
INDUSTRY OVERVIEW

This and other sections of this prospectus contain certain information which is derived from official government publications and industry sources as well as a report we commissioned from Euromonitor International, an Independent Third Party. We believe that the sources of this information are appropriate sources for such information and have taken reasonable care in extracting and reproducing such information. We have no reason to believe that such information is false or misleading or that any fact has been omitted that would render such information false or misleading. The information derived from the above sources has not been independently verified by us, the Sole Sponsor, the Sole Bookrunner, the Underwriters, any of their respective directors, affiliates or any other party involved in the Share Offer and no representation is given as to its accuracy. Unless otherwise indicated, all figures in this industry overview section are in nominal terms.

SOURCES OF INFORMATION

We commissioned a report from Euromonitor International, an Independent Third Party, to conduct an analysis of, and to report on, cigarettes and cigarettes packaging markets in the PRC for the period from 2007 to 2016. The date of the report was 29 June 2012. Euromonitor International has been engaged in a number of market assessment projects in connection with initial public offerings in Hong Kong, covering the PRC's manufacturing industries in particular. A total fee of US\$33,600 was paid to Euromonitor International for the preparation of the report. The report commissioned has been prepared by Euromonitor International independent of our influence.

Euromonitor International has developed a custom research programme to look into the primary interest areas for the cigarette and cigarette packaging markets in the PRC, with following main focuses,

- Overview of the PRC's economy
- Overview of the PRC's cigarette industry
- Cigarette packaging industry in the PRC and Jiangsu Province

Euromonitor International primarily undertook top-down central research with bottom-up intelligence to present a more comprehensive and accurate picture of the cigarette and cigarette packaging market in the PRC.

Euromonitor International gathered information from multiple relevant published data sources, including National Bureau of Statistics of China, STMA, Tobacco Market of China and Tobacco China Online.

Euromonitor International conducted trade interviews with the cigarettes and cigarette packaging manufacturers, distributors, retailers and any other third parties for fresh data, opinions and insights, as well as national or regional industry associations, government,

INDUSTRY OVERVIEW

semi-official and other industry observers. Euromonitor International believes that interviewing respondents from different departments within companies and multiple companies through the value chain enables coverage of a range of issues and help reconcile a spectrum of data and opinions. A reliable data set and valid conclusions is reached by independently building segment consensus.

Euromonitor International adopted its standard practice of both quantitative as well as qualitative forecast in terms of the market size, growth trends on the basis of a comprehensive and in-depth review over the historical market development, and a cross check with established government, industry figures or trade interviews. Estimated statistics for further periods up to 2016 have been derived based on this projection methodology.

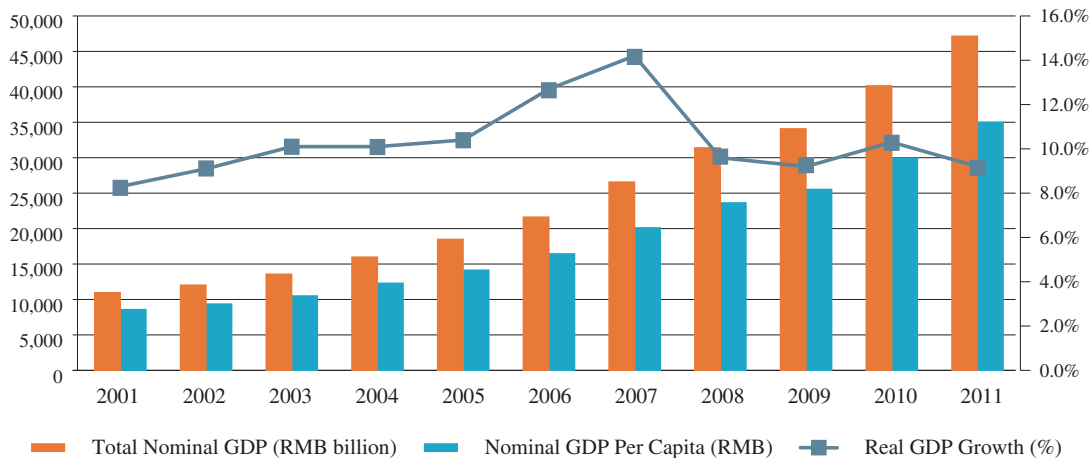
Euromonitor International's primary and secondary research sources are first standardised, checked and validated to ensure a robust research feed for its analysis. A critical analysis of all sources and insights is conducted whereby Euromonitor International compares data, insights and hypotheses to arrive at a set of data and conclusions.

THE PRC ECONOMIC OVERVIEW

The PRC has had accelerated economic growth over the past few years

With the consistent high growth rate around 10% of the PRC's GDP over the last few years, the PRC fortified its position as one of the world's most dynamic economies. Although the global economy stagnated in 2008 during the financial crisis, which caused the PRC to show a slower growth rate compared to previous years, increased growth during 2009 and 2010 indicated that the PRC has been recovering from the economic downturn. The per capita GDP in the PRC reached RMB29,943.3 in 2010, realising a per capita incremental growth of RMB4,398.0 over 2009. According to the latest data preliminarily published by the 中華人民共和國國家統計局 (National Bureau of Statistics of China*), the PRC's GDP achieved RMB47,156.4 billion in 2011, realising 9.2% real growth compared to that in 2010.

Nominal GDP and Nominal Per Capita GDP growth in the PRC



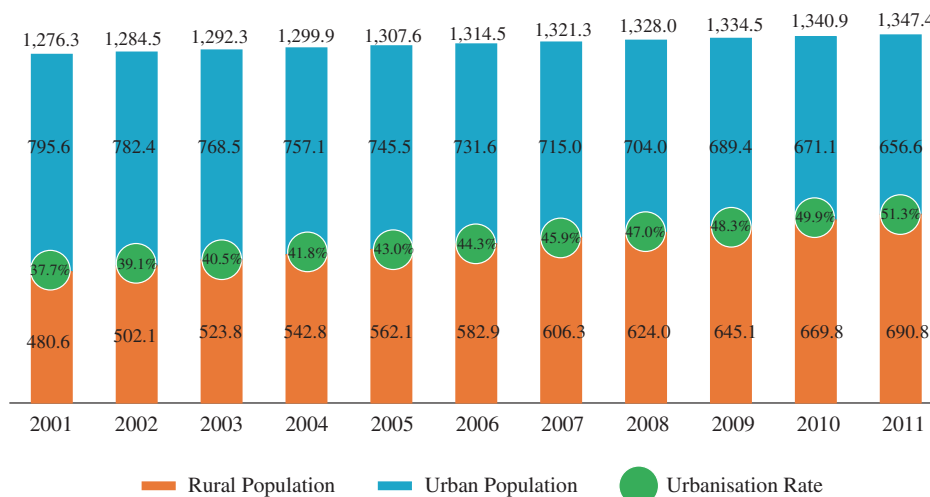
Source: National Bureau of Statistics of China

INDUSTRY OVERVIEW

Rapid urbanisation and increasing disposable income

The PRC's urbanisation is in a stage of acceleration. This is the result of the rapid evolution of the PRC's social structure, with more people settling down in cities and the establishment of more supermarkets, department stores and shopping facilities to meet their rising needs. The latest data issued by the National Bureau of Statistics of China showed that, in 2011, the PRC population reached 1,347.4 million, with the share of urban population making up over half as 51.3% to reach 690.79 million, which indicated that with the past decades of accelerated urbanisation, the PRC has been entitled to come onto a new stage to witness brand-new urban and rural population structure.

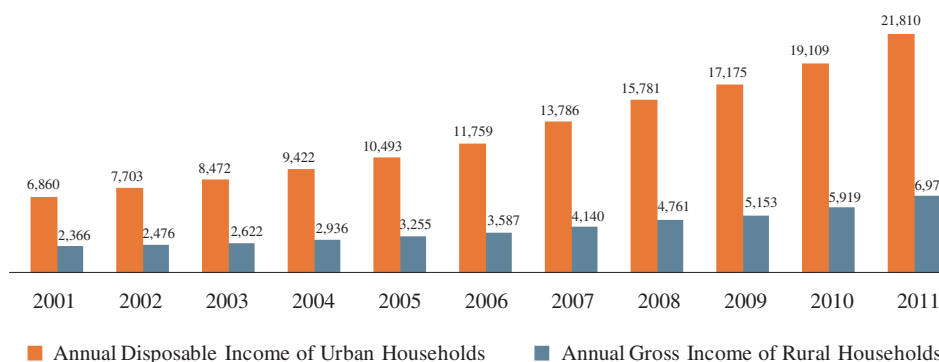
Urban and Rural Population in the PRC (in million)



Source: National Bureau of Statistics of China

The PRC's fast growing economy has brought more disposable income to the Chinese people, which cultivated a solid base of consumers. The per-capita annual disposable income of urban households has reached RMB21,810 in 2011, up to 8.4% in terms of real annual growth rate over the previous year. Simultaneously, the per-capita annual gross income of rural households has sustained continuous growth to reach RMB6,977 in 2011. Due to ascending income levels, the purchasing power of consumers has strengthened, which is directly linked to the performance of consumer market.

Per Capita Annual Income in the PRC (in RMB)



Source: National Bureau of Statistics of China

INDUSTRY OVERVIEW

CIGARETTE MARKET IN THE PRC

Market overview

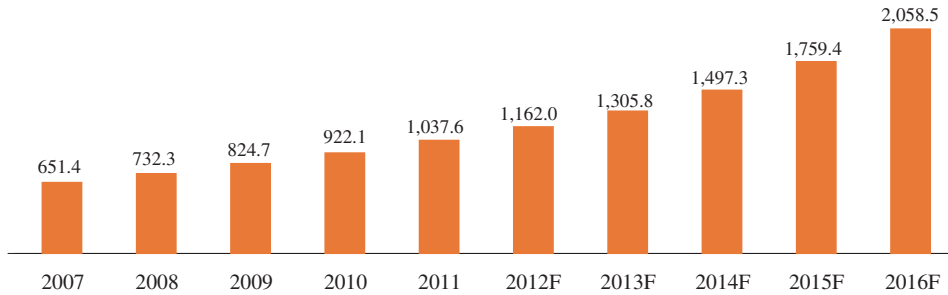
Cigarette market is growing stably in the PRC

The PRC is one of the most important countries for cigarette manufacturing, besides the United States of America and Japan. Cigarette (duty paid) market in the PRC maintained its high growth rate over the past few years and reached RMB1,037.6 billion in retail sales value by the end of 2011, realising a growth of 12.5% over 2010. This was mostly attributable to the on-going consolidation across the cigarette industry, so that all of the companies engaged in this field have been experiencing the same transition. During this transition, the large number of small-sized and low-efficiency players would be washed out and those who stayed in-line with the reform would benefit from the change. Cigarettes are classified into “high-tar cigarettes” (white stick cigarettes with a tar content of greater than 10 milligrams); “mid-tar cigarettes” (white stick cigarettes with a tar content of six to 10 milligrams); “low-tar cigarettes” (white stick cigarettes with a tar content of four to six milligrams); and “ultra low-tar cigarettes” (white stick cigarettes with a tar content of less than four milligrams). With effect from 2011, cigarette with tar level of over 12 milligrams per stick is prohibited to be sold in the PRC, and according to STMA, cigarette with tar level of over 11 milligrams will be prohibited to be sold in the PRC with effect from 2013, while cigarette with tar level of over 10 milligrams will be prohibited to be sold in the PRC in 2015. “High-tar cigarettes” are sold at a lower unit price and captured a higher market share in the PRC currently. Most of the 20 + 10 Key Brands, including Nanjing, Su Yan and the other brand under the “20 + 10” Key Brands for which our Group currently supply packaging materials, supply “high-tar cigarettes”. As a result of the STMA’s policy to prohibit the sale of “high-tar cigarettes” in the PRC, it is expected that cigarette manufactures will migrate to produce other classes of cigarettes, so that smokers in the PRC will switch to consume other classes of cigarettes which are selling at a higher unit price. Accordingly, the forecasted cigarette market size in the PRC in monetary term will be increased at a higher rate than that of the previous several years.

Based on the measures aimed at upgrading the cigarette industry, this market is expected to enjoy the scale-effect and show more prosperous growth in the future. By 2016, the cigarette market in the PRC is expected to achieve RMB2,058.5 billion, attaining a CAGR of 15.4% over the period from 2012 to 2016, even higher than that of the period from 2007 to 2011, when the CAGR was 12.3%.

INDUSTRY OVERVIEW

Cigarette Market Size in the PRC (in RMB billion)

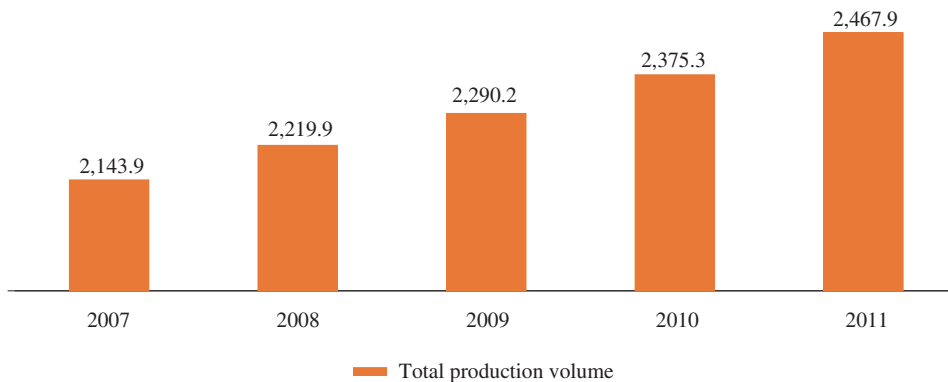


Source: Euromonitor International

In terms of production, the cigarette market in the PRC rose to 2,467.9 billion sticks in 2011, with a mild growth rate of 3.9%. Over the period from 2007 to 2011, the cigarette production kept growing at a stable pace around a CAGR of 3.6%. However in the meantime, the retail sales of cigarette in value terms in the PRC has been increasing at a much higher CAGR of 12.3%. This distinct gap between production volume and the sales value indicated the rising unit selling price of cigarette and the rising cost occurring with the structural adjustment of cigarette industry with more output of mid-to-high end cigarettes.

According to National Bureau of Statistics of China, the production volume of cigarettes in Jiangsu Province and Shandong Province reached 99.1 billion sticks and 136.1 billion sticks respectively. STMA indicated that the sales volume of cigarettes in Jiangsu Province reached 126.9 billion sticks in the first eleven months in 2011 and Shandong Province reached 178.5 billion sticks in the full year of 2011.

Cigarette Production Volume in the PRC (in billion sticks)



Source: National Bureau of Statistics of China

China cigarette market is monopolised by CNTC

Cigarette in China was a monopoly market, with CNTC dominating the market with a share of 97.8% in 2011. CNTC is the only legitimate company to manufacture cigarettes in the PRC, which is comprised of three types of entities: Cigarette Group (煙草集團), Provincial Tobacco Industrial Company (省級中煙工業公司) and China Tobacco Industry Development

INDUSTRY OVERVIEW

Center (中國煙草實業發展中心). The other main companies with sales in cigarette market in the PRC refer to all of the foreign cigarette manufacturers, including British American Tobacco P.L.C, Philip Morris International Inc. and Japan Tobacco Inc., taking a share of 0.6%, 0.3% and 0.1% separately.

According to STMA, CNTC administered a unified management system to regulate the overall twenty-six cigarette manufacturing companies in the PRC. These twenty-six companies include one cigarette group, sixteen “Provincial Tobacco Industrial Companies” (省級中煙工業公司) and nine other non-provincial companies under the “China Tobacco Industry Development Center” (中國煙草實業發展中心).

Cigarette Group

It refers to Shanghai Tobacco Group Co., Ltd.

Provincial Tobacco Industrial Companies

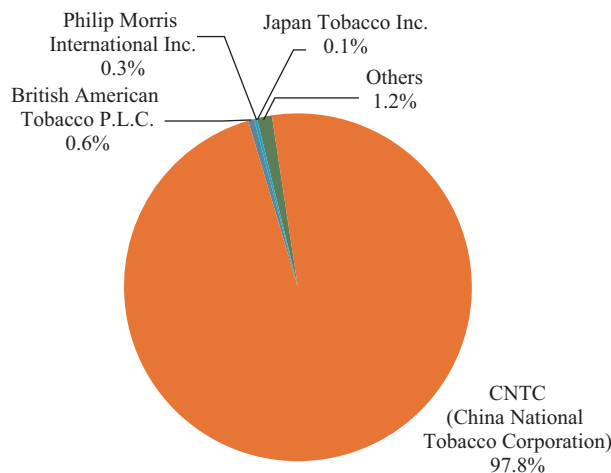
Sixteen Provincial Tobacco Industrial Companies established by CNTC in China to unify its management at the provincial level. The Provincial Tobacco Industrial Companies’ distribution almost covered all the regions in China.

China Tobacco Industry Development Center

It has nine non-provincial tobacco industrial companies in China and is a subsidiary of CNTC.

As with other Provincial Tobacco Industrial Companies, China Tobacco Shandong Industrial Co., Ltd, China Tobacco Jiangsu Industrial Co., Ltd and China Tobacco Guangxi Industrial Co., Ltd monopolise the in-province cigarette manufacturing market in their respective province, taking a share of 4.5%, 3.9% and 2.2% respectively in the cigarette manufacturing market in retail sales volume terms in the PRC in 2011.

Market Shares of Cigarette Market in Retail Sales Volume in the PRC in 2011

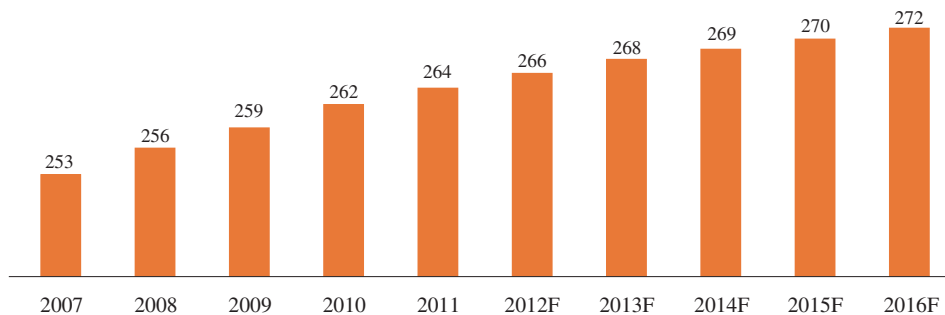


Source: Euromonitor International

INDUSTRY OVERVIEW

Besides, the smoker population of the PRC reached 264.1 million in 2011, and it is forecasted to maintain steady growth in the near future. Although with the increasing awareness of health, smoking population's growth rate has slowed down when compared to that of previous years when it was around 1.1% which is consistent with the historical trend of decrease in the rate of increase of smoking population in the last few years and as a result of the smoking control policies adopted by the PRC Government as set out in the section headed "Regulatory overview" in this prospectus, in face of the huge base of smokers, cigarettes will be continuously in demand, which promises a further development of the cigarette market in the PRC.

Smoking Population in the PRC (in million)

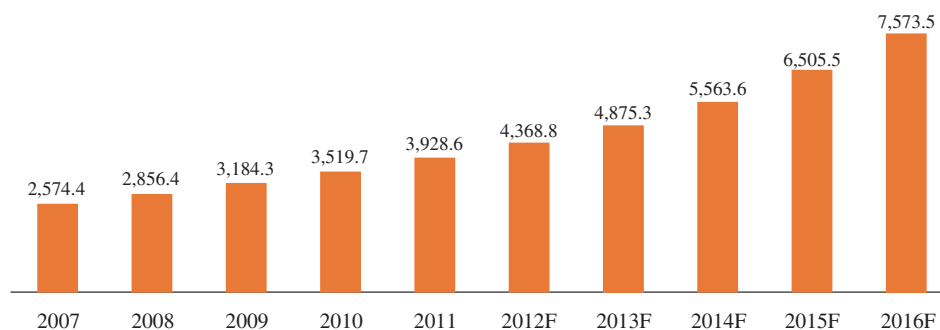


Source: Euromonitor International

Per capita annual consumer expenditure on cigarette for smoking population

Consumer expenditures in the PRC have been growing rapidly due to the PRC's booming economy. Per capita annual consumer expenditures on cigarette for smoking population reached about RMB3,928.6 by the end of 2011, increasing by 11.6% over 2010, when the number was RMB3,519.7. The increase results from the rising disposable income of the population, the development of cigarette industry in the PRC and the expected switch from consuming high-tar cigarettes to other classes of cigarettes, which are selling at a higher unit price, as a result of the government policy to prohibit the sale of high tar cigarettes in the future.

Per Capita Annual Consumer Expenditure on Cigarette for Smoking Population in the PRC (in RMB)



Source: Euromonitor International

INDUSTRY OVERVIEW

Market trends

The PRC Government issued relevant policy to exert great impact on the tobacco industry

In 2002, the STMA raised the development strategy of “Great Market, Famous Brand and Large Enterprise” (大市場、大品牌、大企業), which became the policy basis of brand expansion during the period of “The 10th Five-Year Plan” (十五計劃). In 2003, the concept of the “Chinese-style Cigarette” (中式捲煙) was proposed to be incorporated into the current cigarette brands, which would provide a way to consolidate their brand positions.

In 2003, the PRC signed the WHO Framework Convention on Tobacco Control to protect the health and environment from tobacco consumption and exposure to tobacco smoke to a great extent. The agreement provided a framework for tobacco control measures and came into effect in the PRC in 2005. Relevant measures relating to the reduction of demand for tobacco include (i) Price and tax measures; (ii) Regulation of the contents of tobacco products; (iii) Regulation of tobacco product disclosures; (iv) Packaging and labeling of tobacco products; (v) Education, communication, training and public awareness; (vi) Tobacco advertising, promotion and sponsorship. The cigarette market in the PRC is monopolised by the PRC Government, referring to the STMA (State Tobacco Monopoly Administration) and the CNTC (China National Tobacco Cooperation). As per the promulgation of the Regulation on Tobacco Monopoly in early 1983, the PRC commenced the tobacco retailing market in a pure way of top-down execution. In recent years, the tobacco industry in the PRC has been undergoing restructuring and consolidation. In 2000, there were a total of 1,181 cigarette brands in the PRC and the cigarette industry was faced with inefficiency problems, such as being fragmented, small-scale and having low productivity. Thus in 2001, STMA issued “Proposal on Accelerating Structural Adjustment for Cigarette Products” (關於加快捲煙產品結構調整的意見), framed “Strategic Research Outline of China Cigarette Brands” (中國捲煙品牌戰略研究提綱) and issued the list of “Famous and High Quality Cigarette Brands over the National Tobacco Industry, 2001” (2001年度全國煙草行業名優捲煙品牌), in which 36 brands were listed. Meanwhile, some small factories with an annual output of less than 100,000 master cartons were closed at a gradual pace. Those manufacturers with an annual output of between 100,000 to 300,000 master cartons were acquired by other manufacturers, and the manufacturers with an annual output of around 400,000 master cartons were merged with other manufacturers, according to the brand strategy of the PRC’s cigarettes.

INDUSTRY OVERVIEW

In 2004, the STMA issued a list of 100 brands of cigarette products aiming for a reduction of the number of cigarette brands within two to three years. In 2006, the STMA announced “Development Outline of China Cigarette Brands” (中國捲煙品牌發展綱要), specifying the plan to focus on cultivating 10 key brands and 10 key enterprises during the “The 10th Five-Year Plan”. In 2008, the STMA proposed a “20+10” plan to identify a total of 30 key brands across the national market.

“20+10” Brand Directory

Identity	Brand Name (in English)	Brand Name (in Chinese)	Company Name (in English)	Company Name (in Chinese)
20 Key National Backbone Cigarette Brands	Chunghwa	中華	Shanghai Tobacco Group Co., Ltd	上海煙草(集團)有限責任公司
	Yunyan	雲煙	China Tobacco Yunnan Industrial Co., Ltd	雲南中煙工業有限責任公司
	Furongwang	芙蓉王	China Tobacco Hunan Industrial Co., Ltd	湖南中煙工業有限責任公司
	Yuxi	玉溪	China Tobacco Yunnan Industrial Co., Ltd	雲南中煙工業有限責任公司
	Baisha	白沙	China Tobacco Hunan Industrial Co., Ltd	湖南中煙工業有限責任公司
	Hongtashan	紅塔山	China Tobacco Yunnan Industrial Co., Ltd	雲南中煙工業有限責任公司
	Su Yan	蘇煙	China Tobacco Jiangsu Industrial Co., Ltd	江蘇中煙工業有限責任公司
	Liqun	利群	China Tobacco Zhejiang Industrial Co., Ltd	浙江中煙工業有限責任公司
	Honghe	紅河	China Tobacco Yunnan Industrial Co., Ltd	雲南中煙工業有限責任公司
	Huanghelou	黃鶴樓	China Tobacco Hubei Industrial Co., Ltd	湖北中煙工業有限責任公司
	Septwolves	七匹狼	China Tobacco Fujian Industrial Co., Ltd	福建中煙工業有限責任公司
	Huangshan	黃山	China Tobacco Anhui Industrial Co., Ltd	安徽中煙工業有限責任公司
	Nanjing	南京	China Tobacco Jiangsu Industrial Co., Ltd	江蘇中煙工業有限責任公司
	Shuangxi	雙喜	China Tobacco Guangdong Industrial Co., Ltd	廣東中煙工業有限責任公司
	Double Happiness	紅雙喜	Shanghai Tobacco Group Co., Ltd	上海煙草(集團)有限責任公司
	Hongmei	紅梅	China Tobacco Yunnan Industrial Co., Ltd	雲南中煙工業有限責任公司
	Pride	嬌子	China Tobacco Chuanyu Industrial Co., Ltd	川渝中煙工業有限責任公司
	Huangguoshu	黃果樹	China Tobacco Guizhou Industrial Co., Ltd	貴州中煙工業有限責任公司
	Zhenlong	真龍	China Tobacco Guangxi Industrial Co., Ltd	廣西中煙工業有限責任公司
	Dihao	帝豪	China Tobacco Henan Industrial Co., Ltd	河南中煙工業有限責任公司
The Other 10 Key Cigarette Brands	Taishan	泰山	China Tobacco Shandong Industrial Co., Ltd	山東中煙工業有限責任公司
	Diamond	鑽石	China Tobacco Hebei Industrial Co., Ltd	河北中煙工業有限責任公司
	Jinshen	金聖	China Tobacco Jiangxi Industrial Co., Ltd	江西中煙工業有限責任公司
	Haomao	好貓	China Tobacco Shanxi Industrial Co., Ltd	陝西中煙工業有限責任公司
	Lanzhou	蘭州	Gansu Tobacco Industry Co., Ltd	甘肅煙草工業有限責任公司
	Changbaishan	長白山	Jinlin Tobacco Industry Co., Ltd	吉林煙草工業有限責任公司
	Zhongnanhai	中南海	Shanghai Tobacco Group Co., Ltd	上海煙草(集團)有限責任公司
	Derby	都寶	China Tobacco Anhui Industrial Co., Ltd	安徽中煙工業有限責任公司
	Golden Bridge	金橋	China Tobacco Fujian Industrial Co., Ltd	福建中煙工業有限責任公司
	Guiyan	貴煙	China Tobacco Guizhou Industrial Co., Ltd	貴州中煙工業有限責任公司

Source: STMA

INDUSTRY OVERVIEW

In 2009, the STMA issued “Proposal on Accelerating Cultivation of National Key Brands” (關於加快培育全國性重點骨幹品牌的指導意見) (the “Proposal”) to speed up the brand development strategy, realising the shift from simply scale-output to efficient scale-effect. The “National Key Brands” referred to in the Proposal refers to the national key brands identified pursuant to the National Key Brand Evaluation System (全國性捲煙重點骨幹品牌評價體系) and the top thirty of them are referred as “20+10 Key Brands”. The Proposal did not set out a list of “National Key Brands”. The Proposal was designed to focus on developing tiers one to three cigarette brands as listed above from the “20+10” Key Brands by improving their proportion of sales in the overall tiers one to three cigarette market. Meanwhile, sales of tiers four and five cigarette brands should be controlled within a limited range to facilitate the growth and consolidation of tiers one to three cigarette brands. As such, cigarette product structure is expected to be upgrading with increasing growth of higher tier brands in sales terms. According to the standard for classification of cigarettes in five tiers issued by STMA, the three brands under the “20+10” Key Brands currently using our Group’s products (including Nanjing and Su Yan) are classified as tier-one cigarette brands.

Furthermore, in 2010, the STMA announced the “532” and “461” plans to facilitate the consolidation process and enhance operations within the tobacco industry. Specifically, the “532” plan aims to cultivate five cigarette brands achieving an annual production volume of over two million master cartons, three cigarette brands with an annual production volume of over three million master cartons, and two cigarette brands realising over five million master cartons by 2015, which will aggregate the competitive force to form some giants in cigarette industry in the PRC. On the other hand, the “461” plan was set to bring up twelve cigarette brands with an annual sales turnover of over RMB40 billion, among which six brands would reach a turnover of over RMB60 billion with one cigarette brand achieving an annual sales turnover of over RMB100 billion by 2015. The current plan is on track and the cigarette industry in the PRC will display a more consolidated landscape in the future.

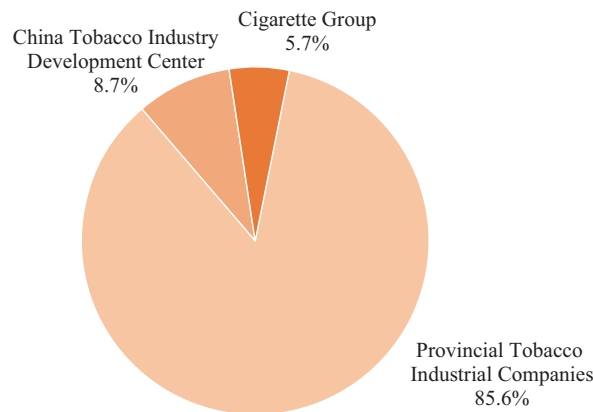
Note: STMA issued the standard for classification of cigarette in five tiers as follows: for one standard carton of cigarettes (200 sticks), 1) tier-1 cigarettes: with selling price (VAT excluded) of above RMB100; 2) tier-2 cigarettes: with selling price (VAT excluded) of RMB70 to RMB100; 3) tier-3 cigarettes: with selling price (VAT excluded) of RMB30 to RMB70; 4) tier-4 cigarettes: with selling price (VAT excluded) of RMB16.5 to RMB30; 5) tier-5 cigarettes: with selling price (VAT excluded) of below RMB16.5.

INDUSTRY OVERVIEW

Tobacco industry has been undergoing a facilitated evolution to realise higher-level consolidation

In line with the relevant policy issued by the PRC Government to exert influence on the industry consolidation at the macro level, specific cigarette brands have been energised to facilitate the process, which was represented in the decreasing number of both manufacturers and brands. During the last round of reconstruction between 1999 and 2009, interprovincial consolidation began to be realised with Hongta Tobacco (Group) Co., Ltd. and China Tobacco Hunan Industrial Co., Ltd. acting as the forefront in the merger rush. Other major tobacco groups emerged as leaders of the revolution with Shanghai Tobacco Group acquiring the Beijing Tobacco Factory in 2003 and Tianjin Tobacco Factory in 2004. According to STMA, the number of cigarette manufacturing companies in the PRC has declined to 26 by 2011, as opposed to the year 2000 when there were nearly 200 enterprises involved in cigarette manufacture. These 26 companies include one cigarette group, 16 “Provincial Tobacco Industrial Companies” (省級中煙工業公司) (Hongyuhonghe Tobacco (Group) Co., Ltd. and Hongta Tobacco (Group) Co., Ltd are the subsidiaries of China Tobacco Yunnan Industrial Co., Ltd.) and nine other non-provincial companies from the “China Tobacco Industry Development Center” (中國煙草實業發展中心). The total brand number decreased from 1,181 in 2000 to 117 by 2011.

Manufacturers in Cigarette Manufacturing Market in the PRC in 2011



INDUSTRY OVERVIEW

State Tobacco Monopoly Administration (國家煙草專賣局)/China National Tobacco Corporation (中國煙草總公司)

Identity	Company Name (in English)	Company Name (in Chinese)	Market Share (Volume)
Cigarette Group/煙草集團	Shanghai Tobacco Group Co., Ltd	上海煙草(集團)有限責任公司	5.7%
Provincial Tobacco Industrial Company/省級中煙工業 公司	China Tobacco Hebei Industrial Co., Ltd	河北中煙工業有限責任公司	85.6%
	China Tobacco Jiangsu Industrial Co., Ltd	江蘇中煙工業有限責任公司	
	China Tobacco Zhejiang Industrial Co., Ltd	浙江中煙工業有限責任公司	
	China Tobacco Anhui Industrial Co., Ltd	安徽中煙工業有限責任公司	
	China Tobacco Fujian Industrial Co., Ltd	福建中煙工業有限責任公司	
	China Tobacco Jiangxi Industrial Co., Ltd	江西中煙工業有限責任公司	
	China Tobacco Shandong Industrial Co., Ltd	山東中煙工業有限責任公司	
	China Tobacco Henan Industrial Co., Ltd	河南中煙工業有限責任公司	
	China Tobacco Hubei Industrial Co., Ltd	湖北中煙工業有限責任公司	
	China Tobacco Hunan Industrial Co., Ltd	湖南中煙工業有限責任公司	
	China Tobacco Guangdong Industrial Co., Ltd	廣東中煙工業有限責任公司	
	China Tobacco Guangxi Industrial Co., Ltd	廣西中煙工業有限責任公司	
	China Tobacco Chuanyu Industrial Co., Ltd	川渝中煙工業有限責任公司	
	China Tobacco Guizhou Industrial Co., Ltd	貴州中煙工業有限責任公司	
China Tobacco Yunnan Industrial Co., Ltd	雲南中煙工業有限責任公司		
China Tobacco Shanxi Industrial Co., Ltd	陝西中煙工業有限責任公司		
China Tobacco Industry Development Center/ 中國煙草實業發展中心	Heilongjiang Tobacco Industry Co., Ltd	黑龍江煙草工業有限責任公司	8.7%
	Hongta Liaoning Tobacco Co., Ltd	紅塔遼寧煙草有限責任公司	
	Jinlin Tobacco Industry Co., Ltd	吉林煙草工業有限責任公司	
	Gansu Tobacco Industry Co., Ltd	甘肅煙草工業有限責任公司	
	Shenzhen Tobacco Industry Co., Ltd	深圳煙草工業有限責任公司	
	Inner Mongolia Kunming Cigarette Co., Ltd	內蒙古昆明捲煙有限責任公司	
	Shangxi Kunming Tobacco Co., Ltd	山西昆明煙草有限責任公司	
	Hainan Hongta Cigarette Co., Ltd	海南紅塔捲煙有限責任公司	
Jilin Tobacco Imp & Exp Co., Ltd	吉林煙草進出口有限責任公司		

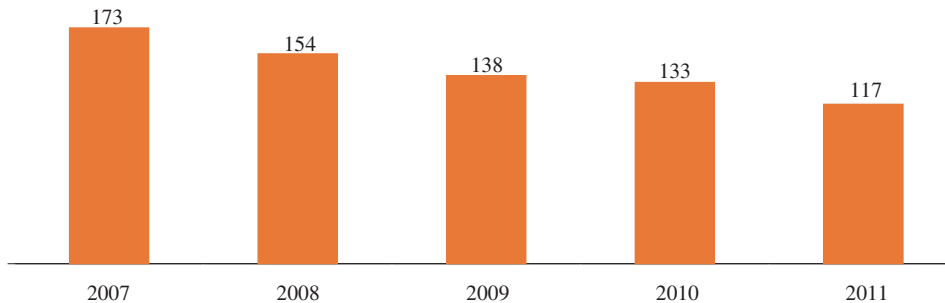
Source: STMA

A series of measures to accelerate tobacco consolidation both from the top-down and bottom-up levels as described above aim to upgrade their industrial structure to realise intensive growth. Furthermore, some world-class tobacco enterprises can be expected to debut in the international market.

INDUSTRY OVERVIEW

On the other hand, cigarette brand in the PRC has also been experiencing the evolution of consolidation. Statistics by STMA indicated that by the end of 2011, there were total 117 domestic cigarette brands in the PRC. Compared to the brands number of 1,181 early in 2000 in the PRC, the cigarette industry now has been consolidated a lot, which would be favourable to ease the inefficiency problem to cultivate a more consolidate cigarette industry.

Total Number of Cigarette Brands in the PRC

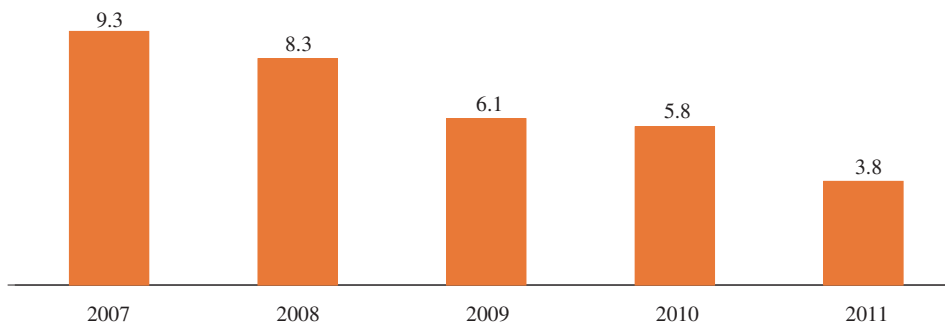


Source: STMA

Huge amount of counterfeit cigarettes flow in to hamper the market

The high margin of sales for cigarettes and strong demand from cigarette smokers tempted some players to inject counterfeit cigarettes into the market, which may hamper the growth of the cigarette industry in the PRC. According to STMA, over 290 large cigarette production hubs have been closed down as of the end 2011. And the volume of counterfeit cigarettes confiscated by the government in 2011 reached 3.8 billion sticks, which are a great amount to hamper the normal cigarette market. However the volume confiscated has declined to a great extent, decreasing 33.6% over 2010. And over the past five years from 2007 to 2011, the counterfeit cigarettes showed a CAGR of -19.9%, which demonstrated that the market is becoming more regulated. In light of the prevention of counterfeit cigarettes, one of the measures adopted by the cigarette manufacturers is to use high-quality cigarette packaging with anti-counterfeit features, such as holographic images, to facilitate customers in distinguishing counterfeit cigarettes from the genuine cigarettes.

Volume of Counterfeit Cigarettes Confiscated in the PRC (in billion sticks)



Source: STMA

INDUSTRY OVERVIEW

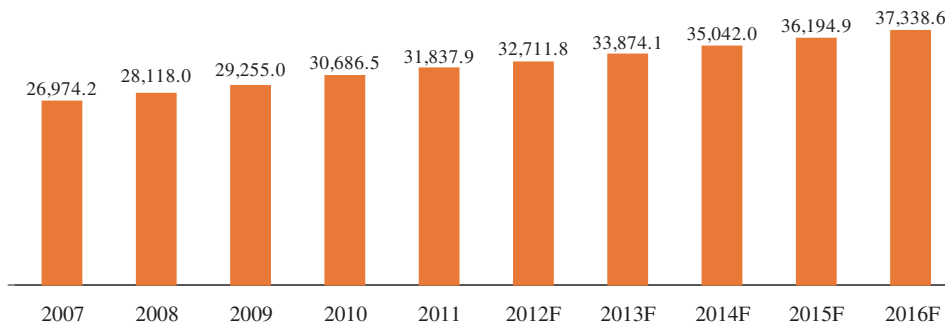
CIGARETTE PACKAGING MARKET IN THE PRC

Cigarette packaging in the PRC

Market overview

The cigarette packaging industry in the PRC has been growing mildly over the review period from 2007 to 2011, amounting to RMB31,837.9 million in value terms in 2011. This was mainly attributable to upper-level consolidation of the cigarette manufacturing market, where brand quantity has been reduced significantly. Cigarette packaging companies have to confront the loss of dozens of brands, as cigarettes are made-to-order products and every single unit is marked with a unique logo. The shortlisted cigarette brands will find it easier to achieve higher market performance, which will help leverage further sales in the cigarette packaging market. It is forecasted that the cigarette packaging market will have a stable growth rate over the next 5 years to reach RMB37,338.6 million by 2016.

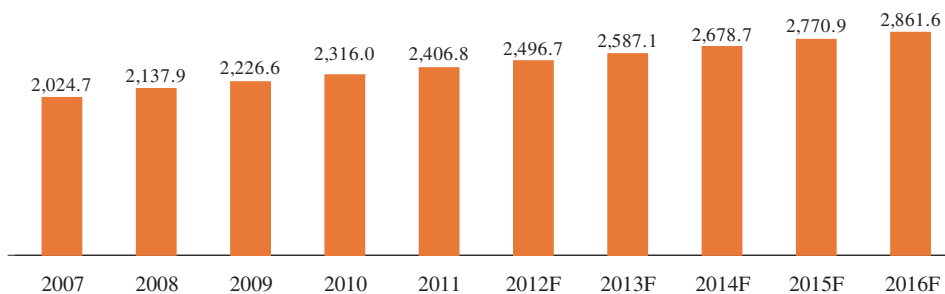
Cigarette Packaging Market Size in the PRC (in RMB million)



Source: Euromonitor International

Accounting for nearly 10% of the cigarette packaging market, the film packaging market showed a similar growth trend to reach a market size of RMB2,406.8 million in value terms and sales volume of 86,736.7 tonnes in 2011. Traditional packaging film mainly functions as the packaging film to wrap the cigarette packet, case and carton. There is an emerging trend to utilise the film packaging as a counterfeit prevention tool during manufacturing by printing the logo into the film or increasing the compressed film layers to differentiate a cigarette brand from others. Anti-counterfeiting measures are certain to be emphasised more in the process of cigarette manufacturing, thus the cigarette film packaging market is forecasted to grow stably to achieve RMB2,861.6 million in 2016.

Cigarette Film Packaging Market Size in the PRC (in RMB million)



Source: Euromonitor International

INDUSTRY OVERVIEW

Market Trends

Cigarette Packaging Industry Will Undergo a Further Consolidation

Over the past few decades, cigarette manufacturers have been implementing a multi-brand strategy to explore the cigarette market in an attempt to grab a higher market share. This method required upstream packaging companies to be operating in a variety of products and services to fulfil the various packaging material and printing technology requests. This brand diversification has given rise to a growing number of companies engaged in cigarette packaging. However in the last few years, as PRC signed the WHO Framework Convention on Tobacco Control in 2003, and a series of revolutionary policies and regulations issued since 2000s, the cigarette industry in the PRC has been in the process of consolidation through restructuring and integration which led to a decrease in number of brands.

Generally one cigarette manufacturer will select two to five cigarette packaging companies as its suppliers for every single brand, which indicates that the on-going consolidation of the cigarette industry will drive a similar move in the cigarette packaging industry in the PRC. Likewise, it is the industry norm for players in the cigarette packaging industry to hold two to five customers to guarantee business stability. The top 5 customers can contribute a combined share of over 60% of the overall retail sales value.

Accompanying reduction of the total cigarette brands from 1,181 to 117 over the past decade, cigarette packaging companies have been undergoing a similar change as well. In 2011, the number of cigarette packaging companies in the PRC was around 150, decreasing by approximately 30% from 2007, when there were over 200. In light of this trend, the number of cigarette packaging companies will likely consolidate further, with several giant packaging companies emerging to forge cooperation with the consolidated cigarette manufacturers by absorbing the fragmented resources of packaging companies that no longer remain in the business.

Cigarette Packaging Players Attempting to Diversify Business

Consolidation in the cigarette industry created opportunities, but also radiated risk in the meantime. To avoid the possible negative influence by fluctuations in cigarette industry policy, the upstream packaging manufacturers have been required to prepare to cope with the changes. For players who maintained a solid connection with the leading cigarette manufacturers, they will continue to benefit from the increased purchase-order quantity from their clients. However confronted with fierce competition from others, especially those emerging with advanced packaging and printing technology, they may lose a portion of their market shares. For players focusing on relationships with small and medium-sized manufacturers, they may suffer the results of the revolution and lose the ability to remain in the cigarette business. Action taken to transfer resources as a business diversification strategy would be critically important to avoid negative effects and attain healthy financial performance. For example, a leading domestic cigarette packaging manufacturer expanded its business coverage to target other industries including liquor packaging, food packaging, medicine packaging, etc.

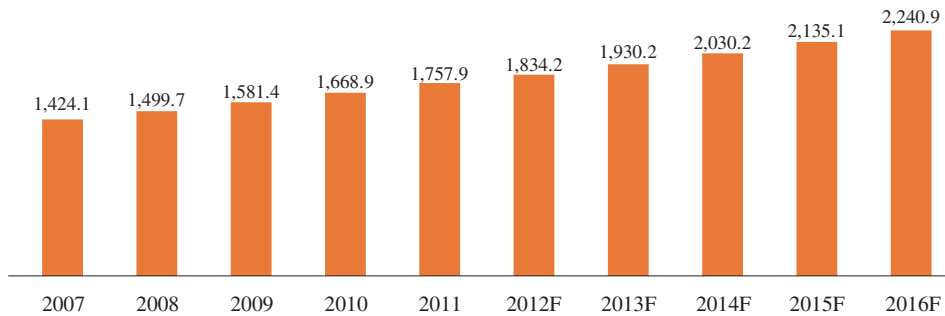
INDUSTRY OVERVIEW

CIGARETTE PACKAGING IN JIANGSU PROVINCE

Market Overview

Compared to the national cigarette packaging market, which maintained a year-on-year growth rate around 4.2% in value terms during the review period from 2007 to 2011, cigarette packaging in Jiangsu Province saw a stronger growth trend, at a CAGR of 5.4% over the same period, achieving a market size of RMB1,757.9 million in value terms in 2011, accounting for approximately 5.5% of the cigarette packaging market in the PRC. China Tobacco Jiangsu Industrial Co., Ltd. who ranks above the average level in the national market, monopolised the downstream cigarette manufacturing market in Jiangsu Province, the PRC, and it is forecasted that the cigarette packaging market in Jiangsu Province will enjoy development at a stable growth pace largely due to their influence. By 2016, this market is estimated to climb to RMB2,240.9 million, realising a CAGR of 5.1%.

Cigarette Packaging Market Size in Jiangsu Province (in RMB million)



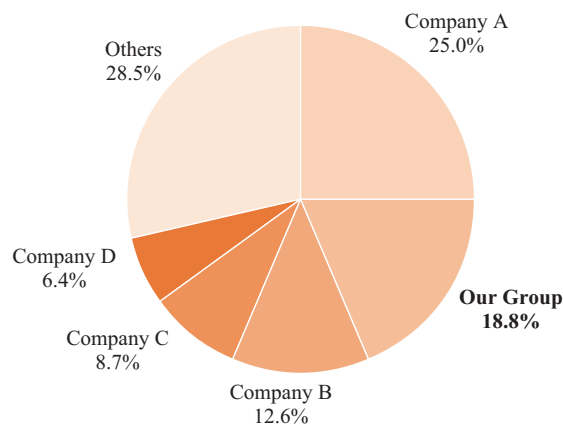
Source: Euromonitor International

INDUSTRY OVERVIEW

Competitive Landscape

About 10 companies supplied cigarette packaging products to China Tobacco Jiangsu Industrial Co., Ltd. in 2011. Top 5 companies contributed a combined share of over 70% in sales value terms, which demonstrated that cigarette packaging in Jiangsu Province saw a highly consolidated market. Company A topped the list with sales value of RMB440.0 million in 2011, accounting for 25.0% of the cigarette packaging market in Jiangsu Province. Our Group ranked second, realising a sales value of RMB329.8 million in 2011 to contribute a share of 18.8% of the cigarette packaging market in Jiangsu Province. The remaining three companies refer to Company B, Company C and Company D. The top five cigarette packaging companies supplied cigarette packaging materials mainly for cigarette brands including Nanjing, Su Yan, Yipinmei, Hongshanshu, Qinhuai, Yuhuashi and Lingshan.

**Share of Cigarette Packaging Companies in
Overall Cigarette Packaging in Jiangsu Province**



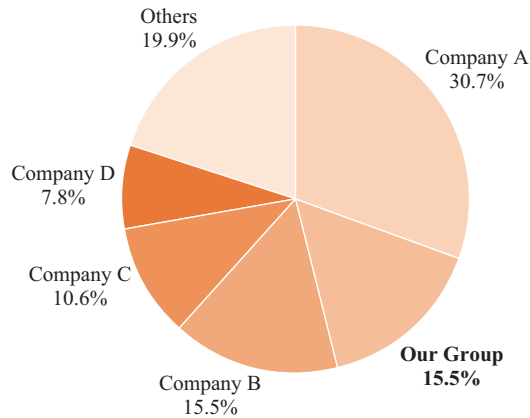
Rank	Company	2011	2011
		Sales Value (RMB million)	Market Share
1	Company A	440.0	25.0%
2	Our Group	329.8	18.8%
3	Company B	221.6	12.6%
4	Company C	152.1	8.7%
5	Company D	111.7	6.4%

Source: Euromonitor International

INDUSTRY OVERVIEW

The overall cigarette packaging market can be divided into three types: paper-box packaging, film packaging and others (including metal box and aluminium foil). Paper-box packaging took the lion's share to account for 80% of the overall cigarette packaging market. In 2011, overall cigarette packaging in Jiangsu Province realised a market size of RMB1,757.9 million, and the paper-box packaging sector reached RMB1,431.7 million. Similar to the landscape of the overall cigarette packaging market, paper-box packaging in Jiangsu Province demonstrated a highly consolidated market, with the top 5 companies occupying a share of nearly 80%. Followed by our Group whose sales value in 2011 reached RMB221.8 million, Company A topped the list with a share of 30.7% of the paper-box packaging market in 2011, achieving RMB440.0 million. Company B ranked the third, accounting for a share of 15.5% of the market to reach a sales value of RMB221.6 million in 2011. The other two manufacturers within the list of top 5 companies are Company C and Company D.

Share of Cigarette Packaging Companies in Paper-box Packaging in Jiangsu Province



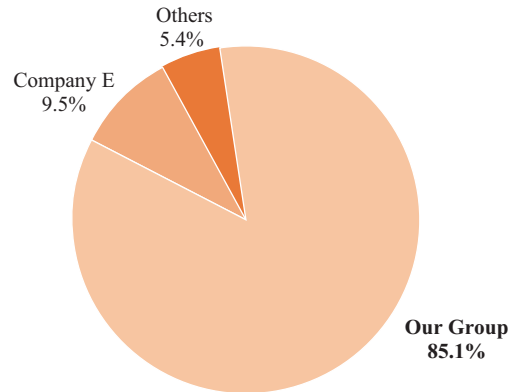
Rank	Company	2011 Sales Value (RMB million)	2011 Market Share
1	Company A	440.0	30.7%
2	Our Group	221.8	15.5%
3	Company B	221.6	15.5%
4	Company C	152.1	10.6%
5	Company D	111.7	7.8%

Source: Euromonitor International

INDUSTRY OVERVIEW

The cigarette film packaging market in Jiangsu reached RMB127.0 million in 2011. Dominated by our Group, who swallowed an individual share of nearly 85.1% of the market, achieving a sales value of RMB108.0 million in 2011, the cigarette film packaging market in the PRC displayed an extremely consolidated market landscape. Company E followed to contribute a share of 9.5% of the market with a sales value of RMB12.0 million. The two companies aggregately took a combined share of 94.5% of this market in 2011.

Share of Cigarette Packaging Companies in Film Packaging in Jiangsu Province



Rank	Company	2011 Sales Value (RMB million)	2011 Market Share
1	Our Group	108.0	85.1%
2	Company E	12.0	9.5%

Source: Euromonitor International

INDUSTRY OVERVIEW

CRUDE OIL PRICE

The key raw material for BOPP films and our films are polypropylene which is a crude oil by-product. According to the graph set out below, the crude oil price decreased by 36.9% from US\$60.1 per barrel at the beginning of 2007 to US\$37.9 per barrel at the end of 2008. However, the crude oil price increased by 159% from US\$41.8 per barrel at the beginning of 2009 to US\$108.3 per barrel at the end of 2011. During the Track Record Period, the highest and the lowest crude oil price were US\$126.7 per barrel and US\$39.1 per barrel respectively.

Price Trend of Crude Oil (in US\$ per barrel)



Source: Bloomberg