CHINA MENGNIU DAIRY COMPANY LIMITED

(Incorporated in the Cayman Islands with limited liability)

(Stock Code: 2319)

ANNOUNCEMENT OF RESULTS FOR THE YEAR ENDED 31 DECEMBER 2004

Highlights

	2004 RMB'000	2003 RMB'000
Revenue	**7,213,827**	4,071,468
Net profit attributable to shareholders	**319,393**	164,372
Dividend — Final	**80,053**	61,860
Earnings per share		
— Basic	**RMB0.357**	RMB0.192
— Diluted	**RMB0.285**	—

- Revenue surged 77.2% to RMB7,213.8 million as a result of the success in brand building and market penetration strategies. According to ACNielsen, market share in the liquid milk market boosted by 5 percentage points from 17% by December 2003 to 22% by December 2004.
- Net profit increased by 94.3% to RMB319.4 million, exceeding 2004 full year forecast as disclosed in the prospectus by 6.5%.
- Basic earnings per share increased by 85.9% to RMB0.357.

The directors (the "Directors") of China Mengniu Dairy Company Limited (the "Company") are pleased to announce the audited results of the Company and its subsidiaries (the "Group") for the year ended 31 December 2004 together with the comparative figures for 2003 as follows:

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2004

	Notes	2004 RMB'000	2003 RMB'000
Revenue	4	**7,213,827**	4,071,468
Cost of sales		**(5,607,363)**	(3,047,949)
GROSS PROFIT		**1,606,464**	1,023,519
Other income	4	**13,138**	9,068
Selling and distribution costs		**(1,039,282)**	(630,046)
Administrative expenses		**(136,662)**	(86,099)
Other operating expenses		**(4,040)**	(10,492)
PROFIT FROM OPERATING ACTIVITIES		**439,618**	305,950
Finance costs, net		**(29,086)**	(12,900)
Share of profit of associates		**32**	738
PROFIT BEFORE TAX		**410,564**	293,788
Tax	5	**(18,465)**	(61,458)
PROFIT AFTER TAX		**392,099**	232,330
Minority interests		**(72,706)**	(67,958)
NET PROFIT ATTRIBUTABLE TO SHAREHOLDERS		**319,393**	164,372
DIVIDEND			
Final	6	**80,053**	61,860
EARNINGS PER SHARE	7		
Basic		**RMB0.357**	RMB0.192
Diluted		**RMB0.285**	—

CONSOLIDATED BALANCE SHEET

As at 31 December 2004

	Notes	2004 RMB'000	2003 RMB'000
NON-CURRENT ASSETS			
Property, plant and equipment, net		**2,227,528**	1,191,478
Construction in progress		**292,013**	146,016
Land use rights		**34,062**	34,293
Investments in associates		**20,578**	1,917
Long term investments		**3,409**	3,409
Goodwill		**115,549**	—
Negative goodwill		**—**	(28,182)
		2,693,139	1,348,931
CURRENT ASSETS			
Inventories		**714,799**	408,790
Trade receivables	8	**185,299**	94,443
Prepayments, deposits and other receivables		**129,186**	105,548
Pledged deposits		**20,763**	2,425
Cash and cash equivalents		**1,018,928**	374,173
		2,068,975	985,379
CURRENT LIABILITIES			
Trade payables	9	**694,597**	427,533
Accruals and other payables		**758,160**	400,536
Interest-bearing bank loans, unsecured		**470,542**	161,534
Other loans, unsecured		**22,600**	27,600
Income tax payable		**1,436**	7,591
		1,947,335	1,024,794
NET CURRENT ASSETS/(LIABILITIES)		**121,640**	(39,415)
TOTAL ASSETS LESS CURRENT LIABILITIES		**2,814,779**	1,309,516
NON-CURRENT LIABILITIES			
Interest-bearing bank loans, unsecured		**239,500**	226,000
Other loans, unsecured		**18,000**	18,000
Long term payables		**189,925**	148,089
Deferred income		**64,226**	57,706
		511,651	449,795
MINORITY INTERESTS		**348,654**	170,511
		1,954,474	689,210
REPRESENTED BY:			
Share capital		**118,138**	—
Reserves		**1,551,647**	335,729
Non-voting convertible redeemable preferred shares		**—**	291,621
Convertible instruments		**204,636**	—
Proposed final dividend		**80,053**	61,860
		1,954,474	689,210

1. GROUP REORGANIZATION AND BASIS OF PRESENTATION

The Company was incorporated in the Cayman Islands on 16 February 2004 as an exempted company with limited liability. The shares of the Company have been listed on The Stock Exchange of Hong Kong Limited (the "Hong Kong Stock Exchange") with effect from 10 June 2004.

Pursuant to a group reorganization scheme (the "Reorganization") to rationalize the structure of the Group in preparation for the public listing of the Company's shares on the Hong Kong Stock Exchange, the Company acquired the entire issued share capital of China Dairy Holdings, the then holding company of the subsidiaries comprising the Group, and thereby became the holding company. Further details of the Group Reorganization are set out in the Company's prospectus dated 1 June 2004.

The Reorganization involved companies under common control and, for accounting purposes, the Group is regarded and accounted for as a continuing group. Accordingly, the consolidated financial statements have been prepared using the pooling of interests method of accounting as if the Company has always been the holding company of the Group. On this basis, the Company has been treated as the holding company of the companies comprising the Group for the financial years presented rather than from the date of acquisition of China Dairy Holdings.

In the opinion of the directors, the financial statements, prepared on the above basis, present fairly the results, cash flows and the state of affairs of the Group as a whole.

2. BASIS OF PREPARATION AND CHANGE IN SIGNIFICANT ACCOUNTING POLICIES

The financial statements, which are presented in Renminbi, have been prepared in accordance with International Financial Reporting Standards ("IFRS") which comprise standards and interpretations approved by the International Accounting Standards Board ("IASB") and are prepared on the historical cost basis, except that long term investments are stated at their fair values. The IASB has issued a number of new and revised IFRSs, herein collectively referred to as the new IFRSs, which are generally effective for accounting periods beginning on or after 1 January 2005. The Group has not early adopted these new IFRSs in the financial statements for the year ended 31 December 2004, except for the following standards:

- IFRS 3 Business Combinations;
- IAS 36 (amended 2004), Impairment of Assets; and
- IAS 38 (amended 2004), Intangible Assets.

The early adoption of IFRS 3 has resulted in the Group ceasing to amortize goodwill acquired during the year, and starting to test for impairment of goodwill annually at the cash-generating unit level (unless an event occurs during the year which requires the goodwill to be tested more frequently). The transitional provisions of IFRS 3 have required the Group to derecognize the carrying amount of negative goodwill at 1 January 2004 of RMB28,182,000 with a corresponding adjustment to the opening balance of retained earnings. The adoption of IAS 36 and IAS 38 (amended 2004) has had no significant impact on the financial statements.

The Group has already commenced an assessment of the impact of the other new IFRSs, which are generally effective for accounting periods beginning on or after 1 January 2005, but is not yet in a position to state whether these new IFRSs would have a significant impact on its result of operations and financial position.

3. SEGMENTAL INFORMATION

The Group's operating businesses are organized and managed separately according to the nature of the products, with each segment representing a strategic business segment that offers different products in the PRC market. The liquid milk products segment carries out the business of the manufacture and distribution of processed UHT milk, milk beverages and yogurt. The ice cream products segment carries out the business of the manufacture and distribution of ice cream products. The other dairy products segment carries out the business of the manufacture and distribution of processed milk powder and milk tablets products.

During the year, the Group's revenue, expenses, results, assets and liabilities and capital expenditure were principally generated in the PRC. Accordingly, an analysis of the Group's revenue, expenses, assets and liabilities and capital expenditure by geographical segment is not presented.

	2004 RMB'000	2003 RMB'000
Segmental revenue:		
Liquid milk	**6,097,187**	3,498,162
Ice cream	**805,208**	475,233
Other dairy products	**311,432**	98,073
Consolidated revenue	**7,213,827**	4,071,468
Segmental net profit		
Liquid milk	**414,265**	327,911
Ice cream	**53,821**	29,683
Other dairy products	**24,142**	2,002
Consolidated net profit	**492,228**	359,596
Unallocated corporate expenses	**(52,610)**	(53,646)
Profit from operating activities	**439,618**	305,950
Finance costs, net	**(29,086)**	(12,900)
Share of profit of associates	**32**	738
Profit before taxation	**410,564**	293,788
Tax	**(18,465)**	(61,458)
Profit after taxation	**392,099**	232,330
Minority interests	**(72,706)**	(67,958)
Net profit attributable to shareholders	**319,393**	164,372

	2004 RMB'000	2003 RMB'000
Segmental assets:		
Liquid milk	**3,492,377**	1,790,802
Ice cream	**585,881**	320,500
Other dairy products	**285,661**	81,466
Unallocated corporate assets	**808,970**	314,699
Elimination	**(410,775)**	(173,157)
Consolidated total assets	**4,762,114**	2,334,310
Segmental liabilities:		
Liquid milk	**2,229,560**	813,508
Ice cream	**170,511**	169,809
Other dairy products	**161,876**	80,457
Unallocated corporate liabilities	**307,814**	583,972
Elimination	**(410,775)**	(173,157)
Consolidated total liabilities	**2,458,986**	1,474,589
Capital expenditure:		
Liquid milk	**764,715**	601,651
Ice cream	**252,653**	125,992
Other dairy products	**81,732**	10,029
Others	**65,341**	3,777
	1,164,441	741,449
Depreciation:		
Liquid milk	**125,092**	49,671
Ice cream	**35,692**	17,555
Other dairy products	**1,628**	177
Others	**7,064**	2,808
	169,476	70,211
Other non-cash expenses:		
Liquid milk	**3,040**	1,366
Ice cream	**910**	(194)
Other dairy products	**6,058**	117
Others	**377**	270
	10,385	1,559

4. **REVENUE AND OTHER INCOME**

An analysis of the Group's revenue and other income is as follows:

	2004 *RMB'000*	2003 *RMB'000*
Revenue	**7,213,827**	4,071,468
Other income		
Government grants	**7,865**	4,561
Trademark fees	**1,000**	1,272
Amortization of deferred income	**3,860**	—
Goodwill amortization	**—**	1,993
Others	**413**	1,242
	13,138	9,068
	7,226,965	4,080,536

Government grants have been received for the contribution of the Group to the local economy with respect to the establishment of infrastructure relating to the dairy products industry. There are no unfulfilled conditions or contingences attached to these grants.

5. **TAX**

Hong Kong profits tax has not been provided as the Group had no assessable profits arising in Hong Kong during the year. The tax charge represents the People's Republic of China (the "PRC") income tax provision for the year.

An analysis of the major components of tax expenses of the Group is as follows:

	2004 *RMB'000*	2003 *RMB'000*
PRC corporate income tax	**18,454**	61,177
Share of tax attributable to associates	**11**	281
	18,465	61,458

Under PRC income tax law, except for certain preferential treatment available to six of its subsidiaries, the entities within the Group are subject to corporate income tax ("CIT") at a rate of 33% on the taxable income as reported in their statutory accounts which are prepared in accordance with the PRC accounting standards and financial regulations.

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

	Note	**2004** *RMB'000*	2003 *RMB'000*
Profit before tax		**410,564**	293,788
At PRC corporate income tax rate at 33%		**135,486**	96,950
Non-taxable items and others, net		**(181)**	10,745
Effect of tax exemption	*i*	**(116,840)**	(46,237)
At effective income tax rates of 4.5% and 21%, respectively		**18,465**	61,458

Note:

i. Six (2003: three) subsidiaries were subject to tax exemption in 2004. The profit before tax in respect of these subsidiaries amounted to RMB354,060,000 (2003: RMB140,112,000) in aggregate. Five (2003: one) subsidiaries were granted tax exemption in accordance with the state tax bureau's approval based on the "Income Tax Law of People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises" under which these subsidiaries would be exempted from CIT for the first two profitable years and subject to 50% of the applicable tax rate for the following three profitable years. The remaining (2003: two) subsidiary was granted an exemption in accordance with the local tax bureau's approvals which are based on the policy of "The Notice of Income Tax Exemption for the Country's Key Enterprises in Agricultural Industries" from the tax authorities..

6. **DIVIDEND**

	Note	**2004** *RMB'000*	2003 *RMB'000*
Proposed final dividend — RMB5.85 cents per ordinary share	*i*	**64,966**	—
Interest on convertible instrument		**15,087**	—
Dividend paid by China Dairy Holdings to the then shareholders of			
— ordinary shares		**—**	41,483
— non-voting convertible redeemable preferred shares		**—**	20,377
		80,053	61,860

Note:

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

7. **EARNINGS PER SHARE**

The calculation of basic earnings per share for the current year is based on the net profit from ordinary activities attributable to shareholders for the year of RMB319,393,000, and the weighted average of 893,965,000 ordinary shares in issue during the year.

The weighted average number of shares used to calculate the basic earnings per share for the year ended 31 December 2004 includes the additional 250,000,000 ordinary shares issued upon the listing of the Company's shares on the Stock Exchange on 10 June 2004 and 110,524,942 ordinary shares issued upon conversion of the convertible instrument on 20 December 2004. The corresponding number of shares used to calculate the basic earnings per share for the year ended 31 December 2003 represents the pro forma issued share capital of the Company, comprising 143,654 ordinary shares and 749,856,346 ordinary shares issued for the Reorganization.

The calculation of basic earnings per share for the year ended 31 December 2003 is based on the net profit from ordinary activities attributable to shareholders for the year of RMB164,372,000, and after the deduction of the dividend entitlement of the holders of the non-voting convertible redeemable preferred shares of RMB20,377,000, as set out in note 6 above, and the weighted average of 750,000,000 ordinary shares assumed to have been in issue during the year ended 31 December 2003.

The calculation of diluted earnings per share is based on the net profit from ordinary activities attributable to shareholders for the year of RMB319,393,000 and the weighted average of 1,118,851,000 ordinary shares in issue during the year, being the weighted average number of ordinary shares outstanding during the year, adjusted for the effects of dilutive potential ordinary shares outstanding during the year.

A reconciliation of the weighted average number of shares used in calculating the basic and diluted earnings per share is as follows:

	2004 *'000*	2003 *'000*
Weighted average number of ordinary shares for the purpose of basic earnings per share calculation	**893,965**	750,000
Weighted average number of ordinary shares, assuming issued at conversion of convertible instrument during the year	**224,886**	
Weighted average number of ordinary shares for the purpose of diluted earnings per share calculation	**1,118,851**	

Diluted earnings per share has not been shown for the year ended 31 December 2003 as the non-voting convertible redeemable preferred shares of the Group outstanding during that year had an anti-dilutive effect on the basic earnings per share.

8. **TRADE RECEIVABLES**

The Group normally allows a credit period of not more than 30 days to its customers. The Group closely monitors overdue balances. A provision for doubtful debts is made when it is considered that amounts due may not be recovered.

An aging analysis of the trade receivables of the Group is as follows:

	2004 *RMB'000*	2003 *RMB'000*
Within 3 months	**168,601**	97,030
Between 4–6 months	**21,904**	2,083
Between 7–12 months	**3,513**	—
Over 1 year	**64**	—
	194,082	99,113
Less: Provision for doubtful debts	**(8,783)**	(4,670)
	185,299	94,443

The amounts due from related parties included in the above can be analyzed as follows:

	2004 *RMB'000*	2003 *RMB'000*
Associates	**21,582**	3,623

The balances are unsecured, non-interest bearing and are repayable on credit terms similar to those offered to other major customers of the Group.

9. **TRADE PAYABLES**

An aging analysis of the trade payables of the Group is as follows:

	2004 *RMB'000*	2003 *RMB'000*
Within 3 months	**585,208**	351,848
Between 4–6 months	**81,172**	65,255
Between 7–12 months	**26,100**	9,532
Over 1 year	**2,117**	898
	694,597	427,533

The amount due to a related party included in the above can be analyzed as follows:

	2004 *RMB'000*	2003 *RMB'000*
An associate	**669**	—

The balances are unsecured, non-interest bearing and are repayable on demand.

MANAGEMENT DISCUSSION & ANALYSIS

Financial Review

The Company was listed on the Main Board of the Hong Kong Stock Exchange on 10 June 2004, representing a significant milestone in the Company's corporate development. The response to its global offering was encouraging. The international offering was significantly over-subscribed whilst the Hong Kong public offering was 205 times over-subscribed.

The Group achieved remarkable growth in 2004. For the year ended 31 December 2004, the Group recorded a revenue of RMB7,213.8 million, representing an increase of 77.2% over that of the previous year. Net profit attributable to shareholders increased by 94.3% to RMB319.4 million. Basic earnings per share was RMB0.357, representing an increase of 85.9% over that of 2003 and the diluted earnings per share was RMB0.285.

Gross Profit

Robust sales growth brought about an increase in gross profit by 57.0% to RMB1,606.5 million. The primary reason for the gross margin decrease was due to the Company's aggressive expansion strategy, intense competition that resulted in lower average selling price for both liquid milk and ice cream products. Overall gross profit margin decreased from 25.1% in 2003 to 22.3% in 2004.

Operating Expenses

In 2004, the Group continued its stringent cost control measures. Although total operating expenses rose by 62.4% in 2004, the growth rate in operating expenses was lower than that of revenue. The Group leveraged greater economies of scale to deliver further operating efficiency. Total operating expenses as a percentage of total revenue in 2004 decreased to 16.4%, against 17.8% in 2003.

Profit from Operating Activities

EBITDA in 2004 amounted to RMB610 million and EBITDA margin slightly decreased to 8.5%. The decrease in EBITDA margin was less than the decrease in gross profit margin, indicating that better cost control was enforced during the year.

Net Profit

Despite the intensifying market competition, the Group's net profit attributable to shareholders reached RMB319.4 million, a surge of 94.3% from 2003, and exceeded 2004 full year forecast of RMB300 million as disclosed in the prospectus by 6.5%.

Capital Structure, Liquidity and Financial Resources

The Group's cash and cash equivalents amounted to RMB1,018.9 million as at 31 December 2004. Net cash from operating activities amounted to RMB572.3 million, representing an increase of 61.5% over that of 2003.

Non-current assets increased by RMB1,344.2 million to RMB2,693 million in 2004, attributable to the increase in investment in fixed assets and construction in progress and the goodwill arising on the acquisition of additional interest in a subsidiary.

As at 31 December 2004, the Group had outstanding bank loans amounting to RMB710.0 million, representing an increase of RMB322.5 million from RMB387.5 million as at 31 December 2003. Out of the outstanding bank loans, RMB470.5 million was repayable within one year and RMB239.5 million was repayable beyond one year.

The shareholders' fund increased from RMB689.2 million as at 31 December 2003 to RMB1,954.5 million as at 31 December 2004, attributable to the listing proceeds of RMB981.5 million and the profit for the year.

Net finance cost increased from RMB12.9 million in 2003 to RMB29.1 million in 2004 as a result of an increase in interest-bearing loans for supporting the Group's expanded operation scale.

The total debt to capital ratio of the Group was 27.8% as at 31 December 2004, as compared with 38.6% as at 31 December 2003.

Market Review

The dairy industry in China experienced strong growth in 2004 as a result of rising GDP and awareness of the nutritional value of liquid milk. The liquid milk industry by volume recorded an average annual increase of 20% over that of 2003, according to ACNielsen. However, the per capita consumption of liquid milk in China was still relatively low when compared to other Asian countries, pointing to tremendous growth potential for China's dairy industry.

Business Review

Branding and Marketing

According to ACNielsen, the Group captured 22.0% share of the liquid milk market by volume in December 2004, as compared with 17.0% in December 2003. Brand equity and strong customer loyalty are key growth drivers for the Group. The competition in the liquid milk market favored key local dairy players, enabling them to expand their market shares, and accelerated industry consolidation. The top three players captured 55.5% market share in December 2004, as compared with 45.9% in December 2003.

The Group has built and maintained a nationwide sales and distribution network predominantly through over 1,000 exclusive third party distributors located across China. To ensure close communication with distributors and gain thorough understanding of market situations, the Group employed sales personnel in key markets to assist distributors in serving retailers and gather first hand market information. Flexible logistics arrangement was in place to meet market demands.

The Group also rolled out effective promotions and advertising campaigns on national television channels in prime time slots to further enhance its brand and product awareness. The advertising and promotion expenses amounted to RMB450.4 million in 2004, which accounted for 6.3% of the total revenue. The Group achieved its spending target disclosed at the time of its Listing, demonstrating the Group's ability in achieving better scale of economy in its branding and marketing efforts.

Products

The Group offers a comprehensive array of choices to consumers with a product portfolio comprising over 200 varieties of liquid milk, ice cream and other dairy products.

Liquid milk

The liquid milk segment remained the primary revenue contributor and accounted for 84.5% of the Group's revenue. Its revenue rose to RMB6,097.2 million, an increase of 74.2% as compared with 2003. The increase was attributable to the Company success in tapping the growth of China liquid milk market through its new product offerings, to cater to the preference of different consumers. In order to attain the goal of delivering healthy, nutritious and high quality products to consumers, UHT milk, the core product of the Group, accounted for 79.2% of the revenue from our liquid milk segment. Apart from its ongoing efforts in consolidating the market share of our traditional UHT milk and sustaining its rapid growth, the Group also offered a variety of functional UHT milk products such as fortified with calcium and milk with low fat and low lactose content, in order to meet the nutritional needs of different consumer groups. Our new offering of breakfast milk, which has been well received by the public since its first launch into the market, has ample room for market development.

Milk beverages and yogurt accounted for 20.8% of the segment and delivered solid increase of 118.1% during the year. These products, which serve to keep one's health, state of relaxation and vigour, are particularly sought after by ladies and teenagers. After several years of research and development, the Group has developed its competitive advantage in these products and has forged cooperation with Chr Hansen, the world-renowned probiotics manufacturer, to develop the Group's proprietary probiotics products. This significantly contributes to the control of the high content quality in products and has laid a good foundation for the future expansion of this product.

Ice cream

During the year, the ice cream segment generated revenue of RMB805.2 million, representing an increase of 69.4% from 2003. A traditional forte of the Group, ice cream products feature wide varieties, quick roll out of new products and seasonality in market demand. As such, the Group emphasizes research and development and strives to lead the market trend by introducing ice cream products that are suitable for sale in retail outlets. In light of the seasonality of ice cream products, the Group also emphasizes the development of premium products that are consumed during wintertime in north-eastern China, eastern China and southern China regions. These strategies have fuelled the continuous increase in the Group's share in the ice cream market.

Other dairy products

Owing to the launch of new product "milk tablets" and successful promotion campaigns in 2004, revenue from other dairy products soared by 217.6% to RMB311.4 million in 2004. Its contribution to revenue increased from 2.4% in 2003 to 4.3% in 2004.

Raw milk supply

The Group established exclusive supply contracts with over 1,000 milk collection centers and raw milk suppliers to ensure a stable supply of quality raw milk to support the growth of the Group.

To help dairy farmers improve productivity and thus ensure stable and quality supply of raw milk in the long run, the Group's indirectly controlled subsidiary, Inner Mongolia Mengniu Founding Industry Management Co., Ltd., invested in the establishment of the single largest dairy farm in China — Mengniu-Australia International Model Ranch — in late 2004. Located near the Group's production base in Helin Geer, the ranch will be constructed in three phases spanning three years. When the ranch is fully completed, it can raise up to 10,000 dairy cows. The ranch adopts a combination of technologies in grass planting, cattle breeding and milking from Australia, Europe, the U.S. and Asia. Advanced milking robot has also been installed on the ranch. The establishment of the ranch will help to promote the application of scientific knowledge and techniques, improvement of quality and quantity of milk supply, the establishment of scalable operations and in turn the modernization of dairy cow breeding in China.

Production

Equipped with world-class production and packaging technologies, the Group operated 11 production bases with a combined production capacity of 2 million tons in 2004.

Prospects

Looking ahead, despite the intensifying market competition, the Group has full confidence in its ability in delivering better financial results and managing the rapid development by launching high quality products and improving the profitability of products.

In addition to its ongoing efforts in optimizing product mix in light of market demand, the Group will continue to enhance its investment portfolio, financial management processes and operational management structure in order to boost its operational capability and live up to its market strategies.

Product quality

In line with our primary focus of strengthening milk source management, Mengniu-Australia International Model Ranch has been established as a role model for future formation and enhancement of a fine pool of raw milk supply. This would serve not only to enhance the quality of raw milk but also regulate and guide the development of the raw milk market. In respect of the quality control process, the GMP and QACP management systems are put in place, targeting at the establishment of standard operation procedures for every single stage of our production process. In addition, we will further invest in state-of-the-art milk inspection facilities boasting high technology and sophistication in pursuit of stability and further enhancement of our product quality.

New products introduction

With liquid milk remains as its key revenue contributor, the Group will invest more resources in introducing a more diversified portfolio of products such as flavored and functional milk products, premium yogurt and other dairy beverages to fulfill the sophisticated tastes of consumers, as well as to capture opportunities for further growth.

The Group is dedicated to improve yogurt products to cater for Chinese consumers to meet their increasing demand for yogurt products. At the same time, the Group will increase the proportion of in-house production of ice cream products, which to date are partly manufactured through OEM arrangements.

According to the market demand, the Group plans to expand the production capacity of milk powder and is dedicated to develop premium milk powder products. To ensure sustained consumer loyalty, the Group has been applying secondary brand names on certain products to differentiate its dairy product offerings for different market segments.

New markets penetration

The Group will seek to achieve better economies of scale of its sales and distribution network by consolidating its leading position in the first-tier markets while expanding prudently into the second and third-tier markets. The Group is also set to further lift its brand position through effective budgeting for its nationwide promotion and advertising campaigns.

Capacity expansion

141 new production lines were added to our factory premises as scheduled during the year. To stay in line with the projected sales growth, the Group will endeavour to expand our capacity so as to achieve an annual aggregate production capacity of approximately 2.75 million tons by the end of 2005.

Partnership cooperation

In view of the vast but relatively fragmented raw milk supply base, the Group will work on enhancing its cooperation with dairy farmers and milk collection centers to expand its milk sources and ensure a quality supply of raw milk. The Group will encourage its suppliers to develop mid and larger scale milk collection centers so as to take advantage of economies of scale and meet the needs of the fast growing business.

Management incentives

To encourage successful implementation of its growth strategies, the Group will continue to build employee excellence by strengthening its management system. The management will encourage employee initiatives and work place excellence by means of its established promotion and compensation systems.

Human Resources and Remuneration of Employees

As at 31 December 2004, the Group employed a total of approximately 21,000 employees (2003: 9,973) in China and Hong Kong. Total staff costs for the year amounted to approximately RMB254 million, including these for the Directors, as compared with approximately RMB117 million in 2003.

The Group invests in continuing education and training programs for its management staff and other employees to constantly improve their skills and knowledge. An internal vocational training center, Mengniu Commercial College, has been set up to develop and implement training programs for the Group's personnel.

Remuneration is maintained at competitive levels with incentive bonuses payable on a merit basis for innovations and improvements which is in line with industry practice. Other staff benefits provided by the Group include a pension contribution plan and insurance schemes.

PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S LISTED SHARES

During the year, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities.

PUBLIC FLOAT

As at the date of this announcement, the Company has maintained the prescribed public float under the Rules Governing the listing of Securities on the Stock Exchange of Hong Kong Limited, based on the information that is publicly available to the Company and to the knowledge of the Directors.

USE OF PROCEEDS

During 2004, the Group was dedicated to the development and expansion of the production capacity in order to capture the anticipated growth in the consumption of dairy products in China. The Group has injected all of the net proceeds into its operating subsidiary, Inner Mongolia Mengniu Milk Industry (Group) Co., Ltd., which then applied the proceeds as follows:

- approximately RMB480 million, RMB140 million and RMB80 million was used to expand the production facilities of liquid milk, ice cream and other dairy product respectively, majority of which were spent on the purchase of equipment;
- approximately RMB40 million was spent on the public facilities of new production bases;
- approximately RMB60 million was used for general working capital; and
- the remaining amount of approximately RMB180 million has been deposited into interest bearing accounts and retained for future expansion plans.

AUDIT COMMITTEE

The audit committee comprises three non-executive Directors, two of whom are independent. The current committee members are Mr Zhang Julin (chairman), Mr Li Jianxin and Mr Jiao Zhen. The audit committee has reviewed with the Company management and the external auditors the accounting principles and practices adopted by the Company and discussed auditing, internal control and financial report matters including the review of the audited annual results for the year ended 31 December 2004.

COMPLIANCE WITH THE CODE OF BEST PRACTICE

None of the Directors of the Company is aware of any information that would reasonably indicate that the Company was not at any time during the year in compliance with the Code of Best Practice as set out by the Hong Kong Stock Exchange in Appendix 14 to the Listing Rules.

COMPLIANCE WITH MODEL CODE

The Company has adopted the Model Code set out in Appendix 10 of the Listing Rules as the Company's code of conduct and rules governing dealings by all Directors in the securities of the Company. Having made specific enquiry of all Directors of the Company, during the year, the Directors of the Company had strictly complied with the Model Code.

BOOK CLOSURE

The register of members of the Company will be closed from 25 May 2005 to 30 May 2005, both days inclusive, during which period no transfer of shares of the Company can be registered. In order to qualify for the abovementioned final dividends, all transfers, accompanied by the relevant share certificates, must be lodged with the Company's share registrar, Computershare Hong Kong Investor Services Limited, at Shops 1712–16, 17th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong for registration no later than 4:00pm of 24 May 2005.

APPRECIATION

The board of Directors would like to take this opportunity to express gratitude to our employees for their hard work and commitment to the Group. We also thank our shareholders, customers and banks for their continued support.

By order of the Board of Directors
Niu Gensheng
Chief Executive Officer

Hong Kong, 6 April 2005

As at the date of this announcement, the Executive Directors are Mr Niu Gensheng, Ms Lu Jun, Mr Sun Yubin and Mr Yang Wenjun. The Non-executive Directors are Mr Jiao Shuge (alias Jiao Zhen), Ms Jin Yujuan, Lily and Mr Liu Haifeng, David. The Independent non-executive Directors are Mr Li Jianxin, Mr Wang Huaibao and Mr Zhang Julin.