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China Mengniu Dairy Company Limited

(Incorporated in the Cayman Islands with limited liability)

(Stock Code: 2319)

Announcement of the interim results for the six months ended 30 June 2004

SUMMARY

- Turnover surged 105.2% to RMB3,472.7 million as a result of effective initiatives in brand building and market penetration
- Net profit of RMB184.1 million exceeded net profit for full year 2003 (RMB164.4 million) by 12%
- Net profit for first half 2004 reached 61% of total forecasted net profit of RMB300 million for full year 2004, while net profit for first half 2003 only accounted for 46% of net profit for full year 2003

INTERIM RESULTS

The board of directors (the “Directors”) of China Mengniu Dairy Company Limited (the “Company”) is pleased to present the unaudited condensed consolidated financial statements of the Company and its subsidiaries (the “Group” or “Mengniu”) for the six months ended 30 June 2004, along with the unaudited comparative figures and selected explanatory notes, which are prepared in accordance with the International Financial Reporting Standards published by the International Accounting Standards Board, and have been reviewed by the Audit Committee of the Company.

Condensed consolidated profit and loss account

		Unaudited For the six months ended 30 Jun	
		2004	2003
	Notes	RMB'000	RMB'000
Turnover	2	3,472,671	1,692,705
Cost of sales		<u>(2,645,737)</u>	<u>(1,266,972)</u>
Gross profit		826,934	425,733
Other revenue	3	2,768	1,405
Selling and distribution costs		(513,464)	(232,874)
Administrative expenses		(58,266)	(34,368)
Other operating expenses		<u>(4,223)</u>	<u>(7,503)</u>

Profit from operating activities	4	253,749	152,393
Finance costs, net	5	(13,622)	(3,878)
Share of profit of associates		<u>1,316</u>	<u>444</u>
Profit before tax		241,443	148,959
Tax	6	<u>(11,240)</u>	<u>(32,230)</u>
Profit after tax		230,203	116,729
Minority interests		<u>(46,123)</u>	<u>(40,766)</u>
Net profit attributable to shareholders		<u>184,080</u>	<u>75,963</u>
Earnings per share — basic (RMB)	7	0.24	0.10
Earnings per share — fully diluted (RMB)	7	<u>0.16</u>	<u>N/A</u>
		Unaudited	Audited
		At 30 Jun	At 31 Dec
		2004	2003
		RMB'000	RMB'000
NON-CURRENT ASSETS			
Property, plant and equipment, net		1,602,120	1,191,478
Construction in progress		297,208	146,016
Land use rights		33,783	34,293
Investments in associates		2,072	1,917
Long term investments		3,409	3,409
Negative goodwill		<u>(26,652)</u>	<u>(28,182)</u>
		<u>1,911,940</u>	<u>1,348,931</u>
CURRENT ASSETS			
Inventories		451,086	408,790
Trade receivables		294,047	94,443
Prepayments, deposits and other receivables		173,045	105,548
Cash and cash equivalents		<u>1,657,757</u>	<u>376,598</u>
		<u>2,575,935</u>	<u>985,379</u>
CURRENT LIABILITIES			
Trade payables		562,099	427,533
Accruals and other payables		596,535	400,536
Short term bank loans		731,224	161,534
Other loans, unsecured		27,600	27,600
Income tax payable		2,944	7,591
Dividend payable		<u>73,260</u>	<u>—</u>
		<u>1,993,662</u>	<u>1,024,794</u>

	Unaudited	Audited
	At 30 Jun	At 31 Dec
	2004	2003
	RMB'000	RMB'000
NET CURRENT ASSETS/(LIABILITIES)	<u>582,273</u>	<u>(39,415)</u>
TOTAL ASSETS LESS CURRENT LIABILITIES	<u>2,494,213</u>	<u>1,309,516</u>
NON-CURRENT LIABILITIES		
Long term bank loans	267,500	226,000
Other loans, unsecured	18,000	18,000
Long term other payables	147,334	148,089
Deferred income	<u>67,706</u>	<u>57,706</u>
	<u>500,540</u>	<u>449,795</u>
MINORITY INTERESTS	<u>205,468</u>	<u>170,511</u>
	<u>1,788,205</u>	<u>689,210</u>
REPRESENTED BY:		
Non-voting convertible redeemable preferred shares	—	291,621
Convertible instruments	291,621	—
Share capital	106,090	—
Share premium	1,085,394	—
Other shareholder's equity	—	335,729
Retained profits	305,100	—
Final dividends	<u>—</u>	<u>61,860</u>
	<u>1,788,205</u>	<u>689,210</u>

Notes:

1. Principal Activities and basis of presentation

The Company was incorporated in the Cayman Islands on 16 February 2004 as an exempted company with limited liability under the Companies Law, Cap. 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands. The Group engages in the manufacture and distribution of dairy products and the Group's operations are principally located in the People's Republic of China. The Company became the holding company of the Group pursuant to the group reorganisation that was completed on 14 May 2004 (the "Reorganisation"). The shares of the Company were admitted to listing on the Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") on 10 June 2004 (the "Listing").

The unaudited condensed interim financial statements have been prepared by adopting the pooling method of accounting as a result of the Reorganisation which resulted in an exchange of shares held by the shareholders of China Dairy Holdings for the shares issued by the Company in exact proportions and class of shares of China Dairy Holdings. In this regard, the Company has been considered as the holding company of China Dairy Holdings and its subsidiaries (the "China Dairy Holdings Subsidiaries") since completion of the Reorganisation, save for the China Dairy Holdings Subsidiaries which were established, incorporated or acquired subsequently.

The unaudited condensed interim financial statements have been prepared in accordance with International Financial Reporting Standards, which comprise standards and interpretations approved by the International Accounting Standards Board, and International Accounting Standards and Standing Interpretations Committee interpretations approved by the International Accounting Standards Committee that remain in effect, and Appendix 16 of the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules").

The details of the Reorganisation, the accounting policies and methods of computation used in the preparation of these interim financial statements are consistent with those used in the preparation of the Accountants' Report as set out in Appendix I of the prospectus issued by the Company dated 1 June 2004 (the "Prospectus").

2. Segmental information

The turnover and net profit attributable to shareholders of the Group by products are as follows:

	Unaudited	
	For the six months	
	ended 30 Jun	
	2004	2003
	RMB'000	RMB'000
Segment revenue:		
Liquid milk	2,737,765	1,390,856
Ice cream	487,597	264,705
Other dairy products	<u>247,309</u>	<u>37,144</u>
Combined revenue	<u>3,472,671</u>	<u>1,692,705</u>
Segment net profit:		
Liquid milk	221,654	146,318
Ice cream	27,138	20,594
Other dairy products	<u>30,679</u>	<u>1,419</u>
	<u>279,471</u>	<u>168,331</u>
	Unaudited	
	For the six months	
	ended 30 Jun	
	2004	2003
	RMB'000	RMB'000
Unallocated corporate expenses	<u>(25,722)</u>	<u>(15,938)</u>
Profit from operating activities	<u>253,749</u>	<u>152,393</u>
Finance costs, net	(13,622)	(3,878)
Share of profits of associates	<u>1,316</u>	<u>444</u>
Profit before tax	241,443	148,959
Tax	<u>(11,240)</u>	<u>(32,230)</u>
Profit after tax	230,203	116,729
Minority interests	<u>(46,123)</u>	<u>(40,766)</u>
Net profit attributable to shareholders	<u><u>184,080</u></u>	<u><u>75,963</u></u>

	Unaudited At 30 Jun 2004 <i>RMB'000</i>	Audited At 31 Dec 2003 <i>RMB'000</i>
Segment assets:		
Liquid milk	2,245,680	1,783,503
Ice cream	655,870	269,207
Other dairy products	260,480	68,381
Unallocated corporate assets	<u>1,325,845</u>	<u>213,210</u>
Combined total assets	<u>4,487,875</u>	<u>2,334,310</u>
Segment liabilities:		
Liquid milk	1,289,970	752,213
Ice cream	290,592	156,929
Other dairy products	170,807	37,650
Unallocated corporate liabilities	<u>742,833</u>	<u>527,797</u>
Combined total liabilities	<u>2,494,202</u>	<u>1,474,589</u>
	Unaudited For the six months ended 30 Jun 2004 <i>RMB'000</i>	2003 <i>RMB'000</i>
Capital expenditure:		
Liquid milk	378,098	302,168
Ice cream	147,610	76,172
Other dairy products	27,231	1,383
Others	<u>8,895</u>	<u>2,036</u>
	<u>561,834</u>	<u>381,759</u>
Depreciation:		
Liquid milk	52,819	16,099
Ice cream	13,710	4,992
Other dairy products	619	38
Others	<u>637</u>	<u>1,127</u>
	<u>67,785</u>	<u>22,256</u>

3. Revenue

The revenue and other revenue of the Group are as follows:

	Unaudited For the six months ended 30 Jun 2004 <i>RMB'000</i>	2003 <i>RMB'000</i>
Revenue	3,472,671	1,692,705
Other revenue		
Government grants	1,053	453
Goodwill amortisation	1,530	820
Others	<u>185</u>	<u>132</u>
Total revenue	<u>3,475,439</u>	<u>1,694,110</u>

4. Profit from operating activities

Profit from operating activities is arrived at after charging/(crediting):

	Unaudited For the six months ended 30 Jun	
	2004	2003
	RMB'000	RMB'000
Cost of inventories sold	2,645,737	1,266,972
Staff costs	97,903	43,998
Depreciation	67,785	22,256
Loss on disposal of property, plant and equipment	169	66
Amortisation of land use rights	442	191
Exchange gain	(453)	(20)

5. Finance costs, net

	Unaudited For the six months ended 30 Jun	
	2004	2003
	RMB'000	RMB'000
Interest on bank loans		
— wholly repayable within five years	16,599	5,188
Less: Amounts capitalised	<u>(1,786)</u>	<u>(449)</u>
	<u>14,813</u>	<u>4,739</u>
Interest income	<u>(1,191)</u>	<u>(861)</u>
Financial costs, net	<u><u>13,622</u></u>	<u><u>3,878</u></u>

The amounts capitalised are borrowing costs related to funds borrowed specifically for the purpose of obtaining qualifying assets. The interest rates on such capitalised borrowings during the periods varied from 4.8% to 5.3% per annum.

6. Tax

	Unaudited For the six months ended 30 Jun	
	2004	2003
	RMB'000	RMB'000
PRC enterprise income tax	10,339	32,083
Share of taxation of associates	<u>901</u>	<u>147</u>
	<u><u>11,240</u></u>	<u><u>32,230</u></u>

- (a) No provision for Hong Kong profits tax has been made in the accounts as the Group has no assessable profits in Hong Kong during the period.
- (b) The tax charge represents the PRC income tax provision for the periods at the prevailing tax rates applicable thereto.

7. Earnings per share

The calculation of the basic earnings per share for the six months ended 30 June 2004 is based on the Group's net profit attributable to shareholders of RMB184,080,000 (2003: RMB75,963,000) and the weighted average number of 781,593,407 ordinary shares (2003: 750,000,000 ordinary shares deemed issued).

The calculation of the diluted earnings per share for six months ended 30 June 2004 is based on the Group's net profit attributable to shareholders of RMB184,080,000 and the weighted average number of 1,150,009,880 shares in issue (assuming full conversion of all outstanding convertible instruments on 1 January 2004).

FINANCIAL REVIEW

Mengniu enjoyed robust growth during the first half of 2004. Mengniu's turnover grew 105.2% over the same period in 2003, climbing to RMB3,472.7 million. Net profit attributable to shareholders increased by 142.3% over the same period last year to reach RMB184.1 million. Basic earnings per share was RMB0.24, while fully diluted earnings per share was RMB0.16.

The Company was listed on the Main Board of the Stock Exchange on 10 June 2004, which marked an important milestone for its corporate development. Its global offering was a great success. The international offering was significantly over-subscribed whilst the Hong Kong public offering was 205 times over-subscribed.

Gross Profit

Strong sales growth drove Mengniu's gross profit up by 94.2% to RMB826.9 million. Nevertheless, overall gross margin decreased slightly by 140 basis points from 25.2% to 23.8%, as a result of higher depreciation expenses charged to cost of goods sold and lower average selling price for liquid milk and ice cream. Gross profit margin before depreciation expenses charged to cost of goods sold was 25.1%, a 100 basis points decrease from the same period in 2003.

Operating Expenses

The total operating expenses as a percentage of total turnover during the period remained relatively stable at 16.6%, against 16.2% in the corresponding period in 2003. Effective management controls facilitated savings on administrative and other operating expenses, which accounted for 1.8% of total turnover in 2004 against 2.5% in 2003. At the same time, selling and distribution cost increased from 13.8% to 14.8% of turnover due to increased cost in transportation and sales and distribution network development.

Profit from operating activities

EBITDA during the period amounted to RMB321.8 million and EBITDA margin decreased to 9.3% by 10 basis points for the same period in 2003. The decrease in EBITDA margin was less than the decrease in gross profit margin, indicating a better cost control.

Net Profit

Mengniu's net profit attributable to shareholders reached RMB184.1 million, an increase of 142.3%, over the same period in 2003. Net profit for the first half of 2004 was above the net profit recorded for the full year of 2003 by 12%.

Mengniu enjoyed a lower effective tax rate of 4.7% in the first half of 2004, as tax exemptions were approved by local tax bureaus in accordance with China's tax policies, to additional subsidiaries during the period. The tax benefits had positively contributed to the bottom line during the period.

At the time of its Listing, Mengniu set forth a forecast combined net profit after taxation and minority interests but before extraordinary items for the year ending 31 December 2004 of not less than RMB300 million. With 61% of its total forecasted profit achieved, the Directors are confident in achieving the projected results for the year.

Capital Structure, Liquidity & Financial Resources

The Group's cash and bank balances amounted to approximately RMB1,657.8 million as at 30 June 2004, of which approximately RMB976.8 million were net proceeds from the global offering in June 2004. Net cash from operating activities amounted to RMB172.0 million which is an increase of 93.3% compared with the same period in 2003.

As a result of the Reorganisation and the Listing, the shareholders' fund increased from RMB689.2 million as at 31 December 2003 to RMB1,788.2 million as at 30 June 2004.

Net finance cost for the period under review amounted to RMB13.6 million, an increase from RMB3.9 million over the same period in 2003, as a result of an increase in interest-bearing loans.

The total debt to capital ratio of the Group was 36.9% as at 30 June 2004, compared with 38.6% as at 31 December 2003.

Pledge of asset

Certain property, plant and equipment of the Group with a carrying value amounting to RMB396,698,830 (31 December 2003: RMB372,771,000) have been pledged to secure the outstanding payable amount under the item "Long term other payables" set out under "Non-Current Liabilities"

Contingent liabilities

The Group is contingently liable in respect of four guarantee contracts with a bank in favour of certain suppliers of raw milk ("Suppliers") in respect of certain bank loans granted to those Suppliers. The outstanding bank loans as at 30 June 2004 amounted to RMB83,000,000. The guarantees are solely given by the Inner Mongolia Mengniu Milk Industry (Group) Co., Ltd., but the guarantees are counter-guaranteed by these Suppliers who are independent third parties. Securities under these counter-guarantees included property, dairy cattle and other assets owned by these Suppliers.

MARKET REVIEW

The dairy industry is generally enjoying strong growth in China as a result of rising GDP. The increasing awareness of the nutritional value of liquid milk, along with improved transportation and cold chain systems has facilitated the growth of liquid milk consumption. The per capita consumption of liquid milk in China was comparatively lower than that in other Asian countries. Such trends indicate tremendous growth potential for the dairy industry in China.

BUSINESS REVIEW

Branding & Marketing

According to ACNielsen, Mengniu captured 19.5% share in the liquid milk market by volume in June 2004, as compared with 12.6% share in June 2003. Brand equity and strong consumer loyalty are key success drivers for the Group. Liquid milk market in China remains dominated by key local dairy product players, with top three players capturing 50.8% market share in June 2004, as compared with 40.7% in June 2003.

Mengniu has been actively building a nationwide sales and distribution network predominantly through over 1,000 exclusive third party distributors located across China. The Group deployed sales personnel in key markets to assist distributors in serving retailers and to gain first hand information about the latest developments in the market.

In the first half of 2004, advertising and promotion expenses reached RMB238 million, which accounted for 6.9% of the total turnover against 7.7% of the same period in 2003.

Products

Mengniu offers a comprehensive choice to consumers and produces over 200 varieties of liquid milk, ice cream and other dairy products.

Liquid Milk

The liquid milk segment remained as the primary revenue contributor and accounted for 78.9% of the Group's total turnover. Its revenue rose to RMB2,737.8 million, an increase of 96.8% over the same period in 2003. Growth was attributable to the extended exclusive distribution network established to meet increasing market demand.

UHT milk accounted for 78.6% within the segment and its revenue increased by 91.2% during the period as a result of strong brand building efforts. In order to meet different nutritional requirements of different consumer segments, the Group also offered a variety of functional UHT milk products such as milk fortified with vitamins and minerals, and milk with lower fat or lower lactose content.

Milk beverages and yogurt during the period accounted for 21.4% of the liquid milk sales. Within this segment, yogurt revenues grew 178.3% compared to the same period in 2003.

Ice Cream

Turnover from ice cream rose by 84.2% to reach RMB487.6 million despite the fact that the majority of this period did not coincide with the peak season for sales of ice cream and accounted for 14.0% of the Group's total turnover. The introduction of new products also contributed to the sales growth.

Other Dairy Products

Turnover from other dairy products accelerated by 565.8% to reach RMB247.3 million in the first half of 2004, with contribution to the total turnover increasing from 2.2% in the first half of 2003 to 7.1% in 2004. The rapid growth was due to successful promotion of the Group's milk tablets in the first half of 2004.

Raw Milk Supply

Established exclusive supply contracts with over 1,000 milk collection centers and individual dairy farmers ensures that Mengniu's growth is supported by a secure supply of quality raw milk.

Production

Equipped with world-class production and packaging technologies, Mengniu operated nine production bases with a combined production capacity of 1.66 million tons in the first half of 2004.

PROSPECTS

The Directors believe that China's growing GDP will increase the purchasing power of individuals and encourage further growth of the dairy industry. To capture greater market share, Mengniu will continue to improve its brand equity, introduce new products, deepen its market penetration, expand its production capacity, forge closer business partnerships, and at the same time manage the risk of over-expansion. The Group is confident of its ability to capitalize on the growth trend of the dairy industry in China.

New Products Introduction

With liquid milk as its key segment, the Group will invest additional resources to strengthen its market position, expand distribution channels and to diverge into different product lines such as flavored and functional milk products, premium yogurt and other dairy products to broaden its product portfolio and to seize additional opportunities.

More medium and high-end ice cream products will be launched to capture broader market segments. The Group will increase its in-house production of ice cream products which to date are partly manufactured through external arrangements.

The Group also intends to develop secondary brand names to better differentiate its dairy products to different segments of consumers.

New Markets Penetration

Mengniu will deepen its market penetration through targeted sales channels to consolidate its leading position in the first-tier markets, while prudently expanding into second and third-tier markets. The Group intends to enhance its brand and product awareness by effective promotions, advertising campaigns on nationwide television channels in prime time slots and by broadening its sales network.

Capacity Expansion

Mengniu ultimately targets to build over 100 new production lines for liquid milk products, over 30 for ice cream products and over 50 for other dairy products, achieving total annual production capacity of 2.75 million tons by the end of 2005. By investing the proceeds raised from the global offering in expanding production capacity, Mengniu is set to fulfill the increasing demands for its products.

Partnership Cooperation

In view of the vast but fragmented raw milk supply base, Mengniu will continue to enhance its cooperation with dairy farmers and milk collection centers to expand its milk sources and to ensure the supply of high quality raw milk. It will continue to encourage its existing and new suppliers to develop mid and larger scale milk collection centers, which will allow Mengniu to meet the growing demands for its products.

Management Incentives

To encourage successful implementation of its growth strategies, Mengniu will continue to build employee excellence by strengthening its management system. The management will encourage employee initiatives and work place excellence through established promotion and compensation systems.

Interim Dividend

The Directors do not recommend the payment of an interim dividend for the six months ended 30 June 2004 (2003: nil).

Human Resources and Remuneration of Employees

As at 30 June 2004, the Group employed a total of 16,583 employees in China and Hong Kong. Total staff costs for the first half of 2004 amounted to approximately RMB97.9 million, excluding Directors, as compared with approximately RMB44.0 million in the same period in 2003.

The Group invests in continuing education and training programs for its management staff and other employees to constantly improve their skills and knowledge. An internal vocational training center has been set up to develop and implement training programs for the Group's personnel.

Remuneration is maintained at competitive levels with incentive bonuses payable on a merit basis for innovations and improvements which is in line with industry practice. Other staff benefits provided by the Group include a pension contribution plan, insurance schemes and housing benefits.

Purchase, Sale or Redemption of the Company's Listed Shares

During the six months ended 30 June 2004, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities.

Use of proceeds

The net proceeds from the global offering of the Company's listing on the Stock Exchange on 10 June 2004 were approximately HK\$921 million, of which HK\$915 million has been deposited into interest-bearing accounts maintained with banks and the remaining balance is to be used as working capital.

Subsequent Events and Commitments

The Company will use the net proceeds of the global offering to subscribe for further shares in Inner Mongolia Mengniu Milk Industry (Group) Co., Ltd. ("MengniuCo") based on pre-agreed terms at a price equivalent to 15% discount to the implied equity value valuation of MengniuCo

under the global offering. Under the subscription agreement between China Dairy (Mauritius) Limited (“MauritiusCo”) and MengniuCo, MauritiusCo will subscribe for such number of shares in MengniuCo in October 2004. After the completion of the subscription, MauritiusCo will own an estimated 84.3% of the total registered capital of MengniuCo.

Audit Committee

The Audit Committee comprises three non-executive Directors, two of whom are independent. The Audit Committee reviewed with the management the accounting principles and practices adopted by the Company and discussed auditing, internal control and financial report matters including the review of the unaudited interim accounts for the six months ended 30 June 2004.

Investor Relations and Communications

The Company adopts a proactive policy of promoting investor relations and communications by holding regular meetings with institutional investors and analysts.

Compliance with the Code of Best Practice

None of the Directors of the Company is aware of any information that would reasonably indicate that the Company was not at any time during the six months ended 30 June 2004 in compliance with the Code of Best Practice as set out by the Stock Exchange in Appendix 14 to the Listing Rules.

Compliance with Model Code

The Company has adopted the Model Code set out in Appendix 10 of the Listing Rules as the Company’s code of conduct and rules governing dealings by all Directors in the securities of the Company. Having made specific enquiry of all Directors of the Company, during this reporting period, the Directors of the Company have strictly complied with the Model Code.

Financial Results of the Group published on the Exchange’s Website

The interim report of the Group containing all information required by Appendix 16 paragraphs 46(1) to 46(6) of the Listing Rules will be published on the Stock Exchange’s website in due course.

By order of the Board of Directors

Niu Gensheng

Chairman & Chief Executive Officer

Hong Kong, 1 September 2004

As at the date of this announcement, the Executive Directors are Mr. Niu Gensheng, Ms. Lu Jun, Mr. Sun Yubin and Mr. Yang Wenjun. The Non-executive Directors are Mr. Jiao Shuge (alias Jiao Zhen), Ms. Jin Yujuan, Lily and Mr. Liu Haifeng, David. The Independent non-executive Directors are Mr. Li Jianxin, Mr. Wang Huaibao and Mr. Zhang Julin.

*Please also refer to the published version of this announcement in the (**The Standard**)*