



# CHINA MENGNIU DAIRY COMPANY LIMITED

(Incorporated in the Cayman Islands with limited liability)

(Stock Code: 2319)

## ANNUAL RESULTS ANNOUNCEMENT FOR THE YEAR ENDED 31 DECEMBER 2006

HIGHLIGHTS			Notes	2006 RMB'000	2005 RMB'000
Revenue		2006 RMB'000		2005 RMB'000	
Net profit attributable to equity holders of the Company		16,246,368		10,824,950	
Earnings per share (RMB)		727,352		456,847	
— Basic		0.532		0.365	
— Diluted		0.532		0.334	
Proposed final dividend per share (RMB)		0.1094		0.0686	
<div><div><div>Through the effective product mix enhancement and market segmentation, together with precise marketing and promotional efforts, the Group's revenue increased by 50.1% to RMB16,246.4 million. Net profit attributable to equity holders of the Company reached RMB727.35 million.</div><div>According to an ACNielsen survey, by sales volume, the Group's market share in the China liquid milk market, excluding milk beverages and yogurt, increased by 4.7 percentage points from 28.6% in December 2005 to 33.3% in December 2006.</div></div></div>					
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" or "Mengniu") for the year ended 31 December 2006, together with the comparative figures for 2005, as follows:					
CONSOLIDATED INCOME STATEMENT					
For the year ended 31 December 2006					
	Notes	2006 RMB'000	2005 RMB'000		
REVENUE	3	16,246,368	10,824,950		
Cost of sales		(12,524,597)	(8,411,745)		
GROSS PROFIT		3,721,771	2,413,205		
Other income and gains		76,459	24,967		
Selling and distribution costs		(2,380,324)	(1,494,970)		
Administrative expenses		(420,004)	(267,817)		
Other operating expenses		(16,712)	(23,897)		
PROFIT FROM OPERATING ACTIVITIES		981,190	651,488		
Interest income		15,827	12,898		
Finance costs	4	(63,081)	(43,956)		
Share of profits and losses of associates		8,384	(3,295)		
PROFIT BEFORE TAX	5	942,320	617,135		
Income tax expense	6	(76,032)	(61,612)		
PROFIT FOR THE YEAR		866,288	555,523		
Attributable to:					
Equity holders of the Company		727,352	456,847		
Minority interests		138,936	98,676		
		866,288	555,523		
DIVIDENDS					
Dividends paid	7	93,873	80,053		
Proposed final dividend	7	149,718	93,873		
EARNINGS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE COMPANY					
Basic	8	RMB0.532	RMB0.365		
Diluted	8	RMB0.532	RMB0.334		
CONSOLIDATED BALANCE SHEET					
As at 31 December 2006					
	Notes	2006 RMB'000	2005 RMB'000		
NON-CURRENT ASSETS					
Property, plant and equipment		4,160,283	3,140,433		
Construction in progress		348,405	235,373		
Other intangible assets		13,204	—		
Land use rights		128,386	65,923		
Interests in associates		40,371	18,700		
Available-for-sale investments		15,316	8,029		
Goodwill		115,549	115,549		
		4,821,514	3,584,007		
CURRENT ASSETS					
Inventories		1,071,460	781,001		
Bills receivable	9	128,093	81,528		
Trade receivables	10	186,976	174,657		
Prepayments, deposits and other receivables		180,506	164,475		
Pledged deposits		45,071	53,673		
Cash and cash equivalents		1,330,058	1,247,764		
		2,942,164	2,503,098		
CURRENT LIABILITIES					
Trade payables	11	1,034,699	887,333		
Bills payable	12	323,736	229,672		
Deferred income		7,889	4,145		
Accruals and other payables		1,439,803	976,574		
Interest-bearing bank loans		234,022	365,590		
Other loans		31,000	23,600		
Income tax payable		6,104	8,472		
		3,077,253	2,495,386		
NET CURRENT (LIABILITIES)/ASSETS		(135,089)	7,712		
TOTAL ASSETS LESS CURRENT LIABILITIES		4,686,425	3,591,719		
NON-CURRENT LIABILITIES					
Interest-bearing bank loans		641,136	445,702		
Other loans		—	11,481		
Long term payables		292,110	311,521		
Deferred income		120,499	55,936		
		1,053,745	824,640		
NET ASSETS					
		3,632,680	2,767,079		
EQUITY					
Equity attributable to equity holders of the Company					
Issued capital		145,573	145,573		
Retained earnings		993,822	569,307		
Other reserves		1,859,469	1,615,741		
		2,998,864	2,330,621		
Minority interests		633,816	436,458		
TOTAL EQUITY		3,632,680	2,767,079		
Notes:					
1. CORPORATE INFORMATION					
The Company was incorporated as an exempted company with limited liability in the Cayman Islands. The Company is an investment holding company and its subsidiaries engage in the manufacture and distribution of dairy products in the People's Republic of China (the "PRC").					
2.1 BASIS OF PREPARATION					
These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs"). They are prepared on a historical cost basis. They are presented in Renminbi ("RMB") and all values are rounded to the nearest thousand except when otherwise indicated.					
Basis of consolidation					
The consolidated financial statements comprise the financial statements of the Group for the year ended 31 December 2006. The financial statements of the subsidiaries are prepared for the same reporting year as the Company, using consistent accounting policies. All intra-group balances, transactions, income and expenses and profits and losses resulting from intra-group transactions that are recognised in assets, are eliminated in full. Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the day that such control ceases.					
Minority interests represent the portion of profit and loss and net assets of the Company's subsidiaries not held by the Group and are presented separately in the consolidated income statement and within equity in the consolidated balance sheet, separately from the Company's shareholders' equity.					
2.2 IMPACT OF NEW AND REVISED IFRSs					
During the year, the Group has adopted the following new and revised IFRS and IFRIC interpretation which are relevant to its operations:					
<div><div>IAS 39 <i>Financial Instruments: Recognition and Measurement</i> ("IAS 39") — <i>Amendment for financial guarantee contracts (issued in August 2005)</i> which amended the scope of IAS 39 to require financial guarantee contracts issued that are not considered to be insurance contracts to be recognised initially at fair value and to be remeasured at the higher of the amount determined in accordance with IAS 37 <i>Provisions, Contingent Liabilities and Contingent Assets</i> and the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with IAS 18 <i>Revenue</i>; and</div><div>IFRIC 4 <i>Determining whether an Arrangement contains a Lease</i> which provides further guidance in determining whether arrangements contain a lease to which lease accounting must be applied.</div></div>					
The adoption of these revised standard and new interpretation did not have any material impact on the financial statements of the Group and the Company.					
3. REVENUE AND SEGMENT INFORMATION					
Revenue, being the turnover of the Group, represents the net invoiced value of goods sold, after allowances for goods returns and trade discounts, and after eliminations of all significant intra-group transactions.					
Business segment					
The Group comprises the following business segments:					
<div><div>liquid milk products segment — manufacture and distribution of ultra-high temperature milk ("UHT milk"), milk beverages and yogurt;</div><div>ice cream products segment — manufacture and distribution of ice cream; and</div><div>other dairy products segment — manufacture and distribution of milk powder.</div></div>					
The following tables present the revenue, results and certain asset and liability information for the Group's business segments for the year ended 31 December 2006:					
		2006 RMB'000	2005 RMB'000		
Segment revenue:					
Liquid milk		14,260,929	9,314,688		
Ice cream		1,818,042	1,295,861		
Other dairy products		167,397	214,401		
		16,246,368	10,824,950		
Segment results:					
Liquid milk		970,207	637,292		
Ice cream		119,610	80,492		
Other dairy products		24,394	(623)		
		1,114,211	717,161		
Unallocated corporate expenses		(133,021)	(65,673)		
Profit from operating activities		981,190	651,488		
Interest income		15,827	12,898		
Finance costs		(63,081)	(43,956)		
Share of profits and losses of associates		8,384	(3,295)		
Profit before tax		942,320	617,135		
Income tax expense		(76,032)	(61,612)		
Profit for the year		866,288	555,523		

	2006 <i>RMB'000</i>	2005 <i>RMB'000</i>
Segment assets:		
Liquid milk	6,049,910	4,274,241
Ice cream	1,029,309	886,902
Other dairy products	118,804	169,559
Unallocated corporate assets	1,668,720	1,226,247
Eliminations	(1,103,065)	(469,844)
Total assets	<u>7,736,678</u>	<u>6,087,105</u>
Segment liabilities:		
Liquid milk	3,809,625	2,547,286
Ice cream	471,854	386,960
Other dairy products	33,655	67,239
Unallocated corporate liabilities	918,929	788,385
Eliminations	(1,103,065)	(469,844)
Total liabilities	<u>4,130,998</u>	<u>3,320,026</u>
Capital expenditure:		
Liquid milk	1,300,644	739,821
Ice cream	86,804	246,915
Other dairy products	7,216	20,823
Others	77,761	38,294
	<u>1,472,425</u>	<u>1,045,853</u>
Depreciation and amortisation:		
Liquid milk	312,529	210,296
Ice cream	73,419	51,972
Other dairy products	5,927	5,713
Others	14,671	10,292
	<u>406,546</u>	<u>278,273</u>
Other non-cash expenses/(income):		
Liquid milk	3,304	(764)
Ice cream	(187)	219
Other dairy products	1,489	2,795
Others	27	(95)
	<u>4,633</u>	<u>2,155</u>

#### Geographical segment

As the Group mainly operates and generates its revenue and results in the PRC, no geographical segment analysis is presented.

#### 4. FINANCE COSTS

	2006 <i>RMB'000</i>	2005 <i>RMB'000</i>
Interest on bank loans wholly repayable within five years	48,474	40,826
Interest on long term payables	14,855	5,415
Less: amounts capitalised	(248)	(2,285)
	<u>63,081</u>	<u>43,956</u>

The amounts capitalised are the borrowing costs related to funds borrowed specifically for the purpose of obtaining qualifying assets. The interest rate on such capitalised borrowings during the year was 5.67% (2005: varied from 2.88% to 5.76%) per annum.

#### 5. PROFIT BEFORE TAX

The Group's profit before tax is arrived at after charging/(crediting):

	2006 <i>RMB'000</i>	2005 <i>RMB'000</i>
Cost of inventories sold	12,524,597	8,411,745
Employee benefits expense (excluding directors' remuneration)		
— Wages, salaries and bonuses	619,649	380,277
— Retirement benefit contributions	51,098	10,050
— Share-based payment expense	3,108	—
	<u>673,855</u>	<u>390,327</u>
Depreciation of property, plant and equipment	403,485	276,964
Amortisation of land use rights	1,707	1,309
Amortisation of intangible assets	1,354	—
Gain on disposal of an investment in an associate	(2,167)	—
Loss on disposal of items of property, plant and equipment	1,075	3,243

#### 6. INCOME TAX EXPENSE

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 provision for PRC corporate income tax ("CIT") for the year.

Under the PRC income tax law, except for certain preferential treatment available to eighteen (2005: fourteen) of the Group's subsidiaries, the entities within the Group are subject to 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 the income tax expense at the Group's effective income tax rate for the year is as follows:

	<i>Note</i>	2006 <i>RMB'000</i>	2005 <i>RMB'000</i>
Profit before tax		<u>942,320</u>	<u>617,135</u>
At PRC CIT rate of 33%		310,966	203,655
Non-(taxable)/deductible items and others, net		(4,234)	22,685
Effect on tax exemptions	(a)	(230,700)	(164,728)
At the effective income tax rate of 8.1% (2005: 10.0%)		<u>76,032</u>	<u>61,612</u>

#### Notes:

- (a) Eighteen (2005: fourteen) subsidiaries were subject to tax concessions in 2006. The total taxable profit of the subsidiaries that are subject to tax concessions amounted to approximately RMB699,090,000 (2005: RMB499,176,000) in aggregate. Out of the eighteen subsidiaries, fifteen (2005: seven) subsidiaries were granted tax concessions by the state tax bureau in accordance with the "Income Tax Law of the 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. Two (2005: seven) subsidiaries were granted tax concessions by the local tax bureau in accordance with the policy of "The Notice of Income Tax Exemption for the Country's Key Enterprises in Agricultural Industries" of the tax authorities. The remaining one (2005: nil) was granted a three-year tax exemption by the local tax bureau in accordance with the state tax bureau's policy to aid the new companies established in remote and destitute areas.
- (b) The share of tax attributable to associates amounting to approximately RMB4,790,000 (2005: RMB1,687,000) is included in the share of profits and losses of associates on the face of the consolidated income statement.

#### 7. DIVIDENDS

	<i>Note</i>	2006 <i>RMB'000</i>	2005 <i>RMB'000</i>
Declared and paid during the year			
Equity dividends on ordinary shares		<u>93,873</u>	<u>80,053</u>
Proposed for approval at AGM			
Equity dividends on ordinary shares:			
Proposed final — RMB0.1094 (2005: RMB0.0686) per ordinary share	(a)	<u>149,718</u>	<u>93,873</u>

#### Notes:

- (a) The proposed total dividends are calculated based on approximately 1,368,416,000 (2005: 1,368,416,000) existing shares in issue. The proposed final dividend for the year is subject to the approval of the Company's shareholders at the forthcoming Annual General Meeting ("AGM"). Such dividend is not recognised as a liability in the consolidated financial statements as at 31 December 2006 but will be reflected as an appropriation of retained earnings for the year ending 31 December 2007.

#### 8. EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the profit for the year attributable to ordinary equity holders of the Company by the weighted average number of ordinary shares outstanding during the year.

The share options outstanding had an antidilutive effect on the calculation of diluted earnings per share for the year ended 31 December 2006. The diluted earnings per share for the year ended 31 December 2005 was calculated by dividing the profit for that year attributable to ordinary equity holders of the Company by the weighted average number of ordinary shares outstanding during that year, being the weighted average number of ordinary shares outstanding during that year, adjusted for the effects of dilutive potential ordinary shares outstanding during that year.

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

	2006 Number of shares '000	2005 Number of shares '000
Weighted average number of ordinary shares for the purpose of the basic earnings per share calculation	1,368,416	1,251,129
Effect of dilution:		
Conversion of convertible instrument	—	117,287
Weighted average number of ordinary shares for the purpose of the diluted earnings per share calculation	<u>1,368,416</u>	<u>1,368,416</u>

#### 9. BILLS RECEIVABLE

An ageing analysis of the bills receivable as at the balance sheet date, based on the invoice date, is as follows:

	2006 <i>RMB'000</i>	2005 <i>RMB'000</i>
Within 3 months	125,140	81,167
4 to 6 months	2,953	361
	<u>128,093</u>	<u>81,528</u>

#### 10. TRADE RECEIVABLES

The Group normally allows a credit period of not more than 30 days to its customers. The Group closely monitors overdue balances. In view of the aforementioned and that the Group's trade receivables relate to a large number of diversified customers, there is no significant concentration of credit risk. Trade receivables are non-interest-bearing.

An ageing analysis of the trade receivables of the Group, net of provision for doubtful debts, is as follows:

	2006 <i>RMB'000</i>	2005 <i>RMB'000</i>
Within 3 months	163,944	160,485
4 to 6 months	20,453	7,580
7 to 12 months	2,104	6,592
Over 1 year	475	—
	<u>186,976</u>	<u>174,657</u>

#### 11. TRADE PAYABLES

An ageing analysis of the trade payables of the Group, based on the invoice date, is as follows:

	2006 <i>RMB'000</i>	2005 <i>RMB'000</i>
Within 3 months	971,494	770,373
4 to 6 months	51,696	94,884
7 to 12 months	5,623	15,438
Over 1 year	5,886	6,638
	<u>1,034,699</u>	<u>887,333</u>

#### 12. BILLS PAYABLE

An ageing analysis of the bills payable of the Group, based on the invoice date, is as follows:

	2006 <i>RMB'000</i>	2005 <i>RMB'000</i>
Within 3 months	221,527	125,645
4 to 6 months	102,209	104,027
	<u>323,736</u>	<u>229,672</u>

### MANAGEMENT DISCUSSION AND ANALYSIS

#### Financial Review

Through the effective implementation of our strategies on product development and diversification, precise market segmentation and strengthening promotional efforts, the Group successfully increased its market share and market penetration, achieving satisfactory results and profit growth for the year. During the period under review, the Group's revenue increased by 50.1% to RMB16.2464 billion (2005: RMB10.8250 billion). Net profit attributable to equity holders of the Company reached RMB727.35 million (2005: RMB456.85 million). Basic earnings per share and diluted earnings per share both recorded RMB0.532 (2005: RMB0.365 and RMB0.334 respectively).

#### Gross Profit

During the year under review, the Group made a satisfactory gross profit of RMB3.7218 billion, a rise of 54.2% as compared with that of 2005 (2005: RMB2.4132 billion). Gross profit margin was stabilized at 22.9%, as a result of the continuous product mix enhancement by launching more high-end products. Through the ongoing enhancement of the production, logistics, warehousing, transportation and quality control systems, the Group has realized cost savings at every stage of the production chain, and has achieved a more precise and streamlined logistics, warehousing and transportation planning, thus the pressure of increased production costs was eased.

#### Operating Expenses

In 2006, the Group recorded operating expenses totaling RMB2.8170 billion (2005: RMB1.7867 billion), representing approximately 17.3% of the Group's revenue (2005: 16.5%). During the period under review, the Group continuously enhanced its operation management system and firmly adhered to its comprehensive budget control system in order to tighten operating expenses, thus improving its sale and management efficiency.

The Group's selling and distribution costs amounted to RMB2.3803 billion (2005: RMB1.4950 billion), representing approximately 14.6% of the Group's revenue (2005:13.8%), of which expenses on advertising and promotion amounted to RMB1.1061 billion, accounting for 6.8% of the Group's revenue (2005: 6.1%). In order to cater for the needs of various market segments, the Group launched a greater variety of innovative and tailor-made advertising and promotion campaigns, resulting in an increase in such expenses. These campaigns were designed to increase the Group's market share through conveying specific and clear messages to targeted customer groups, in particular, impressing on the public the distinctive image of each product series.

Administrative and other operating expenses amounted to RMB436.7 million (2005: RMB291.7 million), representing 2.7% of the Group's revenue, comparable to the level recorded in 2005.

#### Profit from Operating Activities

EBITDA for the period under review increased by 50.7% to RMB1.3961 billion. Despite the increase in the selling and distribution expenses to revenue ratio, the Group's improved gross profit margin allowed it to maintain the EBITDA margin at a healthy level of 8.6% as in 2005.

The Group's taxation expenses reached RMB76.032 million in 2006. Since the Group enjoyed various preferential tax treatment and exemptions, a relatively low tax rate was maintained.

#### Net Profit

Despite the pressure of intense market competition as well as rising production and operating costs, benefiting from various effective measures adopted during the year, net profit attributable to equity holders of the Company for the year reached RMB727.35 million (2005: RMB456.85 million).

#### Capital Structure, Liquidity and Financial Resources

The Group has a healthy consolidated balance sheet. As at 31 December 2006, the Group had cash and cash equivalents of RMB1.3301 billion (2005: RMB1.2478 billion), and net cash flow from operating activities of RMB1.4028 billion (2005: RMB1.3283 billion).

As at 31 December 2006, total outstanding bank loans of the Group were RMB875.16 million (2005: RMB811.3 million), of which RMB234.02 million was repayable within one year and RMB641.14 million was repayable beyond one year. The debt-to-equity ratio (total bank loans to total equity) of the Group was 24.1% as at 31 December 2006, 5.2 percentage points lower than the 29.3% recorded in the same period last year.

Total equity of the Group increased from RMB2.7671 billion as at 31 December 2005 to RMB3.6327 billion in 2006. Net finance costs for the period under review were approximately RMB47.25 million (2005: RMB31.06 million), representing 0.3% of the Group’s revenue, which is comparable to that of 2005.

### Market Review

Mirroring China’s robust economic growth in 2006, the population of dairy product consumers in the country likewise grew. The industry has been developing well benefiting from a rise in consumption power, and the increased market demand on dairy products resulted from consumers’ higher recognition of the nutrition and health benefits associated with dairy products. The government’s efforts on health education have also helped raising awareness among the people, and that in turn has driven demand for nutritious food products, particularly dairy products.

The dairy industry also has strong support on the supply side. In early 2006, the government announced new policies to aid the development of the “Three Agricultures” (三農), comprising of peasant farmers (農民), farming villages (農村) and the farming industry (農業). Those policies have encouraged dairy farmers to pursue technical advancements in stock raising and the optimization of production processes to ensure better quality and yield of raw milk. As a result, dairy farmers are able to improve their living standards.

All of these incentives have been beneficial to the growth of the country’s dairy market. According to the industry estimates, the annual average consumption rate of liquid milk in China for 2006 was approximately 25 kg per capita. An ACNielsen survey conducted in December 2006 also found that the moving annual total sales revenue of the country’s liquid dairy market grew more than 20% when compared with that of 2005.

The burgeoning dairy market has attracted keen competition, not just among local players, but also from foreign enterprises drawn to the market by its tremendous potential. Still other challenges include the fast changing tastes and needs of customers. This means that dairy players with well-recognized brands, as well as solid research and development (“R&D”) and marketing capabilities will be able to survive in this competitive market.

In 2006, Mengniu continued its efforts to spearhead the industry. Accordingly, as a major market player, its core products earned top rankings and captured outstanding market share while at the same time achieved favorable results from various segments of the business.

### Business Review

With enlarging market share and ensuring sustainable profitability as key targets for the year, Mengniu integrated its resources and optimized its production, operation, quality control and management systems to enhance the operational efficiency and competitiveness. In addition, the Group diversified its product mix to better meet the specific needs of different customer segments and formulated marketing programs tailored for each product to ensure more effective market penetration.

The Group’s strategies have been successful in fortifying its position as a key player in the industry. According to an AC Nielsen survey conducted in December 2006, the Group has secured a 33.3% share of the liquid milk market based on volume, excluding milk beverages and yogurt, as compared to 28.6% in December 2005. The top three players in the liquid milk market accounted for 64.9% share of the market in December 2006.

### Branding and Marketing

During the period under review, the Group continued to develop unique and innovative marketing and promotion campaigns to enhance the image of the *MENGNIU* brand while strengthening customer loyalty.

#### Branding

Other than the primary *MENGNIU* brand, the Group has been actively developing secondary brands in each product category. By implementing specific marketing plans for the secondary brands, the Group not only managed to appeal to targeted customer groups, but also boosted the overall market presence of the *MENGNIU* brand.

#### Marketing

Aware of the fact that the market has become more segmented as customers’ tastes become more varied and sophisticated, in addition to the mass advertising programs, the Group came up with segment-based marketing and innovative promotion campaigns designed to capture the attention of specific customer groups.

The Group collaborated with the Hong Kong Disneyland on the “Drink Future Star — Win a Fantasy Trip to Hong Kong Disneyland” program which aimed at highlighting the goodness that *Future Star* (未來星成長奶) can bring to children; in essence, the same happiness and fantastic experience that a trip to Hong Kong Disneyland promises.

During the period under review, the Group continued to cooperate with national and regional television channels to conduct effective marketing campaigns during prime time, including themed programs to highlight the special features and advantages of its different products to the public. These programs included:

- “Mengniu’s Inter-city All People Sports Game” (蒙牛《城市之間》全民運動會), the Olympic Games participated by common people and aimed at arousing public attention on the importance of consuming nutritious foods as well as exercising regularly for better health;
- “Mengniu Probiotics Yogurt — Family Let’s Go” (蒙牛益生菌酸奶全家總動員), a talent contest for parents and children to show their creativity as a team, the ultimate aim of which is to tighten family bond;
- “Mengniu Future Star Outstanding Teenagers” (蒙牛未來星非凡少年), China’s first nationwide interactive program for unleashing the potential of teenagers by providing these “Future Stars” with all-round training; and
- “Mengniu Breakfast Milk Anchor Challenges” (蒙牛早餐奶挑戰主持人), a TV program anchor selection campaign where a healthy body and smart mind are key selection criteria.

The Group also created its own spokesperson — “Milk Man More More” (奶人多多), a symbol of nutrition, energy and good health. Aimed at capturing and maintaining attention on its brand and products, Milk Man More More has been created to attract customers of all ages.

### Products

To further appeal to specific market segments, targeted new product series were introduced during the period under review. The Group also strived to enhance existing products and develop premium high-end products with high added-value so as to assure the Group’s all round growth.

#### Liquid milk

The liquid milk segment continued to be the major revenue contributor of the Group, accounting for 87.8% of revenue. The timely introduction of high added-value products and deployment of successful marketing strategies helped increase liquid milk revenue for the year to RMB14.2609 billion, representing an increase of 53.1% against last year.

#### UHT milk

Revenue from UHT milk products grew by 46.1% to RMB9.5762 billion when compared with last year, accounting for 67.2% of revenue of the liquid milk segment. In addition to the organic growth of plain milk, the launch of high added-value products to cater for different customers’ needs also led to the strong growth. Favorable results from marketing strategies implemented by the Group have made customers become more aware of their nutritional needs and helped build a solid customer base for the Group’s functional milk products, such as *Hi-calcium*, *Low Fat Milk* (高鈣低脂奶) as well as *Breakfast Milk* (早餐奶) and *Good Night Milk* (晚上好奶) series.

The Group’s ongoing efforts on research and product development were well recognized around the world during the period under review. Its self-developed premium milk product series, *Milk Deluxe* (特倫蘇), won the “2006 IDF Marketing Awards — New Product Development” presented by the International Dairy Federation (“IDF”). The Group is the first PRC dairy enterprise to receive the honor in the 104 years’ history of the IDF. Constantly striving to offer higher quality products, the Group also continued to enhance *Milk Deluxe* by fortifying it with osteoblast milk protein (“OMP”). OMP can facilitate retention and absorption of calcium by the body for repairing bones and building stronger bones. As OMP function is certified by the Center for Public Nutrition and Development of China, the *Milk Deluxe* series duly enjoys strong consumer confidence and support.

#### Milk beverages

Revenue from the milk beverages segment increased by 71.9% to RMB3.6412 billion, accounting for 25.5% of liquid milk revenue. In particular, effective targeted marketing efforts helped *Suan Suan Ru* (酸酸乳) generate positive momentum and stable revenue to the milk beverage segment.

During the year, the Group launched the *Future Star* (未來星) children milk series, products that contain various essential nutrients for promoting children’s growth. The new product series reported satisfactory results while the inventive, target-specific marketing programs have laid down a solid foundation that will open the fast-growing children’s milk market for the Group. Still more innovative products will be developed by the Group allowing it to lead the consumption trend and tap the tremendous market potential of this segment.

#### Yogurt

During the period under review, revenue from the yogurt segment increased by 62.8% to RMB1.0435 billion, accounting for 7.3% of liquid milk revenue. Committed to adding value to its products, the Group, in addition to enhancing product varieties and tastes, has adopted probiotics specifically suited for absorption by Chinese consumers. The new product series, *Champion* (冠益乳), is one of the many examples. In cooperation with strategic partner Danone, the Group expects to achieve synergies conducive to product development and technological enhancements, hence allowing for long-term growth in this market segment.

### Ice cream

Accounting for 11.2% of the Group’s revenue, the ice cream segment generated revenues totaling RMB1.8180 billion, representing an increase of 40.3% over that of last year. During the period under review, being fully aware of the emergence of more defined market segments with specific preferences by different consumer groups, the Group created more secondary brands and adopted state-of-art approaches in addressing flavors, tastes, packaging and image as well as distinctive marketing campaigns to uphold its leading position in the market.

During the year, the Group continued to improve its existing product series such as *Sui Bian* (隨變) and *Mood for Green* (綠色心情) by enhancing their added-value, thus the competitiveness in the conventional market. On the other hand, the Group also aggressively developed secondary brands to capture demand from the high-end market. *Rachel* (瑞趣), made with premium quality ingredients and elegantly packaged, is a secondary brand targeted towards customers with higher purchasing power. Another premium product, *Deluxe* (特倫聖雪), is scheduled for rolling out in 2007. The Group will continue to explore the needs of various customer segments and will enhance the competitive edge of its product mix by introducing more pioneering products.

### Other dairy products

Revenue from other dairy products amounted to RMB167.4 million, accounting for 1.0% of the Group’s revenue. During the period under review, the Group established a joint venture with Arla Foods of Denmark for the production of solid form dairy products, such as milk powder products.

The joint venture has realigned the Group’s product mix by shifting emphasis toward high added-value milk powder products. From the joint efforts of Mengniu and Arla Foods, the Group has enhanced its product mix for this segment during the year. A medium-end formula milk powder product targeted at the elderly and women for their special nutritional needs, namely, *Mengniu Arla* (蒙牛阿拉) was launched. Also, *Milex* (美蕾茲), a premium baby milk powder formula was launched at the end of the year. Due to the enhancement of Chinese’s living standards, the demand for premium baby formula milk powder has been keen in the PRC. As Mengniu and Arla Foods continue to complement each other on marketing, and technological expertise on production and R&D, the Group expects to launch even more dairy products that offer promising growth potential.

### Raw Milk Supply

The Group continued to actively correspond with raw milk suppliers, encouraging them to enhance the scale and efficiency of their ranches in order to ensure high quality raw milk supplies. During the period under review, the Group introduced internationally advanced cow breeding technologies and expertise to its operation. With the support of a biotechnology R&D institute set up during the year, the Group has been able to help suppliers under its management to control the quantity and quality of raw milk, and even achieving more effective yield by applying gender selection techniques and choosing better breeds.

Mengniu-Australia International Ranch (“International Ranch”), a ranch in which the Group owned a stake, provides an ideal model for raw milk suppliers to emulate. Through visits of the modernized rearing and production processes, raw milk suppliers are able to take a closer look at and adopt advanced rearing techniques, exchange experiences and advanced technologies, as well as learning more about the benefits of upgrading their rearing scale.

### Production and operation

In December 2006, the Group operated a total of 19 production bases with a combined annual production capacity reaching 3.93 million tons (2005: 2.78 million tons). The Group has adhered to the principle of effective product quality control. In addition to adopting five major internationally recognized quality assurance systems, during the year, the Group consolidated its product quality control and monitoring systems. Moreover, the Group further refined and unified quality standards to ensure that all production bases adhere to the same precise technology, examination, production formulae and quality control standards.

While optimizing the production process, the Group applied a more precise and sophisticated operation management system, and enforced an innovative operation management mechanism so as to integrate and streamline the Group’s resources and monitor the product performance over its entire lifecycle. For realizing the synergies generated from resource integration, all marketing, procurement, logistics and distribution activities implemented by each business segment were collectively organized by the Group. The Group will also timely assessed and monitored the market performance and efficiency of each product at every stage from development, marketing to mass-scale sales, for which its input and output value is based. In accordance with the assessment results, the Group will be able to identify the direction for improvement and thus, the Group can eliminate products with poor market potential and low efficiency. This, in turn allows for a better allocation of resources to a product mix that generates maximum market advantages. As such, operational efficiency and core competitiveness can thus be reinforced.

### Ventures and Alliances

2006 saw the Group realize several fruitful ventures and alliances. Powerful partnerships were formed with a number of international enterprises that are leaders in their respective fields. Leveraging their complementary attributes, the Group’s competitiveness has been further strengthened.

In April 2006, the Group announced its corporate alliance with the Hong Kong Disneyland and became the Official Milk Sponsor and supplier for the Theme Park and its two hotels, Disneyland Hotel and Disney Hollywood Hotel. The alliance has enabled foreign visitors to enjoy the premium, healthy dairy products from China — a true testament to the internationally recognized quality of *MENGNIU* products.

In August 2006, Mengniu Arla (Inner Mongolia) Dairy Products Co. Ltd., a joint venture between the Group and the premier European dairy product manufacturer Arla Foods, was established to manufacture and distribute high-end milk powder and other solid milk products. The strong technical expertise and management experience of Arla Foods has helped boost Mengniu’s competitiveness in the solid dairy product sector, and to gain a foothold in the fast growing baby dairy product market.

In December 2006, the Group announced the establishment of joint ventures with Danone, the world’s largest yogurt manufacturer (in terms of sales volume), to manufacture, develop and distribute yogurt products, thereby expanding its yogurt business in Greater China. Capitalizing on Danone’s and the Group’s respective merits and expertise, Mengniu is confident in its ability to elevate its yogurt products business to new heights.

### Social Responsibilities

Apart from expanding the business and creating greater value for shareholders, Mengniu has never forgotten to honor its responsibilities and has made every effort to support the communities in which it operates. To aid in the building of China into a healthy nation and to realize the dream of China’s Premier, Mr. Wen Jiabao, to have every Chinese, with children as the start, to drink a catty of milk a day, the Group supported the government’s slogan of “A catty of milk a day keeps the Chinese people invigorated always” by introducing a one-year milk sponsorship program for 500 schools in rural areas of China in June 2006.

Mengniu is delighted to be able to provide our future pillar of the community, especially children living in poverty, with premium dairy products that can enhance their health and help them realize their dreams. Mengniu will continue to honor its responsibilities to the community as a good corporate citizen and contribute to the development of the dairy industry in China in the years to come.

### Prospects

The China dairy industry is looking at a future filled with opportunities and challenges. As per capita income rises and consumers become more health conscious, the Group believes that domestic demand for dairy products will continue to follow at a trend of rapid growth. However, the immense potential of the market will also trigger competition for market share among the players, hence the industry will remain highly competitive in the future. Customers’ increasingly sophisticated tastes and demand for product function and quality have also triggered the drive for product innovations and quality assurance.

Seeing the opportunities and challenges ahead, Mengniu has devised coherent strategies with the aim of securing its leading position while developing competitive edges at the same time. Measures will be implemented to consolidate the Group’s resources and ensure its efficient and effective application. As well, continuous efforts will be made to enhance the product mix in order to penetrate different market segments. Perfecting product quality and increasing productivity will also be among the Group’s key objectives.

**We understand that the key to success rests on the quality of our products.** Accordingly, we have stringent mechanisms and measures in place to ensure that the quality of raw milk supplied, the technical R&D employed and the quality of products are all of the highest standards.

**We understand that premium raw milk supply is critical to ensuring the quality of our products and we are committed to provide the best to our valuable customers. As such, our passion for advancement is ongoing, and this is the conviction we share with our over 3,000 raw milk ranches.** To aid our raw milk suppliers to expand the scale of their farms and in turn elevate the yield of dairy cattle as well as the quality of raw milk, we will keep in step with the advanced cattle breeding and gender control assistance. The Group will also continue to use the International Ranch as a lively education facility for sharing its extensive industry experience, which includes promulgating the latest stock raising techniques and efficiency as well as offering assistance on planning and equipment acquisitions. Such measures not only ensure that the stable supply of quality raw milk for the development of premium high-end products, but also effectively improve the living standards of our raw milk suppliers, hence, achieving a win-win situation for all.

**We will continuously improve our product development and quality control systems to deliver the Group’s promise of only offering the best value to customers.** The Group will consolidate and bolster resources for R&D so as to facilitate knowledge and experience sharing among different product segments. This will duly strengthen our technical and R&D capabilities, thus preserving our position as an innovator. By promoting the dairy market’s development while at the same time developing products that deliver optimum nutritional value and taste, the Group will also further raise its competitiveness. Consistent with the Group’s drive for excellence, a new R&D center that is equipped with the most advanced technologies will be put into operation in the first half of 2007. The facility will be used for developing

the highest quality products that combine premium raw milk with unique product formulae. The Group will also continuously strive to optimize the production technology and process, and to ensure its product quality control system in line with the most advanced international standards.

**We are committed to serving our customers, and our efforts to lead and address market development trends fully reflect such commitment.** With strong R&D capabilities and good product quality, we have achieved a positive start for delivering value to our customers. However, a thorough understanding of customers' needs and the ability to continuously employ innovative and refine marketing strategies are crucial for the Group's ongoing success. Accordingly, we will fortify its nationwide distribution network by providing better services and support to our distributors as well as promoting two-way communications for obtaining first-hand market information. The timely feedback from distributors and the results of extensive marketing surveys will help the Group better understand customers' needs and behaviors thereby delivering more unique, segment-focused products and secondary brands. Moreover, the Group will continue to implement innovative, eye-catching marketing programs to draw customers' attention to the outstanding features of the Group's products, as well as raising public awareness of the health benefits of drinking milk.

**We understand that our future hinges on having an efficient management and operation system as well as a global management vision,** which is why we continue to improve internal management effectiveness and efficiency, while at the same time, focus on business opportunities in the global market keeping abreast of the latest trends.

**We strive to achieve operational excellence by encouraging different divisions to realize endeavors through concerted efforts.** During the year, we established the foundation for a more precise and sophisticated operation management system. In the days to come, the Group will seek to ensure effective implementation of the new system at all levels. It will further improve work flows and, achieve higher efficiency, while stricter performance assessment systems will be implemented. Operational targets will be clearly defined and communicated to all divisions in order to enhance the accountability of different business units. The Group will extend its improved system to also cover its distributors and retailers so as to ensure effective communications and consistent controls. With a micro-management system to enhance efficiency, the Group is duly prepared for the potential challenges in the market.

**We forge international alliances at all levels, bolster relations constantly.** To ensure continuous, robust growth of its businesses, the Group will continue to forge strategic alliance with leading international enterprises and institutions thereby generating synergies and mutual benefits in different areas, such as product quality, R&D capabilities, marketing and promotion. In addition, the Group will further enhance its cooperative efforts with current partners, namely, Hong Kong Disneyland, Arla Foods and Danone, by drawing from their strengths and combining forces on different business aspects to promote Mengniu's long-term growth as well as that of the China dairy industry.

Looking forward, the Group will continue to honor its responsibilities to the community by being a good corporate citizen and contributing to charitable activities. It will also seek to advance the development of China's dairy industry.

## **HUMAN RESOURCES AND REMUNERATION OF EMPLOYEES**

As at 31 December 2006, the Group had a total of approximately 29,000 employees (2005: 29,000) in China and Hong Kong. Staff costs, excluding remuneration for the Directors, totaled approximately RMB673.9 million for the year (2005: RMB390.3 million).

Committed to continuous enhancement of staff quality, the Group offers structured pre-job and on-the-job training to ensure employees are kept up to date with the latest technologies and industry knowledge. In addition, to ensure adherence to corporate culture and to maintain high staff morale, the Group organized various staff activities to educate them about Mengniu's beliefs and objectives. To reward employees and provide work incentives, the Group offers competitive remuneration packages with performance-based bonuses and a share option plan.

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

During the year ended 31 December 2006, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities.

## **AUDIT COMMITTEE REVIEW**

The Audit Committee has reviewed with the management of the Company the Group's audited annual results for the year ended 31 December 2006.

## **SCOPE OF WORK OF ERNST & YOUNG**

The figures in respect of the preliminary announcement of the Group's results for the year ended 31 December 2006 have been agreed by the Group's auditors, Ernst & Young, to the amounts set out in the Group's draft consolidated financial statements for the year. The work performed by Ernst & Young in this respect did not constitute an assurance engagement in accordance with Hong Kong Standards on Auditing, Hong Kong Standards on Review Engagements or Hong Kong Standards on Assurance Engagements issued by the Hong Kong Institute of Certified Public Accountants and consequently no assurance has been expressed by Ernst & Young on the preliminary announcement.

## **SUBSEQUENT EVENTS**

The Group entered into a joint venture contract in December 2006 with Danone to set up equity joint ventures in the PRC to produce, market, distribute and sell yogurt and related products. Details were disclosed in the Company's announcement dated 18 December 2006. As of the date of this announcement, the applications for the establishment of the joint ventures were in the process.

On 3 April 2007, Inner Mongolia Mengniu Dairy (Group) Company Limited ("Inner Mongolia Mengniu") entered into an agreement to acquire the 48% interest in Mengniu (Wuhan) Frealth Dairy Co., Ltd. ("Mengniu Wuhan") from the joint venture partner at a consideration of RMB134,400,000. After the acquisition, Mengniu Wuhan will then become a wholly-owned subsidiary of Inner Mongolia Mengniu. Details were disclosed in the Company's announcement dated 4 April 2007.

During the 5th Session of the 10th National People's Congress, which was concluded on 16 March 2007, the PRC Corporate Income Tax Law ("the New Corporate Income Tax Law") was approved and will become effective on 1 January 2008. The New Corporate Income Tax Law introduces a wide range of changes which include, but are not limited to, the unification of the income tax rate for domestic-invested and foreign-invested enterprises at 25%. Since the detailed implementation and administrative rules and regulations have not yet been announced, the financial impact of the New Corporate Income Tax Law to the Group cannot be reasonably estimated at this stage.

## **COMPLIANCE WITH THE CODE ON CORPORATE GOVERNANCE PRACTICE**

During the year, none of the Directors is aware of any information that would indicate that the Company was not at any time during the year in compliance with the Code on Corporate Governance Practice as set out in Appendix 14 to the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules"). Please refer to the Corporate Governance Report in the annual report to be published by the Company for details.

## **COMPLIANCE WITH MODEL CODE**

The Company has adopted the Model Code for Securities Transactions by Directors of Listed Issuers set out in Appendix 10 to the Listing Rules as the Company's code of conduct and rules governing dealings by all Directors in the securities of the Company ("Model Code"). Having made specific enquiry of all Directors of the Company, the Company confirms that, during the year, the Directors of the Company had complied with the Model Code.

## **PROPOSED FINAL DIVIDEND**

The Board has recommended the payment of a final dividend of RMB0.1094 per ordinary share for the year ended 31 December 2006 (2005: RMB0.0686). Upon shareholders' approval at the forthcoming AGM, the proposed final dividend will be paid on or about 18 July 2007 to shareholders whose names shall appear on the register of members of the Company on 22 June 2007.

## **CLOSURE OF REGISTER**

The register of members of the Company will be closed from 19 June 2007 to 22 June 2007, both days inclusive, during which period no transfer of shares of the Company can be registered. In order to qualify for the abovementioned proposed final dividends, all transfers, accompanied by the relevant share certificates, must be lodged with the Company's branch share registrar, Computershare Hong Kong Investor Services Limited, at Shops 1712-16, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong for registration no later than 4:30 p.m. on 18 June 2007.

## **APPRECIATION**

The Board 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 continuous support.

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

Hong Kong, 12 April 2007

As at the date of this announcement, the executive directors are Mr. Niu Gensheng, Mr. Yang Wenjun and Mr. Sun Yubin. The non-executive directors are Mr. Jiao Shuge (alias Jiao Zhen), Ms. Lu Jun and Mr. Julian Juul Wolhardt. The independent non-executive directors are Mr. Wang Huaibao, Mr. Zhang Julin and Mr. Li Jianxin.