Fufeng Group Limited
阜豐集團有限公司
(incorporated in the Cayman Islands with limited liability)
(Stock Code: 546)

# Annual Report 2007

# Contents

# Chairman's Statement

On behalf of the Board, I am pleased to present the annual report of the Group for the year ended 31 December 2007.

As one of the leading vertically integrated manufacturers of corn-based biochemical products, at present the Group is principally engaged in the glutamic acid and MSG related business ("MSG segment") and xanthan gum business ("xanthan gum segment"). The year of 2007 was a difficult period for the Group's industry. After reaching the peak in 2006, the MSG segment now enters an adjusting period facing various unfavourable factors such as adverse market conditions, excess product supply and continuous rise in raw material price. Meanwhile, the construction of IM Plant for xanthan gum operation has been completed in the fourth quarter of 2007 and has not made contribution to our 2007 results.

Despite these unfavourable factors, there was an increase in sales volume and turnover in 2007 which was mainly attributable to the Group's leading status and extensive sales network of our MSG segment and xanthan gum segment. Turnover increased by 37% comparing with 2006 and the turnover for whole year amounted to RMB 2,445,700,000. The Group maintained its profitability, with profit attributable to the Shareholders during the year reaching approximately RMB 45,069,000 and earnings per share was RMB 2.8 cents.

It is expected that the effect of market restructuring of the glutamic acid and MSG related business will show gradually in the year 2008, couples with the substantial reduction in energy cost following the commencement of production of xanthan gum business in IM Plant, we believes that our Group will step out of its tough time gradually in 2008.

## MSG segment

After reaching the peak in 2006, glutamic acid industry in the PRC entered into an adjustment period in 2007. During the year under review, operating environment of this industry has become extremely difficult due to adverse market conditions, excess product supply and continuous rise in raw material price, especially the significant rise in corn price, which leads to the closure of many medium and small-sized glutamic acid manufacturers.

The price of glutamic acid and MSG were reached its peak in high position in 2006 which attracted many competitors entering the market. As a result, the market supply of these products increased significantly. Due to excess product supply, the average prices of various corn processing products, including glutamic acid and MSG, dropped gradually. Furthermore, the serious shortage in supply of pork during 2007 attracted more people entering the pig farming industry which increased the demand for corn-based animal feeds. In addition, as the price of oil remains at a high level and the market expected to use corn refined ethanol as a source of alternative energy, the price of corn climbed up significantly. All these factors contributed to the increase in price of corn kernel, the raw material of our Group's products, thus leading to the decrease in profit margins.

On the other hand, many small scale coal mines shut down due to safety reason which leads to the reduction in supply of coal. Moreover, most of the coal mines were located in remote areas which rely heavily on rail transportation, and the extremely high transportation cost makes it difficult to transfer coal to the places which has high coal demand. As a result, there was a shortage in supply of coal in the PRC during 2007. The change of the PRC from a coal exporting nation into an importing nation led to the increase in international coal prices. All these factors contributed to the increase in fuel prices in the PRC during 2007.

# Chairman's Statement

Despite facing intense marketing competitions and significant increase in the cost of raw materials, by leveraging on the leading statuts of the Group in the industry of glutamic acid and MSG and the strategy of converting glutamic acid to the downstream product of MSG gradually, the Group was able to grasp the opportunities brought forward by the restructuring of the MSG market and has expanded its market share significantly. The increase in sale volume of MSG was doubled in 2007. For glutamic acid, as our Group changed part of its production from glutamic acid to MSG, the sales of glutamic acid only increased slightly.

## Xanthan gum

The market supply of xanthan gum increased gradually over the years and the market competition is heating up, especially the competitions between PRC and foreign corporations. Due to strong market demand, the supply of xanthan gum was well absorbed, but the market price of xanthan gum still decreased slightly. The market will continue to grow with more customers realising the advantage of using xanthan gum, and the expansion of market scale will offset the effect of decrease in market price.

Leveraging on development momentum of the xanthan gum market, the Group actively expand its production capacity of xanthan gum and overseas sales network during the year, which successfully increased the sales of xanthan gum by approximately 14%. Comparing with glutamic acid and MSG related business, the cost of corn represented only 20% of the overall production cost of xanthan gum, therefore the increase in the sales of xanthan gum will effectively reduce the risk of corn price increase. Furthermore, 10,000 tonnes of xanthan gum in IM Plant commenced production in the forth quarter of 2007. The IM Plant has benefit from the lower cost of coal, due to over 45% of the production cost of xanthan gum was attribute to coal. Full production will commence in 2008, which will reduce the production cost of xanthan gum and enhance market competitiveness of the Group.

## Research and Development

The Group obtained various rewards during the year. The R&D Center was promoted from county level technology center to provincial level technology center. In addition, it was accredited as "Research Center on Amino Acid Fermentation Technology of Shandong Province" and was one of the corporates drafting the standards on the fermentation of bio-chemical fertilisers which were issued by the National Development and Reform Commission at the end of 2007. During the year, the Group applied for 32 patents on its own-developed production technology and one patent was granted.

## Prospect and future plan

The aim of the Group is to maintain its leading position in the PRC bio-chemical fermentation industry and increase its domestic and overseas market share by leveraging on its competitive advantages and the adoption of the following strategies:

1. **Adjust its product mix and focus on enhancing the sales of xanthan gum.** The Group will continue to convert glutamic acid to the downstream product of MSG in order to grasp the opportunities arise from the restructuring of the MSG market. Furthermore, we will focus on the sales of xanthan gum and increase the export volume of xanthan gum to enlarge our market shares. On the other hand, due to the significant investment contributed to the PRC agricultural industry, it is expected that the demand for fertilisers will sustained at a high level. Therefore, the selling price and profit margins of the fertilisers will be able to keep at a higher level.

# Chairman's Statement

2. **Elaborate our advantages during market restructuring.** Following the commencement of market restructuring, manufacturers which rely on the glutamic acid prodived by Fufeng will be heavily affected. Moreover, being the leader in the market, Fufeng possesses the competitive advantages of having strong production capacities and better cost control ability which will help us to step out of the tough times. In addition, as some of the competitions was unable to survive the marketing structuring process, the number of market participants will decrease accordingly, which will lead to fall in supply and rise in selling price.

3. **Increase in production capacity and reduction in cost of production of new plant.** To further lower down the cost, the Group transfers the production capacity to IM Plant and Baoji Plant which possess advantage in terms of resources. After commencement of the Stage 1 production of xanthan gum project in IM Plant, production cost will reduce substantially and thus enhancing the Group's profit margins. Moreover, after the expansion of stage 2 of the IM Plant, 10,000 tonnes additional production capacity of xanthan gum will commence production at the end of 2008 or first half of 2009. The Group's total production capacity of xanthan gum will then reach 28,000 tonnes. By that time, the Group will become one of the world's leading xanthan gum manufacturers. Meanwhile, we will enhance the operation of IM Plant to reduce the overall operation cost.

4. **Research and Development.** Our R&D Center will continue to cooperate with various research institutions to develop new products and technologies. Our Group will commercialise new products and technology in due course to minimise risk and obtain new points of growth.

5. **Mergers and acquisition.** The Group will merge and acquire potential businesses in the market in order to widen our product offerings and increase its income sources.

Looking forward, the management will continue its effort to extend its advantage base on the solid financial situation of the Group. We will strive for ideal performance, implement the strict cost control measures to further increase the operation benefit and use its best endeavor execute the aforesaid strategies to overcome the difficult business environment.

## Appreciation

I would like to take this opportunity to express my gratuities towards the members of the Board, the management team, all staffs, business partners, customers and all shareholders as they all have contributed a lot for our development and supported us endlessly. The board will bear for the same faith and the determination of achievement; inherit the trading spirit continuously; endeavor to strengthen and develop the leading status in the market of glutamic acid and MSG related business and xanthan gum business; exploit the new corn-based biochemical products and raise our profitability to bring better return for the Shareholders.

**Li Xuechun**
*Chairman*

Hong Kong
24 April 2008

# Five-year Summary

| | Year | | | | |
|---|---|---|---|---|---|
| | 2003 | 2004 | 2005 | 2006 | **2007** |
| | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | ***RMB'000*** |
| **Operating results – Summary** | | | | | |
| Turnover | 449,224 | 625,313 | 1,296,408 | 1,787,247 | **2,445,652** |
| Gross profit | 72,171 | 108,475 | 317,616 | 355,142 | **249,666** |
| Profit before income tax | 53,144 | 78,086 | 236,280 | 249,808 | **45,485** |
| Profit attributable to Shareholders | 35,710 | 70,957 | 236,167 | 240,483 | **45,069** |
| **Balance sheets – Summary** | | | | | |
| Non-current assets | 174,203 | 328,538 | 566,690 | 1,353,859 | **1,743,481** |
| Current assets | 96,847 | 173,165 | 404,276 | 570,485 | **1,138,354** |
| Total assets | 271,050 | 501,703 | 970,966 | 1,924,344 | **2,881,835** |
| Current liabilities | 153,868 | 212,534 | 393,182 | 1,034,645 | **1,095,170** |
| Non-current liabilities | 64,693 | 167,598 | 231,778 | 363,306 | **337,849** |
| Net assets | 52,489 | 121,571 | 346,006 | 526,393 | **1,448,816** |
| **Financial ratio** | | | | | |
| Earnings per share (RMB Cent) | 2.98 | 5.91 | 19.68 | 20.04 | **2.80** |
| Gross profit ratio (%) *(Note 1)* | 16 | 17 | 25 | 20 | **10** |
| Current ratio *(Note 2)* | 0.63 | 0.81 | 1.03 | 0.55 | **1.04** |
| Inventory turnover days (Day) *(Note 3)* | 40 | 38 | 34 | 38 | **54** |
| Debtors' turnover days (Day) *(Note 4)* | 26 | 37 | 63 | 67 | **74** |
| Trade receivable turnover days (Day) *(Note 5)* | 10 | 8 | 9 | 17 | **10** |
| Creditors' turnover days (Day) *(Note 6)* | 27 | 41 | 64 | 65 | **76** |
| Trade payable turnover days (Day) *(Note 7)* | 20 | 38 | 63 | 58 | **74** |
| Gearing ratio (%) *(Note 8)* | 5 | 29 | 26 | 39 | **22** |

*Notes:*

1. Gross profit ratio is equal to gross profit divided by turnover.

2. Current ratio is equal to current assets divided by current liabilities.

3. The number of inventory turnover days is equal to inventories at the end of year divided by the cost of sales for the corresponding year and then multiplied by 365 days.

4. The number of debtors' turnover days is equal to trade and notes receivables at the end of year divided by the turnover for the corresponding year and then multiplied by 365 days.

5. The number of trade receivables turnover days is equal to trade receivables at the end of year divided by the turnover for the corresponding year and then multiplied by 365 days.

6. The number of creditors' turnover days is equal to trade and notes payables at the end of year divided by the cost of sales for the corresponding year and then multiplied by 365 days.

7. The number of trade payables turnover days is equal to trade payables at the end of year divided by the cost of sales for the corresponding year and then multiplied by 365 days.

8. Gearing ratio is equal to total borrowings at the end of the year divided by total assets at the end of the corresponding year.

# Corporate Information

## Executive Directors
Mr. Li Xuechun
Mr. Wang Longxiang
Mr. Wu Xindong
Mr. Yan Ruliang
Mr. Feng Zhenquan
Mr. Xu Guohua
Mr. Li Deheng
Ms. Li Hongyu
Mr. Gong Qingli

## Independent non-executive Directors
Mr. Choi Tze Kit, Sammy
Mr. Chen Ning
Mr. Liang Wenjun

## Registered Office
Cricket Square
Hutchins Drive, P.O. Box 2681
Grand Cayman KY1-1111
Cayman Islands

## Principal Place of Business in the PRC
Tianqiao Road
Junan County
Shandong Province, PRC

## Principal Place of Business in Hong Kong
Suite 1101, 11th Floor, Chinachem Century Tower,
178 Gloucester Road, Wanchai,
Hong Kong

## Company Secretary and Qualified Accountant
Mr. Yau Wing Yiu *CPA FCCA*

## Authorised Representatives
Mr. Li Xuechun
Mr. Yau Wing Yiu

## Audit Committee
Mr. Choi Tze Kit, Sammy *(Chairman)*
Mr. Chen Ning
Mr. Liang Wenjun

## Remuneration Committee
Mr. Choi Tze Kit, Sammy *(Chairman)*
Mr. Li Xuechun
Mr. Chen Ning
Mr. Liang Wenjun

## Principal Bankers in the PRC
China Construction Bank
Bank of China
Agriculture Bank of China

## Principal Bankers in Hong Kong
ABN AMRO Bank
Hang Seng Bank Limited

## Independent Auditor
PricewaterhouseCoopers

## Legal Adviser
Kirkpatrick & Lockhart Preston Gates Ellis

## Compliance Adviser
Piper Jaffray Asia Limited

## Principal Share Registrar
Butterfield Fund Services (Cayman) Limited

## Branch Share Registrar
Tricor Investor Services Limited

## Website
www.fufeng-group.com

# Biographies of Directors and Senior Management

## Executive Directors

李學純 (Li Xuechun), aged 56, is the principal founder of the Group, the chairman of the Company and an executive Director. Mr. Li is also a director of Acquest Honour, Summit Challenge, Absolute Divine, Expand Base, Shandong Fufeng, Baoji Fufeng and IM Fufeng. Mr. Li is responsible for the strategic planning and formulation of overall corporate development policy of the Group. Mr. Li obtained a bachelor's degree in industrial fermentation from 山東輕工業學院 (Shandong Institute of Light Industry) in 1982. Mr. Li is 山東省第十一屆人大代表 (a member of the Shandong Province 11th People's Congress), as well as being honored with "Outstanding Achievement" by the government of Shandong Province in April 2003. In the same year, he was also labeled as "Model Labour" of Shandong Province. Mr. Li first joined 山東福瑞酒廠 (Shandong Furui Brewery Group) in 1982 as the factory manager of the Junan County MSG Factory and then set up Shandong Fufeng in 1999. Mr. Li established the Group in June 1999 when he was appointed a director of Shandong Fufeng upon its establishment. He has 26 years of experience in the fermentation industry. Mr. Li is the sole director of and is beneficially interested in the entire issued share capital of Motivator Enterprises which in turn is interested in approximately 47.35% of the issued share capital of the Company and is a controlling shareholder of the Company. He is father of 李鴻鈺 (Li Hongyu) (an executive Director) and the brother-in-law of 李德衡 (Li Deheng) (an executive Director).

王龍祥 (Wang Longxiang), aged 46, is an executive Director and the general manager of the Group. Mr. Wang is responsible for the overall management of the Group's daily operations. Mr. Wang obtained a bachelor's degree in industrial fermentation from 山東輕工業學院 (Shandong Institute of Light Industry) in 1982. He is qualified as a senior engineer. Mr. Wang also obtained a master's degree in business administration from 中國科技大學 (University of Science and Technology of China) in 1992. Mr. Wang joined the Group in 2005 and has over 16 years of experience in the fermentation industry. Mr. Wang is interested in 14.3% of the issued share capital of Hero Elite, which in turn is interested in 72,000,000 Shares, representing 4.3% of the issued share capital of the Company. Mr. Wang was granted an option to subscribe for 16,000,000 Shares pursuant to the Pre-IPO Share Option Scheme, representing 0.96% of the issued share capital of the Company.

吳欣東 (Wu Xindong), aged 40, is an executive Director and vice general manager of the Group. Mr. Wu is also a director of Shandong Fufeng, Baoji Fufeng and IM Fufeng. Mr. Wu graduated from 山東廣播電視大學 (Shandong Broadcasting University) in 1989 in industrial enterprise management and later 山東省委黨校專科 (The Party School of Shandong Province) in 1999 with a certificate in economics management. Mr. Wu is responsible for the Group's operation. He was one of the initial management Shareholders. Mr. Wu joined the Group in June 1999 when he was appointed a director of Shandong Fufeng upon its establishment. Mr. Wu has 16 years of experience in the fermentation industry. Mr. Wu is the sole director of and is interested in 25% of the issued share capital of Ever Soar, which in turn is interested in 205,680,000 Shares, representing approximately 12.39% of the issued share capital of the Company.

嚴汝良 (Yan Ruliang), aged 54, is an executive Director and vice general manager of the Group. Mr. Yan is also a director of Shandong Fufeng, Baoji Fufeng and IM Fufeng. Mr. Yan was honored as "Model Labour" of Linyi City in 1998. Mr. Yan is responsible for the Group's administration and management. He first joined Shandong Furui Brewery Group in 1988 and was one of the initial management Shareholders. Mr. Yan has over 19 years of experience in business management. Mr. Yan joined the Group in June 1999 when he was appointed as a director of Shandong Fufeng upon its establishment. Mr. Yan is interested in 15% of the issued share capital of Ever Soar, which in turn is interested in 205,680,000 Shares, representing approximately 12.39% of the issued share capital of the Company.

# Biographies of Directors and Senior Management

馮珍泉 (Feng Zhenquan), aged 38, is an executive Director and vice general manager of the Group. Mr. Feng is also a director of Shandong Fufeng, Baoji Fufeng and IM Fufeng. He is in existing in charge of the operations of Baoji Fufeng. Mr. Feng graduated from 山東輕工業學院專科 (Shandong Institute of Light Industry) in 1990 majoring in electrical and mechanical technology. Mr. Feng was appointed as a director of Shandong Fufeng in May 2002 and has over 14 years of experience in the fermentation industry. He was one of the initial management Shareholders. Mr. Feng is interested in 15% of the issued share capital of Ever Soar, which in turn is interested in 205,680,000 Shares, representing approximately 12.39% of the issued share capital of the Company.

徐國華 (Xu Guohua), aged 39, is an executive Director and vice general manager of the Group who is responsible for the research and development department of the Group. Mr. Xu is also a director of Shandong Fufeng, Baoji Fufeng and IM Fufeng. Mr. Xu graduated from 山東輕工業學院 (Shandong Institute of Light Industry) majoring in fermentation and economics management in July 1991 and 2003 respectively. He completed his study in fermentation engineering from 天津科技大學 (Tianjin University of Science and Technology) in September 2004. Mr. Xu has been elected to stand as the executive council member of the China Fermentation Industry Association in 2004 and prior to that was invited in 2002 to be a member of the Amino Acid Technology Committee under the China Fermentation Industry Association. Mr. Xu first joined Shandong Furui Brewery Group in 1991. Mr. Xu jointed the Group in June 1999 and has over 17 years of experience in the fermentation industry. He was also one of the initial management Shareholders. Mr. Xu was appointed a director of Shandong Fufeng in May 2002. Mr. Xu is interested in 15% of the issued share capital of Ever Soar, which in turn is interested in 205,680,000 Shares, representing approximately 12.39% of the issued share capital of the Company.

李德衡 (Li Deheng), aged 39, is an executive Director and vice general manager of the Group who is in existing responsible for the business operations of IM Fufeng. He is also a director of Shandong Fufeng, Baoji Fufeng and IM Fufeng. Mr. Li graduated from the 山東聊城師範學院 (Shandong Liaocheng Teacher's College) in 1992 and obtained a bachelor's degree in chemistry education. He joined the Group in January 2001 and was appointed a director of Shandong Fufeng in November 2003 and has over 7 years of experience in business management. Mr. Li is the brother-in-law of Mr. Li Xuechun. Mr. Li is interested in 15% of the issued share capital of Ever Soar, which in turn is interested in 205,680,000 Shares, representing approximately 12.39% of the issued share capital of the Company.

李鴻鈺 (Li Hongyu), aged 31, is an executive Director and vice general manager of the Group who is responsible for the finance department of the Group. Ms. Li is also a director of Shandong Fufeng, Baoji Fufeng and IM Fufeng. Ms. Li joined the Group in October 2002 and was appointed a director of Shandong Fufeng in April 2004. Ms. Li graduated from 山東財政學院 (Shandong Finance Institute) in 2000 in taxation. She is the daughter of Mr. Li Xuechun.

龔卿禮 (Gong Qingli), aged 40, is an executive Director and the chief financial officer of the Group who is responsible for financial management and assists in strategic planning of the Group. He is also designated to manage and oversee the internal control and corporate governance systems of the Group. Mr. Gong obtained his accounting degree in 立信會計專科學校 (Shanghai Lixin Accounting College) in 1988. Mr. Gong is a member of the Chinese Institute of Certified Public Accountants. Prior to joining the Group in January 2007, Mr. Gong had over 18 years of experience in accounting, business advisory and risk management services, including some with an international accounting firm. Centerpoint Assets was granted an option to subscribe for 16,000,000 Shares pursuant to the Pre-IPO Share Option Scheme.

# Biographies of Directors and Senior Management

## Independent non-executive Director

蔡子傑 (Choi Tze Kit, Sammy), aged 45, was appointed as an independent non-executive Director in January 2007. Mr. Choi graduated from the Hong Kong Shue Yan College. He is an associate member of the Institute of Chartered Accountants in England and Wales, a fellow member of the Association of Chartered Certified Accountants and a Certified Public Accountant of the Hong Kong Institute of Certified Public Accountants. He is also an independent non-executive director of Yun Sky Chemical (International) Holdings Limited (formerly known as Swank International Manufacturing Company Limited), the issued shares of which are listed on the Stock Exchange. He has over 20 years of experience in finance and auditing.

陳寧 (Chen Ning), aged 45, was appointed as an independent non-executive Director in January 2007. Mr. Chen is a professor at the 天津科技大學生物工程學院 (School of Bioengineering, Tianjin University of Science and Technology), and a committee member of the 天津微生物學會 (Tianjin Society for Microbiology). Mr. Chen had spent ten years in the study and research in microbial metabolism in the control of fermentation processes and in the amino acids technology. Mr. Chen was co-author to 6 academic textbooks and has written over 90 academic papers.

梁文俊 (Liang Wenjun), aged 44, was appointed as an independent non-executive Director in January 2007. Mr. Liang is an associate professor of financial management at the 石油化工管理幹部學院 (Sinopec Management Institute) since 1998. Mr. Liang has over 18 years of experience in financial accounting, auditing and consulting. Mr. Liang received his bachelor's degree in 1989 from 北京化工大學 (Beijing University of Chemical Technology) majoring in industrial engineering management.

## Senior Management

來鳳堂 (Lai Fengtang), aged 39, is a vice general manager of the Group. Mr. Lai graduated from 西北大學 (Northwest University of China) in 1998. He first joined Shandong Furui Brewery Group in 1991. Mr. Lai joined the Group in June 1999 and has over 16 years of experience in the sales and marketing. Mr. Lai is the sole director of and is interested in 14.3% of the issued share capital of Hero Elite, which in turn is interested in 72,000,000 Shares, representing 4.35% of the issued share capital of the Company. Mr. Lai was granted an option to subscribe for 3,200,000 Shares pursuant to the Pre-IPO Share Option Scheme, representing 0.19% of the issued share capital of the Company.

沈德權 (Shen Dequan), aged 42, is a manager of the production department of the Group. Mr. Shen graduated from 山東省臨沂農業學校 (The Agriculture School of Linyi) in 1986, majoring in forestry. Before joining Shandong Fufeng in 1999, he spent 6 years with the Shandong Furui Brewery Group. Mr. Shen has accumulated 9 years of experience in production management. His current responsibilities within the Group include managing the production department. Mr. Shen is interested in 10.7% of the issued share capital of Hero Elite, which in turn is interested in 72,000,000 Shares, representing 4.34% of the issued share capital of the Company.

鈕彩 (Niu Cai), aged 48, is an office manager of the Group. Ms. Niu attained her master's degree in politics and international relations from 北京師範大學研究生院 (the post graduate school of Beijing Teacher's University) in 2004. She is qualified as a statistician. Her primary responsibilities include personnel recruitment, training, evaluation and surveillance. Ms. Niu first joined Shandong Furui Brewery Group in 1977. Ms. Niu joined the Group in June 1999 and has 8 years of experience in business management. Ms. Niu is the sole director of and is interested in 14.3% of the issued share capital of Advanced Quality Limited, which in turn is interested in 72,000,000 Shares, representing 4.34% of the issued share capital of the Company.

# Biographies of Directors and Senior Management

李慧 (Li Hui), aged 41, is a manager of the international trade department of the Group. He obtained his bachelor's degree from 北京科技大學 (University of Science and Technology Beijing) in 1989. In 1999, Mr. Li completed a course in international trade at 對外貿易大學國際貿易專業 (University of International Business and Economics). He joined the Group in 2003 and is responsible for the Group's international market development and sales. He was granted an option to subscribe for 6,400,000 Shares pursuant to the Pre-IPO Share Option Scheme, representing 0.39% of the issued share capital of the Company.

肖勇 (Xiao Yong), aged 39, is a manager in the quality control department of the Group. Mr. Xiao obtained his bachelor's degree from 湖南大學 (Hunan University) in 1992, majoring in chemical industry. Before joining the Group in 2003, Mr. Xiao has accumulated 6 years of experience in quality control management and is primarily responsible for the Group's quality and production control. Mr. Xiao was granted an option to subscribe for 1,280,000 Shares pursuant to the Pre-IPO Share Option Scheme, representing 0.08% of the issued share capital of the Company.

葛文村 (Ge Wencun), aged 47, is a manager of operation department of the Group and has joined the Group since 1999. Mr. Ge obtained his bachelor's degree in 1986 from 山東輕工業學院 (Shandong Institute of Light Industry). Mr. Ge is currently responsible for the Group's domestic and international market development. Mr. Ge first joined Shandong Furui Brewery Group in 1992 and has over 15 years of experience in the fermentation industry. Mr. Ge was granted an option to subscribe for 1,120,000 Shares pursuant to the Pre-IPO Share Option Scheme, representing 0.07% of the issued share capital of the Company.

張元年 (Zhang Yuannian), aged 34, is a manager of the finance department of the Group. Mr. Zhang first joined Shandong Furui Brewery Group in 1994 and graduated from 臨沂市商業學校 (The Commerce School of Linyi). He joined the Group in 1999 and has accumulated over 13 years of experience in finance. Mr. Zhang was granted an option to subscribe for 1,280,000 Shares pursuant to the Pre-IPO Share Option Scheme, representing 0.08% of the issued share capital of the Company.

徐令國 (Xu Lingguo), aged 33, is a manager in sales department of the Group. Mr. Xu graduated in 1997 from 太原理工大學 (Taiyuan University of Technology) majoring in economic law. Mr. Xu joined the Group in 1999. Mr. Xu has 8 years of experience in the fermentation industry and is presently responsible for the Group's sales. Mr. Xu was granted an option to subscribe for 1,280,000 Shares pursuant to the Pre-IPO Share Option Scheme, representing 0.08% of the issued share capital of the Company.

## Company Secretary and Qualified Accountant

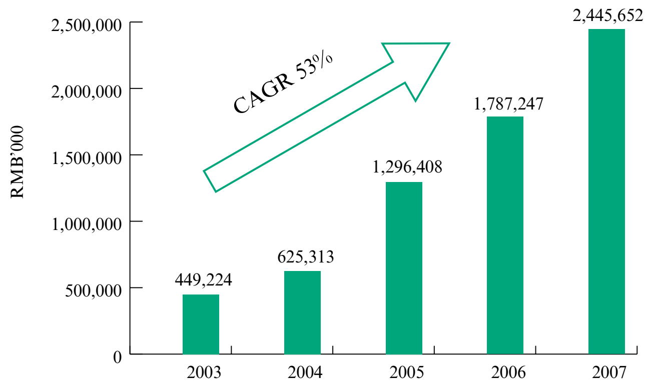
邱榮耀 (Yau Wing Yiu), aged 40, is the qualified accountant and company secretary of the Company since July 2006. Mr. Yau graduated from the Hong Kong Polytechnic University in 1992 with a bachelor's degree of arts in accountancy and is a fellow of the Association of Chartered Certified Accountants and an associate of the Hong Kong Institute of Certified Public Accountants. Mr. Yau has more than 15 years of working experience in the field of finance and accounting including some with international accounting firms. Mr. Yau was granted an option to subscribe for 3,200,000 Shares pursuant to the Pre-IPO Share Option Scheme, representing 0.19% of the issued share capital of the Company.

# Business and Financial Review

## Review of Operations

The Group aims at becoming the leading corn-based biochemical products manufacturer in the PRC by way of expanding the production capacity, diversifying the product range, expanding the sales network and strengthening the research and development capabilities.

The turnover of the Group for the year 2007 was approximately RMB2,445.7 million which represents a growth of approximately RMB658 million or 37% as compared with that in the year 2006 and the annualised compound growth rate for the previous 5 years is 53%.




The profit attributable to the Shareholders for the year 2007 was approximately RMB45 million which represents a decrease of approximately RMB195 million or 81% as compared with that of the year 2006. The decrease is mainly due to the decrease in the gross profit and rise in various expenses of the Group during the year 2007.

In the year 2007, the sales volume and turnover of the Group, especially MSG, increased from that of 2006 although the ASP of the major products dropped. However, gross profit decreased significantly from that of 2006 due to the drop in ASP and increase in the price of corn kernel, the major raw material of the Group. The decrease in gross profit together with the increase in various expenses led to the substantial decrease in the results of the Group for the year 2007.

Although the results for the year 2007 was not encouraging, the production facilities of the Group were almost fully utilised and the increase in sales volume which meant increase in the market share of the Group's products, representing a positive sign on the strategy of the Group.

In the year 2007, in addition to the export of xanthan gum, the Group also exported glutamic acid and MSG mainly to South East Asia. The total export sales of the Group for the year 2007 is approximately 8% (2006: 5%) in terms of the turnover. The Group increases its export sales due to the higher ASP and enlargement of market share.

**Macro Control on corn refinery industry by the PRC government**

Between the beginning of the year 2006 and the end of the year 2007, the price of corn kernel increased significantly about 42%. According to the Directive Statement, approximately 65% of corn kernel produced in the PRC was consumed by animal feeding industry, in which, pig farming shared approximately 55%; approximately 27% of corn kernel produced in the PRC was consumed by corn refinery industry, including corn sweeteners, MSG, lysine, ethanol and various amino acid.

# Business and Financial Review

The Directive Statement issued in September 2007 highlighted the following four major issues facing the corn refinery industry in the PRC:

1. The production capacity in corn refinery industry is unreasonably expanding at a rate faster than the increase in corn production;

2. Most of the manufacturers in the corn refinery industry engage only in the basic level of refinery with low utilisation rate;

3. Certain manufacturers engage only in low technology level refinery and do not attend to environmental protection requirement;

4. Insufficient specialised farmland for corns which led to production of low quality corn kernel and in turn low return on corn refinery industry.

The shortage of pork, the unreasonable expansion of production capacity in corn refinery industry, and the expected increasing consumption of corn kernel for production of ethanol resulted in the increase in demand and in turn the price of corn kernel in the PRC in the year 2007.

According to the NBS, the yearly increase in price of corn kernel in Shandong Province, Shaanxi Province and Inner Mongolia Autonomous Region was approximately 18% in 2007. The price of corn kernel of the Group, which resemble the market price, was approximately RMB1,300 per tonne in the early of 2007 to approximately RMB1,450 per tonne in late 2007.

In order to control the price of corn kernel, being one of the basic foods, the PRC government adopted certain administrative measures in 2006 and 2007 by curbing the production of ethanol from corn kernel and the expansion of corn refinery facilities (including the closure of MSG production facilities of 30,000 tonnes or below). Further, on 20 December 2007, the PRC government revoked the tax rebate on the export of certain agriculture products including corn kernel in order to lower the export of corn kernel.

## Segmental Information

From 2007 onwards, the Group has re-organised its operations around two business segments. The segmental analysis has therefore been restated as MSG segment and Xathan gum segment. Management believes that this analysis better reflects the way in which the business is now managed and its future strategic direction.

MSG segment represents the glutamic acid, MSG, fertilisers, sweeteners and corn-refined products. Xathan gum segment represents the production and sales of xanthan gum.

# Business and Financial Review

## Segment Highlights

| | 2007 | | | 2006 | | | Increase/(Decrease) | | |
|---|---|---|---|---|---|---|---|---|---|
| | MSG | Xanthan gum | Group | MSG | Xanthan gum | Group | MSG | Xanthan gum | Group |
| | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | % | % | % |
| **Revenue** | **2,296,166** | **149,486** | **2,445,652** | 1,647,627 | 139,620 | 1,787,247 | 39% | 7% | 37% |
| **Gross Profit** | **203,543** | **46,123** | **249,666** | 304,278 | 50,864 | 355,142 | (33%) | (9%) | (30%) |
| **Gross profit ratio** | **8.86%** | **30.85%** | **10.21%** | 18.47% | 36.43% | 19.87% | (52%) | (15%) | (49%) |
| **Segment results** | **41,574** | **39,446** | | 223,662 | 47,636 | | (81%) | (17%) | |
| **Segment net assets** | | | | | | | | | |
| Assets | **2,372,359** | **418,435** | | 1,605,432 | 187,863 | | 48% | 123% | |
| Liabilities | **1,116,638** | **313,521** | | 1,273,620 | 122,393 | | (12%) | 156% | |
| Net assets | **1,255,721** | **104,914** | | 331,812 | 65,470 | | 278% | 60% | |

## MSG segment

During the year 2007, the products of this segment were glutamic acid, MSG, fertilisers, sweeteners and corn refined products.

**Market supply and demand of glutamic acid and MSG**

In the year 2006, the market supplies of glutamic acid and MSG were relatively stable. With the increase in demand, the selling prices increased gradually throughout the year and reached the highest level in late 2006. These high selling prices attracted many competitors entering the market in the year 2007. As a result, the market supply of these products increased significantly, leading to market prices drop. The table below shows the approximate selling prices of the glutamic acid and MSG:–

| | | Glutamic acid | MSG |
|---|---|---|---|
| | | *(RMB/Tonne)* | *(RMB/Tonne)* |
| 2006 | – Early | 5,800 | 6,100 |
| | – Late | 6,500 | 6,700 |
| **2007** | – Early | **6,500** | **6,500** |
| | – Late | **5,700** | **5,700** |

# Business and Financial Review

It is expected that market restructuring resulting from the significant drop in selling prices of glutamic acid and MSG since 2007 should be close to an end in the year 2008. As a result, a few major players, of which the Group being one of them, are able to denominate the market in the near future.

### Sales and ASP

The table below shows the sales amount of the products in this segment for the years 2007 and 2006:–

| Product | **2007** *RMB'000* | 2006 *RMB'000* | % of change |
|---|---|---|---|
| Glutamic acid | **1,049,470** | 1,050,090 | – |
| MSG | **550,825** | 199,441 | 176 |
| Fertilisers | **195,870** | 134,824 | 45 |
| Corn refined products | **421,808** | 227,390 | 85 |
| Sweeteners | **78,193** | 35,882 | 118 |

Set out below the ASP of the Group's major products for the years 2007 and 2006:

| Product | **2007** *RMB/tonne* | 2006 *RMB/tonne* | % of change |
|---|---|---|---|
| Glutamic acid | **5,872** | 6,140 | (4) |
| MSG | **5,997** | 6,394 | (6) |
| Fertilisers | **467** | 541 | (14) |

*Glutamic acid*

Highlighted above, the increase in market supply led to a fierce market competition among glutamic acid manufacturers and the ASP of glutamic acid dropped.

*MSG*

With the strategy of moving from glutamic acid to MSG in order to capture the expansion opportunities in the consolidating MSG market, the Group increased the production capacity which in turn increased the MSG available for sales. In addition, increase in the MSG production of the Group by consuming the self-produced glutamic acid reduced the glutamic acid available to the market which in turn reduced the supply of MSG by competitors. Hence, the sales volume of MSG for the year 2007 showed a remarkable increase by approximately 194%. The significant increase in sales of MSG greatly enlarged the market share of the Group proving that the strategy of the Group was successful. Being a downstream product of glutamic acid, the ASP of MSG follows the same pattern as that of glutamic acid.

# Business and Financial Review

*Fertilisers*

Following the market development in the past few years, the Group's fertilisers were recognised by the farmers and the sales volume, increased by 68% in the year 2007. In fourth quarter of 2007, increase in cost of raw materials led to the increase in selling price of the fertilisers in the PRC.

*Sweeteners*

The selling price of sweeteners remained at low level after reaching ceiling in 2006. With an increase in corn price, the profit margin from the sale of sweeteners was narrowed.

*Corn refined products*

The short fall in supply of pork during 2007 attracted more people entering the pig farming industry which increased the demand for corn-based animal feeds. Hence, the sales for corn refined products increased significantly.

**Gross Profit**

Set out below the gross profit for this segment and its major products for the years 2007 and 2006:

| | **2007** | | 2006 | |
|---|---|---|---|---|
| | ***(RMB'000)*** | *%* | *(RMB'000)* | *%* |
| Segment | **203,543** | **9** | 304,278 | 18 |
| Glutamic acid | **107,362** | **10** | 222,925 | 21 |
| MSG | **23,772** | **4** | 31,883 | 16 |
| Fertilisers | **57,128** | **29** | 23,602 | 18 |

Except fertilisers, the gross profit of the major products of this segment decreased in the year 2007 when compared with that of the year 2006 due to the decrease in ASP of all the major products and increase in the cost of production.

# Business and Financial Review

**Production**

Following the commencement of production of IM Plant in December 2006, the production capacities of the Group was expanded in the year 2007.

The annual design production capacity, the actual production output and the utilisation rate of each of the major products in the year 2007 together with the comparative figures in the year 2006 were as follows:

| Product | 2007 *(Tonnes)* | 2006 *(Tonnes)* | Change *(%)* |
|---|---|---|---|
| **Glutamic acid** | | | |
| Annual design production capacity *(Note 1)* | **280,000** | 180,000 | 56 |
| Actual production output | **279,420** | 197,560 | 41 |
| Utilisation rate | **100%** | 110% | |
| **MSG** | | | |
| Annual design production capacity *(Note 1)* | **75,000** | 33,333 | 125 |
| Actual production output | **77,128** | 30,927 | 149 |
| Utilisation rate | **103%** | 93% | |
| **Fertilisers** | | | |
| Annual design production capacity *(Note 1)* | **490,000** | 306,667 | 60 |
| Actual production output | **387,928** | 272,036 | 43 |
| Utilisation rate | **79%** | 89% | |

*Note 1: The production capacity is expressed on pro-rata basis.*

Regarding sweeteners, the selling price of sweeteners remained at the low level after reaching ceiling in 2006. After considering the cost and benefit, there was no production of sweeteners in Junan Plant due to high cost of production while IM Plant kept its normal production in the year 2007. During the year 2007, IM Plant produced 25,217 tonnes of crystallised glucose which represented approximately 25% of the annual design production capacity.

**Cost of production**

The two major raw materials of this segment are corn kernel and coal.

In the year 2007, corn kernel represented approximately 57% (2006: 55%) of the total cost of production of this segment. The Group's cost of corn kernel increase from the yearly average of RMB1,190 per tonne in the year 2006 to RMB1,399 per tonne in the year 2007 which represented an increase of approximately 17.6%. The level of increase is similar to the market benchmark as mentioned above.

# Business and Financial Review

In 2007, coal represented approximately 8% (2006: 11%) of the total cost of production of the segment. The decrease in the percentage is mainly due to the reduction in cost of coal used in the production in IM Plant. Following the commencement of IM Plant, the Group's cost of coal was lowered from approximately RMB315 per tonne in the year 2006 to about RMB285 per tonne in the year 2007 which resulted in the decrease in percentage even though the general market price of coal increased during the year 2007 because of the closing down of small coal mines due to market restructuring and safety purposes, and the increase international coal price due to the import of coal in PRC.

In addition to corn kernel and coal, the cost of sulphuric acid and liquid ammonia, which represents 5% and 11% of the total cost of production of this segment also increased in the year 2007.

## Xanthan gum segment

The market supply of xanthan gum increased gradually over the years. The market of xanthan gum is growing. The increase in supply of xanthan gum was well absorbed by the increasing demand, therefore, the yearly average market price of xanthan gum only dropped slightly in the year 2007.

The selling prices of xanthan gum of the Group were approximate RMB26,000 per tonne in the early of 2007 and approximate RMB23,000 per tonne in late 2007.

The market supply is expected to be stabilised in the year 2008 and maintain at approximately 90,000 tonnes to 93,000 tonnes for a foreseeable future. It is further expected that the market will continue to grow with more customers realising the advantage of using xanthan gum.

*The Development*

The development of xanthan gum of the Group is shown in the time chart below:

| | November 2003 ↓ | September 2006 ↓ | September 2007 ↓ | Between late 2008 and first half of 2009* ↓ |
|---|---|---|---|---|
| **Location** | Junan Plant Phase II | Junan Plant Phase II | IM Plant | IM Plant |
| **Events** | Production trail run | Increase in production capacity | Commencement of production | Increase in production capacity |
| **Production Capacity:** | | | | |
| Increased by | 4,000 Tonnes | 4,000 Tonnes | 10,000 Tonnes | 10,000 Tonnes |
| Accumulated | 4,000 Tonnes | 8,000 Tonnes | 18,000 Tonnes | 28,000 Tonnes |

* *Expected time on the commencement of production*

The Group started the commercial production of xanthan gum in the year 2003 with the production capacity of 4,000 tonnes. In response to the market needs, the Group decided to increase the production capacity by adding additional 4,000 tonnes in Junan Plant Phase II and the construction of 20,000 tonnes production facilities in IM Plant. Out of the 20,000 tonnes production capacity in IM Plant, the production of the first 10,000 tonnes commenced in September 2007 and the rest of 10,000 tonnes is expected to commence production between late 2008 and first half of 2009.

# Business and Financial Review

Before the commencement of operation in IM Plant, the Group is the second largest xanthan gum manufacturer in the PRC. After the full operation of IM Plant, the Group is expected to become one of the major xanthan gum manufacturers in the world.

*Sales and Customers*

The xanthan gum of the Group is sold to both domestic and overseas customers. Set out below certain sales information of xanthan gum over the years 2003 to 2007:

| | **2007** | 2006 | 2005 | 2004 | 2003 |
|---|---|---|---|---|---|
| Turnover (RMB'000) | **149,486** | 139,620 | 66,488 | 17,293 | 893 |
| Average selling price (RMB/tonne) | **24,049** | 25,598 | 26,061 | 27,533 | 26,809 |

From the above table, the turnover increased significantly between 2003 and 2006. The increase is mainly due to the enlargement of the xanthan gum market and the expansion of production capacity of the Group. Although there was a keen market competition, with the hardworking of the sales team of the Group, the sales volume of xanthan gum grow by approximately 14% in the year 2007 when compared with that in the year 2006.

Currently, the Group exported to 34 countries including Oman, Indonesia, Russia, Turkey, United Kingdom, Vietnam, Korea, Singapore, Italy, Egypt, Belgium, Pakistan, Mexico, Poland and Ukraine. Among the sales of xanthan gum, 83% (2006: 65%) in terms of turnover for the year 2007 were exported.

During the year 2007, as major competitors increased their production capacity at the same time as that of the Group, the increase in supply of xanthan gum led to the decrease in its ASP. However, as the market of xanthan gum is developing, the decrease in ASP was compensated by the increase in market size.

Set out below the gross profit and gross profit ratio of xanthan gum for the years 2007 and 2006:

| | **2007** | 2006 |
|---|---|---|
| Gross profit (RMB'000) | **46,123** | 50,864 |
| Gross profit ratio (%) | **31** | 36 |

*Production and cost of sales*

Set out below certain information on the production and cost of sales for xanthan gum over the year 2005 to 2007:

| | **2007** | 2006 | 2005 |
|---|---|---|---|
| Annual design production capacity (tonnes) (Note) | **11,333** | 5,333 | 4,000 |
| Actual production output (tonnes) | **9,930** | 5,079 | 1,972 |
| Utilisation rate | **88%** | 95% | 49% |

*Note: The production capacity is expressed on pro-rata basis.*

# Business and Financial Review

From the above table, about 90% utilisation rate of the production capacity of xanthan gum for the years 2006 and 2007 represents the production capacity were nearly fully utilised.

The major raw materials of xanthan gum are corn kernel and coal. The rising cost of corn kernel has a lesser effect on the production cost of xanthan gum because cost of corn kernel is approximately 20% of the total production cost of xanthan gum in the year 2007. The production cost of xanthan gum is also affected by the cost of energy (ie mainly cost of coal) which is approximately 46% of the total cost of production of the xanthan gum in the year.

*IM Plant*

The cost of raw materials, especially cost of coal, is lower in the Inner Mongolia Autonomous Region than that in Shandong Province and the Group's third production plant is strategically located in the Inner Mongolia Autonomous Region in order to capture lower production cost.

For IM Plant, the cost of coal is similar to that of Baoji Plant but 50% lower than that of Junan Plant. As the consumption of coal accounts for approximately 46% of the total production cost, the production of xanthan gum in IM Plant can substantially reduce the production cost. Hence, the average cost of production of xanthan gum in IM Plant was approximately 29% lower than that of Junan Plant. Due to the production of xanthan gum in IM Plant only commenced in the fourth quarter for the year 2007, the overall cost reduction in xanthan gum of the Group in the year 2007 was not significant. However, with the full year contribution of xanthan gum in IM Plant in 2008 and an additional 10,000 tonnes of xanthan gum in IM Plant which is scheduled to commence production between late 2008 and first half of 2009, the overall cost of production of xanthan gum should be reduced significantly.

## Other business information

**Renovation**

In addition to the increase in production capacity as mentioned above, there were a few renovations in the production processes of the Group.

In the year 2006 or before, the Group produced MSG by using glutamic acid. Since the year 2007, part of glutamic acid was crystallised for the production of MSG. The crystallised glutamic acid can produce higher quality MSG and is expected to be more acceptable by the market.

The cinder generated from the electricity plant was sold out directly before 2007. In 2007, cinder was further processed to brick which is expected to be sold at higher value.

**Research and development**

The Group obtained various significant achievements during the year 2007.

The R&D Center was promoted from county level technology center to provincial level technology center. In addition, it was accredited as "Research Center on Amino Acid Fermentation Technology of Shandong Province".

The Group applied for 32 patents on its own-developed production technology and one patent was granted in 2007. Furthermore, the Group obtained various government subsidies and citations on the new technology developed by the Group.

Finally, the Group led the drafting of standards on bio-chemical fertilisers which were finalised and effective on 1 December 2007. These standards strengthen the quality control on the production of bio-chemical fertilisers.

# Business and Financial Review

**Recent development**

*70,000 tonnes MSG in Baoji Plant*

The Group paid deposit for the acquisitions of a piece of land adjacent to the Baoji Plant for the construction of 70,000 tonnes MSG production facilities in the second half of the year 2007. Due to the delay in the clearance of the land by the local government, the construction of the MSG production facilities has not yet been commenced. Hence, the original schedule on the commencement of production in early 2008 will be postponed to late 2008.

*Close down of Junan Plant Phase I*

Junan Plant Phase I, with the production facilities of 130,000 tonnes of corn starch, 40,000 tonnes of glutamic acid, 25,000 tonnes MSG, 90,000 tonnes of fertilisers and 40,000 tonnes of sweeteners, is located in the downtown of the Junan County, the PRC. During the year 2007, the raw material cost, especially the cost of corn kernel, in Shandong Province increased significantly. The cost of corn kernel in December 2007 was about RMB1,500 per tonne which is higher than that of Baoji Plant and IM Plant. The cost of coal was double of that in Baoji Plant and IM Plant. The high cost of production in Junan Plant Phase I led to a low gross profit or even gross loss on the products it produced. In order to avoid the loss, the Board decided to close down Junan Plant Phase I in late February 2008. The production facilities of Junan Plant Phase I will be relocated to Baoji Plant and IM Plant over the year 2008 in order to maintain the production capacity of the Group. Upon the commencement of operation of IM Plant, the production capacity in Junan Plant Phase I is relatively insignificant and hence, the effect on the close down of Junan Plant Phase I is not expected to be material.

Following the close down of Junan Plant Phase I, Junan Plant Phase II is positioned as the research and development center of the Group. All the research activities on new products or production processes of the Group will be conducted in Junan Plant Phase II in the future. Of course, Junan Plant Phase II will continue its manufacturing of 8,000 tonnes of xanthan gum and 50,000 tonnes of MSG.

*Acquisition of a pharmaceutical company*

The Group acquired Shenhua Pharmaceutical from a third party in late January 2008. Shenhua Pharmaceutical is operated in the biochemical field by applying fermentation technology on its production processes which is the same as that of the Group. In the year 2007, Shenhua Pharmaceutical sold 34 products which included raw material medicines, prescription medicines, over-the-counter medicines and health products. The consideration of the acquisition is approximately RMB4,000,000.

The Board considered that being one of the leading manufacturers in the corn-based biochemical products by applying fermentation technology in the PRC, the acquisition extends our knowledge and technique in fermentation technology and diversify into a fast growing and high profit margin pharmaceutical business in the PRC. The move strengthened the leading position of the Group in the biochemical field by applying fermentation technology. In addition, sweeteners consumed by Shenhua can be supplied internally which further enhances the vertical integration of the Group.

# Business and Financial Review

*Enterprise Income Tax*

(i) Tax rate

Before the enactment of the EIT Law, the standard enterprise income tax rate of the Group's subsidiaries is 33%.Being foreign invested enterprises and were established in the Western part of the PRC, the Group's subsidiaries enjoy various tax concession including tax holiday on the enterprise income tax of the PRC.

After the enactment of the EIT Law, the standard enterprise income tax rate was reduced to 25%. The Group's subsidiaries can continue to enjoy the tax concession until the expiry of the tax concession.

The above effects are analysed in the table below:

| | **Shandong Fufeng** | **Baoji Fufeng** | **IM Fufeng** |
|---|---|---|---|
| Before 1 January 2008 | | | |
| Standard/preferential tax rate | 33% | 15% *(Note 2)* | 15% *(Note 1)* |
| Tax holiday | | | |
| Full exemption(year) | Already expired | Already expired | 2007 and 2008 |
| 50% exemption(year) | 2006 to 2008 | 2007 to 2009 | 2009 to 2011 |
| After 1 January 2008 | | | |
| Standard/preferential tax rate | 25% | 15% *(Note 2)* | 15% *(Note 1)* |
| Tax holiday | | | |
| Full exemption(year) | Already expired | Already expired | 2007 and 2008 |
| 50% exemption(year) | 2006 to 2008 | 2007 to 2009 | 2009 to 2011 |

*Note 1:* with the Opening Up of Western China policy, IM Fufeng is entitled to a preferential enterprise income tax rate of 15% until 31 December 2010.

*Note 2:* with the approval of "High Technology Enterprise", Baoji Fufeng was entitled to a preferential enterprise income tax rate of 15% for the year ended 31 December 2007. For the year ending 31 December 2008 or after, Baoji Fufeng is entitled to opt for preferential tax treatment for the Opening Up of Western China policy or applying for status of "High Technology Enterprise".

(ii) Withholding tax on distribution

Before the enactment of the EIT Law, distribution of the Group's subsidiaries in the PRC to their foreign investors is free from withholding tax. Since 1 January 2008, distribution in respect of earnings for annual period beginning on or after 1 January 2008 is subject to withholding tax under the EIT Law.

# Business and Financial Review

## Other financial information

**Other income**

Other income increased by approximately RMB14 million or 71% from RMB19 million in the year 2006 to RMB33 million in the year 2007. The increase was mainly due to the increase in interest income and approximately RMB7 million government subsidies received by Shandong Fufeng.

**Selling and marketing expenses**

Selling and marketing expenses increased by approximately RMB42 million or 69% from RMB62 million in the year 2006 to RMB104 million in the year 2007. The increase was mainly due to the bearing of the cost of transportation for customers in order to promote sales in IM Plant.

**Administrative expenses**

Administrative expenses increased by approximately RMB73 million or 181% from RMB41 million in 2006 to RMB114 million in 2007. The increase was mainly due to the following:

1. the commencement of operation of IM Plant which amounted to approximately RMB24 million;

2. the charging of fair values on the options granted under the Pre-IPO Share Option Scheme which accounted for approximately RMB18 million.

**Finance cost**

Finance cost increased by approximately RMB30 million or 204% from RMB15 million in the year 2006 to RMB45 million in the year 2007.

The increase in interest expenses contributed approximately RMB8 million to the increase in finance cost. In the year 2007, average bank borrowings were maintained approximately at RMB600 million while for the year 2006, average borrowings were only approximately RMB500 million. Together with the increase in interest rate in the year 2007 caused the increase in interest expenses.

The discontinuation of interest capitalisation contributed approximately RMB19 million to the increase in finance cost. In the year 2006, most of the capital expenditures of the Group (including the construction of IM Plant) were financed by bank borrowings and the related interest expenses was capitalised. After the listing of the Shares in the Stock Exchange, the listing proceeds were used in the capital expenditures of the Group and hence, no interest expense was capitalised.

The Group is a growing enterprise which requires external funding to finance its expansion. One of the major sources of funding is bank borrowings. Currently, all bank borrowings are denominated in RMB. The Directors anticipate that the PRC government will continue to increase the interest rate in order to control the inflation in the PRC. High interest rate would increase the cost of financing to the Group. As such, the Group will explore different financing channels to lower the cost of financing.

# Business and Financial Review

**Staff cost**

Staff cost of the Group increased by approximately RMB84 million or 118% from RMB72 million in 2006 to RMB156 million in 2007. The increase was mainly due to the increase in salaries and allowance of approximately RMB48 million on the commencement of operation of IM Plant in late 2006. The charging of fair value on the Pre-IPO Share Option Scheme contributed another approximately RMB18 million to the increase in staff cost.

**Depreciation**

The depreciation of the Group increased by approximately RMB62 million or 113% from RMB55 million in 2006 to RMB117 million in 2007. The increase was mainly due to the commencement of operation of IM Plant.

**Exchange difference**

During the year 2007, RMB appreciated by approximately 6.8% as compared with the HK$. The appreciation of RMB led to a net exchange loss of approximately RMB13 million on the group's assets and liabilities denominated in HK$. In order to minimise the effect of exchange rate risk, the not-yet in use listing proceeds were place in HK$ short term fixed deposits before converting into RMB, which earned approximately RMB8 million for the year 2007.

Following the listing of the Shares on the Main Board of the Stock Exchange in 2007, the Group enlarged its overseas funding platform. The funding from this platform is largely in foreign currencies. In 2007, the RMB appreciated and it is expected that the appreciation will continue in 2008. Hence, the Group will consider possible alternatives from time to time to reduce the effect of RMB appreciation.

**Taxation**

The income tax expenses for the year 2007 represented the PRC Enterprise Income Tax.

# Outlook

Following the market restructuring of glutamic acid and MSG, together with the substantial reduction in energy cost due to the production of xanthan gum in IM Plant, it is believed that the Group will step out from difficulty gradually in the year 2008.

## MSG segment

The selling prices of glutamic acid and MSG decreased continuously during the year 2007. It is expected that the small players in the market is facing difficulties in maintaining normal operation and incurred substantial losses. According to the Group's internal research, the market demand and supply of glutamic acid and MSG already came to balancing status. Hence, we expect that the market restructuring may speed up and hence, the selling prices could be anticipated to recover in the year 2008. In the meanwhile, the speed up of market restructuring in glutamic acid and MSG would stabilise the market supply by a few leading players, of which the Group is one of them.

With the continuous input from the PRC government on agriculture business, it is expected that the demand for fertilisers and corn refine products for farming and animal feeding business is still high and hence, the selling price and profit margin of fertilisers and corn refine products can be sustained at a high level in 2008. However, it is expected that the corn kernel will maintain at a high level and hence the cost of production will remain at high level too. In addition the cost of sulphuric acid and liquid ammonia, the subsidiary raw materials, will also increase in the year 2008.

## Xanthan gum segment

The commencement of xanthan gum production in IM Plant represents a significant reduction in cost of production which in turn the gross profit margin will be pushed upward. The Group will focus on the marketing development for the xanthan gum both in the international and domestic markets.

In addition, following an additional 10,000 tonnes xanthan gum production capacity in IM Plant which is expected to commence production in late 2008 or the first half of 2009, the total production capacity for xanthan gum of the Group will be increased to 28,000 tonnes. It is expected that the production cost will be further decreased and our market share will increase further upon then and become one of the major xanthan gum manufacturers in the world.

## IM Plant

The production and sales system in IM Plant is improving gradually after operation for a year. The Group believes that in the year 2008, IM Plant enjoys the economies of scale together with advantages from the lower costs in major raw materials and energy.

# Other Information

## Liquidity and financial resources

The Group maintained a healthy liquidity position throughout the year 2007. At 31 December 2007, the cash and cash equivalent and restricted bank deposits of the Group were RMB271 million (2006: RMB65 million). The current bank borrowings were approximately RMB318 million (2006: RMB415 million) and non-current bank borrowings were approximately RMB312 million (2006: RMB335 million).

## Pledge of assets

At 31 December 2007, certain leasehold land, property, plant and equipment of the Group with carrying value of approximately RMB314 million were pledged to certain banks to secure general banking facilities of the Group.

## Foreign exchange exposure

During the year 2007, the Group operated mainly in the PRC and most of the Group's transactions, assets and liabilities were denominated in RMB. Foreign currencies were however received from the export sales of products. The listing proceeds were denominated in HK$. Both the export sales proceeds and the listing proceeds were subject to foreign exchange risk before receiving and translating into RMB.

The foreign currencies received from export sales were translated into RMB upon receiving from the overseas customers. The listing proceeds were placed in HK$ fixed deposits before translating into RMB in order to earn interest income to compensate the appreciation of RMB to certain extent.

## Gearing ratio

At 31 December 2007, the total assets of the Group amounted to approximately RMB2,882 million (2006: RMB1,924 million) whereas the bank borrowings amounted to RMB630 million (2006: RMB750 million). The gearing ratio was approximately 22% (2006: 39%). The gearing ratio is calculated based on the Group's total borrowings over total assets.

## Contingencies

As at 31 December 2007, the Group had no material contingent liabilities.

## Employees

At 31 December 2007, the Group had approximately 1,700 employees. Employees' remuneration is paid in accordance with relevant policies in the PRC. Appropriate salaries and bonuses are paid which are commensurate with the actual practices of the Group. Other corresponding benefits include pension, unemployment insurance, housing allowance, etc. Please refer to note 16 and 23 on the consolidated financial statements for the share options granted to certain Directors and employees of the Group under the Pre-IPO Share Option Scheme.

The Directors' remuneration comprises Directors' fees, basic salaries, bonues, share options and allowances which are determined based on their responsibilities and contribution to the Group.

# Use of Proceeds

The Shares were listed on the Main Board of the Stock Exchange on 8 February 2007. The net listing proceeds from the share offer, including the exercise of over-allotment option on 12 February 2007, received by the Company was about HK$957 million. The progress on the use of proceeds is set out in the following table:

| Project | Planned amount<br>*HKD million* | Used up to<br>31 March 2008<br>*HKD million* |
|---|---|---|
| Construction of IM Plant Phase II | 410 | 410 |
| Construction of MSG plant in Baoji Plant | 120 | 34 |
| Enhancement of sales and marketing function | 10 | – |
| Improving Group's research and development capabilities | 30 | 6 |
| Potential acquisition of related business and facilities | 39 | – |
| Repayment of ABN AMRO loan | 312 | 312 |
| General working capital | 36 | 36 |
| | 957 | 798 |

As at 31 March 2008, save as approximately HK$99 million of the net listing proceeds was remitted and deposited in the banks in the PRC, the unused net listing proceeds of approximately HK$60 million is placed on short-term deposits with licensed banks in Hong Kong.

# Corporate Governance Report

The Company is committed to establish and ensure a high standard of corporate governance practices which places emphasis on quality of the Board, sound and efficient internal control and accountability and transparency to the Shareholders. The Directors are in the opinion that the Company has complied with the code provision as set out in the Code since the Listing Date.

The Company's corporate governance structure includes the Board and two committees under the Board, namely the audit committee (the "Audit Committee") and the remuneration committee (the "Remuneration Committee"). The terms of reference of all committees specify clearly the power and responsibilities of the respective committees.

## Board of Directors

The Board comprises (i) nine executive Directors, Mr. Li Xuechun, Mr. Wang Longxiang, Mr. Wu Xindong, Mr. Yan Ruliang, Mr. Feng Zhenquan, Mr. Xu Guohua, Mr. Li Deheng, Ms. Li Hongyu and Mr. Gong Qingli; and (ii) three independent non-executive Directors, Mr. Choi Tze Kit, Sammy, Mr. Chen Ning and Mr. Liang Wenjun. Mr. Li Xuechun is the chairman of the Board and Mr. Wang Longxiang is the general manager of the Group. Mr. Li Xuechun is the father of Ms. Li Hongyu and brother-in-law of Mr. Li Deheng.

For details of the Directors' biographical information, please refer to the section headed "Biographies of Directors and Senior Management".

The principal function of the Board is to consider and approve the strategies, financial objectives, annual budget, investment proposals and assume the responsibilities of corporate governance of the Company. The day-to-day operations of the Group are delegated to the management of the Group.

The roles of the chairman and general manager are segregated. Mr. Li Xuechun, being chairman of the Group, is responsible for the orderly conduct and operation of the Board while Mr. Wang Longxiang, being the general manager of the Group, is responsible for the daily operations of the Group.

Independent non-executive Directors have been appointed for a term of two years.

Regular Board meetings will be held at least four times a year and the Board will convene other meetings when necessary. Before a Board meeting is convened, relevant documents will be sent to the Directors for their review pursuant to the Listing Rules and the Code. Since the Listing Date until 31 December 2007, four regular Board meetings were held at which all Directors attended the meetings.

The Company has received from each of the independent non-executive Directors a confirmation of his independence in accordance with Rule 3.13 of the Listing Rules. The Company considers all of the independent non-executive Directors are independent.

## Model code on securities transactions

The Company has adopted the Model Code. Having made specific enquiry of all Directors, the Directors have complied with the Model Code since the Listing Date.

# Corporate Governance Report

## Accountability and Auditor's remuneration

The Directors acknowledge their responsibility for preparation of consolidated financial statements of the Group. This responsibility has also been mentioned in the independent auditor's report on page 35.

The Board had conducted a review on the system of internal control of the Group and considers that the system of internal control is effectively operated.

The professional fee payable to the auditor of the Company amounts to RMB3 million for the provision of audit services for the year ended 31 December 2007. The auditor of the Company also received approximately RMB250,000 for provision of tax consulting services to the Group.

## Audit Committee

The Audit Committee, established in compliance with the Code, comprises three independent non-executive Directors, Mr. Choi Tze Kit, Sammy, Mr. Chen Ning and Mr. Liang Wenjun. Mr. Choi Tze Kit, Sammy is the chairman of the Audit Committee.

The principal functions of the Audit Committee are to review the Group's audit, interim and annual accounts of the Group and the system of internal control.

The Audit Committee meetings will be held at least twice a year. Since the Listing Date until 31 December 2007, four Audit Committee meetings were held with Mr. Choi Tze Kit, Sammy attended all the meetings while Mr. Chen Ning and Mr. Liang Wenjun attended three meetings. The purposes of the meetings were to review the Group's results for the year 2006, the interim results for the year 2007 and the audit of the Group.

## Remuneration Committee

The Remuneration Committee established in compliance with the Code, comprises an executive Director, Mr. Li Xuechun and three independent non-executive Directors, Mr. Choi Tze Kit, Sammy, Mr. Chen Ning and Mr. Liang Wenjun. Mr. Choi Tze Kit, Sammy is the chairman of the Remuneration Committee.

The principal functions of the Remuneration Committee are to review, develop and approve the Group's policy on remuneration of all Directors and senior management for the purpose of retaining and attracting talent to manage the Group effectively. The Directors and their associates do not participate in the decisions in relation to their own remuneration.

The Remuneration Committee meetings will be held at least once a year. One meeting was held by the Remuneration Committee after the Listing Date with all committee members attended the meeting. The Chairman of the Board propose with reasons the remuneration package of all executive Directors during the meeting and the Remuneration Committee members consider and approve the proposal if it is in accordance with the remuneration policy of the Directors.

## Nomination of Directors

The Company has not established a nomination committee. The Board is collectively responsible for the appointment of new directors either to fill casual vacancies or as additional Board members.

In nominating candidates for appointment of directors, the Board considers whether the candidates have the necessary expertise and experience to assist the Board to perform its duties.

# Directors' Report

The Board has the pleasure in presenting the report and the audited financial statements of the Group for the year ended 31 December 2007.

## Group reorganisation

The Company was incorporated with limited liability in the Cayman Islands on 15 June 2005. Pursuant to the reorganisation of the Group in July 2006, the Company became the holding company of the companies now comprising the Group. The Shares were listed on the Main Board of the Stock Exchange on 8 February 2007.

## Principal activities

The principal activity of the Company is investment holding. The activities of its subsidiaries are set out in note 34 to the consolidated financial statements.

## Result and appropriations

Results of the Group for the year ended 31 December 2007 are set out under the consolidated income statement on page 39.

The Board recommends the payment of a final dividend of RMB0.82 cent per Share for the year ended 31 December 2007.

## Material acquisitions or disposal of subsidiaries and associated companies

The Group had no material acquisitions or disposal of subsidiaries or associated companies for the year ended 31 December 2007.

## Property, plant and equipment

Details of property, plant and equipment are set out in note 7 to the consolidated financial statements.

## Share capital

Details of the movement in share capital of the Company are set out in note 15 to the consolidated financial statements.

## Distributable reserves

As at 31 December 2007, the Company's reserves available for distribution to the Shareholders amounted to RMB1,039,207,000.

# Directors' Report

## Directors

As at the date of this report, the Board comprised:

**Executive Directors**

Mr. Li Xuechun *(Chairman)*
Mr. Wang Longxiang
Mr. Wu Xindong
Mr. Yan Ruliang
Mr. Feng Zhenquan
Mr. Xu Guohua
Mr. Li Deheng
Ms. Li Hongyu
Mr. Gong Qingli

**Independent Non-executive Directors**

Mr. Choi Tze Kit, Sammy
Mr. Chen Ning
Mr. Liang Wenjun

Biographical details of the Directors are set out in the section headed "Biographies of Directors and Senior Management".

According to Article 87 of the articles of association of the Company, Mr. Wang Longxiang, Mr. Yan Ruliang, Mr. Chen Ning and Mr. Liang Wenjun should retire by rotation and, being eligible, consider to offer themselves for re-election at the forthcoming annual general meeting of the Company.

Each of the Directors proposed for re-election at the forthcoming annual general meeting has a service contract with the Company for an initial term of three years commencing from the Listing Date and renewable automatically for successive terms of one year each commencing from the day following the expiry of the then current term unless and until (i) terminated by either party there to giving not less than three months' prior written notice with the last day of the notice falling on the last day of the initial term or any time thereafter; or (ii) the Director not being re-elected as a Director or being removed by the Shareholders at general meeting of the Company in accordance with its articles of association.

As at 31 December 2007, there were no service contracts which were not determinable by the employer within one year without payment of compensation (other than statutory compensation) between any company in the Group and any Director proposed for re-election at the forthcoming annual general meeting.

## Directors' interests in Shares

The interest and short positions of the Directors and chief executive of the Company in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) (the "SFO")) as at 31 December 2007, as recorded in the register required to be kept under section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code were as follows:

**Long position**

| Name of Director | Name of company | Capacity | Number total and class of securities | Percentage of interests to total issued share capital (approximate) |
|---|---|---|---|---|
| Li Xuechun | The Company | Interests of controlled corporation Shares *(Note 1)* | 786,000,000 | 47.35% |
| Wang Longxiang | The Company | Beneficial interests *(Note 2)* Shares | 16,000,000 | 0.96% |
| Gong Qingli | The Company | Interests of controlled corporation Shares *(Note 3)* | 16,000,000 | 0.96% |

*Notes:*

1. The interest in these Shares is held by Motivator Enterprises. Accordingly, Mr. Li Xuechun is deemed to be interested in all Shares held by Motivator Enterprises under the SFO.

2. These Shares represent the Shares which might be allotted and issued to Mr. Wang Longxiang, an executive Director, upon the exercise in full of the options granted to him pursuant to the Pre-IPO Share Option Scheme.

3. These Shares represent the Shares which might be allotted and issued to Centerpoint Assets upon the exercise in full of the options granted to Centerpoint Assets pursuant to the Pre-IPO Share Option Scheme.

Save as disclosed above, as at 31 December 2007, none of the Directors or the chief executive of the Company had an interest or short position in any shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) as recorded in the register of interests required to be kept by the Company pursuant to section 352 of the SFO, or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code.

# Directors' Report

## Persons having 5% or more shareholdings

As at 31 December 2007, the interests and short positions of the persons, other than a Director or chief executive of the Company, in the Shares and underlying Shares as recorded in the register required to be kept under section 336 of the SFO were as follows:

**Long position**

| **Name of Director** | **Name of Group member** | **Capacity** | **Class and number securities** | **Percentage of interests to total issued share capital (approximate)** |
|---|---|---|---|---|
| Motivator Enterprises *(Note 1)* | The Company | Beneficial interests | 786,000,000 Shares | 47.35% |
| Shi Guiling *(Note 2)* | The Company | Interests of spouse | 786,000,000 Shares | 47.35% |
| Ever Soar | The Company | Beneficial interests | 205,680,000 Shares | 12.39% |

*Notes:*

1. The interest in these Shares is held by Motivator Enterprises. Accordingly, Mr. Li Xuechun is deemed to be interested in all Shares held by Motivator Enterprises under the SFO.

2. Ms. Shi Guiling is the spouse of Mr. Li Xuechun. Accordingly, she is also deemed to be interested in the 786,000,000 Shares held by Motivator Enterprises, which in turn is also deemed to be interested by Mr. Li Xuechun under the SFO.

Save as disclosed above, as at 31 December 2007, according to the register of interests required to be kept by the Company under section 336 of the SFO, there was no person who had any interest or short position in the shares or underlying shares of the Company.

## Arrangements to purchase shares or debentures

Save as disclosed on note 16 regarding the Pre-IPO Share Option Scheme, at no time during the year was the Company, or any of its subsidiaries, a party to any arrangements to enable the Directors to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate, and neither the Directors nor the chief executive, nor any of their spouses or children under the age of 18, had any right to subscribe for the securities of the Company, or had exercised any such right.

# Directors' Report

## Interest in contracts

No contract of significance, to which the Company or subsidiaries was party and in which a Director had material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year, nor had there been any contract of significance entered into between the Group and a controlling shareholder of the Company during the year.

## Major customers and suppliers

The aggregate sales attributable to the Group's largest customer and five largest customers taken together were less than 30% of the total sales for the year 2007.

The aggregate purchases attributable to the Group's largest supplier and five largest suppliers taken together were less than 30% of the Group's total purchases for the year 2007.

## Management contracts

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

## Sufficiency of public float

As at 21 April 2008, being the latest practicable date prior to the issue of this annual report, to the best knowledge of the Directors and based on the information publicly available to the Company, there was sufficient public float as required by the Listing Rules.

## Purchase, redemption or sales of listed securities of the Company

Neither the Company, nor any of its subsidiaries purchased, redeemed or sold any of the Company's listed securities during the year ended 31 December 2007.

## Pre-emptive rights

There are no provisions for pre-emptive rights under the articles of the association of the Company and the Companies Law of the Cayman Islands.

## Corporate governance report

The listing of the Shares on the Main Board of the Stock Exchange took place on 8 February 2007 and the Directors are of the opinion that the Company has complied with the code provision as set out in the Code since then.

## Subsequent events

Details of the significant events occurring after the balance sheet date are set out in note 33 to the consolidated financial statements.

# Directors' Report

## Auditor

A resolution to reappoint PricewaterhouseCoopers as independent auditor of the Company will be proposed at the forthcoming annual general meeting.

On behalf of the Board
**Li Xuechun**
*Chairman*

24 April 2008

# Independent Auditor's Report

PRICEWATERHOUSECOOPERS

羅兵咸永道會計師事務所

PricewaterhouseCoopers
22/F, Prince's Building
Central, Hong Kong

## To the Shareholders of Fufeng Group Limited

(Incorporated in the Cayman Islands with limited liability)

We have audited the consolidated financial statements of Fufeng Group Limited (the "Company") and its subsidiaries (together, the "Group") set out on pages 37 to 96, which comprise the consolidated and company balance sheets as at 31 December 2007, and the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

## Directors' responsibility for the financial statements

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

## Auditor's responsibility

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

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

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

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

# Independent Auditor's Report

## Opinion

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

**PricewaterhouseCoopers**
*Certified Public Accountants*

Hong Kong, 24 April 2008

# Consolidated Balance Sheet

As at 31 December 2007

| | Note | As at 31 December 2007 RMB'000 | 2006 RMB'000 |
|---|---|---|---|
| **ASSETS** | | | |
| **Non-current assets** | | | |
| Leasehold land payments | *6* | **63,070** | 64,918 |
| Property, plant and equipment | *7* | **1,674,021** | 1,288,340 |
| Deferred income tax assets | *11* | **6,390** | 601 |
| | | **1,743,481** | 1,353,859 |
| **Current assets** | | | |
| Inventories | *12* | **326,351** | 148,077 |
| Trade and other receivables | *13* | **540,984** | 357,814 |
| Short-term bank deposits | *14* | **42,170** | 23,500 |
| Cash and cash equivalents | *14* | **228,849** | 41,094 |
| | | **1,138,354** | 570,485 |
| **Total assets** | | **2,881,835** | 1,924,344 |
| **EQUITY** | | | |
| **Capital and reserves attributable to the Shareholders** | | | |
| Share capital | *15* | **169,034** | 123,372 |
| Share premium | *15* | | |
| – Proposed final dividend | | **13,529** | 96,114 |
| – Others | | **1,078,144** | 182,212 |
| Other reserves | *16* | **(276,084)** | (301,478) |
| Retained earnings | *17* | **464,193** | 426,173 |
| **Total equity** | | **1,448,816** | 526,393 |
| **LIABILITIES** | | | |
| **Non-current liabilities** | | | |
| Deferred income | *18* | **24,951** | 27,599 |
| Borrowings | *19* | **312,000** | 335,000 |
| Deferred income tax liabilities | *11* | **898** | 707 |
| | | **337,849** | 363,306 |
| **Current liabilities** | | | |
| Trade, other payables and accruals | *20* | **770,810** | 610,573 |
| Current income tax liabilities | | **875** | 4,244 |
| Current portion of deferred income | *18* | **5,485** | 5,198 |
| Borrowings | *19* | **318,000** | 414,630 |
| | | **1,095,170** | 1,034,645 |
| **Total liabilities** | | **1,433,019** | 1,397,951 |
| **Total equity and liabilities** | | **2,881,835** | 1,924,344 |
| **Net current assets/(liabilities)** | | **43,184** | (464,160) |
| **Total assets less current liabilities** | | **1,786,665** | 889,699 |

**Li Xuechun**
*Director*

**Gong Qingli**
*Director*

The notes on pages 42 to 96 are an integral part of these consolidated financial statements.

# Company Balance Sheet

As at 31 December 2007

| | Note | As at 31 December 2007 RMB'000 | 2006 RMB'000 |
|---|---|---|---|
| **ASSETS** | | | |
| **Non-current assets** | | | |
| Property, plant and equipment | *7* | **217** | 10 |
| Investment in a subsidiary | *8* | **401,698** | 401,698 |
| Loans to subsidiaries | *8* | **170,107** | – |
| | | **572,022** | 401,708 |
| **Current assets** | | | |
| Loan to a subsidiary | *8* | **–** | 290,174 |
| Deposits and other receivables | *13* | **174** | 57 |
| Due from subsidiaries | *8* | **565,506** | – |
| Cash and cash equivalents | *14* | **82,783** | 13,241 |
| | | **648,463** | 303,472 |
| **Total assets** | | **1,220,485** | 705,180 |
| **EQUITY** | | | |
| **Capital and reserves attributable to the Shareholders** | | | |
| Share capital | *15* | **169,034** | 123,372 |
| Share premium | *15* | | |
| – Proposed final dividend | | **13,529** | 96,114 |
| – Others | | **1,078,144** | 182,212 |
| Other reserves | *16* | **18,345** | – |
| Accumulated losses | *17* | **(70,811)** | (5,801) |
| **Total equity** | | **1,208,241** | 395,897 |
| **LIABILITIES** | | | |
| **Current liabilities** | | | |
| Due to subsidiaries | *8* | **9,384** | 1,715 |
| Other payables and accruals | *20* | **2,860** | 1,938 |
| Borrowings | *19* | **–** | 305,630 |
| | | **12,244** | 309,283 |
| **Total liabilities** | | **12,244** | 309,283 |
| **Total equity and liabilities** | | **1,220,485** | 705,180 |
| **Net current assets/(liabilities)** | | **636,219** | (5,811) |
| **Total assets less current liabilities** | | **1,208,241** | 395,897 |

**Li Xuechun**
*Director*

**Gong Qingli**
*Director*

The notes on pages 42 to 96 are an integral part of this financial statement.

# Consolidated Income Statement

For the year ended 31 December 2007

| | Note | 2007 RMB'000 | 2006 RMB'000 |
|---|---|---|---|
| | | **Year ended 31 December** | |
| Revenue | 5 | **2,445,652** | 1,787,247 |
| Cost of sales | 22 | **(2,195,986)** | (1,432,105) |
| **Gross profit** | | **249,666** | 355,142 |
| Other income | 21 | **32,795** | 19,223 |
| Selling and marketing expenses | 22 | **(104,156)** | (61,806) |
| Administrative expenses | 22 | **(113,709)** | (40,529) |
| Other operating expenses | 22 | **(16,746)** | (7,376) |
| Interest income from IPO subscription deposits | | **42,837** | – |
| Finance costs | 25 | **(45,202)** | (14,846) |
| **Profit before income tax** | | **45,485** | 249,808 |
| Income tax expense | 26 | **(416)** | (9,325) |
| **Profit for the year attributable to the Shareholders** | | **45,069** | 240,483 |
| **Earnings per share for profit attributable to the Shareholders during the year** (expressed in RMB cent per share) | | | |
| – basic and diluted | 27 | **2.80** | 20.04 |
| **Dividends** | 28 | **13,529** | 156,210 |

The notes on pages 42 to 96 are an integral part of these consolidated financial statements.

# Consolidated Statement of Changes in Equity

For the year ended 31 December 2007

| | | Attributable to the Shareholders | | | | |
|---|---|---|---|---|---|---|
| | | **Share capital** | **Share premium** | **Other reserves** | **Retained earnings** | **Total** |
| | *Note* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* |
| Balance at 1 January 2006 | | – | – | 76,740 | 269,266 | 346,006 |
| Issuance of Shares for the Reorganisation | *15* | 123,372 | 278,326 | (401,698) | – | – |
| Profit for the year | | – | – | – | 240,483 | 240,483 |
| Profit appropriation | *16* | – | – | 23,480 | (23,480) | – |
| Dividends | *28* | – | – | – | (60,096) | (60,096) |
| Balance at 31 December 2006 | | 123,372 | 278,326 | (301,478) | 426,173 | 526,393 |
| Profit for the year | | – | – | – | 45,069 | 45,069 |
| Profit appropriation | *16* | – | – | 7,049 | (7,049) | – |
| Issuance of Shares for Listing | *15* | 45,662 | 909,461 | – | – | 955,123 |
| Employee share options scheme: | | | | | | |
| – Value of employee service | *16* | – | – | 18,345 | – | 18,345 |
| Dividends | *28* | – | (96,114) | – | – | (96,114) |
| Balance at 31 December 2007 | | 169,034 | 1,091,673 | (276,084) | 464,193 | 1,448,816 |

The notes on pages 42 to 96 are an integral part of these consolidated financial statements.

# Consolidated Cash Flow Statement

For the year ended 31 December 2007

| | Note | 2007 RMB'000 | 2006 RMB'000 |
|---|---|---|---|
| | | **Year ended 31 December** | |
| **Cash flows from operating activities** | | | |
| Cash generated from operations | 29 | **18,680** | 226,628 |
| Interest paid | | **(47,375)** | (37,152) |
| Income tax paid | | **(9,383)** | (5,495) |
| Net cash (used in)/generated from operating activities | | **(38,078)** | 183,981 |
| **Cash flows from investing activities** | | | |
| Purchases of property, plant and equipment | | **(577,570)** | (656,571) |
| Payments for leasehold land | | **–** | (10,874) |
| Proceeds from sale of property, plant and equipment | 29 | **–** | 2,297 |
| Interest received | | **51,162** | 1,043 |
| Net cash used in investing activities | | **(526,408)** | (664,105) |
| **Cash flows from financing activities** | | | |
| Proceeds from issurance of Shares | 15 | **955,123** | – |
| Dividends paid | | **(96,114)** | (64,386) |
| Government grants received | | **10,689** | 9,082 |
| Proceeds from bank borrowings | | **633,600** | 781,085 |
| Repayments of bank borrowings | | **(751,057)** | (278,510) |
| Net cash generated from financing activities | | **752,241** | 447,271 |
| **Net increase/(decrease) in cash and cash equivalents** | | **187,755** | (32,853) |
| Cash and cash equivalents at beginning of the year | 14 | **41,094** | 73,947 |
| **Cash and cash equivalents at end of the year** | 14 | **228,849** | 41,094 |

The notes on pages 42 to 96 are an integral part of these consolidated financial statements.

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2007

## 1. General information

The Company formerly known as China Fufeng Fermentation Technology Group Company Limited, was incorporated in the Cayman Islands on 15 June 2005 as an exempted company with limited liability and changed to its current name on 31 August 2006. The address of its registered office is Cricket Square, Hutchins Drive, P.O. Box 2681, Grand Cayman KY1-1111, Cayman Islands.

Shandong Fufeng is a limited liability company established in the PRC on 9 June 1999. Baoji Fufeng is a limited liability company established in the PRC on 24 September 2004. IM Fufeng is a limited liability company established in the PRC on 31 March 2006. All Shandong Fufeng, Baoji Fufeng and IM Fufeng are engaged in the manufacture and sales of fermentation-based food additive and biochemical products and starch-based products. On 15 July 2006, in consideration for the shareholders transferring the entire issued share capital in Acquest Honour, the then ultimate holding company of Shandong Fufeng, Baoji Fufeng and IM Fufeng to the Company (the "Reorganisation"), (i) an aggregate of 1,199,900,000 Shares of the Company were allotted and issued to the shareholders; and (ii) the aggregate of 100,000 nil-paid shares of the Company previously issued to each of them were credited as fully-paid. Shandong Fufeng, Baoji Fufeng, IM Fufeng and the Company were ultimately owned by the same shareholders with identical relative shareholdings immediately before and after the Reorganisation.

The Reorganisation has been accounted for in accordance with Accounting Guideline 5, paragraph 5, issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA"), which requires the use of a principle similar to that for a reverse acquisition as set out in HKFRS 3 "Business Combinations". The Reorganisation, for accounting purposes, was effected through the acquisition of the Company by Acquest Honour. The consolidated financial statements before the acquisition date consist of the consolidated financial statements of Acquest Honour and its subsidiaries, as the predecessor reporting entity. Upon the acquisition of the Company, its assets and liabilities were recorded at their fair values and the effect of the acquisition, including the elimination of the share capital of Acquest Honour, was reflected in Shareholders' equity.

The Company together with its subsidiaries are hereinafter collectively referred to as the Group. The Group is mainly engaged in the manufacture and sales of fermentation-based food additive and biochemical products and starch-based products. The Group has manufacturing plants in Shandong Province, Shaanxi Province and Inner Mongolia Autonomous Region of the PRC and sells mainly to customers located in the PRC.

These consolidated financial statements have been approved for issue by the Board on 24 April 2008.

Following the completion of the placing and public offering, the Company's shares have been listed on The Stock Exchange of Hong Kong Limited on 8 February 2007.

These consolidated financial statements adopted the same definitions of the annual report unless otheswise stated.

## 2. Summary of significant accounting policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

## 2. Summary of significant accounting policies *(Continued)*

### 2.1 Basis of preparation

The consolidated financial statements of the Group have been prepared in accordance with HKFRS. The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of derivative financial instruments.

The preparation of financial statements in conformity with HKFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in note 4.

(a) Standards, amendment and interpretations effective in 2007

HKFRS 7, "Financial instruments: Disclosures", and the complementary amendment to HKAS 1, "Presentation of financial statements – Capital disclosures", introduces new disclosures relating to financial instruments and does not have any impact on the classification and valuation of the Group's financial instruments, but require additional disclosures in relation to the Group's financial instruments. The main additional disclosures include certain quantitative information of the Group's exposure to credit risk, liquidity risk and market risk, as well as qualitative information of the Group's capital risk management.

HK(IFRIC) – Int 8, "Scope of HKFRS 2", requires consideration of transactions involving the issuance of equity instruments, where the identifiable consideration received is less than the fair value of the equity instruments issued in order to establish whether or not they fall within the scope of HKFRS 2. This interpretation does not have any impact on the Group's financial statements.

HK(IFRIC) – Int 10, "Interim financial reporting and impairment", prohibits the impairment losses recognised in an interim period on goodwill and investments in equity instruments and in financial assets carried at cost to be reversed at a subsequent balance sheet date. This interpretation does not have any significant impact on the Group's consolidated financial statements.

(b) Interpretations effective in 2007 but not relevant

The following standards, amendments and interpretations to published standards are mandatory for accounting periods beginning on or after 1 January 2007 but they are not relevant to the Group's operations:

- HK(IFRIC) – Int 7, "Applying the restatement approach under HKAS 29, Financial reporting in hyper-inflationary economies"; and

- HK(IFRIC) – Int 9, "Re-assessment of embedded derivatives".

## 2. Summary of significant accounting policies *(Continued)*

### 2.1 Basis of preparation *(Continued)*

(c) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Group

The following standards, amendments and interpretations to existing standards have been published and are mandatory for the Group's accounting periods beginning on or after 1 January 2008 or later periods, but the Group has not early adopted them:

- HKAS 1 (Revised), "Presentation of Financial Statements" (effective from 1 January 2009). HKAS 1 (Revised) requires all owner changes in equity to be presented in a statement of changes in equity. All comprehensive income is presented in one statement of comprehensive income or in two statements (a separate income statement and a statement of comprehensive income). It requires presenting a statement of financial position as at the beginning of the earliest comparative period in a complete set of financial statements when there are retrospective adjustments or reclassification adjustments. However, it does not change the recognition, measurement or disclosure of specific transactions and other events required by other HKFRSs. The Group will apply HKAS 1 (Revised) from 1 January 2009.

- HKFRS 2 Amendment "Share-based Payment Vesting Conditions and Cancellations" (effective from 1 January 2009). The amendment clarifies the definition of "vesting conditions" and specifies the accounting treatment of "cancellations" by the counterparty to a share-based payment arrangement. Vesting conditions are service conditions (which require a counterparty to complete a specified period of service) and performance conditions (which require a specified period of service and specified performance targets to be met) only. All "non-vesting conditions" and vesting conditions that are market conditions shall be taken into account when estimating the fair value of the equity instruments granted. All cancellations are accounted for as an acceleration of vesting and the amount that would otherwise have been recognised over the remainder of the vesting period is recognised immediately. The Group will apply HKFRS 2 Amendment from 1 January 2009, but it is not expected to have any impact on the Group's accounts.

- HKAS 23 (Revised), "Borrowing costs" (effective for annual periods beginning on or after 1 January 2009). The amendment requires an entity to capitalise borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset (one that takes a substantial period of time to get ready for use or sale) as part of the cost of that asset. The option of immediately expensing those borrowing costs will be removed. The Group will apply HKAS 23 (Revised) from 1 January 2009. Management is currently assessing the impact of HKAS 23 (Revised), but does not anticipate any material impact on the Group's consolidated financial statements as the Group has already followed the principles of capitalising borrowing costs for qualify assets in accordance with existing HKAS 23.

## 2. Summary of significant accounting policies *(Continued)*

### 2.1 Basis of preparation *(Continued)*

(c) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Group *(Continued)*

- HKAS 27 (Revised) "Consolidated and Separate Financial Statements" (effective from annual period beginning on or after 1 July 2009). The amendment requires non-controlling interests (i.e. minority interests) to be presented in the consolidated statement of financial position within equity, separately from the equity of the owners of the parent. Total comprehensive income must be attributed to the owners of the parent and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance. Changes in a parent's ownership interest in a subsidiary that do not result in the loss of control are accounted for within equity. When control of a subsidiary is lost, the assets and liabilities and related equity components of the former subsidiary are derecognised. Any gain or loss is recognised in profit or loss. Any investment retained in the former subsidiary is measured at its fair value at the date when control is lost. The Group will apply HKAS 27 (Revised) from 1 January 2010, but it is not expected to have any impact on the Group's consolidated financial statements.

- HKFRS 3 (Revised) "Business Combination" (effective for business combinations with acquisition date on or after the beginning of the first annual reporting period beginning on or after 1 July 2009). The amendment may bring more transactions into acquisition accounting as combinations by contract alone and combinations of mutual entities are brought into the scope of the standard and the definition of a business has been amended slightly. The Group will apply HKFRS 3 (Revised) from 1 January 2010.

- HKFRS 8, "Operating segments" (effective from 1 January 2009). HKFRS 8 replaces HKAS 14 and aligns segment reporting with the requirements of the US standard SFAS 131, "Disclosures about segments of an enterprise and related information". The new standard requires a "management approach", under which segment information is presented on the same basis as that used for internal reporting purposes. The Group will apply HKFRS 8 from 1 January 2009. The expected impact is still being assessed in detail by management.

- HK(IFRIC) – Int 11, "HKFRS 2 – Group and treasury share transactions" (effective for annual period beginning on or after 1 March 2007). HK(IFRIC) – Int 11 provides guidance on whether share-based transactions involving treasury shares or involving Group entities (for example options over a parent's shares) should be accounted for as equity-settled or cash-settled share-based payment transactions in the stand-alone accounts of the parent and group companies. The Group will apply HK(IFRIC) – Int 11 from 1 January 2008. Management believes that this interpretation should not have a significant impact on the consolidated financial statements as the Group has already assessed whether options over a parent's shares have been properly recorded in the stand-alone accounts of the parent and group companies using the principles that are consistent with HK(IFRIC) – Int 11.

## 2. Summary of significant accounting policies *(Continued)*

### 2.1 Basis of preparation *(Continued)*

(d) Interpretations to existing standards that are not yet effective and not relevant for the Group's operations

The following interpretations to existing standards have been published and are mandatory for the Group's accounting periods beginning on or after 1 January 2008 or later periods but are not relevant for the Group's operations:

- HKAS 32 and HKAS 1 Amendments "Puttable Financial Instruments and Obligations Arising on Liquidation" (effective from 1 January 2009). The amendment requires some puttable financial instruments and some financial instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation to be classified as equity. As none of the Group entities are going to liquidation, HKAS 32 and HKAS 1 Amendments is not relevant to the Group's operations.

- HK(IFRIC) – Int 12, "Service concession arrangements" (effective for annual periods beginning on or after 1 January 2008). HK(IFRIC) – Int 12 applies to contractual arrangements whereby a private sector operator participates in the development, financing, operation and maintenance of infrastructure for public sector services. HK(IFRIC) – Int 12 is not relevant to the Group's operations because none of the Group's companies provide for public sector services.

- HK(IFRIC) – Int 13, "Customer loyalty programmes" (effective for annual periods beginning on or after 1 July 2008). HK(IRFIC) – Int 13 clarifies that where goods or services are sold together with a customer loyalty incentive (for example, loyalty points or free products), the arrangement is a multiple-element arrangement and the consideration receivable from the customer is allocated between the components of the arrangement using fair values. HK(IFRIC) – Int 13 is not relevant to the Group's operations because none of the Group's companies operate any loyalty programmes.

- HK(IFRIC) – Int 14, "HKAS 19 – The limit on a defined benefit asset, minimum funding requirements and their interaction" (effective for annual periods beginning on or after 1 January 2008). HK(IFRIC) – Int 14 provides guidance on assessing the limit in HKAS 19 on the amount of the surplus that can be recognised as an asset. It also explains how the pension asset or liability may be affected by a statutory or contractual minimum funding requirement. HK(IFRIC) – Int 14 is not relevant to the Group's operations as the Group do not have any defined benefit plan.

### 2.2 Consolidation

The consolidated financial statements include the financial statements of the Company and all of its subsidiaries made up to 31 December.

Subsidiaries

Subsidiaries are all entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity.

## 2. Summary of significant accounting policies *(Continued)*

### 2.2 Consolidation *(Continued)*

Subsidiaries *(Continued)*

Except for the Reorganisation, subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

Except for the Reorganisation, the purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured at the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

Inter-company transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

In the Company's balance sheet the investments in subsidiaries are stated at cost less provision for impairment losses (note 2.7). The results of subsidiaries are accounted by the Company on the basis of dividend received and receivable.

### 2.3 Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments.

### 2.4 Foreign currency translation

(a) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in RMB, which is the functional and presentation currency of the Company.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

### 2.5 Leasehold land payments

Leasehold land payments are up-front prepayments made for the usage of the leasehold land in the PRC and are expensed in the income statement on a straight-line basis over the periods of the lease or when there is impairment.

## 2. Summary of significant accounting policies *(Continued)*

### 2.6 Property, plant and equipment

Property, plant and equipment, comprising plant, machinery, furniture and fixtures, and vehicles, are stated at historical cost less depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Depreciation on property, plant and equipment except for construction in progress is calculated using the straight-line method to allocate their costs to their residual values over their estimated useful lives (note 4.1), as follows:

| | |
|---|---|
| – Plant | 15–20 years |
| – Machinery | 8–10 years |
| – Vehicles | 5–8 years |
| – Furniture and fixtures | 5–8 years |

The assets' residual values and useful lives are reviewed, and adjusted if appropriate at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (note 2.7).

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement.

Construction in progress includes plant under construction and machinery under installation and testing and which, upon completion, management intends to hold as property, plant and equipment. They are carried at cost which includes cost of construction, plant and equipment and other direct cost plus borrowing costs that used to finance these projects during the construction period less accumulated impairment losses if any. No depreciation is provided for construction in progress. On completion, the relevant assets are transferred to property, plant and equipment at cost less accumulated impairment losses.

### 2.7 Impairment of investment in subsidiaries and non-financial assets

Assets that have an indefinite useful life or are not yet available for use are not subject to amortisation and are tested annually for impairment. Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets other than goodwill that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

## 2. Summary of significant accounting policies *(Continued)*

### 2.8 Financial Assets

The Group classifies its financial assets in the category of loans and receivables. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets. Loans and receivables are classified as "trade and other receivables" and "cash and cash equivalents" in the balance sheet (notes 2.11 and 2.12).

Regular purchases and sales of financial assets are recognised on the trade-date – the date on which the Group commits to purchase or sell the asset. Loans and receivables are carried at amortised cost using the effective interest method.

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a Group of financial assets is impaired. Impairment testing of trade receivables is described in note 2.11.

### 2.9 Derivative financial instruments

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently re-measured at their fair value. The method of recognising the resulting gain or loss depends on whether the derivative is designed as a hedging instrument, and if so, the nature of the item being hedged. Changes in the fair value of these derivative instruments that do not qualify for hedge accounting are recognised immediately in the income statement.

### 2.10 Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the weighted average method. The cost of finished goods and work in progress comprises raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity). It excludes borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

### 2.11 Trade and other receivables

Trade and other receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade and other receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that the trade receivable is impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The carrying amount of the assets is reduced through the use of an allowance account, and the amount of the loss is recognised in the income statement. When a trade receivable is uncollectible, it is written off against the allowance account for trade receivables. Subsequent recoveries of amounts previously written off are credited to the income statement.

## 2. Summary of significant accounting policies *(Continued)*

### 2.12 Cash and cash equivalents

Cash and cash equivalents include cash in hand and deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less.

### 2.13 Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds.

### 2.14 Trade and other payables

Trade and other payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

### 2.15 Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

### 2.16 Current and deferred income tax

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the balance sheet date in the countries where the Company and its subsidiaries operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation and establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, if the deferred income tax arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss, it is not accounted for. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

## 2. Summary of significant accounting policies *(Continued)*

### 2.17 Employee benefits

(a) Pension obligations

In accordance with the rules and regulations in the PRC, the employees of the Group's subsidiaries established in the PRC participate in defined contribution retirement benefit plans organised by Shandong Provincial, Shaanxi Provincial and Inner Mongolia Autonomous Regional governments. The Shandong Provincial, Shaanxi Provincial and Inner Mongolia Autonomous Regional governments undertake to assume the retirement benefit obligations of all existing and future retired employees payable under the plan described above. Contributions to these plans are expensed as incurred and other than these monthly contributions, the Group has no further obligation for the payment of retirement benefits of its employees. The assets of these plans are held separately from those of the Group in an independent fund managed by the PRC government.

The Group's contributions to the defined contribution retirement benefit plan are charged to the income statement as incurred.

(b) Share-based compensation

The Group operates a number of equity-settled, share-based compensation plans. The fair value of the employee services received in exchange for the grant of the options is recognised as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted, excluding the impact of any non-market vesting conditions (for example, profitability and sales growth targets). Non-market vesting conditions are included in assumptions about the number of options that are expected to vest. At each balance sheet date, the entity revises its estimates of the number of options that are expected to vest. It recognises the impact of the revision of original estimates, if any, in the income statement, with a corresponding adjustment to equity.

The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised.

Where options are granted to employees of subsidiaries within the Group, in the consolidated financial statements, such share-based arrangement is accounted for as equity-settled. The fair value are accounted for as contributions and recognised as part of the cost of investment in the Company's standalone financial statements.

### 2.18 Provisions

Provisions for environmental restoration, restructuring costs and legal claims are recognised when: the Group has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Restructuring provisions comprise lease termination penalties and employee termination payments. Provisions are not recognised for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2007

## 2. Summary of significant accounting policies *(Continued)*

### 2.18 Provisions *(Continued)*

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

### 2.19 Government grants

Grants from the government are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions.

Government grants relating to costs are deferred and recognised in the income statement over the period necessary to match them with the costs that they are intended to compensate.

Government grants relating to the acquisition of property, plant and equipment are included in liabilities as deferred government grants and are credited to the income statement over the periods and in the proportions in which depreciation on these assets is charged.

### 2.20 Borrowing costs

Borrowing costs that are directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sales are capitalised as part of the cost of that asset during the period of time that is required to complete and prepare the asset for its intended use.

All other borrowing costs are charged to the income statement in the year in which they are incurred.

### 2.21 Revenue recognition

Revenue comprises the fair value of the consideration received or receivable for the sale of goods and services in the ordinary course of the Group's activities. Revenue is shown net of value-added tax, returns, rebates and discounts and after eliminating sales within the Group.

The Group recognises revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity and specific criteria have been met for each of the Group's activities as described below. The amount of revenue is not considered to be reliably measurable until all contingencies relating to the sale have been resolved. The Group bases its estimates on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement.

(a) Sales of goods

Sales of goods are recognised when the Group has delivered products to the customer, the customer has accepted the products and collectability of the related receivables is reasonably assured.

(b) Interest income

Interest income is recognised on a time-proportion basis using the effective interest method.

## 2. Summary of significant accounting policies *(Continued)*

### 2.22 Operating leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lesser are classified as operating leases. Payments made under operating leases (net of any incentives received from the lesser) are charged to the income statement on a straight-line basis over the period of the lease.

### 2.23 Research and development

Research expenditure is recognised as an expense as incurred. Costs incurred on development projects (relating to the design and testing of new or improved products) are recognised as intangible assets when the following criteria are fulfilled:

(a) it is technically feasible to complete the intangible asset so that it will be available for use;

(b) management intends to complete the intangible asset and use it;

(c) there is an ability to use the intangible asset;

(d) it can be demonstrated how the intangible asset will generate probable future economic benefits;

(e) adequate technical, financial and other resources to complete the development and to use the intangible asset are available; and

(f) the expenditure attributable to the intangible asset during its development can be reliably measured.

Other development expenditures that do not meet these criteria are recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period. Capitalised development costs are recorded as intangible assets and amortised from the point at which the asset is ready for use on a straight-line basis over its useful life, not exceeding five years.

### 2.24 Dividend distribution

Dividend distribution to the Company's shareholders is recognised as a liability in the Group's financial statements in the period in which the dividends are approved by the Company's shareholders or Directors, where appropriate.

## 3. Financial risk management

### 3.1 Financial risk factors

The Group's activities expose it to a variety of financial risks: market risk (including foreign exchange risk, fair value interest rate risk and cash flow interest rate risk), credit risk, and liquidity risk. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance.

(a) Market risk

*(i) Foreign exchange risk*

The Group's businesses are principally conducted in RMB and most of the transactions were denominated and settled in RMB. Therefore, the Group has not used any derivatives to hedge its exposure to foreign currency exchange risk for the year ended 31 December 2007. The Group is subject to foreign exchange rate risk arising from sales of products to countries or areas outside PRC ("Export Sales") and the monetary assets denominated in HK$ after the receipt of proceeds from issuance of shares for the Listing.

Foreign currencies received from Export Sales, which is approximately 8% (2006: 5%) of the turnover for the year 2007, is relatively immaterial to the total turnover of the Group. The Group manages the currency risk arising from sales of products by customers paying in advance or keeping the credit period available to customers as short as possible in order to reduce the effect on the fluctuation between US$ and RMB.

Proceeds, denominated in HK$, received from the Listing are mainly used for the expansion of the Group in the PRC. The Group manages foreign exchange risk arising from listing proceeds by remitting the necessary funds to the PRC and translate into RMB as soon as practicable in order to reduce the effect on the fluctuation between HK$ and RMB.

The maximum exposures to the foreign exchange risks are disclosed in note 13 and 14 respectively.

## 3. Financial risk management *(Continued)*

### 3.1 Financial risk factors *(Continued)*

(a) Market risk *(Continued)*

*(i) Foreign exchange risk (Continued)*

The following table summarises the sensitivity of the Group's financial assets and financial liabilities to foreign exchange risk based on the assumption that RMB had weakened/strengthened by 10% against US$ and HK$ with all other variables held constant.

| | | Foreign exchange risk | | | |
|---|---|---|---|---|---|
| | | -10% | | +10% | |
| | Carrying amount | Profit | Equity | Profit | Equity |
| | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* |
| **31 December 2007** | | | | | |
| **Financial assets** | | | | | |
| Cash and cash equivalents | 228,849 | (9,085) | (9,085) | 9,085 | 9,085 |
| Trade and other receivables | 528,289 | (3,242) | (3,242) | 3,242 | 3,242 |
| Total (decrease)/increase | | (12,327) | (12,327) | 12,327 | 12,327 |
| **31 December 2006** | | | | | |
| **Financial assets** | | | | | |
| Cash and cash equivalents | 41,094 | (1,519) | (1,519) | 1,519 | 1,519 |
| Trade and other receivables | 336,011 | (2,243) | (2,243) | 2,243 | 2,243 |
| **Financial liabilities** | | | | | |
| Borrowings | 749,630 | 30,563 | 30,563 | (30,563) | (30,563) |
| Total increase/(decrease) | | 26,801 | 26,801 | (26,801) | (26,801) |

*(ii) Cash flow and fair value interest rate risk*

As the Group has no significant interest-bearing assets except for bank deposits and balances, the Group's income and operating cash flows are substantially independent of changes in market interest rates. The Group's exposure to changes in interest rates is mainly attributable to its current borrowings. Borrowings issued at fixed rates expose the Group to fair value interest rate risk. A portion of current borrowings bear variable rates and expose the Group to cash flow interest rate risk. The maximum exposures to the interest rate risk have been disclosed in note 19.

The Group has not used any derivatives to hedge its exposure to interest rate risk for the year ended 31 December 2007.

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2007

## 3. Financial risk management *(Continued)*

### 3.1 Financial risk factors *(Continued)*

(a) Market risk *(Continued)*

*(ii) Cash flow and fair value interest rate risk (Continued)*

The sensitivity analysis for interest rate risk is based on the assumption that: Interest rate had been 10% lower/higher from the year end rates with all other variables held constant:

| | | Interest rate risk | | | |
|---|---|---|---|---|---|
| | | -10% | | +10% | |
| | Carrying amount | Profit | Equity | Profit | Equity |
| | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* |
| **31 December 2007** | | | | | |
| **Financial liabilities** | | | | | |
| Borrowings | 630,000 | 194 | 194 | (194) | (194) |
| **31 December 2006** | | | | | |
| **Financial liabilities** | | | | | |
| Borrowings | 749,630 | 3,167 | 3,167 | (3,167) | (3,167) |

(b) Credit risk

The Group has no significant concentrations of credit risk. The carrying amounts of cash and cash equivalents, trade and other receivables represent the Group's maximum exposure to credit risk in relation to financial assets. For banks, the Group has policies that deposits are placed in reputable banks. For sales of goods, customers of the Group usually pay in advance before the delivery of products. Credit will only be granted to some customers with long term relationship. The Group performs ongoing credit evaluations of its customers' financial conditions and generally does not require collateral on trade receivables.

(c) Liquidity risk

Prudent liquidity risk management includes maintaining sufficient cash and the available credit facilities to meet obligations when they arise.

Management monitors the funding requirements of the Group and the availability of credit facilities in order to ensure the liquidity of the Group.

The table below analyses the Group's financial liabilities into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows. Balances due within 12 months equal their carrying balances, as the impact of discounting is not significant.

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2007

## 3. Financial risk management *(Continued)*

### 3.1 Financial risk factors *(Continued)*

(c) Liquidity risk *(Continued)*

| | Less than 1 year *RMB'000* | Between 1 and 2 years *RMB'000* |
|---|---|---|
| **The Group** | | |
| **At 31 December 2007** | | |
| Bank borrowings | 318,000 | 312,000 |
| Interest payment on bank borrowings (i) | 7,997 | 33,226 |
| Trade and other payables | 638,795 | – |
| Total | 964,792 | 345,226 |
| **At 31 December 2006** | | |
| Bank borrowings | 414,630 | 335,000 |
| Interest payment on bank borrowings (i) | 26,447 | 30,513 |
| Trade and other payables | 511,747 | – |
| Total | 952,824 | 365,513 |

(i) The interest on borrowings is calculated based on borrowings held as at 31 December 2007 and 2006 without taking into account of future issues. Floating-rate interests are estimated using current interest rate as at 31 December 2007 and 2006 respectively.

### 3.2 Capital risk management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for Shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital.

In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to Shareholders, return capital to Shareholders, issue new shares or sell assets to reduce debt.

The Group monitors capital on the basis of the gearing ratio. This ratio equals to total borrowings at the end of the year divided by total assets at the end of that corresponding year.

The strategy of the Group is to maintain a gearing ratio between 20% and 40%. The gearing ratio at 31 December 2007 and 2006 were as follows:

| | **2007** *RMB'000* | 2006 *RMB'000* |
|---|---|---|
| Total borrowings *(note 19)* | **630,000** | 749,630 |
| Total assets | **2,881,835** | 1,924,344 |
| Gearing ratio | **21.86%** | 38.96% |

The decrease in the gearing ratio for the year ended 31 December 2007 resulted primarily from the increase in share capital and share premiums and repayment of bank borrowings.

## 3. Financial risk management *(Continued)*

### 3.3 Fair value estimation

The fair value of financial instruments traded in active markets is based on quoted market prices at the balance sheet date.

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques. The Group uses a variety of methods and makes assumptions that are based on market conditions existing at each balance sheet date.

The carrying value less impairment provision of trade receivables and payables are a reasonable approximation of their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the Group for similar financial instruments.

## 4. Critical accounting estimates and judgements

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

### 4.1 Critical accounting estimates and assumptions

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

(a) Net realisable value of inventories

Net realisable value of inventories is the estimated selling price in the ordinary course of business, less estimated costs of completion and selling expenses. These estimates are based on the current market condition as at the balance sheet date and the historical experience of manufacturing and selling products of similar nature.

(b) Impairment of property, plant and equipment

The Group reviews property, plant and equipment for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable, in accordance with the accounting policy stated in note 2.8. The recoverable amount of cash-generating unit has been determined based on the higher of value in use and fair value less costs to sell.

(c) Current tax and deferred tax

The Group is subject to income taxes in several jurisdictions. Significant judgement is required in determining the provision for income taxes. There are transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the periods in which such determination are made.

## 4. Critical accounting estimates and judgements *(Continued)*

### 4.1 Critical accounting estimates and assumptions *(Continued)*

(c) Current tax and deferred tax *(Continued)*

Deferred tax assets relate primarily tax losses which are recognised as management considers it is probable that future taxable profit will be available against which the temporary differences or tax losses can be utilised. Where the expectation is different from the original estimate, such differences will impact the recognition of deferred tax assets and taxation in the periods in which such estimate is changed.

Effective from 1 January 2008, the Company shall determine and pay the corporate income tax (hereinafter "EIT") in accordance with the EIT Law as approved by the National People's Congress on 16 March 2007. Under the new EIT Law, the EIT rate applicable to the Company will be gradually increased to 25% in a 5-year period from 2008 to 2012. Deferred tax assets and liabilities have been calculated based on management's estimation of the timing of the reversal of the underlying temporary differences in the next 5-year period and thereafter.

(d) Useful lives of plant and equipment

The Group's management determines the estimated useful lives and related depreciation charges for its plant and equipment. This estimate is based on the historical experience of the actual useful lives of plant and equipment of similar nature and functions. It could change significantly as a result of technical innovations and competitor actions in response to severe industry cycles. Management will increase the depreciation charge where useful lives are less than previously estimated, or it will write off or write down technically obsolete or non-strategic assets that have been abandoned or sold. For the deferred government grants relating to the acquisition of property, plant and equipment, the periodic credits to income statement will also be increased under above mentioned circumstances as such grants are credited to the income statement over the periods and in the proportions in which depreciation on these assets is charged.

### 4.2 Critical judgements in applying the entity's accounting policies

(a) Borrowing costs eligible for capitalisation

The borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are those borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made. It may be difficult to identify a direct relationship between particular borrowings and a qualifying asset and to determine the borrowings that could otherwise have been avoided. Such a difficulty occurs, for example, when the financing activity of an entity is co-ordinated centrally. As a result, the determination of the amount of borrowing costs that are directly attributable to the acquisition of a qualifying asset is difficult and the exercise of judgement is required.

Borrowing costs capitalised into property, plant and equipment are shown in note 7.

## 5. Segmental information

The Group is principally engaged in the manufacture and sales of corn-based biochemical products, including glutamic acid, MSG, fertilisers, xanthan gum, starch sweeteners and corn refined products. Turnover and revenue for the years ended 31 December 2007 and 2006 are analysed as follows:

| | 2007<br>*RMB'000* | 2006<br>*RMB'000* |
|---|---|---|
| Glutamic acid | 1,049,470 | 1,050,090 |
| MSG | 550,825 | 199,441 |
| Corn refined products | 421,808 | 227,390 |
| Fertilisers | 195,870 | 134,824 |
| Xanthan gum | 149,486 | 139,620 |
| Starch sweeteners | 78,193 | 35,882 |
| | 2,445,652 | 1,787,247 |

As at 31 December 2007, the Group is organised into two main business segments: MSG (which includes the sales of glutamic acid, MSG, corn refined products, fertilisers and starch sweeteners) and xanthan gum. There are no significant sales or other transactions between the business segments.

The segment results for the year ended 31 December 2007 are as follows:

| | MSG<br>*RMB'000* | Xanthan gum<br>*RMB'000* | Unallocated<br>*RMB'000* | Group<br>*RMB'000* |
|---|---|---|---|---|
| Total segment revenue | 2,296,166 | 150,152 | – | 2,446,318 |
| Inter-segment revenue | – | (666) | – | (666) |
| Revenue | 2,296,166 | 149,486 | – | 2,445,652 |
| Segment results | 41,574 | 39,446 | (33,170) | 47,850 |
| Interest income from IPO subscription deposits | | | | 42,837 |
| Finance costs | | | | (45,202) |
| Profit before income tax | | | | 45,485 |
| Income tax expense *(note 26)* | | | | (416) |
| Profit for the year | | | | 45,069 |

## 5. Segmental information *(Continued)*

The segment results for the year ended 31 December 2006 are as follows:

| | MSG | Xanthan gum | Unallocated | Group |
|---|---|---|---|---|
| | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* |
| Revenue | 1,647,627 | 139,620 | – | 1,787,247 |
| Segment results | 223,662 | 47,636 | (6,644) | 264,654 |
| Finance costs | | | | (14,846) |
| Profit before income tax | | | | 249,808 |
| Income tax expense *(note 26)* | | | | (9,325) |
| Profit for the year | | | | 240,483 |

Other segment items included in the income statement are as follows:

| | 2007 | | | |
|---|---|---|---|---|
| | **MSG** | **Xanthan gum** | **Unallocated** | **Group** |
| | ***RMB'000*** | ***RMB'000*** | ***RMB'000*** | ***RMB'000*** |
| Depreciation *(note 7)* | **101,939** | **14,646** | **362** | **116,947** |
| Amortisation of leasehold land payments *(note 6)* | **1,620** | **228** | **–** | **1,848** |
| Reversal of write-down of inventories *(note 12)* | **(4,005)** | **–** | **–** | **(4,005)** |
| Loss on sales of property, plant and equipment *(note 29)* | **283** | **–** | **–** | **283** |

| | 2006 | | | |
|---|---|---|---|---|
| | MSG | Xanthan gum | Unallocated | Group |
| | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* |
| Depreciation *(note 7)* | 51,054 | 3,947 | 3 | 55,004 |
| Amortisation of leasehold land payments *(note 6)* | 1,414 | 201 | – | 1,615 |
| Write-down of inventories *(note 12)* | 4,005 | – | – | 4,005 |
| Loss on sales of property, plant and equipment *(note 29)* | 440 | – | – | 440 |

## 5. Segmental information *(Continued)*

The segment assets and liabilities at 31 December 2007 and capital expenditure for the year then ended are as follows:

| | **MSG** *RMB'000* | **Xanthan gum** *RMB'000* | **Unallocated** *RMB'000* | **Group** *RMB'000* |
|---|---|---|---|---|
| Assets | **2,372,359** | **418,435** | **91,041** | **2,881,835** |
| Liabilities | **1,116,638** | **313,521** | **2,860** | **1,433,019** |
| Capital expenditure *(note 6 and 7)* | **363,354** | **139,557** | **–** | **502,911** |

The segment assets and liabilities at 31 December 2006 and capital expenditure for the year then ended are as follows:

| | MSG *RMB'000* | Xanthan gum *RMB'000* | Unallocated *RMB'000* | Group *RMB'000* |
|---|---|---|---|---|
| Assets | 1,605,432 | 187,863 | 131,049 | 1,924,344 |
| Liabilities | 1,273,620 | 122,393 | 1,938 | 1,397,951 |
| Capital expenditure *(note 6 and 7)* | 731,263 | 113,661 | – | 844,924 |

Segment assets consist primarily of leasehold land payments, property, plant and equipment, inventories, trade and other receivables, short-term bank deposits and cash and cash equivalents. Unallocated assets comprise assets held by non-PRC established companies and property, plant and equipment, other receivables, and cash and cash equivalents held by Shandong Fufeng Biotechnologies.

Segment liabilities comprise operating liabilities. Unallocated liabilities comprise operating liabilities of the Company except borrowings of RMB305,630,000 denominated in US$ as at 31 December 2006.

Capital expenditure comprises additions to leasehold land payments (note 6) and property, plant and equipment (note 7).

No geographical segment information is presented as over 90% of the Group's revenue and segment results are attributable to the market within the PRC and all operating assets of the Group are located in the PRC.

## 6. Leasehold land payments – The Group

Leasehold land payments represent the prepaid operating lease payments for the medium term leasehold land (10 to 50 years) in the PRC where the manufacturing plants of Shandong Fufeng, Baoji Fufeng and IM Fufeng are located. Net book values are analysed as follows:

| | **2007** | 2006 |
|---|---|---|
| | ***RMB'000*** | *RMB'000* |
| Outside Hong Kong, held on: | | |
| Leases of between 10 to 50 years | **63,070** | 64,918 |

As at 31 December 2007 and 2006, the net book value of leasehold land pledged as security for the Group's borrowings amounted to approximately RMB35,179,000 and RMB33,051,000 (note 19), respectively.

| | **2007** | 2006 |
|---|---|---|
| | ***RMB'000*** | *RMB'000* |
| Cost | | |
| At beginning of the year | **70,426** | 59,626 |
| Additions | **–** | 10,800 |
| At end of the year | **70,426** | 70,426 |
| Amortisation | | |
| At beginning of the year | **(5,508)** | (3,893) |
| Charge for the year | **(1,848)** | (1,615) |
| At end of the year | **(7,356)** | (5,508) |
| Net book value | | |
| At end of the year | **63,070** | 64,918 |

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2007

## 7. Property, plant and equipment

**The Group**

| | 2007 | | | | | |
|---|---|---|---|---|---|---|
| | **Plant** | **Machinery** | **Furniture and fixtures** | **Vehicles** | **Construction in progress** | **Total** |
| | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* |
| Cost | | | | | | |
| At 1 January 2007 | **264,089** | **939,749** | **21,721** | **17,525** | **176,777** | **1,419,861** |
| Additions | **1,651** | **52,181** | **412** | **2,010** | **446,657** | **502,911** |
| Transfers | **114,317** | **302,274** | **–** | **–** | **(416,591)** | **–** |
| Disposals | **–** | **(787)** | **–** | **–** | **–** | **(787)** |
| At 31 December 2007 | **380,057** | **1,293,417** | **22,133** | **19,535** | **206,843** | **1,921,985** |
| Accumulated depreciation | | | | | | |
| At 1 January 2007 | **(13,871)** | **(108,007)** | **(3,485)** | **(6,158)** | **–** | **(131,521)** |
| Charge for the year | **(13,040)** | **(97,041)** | **(3,107)** | **(3,759)** | **–** | **(116,947)** |
| Disposals | **–** | **504** | **–** | **–** | **–** | **504** |
| At 31 December 2007 | **(26,911)** | **(204,544)** | **(6,592)** | **(9,917)** | **–** | **(247,964)** |
| Net book value | | | | | | |
| At 31 December 2007 | **353,146** | **1,088,873** | **15,541** | **9,618** | **206,843** | **1,674,021** |

| | 2006 | | | | | |
|---|---|---|---|---|---|---|
| | Plant | Machinery | Furniture and fixtures | Vehicles | Construction in progress | Total |
| | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* |
| Cost | | | | | | |
| At 1 January 2006 | 84,053 | 458,076 | 11,057 | 14,773 | 25,317 | 593,276 |
| Additions | 13,891 | 155,367 | 9,986 | 2,210 | 652,670 | 834,124 |
| Transfers | 167,160 | 332,830 | 678 | 542 | (501,210) | – |
| Disposals | (1,015) | (6,524) | – | – | – | (7,539) |
| At 31 December 2006 | 264,089 | 939,749 | 21,721 | 17,525 | 176,777 | 1,419,861 |
| Accumulated depreciation | | | | | | |
| At 1 January 2006 | (10,234) | (66,835) | (1,259) | (3,991) | – | (82,319) |
| Charge for the year | (4,402) | (46,209) | (2,226) | (2,167) | – | (55,004) |
| Disposals | 765 | 5,037 | – | – | – | 5,802 |
| At 31 December 2006 | (13,871) | (108,007) | (3,485) | (6,158) | – | (131,521) |
| Net book value | | | | | | |
| At 31 December 2006 | 250,218 | 831,742 | 18,236 | 11,367 | 176,777 | 1,288,340 |

As at 31 December 2007 and 2006, the net book value of plant and machinery pledged as security for the Group's borrowings amounted to approximately RMB279,234,000 and RMB285,125,000, respectively (note 19).

## 7. Property, plant and equipment *(Continued)*

Depreciation expense included in the consolidated income statement is as follows:

| | 2007<br>*RMB'000* | 2006<br>*RMB'000* |
|---|---|---|
| Cost of sales | **104,021** | 51,484 |
| Administrative expenses | **12,926** | 3,520 |
| | **116,947** | 55,004 |

During the year ended 31 December 2007, there were no borrowing costs capitalised into property, plant and equipment (2006: RMB18,952,000). During the year ended 31 December 2006, capitalisation rate of 9.36% was used, representing the borrowing costs of the loans used to finance the construction.

**The Company**

| | 2007<br>Furniture<br>and fixtures<br>*RMB'000* | 2006<br>Furniture<br>and fixtures<br>*RMB'000* |
|---|---|---|
| Cost | | |
| At beginning of the year | **14** | 14 |
| Additions | **256** | – |
| At end of the year | **270** | 14 |
| Accumulated depreciation | | |
| At beginning of the year | **(4)** | (1) |
| Charge for the year | **(49)** | (3) |
| At end of the year | **(53)** | (4) |
| Net book value | | |
| At end of the year | **217** | 10 |

## 8. Investment in and balances with subsidiaries – The Company

| | 2007 *RMB'000* | 2006 *RMB'000* |
|---|---|---|
| Investment in a subsidiary (a) | **401,698** | 401,698 |
| Loans to subsidiaries (b) | **170,107** | 290,174 |
| Due from subsidiaries (c) | **565,506** | – |
| Due to subsidiaries (d) | **9,384** | 1,715 |

**(a) Investment in a subsidiary**

| | 2007 *RMB'000* | 2006 *RMB'000* |
|---|---|---|
| Unlisted shares, at cost | **401,698** | 401,698 |

The particulars of the Company's directly and indirectly owned subsidiaries are disclosed in note 34.

**(b) Loans to subsidiaries**

The non-current loans to subsidiaries, Summit Challenge and Expand Base as at 31 December 2007, are unsecured and interest free. Non-current loans to subsidiaries were initially recognised at fair value based on the present value of discounted cash flows using a discount rate of 7.47%, and were stated at amortised cost as at 31 December 2007.

The current loan to a subsidiary, Acquest Honour, as at 31 December 2006, is unsecured at the interest rate of LIBOR plus 3.5% margin per annum. The loan is repayable on demand and its carrying amount approximates its fair value as at 31 December 2006.

**(c) Due from subsidiaries**

The amounts due from subsidiaries are unsecured, interest-free and repayable on demand, and their carrying amounts approximate their fair values as at 31 December 2007.

**(d) Due to subsidiaries**

The amounts due to subsidiaries are unsecured, interest-free and repayable on demand, and their carrying amounts of due to subsidiaries approximate their fair values as at 31 December 2007 and 2006.

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2007

## 9. Financial instruments by category

The accounting policies for financial instruments have been applied to the line items below:

**The Group**

| | Loans and receivables<br>*RMB'000* |
|---|---|
| **Assets as per consolidated balance sheet** | |
| 31 December 2007 | |
| Trade and other receivables *(note 13)* | 528,289 |
| Short-term bank deposits *(note 14)* | 42,170 |
| Cash and cash equivalents *(note 14)* | 228,849 |
| Total | 799,308 |
| 31 December 2006 | |
| Trade and other receivables *(note 13)* | 336,011 |
| Short-term bank deposits *(note 14)* | 23,500 |
| Cash and cash equivalents *(note 14)* | 41,094 |
| Total | 400,605 |

| | Other financial liabilities<br>*RMB'000* |
|---|---|
| **Liabilities as per consolidated balance sheet** | |
| 31 December 2007 | |
| Trade, other payables and accruals | 638,795 |
| Borrowings *(note 19)* | 630,000 |
| Total | 1,268,795 |
| 31 December 2006 | |
| Trade, other payables and accruals | 511,747 |
| Borrowings *(note 19)* | 749,630 |
| Total | 1,261,377 |

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2007

## 9. Financial instruments by category *(Continued)*

**The Company**

| | Loans and receivables<br>*RMB'000* |
|---|---|
| **Assets as per balance sheet** | |
| 31 December 2007 | |
| Loans to subsidiaries *(note 8)* | 170,107 |
| Deposits and other receivables *(note 13)* | 174 |
| Due from subsidiaries *(note 8)* | 565,506 |
| Cash and cash equivalents *(note 14)* | 82,783 |
| Total | 818,570 |
| 31 December 2006 | |
| Loan to a subsidiary *(note 8)* | 290,174 |
| Deposits and other receivables *(note 13)* | 57 |
| Cash and cash equivalents *(note 14)* | 13,241 |
| Total | 303,472 |

| | Other financial liabilities<br>*RMB'000* |
|---|---|
| **Liabilities as per balance sheet** | |
| 31 December 2007 | |
| Due to subsidiaries *(note 8)* | 9,384 |
| Other payables and accruals *(note 20)* | 2,860 |
| Total | 12,244 |
| 31 December 2006 | |
| Due to subsidiaries *(note 8)* | 1,715 |
| Other payables and accruals *(note 20)* | 1,938 |
| Borrowings *(note 19)* | 305,630 |
| Total | 309,283 |

## 10. Credit quality of financial assets

**Trade receivables and notes receivables**

The credit quality of financial assets that are neither past due nor impaired can be assessed by types of the financial assets and by reference to historical information about counterparty default rates. The Group categorises its trade receivables into the following:

Group 1 – Bank acceptance notes for which the repayments are guaranteed by large state-owned banks.
Group 2 – Trade receivables due from customers with no defaults in the past.
Group 3 – Trade receivables due from customers with some defaults in the past. All defaults were fully recovered.

**The Group**

| | **2007** | 2006 |
|---|---|---|
| | ***RMB'000*** | *RMB'000* |
| Group 1 | **426,214** | 244,190 |
| Group 2 | **67,164** | 82,783 |
| Group 3 | **–** | – |
| | **493,378** | 326,973 |

**Cash and cash equivalents**

The management considers the credit risks in respect of cash and bank deposits are relatively minimum as each counter party either bears a high credit rating or is large state-owned PRC bank.

The Group categorises its cash in banks into the following:

Group 1 – Major International banks (Hangseng Bank, ABN AMRO Hong Kong and The Hong Kong and Shanghai Banking Corporation Limited)
Group 2 – Top 4 banks in Mainland China (China Construction Bank, Bank of China, Agricultural Bank of China and Industrial and Commercial Bank of China)
Group 3 – Other state-owned banks in mainland PRC

**The Group**

| | **2007** | 2006 |
|---|---|---|
| | ***RMB'000*** | *RMB'000* |
| Group 1 | **84,502** | 14,954 |
| Group 2 | **129,341** | 22,304 |
| Group 3 | **56,550** | 23,970 |
| | **270,393** | 61,228 |

## 10. Credit quality of financial assets *(Continued)*

**The Company**

| | 2007 RMB'000 | 2006 RMB'000 |
|---|---|---|
| Group 1 | 82,783 | 13,241 |
| Group 2 | – | – |
| Group 3 | – | – |
| | 82,783 | 13,241 |

None of the financial assets that are fully performing has been renegotiated in the current or last year.

## 11. Deferred income tax – The Group

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority. The offset amounts are as follows:

| | 2007 RMB'000 | 2006 RMB'000 |
|---|---|---|
| Deferred tax assets: | | |
| – Deferred income tax assets to be recovered after more than 12 months | 6,390 | – |
| – Deferred income tax assets to be recovered within 12 months | – | 601 |
| | 6,390 | 601 |
| Deferred tax liabilities: | | |
| – Deferred income tax liability to be settled after more than 12 months | (898) | (699) |
| – Deferred income tax liability to be settled within 12 months | – | (8) |
| | (898) | (707) |
| Deferred income tax assets/(liabilities), net | 5,492 | (106) |

## 11. Deferred income tax – The Group *(Continued)*

The gross movement on the deferred income tax account is as follows:

| | **2007** | 2006 |
|---|---|---|
| | ***RMB'000*** | *RMB'000* |
| Beginning balance of the year | **(106)** | (113) |
| Credited to the consolidated income statement *(note 26)* | **5,598** | 7 |
| Ending balance of the year | **5,492** | (106) |

Deferred income tax is calculated on temporary differences under the liability method.

The movement in deferred tax assets and liabilities during the year, without taking into consideration the offsetting of balances within the same tax jurisdiction, is as follows:

Deferred tax assets:

| | **Tax losses** | **Write-down of inventories** | **Total** |
|---|---|---|---|
| | ***RMB'000*** | ***RMB'000*** | ***RMB'000*** |
| **1 January 2006** | – | – | – |
| Transfer to income statement *(note 26)* | – | 601 | 601 |
| **31 December 2006** | – | 601 | 601 |
| Transfer to income statement *(note 26)* | 6,390 | (601) | 5,789 |
| **31 December 2007** | **6,390** | **–** | **6,390** |

Deferred income tax assets are recognised for tax loss carry-forwards to the extent that the realisation of the related tax benefit through the future taxable profits is probable.

Deferred tax liabilities:

| | **Interest capitalisation** |
|---|---|
| | ***RMB'000*** |
| **1 January 2006** | 113 |
| Transfer to income statement *(note 26)* | 594 |
| **31 December 2006** | 707 |
| Transfer to income statement *(note 26)* | 191 |
| **31 December 2007** | **898** |

## 12. Inventories – The Group

| | 2007 RMB'000 | 2006 RMB'000 |
|---|---|---|
| Raw materials | **92,972** | 88,047 |
| Work-in-progress | **33,274** | 18,812 |
| Finished goods | **200,105** | 41,218 |
| | **326,351** | 148,077 |

For the year ended 31 December 2007, the Group reversed a previous inventory write-down of RMB4,005,000 (note 22 and 29) made in last year as the Group sold all the underlying goods to third parties during the current year. The amount reversed was included in "cost of sales" in the consolidated income statement.

## 13. Trade and other receivables

**The Group**

| | 2007 RMB'000 | 2006 RMB'000 |
|---|---|---|
| Trade receivables (a) | **67,164** | 82,783 |
| Notes receivables (b) | **426,214** | 244,190 |
| Prepayments | **12,695** | 21,803 |
| Deposits and other receivables | **34,911** | 9,038 |
| | **540,984** | 357,814 |

(a) As at 31 December 2007 and 2006, the ageing analysis of trade receivables was as follows:

| | 2007 RMB'000 | 2006 RMB'000 |
|---|---|---|
| Within 3 months | **59,320** | 77,055 |
| Over 3 months | **7,844** | 5,728 |
| | **67,164** | 82,783 |

The Group sold its products to customers and received settlement either in cash or in form of bank acceptance notes (note (b)) upon delivery of goods. The bank acceptance notes are usually with maturity dates within six months. Major customers with good repayment history are normally offered credit terms for not more than three months.

## 13. Trade and other receivables *(Continued)*

(a) As of 31 December 2007, trade receivables of RMB3,469,000 (2006: RMB4,101,000) were past due but not impaired. These relate to a number of independent customers for whom there is no recent history of default. The directors considered trade receivables that are less than three months past due are not impaired. The ageing analysis of these trade receivables was as follows:

| | **2007** | 2006 |
|---|---|---|
| | ***RMB'000*** | *RMB'000* |
| Past due within 3 months | **3,469** | 4,101 |

(b) As at 31 December 2007, notes receivables were all bank acceptance notes aged less than six months, including amount of RMB334,299,000 (2006: RMB216,815,000) applied for settling the amounts payable to the Group's suppliers.

(c) Trade and other receivables are unsecured and interest-free. The carrying amounts of trade and other receivables approximate their fair values.

(d) The carrying amounts of the Group's trade and other receivables are denominated in the following currencies:

| | **2007** | 2006 |
|---|---|---|
| | ***RMB'000*** | *RMB'000* |
| – RMB | **508,289** | 335,389 |
| – US$ | **32,417** | 22,425 |
| – EUR | **278** | – |
| | **540,984** | 357,814 |

**The Company**

| | **2007** | 2006 |
|---|---|---|
| | ***RMB'000*** | *RMB'000* |
| Deposits and other receivables | **174** | 57 |

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For the year ended 31 December 2007

## 14. Cash and bank balances

**The Group**

| | 2007<br>*RMB'000* | 2006<br>*RMB'000* |
|---|---|---|
| Cash and cash equivalents | **228,849** | 41,094 |
| Short-term bank deposits (a) | **42,170** | 23,500 |
| | **271,019** | 64,594 |
| Cash and bank balances denominated in | | |
| – RMB | **180,172** | 49,408 |
| – US$ | **132** | 13,238 |
| – HK$ | **90,715** | 1,948 |
| | **271,019** | 64,594 |

(a) The short-term bank deposits as at 31 December 2007 included (i) restricted bank deposits of RMB10,000,000 (2006: RMB21,000,000) pledged as security for issuing bank acceptance notes to suppliers (note 20) and of RMB340,000 (2006: nil) pledged as security for issuing letters of credit, and (ii) other short-term bank deposits of RMB30,330,000 (2006: nil) with maturities over 3 months.

(b) The Group's cash and bank balances denominated in RMB were deposited with banks in the PRC. The conversion of these RMB denominated balances into foreign currencies is subject to the rules and regulations of foreign exchange control promulgated by the PRC government.

(c) The weighted average effective interest rate on cash placed with banks and deposits were 1.60% and 1.35% per annum for the years ended 31 December 2007 and 2006, respectively.

## 14. Cash and bank balances *(Continued)*

**The Company**

| | **2007** | 2006 |
|---|---|---|
| | ***RMB'000*** | *RMB'000* |
| Cash and cash equivalents | **82,783** | 13,241 |
| Cash and bank balances denominated in | | |
| – US$ | **132** | 13,238 |
| – HK$ | **82,651** | 3 |
| | **82,783** | 13,241 |

The weighted average effective interest rate on cash placed with banks and deposits were 2.25% and 1.28% per annum for the years ended 31 December 2007 and 2006, respectively.

## 15. Share capital and premium

| | **Number of shares *(thousands)*** | **Share capital *(RMB'000)*** | **Share premium *(RMB'000)*** | **Total *(RMB'000)*** |
|---|---|---|---|---|
| **At 1 January 2006** | – | – | – | – |
| Issuance of Shares for the Reorganisation (note 1) | 1,200,000 | 123,372 | 278,326 | 401,698 |
| **At 31 December 2006** | 1,200,000 | 123,372 | 278,326 | 401,698 |
| Issuance of Shares for the Listing (a) | 460,000 | 45,662 | 909,461 | 955,123 |
| Dividends paid (b) | – | – | (96,114) | (96,114) |
| **At 31 December 2007** | **1,660,000** | **169,034** | **1,091,673** | **1,260,707** |

## 15. Share capital and premium *(Continued)*

The total number of authorised ordinary shares is 10,000,000,000 shares with a par value of HK$0.10 per share as at 31 December 2007 and 2006.

(a) On 8 February 2007, 400,000,000 shares of HK$0.10 each of the Company were issued through a public offering in Hong Kong and an international placing with institutional and professional investors at a cash consideration of HK$2.23 per share, totalling HK$892,000,000 (approximately RMB884,953,000).

On 12 February 2007, additional 60,000,000 shares of HK$0.10 each of the Company were issued through exercising the over-allotment option by the underwriters in respect of the Listing, at a cash consideration of HK$2.23 per share, totalling HK$133,800,000 (approximately RMB132,930,000).

(b) According to the Companies Law, Cap 22 (Law 3 of 1961, as consolidated and revised) of Cayman Islands and the articles of association of the Company, the dividends can be declared out of share premium account subject to a solvency test.

## 16. Other reserves

| | The Group | | | | The Company |
|---|---|---|---|---|---|
| | Capital reserve | Statutory reserves | Share-based payment reserve | Total | Share-based payment reserve |
| | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* |
| 1 January 2006 | 30,938 | 45,802 | – | 76,740 | – |
| Profit appropriation | – | 23,480 | – | 23,480 | – |
| Reserve arising from the Reorganisation | (401,698) | – | – | (401,698) | – |
| 31 December 2006 | (370,760) | 69,282 | – | (301,478) | – |
| Profit appropriation | – | 7,049 | – | 7,049 | – |
| Employee share options scheme: | | | | | |
| – Value of employee services (note 23, 29) | – | – | 18,345 | 18,345 | 18,345 |
| 31 December 2007 | (370,760) | 76,331 | 18,345 | (276,084) | 18,345 |

**(a) Capital reserve**

It mainly represents reserve arising from the Reorganisation as disclosed in note 1 above.

## 16. Other reserves *(Continued)*

**(b) Statutory reserves**

In accordance with the PRC regulations and the Articles of the Association of the companies comprising the Group, before distributing the net profit of each year, each of the companies registered in the PRC is required to set aside 10% of its statutory net profit for the year after offsetting any prior year's losses as determined under the PRC accounting regulations to the statutory surplus reserve fund. When the balance of such reserve reaches 50% of each company's share capital, any further appropriation is optional. The statutory surplus reserve fund can be utilised to offset prior years' losses or to issue bonus shares. However, such statutory surplus reserve fund must be maintained at a minimum of 25% of the entity's share capital after such issuance.

Prior to the conversion of Shandong Fufeng into a foreign-invested limited liability company on 19 April 2004, it was required to set aside 5% to 10% of its statutory net profit for the year to the statutory public welfare fund. The statutory public welfare fund is to be utilised to build or acquire capital items for the entity's employees and cannot be used to pay off staff welfare expenses. Titles to these capital items remain with the entity. Pursuant to certain PRC regulations published in 2006, the balance of statutory public welfare fund brought forward from previous years shall be transferred to the statutory surplus reserve fund.

**(c) Employee share option scheme**

The Company adopted two share option schemes on 10 January 2007, pursuant to which the Company is entitled to grant options prior to and after the IPO. Pursuant to the share option scheme of the Company adopted on 10 January 2007 in relation to the grant of options under Pre-IPO Share Option Scheme, the Company granted options to subscribe for an aggregate of 96,000,000 shares on 10 January 2007 to certain directors and eligible employees as follows:–

| Directors and eligible employees | Date of grant | Number of shares subject to option *(thousands)* | Exercise price *(HK$)* | Exercise period |
|---|---|---|---|---|
| Mr. Wang Longxiang (executive Director) | 10 January 2007 | 16,000 | 2.23 | 8 August 2009 to 7 August 2012 |
| Centerpoint Assets | 10 January 2007 | 16,000 | 2.23 | 8 August 2007 to 7 August 2011 |
| Other eligible employees | 10 January 2007 | 64,000 | 2.23 | 8 August 2009 to 7 August 2012 |
| | | 96,000 | | |

## 16. Other reserves *(Continued)*

**(c) Employee Share Option Scheme** *(Continued)*

Movements in the number of share options outstanding and their related weighted average exercise prices are as follows:

| | 2007 | |
|---|---|---|
| | **Average exercise price in** *HK$ per share* | **Options** *(thousands)* |
| At 1 January | – | – |
| Granted | 2.23 | 96,000 |
| Lapsed | 2.23 | (2,400) |
| At 31 December | 2.23 | 93,600 |

Out of the 93,600,000 options (2006: no options issued), 4,000,000 options were exercisable as at 31 December 2007. No option was exercised in 2007.

Share options outstanding at the end of the year have the following expiry date and exercise prices:

| **Expiry date** | **Exercise price** *HK$ per share* | **Number of options** *(thousands)* 2007 | 2006 |
|---|---|---|---|
| 7 August 2011 | 2.23 | 16,000 | – |
| 7 August 2012 | 2.23 | 77,600 | – |
| | | 93,600 | – |

The total fair value, which was determined by using Black-Scholes option price model, of the options granted under the Pre-IPO Share Option Scheme as at the grant date is approximately RMB55,134,000. The following assumptions were adopted to calculate the fair value of the options on the grant date:

| | |
|---|---|
| Average share price | HK$1.98 |
| Exercise price | HK$2.23 |
| Expected life of options | 4.6 – 5.6 years |
| Expected volatility | 40% |
| Expected dividend yield | 3% |
| Risk free rate | 3.59% |

The average share price of HK$1.98 was estimated by the management at the grant date.

The expected volatility is determined by calculating the historical volatility of the price of listed companies with similar business to the Group. The expected dividend yield is determined by the Directors based on the expected future performance and dividend policy of the Group.

The attributable amount charged to the consolidated income statement during the year ended 31 December 2007 was approximately RMB18,345,000 (2006: nil).

No option is being granted during the year ended 31 December 2007 under the share option scheme which entitled the Company to grant options after the IPO.

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2007

## 17. Retained earnings/(Accumulated losses)

| | The Group | | The Company | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | ***RMB'000*** | *RMB'000* | ***RMB'000*** | *RMB'000* |
| 1 January | **426,173** | 269,266 | **(5,801)** | (872) |
| Profit/(Loss) for the year | **45,069** | 240,483 | **(65,010)** | (4,929) |
| Profit appropriation to statutory reserves | **(7,049)** | (23,480) | **–** | – |
| Dividends relating to 2005 | **–** | (60,096) | **–** | – |
| 31 December | **464,193** | 426,173 | **(70,811)** | (5,801) |

## 18. Deferred income – The Group

| | **2007** | 2006 |
|---|---|---|
| | ***RMB'000*** | *RMB'000* |
| Deferred income | **30,436** | 32,797 |
| *Less:* current portion included in current liabilities | **(5,485)** | (5,198) |
| | **24,951** | 27,599 |

Deferred income includes government grants related to purchase of qualified domestic manufactured equipment and acquisition of certain property, plant and equipment, environment protection and technology improvement.

**(a) Government grants related to purchase of qualified domestic manufactured equipment**

It represents reduction in income tax granted to Shandong Fufeng in the year ended 31 December 2003 on purchase of certain qualified domestic manufactured equipment. It is recognised in the income statement over the periods and in the proportions in which depreciation on these assets is charged. The maturity profile of the government grant credit is as follows:

| | **2007** | 2006 |
|---|---|---|
| | ***RMB'000*** | *RMB'000* |
| 1 to 5 years | **3,492** | 4,365 |
| *Less:* current portion included in current liabilities | **(873)** | (873) |
| | **2,619** | 3,492 |

The movement of the above government grant for the years ended 31 December 2007 and 2006 are as follows:

| | **2007** | 2006 |
|---|---|---|
| | ***RMB'000*** | *RMB'000* |
| At beginning of the year | **4,365** | 5,238 |
| Amortised as income *(note 21)* | **(873)** | (873) |
| At end of the year | **3,492** | 4,365 |

## 18. Deferred income – The Group *(Continued)*

**(b) Government grants related to acquisition of certain property, plant and equipment, environment protection and technology improvement**

They represent grants from government relating to the acquisition of certain property, plant and equipment, environment protection and technology improvement. Grants received are recorded as deferred income and recognised in the income statement over the periods and in the proportions in which depreciation on these assets is charged or over the periods necessary to match them with the costs that they are intended to compensate. The maturity profile of these deferred government grants is as follows:

| | **2007** | 2006 |
|---|---|---|
| | ***RMB'000*** | *RMB'000* |
| 1 to 10 years | **26,944** | 28,432 |
| *Less:* current portion included in current liabilities | **(4,612)** | (4,325) |
| | **22,332** | 24,107 |

The movement of the above government grants for the years ended 31 December 2007 and 2006 are as follows:

| | **2007** | 2006 |
|---|---|---|
| | ***RMB'000*** | *RMB'000* |
| At beginning of the year | **28,432** | 23,900 |
| Granted during the year | **10,981** | 11,022 |
| Amortised as income *(note 21)* | **(12,469)** | (6,490) |
| At end of the year | **26,944** | 28,432 |

## 19. Borrowings

**The Group**

| | 2007 RMB'000 | 2006 RMB'000 |
|---|---|---|
| **Non-current** | | |
| Long-term bank borrowings, secured | 242,000 | 530,630 |
| Long-term bank borrowings, unsecured | 70,000 | 120,000 |
| | 312,000 | 650,630 |
| *Less:* Current portion of long-term bank borrowings, secured | – | (305,630) |
| Current portion of long-term bank borrowings, unsecured | – | (10,000) |
| | 312,000 | 335,000 |
| **Current** | | |
| Short-term bank borrowings, secured | 58,000 | 81,000 |
| Short-term bank borrowings, unsecured | 260,000 | 18,000 |
| Current portion of long-term bank borrowings, secured | – | 305,630 |
| Current portion of long-term bank borrowings, unsecured | – | 10,000 |
| | 318,000 | 414,630 |
| Total borrowings | 630,000 | 749,630 |

As at 31 December 2007, all the borrowings were denominated in RMB and included bank borrowings of RMB300,000,000 secured by leasehold land (note 6), plant and machinery (note 7).

As at 31 December 2006, borrowings of RMB444,000,000 were denominated in RMB and included bank borrowings of RMB296,000,000 secured by leasehold land (note 6), plant and machinery (note 7). Borrowings of RMB305,630,000 for the Group and the Company were denominated in US$ and secured by following: (i) entire share capital of certain subsidiaries of the Group, including Acquest Honour, Summit Challenge, Absolute Divine and Expand Base; (ii) a fixed and floating charge in relation to the land, book debts, stocks and shares, plant and machinery, licences, intellectual property and all undertakings belonging to the Company, Acquest Honour, Summit Challenge, Absolute Divine and Expand Base; (iii) a charge over the Company's bank account maintained with the lender; and (iv) corporate guarantees provided by Acquest Honour, Summit Challenge, Absolute Divine and Expand Base. The borrowings had a repayment term of 15 months from the date of the credit facility agreement dated 24 July 2006 but must be repaid in full on the date on which the Shares are listed on the Stock Exchange. The loan was repaid on 8 February 2007.

As at 31 December 2007 and 2006, the Group's borrowings were repayable as follows:

| | 2007 RMB'000 | 2006 RMB'000 |
|---|---|---|
| Within 1 year | 318,000 | 414,630 |
| Between 1 and 2 years | 312,000 | 335,000 |
| | 630,000 | 749,630 |

## 19. Borrowings *(Continued)*

The weighted average effective interest rates at the balance sheet dates were as follows:

| | 2007 | 2006 |
|---|---|---|
| Bank borrowings | | |
| – RMB | 6.68% | 6.68% |
| – US$ | – | 11.60% |

The carrying amounts and fair values of the non-current borrowings are as follows:

| | Carrying amounts | |
|---|---|---|
| | 2007 | 2006 |
| | *RMB'000* | *RMB'000* |
| Bank borrowings | 312,000 | 335,000 |

| | Fair values | |
|---|---|---|
| | 2007 | 2006 |
| | *RMB'000* | *RMB'000* |
| Bank borrowings | 307,800 | 336,044 |

The fair values are based on cash flows discounted using a rate based on the primary rate published by the People's Bank of China of 7.56% per annum (2006: 6.30% per annum).

The carrying amounts of current borrowings approximate their fair values.

Interest rates of the bank borrowings denominated in RMB are adjusted periodically according to the primary rate announced by the People's Bank of China. The exposure of the Group's bank borrowings to interest-rate changes and the contractual re-pricing dates are as follows:

| | 2007 | 2006 |
|---|---|---|
| | *RMB'000* | *RMB'000* |
| 6 months or less | 308,000 | 404,630 |
| 6 to 12 months | 10,000 | 10,000 |
| 1 to 5 years | 312,000 | 335,000 |
| | 630,000 | 749,630 |

**The Company**

| | 2007 | 2006 |
|---|---|---|
| | *RMB'000* | *RMB'000* |
| **Current** | | |
| Current portion of long-term secured bank borrowings | – | 305,630 |

As at 31 December 2006, borrowings of RMB305,630,000 were denominated in US$ and their terms and securities are described above. The borrowings were fully settled in 2007.

As at 31 December 2006, the weighted average effective interest rate at the balance sheet date was 11.60%

# Notes to the Consolidated Financial Statements

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## 20. Trade, other payables and accruals

**The Group**

| | 2007 RMB'000 | 2006 RMB'000 |
|---|---|---|
| Trade payables (a) | **447,664** | 227,374 |
| Notes payables (b) | **8,950** | 27,249 |
| Advances from customers (c) | **89,650** | 61,217 |
| Payables for leasehold land, property, plant and equipment | **181,065** | 255,724 |
| Other payables and accruals | **43,481** | 39,009 |
| | **770,810** | 610,573 |

(a) At 31 December 2007 and 2006, the ageing analysis of trade payables was as follows:

| | 2007 RMB'000 | 2006 RMB'000 |
|---|---|---|
| Within 3 months | **426,788** | 221,479 |
| 3 to 6 months | **5,642** | 2,961 |
| 6 to 12 months | **10,097** | 2,237 |
| Over 1 year | **5,137** | 697 |
| | **447,664** | 227,374 |

As at 31 December 2007, notes receivables of RMB334,299,000 (2006: RMB216,815,000) were applied for settling the amounts payable to the Group's suppliers.

(b) At 31 December 2007 and 2006, notes payable were all bank acceptance notes with maturity dates within six months and aged less than six months.

(c) Advances from customers represented cash advances received from customers for purchase of the Group's products and would be applied for settlement when sales were incurred.

(d) Trade and other payables are unsecured and interest-free. The carrying amounts of trade and other payables approximate their fair values.

**The Company**

| | 2007 RMB'000 | 2006 RMB'000 |
|---|---|---|
| Other payables and accruals | **2,860** | 1,938 |

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2007

## 21. Other income

| | 2007 RMB'000 | 2006 RMB'000 |
|---|---|---|
| Interest income | **8,325** | 1,043 |
| Amortisation of deferred income | **13,342** | 7,363 |
| Sales of waste products | **7,790** | 8,438 |
| Others | **3,338** | 2,379 |
| | **32,795** | 19,223 |

## 22. Expenses by nature

| | 2007 RMB'000 | 2006 RMB'000 |
|---|---|---|
| Changes in inventories of finished goods and work in progress | **(169,344)** | (29,513) |
| Raw materials and consumables used | **2,151,042** | 1,336,507 |
| Employee benefit expense *(note 23)* | **156,247** | 71,693 |
| Depreciation *(note 7)* | **116,947** | 55,004 |
| Amortisation of leasehold land payments *(note 6)* | **1,848** | 1,615 |
| Transportation expenses | **90,801** | 50,576 |
| Utilities purchased | **11,361** | 12,155 |
| Travelling and office expenses | **7,608** | 7,979 |
| Realised loss of derivative financial instruments | **–** | 2,451 |
| (Reversal of write-down)/Write-down of inventories | **(4,005)** | 4,005 |
| Auditors' remuneration | **3,085** | 1,848 |
| Others | **65,007** | 27,496 |
| Total cost of sales, selling and marketing expenses, administrative expenses and other operating expenses | **2,430,597** | 1,541,816 |

## 23. Employee benefit expenses including directors' emoluments

| | 2007 RMB'000 | 2006 RMB'000 |
|---|---|---|
| Staff costs (including directors' emoluments) | | |
| – Wages, salaries and allowances | **126,019** | 66,672 |
| – Pension costs – defined contribution plans (a) | **11,883** | 5,021 |
| – Share options granted to directors and employees *(note 16)* | **18,345** | – |
| | **156,247** | 71,693 |

## 23. Employee benefit expenses including directors' emoluments *(Continued)*

### (a) Retirement benefit costs – defined contribution plans

The employees of the Group's subsidiaries established in the PRC participated in defined contribution retirement benefit plans organised by the relevant provincial governments under which the Group was required to make monthly contributions to these plans at the rates of 20%, 20% and 20% of the employees' basic salary for Shandong Province, Shaanxi Province and Inner Mongolia Autonomous Region, respectively, for the year ended 31 December 2007 (2006: 19%, 20%, 19%).

### (b) Directors' emoluments

The emoluments of every Director for the years ended 31 December 2007 and 2006, on a named basis, are set out as below:

| | | | 2007 | | |
|---|---|---|---|---|---|
| Name of Director | Fees | Salaries and allowances | Fair value of employee share options granted | Pension costs-defined contribution plans | Total |
| | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* |
| *Executive Directors:* | | | | | |
| Li, Xuechun | – | 596 | – | 15 | 611 |
| Wang, Longxiang | – | 535 | 2,806 | 17 | 3,358 |
| Wu, Xindong | – | 303 | – | 15 | 318 |
| Yan, Ruliang | – | 256 | – | 15 | 271 |
| Feng, Zhenquan | – | 381 | – | 15 | 396 |
| Xu, Guohua | – | 305 | – | 16 | 321 |
| Li, Deheng | – | 310 | – | 15 | 325 |
| Li, Hongyu | – | 105 | – | 15 | 120 |
| Gong, Qingli (i) | – | 250 | 4,735 | – | 4,985 |
| *Independent non-executive Directors:* | | | | | |
| Choi, Tze Kit Sammy (i) | 225 | – | – | – | 225 |
| Chen, Ning (i) | 50 | – | – | – | 50 |
| Liang, Wenjun (i) | 50 | – | – | – | 50 |
| | 325 | 3,041 | 7,541 | 123 | 11,030 |

## 23. Employee benefit expenses including directors' emoluments *(Continued)*

### (b) Directors' emoluments *(Continued)*

| Name of Director | Fees | Salaries and allowances | 2006 Fair value of employee share option granted | Pension cost-defined contribution plans | Total |
|---|---|---|---|---|---|
| | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* |
| *Executive Directors:* | | | | | |
| Li, Xuechun | – | 25 | – | 3 | 28 |
| Wang, Longxiang | – | 202 | – | 2 | 204 |
| Wu, Xindong | – | 24 | – | 2 | 26 |
| Yan, Ruliang | – | 24 | – | 2 | 26 |
| Feng, Zhenquan | – | 26 | – | 2 | 28 |
| Xu, Guohua | – | 23 | – | 2 | 25 |
| Li, Deheng | – | 25 | – | 2 | 27 |
| Li, Hongyu | – | 23 | – | 2 | 25 |
| Gong, Qingli (i) | – | – | – | – | – |
| *Independent non-executive Directors:* | | | | | |
| Choi, Tze Kit Sammy (i) | – | – | – | – | – |
| Chen, Ning (i) | – | – | – | – | – |
| Liang, Wenjun (i) | – | – | – | – | – |
| | – | 372 | – | 17 | 389 |

*Notes:*

(i) Appointed on 8 February 2007.

There was no bonus paid to the Directors for the years ended 31 December 2007 and 2006.

No Director waived or agreed to waive any remuneration for the years ended 31 December 2007 and 2006.

### (c) Five highest paid individuals

The five highest paid individuals consisted of:

| | Number of individuals 2007 | 2006 |
|---|---|---|
| Number of Directors | **2** | 1 |
| Number of employees | **3** | 4 |
| | **5** | 5 |

## 23. Employee benefit expense *(Continued)*

**(c) Five highest paid individuals** *(Continued)*

The five individuals whose emoluments were the highest in the Group for the year include two (2006: one) directors whose emoluments are reflected in the analysis presented above. The emoluments payable to the remaining three (2006: four) individuals during the year are as follows:

| | 2007 RMB'000 | 2006 RMB'000 |
|---|---|---|
| Salaries and allowances | 1,152 | 1,418 |
| Pension costs-defined contribution plan | 43 | 18 |
| Share options granted to directors and employees | 2,806 | – |
| | 4,001 | 1,436 |

For the years ended 31 December 2007 and 2006, no emoluments were paid by the Group to any of the directors or the five highest paid individuals as inducement to join or upon joining the Group or as compensation for loss of office.

The remuneration paid to the above non-director individuals for the year ended 31 December 2007 fell within the banding of HK$1,000,000 to HK$1,500,000 (2006: nil to HK$1,000,000).

## 24. Research and development costs

The following amounts were recognised as expenses and charged to administrative expenses in the consolidated income statement:

| | 2007 RMB'000 | 2006 RMB'000 |
|---|---|---|
| Research and non-capitalised development costs | 4,014 | 722 |

All development costs arose from internal development.

## 25. Finance costs

| | 2007 RMB'000 | 2006 RMB'000 |
|---|---|---|
| Interest expense: | | |
| Bank borrowings wholly repayable within five years | 47,375 | 39,317 |
| *Less:* amount capitalised in property, plant and equipment | – | (18,952) |
| | 47,375 | 20,365 |
| Finance income – Net foreign exchange gains on financing activities | (2,173) | (5,519) |
| Net finance costs | 45,202 | 14,846 |

## 26. Income tax expense

| | 2007 RMB'000 | 2006 RMB'000 |
|---|---|---|
| Current income tax | | |
| – PRC enterprise income tax ("EIT") | **6,014** | 9,332 |
| Deferred income tax *(note 11)* | **(5,598)** | (7) |
| | **416** | 9,325 |

The Company was incorporated in the Cayman Islands as an exempted company with limited liability under the Companies Law (Law 3 of 1961, as consolidated and revised) of the Cayman Islands and is exempted from payment of the Cayman Islands income tax.

Hong Kong profits tax has not been provided for as the Group has no estimated assessable profit in Hong Kong for the years ended 31 December 2007 and 2006.

PRC EIT is calculated based on the effective tax rate on assessable profit of subsidiaries established in the PRC in accordance with PRC tax laws and regulations.

Effective from 19 April 2004, Shandong Fufeng was approved to be a foreign-invested limited liability company. In accordance with the relevant tax laws and regulations in the PRC and a local tax authority approval dated 21 April 2004, effective from 19 April 2004, Shandong Fufeng is entitled to a two-year full exemption followed by a three-year 50% tax reduction from PRC state EIT of 30% and a full exemption from local EIT of 3% during its approved operating period of twelve years, commencing from the first year with cumulative taxable profit. Accordingly, the effective tax rates for Shandong Fufeng for the year ended 31 December 2007 and 2006 are both 15%.

Baoji Fufeng was set up on 24 September 2004 as a foreign-invested limited liability company in Baoji, Shaanxi Province. With the approval of "High Technology Enterprise", Baoji Fufeng was entitled to a preferential enterprise income tax rate of 15% for the year ended 31 December 2007. For the year ending 31 December 2008 or after, Baoji Fufeng is entitled to opt for preferential tax treatment for the Opening Up of Western China policy or applying for the status of "High Technology Enterprise". In addition, being a foreign-invested limited liability company and in accordance with the relevant tax laws and regulations and a local tax authority approval dated 31 May 2005, Baoji Fufeng is entitled to a two-year full exemption followed by a three-year 50% tax deduction from PRC state EIT, commencing from the first year with cumulative taxable profit since its establishment. Accordingly, the effective tax rate for Baoji Fufeng for the years ended 31 December 2007 and 2006 are 7.5% and zero. Baoji Fufeng entered into its first profit making year during the year ended 31 December 2005.

IM Fufeng was set up as a foreign-invested limited liability company on 31 March 2006 in Huhhot, Inner Mongolia Autonomous Region. As IM Fufeng is entitled to the preferential tax treatment for Opening Up of Western China for its production of glutamic acid and corn processing in Inner Mongolia Autonomous Region, the applicable reduced preferential state EIT rate under this policy is 15% up to 31 December 2010 and the local EIT rate is zero during its approved operating period of twelve years. Accordingly, the effective tax rate for IM Fufeng for the period from its date of establishment to 31 December 2006 should be 15%. In addition, being a foreign-invested limited liability company and in accordance with the relevant tax laws and regulations and a local tax authority approval dated 16 April 2007, IM Fufeng is entitled to a two-year full exemption followed by a three-year 50% tax deduction from PRC state EIT, commencing from 2007. Accordingly, the effective tax rate for IM Fufeng for the year ended 2007 is zero.

## 26. Income tax expense *(Continued)*

Shandong Fufeng Biotechnologies was set up as a domestic limited liability company on 7 June 2007 in Junan, Shandong Province. As a small scale taxpayer, the effective EIT rate is 18% for the year ended 31 December 2007.

Effective from 1 January 2008, the subsidiaries incorporated in PRC shall determine and pay the EIT in accordance with the EIT Law as approved by the National People's Congress on 16 March 2007 and the Detailed Implementations Regulations of the Corporate Income Tax Law (the "DIR") as approved by the State Council on 6 December 2007. In accordance with the new EIT Law and DIR, the EIT rate applicable to the subsidiaries incorporated in PRC will be 25% for those with original applicable EIT rates higher than 25%, or gradually increased to 25% in a 5-year period from 2008 to 2012 for those with original applicable EIT rates lower than 25%. Under the implementation guidance of the EIT Law, Shandong Fufeng, Baoji Fufeng and IM Fufeng will continue enjoying the existing tax preferential treatment up to the end of the tax holiday, after which, the 25% standard rate will apply.

The taxation on the Group's profit before income tax differs from the theoretical amount that would arise using the statutory tax rate as follows:

| | 2007<br>*RMB'000* | 2006<br>*RMB'000* |
|---|---|---|
| Profit before income tax | 45,485 | 249,808 |
| Tax calculated at PRC statutory rate of 33% | 15,010 | 82,437 |
| Effect of tax exemption | (10,861) | (71,864) |
| Effect of change of tax rate upon assessing deferred tax assets | (2,556) | – |
| Expenses not deductible for tax purposes | 335 | 267 |
| Income not subject to tax | (1,512) | (1,515) |
| | 416 | 9,325 |

## 27. Earnings per share

**(a) Basic**

Basic earnings per Share for the year ended 31 December 2007 is calculated by dividing the profit attributable to the Shareholders by the weighted average number of ordinary shares in issue during the year.

Basic earnings per share for the year ended 31 December 2006 is calculated by dividing the profit for the year attributable to the Shareholders by the weighted average number of ordinary shares in issue during the year adjusted for as if the Shares issued by the Company for acquiring Acquest Honour for the purpose of the Reorganisation had been outstanding throughout the current and past years.

| | **2007** | 2006 |
|---|---|---|
| Profit attributable to the Shareholders (RMB'000) | **45,069** | 240,483 |
| Weighted average number of ordinary shares in issue (thousands) | **1,610,027** | 1,200,000 |
| Basic earnings per share (RMB cent per Share) | **2.80** | 20.04 |

**(b) Diluted**

The diluted earnings per share is the same as basic earnings per share because the average market price of ordinary shares for the year ended 31 December 2007 did not exceed the exercise prices of each tranche of the share options, hence the share options are anti-dilutive and are ignored in the calculation of the diluted earnings per share.

## 28. Dividends

| | **2007** *RMB'000* | 2006 *RMB'000* |
|---|---|---|
| Declared by Acquest Honour to its then shareholders (a) | **–** | 60,096 |
| Final, proposed (b) | **13,529** | 96,114 |
| | **13,529** | 156,210 |

(a) Amount represented dividends declared by Acquest Honour to its then shareholders before it became a subsidiary of the Company.

(b) At a meeting held on 17 April 2007, the Board proposed a final dividend in respect of the year ended 31 December 2006 of RMB96,114,000, representing RMB5.79 cents per Share. The annual general meeting held on 6 June 2007 approved the Board's dividend proposal. Such final dividend was paid on 11 June 2007.

At a meeting held on 21 April 2008, the Board proposed a final dividend in respect of the year ended 31 December 2007 of RMB13,529,000, representing RMB0.82 cent per Share. This proposed dividend is not reflected as a dividend payable in these financial statements, but will be reflected as an appropriation of share premium for the year ending 31 December 2008.

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2007

## 29. Notes to consolidated cash flow statement – The Group

### (a) Cash generated from operations

| | 2007 RMB'000 | 2006 RMB'000 |
|---|---|---|
| Profit before income tax | **45,485** | 249,808 |
| Adjustments for: | | |
| – (Reversal of write-down)/Write-down of inventories | **(4,005)** | 4,005 |
| – Depreciation *(note 7)* | **116,947** | 55,004 |
| – Amortisation of leasehold land payments *(note 6)* | **1,848** | 1,615 |
| – Amortisation of deferred income *(note 18)* | **(13,342)** | (7,363) |
| – Loss on sale of property, plant and equipment (b) | **283** | 440 |
| – Employee share option scheme *(note 23)* | **18,345** | – |
| – Interest income *(note 21)* | **(8,325)** | (1,043) |
| – Interest income from IPO subscription deposits | **(42,837)** | – |
| – Net finance cost *(note 25)* | **45,202** | 14,846 |
| Changes in working capital: | | |
| – Inventories | **(174,269)** | (60,755) |
| – Trade and other receivables | **(183,170)** | (122,739) |
| – Short-term bank deposits | **(18,670)** | (20,500) |
| – Trade and other payables | **235,188** | 113,310 |
| Cash generated from operations | **18,680** | 226,628 |

### (b) Proceeds from sale of property, plant and equipment

| | 2007 RMB'000 | 2006 RMB'000 |
|---|---|---|
| Net book amount *(note 7)* | **283** | 1,737 |
| Loss on sale of property, plant and equipment | **(283)** | (440) |
| Proceeds received for prior year sales | **–** | 1,000 |
| Proceeds from sale of property, plant and equipment | **–** | 2,297 |

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2007

## 30. Contingencies – The Group

As at 31 December 2007 and 2006, the Group and the Company had no material contingent liabilities.

## 31. Commitments

**The Group**

Capital commitments

| | 2007 | 2006 |
|---|---|---|
| | *RMB'000* | *RMB'000* |
| Purchase of property, plant and equipment | | |
| – Contracted but not yet incurred | 22,011 | 79,197 |

**The Company**

As at 31 December 2007 and 2006, the Company had no material commitments.

## 32. Related party transactions and balances

**The Group**

(a) The Directors are of the view that the following party is considered to be related of the Group for the years ended 31 December 2007 and 2006:

| Name | Relationship with the Group |
|---|---|
| Shanghai Union Strength Business Consulting Co., Ltd ("Union Strength") | An entity 80% owned by a director (effective from the day when the Company appointed Gong, Qingli as an executive director) |

(b) The Directors are of the view that the following related party transactions were carried out in the ordinary course of business:

| | 2007 | 2006 |
|---|---|---|
| | *RMB'000* | *RMB'000* |
| Services fees paid to a related party during the year | | |
| Union Strength | – | 127 |

The fees paid to Union Strength were principally for its corporate advisory services and were determined by the estimated time spent by its professionals for the services and their respective hourly rates.

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2007

## 32. Related party transactions and balances *(Continued)*

(c) Key management compensation

| | **2007** | 2006 |
|---|---|---|
| | ***RMB'000*** | *RMB'000* |
| Salaries and allowances | **4,608** | 1,292 |
| Pension cost- defined contribution plan | **266** | 37 |
| Share options granted | **10,656** | – |
| | **15,530** | 1,329 |

Key management are those persons having authority and responsibility for planning, directing and controlling the activities of the Group, directly or indirectly, including Directors and executive officers.

**The Company**

Please refer to note 8 for details for loans to subsidiaries and amounts due from/to subsidiaries.

## 33. Events after the balance sheet date

**(a) Close down of Junan Plant Phase I**

During the year ended 31 December 2007, the raw materials cost, especially the cost of corn kemel, in Shandong Fufeng, increased significantly. The high cost of production in Junan Plant Phase I of Shandong Fufeng led to low gross profit margin and even gross loss on those products it produced. In order to avoid the loss, the Directors decided to close down Junan Plant Phase I in late February 2008. The production facilities of Junan Plant Phase I will be relocated to Baoji Fufeng and IM Fufeng over the year 2008 in order to maintain the production capacity of the Group.

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2007

## 33. Events after the balance sheet date *(Continued)*

**(b) Acquisition of pharmaceutical company**

The Group acquired 100% of the equity capital of Shenhua Pharmaceutical, a company which operates in the bio-chemical field by applying fermentation technology on its production for a cash consideration of approximately RMB4,000,000 on 23 January 2008.

The preparation of HKFRS financial statements of Shenhua Pharmaceutical and the valuation of its assets and liabilities is in the process. As a result, financial information of Shenhua Pharmaceutical, including the carrying amount and fair value of the assets and liabilities, have not been disclosed.

## 34. Particulars of subsidiaries

As at 31 December 2007, the Company had direct and indirect interests in the following wholly-owned subsidiaries:

| Name | Place incorporation/ establishment | Registered/ Issued and fully paid capital | Principal activities |
|---|---|---|---|
| Directly held: | | | |
| Acquest Honour | The British Virgin Islands ("BVI") | US$2 | Investment holding |
| Indirectly held: | | | |
| Summit Challenge | BVI | US$1 | Investment holding |
| Absolute Divine | BVI | US$1 | Investment holding |
| Expand Base | BVI | US$1 | Investment holding |
| Profit Champion International Limited ("Profit Champion")(i) | Hong Kong | HK$2 | Investment holding |
| Full Profit Investment (Group) Limited ("Full Profit")(i) | Hong Kong | HK$2 | Investment holding |
| Trans-Asia Capital Resources Limited ("Transfer-Asia")(i) | Hong Kong | HK$2 | Investment holding |
| Shandong Fufeng (ii) | PRC | RMB 200,000,000 | Manufacture and sales of glutamic acid, MSG, corn refined products, xanthan gum, fertilisers, starch sweetener and other related products in the PRC |

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2007

## 34. Particulars of subsidiaries *(Continued)*

| Name | Place incorporation/ establishment | Registered/ Issued and fully paid capital | Principal activities |
|---|---|---|---|
| Baoji Fufeng (ii) | PRC | HK$ 80,000,000 | Manufacture and sales of glutamic acid, MSG, com refined products, fertilisers and other related products in the PRC |
| IM Fufeng (ii) | PRC | HK$ 460,000,000 | Manufacture and sales of glutamic acid, MSG, corn refined products, xanthan gum, fertilisers, starch sweetener and other related products, autoclaved aerated concrete block, in the PRC |
| Shandong Fufeng Biotechnologies (iii) | PRC | RMB 5,500,000 | Biological techniques research and development, promotion and industrialisation of new biological techniques and achievements, information services of biological technique, in the PRC |

# Notes to the Consolidated Financial Statements

For the year ended 31 December 2007

## 34. Particulars of subsidiaries *(Continued)*

(i) Profit Champion, Full Profit and Trans-Asia were established in Hong Kong by issuing a subscriber share of HK$1 on 25 October 2007, 7 November 2007 and 31 October 2007 respectively. On 14 November 2007, Summit Challenge acquired the subscriber share of Profit Champion which then became the wholly owned subsidiary of the Group. On 15 November 2007, Absolute Divine and Expand Base acquired the subscriber shares of Full Profit and Trans-Asia respectively which then became the wholly owned subsidiary of the Group.

(ii) The registered capital of Shandong Fufeng was increased to RMB160,000,000 on 13 February 2007 and then to RMB200,000,000 on 2 March 2007.

The registered capital of Baoji Fufeng was increased to HK$80,000,000 on 4 June 2007.

The registered capital of IM Fufeng was increased to HK$280,000,000 on 6 April 2007, then to HK$360,000,000 on 19 July 2007 and then to HK$460,000,000 on 13 September 2007.

(iii) Shandong Fufeng Biotechnologies was established on 7 June 2007, with the share capital of RMB5,500,000. It is wholly owned by Shandong Fufeng.

# Share Information

**Stock Code** 546

**Board lot** 2,000 shares

## Price and turnover

| | Share price | | Turnover |
|---|---|---|---|
| | High | Low | Share |
| **2007** | *(HK$)* | *(HK$)* | *('000)* |
| February* | 3.11 | 2.39 | 530,029 |
| March | 2.68 | 2.10 | 119,778 |
| April | 2.50 | 2.04 | 84,862 |
| May | 2.18 | 1.98 | 127,422 |
| June | 2.17 | 1.91 | 83,487 |
| July | 1.93 | 1.25 | 128,009 |
| August | 1.45 | 0.72 | 99,687 |
| September | 0.88 | 0.65 | 129,276 |
| October | 0.99 | 0.69 | 169,437 |
| November | 0.83 | 0.66 | 38,157 |
| December | 0.74 | 0.66 | 33,959 |

* *The Shares listed on the Stock Exchange on 8 February 2007*

**Issued capital at 31 December 2007** 1,660,000,000 shares

**Closing price at 31 December 2007** HK$0.70 per share

# Glossary

| | |
|---|---|
| Absolute Divine | Absolute Divine Limited, a indirect wholly-owned subsidiary of the Company |
| Acquest Honour | Acquest Honour Holdings Limited, a wholly-owned subsidiary of the Company |
| ASP | average selling price(s) of the products of the Group |
| Baoji Fufeng | 寶雞阜豐生物科技有限公司 (Baoji Fufeng Biotechnologies Co., Ltd.), an indirect wholly-owned subsidiary of the Group |
| Baoji Plant | the production plant of the Group located in Baoji City (寶雞市), Shaanxi Province, the PRC |
| Board | the board of Directors |
| Centerpoint Assets | Centerpoint Assets Management Limited, a company which is wholly owned by Mr. Gong Qingli, an executive Director. |
| Code | Code on Corporate Governance Practice under Appendix 14 of the Listing Rules |
| Company | Fufeng Group Limited |
| Directive Statement | "關於促進玉米深加工健康發展的指導意見" issued by NDRC in September 2007 |
| Director(s) | the director(s) of the Company |
| EIT Law | Enterprise Income Tax Law of the PRC which came into effect on 1 January 2008 |
| Ever Soar | Ever Soar Enterprises Limited, a company with limited liability, the issued share capital of which is owned as to 25% by 吳欣東 (Wu Xindong), 15% by 嚴汝良 (Yan Ruliang), 15% by 馮珍泉 (Feng Zhenquan), 15% by 徐國華 (Xu Guohua), 15% by 李德衡 (Li Deheng), 15% by 郭英熙 (Guo Yingxi) |
| Expand Base | Expand Based Limited, an indirect wholly-owned subsidiary of the Group |
| Group | the Company and its subsidiaries |
| Hero Elite | Hero Elite Limited, a company with limited liability, the issued share capital of which is owned as the 14.3% by 王龍祥 (Wang Longxiang), 14.3% by 來鳳堂 (Lai Fengtang), 14.3% by 劉振余 (Liu Zhenyu), 14.3% by 趙蘭坤 (Zhao Lankun), 10.7% by 王俊任 (Wang Junren), 10.7% by 嚴紅偉 (Yan Hongwei), 10.7% by 李曼山 (Li Manshan) and 10.7% by 沈德權 (Shen Dequan) |
| HKFRS | the Hong Kong Financial Reporting Standards |
| Hong Kong | the Hong Kong Special Administrative Region of the PRC |

# Glossary

| | |
|---|---|
| IM Fufeng | 內蒙古阜豐生物科技有限公司 (Neimenggu Fufeng Biotechnologies Co., Ltd.), an indirect wholly-owned subsidiary of the Company |
| IM Plant | the production plant of the Group located in Inner Mongolia Autonomous Region, the PRC |
| IPO | Initial public offering of the Shares on 8 February 2007 |
| Junan Plant | the production plant of the Group located in Junan County (莒南縣), Shandong Province, the PRC |
| Junan Plant Phase I | phase I of the Junan Plant which commenced commercial production in June 1999 |
| Junan Plant Phase II | phase II of the Junan Plant which commenced commercial production in November 2003 |
| Listing | listing of the Shares on the Stock Exchange |
| Listing Date | 8 February 2007, the date on which the shares were listed on the Stock Exchange |
| Listing Rules | the Rules Governing the Listing of Securities on the Stock Exchange |
| Model Code | Model Code for Securities Transactions by Directors of Listed Issuers as set out in Appendix 10 of the Listing Rules |
| Motivator Enterprises | Motivator Enterprises Limited, the entire issued share capital of which is wholly and beneficially owned by Mr. Li Xuechun, an executive Director and the chairman of the Company |
| MSG | monosodium glutamate, a salt of glutamic acid which is commonly used as a flavour enhancer and additive in the food industry, restaurant and household application |
| NBS | the National Bureau of Statistics of the PRC |
| NDRC | the National Development and Reform Commission |
| PRC | the People's Republic of China, which for the purpose of this annual report exclude Hong Kong, the Macau Special Administrative Region of the PRC and Taiwan |
| Pre-IPO Share Option Scheme | the share options granted to certain Directors and employees of the Company pursuant to the share option scheme adopted by the Company on 10 January 2007 |
| R&D Center | the research and development center of the Group which is situated in Junan County, Shandong Province, the PRC |
| Shandong Fufeng | 山東阜豐發酵有限公司 (Shandong Fufeng Fermentation Co. Ltd.), an indirect wholly-owned subsidiary of the Company |

# Glossary

| | |
|---|---|
| Shandong Fufeng Biotechnologies | 山東阜豐生物科技開發有限公司 (Shandong Fufeng Biotechnologies Development Co. Ltd.), an indirect wholly-owned subsidiary of the Company |
| Shenhua Pharmaceutical | 江蘇神華藥業有限公司 (Shenhua Pharmaceutical Co. Ltd), a company with limited liability established in Jiangsu Province of the PRC |
| SFO | the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) |
| Share(s) | share(s) in the share capital of the Company |
| Shareholder(s) | holder(s) of the Share(s) |
| Stock Exchange | The Stock Exchange of Hong Kong Limited |
| Summit Challenge | Summit Challenge Limited, an indirect wholly-owned subsidiary of the Group |
| RMB | Renminbi, the lawful currency of the PRC |
| HK$ | Hong Kong dollars, the lawful currency of Hong Kong |
| US$ | United States dollars, the lawful currency of United States |
| % | per cent |