

Deyu Agriculture Corp. is a vertically integrated agricultural value chain from farmland to consumer market, which produces, processes, markets and distributes organic and other agricultural products made from corn and grains operating in Shanxi Province in China. The Company has access to over 109,000 acres of farmland in Shanxi Province for breeding, cultivating, processing, warehousing and distributing grain and corn products. **Deyu Agriculture Corp.** has an extensive wholesale network in over 15 provinces and a retail distribution network of approximately 20,000 supermarkets and convenience stores in 29 provinces across China. **Deyu Agriculture Corp.'s** facilities include sophisticated production lines and modern warehouses with a total production capacity of over 105,000 tons for grain products, storage capacity of over 100,000 tons and annual turnover of 700,000 tons for corn products. The Company's website is located at www.deyuagri.com.

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Grain Market Dynamics in China

HIGHLIGHTS

- THE TOTAL GRAIN OUTPUT IN CHINA IN THE FIRST HALF OF 2012 REACHED **129.95 MILLION TONS** (2.8% YEAR ON YEAR INCREASE)¹;
- CHINA IS ANTICIPATING A 9TH CONSECUTIVE YEAR OF GROWTH IN 2012, WITH TOTAL GRAIN OUTPUT OF **571.21 MILLION TONS** IN 2011;
- GRAIN PRICES IN CHINA IN JULY 2012 WERE **UP 3% YEAR ON YEAR**²;
- CHINA HAS BEEN MAINTAINING A SELF-SUFFICIENT GAIN STRATEGY; **95% OF RICE AND WHEAT HAS BEEN PRODUCED DOMESTICALLY**;
- FROM JANUARY TO JULY 2012, CHINA HAS IMPORTED **8.68 MILLION TONS** OF GRAINS AND GRAIN POWDERS;
- IN 2011, PER CAPITA DISPOSABLE INCOME OF URBAN HOUSEHOLDS IN CHINA WAS **US\$ 3,500** (TOTAL INCOME US\$ 3,850), WHICH CONSTITUTES 14% YEAR ON YEAR GROWTH.

China's total grains output has been on a steady rise starting from the year 2004 (2.8% increase in the first half of 2012 compared to 2011, according to Xinhua Insight). Despite a decrease in the grains output among the world's major exporters, such as the United States and Russia, due to the extended drought, China's domestic grain market has remained strong. Reasons for the increased grains output include the following:

- strong market demand;
- government incentives to increase acreage and improve yield;
- as well as good weather³.

The government incentives boosted the enthusiasm of farmers in China, resulting in increased grain production. Besides that, China will continue to implement national objectives to ensure adequate calories for their population and maintain self-sufficiency in rice, wheat and corn. To resist the global grains prices' fluctuations, 95% of rice and wheat has been produced domestically in the recent years.

China prides itself on being the world's largest grain consumer and producer in the world. Its major products are rice, corn, wheat, and soybean. Almost 90% of corn is used in China as feed and for industrial production of sugar, starch and biofuel. This year, however, corn crop may be smaller than expected due to the large damage from armyworms⁴. China has transformed from a net exporter of corn into a net importer of corn.

The domestic production and consumption of rice, as well as exports, have been on a rise in the recent years, although it suffers significantly from the cheaper imports from the nearby countries. As for the wheat consumption, due to the change of preferences and the decline in the demand for traditional wheat products in favor of convenient foods, the wheat quality has becoming more and more of a factor millers have to pay attention to. This is due to the fact that unlike the traditional Chinese food products, the wheat flour for the processed foods requires specialized gluten content and consistent quality.

Along with the total grains output in 2012, the grain prices were up 3% year on year (Xinhua Insight). Many small and medium-size enterprises are facing difficulties, as cheaper rice is being imported from Vietnam and Pakistan to China, creating obstacles for those enterprises to compete domestically. And despite the price stability of most grain products, China has seen an increase in the prices of corn, soybean and edible oils, which made Chinese grain products more expensive in the other countries. In order to achieve the continued growth and expansion in the grains industry in China, the country should maintain a balance in total grain production; attend to the grain production structure; avoid relying exclusively on imports; make innovations in agricultural technology and systems.

¹ "Xinhua Insight: China's grain market remains stable amid global fluctuations". English.news.cn

² "China Latest Economic Indicators". All China Marketing Research. China Periodical. Record Number: 2012 IIS 6330-P1.

³ "USDA Foreign Agricultural Service. GAIN Report". Prepared by K. Latner and J. Jiang. 3/1/2007. All data for this newsletter is taken from the GAIN Report unless is stated otherwise.

⁴ "China's Corn Harvest Set for Smaller Increase on Pest Attack". Bloomberg.