1. CORPORATE INFORMATION/GROUP REORGANISATION AND BASIS OF PRESENTATION OF THE FINANCIAL STATEMENTS

The Company was incorporated in the Cayman Islands on 16 February 2004 as an exempted company with limited liability. The shares of the Company have been listed on The Stock Exchange of Hong Kong Limited (the "Stock Exchange") with effect from 10 June 2004.

Pursuant to a group reorganisation scheme (the "Reorganisation") to rationalise the structure of the Group in preparation for the public listing of the Company's shares on the Stock Exchange, the Company acquired the entire issued share capital of China Dairy Holdings, the then holding company of the subsidiaries set out in note 15 to the financial statements on 14 May 2004, and thereby became the holding company of the Group. Further details of the Group Reorganisation are set out in the Company's prospectus dated 1 June 2004.

The Group Reorganisation involved companies under common control and, for accounting purposes, the Group is regarded and accounted for as a continuing group. Accordingly, the consolidated financial statements have been prepared using the pooling of interests method of accounting as if the Company has always been the holding company of the Group. On this basis, the Company has been treated as the holding company of the companies comprising the Group for the financial years presented rather than from the date of acquisition of China Dairy Holdings.

In the opinion of the directors, the financial statements, prepared on the above basis, present fairly the results, cash flows and the state of affairs of the Group as a whole.

2. IMPACT OF RECENTLY ISSUED INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRSs")

The International Accounting Standards Board has issued a number of new and revised IFRSs, herein collectively referred to as the new IFRSs, which are generally effective for accounting periods beginning on or after 1 January 2005. The Group has not early adopted these new IFRSs in the financial statements for the year ended 31 December 2004, except for the following standards:

- IFRS 3 Business Combinations;
- IAS 36 (amended 2004), Impairment of Assets; and
- IAS 38 (amended 2004), Intangible Assets.

2. IMPACT OF RECENTLY ISSUED INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRSs") (CONTINUED)

The early adoption of IFRS 3 has resulted in the Group ceasing to amortise goodwill acquired during the year, and starting to test for impairment of goodwill annually at the cash-generating unit level (unless an event occurs during the year which requires the goodwill to be tested more frequently). The transitional provisions of IFRS 3 has required the Group to derecognise the carrying amount of negative goodwill at 1 January 2004 of RMB28,182,000 with a corresponding adjustment to the opening balance of retained earnings. The adoption of IAS 36 and IAS 38 (amended 2004) has had no significant impact on the financial statements.

The Group has already commenced an assessment of the impact of the other new IFRSs, which are generally effective for accounting periods beginning on or after 1 January 2005, but is not yet in a position to state whether these new IFRSs would have a significant impact on its result of operations and financial position.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of preparation

These financial statements, which are presented in Renminbi, have been prepared in accordance with the IFRSs, which comprise standards and interpretations approved by the International Accounting Standards Board. They are prepared on the historical cost basis except that long term investments are stated at their fair values.

Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year ended 31 December 2004. The results of subsidiaries acquired or disposed of during the year are consolidated from or to their effective dates of acquisition or disposal, respectively. All significant intercompany transactions and balances within the Group are eliminated on consolidation.

Minority interests represent the interests of outside shareholders in the results and net assets of the Company's subsidiaries.

Subsidiaries

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Associates

The Group's investments in its associates are accounted for under the equity method of accounting. An associate is an entity in which the Group has significant influence and which is neither a subsidiary nor a jointly-controlled entity of the Group. The investments in associates are carried in the balance sheet at cost plus post-acquisition changes in the Group's share of net assets of the operation of the associates, less any impairment in value. The consolidated income statement reflects the Group's share of the results of the operation of the associates.

Long term investments

Long term investment are non-trading investments in unlisted equity securities intended to be held on a long term basis.

Unlisted securities are stated at their estimated fair values, on an individual basis. The estimated fair values of unlisted investments are determined by the directors having regard to, inter alia, the prices of the most recent reported sales or purchases of the securities, or comparison of price/earnings ratios and dividend yields of the securities with those of similar listed securities, with allowance made for the lower liquidity of the unlisted securities.

The gains or losses arising from changes in the fair value of a security are dealt with as movements in the long term investment revaluation reserve, until the security is sold, collected, or otherwise disposed of, or until the security is determined to be impaired, when the cumulative gain or loss derived from the security recognised in the long term investment revaluation reserve, together with the amount of any further impairment, is charged to the consolidated income statement in the period in which the impairment arises.

Property, plant and equipment

Items of property, plant and equipment are stated at cost less accumulated depreciation (see below) and impairment losses. The cost of self-constructed assets includes the cost of materials, direct labour and an appropriate proportion of production overheads.

Where an item of property, plant and equipment comprises major components having different useful lives, they are accounted for as separate items of property, plant and equipment.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Property, plant and equipment (Continued)

Expenditure incurred to replace a component of an item of property, plant and equipment that is accounted for separately, including major inspection and overhaul expenditure, is capitalised. Other subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the item of property, plant and equipment. All other expenditure is recognised in the consolidated income statement as an expense when incurred.

Depreciation is charged to the consolidated income statement on the straight-line basis over the estimated useful lives of items of property, plant and equipment and major components that are accounted for separately.

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

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

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

Construction in progress

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

Land use rights

Land use rights held by the Group are stated at cost less accumulated amortisation and any impairment losses. The land use rights are amortised on the straight-line basis over the unexpired period of approximately 50 years.

At the balance sheet date, the Group assesses whether there is any indication of impairment. If any such indication exists, the recoverable amount is estimated and the assets are written down to the recoverable amount.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Goodwill and negative goodwill

Goodwill on acquisition is initially measured at cost being the excess of the cost of the business combination over the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. As further explained under note 2 "Impact of Recently Issued International Financial Reporting Standards" on adoption of IFRS 3, goodwill is no longer required to be amortised and is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

As at the acquisition date, any goodwill acquired is allocated to each of the cash-generating units expected to benefit from the combination's synergies. Impairment is determined by assessing the recoverable amount of the cash-generating unit, to which the goodwill relates. Where the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognised. Where goodwill forms part of a cash-generating unit and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured on the basis of the relative values of the operation disposed of and the portion of the cash-generating unit retained.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, i.e., assets that necessarily take a substantial period of time to prepare for their intended use, are capitalised as a part of the cost of those assets. The capitalisation of such borrowing costs ceases when the assets are substantially ready for their intended use. The capitalisation rate for the year is based on the actual cost of the related borrowings.

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Inventories

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

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

(a) Raw materials: purchase cost on a weighted average basis.

(b) Finished goods: cost of direct materials and labour and a proportion of manufacturing overheads based on normal operating capacity but excluding borrowing costs on a weighted average basis.

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

Revenue recognition

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

(a) Sale of goods

Revenue is recognised when the significant risks and rewards of ownership of the goods have been transferred to the buyer and the amount of revenue can be measured reliably.

(b) Interest income

Revenue is recognised as interest accrues (taking into account the effective yield on the relevant asset).

Government grants

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Related parties

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or corporate entities.

Operating leases

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Rentals payable under operating leases are charged as expense to the consolidated income statement on the straight line basis over the lease terms.

Research and development costs

All research costs are charged to the consolidated income statement as incurred. Development costs incurred on an individual project are carried forward when its future recoverability can reasonably be regarded as assured. Any expenditure carried forward is amortised over the period of expected future sale from the related project.

The carrying value of development costs is reviewed for impairment annually when the asset is not yet in use, and otherwise when events or changes in circumstances indicate that the carrying value may not be recoverable.

Foreign currency transactions

Transactions in foreign currencies are recorded at the exchange rates ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated into RMB at the exchange rates ruling at the balance sheet date. All foreign exchange gains or losses are accounted for in the consolidated income statement. The assets and liabilities of overseas subsidiaries are translated at the exchange rates ruling at the balance sheet date. The income statements of overseas subsidiaries are translated at weighted average exchange rates for the year. The exchange differences arising on the retranslation are taken directly to equity. On disposal of a foreign entity, accumulated exchange differences are recognised in the consolidated income statement as a component of the gain or loss on disposal.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Income tax

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

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

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

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

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

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

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

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Cash and cash equivalents

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

Trade receivables, other receivables and amounts due from related parties

Trade receivables are recognised and carried at the original invoice amount less an allowance for any uncollectible amounts. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off when identified.

Other receivables and amounts due from related parties are recognised and carried at cost less a provision for any doubtful amount.

Trade and other payables

Trade payables and other payables are carried at cost which is the fair value of the consideration to be paid in the future for goods and services received, whether or not billed to the Group.

Interest-bearing loans and borrowings

All loans and borrowings are initially recognised at cost, being the fair value of the consideration received, net of issue costs associated with the borrowing. After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is calculated by taking into account any issue costs, and any discount or premium on settlement. Gains and losses are recognised in net profit or loss when the liabilities are derecognised or impaired, as well as through the amortisation process.

Provisions

A provision is recognised when the Group has a present legal or constructive obligation as a result of a past event and it is probable that a future outflow of resources embodying economic benefits will be required to settle the obligation provided that a reliable estimate can be made of the amount of the obligation.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Provisions (Continued)

Where the Group expects a provision to be reimbursed, the reimbursement is recognised as a separate asset, but only when the reimbursement is virtually certain. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognised as an interest expense.

Retirement benefits

The companies incorporated in the PRC now comprising the Group participate in defined contribution retirement plans managed by the local municipal government in the locations in which they operate. The relevant authorities of the local municipal government in the PRC undertake the retirement obligations of the Group's employees. The Group has no obligation for payment of retirement benefits beyond the annual contributions. The contribution payable is charged as an expense to the consolidated income statement as and when incurred.

Recoverable amount of non-current assets

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

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs. Impairment losses are recognised in the consolidated income statement.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Contingent liabilities and contingent assets

A contingent liability is a possible obligation that arises from past events for which existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. It can also be a present obligation arising from past events that is not recognised because it is not probable that an outflow of economic resources will be required, or that the amount of the obligation cannot be measured reliably.

A contingent liability is not recognised but is disclosed in the notes to the financial statements. When a change in the probability of an outflow occurs so that an outflow is probable, they will then be recognised as a provision.

A contingent asset is a possible asset that arises from past events for which existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain events not wholly within the control of the Group.

Contingent assets are not recognised but are disclosed in the notes to the financial statements when an inflow of economic benefits is probable. When an inflow is virtually certain, an asset is recognised.

Post balance sheet events

Post balance sheet events that provide additional information about a company's position at the balance sheet date or those that indicate the going concern assumption is not appropriate (adjusting events) are reflected in the financial statements. Post balance sheet events that are not adjusting events are disclosed in the notes to the financial statements when material.

Segment reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

Financial instruments

Financial assets and financial liabilities carried in the balance sheet include cash and cash equivalents, trade receivables and payables, other receivables and payables, loans and balances with related parties. The accounting policies on recognition and measurement of these items are disclosed in the respective accounting policies found in this section.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Financial instruments (Continued)

Financial instruments are classified as liabilities or equity in accordance with the substance of the contractual arrangement. Interest, dividends, gains and losses relating to a financial instrument classified as a liability are reported as expenses or income. Distributions to holders of financial instruments classified as equity are charged directly to equity. Financial instruments are offset when the Group has a legally enforceable right to offset and intends to settle either on a net basis or to realise the asset and settle the liability simultaneously.

Dividend

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

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

4. SEGMENTAL INFORMATION

The Group's operating businesses are organised and managed separately according to the nature of the products, with each segment representing a strategic business segment that offers different products in the PRC market. The liquid milk products segment carries out the business of the manufacture and distribution of UHT milk, milk beverages and yogurt. The ice cream products segment carries out the business of the manufacture and distribution of ice cream products. The other dairy products segment carries out the business of the manufacture and distribution of milk powder and milk tablets products.

4. SEGMENTAL INFORMATION (CONTINUED)

During the year, the Group's revenue, expenses, results, assets and liabilities and capital expenditure were principally generated in the PRC. Accordingly, an analysis of the Group's revenue, expenses, assets and liabilities and capital expenditure by geographical segment is not presented in this report.

	2004 RMB'000	2003 RMB'000
Segmental revenue:		
Liquid milk	**6,097,187**	3,498,162
Ice cream	**805,208**	475,233
Other dairy products	**311,432**	98,073
Consolidated revenue	**7,213,827**	4,071,468
Segmental net profit		
Liquid milk	**414,265**	327,911
Ice cream	**53,821**	29,683
Other dairy products	**24,142**	2,002
Consolidated net profit	**492,228**	359,596
Unallocated corporate expenses	**(52,610)**	(53,646)
Profit from operating activities	**439,618**	305,950
Finance costs, net	**(29,086)**	(12,900)
Share of profit of associates	**32**	738
Profit before taxation	**410,564**	293,788
Tax	**(18,465)**	(61,458)
Profit after taxation	**392,099**	232,330
Minority interests	**(72,706)**	(67,958)
Net profit attributable to shareholders	**319,393**	164,372

4. SEGMENTAL INFORMATION (CONTINUED)

	2004 RMB'000	2003 RMB'000
Segmental assets:		
Liquid milk	**3,492,377**	1,790,802
Ice cream	**585,881**	320,500
Other dairy products	**285,661**	81,466
Unallocated corporate assets	**808,970**	314,699
Elimination	**(410,775)**	(173,157)
Consolidated total assets	**4,762,114**	2,334,310
Segmental liabilities:		
Liquid milk	**2,229,560**	813,508
Ice cream	**170,511**	169,809
Other dairy products	**161,876**	80,457
Unallocated corporate liabilities	**307,814**	583,972
Elimination	**(410,775)**	(173,157)
Consolidated total liabilities	**2,458,986**	1,474,589
Capital expenditure:		
Liquid milk	**764,715**	601,651
Ice cream	**252,653**	125,992
Other dairy products	**81,732**	10,029
Others	**65,341**	3,777
	1,164,441	741,449
Depreciation:		
Liquid milk	**125,092**	49,671
Ice cream	**35,692**	17,555
Other dairy products	**1,628**	177
Others	**7,064**	2,808
	169,476	70,211
Other non-cash expenses:		
Liquid milk	**3,040**	1,366
Ice cream	**910**	(194)
Other dairy products	**6,058**	117
Others	**377**	270
	10,385	1,559

5. REVENUE AND OTHER INCOME

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

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

	2004	2003
	RMB'000	RMB'000
Revenue	**7,213,827**	4,071,468
Other income:		
Government grants	**7,865**	4,561
Trademark fees	**1,000**	1,272
Amortisation of deferred income	**3,860**	—
Goodwill amortisation	**—**	1,993
Others	**413**	1,242
	13,138	9,068
	7,226,965	4,080,536

Government grants have been received for the contribution of the Group to the local economy with respect to the establishment of infrastructure relating to the dairy products industry. There are no unfulfilled conditions or contingences attached to these grants.

6. PROFIT FROM OPERATING ACTIVITIES

The Group's profit from operating activities is arrived at after charging/(crediting):

	2004	2003
	RMB'000	RMB'000
Cost of inventories sold	**5,607,363**	3,047,949
Staff costs (excluding directors' remuneration)	**248,809**	113,673
Retirement benefit contributions	**3,459**	1,292
	252,268	114,965
Depreciation on property, plant and equipment	**169,476**	70,211
Amortisation of land use rights	**906**	406
Research and development costs	**7,428**	2,142
Provision for doubtful debts	**4,113**	1,081
Provision for obsolete inventories	**6,212**	522
Minimum lease payments under operating lease rentals on land and buildings	**3,073**	4,974
Display space leasing fees	**38,597**	6,970
Losses/(gains) on disposal of property, plant and equipment	**60**	(44)
Auditors' remuneration	**1,500**	800
Exchange losses, net	**1,969**	1,038

7. DIRECTORS' AND SENIOR EXECUTIVES' EMOLUMENTS

Directors' remuneration for the year, disclosed pursuant to the Listing Rules and Section 161 of the Hong Kong Companies Ordinance, is as follows:

	2004 RMB'000	2003 RMB'000
Fees	**60**	60
Other emoluments of directors		
— basic salaries, housing benefits, other allowances and benefits in kind	**2,028**	2,420
— retirement benefits contributions	**14**	14
	2,102	2,494

Directors' fees disclosed above include RMB36,000 (2003: RMB18,000) paid to independent non-executive directors.

Three non-executive directors agreed to waive their entitlements to directors' fees totaling RMB18,000 (2003: nil) for the year. Other than this, there was no arrangement under which a director waived or agreed to waive any remuneration during the year.

The number of directors whose remuneration fell within the following bands is as follows:

	2004 Number of directors	2003 Number of directors
Nil to RMB1,000,000	**10**	10

7. DIRECTORS' AND SENIOR EXECUTIVES' EMOLUMENTS (CONTINUED)

The five highest paid individuals in the Group during the year ended 31 December 2004 included three (2003: four) directors. Information relating to their emoluments has been disclosed above. The emoluments paid to the remaining non-director, highest paid senior executives during the year, were as follows:

	2004	2003
	RMB'000	RMB'000
Basic salaries, housing benefits, other allowances and benefits in kind	**1,100**	289
Retirement benefits scheme contributions	**4**	3
	1,104	292

The remuneration of these remaining highest paid senior executives for the year ended 31 December 2004 and 2003 fell within the band of nil to RMB1,000,000.

8. FINANCE COSTS, NET

	2004	2003
	RMB'000	RMB'000
Interest on bank loans wholly repayable within five years	**46,294**	15,881
Less: Amounts capitalised	**(6,862)**	(736)
	39,432	15,145
Interest income	**(10,346)**	(2,245)
Finance costs, net	**29,086**	12,900

The amounts capitalised are borrowing costs related to funds borrowed specifically for the purpose of obtaining qualifying assets. The interest rates on such capitalised borrowings during the years varied from 2.88% to 5.76% per annum.

9. TAX

Hong Kong profits tax has not been provided as the Group had no assessable profits arising in Hong Kong during the year.

9. TAX (CONTINUED)

The tax charge represents the PRC income tax provision for the year. An analysis of the major components of tax expenses of the Group is as follows:

	2004 RMB'000	2003 RMB'000
PRC corporate income tax	**18,454**	61,177
Share of tax attributable to associates	**11**	281
	18,465	61,458

Under PRC income tax law, except for certain preferential treatment available to six of its subsidiaries, the entities within the Group are subject to corporate income tax ("CIT") at a rate of 33% on the taxable income as reported in their statutory accounts which are prepared in accordance with the PRC accounting standards and financial regulations.

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

	Note	2004 RMB'000	2003 RMB'000
Profit before tax		**410,564**	293,788
At PRC corporate income tax rate of 33%		**135,486**	96,950
Non-taxable items and others, net		**(181)**	10,745
Effect of tax exemption	(1)	**(116,840)**	(46,237)
At effective income tax rates of 4.5% and 21%, respectively		**18,465**	61,458

9. TAX (CONTINUED)

Note:

1. Six (2003: three) subsidiaries were subject to tax exemption in 2004. The profit before tax in respect of these subsidiaries amounted to RMB354,060,000 (2003: RMB140,112,000) in aggregate. Five (2003: one) subsidiaries were granted tax exemption in accordance with the state tax bureau's approval based on the "Income Tax Law of People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises" under which these subsidiaries would be exempted from CIT for the first two profitable years and subject to 50% of the applicable tax rate for the following three profitable years. The remaining (2003: two) subsidiary was granted an exemption in accordance with the local tax bureau's approvals which are based on the policy of "The Notice of Income Tax Exemption for the Country's Key Enterprises in Agricultural Industries" from the tax authorities.

10. DIVIDEND

	Note	**2004 RMB'000**	2003 RMB'000
Proposed final — RMB0.0585 cents per ordinary share	(1)	**64,966**	—
Interest on convertible instrument		**15,087**	—
Dividend paid by China Dairy Holdings to the then shareholders of:			
— ordinary shares		**—**	41,483
— non-voting convertible redeemable preferred shares		**—**	20,377
		80,053	61,860

Note:

1. The proposed final dividend for the year is subject to the approval of the Company's shareholders at the forthcoming annual general meeting.

11. EARNINGS PER SHARE

The calculation of basic earnings per share for the current year is based on the net profit from ordinary activities attributable to shareholders for the year of RMB319,393,000, and the weighted average of 893,965,000 ordinary shares in issue during the year.

11. EARNINGS PER SHARE (CONTINUED)

The weighted average number of shares used to calculate the basic earnings per share for the year ended 31 December 2004 includes the additional 250,000,000 ordinary shares issued upon the listing of the Company's shares on the Stock Exchange on 10 June 2004 and 110,524,942 ordinary shares issued upon conversion of the convertible instrument on 20 December 2004. The comparative number of shares used to calculate the basic earnings per share for the year ended 31 December 2003 represents the pro forma issued share capital of the Company, comprising 143,654 ordinary shares and 749,856,346 ordinary shares issued for the Reorganisation as further described in note 30 to the consolidated financial statements.

The calculation of basic earnings per share for the year ended 31 December 2003 is based on the net profit from ordinary activities attributable to shareholders for the year of RMB164,372,000, and after the deduction of the dividend entitlement of the holders of the non-voting convertible redeemable preferred shares of RMB20,377,000, as set out in note 10 to the consolidated financial statements, and the weighted average of 750,000,000 ordinary shares assumed to have been in issue during the year ended 31 December 2003.

The calculation of diluted earnings per share is based on the net profit from ordinary activities attributable to shareholders for the year of RMB319,393,000 and the weighted average of 1,118,851,000 ordinary shares in issue during the year, being the weighted average number of ordinary shares outstanding during the year, adjusted for the effects of dilutive potential ordinary shares outstanding during the year.

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

	2004 Number of '000 shares	2003 Number of '000 shares (Note)
Weighted average number of ordinary shares for the purpose of basic earnings per share calculation	**893,965**	750,000
Weighted average number of ordinary shares, assuming issued at conversion of convertible instrument during the year	**224,886**	
Weighted average number of ordinary shares for the purpose of diluted earnings per share calculation	**1,118,851**	

11. EARNINGS PER SHARE (CONTINUED)

Note:

Diluted earnings per share amount has not been shown for the year ended 31 December 2003 as the non-voting convertible redeemable preferred shares of the Group outstanding during that year had an anti-dilutive effect on the basic earnings per share for that year.

12. PROPERTY, PLANT AND EQUIPMENT, NET

Group

	Buildings and structures RMB'000	Plant and machinery RMB'000	Office equipment RMB'000	Motor vehicles RMB'000	Total RMB'000
At 1 January 2004, net of accumulated depreciation	294,804	823,682	42,033	30,959	1,191,478
Additions	—	76,584	16,146	10,921	103,651
Transfers from construction in progress	504,761	579,251	15,254	2,923	1,102,189
Disposals	—	(156)	(149)	(9)	(314)
Depreciation charged for the year	(24,084)	(127,608)	(10,910)	(6,874)	(169,476)
At 31 December 2004, net of accumulated depreciation	775,481	1,351,753	62,374	37,920	2,227,528
At 1 January 2004					
Cost	305,576	907,363	47,181	35,339	1,295,459
Accumulated depreciation	(10,772)	(83,681)	(5,148)	(4,380)	(103,981)
Net carrying amount	294,804	823,682	42,033	30,959	1,191,478
At 31 December 2004					
Cost	810,337	1,563,042	78,432	49,174	2,500,985
Accumulated depreciation	(34,856)	(211,289)	(16,058)	(11,254)	(273,457)
Net carrying amount	775,481	1,351,753	62,374	37,920	2,227,528

12. PROPERTY, PLANT AND EQUIPMENT, NET (CONTINUED)

The Group's buildings are located in Mainland China.

Certain property, plant and equipment of the Group with a carrying value amounting to RMB430,428,000 (2003: RMB372,771,000) have been pledged to secure the long term payables of the Group, details of which are set out in note 27 to the consolidated financial statements.

Company

	Office equipment RMB'000
At 1 January 2004	—
Additions	**115**
Depreciation charged for the year	**(10)**
At 31 December 2004, net of accumulated depreciation	**105**
At 1 January 2004	
Cost	—
At 31 December 2004	
Cost	**115**
Accumulated depreciation	**(10)**
Net carrying amount	**105**

13. CONSTRUCTION IN PROGRESS

Group

	2004	2003
	RMB'000	RMB'000
At beginning of year	**146,016**	68,288
Additions during the year	**1,248,186**	579,471
Transferred to property, plant and equipment	**(1,102,189)**	(501,743)
At end of year	**292,013**	146,016

The Group's construction in progress is located in the PRC.

14. LAND USE RIGHTS

Group

	RMB'000
Cost:	
At beginning of year	**35,479**
Additions	**675**
At 31 December 2004	**36,154**
Accumulated amortisation	
At beginning of year	**(1,186)**
Additions	**(906)**
At 31 December 2004	**(2,092)**
Net book value	
At 31 December 2004	**34,062**
At 31 December 2003	**34,293**

15. INVESTMENTS IN SUBSIDIARIES

	Company 2004 RMB'000
Unlisted shares, at fair value	**699,572**
Due from a subsidiary	**972,419**
	1,671,991

The amount due from a subsidiary is unsecured, interest-free and has no fixed terms of repayment.

Details of the Company's principal subsidiaries at 31 December 2004 are set out below:

Name	Date of incorporation/ establishment*	Paid-up share/ registered capital	Percentage of equity interests attributable to the Company		Principal activities
			Direct	Indirect	
China Dairy Holdings (i)	5 June 2002	US$214	100%	—	Investment holding
China Dairy (Mauritius) Limited (i)	15 June 2002	US$100	—	100%	Investment holding
Inner Mongolia Mengniu Milk Industry (Group) Co., Ltd. (iii) (內蒙古蒙牛乳業(集團)股份有限公司) Manufacture and sale of dairy products	18 August 1999	RMB267,429,488	—	84.32%	
Inner Mongolia Mengniu Founding Industry Management Co., Ltd. (i) (iii) (內蒙古蒙牛方鼎產業管理有限責任公司)	9 February 2002	RMB30,000,000	—	83.34%	Investment holding
Mengniu Dairy (Wulanhaote) Co., Ltd. (i) (iii) (蒙牛乳業(烏蘭浩特)有限責任公司)	18 June 2002	RMB30,000,000	—	84.31%	Manufacture and sale of dairy products

15. INVESTMENTS IN SUBSIDIARIES (CONTINUED)

Name	Date of incorporation/ establishment*	Paid-up share/ registered capital	Percentage of equity interests attributable to the Company Direct	Indirect	Principal activities
Inner Mongolia Mengniu Dairy Keerqin Co., Ltd. (i) (iii) (內蒙古蒙牛乳業科爾沁有限責任公司)	19 June 2002	RMB20,000,000	—	84.32%	Manufacture and sale of dairy products
Mengniu Dairy (Dangyang) Co., Ltd. (i) (iii) (蒙牛乳業(當陽)有限責任公司)	7 November 2002	RMB42,000,000	—	84.32%	Manufacture and sale of dairy products
Mengniu Dairy (Beijing) Co., Ltd. (i) (iii) (蒙牛乳業(北京)有限責任公司)	11 November 2002	RMB60,000,000	—	84.31%	Manufacture and sale of dairy products
Mengniu Dairy (Shenyang) Co., Ltd. (i) (ii) (蒙牛乳業(沈陽)有限責任公司)	4 December 2003	RMB50,000,000	—	84.32%	Manufacture and sale of dairy products
Beijing Mengniu Hongda Dairy Co., Ltd. (i) (北京蒙牛宏達乳制品有限責任公司)	12 September 2002	RMB10,000,000	—	43.85%	Package and sale of dairy products
Inner Mongolia Mengniu Dairy Baotou Co., Ltd. (i) (iii) (內蒙古蒙牛乳業包頭有限責任公司)	9 January 2003	RMB30,000,000	—	84.32%	Manufacture and sale of dairy products
Mengniu Dairy (Dengkou Bayan Gaole) Co., Ltd. (i) (iii) (蒙牛乳業(磴口巴彥高勒)有限責任公司)	13 July 2003	RMB40,000,000	—	84.31%	Manufacture and sale of dairy products
Inner Mongolia Mengniu Dairy (Group) Shanxi Dairy Co., Ltd. (i) (ii) (內蒙古蒙牛乳業(集團)山西乳業有限公司)	14 July 2003	RMB10,000,000	—	75.89%	Manufacture and sale of dairy products

15. INVESTMENTS IN SUBSIDIARIES (CONTINUED)

Name	Date of incorporation/ establishment*	Paid-up share/ registered capital	Percentage of equity interests attributable to the Company		Principal activities
			Direct	Indirect	
Mengniu Dairy (Jiaozuo) Co., Ltd. (i) (iii) (蒙牛乳業(焦作)有限公司)	6 November 2003	RMB110,000,000	—	84.32%	Manufacture and sale of dairy products
Mengniu Dairy Taian Co., Ltd. (i) (ii) (蒙牛乳業泰安有限責任公司)	18 November 2003	RMB110,000,000	—	84.32%	Manufacture and sale of dairy products
Mengniu Dairy (Luannan) Co., Ltd. (i) (iii) (蒙牛乳業(灤南)有限責任公司)	31 March 2004	RMB35,000,000	—	84.32%	Manufacture and sale of dairy products
Mengniu Dairy (Tangshan) Co., Ltd. (i) (iii) (蒙牛乳業(唐山)有限責任公司)	31 March 2004	RMB35,000,000	—	84.32%	Manufacture and sale of dairy products

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

(i) Not audited by Ernst & Young Hong Kong or other Ernst & Young International member firms.

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

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

The above table lists the subsidiaries of the Company which, in the opinion of the directors, principally affected the results for the year or formed a substantial portion of the net assets of the Group. To give details of other subsidiaries would, in the opinion of the directors, result in particulars of excessive length.

16. INVESTMENTS IN ASSOCIATES

	Group 2004 RMB'000	Group 2003 RMB'000
Share of net assets	**20,578**	1,917

Details of the Group's principal associates at 31 December 2004 are set out below:

Name	Business structure	Place of incorporation/ registration and operations	Percentage of equity attributable to the Group 2004	Percentage of equity attributable to the Group 2003	Principal activities
Xinjiang Tianxue Food Co., Ltd. (i) (新疆天雪食品有限公司)	Corporate	The PRC	**21%**	20%	Trading of dairy products
Inner Mongolia Meng Niu AustAsia Model Dairy Farm Company Limited (i) (內蒙古蒙牛澳亞示範牧場有限責任公司)	Corporate	The PRC	**25%**	—	Production of raw milk, planting of pastures and processing of milk
Shandong Mengniu International Trading Co., Ltd. (i) (山東蒙牛國際貿易有限責任公司)	Corporate	The PRC	**21%**	—	Import and export of equipment
Fuzhou Mengxin Trading Co., Ltd. (i) (福州蒙鑫貿易有限公司)	Corporate	The PRC	**38%**	35%	Trading of dairy products
Shijiazhuang Mengniu Ice Cream Sales Co., Ltd. (i) (石家莊蒙牛冰淇淋銷售有限公司)	Corporate	The PRC	**33%**	30%	Trading of dairy products

16. INVESTMENTS IN ASSOCIATES (CONTINUED)

Name	Business structure	Place of incorporation/ registration and operations	Percentage of equity attributable to the Group 2004	2003	Principal activities
Tianjin Mengniu Ice Cream Sales Co., Ltd. (i) (天津蒙牛冰淇淋銷售有限責任公司)	Corporate	The PRC	**33%**	30%	Trading of dairy products
Guangzhou Mengniu Dairy Trading Co., Ltd. (i) (廣州市蒙牛乳業貿易有限公司)	Corporate	The PRC	**33%**	30%	Trading of dairy products
Wuhan Mengniu Dairy Co., Ltd. (i) (武漢蒙牛乳業有限公司)	Corporate	The PRC	**31%**	28%	Trading of dairy products
Guilin Mengniu Dairy Sales Co., Ltd (i) (桂林蒙牛乳業銷售有限公司)	Corporate	The PRC	**33%**	—	Trading of dairy products
Tianjin Mengniu Dairy Sales Co., Ltd (i) (天津市蒙牛乳業銷售有限公司)	Corporate	The PRC	**33%**	—	Trading of dairy products
Wenzhou Mengniu Dairy Co., Ltd (i) (溫州蒙牛乳業有限公司)	Corporate	The PRC	**33%**	—	Trading of dairy products
Harbin Mengniu Dairy Co., Ltd (i) (哈爾濱蒙牛乳業有限公司)	Corporate	The PRC	**38%**	—	Trading of dairy products
Chengdu Mengniu Dairy Sales Co., Ltd (i) (成都蒙牛乳業銷售有限責任公司)	Corporate	The PRC	**33%**	—	Trading of dairy products

(i) Not audited by Ernst & Young Hong Kong or other Ernst & Young International member firms.

16. INVESTMENTS IN ASSOCIATES (CONTINUED)

The above table lists the associates of the Group which, in the opinion of the directors, principally affected the results for the period or formed a substantial portion of the net assets of the Group. To give details of other associates would, in the opinion of the directors, result in particulars of excessive length.

17. LONG TERM INVESTMENTS

	Group	
	2004	2003
	RMB'000	RMB'000
Unlisted equity investments, at fair value	**3,409**	3,409

18. GOODWILL/NEGATIVE GOODWILL

Group

	Goodwill	**Negative goodwill**
	RMB'000	RMB'000
At 1 January 2004, net of accumulated amortisation	—	(28,182)
Additions during the year	115,549	—
Derecognition of negative goodwill on early adoption of IFRS3	—	28,182
At 31 December 2004	115,549	—
At 1 January 2004		
Cost	—	(30,584)
Accumulated amortisation	—	2,402
Net carrying amount	—	(28,182)
At 31 December 2004		
Net carrying amount	115,549	—

As explained in note 2 to the consolidated financial statements, the Group had early adopted IFRS 3 for the current year.

19. INVENTORIES

	Group	
	2004	2003
	RMB'000	RMB'000
Raw materials	**465,976**	304,860
Finished goods	**248,823**	103,930
	714,799	408,790

The carrying amount of inventories carried at net realisable value included in the above balances was approximately RMB12,000,000 (2003: nil) as at 31 December 2004.

20. TRADE RECEIVABLES

The Group normally allows a credit period of not more than 30 days to its customers. The Group closely monitors overdue balances. A provision for doubtful debts is made when it is considered that amounts due may not be recovered.

An aged analysis of the trade receivables of the Group is as follows:

	Group	
	2004	2003
	RMB'000	RMB'000
Within 3 months	**168,601**	97,030
Between 4 – 6 months	**21,904**	2,083
Between 7 – 12 months	**3,513**	—
Over 1 year	**64**	—
	194,082	99,113
Less: Provision for doubtful debts	**(8,783)**	(4,670)
	185,299	94,443

20. TRADE RECEIVABLES (CONTINUED)

The amounts due from related parties included in the above can be analysed as follows:

	2004	2003
	RMB'000	RMB'000
Associates	**21,582**	3,623

The balances are unsecured, non-interest bearing and are repayable on credit terms similar to those offered to other major customers of the Group.

21. PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

	Group	
	2004	2003
	RMB'000	RMB'000
Deposits	**306**	309
Prepayments	**110,258**	93,370
Other receivables	**18,622**	11,869
	129,186	105,548

22. CASH AND CASH EQUIVALENTS AND PLEDGED DEPOSITS

	Group	
	2004	2003
	RMB'000	RMB'000
Bank balances	**841,322**	376,598
Time deposits	**198,369**	—
	1,039,691	376,598
Less: Deposits pledged for bills payable	**(20,763)**	(2,425)
Cash and cash equivalents	**1,018,928**	374,173

22. CASH AND CASH EQUIVALENTS AND PLEDGED DEPOSITS (CONTINUED)

	Company	
	2004	2003
	RMB'000	RMB'000
Bank balances	**8,736**	—
Time deposits	**2,262**	—
	10,998	—

The Group's cash and cash equivalents comprise cash at banks and in hand. Cash at banks earns interest at floating rates based on daily bank deposit rates. Cash and bank balances aggregating RMB844,974,000 (2003: RMB321,871,000) were denominated in Renminbi, which is not freely convertible in the international foreign exchange market and its exchange rate is determined by the People's Bank of China.

23. TRADE PAYABLES

An aged analysis of the trade payables of the Group is as follows:

	Group	
	2004	2003
	RMB'000	RMB'000
Outstanding balances aged:		
Within 3 months	**585,208**	351,848
Between 4 – 6 months	**81,172**	65,255
Between 7 – 12 months	**26,100**	9,532
Over 1 year	**2,117**	898
	694,597	427,533

23. TRADE PAYABLES (CONTINUED)

The amount due to a related party included in the above can be analysed as follows:

	2004 RMB'000	2003 RMB'000
An associate	**669**	—

The balances are unsecured, non-interest bearing and are repayable on demand.

24. ACCRUALS AND OTHER PAYABLES

	Group	
	2004	2003
	RMB'000	RMB'000
Advances from customers	**136,870**	65,464
Salary and welfare payables	**40,220**	25,446
Current portion of long term payables *(note 27)*	**102,334**	87,146
Other payables	**454,270**	201,256
Other accruals	**24,466**	21,224
	758,160	400,536

The amount due to related parties included in the above can be analysed as follows:

		Group	
		2004	2003
	Note	**RMB'000**	RMB'000
Associates		**17,825**	2,058
A related party	(a)	**1,039**	2,152
		18,864	4,210

(a) The related party is Inner Mongolia Jiuqiang Machinery Co., Ltd., which is controlled and beneficially owned by a director of a major subsidiary of the Group.

The balances are unsecured, non-interest bearing and are repayable on demand.

25. INTEREST BEARING BANK LOANS

	Group	
	2004	2003
	RMB'000	RMB'000
Short term bank loans, unsecured	**470,542**	161,534
Long term bank loans, unsecured	**239,500**	226,000
	710,042	387,534

During the year, the annual interest rates of the short term bank loans and the long term bank loans varied from 3.65% to 5.31% and from 2.88% to 5.76% (2003: varied from 2.82% to 5.49% and from 2.88% to 5.76%), respectively. As at 31 December 2003 and 2004, the Group's interest bearing bank loans were denominated in Renminbi.

The repayment schedule of the bank loans is as follows:

	Group	
	2004	2003
	RMB'000	RMB'000
Within 1 year	**470,542**	161,534
Between 1–2 years	**76,500**	—
Between 2–5 years	**163,000**	226,000
Total interest bearing bank loans	**710,042**	387,534
Less: Amount due within 1 year included in current liabilities	**470,542**	161,534
	239,500	226,000

26. OTHER LOANS, UNSECURED

	Group	
	2004	2003
	RMB'000	RMB'000
Short term	**22,600**	27,600
Long term	**18,000**	18,000
	40,600	45,600

The repayment schedule of the other loans is as follows:

	2004	2003
	RMB'000	RMB'000
Within 1 year	**22,600**	27,600
Between 1–2 years	**18,000**	18,000
	40,600	45,600

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

27. LONG TERM PAYABLES

The Group's long term payables represent outstanding instalments payable for the purchase of plant, machinery and equipment. The balances are interest-free and are repayable as follows:

	2004 **RMB'000**	2003 RMB'000
Within 1 year	**102,334**	87,146
Between 1–2 years	**86,939**	58,809
Between 2–5 years	**102,986**	89,280
Total long term payables	**292,259**	235,235
Less: Amount due within 1 year included in current liabilities *(note 24)*	**(102,334)**	(87,146)
	189,925	148,089

28. DEFERRED TAX

As at 31 December 2004, the Group had unrecognised deferred tax assets in respect of tax losses arising in the PRC of RMB10,491,000 (2003: RMB14,851,000), provision of doubtful debts of RMB9,155,000 (2003: RMB5,483,000), provision for obsolete inventories of RMB7,146,000 (2003: nil) and accrued expenses of RMB16,169,000 (2003: RMB10,109,000).

29. DEFERRED INCOME

During 2004, various local government authorities granted certain fixed assets to the Group for nil consideration and provided finance for the Group to purchase certain fixed assets by way of a cash donation. The fair value of the fixed assets is included in fixed assets. The grants received are regarded as deferred income, which is amortised to match the depreciation charge of such fixed assets in accordance with the useful lives of those fixed assets. The movement of the balance during the year is as follows:

	Group	
	2004	2003
	RMB'000	RMB'000
At beginning of the year	**57,706**	—
Additions during the year	**10,380**	57,706
Amortisation	**(3,860)**	—
At end of the year	**64,226**	57,706

30. SHARE CAPITAL

	Note	Number of ordinary shares '000	RMB'000
Authorised:			
At incorporation on 16 February 2004	(a)	1,000	106
Increase in authorised capital	(b)	2,999,000	319,129
At 31 December 2004		3,000,000	319,235
Issued and fully paid:			
At incorporation on 16 February 2004	(a)	—	—
Shares issued for Reorganisation	(c)	144	15
Additional shares issued for Reorganisation	(d)	749,856	79,770
New issue on public listing	(e)	250,000	26,595
Shares issued upon conversion of convertible instruments	(f)	110,525	11,758
At 31 December 2004		1,110,525	118,138

(a) On 16 February 2004 (date of incorporation), the authorised share capital of the Company was HK$100,000 divided into 1,000,000 ordinary shares of HK$0.10 each. 1 share was allotted and issued at par.

(b) Pursuant to a written resolution of the shareholders on 18 May 2004, the authorised share capital was increased from HK$100,000 (equivalent to RMB106,000) to HK$300,000,000 (equivalent to RMB319,235,000) by the creation of an additional 2,999,000,000 ordinary shares of HK$0.10 each.

(c) On 14 May 2004, as part of the Reorganisation described in note 1 to the consolidated financial statements, the Company issued 143,654 ordinary shares of HK$0.10 each to the then shareholders of China Dairy Holdings in exchange for the entire issued share capital in China Dairy Holdings.

30. SHARE CAPITAL (CONTINUED)

(d) Upon the approval of the Company's listing on the Stock Exchange of Hong Kong Limited and pursuant to the resolution passed on 18 May 2004, the Company issued 749,856,346 ordinary shares of HK$0.10 each to the then existing shareholders in proportion to their respective shareholdings. The issued share capital of RMB79,770,000 was offset with the share premium arising from the public listing.

(e) On 10 June 2004, 250,000,000 ordinary shares of HK$0.10 each were issued to the public at HK$3.925 each for a total cash consideration, before the related issue expenses, of HK$981,250,000 (equivalent to RMB1,043,854,000) giving rise to a share premium of RMB1,017,259,000.

(f) On 20 December 2004, convertible instrument of US$10,570,000 (equivalent to RMB86,985,000) were converted into 110,524,942 ordinary shares of HK$0.10 each (note 32), giving rise to a share premium of RMB75,227,000, being the excess of the value of the convertible instrument of RMB86,985,000 over the par value of the new share issued of RMB11,758,000.

31. RESERVES

(A) Group

The movements in the reserves of the Group are set out in the consolidated statement of changes in equity of the consolidated financial statements.

(a) Statutory reserves

In accordance with the relevant PRC laws and regulations, PRC domestic companies are required to transfer 10% of the profit after income tax, as determined under PRC accounting standards and financial regulations, to the statutory common reserve, until the balance of the fund reaches 50% of the registered capital of that company. Subject to certain restrictions as set out in the relevant PRC laws and regulations, the statutory common reserve may be used to offset against accumulated losses, if any.

Pursuant to the relevant PRC laws and regulations, certain subsidiaries within the Group are also required to transfer 5% to 10% of their net profit, as determined under PRC accounting standards and financial regulations, to the statutory common welfare reserve. This reserve can only be used to provide staff welfare facilities and other collective benefits to the employees of that company. This reserve is non-distributable other than in the event of liquidation.

31. RESERVES (CONTINUED)

(b) Contributed surplus

The contributed surplus of the Group represents the difference between the nominal value of the share capital of the subsidiaries acquired pursuant to the Group Reorganisation, as set out in note 1 to the consolidated financial statements, over the nominal value of the shares of the Company issued in exchange therefor.

(B) Company

	Notes	Share premium RMB'000 Note (a)	Contributed surplus RMB'000 Note (b)	Convertible instrument RMB'000	Retained earnings RMB'000	Total RMB'000
Net profit for the year	Note (c)	—	—	—	81,316	81,316
Issuance of convertible instrument and shares for Reorganisation	30 (c)/32	—	397,574	291,621	—	689,195
Issuance of shares upon public listing	30 (e)	1,017,259	—	—	—	1,017,259
Share premium transfer to share capital	30 (d)	(79,770)	—	—	—	(79,770)
Share issue costs		(62,336)	—	—	—	(62,336)
Shares issued upon conversion of convertible instrument	30 (f)	75,227	—	(86,985)	—	(11,758)
Proposed final dividend	10	—	—	—	(80,053)	(80,053)
At 31 December 2004		950,380	397,574	204,636	1,263	1,553,853

(a) Share premium

Under the Companies Law (2001 Second Revision) of the Cayman Islands, the share premium and contributed surplus are distributable to the shareholders of the Company, provided that immediately following the date on which the dividend is proposed to be distributed, the Company will be in a position to pay off its debts as and when they fall due in the ordinary course of business.

31. RESERVES (CONTINUED)

(b) **Contributed surplus**

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

(c) The net profit attributable to shareholders for the year ended 31 December 2004 dealt with in the financial statements of the Company was RMB81,316,000.

32. NON-VOTING CONVERTIBLE REDEEMABLE PREFERRED SHARES/CONVERTIBLE INSTRUMENT

On 17 October 2003, China Dairy Holdings issued 49,379 non-voting convertible redeemable preferred shares (the "Preferred Shares") to MS Dairy Holdings, CDH China Fund, L.P. and Actis China Investment Company Limited (collectively the "Financial Investors"). The initial subscription price of the Preferred Shares is US$713.54 per share, (the "Subscription Price") which is the same as the conversion price of the Preferred Shares (the "Conversion Price I").

On the same date, China Dairy Holdings declared a stock dividend in the form of (i) 0.86 ordinary shares per existing ordinary share; or (ii) 0.43 Preferred Shares per existing ordinary share. The Financial Investors elected to receive the Preferred Shares while other shareholders elected to receive the ordinary shares. As such, the Company issued an additional 21,187 Preferred Shares to the Financial Investors.

Pursuant to the terms of the Preferred Shares, the Conversion Price I is subject to certain adjustments under certain conditions and the Preferred Shareholders could elect to redeem the Preferred Shares at a predefined rate if certain conditions occur such as the merger and other business combination of the Company or certain subsidiaries. As at 31 December 2003 and 1 June 2004, being the Company's prospectus date, except for the stock dividend declared on 17 October 2003, the above conditions as defined in the terms of the Preferred Shares had not occurred, and no Preferred Shares have been redeemed or converted.

On the fifth anniversary of the closing date of the issuance of the Preferred Shares, China Dairy Holdings would be required to redeem all the Preferred Shares at a price per share equal to the original Subscription Price (plus accrued and unpaid dividend thereon).

Upon the approval of the Company's listing on the Stock Exchange of Hong Kong Limited, the Company issued units of convertible instrument (the "Convertible Instrument") in exchange for all Preferred Shares held by the Financial Investors.

32. NON-VOTING CONVERTIBLE REDEEMABLE PREFERRED SHARES/CONVERTIBLE INSTRUMENT (CONTINUED)

The principal amount of the Convertible Instrument amounted to US$35,233,827 (equivalent to RMB291,621,000) and the holders of the Convertible Instrument are entitled to interest payable simultaneously with any payment of dividends to the holders of the Company's ordinary shares, in an aggregate amount equal to the aggregate amount of the dividends declared on the ordinary shares multiplied by a pre-determined formula. The proposed interest which is regarded as an equity transaction and is calculated based on the proposed final dividend for the ordinary shares as set out in note 10 to the financial statements. The outstanding principal amount of the Convertible Instrument shall convert into such number of ordinary shares of the Company at a conversion price equal to approximately US$0.096 per share (the "Conversion Price II"). Pursuant to the terms of the Convertible Instrument, the Convertible Price II is subject to adjustment under certain conditions and the holders of the Convertible Instrument could elect to redeem the Convertible Instrument at a predefined rate if certain conditions occur such as a merger and other business combination of the Company or certain subsidiaries. The Group has pledged its interest in the entire share capital of China Dairy (Mauritius) Limited, a wholly-owned subsidiary of the Group, to the Financial Investors to secure this Convertible Instrument.

On the fifth anniversary of the date of the listing of Company's shares on the Stock Exchange of Hong Kong Limited, the Company is required to redeem the Convertible Instruments at the principal amount (plus accrued and unpaid dividend thereon) if not already converted by that date.

On 17 December 2004, units of the Convertible Instrument amounting to US$10,570,148 (equivalent to RMB86,985,000) representing 30% of the outstanding principal amount, were converted into 110,524,942 ordinary shares of HK$0.10 each.

33. OPERATING LEASE COMMITMENTS

The Group had total future minimum lease payments under non-cancellable operating leases in respect of buildings as follows:

	Group	
	2004	2003
	RMB'000	RMB'000
Within one year	**1,530**	859
In the second to fifth years, inclusive	**38**	230
	1,568	1,089

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

34. CONTINGENT LIABILITIES

The Group is contingently liable in respect of four guarantee contracts with a bank in favour of certain suppliers of raw milk (the "Suppliers") pursuant to which certain bank loans were granted to those Suppliers. The outstanding bank loans as at 31 December 2004 amounted to RMB83,000,000 (2003: RMB83,000,000). The guarantees are solely given by the Group, but the guarantees are counter-guaranteed by these Suppliers who are independent third parties. Security under these counter-guarantees included property, dairy cattle and other assets owned by these Suppliers.

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

35. COMMITMENTS

The Group had the following outstanding capital commitments in respect of the purchase/construction of plant, machinery and buildings at the end of each of the years:

	Group	
	2004	2003
	RMB'000	RMB'000
Contracted, but not provided for	**419,076**	214,558
Authorised, but not contracted for	**—**	601,786
	419,076	816,344

Subsequent to year end, the board of directors approved capital expenditure amounting to approximately RMB449,000,000.

36. FAIR VALUES OF FINANCIAL INSTRUMENTS

Financial instruments of the Group mainly consist of cash and bank balances, trade receivables, other current assets, trade payables, other payables, short term interest-bearing borrowings, long term interest-bearing borrowings and long term payables.

The carrying amounts of the Group's financial instruments approximated their fair value as at 31 December 2004 because of the short maturity of these instruments, except for long term interest-bearing borrowings. The carrying amount of the Group's long term interest bearing-borrowings approximated its fair value based on borrowing rates currently charged for loans with similar terms and maturities.

It was not practicable to estimate the fair value of the long term payables of RMB189,925,000 (2003: RMB148,089,000) and the long term other loans of RMB18,000,000 (2003: RMB18,000,000) as the instruments are not marketable.

Fair value estimates are made at a specific point in time and based on relevant market information about the financial instruments. These estimates are subjective in nature and involve uncertainties and matters of significant judgement and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

37. RELATED PARTY TRANSACTIONS

In addition to the transactions and balances which are disclosed elsewhere in these financial statements, the Group had the following significant transactions with its associates and related parties. The associates comprise of Guangzhou Mengniu Dairy Trading Co., Ltd., Fuzhou Mengxin Trading Co., Ltd. and other companies which are engaged in the sales of dairy products.

37. RELATED PARTY TRANSACTIONS (CONTINUED)

		Note	2004 RMB'000	2003 RMB'000
(a)	Sales of liquid milk to the associates	(i)	**668,009**	396,194
(b)	Sales of ice cream and other dairy products to the associates	(i)	**26,914**	—
(c)	Purchase of equipment from a related party	(i)/(ii)	**—**	(22,708)
(d)	Purchase of packaging materials from a related party	(i)/(iii)	**(14,450)**	(14,343)

(i) The price was determined with reference to the then prevailing market price/rates and the price charged to third parties.

(ii) The related party is Inner Mongolia Jiuqiang Machinery Co., Ltd. which is controlled and beneficially owned by a director of a major subsidiary of the Group.

(iii) The related party is Chaozhou Yangtian Printing Co., Ltd. which is controlled and beneficially owned by a substantial shareholder of the Company.

38. CONCENTRATION OF RISK

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

(i) Business risk

The Group conducts its operations in the Mainland China and accordingly is subject to special considerations and significant risks. These include risks associated with, inter alia, the political, economic and legal environment, influence of national authorities over pricing regulations and competition in the industry.

Furthermore, the five largest customers represented in aggregate approximately 24.78% and 18.02% of the revenues of the Group for the years ended 31 December 2003 and 2004, respectively.

(ii) Interest rate risk

The interest rates and terms of repayment of the bank loans of the Group are disclosed in note 25 to the consolidated financial statements. The Group has no significant concentration of interest rate risk.

38. CONCENTRATION OF RISK (CONTINUED)

(iii) Foreign currency risk

The Group's businesses are principally located in the PRC and all transactions are conducted in RMB, except for the purchases of machinery and equipment and sales to Hong Kong. As at 31 December 2004, all of the Group's assets and liabilities were denominated in RMB except that cash and cash equivalents of approximately RMB182,179,000 and RMB12,539,000 were denominated in US$ and HK$, respectively. Fluctuation of the exchange rates of RMB against foreign currencies could affect the Group's results of operations. However, in the opinion of the directors, the foreign currency risk exposure is under management's scrutiny.

(iv) Credit risk

In the opinion of the directors, the Group has no significant concentrations of credit risk. The carrying amount of trade receivables and cash included in the consolidated financial statements represent the Group's maximum exposure to credit risk in relation to its financial assets. The Group's cash and cash equivalents are mainly deposited with state-owned banks in the PRC. It has implemented policies to ensure sales of products are made to distributors with an appropriate credit history which is subject to periodic review. In addition, the Group's guarantees to the bank loans borrowed by certain suppliers of raw milk amounting to RMB83,000,000 (2003: RMB83,000,000) (detailed in note 34 to the consolidated financial statements) represent the Group's other exposure to credit risk. These guarantees are cross-guaranteed by assets owned by these suppliers.

39. SUBSEQUENT EVENTS

On 14 January 2005, the Company was informed by Mr Niu Gensheng ("Mr Niu"), the chief executive officer and director of the Company, that he has entered into an agreement (the "Agreement") with Inner Mongolia Mengniu Business Development Association (the "Association"), an independent and non-profit social organization established for the purpose of developing and promoting the business of the Group. Pursuant to the Agreement dated 12 January 2005, the Association will establish the Inner Mongolia Mengniu Business Development Association Laoniu Fund and Mr Niu will donate 51% of the cash dividends received from his shares in the Company and Mengniu to the fund. The fund will be used to provide incentives and rewards to individuals or organisations who have made significant contributions to the business of the Group.

Apart from the above, no other significant events took place subsequent to 31 December 2004.

40. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors on 6 April 2005.