Fufeng Group Limited
阜豐集團有限公司

(incorporated in the Cayman Islands with limited liability)
(Stock Code: 546)

Annual Report 2008

Contents

Chairman's Statement

On behalf of the Board of Directors, I am pleased to present the annual report of the Group for the year ended 31 December 2008.

Being one of the leading vertical integrated corn-based biochemical products manufacturers in China, the Group is principally engaged in the glutamic acid and MSG related business and xanthan gum business. Consolidation of glutamic acid and MSG industry speeded up in 2007 due to the oversupply of glutamic acid and MSG and surging raw materials cost. At the end of the first quarter of 2008, industry consolidation has been nearly completed, which eliminated redundant and inefficient small and medium-sized manufacturers from the market, thus balancing market demand and supply. We believe market consolidation will continue and the leading players will gain more market shares. The Group played a leading role throughout the industry's consolidation process, and has firmly grasped and enlarged our market shares, which significantly enhanced the average selling prices and sales volume of our glutamic acid and MSG products. Meanwhile, the Group's xanthan gum business achieved fruitful results due to our aggressive market expansion. Sales volume increased significantly by more than 200% as compared with the corresponding period last year, which completely absorbed our additional production capacity, and led to the Group's emergence as one of the top three leading xanthan gum manufacturers in the world.

Although the economic crisis during the second half of 2008 caused shockwaves to the global market, the PRC economy remains stable. Due to the continuous growth of income per capita and huge domestic demand, domestic market demand for food products such as MSG maintained robust growth. On the other hand, although global inflation resulted in higher average prices of corn, coal, sulphuric acid and liquid ammonia during the year as compared with 2007, the substantial completion of the glutamic acid and MSG industry consolidation and the significant growth in sales of xanthan gum largely offset the impact of increase in raw material costs. Moreover, due to the changes in economic environment, raw material costs have dropped rapidly since the fourth quarter of 2008. The Group's results has resumed its upward trend and further surpassed its historical high recorded in 2006, with turnover increased by 46.6% to RMB3,585.3 million, and gross profit increased by 158.1% to RMB644.3 million as compared with 2007, with gross profit margin up by 7.8% pts to 18.0%. Profit attributable to the Shareholders during the year increased by 553.9% that in to RMB294.7 million and earnings per share was RMB0.178.

In consideration of the satisfactory results in 2008, the Board of Directors recommends to declare a final dividend of HK10 cents per share as a reward for the support from our shareholders.

Glutamic acid and MSG related business

Having lasted for over a year, the consolidation of the glutamic acid industry approach completion at the beginning of 2008. Leveraging on its leading position in the industry, the Group played a leading role in the adjustment of product prices during the consolidation process. With market consolidation substantially completed, together with the benefits from the robust growth in food consumption, selling prices of glutamic acid and MSG increase gradually since the second quarter of 2008. During the period under review, average selling prices of the Group's glutamic acid and MSG increased by 10.3% and 14.5% respectively as compared with the corresponding period last year. Although corn, coal and chemical prices started to decrease from its peak only since the fourth quarter of 2008, the Group was able to leverage on its leading market position and the leading role in the adjustment of product selling prices to raise the average selling prices, which offset the high costs of corn and coal and enables the Group to maintain a desirable gross profit margin.

In respect of the restructuring of production capacity, the Group has migrated part of our glutamic acid and MSG related business from the Shandong Plant to the Baoji Plant and the IM Plant during the year with further expansion. In addition, the Group completed construction of 100,000 tonnes of MSG production capacity during the year, and continues to implement its strategy of shifting from glutamic acid to MSG.

In order to further realise the advantages of vertical integrated production and optimise our product mix, the Group commenced its corn oil and chicken powder business in 2008. The corn oil and the chicken powder production lines located at the Shandong Plant have been completed basically at the end of 2008. Production and sales of such are expected to begin in 2009. The production of chicken powder (a kind of compound seasoner) represents the Group's new attempt to develop compound seasoning products.

Chairman's Statement

Xanthan gum business

Leveraging on our cost advantage, the Group actively expands its xanthan gum sales during 2008 and successfully enlarged our market share, emerging as one of the top three xanthan gum manufacturers of the world. The Group's xanthan gum sale volume increased significantly from approximately 6,200 tonnes in 2007 to approximately 20,000 tonnes in 2008, completely absorbed the 12,000 tonnes additional production capacity created in 2008. With our effective marketing strategy, the results of the Group's xanthan gum segment increased by over 2 times.

Upon completion of the reengineering project and the construction of new production lines, the Group's production capacity of xanthan gum at the IM Plant reached 24,000 tonnes by the end of 2008. After production capacity consolidation with the Shandong Plant, the Group's production capacity of xanthan gum will reach 32,000 tonnes in 2009. Coal is the major raw material for xanthan gum, which accounts for over 40% of the production cost. The newly constructed production capacity of the IM Plant can enjoy very low coal cost. Although the average selling price of xanthan gum decreased as compared with 2007, leveraging on our marketing effort and cost advantages of the IM Plant as well as the average price of xanthan gum ceased to drop and rebounded during second half of 2008, the gross profit margin of xanthan gum has increased as compared with the same period last year.

As xanthan gum is an exported product, its future growth may be affected by global economic downturns. Nevertheless, we believe that with the market gets a better understanding on the wide application and advantages of xanthan gum, demand will remain strong. The Group has cost effectiveness in the production for xanthan gum, and is more competitive than other manufacturers. We will fully utilise the cost advantages of the IM Plant and grasp the opportunities brought by market consolidation, with an aim to become the leading xanthan gum manufacturer of the world.

Relentless efforts to develop biochemical technology products

In order to drive its long-term growth, the Group continuously explores the possibility of expanding into other business by using its bio-fermentation technology. In view of the enormous potential of pharmaceutical fermentation industry, the Group acquired the 100% shareholdings of Shenhua Pharmaceutical Co., Ltd in January 2008 and extends the application of our fermentation technology into pharmaceutical business. On the other hand, the Group will continue to explore the possibility of developing new products and business, such as the investment of new amino acid products during 2009.

Research and Development (R&D)

With the continuous effort of the R&D division, the Group's R&D center obtained various rewards during the period under review. The Group was approved as a National Post-PhD. Research Center, and has successfully developed new products including threonine and a series of new amino acid products known as valine, norleucine and isoleucine which will commence project establishment in 2009. The polyglutamic acid R&D project has been accredited as a national high-tech industrialised project（國家高技術產業化示範專項）. On the other hand, the Group has applied for 19 patents for its self-developed technologies, with 3 of them already being awarded. Furthermore, by enhancing production technology, consumption of electricity and steam for the Group's MSG production segment has been reduced to an advanced level in the industry, with significant increase in unit productivity as well.

Prospect and future plan

1. **Expand the productivity of glutamic acid in a timely manner and further convert glutamic acid production capacity into MSG production capacity**

   It is expected that the market will continue to consolidate in 2009, and the Group will continue to lead the consolidation process capitalising on its marketing strengths, cost advantages of raw materials and economies of scale. Therefore, the Group will timely expand the production capacity of glutamic acid according to market condition, and will further convert its glutamic acid production capacity into MSG production capacity in order to enlarge market shares and solidify its leading status in the industry while accelerating growth in revenue.

Prospect and future plan *(Continued)*

2. **Strive to become the world's leading xanthan gum manufacturer**
The Group's xanthan gum production facilities are primarily located in Inner Mongolia, which enjoys advantage in low raw material costs. Leveraging on this competitive advantages, the Group will grasp the opportunity brought by market consolidation to speed up expansion of its xanthan gum business and expand its xanthan gum production capacity by another 12,000 tonnes in the IM Plant to become the world's leading xanthan gum supplier.

3. **Focus on developing new products**
In 2009, the Group will begin the commercialisation of two new products known as threonine and a series of new amino acid products such as valine, leucine and isoleucine. Furthermore, the Group is also developing a series of new amino acid products and biomass based polymer products, including proline, tryptophan, polyglutamic acid and welan gum, in order to enhance the Group's product mix and future profitability.

4. **Further expansion of market network and marketing efforts**
The Group strives to extend its domestic as well as international sales networks. Apart from establishing a leading position in the domestic market by building up a nationwide marketing network, the Group has also set up regional sales centres and logistic centres in order to provide market-oriented customer services. Meanwhile, the Group actively expands into the international market, with preliminarily plans to establish operations offices in the Middle East, North America and Europe to strengthen its xanthan gum and MSG export business and broaden income stream.

   In addition, the Group further promotes its brand name in the market by engaging brand spokesperson and enhances popularity of the enterprise and products in the market as well as extending to the retail end-users.

Looking forward, although the global economy is full of uncertainties, we are still confident of achieving satisfactory growth in 2009. The prospect of glutamic acid and MSG market remains optimistic as we expect continuous growth in domestic demand. Moreover, with almost half of the demand for xanthan gum is from the relatively stable food and consumer sectors, the impact brought by the financial crisis will be limited. As the leading manufacturer of the industry, the Group will continue to elaborate our advantages and capture the opportunities brought by market consolidation. The Group will endeavor to strengthen its leading status in the glutamic acid, MSG and xanthan gum market by implementing the above strategies, and will also continue to develop biochemical technology products in order to promote long-term and prudent growth of the Group and become the world's leading manufacturer of biochemical products.

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 indomitable perseverance and determination; inherit the trading spirit continuously; endeavor to strengthen and develop the leading status in the glutamic acid, MSG and xanthan gum business; actively exploit the new biochemical technology products and continue to raise our profitability to bring better returns for the Shareholders.

Li Xuechun
Chairman

Hong Kong
20 March 2009

Five-year Summary

	Year				
	2004	2005	2006	2007	**2008**
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	***RMB'000***
Operating results – Summary					
Turnover	625,313	1,296,408	1,787,247	2,445,652	**3,585,343**
Gross profit	108,475	317,616	355,142	249,666	**644,332**
Profit before income tax	78,086	236,280	249,808	45,485	**325,380**
Profit attributable to Shareholders	70,957	236,167	240,483	45,069	**294,706**
Balance sheets – Summary					
Non-current assets	328,538	566,690	1,353,859	1,743,481	**2,087,602**
Current assets	173,165	404,276	570,485	1,138,354	**1,174,863**
Total assets	501,703	970,966	1,924,344	2,881,835	**3,262,465**
Current liabilities	212,534	393,182	1,034,645	1,095,170	**1,170,225**
Non-current liabilities	167,598	231,778	363,306	337,849	**350,726**
Net assets	121,571	346,006	526,393	1,448,816	**1,741,514**
Financial ratio					
Earnings per share (RMB Cent)	5.91	19.68	20.04	2.80	**17.75**
Gross profit ratio (%) *(Note 1)*	17	25	20	10	**18**
Current ratio *(Note 2)*	0.81	1.03	0.55	1.04	**1.00**
Inventory turnover days (Day) *(Note 3)*	38	34	38	54	**45**
Debtors' turnover days (Day) *(Note 4)*	37	63	67	74	**54**
Trade receivables turnover days (Day) *(Note 5)*	8	9	17	10	**8**
Creditors' turnover days (Day) *(Note 6)*	41	64	65	76	**63**
Trade payables turnover days (Day) *(Note 7)*	38	63	58	74	**63**
Gearing ratio (%) *(Note 8)*	29	26	39	22	**18**

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
Northern Section of Longshan 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
Mr. Lee Wai Yin *CPA FCCA*

Authorised Representatives
Mr. Li Xuechun
Mr. Lee Wai Yin

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 57, 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 27 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 47, 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 17 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 41, 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 sales and operation of xanthan gum. 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 17 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 55, 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 Shandong Fufeng's business operation. He first joined Shandong Brewery Furui Group in 1988 and was one of the initial management Shareholders. Mr. Yan has over 20 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 39, 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 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 15 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 40, is an executive Director and vice general manager of the Group who is responsible for the production and 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 18 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 40, is an executive Director and vice general manager of the Group who is 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 8 years of experience in business management. Mr. Li Deheng 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 32, 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 has over 6 years of experience in the fermentation industry. Ms. Li obtained a master degree of business administration in 北京大學光華管理學院 (Guanghua School of Management, Beijing University) in 2008. She is the daughter of Mr. Li Xuechun.

龔卿禮 (Gong Qingli), aged 41, is an executive Director and the chief financial officer of the Group who is responsible for financial management and who 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 19 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 46, 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 has over 20 years of experience in finance and auditing.

陳寧 (Chen Ning), aged 46, 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 six academic textbooks and has written over 90 academic papers.

梁文俊 (Liang Wenjun), aged 45, 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 19 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 40, is a sales and marketing controller 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 17 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 43, 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 10 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 49, is a manager in administrative department 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 9 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 42, is a vice general 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 business of international trade. 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 40, 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 7 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 48, 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. Mr. Ge jointed the Group in June 1999 and has over 16 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 35, 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 14 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 34, is a manager in the international trade 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 9 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

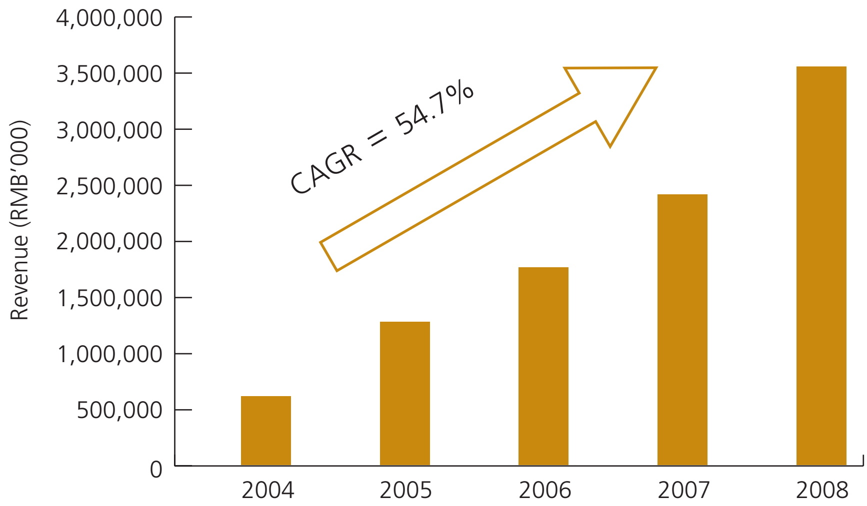
李偉然 (Lee Wai Yin), aged 39, is the company secretary of the Company since August 2008. Mr. Lee graduated from the Hong Kong Shue Yan College in 1993 with a diploma in accountancy and is a fellow of the Association of Chartered Certified Accountants and an associate of the Hong Kong Institute of Certified Public Accountants. Mr. Lee has more than 15 years of working experience in the field of finance and accounting including some with international accounting firms.

Management Discussion and Analysis

Overview

The Group aims at becoming one of the leading corn-based biochemical products manufacturers in the world. The Group's overall growth strategy entails expansion of its production capacity, diversification of its product range, expansion of its sales network and strengthening its research and development capabilities.

The Group recorded an increase of approximately RMB1,139.7 million or 46.6% in revenue to approximately RMB3,585.3 million for the year 2008, as compared with that in the year 2007. The table below illustrates the continuous growth of the Group's revenue in the past 5 years:



The gross profit of the Group increased significantly from approximately RMB249.7 million in 2007 to approximately RMB644.3 million in 2008. Owing to the increase in average selling prices and sales volume of most of the Group's products resulted from improvement of business environment, the gross profit margin of the Group improved to about 18.0% in 2008, representing a 7.8 percentage points increase from 10.2% in 2007.

The profit attributable to the Shareholders in 2008 was approximately RMB294.7 million which is an increase of approximately RMB249.6 million or 553.9% as compared with that of in 2007.

2008 is an encouraging year for the Group, as its results recorded significant rebound after a challenging 2007. The Directors attributed the improved performance of the Group for the following factors:

– the market consolidation of the MSG segment products in 2007 which led to closedown of small and medium-sized manufacturers and strengthening the position of the market leaders such as the Group;

– the improved business environment in the MSG industry resulting in the increase in average selling prices and profit margin;

– the Group's timely strategy of aggressively expanding its production capacity amidst a difficult market thereby capturing more market share;

– the results of the Group's early strategy of setting up production plants in Baoji and Inner Monogolia where there are significant raw material cost advantages;

– the rapid development of the Group's xanthan gum business, particularly the superior costs advantage in the IM Plant.

Management Discussion and Analysis

Segmental review

The Group's products are organised into two business segments, namely MSG segment and Xanthan gum segment. MSG segment includes glutamic acid, MSG, fertilisers, and other related products while Xanthan gum segment represents the production and sale of xanthan gum. Key financials of these two segments in 2008 together with comparative figures in 2007 are set out in the following table:

	2008			2007			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	**3,133,604**	**451,739**	**3,585,343**	2,296,166	149,486	2,445,652	36.5	202.2	46.6
Gross Profit	**488,936**	**155,396**	**644,332**	203,543	46,123	249,666	140.2	236.9	158.1
Gross Profit ratio	**15.6%**	**34.4%**	**18.0%**	8.9%	30.9%	10.2%	6.7ppts.	3.5ppts.	7.8ppts.
Segment results	**273,363**	**130,574**		41,574	39,446		557.5	231.0	
Segment net assets									
Assets	**2,560,470**	**626,257**		2,372,359	418,435		7.9	49.7	
Liabilities	**1,111,634**	**406,634**		1,116,638	313,521		(0.4)	29.7	
Net assets	**1,448,836**	**219,623**		1,255,721	104,914		15.4	109.3	

MSG segment review

Business review

When compared with 2007, the business environment of MSG industry generally improved in 2008, with combination of rebound of products prices since the second quarter of 2008 and decrease in raw materials costs in the fourth quarter of 2008. Leveraging on its leading position in the industry, the Group expanded its production capacity of its MSG to capture more market share. While the total production capacity of the Group's glutamic acid was changed slightly, production capacity of the Group's MSG increased from 75,000 tonnes in 2007 to 171,667 tonnes in 2008. It is the strategy of the Group to expand its product chain by migrating from glutamic acid-focus to MSG-focus. In addition, the Group relocated certain glutamic acid and MSG production facilities in the Shandong Plant to its Baoji Plant and the IM Plant, so as to take advantage of the cost effectiveness in such plants.

In 2008, in addition to the expansion of production capacity of MSG, the Group expanded its products range along with its value chain. During the year under review, the Group intended to make use of corn germ, which is a by-product during the production of corn starch and currently sold to the Group's customers, for the production of corn oil, which is perceived to be relatively healthy edible oil. The Group completed the construction of production capacity of 35,000 tonnes corn oil in the Shandong Plant in December 2008, which is expected to commence commercial production in the first half of 2009. Meanwhile, the Group completed the construction of production capacity of 10,000 tonnes chicken powder, which is a flavour enhancer principally made of MSG, in the Shandong Plant in December 2008, which is expected to commence commercial production in the first half of 2009.

Management Discussion and Analysis

Being part of the Group's strategy, the Group has been exploring potential acquisition and merger of biochemical related businesses, which are complementary to the Group's vertical production model, in order to diversify its business scope and broaden its source of income. In view of the enormous potential of pharmaceutical fermentation industry, in January 2008 the Group acquired the 100% equity interest in Shenhua Pharmaceutical, which is principally engaged in the manufacture and sales of eubacteria material medicine, preparations and food additives and other related products in the PRC.

We noted that oversupply situation of MSG products subsided in 2008, as several small and medium-sized glutamic acid and MSG manufacturers closed down their business. As a result, both the selling prices of glutamic acid and MSG rebounded and have been moving along an upward trend since the second quarter of 2008. Such increase offset the effects of price raised in major raw materials, the gross profit margin of MSG segment has been increasing since the second quarter of 2008. As a result of the increase of selling prices of glutamic acid and MSG products and a drop in the costs of major raw materials in the fourth quarter of 2008, there was a significant improvement in the gross profit margin of glutamic acid and MSG products in the fourth quarter of 2008.

As for fertilisers, the selling price of such in both the international and domestic markets have been increasing since the fourth quarter of 2007, due to significant increase in its respective raw materials and production costs. However, following continuing decrease in raw materials costs in the second half of 2008, the selling price of fertilisers decreased in the fourth quarter of 2008.

The average selling price of corn refined products increased in 2008. Such increase was mainly due to the increase in demand for corn-based animal feed resulted from the uptrend of selling price of pork. However, such demand was subsequently affected by the outbreak of global financial crisis and the selling price slightly dropped in the fourth quarter of 2008.

In 2007, certain administrative measures were promulgated by the PRC to stabilise the corn kernels price. As a result, the corn kernels price gradually stabilised but yet still maintained at a relatively high level in the first three quarters of 2008. Following the collapse of commodity prices globally, the corn kernels price reduced to a reasonable level at the fourth quarter of 2008.

The coal price has been increasing since the fourth quarter of 2007. However, such uptrend reversed following decrease in economic activities resulted from the outbreak of recent financial crisis, the coal price of the Group reduced in the fourth quarter of 2008.

Management Discussion and Analysis

Financial review

Revenue

The revenue generated from the sale of the MSG segment products increased to about RMB3,133.6 million in 2008, representing an increase of about RMB837.4 million or 36.5%, as compared with that in year 2007, which was mainly attributable to increase in the sale of MSG resulted from increase of MSG production capacity and marketing effort so as to enlarge the Group's market share in the industry. Revenue breakdown by products in this segment for the years 2008 and 2007 are set out in the table below:

Product name	**2008** *RMB'000*	2007 *RMB'000*	% of change
Glutamic acid	**1,053,298**	1,049,470	0.4
MSG	**1,004,381**	550,825	82.3
Fertilisers	**380,097**	236,492	60.7
Corn refined products	**509,849**	381,186	33.8
Starch sweeteners	**163,002**	78,193	108.5
Others	**22,977**	–	N/A
	3,133,604	2,296,166	36.5

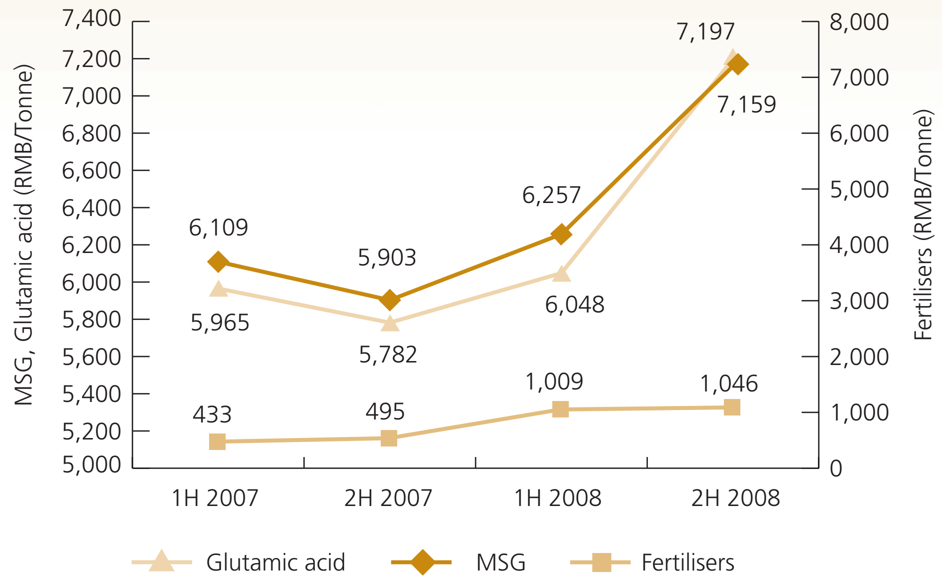
ASPs and sale volume

Set out below the ASPs of the Group's major products for the years 2008 and 2007:

Product name	**2008** *RMB/tonne*	2007 *RMB/tonne*	% of change
Glutamic acid	**6,474**	5,872	10.3
MSG	**6,865**	5,997	14.5
Fertilisers	**1,026**	489	109.8

Management Discussion and Analysis

The chart below illustrates the fluctuation of ASPs of the Group's major products in this segment in recent years:



Glutamic acid

Since late 2007, there were a number of small and medium-sized glutamic acid manufacturers closing down their business in the PRC. In response to the decrease in market supply of glutamic acid, the price of such rebounded in 2008. The ASP of glutamic acid increased from approximately RMB5,872 per tonne in 2007 to approximately RMB6,474 per tonne in 2008, representing an increase of about 10.3%. In particular, there was a further price increase of about 19.0% in the second half of 2008 when comparing with that in the first half of 2008.

As part of the Group's growth strategy, larger amount of glutamic acid were consumed for the production of MSG internally. As such, while total production of glutamic acid remained the same, sales volume of glutamic acid slightly decreased by approximately 9.0% in 2008 when compared to that in 2007.

MSG

Following the same pattern and reasons as that of glutamic acid, the ASP of MSG increased from approximately RMB5,997 per tonne in 2007 to approximately RMB6,865 per tonne in 2008, or an increase of about 14.5%. In particular, there was an increase of about 14.4% in the ASP of MSG in the second half of 2008 when comparing with that in the first half of 2008.

As stated above, leveraging on its leading position in the market, the Group increased marketing effort to boost the sale of its MSG so as to enlarge its market share in the industry in 2008. As such, the sales volume of MSG (in terms of tonnage) increased by approximately 59.2% in 2008 from that of 2007.

Fertilisers

Since the fourth quarter of 2007, the ASP of fertilisers has been increasing in line with those in the international and PRC fertiliser markets. The ASP of fertilisers increased from approximately RMB489 per tonne in 2007 to approximately RMB1,026 per tonne in 2008, representing an increase of about 109.8%. However, due to the outbreak of the recent financial crisis in the second half of 2008, the average unit selling price of fertilisers fell to RMB898 per tonne in the fourth quarter of 2008.

Management Discussion and Analysis

Corn refined products

The revenue of corn refined products increased by about 33.8% in 2008. Such increase was mainly due to the increase in demand for corn-based animal feed resulted from the uptrend of selling price of pork. However, such demand was subsequently affected by the outbreak of global financial crisis and the selling price of corn refined products slightly dropped in the fourth quarter of 2008.

Starch sweeteners

The ASP of starch sweeteners remained stable throughout the year 2008, the sales volume of such increased by about 109.3% to 74,016 tonnes in 2008 as a result of the increase in market recognition of the Group's products.

Cost of production

The breakdowns of cost of production of this segment are set out below:

	2008		2007		% of
	RMB'000	**%**	*RMB'000*	%	change
Major raw materials/Energy	**2,103,892**	**80.6**	1,794,304	80.9	17.3
– Corn Kernels	**1,304,277**	**50.0**	1,263,735	57.0	3.2
– Liquid Ammonia	**331,430**	**12.7**	253,732	11.4	30.6
– Coal	**284,266**	**10.9**	174,136	7.9	63.2
– Sulphuric Acid	**183,919**	**7.0**	102,701	4.6	79.1
Depreciation	**108,551**	**4.2**	93,506	4.2	16.1
Employee benefit	**87,412**	**3.3**	84,788	3.8	3.1
Others	**309,553**	**11.9**	244,907	11.1	26.4
Total cost of production	**2,609,408**	**100**	2,217,505	100	17.7

Corn kernels

In 2008, cost of corn kernels accounted for approximately 50.0% (2007: 57.0%) of the total production cost of this segment. Such decrease was mainly due to relatively increase in the costs of other raw materials, namely liquid ammonia, coal and sulphuric acid. During the year, although the cost of corn kernels stabilised after certain administrative measures were in place, it still remained at relatively high level. The average unit cost of corn kernels increased to about RMB1,424 per tonne in 2008 (2007: RMB1,399 per tonne). Following the collapse of commodity prices globally, the average unit cost of corn kernel gradually decreased to about RMB1,378 per tonne in the fourth quarter of 2008.

Liquid ammonia

Liquid ammonia accounted for approximately 12.7% (2007: 11.4%) of total production cost in this segment in 2008. Such increase was mainly due to increase in the average unit selling price of liquid ammonia. The average unit cost of liquid ammonia increased to about RMB2,700 per tonne in 2008 (2007: RMB1,907 per tonne). Such increase was mainly attributable to increase in industrial demand for such product. The average unit cost of liquid ammonia increased continuously for three straight quarters in 2008. The average unit cost of liquid ammonia peaked at about RMB3,233 per tonne in the third quarter of 2008. However, being affected by the outbreak of recent financial crisis, the average unit cost of liquid ammonia started to decrease, to about RMB2,607 per tonne in the fourth quarter of 2008.

Coal

Coal accounted for about 10.9% (2007: 7.9%) of the total production cost in this segment. Such increase was mainly due to the increase in the average unit selling price of coal. The average unit cost of coal kept increasing from about RMB290 per tonne in the first quarter of 2008 to about RMB449 per tonne in the third quarter of 2008 due to increase in industrial demand for such product. Being affected by the outbreak of recent financial crisis, the average price of coal gradually decreased. The average unit cost of coal reduced to about RMB393 per tonne in the fourth quarter of 2008.

Sulphuric acid

Sulphuric acid accounted for about 7.0% (2007: 4.6%) of the total production cost in this segment. Such increase was mainly due to increase in the average unit selling price of sulphuric acid. The cost of sulphuric acid increased in line with an increase in sulphur resulted from increase in industrial demand for such product. The average unit cost of Sulphuric acid increased to about RMB923 per tonne in 2008 (2007: RMB408 per tonne). Being affected by the outbreak of recent financial crisis, the average unit cost of Sulphuric acid decreased to about RMB390 per tonne in the fourth quarter of 2008.

Gross Profit

The gross profit of this segment increased from about RMB203.5 million in 2007 to about RMB488.9 million in 2008, representing an increase of about RMB285.4 million or 140.2%. Such increase was mainly due to increase in sales volume, average selling price and gross profit margin of products in MSG segment in 2008.

The gross profit margin of MSG segment rebounded from about 8.9% in 2007 to about 15.6% in 2008, representing an increase of about 6.7 percentage points. Such increase was mainly attributable to increase of ASP of the Group's products and decrease in the costs of major raw materials in the fourth quarter of 2008.

Production

The annual design production capacity of each of the major products in this segment by the end of 2008 together with the comparative figures in 2007 was as follows:

	As at 31 December		
Product name	**2008** **(*Tonnes*)**	2007 (*Tonnes*)	Change (%)
Glutamic acid	**350,000**	280,000	25.0
MSG	**280,000**	155,000	80.6
Fertilisers	**460,000**	490,000	(6.1)
Starch sweeteners	**100,000**	140,000	(28.6)

Glutamic acid

The annual design production capacity of Glutamic acid increased to 350,000 tonnes in 2008, from 280,000 tonnes in 2007. Such increase was mainly due to the completion of the reengineering projects carried out in the Baoji Plant and the IM Plant in July 2008.

MSG

The annual design production capacity of MSG increased to 280,000 tonnes in 2008, from 155,000 tonnes in 2007. Such increase was mainly due to completion of the construction of a MSG production line of 100,000 tonnes in the Baoji Plant during the year, which including part of MSG production facilities in the Shandong Plant were relocated to the Baoji Plant. Moreover, certain MSG production facilities in the Shandong Plant and in the IM Plant were reengineered resulting in an additional production capacity of 25,000 tonnes.

Fertilisers

The annual design production capacity of fertilisers deceased to 460,000 tonnes in 2008, from 490,000 tonnes in 2007. Such decrease was mainly due to the sale of obsolete fertilisers production facilities during the course of relocation of certain production facilities of the Shandong Plant.

Starch sweeteners

The annual design production capacity of starch sweeteners decreased from 140,000 tonnes in 2007 to 100,000 tonnes in 2008. The reduced 40,000 tonnes production capacity have been converted into 20,000 tonnes production capacity of glutamic acid in the IM Plant in 2008. The production capacity of starch sweeteners represented the capacity to produce crystallised glucose.

The operation of the Shandong Old Plant was closed down in early 2008. Major production facilities of such situated therein were relocated to the IM Plant.

In addition to the expansion and reconfiguration of the existing production capacities, the Group expanded its product range along with its value chain. In 2008, construction of production capacities of 35,000 tonnes of corn oil and 10,000 tonnes of chicken powder in the Shandong Plant were completed, which are expected to commence commercial production in the first half of 2009.

Management Discussion and Analysis

The actual production output and the utilisation rate of each of the major products in 2008 together with the comparative figures in 2007 were as follows:

Product name	**2008** **(Tonnes)**	2007 *(Tonnes)*	Change *(%)*
Glutamic acid			
Annual design production capacity *(Note)*	**275,000**	280,000	(1.8)
Actual production output	**275,212**	279,420	(1.5)
Utilisation rate	**100%**	100%	
MSG			
Annual design production capacity *(Note)*	**171,667**	75,000	128.9
Actual production output	**150,353**	77,128	94.9
Utilisation rate	**88%**	103%	
Fertilisers			
Annual design production capacity *(Note)*	**405,000**	490,000	(17.3)
Actual production output	**380,531**	387,928	(1.9)
Utilisation rate	**94%**	79%	

Note: the annual production capacity is expressed on a pro-rata base.

Referring to the table above, the Group's production facilities for these products were almost fully utilised.

Owing to the Group's continual fine-tuning of its production line and improvement in the production technique of starch sweeteners, the production output of such product increased. Utilisation rate of production facilities of starch sweeteners increased to about 68% in 2008 (2007: 34%).

Xanthan gum segment

Business review

The global supply and demand of xanthan gum continued to increase in 2008.

The market demand is continuously growing with more end-users realising the advantages of using xanthan gum as an effective thickener, stabiliser or suspension agent applying in food, oil exploration, personal care products and pharmaceutical items.

During the year under review, the Group expanded its production capacity of xanthan gum in the IM Plant to consolidate its leading position in the industry. In addition, upon completion of the reengineering project and the construction of new production line, production capacity of xanthan gum at the IM Plant was further enlarged to 24,000 tonnes and the Group's production capacity of xanthan gum reached 32,000 tonnes at the end of 2008 after the production capacity consolidation with the Shandong Plant. Following such expansion, the Group became one of three largest suppliers in the world by volume.

In 2008, the Group sold its products to certain customers at relatively lower price so as to enlarge its market share in the industry. In addition, there was an increase in the market supply of xanthan gum. As a result, the average selling price of xanthan gum decreased in 2008, comparing with that in 2007. However, it was observed that the selling price of xanthan gum became relatively stable at the end of 2008.

Management Discussion and Analysis

Financial review

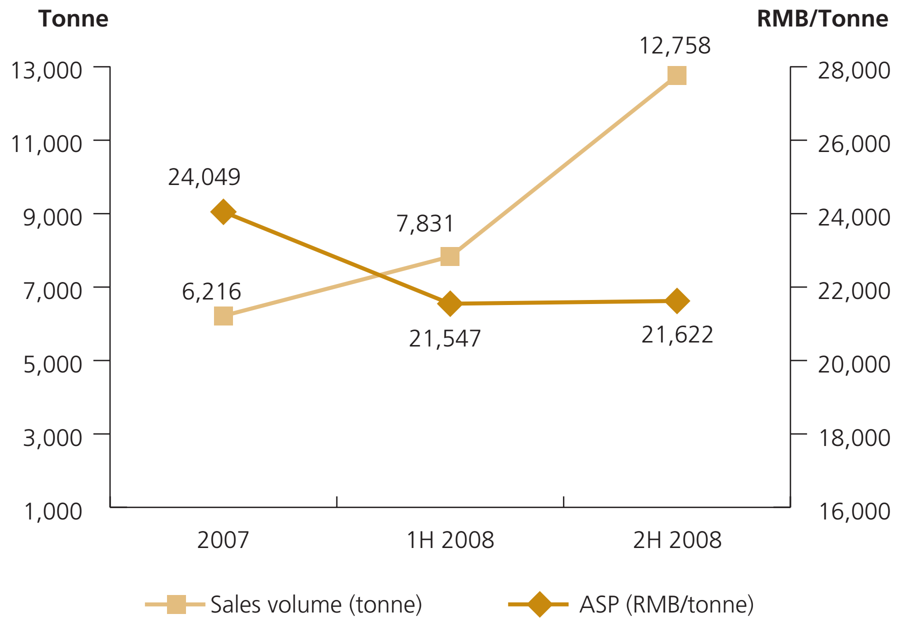
Revenue

The revenue generated from the sales of xanthan gum increased to about RMB451.7 million in 2008, representing an increase of about RMB302.3 million or 202.2%, as compared with that in year 2007. Such increase was mainly due to the expansion of 12,000 tonnes xanthan gum production capacity of the Group in late 2007 are completely absorbed by the market demand, as well as the increased market demand in 2008.

In 2008, overseas sales of xanthan gum contributed about 85% (2007: 83%) to the total sales of the xanthan gum. Such increase was mainly due to the increase in the marketing effort to promote the Group's products. In addition, the Group sold its products to certain customers at relatively lower price to enlarge its market share, which boosted the overseas sales of xanthan gum.

ASP and sale volume

The chart below illustrates the fluctuation of ASP and the growth of sales volume of xanthan gum in recent years:



The average selling price of xanthan gum decreased from about RMB24,049 per tonne in 2007 to about RMB21,594 per tonne in 2008, representing a decrease of about RMB2,455 per tonne or 10.2%. However, it was observed that the selling price of xanthan gum had become relatively stable at the end of 2008. Such decrease was mainly due to two folds:

(1) the expansion of production capacity of xanthan gum in the overall market which has driven down the selling price of xanthan gum; and

(2) the Group intentionally offered discount to certain new customers in order to enlarge the market share of the Group in xanthan gum market.

With the outstanding effort of the sales team, the increase in production capacity of xanthan gum was mostly absorbed by the sales for 2008. Hence, the sales volume of xanthan gum increased by approximately 231.2% in 2008, as compared with that in 2007.

Cost of production

The breakdowns of the cost of production of this segment are set out below:

	2008		2007		% of
	RMB'000	%	*RMB'000*	%	change
Major raw materials/Energy	**224,985**	**74.7**	111,101	73.2	102.5
– Coal	**127,360**	**42.3**	65,724	43.3	93.8
– Corn Kernels	**51,033**	**17.0**	29,866	19.7	70.9
– Starch	**23,290**	**7.7**	5,647	3.7	312.4
– Soy bean	**23,302**	**7.7**	9,864	6.5	136.2
Depreciation	**25,141**	**8.4**	10,515	6.9	139.1
Employee benefit	**18,104**	**6.0**	6,913	4.6	161.9
Others	**32,782**	**10.9**	23,301	15.3	40.7
Total cost of production	**301,012**	**100**	151,830	100	98.3

Coal

In 2008, coal accounted for approximately 42.3% (2007: 43.3%) of the total production cost of this segment. Such decrease was mainly due to the benefit on costs advantage and economic scales from the increased production output of the IM Plant. Part of the decrease was offset by increase in coal price. The IM Plant's average unit cost of coal was about RMB306 per tonne (2007: RMB204 per tonne), which was significantly lower than that of compared to about RMB628 per tonne (2007: RMB479 per tonne) in the Shandong Plant. During the year under review, the average unit cost of coal increased by approximately 32.7%.

Corn Kernels/Starch

In 2008, corn kernels/starch accounted for approximately 24.7% (2007: 23.4%) of the total production cost of this segment. Such increase was mainly because the Group sourced corn starch, which has a higher unit cost, directly from suppliers for its production in the Shandong Plant after the closure of the operation of the Shandong Old Plant in 2008.

Soy bean

In 2008, soy bean accounted for approximately 7.7% (2007: 6.5%) of the total production cost of this segment. Such increase was mainly due to the increase in average unit cost of soy bean from approximately RMB3,207 per tonne in 2007 to approximately RMB4,354 per tonne in 2008, representing an increase of about 35.8%. Following the collapse of commodity prices globally, the average unit cost of soy bean reduced from the highest cost of about RMB4,739 per tonne in the second quarter of 2008 to about RMB3,708 per tonne in the fourth quarter of 2008.

Gross profit and gross profit margin

The gross profit of xanthan gum increased from about RMB46.1 million in 2007 to about RMB155.4 million in 2008, representing an increase of about RMB109.3 million or 236.9%. Such increase was mainly due to the increase in sales volume as discussed above.

Although there was a decrease in average selling price of xanthan gum of about 10.2%, the Group was still able to maintain the gross profit margin of such product at relatively high level and achieved an increase of 3.5% percentage points in 2008, as compared with that in 2007. Such increase was mainly due to increase in production output of the IM Plant, which was strategically located in area with abundant supply of coal, and thus, provides the Group with a convenient source of energy at relative low costs. Additional new production capacity of 12,000 tonnes xanthan gum in the IM Plant has started production since November 2008. Leveraging on such cost advantage and there was a drop in the costs of major raw materials in the fourth quarter of 2008, gross margin of xanthan gum increased to about 37.0% in the fourth quarter of 2008, from about 32.3% in the third quarter of 2008.

Management Discussion and Analysis

Production

The annual design production capacity of xanthan gum in the year 2008 together with the comparative figures in the year 2007 was as follows:

	As at 31 December		
	2008	2007	% of
	(Tonnes)	*(Tonnes)*	change
Xanthan gum	**32,000**	18,000	77.8

In 2008, the Group expanded its production capacity of xanthan gum by way of constructing 12,000 tonnes xanthan gum production capacity in the IM Plant, which was completed in November 2008. Meanwhile, the Group reconfigured its existing production facilities to enhance their production efficiency. As at 31 December 2008, the production capacity of xanthan gum increased to 32,000 tonnes which includes 24,000 tonnes production capacity in the IM Plant.

The actual production output and the utilisation rate of xanthan gum in the year 2008 together with the comparative figures in the year 2007 were as follows:

	2008	2007	% of
	(Tonnes)	*(Tonnes)*	change
Annual design production capacity *(Note)*	**21,000**	11,333	85.3
Actual production output	**21,277**	9,930	114.3
Utilisation rate	**101%**	88%	

Note: the annual production capacity is expressed on a pro-rata base.

With the continual improvement of production technique of xanthan gum, utilisation rate increased in 2008.

Other financial information

Other income

Other income increased by approximately RMB11.5 million or 35.1% from RMB32.8 million in the year 2007 to about RMB44.3 million in the year 2008. The increase was mainly due to the increase in sales of waste products. In addition, the increase was also attributable to a negative goodwill gained from the acquisition of Shenhua Pharmaceutical and wavier of payables due to debt restructuring from Shenhua Pharmaceutical.

Selling and marketing expenses

Selling and marketing expenses increased by approximately RMB62.3 million or 59.8% from RMB104.2 million in the year 2007 to about RMB166.4 million in the year 2008. Such increase was mainly due to the increase in freight expenses and custom declaration charges resulted from an increase in the export sales of the Group's products.

Administrative expenses

Administrative expenses increased by approximately RMB28.3 million or 24.8% from RMB113.7 million in 2007 to about RMB142.0 million in 2008. The increase was mainly due to the increase of research and development related expenses and land use tax of the Shandong Plant and the Baoji Plant.

Finance cost

Finance cost is approximately amount to RMB42.7 million which is decreased slightly by about RMB2.5 million represented 5.6% as compared to 2007. In the year 2008, average bank borrowings were maintained approximately at about RMB600 million which was at the similar level to that in 2007.

Staff cost

Staff cost of the Group increased by approximately RMB14.1 million or 9.0% from RMB156.2 million in 2007 to about RMB170.3 million in 2008. The increase was mainly due to the increase in the staff costs resulted from the expansion of the Group and increase in the average salary of the staffs.

Depreciation

The depreciation of the Group increased by approximately RMB35.6 million or 30.5% from RMB116.9 million in 2007 to about RMB152.5 million in 2008. The increase was mainly due to the expansion and modification of the IM Plant and the Baoji Plant.

Taxation

The income tax expenses for the year 2008 represented the PRC Enterprise Income Tax (“EIT”). Income tax expenses increased by approximately RMB30.3 million from RMB0.4 million in 2007 to about RMB30.7 million in 2008. The increase was mainly due to the increase of profit, the recognition of withholding tax on the earnings of certain subsidiaries incorporated in PRC for 2008 that are expected to be distributed in the foreseeable future and the reversal of deferred tax assets recognised in prior year.

Effective on 1 January 2008, in accordance with the relevant tax laws, the EIT rate applicable to the subsidiaries incorporated in the 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%. However, the Group’s subsidiaries 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 following table summaries the EIT rates applicable to the Group’s subsidiaries:

	Shandong Fufeng	**Baoji Fufeng**	**IM Fufeng**
Standard/preferential tax rate	25%	15% *(Note 1)*	15% *(Note 1)*
Tax holiday			
Full exemption (year)	Already expired	Already expired	Already expired
50% exemption (year)	Already expired	2007 to 2009	2009 to 2011

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

Other achievements

Research and Development

During the period under review, with the continuous effort of the R&D division, the Group’s R&D center obtained various rewards and was approved as a National Post-PhD. Research Center. The Group has applied for 19 patents for its self-developed technology, three of which have been already granted. In 2008, the Group successfully developed several new products, including threonine and a series of new amino acid products known as valine, leucine and isoleucine, which will commence project establishment in 2009. The polyglutamic acid R&D project has been accredited as a national high-tech industrialised project (國家高技術產業化示範專項). Furthermore, by enhancing production technology, consumption of electricity and steam for the Group’s MSG production segment were reduced to an advanced industry level, with significant increase in unit productivity as well.

Outlook and Future Plans

MSG Segment

It is the Group's strategy to continue expanding the production capacity of its MSG segment products. With the planned increase in production capacity, the Group will further strengthen its leading position in the market. The Group's current strategy is to vertically expand along the product chain, by focusing on utilising self-produced glutamic acid to produce more MSG products. The Directors expect that the increase in production capacity should generate additional revenue to the Group while the extension of the product chain should help in strengthening the Group's overall competitiveness. The Directors are optimistic about the Group's prospect in 2009.

After the market consolidation in 2007, the overall ASP and the profit margin of MSG segment products in the PRC rebounded in 2008. While the current selling price of the products is at their highest in the past five years, on the other hand, in the fourth quarter of 2008, the prices of the Group's major raw materials, including coal, liquid ammonia and sulphuric acid, decreased significantly, which is in line with the drop in commodity price worldwide. It is expected that the high profit margin of MSG segment products would attract some enterprises to increase production or re-enter the market, which might eventually put pressure on the selling price and therefore the gross profit margin of the MSG segment products. However, given its market leading position and its experienced management, the Directors believe that the Group is well positioned to remain competitive in the coming year. The Group will continue to closely monitor the price trend of the Group's products, the price trend of its raw materials, and the gross profit margin of MSG segment, and adopt appropriate sales and pricing strategy with an aim to maintain and improve the Group's profitability and leadership in the market.

Xanthan gum

The market demand for xanthan gum is expected to continue to grow with more end-users realising the advantages of using xanthan gum as an effective thickener, stabiliser or suspension agent applying in food, oil exploration, personal care products and pharmaceutical items. To accommodate the growing demand, the Group intends to further expand its production capacity of xanthan gum in the near future. The Group will take full advantage of its cost effectiveness in its IM Plant and capture additional market share. As the Group has become one of the leading xanthan gum manufacturers in the world, the Directors believe that it will have better control of its selling price and hence the profit margin of its products. The Directors expect that the Group's xanthan gum business should continue to grow strongly in the year coming.

Although overseas market was affected by the outbreak of the recent financial crisis, the Directors are of the view that almost half of the demand for xanthan gum is from the relatively stable food and customers sectors, the impacts brought by the financial crisis will be limited. Given production facilities of xanthan gum are strategically located in areas with abundant supply of coal, the Group enjoys relatively lower cost of production. Leveraging on this cost advantage, it is expected that the gross profit margin of xanthan gum will remain at relatively high level in coming year.

Outlook and Future Plans

Future plans

Expand the productivity of glutamic acid in a timely manner and further convert glutamic acid production capacity into MSG production capacity

It is expected that the market will continue to consolidate in the near future, and the Group will continue to lead the consolidation process due to its marketing strengths, cost advantages of raw materials and economies of scale. Therefore, the Group will timely expand the production capacity of glutamic acid according to market condition, and will further convert its glutamic acid production capacity into MSG production capacity in order to enlarge its market shares. Currently, it is expected that production capacity of 100,000 tonnes MSG will commence construction in the second quarter of 2009, which is expected to be completed and commence production by the end of 2009.

Strive to become the world's leading xanthan gum manufacturer

The Group's xanthan gum production facilities are primarily located in Inner Mongolia, which enjoys advantage in low raw material costs. Leveraging on this competitive advantages, the Group will grasp the opportunity brought by market consolidation and strive to become the world's leading xanthan gum supplier. The Group planned to construct an additional production capacity of 12,000 tonnes xanthan gum in the IM Plant. The construction is expected to be completed and commence production by the end of 2009. After the completion of construction, the total production capacity of xanthan gum of the Group increase to 44,000 tonnes, the Group will become as the largest supplier of xanthan gum in the world.

Focus on developing new products

In 2009, the Group will begin the commercialisation of its new products including threonine and a series of new amino acid products such as valine, leucine and isoleucine. The Group intends to commence construction of a new production line of 5,000 tonnes threonine in the IM Plant in the second quarter of 2009, which is expected to commence production by the end of 2009. Meanwhile, the Group intends to build up another production line of 1,000 tonnes valine, leucine and isoleucine in the Shandong Plant in the first quarter of 2009, which is expected to commence production in the second half of 2009.

Furthermore, the Group is also developing a series of new amino acid products and biomass based polymer products, including proline, tryptophan, polyglutamic acid and welan gum, in order to enhance the Group's product mix and future growth driver.

Further expansion of market network and marketing efforts

The Group strives to extend its domestic as well as international sales networks. Apart from establishing a leading position in the domestic market by building up a nationwide marketing network, the Group has also set up regional sales centres and logistic centres in order to provide market-oriented customer services. Meanwhile, the Group actively expands into the international market, with preliminarily plans to establish operations offices in the Middle East, North America and Europe to strengthen its xanthan gum and MSG export business.

In addition, the Group further promotes its brand name in the market by engaging brand spokesperson and enhances popularity of the enterprise and products in the market as well as extending to the retail end-users.

Other Information

Liquidity and financial resources

The Group maintained a healthy liquidity position throughout the year 2008. At 31 December 2008, the cash and cash equivalent and short term bank deposits of the Group were about RMB268 million (2007: RMB271 million). The current bank borrowings were approximately RMB276 million (2007: RMB318 million) and non-current bank borrowings were approximately RMB312 million (2007: RMB312 million).

Pledge of assets

At 31 December 2008, certain leasehold land, property, plant and equipment of the Group with carrying value of approximately RMB189 million (2007: RMB314 million), and short-term bank deposits of the Group with carrying value of approximately RMB12 million (2007: RMB2 million) were pledged to certain banks to secure general banking facilities of the Group.

Foreign exchange exposure

During the year 2008, 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. Such 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.

Gearing ratio

At 31 December 2008, the total assets of the Group amounted to approximately RMB3,262 million (2007: RMB2,882 million) whereas the bank borrowings amounted to RMB588 million (2007: RMB630 million). The gearing ratio was approximately 18% (2007: 22%). The gearing ratio is calculated based on the Group's total interested bearing borrowings over total assets.

Employees

At 31 December 2008, the Group had approximately 1,960 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 the paragraph headed "Share option schemes" under the "Directors' Report" for the share options granted to certain Directors and employees of the Group before the IPO.

Dividend and dividend policy

The Board recommended the declaration of a final dividend of HK10 cents per share, subject to shareholders' approval at the Annual General Meeting.

The final dividend will be payable on or before 8 May 2009 to the shareholders whose names appear on the register of members of the Company on 28 April 2009.

Reference is made to the prospectus of the Company dated 25 January 2007, the Board would like to emphasise that there is no change of the dividend policy of the Group. Subject to the availability of the Company's cash and distributable reserves, the Group's investment requirements, and the cashflow and working capital requirements of the Group, the Directors intend to recommend annually distribution to the Shareholders of not less than 30% of the Group's annual net profits as dividend in the foreseeable future.

In addition, the Board will consider to pay dividend in the form of an interim and a final dividend for each financial year.

Other Information

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 the listing of the Shares.

Audit committee

The Company has established an audit committee in compliance with the Listing Rules. The audit committee comprises three independent non-executive directors, and is responsible for reviewing the Group's audit, interim and annual accounts of the Group and the system of internal control. The audit committee has reviewed the Group's consolidated financial statements for the year ended 31 December 2008, including the accounting principles and practices adopted by the Group.

Closure of register of members

The register of members of the Company will be closed from Wednesday, 22 April 2009 to Tuesday, 28 April 2009 (both dates inclusive), during which no transfer of shares will be registered. In order to qualify for the proposed final dividend, all transfers of shares accompanied by the relevant share certificates must be lodged with the Company's branch registrar in Hong Kong. Tricor Investor Services Limited at 26th Floor, Tesbury Centre, 28 Queen's Road East, Hong Kong not later than 4:00 p.m. on Tuesday, 21 April 2009.

Annual general meeting

The annual general meeting is expected to be held on Tuesday, 28 April 2009. A notice convening the annual general meeting will be despatched to the Shareholders in due course.

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** *HK$ million*	**Used up to 31 December 2008** *HK$ million*
Construction of IM Plant Phase II	410	410
Construction of MSG plant in Baoji Plant	120	100
Enhancement of sales and marketing function	10	5
Improving Group's research and development capabilities	30	27
Potential acquisition of related business and facilities *(Note 1)*	39	39
Repayment of ABN AMRO loan	312	312
General working capital	36	36
	957	929

Note 1: As stated in the Prospectus, the Group intends to use the net proceeds of HK$39 million for the potential acquisition of related business and facilities. After listing of the shares of the Company, the Group has been actively pursuing acquisition opportunities within the biochemical industry. However, no potential target is identified at the moment. As such, the Group decided to use such proceeds to finance the construction of the IM Plant, which has been stated in the Prospectus.

As at 31 December 2008, remaining approximately HK$28 million of the net listing proceeds was remitted and deposited in the banks in the PRC.

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. For the year ended of 31 December 2008, 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 of the 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 36.

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 about RMB4 million for the provision of audit services for the year ended 31 December 2008.

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. For the year ended of 31 December 2008, three Audit Committee meetings were held with Mr. Choi Tze Kit, Sammy and Mr. Liang Wenjun attended all the meetings while Mr. Chen Ning attended two meetings. The Purpose of the meetings were to review the Group's results for the year 2007, the interim results for the year 2008 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 of the 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.

In determining the emolument payable to Directors, the Remuneration Committee takes into consideration factors such as responsibilities of the Directors, time commitment, employment conditions elsewhere in the Group, the desirability of performance-based remuneration and salaries paid by comparable companies.

The Remuneration Committee meetings will be held at least once a year. One meeting was held by the Remuneration Committee during the year of 2008. All Remuneration Committee members attended the meeting. The Remuneration Committee met to determine the policy of the remuneration of Directors.

Nomination of Directors

The Company has not established a nomination committee. The Board is collectively responsible for the appointing 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 2008.

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 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 2008 are set out under the consolidated income statement on page 40.

The Board recommends the payment of a final dividend of HK10 cents (equivalent to RMB8.81 cents) per Share totaling HK$166,000,000 (equivalent to RMB146,293,000) for the year ended 31 December 2008.

Material acquisitions or disposal of subsidiaries and associated companies

On 25 January 2008, the Group acquired 100% of the share capital of Shenhua Pharmaceutical, a company which operates in the bio-chemical field by applying fermentation technology on its production. The total purchase consideration amounted to RMB3,526,000 which paid by cash. For the acquisition, the Group has a negative goodwill of RMB9,657,000 which represents the excess of fair value of net assets acquired over the purchase consideration.

Except for the above, the Group had no material acquisitions or disposal of subsidiaries or associated companies for the year ended 31 December 2008.

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 2008, the Company's reserves available for distribution to the Shareholders amounted to RMB985,474,000.

Directors' Report

Directors

The Directors during the year and up to the date of this Annual Report are:

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. Wu Xindong, Ms. Li Hongyu, Mr. Gong Qingli and Mr. Choi Tze kit, Sammy 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 executive 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 executive Director not being re-elected as an executive Director or being removed by the Shareholders at general meeting of the Company in accordance with its articles of association.

Each of the independent non-executive Directors proposed for re-election at the forthcoming annual general meeting have renewed into a service contract with the Company for two years commencing from 8 February 2009 and is subject to the requirement on rotation, removal, vacation or termination of office according to the articles of association of the Company, the relevant laws and the Listing Rules.

As at 31 December 2008, 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 of the Company.

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 2008, 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 and class of securities	Percentage of interests to total issued share capital (approximate)
Li Xuechun	The Company	Interests of controlled corporation *(Note 1)*	786,000,000 Shares	47.35%
Wang Longxiang	The Company	Beneficial interests *(Note 2)*	16,000,000 Shares	0.96%
Gong Qingli	The Company	Interests of controlled corporation *(Note 3)*	16,000,000 Shares	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. Accordingly, Mr. Gong Qingli is deemed to be interested in all Shares held by Centerpoint Assets under the SFO.

Save as disclosed above, as at 31 December 2008, 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.

Persons having 5% or more shareholdings

As at 31 December 2008, 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	Name of Group member	Capacity	Class and number of 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 2008, 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 to the consolidated financial statements regarding the Pre-IPO Share Option Scheme, no time during the year was the Company, or any of its subsidiaries or the Company's holding company, 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.

Share options

Particulars of the Company's share option scheme are set out in note 16(c) to the financial statements. No option is being granted during the year ended 31 December 2008.

Interest in contracts

No contracts 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.

Directors' Report

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 2008.

The aggregate purchases attributable to the Group's five largest suppliers taken together were less than 30% of the Group's total purchases for the year 2008.

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 19 March 2009, 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 2008.

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.

Five Year Summary
A summary of the results and of the assets and liabilities of the Group for the last five financial years is set out on page 5.

Subsequent events
Details of the significant events occurring after the balance sheet date are set out in note 35 to the consolidated financial statement.

Auditor
The financial statements have been audited by PricewaterhouseCoopers who retire and, being eligible, offer themselves for re-appointment.

On behalf of the Board

Li Xuechun
Chairman

20 March 2009

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 38 to 100, which comprise the consolidated and company balance sheets as at 31 December 2008, 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 2008 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, 20 March 2009

Consolidated Balance Sheet

As at 31 December 2008

	Note	2008 RMB'000	2007 RMB'000
ASSETS			
Non-current assets			
Leasehold land payments	6	132,334	63,070
Property, plant and equipment	7	1,954,845	1,674,021
Deferred income tax assets	11	423	6,390
		2,087,602	1,743,481
Current assets			
Inventories	12	356,288	326,351
Trade and other receivables	13	548,355	540,984
Current income tax recoverable		2,654	–
Short-term bank deposits	14	42,860	42,170
Cash and cash equivalents	14	224,706	228,849
		1,174,863	1,138,354
Total assets		3,262,465	2,881,835
EQUITY			
Capital and reserves attributable to the Shareholders			
Share capital	15	169,034	169,034
Share premium	15		
– Proposed final dividend		146,293	13,529
– Others		931,851	1,078,144
Other reserves	16	(247,904)	(276,084)
Retained earnings	17	742,240	464,193
Total equity		1,741,514	1,448,816
LIABILITIES			
Non-current liabilities			
Deferred income	18	27,798	24,951
Borrowings	19	312,000	312,000
Deferred income tax liabilities	11	10,928	898
		350,726	337,849
Current liabilities			
Trade, other payables and accruals	20	887,533	770,810
Current income tax liabilities		–	875
Current portion of deferred income	18	6,692	5,485
Borrowings	19	276,000	318,000
		1,170,225	1,095,170
Total liabilities		1,520,951	1,433,019
Total equity and liabilities		3,262,465	2,881,835
Net current assets		4,638	43,184
Total assets less current liabilities		2,092,240	1,786,665

Li Xuechun
Director

Gong Qingli
Director

The notes on pages 43 to 100 are an integral part of these consolidated financial statements.

Company Balance Sheet

As at 31 December 2008

	Note	2008 RMB'000	2007 RMB'000
ASSETS			
Non-current assets			
Property, plant and equipment	7	**134**	217
Investment in a subsidiary	8	**401,698**	401,698
Loans to subsidiaries	8	**176,281**	170,107
		578,113	572,022
Current assets			
Deposits and other receivables	13	**2,118**	174
Due from subsidiaries	8	**578,886**	565,506
Cash and cash equivalents	14	**8,595**	82,783
		589,599	648,463
Total assets		**1,167,712**	1,220,485
EQUITY			
Capital and reserves attributable to the Shareholders			
Share capital	15	**169,034**	169,034
Share premium	15		
– Proposed final dividend		**146,293**	13,529
– Others		**931,851**	1,078,144
Other reserves	16	**29,866**	18,345
Accumulated losses	17	**(122,536)**	(70,811)
Total equity		**1,154,508**	1,208,241
LIABILITIES			
Current liabilities			
Due to subsidiaries	8	**10,521**	9,384
Other payables and accruals	20	**2,683**	2,860
		13,204	12,244
Total liabilities		**13,204**	12,244
Total equity and liabilities		**1,167,712**	1,220,485
Net current assets		**576,395**	636,219
Total assets less current liabilities		**1,154,508**	1,208,241

Li Xuechun
Director

Gong Qingli
Director

The notes on pages 43 to 100 are an integral part of these financial statements.

Consolidated Income Statement

For the year ended 31 December 2008

	Note	2008 RMB'000	2007 RMB'000
Revenue	5	**3,585,343**	2,445,652
Cost of sales	22	**(2,941,011)**	(2,195,986)
Gross profit		**644,332**	249,666
Other income	21	**44,300**	32,795
Selling and marketing expenses	22	**(166,407)**	(104,156)
Administrative expenses	22	**(141,961)**	(113,709)
Other operating expenses	22	**(12,222)**	(16,746)
Interest Income from IPO subscription deposits		**–**	42,837
Finance costs	25	**(42,662)**	(45,202)
Profit before income tax		**325,380**	45,485
Income tax expense	26	**(30,674)**	(416)
Profit for the year attributable to the Shareholders		**294,706**	45,069
Earnings per share for profit attributable to the Shareholders during the year (expressed in RMB cent per share)			
– basic and diluted	27	**17.75**	2.80
Dividends	28	**146,293**	13,529

The notes on pages 43 to 100 are an integral part of these consolidated financial statements.

Consolidated Statement of Changes in Equity

For the year ended 31 December 2008

		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 2007		123,372	278,326	(301,478)	426,173	526,393
Profit for the year	*17*	–	–	–	45,069	45,069
Profit appropriation	*17*	–	–	7,049	(7,049)	–
Issuance of shares for Listing	*15(a)*	45,662	909,461	–	–	955,123
Employee share options scheme:						
– Value of employee service	*16*	–	–	18,345	–	18,345
Dividends paid	*15(b)*	–	(96,114)	–	–	(96,114)
Balance at 31 December 2007		169,034	1,091,673	(276,084)	464,193	1,448,816
Profit for the year	*17*	–	–	–	294,706	294,706
Profit appropriation	*17*	–	–	16,659	(16,659)	–
Employee share options scheme:						
– Value of employee service	*16*	–	–	11,521	–	11,521
Dividends paid	*15(b) & 28*	–	(13,529)	–	–	(13,529)
Balance at 31 December 2008		169,034	1,078,144	(247,904)	742,240	1,741,514

The notes on pages 43 to 100 are an integral part of these consolidated financial statements.

Consolidated Cash Flow Statement

For the year ended 31 December 2008

	Note	2008 RMB'000	2007 RMB'000
Cash flows from operating activities			
Cash generated from operations	29	509,811	18,680
Interest paid		(42,662)	(47,375)
Income tax paid		(18,206)	(9,383)
Net cash flows generated from/(used in) operating activities		448,943	(38,078)
Cash flows from investing activities			
Acquisition of subsidiary, net of cash acquired	32	(3,202)	–
Purchase of leasehold land payments		(46,846)	–
Purchases of property, plant and equipment		(355,624)	(577,570)
Proceeds from disposal of property, plant and equipment	29	4,224	–
Interest received		2,152	51,162
Net cash used in investing activities		(399,296)	(526,408)
Cash flows from financing activities			
Proceeds from issuance of Shares	15	–	955,123
Dividends paid to the Company's shareholders		(13,529)	(96,114)
Government grants received		20,068	10,689
Proceeds from bank borrowings		750,000	633,600
Repayments of bank borrowings		(810,329)	(751,057)
Net cash (used in)/generated from financing activities		(53,790)	752,241
Net (decrease)/increase in cash and cash equivalents		(4,143)	187,755
Cash and cash equivalents at beginning of the year	14	228,849	41,094
Cash and cash equivalents at end of the year	14	224,706	228,849

The notes on pages 43 to 100 are an integral part of these consolidated financial statements.

Notes to the Consolidated Financial Statements

For the year ended 31 December 2008

1. General information

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. During the year, the Group acquired control of Shenhua Pharmaceutical, a company which operates in the pharmaceuticals production.

The Company is a limited liability company incorporated in the Cayman Islands. The address of its registered office is Cricket Square, Hutchins Drive, P.O. Box 2681, Grand Cayman KY1-1111, Cayman Islands.

The Company has its primary listing on The Stock Exchange of Hong Kong Limited.

These consolidated financial statements are presented in RMB, unless otherwise stated. These consolidated financial statements have been approved for issue by the Board on 20 March 2009.

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.

2.1 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.

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 accounting policies of the Group. 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) *Interpretations effective in 2008*

- HK(IFRIC) – Int 11, "HKFRS 2 – Group and treasury share transactions", 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. This interpretation does not have an impact on the Group's financial statements.

(b) *Amendments and interpretations effective in 2008 but not relevant*

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

- The HKAS 39, "Financial instruments: Recognition and measurement".

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

2.1 Basis of preparation *(Continued)*

(b) *Amendments and interpretations effective in 2008 but not relevant (Continued)*

- HK(IFRIC) – Int 12, "Service Concession arrangements".

- HK(IFRIC) – Int 14, "HKAS 19 – The limit on a defined benefit asset, minimum funding requirements and their interaction".

(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 and amendments to existing standards have been published and are mandatory for the Group's accounting periods beginning on or after 1 January 2009 or later periods, but the Group has not early adopted them:

- HKAS 1 (Revised), "Presentation of Financial Statements" (effective from 1 January 2009). The revised standard will prohibit the presentation of items of income and expenses (that is, 'non-owner changes in equity') in the statement of changes in equity, requiring 'non-owner changes in equity' to be presented separately from owner changes in equity. All non-owner changes in equity will be required to be shown in a performance statement, but entities can choose whether to present one performance statement (the statement of comprehensive income) or two statements (the consolidated income statement and statement of comprehensive income). Where entities restate or reclassify comparative information, they will be required to present a restated balance sheet as at the beginning comparative period in addition to the current requirement to present balance sheets at the end of the current period and comparative period. The Group will apply HKAS 1 (Revised) from 1 January 2009.

- HKAS 23 (Revised), "Borrowing costs" (effective from 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. It is not expected to have a material impact on the Group's financial statements.

- HKAS 27 (Revised) "Consolidated and Separate Financial Statements" (effective from 1 July 2009). The revised standard requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control and these transactions will no longer result in goodwill or gains and losses. The standard also specifies the accounting when control is lost. Any remaining interest in the entity is re-measured to fair value and a gain or loss is recognised in profit or loss. The Group will apply HKAS 27 (Revised) prospectively to transactions with non-controlling interests from 1 January 2010, but it is not expected to have any impact on the Group's consolidated financial statements.

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)*

- HKFRS 2 (Amendment), "Share-based payment" (effective from 1 January 2009). The amended standard deals with vesting conditions and cancellations. It clarifies that vesting conditions are service conditions and performance conditions only. Other features of a share-based payment are not vesting conditions. As such these features would need to be included in the grant date fair value for transactions with employees and others providing similar services, that is, these features would not impact the number of awards expected to vest or valuation thereof subsequent to grant date. All cancellations, whether by the entity or by other parties, should receive the same accounting treatment. The Group will apply HKFRS 2 (Amendment) from 1 January 2009, but it is not expected to have a material impact on the Group's financial statements.

- HKFRS 3 (Revised), "Business combinations" (effective from 1 July 2009). The revised standard continues to apply the acquisition method to business combinations, with some significant changes. For example, all payments to purchase a business are to be recorded at fair value at the acquisition date, with contingent payments classified as debt subsequently re-measured through the consolidated income statement. There is a choice on an acquisition by acquisition basis to measure the non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets. All acquisition-related costs should be expensed. The Group will apply HKFRS 3 (Revised) prospectively to all business combinations 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 details by management.

- HKICPA's improvements to HKFRS published in October 2008

  ~ HKAS 1 (Amendment), 'Presentation of financial statements' (effective from 1 January 2009). The amendment clarifies that some rather than all financial assets and liabilities classified as held for trading in accordance with HKAS 39, 'Financial instruments: Recognition and measurement' are examples of current assets and liabilities respectively. The Group will apply the HKAS 1 (Amendment) from 1 January 2009. It is not expected to have an impact on the Group's financial statements.

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 19 (Amendment), 'Employee benefits' (effective from 1 January 2009).

– The amendment clarifies that a plan amendment that results in a change in the extent to which benefit promises are affected by future salary increases is a curtailment, while an amendment that changes benefits attributable to past service gives rise to a negative past service cost if it results in a reduction in the present value of the defined benefit obligation.

– The definition of return on plan assets has been amended to state that plan administration costs are deducted in the calculation of return on plan assets only to the extent that such costs have been excluded from measurement of the defined benefit obligation.

– The distinction between short term and long term employee benefits will be based on whether benefits are due to be settled within or after 12 months of employee service being rendered.

– HKAS 37, 'Provisions, contingent liabilities and contingent assets' requires contingent liabilities to be disclosed, not recognised. HKAS 19 has been amended to be consistent.

The Group will apply the HKAS 19 (Amendment) from 1 January 2009.

~ HKAS 23 (Amendment), 'Borrowing costs' (effective from 1 January 2009). The definition of borrowing costs has been amended so that interest expense is calculated using the effective interest method defined in HKAS 39 'Financial instruments: Recognition and measurement'. This eliminates the inconsistency of terms between HKAS 39 and HKAS 23. The Group will apply the HKAS 23 (Amendment) prospectively to the capitalisation of borrowing costs on qualifying assets from 1 January 2009.

~ HKAS 28 (Amendment), 'Investments in associates' (and consequential amendments to HKAS 32, 'Financial Instruments: Presentation' and HKFRS 7, 'Financial instruments: Disclosures') (effective from 1 January 2009). An investment in associate is treated as a single asset for the purposes of impairment testing and any impairment loss is not allocated to specific assets included within the investment, for example, goodwill. Reversals of impairment are recorded as an adjustment to the investment balance to the extent that the recoverable amount of the associate increases. The Group will apply the HKAS 28 (Amendment) to impairment tests related to investment in associates and any related impairment losses from 1 January 2009.

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 36 (Amendment), 'Impairment of assets' (effective from 1 January 2009). Where fair value less costs to sell is calculated on the basis of discounted cash flows, disclosures equivalent to those for value-in-use calculation should be made. The Group will apply the HKAS 36 (Amendment) and provide the required disclosure where applicable for impairment tests from 1 January 2009.

~ HKAS 38 (Amendment), 'Intangible assets' (effective from 1 January 2009). A prepayment may only be recognised in the event that payment has been made in advance of obtaining right of access to goods or receipt of services. The Group will apply the HKAS 38 (Amendment) from 1 January 2009.

~ HKAS 39 (Amendment), 'Financial instruments: Recognition and measurement' (effective from 1 January 2009).

– This amendment clarifies that it is possible for there to be movements into and out of the fair value through profit or loss category where a derivative commences or ceases to qualify as a hedging instrument in cash flow or net investment hedge.

– The definition of financial asset or financial liability at fair value through profit or loss as it relates to items that are held for trading is also amended. This clarifies that a financial asset or liability that is part of a portfolio of financial instruments managed together with evidence of an actual recent pattern of short-term profit-taking is included in such a portfolio on initial recognition.

– The current guidance on designating and documenting hedges states that a hedging instrument needs to involve a party external to the reporting entity and cites a segment as an example of a reporting entity. This means that in order for hedge accounting to be applied at segment level, the requirements for hedge accounting are currently required to be met by the applicable segment. The amendment removes this requirement so that HKAS 39 is consistent with HKFRS 8, 'Operating segments' which requires disclosure for segments to be based on information reported to the chief operating decision maker. Currently, for segment reporting purposes, each subsidiary designates and documents (including effectiveness testing) contracts with group treasury as fair value or cash flow hedges so that the hedges are reflected in the segment to which the hedged items relate. This is consistent with the information viewed by the chief operating decision maker. After the amendment is effective, the hedge will continue to be reflected in the segment to which the hedged items relate (and information provided to the chief operating decision maker) but the Group will not formally document and test this hedging relationship.

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)*

– When remeasuring the carrying amount of a debt instrument on cessation of fair value hedge accounting, the amendment clarifies that a revised effective interest rate (calculated at the date fair value hedge accounting ceases) are used.

The Group will apply the HKAS 39 (Amendment) from 1 January 2009. It is not expected to have an impact on the Group's consolidated income statement.

~ HKFRS 5 (Amendment), 'Non-current assets held for sale and discontinued operations' (and consequential amendment to HKFRS 1, 'First-time adoption') (effective from 1 July 2009). The amendment clarifies that all of a subsidiary's assets and liabilities are classified as held for sale if a partial disposal sale plan results in loss of control, and relevant disclosure should be made for this subsidiary if the definition of a discontinued operation is met. A consequential amendment to HKFRS 1 states that these amendments are applied prospectively from the date of transition to HKFRSs. The Group will apply the HKFRS 5 (Amendment) prospectively to all partial disposals of subsidiaries from 1 January 2010.

~ There are a number of minor amendments to HKFRS 7, 'Financial instruments: Disclosures', HKAS 8, 'Accounting policies, changes in accounting estimates and errors', HKAS 10, ' Events after the balance sheet date', HKAS 18, 'Revenue' and HKAS 34, 'Interim financial reporting' which are not addressed above. These amendments are unlikely to have an impact on the Group's financial statements and have therefore not been analysed in detail.

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

The following interpretations and amendments to existing standards have been published and are mandatory for the Group's accounting periods beginning on or after 1 January 2009 or later periods but are not relevant for the Group's operations:

- HKAS 32 (Amendment), "Financial instruments: Presentation", and HKAS 1 (Amendment), 'Presentation of financial statements' 'Puttable financial instruments and obligations arising on liquidation' (effective from 1 January 2009).

- HKAS 39 (Amendment) 'Financial Instruments: Recognition and Measurement' – 'Eligible hedged items' (effective from 1 July 2009).

- HKFRS 1 (Amendment), "First time adoption of HKFRS" and HKAS 27 "Consolidated and separate financial statements" (effective from 1 January 2009).

- HK(IFRIC) – Int 13, "Customer loyalty programmes" (effective for annual periods beginning on or after 1 July 2008).

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

2.1 Basis of preparation *(Continued)*

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

- HK(IFRIC) – Int 15, "Agreements for construction of real estates' (effective from 1 January 2009).

- HK(IFRIC) – Int 16, "Hedges of a net investment in a foreign operation" (effective from 1 October 2008).

- HK(IFRIC) – Int 17, "Distributions of non-cash assets to owners" (effective from 1 July 2009).

- HKICPA's improvements to HKFRS published in October 2008.

  – HKAS 16 (Amendment), 'Property, plant and equipment' (and consequential amendment to HKAS 7, 'Statement of cash flows') (effective from 1 January 2009).

  – HKAS 20 (Amendment), 'Accounting for government grants and disclosure of government assistance' (effective from 1 January 2009).

  – HKAS 27 (Amendment), 'Consolidated and separate financial statements' (effective from 1 January 2009).

  – HKAS 28 (Amendment), 'Investments in associates' (and consequential amendments to HKAS 32, 'Financial Instruments: Presentation' and HKFRS 7, 'Financial instruments: Disclosures') (effective from 1 January 2009).

  – HKAS 29 (Amendment), 'Financial reporting in hyperinflationary economies' (effective from 1 January 2009).

  – HKAS 31 (Amendment), 'Interests in joint ventures (and consequential amendments to HKAS 32 and HKFRS 7) (effective from 1 January 2009).

  – HKAS 38 (Amendment), 'Intangible assets' (effective from 1 January 2009).

  – HKAS 40 (Amendment), 'Investment property' (and consequential amendments to HKAS 16) (effective from 1 January 2009).

  – HKAS 41 (Amendment), 'Agriculture' (effective from 1 January 2009).

  – The minor amendments to HKAS 20 'Accounting for government grants and disclosure of government assistance', HKAS 29, 'Financial reporting in hyperinflationary economies', HKAS 40, 'Investment property' and HKAS 41, 'Agriculture', which have not been addressed above.

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

2.2 Consolidation

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

(a) 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. 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.

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 consolidated income statement.

Inter-company transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated. Accounting policies of subsidiaries have been changed where necessary in the consolidated financial statements 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 Renminbi ("RMB"), which is the Company's functional and the Group's presentation currency.

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

2.4 Foreign currency translation *(Continued)*

(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 consolidated 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.

2.6 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.

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.

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 consolidated 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
Furniture and fixtures	5–8 years
Vehicles	5–8 years

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

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

2.6 Property, plant and equipment *(Continued)*

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.

2.7 Impairment of investment in subsidiaries and non-financial assets

Assets that have an indefinite useful life 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 an impairment are reviewed for possible reversal of the impairment at each reporting date.

2.8 Financial Assets

(a) *Classification*

The Group classifies its financial assets under 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. The Group's loans and receivables comprise "trade and other receivables", "short-term bank deposits" and "cash and cash equivalents" in the balance sheet (Notes 2.10 and 2.11).

(b) *Recognition and measurement*

Regular way 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 in impaired. Impairment testing of trade receivables is described in Note 2.10.

2.9 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 and marketing expenses.

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

2.10 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 consolidated income statement within "administrative expenses". When a receivable is uncollectible, it is written off against the allowance account for receivables. Subsequent recoveries of amounts previously written off are credited against administrative expense in the income statement.

2.11 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.

2.12 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.

2.13 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.

2.14 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 consolidated 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.

2.15 Current and deferred income tax

The tax expense for the period comprises current and deferred tax. Tax is recognised in the consolidated income statement, except to the extent that it relates to items recognised directly in equity. In this case, the tax is also recognised in equity.

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. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

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

2.15 Current and deferred income tax *(Continued)*

Deferred income tax is recognised, 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, the deferred income tax is not accounted for if it 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. 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.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

2.16 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, Jiangsu Provincial and Inner Mongolia Autonomous Regional governments. The Shandong Provincial, Shaanxi Provincial, Jiangsu 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 under which the entity receives services from employees as consideration for instruments (option) of the Group. 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. The total amount expensed is recognised over the vesting period, which is the period over which all of the specified vesting conditions are to be satisfied. 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.

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

2.16 Employee benefits *(Continued)*

(b) Share-based compensation (Continued)

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.

2.17 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.

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.

2.18 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 consolidated 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 consolidated income statement over the periods and in the proportions in which depreciation on these assets is charged.

2.19 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.

2.20 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.

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

2.20 Revenue recognition *(Continued)*

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.

2.21 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 consolidated income statement on a straight-line basis over the period of the lease.

2.22 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.

2.23 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 directors do not consider the exposure to foreign exchange risk is significant to the Group's operation as the Group mainly operates in the PRC with most of the transactions denominated and settled in RMB. Therefore, the Group has not used any derivatives to hedge its exposure to foreign exchange risk for the year ended 31 December 2008.

However, foreign currencies, mainly US$, are however received from sales of products to countries or areas outside PRC ("Export Sales"). Foreign currencies received from Export Sales is approximately 16% (2007: 8%) of the Group's total turnover for the year ended 31 December 2008. The Group manages the currency risk arising from sales of products by customers paying in advance or keeping the credit period available to customers as short as possible in order to reduce the effect on the fluctuation between US$ and RMB.

Since the listing of the Company's shares in the Main Board of the Stock Exchange of Hong Kong Limited in early 2007, the Group received listing proceeds denominated in HK$. The listing proceeds were mainly used for the expansion of the Group in the PRC. The Group manages foreign exchange risk arising from listing proceeds by remitting the necessary funds to PRC and translate into RMB as soon as practicable in order to reduce the effect on the fluctuation between HK$ 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 strengthened/weakened 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 2008					
Financial assets					
Cash and cash equivalents	224,706	(1,122)	(1,122)	1,122	1,122
Trade and other receivables	534,882	(6,355)	(6,355)	6,355	6,355
Total (decrease)/ increase		(7,477)	(7,477)	7,477	7,477
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

(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. A portion of current borrowings bear variable rates and expose the Group to cash flow interest-rate risk.

Fair value interest rate risk arises from long-term borrowings, which bear fixed interest rates. The carrying amounts and fair values of the non-current borrowings 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 2008.

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	**Profity**	**Equity**	**Profit**	**Equity**
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
31 December 2008					
Financial liabilities					
Borrowings bear variable rates	158,000	545	545	(545)	(545)
31 December 2007					
Financial liabilities					
Borrowings bear variable rates	80,000	194	194	(194)	(194)

(b) Credit risk

The Group has no significant concentrations of credit risk. The carrying amounts of cash and cash equivalents, short term bank deposits, 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 put 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. Credit quality of the financial assets is disclosed in Note 10.

(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.

3. Financial risk management *(Continued)*

3.1 Financial risk factors *(Continued)*

(c) Liquidity risk (continued)

The table below analyses the Group's financial liabilities into relevant maturity groupings based on the remaining period at the balance sheet 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.

	Less than 1 year *RMB'000*	Between 1 and 2 years *RMB'000*
The Group		
At 31 December 2008		
Borrowings	276,000	312,000
Interests payments on bank borrowings (i)	8,711	34,873
Trade and other payables	734,648	–
Total	1,019,359	346,873
At 31 December 2007		
Borrowings	318,000	312,000
Interests payments on bank borrowings (i)	7,997	33,226
Trade and other payables	638,795	–
Total	964,792	345,226

(i) The interests on borrowings are calculated based on borrowings held as at 31 December 2008 and 2007 without taking into account of future issues. Floating-rate interests are estimated using current interest rate as at 31 December 2008 and 2007 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 is equal to total borrowings at the end of the year divided by total assets at the end of the corresponding year.

3. Financial risk management *(Continued)*

3.2 Capital risk management *(Continued)*

The strategy of the Group is to maintain a gearing ratio between 20% and 40%. The gearing ratio at 31 December 2008 and 2007 were as following:

	2008	2007
	RMB'000	*RMB'000*
Total borrowings *(Note 19)*	**588,000**	630,000
Total assets	**3,262,465**	2,881,835
Gearing ratio	**18.02%**	21.86%

The decrease in the gearing ratio for the year ended 31 December 2008 resulted primarily from repayment of bank borrowings.

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 is determined by using valuation techniques. The Group mainly uses discounted cash flow methods and makes assumptions that are based on market conditions existing at each balance sheet date.

The carrying value less impairment provision of trade and other receivables, cash and cash equivalents and short-term bank deposits are assumed to approximate 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.

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.

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

(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 some 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.

Deferred tax assets relating to certain temporary differences and tax losses 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.

(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. In addition, 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.

5. Segment 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. Revenue for the years ended 31 December 2008 and 2007 are analysed as follows:

	2008 RMB'000	2007 RMB'000
Glutamic acid	1,053,298	1,049,470
MSG	1,004,381	550,825
Corn refined products	509,849	381,186
Xanthan gum	451,739	149,486
Fertilisers	380,097	236,492
Starch sweeteners	163,002	78,193
Others	22,977	–
	3,585,343	2,445,652

As at 31 December 2008, the Group is organised into two main business segments: MSG (which includes the sales of glutamic acid, MSG, corn refined products, fertilisers, starch sweeteners, corn oil, pharmaceuticals and bricks) and xanthan gum. There are no significant sales or other transactions between the business segments.

The segment results for the year ended 31 December 2008 are as follows:

	MSG RMB'000	Xanthan gum RMB'000	Unallocated RMB'000	Group RMB'000
Revenue	3,133,604	451,739	–	3,585,343
Segment results	273,363	130,574	(49,499)	354,438
Negative goodwill gained from acquisition *(Note 32)*				9,657
Waiver of payables due to debt restructuring for a newly acquired subsidiary *(Note 21)*				3,947
Finance costs *(Note 25)*				(42,662)
Profit before income tax				325,380
Income tax expense *(Note 26)*				(30,674)
Profit for the year				294,706

5. Segment information *(Continued)*

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

	MSG *RMB'000*	Xanthan gum *RMB'000*	Unallocated *RMB'000*	Group *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 *(Note 25)*				(45,202)
Profit before income tax				45,485
Income tax expense *(Note 26)*				(416)
Profit for the year				45,069

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

	MSG *RMB'000*	**Xanthan gum** *RMB'000*	**Unallocated** *RMB'000*	**Group** *RMB'000*
Year ended 31 December 2008				
Depreciation *(Note 7)*	**124,702**	**27,277**	**562**	**152,541**
Amortisation of leasehold land payments *(Note 6)*	**2,004**	**228**	**–**	**2,232**
Write-down of inventories *(Note 12)*	**1,338**	**–**	**–**	**1,338**
Impairment provision for property, plant and equipment *(Note 7)*	**2,008**	**–**	**–**	**2,008**
Loss on disposal of property, plant and equipment *(Note 29)*	**456**	**–**	**–**	**456**
Year ended 31 December 2007				
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 disposal of property, plant and equipment *(Note 29)*	283	–	–	283

5. Segment information *(Continued)*

Inter-segment transfers or transactions are entered into under terms and conditions that would also be available to unrelated third parties.

The segment assets and liabilities at 31 December 2008 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	**2,560,470**	**626,257**	**75,738**	**3,262,465**
Liabilities	**1,111,634**	**406,634**	**2,683**	**1,520,951**
Capital expenditure *(Notes 6 and 7)*	**354,934**	**223,942**	**10**	**578,886**

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 *(Notes 6 and 7)*	363,354	139,557	–	502,911

Segment assets consist primarily of property, plant and equipment, inventories, trade and other receivables, 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 for the Group as a whole.

Segment liabilities comprise operating liabilities.

Capital expenditure comprises additions to property, plant and equipment (Note 7) and to leasehold land payments (Note 6), including additions resulting from acquisition through business combination.

Geographical segment information is presented as secondary segment reporting as follows:

	2008 *RMB'000*	2007 *RMB'000*
Sales		
Mainland China	**3,019,907**	2,241,699
Hong Kong and overseas	**565,436**	203,953
	3,585,343	2,445,652

5. Segment information *(Continued)*

The overseas countries mainly include United States, Korea, Vietnam, Oman, Egypt, Russia, etc.

Since all operating assets of the Group are located in the PRC, no further analysis of total assets and capital expenditure by geographical segments has been presented.

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, IM Fufeng and Shenhua Pharmaceutical, subsidiaries of the Group are located. Net book value are analysed as follows:

	2008	2007
	RMB'000	*RMB'000*
Outside Hong Kong, held on:		
Leases of between 10 to 50 years	**132,334**	63,070

As at 31 December 2008 and 2007, the net book value of leasehold land pledged as security for the Group's borrowings amounted to approximately RMB88,251,000 and RMB35,179,000 (Note 19), respectively.

	2008	2007
	RMB'000	*RMB'000*
Cost		
At beginning of the year	**70,426**	70,426
Additions	**63,447**	–
Acquisition of a subsidiary *(Note 32)*	**8,049**	–
At end of the year	**141,922**	70,426
Amortisation		
At beginning of the year	**(7,356)**	(5,508)
Charge for the year	**(2,232)**	(1,848)
At end of the year	**(9,588)**	(7,356)
Net book value		
At end of the year	**132,334**	63,070

7. Property, plant and equipment

The Group

	2008					
	Plant *RMB'000*	Machinery *RMB'000*	Furniture and fixtures *RMB'000*	Vehicles *RMB'000*	Construction in progress *RMB'000*	Total *RMB'000*
Cost						
At 1 January 2008	380,057	1,293,417	22,133	19,535	206,843	1,921,985
Additions	–	186,091	12,845	10,298	253,332	462,566
Acquisition of a subsidiary *(Note 32)*	25,693	17,668	199	396	868	44,824
Transfer upon completion	137,711	273,365	403	–	(411,479)	–
Disposals	(47)	(133,355)	(1)	(2,592)	–	(135,995)
At 31 December 2008	543,414	1,637,186	35,579	27,637	49,564	2,293,380
Accumulated depreciation						
At 1 January 2008	(26,911)	(204,544)	(6,592)	(9,917)	–	(247,964)
Charge for the year	(16,005)	(126,689)	(5,470)	(4,377)	–	(152,541)
Disposals	5	62,301	1	1,671	–	63,978
At 31 December 2008	(42,911)	(268,932)	(12,061)	(12,623)	–	(336,527)
Provision for impairment loss						
At 1 January 2008	–	–	–	–	–	–
Charge for the year	–	–	–	–	(2,008)	(2,008)
At 31 December 2008	–	–	–	–	(2,008)	(2,008)
Net book value						
At 31 December 2008	500,503	1,368,254	23,518	15,014	47,556	1,954,845

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

	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
Transfer upon completion	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

As at 31 December 2008 and 2007, the net book value of plant and machinery pledged as security for the Group's borrowings amounted to approximately RMB100,625,000 and RMB279,234,000, respectively (Note 19).

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

	2008	2007
	RMB'000	*RMB'000*
Cost of sales	**133,691**	104,021
Administrative expenses	**18,850**	12,926
	152,541	116,947

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

The Company

	2008 Furniture and fixtures *RMB'000*	2007 Furniture and fixtures *RMB'000*
Cost		
At beginning of the year	270	14
Additions	10	256
At end of the year	280	270
Accumulated depreciation		
At beginning of the year	(53)	(4)
Charge for the year	(93)	(49)
At end of the year	(146)	(53)
Net book value		
At end of the year	134	217

8. Investment in and loans to subsidiaries – The Company

	2008 *RMB'000*	2007 *RMB'000*
Investment in a subsidiary (a)	401,698	401,698
Loans to subsidiaries (b)	176,281	170,107
Due from subsidiaries (c)	578,886	565,506
Due to subsidiaries (d)	10,521	9,384

8. Investment in and loans to subsidiaries – The Company *(Continued)*

(a) Investment in a subsidiary

	2008	2007
	RMB'000	*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 2008 and 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 2008 and 2007.

(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 2008 and 2007.

(d) Due to subsidiaries

The amounts due to subsidiaries are unsecured, interest-free and repayable on demand, and their carrying amounts approximate their fair values as at 31 December 2008 and 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 RMB'000
Assets as per consolidated balance sheet	
31 December 2008	
Trade and other receivables *(Note 13)*	534,882
Short-term bank deposits *(Note 14)*	42,860
Cash and cash equivalents *(Note 14)*	224,706
Total	802,448
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

	Financial liabilities measured at amortised cost or at cost RMB'000
Liabilities as per consolidated balance sheet	
31 December 2008	
Trade, other payables and accruals	734,648
Borrowings *(Note 19)*	588,000
Total	1,322,648
31 December 2007	
Trade, other payables and accruals	638,795
Borrowings *(Note 19)*	630,000
Total	1,268,795

9. Financial instruments by category *(Continued)*

The Company

	Loans and receivables *RMB'000*
Assets as per balance sheet	
31 December 2008	
Loans to subsidiaries *(Note 8(b))*	176,281
Deposits and other receivables *(Note 13)*	2,118
Due from subsidiaries *(Note 8(c))*	578,886
Cash and cash equivalents *(Note 14)*	8,595
Total	765,880
31 December 2007	
Loan to a subsidiary *(Note 8(b))*	170,107
Deposits and other receivables *(Note 13)*	174
Due from subsidiaries *(Note 8(c))*	565,506
Cash and cash equivalents *(Note 14)*	82,783
Total	818,570

	Financial liabilities measured at cost *RMB'000*
Liabilities as per balance sheet	
31 December 2008	
Due to subsidiaries *(Note 8(d))*	10,521
Other payables and accruals *(Note 20)*	2,683
Total	13,204
31 December 2007	
Due to subsidiaries *(Note 8(d))*	9,384
Other payables and accruals *(Note 20)*	2,860
Total	12,244

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.

The Group

	2008 *RMB'000*	2007 *RMB'000*
Group 1	**449,736**	426,214
Group 2	**69,816**	67,164
Group 3	**4,622**	–
	524,174	493,378

Cash and bank balances

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 state-owned PRC bank. The management believes the state is able to support the state-owned PRC banks in the event of a crisis.

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

	2008 *RMB'000*	2007 *RMB'000*
Group 1	**11,139**	84,502
Group 2	**137,972**	129,341
Group 3	**116,432**	56,550
	265,543	270,393

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

The Company

	2008 RMB'000	2007 RMB'000
Group 1	8,594	82,783
Group 2	–	–
Group 3	–	–
	8,594	82,783

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 tax assets and liabilities relate to income taxed levied by the same taxation authority on either the taxable entity or different taxable entities where there is an intention to settle the balances on a net basis. The offset amounts are as follows:

	2008 RMB'000	2007 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	423	–
	423	6,390
Deferred tax liabilities:		
– Deferred income tax liability to be settled after more than 12 months	(10,883)	(898)
– Deferred income tax liability to be settled within 12 months	(45)	–
	(10,928)	(898)
Deferred income tax (liabilities)/assets, net	(10,505)	5,492

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

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

	2008 RMB'000	2007 RMB'000
Beginning balance of the year	**5,492**	(106)
Credited to the consolidated income statement *(Note 26)*	**(15,997)**	5,598
Ending balance of the year	**(10,505)**	5,492

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 RMB'000	Write-down of inventories RMB'000	Others RMB'000	Total RMB'000
1 January 2007	–	601	–	601
Transfer to income statement *(Note 26)*	6,390	(601)	–	5,789
31 December 2007	6,390	–	–	6,390
Transfer to income statement *(Note 26)*	(6,390)	–	423	(5,967)
31 December 2008	**–**	**–**	**423**	**423**

Deferred income tax assets are recognised for tax loss carry-forwards to the extent that the realisation of the related tax benefit through future taxable profits is probable. The Group reversed deferred income tax assets of RMB6,390,000 which was recognised as of year ended 2007 in respect of losses amounting to RMB25,558,000 that can be carried forward against future taxable income because it is now uncertain whether there will be sufficient profit to be net off in the near future. Total tax losses of RMB27,036,000 (2007: RMB25,558,000) were carried forward with losses amount to RMB25,558,000 (2007: RMB25,558,000) will expire in 2012, and losses amount to RMB1,478,000 (2007: nil) will expire in 2013.

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

Deferred tax liabilities:

	Interest capitalisation *RMB'000*	Withholding tax *RMB'000*	Total *RMB'000*
1 January 2007	707	–	707
Transfer to income statement *(Note 26)*	191	–	191
31 December 2007	898	–	898
Transfer to income statement *(Note 26)*	30	10,000	10,030
31 December 2008	**928**	**10,000**	**10,928**

Deferred income tax liabilities of RMB10,000,000 (2007: nil) have been recognised for the withholding tax that would be payable on the estimate of earnings of certain subsidiaries incorporated in PRC for 2008 that are expected to be distributed in the foreseeable future. As to the remaining earnings of the subsidiaries incorporated in PRC, the Group has no plan to distribute the respective retained earnings as at 31 December 2008. Unremitted earnings of the subsidiaries incorporated in PRC amounted to RMB315,117,000 as at 31 December 2008 (2007: RMB198,308,000).

12. Inventories – The Group

	2008 *RMB'000*	2007 *RMB'000*
Raw materials	**151,821**	92,972
Work-in-progress	**32,496**	33,274
Finished goods	**171,971**	200,105
	356,288	326,351

As at 31 December 2008, finished goods included a write-down of RMB3,188,000, composed of RMB1,554,000 made during the year ended 31 December 2008 (2007: nil) and RMB1,634,000 in the beginning balance of Shenhua Pharmaceuticals upon the acquisition by the Group. For the year ended 31 December 2008, the Group reversed RMB216,000 (2007: RMB4,005,000) of a previous inventory write-down as the Group sold part of the goods that were written down to third parties. The net amount of RMB1,338,000 was included in "cost of sales" in the income statement (Note 22 and 29).

13. Trade and other receivables

The Group

	2008 RMB'000	2007 RMB'000
Trade receivables (a)	**74,438**	67,164
Less: provision for impairment of receivables (b)	**(4,622)**	–
Trade receivables, net	**69,816**	67,164
Notes receivables (c)	**449,736**	426,214
Prepayments	**13,473**	12,695
Deposits and others	**15,330**	34,911
	548,355	540,984

(a) As at 31 December 2008 and 2007, the ageing analysis of trade receivables was as follows:

	2008 RMB'000	2007 RMB'000
Within 3 months	**61,761**	59,320
3–12 months	**8,055**	7,844
Over 12 months	**4,622**	–
	74,438	67,164

The Group sold its products to customers and received settlement either in cash or in form of bank acceptance notes (Note (c)) 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.

As at 31 December 2008, trade receivables of RMB3,507,000 (2007: RMB3,469,000) 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 that trade receivables that are less than twelve months past due are not impaired. The ageing analysis of these trade receivables was as follows:

	2008 RMB'000	2007 RMB'000
Past due within 12 months	**3,507**	3,469

13. Trade and other receivables *(Continued)*

(b) As of 31 December 2008, trade receivables of RMB4,622,000 (2007: nil) were impaired and fully provided for. The individually impaired receivables mainly relate to Shenhua Pharmaceuticals. It was assessed that none of these receivables is expected to be recovered. The ageing of these receivables is as follows:

	2008	2007
	RMB'000	*RMB'000*
Past due over 12 months	**4,622**	–

Movements on the Group's provision for impairment of trade receivables are as follows:

	2008	2007
	RMB'000	*RMB'000*
As at 1 January	**–**	–
Acquisition of Subsidiary	**5,546**	–
Reversal of amounts subsequently collected	**(924)**	–
As at 31 December	**4,622**	–

The creation and release of provision for impaired receivables have been included in "administrative expenses" in the consolidated income statement (Note 22).

(c) As at 31 December 2008, notes receivables were all bank acceptance notes aged less than six months, including amounts of RMB430,721,000 (2007: RMB334,299,000) applied for settling the amounts payable to the Group's suppliers.

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

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

	2008	2007
	RMB'000	*RMB'000*
– RMB	**484,807**	508,289
– US$	**63,548**	32,417
– EUR	**–**	278
	548,355	540,984

The Company

	2008	2007
	RMB'000	*RMB'000*
Deposits and other receivables	**2,118**	174

14. Cash and bank balances

The Group

	2008 RMB'000	2007 RMB'000
Cash and cash equivalents		
– Cash on hand	2,023	626
– Cash in bank	222,683	228,223
	224,706	228,849
Short-term bank deposits		
– Secured (a)	42,860	11,840
– Unsecured (b)	–	30,330
	42,860	42,170
	267,566	271,019
Cash and bank balances denominated in		
– RMB	256,342	180,172
– US$	123	132
– HK$	11,101	90,715
	267,566	271,019

(a) The short-term bank deposits as at 31 December 2008 included restricted bank deposits of RMB30,500,000 (2007: RMB10,000,000) pledged as security for issuing bank acceptance notes to suppliers, of RMB11,500,000 (2007: RMB1,500,000) pledged as security for borrowings, and of RMB860,000 (2007: RMB340,000) were pledged as security for issuing letters of credit and letters of guarantee;

(b) The short-term bank deposits as at 31 December 2007 included other short-term bank deposits of RMB30,330,000 with maturities over 3 months.

(c) 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.

(d) The weighted average effective interest rate on cash placed with banks and deposits were 0.86% and 1.60% per annum for the years ended 31 December 2008 and 2007, respectively.

14. Cash and bank balances *(Continued)*

The Company

	2008 *RMB'000*	2007 *RMB'000*
Cash and cash equivalents	**8,595**	82,783
Cash and bank balances denominated in		
– US$	**123**	132
– HK$	**8,472**	82,651
	8,595	82,783

The weighted average effective interest rate on cash placed with banks and deposits were 0.11% and 2.25% per annum for the years ended 31 December 2008 and 2007, respectively.

15. Share capital and premium

		Amount		
	Number of shares *(thousands)*	**Share capital** *RMB'000*	**Share premium** *RMB'000*	**Total** *RMB'000*
At 1 January 2007	1,200,000	123,372	278,326	401,698
Issuance of Shares for Listing, net of issuance cost (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
Dividends paid (b)	–	–	(13,529)	(13,529)
At 31 December 2008	**1,660,000**	**169,034**	**1,078,144**	**1,247,178**

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 2008 and 2007.

(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 *(Note (a))* RMB'000	Statutory reserves *(Note (b))* RMB'000	Share-based payment reserve *(Note (c))* RMB'000	Total RMB'000	Share-based payment reserve *(Note (c))* RMB'000
1 January 2007	(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
Profit appropriation	–	16,659	–	16,659	–
Employee share options scheme:					
– Value of employee services *(Note 23, 29)*	–	–	11,521	11,521	11,521
31 December 2008	**(370,760)**	**92,990**	**29,866**	**(247,904)**	**29,866**

(a) Capital reserve

It mainly represents reserve arising from the Group's reorganisation completed in July 2006.

(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.

16. Other reserves *(Continued)*

(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		

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

	2008		2007	
	Average exercise price in HK$ per share	**Options *(thousands)***	Average exercise price in HK$ per share	Options *(thousands)*
At 1 January	**2.23**	**93,600**	–	–
Granted	**2.23**	**–**	2.23	96,000
Lapsed	**2.23**	**(12,160)**	2.23	(2,400)
At 31 December	**2.23**	**81,440**	2.23	93,600

Out of the 81,440,000 options (2007: 93,600,000), 8,000,000 options were exercisable as at 31 December 2008 (2007: 4,000,000). No options was exercised in 2008 and 2007.

16. Other reserves *(Continued)*

(c) Employee share option scheme *(Continued)*

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

Expiry date	Exercise price	Number of options (thousands)	
	HK$ per share	2008	2007
7 August 2011	2.23	16,000	16,000
7 August 2012	2.23	65,440	77,600
		81,440	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 2008 was approximately RMB11,521,000 (2007: RMB18,345,000).

No option is being granted during the year ended 31 December 2008 and 2007 under the share option scheme which entitled the Company to grant options after the IPO.

17. Retained earnings/(Accumulated losses)

	The Group		The Company	
	2008	2007	**2008**	2007
	RMB'000	*RMB'000*	***RMB'000***	*RMB'000*
1 January	**464,193**	426,173	**(70,811)**	(5,801)
Profit/(Loss) for the year	**294,706**	45,069	**(51,725)**	(65,010)
Profit appropriation to statutory reserves	**(16,659)**	(7,049)	**–**	–
31 December	**742,240**	464,193	**(122,536)**	(70,811)

18. Deferred income – The Group

	2008	2007
	RMB'000	*RMB'000*
Deferred income	**34,490**	30,436
Less: Current portion included in current liabilities	**(6,692)**	(5,485)
	27,798	24,951

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 and Baoji Fufeng in the year ended 31 December 2008 respectively 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:

	2008	2007
	RMB'000	*RMB'000*
1 to 10 years	**5,528**	3,492
Less: Current portion included in current liabilities	**(1,222)**	(873)
	4,306	2,619

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

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

The movements of the above government grant during the years ended 31 December 2008 and 2007 are as follows:

	2008 *RMB'000*	2007 *RMB'000*
At beginning of the year	3,492	4,365
Granted during the year	3,142	–
Amortised as income *(Note 21)*	(1,106)	(873)
At end of the year	5,528	3,492

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

They represent grants from the 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:

	2008 *RMB'000*	2007 *RMB'000*
1 to 10 years	28,962	26,944
Less: Current portion included in current liabilities	(5,470)	(4,612)
	23,492	22,332

The movements of the above government grants for the year ended 31 December 2008 and 2007 are as follows:

	2008 *RMB'000*	2007 *RMB'000*
At beginning of the year	26,944	28,432
Granted during the year	14,275	10,981
Amortised as income *(Note 21)*	(12,257)	(12,469)
At end of the year	28,962	26,944

19. Borrowings – The Group

The Group

	2008 RMB'000	2007 RMB'000
Non-current		
Long-term bank borrowings, secured	232,000	242,000
Long-term bank borrowings, unsecured	80,000	70,000
	312,000	312,000
Current		
Short-term bank borrowings, secured	30,000	58,000
Short-term bank borrowings, unsecured	246,000	260,000
	276,000	318,000
Total Borrowings	588,000	630,000

As at 31 December 2008, all the borrowings were denominated in RMB and included bank borrowings of RMB262,000,000 (2007: RMB300,000,000) secured by leasehold land (Note 6), plant and machinery (Note 7) and short-term bank deposits (Note 14).

As at 31 December 2008 and 2007, the Group's borrowings were repayable as follows:

	2008 RMB'000	2007 RMB'000
Within 1 year	276,000	318,000
Between 1 and 2 years	312,000	312,000
	588,000	630,000

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

	2008 RMB'000	2007 RMB'000
Bank borrowings		
– RMB	6.59%	6.68%

19. Borrowings – The Group *(Continued)*

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

	Carrying amounts	
	2008	2007
	RMB'000	*RMB'000*
Bank borrowings	**312,000**	312,000

	Fair values	
	2008	2007
	RMB'000	*RMB'000*
Bank borrowings	**318,052**	307,800

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 5.40% per annum (2007: 7.56% per annum).

The carrying amounts of current borrowings approximate their fair values.

Interest rates of the bank borrowings denominated in RMB are reset 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:

	2008	2007
	RMB'000	*RMB'000*
6 months or less	**206,000**	308,000
6 to 12 months	**70,000**	10,000
1 to 2 years	**312,000**	312,000
	588,000	630,000

20. Trade, other payables and accruals

The Group

	2008 *RMB'000*	2007 *RMB'000*
Trade payables (a)	**506,894**	447,664
Notes payables (b)	**–**	8,950
Advances from customers (c)	**91,675**	89,650
Payables for leasehold land, property, plant and equipment	**224,737**	181,065
Other payables and accruals	**64,227**	43,481
	887,533	770,810

(a) As at 31 December 2008 and 2007, the ageing analysis of trade payables was as follows:

	2008 *RMB'000*	2007 *RMB'000*
Within 3 months	**480,613**	426,788
3 to 6 months	**12,144**	5,642
6 to 12 months	**3,123**	10,097
Over 12 months	**11,014**	5,137
	506,894	447,664

As at 31 December 2008, notes receivables of RMB430,721,000 (2007: RMB334,299,000) were applied for settling the amounts payable to the Group's suppliers.

(b) As at 31 December 2007, notes payables 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

	2008 *RMB'000*	2007 *RMB'000*
Other payables and accruals	**2,683**	2,860

21. Other income

	2008 RMB'000	2007 RMB'000
Interest income	2,152	8,325
Amortisation of deferred income	13,363	13,342
Sales of waste products	11,958	7,790
Negative goodwill gained from acquisition *(Note 32)*	9,657	–
Waiver of payables due to debt restructuring for a newly acquired subsidiary	3,947	–
Others	3,223	3,338
	44,300	32,795

22. Expense by nature

	2008 RMB'000	2007 RMB'000
Changes in inventories of finished goods and work in progress	30,590	(169,344)
Raw materials and consumables used	2,649,717	2,151,042
Employee benefit expenses *(Note 23)*	170,273	156,247
Depreciation *(Note 7)*	152,541	116,947
Amortisation of leasehold land payments *(Note 6)*	2,232	1,848
Impairment charges *(Note 7)*	2,008	–
Transportation expenses	143,761	90,801
Utilities purchased	10,511	11,361
Travelling and office expenses	12,476	7,608
Write-down/(Reversal of write-down) of inventories *(Note 12)*	1,338	(4,005)
Auditors' remuneration	3,838	3,085
Others	82,316	65,007
Total cost of sales, selling and marketing expenses, administrative expenses and other operating expenses	3,261,601	2,430,597

23. Employee benefit expenses including directors' emoluments

	2008 RMB'000	2007 RMB'000
Staff costs (including directors' emoluments)		
– Wages, salaries and allowance	150,639	126,019
– Pension costs-defined contribution plans *(Note (a))*	8,113	11,883
– Share options granted to directors and employees *(Note 16)*	11,521	18,345
	170,273	156,247

(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 20% of the employees' basic salary for Shandong Province, Shaanxi Province, Inner Mongolia Autonomous Region and Jiangsu Province, respectively, for the year ended 31 December 2008 and 2007.

(b) Directors' emoluments

The emoluments of every director for the years ended 31 December 2008 and 2007, on a named basis, are set out as below:

	2008			
Name of Director	**Fees** *RMB'000*	**Salaries, allowances and pension costs** *RMB'000*	**Fair value of employee share options granted** *RMB'000*	**Total** *RMB'000*
Executive Directors:				
Li, Xuechun	–	797	–	797
Wang, Longxiang	–	728	2,806	3,534
Wu, Xindong	–	388	–	388
Yan, Ruliang	–	375	–	375
Feng, Zhenquan	–	453	–	453
Xu, Guohua	–	445	–	445
Li, Deheng	–	454	–	454
Li, Hongyu	–	128	–	128
Gong, Qingli	–	258	2,176	2,434
Independent non-executive Directors:				
Choi, Tze Kit, Sammy	218	–	–	218
Chen, Ning	50	–	–	50
Liang, Wenjun	50	–	–	50
	318	4,026	4,982	9,326

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

(b) Directors' emoluments *(Continued)*

		2007		
Name of Director	Fees	Salaries, allowances and pension costs	Fair value of employee share options granted	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*
Executive Directors:				
Li, Xuechun	–	611	–	611
Wang, Longxiang	–	552	2,806	3,358
Wu, Xindong	–	318	–	318
Yan, Ruliang	–	271	–	271
Feng, Zhenquan	–	396	–	396
Xu, Guohua	–	321	–	321
Li, Deheng	–	325	–	325
Li, Hongyu	–	120	–	120
Gong, Qingli	–	250	4,735	4,985
Independent non-executive Directors:				
Choi, Tze Kit, Sammy	225	–	–	225
Chen, Ning	50	–	–	50
Liang, Wenjun	50	–	–	50
	325	3,164	7,541	11,030

There was no bonus paid to the directors of the Company for the years ended 31 December 2008 and 2007.

No director waived or agreed to waive any remuneration for the years ended 31 December 2008 and 2007.

(c) Five highest paid individuals

The five highest paid individuals consisted of:

	Number of individuals	
	2008	2007
Number of directors	**2**	2
Number of employees	**3**	3
	5	5

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

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

The five individuals whose emoluments were the highest in the Group for the year include two (2007: two) directors whose emoluments are reflected in the analysis presented above. The emoluments payable to the remaining three (2007: three) individuals during the year are as follows:

	2008 RMB'000	2007 RMB'000
Salaries and allowances	959	1,152
Pension costs-defined contribution plan	69	43
Share options granted to directors and employees	2,806	2,806
	3,834	4,001

For the years ended 31 December 2008 and 2007, 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 remunerations paid to the above non-director individuals for the year ended 31 December 2008 and 2007 fell within the following bands.

	Number of individuals	
	2008	2007
Emolument bands *(in HK dollar)*		
HK$1,000,001 – HK$1,500,000	1	3
HK$1,500,001 – HK$2,000,000	2	-

24. Research and development costs

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

	2008 RMB'000	2007 RMB'000
Research and non-capitalised development costs	22,418	4,014

All development costs arose from internal development.

25. Finance costs

	2008 RMB'000	2007 RMB'000
Interest expense:		
Bank borrowings wholly repayable within 2 years	**42,662**	47,375
Finance income – Net foreign exchange gains on financing activities	**–**	(2,173)
Net finance costs	**42,662**	45,202

26. Income tax expense

	2008 RMB'000	2007 RMB'000
Current income tax		
– PRC enterprise income tax ("EIT")	**14,677**	6,014
Deferred income tax *(Note 11)*	**15,997**	(5,598)
	30,674	416

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 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 2008 and 2007.

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 1 January 2008, the subsidiaries incorporated in PRC are required to determine and pay the EIT in accordance with the Corporate Income Tax Law of the People's Republic of China (the "New EIT Law") as approved by the National People's congress on 16 March 2007 and Detailed Implementations Regulations of the New EIT Law (the "DIR") as approved by the State Council on 6 December 2007. According to the New EIT Law and DIR, the income tax rates for both domestic and foreign investment enterprises have been unified at 25% effective from 1 January 2008. For enterprises which were established before the publication of the New EIT Law and were entitled to preferential treatments of reduced EIT rates granted by relevant tax authorities, the New EIT rate will be gradually increased from the preferential rates to 25% within 5 years after the effective date of the New EIT Law on 1 January 2008. For the regions that enjoy a reduced EIT rate at 15%, the tax rate would gradually increase to 18% for 2008, 20% for 2009, 22% for 2010, 24% for 2011 and 25% for 2012 according to the grandfathering rules stipulated in the DIR and related circular. Enterprises that are currently entitled to exemptions or reductions from the standard income tax rate for a fixed term may continue to enjoy such treatment until the fixed term expires.

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 rate for Shandong Fufeng for the years ended 31 December 2008 is 12.5% (2007: 15%).

26. Income tax expense *(Continued)*

Baoji Fufeng was set up on 24 September 2004 as a foreign-invested limited liability company in Baoji, Shaanxi Province. As Baoji Fufeng is registered in China's western development region and its registered category is encouraged by state, according to the Fiscal and Taxation (2001) No. 202 "The notice on the preferential tax policies of development of the western region issued by the Ministry of Finance, the State Administration of Taxation, General Administration of Customs", the applicable income tax rate is 15% from 2001 to 2010 for domestic and foreign invested enterprises set up in western region and encouraged by state. 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. Baoji Fufeng entered into its first profit making year during the year ended 31 December 2005. Accordingly, the effective tax rate for Baoji Fufeng for the years ended 31 December 2008 and 2007 is 7.5%.

IM Fufeng was set up as a foreign-invested limited liability company on 31 March 2006 in Hohhot, Inner Mongolia Autonomous Region. As IM Fufeng is registered in China's western development region and its registered category is encouraged by state, according to the Fiscal and Taxation (2001) No. 202 "The notice on the preferential tax policies of development of the western region issued by the Ministry of Finance, the State Administration of Taxation, General Administration of Customs", the applicable income tax rate is 15% from 2001 to 2010 for domestic and foreign invested enterprises set up in western region and encouraged by state. 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 31 December 2008 and 2007 is zero.

Shandong Fufeng Biotechnologies was set up as a domestic limited liability company on 7 June 2007 in Junan, Shandong Province. The effective tax rate is 25% for the year ended 31 December 2008 according to the New EIT Law, and 18% for the year ended 31 December 2007 as a small scale taxpayer.

Shenhua Pharmaceutical was acquired on 25 January 2008 and became a foreign-invested limited liability company after that. It is entitled to a two-year full exemption followed by a three-year 50% tax deduction from PRC state EIT, commencing from 2008. Accordingly, the effective tax rate for Shenhua Pharmaceutical for the year ended 31 December 2008 is zero.

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:

26. Income tax expense *(Continued)*

	2008 RMB'000	2007 RMB'000
Profit before income tax	**325,380**	45,485
Tax calculated at PRC statutory rate of 25% (2007:33%)	**81,345**	15,010
Effect of tax exemption	**(66,538)**	(10,861)
Effect of change of tax rate upon assessing deferred tax assets	**30**	(2,556)
Expenses not deductible for tax purposes	**1,010**	335
Income not subject to tax	**(1,563)**	(1,512)
Withholding tax on dividends from PRC subsidiaries *(Note 11)*	**10,000**	–
Reversal of deferred tax assets recognised in prior years	**6,390**	–
	30,674	416

27. Earnings per share

(a) Basic

Basic earnings per Share for the year ended 31 December 2008 and 2007 are calculated by dividing the profit attributable to Shareholders by the weighted average number of ordinary shares in issue during the year.

	2008	2007
Profit attributable to Shareholders (RMB'000)	**294,706**	45,069
Weighted average number of ordinary shares in issue (thousands)	**1,660,000**	1,610,027
Basic earnings per share (RMB cents per Share)	**17.75**	2.80

(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 2008 and 2007 did not exceed the exercise price 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

	2008 RMB'000	2007 RMB'000
Final, proposed *(Note (a))*	**146,293**	13,529

(a) At a meeting held on 16 March 2009, the Board proposed a final dividend of HK$166,000,000 (equivalent to RMB146,293,000) (2007: RMB13,529,000), representing HK10 cents (equivalent to RMB8.81 cents) (2007: HK0.91 cent (equivalent to 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 2009.

29. Notes to consolidated cash flow statement – The Group

(a) Cash generated from operations

	2008 RMB'000	2007 RMB'000
Profit before income tax	**325,380**	45,485
Adjustments for:		
– Write-down/(Reversal of write-down) of inventories *(Note 12)*	**1,338**	(4,005)
– Reversal of provision for accounts receivables *(Note 13)*	**(924)**	–
– Impairment provision for property, plant and equipment *(Note 7)*	**2,008**	–
– Depreciation *(Note 7)*	**152,541**	116,947
– Amortisation of leasehold land payments *(Note 6)*	**2,232**	1,848
– Amortisation of deferred income *(Note 18)*	**(13,363)**	(13,342)
– Loss on disposal of property, plant and equipment *(Note (b))*	**456**	283
– Negative goodwill gained from acquisition *(Note 32)*	**(9,657)**	–
– Employee share option scheme *(Note 23)*	**11,521**	18,345
– Interest income *(Note 21)*	**(2,152)**	(8,325)
– Interest income from IPO subscription deposits	**–**	(42,837)
– Interest expense *(Note 25)*	**42,662**	47,375
– Net foreign exchange gains on financing activities *(Note 25)*	**–**	(2,173)
Changes in working capital:		
– Inventories	**(27,416)**	(174,269)
– Trade and other receivables	**(18,243)**	(183,170)
– Restricted bank deposits	**(690)**	(18,670)
– Trade and other payables	**44,118**	235,188
Cash generated from operations	**509,811**	18,680

29. Notes to consolidated cash flow statement – The Group *(Continued)*

(b) Proceeds from disposal of property, plant and equipment

	2008 RMB'000	2007 RMB'000
Net book amount *(Note 7)*	72,017	283
Less: Net book value transfer to construction in progress	(67,337)	–
Net book amount for sale	4,680	283
Loss on disposal of property, plant and equipment	(456)	(283)
Proceeds from disposal of property, plant and equipment	4,224	–

30. Contingencies – Group

As at 31 December 2008 and 2007, the Group and the Company had no material contingent liabilities.

31. Commitments

The Group

Capital commitments

	2008 RMB'000	2007 RMB'000
Purchase of property, plant and equipment		
– Contracted but not yet incurred	12,958	22,011

Operating lease commitments – Group as lessee

The Group leases buildings under non-cancellable lease agreements. The Group's future aggregate minimum lease payments under these non-cancellable operating leases were as follows:

	2008 RMB'000	2007 RMB'000
No later than 1 year	166	–

The Company

As at 31 December 2008 and 2007, the Company had no material commitments.

32. Business combinations – Group

On 25 January 2008, the Group acquired 100% of the share capital of Shenhua Pharmaceutical, a company which operates in the bio-chemical field by applying fermentation technology on its production. The acquired business contributed revenues of RMB20,241,000 and net profit of RMB3,324,000 to the Group for the period from 25 January 2008 to 31 December 2008. These amounts have been calculated using the Group's accounting policies and by adjusting the results of the subsidiary to reflect the additional depreciation and amortisation that would have been charged taking into account the fair value adjustments to property, plant and equipment and intangible assets which had been applied from 25 January 2008, together with the consequential tax effects. For the acquisition, the Group has a negative goodwill of RMB9,657,000 which represents the excess of fair value of net assets acquired over the purchases consideration.

Details of net assets acquired and goodwill are as follows:

	2008 ***RMB'000***
Purchase consideration	
– Cash paid	**3,526**

The assets and liabilities as of 25 January 2008 arising from the acquisition were as follows:

	Fair value *RMB'000*	**Acquiree's carrying amount** *RMB'000*
Cash and cash equivalents	324	324
Leasehold land payments *(Note 6)*	8,049	1,212
Property, plant and equipment *(Note 7)*	44,824	44,688
Inventories	3,859	3,859
Trade and other receivables	4,919	4,919
Trade and other payables	(30,463)	(30,463)
Borrowings	(18,329)	(18,329)
Net assets	13,183	6,210
Negative Goodwill *(Note 21)*	(9,657)	
Total purchase consideration	3,526	
Purchase consideration settled in cash		3,526
Cash and cash equivalents in subsidiary acquired		(324)
Cash outflow on acquisition		3,202

33. Related party transactions and balances

The Group

Key management compensation

	2008 RMB'000	2007 RMB'000
Salaries and allowances	6,403	4,608
Pension costs-defined contribution plan	466	266
Share options granted to key management	8,658	10,656
	15,527	15,530

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.

34. Particulars of subsidiaries

As at 31 December 2008, the Company has direct and indirect interests in the following wholly-owned subsidiaries:

Name	Place of 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 Ltd. ("Profit Champion")	Hong Kong	HK$2	Investment holding
Full Profit Investment (Group) Ltd.	Hong Kong	HK$2	Investment holding
Trans-Asia Capital Resources Ltd.	Hong Kong	HK$2	Investment holding

34. Particulars of subsidiaries *(Continued)*

Name	Place of incorporation/ establishment	Registered/ Issued and fully paid capital	Principal activities
Shandong Fufeng	PRC	RMB200,000,000	Manufacture and sales of glutamic acid, monosodium glutamate, corn refined products, xanthan gum, fertilisers, starch sweetener and other related products in the PRC
Baoji Fufeng	PRC	HK$80,000,000	Manufacture and sales of glutamic acid, monosodium glutamate, corn refined products, fertilisers and other related products in the PRC
IM Fufeng (a)	PRC	HK$640,000,000	Manufacture and sales of glutamic acid, monosodium glutamate, corn refined products, fertilisers, starch sweetener and other related products, autoclaved aerated concrete block, in the PRC
Shandong Fufeng Biotechnologies	PRC	RMB5,500,000	Biological techniques research and development, promotion and industrialisation of new biological techniques and achievements, information services of biological technique, in the PRC
Shenhua Pharmaceutical (b)	PRC	RMB22,000,000	Manufacture and sales of eubacteria material medicine, preparations and food additives and other related products in the PRC

(a) The registered capital of IM Fufeng was gradually increased to HK$640,000,000 on 13 August 2008.

(b) On 25 January 2008, the Group acquired 100% equity interests in Shenhua Pharmaceutical through Shandong Fufeng and Profit Champion, wholly owned subsidiaries of the Company.

35. Events after the balance sheet date

There is no significant event of the Group after the balance sheet date except the proposed final dividend mentioned in Note 28.

Share Information

Stock Code	546
Board lot	2,000 shares

Price and turnover

2008	Share price **High** *(HK$)*	 **Low** *(HK$)*	 **Turnover** *(Thousand shares)*
January	0.92	0.58	118,774
February	0.67	0.59	15,426
March	0.67	0.49	20,448
April	0.62	0.49	37,260
May	0.71	0.50	54,627
June	0.68	0.55	19,328
July	0.68	0.49	26,102
August	0.69	0.52	33,285
September	0.58	0.40	17,238
October	0.47	0.21	21,118
November	0.37	0.28	13,578
December	0.50	0.33	30,528

Issued capital at 31 December 2008	1,660,000,000 shares
Closing price at 31 December 2008	HK$0.50 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 Company
Baoji Plant	the production plant of the Group located at 寶雞市 (Baoji City), Shaanxi Province, the PRC
Board	the board of Directors
CAGR	cumulative average growth rate
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
Directors	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	Hong Kong Financial Reporting Standards

Glossary

Hong Kong	the Hong Kong Special Administrative Region of the PRC
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 at Inner Mongolia Autonomous Region, the PRC
IPO	initial public offering of the Shares on 8 February 2007
Listing Date	8 February 2007, the date on which the Company was 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
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
Prospectus	the prospectus issued by Fufeng Group Limited dated 25 January 2007 in relation to the listing of the Company's shares on the Main Board of the Stock Exchange of Hong Kong Limited
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
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
Shandong Plant	the production plant of the Group located at 莒南縣 (Junan County), Shandong Province, the PRC
Shandong Old Plant	the production plant of the Group located at 莒南縣 (Junan County), Shandong Province, the PRC which closed the operation in December 2007

Glossary

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, and indirect wholly-owned subsidiary of the Company
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 the United States of America
EUR	Euro, the lawful currency of the participating states within the European Union
%	per cent