蒙牛

CHINA MENGNIU DAIRY COMPANY LIMITED
中國蒙牛乳業有限公司*

(Incorporated in the Cayman Islands with limited liability)

(Stock code: 02319)

ANNOUNCEMENT OF THE ANNUAL RESULTS FOR THE YEAR ENDED 31 DECEMBER 2008

FINANCIAL HIGHLIGHTS

For the year ended 31 December	**2008** *RMB'000*	2007 *RMB'000*
Revenue	**23,864,975**	21,318,062
Net profit/(loss) attributable to equity holders of the Company	**(948,600)**	935,786
Net cash inflow from operating activities	**586,880**	2,058,121
Net cash balances	**1,313,305**	1,947,662
Basic earnings/(loss) per share *(RMB)*	**(0.639)**	0.664

- Leveraging on its market leading position and diversified product portfolio, the Group managed to achieve a 11.9% growth in revenue to RMB23,865 million during the year. However, affected by the Milk Incident in the second half year, the Group reported net loss attributable to equity holders of RMB948.6 million.

- The Group further expanded its production capacity and its combined annual production capacity reached 5.57 million tons in December 2008.

- According to China Industrial Information Issuing Center, National Bureau of Statistics of China, the Group ranked first in China in terms of overall sales volume. It also ranked first, in terms of sales volume, in the sectors of liquid milk, yogurt and ice cream in China dairy industry in 2008.

The board (the "Board") of directors (the "Directors") of China Mengniu Dairy Company Limited (the "Company") is pleased to present the audited results of the Company and its subsidiaries (the "Group") for the year ended 31 December 2008, together with the comparative amounts.

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2008

	Notes	2008 RMB'000	2007 RMB'000
CONTINUING OPERATIONS			
REVENUE	3	**23,864,975**	21,318,062
Cost of sales		**(19,195,576)**	(16,514,557)
GROSS PROFIT		**4,669,399**	4,803,505
Other income and gains		**122,654**	98,096
Selling and distribution costs		**(4,428,027)**	(3,302,020)
Administrative expenses		**(622,162)**	(461,902)
Other operating expenses		**(876,033)**	(21,829)
PROFIT/(LOSS) FROM OPERATING ACTIVITIES		**(1,134,169)**	1,115,850
Interest income		**54,841**	43,566
Finance costs	5	**(39,394)**	(50,060)
Share of profits and losses of associates		**29,447**	20,954
PROFIT/(LOSS) BEFORE TAX	4	**(1,089,275)**	1,130,310
Income tax income/(expense)	6	**161,454**	(21,658)
PROFIT/(LOSS) FOR THE YEAR FROM CONTINUING OPERATIONS		**(927,821)**	1,108,652
DISCONTINUED OPERATION			
Profit for the year from a discontinued operation	3	**3,357**	–
PROFIT/(LOSS) FOR THE YEAR		**(924,464)**	1,108,652
Attributable to:			
Equity holders of the Company		**(948,600)**	935,786
Non-controlling/minority interests		**24,136**	172,866
		(924,464)	1,108,652
DIVIDENDS			
Dividends paid	7	**187,667**	156,020
Proposed final dividend	7	**–**	187,535
EARNINGS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE COMPANY (EXPRESSED IN RMB PER SHARE)	8		
Basic			
– For profit/(loss) for the year		**(0.639)**	0.664
– For profit/(loss) from continuing operations		**(0.641)**	0.664
– For profit from a discontinued operation		**0.002**	N/A
Diluted			
– For profit for the year		**N/A**	0.664
– For profit from continuing operations		**N/A**	0.664
– For profit from a discontinued operation		**0.002**	N/A

CONSOLIDATED BALANCE SHEET

As at 31 December 2008

	Notes	2008 RMB'000	2007 RMB'000
NON-CURRENT ASSETS			
Property, plant and equipment		**5,247,072**	5,042,648
Construction in progress		**215,017**	313,439
Other intangible assets		**32,667**	31,404
Land use rights		**256,524**	228,739
Interests in associates		**40,107**	57,573
Available-for-sale investments		**18,029**	17,316
Goodwill		**199,143**	199,143
Deferred tax assets		**186,881**	6,302
Other financial assets		**18,333**	21,139
		6,213,773	5,917,703
CURRENT ASSETS			
Inventories		**824,453**	877,443
Bills receivable	9	**64,778**	114,882
Trade receivables	10	**284,079**	261,365
Prepayments and deposits		**374,904**	214,364
Other receivables		**90,679**	40,198
Pledged deposits		**41,693**	44,506
Cash and bank balances		**3,041,965**	2,210,818
		4,722,551	3,763,576
Assets of a disposal group classified as held for sale		**378,951**	–
		5,101,502	3,763,576
CURRENT LIABILITIES			
Trade payables	11	**2,155,265**	1,315,395
Bills payable	12	**239,345**	259,065
Deferred income		**12,918**	11,752
Accruals and customers' deposits		**745,535**	544,662
Other payables		**1,048,792**	1,013,171
Interest-bearing bank loans		**1,208,660**	183,156
Other loans		**72,942**	36,004
Income tax payable		**–**	185
		5,483,457	3,363,390
Liabilities directly associated with assets classified as held for sale		**282,649**	–
		5,766,106	3,363,390
NET CURRENT ASSETS/(LIABILITIES)		**(664,604)**	400,186
TOTAL ASSETS LESS CURRENT LIABILITIES		**5,549,169**	6,317,889

	Notes	2008 RMB'000	2007 RMB'000
NON-CURRENT LIABILITIES			
Interest-bearing bank loans		**520,000**	80,000
Long term payables		**107,988**	224,192
Deferred income		**183,210**	178,993
		811,198	483,185
NET ASSETS		**4,737,971**	5,834,704
EQUITY			
Equity attributable to equity holders of the Company			
Issued capital		**163,137**	151,277
Retained earnings		**363,555**	1,547,733
Other reserves		**3,937,924**	3,412,619
		4,464,616	5,111,629
Non-controlling/minority interests		**273,355**	723,075
TOTAL EQUITY		**4,737,971**	5,834,704

Notes:

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 Group for the year ended 31 December 2008. The financial statements of the subsidiaries are prepared for the same reporting year as the Company, using consistent accounting policies. All income and expenses and unrealised gains and losses resulting from intra-group transactions 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.

The acquisition of subsidiaries during the year has been accounted for using the purchase method of accounting. This method involves allocating the cost of the business combinations by recognising the identifiable assets acquired, and liabilities and contingent liabilities assumed at the date of acquisition at their fair value, except for non-current assets (or disposal groups) that are classified as held for sale at the acquisition date in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, which should be recognised at fair value less costs to sell. The cost of the acquisition is measured at the aggregate of the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange.

Non-controlling or minority interests are the equity in subsidiaries not attributable, directly or indirectly, to the Company. An acquisition of non-controlling or minority interests is accounted for using the entity concept method whereby the difference between the consideration and the book value of the share of the net assets acquired is recognised as an equity transaction.

Basis of presentation

The Group has reported a net loss for the year ended 31 December 2008 and, as at that date, it had net current liabilities. The deterioration of the Group's financial performance and position during the year has resulted from the milk contamination event that occurred in September 2008 (the "Milk Incident"). In preparing the consolidated financial statements, the directors of the Company have given careful consideration to the future liquidity of the Group. After making an assessment of the Group's financial performance, working capital and liquidity position, the directors are of the view that the Group will be able to meet in full its financial obligations as they fall due for the foreseeable future. Accordingly, the consolidated financial statements have been prepared on a going concern basis.

2.2 IMPACT OF NEW AND REVISED IFRSs

The Group has adopted the following new interpretations and amendments to IFRSs for the first time for the current year's financial statements:

IAS 39 and IFRS 7 Amendments	Amendments to IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7 *Financial Instruments: Disclosures – Reclassification of Financial Assets*
IFRIC 11	IFRS 2 – *Group and Treasury Share Transactions*
IFRIC 12	*Service Concession Arrangements*
IFRIC 14	IAS 19 – *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*

The adoption of these new interpretations and amendments has had no significant effect on these financial statements.

The Group has early adopted IFRS 3 (as revised in 2008) *Business Combinations* ("IFRS 3R") and IAS 27 (as revised in 2008) *Consolidated and Separate Financial Statements* (as amended in 2008) ("IAS 27R") as of 1 January 2008.

IFRS 3R introduces a number of changes in the accounting for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009. The Group early adopted IFRS 3R on a prospective basis to business combination for which the acquisition date is on or after 1 January 2008. The Group chooses to account for the non-controlling interests (previously the minority interests) in the acquiree at fair value for the business combination during the year.

IAS 27R requires that a change in the ownership interest of a subsidiary without loss of control 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 revised standard changes the accounting for losses incurred by the subsidiary as well as the loss of control of a subsidiary. The changes introduced by IAS 27R will affect future transactions with minority interests.

3. REVENUE AND 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.

Intersegment sales and transfers are transacted with reference to the selling prices used for sales made to third parties at the then prevailing market prices.

A discontinued operation which is principally engaged in raising milk cows and supplying raw milk is presented separately in the consolidated income statement as one-line item "Profit for the year from a discontinued operation". Assets and liabilities related to the discontinued operation are shown separately in the consolidated balance sheet as "Assets of a disposal group classified as held for sale" and "Liabilities of a disposal group classified as held for sale".

The following tables present the revenue, results and certain asset and liability information of continuing operations for the Group's business segments for the year ended 31 December 2008:

	Continuing operations				
Year ended 31 December 2008	**Liquid milk products** *RMB'000*	**Ice cream products** *RMB'000*	**Other dairy products** *RMB'000*	**Eliminations** *RMB'000*	**Consolidated** *RMB'000*
Segment revenue:					
Sales to external customers	**21,068,097**	**2,626,515**	**170,363**	**–**	**23,864,975**
Intersegment sales	**214,891**	**52,308**	**11,460**	**(278,659)**	**–**
Total	**21,282,988**	**2,678,823**	**181,823**	**(278,659)**	**23,864,975**
Segment results	**(602,165)**	**(219,514)**	**(90,760)**	**–**	**(912,439)**
Interest income					**54,841**
Finance costs					**(39,394)**
Share of profits and losses of associates					**29,447**
Unallocated corporate expenses					**(221,730)**
Loss before tax					**(1,089,275)**
Income tax income					**161,454**
Loss for the year					**(927,821)**
Assets and liabilities					
Segment assets	**7,635,614**	**1,124,542**	**343,669**	**(1,776,719)**	**7,327,106**
Unallocated corporate assets					**3,609,218**
Total assets					**10,936,324**
Segment liabilities	**4,646,734**	**664,541**	**256,434**	**(1,776,719)**	**3,790,990**
Unallocated corporate liabilities					**2,503,665**
Total liabilities					**6,294,655**
Other segment information:					
Depreciation and amortisation	**510,425**	**93,382**	**7,822**	**–**	**611,629**
Unallocated amounts					**28,071**
Total depreciation and amortisation					**639,700**
Capital expenditure	**717,945**	**26,474**	**31,663**	**–**	**776,082**
Unallocated capital expenditure					**25,110**
Total capital expenditure					**801,192**
Other non-cash expenses/(income)	**233,555**	**12,937**	**(531)**	**–**	**245,961**
Unallocated amounts					**66,824**
Total non-cash expenses					**312,785**

Year ended 31 December 2007	Liquid milk products *RMB'000*	Ice cream products *RMB'000*	Other dairy products *RMB'000*	Eliminations *RMB'000*	Consolidated *RMB'000*
Segment revenue:					
Sales to external customers	19,148,856	1,991,728	177,478	–	21,318,062
Intersegment sales	150,016	37,141	–	(187,157)	–
Total	19,298,872	2,028,869	177,478	(187,157)	21,318,062
Segment results	1,249,599	85,228	(31,994)	–	1,302,833
Interest income					43,566
Finance costs					(50,060)
Share of profits and losses of associates					20,954
Unallocated corporate expenses					(186,983)
Profit before tax					1,130,310
Income tax expense					(21,658)
Profit for the year					1,108,652
Assets and liabilities					
Segment assets	7,042,655	966,557	230,324	(1,402,477)	6,837,059
Unallocated corporate assets					2,844,220
Total assets					9,681,279
Segment liabilities	3,920,366	470,352	165,928	(1,402,477)	3,154,169
Unallocated corporate liabilities					692,406
Total liabilities					3,846,575
Other segment information:					
Depreciation and amortisation	416,032	91,862	4,718	–	512,612
Unallocated amounts					17,863
Total depreciation and amortisation					530,475
Capital expenditure	1,071,931	71,782	127,295	–	1,271,008
Unallocated amounts					244,053
Total capital expenditure					1,515,061
Other non-cash expenses	12,772	3,336	4,687	–	20,795
Unallocated amounts					14,949
Total non-cash expenses					35,744

4. PROFIT/(LOSS) BEFORE TAX

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

	2008	2007
	RMB'000	*RMB'000*
Cost of inventories sold	**19,195,576**	16,514,557
Employee benefit expense (excluding directors' remuneration)		
– Wages, salaries, housing benefits and other allowances	**889,211**	800,406
– Retirement benefit contributions	**68,503**	50,138
– Share-based payment expense	**105,441**	35,352
	1,063,155	885,896
Depreciation of property, plant and equipment	**630,046**	522,706
Amortisation of land use rights	**5,604**	4,681
Amortisation of other intangible assets	**4,050**	3,088
Write-off of inventories	**655,216**	–
Write-down of inventories to net realisable value	**179,873**	4,413
Cash contribution to a medical compensation fund	**4,985**	–
Loss on disposal of items of property, plant and equipment	**6,227**	8,298

5. FINANCE COSTS

	2008	2007
	RMB'000	*RMB'000*
Interest on long term payables	**16,505**	15,506
Interest on bank loans wholly repayable within five years	**26,796**	36,830
Less: Amounts capitalised	**(3,907)**	(2,276)
	39,394	50,060

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 5.96% (2007: 5.88%) per annum.

6. INCOME TAX (INCOME)/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-two (2007: twenty-one) of the Group's subsidiaries and jointly-controlled entities, the entities within the Group are subject to CIT at a rate of 25% on the taxable income as reported in their statutory accounts which are prepared in accordance with the PRC accounting standards and financial regulations.

	2008	2007
	RMB'000	*RMB'000*
Current income tax	**19,125**	27,960
Deferred income tax	**(180,579)**	(6,302)
	(161,454)	21,658

A reconciliation of the income tax (income)/expense applicable to profit/(loss) 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:

	Note	2008 RMB'000	2007 RMB'000
Profit/(loss) before tax		**(1,089,275)**	1,130,310
At CIT rate of 25% (2007: 33%)	*(a)*	**(272,319)**	373,002
Non-taxable items and others, net		**26,450**	40,802
Adjustment recognised in the year for current tax of prior years		**3,819**	–
Effect of preferential tax rates	*(b)*	**150,658**	(44,061)
Effect on tax exemptions	*(b)*	**(89,990)**	(330,221)
Tax losses not recognised		**19,928**	–
Utilisation of previously unrecognised tax credits		**–**	(17,864)
At the effective income tax rate of 14.8% (2007: 1.9%)		**(161,454)**	21,658

Notes:

(a) On 16 March 2007, the Fifth Plenary Session of the Tenth National People's Congress passed the Corporate Income Tax Law of the People's Republic of China (hereafter the "New Tax Law"). According to the New Tax Law, the applicable tax rates of the Group's subsidiaries in the PRC are unified at 25% with effect from 1 January 2008.

(b) Twenty-two (2007: twenty-one) subsidiaries and a jointly-controlled entity were subject to tax concessions in 2008. The total deductible loss of the subsidiaries that are subject to tax concessions amounted to approximately RMB719,771,000 (2007: taxable profit of RMB1,134,188,000) in aggregate. Out of the twenty-two subsidiaries, nineteen (2007: seventeen) plus the jointly-controlled entity were granted tax concessions by the state tax bureau in accordance with the New Tax Law and the corresponding transitional tax concession policy and "The notice of preferential tax policies for companies located in West China". Three (2007: two) subsidiaries were granted tax concessions in accordance with the policy of "The notice of preferential tax policy for preliminary processing of agriculture products".

(c) The share of tax attributable to associates amounting to approximately RMB5,549,000 (2007: RMB10,428,000) is included in the share of profits and losses of associates on the face of the consolidated income statement.

7. DIVIDENDS

	Note	2008 RMB'000	2007 RMB'000
Declared and paid during the year			
Equity dividends on ordinary shares		**187,667**	156,020
Proposed for approval at the AGM			
Equity dividends on ordinary shares: Proposed final – Nil (2007: RMB0.1315) per ordinary share	*(a)*	**–**	187,535

Note:

(a) The directors do not recommend the payment of a final dividend for the year ended 31 December 2008. The proposed total dividend for the year ended 31 December 2007 was calculated based on approximately 1,426,120,000 existing shares in issue. The proposed final dividend for that year was subject to the approval of the Company's shareholders at the forthcoming Annual General Meeting (the "AGM"). Such dividend was not recognised as a liability in the consolidated financial statements as at 31 December 2007 but was reflected as an appropriation of retained earnings for the year ended 31 December 2008.

8. 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/(loss) 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 was calculated by dividing the profit/(loss) for the year attributable to ordinary equity holders of the Company by the weighted average number of ordinary shares in issue during that 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.

Diluted loss per share amounts for loss for the year and for loss from continuing operations for the year ended 31 December 2008 have not been disclosed as the deemed exercise of share options during 2008 had an anti-dilutive effect on the basic loss per share.

The calculations of basic and diluted earnings per share are based on:

Earnings

	2008 ***RMB'000***	2007 *RMB'000*
Profit/(loss) attributable to ordinary equity share holders of the Company:		
From continuing operations	**(951,957)**	935,786
From a discontinued operation	**3,357**	–
	(948,600)	935,786

Shares

	2008 **Number of shares** ***'000***	2007 Number of shares *'000*
Weighted average number of ordinary shares for the purpose of the basic earnings per share calculation	**1,485,403**	1,408,911
Weighted average number of ordinary shares, assuming issued at no consideration on the deemed exercise of all share options during the year	**35**	859
Weighted average number of ordinary shares for the purpose of the diluted earnings per share calculation	**1,485,438**	1,409,770

9. BILLS RECEIVABLE

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

	2008	2007
	RMB'000	*RMB'000*
Within 3 months	**64,678**	114,832
4 to 6 months	**100**	50
	64,778	114,882

10. TRADE RECEIVABLES

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:

	2008	2007
	RMB'000	*RMB'000*
Within 3 months	**251,774**	226,011
4 to 6 months	**25,587**	24,136
7 to 12 months	**5,716**	10,828
Over 1 year	**1,002**	390
	284,079	261,365

11. TRADE PAYABLES

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

	2008	2007
	RMB'000	*RMB'000*
Within 3 months	**2,033,138**	1,238,629
4 to 6 months	**112,082**	65,590
7 to 12 months	**8,289**	7,904
Over 1 year	**1,756**	3,272
	2,155,265	1,315,395

12. BILLS PAYABLE

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

	2008	2007
	RMB'000	*RMB'000*
Within 3 months	**239,145**	164,684
4 to 6 months	**200**	94,381
	239,345	259,065

MANAGEMENT DISCUSSION AND ANALYSIS

FINANCIAL REVIEW

Leveraging on its market leading position and diversified product portfolio, the Group managed to achieve a 11.9% growth in revenue to RMB23,865 million (2007: RMB21,318.1 million) during the year. However, affected by the Milk Incident in the second half of the year, the Group reported a net loss attributable to equity holders of the Company of RMB948.6 million (2007: profit of RMB935.8 million), and basic loss per share was RMB0.639 (Basic earnings per share for 2007: RMB0.664).

Gross Profit

During the year under review, the Group recorded a gross profit of RMB4,669.4 million (2007: RMB4,803.5 million), representing a decrease of 2.8% as compared with that of 2007. With the impact of rising average price of raw milk in 2008 as compared with prior year, and increasing expenses on product promotion and introduction of various measures on raw milk safety in the second half of the year after the Milk Incident, the overall gross profit margin of the Group for the year was 19.6% (2007: 22.5%). To minimize the cost pressure, the Group actively developed various high-end functional products and improved its product mix during the year.

Operating Expenses

In 2008, the Group recorded operating expenses totalling RMB5,926.2 million (2007: RMB3,785.8 million), representing approximately 24.8% (2007: 17.8%) of the Group's revenue or an increase of 7 percentage points as compared with 2007. During the year, owing to the increase in advertising and promotion expenses and the impact of the Milk Incident, the Group incurred additional operating and non-recurrent expenditures. However, the Group aims to keep such increase to a minimum under the Group's continuous stringent control over its operating expenses.

The selling and distribution costs of the Group amounted to RMB4,428 million (2007: RMB3,302 million), representing approximately 18.6% (2007: 15.5%) of the Group's revenue, of which expenses on advertising and promotion accounted for 9.3%, up by 2.1 percentage points as compared to 7.2% in 2007. Such increase was mainly attributable to the launch of various thematic promotion campaigns in relation to the Beijing Olympics by the Group as a leading player in China dairy industry. The Group also made greater marketing efforts in the second half of the year to enhance consumers' understanding of its production process as well as its improved safety measures.

Administrative and other operating expenses amounted to RMB1,498.2 million (2007: RMB483.8 million), representing 6.3% of the Group's revenue (2007: 2.3%). As a result of inventories written off and certain non-recurrent expenditures incurred after the Milk Incident, administrative and other operating expenses of the Group increased by 4 percentage points as compared with that of last year.

Loss from Operating Activities and Net Loss

As a result of the negative impact of the Milk Incident on the Group, in particular the drop in sales, the write-off of certain products pulled off from the shelves, and additional costs incurred for raw milk disposal and sales promotional campaigns, the Group's LBITDA for 2008 was RMB461.7 million (2007 EBITDA: RMB1,667.3 million) and net loss attributable to equity holders of the Company amounted to RMB948.6 million (net profit attributable to equity holders of the Company for 2007: RMB935.8 million).

Capital Structure, Liquidity and Financial Resources

For the year ended 31 December 2008, the Group's net cash inflow from operating activities amounted to RMB586.9 million (2007: RMB2,058.1 million). Net cash balances (cash and bank balances net of total bank loans) amounted to RMB1,313.3 million (2007: RMB1,947.7 million) as at 31 December 2008, showing that the financial position of the Group remained at a reasonable level.

As at 31 December 2008, the outstanding bank loans of the Group amounted to RMB1,728.7 million (2007: RMB263.2 million), of which RMB1,208.7 million (2007: RMB183.2 million) was repayable within one year and RMB520 million (2007: RMB80 million) was repayable beyond one year. Bank loans in the amount of RMB720.3 million (2007: RMB149.6 million) was fixed interest-bearing.

The total equity of the Group was RMB4,738 million as at 31 December 2008 (2007: RMB5,834.7 million). The debt-to-equity ratio (total bank loans over total equity) of the Group was 36.5% (2007: 4.5%) as at 31 December 2008, 32 percentage points higher than that of 2007.

MARKET REVIEW

The China dairy industry became the public focus and attention in 2008, in particular, the Milk Incident in September 2008 which forced the industry players to review and evaluate, and implement stringent control over the production process, especially the quality of raw materials, rather than solely focus on business growth.

Both the state and local governments quickly introduced a series of measures including the "Regulation on the Supervision and Administration of the Quality and Safety of Dairy Products" (《乳製品質量安全監督管理條例》) and the "Outlines of the Rectification and Revival of the Dairy Industry" (《奶業整頓和振興規劃綱要》) soon after the Milk Incident to strengthen the quality and safety control of dairy products, to protect public health and to promote healthy development of the dairy industry.

The Group responded positively after the Milk Incident with thorough review and evaluation of its operations. The Group implemented a number of effective measures to promote healthy development of the industry, including taking initiatives to construct high quality and standardised raw milk supply bases, exercising stringent control over quality of raw materials and products, implementing inspection on production process from raw milk collection to final product inspection, and improving communication with customers.

BUSINESS REVIEW

During the year under review, customers' health and safety topped the priority of the Group. It implemented stringent product testing and inspection to ensure product quality and safety. The Group enhanced its production transparency allowing customers' better understanding of ***Mengniu*** products. The enhanced transparency showed the confidence of the Group in its product quality. The Group also continued to develop and promote high-end products, offering customers with delicious, nutritious and safe dairy products.

Product Safety

Adhering to its principle of "accepting more responsibility as a big brand", to ensure product safety and to rejuvenate the China dairy industry, the Group promptly responded to the government's call soon after the Milk Incident. Other than recalling the relevant products without delay, the Group pledged to tighten its control over raw milk source. It quickly introduced advanced inspection equipment and increased product testing items. Furthermore, the Group called for and obtained "Undertaking for Quality of Raw Milk" (《原奶質量承諾書》) from more than 3,400 raw milk collection centres across the country to ensure product safety.

To enhance its production transparency, public and media were invited to visit its ranch and production plants from September 2008 onwards. The Group also commenced the "Mengniu Milk Safety Project" (「蒙牛牛奶安全工程」) in November and December 2008 to enhance the production transparency and foster consumer confidence. 10,000 consumers were invited across the country to visit the headquarters of the Group in Inner Mongolia and acted as the safety inspectors of the Group. They were invited to observe the production process of ***Mengniu*** products which was of international quality control standards. 100 of them were subsequently elected as committee members of the "Mengniu Milk Safety Project" to exercise long-term supervision over the Group's production process.

At the same time, the Group also achieved "transparent production" by launching a 24-hour live webcast, the first of its kind in the China industry, allowing consumers a real time inspection of certain of its related milk cattle farms, and its testing and production process. The Group strived to improve public confidence in its products through its transparent and modernised management system.

Branding and Marketing

To encourage public participation in sports in the Olympic year, the Group, as a leading dairy product manufacturer in China, held campaigns and activities under the theme of "Running to Beijing", including "Running to Beijing – Sui Bian Dance Contest" (奔向北京 • 隨變炫舞大賽), "Mengniu's Inter-city All People Sports Game" (蒙牛城市之間全民健身活動), "Mengniu Green Cyclists Running to Beijing" (蒙牛綠色騎手奔向北京). These activities were promoted under the concept of "Exercise, Health and Nutrition for all of China" which aimed to promote public awareness of sports, food nutrition and healthy lifestyle.

With respect to promotion and marketing, during the year, the Group launched an array of marketing campaigns that matched both the Group's product image and consumer preference. These included a series of diversified musical events, such as "Running to Beijing – Make Your Music Dream Comes True" (奔向北京 • 成就音樂夢想) and "Mengniu Suan Suan Ru Music Award Presentation Ceremony" (蒙牛酸酸乳音樂風雲榜頒獎盛典), both of which echoed the young and fashionable image of *Suan Suan Ru* (*酸酸乳*). To tap the tremendous potential in the children dairy product market and to enhance parents' knowledge on nutrition value of dairy products, the Group established the "Future Star Children Milk Nutrition Research Centre" (未來星中國兒童牛奶營養研究中心) and jointly organised a programme called "Winning from the Start – Growth Program" (贏在起點 • 成長工程) with the Women's Federation. The Group also set up its first online interactive parenting platform in China to provide information on relationship between milk nutrition and children growth.

Products

During the year under review, leveraging on its innovative technology and knowledge of niche markets, the Group introduced various high-end functional products that broadened its product portfolio.

Liquid milk

Revenue from the liquid milk segment amounted to RMB21,068.1 million, accounting for 88.3% of the revenue of the Group, remained the major source of income of the Group.

UHT milk

Revenue from UHT milk products reached RMB13,697.1 million, accounting for 65% of the revenue of the liquid milk segment. During the year, the Group further expanded the *Milk Deluxe* series by introducing *Milk Deluxe Organic Milk (特侖蘇有機奶)*. Moreover, to cater for the awareness of city dwellers to improve digestion, the Group developed and launched a new product, *Xin Yang Dao Low-Lactose Milk (新養道低乳糖牛奶)* for easy absorption of nutrients, delivering more quality product choices to customers. To develop secondary brand of children milk, the Group enhanced the *Future Sta*r *(未來星)* series and developed the pure milk products for growing children, establishing a new children milk product line. To cater for the strong emerging demand in the children's market, the Group will continue to develop more nutritious and delicious milk products for children.

Milk beverages

Revenue from the milk beverages segment was RMB5,593.6 million, accounting for 26.6% of the revenue of the liquid milk segment. *Fruit Milk Drink (真果粒)* received the "Country Award"(金獎國別獎) at the 2008 SIAL International Food Products Exhibition organized by Exposium, the largest exhibition group in France and the 10th largest in the world. Supported by different promotion activities, *Suan Suan Ru (酸酸乳)* remained the leading product in the market. *Miao Miao Milk (妙妙奶)*, targeted the children's market, were sold with an innovative and fun packaging to attract children and stimulate their purchase desire. Activities such as "Miao Miao Family Fun Club" (妙妙家族趣樂會) helped promoting consumer understanding and acceptance of the children milk products. In future, the Group plans to introduce more milk beverage of different flavours to widen its product range and create new growth drivers.

Yogurt

Revenue from the yogurt segment totalled RMB1,777.4 million, accounting for 8.4% of the revenue of the liquid milk segment. The Group further improved the product *Champion (冠益乳)* which contains coronatine for digestion improvement. It was in a feminine packaging design and was portrayed as a healthy and energetic icon. The product was promoted along with the campaigns such as "Running to Beijing – Everyone Is a Champion" (奔向北京 • 人人是冠軍). The Group also established a product line, *Fiber Fruit Grain Yogurt (纖維新意果粒)* series, by adding edible fibre into its *Large Fruit Grain Yogurt (大粒果實酸奶)*. Yoga was used in the marketing to highlight the healthy image of the product. The Group plans to expand the high-end functional product market and strengthen the position of yogurt products to capture the increasing demand in the segment.

Ice-cream

Revenue from the ice-cream segment amounted to RMB2,626.5 million, accounting for 11% of the revenue of the Group. With an aim to branding the ice-cream products as "Trendy, Carefree, Pleasant and Youthful", the Group restructured the segment by regrouping the products under five secondary brands, namely "*Sui Bian, Mood for Green, Deluxe, Qu Zai* and *Ice+*" *(隨便、綠色心情、蒂蘭聖雪、趣仔及冰+).* In 2008, *Sui Bian Euro Roll (隨變歐羅旋)* remained the highlight of this segment, featuring with an exotic European taste with a trendy and ready-to-change style. In future, the Group will strive to improve the products under these five secondary brands by developing more flavours and upgrading product packaging. The Group will increase the proportion of high-end and high value-added products to improve the product mix and present a more distinctive image of ***Mengniu*** brand.

Other dairy products

Revenue from the other dairy products amounted to RMB170.4 million, accounting for 0.7% of the Group revenue. For milk powder products, the Group launched *Jinzhuang Jiazhi (金裝佳智)* series, targeting the mid- and high-end markets. Furthermore, as cheese products became more popular in China, the Group successfully developed series of cheese products including *Smoke-dried Cheese (熏制奶酪)*, *Breakfast Cheese (早餐系列)* and *Growth Cheese (成長系列)* that suit Chinese taste. To capture the market potential, the Group will actively improve the flavours of different cheese products and focus on the development of cheese for children, introducing nutritious products to more customers.

Quality Control

The Group is always alert to product quality. It exercised stringent control over various production stages, from raw materials, production, finished products to sales outlets. To ensure the quality of raw milk, the Group continued to strengthen the control of cattle breeding in ranches, including control over the selection, origins and quality of hay and its transportation. New measures were implemented regarding the sanitary standard of cattle farms and cattle vaccination so as to ensure the raw milk quality.

With respect to raw milk collection, the Group established the "Standards for Raw Milk Inspection and Collection" (「原奶檢驗計劃和收購標準」) with reference to the State standards so as to ensure the safety and quality of raw milk. In addition, to enhance the efficiency and standard of raw milk collection and transportation, the Group installed Global Positioning System ("GPS") in raw milk tankers. Management tactics of "three-dimension monitoring and a closed operation" were in place to ensure milk safety and quality where dedicated persons were assigned to monitor the cattle, to monitor the milk collection centres and to monitor the milk tankers. A closed germ-free system was also in place for raw milk production and transportation.

The Group took technological initiatives to ensure that the production was controlled by a centralized system. Milk products were produced in a fully-enclosed environment installed with an intelligent system controlling the allocation and sterilization of raw milk and mixing of ingredients. Data storage and an alarm system were in place. The Group also introduced latest testing equipment to conduct tests for more than 30 items, in addition to the requisite items required by the government, more than 10 extra items suggested by the Group such as fertilizer residue, additives and heavy metal were tested. The Group also conducted batch-by-batch inspection for raw milk, supplementary ingredients and finished products, and engaged third parties to conduct random or double inspection on finished products. The 4-tier safety check ensured the Group's products are reliable so that customers can enjoy safe and fresh dairy products.

Production and Operation

For the year ended 31 December 2008, the Group further expanded the production capacity and had an aggregate annual production capacity of 5.57 million tons (2007: 4.78 million tons).

With the goal of developing proprietary healthy products for the high-end dairy products market and fine niche markets, The Group's Research and Development ("R&D") Centre continued to develop new products and applied technology. It strived to develop more new high-end products aiming to fill the market gap and lead the dairy product trend in China.

The Group made on-going improvement in its management system. Efforts were made in standardizing quality control and optimizing operation and management and enhancing the cost competitiveness of the Group. The Group will review its management system regularly and make timely adjustments to respond to the market requirements.

Industry Exchange

As a leader in the China dairy industry, the Group commits itself to the healthy development of the dairy industry. With the Group's resources, strong operating network, technical services and management support to ranches, smaller farms, collection centres and dairy farmers, it is hoped that the relationship amongst the industry players for mutual development can be fostered.

During the year under review, the Group continued to provide training and guidance to raw milk suppliers by offering training given by either external experts or internal staff. The Group introduced free health care services for milk cattle and provided free raw milk inspection and testing service to raw milk suppliers and on-site guidance on breeding management. The Group also consolidated its resources of different equipment suppliers and built a "Mengniu Service Centre for Designated Collection Centres". The service network covers regions of milk source and investigation and follow up action can be carried out once problem arises. Currently, the Group plans to standardize the management of the service centres to assist raw milk suppliers and collection centres to allocate resources more effectively for a better development of the industry.

On 7 November 2008, professionals specialized in food, dairy products, nutrition and medicine from Beijing Children's Hospital, Dairy Association of China and Chinese Nutrition Society visited the Group's production base and exchanged views with the Group. A seminar called "Dairy Products Safety and National Health" was held at which the importance of dairy products to public health and their future development were discussed.

Social Responsibilities

It is the Group's philosophy to reward the society. In the first half of the year, the Group and Bank of China jointly issued the world's first milk caring credit card, "BOC-Mengniu Milk Loving Care Credit Card" (中銀蒙牛愛心信用卡). In July 2008, the Group jointly established the "Milk Loving Care Fund of China" with China Children and Teenagers' Fund, demonstrating the joint efforts of social organisation and enterprises. In 2008, the "Milk Loving Care" campaign initiated by the Group covered more than 1,000 primary schools across China where more students were benefited from the scheme. During the year under review, China experienced severe snowstorm and earthquakes happened in Sichuan. As a leading dairy enterprise, the Group responded and donated both resources and cash to the affected regions without delay. "Milk Delivery Express" was also available to tent schools to give children nutrients and hope.

The Group has strong commitment to environmental protection and actively participated in different environmental activities. The Group and the China Association for Non-government Organizations Cooperation and the US Environmental Defense Fund jointly organised a charitable event, "Green Journey • Less Discharge of Carbon Dioxide" (綠色出行 • 碳路行動). During the year under review, the Group significantly reduced carbon dioxide emission. The Group also, jointly with the Beijing People's Radio, launched a large cycling event, "Mengniu Green Cyclists Running to Beijing" (蒙牛綠色騎手奔向北京) to promote green transport and arouse public awareness of environmental protection and quality living.

In 2007, the Group set up "Mengniu's Emergency Blood Donation Team" (蒙牛集團青年志願者應急獻血隊), which is now one of the largest emergency blood donation teams among the Chinese enterprises. The Group will continue this chartable activity to encourage blood donation.

OUTLOOK

In December 2008, 13 government ministries and commissions jointly formulated the "Outlines of the Rectification and Revival of the Dairy Industry" (《奶業整頓和振興規劃綱要》) specifying the targets to rejuvenate the dairy industry in China. It aimed to achieve the following targets by October 2011: increase in the scale of milk cattle breeding operations; integration of production and sales; improvement in the processing flow; standardization of the industry; regulatory control over market competition and enhancement of the quality standard system. The outline set out revolutionary requirements on matters such as the ratio of first-class milk cattle, the average output per cattle and the scale of breeding farm operations. To date, milk consumption in China remains far below the international average consumption level, representing huge growth potential. On the back of strong support from the State and efforts of dairy enterprises, it is believed that China dairy products will continue to have promising growth prospects.

2008 marked the turning point for the China dairy industry. Accelerated industry consolidation and elimination of inefficient small-scale enterprises are expected in future. With the challenges and opportunities arising from the industry consolidation and restoration of customer confidence, the Group, as a market leader for years, is confident that it is capable to take the lead in the healthy and ordered development of the China dairy industry leveraging on its strong R&D capabilities, sizeable production and stringent quality control.

Promote internationalized advanced ranches and create better future for the China dairy industry with raw milk suppliers

Quality control at milk sources is fundamental to safety of dairy products. The Group, as the industry leader, has commenced to invest since years ago, in the construction of the international ranch in China. During the recent years, with the Group's experience in its investment in various internationalized advanced dairy farms, the Group has supported to speed up the development of small and medium ranches by assisting the building of sizeable ranches and collection centres across the country, pushing for reform to achieve the objectives of integrated breeding and milking, large-scale breeding of milk cattle and regionalization and standardization of ranches.

In future, the Group will continue to enhance the investment in the building of ranches and cooperate with raw milk suppliers and strengthen the management and control over raw milk production. It is hoped that with the increase in operation efficiency of milk station operators and milk farms by introducing to them species improvement, vaccination, and modern breeding technologies, in turn enhancing their confidence in and motivation to safe production and development of the entire dairy industry chain.

Continue to strengthen research and development of proprietary products, to fill the market gap by high-end value-added products

With the increasing consumption power and health concerns in China, the Group believes that nutrition value of food and beverages will become an important factor in consumers' consumption. In a fragmented market where customers prefer higher-end products, products of natural and functional formulae are the products with increasing value. The Group believes that products which can help the digestive and immunity system, to relieve stress, to improve sleeping quality and for beauty will become the market future focus.

The Group will continue to develop healthy products and improve the taste, functions and packaging of dairy products. It will focus on the high-end dairy market and niche markets and aims to become the icon of market trends by launching new high-tech and value-added products. The Group will increase the communication with customers, enhance its transparency and improve product quality under the monitor of its customers and the society.

Strengthen quality inspection and enhance production process transparency to build up customers' confidence in the Group's products

The Group will remain responsible to its customers. The Group will continue to enhance product quality control and inspection at its production to ensure product safety. Apart from monitoring milk source, the Group will refine the operation practice of collection centres and speed up the construction of modern ranches to ensure the raw milk quality and protect the raw milk suppliers' interests. It will continue to apply advanced technologies to ensure that raw milk is transported and processed in a fully-enclosed and germ-free environment. The adding of supplementary ingredients will also be under stringent control. The Group will also exercise strict inspection of the finished products. It has implemented multi-level inspection and supervision with reference to the highest local and international standards so as to offer high quality products to customers.

To promote consumer understanding of its products, the Group will remain transparent and continue to accept public supervision. It will improve its communication with customers and the media for mutual understanding and trust. Through its transparent production, it is believed that the Group will receive consumer recognition.

HUMAN RESOURCES AND REMUNERATION OF EMPLOYEES

As at 31 December 2008, the Group had approximately 23,500 employees in China and Hong Kong. Total staff costs for the year, excluding directors' remuneration, were approximately RMB1,063.2 million (2007: RMB885.9 million). To enhance the quality and competence of the employees, the Group provided intensive training programs to staff members to enrich their knowledge and awareness of the importance of safe production. The Group also implemented a series of measures to increase revenue and reduce costs. With respect to reducing staff costs, the senior management took the lead to accept reduction in salaries, business travel expenses, communication expenses and other office expenses. Internal fringe benefits were also adjusted. The Group has performance-linked incentive plans and share option schemes to increase incentive and efficiency of the employees.

CORPORATE GOVERNANCE

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 (the "Listing Rules") as its own code of corporate governance practices.

The Board has reviewed the Company's corporate governance practices and is satisfied that the Company has been in compliance with all applicable code provisions set out in the CG Code during the year ended 31 December 2008.

Mr. Li Jianxin, an independent non-executive Director, an audit committee and a remuneration committee member of the Company passed away on 20 February 2009. Following the passing away of Mr. Li, the Company has only two independent non-executive Directors and two audit committee members and accordingly does not have the requisite minimum number of independent non-executive Directors and audit committee members (i.e. three) under the Listing Rules. The Company is in the process of and will as soon as possible within the time period under the Listing Rules appoint a suitable candidate to fill the vacancy.

SECURITIES TRANSACTIONS OF DIRECTORS

The Company has adopted the Model Code for Securities Transactions by Directors of Listed Companies (the "Model Code") set out in Appendix 10 to the Listing Rules as the Company's code of conduct and rules governing dealings by all Directors in the securities of the Company. The Directors have confirmed, following the specific enquiry by the Company, that they have complied with the required standard set out in the Model Code throughout the year.

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

Neither the Company nor any of its subsidiaries purchased, redeemed or sold any of the Company's listed securities shares during the year ended 31 December 2008.

AUDIT COMMITTEE

The Audit Committee has reviewed with the Company's management and the external auditors, the accounting principles and practices adopted by the Company and discussed auditing, internal control and financial reporting matters, including the review of the Group's audited financial statements for the year ended 31 December 2008.

SCOPE OF WORK OF ERNST & YOUNG

The figures in respect of the preliminary announcement of the Group's results for the year ended 31 December 2008 have been agreed by the Group's auditors, Ernst & Young, to the amounts set out in the Group's draft consolidated financial statements for the year. The work performed by Ernst & Young in this respect did not constitute an assurance engagement in accordance with Hong Kong Standards on Auditing, Hong Kong Standards on Review Engagements or Hong Kong Standards on Assurance Engagements issued by the Hong Kong Institute of Certified Public Accountants and consequently no assurance has been expressed by Ernst & Young on the preliminary announcement.

DIVIDEND

The Board do not recommend the payment of any dividend for the year.

PUBLICATION OF ANNUAL RESULTS AND ANNUAL REPORT

This results announcement is published on the websites of the Company's investor relations at www.mengniuir.com and Hong Kong Exchanges and Clearing Limited at www.hkexnews.hk. The annual report of the Company will be despatched to shareholders and available at the same websites in due course.

BOARD OF DIRECTORS

As at the date of this announcement, the executive Directors are Mr. Niu Gensheng, Mr. Yang Wenjun, Mr. Sun Yubin, Mr. Yao Tongshan and Mr. Bai Ying. The non-executive Directors are Mr. Jiao Shuge (alias Jiao Zhen) and Mr. Julian Juul Wolhardt. The independent non-executive Directors are Mr. Wang Huaibao and Mr. Zhang Julin.

APPRECIATION

The Board would like to take this opportunity to express gratitude to our shareholders and the public for their continued support, and to all staff for their hard work and commitment.

By order of the Board
Niu Gensheng
Chief Executive Officer

Hong Kong, 16 April 2009

* *For identification purposes only*