

Market Review

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

Business Review

Branding & Marketing

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

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

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

Products

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

Liquid Milk

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

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

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

Ice Cream

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

Other Dairy Products

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