China Mengniu Dairy Company Limited
中國蒙牛乳業有限公司*

(incorporated in the Cayman Islands with limited liability)
（於開曼群島註冊成立之有限公司）

Stock Code 股份代號：2319



For a BETTER LIFE
只為優質生活



Annual Report 2007
年報 2007

*僅供識別

Corporate Profile

China Mengniu Dairy Company Limited (Stock Code: 2319) and its subsidiaries (the "Group") manufacture and distribute quality dairy products in China, including Hong Kong and Macau. It is one of the leading dairy product manufacturers in China, with ***MENGNIU*** as its core brand. The Group's diverse products include liquid milk products, such as UHT milk, milk beverages and yogurt, ice cream and other dairy products such as milk powder. In December 2007, the Group operated 22 production bases with a combined annual production capacity of 4.78 million tons.

Contents

Financial Highlights

For the year ended 31 December	**2007** *RMB'000*	2006 *RMB'000*
Revenue	**21,318,062**	16,246,368
Net profit attributable to equity holders of the Company	**935,786**	727,352
Net cash from operating activities	**2,058,121**	1,402,826
Earnings per share *(RMB)*		
– Basic	**0.664**	0.532
– Diluted	**0.664**	0.532
Proposed final dividend per share *(RMB)*	**0.1315**	0.1094

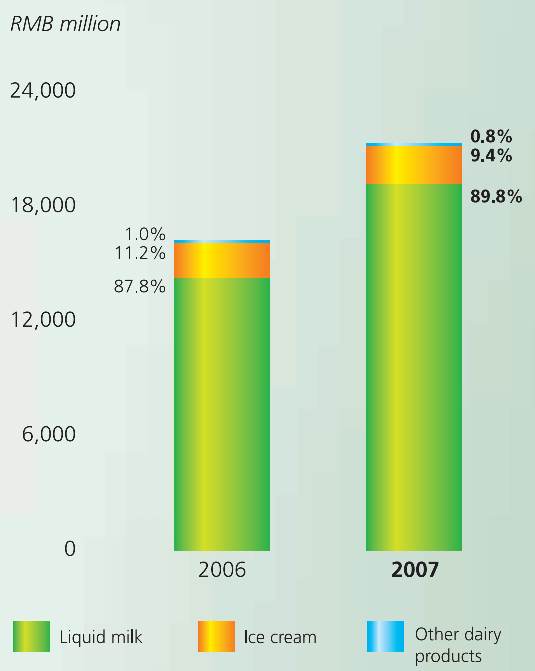
- The Group developed more high value-added products through self-innovation, coupled with its product mix optimization and efficient marketing strategies. The Group's revenue increased by 31.2% to RMB21.3181 billion, with net profit attributable to equity holders of the Company reached RMB935.8 million.

- According to an ACNielsen survey conducted in December 2007, the Group held a 40.7% share of the liquid milk market (excluding milk beverages and yogurt) in China in terms of sales revenue, representing an increase against 36.2% in December 2006, continued to champion the market in China.

- In December 2007, the Group operated 22 production bases with a combined annual production capacity of 4.78 million tons.

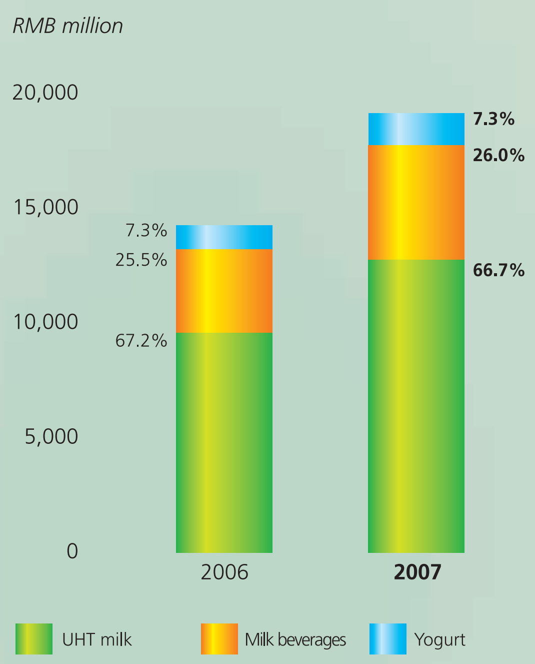
Revenue by Product Mix

For the year ended 31 December

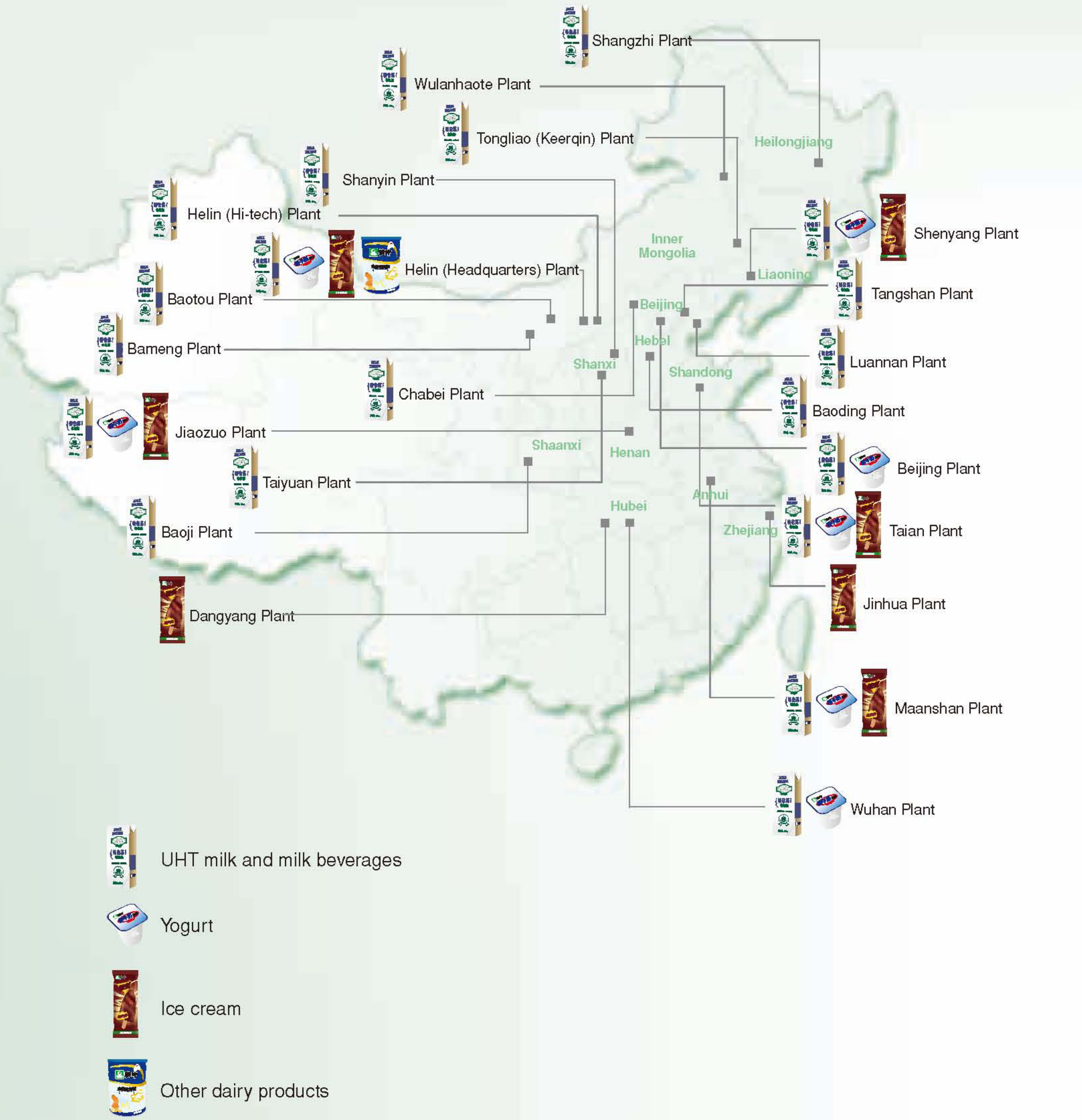


Product Mix in Liquid Milk Segment

For the year ended 31 December



Plant Map



Shangzhi Plant
Wulanhaote Plant
Tongliao (Keerqin) Plant
Shanyin Plant
Helin (Hi-tech) Plant
Helin (Headquarters) Plant
Baotou Plant
Bameng Plant
Chabei Plant
Jiaozuo Plant
Taiyuan Plant
Baoji Plant
Dangyang Plant
Shenyang Plant
Tangshan Plant
Luannan Plant
Baoding Plant
Beijing Plant
Taian Plant
Jinhua Plant
Maanshan Plant
Wuhan Plant
Heilongjiang
Inner Mongolia
Liaoning
Beijing
Hebei
Shanxi
Shandong
Shaanxi
Henan
Anhui
Hubei
Zhejiang
UHT milk and milk beverages
Yogurt
Ice cream
Other dairy products

Possesses...

22

production plants

4.78 million tons

annual production capacity

CEO's Statement

Devoted to produce high-quality dairy product with love
to breed a stronger new generation

Dedicated to unify national dairy industry by innovation
to set a strong foothold to lead the world

NIU Gensheng
Chief Executive Officer

I am pleased to present the annual results of China Mengniu Dairy Company Limited (the "Company") and its subsidiaries ("Mengniu" or the "Group") for the year ended 31 December 2007 to our shareholders.

In 2007, the continuous growth of the PRC's national economy and domestic demand facilitated the dairy industry to develop rapidly in China. The PRC's dairy products market has been expanding and is becoming increasingly important in the world. According to the latest statistics published by China Dairy Industry Association, China has become the world's third largest milk producing country and the world's largest emerging dairy market. The Group captured this market opportunity through self-developed high-end products which catered different targets. At the same time, Mengniu further reinforced its market leading position by implementing effective branding and marketing strategies. Those factors contributed to the satisfactory results of the Group in 2007. It is encouraging that according to the national market statistics announced by Chinese Enterprise Information Center under the National Bureau of Statistics of China, the Group continued to be the national bestseller of liquid milk, and the sales of which was comparable to the world's bestseller.

The Group's profitability was further improved with our efforts in optimizing the existing products through innovation and introducing various high-end and high quality products during the year. The Group's revenue for 2007 increased by 31.2% to RMB21.318 billion while net profit attributable to equity holders of the Company increased by 28.7% to RMB935.8 million. Both basic earnings per share and diluted earnings per share were RMB0.664. The Board of Directors of the Company (the "Board") resolved to recommend the payment of a final dividend of RMB0.1315 per share for the year ended 31 December 2007.

During the year under review, we had an outstanding performance in the liquid milk business due to product optimization and product grade enhancement. With an increase of 34.3%, this segment remained the

Group's main revenue generator, representing 89.8% of the Group's revenue. In respect of ice cream products, focus was placed on product optimization and reorganization. Revenue from this segment grew by 9.6%, representing 9.4% of the Group's revenue. We succeeded in developing several new ice cream products in 2007 and expect our ice cream business to enter into a new chapter in the near future. The Group reorganized its other dairy products and carried out extensive marketing of various products. Milk powder products were well received, bringing the revenue of other dairy products up 6.0%, representing 0.8% of the Group's revenue. Apart from milk powder products, the Group invented in *Smoked-dried Cheese*, a new type of product developed by utilizing advanced technology by Hi-tech Dairy Products Research Institute and Intelligent Product Base ("Research Institute"), offering a wider choice of high quality dairy products for customers.

Aggressive marketing strategy has been continuously carried out throughout the year under review. In addition to cooperating with national and local TV stations to introduce a variety of market oriented and interactive marketing campaigns, we worked with our strategic partners, i.e. Disney, National Basketball Association, Starbucks and KFC, in organizing a series of innovative activities to promote the theme of "care, health and nutrition", as well as healthy life styles. Those diversified marketing campaigns invigorated the popular brand of ***Mengniu***, bringing it to progress with time. ***Mengniu*** is reputable in the market and was awarded with a number of prizes during the year. Mengniu was chosen as one of the "Ten Most Influential Life Style Brands in China" by the China Society for World Trade Organization Studies (中國世界貿易組織研究會), and was honoured the "Most Competitive Brands in the Market" by the Ministry of Commerce and the "Huapu Award – One of the Top 25 Leading Brands in China of the Year" at the first China Brand Festival. On the other hand, our business has expanded in overseas market and consumers in Singapore, the Philippines and Malaysia can now also enjoy the mellow milk products of Inner Mongolia.

CEO's Statement

Apart from the business achievements, we have also laid solid foundations for major developments in 2007, enabling the Group to turn over a new leaf in the future development. The Group established the first international top-tier Research Institute with several renowned enterprises and research and development ("R&D") units within and outside the country, such as Cambridge University in the UK and the Chinese Academy of Sciences. By utilizing the world's advanced equipment and intelligent facilities, together with our R&D efforts on new milk production techniques, we combined, seamlessly, the mellow milk of Inner Mongolia with the world's state-of-the-art technologies, to offer consumers more tasty and nutritious milk product choices. Since the incorporation of Research Institute, we have organized a series of training and international seminars for experience exchange and sharing with our overseas peers. Meanwhile, we successfully invented a number of innovative techniques, including electronic smell analyzer and taste analyzer, providing strong technical support for scientific development and establishment of scientific quality control system of the Group in the future.

As a leading enterprise in China, Mengniu's products, as well as its production processes are environmentally friendly. During the year, Mengniu motivated its partners and has completed the construction of the China's largest methane power plant as an important ancillary facility to a large ranch in the Shengle Economic Zone of Helingeer. It uses cow droppings and fermented cow urine as fuel for power generation and the residue of the process for manufacturing organic fertilizer. The Research Institute in Helingeer is equipped with sewage treatment plants which process sludge and other pollutants. Water after treatment is used to water the trees within the plant district, helping to save water and reduce the negative impact from the production process on the environment, leading the industry to a green road.

Other than the focus to maximize asset value, a respectful enterprise with vision should also be committed to fulfill its corporate social responsibilities. To reciprocate to the community, Mengniu launched a free-milk program, "A catty of milk a day keeps the Chinese people invigorated always", in June 2006 to give out ***Mengniu*** milk as well as nutrition to students in the impoverished areas of China. Mengniu's effort towards the community gained support from a wide range of caring people and a number of international organizations and business giants joined us in 2007. Currently, this "Milk Loving Care" program covers 1,000 schools in impoverished areas, and we expect this "Project Hope of Milk" to form an even bigger force in the future, so that more students will be benefited.

Looking forward, Mengniu is ready to reach new heights through technological reforms and scientific development. With the changing market conditions and government policies, we expect China's dairy industry to experience further market consolidation. Smaller dairy corporations with less brand value will be fading out. For an enterprise to secure its leading position, it needs to spend more efforts on technical research, product development and branding. In the future, leveraging the advanced technologies of the new Research Institute and abundant resources, we will develop more trend-leading high-end products to meet the needs of consumers on taste and nutrition. To strengthen Mengniu's leading position in the market, marketing strategy will be implemented further to widen the coverage. We will penetrate into existing and potential markets by means of extensive channels in order to enlarge our market share and improve our profitability. For the years to come, in addition to exploring opportunities for forming new alliances with renowned enterprises to expand the business, we will also foster closer cooperation with the raw milk suppliers and distributors with an aim to have an effective connection with the entire dairy industry chain, thereby achieving higher production effectiveness and providing force to the industry to grow hand in hand.

The success of Mengniu is attributed to the love and support of all shareholders, customers and business partners towards the Group since its incorporation. I would like to express my heartfelt gratitude again on behalf of Mengniu. My thanks also go to the board members, management team and employees for their dedication and hard work. I am confident that we – the Mengniu team – will create a brighter future for China's dairy industry and bring more satisfying returns to our shareholders.

NIU Gensheng
Chief Executive Officer

Hong Kong, 8 April 2008

Major Awards and Achievements

- According to the data issued by the Chinese Enterprise Information Center of the National Bureau of Statistics of China, Mengniu **liquid milk** continued to be China's **No. 1 seller** in 2007 in terms of sales volume

- According to the survey conducted by the China General Chamber of Commerce on commodity sales of national large-scaled retailers, Mengniu **liquid milk, yogurt and milk beverages** were **No. 1** in terms of market share, and Mengniu dairy products were bestsellers in terms of sales volume

- Mengniu ***Champion (冠益乳)*** was rewarded the **Golden Prize** in the 16th China Food Expo

The Group was awarded the honor of:

- among the **Most Globally Competitive Chinese Companies of the 11th Five-Year Plan** in China by Global Compact organizations such as the China International Institute of Multinational Corporations and the United Nations Development Program

- among the **Top 100 Chinese Companies in the World** during the Asia Pacific (Investment and Finance) Economic Annual Meeting in 2007

- among the **Most Influential Private Enterprise** by research institutes such as the Development Research Center of the State Council, and the China Social and Economic Research Center of the National Bureau of Statistics

- **The Best Community Business Award** by the Sina 2007 Internet Grand Annual Review

- **Best Corporate Public Image Award 2007** by the Enterprise Research Institute of Development Research Center of the State Council and China Credit Research Center of Beijing University, etc

- **People's Social Responsibility Award 2007** by the People's Daily Online

- among the **3rd Outstanding Corporate Citizens** by organizations such as the Economic Channel of CCTV and the China Committee of Corporate Citizenship

- **The Most Influential Chinese Company on International Sports Marketing** as honored by the China Leisure Sports Administrative Center of the China General Administration of Sports, and the China International Brand Development Association, etc

- among the **Top Ten Most Contributing Enterprises for China Ecology 2007** by the China Ecological Forum

- **Award of Outstanding Contribution on Enterprise Culture** by the China Enterprise Culture Improvement Association at the anniversary meeting of National Enterprise Culture in 2007

- **No. 2** of **Top 100 Privately-owned Listed Companies 2007** by *Asian Business Leaders*

*The **Mengniu brand** was named:*

- among the **Ten Most Influential Life Style Brands in China** by the China Society for World Trade Organization Studies

- among the **Most Competitive Brands in the Market** by China's Ministry of Commerce

- for the **Huapu Award** at the first China Brand Festival – recognized as one of **the Top 25 Leading Brands in China of the Year**

- **The Most Influential Brand Award 2007** by the Sina 2007 Internet Grand Annual Review

- for the **Food Safety Credibility Brand 2007** at the 16th China Food Expo

- among the **Top Ten Favorite Brands** in "Vote for Your Favorite Brand Campaign" organized by Wellcome, a Hong Kong supermarket

- for the award of **Most Favorable Brand for Food and Beverage of China's University Students in 2007** by *China Business* for the company's dairy and ice-cream

Others:

- The technology of generating electricity by methane from cow droppings was recognized as one of the **Ten Most Recommended Ecological Technologies** by the China Ecological Forum

- The company's large-scale methane power project and the recycling and reuse of water after sewage treatment were awarded the **Golden Prize of 2nd China Achievements of Building Environmental-Friendly Community Exposition**

40.7%

market share in China's liquid milk market*

Sales of liquid milk *championed* China's market

Awarded one of Hong Kong's

"Top 10 Favorite Brands"

for 3 consecutive years

* in terms of sales revenue, excluding milk beverages and yogurt


蒙牛
特侖蘇
蒙古語金牌牛奶之意
MILK
DELUXE
特侖蘇
純牛奶
3.3
250mL

Management Discussion and Analysis

FINANCIAL REVIEW

Building on the rising demand for dairy products in China, and the Group's innovative products and highly effective promotional strategies, the Group was able to strengthen its industry leadership and market share in the year under review. The Group achieved fruitful results during the year, and its revenue increased by 31.2% to RMB21.3181 billion (2006: RMB16.2464 billion). Net profit attributable to equity holders of the Company increased by 28.7% to RMB935.8 million (2006: RMB727.4 million). Basic earnings per share and diluted earnings per share were both RMB0.664 (2006: RMB0.532), representing an increase of 24.8% compared with 2006.

Gross Profit

During the year under review, the Group recorded a gross profit of RMB4.8035 billion (2006: RMB3.7218 billion), representing an increase of 29.1% as compared with 2006. The Group implemented focused cost control measures, optimized its production processes and enhanced its logistics, warehousing and transportation systems, thus easing the pressure from rising raw material costs. The Group optimized its product mix by launching more high-end functional products, which also helped to minimize the negative impact of increasing costs. The Group's overall gross profit margin for the year maintained at a healthy rate of 22.5%, representing a slight drop of 0.4 percentage point as compared with 2006.

Operating Expenses

In 2007, the Group recorded operating expenses totalling RMB3.7858 billion (2006: RMB2.817 billion), representing approximately 17.8% (2006: 17.3%) of the Group's revenue. During the year under review, the Group continuously enhanced its operation management system and firmly adhered to its comprehensive budget control system in order to tighten operating expenses and improve sales and management efficiency.

The Group's selling and distribution costs amounted to RMB3.302 billion (2006: RMB2.3803 billion), representing approximately 15.5% (2006: 14.6%) of the Group's revenue. With the need to implement differential marketing strategies and enhance promotion for new products, the Group launched a great variety of innovative and unique advertising and promotion campaigns to cater for different market segments. As a result, advertising and promotion expenses accounted for 7.2% of the Group's revenue, representing an increase of 0.4 percentage point compared with 6.8% in 2006. These marketing and promotional activities were designed to increase the Group's market share through distinguishing the unique characteristics of the ***Mengniu*** brand by means of innovative and creative campaigns.

Administrative and other operating expenses amounted to RMB483.8 million (2006: RMB436.7 million), representing a decrease from 2.7% of the Group's revenue in 2006 to 2.3% in 2007. The percentage decrease was mainly benefited from the implementation of a comprehensive management system and stringent control on administrative expenses during the year.

Profit from Operating Activities

The Group's EBITDA for 2007 increased by 19.4% to RMB1.6673 billion (2006: RMB1.3961 billion). Despite the substantial increase in the cost of raw milk and rising advertising and marketing expenses, the Group mitigated the overall cost pressure through operational efficiency improvement and resources allocation optimization during the year, thus enabling it to maintain EBITDA margin at a level of 7.8% (2006: 8.6%).

Net Profit

Despite the keen market competition and rising cost pressure, the Group was able to realize greater economies of scale and optimize its product mix during the year. Its net profit attributable to equity holders of the Company for the year reached RMB935.8 million (2006: RMB727.4 million), representing an increase of 28.7% against 2006.

Capital Structure, Liquidity and Financial Resources

For the year ended 31 December 2007, the Group's net cash inflow from operating activities amounted to RMB2.0581 billion (2006: RMB1.4028 billion). Net cash balances (cash and bank balances net of total bank loans) amounted to RMB1.9477 billion (31 December 2006: RMB454.9 million) as at 31 December 2007, indicating a strong financial position and healthy cash flow status of the Group.

As at 31 December 2007, outstanding bank loans of the Group totaled RMB263.2 million (2006: RMB875.2 million), of which RMB183.2 million was repayable within one year and RMB80 million was repayable beyond one year.

The total equity of the Group increased from RMB3.6327 billion as at 31 December 2006 to RMB5.8347 billion in 2007. The debt-to-equity ratio (total bank loans to total equity) of the Group was 4.5% as at 31 December 2007, 19.6 percentage points lower than the 24.1% recorded in last year.

MARKET REVIEW

With the rapid national economic development and surge in domestic consumption, China dairy industry was presented with precious opportunities for fast growth. According to the statistics of the China Dairy Industry Association, the country has become the world's third largest milk producer and the largest emerging dairy market. According to an ACNielsen survey conducted in December 2007, the moving annual total sales revenue of the country's liquid dairy market had grown more than 20% when compared with 2006. As China dairy market expands and matures, it now assumes growing influence in the global market, and has become one of the largest dairy product markets in the world with the highest potential for growth.

As the China dairy industry matures, the product offerings have seen significant changes with focus now on higher technological content and special functions, reflecting the rising market demand. The industry has emerged from low-end price competition to high-end competition in production technology. The industry now seeks the pursuit of differential competition for overall long-term healthy industry development.

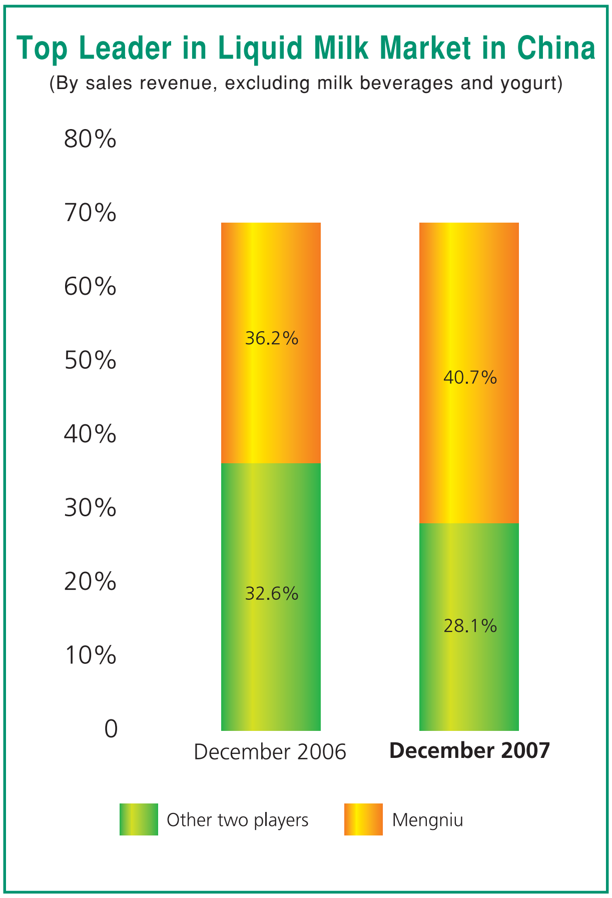
Management Discussion and Analysis

As the leader of the China dairy industry, the Group continued to increase investment in research and development ("R&D") of technologies for high-end products. In July, it organized the first "International Dairy Festival" in Inner Mongolia and dairy experts and enterprises from all over the world were invited to the summit during the festival. By encouraging exchange of knowledge and expertise among the participants of the summit, the Group has contributed to building a stronger dairy industry in China.

BUSINESS REVIEW

In July 2007, the Group's Hi-tech Dairy Products Research Institute and Intelligent Production Base ("Research Institute") commenced operation. It has presented the Group with an ideal R&D platform to develop new products and improve existing ones, so as to provide customers with more high-quality products that are "natural, pollutant free and rich in taste". During the year under review, the Group proactively improved product packaging, enhanced product functions and strengthened promotional campaigns to target different specific market segments. Such strategies, in turn, succeeded in crafting an outstanding image for ***Mengniu*** and its products.

According to a survey conducted by ACNielsen in December 2007, the Group had a 40.7% share of the liquid milk market (excluding milk beverages and yogurt) in China in terms of sales revenue, representing an increase against 36.2% in December 2006. The top three liquid milk manufacturers accounted for 68.8% (2006: 68.8%) share of the market in December 2007, evidencing the strong and solid market position of major manufactures in the dairy industry in China.



Source: ACNielsen

Branding and Marketing

At the consistent brand building efforts of the Group in the past few years, ***Mengniu*** is synonymous to high quality in the hearts of customers in China and around the world. During the year, in addition to recognition by the China Society for World Trade Organization Studies as one of the "Ten Most Influential Life Style Brands in China" (「影響中國生活方式十大品牌」), ***Mengniu*** was also one of the "Most Competitive Brands in the Market" (「最具市場競爭力品牌獎項) according to the Ministry of Commerce. It was also, for the third consecutive year, on the list of "Top 10 Favorite Brands" (「十大最愛品牌」) in Hong Kong and became the winner of the "Huapu Award – One of the Top 25 Leading Brands in China of the Year" (「品牌中國華譜獎－中國年度25大典範品牌」) at the first China Brand Festival. According to domestic market statistics from the Chinese Enterprise Information Center under the National Bureau of Statistics of China, in terms of sale volume, the Group's sales of liquid milk continued to champion the market in China, and almost lead the world. This served as evidence of the Group's solid position in the market as well as customer preference for its products.

During the year, the Group continued to cooperate with national and local TV stations in launching various highly interactive and innovative marketing campaigns (including theme programs), such as "Win in China" (贏在中國), "Mengniu Probiotics Yogurt – Family Let's Go" (蒙牛益生菌酸奶全家總動員) and "Hi-calcium Milk Super Winner" (高鈣奶超級大贏家), to appeal and capture target customer groups from all walks of life. At the same time, the Group also worked closely with Disney, National Basketball Association ("NBA"), Starbucks and KFC to launch a series of events with the theme of "care, health and nutrition". These programs included "Milk Loving Care" and the "NBA Jam Van for Basketball Fans", both of which aimed at promoting the healthy lifestyle of "Drink more milk and exercise more", which is what ***Mengniu*** brand represents.

Furthermore, the Group expanded its reach overseas, extending its coverage to overseas markets including Singapore, the Philippines and Malaysia. By actively pursuing expansion of overseas markets, the Group hopes to enlarge business coverage and become one of the top 15 dairy companies in the world.

Products

On the product development front, taking product segmentation as its R&D strategy, and with the support from high and innovative technology, the Group optimized existing products and introduced more products with high value functions.

Liquid milk

As the Group's main source of revenue, liquid milk brought in revenue of RMB19.1489 billion, accounting for 89.8% of the Group's revenue for the year. The amount represented a 34.3% growth as compared with RMB14.2609 billion in 2006.

UHT milk

The revenue from UHT milk products grew by 33.4% to RMB12.7747 billion when compared with RMB9.5762 billion last year, accounting for 66.7% of the revenue of the liquid milk segment. In addition to continually enhancing its plain milk products, the Group was able to add into it nutritional grain essence powder, giving *Breakfast Milk (早餐奶)* an even better taste and improving its nutritional value. The move led to strong growth in sales of UHT milk and fortified the segmental customer base. Moreover, building on *Milk Deluxe (特侖蘇)*, which won the "IDF Marketing Awards – New Product Development" last year, the Group improved the contents of the products by adding the osteoblast milk protein ("OMP"). OMP gives users a source of calcium and at the same time helps their body to retain calcium. The use of OMP secures the product with strong customer support since its launch, and helps the Group to enlarge its high premium milk product portfolio.

Management Discussion and Analysis

The newly introduced and improved products offered customers more premium choices, that plus rapid economic growth and rising demand for high quality and nutritional products among customers, stimulated strong growth in the Group's UHT milk products. Building on its existing products, the Group has strived for breakthroughs and it plans to launch in 2008, *Milk Deluxe Organic Milk (特侖蘇有機奶)*, its first organic milk product, and the *Low-Lactose Milk (低乳糖牛奶)*, with boosted dietary fiber content which is easier to be absorbed by the body. The Group will continue to diversify its product lines, so as to offer customers with healthier and higher quality choices.

Milk beverages

Revenue from the milk beverages segment increased by 36.8% to RMB4.9806 billion, accounting for 26% of the liquid milk revenue. During the year under review, the Group actively boosted the nutritional value and flavor of its milk beverage products. It launched a new generation of milk beverage products with probiotic elements. Supported by active and effective promotion programs, sales of the Group's milk beverage products climbed.

During the year, the Group joined hands with Disney and launched two beverage products for children – *Xi Xi Shuang Jelly Drink (吸吸爽奶凍)* and *Xi Xi Shuang Milk Drink (吸吸爽牛奶)* under the *Future Star series (未來星)*. These new products, all in packages featuring Disney's cartoon characters, were the favorite choices of both parents and children. Applying advanced technology, the Group also added unique value to its products. By combining rich milk flavor with real fruit pulps, it launched the *Fruit Milk Drink (真果粒)* series, which marked the success of the Group in gaining foothold in various defined market segments.

Yogurt

During the year under review, revenue from the yogurt segment increased by 33.5% to RMB1.3936 billion, accounting for 7.3% of the revenue of the liquid milk segment. Riding on the increasing market recognition of the health benefits of yogurt, the Group launched upgraded and newly flavored products, such as *Champion (冠益乳)* and *Large Fruit Grain Yogurt (大粒果實酸奶)* during the year. All its yogurt products recorded continuous growth in sales.

The Group launched the *Large Grain Fruit Yogurt (大粒果實酸奶)* employing a newly developed technology that enables the addition of fresh fruit pulps into yogurt, enriching its nutrient contents. The Group also launched another product – *Rich Grain Yogurt (粒多濃酸奶)*, which is a mixture of selected natural healthy grains, fresh fruit pulps and yogurt, as well as the LABS probiotics. The product is rich in dietary fiber and protein and can protect the intestines. Building on its R&D achievements, the Group will embark on developing new products with high technology contents and added values, which include *Beauty series (優妍產品)* – to offer women consumers with additional collagen and polydextrose (利體素); and the *Future Star Yogurt (未來星兒童酸奶)* – rich in nutrients that can foster growth of bones and joints as well as development of the brain and the body of children. These products will allow the Group to enhance competitiveness and the market share of this segment.

Ice cream

The Group continued to improve existing products and enhanced promotion efforts for its ice cream. Accounting for 9.4% of the Group's revenue, ice cream products generated revenue totaling RMB1.9917 billion, representing an increase of 9.6% against last year.

The Group continued to improve the flavors, mouth feel and packaging of its products, and launched a high-end product *Deluxe (蒂蘭聖雪)*. This product has become a preferred choice of customers which laid a solid foundation for the Group in the high-end ice cream market. During the year under review, the Group continued to optimize the product structure of the segment and, as such, sales of the segment slacked the overall sales of the Group. The Group had boosted the segment's overall strength and now has a host of new products in the pipeline to be launched soon to targeted customer groups. A series of new products are scheduled to launch in 2008 – On the foundation of the *Sui Bian* series *(隨變)*, the Group improved its image and added probiotic elements to its ready to be launched aromatic *Sui Bian Euro Roll (隨變歐羅旋)* series; the Group cooperated with NBA and Disney, and the respective *New Ice + Basketball Ice (全新冰+籃球冰)* and *Kooka Cup (酷咔杯)* series are also in the pipeline. These ice cream series, which taste better and more refreshing, are introduced with the aim of enhancing profit in this segment.

Other dairy products

During the year, the Group reorganized its dairy products and carried out intensive promotion for products with potential. Revenue from other dairy products amounted to RMB177.5 million, accounting for 0.8% of the Group's revenue. Boasting better quality and a premium brand, as well as advantages as the first mover to the market, Mengniu milk powders reported strong and stable sales. The *Mengniu Arla (蒙牛阿拉)* and *Milex (美蕾滋)* product series, which target at the mid– and high-end market respectively, progressed into the market promotion stage and are expected to become profit drivers of the other dairy products operation.

Furthermore, *Smoke-dried Cheese (熏制乳酪)*, a product developed by the Group using advanced technology, was introduced to the market in late 2007. With a new product attempt, the Group continues to develop new product and hopes to expand the variety of its dairy products thus providing customers with more choices of high quality dairy products.

Raw Milk Supply

To increase raw milk supply and guarantee its quality, during the year under review, the Group continued to provide raw milk suppliers with training on milk cattle breeding and rearing, as well as prevention of diseases in ranch. Such programs have helped to ensure the consistent high quality of raw milk for production. Furthermore, to monitor raw milk quality and ensure the collection process adheres to the highest hygiene standards, the Group took reference of the national standards for collection and food safety, and mapped out a strict workflow for internal examination of raw milk. Apart from monitoring collection centres and the sanitary conditions of milk trucks, it also scrutinized all the work processes for diligent compliance to all control measures. In addition, the Group also rated the raw milk collected according to a set of strict standards, so as to meet the raw milk needs of different products.

Management Discussion and Analysis

Production and Operation

At its tireless effort in production capacity expansion, as of December 2007, the Group operated 22 (2006: 19) production bases with a combined annual production capacity of 4.78 million tons (2006: 3.93 million tons).

In July, the Group's first Research Institute was completed and began operation. Through strategic collaboration with famous domestic and foreign enterprises and R&D institutes such as the University of Cambridge in the UK and the Chinese Academy of Sciences, the new Research Institute has been able to employ the most advanced equipment and intelligent facilities in the world. Being one of the top dairy R&D centers of international standards, the Group has held a number of training programs and international seminars to facilitate industry exchanges since the Research Institute commenced operation. The Group was also able to develop various new technologies, including the use of the electronic smell analyzer technology in comparative testing, application studies, as well as in testing actual products. The Group is expected to be able to adopt electronic technologies in a wider spectrum of more scientific and systematic sensational tests on its products, thus enhancing quality of its new products.

In addition, the Group continued to standardize quality management and optimize operation management system. The Group continued to assess and control the input and output value of each product, on a timely basis, at all stages covering development, marketing and massive sales. After one year's efforts, all production bases attained higher quality and effectiveness in terms of technology, examination, product formulae and quality control.

Ventures and Alliances

During the year, the Group formed new strategic alliances. In January, the Group became the official partner of NBA in China and the exclusive supplier of dairy products, such as liquid milk and yogurt, to all NBA games in the country. At the same time, starting from 2007, the Group has become the designated dairy products supplier for all outlets of Starbucks (the famous special coffee retailer and bakery in the world) in Mainland China. Furthermore, in October, the Group formed alliance with KFC, one of the largest restaurant chains in the world, to provide ***Mengniu*** dairy products to nearly 2,000 KFC restaurants across China starting from 2008. Living up to stringent global quality standard, the Group became a welcomed partner of many international brands. These alliances did not only give recognition to the Group's product quality, but also expand its alliance reach, which provide a stronger standing of the Group on the international marketplace.

Industry Exchange

Apart from securing strategic alliances, the Group also actively organized a number of local and international industry exchange events during the year under review. In July, the Group presented the first "International Dairy Festival" in the country, which was attended by representatives of many international dairy associations. During the festival, a summit titled "Pooling International Wisdom to Build the Dairy Capital of the World" was held. In September, the Group, as the only Chinese dairy enterprise on the invitation list, attended the annual meeting of the International Dairy Federation, the highest level meeting of the global dairy industry. Moreover, the Company also had the honor of making the keynote presentation at the "Summit Forum for Dairy Prairie Industry". The Group shared its innovative measures and experiences on construction of ranches and milk source bases with representatives of major dairy nations such as Denmark, Britain, Australia and the US. In October, the Group organized a technology research and exchange event titled "The Future of Ingredients and Dairy Products". A wide range of international ingredient companies from the US, Switzerland, Denmark and the Netherlands participated the event and discussed the status of dairy markets in Europe, the US, Japan, Taiwan and Mainland China. Views on functional raw materials and application technologies were also exchanged during discussions. Through close exchanges with peers and dairy experts from around the world, the Group was able to improve its scientific technology, gain better knowledge of the global market and be equipped with a wider international market perspective, helping it to prepare for taking its business globally.

Social Responsibilities

To support the government's public health goal encapsulated in the slogan "A catty of milk a day keeps the Chinese people invigorated always", the Group has commenced a national milk sponsorship program since June 2006. After one year's efforts, the total number of beneficiaries increased to 1,000 schools. The Group's efforts resonated with all sectors and groups. In June, the Training Division under the General Administration of Sports, NBA and various well-known international enterprises and organizations decided to join the Group's "Milk Loving Care" campaign, which allocated more resources to provide milk and nutrition for children across China. In addition, to fulfill its corporate citizen responsibility and contribute to the development of the society, the Group participated in a wide range of social campaigns such as "You must hear our Care – Rescue the Deaf" that more needy could feel the care and warmth from others in the society.

As the leader in the local dairy industry, not only did the Group focus on advancing its business and heightening efficiency, it also took care of the need to protect the environment. With the aim to become a "Dual Green Enterprise", the Group established an environmental friendly operational system while delivering green products. The Group motivated its partners and has completed building the China's largest methane power plant in Shengle Economic Zone of Helingeer, as an important complement to a large ranch. Using such as cow droppings and fermented urine as fuel for power generation and residue from the process for manufacturing organic fertilizer, zero emission of pollutants is achieved contributing to the realization of recyclable economic development.

Management Discussion and Analysis

PROSPECTS

In the future, the China dairy industry is set to become a hotspot of the world. With a 1.3 billion population and a booming economy, and a rising living standard, China is fast becoming the largest consumer market in the world. With its rich natural resources and labour as well as fast technological catch up, China will become a major milk-producing country. With various favourable factors, the China dairy industry will be in strong growth momentum unmatched by its counterparts in the world.

As forerunner in the China dairy market, the Group will actively explore the market and increase investment in R&D, so as to capitalize on the growth momentum of the industry. By introducing international experience and technology, as well as engaging in technology exchange and product development, the Group will be able to add more value to its products and provide a greater variety of nutritious high-end products to more customers.

Share with raw milk suppliers the latest technologies to improve raw milk quality

To improve the quality of raw milk and grow together with suppliers, the Group will continue to provide them with relevant training and technical support. Through closer cooperation and information exchange with foreign players, the Group will endeavour to bring in from all over the world the latest technologies in dairy cattle breeding and rearing, and milk collection to its raw milk suppliers, in order to help them meet the higher international standards. In addition, to tighten control and monitory of raw milk quality, the Group will refine its existing quality control plan and also formulate quality improvement plan to raise the quality benchmarks for raw milk sources.

Attain a new milestone in R&D and inspection for development of higher technology content products

Scientific R&D will be one of the Group's development priorities. The Group will refine its products using innovative and advanced scientific equipments and technologies developed from the Research Institute. It will also utilize technologically advanced means, such as electronic smell and taste analyzers as well as sensational judging and management software, to establish a scientific and efficient electronic sensational judgement system, so as to enhance product quality, improve product consistency, prolong product shelf life and incorporate additional product functions. The Group will actively improve its own technology level to keep abreast with world-class standards, so that it can lead China's dairy industry into the international market as the market leader.

Optimize various internal control systems to ensure its operation and products boast the highest relevant standards

The Group has laid a strong foundation for its operation management system, which efficiency has been proved. In the future, the Group will endeavour to improve the system to ensure it operates smoothly at all levels to help the Group optimize its production process and improve efficiency. In addition, the Group will also refine its performance evaluation system to ensure operational targets are clearly defined and conveyed to all departments. To ensure product safety and safeguard the health of customers, the Group enhances its food safety control mechanism by implementing overall quality control on all production units and laboratory examination and approval procedures. Such measures are set to ensure all aspects of its products meet the highest standards of all the production units.

Be responsible for growth of the industry and China by expanding globally and reciprocating to the society

Looking forward, the Group will seek strategic alliance with international enterprises and strive to aid the development of the country's dairy industry in terms of technology, hygiene standard and added value to products. The Group will strengthen communication with domestic and international players and leverage the advanced technology and profound experience of industry players in developed countries. It will also seek to play the role of a gateway between China and the world dairy industry, and lead the China dairy industry in exploring the world market.

In addition, through holding charitable activities with various partners, the Group will make its best efforts to reciprocate to the society, allowing more people to benefit and to feel the support and warmth from other members of the society. To help victims of the disastrous snowstorm in southern China during the Chinese New Year period, on 4 February 2008, the Group, in collaboration with charitable organizations, donated RMB10 million in cash as well as milk products to the Red Cross of China to aid direct relief and rebuilding of affected areas. The Group was the first private enterprise to make donations to the snowstorm victims. The Group will actively honor its social obligations as a leading enterprise, by using its own resources and technology, to contribute to environmental protection and to help building a green society.

HUMAN RESOURCES AND REMUNERATION OF EMPLOYEES

As at 31 December 2007, the Group had approximately 26,000 employees in China and Hong Kong. Total staff costs for the year, excluding directors' remuneration, were approximately RMB885.9 million (2006: RMB673.9 million). To enhance the quality and competence of employees, the Group provided various pre-job and on-the-job training programs to newly joined and existing staff members during the year on, inter alia, the latest industry knowledge and technical and management skills. In addition, the Group also organized various activities which allowed staff members to gain a better understanding of the Group's corporate culture, business concepts and mission. To reward employees and provide work incentives, competitive remuneration packages with performance-based bonuses and share option schemes were provided to staff members.

Directors and Senior Management

EXECUTIVE DIRECTORS

Mr Niu Gensheng, aged 50, is the Chief Executive Officer of the Company. Mr Niu is the Chairman and one of the founders of Inner Mongolia Mengniu Dairy (Group) Company Limited ("Mengniu"). Mr Niu graduated from Inner Mongolia University with a degree in Administration and Management and obtained a Master's degree in Enterprise Management at the Chinese Academy of Social Sciences Graduate School. With his extensive experience and insights in China's dairy industry, Mr Niu receives high reputation in the industry. In 2007, Mr Niu was elected as one of "China's Most Influential Business Leaders" for the fifth consecutive year, honored as "2007 Hong Kong Bauhinia Awards". Mr. Niu is devoted to charity and was ranked third in the 2007 Hurun Top 10 for Charity. Mr Niu currently serves as the Deputy Chairman of Dairy Association of China, China Dairy Industry Association, and the Second China National Committee of International Dairy Federation. Mr Niu is also an independent non-executive director of a listed company.

Mr Yang Wenjun, aged 41, is a Vice President of the Company, the Chief Executive Officer and one of the founders of Mengniu. Prior to the appointment as Mengniu's CEO, Mr Yang was Mengniu's Vice President and the general manager of the liquid milk division, and has solid dairy industry experience. Mr Yang graduated from Inner Mongolia Light Industry Institute in dairy products and he also holds a Master's degree in Business Administration from Barrington University. Mr Yang was jointly elected as "2007 Person of the Year in China" by Global Sources and World Entrepreneur. Mr Yang also received "Special Award of Corporate Culture Building" in 2007 Annual Conference of National Corporate Culture Building.

Mr Sun Yubin, aged 41, is a Vice President of the Company, secretary of the Party committee and one of the founders of Mengniu. Mr Sun graduated from Inner Mongolia University with a degree in Economic Management. Prior to the appointment as Mengniu's secretary of the Party committee, he was a Vice President and the General Manger of ice cream department of Mengniu. Mr Sun has solid dairy industry experience.

NON-EXECUTIVE DIRECTORS

Mr Jiao Shuge (alias Jiao Zhen), aged 42, is the Chairman of the Board of Directors. Mr Jiao joined the Group in September 2002. Mr Jiao is currently the general manager at CDH China Fund, L.P. Mr Jiao received a Bachelor's degree in Mathematics from Shandong University and a Master's degree in Engineering from the Ministry of Space Industry Institute. Mr Jiao serves as a director of various listed companies.

Ms Lu Jun, aged 52, is one of the founders of Mengniu. Ms Lu studied economic management at Inner Mongolia University and has solid dairy industry experience. She worked at Inner Mongolia Securities Regulatory Commission and served as the head of Inner Mongolia Property Rights Exchange. Ms Lu was formerly a deputy chief of the Inner Mongolia Women Entrepreneurs' Association. Ms Lu retired and resigned as a non-executive director with effective from 1 January 2008.

Mr Julian Juul Wolhardt, aged 34, joined the Group in January 2006. Mr Wolhardt is currently a director of KKR Asia Limited focusing on private equity transactions in the Greater China region. Mr Wolhardt is a CPA and CMA and received a B.S. with honors in Accounting from the University of Illinois (Urbana-Champaign).

Directors and Senior Management

INDEPENDENT NON-EXECUTIVE DIRECTORS

Mr Wang Huaibao, aged 70, currently serves as a Deputy Chairman of the Dairy Association of China. Mr Wang graduated from People's University of China. Mr Wang served as the Chairman and the general manager for Beijing Milk Company (now Beijing Sanyuan Food Company Limited). Mr Wang also served as the Chairman of the China Dairy Industry Association. Mr Wang was appointed as an independent director of Mengniu on 18 October 2002 and became an independent director of the Company on 23 February 2004.

Mr Zhang Julin, aged 64, is a professor of accounting. Mr Zhang graduated from the Economics Department of Lanzhou University. Mr Zhang served as an assistant dean to the Inner Mongolia Finance and Economics University. Mr Zhang is currently a Vice Chairman of the Inner Mongolia Audit Society and an independent director for Inner Mongolia Lantai Industrial Co., Ltd. Mr Zhang is also a member of the Chinese Institute of Certified Public Accountants. Mr Zhang was appointed as an independent director for Mengniu on 18 October 2002 and became an independent director of the Company on 23 February 2004.

Mr Li Jianxin, aged 44, is a senior economist. Mr Li studied finance as a graduate student at the School of Economics, Peking University. Mr Li has served as a secretary of commission, director of general manager office and deputy director of the policy research office for China Lucky Film Corporation. Mr Li currently serves as a director and the secretary of the board of Lucky Film Co. Ltd., a company listed on the Shanghai Stock Exchange. Mr Li was appointed as an independent director for Mengniu on 18 October 2002 and became an independent director of the Company on 23 February 2004.

SENIOR MANAGEMENT

Mr Yao Tongshan, aged 51, is the Chief Financial Officer of the Company. Mr Yao joined Mengniu in October 2001. Mr Yao graduated from Tianjin University with a Master's degree in Engineering. Mr Yao served as a director of the international credit department at the Inner Mongolia branch of China Construction Bank, a manager of State Energy Resources Investment Company investment banking division and the Chief Financial Officer of Inner Mongolia Mengxi New Hi-tech Group. Mr Yao has extensive experience in finance and investment management.

Mr Bai Jun, aged 44, a senior engineer, is the Chairman of Mengniu labor union. Mr Bai joined Mengniu upon its establishment in 1999. Mr Bai received a Master's degree in Business Administration from People's University of China. Mr Bai has solid dairy industry experience.

Mr Lei Yongsheng, aged 46, is the Chief Administrative Officer of the Company and is the Secretary of the Board of Directors of Mengniu. Mr Lei joined the Group in February 2002. Mr Lei graduated from Inner Mongolia Finance and Economics University with a degree in Economics. Mr Lei served as a deputy director of Inner Mongolia State-owned Assets Administration Bureau Asset Valuation Center and a deputy director of Inner Mongolia Finance Bureau General Office. Mr Lei has extensive experience in administrative management.

Directors and Senior Management

Mr Deng Jiuqiang, aged 56, is a Vice Chairman of Mengniu and one of the founders of Mengniu. Mr Deng graduated from Inner Mongolia Industrial University with a degree in Equipment Manufacturing. Mr Deng is a founder of and served as a general manager of Hohhot Light Industrial Equipment Company Limited. Mr Deng has extensive experience in management.

Mr Bai Ying, aged 37, is a Vice President of Mengniu and the general manager of UHT milk division. Mr Bai joined Mengniu upon its establishment in 1999 and he possesses solid experience in China's dairy industry. Mr Bai graduated from Inner Mongolia Agriculture University with a Master's degree. Mr Bai was presented the "Outstanding Contribution Award for Development of Western Region of Inner Mongolia Autonomous Region" and was honored as one of the "Ten Outstanding Young Persons" in 2004.

Mr Yao Haitao, aged 46, is a Vice President in Administration. Mr Yao joined Mengniu in 2003. He graduated from Inner Mongolia Finance and Economics College with a Bachelor's degree in Economics. Mr Yao has solid experience in administrative management.

Ms Zhao Yuanhua, aged 45, is a Vice President in Sales and Marketing. Ms Zhao joined Mengniu in 2000. She graduated from Baotou University of Iron and Steel Technology with a Bachelor's degree in Technology. Ms Zhao has solid experience in sales and marketing.

Mr Ding Sheng, aged 40, is a Vice President and the general manager of yogurt division. Mr Ding joined Mengniu in 2003 and has solid dairy industry experience. Mr Ding graduated from Nankai University with a Master's degree in Business Administration. Mr Ding was awarded as an "Outstanding Staff of Dairy Industry in Inner Mongolia" in 2006.

COMPANY SECRETARY AND QUALIFIED ACCOUNTANT

Mr Kwok Wai Cheong, Chris, aged 34, the Financial Controller and Company Secretary of the Company, joined the Group in May 2007. Prior to joining the Group, Mr Kwok was the Financial Controller of a Hong Kong Main Board listed company and he also had served in an international accounting firm. Mr Kwok graduated from The Hong Kong Polytechnic University with a Bachelor's degree in Accountancy. Mr Kwok is a member of the Hong Kong Institute of Certified Public Accountants and a fellow member of Association of Chartered Certified Accountants.

Motivated 14 caring institutes

To deliver Mengniu

benevolent milk to 1,000

schools in the country daily

蒙牛为全国1000所小学免费送奶大型公
每天一斤奶
Half a Kilogram of Milk a Day Keeps Every C
“中国牛奶爱心行动”暨

Corporate Governance Report

The Company is dedicated to ensure high standards of corporate governance with an emphasis on a diligent Board of Directors (the "Board"), sound internal control, and increasing transparency and accountability to shareholders. The Board acknowledges that good corporate governance practices and procedures are beneficial to the Group and its shareholders. The Company is committed to improve those practices and maintain its ethical corporate culture.

The Company has adopted the code provisions set out in the Code of Corporate Governance Practices (the "CG Code") contained in Appendix 14 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") as its own code of corporate governance practices.

Throughout the year, the Group has fully complied with all the compulsory code provisions set out in the CG Code.

THE BOARD

As at 31 December 2007, the Board comprises nine Directors, including three Executive Directors, namely, Mr Niu Gensheng, Mr Yang Wenjun and Mr Sun Yubin, three Non-executive Directors, namely, Mr Jiao Shuge (alias Jiao Zhen), Ms Lu Jun and Mr Julian Juul Wolhardt, and three Independent Non-executive Directors, namely, Mr Wang Huaibao, Mr Zhang Julin and Mr Li Jianxin. The Chairman of the Board is Mr Jiao Shuge and the Chief Executive Officer of the Company is Mr Niu Gensheng.

The Board is responsible for the leadership and management of the Company. Key responsibilities of the Board comprise formulation of the Group's overall strategies and policies, setting of performance and management targets, evaluation of business performance and supervision of management's performance. The management was delegated the authority and responsibility by the Board for the management and operations of the Group. In addition, the Board has also delegated various responsibilities to the Board Committees as detailed in this report.

Biographies of the Directors are set out on pages 24 to 29 of the annual report, which demonstrates a diversity of skills, expertise, experience and qualifications. There is no other material financial, business or relevant relationships among the Directors.

INDEPENDENCE OF INDEPENDENT NON-EXECUTIVE DIRECTORS

The Independent Non-executive Directors possess appropriate professional qualifications, or accounting or related financial management expertise. Their role is to provide independent and objective opinions to the Board for its consideration and decisions. The Company has received annual confirmation of independence from the three Independent Non-executive Directors in accordance with Rule 3.13 of the Listing Rules. The Board has assessed their independence and concluded that all the Independent Non-executive Directors are independent within the definition of the Listing Rules.

BOARD PROCEEDINGS

The Board meets at least four times a year and additional operational meetings are also held, when required. The Company Secretary is responsible for preparing agenda and notices for the meetings. Senior management of the Group also provides the directors with relevant information on a timely basis regarding key business developments of the Group and issues affecting the Group. Agenda and other information package are normally delivered to the directors before the meetings. The directors also have independent access to the senior management in respect of operating issues. The directors may take independent professional advice where appropriate to discharge their duties, at the Company's expenses.

During the year ended 31 December 2007, the Board held six meetings. The attendance of each of the directors at the Board meetings is as follows:

Directors	Attendance of Board meetings in 2007
Niu Gensheng	6/6
Yang Wenjun	5/6
Sun Yubin	6/6
Jiao Shuge (alias Jiao Zhen)	5/6
Lu Jun	6/6
Julian Juul Wolhardt	4/6
Wang Huaibao	5/6
Zhang Julin	6/6
Li Jianxin	6/6

Note: During the year, the Company held four quarterly meetings and two other meetings to handle operational-level matters. According to the Company's articles of association, the quorum for convening a Board meeting is two members.

Minutes of meetings of the Board and Board Committees are kept by the Company Secretary of the Company and are not only open for inspection by the directors but also sent to the directors for records. All directors have access to the Company Secretary of the Company, who is responsible for ensuring that the Board procedures are complied with and advising the Board on compliance matters.

CHAIRMAN AND CHIEF EXECUTIVE OFFICER

The role of the Chairman is separate from that of the Chief Executive Officer to ensure a balance of power and authority. The Chairman is responsible for overseeing the functioning of the Board while the Chief Executive Officer is responsible for managing the Group's business.

The Chairman shall ensure that Board meetings are planned and conducted effectively and all directors are properly briefed on issues arising at Board meetings. He is also responsible for ensuring that the directors receive in a timely manner adequate information, which must be complete and reliable.

APPOINTMENT, RE-ELECTION AND REMOVAL OF DIRECTORS

Each director has entered into a service contract with the Company for an initial term of one year and continuing thereafter for further successive period of one year, for a maximum duration of three years. The directors are subject to retirement by rotation and re-election at each annual general meeting of the Company in accordance with article 112 of the Company's articles of association. The directors appointed as an addition to the Board or to fill a casual vacancy on the Board shall be subject to re-election by the shareholders at the first general meeting after the appointment.

BOARD COMMITTEES

To oversee particular aspects of the Company's affairs and to assist in the execution of its responsibilities, the Company has established three Board Committees under the Board, namely the Audit Committee, the Remuneration Committee and the Nomination Committee, each of which is governed by specific terms of reference approved by the Board, covering its functions, duties and powers. The terms of reference of the respective Board Committees have complied with the CG Code provisions and are available for public inspection at the Company's principal place of business in Hong Kong. The Committees have been structured to include a majority of Independence Non-executive Directors as members in order to reinforce independence.

REMUNERATION COMMITTEE

As at 31 December 2007, the Remuneration Committee comprises five members, three of whom are Independent Non-executive Directors and two Non-executive Directors. The Remuneration Committee is chaired by Mr Wang Huaibao, an Independent Non-executive Director.

The duties of the Remuneration Committee are to review annually and recommend to the Board the overall remuneration policy for the directors and senior management to ensure that the level of remuneration is linked to their level of responsibilities undertaken. The Remuneration Committee shall also evaluate annually the performance of the directors and the senior management and recommend to the Board specific adjustments in their remuneration and/or reward payments.

The Company's policy on remuneration is to maintain fair and competitive packages based on business needs and industry practice. For determining the level of fees paid to members of the Board, market rates and factors such as each Director's workload and required commitment will be taken into account. In addition, factors comprising economic and market situations, individual contributions to the Group's results and development as well as individual potential are considered when determining the remuneration packages of Executive Directors.

During the year, the Remuneration Committee had performed the following:

- assessed the performance of the directors and senior management;
- reviewed and approved the remuneration for the directors and senior management;
- reviewed the remuneration policy and recommended to the Board; and
- reviewed the proposal of granting share options according to the Company's share option plan, and made recommendations to the Board.

The Remuneration Committee held one meeting in 2007 and one meeting to date in 2008. The attendance record of each member of the Remuneration Committee in 2007 is set out below:

Directors	**Attendance of Remuneration Committee Meeting in 2007**
Wang Huaibao *(chairman)*	1/1
Lu Jun	1/1
Julian Juul Wolhardt	1/1
Zhang Julin	1/1
Li Jianxin	1/1

NOMINATION COMMITTEE

The Nomination Committee comprises three Non-executive Directors, two of whom are independent (Mr Wang Huaibao and Mr Zhang Julin). The Nomination Committee is chaired by Mr Jiao Shuge, a Non-executive Director and the Chairman of the Board.

The responsibilities of the Nomination Committee is to review the structure, size and composition, including the skills, knowledge and experiences of the Board and make recommendations to the Board regarding any proposed changes. The Nomination Committee is also responsible to identify and nominate suitable candidates qualified to become Board members and makes recommendations to the Board on relevant matters relating to the appointment or re-appointment of directors if necessary, in particular, candidates who can add value to the management through their contributions in the relevant strategic business areas and which appointments will result in the constitution of a stronger and more diverse Board. In the selection process, the Nomination Committee makes reference to criteria including, inter alia, reputation for integrity, accomplishment and experience in the dairy industry, professional and educational background, and commitment in respect of available time.

No meeting has been convened by the Nomination Committee during 2007.

AUDIT COMMITTEE

The Audit Committee comprises three Non-executive Directors, two of whom are independent and possess the relevant professional qualifications required under the Listing Rules. The Committee is chaired by Mr Zhang Julin, an Independent Non-executive Director.

The Audit Committee serves as a focal point for communication between other directors, the external auditors, and the management as their duties relate to financial and other reporting, internal controls and the auditing. The Audit Committee assists the Board in fulfilling its responsibilities by providing an independent review of financial reporting and by satisfying themselves as to the effectiveness of the Company's internal controls and as to the efficiency of the audits.

During the year, the Audit Committee has performed the following:

- met with the external auditors to discuss the general scope and findings of their audit and interim review works;
- reviewed external auditor's management letter and management's response;
- reviewed and recommended to the Board for approval of the external auditors' remuneration;
- made recommendations to the Board on the re-appointment of the external auditors;
- reviewed the external auditors' independence, objectivity and the effectiveness of the audit process;
- reviewed and monitored the integrity of financial statements, annual and interim reports, and annual and interim announcements of the Company;
- discussed auditing, internal control, risk management and financial reporting matters before recommending them to the Board for approval; and
- reviewed the connected transactions entered into by the Group.

All issues raised by the external auditors and the Audit Committee have been addressed by the senior management. The work and findings of the Audit Committee have been reported to the Board. During the year, no issues brought to the attention of the senior management and the Board were of sufficient significance for disclosure in the annual report.

The Audit Committee held two meetings in 2007 and one meeting to date in 2008. The attendance record of each member of the Audit Committee in 2007 is set out below:

Directors	Attendance of Audit Committee Meetings in 2007
Zhang Julin *(chairman)*	2/2
Jiao Shuge	1/2
Li Jianxin	2/2

Other than the reporting responsibilities of the Company's auditors (please refer to the auditors' report set out on page 49), the directors acknowledge their responsibility for preparing the financial statements of the Group and the Company which give a true and fair view of the state of affairs of the Group and the Company as at 31 December 2007 and the profit and cash flows of the Group for the year then ended.

INTERNAL CONTROL

The Board is responsible for maintaining an established and effective internal control system, to safeguard the assets of the Group and the interest of shareholders, and for reviewing its effectiveness regularly. Aiming at strengthening the risk management culture of the Group and minimizing the impacts of the major risks on the business and earnings of the Group, the senior management of the Group meets to actively evaluate and review the significant risks to which the Group is exposed and reports to the Board on a regular basis. The Group also appoints external consultants, when considered appropriate, to review the Group's internal control, working systems and workflows, as well as the management systems, and to make suggestions on system enhancement.

Besides strict implementation of a performance assessment system and training programs for its staff, the Group has in place a series of written working systems (bearing the five components below) in respect of business, production, finance, legal compliance and administration aspects, to ensure the significant risks, to which the Group is exposed, are contained:

- Control environment – The Group has established defined organizational structures. Authority to operate various business functions is delegated to respective management within limits set by senior management of the headquarters or the Executive Directors. The senior management meets on a regular basis to discuss and approve business strategies, plans and budgets prepared by individual business units. The performance of the Group is reported to the Board on a regular basis.

- Risk assessment – The Group identifies, assesses and ranks the risks that are most relevant to the Group's business according to their likelihood, financial consequence and reputational impact on the Group.

- Control activities – Policies and procedures are set for each business function, in which approvals, authorization, verification, recommendations, performance reviews, asset security and segregation of duties are included.

– Information and communication – The Group's working systems document operational procedures of all business units, as well as authorization and approval procedures for significant decision making.

– Monitoring – The Group adopts a control and risk self-assessment methodology, continuously assessing and managing its business risks by way of assessment by the headquarters of the Group and each business unit on a regular basis, and communication of key control procedures to employees.

During the year ended 31 December 2007, the Board had examined the internal control system and reviewed the evaluation performed by the Audit Committee, the management and internal and external auditors, on the effectiveness of internal control. No significant areas of concern were identified.

EXTERNAL AUDITORS

The Group's independent external auditors are Ernst & Young. The Audit Committee is responsible for the appointment of the external auditors and reviewing the non-audit functions performed by the external auditors for the Group. In particular, the Committee will, prior to the execution of contract with external auditors and the commencement of their duties, consider whether the non-audit functions will result in any potential material conflict of interest.

Details of fees paid or payable to Ernst & Young for the year ended 31 December 2007 are as follows:

Services rendered	**2007** ***RMB'000***	2006 *RMB'000*
2007 annual audit	**3,040**	2,380
2007 interim review	**486**	396
Non-audit service – Review on connected transactions	**–**	40
	3,526	2,816

The Board is satisfied with the audit fees, process and effectiveness of Ernst & Young and has recommended their reappointment as the Company's external auditors at the forthcoming annual general meeting.

DIRECTORS' SECURITIES TRANSACTIONS

The Company has adopted, in terms no less exacting than, the standard required by the Model Code for Securities Transactions by Directors of Listed Issuers set out in Appendix 10 of the Listing Rules as the Company's code of conduct and rules governing dealings by all the directors in the securities of the Company ("Model Code"). Having made specific enquiry of all the directors, the Company confirms that, during the year ended 31 December 2007, all the directors have strictly complied with the Model Code.

INVESTOR RELATIONS AND COMMUNICATIONS

The Company adopts a proactive policy in promoting investor relations and communications. Regular meetings are held with institutional investors and financial analysts to ensure two-way communications on the Company's performance and development. When the Company announces its interim and annual results, briefings are conducted to apprise investors, analysts and the press of the Group's operating results as well as business strategies and outlook. Investor relations website is updated on a timely basis to ensure that investors are able to have access to the Company's information, latest news and reports. Eight out of the nine directors, including the Chairman, have attended the annual general meeting in June 2007 to be available to answer questions at the meeting.

Separate resolutions are proposed at general meetings for each substantially separate issue, including election of directors.

Details of voting procedures by way of a poll and rights of shareholders to demand a poll were included in the circular dispatched to the shareholders of the Company. The circular also included relevant details of proposed resolutions and biography of directors standing for re-election.

Report of the Directors

The board of directors (the "Directors") has the pleasure in presenting its report together with the audited financial statements of the Company and the Group for the year ended 31 December 2007.

PRINCIPAL ACTIVITIES AND ANALYSIS OF OPERATIONS

The principal activity of the Company is investment holding. The principal activities of the main Group's operating subsidiary, Inner Mongolia Mengniu Dairy (Group) Company Limited ("Mengniu"), and its subsidiaries are manufacturing and distribution of dairy products including liquid milk (comprising UHT milk, milk beverages and yogurt), ice cream and other dairy products (such as milk powder) in China, including Hong Kong and Macau.

Particulars of the Company's subsidiaries are set out in Note 15 to the financial statements.

The Group's revenue is derived principally from business activities in China. An analysis of the Group's performance for the year ended 31 December 2007 by business segments is set out in Note 3 to the financial statements.

RESULTS AND APPROPRIATIONS

The results of the Group for the year ended 31 December 2007 are set out in the consolidated income statement on page 51.

The Directors have recommended the payment of a final dividend of RMB0.1315 (2006: RMB0.1094) per share, amounting to approximately RMB187,535,000 (2006: RMB149,718,000) in total, to shareholders whose names appear on the register of members on 28 May 2008.

PROPERTY, PLANT AND EQUIPMENT

Details of the movements in the property, plant and equipment of the Group and the Company during the year are set out in Note 11 to the financial statements.

RESERVES

Details of the movements in the reserves of the Group and of the Company during the year are set out in the consolidated statement of changes in equity on page 54 and Note 35 to the financial statements. The Company's distributable reserves, calculated in accordance with statutory provisions applicable in the Company's place of incorporation, amounted to approximately RMB2,966,963,000 as at 31 December 2007 (2006: RMB1,566,649,000).

DONATIONS

Charitable and other donations made by the Group during the year amounted to approximately RMB6,922,000 (2006: RMB2,841,000).

SHARE CAPITAL AND SHARE OPTIONS

Details of movement in the Company's share capital and share options during the year are set out in Notes 34 and 37 to the financial statements.

DIRECTORS

The Directors during the year and up to the date of this report were:

Executive Directors

Mr NIU Gensheng
Mr YANG Wenjun
Mr SUN Yubin

Non-Executive Directors

Mr JIAO Shuge (alias JIAO Zhen)
Ms LU Jun (resigned with effect from 1 January 2008)
Mr Julian Juul WOLHARDT

Independent Non-Executive Directors

Mr WANG Huaibao
Mr ZHANG Julin
Mr LI Jianxin

In accordance with Article 112 of the Company's articles of association, Mr Niu Gensheng, Mr Sun Yubin and Mr Li Jianxin, will retire by rotation and, being eligible, offer themselves for re-election at the forthcoming annual general meeting.

The Company considers that Mr Wang Huaibao, Mr Zhang Julin and Mr Li Jianxin are independent pursuant to the criteria set out in the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited ("Listing Rules") and that a confirmation of independence has been received from each of them.

BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

Brief biographical details of the Directors and the senior management are set out on pages 24 to 29.

DIRECTORS' SERVICE CONTRACTS

No director proposed for re-election at the forthcoming annual general meeting has service contract with the Company which is not determinable by the Company within one year without payment of compensation, other than statutory compensation.

DIRECTORS' INTERESTS IN CONTRACTS

No contracts of significance in relation to the Group's business to which the Company or any of its subsidiaries was a party and in which a Director had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

DIRECTORS' INTERESTS, LONG AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

As at 31 December 2007, the interests and short positions of the Directors and chief executives of the Company in the shares of the Company and associated corporation as recorded in the register required to be kept under Section 352 of the Securities and Futures Ordinance ("SFO") or as otherwise notified to the Company and the Stock Exchange of Hong Kong Limited (the "Stock Exchange") pursuant to the Model Code for Securities Transactions by Directors of Listed Companies (the "Model Code") were as follows:

Long/short positions in shares of the Company/Associated Corporation:

Name of Director	Company/Name of Associated Corporation	Nature of Interest	Total Number of Ordinary Shares	Percentage of the Company's Issued Share Capital
Niu Gensheng	The Company	Personal Interest	45,505,172 (L)	3.19%
	The Company	Corporate Interest *(Note 1)*	176,104,130 (L)	12.35%
	The Company	Corporate Interest *(Note 2)*	137,395,836 (L)	9.63%
	Mengniu	Personal Interest	49,542,660 (L)	6.18%
	Mengniu	Personal Interest	21,977,010 (S)	2.74%
Lu Jun *(Note 3)*	Mengniu	Personal Interest	2,413,938 (L)	0.30%
Yang Wenjun	Mengniu	Personal Interest	3,205,938 (L)	0.40%
Sun Yubin	Mengniu	Personal Interest	5,317,938 (L)	0.66%

Notes:

1. These shares are held by Yinniu Milk Industry Limited ("Yinniu"), a substantial shareholder of the Company, which is controlled as to 80.2% by Xin Niu International Limited. Niu Gensheng, by virtue of a proxy, has been delegated voting rights to the shares in Yinniu held by Xin Niu International Limited.

2. These shares are held by Jinniu Milk Industry Limited ("Jinniu"), a substantial shareholder of the Company, which is controlled as to 38.6% by Xin Niu International Limited. Niu Gensheng, by virtue of a proxy, has been delegated voting rights to the shares in Jinniu held by Xin Niu International Limited.

3. Lu Jun resigned as Non-executive Director of the company with effect from 1 January 2008 but has retained her interests in Mengniu as a shareholder.

(L) Indicates a long position.
(S) Indicates a short position.

The Directors of the Company have been granted options under the Company's share option scheme, details of which are set out in the section "Share Option Scheme" below.

Save as disclosed above, as at 31 December 2007, none of the Directors and the Chief Executives of the Company had any interests and short positions in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO).

SUBSTANTIAL SHAREHOLDERS' INTERESTS

As at 31 December 2007, the interests or short positions of substantial shareholders, other than the Directors or the Chief Executives of the Company whose interests, long and short positions in the shares of the Company are set out above, in the shares and underlying shares of the Company in the register maintained under section 336 of the SFO were as follows:

Name of Substantial Shareholder	**Number of Ordinary Shares**	**Percentage of Issued Share Capital**
Xin Niu International Limited *(Note 1)*	313,499,966 (L)	21.98%
Yinniu *(Note 2)*	176,104,130 (L)	12.35%
Jinniu *(Note 3)*	137,395,836 (L)	9.63%
UBS AG	85,251,210 (L)	5.98%
	2,936,000 (S)	0.21%
J P Morgan Chase & Co	100,239,048 (L)	7.03%
	1,400,000 (S)	0.10%
	87,538,744 (P)	6.14%

Notes:

(1) These shares are held by Yinniu and Jinniu, both substantial shareholders of the Company themselves. Xin Niu International Limited controls 80.2% and 38.6% of voting rights in Yinniu and Jinniu, respectively.

(2) The shares in Yinniu are held by (i) 4 (comprising Deng Jiuqiang, Hou Jiangbin, Xie Qiuxu and Pang Kaitai) of the founding individuals of Mengniu, (ii) other employees of the Group and (iii) Xin Niu International Limited, which acquired 14,343 shares from Niu Gensheng and 27,705 shares from Xie Qiuxu on 29 October 2007, resulting in it having an aggregate shareholding of approximately 80.2% of all issued shares in Yinniu.

(3) The shares in Jinniu are held by (i) 6 (comprising Deng Jiuqiang, Lu Jun, Sun Yubin, Yang Wenjun, Sun Xianhong and Qiu Lianjun) of the founding individuals of Mengniu, (ii) other employees of the Group and (iii) Xin Niu International Limited, which acquired 24,331 shares, approximately 38.6% of all issued shares in Jinniu from Niu Gensheng on 29 October 2007.

(S) Indicates a short position.
(L) Indicates a long position.
(P) Indicates a lending position.

Saved as disclosed above, as at 31 December 2007, no other interests or short position in the shares or underlying shares of the Company were recorded in the register maintained under section 336 of the SFO.

CONNECTED TRANSACTIONS

On 3 April 2007, Mengniu entered into the Equity Interest Transfer Agreement with Wuhan Frealth Dairy Co., Ltd. ("Wuhan Frealth") to acquire 48% of the equity interest in Mengniu (Wuhan) Frealth Dairy Co., Ltd. ("Mengniu Wuhan") for a consideration of RMB134,400,000 (equivalent to approximately HK$135,767,000). After the acquisition, Mengniu Wuhan became a wholly-owned subsidiary of Mengniu.

Wuhan Frealth is a connected person of the Company and the acquisition constitutes a connected transaction of the Company. As each of the appropriate percentage ratios defined under the Listing Rules is less than 2.5%, the transaction is only subject to the reporting and announcement requirements and is exempted from independent shareholders' approval requirement under the Listing Rules. Details of the acquisition were disclosed in the Company's announcement dated 4 April 2007.

Saved as disclosed above, there were no other transactions which need to be disclosed as connected transactions in accordance with the requirements of the Listing Rules.

SHARE OPTION SCHEME

The Company operates a share option scheme (the "Scheme") for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operations. The following share options were outstanding under the Scheme during the year.

Name or Category of Participant	As at 1 January 2007	Granted during the year	Exercised during the year	Lapsed during the year	As at 31 December 2007	Date of grant of share options	Exercise Period of share options (both dates inclusive)	Exercise price of share options
	Number of share options							
								HK$
Executive directors								
Yang Wenjun	–	4,561,000	–	–	4,561,000	9.11.2007	9.11.2009 to 8.11.2013	32.24
Sun Yubin	–	1,875,000	–	–	1,875,000	9.11.2007	9.11.2009 to 8.11.2013	32.24
Employees in Aggregate	6,803,000	–	(244,351)	(304,088)	6,254,561	26.10.2006	26.10.2007 to 25.10.2012	13.40
	–	38,169,000	–	–	38,169,000	9.11.2007	9.11.2009 to 8.11.2013	32.24
	6,803,000	44,605,000	(244,351)	(304,088)	50,859,561			

The exercise period of the share options granted commences after a certain vesting period and the fulfilment of certain performance targets, and ends on a date which is not later than six years from the date of grant of such options. Further details of the share option scheme are set out in Note 37 to the financial statements.

PRE-EMPTIVE RIGHTS

There is no provision for pre-emptive rights under the Company's articles of association or the laws of the Cayman Islands which would oblige the Company to offer new shares on a pro rata basis to its existing shareholders.

Report of the Directors

PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S LISTED SHARES

During the year, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities.

PUBLIC FLOAT

As at the date of this report, the Company has maintained the prescribed public float under the Listing Rules, based on the information that is publicly available to the Company and within the knowledge of the Directors.

MANAGEMENT CONTRACTS

No contracts concerning the management and administration of the whole or any substantial part of the business of the Company were entered into or existed during the year.

MAJOR CUSTOMERS AND SUPPLIERS

The percentage of purchases attributable to the five largest suppliers of the Group combined was less than 30% of the total purchases of the Group.

The percentage of revenue attributable to the five largest customers of the Group combined was less than 30% of the total revenue of the Group.

PLEDGE OF ASSETS

As at 31 December 2007, the Group pledged certain bank deposits, bills receivable and certain property, plant and equipment aggregating to approximately RMB766,584,000 (2006: RMB774,400,000). Details are set out in respective notes to the financial statements.

CONTINGENT LIABILITIES AND COMMITMENTS

Details of contingent liabilities and commitments are set out in Notes 39 and 38 to the financial statements.

SUBSEQUENT EVENTS

Details of subsequent events are set out in Note 44 to the financial statements.

FINANCIAL SUMMARY

A summary of the results for the year and of the assets and liabilities of the Group as at 31 December 2007 and for the previous four financial periods are set out on page 120.

CORPORATE GOVERNANCE

The Company's corporate governance principles and practices are set out in the Corporate Governance Report on pages 32 to 39.

AUDITORS

The financial statements have been audited by Ernst & Young. A resolution for the re-appointment of Ernst & Young as auditors of the Company will be proposed at the forthcoming annual general meeting.

By order of the Board of Directors
Niu Gensheng
Chief Executive Officer

Hong Kong, 8 April 2008

Corporate Information

BOARD OF DIRECTORS

Executive Directors

Mr NIU Gensheng
Mr YANG Wenjun
Mr SUN Yubin

Non-Executive Directors

Mr JIAO Shuge (alias JIAO Zhen)
Ms LU Jun (resigned with effect from 1 January 2008)
Mr Julian Juul WOLHARDT

Independent Non-Executive Directors

Mr WANG Huaibao
Mr ZHANG Julin
Mr LI Jianxin

SENIOR MANAGEMENT

Mr YAO Tongshan
Mr BAI Jun
Mr LEI Yongsheng
Mr DENG Jiuqiang
Mr BAI Ying
Mr YAO Haitao
Ms ZHAO Yuanhua
Mr DING Sheng
Mr KWOK Wai Cheong, Chris
(Qualified Accountant & Company Secretary)

STOCK CODE

Hong Kong Stock Exchange 2319

INVESTOR RELATIONS CONTACT

Mr KWOK Wai Cheong, Chris
Unit 1001, 10th Floor, Jubilee Centre
18 Fenwick Street, Wanchai
Hong Kong
Email: mengniu_ir@mengniu.com.cn
Website: www.mengniuir.com

PLACE OF BUSINESS IN HONG KONG

Unit 1001, 10th Floor, Jubilee Centre
18 Fenwick Street, Wanchai
Hong Kong

REGISTERED OFFICE

M&C Corporate Service, P.O. Box 309 GT
Ugland House, South Church Street
George Town, Grand Cayman
Cayman Islands

PRINCIPAL SHARE REGISTRAR

Butterfield Fund Services (Cayman) Limited
Butterfield House
68 Ford Street
P.O. Box 705, George Town
Grand Cayman, Cayman Islands

HONG KONG BRANCH SHARE REGISTRAR

Computershare Hong Kong Investor Services Limited
46th Floor, Hopewell Centre
183 Queen's Road East, Wanchai
Hong Kong

LEGAL ADVISORS

As to Hong Kong Law
Norton Rose

As to Cayman Islands Law
Maples and Calder Asia

PRINCIPAL BANKERS

Agricultural Bank of China
Bank of China
Industrial Commercial Bank of China
BNP Paribas

AUDITORS

Ernst & Young

INVESTOR RELATIONS CONSULTANT

Strategic Financial Relations (China) Limited

Independent Auditors' Report

ERNST & YOUNG
安 永

To the shareholders of China Mengniu Dairy Company Limited (the "Company")
(Incorporated in the Cayman Islands with limited liability)

We have audited the financial statements of the Company set out on pages 51 to 119, which comprise the consolidated and company balance sheets as at 31 December 2007, and the consolidated income statement, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

DIRECTORS' RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The directors of the Company are responsible for the preparation and the true and fair presentation of these financial statements in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board and the disclosure requirements of the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

AUDITORS' RESPONSIBILITY

Our responsibility is to express an opinion on these financial statements based on our audit. Our report is made solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

OPINION

In our opinion, the financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2007 and of the Group's profit and cash flows for the year then ended in accordance with International Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

Ernst & Young
Certified Public Accountants

18th Floor
Two International Finance Centre
8 Finance Street, Central
Hong Kong

8 April 2008

Consolidated Income Statement

For the year ended 31 December 2007

	Notes	2007 *RMB'000*	2006 *RMB'000*
REVENUE	4	**21,318,062**	16,246,368
Cost of sales		**(16,514,557)**	(12,524,597)
GROSS PROFIT		**4,803,505**	3,721,771
Other income and gains	4	**98,096**	76,459
Selling and distribution costs		**(3,302,020)**	(2,380,324)
Administrative expenses		**(461,902)**	(420,004)
Other operating expenses		**(21,829)**	(16,712)
PROFIT FROM OPERATING ACTIVITIES		**1,115,850**	981,190
Interest income		**43,566**	15,827
Finance costs	7	**(50,060)**	(63,081)
Share of profits and losses of associates		**20,954**	8,384
PROFIT BEFORE TAX	5	**1,130,310**	942,320
Income tax expense	8	**(21,658)**	(76,032)
PROFIT FOR THE YEAR		**1,108,652**	866,288
Attributable to:			
Equity holders of the Company		**935,786**	727,352
Minority interests		**172,866**	138,936
		1,108,652	866,288
DIVIDENDS			
Dividends paid	9	**156,020**	93,873
Proposed final dividend	9	**187,535**	149,718
EARNINGS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE COMPANY (EXPRESSED IN RMB PER SHARE)	10		
Basic		**0.664**	0.532
Diluted		**0.664**	0.532

Consolidated Balance Sheet

As at 31 December 2007

	Notes	2007 RMB'000	2006 RMB'000
NON-CURRENT ASSETS			
Property, plant and equipment	11	**5,042,648**	4,160,283
Construction in progress	12	**313,439**	348,405
Other intangible assets	13	**31,404**	13,204
Land use rights	14	**228,739**	128,386
Interests in associates	16	**57,573**	40,371
Available-for-sale investments	18	**17,316**	15,316
Goodwill	19	**199,143**	115,549
Deferred tax assets	20	**6,302**	–
Other financial assets	21	**21,139**	–
		5,917,703	4,821,514
CURRENT ASSETS			
Inventories	22	**877,443**	1,071,460
Bills receivable	23	**114,882**	128,093
Trade receivables	24	**261,365**	186,976
Prepayments and deposits	25	**214,364**	162,120
Other receivables		**40,198**	18,386
Pledged deposits	26	**44,506**	45,071
Cash and bank balances	26	**2,210,818**	1,330,058
		3,763,576	2,942,164
CURRENT LIABILITIES			
Trade payables	27	**1,315,395**	1,034,699
Bills payable	28	**259,065**	323,736
Deferred income	33	**11,752**	7,889
Accruals and customers' deposits	29	**544,662**	406,737
Other payables		**1,013,171**	1,033,066
Interest-bearing bank loans	30	**183,156**	234,022
Other loans	31	**36,004**	31,000
Income tax payable		**185**	6,104
		3,363,390	3,077,253
NET CURRENT ASSETS/(LIABILITIES)		**400,186**	(135,089)
TOTAL ASSETS LESS CURRENT LIABILITIES		**6,317,889**	4,686,425

	Notes	2007 *RMB'000*	2006 *RMB'000*
NON-CURRENT LIABILITIES			
Interest-bearing bank loans	30	**80,000**	641,136
Long term payables	32	**224,192**	292,110
Deferred income	33	**178,993**	120,499
		483,185	1,053,745
NET ASSETS		**5,834,704**	3,632,680
EQUITY			
Equity attributable to equity holders of the Company			
Issued capital	34	**151,277**	145,573
Retained earnings		**1,547,733**	993,822
Other reserves	35(A)	**3,412,619**	1,859,469
		5,111,629	2,998,864
Minority interests		**723,075**	633,816
TOTAL EQUITY		**5,834,704**	3,632,680

Niu Gensheng
Director

Jiao Shuge
Director

Consolidated Statement of Changes in Equity

For the year ended 31 December 2007

		Attributable to equity holders of the Company					
		Issued capital	Other reserves	Retained earnings	Total	Minority interests	Total equity
	Notes	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
			Note 35(A)				
At 1 January 2006		145,573	1,615,741	569,307	2,330,621	436,458	2,767,079
Profit for the year		–	–	727,352	727,352	138,936	866,288
Currency translation differences		–	4,313	–	4,313	–	4,313
Total income and expense for the year		–	4,313	727,352	731,665	138,936	870,601
Equity-settled share option arrangements	37	–	3,108	–	3,108	–	3,108
Transfer to statutory reserves		–	208,964	(208,964)	–	–	–
Dividends paid to minority shareholders		–	–	–	–	(21,833)	(21,833)
Dividends paid to equity holders of the Company		–	–	(93,873)	(93,873)	–	(93,873)
Capital injection from minority shareholders		–	–	–	–	107,955	107,955
Additional equity contributed by a minority shareholder		–	27,343	–	27,343	(27,343)	–
Acquisition of minority interests		–	–	–	–	(357)	(357)
At 1 January 2007		**145,573**	**1,859,469**	**993,822**	**2,998,864**	**633,816**	**3,632,680**
Profit for the year		**–**	**–**	**935,786**	**935,786**	**172,866**	**1,108,652**
Currency translation differences		**–**	**(57,529)**	**–**	**(57,529)**	**–**	**(57,529)**
Total income and expense for the year		**–**	**(57,529)**	**935,786**	**878,257**	**172,866**	**1,051,123**
Issue of shares	**34**	**5,682**	**1,342,547**	**–**	**1,348,229**	**–**	**1,348,229**
Shares issued under equity-settled share option arrangements	**37**	**22**	**3,044**	**–**	**3,066**	**–**	**3,066**
Equity-settled share option arrangements	**37**	**–**	**39,233**	**–**	**39,233**	**–**	**39,233**
Transfer to statutory reserves		**–**	**225,855**	**(225,855)**	**–**	**–**	**–**
Dividends paid to minority shareholders		**–**	**–**	**–**	**–**	**(32,801)**	**(32,801)**
Dividends paid to equity holders of the Company	**9**	**–**	**–**	**(156,020)**	**(156,020)**	**–**	**(156,020)**
Acquisition of minority interests		**–**	**–**	**–**	**–**	**(50,806)**	**(50,806)**
At 31 December 2007		**151,277**	**3,412,619**	**1,547,733**	**5,111,629**	**723,075**	**5,834,704**

Consolidated Statement of Cash Flows

For the year ended 31 December 2007

	Notes	2007 RMB'000	2006 RMB'000
Cash flows from operating activities			
Profit before tax		**1,130,310**	942,320
Adjustments for:			
Interest income		**(43,566)**	(15,827)
Finance costs	7	**50,060**	63,081
Depreciation of property, plant and equipment	5	**522,706**	403,485
Amortisation of land use rights	5	**4,681**	1,707
Amortisation of other intangible assets	5	**3,088**	1,354
Loss on disposal of items of property, plant and equipment	5	**8,298**	1,075
Share-based payment expense	37	**39,233**	3,108
(Write-back of provision for)/provision for trade receivables and other receivables	5	**(7,903)**	3,478
Share of profits and losses of associates		**(20,954)**	(8,384)
Gain on disposal of an investment in an associate	4	**–**	(2,167)
Write-down of inventories to net realisable value	5	**4,413**	1,155
Amortisation of deferred income	4	**(10,816)**	(4,605)
Foreign exchange differences, net	4	**(38,822)**	(16,217)
Dilution gain arising from an investment in a jointly controlled entity	4	**–**	(25,000)
Operating profit before working capital changes		**1,640,728**	1,348,563
Increase in other financial assets		**(37,867)**	–
Decrease/(increase) in inventories		**189,604**	(291,614)
Increase in trade and bills receivables		**(53,372)**	(61,683)
Decrease in pledged deposits		**565**	8,602
Increase in prepayments, deposits and other receivables		**(39,574)**	(16,039)
Increase in trade and bills payables		**252,268**	241,430
Increase in accruals and other payables		**174,736**	298,342
Cash generated from operations		**2,127,088**	1,527,601
Interest paid		**(35,088)**	(46,375)
Income taxes paid		**(33,879)**	(78,400)
Net cash inflow from operating activities		**2,058,121**	1,402,826

Consolidated Statement of Cash Flows

For the year ended 31 December 2007

	Notes	2007 RMB'000	2006 RMB'000
Cash flows from investing activities			
Proceeds from disposal of items of property, plant and equipment		**2,554**	36,346
Purchases of items of property, plant and equipment		**(503,039)**	(381,108)
Increase in construction in progress	12	**(819,117)**	(804,266)
Additions to other intangible assets	13	**(21,288)**	(7,558)
Additions to land use rights	14	**(107,178)**	(64,842)
Additions to available-for-sale investments		**(2,000)**	(7,287)
Acquisition of minority interests		**(120,960)**	(357)
Capital injection to associates		**(1,055)**	(18,732)
Capital injection to a jointly controlled entity		**(15,000)**	–
Receipt of government grants		**73,173**	72,913
Proceeds from disposal of an investment in an associate		**–**	5,871
Increase in time deposits with original maturity of more than three months		**(304,000)**	(150,000)
Interest received		**43,566**	15,827
Dividends received from an associate		**4,807**	1,740
Net cash outflow from investing activities		**(1,769,537)**	(1,301,453)
Cash flows from financing activities			
Capital contributions from minority shareholders		**–**	26,881
Proceeds from interest-bearing bank loans		**282,632**	741,094
Repayment of interest-bearing bank loans		**(889,494)**	(674,108)
Dividends paid to equity holders of the Company	9	**(156,020)**	(93,873)
Dividends paid to minority shareholders		**(32,801)**	(21,833)
Proceeds from other loans		**9,504**	22,000
Repayment of other loans		**(4,500)**	(26,081)
Repayment of long term payables		**(236,096)**	(188,275)
Capital contribution by the joint venture partner		**15,000**	45,116
Proceeds from issuance of new shares		**1,363,526**	–
Shares issued under employee share option scheme		**3,066**	–
Share issue costs		**(15,297)**	–
Net cash inflow/(outflow) from financing activities		**339,520**	(169,079)
Net increase/(decrease) in cash and cash equivalents		**628,104**	(67,706)
Cash and cash equivalents at beginning of year	26	**1,180,058**	1,247,764
Effect of foreign exchange rate changes, net		**(51,344)**	–
Cash and cash equivalents at end of year	26	**1,756,818**	1,180,058
Analysis of balances of cash and cash equivalents			
Cash and bank balances	26	**1,756,818**	1,180,058

Balance Sheet

As at 31 December 2007

	Notes	2007 *RMB'000*	2006 *RMB'000*
NON-CURRENT ASSETS			
Property, plant and equipment	11	**65**	65
Interests in subsidiaries	15	**1,682,872**	1,824,225
		1,682,937	1,824,290
CURRENT ASSETS			
Dividends receivable		**193,060**	51,265
Prepayments, deposits and other receivables		**281,151**	95
Cash and cash equivalents	26	**737,085**	11,403
		1,211,296	62,763
CURRENT LIABILITIES			
Accruals and other payables		**1,665**	4,305
Interest-bearing bank loans	30	**–**	6,622
		1,665	10,927
NET CURRENT ASSETS		**1,209,631**	51,836
TOTAL ASSETS LESS CURRENT LIABILITIES		**2,892,568**	1,876,126
NON-CURRENT LIABILITIES			
Interest-bearing bank loans	30	**–**	157,432
NET ASSETS		**2,892,568**	1,718,694
EQUITY			
Issued capital	34	**151,277**	145,573
Reserves	35(B)	**2,741,291**	1,573,121
TOTAL EQUITY		**2,892,568**	1,718,694

Niu Gensheng
Director

Jiao Shuge
Director

Notes to Financial Statements

1. CORPORATE INFORMATION

The Company was incorporated as an exempted company with limited liability in the Cayman Islands. The Company is an investment holding company and its subsidiaries are engaged in the manufacture and distribution of dairy products in the People's Republic of China (the "PRC").

2.1 BASIS OF PREPARATION

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs") and the disclosure requirements of the Hong Kong Companies Ordinance. They are prepared on a historical cost basis except for share options which have been measured at fair value. They are presented in Renminbi ("RMB") and all values are rounded to the nearest thousand except when otherwise indicated.

Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries (collectively referred to as the "Group") for the year ended 31 December 2007. The financial statements of the subsidiaries are prepared for the same reporting year as the Company, using consistent accounting policies. All intra-group balances, transactions, income and expenses and profits and losses resulting from intra-group transactions that are recognised in assets, are eliminated in full. Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the day that such control ceases.

Minority interests represent the portion of profit and loss and net assets of the Company's subsidiaries not held by the Group and are presented separately in the consolidated income statement and within equity in the consolidated balance sheet, separately from the Company's shareholders' equity. An acquisition of minority interests is accounted for using the parent entity extension method whereby the difference between the consideration and the book value of the share of the net assets acquired is recognised as goodwill.

2.2 IMPACT OF NEW AND REVISED IFRSs

The accounting policies adopted are consistent with those of the previous financial year except as follows:

The Group has adopted the following new and revised IFRSs and International Financial Reporting Interpretations Committee ("IFRIC") interpretations during the year. The adoption of these new and revised standards and interpretations did not have any effect on the financial performance or position of the Group and the Company. They did however give rise to additional disclosures, including in some cases, revisions to accounting policies.

- IFRS 7 — *Financial Instruments: Disclosures*
- IAS 1 Amendment — *Presentation of Financial Statements – Capital Disclosures*
- IFRIC 8 — *Scope of IFRS 2*
- IFRIC 9 — *Reassessment of Embedded Derivatives*
- IFRIC 10 — *Interim Financial Reporting and Impairment*

The principal effects of these new and revised IFRSs are as follows:

IFRS 7 *Financial Instruments: Disclosures*

This standard requires disclosures that enable users of the financial statements to evaluate the significance of the Group's financial instruments and the nature and extent of risks arising from those financial instruments. The new disclosures are included throughout the financial statements. While there has been no effect on the financial position or results, comparative information has been revised where needed.

2.2 IMPACT OF NEW AND REVISED IFRSs *(continued)*

IAS 1 Amendment *Presentation of Financial Statements – Capital Disclosures*

This amendment requires the Group to make new disclosures to enable users of the financial statements to evaluate the Group's objectives, policies and processes for managing capital. These new disclosures are shown in note 43 to the financial statements.

IFRIC 8 *Scope of IFRS 2*

This interpretation requires IFRS 2 to be applied to any arrangements in which the Group cannot identify specifically some or all of the goods received, in particular where equity instruments are issued for consideration which appears to be less than fair value. As equity instruments are only issued to employees in accordance with the share option scheme, the interpretation has had no impact on the financial position or performance of the Group.

IFRIC 9 *Reassessment of Embedded Derivatives*

IFRIC 9 states that the date to assess the existence of an embedded derivative is the date that an entity first becomes a party to the contract, with reassessment only if there is a change to the contract that significantly modifies the cash flows. As the Group has no embedded derivative requiring separation from the host contract, the interpretation has had no impact on the financial position or performance of the Group.

IFRIC 10 *Interim Financial Reporting and Impairment*

This interpretation requires that an entity must not reverse an impairment loss recognised in a previous interim period in respect of goodwill or an investment in either an equity instrument or a financial asset carried at cost. As the Group had no impairment losses previously reversed in respect of such assets, the interpretation had no impact on the financial position or performance of the Group.

2.3 IMPACT OF ISSUED BUT NOT YET EFFECTIVE STANDARDS

The Group has not applied the following new and revised IFRSs, that have been issued but are not yet effective, in these financial statements.

Amendment to IFRS 2	*Share-based Payments-Vesting Conditions and Cancellations*[2]
IFRS 3 (Revised)	*Business Combinations*[1]
IFRS 8	*Operating Segments*[2]
IAS 1	*Presentation of Financial Statements*[2]
IAS 23 (Revised)	*Borrowing Costs*[2]
IAS 27 (Revised)	*Consolidated and Separate Financial Statements*[1]
IAS 32 (Revised)	*Financial Instruments – Presentation*[2]
IFRIC 11	*IFRS 2 – Group and Treasury Share Transactions*[3]
IFRIC 12	*Service Concession Arrangements*[5]
IFRIC 13	*Customer Loyalty Programmes*[4]
IFRIC 14	*IAS 19 – The Limit on a Defined Benefit Asset, Minimum Fnding Requirements and their Interaction*[5]

1 Effective for annual periods beginning on or after 1 July 2009
2 Effective for annual periods beginning on or after 1 January 2009
3 Effective for annual periods beginning on or after 1 March 2007
4 Effective for annual periods beginning on or after 1 July 2008
5 Effective for annual periods beginning on or after 1 January 2008

2.3 IMPACT OF ISSUED BUT NOT YET EFFECTIVE STANDARDS *(continued)*

Amendment to IFRS 2 restricts the definition of "vesting condition" to a condition that includes an explicit or implicit requirement to provide services. Any other conditions are non-vesting conditions, which have to be taken into account to determine the fair value of the equity instruments granted. In the case that the award does not vest as the result of a failure to meet a non-vesting condition that is within the control of either the entity or the counterparty, this must be accounted for as a cancellation. The Group has not entered into share-based payment schemes with non-vesting conditions attached and, therefore, does not expect significant implications on its accounting for share-based payments.

IFRS 3 (Revised) introduces a number of changes in the accounting for business combinations that will impact the amount of goodwill recognised, the reported results in the period that an acquisition occurs, and future reported results. IAS 27 (Revised) requires that a change in the ownership interest of a subsidiary is accounted for as an equity transaction. Therefore, such a change will have no impact on goodwill, nor will it give rise to a gain or loss. Furthermore, the amended standard changes the accounting for losses incurred by the subsidiary as well as the loss of control of a subsidiary. The changes introduced by IFRS 3 (Revised) and IAS 27 (Revised) must be applied prospectively and will affect future acquisitions and transactions with minority interests.

IFRS 8, which will replace IAS 14 *Segment Reporting*, specifies how an entity should report information about its operating segments, based on information about the components of the entity that is available to the chief operating decision maker for the purposes of allocating resources to the segments and assessing their performance. The standard also requires the disclosure of information about the products and services provided by the segments, the geographical areas in which the Group operates, and revenue from the Group's major customers.

The revised IAS 1 separates owner and non-owner changes in equity. The statement of changes in equity will include only details of transactions with owners, with all non-owner changes in equity presented as a single line. In addition, the standard introduces the statement of comprehensive income: it presents all items of income and expense recognised in profit or loss, together with all other items of recognised income and expense, either in one single statement, or in two linked statements. The Group is still evaluating whether it will have one or two statements.

IAS 23 has been revised to require capitalisation of borrowing costs when such costs are directly attributable to the acquisition, construction or production of a qualifying asset. As the Group's current policy for borrowing costs aligns with the requirements of the revised standard, the revised standard is unlikely to have any financial impact on the Group.

The amendment to IAS 32 requires certain puttable financial instruments and obligations arising on liquidation to be classified as equity if certain criteria are met. The amendment to IAS 1 requires disclosure of certain information relating to puttable instruments classified as equity. The Group does not expect these amendments to have impact on the financial statements of the Group.

IFRIC 11 requires arrangements whereby an employee is granted rights to the Group's equity instruments, to be accounted for as an equity-settled scheme, even if the Group acquires the instruments from another party, or the shareholders provide the equity instruments needed. IFRIC 11 also addresses the accounting for share-based payment transactions involving two or more entities within the Group.

IFRIC 12 requires an operator under public-to-private service concession arrangements to recognise the consideration received or receivable in exchange for the construction services as a financial asset and/or an intangible asset, based on the terms of the contractual arrangements. IFRIC 12 also addresses how an operator shall apply existing IFRSs to account for the obligations and the rights arising from service concession arrangements by which a government or a public sector entity grants a contract for the construction of infrastructure used to provide public services and/or for the supply of public services. As the Group currently has no such arrangements, the interpretation is unlikely to have any financial impact on the Group.

2.3 IMPACT OF ISSUED BUT NOT YET EFFECTIVE STANDARDS *(continued)*

IFRIC 13 requires that loyalty award credits granted to customers as part of a sales transaction are accounted for as a separate component of the sales transaction. The consideration received in the sales transaction is allocated between the loyalty award credits and the other components of the sale. The amount allocated to the loyalty award credits is determined by reference to their fair value and is deferred until the awards are redeemed or the liability is otherwise extinguished.

IFRIC 14 addresses how to assess the limit under IAS 19 *Employee Benefits*, on the amount of a refund or a reduction in future contributions in relation to a defined benefit scheme that can be recognised as an asset, in particular, when a minimum funding requirement exists.

As the Group currently has no customer loyalty award credits and defined benefit scheme, IFRIC 13 and IFRIC 14 are not applicable to the Group and therefore are unlikely to have any financial impact on the Group.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Subsidiaries

A subsidiary is an entity, whose financial and operating policies the Company controls, directly or indirectly, so as to obtain benefits from its activities. The results of subsidiaries are included in the Company's income statement to the extent of dividends received and receivable. The Company's interests in subsidiaries are stated at cost less any impairment losses.

Associates

An associate is an entity in which the Group has significant influence and which is neither a subsidiary nor a jointly controlled entity. The Group's interests in associates are accounted for under the equity method of accounting. Under the equity method, the investments in associates are carried in the balance sheet at cost plus post-acquisition changes in the Group's share of net assets of the associates. After application of the equity method, the Group determines whether it is necessary to recognise any additional impairment loss with respect to the Group's net investment in the associates. The consolidated income statement reflects the Group's share of the results of the operations of the associates. When there has been a change recognised directly in the equity of the associates, the Group recognises its share of any changes and discloses this, when applicable, in the consolidated statement of changes in equity. Unrealised gains and losses resulting from transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates, except where unrealised losses provide evidence of an impairment of the asset transferred.

The reporting dates of the associates and the Group are identical and the associates' accounting policies conform to those used by the Group for the transactions and events in similar circumstances.

Joint venture

The Group has an interest in a joint venture which is a jointly controlled entity. A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control, and a jointly controlled entity is a joint venture that involves the establishment of a separate entity in which each venturer has an interest. The Group recognises its interest in the joint venture using proportionate consolidation. The Group combines its share of each of the assets, liabilities, income and expenses of the joint venture with the similar items, line by line, in its consolidated financial statements. Unrealised gains and losses resulting from transactions between the Group and its jointly controlled entities are eliminated to the extent of the Group's interest in the jointly controlled entities, except where unrealised losses provide evidence of an impairment of the asset transferred. The financial statements of the joint venture are prepared for the same reporting year as the Group, using consistent accounting policies.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Joint venture *(continued)*

When the Group contributes or sells assets to the joint venture, any portion of gain or loss from the transaction is recognised based on the substance of the transaction. When the Group purchases assets from the joint venture, the Group does not recognise its share of the profits of the joint venture from the transaction until it resells the assets to an independent party. The joint venture is proportionately consolidated until the date on which the Group ceases to have joint control over the joint venture.

Goodwill

Goodwill on acquisition is initially measured at cost being the excess of the cost of the business combination over the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

The Group performs its annual impairment test of goodwill as at 31 December. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Group are assigned to those units or groups of units.

Impairment is determined by assessing the recoverable amount of the cash-generating unit (group of cash-generating units) to which the goodwill relates. Where the recoverable amount of the cash-generating unit (group of cash-generating units) is less than the carrying amount, an impairment loss is recognised. An impairment loss recognised for goodwill is not reversed in a subsequent period.

Where goodwill forms part of a cash-generating unit and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured on the basis of the relative values of the operation disposed of and the portion of the cash-generating unit retained.

Property, plant and equipment and depreciation

Property, plant and equipment, other than construction in progress, are stated at cost, excluding the costs of day to day servicing, less accumulated depreciation and accumulated impairment in value. The cost of self-constructed assets includes the cost of materials, direct labour and an appropriate proportion of production overheads. Such cost also includes the cost of replacing part of the plant and equipment when that cost is incurred, if the recognition criteria are met.

Depreciation is calculated on a straight-line basis to write off the cost of each item of property, plant and equipment to its residual value over its estimated useful life.

The estimated useful lives of property, plant and equipment are as follows:

Buildings and structures	20 years
Plant and machinery	5 to 10 years
Office equipment	5 years
Motor vehicles	5 years

When each major inspection is performed, its cost is recognised in the carrying amount of the property, plant and equipment as a replacement if the recognition criteria are satisfied.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Property, plant and equipment and depreciation *(continued)*

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the consolidated income statement in the year the item is derecognised.

The assets' residual values, useful lives and the depreciation method are reviewed, and adjusted if appropriate, at each financial year end.

Construction in progress

Construction in progress represents plants and properties under construction, which is stated at cost less any impairment losses, and is not depreciated. Cost comprises the direct costs of construction and capitalised borrowing costs on related borrowed funds during the period of construction. Construction in progress is reclassified to the appropriate category of property, plant and equipment when completed and ready for use.

Intangible assets (other than goodwill)

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is the fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. Internally generated intangible assets, excluding capitalised development costs, are not capitalised and expenditure is reflected in the consolidated income statement in the year in which the expenditure is incurred.

The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least at each balance sheet date.

Intangible assets with indefinite useful lives are tested for impairment annually either individually or at the cash-generating unit level. Such intangible assets are not amortised. The useful life of an intangible asset with an indefinite life is reviewed annually to determine whether indefinite life assessment continues to be supportable. If not, the change in the useful life assessment from indefinite to finite is accounted for on a prospective basis.

Patents and licences

Purchased patents and licences are stated at cost less any impairment losses and are amortised on the straight-line basis over their estimated useful lives of 10 years.

Trademark

Acquired trademark is stated at cost less any impairment losses and is amortised on the straight-line basis over its estimated useful lives of 10 years.

Research and development costs

Research costs are expensed as incurred. An intangible asset arising from development expenditure on an individual project is recognised only when the Group can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale, its intention to complete and its ability to use or sell the asset, how the asset will generate future economic benefits, the availability of resources to complete the project and the ability to measure reliably the expenditure during the development.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Intangible assets (other than goodwill) *(continued)*

Research and development costs (continued)

During the period of development, the asset is tested for impairment annually. Following the initial recognition of the development expenditure, the cost model is applied requiring the asset to be carried at cost less any accumulated amortisation and accumulated impairment losses. Amortisation of the asset begins when the development is complete and the asset is available for use. It is amortised over the period of expected future sales. During the period of which the asset is not yet in use, it is tested for impairment annually.

Computer software

Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised on the straight-line basis over their estimated useful lives of 3 to 10 years.

Impairment of non-financial assets other than goodwill

The Group assesses at each reporting date whether there is any indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Group makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case, the recoverable amount is determined for the cash-generating unit to which the asset belongs. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. An impairment loss is charged to the consolidated income statement in the period in which it arises, unless the asset is carried at a revalued amount in which case the impairment loss is accounted for in accordance with the relevant accounting policy for that revalued asset.

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the consolidated income statement in the period in which it arises.

Inventories

Inventories are valued at the lower of cost and net realisable value.

Costs incurred in bringing each product to its present location and condition are accounted for as follows:

Raw materials	–	cost on a weighted average basis;
Finished goods	–	cost of direct materials and labour and a proportion of manufacturing overheads based on normal operating capacity but excluding borrowing costs on a weighted average basis.

Net realisable value is the estimated selling price in the ordinary course of business, less any estimated costs of completion and the estimated costs necessary to make the sale.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Cash and cash equivalents

Cash and cash equivalents comprise cash at banks and on hand and term deposits with an original maturity of three months or less. For the purpose of the consolidated statement of cash flows, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts, if any.

Investments and other financial assets

Financial assets in the scope of IAS 39 are classified as loans and receivables and available-for-sale investments, as appropriate. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Group determines the classification of its financial assets after initial recognition and, where allowed and appropriate, re-evaluates this designation at each financial year end.

All regular way purchases and sales of financial assets are recognised on the trade date, that is, the date that the Group commits to purchase or sell the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

After initial measurement, loans and receivables are subsequently carried at amortised cost using the effective interest method less any allowance for impairment. Amortised cost is calculated taking into account any discount or premium on acquisition and includes fees that are an integral part of the effective interest rate and transaction costs. Gains and losses are recognised in the consolidated income statement when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

Available-for-sale investments

The Group only holds available-for-sale investments which are non-trading investments in unlisted equity securities intended to be held on a long term basis. After initial recognition, available-for-sale investments are measured at fair value with gains or losses being recognised as a separate component of equity until the investment is derecognised or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in equity is included in the consolidated income statement. Interest and dividends earned are reported as interest income and dividend income, respectively and are recognised in the consolidated income statement as “Other income and gains” in accordance with the policies set out for “Revenue recognition” below. Losses arising from the impairment of such investments are recognised in the consolidated income statement as “Impairment losses on available-for-sale financial assets” and are transferred from the available-for-sale investment revaluation reserve.

When the fair value of unlisted equity securities cannot be reliably measured because (a) the variability in the range of reasonable fair value estimates is significant for that investment or (b) the probabilities of the various estimates within the range cannot be reasonably assessed and used in estimating fair value, such securities are stated at cost less any impairment losses.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Investments and other financial assets *(continued)*

Fair value

The fair value of investments that are actively traded in organised financial markets is determined by reference to quoted market bid prices at the close of business at the balance sheet date. For investments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions; reference to the current market value of another instrument which is substantially the same; and a discounted cash flow analysis.

Impairment of financial assets

The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset or a group of financial assets is impaired.

Assets carried at amortised cost

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced through the use of an allowance account. The amount of the impairment loss is recognised in the consolidated income statement. Loans and receivables together with any associated allowance are written off when there is no realistic prospect of future recovery.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. Any subsequent reversal of an impairment loss is recognised in the consolidated income statement, to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date.

In relation to trade and other receivables, a provision for impairment is made when there is objective evidence (such as the probability of insolvency or significant financial difficulties of the debtor and significant changes in the technological, market economic or legal environment that have an adverse effect on the debtor) that the Group will not be able to collect all of the amounts due under the original terms of an invoice. The carrying amount of the receivables is reduced through the use of an allowance account. Impaired debts are derecognised when they are assessed as uncollectible.

Assets carried at cost

If there is objective evidence that an impairment loss has been incurred on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. Impairment losses on these assets are not reversed.

Available-for-sale financial assets

If an available-for-sale financial asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortisation) and its current fair value, less any impairment loss previously recognised in the consolidated income statement, is transferred from equity to the consolidated income statement. A provision for impairment is made for available-for-sale equity investments when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is "significant" or "prolonged" requires judgement. Impairment losses on equity instruments classified as available for sale are not reversed through the consolidated income statement.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Derecognition of financial assets

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- the rights to receive cash flows from the asset have expired;
- the Group retains the rights to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a "pass-through" arrangement; or
- the Group has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Where the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Group's continuing involvement is the amount of the transferred asset that the Group may repurchase, except in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, where the extent of the Group's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

Financial liabilities

Financial liabilities at amortised cost (including interest-bearing bank loans)

Financial liabilities, including trade and bills payables, other payables, other loans, long term payables and interest-bearing bank loans, are initially stated at fair value of the consideration received less directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest method unless the effect of discounting would be immaterial, in which case they are stated at cost. The related interest expense is recognised within "finance costs" in the consolidated income statement.

Gains and losses are recognised in the consolidated income statement when the liabilities are derecognised as well as through the amortisation process.

Financial guarantee contracts

Financial guarantee contracts in the scope of IAS 39 are accounted for as financial liabilities. A financial guarantee contract is recognised initially at its fair value less transaction costs that are directly attributable to the acquisition or issue of the financial guarantee contract, except when such contract is recognised at fair value through profit or loss. Subsequent to initial recognition, the Group measures the financial guarantee contract at the higher of: (i) the amount determined in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*; and (ii) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with IAS 18 *Revenue*.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Derecognition of financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference between the respective carrying amounts is recognised in the consolidated income statement.

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

Where the Group expects some or all of a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the consolidated income statement net of any reimbursement. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognised as a finance cost.

Income tax

Income tax comprises current and deferred tax. Income tax is recognised in the consolidated income statement, or in equity if it relates to items that are recognised in the same or a different period directly in equity.

Current income tax

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted at the balance sheet date.

Deferred income tax

Deferred income tax is provided using the liability method on temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred income tax liabilities are recognised for all taxable temporary differences, except:

- where the deferred income tax liability arises from goodwill or the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interest in a joint venture, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Income tax *(continued)*

Deferred income tax (continued)

Deferred income tax assets are recognised for all deductible temporary differences, carry-forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry-forward of unused tax credits and unused tax losses can be utilised, except:

- where the deferred income tax asset relating to the deductible temporary differences arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

- in respect of deductible temporary differences associated with investments in subsidiaries, associates and interest in a joint venture, deferred income tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised. Unrecognised deferred income tax assets are reassessed at each balance sheet date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

Deferred income tax assets and deferred income tax liabilities are offset if a legally enforceable right exists to set off current income tax assets against current income tax liabilities and the deferred income taxes relate to the same taxable entity and the same taxation authority.

Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and when the revenue can be measured reliably. The following specific recognition criteria must also be met before revenue is recognised:

Sale of goods

Revenue is recognised when the significant risks and rewards of ownership of the goods have been transferred to the buyer, provided that the Group maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold.

Interest income

Revenue is recognised as interest accrues using the effective interest method by applying the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument to the net carrying amount of the financial asset.

Dividends

Revenue is recognised when the Group's right to receive the payment is established.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Government grants

Government grants are recognised where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. When the grant relates to an expense item, it is recognised as income over the period necessary to match the grant on a systematic basis to the costs that it is intended to compensate. Where the grant relates to an asset, the fair value is credited to a deferred income account and is released to the consolidated income statement over the expected useful life of the relevant asset by equal annual instalments.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, i.e., assets that necessarily take a substantial period of time to prepare for their intended use, are capitalised as a part of the cost of those assets. The capitalisation of such borrowing costs ceases when the assets are substantially ready for their intended use. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs capitalised.

All other borrowing costs are recognised as expenses in the consolidated income statement in the period in which they are incurred.

Leases

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement at the inception date of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets or the arrangement conveys a right to use the asset.

Operating leases

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. When the Group is a lessee, operating lease payments are recognised as an expense in the consolidated income statement on a straight-line basis over the lease term.

Land use rights

Land use rights are initially stated at cost and subsequently recognised as an expense in the consolidated income statement on a straight-line basis over the lease terms of 50 years.

Foreign currency translation

Each entity in the Group determines its functional currency based on the assessment of its specific facts and circumstances. The Company, established in the Cayman Islands, has the Hong Kong dollar as its functional currency and the subsidiaries, established in the PRC, have the RMB as their functional currency. As the Group mainly operates in the PRC, RMB is used as the presentation currency of the Group. Transactions in foreign currencies are initially recorded at the functional currency rates ruling at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. All differences are taken to the consolidated income statement. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the date of the initial transaction. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Foreign currency translation *(continued)*

As at the reporting date, the assets and liabilities of companies whose functional currency differs from the presentation currency are translated into the presentation currency of the Group at the rate of exchange ruling at the balance sheet date and their income statements are translated at the weighted average exchange rates for the reporting period. The exchange differences arising on the retranslation are taken directly to a separate component of equity. On disposal of a foreign entity, the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in the income statement.

For the purpose of the consolidated cash flow statement, the cash flows of overseas subsidiaries are translated into RMB at the exchange rates ruling at the dates of the cash flows. Frequently recurring cash flows of overseas subsidiaries which arise throughout the year are translated into RMB at the weighted average exchange rates for the year.

Employee benefits

Retirement benefits

The Group's subsidiaries operating in Mainland China except for Hong Kong participate in a central defined contribution retirement plan managed by the local municipal government in the locations in which they operate. Contributions are made based on a percentage of the companies' payroll costs and are charged to the consolidated income statement as they become payable in accordance with the rules of the central pension scheme.

The Company also participates in the defined contribution Mandatory Provident Fund retirement scheme (the "MPF Scheme") in Hong Kong. Contributions are made to a separately administered fund based on a percentage of the employees' basic salaries and are charged to the consolidated income statement as they become payable in accordance with the rules of the MPF Scheme.

Share-based payment transactions

The Company operates a share option scheme for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operations. Employees (including directors) of the Group receive remuneration in the form of share-based payment transactions, whereby employees render services as consideration for equity instruments ("equity-settled transactions").

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date on which they are granted. The fair value is determined by an external valuer using a binomial model, further details of which are given in note 37 to the financial statements. In valuing equity-settled transactions, no account is taken of any performance conditions, other than conditions linked to the price of the shares of the Company ("market conditions"), if applicable.

The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, over the period in which the performance and service conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award (the "vesting date"). The cumulative expense recognised for equity-settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the Group's best estimate of the number of equity instruments that will ultimately vest. The charge or credit to the consolidated income statement for the period represents the movement in cumulative expense recognised as at the beginning and end of that period.

No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied.

2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Employee benefits *(continued)*

Share-based payment transactions (continued)

Where the terms of an equity-settled award are modified, the minimum expense recognised is the expense if the terms had not been modified. An additional expense is recognised for any modification, which increases the total fair value of the share-based payment arrangement, or is otherwise beneficial to the employee as measured at the date of modification.

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any expense not yet recognised for the award is recognised immediately. However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph.

The dilutive effect of outstanding options is reflected as additional share dilution in the computation of earnings per share (further details are given in note 10).

Dividends

Final dividends proposed by the directors are classified as a separate allocation of retained earnings within the equity section of the balance sheet, until they have been approved by the shareholders in a general meeting. When these dividends are approved by the shareholders and declared, they are recognised as a liability.

Interim dividends are simultaneously proposed and declared, because the Company's memorandum and articles of association grant the directors the authority to declare interim dividends. Consequently, interim dividends are recognised directly as a liability when they are proposed and declared.

2.5 SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES

The preparation of the Group's financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities, at the reporting date. However, uncertainty about these assumptions and estimates could result in outcomes that could require a material adjustment to the carrying amounts of the assets or liabilities affected in the future.

Estimation uncertainty

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

Impairment of goodwill

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the value in use of the cash-generating units to which the goodwill is allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. Details of goodwill are given in note 19 to the financial statements.

2.5 SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES *(continued)*

Estimation uncertainty *(continued)*

Impairment of non-financial assets other than goodwill

The Group assesses whether there are any indicators of impairment for all non-financial assets at each reporting date. Indefinite life intangible assets are tested for impairment annually and at other times when such indicator exists. Other non-financial assets are tested for impairment when there are indicators that the carrying amounts may not be recoverable. When value in use calculations are undertaken, management must estimate the expected future cash flows from the asset or cash-generating unit and choose a suitable discount rate in order to calculate the present value of those cash flows.

Share-based payments

The Group measures the cost of equity-settled transactions with employees by reference to the fair value of the equity instruments at the date at which they are granted. Estimating fair value requires determining the most appropriate valuation model for a grant of equity instruments, which is dependent on the terms and conditions of the grant. This also requires determining the most appropriate inputs to the valuation model including the expected life of the option, volatility and dividend yield and making assumptions about them. The assumptions and models used are disclosed in note 37 to the financial statements.

Deferred tax assets

Deferred tax assets are recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. Significant management judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and level of future taxable profits, which affects the probability of utilisation and the tax rate to be used in the calculations. Details of deferred tax assets are contained in note 20 to the financial statements.

3. SEGMENT INFORMATION

The Group comprises the following business segments:

- Liquid milk products segment – manufacture and distribution of ultra-high temperature milk (“UHT milk”), milk beverages and yogurt;

- Ice cream products segment – manufacture and distribution of ice cream; and

- Other dairy products segment – manufacture and distribution of milk powder.

As the Group mainly operates and generates its revenue and results in Mainland China, no geographical segment analysis is presented.

3. SEGMENT INFORMATION *(continued)*

The following tables present the revenue, results and certain asset and liability information for the Group's business segments for the year ended 31 December 2007:

	2007 *RMB'000*	2006 *RMB'000*
Segment revenue:		
Liquid milk products	**19,148,856**	14,260,929
Ice cream products	**1,991,728**	1,818,042
Other dairy products	**177,478**	167,397
	21,318,062	16,246,368
Segment results:		
Liquid milk products	**1,249,599**	970,207
Ice cream products	**85,228**	119,610
Other dairy products	**(31,994)**	24,394
	1,302,833	1,114,211
Unallocated corporate expenses	**(186,983)**	(133,021)
Profit from operating activities	**1,115,850**	981,190
Interest income	**43,566**	15,827
Finance costs	**(50,060)**	(63,081)
Share of profits and losses of associates	**20,954**	8,384
Profit before tax	**1,130,310**	942,320
Income tax expense	**(21,658)**	(76,032)
Profit for the year	**1,108,652**	866,288

3. SEGMENT INFORMATION *(continued)*

	2007 RMB'000	2006 RMB'000
Segment assets:		
Liquid milk products	**7,042,655**	6,049,910
Ice cream products	**966,557**	1,029,309
Other dairy products	**230,324**	118,804
Unallocated corporate assets	**2,844,220**	1,668,720
Eliminations	**(1,402,477)**	(1,103,065)
Total assets	**9,681,279**	7,763,678
Segment liabilities:		
Liquid milk products	**3,920,366**	3,809,625
Ice cream products	**470,352**	471,854
Other dairy products	**165,928**	33,655
Unallocated corporate liabilities	**692,406**	918,929
Eliminations	**(1,402,477)**	(1,103,065)
Total liabilities	**3,846,575**	4,130,998
Capital expenditure:		
Liquid milk products	**1,071,931**	1,300,644
Ice cream products	**71,782**	86,804
Other dairy products	**127,295**	7,216
Others	**244,053**	77,761
	1,515,061	1,472,425
Depreciation and amortisation:		
Liquid milk products	**416,032**	312,529
Ice cream products	**91,862**	73,419
Other dairy products	**4,718**	5,927
Others	**17,863**	14,671
	530,475	406,546
Other non-cash expenses/(income):		
Liquid milk products	**(6,983)**	3,304
Ice cream products	**(301)**	(187)
Other dairy products	**3,845**	1,489
Others	**(51)**	27
	(3,490)	4,633

4. REVENUE, OTHER INCOME AND GAINS

Revenue, being the turnover of the Group, represents the net invoiced value of goods sold, after allowances for goods returns and trade discounts, and after eliminations of all significant intra-group transactions.

An analysis of the Group's revenue, other income and gains is as follows:

	Notes	2007 *RMB'000*	2006 *RMB'000*
Revenue		**21,318,062**	16,246,368
Other income and gains:			
Government grants	(a)	**41,737**	22,438
Trademark fees		**–**	1,368
Amortisation of deferred income	(b)	**10,816**	4,605
Foreign exchange gains, net		**38,822**	16,217
Dilution gain arising from an investment in a jointly controlled entity	(c)	**–**	25,000
Gain on disposal of an investment in an associate		**–**	2,167
Others		**6,721**	4,664
		98,096	76,459
		21,416,158	16,322,827

Notes:

(a) The government grants have been received for the Group's contribution to the local economy with respect to the establishment of infrastructure relating to the dairy products industry. There are no unfulfilled conditions or contingences attaching to these grants.

(b) The Group has received certain government grants in the form of property, plant and equipment donations or cash donations to purchase property, plant and equipment. The grants are initially recorded as deferred income and amortised to match the depreciation charge of the underlying property, plant and equipment in accordance with the assets' estimated useful lives.

(c) In the prior year, the Group made a capital contribution to a jointly controlled entity by the injection of self-developed intangible assets based on the fair value of such assets. The gain represented the difference between the fair value and the book value of the injected assets attributable to the share of the joint venture partners.

5. PROFIT BEFORE TAX

The Group's profit before tax is arrived at after charging/(crediting):

	2007 RMB'000	2006 RMB'000
Cost of inventories sold	**16,514,557**	12,524,597
Employee benefits expense (excluding directors' remuneration as disclosed in note 6)		
– Wages, salaries, housing benefits and other allowances	**800,406**	637,377
– Retirement benefits contributions	**50,138**	33,370
– Share-based payment expense (note 37)	**35,352**	3,108
	885,896	673,855
Depreciation of property, plant and equipment	**522,706**	403,485
Amortisation of land use rights	**4,681**	1,707
Amortisation of other intangible assets	**3,088**	1,354
Research and development costs	**13,949**	5,506
(Write-back of provision for)/provision for trade receivables and other receivables	**(7,903)**	3,478
Write-down of inventories to net realisable value	**4,413**	1,155
Minimum lease payments under operating leases on buildings and certain production equipment	**205,846**	204,096
Display space leasing fees	**213,112**	87,827
Loss on disposal of items of property, plant and equipment	**8,298**	1,075
Auditors' remuneration	**3,526**	2,816

6. DIRECTORS' AND SENIOR EXECUTIVES' EMOLUMENTS

Directors' remuneration for the year, disclosed pursuant to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") and Section 161 of the Hong Kong Companies Ordinance, is as follows:

	2007 RMB'000	2006 RMB'000
Fees	**270**	270
Other emoluments		
– Basic salaries, housing benefits, other allowances and benefits in kind	**3,844**	4,576
– Retirement benefits contributions	**51**	42
	4,165	4,888

6. DIRECTORS' AND SENIOR EXECUTIVES' EMOLUMENTS *(continued)*

	Notes	Fees RMB'000	Basic salaries, housing benefits, other allowances and benefits in kind RMB'000	Retirement contributions RMB'000	Total remuneration RMB'000
2007					
Executive directors					
– Mr. Niu Gensheng		**30**	**990**	**17**	**1,037**
– Mr. Yang Wenjun		**30**	**1,683**	**17**	**1,730**
– Mr. Sun Yubin		**30**	**1,001**	**17**	**1,048**
Non-executive directors					
– Mr. Jiao Shuge	(b)	**–**	**–**	**–**	**–**
– Ms. Lu Jun	(a)	**30**	**170**	**–**	**200**
– Mr. Julian Juul Wolhardt	(b)	**–**	**–**	**–**	**–**
Independent non-executive directors					
– Mr. Wang Huaibao		**50**	**–**	**–**	**50**
– Mr. Zhang Julin		**50**	**–**	**–**	**50**
– Mr. Li Jianxin		**50**	**–**	**–**	**50**
		270	**3,844**	**51**	**4,165**

6. DIRECTORS' AND SENIOR EXECUTIVES' EMOLUMENTS *(continued)*

	Notes	Fees *RMB'000*	Basic salaries, housing benefits, other allowances and benefits in kind *RMB'000*	Retirement contributions *RMB'000*	Total remuneration *RMB'000*
2006					
Executive directors					
– Mr. Niu Gensheng		30	988	14	1,032
– Ms. Lu Jun	(a)	30	798	–	828
– Mr. Yang Wenjun		30	1,770	14	1,814
– Mr. Sun Yubin		30	1,020	14	1,064
Non-executive directors					
– Mr. Jiao Shuge	(b)	–	–	–	–
– Mr. Liu Haifeng, David	(b)	–	–	–	–
– Ms. Jin Yujuan, Lily	(b)	–	–	–	–
– Mr. Julian Juul Wolhardt	(b)	–	–	–	–
Independent non-executive directors					
– Mr. Wang Huaibao		50	–	–	50
– Mr. Zhang Julin		50	–	–	50
– Mr. Li Jianxin		50	–	–	50
		270	4,576	42	4,888

(a) Ms. Lu Jun was re-designated as a non-executive director in January 2007 and resigned as a non-executive director subsequent to the year end.

(b) The two (2006: four) non-executive directors agreed to waive their entitlements to directors' fees totalling RMB100,000 (2006: RMB108,500) for the year. Other than the aforementioned, there was no arrangement under which a director waived or agreed to waive any remuneration during the year.

(c) During the year, certain directors were granted share options in respect of their services to the Group under the share option scheme of the Company, further details of which are set out in note 37 to the financial statements. In accordance with IFRS 2, share option benefits represent the fair value at grant date of the share options issued under the share option scheme of the Company amortised to the consolidated income statements during the year disregarding whether the options have been vested/exercised or not. No share options were exercised by the directors during the year. During the year, the share option benefits relating to the share options granted to Mr. Yang Wenjun and Mr. Sun Yubin were approximately RMB2,750,000 (2006: nil) and RMB1,131,000 (2006: nil), respectively. The share option benefits relating to the share options granted to the two directors are not included in the above analysis.

6. DIRECTORS' AND SENIOR EXECUTIVES' EMOLUMENTS *(continued)*

Three (2006: Two) of the five highest paid individuals were directors whose emoluments have been shown above. Details of emoluments paid to the remaining two (2006: three) non-directors, highest paid senior executives for the year were as follows:

	2007 *RMB'000*	2006 *RMB'000*
Basic salaries, housing benefits, other allowances and benefits in kind	**2,801**	3,095
Discretionary bonuses	**–**	151
Retirement scheme contributions	**35**	40
	2,836	3,286

The number of non-directors, highest paid employees whose remuneration fell within the following bands is as follows:

	Number of employees	
	2007	2006
HK$1,000,001 to HK$1,500,000	**1**	3
HK$1,500,001 to HK$2,000,000	**1**	–
	2	3

Out of the above amount, approximately RMB1,275,000 (2006: RMB1,140,000) and RMB1,561,000 (2006: RMB1,127,000) were paid or payable to Mr. Yao Tongshan and Mr. Bai Ying, respectively.

During the year, share options were granted to two non-directors, highest paid employees in respect of their services to the Group, further details of which are set out in note 37 to the financial statements. During the year, the share option benefits relating to the share options granted to the two non-directors, highest paid employees were approximately RMB2,676,000 (2006: RMB90,000) in aggregate. The share option benefits relating to the share options granted to the two non-directors, highest paid employees are not included in the above analysis.

7. FINANCE COSTS

	2007 *RMB'000*	2006 *RMB'000*
Interest on long term payables	**15,506**	14,855
Interest on bank loans wholly repayable within five years	**36,830**	48,474
Less: Amounts capitalised	**(2,276)**	(248)
	50,060	63,081

The amounts capitalised are the borrowing costs related to funds borrowed specifically for the purpose of obtaining qualifying assets. The interest rate on such capitalised borrowings during the year was 5.88% (2006: 5.67%) per annum.

8. INCOME TAX EXPENSE

Hong Kong profits tax has not been provided as the Group had no assessable profits arising in Hong Kong during the year. The tax charge represents the provision for the PRC corporate income tax ("CIT") and deferred tax for the year.

Under the PRC income tax law, except for certain preferential treatment available to twenty-one (2006: eighteen) of the Group's subsidiaries, the entities within the Group are subject to CIT at a rate of 33% on the taxable income as reported in their statutory accounts which are prepared in accordance with the PRC accounting standards and financial regulations.

	2007	2006
	RMB'000	*RMB'000*
Current income tax	**27,960**	76,032
Deferred income tax (note 20)	**(6,302)**	–
	21,658	76,032

A reconciliation of the income tax expense applicable to profit before tax at the statutory income tax rate to the income tax expense at the Group's effective income tax rate for the year is as follows:

		2007	2006
	Note	***RMB'000***	*RMB'000*
Profit before tax		**1,130,310**	942,320
At CIT rate of 33%		**373,002**	310,966
Non-taxable items and others, net		**40,802**	90,044
Effect of preferential tax rates	(a)	**(44,061)**	(94,278)
Effect on tax exemptions	(a)	**(330,221)**	(225,142)
Utilization of previously unrecognized tax credits		**(17,864)**	(5,558)
At the effective income tax rate of 1.9% (2006: 8.1%)		**21,658**	76,032

Notes:

(a) Twenty-one (2006: eighteen) subsidiaries were subject to tax concessions in 2007. The total taxable profit of the subsidiaries that are subject to tax concessions amounted to approximately RMB1,134,188,000 (2006: RMB967,939,000) in aggregate. Out of the twenty-one subsidiaries, seventeen (2006: fifteen) subsidiaries were granted tax concessions by the state tax bureau in accordance with the "Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises" under which these subsidiaries would be exempted from CIT for the first two profitable years and subject to 50% of the applicable tax rate for the following three profitable years. Two (2006: two) subsidiaries were granted tax concessions by the local tax bureau in accordance with the policy of "The Notice of Income Tax Exemption for the Country's Key Enterprises in Agricultural Industries" of the tax authorities. The remaining two (2006: one) were granted a three-year tax exemption by the local tax bureau in accordance with the state tax bureau's policy to aid the new companies established in remote and destitute areas.

(b) The share of tax attributable to associates amounting to approximately RMB10,428,000 (2006: RMB4,790,000) is included in the share of profits and losses of associates on the face of the consolidated income statement.

9. DIVIDENDS

	Note	2007 RMB'000	2006 RMB'000
Declared and paid during the year			
Equity dividends on ordinary shares		**156,020**	93,873
Proposed for approval at the AGM			
Equity dividends on ordinary shares: Proposed final – RMB0.1315 (2006: RMB0.1094) per ordinary share	(a)	**187,535**	149,718

Note:

(a) The proposed total dividend is calculated based on approximately 1,426,120,000 (2006: 1,368,416,000) existing shares in issue. The proposed final dividend for the year is subject to the approval of the Company's shareholders at the forthcoming Annual General Meeting (the "AGM"). Such dividend is not recognised as a liability in the consolidated financial statements as at 31 December 2007 but will be reflected as an appropriation of retained earnings for the year ending 31 December 2008.

10. EARNINGS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE COMPANY

The basic earnings per share for the year is calculated by dividing the profit for the year attributable to ordinary equity holders of the Company by the weighted average number of ordinary shares outstanding during the year.

The diluted earnings per share for the year is calculated by dividing the profit for the year attributable to ordinary equity holders of the Company by the weighted average number of ordinary shares in issue during the year, as used in the basic earnings per share calculation; and the weighted average number of ordinary shares assumed to have been issued at no consideration on the deemed exercise of all share options during the year pursuant to contingent ordinary share provision in IAS 33 *Earnings Per Share*.

A reconciliation of the weighted average number of shares used in calculating the basic and diluted earnings per share amounts is as follows:

	2007 Number of shares '000	2006 Number of shares '000
Weighted average number of ordinary shares for the purpose of the basic earnings per share calculation	**1,408,911**	1,368,416
Weighted average number of ordinary shares, assuming issued at no consideration on the deemed exercise of all shares options during the year	**859**	–
Weighted average number of ordinary shares for the purpose of the diluted earnings per share calculation	**1,409,770**	1,368,416

Other transactions involving ordinary shares or potential ordinary shares between the reporting date and the date of completion of these financial statements are disclosed in note 44 of the financial statements.

11. PROPERTY, PLANT AND EQUIPMENT

Movements of the Group's property, plant and equipment during the year are as follows:

	Buildings and structures *RMB'000*	Plant and machinery *RMB'000*	Office equipment *RMB'000*	Motor vehicles *RMB'000*	Total *RMB'000*
At 1 January 2007, net of accumulated depreciation	1,187,696	2,879,953	68,218	24,416	4,160,283
Additions	31,085	477,511	29,313	29,569	567,478
Transfers from construction in progress (note 12)	221,097	606,864	26,122	–	854,083
Disposals	(9,178)	(6,678)	(159)	(475)	(16,490)
Depreciation provided during the year	(62,696)	(423,308)	(24,596)	(12,106)	(522,706)
At 31 December 2007, net of accumulated depreciation	1,368,004	3,534,342	98,898	41,404	5,042,648
At 1 January 2007					
Cost	1,319,536	3,599,339	115,884	54,932	5,089,691
Accumulated depreciation	(131,840)	(719,386)	(47,666)	(30,516)	(929,408)
Net carrying amount	1,187,696	2,879,953	68,218	24,416	4,160,283
At 31 December 2007					
Cost	1,561,686	4,673,230	170,416	83,352	6,488,684
Accumulated depreciation	(193,682)	(1,138,888)	(71,518)	(41,948)	(1,446,036)
Net carrying amount	1,368,004	3,534,342	98,898	41,404	5,042,648

11. PROPERTY, PLANT AND EQUIPMENT *(continued)*

	Buildings and structures *RMB'000*	Plant and machinery *RMB'000*	Office equipment *RMB'000*	Motor vehicles *RMB'000*	Total *RMB'000*
At 1 January 2006, net of accumulated depreciation	1,012,716	2,040,890	55,680	31,147	3,140,433
Additions	40,278	421,414	27,252	4,872	493,816
Capital injection from minority shareholders	37,397	35,422	1,255	–	74,074
Transfers from construction in progress (note 12)	181,058	727,709	4,214	–	912,981
Disposals	(60)	(8,751)	(202)	(1,294)	(10,307)
Investment to a jointly controlled entity (note (c))	(20,115)	–	–	–	(20,115)
Sales to a jointly controlled entity (note (c))	(8,035)	(18,777)	(302)	–	(27,114)
Depreciation provided during the year	(55,543)	(317,954)	(19,679)	(10,309)	(403,485)
At 31 December 2006, net of accumulated depreciation	1,187,696	2,879,953	68,218	24,416	4,160,283
At 1 January 2006					
Cost	1,091,858	2,457,703	84,409	51,955	3,685,925
Accumulated depreciation	(79,142)	(416,813)	(28,729)	(20,808)	(545,492)
Net carrying amount	1,012,716	2,040,890	55,680	31,147	3,140,433
At 31 December 2006					
Cost	1,319,536	3,599,339	115,884	54,932	5,089,691
Accumulated depreciation	(131,840)	(719,386)	(47,666)	(30,516)	(929,408)
Net carrying amount	1,187,696	2,879,953	68,218	24,416	4,160,283

(a) All of the Group's buildings are located in Mainland China.

(b) Certain property, plant and equipment of the Group with a net book value of approximately RMB644,828,000 (2006: RMB609,929,000) have been pledged to secure the long term payables of the Group, details of which are set out in note 32 to the financial statements.

(c) In the prior year, the Group injected capital to a jointly controlled entity in the form of property, plant and equipment with a carrying amount of RMB40,230,000 and sold property, plant and equipment with a carrying amount of RMB54,228,000 to that entity. The amounts disclosed in the above table represented 50% of the transaction amounts, which were the interest attributable to the joint venture partners.

11. PROPERTY, PLANT AND EQUIPMENT *(continued)*

As at the date of this report, the Group is in the process of applying for registration of the ownership certificates for certain of its buildings and structures with an aggregate carrying value of approximately RMB35,649,000 (2006: RMB37,647,000) as at 31 December 2007.

Movements of the Company's property, plant and equipment during the year, which comprise only office equipment, are as follows:

	Company	
	2007	2006
	RMB'000	*RMB'000*
At 1 January, net of accumulated depreciation	**65**	88
Additions	**24**	2
Depreciation provided during the year	**(24)**	(23)
Disposal	**–**	(2)
At 31 December, net of accumulated depreciation	**65**	65
At 1 January		
Cost	**121**	121
Accumulated depreciation	**(56)**	(33)
Net carrying amount	**65**	88
At 31 December		
Cost	**145**	121
Accumulated depreciation	**(80)**	(56)
Net carrying amount	**65**	65

12. CONSTRUCTION IN PROGRESS

Movements of the Group's construction in progress, all of which are located in Mainland China, are as follows:

	Group	
	2007	2006
	RMB'000	*RMB'000*
Carrying amount at beginning of year	**348,405**	235,373
Additions during the year	**819,117**	1,026,013
Transfers to property, plant and equipment (note 11)	**(854,083)**	(912,981)
Carrying amount at end of year	**313,439**	348,405

13. OTHER INTANGIBLE ASSETS

Movements of the Group's other intangible assets are as follows:

	Patents and licenses *RMB'000*	Trademarks *RMB'000*	Computer software *RMB'000*	Total *RMB'000*
Cost at 1 January 2007, net of accumulated amortisation	**6,767**	**–**	**6,437**	**13,204**
Additions	**–**	**15,690**	**5,598**	**21,288**
Amortisation provided during the year	**(353)**	**(1,170)**	**(1,565)**	**(3,088)**
At 31 December 2007	**6,414**	**14,520**	**10,470**	**31,404**
At 31 December 2007				
Cost	**7,000**	**15,690**	**13,156**	**35,846**
Accumulated amortisation	**(586)**	**(1,170)**	**(2,686)**	**(4,442)**
Net carrying amount	**6,414**	**14,520**	**10,470**	**31,404**
Cost at 1 January 2006, net of accumulated amortisation	–	–	–	–
Additions	–	–	7,558	7,558
Contribution from a minority shareholder	7,000	–	–	7,000
Amortisation provided during the year	(233)	–	(1,121)	(1,354)
At 31 December 2006	6,767	–	6,437	13,204
At 31 December 2006				
Cost	7,000	–	7,558	14,558
Accumulated amortisation	(233)	–	(1,121)	(1,354)
Net carrying amount	6,767	–	6,437	13,204

14. LAND USE RIGHTS

	Group 2007 RMB'000	Group 2006 RMB'000
Carrying amount at beginning of year	**131,006**	67,871
Additions during the year	**107,178**	64,842
Amortised during the year	**(4,681)**	(1,707)
Carrying amount at end of year	**233,503**	131,006
Current portion included in prepayments and deposits under current assets (note 25)	**4,764**	2,620
Non-current portion	**228,739**	128,386
	233,503	131,006

The leasehold land is held under a long term lease of 50 years and is situated in Mainland China.

15. INTERESTS IN SUBSIDIARIES

	Company 2007 RMB'000	Company 2006 RMB'000
Unlisted shares, at cost	**826,927**	851,806
Loan to a subsidiary	**855,945**	972,419
	1,682,872	1,824,225

The loan to a subsidiary included in the interests in subsidiaries above is unsecured, interest-free and has no fixed terms of repayment. The carrying amount of the loan to a subsidiary approximates to its fair value.

Details of the Company's subsidiaries at 31 December 2007 are set out below:

Name	Date of incorporation/ establishment*	Issued share capital	Percentage of equity interest attributable to the Company: Direct	Percentage of equity interest attributable to the Company: Indirect	Principal activities
China Dairy Holdings (i)	5 June 2002	US$214	100%	–	Investment holding
China Dairy (Mauritius) Limited (i)	15 June 2002	US$100	–	100%	Investment holding
Inner Mongolia Mengniu Dairy (Group) Company Limited (iii) (內蒙古蒙牛乳業(集團)股份有限公司)	18 August 1999	RMB802,288,466	–	84.32%	Manufacture and sale of dairy products

15. INTERESTS IN SUBSIDIARIES *(continued)*

Details of the Company's subsidiaries at 31 December 2007 are set out below: *(continued)*

Name	Date of incorporation/ establishment*	Issued share capital	Percentage of equity interest attributable to the Company		Principal activities
			Direct	Indirect	
Beijing Mengniu Dairy Co., Ltd. (i) (ii) (iv) (北京蒙牛乳製品有限責任公司)	4 July 2000	RMB500,000	–	43.85%	Packaging and sale of dairy products
Inner Mongolia Mengniu Founding Industry Management Co., Ltd. (i) (ii) (內蒙古蒙牛方鼎產業管理有限責任公司)	9 February 2002	RMB45,000,000	–	84.32%	Investment holding
Mengniu Dairy (Wulanhaote) Co., Ltd. (i) (iii) (蒙牛乳業(烏蘭浩特)有限責任公司)	18 June 2002	RMB30,000,000	–	84.32%	Manufacture and sale of dairy products
Inner Mongolia Mengniu Dairy Keerqin Co., Ltd. (i) (iii) (內蒙古蒙牛乳業科爾沁有限責任公司)	19 June 2002	RMB20,000,000	–	84.32%	Manufacture and sale of dairy products
Mengniu Dairy (Dangyang) Co., Ltd. (i) (iii) (蒙牛乳業(當陽)有限責任公司)	7 November 2002	RMB42,000,000	–	84.32%	Manufacture and sale of dairy products
Mengniu Dairy (Beijing) Co., Ltd. (i) (iii) (蒙牛乳業(北京)有限責任公司)	11 November 2002	RMB120,000,000	26.70%	61.81%	Manufacture and sale of dairy products
Jinhua Mengniu Dairy Co., Ltd. (i) (ii) (iv) (金華蒙牛乳業有限公司)	19 February 2003	RMB500,000	–	43.00%	Manufacture and sale of dairy products
Mengniu Dairy (Shenyang) Co., Ltd. (i) (iii) (蒙牛乳業(瀋陽)有限責任公司)	4 December 2003	RMB100,000,000	26.05%	62.37%	Manufacture and sale of dairy products
Beijing Mengniu Hongda Dairy Co., Ltd. (i) (ii) (iv) (北京蒙牛宏達乳製品有限責任公司)	12 September 2002	RMB10,000,000	–	43.85%	Packaging and sale of dairy products
Inner Mongolia Mengniu Dairy Baotou Co., Ltd. (i) (iii) (內蒙古蒙牛乳業包頭有限責任公司)	9 January 2003	RMB30,000,000	26.40%	62.06%	Manufacture and sale of dairy products
Mengniu Dairy (Dengkou Bayan Gaole) Co., Ltd. (i) (iii) (蒙牛乳業(磴口巴彥高勒)有限責任公司)	13 July 2003	RMB40,000,000	–	84.32%	Manufacture and sale of dairy products

15. INTERESTS IN SUBSIDIARIES *(continued)*

Details of the Company's subsidiaries at 31 December 2007 are set out below: *(continued)*

Name	Date of incorporation/ establishment*	Issued share capital	Percentage of equity interest attributable to the Company		Principal activities
			Direct	Indirect	
Inner Mongolia Mengniu Dairy (Group) Shanxi Dairy Co., Ltd. (i) (ii) (內蒙古蒙牛乳業(集團)山西乳業有限公司)	14 July 2003	RMB10,000,000	–	75.89%	Manufacture and sale of dairy products
Mengniu Dairy (Jiaozuo) Co., Ltd. (i) (iii) (蒙牛乳業(焦作)有限公司)	6 November 2003	RMB110,000,000	–	84.32%	Manufacture and sale of dairy products
Mengniu Dairy Taian Co., Ltd. (i) (iii) (蒙牛乳業泰安有限責任公司)	18 November 2003	RMB110,000,000	26.03%	62.37%	Manufacture and sale of dairy products
Mengniu Dairy (Luannan) Co., Ltd. (i) (iii) (蒙牛乳業(灤南)有限責任公司)	31 March 2004	RMB56,000,000	26.06%	62.34%	Manufacture and sale of dairy products
Mengniu Dairy (Tangshan) Co., Ltd. (i) (iii) (蒙牛乳業(唐山)有限責任公司)	31 March 2004	RMB70,000,000	26.05%	62.35%	Manufacture and sale of dairy products
Mengniu Dairy (Maanshan) Co., Ltd. (i) (iii) (蒙牛乳業(馬鞍山)有限責任公司)	4 February 2005	RMB155,000,000	–	84.32%	Manufacture and sale of dairy products
Mengniu (Wuhan) Frealth Dairy Co., Ltd. (i) (iii) (蒙牛(武漢)友芝友乳業有限公司)	6 January 2006	RMB120,000,000	–	84.32%	Manufacture and sale of dairy products
Inner Mongolia Mengniu Breeding Biotech Co., Ltd. (i) (ii) (內蒙古蒙牛繁育生物技術有限公司)	31 July 2006	RMB20,000,000	–	54.81%	Cultivation and sale of cattle embryos
Inner Mongolia Mengniu Hi-tech Dairy Co., Ltd. (i) (ii) (內蒙古蒙牛高科乳業有限公司)	2 August 2006	RMB150,000,000	–	84.32%	Manufacture and sale of dairy products
Mengniu Dairy (Tai Yuan) Co., Ltd. (i) (ii) (蒙牛乳業(太原)有限公司)	13 April 2006	RMB116,670,000	–	84.32%	Manufacture and sale of dairy products

15. INTERESTS IN SUBSIDIARIES *(continued)*

Details of the Company's subsidiaries at 31 December 2007 are set out below: *(continued)*

Name	Date of incorporation/ establishment*	Issued share capital	Percentage of equity interest attributable to the Company Direct	Indirect	Principal activities
Mengniu Dairy (Shangzhi) Co., Ltd. (i) (ii) (蒙牛乳業(尚志)有限責任公司)	10 June 2005	RMB50,000,000	–	84.32%	Manufacture and sale of dairy products
Mengniu Dairy (Chabei) Co., Ltd. (i) (ii) (蒙牛乳業(察北)有限公司)	15 June 2005	RMB30,000,000	–	65.77%	Manufacture and sale of dairy products
Mengniu Dairy (Baoji) Co., Ltd. (i) (iii) (蒙牛乳業(寶雞)有限公司)	1 November 2005	RMB96,840,000	–	84.32%	Manufacture and sale of dairy products
Mengniu Dairy (Baoding) Co., Ltd. (ii) (蒙牛乳業(保定)有限公司)	22 January 2007	RMB62,000,000	–	84.32%	Manufacture and sale of dairy products
Beijing Mengniu Cheese Co., Ltd. (ii) (北京蒙牛奶酪有限公司)	23 May 2007	RMB5,000,000	–	84.32%	Manufacture and sale of dairy products
Mengniu Dairy Meishan Co., Ltd. (ii) (蒙牛乳業眉山有限公司)	29 August 2007	RMB60,000,000	–	84.32%	Manufacture and sale of dairy products
Mengniu Saibei Dairy Co., Ltd. (iii) (蒙牛塞北乳業有限公司)	29 August 2007	RMB67,121,418	26%	62.40%	Manufacture and sale of dairy products
Mengniu Dairy (Qiqihaer) Co., Ltd. (ii) (蒙牛乳業(齊齊哈爾)有限公司)	23 November 2007	RMB37,500,000	–	84.32%	Manufacture and sale of dairy products

* Except for China Dairy Holdings and China Dairy (Mauritius) Limited, which were incorporated in the Cayman Islands and Mauritius, respectively, all subsidiaries were incorporated in the PRC.

(i) Not audited by Ernst & Young Hong Kong or other member firm of the Ernst & Young global network.

(ii) The subsidiaries are registered as companies with limited liability under the PRC law.

(iii) The subsidiaries are registered as Sino-foreign equity joint ventures under the PRC law.

(iv) Since more than 50% of the equity interest of the subsidiary was held by Inner Mongolia Mengniu Dairy (Group) Company Limited in which the Company held 84.32% equity interest, the Company had control over the subsidiary even with less than 50% of equity interest held indirectly as at the balance sheet date.

16. INTERESTS IN ASSOCIATES

	Group 2007 RMB'000	Group 2006 RMB'000
Share of net assets	**57,573**	40,371

Details of the Group's associates at 31 December 2007 are set out below:

Name	Particulars of issued shares held	Place of incorporation/ registration and operations	Percentage of equity interest attributable to the Group (indirect) 2007	2006	Principal activities
Xinjiang Tianxue Food Co., Ltd. (i) (新疆天雪食品有限公司)	Registered capital	Mainland China	21%	21%	Trading of dairy products
Inner Mongolia Meng Niu AustAsia Model Dairy Farm Company Limited (i) (內蒙古蒙牛澳亞示范牧場有限責任公司)	Registered capital	Mainland China	25%	25%	Production of raw milk, planting of pastures and processing of milk
Fuzhou Mengxin Trading Co., Ltd. (i) (福州蒙鑫貿易有限公司)	Registered capital	Mainland China	39%	39%	Trading of dairy products
Shijiazhuang Mengniu Ice Cream Sales Co., Ltd. (i) (石家庄蒙牛冰淇淋銷售有限公司)	Registered capital	Mainland China	34%	34%	Trading of dairy products
Tianjin Mengniu Ice Cream Sales Co., Ltd. (i) (天津蒙牛冰淇淋銷售有限責任公司)	Registered capital	Mainland China	34%	34%	Trading of dairy products
Guangzhou Mengniu Dairy Trading Co., Ltd. (i) (廣州市蒙牛乳業貿易有限公司)	Registered capital	Mainland China	34%	34%	Trading of dairy products
Wuhan Mengniu Dairy Co., Ltd. (i) (武漢蒙牛乳業有限公司)	Registered capital	Mainland China	24%	24%	Trading of dairy products
Guilin Mengniu Dairy Sales Co., Ltd. (i) (桂林蒙牛乳業銷售有限公司)	Registered capital	Mainland China	34%	34%	Trading of dairy products

16. INTERESTS IN ASSOCIATES *(continued)*

Details of the Group's associates at 31 December 2007 are set out below: *(continued)*

Name	Particulars of issued shares held	Place of incorporation/ registration and operations	Percentage of equity interest attributable to the Group (indirect) 2007	2006	Principal activities
Tianjin Mengniu Dairy Sales Co., Ltd. (i) (天津市蒙牛乳業銷售有限公司)	Registered capital	Mainland China	34%	34%	Trading of dairy products
Wenzhou Mengniu Dairy Co., Ltd. (i) (溫州蒙牛乳業有限公司)	Registered capital	Mainland China	34%	34%	Trading of dairy products
Heilongjiang Mengniu Dairy Sales Co., Ltd. (黑龍江蒙牛乳業銷售有限公司)	Registered capital	Mainland China	38%	38%	Trading of dairy products
Chengdu Mengniu Dairy Sales Co., Ltd (i) (成都蒙牛乳業銷售有限責任公司)	Registered capital	Mainland China	34%	34%	Trading of dairy products
Nanjing Mengniu Dairy Sales Co., Ltd. (i) (南京蒙牛乳業銷售有限公司)	Registered capital	Mainland China	38%	38%	Trading of dairy products
Shenyang Mengniu Dairy Co., Ltd. (i) (ii) (瀋陽蒙牛乳業有限公司)	Registered capital	Mainland China	17%	17%	Trading of dairy products
Jinan Mengniu Dairy Co., Ltd. (i) (濟南蒙牛乳業有限公司)	Registered capital	Mainland China	38%	38%	Trading of dairy products
Taiyuan Mengniu Dairy Co., Ltd. (i) (太原市蒙牛乳業有限公司)	Registered capital	Mainland China	34%	33%	Trading of dairy products
Nanchang Mengniu Dairy Sales Co., Ltd. (i) (南昌蒙牛乳業銷售有限責任公司)	Registered capital	Mainland China	38%	38%	Trading of dairy products
Chongqing Mengniu Dairy Sales Co., Ltd. (i) (重慶市蒙牛乳業銷售有限公司)	Registered capital	Mainland China	38%	38%	Trading of dairy products
Hefei Mengniu Dairy Sales Co., Ltd. (i) (合肥市蒙牛乳業銷售有限公司)	Registered capital	Mainland China	38%	38%	Trading of dairy products

16. INTERESTS IN ASSOCIATES *(continued)*

Details of the Group's associates at 31 December 2007 are set out below: *(continued)*

Name	Particulars of issued shares held	Place of incorporation/ registration and operations	Percentage of equity interest attributable to the Group (indirect) 2007	2006	Principal activities
Shijiazhuang Jinmengyuan Trading Co., Ltd. (i) (石家莊金蒙源貿易有限責任公司)	Registered capital	Mainland China	38%	38%	Trading of dairy products
Beijing Mengniu Technical Development Co., Ltd. (i) (ii) (北京蒙牛科技發展有限公司)	Registered capital	Mainland China	17%	17%	Technical development
Wulumuqi Mengniu Dairy Sales Co., Ltd. (i) (烏魯木齊蒙牛乳業銷售有限公司)	Registered capital	Mainland China	34%	34%	Trading of dairy products
Kunming Deluxe Commercial Trading Co., Ltd. (i) (昆明特侖蘇商貿有限公司)	Registered capital	Mainland China	38%	38%	Trading of dairy products
Changsha Mengniu Dairy Co., Ltd. (i) (長沙市蒙牛乳業有限責任公司)	Registered capital	Mainland China	34%	34%	Trading of dairy products
Xi'an Mengniu Dairy Sales Co., Ltd. (i) (西安蒙牛乳業銷售有限公司)	Registered capital	Mainland China	39%	39%	Trading of dairy products
Changchun Mengniu Dairy Sales Co., Ltd. (i) (長春蒙牛乳品銷售有限公司)	Registered capital	Mainland China	38%	38%	Trading of dairy products
Xuzhou Mengniu Dairy Sales Co., Ltd. (i) (徐州蒙牛乳業銷售有限公司)	Registered capital	Mainland China	34%	34%	Trading of dairy products
Foshan Mengniu Dairy Sales Co., Ltd. (i) (佛山市蒙牛乳業銷售有限公司)	Registered capital	Mainland China	38%	38%	Trading of dairy products
Guiyang Mengniu Dairy Trading Co., Ltd. (i) (貴陽蒙牛乳業貿易有限公司)	Registered capital	Mainland China	38%	38%	Trading of dairy products

16. INTERESTS IN ASSOCIATES *(continued)*

Details of the Group's associates at 31 December 2007 are set out below: *(continued)*

Name	Particulars of issued shares held	Place of incorporation/ registration and operations	Percentage of equity interest attributable to the Group (indirect) 2007	2006	Principal activities
Shengyang Mengniu Dairy Sales Co., Ltd. (i) (ii) (瀋陽蒙牛乳業銷售有限公司)	Registered capital	Mainland China	17%	17%	Trading of dairy products
Xiangfan Mengniu Dairy Sales Co., Ltd. (i) (襄樊市蒙牛乳業銷售有限公司)	Registered capital	Mainland China	41%	34%	Trading of dairy products
Hangzhou Mengniu Dairy Trading Co., Ltd. (i) (杭州蒙牛貿易有限公司)	Registered capital	Mainland China	38%	38%	Trading of dairy products
Suzhou Mengniu Dairy Sales Co., Ltd. (i) (蘇州蒙牛乳製品銷售有限公司)	Registered capital	Mainland China	38%	38%	Trading of dairy products
Guangzhou Mengniu Dairy Sales Co., Ltd. (i) (廣州市蒙牛乳業銷售有限公司)	Registered capital	Mainland China	26%	26%	Trading of dairy products
Shanghai Mengniu Food Sales Co., Ltd. (i) (上海蒙牛食品銷售有限公司)	Registered capital	Mainland China	38%	38%	Trading of dairy products
Shenzhen Mengniu Dairy Sales Co., Ltd. (i) (深圳蒙牛乳業銷售有限公司)	Registered capital	Mainland China	34%	–	Trading of dairy products
Hohhot Menglai Trading Co., Ltd. (i) (呼和浩特市蒙萊商貿有限責任公司)	Registered capital	Mainland China	38%	–	Trading of dairy products
Cangzhou Mengniu Dairy Sales Co., Ltd. (i) (滄州市蒙牛乳業銷售有限公司)	Registered capital	Mainland China	38%	–	Trading of dairy products

(i) Not audited by Ernst & Young Hong Kong or other member firm of the Ernst & Young global network.

(ii) Since more than 20% of the equity interest of the associate was held by Inner Mongolia Mengniu Dairy (Group) Company Limited, in which the Company held an 84.32% equity interest, the Company had significant influence over the associate even with less than 20% of equity interest held indirectly as at the balance sheet date.

16. INTERESTS IN ASSOCIATES *(continued)*

The following table illustrates the summarised financial information of the Group's associates extracted from their unaudited management accounts:

	2007 RMB'000	2006 RMB'000
Share of the associates' assets and liabilities:		
Current assets	**148,778**	125,335
Non-current assets	**81,430**	72,816
Current liabilities	**(134,305)**	(117,443)
Non-current liabilities	**(38,330)**	(40,337)
Net assets	**57,573**	40,371
Share of the associates' revenues and profits and losses:		
Revenues	**1,494,631**	1,075,167
Profits and losses	**20,954**	8,384

17. INTEREST IN A JOINTLY CONTROLLED ENTITY

Details of the Company's jointly controlled entity are set out below:

Name	Particulars of issued shares held	Place of establishment and operations	Percentage of equity interests attributable to the Group (indirect) 2007	2006	Principal activities
Mengniu Arla (Inner Mongolia) Dairy Products Co. Ltd. (i) (內蒙古蒙牛阿拉乳製品有限責任公司)	Registered capital	Mainland China	42.16%	42.16%	Manufacture and sale of dairy products

(i) Not audited by Ernst & Young Hong Kong or other member firm of the Ernst & Young global network.

17. INTEREST IN A JOINTLY CONTROLLED ENTITY *(continued)*

The share of the assets, liabilities, income and expenses of the jointly controlled entity at 31 December 2007 and for the year then ended, which is included in the consolidated financial statements, is as follows:

	2007	2006
	RMB'000	*RMB'000*
Share of the assets and liabilities:		
Current assets	**54,825**	40,077
Non-current assets	**193,819**	78,700
Current liabilities	**(125,460)**	(33,645)
Non-current liabilities	**(40,000)**	–
Net assets	**83,184**	85,132
Share of the revenue and loss:		
Revenue	**164,181**	49,178
Cost of sales and operating expenses	**(196,213)**	(54,098)
Loss	**(32,032)**	(4,920)

18. AVAILABLE-FOR-SALE INVESTMENTS

	Group	
	2007	2006
	RMB'000	*RMB'000*
Unlisted equity investments, at cost	**17,316**	15,316

19. GOODWILL

	Group	
	2007	2006
	RMB'000	*RMB'000*
Carrying amount at 1 January	**115,549**	115,549
Acquisition of a minority interest (note)	**83,594**	–
Carrying amount at 31 December	**199,143**	115,549

Note: On 3 April 2007, the Group entered into an agreement to acquire a 48% equity interest in Mengniu (Wuhan) Frealth Dairy Co., Ltd. ("Mengniu Wuhan") from a minority shareholder at a consideration of RMB134,400,000. The acquisition gave rise to goodwill of RMB83,594,000. After the acquisition, Mengniu Wuhan became a wholly-owned subsidiary of Inner Mongolia Mengniu Dairy (Group) Company Limited. Details of the acquisition were disclosed in the Company's announcement dated 4 April 2007.

19. GOODWILL *(continued)*

Goodwill acquired through business combinations has been allocated to the following cash-generating units (the "CGUs"), which are reportable segments, for impairment testing:

– liquid milk products CGU;

– ice cream products CGU; and

– other dairy products CGU.

The recoverable amount of each CGU has been determined based on a value in use calculation using cash flow projections based on financial budgets or forecasts approved by senior management covering a five-year period. The growth rates used to extrapolate the cash flows beyond the five-year period are based on the estimated growth rate of each unit taking into account of the industry growth rate, past experience and the medium or long term growth target of each CGU. The growth rates for these CGUs are higher than the respective average industry growth rates. Senior management believes such growth rates are justified because:

– the growth rates of these CGUs have significantly exceeded those in the market in the past years;

– the new product launch and new market expansion have been successful in the past;

– strong brand equity and marketing capability contributing to the continuous growth in market share in past years; and

– expertise on product innovation, portfolio enhancement and marketing will be further leveraged.

The discount rates applied to cash flow projections and the growth rates used to extrapolate cash flows beyond the five-year period are as follows:

	Discount rate		**Growth rate**	
	2007	2006	**2007**	2006
Liquid milk products CGU	**10.8%**	12.9%	**6.0%**	8.0%
Ice cream products CGU	**10.8%**	12.9%	**3.0%**	5.0%
Other dairy products CGU	**10.8%**	12.9%	**6.0%**	6.0%

The carrying amounts of goodwill of approximately RMB199,143,000 (2006: RMB115,549,000) at 31 December 2007 allocated to the liquid milk products CGU, ice cream products CGU and other dairy products CGU were approximately RMB167,433,000 (2006: RMB83,839,000), RMB23,865,000 (2006: RMB23,865,000) and RMB7,845,000 (2006: RMB7,845,000), respectively.

Key assumptions were used in the value in use calculation of each CGU. The following describes each key assumption on which management has based its cash flow projections to undertake impairment testing of goodwill:

(a) Budgeted gross margins – The basis used to determine the value assigned to the budgeted gross margins is the average gross margins achieved in the year immediately before the budget year, adjusted for expected efficiency improvements and expected increase in production costs.

(b) Discount rates – The discount rates used are before tax and reflect specific risks relating to the relevant CGUs.

(c) Raw materials price inflation – Reference is made to the actual past year data of countries from where raw materials are sourced. The values assigned to key assumptions are consistent with external information sources.

20. DEFERRED TAX ASSETS

	Group	
	2007	2006
	RMB'000	*RMB'000*
At 1 January	**–**	–
Deferred tax credited to the consolidated income statement during the year (note 8)	**6,302**	–
Gross deferred tax assets at 31 December	**6,302**	–

Deferred tax assets at 31 December 2007 were resulted from un-invoiced accruals.

Deferred tax assets have not been recognised in respect of the following items:

	Group	
	2007	2006
	RMB'000	*RMB'000*
Tax losses arising in Mainland China (i)	**41,501**	2,174
Tax credits related to purchases of domestic equipment (ii)	**88,814**	27,481
Temporary differences	**203,057**	141,707
	333,372	171,362

(i) Tax losses can be carried forward over five years to offset the future taxable profit.

(ii) Tax credits can be carried forward over five to seven years to offset the tax payables if the future year tax exceeded the base year tax.

There are no income tax consequences attaching to the payment of dividends by the Company to its shareholders.

Except for the amount disclosed above, the Group and the Company did not have any material unrecognised deferred tax liabilities or deferred tax assets at 31 December 2007.

21. OTHER FINANCIAL ASSETS

Other financial assets represented entrusted loans to certain dairy farmers via a bank. A maturity analysis of the entrusted loans of the Group is as follows:

	Group	
	2007	2006
	RMB'000	*RMB'000*
Within 1 year	**16,728**	–
1 to 2 years	**6,692**	–
2 to 3 years	**8,742**	–
Over 3 years	**5,705**	–
Total entrusted loans	**37,867**	–
Less: Amount due within one year included in current assets under other receivables	**(16,728)**	–
	21,139	–

The annual interest rates of the entrusted loans varied from 6.0% to 7.2%.

22. INVENTORIES

	Group	
	2007	2006
	RMB'000	*RMB'000*
Raw materials	**486,056**	520,050
Finished goods	**391,387**	551,410
	877,443	1,071,460

23. BILLS RECEIVABLE

An aged analysis of the bills receivable as at the balance sheet date, based on the invoice date, is as follows:

	Group	
	2007	2006
	RMB'000	*RMB'000*
Within 3 months	**114,832**	125,140
4 to 6 months	**50**	2,953
	114,882	128,093

As at 31 December 2007, the bills receivable amounting to approximately RMB77,250,000 (2006: RMB119,400,000) were factored with recourse to financial institutions. The corresponding amount was recorded as short term bank loans (note 30).

The amounts due from associates of approximately RMB12,069,000 (2006: nil) are included in the above balances.

24. TRADE RECEIVABLES

	Group	
	2007	2006
	RMB'000	*RMB'000*
Trade receivables	**265,187**	198,637
Impairment	**(3,822)**	(11,661)
	261,365	186,976

The Group normally allows a credit period of not more than 30 days to its customers. The Group closely monitors overdue balances. In view of the aforementioned and that the Group's trade receivables relate to a large number of diversified customers, there is no significant concentration of credit risk. The trade receivables are non-interest-bearing.

An aged analysis of the trade receivables of the Group, net of provision for doubtful debts, based on the invoice date, is as follows:

	Group	
	2007	2006
	RMB'000	*RMB'000*
Within 3 months	**226,011**	163,944
4 to 6 months	**24,136**	20,453
7 to 12 months	**10,828**	2,104
Over 1 year	**390**	475
	261,365	186,976

The movements in provision for impairment of trade receivables are as follows:

	Group	
	2007	2006
	RMB'000	*RMB'000*
At 1 January	**11,661**	8,860
Impairment losses recognised	**476**	4,306
Amount written off as uncollectible	**(33)**	(1,505)
Impairment losses reversed	**(8,282)**	–
At 31 December	**3,822**	11,661

The aged analysis of the trade receivables that are not considered to be impaired is as follows:

	Group	
	2007	2006
	RMB'000	*RMB'000*
Neither past due nor impaired	**234,144**	177,121
Past due but not impaired		
Within 3 months	**21,437**	1,293
	255,581	178,414

Receivables that were neither past due nor impaired relate to a large number of diversified customers for whom there was no recent history of default.

24. TRADE RECEIVABLES *(continued)*

Receivables that were past due but not impaired relate to a number of independent customers that have a good track record with the Group. Based on past experience, the directors of the Company are of the opinion that no provision for impairment is necessary in respect of these balances as there has not been a significant change in credit quality and the balances are still considered fully recoverable. The Group does not hold any collateral or other credit enhancements over these balances.

The amounts due from associates of approximately RMB82,480,000 (2006: RMB66,459,000) and an amount due from a jointly controlled entity of approximately RMB4,847,000 (2006: RMB1,973,000) are included in the above balances. These balances are unsecured, non-interest-bearing and are repayable on credit terms similar to those offered to other major customers of the Group.

25. PREPAYMENTS AND DEPOSITS

	Group	
	2007	2006
	RMB'000	*RMB'000*
Deposits	**1,869**	4,810
Prepayments	**207,731**	154,690
Land use rights – current portion (note 14)	**4,764**	2,620
	214,364	162,120

The amount due to an associate of approximately RMB2,639,000 (2006: RMB805,000) is included in the above balances.

26. CASH AND BANK BALANCES AND PLEDGED DEPOSITS

	Group	
	2007	2006
	RMB'000	*RMB'000*
Cash and cash equivalents	**1,756,818**	1,180,058
Pledged deposits	**44,506**	45,071
Time deposits with original maturity of more than three months	**454,000**	150,000
	2,255,324	1,375,129
Less: Deposits pledged for banking facilities (note 28)	**(44,506)**	(45,071)
Cash and bank balances	**2,210,818**	1,330,058

	Company	
	2007	2006
	RMB'000	*RMB'000*
Cash and bank balances	**737,085**	11,403

Cash at banks earns interest at floating rates based on daily bank deposit rates. The bank balances and pledged deposits are deposited with creditworthy banks with no recent history of default. Cash and bank balances amounting to approximately RMB1,481,977,000 (2006: RMB1,358,807,000) were denominated in Renminbi, which is not freely convertible in the international foreign exchange market and its exchange rate is determined by the People's Bank of China.

27. TRADE PAYABLES

An aged analysis of the trade payables of the Group, based on the invoice date, is as follows:

	Group	
	2007	2006
	RMB'000	*RMB'000*
Within 3 months	**1,238,629**	971,494
4 to 6 months	**65,590**	51,696
7 to 12 months	**7,904**	5,623
Over 1 year	**3,272**	5,886
	1,315,395	1,034,699

An amount due to an associate of approximately RMB1,924,000 (2006: RMB4,872,000) is included in the above balances. The balance is unsecured, non-interest-bearing and repayable on demand.

The Group's trade payables are unsecured and non-interest-bearing.

28. BILLS PAYABLE

An aged analysis of the bills payable of the Group, based on the invoice date, is as follows:

	Group	
	2007	2006
	RMB'000	*RMB'000*
Within 3 months	**164,684**	221,527
4 to 6 months	**94,381**	102,209
	259,065	323,736

Except for an aggregate balance of approximately RMB74,038,000 (2006: RMB152,902,000) secured by the pledge of certain of the Group's deposits amounting to approximately RMB15,341,000 (2006: RMB36,438,000) (note 26), bills payables are unsecured. The above balances are non-interest-bearing.

29. ACCRUALS AND CUSTOMERS' DEPOSITS

	Group	
	2007	2006
	RMB'000	*RMB'000*
Advances from customers	**402,096**	274,141
Salary and welfare payables	**142,566**	132,596
	544,662	406,737

The amounts due to associates of approximately RMB69,155,000 (2006: RMB52,206,000) are included in the above balances. The balances are unsecured, non-interest-bearing and are repayable on demand.

30. INTEREST-BEARING BANK LOANS

		Group			
		2007		2006	
	Maturity	**Fixed rate**	**Floating rate**	Fixed rate	Floating rate
		RMB'000	***RMB'000***	*RMB'000*	*RMB'000*
Short term bank loans, secured	2008	**77,250**	**–**	119,400	–
Short term bank loans, unsecured	2008	**72,305**	**33,601**	72,000	42,622
Long term bank loans, unsecured	2009-2010	**–**	**80,000**	–	641,136
		149,555	**113,601**	191,400	683,758

		Company			
		2007		2006	
	Maturity	**Fixed rate**	**Floating rate**	Fixed rate	Floating rate
		RMB'000	***RMB'000***	*RMB'000*	*RMB'000*
Short term bank loans, unsecured	2007	**–**	**–**	–	6,622
Long term bank loans, unsecured	2008-2009	**–**	**–**	–	157,432
		–	**–**	–	164,054

At 31 December 2007, short term bank loans of approximately RMB77,250,000 (2006: RMB119,400,000) were secured by certain bills receivable of the Group (note 23).

During the year, the annual interest rates of the short term bank loans and the long term bank loans varied from 3.00% to 6.48% and from 3.00% to 6.90% (2006: varied from 3.00% to 5.81% and from 3.00% to 6.65%), respectively. As at 31 December 2007, except for a short term bank loan of US$5,600,000 equivalent to approximately RMB40,906,000 (2006: US$33,000,000) denominated in United States dollars, all the Group's interest-bearing bank loans were denominated in RMB.

The repayment schedule of the bank loans is as follows:

	Group	
	2007	2006
	RMB'000	RMB'000
Within 1 year	**183,156**	234,022
1 to 2 years	**20,000**	399,630
2 to 5 years	**60,000**	241,506
Total interest-bearing bank loans	**263,156**	875,158
Less: Amount due within 1 year included in current liabilities	**(183,156)**	(234,022)
	80,000	641,136

30. INTEREST-BEARING BANK LOANS *(continued)*

	Company	
	2007	2006
	RMB'000	*RMB'000*
Within 1 year	–	6,622
1 to 2 years	–	69,970
2 to 5 years	–	87,462
Total interest-bearing bank loans	–	164,054
Less: Amount due within 1 year included in current liabilities	–	(6,622)
	–	157,432

31. OTHER LOANS

	Group	
	2007	2006
	RMB'000	*RMB'000*
Short term, unsecured	**36,004**	31,000

The other loans represented unsecured and interest-free loans from various local government authorities to support the Group's establishment of production plants in various locations in the PRC.

32. LONG TERM PAYABLES

The Group's long term payables represent the amortised costs of the outstanding instalment payable for the purchase of production equipment. The effective interest rate used for the amortisation is the prevailing market interest rate. The balances are repayable as follows:

	Group	
	2007	2006
	RMB'000	*RMB'000*
Within 1 year	**171,939**	201,423
1 – 2 years	**141,609**	122,889
2 – 5 years	**82,583**	164,862
Over 5 years	–	4,359
Total long term payables	**396,131**	493,533
Less: Amount due within 1 year included in current liabilities under other payables	**(171,939)**	(201,423)
	224,192	292,110

Certain long term payables are secured by the Group's property, plant and equipment (note 11(b)).

33. DEFERRED INCOME

Various local government authorities have granted certain property, plant and equipment to the Group for nil consideration and provided finance to the Group to purchase certain property, plant and equipment by way of a cash donation. Both the property, plant and equipment and grants are recorded initially at fair value. The grants received are regarded as deferred income, which is amortised to match the depreciation charge of such property, plant and equipment granted or purchased in accordance with their estimated useful lives. Movements of the balances during the year are as follows:

	Group	
	2007	2006
	RMB'000	*RMB'000*
At beginning of year	**128,388**	60,081
Received during the year	**73,173**	72,912
Amortisation during the year	**(10,816)**	(4,605)
At end of year	**190,745**	128,388
Current portion	**11,752**	7,889
Non-current portion	**178,993**	120,499
	190,745	128,388

34. SHARE CAPITAL

	2007	2006
	RMB'000	*RMB'000*
Authorised:		
3,000,000,000 ordinary shares of HK$0.1 each	**319,235**	319,235

	Notes	**Number of ordinary shares** *'000*	*RMB'000*
Issued and fully paid:			
At 1 January 2006 and 1 January 2007		1,368,416	145,573
Issue of shares	(a)	57,460	5,682
Shares issued under employee share option scheme	(b)	244	22
At 31 December 2007		1,426,120	151,277

Notes:

(a) On 26 April 2007, the Company completed the placing of 57,460,000 new shares of the Company with a par value of HK$0.1 each at the placing price of HK$24 (equivalent to RMB23.73) per share, resulting in proceeds, net of share issue expenses, of approximately HK$1,363,404,000 (equivalent to approximately RMB1,348,229,000). The placing gave rise to a share premium of HK$1,357,658,000 (equivalent to approximately RMB1,342,547,000), being the excess of the gross proceeds less share issue expenses over the par value of the new shares issued of HK$5,746,000 (equivalent to approximately RMB5,682,000).

(b) Details of the Company's share option scheme and the share options issued under the scheme are included in note 37 to the financial statements.

35. RESERVES

(A) Group

Movements in the other reserves of the Group during the year are as follows:

	Share premium RMB'000	Contributed surplus RMB'000 Note (a)	Statutory reserves RMB'000 Note (b)	Currency translation differences RMB'000	Share option reserve RMB'000 Note 37	Total RMB'000
At 1 January 2006	1,127,581	204,677	286,099	(2,616)	–	1,615,741
Transfer to statutory reserves	–	–	208,964	–	–	208,964
Currency translation differences	–	–	–	4,313	–	4,313
Additional equity contributed by a minority shareholder	–	27,343	–	–	–	27,343
Equity-settled share option arrangements	–	–	–	–	3,108	3,108
At 1 January 2007	**1,127,581**	**232,020**	**495,063**	**1,697**	**3,108**	**1,859,469**
Issue of shares	**1,342,547**	**–**	**–**	**–**	**–**	**1,342,547**
Transfer to statutory reserves	**–**	**–**	**225,855**	**–**	**–**	**225,855**
Shares issued under equity-settled share option arrangements	**3,044**	**–**	**–**	**–**	**–**	**3,044**
Currency translation differences	**–**	**–**	**–**	**(57,529)**	**–**	**(57,529)**
Equity-settled share option arrangements	**–**	**–**	**–**	**–**	**39,233**	**39,233**
At 31 December 2007	**2,473,172**	**232,020**	**720,918**	**(55,832)**	**42,341**	**3,412,619**

35. RESERVES *(continued)*

(B) Company

Movements in the reserves of the Company during the year are as follows:

	Share premium	Contributed surplus	Currency translation differences	Retained earnings	Share option reserve	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
		Note (a)			Note 37	
At 1 January 2006	1,127,581	387,574	(199)	1,090	–	1,516,046
Profit for the year (note (d))	–	–	–	144,277	–	144,277
Dividends paid	–	–	–	(93,873)	–	(93,873)
Currency translation differences	–	–	3,563	–	–	3,563
Equity-settled share option arrangements	–	–	–	–	3,108	3,108
At 1 January 2007	**1,127,581**	**387,574**	**3,364**	**51,494**	**3,108**	**1,573,121**
Profit for the year (note (d))	**–**	**–**	**–**	**210,743**	**–**	**210,743**
Dividends paid	**–**	**–**	**–**	**(156,020)**	**–**	**(156,020)**
Issue of shares	**1,342,547**	**–**	**–**	**–**	**–**	**1,342,547**
Shares issued under equity-settled share option arrangements	**3,044**	**–**	**–**	**–**	**–**	**3,044**
Equity-settled share option arrangements	**–**	**–**	**–**	**–**	**39,233**	**39,233**
Currency translation differences	**–**	**–**	**(271,377)**	**–**	**–**	**(271,377)**
At 31 December 2007	**2,473,172**	**387,574**	**(268,013)**	**106,217**	**42,341**	**2,741,291**

Notes:

(a) Contributed surplus

The opening balance as at 1 January 2006 of the contributed surplus of the Group represents the difference between the nominal value of the share capital of the subsidiaries acquired pursuant to the group reorganisation over the nominal value of the shares of the Company issued in exchange therefor.

The contributed surplus of the Company represents the difference between the then combined net asset value of the subsidiaries acquired pursuant to the group reorganisation over the nominal value of the shares of the Company issued in exchange therefor.

During the year ended 31 December 2006, a minority shareholder injected additional capital to a subsidiary of the Group. The excess of the amount of capital injected by the minority shareholder over its additional interest in the subsidiary's net assets attributable to the Company's equity holders was recorded as contributed surplus of the Group.

35. RESERVES *(continued)*

(B) Company *(continued)*

Notes: *(continued)*

(b) Statutory reserves

In accordance with the relevant PRC laws and regulations, the PRC domestic companies are required to transfer 10% of their profit after income tax, as determined under the PRC accounting standards and financial regulations, to the statutory common reserve. Subject to certain restrictions as set out in the relevant PRC laws and regulations, the statutory common reserve may be used to offset against the accumulated losses, if any.

(c) Distributable reserves

Under the Companies Law (2001 Second Revision) of the Cayman Islands, the share premium and contributed surplus of the Company are distributable to shareholders, provided that immediately following the distribution of the dividend, the Company is able to pay off its debts as and when they fall due in the ordinary course of business. As at 31 December 2007, the Company's reserves available for distribution to shareholders amounted to approximately RMB2,966,963,000 (2006: RMB1,566,649,000).

(d) The profit attributable to equity holders of the Company for the year ended 31 December 2007 dealt with in the financial statements of the Company was RMB210,743,000 (2006: RMB144,277,000), including the dividend income from subsidiaries amounting to approximately RMB192,079,000 (2006: RMB152,408,000).

36. NON-CASH TRANSACTIONS

During the year, the Group purchased property, plant and equipment by means of long term payables amounting to approximately RMB150, 685,000 (2006: RMB217,313,000).

37. SHARE-BASED PAYMENT PLAN

The Company operates a share option scheme (the "Scheme") for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operations. Eligible participants of the Scheme include the Company's directors, including independent non-executive directors, other employees of the Group, suppliers of goods or services to the Group, customers and any person or entity that provides research, development or technological support to the Group. The Scheme became effective on 28 June 2005 and, unless otherwise cancelled or amended, will remain in force for 10 years from that date.

The maximum number of shares in respect of share options currently permitted to be granted under the Scheme is an amount equivalent, upon their exercise, to 10% of the total number of shares of the Company in issue as at 28 June 2005, which is approximately 136,842,000 shares. The maximum number of shares issuable under share options to each eligible participant in the Scheme within any 12-month period is limited to 1% of the total shares of the Company in issue at any time. Any further grant of share options in excess of these limits is subject to shareholders' approval in a general meeting.

Share options granted to a director, chief executive or substantial shareholder of the Company, or to any of their associates, are subject to approval in advance by the independent non-executive directors. In addition, any share options granted to a substantial shareholder or an independent non-executive director of the Company, or to any of their associates, in excess of 0.1% of the shares of the Company in issue at any time or with an aggregate value (based on the closing price of the Company's shares at the date of grant) in excess of HK$5,000,000, within any 12-month period, are subject to shareholders' approval in advance in a general meeting.

37. SHARE-BASED PAYMENT PLAN *(continued)*

The offer of a grant of share options may be accepted within 20 business days from the date of offer, upon payment of a consideration of HK$1 in total by the grantee. The exercise period of the share options granted is determinable by the directors, and commences after a certain vesting period and ends on a date which is not later than six years from the date of offer of the share options or the expiry date of the Scheme, if earlier.

The exercise price of share options is determinable by the directors, but may not be less than the highest of (i) The Stock Exchange of Hong Kong Limited (the "Stock Exchange") closing price of the Company's shares on the offer date of the share options; (ii) the average Stock Exchange closing price of the Company's shares for the five business days immediately preceding the offer date; and (iii) the nominal value of the shares.

Share options do not confer rights on the holders to dividends or to vote at shareholders' meetings.

Particulars of share options

Date of grant	Exercise period of share options (both dates inclusive)	Exercise price per share option
		(HK$)
26 October 2006	26 October 2007 to 25 October 2012 (a)	13.40
9 November 2007	9 November 2009 to 8 November 2013 (b)	32.24

(a) The share options will vest in four equal batches with 25% of the share options granted vesting on the first, second, third and forth anniversary of the date of grant and accordingly, grantees have to remain in service of the Group for at least a period of four years from the date of grant in order to exercise the share options granted to them in full. In addition, the share options will only be vested if and when the pre-set performance targets of the Group, the division of the grantee and the grantee are achieved. Unless all of these targets are met, the share options will lapse.

(b) The share options will vest in two equal batches with 50% of the share options granted vesting on the second and third anniversary of the date of grant and accordingly, grantees have to remain in service of the Group for at least a period of three years from the date of grant in order to exercise the share options granted to them in full. In addition, the share options will only be vested if and when the pre-set performance targets of the Group, the division of the grantee and the grantee are achieved. Unless all of these targets are met, the share options will lapse.

37. SHARE-BASED PAYMENT PLAN *(continued)*

Particulars of share options *(continued)*

(c) The exercise price per share option was the average closing share price for the five business days immediately preceding the grant date.

Movements of share options

2007

Date of grant	As at 1 January 2007	Granted during the year	Exercised during the year	Lapsed during the year	As at 31 December 2007
26 October 2006	**6,803,000**	**–**	**(244,351)**	**(304,088)**	**6,254,561**
9 November 2007	**–**	**44,605,000**	**–**	**–**	**44,605,000**
Total	**6,803,000**	**44,605,000**	**(244,351)**	**(304,088)**	**50,859,561**

2006

Date of grant	As at 1 January 2006	Granted during the year	Exercised during the year	Lapsed during the year	As at 31 December 2006
26 October 2006	–	6,803,000	–	–	6,803,000

The average fair value of the share options granted during the year is estimated to be RMB9.76 each (2006: RMB4.85) at the grant date, using a binomial model, taking into account the terms and conditions upon which the instruments were granted. The contractual life of each option granted is six years. There are no cash settlement alternatives. The Group recognised an expense of RMB39,233,000 (note 5 and note 6) during the year ended 31 December 2007 (2006: RMB3,108,000).

The following table lists the inputs to the model used:

	2007	2006
Dividend yield (%)	**1.0**	1.0
Expected volatility (%)	**35**	38
Risk-free interest rate (%)	**3.1**	3.9
Expected life of option (years)	**6**	5-5.5
Spot price (HK$)	**31.90**	13.38
Exercise price (HK$)	**32.24**	13.40

37. SHARE-BASED PAYMENT PLAN *(continued)*

Movements of share options *(continued)*

In light of the lack of an historical exercise record, the expected life of the options is based on the results of empirical studies performed in the United States and is not necessarily indicative of exercise patterns that may occur. The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may also not necessarily be the actual outcome. The spot price is the closing price of the Company's shares at the grant date. The exercise price is the average closing share price for the five business days immediately preceding the grant date.

The 244,351 share options exercised during the year resulted in the issue of 244,351 ordinary shares of the Company and new share capital of RMB22,000 and share premium of RMB3,044,000, as further detailed in note 34 to the financial statements. The weighted average share price at the date of exercise for these options was HK$32.4.

At the balance sheet date, the Company had 1,384,061 share options being vested outstanding under the Scheme. The exercise in full of the remaining share options would, under the present capital structure of the Company, result in the issue of 1,384,061 additional ordinary shares of the Company and additional share capital of RMB130,000 and share premium of RMB17,237,000 (before issue expenses).

38. COMMITMENTS

(a) Capital commitments

The Group had the following outstanding capital commitments in respect of the purchase and construction of property, plant and equipment as at the balance sheet date:

	Group	
	2007	2006
	RMB'000	*RMB'000*
Contracted, but not provided for	**303,454**	613,660

Included in the above amount, the commitments of approximately RMB9,287,000 (2006: RMB55,675,000) were in relation to the Group's share of a jointly controlled entity's own capital commitments.

Subsequent to the balance sheet date, the board of directors approved the capital expenditure (not contracted for) amounting to approximately RMB791,815,000 (2006: RMB1,190,000,000), out of which approximately RMB14,900,000 (2006: RMB155,000,000) was related to the Group's interest in a jointly controlled entity.

38. COMMITMENTS *(continued)*

(b) Operating lease commitments

At the balance sheet date, the Group had total future minimum lease payments under non-cancellable operating leases in respect of buildings and certain production equipment as follows:

	Group	
	2007 *RMB'000*	2006 *RMB'000*
Within one year	**6,381**	9,333
In the second to fifth years, inclusive	**11,956**	21,014
Over five years	**5,703**	–
	24,040	30,347

The Company did not have any significant commitments at the balance sheet date.

39. CONTINGENT LIABILITIES

The Group is contingently liable in respect of loan guarantees granted to certain banks in favour of certain suppliers of raw milk (the "Suppliers"). The amount of guarantees granted as at 31 December 2007 was approximately RMB109,800,000 (2006: RMB153,976,000). Approximately RMB89,800,000 (2006: RMB140,976,000) of the above guarantees are cross-guaranteed and secured by assets owned by these suppliers who are independent third parties. Securities under these counter-guarantees included property, dairy cattle and other assets owned by the Suppliers.

The Company did not have any significant contingent liabilities at the balance sheet date.

40. FAIR VALUES OF FINANCIAL INSTRUMENTS

The carrying amounts of the Group's financial assets and liabilities (which are classified as current assets and liabilities) approximated to their fair values at 31 December 2007 because of the short maturity of these instruments.

The carrying amounts of the Group's long term interest-bearing borrowings approximated to their fair values based on borrowing rates currently charged for loans with similar terms and maturities.

The carrying amounts of the Group's long term payables approximated to their fair values based on the implicit interest rate currently used to arrive at the cash price for purchase on normal credit terms.

41. RELATED PARTY TRANSACTIONS

In addition to the transactions and balances which are disclosed elsewhere in these financial statements, the Group had the following significant transactions with its associates, a jointly controlled entity and other related parties.

			Group	
			2007	2006
		Notes	***RMB'000***	*RMB'000*
(a)	Sales of liquid milk products to associates	(i)	**3,034,343**	2,293,796
(b)	Sales of ice cream products to associates	(i)	**121,564**	120,350
(c)	Sales of other dairy products to associates	(i)	**2,033**	661
(d)	Purchase of raw materials from an associate	(i)	**(107,078)**	(64,139)
(e)	Sale of raw materials to a jointly controlled entity	(ii)	**30,691**	48,969
(f)	Purchase of other dairy products from a jointly controlled entity	(i)	**–**	(1,517)
(g)	Purchase of ice cream products from an associate	(i)	**(60,436)**	(22,610)
(h)	Sale of property, plant and equipment to a jointly controlled entity	(iii)	**2,881**	58,776
(i)	Transfer of receivables to a jointly controlled entity	(iv)	**–**	41,104
(j)	Transfer of payables to a jointly controlled entity	(iv)	**–**	(2,337)

Notes:

(i) The considerations were determined with reference to the then prevailing market prices/rates and the prices charged to third parties.

(ii) Such transaction was conducted at cost, which approximated to the prevailing market price of the materials.

(iii) The sales price was determined by reference to the valuation performed by an external valuer.

(iv) The cash considerations were determined based on the carrying amounts of the assets and liabilities transferred on the transaction dates.

(v) The above transactions did not constitute connected transactions as defined in the Listing Rules.

(vi) Key management compensation is detailed in note 6 to the financial statements.

42. FINANCIAL INSTRUMENTS BY CATEGORY

The carrying amounts of each of the categories of financial instruments as at the balance sheet date are as follows:

Financial assets

	Group					
	2007			2006		
	Loans and receivables	Available-for-sale financial assets	Total	Loans and receivables	Available-for-sale financial assets	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Available-for-sale investments	**–**	**17,316**	**17,316**	–	15,316	15,316
Bills receivable	**114,882**	**–**	**114,882**	128,093	–	128,093
Trade receivables	**261,365**	**–**	**261,365**	186,976	–	186,976
Other receivables	**40,198**	**–**	**40,198**	18,386	–	18,386
Other financial assets	**21,139**	**–**	**21,139**	–	–	–
Pledged deposits	**44,506**	**–**	**44,506**	45,071	–	45,071
Cash and bank balances	**2,210,818**	**–**	**2,210,818**	1,330,058	–	1,330,058
	2,692,908	**17,316**	**2,710,224**	1,708,584	15,316	1,723,900

Financial liabilities

	2007 Financial liabilities at amortised cost	2006 Financial liabilities at amortised cost
	RMB'000	*RMB'000*
Trade payables	**1,315,395**	1,034,699
Bills payable	**259,065**	323,736
Other payables	**1,013,171**	1,033,066
Interest-bearing bank loans	**263,156**	875,158
Other loans	**36,004**	31,000
Long term payables	**224,192**	292,110
	3,110,983	3,589,769

42. FINANCIAL INSTRUMENTS BY CATEGORY *(continued)*

The carrying amounts of each of the categories of financial instruments as at balance sheet date are as follows:

Financial assets

	Company	
	2007	2006
	Loans and receivables	Loans and receivables
	RMB'000	*RMB'000*
Loan to a subsidiary included in interests in subsidiaries (note 15)	**855,945**	972,419
Financial assets included in prepayments, deposits and other receivables	**281,151**	95
Cash and cash equivalents	**737,085**	11,403
	1,874,181	983,917

Financial liabilities

	2007	2006
	Financial liabilities at amortised cost	Financial liabilities at amortised cost
	RMB'000	*RMB'000*
Financial liabilities included in accruals and other payables	**1,665**	4,305
Interest-bearing bank loans	**–**	164,054
	1,665	168,359

43. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

Capital management

The primary objective of the Group's capital management is to safeguard the Group's ability to continue as a going concern and to maintain healthy capital ratios in order to support its business and maximise shareholder value.

The Group manages its capital structure and makes adjustments to it, in light of changes in economic conditions. To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, return capital to shareholders or issue new shares. No changes were made in the objectives, policies or processes during the years ended 31 December 2007 and 31 December 2006.

The Group monitors capital using a gearing ratio, which is net debt divided by the total capital plus net debt. The Group's policy is to maintain the gearing ratio between 20% and 50% normally. Net debt includes interest-bearing bank loans, trade, bills and other payables, accruals, less cash and bank balances, and excludes discontinued operations. Capital represents equity attributable to equity holders of the Company. The gearing ratios as at the balance sheet dates were as follows:

Group

	2007	2006
	RMB'000	*RMB'000*
Interest-bearing bank loans	**263,156**	875,158
Trade and bills payables	**1,574,460**	1,358,435
Accruals and customer's deposits	**544,662**	406,737
Other payables	**1,013,171**	1,033,066
Other loans	**36,004**	31,000
Income tax payable	**185**	6,104
Long term payables	**224,192**	292,110
Less: Cash and bank balances	**(2,210,818)**	(1,330,058)
Net debt	**1,445,012**	2,672,552
Equity attributable to equity holders	**5,111,629**	2,998,864
Capital and net debt	**6,556,641**	5,671,476
Gearing ratio	**22%**	47%

43. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES *(continued)*

Financial risk management

The Group's principal financial instruments comprise cash and cash equivalents, trade receivables and payables, other receivables and payables, balances with related parties, interest-bearing bank loans, other loans and long term payables.

The main risks arising from the Group's financial instruments are interest rate risk, foreign currency risk, credit risk and liquidity risk. The board of directors and senior management meet periodically to analyse and formulate measures to manage the Group's exposure to those risks. Generally, the Group adopts reasonably prudent strategies on its risk management. As the Group's exposure to these risks is kept to a minimum, the Group has not used any derivatives and other instruments for hedging purposes. The Group does not hold or issue derivative financial instruments for trading purposes. The board of directors reviews and agrees policies for managing each of these risks and they are summarised below:

(i) Interest rate risk

The Group's income and operating cash flows are substantially independent of changes in market interest rates and the Group has no significant interest-bearing assets, other than cash at banks. The Group's exposure to the risk of changes in market interest rates relates primarily to the Group's borrowings with floating interest rates. The Group closely monitors its interest rate risk by performing periodic reviews and evaluations of its debt portfolio and gearing ratio. The interest rates and terms of repayment of the bank loans of the Group are disclosed in note 30 to the financial statements. In the opinion of the directors, the Group has no significant interest rate risk and has not used any interest rate swaps to hedge its exposure to interest rate risk.

The following table demonstrates the sensitivity to a reasonable possible change in interest rates, with all other variables held constant, of the Group's profit before tax (through the impact on floating rate borrowings):

	Group	
	Increase/ (decrease) in basis points	**Increase/ (decrease) in profit before tax**
	%	*RMB'000*
2007		
RMB	**5**	**(1,288)**
RMB	**(5)**	**1,288**
US dollar	**5**	**(460)**
US dollar	**(5)**	**460**
2006		
RMB	5	(1,848)
RMB	(5)	1,848
US dollar	5	(626)
US dollar	(5)	626

43. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES *(continued)*

Financial risk management *(continued)*

(ii) Foreign currency risk

The Group's businesses are principally located in Mainland China and substantially all transactions are conducted in RMB, except for the purchases of imported machinery and equipment and sales of dairy products to Hong Kong and Macau. As at 31 December 2007, substantially all of the Group's assets and liabilities were denominated in RMB except the cash and cash equivalents of approximately RMB36,048,000 (2006: RMB2,619,000) and RMB722,514,000 (2006: RMB13,703,000) which were denominated in United States dollars and Hong Kong dollars, respectively, and the interest-bearing bank loans of approximately RMB40,906,000 (2006: RMB257,759,000) and long term payables of approximately RMB309,822,000 (2006: RMB363,588,000) which were denominated in United States dollars. The fluctuation of the exchange rates of RMB against foreign currencies could affect the Group's results of operations. However, in the opinion of the directors, the foreign currency risk exposure is under management's control.

The following table demonstrates the sensitivity to a reasonably possible change in the RMB exchange rate, with all other variables held constant, of the Group's profit before tax (due to changes in the fair value of monetary assets and liabilities):

	Increase/ (decrease) in RMB rate	**Increase/(decrease) in profit before tax**
	%	*RMB'000*
2007	**5**	**1,941**
	(5)	**(1,941)**
2006	5	811
	(5)	(811)

(iii) Credit risk

The cash and bank balances, as well as the pledged deposits, of the Group are mainly deposited with state-owned commercial banks in Mainland China.

The majority of the Group's sales are conducted on a cash basis. The Group has implemented policies to ensure that sales of products are made to distributors, who wish to trade on credit terms, with an appropriate credit history which is subject to periodic reviews. Receivable balances are monitored on an ongoing basis and the Group's exposure to bad debts is not significant.

The credit risk of the Group's other financial assets, which comprise deposits and other receivables, arises from default of the counterparty, with a maximum exposure equal to the carrying amounts of these assets.

In addition, the Group's guarantees of the bank loans borrowed by certain suppliers of raw milk amounting to RMB109,800,000 (2006: RMB153,976,000) (note 39) represent the Group's other exposure to credit risk. RMB89,800,000 (2006: RMB140,976,000) of the above guarantees are cross-guaranteed and secured by assets owned by these suppliers.

Except for the above, the Group has no significant concentration of credit risk, with exposure spread over a number of counterparties.

Further quantitative data in respect of the Group's exposure to credit risk arising from trade receivables are disclosed in note 24 to the financial statements.

43. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES *(continued)*

Financial risk management *(continued)*

(iv) Liquidity risk

The Group closely monitors its liquidity risk by performing periodic reviews and evaluations of its liquidity with regard to the industry characteristics, market conditions, business strategies and changes in the Group's state of affairs and adjusting the current and non-current portions of the Group's debt portfolio on a proper and timely basis. In addition, the Group aims to ensure a continuity of fund and flexibility through the use of various means of financing and by keeping committed credit lines available.

The table below summarises the maturity profile of the Group's financial liabilities at 31 December 2007 based on contractual undiscounted payments.

			2007		
		Less than	**1 to 5**	**More than**	
	On demand	**1 year**	**years**	**5 years**	**Total**
	RMB'000	***RMB'000***	***RMB'000***	***RMB'000***	***RMB'000***
Interest-bearing bank loans	**–**	**183,156**	**80,000**	**–**	**263,156**
Other loans	**36,004**	**–**	**–**	**–**	**36,004**
Trade and other payables	**–**	**2,328,566**	**–**	**–**	**2,328,566**
Long term payables	**–**	**173,466**	**245,236**	**–**	**418,702**

			2006		
		Less than	1 to 5	More than	
	On demand	1 year	years	5 years	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Interest-bearing bank loans	–	234,022	641,136	–	875,158
Other loans	31,000	–	–	–	31,000
Trade and other payables	–	2,067,765	–	–	2,067,765
Long term payables	–	202,552	308,514	4,359	515,425

44. SUBSEQUENT EVENTS

On 8 April 2008, the Company entered into an Equity Interest Transfer Agreement with certain sellers, pursuant to which the Company has conditionally agreed to acquire certain minority interest in Inner Mongolia Mengniu Dairy (Group) Company Limited, the main operating subsidiary of the Company. Completion of the transaction is still subject to be approved by the relevant authorities and independent shareholders of the Company. Details were disclosed in the Company's announcement dated 8 April 2008.

45. COMPARATIVE AMOUNTS

As further explained in note 2.2 to the financial statements, due to the adoption of the new and revised IFRSs and IFRIC interpretation during the current year, certain comparative amounts have been adjusted to conform with the current year's presentation and to show comparatives separately in respect of items disclosed for the first time in 2007.

46. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors on 8 April 2008.

Financial Summary

The following is a summary of the audited financial statements of China Mengniu Dairy Company Limited (the "Company") and its subsidiaries for the respective years as hereunder stated.

Results

	Year ended				
	2007	2006	2005	2004	2003
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Revenue	**21,318,062**	16,246,368	10,824,950	7,213,827	4,071,468
Profit before tax	**1,130,310**	942,320	617,135	410,553	293,507
Income tax expense	**(21,658)**	(76,032)	(61,612)	(18,454)	(61,177)
Profit for the year	**1,108,652**	866,288	555,523	392,099	232,330
Attributable to:					
Equity holders of the Company	**935,786**	727,352	456,847	319,393	164,372
Minority interests	**172,866**	138,936	98,676	72,706	67,958
Proposed dividend	**187,535**	149,718	93,873	80,053	61,860
Earnings per share attributable to ordinary equity holders of the Company *(RMB)* (note (i))					
Basic	**0.664**	0.532	0.365	0.357	0.192
Diluted	**0.664**	0.532	0.334	0.285	–

Assets, liabilities and equity

	At 31 December				
	2007	2006	2005	2004	2003
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Total assets	**9,681,279**	7,763,678	6,087,105	4,836,384	2,334,310
Total liabilities	**3,846,575**	4,130,998	3,320,026	2,533,256	1,474,589
Equity attributable to equity holders of the Company	**5,111,629**	2,998,864	2,330,621	1,954,474	689,210
Minority interests	**723,075**	633,816	436,458	348,654	170,511

Note:

(i) Calculation basis for the earnings per share attributable to ordinary equity holders of the Company are set out in note 10 to the consolidated financial statements.

China Mengniu Dairy Company Limited
中國蒙牛乳業有限公司*

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