

**U.S. Securities and Exchange Commission**  
 Washington, D.C. 20549  
**Form 10-K/A**  
 (Amendment No. 1)

**ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934** for the fiscal year ended December 31, 2005

**TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

*Commission File Number: 0-27351*

**American Dairy, Inc.**  
 (Exact name of registrant as specified in its charter)

Utah  
 (State or other jurisdiction of Incorporation or organization)

87-0445575  
 (I.R.S. Employer Identification No.)

C-16 Shin Chen International Building  
 No. 10, Jiu-shen Road, Zho Yan Chu, Beijing  
 The People's Republic of China

(Address of principal executive offices)

Registrant's telephone number, including area code: 011-0452-4312688

Securities registered under Section 12(b) of the Exchange Act:

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Common Stock	NYSE Archipelago Exchange (ArcaEx)

Securities registered under Section 12(g) of the Exchange Act:

N/A  
 (Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.  Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed pursuant to Section 13 or Section 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  Yes  No

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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):  
 Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).  Yes  No

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter closing price: \$29,020,324.

**APPLICABLE ONLY TO REGISTRANTS INVOLVED IN BANKRUPTCY  
 PROCEEDINGS DURING THE PRECEDING FIVE YEARS:**

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15 (d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.  Yes  No

(APPLICABLE ONLY TO CORPORATE REGISTRANTS)

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date: the number of shares of the registrant's common stock outstanding as of March 29, 2006 was 14,132,824 shares.

**DOCUMENTS INCORPORATED BY REFERENCE**

None

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**EXPLANATORY NOTE**

American Dairy, Inc. is filing this Form 10-K/A to amend certain sections of its Form 10-K for the year ended December 31, 2005. We originally filed our Form 10-K for the year ended December 31, 2005 (the "Original Filing") on March 31, 2006. Subsequent to that date, we have received comments from the Securities and Exchange Commission to the Original Filing, as well as to our Quarterly Reports on Form 10-Q for the three months ended March 31, 2006 and September 30, 2005. We have filed amendments to these reports as well. We are amending the Original Filing solely to comply with the Securities and Exchange Commission's comments only in the financial statement, notes thereto, Part I, Item 1., Business, and Item 1A, Risk Factors, Part II, Item 7., Management's Discussion and Analysis, and Item 9A., Disclosure Controls and Procedures and the management certificates appearing as Exhibits 31.1, 31.2 and 32 to this amendment. This Form 10-K/A does not otherwise amend the Original Filing.

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**PART I****Item 1. Business.****General**

American Dairy, Inc. was incorporated under the corporate laws of the State of Utah on December 31, 1985, originally with the corporate name of Gaslight, Inc. It was inactive until March 30, 1988 when it changed its corporate name to Lazarus Industries, Inc. and engaged in the business of manufacturing and marketing medical devices. This line of business was discontinued in 1991, and it became a non-operating public company shell.

Effective May 7, 2003, American Dairy completed the acquisition of 100% of the issued and outstanding capital stock of American Flying Crane Corporation (formerly called American Dairy Holdings, Inc.) ("AFC"), a Delaware corporation. As a result, AFC became a wholly-owned subsidiary of American Dairy. In addition, American Dairy amended its Articles of Incorporation to change its name to "American Dairy, Inc." and completed a one-for-nineteen (1-for-19) reverse split of its Common Stock. For financial reporting purposes, this transaction was treated as a recapitalization of AFC and the historical figures prior to May 7, 2003 represent the activities of AFC. AFC is engaged in the business of processing and wholesale sale of milk powder and other related products.

AFC holds 100% of the issued and outstanding capital of Heilongjiang Feihe Dairy Co., Limited ("Feihe Dairy") in The People's Republic of China. The principal activity of Feihe Dairy is the production and distribution of milk powder and other dairy products. Feihe Dairy has three subsidiaries, BaiQuan Feihe Dairy Co., Limited (of which it owns 100% of the registered capital and which is engaged in the production and supply of processed milk and soybean products for Feihe Dairy), Beijing Feihe Biotechnology Scientific and Commercial Co., Limited (of which it owns 95% of the registered capital, the other 5% being held in a trust for American Dairy, and which is the marketing company for Feihe Dairy) and Shanxi Feihesantai Biotechnology Scientific and Commercial Co., Limited ("Shanxi") (of which it owns 60% of the registered capital and which was originally formed to develop and operate a walnut processing plant).

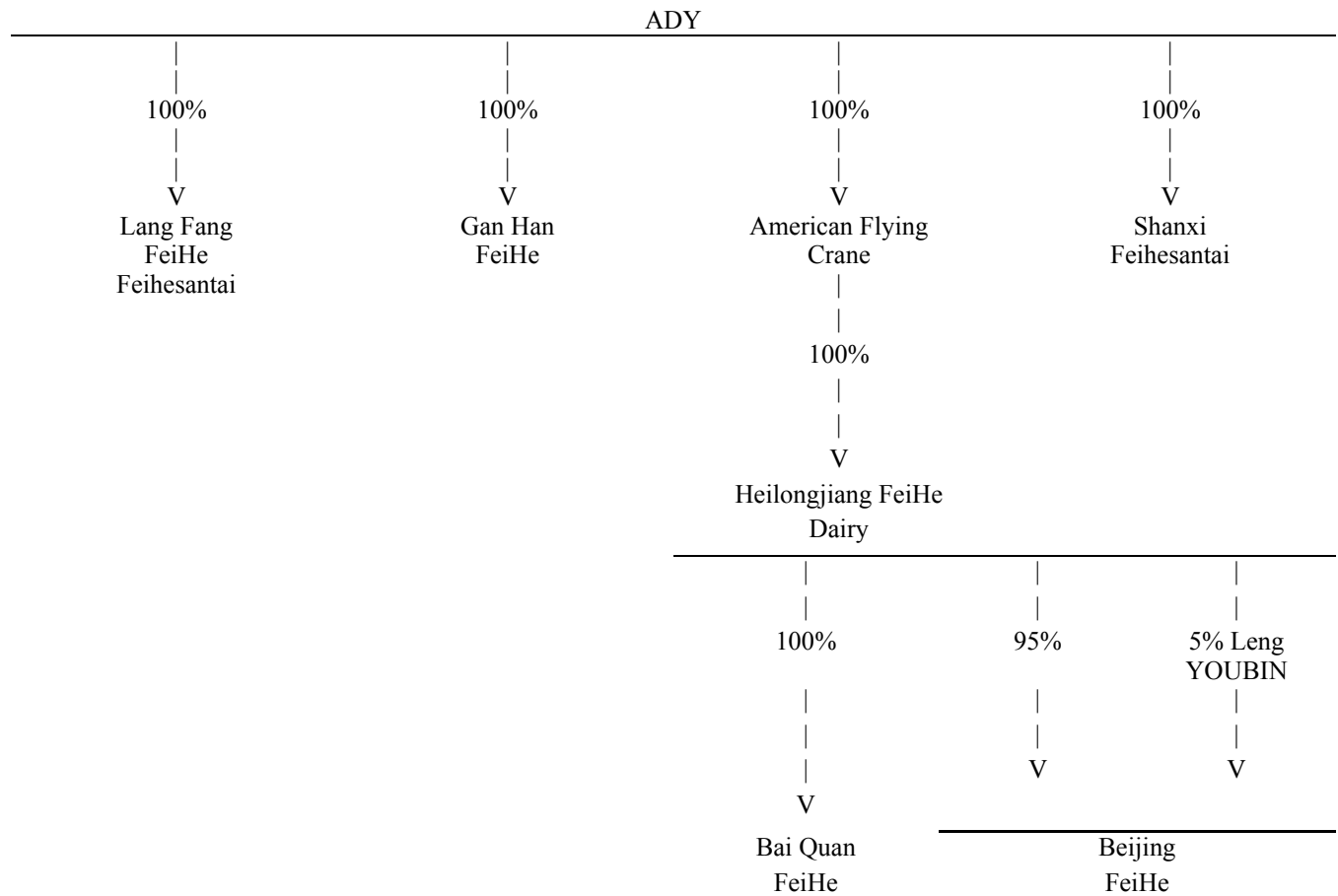
American Dairy purchased all of the outstanding capital stock of AFC from its stockholders in exchange for 9,650,000 restricted shares (post-split) of the common stock of American Dairy. In addition to the shares issued as consideration for the merger, at the time of the closing, AFC paid a dividend in the approximate amount of \$860,000 to its sole shareholder as an

adjustment for the significant increase in value in AFC which occurred between the signing of the agreement and the closing. Pursuant to the written consent of the stockholders holding approximately 66% of the outstanding common stock of American Dairy, the stockholders approved:

1. an amendment to the Articles of Incorporation of American Dairy to change its corporate name to "American Dairy, Inc.";
2. a one-for-nineteen (1-for-19) reverse split of the Common Stock of American Dairy; and
3. the establishment of its 2003 Stock Incentive Plan covering 3,000,000 shares of Common Stock for its key employees, including officers, employees, directors and consultants.

**Current Corporate Structure**

The following chart reflects the current corporate structure of the American Dairy entities:



**Heilongjiang Feihe Dairy Co., Limited and Subsidiaries**

Heilongjiang Feihe Dairy Co., Limited ("Feihe Dairy") and its subsidiaries are companies organized under the laws of The People's Republic of China. The history of Feihe Dairy commenced in 1962 when its predecessor, Heilongjiang Zhaoguang Hongguang Dairy Plants ("Hongguang Dairy Plant") was established as a wholly - owned State Enterprise, whose principal activities were the production and distribution of powdered milk in China. The Hongguang Dairy Plant was located at Zhaoguang Livestock Farm of Zhaoguang Agro-Cultivated Bureau, its production capability was five tons a day and its main sales territory was Shangdong Province.

In 1982, Heilongjiang Zhaoguang Dairy Plants ("Zhaoguang Dairy"), another State Enterprise, was established at Zhaoguang Plantation near BeiAn City. In 1984, Hongguang Dairy Plants and Zhaoguang Dairy were merged into Heilongjiang Zhaoguang Dairy Plants. The State continued to retain ownership of the merged Heilongjiang Zhaoguang Dairy Plants.

In 1997, the merged Heilongjiang Zhaoguang Dairy Plants was further reorganized and its name changed to Heilongjiang Feihe Dairy Group Limited. In February 2000, Heilongjiang Feihe Dairy Group Limited completed its registered capital restructuring to become a private company with registered capital of \$894,226.

In March 2001, the restructured Heilongjiang Feihe Dairy Group Limited changed its name to its present name of Heilongjiang Feihe Dairy Co., Limited and acquired all of the fixed assets (including land use rights, plant and equipment and factory buildings) of Kedong Gongmu Dairy Plants. Heilongjiang Sanhao Dairy Co., Limited ("Sanhao Dairy") was incorporated on March 28, 2001 with registered capital of \$433,110. Feihe Dairy owned 99% of Sanhao Dairy and Fu Man Guo held the remaining 1% in trust for Feihe Dairy. Under a Sale and Purchase Agreement dated February 6, 2001 between Feihe Dairy and Kedong County Economic Committee, Feihe Dairy agreed to acquire all the fixed assets including land use rights from Kedong Gongmu Dairy Plants at a consideration of \$364,269. Following the incorporation of Sanhao Dairy, Feihe Dairy, as its contribution towards the registered capital, injected all the fixed assets from Kedong Gongmu Dairy Plants, except for its land uses rights to 47,640 square meters of land, into Sanhao Dairy, plus cash of \$68,841.

In August 2001, Feihe Dairy's new production facilities in Kedong County commenced production of milk powder.

During 2004, American Dairy merged Sanhao Dairy into BaiQuan Feihe Dairy Co., Limited and consolidated their operations.

During April 2004, American Dairy established a 60% owned subsidiary called Shanxi Feihesantai Biotechnology Scientific and Commercial Co., Limited ("Shanxi Feihesantai"), a limited liability company registered in Shanxi Province in The People's Republic of China. The remaining 40% owner of Shanxi Feihesantai is Licheng Shantia Technology Enterprises Limited, an unaffiliated company. The business of Shanxi Feihesantai is the production and distribution of walnut power and other walnut products.

During June 2005, American Dairy purchased a milk powder processing facility from Nutricia Nutritionals Co. of Heilongjiang Province for \$7,300,000 and its inventory for \$130,000. American Dairy also has acquired 19 milk collection stations in this transaction.

### **Principal Products**

Our products fall into three main product categories, milk powder, soybean powder and walnut products.

#### **Milk Powder**

This is our primary product and itself is divided into several sub-categories. We produce milk powder for babies and young children formulated for 0 to six months, six months to one year, one to three years and three to five years of age. We also produce milk powder for students and for the middle aged and elderly population.

#### **Soybean Powder**

Soybean Powder is an auxiliary product to our milk powders and represents a low fat, high calcium alternative to cow's milk, particularly for seniors.

#### **Walnut Powder and Other Products**

We produce other auxiliary products which we market in conjunction with our baby milk powder as well as to health-conscious adults. These products include walnut powder, walnut dew, walnut oil and rice powder/rice cereal.

#### **Sources of Milk**

Under supply arrangements with numerous small dairy farmers who have cattle grazing rights and use rights to approximately 514,640 acres of land in Kedong County in northeastern China, American Dairy has been able to receive supplies of raw milk without having to make capital investments in farms and cattle. Approximately 27% of this acreage is arable pasture land, and approximately 30% is planted with beans and corn. Historically, the milk industry in China has been very fragmented and segmented with most production being generated by farmers owning and milking one to ten cows.

### **Milk Processing Facilities**

American Dairy has the following principal operating milk powder production and packaging plants:

#### **Kedong I (Sanhao Dairy)**

Located in Kedong County in the City of QiQiHaEr, in Heilongjiang Province, China, American Dairy acquired this plant in March 2001 for \$461,632. The land is approximately 47,640 square meters. The plant buildings have approximately 4,500 square meters of production space and 720 square meters of office space. The plant is approximately 14 years old. Sanhao Dairy has approximately 236 production and packaging employees at this plant and has a capacity of 50 tons per day.

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#### **BaiQuan Feihe Dairy**

American Dairy acquired this plant in January 2003 for \$700,483. Additional land was subsequently acquired for \$293,450 in March 2004. The land is approximately 40,000 square meters. The plant building has approximately 5,458 square meters of production space and 800 square meters of office space, and is approximately 15 years old. BaiQuan Dairy has approximately 62 production and packaging employees and has a capacity of 100 tons per day.

#### **Kedong II**

American Dairy began building a new milk powder processing plant during 2004 in close proximity to its Sanhao Dairy plant in Kedong County. We acquired the land use rights to this location for \$400,966 and entered into a construction contract to build the new plant for approximately \$4,200,000 (Rmb. 34,866,000). We incurred construction costs and ordered new milk powder processing machines and equipment from suppliers at a cost of \$10,757,620 through December 31, 2005. This new plant was completed in December 2005 and has a capacity of 300 tons per day.

#### **Numico**

During 2005, American Dairy entered into an Asset Purchase Agreement with Nutricia Nutritionals Co., Ltd. of Heilongjiang ("Nutritionals") in China. Nutritionals is a wholly-owned subsidiary of Royal Numico N.V., a public limited liability company organized in the Netherlands. Pursuant to the Agreement, Feihe Dairy acquired substantially all of the assets of Nutritionals for \$7,300,000 and its inventory for \$130,000. The assets are comprised primarily of the land use rights and buildings of Nutritionals' milk powder plant in Heilongjiang Province in the PRC and all of its milk powder processing equipment at its plant. The Company also acquired approximately 19 milk collection stations for the collection of raw milk to supply the processing plant. This milk powder plant is capable of processing approximately 8,100 tons of raw milk per month into approximately 1,620 tons of milk powder per month. The milk powder plant in Heilongjiang Province which Feihe Dairy acquired from Nutricia Nutritionals Co., Ltd. in 2005 has a capacity of 270 tons per day. The acquisition increased the production capacity of American Dairy's milk powder operations by approximately 60%.

The combined capacity of all of these plants is 720 tons per day.

The existing production facilities of American Dairy employ approximately 578 total production personnel.

All aspects of production of American Dairy's products are based on traditional practices designed to yield premium quality, wholesome and superior tasting foods. Because of the consistent quality of the milk powder products of American Dairy, it was awarded an ISO9002 quality Assurance Certificate in October 2000. In accordance with the requirements of ISO9002, American Dairy established a "Quality Assurance Handbook" that provides standardized requirements and procedures regarding the purchase of raw milk, its milk processing systems, storage and packaging standards, the distribution of its products, and employee training.

## Milk Processing

American Dairy believes that through purchasing raw milk locally and employing minimal processing techniques, it is able to preserve the fresh taste of milk. American Dairy's dairy processes raw milk within 24 to 36 hours after milking. Most large regional dairies, it believes, process raw milk which may be three to four days old. Milk processed by conventional farms for sale to regional dairies is typically stored at the farm for a minimum of two days, commonly spends a full day in transit to the dairy facility, and is only processed the following day. American Dairy's milk is not homogenized. During homogenization, pressurized milk is forced through openings smaller than the size of the fat globules present in milk, breaking them into smaller particles. Thus treated, the milk fat remains suspended and does not separate out in the form of cream. American Dairy believes that this process adversely affects the taste and feel of milk. In addition, American Dairy's milk is pasteurized at the lowest temperatures allowed by law to avoid imparting a cooked flavor to the milk. When the milk is clarified and the butterfat removed to yield cream and skim milk, a process of cold separation is used, rather than the more commonly employed hot separation which it believes adversely affects the favor of the milk.

## Dairy Product Processing

American Dairy's products are made in small batches using minimal processing techniques to maintain freshness and allow maximum flavor and nutrition retention. They are made with wholesome ingredients. No chemicals or additives are employed. Because they are produced locally, our dairy products arrive to consumers in American Dairy's marketing area sooner after production than most other dairy products. To assure product quality, the beginning of each production run is sampled for flavor, aroma, texture and appearance. In addition, inspectors conduct spot-checks for bacteria and butterfat content in its products, as well as sanitary conditions in its facilities. Product Sales

## Walnut Powder Operations

During April 2004, American Dairy established a 60% owned subsidiary called Shanxi Feihesantai Biotechnology Scientific and Commercial Co., Limited, a limited liability company registered in Shanxi Province in The People's Republic of China. The other 40% of Shanxi Feihesantai is owned by Licheng Shantia Technology Enterprises Limited, an unaffiliated company. The business of Shanxi Feihesantai is the production and distribution of walnut powder and other walnut products. Shanxi Feihesantai was organized with \$402,174 in registered capital. This plant was completed and began operations during October 2005.

## Product Sales

The following table reflects the sales of the five principal products of American Dairy during the fiscal year ended December 31, 2005:

Product name	2005			2004		
	Quantity		%	Quantity		%
	(Kg)	Amount	of sales	(Kg)	Amount	of sale
Ca+Zn series(1)	4,722,624	\$13,348,008	19%	4,719,669	\$12,682,053	34%
CPP series(1)	4,503,308	\$24,700,822	35%	2,398,579	\$12,609,205	34%
Soybean series(2)	1,781,052	\$ 3,065,612	16%	2,199,445	\$ 5,570,911	15%
Nucleotides series(1)	1,094,676	\$11,017,136	10%	219,153	\$ 2,418,618	6%
Rice cereal series(3)	2,664,230	\$ 7,319,683	4%	*	\$ *	

(1) Milk powder product

(2) Soybean powder products

(3) Rice products

## Product Distribution

Currently, FeiHe's products are sold in stores nationwide in China except in Hong Kong SAR, Macau SAR and Taiwan. The

company has a distribution team working out of its headquarters and coordinating a network of over 300 dealers or representatives in key provinces across China. The dealers, in turn, each hire one or two secondary agents who assist in the distribution process, including inventory management, product sales and service and payments. Dealer agents display and sell our products in specially designated areas in stores.

Generally, product is delivered only after receipt of payment from the dealer. Dealers have new agreements each year which specify sales targets and territories among other provisions. The Company seeks to expand the number of key provinces served by its dealer network as part of its growth strategy and ultimately to establish a distribution system based upon local production at local dairies. American Dairy distributed its products to over 25 provinces in China during 2005. No province exceeded 10% of sales.

### **Customers**

No customers of American Dairy equaled or exceeded 10% of its sales during the years ended December 31, 2005, 2004 or 2003, except that one customer, Heilongjiang Changxin Dairy, represented approximately 15% of sales during 2005.

### **Research and Development**

American Dairy has six technicians engaged in research and development activities. These technicians monitor quality control at the milk processing plants of American Dairy to ensure that the processing, packaging and distribution of the milk products result in high quality premium milk products that are safe and healthy for our customers. These technicians also pursue methods and techniques to improve the taste and quality of our milk products and to evaluate new milk products for further production based upon changes in consumer tastes, trends and the introduction of competitive products by other milk producers. During the fiscal years ended December 31, 2003, 2004 and 2005 we spent less than \$10,000 per year on research and development and all of such amount was paid in compensation to our six quality control technicians described above.

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### **Growth Strategy**

The market for dairy products in China is growing rapidly. Our growth strategy involves capturing as much of this market as possible while it is in this rapid growth phase. This includes plans to acquire additional grazing rights and collection stations to secure our supply of raw milk and to acquire or construct additional processing and distribution facilities. We believe that our milk powder products enjoy a reputation for high quality among those familiar with them. We believe that this reputation has spread principally by word-of-mouth and also as a result of favorable press coverage. We have also increased our marketing efforts through national television. Pursuant to our marketing plan, we will seek to build upon our products' reputation and create strong brand identities, making our products more widely recognizable.

We will seek to extend the distribution of our products to contiguous markets with high population concentrations. If we can successfully implement our growth strategy, we will also seek to enter other markets through joint ventures, licensing or other arrangements with local dairy farms which we believe would benefit significantly from selling their raw milk to newly established local dairies that will produce and sell American Dairy brand milk powder products and soybean products in their local markets. The key elements of American Dairy's growth strategy to reach its goal, include:

\* emphasizing local production and distribution of our products, beginning with purchasing raw milk from local farmers, resulting in premium quality milk powder products.

\* increasing regional and national television advertising to better establish the "Feihe" brand name and increase the scope of our market area.

### **Brand Development and Marketing**

American Dairy's marketing will emphasize the local production and national distribution of our products, which begins with local dairy herds and results in premium quality products to a national market. We believe that American Dairy's story adds legitimacy to our marketing claim that we produce farm fresh products and helps to instill confidence in consumers as to the purity and wholesomeness of our products.

We also seek to convey this story through the packaging we use for our products. Our products have also received marketing benefits from a considerable volume of favorable press and other publications of mass circulation which has rated our products highly.

American Dairy's marketing and promotional efforts will continue to include:

- \* Redesigning packaging of non-fluid products to promote a premium quality image.
- \* Refining and targeting our message, which to date has largely been the product of word-of-mouth and product reviews.
- \* Developing trade material, including four-color trade sell sheets and brochures.
- \* Further distinguishing our products from other dairy products.
- \* Expanding retail advertising, including print advertising, televised advertising and focused public relations.

American Dairy incurred advertising costs of \$3,380,218 during fiscal 2005, and incurred advertising costs of \$2,742,257 during fiscal 2004.

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### **Soy Bean and Rice Cereal**

American Dairy also produces soy bean powder and rice cereal which comprised 16% and 4% respectively of sales during the fiscal year ended December 31, 2005.

### **Competition**

The food and beverage business is highly competitive and, therefore, American Dairy faces substantial competition in connection with the marketing and sale of our milk powder products and soybean products. Our products are positioned as premium products and, accordingly, are generally priced higher than certain similar competitive products. We believe that the principal competitive factors in marketing our products are quality, taste, freshness, price and product recognition. While we believe that we compete favorably in terms of quality, taste and freshness, our products are more expensive and less well known than certain other established brands. Our premium products may also be considered in competition with non-premium quality dairy products for discretionary food dollars.

### **Government Regulation**

American Dairy is regulated under national and county laws in China. The following information summarizes certain aspects of those regulations applicable to American Dairy and is qualified in its entirety by reference to all particular statutory or regulatory provisions.

Regulations at the national, province and county levels are subject to change. To date, compliance with governmental regulations has not had a material impact on American Dairy's level of capital expenditures, earnings or competitive position, but, because of the evolving nature of such regulations, management is unable to predict the impact such regulation may have in the foreseeable future.

As a manufacturer and distributor of food products, American Dairy is subject to regulations of China's Agricultural Ministry. This regulatory scheme governs the manufacture (including composition and ingredients), labeling, packaging and safety of food. It also regulates manufacturing practices, including quality assurance programs, for foods through its current good manufacturing practices regulations, and specifies the standards of identity for certain foods, including the products sold by American Dairy, and prescribes the format and content of many of the products sold by American Dairy, prescribes the format and content of certain nutrition information required to appear on food products labels and approves and regulates claims of health benefits of food products.

In addition, China's Agricultural Ministry authorizes regulatory activity necessary to prevent the introduction, transmission or spread of communicable diseases. These regulations require, for example, pasteurization of milk and milk products.

American Dairy and its products are also subject to province and county regulations through such measures as the licensing of dairy manufacturing facilities, enforcement of standards for its products, inspection of its facilities and regulation of its trade practices in connection with the sale of dairy products.

### **Employees**

As of September 1, 2006, we have approximately 10,000 employees on our payroll. Of these, eight are group administrators, approximately 8,250 are in marketing, approximately 24 provide marketing support, approximately 82 work in our Nutrition Department as consultants and managers, approximately 18 perform administrative functions, including financing, auditing and human resources and approximately 750 are in production, storage and distribution.

### **Borrowing Policies**

American Dairy may borrow at competitive rates of interest. Borrowed funds will not be used for dividends to the shareholders.

The precise amount, if any, borrowed by American Dairy will depend in part upon the availability of financing, and prevailing interest rates and other loan costs. Such financing, if any, may be unavailable to American Dairy in the amounts desired or on terms considered reasonable by the Board of Directors.

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Loan agreements may require that American Dairy maintain certain reserves or compensating balances and may impose other obligations on American Dairy. Moreover, since a significant proportion of American Dairy's revenues may be reserved for repayment of debt, the use of financing may reduce the cash that might otherwise be available for dividends until the debt has been repaid and may reduce total cash flow for a significant period.

During April 2005, American Dairy issued a Series A Convertible Note for \$3,000,000 that bears interest at 6 1/2 % per annum which is convertible into the common stock of American Dairy at \$8.00 per share, and has a term of one year. From June to August 2005, American Dairy issued two Series B Convertible Notes for the total amount of \$5,000,000 that bear interest at the rate of 7.5% per annum which are convertible into the common stock of American Dairy at \$10.00 per share, and have a term of two years. The proceeds of the notes were applied primarily to acquisitions, including the acquisition of the milk powder plant and inventory from Nutricia Nutritionals Co., Ltd. of Heilongjiang Province.

American Dairy may, under appropriate circumstances, attempt to cause American Dairy to borrow funds at fixed interest rates. However, American Dairy may borrow funds at rates that vary with a "prime" or "base" rate, particularly on an interim basis or when interest rates are believed to be trending downward. A rise in the indexed rate may increase borrowing costs and reduce the amount of its income and cash available for distribution. In past years, the prime rates charged by major banks have fluctuated significantly; as a result, the precise amount of interest that American Dairy might be charged cannot be predicted with any certainty.

### **Item 1A. Risk Factors.**

#### **General**

**We expect to incur costs related to our planned expansion and growth into new plants and ventures which may not prove to be profitable. Moreover, any delays in our expansion plans could cause our profits to decline and jeopardize our business.**

We anticipate that our proposed expansion of our milk processing plants may include the construction of new or additional facilities. American Dairy's cost estimates and projected completion dates for construction of new production facilities may change significantly as the projects progress. In addition, American Dairy's projects will entail significant construction risks, including shortages of materials or skilled labor, unforeseen environmental or engineering problems, weather interferences and unanticipated cost increases, any of which could have a material adverse effect on the projects and could delay their scheduled openings. A delay in scheduled openings will delay American Dairy's receipt of increased sales revenues, which, when coupled with the increased costs and expenses of our expansion, could cause a decline in our profits.

Our plans to finance, develop, and expand American Dairy's milk processing facilities will be subject to the many risks inherent in the rapid expansion of a high growth business enterprise, including unanticipated design, construction, regulatory and operating problems, and the significant risks commonly associated with implementing a marketing strategy in changing and expanding markets. These projects may not become operational within their estimated time frames and budgets as projected at the time American Dairy enters into a particular agreement, or at all. In addition, American Dairy may develop projects as joint ventures in an effort to reduce its financial commitment to individual projects. The significant expenditures required to expand our milk processing plants may not ultimately result in increased profits.

When our future expansion projects become operational, American Dairy will be required to add and train personnel, expand our management information systems and control expenses. If we do not successfully address American Dairy's increased management needs or are otherwise unable to manage our growth effectively, American Dairy's operating results could be materially and adversely affected.

**Our products may not achieve market acceptance.**

We are currently selling our products principally in northern China. Achieving market acceptance for American Dairy's products, particularly in new markets, will require substantial marketing efforts and the expenditure of significant funds. There is substantial risk that any new markets may not accept or be as receptive to our products. Market acceptance of our current and proposed products will depend, in large part, upon our ability to inform potential customer that the distinctive characteristics of our products make them superior to competitive products and justify their pricing. Our current and proposed products may not be accepted by consumers or able to compete effectively against other premium or non-premium dairy products. Lack of market acceptance would limit our revenues and profitability.

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**Changing consumer preferences make demand for our products unpredictable.** As is the case with other companies marketing dairy products, American Dairy is subject to changing consumer preferences and nutritional and health-related concerns. Our business could be affected by certain consumer concerns about dairy products, such as the fat, cholesterol, calorie, sodium, lactose content or contamination of such products. A significant percentage of customers in China are lactose intolerant, and may therefore prefer other beverages. American Dairy could become subject to increased competition from companies whose products or marketing strategies address these consumer concerns more effectively.

Adverse medical research relating to milk and demand for milk could decrease the demand for our products. Periodically, medical and other studies are released and announcements by medical and other groups are made which raise concerns over the healthfulness of cow's milk in the human diet. To date, we do not believe that any such studies have had a material effect on milk consumption rates in China. However, a study may be published or an announcement made concerning the healthfulness of cow's milk which may result in a decrease in demand for dairy products in China.

**Our planned growth may require more raw milk than is available and could diminish the quality of our dairy products.** The supply of raw milk may be insufficient to meet demand which would limit our growth. Moreover, as we attempt to implement our growth strategy, it may become difficult to maintain current levels of quality control. Thus, concerns over quality control could also limit our growth. The raw milk used in our products is supplied to American Dairy by numerous local farms under output contracts. We believe that our farmers can increase their production of raw milk. We further believe, however, that this supply may not be sufficient to meet increased demand for our products associated with our proposed marketing efforts and that such increase may compromise quality. Though we believe that additional raw milk is available locally, if needed, we may not be able to enter into arrangements with the producers of such milk on terms acceptable to American Dairy, if at all. An inadequate supply of raw milk, coupled with concern over quality control, could limit our ability to grow, cause our earnings to decline and make our business less profitable.

**Possible volatility of raw milk costs makes our operating results difficult to predict, and a steep cost of increase could cause our profits to diminish significantly.** The current policy of China since the mid-1990s has focused on moving the industry in a more market-oriented direction. These reforms have resulted in the potential for greater price volatility relative to past periods, as prices are more responsive to the fundamental supply and demand aspects of the market. These changes in China's dairy policy could increase the risk of price volatility in the dairy industry, making our net income difficult to predict. Also, if prices are allowed to escalate sharply, our costs will rise which will lead to a decrease in profits.

**The loss of any of our key executives could cause an interruption of our business and an increase in our expenses if we are forced to recruit are placement; we have no key-man life insurance covering these executives.** American Dairy is

highly dependent on the services of Leng You-Bin and Liu Hua, and the loss of their services would have a material adverse impact on our operations. These individuals have been primarily responsible for the development of American Dairy and the development and marketing of our products. American Dairy has not applied for key-man life insurance on the lives of these executives but may do so in the future.

**The milk business is highly competitive and, therefore, we face substantial competition in connection with the marketing and sale of our products.** In general, milk products are price sensitive and affected by many factors beyond our control, including changes in consumer tastes, fluctuating commodity prices and changes in supply due to weather, production, feed costs and natural disasters. Our products compete with other premium quality dairy brands as well as less expensive, non-premium brands. American Dairy's milk faces competition from non-premium milk producers distributing milk in our marketing area and other milk producers packaging their milk in glass bottles, and other special packaging, which serve portions of our marketing area. Most of our competitors are well established, have greater financial, marketing, personnel and other resources, have been in business for longer periods of time than American Dairy, and have products that have gained wide customer acceptance in the marketplace. The largest competitors of American Dairy are state-owned dairies owned by the government of China. Large foreign milk companies have also entered the milk industry in China. The greater financial resources of such competitors will permit them to procure retail store shelf space and to implement extensive marketing and promotional programs, both generally and in direct response to advertising claims by American Dairy. The milk industry is also characterized by the frequent introduction of new products, accompanied by substantial promotional campaigns. We may be unable to compete successfully or our competitors may develop products which have superior qualities or gain wider market acceptance than ours.

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**Lack of property and general liability insurance expose American Dairy to the risk of loss of our property as well as liability risks in the event of litigation against our company.** American Dairy and its subsidiaries do not carry any property insurance, general liability insurance, or any other insurance that covers the risks of our business operations. As a result, any material loss or damage to our properties or other assets could lead to an increase in costs to replace or repair lost or damaged property and, possibly, a decline in revenues from lost use of the lost or damaged property. Also, personal injuries arising from our business operations, could significantly increase our costs for attorneys' fees as well as the payment of any damages arising out of the litigation. Any of the above would cause lost profits.

**As we increase the scale of our operations, we may be unable to maintain the level of quality we currently attain by producing our products in small batches.** Our products are manufactured in small batches with milk from the farms of local farmers. We may be unable to maintain the quality of our dairy products at increased levels of production. Increased production levels may cause American Dairy to modify its current manufacturing methods and will necessitate the use of milk from other additional sources. A decline in the quality of our products could damage American Dairy's business, operations and finances.

**We face the potential risk of product liability associated with food products.** American Dairy faces the risk of liability in connection with the sale and consumption of milk products and soybean products should the consumption of such products cause injury, illness or death. Such risks may be particularly great in a company undergoing rapid and significant growth. American Dairy currently maintains no product liability insurance. Any insurance which we may obtain in the future may be insufficient to cover potential claims or the level of insurance coverage needed may be unavailable at a reasonable cost. A partially or completely uninsured successful claim against American Dairy would drive up our costs to defend such claim or pay damages and could cause reputational damage which would hurt our revenues. Either of these results would in turn reduce our profitability.

**Doing business in China involves various risks including internal and international political risks, evolving national economic policies as well as financial accounting standards, expropriation and the potential for a reversal in economic conditions.** Since the late 1970s, the government of the PRC has been reforming the Chinese economic system. These reforms have resulted in significant economic growth and social progress. These policies and measures may from time to time be modified or revised. Adverse changes in economic policies of the Chinese government or in the laws and regulations, if any, could have a material adverse effect on the overall economic growth of China, and could adversely affect our business operations.

**Extensive regulation of the food processing and distribution industry in China could increase our expenses resulting in reduced profits.** American Dairy is subject to extensive regulation by China's Agricultural Ministry, and by other county and local authorities in jurisdictions in which its products are processed or sold, regarding the processing, packaging, storage, distribution and labeling of our products. Applicable laws and regulations governing our products may include nutritional

labeling and serving size requirements. Our processing facilities and products are subject to periodic inspection by national, county and local authorities. We believe that we are currently in substantial compliance with all material governmental laws and regulations and maintain all material permits and licenses relating to our operations. Nevertheless, we may fall out of substantial compliance with current laws and regulations or may be unable to comply with any future laws and regulations. To the extent that new regulations are adopted, American Dairy will be required to conform its activities in order to comply with such regulations. Our failure to comply with applicable laws and regulations could subject American Dairy to civil remedies, including fines, injunctions, recalls or seizures, as well as potential criminal sanctions, which could have a material adverse effect on our business, operations and finances.

**The Chinese currency, "Renminbi", is not a freely convertible currency, which could limit our ability to obtain sufficient foreign currency to support our business operations in the future.** We rely on the Chinese government's foreign currency conversion policies, which may change at any time, in regard to our currency exchange needs. We receive substantially all of our revenues in Renminbi, which is not freely convertible into other foreign currencies. In China, the government has control over Renminbi reserves through, among other things, direct regulation of the conversion of Renminbi into other foreign currencies and restrictions on foreign imports. Although foreign currencies which are required for "current account" transactions can be bought freely at authorized Chinese banks, the proper procedural requirements prescribed by Chinese law must be met. At the same time, Chinese companies are also required to sell their foreign exchange earnings to authorized Chinese banks and the purchase of foreign currencies for capital account transactions still requires prior approval of the Chinese government. This type of heavy regulation by the Chinese government of foreign currency exchange restricts certain of our business operations and a change in any of these government policies, or any other, could further negatively impact our operations which could result in a loss of profits.

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**Fluctuations in the exchange rate between the Chinese currency and the United States dollar could adversely affect our operating results.** The functional currency of our operations in China is "Renminbi". However, results of our operations are translated at average exchange rates into United States dollars for purposes of reporting results. As a result, fluctuations in exchange rates may adversely affect our expenses and results of operations as well as the value of our assets and liabilities. Fluctuations may adversely affect the comparability of period-to-period results. Although we may use hedging techniques in the future (which we currently do not use), we may not be able to eliminate the effects of currency fluctuations. Thus, exchange rate fluctuations could cause our profits, and therefore our stock prices, to decline.

In order for our China subsidiaries to pay dividends to American Dairy, a conversion of Renminbi into us dollars is required which, if we were not allowed by the Chinese government, would cause an interruption in our operating cash flow. Under current Chinese law, the conversion of Renminbi into foreign currency generally requires government consent. Government authorities may impose restrictions that could have a negative impact in the future on the conversion process and upon the ability of American Dairy to meet its cash needs, and to pay dividends to its shareholders. Although, our subsidiaries' classification as wholly - owned foreign enterprises ("WOFEs") under Chinese law permits them to declare dividends and repatriate their funds to American Dairy in the United States, any change in this status or the regulations permitting such repatriation could prevent them from doing so. Any inability to repatriate funds to American Dairy would in turn prevent payments of dividends to our shareholders.

**Dividends paid to American Dairy, as the U.S. parent company, would be subject to U.S. corporate income tax.** American Dairy has not accrued any tax liability associated with the possible payment of dividends to the U.S. parent company. Such a tax liability would be an added expense which would reduce our net income.

**Lack of bank deposit insurance puts our funds at risk of loss from bank foreclosures or insolvencies.** American Dairy maintains certain bank accounts in China that are not insured and are not protected by FDIC insurance or other insurance. As of December 31, 2005, American Dairy held \$206,000 of cash balances in the United States of which \$106,000 was in excess of five insurance limits. If a Chinese bank holding our funds experienced insolvency, it may not permit us to withdraw our funds which would result in a loss of such funds and reduction of our net assets.

**Limited and uncertain trademark protection in China makes the ownership and use of our trademark uncertain.** American Dairy has obtained trademark registrations for the use of our tradename "Feihe", which has been registered with the Trademark Bureau of the State Administration for Industry and Commerce with respect to our milk products. We believe our trademark is important to the establishment of consumer recognition of our products. However, due to uncertainties in Chinese trademark law, the protection afforded by our trademark may be less than we currently expect and may, in fact, be insufficient. Moreover even if it is sufficient, in the event it is challenged or infringed, we may not have the financial resources to defend it against any challenge or infringement and such defense could in any event be unsuccessful. Moreover,

any events or conditions that negatively impact our trademarks could have a material adverse effect on our business, operations and finances.

**Our lack of patent protection could permit our competitors to copy our trade secrets and formulae and thus gain a competitive advantage.** American Dairy has no patents covering our products or production processes, and we expect to rely principally on know-how and the confidentiality of our formulae and production processes for our products and our flavoring formulae in producing competitive product line. Any breach of confidentiality by our executives or employees having access to our formulae could result in our competitors gaining access to such formulae. The ensuing competitive disadvantage could reduce our revenues and our profits.

**We have not held a meeting of our shareholders for several years which could subject American Dairy to a suit to compel such a meeting.** Section 16-10a-701 of the Utah Revised Business Corporations Act calls for a corporation to hold an annual meeting of its shareholders. Our failure to hold an annual meeting is inconsistent with this provision. The most likely remedy for such failure is to compel American Dairy to hold an annual meeting.

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## Item 2. Properties

The principal executives of American Dairy are located at C-16 Shin Chen International Building, No. 10, Jui-shen Road. Zho Yan Chu, Beijing, The People's Republic of China. The building was acquired during 2003 at a purchase price of \$1,200,861.

American Dairy presently operates milk powder processing plants and also rice, soy beans and walnut processing facilities, and various warehouses in northern China, known as Feihe Dairy, Sanhao Dairy and BaiQuan Dairy.

American Dairy has been in the process of constructing a new milk powder production facility in Kedong County, Heilongjiang Province in The People's Republic of China which was completed in December 2005. As of December 31, 2005, American Dairy has expended approximately \$14,000,000 in construction and equipment costs plant.

American Dairy has been in the process of completing the construction of a new plant in Shenyang in northeast China to product walnut powder, a new product of American Dairy. As of December 31, 2005, American Dairy has expended approximately \$3,374,000 in construction costs. This facility was completed in December 2005.

During 2005, American Dairy entered into an Asset Purchase Agreement with Nutricia Nutritionals Co., Ltd. of Hei Long Jiang ("Nutritionals") in The People's Republic of China ("PRC"). Nutritionals is a wholly-owned subsidiary of Royal Numico N.V., a public limited liability company organized in the Netherlands. The Agreement provided that American Dairy would acquire substantially all of the assets of Nutritionals for \$7,300,000 and its inventory for \$130,000. The assets are comprised primarily of the land use rights and buildings of Nutritionals' milk powder plant in Heilongjiang Province in the PRC and all of its milk powder processing equipment at its plant. American Dairy also acquired approximately 19 milk collection stations for the collection of raw milk to supply the processing plant.

In January 2006, American Dairy entered into an Agreement with the government of Gannan County in Heilongjiang Province, PRC, to build a new milk processing plant. Under the terms of the Agreement, American Dairy will receive the rights to approximately 3,000,000 square feet of land, tax incentives, and subsidies for the construction of the new building. In addition, American Dairy will receive exclusive processing and distribution rights to the locally subsidized milk production. The government will also subsidize local farmers for the initial costs of acquiring up to 200,000 milk cows to increase the local production of milk.

There is no private ownership of land in the PRC; all land ownership is held by the government of the PRC, its agencies and collectives. Land use rights are obtained from government for period ranging from 50 to 70 years, and are typically renewable. Land use rights can be transferred upon approval by the land administrative authorities of the PRC (State Land Administration Bureau) upon payment of the required land transfer fee.

## Item 3. Legal Proceedings

During the quarter ended December 31, 2005, American Dairy was not a party to any material litigation, and there were no

material outstanding claims against American Dairy or its assets.

#### **Item 4. Submission of Matters to a Vote of Security Holders**

None

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## **PART II**

### **Item 5. Market for the Company's Common Stock and Related Securityholder Matters**

#### **General**

American Dairy is authorized to issue 50,000,000 shares of Common Stock, \$.001 par value per share. At December 31, 2005, there were 14,132,824 shares of Common Stock issued and outstanding that were held by 461 stockholders of record.

#### **Common Stock**

Holders of Common Stock are entitled to one vote for each share held on all matters voted upon by stockholders, including the election of directors. The holders of Common Stock have no preemptive rights to purchase or subscribe for any stock of American Dairy now or hereafter authorized or for securities convertible into such stock. All of the outstanding shares of Common Stock are fully paid and nonassessable. Upon any liquidation of American Dairy, the holders of Common Stock are entitled to share ratably in assets available for distribution to such stockholders. Holders of Common Stock are entitled to receive dividends out of assets legally available therefore at such times and in such amounts as the Board of Directors may from time to time determine.

Shareholders are not entitled to cumulative voting rights, and accordingly, the holders of a majority of the voting power of the shares voting for the election of directors can elect the entire class of directors to be elected each year if they choose to do so and, in that event, the holders of the remaining shares will not be able to elect any person as a director of such class.

#### **Dividends**

American Dairy has not declared or paid any dividends on its Common Stock and presently does not presently expect to declare or pay any such dividends in the foreseeable future. American Dairy has not yet formulated a future dividend policy in the event restrictions on its ability to pay dividends are created. Payment of dividends to our shareholders would require payment of dividends by our China subsidiaries to American Dairy. This, in turn, would require a conversion of Renminbi into US dollars and repatriation of funds to the US. Under current Chinese law, the conversion of Renminbi into foreign currency generally requires government consent. Government authorities may impose restrictions that could have a negative impact in the future on the conversion process and upon the ability of American Dairy to meet its cash needs, and to pay dividends to its shareholders. Although, our subsidiaries' classification as wholly - owned foreign enterprises ("WOFEs") under Chinese law permits them to declare dividends and repatriate their funds to American Dairy in the United States, any change in this status or the regulations permitting such repatriation could prevent them from doing so. Any inability to repatriate funds to American Dairy would in turn prevent payments of dividends to our shareholders.

#### **Transfer Agent and Registrar**

The transfer agent and registrar for American Dairy is Progressive Transfer Company, 1981 E. Murray Road, Suite 100, Salt Lake City, Utah 84117-5148; telephone (801) 272-9294.

#### **Market for Common Stock**

The following table sets forth the range of high and low closing bid prices per share of the Common Stock (former trading symbol ADIY) of American Dairy until April 18, 2005 (reflecting inter-dealer prices without retail mark-up, mark-down or commission and may not represent actual transactions), and closing sale prices of the Common Stock of American Dairy on the NYSE Archipelago Exchange (ArcaEx) (present trading symbol ADY) from April 18, 2005 through December 31, 2005.

	High Closing Bid Prices	Low Closing Bid Prices
<b>Year Ended December 31, 2003:</b>		
1st Quarter	\$ 0.11	\$ 0.05
2nd Quarter (1)	\$ 2.00	\$ 0.01
3rd Quarter	\$ 1.30	\$ 0.10
4th Quarter	\$ 3.00	\$ 1.30
<b>Year Ended December 31, 2004:</b>		
1st Quarter	\$ 2.00	\$ 2.00
2nd Quarter	\$ 3.00	\$ 2.00
3rd Quarter	\$ 3.90	\$ 2.50
4th Quarter	\$ 5.02	\$ 3.30
<b>Year Ended December 31, 2005:</b>		
1st Quarter	\$ 5.00	\$ 4.35
2nd Quarter (2)	\$ 6.90	\$ 5.35
3rd Quarter	\$ 8.35	\$ 6.30
4th Quarter	\$ 8.00	\$ 5.25

(1) On May 7, 2003, the Company had a one-for-nineteen (1-for-19) reverse stock split of its outstanding Common Stock.

(2) On April 18, 2005, the Common Stock of American Dairy ceased trading on the NASD Electronic Bulletin Board over-the-counter market (OTC-BB), and trading of its Common Stock commenced on the NYSE Archipelago Exchange (ArcaEx).

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The closing sales price of the Common Stock of American Dairy on the NYSE Archipelago Exchange (ArcaEx) on March 29, 2006 was \$12.00 per share. Compensation Plan. American Dairy has a 2003 Incentive Plan that authorizes the issuance of up to 3,000,000 shares of its Common Stock for stock options, SAR's and stock bonuses to its directors, officers, employees and consultants. As of December 31, 2005, no stock option or warrant awards were made under the Plan.

### Sale of Unregistered Securities

During the three months ended December 31, 2005, American Dairy sold shares of its restricted Common Stock that were not registered under the Securities Act of 1933, as described below:

During the three months ended December 31, 2005, warrants to purchase 114,285 shares of restricted common stock of American Dairy were exercised for \$200,000, in reliance upon Section 4(2) under the Securities Act of 1933.

### Item 6. Selected Financial Data

The following table sets forth selected consolidated financial data of the Company for the years ended December 31, 2005, 2004, and 2003. The data are derived from our audited consolidated financial statements revised to reflect the reclassification of certain items. The table should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements, including the notes, appearing in elsewhere in this report.

	Year Ended December 31, 2005	Year Ended December 31, 2004	Year Ended December 31, 2003
Revenues	\$ 68,024,000	\$ 37,416,000	\$ 26,636,000
Cost of goods sold	\$ 38,716,000	\$ 18,007,000	\$ 15,733,000

Distribution expenses	\$ 16,743,000	\$ 13,486,000	\$ 7,899,000
General and administrative	\$ 2,483,000	\$ 1,313,000	\$ 1,670,000
Depreciation	\$ 161,000	\$ 55,000	\$ 131,000
Other income	\$ 2,221,000	\$ 1,489,000	\$ 1,197,000
Gain on disposal of assets	\$ 9,000	\$ 1,000	\$ --
Interest expense	\$ 523,000	\$ 49,000	\$ 25,000
Net income	\$ 11,630,000	\$ 6,258,000	\$ 2,037,000
Other comprehensive income	\$ 605,000	\$ --	\$ --
Total comprehensive income	\$ 12,235,000	\$ 6,258,000	\$ 2,037,000
Basic net income per share	\$ .83	\$ .52	\$ .19
Weighted average basic shares			
outstanding	13,931,000	12,077,000	10,536,000
Diluted net income per common share	\$ .74	\$ .47	\$ .19
Weighted average diluted shares			
outstanding	16,057,000	13,456,000	10,536,000

#### Quarterly Financial Data for 2005 and 2004

	Quarters Ended			
	December 31, 2005	September 30, 2005	June 30, 2005 *	March 31, 2005
Total Revenues	\$ 25,599,747	\$ 14,273,618	\$ 14,589,807	\$ 13,560,828
Gross Profit	9,304,064	6,744,356	6,996,110	6,263,470
Net Income	3,994,723	2,178,699	2,823,250	2,633,328
Net Earnings per common share:				
Basic	\$ 0.27	\$ 0.16	\$ 0.21	\$ 0.19
Diluted	\$ 0.25	\$ 0.14	\$ 0.18	\$ 0.17

	Quarters Ended			
	December 31, 2004 *	September 30, 2004 *	June 30, 2004 *	March 31, 2004 *
Total Revenues	\$ 11,912,681	\$ 8,662,297	\$ 9,124,669	\$ 7,716,353
Gross Profit	7,281,853	3,862,047	4,614,090	3,651,010
Net Income	2,378,178	1,244,586	1,445,281	1,189,955
Net Earnings per common share:				
Basic	\$ 0.20	\$ 0.10	\$ 0.12	\$ 0.10
Diluted	\$ 0.16	\$ 0.09	\$ 0.12	\$ 0.10

\*Effective July 1, 2005 slotting fees paid by American Dairy previously reported as expenses have been reclassified as a reduction of revenues. The above schedule reflects a reclassifying entry for prior periods to conform to this presentation.

#### Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Caution Regarding Forward-Looking Information When used in this report, the words "may," "expect," "anticipate," "continue," "estimate," "project," "intend," and similar expressions are intended to identify forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 regarding events, conditions, and financial trends that may affect the Company's future plans of operations, business strategy, operating results, and financial position. Persons reviewing this report are cautioned that any forward-looking statements are not guarantees of future performance and are subject to risks and uncertainties and that actual results may differ materially from those included within the forward-looking statements as a result of various factors. These risks and uncertainties, many of

which are beyond our control, include (i) the sufficiency of existing capital resources and the Company's ability to raise additional capital to fund cash requirements for future operations; (ii) volatility of the stock market; and (iii) general economic conditions. Although the Company believes the expectations reflected in these forward-looking statements are reasonable, such expectations may prove to be incorrect.

## Overview

Effective May 7, 2003, American Dairy completed the acquisition of 100% of the issued and outstanding capital stock of American Flying Crane Corporation (formerly called American Dairy Holdings, Inc.), a Delaware corporation. As a result, AFC became a wholly-owned subsidiary of American Dairy. For financial reporting purposes, this transaction was treated as a recapitalization of American Flying Crane and the historical figures prior to May 7, 2003 represent the activities of American Flying Crane.

The operations of the Company are conducted primarily through its wholly-owned subsidiary, Feihe Dairy, and Feihe Dairy's subsidiaries, Beijing Feihe and Baiquan Feihe, all of which are enterprises organized and operating in The People's Republic of China ("PRC"). Feihe Dairy engages in the production and distribution of milk powder, soybean milk powder and other dairy products in the PRC.

The principal activities of Beijing Feihe are marketing and distribution of the Feihe Dairy Group's dairy and soybean products to principal agents in 25 provinces. Baiquan Feihe principal activities are the production and supply of processed milk together with Feihe Dairy for sale entirely to Beijing Feihe for distribution to third party customers and distributors. The products are sold primarily under the registered trademark "Feihe".

The discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates including the allowance for doubtful accounts, the salability and recoverability of inventory, income taxes and contingencies. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form our basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We must make estimates of the collectibility of accounts receivable. We analyze historical write-offs, changes in our internal credit policies and customer concentrations when evaluating the adequacy of our allowance for doubtful accounts. Differences may result in the amount and timing of expenses for any period if we make different judgments or use different estimates. As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes. This process involves estimating our current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income, and, to the extent we believe that recovery is not likely, we must establish a valuation allowance. To the extent that we establish a valuation allowance or increase this allowance in a period, we must include a tax provision or reduce our tax benefit in the statements of operations. We use our judgment to determine our provision or benefit for income taxes, deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. We believe, based on a number of factors including historical operating losses, that we will not realize the future benefits of a significant portion of our net deferred tax assets and we have accordingly provided a full valuation allowance against our deferred tax assets. However, various factors may cause those assumptions to change in the near term.

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We cannot predict what future laws and regulations might be passed that could have a material effect on our results of operations. We assess the impact of significant changes in laws and regulations on a regular basis and update the assumptions and estimates used to prepare our financial statements when we deem it necessary.

## Plan of Operation

We perceive that the dairy industry in China is experiencing rapid growth with demand outpacing supply. We further believe that this growth presents a window of opportunity for American Dairy to capture as much of this growing market as possible

while it is in this growth phase. We must increase output of our milk products to meet this demand and capture market share. We must act quickly to secure our supply of raw milk by acquiring additional milking rights and collection stations and expand our production and distribution capacity to handle the additional volume. This involves the acquisition or construction of additional processing and distribution facilities and further increases in our marketing efforts. It is important for American Dairy's future that we concentrate our current efforts on this expansion.

Our expansion strategy will require the continued retention and investment of our earnings from operations as well as additional funding from private debt and equity financing. We currently have sufficient cash to fund our operations for the next twelve months with bank credit facilities available to cover any unforeseen shortfall. However, in order to effect our planned expansion, we will require additional funding in the approximate amount of \$76,000,000. Of this amount, we plan to use approximately \$16 million for the Lang Fang Distribution Plant and \$60 million for the Gannon Processing Plant. On October 3, 2006, we closed on offering of \$18.2 of 7.75% Convertible Notes the terms of which are discussed in greater detail under "Liquidity and Capital Resources." To date, we have used approximately \$10,000,000 of our existing cash to fund the Gannon Processing Plant. We have not yet determined exactly how much of our existing cash we will utilize for our expansion strategy going forward, but we will require a significant amount of additional external funding. Of the additional funding, we anticipate that the majority of it will come from private investors and that we will continue to renew our bank credit facilities for short-term needs. On (See "Liquidity and Capital Resources.")

We have considered various options for obtaining the necessary financing to fund our expansion strategy and, at present, we are considering possible sources of private debt and equity placements. We intend to use the proceeds of any such placement for the construction of a distribution center and a processing plant. We cannot, however, be certain that our fundraising efforts will be successful or how much we will actually raise if any. Moreover, the proceeds raised in any private offering may be inadequate to cover any unforeseen costs associated with the construction of these facilities. In addition to construction of new facilities, we believe that acquisition of existing facilities is a necessary part of our strategy as well.

### Results of Operations

The following table sets forth certain operating information regarding American Dairy, including its subsidiaries.

	2005	2004	2003
Revenues	\$68,024,000	\$37,416,000	\$26,636,000
Cost of good sold	\$38,716,000	\$18,007,000	\$15,733,000
Distribution expense	\$16,743,000	\$13,486,000	\$ 7,899,000
General and administrative expense	\$ 2,483,000	\$ 1,313,000	\$ 1,670,000
Depreciation	\$ 161,000	\$ 55,000	\$ 131,000
Other income	\$ 2,221,000	\$ 1,489,000	\$ 1,197,000
Gain on disposal of assets	\$ 9,000	\$ 1,000	\$ --
Interest expense	\$ (523,000)	\$ (49,000)	\$ (25,000)
Net Income	\$11,630,000	\$ 6,258,000	\$ 2,036,000

### Comparison of Years Ended December 31, 2005 and 2004

Net income increased by 86% from \$6,258,000 in 2004 to \$11,630,000 for 2005. This increase in net income is attributable primarily to the following factors: (1) an 82% increase in sales; (2) a 49% increase in other income, offset in part by (i) a 17% decrease in gross profit margins from 52% in 2004 to 43% in 2005; (ii) a 24% increase in distribution expenses, (iii) an 89% increase in general and administrative expenses, and (iv) a 959% increase in interest expense.

Revenues. Revenues increased by \$30,608,000 or 82% from \$37,416,000 in 2004 to \$68,024,000 in 2005. This increase was due primarily to expanding market areas and adding new value added products. Increase in sales is due to the following factors:

One component of the increase is due to increased sales volumes. The table below reflects the sales volumes in kilograms by product for 2005 as compared to 2004 and 2004:

Product name	2005			2004			Year-on-year Qty. variance
	Quantity (Kg)	Amount sales	% of	Quantity (Kg)	Amount sales	% of	
Ca+Zn series	4,722,624	\$ 13,004,000	19%	4,719,669	\$12,751,000	34%	0%
CPP series	4,503,308	\$ 24,064,000	35%	2,398,579	\$12,678,000	34%	88%
Soybean series	1,781,052	\$ 2,987,000	16%	2,199,445	\$ 5,601,000	15%	(19%)
Nucleotides series	1,094,676	\$ 10,733,000	10%	219,153	\$ 2,434,000	6%	400%
Rice cereal series	2,664,230	\$ 7,131,000	4%	-	\$ -	-	-
Low fat high Calcium	-	\$ -	-	368,968	\$ 979,000	3%	-
Light powder	-	\$ -	-	382,475	\$ 688,000	2%	-
Total	14,765,890	\$ 57,919,000	85%	10,288,289	\$35,131,000	94%	44%
Others	2,444,862	\$ 10,105,000	15%	3,190,356	\$ 2,285,000	6%	(23%)
	17,210,752	\$ 68,024,000	100%	13,478,645	\$37,416,000	100%	28%

The second component is an increase in the average sales price per kilogram as demonstrated below:

	2005	2004
Sales revenues	<u>\$68,024,000</u>	<u>\$37,416,000</u>
Total sales volume (kilograms)	<u>17,210,752</u>	<u>13,478,645</u>
Average selling prices/kilogram	<u>\$ 3.95</u>	<u>\$ 2.78</u>

This increase in average sales price per kilogram is due primarily to the shift in product mix to higher end products rather than an increase in the sales price of individual products.

The following table reflects the average sales price by kilogram by product for 2005 and 2004 and the percentage change in the sales price per kilogram.

Product	Average Price Per Kilogram		Percentage Change
	2005	2004	
Ca+Zn series	\$ 2.75	\$ 2.70	2%
CPP series	\$ 5.34	\$ 5.29	1%
Soybean series	\$ 1.68	\$ 2.24	(25)%
Nucleotides series	\$ 9.80	\$ 11.10	(12)%
Other series	\$ 3.37	\$ 1.08	212%

The growth came primarily from increased sales in the Heilong Jiang Province which had sales of \$21,400,000 in 2005 on 5,794,840 kilograms of product vs. sales of \$3,513,985 on 1,754,068 kilograms of product during 2004.

The above sales and price increases are attributable to the following factors:

Increased popularity of "Feihe" brand of mainland China following the successful advertising campaigns in the previous year and extensive networks of Agencies in 25 provinces;

Demand boosted by improved and high quality ingredients for several products such as Ca+Zn, CPP series, and nucleotides series and families or markets mostly accepted these products;

The dairy milk industry scandal in China in 2003 and the resulting strict control over dairy producers (quality and ingredient contains) drove many unscrupulous Dairy producers and their tainted dairy products out of the market. Consumers concentrated on dairy products produced by such reputable dairy producers as Feihe Dairy.

Increase in sales quantities of several higher priced major products as can be seen from the table above.

**Cost of Goods Sold.** Cost of goods sold increased 115% or \$20,709,000 from \$18,007,000 in 2004 to \$38,716,000 in 2005. This increase is due to the following factors (1) a 28% increase in sales volumes (2) a 49% increase in direct materials cost per kilogram from \$1.35 in 2004 to \$2.00 in 2005 (3) a 25% increase per kilogram in direct labor cost from \$.04 in 2004 to \$.05 in 2005, and (4) a 120% increase in manufacturing overhead from \$.05 per kilogram in 2004 to \$.11 per kilogram in 2005. The increase in direct materials cost is due primarily to the increased use of nutritional supplements used primarily in higher end products. The increase in labor and overhead cost is attributable to the new production facilities coming on line which were not yet operating at full capacity.

**Distribution Expenses.** Distribution expenses for the year ended December 31, 2005 were \$16,743,000, an increase of \$3,257,000 or 24% from the prior year's distribution expenses of \$13,486,000. The principal reasons for the increase were substantial increases in advertising expense, promotional expenses, distribution salaries, and transportation expense which were incurred to expand market areas.

**General and Administrative Expenses.** General and administrative expenses for the year ended December 31, 2005 were \$2,483,000, an increase of \$1,170,000 or 89% from the prior year's general and administrative expenses of \$1,313,000. The principal reason for the increase was mainly due to increases in depreciation expenses, education expenses, entertainment, office expenses, union expenses, transportation expenses, bad debts, and staff salaries, as well as an increase in expense for consulting services incurred at the parent company level.

**Depreciation Expense.** Depreciation expense for the year ended December 31, 2005 was \$161,000 and \$839,000, for general and administrative and cost of goods sold depreciation, respectively, resulting in increases of \$106,000 and \$632,000, respectively, compared to the year ended December 31, 2004, which reflected general and administrative and cost of goods sold depreciation of \$55,000 and \$207,000, respectively. This increase is due primarily to substantial additions of buildings, plant and machinery in Feihe Dairy and Shanxi Feihe during 2005.

**Interest Expense.** Interest expense for the year ended December 31, 2005 was \$523,000 as compared to \$49,000 for the prior year. This increase was due primarily to interest accrued on convertible notes issued in 2005, as well as interest expense arising from new short-term loans.

**Income Taxes.** Income tax benefit decreased by \$262,000 from \$262,000 of benefit in 2004 to \$0 in 2005. This was due primarily to reversal of a 2003 tax accrual for BiaQuan Dairy which was waived by the taxing authorities in 2004.

### Comparison of Years Ended December 31, 2004 and 2003

Net income increased by 207% from \$2,036,000 in 2003 to \$6,258,000 for 2004. This increase in net income is attributable primarily to the following factors: (1) a 40% increase in sales; (2) a 27% increase in gross profit margins from 41% in 2003 to 52% in 2004; and (3) a 70% increase in distribution expenses, offset in part by: (i) a 21% decrease in general and administrative expenses, and (ii) a \$601,000 decrease in enterprise income tax expense.

**Revenues.** Revenues increased by \$10,780,000 or 40% from \$26,636,000 in 2003 to \$37,416,000 in 2004. This increase was due primarily to 28% increase in kilograms sold combined with a 17% average increase in sales price per kilogram. The following tables compare sales volumes and prices by year

Product name	2004			2003		
	Quantity (Kg)	Amount	% of sales	Quantity (Kg)	Amount	% of sales
Ca+Zn series	4,719,669	\$12,751,000	34%	3,718,421	\$ 9,824,000	37%
CPP series	2,398,579	\$12,678,000	34%	785,483	\$ 3,863,000	14%

Soybean series	2,199,445	\$ 5,601,000	15%	2,176,299	\$ 3,069,000	12%
Nucleotides series	219,153	\$ 2,434,000	6%	-	\$ -	-
Low fat high Calcium	368,968	\$ 979,000	3%	667,227	\$ 1,545,000	6%
Other	3,572,831	\$ 2,973,000	8%	3,155,352	\$ 8,335,000	31%
<b>Total</b>	<b>13,478,645</b>	<b>\$37,416,000</b>	<b>100%</b>	<b>10,502,782</b>	<b>\$26,636,000</b>	<b>100%</b>

	<b>2004</b>	<b>2003</b>	<b>Variance</b>
Sales revenues	<u>\$37,416,000</u>	<u>\$26,636,000</u>	40%
Total sales volume (kilograms)	<u>13,478,645</u>	<u>10,502,782</u>	28%
Average selling prices/kilogram	<u>\$ 2.97</u>	<u>2.54</u>	17%

Product	Average Price Per Kilogram		Percentage Change
	2004	2003	
Ca+Zn series	\$ 2.70	\$ 2.64	2%
CPP series	\$ 5.29	\$ 4.92	8%
Soybean series	\$ 2.24	\$ 1.41	59%
Nucleotides series	\$ 11.10	\$ -	N/A
Other series	\$ 1.08	\$ 2.64	(59)%

Increases in sales volumes are attributable to the following factors:

\* Increased popularity of "Feihe" brand of mainland China following the successful advertising campaigns in the previous year and extensive networks of Agencies in 25 provinces;

\* Demands boosted by improved and high quality ingredients for several products such as Ca+Zn CPP series and nucleotides series and families or markets mostly accepted these products;

\* The dairy milk industry scandal in China in 2003 and the resulting strict control over dairy producers (quality and ingredient contains) drove many unscrupulous Dairy producers and their tainted dairy products out of the market. Consumers concentrated on dairy products produced by such reputable dairy producers as Feihe Dairy

Cost of Goods Sold. Cost of goods sold increased 14% or \$2,274,000 from \$15,733,000 in 2003 to \$18,007,000 in 2004. This increase is due primarily to a 28% increase in sales volume offset in part by a 38% improvement in unit gross profit margins from \$1.04 kilogram in 2003 to \$1.44 per kilogram in 2004. The improved gross profit margins were due to increases in sales of high gross profit product and improved manufacturing efficiencies which were obtained as new processing facilities came on line during the year, offset in part by an overall 10% increase in the cost of raw materials.

Distribution Expenses. Distribution expenses for the year ended December 31, 2004 were \$13,486,000, an increase of \$5,587,000 or 71% from the prior year's distribution expenses of \$7,899,000. The principal reasons for the increase were substantial increases in advertising expense, distribution salaries, and transportation expense which were incurred to expand market areas.

General and Administrative Expenses. General and administrative expenses for the year ended December 31, 2004 were \$1,313,000, a decrease of \$357,000 or 21% from the prior year's general and administrative expenses of \$1,670,000. Contributing to the decrease was that in 2003 the Company took a provision for bad debts of \$426,000 resulting in an allowance for bad debts of \$445,000 on receivables totaling \$2,178,762. During 2004, the Company had no provision for bad debts, had reduced the outstanding receivables balance to \$671,000 and had in fact recovered \$434,000 on accounts which had been previously reserved. This improvement was due to the Company's collection efforts and tightened credit policies. Another contributing factor was a reduction in consulting fees incurred at the parent company level from 2003 to 2004.

**Depreciation Expense.** Depreciation expense for the year ended December 31, 2004 was \$55,000 and \$207,000, respectively, for the year ended December 31, 2003, an increase of \$131,000 from the prior year's depreciation expense of \$131,000 which was included in operating and administrative expenses. This increase is due primarily to substantial additions of buildings, plant and machinery in Feihe Dairy and BaiQuan Feihe during 2004.

**Interest Expense.** Interest expense for the year ended December 31, 2004 was \$49,000 as compared to only \$25,000 for the prior year. This increase was due primarily to increases in exchange loss and interest expenses arising from short-term loans repaid in 2004 and a bank loan to finance the acquisition of the Beijing office.

**Other Income.** Other income which consist primarily of VAT tax rebates provided by the provinces as an economic incentive, increased by \$292,000 or 24% from \$1,197,000 in 2003 to \$1,489,000 in 2004 due primarily to increased sales volumes.

**Income Taxes.** Income tax expense decreased by \$601,000 from \$339,000 of expense in 2003 to \$262,000 of income tax benefit in 2004. This was due primarily to reversal of prior year's tax actual on BiaQuan Dairy which was waived by the taxing authorities in 2004.

## Liquidity and Capital Resources

### 2005

**Operating Activities.** Net cash flows provided by operating activities for the year ended December 31, 2005 was \$7,927,000 compared with net cash flows provided by operating activities of \$16,539,000 for the year ended December 31, 2004. This decrease in cash flows from operating activities was attributable primarily to an increase in accounts receivable of \$5,176,000, and an increase in inventory of \$4,580,000.

**Sale of Stock -** During the fiscal year ended December 31, 2005, American Dairy realized \$750,000 from the purchase of its Common Stock by warrant holders pursuant to the exercise of such warrants.

**Working Capital -** At December 31, 2005, the Company had a negative working capital of \$(1,926,000).

## Contractual Obligations

As of December 31, 2005, the Company had the following contractual obligations:

	Payments due by period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
<b>Contractual obligations</b>					
Long-term debt obligations	\$ 5,646,000	\$ 102,000	\$ 5,184,000	\$ 184,000	\$ 176,000
Purchase obligation for building acquisition	604,000	604,000	--	--	--
Purchase obligations for land use rights	273,000	6,000	12,000	12,000	243,000
Purchase obligations for advertising contracts	3,429,000	3,429,000	--	--	--
<b>Total</b>	<b>\$ 9,952,000</b>	<b>\$ 4,141,000</b>	<b>\$ 5,196,000</b>	<b>\$ 196,000</b>	<b>\$ 419,000</b>

Based upon our short term liabilities, we believe our cash and cash equivalents are adequate to satisfy our working capital needs and sustain our ongoing operations in the near term. In the event of an unanticipated shortfall, we have access to a line of credit with the Construction Bank of China to fund our operations.

Our expansion strategy outlined above under "Plan of Operation" will necessitate additional funding most likely through debt or equity financing. In general, the commitment of funds to the acquisition of plant and equipment tends to impair liquidity. However, we believe that because of the upward trend in our revenues in recent years, even if this upward trend levels off, our income from operations coupled with such additional financing should provide sufficient liquidity to meet our needs.

#### CRITICAL ACCOUNTING POLICIES

Certain amounts included in or affecting our consolidated financial statements and related disclosures must be estimated, requiring us to make certain assumptions with respect to values or conditions that cannot be known with certainty at the time the financial statements are prepared. These estimates and assumptions affect the amounts we report for assets and liabilities and our disclosure of contingent assets and liabilities at the date of our financial statements. We routinely evaluate these estimates, utilizing historical experience, consultation with experts and other methods we consider reasonable in the particular circumstances. Nevertheless, actual results may differ significantly from our estimates. Any effects on our business, financial position or results of operations resulting from revisions to these estimates are recorded in the period in which the facts that give rise to the revision become known.

In preparing our consolidated financial statements and related disclosures, we must use estimates in determining the economic useful lives of our assets, the fair values used to determine possible asset impairment charges, provisions for uncollectible accounts receivable, exposures under contractual indemnifications and various other recorded or disclosed amounts. However, we believe that certain accounting policies are of more significance in our consolidated financial statement preparation process than others, which policies are discussed following. See also Note 3 to the consolidated financial statements for a summary of our significant accounting policies.

Estimates of Allowances for Bad Debts - The Company must periodically review its trade and other receivables to determine if all are collectible or whether an allowance is required for possible uncollectible balances.

Estimate of the useful lives of property and equipment - The Company must estimate the useful lives and proper salvage values of property and equipment. The Company must also review its property and equipment for possible impairment or obsolescence.

Inventory - The Company must determine whether it has any obsolete or impaired inventory.

Please refer to the Notes to the financial statements included elsewhere in this filing for a more complete listing of all of the Company's critical accounting policies.

#### New Accounting Pronouncements

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities (SFAS 149)". SFAS 149 amends and clarifies certain derivative instruments embedded in other contracts, and for hedging activities under SFAS 133. SFAS 149 is effective for certain contracts entered into or modified by the Company after June 30, 2003. The adoption of SFAS 149 had no impact on the Company's financial position, results of operations, or cash flows.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Instruments with Characteristics of Both Debt and Equity" (SFAS 150). Statement 150 requires liability classification for three types of instruments: 1) Mandatory redeemable shares that obligate the company to deliver cash or other assets to shareholders on fixed or determinable dates; 2) Freestanding written put options and forward purchase contracts on a company's own shares that obligate the company to

deliver cash or other assets, and 3) Contracts that obligate a company to issue its own shares in amounts that are unrelated to, or inversely related to, the value of the shares. The adoption of SFAS 150 had no impact on the Company's financial position, results of operations, or cash flows.

In November 2004, the FASB issued SFAS No. 151 "Inventory Costs - an amendment of ARB No. 43, Chapter 4". Statement No. 151 requires that certain abnormal costs associated with the manufacturing, freight, and handling costs associated with inventory be charged to current operations in the period in which they are incurred. The adoption of SFAS 151 had no impact on the Company's financial position, results of operations, or cash flows.

In December 2004, the FASB issued a revision of SFAS No. 123 "Share-Based Payment". The statement establishes standards for the accounting for transactions in which an entity exchanges its equity investments for goods and services. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of those equity instruments. The statement does not change the accounting guidance for share-based payments with parties other than employees.

The statement requires a public entity to measure the cost of employee service received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exception). That cost will be recognized over the period during which an employee is required to provide service in exchange for the award (usually the vesting period). A public entity will initially measure the cost of employee services received in exchange for an award of liability instrument based on its current fair value; the fair value of that award will be remeasured subsequently at each reporting date through the settlement date. Changes in fair value during the requisite service period will be recognized as compensation over that period.

The grant-date for fair value of employee share options and similar instruments will be estimated using option-pricing models adjusted for the unique characteristics of these instruments.

The statement was effective for the quarter beginning January 1, 2006. The Company adopted SFAS 123R on January 1, 2006 using the modified prospective method. The Company has no outstanding stock options or unvested stock compensation and SFAS 123R had no effect on the consolidated financial statements.

SFAS No. 152 "Accounting for Real Estate Time Sharing Transactions", SFAS No. 153 "Exchange of Nonmonetary Assets", SFAS No. 154 "Accounting for Changes and Error Corrections", SFAS No. 155 "Accounting for Certain Hybrid Financing Instruments", and SFAS No. 156 "Accounting for Servicing of Final Assets" were recently issued but have no current applicability to the Company and have no effect on the consolidated financial statements.

#### **\* Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

All of the operations of American Dairy are conducted in The People's Republic of China (the "PRC"), and the Renminbi is the national currency in which its operations are conducted. American Dairy has not utilized any derivative financial instruments or any other financial instruments, nor does it utilize any derivative commodity instruments in its operations, nor any similar market sensitive instruments.

The exchange rate between the Renminbi and the U.S. dollar is subject to the PRC foreign currency conversion policies which may change at any time. The exchange rate at December 31, 2005, was 8.11 Renminbi to 1 U.S. dollar, and the exchange rate is currently permitted to float within a very limited range. See Item 1A - Risks of Doing Business in China.

#### **\* Item 8. Financial Statements and Supplementary Data**

Please see the accompanying Financial Statements attached hereto beginning on page F-1.

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### **REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**TO THE BOARD OF DIRECTORS  
AMERICAN DAIRY, INC.**

We have audited the accompanying consolidated balance sheets of American Dairy, Inc. and subsidiaries (the "Company") as of December 31, 2005 and 2004 and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2005. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required, nor have we been engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of American Dairy, Inc. and subsidiaries as of December 31, 2005 and 2004 and the results of their operations and cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

/s/ Murrell, Hall, McIntosh & Co., PLLP

Oklahoma City, Oklahoma

March 12, 2006

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**AMERICAN DAIRY INC.  
CONSOLIDATED BALANCE SHEETS  
AS OF DECEMBER 31, 2005 AND 2004**

ASSETS

	2005	2004
Current assets:		
Cash	\$ 12,958,000	\$ 6,645,000
Accounts receivable		
Trade-net of allowance for bad debts of \$309,461 and \$0, respectively	4,133,000	671,000
Employees	488,000	267,000
Other	1,517,000	333,000
Commercial note receivable - secured	--	218,000
Inventories	9,622,000	5,042,000
Prepaid expenses	875,000	565,000
Advances to suppliers	1,216,000	308,000
Other tax refundable	501,000	37,000
	\$ 22,505,000	\$ 13,885,000

Total current assets	31,310,000	14,086,000
Property and equipment:		
Fixed assets, net of accumulated depreciation	34,686,000	9,027,000
Construction in progress	3,374,000	14,721,000
	<u>38,060,000</u>	<u>23,748,000</u>
Total assets	<u>\$ 69,370,000</u>	<u>\$ 37,834,000</u>

See accompanying summary of accounting policies and notes to financial statements.

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**AMERICAN DAIRY INC.  
CONSOLIDATED BALANCE SHEETS  
AS OF DECEMBER 31, 2005 AND 2004**

LIABILITIES AND STOCKHOLDERS' EQUITY

	<u>2005</u>	<u>2004</u>
Current liabilities:		
Accounts payable and accrued expenses	\$ 11,855,000	\$ 9,034,000
Current portion of long term debt	102,000	118,000
Advances from related parties	933,000	1,142,000
Advances from employees	948,000	654,000
Deferred income	12,074,000	9,694,000
Short-term notes and loans payable	7,324,000	242,000
	<u>33,236,000</u>	<u>20,884,000</u>
Long term debt, net of current portion shown above	<u>5,543,000</u>	<u>598,000</u>
Minority interest	<u>494,000</u>	<u>180,000</u>
Stockholders' equity:		
Common stock, \$.001 par value; 50,000,000 shares authorized; 14,132,824 and 13,556,356 shares issued and outstanding at December 31, 2005 and 2004, respectively	14,000	14,000
Additional paid-in capital	9,209,000	7,519,000
Retained earnings	20,269,000	8,639,000
Accumulated other comprehensive income	605,000	--
	<u>30,097,000</u>	<u>16,172,000</u>
Total liabilities and stockholders' equity	<u>\$ 69,370,000</u>	<u>\$ 37,834,000</u>

See accompanying summary of accounting policies and notes to financial statements.

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**AMERICAN DAIRY INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
FOR THE YEARS ENDED DECEMBER 31, 2005, 2004, AND 2003**

	2005	2004	2003
SALES	\$ 68,024,000	\$ 37,416,000	\$ 26,636,000
COST OF GOODS SOLD	38,716,000	18,007,000	15,733,000
Gross Profit	29,308,000	19,409,000	10,903,000
OPERATING AND ADMINISTRATIVE EXPENSES:			
Distribution expenses	16,743,000	13,486,000	7,899,000
General and administrative expenses	2,483,000	1,313,000	1,670,000
Depreciation	161,000	55,000	131,000
	19,387,000	14,854,000	9,700,000
Income from operations	9,921,000	4,555,000	1,203,000
OTHER INCOME (EXPENSE):			
Other income (expenses)	2,221,000	1,489,000	1,197,000
Gain on disposal of assets	9,000	1,000	--
Interest and finance costs	(523,000)	(49,000)	(25,000)
	1,707,000	1,441,000	1,172,000
MINORITY INTEREST	2,000	--	--
INCOME BEFORE INCOME TAXES	11,630,000	5,996,000	2,375,000
(PROVISION FOR) BENEFIT FROM INCOME TAXES	--	262,000	(339,000)
NET INCOME	11,630,000	6,258,000	2,036,000
Other comprehensive income:			
Foreign currency translation adjustment	605,000	--	--
TOTAL COMPREHENSIVE INCOME	\$ 12,235,000	\$ 6,258,000	\$ 2,036,000
BASIC NET INCOME PER COMMON SHARE	\$ 0.83	\$ 0.52	\$ 0.19
WEIGHTED AVERAGE BASIC SHARES OUTSTANDING	13,931,000	12,077,000	10,536,000
DILUTED NET INCOME PER COMMON SHARE	\$ 0.74	\$ 0.47	\$ 0.19
WEIGHTED AVERAGE DILUTED SHARES OUTSTANDING	16,057,000	13,456,000	10,536,000

See accompanying summary of accounting policies and notes to financial statements.

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**AMERICAN DAIRY, INC.  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

## FOR THE YEARS ENDED DECEMBER 31, 2005, 2004, AND 2003

	Common Stock				Accumulated Other Comprehensive Income	Totals
	Number of Shares	\$ 0.001 par Value	Additional Paid-In Capital	Retained Earnings		
Balance, December 31, 2002	9,785,530	\$ 10,000	\$ (6,000)	\$ 344,000	\$ --	\$ 348,000
Share issued for consulting and syndication services	240,000	--	270,000	--	--	270,000
Share issued in exchange for conversion of shareholder loans	933,155	1,000	1,865,000	--	--	1,866,000
Stock issued for cash	792,285	1,000	1,499,000	--	--	1,500,000
Less offering costs	--	--	(401,000)	--	--	(401,000)
Net income for the year ended December 31, 2003	--	--	--	2,037,000	--	2,037,000
Balance, December 31, 2003	11,750,970	12,000	3,227,000	2,381,000	--	5,620,000
Stock issued for services	46,000	--	97,000	--	--	97,000
Stock issued for cash	1,759,384	2,000	4,672,000	--	--	4,674,000
Less offering costs	--	--	(477,000)	--	--	(477,000)
Net income for the year ended December 31, 2004	--	--	--	6,258,000	--	6,258,000
Balance, December 31, 2004	13,556,354	14,000	7,519,000	8,639,000	--	16,172,000
Stock issued for cash	428,570	--	750,000	--	--	750,000
Stock issued for services	147,900	--	940,000	--	--	940,000
<b>COMPREHENSIVE INCOME:</b>						
Foreign currency translation adjustments	--	--	--	--	605,000	605,000
Net income for the year ended December 31, 2005	--	--	--	11,630,000	--	11,630,000
Balance, December 31, 2005	14,132,824	\$ 14,000	\$ 9,209,000	\$ 20,269,000	\$ 605,000	\$ 30,097,000

See accompanying summary of accounting policies and notes to financial statements.

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**AMERICAN DAIRY INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003**

	2005	2004	2003
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income	11,630,000	6,258,000	\$ 2,037,000
Adjustments to reconcile net income to operating activities -			
Depreciation	1,001,000	262,000	131,000
Provision for doubtful accounts	310,000	84,000	426,000
Compensation expense for stock issued	940,000	97,000	180,000
Gain on disposal of assets	(9,000)	(1,000)	--
Changes in assets and liabilities:			
(Increase) decrease in -			
Accounts and notes receivable	(5,176,000)	538,000	1,681,000
Inventories	(4,580,000)	32,000	(3,086,000)
Prepaid expenses	(310,000)	673,000	(11,000)
Advances to suppliers	(909,000)	322,000	(630,000)
Other tax refundable	(464,000)	522,000	(458,000)
Increase (decrease) in -			
Accounts payable and accrued expenses	3,115,000	2,533,000	3,532,000
Deferred income	2,379,000	4,827,000	2,071,000
Tax payable	--	212,000	164,000
Net cash provided by operating activities	<u>7,927,000</u>	<u>16,359,000</u>	<u>6,037,000</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Purchase of fixed assets	(15,327,000)	(5,241,000)	(3,672,000)
Payments received on note receivable	217,000	--	--
Disposal of assets	24,000	33,000	88,000
Cash received in merger and recapitalization	--	--	18,000
Deposit on land, building and equipment	--	418,000	(418,000)
Contributions by minority interest	313,000	180,000	--
Construction in progress	--	(12,686,000)	(2,035,000)
Net cash used in investing activities	<u>(14,773,000)</u>	<u>(17,294,000)</u>	<u>(6,019,000)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Proceeds from short-term debt	8,549,000	1,660,000	483,000
Proceeds from long-term debt	5,000,000	--	--
Repayments of short-term debt	(1,466,000)	(1,186,000)	--
Repayments of long-term debt	(70,000)	--	--
(Repayment of) advance from shareholder	(209,000)	233,000	(53,000)
Sale of common stock and capital contribution	750,000	4,673,000	1,500,000
Payment of offering costs	--	(477,000)	(396,000)
Purchase obligation (repayment)	--	(362,000)	363,000
Net cash provided by financing activities	<u>12,554,000</u>	<u>4,541,000</u>	<u>1,897,000</u>

Effect of exchange rate change on cash and cash equivalents	605,000	--	--
<b>NET INCREASE IN CASH AND EQUIVALENTS</b>	<b>5,708,000</b>	<b>3,604,000</b>	<b>1,915,000</b>
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	6,645,000	3,041,000	1,126,000
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>\$ 12,958,000</b>	<b>\$ 6,645,000</b>	<b>\$ 3,041,000</b>
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>			
Interest paid, net of capitalized amounts	\$ 139,000	\$ 37,000	\$ 20,000
Income taxes paid	\$ --	\$ --	\$ 339,000

See accompanying summary of accounting policies and notes to financial statements.

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### **SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:**

During the years ended December 31, 2005, 2004, and 2003, the Company issued for services rendered 147,900, 46,000, and 240,000 common shares, valued at \$940,240, \$96,600, and \$270,000, respectively.

During 2005, \$11,347,000 of construction costs were transferred from construction in progress to fixed assets.

During the year ended December 31, 2004, the Company issued 523,305 warrants to underwriters as additional consideration for funds raised in private placements during the year. The exercise price on these warrants ranged from \$1.50 per share to \$2.70 per share and all had a three year life. The fair market value at the date of issuance of these warrants totalled \$862,245. The effect of the issuance is to increase additional paid in capital by the fair value of the warrants issued with an offset to additional paid in capital in the same amount, since offering costs are treated as reductions in additional paid in capital.

During 2004, the net assets of Sanhao Dairy were transferred to Feihe Dairy by way of distribution to members effective July 1, 2004.

See accompanying summary of accounting policies and notes to financial statements.

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### **AMERICAN DAIRY, INC. NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2005**

#### 1. DESCRIPTION OF BUSINESS

##### **ORGANIZATIONAL STRUCTURE**

American Dairy, Inc. ("American Dairy" or the "Company") was incorporated in the State of Utah on December 31, 1985, originally with the name of Gaslight, Inc. It was inactive until March 30, 1988 when it changed its corporate name to Lazarus Industries, Inc. and engaged in the business of manufacturing and marketing medical devices. This line of business was discontinued in 1991, and it became a non-operating public company shell. During 2003, the Company changed its name to American Dairy, Inc.

Effective May 7, 2003, American Dairy completed the acquisition of 100% of the issued and outstanding capital stock of American Flying Crane Corporation ("AFC"), a Delaware corporation. As a result, AFC became a wholly owned subsidiary of American Dairy.

AFC was incorporated on January 15, 2002 in Delaware, with 50,000,000 authorized shares of common stock at a par value

of \$0.0001 per share and 10,000 of which authorized shares are currently issued and outstanding. AFC owns 100% of the registered capital of Heilongjiang Feihe Dairy Co., Limited ("Feihe Dairy") and Feihe Dairy in turn owns 100% of the registered shares of BaiQuan Feihe Dairy Co. Limited ("BaiQuan Dairy") and Heilongjiang Sanhao Dairy Co., Limited ("Sanhao Dairy") which was liquidated into BaiQuan Dairy during 2004, and 95% of Beijing Feihe Biotechnology Scientific and Commercial Co., Limited (Beijing Feihe) with the other 5% being held in trust for the Company. AFC also owns 60% of the registered capital of Shanxi Feihesantai Biotechnology Scientific and Commercial Co., Limited (Shanxi) formed to develop and operating a walnut processing plant.

Currently, the principal core activity of AFC is investment holdings, while the principal core activities of Feihe Dairy, Sanhao Dairy and BiaQuan Dairy are manufacturing and distribution of dairy products under the Feihe trademarks. The principal core activity of Shanxi is the production and distribution of walnut powder. Shanxi commenced operations in October 2005. The subsidiaries' principal country of operations is the People's Republic of China ("PRC").

Included in the consolidated financial statements are the following subsidiaries:

- o American Flying Crane Corporation
- o Heilongjiang Feihe Dairy Co., Limited
- o BaiQuan Feihe Dairy Co., Limited
- o Beijing Feihe Biotechnology Scientific and Commercial Co., Limited
- o Shanxi Feihesantai Biotechnology Scientific and Commercial Co., Limited

## 2. BASIS OF PREPARATION OF FINANCIAL STATEMENTS

The Company's consolidated financial statements include the accounts of American Dairy, Inc., its wholly-owned subsidiaries, AFC, Feihe Dairy, Beijing Feihe, and BaiQuan Feihe and its 60% owned subsidiary, Shanxi Feihe. The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America.

On May 7, 2003, American Dairy, Inc. acquired all of the outstanding common stock of American Flying Crane Corporation. For accounting purposes, the acquisition has been treated as a recapitalization of American Flying Crane Corporation with American Flying Crane Corporation as the acquirer. The historical financial statements presented both before and after May 7, 2003 are those of American Flying Crane Corporation.

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**AMERICAN DAIRY, INC.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
DECEMBER 31, 2005

On December 31, 2002, American Dairy, Inc. (formerly Lazarus Industries Inc. ("Lazarus")) had 7,485,147 shares issued and outstanding. In preparation for the acquisition of AFC, Lazarus did a 19 to 1 stock split which reduced the shares outstanding by 7,090,994 shares. This was followed by the repurchase of an additional 258,623 shares by Lazarus for \$20,000 leaving 135,530 shares outstanding. On May 7, 2003, Lazarus issued 9,650,000 shares of its common stock for the acquisition of 100% of the outstanding stock of AFC.

In accordance with the requirements of SEC Accounting and Disclosure Rules and Practices Appendix B, the May 7, 2003 transaction was treated as a recapitalization of AFC as it was deemed to be the accounting acquirer. Furthermore, in accordance with the requirements of Current Issue and Rulemaking Projects ("CIRP") T.VI.G-11-98, the historical financial statements prior to the acquisition are those of the accounting acquirer, although (in absence of a name change) they are labeled as those of the issuer. Therefore, for financial reporting purposes, the recapitalized financial statements of AFC were rolled back. As of December 31, 2002, the common shares outstanding include the 9,650,000 shares issued to the AFC shareholders plus the 135,530 shares still owned by the original Lazarus shareholders for a total of 9,785,530 shares.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The following is a summary of significant accounting policies:

**CONSOLIDATION POLICY** - All significant inter-company transactions and balances within the Company are eliminated on consolidation.

**CASH AND EQUIVALENTS** - The Company considers all highly liquid debt instruments purchased with maturity period of three months or less to be cash equivalents. The carrying amounts reported in the accompanying consolidated balance sheet for cash and cash equivalents approximate their fair value.

**ACCOUNTS RECEIVABLE** - Provision is made against accounts receivable to the extent which they are considered to be doubtful. Accounts receivable in the balance sheet is stated net of such provision.

**INVENTORIES** - Inventories comprise raw materials, consumables and goods held for resale and are stated at the lower of cost or market value. Cost is calculated using the weighted average method and includes any overhead costs incurred in bringing the inventories to their present location and condition. Overhead costs included in finished goods inventory include direct labor cost and other costs directly applicable to the manufacturing process, including utilities, supplies, repairs and maintenances, and depreciation expense.

Market value represents the estimated selling price in the ordinary course of business less the estimated costs necessary to complete the sale.

**CONSTRUCTION-IN-PROGRESS** - All facilities purchased for installation, self-made or subcontracted are accounted for as construction-in-progress. Construction-in-progress is recorded at acquisition cost, including cost of facilities, installation expenses and the interest capitalized during the course of construction for the purpose of financing the project. Upon completion and readiness for use of the project, the cost of construction-in-progress is to be transferred to fixed assets.

**PROPERTY AND EQUIPMENT** - Property and equipment are recorded at cost. Expenditures for major additions and improvements are capitalized, and minor replacements, maintenance, and repairs are charged to expense as incurred. When property and equipment are retired or otherwise disposed of, the cost and accumulated depreciation are removed from the accounts and any resulting gain or loss is included in the results of operations for the respective period. Depreciation is provided over the estimated useful lives of the related assets using the straight-line method less anticipated salvage values of 10% for financial statement purposes. Land use rights are being amortized on a straight-line basis over the term of the use agreement. The estimated useful lives for significant property and equipment categories are as follows:

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**AMERICAN DAIRY, INC.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
DECEMBER 31, 2005

Buildings	33 years
Plant and machinery	20 years
Motor vehicles	9 years
Computers and equipment	5 years

The Company reviews the carrying value of property, plant, and equipment for impairment whenever events and circumstances indicate that the carrying value of an asset may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. In cases where undiscounted expected future cash flows are less than the carrying value, an impairment loss is recognized equal to an amount by which the carrying value exceeds the fair value of assets. The factors considered by management in performing this assessment include current operating results, trends and prospects, the manner in which the property is used, and the effects of obsolescence, demand, competition, and other economic factors. Based on this assessment there was no impairment at December 31, 2005 or for the three years then ended.

**DEFERRED REVENUES** - Revenue from the sale of goods or services is recognized when goods are delivered or services are rendered. Receipts in advance for goods to be delivered or services to be rendered in the subsequent year are carried forward as deferred revenue.

REVENUE RECOGNITION - Revenue from the sale of goods is recognized on the transfer of risks and rewards of ownership, which generally coincides with the time when the goods are delivered to customers and the title has passed. During 2005, one customer represented 15% of sales. No customer represented over 10% of sales in 2004 and 2003.

Interest income is recognized when earned, taking into account the principal amounts outstanding and the interest rates applicable.

Other income includes compensation received from the State Bureau as incentive to relocate from the previous factory premises, value added tax rebates, profit from the sales of raw materials to third parties and write back of long outstanding trade payables.

FOREIGN CURRENCIES - The Company's principal country of operations is in The People's Republic of China. The financial position and results of operations of the Company are determined using the local currency ("Renminbi" or "Yuan") as the functional currency. The results of operations denominated in foreign currency are translated at the average rate of exchange during the reporting period. Assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the market rate of exchange ruling at that date. The registered equity capital denominated in the functional currency is translated at the historical rate of exchange at the time of capital contribution. All translation adjustments resulting from the translation of the financial statements into the reporting currency ("US Dollars") are dealt with as an exchange fluctuation reserve in shareholders' equity.

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**AMERICAN DAIRY, INC.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
DECEMBER 31, 2005

Historically the local currency's exchange rate had been tied to the US Dollar at a rate of approximately 8.28 Yuan per US Dollar. Effective July 21, 2005 the Yuan was revalued to an effective exchange rate of approximately 8.11 Yuan per US Dollar. Subsequent to the revaluation the Yuan has been allowed to float within a specified range. As of December 31, 2005 the exchange rate was 8.11 Yuan per US Dollar.

TAXATION - In accordance with the requirements of Statement of Financial accounting Standards No. 109 "Accounting Form Income Taxes", deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets, including tax loss and credit carryforwards, and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred income tax expense represents the change during the period in the deferred tax assets and deferred tax liabilities. The components of the deferred tax assets and liabilities are individually classified as current and non-current based on their characteristics. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely that not that some portion or all of the deferred tax assets will not be realized. For the years ended December 31, 2005, 2004, and 2003, Feihe Dairy enjoyed a 100% tax holiday from enterprise income taxes. Therefore the only timing differences giving rise to deferred income taxes during these periods was the tax effect of the net operating loss carryforward at the parent company level, which was subject to a 100% valuation allowance.

A provision has not been made at December 31, 2005 for U.S. or additional foreign withholding taxes on approximately \$25,224,000 of undistributed earnings of foreign subsidiaries because it is the present intention of management to reinvest the undistributed earnings indefinitely in foreign operations. Generally, such earnings become subject to U.S. tax upon the remittance of dividends and under certain other circumstances. It is not practicable to estimate the amount of deferred tax liability on such undistributed earnings.

Enterprise income tax ("EIT") is provided on the basis of the statutory profit for financial reporting purposes, adjusted for income and expense items, which are not assessable or deductible for income tax purposes. Under the Business Promotion Policy Concerning Income Tax on Foreign Enterprises promulgated by the QiQiHaEr City Municipal Government, foreign owned enterprises registered in QiQiHaEr City are entitled to a tax holiday of seven years for full EIT exemption as though the EIT has been paid during the tax holiday periods. The preferential tax treatment commenced in 2003 and will expire in

2009.

#### Value added tax

Value added tax payable in the PRC is charged on an aggregated basis at a rate of 13% or 17% (depending on the type of goods involved) on the full price collected for the goods sold or, in the case of taxable services provided, at a rate of 17% on the charges for the taxable services provided, but excluding, in respect of both goods and services, any amount paid in respect of value added tax included in the price or charges, and less any deductible value added tax already paid by the taxpayer on purchases of goods and services in the same financial year.

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**AMERICAN DAIRY, INC.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
DECEMBER 31, 2005

During 2003, 2004, and 2005, the Kendong County Government had a policy of refunding amounts equal to 50% of the value added tax paid as an economic incentive to support the local economy through the employment the Company provides at its production facilities. These refunds which amounted to \$1,502,127, \$1,144,060 and \$942,907 for the fiscal years ended December 31, 2005, 2004, and 2003 respectively are reflected in other income on the financial statements.

**PRODUCT DISPLAY FEES** - The Company has entered into a number of agreements with the resellers of its products, whereby the Company pays the reseller an agreed upon amount to display its products. As prescribed by the Emerging Issues Task Force Issue 01-09: Accounting for Consideration Given by a Vendor to a Customer, the Company has reduced sales by the amounts paid under these agreements. For the years ended December 31, 2005 and 2004 these totaled \$1,800,000 and \$1,922,000 respectively.

**ADVERTISING COSTS** - Advertising costs are charged to operations when incurred. Advertising expense totaled \$3,394,000, \$2,753,000, and \$1,633,000 during the years ended December 31, 2005, 2004, and 2003, respectively.

**SHIPPING AND HANDLING COSTS** - The Company's shipping and handling costs are included in cost of sales for all periods presented.

**RETIREMENT BENEFIT COST** - According to the People's Republic of China regulations on pension, a company contributes to a defined contribution retirement plan organized by municipal government in the province in which the Company was registered and all qualified employees are eligible to participate in the plan. Contributions to the plan are calculated at 20% of the employees' salaries above a fixed threshold amount and the employees contribute 4% while the Company contributes the balance contribution of 16%. Wholly owned foreign enterprises are exempted from contribution to the retirement plan.

**FAIR VALUE OF FINANCIAL STATEMENTS** - The carrying amounts of certain financial instruments, including cash, accounts receivable, note receivable, other receivables, accounts payable, accrued expenses, advances from staff, notes payable and other payables approximate their fair values as of December 31, 2005 because of the relatively short-term maturity of these instruments.

**USE OF ESTIMATES** - The preparation of financial statements in accordance with generally accepted accounting principles require management to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**RECLASSIFICATIONS** - Certain reclassifications have been made to the prior years' financial statements to conform to the current year presentation. These reclassifications had no effect on previously reported results of operations or retained earnings.

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**AMERICAN DAIRY, INC.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
DECEMBER 31, 2005

In May 2003, the FASB issued SFAS No. 150, "Accounting for Instruments with Characteristics of Both Debt and Equity" (SFAS 150). Statement 150 requires liability classification for three types of instruments: 1) mandatory redeemable shares that obligate the company to deliver cash or other assets to shareholders on fixed or determinable dates; 2) freestanding written put options and forward purchase contracts on a company's own shares that obligate the company to deliver cash or other assets, and 3) contracts that obligate a company to issue its own shares in amounts that are unrelated to, or inversely related to, the value of the shares. The adoption of SFAS 150 had no impact on the Company's financial position, results of operations, or cash flows.

In November 2004, the FASB issued SFAS No. 151 "Inventory Costs - an amendment of ARB No. 43, Chapter 4". Statement No. 151 requires that certain abnormal costs associated with the manufacturing, freight, and handling costs associated with inventory be charged to current operations in the period in which they are incurred. The adoption of SFAS 151 had no impact on the Company's financial position, results of operations, or cash flows.

In December 2004, the FASB issued a revision of SFAS No. 123 "Share-Based Payment". The statement establishes standards for the accounting for transactions in which an entity exchanges its equity investments for goods and services. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of those equity instruments. The statement does not change the accounting guidance for share-based payments with parties other than employees.

The statement requires a public entity to measure the cost of employee service received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exception). That cost will be recognized over the period during which an employee is required to provide service in exchange for the award (usually the vesting period). A public entity will initially measure the cost of employee services received in exchange for an award of liability instrument based on its current fair value; the fair value of that award will be remeasured subsequently at each reporting date through the settlement date. Changes in fair value during the requisite service period will be recognized as compensation over that period.

The grant-date for fair value of employee share options and similar instruments will be estimated using option-pricing models adjusted for the unique characteristics of these instruments.

The statement is effective for the quarter beginning January 1, 2006.

SFAS No. 152 "Accounting for Real Estate Time Sharing Transactions", SFAS No. 153 "Exchange of Nonmonetary Assets", SFAS No. 154 "Accounting for Changes and Error Corrections", SFAS No. 155 "Accounting for Certain Hybrid Financing Instruments", and SFAS No. 156 "Accounting for Servicing of Financial Assets" were recently issued but have no current applicability to the Company and have no effect on the consolidated financial statements.

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**AMERICAN DAIRY, INC.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
DECEMBER 31, 2005

#### 4. CONCENTRATIONS OF BUSINESS AND CREDIT RISK

The Company maintains certain bank accounts in the PRC which are not protected by FDIC insurance or other insurance. As of December 31, 2005 the Company held \$206,000 of cash balances within the United States of which \$106,000 was in excess of FDIC insurance limits.

Geographic Concentration; Fluctuations in Regional Economic Conditions. Nearly all of American Dairy's sales are concentrated in China. Accordingly, American Dairy is susceptible to fluctuations in its business caused by adverse economic conditions in this country. American Dairy's products are priced higher than non-premium quality dairy products. Although American Dairy believes that the quality, freshness, flavor and absence of artificial ingredients in its products compensate for this price differential, there can be no assurance that consumers will be willing to pay more for such products in unfavorable economic conditions, or at all. Difficult economic conditions in other geographic areas into which American Dairy may expand may also adversely affect its business, operations and finances.

The Company provides credit in the normal course of business. Substantially all customers are located in The People's Republic of China. The Company performs ongoing credit evaluations of its customers and maintains allowances for doubtful accounts based on factors surrounding the credit risk of specific customers, historical trends, and other information.

Substantially all of the Company's fixed assets and operations are located in the Peoples Republic of China.

The Company is self-insured for all risks and carries no liability or property insurance coverage of any kind.

Substantially all of the Company's profits are generated from operations in mainland China.

Payments of dividends may be subject to some restrictions; therefore in accordance with Rule 504/4.08 (e) (3) of Regulation S-X, the following are condensed parent company, only financial statements for the three years ended December 31, 2005.

AMERICAN DAIRY, INC. AND AMERICAN FLYING CRANE  
CONDENSED PARENT COMPANY ONLY BALANCE SHEETS  
AS OF DECEMBER 31, 2005, 2004, AND 2003

	2005	2004	2003
<b>Current assets:</b>			
Cash	\$ 216,684	\$ 209,347	\$ 705,091
Accounts receivable, other	1,567	1,567	
Prepaid expenses	22,500	—	113,989
<b>Total current assets</b>	<b>240,751</b>	<b>210,914</b>	<b>819,080</b>
Investment in subsidiaries, reported on equity method	40,047,899	18,118,753	5,886,538
<b>Total assets</b>	<b>\$ 40,288,650</b>	<b>\$ 18,329,667</b>	<b>\$ 6,705,618</b>
	2005	2004	2003
<b>Current liabilities:</b>			
Accounts payable and accrued expenses	\$ 362,153	\$ 138,153	\$ 12,000
Advances from directors	1,829,527	1,091,364	858,418
Advances from subsidiaries	—	928,420	214,152
Short-term notes and loans payable	3,000,000	—	
<b>Total current liabilities</b>	<b>5,191,680</b>	<b>2,157,937</b>	<b>1,084,570</b>
Long term debt, net of current portion shown above	5,000,000	—	—
<b>Stockholders' equity:</b>			
Common stock, \$.001 par value; 50,000,000 shares authorized; 14,134 and 13,558 shares issued and outstanding at December 31, 2005 and 2004, respectively	14,134	13,558	11,571

Additional paid-in capital	9,208,836	7,519,172	3,228,297
Retained earnings	20,269,000	8,639,000	2,381,000
Accumulated other comprehensive income	605,000	—	—
Total stockholders' equity	30,096,970	16,171,730	5,621,048
Total liabilities and stockholders' equity	\$ 40,288,650	\$ 18,329,667	\$ 6,705,618

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AMERICAN DAIRY, INC. AND AMERICAN FLYING CRANE  
CONDENSED PARENT COMPANY ONLY INCOME STATEMENTS  
FOR THE YEARS ENDED DECEMBER 31, 2005, 2004, AND 2003

	2005	2004	2003
SALES	\$ —	\$ —	\$ —
OPERATING AND ADMINISTRATIVE EXPENSES:			
General and administrative expenses	1,448,656	515,149	706,164
Other	69,734	34,990	—
	1,518,390	550,139	706,164
Income from operations	(1,518,390)	(550,139)	(706,164)
OTHER INCOME (EXPENSE):			
Equity in earnings of unconsolidated subsidiaries	13,434,145	6,877,949	3,065,302
Other income (expenses)	13,516	(65,871)	21,862
Interest and finance costs	(299,271)	(3,939)	—
	13,148,390	6,808,139	3,087,164
INCOME BEFORE INCOME TAXES	11,630,000	6,258,000	2,381,000
(PROVISION FOR) BENEFIT FROM INCOME TAXES	—	—	—
NET INCOME	11,630,000	6,258,000	2,381,000

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AMERICAN DAIRY, INC. AND AMERICAN FLYING CRANE  
CONDENSED PARENT COMPANY ONLY STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003

	2005	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:			

Net income	\$ 11,630,000	\$ 6,258,000	\$ 2,381,000
Adjustments to reconcile net income to operating activities -			
Less : Equity in earnings of unconsolidated subsidiaries	(13,434,144)	(6,877,949)	(3,065,302)
Compensation expense for stock issued	940,240	96,600	270,000
Changes in assets and liabilities:			
(Increase) decrease in -Accounts and notes receivable	—	(1,567)	—
Prepaid expenses	(22,500)	113,989	(113,989)
Increase (decrease) in -Accounts payable and accrued expenses	224,000	126,153	12,000
Net cash (used in) operating activities	(662,404)	(284,774)	(516,291)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Investment in subsidiary	(7,890,000)	(5,112,376)	(2,821,236)
Long-term investment	—	(241,890)	—
Net cash (used in) investing activities	(7,890,000)	(5,354,266)	(2,821,236)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Advances from director	738,162	232,946	858,418
Advances from subsidiary	(928,422)	714,269	214,152
Loan proceeds	8,000,000	—	—
Offering proceeds	750,000	4,196,082	2,970,048
Net cash provided by financing activities	8,559,740	5,143,297	4,042,618
Effect of exchange rate change on cash and cash equivalents	—	—	—
NET INCREASE (DECREASE) IN CASH AND EQUIVALENTS	7,336	(495,743)	705,091
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	209,348	705,091	
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 216,684	\$ 209,348	\$ 705,091
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:			
Interest paid, net of capitalized amounts	\$ 299,271	\$ 3,939	\$ —
Income taxes paid	\$ —	\$ —	\$ —

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American Dairy, Inc. and American Flying Crane  
Notes to Condensed Parent Company Only Financial Statements

Note 1 - These condensed parent company only financial statements should be read in connection with the American Dairy consolidated financial statements and notes thereto.

Note 2 - Convertible Debt

As of December 31, 2005 the Company had two series of convertible debt outstanding as described below:

Series A Convertible notes in the amount of \$3,000,000, bearing interest at 6.5% per annum, due on April 26, 2006. These notes are convertible to common stock at a conversion price of \$8.00 per share.

Series B Convertible notes in the amount of \$5,000,000, bearing interest at 7.5% per annum, \$2,500,000 due on June 30, 2007 and \$2,500,000 due on August 14, 2007. These notes are convertible to common stock at a conversion price of \$10 per share.

The Series A Notes are reflected in current liabilities as of March 31, 2006 and December 31, 2005.

As of March 31, 2006 principal payment due by year for the next five years and thereafter on the Series B notes is as follows:

<u>Fiscal year ended December 31</u>	<u>Amount</u>
2006	\$3,000,000
2007	5,000,000
2008	—
2009	—
2010	—
Thereafter	—
	<u>\$8,000,000</u>

## 5. INVENTORIES

Inventories consist of the following as of December 31, 2005 and 2004:

	<u>2005</u>	<u>2004</u>
Raw and partially processed materials	\$3,215,000	\$4,073,000
Finished goods	6,407,000	969,000
	<u>\$9,622,000</u>	<u>\$5,042,000</u>

## 6. TAX REFUNDABLE

Tax refundable represents valued added tax refundable from the local governments in The People's Republic of China.

## 7. TRANSACTIONS WITH RELATED PARTIES

As of December 31, 2005 and 2004 the Company had the following balances due to its officers and directors:

<u>Name</u>	<u>2005</u>	<u>2004</u>
Leng You-bin	\$ 858,000	\$1,134,000
Other officers and directors	75,000	8,000
	<u>\$ 933,000</u>	<u>\$1,142,000</u>

These balances are non-interest bearing and due on demand.

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**AMERICAN DAIRY, INC.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
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## 8. FIXED ASSETS

During 2005, the Company completed the acquisition of the assets of Nutricia Nutritionals Co., Limited for a total consideration of \$7,430,000, of which \$130,000 was allocated to inventory and the balance of \$7,300,000 was allocated to buildings and equipment. This acquisition consisted of a production plant and milk collection centers located in Yushutun and Angangxi Districts.

Fixed assets consist of the following as of December 31, 2005 and 2004:

	2005	2004
Buildings	\$19,352,000	\$4,858,000
Plant and machineries	15,513,000	3,932,000
Motor vehicles	787,000	292,000
Computers and equipment	392,000	299,000
	<u>36,044,000</u>	<u>9,381,000</u>
Less: Accumulated depreciation	(1,358,000)	(354,000)
	<u>\$34,686,000</u>	<u>\$9,027,000</u>

Depreciation expense totaled \$1,001,000, \$261,000, and \$131,000, respectively, for the years ended December 31, 2005, 2004, and 2003 of which \$840,000, \$206,000, and \$0 were included as a component of cost of goods in the respective periods.

## 9. CONSTRUCTION-IN-PROGRESS

The Company had two major construction projects under construction at December 31, 2005 and 2004 as detailed below:

	2005	2004
Feihe Dairy processing facilities	\$2,868,000	\$10,758,000
Shanxi walnut processing facility	506,000	3,963,000
	<u>\$3,374,000</u>	<u>\$14,721,000</u>

## 10. ADVANCES FROM EMPLOYEES

Advances from employees represented temporary funding by employees to finance a temporary working capital shortfall experienced by the Company. The advances were unsecured, interest free and repayable within one year.

## 11. DEFERRED INCOME

Receipts in advance represent advances from new customers and for which goods have not been delivered as of the balance sheet date. Receipts in advance for goods to be delivered or services to be rendered in the subsequent year are carried forward as deferred revenue.

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**AMERICAN DAIRY, INC.**  
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12. NOTES PAYABLE

Short term notes and loans payable consist of the following as of December 31, 2005 and 2004:

	2005	2004
Note payable to a bank, bearing interest at 6.696% per annum, secured by plant and machinery, payable in monthly installments	\$ 3,082,000	\$ —
Series A convertible note, bearing interest at 6.5% per Annum, due on April 26, 2006, convertible to common stock at a conversion price of \$8.00 per share	3,000,000	—
Unsecured, non-interest bearing obligation to an unrelated company, repayable upon demand	995,000	—
Unsecured, non-interest bearing obligation to county finance department, with no fixed repayment terms	247,000	242,000
	<u>\$ 7,324,000</u>	<u>\$ 242,000</u>

13. LONG-TERM DEBT

Long-term debt consists of the following as of December 31, 2005 and 2004:

	2005	2004
Series B convertible notes, bearing interest at 7.5% per annum, payments \$2,500,000 due on June 30, 2007 and August 14, 2007, convertible to common stock at a conversion price of \$10,000 per share	\$ 5,000,000	\$ —
Note payable to a bank, bearing interest at 5.76% per annum, secured by plant and machinery, payable in 96 montly installments	635,000	685,000
Note payable to a finance company, secured by a vehicle payable in 60 monthly installments	10,000	31,000
	5,645,000	716,000
Less: current portion of long-term debt	(102,000)	(118,000)
	<u>\$ 5,543,000</u>	<u>\$ 598,000</u>

Principal payments due by year for the next five years and thereafter on these notes are as follows:

Fiscal year ended December 31,	Amount
2006	\$ 102,000
2007	5,092,000
2008	92,000
2009	92,000
2010	92,000
Thereafter	175,000
	<u>\$5,645,000</u>

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**AMERICAN DAIRY, INC.**  
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14. MINORITY INTEREST

Minority interest represents the proportionate share (40%) of equity of Shanxi Feihesantai Biotechnology Scientific and Commercial Co., Limited (Shanxi) owned by Licheng Shantai Technology Enterprises Co., Limited. At December 31, 2005 and 2004, the Company owned 60% of Shanxi's registered capital stock.

15. CAPITAL STOCK

The Company has 50,000,000 shares of authorized Common Stock with a par value of \$.001 per share.

During 2003, the Company had stock transactions as detailed below:

In anticipation of the merger with AFC, the Company effected a 1 for 19 reverse stock split, which decreased the number of shares of outstanding common stock from 7,485,147 to 394,168. Then certain shareholders contributed 258,638 shares of common stock back to the Company further reducing the outstanding shares to 135,530.

The Company issued 9,640,000 shares of restricted common stock in exchange for all of the outstanding capital stock of AFC.

The Company also issued 240,000 shares of common stock and paid \$60,000 in cash plus the obligation to pay another \$12,000 in cash in connection with a consulting agreement entered into with existing shareholders. This stock was valued at \$270,000 for financial reporting purposes. The consulting agreement is to cover a period of one year commencing May 7, 2003. For financial reporting purposes \$228,000 was charged to consulting fee expense in 2003 with the balance of \$114,000 being treated as a prepaid expense at December 31, 2003.

A shareholder converted advances to the Company in the amount of \$1,866,000 into 933,155 shares of restricted common stock.

Additionally, a total of 792,285 shares of common stock were sold for a total cash consideration of \$1,500,000. Offering and syndication costs totaling \$401,000 were treated as reductions in additional paid-in capital for financial reporting purposes.

During 2004, the Company had stock transactions detailed below:

The Company issued 46,000 shares of its restricted common stock valued at \$97,000 for consulting services.

In connection with two private placements, the Company issued 1,759,384 shares of restricted common stock purchased for total cash consideration of \$4,673,000. Offering and syndication costs totaling \$477,000 were treated as reductions in additional paid-in capital for financial reporting purposes. The Company also issued 1,825,546 warrants in connection with the private placements, 1,302,241 of which went to the purchasers and 523,305 went to the underwriters as additional consideration for funds raised in the private placements. The exercise price of these warrants ranged from \$1.50 to \$3.80 and the warrants expire in three years. The 523,305 warrants issued to underwriters had a market value at the issuance date of \$862,000. The effect of the issuance is to increase additional paid-in capital by the fair value of the warrants issued with an offset to additional paid in capital in the same amount, since offering costs are treated as reductions in additional paid-in capital. No warrants were exercised during the year ended December 31, 2004.

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During 2005, the Company had stock transactions detailed below:

The Company issued 98,900 shares of unrestricted common stock valued at \$643,000 to Chinese employees of Feihe Dairy for bonuses, issued pursuant to a Form S-8 registration statement.

The Company issued 428,570 shares of its common stock pursuant to the exercise of warrants at \$1.75 each for a total consideration paid of \$750,000.

The Company issued 47,000 shares of restricted common stock valued at \$286,000 for bonuses to directors and to others for consulting services.

The Company issued 2,000 share of unrestricted common stock valued at \$11,000 for consulting services, issued pursuant to a Form S-8 registration statement.

#### 16. INCOME TAX

A reconciliation of tax at the statutory rates to the Company's effective rate are as follows:

	Year Ended December 31,		
	2005	2004	2003
Computed expected tax expense	\$ 4,418,000	\$ 2,369,000	\$ 903,000
Increases (reductions) in taxes result from:			
Add back effect of U.S. losses	686,000	245,000	277,000
Foreign income subject to foreign income tax but not expected to be subject to U.S. tax in foreseeable future - Adjustment due to change in effective tax rates	(492,000)	(430,000)	(155,000)
BaiQuan Dairy 2003 tax liability waived by province	—	(262,000)	—
Foreign income subject to foreign tax holiday but not expected to be subject to U.S. tax in foreseeable future	(4,612,000)	(2,184,000)	(686,000)
Actual income tax expense (benefit)	<u>\$ —</u>	<u>\$ (262,000)</u>	<u>\$ 339,000</u>

Under the Provisional Regulation of the PRC, income tax is payable by enterprises at a rate of 33% of their taxable income. Feihe Dairy has been granted a tax holiday of seven years for full enterprise income paid during that period. This tax holiday will expire in April of 2009. The enterprise taxes paid during 2004 and 2003 were accrued (waived) by Sanhao Dairy and BaiQuan Dairy as follows:

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	Year Ended December 31,		
	2005	2004	2003
Sanhao Dairy	\$ —	—	\$ 77,000
BaiQuan Dairy	—	(262,000)	262,000
Total	\$ —	\$ (262,000)	\$ 339,000

The tax holiday resulted in tax savings as follows:

	Year Ended December 31,		
	2005	2004	2003
Approximate tax savings	\$ 4,612,000	\$ 2,455,000	\$ 685,000
Benefit per share			
Basic	\$ 0.33	\$ 0.20	\$ 0.07
Diluted	\$ 0.30	\$ 0.18	\$ 0.07

The Company has a U.S net operating loss carryforward of approximately \$2,914,000 which will begin expiring in 2022. For financial reporting purposes the deferred tax asset of \$1,137,000 associated with this loss carryforward is fully reserved as of December 31, 2005.

Although it is not anticipated in the foreseeable future, should the parent company receive dividends from its foreign subsidiaries, these dividends would be fully taxable, subject to an offset for foreign taxes paid on these earnings. The Company has not provided any accrual for any tax liabilities that might be incurred for the receipt of dividends from its foreign subsidiaries.

#### 17. EARNINGS PER SHARE

Statement of Financial Accounting Standards No. 128, Earnings Per Share, requires presentation of basic and diluted earnings per share (EPS), as defined, on the face of the statements of operations for all entities with complex capital structures. SFAS No. 128 requires a reconciliation of the numerator and denominator of the basic and diluted earnings per shares (EPS) computations:

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	Income (Numerator)	Shares (Denominator)	Per Share Amount
For the year ended December 31, 2005			
Basic EPS income available to Common shareholders	\$ 11,629,000	13,931,006	\$ .83
Effect of dilutive securities:			
Warrants issued	—	1,643,533	\$ .08
Convertible notes	304,000	482,534	\$ .01

Diluted EPS income available to Common shareholders	\$ 11,933,000	16,057,073	\$	.74
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For the year ended December 31, 2004

Basic EPS income available to Common shareholders	\$ 6,258,000	12,077,085	\$	.52
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Effect of dilutive securities:

Warrants issued		1,378,615	\$	.05
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Diluted EPS income available to Common shareholders	\$ 6,258,000	13,455,700	\$	.47
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For the year ended December 31, 2003

Basic EPS income available to Common shareholders	\$ 2,037,000	10,535,964	\$	.19
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Effect of dilutive securities:

Warrants issued		—		—
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Diluted EPS income available to Common shareholders	\$ 2,037,000	10,535,964	\$	.19
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During the year ended December 31, 2005, the Company issued Series A and Series B Convertible Notes (See Notes 12 and 13). These notes allow the holder to convert each note to common stock of the Company at any time during the term of the note.

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**AMERICAN DAIRY, INC.**  
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18. STOCK OPTIONS AND WARRANTS

Effective May 7, 2003, the Company adopted and approved its 2003 Incentive Stock Plan (the "Plan") which reserved 3,000,000 shares of Common Stock for issuance under the Plan. The Plan allows the Company to issue awards of incentive non-qualified stock options, stock appreciation rights, and stock bonuses to directors, officers, employees and consultants of the Company which may be subject to restrictions. The Company applies APB 25 and related interpretations in accounting for its plan. Compensation for services that a corporation receives under APB 25 through stock-based compensation plans should be measured by the quoted market price of the stock at the measurement date less the amount, if any, that the individual is required to pay. Compensation expense of \$940,000 and \$97,000 was recorded during the years ended December 31, 2005 and 2004, respectively, related to the Plan.

As of December 31, 2005, the Company had 2,539,832 warrants outstanding at an average exercise price of \$2.23 per warrant for one share each of the Company's common stock. The warrants will expire five years from the issuance date, with 1,042,858 expiring in 2006 and the balance of 1,496,974 expiring in 2009. During the year ended December 31, 2005, 428,570 warrants were exercised for \$1.75 per share, resulting in proceeds of \$750,000 to the Company.

Information with respect to outstanding warrants to service providers is as follows:

Average

	Shares	Exercise Price
Outstanding warrants at beginning of year	2,968,402	\$ 2.16
Warrants granted	—	—
Exercised	(428,570)	1.75
Expired	—	—
Outstanding warrants at the end of year	<u>2,539,832</u>	<u>\$ 2.23</u>

Warrants Outstanding			Warrants Exercisable	
Shares Outstanding 12/31/05	Average Remaining Life (Years)	Average Exercise Price	Shares Outstanding 12/31/05	Average Exercise Price
2,539,832	2.5	\$ 2.23	2,539,832	\$ 2.23

## 19. COMMITMENTS

As of December 31, 2005, the Company has future commitments to acquire a building of \$604,000, to acquire land use rights totaling \$273,000, and to pay future advertising costs totaling \$3,429,000.

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As of December 31, 2005, there were no minimum future rental payments under non-cancelable operating leases having remaining terms in excess of one year.

Rent expense incurred during the years ended December 31, 2005, 2004, and 2003 totaled \$63,000, \$23,000 and \$6,000, respectively.

In accordance with the terms and conditions of a Sale and Purchase Agreement dated February 23, 2005 between Feihe Dairy and a vendor for the sale and purchase of a land use right in Beijing, in the People's Republic of China, Feihe Dairy agreed to acquire the commercial property for consideration of \$1,009,000 of which three installments totaling \$404,000 have been paid as of December 31, 2005.

In accordance with the terms and conditions of a Sale and Purchase Agreement dated July 25, 2003, the Company has agreed to acquire land use rights and a factory in Kedong County for a total consideration of \$401,000. At the Company's option the liability could be settled through payment of cash consideration or through the issuance of 200,000 shares of its common stock. This option had not expired as of December 31, 2005. The Company accrued the liability during the year ended December 31, 2004. As of December 31, 2005 the Company had not settled the commitment.

## 20. SUBSEQUENT EVENTS

In January 2006 the Company signed an agreement with the government of Gannan County, in Heilongjiang Province in The People's Republic of China to build a new milk processing plant. Under the terms of the agreement the Company will receive land, tax incentives, and subsidies as well as certain exclusive distribution and milk processing rights within the local market.

## 21. QUARTERLY FINANCIAL DATA (UNAUDITED)

Summarized unaudited quarterly financial data for 2005 and 2004 are as follows:

Quarters Ended

	December 31, 2005	September 30, 2005	June 30, 2005	March 31, 2005
Sales	\$ 24,486,000	\$ 14,274,000	\$ 15,143,000	\$ 14,121,000
Gross profit	8,190,000	6,744,000	7,550,000	6,824,000
Net income	3,995,000	2,179,000	2,823,000	2,633,000
Net earnings per common share:				
Basic	\$ 0.27	\$ 0.16	\$ 0.21	\$ 0.19
Diluted	\$ 0.25	\$ 0.14	\$ 0.18	\$ 0.17

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	Quarters Ended			
	December 31, 2004	September 30, 2004	June 30, 2004	March 31, 2004
Total revenues	\$ 10,986,000	\$ 8,662,000	\$ 8,148,000	\$ 9,620,000
Gross profit	6,354,000	3,862,000	5,110,000	4,083,000
Net income	2,378,000	1,245,000	1,445,000	1,190,000
Net earnings per common share:				
Basic	\$ 0.20	\$ 0.10	\$ 0.12	\$ 0.10
Diluted	\$ 0.16	\$ 0.09	\$ 0.12	\$ 0.10

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**\* Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

There have been no disagreements regarding accounting and financial disclosure matters with the independent certified public accountants of American Dairy.

**Item 9A. Controls and Procedures**

*Evaluation of Disclosure Controls and Procedures.* The Company's Chief Executive Officer and the Company's Principal financial officer, after evaluating the effectiveness of the Company's disclosure controls and procedures (as defined in the Securities Exchange Act of 1943, Rule 13a-15(e) and 15d-15(e)) as of December 31, 2005, have concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act of 1934, as amended, is recorded, processed and summarized and reported on a timely basis and is accumulated and communicated to the Company's management, including its principal executive officers as appropriate, to allow timely decisions regarding required disclosure.

*Changes in Internal Controls.* In connection with their evaluation, the certifying officers identified no changes in the Company's internal control over financial reporting during the Company's fiscal quarter ended December 31, 2005 that materially affected or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Item 9B. Other Information**

### PART III

#### Item 10. Directors and Executive Officers of the Registrant

The following table sets forth certain information regarding the executive officers and directors of American Dairy. All officers serve at the pleasure of the Board of Directors. Directors serve until the election and qualification of their successors.

<u>Name</u>	<u>Age</u>	<u>Position</u>
Leng You-Bin	36	Chairman, Chief Executive Officer and President
Liu Hua	33	Chief Financial Officer, Secretary, Treasurer, Director
Liu Sheng-Hui	35	Director
Hui-Lan Lee	56	Director
Dr. Kevil L. Tseng	42	Director
Kirk G. Downing	52	Director

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Leng You-Bin has been the Chairman, Chief Executive Officer, President, and General Manager of American Dairy since May 7, 2003. He is responsible for the overall strategic planning, management and business development of Feihe Dairy. Mr. Leng has been in the dairy industry for more than 13 years. He obtained his Bachelor of Science degree in Food Engineering from Northeast Agriculture University, China. From 1989 to 1997, Mr. Leng acted as technician, deputy director and director of ZhaoGuang Dairy Plants, the predecessor of Feihe Dairy. From 1997 to 2000, Mr. Leng was the General Manager of Feihe Dairy. He became the Chairman and General Manager in 2000. He has researched and patented the "liver protection milk powder" (GanBao Milk Powder).

Liu Hua has been the Chief Financial Officer, Secretary, Treasurer and a director of American Dairy since May 7, 2003, and has been the Financial Officer of Feihe Dairy from November 2000 to the present. From June 1998 to November 2000, he was the Chief Executive Officer of Shenzhen Cima Limited. From September 1993 to January 1996, he was the Chief Executive Officer of Zhengzhou Huacheng Limited. Mr. Liu received a degree from Xian Traffic University in 1993.

Liu Sheng-Hui has been a director of American Dairy since May 7, 2003. He is responsible for the overall financial planning and management of Feihe Dairy. He joined Feihe Dairy in 1992. He has held his current position since 1998. He graduated from Northeast Agriculture University with a Bachelor of Economics degree in Economic Management in 1992.

Hui-Lan Lee (also known as "Tracy Lee") has been a director of American Dairy since May 7, 2003. She has been the Assistant Vice President-Taxation of Countrywide Home Loan, Inc. from April 2003 to the present. She was the Tax Manager of Watson Pharmaceuticals, Inc. from October 26, 1996 to March 2003. From 1979 to 1996, Ms. Lee was employed by major fortune 500 companies including The Flying Tiger Line Inc. (a Tiger International Company), Quotron Systems, Inc. (a subsidiary of the Citigroup, Inc.) and Lear Siegler, Inc. in various management positions. Ms. Lee holds a Master of Science degree in Taxation from Golden Gate University, and a Master of Business Administration degree from Indiana University.

Dr. Tseng became a director of American Dairy on February 21, 2005. From May 1997 to the present, he has been an advanced analyst with Boeing Aerospace engaged in technology development. From January 1994 to May 1997, Dr. Tseng was an Assistant Professor at Purdue University. From October 1991 to January 1994, he was a Research Fellow at the University of Michigan. He graduated in 1985 from Tamkang University majoring in aerospace technology. Dr. Tseng received his M.S.E. degree in 1990 and his Ph.D degree in 1991 from the University of Michigan. He received a M.B.A. degree in management in 2002 from the Marshall School of Business of the University of Southern California.

Mr. Downing became a director of American Dairy on February 21, 2005. From December 1980 to the present, he has been practicing law in Los Angeles, California. From January 1989 to June 1997, Mr. Downing also engaged in ranching, farming, logging and property development. Mr. Downing received his B.A. degree in liberal arts from Portland State University in 1976. He received his Juris Doctorate degree in 1980 from Loyola Law School.

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**Item 11. Executive Compensation**

The officers and directors of American Dairy received compensation during the three fiscal years ended December 31, 2005, as follows:

**SUMMARY COMPENSATION TABLE**

NAME AND PRINCIPAL POSITION	ANNUAL COMPENSATION				LONG TERM COMPENSATION			
	Fiscal Year	Salary	Bonus	Other Annual Compensation	AWARDS		PAYOUTS	
					RESTRICTED Stock Awards	SECURITIES Underlying Options/SARs	FLTIP Payouts	All Other Compensation
Leng You-Bin	2003	\$ 6,884	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Director, Chief Executive Officer and President	2003	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
	2003	\$ 9,000	\$ 0	\$ 0	\$ 33,300	\$ 0	\$ 0	\$ 0
Jack M. Gertino	2003	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
former Chief Executive Officer and President	2003	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
	2003	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0

American Dairy presently has no employment agreements with its officers or key employees, but may enter into such agreements in the future.

**Board Compensation**

American Dairy plans to provide its non-management directors, if any, a competitive directors' compensation package comparable to programs offered by similarly situated corporations.

**Benefit Plans**

American Dairy does not have any profit sharing plan or similar plans for the benefit of its officers, directors or employees. However, American Dairy reserves the right to establish any such plans in the future.

**Incentive Stock Plan**

Effective April 1, 2003, American Dairy adopted and approved its 2003 Incentive Stock Plan (the "Plan") which reserves 3,000,000 shares of Common Stock for issuance under the Plan. The Plan allows us to issue awards of incentive or non-qualified stock options, stock appreciation rights, and stock bonuses which may be subject to restrictions. No awards of stock options, stock appreciation rights, or stock bonuses have been granted to employees as of December 31, 2004.

Mr. Leng You-Bin and Mr. Liu Hua are the members of the Committee that administers the Plan.

**Compliance with Section 16(a) of the Securities Exchange Act**

Section 16(a) of the Exchange Act requires American Dairy's executive officers and directors, and persons who beneficially own more than ten percent (10%) of its equity securities, to file reports of ownership and changes in ownership with the U.S. Securities and Exchange Commission. Officers, directors and greater than ten percent shareholders are required by SEC regulation to furnish American Dairy with copies of all Section 16(a) forms they file.

Based on its review of the copies of such forms received by it, American Dairy believes that during the year ended December

31, 2005, all such filing requirements applicable to its officers, directors and 10% owners of its Common Stock were complied with.

### Limited Liability and Indemnification

Section 16-10a-840 of the Utah Revised Business Corporation Act (the "URBC") requires directors and officers to perform their duties in good faith and with the care that an ordinary person would exercise under similar circumstances in a manner reasonably believed to be in the best interest of the corporation. A director or officer of a corporation is not liable to the corporation, its shareholders or others for any action taken or any failure to act as an officer or director unless he has breached or failed or failed to perform his duties as described above and the breach or failure to perform constitutes gross negligence, wilful misconduct, or intentional infliction of harm on the corporation or its shareholders.

Section 16-10a-841 of the URBC provides that the articles of incorporation of a Utah corporation may eliminate or limit the liability of a director to the corporation or its shareholders for monetary damages, except for (I) a financial benefit to which is not entitled; (ii) an intentional infliction of harm; (iii) unlawful distributions of the corporation constituting a violation of Section 16-10a-842 of the URBC; or (iv) an intentional violation of criminal law.

Section 16-10a-902 of the URBC permits a Utah corporation to indemnify directors made a party to a proceeding because he is or was a director if (i) his conduct was in, or not opposed to, the corporation's best interest; and (ii) he reasonably believed his conduct was in, or not opposed to, the corporation's best interests; and (iii) in the case of a criminal proceeding, he had no reasonable cause to believe his conduct was unlawful. However, a Utah corporation may not indemnify a director if he was adjudged liable to the corporation, or if he was adjudged liable on the basis that he derived an improper personal benefit; and such indemnification in any action brought by the corporation is limited to reasonable expenses incurred in connection with the proceedings.

Article VI of the Articles of Incorporation and Article VIII of the By-Laws of American Dairy provide for the indemnification of directors and officers of American Dairy. Indemnification is mandatory regarding reasonable expenses incurred in connection with proceedings or claims with respect to which he has been successful. Officers, employees, fiduciaries and agents of a Utah corporation may be entitled to indemnification to a greater extent than directors, if not inconsistent with public policy, if provided for in the Articles of Incorporation, By-Laws, the general or specific action of its board of directors or contract.

### Consultants

American Dairy intends to retain consultants to the extent necessary and appropriate. American Dairy will not delegate its authority and responsibility to make management decisions to consultants or any other persons, nor shall any consultant have any discretionary authority or the authority to bind American Dairy in any material respect.

### Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The following table sets forth certain information concerning the beneficial ownership of American Dairy's shares of Common Stock by directors and officers of American Dairy, and by each person known to American Dairy to be a beneficial owner of five percent (5%) or more of its outstanding Common Stock as of December 31, 2005.

Name and Address	Number of Shares (1)	Percentage of Outstanding Shares
Leng You-Bin (4) C-16 Shin Chen International Bldg. No. 10, Jiu-shen Road Zho Yan Chu Beijing The People's Republic of China	8,881,135	62.8%

Liu Hua 19,000 0.14% C-16 Shin Chen International Bldg. No. 10, Jiu-shen Road Zho Yan Chu Beijing The People's Republic of China	19,000	0.14%
Hui-Lan Lee 232 Alabama Street San Gabriel, California 91775	7,000	0.05%
Liu Sheng-Hui C-16 Shin Chen International Bldg. No. 10, Jiu-shen Road Zho Yan Chu Beijing The People's Republic of China	11,500	0.08%
Kirk Downing	4,500	0.03%
Pike Capital Partners LP 275 Madison Avenue Suite 418 New York, NY 10016	821,429	6.1%
All executive officers and directors as a group (4 persons)	9,153,211	67.5%

- (1) They have sole voting and dispositive power with respect to their shares of Common Stock of American Dairy.
- (2) Includes warrants to purchase 571,428 shares of the Common Stock of American Dairy.

### Item 13. Certain Relationships and Related Transactions

Effective May 7, 2003, Mr. Leng You-Bin and Mr. Liu Sheng-Hui, directors and officers of American Dairy, received 8,129,032 shares and 387,476 shares, respectively, of the Common Stock of American Dairy in exchange for all of their registered capital stock of Heilongjiang Feihe Dairy Co., Limited under the terms of a Stock Exchange Agreement.

Effective May 7, 2003, American Dairy acquired 100% of American Dairy Holdings, Inc. ("ADH") in a stock-for-stock exchange. ADH had previously acquired 100% of the ownership of the registered capital of Heilongjiang Feihe Dairy Co., Limited ("Feihe Dairy") in February 2002 for \$2,586,311 (U.S.) from the registered owners of Feihe Dairy, owned primarily by Mr. Leng You-Bin who is the principal stockholder, director, Chief Executive Officer and President of American Dairy. As a result of this acquisition of ADH, American owed approximately \$1,866,311 to Mr. Leng You-Bin after approximately \$700,000 having been paid to him by American Dairy. During June 2003, American Dairy and Mr. Leng You-Bin agreed to cancel the remaining debt of \$1,866,311 in exchange for the issuance of 933,156 shares of the Common Stock of American Dairy.

In May 2003, American Dairy entered into a consulting agreement (the "Consulting Agreement") with Danbury Properties, LLC, a Utah limited liability company ("Danbury"), of which Jack M. Gertino, the former President and a director of American Dairy, and James C. Lewis, a former director of American Dairy, are members. During the one year period of Danbury's engagement, Danbury has agreed to provide to American Dairy consulting services in the areas of financial and

management planning, financing assistance and capital formation. In exchange for such services, Danbury will receive \$60,000 in cash compensation, and 240,000 shares of post-split Common Stock. In addition, American Dairy has agreed to pay the sum of \$12,000 for the cancellation of all outstanding options held by Messrs. Gertino and Lewis. This transaction cannot be considered the result of arms' length negotiations.

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American Dairy also issued 240,000 shares of Common Stock and paid \$60,000 in cash plus the obligation to pay another \$12,000 in cash in May 2003 in connection with a consulting agreement entered into with existing shareholders, including Jack Gertino, then a director and the Chief Executive Officer of American Dairy. This stock was valued at \$270,000 for financial reporting purposes. The consulting agreement is to cover a period of one year commencing May 7, 2003. For financial reporting purposes \$228,011 was charged to consulting fee expense in 2003 with the balance of \$113,989 being treated as a prepaid expense at December 31, 2003.

During the fiscal years ended December 31, 2003 and 2004, Mr. Leng You-Bin, the Chairman of the Board and Chief Executive Officer of American Dairy, made advances to American Dairy in the amount of \$846,228 and \$1,133,822, respectively. These advances were unsecured and did not bear interest.

As of December 31, 2005 and 2004 the Company had the following balances due to its officers and directors:

Name	2005	2004
Leng You-bin	\$ 858,000	\$1,091,000

These balances are non-interest bearing and due on demand.

#### Item 14. Principal Accountant Fees and Services

Fees paid to principal accountants are as follows:

Name	Audit Fees	Audit Related Fees	Tax Fees	All Other Fees
<b>Weinberg &amp; Company, P.A for fiscal year ended</b>				
December 31, 2003	\$ 23,513	\$ 11,045	\$ -0-	\$ -0-
December 31, 2004	\$ 8,044	\$ -0-	\$ -0-	\$ -0-
December 31, 2005	\$ -0-	\$ -0-	\$ -0-	\$ -0-
<b>Murrell, Hall, McIntosh &amp; Co., PLLP for fiscal year ended</b>				
December 31, 2003	\$ 3,770	\$ -0-	\$ -0-	\$ -0-
December 31, 2004	\$ 19,000	\$ 1,250	\$ 5,000	\$ -0-
December 31, 2005	\$ 42,500	\$ 8,900	\$ 5,500	\$ -0-

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The Audit Committee of the Board of Directors evaluated the scope and cost of the audit for its fiscal year ended December 31, 2005 before its auditor rendered its audit and non-audit services.

#### Item 13. Exhibits

(a) Reports on Form 8-K None

## (b) Exhibits

3.1	Articles of Incorporation	Articles of Incorporation of American Dairy, as amended, are incorporated herein by reference to Exhibit 3.1 to its registration statement on Form 10-SB, as filed with the Securities and Exchange Commission on September 16, 1999.
3.2	Amendment to Articles of Incorporation	Amendment to Articles of Incorporation of American Dairy dated May 6, 2003 is incorporated herein by reference to 3.3 By-Laws Exhibit 3.2 to its Form 10-KSB/A of American Dairy, Inc. for its fiscal year ended December 31, 2003 filed on April 11, 2004.
3.3	By-Laws	By-Laws of American Dairy are incorporated herein by reference to Exhibit 3.2 to its registration statement on Form 10-SB, as filed with the Securities and Exchange Commission on September 16, 1999.
10. Material Contracts		
10.1	Stock Exchange Exchange	Stock Exchange Agreement dated January 15, 2003, is incorporated herein by reference to Exhibit 2.1 to American Dairy's Form 8-K current report as filed with the Securities and Exchange Commission on January 21, 2003.
10.2	Amendment to Stock Agreement	Agreement Amendment to Stock Exchange Agreement dated March 5, 2003 is incorporated herein by reference to Exhibit 2.2 of American Dairy's Form 8-K current report as filed with the Securities and Exchange Commission on March 5, 2003.
10.3	Consulting Agreement	Consulting Agreement by and between American Dairy, American Dairy Holdings, Inc. and Danbury Properties, L.L.C., dated March 28, 2003, is incorporated herein by reference to Exhibit 10.3 to the Form 10-KSB annual report of Lazarus Industries, Inc. for its fiscal year ended December 31, 2002.
10.4	Stock Incentive Plan	2003 Stock Incentive Plan is incorporated herein by reference to Exhibit 10 to American Dairy's Form S-8 Registration statement filed on April 4, 2005 (File No. 333-123932).
10.5	Shanxi Joint Venture	Joint Venture Agreement to organize Shanxi Feihesantai Biology Science and Technology Industry, Ltd. is incorporated herein by reference to Exhibit 10.1 to the Form 10-QSB of American Dairy for the three month period ended March 31, 2004.
10.6	Asset Purchase Agreement	Asset Purchase Agreement dated May 20, Agreement 2005, with Nutricia Nutritionals Co., Ltd. of Hei Long Jiang (without all exhibits thereto) is incorporated herein by reference to the Form 8-K current report filed by American Dairy on May 26, 2005.
10.7	Code of Ethics	The Code of Ethics of American Dairy is incorporated herein by reference to Exhibit 14 to the Form 10-KSB of American Dairy for its fiscal year ended December 31, 2004.
21	Description of subsidiaries	Description of subsidiaries is incorporated herein by reference to Exhibit 21 to the Form S-1 registration statement of American Dairy (File No. 333-128075)
23.1	Consent of Murrell, Hall, McIntosh & Co., PLLP	Consent of Murrell, Hall, McIntosh & Co., PLLP

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

AMERICAN DAIRY, INC.

November 20, 2006

By: /s/ Len You-Bin

\_\_\_\_\_  
Len You-Bin, Chief Executive  
Officer, and President

By: /s/ Liu Hua

\_\_\_\_\_  
Liu Hua, Chief Financial Officer,  
Principal Accounting and Financial Officer and  
Treasurer

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

/s/ Leng You-Bin  
\_\_\_\_\_  
Leng You-Bin, Director, Chief  
Executive Officer and President

November 20, 2006

/s/ Liu Hua  
\_\_\_\_\_  
Liu Hua, Director, Chief Financial  
Officer, Principal Accounting and  
Financial Officer, Secretary and  
Treasurer

November 20, 2006

/s/ Liu Sheng-Hui  
\_\_\_\_\_  
Liu Sheng-Hui, Director

November 20, 2006

/s/ Hui-Lan Lee  
\_\_\_\_\_  
Hui-Lan Lee, Director

November 20, 2006

\_\_\_\_\_  
Kevin L. Tseng, Director

November 20, 2006

/s/ Kirk Downing  
\_\_\_\_\_  
Kirk Downing

November 20, 2006

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**INDEX OF EXHIBITS ATTACHED**

<u>Exhibit</u>	<u>Description</u>
31.1	Certification of Leng You-Bin
31.2	Certification of Liu Hua
32	Certification of Leng You-Bin and Liu Hua