



CORPORATE GOVERNANCE REPORT



I have a dream to have every Chinese,
with children as the start,
to drink a catty of milk a day.

Mr. Wen Jiabao, China's Premier
23 April 2008



The Company is dedicated to ensure high standards of corporate governance with an emphasis on a diligent board of directors (the “Board”), sound internal control, and increasing transparency and accountability to shareholders. The Board acknowledges that good corporate governance practices and procedures are beneficial to the Group and its shareholders. The Company is committed to improve those practices and maintain its ethical corporate culture.

The Company has adopted the code provisions set out in the Code of Corporate Governance Practices (the “Code”) contained in Appendix 14 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the “Listing Rules”) as its own code of corporate governance practices.

Throughout the year, the Group has fully complied with all the compulsory code provisions set out in the Code.

The Board

The Board is responsible for the leadership and management of the Company. Key responsibilities of the Board comprise formulation of the Group’s overall strategies and policies, setting of performance and management targets, evaluation of business performance and supervision of management’s performance. The management was delegated the authority and responsibility by the Board for the management and operations of the Group. In addition, the Board has also delegated various responsibilities to the Board committees as detailed in this report.

The Board meets at least four times a year and additional operational meetings are also held, when required. The company secretary is responsible for preparing agenda and notices for the meetings. Senior management of the Group also provides the directors with relevant information on a timely basis regarding key business developments of the Group and issues affecting the Group. Agenda and other information package are normally delivered to the directors before the meetings. The directors also have independent access to the senior management in respect of operating issues. The directors may take independent professional advice where appropriate to discharge their duties, at the Company’s expenses.

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During the year ended 31 December 2006, the Board held eight meetings. The attendance of each of the directors at the Board meetings is as follows:

Directors	Attendance of Board meetings in 2006
Niu Gensheng	8/8
Lu Jun	8/8
Yang Wenjun	7/8
Sun Yubin	8/8
Jiao Shuge (alias Jiao Zhen)	8/8
Liu Haifeng, David (resigned on 26 January 2006)	1/1
Jin Yujuan, Lily (resigned on 7 March 2006)	0/3
Julian Juul Wolhardt (appointed on 26 January 2006)	5/7
Wang Huaibao	8/8
Zhang Julin	5/8
Li Jianxin	8/8

Note: During the year, the Company held four quarterly meetings and four other meetings to handle operational-level matters. According to the Company's articles of association, the quorum for convening a Board meeting is two members.

Minutes of meetings of the Board and Board committees are kept by the company secretary of the Company and are not only open for inspection by the directors but also sent to the directors for records. All directors have access to the company secretary of the Company, who is responsible for ensuring that the Board procedures are complied with and advising the Board on compliance matters.

Chairman and Chief Executive Officer

The role of the chairman of the Board (the "Chairman") is separate from that of the chief executive officer to ensure a balance of power and authority. The Chairman is responsible for overseeing the functioning of the Board while the chief executive officer is responsible for managing the Group's business.

The Chairman shall ensure that Board meetings are planned and conducted effectively and all directors are properly briefed on issues arising at Board meetings. He is also responsible for ensuring that the directors receive in a timely manner adequate information, which must be complete and reliable.



Board Composition

As at 31 December 2006, the Board comprises nine directors, including four executive directors (Mr Niu Gensheng, Ms Lu Jun¹, Mr Yang Wenjun and Mr Sun Yubin), two non-executive directors (Mr Jiao Shuge (alias Jiao Zhen) and Mr Julian Juul Wolhardt) and three independent non-executive directors (Mr Wang Huaibao, Mr Zhang Julin and Mr Li Jianxin). The Chairman of the Company is Mr Jiao Shuge and the chief executive officer of the Company is Mr Niu Gensheng.

The Company has received annual confirmation of independence from the three independent non-executive directors in accordance with Rule 3.13 of the Listing Rules. The Board has assessed their independence and concluded that all the independent non-executive directors are independent within the definition of the Listing Rules. The independent non-executive directors possess appropriate professional qualifications, or accounting or related financial management expertise.

Biographies of the directors are set out on pages 23 to 27 of the annual report, which demonstrates a diversity of skills, expertise, experience and qualifications.

Appointment, Re-election and Removal of Directors

None of the nine directors has entered into any service agreement with the Company or any of its subsidiaries which is not determinable by the Group within one year without payment of compensation, other than statutory compensation.

Each director has entered into a service contract with the Company for an initial term of one year and continuing thereafter for further successive period of one year, for a maximum duration of three years. The directors are subject to retirement by rotation and re-election at each annual general meeting of the Company in accordance with article 112 of the Company's articles of association. The directors appointed as an addition to the Board or to fill a casual vacancy on the Board shall be subject to re-election by the shareholders at the first general meeting after the appointment.

Board Committees

The Company has established three Board committees, namely the audit committee, the remuneration committee and the nomination committee, each of which is governed by specific terms of reference approved by the Board, covering its functions, duties and powers. The terms of reference of the respective Board committees have complied with the Code provisions and are available for public inspection at the Company's principal place of business in Hong Kong.

¹ Ms Lu Jun was re-designated as a non-executive director on 1 January 2007.

Audit Committee

The audit committee comprises three non-executive directors, two of whom are independent and possess the relevant professional qualifications required under the Listing Rules (the "Audit Committee"). The committee is chaired by Mr Zhang Julin, an independent non-executive director.

The Audit Committee serves as a focal point for communication between other directors, the external auditors, and the management as their duties relate to financial and other reporting, internal controls and the auditing. The Audit Committee assists the Board in fulfilling its responsibilities by providing an independent review of financial reporting and by satisfying themselves as to the effectiveness of the Company's internal controls and as to the efficiency of the audits.

During the year, the Audit Committee has performed the following:

- met with the external auditors to discuss the general scope and findings of their audit and interim review works;
- reviewed external auditor's management letter and management's response;
- reviewed and recommended to the Board for approval of the external auditors' remuneration;
- made recommendations to the Board on the re-appointment of the external auditors;
- reviewed the external auditors' independence, objectivity and the effectiveness of the audit process;
- reviewed and monitored the integrity of financial statements, annual and interim reports, and annual and interim announcements of the Company;
- discussed auditing, internal control, risk management and financial reporting matters before recommending them to the Board for approval; and
- reviewed the connected transactions entered into by the Group.

All issues raised by the external auditors and the Audit Committee have been addressed by the senior management. The work and findings of the Audit Committee have been reported to the Board. During the year, no issues brought to the attention of the senior management and the Board were of sufficient significance for disclosure in the annual report.



The Audit Committee held two meetings in 2006 and one meeting to date in 2007. The attendance record of each member of the Audit Committee in 2006 is set out below:

Directors	Attendance of Audit Committee Meetings in 2006
Zhang Julin (<i>chairman</i>)	2/2
Jiao Shuge	2/2
Li Jianxin	2/2

Other than the reporting responsibilities of the Company's auditors (please refer to the auditors' report set out on page 50), the directors acknowledge their responsibility for preparing the financial statements of the Group and the Company which give a true and fair view of the state of affairs of the Group and the Company as at 31 December 2006 and the profit and cash flows of the Group for the year then ended.

Remuneration Committee

As at 31 December 2006, the remuneration committee comprises five members, three of whom are independent non-executive directors, one an executive director¹ and one a non-executive director (the "Remuneration Committee"). The Remuneration Committee is chaired by Mr Wang Huaibao, an independent non-executive director.

The duties of the Remuneration Committee are to review annually and recommend to the Board the overall remuneration policy for the directors and senior management to ensure that the level of remuneration is linked to their level of responsibilities undertaken. The Remuneration Committee shall also evaluate annually the performance of the directors and the senior management and recommend to the Board specific adjustments in their remuneration and/or reward payments.

The Company's policy on remuneration is to maintain fair and competitive packages based on business needs and industry practice. For determining the level of fees paid to members of the Board, market rates and factors such as each Director's workload and required commitment will be taken into account. In addition, factors comprising economic and market situations, individual contributions to the Group's results and development as well as individual potential are considered when determining the remuneration packages of executive directors.

During the year, the Remuneration Committee had performed the following:

- assessed the performance of the directors and senior management;
- reviewed and approved the remuneration for the directors and senior management;
- reviewed the remuneration policy and recommended to the Board; and
- reviewed the proposal of granting share options according to the Company's share option plan, and made recommendations to the Board.

1 The executive director was re-designated as a non-executive director on 1 January 2007. As at the date of this report, the Remuneration Committee is composed of three independent non-executive directors and two non-executive directors.

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The Remuneration Committee held two meetings in 2006 and one meeting to date in 2007. The attendance record of each member of the Remuneration Committee in 2006 is set out below:

Directors	Attendance of Remuneration Committee Meetings in 2006
Wang Huaibao (<i>chairman</i>)	2/2
Lu Jun	2/2
Julian Juul Wolhardt (<i>Note</i>)	1/2
Zhang Julin	2/2
Li Jianxin	2/2

Note: Mr Julian Juul Wolhardt was absent in one of the meetings due to his urgent attention required in another matter and his opinion was presented to the committee in written form prior to the meeting.

Nomination Committee

The nomination committee comprises three non-executive directors, two of whom are independent (Mr Wang Huaibao and Mr Zhang Julin) ("Nomination Committee"). The Nomination Committee is chaired by Mr Jiao Shuge, a non-executive director and the Chairman of the Board.

The responsibilities of the Nomination Committee is to review the structure, size and composition, including the skills, knowledge and experiences of the Board and make recommendations to the Board regarding any proposed changes. The Nomination Committee is also responsible to identify and nominate suitable candidates qualified to become Board members and makes recommendations to the Board on relevant matters relating to the appointment or re-appointment of directors if necessary, in particular, candidates who can add value to the management through their contributions in the relevant strategic business areas and which appointments will result in the constitution of a stronger and more diverse Board. In the selection process, the Nomination Committee makes reference to criteria including, inter alia, reputation for integrity, accomplishment and experience in the dairy industry, professional and educational background, and commitment in respect of available time.

The Nomination Committee held one meeting in 2006 to adopt its terms of reference and to discuss the nomination of a non-executive director to fill the casual vacancy arising from the resignation of a director. No meeting has been convened to date in 2007. The attendance record of each member of the Remuneration Committee in 2006 is set out below:

Directors	Attendance of Nomination Committee Meetings in 2006
Jiao Shuge (<i>chairman</i>)	1/1
Wang Huaibao	1/1
Zhang Julin	1/1

Directors' Securities Transactions

The Company has adopted, in terms no less exacting than, the standard required by the Model Code for Securities Transactions by Directors of Listed Issuers set out in Appendix 10 of the Listing Rules as the Company's code of conduct and rules governing dealings by all the directors in the securities of the Company ("Model Code"). Having made specific enquiry of all the directors, the Company confirms that, during the year ended 31 December 2006, all the directors have strictly complied with the Model Code.

Internal Control

The Board is responsible for maintaining an established and effective internal control system, to safeguard the assets of the Group and the interest of shareholders, and for reviewing its effectiveness regularly. Aiming at strengthening the risk management culture of the Group and minimizing the impacts of the major risks on the business and earnings of the Group, the senior management of the Group meets to actively evaluate and review the significant risks to which the Group is exposed and reports to the Board on a regular basis. The Group also appoints external consultants, when considered appropriate, to review the Group's internal control, working systems and workflows, as well as the management systems, and to make suggestions on system enhancement.

Besides strict implementation of a performance assessment system and training programs for its staff, the Group has in place a series of written working systems (bearing the five components below) in respect of business, production, finance, legal compliance and administration aspects, to ensure the significant risks, to which the Group is exposed, are contained:

- Control environment - The Group has established defined organizational structures. Authority to operate various business functions is delegated to respective management within limits set by senior management of the headquarters or the executive directors. The senior management meets on a regular basis to discuss and approve business strategies, plans and budgets prepared by individual business units. The performance of the Group is reported to the Board on a regular basis.
- Risk environment - The Group identifies, assesses and ranks the risks that are most relevant to the Group's business according to their likelihood, financial consequence and reputational impact on the Group.
- Control activities - Policies and procedures are set for each business function, in which approvals, authorization, verification, recommendations, performance reviews, asset security and segregation of duties are included.
- Information and communication - The Group's working systems document operational procedures of all business units, as well as authorization and approval procedures for significant decision making.
- Monitoring - The Group adopts a control and risk self-assessment methodology, continuously assessing and managing its business risks by way of assessment by the headquarters of the Group and each business unit on a regular basis, and communication of key control procedures to employees.

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During the year ended 31 December 2006, the Board had examined the internal control system and reviewed the evaluation performed by the Audit Committee, the management and internal and external auditors, on the effectiveness of internal control. No significant areas of concern were identified.

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. When the Company announces its interim and annual results, briefings are conducted to apprise investors, analysts and the press of the Group's operating results as well as business strategies and outlook. Investor relations website is updated on a timely basis to ensure that investors is able to have access to the Company's information, latest news and reports. Eight out of the nine directors, including the Chairman, have attended the annual general meeting in June 2006 to be available to answer questions at the meeting.

Separate resolutions are proposed at general meetings for each substantially separate issue, including election of directors.

Details of voting procedures by way of a poll and rights of shareholders to demand a poll were included in the circular dispatched to the shareholders of the Company. The circular also included relevant details of proposed resolutions and biography of directors standing for re-election.

Auditors

Details of fees paid or payable to Ernst & Young for the year ended 31 December 2006 are as follows:

Services rendered	2006 RMB'000	2005 RMB'000
2006 annual audit	2,380	1,860
2006 interim review	396	350
Non-audit service		
Review on connected transactions	40	60
	2,816	2,270

The above fees were approved by the Audit Committee. The re-appointment of Ernst & Young as auditors of the Company has been recommended by the Audit Committee and endorsed by the Board and is subject to approval by the shareholders at the forthcoming annual general meeting.

