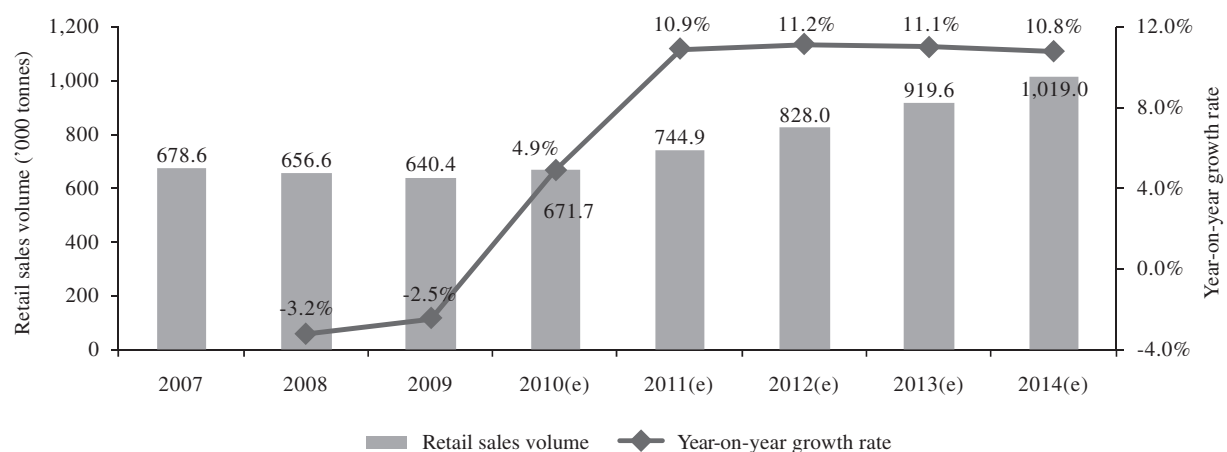
The following charts illustrate the historical (2007 to 2009) and forecast (2010-2014) market size and the year-on-year growth rate of the Milk Powder market in China by retail sales value and retail sales volume, respectively.

Historical (2007-2009) and forecast (2010-2014) market size and year-on-year growth rate of Milk Powder market in China by retail sales value



Source: Euromonitor International

Historical (2007-2009) and forecast (2010-2014) market size and year-on-year growth rate of Milk Powder market in China by retail sales volume



Source: Euromonitor International

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Baby Milk Powder Market in China

(i) Market overview

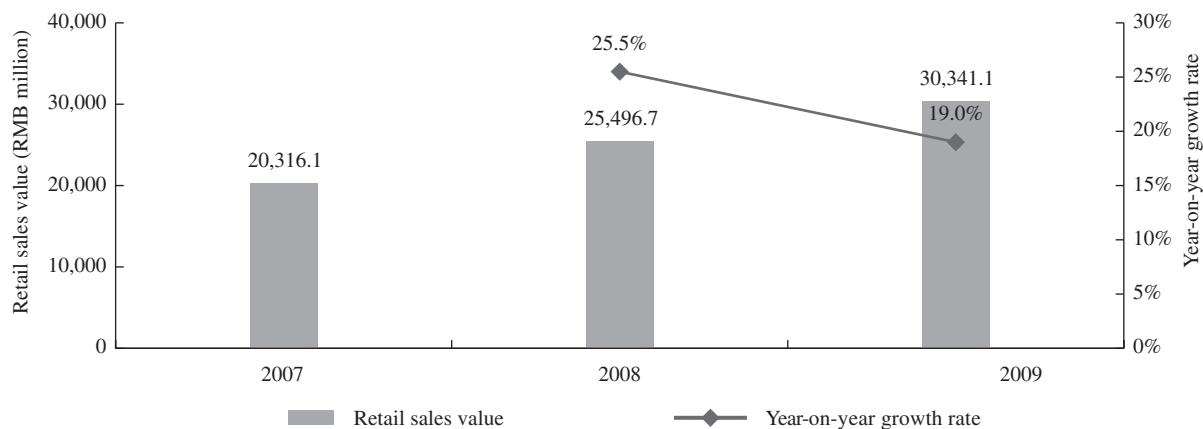
With China’s rising economy and increasing birth rates, the Baby Milk Powder market in China has been experiencing high growth of above 20% in retail sales value since 2005. However, the growth in the Baby Milk Powder market in China slowed down in 2008 and 2009 due to the negative impact caused by the melamine scandal in 2008.

The year-on-year volume growth of the Baby Milk Powder market in China declined to 19.0% in 2008 and declined further to 15.4% in 2009.

Due to the price increase in 2008, the value growth of the Baby Milk Powder market in China maintained a high level of 25.5% in 2008 but dropped to 19.0% in 2009. The total market size of Baby Milk Powder in China by retail sales value amounted to RMB30,341.1 million in 2009.

The following charts illustrate the market size and the year-on-year growth rate of the Baby Milk Powder market in China from 2007 to 2009 by retail sales value and retail sales volume, respectively.

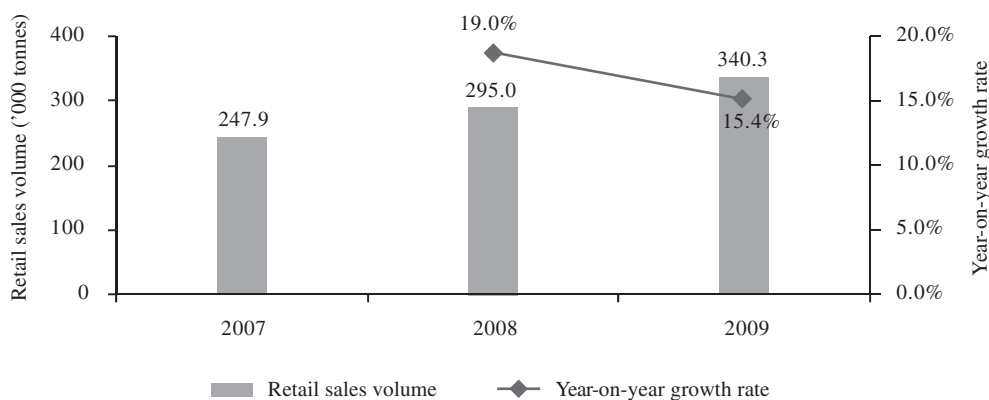
**Market size and year-on-year growth rate of
Baby Milk Powder market in China by retail sales value, 2007-2009**



Source: Euromonitor International

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**Market size and year-on-year growth rate of
Baby Milk Powder market in China by retail sales volume, 2007-2009**



Source: Euromonitor International

(ii) Market drivers & constraints

The melamine scandal in 2008 had, to a certain extent, affected the Baby Milk Powder market in China in 2008 and 2009. However, the market still maintained a high growth rate in the past two years, which was driven by various factors as set out below:

- as a necessity, the demand for Baby Milk Powder is driven by the rising population of babies in China as illustrated above. The birth rate of China has maintained at a high level of above 12% during the period between 2007 and 2008. As a result, demand for Baby Milk Powder has grown steadily during the period from 2007 to 2009 even through its growth rate slowed down between 2008 and 2009;
- the brand names and recognition of many local producers of Baby Milk Powder were tarnished by the melamine scandal. Parents in China have since become increasingly concerned about the quality of Baby Milk Powder and are more cautious when choosing products. To the extent they can afford it, they will try to purchase Baby Milk Powder produced by leading foreign brands and reputable local brands, which are usually higher-priced products;
- various rounds of price increase from 2008 to 2009 have also driven the growth of the Baby Milk Powder market in China. In 2008, many brands that were not involved in the melamine scandal started to increase their product prices. For instance, as consumer demand rose and the supply of milk resources declined, Wyeth further increased its product price. Euromonitor International expects the price increase in Baby Milk Powder to continue in 2010; and

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- many local brands that were not involved in the melamine scandal such as Beingmate (貝因美) and Feihe (飛鶴) have seized upon the opportunity to grow rapidly from 2008 to 2009. For example, Beingmate (貝因美) increased its market share in terms of sales value from 4.0% in 2008 to 5.1% in 2009, and Feihe (飛鶴) increased its market share in terms of sales value from 2.4% in 2008 to 3.6% in 2009.

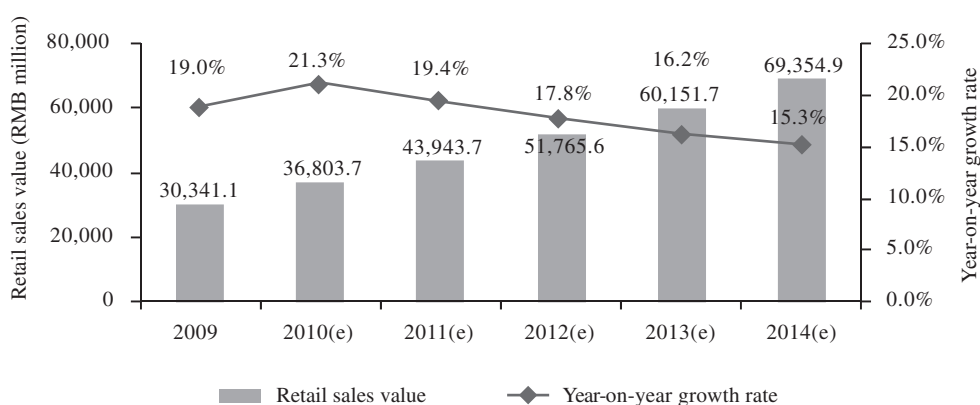
(iii) Outlook

Based on the trends and facts mentioned above, the Baby Milk Powder market in China is expected to recover by 2010 with a value growth at 21.3% and with a volume growth at 15.7%. The value growth is expected to slow down from 2011 to 2014 and the volume growth is expected to slow down from 2012 to 2014 as the Baby Milk Powder market in China becomes more mature.

In 2014, the Baby Milk Powder market in China is estimated to reach RMB69,354.9 million in terms of retail sales value and 685,700 tonnes in terms of retail sales volume. The CAGR in retail sales value and in retail sales volume from 2009 to 2014 is estimated at approximately 18.0% and 15.0%, respectively.

The following charts illustrate the outlook of the market size and the year-on-year growth rate of the Baby Milk Powder market in China between 2009 and 2014 by retail sales value and retail sales volume, respectively.

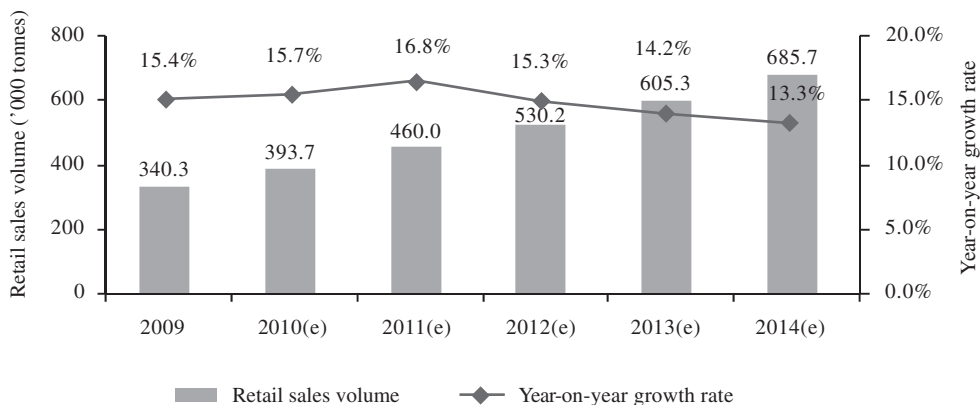
**Market size and year-on-year growth rate of
Baby Milk Powder market in China by retail sales value, 2009-2014**



Source: Euromonitor International

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**Market size and year-on-year growth rate of
Baby Milk Powder market in China by retail sales volume, 2009-2014**



Source: Euromonitor International

Other Milk Powder Market in China

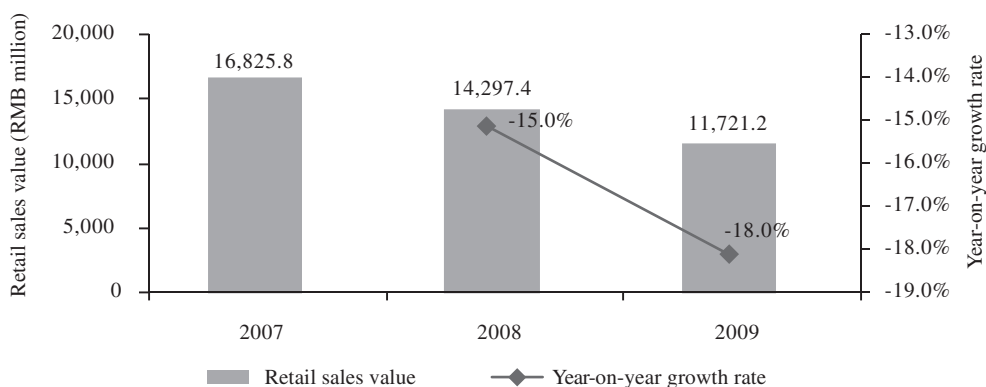
(i) Market overview

The Other Milk Powder market in China was greatly impacted by the melamine scandal. The retail sales value of the Other Milk Powder market in China declined from RMB16,825.8 million in 2007 to RMB14,297.4 million in 2008, and declined further to RMB11,721.2 million in 2009, with a year-on-year value growth at -18.0% in 2009. On the other hand, the retail sales volume of the Other Milk Powder market in China declined from 430,600 tonnes in 2007 to 361,600 tonnes in 2008, and declined further to 300,100 tonnes in 2009, with a year-on-year volume growth at -17.0% in 2009.

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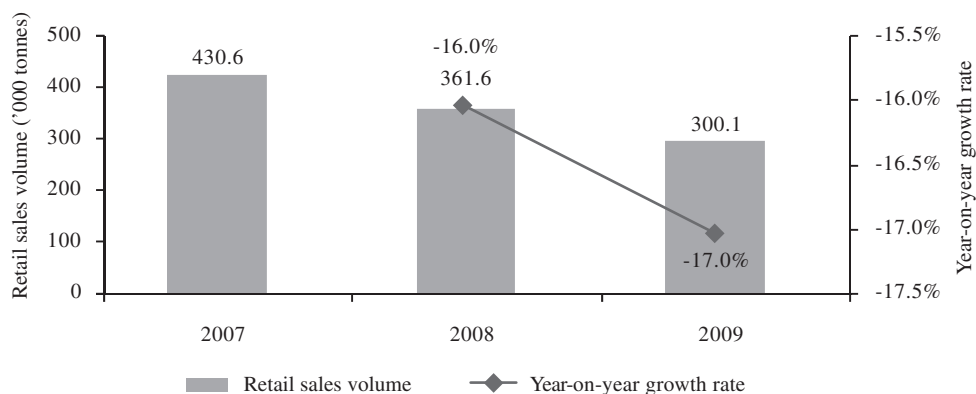
The following charts illustrate the market size and the year-on-year growth rate of the Other Milk Powder market in China between 2007 and 2009 by retail sales value and retail sales volume, respectively.

**Market size and year-on-year growth rate of
Other Milk Powder market in China by retail sales value, 2007-2009**



Source: Euromonitor International

**Market size and year-on-year growth rate of
Other Milk Powder market in China by retail sales volume, 2007-2009**



Source: Euromonitor International

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(ii) Market drivers & constraints

Unlike the Baby Milk Powder market, the Other Milk Powder market in China is more vulnerable to the melamine scandal due to the lack of stable demand. The scandal, coupled with the impact brought about by the global financial crisis in late 2008, has led to many consumers giving up consumption of milk products or becoming more cautious in their consumption of non-necessities such as milk powder for adults. Stocks of some manufacturers and distributors increased dramatically in late 2008.

However, the Other Milk Powder market for pregnant women and elderly persons in China are still considered promising. As young pregnant women in China are increasingly concerned about the health of their babies even before the babies are born, it is expected that they will accept and consume more Other Milk Powder. Consumption of milk products is believed to help minimise calcium insufficiency commonly found in elderly persons. It is expected that traditional adult milk powder will be gradually replaced by functional milk powder in the near future.

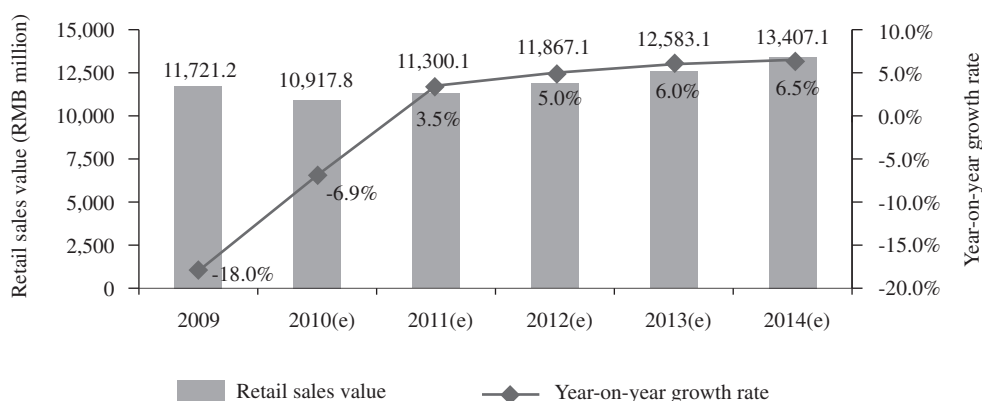
(iii) Outlook

The Other Milk Powder market in China is expected to recover gradually during the forecast period with a CAGR in retail sales value of approximately 2.7% from 2009 to 2014, reaching RMB13,407.1 million in 2014, and a CAGR in retail sales volume of approximately 2.1% from 2009 to 2014, reaching 333,300 tonnes in 2014. The year-on-year growth rates in terms of retail sales value and retail sales volume are expected to turn positive in 2011.

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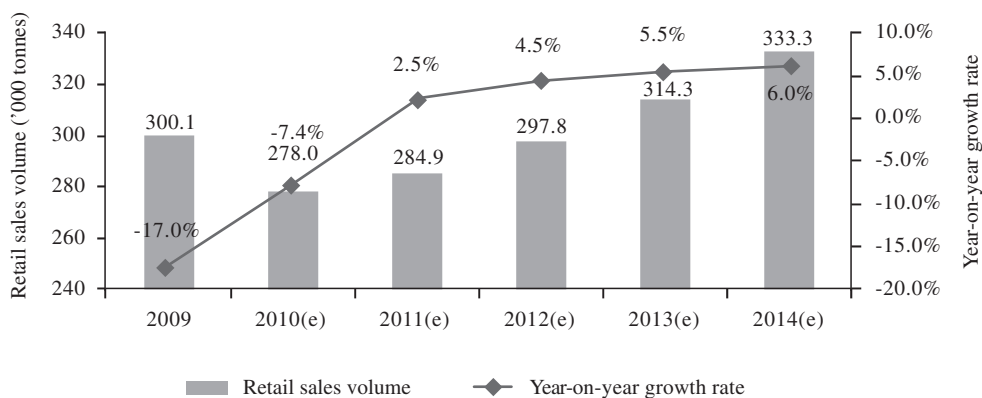
The following charts illustrate the outlook of the market size and the year-on-year growth rate of the Other Milk Powder market in China between 2009 and 2014 by retail sales value and retail sales volume, respectively.

**Market size and year-on-year growth rate of
Other Milk Powder market in China by retail sales value, 2009-2014**



Source: Euromonitor International

**Market size and year-on-year growth rate of
Other Milk Powder market in China by retail sales volume, 2009-2014**



Source: Euromonitor International

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COMPETITION IN THE MILK POWDER INDUSTRY IN CHINA

Market Shares Of Leading Players In Milk Powder Market

The melamine scandal greatly changed the competitive environment of the Milk Powder industry in China. As a result of the scandal, while some companies lost their market shares or disappeared from the market such as 石家莊三鹿集團股份有限公司 (Shijiazhuang Sanlu Group Co., Ltd*), other companies actually benefited from the scandal such as Beingmate Scientific Industry-Trade Share Co Ltd, 黑龍江省完達山乳業股份有限公司 (Heilongjiang Wondersun Dairy Co., Ltd*) and 黑龍江飛鶴乳業有限公司 (Heilongjiang Feihe Dairy Co., Ltd.*), which gained additional 1.1%, 1.5% and 1.2% of market share in 2009, respectively.

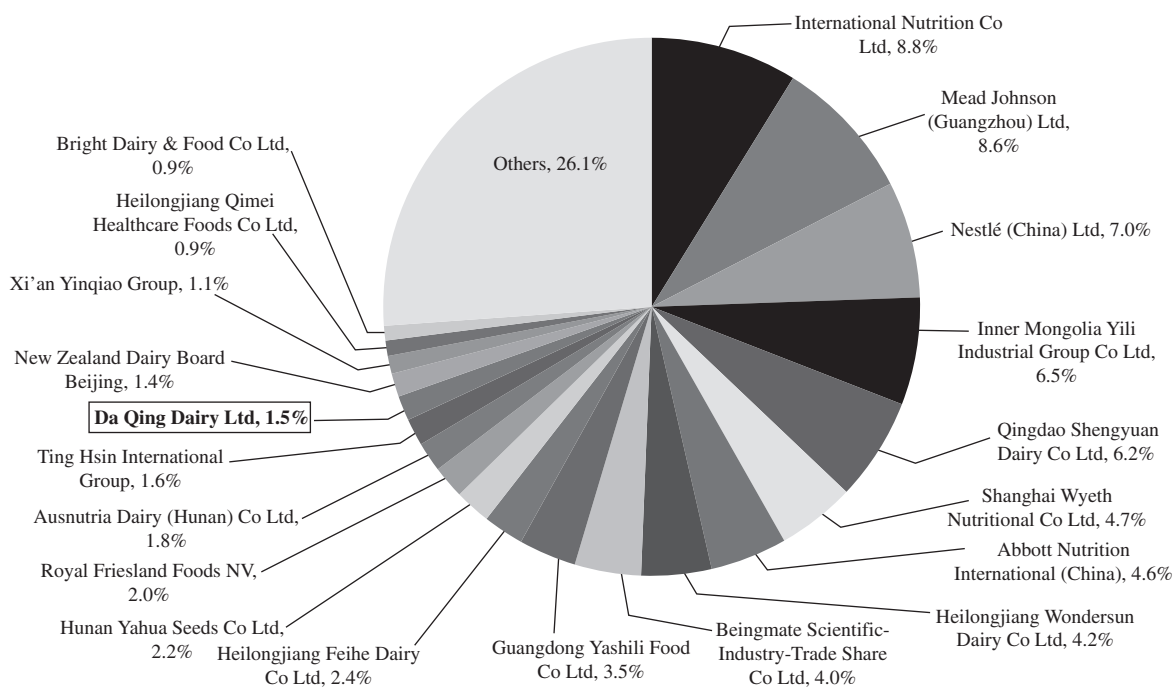
According to the Euromonitor International Report, we ranked ninth among the local brand owners in the Milk Powder market in China with a 1.5% of market share and 15th among the brand owners in the Milk Powder market in China (which comprised both foreign and local brand owners) with a 1.5% of market share in terms of sales value in 2009.

The top 14 Milk Powder producers in China in 2009 comprised leading foreign brands such as Mead Johnson, Dumex, Nestle, Wyeth and Abbott, and some local brands including Yili (伊利), Wondersun (完達山), Beingmate (貝因美) and Synutra (聖元). Our Directors believe that with approximately 40% of the retail sales value in 2009 constituted by a large number of smaller players, our position and competitive advantage (including stringent quality control system, high product quality, strong brand recognition and extensive distribution network) over these other players will enable us to capture an increasing portion of the market share in the Milk Powder market in China, which will reinforce our market position and increase our returns. While the market has yet to see a local Milk Powder manufacturer capable of overriding the leading global brand producers, our Directors believe this will provide us with opportunities to grow, to increase our market share and to further enhance our position in the market in China.

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The following charts illustrate the market shares of top 20 companies in the Milk Powder market in China (comprising both foreign brands ^(Note 1) and local brands ^(Note 2)) based on retail sales values in 2008 and 2009.

**Market shares of top 20 companies
in Milk Power market in China, 2008**



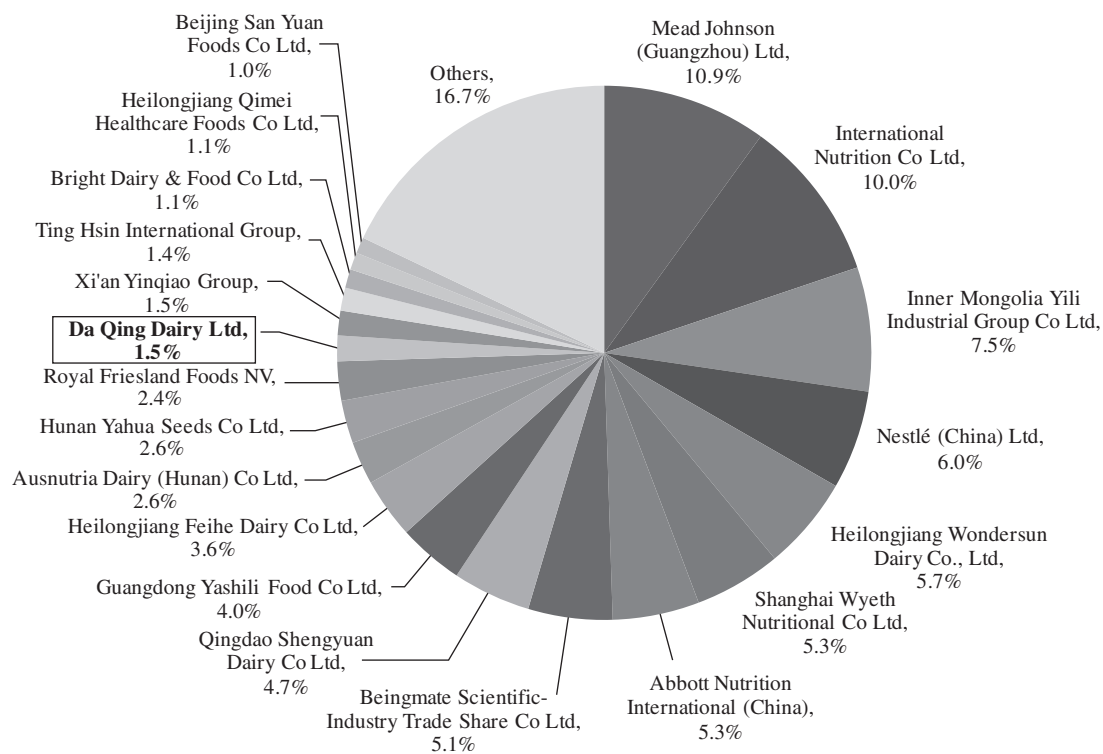
Source: Euromonitor International

Notes:

- (1) Foreign brands refer to brands that derive less than 90% of their retail sales value from China.
- (2) Local brands refer to brands that derive more than 90% of their retail sales value from China.

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**Market shares of top 20 companies
in Milk Powder market in China, 2009**



Source: Euromonitor International

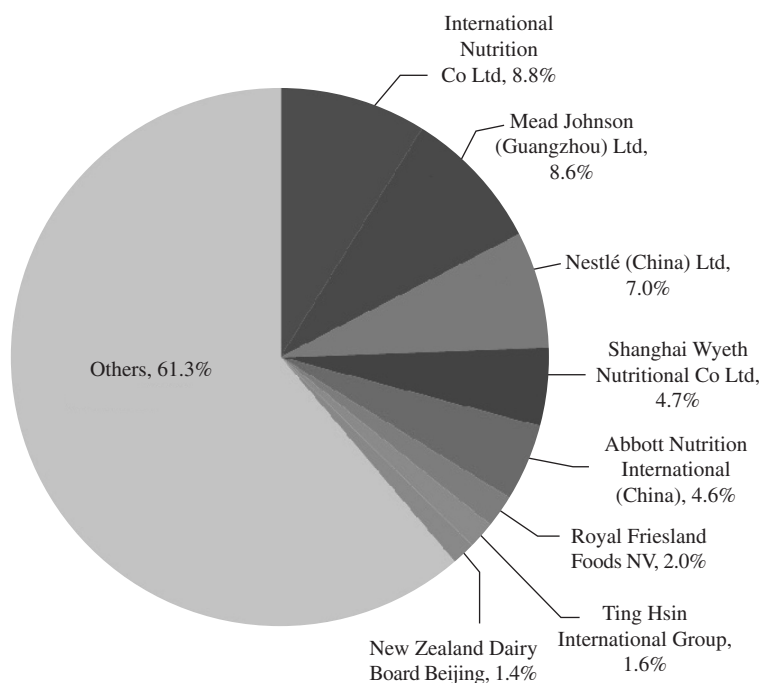
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Market Shares Of Leading Players Of Foreign Brands In Milk Powder Market

As leading players of foreign brands were not involved in the melamine scandal, the market shares are relatively stable. Most of the top leading players of foreign brands actually benefited from the scandal and increased their market shares. For example, Mead Johnson gained an additional 1.3% of market share in 2009.

The following charts illustrate the market shares of leading companies of foreign brands in the Milk Powder market in China in 2008 and 2009.

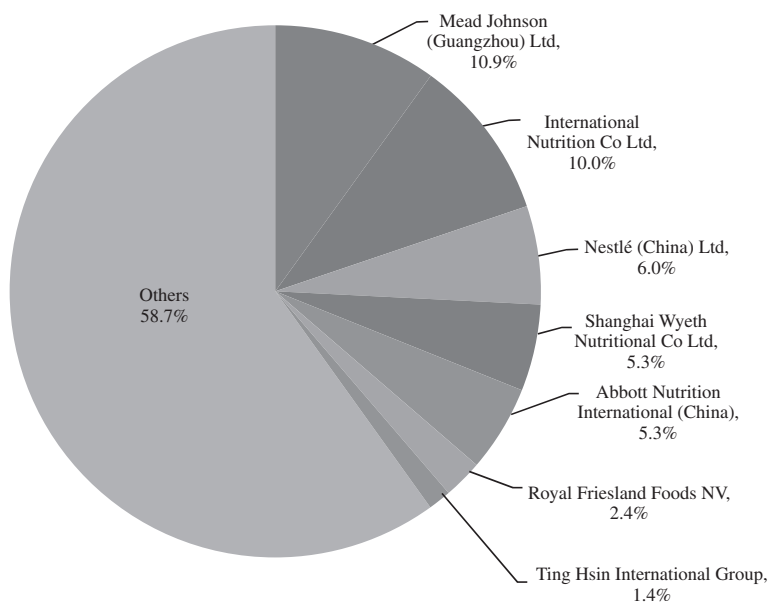
**Market shares of leading companies of foreign brands
in Milk Powder market in China, 2008**



Source: Euromonitor International

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**Market shares of leading companies of foreign brands
in Milk Powder market in China, 2009**



Source: Euromonitor International

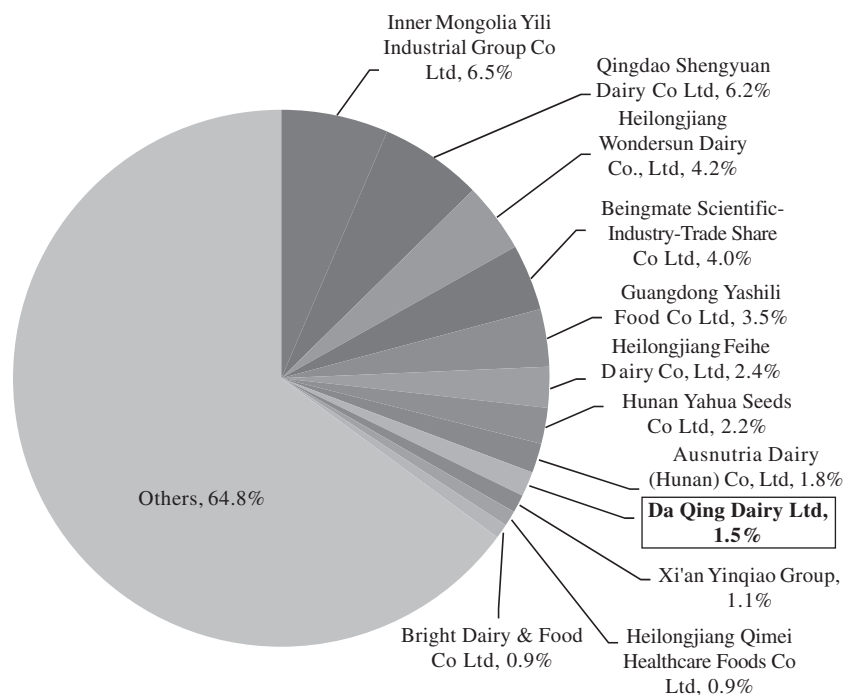
Market Shares Of Leading Players Of Local Brands In Milk Powder Market

Many local players enjoyed dynamic growth in 2009. For example, 黑龍江省完達山乳業股份有限公司 (Heilongjiang Wondersun Dairy Co., Ltd*) gained 1.5% of market share in China and 杭州貝因美集團有限公司 (Hangzhou Beingmate Group Co., Ltd*) gained 1.1% of market share in China. Notwithstanding the negative impact arising out of the melamine scandal, 內蒙古伊利實業集團股份有限公司 (Inner Mongolia Yili Industrial Group Co., Ltd*) recovered quickly in late 2008 and early 2009 by focusing on Baby Milk Powder and maintained a healthy growth in 2009. Other manufacturers such as 黑龍江飛鶴乳業有限公司 (Heilongjiang Feihe Dairy Co., Ltd.*) and 澳優乳品(湖南)有限公司 (Ausnutria Dairy (Hunan) Co., Ltd.*) also performed well in 2009.

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The following charts illustrate the market shares of leading companies of local brands in Milk Powder market in China in 2008 and 2009.

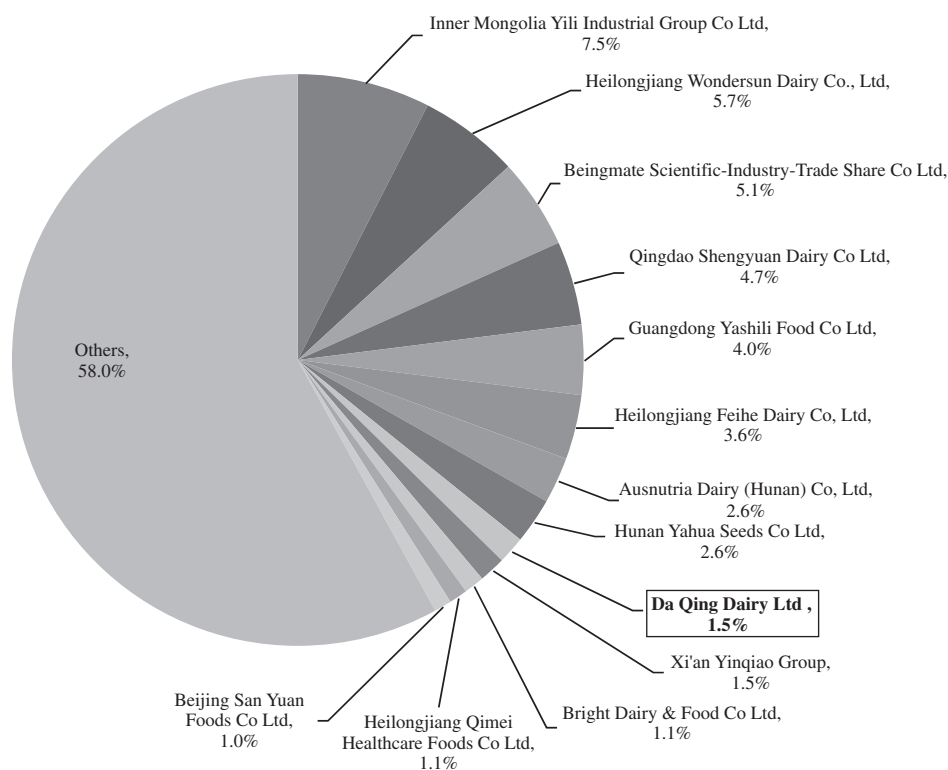
**Market shares of leading companies of local brands
in Milk Powder market in China, 2008**



Source: Euromonitor International

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Market shares of leading companies of local brands in Milk Powder market in China, 2009



Source: Euromonitor International

THE DAIRY INDUSTRY IN HEILONGJINAG PROVINCE

Heilongjiang province is located in the northeast of China and covers an area of 454,000 square km. It has 44.4 million hectares of soiled land with rich organics and 40% of which is suitable for farming. Heilongjiang province is one of the world’s three major black soil zones with 67.6% of its total farmland of 9.9 million hectares which is being cultivated on either black soiled land, marshland or black calcium soil. Furthermore, it has 4.3 million hectares of pastures and 4.8 million hectares of land reserved for farming. Heilongjiang province ranks:

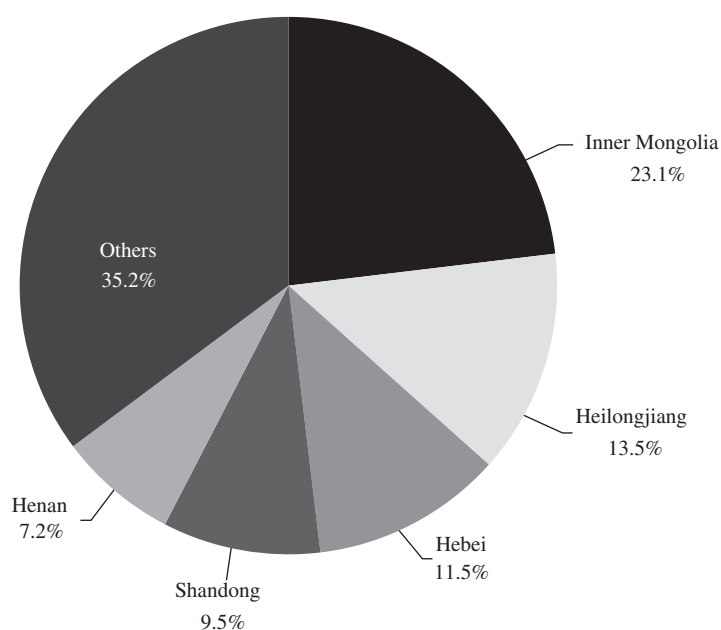
- first in China in terms of farmland and forest area;
- second in China in terms of land reserved for farming;
- forth in China in terms of land available for development; and
- seventh in China in terms of pasture area.

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According to the China Dairy Statistical Report, Heilongjiang recorded raw milk output of 5.3 million tonnes in 2009, which ranked second in China in 2009, representing 13.5% of the total raw milk output in China in 2009 in terms of volume. Furthermore, Daqing municipality, which is in Heilongjiang province and where we are located, ranked fifth among prefectural-level cities in China and produced approximately 1.3 million tonnes of raw milk in 2009, which represent approximately 25% of the total raw milk output in Heilongjiang province in 2009 in terms of volume.

The following chart illustrates the raw milk production output by provinces in China in 2009 in terms of volume.

Raw Milk Production Output by Provinces in China, 2009



Source: China Dairy Statistical Report

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The following chart illustrates the top five raw milk production prefectural-level cities in China in 2009 in terms of volume and Daqing recorded the highest growth in raw milk production in 2009 in terms of volume.

Top Five Raw Milk Production Prefectural-Level Cities in China, 2009

Prefectural-level cities/Provinces/Autonomous Regions	Production	% of total raw milk production output of provinces	% of change from 2008
	(’000 tonnes)		
Hohhot, Inner Mongolia Autonomous Region	3,052.9	33.5%	-21.7%
Tangshan, Hebei province	1,677.3	37.2%	10.2%
Baotou, Inner Mongolia Autonomous Region	1,439.0	15.8%	10.0%
Harbin, Heilongjiang province	1,380.8	26.1%	4.5%
Daqing, Heilongjiang province	1,327.0	25.1%	16.9%

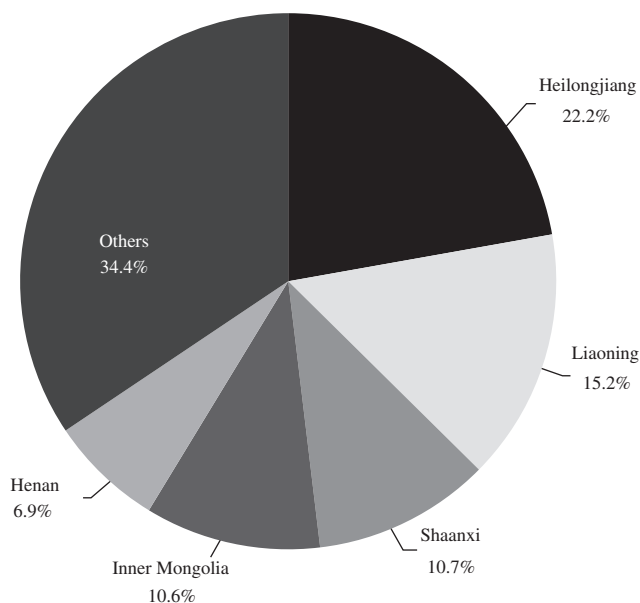
Source: China Dairy Statistical Report

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Heilongjiang province ranked first in China in 2009 in terms of dehydrated dairy production output, representing 22.2% of the total dehydrated dairy production output in China in 2009 in terms of volume. Dehydrated dairy production output refers to dairy products formed by dehydration process such as milk powder, hard cheese and butter other than liquid milk.

The following chart illustrates the dehydrated dairy production output by provinces in China in 2009 in terms of volume.

Dehydrated dairy production output by provinces in China, 2009



Source: China Dairy Statistical Report