Mindray Medical International LTD
Form F-1
September 06, 2006

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As filed with the Securities and Exchange Commission on September 6, 2006

Registration No. 333-

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM F-1
REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

Mindray Medical International Limited
(Exact name of Registrant as specified in its charter)

Cayman Islands	**3841**	**Not Applicable**
(State or other jurisdiction of incorporation or organization)	*(Primary Standard Industrial Classification Code Number)*	*(I.R.S. Employer Identification Number)*

Mindray Building
Keji 12th Road South
Hi-tech Industrial Park, Nanshan
Shenzhen 518057
People s Republic of China
(86-755) 2658-2888
(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices)

CT Corporation System
111 Eighth Avenue, 13th Floor
New York, New York 10011
(212) 894-8940
(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

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1266 Nanjing Road West	**7 Times Square**
Shanghai 200040, P.R.C.	**New York, New York, 10036**
86-21-2307-7007	**212-326-2000**

Approximate date of commencement of proposed sale to the public: As soon as practicable after the effective date of this registration statement.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box. o

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered(1)(2)	Proposed Maximum Aggregate Offering Price(3)	Amount of Registration Fee
Class A Ordinary Shares, par value HK$0.001 per share	US$276,000,000	US$29,532

(1) American depositary shares evidenced by American depositary receipts issuable upon deposit of the Class A ordinary shares registered hereby have been registered pursuant to a separate registration statement on Form F-6 filed with the Commission on , 2006 (Registration Statement No. 333-). Each American depositary share represents one Class A ordinary share.

(2) Includes (a) all Class A ordinary shares represented by American depositary shares initially offered and sold outside the United States that may be resold from time to time in the United States either as part of the distribution or within 40 days after the later of the effective date of this registration statement and the date the securities are first bona fide offered to the public, and (b) Class A ordinary shares represented by American depositary shares that are issuable upon the exercise of the underwriters option to purchase additional shares. The Class A ordinary shares are not being registered for the purpose of sales outside the United States.

(3) Estimated solely for the purposes of computing the amount of the registration fee pursuant to Rule 457(o) under the Securities Act of 1933, as amended.

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until the registration statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

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The information in this preliminary prospectus is not complete and may be changed. These securities may not be sold until the registration statement filed with the Securities and Exchange Commission is effective. This preliminary prospectus is not an offer to sell nor does it seek an offer to buy these securities in any jurisdiction where the offer or sale is not permitted.

Subject to Completion. Dated , 2006

Mindray Medical International Limited

American Depositary Shares

Representing

Class A Ordinary Shares

Mindray Medical International Limited, or Mindray, is offering American depositary shares, or ADSs, and the selling shareholders identified in this prospectus are offering an additional ADSs. Each ADS represents one Class A ordinary share, par value HK$0.001 per share of Mindray. The ADSs are evidenced by American depositary receipts, or ADRs. We will not receive any proceeds from the ADSs sold by the selling shareholders.

Prior to this offering, there has been no public market for our ADSs or our Class A ordinary shares. It is currently estimated that the initial public offering price per ADS will be between US$ and US$. We have received approval to list our ADSs listed on the New York Stock Exchange under the symbol MR subject to official notice of issuance.

See Risk Factors beginning on page 9 to read about risks you should consider before buying our ADSs.

Neither the Securities and Exchange Commission nor any other regulatory body has approved or disapproved of these securities or passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.

	Per ADS	**Total**
Public offering price	US$	US$
Underwriting discount	US$	US$
Proceeds, before expenses, to Mindray	US$	US$
Proceeds, before expenses, to the selling shareholders	US$	US$

To the extent that the underwriters sell more than ADSs, the underwriters have an option to purchase up to an additional ADSs from us and up to an additional ADS from the selling shareholders at the initial public offering price less the underwriting discount.

The underwriters expect to deliver the ADSs evidenced by the ADRs against payment in US dollars in New York, New York on , 2006.

Prospectus dated , 2006.

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PROSPECTUS SUMMARY

The following summary is qualified in its entirety by, and should be read in conjunction with, the more detailed information and financial statements included elsewhere in this prospectus. In addition to this summary, we urge you to read the entire prospectus carefully, especially the risks of investing in our American depositary shares, or ADSs, discussed under Risk Factors, before deciding whether to buy our ADSs.

Our Business

We are a leading developer, manufacturer and marketer of medical devices in China. We also have a significant and growing presence outside of China, primarily in other regions of Asia and in Europe. We offer a broad range of more than 40 products across our three primary business segments: patient monitoring devices, diagnostic laboratory instruments and ultrasound imaging systems. According to Frost & Sullivan, we had the leading market share in China by units sold, and the second leading market share by revenue, for the sale of patient monitoring devices in 2003, and we believe that we continue to be a market leader in China today. In addition, we believe we hold a leading market share position in China in diagnostic laboratory instruments and grayscale ultrasound imaging systems. Due to our leading market position, we believe we have one of the most recognized brands in the medical device industry in China.

We sell our products primarily to distributors, and the balance directly to hospitals, clinics, government agencies, original design manufacturers, or ODMs, and original equipment manufacturers, or OEMs. With over 1,950 distributors and 500 direct sales and sales support personnel, we believe our nationwide distribution, sales and service network is the largest of any medical device manufacturer in China. This extensive platform allows us to be closer than our competitors to end-users and enables us to be more responsive to local market demand. In addition, we sell our products internationally through more than 660 distributors and 75 sales and sales support personnel. This established and expanding international sales and distribution network provides us with a platform from which to build and expand our market position globally. To date, we have sold our products to approximately 25,000 hospitals, clinics and other healthcare facilities in China and sold over 170,000 devices worldwide.

We employ a vertically integrated operating model that enables us to efficiently develop, manufacture and market quality products at competitive prices. Our research and development team and our manufacturing department work closely together to optimize manufacturing processes and develop commercially viable products. In addition, they incorporate regular feedback from our sales and marketing personnel, enabling us to timely and cost-effectively introduce products tailored to end-user needs. Furthermore, our China-based research and development and manufacturing operations provide us with a distinct competitive advantage in international markets by enabling us to leverage low-cost technical expertise, labor, raw materials and facilities.

To enhance our leading market position, we have made and will continue to make significant investments in research and development. We increased our annual investment in research and development activities from 8.6% of net revenues in 2003 to 9.8% of net revenues in 2005 and to 9.9% in the six months ended June 30, 2006, establishing what we believe is the largest research and development team of any medical device manufacturer in China, with more than 570 engineers on our staff. We believe our current spending level, as a percentage of net revenues, is comparable to many of our international competitors and greater than most of our domestic competitors. We continually seek to broaden our market reach by introducing new and more advanced products and new product lines that address different end-user segments. Since 2003, we have introduced more than 25 new products.

Our net revenues increased from RMB460.3 million in 2003 to RMB1,078.6 million (US$134.9 million) in 2005, representing a compounded annual growth rate of 53.1%. Our net revenues grew from RMB436.8 million in the six months ended June 30, 2005 to RMB676.8 million (US$84.7 million) for the same period in 2006, a 54.9% increase. In the six months ended June 30, 2006, our three primary business segments, patient monitoring devices, diagnostic laboratory instruments and ultrasound imaging systems, accounted for 40.5%, 28.4% and 29.9% of our net segment revenues, respectively. Over the past three years, we have significantly expanded our geographic scope and increased the percentage of our revenues generated

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by international sales. Our products are currently sold in more than 120 countries, and international sales grew from 24.7% of our total net revenues in 2003, to 41.9% of our total net revenues in 2005 and to 43.7% of our total net revenue in the six months ended June 30, 2006.

Our Industry

According to Frost & Sullivan, China s market for medical devices had an estimated value of US$7.5 billion in 2004, representing approximately 5% of the US$148 billion global medical device market. China s medical device market, as well as the medical device markets in several developing countries, is projected to grow faster than the global medical device market. According to Frost & Sullivan, China s medical device market is projected to grow from US$7.5 billion in 2004 to US$10.1 billion in 2006. Reasons for this faster growth in China include:

- fast growing economy;
- increasing percentage of gross domestic product, or GDP, expected to be spent on healthcare;
- increasing desire for and utilization of more advanced technologies in Chinese hospitals and clinics;
- increasing availability of healthcare insurance;
- higher degree of operating autonomy at hospitals and clinics; and
- growing desire for better quality of care.

Hospitals and clinics in China purchase almost all of their medical devices and supplies through distributors. These distributors tend to operate in small territories in China, and many focus only on eastern coastal cities. As a result, medical device manufacturers need to develop relationships with several distributors in different regions to be able to reach a broad end-user base. We believe the ability to leverage local contacts and knowledge is vital in establishing an effective distribution network, constituting a significant barrier to entry for both smaller local companies and larger, international competitors that lack a meaningful local presence in China.

Our Products

We believe that we are well positioned to benefit from the growing medical device market in China, as well as from the growing markets in other developing countries. Historically, the primary end-users of a majority of our products have been small- and medium-sized hospitals in China, although a significant portion of our patient monitoring devices have also been sold to large-sized hospitals in China. As these small- and medium-sized hospitals look to offer a higher level of care, we believe our products, which are typically of higher quality than those of most domestic manufacturers, and of comparable quality but lower cost than those of many of our international competitors, will be attractive alternatives.

Our leading product in 2005 was our portable PM-9000 multi-parameter patient monitoring device. We offer more than 15 patient monitoring devices, including four which have received 510(K) clearance from the United States Food and Drug Administration, or FDA. In our diagnostic laboratory instruments business segment, we offer a range of more than ten hematology and biochemistry analyzers that perform analysis on blood, urine and other bodily fluid samples for clinical diagnosis and treatment. We generate a recurring revenue stream by offering single-use reagents, which are substances used to create chemical reactions that are analyzed by our instruments. In our ultrasound imaging systems business segment, we offer more than ten ultrasound imaging systems and we will introduce our first color Doppler ultrasound imaging system in the second half of 2006 for use in several clinical areas, such as urology, gynecology, obstetrics and cardiology.

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Our Strengths, Strategies and Risks

We believe we have the following principal competitive strengths:

- strong brand and leading market position in China s medical device market;
- extensive distribution, sales and service network for medical devices in China;
- established and expanding international distribution and sales network;
- proven research and development capabilities; and
- efficient vertically integrated operating model.

Our objective is to strengthen our position as a leader in developing, manufacturing and marketing medical devices in China and to become a leader in selected international markets. We intend to achieve our objective by implementing the following strategies:

- increasing our market share in China s medical device market;
- enhancing our market position and brand recognition in existing and new international markets;
- broadening our market reach by introducing more advanced products and new product lines; and
- maintaining our disciplined cost focus.

We expect to face risks and uncertainties related to our ability to:

- develop and commercialize new products;
- establish and maintain our relationships with our distributors;
- attract and retain key management and research and development personnel;
- build our brand and expand our sales in international markets; and
- protect our intellectual property rights.

See Risk Factors for a detailed discussion of these and other risks that we face.

Our Offices

Our principal executive offices are located at Mindray Building, Keji 12th Road South, Hi-tech Industrial Park, Nanshan, Shenzhen, 518057, People s Republic of China, and our telephone number is (86-755) 2658-2888. Our website address is http://www.mindray.com. The information on our website does not form a part of this prospectus.

Conventions That Apply to This Prospectus

Unless we indicate otherwise, all information in this prospectus assumes no exercise by the underwriters of their option to purchase up to additional ADSs representing Class A ordinary shares.

Except where the context otherwise requires and for purposes of this prospectus only:

- we, us, our company, our, Mindray International and Mindray refer to Mindray Medical International Li and its consolidated subsidiaries, including Shenzhen Mindray Bio-Medical Electronics Co., Ltd., or Shenzhen Mindray, and Shenzhen Mindray s predecessor entities;
- China or PRC refers to the People s Republic of China, excluding, for purposes of this prospectus only, Taiwan and the Special Administrative Regions of Hong Kong and Macau;
- all references to Renminbi or RMB are to the legal currency of China, all references to US dollars, dollars, $ US$ are to the legal currency of the United States, and all

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references to HK$ are to the legal currency of the Hong Kong Special Administrative Region of China;

ordinary shares refers to our Class A and Class B ordinary shares, par value HK$0.001 per share;

ADSs refers to our American depositary shares, each of which represents one Class A ordinary share;

ADRs refers to American depositary receipts, which, if issued, evidence our ADSs;

PRC GAAP refers to accounting principles and the relevant financial regulations applicable to PRC enterprises; and

US GAAP refers to generally accepted accounting principles in the United States.

Unless specifically indicated otherwise or unless the context otherwise requires, all references to our ordinary shares have been adjusted to give effect to the automatic conversion of all outstanding convertible redeemable preferred shares to Class A ordinary shares upon the completion of this offering.

This prospectus also gives effect to the re-classification of all of our ordinary shares into Class A (one vote per share) and Class B ordinary shares (five votes per share). All Class B ordinary shares will be held by Messrs Xu, Li and Cheng each of whom is a Mindray executive officer.

This prospectus contains translations of Renminbi amounts into US dollars at specified rates solely for the convenience of the reader. Unless otherwise noted, all translations from Renminbi to US dollars were made at the noon buying rates in The City of New York for cable transfers in Renminbi per US dollar as certified for customs purposes by the Federal Reserve Bank of New York, or the noon buying rate, as of and for the year ended December 31, 2005 and six months ended June 30, 2006 into United States dollar has been made at the rate of RMB7.9943 to US$1.00 at June 30, 2006. We make no representation that the Renminbi or US dollar amounts referred to in this prospectus could have been or could be converted into US dollars or Renminbi, as the case may be, at any particular rate or at all. On September 5, 2006, the noon buying rate was RMB7.9495 to US$1.00.

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THE OFFERING

The following assumes that the underwriters will not exercise their option to purchase additional ADSs in the offering, unless otherwise indicated.

ADSs offered by Mindray	ADSs
ADSs offered by the selling shareholders	ADSs
Price per ADS	-US$ per ADS
ADSs outstanding immediately after this offering	ADSs
Class A ordinary shares outstanding immediately after this offering	shares, excluding 6,824,000 Class A ordinary shares issuable upon the exercise of outstanding options and 15,000,000 Class A ordinary shares reserved for issuance under our employee share incentive plan.
Class B ordinary shares outstanding immediately after this offering	shares
The ADSs	Each ADS represents one Class A ordinary share, par value HK$0.001 per share. The ADSs will be evidenced by a global ADR. The depositary will be the holder of the Class A ordinary shares underlying your ADSs and you will have rights as provided in the deposit agreement. If we declare dividends on our ordinary shares, the depositary will pay you the cash dividends and other distributions it receives on our Class A ordinary shares, after deducting its fees and expenses. You may turn in your ADSs to the depositary in exchange for Class A ordinary shares underlying your ADSs. The depositary will charge you fees for exchanges. We may amend or terminate the deposit agreement without your consent, and if you continue to hold your ADSs, you agree to be bound by the deposit agreement as amended. You should carefully read the section in this prospectus entitled Description of American Depositary Shares to better understand the terms of the ADSs. You should also read the deposit agreement, which is an exhibit to the registration statement that includes this prospectus.
Proposed New York Stock Exchange trading symbol	MR. We have received approval to list our ADSs on the New York Stock Exchange, subject to official notice of issuance.
Ordinary Shares	Holders of Class A ordinary shares and Class B ordinary shares have the same rights except for voting and conversion rights. Each Class A ordinary share shall be entitled to one vote on all matters subject to shareholder vote, and each Class B

ordinary share shall be entitled to five votes on all matters subject to shareholder vote.

	Each Class B ordinary share is convertible into one Class A ordinary share at any time by the holder thereof. Class A ordinary shares are not convertible into Class B ordinary shares under any circumstances. Class B ordinary shares shall be automatically and immediately converted into an equal number of Class A ordinary shares upon any transfer to any person or entity which is not an affiliate of the transferor. In addition, if the number of Class B ordinary shares issued and outstanding is less than 20% of the total number of our issued and outstanding ordinary shares, each issued and outstanding Class B ordinary share shall automatically convert into one Class A ordinary share, and we will not issue any Class B ordinary shares thereafter.
Depositary	The Bank of New York
Option to purchase additional ADSs	We and the selling shareholders have granted to the underwriters an option, exercisable within 30 days from the date of this prospectus, to purchase up to an additional ADSs.
Timing and settlement for ADSs	The ADSs are expected to be delivered against payment on , 2006. The global ADR evidencing the ADSs will be deposited with a custodian for, and registered in the name of a nominee of, The Depository Trust Company, or DTC, in New York, New York. In general, beneficial interests in the ADSs will be shown on, and transfers of these beneficial interests will be effected only through, records maintained by DTC and its direct and indirect participants.
Use of proceeds	We expect net proceeds from this offering of approximately US$ million (after deducting underwriting discounts, commissions and the estimated offering expenses payable by us and assuming an initial public offering price of US$, the mid-point of the estimated initial public offering price range shown on the front cover of this prospectus). We anticipate using approximately US$75 million for construction of a new headquarters building and expansion of our manufacturing, assembly and warehouse facilities including the potential relocation into a new facility in Shenzhen, China and the balance to fund working capital and for other general corporate purposes. See Use of Proceeds. We will not receive any of the proceeds from the sale of ADSs by the selling shareholders.
Risk factors	See Risk Factors and other information included in this prospectus for a discussion of risks you should carefully consider before deciding to invest in our ADSs.
Lock-up	We have agreed for a period of 180 days after the date of this prospectus not to sell, transfer or otherwise dispose of any of our ordinary shares or ADSs representing our Class A ordinary shares. Furthermore, each of our directors and executive officers and substantially all of our shareholders, including each of the selling shareholders, have agreed to a similar 180 day lock-up. See Underwriting.

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SUMMARY CONSOLIDATED FINANCIAL INFORMATION

The following summary consolidated financial information for the periods and as of the dates indicated should be read in conjunction with our financial statements and the accompanying notes and Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and related notes, both of which are located elsewhere in this prospectus.

The summary consolidated financial data presented below for the three years ended December 31, 2003, 2004 and 2005 are derived from our audited consolidated financial statements included elsewhere in this prospectus. Our audited consolidated financial statements are prepared in accordance with US GAAP, and have been audited by Deloitte Touche Tohmatsu CPA Ltd., an independent registered public accounting firm. The report of Deloitte Touche Tohmatsu CPA Ltd. on those consolidated financial statements is included elsewhere in this prospectus.

The summary consolidated financial data as of June 30, 2006 and for the six months ended June 30, 2005 and 2006 have been derived from our unaudited consolidated financial statements included elsewhere in this prospectus. Results for the six months ended June 30, 2006 are not necessarily indicative of the results that may be expected for the full year. In our opinion, all adjustments necessary for a fair presentation of the financial data for the six months ended June 30, 2006 are contained in the financial statements that are included elsewhere in this prospectus.

Our historical results for any prior period are not necessarily indicative of results to be expected for any future period.

	For the Year Ended December 31,				For the Six Months Ended June 30,		
	2003	2004	2005	2005	2005	2006	2006
	RMB	RMB	RMB	US$	RMB	RMB	US$
	(In thousands, except share and per share data)						
Statement of Operations Data:							
Net revenues	460,254	697,837	1,078,573	134,918	436,776	676,764	84,656
Cost of revenues[(1)]	(210,565)	(319,013)	(493,326)	(61,710)	(194,892)	(307,330)	(38,444)
Gross profit	249,689	378,824	585,247	73,208	241,884	369,434	46,212
Operating expenses:							
Selling expenses[(1)]	(61,322)	(92,177)	(146,499)	(18,325)	(69,427)	(99,975)	(12,506)
General and administrative expenses[(1)]	(35,808)	(32,340)	(112,082)	(14,020)	(37,750)	(24,865)	(3,110)
Research and development expenses[(1)]	(39,781)	(61,604)	(106,147)	(13,278)	(48,146)	(66,678)	(8,341)
Operating income	112,778	192,703	220,519	27,585	86,561	177,916	22,255
Other income, net	1,918	39	9,210	1,152	707	239	30
Interest income	531	3,087	3,854	482	611	6,543	819
Interest expense	(2,815)	(3,324)	(2,019)	(253)	(1,201)	(279)	(35)

Income before income taxes and minority interests	112,412	192,505	231,564	28,966	86,678	184,419	23,069
Provision for income taxes	(7,624)	(10,758)	(18,066)	(2,260)	(6,449)	(13,191)	(1,650)
Minority interests			(8,409)	(1,052)		(6,455)	(808)
Net income	104,788	181,747	205,089	25,654	80,229	164,773	20,611
Deemed dividend on issuance of convertible redeemable preferred shares at a discount			(14,031)	(1,755)			
Income attributable to ordinary shareholders	104,788	181,747	205,089	23,899	80,229	164,773	20,611
Basic earnings per share	RMB1.22	RMB2.11	RMB2.31	US$0.29	RMB0.93	RMB2.10	US$0.26
Diluted earnings per share	RMB1.22	RMB2.11	RMB2.31	US$0.29	RMB0.93	RMB1.86	US$0.23
Shares used in computation of:							
Basic earnings per share	86,000,000	86,000,000	82,790,427	82,790,427	86,000,000	78,490,233	78,490,233
Diluted earning per share	86,000,000	86,000,000	82,790,427	82,790,427	86,000,000	88,467,984	88,467,984

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	As of June 30, 2006					
	Actual	Actual	Pro Forma[2]	Pro Forma[2]	As Adjusted[3]	As Adjusted[3]
	RMB	US$	RMB	US$	RMB	US$
	(In thousands)					
Balance Sheet Data:						
Cash and cash equivalents	212,875	26,628				
Working capital[4]	204,554	25,587				
Total assets	1,021,911	127,830				
Total liabilities	262,795	32,873				
Minority interests	10	1				
Mezzanine equity	289,867	36,259				
Total shareholders equity	469,239	58,697				

(1) Share-based compensation charges incurred during the period related to:

	For the Year Ended December 31,				For the Six Months Ended June 30,		
	2003	2004	2005	2005	2005	2006	2006
	RMB	RMB	RMB	US$	RMB	RMB	US$
	(In thousands, except share and per share data)						
Cost of revenues			268	34	268	236	30
Selling expenses			8,576	1,073	8,576	3,337	417
General and administrative expenses			59,014	7,382	14,420	4,483	561
Research and development expenses			3,071	384	3,071	2,130	266

(2) Reflects the automatic conversion of all 8,975,105 of our outstanding convertible redeemable preferred shares into 8,975,105 Class A ordinary shares upon completion of this offering.

(3) Reflects the conversion of all of our outstanding convertible redeemable preferred shares and the issuance and sale of ADSs we are offering at an assumed initial public offering price of US$ per ADS, the mid-point of the estimated public offering price shown on the front cover of this prospectus, after deducting underwriting discounts, commissions, and estimated offering expenses payable by us.

(4) Working capital is equal to current assets less current liabilities.

RISK FACTORS

You should consider carefully all of the information in this prospectus, including the risks and uncertainties described below, before investing in our ADSs. Any of the following risks and uncertainties could have a material adverse effect on our business, financial condition, results of operations and prospects. The market price of our ADSs could decline due to any of these risks and uncertainties, and you may lose all or part of your investment.

RISKS RELATING TO OUR BUSINESS AND INDUSTRY

We may fail to effectively develop and commercialize new products, which would materially and adversely affect our business, financial condition, results of operations and prospects.

The medical device market is developing rapidly and related technology trends are constantly evolving. This results in frequent introduction of new products, short product life cycles and significant price competition. Consequently, our future success depends on our ability to anticipate technology development trends and identify, develop and commercialize in a timely and cost-effective manner new and advanced products that our customers demand. New products contribute significantly to our revenues. Products introduced since 2003 accounted for more than 35% of our 2005 total net revenues. We expect the medical device market to continue to evolve toward newer and more advanced products, many of which we do not currently produce. For example, the market for five-part hematology analyzers has been growing faster than the market for three-part hematology analyzers for several years, yet we do not expect to offer a five-part hematology analyzer until the fourth quarter of this year. Moreover, it may take an extended period of time for our new products to gain market acceptance, if at all. Furthermore, as the life cycle for a product matures, the average selling price generally decreases. Although we have previously offset the effect of declining average sales prices through increased sales volumes and reductions in manufacturing costs, we may be unable to do so in the future. Lastly, during a product s life cycle, problems may arise regarding regulatory, intellectual property, product liability or other issues which may affect its continued commercial viability.

Whether we are successful in developing and commercializing new products is determined by our ability to:

- accurately assess technology trends and customer needs and meet market demands;
- optimize our manufacturing and procurement processes to predict and control costs;
- manufacture and deliver products in a timely manner;
- increase customer awareness and acceptance of our products;
- minimize the time and costs required to obtain required regulatory clearances or approvals;
- anticipate and compete effectively with other medical device developers, manufacturers and marketers;
- price our products competitively; and
- effectively integrate customer feedback into our research and development planning.

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We depend on distributors for a significant majority of our revenues and will rely on adding distributors both in China and internationally for most of our revenue growth. Failure to maintain relationships with our distributors or to otherwise expand our distribution network would materially and adversely affect our business.

We depend on distributors for a significant majority of our revenues and will rely on adding distributors both in China and internationally for most of our revenue growth. We do not have long-term distribution agreements. As our existing distribution agreements expire, we may be unable to renew with our desired distributors on favorable terms or at all. In addition, we seek to limit our dependence on any single distributor by limiting and periodically redefining the scope of each distributor s territory and the range of our products that it sells, which may make us less attractive to some distributors. Furthermore, competition for distributors is intense. We compete for distributors domestically and internationally with other leading medical equipment and device companies that may have higher visibility, greater name recognition and financial resources, and a broader product selection than we do. Our competitors also often enter into long-term distribution agreements that effectively prevent their distributors from selling our products. Consequently, maintaining relationships with existing distributors and replacing distributors may be difficult and time consuming. Any disruption of our distribution network, including our failure to renew our existing distribution agreements with our desired distributors, could negatively affect our ability to effectively sell our products and would materially and adversely affect our business, financial condition and results of operations.

We may not be able to effectively manage our distribution network, and our business, prospects and brand may be materially and adversely affected by actions taken by our distributors.

We have limited ability to manage the activities of our distributors, who are independent from us. Our distributors could take one or more of the following actions, any of which could have a material adverse effect on our business, prospects and brand:

- sell products that compete with our products that they have contracted to sell for us;
- sell our products outside their designated territory, possibly in violation of the exclusive distribution rights of other distributors;
- fail to adequately promote our products;
- fail to provide proper training, repair and service to our end-users; or
- violate the anti-corruption laws of China, the United States or other countries.

Failure to adequately manage our distribution network, or non-compliance by distributors with our distribution agreements could harm our corporate image among end users of our products and disrupt our sales, resulting in a failure to meet our sales goals. Furthermore, we could be liable for actions taken by our distributors, including any violations of applicable law in connection with the marketing or sale of our products, including China s anti-corruption laws and the US Foreign Corrupt Practices Act, or FCPA. In particular, we may be held liable for actions taken by our distributors even though almost all of our distributors are foreign companies that are not subject to the FCPA. Recently, PRC government has increased its anti-bribery efforts in the healthcare sector to reduce improper payments received by hospital administrators and doctors in connection with the purchase of pharmaceutical products and medial devices. Our distributors may violate these laws or otherwise engage in illegal practices with respect to their sales or marking of our products. If our distributors violate these laws, we could be required to pay damages or fines, which could materially and adversely affect our financial condition and results of operations. In addition, our brand and reputation, our sales activities or the price of our ADSs could be adversely affected if our company becomes the target of any negative publicity as a result of actions taken by our distributors.

The approval of China Securities Regulatory Commission, or the CSRC, may be required in connection with this offering under a recently adopted PRC regulation; any requirement to obtain prior CSRC approval could delay this offering and a failure to obtain this approval, if required, could have a

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material adverse effect on our business, operating results, reputation and trading price of our ADSs, and may also create uncertainties for this offering.

On August 8, 2006, six PRC regulatory agencies, including the CSRC, promulgated a regulation that will become effective on September 8, 2006, or the New M&A Rule. This regulation has some provisions that purport to require offshore special purpose vehicles, or SPVs, formed for listing purposes and controlled directly or indirectly by PRC companies or individuals, such as our company, to obtain the approval of the CSRC prior to publicly listing their securities on an overseas stock exchange. The New M&A Rule specifically requires that an SPV, when using its offshore company shares to acquire shares of domestic companies (i.e., a share swap), obtain the approval of the CSRC. However, the New M&A Rule is unclear as to whether an SPV using its cash to acquire the domestic companies needs to obtain approval from the CSRC and is silent on if and how the New M&A Rule is applicable to overseas listings such as ours which is already in process prior to the September 8, 2006 effective date. The application of this New M&A Rule is not yet clear, and the new PRC regulation does not contain any specific requirements regarding the timing and process for obtaining any required approvals from the CSRC. Our PRC counsel, King & Wood, have advised us that based on their understanding of current PRC laws, regulations and the new regulation, listing and trading of our ADSs do not require approval of the CSRC because we have completed our restructuring through which we acquired the shares of our subsidiary, Shenzhen Mindray in exchange for cash (and not by share exchange) and have received all the relevant approvals for such restructuring prior to the promulgation of the New M&A Rule, unless (i) other laws, regulations, rules or formal clarifications and guidance are adopted before the closing of this offering or (ii) the CSRC clearly requires in any form on or after the September 8, 2006 effective date of the new regulation the listing of all SPVs on an overseas stock exchange require the approval of the CSRC. King & Wood advised us that although the possibility that the CSRC may have different opinion is very small, they can not completely rule out this possibility.

If the CSRC subsequently determines its prior approval was required, we may face regulatory actions or other sanctions from the CSRC or other PRC regulatory agencies. These regulatory agencies may impose fines and penalties on our operations in the PRC, limit our operating privileges in the PRC, delay or restrict the repatriation of the proceeds from this offering into the PRC, or take other actions that could have a material adverse effect on our business, financial condition, results of operations, reputation and prospects, as well as the trading price of our ADSs. The CSRC or other PRC regulatory agencies also may take actions requiring us, or making it advisable for us, to halt this offering before settlement and delivery of the ADSs offered hereby. Consequently, if you engage in market trading or other activities in anticipation of and prior to settlement and delivery, you do so at the risk that settlement and delivery may not occur.

Although the CSRC is expected to promulgate formal implementing rules and possibly other guidance, the procedures, criteria and timing for obtaining any required CSRC consent have not been established and we cannot predict at this time when this may happen. If implementing rules or formal clarifications and guidance is issued prior to the completion of this offering and consequently we conclude we are required to obtain CSRC approval, this offering will be delayed until we obtain CSRC approval, which may take several months or longer. Furthermore, any delay in the issuance of such implementing rules or guidance may create additional uncertainties with respect to this offering. Moreover, implementing rules or guidance, to the extent issued, may fail to resolve current ambiguities under the new PRC regulation. Uncertainties regarding the New M&A Rule could have a material adverse effect on the trading price of our ADSs.

International expansion may be costly, time consuming and difficult. If we do not successfully expand internationally, our profitability and prospects would be materially and adversely affected.

Our future success is significantly dependent upon our ability to expand in our existing international markets and enter into new international markets. In expanding our business internationally, we have entered and intend to continue to enter markets in which we have limited or no experience and in which our brand may be less recognized. To further promote our brand and generate demand for our products so as to attract distributors in international markets, we expect to spend significantly more on marketing and promotion than we do in our existing markets. We may be unable to attract a sufficient number of distributors, and our selected distributors may not be suitable for selling our products. Furthermore, in new markets we may fail to

anticipate competitive conditions that are different from those in our existing markets. These competitive conditions may make it difficult or impossible for us to effectively operate in these markets. If our expansion efforts in existing and new markets are unsuccessful, our profitability and prospects would be materially and adversely affected.

We are exposed to other risks associated with international operations, including:

- political instability;
- economic instability and recessions;
- changes in tariffs;
- difficulties of administering foreign operations generally;
- limited protection for intellectual property rights;
- obligations to comply with a wide variety of foreign laws and other regulatory requirements;
- increased risk of exposure to terrorist activities;
- financial condition, expertise and performance of our international distributors;
- export license requirements;
- unauthorized re-export of our products;
- potentially adverse tax consequences; and
- inability to effectively enforce contractual or legal rights.

If we fail to accurately project demand for our products, we may encounter problems of inadequate supply or oversupply, especially with respect to our international markets, which would materially and adversely affect our financial condition and results of operations, as well as damage our reputation and brand.

Our distributors typically order our products on a purchase order basis. We project demand for our products based on rolling projections from our distributors, our understanding of anticipated hospital procurement spending, and distributor inventory levels. Lack of significant order backlog and the varying sales and purchasing cycles of our distributors and other customers, however, make it difficult for us to forecast future demand accurately.

Our projections of market demand for our products in international markets are less reliable than our domestic projections because we have less information available on which to base our projections. Specifically, we do not have consistently reliable information regarding international distributor inventory levels, and we often lack extensive knowledge of the local market conditions or about the purchasing patterns, preferences, or cycles of international distributors. Furthermore, because shipping finished products to international distributors typically takes more time than shipping to domestic distributors, inaccurate projections of international demand could result more quickly in unmet demand.

If we overestimate demand, we may purchase more raw materials or components than required. If we underestimate demand, our third party suppliers may have inadequate raw material or product component inventories, which could interrupt our manufacturing and delay shipments, and could result in lost sales. In particular, we are seeking to reduce our procurement and inventory costs by matching our inventories closely with our projected manufacturing needs and by, from time to time, deferring our purchase of raw materials and components in anticipation of supplier price reductions. As we seek to balance reduced inventory costs and production flexibility, we may fail to accurately forecast demand and coordinate our procurement and production to meet demand on a timely

basis. For example, we did not foresee a surge in direct sales orders from hospitals in China during the fourth quarter in 2005. Our underestimation of demand, coupled with our decision to defer our purchase of new raw materials and components in anticipation of a reduction in pricing for certain raw materials and components at the beginning of a new calendar year, resulted in up to three-

week delays in our product deliveries internationally. Our inability to accurately predict our demand and to timely meet our demand could materially and adversely affect our financial conditions and results of operations as well as damage our reputation and corporate brand.

We depend on our key personnel, and our business and growth may be severely disrupted if we lose their services.

Our future success is significantly dependent upon the continued service of our key executives and other key employees. In particular, we are highly dependent on our co-chief executive officers, Mr. Xu Hang and Mr. Li Xiting, and our executive vice president of sales and marketing, Mr. Cheng Minghe, to manage our business and operations, and on our key research and development personnel for the development of new products. We have entered into employment agreements with each of our key executives and other key employees for three-year terms. However, if we lose the services of any senior management or key research and development personnel, we may not be able to locate suitable or qualified replacements, and may incur additional expenses to recruit and train new personnel, which could severely disrupt our business and growth. Furthermore, as we expect to continue to expand our operations and develop new products, we will need to continue attracting and retaining experienced management and key research and development personnel.

Competition for personnel in the medical technology field is intense, and the availability of suitable and qualified candidates in China, particularly Shenzhen, is limited. We compete to attract and retain qualified research and development personnel with other medical device companies, universities and research institutions. Competition for these individuals could cause us to offer higher compensation and other benefits in order to attract and retain them, which could materially and adversely affect our financial condition and results of operations. We may be unable to attract or retain the personnel required to achieve our business objectives and failure to do so could severely disrupt our business and growth.

Our business is subject to intense competition, which may reduce demand for our products and materially and adversely affect our business, financial condition, results of operations and prospects.

The medical device market is highly competitive, and we expect competition to intensify in the future. We face direct competition both domestically and internationally across all product lines and price points. Our competitors also vary significantly according to business segment. For domestic sales, our competitors include publicly traded and privately held multinational companies, as well as domestic Chinese companies. For international sales, our competitors are primarily publicly traded and privately held multinational companies. We also face competition in international sales from companies that have local operations in the markets in which we sell our products. Some of our larger competitors may have:

- greater financial and other resources;
- larger variety of products;
- more products that have received regulatory approvals;
- greater pricing flexibility;
- more extensive research and development and technical capabilities;
- patent portfolios that may present an obstacle to our conduct of business;
- greater knowledge of local market conditions where we seek to increase our international sales;
- stronger brand recognition; and
- larger sales and distribution networks.

As a result, we may be unable to offer products similar to, or more desirable than, those offered by our competitors, market our products as effectively as our competitors or otherwise respond successfully to competitive pressures. In addition, our competitors may be able to offer discounts on competing products as part of a bundle of non-competing products, systems and services that they sell to our customers, and we

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may not be able to profitably match those discounts. Furthermore, our competitors may develop technologies and products that are more effective than those we currently offer or that render our products obsolete or uncompetitive. In addition, the timing of the introduction of competing products into the market could affect the market acceptance and market share of our products. Our failure to compete successfully could materially and adversely affect our business, financial condition, results of operation and prospects.

Moreover, some of our internationally-based competitors have established or are in the process of establishing production and research and development facilities in China, while others have entered into cooperative business arrangements with Chinese manufacturers. If we are unable to develop competitive products, obtain regulatory approval or clearance and supply sufficient quantities to the market as quickly and effectively as our competitors, market acceptance of our products may be limited, which could result in decreased sales. In addition, we may not be able to maintain our manufacturing cost advantage.

In addition, we believe that corrupt practices in the medical device industry in China still occur. To increase sales, certain manufacturers or distributors of medical devices may pay kickbacks or provide other benefits to hospital personnel who make procurement decisions. Our company policy prohibits these practices by our direct sales personnel and our distribution agreements require our distributors to comply with applicable law. As a result, as competition intensifies in the medical device industry in China, we may lose sales, customers or contracts to competitors.

We rely on one principal manufacturing, assembly and storage facility for our products and intend to expand or move into a new facility within the next two years. Any disruption to our current manufacturing facility or in the build out of the new or expanded capacity could reduce our sales and harm our reputation.

We manufacture, assemble and store almost all of our products, as well as conduct some of our primary research and development activities, at a principal facility located in Shenzhen, China. We do not maintain back-up facilities, so we depend on this facility for the continued operation of our business. A natural disaster or other unanticipated catastrophic events, including power interruptions, water shortage, storms, fires, earthquakes, terrorist attacks and wars, could significantly impair our ability to manufacture our products and operate our business, as well as delay our research and development activities. Our facility and certain equipment located in this facility would be difficult to replace and could require substantial replacement lead-time. Catastrophic events may also destroy any inventory located in our facility. The occurrence of such an event could materially and adversely affect our business.

We intend to construct a new headquarters building and expand our manufacturing, assembly and warehouse facilities, including the potential relocation into a facility, and we will move our primary management and administration functions into the new headquarters facility. Our new construction projects or expanded facilities will require significant build-out before we will be able to relocate. We may experience difficulties that disrupt our management and administration or manufacturing activities as we migrate to our new headquarters building and expanded manufacturing facility, which could harm our business, financial condition and results of operations.

If we are unable to obtain adequate supplies of required materials and components that meet our production standards at acceptable costs or at all, our ability to accept and fulfill product orders with the required quality and at the required time could be restricted, which could materially and adversely affect our business, financial condition and results of operations.

We purchase raw materials and components from third party suppliers and manufacture and assemble our products at our facility. Our purchases are generally made on a purchase order basis and we do not have long-term supply contracts. As a result, our suppliers may cease to provide components to us with little or no advance notice. In addition, to optimize our cost structure, we currently rely on single source suppliers to provide some of our raw materials and components for products in all three of our business segments. If the supply of certain materials or components were interrupted, our own manufacturing and assembly processes would be delayed. We also may be unable to secure alternative supply sources in a timely and cost-effective

manner. If we are unable to obtain adequate supplies of required materials and components that meet our production standards at acceptable costs or at all, our ability to accept and fulfill product orders with the required quality, and at the required time could be restricted. This could harm our reputation, reduce our sales or gross margins, and cause us to lose market share, each of which could materially and adversely affect our business, financial condition and results of operations.

Failure to manage our growth could strain our management, operational and other resources, which could materially and adversely affect our business and prospects.

Our growth strategy includes building our brand, increasing market penetration of our existing products, developing new products, increasing our targeting of large-sized hospitals in China, and increasing our exports. Pursuing these strategies has resulted in, and will continue to result in substantial demands on management resources. In particular, the management of our growth will require, among other things:

- continued enhancement of our research and development capabilities;
- information technology system enhancement;
- stringent cost controls and sufficient liquidity;
- strengthening of financial and management controls and information technology systems;
- increased marketing, sales and sales support activities; and
- hiring and training of new personnel.

If we are not able to manage our growth successfully, our business and prospects would be materially and adversely affected.

We generate a significant portion of our revenues from a small number of products, and a reduction in demand in any of these products could materially and adversely affect our financial condition and results of operations.

We derive a substantial percentage of our revenues from a small number of products. Our five top selling products accounted for 63.9%, 53.5%, 45.0% and 38.1% of our total net segment revenues in 2003, 2004, 2005 and the six months ended June 30, 2006, respectively. In the six months ended June 30, 2006, our best-selling product, the portable PM-9000 multi-parameter patient monitoring device, accounted for 13.3% of our total net segment revenues. We expect a small number of our key products will continue to account for a significant portion of our net revenues for the foreseeable future. As a result, continued market acceptance and popularity of these products is critical to our success, and a reduction in demand for our key products due to, among other factors, the introduction of competing products by our competitors, the entry of new competitors, or end-users dissatisfaction with the quality of these products could materially and adversely affect our financial condition and results of operations.

Moreover, we are particularly dependent on sales of our patient monitoring devices, which accounted for 41.0% of our net segment revenues in the six months ended June 30, 2006. If the market for patient monitoring devices deteriorates, our financial condition and results of operations could be materially and adversely affected. We are also susceptible to market changes for diagnostic laboratory instruments and ultrasound imaging systems, which accounted for 28.7% and 30.0% of our net segment revenues in the six months ended June 30, 2006, respectively. Future changes in customer demand and market trends may have a material adverse effect on our business and prospects.

If we fail to protect our intellectual property rights it could harm our business and competitive position.

We rely on a combination of patent, copyright, trademark and trade secret laws and non-disclosure agreements and other methods to protect our intellectual property rights. We own over 60 patents in China covering various products and aspects of our products and have additional patent applications pending in

China. We have also filed 20 patent applications in the United States, which cover some of the more commercially significant aspects of our products and technologies. Due to the different regulatory bodies and varying requirements in the United States and China, we may be unable to obtain patent protection for certain aspects of our products or technologies in either or both of these two countries. In addition, we have not applied for any patents outside of the United States and China.

The process of seeking patent protection can be lengthy and expensive, our patent applications may fail to result in patents being issued, and our existing and future issued patents may be insufficient to provide us with meaningful protection or commercial advantage. Our patents and patent applications may also be challenged, invalidated or circumvented in the future.

We also rely on trade secret rights to protect our business through non-disclosure provisions in the employment agreements with employees. If any of our employees breach their non-disclosure obligations, we may not have adequate remedies in China, and our trade secrets may become known to our competitors.

Implementation of PRC intellectual property-related laws has historically been lacking, primarily because of ambiguities in the PRC laws and difficulties in enforcement. Accordingly, intellectual property rights and confidentiality protections in China may not be as effective as in the United States or other western countries. Furthermore, policing unauthorized use of proprietary technology is difficult and expensive, and we may need to resort to litigation to enforce or defend patents issued to us or to determine the enforceability, scope and validity of our proprietary rights or those of others. Such litigation and an adverse determination in any such litigation, if any, could result in substantial costs and diversion of resources and management attention, which could harm our business and competitive position.

We may be exposed to intellectual property infringement and other claims by third parties which, if successful, could disrupt our business and have a material adverse effect on our financial condition and results of operations.

Our success depends, in large part, on our ability to use and develop our technology and know-how without infringing third party intellectual property rights. As we increase our product sales internationally, and as litigation becomes more common in China, we face a higher risk of being the subject of claims for intellectual property infringement, invalidity or indemnification relating to other parties proprietary rights. Our current or potential competitors, many of which have substantial resources and have made substantial investments in competing technologies, may have or may obtain patents that will prevent, limit or interfere with our ability to make, use or sell our products in either China or other countries, including the United States and other countries in Asia. The validity and scope of claims relating to medical device technology patents involve complex scientific, legal and factual questions and analysis and, as a result, may be highly uncertain. In addition, the defense of intellectual property suits, including patent infringement suits, and related legal and administrative proceedings can be both costly and time consuming and may significantly divert the efforts and resources of our technical and management personnel. Furthermore, an adverse determination in any such litigation or proceedings to which we may become a party could cause us to:

- pay damage awards;
- seek licenses from third parties;
- pay ongoing royalties;
- redesign our products; or
- be restricted by injunctions,

each of which could effectively prevent us from pursuing some or all of our business and result in our customers or potential customers deferring or limiting their purchase or use of our products, which could have a material adverse effect on our financial condition and results of operations.

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Unauthorized use of our brand name by third parties, and the expenses incurred in developing and preserving the value of our brand name, may adversely affect our business.

We regard our brand name as critical to our success. Unauthorized use of our brand name by third parties may adversely affect our business and reputation, including the perceived quality and reliability of our products. We rely on trademark law, company brand name protection policies, and agreements with our employees, customers, business partners and others to protect the value of our brand name. Despite our precautions, we may be unable to prevent third parties from using our brand name without authorization. In the past, we have experienced unauthorized use of our brand name in China and have expended resources and the attention and time of our management to successfully prosecute those who used our brand name without authorization. Moreover, litigation may be necessary in the future to protect our brand name. However, because the validity, enforceability and scope of protection of trademarks in the PRC are uncertain and still evolving, we may not be successful in prosecuting these cases. Future litigation could also result in substantial costs and diversion of our resources, and could disrupt our business, as well as have a material adverse effect on our financial condition and results of operations. In addition, we are in the process of registering our brandname and logo as trademark in countries outside of China. Our registration applications may not be successful in certain countries, which could weaken the protection of our brand name in those countries or may require that we market our products under different names in those countries.

If we fail to obtain or maintain applicable regulatory clearances or approvals for our products, or if such clearances or approvals are delayed, we will be unable to commercially distribute and market our products at all or in a timely manner, which could significantly disrupt our business and materially and adversely affect our sales and profitability.

The sale and marketing of our medical device products are subject to regulation in China and in most other countries where we conduct business. For a significant portion of our sales, we need to obtain and renew licenses and registrations with the PRC State Food and Drug Administration, or SFDA, the FDA, and the regulators administering CE marks in the European Union. The processes for obtaining regulatory clearances or approvals can be lengthy and expensive, and the results are unpredictable. In addition, the relevant regulatory authorities may introduce additional requirements or procedures that have the effect of delaying or prolonging the regulatory clearance or approval for our existing or new products. For example, the SFDA introduced a new safety standard to its approval process for new medical devices, which we believe has increased the typical time period required to obtain such approval by approximately three months. This delayed the planned launch of three of our new products in the third quarter of 2006. If we are unable to obtain clearances or approvals needed to market existing or new products, or obtain such clearances or approvals in a timely fashion, our business would be significantly disrupted, and our sales and profitability could be materially and adversely affected. See Regulation.

We are subject to product liability exposure and have limited insurance coverage. Any product liability claims or potential safety-related regulatory actions could damage our reputation and materially and adversely affect our business, financial condition and results of operations.

Our main products are medical devices used in the diagnosis and monitoring of patients, and the manufacture and sale of these products expose us to potential product liability claims if the use of these products causes or is alleged to have caused personal injuries or other adverse effects. Any product liability claim or regulatory action could be costly and time-consuming to defend. If successful, product liability claims may require us to pay substantial damages. We maintain limited product liability insurance to cover potential product liability arising from the use of our products. However, product liability insurance available in China offers limited coverage compared to coverage offered in many other countries. As a result, future liability claims could be excluded or exceed the coverage limits of our policy. As we expand our sales internationally and increase our exposure to these risks in many countries, we may be unable to maintain sufficient product liability insurance coverage on commercially reasonable terms, or at all. A product liability claim or potential safety-related regulatory action, with or without merit, could result in significant negative

publicity and materially and adversely affect the marketability of our products and our reputation, as well as our business, financial condition and results of operations.

Moreover, a material design, manufacturing or quality failure or defect in our products, other safety issues or heightened regulatory scrutiny could each warrant a product recall by us and result in increased product liability claims. Also, if these products are deemed by the authorities in the countries where we sell our products to fail to conform to product quality and safety requirements, we could be subject to regulatory action. In China, violation of PRC product quality and safety requirements may subject us to confiscation of related earnings, penalties, an order to cease sales of the violating product or to cease operations pending rectification. Furthermore, if the violation is determined to be serious, our business license to manufacture or sell violating and other products could be suspended or revoked.

Our revenues and profitability could be materially and adversely affected if there is a disruption in our existing arrangements with our original design manufacturing and original equipment manufacturing customers.

In 2005 and the six months ended June 30, 2006, ODM customers accounted for 9.7% and 5.4%, respectively, of our net revenues and, during the same period, OEM customers accounted for 7.7% and 5.3%, respectively, of our net revenues. We have invested significant time and resources in cultivating these relationships. In particular, we are typically required to undergo lengthy product approval processes with these customers, which in some cases can take up to 16 months. The length of the approval process may vary and is affected by a number of factors, including customer priorities, customer budgets and regulatory issues. Delays in the product approval process could materially and adversely affect our business, financial condition and results of operations. Moreover, our ODM and OEM customers may develop their own solutions or adopt a competitor s solution for products that they currently purchase from us. We may be unable to maintain our existing arrangements with our ODM and OEM customers. In particular, any failure in generating orders from these customers or decrease in sales to these customers, as well as any adoption by these customers of their own or our competitors product solutions, could have a material adverse effect on our revenues and profitability.

Our quarterly revenues and operating results are difficult to predict and could fall below investor expectations, which could cause the trading price of our ADSs to decline.

Our quarterly revenues and operating results have fluctuated in the past and may fluctuate significantly in the future depending upon numerous factors. Our first quarters ending March 31 have historically been our lowest in terms of quarterly revenues and operating results. We believe that our weaker first quarter performance has been largely due to the Chinese Lunar New Year Holiday. Other factors that may affect our quarterly results include:

- the loss of key customers;
- changes in pricing policies by us or our competitors;
- variations in the purchasing cycles of our customers;
- the length of our sales and delivery cycle;
- the timing and market acceptance of new product introductions by us or our competitors;
- the timing of receipt of government incentives;
- changes in the industry operating environment;
- changes in government policies or regulations (including anti-commercial bribery laws) or their enforcement; and
- a downturn in general economic conditions in China or internationally.

Many of these factors are beyond our control, making our quarterly results difficult to predict, which could cause the trading price of our ADSs to decline below investor expectations. You should not rely on our results of operations for prior quarters as an indication of our future results.

If we experience a significant number of warranty claims, our costs could substantially increase and our reputation and brand could suffer.

We typically sell our products with warranty terms covering 12 months after purchase. Our product warranty requires us to repair all mechanical malfunctions and, if necessary, replace defective components. We accrue liability for potential warranty claims at the time of sale. If we experience an increase in warranty claims or if our repair and replacement costs associated with warranty claims increase significantly, we may have to accrue a greater liability for potential warranty claims. Moreover, an increase in the frequency of warranty claims could substantially increase our costs and harm our reputation and brand. Our business, financial condition, results of operations and prospects may suffer materially if we experience a significant increase in warranty claims on our products.

Our corporate actions are substantially controlled by our principal shareholders. Our dual-class ordinary share structure with different voting rights could discourage others from pursuing any change of control transactions that our shareholders may view as beneficial.

Prior to the completion of this offering, our shareholders will approve our amended memorandum and articles of association to provide for a dual-class ordinary share structure. Our ordinary shares are divided into Class A ordinary shares and Class B ordinary shares. Holders of Class A ordinary shares are entitled to one vote per share, while holders of Class B ordinary shares are entitled to five votes per share.

Upon completion of this offering, three of our shareholders and their affiliated entities will own approximately % of our outstanding ordinary shares, representing approximately % of our voting power due to our dual-class ordinary share structure. Our co-chief executive officers, Mr. Xu Hang and Mr. Li Xiting, and our executive vice president of sales and marketing, Mr. Cheng Minghe, through their respective affiliates, hold all of our Class B ordinary shares. These shareholders will exert control over all matters subject to shareholder vote until they collectively own less than 20% of our outstanding ordinary shares. This concentration of voting power may discourage, delay or prevent a change in control or other business combination, which could deprive you of an opportunity to receive a premium for your ADSs as part of a sale of our company and might reduce the price of our ADSs. The interests of Mr. Xu, Mr. Li, and Mr. Cheng as officers and employees of our company may differ from their interests as shareholders of our company or from your interests as a shareholder.

Anti-takeover provisions in our charter documents may discourage our acquisition by a third party, which could limit our shareholders opportunity to sell their shares, including Class A ordinary shares represented by our ADSs, at a premium.

Our amended and restated memorandum and articles of association include provisions that could limit the ability of others to acquire control of us, modify our structure or cause us to engage in change of control transactions. These provisions could have the effect of depriving our shareholders of an opportunity to sell their shares, including Class A ordinary shares represented by ADSs, at a premium over prevailing market prices by discouraging third parties from seeking to obtain control of us in a tender offer or similar transaction.

For example, our board of directors will have the authority, without further action by our shareholders, to issue preferred shares in one or more series and to fix the powers and rights of these shares, including dividend rights, conversion rights, voting rights, terms of redemption and liquidation preferences, any or all of which may be greater than the rights associated with our Class A ordinary shares. Preferred shares could thus be issued quickly with terms calculated to delay or prevent a change in control or make removal of management more difficult. In addition, if our board of directors authorizes the issuance of preferred shares, the trading price of our ADSs may fall and the voting and other rights of the holders of our Class A ordinary

shares may be materially and adversely affected. See Description of Share Capital Issuance of Additional Ordinary Shares or Preferred Shares.

Certain actions require the approval of a supermajority of at least two thirds of our board of directors which, among other things, would allow our non-independent directors to block a variety of actions or transactions, such as a merger, asset sale or other change of control, even if all of our independent directors unanimously voted in favor of such action, thereby further depriving our shareholders of an opportunity to sell their shares at a premium. In addition, our directors are divided into three classes with staggered terms of three years each, which means that shareholders can elect or remove only a limited number of our directors in any given year. The length of these terms could present an additional obstacle against the taking of action, such as a merger or other change of control, that could be in the interest of our shareholders. See Description of Share Capital Board of Directors.

We may undertake acquisitions, which may have a material adverse effect on our ability to manage our business, and may end up being unsuccessful.

Our growth strategy may involve the acquisition of new technologies, businesses, products or services or the creation of strategic alliances in areas in which we do not currently operate. These acquisitions could require that our management develop expertise in new areas, manage new business relationships and attract new types of customers. Furthermore, acquisitions may require significant attention from our management, and the diversion of our management s attention and resources could have a material adverse effect on our ability to manage our business. We may also experience difficulties integrating acquisitions into our existing business and operations. Future acquisitions may also expose us to potential risks, including risks associated with:

- the integration of new operations, services and personnel;
- unforeseen or hidden liabilities;
- the diversion of resources from our existing businesses and technologies;
- our inability to generate sufficient revenue to offset the costs, expenses of acquisitions; and
- potential loss of, or harm to, relationships with employees or customers, any of which could significantly disrupt our ability to manage our business and materially and adversely affect our business financial condition and results of operations.

We may need additional capital in the future, and we may be unable to obtain such capital in a timely manner or on acceptable terms, or at all.

In order for us to grow, remain competitive, develop new products, and expand our distribution network, we may require additional capital in the future. Our ability to obtain additional capital in the future is subject to a variety of uncertainties, including:

- our future financial condition, results of operations and cash flows;
- general market conditions for capital raising activities by medical device and related companies; and
- economic, political and other conditions in China and elsewhere.

We may be unable to obtain additional capital in a timely manner or on acceptable terms or at all. Furthermore, the terms and amount of any additional capital raised through issuances of equity securities may result in significant shareholder dilution.

We may become a passive foreign investment company, or PFIC, which could result in adverse United States federal income tax consequences to US holders.

Depending upon the value of our shares and ADSs and the nature of our assets and income over time, we could be classified as a passive foreign investment company, or PFIC, by the United States Internal

Revenue Service, or IRS, for US federal income tax purposes. Based on assumptions as to our projections of the value of our outstanding shares during the year and our use of the proceeds of this offering and of the other cash that we will hold and generate in the ordinary course of our business throughout taxable year 2006, we do not expect to be a PFIC for the taxable year 2006. However, there can be no assurance that we will not be a PFIC for the taxable year 2006 and/or later taxable years, as PFIC status is tested each year and depends on our assets and income in such year. Our PFIC status for the current taxable year 2006 will not be determinable until the close of the taxable year ending December 31, 2006.

We will be classified as a PFIC in any taxable year if either: (1) the average percentage value of our gross assets during the taxable year that produce passive income or are held for the production of passive income is at least 50% of the value of our total gross assets or (2) 75% or more of our gross income for the taxable year is passive income. For example, we would be a PFIC for the taxable year 2006 if the sum of our average market capitalization, which is our share price multiplied by the total amount of our outstanding shares, and our liabilities over that taxable year is not more than twice the value of our cash, cash equivalents, and other assets that are readily converted into cash. In particular, we would likely become a PFIC if the value of our outstanding shares were to decrease significantly while we hold substantial cash and cash equivalents.

If we are classified as a PFIC in any taxable year in which you hold our ADSs or shares and you are a US Holder, you would generally be taxed at higher ordinary income rates, rather than lower capital gain rates, if you dispose of ADSs or shares for a gain in a later year, even if we are not a PFIC in that year. In addition, a portion of the tax imposed on your gain would be increased by an interest charge. Moreover, if we were classified as a PFIC in any taxable year, you would not be able to benefit from any preferential tax rate with respect to any dividend distribution that you may receive from us in that year or in the following year. Finally, you would also be subject to special United States federal income tax reporting requirements. We cannot assure you that we will not be a PFIC for 2006 or any future taxable year. For more information on the United States federal income tax consequences to you that would result from our classification as a PFIC, please see Taxation United States Federal Income Taxation US Holders Passive Foreign Investment Company.

We may not be able to ensure compliance with United States economic sanctions laws, especially when we sell our products to distributors over which we have limited control.

The U.S. Department of the Treasury s Office of Foreign Assets Control, or OFAC, administers certain laws and regulations that impose penalties upon U.S. persons and, in some instances, foreign entities owned or controlled by U.S. persons, for conducting activities or transacting business with certain countries, governments, entities or individuals subject to U.S. economic sanctions, or U.S. Economic Sanctions Laws. We will not use any proceeds from the sale of our ADSs to fund any activities or business with any country, government, entity or individual with respect to which U.S. persons or, as appropriate, foreign entities owned or controlled by U.S. persons, are prohibited by U.S. Economic Sanctions Laws from conducting such activities or transacting such business. However, we sell our products in international markets through independent non-U.S. distributors which are responsible for interacting with the end-users of our products. Some of these independent non-U.S. distributors are located in or conduct business with countries subject to U.S. economic sanctions such as Cuba, Sudan, Iran, Syria and Myanmar, and we may not be able to ensure that such non-U.S. distributors comply with any applicable U.S. Economic Sanctions Laws. Moreover, if a U.S. distributor or our United States subsidiary, Mindray USA Corp., conducts activities or transacts business with a country, government, entity or individual subject to U.S. economic sanctions, such actions may violate U.S. Economic Sanctions Laws. As a result of the foregoing, actions could be taken against us that could materially and adversely affect our reputation and have a material and adverse effect on our business, financial condition, results of operations and prospects.

We may be unable to establish and maintain an effective system of internal control over financial reporting, and as a result we may be unable to accurately report our financial results or prevent fraud.

Upon the completion of this offering, we will become a public company in the United States that is or will be subject to, the Sarbanes-Oxley Act. Section 404 of the Sarbanes-Oxley Act, or Section 404, will require that we include a report from management on our internal control over financial reporting in our Annual Report on Form 20-F beginning with our annual report for the fiscal year ending December 31, 2007. In addition, our independent registered public accounting firm must attest to and report on management s assessment of the effectiveness of our internal control over financial reporting. Our management may conclude that our internal controls are not effective. Moreover, even if our management concludes that our internal control over financial reporting is effective, our independent registered public accounting firm may disagree and may decline to attest to our management s assessment or may issue an adverse opinion. Any of these possible outcomes could result in an adverse reaction in the financial marketplace due to a loss of investor confidence in the reliability of our reporting processes, which could adversely affect the trading price of our ADSs.

Our reporting obligations as a public company will place a significant strain on our management, operational and financial resources and systems for the foreseeable future. Prior to this offering, we have been a private company with limited accounting personnel and other resources with which to address our internal controls and procedures. In connection with this offering, a number of control deficiencies in our internal control procedures have been identified that could adversely affect our ability to record, process, summarize and report financial data consistent with the assertions of our management in our consolidated financial statements. Certain identified control deficiencies include the lack of a formalized US GAAP closing and reporting process, internal audit resources and accounting personnel with advanced SEC reporting and US GAAP accounting skills. We may identify additional control deficiencies as a result of the assessment process we will undertake in compliance with Section 404. We plan to remediate control deficiencies identified in time to meet the deadline imposed by the requirements of Section 404 but we may be unable to do so. Our failure to establish and maintain effective internal control over financial reporting could result in the loss of investor confidence in the reliability of our financial reporting processes, which in turn could harm our business and negatively impact the trading price of our ADSs.

RISKS RELATED TO DOING BUSINESS IN CHINA

Changes in China s economic, political and social condition could adversely affect our financial condition and results of operations.

We conduct a substantial majority of our business operations in China and derive a majority of our revenues from our operations in China. Accordingly, our business, financial condition, results of operations and prospects are affected to a significant degree by economic, political and social conditions in China. The PRC economy differs from the economies of most developed countries in many respects, including the amount of government involvement, level of development, growth rate, control of foreign exchange and allocation of resources. The PRC government has implemented various measures to encourage economic growth and guide the allocation of resources. Some of these measures benefit the overall PRC economy, but may also have a negative effect on us. For example, our financial condition and results of operations may be adversely affected by changes in tax regulations applicable to us. The PRC government has implemented certain measures, including a recent interest rate increase, to control the pace of economic growth. These measures may cause decreased economic activity in China, including a slowing or decline in individual hospital spending, which in turn could adversely affect our financial condition and results of operations.

The PRC legal system embodies uncertainties that could limit the legal protections available to you and us.

The PRC legal system is a civil law system based on written statutes. Unlike common law systems, it is a system in which decided legal cases have limited precedential value. In 1979, the PRC government began to

promulgate a comprehensive system of laws and regulations governing economic matters in general. The overall effect of legislation over the past three decades has significantly increased the protections afforded to various forms of foreign investment in China. Our PRC operating subsidiary, Shenzhen Mindray, is a foreign-invested enterprise and is subject to laws and regulations applicable to foreign investment in China as well as laws and regulations applicable to foreign-invested enterprises. These laws and regulations change frequently, and their interpretation and enforcement involve uncertainties. For example, we may have to resort to administrative and court proceedings to enforce the legal protections that we enjoy either by law or contract. However, since PRC administrative and court authorities have significant discretion in interpreting and implementing statutory and contractual terms, it may be more difficult to evaluate the outcome of administrative and court proceedings and the level of legal protection we enjoy than in more developed legal systems. These uncertainties may also impede our ability to enforce the contracts we have entered into. As a result, these uncertainties could materially and adversely affect our business and operations.

Recent PRC regulations relating to offshore investment activities by PRC residents may increase the administrative burden we face and create regulatory uncertainties that could restrict our overseas and cross-border investment activity, and a failure by our shareholders who are PRC residents to make any required applications and filings pursuant to such regulations may prevent us from being able to distribute profits and could expose us and our PRC resident shareholders to liability under PRC law.

The PRC State Administration of Foreign Exchange, or SAFE, recently promulgated regulations that require PRC residents and PRC corporate entities to register with and obtain approvals from relevant PRC government authorities in connection with their direct or indirect offshore investment activities. These regulations apply to our shareholders who are PRC residents in connection with our prior and any future offshore acquisitions.

The SAFE regulation required registration by March 31, 2006 of direct or indirect investments previously made by PRC residents in offshore companies prior to the implementation of the Notice on Issues Relating to the Administration of Foreign Exchange in Fund-Raising and Reverse Investment Activities of Domestic Residents Conducted via Offshore Special Purpose Companies on November 1, 2005. If a PRC shareholder with a direct or indirect stake in an offshore parent company fails to make the required SAFE registration, the PRC subsidiaries of such offshore parent company may be prohibited from making distributions of profit to the offshore parent and from paying the offshore parent proceeds from any reduction in capital, share transfer or liquidation in respect of the PRC subsidiaries. Furthermore, failure to comply with the various SAFE registration requirements described above could result in liability under PRC law for foreign exchange evasion.

We have already notified and urged our shareholders, and the shareholders of the offshore entities in our corporate group, who are PRC residents to make the necessary applications and filings, as required under this regulation. However, as these regulations are still relatively new and there is uncertainty concerning the reconciliation of the new regulation with other approval requirements, it is unclear how the regulation, and any future legislation concerning offshore or cross-border transactions, will be interpreted, amended and implemented by the relevant government authorities. While we believe that the relevant shareholders are in the process of making the applications with local SAFE offices, some of our shareholders may not comply with our request to make or obtain any applicable registrations or approvals required by the regulation or other related legislation. The failure or inability of our PRC resident shareholders to obtain any required approvals or make any required registrations may subject us to fines and legal sanctions, prevent us from being able to make distributions or pay dividends, as a result of which our business operations and our ability to distribute profits to you could be materially and adversely affected.

We rely principally on dividends and other distributions on equity paid by our operating subsidiary to fund cash and financing requirements, and limitations on the ability of our operating subsidiary to pay dividends to us could have a material adverse effect on our ability to conduct our business.

We are a holding company, and we rely principally on dividends and other distributions on equity paid by our operating subsidiary Shenzhen Mindray for our cash and financing requirements, including the funds

necessary to pay dividends and other cash distributions to our shareholders, service any debt we may incur and pay our operating expenses. If Shenzhen Mindray incurs debt on its own behalf in the future, the instruments governing the debt may restrict its ability to pay dividends or make other distributions to us. Furthermore, relevant PRC laws and regulations permit payments of dividends by Shenzhen Mindray only out of its retained earnings, if any, determined in accordance with PRC accounting standards and regulations.

Under PRC laws and regulations, Shenzhen Mindray is required to set aside a portion of its net income each year to fund certain statutory reserves. These reserves, together with the registered equity, are not distributable as cash dividends. As of December 31, 2005, the amount of these restricted portions was approximately RMB160.4 million (US$20.1 million). As a result of these PRC laws and regulations, Shenzhen Mindray is restricted in its ability to transfer a portion of its net assets to us whether in the form of dividends, loans or advances. Limitations on the ability of Shenzhen Mindray to pay dividends to us could adversely limit our ability to grow, make investments or acquisitions that could be beneficial to our businesses, pay dividends, or otherwise fund and conduct our business.

Restrictions on currency exchange may limit our ability to utilize our revenues effectively.

A majority of our revenues and operating expenses are denominated in Renminbi. The Renminbi is currently convertible under the current account, which includes dividends, trade and service-related foreign exchange transactions, but not under the capital account, which includes foreign direct investment and loans. Currently, Shenzhen Mindray may purchase foreign exchange for settlement of current account transactions, including payment of dividends to us, without the approval of SAFE. However, the relevant PRC governmental authorities may limit or eliminate our ability to purchase foreign currencies in the future. Since a significant amount of our future revenues will be denominated in Renminbi, any existing and future restrictions on currency exchange may limit our ability to utilize revenues generated in Renminbi to fund our business activities outside of China denominated in foreign currencies. Foreign exchange transactions under the capital account are still subject to limitations and require approvals from, or registration with, SAFE and other relevant PRC governmental authorities. This could affect the ability of Shenzhen Mindray to obtain foreign exchange through debt or equity financing, including by means of loans or capital contributions from us.

Fluctuations in exchange rates could result in foreign currency exchange losses.

As a majority of our cash and cash equivalents are denominated in Renminbi and the net proceeds from this offering will be denominated in US dollars, fluctuations in exchange rates between US dollars and Renminbi will affect the relative purchasing power of these proceeds and our balance sheet and earnings per share in US dollars following this offering. In addition, appreciation or depreciation in the value of the Renminbi relative to the US dollar would affect our financial results reported in US dollar terms without giving effect to any underlying change in our business, financial condition or results of operations. Since July 2005, the Renminbi is no longer pegged solely to the US dollar. Instead, the Renminbi is reported to be pegged against a basket of currencies, determined by the People s Bank of China, against which it can rise or fall by as much as 0.3% each day. The Renminbi may appreciate or depreciate significantly in value against the US dollar in the long term, depending on the fluctuation of the basket of currencies against which it is currently valued, or it may be permitted to enter into a full float, which may also result in a significant appreciation or depreciation of the Renminbi against the US dollar. Fluctuations in the exchange rate will also affect the relative value of any dividend we issue after this offering which will be exchanged into US dollars and earnings from and the value of any US dollar-denominated investments we make in the future.

Appreciation of the Renminbi relative to other foreign currencies could decrease the per unit revenues generated from international sales. If we increased our international pricing to compensate for the reduced purchasing power of foreign currencies, we would decrease the market competitiveness, on a price basis, of our products. This could result in a decrease in our international sales volumes.

Very limited hedging transactions are available in China to reduce our exposure to exchange rate fluctuations. To date, we have not entered into any hedging transactions in an effort to reduce our exposure to

foreign currency exchange risk. While we may decide to enter into hedging transactions in the future, the availability and effectiveness of these hedges may be limited and we may not be able to successfully hedge our exposure at all. In addition, our currency exchange losses may be magnified by PRC exchange control regulations that restrict our ability to convert Renminbi into foreign currency.

The discontinuation of any of the preferential tax treatments or the financial incentives currently available to us in the PRC could adversely affect our business, financial condition and results of operations.

The PRC government has provided various incentives to Shenzhen Mindray. These incentives include reduced tax rates and other measures. For example, Shenzhen Mindray enjoys preferential tax treatment, in the form of reduced tax rates or tax holidays, provided by the PRC government or its local agencies or bureaus. Shenzhen Mindray benefits from a 15% preferential corporate income tax rate and the preferential policy of two years of exemption and six years of 50% reduction of corporate income tax from the year it becomes profitable, resulting in an effective income tax rate of 7.5% through the end of 2006. Shenzhen Mindray must continue to meet a number of financial and non-financial criteria to qualify for its current tax exemption and future tax holidays.

In 2005, we also received aggregate financial incentives in the form of value added tax refunds of RMB32.1 million (US$4.0 million). In addition, we received certain tax holidays and concessions in 2003, 2004, 2005 and the six months ended June 30, 2006. Without these tax holidays and concessions, we would have had to pay additional tax totaling RMB7.8 million, RMB10.8 million, RMB18.1 million (US$2.3 million), and RMB13.2 million (US$1.7 million) in 2003, 2004, 2005 and the six months ended June 30, 2006, respectively. These financial incentives have been granted by the municipal government of Shenzhen and are subject to annual review by the municipal government. Eligibility for the financial incentives we receive requires that we continue to meet a number of financial and non-financial criteria to continue to qualify for these financial incentives and our continued qualification is further subject to the discretion of the municipal government. Moreover, the central government or the municipal government of Shenzhen could determine at any time to immediately eliminate or reduce these financial incentives, generally with prospective effect. Since the receipt of the financial incentives is subject to periodic time lags and inconsistent government practice on payment times, for so long as we continue to receive these financial incentives, our net income in a particular quarter may be higher or lower relative to other quarters based on the potentially uneven receipt by us of these financial incentives in addition to any business or operating related factors we may otherwise experience.

Pursuant to a PRC tax policy intended to encourage the development of software and integrated circuit industries, our primary operating subsidiary in the PRC, Shenzhen Mindray, was previously entitled to a refund of value-added tax paid at a rate of 14% of the sale value of self-developed software that is embedded in our products. The amount of the refund for this value-added tax included in net revenues was RMB18.5 million, RMB24.6 million and RMB32.1 million (US$4.0 million) in 2003, 2004 and 2005, respectively. Beginning in 2006, our embedded self-developed software is no longer eligible for this value-added tax refund due to changes in the types of software that are eligible for this tax refund.

We may not continue to enjoy these preferential tax treatments or financial incentives in the future. Any increase in Shenzhen Mindray s corporate income tax rate, or any discontinuation of these preferential tax treatments or financial incentives could adversely affect our business, financial condition and results of operations. Moreover, our historical operating results may not be indicative of our operating results for future periods as a result of the expiration of the tax holidays and value-added tax refunds we enjoy.

Any future outbreak of severe acute respiratory syndrome or avian flu in China, or similar adverse public health developments, may severely disrupt our business and operations.

Adverse public health epidemics or pandemics could disrupt businesses and the national economy of China and other countries where we do business. From December 2002 to June 2003, China and other countries experienced an outbreak of a new and highly contagious form of atypical pneumonia now known as

severe acute respiratory syndrome, or SARS. On July 5, 2003, the World Health Organization declared that the SARS outbreak had been contained. However, a number of isolated new cases of SARS were subsequently reported, most recently in central China in April 2004. During May and June of 2003, many businesses in China were closed by the PRC government to prevent transmission of SARS. Moreover, some Asian countries, including China, have recently encountered incidents of the H5N1 strain of bird flu, or avian flu. We are unable to predict the effect, if any, that avian flu may have on our business. In particular, any future outbreak of SARS, avian flu or similar adverse public health developments may, among other things, significantly disrupt our ability to adequately staff our business, and may adversely affect our operations. Furthermore, an outbreak may severely restrict the level of economic activity in affected areas, which may in turn materially and adversely affect our business and prospects. As a result, any future outbreak of SARS, avian flu or similar adverse public health developments may have a material adverse effect on our financial condition and results of operations.

RISKS RELATING TO THIS OFFERING

An active trading market for our ADSs may not develop.

Prior to this offering, there has been no public market for our ADSs or our ordinary shares underlying the ADSs. If an active public market for our ADSs does not develop after this offering, the market price and liquidity of our ADSs may be adversely affected. We have applied to have our ADSs listed on the New York Stock Exchange. A liquid public market for our ADSs may not develop. The initial public offering price for our ADSs will be determined by negotiation between us and the underwriters based upon several factors, and the price at which our ADSs trade after this offering may decline below the initial public offering price. As a result, investors in our ADSs may experience a decrease in the value of their ADSs regardless of our operating performance or prospects.

The trading prices of our ADSs are likely to be volatile, which could result in substantial losses to you.

The trading prices of our ADSs are likely to be volatile and could fluctuate widely in response to factors beyond our control. In particular, the performance and fluctuation of the market prices of other companies with business operations located mainly in China that have listed their securities in the United States may affect the volatility in the price of and trading volumes for our ADSs. Recently, a number of PRC companies have listed their securities, or are in the process of preparing for listing their securities, on US stock markets. Some of these companies have experienced significant volatility, including significant price declines after their initial public offerings. The trading performances of these PRC companies securities at the time of or after their offerings may affect the overall investor sentiment towards PRC companies listed in the United States and consequently may impact the trading performance of our ADSs. These broad market and industry factors may significantly affect the market price and volatility of our ADSs, regardless of our actual operating performance.

In addition to market and industry factors, the price and trading volume for our ADSs may be highly volatile for specific business reasons. In particular, factors such as variations in our revenues, earnings and cash flow, announcements of new investments and cooperation arrangements or acquisitions, could cause the market price for our ADSs to change substantially. Any of these factors may result in large and sudden changes in the volume and trading price of our ADSs. In the past, following periods of volatility in the market price of a company s securities, shareholders have often instituted securities class action litigation against that company. If we were involved in a class action suit, it could divert the attention of senior management, and, if adversely determined, could have a material adverse effect on our financial condition and results of operations.

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The sale or availability for sale of substantial amounts of our ADSs could adversely affect their trading price and could materially impair our future ability to raise capital through offerings of our ADSs.

Sales of substantial amounts of our ADSs in the public market after the completion of this offering, or the perception that these sales could occur, could adversely affect the market price of our ADSs and could materially impair our future ability to raise capital through offerings of our ADSs.

There will be ordinary shares (consisting of Class A ordinary shares represented by ADSs and Class B ordinary shares) outstanding immediately after this offering, or ordinary shares (consisting of Class A ordinary shares and Class B ordinary shares) if the underwriters exercise in full their option to purchase additional ADSs, in each case based on the number of shares outstanding as of August 18, 2006. In addition, as of September 1, 2006, there were outstanding options to purchase 6,824,000 ordinary shares, 150,000 of which were exercisable as of that date. All of the ADSs sold in this offering will be freely tradable without restriction or further registration under the US Securities Act of 1933, as amended, or the Securities Act, unless held by our affiliates as that term is defined in Rule 144 under the Securities Act, or Rule 144. The ordinary shares outstanding prior to this offering (assuming the conversion of all outstanding preferred shares into ordinary shares) are restricted securities as defined in Rule 144 and may not be sold in the absence of registration other than in accordance with Rule 144 or another exemption from registration.

In connection with this offering, we, each of our directors and executive officers and substantially all of our shareholders, including each of the selling shareholders, have agreed, among other things, not to sell any ordinary shares or ADSs for 180 days after the date of this prospectus without the written consent of the underwriters. However, the underwriters may release these securities from these restrictions at any time, subject to applicable regulations of the National Association of Securities Dealers, Inc., or NASD. We cannot predict what effect, if any, market sales of securities held by our significant shareholders or any other shareholder or the availability of these securities for future sale will have on the market price of our ADSs. See Underwriting and Shares Eligible for Future Sale for a more detailed description of the restrictions on selling our securities after this offering.

As the initial public offering price is substantially higher than the pro forma net tangible book value per share, you will incur immediate and substantial dilution.

If you purchase ADSs in this offering, you will pay more for your ADSs than the amount paid by existing shareholders for their ordinary shares on a per ADS basis. As a result, you will experience immediate and substantial dilution of approximately RMB (US$) per ADS (assuming no exercise of outstanding options to acquire ordinary shares), representing the difference between our pro forma net tangible book value per ADS as of June 30, 2006, after giving effect to this offering and the initial public offering price of US$ per ADS (the mid-point of the estimated initial public offering price range shown on the front cover of this prospectus). In addition, you will experience further dilution to the extent that our ordinary shares are issued upon the exercise of share options. All of the ordinary shares issuable upon the exercise of currently outstanding share options will be issued at a purchase price on a per ADS basis that is less than the initial public offering price per ADS in this offering. See Dilution for a more complete description of how the value of your investment in our ADSs will be diluted upon the completion of this offering.

You may face difficulties in protecting your interests, and our ability to protect our rights through the US federal courts may be limited, because we are incorporated under Cayman Islands law.

Our corporate affairs are governed by our amended and restated memorandum and articles of association, the Cayman Islands Companies Law and the common law of the Cayman Islands. The rights of shareholders to take action against the directors and actions by minority shareholders are to a large extent governed by the common law of the Cayman Islands. Cayman Islands law in this area may not be as established and may differ from provisions under statues or judicial precedent in existence in the United States. As a result, our public shareholders may face different considerations in protecting their interests in actions against our

management or directors than would shareholders of a corporation incorporated in a jurisdiction of the United States.

The rights of shareholders and the responsibilities of management and members of the board of directors under Cayman Islands law, such as in the areas of fiduciary duties, are different from those applicable to a company incorporated in a jurisdiction of the United States. For example, the Cayman Islands courts are unlikely:

- to recognize or enforce against us judgments of courts of the United States based on certain civil liability provisions of US federal securities laws; and

- in original actions brought in the Cayman Islands, to impose liabilities against us based on certain civil liability provisions of US federal securities laws that are penal in nature.

As a result, our public shareholders may have more difficulty in protecting their interests in connection with actions taken by our management or members of our board of directors than they would as public shareholders of a company incorporated in the United States.

Certain judgments obtained against us by our shareholders may not be enforceable.

We are a Cayman Islands company and substantially all of our assets are located outside of the United States. Substantially all of our current operations are conducted in the PRC. In addition, most of our directors and officers are nationals and residents of countries other than the United States. A substantial portion of the assets of these persons are located outside the United States. As a result, it may be difficult or impossible for you to bring an action against us or against these individuals in the United States in the event that you believe that your rights have been infringed under the US federal securities laws or otherwise. Even if you are successful in bringing an action of this kind, the laws of the Cayman Islands and of the PRC may render you unable to enforce a judgment against our assets or the assets of our directors and officers. For more information regarding the relevant laws of the Cayman Islands and China, see Enforcement of Civil Liabilities.

We have not determined a specific use for a portion of the net proceeds from this offering, and we may use these proceeds in ways with which you may not agree.

We have not determined a specific use for a portion of the net proceeds of this offering. Our management will have considerable discretion in the application of these proceeds received by us. You will not have the opportunity, as part of your investment decision, to assess whether the proceeds are being used appropriately. You must rely on the judgment of our management regarding the application of the net proceeds of this offering. The net proceeds may be used for corporate purposes that do not improve our profitability or increase our ADS price. The net proceeds from this offering may also be placed in investments that do not produce income or lose value.

Your voting rights as a holder of our ADSs are limited by the terms of the deposit agreement.

You may only exercise your voting rights with respect to the Class A ordinary shares underlying your ADSs in accordance with the provisions of the deposit agreement. Upon receipt of voting instructions from you in the manner set forth in the deposit agreement, the depositary for our ADSs will endeavor to vote your underlying Class A ordinary shares in accordance with these instructions. Under our amended and restated memorandum and articles of association and Cayman Islands law, the minimum notice period required for convening a general meeting is ten days. When a general meeting is convened, you may not receive sufficient notice of a shareholders meeting to permit you to withdraw your Class A ordinary shares to allow you to cast your vote with respect to any specific matter at the meeting. In addition, the depositary and its agents may not be able to send voting instructions to you or carry out your voting instructions in a timely manner. We will make all reasonable efforts to cause the depositary to extend voting rights to you in a timely manner, but you may not receive the voting materials in time to ensure that you can instruct the depositary to vote your shares. Furthermore, the depositary and its agents will not be responsible for any failure to carry out any

instructions to vote, for the manner in which any vote is cast or for the effect of any such vote. As a result, you may not be able to exercise your right to vote and you may lack recourse if your Class A ordinary shares are not voted as you requested.

The depositary for our ADSs will give us a discretionary proxy to vote our Class A ordinary shares underlying your ADSs if you do not vote at shareholders meetings, except in limited circumstances, which could adversely affect your interests.

Under the deposit agreement for our ADSs, the depositary will give us a discretionary proxy to vote our Class A ordinary shares underlying your ADSs at shareholders meetings if you do not vote, unless:

- we have failed to timely provide the depositary with our notice of meeting and related voting materials;
- we have instructed the depositary that we do not wish a discretionary proxy to be given;
- we have informed the depositary that there is substantial opposition as to a matter to be voted on at the meeting;
- a matter to be voted on at the meeting would have a material adverse impact on shareholders; or
- voting at the meeting is made on a show of hands.

The effect of this discretionary proxy is that you cannot prevent our Class A ordinary shares underlying your ADSs from being voted, absent the situations described above, and it may make it more difficult for shareholders to influence the management of our company.

You may not receive distributions on our Class A ordinary shares or any value for them if it is illegal or impractical to make them available to you.

The depositary of our ADSs has agreed to pay you the cash dividends or other distributions it or the custodian for our ADSs receives on our Class A ordinary shares or other deposited securities after deducting its fees and expenses. You will receive these distributions in proportion to the number of our Class A ordinary shares your ADSs represent. However, the depositary is not responsible if it is unlawful or impractical to make a distribution available to any holders of ADSs. For example, it would be unlawful to make a distribution to a holder of ADSs if it consists of securities that require registration under the Securities Act but that are not properly registered or distributed pursuant to an applicable exemption from registration. The depositary is not responsible for making a distribution available to any holders of ADSs if any government approval or registration required for such distribution cannot be obtained after reasonable efforts made by the depositary. We have no obligation to take any other action to permit the distribution of our ADSs, Class A ordinary shares, rights or anything else to holders of our ADSs. This means that you may not receive the distributions we make on our Class A ordinary shares or any value for them if it is illegal or impractical for us to make them available to you. These restrictions may have a material and adverse effect on the value of your ADSs.

You may not be able to participate in rights offerings and may experience dilution of your holdings.

We may, from time to time, distribute rights to our shareholders, including rights to acquire securities. Under the deposit agreement, the depositary will not distribute rights to holders of ADSs unless the distribution and sale of rights and the securities to which these rights relate are either exempt from registration under the Securities Act with respect to all holders of ADSs, or are registered under the provisions of the Securities Act. The depositary may, but is not required to, attempt to sell these undistributed rights to third parties, and may allow the rights to lapse. We may be unable to establish an exemption from registration under the Securities Act, and we are under no obligation to file a registration statement with respect to these rights or underlying securities or to endeavor to have a registration statement declared effective. Accordingly, holders of ADSs may be unable to participate in our rights offerings and may experience dilution of their holdings as a result.

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You may be subject to limitations on transfer of your ADSs.

Your ADSs represented by ADRs are transferable on the books of the depositary. However, the depositary may close its books at any time or from time to time when it deems expedient in connection with the performance of its duties. The depositary may close its books from time to time for a number of reasons, including in connection with corporate events such as a rights offering, during which time the depositary needs to maintain an exact number of ADS holders on its books for a specified period. The depositary may also close its books in emergencies, and on weekends and public holidays. The depositary may refuse to deliver, transfer or register transfers of our ADSs generally when our books or the books of the depositary are closed, or at any time if we or the depositary thinks it is advisable to do so because of any requirement of law or any government or governmental body, or under any provision of the deposit agreement, or for any other reason.

FORWARD LOOKING STATEMENTS

This prospectus contains forward-looking statements that are based on our current expectations, assumptions, estimates and projections about us and our industry. All statements other than statements of historical fact in this prospectus are forward-looking statements. These forward-looking statements can be identified by words or phrases such as anticipate, believe, continue, estimate, expect, intend, is / are likely to may, plan, should, expressions. The forward-looking statements included in this prospectus relate to, among others:

- our goals and strategies;
- our future business development, financial condition and results of operations;
- the expected growth of the medical device market in China and internationally;
- market acceptance of our products;
- our expectations regarding demand for our products;
- our ability to expand our production, our sales and distribution network and other aspects of our operations;
- our ability to stay abreast of market trends and technological advances;
- our ability to effectively protect our intellectual property rights and not infringe on the intellectual property rights of others;
- competition in the medical devices industry in China and internationally;
- relevant government policies and regulations relating to the medical device industry; and
- general economic and business conditions in the countries in which we operate.

These forward-looking statements involve various risks and uncertainties. Although we believe that our expectations expressed in these forward-looking statements are reasonable, our expectations may turn out to be incorrect. Our actual results could be materially different from our expectations. Important risks and factors that could cause our actual results to be materially different from our expectations are generally set forth in the Risk Factors, Management s Discussion and Analysis of Financial Condition and Results of Operations and Business, and other sections in this prospectus.

The forward-looking statements made in this prospectus relate only to events or information as of the date on which the statements are made in this prospectus. We undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date on which the statements are made or to reflect the occurrence of unanticipated events.

Market Data and Forecasts

This prospectus also contains data related to the medical device industry in China. These market data include projections that are based on a number of assumptions. The medical device market may not grow at the rate projected by market data, or at all. The failure of this market to grow at the projected rate may have a material adverse effect on our business and the market price of our ADSs. In addition, the rapidly changing nature of the medical device industry subjects any projections or estimates relating to the growth prospects or future condition of our market to significant uncertainties. Furthermore, if any one or more of the assumptions underlying the market data turns out to be incorrect, actual results may differ from the projections based on these assumptions. You should not place undue reliance on these forward-looking statements.

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Unless otherwise indicated, information in this prospectus concerning economic conditions and our industry is based on information from independent industry analysts and publications, as well as our estimates. Except where otherwise noted, our estimates are derived from publicly available information released by third party sources, as well as data from our internal research, and are based on such data and our knowledge of our industry, which we believe to be reasonable. Other than the Frost & Sullivan statement that in 2003, we had the largest market share for patient monitors in China based on revenues, which comes from a report that we commissioned, none of the independent industry publication market data cited in this prospectus were prepared on our or our affiliates behalf.

OUR CORPORATE STRUCTURE

We are a Cayman Islands holding company and conduct substantially all of our business through our consolidated subsidiary Shenzhen Mindray. We own approximately 99.9% of the equity of Shenzhen Mindray through two British Virgin Islands, or BVI, non-operating holding companies. Our corporate structure reflects common practice for companies with operations in several different countries where separate legal entities are often required or advisable for purposes of obtaining relevant operating licenses in such jurisdictions. Our holding company structure allows our management and shareholders to take significant corporate actions without having to submit these actions for approval or consent of the administrative agencies in every country where we have significant operations. Moreover, our choice of the Cayman Islands as the jurisdiction of incorporation of our ultimate holding company was motivated in part by its relatively well-developed body of corporate law, various tax and other incentives, and its wide acceptance among internationally recognized securities exchanges as a jurisdiction for companies seeking to list securities. For example, it is possible for a Cayman Islands company to list its securities on the Hong Kong Stock Exchange as well as in the United States. We hold our interests in Shenzhen Mindray through two British Virgin Islands holding companies as a matter of historical legacy. Many of the former shareholders of Shenzhen Mindray, from whom we acquired equity interests, chose to incorporate in the British Virgin Islands in part because of the advantageous tax treatments they received. We acquired these equity interests by consolidating the holdings of various British Virgin Islands entities into these two entities because this form of transaction was convenient and effective under British Virgin Islands law.

We commenced operations in 1991 through our predecessor entity and established Shenzhen Mindray, our current operating company in 1999. To enable us to raise equity capital from investors outside of China, we set up a holding company structure by establishing our current Cayman Islands holding company, Mindray International, on June 10, 2005. Mindray International became our holding company in September 2005 when the majority of our existing shareholders, transferred through a series of linked transactions, approximately 91.1% of the equity of Shenzhen Mindray to Mindray International. All such linked transactions involving transfer of shares in Shenzhen Mindray for cash were subject to the approval of the PRC Ministry of Commerce and its appropriate local counterpart, as well as registration with the PRC State Administration of Industry and Commerce and its appropriate local counterpart, and we have obtained those required approvals and registration. There were no conditions or contingencies upon which these approvals were based. As a result of this share transfer, our holding company Mindray International, through two BVI companies, Greatest Elite Limited, or Greatest Elite, and Giant Glory Investments Limited, or Giant Glory, which respectively held approximately 46.0% and 45.1% of the equity of Shenzhen Mindray, controlled approximately 91.1% of Shenzhen Mindray, with the remaining approximately 8.9% distributed among four other shareholders. In May 2006, we changed our name to Mindray Medical International Limited.

In April 2006, Mindray International injected additional capital of RMB174.2 million to subscribe for an additional 99 million shares of Shenzhen Mindray. In addition, we issued to offshore shareholders of Shenzhen Mindray 7,649,646 shares of our company, approximately 8.9% of our share capital, in exchange for all outstanding shares of Shenzhen Mindray not already owned by Mindray International except for 0.0002% of the enlarged share capital of Shenzhen Mindray consisting of 300 shares held by three PRC shareholders who remain as shareholders in order to fulfill corporate requirements under PRC law that a company limited by shares have at least two shareholders, at least one of which should be a PRC domestic shareholder. These 300 shares entitle their owners to identical economic and voting rights as the shares held by our subsidiaries, Giant Glory and Greatest Elite. All other Shenzhen Mindray shares are held by Giant Glory and Greatest Elite, which now collectively hold approximately 99.9% of the equity of Shenzhen Mindray.

Shenzhen Mindray has one subsidiary, Beijing Shen Mindray Medical Electronics Technology Research Institute Co., Ltd., or Beijing Mindray, in which Shenzhen Mindray has a 99.9% equity interest and through which we conduct some of our research and development activities. At the time that Beijing Mindray was incorporated, the PRC Company Law required that any domestic limited liability company have at least two separate legal or natural persons as equity holders. We satisfied this requirement by establishing Beijing Mindray with a principal shareholder and two additional shareholders with nominal equity holdings in the

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entity. The remaining 0.1% equity interest in Beijing Mindray is held in equal 0.05% interests by Messrs. Xu Hang and Li Xiting, our co-CEOs and entitles its owners to identical economic and voting rights as the equity interest held by Shenzhen Mindray. Mindray International has four subsidiaries, two of which are Greatest Elite and Giant Glory that hold only the equity of Shenzhen Mindray. The other two Mindray International subsidiaries, Mindray (UK) Limited, organized under the laws of the United Kingdom, and Mindray USA Corp., incorporated in the State of Massachusetts in the United States, have been established to support our sales in Europe and the United States.

The diagram below illustrates our current corporate structure and the place of formation and affiliation of each of our subsidiaries as of the date of this prospectus:

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USE OF PROCEEDS

We estimate that we will receive net proceeds from this offering of approximately US$ million, or approximately US$ million if the underwriters exercise their option to purchase additional ADSs in full, after deducting underwriting discounts, commissions and the estimated offering expenses payable by us and based upon an assumed initial public offering price of US$ per ADS (the mid-point of the estimated initial public offering price range shown on the front cover of this prospectus). We will not receive any of the proceeds from the sale of ADSs by the selling shareholders. A US$ increase (decrease) in the assumed initial public offering price of US$ per ADS would increase (decrease) the net proceeds to us from this offering by US$ million, after deducting the estimated underwriting discounts and commissions and estimated aggregate offering expenses payable by us and assuming no exercise of the underwriters option to purchase additional ADSs and no other change to the number of ADSs offered by us as set forth on the cover page of this prospectus.

We currently intend to use the net proceeds we receive from this offering as follows:

- approximately US$75 million for construction of a new headquarters building and expansion of our manufacturing, assembly and warehouse facilities, including the potential relocation into a new facility in Shenzhen, China; and

- the balance to fund working capital and for other general corporate purposes.

We may use proceeds to fund through capital contributions Shenzhen Mindray s operations in the future if it requires additional cash resources. Any capital contributions must be approved by the PRC Ministry of Commerce. We may not be able to obtain these government registrations or approvals on a timely basis, if at all.

The foregoing represents our intentions with respect of the use and allocation of the net proceeds from this offering based upon our present plans and business conditions. Our management, however, will have significant flexibility and discretion in applying the net proceeds from the offering. Unforeseen events or changed business conditions may result in application of the proceeds from this offering in a manner other than as described in this prospectus.

Pending their use, we intend to invest the net proceeds from this offering in short-term, interest bearing, debt instruments or bank deposits. These investments may have a material adverse effect on the US federal income tax consequences of your investment in our ADSs. In particular, it is possible that we may become a passive foreign investment company for United States federal income tax purposes, which could result in negative tax consequences for you. See Risk Factors Risks Relating to our Business and Industry We may become a passive foreign investment company, or PFIC, which could result in adverse United States federal income tax consequences to US holders and Taxation United States Federal Income Taxation US Holders Passive Foreign Investment Company.

We will not use the proceeds from the sale of any ADSs, directly or indirectly, for any purpose or activity in connection with business, operations or contracts with the governments or with any person or entity of the Cuba, Sudan, North Korea, Iran, Syria and Myanmar, or any person or entity that is subject to sanctions under any program administered by OFAC.

DIVIDEND POLICY

Beginning in 2007, we intend to pay annual cash dividends in an amount equal to an aggregate of approximately 20% of our annual net income each year. Cash dividends, if any, will be at the discretion of our board of directors and will depend upon our future operations and earnings, capital requirements and surplus, general financial conditions, shareholders interests, contractual restrictions and other factors as our board of directors may deem relevant. We can pay dividends only out of profits or other distributable reserves.

In addition, our ability to pay dividends depends substantially on the payment of dividends to us by our operating subsidiary, Shenzhen Mindray. Shenzhen Mindray may pay dividends only out of its accumulated distributable profits, if any, determined in accordance with its articles of association, and the accounting standards and regulations in China. Moreover, pursuant to relevant PRC laws and regulations applicable to our subsidiaries in the PRC, Shenzhen Mindray is required to provide 10% of its after-tax profits to a statutory common reserve fund. When the aggregate balance in the statutory common reserve fund (also referred to as statutory surplus reserve) is 50% or more of the subsidiaries registered capital, our subsidiaries need not make any further allocations to the fund. Shenzhen Mindray s registered capital is RMB185 million. Allocations to these statutory reserves can only be used for specific purposes and are not distributable to us in the form of loans, advances, or cash dividends. The specific purposes for which statutory common reserve funds can be used include provision of a source of reserve funds to make up deficits in periods in which Shenzhen Mindray has net losses, expansion of production and operations of Shenzhen Mindray, or for conversion into additional working capital in periods in which Shenzhen Mindray does not have a deficit. Furthermore, if Shenzhen Mindray incurs debt on its own behalf in the future, the instruments governing the debt may restrict its ability to pay dividends or make other payments to us. Any limitation on the payment of dividends by our subsidiary could materially and adversely limit our ability to grow, make investments or acquisitions that could be beneficial to our businesses, pay dividends and otherwise fund and conduct our businesses.

We paid cash dividends of RMB17.2 million, RMB86.0 million, RMB206.4 million (US$25.8 million) and RMB323.5 million (US$40.5 million), in 2003, 2004, 2005 and the six months ended June 30, 2006, respectively. See Managements Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Financing Activities.

Holders of ADSs will be entitled to receive dividends, subject to the terms of the deposit agreement, to the same extent as holders of our Class A ordinary shares, less the fees and expenses payable under the deposit agreement. Cash dividends will be paid by the depositary to holders of ADSs in US dollars. Other distributions, if any, will be paid by the depositary to holders of our ADSs in any means it deems legal, fair and practical. See Description of American Depositary Shares Dividends and Other Distributions.

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CAPITALIZATION

The following table sets forth our capitalization as of June 30, 2006:

on an actual basis;

on a pro forma basis, to reflect the automatic conversion of all 8,975,105 of our outstanding convertible redeemable preferred shares into 8,975,105 Class A ordinary shares upon completion of this offering and the re-classification of our ordinary shares into Class A and Class B ordinary shares; and

on a pro forma as adjusted basis to give effect to (1) the conversion of all of our outstanding convertible redeemable preferred shares and (2) the issuance and sale of ADSs we are offering at an assumed initial public offering price of US$ per ADS, the mid-point of the estimated public offering price range shown on the front cover of this prospectus, after deducting underwriting discounts, commissions and estimated offering expenses payable by us.

You should read this table in conjunction with Selected Consolidated Financial Data, Management s Discussion and Analysis of Financial Condition and Results of Operations and our audited consolidated financial statements and related notes included elsewhere in this prospectus.

	As of June 30, 2006					
	Actual	**Actual**	**Pro Forma**	**Pro Forma**	**Pro Forma as Adjusted**	**Pro Forma as Adjusted**
	RMB	**US$**	**RMB**	**US$**	**RMB**	**US$**
	(In thousands, except for share data)					
Total debt						
Minority interests	10	1				
Mezzanine equity						
Convertible redeemable preferred shares (HK$0.001 par value: 1,000,000,000 shares authorized and 8,975,105 shares issued and outstanding, actual; no shares issued and outstanding, pro forma and pro forma as adjusted)	289,867	36,259				
Shareholders equity						
Ordinary shares (HK$0.001 par value: 5,000,000,000 shares authorized and 84,099,572 shares issued and outstanding, actual; none pro forma and pro forma as adjusted)	88	11				
Class A ordinary shares (HK$0.001 par value: no shares authorized and no shares issued						

and outstanding, actual; 4,000,000,000 authorized and and shares issued and outstanding pro forma, and pro forma as adjusted, respectively)

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	As of June 30, 2006					
	Actual	Actual	Pro Forma	Pro Forma	Pro Forma as Adjusted	Pro Forma as Adjusted
	RMB	US$	RMB	US$	RMB	US$
	(In thousands, except for share data)					
Class B ordinary shares (HK$0.001 par value: no shares authorized and no shares issued and outstanding, actual; 1,000,000,000 authorized and shares issued and outstanding pro forma, and pro forma as adjusted)						
Additional paid-in capital[(1)]	402,123	50,301				
Retained earnings	67,028	8,385				
Total shareholders equity[(1)]	469,239	58,697				
Total capitalization[(1)]	469,239	58,697				

(1) A US$1.00 increase (decrease) in the assumed initial public offering price of US$ per ADS would increase (decrease) each of additional paid-in capital, total shareholders equity and total capitalization by US$ million, after deducting the estimated underwriting discounts and commissions and estimated aggregate offering expenses payable by us and assuming no exercise of the underwriters option to purchase additional ADSs and no other change to the number of ADSs offered by us as set forth on the cover page of this prospectus.

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DILUTION

If you invest in our ADSs, your interest will be diluted to the extent of the difference between the initial public offering price per ADS and our net tangible book value per ADS after this offering. Dilution results from the initial public offering price per Class A ordinary share underlying the ADSs substantially exceeding the book value per Class A ordinary share attributable to our presently outstanding ordinary shares.

Our net tangible book value as of June 30, 2006 was approximately RMB190 million (US$24 million), or RMB2.25 (US$0.28) per ordinary share outstanding at that date, and RMB2.25 (US$0.28) per ADS. Net tangible book value is determined by subtracting the value of our intangible assets and total liabilities from our total assets. Dilution is determined by subtracting net tangible book value per ordinary share, after giving effect to the conversion of all outstanding convertible redeemable preferred shares into Class A ordinary shares upon completion of this offering, from the assumed initial public offering price per ordinary share, which is the mid-point of the estimated initial public offering price range shown on the front cover of this prospectus and after deducting the underwriting discounts and commissions and estimated offering expenses payable by us.

Without taking into account any other changes in net tangible book value after June 30, 2006, other than to give effect to our sale of the ADSs offered in this offering at the assumed initial public offering price of US$ per ADS, with estimated net proceeds of US$ million after deducting underwriting discounts and commissions and estimated offering expenses payable by us, our pro forma net tangible book value at June 30, 2006 would have been RMB million (US$ million), or RMB (US$) per outstanding ordinary share, including ordinary shares underlying our outstanding ADSs, and RMB (US$) per ADS. This represents an immediate increase in pro forma net tangible book value of RMB (US$) per ordinary share, or RMB (US$) per ADS, to existing shareholders and an immediate dilution in pro forma net tangible book value of RMB (US$) per ordinary share, or RMB (US$) per ADS, to new investors in this offering.

The following table illustrates this per ordinary share dilution:

	RMB	US$
Assumed initial public offering price per ordinary share		
Net tangible book value per ordinary share at June 30, 2006		
Increase in net tangible book value per ordinary share attributable to this offering		
Increase in net tangible book value per ordinary share attributable to the underwriters exercising in full of their option to purchase additional shares		
Net tangible book value per ordinary share after the offering		
Pro forma net tangible book value per ordinary share after the offering if underwriters exercising in full their option to purchase additional shares		
Dilution in net tangible book value per ordinary share to new investors in the offering		
Dilution in net tangible book value per ADS to new investors in the offering		

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The following table summarizes the number of ordinary shares purchased from us as of June 30, 2006, the total consideration paid to us and the average price per ordinary share/ADS paid by existing investors and by new investors purchasing Class A ordinary shares evidenced by ADSs in this offering at the assumed initial public offering price of US$ per ADS giving effect to underwriting discounts and commissions and other estimated offering expenses payable by us.

	Ordinary Shares Purchased		Total Consideration		Average Price per Class A Ordinary Share Equivalent	Average Price per ADS Equivalent
	Number	Percent	Amount	Percent		
			(000)			
Existing shareholders						
New investors						
Total						

The foregoing discussion and tables do not include the impact of assuming the exercise of the 6,928,000 share options outstanding as of June 30, 2006, each with an exercise price of US$5.00.

If the underwriters exercise in full their option to purchase additional shares, our existing shareholders would own approximately and our new investors would own approximately of the total number of our ordinary shares outstanding after this offering.

A US$1.00 increase (decrease) in the assumed initial public offering price per ADS would increase (decrease) our pro forma net tangible book value after giving effect to the offering by US$ million, the pro forma net tangible book value per ordinary share and per ADS after giving effect to this offering by US$ per ordinary share and US$ per ADS and the dilution in pro forma net tangible book value per ordinary share and per ADS to new investors in this offering by US$ per ordinary share and US$ per ADS, assuming no exercise of the underwriters option to purchase additional ADSs and no change to the number of ADSs offered by us as set forth on the cover page of this prospectus, and after deducting the estimated underwriting discounts and commissions and the estimated aggregate offering expenses payable by us. The pro forma information discussed above is illustrative only. Our net tangible book value following the completion of this offering is subject to adjustment based on the actual initial public offering price of our ADSs and other terms of this offering determined at pricing.

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EXCHANGE RATES

The following table sets forth information concerning exchange rates between the Renminbi and the US dollar for the periods indicated.

	Renminbi per US Dollar Noon Buying Rate			
	AVERAGE	**HIGH**	**LOW**	**PERIOD-END**
2001	8.2770	8.2786	8.2676	8.2766
2002	8.2770	8.2800	8.2669	8.2800
2003	8.2770	8.2800	8.2272	8.2769
2004	8.2768	8.2774	8.2764	8.2765
2005	8.1940	8.2765	8.0702	8.0702
2006				
March	8.0350	8.0505	8.0167	8.0167
April	8.0143	8.0248	8.0040	8.0165
May	8.0131	8.0300	8.0005	8.0215
June	8.0042	8.0225	7.9943	7.9943
July	7.9897	8.0018	7.9690	7.9690
August	7.9722	8.0000	7.9538	7.9538
September (through September 5, 2006)	7.9514	7.9533	7.9495	7.9495

Source: Federal Reserve Bank of New York

On September 5, 2006, the noon buying rate was RMB7.9495 to US$1.00.

We publish our financial statements in Renminbi. This prospectus contains translations of Renminbi amounts into US dollars at specified rates solely for the convenience of the reader. Unless otherwise noted, all translations from Renminbi to US dollars were made at the noon buying rate in The City of New York for cable transfers in Renminbi per US dollar as certified for customs purposes by the Federal Reserve Bank of New York, as of June 30, 2006, which was RMB7.9943 to US$1.00. No representation is made that the Renminbi amounts referred to in this prospectus could have been or could be converted into US dollars at any particular rate or at all.

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SELECTED CONSOLIDATED FINANCIAL INFORMATION

The following selected consolidated financial information for the periods and as of the dates indicated should be read in conjunction with our financial statements and the accompanying notes and Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and related notes, both of which are located elsewhere in this prospectus.

The selected consolidated balance sheet data as of December 31, 2003 were derived from our audited consolidated financial statements that are not included in this prospectus. The selected consolidated financial data presented below as of December 31, 2004 and 2005 and for the three years ended December 31, 2003, 2004 and 2005 are derived from our audited consolidated financial statements included elsewhere in this prospectus. Our audited consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States, or US GAAP, and have been audited by Deloitte Touche Tohmatsu CPA Ltd., an independent registered public accounting firm. The report of Deloitte Touche Tohmatsu CPA Ltd. on those consolidated financial statements is included elsewhere in this prospectus.

The selected consolidated financial data as of and for the six months ended June 30, 2005 and 2006 have been derived from our unaudited consolidated financial statements included elsewhere in this prospectus. Results for the six months ended June 30, 2006 are not necessarily indicative of the results that may be expected for the full year. In our opinion, all adjustments necessary for a fair presentation of the financial data for the six months ended June 30, 2006 are contained in the financial statements that are included elsewhere in this prospectus.

The selected historical statement of operations data for the years ended December 31, 2001 and 2002 and the selected historical balance sheet data as of December 31, 2001 and 2002 have been derived from our unaudited consolidated financial statements that are not included in this prospectus.

Our historical results for any prior period are not necessarily indicative of results to be expected for any future period.

	For the Year Ended December 31,						For the Six Months Ended June 30,		
	2001	**2002**	**2003**	**2004**	**2005**	**2005**	**2005**	**2006**	**2006**
	RMB	**RMB**	**RMB**	**RMB**	**RMB**	**US$**	**RMB**	**RMB**	**US$**
	(In thousands, except share and per share data)								
Statement of Operations Data:									
Net revenues	201,798	306,592	460,254	697,837	1,078,573	134,918	436,776	676,764	84,656
Cost of revenues(1)	(95,472)	(141,004)	(210,565)	(319,013)	(493,326)	(61,710)	(194,892)	(307,330)	(38,444)
Gross profit	106,326	165,588	249,689	378,824	585,247	73,208	241,884	369,434	46,212
Operating expenses:									
Selling expenses(1)	(30,550)	(43,567)	(61,322)	(92,177)	(146,499)	(18,325)	(69,427)	(99,975)	(12,506)
General and administrative expenses(1)	(16,266)	(23,497)	(35,808)	(32,340)	(112,082)	(14,020)	(37,750)	(24,865)	(3,110)
Research and development expenses(1)	(13,249)	(24,797)	(39,781)	(61,604)	(106,147)	(13,278)	(48,146)	(66,678)	(8,341)

Operating income	46,261	73,726	112,778	192,703	220,519	27,585	86,561	177,916	22,255
Other income, net	1,231	851	1,918	39	9,210	1,152	707	239	30
Interest income	1,413	1,322	531	3,087	3,854	482	611	6,543	819
Interest expense	(2,577)	(3,746)	(2,815)	(3,324)	(2,019)	(253)	(1,201)	(279)	(35)
Income before income taxes and minority interests	46,328	72,153	112,412	192,505	231,564	28,966	86,678	184,419	23,069
Provision for income taxes	(3,443)	(4,817)	(7,624)	(10,758)	(18,066)	(2,260)	(6,449)	(13,191)	(1,650)
Minority interests					(8,409)	(1,052)		(6,455)	(808)
Net income	42,885	67,335	104,788	181,747	205,089	25,654	80,229	164,773	20,611

	For the Year Ended December 31,						For the Six Months Ended June 30		
	2001	2002	2003	2004	2005	2005	2005	2006	2006
	RMB	RMB	RMB	RMB	RMB	US$	RMB	RMB	US$
	(In thousands, except share and per share data)								
med dend ance ertible emable erred es at ount					(14,031)	(1,755)			
me butable nary eholders	42,885	67,335	104,788	181,747	191,058	23,899	80,229	164,773	20,
c ings hare	RMB0.50	RMB0.78	RMB 1.22	RMB 2.11	RMB 2.31	US$ 0.29	RMB 0.93	RMB 2.10	US$ (
ted ings hare	RMB0.50	RMB0.78	RMB 1.22	RMB 2.11	RMB 2.31	US$ 0.29	RMB 0.93	RMB1.86	US$ (
es in putation									
ic nings share	86,000,000	86,000,000	86,000,000	86,000,000	82,790,427	82,790,427	86,000,000	78,490,233	78,490,
uted nings share	86,000,000	86,000,000	86,000,000	86,000,000	82,790,427	82,790,427	86,000,000	88,467,984	88,467,
dends nary e		RMB0.15	RMB0.20	RMB1.00	RMB2.40	US$ 0.30	RMB2.40	RMB3.60	US$ (

	As of December 31,						For the Six Months Ended June 30,		
	2001	2002	2003	2004	2005	2005	2005	2006	2006
	RMB	RMB	RMB	RMB	RMB	US$	RMB	RMB	US$
				(In thousands)					
Balance Sheet Data:									
Cash and cash equivalents	76,666	53,961	130,297	178,556	446,143	55,808	107,610	212,875	26,628
Working capital[2]	82,988	98,909	138,065	219,486	468,831	58,647	93,454	204,554	25,587
Total assets	211,341	245,946	384,674	483,053	840,835	105,179	476,452	1,021,911	127,830
Total liabilities	102,625	82,794	133,934	136,556	206,281	25,802	229,763	262,795	32,873
Minority interests				10	37,596	4,703	10	10	1
Mezzanine equity					325,389	40,703		289,867	36,259
Total shareholders equity	108,716	163,151	250,740	346,487	271,569	33,971	246,679	469,239	58,697
Total liabilities and shareholders equity	211,341	245,946	384,674	483,053	840,835	105,179	476,452	1,021,911	127,830

(1) Share-based compensation charges incurred during the period related to:

	For the Year Ended December 31,						For the Six Months Ended June 30,		
	2001	2002	2003	2004	2005	2005	2005	2006	2006
	RMB	RMB	RMB	RMB	RMB	US$	RMB	RMB	US$
					(In thousands)				
Cost of revenues					268	34	268	236	30
Selling expenses					8,576	1,073	8,576	3,337	417
General and administrative expenses					59,014	7,382	14,420	4,483	561
Research and development expenses					3,071	384	3,071	2,130	266

(2) Working capital is equal to current assets less current liabilities.

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion and analysis of our financial condition and results of operations in conjunction with the section entitled Selected Consolidated Financial Information and our audited consolidated financial statements and the related notes included elsewhere in this prospectus. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results and the timing of selected events could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth under Risk Factors and elsewhere in this prospectus.

Overview

We are a leading developer, manufacturer and marketer of medical devices in China. We also have a significant and growing presence outside of China, primarily in other regions of Asia and in Europe. We offer a broad range of more than 40 products across our three primary business segments: patient monitoring devices, diagnostic laboratory instruments and ultrasound imaging systems.

We sell our products primarily to distributors. In the six months ended June 30, 2006, distributor sales accounted for 78.6% of our net revenues. We believe we have one of the largest distribution, sales and service network for medical devices in China, with over 1,950 distributors and 500 direct sales and sales support personnel, and we sell our products internationally through more than 660 distributors and 75 sales and sales support personnel. We also sell our products directly to hospitals, clinics, government health bureaus, and to ODM and OEM customers. To date, we have sold our products to approximately 25,000 hospitals and clinics in China and sold over 170,000 medical devices worldwide, both through our distributors and direct sales.

Our net revenues increased from RMB460.3 million in 2003 to RMB697.8 million in 2004 and to RMB1,078.6 million (US$134.9 million) in 2005, representing a compound annual growth rate of 53.1%. Our net revenues grew from RMB436.8 million in the six months ended June 30, 2005 to RMB676.8 million (US$84.7 million) in the same period in 2006, a 54.9% increase. These significant increases reflect our success in expanding our product lines to include more advanced products and our increasing market penetration, particularly internationally. Our net revenues outside of China from 2003 to 2005 grew at a faster rate than net revenues in China in both real and percentage terms, increasing from RMB113.5 million, or 24.7% of our net revenues in 2003, to RMB238.2 million, or 34.1% of our net revenues in 2004, and to RMB451.6 million (US$56.5 million), or 41.9% of our net revenues in 2005, representing a compound annual growth rate of 99.5%. In the six months ended June 30, 2006, our net revenues outside of China grew to RMB295.8 million (US$37.0 million), or 43.7% of our net revenue, from 38.9% in the same period in 2005, a 74.3% increase. International net revenue growth has been augmented by our expansion of international sales coverage from 67 countries in 2003, to 91 countries in 2004 and to more than 120 countries in 2005, as well as by our increased penetration in existing international markets through our enhanced distributor network, and the introduction of new products in the international markets. As discussed further below, changes in hospitals purchasing patterns as a result of changes in PRC anti-bribery laws and the enforcement thereof and delays in launching certain new products resulted from the changes in the SFDA approval process have had, and may continue to have, an adverse effect on our net revenues.

We continually seek to broaden our market reach by introducing new and more advanced products and new product lines that address different end-user segments. Between 2003 and 2005, we introduced more than 25 new products. We introduced two new products during the six months ended June 30, 2006, and we plan to introduce at least five new products by the end of 2006, including our first color Doppler ultrasound imaging system, DC-6, and our first five-part hematology analyzer, BC-5500.

We increased our annual investment in research and development as a percentage of net revenues from 8.6% in 2003, to 9.8% in 2005 and to 9.9% in the six months ended June 30, 2006. Our investment in research and development in 2005 and the six months ended June 30, 2006 is consistent with our plan to annually invest approximately 10% of our net revenues in research and development activities. This level of investment demonstrates our commitment to creating and maintaining what we believe is the largest research

and development team of any medical device manufacturer in China, with more than 570 engineers on our staff, and continuing to develop and commercialize new and more advanced products.

Pricing

To gain market penetration, we price our products at levels that we believe offer attractive economic returns to our distributors, taking into account the prices of competing products and our gross margins. We do not typically make pricing adjustments based on whether a distributor is located in or out of China. We believe that we offer products of comparable quality to our international competitors at substantially lower prices.

In addition to the sales to distributors, we also sell our products directly to hospitals and clinics in China. We also sell directly to government health bureaus in China by participating in competitive bidding and tenders run by government bidding agents to procure large volume purchase contracts. Although the prices of products sold to hospitals, clinics and government health bureaus in China tend to be slightly lower than those of products sold to distributors, these sales represent an additional source of income for us.

Through our continuous efforts to improve manufacturing efficiencies and reduce our raw material costs, we have been able to reduce our production costs, which contributed to our ability to decrease the average sales prices of our products in recent years. We believe that our ability to offer price reductions without a significant impact to our gross margins allows us to generate increased sales volume and gross profits, and helps alleviate any pricing pressures we may face.

Revenues

Our net revenues represent our total revenues from operations, less value-added taxes, plus a 14% refund for value-added taxes on sales of our software that is embedded in our products. Beginning in 2006, our embedded software is no longer eligible for this value-added tax refund, due to changes in the types of software that qualify for this tax refund. See Taxes and Incentives.

We use a distribution network because we believe it is the most cost-effective way to reach a broad end-user base. Our sales are generally made on a purchase order basis, rather than under any long-term commitments, and we do not currently have long-term contracts with any of our distributor customers. We rely on sales to distributors for a majority of our net revenues. In 2005 and the six months ended June 30, 2006, sales to distributors accounted for 74.0% and 78.9% of our sales in China and 66.9% and 78.3% of our international sales, respectively.

Our customer base is widely dispersed on both a geographic and revenues basis. Our largest customer in each of the years ended 2003, 2004 and 2005 and the six months ended June 30, 2006 was an international ODM customer that accounted for 4.0%, 7.3%, 6.2% and 2.7% of our net revenues, respectively. No other customer accounted for more than 5% of our net revenues in 2003, 2004, 2005 or the six months ended June 30, 2006.

We primarily derive revenues from three business segments: patient monitoring devices, diagnostic laboratory instruments and ultrasound imaging systems. These business segments accounted for 40.5%, 28.4% and 29.9% of our total net segment revenues in the six months ended June 30, 2006, respectively. The accounting policies underlying the net revenues information provided for our business segments are based on accounting principles applicable under PRC GAAP that are different from US GAAP.

Patient Monitoring Devices. We derive revenues for our patient monitoring devices segment from sales of patient monitors and related accessories. Our patient monitoring devices track the physiological parameters of patients, such as heart rate, blood pressure, respiration and temperature. Our patient monitoring devices segment is our largest business segment and has the most extensive market penetration of our three segments both domestically and internationally. We expect to continue to penetrate large-sized hospitals in China and international markets with the introduction of additional advanced products in this business segment.

Diagnostic Laboratory Instruments. We derive revenues for our diagnostic laboratory instruments segment from sales of diagnostic laboratory instruments and related reagents. Our diagnostic laboratory instruments provide data and analysis on blood, urine and other bodily fluid samples for clinical diagnosis and treatment. Our current diagnostic laboratory instruments portfolio consists of two primary product categories: hematology analyzers and biochemistry analyzers. We also sell reagents for use with our products in both of these categories. A reagent is used each time an analysis is performed, generating a recurring revenue stream for us. Diagnostic laboratory instrument sales accounted for 87.4% and 86.3% of the segment s net revenues in 2005 and the six months ended June 30, 2006, respectively, while reagent sales accounted for 11.2% and 10.2% of the segment s net revenues in the same periods, respectively with the balance being revenues generated from related accessories. We anticipate that, on a percentage basis, revenues from the sale of reagents will grow more quickly than revenues from the sale of diagnostic laboratory instruments, as our installed base of diagnostic laboratory instruments grows and we increase the number of reagents that we offer and expand reagent sales internationally. We anticipate that we will continue to grow at a rapid pace as we further penetrate the diagnostic laboratory instruments market through the introduction of new advanced product offerings, such as our five-part hematology analyzers in 2006, and the expansion of the number of reagents we sell to our customers.

Ultrasound Imaging Systems. We derive revenues for our ultrasound imaging systems segment from sales of ultrasound devices and related accessories. Our ultrasound imaging systems use computer-managed sound waves to generate real-time images of anatomical movement and blood flow, and are commonly employed in medical fields such as urology, gynecology, obstetrics and cardiology. We anticipate that net revenues in our ultrasound imaging systems segment will continue to grow more quickly than net segment revenues, as we further penetrate the ultrasound imaging systems market and as we expand our products offerings to include our first color Doppler ultrasound imaging system in 2006.

In 2005 and the six months ended June 30, 2006, our best-selling product across our three business segments, the PM-9000 patient monitoring device, accounted for 20.5% and 13.3% of our net segment revenues, respectively. No other product accounted for more than 8% of our net segment revenues in either period. Although our best selling products change over time, we expect that a small number of key products will continue to account for a substantial portion of our revenues. See Risk Factors Risks Relating to Our Business and Industry We generate a substantial portion of our revenues from a small number of products, and a reduction in demand in any of these products could materially and adversely affect our financial condition and results of operations.

China has an ongoing program to reduce improper payments received by hospital administrators and doctors in connection with the purchase of pharmaceutical products and medical devices. In June 2006, PRC commercial anti-bribery laws were modified to expand and clarify the scope of persons potentially subject to prosecution. For example, it is now easier to prosecute hospital administrators and doctors for illegal activities under the commercial anti-bribery laws. We maintain a strict policy prohibiting our employees and distributors from engaging in improper activities in connection with the sale of our products, and we believe that more strict enforcement is beneficial for our industry and our business in the long term. We believe that our PRC customers have modified their purchasing patterns in response to the statutory modifications and increased enforcement activities. As a result, we expect our revenues will be adversely impacted in the third and possibly the fourth quarters of 2006 and possibly longer.

In May 2006, the SFDA changed the approval process for new medical devices by adding a new medical equipment safety standard, which we estimate increased by three months the typical time period required to obtain approval for new medical devices. This change delayed our planned introduction during the third quarter of 2006 of three new products, including our five-part hematology analyzer, color ultrasound imaging device and our Beneview patient monitor.

As a result of the events described above, our operating results in the six months ended June 30, 2006 may not be indicative of our operating results for the full year of 2006.

Our ability to grow our revenues depends on our ability to increase the market penetration of our existing products and on our ability to successfully identify, develop, introduce and commercialize, in a

timely and cost-effective manner, new and upgraded products. We generally choose to devote resources to product development efforts that we believe are commercially feasible, can generate significant revenues and margins and can be introduced into the market in the near term.

In any period, a number of factors will impact our net revenues, including for example:

- the level of acceptance of our products among hospitals and other healthcare facilities;
- our ability to attract and retain distributors;
- new product introductions by us and our competitors;
- our ability to maintain prices for our products at levels that provide favorable margins; and
- our ability to expand into new international markets.

For a detailed discussion of the factors that may cause our net revenues to fluctuate, see Risk Factors Risks Relating to Our Business and Industry Our quarterly revenues and operating results are difficult to predict and could fall below investor expectations, which could cause the trading price of our ADSs to decline.

Cost of Revenues

Cost of revenues includes our direct costs to manufacture our products, including component and material costs, salaries and related personnel expenses, depreciation costs of plant and equipment used for production purposes, shipping and handling costs and provisional cost of warranty-based maintenance, repair services, and the cost of providing sales incentives.

Product mix is the most significant factor in determining our cost of revenues as a percentage of our net revenues. Cost of revenues has historically been highest in our ultrasound imaging systems segment, which was our fastest-growing segment from 2003 through the six months ended June 30, 2006. See Comparison of Six Months Ended June 30, 2005 and June 30, 2006 Gross Profit and Gross Margin and Comparison of Years Ended December 31, 2003, December 31, 2004 and December 31, 2005 Gross Profit and Gross Margin. We expect our ultrasound imaging systems segment to grow more quickly, as a percentage of net revenues, than our revenues overall, which could negatively impact our average gross margins. However, we have recently been able to improve our cost of revenues for our ultrasound imaging systems, resulting in gross margins of these products in the six months ended June 30, 2006 being comparable to those of our diagnostic laboratory instruments.

The direct costs of manufacturing a new product are generally highest when a new product is first introduced. In periods when we introduce a greater than average number of new products, our cost of revenues as a percentage of net revenues tends to be higher due to start-up costs associated with manufacturing a new product and generally higher raw material and component costs due to lower initial production volumes. As production volumes increase, we typically improve our manufacturing efficiencies and are able to strengthen our purchasing power by buying raw materials and components in greater quantities. In addition, we are able to lower our raw material and component costs by identifying lower-cost raw materials and components. Moreover, when production volumes become sufficiently large, we often gain further cost efficiencies by producing additional components in-house.

We currently have a relatively low cost base compared to medical device companies in more developed countries because we source a significant portion of our raw materials and components and manufacture all of our products in China. Historically, we have been able to reduce our raw material and component costs as we increase purchase volumes and make improvements in manufacturing processes. We have typically passed the majority of these cost savings on to our customers by offering them lower prices while maintaining targeted gross margin levels. However, we believe that, in the future, these reductions will be increasingly offset by rising costs of raw materials, components and wages in China resulting from China s further economic development. In particular, we expect that the costs of raw materials will increase in the near term. In addition, as we focus on more advanced products and new product lines, we may find it necessary to use

higher-cost raw materials and components that may not be cheaper in China. We plan to mitigate future increases in raw material and component costs by using more common resources across our product lines, increasing in-house manufacture of components and adopting more uniform manufacturing and assembly practices.

Gross Profit and Gross Margin

Gross profit is equal to net revenues less cost of revenues. Gross margin is equal to gross profit divided by net revenues. Changes in our gross margins from period to period are primarily driven by changes in product mix. See Cost of Revenues. Between 2003 and 2005 and the six months ended June 30, 2006, we were able to maintain gross margins between approximately 50% and 60% across our business segments. We expect this trend to continue because we generally seek to develop only those products that we believe can provide us with an average gross margin of at least 50% over their life cycles. Gross margins for domestic and international sales tend to be substantially similar. Although the average sales prices of each of our products will generally decrease over time, these decreases do not tend to impact our gross margins negatively because in most instances they result from our ability to reduce our cost of revenues and our strategic decision to pass on these cost savings to our customers.

Operating Expenses

Our operating expenses consist of selling expenses, general and administrative expenses, research and development expenses, and employee share-based compensation expenses.

Selling Expenses

Selling expenses consist primarily of compensation and benefits for our sales and marketing staff, expenses for promotional, advertising, travel and entertainment activities, lease payments for our sales offices, and depreciation expenses related to equipment used for sales and marketing activities.

Between 2003 and 2005 and the six months ended June 30, 2006, selling expenses increased primarily as a result of increased headcount and increased international sales and marketing activities. Selling expenses as a percentage of net revenues decreased from 2003 to 2004, reflecting improved selling efficiencies, and increased in 2005 primarily as a result of employee share-based compensation expenses attributable to the contribution of shares to certain employees by our shareholders. Selling expenses as a percentage of net revenues decreased in the six months ended June 30, 2006 compared to the same period in 2005, principally as a result of a decrease in employee share-based compensation expenses. In the near term, we expect that certain components of our selling expenses will increase as we open new international sales and service offices to increase our market penetration in selected international markets. We presently operate four international sales and service offices and expect to open three more in the next 12 months.

Similar to most China-based manufacturers of medical devices, we primarily sell our products to distributors. Consequently, our sales and marketing expenses as a percentage of net revenues are significantly lower than manufacturers of medical devices that primarily sell their products directly to end-users. While we intend to continue to sell our products primarily to distributors, we also seek to build recognition of our brand through increasing marketing activities, which may increase our selling expenses in the future.

General and Administrative Expenses

General and administrative expenses consist primarily of compensation and benefits for our general management, finance and administrative staff, depreciation and amortization with respect to equipment used for general corporate purposes, professional advisor fees, lease payments and other expenses incurred in connection with general corporate purposes. We expect that most components of our general and administrative expenses will increase in the future as our business grows and as we incur increased costs related to being a public company. However, as a percentage of net revenues, we expect that general and administrative expenses will decrease in 2006 as compared to 2005 due primarily to lower share-based

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compensation expenses and improved operating leverage attributable to growing our staff more slowly than our net revenues. See Employee Share-Based Compensation Expenses.

Research and Development Expenses

Research and development expenses consist primarily of costs associated with the design, development and testing of our products. Among other things, these costs include compensation and benefits for our research and development staff, expenditures for purchases of supplies, depreciation expenses related to equipment used for research and development activities, and other relevant costs. Research and development expenses as a percentage of net revenues increased from 8.6% in 2003 to 9.8% in 2005 and to 9.9% in the six months ended June 30, 2006. Our investment in research and development in 2005 and in the six months ended June 30, 2006 is consistent with our plan to annually invest approximately 10% of our net revenues in research and development activities. This level of investment demonstrates our commitment to creating and maintaining what we believe is the largest research and development team of any medical device manufacturer in China, and continuing to develop and commercialize new and more advanced products.

Employee Share-Based Compensation Expenses

We account for employee share-based compensation expenses based on the fair value of share option grants at the date of grant, and we record employee share-based compensation expense to the extent that the fair value of those grants are determined to be greater than the price paid by the employee.

We did not incur any employee share-based compensation expenses in 2003 or 2004. We incurred three separate employee share-based compensation charges in 2005 totaling RMB70.9 million (US$8.9 million). The first charge, in the amount of RMB26.3 million (US$3.3 million), was recorded in connection with shares granted in 2005 to certain employees by our shareholders in consideration of past and present services to us. The second charge, in the amount of RMB11.6 million (US$1.5 million), was recorded in connection with the issuance of three million of our preferred shares to some of our employees and one non-employee director in exchange for three million of our ordinary shares. The third charge, in the amount of RMB33.0 million (US$4.1 million), related to an earnings adjustment provision entered into between those employees and our preferred shareholders. See notes 2(p) and 9 to our consolidated financial statements included elsewhere in this prospectus. We do not expect any future shareholder contribution of shares as part of any future employee share-based compensation plan.

The table below shows the effect of the 2005 and 2006 share-based compensation charges on our operating expense line items:

Employee Share-Based Compensation Related to:	2003	2004	2005	1H2005	1H2006
			(in RMB thousands)		
Cost of revenues			268	268	236
Selling expenses			8,576	8,576	3,337
General and administrative expenses			59,014	14,420	4,483
Research and development expenses			3,071	3,071	2,130

In February 2006, we adopted a new employee share-based compensation plan, pursuant to which certain members of our senior management and certain of our key employees received options to purchase up to 7,033,000 ordinary shares at an exercise price of US$5.00 per ordinary share. These options generally vest over the required service period, with approximately 25% of them vesting on each of January 31, 2007, 2008, 2009 and 2010. These options will also vest only if the option holder is still an employee of our company at the time of the relevant vesting and the individual has met performance criteria at that time. These options will expire on the eighth anniversary of their grant.

We incurred RMB10.2 million (US$1.3 million) in employee share-based compensation expenses in the six months ended June 30, 2006, and expect to incur employee share-based compensation expense in the amount of approximately RMB21.2 million (US$2.7 million) for the year ending December 31, 2006.

Other Income (Expense)

Other income (expense), is the sum of the line items other income, net plus interest income less interest expense from our consolidated financial statements. Other income, net, has in the past consisted primarily of government subsidies for the development of new high technology medical products and government incentives for making high technology investments in our local region. We do not receive government subsidies or government incentives on a regular basis, and the amounts that we have received in the past have tended to fluctuate significantly. While we intend to continue to apply for government subsidies and government incentives in the future, there can be no guarantee that we will receive any.

Corporate Structure

Our predecessor entity was established and began operations in 1991. Today, we operate through a structure that was implemented in September 2005 under our Cayman Islands holding company Mindray International. We operate our business primarily through our PRC operating subsidiary, Shenzhen Mindray, which was formed in 1999. We conduct some of our research and development activities through Shenzhen Mindray s subsidiary, Beijing Mindray. In 2005, we established two subsidiaries in North America and Europe to support sales and service in those parts of the world.

Mindray International became our holding company on September 26, 2005 when the majority of our equity shareholders transferred approximately 91.1% of the equity of Shenzhen Mindray to Mindray International, through a series of linked transactions. In April 2006, we acquired all remaining shares in Shenzhen Mindray except for 300 shares. As a result, our holding company, Mindray International, now holds approximately 99.9% of the equity of Shenzhen Mindray. See Our Corporate Structure.

Taxes and Incentives

Our company is a tax exempted company incorporated in Cayman Islands and is not subject to taxation under the current Cayman Islands law. Our subsidiaries operating in the PRC are subject to PRC taxes as described below and the subsidiaries incorporated in the BVI are not subject to taxation.

The basic corporate income tax rate for the foreign-invested enterprises in the PRC is currently 33% (30% state tax and 3% local tax). However, as Shenzhen Mindray is a manufacturing enterprise located in Shenzhen special economic zone, the applicable income tax rate is 15% state tax and no local tax. Shenzhen Mindray is entitled to a tax exemption for two years from the year of its first taxable profit and a 50% tax reduction for the third to fifth year (7.5% state tax and nil% local tax). The first profitable year was 1999. Shenzhen Mindray also has been designated as a new and high technology enterprise, and is therefore eligible to receive a special additional corporate income tax holiday which represents a reduction in income tax of 50% resulting in a reduced tax rate of 7.5% for three years beginning in 2004 through 2006. For 2007, we plan to apply for classification of Shenzhen Mindray as a key software company, which would result in the qualification for a reduced corporate income tax rate of 10% for Shenzhen Mindray. Shenzhen Mindray has qualified as a key software enterprise in prior years, but did not apply for this 10% tax rate because its corporate tax rate was lower in those years. In 2007, a 10% corporate income tax rate would be the lowest rate available to Shenzhen Mindray. If Shenzhen Mindray does not qualify for key software enterprise status, it would be subject to a corporate income tax rate of 15%.

Beijing Mindray is entitled to a corporate income tax exemption for three years from its first year of operations and 50% tax reduction for the fourth to sixth year (15% state tax and no local tax).

The additional tax that would otherwise have been payable without corporate income tax preferential treatment totaled RMB7.8 million, RMB10.8 million, RMB18.1 million (US$2.3 million) and RMB13.2 million (US$1.7 million) in 2003, 2004, 2005 and in the six months ended June 30, 2006, respectively, representing a reduction in basic earnings per ordinary share of RMB0.09, RMB0.13, RMB0.22 (US$0.03) and RMB0.17 (US$0.02) in 2003, 2004, 2005 and in the six months ended June 30, 2006, respectively.

Pursuant to a PRC tax policy intended to encourage the development of software and integrated circuit industries, Shenzhen Mindray was previously entitled to a refund of value-added tax paid at a rate of 14% of the sale value of self-developed software that is embedded in our products. The amount of the refund for this value-added tax included in net revenues was RMB18.5 million, RMB24.6 million and RMB32.1 million (US$4.0 million) in 2003, 2004 and 2005, respectively. Beginning in 2006, our embedded self-developed software is no longer eligible for this value-added tax refund due to changes in the types of software that are eligible for this tax refund. In the six months ended June 30, 2006, no value-added tax refunds were refundable on sales made during this period for embedded self-developed software, compared with refunds of RMB13.6 million in the same period of 2005.

We classify value-added tax refunds as Other income under segment reporting and include them in net revenues in our consolidated statement of operations included elsewhere in this prospectus.

Our effective income tax rates in 2003, 2004 and 2005 were 6.8%, 5.6% and 7.8%, respectively. Our effective income tax rates in the six months ended June 30, 2005 and 2006 were 7.4% and 7.2%, respectively.

As a result of the pending lapse of reduced corporate income tax rates for Shenzhen Mindray and Beijing Mindray and the loss of eligibility for value-added tax refunds for embedded, self-developed software, our historical operating results may not be indicative of our operating results for future periods. See Risk Factors Risks Related to Doing Business in China The discontinuation of any of the preferential tax treatments or the financial incentives currently available to us in the PRC could adversely affect our business, financial condition and results of operations.

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Results of Operations

The following table sets forth our condensed consolidated statements of operations by amount and as a percentage of our total net revenues for the periods indicated:

	Year ended December 31,							Six Months ended June 30,				
	2003		2004		2005			2005		2006		
	Amount	% of Total Net Revenues	Amount	% of Total Net Revenues	Amount	Amount	% of Total Net Revenues	Amount	% of Total Net Revenues	Amount	Amount	% of T N Rev
	RMB		RMB		RMB	US$		RMB (Unaudited)		RMB (Unaudited)	US$ (Unaudited)	
	(In thousands, except percentages)											
venues	460,254	100.0%	697,837	100.0%	1,078,573	134,918	100.0%	436,776	100.0%	676,764	84,656	1
f es[1]	(210,565)	45.7	(319,013)	45.7	(493,326)	(61,710)	45.7	(194,892)	44.6	(307,330)	(38,444)	
profit	249,689	54.3	378,824	54.3	585,247	73,208	54.3	241,884	55.4	369,434	46,212	
ting ses:												
g ses [1]	(61,322)	13.3	(92,177)	13.2	(146,499)	(18,325)	13.6	(69,427)	15.9	(99,975)	(12,506)	
ral and nistrative ses[1]	(35,808)	7.8	(32,340)	4.6	(112,082)	(14,020)	10.4	(37,750)	8.6	(24,865)	(3,110)	
rch and opment ses [1]	(39,781)	8.6	(61,604)	8.8	(106,147)	(13,278)	9.8	(48,146)	11.0	(66,678)	(8,341)	
ting ses	(136,911)	29.7	(186,121)	26.7	(364,728)	(45,623)	33.8	(155,323)	35.6	(191,518)	(23,957)	
ting e	112,778	24.5	192,703	27.6	220,519	27,585	20.4	86,561	19.8	177,916	22,255	
income se)[2]	(366)	0.0	(198)	0.0	11,045	1,381	1.0	117	0.0	6,503	814	
e before e taxes nority ts	112,412	24.4	192,505	27.6	231,564	28,966	21.5	86,678	19.8	184,419	23,069	
ion for e taxes	(7,624)	1.7	(10,758)	1.5	(18,066)	(2,260)	1.7	(6,449)	1.6	(13,191)	(1,650)	
					(8,409)	(1,052)	0.8			(6,455)	(808)	

ity ts												
come	104,788	22.8%	181,747	26.0%	205,089	25,654	19.0%	80,229	18.3	164,773	20,611	

(1) Share-based compensation charges incurred during the period related to:

	Year ended December 31,							Six Months ended June 30,				
	2003		2004		2005			2005		2006		
	Amount	% of Total Net Revenues	Amount	% of Total Net Revenues	Amount	Amount	% of Total Net Revenues	Amount	% of Total Net Revenues	Amount	Amount	% of Total Net Revenues
	RMB		RMB		RMB	US$		RMB		RMB	US$	
	(In thousands, except percentages)											
Cost of revenues					268	34		268		236	30	
Selling expenses					8,576	1,073	0.8%	8,576	2.0%	3,337	417	0.5%
General and administrative expenses					59,014	7,382	5.5%	14,420	3.3%	4,483	561	0.7%
Research and development expenses					3,071	384	0.3%	3,071	0.7%	2,130	266	0.3%

(2) Other income (expense) is the sum of the line items other income, net plus interest income less interest expense from our audited consolidated financial statements.

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Comparison of Six Months Ended June 30, 2005 and June 30, 2006

Net Revenues

The following table sets forth net revenues by geographic regions and the percentage of our total net revenues and net revenues by business segment for the six months ended June 30, 2005 and 2006:

	Six Months Ended June 30				
	2005		2006		
	Net Revenues RMB	Net Revenues % of Total	Net Revenues RMB	Net Revenues US$	Net Revenues % of Total
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Geographic Data:					
China	267,067	61.1%	380,935	47,651	56.3%
Other Asia	77,851	17.8	86,672	10,842	12.8
Europe	35,514	8.1	114,245	14,291	16.9
North America	35,280	8.1	44,593	5,578	6.6
Other	21,064	4.8	50,320	6,294	7.4
Total Net Revenues	436,776	100.0%	676,764	84,656	100.0%
Segment Data:[1]					
Patient monitoring devices	217,731	51.8%	271,571	33,971	40.5%
Diagnostic laboratory instruments	104,491	24.9	190,454	23,824	28.4
Ultrasound imaging systems	93,037	22.1	200,300	25,055	29.9
Others	4,960	1.2	8,266	1,034	1.2
Total net segment revenues	420,219	100.0%	670,591	83,884	100.0%

(1) The segmental information was prepared primarily in accordance with PRC GAAP.

Our net revenues increased by RMB240.0 million (US$30.0 million), or 54.9%, to RMB676.8 million (US$84.7 million) in the six months ended June 30, 2006 from RMB436.8 million in the same period in 2005. This increase reflects primarily our continued sales volume growth in China and expanding sales volume in the international markets. In addition, we increased our number of exclusive domestic and international distributors to approximately 600 during this period.

On a geographic basis, net revenues generated in China increased by RMB113.8 million (US$14.2 million), or 42.6%, to RMB380.9 million (US$47.7 million) in the six months ended June 30, 2006 from RMB267.1 million in the same period in 2005. This increase reflects improvements across all of our business segments and increased government tender activities. Net revenues generated outside of China grew even faster than net revenues generated in China, increasing by 74.3% to RMB295.8 million (US$37.0 million) in the six months ended June 30, 2006 from RMB169.7 million for the same period in 2005. As a percentage of total net revenues, net revenues generated outside of China increased in the six months ended June 30, 2006 to 43.7% from 38.9% in the same period in 2005. This increase reflects our improved penetration in the international markets. In the six months ended June 30, 2006, net revenues from Europe increased by RMB78.7 million (US$9.8 million) compared to the same period in 2005. This

increase was primarily due to an increase in sales of biochemistry analyzers. We also began selling an additional ultrasound imaging system during this period in the European market after receiving the CE mark. Gross margins for domestic and international sales were substantially the same during this period. In the long-term, we expect that our net revenues generated outside of China will continue to grow at a faster rate than revenues generated in China.

Each of our business segments experienced significant net revenue growth in the six months ended June 30, 2006. Net revenues in our patient monitoring devices segment increased by RMB53.9 million (US$6.7 million), or 24.7%, to RMB271.6 million (US$34.0 million) in the six months ended June 30, 2006 from RMB217.7 million in the same period in 2005. This growth was primarily due to increased sales of our existing patient monitoring devices, particularly new products, which we define as those introduced in the

preceding four quarters, in both our domestic and international markets. In particular, more than 50% of net revenues in our patient monitoring devices segment was attributable to new products such as our PM-8000 and PM-9000 patient monitoring devices. One ODM customer accounted for approximately 10.0%, and 6.5% of our patient monitoring devices segment revenues in the six months ended June 30, 2005 and 2006, respectively.

Net revenues in our diagnostic laboratory instruments segment increased by RMB86.0 million (US$10.8 million), or 82.3%, to RMB190.5 million (US$23.8 million) in the six months ended June 30, 2006 from RMB104.5 million in the same period in 2005. This growth was mainly due to increased sales of our diagnostic laboratory instruments, with sales of new products accounting for more than 50% of net revenues in our diagnostic laboratory instruments segment. In particular, our BS-200 a biochemistry analyzer, which we introduced in late 2005, accounted for more than 10% of our diagnostic laboratory instruments segment revenues in the six months ended June 30, 2006.

Net revenues in our ultrasound imaging systems business segment increased by RMB107.3 million (US$13.4 million), or 115.3%, to RMB200.3 million (US$25.1 million) in the six months ended June 30, 2006 from RMB93.0 million in the same period in 2005. This growth was principally a result of increased sales of our existing ultrasound imaging systems, particularly DP-9900, DP-6600, DP-3300 and DP-8800, and our increasing penetration into European and North American markets. In addition, there were increased government tender activities for ultrasound imaging equipment during the six months ended June 30, 2006 in China.

Cost of Revenues

Total cost of revenues as a percentage of total net revenues increased slightly from 44.6% to 45.4% in the six months ended June 30, 2005 and 2006, respectively. This slight increase as a percentage of total net revenues is due to elimination of value-added tax refunds on embedded self-developed software since 2006, and minor price decreases across our product lines, offset by cost controls on raw materials and component costs. Total cost of revenues increased by RMB112.4 million (US$14.1 million), or 57.7%, to RMB307.3 million (US$38.4 million) in the six months ended June 30, 2006 from RMB194.9 million in the same period in 2005. This increase was primarily due to an increase in the volume of our products sold during this period.

Gross Profit and Gross Margin

The following table sets forth gross profit in total and by segment, and gross margin (being gross profit divided by the related net revenues) overall and by segment in the six months ended June 30, 2005 and 2006:

	Six Months ended June 30,				
	2005		2006		
	Gross Profit	Gross Margin	Gross Profit	Gross Profit	Gross Margin
	(RMB)		(RMB)	(US$)	
	(in thousands, except percentages)				
Total:[(1)]	241,884	55.4%	369,434	46,212	54.6%
Segment Data:[(2)]					
Patient monitoring devices	130,285	59.8%	163,249	20,421	60.1%
Diagnostic laboratory instruments	58,875	56.3%	107,395	13,434	56.4%
Ultrasound imaging systems	47,313	50.9%	112,029	14,014	55.9%
Others	(5,246)		(8,133)	(1,017)	
Total	231,227		374,540	46,851	

(1) As reported in the consolidated statements of operations included elsewhere in this prospectus.

(2) The segmental information was prepared primarily in accordance with PRC GAAP.

Total gross profits increased by RMB127.5 million (US$15.9 million), or 52.7%, to RMB369.4 million (US$46.2 million) in the six months ended June 30, 2006 from RMB241.9 million in the same period in 2005. Our consolidated gross margin decreased to 54.6% in the six months ended June 30, 2006 from 55.4% in the same period in 2005, due to the elimination in 2006 of value-added tax refunds on embedded self-

developed software previously available to us, which had contributed an additional RMB13.6 million to gross profits during the same period in 2005.

Gross margin for the patient monitoring devices segment slightly increased to 60.1% in the six months ended June 30, 2006 from 59.8% in the same period in 2005, primarily due to our ability to continue to increased sales of higher margin products.

Gross margin for the diagnostic laboratory instruments segment increased to 56.4% in the six months ended June 30, 2006 from 56.3% in the same period in 2005, reflecting primarily increased sales of models with higher margins as well as our ability to improve our cost structure as we improved economies of scale in manufacturing diagnostic laboratory instruments introduced during the last two years.

Gross margin for the ultrasound imaging systems increased to 55.9% in the six months ended June 30, 2006 from 50.9% in the same period in 2005, principally as a result of increased sales of models with higher margins, and increased net revenues from sales of our own brand products, as a percentage of total segment net revenue relative to ODM and OEM products. In particular, ODM sales tend to have lower gross margins but are higher in unit volume than sales to distributors or other customers. We do not intend to actively seek new ODM customers, as our growth strategy is focused on increasing sales of new products sold under our own brand. However, we may decide to add new ODM customers, if we believe these new customers would provide a valuable strategic opportunity. See Business Customers.

Operating Expenses

Our operating expenses consist primarily of selling expenses, general and administrative expenses, and research and development expenses. Our operating expenses increased by RMB36.2 million, or 23.3%, to RMB191.5 million (US$24.0) million in the six months ended June 30, 2006 from RMB155.3 million in the same period in 2005. This increase was primarily attributable to increases in salaries and expenses resulting from headcount increases. However, operating expense, as a percentage of total net revenue, decreased to 28.3% in the six months ended June 30, 2006 from 35.6% in the same period in 2005. This decrease was primarily attributable to a decrease in employee share-based compensation expenses included in operating expenses.

Selling Expenses

Our selling expenses increased by RMB30.5 million, or 44.0%, to RMB100.0 million (US$12.5 million) in the six months ended June 30, 2006 from RMB69.4 million in the same period in 2005. As a percentage of total net revenues, selling expenses decreased to 14.8% in the six months ended June 30, 2006 from 15.9% in the same period in 2005. This decrease was attributable to a decrease in share-based compensation allocated to selling expenses, partially offset by growing sales headcount, particularly on our international sales team, as well as increasing marketing expenses from a higher level of promotional activities.

General and Administrative Expenses

Our general and administrative expenses decreased by RMB12.9 million, or 34.1%, to RMB24.9 million (US$3.1 million) in the six months ended June 30, 2006 from RMB37.8 million in the same period in 2005. As a percentage of total net revenues, general and administrative expenses decreased to 3.7% in the six months ended June 30, 2006 from 8.6% in the same period in 2005. Of the total decrease, approximately RMB9.9 million was attributable to a decrease in share-based compensation expense in addition to a decrease of approximately RMB8.3 million in overhead expenses, such as social insurance and meal expenses, which have been classified as selling and research and development expenses starting from January 1, 2006. Such decreases were partially offset by an increase in salaries and depreciation expense.

Research and Development Expenses

Our research and development expenses increased by RMB18.5 million, or 38.5%, to RMB66.7 million (US$8.3 million) in the six months ended June 30, 2006 from RMB48.1 million in the same period in 2005.

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This increase was primarily attributable to increases in salaries and related expenses and increases in corporate overhead expenses. As a percentage of total net revenues, research and development expenses decreased to 9.9% in the six months ended June 30, 2006 from 11.0% in the same period in 2005. The decrease was attributable primarily to increased share-based compensation expense attributed to research and development expenses in the six months ended June 30, 2005.

Other Income

Other income was RMB0.1 million and RMB6.5 million (US$0.8 million) in the six months ended June 30, 2005 and 2006, respectively. The increase in other income was primarily due to an increase in interest income to RMB6.5 million (US$0.8) million in the six months ended June 30, 2006 compared to RMB0.6 million in the same period in 2005 as our average cash balance grew significantly.

Provision for Income Taxes

Provision for income taxes increased to RMB13.2 million (US$1.7 million) in the six months ended June 30, 2006, from RMB6.4 million in the same period in 2005. Due to various special tax rates and incentives in China, our taxes have been relatively low. Our effective income tax rates in the six months ended June 30, 2005 and 2006 were 7.4% and 7.2%, respectively. If these tax incentives had expired or were determined not to be available to us, we would have been required to pay an additional RMB13.2 million (US$1.7 million) in the six months ended June 30, 2006.

Minority Interests

Minority interests was RMB6.5 million (US$0.8 million) in the six months ended June 30, 2006 compared to nil in the same period in 2005, reflecting minority interests resulted from our reverse acquisition in September 2005, in which majority shareholders of Shenzhen Mindray exchanged their shares, representing approximately 91.1% of the share capital of Shenzhen Mindray, for the entire share capital of our holding company. We expect the minority interests charge to decrease substantially as a result of our acquisition of the minority interests in April 2006 which increased our holding company s equity ownership of Shenzhen Mindray to approximately 99.9%. See Our Corporate Structure .

Net Income

As a result of the foregoing, net income in the six months ended June 30, 2006 increased to RMB164.8 million (US$20.6 million) from RMB80.2 million in the same period in 2005, while net margin in the six months ended June 30, 2006 increased to 24.3% from 18.3% in the same period in 2005.

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Comparison of Years Ended December 31, 2003, December 31, 2004 and December 31, 2005

Net Revenues

The following table sets forth net revenues by geography and the percentage of our total net revenues and net revenues by business segment for 2003, 2004 and 2005:

	Year ended December 31,						
	2003		2004		2005		
	Net Revenues RMB	Net Revenues % of Total	Net Revenues RMB	Net Revenues % of Total	Net Revenues RMB	Net Revenues US$	Net Revenues % of Total
	(in thousands, except percentages)						
Geographic Data:							
China	346,772	75.3%	459,602	65.9%	626,997	78,431	58.1%
Other Asia	33,523	7.3	103,604	14.8	181,094	22,653	16.8
Europe	30,633	6.7	51,720	7.4	135,586	16,960	12.6
North America	35,271	7.7	52,825	7.6	69,135	8,648	6.4
Other	14,055	3.0	30,086	4.3	65,761	8,226	6.1
Total net revenues	460,254	100.0%	697,837	100.0%	1,078,573	134,918	100.0%
Segment Data:[1]							
Patient monitoring devices	280,584	63.5%	364,994	54.9%	496,464	62,102	47.8%
Diagnostic laboratory instruments	116,733	26.4	172,703	26.0	263,162	32,919	25.3
Ultrasound imaging systems	36,281	8.2	112,739	17.0	264,267	33,057	25.5
Others	8,142	1.9	14,481	2.1	14,334	1,793	1.4
Total net segment revenues	441,740	100.0%	664,917	100.0%	1,038,227	129,871	100.0%

(1) The segmental information was prepared primarily in accordance with PRC GAAP.

Our total net revenues increased from RMB460.3 million in 2003 to RMB697.8 million in 2004 and to RMB1,078.6 million (US$135.0 million) in 2005, or 51.6% and 54.6% growth, respectively. These increases primarily resulted from improved penetration in both our domestic and international markets and our introduction of new products. In addition, we increased our number of distributors from approximately 1,400 in 2003 to approximately 2,000 in 2004 and to approximately 2,500 in 2005. Between 2003 and 2005, we introduced more than 25 new products, which accounted for more than 35% of our 2005 total net revenues.

On a geographic basis, net revenues generated in China increased from RMB346.8 million in 2003 to RMB459.6 million in 2004 and to RMB627.0 million (US$78.4 million) in 2005, or 32.5% and 36.4% growth, respectively. These increases reflect increased sales generated from our new products to existing and new customers

as we added products that meet the needs of customers from different segments.

During the period from 2003 to 2005, net revenues generated outside of China grew even faster than net revenues generated in China, increasing from RMB113.5 million in 2003 to RMB238.2 million in 2004 and to RMB451.6 million (US$56.5 million) in 2005, or 109.9% and 89.6% growth, respectively. As a percentage of total net revenues, net revenues generated outside of China increased from 24.7% in 2003 to 34.1% in 2004 and to 41.9% in 2005. These increases reflect our improved penetration in international markets, with sales into 67 countries in 2003, 91 countries in 2004 and more than 120 countries in 2005. In 2005, net revenues from Europe increased by RMB83.9 million (US$10.5 million), or 162.3%, compared to 2004, while our net revenues in Asia, other than China, increased by RMB77.5 million (US$9.7 million), or 74.8%, compared to 2004. Gross margins for domestic and international sales are substantially similar. In the long term, we expect that these revenues will continue to grow at a faster rate than revenues from China.

Each of our business segments experienced significant net revenues growth in 2004 and 2005. Net revenues in our patient monitoring devices segment increased from RMB280.6 million in 2003 to

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RMB365.0 million in 2004 and to RMB496.5 million (US$62.1 million) in 2005, or 30.1% and 36.0% growth, respectively. This growth primarily resulted from increased sales of our existing patient monitoring devices, the introduction of our MEC-1000, MEC-2000 and PM-5000 patient monitoring devices in 2003, PM-50 and two OEM patient monitoring devices in 2004, and our PM-7000, VS-800 and Hypervisor VI patient monitoring devices in 2005. One ODM customer accounted for approximately 6.6%, 9.7%, and 7.3% of our patient monitoring devices segment revenues in 2003, 2004, and 2005, respectively.

Net revenues in our diagnostic laboratory instruments segment increased from RMB116.7 million in 2003 to RMB172.7 million in 2004 and to RMB263.2 million (US$32.9 million) in 2005, or 47.9% and 52.4% growth, respectively. This growth primarily resulted from increased sales of our existing diagnostic laboratory instruments, and the introduction of our BC-1800 hematology analyzer and BS-300 biochemistry analyzer in 2003 and the introduction of our BC-2800 series hematology analyzer in 2005.

Net revenues in our ultrasound imaging systems business segment increased from RMB36.3 million in 2003 to RMB112.7 million in 2004 and to RMB264.3 million (US$33.1 million) in 2005, or 210.5% and 134.5% growth, respectively. This growth primarily resulted from increased sales of our existing ultrasound imaging systems and the introduction of our MG-66 and DP-8800 ultrasound imaging systems in 2003, the introduction of our DP-6600 ultrasound imaging system and the production of an ultrasound imaging system for an ODM customer in 2004, and the introduction of our three ultrasound imaging systems, our DP-7700, DP-3200 and DP-3300, in 2005. This ODM customer accounted for 44.6% and 25.4% of our ultrasound imaging systems segment revenues in 2004 and 2005, respectively.

Cost of Revenues

Total cost of revenues as a percentage of total net revenues was 45.7% in each of 2003, 2004 and 2005. This stability is attributable primarily to the increase in sales volume being offset by savings on raw materials and components and improved manufacturing efficiencies. Total cost of revenues increased from RMB210.6 million in 2003 to RMB319.0 million in 2004 and to RMB493.3 million (US$61.7 million) in 2005, or 51.5% and 54.6% growth, respectively. These increases were primarily due to increases in the volume of our products sold during these periods.

Gross Profit and Gross Margin

The following table sets forth gross profit in total and by segment, and gross margin overall and by segment for the periods indicated:

	For the Years Ended December 31,						
	2003		2004		2005		
	Gross Profit	Gross Margin	Gross Profit	Gross Margin	Gross Profit	Gross Profit	Gross Margin
	(RMB)		(RMB)		(RMB)	(US$)	
	(In thousands, except percentages)						
Total[1]	249,689	54.3%	378,824	54.3%	585,247	73,208	54.3%
Segment Data[2]:							
Patient monitoring devices	163,426	58.2%	220,695	60.5%	293,643	36,732	59.1%
Diagnostic laboratory instruments	61,846	53.0	91,149	52.8	147,442	18,443	56.0
	17,849	49.2	56,603	50.2	133,348	16,680	50.5

Ultrasound imaging systems				
Others	(6,061)	(7,733)	(12,950)	(1,620)
Total	237,060	360,714	561,483	70,235

(1) As reported in the consolidated statement of operations included elsewhere in this prospectus.

(2) The segmental information was prepared primarily in accordance with PRC GAAP.

Total gross profit increased from RMB249.7 million in 2003 to RMB378.8 million in 2004 and to RMB585.2 million (US$73.2 million) in 2005, or 51.7% and 54.5% growth, respectively. Our consolidated gross margin was 54.3% in each of 2003, 2004 and 2005.

Gross margin for the patient monitoring devices segment increased from 58.2% in 2003 to 60.5% in 2004, reflecting primarily improvements in the cost structure of our best selling patient monitoring device, PM-9900, and decreased to 59.1% in 2005, reflecting slight margin declines in some of our best selling patient monitoring devices, as a result of our strategic decision to further expand market share in China and internationally by selling at more competitive prices.

Gross margin for the diagnostic laboratory instruments segment decreased from 53.0% in 2003 to 52.8% in 2004, reflecting primarily a change in product mix as we increased sales of our new biochemistry products introduced in 2003, and increased to 56.0% in 2005, reflecting the introduction of an upgraded model with a higher gross margin to one of our best selling hematology analyzers and our ability to improve the cost structure of our best selling biochemistry analyzers.

Gross margin for the ultrasound imaging systems segment increased from 49.2% in 2003 to 50.2% in 2004, reflecting primarily a change in product mix as we increased sales of new products with higher gross margin, and increased again slightly to 50.5% in 2005, due to increased sales of our own brand products, which generally have higher gross margins than our ODM and OEM products in 2005.

Operating Expenses

Our operating expenses consist of selling expenses, general and administrative expenses, and research and development expenses. Our operating expenses increased from RMB136.9 million in 2003 to RMB186.1 million in 2004 and to RMB364.7 million (US$45.6 million) in 2005, or 35.9% and 96.0% growth, respectively. Operating expense, as a percentage of total net revenue, decreased from 29.7% in 2003 to 26.7% in 2004, and increased to 33.8% in 2005.

Selling Expenses

Our selling expenses, as a percentage of total net revenues, decreased from 13.3% in 2003 to 13.2% in 2004 and increased to 13.6% in 2005, reflecting improved selling efficiencies in each of these years, which was offset in 2005 by employee share-based compensation expenses. Our selling expenses increased from RMB61.3 million in 2003 to RMB92.2 million in 2004 and to RMB146.5 million (US$18.3 million) in 2005. These increases were primarily attributable to the following:

- increases in salaries and bonus payments accounted for 38.5% of the increase in 2004, and 46.3% of the increase in 2005 (excluding employee share-based compensation expenses relating to a share grant contributed by shareholders in the amount of RMB8.6 million);

- increases in travel and entertainment expenses accounted for 13.8% of the increase in 2004, and 22.5% of the increase in 2005;

- increases in marketing and training expenses accounted for 25.9% of the increase in 2004, and 8.3% of the increase in 2005; and

- an increase in 2005 in employee share-based compensation expenses related to a share grant contributed by shareholders as compensation for past and current services provided, which accounted for 5.9% of the increase in 2005.

General and Administrative Expenses

Our general and administrative expenses, as a percentage of total net revenues, decreased from 7.8% in 2003 to 4.6% in 2004, and increased to 10.4% in 2005. Our general and administrative expenses decreased from RMB35.8 million in 2003 to RMB32.3 million in 2004, and increased to RMB112.1 million (US$14.0 million) in 2005. Of the total decrease between 2003 and 2004, a decrease in salaries and performance bonus payments accounted for the majority of the decrease, which was partially offset by increases in other overhead expenses such as training costs. Of the total increase in our general and administrative expenses between 2004 and 2005, 74.0% was attributable to employee share-based compensation expenses in connection with both a share grant contributed by shareholders in January 2005 as

compensation for past and current services provided, and the issuance of convertible preferred shares in September 2005.

Research and Development Expenses

Our research and development expenses, as a percentage of total net revenues, increased from 8.6% in 2003 to 8.8% in 2004 and to 9.8% in 2005. Our research and development expenses increased from RMB39.8 million in 2003 to RMB61.6 million in 2004 and to RMB106.1 million (US$13.3 million) in 2005. Increases in the headcount of our research and development staff accounted for 65.4% of the increase in 2004, and 57.3% of the increase in 2005. Employee share-based compensation expenses accounted for 6.9% of the increase in 2005. See Employee Share-Based Compensation Expenses.

Other Income (Expense)

We had other expenses of RMB(0.4) million and RMB(0.2) million in 2003 and 2004, and other income of RMB11.0 million (US$1.4 million) in 2005, respectively. A majority of other income in 2005 was related to our receipt of government subsidies. We receive government subsidies on an intermittent basis, and while we expect to continue to apply for them, we may not receive them in the future.

Provision for Income Taxes

Provision for income taxes increased from RMB7.6 million in 2003 to RMB10.8 million in 2004 and to RMB18.1 million (US$2.3 million) in 2005. Due to various special tax rates, tax holidays and incentives that have been granted to us in China, our taxes in recent years have been relatively low. The additional amounts of taxes that we would have otherwise been required to pay had we not enjoyed the various special tax rates, tax holidays and incentives in China would have been RMB7.8 million in 2003, RMB10.8 million in 2004 and RMB18.1 million (US$2.3 million) in 2005.

Minority Interests

We had no minority interests in 2003, and minority interests increased to RMB1.0 million on 2004 and to RMB8.4 million (US$1.1 million) in 2005. The increase in 2005 resulted from the reverse merger in September 2005.

Net Income

As a result of the foregoing, net income increased from RMB104.8 million in 2003 to RMB181.7 million in 2004 and to RMB205.1 million (US$25.7 million) in 2005, while net margin increased from 22.8% in 2003 to 26.0% in 2004 and decreased to 10.0% in 2005. The increase in net margin from 2003 to 2004 reflects primarily a decrease in general and administrative expenses, which was partially offset by an increase in research and development expenses. The decrease in net margin from 2004 to 2005 reflects primarily increases in employee share-based compensation expenses, minority interests and research and development costs.

Liquidity and Capital Resources

	Years ended December 31,				Six Months ended June 30,		
	2003	2004	2005	2005	2005	2006	2006
	RMB	RMB	RMB	US$	RMB (Unaudited)	RMB (Unaudited)	US$ (Unaudited)
	(In thousands)						
Cash and cash equivalents	130,297	178,556	446,143	55,808	107,610	212,875	26,628
Net cash from operating activities	149,406	165,840	363,385	45,455	149,191	203,474	25,452
Net cash used in investing activities	(53,869)	(21,591)	(62,428)	(7,809)	(37,630)	(137,385)	(17,186)
Net cash used in financing activities	(19,200)	(95,990)	(33,370)	(4,174)	(182,507)	(299,357)	(37,446)

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Operating Activities

Net cash provided by operating activities in 2003, 2004, 2005 and the six months ended June 30, 2006, was generated from our net income of RMB104.8 million, RMB181.7 million, RMB205.1 million (US$25.7 million), and RMB164.7 million (US$20.6 million), after adjustment in each year for non-cash items, such as depreciation and amortization, and for changes in various assets and liabilities, such as accounts receivables, inventories and prepaid expenses.

Our inventory balances as of December 31, 2003, 2004, 2005 and June 30, 2006 were RMB65.3 million, RMB86.3 million, RMB105.4 million (US$13.2 million) and RMB120.7 million (US$15.1 million), respectively. Our number of inventory days, which we define as the average annual inventory balances divided by cost of revenues, multiplied by 365, declined from 87 days in 2004, to 71 days in 2005, and to 67 days in the six months ended June 30, 2006. As of December 31, 2004 and 2005, we had aggregate increases of RMB13.7 million and RMB32.4 million (US$4.0 million), respectively, in accounts receivable, in each case as compared to the prior year. Our accounts receivable decreased from RMB71.3 million as of December 31, 2005 to RMB66.6 million (US$8.3 million) as of June 30, 2006. Average accounts receivable days increased from 17 days in 2004 and to 19 days in 2005 and remained at 19 days in the six months ended June 30, 2006. These increases primarily resulted from our growth in net revenues from expansion of international sales, because of our international distributors receiving longer average payment terms and in some cases paying by letter of credit, and our increased volume of tender sales.

Our accounts payable as of December 31, 2003, 2004, 2005 and June 30, 2006 were RMB14.5 million, RMB33.0 million, RMB62.8 million (US$7.9 million) and RMB66.1 million (US$8.3 million), respectively. Our average number of days of accounts payable at December 31, 2004 and 2005 and June 30, 2006 was 27 days, 35 days and 38 days, respectively.

Investing Activities

Investing activities primarily include pledged bank deposits, restricted cash, third party loans and purchases of property, plant and equipment. Net cash used in investing activities was RMB53.9 million in 2003, RMB21.6 million in 2004 and RMB62.4 million (US$7.8 million) in 2005, reflecting largely purchases of property, plant and equipment. These purchases were primarily made in connection with the expansion and upgrade of our research and development and manufacturing facilities. Net cash used in investing activities was RMB137.4 million (US$17.2 million) in the six months ended June 30, 2006, reflecting primarily an investment of RMB100.0 million (US$12.5 million) in a two-year debt instrument guaranteed by a major PRC commercial bank. See note 6 to our consolidated financial statements included elsewhere in this prospectus. We expect other investing activities for the full year in 2006 to remain at levels comparable to 2005. However, net cash to be used in investing activities in the next three years will likely increase significantly from previous levels, reflecting our plan to further upgrade and expand our existing facilities, particularly the expansion of our headquarters building adjacent to our current Shenzhen headquarters.

Financing Activities

Cash used in financing activities consist of dividend payments, which totaled RMB17.2 million, RMB86.0 million and RMB206.4 million (US$25.8 million) in 2003, 2004 and 2005, respectively, and repayment of bank loans, which totaled RMB2.0 million, RMB10.0 million and RMB37.0 million (US$4.6 million) in 2003, 2004 and 2005, respectively. Cash used in financing activities in 2005 was partially offset by cash in the amount of RMB209.9 million (US$26.3 million) that we generated from the issuance of convertible preferred shares. In the six months ended June 30, 2006, cash used in financing activities primarily consisted of dividend payments of RMB299.4 million (US$37.4 million).

We maintain three small working capital facilities with banks in China. We have applied RMB17.2 million (US$2.1 million) of the credit facilities towards issuance of letters of credit used as payments to our suppliers and also as security deposits when we bid in government tenders. As of June 30, 2006, the total borrowing capacity under these working capital facilities was RMB250.0 million (US$31.3 million), of which RMB247.6 million (US$31.0 million) was available. We maintain these working

capital facilities primarily to foster long-term relationships with our banks and are not subject to any operational or financial covenants under these working capital facilities.

Pursuant to relevant PRC laws and regulations applicable to our subsidiaries in the PRC, these subsidiaries are required to make appropriations from net income as determined in accordance with PRC GAAP to non-distributable reserves (also referred to as statutory common reserves), which included a statutory surplus reserve and a statutory welfare reserve as of December 31, 2005. Based on newly revised PRC Company law which took effect on January 1, 2006, the PRC subsidiaries are no longer required to make appropriations to the statutory welfare reserve but appropriations to the statutory surplus reserve are still required to be made at 10% of the profit after tax as determined under PRC GAAP until the balance of such reserve fund reaches 50% of the subsidiaries registered capital.

The statutory surplus reserve is used to offset future extraordinary losses. Our subsidiaries may, upon a resolution passed by the shareholders, convert the statutory surplus reserve into capital. The statutory welfare reserve was used for the collective welfare of the employees of subsidiaries. These reserves represent appropriations of retained earnings determined according to PRC law and may not be distributed. There were no appropriations to reserves other than to those of our subsidiaries in the PRC during any of the periods presented. However, as a result of these laws, approximately RMB160.4 million (US$20.1 million) of our retained earnings was not available for distribution as of December 31, 2005.

We believe that our current levels of cash and cash equivalents and cash flows from operations, combined with the net proceeds from this offering, will be sufficient to meet our anticipated cash needs for at least the next 12 months. However, we may need additional cash resources in the future if we experience changed business conditions or other developments. We may also need additional cash resources in the future if we find and wish to pursue opportunities for investment, acquisition, strategic cooperation or other similar action. If we ever determine that our cash requirements exceed our amounts of cash and cash equivalents on hand, we may seek to issue debt or equity securities or obtain a credit facility. Any issuance of equity securities could cause dilution for our shareholders. Any incurrence of indebtedness could increase our debt service obligations and cause us to be subject to restrictive operating and finance covenants. It is possible that, when we need additional cash resources, financing will only be available to us in amounts or on terms that would not be acceptable to us or financing will not be available at all.

Capital Expenditures

In 2003, 2004, 2005 and the six months ended June 30, 2006, our capital expenditures totaled RMB50.5 million, RMB28.1 million, RMB68.2 million (US$8.5 million) and RMB26.9 million (US$3.4 million), respectively. In past years, our capital expenditures consisted primarily of the purchases of property, plant and equipment and investments in buildings that we made in connection with expansions of our sales and services offices. We expect to spend approximately RMB240.0 million (US$30.0 million) in the next 12 months on the expansion of our headquarters building adjacent to our current Shenzhen headquarters.

Contractual Obligations

A summary of our contractual obligations at December 31, 2005 is as follows:

	Contractual Obligations					
	Less than 1 Year	**1-3 Years**	**3-5 Years**	**More than 5 Years**	**Total**	**Total**
	RMB	**RMB**	**RMB**	**RMB**	**RMB**	**US$**
			(In thousands)			
Capital commitments	11,512				11,512	1,440
Operating leases[1]	4,682	7,487	2,127		14,296	1,788
Bank loans						
Notes payable	17,153				17,153	2,146

Total	33,347	7,487	2,127		42,961	5,374

(1) Operating leases are for office premises and our assembly and manufacturing facility.

Off-Balance Sheet Arrangements

We do not have any outstanding off-balance sheet guarantees, interest rate swap transactions or foreign currency forward contracts. We do not engage in trading activities involving non-exchange traded contracts. In our ongoing business, we do not enter into transactions involving, or otherwise form relationships with, unconsolidated entities or financials partnerships that are established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Critical Accounting Policies

We prepare our financial statements in conformity with US GAAP, which requires us to make estimates and assumptions that affect our reporting of, among other things, assets and liabilities, contingent assets and liabilities and net revenues and expenses. We continually evaluate these estimates and assumptions based on the most recently available information, our own historical experiences and other factors that we believe to be relevant under the circumstances. Since our financial reporting process inherently relies on the use of estimates and assumptions, our actual results could differ from what we expect. This is especially true with some accounting policies that require higher degrees of judgment than others in their application. We consider the policies discussed below to be critical to an understanding of our audited consolidated financial statements because they involve the greatest reliance on our management s judgment.

Allowance for Doubtful Accounts

We generally require domestic customers to make a deposit prior to shipment, and from time to time we also grant credit to domestic customers in the normal course of business. Our international customers are required to pre-pay for their products in cash or with letters of credit. We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. The allowance is determined by (1) analyzing specific customer accounts that have known or potential collection issues and (2) applying historical loss rates to the aging of the remaining accounts receivable balances. The allowance for doubtful accounts was RMB2.0 million, RMB2.0 million (US$0.3 million) and RMB 2.0 million (US$0.3 million) in 2004, 2005 and the six months ended June 30, 2006, respectively. In the future, additional allowance may be required if we change our credit policy as our customer base expands and further diversifies, or if we begin to extend credit to our international customers, and if the financial condition of our customers were to deteriorate.

Provisions for Inventories

Inventories, which include material, labor and manufacturing overhead, are valued at the lower of cost or market using the weighted average method of determining inventory cost. Management evaluates inventory from time to time for obsolete or slow-moving inventory and we base our provisions on our estimates of forecasted net revenue levels, economic market conditions and quantity on hand. A significant change in the timing or level of demand for our products as compared to forecasted amounts may result in recording additional provisions for obsolete or slow-moving inventory in the future. We record such adjustments to cost of sales in the period the condition exists.

Provisions for Income Taxes

We record liabilities for probable income tax assessments based on our estimate of potential tax related exposures. Recording of these assessments requires significant judgment as uncertainties often exist in respect to new laws, new interpretations of existing laws and rulings by taxing authorities. Differences between actual results and our assumptions, or changes in our assumptions in future periods, are recorded in the period they become known. Although we have recorded all probable income tax accruals in accordance with Statement of Financial Accounting Standards (SFAS) No. 5, *Accounting for Contingencies*, and SFAS No. 109, *Accounting for Income Taxes*, our accruals represent accounting estimates that are subject to the inherent uncertainties associated with the tax audit process, and therefore include certain contingencies. We believe that any potential tax assessments from the various tax authorities that are not covered by our income tax

provision will not have a material adverse impact on our consolidated financial position or cash flows. However, they may be material to our consolidated earnings of a future period. Our overall effective tax rate was 7.8% in 2005 and 7.2% for the six months ended June 30, 2006.

Revenue Recognition

Our revenue primarily consists of the sale of medical products. Revenue is considered to be realized or realizable and earned when all of the following criteria are met: persuasive evidence of a sales arrangement exists; delivery has occurred or services have been rendered; the price is fixed or determinable; and collectibility is reasonably assured. These criteria are generally met at the time of shipment when the risk of loss passes to the customer.

We offer sales incentives to certain customers in the form of future credits or free products. We treat and accrue the cost of these sales incentives as a cost of revenues and classify the corresponding liability as current.

Valuation of Share-Based Compensation

We account for share-based compensation to our employees based on SFAS No. 123, and will record compensation expense to the extent the fair value of the options or shares transferred is determined to be greater than the price paid by the employee on the date of grant. We incurred three separate compensation charges in 2005 totaling RMB70.9 million (US$8.9 million). The first charge, in the amount of RMB26.3 million (US$3.3 million), was recorded in connection with a share grant contributed by shareholders in January 2005 to certain of our employees for past and current services. The second charge in the amount of RMB11.6 million (US$1.5 million), was recorded in connection with the issuance of three million of our preferred shares to some of our employees and one non-employee director in exchange for three million of our ordinary shares. The third charge, in the amount of RMB33.0 million (US$4.1 million), related to our earnings adjustment provision entered into between those employees and our preferred shareholders. See Related Party Transactions Shareholders Agreement and notes 2(p) and 9 to our consolidated financial statements included elsewhere in this prospectus for a discussion of the mechanics of the earnings adjustment provision.

With respect to the shares granted in January 2005, we retained an independent appraiser to produce a valuation report on the fair value of our company. The independent appraiser employed two valuation approaches, the comparable transaction method and a discounted cash flow model, and presented in the valuation report a fair value of US$2.49 per share, based on a weighted average of the resulting valuations from the two different approaches. Significant management judgment is involved in determining the discounted cash flows and the underlying variables. The discount rate reflects the risk that is specific to the business. We concluded that US$2.49 was the fair value based on management s evaluation of the report.

The fair value of preferred shares issued has been estimated at fair value of approximately US$4.18, which was based on a valuation report by an independent appraiser on the fair value of our company that allocated the value between the convertible preferred shares and ordinary shares. The independent appraiser employed two valuation approaches, the comparable transaction method and a discounted cash flow model, and presented in the valuation report with a 13.0% differential between the ordinary and convertible preferred shares, based on a weighted average of the resulting valuations from the two different approaches. Significant management judgment is involved in determining the discounted cash flows and the underlying variables. The discount rate reflects the risk that is specific to the business. We concluded that the best estimate of fair value of the ordinary shares in September 2005 was approximately US$3.70.

In the first quarter of 2006, we granted share options to our employees. We used the Black-Scholes option-pricing model to determine the amount of employee share-based compensation expense. This approach requires us to make assumptions on such variables as share price volatility, expected lives of options and discount rates. Changes in these assumptions could significantly affect the amount of employee share-based compensation expense we recognize in our consolidated financial statements.

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Quantitative and Qualitative Disclosures about Market Risk

Foreign Exchange Risk

Although the conversion of the Renminbi is highly regulated in China, the value of the Renminbi against the value of the US dollar (or any other currency) nonetheless may fluctuate and be affected by, among other things, changes in China s political and economic conditions. Under the currency policy in effect in China today, the Renminbi is permitted to fluctuate in value within a narrow band against a basket of certain foreign currencies. China is currently under significant international pressures to liberalize this government currency policy, and if such liberalization were to occur, the value of the Renminbi could appreciate or depreciate against the US dollar.

We use the Renminbi as the reporting and functional currency for our financial statements. All transactions in currencies other than the Renminbi during the year are re-measured at the exchange rates prevailing on the respective relevant dates of such transactions. Monetary assets and liabilities existing at the balance sheet date denominated in currencies other than the Renminbi are re-measured at the exchange rates prevailing on such date. Exchange differences are recorded in our consolidated statement of operations.

Fluctuations in exchange rates may affect our costs, operating margins and net income. For example, in 2005, 58.1% of our net revenues were generated from sales denominated in Renminbi, and 4.7% of our operating expenses were denominated in US dollars and other foreign currencies. In 2005 and the six months ended June 30, 2006, fluctuations in the exchange rates between the Renminbi and US dollar and other foreign currencies resulted in an increases in operating income of RMB2.8 million (US$0.3 million) and RMB2.6 million (US$0.3 million), respectively, and decreases in operating expenses of RMB4.0 million (US$0.5 million) and RMB3.7 million (US$0.5 million), respectively.

Fluctuations in exchange rates may also affect our balance sheet. For example, to the extent that we need to convert US dollars received in this offering into Renminbi for our operations, appreciation of the Renminbi against the US dollar would have an adverse effect on the Renminbi amount that we receive from the conversion. Conversely, if we decide to convert our Renminbi into US dollars for the purpose of making payments for dividends on our ordinary shares or ADSs or for other business purposes, appreciation of the US dollar against the Renminbi would have a negative effect on the US dollar amount available to us. Considering the amount of our cash and cash equivalents as of June 30, 2006, and including with that amount the anticipated net proceeds that we will receive from this offering, a 1.0% change in the exchange rates between the Renminbi and the US dollar will result in an increase or decrease of RMB10.5 million (US$1.3 million) for our total amount of cash and cash equivalents.

We have not used any forward contracts or currency borrowings to hedge our exposure to foreign currency exchange risk and do not currently intend to do so.

Interest Rate Risk

As of June 30, 2006, we had no short-term or long-term borrowings. If we borrow money in future periods, we may be exposed to interest rate risk. We do not have any derivative financial instruments and believe our exposure to interest rate risk and other relevant market risks is not material.

Inflation

In recent years, China has not experienced significant inflation, and thus inflation has not had a material impact on our results of operations. According to the National Bureau of Statistics of China, the change in Consumer Price Index in China was 1.2%, 3.9% and 1.8% in 2003, 2004 and 2005, respectively.

Recently Issued Accounting Pronouncements

In November 2004, the Financial Accounting Standards Board, or the FASB, issued Statement of Financial Accounting Standard, or SFAS, No. 151, which is entitled *Inventory Costs an amendment of ARB No. 43, Chapter 4.* SFAS No. 151 clarifies the accounting principles that require abnormal amounts of

idle facility expenses, freight and handling costs and spoilage costs to be recognized as current-period charges. It also requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 is effective for inventory costs incurred on or after June 15, 2005. The issuance of SFAS No. 151 did not have a material effect on our financial position or results of operations.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), also known as SFAS No. 123R, which is entitled *Share-Based Payments.* SFAS No. 123R eliminates the option to apply the intrinsic value measurement provisions of Accounting Principles Board, or APB, Opinion No. 25, which is entitled *Accounting for Stock Issued to Employees,* to stock compensation awards issued to employees. Instead, companies are required to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide services in exchange for the award. SFAS 123R is effective for the fiscal year beginning January 1, 2006 and applies to all awards granted, modified, repurchased or cancelled such that date. The issuance of SFAS No. 123R did not have a material effect on our financial position or results of operations.

In December 2004, the FASB issued SFAS No. 153, which is entitled *Exchanges of Nonmonetary Assets an amendment of APB Opinion No. 29.* SFAS No. 152 amends APB Opinion No. 29, which is entitled *Accounting for Nonmonetary Transactions,* to eliminate the exception for nonmonetary exchanges of similar productive assets. The eliminated exception is replaced a general exception for exchanges of nonmonetary assets that do not have commercial substance. SFAS 153 is effective for nonmonetary assets exchanges occurring in fiscal periods beginning after June 15, 2005. The adoption of this statement is not expected to have a material effect on our financial position or results of operations.

In March 2005, the FASB issued FASB Interpretation No., or FIN, 47, which is entitled *Accounting for Conditional Asset Retirement Obligations, an interpretation of SFAS No. 143.* FIN 47 clarifies that an entity is required to recognize a liability for a legal obligation to perform an asset retirement activity if the fair value can be reasonably estimated even though the timing and/or method of settlement are conditional on a future event. FIN 47 is required to be adopted for annual reporting periods ending after December 15, 2005. We are currently evaluating the effect of the adoption of FIN 47 and believe at this time that the issuance of FIN 47 will not have a material effect on our financial position or results of operations.

In May 2005, the FASB issued SFAS No. 154, which is entitled *Accounting Changes And Error Corrections a replacement of APB Opinion No. 20 and FASB Statement No. 3.* SFAS No. 154 supersedes both APB Opinion No. 20, which is entitled *Accounting changes* and SFAS No. 3, which is entitled *Reporting Accounting changes in Interim Financial Statements.* SFAS No. 154 requires changes in accounting principles to be retrospectively applied to financial statements for past periods, unless it would be impracticable to determine the period-specific effects or the cumulative effects of such changes. Under the previous standard set forth in APB Opinion No. 20, most voluntary changes in accounting principles were required to be recognized by including in the net income for the period of a change the cumulative effects of such change. SFAS No. 154 will be effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The issuance of SFAS No. 154 is not expected to have a material effect on our financial position or results of operations.

In September 2005, the FASB s Emerging Issues Task Force, or EITF, reached a final consensus on Issue 04-13, which is entitled *Accounting for Purchases and Sales of Inventory with the Same Counterparty.* EITF 04-13 requires two or more legally separate exchange transactions by a party with the same counterparty to be combined and considered a single arrangement for purposes of applying APB Opinion No. 29, which is entitled *Accounting for Nonmonetary Transactions,* when such legally separate transactions are entered into in contemplation of one another. EITF 04-13 is effective for new arrangements entered into, or modifications or renewals of existing arrangements made, in the reporting periods beginning after March 15, 2006. The adoption of EITF 04-13 is not expected to have a material effect on our financial position or results of operations.

OUR INDUSTRY

The Global Medical Device Industry Overview

According to Frost & Sullivan, the global medical device industry had an estimated value of US$148 billion in 2004. The United States is the largest market for medical devices with an estimated value of US$64 billion in 2004, or 43.0% of the global market. Europe is the second largest market for medical devices with an estimated value of US$44 billion in 2004, or 30.0% of the global market. China s market for medical devices had an estimated value of US$7.5 billion, or 5.1% of the global market.

Background on China s Medical Device Market

China s medical device market, as well as the medical device markets in several developing countries, is projected to grow faster than the global medical device market. According to Frost & Sullivan, China s medical device market is projected to grow from US$7.5 billion in 2004 to US$10.1 billion in 2006. Reasons for this faster growth in China include:

A fast growing domestic economy. According to Frost & Sullivan, China s GDP is projected to grow from $1.6 trillion in 2004 to $2.5 trillion in 2008.

Increasing expenditures on healthcare as a percentage of GDP. Frost & Sullivan estimates that in 2005, the United States, with a population of approximately 296 million, had healthcare expenditures representing 15.9% of its GDP, compared to just 6.7% of GDP that China, with a population of approximately 1.3 billion, spent on healthcare. China s healthcare expenditures grew from 5.0% of GDP in 1999 to 6.7% of GDP in 2005, representing a growth rate of approximately 5%. During the same period, US healthcare expenditures grew from 13.2% to 15.9%, representing a growth rate of approximately 3%.

Increasing desire for and utilization of more advanced technologies in Chinese hospitals and clinics. The market penetration of common medical equipment in Chinese hospitals is low when compared to hospitals in more developed countries. However, we believe hospitals in China are purchasing more advanced technology as they attempt to compete for patients and generate additional profits.

Increasing availability of healthcare insurance. The increasing availability of healthcare insurance generally provides coverage for more advanced and extensive healthcare services than were previously available.

Increasing autonomy at the hospital level. Although governmental entities own and control substantially all of the hospitals in China, recent healthcare system reforms have resulted in a trend of greater operating autonomy at local levels. For example, hospitals in China today rely less and less on governmental funding and are generally expected to earn enough revenues on their own to cover 70% to 90% of their operating expenses. This has led to a greater focus on achieving efficiencies and improving services by regional hospital administrators, who now typically have the authority to make decisions regarding equipment purchases.

Increasing government focus on improving quality of care. The outbreak of SARS in 2003 heightened the government s awareness of the need to improve the country s healthcare infrastructure, and healthcare has become a priority for the PRC government.

Chinese Healthcare Institutions

According to the PRC Ministry of Health, there were approximately 18,700 hospitals and 41,700 healthcare clinics in China in 2005. The hospitals, which on average had approximately 130 beds, can be further divided into approximately 950 large-sized hospitals, 5,200 medium-sized hospitals and 12,500 small-sized hospitals, commonly referred to as Tier III, Tier II and Tier I and other hospitals, respectively, in China.

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Decrease (increase) in:			
Premiums and agent balances receivable	(713)	(6,277)	(6,134)
Reinsurance recoverable on paid and unpaid losses	(33,513)	(2,445)	37,201
Prepaid reinsurance premiums	1,488	(5,157)	(2,377)
Deferred policy acquisition costs	(1,204)	(5,773)	(7,424)
Other assets	5,612	2,772	(3,747)
Increase (decrease) in:			
Losses and loss adjustment expenses	80,521	38,692	(35,468)
Unearned premiums	6,688	24,625	40,999
Payable to insurance companies	(307)	(863)	(505)
Reinsurance funds held and balances payable	(2,591)	3,659	(2,238)
Other liabilities	609	1,577	9,243
Total adjustments	64,037	56,613	37,431
Net cash provided by operating activities	81,947	70,674	47,530
Cash Flows From Investing Activities			
Purchase of debt securities available for sale	(203,789)	(115,954)	(89,433)
Proceeds from sale of equity securities available for sale	8	2,409	
Proceeds from sales and maturities of debt securities available for sale	122,317	47,362	59,483
Capital expenditures	(15,810)	(5,244)	(2,155)
Purchase of books of business	(3,557)	(446)	(738)
Proceeds from sale of assets	633	2,837	
Deconsolidation of subsidiary		(4,218)	
Loan receivable	(5,905)	174	1,002
Net cash deposited in funds held	501	2,315	1,208
Net cash used in investing activities	(105,602)	(70,765)	(30,633)
Cash Flows From Financing Activities			
Proceeds from lines of credit	14,307	10,489	18,957
Payment of lines of credit	(19,451)	(15,851)	(33,948)
Book overdraft	924	268	1,212
Net proceeds from debentures	19,400	24,250	9,700
Stock options exercised	1,092	145	
Share repurchases of common stock	(4,191)		(1,562)
Other financing activities	(263)	18	6
Net cash provided by (used in) financing activities	11,818	19,319	(5,635)
Net (decrease) increase in cash and cash equivalents	(11,837)	19,228	11,262
Cash and cash equivalents, beginning of year	69,875	50,647	39,385
Cash and cash equivalents, end of year	$ 58,038	$ 69,875	$ 50,647
Supplemental Disclosure of Cash Flow Information:			

Interest paid	$	3,428	$	1,902	$	835
Net income taxes paid	$	6,404	$	5,578	$	76
Supplemental Disclosure of Non Cash Investing and Financing Activities:						
Tax benefit from stock options	$	105	$	30	$	
Stock-based employee compensation	$	41	$	78	$	189
Accrued liability for purchase of building(1)	$		$	11,583	$	

(1) On January 19, 2005, the Company closed on the purchase of its new headquarters in Southfield, Michigan, with a cash settlement of $11.6 million paid to the developer.

The accompanying notes are an integral part of the Consolidated Financial Statements.

MEADOWBROOK INSURANCE GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

The accompanying consolidated financial statements have been prepared in conformity with generally accepted accounting principles (GAAP), which differ from statutory accounting practices prescribed or permitted for insurance companies by regulatory authorities. Prescribed statutory accounting practices include a variety of publications of the National Association of Insurance Commissioners (NAIC), as well as state laws, regulations and general administrative rules. Permitted statutory accounting practices encompass all accounting practices not so prescribed.

The consolidated financial statements include accounts, after elimination of intercompany accounts and transactions, of Meadowbrook Insurance Group, Inc. (the Company), its wholly owned subsidiary Star Insurance Company (Star), and Star s wholly owned subsidiaries, Savers Property and Casualty Insurance Company, Williamsburg National Insurance Company, and Ameritrust Insurance Corporation (which are collectively referred to as the Insurance Company Subsidiaries), and Preferred Insurance Company, Ltd. The consolidated financial statements also include Meadowbrook, Inc., Crest Financial Corporation, and their subsidiaries.

Pursuant to Financial Accounting Standards Board Interpretation Number (FIN) 46(R), the Company does not consolidate its subsidiaries, Meadowbrook Capital Trust I and II (the Trusts), as they are not variable interest entities and the Company is not the primary beneficiary of the Trusts. The consolidated financial statements, however, include the equity earnings of the Trusts. In addition and in accordance with FIN 46(R), the Company does not consolidate its subsidiary American Indemnity. While the Company and its subsidiary Star are the common shareholders, they are not the primary beneficiaries of American Indemnity. The consolidated financial statements, however, include the equity earnings of American Indemnity.

Reclassifications

Certain amounts in the 2004 and 2003 financial statements and notes to consolidated financial statements have been reclassified to conform to the 2005 presentation. These amounts specifically relate to the allocation of corporate overhead and a reclassification of revenue and net income related to a specific subsidiary. The Company s segment information has been reclassified to include an allocation of corporate overhead from the specialty risk management operations segment to the agency operations segment. This reclassification for the allocation of corporate overhead more accurately presents the Company s segments as a result of improved cost allocation information. Previously, 100% of corporate overhead was allocated to specialty risk management operations. In addition, the Company reclassified revenues and the overall net income related to a specific subsidiary from the agency operations segment to the specialty risk management operations segment.

Business

The Company, through its subsidiaries, is engaged primarily in developing and managing alternative risk management programs for defined client groups and their members. These services include: risk management consulting, claims administration and handling, loss control and prevention, and reinsurance placement, along with various types of property and casualty insurance coverage, including workers compensation, commercial multiple peril, general liability, commercial auto liability, and inland marine. The Company, through its Insurance Company Subsidiaries, issues insurance policies for risk-sharing and fully insured programs. The Company retains underwriting risk in these insurance programs, which may result in fluctuations in earnings. The Company also operates retail insurance agencies, which primarily place commercial insurance as well as personal property, casualty, life and accident and health insurance, with multiple insurance carriers. The Company does not have significant exposures to environmental/asbestos and catastrophic coverages. Insur-

MEADOWBROOK INSURANCE GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

ance coverage is primarily provided to associations or similar groups of members, commonly referred to as programs.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. While management believes the amounts included in the consolidated financial statements reflect management s best estimates and assumptions, actual results may differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and highly liquid short-term investments. The Company considers all short-term investments purchased with an original maturity of three months or less to be cash equivalents.

Investments

The Company s investment securities at December 31, 2005 and 2004, are classified as available for sale. Investments classified as available for sale are available to be sold in the future in response to the Company s liquidity needs, changes in market interest rates, tax strategies and asset-liability management strategies, among other reasons. Available for sale securities are reported at fair value, with unrealized gains and losses reported in the accumulated other comprehensive income component of shareholders equity, net of deferred taxes.

Realized gains or losses on sale of investments are determined on the basis of specific costs of the investments. Dividend income is recognized when declared and interest income is recognized when earned. Discount or premium on debt securities purchased at other than par value is amortized using the effective yield method. Investments with other than temporary declines in fair value are written down to their estimated net fair value and the related realized losses are recognized in income.

Other Than Temporary Impairments of Securities and Unrealized Losses on Investments

The Company s investment portfolio is primarily invested in debt securities classified as available for sale, with a concentration in fixed income securities of a high quality. The Company s policy for the valuation of temporarily impaired securities is to determine impairment based on analysis of the following factors: (1) rating downgrade or other credit event (e.g., failure to pay interest when due); (2) financial condition and near-term prospects of the issuer, including any specific events which may influence the operations of the issuer such as changes in technology or discontinuance of a business segment; (3) prospects for the issuer s industry segment, and (4) intent and ability of the Company to retain the investment for a period of time sufficient to allow for anticipated recovery in market value. The Company evaluates its investments in securities to determine other than temporary impairment, no less than quarterly. Investments that are deemed other than temporarily impaired are written down to their estimated net fair value and the related losses are recognized in income. There were no impaired investments written down in 2005, 2004, and 2003.

Losses and Loss Adjustment Expenses and Reinsurance Recoverables

The liability for losses and loss adjustment expenses (LAE) represent case base estimates of reported unpaid losses and LAE and actuarial estimates of incurred but not reported losses (IBNR) and LAE. In addition, the liability for losses and loss adjustment expenses represents estimates received from ceding

MEADOWBROOK INSURANCE GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

reinsurers on assumed business. Such liabilities, by necessity, are based upon estimates and, while management believes the amount of its reserves is adequate, the ultimate liability may be greater or less than the estimate.

Reserves related to the Company s direct business and assumed business it manages directly, are established through transactions processed through the Company s internal systems and related controls. Accordingly, case reserves are established on a current basis, and therefore there is no backlog, and IBNR is determined utilizing various actuarial methods based upon historical data. Ultimate reserve estimates related to assumed business from residual markets are provided by individual states on a two quarter lag and include an estimated reserve based upon actuarial methods for this lag. Assumed business which is subsequently 100% retroceded to participating reinsurers relates to business previously discontinued and now is in run-off. Lastly, in relation to assumed business from other sources, the Company receives case and paid loss data within a forty-five day reporting period and develops estimates for IBNR based on current and historical data.

In addition to case reserves and in accordance with industry practice, the Company maintains estimates of reserves for losses and LAE incurred but not yet reported. The Company projects an estimate of ultimate losses and LAE expenses at each reporting date. The difference between the projected ultimate loss and LAE reserves and the case loss and LAE reserves, is carried as IBNR reserves. By using both estimates of reported claims and IBNR determined using generally accepted actuarial reserving techniques, the Company estimates the ultimate liability for losses and LAE, net of reinsurance recoverables.

Reinsurance recoverables represent (1) amounts currently due from reinsurers on paid losses and LAE, (2) amounts recoverable from reinsurers on case basis estimates of reported losses and LAE, and (3) amounts recoverable from reinsurers on actuarial estimates of incurred but not reported losses and LAE. Such recoverables, by necessity, are based upon estimates and, while management believes that the amount accrued is collectible, the ultimate recoverable may be greater or less than the amount accrued.

The methods for making such estimates and for establishing the loss reserves and reinsurance recoverables are continually reviewed and updated. There were no changes in key assumptions during 2005, 2004 and 2003.

Revenue Recognition

Premiums written, which include direct, assumed, and ceded are recognized as earned on a pro rata basis over the life of the policy term. Unearned premiums represent the portion of premiums written that are applicable to the unexpired terms of policies in force. Provisions for unearned premiums on reinsurance assumed from others are made on the basis of ceding reports when received and actuarial estimates.

For the year ending December 31, 2005, total assumed written premiums were $67.7 million, of which $56.0 million, relates to assumed business we manage directly, and therefore, no estimation is involved. The remaining $11.7 million of assumed written premiums represents $10.9 million related to residual markets.

Assumed premium estimates are specifically related to the mandatory assumed pool business from the National Council on Compensation Insurance (NCCI), or residual market business. The pool cedes workers compensation business to participating companies based upon the individual company s market share by state. The activity is reported from the NCCI to participating companies on a two quarter lag. To accommodate this lag, the Company estimates premium and loss activity based on historical and market based results. Historically, the Company has not experienced any material difficulties or disputes in collecting balances from NCCI; and therefore, no provision for doubtful accounts is recorded related to the assumed premium estimate.

In addition, certain premiums are subject to retrospective premium adjustments. Premium is recognized over the term of the insurance contract.

MEADOWBROOK INSURANCE GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Fee income, which includes risk management consulting, loss control, and claims services, is recognized during the period the services are provided. Depending on the terms of the contract, claims processing fees are recognized as revenue over the estimated life of the claims, or the estimated life of the contract. For those contracts that provide services beyond the expiration or termination of the contract, fees are deferred in an amount equal to management s estimate of the Company s obligation to continue to provide services.

Commission income, which includes reinsurance placement, is recorded on the later of the effective date or the billing date of the policies on which they were earned. Commission income is reported net of any sub-producer commission expense. Commission and other adjustments are recorded when they occur and the Company maintains an allowance for estimated policy cancellations and commission returns. Profit sharing commissions from insurance companies are recognized when determinable, which is when such commissions are received.

The Company reviews, on an ongoing basis, the collectibility of its receivables and establishes an allowance for estimated uncollectible accounts.

Deferred Policy Acquisition Costs

Commissions and other costs of acquiring insurance business that vary with and are primarily related to the production of new and renewal business are deferred and amortized over the terms of the policies or reinsurance treaties to which they relate. Investment earnings are anticipated in determining the recoverability of such deferred amounts. The Company reduces these costs for premium deficiencies. There were no premium deficiencies for the years ending December 31, 2005, 2004 and 2003.

Participating Policyholder Dividends

The Company s method for determining policyholder dividends is a combination of subjective and objective decisions, which may include loss ratio analysis for the specific program and the Company s overall business strategy. The Company determines the total dividends to be paid and then obtains the approval of the Board of Directors to pay up to a certain amount. At December 31, 2005 and 2004, the Company had $596,000 and $350,000 accrued for policyholder dividends, respectively.

Furniture and Equipment

Furniture and equipment are stated at cost, net of accumulated depreciation, and are depreciated using the straight-line method over the estimated useful lives of the assets, generally three to ten years. Upon sale or retirement, the cost of the asset and related accumulated depreciation are eliminated from their respective accounts, and the resulting gain or loss is included in income. Repairs and maintenance are charged to operations when incurred.

Goodwill and Other Intangible Assets

The Company is required to test, at least annually, all existing goodwill for impairment using a fair value approach, on a reporting unit basis. The Company s annual assessment date for goodwill impairment testing is October 1st. Also pursuant to Statement of Financial Accounting Standards (SFAS) No. 142 *Goodwill and Other Intangible Assets,* the Company is required to test for impairment more frequently if events or changes in circumstances indicate that the asset might be impaired. In addition, the Company has an other intangible asset which has an indefinite life and is evaluated annually in accordance with SFAS No. 142. The Company s remaining other intangible assets are amortized over a five-year period.

MEADOWBROOK INSURANCE GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Income Taxes

The Company accounts for its income taxes under the asset and liability method. Deferred federal income taxes are recognized for the tax consequences of temporary differences by applying enacted statutory tax rates to differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities.

At December 31, 2005, the Company had a deferred tax asset of $16.6 million. Realization of the deferred tax asset is dependent upon generating sufficient taxable income to absorb the applicable reversing temporary differences. At December 31, 2005, management concluded the positive evidence supporting the generation of future taxable income sufficient to realize the deferred tax asset. This positive evidence includes cumulative pre-tax income of $62.3 million for the three years ended December 31, 2005. In addition, the Company continues to have alternative tax strategies, which could generate capital gains from the potential sale of assets and/or subsidiaries.

Stock Options

Effective January 1, 2003, the Company adopted the requirements of SFAS No. 148 *Accounting for Stock-Based Compensation Transition and Disclosure an amendment of FASB Statement No. 123,* utilizing the prospective method. Under the prospective method, stock-based compensation expense is recognized for awards granted after the beginning of the fiscal year in which the change is made. Upon implementation of SFAS No. 148 in 2003, the Company is recognizing stock-based compensation expense for awards granted after January 1, 2003.

Prior to the adoption of SFAS No. 148, the Company applied the intrinsic value-based provisions set forth in Accounting Principles Board Opinion No. 25. Under the intrinsic value method, compensation expense is determined on the measurement date, which is the first date on which both the number of shares the employee is entitled to receive and the exercise price are known. Compensation expense, if any, resulting from stock options granted by the Company is determined based on the difference between the exercise price and the fair market value of the underlying common stock at the date of grant. The Company s Stock Option Plan requires the exercise price of the grants to be at the current fair market value of the underlying common stock.

The Company, through its 1995 and 2002 Amended and Restated Stock Option Plans (the Plans), may grant options to key executives and other members of management of the Company and its subsidiaries in amounts not to exceed 2,000,000 shares of the Company s common stock allocated for each plan. The Plans are administered by the Compensation Committee (the Committee) of the Board of Directors. Option shares may be exercised subject to the terms of the Plans and the terms prescribed by the Committee at the time of grant. Currently, the Plans options have either five or ten-year terms and are exercisable and vest in equal increments over the option term.

MEADOWBROOK INSURANCE GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

If compensation cost for stock option grants had been determined based on a fair value method, net income and earnings per share on a pro forma basis for 2005, 2004, and 2003 would be as follows (in thousands):

	2005	2004	2003
Net income, as reported	$ 17,910	$ 14,061	$ 10,099
Add: Stock-based employee compensation expense included in reported income, net of related tax effects	27	52	125
Deduct: Total stock-based employee compensation expense determined under fair-value-based methods for all awards, net of related tax effects	(108)	(220)	(443)
Pro forma net income	$ 17,829	$ 13,893	$ 9,781
Earnings per share:			
Basic as reported	$ 0.62	$ 0.48	$ 0.35
Basic pro forma	$ 0.62	$ 0.48	$ 0.34
Diluted as reported	$ 0.60	$ 0.48	$ 0.35
Diluted pro forma	$ 0.60	$ 0.47	$ 0.33

The Black-Scholes valuation model utilized the following annualized assumptions for 2003: (1) risk-free interest rate of 2.90%, (2) no dividends were declared, (3) the volatility factor for the expected market price of the Company s common stock was 0.586, and (4) the weighted-average expected life of options was 5.0. No options were granted in 2005 and 2004.

Compensation expense of $41,000, $78,000, and $189,000 has been recorded for stock options in 2005, 2004, and 2003 under SFAS No. 148, respectively.

Long Term Incentive Plan

In 2004, the Company approved the adoption of a Long Term Incentive Plan (the LTIP). The LTIP provides participants with the opportunity to earn cash and stock awards based upon the achievement of specified financial goals over a three-year performance period with the first performance period commencing January 1, 2004. At the end of the three-year performance period, and if the performance target is achieved, the Committee shall determine the amount of LTIP awards that are payable to participants in the LTIP. One-half of any LTIP award will be payable in cash and one-half of the award will be payable in the form of a restricted stock award. If the Company achieves the three-year performance target, payment of the award would be made in three annual installments, with the first payment being paid as of the end of the performance period and the remaining two payments to be paid in the fourth and fifth year. Any unpaid portion of a cash award is subject to forfeiture if the participant voluntarily leaves the Company or is discharged for cause. The portion of the award to be paid in the form of stock will be issued as of the end of the performance period. The number of shares of Company s common stock subject to the restricted stock award shall equal the dollar amount of one-half of the LTIP award divided by the fair market value of Company s common stock on the first date of the performance period. The restricted stock awards shall be made subject to the terms and conditions of the LTIP and Plans. The Company accrues awards based upon the criteria set forth and approved by the Committee, as included in the LTIP.

Earnings Per Share

Basic earnings per share are based on the weighted average number of common shares outstanding during the year, while diluted earnings per share includes the weighted average number of common shares and potential dilution from shares issuable pursuant to stock options using the treasury stock method.

MEADOWBROOK INSURANCE GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Outstanding options of 534,201, 936,502, and 1,693,119 for the periods ended December 31, 2005, 2004, and 2003, respectively, have been excluded from the diluted earnings per share as they were anti-dilutive. Shares issuable pursuant to stock options included in diluted earnings per share were 298,851, 300,531, and 71,154 for the years ended December 31, 2005, 2004, and 2003, respectively. Restricted shares related to the LTIP included in diluted earnings per share were 392,988 for the year ended December 31, 2005. There were no shares related to the LTIP included in diluted earnings per share for the years ended December 31, 2004 and 2003. In addition, shares issuable pursuant to outstanding warrants included in diluted earnings per share were 71,908 and 8,678 for the years ended December 31, 2004 and 2003, respectively. There were no outstanding warrants as of December 31, 2005.

Comprehensive Income

Comprehensive income (loss) encompasses all changes in shareholders equity (except those arising from transactions with shareholders) and includes net income, net unrealized capital gains or losses on available-for-sale securities, and net deferred derivative gains or losses on hedging activity.

Derivative Instruments

The Company entered into two interest rate swap transactions in order to mitigate its interest rate risk. The Company recognized these transactions in accordance with SFAS No. 133 *Accounting for Derivative Instruments and Hedging Activities,* as subsequently amended. These interest rate swap transactions have been designated as a cash flow hedge and are deemed a highly effective transaction under SFAS No. 133. In accordance with SFAS No. 133, these interest rate swap transactions are recorded at fair value on the balance sheet and any changes in their fair value are accounted for within other comprehensive income. Any portion of the hedge deemed to be ineffective is recognized within the consolidated statements of income. The Company does not use interest rate swaps for trading or other speculative purposes.

In December 2005, the Company entered into a $6.0 million convertible note receivable with an unaffiliated insurance agency. The effective interest rate of the convertible note is equal to the three-month LIBOR, plus 5.2% and is due December 20, 2010. This note is convertible at the option of the Company based upon a pre-determined formula, beginning in 2007. The conversion feature of this note is considered an embedded derivative pursuant to SFAS No. 133, and therefore is accounted for separately from the note. At December 31, 2005, the estimated fair value of the derivative is zero.

Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS 123(R)), which replaces SFAS No. 123, *Accounting for Stock Issued to Employees.* SFAS 123(R) requires all share-based payments to employees to be recognized in the financial statements based on their fair values. The pro forma disclosures previously permitted under SFAS 123, will no longer be an alternative to financial statement recognition. Commencing in the first quarter of 2003, the Company began expensing the fair value of all stock options granted since January 1, 2003 under the prospective method. The Company has not issued stock options to employees since 2003. Under SFAS 123(R), the Company must determine the appropriate fair value model to be used for valuing share-based payments, the amortization method for compensation cost and the transition method to be used at the date of adoption. The transition methods include prospective and retroactive adoption options. Under the retroactive options, prior periods may be restated either as of the beginning of the year of adoption or for all periods presented. The prospective method requires that compensation expense be recorded at the beginning of the first quarter of adoption of SFAS 123(R) for all unvested stock options and restricted stock based upon the previously disclosed SFAS 123 methodology and amounts. The retroactive methods would record compensation expense beginning with the first period restated for all unvested stock options and restricted

MEADOWBROOK INSURANCE GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

stock. On April 14, 2005, the Securities and Exchange Commission adopted a new rule that delays the compliance dates for SFAS 123(R). Under the new rule, SFAS 123(R) is effective for public companies for annual, rather than interim periods, which begin after June 15, 2005. Therefore, the Company is required to adopt SFAS 123(R) in the first quarter of 2006, or beginning January 1, 2006. The Company has evaluated the requirements of SFAS 123(R) and has determined the impact on its financial statements related to existing stock options is immaterial.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3.* SFAS No. 154 replaces the mentioned pronouncements and changes the requirements for the accounting and reporting of a change in an accounting principle. This Statement applies to all voluntary changes in accounting principle, as well as changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. However, when a pronouncement includes specific transition provisions, those provisions should be followed. SFAS No. 154 requires retrospective application to prior period financial statements for changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS No. 154 also requires that retrospective application of a change in accounting principle be limited to the direct effects of the change. Indirect effects of a change in accounting principle should be recognized in the period of the accounting change. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. However, early adoption is permitted for accounting changes and corrections of errors made in fiscal years beginning after the date this Statement was issued. The Company is required to adopt the provisions of SFAS No. 154, as applicable, beginning in 2006. The adoption of SFAS No. 154 will not have a material impact on the Company s consolidated financial statements.

In September 2005, the American Institute of Certified Public Accountants issued Statement of Position (SOP) 05-1, *Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts,* effective for contract replacements occurring in fiscal years beginning after December 15, 2006. The SOP 05-1 defines an internal replacement of an insurance contract as a modification in product features, rights, or coverages that occurs by the exchange of an existing contract for a new contract, or by amendment endorsement, or rider to a contract, or by the election of a feature or coverage with a contract. Insurance contracts meeting this replacement criteria should be accounted for as an extinguishment of the replaced contract. The Company will review the guidance during 2006 and determine the applicability to any of its various insurance contracts.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. Investments

The estimated fair value of investments in securities is determined based on published market quotations and broker/dealer quotations. The cost or amortized cost and estimated fair value of investments in securities at December 31, 2005 and 2004 are as follows (in thousands):

	December 31, 2005			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt Securities:				
Debt securities issued by the U.S. government and agencies	$ 57,026	$ 498	$ (720)	$ 56,804
Obligations of states and political subdivisions	143,093	1,054	(1,493)	142,654
Corporate securities	107,761	2,106	(1,722)	108,145
Mortgage and asset-backed securities	96,067	127	(1,602)	94,592
Total Debt Securities available for sale	$ 403,947	$ 3,785	$ (5,537)	$ 402,195

	December 31, 2004			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt Securities:				
Debt securities issued by the U.S. government and agencies	$ 56,492	$ 1,234	$ (288)	$ 57,438
Obligations of states and political subdivisions	104,009	1,857	(271)	105,595
Corporate securities	99,784	4,813	(446)	104,151
Mortgage and asset-backed securities	64,681	673	(296)	65,058
Total Debt Securities available for sale	324,966	8,577	(1,301)	332,242
Equity Securities:				
Common Stocks		39		39
Total Equity Securities available for sale		39		39
Total Securities available for sale	$ 324,966	$ 8,616	$ (1,301)	$ 332,281

Gross unrealized appreciation and depreciation on available for sale securities were as follows (in thousands):

	December 31,	
	2005	2004
Unrealized appreciation	$ 3,785	$ 8,616
Unrealized depreciation	(5,537)	(1,301)
Net unrealized (depreciation) appreciation	(1,752)	7,315
Deferred federal income tax benefit (expense)	613	(2,487)
Net unrealized (depreciation) appreciation on investments, net of deferred federal income taxes	$ (1,139)	$ 4,828

The gross realized gains and gross realized losses on the sale of available for sale debt securities were $47,059 and $141,751, respectively, for the year ended December 31, 2005. The gross realized gains and gross

MEADOWBROOK INSURANCE GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

realized losses on the sale of available for sale equity securities were $8,482 and $0, respectively, for the year ended December 31, 2005. The proceeds from the sale of debt securities and equity securities were $95.1 million and $8,482, respectively.

The gross realized gains and gross realized losses on the sale of available for sale debt securities were $97,279 and $189,766, respectively, for the year ended December 31, 2004. The gross realized gains and gross realized losses on the sale of available for sale equity securities were $429,288 and $0, respectively, for the year ended December 31, 2004. The proceeds from the sale of debt securities and equity securities were $7.0 million and $2.4 million, respectively.

The gross realized gains and gross realized losses on the sale of available for sale debt securities were $406,200 and $103,700, respectively, for the year ended December 31, 2003. There were no sales of available for sale equity securities for the year ended December 31, 2003. The proceeds from the sale of debt securities and equity securities were $13.7 million and $0, respectively.

At December 31, 2005, the amortized cost and estimated fair value of available for sale debt securities, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because certain borrowers may have the right to call or prepay obligations with or without call or prepayment penalties (in thousands):

	Available for Sale	
	Amortized Cost	**Estimated Fair Value**
Due in one year or less	$ 26,862	$ 26,842
Due after one year through five years	155,095	154,740
Due after five years through ten years	114,172	114,050
Due after ten years	11,750	11,970
Mortgage-backed securities	96,068	94,593
	$ 403,947	$ 402,195

Net investment income for the three years ended December 31, 2005, 2004, and 2003 was as follows (in thousands):

	2005	**2004**	**2003**
Net Investment Income On:			
Debt securities	$ 16,080	$ 13,559	$ 12,481
Equity securities	37	149	182
Cash and cash equivalents	2,291	1,657	1,425
Total gross investment income	18,408	15,365	14,088
Less investment expenses	433	454	604
Net investment income	$ 17,975	$ 14,911	$ 13,484

United States government obligations, municipal bonds, and bank certificates of deposit aggregating $128.7 million and $109.5 million were on deposit at December 31, 2005 and 2004, respectively, with state regulatory authorities or otherwise pledged as required by law or contract.

Other Than Temporary Impairments of Securities and Unrealized Losses on Investments

At December 31, 2005 and 2004, the Company had 267 and 124, securities that were in an unrealized loss position, respectively. These investments all had unrealized losses of less than ten percent. At

MEADOWBROOK INSURANCE GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2005, thirty-nine of those investments, with an aggregate $29.9 million and $1.2 million fair value and unrealized loss, respectively, have been in an unrealized loss position for more than eighteen months. At December 31, 2004, two investments, with an aggregate $2.7 million and $75,000 fair value and unrealized loss, respectively, were in an unrealized loss position for more than eighteen months. Positive evidence considered in reaching the Company s conclusion that the investments in an unrealized loss position are not other than temporarily impaired consisted of: 1) there were no specific events which caused concerns; 2) there were no past due interest payments; 3) there has been a rise in market prices; 4) the Company s ability and intent to retain the investment for a sufficient amount of time to allow an anticipated recovery in value; and 5) the Company also determined that the changes in market value were considered temporary in relation to minor fluctuations in interest rates.

The fair value and amount of unrealized losses segregated by the time period the investment has been in an unrealized loss position were as follows for the years ended (in thousands):

	December 31, 2005					
	Less than 12 months		Greater than 12 months		Total	
	Fair Value of Investments with Unrealized Losses	Gross Unrealized Losses	Fair Value of Investments with Unrealized Losses	Gross Unrealized Losses	Fair Value of Investments with Unrealized Losses	Gross Unrealized Losses
Debt Securities:						
Debt securities issued by U.S. government and agencies	$ 10,627	$ (155)	$ 24,328	$ (565)	$ 34,955	$ (720)
Obligations of states and political subdivisions	64,559	(877)	24,818	(616)	89,377	(1,493)
Corporate securities	33,820	(769)	29,586	(953)	63,406	(1,722)
Mortgage and asset backed securities	58,048	(953)	20,667	(649)	78,715	(1,602)
Totals	$ 167,053	$ (2,754)	$ 99,399	$ (2,783)	$ 266,452	$ (5,537)

	December 31, 2004					
	Less than 12 months		Greater than 12 months		Total	
	Fair Value of Investments with	Gross	Fair Value of Investments with	Gross	Fair Value of Investments with	Gross

	Unrealized Losses	Unrealized Losses	Unrealized Losses	Unrealized Losses	Unrealized Losses	Unrealized Losses
Debt Securities:						
Debt securities issued by U.S. government and agencies	$ 18,480	$ (138)	$ 4,871	$ (150)	$ 23,351	$ (288)
Obligations of states and political subdivisions	28,581	(257)	551	(14)	29,132	(271)
Corporate securities	23,323	(220)	7,450	(226)	30,773	(446)
Mortgage and asset backed securities	19,583	(167)	6,442	(129)	26,025	(296)
Totals	$ 89,967	$ (782)	$ 19,314	$ (519)	$ 109,281	$ (1,301)

MEADOWBROOK INSURANCE GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Liability for Losses and Loss Adjustment Expenses

The Company regularly updates its reserve estimates as new information becomes available and further events occur that may impact the resolution of unsettled claims. Changes in prior reserve estimates are reflected in results of operations in the year such changes are determined to be needed and recorded. Activity in the reserves for losses and loss adjustment expenses is summarized as follows (in thousands):

	For the Years Ended December 31,		
	2005	**2004**	**2003**
Balance, beginning of year	$ 378,157	$ 339,465	$ 374,933
Adjustment for deconsolidation of subsidiary(1)		(2,989)	
Less reinsurance recoverables	151,161	147,446	181,817
Net balance, beginning of year	226,996	189,030	193,116
Incurred related to:			
Current year	146,658	131,409	95,565
Prior years	4,884	4,529	2,907
Total incurred	151,542	135,938	98,472
Paid related to:			
Current year	28,059	26,534	21,446
Prior years	79,056	71,438	78,123
Total paid	107,115	97,972	99,569
Net balance, end of year	271,423	226,996	192,019
Plus reinsurance recoverables	187,254	151,161	147,446
Balance, end of year	$ 458,677	$ 378,157	$ 339,465

(1) In accordance with FIN 46(R), the Company performed an evaluation of its business relationships and determined that its wholly owned subsidiary, American Indemnity, did not meet the tests for consolidation, as neither the Company, nor its subsidiary Star, are the primary beneficiaries of American Indemnity. Therefore, effective January 1, 2004, the Company deconsolidated American Indemnity on a prospective basis in accordance with the provisions of FIN 46(R). The adoption of FIN 46(R) and the deconsolidation of American Indemnity did not have a material impact on the Company s consolidated balance sheet or consolidated statement of income.

As a result of adverse development on prior accident years reserves, the provision for loss and loss adjustment expenses increased by $4.9 million, $4.5 million, and $2.9 million, in calendar years 2005, 2004, and 2003, respectively.

For the year ended December 31, 2005, the Company reported net adverse development on loss and LAE of $4.9 million, or 2.2% of net loss and LAE reserves. There were no significant changes in the key assumptions utilized

in the analysis and calculations of the Company s reserves during 2005. The $4.9 million of adverse development reflects $1.6 million related to workers compensation programs, $1.6 million related to other lines of business, $1.1 million related to commercial auto programs, $392,000 related to commercial multiple peril and general liability programs and $179,000 related to residual markets.

For the year ended December 31, 2004, the Company reported net adverse development on loss and LAE of $4.5 million, or 2.4% of net loss and LAE reserves. There were no significant changes in the key assumptions utilized in the analysis and calculations of the Company s reserves during 2004. The $4.5 million of adverse development reflects $3.0 million related to commercial multiple peril and general liability programs, $2.7 million related to workers compensation programs, and $1.2 million related to commercial

MEADOWBROOK INSURANCE GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

auto programs. Partially offsetting this adverse development was favorable development on residual markets of $1.7 million, and other lines of business of $670,000.

For the year ended December 31, 2003, the Company reported net adverse development on loss and LAE of $2.9 million, or 1.5% of net loss and LAE reserves. There were no significant changes in the key assumptions utilized in the analysis and calculations of the Company s reserves during 2003. The $2.9 million of adverse development reflects $5.3 million related to commercial multiple peril and general liability programs. Partially offsetting this adverse development was favorable development on workers compensation programs of $2.7 million.

4. Reinsurance

The Insurance Company Subsidiaries cede insurance to other insurers under pro-rata and excess-of-loss contracts. These reinsurance arrangements diversify the Company s business and minimize its exposure to large losses or from hazards of an unusual nature. The ceding of insurance does not discharge the original insurer from its primary liability to its policyholder. In the event that all or any of the reinsuring companies are unable to meet their obligations, the Insurance Company Subsidiaries would be liable for such defaulted amounts. Therefore, the Company is subject to credit risk with respect to the obligations of its reinsurers. In order to minimize its exposure to significant losses from reinsurer insolvencies, the Company evaluates the financial condition of its reinsurers and monitors the economic characteristics of the reinsurers on an ongoing basis. The Company also assumes insurance from other insurers and reinsurers, both domestic and foreign, under pro-rata and excess-of-loss contracts. Based upon management s evaluation, they have concluded the reinsurance agreements entered into by the Company transfer both significant timing and underwriting risk to the reinsurer and, accordingly, are accounted for as reinsurance under the provisions of SFAS. No. 113 *Accounting and Reporting for Reinsurance for Short-Duration and Long-Duration Contracts.*

Intercompany pooling agreements are commonly entered into between affiliated insurance companies, so as to allow the companies to utilize the capital and surplus of all of the companies, rather than each individual company. Under pooling arrangements, companies share in the insurance business that is underwritten and allocate the combined premium, losses and related expenses between the companies within the pooling arrangement. Effective January 1, 2005, the Insurance Company Subsidiaries entered into an Inter-Company Reinsurance Agreement (the Pooling Agreement). This Pooling Agreement includes Star, Ameritrust Insurance Corporation (Ameritrust), Savers Property and Casualty Insurance Company (Savers) and Williamsburg National Insurance Company (Williamsburg). Pursuant to the Pooling Agreement, Savers, Ameritrust and Williamsburg have agreed to cede to Star and Star has agreed to reinsure 100% of the liabilities and expenses of Savers, Ameritrust and Williamsburg, relating to all insurance and reinsurance policies issued by them. In return, Star agrees to cede and Savers, Ameritrust and Williamsburg have agreed to reinsure Star for their respective percentages of the liabilities and expenses of Star. The Pooling Agreement was filed with the applicable regulatory authorities. Any changes to the Pooling Agreement must be submitted to the applicable regulatory authorities.

The Company receives ceding commissions in conjunction with reinsurance activities. These ceding commissions are offset against the related underwriting expenses and were $13.5 million, $12.1 million, and $11.7 million in 2005, 2004, and 2003, respectively.

At December 31, 2005 and 2004, the Company had reinsurance recoverables for paid and unpaid losses of $202.6 million and $169.1 million, respectively. The Company manages its credit risk on reinsurance recoverables by reviewing the financial stability, A.M. Best rating, capitalization, and credit worthiness of prospective and existing risk-sharing partners. The Company customarily collateralizes reinsurance balances due from non-admitted reinsurers through funds withheld trusts or stand-by letters of credit issued by highly rated banks. The largest unsecured reinsurance recoverable is due from an admitted reinsurer with an A A.M. Best rating and accounts for 43.8% of the total recoverable for paid and unpaid losses.

MEADOWBROOK INSURANCE GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company has historically maintained an allowance for the potential exposure to uncollectibility of certain reinsurance balances. At the end of each quarter, an analysis of these exposures is conducted to determine the potential exposure to uncollectibility. The following table sets forth the Company s exposure to uncollectible reinsurance and related allowances for the years ending December 31, 2005 and 2004 (in thousands):

	2005	2004
Gross Exposure	$ 14,046	$ 14,044
Collateral or other security	(2,749)	(3,323)
Allowance	(9,662)	(8,324)
Net Exposure	$ 1,635	$ 2,397

During 2005, in relation to a discontinued surety program, the Company received updated financial information from the liquidator of the reinsurer on that program. Based upon this information, the Company increased the allowance to 100% of the uncollateralized exposure as of June 30, 2005. In relation to a discontinued workers compensation program, the Company received updated information relating to the collectibility of the asset. As a result, the Company increased its exposure allowance to 75% of the uncollateralized exposure as of December 31, 2005. Although, the Company increased its allowance for these specific exposures, the actual exposures did not increase. While management believes this allowance to be adequate, no assurance can be given, however, regarding the future ability of any of the Company s risk-sharing partners to meet their obligations.

The Company maintains an excess-of-loss reinsurance treaty designed to protect against large or unusual loss and loss adjustment expense activity. The Company determines the appropriate amount of reinsurance primarily based on the Company s evaluation of the risks accepted, but also considers analysis prepared by consultants and reinsurers and on market conditions including the availability and pricing of reinsurance. To date, there have been no material disputes with the Company s excess-of-loss reinsurers. No assurance can be given, however, regarding the future ability of any of the Company s excess-of-loss reinsurers to meet their obligations.

Under the workers compensation reinsurance treaty, reinsurers are responsible for 100% of each loss in excess of $350,000, up to $5.0 million for each claimant, on losses occurring prior to April 1, 2005. The Company increased its retention from $350,000 to $750,000, for losses occurring on or after April 1, 2005. In addition, there is coverage for loss events involving more than one claimant up to $50.0 million per occurrence. In a loss event involving more than one claimant, the per claimant coverage is $10.0 million.

Under the core liability reinsurance treaty, the reinsurers are responsible for 100% of each loss in excess of $350,000, up to $2.0 million per occurrence on policies effective prior to June 1, 2005. The Company increased its retention from $350,000 to $500,000, for losses occurring on policies effective on or after June 1, 2005. The Company also purchased an additional $3.0 million of reinsurance clash coverage in excess of the $2.0 million to cover amounts that may be in excess of the $2.0 million policy limit, such as expenses associated with the settlement of claims or awards in excess of policy limits. Reinsurance clash coverage reinsures a loss when two or more policies are involved in a common occurrence.

The Company has a separate treaty to cover liability specifically related to commercial trucking, where reinsurers are responsible for 100% of each loss in excess of $350,000, up to $1.0 million for losses occurring prior to December 1, 2005. The Company increased its retention from $350,000 to $500,000 for losses occurring on or after December 1, 2005. In addition, the Company purchased an additional $1.0 million of reinsurance clash coverage. The Company also established a separate treaty to cover liability related to chemical distributors and repackagers, where reinsurers are responsible for 100% of each loss in excess of $500,000, up to $1.0 million, applied separately to general liability and auto liability.

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MEADOWBROOK INSURANCE GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Under the property reinsurance treaty, reinsurers are responsible for 100% of the amount of each loss in excess of $500,000, up to $5.0 million per location for an occurrence. In addition, there is coverage for loss events involving multiple locations up to $20.0 million after the Company has incurred $750,000 in loss. There were no significant changes to the terms of this reinsurance treaty from 2005 to 2004.

Under the semi-automatic facultative reinsurance treaties, covering the Company s umbrella policies, the reinsurers are responsible for a minimum of 85% of the first million in coverage and 100% of each of $2.0 million through $5.0 million of coverage. The reinsurers pay a ceding commission to reimburse the Company for its expenses associated with the treaties.

Effective September 30, 2004, the Company amended an existing reinsurance agreement that provided reinsurance coverage for policies with effective dates from August 1, 2003 to July 31, 2004, which were written in the Company s public entity excess liability program. This reinsurance agreement provided coverage on an excess-of-loss basis for each occurrence in excess of the policyholder s self-insured and the Company s retained limit. This reinsurance agreement was amended by revising premium rate and loss coverage terms, which effected the transfer of risk to the reinsurer and reduced the net estimated costs of reinsurance to the Company. The amended reinsurance cost for this coverage is a flat percentage of premium subject to this treaty and provides reinsurance coverage of $4.0 million in excess of $1.0 million for each occurrence in excess of the policyholder s self-insured retention. These amended terms were applicable to the renewal of this reinsurance agreement for the period August 1, 2004 to January 31, 2006.

In addition, the Company purchased $10.0 million in excess of $5.0 million for each occurrence, which is above the underlying $5.0 million of coverage for the Company s public entity excess liability program. Under this agreement, reinsurers are responsible for 100% of each loss in excess of $5.0 million for all lines, except workers compensation, which is covered by the Company s core catastrophic workers compensation treaty structure up to $50.0 million per occurrence.

Additionally, several small programs have separate reinsurance treaties in place, which limit the Company s exposure to $350,000 or less.

Facultative reinsurance is purchased for property values in excess of $5.0 million, casualty limits in excess of $2.0 million, or for coverage not covered by a treaty. There were no significant changes to the terms of this reinsurance treaty from 2004 to 2005.

Reconciliations of direct to net premiums, on a written and earned basis, for 2005, 2004, and 2003 are as follows (in thousands):

	2005		2004		2003	
	Written	**Earned**	**Written**	**Earned**	**Written**	**Earned**
Direct	$ 264,571	$ 264,381	$ 261,653	$ 247,169	$ 229,647	$ 198,991
Assumed(1)	67,698	61,141	51,840	41,699	23,633	13,290
Ceded	(74,075)	(75,563)	(79,532)	(74,375)	(63,453)	(61,076)
Net	$ 258,194	$ 249,959	$ 233,961	$ 214,493	$ 189,827	$ 151,205

(1) For the years ending December 31, 2005, 2004, and 2003, $56.0 million, $38.2 million, and $15.6 million, relates to assumed business the Company manages directly, respectively. The related transactions of this business are processed through the Company s internal systems and related controls. In addition, the Company does not assume any foreign reinsurance.

One reinsurer, with a financial strength rating of A (Excellent) rated by A.M. Best, accounts for 12.9% of ceded premiums in 2005.

MEADOWBROOK INSURANCE GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. Segment Information

The Company defines its operations as specialty risk management operations and agency operations based upon differences in products and services. The separate financial information of these segments is consistent with the way results are regularly evaluated by management in deciding how to allocate resources and in assessing performance. Intersegment revenue is eliminated upon consolidation. It would be impracticable for the Company to determine the allocation of assets between the two segments.

Specialty Risk Management Operations

The specialty risk management operations segment focuses on specialty or niche insurance business in which it provides various services and coverages tailored to meet specific requirements of defined client groups and their members. These services include risk management consulting, claims administration and handling, loss control and prevention, and reinsurance placement, along with various types of property and casualty insurance coverage, including workers compensation, commercial multiple peril, general liability, commercial auto liability, and inland marine. Insurance coverage is provided primarily to associations or similar groups of members and to specified classes of business of the Company s agent-partners. The Company recognizes revenue related to the services and coverages the specialty risk management operations provides within seven categories: net earned premiums, management fees, claims fees, loss control fees, reinsurance placement, investment income, and net realized gains.

Agency Operations

The Company earns commissions through the operation of its retail property and casualty insurance agency, which was formed in 1955. The agency is one of the largest agencies in Michigan and, with acquisitions, has expanded into California and Florida. The agency operations produce commercial, personal lines, life, and accident and health insurance, for more than fifty unaffiliated insurance carriers. The agency produces an immaterial amount of business for its affiliated Insurance Company Subsidiaries.

MEADOWBROOK INSURANCE GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table sets forth the segment results (in thousands):

	For the Years Ended December 31,		
	2005	2004	2003
Revenues			
Net earned premiums	$ 249,959	$ 214,493	$ 151,205
Management fees	16,741	16,253	18,751
Claims fees(4)	7,113	13,207	14,756
Loss control fees	2,260	2,174	2,303
Reinsurance placement	660	420	308
Investment income	17,692	14,887	13,471
Net realized gains	85	339	823
Specialty risk management	294,510	261,773	201,617
Agency operations(2)	11,304	9,805	9,378
Reconciling items(3)	365	24	13
Intersegment revenue(2)	(2,162)	(1,324)	(205)
Consolidated revenue	$ 304,017	$ 270,278	$ 210,803
Pre-tax income:			
Specialty risk management(1) & (2)	$ 29,444	$ 23,205	$ 16,703
Agency operations(1) & (2)	3,343	2,257	2,064
Other corporate	(7,121)	(5,088)	(2,489)
Consolidated pre-tax income	$ 25,666	$ 20,374	$ 16,278

(1) The Company s agency operations include an allocation of corporate overhead, which includes expenses associated with accounting, information services, legal, and other corporate services. The corporate overhead allocation excludes those expenses specific to the holding company. Prior to January 1, 2005, corporate overhead was only reflected in the specialty risk management operations segment. This reclassification for the allocation of corporate overhead more accurately presents the Company s segments as a result of improved cost allocation information. As a result, the segment information for the years ended December 31, 2004 and 2003 have been adjusted to reflect this allocation. For the years ended December 31, 2005, 2004, and 2003, the allocation of corporate overhead to the agency operations segment was $3.1 million, $3.5 million, and $2.8 million, respectively.

(2) In addition to the reclassification for the allocation of corporate overhead as described above, the Company also reclassified 2004 and 2003 revenues related to the conversion of a west-coast commercial transportation program, which was converted to a specialty risk program with one of its subsidiaries, from the agency operations segment to the specialty risk management operations segment. Accordingly, the agency operations revenue and intersegment revenue have been reclassified. As a result, $7.9 million and $5.6 million were reclassified within the agency operations segment and the intersegment revenue for the years ended December 31, 2004 and 2003,

respectively. In addition, the overall net income related to this subsidiary was reclassified from the agency operations to the specialty risk management operations segment. As a result, pre-tax net income of $3.2 million and $2.0 million related to this subsidiary was reclassified to the specialty risk management operations pre-tax income from the agency operations segment for the years ended December 31, 2004 and 2003, respectively.

(3) In December 2003, the Company entered into a Purchase and Sale Agreement with an unaffiliated third party for the sale of land. In July 2004, a land contract was executed and the transaction closed in escrow subject to the conveyance of certain land by the city to both parties. In May 2005, the settlement of the land contract was completed. The sale of this land resulted in a total gain of approximately $464,000. In accordance with SFAS No. 66 *Accounting for Sales of Real Estate,* the Company recorded this transaction based on the installment method of accounting. Accordingly, the Company recorded a gain of $82,000, as of June 30, 2005, which reflects a portion of the total gain allocated proportionately based on the down payment to the total purchase price. The remaining $382,000 will be deferred until the land contract is paid in full, or as principal payments are received. In addition, the Company has received $121,000 in interest income related to the land contract, which has been included in reconciling items. The remaining $162,000 in reconciling items relates to miscellaneous interest income.

MEADOWBROOK INSURANCE GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(4) During 2004, the Company accelerated the recognition of $3.5 million in deferred claim revenue, as a result of an earlier than anticipated termination of two limited duration administrative services and multi-state claims run-off contracts. These contracts had been terminated by the liquidator for the companies during the third quarter of 2004. Had the contract not been terminated, the Company would have received additional claims fee revenue for continued claims handling services.

The following table sets forth the pre-tax income (loss) reconciling items (in thousands):

	For the Years Ended December 31,		
	2005	2004	2003
Holding company expenses	$ (2,892)	$ (2,431)	$ (1,159)
Amortization	(373)	(376)	(353)
Interest expense	(3,856)	(2,281)	(977)
	$ (7,121)	$ (5,088)	$ (2,489)

6. Debt

Lines of Credit

In November 2004, the Company entered into a revolving line of credit for up to $25.0 million. The revolving line of credit replaced the Company s former term loan and line of credit and expires in November 2007. The Company had drawn approximately $9.0 million on this new revolving line of credit to pay off its former term loan. The Company uses the revolving line of credit to meet short-term working capital needs. Under the revolving line of credit, the Company and certain of its non-regulated subsidiaries pledged security interests in certain property and assets of the Company and named subsidiaries.

At December 31, 2005 and 2004, the Company had an outstanding balance of $5.0 million and $9.0 million, respectively, on the revolving line of credit.

The revolving line of credit provides for interest at a variable rate based, at the Company s option, upon either a prime based rate or LIBOR based rate. In addition, the revolving line of credit also provides for an unused facility fee. On prime based borrowings, the applicable margin ranges from 75 to 25 basis points below prime. On LIBOR based borrowings, the applicable margin ranges from 125 to 175 basis points above LIBOR. The margin for all loans is dependent on the sum of non-regulated earnings before interest, taxes, depreciation, amortization, and non-cash impairment charges related to intangible assets for the preceding four quarters, plus dividends paid or payable to the Company from subsidiaries during such period (Adjusted EBITDA). At December 31, 2005, the average interest rate for LIBOR based borrowings outstanding was 4.7%.

Debt covenants consist of: (1) maintenance of the ratio of Adjusted EBITDA to interest expense of 2.0 to 1.0, (2) minimum net worth of $130.0 million and increasing annually commencing June 30, 2005, by fifty percent of the prior year s positive net income, (3) minimum A.M. Best rating of B , and (4) minimum Risk Based Capital Ratio for Star of 1.75 to 1.00. As of December 31, 2005, the Company was in compliance with these covenants.

In addition, a non-insurance premium finance subsidiary of the Company maintains a line of credit with a bank, which permits borrowings up to 75% of the accounts receivable, which collateralize the line of credit. At December 31, 2005 and 2004, this line of credit had an outstanding balance of $2.0 million and $3.1 million, respectively. On April 26, 2005, the terms of this line of credit were modified. The modifications included a decrease in the line of credit from $8.0 million to $6.0 million. The interest terms of this line of credit provide for interest at the prime rate minus 0.5%, or a LIBOR-based rate, plus 2.0%. At December 31, 2005, the average interest rate on this line of credit

was 5.2%.

MEADOWBROOK INSURANCE GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Senior Debentures

In April 2004, the Company issued senior debentures in the amount of $13.0 million. The senior debentures mature in thirty years and provide for interest at the three-month LIBOR, plus 4.0%, which is non-deferrable. At December 31, 2005, the interest rate was 8.33%. The senior debentures are callable by the Company at par after five years from the date of issuance. Associated with this transaction, the Company incurred $390,000 of commissions paid to the placement agents. These issuance costs have been capitalized and are included in other assets on the balance sheet, which are being amortized over seven years as a component of interest expense.

In May 2004, the Company issued senior debentures in the amount of $12.0 million. The senior debentures mature in thirty years and provide for interest at the three-month LIBOR, plus 4.2%, which is non-deferrable. At December 31, 2005, the interest rate was 8.59%. The senior debentures are callable by the Company at par after five years from the date of issuance. Associated with this transaction, the Company incurred $360,000 of commissions paid to the placement agents. These issuance costs have been capitalized and are included in other assets on the balance sheet, which are being amortized over seven years as a component of interest expense.

The Company contributed $9.9 million of the proceeds to its Insurance Company Subsidiaries in December 2004. The remaining proceeds from the issuance of the senior debentures may be used to support future premium growth through further contributions to the Insurance Company Subsidiaries and general corporate purposes.

Junior Subordinated Debentures

In September 2005, Meadowbrook Capital Trust II (the Trust II), an unconsolidated subsidiary trust of the Company, issued $20.0 million of mandatorily redeemable trust preferred securities (TPS) to a trust formed by an institutional investor. Contemporaneously, the Company issued $20.6 million in junior subordinated debentures, which includes the Company s investment in the trust of $620,000. These debentures have financial terms similar to those of the TPS, which includes the deferral of interest payments at any time, or from time-to-time, for a period not exceeding five years, provided there is no event of default. These debentures mature in thirty years and provide for interest at the three-month LIBOR, plus 3.58%. At December 31, 2005, the interest rate was 8.07%. These debentures are callable by the Company at par beginning in October 2010.

The Company received $19.4 million in net proceeds, after the deduction of approximately $600,000 of commissions paid to the placement agents in the transaction. These issuance costs have been capitalized and are included in other assets on the balance sheet, which will be amortized over seven years as a component of interest expense.

The Company contributed $10.0 million of the proceeds from the issuance of these debentures to its Insurance Company Subsidiaries and the remaining balance will be used for general corporate purposes.

In September 2003, Meadowbrook Capital Trust (the Trust), an unconsolidated subsidiary trust of the Company, issued $10.0 million of mandatorily redeemable TPS to a trust formed by an institutional investor. Contemporaneously, the Company issued $10.3 million in junior subordinated debentures, which includes the Company s investment in the trust of $310,000. These debentures have financial terms similar to those of the TPS, which includes the deferral of interest payments at any time, or from time-to-time, for a period not exceeding five years, provided there is no event of default. These debentures mature in thirty years and provide for interest at the three-month LIBOR, plus 4.05%. At December 31, 2005, the interest rate was 8.07%. These debentures are callable by the Company at par beginning in October 2008.

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The Company received $9.7 million in net proceeds, after the deduction of approximately $300,000 of commissions paid to the placement agents in the transaction. These issuance costs have been capitalized and are included in other assets on the balance sheet, which are being amortized over seven years as a component of interest expense.

The Company contributed $6.3 million of the proceeds from the issuance of these debentures to its Insurance Company Subsidiaries and the remaining balance has been used for general corporate purposes.

The junior subordinated debentures are unsecured obligations of the Company and are junior to the right of payment to all senior indebtedness of the Company. The Company has guaranteed that the payments made to both Trusts will be distributed by the Trusts to the holders of the TPS.

The Company estimates that the fair value of the above mentioned junior subordinated debentures and senior debentures issued approximate the gross proceeds of cash received at the time of issuance.

The seven year amortization period in regard to the issuance costs represents management s best estimate of the estimated useful life of the bonds related to both the senior debentures and junior subordinated debentures described above.

7. Derivative Instruments

In October 2005, the Company entered into two interest rate swap transactions with LaSalle Bank (LaSalle) to mitigate its interest rate risk on $5.0 million and $20.0 million of the Company s senior debentures and trust preferred securities, respectively. The Company will recognize these transactions in accordance with SFAS No. 133 *Accounting for Derivative Instruments and Hedging Activities,* as subsequently amended. These interest rate swap transactions have been designated as a cash flow hedge and are deemed a highly effective transaction under SFAS No. 133. In accordance with SFAS No. 133, these interest rate swap transactions are recorded at fair value on the balance sheet and any changes in their fair value are accounted for within other comprehensive income. The interest differential to be paid or received is being accrued and is being recognized as an adjustment to interest expense.

The first interest rate swap transaction, which relates to $5.0 million of the Company s $12.0 million issuance of senior debentures, has an effective date of October 6, 2005 and ending date of May 24, 2009. The Company is required to make certain quarterly fixed rate payments to LaSalle calculated on a notional amount of $5.0 million, non-amortizing, based on a fixed annual interest rate of 8.925%. LaSalle is obligated to make quarterly floating rate payments to the Company referencing the same notional amount, based on the three-month LIBOR, plus 4.20%.

The second interest rate swap transaction, which relates to $20.0 million of the Company s $20.0 million issuance of trust preferred securities, has an effective date of October 6, 2005 and ending date of September 16, 2010. The Company is required to make quarterly fixed rate payments to LaSalle calculated on a notional amount of $20.0 million, non-amortizing, based on a fixed annual interest rate of 8.34%. LaSalle is obligated to make quarterly floating rate payments to the Company referencing the same notional amount, based on the three-month LIBOR, plus 3.58%.

In relation to the above interest rate swaps, the net interest expense incurred for the year ended December 31, 2005, was approximately $4,000. The total fair value of the interest rate swaps as of December 31, 2005, was approximately $14,000. Accumulated other comprehensive income at December 31, 2005 included the accumulated income on the cash flow hedge, net of taxes, of $9,100.

In July 2005, the Company made a $2.5 million loan, at an effective interest rate equal to the three-month LIBOR, plus 5.2%, to an unaffiliated insurance agency. In December 2005, the Company loaned an additional $3.5 million to the unaffiliated insurance agency. The original $2.5 million demand note was replaced with a $6.0 million convertible note. The effective interest rate of the convertible note is equal to the

MEADOWBROOK INSURANCE GROUP, INC.
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three-month LIBOR, plus 5.2% and is due December 20, 2010. This agency has been a producer for the Company for over ten years. As security for the loan, the borrower granted the Company a security interest in its accounts, cash, general intangibles, and other intangible property. Also, the shareholder then pledged 100% of the common shares of three insurance agencies, the common shares owned by the shareholder in another agency, and has executed a personal guaranty. This note is convertible at the option of the Company based upon a pre-determined formula, beginning in 2007. The conversion feature of this note is considered an embedded derivative pursuant to SFAS No. 133, and therefore is accounted for separately from the note. At December 31, 2005, the estimated fair value of the derivative is zero.

8. Regulatory Matters and Rating Issues

A significant portion of the Company s consolidated assets represent assets of the Insurance Company Subsidiaries that at this time, without prior approval of the State of Michigan Office of Financial and Insurance Services (OFIS), cannot be transferred to the holding company in the form of dividends, loans or advances. The restriction on the transferability to the holding company from its Insurance Company Subsidiaries is regulated by Michigan insurance regulatory statutes which, in general, are as follows: the maximum discretionary dividend that may be declared, based on data from the preceding calendar year, is the greater of each insurance company s net income (excluding realized capital gains) or ten percent of the insurance company s surplus (excluding unrealized gains). These dividends are further limited by a clause in the Michigan law that prohibits an insurer from declaring dividends, except from surplus earnings of the company. Earned surplus balances are calculated on a quarterly basis. Since Star is the parent insurance company, its maximum dividend calculation represents the combined Insurance Companies Subsidiaries surplus. Based upon the 2005 statutory financial statements, Star may only pay dividends to the Company during 2006 with the prior approval of OFIS. Star s earned surplus position at December 31, 2005 was negative $7.2 million. No dividends were paid in 2005 or 2004.

Summarized 2005 and 2004 statutory basis information for the primary insurance subsidiaries, which differs from generally accepted accounting principles, follows (in thousands):

	2005				2004			
	Star	**Savers**	**Williamsburg**	**Ameritrust**	**Star**	**Savers**	**Williamsburg**	**Ameritrust**
Statutory capital and surplus	$ 141,136	$ 31,883	$ 16,447	$ 14,398	$ 120,727	$ 29,303	$ 15,579	$ 13,001
RBC authorized control level	37,265	7,673	4,043	4,000	28,436	3,572	2,600	4,000
Statutory net income (loss)	13,446	283	(518)	539	7,040	(1,816)	2,544	4

Insurance operations are subject to various leverage tests (e.g. premium to statutory surplus ratios), which are evaluated by regulators and rating agencies. The Company s targets for gross and net written premium to statutory surplus are 2.8 to 1.0 and 2.25 to 1.0, respectively. The Company contributed $10.0 million to the surplus of the Insurance Company Subsidiaries during the third quarter of 2005 and $9.9 million during the third quarter of 2004. As of December 31, 2005, on a statutory combined basis, the gross and net premium leverage ratios were 2.4 to 1.0 and 1.8 to 1.0, respectively.

The National Association of Insurance Commissioners (NAIC) has adopted a risk-based capital (RBC) formula to be applied to all property and casualty insurance companies. The formula measures required capital and surplus based on an insurance company s products and investment portfolio and is used as a tool to evaluate the capital of regulated companies. The RBC formula is used by state insurance regulators to monitor trends in statutory capital and surplus for the purpose of initiating regulatory action. In general, an insurance company must submit a calculation of its RBC

formula to the insurance department of its state of domicile as of the end of the previous calendar year. These laws require increasing degrees of regulatory

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oversight and intervention as an insurance company s RBC declines. The level of regulatory oversight ranges from requiring the insurance company to inform and obtain approval from the domiciliary insurance commissioner of a comprehensive financial plan for increasing its RBC to mandatory regulatory intervention requiring an insurance company to be placed under regulatory control in a rehabilitation or liquidation proceeding.

The RBC Model Act provides for four different levels of regulatory attention depending on the ratio of the company s total adjusted capital, defined as the total of its statutory capital, surplus and asset valuation reserve, to its risk-based capital.

At December 31, 2005, all of the Insurance Company Subsidiaries were in compliance with RBC requirements. Star reported statutory surplus of $141.1 million and $120.7 million at December 31, 2005 and 2004, respectively. The calculated RBC was $37.3 million in 2005 and $28.4 million in 2004. The threshold requiring the minimum regulatory involvement was $74.5 million in 2005 and $56.9 million in 2004.

9. Deferred Policy Acquisition Costs

The following table reflects the amounts of policy acquisition costs deferred and amortized (in thousands):

	For the Years Ended December 31,		
	2005	**2004**	**2003**
Balance, beginning of period	$ 25,167	$ 19,564	$ 12,140
Acquisition costs deferred	35,367	30,883	25,626
Amortized to expense during the period	(34,163)	(25,280)	(18,202)
Balance, end of period	$ 26,371	$ 25,167	$ 19,564

The Company reduces deferred policy acquisition costs for premium deficiencies. There were no premium deficiencies at December 31, 2005, 2004, and 2003.

10. Income Taxes

The provision for income taxes consists of the following (in thousands):

	For the Years Ended December 31,		
	2005	**2004**	**2003**
Current tax expense	$ 6,410	$ 4,775	$ 1,767
Deferred tax expense	1,347	1,577	4,415
Total provision for income tax expense	$ 7,757	$ 6,352	$ 6,182

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A reconciliation of the Company s tax provision on income from operations to the U.S. federal income tax rate of 35% in 2005, and 34% in 2004 and 2003 is as follows (in thousands):

	For the Years Ended December 31,		
	2005	**2004**	**2003**
Tax provision at statutory rate	$ 8,982	$ 6,927	$ 5,535
Tax effect of:			
Tax exempt interest	(1,291)	(777)	(371)
State income taxes, net of federal benefit	458	38	816
Impact of increase in statutory rate relating to deferred tax assets at December 31, 2005	(386)		
Other, net	(6)	164	202
Federal income tax expense	$ 7,757	$ 6,352	$ 6,182
Effective tax expense rate	30.2%	31.2%	38.0%

The current statutory tax rate of 35% is based upon $25.0 million of taxable income. The 2004 statutory tax rate of 34% is based upon $6.8 million of taxable income after the utilization of $13.1 million of net operating loss carryforwards. At $18.3 million of taxable income, the statutory tax rate increased to 35%. At December 31, 2005 and 2004, the current taxes payable were $268,000 and $378,000, respectively.

Deferred federal income taxes, under SFAS No. 109, *Accounting for Income Taxes* , reflect the estimated future tax effect of temporary differences between the bases of assets and liabilities for financial reporting purposes and such amounts as measured by tax laws and regulations.

MEADOWBROOK INSURANCE GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The components of deferred tax assets and liabilities as of December 31, 2005 and 2004 are as follows (in thousands):

	2005		2004	
	Deferred Tax Assets	Deferred Tax Liabilities	Deferred Tax Assets	Deferred Tax Liabilities
Unpaid losses and loss adjustment expenses	$ 14,125	$	$ 11,815	$
Unearned premium reserves	8,248		7,512	
Unrealized loss/gains on investments	608			2,487
Deferred policy acquisition expense		9,230		8,557
Allowance for doubtful accounts	1,330		1,440	
Policyholder dividends	208		112	
Alternate minimum tax credit	637		4,061	
Net operating loss carryforward			125	
Goodwill		1,529		1,131
Deferred revenue	125		147	
Long term incentive plan	865		442	
Amortization of intangible assets	227		171	
Deferred gain on sale-leaseback transaction	262		284	
Other	754		1,022	
Total deferred taxes	27,389	10,759	27,131	12,175
Net deferred tax assets	$ 16,630		$ 14,956	

Realization of the deferred tax asset is dependent on generating sufficient taxable income to absorb the applicable reversing temporary differences. Refer to Note 1 *Summary of Significant Accounting Policies*.

11. Stock Options and Long Term Incentive Plan

The Company, through its 1995 and 2002 Amended and Restated Stock Option Plans (the Plans), may grant options to key executives and other members of management of the Company and its subsidiaries in amounts not to exceed 2,000,000 shares of the Company s common stock in each plan. The Plans are administered by the Compensation Committee (the Committee) appointed by the Board of Directors. Option shares may be exercised subject to the terms of the Plans and the terms prescribed by the Committee at the time of grant. Currently, the Plans options have either five or ten-year terms and are exercisable/vest in equal increments over the option term.

MEADOWBROOK INSURANCE GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following is a summary of the Company s stock option activity and related information for the years ended December 31:

	2005		2004		2003	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding beginning of year	2,121,317	$ 5.53	2,381,609	$ 5.80	2,693,223	$ 6.78
Granted					331,490	$ 2.17
Exercised	(97,825)	$ 2.90	(39,500)	$ 2.74	(550)	$ 2.82
Forfeited	(417,591)	$ 6.57	(220,792)	$ 8.97	(642,554)	$ 8.01
Outstanding end of year	1,605,901	$ 5.42	2,121,317	$ 5.53	2,381,609	$ 5.80
Exercisable at end of year	1,288,296	$ 5.65	1,451,015	$ 5.92	1,231,981	$ 6.75
Weighted-average fair value of options granted during the year					$ 1.14	

The following table summarizes information about stock options outstanding at December 31, 2005:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Options	Weighted-Average Remaining Life (Years)	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
$2.173 to $3.066	496,700	1.8	$ 2.66	327,690	$ 2.74
$3.507	575,000	1.4	$ 3.51	460,000	$ 3.51
$6.48 to $6.5063	395,000	0.7	$ 6.51	393,500	$ 6.51
$10.91 to $30.45	139,201	2.1	$ 20.10	107,106	$ 20.60
	1,605,901	1.5	$ 5.42	1,288,296	$ 5.65

In 2004, the Company approved the adoption of a Long Term Incentive Plan (the LTIP). The LTIP provides participants with the opportunity to earn cash and stock awards based upon the achievement of specified financial goals over a three-year performance period with the first performance period commencing January 1, 2004. At the end of the three-year performance period, and if the performance target is achieved, the Compensation Committee of the Board of Directors shall determine the amount of LTIP awards that are payable to participants in the LTIP. One-half of any LTIP award will be payable in cash and one-half of the award will be payable in the form of a restricted stock

award. If the Company achieves the three-year performance target, payment of the cash portion of the award would be made in three annual installments, with the first payment being paid as of the end of the performance period and the remaining two payments to be paid in the fourth and fifth year. Any unpaid portion of a cash award is subject to forfeiture if the participant voluntarily leaves the Company or is discharged for cause. The portion of the award to be paid in the form of stock will be issued as of the end of the performance period The number of shares of Company s common stock subject to the restricted stock award shall equal the dollar amount of one-half of the LTIP award divided by the fair market value of Company s common stock on the first date of the performance period. The restricted stock awards shall be made subject to the terms and conditions of the LTIP and Plans. The Company accrues awards based upon the criteria set-forth and approved by the Compensation Committee of the Board of Directors, as included in the LTIP. At December 31, 2005, the Company had $894,000 and $1.6 million accrued for the cash and restricted stock award, respectively, for a total accrual of $2.5 million under the LTIP. At December 31, 2004, the Company had $650,000 and $650,000 accrued for the cash and restricted stock award, respectively, for a total accrual of $1.3 million under the LTIP.

MEADOWBROOK INSURANCE GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Accordingly, the Company included 392,988 shares diluted earnings per share for the year ended December 31, 2005. There were no shares included in diluted earnings per share for the year ended December 31, 2004.

12. Shareholders Equity

At December 31, 2005, shareholders equity was $177.4 million, or a book value of $6.19 per common share, compared to $167.5 million, or a book value of $5.76 per common share at December 31, 2004.

In June 2002, the Company sold 18,500,000 shares of newly issued common stock at $3.10 per share in a public offering. In addition, the underwriters exercised their over-allotment option to acquire 2,775,000 of additional shares of the Company s common stock. In conjunction with the public offering, the Company issued warrants entitling the holders to purchase an aggregate of 300,000 shares of common stock at $3.10 per share. The warrants could be exercised at any time from June 6, 2003 through June 6, 2005, at which time any warrants not exercised would become void. In July 2004, the holders exercised 15,000 warrants. In May 2005, the remaining 285,000 outstanding warrants were exercised.

In November 2004, the Company s Board of Directors authorized management to repurchase up to 1,000,000 shares of its common stock in market transactions for a period not to exceed twenty-four months. At its regularly scheduled board meeting on October 28, 2005, the Company s Board of Directors authorized management to purchase up to 1,000,000 shares, or approximately 3%, of its common stock in market transactions for a period not to exceed twenty-four months, replacing its current share repurchase program originally authorized in November 2004. For the year ended December 31, 2005, the Company purchased and retired 772,900 shares of common stock for a total cost of approximately $4.2 million. The Company did not repurchase any common stock during 2004. As of December 31, 2005, the cumulative amount the Company repurchased and retired under the current share repurchase plan was 772,900 shares of common stock for a total cost of approximately $4.2 million.

The Company s Board of Directors did not declare a dividend in 2005 or 2004. When evaluating the declaration of a dividend, the Board of Directors considers a variety of factors, including but not limited to, the Company s cash flow, liquidity needs, results of operations and its overall financial condition. As a holding company, the ability to pay cash dividends is partially dependent on dividends and other permitted payments from its subsidiaries. The Company did not receive any dividends from its regulated insurance subsidiaries in 2005 and 2004. Refer to Note 8 *Regulatory Matters and Rating Issues* for additional information regarding dividend restrictions.

13. Goodwill and Other Intangible Assets

Goodwill

The Company evaluates existing goodwill for impairment on an annual basis as of October 1st, or more frequently if events or changes in circumstances indicate that the asset might be impaired. The Company carries goodwill on two reporting units within the agency operations segment in the amount of $5.8 million and three reporting units within the specialty risk management operations segment in the amount of $25.0 million. The operating results for the reporting units that carry goodwill have historically generated profits.

In 2005, the Company acquired a Florida based agency that generated $1.8 million in goodwill. During 2005, 2004, and 2003, the Company did not record any impairment losses in relation to its existing goodwill.

MEADOWBROOK INSURANCE GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following sets forth the carrying amount of goodwill by business segment (in thousands):

	Agency Operations	Specialty Risk Management Operations	Total
Balance at December 31, 2005	$ 5,769	$ 25,033	$ 30,802
Balance at December 31, 2004	$ 3,964	$ 25,033	$ 28,997

Other Intangible Assets

At December 31, 2005 and 2004, the Company had other intangible assets, net of related accumulated amortization, of $2.4 million and $1.1 million, respectively, recorded on the consolidated balance sheet as part of Other Assets .

During the fourth quarter 2005, the Company acquired a Florida based agency and its related book of business. The total purchase price of this acquisition was $3.5 million, consisting of $1.7 million recognized as an other intangible asset. The remaining $1.8 million relates to goodwill, as indicated above. There was an immaterial amount of tangible assets related to this acquisition. The Company is amortizing $1.2 million of the other intangible asset related to the purchase over a five year period. The remaining $500,000 of the other intangible asset has an indefinite life and is evaluated annually in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets.*

During the first quarter of 2003, the Company completed a purchase of the renewal rights of a book of business. The total purchase price was determined based on a percentage of estimated gross written premium collected by the Company. The actual purchase price was contingent upon actual written premium collected over a three year period. As of December 31, 2005, the total purchase price was estimated at $2.3 million, consisting of $1.3 million of fixed assets and $994,000 recognized as an other intangible asset being amortized over a five-year period.

At December 31, 2005 and 2004, the gross carrying amount of other intangible assets was $3.3 million and $1.8 million, respectively, and the accumulated amortization was $942,000 and $744,000, respectively. Amortization expense related to other intangible assets for 2005, 2004, and 2003, was $373,000, $376,000, and $353,000, respectively.

Amortization expense for the five succeeding years is as follows (in thousands):

2006	$ 410
2007	407
2008	108
2009	101
2010	95
Total amortization expense	$ 1,121

14. Commitments and Contingencies

The Company has certain operating lease agreements for its offices and equipment. A majority of the Company s lease agreements contain renewal options and rent escalation clauses. At December 31, 2005,

MEADOWBROOK INSURANCE GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

future minimum rental payments required under non-cancelable long-term operating leases are as follows (in thousands):

2006	$ 2,442
2007	2,210
2008	1,851
2009	1,685
2010	1,448
Thereafter	3,739
Total minimum lease commitments	$ 13,375

Rent expense for the year ended December 31, 2005, 2004, and 2003, amounted to $2.2 million, $3.3 million, and $3.2 million, respectively.

In June 2003, the Company entered into a guaranty agreement with a bank. The Company is guaranteeing payment of a $1.5 million term loan issued by the bank to an unaffiliated insurance agency. In the event of default on the term loan by the insurance agency, the Company is obligated to pay any outstanding principal (up to a maximum of $1.5 million), as well as any accrued interest on the loan, and any costs incurred by the bank in the collection process. In exchange for the Company s guaranty, the president and member of the unaffiliated insurance agency pledged 100% of the common stock of two insurance agencies that he wholly owns. In the event of default of the term loan by the unaffiliated insurance agency, the Company has the right to sell all or a portion of the pledged assets (the common stock of the two insurance agencies) and use the proceeds from the sale to recover any amounts paid under the guaranty agreement. Any excess proceeds would be paid to the president and member of the insurance agency who is the sole shareholder. As of December 31, 2005, no liability has been recorded with respect to the Company s obligations under the guaranty agreement, since the collateral is in excess of the guaranteed amount. On January 30, 2006, the unaffiliated insurance agency paid off the term loan in full. As such, the Company s legal obligations under the guaranty agreement terminated.

Most states require admitted property and casualty insurers to become members of insolvency funds or associations, which generally protect policyholders against the insolvency of such insurers. Members of the fund or association must contribute to the payment of certain claims made against insolvent insurers. Maximum contributions required by law in any one year vary between 1% and 2% of annual premium written by a member in that state. Assessments from insolvency funds were $664,000, $784,000, and $783,000, respectively, for 2005, 2004, and 2003. Most of these payments are recoverable through future policy surcharges and premium tax reductions.

The Company s Insurance Company Subsidiaries are also required to participate in various mandatory insurance facilities or in funding mandatory pools, which are generally designed to provide insurance coverage for consumers who are unable to obtain insurance in the voluntary insurance market. Among the pools participated in are those established in certain states to provide windstorm and other similar types of property coverage. These pools typically require all companies writing applicable lines of insurance in the state for which the pool has been established to fund deficiencies experienced by the pool based upon each company s relative premium writings in that state, with any excess funding typically distributed to the participating companies on the same basis. To the extent that reinsurance treaties do not cover these assessments, they may have an adverse effect on the Company. Total assessments paid to all such facilities were $3.0 million, $2.3 million, and $2.4 million, respectively, for 2005, 2004, and 2003.

The Company, and its subsidiaries, are subject at times to various claims, lawsuits and proceedings relating principally to alleged errors or omissions in the placement of insurance, claims administration,

MEADOWBROOK INSURANCE GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

consulting services and other business transactions arising in the ordinary course of business. Where appropriate, the Company vigorously defends such claims, lawsuits and proceedings. Some of these claims, lawsuits and proceedings seek damages, including consequential, exemplary or punitive damages, in amounts that could, if awarded, be significant. Most of the claims, lawsuits and proceedings arising in the ordinary course of business are covered by errors and omissions insurance or other appropriate insurance. In terms of deductibles associated with such insurance, the Company has established provisions against these items, which are believed to be adequate in light of current information and legal advice. In accordance with SFAS No. 5, *Accounting for Contingencies,* if it is probable that an asset has been impaired or a liability has been incurred as of the date of the financial statements and the amount of loss is estimable; an accrual for the costs to resolve these claims is recorded by the Company in its consolidated balance sheets. Period expenses related to the defense of such claims are included in other operating expenses in the accompanying consolidated statements of income. Management, with the assistance of outside counsel, adjusts such provisions according to new developments or changes in the strategy in dealing with such matters. On the basis of current information, the Company does not expect the outcome of the claims, lawsuits and proceedings to which the Company is subject to, either individually, or in the aggregate, will have a material adverse effect on the Company s financial condition. However, it is possible that future results of operations or cash flows for any particular quarter or annual period could be materially affected by an unfavorable resolution of any such matters.

15. Sale-Leaseback Transaction

In July 2004, the Company entered into an agreement with an unaffiliated third party to sell its property at 12641 East 116th Street, Cerritos, California, owned by Savers and subsequently leaseback the property to Meadowbrook, Inc. There were no future commitments, obligations, provisions, or circumstances included in either the sale contract or the lease contract that would result in the Company s continuing involvement; therefore, the assets associated with the property were removed from the Company s consolidated balance sheets.

The sale proceeds were $2.9 million and the net book value of the property was $1.9 million. Direct costs associated with the transaction were $158,000. In conjunction with the sale, a deferred gain of $880,000 was recorded and will be amortized over the ten-year term of the operating lease. At December 31, 2005 and 2004, the Company had a deferred gain of $748,000 and $836,000, respectively, on the consolidated balance sheet in Other Liabilities . Total amortization of the gain for 2005 and 2004 was $88,000 and $44,000, respectively, for a total accumulated amortization of $132,000.

16. Related Party Transactions

At December 31, 2005 and 2004, respectively, the Company held an $858,923 and $868,125 note receivable, including $198,134 of accrued interest at December 31, 2005, from an executive officer of the Company. Accrued interest at December 31, 2004 was $207,335. This note arose from a transaction in late 1998 in which the Company loaned the officer funds to exercise 64,718 common stock options to cover the exercise price and the taxes incurred as a result of the exercise. The note bears interest equal to the Company s borrowing rate and is due on demand any time after January 1, 2002. The loan is partially collateralized by 64,718 shares of the Company s common stock under a stock pledge agreement. For the years ended December 31, 2005 and 2004, $42,000 and $42,000, respectively, have been paid against the loan. As of December 31, 2005, the cumulative amount that has been paid against this loan was $87,500.

On June 1, 2001, the Company and the officer entered into an employment agreement which provides the note is a non-recourse loan and the Company s sole legal remedy in the event of a default is the right to reclaim the shares pledged under the stock pledge agreement. Also, if there is a change in control of the Company and the officer is terminated or if the officer is terminated without cause, the note is cancelled and

MEADOWBROOK INSURANCE GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

deemed paid in full. In these events, the officer may also retain the pledged shares of the Company, or, at the officer s discretion, sell these shares back to the Company at the then current market price or their book value, whichever is greater.

If the officer is terminated by the Company for cause, the note is cancelled and considered paid in full. In this case, however, the officer forfeits the pledged shares of the Company, or, at the Company s discretion, must sell these shares back to the Company for a nominal amount.

If the officer terminates his employment during the term of the agreement, the Company could demand full repayment of the note. If the note was not paid by the officer on the demand of the Company, the Company s only recourse is to reclaim the shares of the Company that were pledged under the stock pledge agreement.

17. Employee Benefit Plans

Company employees over the age of $20^1/2$ who have completed six months of service are eligible for participation in The Meadowbrook, Inc. 401(k) Profit Sharing Plan (the 401(k) Plan). The 401(k) Plan provides for matching contributions and/or profit sharing contributions at the discretion of the Board of Directors of Meadowbrook, Inc. In 2005, 2004, and 2003, the matching contributions were $806,000, $600,000, and $513,000, respectively. There were no profit sharing contributions in 2005, 2004, and 2003.

18. Fair Value of Financial Instruments

SFAS No. 107, *Disclosures about Fair Value of Financial Instruments,* requires companies to disclose the fair value information about their financial instruments. This standard excludes certain insurance related financial assets and liabilities and all nonfinancial instruments from its disclosure requirements.

Due to the short-term nature of cash and cash equivalents, premiums and agent balances receivable, and accrued interest, their estimated fair value approximates their carrying value. Since debt and equity securities are recorded in the financial statements at their estimated fair market value as securities available for sale under SFAS No. 115 *Accounting for Certain Investments in Debt and Equity Securities* , their carrying value is their estimated fair value. The senior debentures, junior subordinated debentures, and the lines of credit bear variable rate interest, so their estimated fair value approximates their carrying value. In addition, the Company s derivative instruments, as disclosed in Note 7 *Derivative Instruments,* are recorded in accordance with SFAS No. 133 *Accounting for Derivative Instruments and Hedging Activities,* and therefore are recorded at fair value.

MEADOWBROOK INSURANCE GROUP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

19. Quarterly Financial Data (Unaudited)

The following is a summary of unaudited quarterly results of operations for 2005 and 2004 (in thousands, except per share and ratio data):

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
2005:				
Gross premiums written	$ 90,992	$ 75,959	$ 86,075	$ 79,183
Net premiums written	68,990	61,288	67,420	60,436
Net premiums earned	60,787	63,364	63,205	62,603
Net commissions and fees	10,099	8,034	9,200	8,583
Net investment income and realized gains/losses	3,977	4,581	4,632	4,952
Net losses and LAE incurred	37,134	37,728	38,469	38,211
Policy acquisition and other underwriting expenses	10,822	10,971	11,947	10,699
Other administrative expenses	7,785	6,046	6,037	7,315
Salaries and employee benefits	12,605	13,648	12,913	12,165
Interest expense	773	806	948	1,329
Net income	3,743	4,580	4,662	4,925
Diluted earnings per share	$ 0.13	$ 0.16	$ 0.16	$ 0.17
GAAP combined ratio(1)	99.3%	97.1%	99.8%	98.7%
2004:				
Gross premiums written	$ 81,054	$ 70,871	$ 79,234	$ 82,334
Net premiums written	62,951	53,025	56,303	61,682
Net premiums earned	49,713	53,083	52,963	58,734
Net commissions and fees	11,281	8,844	12,669	7,741
Net investment income and realized gains/losses	3,477	3,515	3,836	4,422
Net losses and LAE incurred	32,509	32,826	31,829	38,774
Policy acquisition and other underwriting expenses	7,546	8,870	8,169	8,839
Other administrative expenses	6,096	6,469	6,802	6,597
Salaries and employee benefits	12,808	12,325	14,284	12,880
Interest expense	315	528	686	752
Net income	3,232	2,820	5,252	2,757
Diluted earnings per share	$ 0.11	$ 0.10	$ 0.18	$ 0.09
GAAP combined ratio(1)	102.0%	101.2%	99.5%	102.6%

(1) Management uses the GAAP combined ratio and its components to assess and benchmark underwriting performance. The GAAP combined ratio is the sum of the GAAP loss and loss adjustment expense ratio and the GAAP expense ratio. The GAAP loss and loss adjustment expense ratio is the unconsolidated net incurred loss and loss adjustment expense in relation to net earned premium. The GAAP expense ratio is the unconsolidated policy acquisition and other underwriting expenses in relation to net earned premium.

SCHEDULE I
MEADOWBROOK INSURANCE GROUP, INC.
SUMMARY OF INVESTMENTS OTHER THAN INVESTMENTS IN RELATED PARTIES
As of December 31, 2005
(In thousands)

Type of Investment	Cost	Value	Amount at Which Shown in the Balance Sheet
Fixed Maturities:			
US government and government agencies and authorities	$ 57,026	$ 56,804	$ 56,804
States and political subdivisions	143,093	142,654	142,654
Corporate securities	107,761	108,145	108,145
Mortgage-backed securities	96,067	94,592	94,592
Total Investments	$ 403,947	$ 402,195	$ 402,195

SCHEDULE II
CONDENSED FINANCIAL INFORMATION OF REGISTRANT
MEADOWBROOK INSURANCE GROUP, INC.
PARENT COMPANY ONLY
BALANCE SHEET

	December 31,	
	2005	**2004**
	(In thousands)	
ASSETS		
Cash and cash equivalents	$ 73	$ 5,755
Investment in subsidiaries	225,475	200,029
Goodwill	3,024	3,024
Other assets	25,441	18,722
Total assets	$ 254,013	$ 227,530
LIABILITIES		
Other liabilities	$ 1,448	$ 12,609
Payable to subsidiaries	14,270	3,057
Debt	5,000	9,044
Debentures	55,930	35,310
Total liabilities	76,648	60,020
SHAREHOLDERS EQUITY		
Common stock	287	290
Additional paid-in capital	124,819	126,085
Retained earnings	54,248	37,175
Note receivable from officer	(859)	(868)
Accumulated other comprehensive (loss) income	(1,130)	4,828
Total shareholders equity	177,365	167,510
Total liabilities and shareholders equity	$ 254,013	$ 227,530

SCHEDULE II
CONDENSED FINANCIAL INFORMATION OF REGISTRANT
MEADOWBROOK INSURANCE GROUP, INC.
PARENT COMPANY ONLY
INCOME STATEMENT

	For the Years Ended December 31,		
	2005	2004	2003
Revenue	$ 2,198	$ 466	$ 216
Operating expenses:			
Interest expense	4,233	2,369	1,061
Other expenses	3,540	2,898	1,374
Total operating expenses	7,773	5,267	2,435
Loss before income taxes and subsidiary equity	(5,575)	(4,801)	(2,219)
Federal and state income tax benefit	(2,203)	(1,906)	(828)
Loss before subsidiary equity earnings	(3,372)	(2,895)	(1,391)
Subsidiary equity earnings	21,282	16,956	11,490
Net income	$ 17,910	$ 14,061	$ 10,099

SCHEDULE II
CONDENSED FINANCIAL INFORMATION OF REGISTRANT
MEADOWBROOK INSURANCE GROUP, INC.
PARENT COMPANY ONLY
STATEMENT OF COMPREHENSIVE INCOME

	For the Years Ended December 31,		
	2005	2004	2003
Net income	$ 17,910	$ 14,061	$ 10,099
Other comprehensive income, net of tax:			
Unrealized losses on securities:	(6,023)	(2,364)	(814)
Net deferred derivative gain hedging activity	9		
Deconsolidation of subsidiary		(45)	
Less: reclassification adjustment for gains (losses) included in net income	56	(222)	(200)
Other comprehensive loss	(5,958)	(2,631)	(1,014)
Comprehensive income	$ 11,952	$ 11,430	$ 9,085

SCHEDULE II
CONDENSED FINANCIAL INFORMATION OF REGISTRANT
MEADOWBROOK INSURANCE GROUP, INC.
PARENT COMPANY ONLY
STATEMENT OF CASH FLOWS

	For the Years Ended December 31,		
	2005	**2004**	**2003**
Net cash (used in) provided by operating activities:	$ (8,437)	$ (4,489)	$ 15,404
Cash Flow from Investing Activities:			
Purchase of land			(3,228)
Dividends from subsidiaries	6,089	3,678	
Investment in subsidiaries	(15,600)	(13,539)	(6,272)
Net cash used in investing activities	(9,511)	(9,861)	(9,500)
Cash Flow from Financing Activities:			
Proceeds from borrowings	9,500	3,744	8,800
Principal payments on borrowings	(13,544)	(8,700)	(22,350)
Net proceeds from issuance of debentures	19,400	24,250	9,700
Stock options exercised	1,092	145	
Share repurchases of common stock	(4,191)		(1,562)
Other financing activities	9	18	6
Net cash provided by (used in) financing activities	12,266	19,457	(5,406)
(Decrease) increase in cash and cash equivalents	(5,682)	5,107	498
Cash and cash equivalents, beginning of year	5,755	648	150
Cash and cash equivalents, end of year	$ 73	$ 5,755	$ 648

SCHEDULE III
MEADOWBROOK INSURANCE GROUP, INC.
SUPPLEMENTARY INSURANCE INFORMATION
December 31, 2005
(In thousands)

	Deferred Policy Acquisition Costs	Future Policy Benefits, Losses, Claims & Loss Expenses	Unearned Premium	Other Policy Claims & Benefits Payable	Premium Revenue
Speciality Risk Management Operations	$ 26,371	$ 458,677	$ 140,990		$ 249,959
Agency Operations					
Reconciling Items					
	$ 26,371	$ 458,677	$ 140,990		$ 249,959

	Net Investment Income	Benefits, Claims, Losses & Settlement Expenses	Amortization of Deferred Policy Acquisition Costs	Other Operating Expenses	Premium Written
Speciality Risk Management Operations	$ 17,692	$ 151,542	$ 34,163	$ 79,361	$ 258,134
Agency Operations				7,961	
Reconciling Items	283			5,324	
	$ 17,975	$ 151,542	$ 34,163	$ 92,646	$ 258,134

SCHEDULE III
MEADOWBROOK INSURANCE GROUP, INC.
SUPPLEMENTARY INSURANCE INFORMATION
December 31, 2004
(In thousands)

	Deferred Policy Acquisition Costs	Future Policy Benefits, Losses, Claims & Loss Expenses	Unearned Premium	Other Policy Claims & Benefits Payable	Premium Revenue
Speciality Risk Management Operations	$ 25,167	$ 378,157	$ 134,302		$ 214,493
Agency Operations					
Reconciling Items					
	$ 25,167	$ 378,157	$ 134,302		$ 214,493

	Net Investment Income	Benefits, Claims, Losses & Settlement Expenses	Amortization of Deferred Policy Acquisition Costs	Other Operating Expenses	Premium Written
Speciality Risk Management Operations	$ 14,887	$ 135,938	$ 25,280	$ 83,978	$ 233,961
Agency Operations				8,805	
Reconciling Items	24			(4,097)	
	$ 14,911	$ 135,938	$ 25,280	$ 88,686	$ 233,961

SCHEDULE III
MEADOWBROOK INSURANCE GROUP, INC.
SUPPLEMENTARY INSURANCE INFORMATION
December 31, 2003
(In thousands)

	Deferred Policy Acquisition Costs	Future Policy Benefits, Losses, Claims & Loss Expenses	Unearned Premium	Other Policy Claims & Benefits Payable	Premium Revenue
Speciality Risk Management Operations	$ 19,564	$ 339,465	$ 109,677		$ 151,205
Agency Operations					
Reconciling Items					
	$ 19,564	$ 339,465	$ 109,677		$ 151,205

	Net Investment Income	Benefits, Claims, Losses & Settlement Expenses	Amortization of Deferred Policy Acquisition Costs	Other Operating Expenses	Premium Written
Speciality Risk Management Operations	$ 13,471	$ 98,472	$ 18,202	$ 73,121	$ 189,827
Agency Operations				8,009	
Reconciling Items	13			(3,279)	
	$ 13,484	$ 98,472	$ 18,202	$ 77,851	$ 189,827

SCHEDULE IV
MEADOWBROOK INSURANCE GROUP, INC.
REINSURANCE
For the Years Ended December 31,
(In thousands)

	Gross Amount	Ceded to Other Companies	Assumed from Other Companies	Net Amount	Percentage of Amount Assumed to Net
Property and Liability Insurance					
2005	$ 264,381	$ 75,563	$ 61,141	$ 249,959	24.46%
2004	$ 247,169	$ 74,375	$ 41,699	$ 214,493	19.44%
2003	$ 198,991	$ 61,076	$ 13,290	$ 151,205	8.79%

SCHEDULE V
MEADOWBROOK INSURANCE GROUP, INC.
VALUATION AND QUALIFYING ACCOUNTS
For the Years Ended December 31,
(In thousands)

		Additions			
	Balance at Beginning of Period	Charged to Costs and Expense	Charged to Other Accounts	Deductions from Allowance Account	Balance at End of Period
Allowance for doubtful accounts					
2005	$ 4,336	$ 704		$ 1,139	$ 3,901
2004	$ 4,651	$ 822		$ 1,137	$ 4,336
2003	$ 4,747	$ 2,724		$ 2,820	$ 4,651

SCHEDULE VI
MEADOWBROOK INSURANCE GROUP, INC.
SUPPLEMENTAL INFORMATION CONCERNING PROPERTY AND CASUALTY INSURANCE OPERATIONS

For the Years Ended December 31,
(In thousands)

Affiliation with Registrant	Deferred Policy Acquisition Costs	Reserves for Losses and Loss Adjustment Expenses(2)	Discount, if any, deducted from previous column(1)	Unearned Premiums(2)	Net Premiums Earned	Net Investment Income
(a)Consolidated Property and Casualty Subsidiaries						
2005	$ 26,371	$ 458,677	$	$ 140,990	$ 249,959	$ 17,692
2004	$ 25,167	$ 378,157	$	$ 134,302	$ 214,493	$ 14,887
2003	$ 19,564	$ 339,465	$	$ 109,677	$ 151,205	$ 13,471

	Losses and loss adjustment expense		Amortization of deferred policy acquisition expenses	Paid losses and loss adjustment expenses	Net Premiums Written
	Current Year	Prior Years			
2005	$ 146,658	$ 4,884	$ 34,163	$ 107,115	$ 258,134
2004	$ 131,409	$ 4,529	$ 25,280	$ 97,972	$ 233,961
2003	$ 95,565	$ 2,907	$ 18,202	$ 99,569	$ 189,827

(1) The Company does not employ any discounting techniques.

(2) Reserves for losses and loss adjustment expenses are shown gross of $187.3 million, $151.2 million and $147.4 million of reinsurance recoverable on unpaid losses in 2005, 2004 and 2003, respectively. Unearned premiums are shown gross of ceded unearned premiums of $24.6 million, $26.1 million and $20.5 million in 2005, 2004 and 2003, respectively.

MEADOWBROOK INSURANCE GROUP, INC.
Exhibit Index

Exhibit No.	Description	Filing Basis
3.1	Amended and Restated Articles of Incorporation of the Company	(5)
3.2	Amended and Restated Bylaws of the Company	(1)
4.1	Junior Subordinated Indenture between Meadowbrook Insurance Group, Inc., and JP Morgan Chase Bank, dated September 30, 2003	(7)
4.2	Junior Subordinated Indenture between Meadowbrook Insurance Group, Inc. and LaSalle Bank National Association, dated as of September 16, 2005	(14)
10.1	Meadowbrook Insurance Group, Inc. Amended and Restated 1995 Stock Option Plan	(9)
10.2	Meadowbrook, Inc. 401(k) and Profit Sharing Plan Trust, amended and restated December 31, 1994	(1)
10.3	Demand Note dated November 9, 1998 among the Company and Robert S. Cubbin and Kathleen D. Cubbin and Stock Pledge Agreement	(4)
10.4	Meadowbrook Insurance Group, Inc. Amended and Restated 2002 Stock Option Plan	(9)
10.5	Agency Agreement by and between Meadowbrook, Inc., Preferred Insurance Agency, Inc., TPA Insurance Agency, Inc., Preferred Comp Insurance Agency of New Hampshire, TPA Insurance Agency of New Hampshire, Inc., Meadowbrook of Nevada, Inc., d/b/a Meadowbrook Insurance Services, Meadowbrook of Florida, Inc., Association Self-Insurance Services, Inc., Commercial Carriers Insurance Agency, Inc., and Star Insurance Company, Savers Property and Casualty Insurance Company, Williamsburg National Insurance Company, and Ameritrust Insurance Corporation, dated January 1, 2003	(6)
10.6	Purchase Agreement among Meadowbrook Insurance Group, Inc., Meadowbrook Capital Trust I, and Dekania CDO I, Ltd., dated September 30, 2003	(7)
10.7	Amended and Restated Trust Agreement among Meadowbrook Insurance Group, Inc., JP Morgan Chase Bank, Chase Manhattan Bank USA, National Association, and The Administrative Trustees Named Herein, dated September 30, 2003	(7)
10.8	Guaranty Agreement between Meadowbrook Insurance Group, Inc., and JP Morgan Chase Bank, dated September 30, 2003	(7)
10.9	Employment Agreement between the Company and Robert S. Cubbin, dated January 1, 2004	(8)
10.10	Employment Agreement between the Company and Michael G. Costello, dated January 1, 2004	(8)
10.11	Meadowbrook Insurance Group, Inc. Long Term Incentive Plan	(11)
10.12	Indenture between Meadowbrook Insurance Group, Inc. and JPMorgan Chase Bank, as Trustee, dated April 29, 2004	(11)
10.13	Amended and Restated Loan and Security Agreement between Liberty Premium Finance, Inc., and Comerica Bank, dated May 7, 2004	(11)
10.14	Indenture between Meadowbrook Insurance Group, Inc. and Wilmington Trust Company, as Trustee, dated May 26, 2004	(11)

10.15	Land Contract between Meadowbrook Insurance Group, Inc. and MB Center II LLC, dated July 15, 2004	(11)
10.16	Loan Agreement by and between Ameritrust Insurance Corporation, Savers Property and Casualty Insurance Company, Star Insurance Company, Williamsburg National Insurance Company, Meadowbrook Insurance Group, Inc., and Meadowbrook, Inc., dated September 1, 2004	(12)
10.17	Credit Agreement among Meadowbrook Insurance Group, Inc. and Standard Federal Bank National Association dated as of November 12, 2004	(10)

Exhibit No.	Description	Filing Basis
10.18	Revolving Note among Meadowbrook Insurance Group, Inc. and Standard Federal Bank National Association dated as of November 12, 2004	(10)
10.19	Security Agreement among Meadowbrook Insurance Group, Inc. and Standard Federal Bank National Association dated as of November 12, 2004	(10)
10.20	Form of Nonqualified Stock Option Agreement under the Meadowbrook Insurance Group, Inc., Stock Option Plan, dated February 21, 2003	(12)
10.21	Lease Agreement between Meadowbrook Insurance Group, Inc. and Meadowbrook, Inc., dated December 6, 2004	(12)
10.22	Master Lease Agreement between LaSalle National Leasing Corporation and Meadowbrook Insurance Group, Inc., dated December 30, 2004	(12)
10.23	Promissory Note between Meadowbrook Insurance Group, Inc. and Star Insurance Company, dated January 1, 2005	(12)
10.24	Commercial Mortgage between Meadowbrook Insurance Group, Inc. and Star Insurance Company, dated January 1, 2005	(12)
10.25	Assignment of Leases and Rents between Meadowbrook Insurance Group, Inc. and Star Insurance Company, dated January 1, 2005	(12)
10.26	Form of At-Will Employment and Severance Agreement by and among Meadowbrook, Inc., Meadowbrook Insurance Group, Inc., and Karen M. Spaun, Stephen Belden, Gregory L. Wilde, Robert C. Spring, Archie S. McIntyre, Arthur C. Pletz, Randolph W. Fort, Angelo L. Williams, Susan L. Cubbin, and Kenn R. Allen, dated January 1, 2005 and Steven C. Divine dated March 1, 2006	(12)
10.27	Amendment to Demand Note Addendum among the Company and Robert S. Cubbin and Kathleen D. Cubbin, dated February 17, 2005	(12)
10.28	First Modification to the Amended and Restated Loan and Security Agreement between Liberty Premium Finance, Inc. and Comerica Bank, dated April 26, 2005	(13)
10.29	Reciprocal Easement and Operation Agreement between Meadowbrook Insurance Group, Inc. and MB Center II, LLC, dated May 9, 2005	(13)
10.30	First Amendment to Land Contract between MB Center II, LLC and Meadowbrook Insurance Group, Inc., dated May 20, 2005	(13)
10.31	Amendment to Credit Agreement between Meadowbrook Insurance Group, Inc. and Standard Federal Bank National Association, dated May 20, 2005	(13)
10.32	Second Amendment to Credit Agreement between Meadowbrook Insurance Group, Inc. and Standard Federal Bank National Association, dated September 8, 2005	(15)
10.33	Purchase Agreement among Meadowbrook Insurance Group, Inc., Meadowbrook Capital Trust II, and Merrill Lynch International, dated as of September 16, 2005	(14)
10.34	Amended and Restated Trust Agreement among Meadowbrook Insurance Group, Inc., LaSalle Bank National Association, Christiana Bank & Trust Company, and The Administrative Trustees Named Herein, dated as of September 16, 2005	(14)
10.35	Guarantee Agreement between Meadowbrook Insurance Group, Inc., and LaSalle Bank National Association, dated as of September 16, 2005	(14)

10.36	Convertible Note between Meadowbrook Insurance Group, Inc. and Renaissance Insurance Group, LLC, dated December 20, 2005
10.37	Third Amendment to Credit Agreement between Meadowbrook Insurance Group, Inc. and LaSalle Bank Midwest National Association, dated December 28, 2005
10.38	Inter-Company Reinsurance Agreement by and between Star Insurance Company and Ameritrust Insurance Company, Savers Property and Casualty Insurance Company, and Williamsburg National Insurance Company, dated January 1, 2006

Exhibit No.	Description	Filing Basis
10.39	Form of Management Services Agreement by and between Meadowbrook Insurance Group, Inc., Meadowbrook, Inc., and Star Insurance Company, Williamsburg National Insurance Co., Ameritrust Insurance Corporation, American Indemnity Insurance Company, Ltd., and Preferred Insurance Company, Ltd., respectively, each dated January 1, 2006	
10.40	Management Services Agreement by and between Savers Property and Casualty Insurance Company and Meadowbrook, Inc., dated January 1, 2006	
10.41	Employment Agreement between Meadowbrook, Inc., and Meadowbrook Insurance Group, Inc. and Merton J. Segal, dated January 1, 2006	(16)
14	Compliance Program/ Code of Conduct	
16	PricewaterhouseCoopers Letter to the Commission dated August 10, 2005, filed as Exhibit 16.1 to the Company s Form 8-K, dated August 12, 2005	
21	List of Subsidiaries	
23.1	Consent of Independent Registered Public Accounting Firm (Ernst & Young LLP)	
23.2	Consent of Independent Registered Public Accounting Firm (PricewaterhouseCoopers LLP)	
24	Power of Attorney	
28.1	Star Insurance Company s 2005 Schedule P	(2)
28.2	Savers Property & Casualty Insurance Company s 2005 Schedule P	(2)
28.3	Williamsburg National Insurance Company s 2005 Schedule P	(2)
28.4	Ameritrust Insurance Corporation s 2005 Schedule P	(2)
31.1	Certification of Robert S. Cubbin, Chief Executive Officer of the Corporation, pursuant to Securities Exchange Act Rule 13a-14(a)	
31.2	Certification of Karen M. Spaun, Chief Financial Officer of the Corporation, pursuant to Securities Exchange Act Rule 13a-14(a)	
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, signed by Robert S. Cubbin, Chief Executive Officer of the Corporation	
32.2	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, signed by Karen M. Spaun, Chief Financial Officer of the Corporation	
99.1	Rights Agreement, dated as of September 30, 1999, by and between Meadowbrook Insurance Group, Inc. and First Chicago Trust Company of New York, including the Certificate of Designation, the form of Rights Certificate and the Summary of Rights attached thereto as Exhibits A, B and C, respectively	(3)

(1) Incorporated by reference to Form S-1 Registration Statement (No. 33-2626206) of Meadowbrook Insurance Group, Inc. declared effective November 20, 1995.

(2) Submitted in paper format under separate cover; see Form SE filing.

(3) Incorporated by reference to Exhibit 99.1 to the Company s Form 8-A filed with the Securities and Exchange Commission on October 12, 1999.

(4) Filed as Exhibit to Form 10-K for the year ending December 31, 1998.

(5) Filed as Exhibit to Form 10-Q for the period ending March 31, 2002.

(6) Filed as Exhibit to Form 10-K for the year ending December 31, 2002.

(7) Filed as Exhibit to Form 10-Q for the period ending September 30, 2003.

(8) Filed as Exhibit to Form 10-K for the year ending December 31, 2003

(9) Filed as Appendix to Meadowbrook Insurance Group, Inc. 2004 Proxy Statement.

(10) Filed as Exhibit to Current Report on Form 8-K filed on November 18, 2004.

(11) Filed as Exhibit to Form 10-Q for the period ending June 30, 2004.

(12) Filed as Exhibit to Form 10-K for the year ending December 31, 2004.

(13) Filed as Exhibit to Form 10-Q for the period ending June 30, 2005.

(14) Filed as Exhibit to Current Report on Form 8-K filed on September 22, 2005.

(15) Filed as Exhibit to Form 10-Q for the period ending September 30, 2005.

(16) Filed as Exhibit to Current Report on Form 8-K filed on March 9, 2006.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities and Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized, in Southfield, Michigan.

Meadowbrook Insurance Group, Inc.
By:

Robert S. Cubbin
Chief Executive Officer
(Principal Executive Officer)

By:

Karen M. Spaun
Senior Vice President and
Chief Financial Officer
(Principal Financial Officer)

Dated: March 14, 2006

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
** Merton J. Segal	Chairman and Director	March 14, 2006
Robert S. Cubbin	President, Chief Executive Officer and Director (Principal Executive Officer)	March 14, 2006
** Joseph S. Dresner	Director	March 14, 2006
** Hugh W. Greenberg	Director	March 14, 2006
** Florine Mark	Director	March 14, 2006
** Robert H. Naftaly	Director	March 14, 2006
**	Director	March 14, 2006

David K. Page		
**	Director	March 14, 2006
Robert W. Sturgis		
**	Director	March 14, 2006
Bruce E. Thal		

Signature	Title	Date
**	Director	March 14, 2006
Herbert Tyner		
**By:		
Robert S. Cubbin, Attorney-in-fact		

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