
BUSINESS

OVERVIEW

We are one of the leading grape wine producers in the PRC, with our signature wines produced from the indigenous *vitis amurensis* variety of grapes (colloquially referred to as “mountain grapes”) grown in vineyards at the foothills of the Changbai mountain range near Ji’An City, Jilin Province, the PRC. As at the Latest Practicable Date, our product range comprises [18] different grape wine products, which can broadly be categorised into sweet wine and dry wine. All our signature wine products are sold under the “Tongtian” (通天) and “Tongtian Hong” (通天紅) labels in [19] provinces and [3] municipal cities in the PRC through the sales networks and distribution channels of [71] distributors as at the Latest Practicable Date.

OUR COMPETITIVE STRENGTHS

We believe that the following strengths enable us to compete effectively:

Strategically located production facilities and access to good quality grapes

Our Directors believe that the critical factor in producing good wines is the quality of the grapes used. Our winery is located at the foothills of the Changbai mountain range near Ji’An City, Jilin Province, the PRC, surrounded by vineyards where we source our supply of grapes for the production of our grape wine products. The Ji’An region is among the few regions worldwide cultivating the unique *vitis amurensis* variety of grapes which give the distinctive taste to the wines produced by our Group. In particular, mountain grapes, as a natural produce of the region, have relatively higher levels of tannins and polyphenols, including resveratrol, compared with the levels in the other varietals. Our Directors believe that these mountain grapes used in our wines offer a range of health benefits to consumers, and enable us to effectively compete with other grape wine producers in the PRC.

The Ji’An region is recognised as one of the top 3 wine producing regions of the PRC, and is situated between the ideal latitudinal zone of between 40° and 50° north, which enjoys ideal grape growing conditions: a continental temperate climate with a temperature ranging from approximately -40°C to -45°C in winter and no more than approximately 36°C in summer each year, sufficient rainfall from 400mm to 1,100mm per year, adequate average total sunshine from 2,400 hours to 2,500 hours per year and 110 to 130 frost free days per year. This region is also blessed with ideal grape growing soil, being predominantly limestone and clay, and has been historically and culturally renowned for its ubiquitous vineyards. This has resulted in a deep pool of experienced vineyard and wine processing workers and experts in the region which we can tap, as well as a secure and stable source of grapes, including the mountain grape variety used in the production of our wines. Our winery facility is strategically located next to our grape supply base in this region, which is also in close proximity to our wine production facilities situated in the Tonghua region. These two regions are connected by a developed network of railways and vehicular expressways. The proximity to the suppliers of our raw materials and our wine production facilities enables our Group to maintain a stable and reliable supply of good quality grapes and grape juice for the production of our wines.

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Recognition of the “Tongtian” (通天) and “Tongtian Hong” (通天紅) brand names for niche sweet wine products in the PRC

All our grape wine products are sold under our brand labels “Tongtian” (通天) and “Tongtian Hong” (通天紅). Our Directors believe that since our establishment in 2001, our brand name has been well recognised as a leading producer of sweet wines. We were awarded the “Top 10 PRC Grape Wine Industry Brands” award and the “Top 500 Brands of the PRC” award by the China Market Brands Strategy Forum Organising Committee in March 2008. While we intend to continue producing our range of dry wines, our key focus has been targeted towards gaining a greater market share in sweet wines, which we believe has not been dominated by any competitors of comparable scale. Our Directors believe that the demand in the PRC for sweet wine will grow at a faster pace than the demand for dry wine.

We believe that our brand name is becoming widely recognised among our consumers as a symbol of quality sweet wines. Our grape wine products were recognised as “Wine of Excellent Quality” by the Expert Committee of the Grape and Fruit Wine, China Food Industry Association in 2004. We believe that such recognition is synonymous with our track record and market reputation in the industry for our high quality sweet wine products. With the PRC market for grape based wines being relatively undeveloped, we firmly believe that our established brand name will give us a competitive advantage in capturing more business opportunities in the provinces and municipal cities within our distribution network, and provide us with a solid platform for expanding into new markets throughout the PRC. We will continue to work towards increasing our brand visibility with strategic and more innovative marketing activities.

Extensive nationwide sales and distribution network in the PRC

We have established and maintained an extensive sales and distribution network in the PRC. As at the Latest Practicable Date, our wine products were being sold in [19] provinces and [3] municipal cities in the PRC. We sell our wine products to different distributors located in these provinces and municipal cities across the PRC, who in turn distribute and sell our wine products to third-party retailers, including supermarkets, and specialty stores selling tobacco and alcohol, food and beverage outlets such as restaurants, hotel restaurants and bars, as well as through their own direct sales distribution to end-consumers and other sub-distributors. As at the Latest Practicable Date, we have a total of [71] distributors. Not all of our distributors exclusively distribute and sell our Group’s products.

Our established sales and distribution network is supported by our experienced and dedicated sales team, led by our executive Director, Mr. Zhang. Our sales staff offer services to our distributors ranging from providing and updating of product information, taking sales orders and addressing the customers’ needs. Our sales staff also visit our customers regularly to further understand their requirements, and to obtain their feedback and suggestions on our products and services. Our Directors believe that the experience and dedication of our sales team enables us to maintain and continuously strengthen our relationship with our distributors and respond more quickly to changes in customer preferences in the market.

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Experienced management team with extensive experience in the PRC grape wine industry

Members of our senior management team, including, in particular, our Chairman and chief executive officer, Mr. Wang, possess an in-depth knowledge of the business and operating environment of the PRC grape wine industry. Most of our key employees have more than 20 years of experience in the PRC grape wine industry. Our technical experts, in addition to their industry experience, have received numerous provincial and national industry technical certifications and accreditations. We believe that the collective knowledge and experience of our senior management enables us to respond more rapidly to changes in the growing PRC grape wine industry, and are fundamental to the successful and sustainable long-term development of our business. For further details of our senior management team, please refer to the section headed “Directors, Senior Management and Employees” of this document.

Strong quality management system and the production of quality wine products

We place great emphasis on product quality and have established a strong quality management system to support the production of quality wine products. We have established a stringent quality management system to ensure adherence to, and consistency in, quality, cleanliness and hygiene standards for our raw ingredients and finished wine products, and consistency in taste, packaging and other product quality attributes. In December 2005, we obtained ISO 9001:2000 certification for our operation and management system with respect to our grape wine products. Our Directors believe that our quality management system is instrumental to our success and to maintaining our brand recognition as a producer of quality wine products. For further details of our quality management system, please refer to the section headed “Business – Quality Management System” of this document.

OUR STRATEGIES

Increase our production capacity

As at the Latest Practicable Date, our annual total wine production capacity (based on our maximum bottling capacity) was approximately 19,000 tonnes. To meet the anticipated increase in market demand for wine products, we intend to expand our annual production capacity from approximately 19,000 tonnes as at 30 June 2009 to approximately 39,000 tonnes in aggregate by the end of 2010. We plan to achieve this through the construction of additional wine production facilities, and the purchase and installation of additional wine-making machinery and equipment.

In September 2007, we commenced the expansion of our current wine production facility in Tonghua County, Jilin Province, the PRC, with the construction of new wine production facilities which are adjacent to our current wine production facilities in Tonghua City. Our new wine production facilities, which we expect to be operational by the end of 2010, will increase our annual wine production capacity by an additional approximately 20,000 tonnes to a total of approximately 39,000 tonnes by the end of 2010.

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The estimated cost for completing the construction of our new wine production facility is around HK\$[●] million, out of which approximately HK\$[●] million will be financed by internal resources and the remaining amount will be financed by [●], in which approximately HK\$[●] million will be applied towards the completion of our new wine production facility and the remaining HK\$[●] million will be applied towards the payment of other related expenses, including purchase of machinery.

Develop our Tongtian wine estate

We intend to develop a wine estate in Ji’An City, Jilin Province, the PRC, to produce premium range of our estate bottled wines from high quality grapes. Wines produced from our Tongtian wine estate, which will be labelled as “Estate Bottled”, will be produced from high quality grapes grown in our self-operated vineyards within our wine estate. We intend to acquire vineyards for the establishment of our wine estate [but we have not yet identified any specific site as at the Latest Practicable Date.] Our Tongtian wine estate will include wine production and wine cellaring facilities. Through an optimal crop yield control in volume and quality, and with advanced wine making facilities, we intend to produce our representative wines of Tongtian wine estate of premium quality. We plan to establish this Tongtian wine estate with 2,000 mu vineyards, and with an annual yield of [500] to [600] tonnes (equivalent to [400,000] to [480,000] 750ml bottles) of Tongtian estate wines. The development of our Tongtian wine estate will be financed entirely by [●].

Develop wine cellaring capabilities

We intend to develop wine cellaring capabilities to complement our production facilities in Tonghua County, Jilin Province, the PRC. A wine cellar is a place where a stock of wine is properly stored under a controlled environment to undergo an ageing process to produce a range of products. We intend to establish a wine cellar at our production facility in Tonghua with a storage capacity of up to [2,000] oak barrels of 225 litres in volume, in which could be bottled up to [600,000] 750ml bottles. The development of our wine cellar in Tonghua will be financed entirely by [●].

Continue to expand and develop our sales and distribution network in the PRC and strengthen our brand awareness

We plan to enhance our current sales and distribution capabilities and network throughout the PRC. In view of this, we intend to expand our sales team through the recruitment and training of additional sales staff, increase the number of our distributors and establish up to 20 Tongtian wine estate branded retail outlets in certain selected markets in the PRC within next 4 years. [We have not yet identified any specific site as at the Latest Practicable Date.] These retail outlets will function as direct sales and marketing platform for Tongtian brands, not only providing Tongtian wine experience for consumers but also providing marketing support to the designated local markets of major cities such as Beijing, Chengdu and Shenyang, to promote our wine products such as our Tongtian ice wines and rose wine.

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In addition, our Directors believe that our “Tongtian” (“通天”) and “Tongtian Hong” (“通天紅”) brand names are becoming widely recognised among consumers throughout the PRC. We have won various awards and certificates over the years at both the national and provincial levels, and were newly accredited as one of the “Top 10 PRC Grape Wine Industry Brands (中國葡萄酒行業十大品牌)” by the China Market Brands Strategy Forum Organising Committee (中國市場品牌戰略論壇組委會). We intend to continue our efforts to actively promote our “Tongtian” (“通天”) and “Tongtian Hong” (“通天紅”) brand names in the PRC.

We intend to achieve this through increasing our marketing and branding activities, which include advertising campaigns through mass media such as television, outdoor billboards and magazines.

Explore opportunities to further expand our market share

We will also explore further opportunities to expand our business and in particular, our production capacity, through acquisitions, joint ventures or strategic alliances with domestic and/or international entities that could create synergy with our existing business. We believe that suitable acquisitions or joint ventures or strategic alliances with other wine producers will enable us to increase our production capacities, benefit from synergies and allow us to access new markets and customer base, as well as bring about economies of scale.

As at the Latest Practicable Date, we had not identified any potential targets for acquisition or for the formation of joint ventures or strategic alliances. We intend to intensify our efforts to locate such suitable opportunities for growth. We have not planned to allocate any part of our [●] for expansion through acquisitions, joint ventures or strategic alliances. Should and when the opportunity arise, we will fund such expansion from internally generated funds and/or future external fund raising activities, and will seek approval, where necessary, from our Shareholders and the relevant authorities as required under applicable laws and regulations.

OUR PRODUCTS

We offer a range of grape wine products, including sweet wine and dry wine, sold under the “Tongtian” (通天) and “Tongtian Hong” (通天紅) labels. During the Track Record Period, our product range comprises [18] different grape wine products with different flavours and styles for consumer appeal, with prices (to our distributors) ranging from [RMB5.9] to [RMB115] per bottle.





Sweet Wine

Sweet wine refers to a type of wine which has 45gm or more of sugar residue per litre. Our sweet wines are produced using grapes which are grown and harvested at normal temperatures and made with the mountain grape variety unique to Tonghua area in Jilin Province, the PRC.

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Rose wine and ice wines are two typical categories of sweet wines. Our rose wine is made with mountain grapes and flavoured with rose extracts from wild mountain rose petals. Our ice wines are made with grapes that are harvested while still frozen on the vines. Our ice wines are sweet wines produced from frozen mountain grapes which are harvested at a temperature of minus 7 degree Celsius (-7°C) or lower. At this temperature, only the water, and not the sugar and other solid components in the grapes, is frozen, thereby allowing a more concentrated form of grape juice to be pressed from the frozen mountain grapes, which can be used to produce a very sweet wine. After being harvested, these frozen grapes are then pressed and fermented at low temperatures of 10 to 20 degree Celsius (10 to 20°C).




We set out below further details of some of our representative sweet wines:

Product and Year Launched	Major Raw Material	Alcohol Content	Sample Product Picture
Tongtian Hong Mountain Grape Wine (通天紅山葡萄酒) (2006)	Mountain grapes	7.0%	
Tongtian Hong Full Juice Mountain Grape Wine (通天紅全汁山葡萄酒) (2006)	Mountain grapes	11.0%	
Tongtian Wild Rose Grape Wine (通天野玫瑰 葡萄酒) (2007)	Mountain grapes and wild rose petals	8.5%	
Tongtian Ice Wine (通天冰酒) (2004)	Frozen mountain grapes	8.5%	

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Dry Wine

Our dry wine is mainly produced from the mountain grape varieties grown in the Tonghua area in Jilin Province, the PRC. Our dry wine is made with a sugar content of less than 4gm per litre. Some of our representative dry wine products include:

Product and Year Launched	Major Raw Material	Alcohol Content	Sample Product Picture
Tongtian Hong Cellar Stored Premium Mountain Grape Dry Wine (通天紅窖藏精品 干紅山葡萄酒) (2006)	Mountain grapes	11.5%	
Tongtian Hong Dry Wine (通天紅干紅山 葡萄酒) (2006)	Mountain grapes	11.5%	
Tongtian Dry Wine (通天干紅山 葡萄酒) (2001)	Mountain grapes	12.0%	

The following table sets out a breakdown of our revenue by product categories for the Track Record Period:

	Year ended 31 December						Six months ended 30 June			
	2006		2007		2008		2008		2009	
	RMB'000	%	RMB'000	%	RMB'000	%	RMB'000	%	RMB'000	%
Sweet Wine	[174,830]	[62.0]	[239,935]	[61.3]	[321,387]	[66.0]	[138,703]	[67.3]	[165,515]	[68.2]
Dry Wine	[106,993]	[38.0]	[151,635]	[38.7]	[165,321]	[34.0]	[67,325]	[32.7]	[77,200]	[31.8]
Total	<u>[281,823]</u>	<u>[100.0]</u>	<u>[391,570]</u>	<u>[100.0]</u>	<u>[486,708]</u>	<u>[100.0]</u>	<u>[206,028]</u>	<u>[100.0]</u>	<u>[242,715]</u>	<u>[100.0]</u>

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Awards and recognition

Our grape wine products have been well recognised in the PRC since 2001 and have received the following awards and certificates:

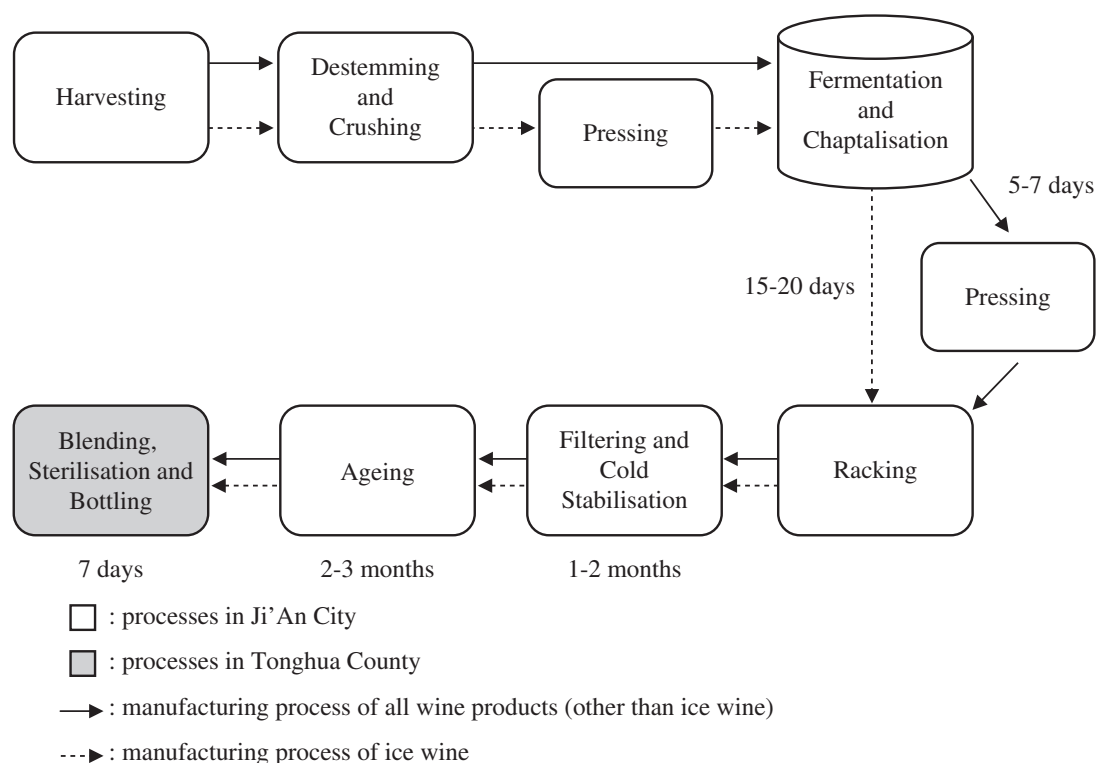
Year of grant	Awards/Certificate	Awarding body
2001	PRC Public Recommended Brand (全國公眾推薦名優品牌)	The China Socio-Economic Strategy Consultation Centre (中國社會經濟決策諮詢中心) and the Famous Brand Protection and Inspection Institute (名牌產品市場 保護調查所)
	China Famous and Premium Wine Award (中國名優葡萄酒)	The China Food Industry Association (中國食品工業協會)
2002	Asia-Pacific Satisfactory Consumer Products Awards in 2002 (2002年度亞太地區消費者 滿意的葡萄酒品牌)	The China International Food Industry Association (中國國際食品工業協會)
2004	Wine of Excellent Quality (優秀葡萄酒)	The Expert Committee of the Grape and Fruit Wine, China Food Industry Association (中國食品工業協會 葡、果酒專家委員會)
	Green Food – Class A (綠色食品A級標準)	The China Green Food Development Centre (中國綠色食品發展中心)
2006	Famous Product of Jilin Province Award (吉林省名牌產品)	People’s Government of Jilin Province (吉林省人民政府)
	The Geographic Indication Protected Products of the PRC (中華人民共和國 地理標誌保護產品)	The Association for Geographic Indication Protected Products of Jilin Province (吉林省地理標誌 產品保護協會)

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Year of grant	Awards/Certificate	Awarding body
2007	Green Food – Class A (綠色食品A級標準) (Renewed for another three years)	The China Green Food Development Centre (中國綠色食品發展中心)
2008	Top 500 Brands of the PRC (中國品牌500強)	The China Market Brands Strategy Forum Organising Committee (中國市場品牌戰略 論壇組委會)
	Top 10 PRC Grape Wine Industry Brands (中國葡萄酒行業 十大品牌)	The China Market Brands Strategy Forum Organising Committee (中國市場品牌戰略 論壇組委會)

PRODUCTION PROCESS

The production processes for all our products are basically similar, varying only in the types of grapes used and the harvesting period. The following flowchart illustrates a typical production process of our grape wines with the approximate time for some of the processes:



Generally speaking, our production process varies from approximately 4-6 months depending on kinds of product.

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General procedures

Harvesting

The harvest season of grapes is between September and November of each year. When the harvest seasons approach, we will inspect and test the natural sugar level of the grapes in the vineyards of Ji’An City in order to determine whether they are of a desired balance. The grapes are handpicked by the grape farmers at the vineyard and are then carefully collected in buckets or crates and transported to our winery facility in Ji’An City. Our quality management team will perform visual inspection to ensure that there are no rotten grapes, leaves or dirt and re-test the sugar level on a sampling basis at our winery facility.

During the Track Record Period, we also purchase raw grape juice from one supplier who is a manufacturer that has entered into a supply agreement with us. The kind of grape used by this supplier to produce grape juice is Cabernet Sauvignon. Pursuant to the supply agreement, we are not obliged to purchase grape juice exclusively from this supplier. Our supplier is located in Hebei province where Cabernet Sauvignon grows, and such grape juice is fermented and not concentrated when delivered to us. The grape juice supplier is not our exclusive supplier. We contract with our juice supplier to determine the price and quantity of purchase annually for the production of certain dry wines throughout the year. The contract prices of grape juice are determined by negotiation between the parties with reference to the market prices of grape juice. For our ice wine production, we harvest frozen mountain grapes in early November when the temperature drops to minus 7 degree Celsius (-7°C) or lower.

Destemming and Crushing

Once delivered to our winery facility in Ji’An City, the grapes are destemmed and crushed by grapes crushing and pressing machines. Destemming is the process of removing the grapes from the main stem which holds each bunch of grapes. This process is quality driven because the stems and the leaves may result in bitterness in our products. Crushing is the process of squeezing the grapes and breaking the skins. The grapes crushing and pressing machines are in operation only during the grape harvesting season.

The freshly extracted grape juice, together with the skin and pulp pips is called the must. The solid, pulp portion of the must is called pomace and can provide the necessary colour for red wines, accounting for up approximately 7% to 23% of the total weight of the must. The length of time before proceeding to the next step is critical for the wine’s quality.

Fermentation and Chaptalisation

Following the crushing process, the extracted grape juice is pumped into our stainless steel fermentation tanks for alcoholic fermentation with yeast at a specific temperature. The fermentation is initialised by yeast which converts the sugar into alcohol and carbon dioxide gas. The length of the fermentation process depends on the style of wine being made.

Chaptalisation is a process that involves the adding of sugar to unfermented grape must in order to increase the alcohol content as required after fermentation.

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For our rose wine production, the extracts from wild mountain rose petals are added at this stage to enrich the flavour of our product.

Pressing

After racking, the pomace is removed from the grape juice. The pomace is then pressed to extract the remaining grape juice.

For our ice wine production, because of its nature, the frozen mountain grapes are pressed to extract more grape juice immediately after destemming and crushing.

Racking

After the fermentation process is completed, the process of racking begins, where the yeast settled to the bottom of the tank is removed. This process may take place several times before the wine becomes clear. The grape juice has now become base wine, and is pumped out of the tank, leaving the yeast and sediment behind at the bottom of the container.

Filtering and Cold Stabilisation

Once the base wine is produced, it will undergo an extensive filtering process, where unwanted fine sediments are removed. After the filtering process is completed, the wines are then delivered to temperature-controlled stainless steel containers for further processing. Cold stabilisation removes tartrate crystals which are natural products that form when the wine gets too cold.

Ageing

The base wine is then to be stored in our stainless steel storage tanks for about 2 to 3 months for ageing.

Blending, Sterilisation and Bottling

The base wine is then transported to our production facilities in Tonghua County, Jilin Province.

Blending refers to blending different batches of wines before bottling in order to achieve the desired taste. In order to have a consistent taste for each type of our products, our winemaker can correct perceived inadequacies in the wine by mixing wines from different grapes and batches that were produced under different conditions.

Once the blending is completed, the wine has to go through stringent germ free filtration and assessment before bottling and packaging. Our Group currently has 2 bottling lines using advanced equipment to bottle, cork and label finished wine products.

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PRODUCTION FACILITIES

Current facilities

Our main wine production bottling facilities are located in Tonghua County, Jilin Province, the PRC which occupy an aggregate land area of approximately 58,343 sq.m. Our winery facility is located next to our grape supply base in Ji’An City, Jilin Province and occupies an aggregate land area of approximately 6,555 sq.m. Our grapes crushing and pressing machines and 289 tanks (of which 80 are owned by us and 209 are leased from three lessors located in Ji’An) are located in our winery facility in Ji’An City. The tanks are crucial to our Group’s operations. Each of the lease agreements for these tanks has a lease term of three years and our Directors intend to renew all of these lease agreements when they expire. The early stages of our production process are carried out in our facilities in Ji’An City, Jilin Province, where base wines are produced and transported to our wine production facilities in Tonghua County, Jilin Province, the PRC for further processing and bottling.

Our wine production bottling facilities in Tonghua County, Jilin Province, the PRC comprise wine storage tanks, bottling lines, warehouses, offices and staff quarters. As at the Latest Practicable Date, we have 28 storage tanks and 2 fully automated bottling lines, which commenced operation in August 2003 and August 2004, respectively. Our 2 fully automated bottling lines have an annual aggregate bottling capacity of up to approximately 19,000 tonnes of wine, below please find our actual annual production capacity for each of the three years ended 31 December 2008 and the six months ended 30 June 2009.

The average utilisation rates of our wine production facilities for our wine production and our actual production volumes for the three years ended 31 December 2008 and the six months ended 30 June 2009 are set forth as below:

	For the year ended 31 December				For the six months ended 30 June			
	2006		2007		2008		2009	
	Average Utilisation Rate	Actual Production Volume	Average Utilisation Rate	Actual Production Volume	Average Utilisation Rate	Actual Production Volume	Average Utilisation Rate	Actual Production Volume
	(%)	(tonnes)	(%)	(tonnes)	(%)	(tonnes)	(%)	(tonnes)
Finished Wine Products ⁽¹⁾	[70.1]	13,324	[78.2]	14,853	[89.8]	17,057	[89.1] ⁽²⁾	8,461

Notes:

- (1) Our annual production capacity of finished wine products is primarily limited by our aggregate bottling capacity. As at the Latest Practicable Date, we have 2 fully automated bottling lines capable of bottling up to approximately 19,000 tonnes of wine products per annum. The annual bottling capacity is calculated based on operation of our facilities for 2 shifts (or a total of 16 hours a day) and 300 production days a year, which excluded time required for maintenance and repair, and festive periods.
- (2) The utilisation rate for the six months ended 30 June 2009 was calculated based on the annualised actual production for the six months ended 30 June 2009.

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Planned expansion

In April 2008, we commenced the expansion of our current wine production facility in Tonghua County, Jilin Province, the PRC, with the construction of new production facilities which are adjacent to our current production facilities in Tonghua City. We expect that our planned expansion will be completed by the end of 2010 and increase our annual wine production capacity by approximately 20,000 tonnes to a total of approximately [39,000] tonnes. As our production capacity is measured in terms of bottling capacity, the output level of dry wine and sweet wine can be adjusted from time to time in response to market conditions.

PROCUREMENTS, RAW MATERIALS AND SUPPLIERS

Raw materials

Our principal raw materials for the production of our wine products comprise grapes, grape juice, packaging materials (including bottles, labels and corks), and ancillary ingredients such as sugar. We use grapes from local vineyards for the production of [15] different sweet and dry wine products and grape juice from a non-exclusive supplier, a company primarily engaged in the production of dry wine and located in Hebei province where Cabernet Sauvignon grapes are grown, for the production of [3] different dry wine products. Our grape juice supplier procured grapes from local farmers in Hebei province. Hence, grapes and grape juice are neither substitutes nor complements in our production process.

Long-term supply agreements for grapes

As at the Latest Practicable Date, we source our supply of grapes from local vineyards covering an area of approximately [14,577,408] sq.m. These vineyards are located in the regions around Ji’An City, Jilin Province, the PRC at the foothills of the Changbai mountain range on the banks of the Yalu river.

We have entered into long-term supply agreements with local grape farmers, under which they are to supply us with their annual harvests of grapes for a period of 20 years. As at the Latest Practicable Date, we entered into [173] long-term supply contracts with our local grape farmer suppliers. The first long-term supply agreement was entered into with local farmers in [2004], and we continued to enter into similar agreements up to and including [2008]. We source the grapes from them during the harvesting months between September and November of each year. All of our long-term supply agreements with the local grape farmers contain identical principal terms, except for the contracted supply quantity and the contract period. The salient terms of these long-term supply agreements are set out below:

- *Contract period.* We entered into these long-term supply agreements in either 2004, 2005, 2006, 2007 or 2008. Each of these long-term supply agreements took effect on the contract signing date and is valid for a period of 20 years.

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- *Rights and obligations.* The local grape farmers are required to supply a fixed quantity of their annual harvests of grapes. Such quantities are determined by the size of the vineyards owned by the local grape farmers. The long term supply agreements also specify the breakdown (by acreage) of the grape varieties to be grown.
- *Pricing and settlement.* The grapes are sold to us with reference to various minimum selling prices of the respective grape varieties as agreed in the long term supply agreements, and the actual selling prices may be adjusted upward subject to further negotiation and agreement between the parties with reference to the prevailing market prices. In practice, we would enter into a separate agreement with the local grape farmers when the actual selling prices are agreed with them each year by negotiation between the parties with reference to market prices of grapes. The actual prices paid by us may be lower than the agreed selling prices only if the harvested grapes do not fulfill certain pre-determined quality criteria (such as sugar levels). We pay grape farmers cash on delivery for the purchase of grapes.
- *Exclusivity.* Under the long-term supply agreements, the grape farmers are required to supply their harvest to us on an exclusive basis and are prohibited from selling their grapes to other third parties, including any of our competitors.
- *Logistics.* The grape farmers are required to bear their own costs of transporting the harvested grapes to our winery facility in Qingshi Town, Ji’An City.
- *Termination.* Any of the long-term supply contracts may be terminated if the relevant farmer(s) has/have breached the exclusivity supply term and supplies his/their harvest of grapes to another third party. To the best knowledge of our Directors, none of the local grape farmers who signed long-term supply agreements with us had supplied any of their harvest of grapes to other third parties during their respective contract period, and as at the Latest Practicable Date, we have not terminated any of the long-term supply contracts signed with local grape farmers. In order to ensure that the local grape farmers supply their harvest of grapes on an exclusive basis, our Group has taken the following measures: (i) in order to protect the long-term interests of the grape farmers, the grapes are sold to us with reference to various minimum selling prices of the respective grape varieties as agreed in the long term supply agreements, and the actual selling prices may be adjusted upward subject to further negotiation and agreement between the parties with reference to the prevailing market prices; and (ii) if the grape farmers sell any of their harvest of grapes to any other third parties, they shall be responsible for liabilities incurred as a result of their breach and our Group will be entitled to terminate the supply contracts. During the Track Record Period, we have [not experienced any material disputes with the grape farmers.] Except due to force majeure, such as natural disaster, neither party can terminate the contract at will or fail to carry out the contract, otherwise, the breaching party shall compensate the other party according to the PRC Contract Law (合同法). Save as disclosed in this paragraph, there are no other circumstances which will lead to termination of the contract.

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We do not rely on any particular grape farmer for the supply of quality grapes. In the event that any grape farmers who contracted with us fail to supply grapes to us in accordance with the long-term supply agreements, except due to force majeure such as natural disaster, the grape farmers that fail to satisfy the supply requirements under the long-term supply shall compensate for our losses in accordance with the PRC Contract Laws (合同法), and we will source grapes that meet our quality standards from other grape farmers in the Ji’An region.

As part of the long-term supply arrangements, in our winery facility in Qingshi Town, Ji’An City, we have a vineyard management team comprising a vineyard manager and two vineyard technicians to oversee the vineyards covered by the long term contracts. They are in charge of supervising the planting, nurturing and harvesting of the grapevines, as well as the delivery of the grapes to our winery facility. This is to ensure that we have optimum control over the quality of our grapes.

Supply contracts with our supplier of grape juice

During the Track Record Period, we purchased raw grape juice made from Cabernet Sauvignon grapes from one supplier. We contract with our juice supplier to determine the price and quantity of purchase annually for the production of certain dry wines throughout the year, while other terms and conditions among these supply contracts remain the same from year to year. The contract prices of grape juice are determined by negotiation between the parties with reference to the market prices of grape juice. We are provided with a credit period of three months under our supply contracts with the grape juice supplier. We are not obligated to exclusively source grape juice from this supplier nor is this supplier obligated to supply its grape juice to us exclusively.

Our suppliers

We have a pre-approved list of suppliers for raw materials other than grapes, who are selected based on the quality of raw materials they supply as well as the prices of raw materials they can offer and their background, such as their experience, management skill and reputation in the market. We pay grape farmers cash on delivery for the purchase of grapes. The average credit period offered by our suppliers on purchase of raw materials other than grapes is approximately 90 days.

We are not dependent on any single supplier. Our five largest suppliers together accounted for approximately [69.6]%, [63.0]%, [63.4]%, and [59.9]% of our raw materials purchases for each of the three years ended 31 December 2008 and the six months ended 30 June 2009, respectively. Our largest supplier accounted for approximately [22.4]%, [19.0]%, [16.3]%, and [14.8]% of our total raw materials purchases for each of the three years ended 31 December 2008 and the six months ended 30 June 2009, respectively. All of our five largest suppliers in 2008 by purchase volume were suppliers of grape juice, glass bottles, packaging and labels and sugar. None of our Directors or any person who owned 5% or more of the issued share capital of our Company as at the Latest Practicable Date or any of their respective associates has any interest in any of our five largest suppliers for the three years ended 31 December 2008 and the six months ended 30 June 2009.

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Save for the long-term supply agreements entered into with local grape farmers as mentioned above, we currently have not entered into any other formal long-term contracts with our other grape suppliers or other suppliers.

Our Group has not experienced any material difficulties in obtaining adequate raw materials.

SALES AND DISTRIBUTION

Sales and distribution network

We sell substantially all of our products to distributors, who distribute and sell our grape wine to third-party retailers, including supermarkets, and specialty stores selling tobacco and alcohol, food and beverage outlets such as restaurants, and hotel restaurants, as well as through their own direct sales distribution to end-consumers and other sub-distributors. As at the Latest Practicable Date, our products are sold through [71] distributors in [19] provinces and [3] municipal cities in the PRC.

The following map illustrates our Group’s distribution network in the PRC as at the Latest Practicable Date:



Notes:

1. ■: North-east region of China includes Liaoning Province, Jilin Province and Heilongjiang Province.
2. ■: Northern region of China includes Hebei Province, Shaanxi Province, Inner Mongolia, Shanxi Province and Beijing.
3. ■: Eastern region of China includes Jiangsu Province, Zhejiang Province, Anhui Province, Fujian Province, Shandong Province and Shanghai.

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4. ■: South-central region of China includes Henan Province, Hubei Province, Guangdong Province and Hainan Province.
5. ■: South-west region of China includes Sichuan Province, Yunnan Province, Guizhou Province and Chongqing.
6. The number of distributors of our products in each province or municipality is set next to the name of the relevant province or municipality.

The following table sets forth a breakdown of our revenue by sales region for the Track Record Period:

Region	2006		Year ended 31 December 2007		2008		Six months ended 30 June 2009	
	RMB'000	%	RMB'000	%	RMB'000	%	RMB'000	%
North-East (<i>Refer to Note 1 above</i>)	38,588	13.7	58,403	14.9	76,479	15.7	[33,054]	[13.6]
Northern (<i>Refer to Note 2 above</i>)	60,992	21.6	71,715	18.3	89,535	18.4	[48,251]	[19.9]
Eastern (<i>Refer to Note 3 above</i>)	89,780	31.9	136,063	34.8	166,945	34.3	[85,538]	[35.2]
South-Central (<i>Refer to Note 4 above</i>)	33,298	11.8	42,753	10.9	58,544	12.0	[29,591]	[12.2]
South-West (<i>Refer to Note 5 above</i>)	59,165	21.0	82,636	21.1	95,205	19.6	[46,281]	[19.1]
Total	281,823	100.0	391,570	100.0	486,708	100.0	[242,715]	[100.0]

Note: Sale in North East region includes direct sales in Jilin Province, which accounted for approximately [0.3]%, [0.3]%, [0.7]% and [0.3]% of our sales for each of the three years ended 31 December 2008 and the six months ended 30 June 2009.

The geographical distribution of our sales remained relatively stable during the Track Record Period. Revenue derived from our sales in the eastern region of China made the largest contribution to our total revenue during the Track Record Period, accounted for approximately 31.9%, 34.8%, 34.3%, and [35.2]% of our total revenue for the years ended 31 December 2006, 2007 and 2008 and the six months ended 2009, respectively. The eastern region of China is our largest market with the highest number of distributors, as it is a more affluent region in the PRC with relatively high levels of per capita income, where consumers have a general preference towards wine products over other alcoholic beverages. The south-west and the northern regions of China are also our significant markets, where some of our key distributors are located.

Our Group does not have any ownership or management control over the distribution network. In order to supervise these distributors, we assign sales managers to work closely with the distributors in order to monitor their performance and obtain market feedback on our wine products. In addition, we conduct annual appraisals on our distributors to determine whether we will renew the distribution agreements with them, taking into consideration their sales network, promotion approach, creditability and inventory accumulation.

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Major customers

We do not have any long-term framework agreements with our distributors, but enter into a standard distribution agreement with each of our selected distributors for a period of one year. We do not require our distributors to purchase a minimum initial or annual minimum amount from us. Our total number of distributors increased from 56 as at 31 December 2006 to 68 as at 31 December 2007. Our total number of distributors further increased from 68 as at 31 December 2007 to 71 as at 31 December 2008, representing the addition of 4 new distributors and the termination of 1 distributor. Although our total number of distributors remained the same at 71 as at 30 June 2009, we have added 3 new distributors and have terminated our relationship with 3 distributors. We terminated our relationship with some of our distributors in the past as they were unable to meet our sales expectation. Set forth below is the breakdown of our distributors by region during the Track Record Period:

Region	No. of distributors			Six months ended
	Year ended 31 December			30 June
	2006	2007	2008	2009
North-East	8	9	10	10
Northern	11	13	15	15
Eastern	21	25	25	25
South-Central	5	8	8	8
South-West	11	13	13	13
	<u>56</u>	<u>68</u>	<u>71</u>	<u>71</u>

As at the Latest Practicable Date, we had a total of [71] distributors, who are generally engaged in the business of distributing and selling of grape wine products, all of whom are Independent Third Parties. Our years of relationship with our distributors ranged from one to eight years, as a result of our continuous distribution network expansion and annual appraisal of our existing distributors. We generally have more than five years of relationship with our five largest distributors, and have more than seven years of relationship with our largest distributor. Our five largest customers together accounted for approximately 18.3%, 15.1%, 14.9%, and [11.0]% of our total revenues for each of the three years ended 31 December 2008 and the six months ended 30 June 2009, respectively. Our largest customer accounted for approximately 4.8%, 3.4%, 3.3%, and [2.3]% of our total revenues for each of the three years ended 31 December 2008 and the six months ended 30 June 2009, respectively. All of our five largest customers in 2008 were engaged in the business of distributing and selling of goods.

None of our Directors or any person who owned 5% or more of the issued share capital of our Company as at the Latest Practicable Date or any of their respective associates has any interest in any of our five largest customers for the three years ended 31 December 2008 and the six months ended 30 June 2009.

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Selection of our distributors

We have strict criteria for the selection of our distributors based on factors such as economic strength, sales network in our target market, product knowledge, mutual goodwill and common objectives, good track record and successful experience in consumption goods distribution, and high moral integrity, credibility and social standing. We believe that building long-term mutually beneficial relationships with our key distributors would also benefit our business.

Distribution agreements

We have no direct control over the business operation of our distributors and we generally select distributors to distribute our products within a designated geographical area. We enter into a standard distribution agreement with each of our selected distributors for a period of one year and following successful negotiation between the parties upon the expiry of the existing distribution agreements, will renew such agreements with our distributors each year. Each of the distribution agreements will specify an estimated sales volume for the coming year. The estimated sales volume can be negotiated and adjusted between our distributors and us according to the market situation; whilst such estimated sales volume serves as targets to be achieved by the distributors, we neither provide any incentives for distributors which meet the estimated sales volume nor impose any penalties on distributors who fail to meet the estimated sales volume. However, in order to facilitate and assist the marketing and the sales of our distributors, we implement and will continue to implement our advertising strategies primarily through television commercial, outdoor billboards, magazines and emphasize the health benefits of moderate consumption of grape wines in order to establish consumer loyalty and strengthen the popularity of our products. In addition, we bear the delivery costs in our distribution agreements. We do not enter into any separate agreements with the third-party retailers or any of the sub-distributors, who are customers of our distributors. The salient terms of the distribution agreements are as follows.

Contract Period. One year.

Rights and Liabilities. Our Company shall sell and the distributor shall purchase the wine products stipulated in the distribution agreement.

Pricing and Settlement. The payment is conducted generally by bank settlement and the settlement terms are generally three months.

Quality. Our Company shall provide the wine products in compliance with the industrial standards and the distributor shall inspect the wine products within five days after the goods are delivered.

Logistics. The wine products are delivered to the place designated by the distributor at our cost.

Goods Return. Any return of goods not due to our fault shall be approved by our Company and the relevant expenses shall be borne by the distributor.

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Termination and Renewal. The agreement terminates upon the expiry and there are no other termination and renewal clauses under the distribution agreement.

Pricing

The prices of our grape wine products are determined by reference to the costs and related expenses of our products, including the costs of grapes and grape juice and the relevant advertising expenses.

While the selling prices of our products to distributors are identical, the retail prices are generally determined by each distributor with reference to the local market conditions. We have set a recommended retail selling price range to our distributors but the final selling price is subject to market conditions and at the discretion of our distributors.

Revenue recognition, settlement and credit control

Revenue derived from sales to our distributors is recognised when our products are delivered and title to our products has passed to our distributors.

We require our new distributors to settle our invoices upfront in cash for the whole or substantially the whole of our initial shipments. For distributors with whom we have an established working relationship, we will usually review their credit rating and grant a credit period of 90 days. All credit terms and limits for each customer will be reviewed and are generally approved by our chief executive officer and/or executive Director, namely Mr. Wang and Mr. Zhang Hebin.

The credit terms and limits for each customer are based on factors such as our assessment of the relevant customer’s financial position, past collection history, volume of sales and its business performance. We monitor and follow up on the payment status of each customer through the combined efforts of our sales and finance departments. Our sales department will gather feedback from the finance department and assess each customer’s payment record, financial strength, as well as the size of the transaction. In addition, our sales personnel visit our customers regularly to better gauge their financial status, profitability and creditworthiness and report any significant changes to both the sales and finance departments. We also actively monitor our customers’ payments such that they do not exceed the credit period extended to them.

Sales return policies

We only accept return of our delivered goods due to quality defects, which must be notified to us within 5 business days upon delivery. Any loss or damage arising from transportation shall also be notified to us within 2 business days upon receipt of the goods. Except for such sales return, title to our products are passed to our customers without any recourse when delivered. During the Track Record Period, our Directors confirmed that we have received no such request for sales return from our distributors.

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INVENTORY CONTROL

Our inventory comprises raw materials, semi-finished wine products (i.e. base wine) and finished wine products (i.e. bottled wine). The raw materials which we use, such as grape juice, packaging materials (including bottles, labels and corks), and ancillary ingredients such as sugar are stored in anti-pest and anti-mould storage facilities, while our base wine is stored in stainless steel storage tanks within our production facilities.

During the months of September to November of each year, we procure all grapes required for the production of our wine products for the following year. The grapes are then processed into base wine, and blended and aged accordingly to achieve the desired taste and quality of the respective wine products that we produce. Our inventory levels for our finished wine products are largely determined by forthcoming sales orders placed by our customers. We monitor the level of our inventory of packaging materials to maintain a level sufficient for our wine production.

The balance of our inventory levels as at 31 December 2006, 2007 and 2008 and the six months ended 30 June 2009 accounted for approximately 70.7%, 64.6%, 41.9%, and [25.9]%, respectively, of our total current assets. Most of our inventory at year-end comprises of base wine and bottled wine.

We plan our production and procurement based on our preliminary market assessment and sales plans developed by our sales and marketing department, in line with our overall long-term production and procurement strategies. Our management will monitor market demand levels, confirmed sales orders and the sufficiency of our inventory level on a regular basis to ensure that we will produce sufficient finished products and procure sufficient raw materials to meet assessed market demands, and update our production and procurement plans where necessary.

The physical conditions of our inventory are reviewed by our management on a half-yearly basis. Our policy on obsolete or damaged inventory is to write off such inventory when our management considers the obsolete or damaged inventory to have no residual value. In addition, specific provisions are made on the diminution in market value of the inventory should our management decide that the current level of provision is inadequate. We have not made any provision for nor written off any inventory for damage or obsolescence for the three years ended 31 December 2008 and the six months ended 30 June 2009, as we have not experienced any significant damage or loss in respect of our inventory.

For the three years ended 31 December 2008 and the six months ended 30 June 2009, our average inventory turnover days were approximately [348], [318], [302], and [274], respectively. The inventory turnover days for our business are generally high because we procure all the grapes, being the principal raw material for the production of our grape wine products, required for our production during the harvesting months between September and November of each year which will then be consumed in the course of our production until the next harvest of grapes in the following year. Our overall inventory level has remained relatively stable despite our increasing sales, as our Group has managed to strike a balance between maintaining sufficient inventory of base wine and finished products to meet the increased sales during the Track Record Period.

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LOGISTICS

Raw materials are delivered to us by our suppliers at their cost.

Our finished products are delivered by vehicle to the warehouses designated by our distributors. Based on the agreements with our distributors, we are responsible for delivering our finished goods to the destinations specified by our distributors and costs of delivery are borne by us. We currently engage one logistics company, which is an Independent Third Party and the transportation agreement between us and the logistics company is such that the logistics company will be compensated for any loss or damage to our goods during the transportation of our goods. We have not experienced any material loss in relation to the delivery of our products during the Track Record Period. We require our distributors to maintain suitable warehousing facilities with air-conditioning systems suitable for wine storage.

QUALITY MANAGEMENT SYSTEM

Our Directors believe that our ability to consistently produce quality products is one of the key factors to our Group’s success. In order to ensure the quality of our products, we have established a stringent quality management system to ensure adherence to quality, cleanliness and hygiene standards for our raw ingredients and finished wine products, and consistency in taste, packaging and other product quality attributes. As at the Latest Practicable Date, we have a team of 11 quality control personnel, of which four are based in our winery facility in Ji’An City, Jilin Province, the PRC and the other seven are based in our main production facility in Tonghua County. In December 2005, we obtained ISO 9001:2000 certification for our operation and management system in respect of our wine products, which our Directors believe is evidence of our stringent quality control systems and procedures. This ISO certification is subject to renewal every 3 years after an inspection entailing a review of our facilities and a test of our quality control systems by testers from China Environmental United Certification Centre Co., Ltd. (中環聯合北京認證中心有限公司) and has been renewed in December 2008.

We generally focus our quality control efforts on the following critical stages of our production processes:

Sourcing and Procurement

Our vineyard technicians closely supervise the nurturing of the grapes at the vineyards from where we source our grapes by visiting the vineyards and the grape farmers from time to time through out the year through regular inspection, and also recording the natural sugar content of the grapes during the grape harvest season from September to November in accordance with our strict standards. They also schedule the delivery of harvested grapes by the farmers to our winery facility to ensure that we are supplied only with grapes of suitable maturity and quality. A further inspection is carried out when the grapes are delivered to the winery facility. Grapes that are not suitable in terms of ripeness, sugar content or condition of the grape skin will be rejected then.

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A critical element in quality control at this stage is ensuring that grapes are processed by our grapes crushing and pressing machines immediately or as soon as possible after harvest, in order to reduce the risk of oxidization of the grapes through exposure to air as well as decomposition in relatively higher temperatures resulting from prolonged transport and storage.

As part of our quality assurance policy, our quality management team conducts quality control checks, by inspecting and testing random samples of our other raw materials at our main production facility in Tonghua County, Jilin Province, the PRC. These other raw materials include packaging materials (including bottles, labels, and corks), and ancillary ingredients such as sugar. We will reject delivery of poor quality raw materials and return the same to our suppliers immediately. As at the Latest Practicable Date, we have not experienced any significant incidences of receiving defective raw materials from our suppliers.

Production

Our quality management team is responsible for determining and setting our quality assurance policies and standards, implementing our quality management systems, evaluating and conducting quality control activities during our production process and conducting quality assurance inspections during the different stages of the production process.

MARKETING AND PROMOTION

Our Directors believe that our Group’s marketing and promotion strategy has been an important component of our success. In the major cities in China which we believe have relatively higher per capita income, and [where] we have an established market presence, we are able to focus on marketing our higher gross margins products, such as [rose wine and ice wines]. In other regions of China where we intend to expand our market presence, we will initially market and promote lower-end products. We believe that establishing a strong awareness of our brand name will contribute significantly to our ability to broaden our customer base and increase our sales of our products in the PRC.

For the three years ended 31 December 2008 and the six months ended 30 June 2009, our Group’s marketing and advertising expenditure amounted to approximately RMB18.2 million, RMB41.8 million, RMB22.0 million, and RMB[9.6] million, respectively, representing approximately 6.5%, 10.7%, 4.5%, and [3.9]% of our total revenue, respectively.

As part of our marketing and promotion strategies, we carry out the following activities:

Advertising

Our Directors believe that we are one of the leading suppliers of sweet wines, in terms of manufacturing and sales volume, in the PRC. Our advertising strategies focus on the fact that our sweet wines are made from mountain grape varieties from the Jilin Province. Grape wines are not traditionally the most popular alcoholic beverage in the PRC, but we believe they

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are becoming increasingly popular in the modern and affluent regions of the PRC. As such, we have put our efforts into marketing and promotion in those regions with the aim of increasing the level of [consumer] acceptance of grape wines and in particular our products. In addition, we emphasize the health benefits of moderate consumption of grape wines in order to establish consumer loyalty.

We implement and will continue to implement the above advertising strategies primarily through television advertising, outdoor billboards and magazines.

Food and beverage trade fairs

We also selectively participate in food and beverage trade fairs held in the PRC usually in the spring and autumn seasons, such as the China Food & Beverage Fairs (全國糖酒商品交易會), held semi-annually in the spring and autumn seasons. Through participating in these food and beverage trade fairs, we are able to showcase our products to consumers and current and potential distributors, and to gather information and feedback on the current market trends and changing consumer preferences.

PRODUCT AND PACKAGE DESIGN AND DEVELOPMENT

Product development

In order to maintain our competitiveness, we seek to constantly keep abreast of market trends and consumer preferences, and place strong emphasis on innovating new grape wine products and on improving the quality and taste of our existing wines. Our product development activities are undertaken by our product development team comprising 7 members, headed by our chief winemaker, Ms. Ji Chunhua.

The main activities of our product development team include the formulation of new wine products with varying degrees of alcohol content and flavours, improving the flavours and quality of our existing wine products and broadening our range of wine products to suit the market trends and changing consumer preferences. Our product development team also samples and tastes wine produced by other competitors to compare the quality and taste of our wine products.

In addition, from time to time, we also commission the Northwest A&F University (西北農林科技大學) to conduct certain research projects for us such as the development of new types of wines and studies on topics related to wine-making.

For the three years ended 31 December 2008 and the six months ended 30 June 2009, our product development costs amounted to approximately RMB0.85 million, RMB1.15 million, RMB1.18 million and nil, respectively.

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Package design and development

We have a dedicated package design team which is responsible for the design of all our packaging. Our aim is to create new and attractive ways of packaging our products to suit the corresponding target consumer markets. We believe that attractive product packaging will enhance the value of our product, brand image and increase the visibility of our products displayed at retail markets.

INTELLECTUAL PROPERTY RIGHTS

We currently use three trademarks including the Tongtian (通天) trademark for the marketing and sales of our wine products, all of which have been registered by us in the PRC but as at the Latest Practicable Date, we are still in the process of applying for registration of the Tongtian Hong (通天紅) trademark. Jingtian & Gongcheng, our PRC Law legal advisers, are of the opinion that there is no legal obstacle for us to use or registered the “Tongtian Hong” (“通天紅”) trademark because (i) it is not expected that the Trademark Office would turn down the trademark application for the same reason or for reason of resemblance because both of the trademarks are owned by Tongtian Winery; and (ii) having conducted a search through the online data base of the Trademark Bureau, there was no other identical or similar trademark application or registration regarding “Tongtian Hong” (“通天紅”) in the category of winery or other alcohol products by any third party [as at the Latest Practicable Date]. For further details of our intellectual property rights, please refer to the paragraph headed “Intellectual Property Rights of our Group” in Appendix VI to this document.

Save as disclosed above, our business or profitability is not dependent on any patent or licence, or new manufacturing process or any other intellectual property rights.

We rely on various intellectual property laws, especially trademark laws, to protect our proprietary rights. We recognise the importance of protecting and enforcing intellectual property rights.

As disclosed in the risk factor and financial information sections of this document, we might face possible infringement claim on the historical sales of our products under the “Tongtian Cabernet” (“通天解百納”) name. Jingtian & Gongcheng, our PRC legal advisers, have advised us that should such legal proceedings be successfully carried out by the Yantai Changyu group against our Group, the damages which may be awarded by the PRC courts under the Trademark Law of the PRC (中華人民共和國商標法) may be in the form of repatriation of profits earned by our Group through the sale of “解百納” labelled wine products, or the losses suffered by the Yantai Changyu group as a result of our Group’s infringement during the Period of Alleged Infringement (including any reasonable costs incurred by the Yantai Changyu group to stop such infringement). Pursuant to the Trademark Law, where the profit earned or losses incurred cannot be determined, the maximum damages shall be not more than RMB500,000. Jingtian & Gongcheng, our PRC legal advisers, have further advised us that if the Yantai Changyu group eventually fail to obtain a favourable court judgment for the Registration, our Company, as well as other wine producers, may use the Chinese characters for Cabernet, “解百納”, as a name for its winery products.

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Save as mentioned above, as at the Latest Practicable Date, we were also not aware of any pending or threatened claims against us or any of our subsidiaries in relation to the infringement of any intellectual property rights of third parties. As at the Latest Practicable Date, we were not aware of any material infringement of our intellectual property rights and we believe that we have taken all reasonable measures to prevent any infringement of our own intellectual property rights.

COMPETITION

The wine industry is highly competitive within the PRC, fragmented with some large producers and many small producers. According to the 2008 Yearbook of the China Alcoholic Drinks Industry, there were approximately 600 wine enterprises in the PRC in 2007. The top ten wine producing enterprises in total accounted for approximately 61.84% of total wine output in the PRC in 2007. The output of the Changyu, Great Wall, Dynasty and Weilong brand wines in total accounted for approximately 40.73% of total wine output in the PRC in 2007. We face intense competition from existing producers and new market entrants, including competition from imported wines.

In Jilin Province, where the main raw material used in the production of wines is the *vitis amurensis* grape variety, our Directors consider the following to be our main competitors:

- Tonhwa Winery Limited (通化葡萄酒股份有限公司)
- Chang Bai Shan Wine Holding Co. Ltd. (長白山酒業集團有限公司)

In respect of the PRC market as a whole, our Directors consider the following to be our main competitors:

- Dynasty Fine Wines Group Limited (王朝葡萄酒業集團有限公司)
- Yantai Changyu Pioneer Wine Company Limited (煙台張裕葡萄釀酒股份有限公司)
- China Great Wall Wine Co., Ltd. (中國長城葡萄酒有限公司)

None of our Directors or Substantial Shareholders of our Group has any interest, direct or indirect, in any of the above competitors.

Our Directors believe that we are able to maintain our competitiveness as our strategic focus is on the production of wines using the *vitis amurensis* grape variety, which we are strongly placed to procure a consistent and sufficient supply of quality grapes in the long-run. Our Directors believe that the pricing of our wines is also attractive to the mass market in the PRC and that the “Tongtian” (通天) and “Tongtian Hong” (通天紅) are established brand names for niche sweet wine products recognised in the PRC wine market. In the future, we intend to strengthen our strategic focus on promoting our sweet wine products, which are products that our Directors believe would offer greater potential for growth.

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EMPLOYEES

As at the Latest Practicable Date, our Group had a total of [362] full-time employees. The following table shows a breakdown of our employees by functions as at the Latest Practicable Date:

	Numbers of Employees
Management	[10]
Control and compliance	[1]
Production	[267]
Technical and product development	[9]
Sales and marketing	[36]
Finance	[7]
Procurement	[7]
Human resource and administration	[25]
Total	[362]

In accordance with the applicable PRC laws and regulations on social insurance, we contribute to various social insurance plans such as pension contribution plans, medical insurance plans, work-related injury insurance plans, unemployment insurance plans and birth insurance plans as well as housing accumulation funds for our employees. Our PRC legal advisers, Jingtian & Gongcheng, have confirmed that we comply with all statutory social insurance obligations applicable to us under the PRC laws and regulations.

Our contributions to the statutory social insurance plans are charged to the consolidated profit and loss account as and when incurred. For the three years ended 31 December 2008 and the six months ended 30 June 2009, our total expenses under the statutory social insurance plans were approximately RMB0.4 million, RMB0.4 million, RMB0.6 million, and RMB[0.3] million, respectively.

We provide training to our staff as appropriate and also arrange for our staff in the finance department to attend finance related professional training conducted by the PRC Ministry of Finance every year.

We believe that we maintain a good working relationship with our employees, and we have not experienced significant problems with our employees or disruption to our operations due to labour disputes.

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ENVIRONMENTAL MATTERS

In accordance with Environmental Protection Law of the PRC (中華人民共和國環境保護法) adopted by the Standing Committee of the National People’s Congress on 26 December 1989, the State Environment Protection Administration of the PRC sets the national guidelines for the discharge of pollutants. The provincial and municipal governments of provinces, autonomous regions and municipalities may also set their own guidelines for the discharge of pollutants within their own provinces or districts in the event that the national guidelines are inadequate. A company or enterprise, which causes environmental pollution and discharges other polluting materials which endanger the public, should implement environmental protection methods and procedures into their business operations. This may be achieved by setting up a system of accountability within the company’s business structure for environmental protection; adopting effective procedures to prevent environmental hazards such as waste gases, water and residues, dust powder, radioactive materials and noise arising from production, construction and other activities from polluting and endangering the environment. The environmental protection system and procedures should be implemented simultaneously with the commencement of and during the operation of construction, production and other activities undertaken by the company. Any company or enterprise which discharges environmental pollutants should report and register such discharge with the Administration Supervisory Department of Environmental Protection and pay any fines imposed for the discharge. A fee may also be imposed on the company for the cost of any work required to restore the environment to its original state. Companies which have caused severe pollution to the environment are required to restore the environment or remedy the effects of the pollution within a prescribed time limit.

If a company fails to report or register the environmental pollution caused by it, it will receive a warning or be penalised. Companies which fail to restore the environment or remedy the effects of the pollution within the prescribed time will be penalised or have their business licences terminated. Companies or enterprises which have polluted and endangered the environment must bear the responsibility for remedying the danger and effects of the pollution, as well as to compensate any losses or damages suffered as a result of such environmental pollution.

We were granted the waste discharge license issued by Tonghua Environmental Protection Bureau. Our PRC legal advisers, Jingtian & Gongcheng, have confirmed that during the Track Record Period, (i) we fully complied with the relevant environmental rules and regulations and have obtained all the required permits and environmental approvals for our production facilities, (ii) no environmental pollution incident was discovered, and (iii) no penalty of any kind was imposed on any member of our Group.

Our Directors confirm that we comply with the relevant requirements under the PRC laws and regulations for waste water treatment.

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PROPERTIES

Owned properties

As at the Latest Practicable Date, we owned the following [two] parcels of land:

- The land located at Dong’an Village, Kuaidamao Town, Tonghua County, Tonghua City (通化市通化縣快大茂鎮東安村) with an aggregate site area of 58,343.4 square metres, on which offices, warehouses, workshop, ancillary facilities and wine production line expansion construction project under progress are situated, with a total construction area of approximately [29,207.76] square metres (comprising about [12,038.76] sq.m. of area constructed, and [17,169.00] sq.m. of area under construction). We have obtained legal title to the land and buildings comprising this property and all required permits and licenses for the construction.
- The land located at Changchuan Village, Qingshi Town, Tonghua Jian City (通化集安市青石鎮長川村) with an aggregate site area of 6,555.5 square metres, on which offices and warehouses are situated, with a total construction area of [752] square metres. We have obtained legal title to the land and buildings comprising this property.

Further details of our owned properties are disclosed in the property valuation report set out in Appendix IV to this document.

Leased properties

As at the Latest Practicable Date, we leased an office building from Shenyang Maryland International Industrial Co., Ltd. Real Estate Development Branch (瀋陽瑪莉藍國際實業有限公司房產開發分公司), an [Independent Third Party], located at No. 69 Heping Bei Da Street Heping District (和平區和平北大街69號) with a gross floor area of approximately 336,476 square metres. The expiry date of the tenancy for these properties is 19 July 2011. If we intend to renew the lease agreement, we are required to notify the lessor within two months prior to the expiry of the tenancy. Our current leased properties have been filed and registered by the lessor with the relevant PRC government authority.

As at the Latest Practicable Date, we leased a warehouse located at Li Ming Industrial Zone, Kuaidamao Town, Tonghua County, Jilin Province (吉林省通化縣快大茂鎮黎明工業區) from Tonghua Da Sen Lin Ye Development Co., Ltd. (通化大森林業開發有限責任公司), an [Independent Third Party], for approximately 700 square metres. The expiry date of the tenancy for these properties is 29 September 2010. The lessor cannot provide the relevant building ownership certificates for the warehouse. According to a supplemental agreement executed by Tonghua Da Sen Lin Ye Development Co., Ltd. and our Company dated 30 September 2009, the lessor will compensate all our losses in case we cannot continue to use the warehouse during the lease period due to the lack of relevant building ownership certificates. As advised by our PRC legal advisor, Jingtian & Gongcheng, the lease may not be protected by relevant

BUSINESS

PRC governmental authorities due to the lack of the relevant building ownership certificates. However, our Company has the right pursuant to the supplemental agreement to require the lessor to compensate our losses. To the best of our knowledge, the lessor has not applied for the ownership certificate for the warehouse. Our Directors are of the view that the warehouse is not crucial to our business because our Directors do not anticipate any obstacles for our Company to lease an alternative warehouse should we be required to vacate from the said warehouse and the impact of the vacation on our Group’s operations would be minimal. Our Directors estimate that our Company will take not more than 3 months and incur an expenditure of not more than RMB500,000 if it is necessary for us to relocate to another warehouse.

Details of this property are disclosed in the property valuation report set out in Appendix IV to this document.

INSURANCE

Our insurance coverage includes composite property insurance for the fixed assets, product liability insurance and general insurance against risks to cash. We also have automobile insurance coverage in respect of all our vehicles, including our vans and trucks used for transporting the base wine from our winery facility in Ji’An to our production facility in Tonghua. Such coverage is in respect of third party liability and passenger and vehicular risks. Our Directors confirm that our insurance coverage is in line with the general practice in the industry and is adequate for our operations.

As at the Latest Practicable Date, we had not made nor been the subject of any material insurance claims. We have made contributions in relation to the retirement of our employees in accordance with applicable laws and regulations in the PRC which requires contribution by both our employees and us at a fixed percentage of the salaries of our employees. During the Track Record Period, we did not receive any material claim from customers or consumers relating to any liability arising or relating to the use of our products.

LEGAL AND ADMINISTRATIVE PROCEEDINGS

As at the Latest Practicable Date, we were not engaged in any litigation, arbitration or claim of material importance, and no litigation, arbitration or claim is known to our Directors to be pending or threatened by or against us, that would have a material adverse effect on our operation results or financial condition.