

REPORT OF THE DIRECTORS

The Board of Directors (the “Directors”) takes pleasure in submitting the interim report together with the unaudited condensed consolidated financial statements of the Company and its subsidiaries (the “Group”) for the six months ended 30 June 2006 (“interim financial statements”).

Interim Dividend

The Directors do not recommend the payment of an interim dividend for the six months ended 30 June 2006 (2005: nil).

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

As at 30 June 2006, the interests, long and short term positions 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 (the “Stock Exchange”) 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)	3.33%
	The Company	Corporate Interest (<i>Note 1</i>)	253,292,187(L)	18.51%
	Mengniu	Personal Interest (<i>Note 2</i>)	16,514,220(L)	6.18%
	Mengniu	Personal Interest (<i>Note 3</i>)	7,325,670(S)	2.74%
Lu Jun	Mengniu	Personal Interest	804,646(L)	0.30%
Yang Wenjun	Mengniu	Personal Interest	1,068,646(L)	0.40%
Sun Yubin	Mengniu	Personal Interest	1,772,646(L)	0.66%

Notes:

- (1) 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 held 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 the shares in Yinniu held on trust by him for a selected group of individuals comprising employees and business associates of Inner Mongolia Mengniu Dairy (Group) Company Limited (“Mengniu”). Xie Qiuxu has similarly delegated the voting rights of his own shares in Yinniu to Niu Gensheng. Together with his personal interest in Yinniu, Niu Gensheng controls 81.7% of the voting rights of Yinniu as of 30 June 2006. Subsequent to 30 June 2006, the percentage of shareholding of Yinniu in the Company decreased to 15.8%, which caused a corresponding change of Niu Gensheng’s corporate interest as shown above. Details of this change are disclosed in Note 3 under the section headed “Substantial Shareholders’ Interests” in this report.

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- (2) During the reporting period, Niu Gensheng donated 2% of his equity interest in Mengniu to an unconnected social organization. Details of the donation have been disclosed in the Company's announcement dated 7 February 2006.
- (3) Out of his shareholdings in Mengniu, Niu Gensheng granted an option of 7,325,670 shares in total, representing approximately 2.7% of the issued capital of Mengniu, to CDH China Fund. L.P., Actis 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. As at the date of this report, none of the options have been exercised.

(L) Indicates a long position.

(S) Indicates a short position.

Saved as disclosed above, as at 30 June 2006, none of the Directors and the chief executives 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 2006, the interests or short positions of substantial shareholders, other than the Directors or the chief executives of the Company whose interests, long and short positions in the shares of the Company are set out above, in the shares and underlying shares of the Company in the register maintained under section 336 of the SFO were as follows:

Name of Substantial Shareholder	Number of Ordinary Shares	Percentage of Issued Share Capital
Xie Qiuxu (<i>Notes 1 and 3</i>)	253,292,187(L)	18.51%
Jinniu Milk Industry Limited ("Jinniu") (<i>Notes 2 and 3</i>)	181,997,979(L)	13.30%
AllianceBernstein L.P. (Formerly known as Alliance Capital Management L.P.)	82,388,000(L)	6.02%
The Capital Group Companies, Inc.	70,987,000(L)	5.19%

Notes:

- (1) As at 30 June 2006, Xie Qiuxu legally owned 62.7% of the issued share capital of Yinniu, which directly owned 18.5% of the issued shares of the Company. Accordingly, the 253,292,187 shares attributable to Xie Qiuxu above represent his indirect effective interest in the Company via his legal shareholding interest in Yinniu.

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- (2) 10 founding individuals, namely Niu Gensheng, Deng Jiuqiang, Hou Jiangbin, Sun Yubin, 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 2006, Niu Gensheng, Deng Jiuqiang, Lu Jun, Sun Yubin, Yang Wenjun, Sun Xianhong and Qiu Lianjun who are shareholders of Jinniu together controlled approximately 81.2% of Jinniu. Niu Gensheng, Xie Qiuxu, Pang Kaitai, Hou Jiangbin and Deng Jiuqiang who are shareholders of Yinniu together controlled approximately 87.7% of Yinniu. As at 30 June 2006, Jinniu and Yinniu in aggregate controlled approximately 31.8% of the voting power at the general meeting of the Company.
- (3) Subsequent to 30 June 2006, the shareholding of Yinniu and Jinniu decreased to 15.8% and 11.1% respectively as a result of placement of shares to the public. Accordingly, the interest of Xie Qiuxu in the Company, as shown above, was reduced to 15.8%. Details of the placement of shares by Yinniu and Jinniu have been disclosed in the Company's announcement dated 30 June 2006.
- (L) Indicates a long position.

Saved as disclosed above, as at 30 June 2006, 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.

Share Option Scheme

The Company adopted a share option scheme to provide incentives to the employees of the Group in June 2005. As at 30 June 2006, no option has been granted.

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

During the six months ended 30 June 2006, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities.

Foreign Currency Risk

The Group's businesses are principally located in the People's Republic of China and substantially all transactions are conducted in RMB, except for the purchases of machinery and equipment and sales of dairy products to Hong Kong and Macau. As at 30 June 2006, substantially all of the Group's assets and liabilities were denominated in RMB except that cash and bank balances of approximately RMB116,789,000 (31 December 2005: RMB16,019,000) were denominated in United States dollars and Hong Kong dollars, and bank loans and long term payables aggregating to approximately RMB556,484,000 (31 December 2005: RMB219,761,000) were denominated in United States dollars. Management has set up procedures to periodically review and monitor the foreign currency risk exposure.

Pledge of Assets

As at 30 June 2006, the Group pledged bank deposits, bills receivable and certain property, plant and equipment aggregating approximately RMB736,943,000 (31 December 2005: RMB601,930,000). Details are set out in the respective notes to the interim financial statements.

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Contingent Liabilities and Commitments

Details of contingent liabilities and commitments are set out in Notes 20 and 21 to the interim financial statements.

Subsequent Events

Details of subsequent event are set out in Note 23 to the interim financial statements.

Audit Committee

The audit committee of the Company ("Audit Committee") comprises three non-executive Directors, two of whom are independent. The current committee members are Mr Zhang Julin (chairman), Mr Li Jianxin and Mr Jiao Shuge (alias Jiao Zhen). The Audit Committee has reviewed with the Company's management and the external auditors, the accounting principles and practices adopted by the Company and discussed auditing, internal control and financial reporting matters, including the review of the unaudited interim financial statements for the six months ended 30 June 2006.

Investor Relations and Communications

The Company adopts a proactive policy in promoting investor relations and communications. Regular meetings are held with institutional investors and financial analysts to ensure two-way communications on the Company's performance and development.

Compliance with the Code on Corporate Governance Practices

None of the Directors is aware of any information that would reasonably indicate that the Company was not at any time during the six months ended 30 June 2006 in compliance with the Code on Corporate Governance Practices as set out in Appendix 14 to the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited ("Listing Rules").

Compliance with the Model Code

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

By order of the Board of Directors

Niu Gensheng

Chief Executive Officer

Hong Kong, 5 September 2006