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Approved by:

LaVerne E. Brabant
ATOBEIJING

Prepared by:

Han Mei, Xu Min, Vivian Xian, Hu Jiali

Report Highlights: China's booming Hotel Restaurant and Institutional (HRI) sector which emerged from a mere handful of government-operated cafeterias in the late 1970s was valued at more than \$139.8 billion at the end of 2007. The sector is characterized by a highly diverse and evolving mix of national and regional food and lodging options fueled by China's rapidly growing urban consumer affluence and international exposure. Affluent urban consumers demand for healthier, faster, and safer meal solutions as well as clean, affordable lodging continues to shape the market. In Emerging City Markets (second and third-tier cities), and home to millions of affluent consumers, many of whom are trying Western and imported food for the very first time is also driving demand. The 2008 Beijing Olympics and 2010 Shanghai World Expo represent new milestones for the HRI sector as China prepares to meet the demand of millions of international and domestic visitors over the next few years.

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Section I. Market Summary

Summary – A Changing Economy

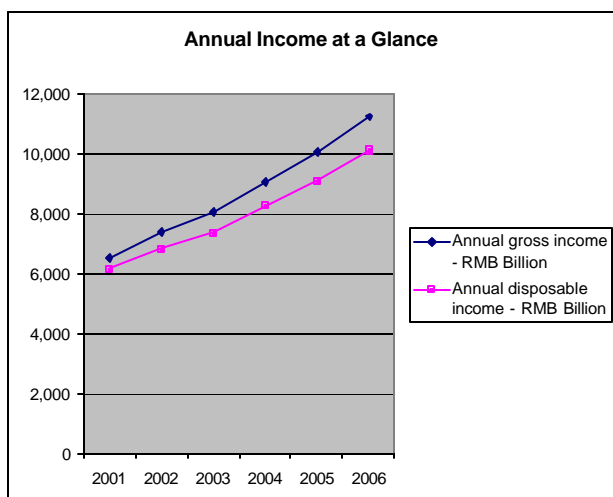
China's domestic HRI sector first opened to international investment and domestic privatization as a result of Reform and Opening policies implemented in the late 1970s. In the intervening decades, China's HRI sector has evolved and developed swiftly, thanks in large part to expatriates, and overseas Chinese entrepreneurs who were a part of China's economic miracle of the last 25 years. International hotels, world-class restaurants, and high-end foodservice options all emerged to meet growing demand fueled by working professionals in urban China. Expatriates, international and domestic tourists, officials on expense accounts and an ever-growing cadre of affluent, middle-class consumers have driven more than two decades of uninterrupted HRI sector development.



In recent years there has been a significant shift in the pattern of HRI consumption. Today, China's wealthy, and urban consumers are the primary demographic targets of star-rated hotels, upscale restaurants, and other foodservice operators. However, China's growing middle-class is now consuming at near international levels, and the proportion of the middle-class compared to the total consumer base continues to grow rapidly. Based on official 2007 statistics, urban per capita disposable income rose 10.4 percent over 2006 to \$1,469. The number of urban households with yearly incomes greater than \$5,000 is expected to grow by nearly 25 percent annually over the next several years, potentially creating millions of new middle-class Chinese consumers. Nearly 6 million Chinese households already enjoy "Western" levels of disposable income with annual disposable income exceeding \$10,000. Disposable income is expected to continue rising over the next ten years. In just a little over 20 years, per capita GDP rose from RMB963 (\$107) in 1986 to RMB16,804 (\$2,010.5) in 2006, or 16 times the increment and is expected to reach \$3,558 by 2010.

Growing Middle Class

The number of Chinese middle-class consumers, defined as those with annual household income between RMB60,000 (\$7,322) to RMB 500,000 (\$61,016), range between 200-500 million based on A.T.Kerney, Inc. and Euromonitor International estimates. Consumers in the highest income tiers increasingly demand high quality luxury goods and analysts expect mid to high-end Chinese consumers to spend more than US\$650 billion on food alone by 2017. Most of China's middle-class lives in urban areas concentrated in Beijing, Shanghai and cities along the Yangtze River, as well as cities along Guangdong province's Pearl River Delta. Large urban centers such as Shanghai and Beijing had above average per capita dining out expenditures. Shanghai ranked as number one with more than double the national average at \$232 (RMB1,722). Beijing and the overall average for Guangdong Province tied for second place with average per capita dining out expenditures of US \$178.2 (RMB1,319). Due to the rapid rise in GDP over the last five years, consumer confidence continued to grow along with their wallets, producing marked increases in average consumption expenditures in restaurants. Between 2003 and 2006, consumer expenditures on food jumped over 17 percent.



Source: China Statistical Yearbook

As disposable incomes rise, the younger generation and their families prefer to celebrate holidays and personal milestones going out to eat in restaurants or hotels. While time and effort savings associated with dining out is important, Chinese view dining out as a way to establish as well as maintain close personal and professional relationships. Dining establishments with nice ambiance, prompt service, and high quality food – especially those offering imported food and alcoholic beverages, dessert and coffee. Hotels and restaurants often offer special holiday menus to attract families, couples, and businesspeople throughout the year. During traditional festivals such as Lunar New Year and Mid-Autumn (moon) Festival, reservations are often made 2 to 3 months in advance in stand-alone restaurants as well as hotels.

What Drives the Market?

The predominance of local consumers in the Chinese HRI Market means cultural factors play a major role in determining consumption patterns. In 2007 the Chinese Zodiac had a large influence on wedding banquets and other high-end dining out as it is believed that those born in the 'Year of the Pig' will get rich easily. As a result, many couples married in 2006, hoping to have children in 2007. This phenomenon boosted the food service sector since 2006 and continues to create additional market opportunities. The wedding industry has become a multibillion dollar industry in China and prior to couples tying the knot, they plan an once-in-a-lifetime event, which often includes an extravagant ceremony and banquet. The wedding industry combined with generally rising incomes has had a highly positive impact on China's HRI Sector, creating niche market for hotels, restaurants, and caterers.

The country's one-child policy is also increasingly influencing the dining out preferences of Chinese families. Chinese are notorious for spoiling only children, and many select restaurants based on the preferences of the child. International quick service restaurants (QSR) such as McDonald's, and KFC have succeeded in capturing market share by offering playgrounds, children's menus, toys, and birthday party packages designed to win the hearts and stomachs of young consumers. However, parents are also increasingly conscious of health and food safety considerations when selecting meals for their children, affecting QSR and school foodservice providers rather significantly in recent years.

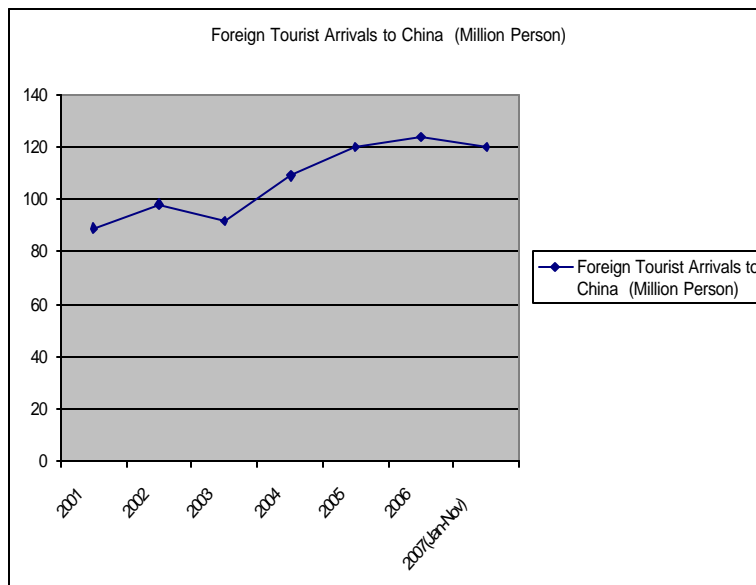
Banquets and working dinners are a central part of the Chinese business culture, and represent a large segment of China's HRI sector. This is particularly true in Beijing, where businesspeople with large expensive accounts host officials and other decision makers to extravagant meals. Seeking to impress a clients or potential partner, it is not unheard of for these meals to cost thousands of dollars at a single sitting at high-end restaurants. As a rule, these customers are not price sensitive, since meals are on an expense account. However, these patrons often demand very private, peaceful, and comfortable dining environments, high-quality menu items and presentation along with a good selection of domestic and imported beverages, often with private parking spaces or entrances.

Despite the sophisticated nature of Chinese cuisine at many traditional restaurants, shortcomings persist in presentation, nutrition, ingredient quality and preparation. Also the

definition of healthy food is changing which can include: organic, hormone-free and fat-free, with special attributes such as high in antioxidants, omega-3, and rich-in-fiber. In recent months, it's not just what is excluded from a food offering or dish—fat, calories, sodium, sugar—but what is included that makes it perceived as healthy. Well-heeled Chinese in first-tier cities like Beijing, Shanghai, and Guangzhou continue to seek new and stimulating food experiences. The number of restaurants featuring international and fusion cuisine is also on the rise, with an estimated 1,350 restaurants serving international cuisine in Beijing; 1,600 in Shanghai; and more than 3,000 in Guangzhou. Affluent white-collar workers, professionals, and expatriates increasingly demand ambiance, décor, music, knowledgeable wait staff, exotic aromas, domestic and imported wine lists along with other healthy or fresh fruit based beverages in addition to good food – in short, a lifestyle experience.

International Influx

Accession to the WTO has benefited Chinese industries across the board, with gradual removal of market barriers and trade restrictions creating increased competition among domestic and foreign operators. The thousands of international citizens working in and traveling through China continue to significantly influence the HRI food service market. Demand for high quality food products which meet stringent food safety standards is rising due in part due to China's hosting of the 2008 Olympic Games in Beijing, and 2010 World Expo in Shanghai. In addition, a large number of expatriates, international visitors, and returning Chinese scholars come to China each year. Official figures suggest that more than 2 million foreign passport holders were working in China during 2006, with an additional 5 million visitors arriving for business and conferences. These international customers continue to inspire and influence the tastes of the wealthy, as well as erudite and hip young Chinese.



Source: China Statistical Year book

Current predictions estimate that by 2020, China will be the number-one tourist destination in the world with over 130 million international visitors annually. This trend is particularly noteworthy given China's international tourism industry only began in the late 1970's. Nearly 20 years after China opened its borders to global visitors, 22.21 million foreign visitors and tourists (excluding Hong Kong, Macao and Taiwan) collectively spent nearly \$30 billion.

In addition to international visitors, Chinese are increasingly able to travel within China: 744 million Chinese traveled domestically in 2000 and this number exceeded 1.4 billion in 2006, nearly doubling the amount of domestic tourists in just 6 years. As China's economy grows, business travel is also on the upswing, creating increased demand for travel accommodations. Rising incomes mean that every year more Chinese join a growing middle-class that can afford to travel. As a result, the government has boosted leisure travel by loosening travel restrictions and introducing a five-day workweek and additional vacation time. The Golden Week holiday is the peak domestic travel time during October 1st National Day holidays with the elimination or reduced May Day or International Labor Day holiday to

just one day. However, a number of new traditional Chinese holidays have been added to the list of official including Chingming, Duanwu, and Mid-Autumn Festival that will no doubt create even greater multipliers for the industry since holidays provide a big boost to domestic travel and dining out. To encourage domestic tourism the government is upgrading travel-related infrastructure such as roads, seaports, airports, and tourist sites. As China continues to open, develop, and maintain a strong growth trajectory, urban living standards continue to improve, and create many new HRI sector opportunities.

Major events like the 2008 Beijing Olympics and Paralympics as well as the 2010 World Expo in Shanghai, continue to create a favorable environment for HRI sector expansion in China. In addition to the many new hotels scheduled to open in 2008, the Olympic Village expects an estimated 17,000 visitors, including a permanent population of more than 10,000 residents. Round-the-clock catering services for the Olympic Village and Media Villages will span some 45 consecutive days, leading up to, during, and beyond the Olympic Games.

Food Safety Concerns

More than 95 percent of Chinese consumers rank food safety as a “very important” in shaping their food purchasing behavior. Food safety has become a major public concern here over the past few years as a number of food product and contamination cases have surfaced in the media. These range from parasite-infected snails, to antibiotic residue in fish, to poultry and egg contamination with Sudan Red dye – reportedly fed to chickens so they would produce red egg yolks. These and other health scares have brought greater scrutiny and tighter controls on food products and food safety. Reportedly, 621 food production licenses of 564 producers were revoked in an effort to improve food safety in 2007. In September 2007, the government launched a national campaign to improve food safety in the catering sector, focused on school dining hall and small restaurant inspections in particular. The website www.51trace.org was created to trace food product origin as well as provide food safety alerts and updates. Food product health and safety scares have served to create strengthened consumer awareness about food safety, and food origin, which could potentially be a boon for some food exporters since imported food and beverages, including wine, from the United States generally enjoy a good reputation for meeting high quality and product safety standards. However, given the new levels of awareness and product perception on the part of the consumer, new market rules continue to evolve.



While there has been some debate in the international press about food safety measures for the Olympic Games, the government here has implemented a strict tracking system designed to secure the safety of ingredients during the production of food supplies. In addition, procedures require samples of all food to be used be inventoried for possible further testing as necessary. More than 350 ingredients that fall under the 10 basic food categories for the Olympic Games are under government supervision and inspection by the Beijing Food Security Office (BFSO), with food suppliers selected required to use highly strict standards mandated by the BFSO. Based on post's observation, the designated Olympic hotels food supply, including meat, vegetables, packaged food and beverages are under scrutiny from point of production to delivery to ensure food safety and security. The tracking system is expected to provide maximum food safety for hotel guests during the Olympics, and beyond.

B. Sub-Sector Profiles

1. Hotels and Resorts

The World Tourism Organization (WTO) estimates by 2008 China will exceed Spain as the world's second most popular travel destination, and by 2010 become the world's most popular. Despite continuing appreciation of Yuan values since 2006, the value of China's inbound tourism increased more than 6% to \$34 billion. In 2006, 2.6 percent of the value of China's FDI was invested in the HRI sector or 1,060 HRI projects.

China's Hotel Companies at a Glance:

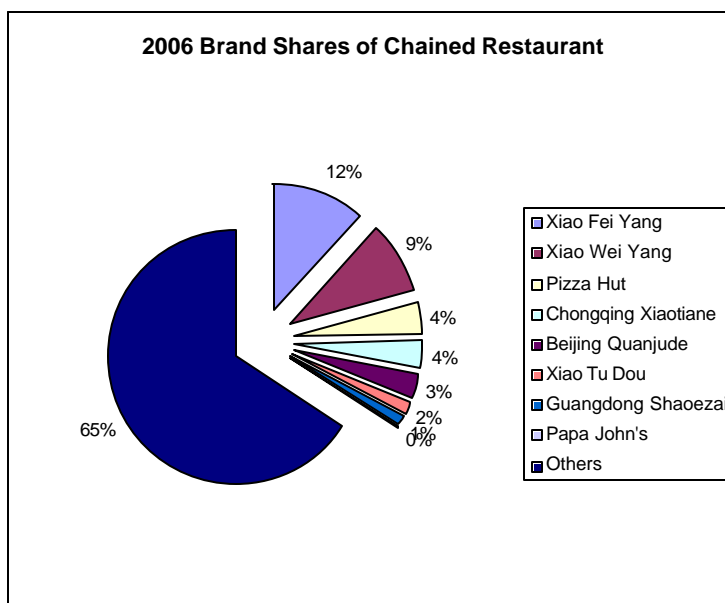
Enterprise	# of Corporations	# of Establishments
Domestic	9,396	11,254
Hong Kong, Macao and Taiwan	484	577
Foreign Funded	389	440
Total	10,269	12,271

Source: China Commerce Year Book 2007

The 2008 Beijing Olympics and 2010 Shanghai World Expo have inspired China's hotel industry to embrace new market opportunities. As of September 2007, UK based Inter-Continental Hotels was the most ambitious player in China with a portfolio that includes 51 hotels with plans to develop 74 more by 2008. Hong Kong Shangri-La Group has 20 properties and plans to develop 17 more by 2008; Marriott has 26 hotels and plans to grow its holding to 35 by 2008, 10 in Beijing alone; French Accor Group has 30 hotels scheduled to open prior to the 2008 Olympics. In 2006, Beijing's five-star hotels daily room revenues averaged \$150 with occupancy rates above 76 percent, the highest levels in nearly 15 years.

Vocational training continues to bring services to an international level; increasingly, this training is being strengthened to meet growing the demand for food service industry staff. Most multinational hotels continue to use value-added products, although purchasing managers and executive chefs are highly price sensitive. Traditionally, food imports make up 30-50% of the value of food purchased by internationally managed five-star hotels although this varies from region to region in the large and highly diverse China market.

Many hotel chains are state-owned, but market pressures are forcing improvements and modernization of management including efficient and profitable food service operations. However, these hotels traditionally focus their food service on Chinese cuisine, depending mostly on locally grown products and ingredients. As a result, Chinese-managed five-star hotels, private and state owned, purchase far less imported food than international hotels, which consume an average \$350,000 of food imports annually. Internationally branded hotels cater to a more diverse clientele and provide multiple dining options including international cuisine. In major business and tourist



Source: China Statistical yearbook 2007

destinations such as Beijing, Shanghai, Guangzhou, Chengdu, Hangzhou, Xiamen, and Xi'an, hotels purchase larger volumes of imported food items to satisfy business and their international traveler based business.

2. Restaurants

Geographically large and regionally diverse, China has very distinct local and regional preferences for food and flavor. Culinary styles differ widely by city, which necessitates regionally tailored product marketing strategies and effort. Among domestic consumer foodservice players, numerous well-known, distinctive local brands exist. However, only a handful of national brands that provide specialty foods enjoy widespread acceptance. Some of these include: Quanjudu Roast Duck headquartered in Beijing; Xiaonanguo and YuanYuan in Shanghai; and Xiaofei yang based in Inner Mongolia. Full-service restaurants are well positioned in East and Northeast China. In addition to domestic food service players, increasing exposure and interest in foreign culture and travel means consumers are often curious to try new Western-style foods. However, it is important to be aware of regional diversity when entering the China market, which in fact is a series of many markets.

A New Dining Lifestyle

China's HRI sector represents a mix of different food trends, and regional differences in first-tier cities are diminishing. Business visitors, tourists, students and expatriates have all contributed to the creation of a diverse, international dining culture. Many high-end restaurant chefs do not limit their creations to local products, evidenced by the widespread use of items such as *foie gras* and snow crabs. In fact, it is not uncommon for high value food and beverage imports to top the list on upper-end restaurant menus.

Affluent white-collar workers enjoy dining in international hotels or stand-alone restaurants featuring American, French, Italian, Thai, and other international cuisine to satisfy adventurous food cravings. The Cuisine, restaurant, and ambiance are important in drawing affluent and often young consumers to these eateries. Some wealthy Chinese also like to share or enjoy such dining experience with their children. According to one local mother, "We like to go take our son to try different international cuisines as it is a good experience for him, he needs to experience different cultures and foods is one of best and fun way to do so."



Rising consumption, preferences for dining options, excellent service and stylish ambiance has significantly given full service restaurants and cafés/bars a boost across much of China. The number of specialty coffee shops and cafés continues to grow rapidly. In addition, the popularity of premium restaurants in Beijing, Shanghai, and Guangzhou illustrates increasing preference for dining options that provide more than just good food. Café and bar chains, international and domestic, have been able to offer consistency and quality of food sought by consumers, leading dynamic growth in consumer foodservice outlets in China. For example, Starbucks, offers ambiance, aroma and comforting background music. Wireless Internet access and comfortable seating encourage affluent clientele to leisurely enjoy their time while sipping coffee. Among young urban Chinese and expatriates, it is fashionable to meet friends in cafés rather than quick service or other restaurants, with places like Starbucks often a landmark or meeting point. Premium restaurants are another form of lifestyle consumption as diners enjoy delicious meals in lavish environments that may include designer lighting, an intimate atmosphere and high level of personal service.

Emerging middle and upper class consumers, now largely confined to a few major cities, continue to expand inland. Rising incomes in China have consistently produced interest in restaurants and cafés that offer more than just traditional food and beverage options. The appeal of dining options which offer superior food in a stylish setting is increasingly very widespread, continuing to create a market for high-quality food products that should continue to expand with China's development.

3. Fast Food



While fast food is often perceived as unhealthy by many consumers, it continues to enjoy significant growth in China. Snack foods sold by street vendors, around for centuries, these continue to decline in number given rising food sanitation-safety concerns. Longer working days in urban environments minus traditional leisurely lunch breaks have resulted in some Chinese consumers turning to fast food, which provides both quick, sanitary food. Fast food sales values increased more than 10 percent reaching RMB318 Billion (\$43 billion) in 2006. More than 985,000 fast food outlets were reported in 2006, which represents an increase of 7 percent over the previous year. The accelerating pace of life, especially in urban areas, continues to squeeze consumers for time, and consequently quick service restaurants (QSR) are able to provide clean, fast, and inexpensive dining out options.

Top 20 Chained Fast Food Brands in China, 2006

Rank	Brand	Company
1	KFC	Yum! Brands Inc
2	McDonald's	McDonald's Corp
3	Dicos	Ting Hsin International Group
4	Café De Coral	Café de Coral Holdings Ltd.
5	Ajisen	Ajisen Ramen Chain
6	Malan Lamian	Malan Lamian Fast Food Chian Co. Ltd.
7	Daniang Dumpling	Jiangshu Grand Mother Dumplings
8	Laobian Dumplings	Shenyang Laobian Dumplings Co. Ltd.
9	Haagen-Dazs	General Mills Inc
10	Mian Dian Wang	Shenzhen Mian Dian Wang Foodservice Co Ltd
11	Lian Hua	Shanghai Lianhua Supermarket Co Ltd
12	Yong He King	Jollibee Foods Corp
13	Dairy Queen	International Dairy Queen Inc
14	TCBY	TCBY Enterprises Inc
15	New Asia Snack	Shanghai Xinya Dabao Co Ltd
16	Baskin-Robbins	Dunkin' Brands Inc
17	California Beef Noodle King	California Beef Noodle King Co Ltd
18	Kedi	Shanghai Bright Dairy & Food Co. Ltd
19	Burger King	Burger King Holdings Inc.
20	Yoshinoya	Yoshinoya D & C Co. Ltd

Source: Euromonitor International 2007

Successful fast food operators like KFC and McDonalds created breakfast menus to cater to many white-collar workers who are strapped for time and often do not prepare breakfast before leaving for work. Instead of going hungry, many consumers enjoy a quick, hygienic, and nutritious meal from one of these restaurants. In November 2007, KFC China opened its 2000th KFC outlet in Chengdu. Since the first KFC opened in 1987 in Beijing, the number of KFC outlets has continued to expand from 100 in 1996 to 500 in 2001 and to 1,000 in 2004.

Currently, KFC opens 1 new KFC outlet daily in response to the rapidly and rising demand for convenience across most of China's urban and Emerging City markets.

While Asian fast food offerings continue to dominate the market, with its sales value representing approximately 70 percent of the total in 2006. Competition among fast food operators has become increasingly fierce in some large urban cities; forcing market leaders to expand into smaller cities and inland areas. Beginning in 2006, QSR giant KFC has lowered its franchising fee in order to encourage openings in smaller cities.

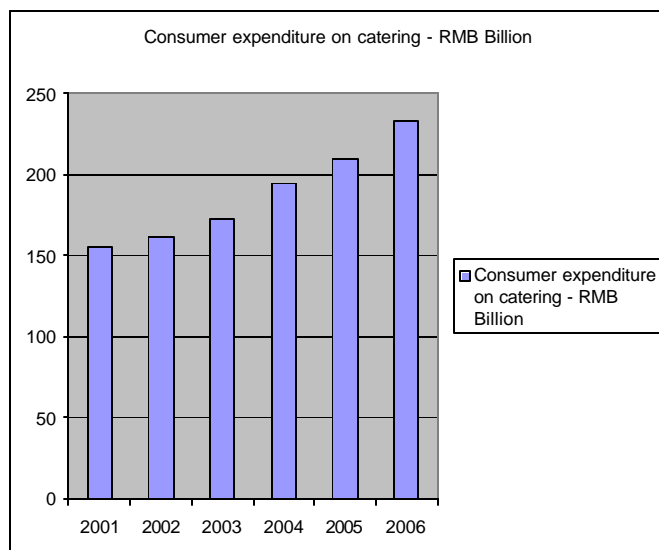
Nutrition and health are major trends in the HRI sector including quick service restaurants (QSRs). With consumers increasingly aware of health implications related to consumption habits, QSR operators have had to adapt to consumer demand for more nutritious product offerings. In a move to offer healthier food, KFC launched a successful deep-sea cod promotion in 2007 followed with a promotion using Alaskan Salmon nuggets in December.

The ability to incorporate local flavor is key to success for international fast food players. In 2005, Yum! Brand's (KFC, Taco Bell, and Pizza Hut) first Chinese-style fast food outlet made its debut in Shanghai under the 'East Dawning' brand. The new QSR focuses on Chinese and Asian-style snacks, desserts and recipes that provide the distinctive taste of Chinese-style fast food. The restaurant also offers a clean and modern environment, and the convenience and speed of service characterized by Western fast food outlets. KFC also has had good success with incorporating Chinese elements into its menus to cater to Chinese tastes. Capturing multiple consumer segments such as those who prefer Asian-style fast food had enabled Yum! Brands to maintain its market leader position in China's fast food environment.

4. Institutional Food Service

Catering to the Masses

Growth in the catering market segment has consistently been in double-digits territory over the past 15 years as consumer expenditures climbed nearly 35 percent from RMB 173.6 billion in 2003 to RMB 233.7 billion in 2006. Traditionally only hospital, government, school, transportation and airline employees were served by institutional



foodservice. However, in the past few years, institutional foodservice continues to expand into high-end office complexes and private companies. Due to consumer demand, the institutional foodservice industry increasingly has had to meet rising hygiene, convenience, quality and nutrition standards. China's catering sector continues to expand and is on the verge of a boom.

Modern Chinese culture increasingly accepts the practice of catering corporate, personal, and social events. This option is easy, convenient, and a timesaving alternative to self-preparation, and often provides better

service than restaurants. Nevertheless, the Chinese tradition that dictates royal treatment for guests, expansion in the high-end catering market segment has been slower than expected, and remains stigmatized by the perception of association with lower-end food service options. However, these perceptions are changing, and high-end catering options continue to improve as well as a few equated with premier quality food service.

In 2006, as much as 40 percent of HRI revenues came from institutional food service. Working lunches, student meals, office and factory worker catering services, travelers, conferences, exhibitions and other public and private events make up this growing HRI segment. Based in Shanghai, FU JI Food and Catering is one of the largest, and most successful domestic caterers in China. Listed on the Hong Kong Stock Exchange, the company reportedly doubles its revenues each year. Other major international catering players in this market include: Eurest; Sodexho, Gate Gourmet and Aramark (official caterer for the 2008 Olympics). The 2008 Beijing Olympic Games are an opportunity to take institutional food service in Beijing, if not China, to its next stage of development.

It is estimated there are as many as one million domestic catering businesses in China, although a majority are small. In Shanghai, catering companies with annual revenues above \$10 million continue to emerge. Local surveys indicate 80 percent of consumers would like to try catered food or catering services, if the food offered is healthy, prepared according to industry standards, and convenient. As international players enter the Chinese food service market, it is critical they understand the pitfalls, including the absence of regulations and standards in the current environment including a lack of transparency in such areas as contracting, food safety inspection, and taxation.

5. Coffee/dessert shops

Coffee and desert shops, relatively new in China, are often popular in first-tier cities like Beijing, Guangzhou, Shanghai, and increasingly second-tier Emerging City markets (ECMs) like Hangzhou, Tianjin, and coastal cities. Some of specialty café's or shops may be suitable venues to promote high-value food products given Chinese consumers continue move up from price to brand recognition as a trigger for purchasing or consuming products for reasons often related to status or quality of life.

Westernization of diet and consumer composition, especially with growing numbers of expatriates and overseas Chinese or returnees settling in major cities continues to fuel interest in the cafe culture. Growing affluence has also fostered increases in the number of consumers willing to regularly pay a premium for a comfortable environment for social gatherings to enjoy coffee, dessert or ice-cream with friends, colleagues or family. The key to success for café's in the China market is location, location, and location. International coffee and dessert shop chains like Starbuck's and Haagen-Dazs keep a careful watch on consumers willing to pay both a premium as well as purchase products on a regular basis.



C. Regional Market Profiles

Beijing Market Summary

Beijing is the capital of China, a major business hub, and a popular tourist destination. The city's total population reached 15.8 million in 2006, of which 13.3 million live in urban areas and the remaining 2.5 million classified as rural residents. Beijing is also one of the largest

and wealthiest cities in China with a per capita disposable income of nearly \$2,600 in 2006. Over the past five years, Beijing's GDP grew 12.1 percent on average, reaching over \$100 billion in 2006. Beijing's per capita GDP in 2006 was RMB 50,467, equal to \$6,210, placing it just behind Shanghai, which enjoys the highest purchasing power in China. In 2006, the average annual per capita dining out expenditure exceeded RMB1, 320 (\$178.4).

Conferences, business meetings, corporate and diplomatic events that take place in an international capital like Beijing set the stage for billions of RMB spent on business lunches, dinners, banquets and snacks each year. Increasing international interest in China and a concentration of must-see historical and World Heritage sights drew more than four million international tourists to Beijing in 2006 alone, reportedly generating \$4 billion in total tourism revenues. The Beijing Municipal Tourism Administration reports that 132 million Chinese visitors from every corner of the country visited the nation's capital, spending an additional \$20 billion in Beijing. Economic development and international exposure has translated into an increasingly sophisticated and adventurous clientele frequenting the city's ever-expanding list of diverse, upscale and new to market HRI venues.

Beijing HRI Sector Reviews by Sub-Sector		
Sub-Sector	Registered Companies	Business Revenue
Hotel (Yearly sales over 5 million RMB)	837	23.7 Billion RMB
Restaurant (Yearly sales over 2 million RMB)	1126	12.8 Billion RMB
Fast Food / snack counter (Yearly sales over 2 million RMB)	86	3.8 Billion RMB
Institutional (Yearly sales over 2 million RMB)	35	273 Million RMB
Source: <i>Beijing Statistical Yearbook 2007</i>		

Beijing also shares close ties with many emerging cities in North China – particularly Tianjin, Qingdao, Shenyang, Dalian, and Harbin. These nearby cities are increasingly affluent major domestic tourist attractions poised for HRI sector expansion. Interviews indicate distribution networks of international food distributors have expanded over the last several years in servicing four and five star hotels throughout North China. Cuisine styles such as fusion or the 'Chinese Kitchen' styles using US food products are on the rise. ATO Beijing has developed partnerships with local HRI operators and discovered significant interest in US food products from local trade, media and consumers. Despite growing interest, Western style cuisine is still relatively uncommon in Beijing among local residents, and many locals are unfamiliar with Western food or how to prepare it using ingredients foreign to them.

Hotel

Continuing Swift Expansion

As the 2008 Summer Olympics approach, hotel development has focused on Olympic preparations. To date, Beijing Organizing Committee of Olympic Games (BOCOG) has signed deals with 122 star-rated hotels, stating 70 percent of their rooms will be used to accommodate organizations sponsoring the Olympics.

Beijing continues to set new records for total rooms each year, and has the highest growth rate of new hotel buildings in Asia. Some 17 star-rated hotels were newly opened between 2006 and 2007, with additional 12 new properties planning to open in 2008. The newest estimates indicate that Beijing has more than 700 star-rated hotels, including 253 newly rated properties in 2006. Review and rating of previously unrated hotels continues in 2008 in an effort to boost the level of accommodation in the city in time for the Olympics. By 2008, the number of star-rated hotels in Beijing is expected to reach more than 800 properties.

ATO interviews with chefs-food & beverage (F & B) managers at a number of star-rated hotels in Beijing and other north China cities confirm that imported food products make up a very substantial portion of hotel food budgets. One major five-star hotel in Beijing states that food imports account for more than 50% of overall food-purchasing budgets and estimate that comparable hotels have

Visitor Origins for Beijing's Star Grade Hotels				
Visitor Origin	2006	% of total	2005	% of total
Domestic	12.4 mil	78.6%	12.1 mill	78.6%
International	2.9 mill	18.6%	2.8 mill	18.4%
Hong Kong, Macau & Taiwan	442.3 thou	2.8%	462.1 thou	3.0%
Total	15.8 mil	100%	15.4 mil	100%

Source: Beijing Statistical Yearbook 2007

similar purchasing patterns. Food ingredients and meat products make up the bulk of the imported food purchased by these hotels. The newly opened JW Marriott Hotel adjacent to the new Ritz Carlton Hotel, for example, has 5 different food and beverage outlets featuring American, Italian, French, international and Chinese cuisine as well as lounges and bars. In general, the Western style food service operations such as steakhouses, for example, purchase a larger proportion of food imports than Chinese Kitchen outlets. In addition, banquet and conference food service use a large proportion of imports in upscale hotels.

Beijing's star-rated hotels do not normally target price-sensitive consumers, and during interviews, chefs and food & beverage directors assured us delicious, high quality food is their highest priority, and price is less important. Hotel food service operators concentrate on creating trendy and attractive menus, incorporating high-quality food products emphasizing nutrition and health benefits. According to one hotel chef in Beijing, "Imported food, especially American imports offer good food safety and quality control assurances prior to export, so we are very happy to purchase high quality food from the U. S. We would also like to learn more about new food service trends through the media, promotion, and chef training to help us stay on the forefront of providing premium food service."

Leading Companies and New Markets

The 2008 Beijing Olympic Games represents a unique opportunity for international lodging companies to establish their brands in Beijing, and throughout China. Shangri-La, Marriott, Hyatt, InterContinental, Accor, Starwood and Hilton are global as well as market leaders in Asia, continuing to expand their presence in Beijing. Additionally, Hong Kong-based Shangri-La Hotels is one of the major players in Beijing, with 3 five-star hotels and 1 four-star hotel, and 2 additional hotels scheduled to open in 2008. Marriott currently operates 26 hotels in China, 5 of which are located in Beijing. The group plans to expand its presence in China and hopes to have 35 hotels nationwide by 2008, with 10 to be located in Beijing, doubling its current hotel numbers in the city. Inter-Continental Hotels is planning to develop 74 more hotels in China by 2008, with 7 to open in Beijing. Recent ATO market research identified 25

new five-star hotels planning to open (or some have newly been opened). These hotel brands include: Park Hyatt, Mandarin Oriental, Sofitel, JW Marriott, Ritz Carlton and Westin.

Beijing's high-end hotels are ideal venues for introducing new-to-market food and cuisine. Restaurants in international-branded hotels associated with stylish ambience, convenient location, highly trained chefs and wait staff tend to be open to using top-quality ingredients. Hotel dining has expanded beyond resident guests, with well above 50 percent of diners coming from outside the hotel. Wedding banquets are again an important market niche for hotels. The newly opened Ritz Carlton Hotel currently has a special package for newly weds and owns the first-ever Wedding Chapel in a hotel here in Beijing to specifically target the wedding business! Hotel dining is also well positioned to capture the business entertainment market segment, and is a popular dining option for many business groups and individuals.

Restaurants

Beijing is home to some of China's most sophisticated food culture from ancient times. During the Ming Dynasty the capital was moved to Beijing with a diverse variety of foods from all over China finding their way to Beijing. In addition to the delicate and subtle flavors of Imperial cuisine, world-famous Peking duck, lamb hot pot are said to all have originated in here. Now an international crossroad, Beijing diners savor the food and flavors of China's regional cuisine as well as an expanding range of international options. From the all-American brunch at Chef Too to modern Spanish Mare Notre, palates of Beijinger's continue to expand along with their pocketbooks.

Beijing Restaurants Profits at a Glance:

Beijing Restaurant Business Profits (US dollars)				
2002	2003	2004	2005	2006
1.5 bill	1.9 bill	3.3 bill	3.5 bill	8.3 bill

Beijing Statistical Yearbook 2007

Beijing's place as a center for top universities, central government agencies, international diplomatic missions and the global business community puts the city on the leading edge of global dining trends. Initially inspired by returned overseas Chinese and expatriates, affluent local Beijinger's are now part of the driving force behind a strong trend for diversity in dining



Well-appointed dining facilities, Elements Restaurant at Hilton Hotel Beijing

options. Interviews with food service managers reveal that today's Beijing diners are willing to try almost anything – particularly those with high disposable incomes. According to the Beijing Western Food Association, the number of restaurants serving international cuisine is expected to more than double between 2004 and 2008, from over 1,000 to more than 3,000 restaurants. Price increasingly takes a backseat to perceptions of lifestyle; customers expect that the food will be excellent and have turned their attention to service, ambience, and, creative restaurant themes. Modern Western restaurants often offer wine bar, or wine club to create a platform among those gourmet customers. Wine tastings and dinners are a common occurrence and continue to attract the attention of the city's affluent.

Beijing's size means that, like most metropolitan areas, location plays a large role in restaurants' client base and success. The

Central Business District (CBD), stretching across central and eastern Beijing, is home to many of Beijing's best restaurants. Many fashionable new dining destinations opened in the CBD in 2007, including The Place and Shing Kong Place, both of which are home to multiple

restaurants serving a wide range of international cuisine. Convenience for young and wealthy Chinese professionals and proximity to businesses and embassies likely to expense lunch or dinner make the CDB prime real estate for many high-end dining establishments.

Sichuan style is one of the most popular cuisines in Beijing, along with Hunan, Cantonese, Shanghainese and Dongbei styles. Many will tell you it is hard to find real Beijing food, and the places claiming to serve authentic Beijing specialties, such as Quanjude for Beijing Roast Duck, are mainly for tourists.

Beijing's nightlife continues to be dominated by increasingly sophisticated bars and clubs in the Sanlitun, Workers Stadium, and Houhai areas, catering to wealthy affluent young professionals. Beijing's popular English language lifestyle magazine, That's Beijing, whose readers are expats, foreign students, tourists and upscale white collar workers. On the magazine's yearly poll on Beijing's best restaurant and best bar, the selection criteria ranges from staff, decor, and location to food, ambience, price and services, meaning the public is seeking quality eatery places from every angle. Beijing's nightlife neighborhoods are filled with high-end dining options, many have international cuisine or snacks on the menu, and more global players are expected to enter this exciting city.

Institutional Food Service

Cost-conscious young professionals seeking convenient dining options, largely drive Beijing's institutional food service at this point. As property values rise across Beijing's Central Business District (CBD), 30-story office buildings have replaced many local mom-and-pop eateries. Professionals who don't want to pack a lunch are left scrounging for options. Most office buildings over 10 stories have outsourced cafeterias managed by Chinese companies located in the basement, but quality food products are not readily available, even at the best international office complexes. Cafeteria lunches range from around 10-20 RMB (US \$1.3-2.6), and generally include a number of Chinese-style main and side dishes, rice, bread and soup. While bulk imported food products like flour and oils may find a market here in coming years, the price point of cafeteria food service in Beijing, and in the rest of China, still does not accommodate the incorporation of high value imported food and beverage products.

Domestic catering services such as old-time Lihua Fast Food is one of the largest food delivery companies in China, and is still widely accepted and popular in Beijing. It delivers single lunchboxes to offices or home for a fee ranging from RMB 8 to RMB 20. Like many catering services, Lihua has no storefronts and orders are placed by phone. Lunchboxes are delivered by teams armed with maps and GPS systems, and orders are guaranteed to arrive within 30 minutes after the order is placed, or your money is refunded. Newly emerged on-line catering services 'Goodies' and 'Isender' have developed amazingly successful business module to deliver food from several of the major restaurants around town to anywhere in the city. Customers place orders by phone, which are relayed to food production centers via Internet. For an increasingly overworked workforce, it is certainly a convenient, relatively inexpensive and time-saving meal solution.

As catering services continue to develop in Beijing, current domestic players are not fully successful in satisfying the increasingly high nutritional, hygiene, price, and efficiency expectations of consumers, there is still room in this market segment and more market players are emerging to compete, forcing domestic old-style catering service to change or to be out of the game. Beijing Zhenda Food Service Co., Ltd (Zhenda), established in 2001, is one of the leading caters in Beijing to provide office meal services in many of the major office buildings in Beijing, including Oriental Plaza, Kerry Center, and Fortune Plaza. Recently, the company has signed contract with Japanese food service provider Lvchu (meaning: Green Kitchen) to improve the overall management and training in their cafeterias across Beijing. After the cooperation, Zhenda has made full renovation to their cafeterias, improved menu

combinations using high quality food products to provide safe, delicious, healthy, well-balanced, and convenient food.

The rise of office and home delivery services has brought more players into the institutional and catering market in Beijing. Global brands such as Aramark and Canada's Popmeal Fastfood (Beijing) Inc. are taking the lead in high-end institutional food service. Most of Beijing's full-service restaurants and major fast food outlets provide delivery services as well. International brands such as Pizza Hut, Papa Johns, and Domino's continue to introduce higher-profile delivery services in Beijing. Friendly familiar delivery services make sure all deliver to your door if orders are over a minimum amount. Local and unchained restaurants are beginning to roll out delivery options with just a phone call away to meet this demand.

2008 Olympic Games in Beijing



Like a debutante preparing for her coming out ball, Beijing is planning, building, and training at a furious pace for the 2008 summer Olympic Games. The Olympic Games will have an intense short-term effect on the HRI sector, as an estimated half a million overseas visitors pour into the city, joined by 1 million domestic spectators.

As of February 2007, 122 three, four, and five-star hotels have been explicitly designated as 'Olympic hotels,' and an updated list is available on the Olympics Organizing Committee's website: <http://en.beijing2008.cn>. The hundreds of other hotels not officially partnered with the Olympics are also well positioned – our interviews suggest that some hotels are already fully booked, largely through agreements with international companies and travel agencies, or are strategically planning to distribute their room bookings to ensure the maximum profits in the pocket.

Beijing's restaurants will also experience a surge in business during the Olympics as millions of Beijing residents, domestic and international visitors will all try to secure meals at the same time. On the food service side, Beijing Western Food Association's (BWFA) Secretary General Xu Bin estimates that more than ten thousand local western food chefs in 2007 and 2008 will be trained to serve during the Olympics period. BWFA is organizing a series of food and beverage training sessions in cooperation with the Beijing Organizing Committee for the Games of the XXIX Olympiad (BOCOG). ATO Beijing is also liaising with BOCOG in preparation of upcoming chef trainings prior to Olympic Games in August.

Institutional food service is getting in on the Olympic Bonanza as well: catering service for the Olympic Village will run 24-hour service for the 22,000 people expected each day. The Olympic Organizing Committee has adopted western food as the primary menu offering, accounting for up to 70 percent of the Olympic Village menu. Hotel food service outlets have also been specifically designated for the use of particular groups of guests. Inter Continental Hotel Beijing North reported that it has been assigned to provide accommodations and food services for the media.

The Aramark Corporation and Beijing Tourism Group Co., Ltd will provide catering services for the Olympic Village, Media Village, Main Press and International Broadcasting Centers. Top Olympic sponsor McDonald's is to provide catering services for thousands of athletes, coaches, officials, media and spectators. Kerry Oils & Grains (China) Limited (Arawana) is the exclusive edible oil supplier for the Games, and the Mars Company (Effem Foods) will also supply candy products for the 2008 Beijing Olympic Games.

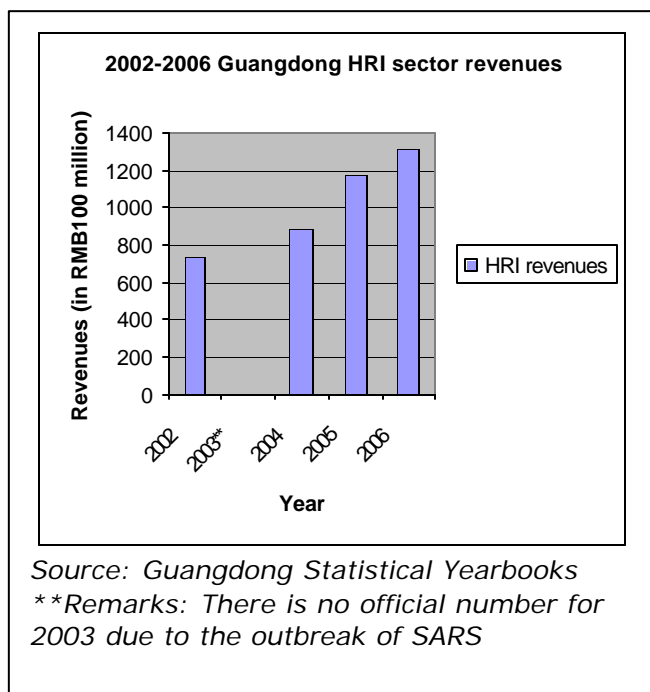
South China Market Overview

South China's HRI sector, especially in Guangdong province, takes the lead in China and is expected to maintain strong momentum based on a robust economy and strong demand for dining out.

2006 Guangdong HRI Sector Revenues by Sub-sectors							
Year	Star rated hotels	Number	Restaurant above designated size *	Number	Institutional	Number	Total
2006	RMB23.5 billion (\$322 million)	1,139	EMB25.3 billion (\$347 million)	1,731	RMB529 million (\$72.5 million)	38	RMB49.3 billion (\$675 million)

Source: 2007 Guangdong Statistics Yearbook

Remarks: "Restaurant above designated size" means restaurant with annual sales greater than \$274,000 (RMB2 million).



The HRI sector in Guangdong province generated estimated revenue at \$18.1 billion (RMB132.1 billion) in 2007, a 16.4 percent increase from previous year. This accounts for 10.8 percent of China's total HRI revenue. The Pearl River Delta, including Guangzhou, Shenzhen, Foshan, Dongguan, Zhongshan and Zhuhai, accounts for 84 percent of Guangdong's total revenue.

In general imported food products enjoy good reputation for quality in South China. Local chefs like to use U.S. products, such as beef, scallops, salad dressings and seasonings.

Increasingly U.S. ingredients are used by local chefs as the market recognizes healthier lifestyles and rising concerns about food safety.

Hotels

The hotel sector is fairly well-established in the major cities such as Guangzhou, Shenzhen, Zhuhai, Dongguan, Xiamen, Sanya, Fuzhou and Guilin. However the booming local economy and strong demand from business travelers are spurring investment in the high-end hotel sector.

As is the case with most hotels, F&B (food and beverages) make up a considerable portion of total revenues. Increasingly hotel management leverage their F&B operations as a branding positioning strategy by offering distinct styles and tastes to appeal to niche markets. Many feature imported ingredients and hold promotions to attract local consumers towards Western style dishes.

With this in mind, high-end hotels remain an influential brand or product launching platform into South China.

It's fairly common practice in South China for the four and five star hotels to allot \$10 per person to the kitchen for breakfast buffet. This allows chefs to include imported breakfast cereals, butter and cheeses and otherwise difficult-to-find seasonings for overseas tourists to feel more at home during their stay.



Open kitchen at one of the high-end hotels in South China

To source such specialty foods, chefs tend to work with reputable local distributors. While more regular ingredients (such as rice, wheat flour and cooking oil), are purchased through central purchasing divisions within the larger hotel chains.

Budget hotel chains and international management franchises are entering this segment of the market. Many offer services that would normally only be available in higher rated hotels such as broadband services while room rates remain competitive at \$27-50 (RMB200 to 350). Such strategies are gaining traction and winning price conscious business travelers away from the higher rated and more expensive hotels. One good example is the 7 Days Inn Group that have been successful in penetrating this end of the market having now opened more than 100 properties across China.

Staffing Challenges

Another significant pressure established hotel and restaurant operators are facing is the shining lights from nearby 'boom town' Macau. Awash with international gaming investment capital, last year Macau surpassed Las Vegas's gaming revenue. Subsequently, with so many new casinos and service based business opening in Macau, demand for quality trained staff and management has caused significant staff turnover issue throughout South China's HRI sector.

Guangzhou

At the end of 2006, Guangzhou had 206 star-rated hotels, of which 32 were recognized as four stars and above. However, further expansion is expected by industry insiders as Guangzhou prepares to host the 2010 Asian Games. The most up-to-date figures available state total revenues for Guangzhou's hotel sector were \$918 million (RMB6.7 billion) in 2006, up by 7 percent from the previous year.

Guangzhou's hotel sector services 30 million domestic and international visitors each year. Peaking twice a year China Import & Export Commodity Fair (known as the Canton Fair) brings thousands of buyers from overseas in late April and late October every year. As a result, almost all star rated hotels are fully booked, and room rates double or even triple during the show period. Some visitors have to stay in other cities to avoid big crowds and price jumps.

CBD, hot new locations for high-end hotels

Guangzhou's fast rising CBD includes new high-end hotels

A new development of CBD (Central Business District) area is undergoing in the Zhujiang New Town centered in Tianhe district of Guangzhou. Four international hotel brands are soon to open or under construction in this area, including the Ritz Carlton, Grand Hyatt, the W hotel and Park Hyatt. Industry insiders also say that the Four Seasons Group also plans to build their first hotel in Southern China in this new area.

2010 Asian Games in Guangzhou

Guangzhou will host the 10th Asian Games in 2010, which is one of the most highly recognized events in the Asia Pacific region. Towards this goal, the city government has approved ten new high-end hotels to be ready for this hallmark event.

Shenzhen

Shenzhen's stellar economic development over the past 20 years has provided its hotel sector with more than favorable conditions to establish and flourish. By the end of 2006, Shenzhen had 161 star-rated hotels, of which 37 were rated four stars and above. 2006 total revenues were \$734 million (RMB5.4 billion).

Only a 30 minutes train ride away from Hong Kong's downtown, international visitors are attracted to stay overnight in Shenzhen because of its more favorable room rates. In an attempt to keep visitors longer, Shenzhen developed several amusement parks with resort style hotels targeting families from the mainland, HK, Macau and overseas.

Other Emerging Markets

Beyond the main cities of South China, fast growing emerging markets such as Dongguan, Nanning, Xiamen, Fuzhou, Zhongshan, Zhuhai and Sanya increasingly receive interest from developers and tourism entities.

2006 South China Hotel Numbers				
Province/City	5-star hotels	4-star hotels	Lower rating	Total
Guangdong	47	158	959	5,106
- Guangzhou	7	30	172	2,118
- Shenzhen	11	26	124	498
- Zhuhai	5	8	67	363
- Dongguan	16	25	55	440
- Foshan	1	16	80	137
- Zhongshan	2	4	32	113
Fujian	10	15	70	360

Hunan	8	34	459	501
Guangxi	11	26	337	374
Hainan	13	50	198	387

Source: 2007 Statistic Yearbook of related provinces and ATO/Guangzhou survey

Restaurants

Cantonese cuisine is world renown. In addition to their much loved traditional fare Cantonese are also known to appreciate different tastes, are curious about other food styles and on occasion have been cast as 'eating everything'.

This encourages food restaurateurs to seek-out new trends and offerings to win interest and remain competitive. This, of course, provides a good avenue for U.S. producers to satisfy this strong demand.

Towards this goal, distributors need to give restaurant chefs new recipes and ideal selling points to support efforts to include U.S. produce on their menus.

The restaurant sector in South China enjoyed solid growth over the past few years. Guangdong's 2006 Sales Revenues were recorded at \$347 million (RMB25.3 billion), up 15 percent from the previous year. Other provinces in Southern China totaled \$4.3 billion (RMB31.6 billion) in 2006.



Seafood is always a treat for Cantonese

Food safety would arguably be one of the hottest topics in 2007. Consumers are more concerned about the quality of local products and are willing to pay a premium for finer imported items. To meet this shift in demand, more restaurants offer dishes with health promoting ingredients.

Increasingly Western-style restaurant chains continue to strengthen their presence throughout Southern China. Most appear to expand operations through either direct investment or franchising. To ensure quality standards, most have set up centralized food processing centers to maintain standard recipes. Pork, poultry, seafood, almond, cheese and other seasoning products from the U.S. are regularly promoted on their menus as a key selling point to local consumers.

Fast food giants such as KFC and McDonald's are expanding rapidly into the fast emerging second and third tier cities. Sales revenues for these two chains in Guangdong are reputedly the highest in China. Yums!, a well known company managing KFC, Pizza Hut and Taco Bell, opened its third regional food ingredients and logistic center in Guangzhou in 2007. To reflect the pace of expansion in this sector, industry sources have shared that the demand for imported U.S. frozen potato products rose by 30 percent in 2007. While serving the regular menu items found in their outlets all over the world, one trend that is attracting favorable local response is inclusion of new recipes developed specifically for local palates. For example, KFC introduced egg drop soup and an Alaska black cod burger, successfully attracting customer response for their reputed health benefits.

Other Major Trends

Increasingly Cantonese catering companies are expanding their business interests nationally. Either through direct capital investment, franchising or providing professional management consultancy services to expand their presence throughout China.

South China Restaurant Industry Revenues			
Province	Revenues in 2005	Revenues in 2006	Change
Guangdong	\$3.5 billion (RMB25.3 billion)	\$3 billion (RMB22 billion)	15.0%
Fujian	\$425 million (RMB3.1 billion)	\$575 million (RMB4.2 billion)	35.5%
Hunan	\$411 million (RMB3 billion)	\$534.2 million (RMB3.9 billion)	30.0%
Guangxi	\$124.5 million (RMB909 million)	\$136 million (RMB992.9 million)	9.2%
Hainan	\$50.5 million (RMB368.8 million)	\$72.2 million (RMB 526.9 million)	42.9%

Source: 2006 Statistics Yearbook of related provinces

Remarks: All restaurants be surveyed must have annual sales greater than \$274,000 (RMB2 Million)

Moreover, international investors have shown strong interest in privately-owned and managed restaurant chains. According to some industry sources, several well known local chains have already reached agreements to expand their business having highly recognized management systems and a good reputation locally.

Centralized kitchens and distribution networks are important for such restaurant chains to better monitor costs and quality control. At the same time through economies of scale and notable rising local food prices, imported food ingredients are becoming more cost competitive today.

What is needed is better education for local chefs so that they are more aware and familiar with U.S. ingredients and how to fully utilize them. One local executive chefs recently shared with the ATO Guangzhou that he learned about Texas slow-roasting of beef while he was in the U.S. few years ago, and this dish has become his most popular, accounting for more than 60 percent of his restaurant's revenue.



International standards help local fast food chain to expand

Another emerging regional trend is fusion cooking or combining the best of both East & West ingredients and styles. Fusion cooking provides a bridging of tastes that takes advantage of local expertise and U.S. ingredients, and is an avenue for experimenting and creating new flavors and combinations to excite local palates by exploring new food experiences.

Locally, several catering associations are fairly active in or around Guangzhou with the aim of providing a regulator role for the industry. A few local celebrity chefs and restaurant owners have also taken the initiative to establish their own clubs and societies to exchange ideas. ATO Guangzhou has worked with one such club known as the Culinary Art Master Club. This is one example for U.S. producers to further educate and encourage leading chefs to learn more about U.S. produce and ingredients so they can appreciate and better utilize them.

Growing Demand for Wine

Along with food, wine consumption is steadily growing in South China. Middle to higher-priced imported wines have found their niche in upper end restaurants and hotels, while lower-priced wines are readily available in international style retail outlets.

According to some industry sources, wines priced at \$40 (RMB300) per bottle enjoy strong demand. However, French and Australian producers have taken the lead in promoting their brands.

Major wine importers regularly organize wine tasting events and connoisseur dinners accompanied with fine wine selections to promote their products to upwardly mobile customers. On occasion wine makers fly in to promote their products, however to date American wine producers have maintain a fairly low profile in Southern China.



Wine consumption is growing steadily

Institutional Food Service

The expatriate community is the main market for high-end western style catering services. The number of expatriates in South China has grown and is fast emerging as a market opportunity for imported food and beverage producers, particularly cheese, meat products, seasonings and soft drinks.

Local catering companies remain steadfast about producing low cost 'lunch box' products. An increasing number of businesses today arrange with catering companies to supply lunch to their staff as benefit of employment.

Two distinct categories are available, 'white-collar lunch boxes' priced at US\$1.50 to US\$4 per box, and 'blue-collar lunch boxes' ranging from US\$.50 to US\$1.50 per box. No doubt, using expensive imported ingredients is not a practical option at this point in time.

One emerging trend is the demand for 'Off-site catering'. Most leading hotels and restaurants offer this service. For example for business meetings, special events or private party such catering services are viewed positively for both 'status' recognition and convenience.

During holiday seasons, such as Chinese New Year celebrations, demand is rising for catering services. Particularly with more affluent families not restricted by a budget, outside catering offers opportunities to enjoy imported ingredients such as seafood and U.S. steaks that are less readily available.

Conclusion

Competition in Southern China's HRI sector is fierce, but market opportunities exist for experienced operators to establish their brand in one of the fastest growing economies of the world.

SWOT Analysis of American Products in the South China HRI Sector	
SWOT	South China HRI Industry
Strengths	<p>American products' reputation for high quality, safety and nutrition</p> <p>Health consciousness and rising income stimulate demand for imported food products</p> <p>High GDP in Mainland China and strong purchasing power</p> <p>Major hub for imports</p> <p>Good distribution system in major cities</p>
Weaknesses	<p>High prices</p> <p>Not enough awareness of American products</p> <p>Lack of knowledge on how to handle imported ingredients</p> <p>Lack of education and training in the HRI sector</p>
Opportunities	<p>Decline of import duties</p> <p>Food safety and nutritional concerns by local consumers</p> <p>Sustainable growth in the HRI sector</p> <p>Some of the most sophisticated restaurants are being operated in the region by highly skilled chefs that are open to new ideas</p> <p>International renowned 5-star hotel chains operate locally</p> <p>Appreciation of value of the Chinese currency</p>
Threats	<p>Unreliable distribution systems in newly emerging cities</p> <p>Increasing competition from domestic and foreign suppliers</p> <p>Consumers lack knowledge on how to identify authentic American products</p> <p>Non-tariff and technical barriers</p>

Appendix

U.S. products in South China HRI Sector	U.S. products with good potential	Available competitors' products
Beef, pork, seafood products, frozen potato products, almonds, cheese, sweet corn, poultry products, fruits, sauces and seasoning	Cheese, red wine, high-value seafood products, beef, sweet corn, seasoning products, sauces, almonds, olive oil, frozen potato products	Cheese, beef, seasoning products, olive oil, sun dried tomato, sausage, fruits, poultry products, frozen potato product,

products, wines and liquor		seafood products, pork, pasta, red wine, liquor
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Shanghai Market Summary

Shanghai is China's largest city, its leading commercial and financial center and the home of its largest port. With an official population of 18.6 million and a 2007 GDP of \$167 billion, per capita GDP reached \$8,594, significantly higher than the rest of China and 19.5% higher than the previous year. Shanghai's economy is becoming increasingly focused on finance and services, as rising prices drive manufacturing further outside the city borders. International companies continue to find Shanghai attractive. The investment level reached \$7.9 billion although value of foreign investment declined by 8.7 percent owing to the readjustments of economic structure. An increasing number of international companies located their regional headquarters in Shanghai in 2007. Shanghai is an aggressively cosmopolitan city, which derives much of its strong sense of identity from its knowledge and adoption of international brands and fashions. Hence, while Shanghai has a very distinct food culture of its own, the Shanghaiese are open to new tastes and new products, making it an excellent market for imported food. As with the rest of China, food plays a central role in all aspects of Shanghai life. Business, networking, celebrations and friendly get-togethers are invariably centered around a meal. Food is widely given as gifts, particularly during festival periods, and this has become an important niche market. Affluent local residents are more than willing to pay for quality products, provided they can be persuaded the product is truly special.

Restaurants

Not surprisingly, Shanghai's robust economy in 2007 and rapid increase in incomes played a major role in boosting the local restaurant industry. According to the Shanghai Restaurant Industry Association (SRIA), the total sales revenue generated by 40,000 restaurants reached RMB 55.7 billion in 2007, an increase of 23.1 percent over the previous year. As much as 14.5 percent of total Shanghai retail sales of consumer goods came from the sales revenue of the restaurant industry. Shanghai remains at the top of the list for total restaurant sales revenue in China. Shanghaiese per capita spending on dining out reached RMB 1,722 in 2007, an increase of 16.3% over the previous year. However, the growth rate of 2007 sales revenue slowed by 6 percentage points compared with the growth rate in 2006 owing to high inflation, particularly to soaring food prices throughout the year.

	Total Industry Sales Revenue		Per Capita Disposable Income		Per Capita Expenditure on Dining Out
	RMB (Billion)	Growth Rate (%)	RMB	Growth Rate (%)	RMB
2007	55.646	23.1	23,623	14.3	1,722
2006	45.216	29.1	20,668	10.8	1,482
2005	35.031	16.7	18,645	11.7	1,331
2004	30.017	39.7	16,683	12.2	1,183
2003	21.483	16.6	14,867	12.2	897

Source: Shanghai Restaurant Industry Association, Shanghai Statistical Year Book. Shanghai Mayor's Report

One major characteristic of the Shanghai restaurant industry is the consumption pattern during the holiday and festive season. According to the SRIA, all the major Chinese restaurant groups report 15 – 36 percent growth rate during the major Chinese holidays/festivals, such as the traditional Chinese Lunar New Year as well as May 1 and October 1 holidays. Chinese consider the Chinese New Year's Eve dinner the most important meal of the year, as it inculcates family cohesion by providing an opportunity for family members to gather and celebrate the New Year together. As work becomes more hectic, more and more families choose to have their reunion dinner in restaurants. All major Shanghai restaurants are fully booked during this day. Some restaurants even have to impose timings per meal in order to turn the table around as many times as possible that night.



Most of medium to high-end Shanghai restaurants are the potential users for high-end imported food ingredients. Some restaurants already feature imported U.S. ingredients in their recipes as they develop innovative products/dishes to appeal to the more adventurous consumers willing to try new products. Thanks to the continuous marketing efforts by ATO, USDA cooperators and distributors, U.S. food ingredients and beverage products such as pork, seafood, poultry, frozen potato products, dry fruits and nuts, seasoning products, wine and beer are becoming more and more popular as ingredients in both Chinese and western style dishes, and on the wine lists of popular local restaurants and bars.



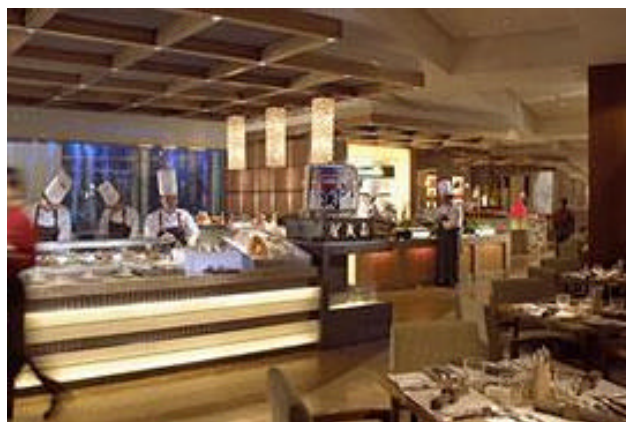
Shanghai's many different types and styles of restaurants provide a wide experience of food entertainment venues, including fine dining, casual dining, Chinese and western fast food restaurants. Based on discussions with SRIA, there are more than 1,600 western and other foreign style restaurants in Shanghai offering more than 30 different cuisines to local consumers as well as the approximate 500,000 expatriates living and working in Shanghai. The increase in disposable income has also led many Shanghainese to indulge in western cuisines. High-end restaurants, such as Jean Georges,

New Heights and Sens & Bund, scattered around the famous Bund area in Shanghai, are always full despite the steep prices as high as RMB 1,000 per person. To cater to the average consumer, there are also a huge number of western restaurants offering affordable packages at RMB 100 per person.

Trends

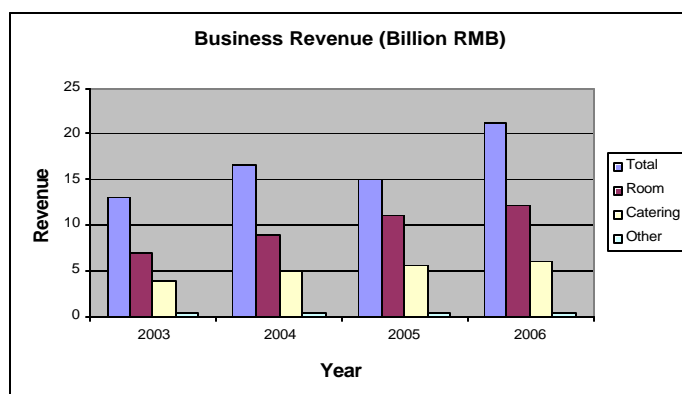
The Shanghai restaurant industry is expected to maintain its strong momentum based on the fast-growing economic indicators, an increasing number of visitors and strong demand for dining out. Furthermore, international venture capitalists have taken a strong interest in privately-owned chain restaurants, sparking a phenomenal trend in franchising across China.

Large chain restaurants continue to play an important role in Shanghai's restaurant industry. Local brands like Fuji, Xinhualou, Yuyuan, Xiaonanguo, Jade Garden and Fengshouri, each with about a 1.5 percent market share, contribute more than 30 percent of the total Shanghai's dining out sale revenue. While the rise of formal dining restaurants has slowed somewhat, medium and small size theme restaurants with river-view, plus casual, specialty and private club and restaurants with stylish ambience and convenient location, achieved impressive sales records in 2007. Shanghai Chamate Food Co., a Chinese food restaurant chain serving tea and light meals, currently has 56 stores, and plans to double the number of stores in 2008 nationwide. There will likely be more chain restaurants in the future where a centralized kitchen and a distribution channel are established to closely monitor costs and quality.



With a population of 2.75 million people aged 60 and above, accounting for 20 percent of the total urban registered population, Shanghai will be the leader in adapting new services for aged community among other cities in China. Aged Chinese people tend to have more light and vegetarian food. Last year, the Shanghai Restaurant Industry Association formed a Vegetarian Food Committee to advise foodservice entrepreneurs who view this rising industry as a new business opportunity.

Hotels



Source: Shanghai Statistics Yearbook 2007

In 2006, hotel catering revenue reached 6 billion RMB (\$834 million), which experts believe was mostly contributed by star-rated hotels. It is the norm in Shanghai for four and five star hotels to allot \$13/person (usually already included in the room tariffs) to the kitchen to enable the chef to include imported food ingredients into the breakfast buffet menu. Judging from the four and five star hotels' average occupancy and room rate (which stood at 66.7 percent and \$91 (RMB 658), and 72.6 percent, \$195 (RMB 1,406), respectively, for 2006),

breakfast revenue formed a very stable source of revenue. It is therefore not surprising that four and five star hotels remain the core markets for new-to-market and high-end imported food ingredients. Though there is no data available to substantiate our findings on the demand for and consumption of domestic versus imported food products by the hotel industry, one major imported food distributor supplying hotels in Shanghai reported an annual growth of 20 percent in its hotel catering business sector over the past three years.

Shanghai's hotel sector is extremely well-developed, and continues to expand under the pressure of growing demand. This steady growth can be attributed to the annual influx of more than 88 million domestic and international visitors to Shanghai attending commercial

events such as trade shows, conferences, sports events and business trips, an increase of about 17 percent from the previous year. The Shanghai municipal government also works hard to promote the city by working with international organizations to host events, meetings and conferences, and at the same time appeal to individual and group tourists. As a result, four and five star hotels are routinely fully booked, and during peak seasons there may be no rooms available at this level in the city.

Industry sources estimate there are more than 3,800 hotels and inns in Shanghai. They can be categorized based on the services that they provide into star-rated hotels or social hotels. While star-rated hotels provide a complete range of premium services from rooms, food and beverages, health clubs to meeting facilities, social hotels only provide the basic minimum accommodation facilities (which depending on locations, may include simple breakfast services).

Shanghai Hotel Industry Statistics 2003-2006				
Year	Total	Five Star	Four Star	Others
2006	317	26	43	248
2005	351	25	41	285
2004	359	24	37	279
2003	338	20	30	288

*Source: Shanghai Statistical Yearbook

At the end of 2006, Shanghai had 317 star-rated hotels, of which 69 were rated four stars or higher, an increase of one 5-star and two 4-star hotels over the previous year. Expansion of highly rated hotels is likely to continue or accelerate, particularly in advance of the 2010 Shanghai World Expo. Since early 2007, a number of hotels rated three stars or below have closed or been partially open to business for reconstruction or expansion for receiving visitors to the 2010 World Expo. Total business revenues for Shanghai's hotel industry hit a high of 21.2 billion RMB (\$2.95 billion) in 2006, an increase of 9 percent from 2005, while total profits reached RMB 2.8 billion. Official statistics show that the small number of star-rated hotels, amounting to 317 in 2006, contributed 72.6 percent of the total industry's business revenue, equaling 15.4 billion RMB (\$2.1 billion).

Shanghai Star-Rated Hotel (SRH) Statistics 2003 -2006			
Year	No. of SRH	Business Revenues (Billion RMB)	Percentage of Total Industry Revenue
2006	317	15.4	73
2005	351	15.3	78
2004	359	14.0	84
2003	338	9.7	74

*Source: Shanghai Statistical Yearbook

Trends

With the approach of the 2010 Shanghai Expo, Shanghai is witnessing a stream of investments in the construction of both high-end premium hotels and in low-end budget chain inns. The Shanghai World Expo Committee speculated that around 60 premier hotels to be constructed by 2010 will help accommodate an additional 3 million guests. The budget chains too have seen tremendous growth since their launch in China a few years ago. At the projected double-digit annual growth rate for the next few years, it is inevitable that more new players will attempt to enter the budget hotel industry.

Institutional Food Service

Institutional food service in Shanghai is not as well developed as either the restaurant or hotel sectors, although there is a thriving industry that provides "lunch boxes" to offices, schools, companies, and kiosks and C-stores. The target price for these meals is between \$1 - 3 each, making them a poor candidate for high value imported products. According to the Shanghai Restaurant Industry Association, based on the calculation of an average price of RMB 10 (\$1.4) and five million people consuming lunch boxes on working days in Shanghai, the catering market can be estimated at around RMB 12 billion. A potential bright light for imported products is at the universities, hospitals, exhibitions, government and academic institutions, and large companies whose canteens are managed and serviced on a contractual basis by certified catering companies where meals tend to emphasize quality, nutrition and wholesomeness. Catering service companies like Shanghai Lanchao and Shanghai Luquan have well-trained management and chef teams as well as professional material-sourcing and distribution channels to control food safety, quality and cost. Their Shanghai based business has gradually penetrated to neighboring cities throughout the Yangtze River Delta. Airline catering rounds out the institutional food sector, but again the focus in that segment tends to be on bottom-line cost. Domestic in-flight catering only provides imported dry fruits and nuts in small snack food packs to the passengers.

Sichuan Market Summary

The Sichuan province is known as the land of abundance. Its abundant land, water and mineral resources have supported strong economic development in capitalist China. In 2007, Sichuan gross domestic product (GDP) was more than \$146 billion, up a record 14.2 percent from the previous year. More than 32 percent of Sichuan GDP is derived from the capital city of Chengdu.

Sichuan GDP/Disposable Per Capital Income (2002--2006)				
Year	GDP (million)	Growth Rate	Disposable Income	Growth Rate
2002	\$67.9	10.6%	\$925.26	
2003	\$76.0	11.8%	\$981.22	6.5%
2004	\$91.4	12.7%	\$1,074.35	9.5%
2005	\$102.9	12.6%	\$1,168.56	8.8%
2006	\$120.4	13.3%	\$1,302.95	11.5%

(Resource: Sichuan provincial government)

Sichuan is also a tourist destination with a unique set of must-see historical and world heritage sights. Sichuan saw more than 140,170 tourists in 2007, generating slightly over \$17 billion, of which over \$5 billion was from foreign tourists, up 24 percent and 29.6 percent from the previous year, respectively. Tourism has supported a service culture in Sichuan, providing a basis for the booming hotel and restaurant industry and making it an attractive place to live.

The Future of the Province is Hot

The provincial government's blueprints Sichuan to be the logistics hub for Southwest China. (Southwest China includes Sichuan, Chongqing, Yunnan, Guizhou. Culturally, Sichuan has influenced Xinjiang and Tibet which are considered part of Western China). The province forecasts GDP in 2008 at over 10 percent. Following Shenzhen, the spiritual center of Chinese capitalism, in 2007, the central Chinese government established Sichuan and Chongqing as one of four Target Economic Development Zones. Taking the lead from the central government, the 2008 Annual provincial government proposes a set of special

programs improve foreign direct investment, develop Chengdu as a financial center, and position it as a logistics hub for Southwest China, making it both center of modern manufacturing, including processed agricultural products, and technology innovation. At the center of this is the capital of Sichuan, Chengdu.

Chengdu: Southwest China's Cultural and Economic Leader

Chengdu's prosperity, high standards of living and quality of life has given the city a reputation of being an easy place to move to, but a hard place to leave. In 2007, the city's GDP was \$46.3 billion, up 15.8 percent from the previous year. Per capita GDP was over \$4000. Known for the relatively high consumption rate, per capita disposable income was just over \$2000 in 2007 which is up 15.7 percent from the previous year.

Sichuan is a high consumption urban province. Chengdu's population, over 12 million, is the fourth largest in China, and represents almost 20 percent of Sichuan's urban residents. Chengdu has the second highest per capita purchasing of automobiles and the highest per capita expenditures on out-of-household dining. While China's population is almost 40 percent rural, in Sichuan less than 20 percent of the population is rural-based.

As the capital and cultural center of Sichuan, Chengdu is an attractive business development center. As a result, more than 125 of the Fortune 500 companies have established offices or invested in Chengdu. This business presence has driven increased demand for conferences, business meetings and other events. This, combined with tourism and the tradition of dining out, has set the stage for annual expenditure of billions of RMB on lunches, dinners and banquets. As Chengdu has become more cosmopolitan, western food has increasingly influenced food consumption patterns and the dining environment, fostering the incorporation of western foods in traditional cuisines and a growing presence of western food restaurants.

Home Away From Home: Hotels Hot in Chengdu

Chengdu's robust economy and international exposure set the stage for a large expansion in the hotel industry. The number of international 5-star hotels has more than doubled in the last 5 years and includes Starwood Hotels and Resorts Worldwide, Inc., Intercontinental Hotel Group, ACCOR Group and Shangri-la Group. The increased number of international hotels in Chengdu has expanded the opportunities for U.S. food products. Large numbers of sophisticated travelers expect top-quality food and service, with a spicy Sichuan twist. This has put pressure on local 4- and 5-star hotels and influenced the local restaurant sector.

Province	Revenues in 2006
Sichuan	\$567.2million
Chongqing	\$321.9million
Yunnan	\$412.5million
Guizhou	\$147.7million

In addition to the international hotel chains, Chengdu also has several regionally-known 4- and 5-star hotels including the Jingjiang Hotel and the Minshan Hotel. Increased competition from their international counterparts has pushed local brands to upgrade hotel management, hotel facilities, and food service. The Minshan Hotel recently finished phase one of a room renovation program and the Jingjiang Hotel will upgrade its rooms in 2008. Service and food quality have also improved drastically.

Southwest China Hotel Industry Business Revenue (2006)			
	Total	Room Service	Food Service
Chongqing	\$567.2 million	\$301 million	\$197.9 million
Yunnan	\$412.5 million	\$232.7 million	\$129.5 million

Guizhou	\$147.7 million	\$87.7 million	\$47.4 million
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In terms of food and beverages, increasingly local and international hotels try to differentiate themselves by providing both authentic western cuisine and traditional Sichuan Cuisine to satisfy the diverse demand of the business, tourist and wedding market. To this end, the Chengdu Sofitel Hotel recently began sourcing its fresh seafood directly from the seaports of Dalian and Shanghai to compete with newly-opened Shangri-la and InterContinental hotels. Thus, increasingly, imported ingredients, including meat, cheese, olive oil, seasoning products and sauces pasta, and seafood products, are being included on the menu in up-scale hotels.

Eating Out: A Way of Life in Sichuan

Eating out is a tradition of Sichuan society. Residents enjoy relaxing and sharing time and diverse foods with family, friends and business associates. The cuisine highlights not the color, aroma and, strong tastes of hot pepper and Sichuan pepper. Despite the spice, however, the flavors are complex and at once refined and popular.

The traditional food culture and robust economy has benefited restaurant industry. It is not uncommon to wait in long lines at Chengdu's high quality and sophisticated restaurants, even on weekdays. As the booming economy expands the economic roles of middle class and white-collar workers, dinning out on special occasions like Valentine's Day, Chinese New Year, and even Christmas, can require two weeks or more advance reservations.

Tourism and foreign investment has led to increased foreign food establishments and an interest in foreign food cultures. The Chengdu restaurant market accommodates not only other Chinese cuisine, like Cantonese and Shanghai cuisine, but also international foods, including American, French, Indian, Italian, Japanese and Tex-Mex. As incomes have increased and tastes influenced by western food culture, consumers are increasingly attentive to food safety and food nutrition.

Province	Revenues in 2006
Sichuan	\$470million
Chongqing	\$468million
Yunnan	\$147million
Guizhou	\$87.7million
Xinjiang	\$93.9million

Influenced by this trend, in recent years, traditional Sichuan cuisine has evolved a "new Sichuan cuisine." The new cuisine puts increased emphasis on food nutrition and the inclusion of non-traditional and foreign ingredients. This has been a boon to western style products, like dairy products, and imports, including imported meats and seafood. The "new Sichuan cuisine" not only pushes the traditions Sichuan cuisine impacts food consumption patterns throughout Southwest China.

Institutional Food Service

Imports generally are not competitive and most caterers are unfamiliar with imported products. In general, the catering industry in Sichuan focuses on providing lunch box foods. Commodity pricing ranges from \$ 0.7 to \$1.39 per unit. Where imports are not the low cost input, the low price of catered products makes it difficult for imported products to compete. Further, most catering is performed by in-house service units. As a result, many catering services lack knowledge of and experience using imported products

The upscale catering industry in Sichuan market is in the initial stage of development. Most five-star hotels and some high-end restaurants now offer off-site catering services targeted towards special occasions. The international business community, including companies like Intel, Motorola and Nokia has reported using these nascent services.

Part II: ROAD MAP FOR MARKET ENTRY

A. Market Structure

1. Target Population

The top economic tier of China's urban population now earn per capita incomes in the neighborhood of RMB 3,600 monthly, or RMB 43,200 (\$5,575) annually. Rising disposable incomes, particularly among white-collar workers, means this segment can now afford to try imported food and beverages on a regular basis. Increasingly, it is fashionable to sample international cuisine and wine, and many urban Chinese have both the desire and means to dine out regularly in upscale restaurants and bars. Chinese consumers actively pursue information about imported food and food products, often seeking opportunities for new culinary experiences beyond traditional Chinese Cuisine.

Increased consumer and media consciousness of nutrition, food safety, and health is also driving the market for food imports. Obesity has rapidly evolved as a public health issue in China, especially child obesity, with demand for low-fat, calorie conscious and healthy options rising. A number of large-scale school food service contamination events in 2006 brought food safety related to children to the forefront of the public consciousness. Women are increasingly interested in food and beverages that promise to improve hair and skin health, and seniors seek vitamin-fortified products with real and perceived health benefits. Functional foods with ingredients like n-3 fatty acids, pro-biotics, anti-oxidants, and high-fiber have also found a growing market in urban China.

Major cities like Beijing, Shanghai, Guangzhou and Chengdu have benefited greatly from economic reform and foreign investment boosting well-developed international product markets in urban areas. The potential for growth in food imports appears to be particularly promising in Emerging City Markets (ECMs), where new development effort and growing integration with the global economy is driving demand for new products. Some of these Chinese cities include Tianjin, Qingdao and Dalian in the north; Suzhou, Wuxi and Hangzhou in the Yangtze Delta; Shenzhen, Dongguan, Zhuhai in the southern Pearl River Delta.

2. Distribution

Less than a decade ago most imported products flowing into mainland China arrived via Hong Kong. Transit times by truck to Beijing take four days from Hong Kong and the trek by truck from Shanghai to China's far western provinces 6 days. With economic and policy liberalization as well as infrastructure improvements, increasing levels of 'direct imports' enter China via Shanghai, Dalian, Tianjin, and other ports, improving transport times and increasing market access for and information about the diverse variety of food and agricultural products consumed in China.

Distribution improvements have been realized in major markets such as Beijing, Shanghai and Guangzhou, according to food service industry insiders. Improved expressways, ports and cold chain infrastructure continue to expedite transportation and delivery. However, outside major metropolitan areas, cold chain distribution is still often unreliable. Purchasing managers at major hotels in some Emerging City Markets (ECMs) resort to transporting imported products primarily by air, and even then, complications are not uncommon. "We commit to a menu, but we can't get consistent product supplies, and if we switch to domestic products, quality is far from adequate," says one restaurateur. Expanded warehousing, improving importer-local agent networks in Emerging City Markets increasingly enables distributors to keep key items in stock, despite long transoceanic shipment lead times.

Cash flow presents difficulty for many distributors: buyers, especially large-scale customers like hotels, usually with a pay period of 45-90 days post delivery. Payment for food imports

often takes place 30 days after invoicing, usually upon shipment. As distributors become more familiar, fewer suppliers require full payment in advance, but even under the best of circumstances, top distributors are still required to make deposits that can average 30% or more on some products like meat.

Despite overland infrastructure improvements, distributors say air continues to make up around 10% of their import cost by volume and more than twice that amount in value terms. Air meat and dairy product as well as some fruit and vegetable air shipments are routine. Some traders report airborne imports face fewer customs and quarantine difficulties compared to imports by sea. Complex quarantine and customs procedures often cause import delays on an all-too-regular basis although distributors report the port of entry is a large variable in the frequency and duration of delays.

Gray Channel Supplies

The Hong Kong 'gray channel' is still a primary supply route for products destined for the Pearl River Delta and southwestern China, including Sichuan, Yunnan, Hunan provinces, and Chongqing. Most northern distributors have eliminated reliance on the gray channel or reduced such imports to less than 20% of total volume. Gray channel goods are handled by Hong Kong agents who work with Chinese agents, often based on family connections, across the border in Guangdong Province. Cargo is under-invoiced to reduce tariffs. In addition, some distributors say, it is easier and less expensive to source low-volume shipments from Hong Kong, rather than taking the risk of landing full containers in more northern ports.

However, WTO tariff reductions and a general loosening of controls have diminished the advantages of under-invoicing, as the central government continues to crack down on customs tariff and tax avoidance. In addition, the growth in imported food is moving North and East, away from Guangzhou, since the cost of transportation and quality issues can eat into the perceived savings of gray channel product shipments.

Direct Imports

The bustling development that has taken place across most of China created a high-end food market, with food import volumes increasing in Dalian, Tianjin, Qingdao, Shanghai, and Xiamen, all with modern docks, warehouses and container handling. Customs procedures have become more transparent as standard protocols for individual products evolve port-by-port. However, arbitrary treatment and policy changes still impede shipments unexpectedly, and importers complain inspectors are inconsistent: "They will block something for slight variations in bills of landing or other documents," says one importer.

Major distribution options include:

- Full-service distributors (see above).
- Third-party/ fourth-party Logistics. China has liberalized its distribution industry under WTO rules, and a small group of foreign-managed companies has developed in ports and free trade zones offering customs clearance, foreign exchange conversion, bonded warehousing and shipment. However, most do not specialize in the food business, so distributors or sales agents still need to sell, promote, and navigate many bureaucratic hoops such as licensing, labeling, and perhaps most importantly get paid from customers.
- Direct sales to end-users. This is limited to high volume customers like fast food and large hotel chains. Post suggests having local agents handle the paperwork and licensing issues to relieve the unexpected hassles, which can cause delays and risk the loss of whole containers of goods.
- US consolidators fill orders for China-based distributors, and also fill direct orders for restaurants and hotels, so you still need to make sales in China. US consolidator efficiency is considered a major advantage for US exporters.

- Hong Kong distributors, who frequently make use of the gray channel. Many have a large network of offices or affiliates inside China, but basically provide the equivalent of 3rd party logistics services. The supplier still remains responsible for promotion, training and developing a market.
- Cash 'n Carry Outlets, such as Metro or Wal-mart that target commercial customers like restaurateurs for purchase of bulk supplies – able to reach the restaurant food service trade directly.

China's cold chain and logistic bottlenecks affect the food service industry. Large Western quick service operator - Yum! Brands recently opened a 12,000 square meter distribution centre in South China to provide cold chain distribution solutions for more than 400 stores in Guangzhou, and surrounding cities. In total, Yum! Now owns 16 distribution centers in China to serve 2,000 KFC, Taco Bell and Pizza Hut outlets. 'Fourth (4th) Party' logistics is also used by contemporary food service operators to cut costs and increase efficiency, and relies heavily on information management systems provided by an outside consultant. Although this approach is new to China, market leaders like Yoshinoya were among the first to benefit from 4th Party logistics, which streamlined purchasing, distribution and integrated accounting with front-line outlets in real time, reducing inventory loss and market response time.

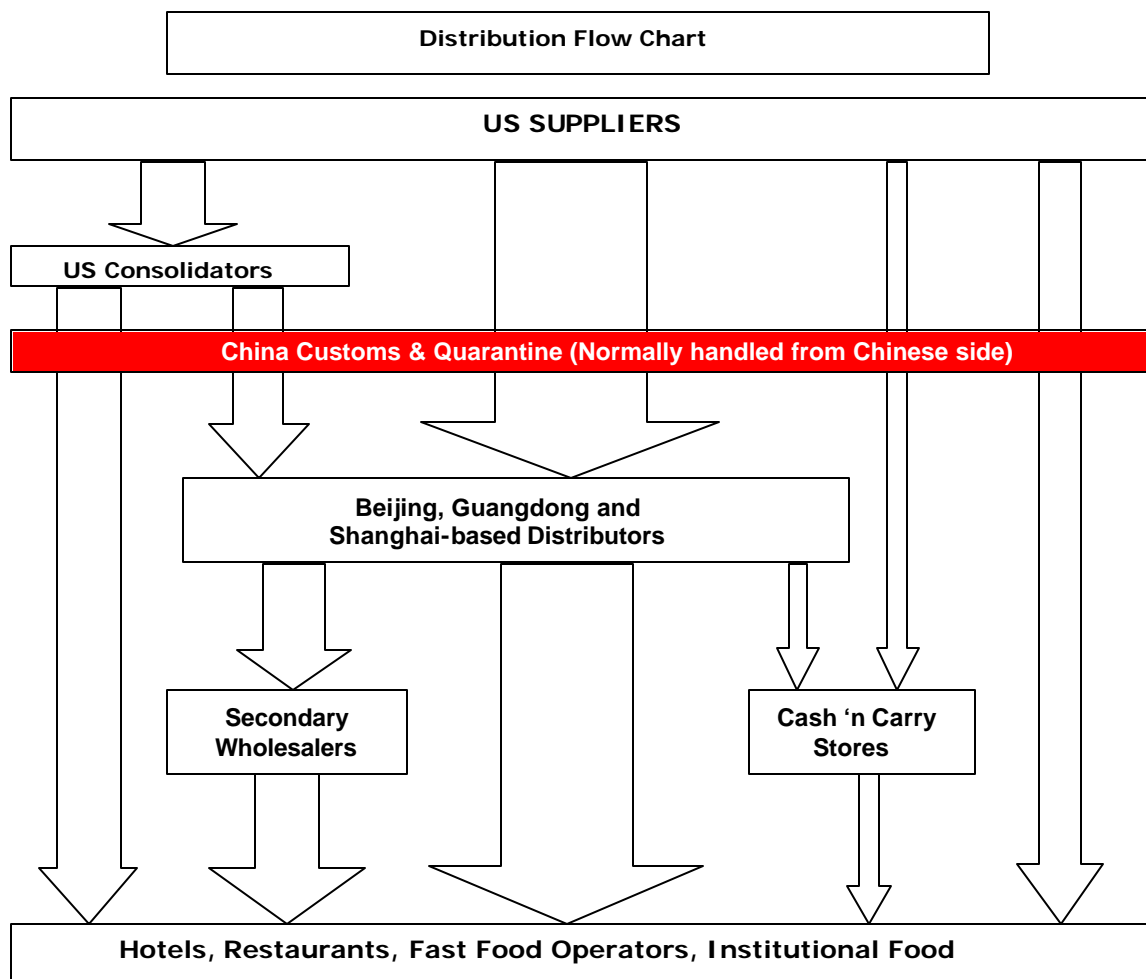
B. Entry Strategy

1. Overview

Entering China's market can be incredibly rewarding, but it requires hard work: selling and distributing your product requires face-to-face contact, a special effort to educate the entire value chain, and attention to the details of distribution. Even good distributors in China lack marketing experience and it can also be difficult to get them to focus on promoting your product among the hundreds or even thousands they may carry. Some suppliers conduct marketing on parallel tracks, working with their local distributors but also engaging a small independent marketing and sales force that reports directly to them. Entry strategy should focus on the elements below:

- Marketing, Sales and Education: Introducing your product and persuading them to use it is only the beginning. Chinese distributors and chefs are often interested in imported products, but usually lack proper handling and preparation knowledge. This can extend even to very basic products, like condensed canned soup or ingredients, etc. and strong educational effort is required.
- Selecting a Distribution Channel: At the same time, it is also important to make sure that your distribution channel can provide a consistent supply for your customers. Often, the first question buyers ask about a new product is, "Can I order it now?" This can be and often is a bit of a chicken-and-egg syndrome for a new supplier in the China market, but an important consideration nonetheless.

2. Marketing, Sales and Education



If there is one mantra that emerges from extensive discussions with HRI industry insiders, it is that the Chinese market needs to be educated from A-to-Z for most imported products. These means showing distributors how to handle and sell the product; developing recipes and demonstrating to chefs and food service staff how to use, prepare and serve it; launching promotional events to entice consumers with the resulting menu, and last but not least, persuasive articulation of why the product use makes commercial and economic sense in local terms.

Distributors will not make the effort alone, but are willing to work together with suppliers to make a product successful. Several full-service distributors say they focus on building worthwhile brands, which requires building relationships with buyers, providing technical support and training, making joint calls and hosting promotions. "You have to make people truly understand and how to use the product," says one of the major north China importers.

Successful suppliers have developed a number of strategies to educate the market. On sales calls, they go fully prepared to demonstrate their product. They develop recipes that incorporate the product into Chinese cuisine, illustrating broader versatility. Some bring in

chefs and set up a theme promotion at a local hotel for several weeks, often giving intensive and highly focused workshops for local chefs.

Catalogues, recipes and handling instructions are best provided in Chinese. This is particularly important with Chinese-operated hotels and restaurants, but even five-star hotels with western-trained chefs often have staff that have difficulty understanding labels and directions unless printed fully and clearly in Chinese.

Restaurateurs cite national or ethnic food fairs and promotions as an effective way to reach the ultimate consumer. Many restaurants look for opportunities to do special promotions, capturing customers on the lookout for a new dining experience. During 2008 Olympic Games in Beijing, large events like promotion and exhibitions will be considerably reduced, and months before the game actually start. One of the major food exhibitions, FHC China will instead to have the Beijing exhibition in 2009.

The United States Department of Agriculture (USDA) has several export programs that can help support promotion and training. As well, a number of US states and even some cities have offices in China; many cooperate with the US Agricultural Trade Offices in Beijing, Chengdu, Guangzhou, and Shanghai. The State Regional Trade Groups and other USDA market development cooperators also conduct a variety of effective educational and promotional market development programs and/or maintain representative offices in China.

3. Establishing the Supply Channel

The most important advice for U.S. suppliers before entering the China market is to partner with a good distributor. Like many Asian countries, business culture is heavily dependent on personal relationships in China. Face-to-face contact plays a key role in ensuring reliability in situations where legal structure and contract enforcement are vague. Selecting suitable distributors requires effort and cooperation on both sides. US suppliers should work to develop an understanding of target markets within China and clearly define their market expectations for their local distributor.

For their part, the distributor should be able to handle customs, quarantine and any licensing procedures. Some distributors do their own paperwork, while others use import agents. These procedures involve so many requirements and 'red tape' that few suppliers or end-users, including Chinese state-owned companies, try to do it on their own. Apart from the licenses and permits, hygiene certificates from the US government are also required for food products. In addition, Chinese import permits, hygiene and quarantine inspection certificates are expected on product entry. Proper labels in Chinese may be required, but stick-on labels are acceptable as long as they have already been applied to the product upon entry. Your distributor should have the ability to facilitate everything mentioned above. Plan ahead and work with distributors to understand the duration of each stage of the process – for example, getting label clearance may take 2 to 3 months and cost around RMB 2,500 (\$325).

It is crucial your importer or distributor is able to make payments in hard currency, or you will have trouble collecting payment. The government has considered plans to make the Chinese Yuan (CNY), also called Renminbi (RMB), into a fully convertible currency, but it may be a number of years before such plans become a reality. Currently, Chinese companies need special licenses to change RMB into US Dollars. Also, RMB exchange rates began to fluctuate and continue to appreciate against the US Dollar in 2007 – it is important to establish an agreed upon currency and exchange rate system or policy for any payments or costs.

Suppliers of perishable products need to be alert to the cold chain procedure of distributors, because infrastructure is uneven. Even in cities like Beijing, Shanghai and Guangzhou, many buyers use infrared guns and in-transit thermometers to check for tampering-temperature

variations. "You have to be a policeman; otherwise, they will cheat you." says the head of one local institutional catering company in Beijing.

The 2008 Olympic Games in Beijing will boost the food service sector as well as create improved safety of food supplies in particular, possibly affecting distribution and delivery. Traffic restrictions for trucks and vehicles delivering food to food service locations are to put in place during the Games. The 2008 Olympic Games, mainly hosted in Beijing, also have events and venues in Hong Kong, Qingdao, Qinhuangdao, Shanghai, Shenyang and Tianjin.

4. Protect Your Intellectual Property Rights

FAS China established an IPR Office in 2006 to address IPR and Labeling issues related to US agricultural and food products in China. The aim of the Office is to provide direct assistance to U.S. industry and commodity associations and businesses, in their effort to secure registration, as well as to prevent and/or address IPR infringement with appropriate market and legal enforcement remedies.

Although China continues to make efforts to strengthen its legal framework and amend its intellectual property rights (IPR) laws and regulations to comply with WTO obligations, U.S. agriculture and food products still face serious IPR infringement problems. Some examples of IPR infringement issues include:

- "Stickering" and labeling domestic and third-country products with U.S. identification such as California Table Grapes, California Pistachios, U.S. Wheat Flour, Washington Apples, Wisconsin Ginseng, etc., is widespread.
- False branding and packaging of domestic and third-country products with U.S. identification such as Sunkist® Citrus, Sun-Maid® Raisins, Napa Valley Wine
- Counterfeiting or mixing of domestic or third country products with U.S. food and beverages including poultry, beef and pork.
- Unauthorized sale-use of U.S. PVP protected plant materials and germplasm.

The most effective deterrent to piracy is to properly register patents, trademarks, plant varieties, geographical indicators, food labels, and other such IPR at home, in China, and third-country markets. Below are some of suggested resources to use. All of them contain information on China's patent, trademark legislation and enforcement, as well as Plant Variety Protection laws (PVP).

- Review FAS China's website: www.usdachina.org, find 'IPR in CHINA/ Introduction to Trademark Registration in China', the IPR Manual produced in 2007 by FAS IPR Office as well as other related information.
- Online reports: CH7027, CH7030, CH7046, CH7023, CH7028, CH7035, CH2049 and CH4059, available from: <http://www.fas.usda.gov/scriptsw/AttacheRep/default.asp>
- The U.S. Embassy's China IPR toolkit: http://beijing.usembassy-china.org.cn/protecting_ipr.html

The FAS China IPR Office is located in the Agricultural Trade Office (ATO) Beijing. For additional information, please email chinaipr@fas.usda.gov.

5. Entry Tips

Experienced distributors and buyers offer the following advice for those who wish to enter the China market:

- Take time to study the market. Understand the exporting/importing process from start to finish. Partner with a reliable and capable distributor to execute all necessary importing documents and licenses.
- Having a great product is only the beginning. It is critical to understand the target market and prospective clients before you enter the market. If an international hotel, restaurant, fast food chain or air caterer is an existing client in the U.S., try to use that as an entrée to the China branch.
- Be sure the products you carry are unique – if there is a similar domestic substitute or established foreign competitor, it may be difficult to compete on price/quality. An alternative strategy may be to enter the market by exploring geographic market segments not yet covered by the competition.
- Many suppliers get excellent market information by scheduling an initial visit to coincide with one of the many large international exhibitions held here in China, such as SIAL China, Food Ingredients China, Food & Hotel China (FHC), or China Fisheries and Seafood Expo. ATOs in Beijing, Chengdu, Guangzhou or Shanghai can provide contact details for show organizers upon request.
- Be financially prepared. Consider all possible costs, such as: license, customs handling, promotion, education and training, freight, tariffs and VAT.
- Unless you are supplying one of the fast food chains or a hotel group, only selected products may ship large volumes. Most likely you won't be able to start with full container loads so consider waiving order minimums during the market entry phase.
- Different regions in China have unique and diverse dietary habits and tastes in food, just as they do in the US. Always start in one region and conduct market tests before entering another. You may need to modify a product to make it conform to regional tastes and purchasing habits.
- Don't be too ambitious. Expand your business only after full confidence in operation in one location. One of the most common mistakes made in the China market is overly ambitious expansion without a solid foundation and loyal customers.
- Work to incorporate locally celebrated holidays, festivals and customs: Chinese New Year (Spring Festival), Mid-Autumn Festival, Qingming, Duanwu, May Day holiday and National Day holiday. Western holidays like Valentine's Day and Christmas are also increasingly celebrated here. International sporting events (Olympics, World Cup Soccer) are also very popular, and association with special events like weddings and business celebrations can provide good business opportunities.

Part III: COMPETITION

Imported food accounts for around 24% of the total value of China's food and beverage sector – as such, the imported foods market in China is very competitive with suppliers from around the world battling for market share. Australia, New Zealand, South Africa and the European Union are most likely to supply products that compete with American products. European suppliers in particular provide heavy support for chefs, and the media including regular training in China and abroad.

Future food trends in China include: 1. Increased focus on healthy-nutritious options as obesity and food safety continue to attract attention; 2. Growing popularity of 'fusion' foods as a combination of western and Asian flavors increasingly is accepted by consumers; 3.

Widespread exposure of Western food due to popularity of chained mass-marketers like KFC and McDonald's; 4. Olympic Games as a catalyst for internationalization in food as millions of Chinese are exposed to the catering services during the upcoming games. Value-added, self-service, portion control, increased food safety, and value for money or cost perceptions all are working to enhance the viability and acceptance of Western food options here.

In response to consumer demand for healthier foods, both McDonald's and Yum! Brands (KFC, Taco Bell and Pizza Hut) have introduced alternatives to traditionally perceived high-calorie Western fast food. Yum! Brands China launched a Chinese-style fast food chain 'Dongfang Ji Bai', also introduced healthier options like porridge, salads and wraps have found their way onto McDonalds and KFC menus.

Imported U.S. food products have an excellent reputation for consistent quality. Chefs' exhibit strong loyalties to US beef, despite the fact its unavailability at present. French up-market cheeses, yogurt and chocolates and Norwegian salmon are also considered premium quality. New Zealand and Australia have a clear proximity advantage in shipping times and cost, and dominate standard dairy imports destined for the HRI Sector here.

Most imported products face at least some locally manufactured and lower priced competition, unless it is something China doesn't produce at all (for example, olive oil). In addition, multi-nationals such as McCormick and DANONE manufacture products in China to for cost or market access reasons. Recently, a number of small companies have popped up near major cities, successfully producing highly perishable international food like mozzarella using overseas technology. Domestically produced product quality is improving; so, chefs and purchasing managers are increasingly faced with the decision of either substituting imported with a variety of improved local foods and food products.

Some buyers believe China will never be able to produce commodities that require large-scale corporate farming operations. For example, China still imports around 70% of its French fries, because Chinese growers have difficulty most years producing potatoes that are consistent in quality and economically competitive.

Counterfeit goods are another important competitive factor for products from the U.S. When a brand is established, counterfeit and cheap imitations often follow. Bad experiences with a high-priced "import" that is actually counterfeit can tarnish brand names and affect business for years. As a rule, QSR and high-end restaurants make a significant effort to ensure the integrity of the products it uses as genuine.

US product has a slight currency advantage due continuing appreciation of the RMB relative to the US Dollar, which make American products slightly less expensive relative to European or Australian products. However, the differences are still somewhat minimal and any cost savings are often not passed onto the consumer. The RMB is expected to continue its rise against the dollar, but some sources believe a major shift is less likely in the near term.

Imports and Competition

Product Category	Major Sources	Strength of Key Suppliers	Advantage/Disadvantage of Local Suppliers
Beef (fresh/chilled) Imports \$6 mil	1. Australia, 99% 2. New Zealand 3. Uruguay	Australia is clear leader as US out of the market due to BSE-related restrictions. Strong rebound expected when restrictions on US product lifted.	China's beef industry is nascent and meat quality not generally acceptable for stand-alone use such as steaks.
Beef (Frozen) Imports \$7 mil	1. Australia, 63% 2. Uruguay, 26% 3. Brazil, 6%		
Pork Imports \$123 mil	1. US, 57% 2. Canada, 22% 3. France, 13%	Canada, early in the China market, combined with strong export promo increased pork distribution in many of China's major ports.	Domestic pork industry is large, but made up of small farms with low production efficiency, poor consistency, and variable quality.
Lamb Imports \$78 mil	1. New Zealand, 61% 2. Australia, 39% 3. Uruguay, 0.4%	Unsurprisingly, global leaders New Zealand and Australia make a strong showing here	China's well-developed domestic lamb industry is centered in Inner Mongolia and particularly well branded.
Poultry Imports \$944 mil	1. US, 65% 2. Brazil, 21% 3. Argentina, 14%	Brazil and Argentina are aggressively seeking to build on their low-cost production to expand share and attract Chinese investment.	China's poultry industry has modern producers who are expanding into export. Much of the industry still produces live chicken for retail sales.
Fish and Seafood Imports \$3.4 bil	1. Russia, 39% 2. US, 13% 3. Japan, 6%	Much of Russia's exports are fish-meal; US leads in fish fillet category with 8,639 MT	China has a large and pervasive international fishing fleet
Dairy Imports \$753 mil	1. New Zealand, 39% 2. France, 15% 3. US, 14%	New Zealand is an aggressive supplier and has an advantage in shipping time. France has a strong reputation among high-end cheese buyers.	China's dairy industry is growing very rapidly, but still in an early stage of development. It produces milk and yogurt but doesn't really compete in cheeses or butters.
Cereals Imports \$514 mil	1. Thailand, 34% 2. Australia, 45% 3. Canada, 14%	US is after France and Vietnam occupying 5% market share.	China's cereal industry is large and growing very rapidly.
Nuts and edible fruits Imports \$912 mil	1. Thailand, 28% 2. US, 13% 3. Vietnam, 12%	Thailand is the leading supplier of tropical fruits; US is strong in and almonds, walnuts.	China is a large walnut grower as well as many other temperate nuts, but quality remains low.
Soups, Broths, Preparations Imports \$6.8 mil	1. Japan, 35% 2. Australia, 23% 3. US, 19%	The US is considered a technological leader in this category.	Cheap labor meant slow growth in this market, but demand for prepared products is escalating rapidly.
Beverages Imports \$867 mil	1. France, 54% 2. UK, 14% 3. Australia, 5%	France's strong lead is largely due to its early and dominant wine position in global markets.	China's fruit juice industry is well developed; wine is low or inconsistent in quality. The highly competitive domestic beer industry includes multinational players like Budweiser.
Vegetables Imports \$801 mil	1. Thailand, 57% 2. Vietnam, 22% 3. Canada, 8%	Thailand and Vietnam profit from geographic proximity and are able to meet domestic food safety standards. US imports are mostly negligible.	Production of fresh vegetables has increased consistently with some imports substituted in recent years.

China Customs Data, retrieved from World Trade Atlas 2008

Part IV: BEST PRODUCT PROSPECTS

Interviews with HRI food service professionals repeatedly confirm that US food exporters should select top quality products for export to China. US foods benefit from expectations of high quality, attractive appearance, convenient package and food safety. On the other hand, it is difficult for most US food products to compete with Chinese domestic products on price, particularly for those foods in demand by the HRI market. Instead, suppliers should consider targeting niche as well as regional markets with top-quality products that are unique, healthy, and nutritious.

U.S. beef has been banned for import in China since December 2003 due to BSE. Food service professionals in the HRI sector remain committed to using US beef due to consistent and unparalleled quality, and note that it out easily out-competes competitor suppliers on flavor and appearance. Salmon, from a variety of country suppliers, is a popular import item, used widely in Japanese kitchens. American lobster, particularly live lobster, generates much interest; however, high costs and losses associated with shipping live product have resulted in a market dominated by Australian lobster. U.S. citrus, apples and table grapes from the US remain strong competitors in the imported fruit market, especially during the off season for domestic products. Tree nuts are also very popular in China, especially almonds, walnuts, and to some extent pistachios, as a result of perceived health and nutrition benefits.

As China's economic development continues and interest in processed food grows, the secondary production of goods, such as meat and fish, may well become attractive to manufacturers and agricultural sub-sectors may also manage to profit from foreign direct investment. The secondary stage of processing such goods, for example, sliced meats, prepared chicken, etc., has had a huge impact on HRI sector sales. Also, ready-to-use and value-added products considered unlikely prospects only a few years ago are increasingly in demand. Ready-made, pre-cooked and portion-control sauces, soups, pizzas, vegetables, fish fillets, meat and meat products, and frozen dough.

Likewise, organic food in China could prove a strong long-term opportunity. At present, due to a lack of local understanding of organic with little investment in the sector, the industry is under-developed with official organic agriculture representing much less than 1% of domestic agricultural production. The higher price for organic products and lack of awareness of the concept means China's organic market is still in its early phase. However, with careful promotion, high-quality imported organic products appeal to hip, young professionals, and their grandparents who remember when it was safe to eat an apple without peeling it first. These products have good potential in China's increasingly food-safety conscious market.

In the Market with Potential	Present and with Good Potential	Products not Present or Diminishing
Beef Beer Bottled water Breakfast cereals, muesli Chocolate Chicken paws Coffee Condiments Cream Dairy Frozen potatoes (French fries, wedges) Frozen berries Fruit (grapes, grapefruit, oranges, Kiwi) Lamb Liquor Nuts and dried fruit Olive oil Pasta Pork Potato preparations Premium fruit juices Premium yogurt Seafood (lobster, tuna, salmon, mussels, seaweed) Veal Wheat flour Wine	Organic foods; Pre-cooked sauces; Portion-control fish fillet and meats; Cheese; Butter; Bulk cheese for catering use; Colors and flavors; Fresh, Canned and maraschino cherries and other berries; Turkey and other poultry products	Fresh Fruits (domestic substitution of apples, pears) Mayonnaise (JV manufacturing in China) Ketchup (JV manufacturing in China) Baked potatoes Onion rings Red cabbage (domestic substitution)

Part V: Post Contact and Additional Resources

For further information about the China market, as well as updates on our upcoming events and activities, please visit our website at www.usdachina.org or contact one of USDA's six offices in China:

FAS/Agricultural Affairs Office, Beijing

5-2 Qijiayuan Diplomatic Compound
Jianguomenwai, Beijing, China, 100600
Phone: (8610) 6532-1953
Fax: (8610) 6532-2962
E-mail: agbeijing@usda.gov

Animal and Plant Health Inspection Service (APHIS), Beijing

Room 618, Beijing International Club Office Building
No. 21 Jianguomenwai Avenue
Beijing, China 100020
Phone: (8610) 6532-3212
Fax: (8610) 6532-5813
E-mail: theresa.boyle@aphis.usda.gov

Agricultural Trade Office, Beijing

Kerry Center, South Tower
Suite #2425, 24th Floor
No. 1 Guanghua Lu, Beijing 100020
Phone: (8610) 8529-6418
Fax: (8610) 8529-6692
E-mail: atobeijing@fas.usda.gov

IPR Office

Email: chinaipr@fas.usda.gov

Agricultural Trade Office, Guangzhou

China Hotel Office Tower, 14/F
Guangzhou 510015, China
Phone: (8620) 8667-7553
Fax: (8620) 8666-0703
Email: atoguangzhou@fas.usda.gov

Agricultural Trade Office, Shanghai

Shanghai Center, Suite 331
1376 Nanjing West Road
Shanghai 20040, China
Phone: (8621) 6279-8622
Fax: (8621) 6279-8336
E-mail: atoshanghai@fas.usda.gov

Agricultural Trade Office, Chengdu

1222 Western Tower,
No. 19, 4th Section, Renmin Nan Road, Chengdu, 610041 China
Phone: (8628) 8526 8668
Fax: (8628) 8526 8118
E-mail: atochengdu@fas.usda.gov