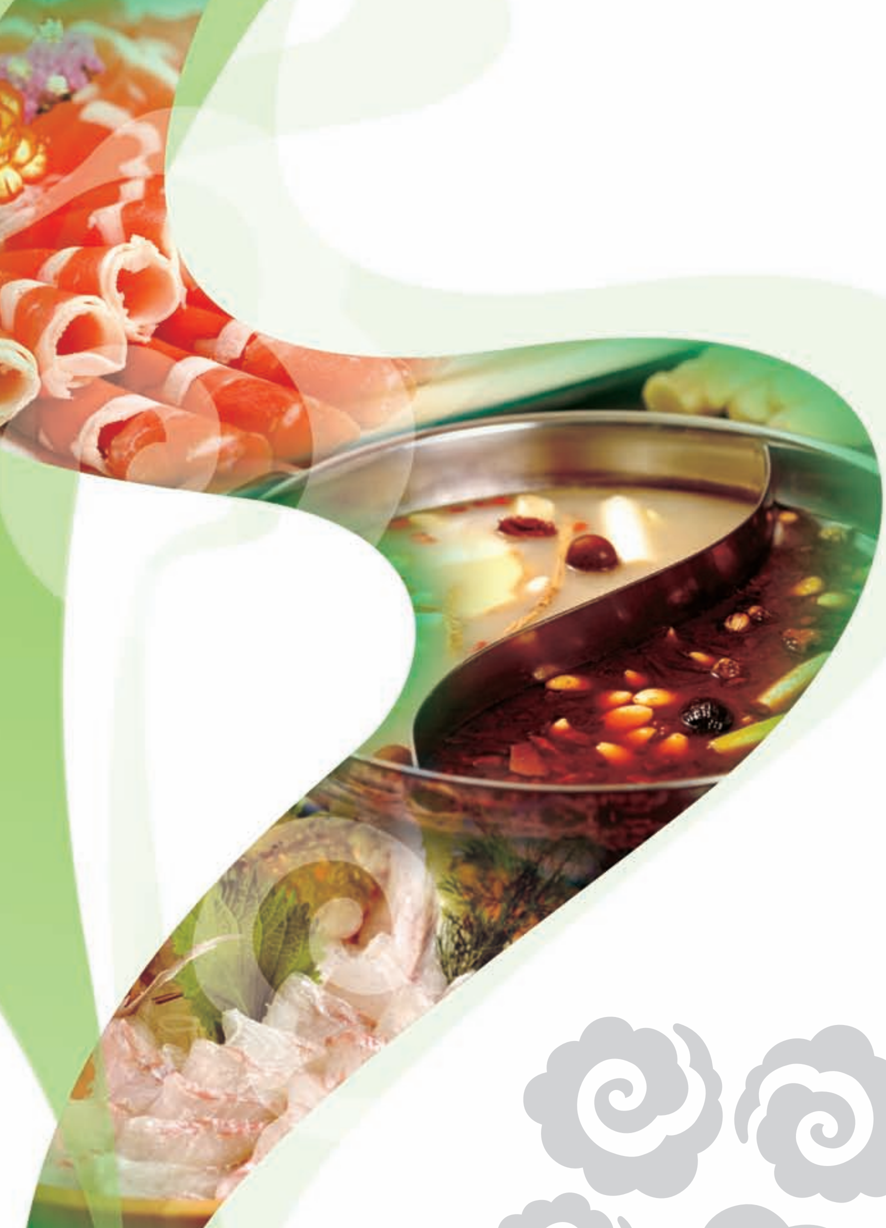
Little Sheep Group Limited
小肥羊集團有限公司

(Incorporated in the Cayman Islands with limited liability)
Stock Code : 968



LITTLE SHEEP 小肥羊

ANNUAL report 2008

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CORPORATE INFORMATION

BOARD OF DIRECTORS

Executive Directors

Mr. Zhang Gang *(Chairman)*
Mr. Lu Wenbing *(Chief Executive Officer)*
Mr. Yeung Yiu Keung
Mr. Wang Daizong
Mr. Zhang Zhanhai
Ms. Kou Zhifang
Ms. Li Baofang

Non-executive Directors

Mr. Chen Hongkai
Mr. Nishpank Rameshbabu Kankiwala

Independent non-executive Directors

Dr. Xiang Bing
Mr. Yeung Ka Keung
Mr. Shin Yick, Fabian

AUDIT COMMITTEE

Mr. Yeung Ka Keung *(Chairman)*
Mr. Shin Yick, Fabian
Dr. Xiang Bing

REMUNERATION COMMITTEE

Dr. Xiang Bing *(Chairman)*
Mr. Zhang Gang
Mr. Lu Wenbing
Mr. Shin Yick, Fabian
Mr. Yeung Ka Keung

NOMINATION COMMITTEE

Mr. Shin Yick, Fabian *(Chairman)*
Mr. Zhang Gang
Mr. Yeung Yiu Keung
Mr. Yeung Ka Keung
Dr. Xiang Bing

AUTHORIZED REPRESENTATIVES

Mr. Wang Daizong
Mr. Lee Kwok Wa

COMPANY SECRETARY

Mr. Lee Kwok Wa, *FCCA, solicitor of HKSAR*

REGISTERED OFFICE

Cricket Square
Hutchins Drive
P.O. Box 2681
Grand Cayman KY1-1111
Cayman Islands

PRINCIPAL PLACE OF BUSINESS IN HONG KONG

Unit 1104
11/F, Jubilee Centre
42–46 Gloucester Road
Wanchai
Hong Kong

COMPANY'S HEAD OFFICE

No. 8 Qingnian Road
Kundulun District
Baotou
Inner Mongolia, PRC

PRINCIPAL SHARE REGISTRAR

Butterfield Fund Services (Cayman) Limited
Butterfield House
68 Fort Street
P.O. Box 705
Grand Cayman KY1-1107
Cayman Islands

HONG KONG BRANCH SHARE REGISTRAR AND TRANSFER OFFICE

Tricor Investor Services Limited
26/F, Tesbury Centre
28 Queen's Road East
Wanchai, Hong Kong

PRINCIPAL BANKERS

Agricultural Bank of China, Kunqu branch
Bank of Communications, Wantong branch
China Merchants Bank, Huhhot Branch

COMPLIANCE ADVISER

N M Rothschild & Sons (Hong Kong) Limited

AUDITORS

Ernst & Young
Certified Public Accountants

STOCK CODE

968

COMPANY WEBSITE

www.LittleSheep.com

FINANCIAL AND OPERATIONAL HIGHLIGHTS

	For the year ended 31 December **2008** **RMB'000**	2007 RMB'000	% Change Increase/ (Decrease)
Financial Highlights			
Consolidated revenue	**1,271,523**	949,174	34.0%
Sales from restaurant operations	**1,010,690**	750,867	34.6%
Consolidated profit before tax	**165,328**	129,369	27.8%
Profit attributable to shareholders	**128,698**	91,163	41.2%
Basic earnings per share (RMB cents)	**13.55**	10.69	26.8%
Proposed final dividend per share (HK cents)	**7.6**	N/A	N/A
Operational Highlights			
Same store sales growth	**10.0%**	3.3%	
Average per capita customer spending (RMB)	**53.93**	51.16	5.4%
Utilization rate	**1.35**	1.40	(3.6)%

	Number of Restaurants			
	As of 31 December 2008		As of 31 December 2007	
Region and Province/City	**Company-owned**	**Franchise**	Company-owned	Franchise
Northern PRC	**32**	**110**	20	114
Eastern PRC	**44**	**54**	32	49
Southern PRC	**29**	**22**	20	24
Northeastern PRC	**5**	**5**	4	8
Northwestern PRC	**11**	**46**	5	44
Special Administrative Regions	**5**	**—**	5	—
Overseas	**1**	**11**	4	8
Other	**—**	**—**	—	10
Total	**127**	**248**	90	257

	31 December 2008	31 December 2007
Liquidity and Gearing		
Current ratio[(1)]	**3.30**	1.49
Quick ratio[(2)]	**2.43**	0.97
Gearing ratio[(3)]	**—**	0.37

Notes:

(1) Current ratio is calculated as current assets divided by current liabilities.

(2) Quick ratio is calculated as current assets less inventories divided by current liabilities.

(3) Gearing ratio is calculated as total debts (interest-bearing bank borrowings and convertible bonds) divided by total assets.

CHAIRMAN'S STATEMENT

ZHANG Gang
Chairman

Dear shareholders,

It is my great pleasure to present you the first annual results of Little Sheep Group Limited ("the Company" or "Little Sheep", together with its subsidiaries, the "Group") since the Company's listing on The Stock Exchange of Hong Kong Limited (the "Stock Exchange"). 2008 was a meaningful year for Little Sheep, which marked the Company's official presence in the equity market, the most strategic move in the Company's history. At the same time, there were cataclysmic changes in the macro economies during the year, ranging from operating pressures brought by natural disasters and increasing prices of raw materials in the first half of the year to contraction of global economy and declining consumer confidence caused by the financial crisis in the second half. These adverse factors placed great challenges to every industry. However, leveraging on our distinguished business model, strong frontline and back office operations, highly competitive brand reputation, as well as our further consolidated financial strength after the listing, the Company's businesses had developed steadily and substantially throughout the year under review.

The Company achieved outstanding performances in 2008. During the year, we had opened a total of 33 company-owned restaurants and 41 franchise restaurants, being the record highs in terms of restaurants opened in a single year since the Company was established. Meanwhile, our diversified marketing strategies were paying off. Same store sales growth reached 10.0% during the year. Generally speaking, the performances throughout the year were outstanding. Revenue and the profit attributable to the shareholders of the Company for the year ended 31 December 2008 were RMB1,271.5 million and RMB128.7 million respectively, increasing by 34.0% and 41.2% respectively when compared with 2007. In view of the outstanding financial results of the year, the board of directors (the "Directors") of the Company (the "Board") resolved to declare a final dividend of HK cents 7.6 per share.

During the year, we launched a management programme named "Project Leader Sheep" which centralised the openings of new restaurant and management of restaurant operations across regions. We also set up a special team to

strengthen the research and development capacity in new products. In respect of franchise restaurants, we continued to implement the new franchise fee payment structure and reinforced our management and support towards the operations of franchise restaurants. More than 70 franchisees had agreed to adopt the new fee payment structure, which in turn had largely increased the quality and stability of our franchise income.

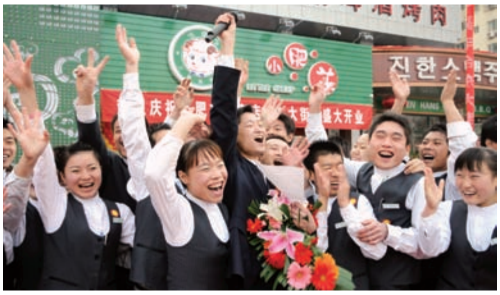
Meanwhile, we proactively enhanced the capacity of our back office in order to keep pace with the rapid growth of frontline operations. An integrated information platform was established through successful upgrade of the information management system and the completion of switching of systems between finance and supply chains. As a result, we are able to centralise and unify data. With regard to human resources, we further improved our corporate organization structure and remuneration system, and strengthened our staff training. We also set up "Little Sheep Management Associate Training Base" in December 2008, which served to provide constant and professional training for staff improvement and develop strong human resources support for the Company's rapid and sustainable development. During the year, we had put vigorous efforts into enhancing our corporate profile, and further consolidated and strengthened the Little Sheep brand by launching marketing campaigns that continued to improve over time with different cooperative vehicles.

Looking forward to 2009, unfavourable factors such as the deepening financial crisis, weak global economy, uncertain outlook and weakened employment market will severely undermine consumer's confidence and sentiment. However, given the relatively solid foundation of China's economy, it is expected that China's economic stimulus policies and measures to boost domestic demand will provide great support to the steady growth of its economy and consumption as well as the development of the catering industry. Therefore, we remain cautiously optimistic about our prospects.

The Company will expand its restaurant network in a prudent manner by establishing approximately 40 new company-owned restaurants nationwide, with the aim to further expand the domestic market. We will also develop innovative signature dishes and products to keep our menu refreshing and attractive. In addition, the Company will elevate its brand competitiveness by intensifying brand promotion and further raising its corporate profile. In short, we are committed to retaining existing customers and attracting new customers through various measures.

On the other hand, we will continue to strengthen management and put additional focus on corporate reform. We will improve our operating procedures by evolving around "Project Leader Sheep", expanding information technology application in back office, optimizing corporate structure and implementing continuous performance evaluation, so as to achieve enhanced management, centralization of resources and increased efficiency. Our goal is to boost the overall competitiveness of Little Sheep and strive to maintain stable operation in the face of various challenges. At the same time, we will keep an eye on opportunities created in the current economic downturn and closely watch and identify merger and acquisition opportunities that can create value to the Company, with the aim of expanding business operations and increasing long-term profits and returns.

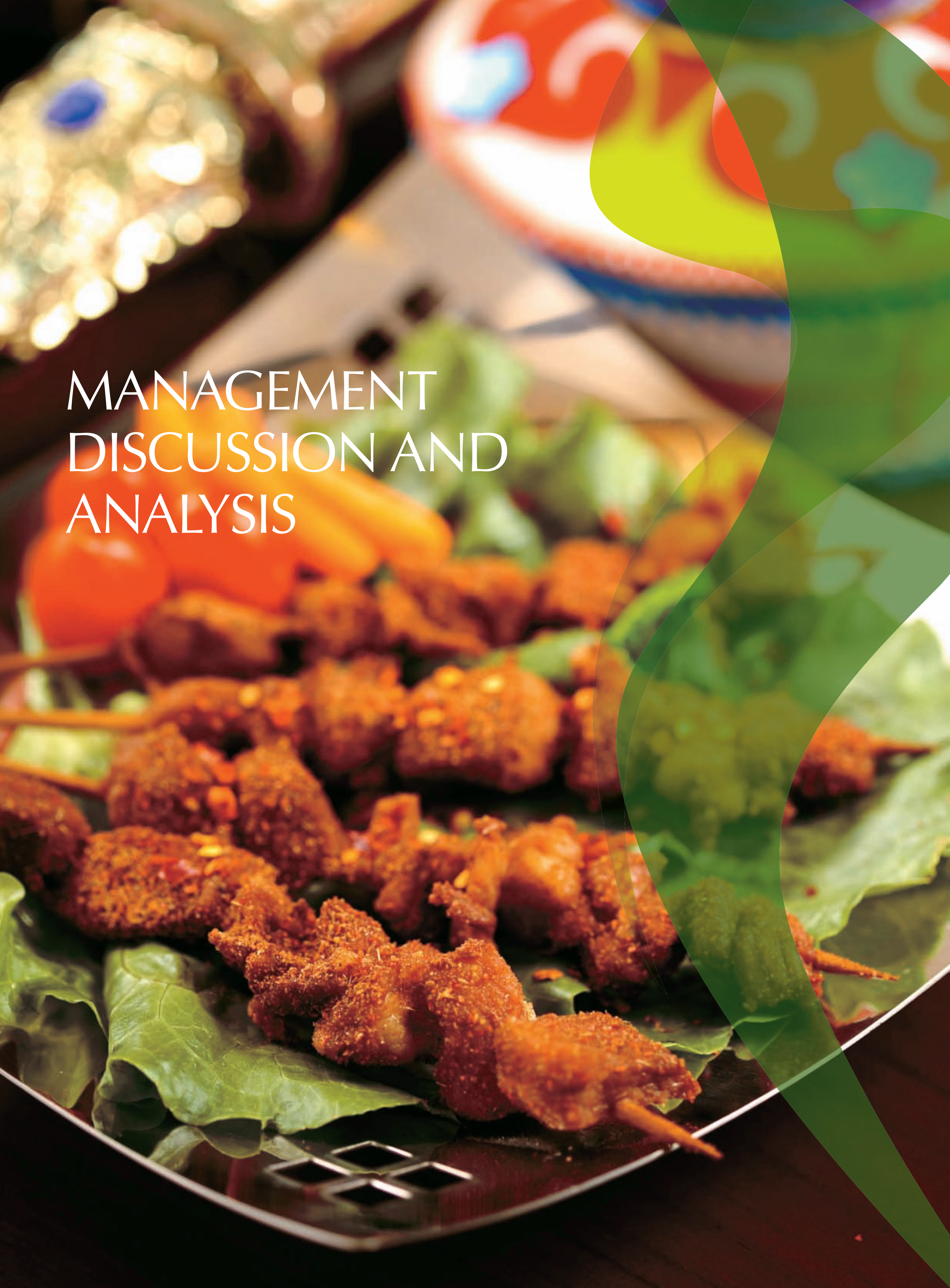
The year of 2009 marks the tenth anniversary of the Company. The above measures will continue to improve our frontline and back office operations, lay a solid foundation for our development for the next decade and invigorate the Company to create more breakthroughs in the future. On behalf of the Board, I would like to thank our customers, shareholders and business partners for their trust and support. I would also like to express my gratitude to the Directors and the management for their well-planned strategies and to all of our staff for their devoted services in the past year. We will work with determination and great effort in a bid to attain success and open a new chapter in the Company's development.



Zhang Gang
Chairman

Hong Kong, 16 March 2009

MANAGEMENT DISCUSSION AND ANALYSIS



MARKET REVIEW

2008 was a year full of challenges and opportunities. In the first three quarters of 2008, the Chinese economy expanded steadily. The improved living standards, urbanization, coupled with a considerable increase in household income and individual consumption power, had sparked a remarkable increase in consumer spending, and in particular, dining out has become one of the major activities in people's daily lives. This trend has created a favourable market environment for operators in China's catering industry. However, the financial crisis had slowed global economic growth in the fourth quarter. Although China's economy was not the most impacted, consumers have become relatively cautious as a result of the uncertain economic outlook.

The series of food safety issues in 2008 has raised concerns in the community and the government has strengthened its efforts in regulating unscrupulous caterers. As a result, consumers are now more aware of food safety. The middle class, in particular, who have higher consuming power and are more focused on quality of life, are more prone to opt for restaurants with trusted brands and vast scale. This provided prime opportunities to qualified catering operators.

BUSINESS REVIEW

Little Sheep specializes in Mongolian-style hot pot cuisine with a vertically integrated business model. We operate restaurants in China and overseas markets under the "Little Sheep" brand, and engage in the processing and sales of lamb and soup base products and the wholesale distribution of fresh and dried food products. Leveraging on its proprietary soup base and superior quality of its lamb meat, Little Sheep has grown to become a restaurant chain with the highest brand awareness in hot pot cuisine in China.

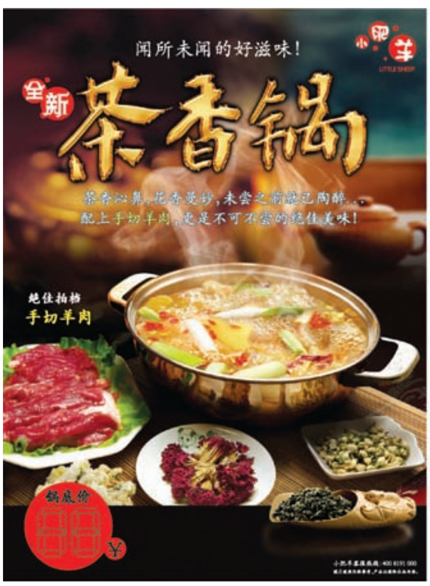
The Company achieved satisfactory performances with revenue and profit attributable to shareholders up by 34.0% and 41.2% year-on-year to RMB1,271.5 million and RMB128.7 million respectively during the year. We are devoted to enhancing modernised management and the operational efficiency of our restaurants. During the year, revenue from the restaurants operation segment increased by 34.6%, contributing to the favourable performance by the Company as a whole.

Flagship restaurant

Mainstream restaurant

Restaurant Operations

During the year, our company-owned restaurants achieved excellent results. Our revenue from restaurant operations recorded an increase of 34.6% to RMB1,010.7 million compared to the corresponding period last year. The growth was mainly attributable to the enhancement of our brand image, openings of new restaurants as well as continued improvement of our product mix. The launch of new menus such as "Cha-Xiang-Guo", a special hot pot with additions of teas and essence of flowers, were well received by our customers, which resulted in a booming consumption. During the year, the average customer spending increased by 5.4% and same store sales went up 10.0% from last year.



To enhance our brand image and promote our products, we had conducted a series of marketing and promotion campaigns during the year. From October to December in 2008, we ran marketing campaigns and advertisements to promote our new product "Cha-Xiang-Guo" on Mobile Media of CCTV and the railway transport media of Data Media Group (DMG), both of which covered a wide range of network across the major cities in China.

We set up 33 new company-owned restaurants during the year. These new restaurants are mainly located in first- and second-tier cities with better developed economy and higher spending power in Eastern and Southern China. With the adoption of fashionable interior design, they successfully attracted more customers and thus enhanced our restaurant business. In addition, we acquired ten highly qualified franchise restaurants during the year in order to improve the operating revenue of the Company. During the year, the Company closed down three company-owned restaurants and converted three company-owned restaurants in Japan to franchise restaurants. As of 31 December 2008, the Company had a total of 127 company-owned restaurants.

Community restaurant

Shopping mall unit

During the year, we proactively renovated our existing company-owned restaurants to build a unified image. Restaurants were divided into four categories by location and consuming capacity, namely, flagship restaurant, mainstream restaurant, community restaurant and shopping mall unit. Each category has its own unified interior design and new fashion elements were introduced into the design. All these contributed to a well-established image of the Company. Moreover, food and services from the four categories are differentiate to cater for various demands and consuming capacity, so as to expand our customer bases.

In line with our commitment towards offering diversity to the customers, we began to offer business lunch in four restaurants for trial in December 2008, aiming to increase our sales during lunch hour. We plan to expand the scope in Shanghai based on the operating results and customer's response in the first half of 2009. We target to expand the trial to all restaurants in China eventually so as to increase customer traffic and expand our source of revenue.

Since its listing in June 2008, Little Sheep has been committed to enhancing its operating efficiency. We have launched "Project Leader Sheep" during the year for the purpose of establishing a sophisticated and scientific operating and management system, as well as improving customer's level of satisfaction. The Company gave its support to each regional unit through the operating center in Shanghai in respect of resources and strategy. Our operating center in Shanghai has four major functions: operation management, expansion of restaurant network, marketing, and research and development (R&D) of products.

- Operational management — Integrate the information reporting structure and streamline the process, strengthen effort on information collection and analysis so as to better grasp the market trend and the ever changing consumption pattern and taste; identify and select potential partners of acquisition and cooperation, realizing synergy effect and solid development.

- Expansion of restaurant network — Standardise the approval process for opening new restaurants to realize scientific decision-making process; unify design and material specification; leverage on economy of scale and efficiency of centralized purchase to control the cost, meanwhile maintaining consistency of quality to create a comfortable environment for customers and improve their level of satisfaction.

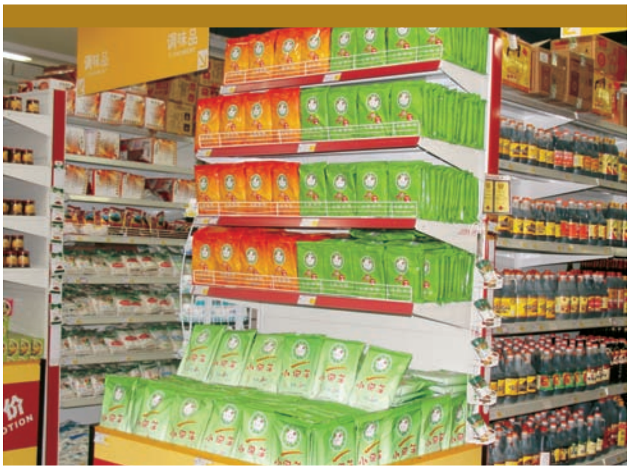
- Marketing — Launch marketing campaigns on a unified basis by formulating more comprehensive plans on the allocation of resources, advertisement design and media selection, etc.; leverage on the economy of scale of our national restaurant network to speed up the development of the Company as well as unify the brand image.

- R&D of products — Set up a new R&D department with more resources input to develop more new products tailored for the consumer taste based on market research.

Sale of food products

Little Sheep provides a range of fresh and dried food products including lamb, hot pot soup base and other seasonings to wholesale distributors nationwide for their retail sales in hypermarkets, supermarkets, and convenience stores. With increasing customer recognition of our products, and our enhanced wholesaling structure, we achieved remarkable sales in hot pot soup base and lamb products, the revenue from sales of food products increased by 40.7% year-on-year to RMB239.9 million during the year.

As the largest lamb processing company in the PRC, Little Sheep operates two lamb processing facilities in Inner Mongolia, both of which are equipped with modern lamb processing equipment and technology. During the year, the Company processed approximately 6,909 tons of lamb, up from about 5,158 tons in 2007, representing an increase of 33.9%.



Franchise restaurants

During the year, revenue from franchise operations reached RMB18.9 million, representing a year-on-year decrease of 28.4%. The drop was due to closure and acquisition of a number of franchise restaurants. The Company had implemented and consolidated the new franchise fee payment structure, adjusting the previous one-off franchise fee of fixed amount to a franchise fee based on a certain percentage of the total operating revenue. The Company believes the new payment structure may incur short term impacts, but will achieve better allocation of operating revenue, which in the long-run will boost the Company's

revenue from franchise operations, stimulate the enthusiasm of franchisees, raise the operating standards of franchise restaurants and provide customers with products and services of higher quality. During the year, more than 70 franchisees had agreed to adopt the new franchise fee payment structure. The Company aims to have the new scheme fully implemented by the end of 2010.

During the year, 41 new franchise restaurants were established, all of which adopted the new franchise fee payment structure. By the end of 31 December 2008, the Company operated a total of 248 franchise restaurants.

To further strengthen the management of franchise restaurants, the Company has further improved its code of practice for franchise restaurants. Meanwhile, a computer management system was also installed at franchise restaurants to collect and analyze operating and revenue information of franchise restaurants, which could allow us to monitor the latest sales performance.

Stringent control on food quality

With food quality as its top priority, the Company has established a food quality and safety supervising team to conduct stringent control on various operating procedures, including origin of production, plantation of raw materials, procurement and supply, storage, manufacturing, product sales, product protection, and food and beverage consumption, etc. In 2008, the Company continued to invest a substantial amount of resources in food safety test and plantation base construction, so as to ensure that our products meet the highest food safety standards.

Invited by the General Administration of Quality Supervision, Inspection and Quarantine of the People's Republic of China (國家質量監督檢驗檢疫總局) and the National Testing Center of Agricultural and Sideline Products and Condiments (國家農副產品及調味品檢測中心), the Company participated in the drafting of *National Standards for Seasonings of Hot Pot Soup Base* (《火鍋底料國家標準》) during the year. This reflects the public's recognition and appreciation of Little Sheep's efforts in food quality supervision.

BUSINESS OUTLOOK

Looking forward, the global economy in 2009 will continue to experience various uncertainties as a result of the current financial crisis. However, the Company believes that there are still considerable demands for the catering industry in China, as people dine out more frequently nowadays with the rapid emergence of the middle class over the past few years, and the government endeavours to stimulate domestic demand by various measures. Therefore, Little Sheep will concentrate its resources on continually expanding its restaurants network in a prudent manner by establishing about 40 new company-owned restaurants nationwide, aiming at further expanding the domestic market. Meanwhile, the Company will develop innovative signature dishes and products on a constant basis to cater to the market trend and the customer's taste. The Company will also elevate its brand competitiveness by intensifying brand promotion and further raising its corporate profile through various channels. In addition, the Company will continue to strengthen management and put additional focus on corporate reform. By carrying out the "Project Leader Sheep", the Company is committed to boosting the overall competitiveness of Little Sheep and seizing various opportunities in the market.

FINANCIAL REVIEW

Net revenue

During the year, our total revenue increased by 34.0% year-on-year to RMB1,271.5 million. The increase was primarily due to the significant increase in revenue from restaurant operations and sales of food products, which resulted from the higher customer consumption and product sales boosted by the opening of new shops, launch of new products coupled with the well-received brand image and promotion campaign.

Revenue from restaurant operations

Revenue from restaurant operations increased by 34.6% year-on-year to RMB1,010.7 million, primarily due to the contribution from newly opened restaurants as well as the growth in existing restaurants sales.

Revenue from sales of food products

Revenue from sales of food products increased by 40.7% year-on-year to RMB239.9 million, mainly due to increases in the sales volume of our soup base and lamb products.

Revenue from franchise operations

Revenue from franchise operations decreased by 28.4% year-on-year to RMB18.9 million. This was due to closure and the Group's acquisition of a number of franchise restaurants during the year.

Revenue from management service fee

Revenue from management service fee represents monthly fees that the Group receives for the provision of restaurant management services to franchisees. During the year, revenue from management service fee increased by 43.8% year-on-year to RMB2.1 million. This rise was due to adjustments of the rates of fees and the growth in the number of franchise restaurants managed by the Group.

Other income

Regarding the rest of the income, it represents income received from non-core operations, increased by 213.7% year-on-year to RMB30.0 million during the year. This was primarily attributed to the increases in government grants, gains on disposal of our restaurants in Japan and income from waiver of interest expenses on convertible bonds.

Cost of inventories sold

The cost of inventories sold increased by 39.1% year-on-year to RMB524.4 million. The growth was mainly attributed to the rise in sales volume and costs of raw materials.

Staff costs

Our staff costs increased by 55.1% year-on-year to RMB257.3 million, primarily due to the overall increase in salaries and other employee benefits, as well as the increase in headcount resulting from the opening of new restaurants and the improvement of productivity in sectors such as seasoning.

Depreciation and amortization

Depreciation and amortization amounted to RMB40.6 million, representing an increase of 26.5% year-on-year. Such increase was attributable to the overall increase in depreciation and amortization expenses resulting from an increase in the number of restaurants and the renovations undertaken at certain existing restaurants.

Rental expenses

Rental expenses increased by 23.4% year-on-year to RMB119.5 million, mainly due to the increase in the number of company-owned restaurants.

Fuel and utility expenses

Fuel and utility expenses increased by 33.1% year-on-year to RMB55.8 million, attributable to the increase in the number of company-owned restaurants.

Other operating expenses

Other operating expenses increased by 39.0% year-on-year to RMB131.9 million, mainly due to the increase in the number of company-owned restaurants.

Finance costs

Our finance costs during the year were RMB6.6 million, primarily attributable to interest expenses, while finance costs of RMB20.6 million were recorded for last year. Finance costs decreased significantly as convertible bonds had been converted into shares during the year, and bank loans from last year had been settled.

Tax

Our tax expenses decreased by 10.3% from the previous year to RMB30.8 million year-on-year, as a result of the decrease in corporate income tax rate from the original 33% to 25% in China. In addition, the consolidation of tax payments of the head office and its branches which has begun this year also helped the inter-tax deduction.

Profit for the year

Our profit for the year increased by 41.5% year-on-year to RMB134.5 million as a result of the cumulative effect of the foregoing factors.

Liquidity and Financial Resources

As at 31 December 2008, cash and bank balances stood at RMB424.0 million and net current assets were RMB474.8 million with a current ratio of 3.30. The strong cash position and relatively high current ratio was mainly due to inflow of proceeds from the initial public offering of the Company in June 2008.

As at 31 December 2008, total bank loans were RMB0.9 million which was an agricultural development loan made for our subsidiary Bayannur City Little Sheep Meat Co., Ltd. Out of which, RMB0.5 million was repayable within one year, and RMB0.4 million was repayable from the second year to the fifth year.

The annual interest rates on bank loans during the year varied from 2.40% to 5.91%, and the annual interest rates on long-term bank loans stood at 2.40%.

Regarding the foreign exchange fluctuations, during the year, the Group's revenue and business incomes and expenses were mainly denominated in Renminbi while those from our overseas company-owned restaurants outside mainland China were denominated in foreign currencies, including Hong Kong dollars. Although the Group's operation currently would not generate any significant foreign currency exposure, we will continue to take effective measures and monitor closely the foreign currency movement. As at 31 December 2008, the Group did not have any derivative instrument for hedging against foreign exchange risk.

Cash Flow

Net cash inflow from operating activities in 2008 were RMB142.1 million, attributable primarily to increased cash inflow from the Company's revenue.

Net cash outflow from investing activities in 2008 were RMB179.5 million, consisting primarily of investment in restaurants and bases of RMB86.6 million, acquisition of restaurants of RMB29.0 million and purchase of operation office premises of RMB62.4 million.

Net cash inflow from financing activities in 2008 were RMB261.5 million, consisting primarily of proceeds from listing of RMB430.7 million, repayments of bank loans of RMB92.5 million and payments of dividends of RMB91.1 million.

Capital Expenditures

Our capital expenditures for the whole year of 2008 were RMB154.6 million which were primarily related to the expenditures from the opening and refurbishment of company-owned restaurants, bases construction, information technology construction and purchase of office premises. Our planned capital expenditures for 2009 are approximately RMB170.3 million which will be funded by internal resources and proceeds from the initial public offering of the Company.

Human Resources

As at 31 December 2008, the Group had 9,106 employees. In order to attract and retain high quality talents to ensure smooth operation and cater for the Group's constant expansion, the Group offers competitive remuneration packages (with reference to market conditions and individual qualifications and experience) and various internal training courses. The remuneration packages are subject to review on a regular basis.

In addition, the Group also adopted a Pre-IPO share option scheme and a share option scheme, under which eligible employees are entitled to various share options to subscribe for the ordinary shares of the Company to reward their past and potential contributions to the growth of the Group.

For details of the share option schemes, please refer to the paragraph headed "Share Capital and Share Option Schemes" in the "Report of the Directors" section of this annual report.

The Board is committed to creating value and maximizing returns to the shareholders of the Company (the "Shareholders") while striving to maintain high standards of corporate governance. The Board will continue to review and enhance the quality of corporate goverance practices with reference to local and international standards.

The Company had, throughout the period from its listing on the Stock Exchange on 12 June 2008 (the "Listing Date") to 31 December 2008, adopted and complied with all applicable code provisions under the Code on Corporate Governance Practices ("CG Code") as set forth in Appendix 14 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules")

MODEL CODE FOR SECURITIES

The Company has adopted the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") as set forth in Appendix 10 to the Listing Rules as its own code of conduct for dealing in securities by the Directors of the Company. Based on specific enquiry with the Directors, all the Directors confirmed that they have complied with the required standards as set out in the Model Code throughout the period from the Listing Date to 31 December 2008.

BOARD OF DIRECTORS

The Board is responsible for formulating the Group's overall strategic policies, setting objectives for the management and monitoring the performance of the management.

The Board comprises twelve Directors, including seven Executive Directors, two Non-executive Directors and three Independent Non-executive Directors. The Non-executive Directors who have diverse business and professional backgrounds have brought in a wealth of experience and expertise that promote the best interests of the Group and the Shareholders.

The brief biographical details of the Directors are set out in the "Directors Profile" section on pages 33 to 36 of this annual report.

The Board has received from each of the Independent Non-executive Directors an annual confirmation of his independence and considers that all the Independent Non-executive Directors are independent under the guidelines set out in Rule 3.13 of the Listing Rules.

Under the Company's Articles of Association, one-third of the Directors must retire, thus becoming eligible for re-election at each annual general meeting. This year, Mr. Lu Wenbing, Mr. Zhang Zhanhai, Ms. Li Baofang and Mr. Chen Hongkai shall retire at the forthcoming annual general meeting. The retiring Directors, all being eligible, shall offer themselves for re-election. None of the Directors for re-election at the forthcoming annual general meeting has a service contract with any member of the Group which is not determinable by the relevant employer within one year without payment of compensation.

Each of the Executive Directors of the Company had entered into a service contract with the Company for an initial term of three years commencing from 15 May 2008 and may be terminated in accordance with the provisions of the service contract by either party giving the other not less than six months' prior written notice.

The Company has issued a letter of appointment to each of the Non-executive Directors and Independent Non-executive Directors for a term of three years commencing from 15 May 2008 unless terminated by either party giving to the other not less than six months' prior written notice.

THE CHAIRMAN AND CHIEF EXECUTIVE OFFICER

CG Code Provision A.2.1 stipulates that the roles of Chairman and Chief Executive Officer should be separate and should not be performed by the same individual. To ensure a balance of power and authority, Mr. Zhang Gang and Mr. Lu Wenbing have been appointed as the Chairman and Chief Executive Officer of the Company, respectively.

BOARD COMMITTEES

The Board has established three committees, namely the Audit Committee, the Remuneration Committee and the Nomination Committee, to oversee particular aspects of the Company's affairs. Each of these committees has been established with written terms of references.

A summary of the membership, duties and responsibilities of each of the committees are set out below:

Audit Committee

Members comprise:
Mr. Yeung Ka Keung *(Chairman)*
Dr. Xiang Bing
Mr. Shin Yick, Fabian

Duties and responsibilities include:

- Provide an independent review of the effectiveness of the financial reporting process and the internal control and risk management systems
- Review and monitor the external auditors' independence and objectivity, and the effectiveness of the audit process
- Monitor the integrity of the Company's financial statements, annual reports and account
- Review the Group's financial and accounting policies and practices

The Audit Committee had reviewed the internal control, connected transactions, interim results and annual results of the Group for the year ended 31 December 2008 and the accounting principles and practices adopted by the Group. Our Chief Financial Officer, external auditors and senior management attended the meetings to answer questions raised by the Audit Committee.

Nomination Committee

Members comprise:
Mr. Shin Yick, Fabian *(Chairman)*
Mr. Zhang Gang
Mr. Yeung Yiu Keung
Mr. Yeung Ka Keung
Dr. Xiang Bing

Duties and responsibilities include:

- Formulate nomination policy for the Board's consideration
- Identify and nominate candidates to become members of the Board
- Review and recommend the structure, size and composition of the Board
- Recommend to the Board on relevant matters relating to the succession planning for Directors
- Assess the independence of Independent Non-executive Directors

For the period between the Listing Date and 31 December 2008, there was no change in composition of the Board and the Nomination Committee did not convene any meeting.

Remuneration Committee

Members comprise:
Dr. Xiang Bing *(Chairman)*
Mr. Zhang Gang
Mr. Lu Wenbing
Mr. Yeung Ka Keung
Mr. Shin Yick, Fabian

Duties and responsibilities include:

- Recommend to the Board on the Company's policy and structure for all remuneration of Directors and senior management and on the establishment of a formal and transparent procedure for developing policy on such remuneration
- Review and approve performance – based remuneration by reference to corporate goals and objectives
- Review and approve compensation arrangements relating to dismissal or removal of Directors for misconduct
- Consider the granting of share options to directors pursuant to any share option scheme adopted by the Company

For the period between the Listing Date and 31 December 2008, there was no change in the policy and structure of the remuneration for Directors and senior management of the Company, and accordingly, the Remuneration Committee did not convene any meeting.

BOARD MEETINGS AND INDIVIDUAL ATTENDANCES

The Board is scheduled to meet regularly at least four times a year, and Directors will receive at least 14 days, prior written notice of such meetings. For any ad hoc board meetings, Directors are given as much notice as is reasonably practicable in those circumstances.

Details of Directors' attendance at Board meetings and Board committee meetings held since the Listing Date to end of the year are set forth in the following table:

Number of meetings held during the year (since the Listing Date)	Board	Audit Committee	Remuneration Committee	Nomination Committee
Executive Directors				
Mr. Zhang Gang *(Chairman)*	3/3	—	—	—
Mr. Lu Wenbing *(Chief Executive Officer)*	3/3	—	—	—
Mr. Yeung Yiu Keung	2/3	—	—	—
Mr. Wang Daizong	2/3	—	—	—
Mr. Zhang Zhanhai	2/3	—	—	—
Ms. Kou Zhifang	2/3	—	—	—
Ms. Li Baofang	2/3	—	—	—
Non-Executive Directors				
Mr. Chen Hongkai	2/3	—	—	—
Mr. Nishpank Rameshbabu Kankiwala	1/3	—	—	—
Independent Non-Executive Directors				
Dr. Xiang Bing	1/3	2/2	—	—
Mr. Yeung Ka Keung	1/3	2/2	—	—
Mr. Shin Yick, Fabian	1/3	2/2	—	—

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND EXTERNAL AUDITORS

The Directors are responsible for the preparation of the financial statements, which give a true and fair view of the state of affairs, results and cash flow of the Group in accordance with relevant law and disclosure requirements under the Listing Rules. The external auditors are responsible for forming an independent opinion, based on the audit, on the financial statements prepared by the Directors and report the opinion solely to the Shareholders as a body and for no other purpose.

INTERNAL CONTROL AND INTERNAL COMPLIANCE GUIDELINES

The Board has overall responsibility for maintaining the soundness and effectiveness of the internal control and risk management systems of the Group. Such systems are designed to meet the Group's particular needs and the risk by which it is exposed. The Group has adopted the "Internal Control Integrated Framework" formulated by the Reporting Committee of Sponsoring Organisations of the Treadway Committee, which is a recommended framework under the HKICPA Corporate Governance Guidelines. Procedures have been set up for safeguarding the Group's assets against any unauthorized use or disposition and ensuring an appropriate maintenance of accounting records and the availability of reliable financial information for internal or external use.

The Company has established an internal audit department which is responsible for performing regular and systematic review of internal control and risk management systems. The reviews provide reasonable assurance that the internal control and risk management systems continue to operate effectively within the Group.

The Company also has an internal compliance team which is charged with monitoring the application and maintenance of licenses, approvals, permits and registration of the Company-owned restaurants. It is also responsible for overseeing the implementation of our internal compliance guidelines so as to ensure that all the requisite requirements are complied with prior to the opening of the Company-owned restaurants. During the year, the internal compliance team had conducted regular review to ensure that all licenses and approvals are valid and subsisting and that renewals of licenses are made in a timely manner. The results of the review were satisfactory.

The Board has engaged an external consultant to conduct a review of the effectiveness of the Group's internal control systems, workflows and the management systems which were assessed to be satisfactory and were functioning properly in compliance with the internal compliance guidelines the Group's assets.

For the year ended 31 December 2008, the Board had, through the Audit Committee's reviews, the findings of the external consultant and the reports by the internal audit department and the internal compliance team, reviewed the Group's internal control procedures and compliance with the internal compliance guidelines and considered them having been effectively implemented and properly complied with.

EXTERNAL AUDITOR'S REMUNERATION

For the year ended 31 December 2008 the total remuneration for the audit services provided by the external auditors amounted to RMB4.5 million (equivalent to approximately HK$5.0 million).

For the year ended 31 December 2008 the total remuneration for the permissible non-audit services (namely, review of the Group's internal control system) provided by the external auditors amounted to RMB0.5 million (equivalent to approximately HK$0.6 million).

The re-appointment of Ernst & Young as auditors of the Company has been recommended by the Audit Committee and endorsed by the Board and is subject to approval by the Shareholders at the forthcoming annual general meeting.

INVESTOR RELATIONS

The Company believes that effective communications with the investment community are pivotal in enhancing investors' understanding of the Company's business and development. To achieve this and to enhance transparency, the Company maintains a proactive approach in promoting investor relations and communications. As such, the objectives of the Company's investor relations policy is to enable investors to have access, on a fair and timely basis, to information relating to the Group so that they can make informed decisions.

Investors are welcome to share their views with the Board by writing to the Company or sending enquiries to the Company's website at www.LittleSheep.com. The website also enables investors and the public to obtain up-to-date corporate information of the Group.

The Directors have pleasure in presenting this annual report and the audited financial statements of the Company and its subsidiaries for the year ended 31 December 2008.

GROUP REORGANISATION

The Company is a limited liability company incorporated in the Cayman Islands on 18 December 2007. Pursuant to a group reorganization in preparation for listing on the Stock Exchange, the Company had become the holding company of the subsidiaries now comprising the Group since 23 May 2008. Further details of the Group's reorganization are set forth in the Company's listing prospectus dated 2 June 2008 (the "Prospectus"). Shares in the Company had been listed on the Main Board of the Stock Exchange since 12 June 2008.

PRINCIPAL ACTIVITIES

The Company is an investment holding company. The Group is principally engaged in the operation of full-service restaurants chain, provision of catering services and sale of related food products.

RESULTS AND DIVIDENDS

The Group's profit the year ended 31 December 2008 and the state of affairs of the Company and the Group at that date are set out in the financial statements on pages 38 to 44.

The Company has not declared any interim dividend since the Listing Date. The Directors recommend the payment of a final dividend of HK cents 7.6 per share (equivalent to approximately RMB cents 6.7 per share) in respect of the year, to the Shareholders whose names appear on the register of members of the Company on 18 May 2009.

The register of members of the Company will be closed from 13 May 2009 to 18 May 2009, both days inclusive, during which period no transfer of shares in the Company will be effected. In order to qualify for the proposed final dividend and attending the forthcoming annual general meeting of the Company, all transfer documents accompanied by the relevant share certificates must be lodged for registration with the Company's branch share registrar in Hong Kong, Tricor Investor Services Limited, at 26/F, Tesbury Centre, 28 Queen's Road East, Wanchai, Hong Kong not later than 4:30 p.m. on 12 May 2009.

USE OF PROCEEDS FROM THE COMPANY'S LISTING

The proceeds from the Company's issue of new shares at the time of its listing on the Stock Exchange in June 2008, after deduction of the related issuance expenses, amounted to approximately HK$488.4 million (equivalent to approximately RMB430.7 million). These proceeds were applied during the year ended 31 December 2008 in accordance with the proposed applications set out in the Prospectus, as follows:

	Per Prospectus		**Utilized**		**Unutilized as at 31 December 2008**	
	HK$ million	Equivalent to approximately RMB million	HK$ million	Equivalent to approximately RMB million	HK$ million	Equivalent to approximately RMB million
Set up and refurbishment of company-owned restaurants	293.0	258.4	57.1	50.4	235.9	208.0
Upgrade and expansion of lamb processing and soup base production facilities	97.7	86.2	2.7	2.4	95.0	83.8
IT system upgrade and establishment of central kitchens	24.4	21.5	1.0	0.9	23.4	20.6
Acquisition of franchise restaurants	48.9	43.1	17.5	15.4	31.4	27.7
General working capital	24.4	21.5	22.7	20.0	1.7	1.5
	488.4	430.7	101.0	89.1	387.4	341.6

The unutilized balances have been placed with licensed banks and financial institutions in Hong Kong and the PRC as interest-bearing deposits.

RESERVES

Details of the movements in the reserves of the Group and the Company during the year are set out in Consolidated Statement of Change in Equity on page 41 and note 38 to the financial statements.

DISTRIBUTABLE RESERVES

As at 31 December 2008, the Company's reserves, including the share premium account, available for distribution, calculated in accordance with the Companies Law, Cap 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands ("Companies Law"), amounted to RMB320,302,000, of which RMB68,852,000 has been proposed as a final dividend for the year. Under the Companies Law, a company may make distribution to its shareholders out of the share premium account under certain circumstances.

CHARITABLE DONATIONS

Charitable donations made by the Group during the year amounted to approximately RMB329,000 (equivalent to approximately HK$368,000) (2007: RMB Nil)

PROPERTY, PLANT AND EQUIPMENT

Details of the movements in the property, plant and equipment of the Group during the year are set forth in note 13 to the financial statements.

PRE-EMPTIVE RIGHTS

There is no provision for pre-emptive rights under the Company's Articles of Association or the laws of the Cayman Islands which would oblige the Company to offer new shares on a pro rata basis to the existing Shareholders.

SUBSIDIARIES

Details of the Company's principal subsidiaries as at 31 December 2008 are set out in note 16 to the financial statements.

DIRECTORS

The Directors of the Company since the Listing Date and up to the date of this annual report have been:

Executive Directors
Mr. Zhang Gang *(Chairman)*
Mr. Lu Wenbing *(Chief Executive Officer)*
Mr. Yeung Yiu Keung
Mr. Wang Daizong
Mr. Zhang Zhanhai
Ms. Kou Zhifang
Ms. Li Baofang

Non-executive Directors
Mr. Chen Hongkai
Mr. Nishpank Rameshbabu Kankiwala

Independent Non-Executive Directors
Dr. Xiang Bing
Mr. Yeung Ka Keung
Mr. Shin Yick, Fabian

DIRECTORS' SERVICE CONTRACTS

None of the Directors proposed for re-election at the forthcoming annual general meeting has entered or has proposed to enter into any service contracts with the Company or any of its subsidiaries which is not determinable by the Group within one year without payment of compensation, other than statutory compensation.

BIOGRAPHICAL INFORMATION OF DIRECTORS AND SENIOR MANAGEMENT

Brief biographical information of the Directors of the Company are set out in the "Directors' Profile" section on pages 33 to 36.

DIRECTORS' INTERESTS IN COMPETING BUSINESS

During the year ended 31 December 2008, none of the Directors of the Company was interested in any business which competes or is likely to compete, either directly or indirectly, with the business of the Group.

DIRECTORS' INTERESTS IN SECURITIES

As at 31 December 2008, the interests and short positions of the Directors in the share, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) as recorded in the register maintained by the Company under section 352 of the SFO or as notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transaction by Directors of Listed Issuers ("Model code") were as below:

		Capacity	Total number of ordinary shares	Approximate percentage of shareholding
(1)	**The Company**			
	Name of Director			
	Zhang Gang	Interest of a controlled corporation[1]	3,091,000	0.30%
(2)	**Associated Corporation: Possible Way International Limited ("Possible Way")**			
	Name of Director			
	Zhang Gang	Personal interest	2,550	25.50%
	Chen Hongkai	Personal interest	1,836	18.36%
	Kou Zhifang	Personal interest	739	7.39%
	Li Baofang	Personal interest	613	6.13%
	Zhang Zhanhai	Personal interest	450	4.50%
	Lu Wenbing	Personal interest	557	5.57%
	Wang Daizong	Personal interest	163	1.63%
	Yeung Yiu Keung	Personal interest	103	1.03%
	Nishpank Rameshbabu Kankiwala	Personal interest	7	0.07%

Notes:

(1) *These shares are held by Beefup Group Limited of which Mr. Zhang Gang is interested in the entire issued share capital.*

(2) *The interest of Directors in the underlying of equity derivatives in respect of options granted to them pursuant to the Pre-IPO Share Scheme are detailed in the paragraph headed "Share Capital and Share Option Schemes" below.*

(3) *All interests disclosed above represent long position in the respective shares of the Company and the associated corporation.*

SUBSTANTIAL SHAREHOLDERS' INTERESTS IN SECURITIES

As at 31 December 2008, the interests and short positions of every persons, other than Directors or chief executive of the Company, in the shares and underlying shares of the Company, being 5% or more of the Company's issued share capital, as recorded in the register maintained and kept by the Company under section 336 of the SFO were as below:

Name	Name of registered owner	Name of beneficial owner	Number of shares	Approximate percentage of issued share capital
Possible Way	Possible Way	Possible Way	522,685,500	50.86%[L]
Billion Year International Limited ("Billion Year")	Billion Year	Billion Year	114,341,500	11.13%[L]
3i Investments plc[1]	N/A	N/A	116,363,896[2]	11.32%[3][L]
3i GP 2006–08 Limited[1]	N/A	N/A	78,948,956[2]	7.68%[3][L]
3i Holdings plc[1]	N/A	N/A	78,948,956[2]	7.68%[3][L]
3i Group plc ("3i")[1]	3i	3i	116,363,896[2]	11.32%[3][L]
3i Global Growth 2006–08 LP[1][b]	3i Nominees Limited	3i Global Growth 2006–08 LP[1][b]	51,831,706[1][b]	5.04%[3][L]

(L) denotes long position

Notes:

(1) 3i, a shareholder of the Company, is a company incorporated in England having its shares listed on the London Stock Exchange. 3i legally and beneficially owns 37,414,940 Shares, representing approximately 3.64% of the issued share capital of the Company. 3i Nominees Limited is a shareholder of the Company and acts:

(a) as nominee of 3i Asia Growth 2006–08 LP, an English limited partnership. 3i Asia Growth 2006–08 LP beneficially owns 25,915,853 Shares, representing approximately 2.52% of the issued share capital of the Company;

(b) as nominee of 3i Global Growth 2006–08 LP, an English limited partnership. 3i Global Growth 2006–08 LP beneficially owns 51,831,706 Shares, representing approximately 5.04% of the issued share capital of the Company;

(c) as nominee of Asia Growth Co-invest 2006–08 LP, an English limited partnership. Asia Growth Co-invest 2006–08 LP beneficially owns 1,072,676 Shares, representing approximately 0.10% of the issued share capital of the Company; and

(d) as nominee of Global Growth Co-invest 2006–08 LP, a limited partnership registered under the laws of Jersey. Global Growth Co-invest 2006–08 LP beneficially owns 128,721 Shares, representing approximately 0.01% of the issued share capital of the Company.

3i Investments plc, as the manager of the investments for each of 3i, 3i Asia Growth 2006–08 LP, 3i Global Growth 2006–08 LP, Asia Growth Co-invest 2006–08 LP and Global Growth Co-invest 2006–08 LP, has the discretionary power to control the exercise of the voting rights to the shares beneficially owned by 3i, 3i Asia Growth 2006–08 LP, 3i Global Growth 2006–08 LP, Asia Growth Co-invest 2006–08 LP and Global Growth Co-invest 2006–08 LP. Accordingly, 3i Investments plc is deemed to be interested in all the Shares held by 3i, 3i Nominees Limited (as nominee of 3i Asia Growth 2006–08 LP), 3i Nominees Limited (as nominee of 3i Global Growth 2006–08 LP), 3i Nominees Limited (as nominee of Asia Growth Co-invest 2006–08 LP) and 3i Nominees Limited (as nominee of Global Growth Co-invest 2006–08 LP), being a total of 116,363,896 Shares, representing approximately 11.32% of the issued share capital of the Company. 3i Investments plc is an indirect wholly owned subsidiary of 3i. Similarly, 3i Nominees Limited and 3i GP 2006–08 Limited as the general partner of each of 3i Asia Growth 2006–08 LP, 3i Global Growth 2006–08 LP, Asia Growth Co-invest 2006–08 LP and Global Growth Co-invest 2006–08 LP are also indirect wholly owned subsidiaries of 3i. 3i GP 2006–08 Limited, as the general partner of each of 3i Asia Growth 2006–08 LP, 3i Global Growth 2006–08 LP, Asia Growth Co-invest 2006–08 LP and Global Growth Co-invest 2006–08 LP, has the authority to manage the partnerships. 3i GP 2006–08 Limited is wholly owned by 3i Holdings plc which in turn is wholly owned by 3i. Accordingly, each of 3i GP 2006–08 LP and 3i Holdings plc is deemed to be interested in all the Shares held by 3i Asia Growth 2006–08 LP, 3i Global Growth 2006–08 LP, Asia Growth Co-invest 2006–08 LP and Global Growth Co-invest 2006–08 LP.

(2) In addition to the 37,414,940 Shares beneficially owned by 3i itself, 3i is also deemed to be interested in a total of 78,948,956 Shares beneficially owned by 3i Asia Growth 2006–08 LP, 3i Global Growth 2006–08 LP, Asia Growth Co-invest 2006–08 LP and Global Growth Co-invest 2006–08 LP. 3i Investments plc, as investment manager, is also be deemed to be interested in those 116,363,896 Shares.

(3) The 116,363,896 Shares represent the same interests and are therefore duplicated between 3i and 3i Investments plc. The 78,948,956 Shares beneficially owned by 3i Asia Growth 2006–08 LP, 3i Global Growth 2006–08 LP, Asia Growth Co-invest 2006–08 LP and Global Growth Co-invest 2006–08 LP, of which 3i GP 2006–08 Limited is the general partner, represent the same interest and are therefore duplicated among 3i, 3i Investments plc, 3i GP 2006–08 Limited and 3i Holdings plc. Further, the 51,831,706 Shares beneficially owned by 3i Global Growth 2006–08 LP represent the same interest and are therefore duplicated among 3i, 3i Global Growth 2006–08 LP and 3i Investments plc.

SHARE CAPITAL AND SHARE OPTION SCHEMES

Details of the movements in the share capital of the Company during the year are set out in note 37 to the financial statements. The Company currently has two share option schemes in force to incentivise eligible participants who contribute to the success of the Group's.

(1) Pre-IPO Share Option Scheme

Pursuant to the Pre-IPO share option scheme ("Pre-IPO Share Option Scheme") adopted on 20 December 2007, the Company has granted certain options to eligible directors, senior management and employees of the Group to subscribe for ordinary shares in the Company subject to the terms and conditions stipulated under the Pre-IPO Share Option Scheme. The Pre-IPO Share Option Scheme will remain in force for a period of 10 years from the adoption date. At 31 December 2008, 26,379,680 options, respresenting approximately 2.57% of the total issued share capital of the Company as at the date of this annual report, had been granted under the Pre-IPO Share Option Scheme, and no such share options have been exercised yet. Details of the share options outstanding as at 31 December 2008 which have been granted under the Pre-IPO Share Option Scheme are as follows:

Name of Grantees	Options outstanding at 1 January 2008	Options granted during the period	Options exercised during the period	Options lapsed on expiry	Options cancelled upon termination of employment	Options outstanding at 31 December 2008
Directors of the Company						
Chen Hongkai	300,000	—	—	—	—	300,000
Lu Wenbing	2,487,680	—	—	—	—	2,487,680
Wang Daizong	150,000	—	—	—	—	150,000
Yeung Yiu Keung	1,400,000	—	—	—	—	1,400,000
Kou Zhifang	510,000	—	—	—	—	510,000
Li Baofang	730,000	—	—	—	—	730,000
Directors of subsidiaries						
Li Lichen	100,000	—	—	—	—	100,000
Hu Guili	50,000	—	—	—	—	50,000
Guo Lili	50,000	—	—	—	—	50,000
Wang Yuzhu	50,000	—	—	—	—	50,000
Wang Wei	50,000	—	—	—	—	50,000
Xu Zhonggang	50,000	—	—	—	—	50,000
Li Jianbo	50,000	—	—	—	—	50,000
Zhang Guiying	50,000	—	—	—	—	50,000
Li Chunmei	50,000	—	—	—	—	50,000
Xie Lixia	50,000	—	—	—	—	50,000
Zhang Xiuping	400,000	—	—	—	—	400,000
Other employees	19,852,000	—	—	—	—	19,852,000
	26,379,680	—	—	—	—	26,379,680

Notes:

(1) All options under the Pre-IPO Option Scheme were granted on 28 December 2007 at an exercise price of HK$2.11 per share.

(2) All holders of options granted under the Pre-IPO Share Option Scheme may only exercise their options in the following manner:

Maximum percentage of options exercisable	***Period for vesting of the relevant percentage of the option***
10% of the total number of the options to any grantee	*From the grant date of the options to expiry of the 12-month period after the grant date of the options or of the 6-month period after the date of the initial public offering of the Company (i.e. 12 June 2008), whichever is later*
15% of the total number of the options to any grantee	*From the grant date of the options to expiry of 24-month period after the grant date of the options*
30% of the total number of the options to any grantee	*From the grant date of the options to expiry of 36-month period after the grant date of the options*
45% of the total number of the options to any grantee	*From the grant date of the options to expiry of 48-month period after the grant date of the options*

(2) Share Option Scheme

Pursuant to the share option scheme ("Share Option Scheme") adopted by the Company on 15 May 2008, the Directors may invite participants to take up options at a price determined by the board of Directors provided that it shall be at least the highest of (a) the closing price of the shares as stated in the Stock Exchange's daily quotations sheet on the date on which an offer is made by our Company to the grantee (which date must be a business day, "Offer Date"); (b) a price being the average of the closing prices of the shares of the Company as stated in the Stock Exchange's daily quotations sheets for the 5 business days immediately preceding the Offer Date (provided that the Offer Price shall be used as the closing price for any business day falling within the period before listing of the shares of the Company where our Company has been listed for less than five business days as at the Offer Date); and (c) the nominal value of a share of the Company.

The total number of Shares which may be issued upon exercise of all options to be granted under the Share Option Scheme and any other share option scheme of the Company shall not in aggregate exceed 102,764,287 Shares, representing 10% of the total number of Shares in issue as at the date of this annual report unless the Company obtains a fresh approval from the Shareholders to refresh the limit.

The maximum entitlement for any one participant is that the total number of the Shares issued and to be issued upon exercise of the options granted under the Share Option Scheme to each participant (including both exercised and outstanding Options) in any 12-month period shall not exceed 1% of the total number of Shares in issue unless otherwise approved by the Shareholders at a general meeting of the Company.

The option may be exercised in accordance with the terms of the Share Option Scheme at any time during the option period which may be determined and notified by the board of Directors to the grantee at the time of making an offer which shall not expire later than 10 years from the grant date. As at the date of this report, no options have been granted or agreed to be granted pursuant to the Share Option Scheme.

DIRECTORS' RIGHTS TO ACQUIRE SHARES OR DEBT SECURITIES

Other than as disclosed in the paragraph headed "Share Capital and Share Option Schemes" in this report, at no time during the year was the Company or any of its subsidiaries a party to any arrangement to enable the Directors or chief executives of the Company (including their spouses or children under 18 years of age) to have any right to subscribe for securities of the Company or any of its associated corporations as defined in the SFO or to acquire benefits by means of acquisition of shares in, or debentures of, the Company or any other body corporate.

DIRECTORS' INTERESTS IN CONTRACTS

Other than those lease transactions set out in the paragraph headed "Connected Transactions", at the end of the year or at any time during the year, there was no contract of significance in relation to the Company's business, to which the Company or any of its subsidiaries was a party, subsisted, and in which a Director had, whether directly or indirectly, a material interest.

MANAGEMENT CONTRACTS

No contract concerning the management and administration of the whole or any substantial part of the business of the Group was entered into or existed during the year.

CONNECTED TRANSACTIONS

During the year, the Group entered into the following connected transactions:

(1) Leasing of Properties from certain Directors

Pursuant to the tenancy agreements (collectively, the "Tenancy Agreements") entered into between certain members of the Group and the Directors named in the table below, the Group has leased from those Directors certain properties in the PRC for use as hot pot restaurants and offices for a term of three years commencing from 1 January 2008. Details of the Tenancy Agreements are as follows:

Premises	Landlord(s)	Tenant	Approximate Gross Floor Area (square meters)	Annual Rental (RMB)
No. 69 Beichen West Road, Chaoyang District, Beijing	Mr. Zhang Gang	Little Sheep PRC Beijing Catering Management Branch (內蒙古小肥羊餐飲連鎖有限公司北京餐飲管理分公司)	626.7	540,000
Ground Floor and 1st Floor, No. 1679 Huangxing Road, Yangpu District, Shanghai	Mr. Zhang Gang Mr. Chen Hongkai	Shanghai Yangpu Little Sheep Catering Co., Ltd. (上海楊浦小肥羊餐飲有限公司)	Total: 1,548.55	Total: 1,000,000[1] (Mr. Zhang Gang: 590,000, Mr. Chen Hongkai: 410,000)

Premises	Landlord(s)	Tenant	Approximate Gross Floor Area (square meters)	Annual Rental (RMB)
Block A (1st–3rd Floor), Dushi Huating Yindu Dasha, Xilin South Road, Hohhot City, Inner Mongolia	Mr. Zhang Gang	Little Sheep PRC Hohhot City Little Sheep No. 2 Branch (內蒙古小肥羊餐飲連鎖有限公司呼市小肥羊二分公司)	3,420	1,000,000
No. 1332 Lujiabang Road, Huangpu District, Shanghai	Mr. Chen Hongkai: Rooms 1902, 1905, 1907–1909 Mr. Zhang Gang: Rooms 1901, 1903, 1904, 1906and 1910	Little Sheep PRC Shanghai Branch (內蒙古小肥羊餐飲連鎖有限公司上海分公司)	Total: 1,013.46	Total: 910,800 (Mr. Zhang Gang: 466,800 Mr. Chen Hongkai: 444,000)
1st Floor, No. 1392 Lujiabang Road, Huangpu District, Shanghai	Mr. Zhang Gang: Room 103 Mr. Chen Hongkai: Room 101 Ms. Kou Zhifang Room 102	Shanghai Lujiabang Little Sheep Catering Co., Ltd. (上海陸佳濱小肥羊餐飲有限公司)	Total: 416.37	Total: 720,000(2) (Mr. Zhang Gang: 253,360, Mr. Chen Hongkai: 233,320, Ms. Kou Zhifang: 233,320)

Notes:

(1) *The annual rent for this property shall be RMB1,000,000 for each of the two years ending 31 December 2009 and RMB1,450,000 for the year ending 31 December 2010.*

(2) *This property is rent-free for the two years ending 31 December 2009 and an annual rent of RMB720,000 is payable for the year 2010.*

The aggregate annual cap for the Tenancy Agreements for the year ended 31 December 2008 is RMB3,450,800. The total rent paid by the Group, during the year in respect of the foregoing properties amounted to RMB3,450,800.

Waiver from The Stock Exchange

The leasing of properties ("Leases") under the Tenancy Agreements constitute continuing connected transactions and are subject to the reporting and announcement requirements under Chapter 14A of the Listing Rules.

Pursuant to Rule 14A.42(3) of the Listing Rules, the Group applied to the Stock Exchange and the Stock Exchange has granted, a waiver from strict compliance with the disclosure requirements stipulated in Chapter 14A of the Listing Rules in respect of each of the continuing connected transaction under the Tenancy Agreements.

The Board, including the Independent Non-Executive Directors, has reviewed and confirmed that the Leases have been entered into:

(i) in the ordinary and usual course of the business of the Group;

(ii) on normal commercial terms; and

(iii) in accordance with the relevant agreements governing them and on terms that are fair and reasonable and in the interests of the Company and the shareholders of the Company as a whole.

The Directors are further of the opinion that the caps for the leases are arrived at after due and careful consideration and are fair and reasonable.

The auditors of the Company have performed certain agreed-upon procedures and reported their findings as to whether the continuing connected transactions entered into by the Group set out above for the year ended 31 December 2008:

(i) have received the approval of the Company's Board of Directors;

(ii) have been entered into in accordance with the relevant terms of the agreements governing the transactions; and

(iii) have not exceeded the relevant cap amount disclosed in the Prospectus.

As Mr. Zhang Gang, Mr. Chen Hongkai and Ms. Kou Zhifang have interests in the Tenancy Agreements, they have abstained from physically attending meetings or have abstained from voting on any such board resolution approving the Leases.

(2) Disposal of Interest in XiaoFeiYang Japan Co. Ltd.

On 31 October 2008, the Company's indirect wholly owned subsidiary Inner Mongolia Little Sheep Catering Chain Co. Ltd. (內蒙古小肥羊餐飲連鎖有限公司) ("Little Sheep PRC"), entered into a transfer agreement ("Transfer Agreement") with Webcrew Corporation ("Webrew"). Pursuant to the Transfer Agreement, Little Sheep PRC agreed to dispose of its 62.5% equity interest ("Disposal") in XiaoFeiYang Japan Co. Ltd. ("XFY Japan"), being the entire equity interest owned by Little Sheep PRC in XFY Japan, to Webcrew for a consideration of JPY31,250,000 (equivalent to approximately HK$2,548,000).

Webcrew was interested in 37.5% of the equity interest in XFY Japan and thus was a substantial shareholder of XFY Japan and a connected person of the Company. As such, the Disposal constituted a connected transaction for the Company under Chapter 14A of the Listing Rules.

As disclosed in the Prospectus, the Group intends to stay highly focused on expanding restaurant network by increasing the number of company-owned restaurants in larger and more developed cities in the PRC. The Directors believe that the Disposal allows the Group to better allocate its resources to its core business in the PRC and is in line with the business strategies of the Group. After the Disposal, XFY Japan had ceased to be a subsidiary of the Group.

The Directors, including the Independent Non-Executive Directors, consider that the terms of the Transfer Agreement are on normal commercial terms which were arrived at after arm's length negotiations between the parties and are fair and reasonable and in the interests of the Company and its Shareholders as a whole.

PURCHASE, SALE OR REDEMPTION OF LISTED SECURITIES

During the period from the Listing Date to 31 December 2008, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities.

BANK LOANS AND OTHER BORROWINGS

Details of the Group's bank loans and other borrowings as at 31 December 2008 are set out in note 25 to the financial statements.

MAJOR CUSTOMERS AND SUPPLIERS

The aggregate sales to the five largest customers of the Group accounted for approximately 4.2% of the Group's total revenue and sales to the largest customer accounted for approximately 1.8% of the Group's total revenue for the year 2008. The aggregate purchases from the five largest suppliers of the Group accounted for approximately 12.1% of the Group's total purchases and purchases from the largest supplier accounted for approximately 3.4% of the Group's total purchases for the year 2008.

None of the Directors, their associates, or any Shareholder which to the knowledge of the Directors own more than 5% of the Company's issued share capital has any interest in the Group's five largest suppliers or the Group's five largest customers.

RETIREMENT BENEFIT SCHEMES

Details of the retirement benefit schemes of the Group are set out in note 3 to the financial statements.

PUBLIC FLOAT

Based on the information that is publicly available to the Company and within the knowledge of the Directors at the date of this annual report, there was a sufficient prescribed public float of the issued share of the Company under the Listing Rules.

AUDITORS

The financial statements were audited by Ernst & Young who will retire at the conclusion of the forthcoming annual general meeting and being eligible, offer themselves for re-appointment. A resolution for the re-appointment of Ernst & Young as auditors of the Company is to be proposed at the forthcoming annual general meeting.

On behalf of the Board
Zhang Gang
Chairman

Hong Kong, 16 March 2009

Executive Directors

ZHANG Gang, aged 44, is the co-founder of the Group and the Company's Executive Director and Chairman. He is responsible for the operation of the Board and the key decision-maker of the Group. Mr. Zhang founded the first Little Sheep restaurant in Inner Mongolia in 1999 and has played a vital role in the development of the Group since its commencement in July 2001. Mr. Zhang is an experienced entrepreneur and has over nine years of experience in the catering industry. He is a deputy member of the People's Congress in Inner Mongolia. Mr. Zhang completed the Executive Master of Business Administration program at the Guanghua School of Management of Peking University.

LU Wenbing, aged 41, is an Executive Director and Chief Executive Officer of the Company. He joined the Group in 2004. Before joining the Group, he served as an Investment Controller and Vice President of Inner Mongolia Mengniu Milk Industry (Group) Co., Limited and had also served as Deputy General Manager of the Third Investment Banking Department and Chief Representative of the Inner Mongolia Representation Office of Everbright Securities Co., Ltd. He holds a master's degree in Executive Business Administration from Renmin University of China and a master's degree of Laws in International Economic Law from China University of Political Science and Law.

YEUNG Yiu Keung, aged 46, is an Executive Director and Chief Operating Officer of the Company. Mr. Yeung joined the Group in October 2007 and has over 10 years of experience in the food and beverage industry. In 1999, Mr. Yeung assumed the role of Managing Director of Birdland (Hong Kong) Limited, a franchisee of KFC for the Special Administrative Regions of Hong Kong and Macau. He was the Chief Executive Officer and Principal Operator of Birdland (Hong Kong) Limited until August 2007. Mr. Yeung holds a master's degree in Business Administration from the Kellogg School of Management of Northwestern University and the Hong Kong University of Science and Technology. He was a member of the Illinois Institute of Certified Public Accountants.

WANG Daizong, aged 34, is an Executive Director and Chief Financial Officer of the Company and is in charge of finance, strategy and planning, and human resources. He joined Little Sheep PRC as Senior Vice President in October 2007 and was

LU Wenbing ZHANG Gang YEUNG Yiu Keung WANG Daizong appointed as a Director of the Company in December 2007. From 2005 to 2007, Mr. Wang was a Director of 3i Asia Pacific plc. where he originated and executed 3i's investment in Little Sheep PRC in 2006. From 2001 to 2005, he had worked in the investment banking division of Goldman Sachs (Asia) LLC. He holds a master's degree of Business Administration from the Wharton School of the University of Pennsylvania.

ZHANG Zhanhai, aged 41, is an Executive Director and Senior Vice President of the Company and General Manager of northern PRC region. He is responsible for legal affairs and overall brand management of our Group as well as the overall management of the northern PRC region. Mr. Zhang joined Little Sheep PRC in November 2001. He has over 10 years of experience in the catering industry. Mr. Zhang holds a bachelor's degree of Business Administration from Northeastern University and completed the Advanced Management Program for Senior Managers under the Executive Development Program at the Guanghua School of Management of Peking University. Mr. Zhang is elected as a Deputy General Secretary of the Hot Pot Cuisine Committee under the Hot Pot Committee of China Cuisine Association and a member of the executive council of China Chain Store & Franchise Association.

KOU Zhifang, aged 43, is an Executive Director and Senior Vice President of the Company and General Manager of the eastern PRC region. She is responsible for overseeing the overall business management of the Group in the eastern PRC region. Ms Kou joined the Group in 2001. She is an experienced entrepreneur and has over eight years of experience in the catering industry. Ms. Kou holds a postgraduate diploma from the Chinese Academy of Social Sciences.

LI Baofang, aged 43, is an Executive Director and Senior Vice President of the Company and General Manager of the southern PRC region. She is responsible for overseeing the overall business management of the Group in the Southern PRC region. Ms Li joined the Group in 2001. She is an experienced entrepreneur and has over eight years of experience in the catering industry. Ms. Li holds a postgraduate diploma from the Chinese Academy of Social Sciences.

ZHANG Zhanhai

KOU Zhifang

LI Baofang

Non-executive Directors

CHEN Hongkai, aged 41, is the co-founder of the Group. Mr. Chen played a vital role in the founding of the Group's business with Mr. Zhang Gang since 1999 and with his extensive experience in the catering industry, contributed to our Group's further development and expansion. Mr. Chen is an experienced entrepreneur and has over eight years of experience in the catering industry.

Nishpank Rameshbabu KANKIWALA, aged 51, joined the Group in June 2006, Mr. Kankiwala has been the Chief Executive Officer of Mayborn Group Limited since 2006. From 2003 to 2005, he acted as the President of Burger King International. Before joining Burger King International, Mr. Kankiwala spent nine years working at PepsiCo Beverages International. He joined PepsiCo Beverages International in Ireland in 1994 as the General Manager of the International Concentrate Business, and he was the Vice President of Operations, Sales, Franchise VP Africa from 1996 to 2000. From 2000 to 2003, he acted as the President of the Europe Business Unit of PepsiCo Beverages International. From 1979 to 1994, Mr. Kankiwala worked at Unilever where he held a number of marketing, sales, operations and general management roles in Europe, Asia and the USA. Mr. Kankiwala obtained a bachelor's degree of Science (Chemical Engineering) with first class Honors from the University of London in 1979, and he was admitted to the Fellowship of University College of London in 2005.

Independent non-executive Directors

Dr. XIANG Bing, aged 46, joined the Group in May 2008 as an Independent Non-executive Director and also serves as Chairman of the Remuneration Committee. Dr. Xiang holds a bachelor's degree of Engineering from Xi'an Jiaotong University and a doctoral degree in philosophy of accounting from the University of Alberta, Canada. Dr. Xiang is currently the founding dean and professor of the Cheung Kong Graduate School of Business. He is also currently an independent non-executive director and a committee member of the audit committee of Dan

CHEN Hongkai

Nishpank Rameshbabu KANKIWALA

Dr. XIANG Bing

Form Holdings Company Limited, HC International, Inc., Jutal Offshore Oil Services Limited and China Dongxiang (Group) Co., Ltd., all of which are companies listed on the Stock Exchange. He is also an independent director of Shenzhen Terca Technology Co., Ltd. and TCL Corporation, all of which are listed on the Shenzhen Stock Exchange. He is also an independent non-executive director of LDK Solar Co. Ltd., Perfect World Co., Ltd., and EHouse (China) Holdings Limited, all of which are listed on the New York Stock Exchange. He was a director of Wuhan Jianmin Pharmaceutical Groups Co., Ltd., which is a company listed on the Shanghai Stock Exchange. He was also a director of Shaanxi Qinchuan Machine Development Co., Ltd. and Guangdong Midea Electric Appliances Co., Ltd., all of which are listed on the Shenzhen Stock Exchange.

YEUNG Ka Keung, aged 49, joined the Group in May 2008 as an Independent Non-executive Director and also serves as Chairman of the Audit Committee. Mr. Yeung is the executive Vice President and Chief Financial Officer of Phoenix Satellite Television Co. Ltd. and Phoenix Satellite Television Holdings Limited, a company listed on the Stock Exchange. He is also the qualified accountant and company secretary of Phoenix Satellite Television Holdings Limited. Mr. Yeung graduated from the University of Birmingham and obtained qualification as a chartered accountant with the Institute of Chartered Accountants in England and Wales.

SHIN Yick, Fabian, aged 40, joined the Group in May 2008 as an Independent Non-executive Director and also serves as Chairman of the Nomination Committee. He is currently the managing director of ICEA Capital Limited. He is also an independent director of C & O Pharmaceutical Technology (Holdings) Limited, a company listed on Singapore Exchange Securities Trading Limited. Mr. Shin is a fellow member of Hong Kong Institute of Certified Public Accountants, Association of Chartered Certified Accountants, Institute of Chartered Secretaries and Administrators and the Hong Kong Institute of Company Secretaries. Mr. Shin holds a bachelor's degree in Commerce from the University of Birmingham in England.

YEUNG Ka Keung

SHIN Yick, Fabian

INDEPENDENT AUDITORS' REPORT

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安 永

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To the shareholders of Little Sheep Group Limited
(Incorporated in the Cayman Islands with limited liability)

We have audited the financial statements of Little Sheep Group Limited (the "Company") and its subsidiaries (the "Group") set out on pages 38 to 101, 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 financial statements in accordance with International Financial Reporting Standards and the disclosure requirements of 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.

AUDITORS' RESPONSIBILITY

Our responsibility is to express an opinion on these financial statements based on our audit. Our report is made 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 auditors' judgement, 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 auditors consider internal control relevant to the entity's preparation and the 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.

OPINION

In our opinion, the 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 International Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of Hong Kong Companies Ordinance.

Ernst & Young
Certified Public Accountants
Hong Kong

16 March 2009

CONSOLIDATED INCOME STATEMENT

Year ended 31 December 2008

	Notes	2008 RMB'000	2007 RMB'000
REVENUE	5	**1,271,523**	949,174
Other income	5	**29,964**	9,551
Cost of inventories		**(524,390)**	(377,073)
Staff costs	6	**(257,342)**	(165,886)
Depreciation and amortization		**(40,591)**	(32,096)
Rental expenses		**(119,534)**	(96,904)
Fuel and utility expenses		**(55,752)**	(41,892)
Other operating expenses		**(131,947)**	(94,895)
Finance costs	7	**(6,603)**	(20,610)
PROFIT BEFORE TAX	6	**165,328**	129,369
Tax	9	**(30,793)**	(34,318)
PROFIT FOR THE YEAR		**134,535**	95,051
Attributable to:			
Shareholders of the Company	11	**128,698**	91,163
Minority interests		**5,837**	3,888
		134,535	95,051
DIVIDENDS			
Proposed final	10	**68,852**	—
EARNINGS PER SHARE ATTRIBUTABLE TO SHAREHOLDERS OF THE COMPANY	12		
— Basic (RMB)		**13.55 cents**	10.69 cents
— Diluted (RMB)		**13.53 cents**	10.68 cents

CONSOLIDATED BALANCE SHEET

31 December 2008

	Notes	2008 RMB'000	2007 RMB'000
NON-CURRENT ASSETS			
Property, plant and equipment	13	**277,684**	181,975
Deposits for purchases of items of plant and equipment		**5,567**	8,517
Intangible assets	14	**171,131**	143,193
Land lease prepayments	15	**11,717**	11,858
Long-term rental deposits	17	**13,281**	17,814
Deferred income tax assets	18	**2,928**	2,756
Total non-current assets		**482,308**	366,113
CURRENT ASSETS			
Inventories	20	**179,400**	144,143
Trade receivables	21	**12,175**	5,373
Due from the holding company and a shareholder	22	**—**	78
Prepayments, deposits and other receivables	23	**65,902**	55,208
Cash and cash equivalents	24	**424,038**	204,126
Total current assets		**681,515**	408,928
CURRENT LIABILITIES			
Bank loans	25	**535**	97,992
Trade payables	26	**40,803**	37,448
Deposits, other payables and accruals	27	**137,807**	92,715
Due to minority equity holders/shareholders of subsidiaries	28	**12,528**	28,685
Tax payable		**14,994**	16,947
Total current liabilities		**206,667**	273,787
NET CURRENT ASSETS		**474,848**	135,141
TOTAL ASSETS LESS CURRENT LIABILITIES		**957,156**	501,254
NON-CURRENT LIABILITIES			
Convertible bonds	36	**—**	190,966
Bank loans	25	**375**	910
Long-term payables	29	**6,885**	4,771
Deferred income tax liabilities	18	**—**	292
Total non-current liabilities		**7,260**	196,939
NET ASSETS		**949,896**	304,315

CONSOLIDATED BALANCE SHEET

31 December 2008

	Notes	2008 RMB'000	2007 RMB'000
EQUITY			
Equity attributable to shareholders of the Company			
Issued capital	37	**90,823**	—
Reserves	38	**850,776**	287,952
		941,599	287,952
Minority interests		**8,297**	16,363
TOTAL EQUITY		**949,896**	304,315

Zhang Gang
Director

Lu Wenbing
Director

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2008

	Attributable to shareholders of the Company									
	Issued capital RMB'000	**Capital reserves RMB'000**	**PRC reserve funds RMB'000**	**Foreign currency translation reserve RMB'000**	**Equity component of convertible bonds RMB'000**	**Share option reserve RMB'000**	**Retained profits RMB'000**	**Total RMB'000**	**Minority interests RMB'000**	**Total equity RMB'000**
At 1 January 2008	—	**125,314**	**34,553**	**10,641**	**3,486**	**100**	**113,858**	**287,952**	**16,363**	**304,315**
Change in the foreign currency translation reserve	—	—	—	**3,164**	—	—	—	**3,164**	—	**3,164**
Total income and expense for the year recognized directly in equity	—	—	—	**3,164**	—	—	—	**3,164**	—	**3,164**
Profit for the year	—	—	—	—	—	—	**128,698**	**128,698**	**5,837**	**134,535**
Total income and expense for the year	—	—	—	**3,164**	—	—	**128,698**	**131,862**	**5,837**	**137,699**
Conversion of Bonds (note 36)	—	**198,300**	—	**(20,523)**	**(3,486)**	—	—	**174,291**	—	**174,291**
Issue of ordinary shares, net of share issue expenses (note 37)	**90,823**	**331,768**	—	—	—	—	—	**422,591**	—	**422,591**
Equity-settled share option arrangement (note 39)	—	—	—	—	—	**3,409**	—	**3,409**	—	**3,409**
Dividend paid by subsidiaries to their then shareholders	—	—	—	—	—	—	**(78,506)**	**(78,506)**	**(12,558)**	**(91,064)**
Transfer to the PRC reserve funds	—	—	**1,599**	—	—	—	**(1,599)**	—	—	—
Acquisition of minority interests of subsidiaries	—	—	—	—	—	—	—	—	**(892)**	**(892)**
Acquisition of a subsidiary	—	—	—	—	—	—	—	—	**149**	**149**
Disposal of a subsidiary	—	—	—	—	—	—	—	—	**(602)**	**(602)**
At 31 December 2008	**90,823**	**655,382***	**36,152***	**(6,718)***	**—***	**3,509***	**162,451***	**941,599**	**8,297**	**949,896**
At 1 January 2007	—	116,902	27,763	2,091	3,486	—	61,335	211,577	8,243	219,820
Change in the foreign currency translation reserve	—	—	—	8,550	—	—	—	8,550	—	8,550
Total income and expense for the year recognized directly in equity	—	—	—	8,550	—	—	—	8,550	—	8,550
Profit for the year	—	—	—	—	—	—	91,163	91,163	3,888	95,051
Total income and expense for the year	—	—	—	8,550	—	—	91,163	99,713	3,888	103,601
Equity-settled share option arrangement	—	—	—	—	—	100	—	100	—	100
Capital contributions from minority equity holder of a subsidiary	—	8,412	—	—	—	—	—	8,412	5,471	13,883
Dividend paid by subsidiaries to their then shareholders	—	—	—	—	—	—	(31,850)	(31,850)	(1,793)	(33,643)
Transfer to the PRC reserve funds	—	—	6,790	—	—	—	(6,790)	—	—	—
Acquisition of subsidiaries	—	—	—	—	—	—	—	—	554	554
At 31 December 2007	—	125,314*	34,553*	10,641*	3,486*	100*	113,858*	287,952	16,363	304,315

* *These reserve accounts comprise the consolidated reserves of RMB850,776,000 (2007: RMB287,952,000) in the consolidated balance sheet.*

CONSOLIDATED CASH FLOW STATEMENT

Year ended 31 December 2008

	Notes	2008 RMB'000	2007 RMB'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Profit before tax		**165,328**	129,369
Adjustments for:			
Finance costs	7	**6,603**	20,610
Interest income from bank balances	5	**(4,019)**	(1,772)
Waiver of 2007 interest expenses on convertible bonds	5	**(8,463)**	—
Depreciation		**40,247**	31,876
Amortization of intangible assets		**98**	97
Amortization of lease prepayments		**246**	123
Net loss on disposal of items of property, plant and equipment	6	**288**	3,583
Provision against trade receivables	6	**250**	1,075
Gain on disposal of a subsidiary	31	**(4,158)**	—
Equity-settled share option arrangement	6	**3,409**	100
Operating profit before working capital changes		**199,829**	185,061
Increase in inventories		**(33,319)**	(81,555)
Increase in trade receivables		**(7,088)**	(1,168)
Increase in prepayments, deposits and other receivables		**(28,741)**	(16,110)
Decrease in amounts due from the holding company and a shareholder		**78**	—
Decrease in amounts due from equity holders/shareholders of the holding company		**—**	9,473
Increase/(decrease) in amounts due to minority equity holders/shareholders of subsidiaries		**(15,318)**	10,059
Increase in trade payables		**2,777**	8,142
Increase in customers' deposits, other payables and accruals		**50,375**	16,633
Increase/(decrease) in long-term payables		**6,647**	(1,693)
Cash generated from operating activities		**175,240**	128,842
Income tax paid		**(33,096)**	(29,065)
Net cash inflow from operating activities		**142,144**	99,777

CONSOLIDATED CASH FLOW STATEMENT

Year ended 31 December 2008

	Notes	2008 RMB'000	2007 RMB'000
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from disposal of items of property, plant and equipment		**2,121**	2,139
Purchases of items of property, plant and equipment		**(148,967)**	(50,656)
Additions to intangible assets	14	**(9)**	(7)
Additions to lease prepayments	15	**(105)**	(7,811)
Acquisition of subsidiaries and branches	19	**(28,976)**	(57,450)
Acquisitions of minority interests		**(3,000)**	—
Deposits paid for purchases of items of plant and equipment		**(5,567)**	(8,517)
Proceeds from disposal of a subsidiary	31	**1,011**	—
Interest received		**4,019**	1,772
Net cash outflow from investing activities		**(179,473)**	(120,530)
CASH FLOWS FROM FINANCING ACTIVITIES			
New bank loans		**21,000**	98,902
Net proceeds from issuance of new shares upon listing		**430,666**	—
Capital contributions from minority equity holder of a subsidiary		**—**	13,882
Repayment of bank loan		**(92,503)**	—
Dividends paid		**(91,064)**	(43,198)
Interest paid		**(6,603)**	(10,266)
Net cash inflow from financing activities		**261,496**	59,320
NET INCREASE IN CASH AND CASH EQUIVALENTS		**224,167**	38,567
Cash and cash equivalents at beginning of year		**204,126**	168,720
Effect of foreign exchange rate changes, net		**(4,255)**	(3,161)
CASH AND CASH EQUIVALENTS AT END OF YEAR		**424,038**	204,126
ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS			
Cash and bank balances	24	**424,038**	204,126

BALANCE SHEET

31 December 2008

	Notes	2008 RMB'000
NON-CURRENT ASSETS		
Property, plant and equipment	13	**20**
Investment in a subsidiary	16	**92**
		112
CURRENT ASSETS		
Due from a subsidiary	16	**411,156**
Prepayments, deposits and other receivables		**2,519**
Cash and cash equivalents	24	**14,019**
		427,694
CURRENT LIABILITIES		
Deposits, other payables and accruals		**13,979**
NET CURRENT ASSETS		**413,715**
NET ASSETS		**413,827**
EQUITY		
Equity attributable to shareholders of the Company		
Issued capital	37	**90,823**
Reserves	38(b)	**323,004**
TOTAL EQUITY		**413,827**

Zhang Gang
Director

Lu Wenbing
Director

1. CORPORATE INFORMATION AND REORGANISATION

Little Sheep Group Limited (the "Company") was incorporated on 18 December 2007 in the Cayman Islands with limited liability. The registered office of the Company is located at Cricket Square, Hutchins Drive, PO Box 2681, Grand Cayman, KY1-1111, Cayman Islands. The ordinary shares of the Company were listed on the Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") on 12 June 2008. In the opinion of the directors, the ultimate holding company of the Company is Possible Way International Limited ("Possible Way") which is incorporated in the British Virgin Islands.

The Company acts as an investment holding company. The principal activities of its subsidiaries are the operation of Chinese hot pot restaurants, the provision of catering services and the sale of related food products in the People's Republic of China (the "PRC), Hong Kong, Macau, the United States of America and Japan. The Group has established a principal place of business in Hong Kong at Unit 1104, 11/F, Jubilee Center, 42–46 Gloucester Road, Wan Chai, Hong Kong.

Pursuant to a group reorganisation (the "Reorganisation") for the purpose of listing the Company's ordinary shares on the Stock Exchange, the Company acquired the entire issued share capital of China XiaoFeiYang Catering Chain Co., Ltd. ("China XiaoFeiYang"), a company registered in the British Virgin Islands, and its subsidiaries and thereby became the holding company of the companies now comprising the Group on 23 May 2008. Further details of the Reorganisation are set out in the Company's prospectus dated 2 June 2008.

As the Company and China XiaoFeiYang were under the common control of Possible Way before and after the Reorganisation, the acquisition of China XiaoFeiYang by the Company has been reflected in the consolidated financial statements as a common control transaction. Accordingly, the Company was treated as the holding company of China XiaoFeiYang and its subsidiaries for the period presented rather than from the date of acquisition of China XiaoFeiYang applying the principles of merger accounting.

In the opinion of the directors, the consolidated financial statements prepared on the above basis present more fairly the results and state of affairs of the Company and its subsidiaries (collectively referred to as the "Group") as a whole.

2.1 BASIS OF PRESENTATION

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs"), which include International Accounting Standards ("IASs") and Interpretations promulgated by the International Accounting Standards Board and the disclosure requirements of the Hong Kong Companies Ordinance. They have been prepared under the historical cost convention. These financial statements are presented in Renminbi ("RMB") and all values are rounded to the nearest thousand (RMB'000) except when otherwise indicated.

2.1 BASIS OF PRESENTATION (continued)

Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year ended 31 December 2008. Except for the acquisition of China XiaoFeiYang and its subsidiaries which are consolidated using the principles of merger accounting as detailed in note 1 above, the results of subsidiaries are consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date that such control ceases. All income, expenses and unrealised gains and losses resulting from intercompany transactions and intercompany balances within the Group are eliminated on consolidation in full.

The acquisition of subsidiaries during the year has been accounted for using the purchase method of accounting. This method involves allocating the cost of the business combinations to the fair value of the identifiable assets acquired, and liabilities and contingent liabilities assumed at the date of acquisition. The cost of the acquisition is measured at the aggregate of 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.

Minority interests represent the interests of outside shareholders not held by the Group in the results and net assets of the Company's subsidiaries. An acquisition of minority interests are accounted for using the parent entity extension method whereby the difference between the consideration and the book value of the share of the net assets acquired is recognized as goodwill.

2.2 IMPACT OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS

The Group has adopted the following amendments to IFRSs and new International Financial Reporting Interpretations Committee ("IFRIC") interpretations during the year.

IAS 39 and IFRS 7 Amendments	Amendments to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 7 Financial Instruments: Disclosures — Reclassification of Financial Assets
IFRIC 11	IFRS 2 — Group and Treasury Share Transactions
IFRIC 12	Service Concession Arrangements
IFRIC 14	IAS 19 — The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction

The adoption of these new interpretations and amendments has had no significant financial effect on these consolidated financial statements and there have been no significant changes to the accounting policies applied in these financial statements.

2.2 IMPACT OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS (continued)

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

(a) Amendments to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 7 Financial Instruments: Disclosures — Reclassification of Financial Assets

The amendments to IAS 39 permit an entity to reclassify a non-derivative financial asset classified as held for trading, other than a financial asset designated by an entity as at fair value through profit or loss upon initial recognition, out of the fair value through profit or loss category if the financial asset is no longer held for the purpose of selling or repurchasing in the near term, if specified criteria are met.

A debt instrument that would have met the definition of loans and receivables (if it had not been required to be classified as held for trading at initial recognition) may be classified out of the fair value through profit or loss category or (if it had not been designated as available for sale) may be classified out of the available-for-sale category to the loans and receivables category if the entity has the intention and ability to hold it for the foreseeable future or until maturity.

In rare circumstances, financial assets that are not eligible for classification as loans and receivables may be transferred from the held-for-trading category to the available-for-sale category or to the held-to-maturity category (in the case of a debt instrument), if the financial asset is no longer held for the purpose of selling or repurchasing in the near term.

The financial asset shall be reclassified at its fair value on the date of reclassification and the fair value of the financial asset on the date of reclassification becomes its new cost or amortised cost, as applicable. The amendments to IFRS 7 require extensive disclosures of any financial asset reclassified in the situations described above. The amendments are effective from 1 July 2008.

As the Group has not reclassified any of its financial instruments, the amendments have had no impact on the financial position or results of operations of the Group.

(b) IFRIC 11 – IFRS 2 — Group and Treasury Share Transactions

IFRIC 11 requires arrangements whereby an employee is granted rights to the Group's equity instruments to be accounted for as an equity-settled scheme, even if the Group buys the instruments from another party, or the shareholders provide the equity instruments needed. IFRIC 11 also addresses the accounting for share-based payment transactions involving two or more entities within the Group. As the Group currently has no such arrangements, the interpretation has had no impact on the financial position or results of operations of the Group.

(c) IFRIC 12 — Service Concession Arrangements

IFRIC 12 applies to service concession operators and explains how to account for obligation undertaken and the rights received in service concession arrangements. No member of the Group is an operator and, therefore, this interpretation has had no impact on the financial position or results of operations of the Group.

2.2 IMPACT OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS (continued)

(d) IFRIC 14 – IAS 19 — The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction

IFRIC 14 addresses how to assess the limit under IAS 19 *Employee Benefits*, on the amount of a refund or a reduction in future contributions in relation to a defined benefit scheme that can be recognized as an asset, including situations when a minimum funding requirement exists. As the Group has no defined benefit scheme, the interpretation has had no effect on these consolidated financial statements.

2.3 IMPACT OF ISSUED BUT NOT YET EFFECTIVE INTERNATIONAL FINANCIAL REPORTING STANDARDS

The Group has not applied the following new and revised IFRSs, which have been issued but are not yet effective, in these consolidated financial statements:

IFRS 1 and IAS 27 Amendments	Amendments to IFRS 1 First-time Adoption of IFRSs and IAS 27 Consolidated and Separate Financial Statements — Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate[1]
IFRS 2 Amendments	Amendments to IFRS 2 Share-based payment — Vesting Conditions and Cancellations[1]
IFRS 3 (Revised)	Business Combinations[2]
IFRS 8	Operating Segments[1]
IAS 1 (Revised)	Presentation of Financial Statements[1]
IAS 23 (Revised)	Borrowing Costs[1]
IAS 27 (Revised)	Consolidated and Separate Financial Statements[2]
IAS 32 and IAS 1 Amendments	Amendments to IAS 32 Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements — Puttable Financial Instruments and Obligations Arising on Liquidation[1]
IAS 39 Amendment	Amendment to IAS 39 Financial Instruments: Recognition and Measurement — Eligible Hedged Items[2]
IFRIC 13	Customer Loyalty Programmes[3]
IFRIC 15	Agreements for the Construction of Real Estate[1]
IFRIC 16	Hedges of a Net Investment in a Foreign Operation[4]
IFRIC 17	Distribution of Non-cash Assets to Owners[2]

Apart from the above, IASB has also issued Improvements to IFRSs* which sets out amendments to a number of IFRSs primarily with a view to removing inconsistencies and clarify wording. Except for the amendment to IFRS 5 which is effective for the annual periods on or after 1 July 2009, other amendments are effective for annual periods beginning on or after 1 January 2009 although there are separate transitional provisions for each standard.

1 Effective for annual periods beginning on or after 1 January 2009
2 Effective for annual periods beginning on or after 1 July 2009
3 Effective for annual periods beginning on or after 1 July 2008
4 Effective for annual periods beginning on or after 1 October 2008

* *Improvements to IFRSs contain amendments to IFRS 5, IFRS 7, IAS 1, IAS 8, IAS 10, IAS 16, IAS 18, IAS 19, IAS 20, IAS 23, IAS 27, IAS 28, IAS 29, IAS 31, IAS 34, IAS 36, IAS 38, IAS 39, IAS 40 and IAS 41.*

2.3 IMPACT OF ISSUED BUT NOT YET EFFECTIVE INTERNATIONAL FINANCIAL REPORTING STANDARDS (continued)

The IAS 27 Amendment requires all dividends from subsidiaries, associates or jointly-controlled entities to be recognized in the income statement in the separate financial statements. The amendment is applied prospectively only. The IFRS 1 Amendment allows a first-time adopter of IFRSs to measure its investment in subsidiaries, associates or jointly-controlled entities using a deemed cost of either fair value or the carrying amount under the previous accounting practice in the separate financial statements. The Group expects to adopt the IAS 27 Amendment from 1 January 2009. The amendments have no impact on the consolidated financial statements. As the Group is not a first-time adopter of IFRSs, the IFRS 1 Amendment is not applicable to the Group.

The IFRS 2 Amendments clarify that vesting conditions are service conditions and performance conditions only. Any other conditions are non-vesting conditions. Where an award does not vest as a result of a failure to meet a non-vesting condition that is within the control of either the entity or the counterparty, this is accounted for as a cancellation. The Group has not entered into share-based payment schemes with non-vesting conditions attached and, therefore, the amendments are unlikely to have any significant implications on its accounting for share-based payments.

IFRS 3 (Revised) introduces a number of changes in the accounting for business combinations that will impact the amount of goodwill recognized, the reported results in the period that an acquisition occurs, and future reported results.

IAS 27 (Revised) requires that a change in the ownership interest of a subsidiary without loss of control is accounted for as an equity transaction. Therefore, such a change will have no impact on goodwill, nor will it give rise to a gain or loss. Furthermore, the revised standard changes the accounting for losses incurred by the subsidiary as well as the loss of control of a subsidiary. Other consequential amendments were made to IAS 7 Statement of Cash Flows, IAS 12 Income Taxes, IAS 21 The Effects of Changes in Foreign Exchange Rate, IAS 28 Investments in Associates and IAS 31 Interests in Joint Ventures.

The Group expects to adopt IFRS 3 (Revised) and IAS 27 (Revised) from 1 January 2010. The changes introduced by these revised standards must be applied prospectively and will affect future acquisitions, loss of control and transactions with minority interests.

IFRS 8, which replaces IAS 14 Segment Reporting, specifies how an entity should report information about its operating segments, based on information about the components of the entity that is available to the chief operating decision maker for the purpose of allocating resources to the segments and assessing their performance. The standard also requires the disclosure of information about the products and services provided by the segments, the geographical areas in which the Group operates, and revenue from the Group's major customers. The Group expects to adopt IFRS 8 from 1 January 2009.

IAS 1 (Revised) introduces changes in the presentation and disclosures of financial statements. The revised standard separates owner and non-owner changes in equity. The statement of changes in equity will include only details of transactions with owners, with all non-owner changes in equity presented as a single line. In addition, this standard introduces the statement of comprehensive income, with all items of income and expense recognized in profit or loss, together with all other items of recognized income and expense recognized directly in equity, either in one single statement, or in two linked statements. The Group expects to adopt IAS 1 (Revised) from 1 January 2009.

2.3 IMPACT OF ISSUED BUT NOT YET EFFECTIVE INTERNATIONAL FINANCIAL REPORTING STANDARDS (continued)

IAS 23 has been revised to require capitalisation of borrowing costs when such costs are directly attributable to the acquisition, construction or production of a qualifying asset. As the Group's current policy for borrowing costs aligns with the requirements of the revised standard, the revised standard is unlikely to have any financial impact on the Group.

The IAS 32 Amendments provide a limited scope exception for puttable financial instruments and instruments that impose specified obligations arising on liquidation to be classified as equity if they fulfill a number of specified features. IAS 1 Amendments require disclosure of certain information relating to these puttable financial instruments and obligations classified as equity. The amendments are unlikely to have any financial impacts on the Group, as the Group has not issued such instruments.

The amendment to IAS 39 addresses the designation of a one-sided risk in a hedged item, and the designation of inflation as a hedged risk or portion in particular situations. It clarifies that an entity is permitted to designate a portion of the fair value changes or cash flow variability of a financial instrument as hedged item. As the Group has not entered into any such hedges, the amendment is unlikely to have any financial impact on the Group.

IFRIC 13 requires customer loyalty award credits to be accounted for as a separate component of the sales transaction in which they are granted. The consideration received in the sales transaction is allocated between the loyalty award credits and the other components of the sale. The amount allocated to the loyalty award credits is determined by reference to their fair value and is deferred until the awards are redeemed or the liability is otherwise extinguished. As the Group currently has no customer loyalty award scheme, the interpretation is not applicable to the Group and therefore is unlikely to have any financial impact on the Group.

IFRIC 15 clarifies when and how an agreement for the construction of real estate should be accounted for as a construction contract in accordance with IAS 11 Construction Contracts or an agreement for the sale of goods or services in accordance with IAS 18 Revenue. IFRIC 15 will not have an impact on the consolidated financial statement because the Group does not conduct such activity.

IFRIC 16 provides guidance on the accounting for a hedge of a net investment in a foreign operation. This includes clarification that (i) hedge accounting may be applied only to the foreign exchange differences arising between the functional currencies of the foreign operation and the parent entity; (ii) a hedging instrument may be held by any entities within a group; and (iii) on disposal of a foreign operation, the cumulative gain or loss relating to both the net investment and the hedging instrument that was determined to be an effective hedge should be reclassified to the income statement as a reclassification adjustment. As the Group currently has no hedge of a net investment in a foreign operation, the interpretation is unlikely to have any financial impact on the Group.

2.3 IMPACT OF ISSUED BUT NOT YET EFFECTIVE INTERNATIONAL FINANCIAL REPORTING STANDARDS (continued)

IFRIC 17 standardises practice in the accounting for non-reciprocal distributions of non-cash assets to owners. The Group expects to apply the interpretation from 1 January 2010 prospectively. The Interpretation clarifies that (i) a dividend payable should be recognized when the dividend is appropriately authorised and is no longer at the discretion of the entity; (ii) an entity should measure the dividend payable at the fair value of the net assets to be distributed; and (iii) an entity should recognise the difference between the dividend paid and the carrying amount of the net assets distributed in profit or loss. Other consequential amendments were made to IAS 10 Events after the Balance Sheet Date and IFRS 5 Non-current Assets Held for Sale and Discontinued Operations. While the adoption of the interpretation may result in changes in certain accounting policies, the interpretation is unlikely to have any material financial impact on the Group.

Improvements to IFRSs

In May 2008, the IASB issued its first omnibus of amendments to its standards, primarily with a view to removing inconsistencies and clarifying wording. There are separate transitional provisions for each standard. The Group has not yet adopted the following amendments and anticipates that these changes will have no material effect on the financial statements.

(a) IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations:* Clarifies that all assets and liabilities of a subsidiary shall be classified as held for sale if an entity has a sale plan involving loss of control of the subsidiary, regardless of whether the entity will retain a non-controlling interest.

(b) IFRS 7 *Financial Instruments: Disclosures:* Removes the reference to "total interest income" as a component of finance costs.

(c) IAS 1 *Presentation of Financial Statements:* Clarifies that assets and liabilities which are classified as held for trading in accordance with IAS 39 are not automatically classified as current in the balance sheet.

(d) IAS 16 *Property, Plant and Equipment:* Replaces the term "net selling price" with "fair value less costs to sell" and the recoverable amount of property, plant and equipment is calculated as the higher of an asset's fair value less costs to sell and its value in use.

In addition, items held for rental that are routinely sold in the ordinary course of business after rental, are transferred to inventory when rental ceases and they are held for sale.

(e) IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance:* Requires government loans granted in the future with no or at a below-market rate of interest to be recognized and measured in accordance with IAS 39 and the benefit of the reduced interest to be accounted for as a government grant.

(f) IAS 27 *Consolidated and Separate Financial Statements:* Requires that when a parent entity accounts for a subsidiary at fair value in accordance with IAS 39 in its separate financial statements, this treatment continues when the subsidiary is subsequently classified as held for sale.

2.3 IMPACT OF ISSUED BUT NOT YET EFFECTIVE INTERNATIONAL FINANCIAL REPORTING STANDARDS (continued)

Improvements to IFRSs (continued)

(g) IAS 28 *Investments in Associates:* Clarifies that an investment in an associate is a single asset for the purpose of conducting the impairment test and that no impairment is separately allocated to goodwill included in the investment balance.

(h) IAS 36 *Impairment of Assets:* When discounted cash flows are used to estimate "fair value less cost to sell", additional disclosure is required about the discount rate, consistent with the disclosures required when the discounted cash flows are used to estimate "value in use".

(i) IAS 38 *Intangible Assets:* Expenditure on advertising and promotional activities is recognized as an expense when the Group either has the right to access the goods or has received the service.

The reference to there being rarely, if ever, persuasive evidence to support an amortization method of intangible assets other than a straight-line method has been removed.

(j) IAS 40 *Investment Property:* Revises the scope such that property being constructed or developed for future as an investment property is classified as an investment property.

2.4 SIGNIFICANT ACCOUNTING ESTIMATES

The preparation of the Group's consolidated financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities, at the reporting date. However, uncertainty about these assumptions and estimates could result in outcomes that could require a material adjustment to the carrying amount of the asset or liability affected in the future.

Estimation uncertainty

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, 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:

Valuation of inventories

Inventories are stated at the lower of cost and net realisable value at the balance sheet date. Net realisable value is determined on the basis of the estimated selling price less the estimated costs necessary to make the sale. The directors estimate the net realisable value of inventories based primarily on the latest transaction prices and current market conditions. In addition, the directors perform an inventory review at each year end date and assess the need for the write-down of inventories.

2.4 SIGNIFICANT ACCOUNTING ESTIMATES (continued)

Estimation uncertainty (continued)

Goodwill

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the value in use of the cash-generating units to which the goodwill is allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows.

Depreciation

Depreciation of each item of property, plant and equipment is calculated on the straight-line basis over its expected useful life, after taking into account their estimated residual value. The Group has estimated the useful lives of its property, plant and equipment of 5 to 40 years after taking into account their estimated residual values. This requires an estimation of the residual value and useful life of assets if the related assets were already of the age and in condition expected at end of its useful life.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Subsidiaries

A subsidiary is an entity whose financial and operating policies the Company controls, directly or indirectly, so as to obtain benefits from its activities. Subsidiaries are consolidated from the date on which control is transferred to the Group and cease to be consolidated from the date on which control is transferred out of the Group.

The results of subsidiaries are included in the Company's income statement to the extent of dividends received and receivable. The Company's interests in subsidiaries are stated at cost less any impairment losses.

Joint ventures

A joint venture is an entity set up by contractual arrangement, whereby the Group and other parties undertake an economic activity. The joint venture operates as a separate entity in which the Group and the other parties have an interest.

The joint venture agreement between the venturers stipulates the capital contributions of the joint venture parties, the duration of the joint venture entity and the basis on which the assets are to be realised upon its dissolution. The profits and losses from the joint venture's operations and any distributions of surplus assets are shared by the venturers, either in proportion to their respective capital contributions, or in accordance with the terms of the joint venture agreement.

A joint venture is treated as:

(a) a subsidiary, if the Group has unilateral control, directly or indirectly, over the joint venture;

(b) a jointly-controlled entity, if the Group does not have unilateral control, but has joint control, directly or indirectly, over the joint venture;

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Joint ventures (continued)

(c) an associate, if the Group does not have unilateral or joint control, but holds, directly or indirectly, generally not less than 20% of the joint venture's registered capital and is in a position to exercise significant influence over the joint venture; or

(d) an equity investment accounted for in accordance with IAS 39, if the Group holds, directly or indirectly, less than 20% of the joint venture's registered capital and has neither joint control of, nor is in a position to exercise significant influence over, the joint venture.

Goodwill

Goodwill arising on business combination is initially measured at cost being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets acquired, and liabilities and contingent liabilities assumed as at the date of acquisition. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. The Group performs its annual impairment test of goodwill as at 31 December.

For the purpose of impairment testing, goodwill arising on a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Group are assigned to those units or group of units.

Impairment is determined by assessing the recoverable amount of the cash-generating unit (group of cash-generating units) to which the goodwill relates. Where the recoverable amount of the cash-generating unit (group of cash-generating units) is less than the carrying amount, an impairment loss is recognized. An impairment loss recognized for goodwill is not reversed in a subsequent period. Where goodwill forms part of a cash-generating unit (group of cash-generating units) and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

Impairment of non-financial assets other than goodwill

The Group assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Group makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses are recognized in the income statement in the period in which it arises.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Impairment of non-financial assets other than goodwill (continued)

An assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation/amortization, had no impairment loss been recognized for the asset in prior years. Such reversal is credited in the income statement in the period in which it arises.

Related parties

A party is considered to be related to the Group if:

(a) the party, directly or indirectly through one or more intermediaries, (i) controls, is controlled by, or is under common control with, the Group; (ii) has an interest in the Group that gives it significant influence over the Group; or (iii) has joint control over the Group;

(b) the party is an associate;

(c) the party is a jointly-controlled entity;

(d) the party is a member of the key management personnel of the Company or its parent;

(e) the party is a close member of the family of any individual referred to in (a) or (d); or

(f) the party is an entity that is controlled, jointly controlled or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e).

Property, plant and equipment and depreciation

Property, plant and equipment, other than construction in progress, are stated at cost less accumulated depreciation and provision for any impairment loss.

The cost of an item of property, plant and equipment comprises its purchase price and any directly attributable costs of bringing the item of property, plant and equipment to its working condition and location for its intended use. Expenditure incurred after items of property, plant and equipment have been put into operation, such as repairs and maintenance, is normally charged to the income statement in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the items of property, plant and equipment, the expenditure is capitalised as an additional cost of that items of property, plant and equipment.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Property, plant and equipment and depreciation (continued)

Depreciation of property, plant and equipment is calculated on the straight-line basis over the expected useful life, after taking into account its estimated residual value, as follows:

Buildings	40 years
Leasehold improvements	Over the unexpired period of the lease
Motor vehicles	5 to 8 years
Equipment and fixtures	5 to 8 years

Construction in progress represents storage facilities under construction, or renovation works of restaurants and office in progress and is stated at cost less any impairment loss, and is not depreciated. Cost comprises development and construction expenditure incurred and other costs directly attributable to the development less any accumulated impairment losses. On completion, the relevant assets are transferred to property, plant and equipment at cost less accumulated impairment losses.

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

Intangible assets (other than goodwill)

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and any accumulated impairment losses. Internally generated intangible assets, excluding capitalised development costs, are not capitalised and expenditure is charged against profits in the year in which the expenditure is incurred. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortization period and the amortization method for an intangible asset with a finite useful life is reviewed at least at each financial year end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortization period or method, as appropriate, and are treated as changes in accounting estimates. The amortization expense on intangible assets with finite lives is recognized in the income statement in the expense category consistent with the function of the intangible asset.

Leases

Leases where substantially all the rewards and risks of ownership of assets remain with the lessor are accounted for as operating leases. Where the Group is the lessor, assets leased by the Group under operating leases are included in non-current assets, and rentals receivable under the operating leases are credited to the consolidated income statement on the straight-line basis over the lease terms. Where the Group is the lessee, rentals payable under the operating leases are charged to the consolidated income statement on the straight-line basis over the lease terms.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Lease prepayments

Lease prepayments represent land use rights paid to the PRC government authorities. Land use rights are carried at cost and are charged to the consolidated income statement on the straight-line basis over the respective periods of the rights ranging from 40 to 70 years. When the lease payments cannot be allocated reliably between the land and buildings elements, the entire lease payments are included in the cost of the land and buildings as a finance lease in property, plant and equipment.

Financial assets

The Group's financial assets in the scope of IAS 39 are classified as loans and receivables. When financial assets are recognized initially, they are measured at fair value. The Group determines the classification of its financial assets after initial recognition and, where allowed and appropriate, re-evaluates this designation at each financial year end.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement loans and receivables are carried at amortised cost using the effective interest method less any allowance for impairment. Gains and losses are recognized in consolidated income statement when the loans and receivables are recognized or impaired, as well as through the recognized process.

Impairment of financial assets

The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets is impaired.

Assets carried at amortised cost

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). The carrying amount of the asset shall be reduced either directly or through the use of an allowance account. The amount of the impairment loss shall be recognized in the income statement.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed. Any subsequent reversal of an impairment loss is recognized in the income statement, to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial liabilities at amortised cost (including interest-bearing loans and borrowings)

Financial liabilities including trade and other payables, amounts due to the minority equity holders/shareholders of subsidiaries and interest-bearing loans and borrowings are initially stated at fair value less directly attributable transaction costs and are subsequently measured at amortised cost, using the effective interest method unless the effect of discounting would be immaterial, in which case they are stated at cost. The related interest expense is recognized within "finance costs" in the income statement.

Gains and losses are recognized in the income statement when the liabilities are derecognized as well as through the amortization process.

Convertible bonds

The component of convertible bonds that exhibits characteristics of a liability is recognized as a liability in the balance sheet, net of transaction costs. On issuance of convertible bonds, the fair value of the liability component is determined using a market rate for an equivalent non-convertible bond; and this amount is carried as a long-term liability on the amortised cost basis until extinguished on conversion or redemption.

The fair values of derivative components of convertible bonds at issuance date are determined using market value basis and are recognized as liabilities in the balance sheet, net of transaction costs. Subsequent changes in fair values of derivative components are recognized in the income statement.

The remainder of the proceeds is allocated to the conversion option that is recognized and included in shareholders' equity, net of transaction costs. The carrying amount of the conversion option is not remeasured in subsequent years.

Transaction costs are apportioned among the liability, derivative and equity components of the convertible bonds based on the allocation of proceeds to the liability, derivative and equity components when the instruments are first recognized.

Derecognition of financial assets and liabilities

Financial assets

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognized where:

- the rights to receive cash flows from the asset have expired;
- the Group retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a "pass-through" arrangement; or
- the Group has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Derecognition of financial assets and liabilities (continued)

Financial assets (continued)

Where the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognized to the extent of the Group's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Group's continuing involvement is the amount of the transferred asset that the Group may repurchase, except that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, the extent of the Group's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

Financial liabilities

A financial liability is derecognized when the obligation under the liability is discharged or cancelled, or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in the income statement.

Inventories

Inventories represent ingredients, consumables and food and beverages and are stated at the lower of cost and net realisable value, after making due allowances for any obsolete or slow-moving items. Cost is determined on the first-in, first-out basis, and includes all costs of purchase and other costs incurred in bringing the inventories to their present location and condition. Net realisable value is based on estimated selling prices less any further costs expected to be incurred to completion and disposal.

Trade and other receivables

Trade receivables, which generally have credit terms of less than 90 days, are recognized and carried at the original invoice amount less an allowance for any uncollectible amounts.

Other receivables are recognized and carried at cost less an allowance for any uncollectible amounts.

An estimate for impairment of trade receivables is made when there is objective evidence that collection of the full amount is no longer probable. Trade receivables are written off when identified.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Cash and cash equivalents

For the purpose of the consolidated cash flow statement, cash and cash equivalents comprise cash on hand and demand deposits, and short term highly liquid investments that are readily convertible into known amounts of cash and are subject to an insignificant risk of changes in value, and have a short maturity of generally within three months when acquired, less bank overdrafts which are repayable on demand and form an integral part of the Group's cash management.

For the purpose of the balance sheets, cash and cash equivalents comprise cash at banks and on hand and short term deposits, which are not restricted as to use.

Provisions

Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation provided and a reliable estimate can be made of the amount of the obligation. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as an interest expense.

Income tax

Current tax

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the balance sheet date.

Deferred tax

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

Deferred income tax liabilities are recognized for all taxable temporary differences, except:

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

- in respect of taxable temporary differences associated with investments in subsidiaries and interests in a jointly-controlled entity, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Income tax (continued)

Deferred tax (continued)

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

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

- in respect of deductible temporary differences associated with investments in subsidiaries and interests in a jointly-controlled entity, deferred tax assets are only recognized to the extent that it is probable that the temporary differences will be reversed in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

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

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

Income tax relating to items recognized directly in equity is recognized in equity and not in the consolidated income statement.

Deferred tax assets and deferred tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

Government grants

Government grants are recognized at their fair values where there is reasonable assurance that the grants will be received and all attaching conditions will be complied with. When a grant relates to an expense item, it is recognized as income over the periods necessary to match the grant on a systematic basis to the costs that it is intended to compensate. Where the grant relates to an asset, the fair value is credited to a deferred income account and is released to the consolidated income statement over the expected useful life of the relevant assets by equal annual instalments. Government grants received where the attaching conditions have not yet been fulfilled are recognized as liabilities.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Revenue recognition

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured on the following basis:

Revenue from restaurant operations and provision of catering services

Revenue is recognized when the related services have been rendered to customers.

Sale of food products

Revenue is recognized when the products are delivered and accepted by customers and the significant risks and rewards of ownership of the goods have been transferred to the buyer, provided that the Group maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold.

Franchise income

Franchise income for the rights granted is recognized as the rights have been used.

Interest income

Interest income is recognized as interest accrues, using the effective interest method by applying the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument to the net carrying amount of the financial asset.

Management service fee income

Management service fee income is recognized when the relevant services are rendered.

Borrowing costs

Borrowing costs are recognized as an expense when incurred.

Employee benefits

Salaries, bonuses, paid annual leave and the cost to the Group of non-monetary benefits are accrued in the year in which the associated services are rendered by employees of the Group. Where payment or settlement is deferred and the effect would be material, these amounts are stated at their present values.

Contributions to defined contribution retirement plans are recognized as an expense in the income statement as incurred.

Pension schemes and other retirement benefits

Pursuant to the relevant PRC laws and regulations, each of the PRC subsidiaries of the Group is required to participate in a retirement benefits scheme organised by the local municipal government whereby the Group is required to contribute a certain percentage of the salaries of its employees to the retirement benefits scheme. The only obligation of the Group with respect to the retirement benefits scheme is to pay the ongoing required contributions. Contributions made to the defined contribution retirement benefits scheme are charged to the income statement as incurred.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Employee benefits (continued)

Pension schemes and other retirement benefits (continued)

The Group operates a Mandatory Provident Fund retirement benefits scheme (the "MPF Scheme") under the Hong Kong Mandatory Provident Fund Schemes Ordinance for employees in Hong Kong under the jurisdiction of the Hong Kong Employment Ordinance. Contributions are made based on a percentage of the employees' basic salaries and are charged to the consolidated income statement as they become payable in accordance with the rules of the MPF Scheme. The assets of the MPF Scheme are held separately from those of the Group in an independently administered fund. The Group's employer contributions vest fully with the employees when contributed into the MPF Scheme.

Termination benefits are recognized when, and only when, the Group demonstrably commits itself to terminate employment or to provide benefits as a result of voluntary redundancy by having a detailed formal plan which is without realistic possibility of withdrawal.

Share-based payment transactions

Employees (including senior executives) of the Group receive remuneration in the form of share-based payment transactions, whereby employees render services as consideration for equity instruments ("equity settled transactions").

In situations where some or all of the goods or services received by the entity as consideration for equity instruments cannot be specifically identified, they are measured as the difference between the fair value of the share-based payment and the fair value of any identifiable goods or services received at the grant date. For cash-settled transactions, the liability is measured at each reporting date until settlement.

Equity-settled transactions

The cost of equity-settled transactions with employees, for awards granted after 7 November 2002, is measured by reference to the fair value at the date on which they are granted. The fair value is determined by an external valuer using an appropriate pricing model.

The cost of equity-settled transactions is recognized, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award ("the vesting date"). The cumulative expense recognized for equity-settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the Group's best estimate of the number of equity instruments that will ultimately vest. The charge or credit to the consolidated income statement for a period represents the movement in cumulative expense recognized as at the beginning and end of that period.

No expense is recognized for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied.

Where the terms of an equity-settled award are modified, the minimum expense recognized is the expense if the terms had not been modified. An additional expense is recognized for any modification, which increases the total fair value of the share based payment arrangement, or is otherwise beneficial to the employee as measured at the date of modification.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Employee benefits (continued)

Equity-settled transactions (continued)

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any expense not yet recognized for the award is recognized immediately. However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph.

The dilutive effect of outstanding options is reflected as additional share dilution in the computation of earnings per share.

Foreign currencies

The consolidated financial statements are presented in Renminbi, which is the Company's presentation currency. The functional currency of the Company is United States dollars. Each entity in the Group determines its own functional currency, and items included in the financial statements of each entity are measured using that functional currency. Transactions in foreign currencies are initially recorded at the functional currency exchange rates ruling at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated at the functional currency exchange rates ruling at the balance sheet date. All differences are taken to the income statement. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates ruling at the dates of initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

The functional currencies of overseas subsidiaries are their respective local currencies. As at the balance sheet date, the assets and liabilities of these overseas subsidiaries are translated into the Company's presentation currency at the exchange rates ruling at the balance sheet date and the income statements are translated at the weighted average exchange rates for the year. The exchange differences arising on the translation are taken directly to the foreign currency translation reserve inside the equity. On disposal of a foreign entity, the deferred cumulative amount recognized in equity relating to that particular foreign operation is recognized in the income statement.

For the purpose of the cash flow statement, the cash flows of overseas subsidiaries are translated into Renminbi at the exchange rates ruling at the dates of the cash flows. Frequently recurring cash flows of overseas subsidiaries, which arise throughout the year, are translated into Renminbi at the weighted average exchange rates for the year.

4. SEGMENT INFORMATION

Segment information is presented by way of two segment formats: (i) on a primary segment reporting basis, by business segment; and (ii) on a secondary segment reporting basis, by geographical segment.

In determining the Group's geographical segments, revenue are attributed to the segments based on the location of the customers, and assets are attributed to the segments based on the location of the assets.

4. SEGMENT INFORMATION (continued)

Intersegment sales and transfers are transacted with reference to the selling prices used for sales made to third parties at the then prevailing market prices.

The Group's operating business are structured and managed separately, according to the nature of their operations and the products and services they provide. Each of the Group's business segments represents a strategic business unit that offers products and services which are subject to risks and returns that are different from those of the other business segments.

Details of the business segments are summarised as follows:

(a) The operation of restaurants and provision of catering services segment engages in Chinese hot pot restaurants;

(b) Sale of food products segment engages in the production of soup base seasoning and sale of lamb meat;

(c) Franchise income segment represents the charges to the franchisees for the rights of using the Little Sheep's trademark; and

(d) Others represents provision of the services of sales promotion, purchase, training, and other administrative services rendered to franchise restaurants.

Details of the geographical segments are summarised as follows:

(a) North China segment represents the subsidiaries and branches located in Beijing, Tianjin, Shandong Province and Inner Mongolia Autonomous Region.

(b) East China segment represents the subsidiaries and branches located in Shanghai, Jiangsu Province, Zhejiang Province, Fujian Province and Anhui Province.

(c) South China segment represents the subsidiaries and branches located in Guangdong Province, Guangxi Autonomous Region, Hubei Province and Hunan Province.

(d) North West China segment represents the subsidiaries and branches located in Shaanxi Province, Sichuan Province, Ningxia Autonomous Region and Gansu Province.

(e) North East China represents the subsidiaries and branches located in Liaoning Province.

(f) Others represents the subsidiaries and branches located in United States, Japan, Hong Kong and Macau.

4. SEGMENT INFORMATION (continued)

Business segments

The following table presents revenue and profit and certain asset, liability and expenditure information regarding the Group's business segments for years ended 31 December 2008 and 2007.

Year ended 31 December 2008	Restaurant operations and provision of catering services RMB'000	Food products RMB'000	Franchise income RMB'000	Others RMB'000	Eliminations RMB'000	Consolidated RMB'000
Segment revenue:						
Sales to external customers	1,010,690	239,858	18,886	2,089	—	1,271,523
Intersegment sales	—	314,625	—	23,290	(337,915)	—
Total	1,010,690	554,483	18,886	25,379	(337,915)	1,271,523
Segment results	167,833	10,557	9,869	(4,068)	(508)	183,683
Other income						29,964
Unallocated expenses						(41,716)
Finance costs						(6,603)
Profit before tax						165,328
Tax						(30,793)
Profit for the year						134,535
Assets and liabilities:						
Segment assets	478,717	323,920	547,466	557,481	(743,761)	1,163,823
Segment liabilities	221,706	90,498	166,739	478,745	(743,761)	213,927
Other segment information:						
Depreciation and amortization	37,311	1,306	1,394	580	—	40,591
Capital expenditure	72,962	16,483	63,980	1,223	—	154,648
Impairment losses recognized in the consolidated income statement	—	—	250	—	—	250

4. SEGMENT INFORMATION (continued)

Business segments (continued)

Year ended 31 December 2007	Restaurant operations and provision of catering services RMB'000	Food products RMB'000	Franchise income RMB'000	Others RMB'000	Eliminations RMB'000	Consolidated RMB'00
Segment revenue:						
Sales to external customers	750,867	170,479	26,375	1,453	—	949,174
Intersegment sales	—	245,209	—	6,420	(251,629)	—
Total	750,867	415,688	26,375	7,873	(251,629)	949,174
Segment results	134,448	9,546	10,902	480	(3,643)	151,733
Other income						9,551
Unallocated expenses						(11,305)
Finance costs						(20,610)
Profit before tax						129,369
Tax						(34,318)
Profit for the year						95,051
Assets and liabilities:						
Segment assets	407,897	350,953	437,253	232,796	(653,858)	775,041
Segment liabilities	245,060	177,572	240,424	227,164	(419,494)	470,726
Other segment information:						
Depreciation and amortization	26,856	3,772	1,152	316	—	32,096
Capital expenditure	47,622	11,898	2,564	369	—	62,453
Impairment losses recognized in the consolidated income statement	—	—	1,075	—	—	1,075

4. SEGMENT INFORMATION (continued)

Geographical segments

The following table presents revenue and profit information regarding the Group's geographical segments for years ended 31 December 2008 and 2007.

Year ended 31 December 2008	**North China RMB'000**	**East China RMB'000**	**South China RMB'000**	**North West China RMB'000**	**North East China RMB'000**	**Others RMB'000**	**Eliminations RMB'000**	**Consolidated RMB'000**
Segment revenue:								
Sales to external customers	**803,500**	**291,881**	**275,427**	**49,715**	**14,012**	**174,903**	**(337,915)**	**1,271,523**
Other segment information:								
Segment assets	**954,910**	**215,358**	**150,170**	**29,523**	**10,870**	**546,753**	**(743,761)**	**1,163,823**
Capital expenditure	**96,335**	**23,308**	**18,074**	**7,862**	**4,075**	**4,994**	**—**	**154,648**

Year ended 31 December 2007	North China RMB'000	East China RMB'000	South China RMB'000	North West China RMB'000	North East China RMB'000	Others RMB'000	Eliminations RMB'000	Consolidated RMB'000
Segment revenue:								
Sales to external customers	563,954	234,929	186,790	28,269	6,021	180,840	(251,629)	949,174
Other segment information:								
Segment assets	832,622	153,150	103,935	14,150	5,770	319,272	(653,858)	775,041
Capital expenditure	28,822	9,008	7,964	3,021	2,190	11,448	—	62,453

5. REVENUE AND OTHER INCOME

Revenue

Revenue, which is also the Group's turnover, represents the net amount received and receivable from the provision of catering services; the sale of food products to franchised restaurants and customers, less returns and allowances; franchise income; and management service fee income. An analysis of revenue is presented below:

	2008 RMB'000	2007 RMB'000
Restaurant operations and provision of catering services	**1,010,690**	750,867
Sale of food products	**239,858**	170,479
Franchise income	**18,886**	26,375
Management service fee income	**2,089**	1,453
	1,271,523	949,174

5. REVENUE AND OTHER INCOME (continued)

Other Income

	Notes	2008 RMB'000	2007 RMB'000
Government grants	(i)	**5,038**	3,440
Gain on disposal of a subsidiary	31	**4,158**	—
Sales of low value consumables		**2,318**	1,173
Interest income on bank balances		**4,019**	1,772
Waiver of 2007 interest expenses on convertible bonds	(ii)	**8,463**	—
Others		**5,968**	3,166
		29,964	9,551

(i) Various local government grants have been granted to reward the Group for its contributions to the local economy. There were no unfulfilled conditions or contingencies attaching to these government grants.

(ii) Pursuant to the letter of confirmation dated 14 May 2008 from holders of the convertible bonds, namely, 3i Group plc ("3i") and PraxCapital Fund I ("PraxCapital"), to China XiaoFeiYang Catering Chain Co., Ltd., 3i and PraxCapital have agreed to waive part of their respective entitlement to interest on the convertible bonds for 2007 of US$1.2 million (equivalent to RMB8,463,000), in view of the change in the financial market condition after the parties entering into the convertible bonds in June 2006.

6. PROFIT BEFORE TAX

The Group's profit before tax is arrived at after charging:

	2008 RMB'000	2007 RMB'000
Staff costs including directors' remuneration (note 8):		
Wages, salaries and bonuses	**215,662**	146,575
Expense of share-based payments	**3,409**	100
Pension scheme costs	**16,529**	5,883
Social welfare and other costs	**21,742**	13,328
	257,342	165,886
Depreciation	**40,247**	31,876
Amortization of intangible assets	**98**	97
Amortization of lease prepayments	**246**	123
Auditors' remuneration	**4,500**	2,224
Net loss on disposal of items of property, plant and equipment	**288**	3,583
Provision against trade receivables	**250**	1,075
Minimum lease payments under operating leases in respect of buildings	**119,534**	96,904

7. FINANCE COSTS

	2008 RMB'000	2007 RMB'000
Interest expense on bank loans and other borrowings	856	1,751
Interest expense on convertible bonds	5,747	18,859
	6,603	20,610

8. DIRECTORS' AND SENIOR EXECUTIVES' EMOLUMENTS

Directors' remuneration for the year, disclosed pursuant to the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (the "Listing Rules") and Section 161 of the Hong Kong Companies Ordinance, is as follows:

	2008 RMB'000	2007 RMB'000
Fees	536	157
Other emoluments:		
Salaries, allowances, bonuses and other benefits	6,500	970
Equity-settled share option expenses	721	21
Pension scheme contributions	95	1
	7,852	1,149

(a) Independent non-executive directors

	Fee RMB'000
2008	
Mr. Xiang Bing	134
Mr. Yeung Ka Keung	134
Mr. Shin Yick, Fabian	134
	402

8. DIRECTORS' AND SENIOR EXECUTIVES' EMOLUMENTS (continued)

(a) Independent non-executive directors (continued)

	Fee RMB'000
2007	
Mr. Xiang Bing	—
Mr. Yeung Ka Keung	—
Mr. Shin Yick, Fabian	—
	—

(b) Executive directors and two non-executive directors

	Fees RMB'000	Salaries, allowances, and benefit in kind RMB'000	Performance related bonuses RMB'000	Equity-settled share option expenses RMB'000	Pension scheme contributions RMB'000	Total RMB'000
2008						
Executive directors:						
Mr. Zhang Gang	—	500	500	—	—	1,000
Mr. Lu Wenbing	—	400	400	322	1	1,123
Mr. Yeung Yiu Keung	—	1,700	300	181	13	2,194
Mr. Wang Daizong	—	600	300	19	13	932
Mr. Zhang Zhanhai	—	300	300	—	12	612
Ms. Kou Zhifang	—	300	300	66	—	666
Ms. Li Baofang	—	300	300	94	4	698
	—	4,100	2,400	682	43	7,225
Non-executive directors:						
Mr. Chen Hongkai	—	—	—	39	—	39
Mr. Nishpank Rameshbabu Kankiwala	134	—	—	—	52	186
	134	4,100	2,400	721	95	7,450

8. DIRECTORS' AND SENIOR EXECUTIVES' EMOLUMENTS (continued)

(b) Executive directors and two non-executive directors (continued)

	Fees RMB'000	Salaries, allowances, and benefit in kind RMB'000	Performance related bonuses RMB'000	Equity-settled share option expenses RMB'000	Pension scheme contributions RMB'000	Total RMB'000
2007						
Executive directors:						
Mr. Zhang Gang	—	84	—	—	—	84
Mr. Lu Wenbing	—	72	—	9	1	82
Mr. Yeung Yiu Keung	—	552	—	5	—	557
Mr. Wang Daizong	—	82	—	1	—	83
Mr. Zhang Zhanhai	—	60	—	—	—	60
Ms. Kou Zhifang	—	60	—	2	—	62
Ms. Li Baofang	—	60	—	3	—	63
	—	970	—	20	1	991
Non-executive directors:						
Mr. Chen Hongkai	—	—	—	1	—	1
Mr. Nishpank Rameshbabu Kankiwala	157	—	—	—	—	157
	157	970	—	21	1	1,149

(c) Five highest paid employees

The five highest paid employees during the year included four (2007: five) directors, details of whose remuneration are set out in notes 8(a) and 8(b) above. Details of the remuneration of the remaining one (2007: nil) non-director, highest paid employee for the year are as follows:

	2008 RMB'000
Salaries, allowances and benefits in kind	749
Performance related bonuses	125
Equity-settled share option expenses	84
Pension scheme contributions	11
	969

The emoluments of the non-director, highest paid employee fall within the range of nil to RMB1 million during the year.

8. DIRECTORS' AND SENIOR EXECUTIVES' EMOLUMENTS (continued)

During the year, certain directors and non-director, highest paid employee were granted share options, in respect of their services to the Group, under the share option scheme of the Company, further details of which are set out in note 40 to the financial statements. The fair value of such options which has been recognized to the consolidated income statement over the vesting period, was determined as at the date of grant and the amount included in the financial statements for the current year is included in the above directors' and senior executives' remuneration disclosures.

9. TAX

The Group is subject to income tax on an entity basis on the profit arising in or derived from the tax jurisdictions in which members of the Group are domiciled and operate.

Under the New PRC corporate income tax law, since 1 January 2008 except for the preferential treatment available to certain subsidiaries operating in the PRC, the companies of the Group which operate in the PRC are subject to corporate income tax at a rate of 25% on their respective taxable income or deemed profit assessed based on the verification collection method. During the year ended 31 December 2008, after obtaining approval from the relevant PRC tax authorities, 17 (2007: 13) entities of the Group were subject to a preferential corporate income tax rate of 18%, 5 (2007: 4) entities of the Group were exempt from the corporate income tax and 36 (2007: 28) entities of the Group were assessed based on the verification collection method. All the tax concessions enjoyed by the Group were granted by various competent tax bureaus.

The provision for Hong Kong profits tax is calculated at 16.5% of the profit for the year ended 31 December 2008 (2007: 17.5%).

An analysis of the provision for tax in the consolidated income statement is as follows:

	Note	**2008** **RMB'000**	2007 RMB'000
Group			
Current		**31,257**	33,950
Deferred	18	**(464)**	368
		30,793	34,318

9. TAX (continued)

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

	Hong Kong		Mainland China		Others		Total	
	RMB'000	**%**	**RMB'000**	**%**	**RMB'000**	**%**	**RMB'000**	**%**
Group — 2008								
Profit/(loss) before tax	**9,999**	**100.0**	**158,651**	**100.0**	**(3,322)**	**100.0**	**165,328**	**100.0**
Tax at the statutory tax rate	**1,650**	**16.5**	**39,663**	**25.0**	**640**	**(19.3)**	**41,953**	**25.4**
Tax effect of preferential income tax rates	**—**	**—**	**(8,180)**	**(5.1)**	**—**	**—**	**(8,180)**	**(5.0)**
Effect of the verification collection method	**—**	**—**	**(4,190)**	**(2.6)**	**—**	**—**	**(4,190)**	**(2.5)**
Income not subject to tax	**—**	**—**	**(160)**	**(0.1)**	**(665)**	**20.0**	**(825)**	**(0.5)**
Expenses not deductible for tax	**318**	**3.2**	**1,784**	**1.1**	**—**	**—**	**2,102**	**1.2**
Tax losses utilised from previous period	**—**	**—**	**(1,206)**	**(0.8)**	**—**	**—**	**(1,206)**	**(0.7)**
Tax losses not recognized	**—**	**—**	**2,985**	**1.9**	**—**	**—**	**2,985**	**1.8**
Others	**22**	**0.2**	**(1,722)**	**(1.1)**	**(146)**	**4.4**	**(1,846)**	**(1.1)**
Tax charge at the Group's effective rate	**1,990**	**19.9**	**28,974**	**18.3**	**(171)**	**5.1**	**30,793**	**18.6**

	Hong Kong		Mainland China		Others		Total	
	RMB'000	%	RMB'000	%	RMB'000	%	RMB'000	%
Group — 2007								
Profit/(loss) before tax	13,884	100.0	131,849	100.0	(16,364)	100.0	129,369	100.0
Tax at the statutory tax rate	2,430	17.5	43,511	33.0	396	(2.4)	46,337	35.8
Tax effect of preferential income tax rates	—	—	(11,523)	(8.7)	—	—	(11,523)	(8.9)
Effect of the verification collection method	—	—	(4,691)	(3.6)	—	—	(4,691)	(3.6)
Income not subject to tax	(59)	(0.4)	—	—	—	—	(59)	—
Expenses not deductible for tax	—	—	1,772	1.3	—	—	1,772	1.3
Tax losses utilised from previous period	(387)	(2.8)	(1,049)	(0.8)	(54)	0.3	(1,490)	(1.2)
Tax losses not recognized	—	—	2,532	1.9	388	(2.4)	2,920	2.3
Others	62	0.4	990	0.8	—	—	1,052	0.8
Tax charge at the Group's effective rate	2,046	14.7	31,542	23.9	730	(4.5)	34,318	26.5

10. DIVIDENDS

	2008 RMB'000	2007 RMB'000
Dividend paid by China XiaoFeiYang to the then shareholders	**78,506**	31,850
Proposed final — HK cents 7.6 per share (equivalent to approximately RMB6.7 cents per share)	**68,852**	—

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

11. PROFIT ATTRIBUTABLE TO SHAREHOLDERS OF THE COMPANY

The consolidated profit attributable to equity holders of the Company for the year ended 31 December 2008 includes a loss of RMB11,366,000 which has been dealt with in the financial statements of the Company (note 38(b)).

12. EARNINGS PER SHARE ATTRIBUTABLE TO SHAREHOLDERS OF THE COMPANY

The calculation of basic earnings per share for the year is based on the profit attributable to shareholders of the Company for the year of RMB128,698,000 (2007: RMB91,163,000) and the weighted average number of 950,104,846 ordinary shares (2007: 852,943,000 ordinary shares) of the Company.

The weighted average number of ordinary shares used to calculate the basic earnings per share for the year ended 31 December 2008 includes the 174,700,000 ordinary shares issued in connection with the listing of the Company's ordinary shares on the Stock Exchange on 12 June 2008.

The weighted average number of ordinary shares used to calculate the basic earnings per share for the year ended 31 December 2007 was based on the 852,943,000 ordinary shares issued in accordance with the Reorganisation, as further detailed in note 37 to the consolidated financial statements.

The calculation of diluted earnings per share for the year ended 31 December 2008 is based on the profit attributable to shareholders for the year of RMB128,698,000 (2007: RMB91,163,000) and on 950,954,446 ordinary shares (2007: 853,313,007 ordinary shares), as used in the calculation of basic earnings per share and the weighted average of 849,600 ordinary shares (2007: 370,007 ordinary shares) assumed to have been issued at no consideration on the deemed exercise of the Pre-IPO Options Scheme (as defined in note 40 to the consolidated financial statements).

13. PROPERTY, PLANT AND EQUIPMENT

Group

31 December 2008	Buildings RMB'000	Leasehold improvements RMB'000	Motor vehicles RMB'000	Equipment and fixtures RMB'000	Construction in progress RMB'000	Total RMB'000
At 1 January 2008, net of accumulated depreciation	60,684	77,248	3,350	40,566	127	181,975
Additions	9	58,567	1,906	21,071	71,884	153,437
Transfers from construction in progress	729	—	—	4,451	(5,180)	—
Acquisition of subsidiaries and branches (note 19)	—	—	42	914	—	956
Disposal of a subsidiary (note 31)	—	(12,171)	(75)	(2,989)	—	(15,235)
Disposals	—	(370)	(158)	(1,678)	(203)	(2,409)
Exchange differences	—	(347)	—	(446)	—	(793)
Depreciation charge for the year	(1,904)	(26,900)	(837)	(10,606)	—	(40,247)
At 31 December 2008, net of accumulated depreciation	59,518	96,027	4,228	51,283	66,628	277,684
At 1 January 2008:						
Cost	66,660	134,698	5,183	71,617	127	278,285
Accumulated depreciation	(5,976)	(57,450)	(1,833)	(31,051)	—	(96,310)
Net carrying amount	60,684	77,248	3,350	40,566	127	181,975
At 31 December 2008:						
Cost	67,239	179,435	6,608	88,158	66,628	408,068
Accumulated depreciation	(7,721)	(83,408)	(2,380)	(36,875)	—	(130,384)
Net carrying amount	59,518	96,027	4,228	51,283	66,628	277,684

13. PROPERTY, PLANT AND EQUIPMENT (continued)

Group (continued)

31 December 2007	Buildings RMB'000	Leasehold improvements RMB'000	Motor vehicles RMB'000	Equipment and fixtures RMB'000	Construction in progress RMB'000	Total RMB'000
At 1 January 2007, net of accumulated depreciation	61,082	57,365	3,314	38,420	392	160,573
Additions	1,176	37,344	994	13,908	1,213	54,635
Transfers from construction in progress	413	—	—	189	(602)	—
Acquisition of subsidiaries and branches	—	3,854	13	1,342	—	5,209
Disposals	(135)	(3,558)	(311)	(842)	(876)	(5,722)
Exchange differences	—	(263)	—	(581)	—	(844)
Depreciation charge for the year	(1,852)	(17,494)	(660)	(11,870)	—	(31,876)
At 31 December 2007, net of accumulated depreciation	60,684	77,248	3,350	40,566	127	181,975
At 1 January 2007:						
Cost	65,224	98,868	4,872	58,519	392	227,875
Accumulated depreciation	(4,142)	(41,503)	(1,558)	(20,099)	—	(67,302)
Net carrying amount	61,082	57,365	3,314	38,420	392	160,573
At 31 December 2007:						
Cost	66,660	134,698	5,183	71,617	127	278,285
Accumulated depreciation	(5,976)	(57,450)	(1,833)	(31,051)	—	(96,310)
Net carrying amount	60,684	77,248	3,350	40,566	127	181,975

13. PROPERTY, PLANT AND EQUIPMENT (continued)

Group (continued)

All of the Group's buildings are located in the PRC.

As at 31 December 2008, certain equipment of the Group was pledged as security for bank loans of the Group as disclosed in note 25 to the financial statements. The aggregate carrying value of the pledged equipment attributable to the Group as at 31 December 2008 amounted to RMB922,000.

As at 31 December 2008, certificates of ownership in respect of an office premises of the Group in Shanghai with an aggregate net book value of RMB62,413,000 (2007: Nil) had not been issued by the relevant PRC authorities. The directors of the Company represented that the Group will obtain the certificates of ownership in respect of the above-mentioned office premises from the relevant PRC authorities in the near future.

Company

31 December 2008	**Equipment and fixtures RMB'000**
At 1 January 2008, net of accumulated depreciation	—
Additions	**22**
Depreciation charge for the year	**(2)**
At 31 December 2008, net of accumulated depreciation	**20**
At 1 January 2008:	
Cost	—
Accumulated depreciation	—
Net carrying amount	—
At 31 December 2008:	
Cost	**22**
Accumulated depreciation	**(2)**
Net carrying amount	**20**

14. INTANGIBLE ASSETS

The movements in intangible assets during the year are as follows:

Group

	Notes	Goodwill RMB'000	Trademark RMB'000	Total RMB'000
31 December 2008				
At 1 January 2008, net of accumulated amortization		**142,444**	**749**	**143,193**
Additions		**—**	**9**	**9**
Arising from acquisition of subsidiaries and branches	19(a)	**26,625**	**—**	**26,625**
Arising from acquisition of minority interests of subsidiaries	19(b)	**1,402**	**—**	**1,402**
Amortization provided for the year		**—**	**(98)**	**(98)**
At 31 December 2008, net of accumulated amortization		**170,471**	**660**	**171,131**
At 1 January 2008:				
Cost		**142,444**	**963**	**143,407**
Accumulated amortization		**—**	**(214)**	**(214)**
Net carrying amount		**142,444**	**749**	**143,193**
At 31 December 2008:				
Cost		**170,471**	**972**	**171,443**
Accumulated amortization		**—**	**(312)**	**(312)**
Net carrying amount		**170,471**	**660**	**171,131**
31 December 2007				
At 1 January 2007, net of accumulated amortization		84,653	839	85,492
Additions		57,791	7	57,798
Amortization provided for the year		—	(97)	(97)
At 31 December 2007, net of accumulated amortization		142,444	749	143,193
At 1 January 2007:				
Cost		84,653	956	85,609
Accumulated amortization		—	(117)	(117)
Net carrying amount		84,653	839	85,492
At 31 December 2007:				
Cost		142,444	963	143,407
Accumulated amortization		—	(214)	(214)
Net carrying amount		142,444	749	143,193

14. INTANGIBLE ASSETS (continued)

Impairment testing of goodwill

Goodwill acquired through business combinations has been allocated to the following cash-generating units, which are reportable geographical segments, for impairment testing:

Segment	Notes	**2008 RMB'000**	2007 RMB'000
North China segment	(i)	**64,724**	44,207
East China segment	(ii)	**65,314**	59,563
South China segment	(iii)	**35,951**	35,951
North West China segment	(iv)	**4,482**	2,723
		170,471	142,444

Notes:

(i) North China segment represents the subsidiaries and branches located in Beijing, Tianjin, Shandong Province and Inner Mongolia Autonomous Region.

(ii) East China segment represents the subsidiaries and branches located in Shanghai, Jiangsu Province, Zhejiang Province, Fujian Province and Anhui Province.

(iii) South China segment represents the subsidiaries and branches located in Guangdong Province, Guangxi Autonomous Region, Hubei Province and Hunan Province.

(iv) North West China segment represents the subsidiaries located in Shanxi Province, Sichuan Province, Ningxia Autonomous Region and Gansu Province.

The goodwill comprises the fair value of expected business synergies arising from the acquisitions, which is not separately recognized.

The recoverable amount of each cash-generating unit has been determined based on a value in use calculation. To calculate this, cash flow projections are based on financial budgets as approved by senior management which cover a period of five years. The discount rate applied to cash flow projections beyond the one-year period is 16%.

Key assumptions used in the value in use calculation

The following describes the key assumptions of the cash flow projections.

Restaurant revenue — the bases used to determine the future earnings of a restaurant are the historical sales and the average growth rate of similar restaurants of the Group, which operate in the same city, over the last two years.

Operating expenses — the bases used to determine the values assigned are cost of inventories, staff costs, depreciation and amortization, rental expenses, fuel and utility expenses and other operating expenses. The values assigned to the key assumption reflect past experience and management's commitment to maintain its operating expenses at an acceptable level.

Discount rates — discount rates reflect management's estimate of the risks specific to these entities. In determining appropriate discount rates for each unit, a consideration has been given to the applicable borrowing rates of the respective units in the current year.

15. LAND LEASE PREPAYMENTS

Lease prepayments represent land use rights paid to the PRC government authorities and are amortised on the straight-line basis over their respective lease periods.

Group

	2008 RMB'000	2007 RMB'000
At 1 January, net of accumulated amortization	**11,858**	4,170
Additions	**105**	7,811
Amortization provided for the year	**(246)**	(123)
At 31 December, net of accumulated amortization	**11,717**	11,858
At 1 January:		
Cost	**12,136**	4,325
Accumulated amortization	**(278)**	(155)
Net carrying amount	**11,858**	4,170
At 31 December:		
Cost	**12,241**	12,136
Accumulated amortization	**(524)**	(278)
Net carrying amount	**11,717**	11,858

16. INVESTMENT IN A SUBSIDIARY

	2008 RMB'000
Unlisted shares, at cost	**92**

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

16. INVESTMENT IN A SUBSIDIARY (continued)

Particulars of the principal subsidiaries are as follows:

Name	Place of incorporation/ registration and operations	Registered share capital	Percentage of equity attributable to the Company Direct	Indirect	Principal activities
China XiaoFeiYang Catering Chain Co., Ltd. (中國小肥羊餐飲連鎖有限公司)	British Virgin Islands	US$432,548.85	100	—	Investment holding
Inner Mongolia Little Sheep Catering Chain Company Limited* (內蒙古小肥羊餐飲連鎖有限公司)	The PRC	RMB540,955,584	—	100	Restaurant and catering services
Inner Mongolia Little Sheep Meat Company Limited** (內蒙古小肥羊肉業有限公司)	The PRC	RMB34,307,700	—	87	Slaughtering and meat processing
Inner Mongolia Little Sheep Seasoning Company Limited** (內蒙古小肥羊調味品有限公司)	The PRC	RMB3,030,000	—	99	Manufacture and trading of food products
Bayannur Little Sheep Meat Company Limited** (巴彥淖爾市小肥羊肉業有限責任公司)	The PRC	RMB1,010,000	—	99	Slaughtering and meat processing
Shenzhen Little Sheep Catering Chain Company Limited** (深圳市小肥羊餐飲連鎖有限公司)	The PRC	RMB1,000,000	—	100	Restaurant and catering services
Little Sheep Hong Kong Holdings Company Limited (小肥羊香港控股有限公司)	Hong Kong	HK$18,000,000	—	100	Investment Holding
Baotou Little Sheep Shenhua Catering Company Limited** (包頭市小肥羊神華餐飲有限公司)	The PRC	RMB3,000,000	—	51	Restaurant and catering services

* *registered as a wholly-foreign-owned enterprise under the PRC law*

** *registered as a limited liability company under the PRC law*

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

17. LONG-TERM RENTAL DEPOSITS

The long-term rental deposits represented the rental deposits paid to the various landlords with lease terms that will expire more than one year after the balance sheet date.

18. DEFERRED INCOME TAX ASSETS AND LIABILITIES

The movements in deferred tax assets and liabilities during the year are as follows:

31 December 2008	Balance at 1 January 2008 RMB'000	Recognized in the income statement RMB'000	Balance at 31 December 2008 RMB'000
Deferred income tax assets:			
Tax losses	182	(182)	—
Pre-operating expenses	2,100	211	2,311
Accrued rental expenses	474	143	617
	2,756	172	2,928
Deferred income tax liabilities:			
Prepaid rental expenses	(292)	292	—
	2,464	464	2,928

31 December 2007	Balance at 1 January 2007 RMB'000	Recognized in the income statement RMB'000 (note 9)	Balance at 31 December 2007 RMB'000
Deferred income tax assets:			
Tax losses	390	(208)	182
Pre-operating expenses	2,112	(12)	2,100
Accrued rental expenses	702	(228)	474
	3,204	(448)	2,756
Deferred income tax liabilities:			
Accelerated tax depreciation	(32)	32	—
Prepaid rental expenses	(340)	48	(292)
	(372)	80	(292)
	2,832	(368)	2,464

19. BUSINESS COMBINATIONS

(a) Acquisition of subsidiaries and branches

During the year, the Group entered into various sales and purchase agreements to acquire seven branches and three subsidiaries from various independent third parties for an aggregate cash consideration of RMB30,140,000 which generated goodwill of RMB26,625,000.

The fair values of the identifiable assets and liabilities acquired by the Group during the year were:

	Recognized on acquisition RMB'000	**Carrying value** RMB'000
Property, plant and equipment	956	956
Trade receivables	14	14
Inventories	2,114	2,114
Prepayments, deposits and other receivables	2,695	2,695
Cash and cash equivalents	1,164	1,164
Other current assets	200	200
Trade payables	(1,613)	(1,613)
Tax payable	(304)	(304)
Customers' deposits, other payables and accruals	(1,711)	(1,711)
Fair value of net assets acquired by the Group	3,515	3,515
Goodwill on acquisition	26,625	
Cash consideration	30,140	

The cash outflow in respect of the acquisition is as follows:

	RMB'000
Net cash and cash equivalents acquired	1,164
Cash paid	(30,140)
Net cash outflow in respect of the acquisition of subsidiaries and branches	(28,976)

The aggregate revenue and profit of these subsidiaries and branches, which are franchised restaurants for the period from their respective dates of acquisition to 31 December 2008 amounted to RMB37.1 million and RMB8.3 million, respectively.

Due to the fact that the Group is unable to obtain the pre-acquisition results of these franchised restaurants from the vendors, it is impractical to disclose such information as required under IFRS 3.70.

19. BUSINESS COMBINATIONS (continued)

(b) Acquisition of minority interests of subsidiaries

On 1 January 2008, the Group entered into various sales and purchase agreements to acquire the minority interests of Inner Mongolia Little Sheep Meat Company Limited, Inner Mongolia Little Sheep Seasoning Company Limited and Bayannur Little Sheep Meat Company Limited of 0.87%, 0.99% and 0.99%, respectively, for an aggregate cash consideration of RMB3,000,000 which generated goodwill of RMB1,402,000.

20. INVENTORIES

	2008 RMB'000	2007 RMB'000
Raw materials	5,782	7,513
Consumables	13,469	8,608
Food and beverages	160,149	128,022
	179,400	144,143

At as 31 December 2008, there were no inventories stated at net realisable value (2007: Nil).

21. TRADE RECEIVABLES

Trade receivables are mainly franchise fees receivable and receivables from the sale of food products to franchisees or independent third party distributors who have an established trading history with the Group. Allowance for trade receivables is provided when it is considered that the trade receivable amounts may not be fully recovered. Trade receivables are non-interest bearing and are generally on three months' terms.

An aged analysis of the trade receivables as at the balance sheet date, based on the invoice date and net of provision, is as follows:

	2008 RMB'000	2007 RMB'000
Within 3 months	9,370	5,304
3 to 6 months	2,045	54
6 to 12 months	760	15
	12,175	5,373

21. TRADE RECEIVABLES (continued)

As at 31 December 2008, trade receivables at nominal value of RMB250,000 (2007: RMB5,672,000) were impaired and fully provided for. Movements in the provision for impairment of receivables were as follows

	Total RMB'000
At 1 January 2007	4,597
Charge for the year	1,075
At 31 December 2007	5,672
Charge for the year	250
Write-off	(5,672)
At 31 December 2008	250

At 31 December 2008, the ageing analysis of trade receivables is as follows:

			Past due but not impaired	
	Total RMB'000	Neither pass due nor impaired RMB'000	Within 3 months RMB'000	Over 3 months but within 6 months RMB'000
2008	**12,175**	**9,370**	**2,045**	**760**
2007	5,373	5,304	54	15

22. DUE FROM THE HOLDING COMPANY AND A SHAREHOLDER

The amounts due from the holding company (Possible Way) and the shareholder (Billion Year International Limited ("Billion Year")) of RMB64,000 and RMB14,000, respectively were interest-free, unsecured and were settled during the year.

23. PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

	2008 RMB'000	2007 RMB'000
Rental deposits and prepayments	**18,062**	15,709
Deposits to suppliers	**5,632**	8,082
Prepayments and other receivables	**42,208**	31,417
	65,902	55,208

24. CASH AND CASH EQUIVALENTS

	Group		Company	
	2008	2007	**2008**	2007
	RMB'000	RMB'000	**RMB'000**	RMB'000
Cash and bank balances	**324,038**	204,126	**14,019**	—
Short-term deposits	**100,000**	—	**—**	—
	424,038	204,126	**14,019**	—

Cash and cash equivalents of the Group comprised of cash and bank balances. The bank balances earn interest at floating rates based on daily bank deposit rates.

As at 31 December 2008, cash and bank balances, and short-term deposits of the Group aggregating to RMB371,750,000 (2007: RMB169,079,000) were denominated in Renminbi, which are not freely convertible in the international market. The remittance of funds out of the PRC is subject to the exchange restrictions imposed by the PRC government.

25. BANK LOANS

	2008	2007
	RMB'000	RMB'000
Bank loans:		
Secured	**910**	21,070
Unsecured	**—**	77,832
	910	98,902
Bank loans repayable:		
Within one year or on demand	**535**	97,992
In the second year	**375**	—
In the third to fifth years, inclusive	**—**	910
Total bank loans	**910**	98,902
Less: Portion classified as current liabilities	**(535)**	(97,992)
Non current portion	**375**	910

At 31 December 2008, bank loans of RMB910,000 were secured by pledges of equipment of the Group with an aggregate carrying value of RMB1,150,000 (note 13).

The long term loan was from the local finance bureau in Bayannaoer City (Bameng) with a preferential interest rate of 2.40%. The Group's interest-bearing bank loans were denominated in Renminbi.

26. TRADE PAYABLES

An ageing analysis of the trade payables is as follows:

	2008 RMB'000	2007 RMB'000
Within 3 months	**39,546**	32,060
Over 3 months	**1,257**	5,388
	40,803	37,448

27. DEPOSITS, OTHER PAYABLES AND ACCRUALS

An analysis of customers' deposits, other payables and accruals as at the balance sheet date is as follows:

	2008 RMB'000	2007 RMB'000
Deposits and advances from customers	**33,330**	32,257
Construction fee payables	**21,170**	11,568
Accrued wages and salaries	**32,064**	14,598
Other payables and accruals	**51,243**	34,292
	137,807	92,715

28. DUE TO MINORITY EQUITY HOLDERS/SHAREHOLDERS OF SUBSIDIARIES

The amounts are interest-free, unsecured and have no fixed terms of repayment.

29. LONG TERM PAYABLES

The long-term payables represent the long term portion of accrued rental expenses, and are stated at amortised cost.

30. CONTINGENT LIABILITIES

The Group did not have any significant contingent liabilities as at 31 December 2008 (2007: Nil).

31. DISPOSAL OF A SUBSIDIARY

	2008 RMB'000
Net assets disposed of:	
Property, plant and equipment	15,235
Cash and bank balances	1,160
Trade receivables	50
Inventories	176
Prepayments and other receivables	33,591
Trade payables	(1,035)
Accruals and other payables	(23,655)
Short term loan	(26,489)
Tax payable	(418)
Minority interests	(602)
	(1,987)
Gain on disposal of a subsidiary (note 5)	4,158
	2,171
Satisfied by:	
Cash	2,171

31. DISPOSAL OF A SUBSIDIARY (continued)

An analysis of the net inflow of cash and cash equivalents in respect of the disposal of a subsidiary is as follows:

	2008 RMB'000
Cash consideration	2,171
Cash and bank balances disposed of	(1,160)
Net inflow of cash and cash equivalents in respect of the disposal of a subsidiary	1,011

32. COMMITMENTS

(i) Operating lease commitments — as lessee

The Group leases certain properties under operating lease arrangements. These leases have an average life of between 1 and 13 years. In entering into these lease agreements, no restrictions were placed upon the Group.

As at 31 December 2008, the Group had the future minimum rentals payable under non-cancellable operating leases falling due as follows:

	2008 RMB'000	2007 RMB'000
Within one year	116,660	82,370
In the second to fifth years, inclusive	247,883	153,830
After five years	84,515	19,923
	449,058	256,123

(ii) Capital commitments

The Group has the following capital commitments at the balance sheet date:

	2008 RMB'000	2007 RMB'000
Authorised, but not contracted for:		
Acquisition of subsidiaries	—	12,420

33. RELATED PARTY TRANSACTIONS

In addition to the transactions and balances which are disclosed elsewhere in these financial statements, the Group had the following significant transactions with related parties during the year:

	Note	2008 RMB'000	2007 RMB'000
Rental expenses	(i)	**3,451**	4,204

Note:

(i) The amount represented rental expenses payable to Mr. Zhang Gang, Mr. Chen Hongkai and Ms. Kou Zhifang for leasing five (2007: five) office buildings and restaurants which are classified as ongoing connected transactions in accordance with the Listing Rules. The amounts of the rental expenses were agreed by the parties by reference to market rentals.

34. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's principal financial liabilities, comprise bank loans and trade payables. The main purpose of these financial liabilities is to raise finance for the Group's operations. The Group has various financial assets such as trade receivables and cash and short term deposits, which arise directly from its operations.

It is, and has been throughout 2008 and 2007, the Group's policy that no trading in derivatives shall be undertaken.

The main risks arising from the Group's financial instruments are cash flow interest rate risk, liquidity risk, foreign currency risk and credit risk. The Board of Directors reviews and agrees policies for managing each of these risks which are summarised below.

Interest rate risk

The Group's earnings are affected by changes in interest rates due to the impact of such changes on interest income and expense from interest-bearing financial assets and liabilities. The Company's interest-bearing financial assets and liabilities are predominately denominated in RMB. The Group's financial assets comprised primarily of cash deposits with fixed interest rates and loans and receivables, and the Group does not have any material interest-bearing debt obligations as at 31 December 2008. Therefore, the Group considers that the exposure to interest rate risks is insignificant.

34. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

Foreign currency risk

The Group's businesses are principally conducted in RMB which cannot be freely exchanged into foreign currencies. As at 31 December 2008, a substantial amount of the Group's assets and liabilities was denominated in RMB. Fluctuation of the exchange rates of RMB against other currencies can affect the Group's results of operations.

The Group currently does not have a foreign currency hedging policy. However, management monitors foreign exchange exposure and will consider hedging significant foreign currency exposure should the need arise.

The following table demonstrates the sensitivity to a reasonably possible change in the US dollar exchange rate, with all other variables held constant, of the Group's profit before tax (due to changes in the fair value of monetary assets and liabilities) and the Group's equity (due to changes in the fair value of forward exchange contracts and net investment hedges).

	Increase/ decrease in US$ rate	Effect on profit before tax RMB'000	Effect on equity RMB'000
2008	**+5%**	**—**	**—**
	-5%	**—**	**—**
2007	+5%	(941)	(9,130)
	-5%	941	9,130

34. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

Credit risk

The cash at banks, short term deposits, trade receivables and prepayments, deposits and other receivables included in the consolidated financial statements represent the Group's major exposure to the credit risk attributable to its financial assets. The Group has no other significant concentrations of credit risk.

Liquidity risk

The Group's objective is to maintain a balance between continuity of funding and flexibility through the use of bank loans and other interest-bearing loans. As at 31 December 2008, the Group had bank loans balances of RMB535,000 (2007: RMB97,992,000) which will mature within 12 months. The directors have reviewed the Group's working capital and capital expenditure requirements and determined that the Group has no significant liquidity risk.

The table below summarises the maturity profile of the Group's financial liabilities at 31 December 2008 based on contractual undiscounted payments.

Year ended 31 December 2008

	On demand RMB'000	Less than 3 months RMB'000	3 to 12 months RMB'000	1 to 5 years RMB'000	Total RMB'000
Bank loans	—	—	535	375	910
Trade payables	—	39,546	1,257	—	40,803
Due to minority equity holders/ shareholders of subsidiaries	12,528	—	—	—	12,528
Other payables	—	116,637	21,170	—	137,807
	12,528	156,183	22,962	375	192,048

Year ended 31 December 2007

	On demand RMB'000	Less than 3 months RMB'000	3 to 12 months RMB'000	1 to 5 years RMB'000	Total RMB'000
Bank loans	—	30,000	67,992	910	98,902
Convertible bond	—	—	—	190,966	190,966
Trade payables	—	32,060	5,388	—	37,448
Due to minority equity holders/ shareholders of subsidiaries	5,609	—	23,076	—	28,685
Other payables	—	41,672	11,568	—	53,240
	5,609	103,732	108,024	191,876	409,241

34. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

Capital management

The primary objective of the Group's capital management is to ensure that it maintains healthy capital ratios in order to support its business and maximise shareholder value.

The Group manages its capital structure and makes adjustments to it, in light of changes in economic conditions. To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, return capital to shareholders or issue new shares. No changes were made in the objectives, policies or processes during the years end 31 December 2008 and 2007.

The Group includes within net debt, interest bearing loans and borrowings, trade and other payables, less cash and cash equivalents, excluding discontinued operations. Capital includes convertible bonds and equity attributable to the equity holders of the Company.

	2008	2007
	RMB'000	RMB'000
Interest bearing loans and borrowing	**910**	98,902
Trade and other payables	**178,610**	130,163
Less: cash and short term deposit	**(424,038)**	(204,126)
Net debt	**(244,518)**	24,939
Convertible bonds	—	190,966
Equity	**941,599**	287,952
Total capital	**941,599**	478,918
Capital and net debt	**697,081**	503,857
Gearing ratio	**(26.0)%**	5.0%

35. FINANCIAL INSTRUMENTS

Set out below is a comparison by category of carrying amounts and fair values of all of the Group's financial instruments, including that are carried in the financial statements.

	Carrying amount		Fair value	
	2008	2007	**2008**	2007
	RMB'000	RMB'000	**RMB'000**	RMB'000
Financial assets				
Cash and cash equivalents	**424,038**	204,126	**424,038**	204,126
Trade receivables	**12,175**	5,373	**12,175**	5,373
Prepayments, deposits and other receivables	**65,902**	55,208	**65,902**	55,208
	502,115	264,707	**502,115**	264,707
Financial liabilities				
Bank loans	**910**	98,902	**910**	98,902
Trade payables	**40,803**	37,448	**40,803**	37,448
Convertible bonds	**—**	190,966	**—**	190,966
Other liabilities	**172,214**	143,118	**172,214**	143,118
	213,927	470,434	**213,927**	470,434

36. CONVERTIBLE BONDS

On 30 June 2006, the Company entered into a Convertible Bond Instrument (the "Bonds Agreement") with 3i and PraxCapital. Pursuant to the Bonds Agreement, the Company issued 6% fixed rate convertible bonds due 2011 to 3i and PraxCapital with subscription prices of US$20,000,000 and US$5,000,000 (the "Bonds"), respectively.

Pursuant to the Bonds Agreement:

i) The Bonds bear an interest rate of 6%, payable annually in arrears;

ii) The bondholders can convert the Bonds into ordinary shares of the Company based on an initial deemed subscription price of US$7,375 per share ("Conversion Shares");

iii) If the Company undertakes an initial public offering ("IPO") exercise, all bonds outstanding shall be automatically converted into Conversion Shares upon the listing of the Company's shares on a stock exchange;

iv) The Company can declare a dividend to existing ordinary shareholders up to an amount equivalent to the annual interest payable to the bondholders. Any dividend in excess of such amount shall be distributed to the shareholders and bondholders pro rata according to the number of ordinary shares and Conversion Shares, respectively;

36. CONVERTIBLE BONDS (continued)

v) The bondholders may, at any time after 31 March 2009, require the Company to redeem all or part of the Bonds by cash. The redemption amount is equivalent to the outstanding principal amount of the bonds plus an additional amount (inclusive of all interests and dividends accrued) sufficient to result in the bondholders receiving a yield to maturity on the bonds at a rate of return of 15% per annum;

vi) The bondholders may submit to the Company a proposal for an IPO as and when they deem appropriate. If such IPO proposal is rejected by the board of directors of the Company for reasons other than (i) the proposed timing; (ii) other proposed terms of such IPO proposal, in its entirety, not being in the interest of the Company, the shareholders and the bondholders as a whole; or (iii) the Company's failure to meet the applicable qualifications for an IPO, the bondholders may redeem all or part of the bonds equivalent to the outstanding principal amount of bonds plus an additional amount (inclusive of all interests and dividends accrued) equal to the highest of (i) an internal rate of return of 25% per annum of the outstanding principal amount of the bonds; (ii) the budgeted consolidated net profit of the Company for the financial year in which the redemption is to take place, as multiplied by a price-to-earnings ratio of 12.3, subject to the redemption on an as-converted basis and for the period from the commencement date of the financial year to the date of redemption; and (iii) the fair market value of the relevant bonds on an as-converted basis;

vii) All payments regarding interest, dividend or redemption shall be made in US$.

The Bonds have been split as to the liability and equity components, as follows:

	2008	2007
	RMB'000	RMB'000
Nominal value of convertible bonds issued on 30 June 2006 (original currency of US$25,000,000)	**195,218**	195,218
Equity component	**(3,486)**	(3,486)
Direct transaction costs attributable to the liability component	**(7,097)**	(7,097)
Liability component at the issuance date	**184,635**	184,635
Interest expenses payable on the Bonds	**18,642**	18,886
Exchange realignment	**(20,523)**	(12,555)
Waiver of 2007 interest expense on the Bonds	**(8,463)**	—
Converted into China XiaoFeiYang's shares and transferred to the Group's capital reserves	**(174,291)**	—
	—	190,966

36. CONVERTIBLE BONDS (continued)

Upon conversion of the Bonds by 3i and PraxCapital on 14 May 2008, the amounts converted into China XiaoFeiYang's shares and transferred to capital reserves of the Group are further analysed as follows:

	RMB'000
Transferred from the liability component of the Bonds	**174,291**
Transferred from the equity component of the Bonds	**3,486**
Released from the foreign currency translation reserve	**20,523**
	198,300

37. SHARE CAPITAL

	Notes	Number of ordinary shares of HK$0.10 each '000	Nominal value RMB'000
Authorized:			
On incorporation and at 31 December 2007	(i)	500	44
Increase in authorised share capital	(ii)	9,999,500	883,756
At 31 December 2008		10,000,000	883,800
Allotted and issued as nil paid:			
Upon incorporation and at 31 December 2007	(i)	10	—
Upon conversion of the Bonds	(iii)	3	—
On acquisition of China XiaoFeiYang:			
Consideration shares	(iv)	852,930	75,382
Nil paid shares credited as fully paid	(iv)	—	1
New issue of shares by way of public offering	(v)	174,700	15,440
At 31 December 2008		1,027,643	90,823

(i) On 18 December 2007, the Company was incorporated in the Cayman Islands as a limited liability company with an authorized share capital of HK$50,000 divided into 500,000 ordinary shares of HK$0.10 each. On the same date, 8,205 and 1,795 ordinary shares of HK$0.10 each were allotted and issued nil paid to Possible Way and Billion Year. The said ordinary shares were subsequently credited as fully paid as described in (iv) below.

(ii) Pursuant to written resolutions of all shareholders of the Company passed on 15 May 2008, the authorised share capital of the Company was increased from HK$50,000 to HK$1,000,000,000 by the creation of 9,999,500,000 new ordinary shares of HK$0.10 each.

(iii) A total of 2,712 ordinary shares and 678 ordinary shares of HK$0.10 each were allotted and issued to 3i and PraxCapital, respectively, on 22 May 2008.

37. SHARE CAPITAL (continued)

(iv) On 23 May 2008, the Company allotted and issued 522,650,295, 114,339,705, 172,751,688 and 43,187,922 ordinary shares of HK$0.10 each to Possible Way, Billion Year, 3i and PraxCapital, respectively, credited as fully paid, in consideration for the transfer of the entire issued share capital of China XiaoFeiYang as described in note 1 to the financial statements and the Company's prospectus dated 2 June 2008.

At the same date, the 10,000 nil paid ordinary shares of HK$0.10 each held by Possible Way and Billion Year as described in (i) were credited as fully paid.

(v) In connection with the Company's initial public offering, 174,699,870 new ordinary shares of HK$0.10 each were issued at a price of HK$3.18 per share for a total cash consideration, before expenses, of approximately HK$555,546,000 (equivalent to RMB488,436,000). Dealings in these ordinary shares on the Stock Exchange commenced on 12 June 2008.

(vi) In connection with the public offering, the Company, 3i and PraxCapital granted to the international underwriters the over-allotment option (the "Over-allotment Option"), exercisable by the joint global coordinators, Merrill Lynch International and Deutsche Bank, for themselves and on behalf of the international underwriters within 30 days from 5 June 2008, to require the Company to issue and 3i and PraxCapital to sell up to an aggregate of 36,778,000 additional ordinary shares at HK$3.18, among other things, to cover over-allocations in the offering, if any. The Over-allotment Option had not been exercised and it lapsed on 4 July 2008.

38. RESERVES

(a) Group

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

(i) Capital reserves

The Group's consolidated capital reserve represents the difference between (i) the aggregate of the nominal value of the issued share capital and the capital reserve of China XiaoFeiYang acquired pursuant to the Reorganisation set out in note 1 to the financial statements, and (ii) the nominal value of the Company's shares in issue.

(ii) PRC reserve funds

Pursuant to the relevant PRC laws and regulations, wholly-foreign-owned enterprises ("WFOEs") registered in PRC are required to transfer not less than 10% of their profit after tax, as determined in accordance with PRC GAAP, to the reserve funds, until the balance of the funds reaches 50% of the registered capital of that company. WFOEs registered in PRC are also required to transfer a certain percentage, as approved by the board of directors, of their profit after tax to the employee bonus and welfare fund. These funds are restricted as to use.

In accordance with the relevant PRC laws and regulations, PRC domestic companies are required to transfer 10% of their profit after income tax, as determined in accordance with PRC GAAP, to the statutory common reserve, until the balance of the reserve reaches 50% of the registered capital of that company. Subject to certain restrictions as set out in the relevant PRC regulations, the statutory common reserve may be used to offset against accumulated losses, if any. PRC domestic companies are also required to transfer 5% to 10% of net profit, as determined under PRC accounting regulations, to the statutory common welfare fund. This fund can only be used to provide staff welfare facilities and other collective benefits to the employees of that company. This fund is non-distributable other than in the event of liquidation.

38. RESERVES (continued)

(b) Company

	Notes	Capital reserves RMB'000	Foreign currency translation reserve RMB'000	Share option reserve RMB'000	Accumulated losses RMB'000	Total RMB'000
At 1 January 2008		—	—	100	(100)	—
Change in the foreign currency translation reserve		—	(807)	—	—	(807)
Loss for the year		—	—	—	(11,366)	(11,366)
Issue of ordinary shares, net of share issue expenses	37	331,768	—	—	—	331,768
Equity-settled share option arrangement	39	—	—	3,409	—	3,409
At 31 December 2008		331,768	(807)	3,509	(11,466)	323,004

The Company was incorporated on 18 December 2007. As at 31 December 2007, the Company had no material asset or liability.

39. SHARE OPTION RESERVE

	RMB'000
At 1 January 2008	100
Employee share-based payment charge to consolidated income statement	3,409
At 31 December 2008	3,509

40. EMPLOYEE SHARE-BASED PAYMENT

On 20 December 2007, a share option scheme (the "Pre-IPO Option Scheme") was approved pursuant to written resolutions of the Company. The purpose of the Pre-IPO Option Scheme is to recognise the contribution of certain employees of the Group to its growth. On 28 December 2007, the Company granted to 439 eligible employees of the Group a total of 26,379,680 share options for nil consideration and each with an exercise price of HK$2.11 (HK$1 = RMB0.944) per share and subject to the vesting schedule as set out in the Company's prospectus dated 2 June 2008. The following share options were outstanding under the Pre-IPO Option Scheme during the year:

	2008	2007
At 1 January	**26,379,680**	—
Granted during the year	**—**	26,379,680
At 31 December	**26,379,680**	26,379,680

All holders of options granted under the Pre-IPO Share Option Scheme may only exercise their options in the following manner:

Maximum percentage exercisable	**Period for vesting of the relevant percentage of the option**
Lot 1: 2,637,868 shares (10% of the total number of the options to any grantee)	From the grant date of the options to expiry of the 12-month period after the grant date of the options or of the 6-month period after the date of the initial public offering of the Company (i.e. 12 June 2008), whichever is later
Lot 2: 3,956,952 shares (15% of the total number of the options to any grantee)	From the grant date of the options to expiry of 24-month period after the grant date of the options
Lot 3: 7,913,904 shares (30% of the total number of the options to any grantee)	From the grant date of the options to expiry of 36-month period after the grant date of the options
Lot 4: 11,870,856 shares (45% of the total number of the options to any grantee)	From the grant date of the options to expiry of 48-month period after the grant date of the options

The fair value of the options granted is estimated at the date of grant using a Binomial option pricing model, taking into account the terms and conditions upon which the options were granted.

40. EMPLOYEE SHARE-BASED PAYMENT (continued)

The fair value of options granted during the year ended 31 December 2008 was estimated on the date of grant using the following assumptions:

Dividend yield (%)	1.923
Expected volatility (%)	37
Risk-free interest rate (%)	2.907
Expected life (year)	5
Share price (HK$)	1.691

At the balance sheet date, the Company had 26,379,680 share options outstanding under the Pre-IPO Share Option Scheme. The exercise in full of the remaining share options would, under the present capital structure of the Company, result in the issue of 26,379,680 additional ordinary shares of the Company and additional share capital of HK$2,638,000 (equivalent to approximately RMB2,326,000) and share premium of HK$53,023,000 (equivalent to approximately RMB46,761,000) (before issue expenses).

At the date of approval of these financial statements, the Company had 26,379,680 share options outstanding under the Pre-IPO Share Option Scheme, which represented approximately 2.57% of the Company's shares in issue as at that date.

41. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors on 16 March 2009.

FINANCIAL SUMMARY

	Year ended 31 December			
	2008	2007	2006	2005
	RMB'000	RMB'000	RMB'000	RMB'000
Results				
Revenue	**1,271,523**	949,174	702,713	513,122
Profit before tax	**165,328**	129,369	102,308	82,809
Taxation	**(30,793)**	(34,318)	(21,962)	(20,061)
Profit for the year	**134,535**	95,051	80,346	62,748
Attributable to:				
Shareholders of the Company	**128,698**	91,163	79,555	60,078
Minority interests	**5,837**	3,888	791	2,670
Assets and liabilities				
Total assets	**1,163,823**	775,041	557,783	362,432
Total liabilities	**(213,927)**	(470,726)	(337,963)	(165,956)
Minority interests	**(8,297)**	(16,363)	(8,243)	(5,195)
Equity attributable to shareholders of the Company	**941,599**	287,952	211,577	191,281

The summary of the results and assets and liabilities for each of the three years ended 31 December 2007 were extracted from the Company's prospectus dated 2 June 2008 and were prepared on a combined basis as if the current structure of the Group had been in existence throughout the years.