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[●]

The Directors
Modern Farming (Group) Co., Ltd.

[●]

[●]

Dear Sirs,

We set out below our report on the financial information (the “Financial Information”) relating to Modern Farming (Group) Co., Ltd. (“Modern Farm”) and its subsidiaries (hereinafter collectively referred to as the “Modern Farm Group”) for the period from 7 July 2008 (date of establishment) to 30 June 2009 and the year ended 30 June 2010 (the “Relevant Periods”) [●].

Modern Farm was established in the People’s Republic of China (the “PRC”) on 7 July 2008 as a private limited liability company.

Particulars of the subsidiaries which were established in the PRC held by Modern Farm at the end of each reporting period are as follows:

Name of subsidiary	Date of establishment	Registered capital	Equity interest directly attributable to Modern Farm as at		Principal activities
			30 June 2009	30 June 2010	
			%	%	
Maanshan Leading Farming Company Limited (“Leading Farming”)	2 September 2005	RMB250,000,000	(note i)	(note i)	Production of milk
Shandong Mengniu International Trading Co., Ltd.#	5 November 2003	RMB20,000,000	100	100	Import and export agency services
Helingeer Modern Farming Co., Ltd. (Formerly known as Inner Mongolia Mengniu AustAsia Model Dairy Farm Co., Ltd.)#	12 July 2004	RMB96,100,000	100	100	Production of milk
Zhangjiakou Saibei Modern Farm Co., Ltd. #	1 December 2005	RMB90,000,000	100	100	Production of milk
Wenshang Modern Farm Co., Ltd.#	12 May 2006	RMB55,000,000	100	100	Production of milk

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Name of subsidiary	Date of establishment	Registered capital	Equity interest directly attributable to Modern Farm as at		Principal activities
			30 June 2009	30 June 2010	
			%	%	
Shangzhi Modern Farm Co., Ltd. #	25 May 2006	RMB55,000,000	100	100	Production of milk
Hongya Modern Farm Co., Ltd. #	14 June 2007	RMB10,000,000	100	100	Production of milk
Modern Farming Group (Anhui) Sijibao Organic Fertiliser Co., Ltd. #	26 May 2008	RMB10,000,000	100	100	Production of fertilizers
Modern Farming (Chabei) Co., Ltd.#	17 November 2008	RMB8,000,000	100	100	Production of milk
Modern Farming (Baoji) Co., Ltd. #	2 December 2008	RMB10,000,000	100	100	Production of milk
Maanshan Modern Farming Feedstock Co., Ltd. #	24 February 2009	RMB1,000,000	100	100	Sales of feeds
Modern Farm (Feidong) Co., Ltd.#	2 December 2009	RMB50,000,000	—	100	Production of milk
Modern Farming (Inner Mongolia) Dairy Product Sales Co., Ltd.*	30 April 2010	RMB3,000,000	—	56	Sales of milk
Feidong Sijibao Organic Fertiliser Co., Ltd. #	18 September 2009	RMB1,000,000	—	100	Production of fertilizers
Baoji Sijibao Organic Fertiliser Co., Ltd. #	18 September 2009	RMB1,000,000	—	100	Production of fertilizers
Hongya Sijibao Organic Fertiliser Co., Ltd. #	16 September 2009	RMB1,000,000	—	100	Production of fertilizers
Shangzhi Sijibao Organic Fertiliser Co., Ltd. #	16 September 2009	RMB1,000,000	—	100	Production of fertilizers
Zhangjiakou Chabei Sijibao Organic Fertiliser Co., Ltd. #	19 April 2010	RMB1,000,000	—	100	Production of fertilizers
Zhangjiakou Saibei Sijibao Organic Fertiliser Co., Ltd. #	26 April 2010	RMB1,000,000	—	100	Production of fertilizers
Modern Farming (Tongshan) Co., Ltd.#	15 May 2010	RMB30,000,000	—	100	Production of milk
Modern Farming (Tongliao) Co., Ltd.#	12 June 2010	RMB30,000,000	—	100	Production of milk
Modern Farm (Chabei) Hengsheng Co., Ltd. #	25 June 2009	RMB5,000,000	(note ii)	100	Production of milk

Note i: It was established in PRC as domestic company and was acquired in July 2008 and disposed of before 30 June 2009.

Note ii: It was acquired in June 2010.

These entities were established in PRC as domestic company and wholly owned by Modern Farm.

* The entity was established in PRC as a domestic company.

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The financial year end date of all the companies now comprising Modern Farm Group is 31 December.

The statutory financial statements of Modern Farm and certain of its subsidiaries were prepared in accordance with the relevant accounting principles and financial regulations in the PRC. They were audited by the following certified public accountants registered in the PRC. No statutory financial statements for other subsidiaries established in the PRC have been prepared for the Relevant Periods as there is no such statutory requirement.

<u>Name of subsidiary</u>	<u>Financial year/period</u>	<u>Name of auditor</u>
Modern Farm	From 7 July 2008 (date of establishment) to 31 December 2008 and year ended 31 December 2009	Anhui Jiangnan CPA Limited (“安徽江南會計師事務所”)
Leading Farming	Year ended 31 December 2008	Anhui Jiangnan CPA Limited (“安徽江南會計師事務所”)
Helingeer Modern Farming Co., Ltd.	Year ended 31 December 2009	Anhui Jiangnan CPA Limited (“安徽江南會計師事務所”)

For the purpose of this report, the directors of Modern Farm have prepared the consolidated financial statements of Modern Farm Group for the Relevant Periods in accordance with International Financial Reporting Standards (“IFRSs”) issued by the International Accounting Standards Board (“IASB”) (the “Underlying Financial Statements”). Deloitte Touche Tohmatsu CPA Ltd. has carried out an independent audit on the Underlying Financial Statements in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants (the “HKICPA”).

We have examined the Underlying Financial Statements in accordance with the Auditing Guideline 3.340 “Prospectuses and the Reporting Accountant” as recommended by the HKICPA.

The Financial Information of Modern Farm Group for the Relevant Periods as set out in this report has been prepared from the Underlying Financial Statements. No adjustments were considered necessary by us to the Underlying Financial Statements for the preparation of the Financial Information in preparing our report for inclusion in the document.

The Underlying Financial Statements are the responsibility of the directors of Modern Farm who approved their issue. The directors of the Company are responsible for the contents of the document in which this report is included. It is our responsibilities to compile the Financial Information set out in this report from the Underlying Financial Statements, to form an independent opinion on the Financial Information and to report our opinion to you.

In our opinion, the Financial Information gives, for the purpose of this report, a true and fair view of the state of affairs of Modern Farm Group as of 30 June 2009 and 2010 and of the consolidated results and consolidated cash flows of Modern Farm Group for the Relevant Periods.

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ACCOUNTANTS’ REPORT OF MODERN FARM

A. FINANCIAL INFORMATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Notes	7 July 2008 (date of establishment) to 30 June 2009	1 July 2009 to 30 June 2010
		RMB’000	RMB’000
Sales of milk produced	6	334,015	589,775
Gain arising from changes in fair value less costs to sell of dairy cows	18	70,573	60,620
Other income	7	25,036	65,371
Farm operating expenses	8	(263,746)	(437,616)
Employee benefits expense	9	(47,152)	(66,695)
Depreciation		(22,068)	(44,174)
Other gains and losses	10	(1,490)	(613)
Other expenses		(32,145)	(28,275)
Bargain purchase gain	25	3,257	—
Profit before finance costs and tax	11	66,280	138,393
Finance costs	12	(23,606)	(29,765)
Profit before tax		42,674	108,628
Income tax charge	13	—	(73)
Profit and total comprehensive income for the period/year		<u>42,674</u>	<u>108,555</u>
Profit and total comprehensive income attributable to:			
Owners of Modern Farm		42,674	108,555
Non-controlling interests		—	—
		<u>42,674</u>	<u>108,555</u>

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CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

	Notes	30 June 2009	30 June 2010
		RMB’000	RMB’000
NON-CURRENT ASSETS			
Property, plant and equipment	16	947,508	1,578,395
Land use rights	17	41,185	63,616
Long-term prepaid rentals		259	194
Deposit for acquisition of biological assets		37,381	13,028
Biological assets	18	<u>936,816</u>	<u>1,742,891</u>
		<u>1,963,149</u>	<u>3,398,124</u>
CURRENT ASSETS			
Inventories	19	83,138	139,407
Trade and other receivables	20	78,618	76,772
Land use rights	17	930	1,184
Pledged bank balances	21	48,696	36,350
Bank balances and cash	21	<u>731,090</u>	<u>249,528</u>
		<u>942,472</u>	<u>503,241</u>
CURRENT LIABILITIES			
Trade and other payables	22	188,306	351,050
Amount due to a related party	31(b)	6,622	1,247
Interest payable		1,424	1,249
Borrowings - due within one year	23	251,595	384,647
Deferred income	24	<u>52</u>	<u>3,868</u>
		<u>447,999</u>	<u>742,061</u>
NET CURRENT ASSETS (LIABILITIES)		<u>494,473</u>	<u>(238,820)</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		<u>2,457,622</u>	<u>3,159,304</u>
CAPITAL AND RESERVES			
Paid-in capital		517,754	517,754
Reserves		<u>1,635,858</u>	<u>1,744,413</u>
Equity attributable to owners of Modern Farm		2,153,612	2,262,167
Non-controlling interests		<u>—</u>	<u>1,320</u>
		<u>2,153,612</u>	<u>2,263,487</u>
NON-CURRENT LIABILITIES			
Borrowings - due after one year	23	300,595	840,470
Deferred income	24	<u>3,415</u>	<u>55,347</u>
		<u>304,010</u>	<u>895,817</u>
		<u>2,457,622</u>	<u>3,159,304</u>

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CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

	Attributable to owners of Modern Farm						Non-controlling interests	Total
	Paid-in capital	Capital reserve	Share options reserve	Retained earnings	Total			
	RMB’000 (Note i)	RMB’000 (Note ii)	RMB’000	RMB’000	RMB’000	RMB’000		
Contribution from equity owners at date of establishment . . .	202,180	—	—	—	202,180	—	202,180	
Acquisition of subsidiaries.	—	—	—	—	—	2,296	2,296	
Contribution from equity owners . .	315,574	1,584,112	—	—	1,899,686	—	1,899,686	
Acquisition of non-controlling interest	—	—	—	—	—	(2,296)	(2,296)	
Profit and total comprehensive income for the period.	—	—	—	42,674	42,674	—	42,674	
Recognition of equity-settled share-based payment	—	—	9,072	—	9,072	—	9,072	
Balance at 30 June 2009.	517,754	1,584,112	9,072	42,674	2,153,612	—	2,153,612	
Profit and total comprehensive income for the year	—	—	—	108,555	108,555	—	108,555	
Contributions from non-controlling interests	—	—	—	—	—	1,320	1,320	
Balance at 30 June 2010.	<u>517,754</u>	<u>1,584,112</u>	<u>9,072</u>	<u>151,229</u>	<u>2,262,167</u>	<u>1,320</u>	<u>2,263,487</u>	

Notes:

- (i) The paid-in capital represents the registered capital of Modern Farm and is fully paid up.
- (ii) Capital reserve mainly arising from (i) the difference of RMB247,144,000 between the consideration paid and the fair value of the net assets attributable to the adjusted interest in a subsidiary being acquired from certain equity owners of Modern Farm; (ii) the difference of RMB1,120,006,000 between the registered capital and the funds contributed by the new equity owners during the Equity Financing (as defined in note 1 to the Financial Information); and (iii) the difference of RMB216,962,000 between the registered capital and funds contributed by the existing equity owners of Modern Farm.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

	7 July 2008 (date of establishment) to 30 June 2009	1 July 2009 to 30 June 2010
	RMB’000	RMB’000
OPERATING ACTIVITIES		
Profit before tax	42,674	108,628
Adjustments for:		
Depreciation of property, plant and equipment . .	22,068	44,174
Bargain purchase gain.	(3,257)	—
Release of land use rights and long-term prepaid rental.	720	1,097
Interest income	(3,192)	(3,001)
Government grant credited to income.	(113)	(967)
Finance costs	23,606	29,765
Write-off of bad debt	767	445
Payable written off	(1,662)	(887)
Loss (gain) on disposal of property, plant and equipment	483	(1,006)
Expense recognised in respect of equity-settled share-based payment	9,072	—
Gain arising from changes in fair value less costs to sell of dairy cows	<u>(70,573)</u>	<u>(60,620)</u>
Operating cash flows before movements in working capital.	20,593	117,628
Increase in inventories	(21,065)	(54,121)
(Increase) decrease in trade and other receivables . .	(46,576)	9,729
(Decrease) increase in trade and other payables. . .	<u>(99,490)</u>	<u>47,037</u>
Cash (used in) generated from operations	(146,538)	120,273
Income taxes paid	<u>(47)</u>	<u>(73)</u>
NET CASH (USED IN) FROM OPERATING ACTIVITIES.	<u>(146,585)</u>	<u>120,200</u>

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		7 July 2008 (date of establishment) to 30 June 2009	1 July 2009 to 30 June 2010
		RMB’000	RMB’000
INVESTING ACTIVITIES			
Interest received		3,192	3,001
Purchases of property, plant and equipment		(342,960)	(534,682)
Addition to biological assets		(339,523)	(743,534)
(Increase) decrease in pledged bank balances		(48,696)	12,346
Purchases of land use rights		(15,124)	(23,717)
Proceeds on disposal of property, plant and equipment		—	6,996
Proceeds on disposal of dairy cows		41,869	87,640
Payment of long-term prepaid rentals		(324)	—
Net cash outflow from acquisition of subsidiaries	25	(209,144)	(45,586)
Government grants received		3,580	56,715
NET CASH USED IN INVESTING ACTIVITIES		<u>(907,130)</u>	<u>(1,180,821)</u>
FINANCING ACTIVITIES			
Interest paid		(31,653)	(55,188)
New borrowings raised		264,152	1,010,653
Repayment of borrowings		(300,120)	(377,726)
Contribution from the equity owners		1,854,722	—
Contribution from non-controlling interests		—	1,320
Purchase of additional interest in a subsidiary		(2,296)	—
NET CASH FROM FINANCING ACTIVITIES		<u>1,784,805</u>	<u>579,059</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		731,090	(481,562)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD/YEAR		<u>—</u>	<u>731,090</u>
CASH AND CASH EQUIVALENTS AT END OF PERIOD/YEAR, represented by bank balances and cash		<u>731,090</u>	<u>249,528</u>

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B. NOTES TO THE FINANCIAL INFORMATION

1. GENERAL INFORMATION

Modern Farm is a private limited liability company established in the PRC on 7 July 2008. The registered office and the principal place of business of Modern Farm is situated at No. 123, Hongqinan Lu, Economic Development Area, Maanshan City, Anhui Province, the PRC.

The principal activity of Modern Farm Group is production and sales of milk.

The Financial Information is presented in Renminbi (“RMB”), the currency of the primary economic environment in which the principal subsidiaries of Modern Farm Group operate (functional currency).

Certain equity owners of Leading Farming has established Modern Farm in July 2008 to acquire 100% interest in Leading Farming in July 2008.

By 4 rounds of equity financings (the “Equity Financings”) made by the Company (incorporated in the Cayman Islands) through Aquitair Holdings Limited (“Aquitair”) (incorporated in Ireland), a wholly owned subsidiary of the Company during the period from September 2008 to June 2009, the Company has obtained 50.05% equity interest in Modern Farm. Details in respect of the Equity Financings are set out in the table below:

<u>Rounds of Equity Financings</u>	<u>Date of completion</u>	<u>Financing amounts</u>	<u>Equity interest in Modern Farm held by the Company (through Aquitair) after each round of Equity Financings</u>
		RMB’000	
1	14 October 2008	150,636	9.96%
2	4 December 2008	545,602	33.73%
3	26 February 2009	614,698	48.82%
4	26 June 2009	68,200	50.05%

As a result of the Equity Financings, the Modern Farm became a sino-foreign enterprise and its parent is Aquitair and its ultimate holding company is Advance Dairy Company Limited. The ultimate controlling party is KKR Asian Fund L.P. (incorporated in the Cayman Islands).

2. BASIS OF PREPARATION OF THE FINANCIAL INFORMATION

Going concern

In preparing the Financial Information, the directors of Modern Farm (the “Directors”) have given careful consideration of Modern Farm Group in light of its net current liabilities of approximately RMB239 million as at 30 June 2010. Having considered the secured credit facilities of approximately RMB1,109 million which remains unutilized as at 30 September 2010, the Directors are satisfied that Modern Farm Group will be able to meet in full its financial obligations as they fall due for the foreseeable future. Accordingly, the Financial Information has been prepared on a going concern basis.

3. APPLICATION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS

For the purpose of preparing and presenting the Financial Information for the Relevant Periods, Modern Farm Group has consistently applied the International Accounting Standards (“IASs”), International Financial Reporting Standards (“IFRSs”), amendments and Interpretations (“IFRICs”), issued by International Accounting Standards Board (“IASB”), which are effective for the accounting period beginning on 1 July 2009.

At the date of this report, the IASB has issued the following new and revised standards, amendments and interpretation which are not yet effective:

IFRSs (Amendments)	Improvements to IFRSs April 2009 ¹
IFRSs (Amendments)	Improvements to IFRSs May 2010 ²
IAS 24 (Revised)	Related Party Disclosures ⁶
IAS 32 (Amendment)	Classification of Rights Issues ⁴
IFRS 1 (Amendment)	Additional Exemptions for First-time Adopters ³
IFRS 1 (Amendment)	Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters ⁵
IFRS 2 (Amendment)	Group Cash-settled Share-based Payment Transactions ³
IFRS 9	Financial Instruments ⁷
IFRS 7 (Amendment)	Disclosures — Transfers of Financial Assets ⁸
IFRIC 14 (Amendment)	Prepayments of a Minimum Funding Requirement ⁶
IFRIC 19	Extinguishing Financial Liabilities with Equity Instruments ⁵

¹ Amendments that are effective for annual periods beginning on or after 1 January 2010

² Effective for annual periods beginning on or after 1 July 2010 and 1 January 2011, as appropriate

³ Effective for annual periods beginning on or after 1 January 2010

⁴ Effective for annual periods beginning on or after 1 February 2010

⁵ Effective for annual periods beginning on or after 1 July 2010

⁶ Effective for annual periods beginning on or after 1 January 2011

⁷ Effective for annual periods beginning on or after 1 January 2013

⁸ Effective for annual periods beginning on or after 1 July 2011

Modern Farm Group has not early adopted these new and revised standards, amendments and interpretation in the preparation of the Financial Information. The Directors anticipate that the application of the new and revised standards, amendments and interpretation will have no material impact on the consolidated results and financial position of Modern Farm.

4. SIGNIFICANT ACCOUNTING POLICIES

The Financial Information has been prepared under the historical cost basis except for the biological assets, which are measured at fair value less costs to sell, as explained in the accounting policies set out below.

The Financial Information has been prepared in accordance with the following accounting policies which conform with IFRSs. These policies have been consistently applied throughout the Relevant Periods. In addition, the Financial Information includes applicable disclosures required by the [●] and by the Hong Kong Companies Ordinance.

Basis of consolidation

The Financial Information incorporates the financial statements of Modern Farm and entities controlled by Modern Farm (its subsidiaries). Control is achieved where Modern Farm has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

The results of subsidiaries acquired or disposed of during the period/year are included in the consolidated statements of comprehensive income from the effective date of acquisition up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of Modern Farm Group.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Non-controlling interests in subsidiaries are presented separately from the equity attributable to the owners of Modern Farm.

Allocation of total comprehensive income to non-controlling interests

Total comprehensive income and expense of a subsidiary is attributed to the owners of Modern Farm and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

Changes in Modern Farm Group’s ownership interests in existing subsidiaries

Changes in Modern Farm Group’s ownership interest in a subsidiary that do not result in Modern Farm Group losing control over the subsidiary are accounted for as equity transactions. The carrying amounts of Modern Farm Group’s interests and the non-controlling interests are adjusted to reflect the changes in their relative interests in the subsidiary. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to owners of Modern Farm.

When Modern Farm Group loses control over a subsidiary, the profit or loss on disposal is calculated as the difference between (i) the aggregated amount of the fair value of the consideration received and the fair value of any retained interest determined at the date when control is lost and (ii) the previous carrying amount of the assets (including goodwill), and liabilities of the subsidiary and any non-controlling interests. The fair value of any investment retained in the former subsidiary at the date when control is lost is regarded as the fair value on initial recognition for subsequent accounting under IAS 39 Financial Instruments: Recognition and Measurement or, when applicable, the cost on initial recognition of an investment in an associate or a jointly controlled entity.

Business combinations

Acquisitions of businesses are accounted for using the acquisition method. The consideration transferred in a business combination is measured at fair value, which is calculated as the sum of the acquisition-date fair values of the assets transferred by Modern Farm Group, liabilities incurred by Modern Farm Group to former owners of the acquiree and the equity interests issued by Modern Farm Group in exchange for control of the acquiree. Acquisition-related costs are recognized in profit or loss as incurred.

At the acquisition date, the acquiree’s identifiable assets and liabilities that meet the conditions for recognition under IFRS 3(2008) Business Combinations are recognized at their fair value at the acquisition date, except that:

- deferred tax assets or liabilities and liabilities or assets related to employee benefit arrangements are recognized and measured in accordance with IAS 12 Income Taxes and IAS 19 Employee Benefits respectively;
- liabilities or equity instruments related to the replacement by Modern Farm Group of an acquiree’s share-based payment awards are measured in accordance with IFRS 2 Share-based Payment; and
- assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations are measured in accordance with IFRS 5.

Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree, and the fair value of the acquirer’s previously held equity interest in the acquiree (if any) over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed. If, after assessment, Modern Farm Group’s interest in the fair value of the acquiree’s identifiable net assets exceeds the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree and the fair value of the acquirer’s previously held interest in the acquiree (if any), the excess is recognized immediately in profit or loss as a bargain purchase gain.

Non-controlling interests was initially measured at the non-controlling interests’ proportionate share of the fair value of the acquiree’s identifiable net assets.

Where a business combination is achieved in stages, Modern Farm Group’s previously held equity interest in the acquiree is remeasured to fair value at the acquisition date (i.e. the date when Modern Farm Group obtains control) and the resulting gain or loss, if any, is recognized in profit or loss. Amount arising from previously held equity interest recognized in other comprehensive income and accumulated in equity before the acquisition date are reclassified to profit or loss when Modern Farm Group obtains control over the acquiree.

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Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods sold in the normal course of business, net of value added tax and returns.

Revenue from sales of milk produced is recognized when the milk is delivered and title has been passed.

Revenue from sales of goods are recognized when the goods are delivered and title has been passed.

Interest income from a financial asset is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset’s net carrying amount.

Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Modern Farm Group as lessee

Rentals payable under operating leases payments are recognized as expenses on a straight-line basis over the term of the relevant lease. Contingent rental expenses, if any, are charged as expenses in the periods in which they are incurred. Benefits received and receivable as an incentive to enter into an operating lease are recognized as a reduction of rental expenses on a straight-line basis over the lease term.

Foreign currencies

The individual financial statements of each group entity are presented in the currency of the primary economic environment in which the entity operates (the functional currency, i.e. RMB).

In preparing the financial statements of individual entities, transactions in currencies other than the entity’s functional currency (foreign currency) are recorded at the rates of exchange prevailing on the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are re-translated at the rates prevailing at that date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing on the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items, and on the retranslation of monetary items, are recognized in profit or loss in the period in which they arise.

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Borrowing costs

Borrowing costs directly attributed to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing cost eligible for capitalization.

All other borrowing costs are recognized in profit and loss in the period in which they are incurred.

Retirement benefit costs

Payments to defined contribution retirement benefits under the state-managed retirement benefit schemes in the PRC are charged as an expense when employees have rendered service entitling them to the contribution.

Government grants***Grants relating to biological assets***

An unconditional government grant related to a biological asset measured at its fair value less costs to sell shall be recognized in profit or loss when, and only when, the government grant becomes receivable. If a government grant related to a biological asset measured at its fair value less costs to sell is conditional, an entity shall recognize the government grant in profit or loss when, and only when, the conditions attaching to the government grant are met.

Other grants

Other government grants are recognized as income over the periods necessary to match them with the costs for which they are intended to compensate, on a systematic basis. Government grants that are receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to Modern Farm Group with no future related costs are recognized in the profit or loss in the period in which they become receivable. Other government grants related to depreciable assets are recognized as deferred income in the consolidated statement of financial position and released to profit or loss over the useful lives of the related assets.

Share-based payment transactions***Equity-settled share-based payment transactions***

The fair value of services received determined by reference to the fair value of share options granted at the grant date is recognised as an expense in full at the grant date when the share options granted vest immediately, with a corresponding increase in equity (share options reserve).

At the time when the share options are exercised, the amount previously recognised in share options reserve will be transferred to capital reserve. When the share options are forfeited after the vesting date or are still not exercised at the expiry date, the amount previously recognised in share options reserve will be transferred to retained earnings.

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Taxation

Income tax expenses represent the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the period/year. Taxable profit differs from profit as reported in the consolidated statements of comprehensive income because it excludes items of income or expense that are taxable or deductible in other periods/years and it further excludes items that are never taxable or deductible. Modern Farm Group’s liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax is recognized on temporary differences between the carrying amount of assets and liabilities in the Financial Information and the corresponding tax base used in the computation of taxable profit. Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilized. Such assets and liabilities are not recognized if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries, except where Modern Farm Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the asset to be recovered.

Deferred tax liabilities and assets are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset is realized, based on tax rate (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which Modern Farm Group expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities. Deferred tax is recognized in profit or loss, except when it relates to items that are recognized in other comprehensive income or directly in equity, in which case the deferred tax is also recognized in other comprehensive income or directly in equity respectively.

Property, plant and equipment

Property, plant and equipment including buildings held for use in the production or supply of goods or services, or for administrative purposes other than construction in progress are stated at cost less subsequent accumulated depreciation and accumulated impairment losses.

Depreciation is provided to write off the cost of items of property, plant and equipment other than construction in progress over their estimated useful lives and after taking into account of their estimated residual value, using the straight-line method.

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Construction in progress includes property, plant and equipment in the course of construction for production or for its own use purposes. Construction in progress is carried at cost less any recognized impairment loss. Construction in progress is classified to the appropriate category of property, plant and equipment when completed and ready for intended use. Depreciation of these assets, on the same basis as other property assets, commences when the assets are ready for their intended use.

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

Land use rights

Land use rights are stated at cost and released on a straight-line basis over the lease terms. Land use rights which are to be released in the next twelve months or less are classified as current assets.

Impairment of tangible assets

At the end of each reporting period, Modern Farm Group reviews the carrying amounts of its tangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss. Where it is not possible to estimate the recoverable amount of an individual asset, Modern Farm Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognized immediately in profit or loss.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset in prior years. A reversal of an impairment loss is recognized immediately in profit or loss.

Inventories

Inventories are stated at the lower of cost and net realizable value. Cost is calculated using weighted average method.

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Biological assets***Dairy cows***

Dairy cows, including milkable cows, heifers and calves are measured on initial recognition and at the end of each operating period at their fair value less costs to sell, with any resultant gain or loss recognized in profit or loss for the period in which it arises. Costs to sell are the incremental costs directly attributable to the disposal of an asset, mainly transportation cost and excluding finance costs and income taxes. The fair value of dairy cows is determined based on its present location and condition and is determined independently by professional valuer.

The feeding costs and other related costs including the depreciation charge, utilities cost and consumables incurred for raising of heifers and calves are capitalized, until such time as the heifers and calves begin to produce milk.

Agricultural produce***Milk***

Agricultural produce represents the milk. Milk is recognized at the point of harvest at its fair value less costs to sell. The fair value of milk is determined based on market prices in the local area. The costs to sell are the incremental costs directly attributable to the sales of milk, mainly transportation cost, excluding finance cost and income taxes.

Financial instruments

Financial assets and financial liabilities are recognized on the consolidated statements of financial position when a group entity becomes a party to the contractual provisions of the instrument. Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition.

Financial assets

Modern Farm Group’s financial assets represent loans and receivables.

Effective interest method

The effective interest method is a method of calculating the amortized cost of a financial asset and of allocating interest income over the relevant periods. The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial asset, or, where appropriate, a shorter period to the net carrying amount on initial recognition.

Interest income is recognized on an effective interest basis for debt instruments.

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Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Subsequent to initial recognition, loans and receivables (including trade and other receivables, pledged bank balances and bank balances and cash) are carried at amortized cost using the effective interest method, less any identified impairment losses (see accounting policy on impairment loss on financial assets below).

Impairment of loans and receivables

Loans and receivables are assessed for indicators of impairment at the end of each reporting period. Loans and receivables are impaired where there is objective evidence that, as a result of one or more events that occurred after its initial recognition, the estimated future cash flows have been impacted.

Objective evidence of impairment could include:

- significant financial difficulty of the issuer or counterparty; or
- default or delinquency in interest or principal payments; or
- it becoming probable that the borrower will enter bankruptcy or financial re-organization.

For trade receivables that are assessed not to be impaired individually are subsequently assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of receivables could include Modern Farm Group’s past experience of collecting payments, an increase in the number of delayed payments in the portfolio past the credit period of 60 days, and observable changes in national or local economic conditions that correlate with default on receivables.

An impairment loss is recognized in profit or loss when there is objective evidence that the asset is impaired, and is measured as the difference between the asset’s carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. Changes in the carrying amount of the allowance account are recognized in profit or loss. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited to profit or loss.

If, in a subsequent period, the amount of impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment loss was recognized, the previously recognized impairment loss is reversed through profit or loss to the extent that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

Financial liabilities and equity

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument. An equity instrument is any contract that evidences a residual interest in the assets of Modern Farm Group after deducting all of its liabilities.

Effective interest method

The effective interest method is a method of calculating the amortized cost of a financial liability and of allocating interest expense over the relevant periods. The effective interest rate is the rate that exactly discounts estimated future cash payments (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial liability, or, where appropriate, a shorter period to the net carrying amount on initial recognition.

Interest expense is recognized on an effective interest basis for debt instruments.

Financial liabilities

Financial liabilities including borrowings, trade and other payables, interest payable and amount due to a related party are subsequently measured at amortized cost, using the effective interest method.

Equity instruments

Equity instruments issued by Modern Farm are recorded at the proceeds received, net of direct issue costs.

Derecognition

Financial assets are derecognized when the rights to receive cash flows from the assets expire or, the financial assets are transferred and Modern Farm Group has transferred substantially all the risks and rewards of ownership of the financial assets. On derecognition of a financial asset, the difference between the asset’s carrying amount and the sum of the consideration received and receivable is recognized in profit or loss.

Financial liabilities are derecognized when the obligation specified in the relevant contract is discharged, cancelled or expires. The difference between the carrying amount of the financial liability derecognized and the consideration paid and payable is recognized in profit or loss.

5. KEY SOURCES OF ESTIMATION UNCERTAINTY

The key assumptions concerning the future, and other key sources of estimation uncertainty at the end of reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are disclosed below.

Fair value of dairy cows

Modern Farm Group’s dairy cows are valued at fair value less costs to sell. The fair value of dairy cows is determined based on either the market-determined prices as at the end of each reporting periods adjusted with reference to the species, age, growing condition, costs incurred and expected yield of the milk to reflect differences in characteristic and/or stages of growth of dairy cows; or the present value of expected net cash flows from the dairy cows discounted at a current market-determined rate, when market-determined prices are unavailable. Any change in the estimates may affect the fair value of the dairy cows significantly. The independent qualified professional valuer and management review the assumptions and estimates periodically to identify any significant change in the fair value of dairy cows. Details of the assumptions used are disclosed in note 18.

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6. SALES OF MILK PRODUCED AND SEGMENT INFORMATION

Sales of milk produced represented mainly the fair value of milk produced less costs to sell at the point of harvest.

IFRS 8 Operating Segments requires operating segments to be identified on the basis of internal reports about components of Modern Farm Group that are regularly reviewed by the chief operating decision maker, the President of Modern Farm Group (the “President”), in order to allocate resources and to assess performance. The operation of the Modern Farm Group constitutes one operating segment i.e. production and sales of milk. The information reported to Modern Farm Group’s President for the purpose of resource allocation and assessment of performance, does not contain the gain arising from changes in fair value, less costs to sell, of dairy cows, and the President reviewed the profit before tax, assets and liabilities as a whole and the difference between the profit before tax and assets reported under IFRSs and to the President is mainly arising from the difference of the accounting treatment of the dairy cows. Under the report to the President, the dairy cows are stated at cost less depreciation but the dairy cows are stated at their fair value less costs to sell under IFRSs. The difference of the profit (loss) before tax and assets reported to the President and IFRSs are as follows:

	7 July 2008 (date of establishment) to 30 June 2009	1 July 2009 to 30 June 2010
	RMB’000	RMB’000
Loss before tax reported to the President	(65,916)	(8,371)
Add: Gain arising from changes in fair value less costs to sell of dairy cows	70,573	60,620
Depreciation of dairy cows	<u>38,017</u>	<u>56,379</u>
Profit before tax under IFRSs	<u>42,674</u>	<u>108,628</u>
	As at 30 June 2009	As at 30 June 2010
	RMB’000	RMB’000
Assets reported to the President	2,309,658	2,816,678
Add: Gain arising from changes in fair value less costs to sell of dairy cows	539,907	1,007,305
Accumulated depreciation of dairy cows	<u>56,056</u>	<u>77,382</u>
Assets under IFRSs	<u>2,905,621</u>	<u>3,901,365</u>

The segment liabilities is same as total liabilities under IFRSs at end of respective reporting periods.

All external sales of milk produced of Modern Farm Group during the Relevant Periods are contributable to customers established in the PRC, the place of domicile of Modern Farm Group’s operating entities. Meanwhile, Modern Farm Group’s non-current assets are all located in the PRC.

Sales of milk produced of RMB332,712,000 and RMB575,441,000 for the period ended 30 June 2009 and year ended 30 June 2010 respectively is from a single external customer.

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7. OTHER INCOME

	7 July 2008 (date of establishment)	
	to 30 June 2009	1 July 2009 to 30 June 2010
	RMB’000	RMB’000
Government grant related to		
- Biological assets (Note i)	4,804	34,390
- Income (Note ii)	12,311	23,766
- Other assets (Note 24)	113	967
Sales of fertilizers	1,161	526
Bank interest income	3,192	3,001
Write-off of payables	1,662	887
Others	1,793	1,834
	<u>25,036</u>	<u>65,371</u>

Note i: These government grants are unconditional government subsidies received by Modern Farm Group from relevant government bodies for the purpose of supporting Modern Farm Group to purchase dairy cows.

Note ii: These government grants are unconditional government subsidies received by Modern Farm Group from relevant government bodies for the purpose of giving financial support to Modern Farm Group’s operation.

8. FARM OPERATING EXPENSES

	7 July 2008 (date of establishment)	
	to 30 June 2009	1 July 2009 to 30 June 2010
	RMB’000	RMB’000
Feeds	245,478	396,225
Utilities	10,709	15,484
Other farm operating expenses	7,559	25,907
Total farm operating expenses	<u>263,746</u>	<u>437,616</u>

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9. EMPLOYEE BENEFITS EXPENSE

	7 July 2008 (date of establishment) to 30 June 2009	1 July 2009 to 30 June 2010
	RMB’000	RMB’000
Salaries, bonuses and allowances.	34,917	58,341
Contributions to retirement benefit schemes	3,163	8,354
Equity-settled share-based payment.	9,072	—
	<u>47,152</u>	<u>66,695</u>

The employees of Modern Farm and its PRC subsidiaries are members of the state-managed retirement benefit schemes operated by the local government. The subsidiaries in the PRC are required to contribute a specified percentage of their basic payroll costs to the retirement benefit schemes to fund the benefits. The only obligation of Modern Farm Group with respect to the retirement benefit schemes is to make the specified contributions.

10. OTHER GAINS AND LOSSES

	7 July 2008 (date of establishment) to 30 June 2009	1 July 2009 to 30 June 2010
	RMB’000	RMB’000
Net foreign exchange loss	240	1,174
Write-off of bad debt	767	445
Loss (gain) on disposal of property, plant and equipment.	483	(1,006)
	<u>1,490</u>	<u>613</u>

11. PROFIT BEFORE FINANCE COSTS AND TAX

Profit before finance costs and tax has been arrived at after charging:

	7 July 2008 (date of establishment) to 30 June 2009	1 July 2009 to 30 June 2010
	RMB’000	RMB’000
Auditors’ remuneration	999	951
Release of land use rights	655	1,032
	<u>1,654</u>	<u>1,983</u>

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12. FINANCE COSTS

	7 July 2008 (date of establishment) to 30 June 2009	1 July 2009 to 30 June 2010
	RMB’000	RMB’000
Interest expenses on:		
Bank borrowings wholly repayable within five years	31,743	47,872
Bank borrowings wholly repayable after five years	—	6,612
Other borrowings wholly repayable within five years	<u>459</u>	<u>529</u>
Total borrowing cost	32,202	55,013
Less: capitalized amount	<u>(8,596)</u>	<u>(25,248)</u>
	<u>23,606</u>	<u>29,765</u>

The weighted average interest rate on specific borrowings being capitalised was 7.16% and 3.24% for the period from 7 July 2008 to 30 June 2009 and year ended 30 June 2010 respectively.

13. INCOME TAX CHARGE

	7 July 2008 (date of establishment) to 30 June 2009	1 July 2009 to 30 June 2010
	RMB’000	RMB’000
The charge comprises:		
Current tax:		
PRC enterprise income tax	<u>—</u>	<u>73</u>

The tax charge for the Relevant Periods represents income tax in the PRC which is calculated at the prevailing tax rate on the taxable income of Modern Farm and its subsidiaries established in the PRC.

On 16 March 2007, the National People’s Congress promulgated the Law of the People’s Republic of China on Enterprise Income Tax (the “New EIT Law”) by order No. 63 of the President of the PRC which is effective from 1 January 2008. On 6 December 2007, the State Council issued Implementation Regulation of the New EIT Law. Pursuant to the New EIT Law and Implementation Regulation, a uniform income tax rate of 25% was imposed for both domestic and foreign-invested enterprises from 1 January 2008. In addition, the New EIT Law provides that qualified dividend income between two “resident enterprises” that have a direct investment relationship is exempted from income tax. Otherwise, such dividends will be subject to a 5% or 10% withholding tax under the tax treaty or the domestic law.

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The income tax rates applicable to Modern Farm and its subsidiaries established in the PRC are as follows:

	Year ended/ending 31 December		
	2008	2009	2010
	(Note)	(Note)	(Note)
Modern Farm	0%	0%	0%
Leading Farming	0%	N/A	N/A
Shandong Mengniu International Trading Co.,Ltd.	25%	25%	25%
Helingeer Modern Farming Co., Ltd.	0%	0%	0%
Zhangjiakou Saibei Modern Farm Co., Ltd.	0%	0%	0%
Wenshang Modern Farm Co., Ltd.	0%	0%	0%
Shangzhi Modern Farm Co., Ltd.	0%	0%	0%
Hongya Modern Farm Co., Ltd.	0%	0%	0%
Modern Farming Group (Anhui) Sijibao Organic Fertiliser Co., Ltd.	25%	25%	25%
Modern Farming (Chabei) Co., Ltd.	0%	0%	0%
Modern Farming (Baoji) Co., Ltd.	0%	0%	0%
Maanshan Modern Farming Feedstock Co., Ltd.	N/A	25%	25%
Modern Farm (Feidong) Co., Ltd.	N/A	0%	0%
Modern Farming (Inner Mongolia) Dairy Product Sales Co., Ltd.	N/A	N/A	25%
Feidong Sijibao Organic Fertiliser Co., Ltd.	N/A	25%	25%
Baoji Sijibao Organic Fertiliser Co., Ltd.	N/A	25%	25%
Hongya Sijibao Organic Fertiliser Co., Ltd.	N/A	25%	25%
Shangzhi Sijibao Organic Fertiliser Co., Ltd.	N/A	25%	25%
Zhangjiakou Chabei Sijibao Organic Fertiliser Co., Ltd.	N/A	N/A	25%
Zhangjiakou Saibei Sijibao Organic Fertiliser Co., Ltd.	N/A	N/A	25%
Modern Farming (Tongshan) Co., Ltd.	N/A	N/A	0%
Modern Farming (Tongliao) Co., Ltd.	N/A	N/A	0%
Modern Farm (Chabei) Hengsheng Co., Ltd.	N/A	N/A	0%

Note:

According to the prevailing tax rules and regulation, those entities of Modern Farm Group operating in agricultural business is exempted from enterprise income tax.

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The tax charge for the Relevant Periods can be reconciled to the profit per the consolidated statements of comprehensive income as follows:

	7 July 2008 (date of establishment) to 30 June 2009	1 July 2009 to 30 June 2010
	RMB’000	RMB’000
Profit before tax	42,674	108,628
Tax at applicable income tax rate at 25%.	10,669	27,157
Effect of tax exemption granted to agricultural entities	(10,669)	(27,084)
Income tax charge	—	73

14. DIRECTORS’ EMOLUMENTS

Details of emoluments paid by Modern Farm Group to the directors of Modern Farm during the Relevant Periods.

	7 July 2008 (date of establishment) to 30 June 2009	1 July 2009 to 30 June 2010
	RMB’000	RMB’000
Executive directors		
- Salaries, discretionary bonus and other allowances	662	1,911
- Retirement benefits scheme contributions	70	70
- Equity-settled share-based payment (note 26)	6,077	—
Non-executive directors	—	—
	<u>6,809</u>	<u>1,981</u>
Executive directors		
Mr. Deng Jiuqiang	305	1,028
Mrs. Gao Lina	3,268	528
Mr. Han Chunlin (appointed on 14 November 2008)	3,236	425
Non-executive directors		
Mr. Lu Jun	—	—
Mr. Wolhardt Julian Juul	—	—
Mr. Hui Chi Kin Max	—	—
	<u>6,809</u>	<u>1,981</u>

No directors waived or agreed to waive any emoluments during the Relevant Periods.

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15. EMOLUMENTS OF THE FIVE HIGHEST PAID INDIVIDUALS

Of the five individuals with the highest emoluments in Modern Farm Group, three were directors of Modern Farm whose emolument are included in the disclosures in note 14 above. The emoluments of the remaining two during the period from 7 July 2008 (date of establishment) to 30 June 2009 and year ended 30 June 2010 respectively are as follows:

	7 July 2008 (date of establishment) to 30 June 2009	1 July 2009 to 30 June 2010
	RMB’000	RMB’000
Salaries and other benefits.	437	497
Retirement benefit schemes contributions	46	46
Equity-settled share-based payment (note 26)	<u>2,995</u>	<u>—</u>
	<u><u>3,478</u></u>	<u><u>543</u></u>

	7 July 2008 (date of establishment) to 30 June 2009	1 July 2009 to 30 June 2010
	No. of employees	No. of employees
Nil to HK\$ 1,000,000.	1	2
HK\$3,000,001 to HK\$3,500,000	<u>1</u>	<u>—</u>
	<u><u>2</u></u>	<u><u>2</u></u>

No emoluments were paid by Modern Farm Group to the directors or the five highest paid individuals as inducement to join or upon joining Modern Farm Group or as compensation for loss of office.

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16. PROPERTY, PLANT AND EQUIPMENT

	Buildings	Motor vehicles	Plant and equipment	Construction in progress	Total
	RMB’000	RMB’000	RMB’000	RMB’000	RMB’000
COST					
At date of establishment	—	—	—	—	—
Additions	4,161	4,889	40,542	344,025	393,617
Acquisition of subsidiaries	345,031	10,592	73,998	160,635	590,256
Transfer	179,788	—	5,988	(185,776)	—
Disposal	(116)	—	(457)	—	(573)
At 30 June 2009	<u>528,864</u>	<u>15,481</u>	<u>120,071</u>	<u>318,884</u>	<u>983,300</u>
Acquisition of a subsidiary	436	—	4,644	39,653	44,733
Additions	2,211	5,350	85,585	574,114	667,260
Transfer	522,526	—	73,060	(595,586)	—
Disposals	(7,023)	(67)	(2,290)	—	(9,380)
At 30 June 2010	<u>1,047,014</u>	<u>20,764</u>	<u>281,070</u>	<u>337,065</u>	<u>1,685,913</u>
ACCUMULATED DEPRECIATION					
At date of establishment	—	—	—	—	—
Charge for the period	22,597	452	12,833	—	35,882
Eliminated on disposals	—	—	(90)	—	(90)
At 30 June 2009	<u>22,597</u>	<u>452</u>	<u>12,743</u>	<u>—</u>	<u>35,792</u>
Charge for the year	45,582	1,702	27,832	—	75,116
Eliminated on disposals	(1,881)	(35)	(1,474)	—	(3,390)
At 30 June 2010	<u>66,298</u>	<u>2,119</u>	<u>39,101</u>	<u>—</u>	<u>107,518</u>
CARRYING AMOUNT					
At 30 June 2009	<u>506,267</u>	<u>15,029</u>	<u>107,328</u>	<u>318,884</u>	<u>947,508</u>
At 30 June 2010	<u>980,716</u>	<u>18,645</u>	<u>241,969</u>	<u>337,065</u>	<u>1,578,395</u>

As at 30 June 2009 and 30 June 2010, certain of Modern Farm Group’s buildings and plant and equipment with an aggregate carrying amount of RMB145,782,000 and RMB144,890,000 respectively were pledged as security for bank and other loans of Modern Farm Group (Note 23).

As at 30 June 2009 and 30 June 2010, Modern Farm Group is in the process of obtaining the building ownership certificates of buildings with carrying amounts of RMB402,760,000 and RMB884,853,000 respectively.

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Depreciation is charged using straight-line over the expected useful life, after taking into account its estimate residual value, as follows:

Buildings	20 years
Motor vehicles.	5 years
Plant and equipment	5 - 10 years

During the reporting periods ended 30 June 2009 and 2010, depreciation charge amounting to RMB13,814,000 and RMB30,942,000 respectively have been capitalized in biological assets.

17. LAND USE RIGHTS

	<u>RMB’000</u>	
At date of establishment		—
Acquisition of subsidiaries.		27,646
Addition		15,124
Release to profit and loss		<u>(655)</u>
At 30 June 2009		42,115
Addition		23,717
Release to profit and loss		<u>(1,032)</u>
At 30 June 2010		<u>64,800</u>
	<u>30 June 2009</u>	<u>30 June 2010</u>
	RMB’000	RMB’000
Analyzed for reporting purpose as:		
- Current assets	930	1,184
- Non-current assets.	<u>41,185</u>	<u>63,616</u>
	<u>42,115</u>	<u>64,800</u>

The amount represents the payment for land use rights situated in the PRC. The leasehold interests in land have lease terms ranging from 20 to 50 years.

As at 30 June 2009 and 30 June 2010, land use rights with carrying amount of RMB4,220,000 and RMB14,184,000 respectively were pledged against certain bank facilities granted to Modern Farm Group (Note 23).

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18. BIOLOGICAL ASSETS

A - Nature of Activities

Modern Farm Group and its subsidiaries are primarily milk production companies, that principally engaged in production and sales of milk produced. Dairy cows are primarily held to produce milk.

The quantity of dairy cows owned by Modern Farm Group at 30 June 2009 and 30 June 2010 is shown below. Modern Farm Group’s dairy cows are primarily milkable cows held for milk production. Heifers and calves held at 30 June 2009 and 30 June 2010 are dairy cows that have not reached the age to produce milk.

	<u>30 June 2009</u>	<u>30 June 2010</u>
	head	head
Dairy cows		
Milkable cows	20,427	26,607
Heifers and calves	<u>23,532</u>	<u>45,584</u>
Total dairy cows	<u>43,959</u>	<u>72,191</u>
	7 July 2008	
	(date of	
	establishment)	
	to 30 June	1 July 2009 to
	2009	30 June 2010
	KG	KG
Volume of sales of milk produced	<u>96,306,325</u>	<u>158,080,873</u>

Modern Farm Group is exposed to fair value risks arising from changes in price of the dairy products. Modern Farm Group does not anticipate that the price of the dairy products will decline significantly in the foreseeable future and the directors of Modern Farm are of the view that there is no available derivative or other contracts which Modern Farm Group can enter into to manage the risk of a decline in the price of the dairy products.

In general, the heifers are inseminated with semen when heifers reached approximately 14 months old. After an approximately 9 month pregnancy term, a calf is born and the milkable cow begins to produce raw milk and the lactation period begins. A milkable cow is typically milked for approximately 305 days before approximately 60 days dry period.

When a heifer begins to produce milk, it would be transferred to the category of milkable cows based on the estimated fair value on the date of transfer. The sales of dairy cows is not one of the Group’s principal activities and is not included as revenue. The sales of dairy cows is determined based on the actual selling price.

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B - Value of Dairy cows

The value of dairy cows at end of reporting periods was:

	<u>30 June 2009</u>		<u>30 June 2010</u>	
	<u>RMB’000</u>		<u>RMB’000</u>	
Dairy cows	<u>936,816</u>		<u>1,742,891</u>	
	<u>Heifers and calves</u>	<u>Milkable cows</u>	<u>Total</u>	
	<u>RMB’000</u>	<u>RMB’000</u>	<u>RMB’000</u>	
At date of establishment	—	—	—	
Acquisition of subsidiaries	194,738	397,418	592,156	
Increases due to purchase	137,463	4,951	142,414	
Increase due to raising (Feeding cost and others)	173,542	—	173,542	
Transfer	(162,247)	162,247	—	
Decrease due to sales	(13,289)	(28,580)	(41,869)	
Gains arising from changes in fair value less costs to sell	<u>109,767</u>	<u>(39,194)</u>	<u>70,573</u>	
Balance as at 30 June 2009	439,974	496,842	936,816	
Acquisition of a subsidiary	13,563	20,703	34,266	
Increases due to purchase	451,424	—	451,424	
Increase due to raising (Feeding cost and others)	347,405	—	347,405	
Transfer	(534,448)	534,448	—	
Decrease due to sales	(7,762)	(79,878)	(87,640)	
Gains arising from changes in fair value less costs to sell	<u>180,438</u>	<u>(119,818)</u>	<u>60,620</u>	
Balance as at 30 June 2010	<u>890,594</u>	<u>852,297</u>	<u>1,742,891</u>	

Modern Farm Group’s dairy cows in the PRC were independently valued by Jones Lang LaSalle Sallmanns Limited (“Sallmanns”) in early November 2010, a firm of independent qualified professional valuers not connected with Modern Farm Group, who has appropriate qualifications and recent experiences in valuation of biological assets. The address of Sallmanns is 17/E, Dorset House, Taikoo Place, 979 King’s Road, Quarry Bay, Hong Kong. The fair value less costs to sell of heifers and calves are determined with reference to the market-determined prices of items with similar age, breed and genetic merit, if the market-determined prices are available. Due to the fact that the market-determined prices of milkable cows are not available, Sallmanns has applied the net present value approach to calculate the fair value less cost to sell of these items.

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The principal valuation assumptions adopted in applying the net present value approach are as follows:

- The quantities of the existing cows at the end of the reporting period will reduce at a certain culling rate due to the natural or unnatural factors.
- The culling rates adopted are 8%, 12%, 20%, 20% and 100% for milkable cows in the first to fifth lactation cycles. These rates are based on the historical breeding data of Modern Farm and future operating plans.
- The quantities of dairy cows will increase as calves are born.
- The expected average prices of milk during the projected period of 5 years, which is the estimated production period of a dairy cow are estimated after, taking into account certain percentage growth for each projected year after considering future demand and inflation in the PRC;
- The cash flows for financing the assets and taxation are not included as required by IAS 41 Agriculture;
- Costs are average costs based on historical cost information.
- The discount rates used are 9.7% and 9.24% as at 30 June 2009 and 30 June 2010 respectively.

As at 30 June 2009 and 30 June 2010, Modern Farm Group has pledged dairy cows with carrying amount of RMB367,489,000 and RMB1,315,640,000 respectively to banks to secure the general banking facilities granted to Modern Farm Group.

The aggregate gain or loss arising during the period ended 30 June 2009 and year ended 30 June 2010 on initial recognition of dairy cows and milk and from the change in fair value less costs to sell of dairy cows is analyzed as follows:

	7 July 2008 (date of establishment)	
	to 30 June 2009	1 July 2009 to 30 June 2010
	RMB’000	RMB’000
Sales of milk/fair value of milk produced less costs to sell	334,015	589,775
Gain arising from changes in fair value less costs to sell of dairy cows.	<u>70,573</u>	<u>60,620</u>
	<u>404,588</u>	<u>650,395</u>

19. INVENTORIES

	30 June 2009	30 June 2010
	RMB’000	RMB’000
Feeds	79,050	130,963
Others	<u>4,088</u>	<u>8,444</u>
	<u>83,138</u>	<u>139,407</u>

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20. TRADE AND OTHER RECEIVABLES

The following is an analysis of trade and other receivables at the end of respective reporting periods:

	<u>30 June 2009</u>	<u>30 June 2010</u>
	RMB’000	RMB’000
Trade receivables		
- within 60 days based on invoice date	35,247	44,301
- over 60 days based on invoice date	<u>483</u>	<u>353</u>
	35,730	44,654
Advances to suppliers	17,802	17,228
Others	<u>25,086</u>	<u>14,890</u>
	<u><u>78,618</u></u>	<u><u>76,772</u></u>

The Modern Farm Group allows credit period of 60 days to its trade customers.

Trade receivables at the end of respective reporting periods principally represent receivables from sales of milk.

Before accepting any new customer, the Modern Farm Group will internally assess the credit quality of the potential customer and define appropriate credit limits.

Management closely monitors the credit quality of trade receivables and considers the trade receivables that are neither past due nor impaired to be of a good credit quality.

Included in the Group’s trade receivable balance are debtors with aggregate carrying amount of RMB483,000 and RMB353,000 which are past due as at 30 June 2009 and 30 June 2010, respectively for which the Modern Farm Group has not provided for impairment loss. The Modern Farm Group does not hold any collateral over these balances. The average age of these receivables as at 30 June 2009 and 30 June 2010 are 180 days.

21. PLEDGED BANK BALANCES AND CASH AND BANK BALANCES

Pledged bank balances

The pledged bank balances as at 30 June 2009 and 2010 represent deposits pledged for short-term bank borrowings. The pledged bank balances carry interest at prevailing market saving rates at 0.36% and 0.36% per annum respectively.

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Bank balances and cash

Bank balances and cash comprise cash and short-term deposits with an original maturity of three months or less which are held with financial institutions and carry interest at prevailing market saving rates ranging from 0.36% to 3.33% and 0.36% to 1.98% per annum as at 30 June 2009 and 30 June 2010 respectively.

Bank balances and cash at 30 June 2009 and 30 June 2010 were denominated in USD and RMB. RMB is not a freely convertible currency in the international market. The exchange rate of RMB is determined by the Government of the PRC and the remittance of these funds out of the PRC is subject to exchange restrictions imposed by the Government of the PRC.

Bank balances and cash that are denominated in currency other than the functional currency of the relevant entities are set out below:

	<u>30 June 2009</u>	<u>30 June 2010</u>
	RMB’000	RMB’000
USD.	<u>660,673</u>	<u>64,578</u>

22. TRADE AND OTHER PAYABLES

The credit period taken for the settlement of trade purchases is 60 days. The following is an aged analysis of trade payables at the end of the respective reporting periods:

	<u>2009</u>	<u>2010</u>
	RMB’000	RMB’000
Trade payables		
Within 60 days based on invoice date	82,607	111,507
Over 60 days based on invoice date	<u>1,334</u>	<u>3,532</u>
	<u>83,941</u>	<u>115,039</u>
Payable for acquisition of property, plant and equipment	37,533	150,238
Consideration payable for acquisition of a subsidiary	47,524	5,150
Accrued staff costs	9,897	14,644
Advance payment from customers	1,627	57,977
Others	<u>7,784</u>	<u>8,002</u>
	<u>104,365</u>	<u>236,011</u>
	<u>188,306</u>	<u>351,050</u>

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23. BORROWINGS

	<u>30 June 2009</u>	<u>30 June 2010</u>
	<u>RMB’000</u>	<u>RMB’000</u>
Bank borrowings	543,950	1,216,992
Other borrowings (Note i)	8,240	8,125
	<u>552,190</u>	<u>1,225,117</u>
Unsecured borrowings	71,153	209,696
Guaranteed borrowings (Note iii)	77,470	74,170
Secured borrowings (Note ii).	403,567	941,251
	<u>552,190</u>	<u>1,225,117</u>
Carrying amount repayable:		
Within one year	251,595	384,647
Between one to two years	120,125	162,264
Between two to five years	180,470	407,206
Over five years.	—	271,000
	552,190	1,225,117
Less: Amounts due within one year shown under current liabilities .	<u>(251,595)</u>	<u>(384,647)</u>
	<u>300,595</u>	<u>840,470</u>

The bank and other borrowings comprise:

	<u>30 June 2009</u>	<u>30 June 2010</u>
	<u>RMB’000</u>	<u>RMB’000</u>
Fixed-rate borrowings	142,590	285,159
Variable-rate borrowings	409,600	939,958

The effective interest rates, which are also equal to contracted interest rates, per annum at the end of the respective reporting periods are as follows:

	<u>30 June 2009</u>	<u>30 June 2010</u>
Fixed-rate borrowings	2.40% to 7.47%	2.40% to 7.47%
Variable-rate borrowings	6.12% to 7.65%	4.86% to 7.29%

All borrowings are denominated in RMB. Variable-rate borrowings interest rates are determined based on the borrowing rates announced by the People’s Bank of China.

Notes:

- (i) Other borrowings represented the loans from local government for financing the purchase of dairy cows for Modern Farm Group. The loans were secured by certain plant and equipment owned by Modern Farm Group as set out in note 16, interest bearing of 2.4% per annum and were repayable on 31 October 2011 and 1 November 2013.

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- (ii) The loans were secured by:
 - i) certain property, plant and equipment, land use rights, dairy cows and bank balances owned by Modern Farm Group as set out in Notes 16, 17, 18 and 21 respectively; and
 - ii) 100% equity interest in Zhangjiakou Seibe Modern Farm Co., Ltd., Modern Farm (Feidong) Co., Ltd and Helingeer Modern Farming Co., Ltd. held by Modern Farm.
- (iii) The balances were guaranteed by Modern Farm Group’s subsidiaries.

24. DEFERRED INCOME

	Arising from government grants	
	RMB’000	
At date of establishment		—
Additions.		3,580
Released to income		<u>(113)</u>
At 30 June 2009		3,467
Additions.		56,715
Released to income		<u>(967)</u>
At 30 June 2010		<u>59,215</u>
	At 30 June 2009	At 30 June 2010
	RMB’000	RMB’000
Analyzed for reporting purpose as:		
- Current portion	52	3,868
- Non-current portion	<u>3,415</u>	<u>55,347</u>
	<u>3,467</u>	<u>59,215</u>

Deferred income arising from government grant represents the government subsidies obtained in relation to the construction and acquisition of property, plant and equipment, which was included in the consolidated statements of financial position as deferred income and credited to the consolidated statements of comprehensive income on a systematic basis over the useful lives of the related assets.

25. ACQUISITION OF SUBSIDIARIES

- (a) On 7 July 2008, Modern Farm acquired 100% equity interest in Leading Farming from certain equity owners of Modern Farm and third parties. Leading Farming and Modern Farm have some common equity owners. Leading Farming and its subsidiaries are principally engaged in dairy cow farming and were acquired with the objective of expansion of business.

Consideration transferred

	RMB’000
Cash	<u>202,180</u>

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Assets and liabilities recognized at the date of acquisition

	<u>RMB’000</u>
<i>Current assets</i>	
Cash and cash equivalents	14,348
Trade and other receivables	22,275
Inventories	4,533
Land use rights	709
<i>Non-current assets</i>	
Property, plant and equipment	458,379
Land use rights	15,846
Biological assets	447,210
<i>Current liabilities</i>	
Trade and other payables	(105,687)
Amount due to a related party	(2,094)
Interest payable	(811)
Borrowings - due within one year	(176,000)
<i>Non-current liabilities</i>	
Borrowings - due after one year	(227,088)
	<u>451,620</u>

The receivables acquired (which principally comprised trade receivables) with a fair value of RMB22,275,000 had gross contractual amounts of RMB22,275,000.

Non-controlling interests

The non-controlling interest (5% in Zhangjiakou Chabei Modern Farming Dairy Cow Professional Cooperative and 30% in Modern Farming Group (Anhui) Sijibao Organic Fertiliser Co., Ltd.) recognized at the acquisition date was measured by reference to the proportionate share of the fair value of the acquiree’s identifiable net assets and amounted to RMB2,296,000.

Contribution for owners of Modern Farm arising on acquisition

	<u>RMB’000</u>
Consideration transferred	202,180
Plus: non-controlling interests	2,296
Less: fair value of identifiable net assets acquired	(451,620)
Contribution from owners of Modern Farm recognized in capital reserve . . .	<u>(247,144)</u>

Net cash outflow arising on acquisition

	<u>RMB’000</u>
Consideration paid in cash	(202,180)
Less: cash and cash equivalent balances acquired	14,348
	<u>(187,832)</u>

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Impact of acquisition on the results of the Modern Farm Group

Leading Farming and its subsidiaries contributed approximately RMB234,672,000 sales of milk produced and RMB18,213,000 profit to Modern Farm Group’s sales of milk produced and profit for the period between the date of acquisition and 30 June 2009.

- (b) On 31 December 2008, Modern Farm acquired 100% equity interest in Inner Mongolia Mengniu AustAsia Model Dairy Farm Co., Ltd. (subsequently change the name to Helingeer Modern Farming Co., Ltd. “Helingeer Modern Farm”) Helingeer Modern Farm is principally engaged in dairy cow farming and was acquired with the objective of expansion of business.

Consideration transferred

	RMB’000
Cash paid during the year ended 30 June 2010 and recorded as other payable as at 30 June 2009	47,524
Cash paid during the year ended 30 June 2009.....	48,576
	96,100

Assets and liabilities recognized at the date of acquisition

	RMB’000
<i>Current assets</i>	
Bank balances and cash	13,278
Pledged bank balances	13,986
Trade and other receivables.....	10,534
Inventories.....	57,540
Land use rights	244
<i>Non-current assets</i>	
Property, plant and equipment	131,877
Land use rights	10,847
Biological assets	144,946
<i>Current liabilities</i>	
Trade and other payables	(72,163)
Amount due to a related party	(16,662)
Borrowings - due within one year.....	(195,070)
	99,357

The receivables acquired (which principally comprised trade receivables) with a fair value of RMB10,534,000 had gross contractual amounts of RMB10,534,000.

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Net cash outflow arising on acquisition

	<u>RMB’000</u>
Consideration paid in cash	(48,576)
Less: cash and cash equivalent balances acquired	<u>27,264</u>
	<u>(21,312)</u>

Bargain purchase gain arising on acquisition

	<u>RMB’000</u>
Consideration transferred	96,100
Less: fair value of identifiable net assets acquired	<u>(99,357)</u>
Bargain purchase gain arising on acquisition	<u>(3,257)</u>

The bargain purchase gain arose on the acquisition of Helingeer Modern Farm is attributable to the acquisition consideration was determined in November 2008 but the acquisition transaction was completed in December 2008.

Impact of acquisition on the results of the Modern Farm Group

Helingeer Modern Farm contributed approximately RMB99,343,000 sales of milk produced and RMB12,790,000 profit to Modern Farm Group’s sales of milk produced and profit for the period between the date of acquisition and 30 June 2009.

If the acquisitions had been completed on the date of establishment, total Modern Farm Group sales of milk produced for the period ended 30 June 2009 would have been approximately RMB439,795,000, and profit before tax for the period ended 30 June 2009 would have been approximately RMB50,988,000. The pro forma information is for illustrative purposes only and is not necessarily an indication of sales of milk produced and results of operations of Modern Farm Group that actually would have been achieved had the acquisitions been completed on the date of establishment, nor is intended to be a projection of future results.

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- (c) On 30 June 2010, Modern Farm acquired 100% equity interest in Modern Farm (Chabei) Hengsheng Co., Ltd. (“Hengsheng Modern Farm”). Hengsheng Modern Farm is principally engaged in dairy cow farming and was acquired with the objective of expansion of business.

Consideration transferred

	<u>RMB’000</u>
Other payable	5,150
Cash	<u>9</u>
	<u>5,159</u>

Assets and liabilities recognized at the date of acquisition

	<u>RMB’000</u>
<i>Current assets</i>	
Cash and cash equivalents	1,947
Trade and other receivables	8,328
Inventories	2,148
<i>Non-current assets</i>	
Property, plant and equipment	44,733
Biological assets	34,266
<i>Current liabilities</i>	
Trade and other payables	(46,263)
Borrowings - due within one year	<u>(40,000)</u>
	<u>5,159</u>

The receivables acquired (which principally comprised trade receivables) with a fair value of RMB8,328,000 had gross contractual amounts of RMB8,328,000.

Net cash inflow arising on acquisition

	<u>RMB’000</u>
Consideration paid in cash	(9)
Less: cash and cash equivalent balances acquired	<u>1,947</u>
	<u>1,938</u>

Impact of acquisition on the results of the Modern Farm Group

Hengsheng Modern Farm has no contribution in profit and sales of milk produced to Modern Farm Group’s profit and sales of milk produced for the year ended 30 June 2010.

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If the acquisition had been completed since 1 July 2009, total Modern Farm Group sales of milk produced for the year ended 30 June 2010 would have been approximately RMB606,446,000, and profit before tax for the year would have been approximately RMB109,166,000. The pro forma information is for illustrative purposes only and is not necessarily an indication of sales of milk produced and results of operations of Modern Farm Group that actually would have been achieved had the acquisition been completed on the date of establishment, nor is intended to be a projection of future results.

26. SHARE-BASED PAYMENT TRANSACTIONS

The Modern Farm’s option scheme (the “Scheme”) was adopted pursuant to agreement dated 9 June 2009 for the primary purpose of providing incentives to directors and eligible employees of Modern Farm Group, and will expire on 8 June 2019. Under the Scheme, the Directors granted options to two directors and one top management of Modern Farm (the “MF Grantees”) to subscribe for a total of RMB10,821,069 paid-in capital (the “MF Options”) and each MF Options with an exercise price RMB5.9883 per RMB1 paid-in capital on 17 June 2009.

At 30 June 2009 and 2010, the amount of paid-in capital in respect of which the MF Grantees can subscribe for and remained outstanding under the Scheme was RMB10,821,069 and RMB10,821,069, respectively representing 2.09% and 2.09% of the paid-in capital of Modern Farm at those dates respectively.

No consideration is payable on the grant of an option. Options may be exercised at any time from the date of grant. The exercise price is determined by the Directors. In accordance with the terms of the Scheme, options issued during the period ended 30 June 2009 vested at the date of grant.

The fair value of each MF Options granted during the period ended 30 June 2009 is RMB0.8384. Options were priced using a binomial option pricing model. The fair value of options granted during the period ended 30 June 2009 was estimated on the date of grant using the following assumption:

Estimated fair value of each RMB1 paid-in capital	RMB5.45
Exercise price	RMB5.9883
Expected volatility	39.32%
Expected option life	10 years
Dividend yield	3%
Risk-free interest rate	3.13%

Estimate fair value of each RMB1 paid-in capital was determined by reference to recent capital injection transaction.

Expected volatility was determined by using the historical volatility of comparable companies. The expected option life used in the mode has been adjusted, based on management’s best estimate, for the effects of non-transferability, exercise restriction and behavioural consideration.

Modern Farm recognized the total expenses of RMB9,072,000 for the period ended 30 June 2009 in relation to options granted by Modern Farm.

On 31 October 2010, the Company granted options of the Company to the MF Grantees to replace the MF Options which lapsed and ceased to have effect at the same time.

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27. CAPITAL RISK MANAGEMENT

Modern Farm Group manages its capital to ensure that entities in Modern Farm Group will be able to continue as a going concern while maximizing the return to stakeholders through the optimization of the debt and equity balance. Modern Farm Group’s overall strategy remains unchanged during the Relevant Periods.

The capital structure of Modern Farm Group consists of net debt, comprising bank and other borrowings as disclosed in Note 23, net of cash and cash equivalents and equity attributable to owners of Modern Farm, comprising paid-in capital, retained earnings and other reserves as disclosed in the consolidated statements of changes in equity.

Modern Farm Group’s management reviews the capital structure on a regular basis. As part of the review, the management considers the cost of capital and the risks associated with each class of capital. Modern Farm Group will balance its overall capital structure through the payment of dividends, injection of capital and as well as the issue of new debt or the redemption of existing debt.

28. FINANCIAL INSTRUMENTS

Categories of financial instruments

	<u>30 June 2009</u>	<u>30 June 2010</u>
	RMB’000	RMB’000
Financial assets:		
Loans and receivables (including cash and cash equivalents)	840,602	345,422
Financial liabilities:		
Amortized cost	746,915	1,520,686

Financial risk management objectives and policies

Modern Farm Group’s major financial instruments include trade and other receivables, trade and other payables, amount due to a related party, interest payable, borrowings, pledged bank balances, bank balances and cash. Details of these financial instruments are disclosed in the respective notes.

The risks associated with these financial instruments and the policies on how to mitigate these risks are set out below. The management manages and monitors these exposures to ensure appropriate measures are implemented on a timely and effective manner. Modern Farm Group’s objectives, policies and processes managing the risk and the methods used to measure the risk remains unchanged during the Relevant Periods.

Credit risk

Modern Farm Group’s maximum exposure to credit risk which will cause a financial loss to Modern Farm Group due to failure to discharge an obligation by the counterparties is arising from the carrying amount of the respective recognized financial assets as stated in the consolidated statements of financial position at the end of the respective reporting periods.

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In order to minimize the credit risk, the management of Modern Farm Group has delegated a team responsible for determination of credit limits, credit approvals and other monitoring procedures to ensure that follow-up action is taken to recover overdue debts. The amounts presented in the consolidated statements of financial position are net of allowances for doubtful receivables, if any, estimated by the Modern Farm Group's management based on prior experience and the current economic environment. Modern Farm Group reviews the recoverable amount of each individual debt at the end of each reporting period to ensure that adequate impairment losses are made for irrecoverable amounts. In this regard, the directors of the Modern Farm consider that Modern Farm Group's credit risk is significantly reduced.

The credit risk on liquid funds is limited because the counterparties are authorized banks in the PRC.

Modern Farm Group has concentration of credit risk as 99.6% and 97.6% of total trade receivables as at 30 June 2009 and 30 June 2010, respectively, was due from Modern Farm Group's largest customer.

Interest rate risk

Modern Farm Group are exposed to cash flow interest rate risk due to fluctuations in the prevailing market interest rates on bank balances, pledged bank balances and bank borrowings which carry interest at variable interest rates.

Modern Farm Group's fair value interest rate risk relates primarily to fixed-rate bank and other borrowings. Modern Farm Group currently does not have an interest rate hedging policy. However, the management monitors interest rate exposure and will consider hedging significant interest rate exposure should the need arises.

Interest rate sensitivity

The sensitivity analyses below have been determined based on the exposure to market lending interest rates for non-derivative instruments at the end of each reporting period. The sensitivity analyses below have been determined based on the exposure to interest rates for variable interest rate bank borrowings. Bank balances are excluded from the sensitivity analyses since they are not considered sensitive to fluctuation in interest rate. The analysis is prepared assuming the variable interest rate bank borrowings outstanding at the end of respective reporting periods were outstanding for the whole period/year. A 50 basis point increase or decrease is used when reporting interest rate risk internally to key management personnel and represents management's assessment of the reasonably possible change in interest rates.

At the end of each reporting period, if interest rates had been increased/decreased by 50 basis points and all other variables were held constant, Modern Farm Group's profit for the period/year would decrease/increase by RMB1,448,000 and RMB1,300,000 for the period from 7 July 2008 (date of establishment) to 30 June 2009 and year ended 30 June 2010 respectively and Modern Farm Group's property, plant and equipment would increase/decrease by RMB600,000 and RMB3,400,000 as at 30 June 2009 and 30 June 2010, respectively for interest capitalization.

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Liquidity risk

The Modern Farm Group finance their operations by using a combination of borrowings and equity. Adequate lines of credit are maintained to ensure necessary liquidity is available when required. The management monitors the liquidity position of the Modern Farm Group on a periodical basis to ensure the availability of sufficient liquid funds to meet all obligations. With reference to the existing unutilized facilities, newly obtained facilities up to the date of this report and re-financing arrangements, the Directors consider the liquidity and source of capital for the daily operation are sufficient.

The Modern Farm Group has net current liabilities of approximately RMB239 million as at 30 June 2010. The Directors consider the Modern Farm Group has sufficient internally generated funds and available facilities to meet the Modern Farm Group’s financial obligations.

The following table details Modern Farm Group’s contractual maturity for its non-derivative financial liabilities. The table has been drawn up based on the undiscounted cash flows of financial liabilities based on the earliest date on which Modern Farm Group can be required to pay. The table includes both interest and principal.

	Weighted average interest rates	Within 180 days	181 days to 365 days	1-2 years	Over 2 years	Total undiscounted cash flows	Carrying amount
	%	RMB’000	RMB’000	RMB’000	RMB’000	RMB’000	RMB’000
As at 30 June 2009							
Non-interest bearing .	—	194,725	—	—	—	194,725	194,725
Fixed interest rate borrowings	7	139,167	—	3,740	4,669	147,576	142,590
Variable interest rate borrowings	7	<u>131,466</u>	<u>10,236</u>	<u>136,943</u>	<u>200,640</u>	<u>479,285</u>	<u>409,600</u>
		<u>465,358</u>	<u>10,236</u>	<u>140,683</u>	<u>205,309</u>	<u>821,586</u>	<u>746,915</u>
As at 30 June 2010							
Non-interest bearing .	—	295,569	—	—	—	295,569	295,569
Fixed interest rate borrowings	6	59,868	126,175	46,148	70,707	302,898	285,159
Variable interest rate borrowings	6	<u>150,357</u>	<u>106,334</u>	<u>162,760</u>	<u>691,488</u>	<u>1,110,939</u>	<u>939,958</u>
		<u>505,794</u>	<u>232,509</u>	<u>208,908</u>	<u>762,195</u>	<u>1,709,406</u>	<u>1,520,686</u>

Foreign currency risk

Modern Farm Group collects its sales of milk produced in RMB and incurs most of the expenditures as well as capital expenditures in RMB. The major asset denominated in foreign currency is the bank balances and cash which disclosed in note 21. The balances represent the capital injection by the equity-owners.

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Modern Farm Group currently does not use any derivative contracts to hedge against its exposure to foreign currency risk. Modern Farm Group manages its foreign currency risk by closely monitoring the movement of the foreign currency rate.

Foreign currency sensitivity analysis

0.5% is the sensitivity rate used in each reporting period when reporting foreign currency risk internally to key management personnel and represents management’s assessment of the reasonably possible change in foreign exchange rates.

At the end of each reporting period, if the exchange rate had been strengthen/weaken in Renminbi against US Dollars by 0.5% and all other variables were held constant, Modern Farm Group’s profit for the period/year would decrease/increase by RMB3,303,000 and RMB323,000 for the period from 7 July 2008 (date of establishment) to 30 June 2009 and year ended 30 June 2010 respectively.

Fair value

The fair value of financial assets and financial liabilities are determined in accordance with generally accepted pricing models based on discounted cash flow analysis or using prices from observable current market transactions.

The directors of Modern Farm consider that the carrying amounts of financial assets and financial liabilities recorded at amortized cost in the Financial Information approximate their fair values at the end of respective reporting periods.

29. OPERATING LEASE COMMITMENTS

Modern Farm Group as lessee

At the end of each reporting period, Modern Farm Group was committed to making future minimum lease payments in respect of plant and vehicles rented under non-cancellable operating leases which fall due as follows:

	<u>30 June 2009</u>	<u>30 June 2010</u>
	RMB’000	RMB’000
Within one year	533	941
In the second to fifth year inclusive	1,498	787
Over five years	<u>5,999</u>	<u>5,770</u>
	<u>8,030</u>	<u>7,498</u>

Operating lease payments represent rentals payable by Modern Farm Group for certain of its plant and vehicles which are negotiated for an average term of 5 years and rentals are fixed for an average of 5 years.

The minimum lease payments paid under operating lease during the period ended 30 June 2009 and the year ended 30 June 2010 are approximately RMB553,000 and RMB542,000 respectively.

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30. CAPITAL COMMITMENTS

	<u>30 June 2009</u>	<u>30 June 2010</u>
	RMB’000	RMB’000
Capital expenditure contracted but not provided for in respect of the acquisition of:		
- property plant and equipment	299,905	261,573
- biological assets	<u>299,850</u>	<u>303,152</u>
	<u>599,755</u>	<u>564,725</u>

31. RELATED PARTY TRANSACTIONS

(a) Name and relationship with related party is as follows:

<u>Name</u>	<u>Relationship</u>
Inner Mongolia Jiuqiang Machinery Co., Ltd.	Company owned by a director

(b) At the end of each reporting period, Modern Farm Group had the following balances with related party:

Amount due to a related party

	<u>30 June 2009</u>	<u>30 June 2010</u>
	RMB’000	RMB’000
Other payable nature		
Inner Mongolia Jiuqiang Machinery Co., Ltd. (Note)	<u>6,622</u>	<u>1,247</u>

Note: The amount mainly represented construction cost payable at the end of respective reporting periods. It was interest-free, unsecured and repayable on demand.

Except for the transaction mentioned in Note 25(a), there is no other significant transactions with other related parties.

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(c) Compensation of key management personnel

The emoluments of key management during Relevant Periods were as follows:

	7 July 2008 (date of establishment) to 30 June 2009	1 July 2009 to 30 June 2010
	RMB’000	RMB’000
Short-term employees benefits	1,099	2,408
Post-employment benefits	116	116
Equity-settled share-based payment	<u>9,072</u>	<u>—</u>
	<u>10,287</u>	<u>2,524</u>

C. SUBSEQUENT EVENTS

On 31 October 2010, the Company granted share options of the Company to the MF Grantees to replace the MF Options which lapsed and ceased to have effect at the same time. Details of the options issued by the Company to the MF Grantees are set out in the sub-section headed “D. Other Information — 2. Management Options” in Appendix VI to the document.

Yours faithfully,
Deloitte Touche Tohmatsu
Certified Public Accountants
Hong Kong