

Report of the Directors

The Board of Directors (the “Directors”) takes pleasure in submitting their first interim report together with the unaudited financial statements for the six months ended 30 June 2004.

Interim Dividend

The Directors do not recommend the payment of an interim dividend for the six months ended 30 June 2004 (2003: nil).

Directors’ Interests, Long and Short Positions in Shares, Underlying Shares and Debentures

As at 30 June 2004, the interests of the Directors and chief executives of the Company in the shares of the Company and associated corporation as recorded in the register required to be kept under Section 352 of the Securities and Futures Ordinance (“SFO”) or as otherwise notified to the Company and the Stock Exchange of Hong Kong Limited pursuant to the Model Code for Securities Transactions by Directors of Listed Companies (the “Model Code”) were as follows:

Name of Director	Company/Name of Associated Corporation	Nature of Interest	Total Number of ordinary shares	Percentage of the Company’s Issued Share Capital
Niu Gensheng	The Company	Personal Interest	45,505,172 (L)	4.6%
	The Company	Corporate Interest (<i>Note 1</i>)	158,344,007 (L)	15.8%
	The Company	Corporate Interest (<i>Note 2</i>)	335,937,391 (L)	33.6%
	Mengniu	Personal Interest (<i>Note 3</i>)	21,862,810 (L)	9.8%
Lu Jun	Jinniu Milk Industry Limited (“Jinniu”)	Personal Interest	4,924 (L)	5.98%
	Mengniu	Personal Interest	804,646 (L)	0.36%
Sun Yubin	Jinniu	Personal Interest	10,847 (L)	13.18%
	Mengniu	Personal Interest	1,772,646 (L)	0.799%
Yang Wenjun	Jinniu	Personal Interest	6,539 (L)	7.95%
	Mengniu	Personal Interest	1,068,646 (L)	0.481%

Notes:

- (1) These shares are held by Jinniu, a substantial shareholder of the Company, and Niu Gensheng legally owns 27.97% in the issued share capital of Jinniu. He also has a short position in Jinniu amounting to 9.1% of the enlarged issued share capital of Jinniu assuming all equity rights which have been granted are exercised. None of the equity rights have been exercised.
 - (2) These shares are held by Yinniu Milk Industry Limited (“Yinniu”), a substantial shareholder of the Company, and Niu Gensheng by virtue of the Xie Trust has been delegated voting rights to the shares in Yinniu in the Xie Trust. The Xie Trust has been in effect since September 2002 and is a trust declared by Xie Qiuxu in respect of Shares in Yinniu held on trust by him for a selected group of individuals comprising employees and business associates of Mengniu. Xie Qiuxu has similarly delegated the voting rights of his own shares in Yinniu to Niu Gensheng. Therefore, Niu Gensheng controls 63.5% of the voting rights of Yinniu. Niu Gensheng also has equity rights which would convert to 17.8% of the enlarged issued share capital of Yinniu assuming all equity rights issued have been exercised in Yinniu. None of the equity rights have been exercised.
 - (3) Out of his share interests in Mengniu, Niu Gensheng granted an option of over 7,325,670 shares in total representing approximately 3.3% of the issued capital of Mengniu to CDH China Fund. L.P., CGU-CDC China Investment Company Limited and MS Dairy Holdings (“Financial Investors”) on 23 March 2004. Such options can be exercised in one or more tranches by each Financial Investor and are exercisable within 10 years. None of the options have been exercised.
- (L) Indicates a long position.

Save as disclosed above, as at 30 June 2004, none of the Directors or their associates had any interests and short positions in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO).

Substantial Shareholders' Interests

As at 30 June 2004, the interests or short positions of substantial shareholders, other than the Directors of the Company, in the shares and underlying shares of the Company as recorded in the register maintained under section 336 of the SFO were as follows:

Name	Number of Shares	Percentage of Issued Share Capital
Morgan Stanley Global Emerging Markets Inc	371,664,288(L) 87,295,726(S)	37.17(L) 8.73(S)
Morgan Stanley	338,728,550(L) 52,260,988(S)	33.87(L) 5.23(S)
Morgan Stanley Global Emerging Markets Private Investment Fund, L.P.	336,629,550(L) 52,260,988(S)	33.66(L) 5.23(S)
MS Dairy Holdings	336,629,550(L) 52,260,988(S)	33.66(L) 5.23(S)
MSGEM, LLC	336,629,550(L) 52,260,988(S)	33.66(L) 5.23(S)
Xie Qiuxu	335,937,391(L)	33.59(L)
Yinniu Milk Industry Limited <i>(Note 1)</i>	335,937,391(L)	33.59(L)
Jinniu Milk Industry Limited <i>(Note 1)</i>	236,657,176(L) 78,313,169(S)	23.67(L) 7.83(S)
CDH China Fund, L.P.	106,813,544(L) 16,581,508(S)	10.68(L) 1.66(S)
CDH China Holdings Company Limited	106,813,544(L) 16,581,508(S)	10.68(L) 1.66(S)
China Diamond Holdings Company Limited	106,813,544(L) 16,581,508(S)	10.68(L) 1.66(S)
China Diamond Holdings, L.P.	106,813,544(L) 16,581,508(S)	10.68(L) 1.66(S)
Morgan Stanley Capital Management, LLC	54,847,000(L) 52,500,000(S)	5.48(L) 5.25(S)
Morgan Stanley International Incorporated	54,847,000(L) 52,500,000(S)	5.48(L) 5.25(S)
Morgan Stanley Domestic Capital Inc.	54,847,000(L) 52,500,000(S)	5.29(L) 5.25(S)
Morgan Stanley & Co International Limited	52,865,000(L) 52,500,000(S)	5.29(L) 5.25(S)
Morgan Stanley Group (Europe)	52,865,000(L) 52,500,000(S)	5.29(L) 5.25(S)
Morgan Stanley International Limited	52,865,000(L) 52,500,000(S)	5.29(L) 5.25(S)
Morgan Stanley UK Group	52,865,000(L) 52,500,000(P)	5.29(L) 5.25(P)
The Capital Group Companies, Inc.	50,112,000(L)	5.01(L)

Notes:

- (1) 10 founding individuals, namely Niu Gensheng, Deng Jiuqiang, Hou Jiangbin, Sun Yunbin, Qiu Lianjun, Yang Wenjun, Pang Kaitai, Lu Jun, Sun Xianhong and Xie Qiuxu, have been acting as a controlling group over the business since its inception in 1999. Therefore, they as a group are controlling shareholders of the Company. As at 30 June 2004, Niu Gensheng, Deng Jiuqiang, Lu Jun, Sun Yubin, Yang Wenjun, Sun Xianhong and Qiu Lianjun who are shareholders of Jinniu together control approximately 87.4% of Jinniu. Xie Qiuxu, Pang Kaitai, Hou Jiangbin and Deng Jiuqiang who are shareholders of Yinniu together control approximately 70.8% of Yinniu. Jinniu and Yinniu in aggregate control approximately 49.4% of the voting power at the general meeting of the Company.
- (L) Indicates a long position.
- (S) Indicates a short position.
- (P) Indicates a lending pool.

Saved as disclosed above, as at 30 June 2004, no other interests or short positions in the shares or underlying shares of the Company were recorded in the register maintained under section 336 of the SFO.

Connected Transactions

The Directors (including the independent non-executive Directors) are of the opinion that the connected transactions have been entered into and were carried out in the ordinary and usual course of business of the members of the Group and on normal commercial terms which are fair and reasonable so far as the interests of the shareholders of the Company are concerned.

There were no other transactions which need to be disclosed as connected transactions in accordance with the requirements of the Listing Rules.

Share Option Scheme

As at 30 June 2004, the Company had not adopted a share option scheme and no option had been granted or agreed to be granted.

Human Resources and Remuneration of Employees

As at 30 June 2004, the Group employed a total of 16,583 employees in China and Hong Kong. Total staff costs for the first half of 2004 amounted to approximately RMB97.9 million, excluding Directors, as compared with approximately RMB44.0 million in the same period in 2003.

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

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

Purchase, Sale or Redemption of the Company's Listed Shares

During the six months ended 30 June 2004, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities.

Use of proceeds

The net proceeds from the global offering of the Company's listing on the Stock Exchange on 10 June 2004 were approximately HK\$921 million, of which HK\$915 million has been deposited into interest-bearing accounts maintained with banks and the remaining balance is to be used as working capital.

Subsequent Events and Commitments

The Company will use the net proceeds of the global offering to subscribe for further shares in Inner Mongolia Mengniu Milk Industry (Group) Co., Ltd. ("MengniuCo") based on pre-agreed terms at a price equivalent to 15% discount to the implied equity value valuation of MengniuCo under the global offering. Under the subscription agreement between China Dairy (Mauritius) Limited ("MauritiusCo") and MengniuCo, MauritiusCo will subscribe for such number of shares in MengniuCo in October 2004. After the completion of the subscription, MauritiusCo will own an estimated 84.3% of the total registered capital of MengniuCo.

Audit Committee

The Audit Committee comprises three non-executive Directors, two of whom are independent. The Audit Committee reviewed with the management the accounting principles and practices adopted by the Company and discussed auditing, internal control and financial report matters including the review of the unaudited interim accounts for the six months ended 30 June 2004.

Investor Relations and Communications

The Company adopts a proactive policy of promoting investor relations and communications by holding regular meetings with institutional investors and analysts.

Compliance with the Code of Best Practice

None of the Directors of the Company is aware of any information that would reasonably indicate that the Company was not at any time during the six months ended 30 June 2004 in compliance with the Code of Best Practice as set out by the Stock Exchange in Appendix 14 to the Listing Rules.

Compliance with Model Code

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

By order of the Board of Directors

Niu Gensheng

Chairman & Chief Executive Officer

Hong Kong, 1 September 2004