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## 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: 2319)**

### ANNOUNCEMENT OF THE ANNUAL RESULTS FOR THE YEAR ENDED 31 DECEMBER 2010

#### FINANCIAL HIGHLIGHTS

|  | <b>2010</b>       | 2009           |
|--|-------------------|----------------|
| <b>For the year ended 31 December</b>            | <b>RMB'000</b>    | <b>RMB'000</b> |
| Revenue  | <b>30,265,415</b> | 25,710,460     |
| Net profit attributable to owners of the Company | <b>1,237,273</b>  | 1,115,799      |
| Net cash flows from operating activities         | <b>2,485,117</b>  | 2,131,571      |
| Net cash balances                                | <b>5,997,027</b>  | 5,476,428      |
| Basic earnings per share (RMB)                   | <b>0.712</b>      | 0.681          |
| Proposed final dividend per share (RMB)          | <b>0.16</b>       | 0.1413         |

- The Group further optimised its product portfolio to consolidate the market share of its high-end products. The revenue during the year increased by 17.7% to RMB30,265.4 million as compared with 2009. Net profit attributable to owners of the Company was RMB1,237.3 million.
- The Group continuously expanded its production capacity and its aggregate annual production capacity reached 6.5 million tonnes in December 2010.
- In the top 20 global dairy enterprises issued by Rabobank, the Netherlands, Mengniu's ranking jumped to 16th, reflecting that its corporate strengths have been recognised internationally.
- In November 2010, Mengniu successfully acquired Shijiazhuang Junlebao Dairy Co., Ltd. (石家莊君樂寶乳業有限公司), the largest yogurt manufacturer in Northern China. Through this acquisition, Mengniu created development synergies in terms of milk sources, markets and channels in specific competitive areas, commencing industry consolidation and further reinforcing the leading position of Mengniu in the national yogurt market.

\* For identification purposes only

The board (the “Board”) of directors (the “Directors”) of China Mengniu Dairy Company Limited ( the “Company”) is pleased to present the results of the Company and its subsidiaries (the “Group”) for the year ended 31 December 2010, together with the comparative amounts.

## CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2010

|   | Notes | 2010<br>RMB'000         | 2009<br>RMB'000     |
|---|-------|-------------------------|---------------------|
| <b>REVENUE</b>  | 3     | <b>30,265,415</b>       | 25,710,460          |
| Cost of sales   |       | <u>(22,478,979)</u>     | <u>(18,858,229)</u> |
| <b>GROSS PROFIT</b>   |       | <b>7,786,436</b>        | 6,852,231           |
| Other income and gains  |       | <b>193,472</b>          | 80,959              |
| Selling and distribution costs  |       | <b>(5,429,141)</b>      | (4,653,460)         |
| Administrative expenses   |       | <b>(1,036,039)</b>      | (863,750)           |
| Other operating expenses  |       | <u><b>(59,745)</b></u>  | <u>(113,045)</u>    |
| <b>PROFIT FROM OPERATING ACTIVITIES</b>   |       | <b>1,454,983</b>        | 1,302,935           |
| Interest income   |       | <b>87,884</b>           | 85,042              |
| Finance costs   | 5     | <b>(45,203)</b>         | (61,153)            |
| Share of profits and losses of associates   |       | <u><b>40,438</b></u>    | <u>19,522</u>       |
| <b>PROFIT BEFORE TAX</b>  | 4     | <b>1,538,102</b>        | 1,346,346           |
| Income tax expense  | 6     | <u><b>(182,185)</b></u> | <u>(126,240)</u>    |
| <b>PROFIT FOR THE YEAR</b>  |       | <u><b>1,355,917</b></u> | <u>1,220,106</u>    |
| Attributable to:  |       |                         |                     |
| Owners of the Company   |       | <b>1,237,273</b>        | 1,115,799           |
| Non-controlling interests   |       | <u><b>118,644</b></u>   | <u>104,307</u>      |
|   |       | <u><b>1,355,917</b></u> | <u>1,220,106</u>    |
| <b>EARNINGS PER SHARE ATTRIBUTABLE<br/>TO ORDINARY EQUITY HOLDERS OF<br/>THE COMPANY (EXPRESSED IN RMB<br/>PER SHARE)</b> | 8     |                         |                     |
| – Basic   |       | <b>0.712</b>            | 0.681               |
| – Diluted   |       | <u><b>0.711</b></u>     | <u>N/A</u>          |

Details of the dividends payable and proposed for the year are disclosed in note 7 to the financial statements.

## CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2010

|  | <i>Notes</i> | <b>2010</b><br><i>RMB'000</i> | 2009<br><i>RMB'000</i> |
|--|--------------|-------------------------------|------------------------|
| <b>NON-CURRENT ASSETS</b>                    |              |                               |                        |
| Property, plant and equipment                |              | <b>5,380,385</b>              | 4,919,608              |
| Construction in progress                     |              | <b>535,104</b>                | 326,679                |
| Land use rights                              |              | <b>484,572</b>                | 367,191                |
| Goodwill                                     |              | <b>451,613</b>                | 199,143                |
| Other intangible assets                      |              | <b>221,508</b>                | 31,637                 |
| Investments in associates                    |              | <b>113,857</b>                | 67,383                 |
| Available-for-sale investments               |              | <b>301,681</b>                | 17,409                 |
| Deferred tax assets                          |              | <b>81,060</b>                 | 131,741                |
| Other financial assets                       |              | <b>71,754</b>                 | 20,868                 |
|  |              | <u><b>7,641,534</b></u>       | <u>6,081,659</u>       |
| <b>CURRENT ASSETS</b>                        |              |                               |                        |
| Inventories                                  |              | <b>1,176,423</b>              | 714,897                |
| Bills receivable                             | 9            | <b>20,539</b>                 | 52,449                 |
| Trade receivables                            | 10           | <b>554,933</b>                | 527,303                |
| Prepayments and deposits                     |              | <b>942,303</b>                | 272,627                |
| Other receivables                            |              | <b>169,897</b>                | 66,202                 |
| Pledged deposits                             |              | <b>102,399</b>                | 230,968                |
| Cash and bank balances                       |              | <b>6,697,813</b>              | 6,150,021              |
|  |              | <u><b>9,664,307</b></u>       | <u>8,014,467</u>       |
| <b>CURRENT LIABILITIES</b>                   |              |                               |                        |
| Trade payables                               | 11           | <b>2,061,193</b>              | 1,531,366              |
| Bills payable                                | 12           | <b>1,487,302</b>              | 808,409                |
| Deferred income                              |              | <b>15,082</b>                 | 13,162                 |
| Accruals and customers' deposits             |              | <b>880,142</b>                | 559,291                |
| Other payables                               |              | <b>1,061,253</b>              | 1,211,172              |
| Interest-bearing bank loans                  |              | <b>550,786</b>                | 323,593                |
| Other loans                                  |              | <b>140,018</b>                | 106,947                |
| Income tax payable                           |              | <b>42,513</b>                 | –                      |
|  |              | <u><b>6,238,289</b></u>       | <u>4,553,940</u>       |
| <b>NET CURRENT ASSETS</b>                    |              | <u><b>3,426,018</b></u>       | <u>3,460,527</u>       |
| <b>TOTAL ASSETS LESS CURRENT LIABILITIES</b> |              | <u><b>11,067,552</b></u>      | <u>9,542,186</u>       |

|  | <b>2010</b>              | 2009             |
|--|--------------------------|------------------|
| <i>Notes</i>                                 | <b><i>RMB'000</i></b>    | <i>RMB'000</i>   |
| <b>NON-CURRENT LIABILITIES</b>               |                          |                  |
| Interest-bearing bank loans                  | <b>150,000</b>           | 350,000          |
| Long term payables                           | <b>14,102</b>            | 49,879           |
| Deferred income                              | <b>226,049</b>           | 230,613          |
| Deferred tax liabilities                     | <b>39,865</b>            | –                |
| Other financial liabilities                  | <b>420,027</b>           | –                |
|  | <u><b>850,043</b></u>    | <u>630,492</u>   |
| <b>NET ASSETS</b>                            | <u><b>10,217,509</b></u> | <u>8,911,694</u> |
| <b>EQUITY</b>                                |                          |                  |
| Equity attributable to owners of the Company |                          |                  |
| Issued capital                               | <b>178,679</b>           | 178,611          |
| Retained earnings                            | <b>2,050,216</b>         | 1,294,766        |
| Other reserves                               | <b>7,529,169</b>         | 7,102,301        |
|  | <u><b>9,758,064</b></u>  | <u>8,575,678</u> |
| Non-controlling interests                    | <b>459,445</b>           | 336,016          |
| <b>TOTAL EQUITY</b>                          | <u><b>10,217,509</b></u> | <u>8,911,694</u> |

## 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 mainly 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") issued by the International Accounting Standards Board ("IASB") and the disclosure requirements of the Hong Kong Companies Ordinance. They have been prepared on a historical cost basis except for share options and certain available-for-sale equity investments 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 2010. The financial statements of the subsidiaries are prepared for the same reporting period as the Company, using consistent accounting policies. All intra-group balances, transactions, unrealised gains and losses resulting from intra-group transactions and dividends are eliminated on consolidation in full. The result of subsidiaries are 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.

Losses within a subsidiary are attributed to the non-controlling interest even if that results in a deficit balance.

A change in the ownership of a subsidiary, without a loss of control, is accounted for as an equity transaction.

If the Group loses control over a subsidiary, it derecognises (i) the assets (including goodwill) and liabilities of the subsidiary, (ii) the carrying amount of any non-controlling interest and (iii) the cumulative translation differences recorded in equity; and recognises (i) the fair value of the consideration received, (ii) the fair value of any investment retained and (iii) any resulting surplus or deficit in profit or loss. The Group's share of components previously recognised in other comprehensive income is reclassified to profit or loss or retained profits, as appropriate.

#### 2.2 IMPACT OF NEW AND REVISED IFRSs

The Group has adopted the following new and revised IFRSs for the first time for the current year's financial statements.

|  |  |
|--|--|
| IFRS 1 (Revised)   | <i>First-time Adoption of International Financial Reporting Standards</i>  |
| IFRS 1 Amendments  | <i>Amendments to IFRS 1 First-time Adoption of International Financial Reporting Standards – Additional Exemptions for First-time Adopters</i>   |
| IFRS 2 Amendments  | <i>Amendments to IFRS 2 Share-based Payment – Group Cash-settled Share-based Payment Transactions</i>  |
| IAS 39 Amendment   | <i>Amendment to IAS 39 Financial Instruments: Recognition and Measurement – Eligible Hedged Items</i>  |
| IFRIC 17   | <i>Distributions of Non-cash Assets to Owners</i>  |
| Amendments to IFRS 5 included in <i>Improvements to IFRSs (May 2008)</i> | <i>Amendments to IFRS 5 Non-current Assets Held for Sale and Discontinued Operations – Plan to sell the controlling interest in a subsidiary</i> |
| Improvements to IFRSs (April 2009)                                       | <i>Amendments to a number of IFRSs</i>   |

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

Other than as further explained below, the adoption of the new and revised IFRSs has had no significant financial effect on these financial statements.

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

### Improvements to IFRSs (April 2009)

In April 2009, the IASB issued its second omnibus of amendments to its standards, primarily with a view to removing inconsistencies and clarifying wording. There are separate transitional provisions for each standard. The adoption of the following amendments resulted in changes to accounting policies but did not have any impact on the financial position or performance of the Group.

- *IFRS 8 Operating Segment*: Clarifies that segment assets and liabilities need only be reported when those assets and liabilities are included in measures that are used by the chief operating decision maker. As the Group's chief operating decision maker does review segment assets and liabilities, the Group has continued to disclose this information in Note 3.
- *IAS 7 Statement of Cash Flows*: States that only expenditure that results in recognising an asset can be classified as a cash flow from investing activities. This amendment will impact amongst others, the presentation in the statement of cash flows of the contingent consideration on the business combination completed in 2010 upon cash settlement.
- *IAS 36 Impairment of Assets*: Clarifies that the largest unit permitted for allocating goodwill, acquired in a business combination, is the operating segment as defined in IFRS 8 before aggregation for reporting purposes. The amendment has no impact on the Group as the annual impairment test is performed before aggregation.

Other amendments resulting from Improvements to IFRSs did not have any impact on the accounting policies, financial position or performance of the Group.

## 3. REVENUE AND OPERATING SEGMENT INFORMATION

For management purposes, the Group is organised into business units based on their products and services and has three reportable operating segments as follows:

- 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 – mainly manufacture and distribution of milk powder.

Management monitors the results of its operating segments separately for the purpose of making decisions about resources allocation and performance assessment. Segment performance is evaluated based on reportable segment profit/(loss), which is a measure of adjusted profit/(loss) before tax. The adjusted profit/(loss) before tax is measured consistently with the Group's profit/(loss) before tax except that interest income, finance costs, dividend income, as well as head office and corporate expenses are excluded from such measurement.

Segment assets exclude equity investments and other unallocated head office and corporate assets as these assets are managed on a group basis.

Segment liabilities exclude other unallocated head office and corporate liabilities as these liabilities are managed on a group basis.

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.

### 3. REVENUE AND OPERATING SEGMENT INFORMATION *(continued)*

Year ended 31 December 2010

|  | Liquid milk<br>products<br>RMB'000 | Ice cream<br>products<br>RMB'000 | Other dairy<br>products<br>RMB'000 | Total<br>RMB'000   |
|--|------------------------------------|----------------------------------|------------------------------------|--------------------|
| <b>Segment revenue:</b>  |                                    |                                  |                                    |                    |
| Sales to external customers  | 26,871,834                         | 3,111,521                        | 282,060                            | 30,265,415         |
| Intersegment sales   | 75,917                             | 736                              | 250,196                            | 326,849            |
|  | <u>26,947,751</u>                  | <u>3,112,257</u>                 | <u>532,256</u>                     | <u>30,592,264</u>  |
| Reconciliation:  |                                    |                                  |                                    |                    |
| Elimination of intersegment sales                                    |                                    |                                  |                                    | <u>(326,849)</u>   |
| Revenue  |                                    |                                  |                                    | <u>30,265,415</u>  |
| <b>Segment results</b>   | <b>1,836,040</b>                   | <b>17,125</b>                    | <b>(25,181)</b>                    | <b>1,827,984</b>   |
| Interest income  |                                    |                                  |                                    | 87,884             |
| Finance costs  |                                    |                                  |                                    | (45,203)           |
| Share of profits and losses of associates                            |                                    |                                  |                                    | 40,438             |
| Unallocated corporate expenses                                       |                                    |                                  |                                    | <u>(373,001)</u>   |
| Profit before tax  |                                    |                                  |                                    | 1,538,102          |
| Income tax expense   |                                    |                                  |                                    | <u>(182,185)</u>   |
| Profit for the year  |                                    |                                  |                                    | <u>1,355,917</u>   |
| <b>Segment assets</b>  | <b>11,499,448</b>                  | <b>1,387,524</b>                 | <b>372,228</b>                     | <b>13,259,200</b>  |
| Reconciliation:  |                                    |                                  |                                    |                    |
| Elimination of intersegment receivables                              |                                    |                                  |                                    | <u>(3,938,771)</u> |
| Unallocated corporate assets   |                                    |                                  |                                    | <u>7,985,412</u>   |
| Total assets   |                                    |                                  |                                    | <u>17,305,841</u>  |
| <b>Segment liabilities</b>   | <b>8,995,050</b>                   | <b>848,956</b>                   | <b>275,372</b>                     | <b>10,119,378</b>  |
| Reconciliation:  |                                    |                                  |                                    |                    |
| Elimination of intersegment payables                                 |                                    |                                  |                                    | <u>(3,938,771)</u> |
| Unallocated corporate liabilities                                    |                                    |                                  |                                    | <u>907,725</u>     |
| Total liabilities  |                                    |                                  |                                    | <u>7,088,332</u>   |
| <b>Other segment information:</b>                                    |                                    |                                  |                                    |                    |
| Depreciation and amortisation  | 569,016                            | 83,855                           | 22,727                             | 675,598            |
| Unallocated amounts  |                                    |                                  |                                    | <u>37,178</u>      |
| Total depreciation and amortisation                                  |                                    |                                  |                                    | <u>712,776</u>     |
| Capital expenditure  | 1,305,886                          | 70,429                           | 4,325                              | 1,380,640          |
| Unallocated amounts  |                                    |                                  |                                    | <u>45,423</u>      |
| Total capital expenditure  |                                    |                                  |                                    | <u>1,426,063*</u>  |
| Impairment losses recognized in<br>the consolidated income statement | (889)                              | 178                              | 563                                | (148)              |
| Other non-cash expenses  | 147,262                            | 8,814                            | 4,140                              | 160,216            |
| Unallocated amounts  |                                    |                                  |                                    | <u>205,967</u>     |
| Total non-cash expenses  |                                    |                                  |                                    | <u>366,035</u>     |

\* Capital expenditure consists of additions to property, plant and equipment, construction in progress, intangible assets, land use rights, and assets from the acquisition of associates and subsidiaries.

### 3. REVENUE AND OPERATING SEGMENT INFORMATION *(continued)*

Year ended 31 December 2009

|  | Liquid milk<br>products<br><i>RMB'000</i> | Ice cream<br>products<br><i>RMB'000</i> | Other dairy<br>products<br><i>RMB'000</i> | Total<br><i>RMB'000</i> |
|--|---|---|---|-------------------------|
| <b>Segment revenue:</b>  |   |   |   |                         |
| Sales to external customers  | 22,736,162                                | 2,685,056                               | 289,242                                   | 25,710,460              |
| Intersegment sales   | 61,408                                    | 16,115                                  | 4,633                                     | 82,156                  |
|  | <u>22,797,570</u>                         | <u>2,701,171</u>                        | <u>293,875</u>                            | <u>25,792,616</u>       |
| Reconciliation:  |   |   |   |                         |
| Elimination of intersegment sales                                    |   |   |   | (82,156)                |
| Revenue  |   |   |   | <u>25,710,460</u>       |
| <b>Segment results</b>   | 1,648,996                                 | 29,149                                  | (11,901)                                  | 1,666,244               |
| Interest income  |   |   |   | 85,042                  |
| Finance costs  |   |   |   | (61,153)                |
| Share of profits and losses of associates                            |   |   |   | 19,522                  |
| Unallocated corporate expenses                                       |   |   |   | (363,309)               |
| Profit before tax  |   |   |   | 1,346,346               |
| Income tax expense   |   |   |   | (126,240)               |
| Profit for the year  |   |   |   | <u>1,220,106</u>        |
| <b>Segment assets</b>  | 8,398,855                                 | 1,172,153                               | 336,725                                   | 9,907,733               |
| Reconciliation:  |   |   |   |                         |
| Elimination of intersegment receivables                              |   |   |   | (2,870,958)             |
| Unallocated corporate assets   |   |   |   | 7,059,351               |
| Total assets   |   |   |   | <u>14,096,126</u>       |
| <b>Segment liabilities</b>   | 5,139,046                                 | 766,052                                 | 216,681                                   | 6,121,779               |
| Reconciliation:  |   |   |   |                         |
| Elimination of intersegment payables                                 |   |   |   | (2,870,958)             |
| Unallocated corporate liabilities                                    |   |   |   | 1,933,611               |
| Total liabilities  |   |   |   | <u>5,184,432</u>        |
| <b>Other segment information:</b>                                    |   |   |   |                         |
| Depreciation and amortisation  | 530,942                                   | 87,577                                  | 22,357                                    | 640,876                 |
| Unallocated amounts  |   |   |   | 34,522                  |
| Total depreciation and amortisation                                  |   |   |   | <u>675,398</u>          |
| Capital expenditure  | 556,128                                   | 16,049                                  | 11,913                                    | 584,090                 |
| Unallocated amounts  |   |   |   | 56,115                  |
| Total capital expenditure  |   |   |   | <u>640,205*</u>         |
| Impairment losses recognized in<br>the consolidated income statement | 15,631                                    | 233                                     | 1,149                                     | 17,013                  |
| Other non-cash expenses  | 110,786                                   | 26,419                                  | 4,063                                     | 141,268                 |
| Unallocated amounts  |   |   |   | 143,378                 |
| Total non-cash expenses  |   |   |   | <u>301,659</u>          |

\* Capital expenditure consists of additions to property, plant and equipment, construction in progress, intangible assets, land use right, and assets from the acquisition of associates and subsidiaries.

### 3. REVENUE AND OPERATING SEGMENT INFORMATION *(continued)*

#### Geographical information

(a) *Revenue from external customers*

Over 90% of the revenue is contributed by the customers in Mainland China.

(b) *Non-current assets*

Over 90% of the Group's non-current assets are located in Mainland China.

### 4. PROFIT BEFORE TAX

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

|   | <b>2010</b>       | 2009       |
|---|-------------------|------------|
|   | <b>RMB'000</b>    | RMB'000    |
| Cost of inventories sold  | <b>22,478,979</b> | 18,858,229 |
| Employee benefit expense (excluding directors' remuneration)                                |                   |            |
| – Wages, salaries, housing benefits and other allowances                                    | <b>1,172,323</b>  | 1,021,717  |
| – Retirement benefit contributions  | <b>93,941</b>     | 71,695     |
| – Share-based payment expense   | <b>290,587</b>    | 223,902    |
|   | <b>1,556,851</b>  | 1,317,314  |
| Loss on disposal of items of property, plant and equipment                                  | <b>18,661</b>     | 7,834      |
| Depreciation of property, plant and equipment   | <b>697,996</b>    | 663,863    |
| Amortisation of land use rights   | <b>9,172</b>      | 7,231      |
| Amortisation of other intangible assets   | <b>5,608</b>      | 4,304      |
| Research and development costs – current year expenditure                                   | <b>37,111</b>     | 42,158     |
| Provision/(write-back of provision) for trade receivables and other receivables             | <b>(1,013)</b>    | 15,980     |
| Minimum lease payments under operating leases on buildings and certain production equipment | <b>252,888</b>    | 222,429    |
| Display space leasing fees  | <b>495,076</b>    | 172,306    |
| Auditors' remuneration  | <b>3,940</b>      | 3,790      |

### 5. FINANCE COSTS

An analysis of finance costs is as follows:

|   | <b>2010</b>    | 2009    |
|---|----------------|---------|
|   | <b>RMB'000</b> | RMB'000 |
| Interest on long term payables                            | <b>6,339</b>   | 10,543  |
| Interest on bank loans wholly repayable within five years | <b>38,864</b>  | 50,610  |
|   | <b>45,203</b>  | 61,153  |

## 6. 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-three (2009: twenty-one) of the Group’s subsidiaries and a jointly controlled entity, the entities within the Group are subject to CIT at a rate of 25% (2009: 25%) on the taxable income as reported in their statutory accounts which are prepared in accordance with the PRC accounting standards and financial regulations.

|  | 2010<br><i>RMB’000</i> | 2009<br><i>RMB’000</i> |
|--|------------------------|------------------------|
| <b>Current income tax</b>  |                        |                        |
| Current income tax charge  | 131,504                | 71,100                 |
| <b>Deferred income tax</b>   |                        |                        |
| Relating to origination and reversal of tax losses and temporary differences | 50,681                 | 55,140                 |
|  | <b>182,185</b>         | <b>126,240</b>         |

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:

|  | Notes | 2010<br><i>RMB’000</i> | 2009<br><i>RMB’000</i> |
|--|-------|------------------------|------------------------|
| Profit before tax  |       | 1,538,102              | 1,346,346              |
| At CIT rate of 25% (2009: 25%)                                   |       | 384,525                | 336,587                |
| Non-deductible items and others, net                             |       | 55,376                 | 63,888                 |
| Adjustment recognised in the year for current tax of prior years |       | 953                    | 1,017                  |
| Effect of preferential tax rates                                 | (a)   | (148,950)              | (173,623)              |
| Effect of tax exemptions   | (a)   | (68,368)               | (55,432)               |
| Tax losses not recognised  |       | 7,514                  | 1,092                  |
| Utilisation of previously unrecognised tax credits               |       | (48,865)               | (47,289)               |
| At the effective income tax rate of 11.8% (2009: 9.4%)           |       | <b>182,185</b>         | <b>126,240</b>         |

Notes:

- (a) Twenty-three (2009: twenty-one) subsidiaries and a jointly controlled entity were subject to tax concessions in 2010. The total taxable profits of the subsidiaries that are subject to tax concessions amounted to approximately RMB804,315,000 (2009: RMB792,749,000) in aggregate. Out of the twenty-three subsidiaries, fourteen (2009: sixteen) 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”. Nine (2009: five) subsidiaries were granted tax concessions in accordance with the policy of “The notice of preferential tax policy for preliminary processing of agriculture products”.
- (b) The share of tax attributable to associates amounting to approximately RMB9,948,000 (2009: RMB8,178,000) is included in the share of profits and losses of associates on the face of the consolidated income statement.

## 7. DIVIDENDS

|   | <i>Notes</i>   | <b>2010</b><br><b>RMB'000</b> | 2009<br><i>RMB'000</i> |
|---|----------------|-------------------------------|------------------------|
| <i>Declared and paid during the year</i>                |                |                               |                        |
| Equity dividends on ordinary shares                     |                | <u>245,445</u>                | <u>–</u>               |
| <i>Proposed for approval at the AGM</i>                 |                |                               |                        |
| Equity dividends on ordinary shares:                    |                |                               |                        |
| Proposed final – 0.16 (2009: 0.1413) per ordinary share | <i>(a)/(b)</i> | <u>278,078</u>                | <u>245,465</u>         |

### *Notes:*

- (a) 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 was not recognised as a liability in the consolidated financial statements as at 31 December 2010 but was reflected as an appropriation of retained earnings for the year ending 31 December 2011.
- (b) The proposed final dividend for the year is appropriated from the undistributed profit earned before 1 January 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 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 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 the contingent ordinary share provision in *IAS 33 Earnings per Share*.

The share options outstanding had no dilutive effect on the calculation of diluted earnings per share for 2009.

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

|   | <b>2010</b><br><i>Number of</i><br><b>Shares</b><br><b>'000</b> | 2009<br><i>Number of</i><br><i>shares</i><br><i>'000</i> |
|---|---|--|
| Weighted average number of ordinary shares for the purpose of the basic earnings per share calculation                                      | <b>1,737,398</b>  | 1,637,304  |
| Weighted average number of ordinary shares, assuming issued at no consideration on the deemed exercise of all share options during the year | <u>3,443</u>  | <u>–</u>   |
| Weighted average number of ordinary shares for the purpose of the diluted earnings per share calculation                                    | <u><b>1,740,841</b></u>   | <u>1,637,304</u>   |

## 9. **BILLS RECEIVABLE**

An aged analysis of the bills receivable as at the end of the reporting period, based on the invoice date, is as follows:

|                 | <b>2010</b><br><i>RMB'000</i> | 2009<br><i>RMB'000</i> |
|-----------------|-------------------------------|------------------------|
| Within 3 months | <b>19,439</b>                 | 51,949                 |
| 4 to 6 months   | <b>1,100</b>                  | 500                    |
|                 | <u><b>20,539</b></u>          | <u>52,449</u>          |

## 10. **TRADE RECEIVABLES**

The Group normally allows a credit period of not more than 30 days to its customers which is extendable in certain circumstances. The Group closely monitors overdue balances. In view of the aforementioned and the fact 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:

|                 | <b>2010</b><br><i>RMB'000</i> | 2009<br><i>RMB'000</i> |
|-----------------|-------------------------------|------------------------|
| Within 3 months | <b>444,546</b>                | 471,122                |
| 4 to 6 months   | <b>101,423</b>                | 46,112                 |
| 7 to 12 months  | <b>8,205</b>                  | 7,243                  |
| Over 1 year     | <b>759</b>                    | 2,826                  |
|                 | <u><b>554,933</b></u>         | <u>527,303</u>         |

## 11. **TRADE PAYABLES**

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

|                 | <b>2010</b><br><i>RMB'000</i> | 2009<br><i>RMB'000</i> |
|-----------------|-------------------------------|------------------------|
| Within 3 months | <b>1,994,978</b>              | 1,463,848              |
| 4 to 6 months   | <b>51,315</b>                 | 63,708                 |
| 7 to 12 months  | <b>13,909</b>                 | 2,868                  |
| Over 1 year     | <b>991</b>                    | 942                    |
|                 | <u><b>2,061,193</b></u>       | <u>1,531,366</u>       |

## 12. BILLS PAYABLE

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

|                 | 2010<br><i>RMB'000</i> | 2009<br><i>RMB'000</i> |
|-----------------|------------------------|------------------------|
| Within 3 months | 493,824                | 712,105                |
| 4 to 6 months   | 993,478                | 96,304                 |
|                 | <u>1,487,302</u>       | <u>808,409</u>         |

## MANAGEMENT DISCUSSION AND ANALYSIS

### Financial Review

In the context of strengthening domestic consumption, the Group further optimised its product portfolio to consolidate the market share of its high-end products, and implemented stringent cost control measures, as well as adjusted the selling prices of certain products to cope with market change. These and other initiatives together contributed to the satisfactory results of the Group. During the year under review, revenue of the Group amounted to RMB30,265.4 million, an increase of 17.7% as compared with RMB25,710.5 million in 2009. Net profit attributable to owners of the Company was RMB1,237.3 million (2009: RMB1,115.8 million). Basic earnings per share were RMB0.712 (2009: RMB0.681).

#### *Gross Profit*

The Group recorded a gross profit of RMB7,786.4 million, an increase of 13.6% as compared with RMB6,852.2 million in 2009. Despite the rising raw material prices as a result of growing inflation in China, the Group managed to control the overall gross profit margin for the year at 25.7% (2009: 26.7%), attributable to the increased portion of high-end products, optimisation of product portfolio, stringent cost control measures and adjustment on selling prices of certain products, which effectively offset the effects brought by the surge in raw material prices.

#### *Operating Expenses*

In 2010, as the scale of operation of the Group expanded, the operating expenses of the Group increased to RMB6,524.9 million (2009: RMB5,630.3 million). However, its percentage to the Group's revenue for the year declined to 21.6% (2009: 21.9%) as a result of precise management and effective cost control.

Selling and distribution costs accounted for 17.9% of the Group's revenue, down from 18.1% in 2009. The Group implemented specified marketing campaigns for its products and maximised the utilisation of marketing resources to ensure enhancement of the brand image of *MENGNIU* and market share of the Group whilst lowering related costs. The percentage of advertising and promotion expenses to the Group's revenue for the year decreased from 10.3% in 2009 to 7.8% in the year under review.

The percentage of administrative and other operating expenses to the Group's revenue was effectively lowered to 3.7% (2009: 3.8%), which was attributable to the Group's initiatives on internal structural reform and stringent control of related expenses.

#### *Profit from Operating Activities and Net Profit Attributable to Owners of the Company*

The Group's EBITDA for the year was RMB2,208.2 million (2009: RMB1,997.9 million). Although the Group was under pressure arising from the upsurge in raw material prices, EBITDA margin slightly adjusted to 7.3% (2009: 7.8%) through an upgrade of product portfolio and effective cost control measures. During the year under review, net profit attributable to owners of the Company was RMB1,237.3 million (2009: RMB1,115.8 million), and net profit margin to owners of the Company for the year was 4.1% (2009: 4.3%).

#### *Capital Structure, Liquidity and Financial Resources*

For the year ended 31 December 2010, the Group's net cash inflow from operating activities amounted to RMB2,485.1 million (2009: RMB2,131.6 million). Net cash balances (cash and bank balances net of total bank loans) reached RMB5,997 million as at 31 December 2010 (31 December 2009: RMB5,476.4 million), indicating the strong financial position and healthy cash flow of the Group.

As at 31 December 2010, the outstanding bank loans of the Group amounted to RMB700.8 million (31 December 2009: RMB673.6 million), of which RMB550.8 million (31 December 2009: RMB323.6 million) was repayable within one year and RMB150 million (31 December 2009: RMB350 million) was repayable beyond one year. The bank loans totalling RMB270.8 million (31 December 2009: RMB323.6 million) were fixed interest-bearing loans.

The total equity of the Group was RMB10,217.5 million as at 31 December 2010 (31 December 2009: RMB8,911.7 million), and the debt-to equity ratio (total bank loans over total equity) of the Group was 6.9% (31 December 2009: 7.6%).

For the year ended 31 December 2010, the Group's finance costs amounted to RMB45.2 million (2009: RMB61.15 million), representing approximately 0.1% of the Group's revenue (2009: 0.2%).

#### **Market Review**

China's dairy companies pressed ahead amidst a market environment with opportunities and challenges abounding in 2010.

Following a development theme of "Adjusting Structure and Promoting Consumption", the Government aimed at vigorously boosting consumption demand and facilitating stable economic growth by speeding up urbanisation and expanding domestic consumption. Driven by the continuing increase in spending on food consumption and demand for quality consumption by Chinese people, the China dairy industry grew steadily in 2010. At the same time, the Government continued to strengthen safety control on the dairy industry. In 2010, 66 new national safety standards including those related to raw milk (《生乳》) were revised and re-promulgated and the Notice of Further Strengthening of Measures regarding the Quality and Safety of Dairy Products (《關於進一步加強乳品質量安全工作的通知》) and the Rules

Governing the Review of Permission Granted for the Production of Dairy Products (《乳製品生產許可審查細則》) were promulgated to regulate the dairy market and accelerate industry consolidation.

On the other hand, inflation in China with a rise in the consumer price index exceeded expectations, thus surging prices of raw milk and raw materials had brought considerable cost pressures to bear on dairy companies. Meanwhile, as a result of industry competition, dairy companies sought to maintain their foothold. Under the environment of high raw material prices and market competition, Mengniu implemented stringent cost control, optimised its product portfolio and adjusted selling prices to effectively alleviate the pressure arising from the soaring costs. The Group also carried out structural reform and formulated its five-year development plan to strengthen its leading position in the industry and lay a solid foundation for its future development.

## **Business Review**

Unique market insights and well-advanced development strategies were the keys to the Group's success in overcoming the tough situation across the dairy industry during the year.

By implementing stringent cost control measures, Mengniu streamlined each source of costs and implemented cost improvement scheme within its various processes, ranging from raw materials, procurement, production, logistics, marketing and administrative management. The Group also introduced focused cost saving proposals and adjusted the prices of certain products timely to secure profitability.

With reference to international enterprises, Mengniu carried out structural reform to reclassify business segments, adopt systematic responsibilities and management, facilitate exchange and cooperation between different departments and optimise resource allocation. Overall synergies to be created year-by-year will effectively reduce the costs of the Group.

In line with the development strategy for high-end functional dairy products, whilst strengthening the enhancement of milk sources and enhancing product quality, the Group also forged ahead with the development and promotion of high value-added products and tapped market opportunities to add new growth drivers to the Group's business. In November 2010, the Group successfully acquired 51% equity interest in Shijiazhuang Junlebao Dairy Co., Ltd., the largest yogurt manufacturer in Northern China, becoming its largest shareholder. Through this acquisition, Mengniu turned the competitor into its partner to create development synergies in terms of milk sources, markets and channels in local competitive areas. The win-win cooperation commenced industry consolidation and further reinforced the leading position of Mengniu in the national yogurt market. The acquisition is beneficial within to the Group's overall planning and conducive to its long-term development.

Leveraging its advanced planning and timely and effective adjustment measures, Mengniu outperformed its peers amid intense competition and delivered outstanding results better than the average industry level during the year. According to statistics of China Industrial Information Issuing Centre under China's National Bureau of Statistics, the Group's dairy products ranked first in terms of sales volume and sales value among similar products in China for the fifth consecutive year. Furthermore, according to monitoring statistics of Nielsen Company, market share of the Group's liquid milk and yogurt both ranked first in

terms of market share. The Group's leading position in the industry was demonstrably further consolidated.

### *Branding and Marketing*

In 2010, Mengniu launched its brand new image of “High Quality for a Green Life” (好品質，綠生活), demonstrating its determination towards becoming a green enterprise, offering green products and advocating green consumption. The Group also focused on the society and the future, contributing to the exploration of the low-carbon economic development model. As a brand of pastures, Mengniu is committed to extending its green source dependence on a green environment and performing its necessary responsibility and mission as a leading Chinese dairy enterprise.

While organising various large-scale eco-activity campaigns in China, Mengniu also launched large-scale marketing campaigns for its mainstay products. Examples include a music talents cultivation programme “Mengniu Suan Suan Ru Music Dream Academy” (蒙牛酸酸乳音樂夢想學院), the “Cholesterol Health Dissemination Expert Seminar Tour” (膽固醇健康傳播行動專家巡講) aiming at dissemination of health knowledge and the “Champion Technology Pavillion” (冠益乳科技館) for promotion of the high-tech value of products at the Shanghai World Expo, to boost its product sales as well as enhance our brand reputation among consumers.

Through a series of focused activities, the Group further enhanced its corporate brand image and became the only dairy product partner of the Boao Forum for Asia for the fifth time. In the top 20 global dairy enterprises issued by Rabobank, the Netherlands, in June 2010, Mengniu's ranking jumped to 16th, reflecting that its corporate strengths have been recognised internationally. Mengniu was one of the “Top 500 Asian Brands” (亞洲品牌500強) for the fifth consecutive year, ranking 132nd, up 41 places, in the list and the second among dairy brands in Asia. It was included as one of the “Asia's Fab 50 Companies 2010” (亞洲上市公司50強) compiled by Forbes, the only dairy company in China on the roll, and ranked 20th in the “Top 50 Most Valuable Chinese Brands 2010” (2010年中國最具價值品牌50強) published by WPP, a world leader in marketing communications.

### *Products*

Catering for consumers in pursuit of a healthy life and quality products along with the enhancement of society standards, the Group stepped up its efforts on the enhancement of milk sources and upgraded the supply of raw milk fully guaranteeing quality products manufactured from superior grades of milk. Meanwhile, Mengniu also focused on market segmentation, product research and development (R&D), quality improvement and portfolio enhancement to meet the needs of the market. By offering consumers natural dairy products with premium quality, Mengniu led the market through innovations and the concept of healthy life.

## Liquid milk

Revenue from the liquid milk segment amounted to RMB26,871.8 million, an increase of 18.2% as compared with RMB22,736.2 million in 2009, accounting for 88.8% (2009: 88.4%) of the revenue of the Group as its major income source.

## UHT milk

Revenue from UHT milk products grew by 18.3% to RMB16,790.4 million (2009: RMB14,196.2 million), accounting for 62.5% (2009: 62.4%) of liquid milk segment revenue.

The *Future Star Milk* (未來星兒童奶) series was upgraded by adding DHA algal oil through the application of advanced technologies. The *Upgraded Wisdom* (升級智慧型), *Upgraded Vitality* (升級活力型) and *Upgraded Youhu* (升級優護型) series were launched to cater for different stages of growth of children. *Future Star Milk* (未來星兒童奶) garnered numerous awards during the year, including the Innovative Product Award at the French International Food Fair (SIAL) (法國SIAL國際食品展創新產品大獎), the Monde Selection prize by the Belgian International Institute for Quality Selections, which is known as the Food Nobel Prize (食品界諾貝爾獎), evidence of its remarkable success. *Milk Deluxe* (特倫蘇) continued to be a mainstay high-end milk product, and under its product series, *Milk Deluxe Chunxian* (醇纖特倫蘇) was launched. With phytosterol esters and food fiber, it effectively balances the level of cholesterol in the human body, and enhances health, digestion and absorption. The product was well received by white-collar workers. *Milk Deluxe* (特倫蘇) high-end product series sponsored the “On the Stage with Lang Lang, a Splendid Life with Milk Deluxe” (與朗朗同台，卓越特倫蘇人生), leveraging the outstanding musical achievements of Lang Lang and his image as an international elite to highlight the top brand image of the product. Currently, members of the Milk Deluxe Club (特倫蘇名仕會) reached 1.22 million, which gathered a social group with relatively greater influence and demand for high-end living quality. Mengniu launched *XinYangDao Zhenyang Milk* (新養道珍養牛奶), which was the first in China developed for improving blood circulation and skin beauty of female. The mid-range to high-end product tailor-made for female consumers has combined essences of donkey-skin, medlar and red jujube, considered to be beneficial to blood circulation.

## Milk beverages

Revenue from the milk beverages segment was RMB7,336.2 million (2009: RMB6,387.3 million), increased by 14.9% from last year, accounting for 27.3% (2009: 28.1%) of the liquid milk segment revenue.

Mengniu continued to devote efforts on innovation and R&D. Featuring a high-end fashionable style, *Fruit Milk Drink* (真果粒) obtained three independent intellectual property patents across the world, including one formula development patent and two production process patents, and has gained wide recognition in the market. The brand affinity of *Suan Suan Ru* (酸酸乳) was strengthened by charity and through sponsorship of the “Mengniu Suan Suan Ru Music Dream Academy” (蒙牛酸酸乳音樂夢想學院), and achieved market penetration aided by its positive brand image associates with “Music, Dream and Charity”. Its *Fruit and Vegetable Suan Suan Ru* (果蔬酸酸乳) contains a variety of nutritional elements to build a “Pyramid of Nutrition”(膳食寶塔) and supplement daily nutritional requirement for consumers

pursuing health. Specially designed for children, *Miao Miao Fruit and Vegetable* (妙妙果蔬) focused on the two new tasty strawberry and pineapple flavours. Added with isomaltose (低聚異麥芽糖), the product is effective in aiding digestion. Not only does the product cater for children's demand for tasty beverages, but also helps children to ingest balanced nutrition and spur healthy growth. In addition, Mengniu launched a brand new series of *Yiyou Te* (益優特), produced in plastic packages features vitamins and newly added special nutrients (Galactooligosaccharides, whey protein and milk minerals). This new product has further expanded the Group's product mix.

## Yogurt

Revenue from the yogurt segment grew by 27.5% to RMB2,745.2 million (2009: RMB2,152.7 million), accounting for 10.2% (2009: 9.5%) of the liquid milk segment revenue.

*Champion* (冠益乳), the bi-functional yogurt with a dominant position in the yogurt market, was honoured with the Innovative Products Award at the French International Food Fair (SIAL) (法國SIAL國際食品展創新產品大獎), the International Food Industry Award (國際食品工業大獎) presented by the International Union of Food Science and Technology (國際食品科技聯盟) and the Most Innovative Product Idea Award (最具創新意識產品獎) at the China International Health Brand Introduction Conference (中國國際健康品牌推介大會). It was the first brand of Mengniu to obtain national certification as a health-care product and has enjoyed overwhelming favourable market response. Besides, *Champion* (冠益乳) spread consumers' understanding and knowledge of its products and enhanced its image as the top yogurt brand through the Champion Technology Pavillion (冠益乳科技館) at the Shanghai World Expo. The natural, pure *Inner Mongolia Old Yogurt* (內蒙古老酸奶), produced with Mengniu's modernised technology to enhance its smooth and delicate texture, has become one of the best-selling yogurt products during the year. *Youyi C* (優益C), which is rich with lactobacillus casein and fat-free, was well received by health-conscious consumers as it aids digestion.

## Ice cream

Revenue of the ice cream segment amounted to RMB3,111.5 million (2009: RMB2,685.1 million), up 15.9% from last year, accounting for 10.3% (2009: 10.5%) of the revenue of the Group.

By enriching product categories, strengthening the development of mid-range to high-end products and expanding market coverage, its product sales grew continually. With *Sui Bian* (隨變), *Ice+* (冰+) and *Mood for Green* (綠色心情) as the three major brands, Mengniu continued to enrich its product series. *Sui Bian* (隨變) maintained its brand image of "Ready-for-Change" (勇於改變) and initiated the "Endless Joy with One More" (歡樂無限，再來一支) campaign for a second time to stimulate the consumption market. It has launched the new *Euro* (歐羅) series with big chocolate chips added to bring an unique texture and a double taste to consumers. *Ice+* (冰+) launched *Cranberry+Yogurt Flavor Bar* (蔓越莓+酸奶口味冰棒), offering consumers with taste sensations for summer refreshment. Under the *Mood for Green* (綠色心情) brand *Lueshasha* (綠莎莎) was launched, which is an authentic flavour with green beans and cane sugar-free, satisfying health conscious consumers.

## Other dairy products

Revenue from other dairy products amounted to RMB282.1 million (2009: RMB289.2 million), accounting for 0.9% (2009: 1.1%) of the revenue of the Group.

For milk powder, *ChaoJinzhuang ZhiJiayi*™ (超金裝智佳益™), a product of *MENGNIU ARLA* (蒙牛阿拉), was launched with the amount of probiotics increased fourfold to provide sufficient nutrition for infants and improve their immune systems and their all-round development. In view of the growing demand for international branded milk powder in the market, Mengniu is poised to tap business opportunities through internal structure reform and rebranding. In addition, Mengniu has conducted market research during the year to gain a thorough understanding of market preferences. Tracing closely the trend of market development, the Chinese name of *MENGNIU ARLA* (蒙牛阿拉) was renamed as *MENGNIU ARLA* (歐世蒙牛) in December 2010, and will focus on the high-end market. *MENGNIU ARLA* (歐世蒙牛) is undergoing a comprehensive quality upgrade and is to be launched into the market with a brand new packaging, aiming to build a clear international brand image, embellishing the position of Mengniu's milk powder in the high-end market.

In respect of cheese, the Group has continued its R&D to develop cheese products that are suitable for the taste of Chinese. Focusing on the promotion of three major product series, namely *Family Breakfast Cheese* (家庭早餐), *Growth Cheese* (兒童成長) and *Soft Cheese* (軟質乳酪), the Group further enhanced its market penetration. In particular, the *Growth Cheese* (兒童成長乳酪) series was Mengniu's focus in promotion. The "Tour to Woolearn Academy" (帶你暢遊《烏龍學院》) campaign was organised to increase product exposure, deepen consumers' knowledge of the product and capture the expanding market share of children's yogurt.

## Quality Control

In response to the further implementation of various national policies in the PRC to strengthen the supervision and evaluation of the safety of dairy products, the Group adhered to its serious attitude towards quality control at every stage of its production process. Efforts have been made to enhance the testing level and supervision over food safety. On the basis of the certifications already obtained for its quality control, environmental management, occupational safety and health management and food management, the Group continued to embark upon its implementation of GMP for dairy products production, obtaining GMP certification for seven of its production plants. The Group's five laboratories in Beijing, Jiaozuo, Ma'anshan, Wuhan and Shenyang also passed evaluation earning qualification certificates, providing a sound guarantee for the Group's technological advancement in daily inspection of its products. To actively foster external cooperation in respect of laboratory testing projects, the Group collaborated with the Chinese Academy of Inspection and Quarantine (中國檢驗檢疫科學研究院) to establish a "Joint Dairy Products Laboratory" (乳品聯合實驗室), to jointly engage in the R&D of new methods for supervising and testing food safety. To strengthen its control over suppliers' quality and ensure the quality and safety of the raw materials, the Group has also established a supplier quality management department to engage in regular guidance work in evaluating its suppliers.

## *Production and Operations*

During the year, the Group continued to strive to expand production capacity. The aggregate annual production capacity increased to 6.5 million tonnes in December 2010 (2009: 5.76 million tonnes).

By introducing technologically advanced production facilities including a fully automated high-speed injection machine (全自動高速灌裝機) and fully automated packaging machines (全自動裹包機) from France and Italy, the Group's per-capita production capacity and production rate of labour had been effectively boosted. Working around the idea of "selling to where it is produced", the Group has established additional liquid milk production bases in northeastern China and more milk beverage production bases in southern China as well, in accordance with the regional diversification of the raw milk supply and market demand. Plant facilities were deployed for the second time, by enhancing the utilisation of its facilities and achieving the matching of sales and production, so that allocation of resources can be optimised. Further, in constructing new production plants, we pay special attention to the use of energy-saving equipment to reduce the Group's operating costs.

The reform of the Group's internal structure has contributed to the integration of the existing production units under the Group which had previously been running quite separately. This move has created favorable conditions for the sharing of resources and cost saving. In addition, asset enhancement projects have been initiated, which have involved the handling of idle equipment and slow-moving components in operations by way of redeployment, re-sale or disposal. Meanwhile, an operating costs reduction project was put under trial run by the High Tech Department of the Group which aimed at reducing operating costs and enhancing the level of operational management. The project has delivered a promising initial performance and is planned to be promoted to various production regions under the Group.

## *Enhancement of Milk Sources*

The enhancement of milk sources is viewed by the Group as the key to being a leader in the industry. For years, the Group has been putting in continuous efforts in building up a pool of milk sources, stressing the modernisation of raw milk production and the tracking of such milk sources in the supply chain, which would secure the production of safe and reliable dairy products. During the year, the Group invested more than RMB700 million in enhancing these milk sources and supporting their production. This included providing of entrusted loans, prepaying for raw milk, investing in large scaled ranches and constructing in modernised ranches facilities. These ranches are all equipped with standardised and professional equipment and encouraged to apply modern cattle raising technology, creating favorable conditions for the provision of stable raw milk production and quality, and further raising the proportion of milk sources provided by ranches and scaled farms to more than 70% in 2010, well above the industry level. In addition, the Group has extended its reach to dairy farmers for providing technical services, establishing dairy farm technology service centres to provide all-round services to milk farmers who could learn scientific techniques in cattle raising and in disease prevention. The Group also provided instruction in actively enhancing the level of supervision of the safety of fodder and drugs, monitoring the use of cleansing equipment by milk farmers and the inspection of cattle's health, adjusting and reducing the transportation time of milk-carriers for enhancing freshness of raw milk, all with a view to fully securing the good quality of Mengniu dairy products at the upstream links of the production chain.

## *R&D Achievements*

The Group has been stressing the importance of investing in R&D. This investment has given rise to the continuous increase in the technological level of the Group and kept the Group in a leading position well ahead of its peers. During the year, Mengniu set up its overseas R&D station in Paris and overseas information stations in Geneva and Tokyo, for closer connection with the latest development trends of global technology and timely introduction of internationally leading technology. Meanwhile, Mengniu has also strengthened its independent innovation and R&D capability, and has been approved by the PRC's Ministry of Human Resources and Social Security for establishing a post-doctoral scientific research centre. Adding to that is the Group's breakthrough development in its joint research project with Harbin Institute of Technology on "Development of Lactic Acid Bacteria and Fermentation Agents with Self-owned Intellectual Property Rights" (開發自主知識產權乳酸菌及發酵劑). The project was evaluated by experts of the Chinese Institute of Food Science and Technology (中國食品科學技術學會) that the achievement was vital to the development of lactic acid bacteria. This achievement is also a boon to the Group in its R&D of yogurt products which are better suited to the body features of Chinese. As of 31 December 2010, Mengniu has, on a cumulative basis, submitted 1,012 patent applications and obtained patents in respect of 750 items, out of which 88 patents were applied for and 83 patents were obtained during the year. The fruitful technological achievements have been widely deployed in the development of products and have provided the wherewithal for maintaining the leading position of Mengniu in technological advancement.

## *Environmental Protection*

The Group has taken numerous actions in support of a green and low-carbon economy by paying attention to various aspects of resources protection and bringing awareness of environmental protection to every detailed aspect of the Group as part of its commitment to promoting the green concept to the community as a whole.

In its production operation, the Group implemented energy-saving and emission-reduction measures in each of its systems, including wise use of electricity, the renovation of equipment for reducing energy consumption, the adoption of recycling of cold/hot water in its self-built ranches, which effectively improved the utilisation of resources. Other environmentally-friendly projects include methane power generation, sewage treatment, and turning abandoned mountains to green areas as part of its production process. Mengniu became the first dairy enterprise in the PRC to engage in carbon auditing for the full range of its production processes, in the hope of creating new approaches to the low-carbon development of the industry.

In respect of brand building, the Group closely linked its corporate image to the concept of a green lifestyle and advocated the community's general recognition of environmental awareness. The Group is committed to involving all citizens in the PRC to let the "Eco-China" dream come true. During the year, the Group initiated 90 large-scale ecological experience activities "Ecological Movement Support China" (生態行動，助力中國) in 30 cities across the PRC, and launched an online "Carbon Test" (碳測試) in collaboration with cooperation partners on the network, to let consumers from different localities to easily calculate their own carbon footprints. Advocating the formation of a green ecological production chain in the dairy industry, Mengniu became a pioneer in the industry in using packaging materials which

were certified by FSC. The Group has also successfully kicked off a package recycling activity in Shanghai under the slogan of “Press it Flat after Drinking and Support the Recycling of Milk Cartons” (喝完壓扁，支持回收). In addition, Mengniu also initiated a three-year “Low-Carbon Enterprise Responsibility Programme” (低碳企業責任行動) in cooperation with about 10 industry leaders such as Lenovo, Haier Group and Sohu, to harness the power of the pioneers from various sectors and jointly fostered the implementation and development of a low-carbon economy of the PRC.

During the year, leveraging its efforts in low-carbon economy and its long-term green charitable deeds which have been widely applauded by the community, Mengniu was recognized as the “Most-Watched Low Carbon Contribution Enterprise” (最受關注的低碳貢獻企業) at the “First Annual China Low Carbon Forum” (低碳中國論壇首屆年會), the most authoritative and highest-ranking low carbon forum in the PRC. Further, it was recognised as an “China’s Outstanding Low Carbon and Energy Saving Enterprise in the PRC” (中國低碳節能優秀企業獎) at the High-tech Enterprise Development International Forum of the 3th High-Tech Forum of CHITEC (第十三屆科博會中國高新企業發展國際論壇). It was also granted a “Eco-China Contribution Award” (生態中國貢獻獎) at the “First Ecological China Forum” (首屆生態中國論壇).

### *Social Responsibilities*

The Group strongly believes that an enterprise which benefits from the community shall also contribute to the community, so it cares about social issues and participates in charitable activities all the way. During the year, Mengniu extended its “Love Gifts Action”, joining hands with The Foundation for Children and Teenagers (兒童少年基金會) and China Milk Caring Fund (中國牛奶愛心基金) to bring the love of millions of netizens to children and promote good health and good fortune through campaigns such as the “New Year’s Love Gifts” for Beijing Guangai School, “Love Gifts Scheme” for Shanghai Dabieshan Elementary School, and “Wenchuan’s Wishes” in Chapingxiang Elementary School in An County, Mianyang City, Sichuan Province. Mengniu has been actively and continuously participating in various charitable deeds including the donation campaign for drought relief in southwestern China, the disaster rescue action in Yushu after the earthquake, the “Mengniu Lets Your Dream Come True” campaign which attempted to locate lost parents of 3,000 orphans, the donation in collaboration with the General Administration of Sport of China for helping Hulunbeier Elementary School, the visit to the Shanghai Expo Security Guard Teams, and the visit to Sichuan Satellite Centre, contributing to the community.

### *Joint Ventures and Alliances*

During the year, the Group continued to explore cooperation with top-notch enterprises in different industries for exploring complementary resources advantage for supporting our development. Mengniu has forged an alliance with China Modern Dairy Holdings Ltd. (“China Modern Dairy”), the largest cattle-raising company and raw milk producer in the PRC, for priority supply. Under this arrangement Mengniu has the first right of refusal in respect of most of the raw milk of China Modern Dairy for the next six years, laying a solid foundation for securing a reliable and safe milk supply source. Mengniu also passed a stringent investigation by the Office of Lunar Exploration Program of the PRC (中國探月工程辦公室) and has become the only designated dairy product for the Lunar Exploration Program. It

has been providing products exclusively for China's Space Programme for eight successive years. In addition, Mengniu once again became the exclusive milk products for athletes under the General Administration of Sport of China in their preparation for the Olympic Games, and once again engaged in official cooperation with NBA China. In addition, it was the sole dairy product cooperation partner in the Boao Forum for Asia for the fifth time.

### *Human Resources*

As at 31 December 2010, the Group had approximately 21,500 employees in Mainland China and Hong Kong. Total staff costs for the year, excluding directors' remuneration, were approximately RMB1,556.9 million (2009: RMB1,317.3 million).

In 2010, the Group was in full gear in kicking off its employment qualification system and clarifying with employees a behavioral code of conduct and necessary knowledge and skills in their workplace. This served to enhance their business operating capability, enabling the Group to provide personalised training to its employees identifying the employee's potential and achieving the rational deployment of human resources. Other efforts include ongoing development of pre-job orientation and on-the-job training to staff members and arranging tests of the professional knowledge for enhancing their business skills and expertise. The human resources centre also enlisted overseas experts and specialists in the dairy industry to instruct its divisions responsible for R&D, sales and marketing, strategy formulation, legal affairs, international business and investment to bolster the overall strategic planning and operational needs of the Group, thereby facilitating the smooth operation of the Group.

### **Prospects**

2011 will be a year of good prospects as well as a year of change for the dairy industry in China. It is therefore vital for an enterprise to do its best and be flexible in facing the challenges.

At present, the dairy industry has resumed the steady growth rate of around 10%. The relatively low level of liquid milk consumption per capita in China compared with the international standard, increasing urbanisation, the growth of residents' incomes in urban and rural areas, and the continuous rise in consumption, are all favorable factors to boost future demand for dairy products. Under the 12th Five-Year Plan starting in 2011, it has been proposed to implement a strategy of expanding domestic demand and fostering the modernisation of the agricultural sector, which are favorable conditions for the future development of the industry. Mengniu is a pioneer in proposing a strategy of green development, creating a green industry chain and initiating a low-carbon economy, which is in line with China's policy direction of expediting the construction of a resources-conservation society and bolstering the country's environmental protection during the 12th Five-Year Plan Period.

During the year, the PRC Government rolled out the Rules Governing the Review of Permission Granted for the Production of Dairy Products (《乳製品生產許可審查細則》), which requires those enterprises without production permits to exit from the dairy market. The increasingly stringent policy of the PRC towards the supervision of food safety in the dairy industry has provided a healthy industry environment for the development of dairy enterprises. It can also inspire consumer confidence in branded products.

As an industry leader, the Group will engage in its strategic deployment from the long-term perspectives of the enterprise as well as the industry and formulate the five-year development plan of Mengniu, with the goal of becoming one of the world's top ten dairy companies. In order to realise this strategic vision, Mengniu will in the future focus on five aspects namely enhancement of milk sources, product portfolio, R&D capability, management system and brand building, via which it is envisaged to enhance the competitive strengths of the Group and lead the dairy industry of the PRC to enter a new stage of development.

*I. Enhancement of Milk Sources – Further implement the Group's strategy of standardizing ranches and enhancing the management of milk sources renders, to build its advantage in milk sources as a core competitive edge for future development*

To ensure product quality in upstream, on the basis of the enhancement of milk sources, the Group will continue its strategy of ranches standardisation by building its own ranches facilities and investing in ranch areas, aiming to further increase the proportion of ranch and scaled farm milk sources. Currently, the Group is already in full control of the quality-related process of its milk sources and the proportion of the milk source from ranches to total milk source is far higher than the industry average. In the fiercely competitive dairy market, milk sources, which are closely related to product quality, represent the core competence of an enterprise. Therefore the Group will consolidate the advantage of its already-existing milk sources and continue to step up efforts in the exploration of milk sources as well as further expand its modern ranch construction through various measures, thereby promoting an advanced approach to cattle raising and contributing to the modernised raw milk production of the PRC's dairy industry.

*II. Product Portfolio – Continue to optimise product portfolio, increase the proportion of high-end products, and enrich its product line with market segmentation*

Under the rapid growth of the consumption level of the Chinese society and the significant upgrade of consumption demand, high quality and functionality of dairy products will become the focus of the market in future. On the foundation of established leading position in UHT milk, yogurt and ice cream market, Mengniu will continue to strengthen its influence and maintain its market leadership. For high-end products, Mengniu will continue to focus on different niche demographic markets, especially children and the elderly segments which have vast growth potential, to develop functional products with high added value. The Group will optimise its product portfolio and enhance profitability, as well as consolidate its market leading position by innovative quality, in order to solidify the image as a high-end brand. Mengniu will keep itself abreast of market trends and proactively explore and identify market demand. It will keep on delivering new and diversified products in response to the increasingly high-quality healthy lifestyle of the consumers in the PRC.

*III. R & D Capability – Introduce advanced international technology, enhance internal R&D capability and ensure a leading position in technological advance*

R&D capability represents a momentum to drive the sound development of an enterprise. As a leader in the Chinese dairy industry, Mengniu is committed to cultivating its R&D capability in the dairy industry which is considered domestically as a leader and internationally as top-notch. Accordingly, the Group will continue to establish additional overseas R&D stations and strengthen its management over overseas information stations. It shall cooperate with

internationally leading R&D teams, forging strong collaboration and shall keep itself abreast of development trends within the industry and advanced technology around the world. It shall leverage overseas technological advances to drive the improvement of the core competence of the enterprise and bring the Group's R&D capability to an internationally leading level. In addition, the Group also attaches importance to the research of fundamental technology and the enhancement of internal R&D capability, so as to lay the foundation for its R&D innovation and guide the overall development of the industry via enhancing its own internal technological capability.

#### *IV. Management System – Foster organizational reform, solidify employment qualification system and emphasize precise management*

In the course of growth and development, Mengniu attaches great importance to its people and has continuously reformed its internal system for enhancing management level and laying the solid foundation for an enterprise to last a century. In 2010, Mengniu completed the initial reform of its organisational structure and will, on an orderly basis in the future, continue to implement reform, so as to achieve synergies among the systems upon integration. For the employment qualification system which is already in place, its functions will also be solidified and put into practice, in order to secure specialised development of staff and thus a solid human resources platform to support the development of the Group. Mengniu will also continue to enhance the level of its precise management as one of its focal points, and shall streamline its production, procurement, operation, marketing and R&D. It shall enhance its standardised management approach and stringently administer according to the standards applicable to an internationally advanced dairy enterprise. It will apply these standards to the areas of ranch construction and quality inspection, ensuring that its internal system can be aligned with the development scale of Mengniu as a leading dairy enterprise in the PRC and fully safeguard the system upon which the future development of the Group will be based.

#### *V. Brand Building – Work around “High Quality for a Green Life”, advocate its low-carbon initiative and build its international brand image fulfilling social responsibility*

With the increasing concern about environmental protection around the world, “green” and “ecology” will be the key focuses for the future economic development, and also an important signpost guiding the economic transformation of the PRC under the country's 12th Five-Year Plan. The concept of “High Quality for a Green Life” articulated by Mengniu will also be a theme in the course of the Group's development in the next few years. The Group shall fully comprehend and analyze the concept and adhere to its green strategy. It will build a brand image of caring for the society and caring for the environment, with an aim to become one of the top five most valuable and most influential brands within the fast moving consumer goods industry in the PRC. Mengniu will not only upgrade its product level, but also insist on natural and ecological “good quality”. Embracing a strong sense of social responsibility, it shall take action for achieving low-carbon economy by saving energy and reducing emissions in its production process and promote environmental protection in its marketing activities. It shall commit itself towards leading the PRC's development of ecological awareness among all citizens, bringing the growth of Mengniu in tandem with social development, achieving positive brand equity and resulting in a win-win situation of both the enterprise and the society.

Mengniu is fully confident of the future, given the vast potential of growth in the dairy product consumption market in the PRC. In response to market development trends, the Group's efforts will centre around its five-year plan and adhere to reform and innovation, enhance its management level, and foster the further international development, striving to become one of the world's top ten dairy companies.

## **CODE ON CORPORATE GOVERNANCE PRACTICE**

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.

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 2010.

## **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 2010.

## **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 2010.

## **SCOPE OF WORK OF ERNST & YOUNG**

The financial information in respect of the preliminary announcement of the Group's results for the year ended 31 December 2010 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.

## **PROPOSED FINAL DIVIDEND**

The Board has recommended the payment of a final dividend of RMB0.16 (2009: RMB0.1413) per ordinary share for the year ended 31 December 2010. Upon shareholders' approval at the forthcoming AGM, the proposed final dividend will be paid on or about 20 June 2011 to shareholders whose names appear on the register of members of the Company on 10 June 2011.

## **CLOSURE OF REGISTER**

The register of members of the Company will be closed from 7 June 2011 to 9 June 2011, both days inclusive, during which period no transfer of shares of the Company can be registered. In order to qualify for the abovementioned proposed final dividends, all transfers, accompanied by the relevant share certificates, must be lodged with the Company's branch share registrar, Computershare Hong Kong Investor Services Limited, at Shops 1712-16, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong for registration no later than 4:30 p.m. on 3 June 2011.

## **PUBLICATION OF ANNUAL RESULTS AND ANNUAL REPORT**

This results announcement is published on the websites of the Company's investor relations at [www.mengniu.com](http://www.mengniu.com) and Hong Kong Exchanges and Clearing Limited at [www.hkexnews.hk](http://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. Yang Wenjun, Mr. Bai Ying, Mr. Wu Jingshui and Mr. Ding Sheng. The Non-executive Directors are Mr. Niu Gensheng, Mr. Ning Gaoning, Mr. Jiao Shuge (alias Jiao Zhen), Mr. Julian Juul Wolhardt, Mr. Yu Xubo, Mr. Ma Jianping, Mr. Fang Fenglei and Mr. Ma Wangjun. The Independent Non-executive Directors are Mr. Zhang Julin, Mr. Liu Fuchun and Mr. Zhang Xiaoya.

## **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  
**Yang Wenjun**  
*Chief Executive Officer*

Hong Kong, 31 March 2011