You should read the following discussion and analysis of our financial condition and results of operations together with our combined financial information as of and for each of the years ended 31 December 2007, 2008 and 2009 and for the six months ended 30 June 2009 and 2010 and the accompanying notes included in the accountants' report set out in Appendix I to this Prospectus. Our combined financial information have been prepared in accordance with IFRS. Potential investors should read the whole of the accountants' report set out in Appendix I to this Prospectus and not rely merely on the information contained in this section. The following discussion and analysis contains forward-looking statements that involve risks and uncertainties. For additional information regarding these risks and uncertainties, please refer to the section headed "Risk Factors" in this Prospectus.

Unless otherwise indicated, all financial data, whether presented on a combined basis or by operating segment, is presented net of inter-segment and/or inter-company transactions (i.e., inter-segment and other inter-company transactions have been eliminated).

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

We are a leader in China's pediatric milk formula products with the third largest market share among domestic companies in 2009, capturing approximately 7.6% of total retail sales in China, according to AC Nielsen. We manufacture, market and sell our pediatric milk formula products under the *Yashily* and *Scient* brands targeting different consumer groups. We are committed to creating trusted nutritional brands and products which promote the healthy development of infants and children throughout China. Our comprehensive milk formula portfolio addresses a broad range of nutritional needs for infants, young children and expectant and nursing mothers. In addition to our core operating segments, we also produce, market and sell other nutritional food products under the *Yashily* brands.

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*. For the years ended 31 December 2007, 2008 and 2009 and for the six months ended 30 June 2010, the revenue generated from our *Yashily* pediatric milk formula products accounted for 48.9%, 54.9%, 59.6% and 61.1% of our total revenue, respectively.

- ***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. For the years ended 31 December 2007, 2008 and 2009 and for the six months ended 30 June 2010, the revenue generated from our *Scient* pediatric milk formula products accounted for 31.6%, 27.5%, 20.2% and 23.2% of our total revenue, respectively.

- **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, and milk powder designed for specific adult consumer groups and teenagers. For the years ended 31 December 2007, 2008 and 2009 and for the six months ended 30 June 2010, the revenue generated from our nutritional food products accounted for 17.5%, 16.5%, 19.6% and 15.2% of our total revenue, respectively.

- **Others** — include: (i) whole milk powder as a raw material in the industrial production of dairy foods, such as ice cream; (ii) packaging materials; (iii) sales of surplus raw material supplies, such as raw milk, to external customers; and (iv) preserved fruit products manufactured by Haoweijia Food sold to external customers. For the years ended 31 December 2007, 2008 and 2009 and for the six months ended 30 June 2010, the revenue generated from our other products, excluding revenue from external sales of our discontinued operation, accounted for 2.0%, 1.1%, 0.6% and 0.5% of our total revenue, respectively.

Basis of Presentation

We were incorporated in the Cayman Islands under the Cayman Companies Law as an exempted company with limited liability on 3 June 2010. In anticipation of the listing of our Shares on the Hong Kong Stock Exchange, we underwent a reorganization in 2010 as detailed under the section headed "History and Corporate Structure — Reorganization" in this Prospectus and "Statutory and General Information — A. Further information about our Group — 1. Incorporation" and "Statutory and General Information — A. Further information about our Group — 2. Changes in share capital of our Company", each included in Appendix VI to this Prospectus.

Yashili (Guangdong) is a holding company of its subsidiaries, which mainly engage in the production and sales of pediatric milk formula and other nutritional food products. Pursuant to the Reorganization, our Company became the intermediate holding company of Yashili (Guangdong) and its subsidiaries. The companies that took part in the Reorganization and now comprise our Group were controlled by the same group of equity shareholders, namely our controlling equity owners, before and after the Reorganization. The control is not transitory and, consequently, there was a continuation of the risks and benefits to the Controlling Shareholders. Therefore, the Reorganization is considered to be a business combination of entities under common control and merger accounting has been applied in the accounting of the Reorganization.

The combined financial information presents the results of operations and financial position of our Company and all of our subsidiaries for the years ended or as of 31 December 2007, 2008 and 2009 and for the six-month period ended or as of 30 June 2010, or where any of our subsidiaries were incorporated/established at a date later than 1 January 2007, for the period from the date of incorporation/establishment of the respective subsidiaries to 30 June 2010 or as of the respective date of incorporation/establishment, as if the Reorganization had been completed at the beginning of the Track Record Period.

All significant inter-company transactions and balances have been eliminated on combination. Our combined subsidiaries as of and for the years ended 31 December 2007, 2008 and 2009 and the six months ended 30 June 2010 are set out in Section A of Appendix I to this Prospectus.

Factors Affecting Our Results of Operations and Financial Condition and Comparability

Our results of operations and the period-to-period comparability of our financial results are affected by a number of external factors. Our combined financial statements may not be indicative of our future earnings, cash flows or financial position for numerous reasons, including but not limited to those described below:

Levels of disposable income, consumer spending and industry growth in the PRC

Substantially all of our products were sold in China during the Track Record Period. As a result, our financial results have been and will continue to be affected by levels of disposable income and consumer spending on pediatric nutrition, dairy and nutritional food products in China. The significant growth of the PRC economy has led to increased per capita disposable income and consumer spending on pediatric nutrition and dairy products. As the fastest-growing market sector in the overall dairy products industry, China's pediatric milk formula market has witnessed an increase in total retail sales value from approximately US$1,780 million in 2005 to US$4,359 million in 2009, representing a CAGR of 25.1%, according to Euromonitor International. We believe China's pediatric milk formula market will continue to expand rapidly due to increased urbanization and disposable income, a stable birth rate and the increasing number of working mothers in China.

We expect that the foregoing factors will continue to drive the growth of China's pediatric milk formula market and that we will benefit from the fast-growing industry with our leading position and strong brand reputation.

Product recalls in late 2008

In 2008, our business was substantially interrupted by the 2008 nationwide melamine incident. See the section headed "Business — Quality assurance, quality control and safety — Background of the 2008 nationwide melamine incident" for more details.

On 17 September 2008, immediately after the 2008 nationwide melamine incident was discovered, we conducted a compulsory recall on all contaminated lots of our products, which were completely destroyed by May 2009 under the supervision of local government authorities. In addition, beginning on 18 October 2008, we also conducted voluntary recalls of all pediatric milk formula products and milk powder for adults and teenagers manufactured before 14 September 2008, which were subsequently destroyed under the supervision of local government authorities by March 2010. The 2008 nationwide melamine incident, though caused by illegal acts of raw milk dealers, severely damaged our reputation and our business suffered significant losses from product recalls, inventory write down/write-off and subsequent loss of sales. Due to the product recalls, we incurred losses arising from the melamine incident of RMB787.1 million and had a net loss of RMB614.8 million in 2008. 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 recalls in 2008, we 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 had not been met as a result of the sales 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 from September

2008. Due to the impact of the 2008 nationwide melamine incident and the product recalls, our financial results during the Track Record Period showed significant volatility and may not be indicative and comparable. Please also refer to relevant disclosure under the section headed "Risk Factors — Risks relating to our business operations — We have recently incurred operating losses and decrease in revenue, therefore our results of operation during the Track Record Period may not be indicative and comparable and we may not be able to achieve and sustain the historical level of revenue and profitability."

The product recalls have been completed and, based on current information, we do not expect to incur further material product recalls cost relating to such incident. We believe that our fast response to and immediate actions after the 2008 nationwide melamine incident, including conducting voluntary recalls, were well recognized by the public and helped us maintain our reputation, brand recognition and relationships with our distributors and suppliers. However, there can be no assurance that similar incidents will not be identified in the future. Such an event may trigger wider negative perception of quality and safety of all producers in the industry and this may have an adverse effect on our results of operations. Also see "Risk Factors — Risks relating to our business operations — We are highly dependent upon consumers' perception of the safety and quality of our products and particularly susceptible to any ill effects, product liability claims, recalls, adverse publicity or negative public perception regarding particular ingredients or products or our industry in general."

Consumer perception of product quality and safety

Rising income in China and greater consumer sophistication have led to higher demand for quality pediatric dairy products. Therefore, we believe that pediatric milk formula producers with a reputation for quality and safety should be able to command higher average selling prices and capture larger market shares than competitors who do not possess the same perceived reputation. On the other hand, any perceived decrease in the quality and safety of our products could significantly impact our sales and profit.

Nonetheless, we believe that the 2008 nationwide melamine incident has further enhanced consumer's awareness of product quality and safety and improved industry-wide quality control standards. We have made a serious commitment to respond to this incident, including prompt product recalls and exchanges and implementation of a comprehensive quality control system spanning the entire production chain to ensure the quality and safety of our products. We also made a strategic decision to source all of our raw milk powder for pediatric formula products from reputable suppliers in New Zealand and Australia. We expect to continue to provide safe and high-quality products to meet the nutritional needs of infants, young children and expectant and nursing mothers. Further details are set out in the section headed "Business — Quality assurance, quality control and safety — Quality control systems".

Competition and brand recognition

Due to China's enormous economic potential and the expected growth of the pediatric milk formula market, industry competition is intense. A small number of established national brands enjoy significant market share and brand name recognition in China. We believe that these companies will gradually capture market share from smaller regional brands. In order to distinguish ourselves and enhance our market position, we continuously invest in marketing activities and cultivate customer loyalty and brand awareness by employing a variety of marketing and promotional channels. Such channels include advertising in traditional and new media outlets, brand-building activities, and outreach to potential customers by hosting educational activities with health organizations and birth centers. We plan to allocate more resources to our promotional and marketing activities, which will provide us with opportunities to solidify our leading brand image and further grow our business.

Distribution network and sales force

We rely on our network of regional distributors to place our products through retail outlets to reach end consumers. The effectiveness and geographic reach of our distribution network and sales force directly impact our operations. During the Track Record Period, we managed to maintain a comprehensive distribution network and had developed strong relationships with our regional distributor customers. As of 30 June 2010, we sold our products to end consumers through over 1,300 regional distributors, who further distributed our products to various retail locations across every province, municipality and autonomous region in China. In addition to our over 2,000 sales force and marketing personnel, more than 28,000 commissioned sales promoters had been dispatched to over 19,000 select retail locations to promote and sell our products.

To further expand our distribution network, we plan to increase the number of qualified regional distributors and retail sales locations to broaden our sales coverage. In addition, we will explore new sales platforms, such as online sales, in order to develop a multi-channel sales strategy and serve different consumer groups.

Product price and product mix

The prices of our products are generally determined based on several factors, including our promotional policies and marketing strategy, cost of sales, target consumer groups, brand positioning, market competition as well as fluctuations in supply and demand in the domestic market. As of the Latest Practicable Date, selling prices of all our products were not subject to price controls imposed by the PRC Government.

The mix of products within our product portfolio also directly affects our profitability. We offer a range of pediatric milk formula products targeting different consumer groups under the *Yashily* and *Scient* brands, as well as selections of other nutritional food products. During the Track Record Period, our main revenue source was from the sales of our pediatric milk formula products, which accounted for over 75% of our total annual revenue. As a result, our gross profit margin is also determined by the combination of various products within and across operating segments, especially our pediatric milk formula products, and may fluctuate as a result of any introduction of new products.

Cost of raw materials and supply

The key component of our cost of sales is the raw material costs, such as raw milk powder, raw milk, soybeans and other ingredients for our pediatric milk formula and nutritional food products. Cost of raw materials accounted for 81.1%, 77.2%, 71.8% and 75.1% of our total costs of sales for the years ended 31 December 2007, 2008 and 2009 and the six months ended 30 June 2010, respectively. In order to distinguish ourselves from major domestic brand competitors, who generally source all or part of their raw materials locally, we made a major strategic decision in late 2008 to transition from sourcing domestically produced dairy materials to importing high-quality raw milk powder from established overseas suppliers. We currently import all raw milk powder from high-quality overseas suppliers in New Zealand and Australia for our pediatric milk formula products.

The prices for raw milk powder or other raw materials are volatile and affected by supply and demand. In particular, our ability to pass on part or all of our cost increase to our customers largely depends on market conditions and pricing methods employed in the markets we operate. During the Track Record Period, we had been able to manage our raw material procurement prices, enhance our operating efficiency and, to a lesser extent, increase selling price of our products to maintain the competitiveness of our products as well as our profitability. However, if the portion of the increased raw material costs cannot be compensated by utilizing cost-competitive measures for our production or by raising the price of our products due to consumer sensitivity to pricing or otherwise, we may not be able to maintain historical levels of profitability and our gross margin could be reduced.

Preferential Tax Treatments

We enjoy substantial income tax reductions under various tax incentive programs applicable to our PRC subsidiaries on a stand-alone basis. Pursuant to the then applicable PRC national and local tax laws, our PRC subsidiaries were subject to the EIT at the statutory rate of 33% in 2007. Since 1 January 2008, under the new EIT laws promulgated on 16 March 2007, the EIT was reduced from 33% to a uniform tax rate of 25% on all PRC enterprises, including foreign-invested enterprises, unless they qualify for preferential tax rates under certain limited circumstances. According to the new EIT laws, the income tax rate of the enterprises established prior to the publication of the new EIT laws and entitled to preferential tax rates, specifically with respect to those preferential tax rates of 15% in 2007, will gradually increase to 18% in 2008, 20% in 2009, 22% in 2010, 24% in 2011 and 25% in 2012.

Although the standard income tax rate in the PRC was 33% in 2007 and 25% in 2008 and 2009, some of our subsidiaries enjoyed preferential tax treatment during the Track Record Period. Yashili (Guangdong) is a foreign invested enterprise, or FIE, and was entitled to a two-year income tax exemption in 2006 and 2007, followed by a 50% tax reduction for three years from 2008 to 2010. Scient (Guangzhou) is a FIE, which engages in manufacturing and is entitled to preferential income tax rates of 15% in 2007, 18% in 2008, 20% in 2009 and 22% in 2010. Scient (Guangzhou) was also exempted from enterprise income tax for two years commencing from its first year with assessable profits after deducting tax losses brought forward in 2004 and was entitled to a 50% tax reduction for the subsequent three years from 2006. In addition, Scient (Guangzhou) was entitled to another two-year exemption and three-year tax reduction with respect to the EIT for the re-investment in Scient (Guangzhou) from undistributed profit in 2005, which began taking effect in 2008 and was applicable to the taxable income derived from the new plant of Scient (Guangzhou). However, Scient (Guangzhou) did not enjoy such tax exemption and reduction due to its losses in 2008 and 2009. Yashili (Heilongjiang) is a manufacturing enterprise established in Tailai County of Heilongjiang Province, which is a remote and impoverished area, and was entitled to a three-year exemption from the EIT since its commencement of operations in 2005. As a result, Yashili (Heilongjiang) was exempted from income tax until 2007. Yashili (Zhengzhou), a FIE established in the Zhengzhou Economic and Technological Development Zone, was exempted from EIT for two years commencing from its first year with assessable profits after deducting tax losses brought forward and was entitled to a 50% tax reduction for the subsequent three years and a preferential tax rate of 15%. Yashili (Zhengzhou) sustained a tax loss for 2007 and was required to start its tax holiday in 2008.

The table below sets out the enterprise income tax rates of the members of our Group which were/are entitled to PRC preferential tax treatments during the Track Record Period and thereafter; however, such preferential tax treatments and statutory tax rates may be subject to further changes in the future:

	2007	2008	2009	2010	2011	2012
Yashili (Guangdong)	0%	12.5%	12.5%	12.5%	25%	25%
Scient (Guangzhou)[1]	7.5%	9%	20%	22%	24%	25%
Yashili (Heilongjiang)	0%	25%	25%	25%	25%	25%
Yashili (Zhengzhou)	N/A	0%	0%	11%	12%	12.5%

(1) Scient (Guangzhou) was also entitled to another two-year exemption and three-year tax reduction with respect to the EIT for the re-investment in Scient (Guangzhou) from undistributed profit in 2005, starting from 2008.

Termination or revision of various types of PRC preferential tax treatments that certain of our subsidiaries currently enjoy would have a negative impact on our financial condition and results of operations.

Other than the aforementioned subsidiaries that enjoy preferential tax treatments, the rest of our PRC subsidiaries had been subject to the applicable standard PRC enterprise income tax rate during the Track Record Period. Scient (USA), our indirect subsidiary incorporated in the state of Texas of the United States, did not enjoy any preferential tax treatment during the Track Record Period.

As a result of the foregoing, our effective tax rate was 4.8% in 2007, 14.6% in 2009 and 15.4% in the six months ended 30 June 2010, respectively. In 2008, we recorded an income tax credit due to our net loss for the year resulting from the product recalls.

Critical Accounting Policies and Estimates

The discussion and analysis of our results of operations and financial conditions is based on our combined financial information, which have been prepared in accordance with IFRS. Our results of operations and financial condition are sensitive to accounting policies, assumptions and estimates that underlie the preparation of our combined financial information. The assumptions and estimates are based on historical experience and other various factors which we currently believe to be reasonable, and the results of which form the basis for making judgments on matters that are not readily apparent from other sources. Our management evaluates these estimates on an ongoing basis. Actual results may differ from these assumptions and estimates as the facts, circumstances and conditions underlying these assumptions may change.

Our management team considers the following factors in reviewing the respective combined financial information:

- the selection of critical accounting policies; and
- the judgments and other uncertainties affecting the application of those critical accounting policies.

The selection of critical accounting policies, the judgments and other uncertainties affecting the application of those policies as well as the sensitivity of reported results to changes in conditions and assumptions are all factors to be considered when reviewing our financial information. Our significant accounting policies are summarized in Section C-1 to the Accountants' Report of our Company in Appendix I to this Prospectus. We believe the following critical accounting policies and estimates involve the most significant estimates and judgments used in the preparation of our combined financial information.

Revenue Recognition

Revenue from the sale of goods is measured at the fair value of the consideration received or receivable, net of returns and allowances, trade discounts and volume rebates and excluding value-added tax or other sales taxes. Revenue is recognized when the significant risks and rewards of ownership have been transferred to our customers, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably, and there is no continuing management involvement with the goods. If it is probable that discounts will be granted and the amount can be measured reliably, the discount is recognized as a reduction of revenue as the sales are recognized.

Depreciation and amortization

Property, plant and equipment, investment properties and intangible assets are depreciated and amortized using the straight-line method over their useful lives after taking into account residual value. The useful lives are regularly reviewed to determine the depreciation and amortization costs charged in each reporting period. The useful lives are determined based on our historical experience of similar assets and the estimated technical changes. If there is an indication that there has been a change in the factors used to determine the depreciation or amortization, the amount of depreciation or amortization will be revised.

Impairment

Receivables

Receivables are reviewed at each reporting date to determine whether there is objective evidence of impairment. If any such evidence exists, impairment loss is provided. Objective evidence of impairment includes observable data that comes to our attention about loss events, such as a significant decline in the estimated future cash flow of an individual debtor or the portfolio of debtors and significant changes in the financial condition that have an adverse effect on the debtor. If there is an indication that there has been a change in the factors used to determine the provision for impairment, the impairment loss recognized in prior years will be reversed.

Non-financial long-term assets

Non-financial long-term assets are reviewed at each reporting date to determine whether the carrying amount exceeds the recoverable amount of the assets. If any such indication exists, impairment loss is provided. The recoverable amount of an asset (asset group) is the greater of its net selling price and its present value of expected future cash flows. Since the market price of an asset (asset group) cannot be obtained reliably, the fair value of the asset cannot be estimated reliably. In assessing value in use, significant judgments are exercised over the asset's production, selling price, related operating expenses and discount rate to calculate the present value. All relevant materials which can be obtained are used for estimation of the recoverable amount, including the estimation of the production, selling price and related operating expenses based on reasonable and supportable assumptions.

Inventories

Inventories are recorded at the lower of cost and net realizable value. Any excess of the cost over the net realizable value of each class of inventories is recognized as a provision for diminution in the value of inventories.

Net realizable value is the estimated selling price in the normal course of business less the estimated costs to completion and the estimated expenses necessary to make the sales. For inventories with committed sales orders or active market, we estimate the net realizable value with reference to the selling prices set out in the committed sales orders or in the active market. For inventories without committed sales orders or active market, we carefully estimate the net realizable value based on available information and reasonable and supportive assumptions on expected selling prices, manufacturing costs, selling expenses, sales taxes and other assumptions.

Deferred tax assets

Deferred tax assets arising from deductible temporary differences and tax losses are recognized to the extent that it is probable that future taxable income will be available against which deductible temporary differences and tax losses can be utilized. The outcome of their actual utilization may be different.

Description of Components of Results of Continued Operations

Revenue

By operating segments

We engage in and generate all of our revenue from the sales of pediatric milk formula, nutritional food products and other products. Revenue represents the sales value of the products supplied to our customers, excluding sales taxes and surcharges and after deduction of trade discounts. The table below sets forth a breakdown of our external segment revenue and the percentage of each segment revenue item, after elimination of inter-segment sales and excluding revenue from external sales of our discontinued operation in 2007, of our total revenue for the periods indicated:

	Year ended 31 December						Six months ended 30 June			
	2007		2008		2009		2009		2010	
	(RMB million)	%	(RMB million)	%	(RMB million)	%	(RMB million)	%	(RMB million)	%
							(Unaudited)			
External Segment Revenue										
***Yashily* pediatric milk formula**	1,415.2	48.9	1,511.8	54.9	1,540.4	59.6	815.4	59.3	840.5	61.1
***Scient* pediatric milk formula**	912.8	31.6	755.0	27.5	521.3	20.2	284.0	20.6	319.3	23.2
Nutritional food products	506.6	17.5	454.2	16.5	507.6	19.6	273.7	19.9	208.9	15.2
Others	57.6	2.0	30.6	1.1	16.7	0.6	3.1	0.2	6.8	0.5
Total External Revenue	2,892.2	100.0	2,751.6	100.0	2,586.0	100.0	1,376.2	100.0	1,375.5	100.0

During the Track Record Period, we generated the majority of our revenue from the sales of pediatric milk formula products under the *Yashily* and *Scient* brands. We also generated revenue from the sales of nutritional food products, including soymilk powder and cereal in different formulas for specific adult age groups as well as for the general population, rice flour in different formula for infants under two years old, and milk powder for adults and teenagers. Substantially all of our pediatric milk formula and nutritional food products were distributed to retail channels through regional distributors and, to a limited extent, we also conducted direct sales to certain key account customers, who were major national and regional retail chains. 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 of pediatric milk formula and nutritional food products during the same periods. Our direct sales of pediatric milk formula and nutritional food products were RMB94.5 million, RMB56.2 million, RMB23.7 million and RMB22.5 million in 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 of pediatric milk formula and nutritional food products during the same periods. Given the credit exposure related to the trade receivables from conducting direct sales, we have been focusing on sales of our products through distributors and intend to limit our direct sales.

To a lesser and limited extent, we also generated revenue from the external sales of whole milk powder for industrial use, packaging materials and sales of surplus raw material supplies, such as raw milk and preserved fruit products manufactured by Haoweijia Food. The revenue from external sales of our discontinued operation in 2007 was eliminated from our combined revenue.

Our revenue on a combined basis is presented after elimination of inter-segment sales. As a result, only income generated from sales made to external customers are accounted for as our revenue. For the years ended 31 December 2007, 2008 and 2009 and the six months ended 30 June 2009 and 2010, our revenues were RMB2,892.2 million, RMB2,751.6 million, RMB2,586.0 million, RMB1,376.2 million and RMB1,375.5 million, respectively. Our inter-segment sales were mainly derived from sales of packaging materials from our other operation to *Yashily* pediatric milk formula, *Scient* pediatric milk formula and nutritional food products segments. For the years ended 31 December 2007, 2008 and 2009 and the six months ended 30 June 2009 and 2010, our inter-segment revenues were RMB41.9 million, RMB129.7 million, RMB99.8 million, RMB53.5 million and RMB50.3 million, respectively.

By geographical region

The following table sets forth a geographical breakdown of the revenue derived from the sales of our *Yashily* pediatric milk formula and nutritional food products for the periods indicated:

	Year ended 31 December						Six months ended 30 June			
	2007		2008		2009		2009		2010	
	(RMB million)	(%)	(RMB million)	(%)	(RMB million)	(%)	(RMB million)	(%)	(RMB million)	(%)
							(Unaudited)			
Eastern China I[1]	432.3	22.5	397.9	20.2	430.3	21.0	233.1	21.4	209.0	19.9
Eastern China II[2]	286.8	14.9	278.7	14.2	325.0	15.9	176.6	16.2	154.9	14.8
Southern China I[3]	395.0	20.6	316.0	16.1	278.3	13.6	137.2	12.6	153.8	14.6
Southern China II[4]	289.7	15.1	402.2	20.5	408.8	20.0	221.1	20.3	230.5	22.0
Northern China[5]	263.7	13.7	271.9	13.8	304.3	14.9	160.8	14.8	153.0	14.6
Western China[6]	254.3	13.2	299.3	15.2	301.3	14.7	160.3	14.7	148.2	14.1
Total	1,921.8	100.0	1,966.0	100.0	2,048.0	100.0	1,089.1	100.0	1,049.4	100.0

(1) Includes Shandong, Jiangsu and Henan provinces.

(2) Includes Anhui, Hubei and Zhejiang provinces and Shanghai municipality.

(3) Includes Fujian, Hainan and Guangdong provinces.

(4) Includes Guangxi, Guizhou, Hunan and Jiangxi provinces.

(5) Includes Beijing and Tianjin municipalities, Hebei, Jilin, Liaoning, Heilongjiang and Shanxi provinces and Inner Mongolia autonomous region.

(6) Includes Sichuan, Shaanxi, Gansu, Qinghai, Yunnan and Xinjiang provinces, Chongqing municipality and Ningxia and Tibet autonomous regions.

The following table sets forth a geographical breakdown of the revenue derived from the sales of our *Scient* pediatric milk formula products for the periods indicated:

	Year ended 31 December						Six months ended 30 June			
	2007		2008		2009		2009		2010	
	(RMB million)	(%)	(RMB million)	(%)	(RMB million)	(%)	(RMB million)	(%)	(RMB million)	(%)
							(Unaudited)			
Southern China[1]	391.6	42.9	282.6	37.4	148.5	28.5	77.2	27.2	96.8	30.3
Eastern China[2]	271.5	29.7	228.3	30.2	150.8	28.9	87.3	30.7	91.5	28.7
Northern China[3]	106.1	11.6	114.0	15.1	117.4	22.5	63.7	22.4	70.1	22.0
Western China[4]	143.6	15.7	130.1	17.2	104.6	20.2	55.8	19.6	60.9	19.0
Total	912.8	100.0	755.0	100.0	521.3	100.0	284.0	100.0	319.3	100.0

(1) Includes Guangdong, Fujian, Hainan and Jiangxi provinces.

(2) Includes Hunan, Hubei, Anhui, Zhejiang and Jiangsu provinces and Shanghai municipality.

(3) Includes Shandong, Henan, Hebei, Liaoning, Heilongjiang and Jilin provinces and Beijing and Tianjin municipalities.

(4) Includes Guangxi, Guizhou,Yunan, Shaanxi, Shanxi, Sichuan, Gansu and Xinjiang provinces and Chongqing municipality.

By city tier

The following table sets forth a breakdown of the revenue derived from the sales of our *Yashily* pediatric milk formula products in different city tiers during the periods indicated:

	Year ended 31 December						Six months ended 30 June			
	2007		2008		2009		2009		2010	
	(RMB million)	(%)	(RMB million)	(%)	(RMB million)	(%)	(RMB million) (Unaudited)	(%)	(RMB million)	(%)
Revenue of *Yashily* pediatric milk formula derived from:										
— First-tier cities(1)	304.5	21.5%	347.7	23.0%	304.1	19.7%	143.3	17.6%	152.1	18.1%
— Second-tier cities(2)	771.5	54.5%	830.3	54.9%	865.7	56.2%	475.3	58.3%	467.7	55.6%
— Third-tier cities and others(3)	339.2	24.0%	333.8	22.1%	370.6	24.1%	196.8	24.1%	220.7	26.3%
Total	1,415.2	100%	1,511.8	100%	1,540.4	100%	815.4	100%	840.5	100%

(1) Examples include Beijing, Shanghai, Nanchang, Chongqing, Shijiazhuang and Guangzhou.

(2) Examples include Dongguan, Nanyang, Jiujiang, Shenzhen and Foshan.

(3) Examples include Jinjiang, Yunmeng, Bozhou, Kunshan and Luohe.

The following table sets forth a breakdown of the revenue derived from the sales of our *Scient* pediatric milk formula products in different city tiers during the periods indicated:

	Year ended 31 December						Six months ended 30 June			
	2007		2008		2009		2009		2010	
	(RMB million)	(%)	(RMB million)	(%)	(RMB million)	(%)	(RMB million) (Unaudited)	(%)	(RMB million)	(%)
Revenue of *Scient* pediatric milk formula derived from:										
— First-tier cities(1)	217.4	23.8%	165.6	21.9%	95.0	18.2%	54.1	19.1%	48.5	15.2%
— Second-tier cities(2)	620.1	67.9%	528.0	69.9%	379.1	72.7%	205.7	72.4%	235.1	73.6%
— Third-tier cities and others(3)	75.3	8.3%	61.4	8.2%	47.2	9.1%	24.2	8.5%	35.7	11.2%
Total	912.8	100%	755.0	100%	521.3	100%	284.0	100%	319.3	100%

(1) Examples include Beijing, Shanghai, Nanchang, Chongqing, Shijiazhuang and Guangzhou.

(2) Examples include Dongguan, Nanyang, Jiujiang, Shenzhen and Foshan.

(3) Examples include Jinjiang, Yunmeng, Bozhou, Kunshan and Luohe.

Sales volume and average selling price

Our sales revenues are determined by our sales volume and the prices at which we sell our products. The following table sets forth the sales volume and price information of our *Yashily* pediatric milk formula, *Scient* pediatric milk formula and nutritional food products for the periods indicated:

	Year ended 31 December						Six months ended 30 June			
	2007		2008		2009		2009		2010	
	Sales volume	Average selling price	Sales volume	Average selling price	Sales volume	Average selling price	Sales volume	Average selling price	Sales volume	Average selling price
	(tonne)	(RMB per tonne)	(tonne)	(RMB per tonne)	(tonne)	(RMB per tonne)	(tonne)	(RMB per tonne)	(tonne)	(RMB per tonne)
Yashily pediatric milk formula. . .	25,181	56,201	25,049	60,355	23,813	64,689	13,439	60,674	11,581	72,579
Scient pediatric milk formula . . .	13,306	68,600	11,919	63,343	8,084	64,480	4,368	65,012	4,393	72,657
Nutritional food products	35,971	14,081	31,639	14,355	32,229	15,750	18,107	15,115	11,056	18,897

Cost of Sales

By type

Cost of sales represents the direct costs of production, which include primarily costs of raw materials, costs of packaging materials, labor costs and manufacturing overheads. The following table sets forth a breakdown of our cost of sales for the periods indicated:

	Year ended 31 December						Six months ended 30 June			
	2007		2008		2009		2009		2010	
	(RMB million)	(%)	(RMB million)	(%)	(RMB million)	(%)	(RMB million)	(%)	(RMB million)	(%)
							(unaudited)			
Cost of sales										
Raw materials	1,328.3	81.1	1,130.6	77.2	786.7	71.8	448.2	71.3	423.4	75.1
Packaging materials.	205.1	12.5	186.2	12.8	152.9	14.0	86.7	13.8	68.1	12.1
Labor.	25.5	1.6	23.9	1.6	27.5	2.5	16.3	2.6	13.5	2.4
Manufacturing overheads	78.2	4.8	123.0	8.4	128.5	11.7	77.5	12.3	58.8	10.4
Total cost of sales	1,637.1	100.0	1,463.7	100.0	1,095.6	100.0	628.7	100.0	563.9	100.0

Raw material costs, including the costs of raw milk powder and other raw materials for our pediatric milk formula and nutritional food products, were the main component of our cost of sales. Raw milk and/or raw milk powder is the key raw dairy material used in our pediatric milk formula products. We made a major strategic decision in late 2008 to transition from sourcing domestically produced dairy materials to importing high-quality raw milk powder from established overseas suppliers in New Zealand and Australia. Furthermore, due to the lower price of imported raw milk powder compared to domestic milk sources in 2008 and 2009, we strategically imported a large quantity of raw milk powder from overseas starting from late 2008, which lowered our raw material costs. Imported raw milk powder prices are susceptible to volatility caused by conditions beyond our control, including changes in environmental, climate, economic, political and social conditions, modifications of governmental agricultural programs in the origins of our raw milk powder sources, supply and demand, currency fluctuations as well as fluctuations in regional and global commodities markets. We believe that the relatively low prices of imported raw milk powder from late 2008 to 2009 were primarily due to various factors, including inflation, rising fuel prices and production costs in 2007 and 2008, significant fluctuations in global economic conditions and the commodity market since late 2008 as well as the appreciation of Renminbi. Our costs of raw milk and/or raw milk powder were RMB826.8 millions, RMB612.2 million and RMB414.0 million for the years ended 31 December 2007, 2008 and 2009, respectively, and accounted for 62.3%, 54.1% and 52.6% of our raw material costs and 50.5%, 41.8% and 37.8% of our total costs of sales during the same periods, respectively. Our costs of raw milk and/or raw milk powder for the six months ended 30 June 2010 was RMB234.8 million, accounting for 55.4% of our raw material costs and 41.6% of our total cost of sales, primarily due to the increase in our average purchase price of raw milk powder in the first half of 2010. During the Track Record Period, our average purchase prices of imported raw milk powder had been in line with the commodity market price trend. Our purchase prices for domestic raw milk had been fluctuating during the Track Record Period where the average prices in 2007 and 2009 were relatively low and the average prices in 2008 and 2010 were higher, which also affected our raw material costs and results of operations to a lesser extent. The fluctuation in purchase prices and the availability of domestic raw milk/imported raw milk powder had affected our raw material costs and operations, and our financial results during the Track Record Period may not be comparable after our transition to importing raw milk powder from overseas sources beginning at the end of 2008. In addition, our cost of raw materials also included the amount of RMB9.1 million we paid in 2009 to PBM Products for manufacturing *Scient* Imported Skimmed Pediatric Milk Formula products, which we launched in June 2009. Other raw materials included nutritional ingredients for our pediatric milk formula products, such as lactose, whey protein, minerals and vitamins, and other major raw materials for the production of our nutritional food products, such as raw milk, soybean, flour and ground corn powder.

Packaging material costs mainly represent the costs of raw materials for our packaging materials, such as printed cardboard boxes, aluminum foil packages, cans and others. Labor costs comprised mainly of wages for our employees working at our production facilities. Manufacturing overheads include utility costs for our plants, indirect plant supplies, repair and maintenance expenses and depreciation and amortization expenses.

By operating segment

Cost of sales for each operating segment during the Track Record Period was as follows:

	Year ended 31 December						Six months ended 30 June			
	2007		2008		2009		2009		2010	
	(RMB million)	(%)	(RMB million)	(%)	(RMB million)	(%)	(RMB million)	(%)	(RMB million)	(%)
							(unaudited)			
Cost of sales										
Yashily pediatric milk formula	847.5	51.8	731.6	50.0	570.4	52.1	342.3	54.4	306.3	54.3
Scient pediatric milk formula	364.6	22.3	374.8	25.6	228.3	20.8	123.9	19.7	133.2	23.6
Nutritional food products	373.4	22.8	330.8	22.6	283.4	25.9	159.9	25.4	118.7	21.0
Others	51.6	3.1	26.5	1.8	13.5	1.2	2.6	0.5	5.7	1.1
Total cost of sales	1,637.1	100.0	1,463.7	100.0	1,095.6	100.0	628.7	100.0	563.9	100.0

Gross profit

Gross profit is equal to revenue less cost of sales and gross profit margin is equal to gross profit divided by revenue. For the years ended 31 December 2007, 2008 and 2009 and the six months ended 30 June 2009 and 2010, our gross profit was RMB1,255.1 million, RMB1,287.9 million, RMB1,490.4 million, RMB747.5 million and RMB811.6 million and our gross profit margin was 43.4%, 46.8%, 57.6%, 54.3% and 59.0%, respectively. The following table sets forth our gross profit and gross profit margin by product segments for the periods indicated:

	Year ended 31 December						Six month ended 30 June			
	2007		2008		2009		2009		2010	
	Gross profit	Gross profit margin	Gross profit	Gross profit margin	Gross profit	Gross profit margin	Gross profit	Gross profit margin	Gross profit	Gross profit margin
	(RMB million)	(%)	(RMB million)	(%)	(RMB million)	(%)	(RMB million)	(%)	(RMB million)	(%)
							(Unaudited)			
Yashily pediatric milk formula	567.7	40.1	780.2	51.6	970.0	63.0	473.1	58.0	534.3	63.6
Scient pediatric milk formula	548.2	60.1	380.2	50.4	293.0	56.2	160.1	56.4	186.1	58.3
Nutritional food products	133.2	26.3	123.4	27.2	224.2	44.2	113.8	41.6	90.2	43.2
Others	6.1	10.6	4.1	13.4	3.2	19.3	0.5	16.1	1.1	16.2
Total gross profit/gross profit margin	1,255.1	43.4	1,287.9	46.8	1,490.4	57.6	747.5	54.3	811.6	59.0

The increases in gross profit margin of *Yashily* pediatric milk formula products during the Track Record Period were primarily attributable to: (i) the upgrade and improvement of our manufacturing technology and equipment, which enhanced production efficiency and reduced cost; (ii) changes of product mix within the *Yashily* pediatric milk formula segment to focus on sales of premium products with higher margins, namely *Yashily* α-Golden Stage; (iii) the changes of raw material costs; and (iv) the increase in selling prices of *Yashily* pediatric milk formula products.

The changes in gross profit margin of *Scient* pediatric milk formula products during the Track Record Period were primarily attributable to: (i) the fluctuation in raw material costs; (ii) the promotion policy to provide complimentary small packages of pediatric milk formula; (iii) the increase in sales of products with higher selling prices and gross margins; and (iv) the increase in selling prices of *Scient* pediatric milk formula products in general.

The changes in gross profit margin of our nutritional food products during the Track Record Period were primarily attributable to: (i) the changes in raw material costs; and (ii) the changes in revenue composition within the nutritional food segment, where the products with higher margins, such as milk powder, rice flour and cereal, accounted for a higher percentage of sales.

Other revenue

Other revenue mainly consisted of government grants, compensation income, write-off of trade payables, rental income, reversal of input VAT transferred out and others. The primary source of our other revenue was government grants we received from various local government organizations in the form of cash subsidies, amounting to RMB19.3 million, RMB12.1 million, RMB19.6 million, RMB14.9 million and RMB6.7 million for the years ended 31 December 2007, 2008 and 2009 and the six months ended 30 June 2009 and 2010, respectively. These government grants primarily consisted of unconditional subsidies for the purpose of developing our business operations and helping us to recover from the 2008 nationwide melamine incident as well as conditional subsidies in the form of tax refunds for the purpose of encouraging our expansion in sales and production.

Other revenue also consisted of compensation income, including the compensation we received from distributors for cross-territory sales that breached the terms of the distribution agreement as well as the damages of RMB6.0 million we recovered in a legal proceeding in connection with the property of Scient (Guangzhou) for office use in 2009. We made write-offs for trade payables of RMB2.3 million for the year ended 31 December 2009 pursuant to final court judgments that discharged our payment obligations for trade payables due to one domestic supplier of base milk powder. Such base milk powder was proved to be contaminated by melamine. We also made other write-offs of trade payables to other suppliers due to shortage of quantity or damage of raw materials during the transportation process. In addition, we received rental income from the leases of the office building of Scient (Guangzhou) in Guangzhou, Guangdong Province, to third parties of RMB1.0 million in 2008, RMB1.5 million in 2009 and RMB1.9 million for the six months ended 30 June 2010. Reversal of input VAT transfer-out of RMB22.8 million in 2008 was approved by the local tax bureau in relation to our previous input VAT transfer-out in 2008 regarding the write-off and destruction of inventories during the 2008 nationwide melamine incident.

For the years ended 31 December 2007, 2008 and 2009 and the six months ended 30 June 2009 and 2010, our other revenue was RMB20.2 million, RMB17.0 million, RMB34.7 million, RMB18.4 million and RMB34.9 million, respectively.

Other net loss/income

Other net loss or income primarily relates to the loss or profit derived from the disposal of our plant and building, machinery and equipment, motor vehicle and other fixed assets, which is attributable to the differences between the net book value of and the consideration received for such assets. For the years ended 31 December 2007 and 2008 and the six months ended 30 June 2010, we had an other net loss of RMB139,000, RMB1,042,000 and RMB69,000, respectively. For the six months ended 30 June 2009 and the year ended 31 December 2009, we had an other net income of RMB19,000 and RMB128,000.

Selling and distribution costs

Our selling and distribution costs consisted primarily of advertising expenses, promotional and gift expenses as well as transportation expenses, salaries and relevant employee benefits for our sales personnel and other miscellaneous expenses in connection with the sales and distribution of our products.

We engage in a variety of marketing and promotional activities to promote brand recognition of our products. We conduct marketing campaigns through advertising on television and other media, such as newspapers, magazines and prominent portals and baby forum websites. We engage local human resource agencies, who in turn retain the requisite commissioned sales promoters to promote our brands at retail outlets on a contractual basis. To enhance the attractiveness of our products, we from time to time purchase toys and children's books from external sources as complimentary gifts to be distributed with our products.

The following table sets forth the breakdown of our selling and distribution costs for the periods indicated:

	Year ended 31 December						Six months ended 30 June			
	2007		2008		2009		2009		2010	
	(RMB'000)	(%)	(RMB'000)	(%)	(RMB'000)	(%)	(RMB'000) (unaudited)	(%)	(RMB'000)	(%)
Promotional and gift expenses	424,327	59.8	626,813	59.2	534,931	60.0	278,150	61.2	283,328	60.1
Advertising expenses	131,353	18.5	173,591	16.4	140,945	15.8	68,453	15.1	87,978	18.7
Transportation expenses	51,113	7.2	97,916	9.2	70,815	7.9	41,022	4.0	31,921	6.8
Staff costs	55,102	7.8	79,716	7.5	70,492	7.9	30,038	6.6	29,990	6.4
Others[(1)]	47,104	6.6	81,066	7.6	74,756	8.4	37,073	8.2	38,477	8.2
Total	709,001	100.0	1,059,101	100.0	891,938	100.0	454,736	100.0	471,694	100.0

(1) Others include travel and accommodation expenses, rental expenses for sales offices and other miscellaneous expenses associated with our sales and marketing activities.

Administrative expenses

Administrative expenses consisted primarily of salaries and employee benefits of administrative and management staff, depreciation and amortization expenses, travel and entertainment expenses, audit fees, research and development expenses, provisions for doubtful receivables and office rental expenses, as well as miscellaneous office expenses. The following table sets forth the breakdown of our administrative expenses for the periods indicated:

	Year ended 31 December						Six months ended 30 June			
	2007		2008		2009		2009		2010	
	(RMB'000)	(%)	(RMB'000)	(%)	(RMB'000)	(%)	(RMB'000)	(%)	(RMB'000)	(%)
Staff costs and employee benefit expenses[(1)]	26,903	40.4	65,848	48.0	64,762	50.1	29,307	49.4	34,599	43.1
Depreciation and amortization expenses	5,109	7.7	12,773	9.3	19,262	14.9	9,103	15.3	10,633	13.3
Travel and entertainment expenses	7,661	11.5	10,212	7.4	6,851	5.3	2,639	4.4	4,121	5.1
Stamp duty, property taxes and insurance premium	7,466	11.2	8,917	6.5	10,856	8.4	6,617	11.2	6,067	7.6
Audit fees	421	0.6	1,200	0.9	550	0.4	321	0.5	3,667	4.6
Provisions for doubtful receivables	835	1.3	2,071	1.5	2	0.002	—	0.0	1,845	2.3
Research and development expenses	432	0.6	996	0.7	950	0.7	629	1.1	355	0.4
Other office expenses[(2)]	17,763	26.7	35,255	25.7	25,845	20.0	10,695	18.0	18,947	23.6
Total	66,590	100.0	137,272	100.0	129,078	100.0	59,311	100.0	80,234	100.0

(1) Includes expenses relating to equity-settled share-based payment.

(2) Other office expenses include postal and telecommunication expenses, office rental expenses, fuel, water and electricity expenses, expenses relating to the preparation of the Listing incurred in 2010 and other miscellaneous expenses associated with our daily operations.

Other expenses

Other expenses mainly was comprised of losses arising from the product recalls, loss on disposal of inventory, donation expenses and indemnity payments. In response to the 2008 nationwide melamine incident, we recalled all contaminated lots of our products and also voluntarily recalled all pediatric milk formula products and milk powder for adults and teenagers products manufactured prior to 14 September 2008. Our voluntarily recalled products comprised the majority of our total recalled products since contaminated products under our compulsory recall were a relatively small quantity. For the years ended 31 December 2008 and 2009 and the six months ended 30 June 2010, our losses arising from the 2008 nationwide melamine incident were RMB787.1 million, RMB1.3 million and RMB1.0 million, respectively. The losses in 2008 arising from the melamine incident primarily was comprised of (i) write-down of the inventory of RMB456.9 million; (ii) inventory disposal loss of RMB159.7 million, 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) our contribution to the compensation fund of the China Dairy Industry Association of RMB61.2 million; and (iv) relevant input VAT transfer-out with respect to the disposal of inventory of RMB108.1 million. Input VAT transfer-out is undeductible input VAT regarding the raw materials disposed of or used for production of finished goods, which were returned to us due to the product recall. Total losses arising from the melamine incident for the year ended 31 December 2009 were approximately 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. Our losses on disposal of inventory during the Track Record Period were primarily related to general stocktake loss, disposal of dampened or deteriorated inventory in the ordinary course of our business and disposal of packaging materials due to changes of packaging and labelling.

For the years ended 31 December 2007, 2008 and 2009 and the six months ended 30 June 2009 and 2010, our other expenses were RMB8.8 million, RMB795.9 million, RMB14.2 million, RMB9.5 million and RMB6.3 million, respectively.

Finance income

Our finance income mainly consisted of bank interest income and fair value gain on trading investment products. For the years ended 31 December 2007, 2008 and 2009 and the six months ended 30 June 2009 and 2010, our finance income was RMB14.8 million, RMB7.8 million, RMB3.4 million, RMB0.9 million and RMB2.8 million, respectively.

Finance costs

Our finance costs primarily consisted of interest expenses on bank borrowings, partly adjusted by capitalizing interest expenses of the bank borrowings for the plant and equipment of Scient (Guangzhou). For the years ended 31 December 2007, 2008 and 2009 and the six months ended 30 June 2009 and 2010, our finance costs were RMB11.6 million, RMB21.3 million, RMB22.1 million, RMB11.1 million and RMB6.0 million, respectively.

Income tax expenses

Income tax expenses represent the enterprise income tax at the statutory rates applicable to our assessable profit before taxation as determined under relevant laws and regulations and the movement in deferred tax assets or liabilities recognized for the period.

The following table sets forth the components of income tax expenses for the periods indicated:

	Year ended 31 December						Six months ended 30 June			
	2007		2008		2009		2009		2010	
	(RMB '000)	(%)	(RMB '000)	(%)	(RMB '000)	(%)	(RMB '000)	(%)	(RMB '000)	(%)
							(Unaudited)			
Income tax from continuing operations										
Current enterprise income tax	23,312	96.3	42,680	(49.0)	5,275	7.7	6,609	19.2	17,625	40.1
Deferred enterprise income tax	157	0.6	(129,782)	149.0	63,599	92.3	27,862	80.8	26,342	59.9
	23,469	96.9	(87,102)	100.0	68,874	100.0	34,471	100.0	43,967	100.0
Income tax expenses from discontinued Operations	744	3.1	—	—	—	—	—	—	—	—
Total income tax expenses	24,213	100.0	(87,102)	100.0	68,874	100.0	34,471	100.0	43,967	100.0

Enterprise income tax

Pursuant to the then applicable PRC national and local tax laws, our subsidiaries located in the PRC were subject to EIT at the statutory rate of 33% in 2007. Since 1 January 2008, under the new EIT laws promulgated on 16 March 2007, the EIT has been reduced from 33% to a uniform tax rate of 25% on all PRC enterprises, including foreign-invested enterprises, unless they are qualified for preferential tax rates under certain limited circumstances. We derive substantially all of our revenue from our subsidiaries in China, primarily Yashili (Guangdong) and Scient (Guangzhou). During the Track Record Period, some of our subsidiaries enjoyed preferential tax treatment, see the section headed "— Factors affecting our results of operations and financial condition and comparability — Preferential tax treatments" for more details. Our subsidiary incorporated in the United States, Scient (USA), is subject to a progressive income tax rate scale pursuant to applicable US taxation laws and regulations. However, Scient (USA) had recorded losses during the Track Record Period and had not incurred any income tax expenses.

Our Directors confirm that we have made all the required tax filings under relevant applicable tax laws and regulations in the jurisdictions we operated and paid all tax liabilities. We are not subject to any pending dispute and are not aware of any potential dispute with relevant competent tax authorities.

Deferred tax

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of tax assets and tax liabilities in the financial statements and the corresponding tax basis and is recognized using the balance sheet method. Deferred tax assets and liabilities are determined at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates and regulations that have been enacted or substantially enacted at the balance sheet date.

As a result of the foregoing, our income tax expenses for the years ended 31 December 2007 and 2009, and for the six months ended 30 June 2009 and 2010 were RMB23.5 million, RMB68.9 million, RMB34.5 million and RMB44.0 million respectively; the effective tax rate for the same periods was 4.8%, 14.6%, 14.9% and 15.4% respectively. As a result of relevant expenses arising from product recalls in late 2008, we recorded a net loss before income tax of RMB701.9 million and an income tax credit of RMB87.1 million for the year ended 31 December 2008.

Description of Discontinued Operation

On 31 December 2007, we sold our wholly-owned subsidiary, Haoweijia Food, which manufactured and sold preserved fruit snacks, to our controlling equity owners pursuant to our strategy to focus our business operations on production and sales of pediatric milk formula and nutritional products. For the year ended 31 December 2007, Haoweijia Food recorded revenue of RMB40.2 million and net profit of RMB1.5 million.

The transaction was conducted on an arm's length basis and the consideration of the disposal was RMB10.8 million in the form of cash, which was based on the then registered capital of Haoweijia Food and received in February 2008. We incurred a loss of RMB2.0 million from the sale of the discontinued operation, representing the difference between the consideration we received and the carrying value of the net assets disposed. As a result, we had a loss of approximately RMB0.5 million for the year ended 31 December 2007 in respect of our discontinued operation.

Results of Our Continued Operations

The following table sets forth, for the periods indicated, information relating to certain income and expense items from our combined income statements:

	Year ended 31 December						Six months ended 30 June			
	2007		2008		2009		2009		2010	
	(RMB million)	(%)	(RMB million)	(%)	(RMB million)	(%)	(RMB million) (Unaudited)	(%)	(RMB million)	(%)
Combined income statements										
Revenue	2,892.2	100.0	2,751.6	100.0	2,586.0	100.0	1376.2	100.0	1,375.5	100.0
Cost of sales	(1,637.1)	(56.6)	(1,463.7)	(53.2)	(1,095.6)	(42.4)	(628.7)	(45.7)	(563.9)	(41.0)
Gross profit	1,255.1	43.4	1,287.9	46.8	1,490.4	57.6	747.5	54.3	811.6	59.0
Other revenue	20.2	0.7	17.0	0.6	34.8	1.3	18.4	1.3	34.9	2.5
Other net/(loss) income	(0.1)	(0.004)	(1.0)	(0.04)	0.1	(0.005)	0.0	0.0	(0.1)	(0.0)
Selling and distribution costs	(709.0)	(24.5)	(1,059.1)	(38.5)	(891.9)	(34.5)	(454.7)	(33.0)	(471.7)	(34.3)
Administrative expenses	(66.6)	(2.3)	(137.3)	(5.0)	(129.1)	(5.0)	(59.3)	(4.3)	(80.2)	(5.8)
Other expenses	(8.8)	(0.3)	(795.9)	(28.9)	(14.2)	(0.5)	(9.5)	(0.7)	(6.3)	(0.5)
Profit (loss) from operations	490.7	17.0	(688.4)	(25.0)	490.0	18.9	242.3	17.6	288.2	20.9
Finance income	14.8	0.5	7.8	0.3	3.4	0.1	0.9	0.1	2.8	0.2
Finance costs	(11.6)	(0.4)	(21.3)	(0.8)	(22.1)	(0.8)	(11.1)	(0.8)	(6.0)	(0.4)
Net finance income (expense)	3.2	0.1	(13.5)	(0.5)	(18.7)	(0.7)	(10.2)	(0.7)	(3.2)	(0.2)
Profit/(loss) before income tax	493.9	17.1	(701.9)	(25.5)	471.3	18.2	232.1	16.9	285.0	20.7
Income tax expenses	(23.5)	(0.8)	87.1	3.2	(68.9)	(2.7)	(34.5)	(2.5)	(44.0)	(3.2)
Profit/(loss) from continuing operations	470.4	16.3	(614.8)	(22.3)	402.4	15.5	197.6	14.4	241.0	17.5
Discontinued operation										
Loss from discontinued operation (net of income tax)	(0.5)	(0.02)	—	—	—	—	—	—	—	—
Profit/(loss) for the year/period	469.9	16.3	(614.8)	(22.3)	402.4	15.5	197.6	14.4	241.0	17.5
Profit attributable to Equity holders of the Company	415.6	14.4	(563.9)	(20.5)	404.7	15.6	198.0	14.4	239.7	17.4
Non-controlling interests	54.3	1.9	(50.9)	(1.8)	(2.3)	(0.1)	(0.4)	(0.0)	1.3	0.1
Profit/(loss) for the year/period	469.9	16.3	(614.8)	(22.3)	402.4	15.5	197.6	14.4	241.0	17.5

Six months ended 30 June 2010 compared with six months ended 30 June 2009

Revenue

Our revenue decreased slightly from RMB1,376.2 million in the six months ended 30 June 2009 to RMB1,375.5 million in the six months ended 30 June 2010. The decrease was primarily due to the decrease in sales of our nutritional food products in the six months ended 30 June 2010, partly offset by the increase in revenue from our *Yashily* and *Scient* pediatric milk formula operations.

Sales of our *Yashily* pediatric milk formula products increased by 3.0% from RMB815.4 million for the six months ended 30 June 2009 to RMB840.5 million for the six months ended 30 June 2010. While the sales volume of *Yashily* pediatric milk formula products decreased by 13.8% from 13,439 tonnes for the six months ended 30 June 2009 to 11,581 tonnes for the six months ended 30 June 2010, average selling price of *Yashily* pediatric milk formula products increased by 19.6% from approximately RMB60,674 per tonne for the six months ended 30 June 2009 to approximately RMB72,579 per tonne for the six months ended 30 June 2010, which was attributable to the increase in the sales volume of our high-end products, namely *Yashily* α-Golden Stage series, as well as the overall increase in selling prices of most of the *Yashily* pediatric products.

Sales of our *Scient* pediatric milk formula increased by 12.4% from RMB284.0 million for the six months ended 30 June 2009 to RMB319.3 million for the six months ended 30 June 2010. The sales volume increased slightly from 4,368 tonnes for the six months ended 30 June 2009 to 4,393 tonnes for the six months ended 30 June 2010. Meanwhile, the average selling price of *Scient* milk formula products increased by 11.8% from RMB65,012 per tonne for the six months ended 30 June 2009 to RMB72,657 per tonne for the six months ended 30 June 2010, primarily due to the increase in the sales volume of high-end products, namely *Scient* Golden Stage series, and the overall increase in the selling prices of most of the *Scient* pediatric milk formula products.

Our revenue from nutritional food products decreased from RMB273.7 million for the six months ended 30 June 2009 to RMB208.9 million for the six months ended 30 June 2010. Such decrease was mainly caused by the decrease in sales of soymilk powder products, as affected by the increase in the selling price of these products. Such price increase was for the purpose of sustaining a reasonable profitability level for our soymilk powder products.

Our revenue from other products increased from RMB3.1 million for the six months ended 30 June 2009 to RMB6.8 million for the six months ended 30 June 2010, primarily due to the increase in sales of preserved fruit products distributed by Yashili (Shanghai).

Cost of sales

Our cost of sales decreased by 10.3% from RMB628.7 million for the six months ended 30 June 2009 to RMB563.9 million for the six months ended 30 June 2010, which was primarily due to the decrease in cost of sales of our *Yashily* pediatric milk formula and nutritional food products.

Cost of sales of our *Yashily* pediatric milk formula products decreased by 11.2% from RMB342.3 million for the six months ended 30 June 2009 to RMB306.3 million for the six months ended 30 June 2010. Such decrease was primarily due to the decrease in sales volume of *Yashily* pediatric milk formula products, partly offset by the increase in average purchase price of raw milk powder.

Cost of sales of our *Scient* pediatric milk formula products increased by 7.5% from RMB123.9 million for the six months ended 30 June 2009 to RMB133.2 million for the six months ended 30 June 2010. Such increase was primarily due to the increase in average purchase price of raw milk powder.

Cost of sales of our nutritional food products decreased from RMB159.9 million for the six months ended 30 June 2009 to RMB118.7 million for the six months ended 30 June 2010, primarily due to the decrease in our sales volume of soymilk powder products in 2010, partly offset by the increase in the average purchase price of raw materials.

Cost of sales of our other products increased from RMB2.6 million for the six months ended 30 June 2009 to RMB5.7 million for the six months ended 30 June 2010, which was consistent with the increase in revenue generated from our other segments.

Gross profit

As a result of the foregoing, our gross profit increased by 8.6% from RMB747.5 million for the six months ended 30 June 2009 to RMB811.6 million for the six months ended 30 June 2010. Our gross profit margin also increased from 54.3% for the six months ended 30 June 2009 to 59.0% for the six months ended 30 June 2010.

Gross profit for our *Yashily* pediatric milk formula products increased from RMB473.1 million for the six months ended 30 June 2009 to RMB534.3 million for the six months ended 30 June 2010, and gross profit margin increased from 58.0% to 63.6% in the same period. Such increase in gross profit margin was caused by the increase in sales of high-end products with higher selling price and margin, namely *Yashily* α-Golden Stage series, and an overall increase in selling prices for most lines of *Yashily* pediatric milk formula products.

Gross profit for our *Scient* pediatric milk formula products increased from RMB160.1 million for the six months ended 30 June 2009 to RMB186.1 million for the six months ended 30 June 2010, and gross profit margin increased from 56.4% to 58.3% in the same period. Such increase in gross profit margin was mainly caused by the increase in sales of high-end products with higher selling price and margin, such as *Scient* Golden Stage, and an overall increase in selling prices for most lines of *Scient* pediatric milk formula products.

Gross profit for our nutritional food products decreased from RMB113.8 million for the six months ended 30 June 2009 to RMB90.2 million for the six months ended 30 June 2010, but the gross profit margin increased from 41.6% to 43.2% in the same period. Such increase in gross profit margin was a result of the change in revenue composition within our nutritional food operations, where the products with higher margins, such as milk powder, rice flour and cereal, accounted for a higher percentage of sales.

Gross profit for our other products increased from RMB0.5 million for the six months ended 30 June 2009 to RMB1.1 million for the six months ended June 2010. The gross profit margin was 16.1% and 16.2% for the six months ended 30 June 2009 and 2010, respectively.

Other revenue

Other revenue increased from RMB18.4 million for the six months ended 30 June 2009 to RMB34.9 million for the six months ended 30 June 2010, primarily due to the reversal as approved by local tax bureau of input VAT transfer-out of RMB22.8 million relating to our destruction of products manufactured before 14 September 2008 and melamine-contaminated raw materials in late 2008.

Other net loss/income

We had other net income of RMB19,000 for the six months ended 30 June 2009 and had net loss of RMB69,000 for the six months ended 30 June 2010. Such change was mainly attributable to the differences between the book value and the consideration we received for disposal of certain fixed assets.

Selling and distribution costs

Our selling and distribution costs increased by 3.7% from RMB454.7 million for the six months ended 30 June 2009 to RMB471.7 million for the six months ended 30 June 2010. Such increase was primarily due to the increase in advertising expenses for television advertising. Such increase was partly offset by the decrease in transportation expenses due to the decrease in the overall sales volume of our products.

Administrative expenses

Our administrative expenses increased by 35.2% from RMB59.3 million for the six months ended 30 June 2009 to RMB80.2 million for the six months ended 30 June 2010. Such increase was primarily due to: (i) the increase in staff costs and employee benefit expenses resulting from the increase in average wage level and additional employee welfare; and (ii) the increase in the relevant expenses for the preparation of the Listing.

Other expenses

Our other expenses decreased by 33.7% from RMB9.5 million for the six months ended 30 June 2009 to RMB6.3 million for the six months ended 30 June 2010. Such decrease was primarily due to the decrease in our losses from general stocktake and the disposal of dampened or deteriorated inventory and packaging materials.

Finance income

Our finance income increased from RMB0.9 million for the six months ended 30 June 2009 to RMB2.8 million for the six months ended 30 June 2010. Such increase was primarily due to the increase in the weighted average balance of our interest-bearing bank deposits.

Finance costs

Our finance costs decreased from RMB11.1 million for the six months ended 30 June 2009 to RMB6.0 million for the six months ended 30 June 2010. Such decrease was primarily due to the decrease in the weighted average balance of our outstanding bank borrowings.

Income tax expense

Our income tax expense for the six months ended 30 June 2009 and 2010 was RMB34.5 million and RMB44.0 million, respectively. Our effective income tax rate for the same periods was 14.9% and 15.4%, respectively.

Profit for the period

As a result of the foregoing factors, we had a profit for the six months ended 30 June 2009 of RMB197.6 million and profit for the six months ended 30 June 2010 of RMB241.0 million.

Profit attributable to equity holders of the Company

Our profit attributable to equity holders, or net profit, was RMB198.0 million and our net profit margin was 14.4% for the six months ended 30 June 2009. Our net profit was RMB239.7 million and our net profit margin was 17.4% for the six months ended 30 June 2010. The changes were primarily due to our overall increase in our gross margins and the improved profitability of our *Scient* pediatric milk formula operations.

Year ended 31 December 2009 compared with year ended 31 December 2008

Revenue

Our revenue decreased by 6.0% from RMB2,751.6 million in 2008 to RMB2,586.0 million in 2009. The decrease was primarily due to the decrease in the sales of our *Scient* pediatric milk formula products in 2009, partly offset by the increase in revenue from our *Yashily* pediatric milk formula and nutritional food operations.

Sales of our *Yashily* pediatric milk formula products increased by 1.9% from RMB1,511.8 million in 2008 to RMB1,540.4 million in 2009. While the sales volume of *Yashily* pediatric milk formula products decreased by 4.9% from 25,049 tonnes in 2008 to 23,813 tonnes in 2009, average selling price of *Yashily* pediatric milk formula products increased by 7.1% from approximately RMB60,355 per tonne in 2008 to approximately RMB64,689 per tonne in 2009, which was attributable to the increase in sales volume of products with higher selling prices, such as *Yashily* α-Golden Stage series and *Ambery* series. The overall increase in our revenue from sales of *Yashily* pediatric milk products evidenced the recovery of market recognition of and consumer confidence in our *Yashily* pediatric milk formula products.

Sales of our *Scient* pediatric milk formula decreased by 31.0% from RMB755.0 million for the year ended 31 December 2008 to RMB521.3 million for the year ended 31 December 2009. The sales volume decreased by 32.2% from 11,919 tonnes in 2008 to 8,084 tonnes in 2009, primarily due to the negative publicity regarding our *Scient* brand on the Internet and other media outlets distributed in June 2009. Meanwhile, the average selling price of *Scient* pediatric milk formula products remained stable and was RMB63,343 per tonne in 2008 and RMB64,480 per tonne in 2009.

The revenue from our nutritional food products increased from RMB454.2 million in 2008 to RMB507.6 million in 2009. The increase in revenue from our nutritional food products was mainly caused by the increase in the sales of milk powder for adults and teenagers.

Our revenue from other products decreased from RMB30.6 million in 2008 to RMB16.7 million in 2009, primarily due to the decrease in the sales of surplus raw milk.

Cost of sales

Our cost of sales decreased by 25.1% from RMB1,463.7 million for the year ended 31 December 2008 to RMB1,095.6 million for the year ended 31 December 2009, which was primarily due to the decrease in cost of sales for our *Yashily* and *Scient* pediatric milk formula products.

Cost of sales of our *Yashily* pediatric milk formula products decreased by 22.0% from RMB731.6 million in 2008 to RMB570.4 million in 2009. The decrease was primarily due to the decrease in the average purchase price of raw milk powder in 2009.

Cost of sales of our *Scient* pediatric milk formula products decreased by 39.1% from RMB374.8 million in 2008 to RMB228.3 million in 2009. The decrease was primarily due to the decrease in our sales volume of the *Scient* pediatric milk formula products in 2009 and the decrease in average purchase price of raw milk powder in 2009.

Cost of sales of our nutritional food products decreased from RMB330.8 million in 2008 to RMB283.4 million in 2009, primarily due to the decrease in average purchase price of raw materials.

Cost of sales of our other products decreased from RMB26.5 million in 2008 to RMB13.5 million in 2009, which was consistent with the decrease in the revenue generated from our others segment.

Gross profit

As a result of the foregoing, our gross profit increased by 15.7% from RMB1,287.9 million in the year ended 31 December 2008 to RMB1,490.4 million in the year ended 31 December 2009. Our gross profit margin also increased from 46.8% in 2008 to 57.6% in 2009.

Gross profit for our *Yashily* pediatric milk formula products increased from RMB780.2 million in 2008 to RMB970.0 million in 2009, and gross profit margin increased from 51.6% to 63.0% in the same period. Such increase in gross profit margin was caused by an increase in sales of products with higher selling prices and margins, such as *Yashily* α-Golden Stage and *Ambery* series, and the lower raw material costs in 2009.

Gross profit for our *Scient* pediatric milk formula products decreased from RMB380.2 million in 2008 to RMB293.0 million in 2009, but gross profit margin increased from 50.4% to 56.2% in the same period. Such increase in gross profit margin was mainly caused by the lower raw material costs in 2009.

Gross profit for our nutritional food products increased from RMB123.4 million in 2008 to RMB224.2 million in 2009, and the gross profit margin increased from 27.2% to 44.2% in the same period. Such increase in gross profit margin was caused by the lower raw material costs in 2009.

Gross profit for our other products decreased from RMB4.1 million in 2008 to RMB3.2 million in 2009, but gross profit margin increased from 13.4% to 19.3% in the same period. Such increase in gross profit margin was mainly caused by the lower raw material costs in 2009.

Other revenue

Other revenue increased from RMB17.0 million for the year ended 31 December 2008 to RMB34.7 million for the year ended 31 December 2009, primarily due to the increases in: (i) compensation income relating to the damages of RMB5.9 million we recovered in a legal proceeding with respect to the property for office use of Scient (Guangzhou); (ii) government grants for acquisition of new plants and technical innovation and production line expansion projects; and (iii) write-off of trade payables to our suppliers pursuant to final court judgments.

Other net loss/income

We had other net loss of RMB1.0 million for the year ended 31 December 2008 and other net income of RMB128,000 for the year ended 31 December 2009, respectively. Such change was mainly attributable to the differences between the book value and the consideration we received for disposal of certain fixed assets.

Selling and distribution costs

Our selling and distribution costs decreased by 15.8% from RMB1,059.1 million for the year ended 31 December 2008 to RMB891.9 million for the year ended 31 December 2009. The decrease in selling and distribution costs in 2009 was primarily due to our control of the selling, marketing and promotion budget at a reasonable level in line with our sales scale. In 2008, we increased our marketing and promotional activities pursuant to our growing strategies, which was consistent with the expansion of our sales and operation scale in the first eight months of 2008.

Administrative expenses

Our administrative expenses decreased by 6.0% from RMB137.3 million for the year ended 31 December 2008 to RMB129.1 million for the year ended 31 December 2009. The decrease was primarily due to (i) the decrease in travel and entertainment expenses; and (ii) the decrease in office and rental expenses.

Other expenses

Our other expenses decreased significantly from RMB795.9 million for the year ended 31 December 2008 to RMB14.2 million for the year ended 31 December 2009. In 2008, we incurred losses arising from the melamine incident of RMB787.1 million.

Finance income

Our finance income decreased from RMB7.8 million for the year ended 31 December 2008 to RMB3.4 million for the year ended 31 December 2009. Such decrease was primarily due to the decrease in the weighted average balance of interest-bearing bank deposits and the decrease in fair value gain on investment products.

Finance costs

Our finance costs increased slightly from RMB21.3 million for the year ended 31 December 2008 to RMB22.1 million for the year ended 31 December 2009. Such increase was primarily due to the increase in the weighted average balance on our outstanding bank borrowings, partly offset by (i) the decrease in interest rate in 2009; and (ii) the capitalized interest expenses for the bank financing relating to our Guangzhou Plant.

Income tax expense

Our income tax expense for the year ended 31 December 2009 was RMB68.9 million. Our effective income tax rate was 14.6% for the year ended 31 December 2009. We had an income tax credit of RMB87.1 million for the year ended 31 December 2008 due to our loss resulting from the product recalls beginning in September 2008.

Profit/loss for the year

As a result of the foregoing factors, we had profit for the year ended 31 December 2009 of RMB402.4 million and loss for the year ended 31 December 2008 of RMB614.8 million.

Profit attributable to equity holders of the Company

Our profit attributable to equity holders, or net profit, was RMB404.7 million and our net profit margin was 15.6% for the year ended 31 December 2009. Our net loss attributable to equity holders for the year ended 31 December 2008 was RMB563.9 million. The changes were primarily due to the significant expenses and losses resulting from our product recalls in 2008.

Year ended 31 December 2008 compared with year ended 31 December 2007

Revenue

Our revenue decreased by 4.9% from RMB2,892.2 million for the year ended 31 December 2007 to RMB2,751.6 million for the year ended 31 December 2008. The changes were primarily due to the product recalls beginning in September 2008, which significantly affected the operations of our *Yashily* and *Scient* pediatric milk formula segments for the remaining period of 2008.

The sales of our *Yashily* pediatric milk formula products increased by 6.8% from RMB1,415.2 million for the year ended 31 December 2007 to RMB1,511.8 million for the year ended 31 December 2008. The sales volume of *Yashily* pediatric milk formula products was 25,181 tonnes in 2007 and 25,049 tonnes in 2008. The sales volume in 2008 slightly decreased, which in part reflected the impact of our product recalls beginning in September 2008. Average selling price of *Yashily* pediatric milk formula products increased by 7.5% from approximately RMB56,201 per tonne in 2007 to approximately RMB60,355 per tonne in 2008, primarily attributable to the increase in sales of products with higher selling prices, such as *Yashily* α-Golden stage and *Ambery* series.

Sales of our *Scient* pediatric milk formula decreased by 17.3% from RMB912.8 million for the year ended 31 December 2007 to RMB755.0 million for the year ended 31 December 2008. The sales volume decreased from 13,306 tonnes in 2007 to 11,919 tonnes in 2008. Such decrease was driven by the recalls for all of our *Scient* pediatric milk formula products beginning in September 2008. The average selling price of our *Scient* pediatric milk formula products decreased by 7.7% from approximately RMB68,600 per tonne in 2007 to RMB63,343 per tonne in 2008, primarily because we enhanced the promotional activities to provide complimentary small packages of pediatric milk formula.

Sales of our nutritional food products decreased from RMB506.6 million in 2007 to RMB454.2 million in 2008, primarily due to the decrease in sales of milk powder for adults and teenagers and cereal products. Such decrease was partly offset by the increase in sales of our rice flour products, as a result of our enhanced selling efforts in 2008.

Our revenue from other products decreased from RMB57.6 million in 2007 to RMB30.6 million in 2008, primarily due to a decrease in external sales of whole milk powder.

Cost of sales

Our cost of sales decreased by 10.6% from RMB1,637.1 million for the year ended 31 December 2007 to RMB1,463.7 million for the year ended 31 December 2008, which was primarily due to the decrease in cost of sales for our *Yashily* pediatric milk formula and nutritional food products.

Cost of sales of our *Yashily* pediatric milk formula products decreased by 13.7% from RMB847.5 million in 2007 to RMB731.6 million in 2008, which was primarily due to the upgrade and improvement of our manufacturing technologies and equipment, which increased production efficiency and reduced costs, and the decrease in the costs of base milk powder as a result of the commencement of our Shuozhou Plant operations in March 2008. Such decrease was partly offset by an increase in raw material purchase costs.

Cost of sales of our *Scient* pediatric milk formula products slightly increased from RMB364.6 million in 2007 to RMB374.8 million in 2008, which was primarily due to an increase in raw material purchase costs and the promotion policy to distribute additional small packages of milk formula on a complimentary basis with our *Scient* pediatric milk formula products.

Cost of sales of our nutritional food products decreased by 11.4% from RMB373.4 million in 2007 to RMB330.8 million in 2008, which was consistent with the decrease in revenue from nutritional food products in 2008.

Cost of sales of our other products decreased from RMB51.6 million in 2007 to RMB26.5 million in 2008, which was consistent with the decrease in revenue from our other products.

Gross profit

As a result of the foregoing, our gross profit increased by 2.6% from RMB1,255.1 million for the year ended 31 December 2007 to RMB1,287.9 million for the year ended 31 December 2008. Our gross profit margin increased from 43.4% for the year ended 31 December 2007 to 46.8% for the year ended 31 December 2008.

Gross profit of our *Yashily* pediatric milk formula products increased from RMB567.7 million in 2007 to RMB780.2 million in 2008, and the gross profit margin increased from 40.1% to 51.6% during the same period. Such increase in gross profit margin was caused by the upgrade and improvement of our manufacturing technology and equipment, which increased production efficiency and reduced costs, and the change of our product mix to focus on premium products with higher selling prices and margins.

Gross profit of our *Scient* pediatric milk formula products decreased from RMB548.2 million in 2007 to RMB380.2 million in 2008, and the gross profit margin decreased from 60.1% to 50.4% during the same period. Such decrease in gross profit margin was attributable to the increased raw material prices and the decreased average selling price of *Scient*'s milk formula products as a result of our promotion policy.

Gross profit for our nutritional food products slightly decreased from RMB133.2 million in 2007 to RMB123.4 million in 2008, but the gross profit margin increased from 26.3% in to 27.2% during the same period.

Gross profit for our other products decreased from RMB6.1 million in 2007 to RMB4.1 million in 2008, but gross profit margin increased from 10.6% to 13.4% during the same period.

Other revenue

Other revenue decreased from RMB20.2 million for the year ended 31 December 2007 to RMB17.0 million for the year ended 31 December 2008. Such decrease was primarily due to a decrease in government grants of RMB7.2 million in 2008.

Other net loss

We had other net losses of RMB139,000 and RMB1.0 million for the years ended 31 December 2007 and 2008, respectively. Such change was mainly attributable to the differences between the book value and the consideration we received for disposal of certain fixed assets.

Selling and distribution costs

Our selling and distribution costs increased by 49.4% from RMB709.0 million for the year ended 31 December 2007 to RMB1,059.1 million for the year ended 31 December 2008. The increase consisted of the significant increases in outsourced labor costs, promotional and gift expenses and advertising expenses in 2008, which was primarily due to and consistent with the rapid expansion of our sales and business operations in the first eight months of 2008 pursuant to our growing strategies before the product recalls, as compared to 2007.

Administrative expenses

Our administrative expenses increased by 106.2% from RMB66.6 million for the year ended 31 December 2007 to RMB137.3 million for the year ended 31 December 2008. The increase was mainly caused by the increase in our staff costs and employee benefit expenses and the increase in administrative expenses due to the commencement of operations of Yashili (Shanxi).

Other expenses

Our other expenses increased significantly from RMB8.8 million for the year ended 31 December 2007 to RMB795.9 million for the year ended 31 December 2008. Such increase was primarily due to our losses arising from the melamine incident of RMB787.1 million in 2008, comprising the disposal cost of the contaminated inventory, write-down of contaminated inventory pending disposal, contribution to the compensation fund of the China Dairy Industry Association and relevant input VAT transfer-out loss. To a lesser extent, an increase in donation expenses of approximately RMB2.5 million for the Sichuan earthquake in 2008 also contributed to the increase in our other expenses.

Finance income

Our finance income decreased from RMB14.8 million for the year ended 31 December 2007 to RMB7.8 million for the year ended 31 December 2008. Such decrease was primarily due to the decrease in fair value gain on trading investment products in 2008, as compared to that in 2007.

Finance costs

Our finance costs increased by 83.6% from RMB11.6 million for the year ended 31 December 2007 to RMB21.3 million for the year ended 31 December 2008. Such increase was primarily due to the increase in the weighted average amount of outstanding bank borrowings. The weighted average interest rate of bank borrowings in 2007 and 2008 remained at a stable level.

Income tax expense

We recorded an income tax credit of RMB87.1 million for the year ended 31 December 2008 and incurred income tax expenses of RMB23.5 million for the year ended 31 December 2007. Such change was primarily due to our loss resulting from the product recalls that began in September 2008. Our effective income tax rate was 4.8% for the year ended 31 December 2007, primarily due to the preferential tax treatments enjoyed by our subsidiaries, including Yashili (Guangdong) and Scient (Guangzhou).

Profit/loss for the year

As a result of the foregoing factors, we had a loss for the year ended 31 December 2008 of RMB614.8 million and profit for the year ended 31 December 2007 of RMB469.9 million.

Profit attributable to equity holders of the Company

Our net loss attributable to equity holders in 2008 was RMB563.9 million, while our profit attributable to equity holders in 2007 was RMB415.6 million and we recorded a net profit margin of 14.4% for the year ended 31 December 2007. The changes were primarily due to the significant expenses and losses resulting from our product recalls in 2008.

Financial Position, Liquidity and Capital Resources

Our primary liquidity requirements are to fund working capital and normal recurring expenses, invest in additional manufacturing facilities and equipment, and service our indebtedness. To date, we have financed our cash requirements through a combination of cash generated from operating activities, proceeds from the capital contributions from our shareholders, working capitals and loans and bank borrowings. In the future, we expect to continue to rely principally on cash flows from operations and loans and bank borrowings to fund our working capital needs and will use the proceeds from the Global Offering to finance part of our business expansion.

Cash Flow

Cash flows from operating activities represent the inflows of cash from sales of our products and the outflows of cash for inventory purchases, selling and distribution costs and other expenses and taxes. Cash flows used in investing activities primarily represent capital expenditure for property, plants and equipment. Cash flows used in financing activities primarily represent the dividend paid to our shareholders, and cash inflows from financing activities represent contributions made by shareholders and bank loans.

As of 30 June 2010, we had cash and cash equivalents of RMB610.4 million for the purposes of the combined cash flow statement. The following table sets out changes in cash flows for the periods indicated:

	Year ended 31 December			Six months ended 30 June	
	2007	2008	2009	2009	2010
			(RMB million)		
				(unaudited)	
Combined cash flow statements					
Cash and cash equivalents on 1 January	311.4	96.9	304.9	304.9	660.6
Net cash generated from/(used in) operating activities	450.7	246.8	(105.5)	(167.2)	(38.5)
Net cash used in investing activities	(571.3)	(69.2)	(129.3)	(92.3)	(6.8)
Net cash (used in)/generated from financing activities	(93.9)	30.4	590.6	127.6	(4.9)
Net increase/(decrease) in cash and cash equivalents	(214.5)	208.0	355.8	(131.9)	(50.2)
Cash and cash equivalents on 31 December/30 June	96.9	304.9	660.6	172.9	610.4

Cash flows from operating activities

For the six months ended 30 June 2010, we had a net cash outflow from operating activities of RMB38.5 million, consisting of cash used in operations of RMB35.5 million and income tax paid of RMB2.9 million. Our profit before working capital adjustments was RMB329.3 million. Negative working capital adjustments reflected primarily: (i) a decrease in trade and other payables of RMB249.0 million, mainly due to the significant decrease in advances from our distributors, which were recorded when our customers made sales returns to us under the product recalls in 2008 and such balance under our trade and other payables was subsequently deducted gradually to offset against our delivery of new lots of products or cash refunds to our customers, and our repayment of trade payables to our suppliers, which were deferred as a result of the 2008 nationwide melamine incident, both resulting in our operating cash outflows; and (ii) an increase in inventories of RMB146.1 million, primarily due to the higher inventory level we maintained for imported raw milk powder and the increase in inventory level of base milk powder in Shuozhou Plant that corresponded to our transition from domestic to overseas sources for raw milk powder.

For the year ended 31 December 2009, we had net cash outflow from operating activities of RMB105.5 million, consisting of cash used in operations of RMB104.0 million and income tax paid of RMB1.5 million. Our profit before working capital adjustments was RMB562.5 million. Negative working capital adjustments reflected primarily: (i) a decrease in trade and other payables amounting to RMB645.0 million, mainly due to the significant decrease in advances from our distributor customers, which were recorded when our customers made sales returns to us under the product recalls in 2008 and such balance under our trade and other payables was subsequently deducted gradually to offset against our delivery of new lots of products or cash refunds to our customers, and our repayment of trade payables to our suppliers, which were deferred as a result of the 2008 nationwide melamine incident, both resulting in operating cash outflows; and (ii) an increase in prepayments and other receivables amounting to RMB58.0 million, mainly due to the increase in our prepayment to suppliers for raw material purchases. Such negative adjustments were partly offset by a decrease in inventories amounting to RMB76.8 million, primarily due to our enhanced control of our inventory level for raw materials and finished goods.

For the year ended 31 December 2008, we had net cash generated from operating activities of RMB246.8 million, consisting of cash generated from operations of RMB300.5 million subtracted by income tax paid of RMB53.8 million. Our loss before working capital adjustments was RMB178.4 million. Positive working capital adjustments reflected primarily the increase in trade and other payables amounting to RMB720.6 million, mainly due to: (i) the increase in advances from customers resulting from our product recalls in late 2008, for which we were responsible for exchanging products recalled for new products to our distributor customers; and (ii) our delay of repayments for trade payables to our suppliers due to the impact of the product recalls. Such positive adjustments were partly offset by an increase in inventories of RMB401.8 million, mainly due to the increase in our inventories as a result of the product recalls in 2008, which were subsequently written-down/written-off.

For the year ended 31 December 2007, we had net cash generated from operating activities of RMB450.7 million, consisting of cash generated from operations of RMB466.8 million, subtracted by income tax paid of RMB16.1 million. Our profit before working capital adjustments was RMB515.4 million. Negative working capital adjustments reflected primarily: (i) an increase in inventories amounting to RMB188.6 million due to the increase in raw materials and packaging materials corresponding to the scale of our business operations and sales; and (ii) an increase in prepayment and other receivables amounting to RMB95.6 million, as a result of the expansion of our operation. Such negative adjustments were partly offset by an increase in trade and other payables amounting to RMB290.5 million, mainly consisting of advances from customers due the rapid growth of our business in 2007.

Cash flows from investing activities

For the six months ended 30 June 2010, our net cash used in investing activities was RMB6.8 million. Our net cash outflows for investing activities mainly consisted of the acquisition of property, plants and equipment primarily for the Shuozhou Plant and the acquisition of other investment products. Such cash outflows were partly offset by the proceeds from the disposal of investment products and our acquisition of Victory Trading, net of cash acquired.

For the year ended 31 December 2009, our net cash used in investing activities was RMB129.3 million. Our net cash outflows for investing activities mainly consisted of the acquisition of property, plants and equipment primarily for our Guangzhou, Shuozhou and Chaozhou plants and the acquisition of lease prepayments in connection with the property of Scient (Guangzhou).

For the year ended 31 December 2008, our net cash used in investing activities was RMB69.2 million. Our net cash outflows for investing activities mainly consisted of the acquisition of property, plants and equipment primarily for our Guangzhou, Shuozhou and Chaozhou plants, partly offset by the proceeds from sales of our investment products and collection of advances to our controlling equity owners.

For the year ended 31 December 2007, our net cash used in investing activities was RMB571.3 million. Our net cash outflows for investing activities mainly consisted of the purchase of property, plants and equipment primarily for our Guangzhou, Shuozhou and Chaozhou plants and the acquisition of investment products, partly offset by the proceeds from the sales of other investment products.

Cash flows from financing activities

For the six months ended 30 June 2010, our net cash used in financing activities was RMB4.9 million. Our net cash outflow from financing activities mainly consisted of interest paid for our borrowings, partly offset by the advances from our controlling equity owners of RMB1.1 million.

For the year ended 31 December 2009, our net cash generated from financing activities was RMB590.6 million. Our net cash inflow from financing activities mainly consisted of: (i) capital contributions by our shareholders, including Zhang's Family and Carlyle, of RMB899.5 million; (ii) proceeds of bank loans of RMB338.0 million; and (iii) cash advances from our controlling equity owners of RMB193.0 million, partly offset by: (i) the repayment of bank loans of RMB475.3 million; (ii) the repayment of cash advances from our controlling equity owners of RMB283.0 million; and (iii) the dividend payments of Scient (Guangzhou) of RMB59.0 million.

For the year ended 31 December 2008, our net cash generated from financing activities was RMB30.4 million. Our net cash inflow from financing activities mainly consisted of: (i) proceeds of bank loans of RMB413.8 million; and (ii) cash advances from our controlling equity owners of RMB90.0 million, which was partly offset by: (i) the repayment of bank loans of RMB210.5 million; (ii) the repayment of cash advances from our controlling equity owners of RMB154.0 million; and (iii) the dividend payments of Scient (Guangzhou) of RMB87.6 million.

For the year ended 31 December 2007, our net cash used in financing activities was RMB93.9 million. Our net cash outflows for financing activities mainly consisted of: (i) the consideration of RMB185.3 million we paid to the then equity holders of Yashili (Shanxi), Yashili (Heilongjiang), Yashili (Guangdong), Haoweijia Food, Bisheng, Yashili Dairy and Yashili Nutrition arising from our reorganization process, which was deemed as a distribution to our controlling equity owners according to merger accounting principles; (ii) repayment of bank loans of RMB129.0 million; (iii) repayment of cash advances from our controlling equity owners of RMB43.1 million; and (iv) dividend payments of Yashili (Guangdong) and Scient (Guangzhou) of RMB41.6 million, partly offset by the proceeds of bank loans in the amount of RMB153.0 million and cash advances from our controlling equity owners of RMB138.0 million.

Working Capital

Working capital is critical to our financial performance and we must maintain sufficient liquidity and financial flexibility to continue our daily operations.

Our current assets primarily consist of cash and cash equivalents, inventories, prepayments and other receivables and trade and bill receivables due from our customers, amounts due from related parties and restricted bank deposits. Our current liabilities primarily consist of trade and other payables, loans and borrowings, amounts due to related parties, provisions and income tax payables. We manage our working capital by closely monitoring the level of our trade and other payables, loan and borrowings and amounts due to related parties as well as inventory level. We also intend to optimize our profitability by improving operating cash flows. During the Track Record Period, we experienced negative operating cash flows, primarily due to the impact of our product recalls and sales returns in 2008. Going forward, we plan to closely monitor and manage our inventory level, particularly the procurement of imported raw milk powder, and perform regular review and management of the level and payment schedule of our trade and other payables to improve our operating cash flows. We may also increase our credit facilities from time to time to complement our working capital needs.

Our cash position consists primarily of bank balances, less restricted bank deposits as guarantee for issuance of bank acceptances and letters of credit. As of 31 August 2010, we had cash and cash equivalents excluding restricted bank deposits of RMB597 million and we also had credit facilities in the aggregate maximum amount of approximately RMB660 million made available to us based on the indications of two commercial banks, of which approximately RMB382 million was not utilized. As of the Latest Practicable Date, we had not experienced any difficulties in renewing or obtaining bank facilities. Taking into account our cash and cash equivalents on hand, our available credit facilities, cash generated from our future operations and the estimated net proceeds from the Global Offering, our Directors are of the opinion that we have sufficient working capital to meet our present and future financial requirements for at least 12 months from the date of this Prospectus.

We had a net current liability position of RMB111.7 million and RMB1,030.0 million as of 31 December 2007 and 2008, respectively. We had a net current asset position of RMB320.2 million and RMB604.4 million as of 31 December 2009 and 30 June 2010, respectively. As of 31 August 2010, we had a net current asset position of RMB647.5 million. The table below sets forth our current assets, current liabilities and net current assets as of the dates indicated:

	As of 31 December			As of 30 June	As of 31 August
	2007	2008	2009	2010	2010
			(RMB million)		
					(unaudited)
Current assets					
Inventories	424.2	369.1	292.0	523.3	509.7
Trade and bills receivables	66.6	49.9	79.1	57.6	64.3
Prepayments and other receivables	162.9	98.2	143.3	121.7	143.7
Restricted bank deposits	21.9	6.9	19.7	138.8	138.5
Other investments	38.2	—	—	—	—
Cash and cash equivalents	96.9	304.9	660.6	610.4	597.3
Amounts due from related parties	128.6	18.0	21.2	16.8	1.1
Income tax recoverable	—	9.2	0.5	—	—
Total current assets	939.3	856.1	1,216.4	1,468.6	1,454.6
Current liabilities					
Loans and borrowings	164.0	327.3	230.0	330.5	330.5
Trade and other payables	604.4	1,347.9	643.3	504.3	461.1
Amounts due to related parties	271.9	155.5	10.1	7.8	6.4
Income tax payables	10.6	8.8	3.8	20.2	8.5
Provision for sales return	—	46.7	9.0	1.4	0.6
Total current liabilities	1,050.9	1,886.2	896.2	864.2	807.1
Net current (liabilities)/assets	(111.7)	(1,030.0)	320.2	604.4	647.5

Our net current liability position as of 31 December 2007 was primarily the result of our acquisition of non-current assets for our Shuozhou Plant, which had incurred current liabilities, such as construction expenses payables. Our net current liability position as of 31 December 2008 was the result of the increase in trade and other payables of RMB720.6 million, as compared to the balance as of 31 December 2007, primarily due to: (i) the increase in advances from customers resulting from our product recalls right after the 2008 nationwide melamine incident and our responsibility to exchange recalled products for new products; and (ii) our delayed repayments for trade payables to our suppliers due to the product recalls. Our net current asset position as of 31 December 2009 was the result of: (i) the decrease in our trade and other payables, particularly the advances from customers and trade payables to our suppliers, reflecting the recovery of our business operations and liquidity in 2009 from the product recalls in 2008; and (ii) the capital contribution in cash payments by our shareholders of RMB899.5 million from August to December 2009. Our net current asset position as of 30 June 2010 reflected: (i) the increase in our inventories, mainly due to the higher inventory level we maintained for imported raw milk powder, the addition of good-in-transit for the purchases of raw milk powder by Victory Trading, which we acquired in June 2010, in our inventory and the increase in inventory level of base milk powder in Shuozhou Plant that corresponded to our transition from domestic to overseas sources for raw milk powder; and (ii) the decrease in trade and other payables.

Our current assets divided by current liabilities, or current ratio, was 0.89, 0.45, 1.36 and 1.70 as of 31 December 2007, 2008 and 2009 and 30 June 2010, respectively. Our current assets after subtraction of inventories divided by current liabilities, or quick ratio, was 0.49, 0.26, 1.03 and 1.09 as of 31 December 2007, 2008 and 2009 and 30 June 2010, respectively. The changes of our current ratio and quick ratio in 2008 and 2009 were primarily due to the significant fluctuation in our current liabilities, in particular our trade and other payables in 2008, resulting from the product recalls.

Trade and Bills Receivables, Inventories and Trade and Bills Payables Turnover

The following table sets forth the turnover days of our trade and bills receivables, inventories and trade and bills payables for the periods indicated:

	Year ended 31 December			Six months ended 30 June
	2007	**2008**	**2009**	**2010**
		(days)		
Turnover days of trade and bills receivables[1]	8.4	6.6	11.2	7.6
Turnover days of inventories[2]	94.6	92.0	97.3	168.0
Turnover days of trade and bills payables[3]	36.3	93.4	91.6	88.0

(1) Turnover days of trade and bills receivables is derived by dividing the period end balances of trade and bills receivables for the relevant period by revenue and multiplying by 365 days with respect to turnover days of trade and bill receivables for a year or multiplying these figures by 181 days with respect to turnover days of trade and bill receivables for a six-month period.

(2) Turnover days of inventories is derived by dividing the period end balances of inventories for the relevant period by cost of sales and multiplying by 365 days with respect to the turnover days of inventories for a year or multiplying these figures by 181 days with respect to turnover days of inventories for a six-month period.

(3) Turnover days of trade and bills payables is derived by dividing the period end balances of trade and bills payables for the relevant period by cost of sales and multiplying by 365 days with respect to the turnover days of trade and bills payables for a year or multiplying these figures by 181 days with respect to turnover days of trade and bills payables for a six-month period.

Trade and bills receivables

Our trade and bills receivables mainly represent the limited situation of credit sales of our products, less impairment provision. The following table sets forth a breakdown of our trade and bills receivables as of the dates indicated:

	As of 31 December			As of 30 June
	2007	2008	2009	2010
	(RMB'000)			
Bills receivables	3,831	—	887	458
Trade receivables	66,612	54,792	79,489	59,605
Less: allowance for doubtful debts	(3,887)	(4,905)	(1,317)	(2,477)
	66,556	49,887	79,059	57,586

Trade and bills receivables are initially recognized at fair value and subsequently measured at amortized cost less allowance for impairment of doubtful debts. For the determination of allowance for impairment provision, we consider factors such as the significant financial difficulties of the debtors, the probability that the debtor will file for bankruptcy or be subject to financial reorganization, and the possibility of default or delinquent payments. As of 31 December 2007, 2008 and 2009 and 30 June 2010, we had impairment provisions for trade and bills receivables of RMB3.9 million, RMB4.9 million, RMB1.3 million and RMB2.5 million, respectively. Such provisions were for individually impaired receivables relating to customers that were in default or delinquency of payments. We do not hold any collateral or other credit enhancements over such amounts.

Regional distributors as our direct customers are generally required to pay in advance for the supply of our products. In principal, we do not allow credit purchases for orders made by distributors. This arrangement assists us in strengthening our cash flows, minimizing our receivables and preventing our exposure to the risk of engaging in bad debts. In limited direct sales made to certain major retail chains as well as in sales made to our trusted distributors with a good track record and with special approval from our senior management, we may offer unsecured credits ranging from 60 to 90 days for direct sales customers or ranging from 10 to 60 days for distributor customers for their purchases. The total amount of such trade receivables as of 31 December 2007, 2008 and 2009 and 30 June 2010 was RMB66.6 million, RMB49.9 million, RMB79.1 million and RMB57.6 million, representing 7.1%, 6.4%, 6.5% and 4.1% of our total current assets as of 31 December 2007, 2008 and 2009 and 30 June 2010, respectively.

The following table sets forth the aging analysis of our trade and bills receivables, net of allowance, as of 31 December 2007, 2008 and 2009 and 30 June 2010.

	As of 31 December			As of 30 June
	2007	2008	2009	2010
	(RMB'000)			
Current	65,200	49,877	67,338	45,521
Less than three months past due	915	—	3,231	2,957
Over three months but less than six months past due	19	—	138	1,391
Over six months but less than 12 months past due	—	10	1,231	777
Over 12 months but less than 24 months past due	422	—	7,121	6,940
	66,556	49,887	79,059	57,586

The increase of the balance of our overdue trade receivables as of 31 December 2009 was primarily due to the overdue trade receivables of RMB11.7 million from several major retail chain operators, which we assumed from Yashili (Shanghai) in July 2009. The delay of settlement for such receivables was attributable to the transition after our acquisition of Yashili (Shanghai). We have been closely following up on such receivables with the related customers and settled RMB6.0 million of the outstanding amount as of the Latest Practicable Date. We expect to settle the remaining amount by the end of 2010.

As of 31 August 2010, RMB35.9 million, or 62.8% of our trade receivables as of 30 June 2010 were subsequently settled.

We regularly review aging analysis of our trade receivables to monitor our credit exposures as well as the recoverability of our trade receivables and, when appropriate, we provide for impairment of the same. Our general policy is to make specific provisions for impairment of individual trade receivables that have been identified as impaired. The amount of provision made is the difference between the individual trade receivables carrying amount and the value of the estimated future cash inflow. Our provisions for impairment of trade receivables made pursuant to such policy have been able to reflect the recoverability of our overdue trade receivables and, as a result, our Directors believe that we made adequate provisions for impairment of trade receivables during the Track Record Period.

The turnover days of trade and bills receivables were 8.4, 6.6, 11.2 and 7.6 days for the years ended 31 December 2007, 2008 and 2009 and the six months ended 30 June 2010, respectively. The average turnover days of our trade and bills receivables during the Track Record Period remained at a reasonable level primarily due to the enforcement of our stringent credit policy.

Inventories

Our inventories primarily consist of raw materials, works in progress, finished goods, packaging materials and low value consumables. The following table sets forth the components of our inventories as of the dates indicated:

	As of 31 December			As of 30 June
	2007	**2008**	**2009**	**2010**
		(RMB'000)		
Raw materials	280,840	125,151	166,714	329,438
Finished goods	89,595	155,537	37,214	61,930
Works in progress	27,656	45,040	46,365	101,516
Packaging materials	24,005	36,254	33,287	23,291
Low value consumables	2,074	7,084	8,428	7,135
Total	424,170	369,066	292,008	523,310

Inventories of raw materials decreased from RMB280.8 million as of 31 December 2007 to RMB125.2 million as of 31 December 2008 and increased to RMB166.7 million as of 31 December 2009 and further to RMB329.4 million as of 30 June 2010. The change in our inventories of raw materials in 2008 was primarily due to the commencement of operations of our Shuozhou Plant, which enabled us to produce and secure sufficient supplies of base milk powder for our pediatric milk formula operations and reduce inventories of base milk powder. The change in inventories of raw materials in 2009 and the first half of 2010 was because we maintained a higher inventory level for imported raw milk powder to ensure an uninterrupted supply in light of the longer time required for shipment and relevant checking and custom clearance procedures. The increase in inventory level of raw materials in 2010 was also due to the addition of good-in-transit of RMB85.7 million in connection with the raw materials purchased by Victory Trading, which we acquired in June 2010. Finished goods are being sold to our customers within 20 to 30 days upon completion. Inventories of finished goods were RMB89.6 million as of 31 December 2007, RMB155.5 million as of 31 December 2008, RMB37.2 million as of 31 December 2009 and RMB61.9 million as of 30 June 2010. Such changes were primarily due to the prolonged inspection period for finished goods after the 2008 nationwide melamine incident and our enhanced control over inventory level of finished products. Inventories of works in progress, consisting mainly of the base milk powder for our pediatric milk formula products, increased from RMB27.7 million as of 31 December 2007 to RMB45.0 million as of 31 December 2008, to RMB46.4 million as of 31 December 2009 and to RMB101.5 million as of 30 June 2010, primarily due to the commencement of operations of the Shuozhou Plant in 2008 and the change in transportation method for base milk powder to our Shantou and Guangzhou plants from ground transportation to shipping. Inventories of packaging materials increased from RMB24.0 million as of 31 December 2007 to RMB36.3 million as of 31 December 2008 and decreased to RMB33.3 million as of 31 December 2009 and further to RMB23.3 million as of 30 June 2010.

As of 31 August 2010, RMB395.8 million, or 75.6% of our inventories as of 30 June 2010 were subsequently consumed or sold.

We actively monitor our inventory levels and seek to maintain a reasonable level of inventory of raw materials, works in progress and finished products. We closely monitor and assess the sales performance of our products so that we can adjust our production plans. We increase the purchase of raw materials when we believe the costs of raw materials may decrease and our estimates of production and sales make it prudent to do so. Inventories are stated at cost or net realized value, whichever is lower. Net realized value is the estimated selling price in the normal course of our business less the estimated costs to completion and the estimated expenses necessary to make the sale. We make provisions for impairment of inventories when the carrying value of inventories declines below the net realizable value. We review our inventory of raw materials, works in progress, finished goods and packaging materials on a case-by-case basis to determine whether it has become obsolete and make write-down or write-off charges. If actual market conditions are less favorable or other factors arise that are significantly different from those anticipated by management, additional inventory write-downs or increases in obsolescence reserves may be required. As of 31 December 2007, 2008 and 2009 and 30 June 2010, the balances of our provisions for impairment of inventories were nil, RMB456.9 million, RMB30.6 million and RMB28.0 million, respectively. We had write-downs of inventories of RMB456.9 million and disposal of inventories of RMB159.7 million in 2008 and disposal of inventories of RMB0.5 million in 2009, primarily due to the product recalls beginning in September 2008, which did not recur in 2010. In addition, we also recorded losses on disposal of inventory of RMB7.3 million, RMB3.5 million, RMB9.0 million and RMB3.4 million for the years ended 31 December 2007, 2008 and 2009 and the six months ended 30 June 2010, respectively, which were primarily relating to general stocktake losses and disposal of dampened or deteriorated inventory as well as disposal of packaging materials due to the change of packaging and labeling in the ordinary course of business.

Our turnover days of inventories were 94.6 days in 2007, 92.0 days in 2008 and 97.3 days in 2009, primarily due to our continuous efforts to enforce our inventory control policies. Our turnover days of inventories increased to 167.1 days for the six months ended 30 June 2010, primarily due to (i) the higher inventory levels we maintained to ensure uninterrupted supply of raw materials and semi-finished products during our production process in response to our transition to import raw milk powder from overseas suppliers; and (ii) the addition of good-in-transit relating to the imported raw materials purchased by Victory Trading, which we acquired in June 2010, to our inventory.

Trade and other payables

The following table sets forth the components of our trade and other payables as of the dates indicated:

	As of 31 December			As of 30 June
	2007	2008	2009	2010
	(RMB'000)			
Trade payables	158,495	364,330	265,836	268,998
Bills payables	4,437	10,310	8,988	5,135
Advances from customers	295,131	677,547	154,561	83,672
Accrued payroll	23,946	20,712	26,360	12,444
Other taxes payables	30,670	87,115	62,961	21,956
Advances from local government	—	60,000	50,000	40,000
Derivative financial liabilities	—	—	—	432
Pledged deposit from customers	1,898	26,949	27,115	30,147
Other payables and accruals	89,841	100,959	47,421	41,479
Total	604,418	1,347,922	643,242	504,263

Our trade payables mainly comprise of amounts outstanding for trade purchases from the suppliers of raw materials, packaging materials and gifts for our products. Our trade payables increased from RMB158.5 million as of 31 December 2007 to RMB364.3 million as of 31 December 2008 and then decreased to RMB265.8 million as of 31 December 2009 and remained stable at RMB269.0 million as of 30 June 2010. Such changes were primarily due to the delay of our repayments of certain trade payables in 2008 in responses to our relatively tight liquidity after product recalls in 2008, to the extent that we repaid within the credit period agreed to by the suppliers. As of 31 August 2010, RMB208.0 million, or 77.3% of our trade payables as of 30 June 2010 was subsequently settled.

The following table sets forth the aging analysis of our trade payables as of 31 December 2007, 2008 and 2009 and 30 June 2010:

	As of 31 December			As of 30 June
	2007	2008	2009	2010
	(RMB'000)			
Within one month or on demand	63,226	180,277	86,704	106,878
After one month but within three months	68,018	127,027	150,878	140,586
After three months but within six months	27,251	57,026	28,254	21,534
	158,495	364,330	265,836	268,998

Our suppliers generally grant us a credit period from 30 days to 90 days. Our turnover days of trade and bills payables were 36.3, 93.4, 91.6 and 87.5 days for the years ended 31 December 2007, 2008 and 2009 and the six months ended 30 June 2010, respectively. Such changes in turnover days were primarily because of the product recalls in late 2008 that significantly affected our working capital requirements. We successfully negotiated with our suppliers and managed to extend our credit period based on our good relationship with our suppliers, reliable track record and reputation after the product recalls.

Advances from customers primarily represented the payments provided by our customers when they placed their purchase orders, for which we processed but had not completed the delivery of products ordered. The advances from customers were RMB295.1 million, RMB677.5 million, RMB154.6 million and RMB83.7 million as of 31 December 2007, 2008 and 2009 and 30 June 2010, respectively. The significant increase in the advances from customers in 2008 was primarily due to our product recalls and sales returns as a result of the 2008 nationwide melamine incident, for which we were responsible for exchanging products recalled with new products or make cash refunds to our customers subsequently. We recorded the sales amounts of recalled products as advances from customers after our customers returned such products to us because we were not able to complete the delivery of new lots of products or make cash refunds to them concurrently at the time of the product recalls in 2008 due to the large amount of sales returns of approximately RMB985 million. The relevant balance of advances from customers recorded in connection with the product recalls in 2008 was deducted gradually to offset against our delivery of new lots of products or cash refunds to our customers, mainly in the fourth quarter of 2008 and in 2009. The decrease of advances from customers since 2009 mainly reflected the completion of exchanging products recalled in 2008 for new products and our enhanced operating efficiency for processing purchase orders and delivering our products.

We received advances of RMB60 million from local governments in late 2008 as assistance for our response to the 2008 nationwide melamine incident. The advance of RMB30 million received from the People's Government of Ying County bears a fixed interest rate of 5.76% per annum and is secured by relevant buildings, machinery and equipment of our Shuozhou Plant. Such advance was provided to serve as our working funds for purchasing raw materials only and the use of such advance shall be under the supervision of finance and audit departments of the local government. Another advance of RMB30 million from the People's Government of Chao'an County is unsecured, interest-free and with no condition. The People's Government of Chao'an County waived RMB10 million in 2009 as a government grant to us and we further repaid RMB10 million in April 2010 to the People's Government of Chao'an County. There is no fixed repayment terms over such advances. Our PRC legal advisor, Tian Yuan Law Firm, has advised that the advances from local governments may be deemed invalid under relevant PRC laws and regulations. If such advances are deemed invalid, such lending shall be restituted and the Company shall return the advances to the government authorities. Although the local governments have not requested repayment of the advances, we have sufficient funds and will repay the advances upon the requests of the local governments. According to the PRC General Rules on Loans (貸款通則) promulgated by the People's Bank of China, the PBOC may impose a fine on the lender equivalent to one to five times of the amount of illegal gains, such as interest income, from the advances; however, there is no specific penalty provision on us as the borrower.

Other payables and accruals primarily consist of dividends payables, payables for construction and payables for land use rights. As of 31 December 2007, 2008 and 2009 and 30 June 2010, our other payables and accruals were RMB89.8 million, RMB101.0 million, RMB47.4 million and RMB41.5 million, respectively. The significant increase of the balance of other payables and accruals in 2008 was mainly attributable to the payables for construction and the acquisition of relevant land use rights with respect to our Guangzhou Plant.

Provision for sales return

In September 2008 after the 2008 nationwide melamine incident, we offered an agreed percentage of permitted sales return to distributors for our products manufactured and sold during the period between October and December 2008, which were not able to be sold by our distributors. The maximum percentage of permitted sales return for our *Scient* and *Yashily* products was 10% and 15%, respectively. All of our provisions for sales return during the Track Record Period were made in this regard for losses arising from the potential sales return based on our best estimate. As of 31 December 2008 and 2009 and 30 June 2010, our provision for sales return was RMB46.7 million, RMB9.0 million and RMB1.4 million, respectively.

The following table sets forth the movement of the balance of our provision for sales return during the Track Record Period:

	As of 31 December			As of 30 June
	2007	2008	2009	2010
	(RMB'000)			
Balance at the beginning of the year/ period	—	—	46,665	9,023
Charge for the year/period	—	46,665	1,923	—
Utilized during the year/period	—	—	(39,565)	(7,614)
	—	46,665	9,023	1,409

Restricted bank deposits and cash and cash equivalents

Our restricted bank deposits primarily consist of collaterals we provided for bank acceptance, letters of credit and bank loans, in the amount of RMB21.9 million, RMB6.9 million, RMB19.7 million and RMB138.8 million as of 31 December 2007, 2008 and 2009 and 30 June 2010, respectively.

We also had frozen deposits of RMB10.7 million as of 31 December 2009 and RMB9.4 million as of 30 June 2010. The frozen deposits were in relation to two suppliers. An amount of RMB4.9 million of our bank deposits was frozen by the court in a pending litigation between us and our supplier involving a dispute of payments for dairy materials containing melamine. During the litigation, a creditor of such supplier applied for freezing our bank deposits on the ground that the supplier had trade payables from us. The court then found for us in this case and ordered the supplier to pay us RMB7,109,000 as compensation for the melamine-contaminated dairy materials provided by such suppliers and, as a result, such frozen deposits were subsequently released on 11 June 2010. Another RMB5.8 million and RMB3.6 million were frozen by the court on 13 June 2009 and on 9 June 2010, respectively, in a pending litigation against us, where another supplier requested our payments for the dairy products it provided to us. Although such supplier was ordered by the court to pay us approximately RMB6.4 million as compensation for providing melamine-contaminated dairy materials to us in 2008, the litigation against us was still pending as of the Latest Practicable Date.

As of 31 December 2007, 2008 and 2009 and 30 June 2010, we also have cash on hand and in the bank of RMB96.9 million, RMB304.9 million, RMB660.6 million and RMB610.4 million, respectively.

Amounts due from related parties

As of 31 December 2007, 2008 and 2009 and 30 June 2010, we had amounts due from related parties of RMB128.6 million, RMB18.0 million, RMB21.2 million and RMB16.8 million, respectively.

These amounts included trade related amounts due from related parties of RMB12.2 million, RMB2.4 million, RMB3.5 million and RMB1.3 million as of 31 December 2007, 2008 and 2009 and 30 June 2010, respectively, primarily from our sales of packaging materials to Haoweijia Food. Furthermore, we also had other receivables from our controlling equity owners for the payment of individual income tax of RMB15.6 million as of 31 December 2008 and 2009 and as of 30 June 2010 on dividend distributed by Yashili (Guangdong), which we prepaid on behalf of the individual shareholders of Yashili (Guangdong).

In addition, we had non-trade amounts due from related parties during the Track Record Period, including advances to our controlling equity owners for their short-term funding needs. Our advances to our controlling equity owners included RMB76.2 million as of 31 December 2007, of which RMB56.0 million bore a fixed interest rate at 2.4% and RMB20.2 million bore a fixed interest rate at 3.6%, and RMB2.0 million as of 31 December 2009, which was interest-free. Our PRC legal advisor, Tian Yuan Law Firm, has confirmed that our advances to our controlling equity owners through entrusted loan arrangements were legal and valid under relevant PRC laws and regulations.

Pursuant to the relevant PRC laws and regulations, including but not limited to the PRC General Rules on Loans, no PRC corporation is allowed to make any advancement of a loan to others without approval. Failure to comply with the PRC General Rules on Loans may subject the lender to a fine of not less than one time but no more than five times the amount of the illegal gains as a result of such breach. According to our PRC legal advisor, Tian Yuan Law Firm, our advances made to the controlling equity owners constituted breaches of the General Rules on Loans. Our Controlling Shareholders have agreed to indemnify us for any losses or damages arising from the advances made if we are subject to any penalty or fines resulting from the said advances we made.

As of the Latest Practicable Date, such advances were repaid in full and we will not provide such advances to related parties after the Listing.

Other investments

As of 31 December 2007, we had other investments of RMB38.2 million, representing investment products such as bank-issued investment products, mutual funds and listed equity securities purchased by Scient (Guangzhou). Since 2008, we have adopted an internal policy to restrict investment in equity securities and mutual funds with higher risk and volatility and only allow lower risk investments, such as products or deposits that offer protection of principal to maturity. Our finance and risk management departments have closely monitored such other investments and any investment exceeding RMB30 million requires the approval from our Board of Directors. As a result, we primarily purchased and sold principal protected investment products issued by banks mainly for inflation-proof purposes with the consideration of the low interest rates for our bank deposits in 2008 and 2009 and for the six months ended 30 June 2010. We had gains from our other investments of RMB11.5 million in aggregate during the Track Record Period. However, such investments had not been and will not be a major source of our income during the Track Record Period and in the future. We expect that we will not make significant investments in such products after the Listing.

Capital Expenditures

Our capital expenditures, which primarily relate to cash payments for purchase of property, plants and equipment and other long-term assets, were RMB481.4 million, RMB220.2 million, RMB129.9 million and RMB29.5 million for the years ended 31 December 2007, 2008 and 2009 and the six months ended 30 June 2010, respectively. Our principal requirements for capital expenditures are in relation to the organization and construction of new production facilities or expansion of our production facilities, modernization of our existing plants and machinery for our pediatric milk formula production lines.

As part of our future growth strategy, we estimate that our capital expenditures will be approximately RMB41.7 million for the year ending 31 December 2010. Our planned capital expenditures for our business operations will primarily consist of acquisition of land use right and purchase and construction of property, plant and equipment.

Total estimated capital expenditures for the resumed construction of and equipment purchase for the Zhengzhou Plant, the upgrade of existing facilities of the Chaozhou Plant and the construction of our new production plant in Chaozhou are expected to amount to RMB450 million, 91 million and 340 million, respectively. We have incurred expenditures of approximately RMB55 million for Zhengzhou Plant but have not incurred any expenditure or contracted for any commitment for the new production plant in Chaozhou and the upgrade of our Chaozhou Plant as of 30 June 2010. Total estimated expenditures for our new food research institute and the acquisition of laboratory equipment are expected to be approximately RMB286 million.

We anticipate that the capital expenditures described above will be financed by cash generated from our operations and the net proceeds from the Global Offering. We currently do not seek other additional financing for such expenditures. The estimated amount of expenditures may vary from the actual amount for a variety of reasons, including changes in market conditions, competition and other factors.

Our current plan with respect to future capital expenditures is subject to change based on the evolution of our business plan, including potential acquisitions, the progress of our capital projects, prevailing market conditions and our future outlook. There is no guarantee that any of the planned capital expenditures outlined above will proceed as planned. As we continue to expand, we may incur additional capital expenditures. Other than as required by law, we do not undertake any obligation to publish updates of our capital expenditure plans. See "Forward-looking Statements".

Indebtedness

Loans and Borrowings

As of 31 August 2010, we had credit facilities in the aggregate maximum amount of RMB660 million made available to us based on the indications of two commercial banks, of which RMB382 million were not utilized and available to be drawn down. Our banking facilities primarily consisted of short-term working capital loans, although we also utilized a smaller amount of long-term loans in relation to longer-term commitments. All of our total loans and borrowings as of 30 June 2010 were due within one year. The following table sets forth a breakdown of our loans and borrowings and maturity profiles as of the dates indicated:

	As of 31 December			As of 30 June	As of 31 August
	2007	2008	2009	2010	2010
			(RMB'000)		
					(unaudited)
Within one year or on demand	164,000	327,340	230,000	330,535	330,535
After one year but within two years	—	40,000	—	—	—
	164,000	367,340	230,000	330,535	330,535

All of our loans and borrowings were fixed interest rate loans.

	As of 31 December			As of 30 June	As of 31 August
	2007	2008	2009	2010	2010
			(RMB'000)		(unaudited)
Bank loans	129,000	316,000	230,000	330,535	330,535
Entrusted loans	35,000	49,000	—	—	—
Other loan	—	2,340	—	—	—
	164,000	367,340	230,000	330,535	330,535

The outstanding amount of our Renminbi denominated bank loans as of 31 December 2007, 2008 and 2009 and 30 June 2010 were RMB129.0 million, RMB316.0 million, RMB230.0 million and RMB330.5 million, respectively. Such bank loans were all short-term loans and carried weighted average interest rates of 6.76%, 6.76%, 5.22% and 5.22% per year as of 31 December 2007, 2008 and 2009 and 30 June 2010, respectively. In addition, we have RMB100.5 million bank loans denominated in US dollars as of 30 June 2010, which carried a weighted average interest rate of 2.0% per annum and were secured by the equivalent amount of our bank deposits. Such loans were extended to our subsidiary, Victory Trading, that we acquired in June 2010. In addition, we had entrusted loans of RMB35.0 million and RMB49.0 million as of 31 December 2007 and 2008, respectively. Such entrusted loans were extended by commercial banks upon the request of six individuals who are Independent Third Parties and good friends of our Controlling Shareholders and carried weighted average interest rates of 5.78% and 6.76% per year as of 31 December 2007 and 2008, respectively. Such entrusted loans were for our short term funding needs and had been repaid in full. Our PRC legal advisor, Tian Yuan Law Firm, has advised that such entrusted loan arrangements were legal and valid under the relevant PRC laws and regulations. Other loan represented an unsecured short-term loan of RMB2.3 million from Guangzhou Development Zone Enterprise Construction and Service Bureau with a fixed interest rate of 6.12%.

The following table sets forth a breakdown of our secured and unsecured loans and borrowings as of the dates indicated:

	As of 31 December			As of 30 June	As of 31 August
	2007	2008	2009	2010	2010
			(RMB'000)		(unaudited)
Bank loans					
Secured	129,000	216,000	230,000	330,535	330,535
Unsecured	—	100,000	—	—	—
Unsecured loans	35,000	51,340	—	—	—
	164,000	367,340	230,000	330,535	330,535

Our secured bank loans are generally secured by:

- pledge over certain of our property, plant and equipment, with carrying amounts of RMB8.9 million, RMB50.3 million, RMB170.2 million and RMB97.3 million as of 31 December 2007, 2008 and 2009 and 30 June 2010, respectively;

- pledge over our investment properties, with carrying amounts of RMB43.1 million and RMB61.3 million as of 31 December 2009 and 30 June 2010;

- pledge over our lease prepayments, with carrying amounts of RMB33.5 million, RMB40.2 million, RMB42.3 million and RMB38.9 million as of 31 December 2007, 2008 and 2009 and 30 June 2010, respectively;

- pledge over our bank deposit with carrying amount of RMB101.1 million as of 30 June 2010; and

- guarantees provided by our controlling equity owners, amounting to RMB64.0 million and RMB97.0 million as of 31 December 2007 and 2008, respectively.

Gearing ratio is calculated by dividing total interest-bearing bank loans by total assets as of each balance sheet date. Our gearing ratios as of 31 December 2007, 2008 and 2009 and 30 June 2010 were 9.8%, 19.2%, 10.3% and 13.6%, respectively. The changes in gearing ratio during the Track Record Period were mainly driven by bank borrowing level changes as of the end of each year and the steady increases in our total assets. We increased our short-term bank borrowings, after the product recalls, in 2008 and 2009 to accommodate our working capital needs, especially for relevant product recall arrangements and implementation of our stricter quality control system. We repaid part of the bank borrowings after we received the capital contribution from our shareholders in cash in 2009.

Other than the short-term bridge loans in the amount of HK$13 million and US$1 million for the purpose of paying relevant expenses in connection with the Global Offering, there has been no material change in our indebtedness since 31 August 2010.

Advances from the Controlling Equity Owners

As of 31 December 2007, 2008 and 30 June 2010, we had advances from our controlling equity owners of RMB154.0 million, RMB90.0 million and RMB1.0 million, respectively. The advances of RMB152.0 million as of 31 December 2007 were provided to us through entrusted loan arrangements and carried a weighted average interest rate of 6.97%. Our PRC legal advisor, Tian Yuan Law Firm, has advised that the advances from our controlling equity owners in the form of entrusted loans were legal and valid under relevant PRC laws and regulations. The advances of RMB2.0 million, RMB90.0 million and RMB1.0 million as of 31 December 2007 and 2008 and 30 June 2010, respectively, were provided by our controlling equity owners. Our PRC legal advisor, Tian Yuan Law Firm, has advised that the advances made by Zhang's Investment (Shantou) to us constituted a breach of the General Rules on Loans. We have repaid in full such advances from our controlling equity owners and will not continue such financing after the Listing.

Contingent Liabilities

As of 31 December 2009, we provided guarantees to Industrial and Commercial Bank of China, Chao'an Branch for the bank loans and bank acceptances of Victory Trading, one of our then raw milk powder suppliers in 2009, in the amount of RMB100.0 million. During the Track Record Period, no claims had been made against us under such guarantees. On 25 June 2010, we acquired 100% equity interest in Victory Trading. Except for such guarantees, we did not have any outstanding loan capital, bank overdraft, liabilities under acceptance or other similar indebtedness, debenture, mortgage, charges, acceptance credits, hire purchase commitments or other material contingent liabilities during the Track Record Period and as of 30 June 2010.

Save as disclosed in this Prospectus, we confirm that there has not been any material change in the contingent liabilities of our Company since 30 June 2010.

Commitments

Contractual obligations

We lease certain production plants, warehouses and equipment under operating lease arrangements. Except for a lease of plant from our controlling equity owners with a lease period of ten years, our operating leases generally run for a one-year period, with an option to renew the lease when all terms are renegotiated. The terms of the leases generally require us to pay security deposits and none of these terms include contingent rentals. Our future aggregate minimum operating lease payments under non-cancellable operating leases as of the dates indicated are set forth below:

	As of 31 December			As of 30 June
	2007	2008	2009	2010
	(RMB'000)			
Less than one year	2,456	11,966	10,436	7,710
Between one year to five years	212	10,955	10,791	10,901
More than five years	—	11,391	8,711	7,371
Total	2,668	34,312	29,938	25,982

Capital commitments

In addition to the operating lease commitments, we had the following commitments as of the dates indicated:

	As of 31 December			As of 30 June
	2007	2008	2009	2010
	(RMB'000)			
Contracted for:				
Property, plant and equipment	61,269	61,802	10,982	10,982

Our capital commitments as of 31 December 2007 and 2008 were primarily relating to the construction of our Guangzhou Plant and our capital commitments as of 31 December 2009 and 30 June 2010 were primarily relating to our Zhengzhou Plant.

Off-balance Sheet Arrangements

As of 30 June 2010, we did not have any material off-balance sheet arrangements with unconsolidated entities.

Quantitative and Qualitative Disclosures about Market Risk

We are exposed to various types of market risks in the ordinary course of our business, including fluctuations in interest rates and changes in commodity prices for our raw materials, as well as credit risk and liquidity risk. We manage our exposure to these and other market risks through regular operating and financial activities.

Commodity Price Risk

Raw milk powder, other raw materials and packaging materials are the major materials of our products, which account for more than 85% of our total costs of sales. Fluctuation on commodity prices of raw materials and packaging materials will have a significant impact on our earnings, cash flows as well as the value of our inventories. We minimize the costs of materials by centralizing the purchase of raw materials for our Group and by self-producing part of our packaging materials, such as cans, PVC bags and large printed cardboard boxes. We have not historically entered into any commodity derivative instruments to hedge our potential commodity price changes.

Interest Rate Risks

Except for bank deposits with variable interest rates pursuant to the adjustment of the PBOC benchmark rate and the advances to related parties with fixed interest rates, we have no interest-bearing assets. Accordingly, our income and operating cash flows are substantially independent of market rate changes.

We did not account for any fixed rate financial assets or liabilities at fair value in the Track Record Period, nor did we obtain any loans and borrowings as well as advances from our controlling equity owners at variable interest rates and, therefore, a change in interest rate would not affect our finance costs and financial cash flows.

For the years ended 31 December 2007, 2008 and 2009 and the six months ended 30 June 2010, if interests rates on our deposits with banks had been 27 basis points higher/lower with all other variables held constant, our profit before tax for the year would have been RMB278,000, RMB714,000, RMB1,588,000 and RMB311,000 higher/lower, respectively.

We have not historically used, and do not expect to use in the future, any derivatives financial instruments to manage our interest rate exposure.

Foreign currency risk

Our businesses are principally located in the PRC and our sales and purchases have been mainly settled in our functional currency, Renminbi, even though the purchase prices of some raw materials are determined by reference to the prevailing prices of the global market at the prevailing currency of US dollars. However, our subsidiary Victory Trading, which was acquired on 25 June 2010, is exposed to foreign currency exchange risk when it purchases raw milk powder overseas. To manage foreign currency transaction costs, Victory Trading entered into a number of foreign currency forward contracts, in which the bank offers a lower rate than spot rate to Victory Trading for purchasing US dollars when it settles the due letter of credit; and at the same time, the bank also granted loans in US dollars to Victory Trading with the equivalent amount.

Our net exposure to foreign currency risk was US$5.2 million as of 30 June 2010. As of 30 June 2010, if the exchange rate of Renminbi had increased or decreased by 5% against the US dollar, our profit after tax and retained profits would have increased or decreased by RMB1.8 million. Save for the foreign currency forward contracts into which Victory Trading entered to manage transaction costs for its trading business, we did not enter into any contracts to hedge the foreign currency exchange risks.

Credit risk

Our credit risk is primarily attributable to trade and other receivables. Trade receivable balances are monitored by our management on an ongoing basis. All trade debtors who wish to trade on credit terms are subject to credit verification procedures. It is our policy to offer unsecured credit only to certain large supermarkets and retail chains ranging from 60 to 90 days and to a limited number of distributors, who have been trading with us for many years with good track records, on a transaction-to-transaction basis ranging from 10 to 60 days. Special credit is granted to credit-worthy distributor customers when we promote certain lines of products. Except for a limited number of credit sales, we request full advances for our sales to other customers. We regularly review aging analysis of our trade receivables to monitor our credit exposure.

The majority of our distributor customers have been trading with us for over three years and we did not record significant bad debts losses during the Track Record Period. Sufficient impairment allowance had been made against our trade receivables as of 31 December 2007, 2008 and 2009 and 30 June 2010. We have certain concentration risk on our trade receivables as of balance sheet dates, and our top five trade debtors accounted for 30.7%, 82.3%, 42.3% and 40.9% as of 31 December 2007, 2008 and 2009 and 30 June 2010, respectively. The balance of trade receivables as of 31 December 2008 included trade receivables due from Yashili (Shanghai), which was acquired by us in 2009, of RMB31.5 million, accounting for 63.2% of our total trade receivables. All of our trade receivables were due from our customers with good track records and no impairment was made against such customers during the Track Record Period.

With respect to credit risk arising from the other major financial assets of our Company, which comprise of cash and cash equivalents, restricted bank deposits, amounts due from related parties and prepayments and other receivables, our exposure to credit risk arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these assets. In addition, substantially all of our cash and cash equivalents are held in major financial institutions located in China, which our management believes are of high credit quality. Except for the guarantee we provided for Victory Trading, we did not provide any other guarantee which will subject us to credit risk. As of the date of the Prospectus, we had not experienced any material adverse change to our business due to any bankruptcy filings or defaults on the part of our major customers, suppliers or counterparties.

Liquidity risk

We are exposed to a liquidity risk that we may not be able to meet our financial obligations when they fall due. Our approach to managing liquidity risk is to ensure that our Group, as a whole, will have sufficient liquidity to meet our liabilities when they fall due, under both normal and stressed situations, without incurring unacceptable losses or risking damage to our reputation. Our objective is to maintain a balance between continuity of funding and flexibility through maintaining sufficient cash and cash equivalents and available funding through an adequate amount of committed credit facilities from bank borrowings and other available sources of financing. Our cash and cash equivalents are placed with reputable financial institutions. We have also obtained credit facilities in the aggregate maximum amount of approximately RMB660 million based on the indications of two commercial banks, of which approximately RMB382 million had not been utilized as of 31 August 2010. Taking into account these factors and our expected cash generated from operating activities as well as our planned business expansion, our Directors are of the view that we will not have any difficulty in meeting our liquidity needs within 12 months from the date of this Prospectus.

DISCLOSURE UNDER RULES 13.13 TO 13.19 OF THE HONG KONG LISTING RULES

Our Directors confirm that as of the Latest Practicable Date, there were no circumstances which would give rise to the disclosure requirements under Rules 13.13 to 13.19 of the Hong Kong Listing Rules had the Shares been listed on the Hong Kong Stock Exchange on that date.

ADJUSTED NET TANGIBLE ASSETS

The following is an illustrative and pro forma statement of adjusted net tangible assets of our Group which has been prepared on the basis of the notes set out below for the purpose of illustrating the effect of the Global Offering as if it had taken place on 30 June 2010. This unaudited pro forma statement of adjusted net tangible assets has been prepared for illustrative purposes only and because of its hypothetical nature, it may not give a true picture of the financial positions of our Group had the Global Offering been completed on 30 June 2010 or any future dates.

	Combined net tangible assets attributable to the equity holders of our Company as of 30 June 2010(1)	Estimated net proceeds from the Global Offering(2)	Unaudited pro forma adjusted net tangible assets	Unaudited pro forma adjusted net tangible assets per Share(3)	
	(RMB'000)	(RMB'000)	(RMB'000)	(RMB)	(HK$)
Based on the Offer Price of HK$3.55 for each Offer Share	1,511,768	1,678,261	3,190,029	0.911	1.055
Based on the Offer Price of HK$4.80 for each Offer Share	1,511,768	2,282,283	3,794,051	1.084	1.255

(1) The combined net tangible assets attributable to the equity holders of our Company as of 30 June 2010 is extracted from the Accountants' Report set out in Appendix I to this Prospectus, which is based on the combined net assets attributable to the equity holders of our Company as of 30 June 2010 of RMB1,520.0 million after deducting intangible assets of RMB8.3 million and adjusting the share of these intangible assets attributable to non-controlling interests of RMB0.03 million.

(2) The estimated net proceeds from the Global Offering are based on an indicative Offer Price of HK$3.55 (equivalent to RMB3.07) and HK$4.80 (equivalent to RMB4.14) per Share respectively (after deducting the underwriting fees and other related expenses), and takes no account of any Shares which may be issued pursuant to the Over-allotment Option, the options granted under the Pre-IPO Share Option Scheme or the options that may be granted under the Share Option Scheme. For the purpose of the estimated net proceeds from the Global Offering, the translation of RMB into HK dollars was made at the rate of RMB0.8635 to HK$1, the exchange rate prevailing on 30 September 2010 set by PBOC for foreign exchange transactions.

(3) The unaudited pro forma adjusted net tangible assets per Share is arrived at by dividing the unaudited pro forma adjusted net tangible assets by 3,500,000,000 Shares, being the number of shares in issue assuming that the Global Offering has been completed on 30 June 2010 but takes no account of any Shares which may be issued upon the exercise of the Over-allotment Option, the options granted under the Pre-IPO Share Option Scheme and the options that may be granted under the Share Option Scheme.

(4) Our property interests as of 31 August 2010 have been valued by Vigers Appraisal and Consulting Ltd., an independent property valuer. The details of such valuation are set out in Appendix IV to this Prospectus. We will not incorporate the revaluation surplus of RMB169,334,000 in our financial statements. It is our Group's accounting policy to state our land and buildings held for own use and our investment properties at cost less accumulated depreciation and any impairment loss in accordance with IFRS, rather than at revalued amounts. With reference to the valuation of our property interests as set forth in Appendix IV to this Prospectus, if such revaluation surplus was incorporated in our financial statements, an additional depreciation charge of approximately RMB4.5 million per annum would have been incurred.

PROPERTY INTERESTS AND PROPERTY VALUATION

Vigers Appraisal and Consulting Ltd., an independent property valuer, has valued our property interests as of 31 August 2010. The full text of the letter, summary of valuation and valuation certificates with regard to such property interests are set out in Appendix IV to this Prospectus.

The table below sets forth the reconciliation between the net book value of our property interests as of 30 June 2010 and the valuation of such property interest as of 31 August 2010:

	(RMB thousand)
Net book value of our property interests as of 30 June 2010	
— Buildings, land use rights and construction in progress	581,417
Movements for the two months ended 31 August 2010	
Add: Net addition during the period	1,875
Less: Depreciation and amortization during the period	(3,542)
Net book value as of 31 August 2010	579,750
Valuation surplus	169,334
Valuation as of 31 August 2010[1]	749,084

(1) Net book value of our property interests as of 30 June 2010 represented the properties, including plant and buildings, investment properties, lease prepayments and buildings under construction with net book value of RMB372,515,000, RMB63,022,000, RMB113,734,000 and RMB32,146,000 respectively, with or without certificates. The valuation was performed by Vigers Appraisal and Consulting Ltd., which are described in Appendix IV to this Prospectus.

PROFIT FORECAST

We believe that on the bases and assumptions as set forth in Appendix III to this Prospectus, and in the absence of unforeseen circumstances, our consolidated profit attributable to equity holders of our Company for the year ending 31 December 2010 is expected to be not less than RMB496 million. The profit forecast has been prepared by our Directors based on our audited combined results for the six months ended 30 June 2010 and the unaudited consolidated results for the two months ended 31 August 2010 and the forecast results of the consolidated results for the remaining four months ending 31 December 2010.

The profit forecast is presented on a basis consistent in all material respects with the accounting policies currently adopted by us as set out in the Accountants' Report in Appendix I to this Prospectus.

Our Directors have prepared a profit forecast only for the year ending 31 December 2010, as the factors described under "Risk Factors" and "Financial Information — Management's discussion and analysis of financial condition and results of operations — Factors affecting our results of operations and financial condition and comparability" make any forecast for a longer period subject to too many uncertainties.

The unaudited pro forma forecast earnings per Share for the year ending 31 December 2010 is expected to be not less than RMB0.14. This amount has been calculated based on the forecast consolidated profit attributable to equity holders of the Company for the year ending 31 December 2010 and assuming that our Company had been listed since 1 January 2010 and a total of 3,500,000,000 Shares were in issue during the year ending 31 December 2010, without taking into account any Shares which may be allotted and issued upon the exercise of the Over-Allotment Option or any option which may be granted under the Pre-IPO Share Option Scheme and the Share Option Scheme.

DIVIDEND POLICY

After completion of the Global Offering, we may distribute dividends by way of cash or by other means that our Directors consider appropriate. A decision to distribute any interim dividend or recommend any final dividend would require the approval of our Board of Directors and will be at their discretion. In addition, any final dividend for a financial year will be subject to Shareholders' approval. Our Board of Directors will review our Company's dividend policy from time to time in light of the following factors in determining whether dividends are to be declared and paid:

- our financial results;
- Shareholders' interests;
- general business conditions, strategies and future expansion needs;
- our Company's capital requirements;
- the payment by its subsidiaries of cash dividends to our Company;
- possible effects on liquidity and financial position of our Company; and
- other factors the Board of Directors may deem relevant.

Subject to the factors described above, our Board of Directors currently intends to recommend at the relevant Shareholders' meetings of our Company an annual dividend of no less than 25% of our profits available for distribution after the Listing and available for distribution to our Shareholders in the foreseeable future.

DISTRIBUTABLE RESERVES

As our Company was only incorporated on 3 June 2010, there were no reserves available for distribution to shareholders as of 30 June 2010.

NO MATERIAL ADVERSE CHANGE

Save as disclosed in "— Management's discussion and analysis of financial condition and results of operations — Indebtedness" and "— Dividend policy", we have confirmed that there has been no material adverse change in our financial or trading position since 30 June 2010 (being the date to which our Company's latest combined financial results were prepared, as set out in the Accountants' Report in Appendix I to this Prospectus).