Little Sheep Group Limited
小肥羊集團有限公司

interim report 2010

(Incorporated in the Cayman Islands with limited liability) | Stock Code : 968

Contents

Corporate Information

BOARD OF DIRECTORS

Executive Directors

Mr. Zhang Gang *(Chairman)*
Mr. Lu Wenbing *(Chief Executive Officer)*
Mr. Zhang Zhanhai
Mr. Wang Daizong
Ms. Li Baofang

Non-executive Directors

Mr. Chen Hongkai
Mr. Su Jing Shyh Samuel
Mr. Koo Benjamin Henry Ho Chung
Ms. Hsieh Hui-yun Lily

Independent non-executive Directors

Dr. Xiang Bing
Mr. Yeung Ka Keung
Mr. Shin Yick, Fabian

AUDIT COMMITTEE

Mr. Yeung Ka Keung *(Chairman)*
Mr. Shin Yick, Fabian
Dr. Xiang Bing

REMUNERATION COMMITTEE

Dr. Xiang Bing *(Chairman)*
Mr. Zhang Gang
Mr. Lu Wenbing
Mr. Shin Yick, Fabian
Mr. Yeung Ka Keung

NOMINATION COMMITTEE

Mr. Shin Yick, Fabian *(Chairman)*
Mr. Zhang Gang
Mr. Yeung Ka Keung
Dr. Xiang Bing

AUTHORIZED REPRESENTATIVES

Mr. Wang Daizong
Mr. Lee Kwok Wa

COMPANY SECRETARY

Mr. Lee Kwok Wa, *FCCA, solicitor of HKSAR*

COMPANY'S HEAD OFFICE

No. 8 Qingnian Road
Kundulun District
Baotou
Inner Mongolia, PRC

REGISTERED OFFICE

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Grand Cayman KY1-1111
Cayman Islands

PRINCIPAL PLACE OF BUSINESS IN HONG KONG

Unit 1104
11/F, Jubilee Centre
42–46 Gloucester Road
Wanchai
Hong Kong

PRINCIPAL SHARE REGISTRAR

Butterfield Fund Services (Cayman) Limited
Butterfield House
68 Fort Street
P.O. Box 705
Grand Cayman KY1-1107
Cayman Islands

HONG KONG BRANCH SHARE REGISTRAR AND TRANSFER OFFICE

Tricor Investor Services Limited
26/F, Tesbury Centre
28 Queen's Road East
Wanchai, Hong Kong

PRINCIPAL BANKERS

Agricultural Bank of China, Kunqu branch
Bank of Communications, Wantong branch
China Merchants Bank, Huhhot Branch

AUDITORS

Ernst & Young
Certified Public Accountants

STOCK CODE

968

COMPANY WEBSITE

www.LittleSheep.com

Financial Highlights and Operating Statistics

	Six months ended		
	30 June 2010 (Unaudited) RMB'000	30 June 2009 (Unaudited) RMB'000	% Change Increase/ (Decrease)
Financial Highlights			
Consolidated revenue	**754,829**	626,298	20.5%
Sales from restaurant operations	**625,199**	516,657	21.0%
Consolidated profit before tax	**54,619**	57,607	(5.2%)
Profit attributable to owners of the Company	**38,083**	39,155	(2.7%)
Basic earnings per share (RMB cents)	**3.70**	3.81	(2.9%)

	Six months ended	
	30 June 2010	30 June 2009
Operating Statistics of Company-owned Restaurants		
Same store sales growth	**6.9%**	1.3%
Average spending per customer (RMB)	**49.9**	53.6
Utilization rate	**1.31**	1.22

Total number of company-owned restaurants and franchise restaurants as of 30 June 2010 reached 179 and 301 respectively which are located in the following areas:

	Number of Restaurants			
	As of 30 June 2010		As of 31 December 2009	
Region and Province/City	**Company-owned**	**Franchise**	Company-owned	Franchise
Northern PRC	**59**	**143**	46	142
Eastern PRC	**56**	**58**	54	56
Southern PRC	**38**	**25**	35	22
Northeastern PRC	**7**	**9**	8	6
Northwestern PRC	**14**	**47**	13	49
Special Administrative Regions	**5**	**—**	5	—
Overseas	**—**	**19**	—	18
Total	**179**	**301**	161	293

	30 June 2010	31 December 2009
Liquidity and Gearing		
Current ratio[1]	**2.19**	2.62
Quick ratio[2]	**1.57**	1.81
Gearing ratio[3]	**0.02**	—

Notes:

(1) Current ratio is calculated as current assets divided by current liabilities.

(2) Quick ratio is calculated as current assets less inventories divided by current liabilities.

(3) Gearing ratio is calculated as total debts (interest-bearing bank borrowings) divided by total assets.

Chairman's Statement

Dear Shareholders,

The global economy turned a corner in the first half of 2010 and started to show signs of a continued recovery. Thanks to the government's liquidity enhancing policies, nowhere has this upturn more apparent than in China. Renewed consumer confidence has reinvigorated the catering sector and provided a more favourable operating environment for our company.

This upsurge in economic activity however has proved to be a double-edged sword, with rising inflation hitting our raw material costs. These challenges are a timely reminder of the need for us to strengthen our business model and further grow our business, while maintaining our core commitment to provide quality food and services to our customers.

The consolidated revenue for Little Sheep Group Limited ("the Company" or "Little Sheep", together with its subsidiaries, "the Group") for the six months ended 30 June 2010 surged 20.5% year-on-year to RMB754.8 million as we continued to rapidly build our customer base and expand our restaurant network. However, our profit attributable to shareholders fell 2.7% to RMB38.1 million due to inflationary pressure.

To counter this challenge, our focus this year has been to optimize our business model in order to raise efficiency and profitability. This effort is most visible at the back of our stores where we have set out to achieve economies of scale in our supply chain and store workflows. This year, we have witnessed the successful implementation of our central kitchens in Shenzhen and Shanghai, which have proved their effectiveness in supplying our restaurants in these cities. We are also examining other initiatives to further streamline our labour force and optimize in-store processes.

We have continued to capitalize on opportunities to acquire some of our franchises, while also extending our network of company-owned restaurants in China's first and second-tier cities. This year we have begun further growing this network into China's rapidly urbanizing third-tier cities.

By growing our food products and lamb processing businesses, we have also strengthened and diversified our revenue stream. Revenue from the sale of food products rose 33.6% to RMB115.7 million and now contributes 15.3% of overall revenue. We will continue to examine ways to expand our business further upstream in the second half of the year.

Although Little Sheep has been a household name in China for many years, our reputation as a global ambassador for Mongolian hot pot and Chinese cuisine as a whole was reinforced by our participation in the Shanghai World Expo as part of the "Chinese Food Street". Our fast food products have proved very popular, with our store consistently achieving the highest level of revenue on the street.

This recognition has also been extended to other areas of our business. Little Sheep was awarded the *2009–2010 China Outstanding Franchise Brand of the Year*. We were also named as a *National Consumer Brand in Satisfactory Food Quality*. This further added to our reputation of being one of China's most recognized champions of food quality.

Going forward we will continue to identify ways to further optimize our business and strengthen our profitability. On behalf of the Board, I would like to express my sincere gratitude to our management and staff for their dedication and hard work. I would also like to thank our shareholders and business partners for their unwavering support. As the year progresses, we are confident that Little Sheep will continue to create long term value for shareholders.

ZHANG Gang
Chairman

25 August 2010

MARKET REVIEW

The first half of 2010 saw the continued recovery of the global economy, led first and foremost by China. Consumer confidence bounced back strongly, although increasing inflation still poses a challenge as excess liquidity circulates through the economy. According to the National Bureau of Statistics of China, food prices rose 5.5%, which reflects the rising raw material costs for lamb and side dishes.

To overcome these difficulties, Little Sheep has been proactive in enhancing its management system in order to offset the impact inflation has had on its raw material costs. These measures were supported by a renewed focus on increasing efficiency and delivering quality food and services, further strengthening the company's competitiveness over the period.

BUSINESS REVIEW

Little Sheep's efforts to build its brand and enhance its services has continued to be recognized by customers. Same-store sales and customer traffic grew at a record pace in China, up 6.9% and 9.8% respectively in the first half of 2010. The food product business also continued to grow steadily over the period through effective cost control and process automation. These achievements, together with the favorable economic environment in China, helped the Company realize strong and steady growth across all of its business segments in the first half of the year. In the six months ended 30 June 2010, the Company's consolidated revenue grew 20.5% year-on-year to RMB754.8 million.

To facilitate the future growth of the business, the Company continued its restaurant expansion and renovation program, which added some short-term bottom line pressure. Factors such as inflation, material costs and the temporary closure of some stores in major cities for renovation affected overall profit. In the six months ended 30 June 2010, the Company's profit attributable to shareholders fell 2.7% to RMB38.1 million.

Thanks to the strong support of its business partners, shareholders and the public, Little Sheep has grown to become one of China's most recognized culinary brands. This reputation is a testament to the Company's unwavering commitment to food safety and quality, as well as providing its customers with a high quality dining experience.

The Company was once again recognized for its leadership in the Chinese catering sector in the first half of the year and was the only Chinese restaurant chain to be included in the top 100 brands of the *Hurun Most Valuable Privately-Held Chinese Brands 2010*. Little Sheep also received its sixth consecutive accreditation from the World Brand Lab as one of the 500 most valuable brands in China and was the second highest ranking restaurant chain.

Restaurant Operations

The Company's restaurant operations remained the largest contributor to revenue in the first half of 2010, accounting for 82.8% of total revenue. Revenue from company-owned restaurants increased 21.0% year-on-year to RMB625.2 million, while same-store sales and customer numbers in China increased by 6.9% and 9.8% respectively. This increase in revenue was attributable to the opening of new restaurants, growth in same-store sales, the launch of new products and continuous service enhancement. To further sustain this growth, the Company also implemented the following strategies in the first half of 2010:

- *Expansion and refurbishment of company-owned restaurants*

  The Company added 18 stores to its network of company-owned restaurants in the first half of 2010, by launching 15 new stores, acquiring six franchises, and shedding three restaurants. This expansion is part of a long-term strategy to increase the number of company-owned restaurants and raise profitability. Little Sheep operated a total of 179 company-owned restaurants as of 30 June 2010.

  The Company continued its refurbishment program throughout the first half of the year in order to provide a more comfortable dining environment for its customers. The new restaurant design blends tradition, prairie culture and modern elements to create a distinctive and functional interior, which has attracted more customer traffic as well as accolades from diners. In the first half of the year, the Company completed renovation work on ten restaurants, all of which have since resumed operations, while nine restaurants are still undergoing refurbishment.

In the second half of the year, Little Sheep will continue its expansion and refurbishment plan in China's first and second-tier cities, while also looking at expanding its restaurant network into third-tier cities.

- *Optimizing work flow and enhancing efficiency*

  The Company invested in various systems in the first half of the year in order to enhance the effectiveness of its workforce. This included membership management systems, menu coding and backend systems. Some work processes were also mechanized in an effort to reduce the number of manual activities. This has significantly improved order handling, queuing times and table turnover in its restaurants. In some stores, Little Sheep launched a trial campaign to reduce time for delivering table orders to less than six minutes during lunch and dinner sessions.

  This year, the Company also successfully implemented it's highly modernized central kitchens in Shenzhen and Shanghai which has centralized and simplified much of the work flow in these cities' restaurants. These facilities have lifted productivity, promoted scale efficiency and allowed the reallocation of labour resources.

- *Promotional campaigns and new product launches*

  The Company ran a number of promotional campaigns to introduce new products during the first half of the year. These were well received by the public and contributed to the strong growth in customer traffic over the period.

  Seasonal campaigns, including the Chinese New Year Family Reunion Promotion, 315 Quality Month Promotion and the Spring New Product Promotion featured dishes such as "Shan-Zhen-Jun-Tang-Guo" (山珍菌湯鍋), "Yu-Zhi-Gao-Yang" (玉脂羔羊) and "Hua-Run-San-Xian" (滑潤三鮮). The 315 Quality Month Promotion boosted customer traffic and same-store sales by 15.7% and 11.4% respectively, while also familiarizing customers with the Company's production chain and safety measures. These were followed by the particularly successful Summer New Product Promotion which featured set meals such as "Qing-Liang-Guo"(清涼鍋) and "Beer and Lamb"(啤酒羔羊肉).

  Another notable promotion was the launch of a VIP membership program in partnership with China Merchant Bank and Air China, which provided discounts to members, as well as special promotions.

  This year also saw Little Sheep become a global ambassador for Mongolian hot pot after opening a restaurant at the Shanghai World Expo's "Chinese Food Street". The Company's fast food products have proved extremely popular with both international and Chinese visitors with the store frequently attracting the highest revenue on the street.

  Closer to home, the Company launched a series of marketing activities in Inner Mongolia. These included the Thanksgiving Model Worker campaign which employs model workers from the Autonomous Region to work as food safety inspectors. Little Sheep also organized the first Inner Mongolia Autonomous Region Children Drawing Competition which was well-received by the public and strengthened its local brand image.

- *Brand image enhancement*

  In order to effectively shape its image among the public, Little Sheep also conducted brand management studies in each region of China and issued clear internal guidelines which systematically standardized staff appearance, restaurant design, usage of retail products and sub-brand products, advertising, etc. This uniform approach to brand building also raised the image of overall management standards.

  The Company launched its "Make the World Listen to the Prairie" website in conjunction with the opening of the Shanghai World Expo. The website incorporated three themes to attract consumers to its Shanghai stores and also sought to introduce prairie culture to visitors. These themes were *Little Sheep and the World Expo, Little Sheep in Shanghai and Beautiful Prairie is My Home.*

  In recognition of its continuous efforts in enhancing its brand image, Little Sheep was once again named as one of the *500 most valuable brands in China* by the World Brand Lab. This was the sixth straight accreditation with Little Sheep's overall ranking improving to 97th place.

- *Enhancing service quality to increase customer satisfaction*

  Little Sheep believes that employee morale plays a big part in enhancing the quality of service it provides to customers. This year, the Company launched an employee engagement program which aims to foster a positive learning environment to increase job satisfaction and improve work performance. Starting with its restaurants in selected regions, the Company is encouraging its staff and managers to share their experiences in order to build a better business together. Under this program, innovative ideas and successful management strategies are profiled internally so that all employees can learn to improve their own practices. The program will be further extended in the second half of 2010.

  Following the success of "Program Happy Sheep" (快樂服務領頭羊計劃), the Company implemented a number of initiatives this year to create a happy and harmonious team atmosphere, raise employee commitment, and build closer ties between employees and customers.

  Customer satisfaction also remains a key element in the Company's success. To monitor this, Little Sheep continued its 'mystery shopper' program this year as part of its internal operational review in order to measure service quality and areas for improvement. A "Small Details Enhancement" (細部大開發) program was also launched to fine-tune and perfect service levels and raise customer satisfaction.

Franchise Business

The Company is committed to enhancing the operation of its franchises and providing assistance with their renovation programs. This commitment was recognized as Little Sheep was named as the *2009–2010 China Outstanding Franchise Brand of the Year*. Little Sheep currently operates 301 franchised restaurants, of which 19 are based in the United States, Canada, Japan and the UAE. All overseas franchises performed well in the first half of the year.

As of 30 June 2010, revenue from franchises was RMB13.5 million, a decrease of 39.0%. This was primarily attributable to the Company's strategy of expanding the number of company-owned restaurants by acquiring franchises and a slow down in the number of new franchises.

Sale of Food Products

Lamb processing and seasonings remained the Company's core focus for its upstream business. Little Sheep currently operates two lamb processing facilities in China, which is one of the largest production scales in the country. Its current product line-up includes fresh and frozen lamb products, hot pot soup bases and other seasonings.

In the first half of 2010, the Company strengthened the wholesale distribution of its food products by expanding to the high-end market. The Company has improved its customers' understanding of the quality of Little Sheep's food production and differentiated its fine quality from peers. As a result of increased market share, the Company succeeded in increasing revenue from its food product and seasoning business by 33.6%, to a total of RMB115.7 million.

Aside from increasing the sales of food products, the Company also focused on enhancing the profitability of its food processing and seasoning business through stringent cost control and strategic purchases. To offset the inflationary pressure, the Company closely monitored market prices and increased purchase volumes when the price was stable. Furthermore, the Company looked into sourcing from outlying regions with cost advantages in order to supplement lamb supply and lower overall material costs.

As the popularity and demand for its food products continues to increase, the Company has continued to look towards expanding its upstream businesses. Throughout the period, Little Sheep invested in upgrading its equipment and technology for lamb processing and seasoning products. The Company is also closely monitoring market demand and launching new products in response to the needs of its consumers. In 2010, it began to develop chicken, lamb and beef sauce products to improve its product mix.

Food Safety

Little Sheep is dedicated to providing the highest standard of quality in its food and meeting all domestic and international food safety standards. This year, the Company has focused on enforcing food safety practices across its entire production chain by producing a corporate code on food safety management based on HACCP (Hazard Analysis and Critical Control Points) principles. This code pre-empts every possible hazard on the production chain and gives clear and strict instructions for units to comply with. The introduction of central kitchens has also contributed to a simpler and more centralized control function for food safety. As the result of these initiatives, Little Sheep employees from the front-of-house to the back-end fully understand the importance of food safety and are committed to delivering quality products and services.

The Company has also taken the initiative to publicly demonstrate the importance it places on food safety and corporate social responsibility. This year, the Company led a group of over 100 companies in the food industry to lobby for a ban on the use of discarded cooking oil. It also invited the public to visit its central kitchen in Shenzhen, to demonstrate the safety measures the Company has applied to its whole production chain. As part of its *315 Quality Month Promotion*, the Company introduced its holistic approach to food safety management and its tracing system, assuring customers that every process in its production chain is being taken good care of and that it is well prepared to tackle any issue that compromises food safety. This provided customers with additional assurance and raised the Company's reputation for food safety amongst its peers.

Information System

In the first half of the year, the Company promoted the uptake of new and self-developed technology systems to upgrade its platform for management information access and improve general operational management. The newly adopted systems are known as RIF and BI.

RIF is a value-adding service which allows users of the system to objectively assess the consumer market and monitor their operations in an effective and scientific manner. The BI system provides business intelligence to Little Sheep's company-owned restaurants on the Company's entire supply chain, as well as performance data on its restaurants, regional branches and headquarters, making it an important decision making tool for management.

Business Outlook

Looking ahead, China's growth momentum will continue to support the development of the catering sector and provide Little Sheep with growth opportunities. However, emerging global and domestic uncertainties such as the European debt crisis and domestic inflation means the Company remains cautious on the outlook for the Chinese economy. In the second half of the year, the Company will seek to overcome rising cost pressures to maintain revenue growth and its profit ratio.

To achieve this, the Company will continue to develop its company-owned restaurant network in China's first and second-tier cities, and expand its franchise business both internationally and domestically. As it expands its restaurant network, the Company will remain focused on raising customer satisfaction and maintaining the momentum in customer traffic growth. Furthermore, the Company will enhance its overall profitability and competitiveness by continuing to expand its upstream business and introducing new products with higher profit margins. With inflation remaining a challenge, the Company will maintain its stringent cost control measures by further optimizing its internal procedures, improving operational and scale efficiency, and enhancing its price management mechanism.

By strengthening its management processes, as well as effectively utilizing its resources, Little Sheep will lay a solid foundation for its future development and the continuous creation of shareholder value.

FINANCIAL REVIEW

Revenue

In the six months ended 30 June 2010, our total revenue increased by 20.5% year-on-year to RMB754.8 million. The increase was primarily due to the increase in the number of restaurants and the increase in revenue from sale of food products.

Revenue from Restaurant Operations

Revenue from the Company's restaurant operations increased by 21.0% year-on-year to RMB625.2 million, which was mostly attributable to the contribution from newly opened restaurants, the growth in same-store sales from its existing restaurants, and the increase in customer traffic.

Revenue from Sales of Food Products

Revenue from sales of the Company's food products increased by 33.6% year-on-year to RMB115.7 million, which was mainly due to an increase in the sales volume of its soup base and lamb products, as well as the introduction of new products.

Revenue from Franchise Operations

Revenue from the Company's franchise operations decreased by 39.0% year-on-year to RMB13.5 million. This was due to a decrease in the initial franchise fees charged to new franchises granted during the period as the result of different fee levels being charged for different cities, a slowdown in the number of new franchises, and revenue transferred following the purchase of franchises by the Company.

Revenue from Management Service Fees

Revenue from management service fees represents the monthly fees the Group receives for the provision of restaurant management services to franchisees. In the six months ended 30 June 2010, revenue from management service fees dropped by 51.9% year-on-year to RMB0.4 million. The decrease was primarily due to a decrease in the number of franchise restaurants to which the Group provided management services.

Other Income

Other income, which includes income from the Company's non-core operations, increased by 87.2% year-on-year to RMB17.0 million. This was primarily attributable to the increase in government grants, gain on disposal of restaurants and sale of low-value consumables.

Cost of Inventories Sold

The cost of inventories sold increased by 32.4% year-on-year to RMB319.3 million. The increase was mainly attributable to the rise in sales volume and costs of raw materials.

Staff Costs

Our staff costs increased by 16.1% year-on-year to RMB171.2 million, which was mostly attributable to the overall increase in salaries and other employee benefits, as well as the increase in headcount resulting from the opening of new restaurants.

Depreciation and Amortization

Depreciation and amortization amounted to RMB33.8 million, representing an increase of 45.4% year-on-year. Such increase was attributable to the overall increase in depreciation and amortization expenses resulting from an increase in the number of restaurants, the renovations of existing restaurants, and increase in non-current assets of the back office.

Management Discussion and Analysis (continued)

Rental Expenses

Rental expenses increased by 11.7% year-on-year to RMB76.5 million, mainly due to the increase in the number of company-owned restaurants.

Fuel and Utility Expenses

Fuel and utility expenses increased by 24.7% year-on-year to RMB35.4 million, attributable to the increase in the number of company-owned restaurants.

Other Operating Expenses

Other operating expenses increased by 17.5% year-on-year to RMB81.1 million, mainly due to the increase in the number of company-owned restaurants and the increase in the advertisement, promotional and marketing expenses.

Finance Costs

Our finance costs during the period amounted to RMB14,000 which were primarily interest on bank borrowings.

Income Tax Expense

Our income tax expenses decreased by 2.6% year-on-year to RMB15.0 million mainly attributable to the decrease in pre-tax profit during the period.

Profit for the Six months Ended 30 June 2010

Our profit for the six months ended 30 June 2010 decreased by 6.1% year-on-year to RMB39.6 million as a result of the cumulative effect of the foregoing factors.

Net Profit Attributable to Owners of the Company

Our net profit attributable to owners of the Company in the six months ended 30 June 2010 was RMB38.1 million, recording a decrease of 2.7% year-on-year, as a result of the cumulative effect of the foregoing factors.

Liquidity and Financial Resources

As at 30 June 2010, cash and bank balances stood at RMB251.3 million and net current assets were RMB268.6 million with a current ratio of 2.2.

As at 30 June 2010, total outstanding bank loans stood at RMB20.4 million.

Regarding the foreign exchange fluctuations, during the period, the Group's revenue and business incomes and expenses were mainly denominated in Renminbi while those from our overseas company-owned restaurants outside mainland China were denominated in foreign currencies, including Hong Kong dollars. Although the Group's operation currently would not generate any significant foreign currency exposure, we will continue to take effective measures and monitor closely the foreign currency movement. As at 30 June 2010, the Group did not have any derivative instrument for hedging against foreign exchange risk.

Cash Flow

Net cash inflow from operating activities in the six months ended 30 June 2010 was RMB86.8 million, attributable primarily to increased cash inflow from the Company's revenue.

Net cash outflow from investing activities in the six months ended 30 June 2010 were RMB123.6 million, consisting primarily of investments in restaurants and production bases of RMB80.6 million, and acquisition of restaurants of RMB46.8 million. Net cash outflow from financing activities over the period were RMB36.9 million, which mainly comprised the increase in bank loan of RMB20.0 million and payments of dividends of RMB62.0 million.

Capital Expenditures

Our capital expenditures for the six months ended 30 June 2010 were RMB92.7 million which were primarily related to the expenditures on information technology, the opening and refurbishment of company-owned restaurants, and construction of production bases.

Our planned capital expenditures for the rest of 2010 are approximately RMB119.9 million which will be funded by internal resources and proceeds from the initial public offering of the Company.

Human Resources

As at 30 June 2010, the Group had 13,784 employees. To ensure smooth operation and sustainable development, the Group places high emphasis on human capital and adopts effective measures including offering competitive remuneration packages and a promising career to attract and retain high quality employees. Remuneration packages and promotions are commensurate with market conditions and an employee's qualification and work experience. In addition, the Group has developed an effective structure to plan, organize, execute and evaluate staff training programs. These programs took place in the Company's headquarter, regional branches and restaurants chains. Over the period, the Group has already conducted training courses for front-store managers and employed external training institution to improve management and team work.

Use of Proceeds

The application of the proceeds from the initial public offering of the Company does not materially change from the allocation stated in the prospectus of the Company dated 2 June 2008.

Report on Review of Interim Condensed Consolidated Financial Statements

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安 永

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To the board of directors of Little Sheep Group Limited
(Incorporated in the Cayman Islands with limited liability)

INTRODUCTION

We have reviewed the accompanying interim condensed consolidated financial statements set out on pages 13 to 36 which comprises the interim condensed consolidated statement of financial position of Little Sheep Group Limited and its subsidiaries as at 30 June 2010 and the related interim condensed consolidated statements of income, comprehensive income, changes in equity and cash flows for the six months then ended, and explanatory notes. The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited require the preparation of a report on interim condensed consolidated financial statements to be in compliance with the relevant provisions thereof and International Accounting Standard 34 "Interim Financial Reporting" ("IAS 34") issued by the International Accounting Standards Board.

The directors of the Company are responsible for the preparation and presentation of these interim condensed consolidated financial statements in accordance with IAS 34. Our responsibility is to express a conclusion on these interim condensed consolidated financial statements based on our review. Our report is made solely to you, as a body, in accordance with our agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

SCOPE OF REVIEW

We conducted our review in accordance with Hong Kong Standard on Review Engagements 2410 "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Hong Kong Institute of Certified Public Accountants. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Hong Kong Standards on Auditing. Consequently, it does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

CONCLUSION

Based on our review, nothing has come to our attention that causes us to believe that the accompanying interim condensed consolidated financial statements are not prepared, in all material respects, in accordance with IAS 34.

Ernst & Young
Certified Public Accountants
Hong Kong

25 August 2010

Interim Condensed Consolidated Income Statement

Six months ended 30 June 2010

	Notes	Six months ended 30 June 2010 (Unaudited) RMB'000	30 June 2009 (Unaudited) RMB'000
REVENUE	4	**754,829**	626,298
Other income	4	**17,012**	9,090
Cost of inventories sold	5	**(319,261)**	(241,106)
Staff costs	5	**(171,221)**	(147,539)
Depreciation and amortisation	5	**(33,756)**	(23,210)
Rental expenses	5	**(76,502)**	(68,507)
Fuel and utility expenses		**(35,360)**	(28,356)
Other operating expenses		**(81,108)**	(69,045)
Finance costs	6	**(14)**	(18)
PROFIT BEFORE TAX		**54,619**	57,607
Income tax expense	7	**(15,022)**	(15,421)
PROFIT FOR THE PERIOD		**39,597**	42,186
Attributable to:			
Owners of the Company		**38,083**	39,155
Non-controlling interests		**1,514**	3,031
		39,597	42,186
EARNINGS PER SHARE ATTRIBUTABLE TO OWNERS OF THE COMPANY	9		
— Basic (RMB)		**3.70 cents**	3.81 cents
— Diluted (RMB)		**3.67 cents**	3.79 cents

Interim Condensed Consolidated Statement of Comprehensive Income

Six months ended 30 June 2010

	Six months ended	
	30 June 2010	30 June 2009
	(Unaudited)	(Unaudited)
	RMB'000	RMB'000
PROFIT FOR THE PERIOD	**39,597**	42,186
Exchange differences on translation of foreign operations	**(1,949)**	(453)
Other comprehensive income for the period, net of tax	**(1,949)**	(453)
Total comprehensive income for the period, net of tax	**37,648**	41,733
Attributable to:		
Owners of the Company	**36,134**	38,702
Non-controlling interests	**1,514**	3,031
	37,648	41,733

Interim Condensed Consolidated Statement of Financial Position

30 June 2010

	Notes	30 June 2010 (Unaudited) RMB'000	31 December 2009 (Audited) RMB'000
NON-CURRENT ASSETS			
Property, plant and equipment	10	413,443	358,544
Deposits for purchases of items of plant and equipment		—	15,903
Intangible assets		274,995	236,774
Prepaid land lease payments		49,932	50,055
Long-term rental deposits		18,897	15,984
Deferred income tax assets		5,381	5,455
Total non-current assets		762,648	682,715
CURRENT ASSETS			
Inventories	11	139,635	182,126
Trade receivables	12	15,260	19,297
Prepayments, deposits and other receivables	13	88,104	61,584
Cash and cash equivalents	14	251,248	325,207
Total current assets		494,247	588,214
CURRENT LIABILITIES			
Interest bearing bank borrowings	15	20,375	375
Trade payables	16	45,093	51,098
Deposits, other payables and accruals	17	125,016	134,207
Due to non-controlling interests	18	26,036	14,900
Tax payable		9,172	23,764
Total current liabilities		225,692	224,344
NET CURRENT ASSETS		268,555	363,870
TOTAL ASSETS LESS CURRENT LIABILITIES		1,031,203	1,046,585
NON-CURRENT LIABILITIES			
Long-term payables		10,569	8,763
Total non-current liabilities		10,569	8,763
NET ASSETS		1,020,634	1,037,822

Interim Condensed Consolidated Statement of Financial Position (continued)

30 June 2010

	Notes	30 June 2010 (Unaudited) RMB'000	31 December 2009 (Audited) RMB'000
EQUITY			
Equity attributable to owners of the Company			
Issued capital	19	91,096	90,826
Reserves		920,070	939,952
		1,011,166	1,030,778
Non-controlling interests		9,468	7,044
TOTAL EQUITY		1,020,634	1,037,822

Interim Condensed Consolidated Statement of Changes in Equity

Six months ended 30 June 2010

	Attributable to owners of the Company								
	Issued capital (Unaudited) RMB'000 (note 19)	Capital reserve (Unaudited) RMB'000 (note 19)	PRC reserves funds (Unaudited) RMB'000	Foreign currency translation reserve (Unaudited) RMB'000	Share option reserve (Unaudited) RMB'000	Retained profits (Unaudited) RMB'000	Total (Unaudited) RMB'000	Non-controlling interests (Unaudited) RMB'000	Total equity (Unaudited) RMB'000
At 1 January 2010	90,826	586,879	36,985	(6,949)	6,055	316,982	1,030,778	7,044	1,037,822
Total comprehensive income	—	—	—	(1,949)	—	38,083	36,134	1,514	37,648
Equity-settled share option arrangement (note 5)	—	—	—	—	556	—	556	—	556
Exercise of employee share options	270	6,445	—	—	(1,026)	—	5,689	—	5,689
Final 2009 dividend paid	—	(61,991)	—	—	—	—	(61,991)	—	(61,991)
Acquisition of subsidiaries	—	—	—	—	—	—	—	590	590
Disposal of subsidiaries	—	—	—	—	—	—	—	320	320
At 30 June 2010	91,096	531,333*	36,985*	(8,898)*	5,585*	355,065*	1,011,166	9,468	1,020,634
At 1 January 2009	90,823	655,382	36,152	(6,718)	3,509	162,451	941,599	8,297	949,896
Total comprehensive income	—	—	—	(453)	—	39,155	38,702	3,031	41,733
Transfer to the PRC reserve funds	—	—	25	—	—	(25)	—	—	—
Equity-settled share option arrangement (note 5)	—	—	—	—	1,278	—	1,278	—	1,278
Exercise of employee share options	1	12	—	—	—	—	13	—	13
Final 2008 dividend paid	—	(68,846)	—	—	—	—	(68,846)	—	(68,846)
Acquisition of subsidiaries	—	—	—	—	—	—	—	1,531	1,531
At 30 June 2009	90,824	586,548	36,177	(7,171)	4,787	201,581	912,746	12,859	925,605

* These reserve accounts comprise the consolidated reserves of RMB920,070,000 (31 December 2009: RMB939,952,000) in the interim condensed consolidated statement of financial position.

Interim Condensed Consolidated Cash Flow Statement

Six months ended 30 June 2010

	Notes	Six months ended 30 June 2010 (Unaudited) RMB'000	30 June 2009 (Unaudited) RMB'000
Net cash inflow from operating activities		**86,837**	67,299
Net cash outflow from investing activities		**(123,579)**	(112,623)
Net cash outflow from financing activities		**(36,906)**	(67,452)
Net decrease in cash and cash equivalents		**(73,648)**	(112,776)
Cash and cash equivalents at beginning of period		**325,207**	424,038
Effect of foreign exchange rate changes, net		**(311)**	(276)
Cash and cash equivalents at end of period	14	**251,248**	310,986

1. CORPORATE INFORMATION AND REORGANISATION

Little Sheep Group Limited (the "Company") was incorporated on 18 December 2007 in the Cayman Islands with limited liability. The registered office of the Company is located at Cricket Square, Hutchins Drive, PO Box 2681, Grand Cayman, KY1-1111, Cayman Islands. The ordinary shares of the Company were listed on the Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") on 12 June 2008. In the opinion of the directors, the ultimate holding company of the Company is Possible Way International Limited ("Possible Way") which is incorporated in the British Virgin Islands.

The Company acts as an investment holding company. The principal activities of its subsidiaries are the operation of Chinese hot pot restaurants, the provision of catering services and the sale of related food products in the People's Republic of China (the "PRC"), Hong Kong and Macau. The Group has established a principal place of business in Hong Kong at Unit 1104, 11/F, Jubilee Center, 42–46 Gloucester Road, Wan Chai, Hong Kong.

2. BASIS OF PRESENTATION AND IMPACT OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS

Basis of presentation

The interim condensed consolidated financial statements for the six months ended 30 June 2010 have been prepared in accordance with International Accounting Standard ("IAS") 34 "Interim Financial Reporting" issued by the International Accounting Standards Board ("IASB") and the disclosure requirements under the Rules Governing the Listing of Securities on The Hong Kong Stock Exchange Limited.

The interim condensed consolidated financial statements do not include all the information and disclosures required in the annual financial statements, and should be read in conjunction with the Group's annual financial statements as at 31 December 2009.

Impact of new and revised International Financial Reporting Standards

The accounting policies adopted in the preparation of the interim condensed consolidated financial statements are consistent with those followed in the preparation of the Group's annual financial statements for the year ended 31 December 2009, except for the adoption of new or revised International Financial Reporting Standards ("IFRSs") and International Financial Reporting Interpretations Committee ("IFRIC") interpretations as of 1 January 2010, noted below:

IFRS 1 (Revised)	First-time Adoption of IFRSs
IFRS 1 Amendments	Amendments to IFRS 1 First-time Adoption of IFRSs — Additional Exemptions for First-time Adopters
IFRS 2 Amendments	Amendments to IFRS 2 Share-based Payment — Group Cash-settled Share-based Payment Transactions
IFRS 3 (Revised)	Business Combinations
IAS 27 (Revised)	Consolidated and Separate Financial Statements
IAS 39 Amendment	Amendment to IAS 39 Financial Instruments: Recognition and Measurement — Eligible Hedged Items
IFRIC 17	Distributions of Non-cash Assets to Owners
Amendments to IFRS 5 included in Improvements to IFRSs issued in October 2008	Amendments to IFRS 5 Non-current Assets Held for Sale and Discontinued Operations — Plan to Sell the Controlling Interest in a Subsidiary

2. BASIS OF PRESENTATION AND IMPACT OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS *(continued)*

Impact of new and revised International Financial Reporting Standards *(continued)*

Except for the adoption of IFRS 3 (Revised) and IAS 27 (Revised) resulted in new or amended disclosures, the adoption of these new interpretations and amendments has had no significant financial effect on these interim condensed consolidated financial statements and there have been no significant changes to the accounting policies applied in these interim condensed consolidated financial statements.

IFRS 3 (Revised) Business Combinations

The revised standard introduces a number of changes in the accounting for business combinations that will impact the amount of goodwill recognised, the reported results in the period that an acquisition occurs, and future reported results.

IAS 27 (Revised) Consolidated and Separate Financial Statements

The revised Standard requires that a change in the ownership interest of a subsidiary without loss of control is accounted for as an equity transaction. Therefore, such a change will have no impact on goodwill, nor will it give rise to a gain or loss. Furthermore, the revised standard changes the accounting for losses incurred by the subsidiary as well as the loss of control of a subsidiary. Other consequential amendments were made to IAS 7 Statement of Cash Flows, IAS 12 Income Taxes, IAS 21 The Effects of Changes in Foreign Exchange Rates, IAS 28 Investments in Associates and IAS 31 Interests in Joint Ventures.

Improvements to IFRSs

In April 2009, the Board issued its second omnibus of amendments to its standards, primarily with a view to removing inconsistencies and clarifying wording. There are separate transitional provisions for each standard. These amendments resulting from Improvements to IFRSs to the following standards did not have any impact on the accounting policies, financial position or performance of the Group:

IAS 1	*Presentation of Financial Statements*
IAS 7	*Statement of Cash Flows*
IAS 17	*Leases*
IAS 36	*Impairment of Assets*
IAS 38	*Intangible Assets*
IAS 39	*Financial Instruments: Recognition and Measurement*
IFRS 2	*Share-based Payment*
IFRS 5	*Non-current Assets Held for Sale and Discontinued Operations*
IFRS 8	*Operating Segments*
IFRIC — Int 9	*Reassessment of Embedded Derivatives*
IFRIC — Int 16	*Hedges of a Net Investment in a Foreign Operation*

The Group has not early adopted any other standard, interpretation or amendment that was issued but is not yet effective.

3. SEGMENT INFORMATION

For management purposes, the Group is organised into business units based on their products and services, and has four reportable operating segments as follows:

(a) the operation of restaurants and provision of catering services segment engages in Chinese hot pot restaurants;

(b) the sale of food products segment engages in the production of soup-based seasoning and the sale of lamb meat;

(c) the franchise income segment represents the charges to the franchisees for the rights of using the trademark of Little Sheep; and

(d) the "others" segment represents the provision of services of sales promotion, purchase, training, and other administrative services rendered to franchise restaurants.

Management monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on operating profit or loss which in certain respects, as explained in the table below, is measured differently from operating profit or loss in the interim condensed consolidated financial statements. Group financing (including finance costs and finance revenue) and income taxes are managed on a group basis and are not allocated to operating segments.

3. SEGMENT INFORMATION *(continued)*

The following tables present revenue and profit information regarding the Group's operating segments for the six months ended 30 June 2010 and 2009, respectively.

Six months ended 30 June 2010 (unaudited)	**Restaurant operations and provision of catering services RMB'000**	**Food products RMB'000**	**Franchise income RMB'000**	**Others RMB'000**	**Adjustments and eliminations RMB'000**	**Total RMB'000**
Segment revenue:						
Third party	**625,199**	**115,694**	**13,532**	**404**	**—**	**754,829**
Inter-segment	**—**	**104,958**	**—**	**11,763**	**(116,721)**	**—**
Total revenue	**625,199**	**220,652**	**13,532**	**12,167**	**(116,721)**	**754,829**
Results						
Segment profit/(loss) before tax	**64,608**	**3,925**	**3,651**	**(6,564)**	**(11,001)**	**54,619**

Six months ended 30 June 2009 (unaudited)	Restaurant operations and provision of catering services RMB'000	Food products RMB'000	Franchise income RMB'000	Others RMB'000	Adjustments and eliminations RMB'000	Total RMB'000
Segment revenue:						
Third party	516,657	86,602	22,199	840	—	626,298
Inter-segment	—	88,314	—	10,880	(99,194)[(1)]	—
Total revenue	516,657	174,916	22,199	11,720	(99,194)	626,298
Results						
Segment profit/(loss) before tax	65,226	(260)	12,154	(9,798)	(9,715)[(2)]	57,607

1. Inter-segment revenue are eliminated on consolidation.

2. The profit for each operating segment does not include other income (2010: RMB17,012,000; 2009: RMB9,090,000), unallocated expenses (2010: RMB28,713,000; 2009: RMB18,787,000), nor finance cost (2010: RMB14,000; 2009: RMB18,000).

3. SEGMENT INFORMATION *(continued)*

The following table presents segment assets of the Group's operating segments as at 30 June 2010 and 31 December 2009.

	Restaurant operations and provision of catering services RMB'000	Food products RMB'000	Franchise income RMB'000	Others RMB'000	Adjustments and eliminations RMB'000	Total RMB'000
Segment assets						
At 30 June 2010 (unaudited)	**611,631**	**372,817**	**956,322**	**450,833**	**(1,134,708)[(1)]**	**1,256,895**
At 31 December 2009 (audited)	584,092	429,449	941,721	476,069	(1,160,402)[(1)]	1,270,929

1. Inter-segment current accounts are eliminated on consolidation.

4. REVENUE AND OTHER INCOME

Revenue

Revenue, which is also the Group's turnover, represents the net amount received and receivable from restaurant operations, the provision of catering services and the sale of food products to franchise restaurants and customers, less returns and allowances; franchise income; and management service fee income. An analysis of revenue and other income is presented below:

	Six months ended	
	30 June 2010 (Unaudited) RMB'000	30 June 2009 (Unaudited) RMB'000
Restaurant operations and provision of catering services	**625,199**	516,657
Sale of food products	**115,694**	86,602
Franchise income	**13,532**	22,199
Management service fee income	**404**	840
	754,829	626,298

4. REVENUE AND OTHER INCOME *(continued)*

Other income

	Six months ended	
	30 June 2010	30 June 2009
	(Unaudited)	(Unaudited)
	RMB'000	RMB'000
Gain on disposal of subsidiaries	**4,338**	—
Government grants	**1,705**	1,153
Sale of low-value consumables	**1,789**	643
Interest income on bank balances	**824**	1,089
Excess over the cost of a business combination recognised in the income statement	**257**	—
Others	**8,099**	6,205
	17,012	9,090

Various local government grants have been granted to reward the Group for its contributions to the local economy. There were no unfulfilled conditions or contingencies attaching to these government grants.

5. PROFIT BEFORE TAX

The Group's profit before tax is arrived at after charging:

	Six months ended	
	30 June 2010	30 June 2009
	(Unaudited)	(Unaudited)
	RMB'000	RMB'000
Cost of inventories sold	**319,261**	241,106
Staff costs including directors' remuneration:		
Wages, salaries and bonuses	**149,228**	126,815
Expense of share-based payments	**556**	1,278
Pension scheme costs	**6,407**	6,917
Social welfare and other costs	**15,030**	12,529
	171,221	147,539
Depreciation and amortisation	**33,756**	23,210
Minimum lease payments under operating leases in respect of buildings	**76,502**	68,507

6. FINANCE COSTS

Financial costs represent the interest on bank borrowings.

7. INCOME TAX EXPENSE

	Six months ended	
	30 June 2010	30 June 2009
	(Unaudited)	(Unaudited)
	RMB'000	RMB'000
Income tax		
Current income tax	**15,117**	16,702
Deferred income tax	**(95)**	(1,281)
	15,022	15,421

The Group is subject to income tax on an entity basis on the profit arising in or derived from the tax jurisdictions in which members of the Group are domiciled and operates.

Under the relevant PRC income tax law, except for the preferential treatment available to certain subsidiaries operating in the PRC, the companies of the Group which operate in the PRC are subject to corporate income tax at a rate of 25% on their respective taxable income or deemed profit assessed based on the verification collection method. During the six months ended 30 June 2010, after obtaining approval from the relevant PRC tax authorities, 19 (30 June 2009: 18) entities of the Group were subject to a preferential corporate income tax rate of 22% (30 June 2009: 20%), 3 (30 June 2009: 3) entities of the Group were exempt from the PRC corporate income tax and 46 (30 June 2009: 42) entities of the Group were assessed based on the verification collection method. All the tax concessions enjoyed by the Group were granted by various competent tax bureaus.

The provision for Hong Kong profits tax is calculated at 16.5% of the estimated assessable profits for the six months ended 30 June 2010 (30 June 2009: 16.5%).

Taxes on profits assessable elsewhere have been calculated at the rates of tax prevailing in the regions in which the Group operates, based on existing legislation, interpretations and practices in respect thereof.

8. DIVIDEND

At the annual general meeting held on 20 May 2010, the Company's shareholders approved the payment of the final dividend for the year ended 31 December 2009 of HK cents 6.9 per share (equivalent to approximately RMB cents 6.0 per share) which amounted to RMB61,991,000. The dividend declared has been paid as at 30 June 2010.

The Directors did not recommend the payment of any interim dividend for the six months ended 30 June 2010.

9. EARNINGS PER SHARE ATTRIBUTABLE TO OWNERS OF THE COMPANY

The calculation of basic earnings per share for the period is based on the profit attributable to owners of the Company for the period of RMB38,083,000 (30 June 2009: RMB39,155,000) and the weighted average number of 1,028,270,170 ordinary shares (30 June 2009: 1,027,650,870 ordinary shares) of the Company.

The calculation of diluted earnings per share for the six months period ended 30 June 2010 is based on the profit attributable to owners of the Company for the period of RMB38,083,000 (30 June 2009: RMB39,155,000) and on 1,028,270,170 ordinary shares (30 June 2009: 1,027,650,870 ordinary shares), as used in the calculation of basic earnings per share and the weighted average of 9,995,378 ordinary shares (30 June 2009: 6,361,790 ordinary shares) assumed to have been issued at no consideration on the deemed exercise of the Pre-IPO Options Scheme adopted by the Company on 20 December 2007.

10. PROPERTY, PLANT AND EQUIPMENT

During the six months ended 30 June 2010, the Group acquired property, plant and equipment at a total cost of RMB85,503,000 (31 December 2009: RMB133,299,000), not including property, plant and equipment acquired through business combination.

Property, plant and equipment with a net book value of RMB4,519,000 (31 December 2009: RMB4,745,000) were disposed of by the Group during the six months ended 30 June 2010, resulting in a net loss on disposal of RMB489,000 (30 June 2009: a net gain of RMB125,000), not including property, plant and equipment disposed through the disposal of subsidiaries.

As at 30 June 2010, certain buildings of the Group were pledged as security for bank loans of the Group as disclosed in note 15 to the interim condensed consolidated financial statements. The aggregate carrying value of the pledged buildings and equipment attributable to the Group as at 30 June 2010 amounted to RMB 758,000 (31 December 2009: RMB813,000).

11. INVENTORIES

	30 June 2010 (Unaudited) RMB'000	31 December 2009 (Audited) RMB'000
Raw materials	**4,726**	6,376
Consumables	**17,156**	16,432
Food and beverages	**117,753**	159,318
	139,635	182,126

12. TRADE RECEIVABLES

Trade receivables are non-interest bearing and are generally on three months' terms. An ageing analysis of trade receivables based on the payment due date, is as follows:

	30 June 2010 (Unaudited) RMB'000	31 December 2009 (Audited) RMB'000
Within 3 months	14,174	17,916
3 to 6 months	910	1,119
6 to 12 months	22	94
1 to 2 years	154	168
	15,260	19,297

13. PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

	30 June 2010 (Unaudited) RMB'000	31 December 2009 (Audited) RMB'000
Rental prepayments	27,109	21,774
Advances to suppliers	5,161	5,380
Prepayments and other receivables	55,834	34,430
	88,104	61,584

14. CASH AND CASH EQUIVALENTS

The bank balances earn interest at floating rates based on daily bank deposit rates.

As at 30 June 2010, cash and bank balances of the Group aggregating RMB223,452,000 (31 December 2009: RMB292,185,000) were denominated in Renminbi, which is not freely convertible into other currencies. The remittance of funds out of the PRC is subject to the exchange restrictions imposed by the PRC government.

15. INTEREST BEARING BANK BORROWINGS

	30 June 2010 (Unaudited) RMB'000	31 December 2009 (Audited) RMB'000
Bank borrowings:		
Unsecured	20,000	—
Secured	375	375
	20,375	375
Bank borrowings repayable:		
Within one year or on demand	20,375	375
Total bank borrowings	20,375	375
Less: Portion classified as current liabilities	20,375	375
Non current portion	—	—

As at 30 June 2010, bank borrowings of approximately RMB375,000 were secured by pledges of certain buildings and equipment of the Group with an aggregate carrying value of RMB758, 000 (31 December 2009: RMB813,000) (note 10).

The annual interest rate of the bank borrowings during the period varied from 2.40% to 4.62% (31 December 2009: 2.40%). As at 30 June 2010, the Group's interest-bearing bank borrowings were denominated in Renminbi.

16. TRADE PAYABLES

An ageing analysis of the trade payables is as follows:

	30 June 2010 (Unaudited) RMB'000	31 December 2009 (Audited) RMB'000
Within 3 months	43,740	49,565
Over 3 months	1,353	1,533
	45,093	51,098

17. DEPOSITS, OTHER PAYABLES AND ACCRUALS

	30 June 2010 (Unaudited) RMB'000	31 December 2009 (Audited) RMB'000
Deposits from customers	**34,309**	36,364
Construction fees payable	**24,546**	23,370
Accrued wages and salaries	**25,728**	32,316
Other payables and accruals	**40,433**	42,157
	125,016	134,207

18. DUE TO NON-CONTROLLING INTERESTS

The amounts are interest-free, unsecured and have no fixed terms of repayment.

19. SHARE CAPITAL AND CAPITAL RESERVES

	Number of ordinary shares issued	**Issued share capital** RMB'000	**Capital reserves** RMB'000
At 1 January 2010	1,027,678,370	90,826	586,879
Share option exercised by employees	3,070,100	270	6,445
Dividend paid	—	—	(61,991)
At 30 June 2010	1,030,748,470	91,096	531,333

During the six months ended 30 June 2010, 3,070,100 share options were exercised at HK$2.11 per share. This gives rise to net proceeds from issue of shares amounting to approximately HK$6,478,000 (equivalent to approximately RMB5,689,000).

20. EMPLOYEE SHARE-BASED PAYMENT

On 20 December 2007, a share option scheme (the "Pre-IPO Option Scheme") was approved pursuant to written resolutions of the Company. The purpose of the Pre-IPO Option Scheme is to recognize the contribution of certain employees of the Group to its growth. On 28 December 2007, the Company granted to 439 eligible employees of the Group a total of 26,379,680 share options for nil consideration and each with an exercise price of HK$2.11 (HK$1 = RMB0.944) per share and subject to the vesting schedule as set out in the Company's prospectus dated 2 June 2008.

All holders of options granted under the Pre-IPO Share Option Scheme may only exercise their options in the following manner:

Maximum percentage exercisable		**Period for vesting of the relevant of options percentage of the option**
Lot 1:	2,637,968 shares (10% of the total number of the options to any grantee)	From the grant date of the options to expiry of the 12-month period after the grant date of the options or of the 6-month period after the date of the initial public offering of the Company (i.e. 12 June 2008), whichever is later
Lot 2:	3,956,952 shares (15% of the total number of the options to any grantee)	From the grant date of the options to expiry of 24-month period after the grant date of the options
Lot 3:	7,913,904 shares (30% of the total number of the options to any grantee)	From the grant date of the options to expiry of 36-month period after the grant date of the options
Lot 4:	11,870,856 shares (45% of the total number of the options to any grantee	From the grant date of the options to expiry of 48-month period after the grant date of the options

The fair value of the options granted is estimated at the date of grant using a binomial option pricing model, taking into account the terms and conditions upon which the options were granted.

20. EMPLOYEE SHARE-BASED PAYMENT *(continued)*

The fair value of options granted during the year ended 31 December 2008 was estimated on the date of grant using the following assumptions:

Dividend yield (%)	1.923
Expected volatility (%)	37
Risk-free interest rate (%)	2.907
Expected life (year)	5
Share price (HK$)	1.691

21. COMMITMENTS

(i) Operating lease commitments — as lessee

The Group leases certain properties under operating lease arrangements. These leases have an average life of between 1 and 15 years. In entering into these lease agreements, no restrictions were placed upon the Group.

As at 30 June 2010, the Group had the future minimum rentals payable under non-cancellable operating leases falling due as follows:

	30 June 2010 (Unaudited) RMB'000	31 December 2009 (Audited) RMB'000
Within one year	**137,810**	123,929
In the second to fifth years, inclusive	**380,887**	343,131
After five years	**156,025**	91,299
	674,722	558,359

(ii) Capital commitments

As at 30 June 2010, the Group has the following capital commitments:

	30 June 2010 (Unaudited) RMB'000	31 December 2009 (Audited) RMB'000
Contracted, but not provided for:		
Construction of a new factory	**13,071**	26,711

22. RELATED PARTY TRANSACTIONS

In addition to the transactions and balances which are disclosed elsewhere in these interim condensed consolidated financial statements, the Group had the following significant transactions with related parties during the period:

		Six months ended	
		30 June 2010	30 June 2009
		(Unaudited)	(Unaudited)
	Note	**RMB'000**	RMB'000
Rental expenses	(i)	**2,298**	2,085

Note:

(i) The amount represented rental expenses payable to Mr. Zhang Gang and Mr. Chen Hongkai (directors of the Company), and Ms. Kou Zhifang (an officer of the Group) for leasing five (30 June 2009: five) office buildings and restaurants which are classified as ongoing connected transactions in accordance with Hong Kong Listing Rules. The amounts of the rental expenses were agreed by the parties by reference to market rentals.

23. BUSINESS COMBINATIONS

(i) Acquisition of restaurants

On 1 May 2010 the Group entered into various sale and purchase agreements to acquire 100% equity interests in six hot pot restaurants from various independent PRC citizens for an aggregate cash consideration of RMB47,400,000, which generated goodwill of RMB38,278,000. The cash consideration was paid in full in the current period.

The aggregate fair values of the identifiable assets and liabilities acquired by the Group during the period were:

	Recognised on acquisition RMB'000	**Carrying value** RMB'000
Property, plant and equipment	7,208	7,261
Trade receivables	23	23
Inventories	1,754	1,754
Prepayments, deposits and other receivables	2,435	2,435
Cash and cash equivalents	900	900
Trade payables	(1,742)	(1,742)
Customers' deposits, other payables and accruals	(1,456)	(1,456)
Fair value of net assets acquired by the Group	9,122	9,175
Goodwill on acquisition	38,278	
Consideration	47,400	

The net cash outflow in respect of the acquisition is as follows:

	RMB'000
Net cash and cash equivalents acquired	900
Cash paid	(47,400)
Net cash outflow in respect of acquisition of branches	(46,500)

23. BUSINESS COMBINATIONS *(continued)*

(ii) Acquisition of a herding subsidiary

On 22 April 2010, the Group acquired a 100% equity interest in Sheep King Herding Co., Ltd. from a manager of the Group and an independent PRC citizen for a cash consideration of RMB500,000 which generated an excess over the cost of business combination recognised in the income statement of RMB257,000 on this acquisition.

The fair values of the identifiable assets and liabilities acquired by the Group during the period were:

	Recognised on acquisition	**Carrying value**
	RMB'000	RMB'000
Property, plant and equipment	1,277	1,029
Trade receivables	36	36
Livestocks	90	90
Cash and cash equivalents	160	160
Customers' deposits, other payables and accruals	(806)	(806)
Fair value of net assets acquired by the Group	757	509
Excess over the cost of a business combination recognised in the income statement (note 4)	(257)	
Consideration	500	

The net cash outflow in respect of the acquisition is as follows:

	RMB'000
Net cash and cash equivalents acquired	160
Cash paid	(500)
Net cash outflow in respect of acquisition of a subsidiary	(340)

23. BUSINESS COMBINATIONS *(continued)*

(ii) Acquisition of a herding subsidiary *(continued)*

Since these acquisitions, the above restaurants and the herding subsidiary contributed in aggregate approximately RMB6,963,000 to the Group's revenue and a net gain of approximately RMB384,000 to the Group's net profit for the six months ended 30 June 2010.

The Group considers the most important factors to decide the purchase consideration are customer flow and favorable locations, which are not recognized as intangible assets at respective acquisition dates because they cannot be measured reliably.

Due to the fact that the Group is unable to obtain the pre-acquisition results of these franchised restaurants and the herding subsidiary from the vendors, it is impractical to disclose such information as required under paragraph 70 of IFRS 3 Business Combination.

24. DISPOSAL OF SUBSIDIARIES

In May and June 2010, the Group disposed of its 90% equity interest in a restaurant and its 95% equity interest in another restaurant to two independent PRC citizens respectively, for an aggregate consideration in the form of cash of RMB185,000 which was received in the current period.

	RMB'000
Net assets disposed of:	
Property, plant and equipment	1,320
Cash and bank balances	41
Inventories	89
Prepayments and other receivables	201
Trade payables	(10)
Accruals and other payables	(6,114)
Non-controlling interests	320
	(4,153)
Gain on disposal of subsidiaries (note 4)	4,338
	185
Satisfied by:	
Cash	185

An analysis of the net inflow of cash and cash equivalents in respect of the disposal of subsidiaries is as follows:

	RMB'000
Cash consideration	185
Cash and bank balances disposed of	(41)
Net inflow of cash and cash equivalents in respect of the disposal of subsidiaries	144

25. EVENT AFTER THE BALANCE SHEET DATE

The Group did not have any significant events taken place subsequent to 30 June 2010.

26. APPROVAL OF THE FINANCIAL STATEMENTS

The interim condensed consolidated financial statements were approved and authorised for issue by the board of directors on 25 August 2010.

Other Information

CODE ON CORPORATE GOVERNANCE PRACTICES

During the six months ended 30 June 2010, the Company had complied with all applicable code provisions of the Code on Corporate Governance Practices as set out in Appendix 14 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules").

MODEL CODE FOR SECURITIES TRANSACTIONS

The Company has adopted the Model Code as set out in Appendix 10 to the Listing Rules as its own code of conduct of dealings in securities of the Company by the directors of the Company ("Directors"). Based on specific enquiry with the Directors, all Directors have confirmed that they complied with the required standards set out in the Model Code during the six months ended 30 June 2010.

AUDIT COMMITTEE

The Audit Committee of the Board has reviewed together with the management the accounting principles and practices adopted by the Group and discussed the internal control and financial reporting matters. The interim results for the six months ended 30 June 2010 are unaudited, but have been reviewed by Ernst & Young in accordance with Hong Kong Standard on Review Engagements 2410 *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*, issued by the Hong Kong Institute of Certified Public Accountants. The interim results for the six months ended 30 June 2010 have been reviewed by the Audit Committee of the Board.

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

During the six months ended 30 June 2010, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the listed securities of the Company.

DIRECTORS' INTERESTS IN SECURITIES

As at 30 June 2010, the interests and short positions of the Directors in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) as recorded in the register maintained by the Company under section 352 of the SFO or as notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transaction by Directors of Listed Issuers ("Model code") were as below:

	Capacity/nature of interest	Total number of shares/underlying shares held	Total	Approximate percentage of shareholding
The Company				
Name of Director				
Zhang Gang	Interest of controlled corporation	3,091,000		
	Personal interest	21,810,626	24,901,626[(1)]	2.42%
Chen Hongkai	Personal interest	8,819,122		
	Founder of a discretionary trust	234,103	9,053,225[(2)]	0.88%
Lu Wenbing	Personal interest	6,531,944[(3)]		0.64%
Zhang Zhanhai	Personal interest	2,033,343		0.20%
Wang Daizong	Personal interest	1,509,992[(4)]		0.15%
Li Baofang	Personal interest	6,047,321[(5)]		0.59%

Notes:

(1) The interest comprises (a) interest in 3,091,000 shares in the Company ("Share") held by Beefup Group Limited, a company controlled by Mr. Zhang Gang; and (b) interest in 21,810,626 Shares owned by Mr. Zhang.

(2) The interest comprises (a) interest in 8,519,122 Shares owned by Mr. Chen Hongkai; (b) interest in 234,103 Shares held by Palace Glory Investment Limited, a company owned by the trustee of a trust established by Mr. Chen for the benefit of his family; and (c) interest in 300,000 underlying shares in respect of the share options granted to Mr. Chen pursuant to the Pre-IPO Share Option Scheme. Details of the share options granted to the Directors are set out in the section headed "Share Option Schemes" below.

(3) The interest comprises (a) interest in 4,044,264 Shares owned by Mr. Lu Wenbing; and (b) interest in 2,487,680 underlying shares in respect of the share options granted to Mr. Lu pursuant to the Pre-IPO Share Option Scheme.

(4) The interest comprises (a) interest in 1,359,992 Shares owned by Mr. Wang Daizong; and (b) interest in 150,000 underlying shares in respect of the share options granted to Mr. Wang pursuant to the Pre-IPO Share Option Scheme.

(5) The interest comprises (a) interest in 5,317,321 Shares owned by Ms. Li Baofang; and (b) interest in 730,000 underlying shares in respect of the share options granted to Ms. Li pursuant to the Pre-IPO Share Option Scheme.

SUBSTANTIAL SHAREHOLDERS' INTERESTS IN SECURITIES

As at 30 June 2010, the interests and short positions of every person, other than Directors or chief executive of the Company, in the shares and underlying shares of the Company, being 5% or more of the Company's issued share capital, as recorded in the register maintained and kept by the Company under section 336 of the SFO were as below:

Name	Capacity	Number of Shares	Approximate percentage to the Company's issued share capital
Possible Way International Limited ("Possible Way")	Beneficial Owner	308,301,875	29.98%
	Interest of a party to an agreement to acquire shares	280,571,030[(1)]	27.28%
Yum! Brands, Inc. ("Yum")	Interest of controlled corporation	280,571,030[(2)]	27.28%
	Interest of a party to an agreement to acquire shares	308,301,875[(3)]	29.98%
FMR LLC	Interest of controlled corporations	63,048,000[(4)]	6.13%

Notes:

1. Possible Way was taken to be interested in the 280,571,030 Shares held by Wandle Investment Ltd. ("Wandle Investment"), an indirect wholly owned subsidiary of Yum, under the SFO as Possible Way and Wandle Investment had entered into an agreement to acquire shares to which sections 317(1)(a) and 318 of the SFO applied.

2. The 280,571,070 Shares were held by Wandle Investment, an indirect wholly owned subsidiary of Yum. Accordingly, Yum was taken to be interested in such 280,571,030 Shares under the SFO.

3. Yum was taken to be interested in the 308,301,875 Shares held by Possible Way under the SFO as Wandle Investment and Possible Way had entered into an agreement to acquire shares to which sections 317(1)(a) and 318 of the SFO applied.

4. The 63,048,000 Shares were indirectly held by Fidelity Management & Research Company as to 58,398,000 Shares and Fidelity Management Trust Company, Pyramis Global Advisors LLC as to 4,650,000 Shares. Each of Fidelity Management & Research Company and Fidelity Management Trust Company, Pyramis Global Advisors LLC is controlled by FMR LLC.

All of the above interests in the Company held by Possible Way, Yum and FMR LLC were long positions.

Other Information (continued)

SHARE OPTION SCHEMES

(1) Pre-IPO Share Option Scheme

Pursuant to the Pre-IPO Share Option Scheme adopted on 20 December 2007, the Company has granted certain options to eligible directors, senior management and employees of the Group to subscribe for ordinary shares in the Company subject to the terms and conditions stipulated under the Pre-IPO Share Option Scheme. The Pre-IPO Share Option Scheme will remain in force for a period of 10 years from the adoption date. During the period from 1 January 2010 to 30 June 2010, 3,070,100 and 828,000 share options had been exercised and cancelled respectively. Details of the share options outstanding as at 30 June 2010 which had been granted under the Pre-IPO Share Option Scheme are as follows:

Name of Grantees	Options outstanding at 1 January 2010	Options granted during the period	Options exercised during the period	Options lapsed on expiry	Options cancelled upon termination of employment	Options outstanding at 30 June 2010
Directors of the Company						
Chen Hongkai	300,000	—	—	—	—	300,000
Lu Wenbing	2,487,680	—	—	—	—	2,487,680
Wang Daizong	150,000	—	—	—	—	150,000
Li Baofang	730,000	—	—	—	—	730,000
Directors of subsidiaries						
Li Lichen	100,000	—	25,000	—	—	75,000
Hu Guili	50,000	—	—	—	—	50,000
Guo Lili	50,000	—	—	—	—	50,000
Wang Yuzhu	50,000	—	—	—	—	50,000
Xu Zhonggang	50,000	—	—	—	—	50,000
Li Jianbo	50,000	—	—	—	—	50,000
Li Chunmei	50,000	—	12,000	—	—	38,000
Xie Lixia	50,000	—	—	—	—	50,000
Zhang Xiuping	400,000	—	100,000	—	—	300,000
Other employees	20,524,200	—	2,933,100	—	828,000	16,763,100
	25,041,880	—	3,070,100	—	828,000	21,143,780

Notes:

(1) All options under the Pre-IPO Option Scheme were granted on 28 December 2007 with an exercise price of HK$2.11 per share.

(2) All holders of options granted under the Pre-IPO Share Option Scheme may only exercise their options in the following manner:

Maximum percentage of options exercisable	Period for vesting of the relevant percentage of the option
10% of the total number of the options to any grantee	From the grant date of the options to expiry of the 12-month period after the grant date of the options or of the 6-month period after the date of the initial public offering of the Company (i.e. 12 June 2008), whichever is later
15% of the total number of the options to any grantee	From the grant date of the options to expiry of 24-month period after the grant date of the options
30% of the total number of the options to any grantee	From the grant date of the options to expiry of 36-month period after the grant date of the options
45% of the total number of the options to any grantee	From the grant date of the options to expiry of 48-month period after the grant date of the options

(2) Share Option Scheme

Pursuant to the Share Option Scheme adopted by the Company on 15 May 2008, the Directors may invite participants to take up options at a price determined by the board of Directors provided that it shall be at least the highest of (a) the closing price of the shares as stated in the Stock Exchange's daily quotations sheet on the date on which an offer is made by our Company to the grantee (which date must be a business day, "Offer Date"); (b) a price being the average of the closing prices of the shares of the Company as stated in the Stock Exchange's daily quotations sheets for the 5 business days immediately preceding the Offer Date (provided that the Offer Price shall be used as the closing price for any business day falling within the period before listing of the shares of the Company where our Company has been listed for less than five business days as at the Offer Date); and (c) the nominal value of a share of the Company.

The option may be exercised in accordance with the terms of the Share Option Scheme at any time during the option period which may be determined and notified by the board of Directors to the grantee at the time of making an offer which shall not expire later than 10 years from the grant date. As at the date of this report, no options have been granted or agreed to be granted pursuant to the Share Option Scheme.

Other Information (continued)

PUBLICATION OF INTERIM REPORT

The electronic version of this interim report is published on the website of the Stock Exchange (http://www.hkexnews.hk) and on the Company's website (http://www.littlesheep.com).

By order of the Board
Little Sheep Group Limited
Zhang Gang
Chairman

Hong Kong, 25 August 2010

This interim report contains forward-looking statements and information relating to us and our operations and prospects that are based on current beliefs and assumptions as well as information currently available to us. The words "anticipate", "believe", "estimate", "expect", "plans", "prospects", "going forward" and similar expressions, as they relate to us or our business, are intended to identify forward-looking statements. Such statements reflect our current views with respect to future events and are subject to risks, uncertainties and various assumptions.

Should one or more of these risks or uncertainties materialize, or should any of the underlying assumptions prove incorrect, actual results may diverge significantly from the forward-looking statement. We do not intend to update these forward-looking statements other than our on-going disclosure obligations pursuant to the Listing Rules or other requirements of the Stock Exchange.