

OVERVIEW

We are a leading player in China's pediatric milk formula industry. We manufacture, market and sell our family of products in China under two widely-recognized brands targeting different consumer groups, with *Yashily* mainly marketed to mid-end and upper-end consumers and *Scient* geared towards high-end consumers. We are committed to creating trusted nutritional brands and products which promote the healthy development of infants and children throughout China. Our comprehensive pediatric milk formula portfolio addresses a broad range of nutritional needs for infants, young children and expectant and nursing mothers. We have approximately 20 years of experience in the dairy food and nutritional product industry, during which we have developed and improved many popular products. Our business model integrates imported high-quality dairy raw materials, proprietary product formulas, a first-class manufacturing system and localized consumer marketing expertise.

Our Key Products**Leading position and distribution network**

Our *Yashily* and *Scient* brands are two of China's leading brand names in the pediatric milk formula market. We are the third largest domestic pediatric milk formula producer with approximately 7.6% market share in terms of total retail sales value in China in 2009, according to AC Nielsen. In particular, we believe we have been highly successful in establishing a leading position in second- and third-tier cities, which are experiencing rapid economic growth. As of 30 June 2010, we primarily sold our products to consumers through more than 1,300 regional distributors, which further distributed our products directly and indirectly to over 80,000 retail outlets, including local grocery stores, regional retail chains, specialty stores and national retail chains across every province, municipality and autonomous region in China. Our extensive sales and distribution reach has allowed us to establish a comprehensive nationwide network effectively covering not only modern retail formats, such as retail chains, but also traditional retail formats, such as local grocery stores. We deploy more than 28,000 sales promoters in over 19,000 selected retail locations to promote the sales of our products. In addition, our extensive distribution network is supported by over 2,000 sales and marketing staff. We believe our leading position in second- and third-tier cities and our strength in traditional retail formats effectively differentiate us from multinational and domestic competitors and allow us to successfully deliver high-quality products. We further believe we are well-positioned to capitalize on the rapid growth of the domestic pediatric milk formula industry, which is driven by increased urbanization, a stable birth rate and the increase in disposable income and number of working mothers in China.

Note:

First-tier cities generally include direct-controlled municipalities, the highest level of cities under the direct administration of the PRC central government, and provincial capital cities, for example, Beijing, Shanghai, Nanchang, Chongqing, Shijiazhuang and Guangzhou. Second-tier cities generally refer to prefecture-level cities, the administrative division of the PRC ranking below a province and above a county in China's administrative structure, for example, Dongguan, Nanyang, Jiujiang, Shenzhen and Foshan. Third-tier cities generally refer to county-level cities, the county level administrative divisions of the PRC, for example, Jinjiang, Yunmeng, Bozhou, Kunshan and Luohe. As there is no official classification, such classification is determined based on our Directors' knowledge and experience.

The impact of the 2008 nationwide melamine incident

On 16 September 2008, the General Administration of Quality Supervision, Inspection and Quarantine of the PRC, or the AQSIQ, announced that the products of 22 domestic pediatric milk formula producers, including ours, were found to be contaminated with melamine, a substance not approved for use in food and linked to the development of health problems of infants and children in China. We believe that this incident was due to some raw milk dealers who added melamine to raw milk to artificially inflate its protein level. Although we did not add melamine to the affected products nor did we have any relationship with such dealers, and despite the fact that no industry standard or government regulation existed in China for the detection of melamine at the time, we were nevertheless accountable for product liabilities as the producer of melamine-contaminated products. We immediately conducted a compulsory recall of all contaminated lots of products and further conducted voluntary recalls for all of our pediatric milk formula products and milk powder for adults and teenagers manufactured prior to 14 September 2008. We also suspended our production and cooperated with relevant government agencies on inspection and examination requests for our products and production facilities. While an administrative sanction was levied against Scient (Guangzhou) by Guangzhou Administration of Industry and Commerce on 14 April 2009 as a result of the 2008 nationwide melamine incident, it was mitigated by such authority in light of our proactive measures to perform timely product recalls. With the approval of the State Council, China Dairy Industry Association and the 22 companies, including us, set up a compensation fund in late 2008 to compensate the affected infants and families of contaminated milk powder. We have authorized China Dairy Industry Association to make such compensation and contributed RMB61.2 million to fulfill our relevant compensation responsibilities to those infants or families who registered with relevant health administrative authorities or medical institutions for compensation. We incurred losses arising from the melamine incident, primarily consisting of write-off of inventories and inventory disposal costs for the recalled products, of RMB787.1 million in 2008. We also had losses arising from the melamine incident of RMB1.3 million and RMB1.0 million for the year ended 31 December 2009 and the six months ended 30 June 2010, respectively. For more details, please see the sections headed “Summary — The 2008 nationwide melamine incident and our improved quality control” and “— Quality assurance, quality control and safety”.

Our quality assurance and strategy of imported milk source

We strive to be a premier pediatric milk formula company through our focus on quality and safety. In response to the 2008 nationwide melamine incident, we made a major strategic decision to transition from using domestically produced dairy materials to importing premium, high-quality raw materials for our pediatric milk formula products. Since the end of June 2010, we have been using and plan to continue procuring 100% imported raw milk powder from high-quality overseas dairy sources, primarily in New Zealand, for producing our pediatric milk formula products. We believe our policy of importing high-quality dairy materials enables us to distinguish ourselves from other domestic pediatric milk formula manufacturers, who generally source all or a significant portion of their materials locally. In addition, our comprehensive system of quality control spans the entire value chain and consists of various measures instituted across sourcing, manufacturing and distribution. We conduct our production process in GMP-certified plants and have passed multiple certification tests for quality control measures, such as ISO9001 for quality control management, HACCP for food safety management, ISO14001 for environmental management and OHSAS 18001 for occupational health and safety management.

Our Other Products

While we are focused on our core products of pediatric milk formula, we also produce, market and sell other nutritional food products under the *Yashily* brand that offer us additional growth potential. Our products in this segment include soymilk powder, cereal, rice flour and milk powder for adults and teenagers. We are a leader in the soymilk powder market in China, with the second largest market share of approximately 14.9% in terms of retail sales in 2009 according to Kantar Worldpanel, an international market research company. After we started using 100% imported raw milk powder for the production of our pediatric milk formula products, all of the raw milk that we source in China has been processed to manufacture milk powder for adults and teenagers or whole milk powder sold externally for industrial food manufacturing purposes.

The combination of China's rapidly growing economy, greater awareness of pediatric nutrition options and increasing disposable income has resulted in greater demand for our products. We achieved a total revenue of RMB2,892.2 million and profit for the year of RMB469.9 million in the year ended 31 December 2007. For the year ended 31 December 2008, our revenue was RMB2,751.6 million and we had a loss for the year of RMB614.8 million, which was mainly attributable to the costs and expenses relating to product recalls and decreased sales in the second half of September 2008 as a result of the 2008 nationwide melamine incident. For the year ended 31 December 2009, our total revenue was RMB2,586.0 million and we achieved profit for the year of RMB402.4 million. For the six months ended 30 June 2010, our revenue amounted to RMB1,375.5 million and our profit for the period was RMB241.0 million, representing an increase of 22.0% over the same period in 2009.

OUR COMPETITIVE STRENGTHS

We have a clearly defined market position. Our national distribution network with a focus on second- and third-tier cities offers affordable high-quality and safe products, which has allowed us to capitalize on the fastest-growing markets in China's pediatric milk formula industry. We believe that our success is attributable to the following competitive strengths:

We are a leading player in the pediatric milk formula market in China's fast-growing second- and third-tier cities.

We are a leading player in China's pediatric milk formula industry, one of the world's largest and fastest-growing pediatric milk formula markets according to statistics from Euromonitor International. Our *Yashily* and *Scient* brands collectively captured the third largest market share of approximately 7.6% among domestic pediatric milk formula companies in 2009 in terms of total retail sales in China, according to AC Nielsen. In addition, we are a leading provider of pediatric milk formula products in the rapidly growing market of China's second- and third-tier cities. China's pediatric milk formula market has witnessed an increase in total sales from approximately RMB12.1 billion in 2005 to RMB29.0 billion in 2009, respectively, representing a CAGR of 24.4% according to Euromonitor International. We believe that our leading market position will enable us to benefit from the expected continued growth in the PRC pediatric milk formula industry.

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We have a well-established leading market position and benefit from high barriers to entry in terms of brand recognition, distribution network coverage and quality control system. With our leading market brands, high standard of quality control and strong operational efficiency, we believe that we can build upon our current leadership position in China's pediatric milk formula market and fully possess the capability to compete as well as capture and expand our market share in this fast-growing industry.

We have a nationwide and widely-recognized brand portfolio.

We believe our brands have been well-established in China as consumers associate them with high-quality and affordable products. In recognition of the high-quality of our products, our *Yashily* brand has received a number of awards over the years, including "China's 500 Most Valuable Brands" (中國500最具價值品牌), "Famous Product of China" (中國名牌產品), and "Well-known Trademark in China" (中國馳名商標). We are committed to strengthening our quality control measures and we procure all key dairy materials for pediatric milk formula products from quality overseas suppliers. We believe our high-quality products under the *Yashily* and *Scient* brands are well-positioned to benefit from the increasing consumer preference for premium products. As consumers increasingly appreciate the importance of quality and nutritional value in pediatric milk formula products, the domestic market will be driven by a trend towards premiumization. We believe that the wide-recognition of our award-winning *Yashily* and *Scient* brands and our full range of product portfolio will allow us to seize new opportunities generated by market trends.

We have adopted a multi-brand strategy with an extensive product portfolio that enables us to cover the full range of age groups in the middle- to high-end price categories. Our *Yashily* and *Scient* brands are two of China's leading brands in the pediatric milk formula market targeted at different consumer groups. Our *Yashily* brand is primarily targeted at mid-end and upper-end consumers in the second- and third-tier cities. We have also been gradually upgrading our *Yashily* product offerings to extend into the high-end segment. Our *Scient* brand is primarily marketed towards high-end consumers, who are more affluent and willing to pay a premium price for high-quality pediatric milk formula products. Both of our *Yashily* and *Scient* brands offer a full range of products, generating significant consumer conversion and loyalty. Our comprehensive product portfolio includes routine pediatric milk formulas and formulated milk powder products to pregnant and nursing women. In addition to our core pediatric milk formula products, we also offer supplementary nutritional food products such as soymilk powder, rice flour and cereal, which complete our product offerings to meet the variety of nutritional needs of consumers.

We have a comprehensive nationwide sales and distribution network effectively covering not only modern retail formats but also traditional retail formats.

We sell our products through a comprehensive nationwide sales and distribution network covering all provinces and provincial-level municipalities in China. As of 30 June 2010, this network comprised over 1,300 regional distributors who directly or indirectly sold our products to over 80,000 retail outlets, including local grocery stores, regional retail chains, specialty stores and national retail chains. Our extensive sales and distribution reach has allowed us to establish a comprehensive nationwide network effectively covering not only modern retail formats, such as retail chains, but also traditional retail formats, such as local grocery stores. Our comprehensive distribution network is supported by over 2,000 sales and marketing staff, 190 sales offices and more than 28,000 sales promoters dispatched to over 19,000 selected retail locations. Our strong distribution capability has enabled deep market

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penetration in second- and third-tier cities and even counties, townships and rural areas. We believe our penetration into second- and third-tier cities provides us with a competitive advantage over our multinational brand competitors, given that the pediatric milk formula markets in second- and third-tier cities are expected to grow at a much faster rate than that in first-tier cities.

We have implemented a system of sales management and an efficient structure of incentives to continuously attract and motivate capable distributors and staff to increase our revenue and market share. Our stringent control over our distribution network ensures that all distributors manage sales and customer contacts in their sales territories according to our distribution policy and sales strategy. We coordinate a range of marketing and promotional activities, and regularly conduct after-sales and customer surveys to assist sales of our distributors and continuously improve our sales management. Our effective product tracking system, in which a unique two-dimensional bar code is marked on each packaging unit, allows us to track the details and movement of every finished product by distributors and effectively prevent distributors' cross-territory sales. Over our long operating history, by providing our distributors with an effective system of sales management and superior sales and distribution network, we have been able to develop a stable network of distributors and establish close partnerships. As of 30 June 2010, approximately 31% of our distributors had maintained a business relationship with us for over five years, of which some even span for more than 12 years. We believe our deep experience in managing a wide-reaching sales and distribution network has enabled us to successfully penetrate markets in second- and third-tier cities and establish leading positions in counties and townships. Our strategy of combining a broad and deep sales and marketing system with multiple means of support for our distributors has enabled us to steadily expand our sales reach and efficiently deliver high-quality products and services to consumers.

We are committed to maintaining strict standards of quality control and food safety.

We are committed to maintaining strict standards of quality control and assurance over the course of our long operating history. We have continuously made improvements on quality control measures throughout our research, supply, production and distribution chains to strictly adhere to national standards. Our comprehensive quality assurance program and disciplined implementation reflect our commitment to delivering safe and high-quality products to consumers.

We conduct our production process in GMP-certified plants, which have passed multiple certification tests for quality control measures, such as ISO9001 for quality control management, HACCP for food safety management, ISO14001 for environmental management and OHSAS 18001 for professional health and safety management. In order to ensure the safety of our raw materials, we have invested in various high-precision inspection instruments manufactured in the United States and Sweden, such as liquid chromatography mass spectrometers, gas chromatographic analyzers and graphite furnace atomic absorption spectrophotometers, which are used for measurement of contents stipulated in national regulatory standards as well as specialized detection of melamine, harmful pesticides and heavy metals.

We are dedicated to creating and continuously improving a comprehensive system of quality control spanning across the entire value chain from procurement to retail sales. As dairy material is the key ingredient in pediatric milk formula, we have carefully selected reputable suppliers located outside China to secure reliable and high-quality raw milk sources. We currently procure 100% of the raw milk powder used to manufacture our pediatric milk formula products from well-established suppliers in New Zealand and Australia. To ensure that our finished products fully comply with national regulations, we

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have also proactively taken an extra measure to submit samples from every batch of finished products to relevant government agencies for quality inspection on a voluntary basis. In addition, our product tracking system, in which a unique two-dimensional bar code is marked on each product packaging unit, serves as an effective anti-counterfeiting measure by assuring that only our genuine, high-quality products reach end-consumers. We require all personnel involved in every stage of our operations, including procurement, production, packaging and sales, to strictly observe the relevant quality control and safety measures. We believe that our focus on developing high-quality pediatric milk formula products by integrating local production systems with comprehensive quality control and reliable imported dairy raw materials has enabled us to build the trust and confidence of consumers in China.

We have a localized and experienced research and development team dedicated to the Chinese consumer market.

We have continuously invested in advanced technologies and building strong research and development capabilities to introduce the highest quality pediatric milk formula products that promote the healthy development of infants and children throughout China. We have focused on developing innovative products and formulas that possess nutritional constituents similar to breast milk and specifically cater to the needs of infants in China. As of 30 June 2010, our dedicated research and development team comprised 32 full-time researchers who hold university degrees relating to food technology and whose efforts have resulted in product innovation, such as the development of our proprietary pediatric milk formula products. For example, we successfully introduced the *Yashily* α -Golden Stage Pediatric Milk Formula series in 2007 and the *Ambery* Pediatric Milk Formula series in 2008, both of which contained lutein, a key antioxidant responsible for promoting retinal health development. Our research projects for pediatric milk formula are headed by Mr. Tong Chengfu, who has over twenty-two years of research experience in pediatric nutrition. In addition to his wealth of professional industry experience, Mr. Tong is also a committee member of the Strategic Professional Alliance for Technological Development of Dairy Industry, an industry association established in China. We have also recruited Dr. Lee Fun-ya, a well-regarded expert in the food and beverage industry with extensive product development and research and development experience, to be our Chief Technical Officer and the head of our new international food research institute. We believe that we will benefit significantly from the wealth of the industry and professional experience of Mr. Tong and Dr. Lee.

In addition to our internal research capabilities, we engage renowned industry experts and nutrition consultants, as well as major universities and reputable third-party research and development institutes in China, for assistance and collaboration in product development and innovation. For example, we have entered into a collaborative agreement with the China Agricultural University in connection with the research and development of a high-protein specialty milk formula for adults and the elderly. Members of our research team have also actively participated in setting the national and industry nutritional standards for pediatric milk formula products, soymilk powder and cereal.

We have a dedicated and experienced management team with strong execution abilities and global vision.

We have a highly stable and experienced leadership team whose members possess an average tenure of over eight years with our Group. Our senior management is dedicated to our core products of pediatric milk formula and possesses a wealth of industry experience. Our co-founder and Chairman of the Board of Directors, Mr. Zhang Lidian, and our co-founder and the Chairman of the Board of Yashili

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(Guangdong), Mr. Zhang Likun, each has over 25 years of experience in the food industry, more than 15 years of experience in the dairy nutrition industry and over 10 years of experience in the pediatric dairy nutrition industry. In addition, Mr. Zhang Lidian has held various senior positions within the China Dairy Committee. We believe Mr. Zhang Lidian and Mr. Zhang Likun have demonstrated a proven track record of in-depth market knowledge, corporate management and execution abilities. For example, under their leadership and supervision, within seven years of entering the pediatric milk formula market, we achieved the number one market share position based on retail sales in China from March 2007 to August 2008 among all domestic and multinational producers according to AC Nielsen. Furthermore, our general manager of sales and marketing, Mr. Xie Xunpeng, has accumulated extensive experience and intimate familiarity of our business from numerous roles he has held within the sales department during his 17 years of tenure with our Group. We have also recruited industry experts such as Mr. Allen Ho and Dr. Lee Fun-ya, who bring a wealth of international experience in their respective professional fields of quality control and product development in the food industry.

Our Directors and senior management have played a key role in fostering a distinct corporate environment that promotes responsibility, achievement and innovation, which in turn encourages the delivery of consistent and high-quality products. We have created a vibrant, performance-driven corporate culture by providing incentives such as our share-based compensation scheme to senior management and employees. Our competitive compensation and training and career development programs have allowed us to continue to attract, motivate and retain highly skilled and experienced management personnel with domestic and international backgrounds. We are strongly focused on execution by emphasizing expedient implementation of strategies facilitated by efficient internal communication. Furthermore, under the assistance and contribution from our strategic investors, Fosun and Carlyle, we have developed a set of corporate governance practices and performance and operational standards that take into account key elements of international best practices.

The foresight and in-depth industry knowledge of our Directors, senior management and major investors have enabled us to formulate sound business strategies, better assess and manage risks, promptly anticipate and react to changes in consumer preferences and strategically position ourselves to capture significant market opportunities. We believe that our management team possesses the leadership, commitment and qualifications to sustain our business and drive our future growth and tactically explore international opportunities such as upstream expansion overseas.

OUR BUSINESS STRATEGIES

We believe that the following strategies will effectively assist us in solidifying our leading position in second- and third-tier cities and in successfully expanding further into first-tier cities:

Continue to pursue excellence in quality.

Consistent with our focus on delivering high-quality and safe products, we will continue to improve our quality control program and institute new measures to strengthen our existing system. We have established a Food Quality and Safety Advisory Committee that consists of experts from diverse scientific, professional and geographical backgrounds, who will seek to implement industry-leading quality control practices to ensure the safety and quality of our products. The Committee, established in August 2010, will provide strategic guidance on our policies and procedures for ensuring product safety and quality, introduce industry best practices and advise on the compliance of our operations with relevant laws and regulations. It is authorized by our Board to conduct independent investigations into

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our operations and evaluate our quality control system. The Committee will also analyze and disseminate to the members of the Board the latest industry information and developments relevant to food safety and quality control. With the establishment of the Committee, we aim to be a pioneer in product safety and quality in the PRC pediatric milk formula industry to further solidify consumer confidence.

To ensure that our Food Quality and Safety Advisory Committee adheres to international best practices, we have recruited six industry experts, including Dr. Robert Brackett and Mr. Allen Ho, to become members of the Committee. Dr. Brackett is currently the director and vice president of the National Center for Food Safety and Technology at Illinois Institute of Technology. He has previously served as the director of the US Food and Drug Administration's Center for Food Safety and Applied Nutrition and as the senior vice president of the US Grocery Manufacturers Association (GMA). He serves as the chairman of our Food Quality and Safety Advisory Committee. In addition, we engaged Mr. Allen Ho as our chief quality advisor. Mr. Ho has been serving on the advisory committee to the Hong Kong Food and Health Bureau and is an expert adviser to the Food and Environment Hygiene Department of the Hong Kong SAR Government. He brings over 30 years of experience in quality, technical and regulatory leadership positions with leading multinational companies in the food industry in the United States and Asian countries. We believe Mr. Ho's extensive professional experience and comprehensive industry knowledge will enable us to create a world-class program of quality control and management.

In addition, we plan to continue procuring 100% of the raw milk powder used in our pediatric milk formula products from well-established suppliers overseas and further develop and strengthen our control over high-quality imported dairy materials. In particular, we plan to expand into upstream operations overseas and establish vertically-integrated production facilities. We intend to carefully select, acquire and operate integrated dairy companies overseas with a view to securing stable supplies of high-quality dairy materials. We take into consideration the operating scale and track records, financial condition, asset quality, production facilities and capacity, capability of employee and efficiency of management and information system of dairy companies when we identify and evaluate potential targets for acquisition or cooperation to develop integrated overseas facilities. In addition, we intend to explore opportunities for cooperation with overseas dairy related products companies and/or other strategic investors in order to leverage their experience in quality control and research and development and thus to further enhance our relevant capabilities. We believe due to the increasing demand for imported dairy products in the PRC market since 2009, our strategy of acquiring and operating our own integrated manufacturing facilities in overseas countries will allow us to exercise better control over the source and quality of upstream dairy inputs. The foregoing measures will also enable us to secure ownership and maintain steady supplies of high-quality raw milk powder as well as minimize our dependence on any single supplier. As of the Latest Practicable Date, we had entered into discussion with several overseas dairy operators but had no specific acquisition targets.

Continue to expand and solidify our sales and marketing channels.

Given the rapid development of China's economy, the increase in disposable income, and China's enormous population and stable birth rate, we believe that an expansive sales and distribution network will provide us with the ability to capture significant growth opportunities in the domestic PRC market. We aim to increase our penetration in traditional retail formats such as local grocery stores across China's second- and third-tier cities as well as counties and townships, where economic growth will be

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supported by favorable government policies. At the same time, we will also continue to strengthen our presence in modern retail formats such as national and regional retail chains in order to enhance the national brand recognition of *Yashily* and *Scient*. In addition to our existing sales channels, we will explore new sales platforms such as online sales in order to develop a multi-channel sales strategy and satisfy the demands and preferences of different consumer groups.

We will also strengthen our market analysis capabilities and distribution management to create an optimal network of support for our sales strategy. We will strengthen our systematic tracking of sales, brand performance and market data to better inform our operational decision-making. We will create a management dashboard to perform integrated analysis of our operations and form a more balanced assessment of overall business performance. We will also continue to enhance our strategic management of product positioning and market tactics in order to create a clearly defined long-term brand architecture and product positioning. We will optimize our distribution network by reducing the number of sub-distributors to strengthen our control over sales channels, thereby improving distributor management and enhancing cost efficiency. In addition, through ongoing studies and analyses of the needs and purchasing power of different customer segments, we will also continue to develop different varieties of products catering to the specific needs and preferences of a wider range of consumer groups.

Continue to optimize our product portfolio and enhance our research and development capabilities.

We constantly evaluate our brands and product offerings and seek to adapt to changing market conditions by updating our existing product portfolio to reflect new trends in consumer preferences. We believe that the increase in average resident disposable income and the trend of consumer preference shifting towards high-quality premium products will continue. We will continue to increase marketing and promotion of our premium products and product lines, such as our *Yashily* α -Golden Series, *Yashily* sub-brand *Ambery*, *Scient Golden Series* and *Scient* imported pediatric milk formula.

We aim to be an industry pioneer in the development of innovative pediatric dairy nutritional products that advance the health of infants and young children, and have continuously invested in the research and development of new, high-quality products and formulas with nutritional benefits close to those in breast milk. In the future, we plan to develop specialty formulas tailored to address specialized needs of specific infants, such as soy-based products and other substitute formulas for infants suffering from lactose intolerance. We will also explore new pediatric and adult nutritional products to meet changing market demands and consumer preferences, such as introducing organic products and milk formula products for adults and the elderly.

To further enhance our technological capabilities, we plan to construct a new food research institute in Shantou, Guangdong Province, where we will invest significantly in acquiring new, advanced laboratory equipment and facilities and centralize our research and development efforts. This research institute will be dedicated to the development of new market-competitive products and research of core technologies, with a goal to develop new products for the pediatric milk formula market and selectively expand our other existing nutritional food product offerings, such as milk beverages, other beverages, confectionaries and other related products. In order to achieve an optimal profile of risk and reward, we will direct our research focus on commercially-viable products in the near-term, and explore higher-risk products with breakthrough potential over a longer time horizon.

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We will engage additional food technology researchers, professional engineers and expert nutritionists to enhance our in-house research and development capacity. We intend to increase our collaborative efforts with major international universities and renowned third-party research and development institutes to discover and upgrade breakthrough technologies and innovative products. We intend to collaborate with Massey University in New Zealand in the research and development of pediatric formula, technologies and functional raw materials. In addition, we have entered into a collaborative arrangement with the China Agricultural University in connection with the research and development of a high-protein specialty milk formula product for adults and the elderly. In order to capture the significant market opportunity in adults and elderly nutrition generated by China's steadily aging society, we intend to develop an innovative specialty milk formula product with highly-nutritious content and easy absorption characteristics. We believe cooperation with advanced research institutions will enhance the quality and competitiveness of our products and promote consumer trust and confidence in our products.

Continue to strengthen our brand recognition.

Although our *Yashily* and *Scient* brands are already widely-recognized in the PRC market, we will continue to launch advertising campaigns to promote our *Yashily* and *Scient* brands. We plan to leverage our national reputation to increase brand recognition and enhance our image in our target markets through increased television advertising on major nation-wide and local television networks as well as other promotional methods focused on our premium products. In addition, to maximize the impact of our advertising campaign, we will continue to feature a number of high-profile artists or celebrities as our spokespersons to promote our products.

Due to the importance of the Internet as an increasingly popular advertising medium, we also intend to expand our marketing activities over the Internet to strengthen our brand presence. We will increase marketing and promotional activities at prominent portals, baby forum websites and other mainstream websites to reach a greater percentage of young parents who utilize the Internet to access information. We also plan to strengthen cooperation with leading parenting and healthcare magazines and newsletters. We will increase our investment in print media to enhance our corporate and brand image, thereby further supporting our sales efforts. In conjunction with our increased investment in advertising, we also intend to increase our support of public charities and foundations in order to cultivate a socially responsible brand image and promote our corporate values to the general public.

We believe that our wide range of promotional activities will provide us with opportunities to further expose parents to our brands and products and enable them to receive educational and comprehensive information on the benefits and value proposition of our products. We believe that through increased marketing and product promotional efforts, we will be able to cultivate greater awareness and acceptance of our products, enhance the ability of consumers to associate our brand names with high product quality and safety, foster loyalty in our target consumers and promote demand for our products.

Expand our production facilities and continue to upgrade our manufacturing capabilities.

We intend to invest in new production facilities and continue to upgrade our existing manufacturing capabilities to capitalize on the anticipated growth of the pediatric milk formula industry and enlarge our market share. We plan to invest in the construction of a new production facility in

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Chaozhou, Guangdong Province, and resume construction of our plant in Zhengzhou, Henan Province. Upon the completion of our expansion plan, our increased production capacity will support our expected future growth.

We will also upgrade our existing manufacturing facilities in Chaozhou in an attempt to meet the criteria specified in US FDA certification guidelines for pediatric milk formula production, while also complying with relevant PRC laws and regulations. Although we do not have nor intend to conduct any manufacturing or sales operations in the United States, we are proactively committing ourselves to producing the highest quality products in the market by complying with the US FDA certification guidelines because we believe that the US FDA has one of the most stringent standards for food quality in the world. We aim to achieve standards of quality and production management for our core products that are on par with our multinational competitors. We believe that by putting in place new and enhanced production capabilities and facilities, we will be well-positioned to attain economies of scale, capture new opportunities generated by continuing industry growth and provide our consumers with market-competitive products.

OUR OPERATING SEGMENTS

We have established *Yashily* and *Scient* as leading brands in China's pediatric dairy product market. Our imported raw milk powder materials, stringent quality control system, strong sales capabilities and extensive sales channels have enabled us to become a market leader offering a wide range of pediatric milk formula and food and nutrition products designed to meet the varying needs of different consumer groups. Our principal operating segments consist of the following:

- **Yashily pediatric milk formula** — pediatric milk formula primarily for infants under three years old, as well as milk formula designed exclusively for expectant and nursing mothers marketed under the *Yashily* family of brands, including *Yashily*, *Ambery* and *Newwitt*;
- **Scient pediatric milk formula** — pediatric milk formula primarily for infants under three years old, as well as milk formula designed exclusively for expectant and nursing mothers marketed under the *Scient* brand;
- **Nutritional food products** — include soymilk powder and cereal in different formulas for specific adult age groups as well as for the general population, rice flour in different formulas and packages for infants under two years old, milk powder designed for specific adult consumer groups and teenagers; and
- **Others** — include: (i) whole milk powder as a raw material in the industrial production of dairy foods, such as ice cream; (ii) packaging material; (iii) sales of surplus raw material supplies such as raw milk; and (iv) preserved fruit products manufactured by Haoweijia Food sold to external customers.

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The following table sets forth our total revenue by operating segment for the periods indicated after the elimination of inter-segment revenue and excluding revenue from external sales of our discontinued operation in 2007:

	Year ended 31 December						Six months ended 30 June	
	2007		2008		2009		2010	
	RMB (million)	%	RMB (million)	%	RMB (million)	%	RMB (million)	%
<i>Yashily</i> pediatric milk formula.	1,415.2	48.9	1,511.8	54.9	1,540.4	59.6	840.5	61.1
<i>Scient</i> pediatric milk formula.	912.8	31.6	755.0	27.5	521.3	20.2	319.3	23.2
Nutritional food products.	506.6	17.5	454.2	16.5	507.6	19.6	208.9	15.2
Others ⁽¹⁾	57.6	2.0	30.6	1.1	16.7	0.6	6.8	0.5
Total external revenue	2,892.2	100.0	2,751.6	100.0	2,586.0	100.0	1,375.5	100.0

(1) Includes whole milk powder, packaging materials, surplus raw material supplies such as raw milk and preserved fruit products manufactured by Haoweijia Food sold to external customers.

PRODUCTS

Overview of Pediatric Milk Formula

We develop pediatric milk formula products primarily for the routine feeding of healthy, full-term infants and toddlers to satisfy their common nutritional needs. Our pediatric milk formula can supplement breast milk as an infant’s major sources of nutrition. All of our pediatric milk formula products use high-quality imported milk sources mainly from New Zealand and Australia. We also imported one product series of *Scient* pediatric milk formula from the United States. We seek to develop formulas with the most ideal nutritional profile suited for various growth and development stages of an infant.

Each product is formulated because it is designed for the specific nutritional needs of an infant of a given age. Generally, routine pediatric milk formula has the following four main components: (i) protein from cow’s milk that is processed to have a profile similar to human breast milk; (ii) a blend of vegetable fats to replace bovine milk fat in order to better resemble the composition of human breast milk; (iii) a carbohydrate, generally lactose from cow’s milk; and (iv) a vitamin and mineral “micronutrient” pre-mix that is blended into the base milk powder to meet the specific needs of the infant at a given age. Patterned after breast milk, which changes composition to meet an infant’s changing nutritional needs, we produce three stages of pediatric milk formula: Stage one formula, or infant formula, is generally consumed by newborn infants up to six months of age; Stage two formula, or follow-up infant formula, is generally consumed by infants of ages between six and 12 months; and Stage three formula, or toddler formula, is generally consumed by infants of ages between one and three years. We also produce milk formula exclusively designed for expectant and nursing mothers and young children of ages between three and six years. All of our pediatric milk formula products are sold in the form of milk-based powder.

BUSINESS

We have created pediatric milk formula lines targeted at consumers across different price segments. Our pediatric milk formula series under the *Scient* brand and the *Ambery* sub-brand of *Yashily* are products with high-quality nutrients targeted at consumers in the high-end market. Our *Yashily* pediatric milk formula products include series with different specifications and characteristics to primarily target consumers in the mid-end and upper-end market segments. All of our products are currently sold in the PRC. In 2007 and 2008, we also had a minimal amount of overseas sales to certain African, South Asia and Middle Eastern countries, accounting for approximately 0.05% and 0.08% of total revenue for the years ended 31 December 2007 and 2008, respectively. We ceased overseas sales after the 2008 nationwide melamine incident and have no plan to resume overseas sales in the foreseeable future. Our past overseas sales were made through domestic trading companies in the PRC, which resold our products to overseas markets, or sold to distributors located in the overseas markets. Our Directors confirm that to the best of their knowledge, we had complied with the relevant overseas regulatory requirements for the export of goods.

***Yashily* pediatric milk formula**

Our core brand *Yashily* is primarily targeted at mid-end and upper-end consumer groups. We source high-quality raw milk powder mainly from New Zealand and Australia to produce milk formula products for infants and expectant and nursing mothers in our GMP-certified plants. Our pediatric milk formula products marketed under the “*Yashily*” brand include *Yashily* α -Golden Stage Pediatric Milk Formula, *Yashily* α -Golden Stage Mothers’ Formula, *Yashily Newwitt* Golden Pack Pediatric Milk Formula, *Yashily Newwitt* Golden Pack Mothers’ Formula, *Ambery* Pediatric Milk Formula and *Yashily* New Pediatric Milk Formula. We source the raw materials from major milk powder suppliers in New Zealand and Australia in order to ensure quality.




For the years ended 31 December 2007, 2008, 2009 and the six months ended 30 June 2010, we produced and sold approximately 25,181 tonnes, 25,049 tonnes, 23,813 tonnes and 11,581 tonnes of *Yashily* pediatric milk formula products, respectively. For the years ended 31 December 2007, 2008, 2009 and the six months ended 30 June 2010, sales of our *Yashily* pediatric milk formula products accounted for 48.9%, 54.9%, 59.6% and 61.1% of our total revenue, respectively.

BUSINESS


The table below sets forth our pediatric milk formula products marketed under the “Yashily” brand as of 30 June 2010:

	<u>Product name</u>	<u>Suggested retail price (RMB)</u>	<u>Product description</u>
	Yashily α -Golden Stage Pediatric Milk Formula:		Each 900 grams can, 400 grams box or 400 grams bag has the following specifications:
	Stage one — for infants from zero to six months old	Stage one — 900g can: 198.00 400g box: 75.00 400g bag: 69.00	— containing lutein, DHA and ARA, choline, oligofructose and lactoferrin
	Stage two — for older infants from six to 12 months old	Stage two — 900g can: 188.00 400g box: 69.00 400g bag: 59.00	— fortified with vitamins and minerals, such as calcium and iron, for enhanced nutrition
	Stage three — for toddlers from one to three years old	Stage three — 900g can: 178.00 400g box: 63.00 400g bag: 59.00	— sourcing from major milk powder suppliers in New Zealand and Australia to ensure quality — primarily targets the high-end market — shelf life — 900g can: 24 months 400g box: 18 months 400g bag: 18 months
	Yashily α -Golden Stage Mothers' Formula	— 900g can: 188.00	Each 900 grams can has the following specifications:
			— containing folic acid, DHA, choline and oligofructose — sourcing from major milk powder suppliers in New Zealand and Australia to ensure quality — primarily targets the high-end market — shelf life: 24 months

BUSINESS

	<u>Product name</u>	<u>Suggested retail price (RMB)</u>	<u>Product description</u>
	Yashily Newwitt Golden Pack Pediatric Milk Formula:		Each 900 grams can from Stage one to four or 400 grams bag from Stage one to three has the following specifications:
	Stage one — for infants from zero to six months old	Stage one — 900g can: 168.00 400g bag: 61.00	— containing DHA and ARA, oligofructose and lactoferrin
	Stage two — for older infants from six to 12 months old	Stage two — 900g can: 159.00 400g bag: 59.00	— sourcing from major milk powder suppliers in New Zealand and Australia to ensure quality
	Stage three — for toddlers from one to three years old	Stage three — 900g can: 155.00 400g bag: 56.00	— primarily targets the mid-end market
	Stage four — for young children from three to six years old	Stage four — 900g can: 148.00	— shelf life — 900g can: 24 months 400g bag: 18 months
	Yashily Newwitt Golden Pack Mothers' Formula	— 900g can: 159.00 400g bag: 59.00	Each 900 grams can or 400 grams bag has the following specifications:
			— containing folic acid, DHA and oligofructose — sourcing from major milk powder suppliers in New Zealand and Australia to ensure quality — primarily targets the mid-end market — shelf life — 900g can: 24 months 400g bag: 18 months
	Ambery Pediatric Milk Formula:		Each 900 grams can or 400 grams box has the following specifications:
	Stage one — for infants from zero to six months old	Stage one — 900g can: 228.00 400g box: 98.00	— containing prebiotics, lutein, DHA and ARA, choline and lactoferrin
	Stage two — for older infants from six to 12 months old	Stage two — 900g can: 215.00 400g box: 89.00	— sourcing from major milk powder suppliers in New Zealand and Australia to ensure quality
	Stage three — for toddlers from one to three years old	Stage three — 900g can: 198.00 400g box: 81.00	— primarily targets the high-end market — shelf life — 900g can: 24 months 400g box: 18 months

BUSINESS

	<u>Product name</u>	<u>Suggested retail price (RMB)</u>	<u>Product description</u>
	Yashily New Pediatric Milk Formula:		Each 700 grams bag from Stage one to three or 400 grams bag from Stage one to four has the following specifications:
	Stage one — for infants from zero to six months old	Stage one — 700g bag: 59.00 400g bag: 41.00	— containing DHA and choline
	Stage two — for older infants from six to 12 months old	Stage two — 700g bag: 59.00 400g bag: 39.00	— sourcing from major milk powder suppliers in New Zealand and Australia to ensure quality
	Stage three — for toddlers from one to three years old	Stage three — 700g bag: 59.00 400g bag: 39.00	— primarily targets the middle and budget markets
	Stage four — for young children from three to six years old	Stage four — 400g bag: 35.00	— shelf life: 18 months



Scient pediatric milk formula

Scient is an independent premium brand which is targeted at high-end consumers, with products that compete with major international pediatric milk formula brands. We source high-quality raw milk powder from New Zealand for our Golden and Standard Series formula for infants and expectant and nursing mothers. We also engage a well-known OEM of pediatric milk formula, PBM Products, in the United States to produce a pediatric milk formula that is sold as 100% imported. Our pediatric milk formula products marketed under the “*Scient*” brand include *Scient* Golden Stage Pediatric Milk Formula, *Scient* Golden Stage Mothers’ Formula, *Scient* Standard Stage Pediatric Milk Formula, *Scient* Standard Stage Mothers’ Formula and *Scient* Imported Skimmed Pediatric Milk Formula, all of which target the high-end market.

For the years ended 31 December 2007, 2008 and 2009 and the six months ended 30 June 2010, we produced and sold approximately 13,306 tonnes, 11,919 tonnes, 8,084 tonnes and 4,393 tonnes of our *Scient* pediatric milk formula products, respectively. For 2007, 2008, 2009 and the first six months of 2010, sales of our *Scient* pediatric milk formula products accounted for 31.6%, 27.5%, 20.2% and 23.2% of our total revenue, respectively. In June 2009, we launched our *Scient* Imported Skimmed Pediatric Milk Formula products, the only series of *Scient* products that we sell with original packages and without further processing, save for labeling and paper box packaging prior to distribution. Since launch, we generated RMB17.0 million and RMB1.3 million from the sales of such products for the year ended 31 December 2009 and the six months ended 30 June 2010, which accounted for 0.7% and 0.1% of our total revenue for the same period, respectively.

BUSINESS

The table below sets forth our pediatric milk formula products marketed under the “*Scient*” brand as of 30 June 2010:

	<u>Product name</u>	<u>Suggested retail price (RMB)</u>	<u>Product description</u>
	Scient Golden Stage Pediatric Milk Formula:		Each 900 grams can, 400 grams box or 400 grams bag has the following specifications:
	Stage one — for infants from zero to six months old	Stage one — 900g can: 223.00 400g box: 84.00 400g bag: 77.00	— containing galacto-oligosaccharides, which are a group of prebiotics, DHA and ARA, choline, oligofructose and lactoferrin
	Stage two — for older infants from six to 12 months old	Stage two — 900g can: 207.00 400g box: 80.00 400g bag: 72.00	— sourcing from major milk powder suppliers in New Zealand to ensure quality
	Stage three — for toddlers from one to three years old	Stage three — 900g can: 207.00 400g box: 80.00 400g bag: 72.00	— primarily targets the high-end market — shelf life — 900g can: 24 months 400g box: 18 months 400g bag: 18 months
	Scient Golden Stage Mothers' Formula	— 900g can: 192.00 400g box: 73.00	Each 900 grams can or 400 grams box has the following specifications:
			— containing dietary fibers, folic acid, galacto-oligosaccharides, which are a group of prebiotics, DHA and ARA, choline and oligofructose — sourcing from major milk powder suppliers in New Zealand to ensure quality — primarily targets the high-end market — shelf life — 900g can: 24 months 400g box: 18 months

BUSINESS

	<u>Product name</u>	<u>Suggested retail price (RMB)</u>	<u>Product description</u>
	Scient Standard Stage Pediatric Milk Formula:		Each 900 grams can, 700 grams bag or 400 grams box has the following specifications:
	Stage one — for infants from zero to six months old	Stage one — 900g can: 173.00 700g bag: 92.00 400g bag: 53.00	— containing nucleotides, DHA and ARA and lactoferrin
	Stage two — for older infants from six to 12 months old	Stage two — 900g can: 166.00 700g bag: 86.00 400g bag: 51.00	— sourcing from major milk powder suppliers in New Zealand to ensure quality
	Stage three — for toddlers from one to three years old	Stage three — 900g can: 166.00 700g bag: 86.00 400g bag: 51.00	— primarily targets the high-end market
	Stage four — for young children from three to six years old	Stage four — 900g can: 141.00 700g bag: 86.00 400g bag: 51.00	— shelf life — 900g can: 24 months 700g bag: 18 months 400g bag: 18 months
	Scient Standard Stage Mothers' Formula	— 900g can: 152.00 400g bag: 52.00	Each 900 grams can or 400 grams bag has the following specifications:
			— containing folic acid, DHA and oligofructose — sourcing from major milk powder suppliers in New Zealand to ensure quality — primarily targets the high-end market — shelf life — 900g can: 24 months 400g bag: 18 months
	Scient Imported Skimmed Pediatric Milk Formula with Original Packaging:		Each 900 grams can has the following specifications:
	Stage one — for infants from zero to six months old	Stage one — 900g can: 268.00	— containing L-carnitine, nucleotides, DHA and ARA, oligofructose and lactoferrin
	Stage two — for older infants from six to 12 months old	Stage two — 900g can: 258.00	— fortified with nine different minerals and fourteen different vitamins
	Stage three — for toddlers from one to three years old	Stage three — 900g can: 258.00	— 100% produced by PBM Products, a well-known OEM of pediatric milk formula in the U.S. — primarily targets the high-end market — shelf life: 36 months

Nutritional Food Products

We also offer four categories of nutritional food products, namely, soymilk powder, cereal under *Yashily* brand and cereal under the *Zhengwei* Brand, rice flour and milk powder for adults and teenagers under *Youyi* brand.


We offer milk powder products containing different combinations of nutrients that are specifically designed for consumers with particular needs, such as adults requiring iron and calcium supplements, as well as products fortified with vitamins and minerals suitable for the general population. Our milk powder products include *Youyi* Milk Powder for Adults and the Elderly, *Youyi* Milk Powder for Women, *Youyi* Milk Powder for Elementary and Middle School Students, *Youyi* Skim Milk Powder with High Calcium and Iron and *Youyi* Whole Milk Powder Fortified with Vitamin A and Vitamin D.

Our soymilk powder series includes six products Soymilk Powder with Vitamins, Soymilk Powder with Vitamin A and D, Soymilk Powder for Adults and the Elderly, Soymilk Powder for Breakfast, Soymilk Powder for Women and Soymilk Powder for Students, with different nutritional formulas that benefit all ordinary teenagers and adults seeking healthy choices of nutritional products.



Our rice flour series includes different formulas of nutrients for various stages of an infant's development between six and 24 months. We also offer a wide array of popular flavors, such as pumpkin and red date. Our cereal products include oatmeal cereal and cereal flakes, which cater to the particular nutritional preferences of specific adult groups as well as to ordinary consumers.

For the years ended 31 December 2007, 2008 and 2009 and the six months ended 30 June 2010, we sold approximately 35,971 tonnes, 31,639 tonnes, 32,229 tonnes and 11,056 tonnes of our nutritional food products, respectively. For the years ended 31 December 2007, 2008 and 2009 and the six months ended 30 June 2010, sales of our nutritional food products accounted for 17.5%, 16.5%, 19.6% and 15.2% of our total revenue, respectively.


The following table sets forth information on our key nutritional food products as of 30 June 2010:


	Product name	Suggested retail price (RMB)	Product description
	Youyi Milk Powder for Adults and the Elderly	— 900g can: 82.00 400g bag: 29.00	Each 900 grams can or 400 grams bag has the following specifications: <ul style="list-style-type: none"> — enriched with vitamins A, D and E, dietary fibers and a high concentration of calcium for enhanced nutrient absorption — containing prebiotics and probiotics and oligofructose — manufactured from quality domestically-sourced raw milk in the PRC — shelf life — 900g can: 24 months 400g bag: 18 months

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	<u>Product name</u>	<u>Suggested retail price (RMB)</u>	<u>Product description</u>
	Youyi Milk Powder for Women	— 900g can: 82.00 400g bag: 29.00	Each 900 grams can or 400 grams bag has the following specifications: <ul style="list-style-type: none"> — enriched with vitamins A and D, dietary fibers and calcium for enhanced nutrient absorption — containing folic acid, prebiotics and probiotics and oligofructose — manufactured from quality domestically-sourced raw milk in the PRC — shelf life — 900g can: 24 months 400g bag: 18 months
	Youyi Milk Powder for Elementary and Middle School Students	— 900g can: 80.00 400g bag: 28.00	Each 900 grams can or 400 grams bag has the following specifications: <ul style="list-style-type: none"> — enriched with vitamins A and D and oligofructose for enhanced nutrient absorption — containing prebiotics and probiotics — manufactured from quality domestically-sourced raw milk in the PRC — shelf life — 900g can: 24 months 400g bag: 18 months
	Youyi Skim Milk Powder with High Calcium and Iron	— 900g can: 82.00 400g bag: 29.00	Each 900 grams can or 400 grams bag has the following specifications: <ul style="list-style-type: none"> — enriched calcium and iron content that is 25% higher than ordinary levels in whole milk, specifically designed for consumers deficient in these two nutrients — containing prebiotics and probiotics and oligofructose — manufactured from quality domestically-sourced raw milk in the PRC — shelf life — 900g can: 24 months 400g bag: 18 months

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	<u>Product name</u>	<u>Suggested retail price (RMB)</u>	<u>Product description</u>
	Youyi Whole Milk Powder Fortified with Vitamin A and Vitamin D	— 900g can: 80.00 400g bag: 28.00	Each 900 grams can or 400 grams bag has the following specifications: <ul style="list-style-type: none"> — enriched with vitamins A, D and E for a wholesome, nutritious food supplement suitable for all age groups — containing oligofructose — manufactured from quality domestically-sourced raw milk in the PRC — shelf life — 900g can: 24 months 400g bag: 18 months

<u>Soy milk powder</u>	<u>Product name</u>	<u>Suggested retail price (RMB)</u>	<u>Product description</u>
	Yashily Soy Milk Powder	— 480g bag: 9.00 500g bag: 10.50 580g bag: 14.80	Each 480 grams flat bag package contains 20 sachet powder bags, and 500 grams flat bag package contains 12 sachet powder bags. There are six products with different formulas of nutrients addressing the specific preferences of various consumer groups: <ul style="list-style-type: none"> — Soymilk Powder with Vitamins: enriched with multi-vitamins, propagation nutrition (動植物營養) and naturally occurring calcium carbonate — Soymilk Powder with Vitamin A and D: enriched with vitamin A and D, propagation nutrition (動植物營養) and naturally occurring calcium carbonate — Soymilk Powder for Adults and Seniors: enriched with propagation nutrition (動植物營養) and calcium in a low-sugar formula — Soymilk Powder for Breakfast: enriched with propagation nutrition (動植物營養) and protein — Soymilk Powder for Women: enriched with iron and vitamin A and D in a low-sugar formula — Soymilk Powder for Students: enriched with propagation nutrition (動植物營養) and naturally occurring calcium carbonate — shelf life: 12 months

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Rice flour	Product name	Suggested retail price (RMB)	Product description
	Yashily Rice Flour		<p>Each package contains 16 boxes or 18 sachet powder bags with specifically formulated nutrients and flavoring designed for infants from 6 to 24 months old:</p> <ul style="list-style-type: none"> — two types available: Calcium Iron and Zinc, Carrot and Pumpkin (only available in 18 sachet powder bags) — enriched with multi-vitamins, calcium, iron and zinc — containing prebiotics — shelf life: 12 months
	Stage one — for infants from six to 24 months old	Stage one — Calcium Iron and Zinc 250g box: 19.00 280g box: 9.50 — Carrot and Pumpkin 250g box: 19.00	
	Yashily Rice Flour		<p>Each package contains 18 boxes or 16 sachet powder bags with specifically formulated nutrients and flavoring designed for infants from 7 to 24 months old:</p> <ul style="list-style-type: none"> — three types available: Bifidus Factor and Egg yolk, Black Rice and Red Date, and Chicken and Vegetable (only available in 18 boxes) — fortified with vitamins — containing prebiotics — containing bifidus factor, a prebiotic — shelf life: 12 months
	Stage two — for infants from seven to 24 months old	Stage two — 250g box: 19.00 280g box: 9.50	
	Yashily Rice Flour		<p>Each package contains 18 boxes or 16 sachet powder bags with specifically formulated nutrients and flavoring designed for infants from 8 to 24 months old:</p> <ul style="list-style-type: none"> — three types available: Fish and Vegetable, Vitamin A and D and Calcium, and Honey and Bifidus Factor (only available in 18 boxes) — fortified with vitamins — containing DHA and ARA — shelf life: 12 months
	Stage three — for infants from eight to 24 months old	Stage three — 250g box: 19.00 280g bag: 9.50	

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Cereal	Product name	Suggested retail price (RMB)	Product description
	Yashily Oatmeal Cereal	— 600g bag: 22.00	<p>Each package contains 20 bags of oatmeal cereal with a shelf life of 18 months. There are five products with different formulas and nutritional benefits suitable for specific consumer groups as well as the ordinary adult:</p> <ul style="list-style-type: none"> — Yashily High Protein Oatmeal Cereal: containing whole milk powder, soy protein and protein-based nutrients — Yashily Breakfast Oatmeal Cereal: containing high-quality milk powder — Yashily Walnut High-Calcium Oatmeal Cereal: containing walnut powder and high concentration of calcium — Yashily Low-Sugar Oatmeal Cereal for Adults and Seniors: containing calcium and iron — Yashily High Calcium & High Iron Oatmeal Cereal: enriched with calcium and iron
	Zhengwei Oatmeal Cereal	— 600g bag: 14.50	<p>Each package contains 20 sachet powder bags of oatmeal cereal with a shelf life of 18 months. The product contains nutritional benefits suitable for specific consumer groups as well as the ordinary adult:</p> <ul style="list-style-type: none"> — Zhengwei Original Flavour Oatmeal Cereal: containing corn extracts, carbohydrate compounds and oligofructose
	Yashily Nutritional Oat Flakes	— 500g bag: 9.30 — 700g bag: 13.00 — 900g can: 21.50	<p>Oat flakes in three different package sizes of 500 grams, 700 grams bag and 900 grams can:</p> <ul style="list-style-type: none"> — enriched with carbohydrate compounds and dietary fiber — shelf life: 12 months

Other Products

At our Qiqihaer Plant, we produce whole milk powder, which is further processed into base milk powder primarily for our internal use in the production of milk powder for adults and teenagers. When our internal supply of self-produced whole milk powder exceeds internal demand, we also sell our surplus whole milk powder as a raw material to third party manufacturers engaged in the commercial production of dairy products, such as ice cream.

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We also produce packaging materials such as cans and cardboard boxes for internal use. A limited amount of the packaging materials was sold externally during the Track Record Period. We also sell surplus raw material supplies such as raw milk to external manufacturers of dairy products. In addition, we generated revenue from the sale of preserved fruit products manufactured by Haoweijia Food, our former subsidiary, which we sold to our Controlling Shareholders on 31 December 2007.

For the years ended 31 December 2007, 2008 and 2009 and the six months ended 30 June 2010, external sales of these products were RMB57.6 million, RMB30.6 million, RMB16.7 million and RMB6.8 million accounted for 2.0%, 1.1%, 0.6% and 0.5% of our total revenue, respectively.

SALES AND DISTRIBUTION CHANNELS

Our Team and Coverage

The primary responsibility of our sales team is to act as the primary point of contact with our distributors in their respective designated sales regions, to identify new business opportunities and recruit new distributors to expand our distribution coverage and strengthen penetration. Our sales staff may also assist in providing customer services and carrying out marketing or promotional campaigns, such as assisting our distributors in their marketing activities at our request.

We divide our sales team and distribution coverage based on our major brands, namely *Yashily* and *Scient*. Our *Yashily* family of brands mainly consists of *Yashily*, *Ambery*, *Newwitt*, *Youyi* and *Zhengwei* brands, covering a broad range of products such as pediatric milk formula products and nutritional food products. Our *Scient* brand is used primarily for the marketing of pediatric milk formula products.

As of 30 June 2010, we primarily sold our products to consumers through more than 1,300 regional distributors, which further distributed our products to retail outlets across every province, municipality and autonomous region in China.

Our sales staff implements on-the-ground distributor management and provides assistance to our distributors. We have instituted a performance-based incentive scheme and competitive promotion plan to motivate our sales personnel, who are our primary points of contact with our distributors and other direct customers. Our distributors are responsible for managing the sales of our products to their customers in accordance with the terms of our distribution agreement. We collaborate with our distributors from time to time to conduct promotional events for our products. We also staff sales promoters, who are employed by human resource agencies, in retail locations to promote the sales of our products and directly enhance consumers' awareness of our products and recognition of our brands.

As of 30 June 2010, we engaged 905 distributors for the distribution of our *Yashily* pediatric milk formula and nutritional food products and 484 distributors for distributing our *Scient* pediatric milk formula products. The following table sets out the number of our distributors in different city tiers as of 30 June 2010:

	<u>First-tier cities</u>	<u>Second-tier cities</u>	<u>Third-tier cities</u>
Yashily	98	447	360
Scient (Guangzhou)	94	338	52
Total	<u>192</u>	<u>785</u>	<u>412</u>

Sales of *Yashily* pediatric milk formula and nutritional food products

We centralize our planning and coordination for marketing functions at the headquarters of *Yashili* (Guangdong) in Chaozhou, Guangdong Province, China for our products under the *Yashily* brand, including *Yashily* pediatric milk formula products and nutritional food products. In order to effectively conduct our sales and marketing activities, we divide our sales and marketing team by our major brands to cover principal geographical regions and extend our sales network to reach every province, municipality and autonomous region in China.

As of 30 June 2010, we had a sales force of over 1,500 staff members for our *Yashili* branded products located across its distribution network in China, including over 1,300 sales personnel and 200 marketing personnel, complemented by more than 20,000 outsourced and commissioned sales promoters to promote and sell the pediatric milk formula products and nutritional food products under our *Yashily* family of brands. Our marketing and promotional activities are designed based on internal branding strategies formulated by our marketing team, which allocates appropriate funding and resources for each activity. Marketing personnel are designated to our sales branches and offices to supervise and oversee the execution of our marketing strategies. Our sales promoters are incentivized by commission-based compensation schemes through our distributors to achieve higher sales of *Yashily's* products.

Sales of *Scient* pediatric milk formula products

We centralize our planning and coordination for marketing functions at the headquarters of *Scient* (Guangzhou) in Guangzhou, Guangdong Province, China for our *Scient* branded pediatric milk formula products. In order to effectively conduct our sales and marketing activities, we divide our sales and marketing team to cover principal geographical regions and extend our sales network to reach nearly every province, municipality and autonomous region in China, excluding Tibet and Heilongjiang. Considering the local market volume and selling efforts required, we have not extended the reach of our distribution network of *Scient* pediatric milk formula products to Heilongjiang and Tibet.

As of 30 June 2010, we had a sales force of over 700 staff members for our *Scient* pediatric milk formula products located across its distribution network in China, including more than 550 sales personnel and over 150 marketing personnel, complemented by more than 8,000 outsourced and commissioned sales promoters to promote and sell the *Scient* pediatric milk formula products. Our marketing and promotional activities are designed based on internal branding strategies formulated by our marketing team, which allocates appropriate funding and resources for each activity. Marketing personnel are designated to our sales branches and offices to supervise and oversee the execution of our marketing strategies. Our sales promoters are incentivized by commission-based compensation schemes through our distributors to achieve higher sales of *Scient's* products.

Sales Channels

As of 30 June 2010, our pediatric milk formula and nutritional food products marketed under *Yashily* family of brands were sold to over 800 regional distributors. At the same time, our *Scient* branded pediatric milk formula products were sold to over 450 regional distributors. Among these regional distributors, 46 distributors purchased both our *Yashily* branded and *Scient* products. These regional distributors are our direct customers. During the Track Record Period, a small amount of our products was also sold to certain retail chains through our direct sales.

The distributors re-sell our products to consumers through sub-distributors and retail outlets, such as local grocery stores, regional retail chains, specialty stores and national retail chains across every province, municipality and autonomous region in China. In addition, during the Track Record Period, we also conducted direct sales for our products to certain key customers that are major national and regional retail chains in urban and municipal areas of the eastern China region to a limited extent. Our sales of pediatric milk formula and nutritional food products to distributors were RMB2,740.0 million, RMB2,664.8 million, RMB2,545.6 million and RMB1,346.1 million for the years ended 31 December 2007, 2008 and 2009 and the six months ended 30 June 2010, respectively, representing 96.7%, 97.9%, 99.1% and 98.4% of our total revenue from pediatric milk formula and nutritional food products during the same periods. Our direct sales of these products amounted to RMB94.5 million, RMB56.2 million, RMB23.7 million and RMB22.5 million for the years ended 31 December 2007, 2008 and 2009 and the six months ended 30 June 2010, respectively, accounting for 3.3%, 2.1%, 0.9% and 1.6% of our total revenue from pediatric milk formula and nutritional food products during the same periods. Given the credit exposure related to conducting direct sales to major retail chains, we will reduce direct sales and focus on sales of our products through distributors.

We have been successful in establishing a leading position in China's second- and third-tier cities as well as counties and townships, where economic growth will be supported by favorable government policies. Given our leading market position in the overall China market, and our consistent record of generating more than 70% of our total revenue from second-tier cities, for example, Dongguan, Nanyang, Jiujiang, Shenzhen and Foshan, and third-tier cities, for example, Jinjiang, Yunmeng, Bozhou, Kunshan and Luohe, we believe that we have established a leading market position in these fast growing markets. For more details, please refer to the section headed "Financial Information — Management's discussion and analysis of financial condition and results of operations — Description of components of results of continued operations — Revenue". We believe our close cooperation with a stable and extensive network of distributors has given us a significant advantage over our multinational competitors, whose product presence is relatively weaker in the second- and third-tier cities due to a lack of adequate distribution infrastructure.

Our customer service representatives conduct regular after-sales visits to collect feedback from our distributors, update them with information about our products, and encourage evaluations of our sales staff and sales management process. We have also established an independent internal sales audit team to ensure that our selling and distribution expenses are effectively applied to promote customer loyalty pursuant to our internal policy.

Regional distributors

We carefully select our regional distributors according to our strict selection policy. We carefully consider the background and credentials of each potential distributor in different regions and examine the suitability of the distributors before appointing any distributor in any particular region. We also take into account factors such as their distribution network, sales channels, financial condition, business reputation, background of capital resources, business mission and goals, negotiation ability, as well as the experience of their distribution personnel to assess the suitability of a distributor.

We divide our distribution network into regional areas in order to effectively manage distributors within each area. We manage the sales performance of our distributors by establishing clear sales targets, conducting regular evaluations, providing guidance and terminating our relationship with distributors that do not meet our criteria. Our product sales and operational management are also tailored for different regional distribution areas, sales channels and product types. We retain effective control over our pricing strategy by ensuring strict and uniform implementation of our pricing policies. We dispatch our sales personnel to conduct price checks in retail locations and our sales department monitors and verifies pricing information to ensure that our pricing strategy is effectively enforced. Our sales personnel regularly conduct checks of our distributor's inventories, and the sales promoters are responsible for managing inventory levels at retail sales locations.

Standard distribution agreement

Our distributors are generally required to sign a standard distribution agreement with us. Major terms of our standard distribution agreement include:

- *Initial payment of lump sum deposit.* Distributors that we engage to distribute our products are required to pay us an initial lump sum deposit that we determine based on the scale of distributors before we supply them with our products. Such initial lump sum payment generally ranges from RMB20,000 to RMB80,000. Under normal circumstances, it is retained by us until the termination of the standard distribution agreement. We are entitled to the relevant interest generated from the deposit.
- *Conditions for cooperation.* Distributors are required to cooperate with us with respect to the operation and maintenance of our distribution network and sales channels in the designated regions as mutually agreed upon. We may have one to multiple distributors in one region depending on the market size as well as the types of sales channels, such as sub-distributors or different retail formats, of such distributor. Each distributor is responsible for developing its own sales network and contacting its own customers (i.e. sub-distributors and retail outlets) and we require specific penetration rates of our products to be offered to sizable retail outlets in the regions covered by the distributor. We also separately negotiate sales objectives for our distributors, which generally range from several to ten million Renminbi per month, depending on the geographical location and sales network of each distributor. We set out suggested sub-distribution prices, selling prices to retailers and retail prices in the distribution agreement. The distributors, the respective sub-distributors and retail channels observe such suggested prices, unless otherwise amended by us. Distributors are required to meet our management standards in terms of financial and other resources provided for their operations. Moreover, we typically include a provision prohibiting cross-territory sales in the standard distribution agreement, stipulating that distributors must strictly

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observe the boundaries of the designated region to conduct their sales. In addition, distributors bear the responsibility of monitoring and ensuring that their customers do not conduct cross-territory sales. We also set out strict penalties for cross-territory sales, which may include the forfeiture of the full deposit to us, termination of the distribution agreement and pursuit of further legal actions.

- *Order, delivery and logistic management.* We require our distributors to place orders generally ten days prior to the requested delivery date. Our obligation to sell and the distributor's obligation to purchase arise only at the time a purchase order is accepted. Once payment has been received from the distributor, we are responsible for delivering the products to the distributor's designated warehouse at our cost. The distributors are responsible for all costs associated with products as well as all deliveries and associated costs thereafter, including delivery of our products to sub-distributors and end consumers. All distributors are also required to comply with our logistics management requirements.
- *Payments.* Distributors are required to pay us for our supply of products in advance of delivery. Credit purchases for orders placed by any distributor are generally not allowed. This strict arrangement assists us in strengthening our cash flows, minimizing our receivables to be collected and preventing us from being exposed to the risk of bad debts.
- *Marketing support.* We conduct marketing and promotional activities of our products and we request our distributors to assist our marketing activities. We bear the costs for contracting local human resource agencies, who in turn recruit the sales promoters at their own costs.
- *Sales promoters.* We are responsible for the payment of the base salary for sales promoters. Distributors are responsible for the payment of commissions, which must meet the minimum rates per product category that we have specified in the standard distribution agreement.
- *Return and exchange of products.* We generally do not allow any refunds or returns of our products from our distributors except in the case of a problem with product quality caused by us.
- *Confidentiality.* All information regarding our distribution system, pricing system, marketing strategy, promotion arrangement, as well as distribution and other agreements and business correspondence between our distributors and us are required to be kept confidential at all times.
- *Agreement renewal.* The term of our distribution agreement is usually one year. If both parties agree, the renewed distribution agreement must be signed within one month after the expiration of the current agreement.

We reserve the right to vary the terms of our standard distribution agreement depending on particular circumstances of our distributors and suggested sub-distribution prices, selling prices to retailers and retail prices for each of our products. Under the standard distribution agreement, we are entitled to terminate the agreement if a distributor fails to achieve their sales objectives or breaches the terms in the standard distribution agreement. We believe that, by relying on our sales staff and management to actively monitor, supervise, evaluate and ensure our distributors' sales performance,

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product pricing and management of inventory and promotional activities, as well as actively monitoring the inventory and pricing of our products in retail locations, we are able to implement an effective sales management strategy and prevent distributors or sub-distributors from breaching the terms of distribution agreements during their daily operations or conducting activities harmful to our reputation. During the Track Record Period, we were not aware of any unlawful activities or practices by our distributors that would subject us to any liabilities for our distributors' operations.

Relationship with distributors

Our distributors are usually local distributors who are engaged in the sales distribution of pediatric nutrition, dairy or nutritional food products. We consider the support from our regional distributors as a key element to ensure the effectiveness of our distribution network. We believe that we have a stable network of distributors, which demonstrates their recognition of our strong business model and sales management. As of 30 June 2010, we had maintained business relationships for periods ranging from 1 year to 12 years with our distributors, of which approximately 31% have maintained a business relationship with us for over five years. As of the same date, our five largest distributors for the six months ended 30 June 2010 have maintained business relationships with us for periods ranging from two years to 12 years.

The following table sets forth the changes in the number of our distributors during the Track Record Period:

	Year ended 31 December			Six months ended 30 June
	2007	2008	2009	2010
	Additions of new distributors	162	90	139
Termination of existing distributors	(43)	(63)	(55)	(36)
Net change in distributors.	119	27	84	76
Distributors at the end of the period.	1,202	1,229	1,313	1,389

The termination of relationships with our distributors during the Track Record Period was primarily due to our regular evaluation of the qualification, suitability, performance and service quality as well as expiration of distribution agreements with some distributors, who discontinued their operations as a result of the 2008 nationwide melamine incident.

To ensure that distributors comply with our guidelines and policies, we have put in place a control and monitoring system, and provide guidance to our distributors' staff through publishing quarterly and monthly sales guidelines and arrange meetings with our distributors on a regular basis to review and discuss sales performance and management. While we do not directly manage our sub-distributors, we do track sub-distributor performance through coordinated efforts between our own sales personnel in the field and our distributors. To ensure quality consumer service, we also offer our regional distributors regular training programs so as to enhance their knowledge of our products and promotional activities, exchange information and intelligence on latest market development and consumer demographic profile, preference and feedback. To effectively prevent distributors' cross-territory sales, a unique two-dimensional barcode is marked on each packaging unit, allowing us to track the details and movement of every finished product and its respective distributor and region. In addition, we require our distributors to submit monthly reports of their sales and inventory. Through the distributors' monthly reports as well as the on-site sales record from our sales promoters dispatched to the retail outlets, we may track and

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monitor inventory levels of and sales prices offered by our distributors and retail outlets. Our sales personnel will also visit distributors and retail outlets regularly to verify relevant inventory level and product series information.

For the years ended 31 December 2007, 2008 and 2009 and the six months ended 30 June 2010, our five largest distributors, accounted for approximately 4.3%, 4.1%, 3.5% and 3.8% of our total sales revenue for the respective periods. For the years ended 31 December 2007, 2008 and 2009 and the six months ended 30 June 2010, our single largest distributor accounted for approximately 1.0%, 1.0%, 0.7% and 0.8%, respectively, of our total sales revenue.

As of the Latest Practicable Date, none of our Directors or their associates or our Shareholders, who, to the best knowledge of our Directors, owns more than 5% of our issued capital, or had any interest in any of our five largest distributors. Our Directors confirm that none of our distributors, in their past or present, have had any relationships with our Group, our Shareholders, Directors, senior management, or any of its associates, and that none of these distributors are or had been employees of our Company or our subsidiaries.

Sales promoters

We typically enter into long-term agreements effective for two years with human resource agencies, who recruit sales promoters of our products. The human resource agencies recruit candidates based on our specified criteria and dispatch qualified sales promoters to designated retail locations. Sales promoters enter into direct labor contracts with the human resource agencies. The labor contracts stipulate that they will be staffed as sales promoters for our products and must strictly adhere to all relevant labor, compensation and evaluation policies stipulated by us. The human resource agencies are responsible for the timely payments of all contributions, as well as all relevant social and insurance contribution plans. We pay service fees to human resource agencies, who will then timely disburse the relevant compensation to the sales promoters they recruit. For the years ended 31 December 2007, 2008 and 2009 and the six months ended 30 June 2010, the service fees we paid to human resource agencies in connection with the sales promoters for our products were RMB182.6 million, RMB315.6 million, RMB266.5 million and RMB150.8 million, respectively. Our distributors are responsible for sales-based commissions for sales promoters. In order to ensure the quality of services provided by the sales promoters, we provide regular training on areas including market trends, consumer sentiment, proper conduct and etiquette and product features. In addition to distributing our guidelines on conduct and performance, we also regularly and randomly dispatch our staff to retail locations to examine and evaluate the performance of sales promoters. If any sales promoter violates our internal policies or procedures, the human resource agency is responsible for providing timely replacements.

Retail outlets

Our regional distributors market our products to each of the retail channels where our products can be purchased by consumers, including local grocery stores, regional retail chains, specialty stores and national retail chains.

Local grocery stores

Local grocery stores may range from smaller outlets exclusively focused on food products, to larger outlets with a variety of offerings such as fresh produce and clothing. In China's second- and third-tier cities, local grocery stores are the predominant choice of supplier for mid-end to upper-end consumers' daily household and food purchases. Through our deep distribution and sales reach, we have been able to establish a strong presence in this traditional retail format. In capturing market share in this retail segment, our close cooperation with a stable and extensive network of distributors has given us a significant advantage over multinational competitors, whose product presence is relatively weaker due to a lack of adequate distribution infrastructure.

Regional retail chains

Regional retail chains include supermarkets and retail chains with a regional footprint. We generally maintain product zones in regional retail chains where all of our products will be displayed on counter shelves by series with our logos. Our sales promoters are staffed at major retail chain locations to promote our products and encourage consumers to join our membership program, namely the Love Baby Home (愛嬰家園) membership program for *Yashily* pediatric milk formula products and our membership program for *Scient* pediatric milk formula products.

Specialty stores

Specialty stores are retailers specializing in the sale of clothing, food and personal care products and necessities targeted at particular consumer groups. We sell our pediatric milk formula and milk formula for expectant and nursing mothers primarily to specialty stores whose products are particularly geared towards infants, children and expectant and nursing mothers.

National and regional retail chains

We also distribute our products to national and regional retail chains, which include supermarkets and retail chains with a national and regional footprint. We generally maintain product zones in national and regional retail chains where all of our products will be displayed on counter shelves by series with our logos. We may also provide sales discounts to selected major retail outlets for our products to promote sales volume at key locations. We have developed and maintained relationships with eight national retail chains and 36 regional retail chains. To further capture growth opportunities, we have an experienced and dedicated sales team to strengthen our presence in these modern retail formats.

Sales Process

Our major operating segments, which include *Yashily* and *Scient* pediatric milk formula series and nutritional food products, share similar major sales policies.

Our distributors are generally required to prepay the amount for placed orders; however, on a transaction by transaction basis, we grant temporary credit ranging from ten to 60 days to distributors who have been trading with us for many years and with good track records. To a limited extent, we grant credit periods ranging from 60 to 90 days with respect to our direct sales to certain key retail chains customers in certain urban and municipal areas in the eastern China region. Upon receipt of prepayment for the products ordered, we will arrange for delivery of the products to the distributors. Generally, the distributors place orders for our products two to three times each month. The frequency in which our distributors place orders with us depends on the volume of our products sold by the distributors and the flexibility of our logistic capabilities.

Our sales staff visit all distributors on a regular basis to ensure that they have sufficient stock and that our products are sold to consumers within the preservation period. All sales are recorded in our logistics and inventory management system, which allows us to track the destination of each batch of products and the respective distributors. We also require our distributors to submit monthly reports of their sales and inventory and collect the on-site sales record from the sales promoters of our products dispatched to the retail outlets, through which we may monitor the inventory levels of and sales prices offered by our distributors and retail outlets. Due to our advance payment policy as well as our no refund/exchange policy except for defective or damaged goods, distributors that accumulate inventories run the risk of suffering cash flow problems or incurring losses because our products may expire before re-selling to retail outlets.

We generally set uniform selling prices to distributors and suggested selling prices to sub-distributor and retailers of our products applicable to our distributors and direct sales customers. We strictly enforce our pricing policy. Under very limited circumstances, we adjust the selling prices to retailers at the request of major national or regional retail chains on a case-by-case basis to accommodate their promotional activities or specific gross margin targets. Prices for our various products are determined with reference to a number of factors, including market prices for each product type, consumer sensitivity, data collected from our market research, our costs of sales and profitability analysis as well as our promotion policy. In particular, the increase in the prices of the key raw materials of our products may result in lower profitability level, and compel us to implement more cost-competitive alternatives for our production or pass through the cost increases to our customers. We aim to set product prices that are market competitive for our customers while also delivering satisfactory profit to us and our distributors. During the Track Record Period, we had been able to maintain the competitiveness of our products as well as our profitability by managing our raw material procurement costs, enhancing our operating efficiency, and to a lesser extent, increasing the selling price of our products, after taking into consideration the market conditions.

We believe that we provide our distributors with an attractive system of incentives and comprehensive sales management system, which ensures market order and pricing stability. We believe that our stable and comprehensive distribution network will further guarantee the successful introduction of our new products in years to come.

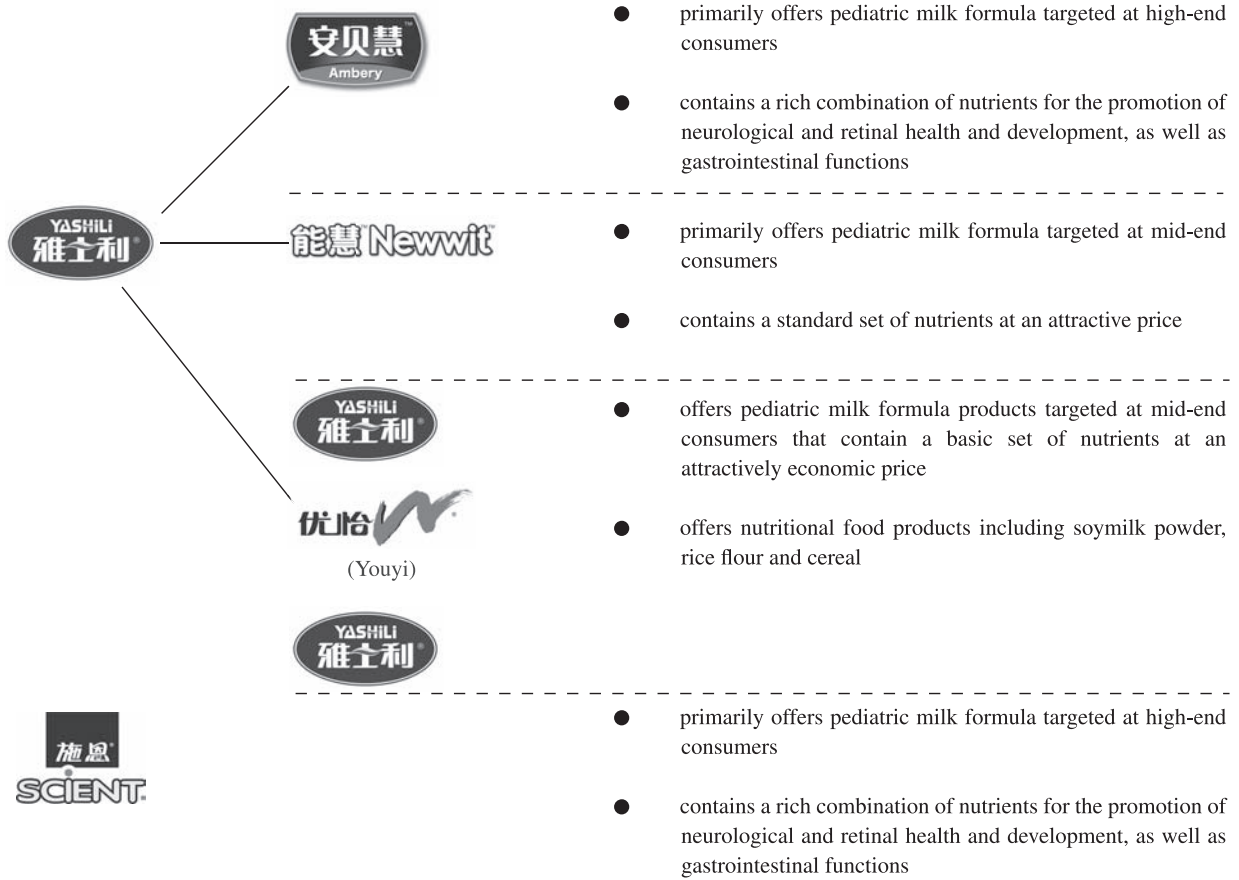
BRANDING AND MARKETING

Branding

We believe that we are one of the most widely recognized pediatric milk formula brands in China. We have adopted a multi-brand strategy that enables us to market our products across a broader range of operating segments, which has allowed us to reach a wider consumer base with different purchasing power. We continue to build brand recognition for our *Yashily* and *Scient* trademarks, which are associated with our high-quality and reliable pediatric milk formula and nutritional food products. With an established foundation of consumer loyalty, we believe that our brand recognition can be further strengthened through word of mouth regarding our product quality and the associated health benefits of our products. Our success with the *Yashily* family of brands and *Scient* also enables us to leverage our widely-recognized brands to introduce and launch new product lines in the future.

We position ourselves as a producer of a family of leading brands in pediatric nutritional products. We believe that our brand recognition and reputation have played a critical role in the growth of our business. For our high-end imported pediatric milk formula product series under the *Scient* brand, we associate our brand with high-quality, imported dairy materials from New Zealand, as well as a series of 100% imported pediatric milk formula product from the United States in our advertising campaigns and product packaging. In addition, all of our pediatric milk formula products currently use imported raw milk powder from New Zealand and Australia. Our high-quality, imported raw milk powder allows us to distinguish ourselves from other PRC domestic manufacturers of pediatric milk formula products, who typically source all or part of their dairy materials locally. We believe this allows us to compete with the major international brands in China's pediatric milk formula market.

The map of our multi-branding strategies is summarized as follows:



Promotional and Marketing Activities

We manage promotional and marketing activities for our *Yashily* and *Scient* brands according to entirely independent strategies by separate marketing forces. For both *Yashily* and *Scient*, we engage in a variety of marketing and promotional activities, directly or through our distributors. We primarily conduct marketing campaigns through television advertising, which we believe allows us to reach a wider viewing audience. In order to deliver our message effectively to consumers, we purchase leading prime time advertising slots on major television networks including CCTV, as well as national and provincial satellite and cable channels. We also purchase other types of television advertising slots on national and local television networks to target specific consumer groups. We vary the frequency of our television advertising depending on whether the product is mature or newly launched. We also enter into contracts with celebrities in China to serve as spokespersons in our television commercials.

In addition to television advertising, we also utilize other media channels, such as newspapers and lifestyle magazines and Internet publications. We display advertisements for our products on prominent portal websites and baby forum websites to expand our marketing activities and brand presence on the Internet to reach young parents, who are generally increasingly reliant on the Internet as a major source of information.

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We enter into contracts with retail outlets to maintain our product zones. Major retail outlets with our product zones are required to install in-store displays featuring our logos to reinforce our brand image. We deploy sales promoters in major retail outlets to promote our products and collect direct feedback from consumers. As of 30 June 2010, we had more than 28,000 and 8,000 full-time and part-time sales promoters nationwide supporting product sales under the *Yashily* and *Scient* brands, respectively. We may also include complimentary small packages of pediatric milk formula products with purchases of our *Scient* pediatric milk formula products in order to stimulate sales periodically. For the years ended 31 December 2007, 2008 and 2009 and for the six months ended 30 June 2010, our costs of sales incurred in connection with the complimentary pediatric milk formula products were approximately RMB58.8 million, RMB107.1 million, RMB109.9 million and RMB65.6 million, respectively.

For our *Yashily* family of brands, we have created a free-to-join loyalty program, namely the Love Baby Home membership program, which provides services to members that have purchased our products from retail outlets. As of 30 June 2010, the Love Baby Home membership program had more than 1,770,000 members, and provides services such as a customer service hotline, an on-line consumer community, www.aiyingjiayuan.com and publications such as complimentary periodic magazine. Our service hotline is one of the most popular features within our membership program, through which callers can consult our baby care specialists who are able to provide extensive baby care and child health information. Our www.aiyingjiayuan.com website is an on-line community where expectant and nursing mothers can interact and share their experiences as well as receive product information and provide feedback on our products.

For our *Scient* brand, we have also established a membership program designed to build customer loyalty and brand recognition. We collect a range of member information, such as children's birthdays and parents' contacts, which allows us to deliver services and information such as birthday cards, product promotional events, infant nutrition and new product information, all of which enhance the value and experience of becoming a member of our program. We are also able to closely track and analyze consumer behavior by leveraging our vast database of member contacts and information, which is managed by a Customer Resource Management computer system. We conduct telephone interviews on a regular basis to collect information about members' recent purchase record of pediatric milk formula products. As of 30 June 2010, our membership program had more than 400,000 registered members. We have also set up a customer service hotline to provide our members with convenient access to information about infant nutrition and our products.

Our total promotional and gift expenses as well as advertising expenses for *Yashily* and *Scient* pediatric milk formula and nutritional food products for the years ended 31 December 2007, 2008 and 2009 and the six months ended 30 June 2010 were RMB555.7 million, RMB800.4 million, RMB675.9 million and RMB371.3 million, respectively, representing 19.2%, 29.1%, 26.1% and 27.0%, respectively, of our total revenue for the respective periods.

RESEARCH AND DEVELOPMENT

We believe that our research and development efforts support and improve our ability to introduce innovative, technologically advanced new products and materials and improve our production processes to meet market demands. Over the course of our operating history, we researched and developed proprietary milk formula customized for Chinese infants and young children. We believe that our

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pediatric milk products are easily dissolved and digested as compared to those offered by our multinational competitors. Among a number of our successful products, we successfully developed and introduced *Yashily* α -Golden Stage Pediatric Milk Formula, which contains lutein, an important antioxidant that prevents light damage to the eyes, slows retinal aging and prevents pathological changes; DHA and ARA, two nutrients found in breast milk that promote infant brain and eye development; choline, a strong organic base and necessary constituent in the formation of lecithin that promotes neurological development and improves memory retention; and oligofructose, an alternative sweetener with prebiotic functions that promotes gastrointestinal health.

We have a dedicated research and development team responsible for optimizing our product portfolio mix and quality. As of 30 June 2010, our research and development team comprised of 32 researchers. Our research staff members hold degrees relating to agriculture, food or nutrition technology, chemistry or industrial engineering and possess extensive experiences in food and dairy industries or qualification as appraiser of dairy products. As a demonstration of our leading development capabilities, we have actively participated in setting the national and industry nutritional standards for pediatric milk formulas, soymilk powder and cereal.

One of the key focuses of our research and development department is to conduct ongoing research on pediatric nutrition and pediatric milk formula, including the constituents of breast milk, pediatric milk formula, soy-based products and other milk formula substitutes for infants that suffer from lactose intolerance syndrome as well as the application of soy protein isolate in our product series. Our research projects for pediatric milk formula is headed by Mr. Tong Chengfu, who has over twenty-two years of research experience in pediatric nutrition. Mr. Tong is a PRC national-level master appraiser of dairy products, a committee member of the Strategic Professional Alliance for Technological Development of Dairy Industry, the main drafter of the national standard GB/T5410-2008 for milk powder, and participant in the drafting of the national GB-5413 standard for the Standard Methods for the Examination of Dairy Products in 2008. In 1990, he participated in the National Light Industrial Science Research Department's drafting project for "Pediatric Milk Formula III" research and product standards. Our focus on research and development in the near future may also include the development of new product lines of pediatric and adult nutrition products to meet changing market demands and consumer preferences, such as the introduction of organic pediatric nutrition products and milk formula for adults and the elderly.

To further enhance our technological capabilities and ensure that we are equipped to deliver effective, leading-edge solutions, we plan to construct a new food research institute in Shantou, Guangdong Province, where we will invest significantly in acquiring new, advanced laboratory equipment and facilities from domestic and overseas suppliers and centralize our research and development efforts. The acquisition of the land use rights for the food research institute and the infrastructure construction are expected to commence in 2011 and we expect the construction as well as acquisition of relevant equipment to be completed in 2013. This food research institute will be dedicated to the development of new market-competitive products and research of core technologies, and explore the development of related nutrition products such as milk beverages, other beverages, confectionaries and other related products. In order to achieve an optimal profile of risk and reward, we will direct our research focus on commercially-viable products in the near-term, and explore higher-risk products with breakthrough potential over a longer time horizon.

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We have also recruited a well-regarded expert in the food industry in March 2010, Dr. Lee Fun-ya, to be the head of our new food research institute. Dr. Lee has a wealth of corporate and professional experience, and has successfully developed and launched numerous product lines for major food and beverage companies. Dr. Lee is a recipient of the Outstanding Food Technologist Award, honored by the Taiwan Association for Food Science and Technology. He is also a professional member of USA Institute of Food Technologist and American Dairy Science Association. We will benefit significantly from the wealth of industry and professional experience of Dr. Lee, who will lead our research and development team to develop new innovative products and technologies. We also plan to recruit approximately 20 research staff with dairy, nutritional food, industrial engineering or quality control background and experiences from domestic and overseas for our new food research institute and to engage up to 30 additional research staff by 2011.

In addition to our internal research capabilities, we engage renowned industry experts and nutrition consultants, as well as major universities and reputable third-party research and development institutes in China, for assistance and collaboration in product development and innovation. We intend to collaborate with Massey University in New Zealand in the research and development of pediatric formula, technologies and functional raw materials. In addition, we have entered into a collaborative arrangement with the China Agricultural University in connection with the research and development of a high-protein specialty milk formula for adults and the elderly. We will provide a specified sum of total funding to be used for the development of the specialty milk formula. All rights to intellectual property and patents related to the specialty milk formula developed during the collaboration will belong to both parties. Through our collaboration with China Agricultural University, we intend to introduce an innovative specialty milk formula that will capture the significant market opportunity in adults and elderly nutrition for highly-nutritious products with easy absorption characteristics.

Our research and development expenses recorded under our administrative expenses for the years ended 31 December 2007, 2008, 2009 and the six months ended 30 June 2010 were RMB432,000, RMB996,000, RMB950,000 and RMB355,000, respectively. We plan to enhance our investments in research and development activities and expect our research and development expenses to continue to grow in 2010. We expect our research and development expenses, excluding our expenditures for the construction of our food research institute and acquisition of laboratory equipment as well as for our in-house and collaborative research projects, to be approximately RMB2.5 million and RMB4.5 million for 2010 and 2011, respectively. We intend to invest significant resources in our research and development program to maintain strong business momentum, build up our in-house research and development team and food research institute, and strengthen our development partnerships with reputable third-party research and development institutes.

MANUFACTURING

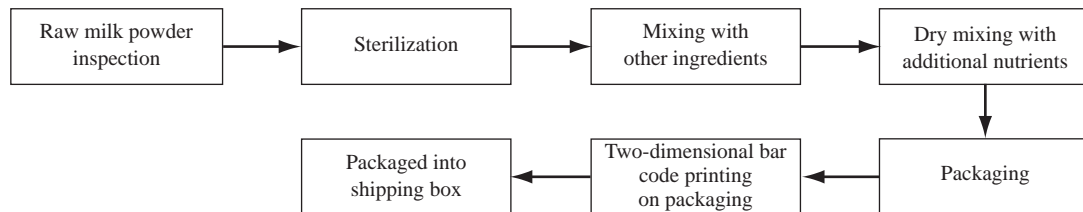
Production Process

Yashily and Scient pediatric milk formula

We have been importing 100% of the raw milk powder used as a base material for our pediatric milk formula products from New Zealand and Australia since the end of June 2010. Our imported raw milk powder is first strictly screened by PRC customs and delivered to our production plant, where it is strictly inspected by our own quality control staff before entering storage. Raw milk powder, such as whole milk powder and skim milk powder, is mixed with other ingredients such as whey protein powder

and plant oil, and further mixed with suitable amounts of vitamins and minerals, in quantities strictly specified by the scientific formulas established by our research and development department. The mixture undergoes processes in our advanced, imported closed production equipment manufactured by the GEA Group, a well-known food systems provider headquartered in Germany. The emerging semi-finished product, or base milk powder, is examined for quality and transported to our Chaozhou Plant or Guangzhou Plant, where it is inspected for quality once again before entering storage. At our 10,000-level GMP-certified production facilities in Chaozhou and Guangzhou, appropriate amounts of various nutrients, such as DHA, ARA, lactoferrin and nucleotides, are added to the base milk powder and packaged in a can, box or bag as a finished product. Our packaging materials must also pass through strict inspection, testing and sterilization to ensure that they meet quality and hygiene standards. Each of our finished-product packaging unit is also marked with a unique two-dimensional bar code to prevent counterfeiting and track our products. We also strictly follow relevant food labeling requirements for our products, including identifying the place and date of production, expiry date, ingredient and name and address of the manufacturer. In addition, we clearly identify the source of dairy materials on our product labels, such as with the label “100% imported dairy materials” on our pediatric milk formula products that use 100% imported raw milk powder. Our PRC legal advisor, Tian Yuan Law Firm, has confirmed that we had complied with relevant PRC laws and regulations regarding packaging and labeling of dairy products during the Track Record Period and as of the Latest Practicable Date.

The following chart illustrates the general production process of our pediatric milk formula products:



We also import one series of *Scient* pediatric milk formula product manufactured by PBM Products, a well-known OEM supplier located in the United States.

Soymilk powder

Soybean is the key raw material in soymilk powder, accounting for approximately half of all raw materials required for the production of soymilk powder. The soybeans are purchased from domestic agricultural suppliers. Upon entering our production plant, soybeans are first prepared for processing through filtering, drying and de-hulling to produce bean pellets. The pellets are grinded and mixed with soybean oil and other nutrients, and undergo boiling, sterilization, filtration, homogenization and spray-drying into a powder form. Our soymilk powder packaging facility at the Chaozhou Plant is a 100,000-level GMP-certified facility.

Rice flour

Our rice flour is primarily manufactured through the processing of high-quality rice grain provided by domestic suppliers. Upon entering our 10,000-level GMP-certified production facility, high-quality rice grain is first soaked and grinded, then wet-mixed with other ingredients such as vitamins and minerals before homogenized and drum-dried to produce a finished product in powder form.

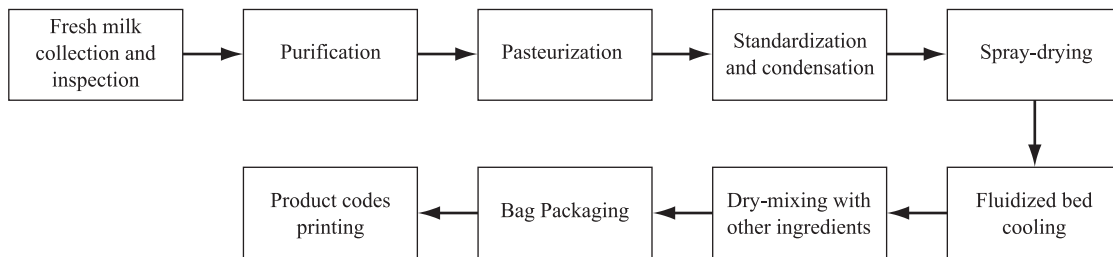
Cereal

The key raw materials of our cereal products are flour, ground corn powder and oats procured from domestic suppliers. Flour and ground corn powder are first mixed with other nutrients, then drum-dried under high temperature and granulated into uniform cereal flakes. Cereal flakes are then evenly mixed with other raw materials such as oats, cream and sugar and packaged into the final product.

Milk powder for adults and teenagers and whole milk powder

The base milk powder for our milk powder products for adults and teenagers are produced in our own plant in Qiqihaer, Heilongjiang Province. In our Qiqihaer Plant, we manufacture our own base milk powder using raw milk from local dairy farmers. All raw milk is collected at stations staffed with professional personnel trained by us, who receive monthly training in proper handling and procedural standards from us. All collected raw milk is inspected for compliance with our quality standards. Raw milk that meet our quality standards is clarified for impurities, pasteurized, standardized, condensed, spray-dried and cooled into our semi-finished product, base milk powder.

The following chart illustrates the production process of base milk powder at our Qiqihaer Plant before it is delivered to storage:



After the base milk powder undergoes quality inspection, it is delivered to our Chaozhou Plant and inspected once again for quality before entering storage. The base milk powder is evenly mixed with appropriate amounts of vitamins and minerals, and packaged into a can or bag as the finished product. Our packaging materials must also go through strict inspection, testing and sterilization to ensure that they meet quality and hygiene standards. For the production of base milk powder, we also manufacture whole milk powder. The surplus of base milk powder is sold externally to other dairy manufacturers.

Our Existing Production Facilities

As of the Latest Practicable Date, we owned and operated four production plants in: (i) Chaozhou, Guangdong Province; (ii) Guangzhou, Guangdong Province; (iii) Qiqihaer, Heilongjiang Province; and (iv) Shuozhou, Shanxi Province. We generally purchase the equipment and machinery that we utilize in our plants. The following map and sections illustrate the products, location and production capacities of our production plants:



Chaozhou Plant — *Yashily* pediatric milk formula, soymilk powder, cereal, rice flour and milk powder for adults and teenagers

Our production line for pediatric milk formula and milk powder for adults and teenagers performs secondary processing of base milk powder internally manufactured by our Shuozhou Plant and Qiqihaer Plant. Secondary processing primarily involves the addition of nutrients such as vitamins, DHA and ARA. We have complete production lines for each of soymilk powder, cereal and rice flour, from raw material processing to finished product output.

The Chaozhou Plant is owned by us and began production in 1998. As of 30 June 2010, our production facilities at our Chaozhou Plant had the capacity to produce 25,056 tonnes of soymilk powder, 3,600 tonnes of cereal, 3,780 tonnes of rice flour and 33,755 tonnes of pediatric milk formula, milk powder for adults and teenagers per year. As demand for our products increases, we expect that utilization of our production facilities will increase.

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The following table sets forth the designed capacity and actual production volume of our main production line at our Chaozhou Plant during the Track Record Period:

Production line	Years ended 31 December									Six months ended 30 June		
	2007			2008			2009			2010		
	Designed capacity ⁽¹⁾	Actual production volume	Utilization rate ⁽²⁾	Designed capacity ⁽¹⁾	Actual production volume	Utilization rate ⁽²⁾	Designed capacity ⁽¹⁾	Actual production volume	Utilization rate ⁽²⁾	Designed capacity ⁽¹⁾	Actual production volume	Utilization rate ⁽²⁾
	(tonnes/year)	(tonnes/year)	(%)	(tonnes/year)	(tonnes/year)	(%)	(tonnes/year)	(tonnes/year)	(%)	(tonnes/six months)	(tonnes/six months)	(%)
Pediatric milk formula and milk powder for adults and teenagers and packaging line	33,755	29,346	87	33,755	41,876	124	33,755	22,931	68	16,878	13,261	79

(1) Designed capacity is calculated based on the assumption that there are two eight-hour shifts per day and five days off per month for maintenance.

(2) Utilization rate is derived from dividing our actual production for the period by designed capacity of the same period.

Guangzhou Plant — *Scient* pediatric milk formula products

We currently operate a production plant in Guangzhou, Guangdong Province for pediatric milk formula products under the *Scient* brand. Our Guangzhou Plant is equipped with seven production lines, each of which is engaged in processing of semi-finished base milk powder with other added ingredients and packaging of pediatric milk formula products. All of our base milk powder is purchased from our Shuozhou Plant, which sources all raw milk powder for production from overseas. We have three production lines for canned packaging, three production lines for bagged packaging and one production line for box packaging.

The new production facility at Guangzhou Plant began operations in May 2009 and is owned by us. We imported one automated production line for bagged packaging manufactured by German provider ROVEMA, which has significantly higher efficiency than domestically manufactured equipment.

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For the years ended 31 December 2007 and 2008, we produced 13,900 tonnes and 16,095 tonnes of pediatric milk formula at our previous production facilities located on leased property in Guangzhou, Guangdong Province. As of 30 June 2010, we are capable of producing 11,924 tonnes of pediatric milk formula per year in aggregate. The following table sets forth our main production lines' actual capacity, actual production volume and utilization rate at Guangzhou Plant during the Track Record Period:

Production line	Year ended 31 December 2009			Six months ended 30 June 2010		
	Designed capacity ⁽¹⁾	Actual production volume	Utilization rate ⁽²⁾	Designed capacity ⁽¹⁾	Actual production volume	Utilization rate ⁽²⁾
	(tonnes/year)	(tonnes/year)	(%)	(tonnes/six months)	(tonnes/six months)	(%)
Pediatric milk formula production line for canned packaging . . .	2,592	2,420	93	1,620	1,460	90
Pediatric milk formula production lines for complimentary small packages (x2)	1,555	1,360	87	778	738	95
Pediatric milk formula production line for bagged packaging . . .	1,872	1,400	75	936	680	73
Pediatric milk formula production line for bagged packaging . . .	2,016	1,500	74	1,008	522	52
Pediatric milk formula production line for bagged packaging ⁽³⁾ . .	2,592	750	29	1,296	805	62
Pediatric milk formula production line for box packaging ⁽³⁾	648	460	71	324	260	80

- (1) Designed capacity is calculated based on the assumption that there are two eight-hour shifts per day and five days off per month for maintenance.
- (2) Utilization rate is derived from dividing our actual production for the period by designed capacity of the same period.
- (3) Production line was purchased in May 2009 and began full-scale production in July 2009.

Qiqihaer Plant — Base milk powder for adults and teenagers and whole milk powder

Our Qiqihaer Plant consists of two production lines for semi-finished base milk powder, which is further used in the production of milk powder for adults and teenagers at our Chaozhou Plant. Both production lines at the Qiqihaer Plant process raw milk from local dairy farmers mixed with other ingredients such as whey protein powder to produce base milk powder. Samples are drawn from each batch of raw milk and checked for strict compliance with national standards. Most base milk powders are delivered by truck to our Chaozhou Plant, where they are mixed with additional nutrients, and packaged as a finished end-product of milk powder for adults and teenagers. During the Track Record Period, we also sold surplus supplies of whole milk powder, a semi-finished end-product during the production of base milk powder, to external manufacturers of dairy products for industrial use.

The Qiqihaer Plant began full-scale operations in June 2006 and is fully owned by us. As of 30 June 2010, we are capable of producing approximately 20,448 tonnes of base milk powder per year on both production lines. Our designed capacity is calculated by assuming that production continues for 24 hours per day, with six days off per month for maintenance. During the six months ended 30 June 2010, our aggregate actual production volume was 3,335 tonnes, which yields a utilization rate of approximately 33%.

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The following table sets forth our main production lines' designed capacity, actual production volume and utilization rate at our Qiqihaer Plant during the Track Record Period:

Production line	Years ended 31 December									Six months ended 30 June		
	2007			2008			2009			2010		
	Designed capacity ⁽¹⁾	Actual production volume	Utilization rate ⁽²⁾	Designed capacity ⁽¹⁾	Actual production volume	Utilization rate ⁽²⁾	Designed capacity ⁽¹⁾	Actual production volume	Utilization rate ⁽²⁾	Designed capacity ⁽¹⁾	Actual production volume	Utilization rate ⁽²⁾
	(tonnes/year)	(tonnes/year)	(%)	(tonnes/year)	(tonnes/year)	(%)	(tonnes/year)	(tonnes/year)	(%)	(tonnes/six months)	(tonnes/six months)	(%)
Base milk powder production line (x2) . . .	20,448	19,588	96	20,448	20,305	99	20,448	8,356	41	10,224	3,335	33

(1) Designed capacity is calculated based on the assumption that production continues for 24 hours per day, with six days off per month for maintenance.

(2) Utilization rate is derived from dividing our actual production for the period by the designed capacity of the same period.

Shuozhou Plant — Base milk powder and whole milk powder

Our Shuozhou Plant consists of two milk powder production lines for our semi-finished base milk powder. These two production lines mix raw milk powder such as whole milk powder and skim milk powder with other ingredients such as whey protein powder, and mix into a semi-finished base milk powder. All of our raw milk powder is imported for better quality guarantee. All semi-finished base milk powder products are delivered by truck to our Chaozhou Plant and Guangzhou Plant, where it is mixed with nutrients such as DHA and ARA, and packaged as pediatric milk formula products for storage.

The Shuozhou Plant began full operations in June 2008 and is fully owned by us. All components for our two production lines are assembled from equipment manufactured by the GEA Group, a well-known German systems provider of food processes, and its subsidiaries in France and Denmark. The Shuozhou Plant is in the process of applying for approval of its 10,000-level GMP-certification and expects to obtain the GMP-certification in November 2010.

As of 30 June 2010, we were capable of producing 34,560 tonnes of base milk powder per year in aggregate with our two production lines. Our designed capacity is calculated by assuming that there are three eight-hour shifts per day and six days off per month for maintenance. During the six months ended

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30 June 2010, our aggregate actual production volume was approximately 17,167 tonnes, which yields a utilization rate of approximately 99%. The following table sets forth our main production lines' designed capacity, actual production and utilization rate at our Shuozhou Plant during the Track Record Period:

Production line	Years ended 31 December						Six months ended 30 June		
	2008			2009			2010		
	Designed capacity ⁽¹⁾	Actual production volume	Utilization rate ⁽²⁾	Designed capacity ⁽¹⁾	Actual production volume	Utilization rate ⁽²⁾	Designed capacity ⁽¹⁾	Actual production volume	Utilization rate ⁽²⁾
	(tonnes/year)	(tonnes/year)	(%)	(tonnes/year)	(tonnes/year)	(%)	(tonnes/ six months)	(tonnes/ six months)	(%)
Base milk powder production line (x2) ⁽³⁾	34,560	26,200	76	34,560	20,700	60	17,280	17,167	99

(1) Designed capacity is calculated based on the assumption that production continues for 24 hours per day, with six days off per month for maintenance.

(2) Utilization rate is derived from dividing our actual production for the period by the designed capacity of the same period.

(3) Production lines began full-scale production in June 2008.

Our Production Facilities under Construction

We repair and maintain our machinery, equipment and facilities on a regular basis to ensure the efficient operation of our production facilities. We also intend to invest in new production facilities and continue to upgrade our manufacturing capabilities to capitalize on the anticipated growth of the pediatric milk formula industry and enlarge our market share in China.

We plan to invest in the construction of a new production facility in Chaozhou, Guangdong Province, and resume construction of our plant in Zhengzhou, Henan Province by the end of 2010, which will increase our manufacturing capacity to meet the demands of our future growth. In 2008, we implemented the plan of our new Zhengzhou Plant for our anticipated business growth, the integrated transportation system and favorable investment environment in Zhengzhou. The construction of infrastructure in Zhengzhou commenced in March 2008 but was suspended in October 2008 due to the operational and financial impact from the 2008 nationwide melamine incident. Upon resumption expected at the end of 2010, the construction of the Zhengzhou Plant is expected to be completed within two years, after which our production capacity is expected to increase by 30,000 tonnes for soymilk powder. The designated annual production capacity of the new facility in Chaozhou is expected to be approximately 30,000 tonnes for pediatric milk formula and milk powder for adults and teenagers and 10,000 tonnes for rice flour. We expect to finalize the design and planning of the new production facility in Chaozhou by the end of 2010, to commence construction in 2012 and to launch commercial operations in 2013.

We will also upgrade our existing manufacturing facilities in Chaozhou in an attempt to meet the criteria specified in the US FDA certification guidelines for pediatric milk formula production lines. The US FDA certification sets out stringent standards covering every aspect of the facility and materials used for production, including but not limited to water, air and environmental safety, sources and quality of raw materials, equipment and processing, packaging, quality control procedures, personnel, and cleaning

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and sanitizing. The upgraded production facility in Chaozhou is expected to expand the facility's current designed capacity for pediatric milk formula and milk powder for adults and teenagers by approximately 30%. We expect to finalize the design and planning of the upgrade in 2011 and to reach the new production capacity in early 2012. We will import advanced technology and equipment from Germany, Switzerland and other countries. By upgrading our existing facilities and constructing new facilities, we aim to achieve standards of quality and management in the production of our core products that are on par with our multinational competitors.

The following table sets forth the expected increases in designed capacity at our new or upgraded production facilities:

<u>Production line</u>	<u>Expected increase in designed capacity</u>
Existing Chaozhou Plant (expected to complete upgrade in 2012)	
Pediatric milk formula and milk powder for adults and teenagers	10,000 tonnes/year
New Chaozhou Plant (expected to commence production in 2013)	
Pediatric milk formula and milk powder for adults and teenagers	30,000 tonnes/year
Rice flour.	10,000 tonnes/year
New Zhengzhou Plant (expected to commence production in 2012)	
Soymilk powder	30,000 tonnes/year

Prior to commencing the construction of our new production facilities, we shall obtain the various permits from competent PRC government authorities, including: (i) the state-owned land use right certificate issued by the provincial branch of the Ministry of Land and Resources; (ii) the official approval of the feasibility study report issued by the local branch of the National Reform and Development Commission; (iii) the official approval of the environment impact appraisal report issued by the local environment protection bureau; and (iv) the construction project planning permit and construction project construction permit issued by the local construction bureau. We are not required to obtain additional permits for the upgrade of our existing facilities in Chaozhou.

After our acceptance check of the construction and the inspection by relevant and competent government authorities, we shall obtain: (i) the property ownership certificate issued by the local housing administration bureau; (ii) relevant pollutants emission permits issued by the local environment protection bureau; and (iii) the production license issued by the provincial branch of the AQSIQ before we commence production at our new facilities.

We have not experienced any significant production interruptions due to equipment failure or breakdown, raw material shortages, power interruptions, fire or labor disputes.

RAW MATERIALS AND SUPPLIERS

Raw Milk Powder

Raw milk powder, which includes whole milk powder and skim milk powder, is the primary ingredient used in our pediatric milk formula production. During the raw milk powder extraction and production process, raw milk is first standardized and pasteurized into homogenous milk content. Water from the milk is then removed by boiling the milk under reduced pressure at a low temperature using a process known as evaporation. The resulting concentrated milk is sprayed in a fine mist into a room of

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hot air to remove any remaining moisture, leaving behind milk in powder form. Currently, we import 100% of the raw milk powder used in our pediatric milk formula products mainly from New Zealand and Australia.

We are able to secure a stable supply of raw milk powder from major suppliers in New Zealand. The majority of our imported raw milk powder is sourced from three major milk processors in New Zealand, namely Synlait Milk Limited, Fonterra Limited and Open Country Dairy Limited, which possess over 10,000 natural open-range dairy farms in New Zealand and Australia, and world-leading processing capabilities. For the years ended 31 December 2007, 2008 and 2009 and for the six months ended 30 June 2010, we sourced approximately 563 tonnes, 415 tonnes, 11,324 tonnes and 10,896 tonnes of our imported raw milk powder from these three major suppliers, respectively, accounting for approximately 70.3%, 16.1%, 81.7% and 92.1% of our total imported raw milk powder by volume for the same periods.

Synlait Milk Limited

Synlait Milk Limited is a producer of dairy ingredients based in New Zealand, and exports its products around the world to consumer product companies in Asia, North and Central America. We commenced business relations with Synlait Milk Limited at the end of 2008 and have entered into contracts with the same for each purchase order. We have entered into discussions with Synlait Milk Limited on entering into renewable annual supply contracts for raw milk powder and, pending a successful outcome to the discussions, we expect to reach a supply agreement with the same for the year 2011 by the end of November 2010.

Fonterra Limited

Fonterra Limited is a leading multinational dairy exporter based in New Zealand and the world's seventh largest dairy company by sales value. Fonterra Limited has been operating in the China market for over 20 years, and currently employs a global, Internet-based auction platform open to all its customers for the sale of dairy ingredients. We commenced business relations with Fonterra Limited in 2001. As all sales of Fonterra's products are conducted through its online platform on which customers bid for its products, we do not enter into any periodic supply agreement with Fonterra.

Open Country Dairy Limited

Open Country Dairy Limited is a dairy ingredient manufacturer formed in 2001 in New Zealand and exports to more than 40 countries worldwide. We commenced business relations at the end of 2008 and have secured a one-year supply agreement with Open Country Dairy Limited, in which we are to be provided with approximately 10,800 tonnes of raw milk powder in various quantities spread over four quarters of the year from September 2010 to August 2011. Prices will be negotiated on a monthly basis and at least two months in advance in a separate purchase order contract. We reserve the right to adjust the monthly order quantity by 20% according to our production plan. The quantities to be provided are subject to price confirmation and availability of raw milk powder upon milk flows and production capacity of the supplier.

We conclude standard purchase orders stipulating the price, quantity, product specification, payment method and date and port of shipment for purchase of every batch of raw milk powder with each of our New Zealand suppliers. Prices for our raw milk powder are determined based on market

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prices, conditions of demand and supply and our bargaining power with respect to our suppliers. The suppliers are responsible for ensuring the quality of the raw milk powder. We maintain the right to return substandard products once a mutually agreed upon authority, such as the AQSIQ, has determined that the products do not meet quality standard. We are also entitled to claim against such suppliers for any damages effected on us by their substandard products.

During the Track Record Period, we did not encounter any shortage or interruption in the supply of raw milk powder. Due to the stable relationships we have developed with our overseas suppliers, we highly value our mutual business cooperation and believe that the probability of terminating such relationships is very small. However, in the unlikely event of these suppliers' absence, we have identified three other potential raw milk powder suppliers in New Zealand as alternative sources of raw milk powder. Given the scale of operations and development of the three suppliers, we believe they have the ability to provide us with a stable supply of raw milk powder of similar quantity and quality.

In 2009, we imported a substantial portion, or approximately 55% in terms of volume, of our raw milk powder sourced from overseas in New Zealand and Australia through Victory Trading, which was not part of our Group at the time. We procured 37% of our imported raw milk powder directly from overseas suppliers in 2009. A small portion, or 8%, of our imported raw milk powder was purchased through other third-party suppliers engaged in the trading of raw milk powder and raw materials. We typically conclude one-year supply contracts with such third-party trading companies, stipulating the type of products to be provided, price determination mechanism, product inspection methods, delivery methods and delivery cost responsibilities. For the six months ended 30 June 2010, we purchased over 90% of our raw milk powder directly from overseas suppliers through Victory Trading, which we acquired in June 2010 and is now a wholly-owned subsidiary of our Company. Victory Trading mainly sources raw milk powder from our major suppliers, namely Synlait Milk Limited, Fonterra Limited and Open Country Dairy Limited, but has also imported raw milk powder from five other reputable suppliers with dairy sources in New Zealand, Australia and Europe. To a lesser extent, we purchased the remaining quantity of raw milk powder for the six months ended 30 June 2010 through third-party trading companies. We may continue to purchase small quantities of raw milk powder through trading companies or other trading entities designated by suppliers depending on market conditions and the availability of favourable prices.

In addition, we plan to further develop and strengthen our control over the high-quality raw dairy materials used in our pediatric milk formula products. In particular, we plan to expand into upstream operations overseas and establish vertically-integrated production facilities. We intend to carefully select, acquire and operate integrated dairy companies overseas with a view towards securing stable supplies of high-quality dairy materials. We take into consideration the operating scale and track records, financial condition, asset quality, production facilities and capacity, capability of employee and efficiency of management and information system of dairy companies when we identify and evaluate potential targets for acquisition or cooperation to develop integrated overseas facilities. In addition, we intend to explore opportunities for cooperation with overseas dairy related products companies and/or other strategic investors in order to leverage their experience in quality control and research and development and thus to further enhance our relevant capabilities. As of the Latest Practicable Date, we had entered into discussion with several integrated dairy companies as well as overseas dairy related products companies, but had no specific acquisition targets.

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Raw Milk

Raw milk is the primary material in our self-produced raw milk powder, which is further used to produce milk powder for adults and teenagers, or sold externally for industrial food manufacturing purposes to manufacturers of dairy products in the event of surplus. During the Track Record Period, we sourced raw milk from approximately 3,000 individual domestic dairy farms. The dairy farmers bring their dairy cattle to collection stations where raw milk is automatically extracted using fully enclosed, stainless-steel vacuum milking machines. These collection stations collect and transport the raw milk in stainless-steel containers to our Qiqihaer Plant by refrigerated truck on a daily basis. Once received, the raw milk is processed with refrigeration equipment that cools the raw milk to approximately four degrees celsius. The raw milk is then stored in air-tight tanks in preparation for production. We generally enter into supply contracts with terms of one to three years with dairy farmers. Our supply contract stipulates daily provision of raw milk at prices determined by product quantity and changes in market rates. We pay dairy farmers directly in cash for raw milk purchases upon collection, and reserve the right to refuse any milk that does not meet our quality standards. We are responsible for the delivery cost of raw milk from milk collection stations to our production plant. For the years ended 31 December 2007, 2008 and 2009 and the six months ended 30 June 2010, we purchased approximately 24,400 tonnes, 33,500 tonnes, 33,000 tones and 14,600 tones of raw milk from domestic dairy farms at RMB44.0 million, RMB82.9 million, RMB68.0 million and RMB37.0 million, respectively.

As of 30 June 2010, we were licensed to operate over 70 milk collection stations and had exclusive cooperation relationships with third-party milk collection station partners, which are all Independent Third Parties that own the buildings and equipment of the milk collection stations. In our exclusive contracts with milk collection station partners, we manage and operate the milk collection station, as well as stipulate each milk collection station to maintain its facilities strictly according to our requirements. Collection station partners provide maintenance and logistic services, and are to be paid for the milk collected based on a fixed rate per unit volume, which typically amounts to approximately RMB460,000 to RMB700,000 per month. During the term of our agreement with the milk collection station partner, we have the exclusive right to manage and operate the station. Milk collection stations source directly from dairy farmers, with whom we conclude supply contracts which specify that raw milk supplied must comply with our quality standard. Our PRC legal adviser, Tian Yuan Law Firm, advised us that as we are the licensee of the milk collection stations, we shall undertake the legal liabilities relating to the operation of the milk collection stations. However, with respect to any liability that arises as a result of the breach of agreement on the part of the milk collection station partners, we are entitled to initiate separate claims against them.

The daily operation of each milk collection station is managed by professional staff trained by us, who enforce strict internal standards for milk handling procedures and quality check. As of 30 June 2010, 162 professional staff members, each familiar with the raw milk handling procedure and quality testing, worked at the milk stations managed and operated by us. Every staff member stationed at a milk collection station must undergo monthly training for quality control and management procedures. We also dispatch our own inspection personnel to examine sanitary conditions and overall maintenance at each milk collection station on a daily basis.

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While we have been able to secure sufficient supply of imported raw milk powder and do not foresee any shortage in the future, we believe that by maintaining relationships with domestic milk farmers and milk collection stations, we are able to retain flexibility to procure our own raw milk for the production of raw milk powder and pediatric milk formula products in the event of a shortage in imported raw milk powder supply.

Imported Pediatric Milk Formula

We purchase one series of *Scient* Imported Skimmed Milk Pediatric Milk Formula product from an OEM supplier located in the United States. Our OEM supplier, PBM Products, is a well-known manufacturer of pediatric dairy products in the industry, and produces pediatric milk formula products for other leading international brands. We currently submit bulk purchase orders to PBM Products, which manufactures our product based on the proprietary formula we submit. We conclude a purchase contract with PBM Products for each batch of product order. Our purchase contract typically sets out the quantity, purchase price, product specification, payment method and delivery location and time. The purchase contract also requires PBM Products to provide us with certificates of quality and health, inspection reports for all technical parameters and a melamine free certificate for each batch of products. The first batch of products was introduced in June 2009, and we expect to launch a second batch of products on retail shelves in the fourth quarter of 2010.

Other Production Materials

For the production of our pediatric milk formula, we also require a variety of ingredients in addition to raw milk powder, such as lactose, whey protein powder, DHA, ARA, minerals and vitamins. Depending on the formulaic requirements of our different product offerings, we import a portion of these ingredients, such as whey protein powder and DHA from European countries and lactose from the US, and source the remainder from domestic suppliers or trading companies.

Major raw materials for the production of our nutritional food products include soybean, rice, flour, oat flakes and ground corn. Other production additives commonly used in most of our production lines include antioxidants, stabilizers, and flavorings. These raw materials are commodities generally available from numerous suppliers. Prices for such raw materials are determined by domestic market rates, which may fluctuate based on changes in the commodity market. We regularly monitor supply and cost trends of these commodities to secure stable supplies at favorable prices. We source all of these raw materials from suppliers in China as well as trading companies engaged in commodity trading.

We also purchase promotional items such as children's toys from domestic manufacturers and trading companies.

All raw materials are delivered by trucks to our production plants. Depending on production needs and negotiations between us and our suppliers, the cost of transportation may be either borne by us or our suppliers.

During the Track Record Period, we did not experience any significant delays or constraints in production due to any disruption of supply of materials. We believe that there are sufficient alternative suppliers for all of our raw materials.

Packaging Materials

We procure raw materials such as packaging films to manufacture packaging materials primarily through our wholly-owned subsidiary, Bisheng. We purchase all raw materials for our packaging materials at market rates directly from domestic suppliers as well as through trading companies. Most of our finished packaging materials, such as product cans are used internally for the packaging of our finished products. Due to the proximity of Bisheng to our Chaozhou Plant, we are able to achieve significant savings in transportation costs.

Suppliers

For 2007, 2008, 2009 and the first six months of 2010, purchases from our five largest suppliers accounted for approximately 22.6%, 14.1%, 19.2% and 46.6%, respectively, of our total purchases, and purchases from our largest supplier accounted for approximately 5.6%, 3.7%, 7.0% and 35.3%, respectively, of our total purchases. Our five largest suppliers are manufacturers of dairy ingredients and third-party trading companies engaged in the sale of dairy materials and we have maintained relationships with these suppliers for one to six years. We purchase dairy materials from these suppliers, which typically include raw milk powder, lactose and whey protein. None of our Directors, senior management, their associates, or any shareholders holding more than 5% of the issued share capital of our Company held any interest in any of our five largest suppliers for the three years ended 31 December 2009 and the six months ended 30 June 2010.

INVENTORY MANAGEMENT AND LOGISTICS

We adopt similar policies for inventory management and logistics across our operating segments of *Yashily* and *Scient* pediatric milk formula, nutritional food products and other products.

Inventory Management

We manage our inventory levels based principally on expected demand patterns, production schedules and volumes of sales orders. We have inventory management procedures that ensure the planning and allocation of storage space and stock of our inventory to meet delivery requirements and schedules. Since February 2010, we have adopted an Enterprise Resource Planning (ERP) system from ORACLE to monitor and control our inventory levels and optimize our production and operations. The ERP system facilitates the flow of information between all business functions by consolidating and standardizing our information databases. It enhances our inventory management by providing information on the product batches in inventory, including their respective shelf life, so as to ensure the preservation of our inventories. Prior to its adoption, we had been gradually transitioning from a manually controlled system to an electronically controlled system. We believe the ERP system will substantially enhance our monitoring and control over the level of inventories.

Our inventories primarily include raw materials, packaging materials, works-in-progress and finished products. To ensure the quality of different types of our inventories, we make conscientious plans for raw materials procurement and for production based on our full-year sales target, actual sales volume, monthly feedback from sales promoters dispatched to retail outlets as well as our promotion plan, so that our inventories may remain at a reasonable level. We efficiently allocate our storage spaces into freezing, air-conditioned, and room-temperature warehouses and regularly monitor relevant humidity levels based on the conditions and requirements of different types of inventories. Each type of

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inventory is stored in a separate area with its own storage and protection equipment and a uniquely designed management procedure to maintain optimal storage condition. We use pallet racks for the storage of our products and specify precise distances from the wall and the ground to maintain the quality of our products. We also strictly monitor the quality and preservation period of raw materials and packaging materials we receive and do not allow any expired or unqualified materials to enter or remain in our warehouses.

For our imported raw milk powder, we typically maintain inventory levels sufficient to meet 60 days of production needs. For most of our key semi-finished products such as base milk powder, we typically maintain inventory levels sufficient to meet 30 to 40 days of supply needs for normal production. For other minor raw material ingredients such as lactose, we generally maintain inventory levels sufficient to meet 20 to 30 days of supply needs. For most of our finished products, we typically maintain inventory levels of 10 days of supply to satisfy demands from our distributors.

Furthermore, we conduct monthly evaluations of our inventories to expedite the sales of our products with shorter preservation periods and write off any obsolete inventory, if any. During the Track Record Period, we had not experienced material impairment of our inventories in storage.

Logistics

Our inventory comprises raw materials, semi-finished products, finished products and packaging materials. We store our inventory primarily in warehousing facilities located within our production plants.

We outsource substantially all of our product transportation in China to other logistics companies. Transportation costs are built into the price of our finished products. These outsourcing arrangements allow us to reduce our capital investment and reduce the risk of liability for transportation accidents, delivery delays or loss. Our products are delivered primarily by trucks and a portion via railway from our production facilities to our distributors' warehouses.

For the years ended 31 December 2007, 2008 and 2009 and the six months ended 30 June 2010, transportation costs were RMB51.1 million, RMB97.9 million, RMB70.8 million and RMB31.9 million, respectively.

QUALITY ASSURANCE, QUALITY CONTROL AND SAFETY

Quality control is essential for pediatric milk formula products, since they are designed for consumption by infants and young children. We believe that the only way to achieve and maintain high-quality standards is to establish a comprehensive and effective quality control system with clearly established procedural guidelines for every step of the production process, multiple points of cross-checks and testings, and efficient systems for detecting and dealing with defective products to ensure full compliance with China's food safety and health regulations. To that end, we have instituted a group-wide quality assurance program to ensure the production of high-quality products.

In order to effectively implement our extensive quality control program, we have established a Quality Control Department comprising of 165 employees as of 30 June 2010. All of our quality control staff members hold professional degrees in biology, medicine, food, or quality control. In addition, they possess extensive technical expertise as well as strong quality control and management capabilities from

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years of work experience in the field of food research and analysis as analyst, food inspectors and senior nutritionists. Our quality control staff forms a number of dedicated teams stationed at production plants to perform regular quality control tests. In addition, all of our staff members in this department have received in-depth training on the proper handling of customer complaints on a regular basis.

As consumer awareness regarding the safety and quality of pediatric milk formula products escalated in China following the 2008 nationwide melamine incident, we have continuously sought to enhance the quality control system that governs the entirety of our operations. With the assistance and contribution from our strategic investors, Carlyle and Fosun, we conceived in late 2009 the establishment of the Food Quality and Safety Advisory Committee consisting of experts from diverse scientific, professional and geographical backgrounds, who will seek to implement industry-leading quality control practices with the stated intention of maintaining the safety and quality of our products. The Committee, established in August 2010, will provide strategic guidance on our policies and procedures for ensuring product safety and quality, introduce industry best practices and advise on the compliance of our operations with relevant laws and regulations. It is authorized by our Board to conduct independent investigations into our operations and evaluate our quality control system. The Committee will also analyze and disseminate to the members of the Board the latest industry information and developments relevant to food safety and quality control. With the establishment of the Committee, we aim to be a pioneer in product safety and quality in the PRC pediatric milk formula industry to further solidify consumer confidence. The Committee is to meet at least six times a year by physical meetings or conference calls and to submit quarterly written progress reports to the Board. It is in the process of reviewing and refining our quality control and management system to be on par with leading international best practices. It has commissioned internal and external reviews of our production and distribution process to identify areas for improvement. The Committee expects the reviews to be completed by the end of 2010, at which time it will utilize their results in discussions with our management to establish procedures for improving our food safety and quality practices. Going forward, the Committee will continue strengthening and enhancing our quality control and management system to be exemplary for the PRC milk formula industry.

To ensure that our Food Quality and Safety Advisory Committee adheres to international best practices, we have recruited several industry experts to become members of the Committee. The Committee comprises of one chairman and five experts from leading academic institutions, regulatory bodies, the food industry and industry associations of North America, Oceania and Greater China. We have engaged Dr. Robert Brackett to serve as the chairman of the Committee. Dr. Brackett is currently the director and vice president of the National Center for Food Safety and Technology at Illinois Institute of Technology. He has previously served as the director of the US Food and Drug Administration's Center for Food Safety and Applied Nutrition and as the senior vice president of the US Grocery Manufacturers Association (GMA). Other experts on the committee are Mr. Allen Ho, Dr. Kenneth Buckle, Mr. Andrew McKenzie, Professor Zhuoqin Jiang and Professor Liegang Liu. Mr. Ho has been serving on the advisory committee to the Hong Kong Food and Health Bureau and is an expert adviser to the Food and Environment Hygiene Department of the Hong Kong SAR Government. Dr. Buckle is an emeritus professor in the Food Science and Technology Group at the University of New South Wales in Australia, fellow of the Food Standards Australia New Zealand (FSANZ) and chair of the editorial advisory board of the World of Food Science magazine. Mr. McKenzie is the chief executive of New Zealand Food Safety Authority (NZFSA). Professor Jiang and Professor Liu both have

strong academic backgrounds in food hygiene and medical nutrition, and have published numerous research papers and textbooks. We have engaged the above members of the Committee as consultants on a part-time basis.

In May 2010, we also engaged Mr. Allen Ho to serve as our chief consultant on quality control. He brings over 30 years of experience in quality, technical and regulatory leadership positions with leading multinational companies in the food industry in the United States and Asian countries. In addition to his wealth of corporate experience, Mr. Ho has also served as a member of the Review Panel of Hong Kong R&D Centre for Logistic and Supply Chain Management Enabling Technologies and the Governing Board for the Hong Kong Organic Resources Centre. We have entered into a one-year non-exclusive consulting agreement with Mr. Ho that contains confidentiality provisions. We believe Mr. Ho's extensive professional experience and comprehensive industry knowledge will enable us to create a world-class program of quality control and management.

Background of the 2008 Nationwide Melamine Incident

On 16 September 2008, the AQSIQ announced that the products of 22 domestic pediatric milk formula producers, including ours, were found to be contaminated with melamine, a substance not approved for use in food and linked to the development of health problems of infants and children in China. Based on the currently available public information, approximately 300,000 infants and children had suffered kidney-related illnesses due to the consumption of contaminated pediatric milk formulas, according to China's Ministry of Health. Prior to the 2008 nationwide melamine incident, the predominant source of China's raw milk supplies came from individual dairy farmers. Due to the scattered nature of the supply market, domestic pediatric milk formula producers were unable to efficiently manage supply sources. This led to the market entry of raw milk dealers, who were middle men that purchased raw milk from individual dairy farmers and resold it to domestic pediatric milk formula producers. Some of these raw milk dealers added melamine to the raw milk they sold in order to artificially inflate protein level. We did not add melamine to the affected products nor did we have any relationship with such dealers. Furthermore, prior to the melamine incident, no industry or national standards existed in China for the detection of melamine, and we believe that our normal production and quality control procedures were carried out in accordance with national regulations and generally accepted internationally practices at the time. Given the high concentration of the domestic pediatric milk formula market, and that the 22 domestic producers whose products were found to be contaminated were large companies comprising the majority of the domestic industry, the incident became an industry-wide crisis. The 2008 nationwide melamine incident severely impacted the entire dairy industry, causing significant losses from product recalls. This incident also undermined consumers' confidence in pediatric milk formula produced using milk sources from the PRC, resulting in a significant drop in the purchase of such products and in turn a decrease in sales and production volume of domestic dairy companies, including ours.

Measures Implemented by the Government

After the 2008 nationwide melamine incident, the PRC Government promulgated a series of regulations aimed at improving the industry's quality control mechanism and framework, including but not limited to the *Regulation on the Supervision and Administration of the Quality and Safety of Dairy Products* (乳品質量安全監督管理條例) promulgated by the State Council of the PRC. For more details, see the section headed "Regulations — Regulatory system relating to the infant food industry".

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Relevant government authorities also adopted strict measures to inspect all dairy products, especially pediatric milk formula products. Such measures include on-site inspection by the provincial authorities for quality and technology supervision as well as sampling inspection on raw materials and products, inspection of production facilities and product quality at manufacturing plants for pediatric milk formula products, and requirement of dairy manufacturers whose products have been found with quality problems to suspend production and recall those products. According to the *Regulation on the Supervision and Administration of the Quality and Safety of Dairy Products* (乳品質量安全監督管理條例), which is still in effect as of the Latest Practicable Date, it is prohibited to distribute the products of dairy manufacturers, including ours, before such products are inspected batch by batch by such manufacturers for quality assurance.

At the same time, pediatric milk formula manufacturers are required to establish good manufacturing practices in raw material inspection, food additives management, and products inspection, aiming to achieve GMP, GB/T22000-2006 or HACCP certifications gradually.

Our Product Recalls and Other Immediate Actions after the 2008 Nationwide Melamine Incident

Immediately following the government announcement, we commenced compulsory recall pursuant to the order by the government on 17 September 2008 of all contaminated lots of our products, which were those finished products discovered to be contaminated with melamine by the AQSIQ and provincial administrative authorities of quality and technology supervision and were designated to be destroyed under government supervision. Each contaminated lot was specified by its product name, batch number and date of production. We were thus able to trace and record these products during the compulsory recall process when our distributors returned products to us from all over China. The contaminated lots were completely destroyed by May 2009 under the supervision and verification of local government authorities. Our pediatric milk formula and milk powder for adults and teenagers products that were recalled and destroyed under the contaminated lots amounted to approximately 130 tonnes. As of the Latest Practicable Date, approximately 1.3 tonnes, or 1.5% by weight of the 30 contaminated lots of *Yashily* pediatric milk formula products and approximately 1.1 tonnes, or 4% by weight of the six contaminated lots of *Scient* pediatric milk formula products were sold and have not been recalled; approximately 0.3 tonnes, or 1.5% by weight of the 13 contaminated lots of *Yashily* milk powder for adults and teenagers products were sold and have not been recalled. We believe that such products which were not successfully recalled had either already been consumed by end consumers or expired. We also suspended our production at Yashili (Guangdong) and Scient (Guangzhou) on 12 September 2008 and at Yashili (Shanxi) on 17 September 2008; and we cooperated with the AQSIQ and provincial administrative authorities of quality and technology supervision on on-site inspections and examination requests for our products and production facilities and swiftly moved to resolve complaints and issues raised by consumers of our products. We and our PRC legal advisor, Tian Yuan Law Firm, confirmed that there was no finding of our non-compliance with relevant provincial administrative authorities for quality and technology supervision during their on-site inspections and examinations at our production facilities. As a result, Yashili (Guangdong), Scient (Guangzhou) and Yashili (Shanxi) resumed production on 23 September 2008, 30 September 2008 and 1 October 2008, respectively, pursuant to the approvals of provincial administrative authorities of quality and technology supervision.

Furthermore, beginning on 18 October 2008, we conducted voluntary recalls of all pediatric milk formula products and milk powder for adults and teenagers manufactured prior to 14 September 2008, which were subsequently destroyed under the supervision and verification of local government

authorities by March 2010. According to the emergency order issued by the six government ministries and administration (國家六部委) on 14 October 2008, all pediatric milk formula products manufactured prior to 14 September 2008 must be tested for quality compliance by the producers. Due to the relative amount of resources that would have been required to test all products under such scope, we chose to conduct voluntary recall and destruction of all pediatric milk formula products manufactured prior to 14 September 2008 as a practical and responsible solution. Voluntarily recalled products comprised the majority of our total recalled products since contaminated products under the compulsory recall were of a relatively small quantity. We voluntarily recalled approximately 10,735 tonnes of our *Yashily* milk formula products and approximately 3,811 tonnes of our *Scient* milk formula products. Given the large quantity of voluntarily recalled products and the shortage of government-supervised destruction facilities at the time, the destruction of all of our voluntarily recalled products required a longer period of time to complete. During the Track Record Period and up to the Latest Practicable Date, there was no further product recall apart from those conducted in association with the 2008 nationwide melamine incident.

To ensure that recalled products and unsold and semi-finished products manufactured prior to 14 September 2008 as well as raw materials did not leak into the market, we designated locked and regularly patrolled areas in our warehouse to store such products and materials before their destruction. In addition, we unwrapped the recalled, unsold and semi-finished products as well as raw materials in our inventory and added coal cinder into the same so that they were no longer fit for consumption or reproduction. Relevant government authorities participated on-site to inspect the products and materials to be destroyed, including the checking of product names, batch numbers, quantities and weights. They also supervised the destruction process, confirming the weight of each batch of products against their records, and stamped on the destruction records as verification.

All products returned from the compulsory and voluntary recalls by the distributors were refunded at their original selling prices or exchanged for new products, providing sufficient monetary incentive for our distributors to return products. All products returned by consumers were fully refunded in cash. Any distributor, retail store or consumer was eligible to return any product in the contaminated lots under our compulsory recall, or any product manufactured prior to 14 September 2008 as part of our voluntary recall. Consumers could return products to the original retail location from which they were purchased, and retail stores would collect the returned products and return them to our distributors. The distributors would thereafter send batches of returned products to us for refunds or exchanges. Due to the extensive nationwide media coverage of the 2008 nationwide melamine incident at the time, we believe that consumer awareness about the relevant government measures and dairy product manufacturers' actions, including product recalls, was widespread. Furthermore, relevant government authorities began to conduct stringent inspections of pediatric milk formula products in the market and would impose severe penalties on the parties involved for distributing contaminated products manufactured prior to 14 September 2008. Given (i) the stringent government measures; (ii) heightened public concern regarding contaminated products; and (iii) penalties and criminal liabilities associated with leaking contaminated products to the market, we believe our distributors were willing to recall the products from their customers and return them to us for refunds or exchanges. Although our distributors, retail stores and consumers are still eligible to return products under compulsory and voluntary recalls to us, we expect that there will not be significant returns of such products in the future, as we have not received any material returns in this regard after July 2009.

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We believe our compulsory recalls on the contaminated lots of products and voluntary recalls on the rest of our milk formula products manufactured before 14 September 2008 have been effective based on: (i) the series of measures we adopted; (ii) the verification records from the relevant government quality control authorities confirming the dates, product types and quantities of successfully destroyed recalled products; (iii) the limited number of consumer lawsuits we received in relation to our melamine-contaminated products discussed under the section headed “— Legal proceedings and compliance”; and (iv) that there have been no significant returns of such products from our distributors, retail outlets and consumers since July 2009.

Our total losses arising from the melamine incident for the year ended 31 December 2008 were RMB787.1 million, which consisted of: (i) RMB456.9 million as write-down of the inventory; (ii) RMB159.7 million as inventory disposal loss, which mainly included costs of the disposed finished products, semi-finished products and raw materials as a result of the melamine incident and other miscellaneous charges for the disposal; (iii) RMB108.1 million for input VAT transfer-out; and (iv) RMB62.5 million of other expenses primarily relating to payment of RMB61.2 million to the compensation fund set up by the China Dairy Industry Association. Meanwhile, the sales returns in relation to our product recalls in 2008 amounted to RMB984.9 million and were set-off against our gross sales for the year ended 31 December 2008. Subsequent to the product recall in 2008, we had delivered new lots of products to our customers in the fourth quarter of 2008 and in the year ended 31 December 2009 to fulfill those orders which have not been met as a result of the sale returns in 2008. The sales amount of such products were RMB541.2 million, RMB344.7 million, RMB30.2 million and RMB1.9 million in the fourth quarter of 2008, the six months ended 30 June 2009, the six months ended 31 December 2009 and the six months ended 30 June 2010, respectively. As of 30 June 2010, we had also settled RMB64.9 million by cash refunds in connection with our product recalls in late 2008. Total losses arising from the melamine incident for the year ended 31 December 2009 were RMB1.3 million, which consisted of RMB466,000 in inventory disposal loss, RMB102,000 for input VAT transfer-out and RMB756,000 of other inventory disposal handling charges. Total losses arising from the melamine incident for the six months ended 30 June 2010 were RMB1.0 million, primarily relating to inventory disposal handling charges. There was no write-back or gain recognized in connection with our losses arising from the melamine incident during the Track Record Period. Our insurance policies did not cover losses arising from the melamine incident. To the best knowledge of our Directors, no domestic insurance policy is available for coverage of losses arising from intentional contamination or poisoning by third-parties.

Our Directors confirm and our PRC legal advisor, Tian Yuan advises that, based on public available sources and the confirmations of the Directors, that none of the directors, senior management or legal representatives of the Group was found liable or has been penalized or fined for the 2008 nationwide melamine incident.

Since the 2008 nationwide melamine incident, we have made significant investments and efforts in strengthening our quality control, with particular emphasis on stringent control over high-quality milk sources to guarantee the safety of our raw material supplies. Since September 2008, we have incurred expenses of RMB9.3 million in equipment purchases and testing fees for strengthening our quality control system. Going forward, we expect to invest RMB210,000 monthly for the same purpose. The expenses incurred mainly consist of purchases of testing equipment and fees for inspection and examination of our products conducted by relevant government authorities. We believe our commitment to improving and establishing a comprehensive quality assurance program has allowed us to regain the

trust of consumers and substantially recover from the 2008 nationwide melamine incident. Our PRC legal advisor, Tian Yuan Law Firm, confirmed that we have fully complied with relevant requirements and measures implemented by relevant PRC government authorities after the 2008 nationwide melamine incident.

Quality Control Systems

Overseas milk source

Prior to September 2008, domestically produced raw milk and raw milk powder were the primary raw materials we used to produce pediatric milk formula and milk powder for adults and teenagers. Following the 2008 nationwide melamine incident, we made a major strategic decision in December 2008 to transition from sourcing domestically produced dairy materials to importing high-quality raw milk powder from established suppliers overseas. For the years ended 31 December 2008 and 2009 and for the six months ended 30 June 2010, approximately 10%, 66% and 78% of our pediatric milk formula products and approximately 7%, 76% and 40% of our milk powder products for adults and teenagers were produced from raw milk sourced from overseas. We completed the switch to overseas dairy material source for *Scient* pediatric milk formula products in January 2009. Since the end of June 2010, we have been using and plan to continue procuring 100% imported raw milk powder for our *Yashily* and *Scient* pediatric milk formula products. We import raw milk powder from New Zealand and Australia, with the majority from New Zealand, which is a major exporter of dairy products with a well-known reputation for natural open-range dairy farms, high-quality dairy products and world-leading processing capabilities. The raw milk powder we purchase from dairy sources in New Zealand and Australia is required to comply with the local requirements for food safety. Relevant local authorities of the export countries perform inspection on every batch of raw milk powder before exportation and provide our suppliers with health certificates. The raw milk powder for our pediatric milk formula products had complied with all the relevant food safety and hygiene regulations in their respective origins, including but not limited to New Zealand, Australia and Europe. In addition, the origins of our raw milk powder and dairy materials all have strict legislations prohibiting the use of hormonal growth promotants on milking cattle and our suppliers represented that they have strictly complied with such requirements of its respective jurisdiction. Going forward, our suppliers may also conduct hormone tests on every batch of raw milk powder before exportation at our request. We have also implemented strict procedures to inspect the quality of our imported raw milk powder as a key dairy material. Sample testing is performed for every batch of order to confirm quality compliance. In addition, our management team conducts regular site visits abroad at suppliers' plants to inspect factory conditions and quality control measures.

Quality assurance of domestically sourced milk

During our transition from sourcing domestic milk to importing raw milk powder, we have implemented a series of procedures to ensure the quality of our domestically sourced milk. In order to control the quality of collected raw milk, we no longer purchase from milk collection stations operated by raw milk dealers. Instead, we only source raw milk directly from milk collection stations with whom we have exclusive agreements and which are supervised by our trained personnel. At each milk collection station, we staff professional personnel trained by us to manage the collection process and enforce our strict standards for handling and conducting quality checks. We also dispatch our own inspection staff to examine sanitary conditions and overall maintenance at each milk collection station

on a daily basis. Upon receiving raw milk, the staff performs inspection on the content of alcohol, alkalis, nitrites and antibiotics in the raw milk to ensure that it does not contain any substance harmful to human beings. This prevents any unknown substance from tampering with the raw milk collection process. After each batch of raw milk is checked for quality compliance, the raw milk is checked again upon arrival at our production plant, and once more just prior to use in our production line.

Quality testing

Prior to the 2008 nationwide melamine incident

Prior to the 2008 nationwide melamine incident, we had implemented multiple checkpoints throughout the production chain with comprehensive testing procedures to ensure the quality of our raw materials, semi-finished products and finished products. We also submitted samples of our finished products to relevant authorities for inspection on a quarterly basis. Throughout our operating history, we have performed testing in line with applicable PRC rules, regulations and accepted practices at the time, and have broadened the scope of our tests performed pursuant to developments of relevant PRC laws and regulations.

Since the 2008 nationwide melamine incident

Following the 2008 nationwide melamine incident, we increased the sample size of testing at quality checkpoints throughout the supply and production chain and further reinforced our quality control system. Suppliers of our imported raw milk powder and imported *Scient* pediatric milk formula must submit inspection records prepared by them detailing the contents and levels measured for each batch of supply. When our imported raw milk powder and *Scient* pediatric milk formula products pass through PRC customs, each batch must be inspected by the relevant Entry-Exit Inspection and Quarantine Bureau (出入境檢驗檢疫局) for compliance with applicable PRC food safety laws and regulations. Upon receipt of the imported raw milk powder, our production plants inspect each batch of supply for quality check. We also request the suppliers of other ingredients and nutrients used in our products, such as whey protein powder, lactose and vitamins, to provide requisite food safety and hygiene certification from their respective origins as well as in the PRC and conduct sample quality checks before acceptance. Once the approved raw milk powder supplies and other ingredients are used to manufacture base milk powder, the semi-finished product is subject to quality check before being transported to our Chaozhou Plant and Guangzhou Plant for final processing. Prior to using the base milk powder in production, the Chaozhou Plant and Guangzhou Plant inspect each batch once again for quality compliance. Each batch of finished products also goes through our internal random testing. To the best of our knowledge, each substance contained in our current products complies with its statutory limit under the relevant rules and regulations. After the 2008 nationwide melamine incident, to ensure that our finished products fully comply with relevant laws and regulations, we have also submitted samples from every batch of finished products to relevant provincial administrative authorities of quality and technology supervision for quality inspection and received their confirmation that such samples have passed inspection before the distribution of our milk formula products. As of the Latest Practicable Date, all samples of our products submitted for inspection had been determined to meet the prescribed standards and no non-compliance was found during the inspections by the relevant authorities.

Over the course of our operating history, we have invested approximately RMB20 million in acquiring advanced testing instruments for our production plants. We have imported advanced testing equipment from countries such as the United States and Sweden, which we utilize to measure and detect

over 60 chemical compounds and microorganisms, including all contents stipulated in national regulatory standards as well as other groups of specific nutrients and contents. Our testing apparatuses include an advanced liquid chromatography mass spectrometer acquired in January 2009, which is able to detect minute traces of melamine, harmful pesticides and heavy metal at a high-precision level of 0.001 mg/kg, a gas chromatographic analyzer, which can inspect iodine, DHA, ARA and linolenic acid, and a graphite furnace atomic absorption spectrophotometer, which can inspect mineral elements and heavy metals. The use of this testing equipment ensures that any minute trace of melamine, harmful pesticides and heavy metal will be immediately detected in our raw materials, semi-finished and finished products. We perform testing in line with the current applicable PRC rules, regulations and accepted practices at the time, and will broaden the scope of our tests performed pursuant to developments of relevant PRC laws and regulations. We will continuously introduce new testing equipment or engage external testing organizations to inspect other harmful substances, including but not limited to hormones, recommended by scientific research or as required by relevant government authorities from time to time, to enhance our quality control procedures.

Production process

Apart from assuring the quality of raw materials, we also recognize the importance of quality control of semi-finished products, finished products and the production process. Our production process is conducted in GMP-certified plants to meet applicable national quality standards. We received GB/T 22000-2006 certification for food safety management in 2007 and GMP certification for the manufacturing of dairy products as well as HACCP certification for food safety management in March 2010. In addition, we have passed multiple certification tests for quality control measures such as ISO9001 for quality control management, ISO14001 for environmental management, and OHSAS 18001 for occupational health and safety management. Our inspection labs obtained national certification in 2005 by the China National Accreditation Service for Conformity Assessment. We strive to achieve our aim of “zero tolerance for failure” and require all personnel involved in every stage of our operations, including procurement, production, packaging, sales, storage and transportation to strictly observe relevant quality control and safety measures. Furthermore, since the 2008 nationwide melamine incident, relevant government authorities have conducted over ten random inspections on our plants annually, in addition to their annual inspections of our plants in respect of the food production permit, and no non-compliance was found by relevant provincial administrative authorities for quality and technology supervision during such inspections.

To ensure the quality of our packaging materials, we have quality control procedures in place throughout their procurement and production chain. When we procure raw materials for packaging or packaging materials, we require our suppliers to provide production licenses as well as quality inspection records of every batch of their products. We perform selective quality inspection of such raw materials or packaging materials before they are allowed to enter our warehouses. Our Quality Control Department also inspects every batch of packaging materials we produce in-house. Our packaging process follows stringent quality control standards regarding personnel, equipment, materials, operations and sanitation to ensure the quality and safety of our finished products. Cans for the packaging of our products are sterilized by ultraviolet irradiation before being filled with milk powder in the filling chamber. Then, oxygen in the filled cans is replaced with nitrogen in an airtight chamber. The cans are sealed immediately afterwards and affixed with the appropriate labels. We also sterilize other packaging materials by ozone treatment and ultraviolet irradiation before filling them with our other products.

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In addition, our product tracking system, in which a unique two-dimensional code is marked on each product packaging, serves as an effective anti-counterfeiting measure by assuring that only our genuine, high-quality products reach end-consumers. Any defective or contaminated product will be strictly dealt with according to our control procedures for failed and potentially unsafe products.

Quality assurance of imported finished products

We also stringently monitor the quality of our imported pediatric milk formula products under the *Scient* brand supplied by PBM Products. Our product supplier first performs internal quality inspection of its products and combines additional vitamins and nutrients according to our proprietary formula. After we have determined that the products satisfy our standards and specifications, PBM Products begins small-scale production. We verify the quality of these products in small scale before placing bulk purchase orders. PBM Products then performs internal quality inspection of the raw materials and begins full production. It also inspects and provides us with certificates of quality and health, inspection reports for all technical parameters and a melamine-free certificates for each batch of finished products. The finished products are inspected by the relevant Entry-Exit Inspection and Quarantine Bureau (出入境檢驗檢疫局) as well as by us for quality assurance.

Recent Incident regarding Hormone Level in Pediatric Milk Formula Products

There have been media reports linking hormone levels in pediatric milk formula products of a domestic manufacturer with alleged premature development and precocity of infants in the PRC in the summer of 2010. In response to such incident, China's Ministry of Health conducted a clinical investigation and found no evidence of abnormality in the hormone content of the products under question. Under relevant PRC laws and regulations, it is prohibited to purchase, produce and sell dairy products made from raw milk with veterinary medicine residue, including hormones; however, there is no specific requirement for inspection of the hormone levels in milk powder products. Our Directors confirm that, as of the Latest Practicable Date, we did not add any hormones into our products. Although our products were not directly related to the incident, we have proactively submitted samples of every batch of our pediatric milk formula products to Guangzhou Quality Monitoring and Inspection Institute, an independent institution for quality testing and inspection established by the Administration of Quality and Technology Supervision of Guangdong Province, for hormone tests since August 2010. Our PRC legal advisor, Tian Yuan Law Firm, has advised that there is currently no applicable PRC laws and regulations governing the level of hormones in milk powder products. Accordingly, while Guangzhou Quality Monitoring and Inspection Institute conducts testing on hormone level upon our request, it will not publish any accredited reports on the testing results and such results are only used for internal reference as part of our continuously improving quality control system. As of the Latest Practicable Date, our product samples had not been found to contain any exogenous hormone.

Customer Service

We have also created a clearly outlined system for handling customer complaints. For complaints which report a common product attribute that does not violate national regulations, we will conduct internal product examination and fully explain the nature of such occurrences to customers. For complaints which cannot establish a reasonable link between our product and the nature of the complaint, we will explain to the customer and continue to strictly observe quality assurance and control procedures.

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For cases in which a serious customer complaint results in product recalls, we have established a set of recall control procedures outlining each specific step. If the grounds for a serious customer complaint are substantiated following our internal product examination, a management meeting will be convened to create and execute a plan for the recall of products in the same batch. The marketing department will forward a clear set of procedural details, such as the responsibility for transportation costs, to the sales department. The sales department will then communicate the recall plan to all relevant distributors. The recall will also be reported to the local authority in charge of product quality regulation.

Following the 2008 nationwide melamine incident, we received approximately 1,300 customer complaints from 14 September 2008 to the end of 2008. We received approximately 500 customer inquiries in 2009 and only three inquiries in the first six months of 2010. The above complaints or inquiries were all related to the melamine-contaminated products.

In addition, in early September 2010, there were some false allegations on the Internet and in some news articles indicating that we did not destruct melamine-contaminated products and that we repackaged or recycled such products at our Shanxi Plant. We immediately made public clarification announcements on our website as well as through major media outlets and promptly responded to our customers' inquiries. As of the Latest Practicable Date, we had not received any further consumers' inquiries after a few days following our public clarification announcements or experienced any significant decrease in our sales in connection with this incident.

COMPETITION

We primarily compete with domestic and international producers of pediatric dairy products for our core products of pediatric milk formula. We believe pediatric milk formula products in the PRC market can be broadly categorized into three types: (i) domestically manufactured products using dairy material imported from overseas; (ii) 100% imported products; and (iii) domestically manufactured products using dairy material sourced in the PRC. We position ourselves as a producer of products in the first and second categories. By adopting a multi-brand strategy, we have expanded our product offerings to reach consumers across various market groups. We believe we are competitive on the basis of our high-quality products, established brands, extensive distribution network, strong marketing capability and product innovation. Based on the above factors, we believe that we are well-positioned to compete in the domestic market.

We have a well-established leading market position and benefit from high barriers to entry in terms of brand recognition, advertising investment, sales network and fees to retail outlets. Due to consumers' increased appreciation for product quality and safety, the domestic market has been experiencing a trend towards premiumization. This has led to increased significance in brand recognition and investment in quality control. Due to the significant expenditure required to build brand recognition and scale in the market and sustain competitive positioning, new companies are typically constrained by their limited financial resources to overcome the high entry barriers.

Following the 2008 nationwide melamine incident, the entire domestic supply chain of dairy products was severely affected and there has been a shift in consumer preference for imported pediatric milk formula products in China, which further resulted in a decrease in the sales and production volume of PRC dairy companies, including ours. The market share in terms of retail sales of the five largest international pediatric milk formula producers in the PRC market increased from approximately 38%

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during the first nine months of 2008 to 45% during the first nine months of 2009, according to data from AC Nielsen. The market share in terms of retail sales of the five largest domestic pediatric milk formula producers in the PRC market decreased from approximately 39% during the first nine months of 2008 to approximately 32% during the first nine months of 2009, according to data from AC Nielsen. We have taken immediate actions to recall our products, enhance our quality control system to ensure product safety and quality and implement the strategy to use high-quality imported raw milk powder for our pediatric milk formula products. We believe our responsiveness to this incident and our commitment to providing high quality products enabled us to restore consumers' confidence and to compete effectively with multinational producers as well as domestic producers in the PRC pediatric milk formula market.

Compared to multinational producers of pediatric milk formula products, we believe we are able to compete on the basis of our product value proposition, sales penetration, distribution reach and quality control. We are able to provide high-quality products that are more affordable than those offered by multinational companies. Given our consistent record of generating more than 70% of our total revenue from second- and third-tier cities, we believe that we have established a leading position and strength in second- and third-tier cities, which have enabled us to seize the market demand generated by the rapid economic growth in these regions. Our deep distribution and sales network have allowed us to penetrate markets located in townships and counties, where the presence of multinational companies is relatively weaker due to their inadequate distribution infrastructure. Furthermore, multinational companies would be unable to establish a distribution network with comparable degrees of depth and breadth in a short period of time. In addition, we are continuously enhancing our extensive quality control system, which comprehensively covers the entire value chain from procurement to retail sales. Further details of our quality control program are set out in the section headed “ — Quality assurance, quality control and safety”.

Compared to domestic producers of pediatric milk formula products, we are able to compete on the basis of scale, investment from strategic investors and imported dairy material. As industry consolidation continues to accelerate, market dynamics increasingly favor producers with greater business scale. We are one of the largest domestic producers, capturing the third largest market share of approximately 7.6% among domestic companies in China in 2009 according to AC Nielsen. As a demonstration of confidence in our business model, we have also attracted investment from two well-known strategic investors, Carlyle and Fosun, whose contribution and guidance have enabled us to implement international best practices. Furthermore, we have transitioned from using domestically sourced milk to importing all of our raw milk powder from overseas, and currently use high-quality imported raw milk powder for all of our pediatric milk formula products. The combination of our production scale, investment from strategic investors, and high-quality imported raw milk powder enable us to differentiate ourselves from other domestic producers in the market.

We believe we are favorably positioned in the pediatric milk formula industry given the combination of high barriers to entry and our respective competitive strengths versus international and domestic companies.

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AWARDS, CERTIFICATES, ACCREDITATIONS, PERMITS AND REGISTRATIONS

We have received the following major awards and accreditations:

Award Name	Awarding Agency	Date Awarded
Outstanding Private Owned Enterprise (2007年-2008年度優秀民營企業) for the year from 2007 to 2008	People's Government of Chaozhou City (潮州市人民政府)	April 2009
Pioneer Company of Well-known Brands and Trademarks in Chaozhou (潮州市創名牌名標先進企業)	People's Government of Chaozhou City (潮州市人民政府)	February 2009
Guangdong Top 100 Private Owned Enterprises (廣東省百強民營企業)	People's Government of Guangdong Province (廣東省人民政府)	October 2008
China's Top 500 Private Owned Enterprises (中國民營500強)	China Association of Private Owned Enterprise (中國民營企業聯合會); China Association of Statistics (中國統計協會); Research Center of Enterprise Development of China Academy of Administration (中國管理科學研究院企業發展研究中心)	November 2008
China's 500 Most Valuable Brands (中國500最具價值品牌)	World Brand Lab (世界品牌實驗室)	June 2008
Enterprise Technology Center of Guangdong Province (企業技術中心)	Guangdong Provincial Committee of Economy and Trade (廣東省經濟貿易委員會); Guangdong Provincial Department of Finance (廣東省財政廳); Guangdong Provincial Administration of State Tax (廣東省國稅局); Guangdong Provincial Administration of Local Tax (廣東省地稅局); Guangdong Customs (廣東省海關總署)	April 2008
Famous Brand of Guangdong Province (廣東省名牌商標) for  brand	Guangdong Administration of Commerce and Industry (廣東工商行政管理局)	February 2008
Famous Brand of Guangdong Province (廣東省名牌商標) for  brand	Guangdong Administration of Commerce and Industry (廣東工商行政管理局)	February 2008
Top 10 Enterprise (十強企業)	China Food Safety Committee (中國食品安全委員會)	September 2007
Top 10 Enterprise in Food Industry in Chaozhou City in 2006 (2006年度潮州市食品行業十強企業)	People's Government of Chaozhou City (潮州市人民政府)	August 2007
Pioneer Company of Well-known Brands and Trademarks in Chaozhou City (潮州市爭創名牌名標產品先進單位)	People's Government of Chaozhou City (潮州市人民政府)	August 2007
National Quality and Integrity Exemplary Enterprise in 2007 (2007年3•15全國質量誠信放心示範單位)	China Foundation of Consumer Protection (中國保護消費者基金會)	March 2007
Famous Product of Guangdong Province (廣東省名牌產品) for <i>Yashily</i> pediatric milk formula products	Administration of Quality and Technology Supervision of Guangdong Province (廣東省質量技術監督局)	September 2006

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<u>Award Name</u>	<u>Awarding Agency</u>	<u>Date Awarded</u>
China Famous Brand Product (中國名牌產品) for <i>Yashily</i> soymilk powder products	China's General Administration of Quality Supervision, Inspection and Quarantine (國家質量監督檢驗檢疫總局)	September 2005
China Dairy Products Top Ten Influential Product (中國乳製品十大影響力品牌) for <i>Yashily</i> dairy products	China Dairy Industry Association (中國乳製品工業協會)	January 2005
Well-known Trademark (馳名商名) for <i>Yashily's</i> trademark image	Trademark Office of the State Administration for Industry and Commerce of the PRC (國家工商行政管理總局商標局)	2004

INTELLECTUAL PROPERTY

We rely on a series of trademark registrations to protect the rights and interests of our brands, which are critical for building customer recognition of our products. As of the Latest Practicable Date, we had 355 material registered trademarks and had made 68 material trademark applications of different classes for our brands and sub-brands domestically and overseas. Details of our registered trademark portfolio are provided in the section headed “C. Further information about our business — 2. Intellectual property rights of our Group” in Appendix VI of this Prospectus.

Substantially all of our product formulas have been developed in-house and are proprietary. We have not registered or applied for protection in China for most of our intellectual property or proprietary formulations of our pediatric milk formula. Although we believe that, as of today, patents and copyrights have not been essential to maintaining our competitive market position, we intend to assess in the future whether seeking patent and copyright protection for those aspects of our business could provide significant competitive advantages.

We actively take steps to protect our intellectual property rights and implement a set of internal intellectual property management rules. We rely on trade secret protection and confidentiality agreements to protect our proprietary information and know-how. Our management and research and development personnel have entered into confidentiality agreements with us acknowledging that all inventions, designs, trade secrets, works of authorship, developments and other processes generated by them during the course of employment are our property. This assigns to us any ownership rights that they may claim in those works. As of the Latest Practicable Date, we had not experienced any infringement of our intellectual property rights which could have a material effect on our business.

ENVIRONMENTAL MATTERS

We are subject to PRC environmental laws and regulations, which include the Environmental Protection Law of the PRC, Law of the PRC on the Prevention and Control of Water Pollution, Law of the PRC on the Prevention and Control of Atmospheric Pollution, Law of the PRC on the Prevention and Control of Pollution From Environmental Noise and Law of the PRC on the Prevention and Control of Environmental Pollution by Solid Waste. These laws and regulations govern a broad range of environmental matters, including air pollution, noise emissions and water and waste discharge. Although we do not operate in a highly pollutive industry, our manufacturing processes generate solid waste and exhaust gas as well as discharge of waste water, which mainly includes water used for cleaning purposes. Our production facilities in Chaozhou, Guangzhou Province and Qiqihaer, Heilongjiang Province have obtained GMP certifications for production management and comply with all relevant

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environmental and manufacturing standards required by the GMP certification system. Each of our production facilities has also obtained relevant pollutant emission permits as required by local environmental administrations.

Our PRC legal advisor, Tian Yuan Law Firm, also confirms that we are in compliance with all applicable PRC environmental laws and regulations. As of the Latest Practicable Date, we have not been subject to any material fines or legal action for non-compliance with any PRC environmental laws or regulations.

INSURANCE

We also maintain insurance policies with respect to property, equipment, and inventory covering losses due to fire, explosion, earthquake, typhoon, flood and certain other risks. We currently do not maintain product liability insurance for our products. To the best knowledge of our Directors, no domestic insurance policy is available for coverage of losses arising from intentional contamination or poisoning by third-parties.

While we believe our insurance policies are adequate and in line with industry norms in China, significant damage to any of our manufacturing and production facilities, whether as a result of fire or other causes, could have a material adverse effect on us. We do not carry business interruption insurance or key-personnel insurance or any policy of a similar nature.

PROPERTIES

Our corporate headquarters, as well as our main production facilities for finished products under the *Yashily* brand, are located in Chaozhou, Guangdong Province. Our main production facilities for finished products under the *Scient* brand are located in Guangzhou, Guangdong Province. We also carry out production at two facilities in Shuozhou, Shanxi Province and Qiqihaer, Heilongjiang Province. We have begun construction of an additional production facility in Zhengzhou, Henan Province.

Owned property

We own three parcels of land in Chaozhou, Guangdong Province, where our production facilities for finished products under the *Yashily* brand and our corporate headquarters are located. We hold the land use rights to two parcels of land that have a total site area of approximately 30,050 m². We are the registered owner of ten building ownership certificates for nine buildings thereon with a total gross floor area of approximately 53,525 m², which we use for production and ancillary purposes. There are three other buildings that house our production workshops and one level of an office building for which we have not obtained building ownership certificates for a total gross floor area of approximately 3,831 m². The Chaozhou Construction Bureau issued a letter dated 30 June 2010, confirming that: (i) the construction of such four buildings was in compliance with laws and regulations from the inception; (ii) they have accepted our application for building ownership certificates in relation to the three buildings; (iii) they would grant the same certificates to us; and (iv) we would not be subject to any fine and/or penalty in relation to the construction of such three buildings. We hold the land use rights to a third parcel of land that has a total site area of approximately 124,670 m². We are the registered owner of seven building ownership certificates for five buildings thereon with a total gross floor area of approximately 79,020.77 m², which we use for production and ancillary purposes. There are five other buildings that house our production workshops for which we have not obtained building ownership

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certificates for a total gross floor area of approximately 17,906 m². The same letter dated 30 June 2010 from Chaozhou Construction Bureau also confirms that: (i) our construction of such five buildings was in compliance with laws and regulations from the inception; (ii) they have accepted our application for building ownership certificates in relation to the five buildings; (iii) they would grant the same certificates to us; and (iv) we would not be subject to any fine and/or penalty in relation to the construction of such five buildings. We also own a property used for staff quarters in Chaozhou, Guangdong Province. We hold the ownership certificates to the property, which consists of eighteen residential units and six car park spaces with a total gross floor area of approximately 3,092.19 m². Tian Yuan has advised that Chaozhou Construction Bureau is the competent authority to issue the letter in respect of the titles of the properties set out above.

We own one parcel of land in Guangzhou, Guangdong Province used for our main production facilities for finished products under the *Scient* brand. We hold the land use rights to the underlying land, which has a total site area of approximately 52,500 m². We own the building ownership certificates for the building located thereon with a total gross floor area of approximately 36,535.69 m² used primarily for production purposes. In addition, we own a property in Guangzhou, Guangdong Province, which comprised 12 office units and 15 car park spaces for owner-occupation purposes and 19 offices units for investment purposes located at various levels of a 29-storey building.

We own one parcel of land in Shuozhou, Shanxi Province for our production facility for semi-finished product for pediatric milk formula. We hold the land use rights to the underlying land, which has a total site area of approximately 245,200 m². We own the building ownership certificates for nine buildings located thereon with a total gross floor area of approximately 48,431 m² used primarily for production, office and staff dormitory purposes. There are seven other buildings and an extension of a dormitory used for production, office and ancillary purposes with a total gross floor area of approximately 16,376 m² for which we have not obtained the building ownership certificates. The Ying County Construction Bureau issued a letter on 30 June 2010, confirming that: (i) the construction of such six buildings was in compliance with laws and regulations from the inception; (ii) they have accepted our application for building ownership certificates in relation to the six buildings; (iii) they would grant the same certificates to us; and (iv) we would not be subject to any fine and/or penalty in relation to the construction of such six buildings. Our PRC legal advisor, Tian Yuan Law Firm, has advised that Ying County Construction Bureau is the competent authority to issue such a letter.

The abovementioned 18 buildings in Chaozhou, Guangdong Province and Ying County, Shanxi Province are all situated on lands of which we hold land use rights. Therefore, our PRC legal adviser, Tian Yuan Law Firm, has advised that there is a very low likelihood of our Group being forced to relocate from the defective properties due to lack of the certificates for which are being applied. Our Directors would expect to acquire building ownership certificates for these buildings by the end of November 2010.

We own one parcel of land in Qiqihaer, Heilongjiang Province for our production facility for semi-finished product for our milk powder for adults and teenagers. We hold the land use rights to the underlying land, which has a total site area of approximately 73,206 m². We own the building ownership certificates for the 14 buildings located thereon with a total gross floor area of approximately 25,996 m² mainly used for production, warehouse and ancillary purposes.

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We own a factory development in Zhengzhou, Henan Province upon which we had begun preliminary construction for a new production facility in 2007. We hold the land use rights to the underlying land, which has a total site area of approximately 60,544 m². A production workshop with a total gross floor area of approximately 25,400 m² is under construction and is expected to be completed in December 2011. We and the land and resources bureau of Zhengzhou City entered into a state-owned construction land use right transfer contract on 30 August 2010 for purchase of one parcel of land, which has a total site area of approximately 85,267 m², for a total consideration of RMB22.92 million for the construction of the new production facility. We paid part of the consideration of RMB11 million and will pay the rest of the consideration, which amounts to RMB11.92 million, before 27 October 2010. We have obtained the construction land use planning permit. We have submitted the required documents for the application of other relevant construction permits to the local environmental and property authorities. Based on the confirmation from the local environmental and property authorities that there is no obstacle to obtaining any relevant construction permit or building ownership certificate, our PRC legal advisor, Tian Yuan Law Firm, has confirmed that we have the right to construct the production workshop and that there is no legal obstacle to obtaining any building ownership certificate.

We also own a residential property in Chaozhou, Guangdong Province with a total gross floor area of approximately 225 m², which is used for staff quarters for Victory Trading.

We own a property in the United States with a total site area of approximately 959.1 m² for investment use.

As advised by our PRC legal advisor, for all the aforementioned buildings to which we have not obtained the building ownership certificates, there is no actual legal obstacle for us to obtain the titles. In the future, where we plan to acquire or construct new properties, we will delegate personnel to handle the application and other matters to ensure full compliance with relevant laws and regulations in a timely manner.

Leased property

We lease a property in Chaozhou, Guangdong Province from Zhang's Investment (Shantou) for production, warehouse and ancillary purposes for our subsidiary, Bisheng. The property consists of a parcel of land with a total site area of approximately 17,176 m² and four buildings thereon with a total gross floor area of approximately 18,613 m². For further details on the lease arrangement, please see "Connected Transactions — Non-exempted continuing connected transactions — 3. The Chaoan lease". The leased property is built on collectively-owned land, which is owned by the committee of the local villagers and is not permitted to be leased to others for non-agricultural or industrial purposes under applicable PRC laws, rules and regulations. We leased the property for industrial purposes. As advised by our PRC legal advisor, Tian Yuan Law Firm, such illegal use of the land may give rise to legal liabilities. In particular, we may be required to relocate. In the event that Bisheng is required to evacuate from the leased property, we plan to relocate the relevant operations and such relocation is expected to be completed within one month. The actual costs would depend on labor and transportation costs and other factors involved. Our Directors estimate that the costs of the potential relocation would be approximately RMB500,000. Our Directors do not expect that the relocation would incur any loss of profit because we believe we can adjust our production schedule to avoid any loss in sales arising from the temporarily reduced production capacity during the relocation. The competent authority may also confiscate the buildings and other premises built on such land and, at the same time, impose fines of no

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more than RMB30 per square meters base on the size of the land. Given the property is mainly used for producing packaging materials of the products of the Group and other ancillary purposes and that it can be relocated to other plants of the Group without significant obstacle, the operation carried on the property leased by Bisheng is not material to its operation as a whole. In addition, since in the unlikely event in which Bisheng is subject to forced removal, we can relocate its operations to a new location without difficulty, our Directors believe that such potential risk would not have any material financial or operational impact on our business.

We lease an office unit in a building in Shanghai from Zhang's Investment (Shantou) with a total gross floor area of approximately 400 m² for office purposes for Yashili (Shanghai). For further details on the lease arrangement, please see "Connected Transactions — Non-exempted continuing connected transactions — 4. The Shanghai lease". Our PRC legal advisor has confirmed that we have entered into a valid lease agreement with the lessor and that we have the right to use the property during the lease period.

We also lease an office unit in a building in Chengdu, Sichuan Province with a total gross floor area of approximately 132 m² for office purposes. The property is leased to us by an Independent Third-Party for a term from 10 June 2010 and expiring on 9 June 2012 at a monthly rent of RMB2,600. Our PRC legal advisor has confirmed that we have entered into a valid lease agreement with the lessor and that we have the right to use the property during the lease period.

We have not registered all the above leases with local administrations of land and property. Tian Yuan has advised that such non-registration will not affect the legality and validity of the leases since, under relevant PRC law and regulation, the potential liability is to be borne by the lessors; therefore there will be no material adverse impact on the operation of the Group.

EMPLOYEES

As of 30 June 2010, we had 5,135 full-time employees as set out in the following table:

Function	Number of employees as of 30 June 2010
Management and administration	284
Production	1,934
Procurement	175
Sales and marketing	2,310
Finance and accounting	160
Quality control	165
Research and development and product design	32
Others ⁽¹⁾	75
Total	5,135

(1) Others mainly include human resource staff, legal and compliance staff and information technology staff. The legal and compliance department consists of six staff, four of whom possess PRC legal qualifications with experience in litigation matters, project management and contract management. The remaining two staff members are assistants.

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Our employee hiring and retention policies are influenced by a number of factors, including current market conditions, business demands and future capacity expansion, and our employees are selected through a competitive process.

We have implemented a number of initiatives in recent years to enhance the productivity of our employees. We conduct periodic performance reviews for all our employees, and base salaries and bonuses are performance-based. In addition, we have implemented training programs for different job requirements. We believe that these initiatives have contributed to increased employee productivity.

The remuneration package for our employees generally includes base salary and performance bonuses. As required by PRC laws, employees also receive welfare benefits including medical care, unemployment and occupational injury insurance. As required by the applicable regulations in China, we participate in various retirement plans organized by municipal and provincial governments for our employees. A member of such plan is entitled to a basic retirement pension. We have fully paid the staff members a housing fund and retirement pension according to PRC rules and regulations.

We believe that the quality of our human resources, particularly our management and professional personnel, is critical to our ability to compete effectively. We aim to achieve and exceed international standards of performance excellence by adhering to international best practices for management processes and corporate governance. We also seek to continue to attract and retain highly skilled and experienced domestic and international management and technical personnel through the continued implementation of our performance bonus programs.

Training

We emphasize the long-term training of our managerial personnel and employees. We hold regular training programs for our management and employees. The training programs focus on providing training to newly hired employees and continuing training for existing employees.

We have also provided regular training for our sales personnel. These training programs include promotional skills training, operational knowledge training and product display training, which seek to improve their knowledge of our products as well as sales and marketing skills to better serve consumers of our products.

LEGAL PROCEEDINGS AND COMPLIANCE

Our Company or any of our subsidiaries may from time to time be involved in litigation incidental to our business operations.

Legal Proceedings and Administrative Sanction Relating to the 2008 Nationwide Melamine Incident

On 16 September 2008, the General Administration of Quality Supervision, Inspection and Quarantine of the PRC, or the AQSIQ, announced that the products of 22 domestic pediatric milk formula producers, including ours, were found to be contaminated by melamine, a substance not approved for use in food and linked to the development of health problems of infants and children in China. Under the prevailing PRC laws and regulations at the time of this incident, the applicable legal consequences for manufacturing or distribution of dairy products contaminated with melamine or other

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harmful substances in the PRC included liabilities for damages suffered by the consumers, penalties from the governmental authorities including suspension of production and distribution, confiscation of the products that have been produced and distributed, a fine in accordance with the value of the products that have been produced or distributed, confiscation of illegal proceeds obtained therefrom, or revocation of the business license. If a criminal offence is involved, the offender shall be prosecuted and subject to criminal liabilities under the relevant laws. For the legal consequences under the current regulatory regime, please refer to the section headed “Regulations” for further information.

As of the Latest Practicable Date, one lawsuit had been filed by a consumer against a retailer and Yashili (Guangdong) on 21 May 2009, alleging to be affected by melamine contamination of our product. The retailer and Yashili (Guangdong) reached a settlement with the plaintiff of RMB30,000 payable by the retailer to the plaintiff and RMB3,029 in legal fees payable by us, that terminated any right to sue for liability associated with this incident in the future. In addition, there was one consumer lawsuit against a retail store which had named our product for suspected cause of kidney illness. A settlement was reached between the retail store and the plaintiff for a sum of RMB11,000, after which the plaintiff agreed to drop all charges. Our PRC legal advisor, Tian Yuan Law Firm, has advised that we will not be subject to any further liabilities or obligations in relation to the alleged matters in such two consumer claims.

We have launched lawsuits against two of the three suppliers who provided dairy materials contaminated with melamine to us. We filed suit against one supplier on 23 April 2009, and the supplier was ordered by the court to pay us approximately RMB7,109,000 as compensation for the melamine-contaminated raw materials it had provided and we had written off the trade payables of RMB2,274,000 to such supplier pursuant to the court judgment. We had received compensation of approximately RMB221,000 from such supplier and is currently in the process of compulsory enforcement of the court judgment for the remaining amount. On 29 December 2009, another supplier was ordered by a court to pay us approximately RMB6,375,000 as compensation for the melamine-contaminated raw materials it had provided and we had received compensation of approximately RMB366,000 from such supplier. However, the latter supplier had also initiated a lawsuit against us in its local jurisdiction for payments of purchase price and breach of contract, and applied to the local court to freeze our deposits totaling RMB9,406,000. Our PRC legal advisor has advised us that the suppliers shall compensate us for any loss and damage we suffered as a result of melamine-contaminated raw materials procured from them, including but not limited to our liabilities arising from any product liability claims against us. We are currently in the process of recovering the remaining compensation from such suppliers through compulsory enforcement of the court judgments. Whether we can receive such amount in full depends on the result of such enforcement proceedings. We reached an agreement on 25 September 2009 with the third supplier to offset our payment obligations to such supplier with the supplier’s liabilities for providing contaminated raw materials. These three raw milk suppliers are no longer our suppliers.

An administrative sanction on Scient (Guangzhou) was levied by Guangzhou Administration of Industry and Commerce on 14 April 2009 for failure to comply with provincial regulations relating to product quality as a result of the 2008 nationwide melamine incident, where the applicable sanctions included: (i) suspension of production and distribution; (ii) confiscation of products with quality issues, revenue derived from such products as well as relevant raw materials, semi-finished products, production equipment and facilities; (iii) revocation of relevant licenses and permits; and (iv) imposition of a fine of up to five times of the value of products with quality issues (in the event that the total value of the products is more than RMB100,000). In light of the timely corrective measures Scient (Guangzhou) put

in place as ordered by the authority, namely the timely recall of contaminated products from the market through distributors, the authority rendered a mitigated administrative sanction based on its discretionary power as provided by relevant administrative laws and regulations, by ordering us to cease the production of products with quality issues and to ensure the recalls and destruction of such products and did not impose any fines on us. Nonetheless, before the date of such sanction, we had conducted the requisite rectifications and resumed production pursuant to the approval of relevant quality and technology supervision authorities and as such, we did not suspend production again when we received the sanction. Our PRC legal advisor, Tian Yuan Law Firm, has confirmed that aside from the administrative sanction mentioned above, there has been no other administrative sanction levied against us. Our Directors also confirm that we are not currently under any investigation or disciplinary action by the PRC government. Our PRC legal advisor, Tian Yuan Law Firm, has further advised that the risk for us to be subject to further administrative sanctions or penalties in relation to the melamine contamination found in our products is little, given the statute of limitations for relevant administrative sanctions will expire soon after two years of the discovery of our incompliance by relevant government agencies pursuant to relevant PRC laws and regulations.

The Background and Operation of the Compensation Fund

In response to the 2008 nationwide melamine incident, the Ministry of Health, the AQSIQ and other national government authorities led efforts to publicize the policies and procedures in place for the treatment and compensation of affected families through various forms of media and announcements. To further ensure that the public received the relevant information and the affected families sought timely treatment and compensation for their infants' illnesses, provincial health administrative authorities assigned personnel to urban as well as rural regions to guide the affected families in seeking diagnosis and medical treatment for their infants. With the approval of the State Council, China Dairy Industry Association and the 22 companies that were found to carry contaminated products set up a compensation fund in late 2008 to compensate victim infants of contaminated milk powder. The compensation fund is operated under the instruction and supervision of the relevant governmental authorities, including the Ministry of Health and the Ministry of Industry and Information Technology. Once affected families receive diagnostic confirmation that their infants have been affected by melamine, relevant health administrative authorities and consumer protection organizations would assign personnel to explain the policies and procedures for making claims through the medical funds. Any victim or his/her family is eligible to claim compensation under the fund if the infant: (i) has been diagnosed that his/her health problems are caused by the consumption of melamine-contaminated milk formula products; (ii) duly registered with relevant health administrative authorities; and (iii) accepted and signed a settlement letter jointly issued by the 22 companies. Compensation from the fund consisted of three components, namely repayment of emergency care costs which have been or are expected to be incurred by the relevant medical institutions, one-off compensation to the affected infants, and a medical care fund which will fully cover any medical costs associated with future illnesses of the urinary system caused by melamine-contaminated products up to 18 years after the victim's first emergency care and which are not covered by the social medical insurance.

Approximately RMB240 million was designated for repaying the emergency care costs advanced or incurred by relevant medical institutions for diagnosing and providing emergency medical treatments to the infants affected by the contaminated milk formula. Approximately RMB671 million of one-off and non-exclusive compensation was distributed to provincial governments and then, in turn, distributed to the affected infants and families through provincial health administrative authorities or consumer

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protection organizations. The China Dairy Industry Association confirms that almost all registered infants have accepted the one-off compensation. The remaining amount of the compensation fund of RMB200 million was designated for establishing a medical care fund entrusted to China Life Insurance Co., Ltd, which is to manage and arrange for the payment of medical costs to the affected infants and their families who agreed to settle their claims for medical costs associated with future illnesses through the branches of China Life Insurance Co., Ltd nationwide. Affected infants and their families who have received the one-off compensation are still eligible for claims of relevant medical costs under the medical care fund. On 8 January 2009, the Ministry of Humans Resources and Social Security, Ministry of Health and the China Insurance Regulatory Committee further jointly published the *Notice of Reimbursement of Medical Expenses for the Infants affected by the Infant Formula Contamination Incident* (關於做好嬰幼兒奶粉事件患兒相關疾病醫療費用支付工作的通知), which set out that the medical care fund is under the direction and supervision of relevant PRC government authorities; it also set out the guidelines regarding the reimbursement of medical expenses to eligible victims under the medical care fund. China Life Insurance Co. is responsible for the management and payment of the medical care fund and shall formulate rules regulating the management of the fund and maintain database of the reimbursement payments by the medical care fund pursuant to such notice. As of the Latest Practicable Date, there was no publicly available information regarding the amount of the medical care fund already paid to affected infants and their families.

As of the Latest Practicable Date, the total amount contributed to the compensation fund by the 22 companies to settle existing and potential claims arising in China from families of infants affected by melamine contamination was approximately RMB1.1 billion. We have authorized China Dairy Industry Association to make such compensation and contributed RMB61.2 million. The amount of contribution from each company, including us, was determined based on the level of melamine contamination found in the milk formula products from the government's sample inspections, and the number of contaminated lots discovered for each company. China Dairy Industry Association has confirmed that in contributing the requested amount to the compensation fund, we have fulfilled our relevant compensation responsibilities to those infants or his/her families who had registered with relevant health administrative authorities or medical institutions for compensation as a result of the 2008 nationwide melamine incident. Furthermore, according to the interview with the China Dairy Industry Association conducted by our PRC legal advisor, Tian Yuan Law Firm, the association also confirmed that if we are held liable by the court to compensate those who had registered with relevant health administrative authorities or medical institutions but did not settle their claims for compensation through the fund, the association will compensate relevant claims on our behalf by utilizing the fund.

However, according to our PRC legal advisor, Tian Yuan Law Firm, for those victims and their families affected by melamine contamination but have not registered with relevant health administrative authorities for their existing and potential claims in relation to the 2008 nationwide melamine incident, they may still bring claims against the manufacturers of contaminated dairy products within the statute of limitations of two years, which shall run from when the plaintiff is aware or should have been aware of the damages or illness he/she suffers and the confirmation of diagnosis of his/her illness resulting from the consumption of the contaminated products. Save for the two claims filed by consumers of our products under this section, we have not received any notice from any court regarding any other claims brought by consumers alleging to be affected by our melamine-contaminated products. Nor are we aware of from publicly available sources any final and valid judicial decisions ruling pediatric milk formula manufacturers to compensate consumers' damages in relation to the melamine contamination. The consumers' awareness about the 2008 nationwide melamine incident and the compensation funds was

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widespread due to the nationwide media coverage at the time of the 2008 nationwide melamine incident since 18 September 2008 and we believe the two-year statute of limitations will expire soon given that under general circumstances the consumer will seek confirmation of diagnosis after their awareness of the 2008 nationwide melamine incident, unless such statute of limitations be interrupted as stipulated by relevant PRC laws and regulations. Our PRC legal advisor, Tian Yuan Law Firm, has advised that the possibility that we will be held liable by the court for compensating the consumers in connection with the 2008 nationwide melamine incident is little. Our Controlling Shareholders have agreed to indemnify us for liabilities arising from any final judicial or arbitration decision for the claims brought by the consumers affected by the incident but have not registered with relevant health administrative authorities for compensation. Our Controlling Shareholders have also undertaken to indemnify us for any payment made pursuant to the settlement we enter into with such consumers as long as the Controlling Shareholders maintain their controlling stakes in us. Based on the foregoing as well as the confirmation letter issued by the China Dairy Industry Association, our Directors believe and our PRC legal adviser, Tian Yuan Law Firm, confirms that the RMB61.2 million contributions to the compensation fund were sufficient, and that no further provision is required in respect of our liabilities under the 2008 nationwide melamine incident.

Other Pending Legal Proceedings

In addition to the legal proceedings disclosed in the foregoing paragraphs under this section, as of the Latest Practicable Date, we were involved in three other legal proceedings relating to disputes on supply contracts and traffic incident brought against us by three individuals and one company of which the total of relief sought from us amounted to approximately RMB2.8 million. As of the Latest Practicable Date, we had launched seven legal proceedings relating to disputes on construction, supply and equipment purchase contracts and our claims to invalidate certain arbitration decisions on labour disputes against three companies and 15 individuals, of which the total relief sought amounted to approximately RMB28.0 million. Such legal proceedings arose in the ordinary course of our business and do not, individually or collectively, have material adverse effect on our business operations. Save for the aforementioned, as of the Latest Practicable Date, we are not aware of any other pending or threatened litigation, arbitration or administrative proceedings against us or any of our subsidiaries which could have a material adverse effect on our operations, financial condition or results of operations.

Furthermore, our PRC legal advisor, Tian Yuan Law Firm, has advised that save for the disclosure under the section headed “— Quality assurance, quality control and safety — Our product recalls and other immediate actions after the 2008 nationwide melamine incident” and this section, we had been in compliance with the PRC laws in all material aspects during the Track Record Period. We had also obtained all requisite licenses, approval and permits for our operations during the Track Record Period, except for certain permits under application process as disclosed under the sections headed “— Properties”.