

Report of the Directors

The board of directors (the "Board" or the "Directors") of China Yurun Food Group Limited (the "Company", together with its subsidiaries, the "Group") takes pleasure in submitting its 2006 annual report, together with the report of the Directors and the audited financial statements of the Group for the year ended 31 December 2006.

Principal Activities

The principal activity of the Company is investment holding. The principal activities of the subsidiaries comprise the offer of a wide range of meat (chilled and frozen) and processed meat (low temperature meat products and high temperature meat products) (with a particular focus on pork products), marketed under its primary "Yurun", "Furun", "Wangrun" and "Popular Meat Packing" brands. There were no significant changes in the nature of the Group's principal activities during the year. The activities of the subsidiaries are set out in note 20 to the financial statements.

Results and Appropriations

The Group's profit for the year ended 31 December 2006 and the state of affairs of the Group at that date are set out in the audited financial statements on pages 44 to 124.

The Board has recommended a final dividend of HK\$0.042 (equivalent to approximately RMB0.042) (2005: HK\$0.065) per share. This final dividend, together with the interim dividend of HK\$0.042 per share, will make a total dividend of HK\$0.084 for the full year ended 31 December 2006 (2005: HK\$0.065).

The final dividend will be paid on or about Tuesday, 22 May 2007 to shareholders whose names appear on the Register of Members of the Company on Wednesday, 16 May 2007.

Fixed Assets

Details of movements in the fixed assets of the Group for the year ended 31 December 2006 are set out in note 18 to the financial statements.

Share Capital

Details of the movements in the share capital of the Company during the year are set out in note 33 to the financial statements.

Pre-emptive Rights

There are no provisions for pre-emptive rights under the Company's Bye-laws or the laws of Bermuda.

Purchase, Sale or Redemption of Listed Securities of the Company

Neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities during the year.

Reserves

Details of movements in the reserves of the Company during the year are set out in note 34 to the financial statements. The details of movements in the reserves of the Group during the year are also included in the Consolidated Statement of Changes in Equity on page 48 of this annual report.

Financial Summary

A summary of the published results and the assets and liabilities of the Group for the last five financial years is set out on pages 125 to 126 of this annual report.

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Distributable Reserves

As of 31 December 2006, the Company's reserves available for distribution, calculated in accordance with the Companies Act 1981 of Bermuda, amounted to approximately RMB326,048,000, of which approximately RMB60,982,000 has been proposed as a final dividend for the year.

Charitable Contributions

During the year, the Group made charitable contributions totalling RMB100,000 (2005: RMB1,040,000).

Major Customers and Suppliers

Sales to the largest and the five largest customers of the Group accounted for approximately 2.68% and 8.98% respectively of the Group's total turnover for the year.

Purchases from the largest and the five largest suppliers of the Group accounted for approximately 1.26% and 5.24% respectively of the Group's total purchases for the year.

None of the Directors, their respective associates or to the knowledge of the Directors, the existing shareholders who, own more than 5% of the Company's share capital, has any interest in any of the five largest customers and suppliers.

Directors

The Directors of the Company during the year and up to the date of this annual report were:

Executive Directors

Zhu Yicai ^{R/N} (Chairman)
Zhu Yiliang (Chief Executive Officer)
Zhang Yuanfei (Chief Operating Officer)
Feng Kuande
Ge Yuqi
Bi Guoxiang (Resigned on 12 April 2007)

Non-executive Directors

Jiao Shuge ^A (alias Jiao Zhen)
Liu Yi Lan, Katherine (Appointed on 29 March 2006)
Hsu Shang Wi, William (Resigned on 16 August 2006)
Hsu I-Yin, Joyce (Resigned on 15 February 2006)

Independent Non-executive Directors

Zheng Xueyi
Kang Woon ^{A/R/N}
Gao Hui ^{A/R/N}

A: Members of Audit Committee

R: Members of Remuneration Committee

N: Members of Nomination Committee

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In accordance with Bye-law 87 of the Company's Bye-laws, Mr. Zhu Yiliang, Mr. Zhang Yuanfei, Mr. Feng Kuande and Mr. Jiao Shuge will retire from office by rotation and, being eligible, offer themselves for re-election at the forthcoming annual general meeting.

The Company has received from each independent non-executive Director an annual confirmation of his independence pursuant to Rule 3.13 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") and the Company considered all independent non-executive directors to be independent.

Biographical Details of Directors and Senior Management

Biographical details of the Directors and the senior management of the Group as at the date of this annual report are set out on pages 17 to 18 of this annual report.

Directors' Service Contracts

Each of the executive Directors has entered into a service contract with the Company with effect from 3 October 2005 for a term of three years. Each of these contracts may be terminated by either party giving not less than three months' notice in writing, provided that the executive Directors shall not resign during the first twelve months of the contract.

The non-executive Directors and independent non-executive Directors are appointed for a period of one year and will be extended for a further period of one year in accordance with their respective appointment letters.

The Directors shall retire by rotation and be eligible for re-election subject to the rotation provisions in the Bye-laws of the Company.

None of the Directors has a service contract with the Company which is not determinable by the Company within one year without payment of compensation, other than statutory compensation.

Pursuant to the services agreements entered into between the Company and each of the executive Directors, each of them is entitled to a remuneration of US\$60,000 per annum. The Company received written confirmations from the executive Directors on 11 April 2007, pursuant to which they have agreed to waive part of their remunerations payable by the Group for the services rendered for the year ended 31 December 2006. Details of the remunerations payable to the Directors for the year have been set out in note 13 to the financial statements.

Directors' Interests in Contracts

Details of the connected transactions and related party transactions are set out on pages 26 to 33 and pages 112 to 122 of this annual report respectively. Save for the above, no Director had a material interest whether directly or indirectly in any contract of significance to the business of the Group to which the Company, or any of its holding companies, subsidiaries or fellow subsidiaries was a party during or at the end of the year.

Management Contracts

No contracts concerning the management and administration of the whole or any substantial part of the business of the Company and the Group were entered into or existed during the year.

Directors' Interests and Short Positions in Shares, underlying Shares and Debentures

As of 31 December 2006, the number of issued ordinary shares of the Company was 1,451,952,650; and the interests and short positions of the Directors and chief executive of the Company in the shares, underlying shares and debentures of the Company or any associated corporation (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")), as recorded in the

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register of the Company required to be kept under Section 352 of the SFO, or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies ("Model Code") in the Listing Rules were as follows:

Interest in shares and underlying shares of the Company

Name of Directors	Company/name of associated corporation	Capacity	Interest in ordinary shares	Interest in underlying shares ⁽³⁾	Total	Approximate percentage of the issued ordinary shares in such corporation
Zhu Yicai ("Mr. Zhu")	Company	Interest of a controlled corporation	748,158,900 ⁽¹⁾	–	748,158,900	51.53%
	Willie Holdings Limited ("Willie Holdings")	Beneficial owner	100 ⁽¹⁾	–	100	100%
Zhu Yiliang	Company	Beneficial owner	–	5,000,000	5,000,000	0.34%
Zhang Yuanfei	Company	Beneficial owner	–	5,300,000	5,300,000	0.37%
Feng Kuande	Company	Beneficial owner	–	5,000,000	5,000,000	0.34%
Ge Yuqi	Company	Beneficial owner	–	5,000,000	5,000,000	0.34%
Bi Guoxiang ⁽²⁾	Company	Beneficial owner	–	2,000,000	2,000,000	0.14%

Notes:

- (1) Willie Holdings is owned as to 93.41% by Mr. Zhu and 6.59% by Ms. Wu Xueqin ("Ms. Wu"), the spouse of Mr. Zhu. Mr. Zhu is taken to be interested in these shares by virtue of Part XV of the SFO.
- (2) Mr. Bi Guoxiang resigned on 12 April 2007
- (3) The interests in underlying shares represent the interests in share options granted on 10 November 2006 pursuant to the Company's share option scheme, details of which are set out in note 32 to the financial statements and the section headed "Share Option Scheme" below.
- (4) None of the Directors held any short position in the shares, underlying shares of equity derivatives or debentures of the Company.

Save as disclosed above, as of 31 December 2006, none of the Directors or chief executive of the Company had any interests or short positions in the shares, underlying shares or debentures of the Company or any associated corporation (within the meaning of Part XV of the SFO) as recorded in the register of the Company required to be kept under Section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code.

Share Option Scheme

Pursuant to the resolution passed by the shareholders of the Company on 10 September 2005, a share option scheme ("Scheme") was unconditionally approved and adopted on 3 October 2005, particulars of which are set out as follows:

(a) *The purpose of the Scheme*

The Scheme seeks to provide an incentive for the Qualified Participants (as hereinafter defined) to work with commitment towards enhancing the value of the Company and its shares for the benefit of the shareholders, and to maintain or attract business relationships with the Qualified Participants whose contributions are or may be beneficial to the growth of the Group.

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(b) *Qualified Participants*

The Board may at its discretion grant options to: (i) any executive director, or employee (whether full time or part time) of the Company, any member of the Group or any entity in which any member of the Group holds an equity interest ("Invested Entity"); (ii) any non-executive director (including independent non-executive director) of the Company, any member of the Group or any Invested Entity; (iii) any supplier of goods or services to the Company, any member of the Group or any Invested Entity; (iv) any customer of the Company, any member of the Group or any Invested Entity; and (v) any person or entity that provides research, development or technological support to the Company, any member of the Group or any Invested Entity (collectively, "Qualified Participants").

(c) *Maximum number of shares available for issue under the Scheme*

The total number of shares which may be issued upon exercise of all options to be granted under the Scheme must not in aggregate exceed 10% of the issued share capital of the Company as of 3 October 2005, that is, the listing date of the Company or 30% of the issued share capital of the Company from time to time. As of the date of this annual report, the total number of shares available for issue in respect thereof is 139,708,380 shares, representing approximately 9.6% of the total number of shares in issue.

(d) *Maximum entitlement of each participant under the Scheme*

Unless approved by shareholders in general meeting in the manner prescribed in the Listing Rules, the Board shall not grant options to any option-holder if the acceptance of those options would result in the total number of shares issued and to be issued to that Qualified Participant on exercise of his options (including both exercised and outstanding options) during any 12-month period exceeding 1% of the total shares then in issue.

(e) *Timing for exercise of options*

The period during which an option may be exercised in accordance with the terms of the Scheme shall be a period of time to be notified by the Board to each option-holder, which the Board may in its absolute discretion determine, save that such period shall not be more than ten years commencing on the offer date. The Group and/or the grantee may or may not require achieving performance target in order to exercise the share options, depending on the terms set out in the individual offer letters.

(f) *Payment for acceptance of option*

Upon acceptance of the option, the grantee shall pay HK\$1.00 to the Company by way of consideration for the grant.

(g) *Basis of determining the exercise price*

The exercise price shall be a price determined by the Board but in any event shall be at least the highest of: (i) the closing price of the shares as stated in the Stock Exchange's daily quotation sheets on the date on which the option is offered to a Qualified Participant ("Offer Date"); (ii) the average of the closing prices of the shares as stated in the Stock Exchange's daily quotation sheets for the five business days immediately preceding the Offer Date; and (iii) the nominal value of the shares.

(h) *Period of the Scheme*

Subject to earlier termination by the Company in general meeting or by the Board, the Scheme shall be valid and effective for a period of ten years from 3 October 2005.

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The following share options were outstanding under the Scheme during the year:

Name or category of participant	Number of share options					Option period ⁽⁴⁾
	As of 1 January 2006	Granted during the year ⁽¹⁾	Exercised during the year	Lapsed during the year	As of 31 December 2006	
Directors						
Zhu Yiliang	–	5,000,000	–	–	5,000,000	10.11.2006 – 09.11.2016
Zhang Yuanfei	–	5,300,000	–	–	5,300,000	10.11.2006 – 09.11.2016
Feng Kuande	–	5,000,000	–	–	5,000,000	10.11.2006 – 09.11.2016
Ge Yuqi	–	5,000,000	–	–	5,000,000	10.11.2006 – 09.11.2016
Bi Guoxiang ⁽⁵⁾	–	2,000,000	–	–	2,000,000	10.11.2006 – 09.11.2016
Subtotal	–	22,300,000	–	–	22,300,000	
Employees (other than Directors)						
In aggregate	–	17,950,000	–	(200,000)	17,750,000	10.11.2006 – 09.11.2016
Subtotal	–	17,950,000	–	(200,000)	17,750,000	
Total	–	40,250,000	–	(200,000)	40,050,000	

Notes:

- All the share options were granted on 10 November 2006 and the exercise price is HK\$7.460.
- The closing price of the shares of the Company immediately before the date of grant (as of 9 November 2006) was HK\$7.580.
- No share options were cancelled under the Scheme during the year.
- All share options are subject to a restricted period which is from the date of grant up to the date on which the share options are exercisable in part or whole. Subject to the satisfaction of other conditions such as performance targets of the Group and/or individual, if any, as set out in individual offer letters, options will be vested in four equal batches i.e. 25% of the options will become vested after the first, second, third and fourth anniversaries of the date of grant after the publication of the results of the relevant financial year.
- Bi Guoxiang resigned on 12 April 2007. The Board has resolved to keep the share options of Mr. Bi in view of his past contributions to the Group.

Information on the accounting policy for share options granted is provided in note 4 (j) (iii) to the financial statements.

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Save as disclosed above, at no time during the year was the Company or any of its subsidiaries a party to any arrangement to enable the Directors or chief executives of the Company to acquire benefits by means of acquisition of shares in or debentures of the Company or any other body corporate.

Directors' Rights to Acquire Shares or Debentures

Details of share options granted to or exercised by the Directors or chief executive of the Company during the year and their outstanding balances as of 31 December 2006 are set out in "Share Option Scheme" on pages 22 to 25 of this annual report and note 32 to the financial statements.

Substantial Shareholders' Interests and Short Positions in Shares and Underlying Shares

As of 31 December 2006, so far as is known to the Directors and chief executive of the Company, the interests or short positions of substantial shareholders/other persons (other than Directors and chief executives of the Company) in the shares and underlying shares of the Company as recorded in the register of the Company required to be kept under Section 336 of the SFO were as follows:

Shares and underlying shares of the Company

Name	Nature of interest	Number of shares ⁽¹⁾	Approximate percentage of the issued ordinary shares
Willie Holdings	Beneficial owner	748,158,900 (L)	51.53%
Ms. Wu	Interest of spouse	748,158,900 (L) ⁽²⁾	51.53%
The Goldman, Sachs & Co. LLC	Interest of a controlled corporation	183,819,096 (L)	12.66%
		179,139,400 (S)	12.34%
AllianceBernstein L.P.	Interest of a controlled corporation	130,587,000 (L)	8.99%

Notes:

- (1) The letters "L" and "S" denote the person's long position and short position in such shares, respectively.
- (2) Willie Holdings is holding 748,158,900 shares in the Company. Willie Holdings is owned as to 93.41% by Mr. Zhu and as to 6.59% by Ms. Wu, the spouse of Mr. Zhu. Ms. Wu is taken to be interested in these shares by virtue of the SFO.

Save as disclosed above, as of 31 December 2006, no other parties were recorded in the register of the Company required to be kept under Section 336 of the SFO as having interests or short positions in the shares and underlying shares of the Company.

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Connected Transactions

Pursuant to Chapter 14A of the Listing Rules, the following connected transactions require disclosure in the annual report of the Company:

(A) *Continuing connected transactions:*

Types of transactions		Amount (RMB'000)
1.	Distribution fee in connection with sale of the Group's chilled and frozen pork by Shanghai Yurun Meat Product Co., Ltd. ("Shanghai Yurun")	4,564
2.	Sale of raw pork to, and distribution fee in connection with procurement of packaging materials for, Anhui Xuerun Meat Product Co., Ltd. ("Anhui Xuerun")	17,525
3.	Purchase of raw chicken meat from each of Anqing Furun Poultry Product Co. Ltd. ("Anqing Furun") and Liaocheng Furun Poultry Product Co., Ltd. ("Liaocheng Furun")	7,908
4.	Leases between the Group and the Predecessor Group including the following:	
4.1	Lease of land and buildings in Jianye District, Nanjing, Jiangsu Province between Nanjing Yurun Food Joint Stock Co., Ltd. ("Yurun Stock") and Nanjing Yurun Food Co., Ltd. ("Nanjing Yurun")	1,100
4.2	Lease of land and buildings in Donghai County, Lianyungang, Jiangsu Province between Jiangsu Furun Meat Processing Co., Ltd. ("Jiangsu Furun") and Lianyungang Furun Food Co., Ltd. ("Lianyungang Furun")	980
4.3	Lease of land and buildings in Yingdong District, Fuyang, Anhui Province between Anhui Furun Meat Processing Co., Ltd. ("Anhui Furun") and each of Fuyang Furun Meat Processing Co., Ltd. ("Fuyang Furun") and Fuyang Yurun Meat Processing Co., Ltd. ("Fuyang Yurun") ⁽²⁾	703
4.4	Lease of land and buildings in Suzhou, Anhui Province between Suzhou Furun Meat Product Co., Ltd. ("Suzhou Furun") and Suzhou Wanrun Meat Processing Co., Ltd. ("Suzhou Wanrun") ⁽²⁾	1,077
4.5	Lease of land and buildings in Shizhong District, Neijiang, Sichuan Province between Sichuan Furun Meat Product Co., Ltd. ("Sichuan Furun") and each of Neijiang Furun Food Co. Ltd. ("Neijiang Furun") and Neijiang Yurun Food Co., Ltd. ("Neijiang Yurun") ⁽²⁾	2,415
4.6	Lease of land and buildings in Kaiyuan, Liaoning Province between Liaoning Kaiyuan Yurun Meat Product Co., Ltd. ("Kaiyuan Yurun") and Kaiyuan People Food Co., Ltd. ("Kaiyuan Dazhong")	365

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Types of transactions		Amount (RMB'000)
4.7	Lease of land and buildings in Kaiyuan, Liaoning Province between Kaiyuan Yurun, Kaiyuan Furun Meat Product Co., Ltd. ("Kaiyuan Furun") and Kaiyuan Wanrun Food Co., Ltd. ("Kaiyuan Wanrun") ⁽³⁾	495
4.8	Lease of land and buildings in Tongzhou District, Beijing between Beijing Yurun Food Co., Ltd. ("Beijing Yurun Food") and Beijing Yurun Meat Co., Ltd. ("Beijing Yurun")	600
4.9	Lease of land and buildings in Baiyin Gansu Province between Baiyin Yurun Meat Product Co., Ltd. ("Baiyin Yurun"), Jiangsu Yurun Food Industry Group Company Limited ("Jiangsu Yurun Food Group") and Gansu Yurun Food Co., Ltd. ("Gansu Yurun")	1,400
4.10	Lease of land and buildings in Daowai District, Harbin, Heilongjiang Province between Harbin Popular Meat-Packing Group Co., Ltd. ("Harbin Popular") and each of Harbin Popular Fresh Food Co., Ltd. ("Harbin Fresh") and Harbin Popular Meat Product Co., Ltd. ("Harbin Product")	1,605
4.11	Lease of land and buildings in Donghai County, Lianyungang, Jiangsu Province between Donghai Wangrun branch of Yurun Stock ("Donghai Wangrun") and Nanjing Yurun	950
4.12	Lease of land and buildings in Conghua District, Guangzhou, Guangdong Province between Guangzhou Jinrun Food Co., Ltd. ("Guangzhou Jinrun") and Guangzhou Yurun Meat Food Co., Ltd. ("Guangzhou Yurun")	200
4.13	Lease of land and buildings in Fengfeng Mining Area, Handan City, Hebei Province between Handan Furun Meat Product Co., Ltd. ("Handan Furun") and Handan Wanrun Food Co., Ltd. ("Handan Wanrun") ⁽²⁾	394
4.14	Lease of land and buildings in Nangan District, Kaifeng City, Henan Province between Kaifeng Furun Meat Product Co., Ltd. ("Kaifeng Furun") and Kaifeng Wanrun Food Co., Ltd. ("Kaifeng Wanrun") ⁽²⁾	596
4.15	Lease of land and buildings in Yuanba Town, Guangyuan, Sichuan Province between Guangyuan Furun Meat Product Co., Ltd. ("Guangyuan Furun") and Harbin Fresh ⁽²⁾	321
		13,201
	Total:	43,198

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1. *Distribution fee in connection with sale of the Group's chilled and frozen pork by Shanghai Yurun*

On 30 March 2005, Shanghai Yurun entered into a distribution agreement with each of Kaiyuan Wanrun, Kaifeng Wanrun, Fuyang Furun, Lianyungang Furun, Suzhou Wanrun, Guangyuan branch of Harbin Fresh, Dujiangyan branch of Harbin Fresh, Harbin Fresh, Neijiang Furun, Handan Wanrun and Suihua Dazhong Meat Co., Ltd. ("Suihua Dazhong"). Pursuant to the distribution arrangements, Shanghai Yurun will distribute chilled and frozen pork for the Group's members in Shanghai at a distribution fee of 0.8% of the aggregate sales amount. The distribution fee is determined by reference to market price. The terms of the distribution arrangements took effect on 31 March 2005 and will expire on 31 December 2007. Shanghai Yurun has agreed to extend the term unconditionally if the relevant Group members agree.

The aggregate transaction value during the year amounted to approximately RMB4,564,000, which is equivalent to 0.10% of the Group's audited turnover for the year ended 31 December 2006.

2. *Sale of raw pork to, and distribution fee in connection with procurement of packaging materials for, Anhui Xuerun*

On 31 March 2005, Nanjing Yurun and Anhui Xuerun entered into an agreement. Pursuant to the agreement, Nanjing Yurun has agreed to supply raw pork or packaging materials that are required by Anhui Xuerun in its production. The fee charged for procuring materials for Anhui Xuerun is 3% of the amount of the materials procured. The agreement is valid for three years, commencing on 1 January 2005 and ending on 31 December 2007, unless terminated by either party serving not less than three months' written notice.

The aggregate transaction value during the year amounted to approximately RMB17,525,000, in which RMB17,308,000 was for sales of raw pork and RMB217,000 was for procurement of packaging materials, which is equivalent to 0.37% of the Group's audited turnover for the year ended 31 December 2006.

3. *Purchase of raw chicken meat from each of Anqing Furun and Liaocheng Furun*

On 1 April 2005, Nanjing Yurun entered into an agreement with each of Anqing Furun and Liaocheng Furun. Pursuant to the agreements, each of Anqing Furun and Liaocheng Furun has agreed to provide raw materials to Nanjing Yurun. The price that Nanjing Yurun has to pay to each of Anqing Furun and Liaocheng Furun shall be determined by the relevant parties after negotiation by reference to the market price at the time the order is placed. Such price, however, shall in no event be higher than the average price at which Anqing Furun and Liaocheng Furun supply the same kind of product to other parties in that month. The agreements are valid for three years, commencing on 1 January 2005 and ending on 31 December 2007.

The aggregate transaction value during the year amounted to approximately RMB7,908,000, which is equivalent to 0.17% of the Group's audited turnover for the year ended 31 December 2006.

4. *Leases between the Group and the Predecessor Group*

On 31 December 2004, the members of the Group entered into land and buildings lease agreements with the relevant companies of the Predecessor Group. Pursuant to the agreements, relevant members of the Predecessor Group have agreed to grant members of the Group the right to use certain land and buildings leases. The term of the lease is for 20 years commencing from 1 January 2005 and expiring on 31 December 2024. The aggregate amount of annual rental payments under the lease agreements is RMB14,385,000.

The aggregate amount of rental payments during the year amounted to approximately RMB13,201,000, which is equivalent to 0.28% of the Group's audited turnover for the year ended 31 December 2006.

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Details of each of the lease agreement between the Group and the Predecessor Group and their respective transaction values during the year were as follows:

4.1 *Lease of land and buildings in Jianye District, Nanjing, Jiangsu Province between Yurun Stock and Nanjing Yurun*

A lease agreement dated 31 December 2004 and two supplementary agreements dated 25 March 2005 and 30 May 2005, respectively were entered into between Yurun Stock as the lessor and Nanjing Yurun as the lessee for the leasing of an industrial building situate at 17 Yurun Road, Jianye District, Nanjing, Jiangsu Province. The term of the lease is for 20 years, commencing on 1 January 2005 and expiring on 31 December 2024. The amount of the rental payments under the lease agreements is RMB1,100,000 per annum. The transaction value during the year amounted to RMB1,100,000.

4.2 *Lease of land and buildings in Donghai County, Lianyungang, Jiangsu Province between Jiangsu Furun and Lianyungang Furun*

A lease agreement dated 31 December 2004 and two supplementary agreements dated 25 March 2005 and 30 May 2005, respectively were entered into between Jiangsu Furun as the lessor and Lianyungang Furun as the lessee for the leasing of an industrial building situate at 8 Xu Hai Xi Lu, Niu Shan Zhen, Donghai County, Lianyungang, Jiangsu Province. The term of the lease is for 20 years, commencing on 1 January 2005 and expiring on 31 December 2024. The amount of the rental payments under the lease agreements is RMB980,000 per annum. The transaction value during the year amounted to RMB980,000.

4.3 *Lease of land and buildings in Yingdong District, Fuyang, Anhui Province between Anhui Furun and each of Fuyang Furun and Fuyang Yurun⁽²⁾*

A lease agreement dated 31 December 2004 and two supplementary agreements dated 25 March 2005 and 30 May 2005, respectively were entered into between Anhui Furun as the lessor and each of Fuyang Furun and Fuyang Yurun as the lessee for the leasing of an industrial building situate at 16 Fu Hu Lu, Yingdong District, Fuyang, Anhui Province. The term of the leases is for 20 years, commencing on 1 January 2005 and expiring on 31 December 2024. The amount of the rental payments under the lease agreements is RMB1,405,000 per annum. The transaction value during the year amounted to approximately RMB703,000.

4.4 *Lease of land and buildings in Suzhou, Anhui Province between Suzhou Furun and Suzhou Wanrun⁽²⁾*

A lease agreement dated 31 December 2004 and two supplementary agreements dated 25 March 2005 and 30 May 2005, respectively were entered into between Suzhou Furun as the lessor and Suzhou Wanrun as the lessee for the leasing of an industrial building situate at 18 Huai Hai Lu, Suzhou, Anhui Province. The term of the lease is for 20 years, commencing on 1 January 2005 and expiring on 31 December 2024. The amount of the rental payments under the lease agreements is RMB1,175,000 per annum. The transaction value during the year amounted to approximately RMB1,077,000.

4.5 *Lease of land and buildings in Shizhong District, Neijiang, Sichuan Province between Sichuan Furun and each of Neijiang Furun and Neijiang Yurun⁽²⁾*

A lease agreement dated 31 December 2004 and three supplementary agreements dated 25 March 2005, 8 May 2005 and 30 May 2005, respectively were entered into between Sichuan Furun as the lessor and each of Neijiang Furun and Neijiang Yurun as the lessee for the leasing of an industrial building situate at 281 Le Jiang Si Lu, Shizhong District, Neijiang, Sichuan Province. The term of the leases is for 20 years, commencing on 1 January 2005 and expiring on 31 December 2024. The amount of the rental payments under the lease agreements is RMB2,635,000 per annum. The transaction value during the year amounted to approximately RMB2,415,000.

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4.6 *Lease of land and buildings in Kaiyuan, Liaoning Province between Kaiyuan Yurun and Kaiyuan Dazhong⁽²⁾*

A lease agreement dated 31 December 2004 and two supplementary agreements dated 25 March 2005 and 30 May 2005, respectively were entered into between Kaiyuan Yurun as the lessor and Kaiyuan Dazhong as the lessee for the leasing of an industrial building situate at 69 Tie Xi Jie, Kaiyuan, Liaoning Province. The term of the lease is for 20 years, commencing on 1 January 2005 and expiring on 31 December 2024. The amount of the rental payments under the lease agreements is RMB365,000 per annum. The transaction value during the year amounted to RMB365,000.

4.7 *Lease of land and buildings in Kaiyuan, Liaoning Province between Kaiyuan Yurun, Kaiyuan Furun and Kaiyuan Wanrun⁽³⁾*

A lease agreement dated 31 December 2004 and two supplementary agreements dated 25 March 2005 and 30 May 2005, respectively were entered into between Kaiyuan Yurun and Kaiyuan Furun as the lessor and Kaiyuan Wanrun as the lessee for the leasing of an industrial building situate at 69 Tie Si Jie, Tie Si Community, Kaiyuan, Liaoning Province. The term of the lease is for 20 years, commencing on 1 January 2005 and expiring on 31 December 2024. The amount of the rental payments under the lease agreements is RMB540,000 per annum. The transaction value during the year amounted to RMB495,000.

4.8 *Lease of land and buildings in Tongzhou District, Beijing between Beijing Yurun Food and Beijing Yurun*

A lease agreement dated 31 December 2004 and three supplementary agreements dated 25 March 2005, 8 May 2005 and 30 May 2005, respectively were entered into between Beijing Yurun Food as the lessor and Beijing Yurun as the lessee for the leasing of an industrial building situate at 1 Chuang Ye Hua Yuan, Tai Hu Xiang Kou Zi Cun Dong, Taihu County, Tongzhou District, Beijing. The term of the lease is for 20 years, commencing on 1 January 2005 and expiring on 31 December 2024. The amount of the rental payments under the lease agreements is RMB600,000 per annum. The transaction value during the year amounted to RMB600,000.

4.9 *Lease of land and buildings in Baiyin District, Baiyin, Gansu Province between Baiyin Yurun, Jiangsu Yurun Food Group and Gansu Yurun*

A lease agreement dated 31 December 2004 and three supplementary agreements dated 25 March 2005, 8 May 2005 and 30 May 2005, respectively were entered into between Baiyin Yurun and Jiangsu Yurun Food Group as the lessor and Gansu Yurun as the lessee for the leasing of an industrial building situate at 25 Jian She Xi Lu, Baiyin District, Baiyin, Gansu Province. The term of the lease is for 20 years, commencing on 1 January 2005 and expiring on 31 December 2024. The amount of the rental payments under the lease agreements is RMB1,400,000 per annum. The transaction value during the year amounted to RMB1,400,000.

4.10 *Lease of land and buildings in Daowai District, Harbin, Heilongjiang Province between Harbin Popular and each of Harbin Fresh and Harbin Product*

A lease agreement dated 31 December 2004 and two supplementary agreements dated 25 March 2005 and 30 May 2005, respectively were entered into between Harbin Popular as the lessor and each of Harbin Fresh and Harbin Product as the lessee for the leasing of an industrial building situate at 54 Nan Ji Jie, Daowai District, Harbin, Heilongjiang Province. The term of the lease is for 20 years, commencing on 1 January 2005 and expiring on 31 December 2024. The amount of the rental payments under the lease agreements is RMB1,605,000 per annum. The transaction value during the year amounted to RMB1,605,000.

Report of the Directors

4.11 *Lease of land and buildings in Donghai County, Lianyungang, Jiangsu Province between Donghai Wangrun branch of Yurun Stock and Nanjing Yurun*

A lease agreement dated 31 December 2004 and three supplementary agreements dated 25 March 2005, 8 May 2005 and 30 May 2005, respectively were entered into between Donghai Wangrun branch of Yurun Stock as the lessor and Nanjing Yurun as the lessee for the leasing of an industrial building situate at 6 Xu Hai Xi Lu, Niu Shan Zhen, Donghai County, Lianyungang, Jiangsu Province. The term of the lease is for 20 years, commencing on 1 January 2005 and expiring on 31 December 2024. The amount of the rental payments under the lease agreements is RMB950,000 per annum. The transaction value during the year amounted to RMB950,000.

4.12 *Lease of land and buildings in Conghua District, Guangzhou, Guangdong Province between Guangzhou Jinrun and Guangzhou Yurun*

A lease agreement dated 31 December 2004 and two supplementary agreements dated 25 March 2005 and 30 May 2005, respectively were entered into between Guangzhou Jinrun as the lessor and Guangzhou Yurun as the lessee for the leasing of an industrial building situate at Ling Nan Industrial Park, Ling Nan Cun, Qi Gan Zhen, Conghua District, Guangzhou, Guangdong Province. The term of the lease is for 20 years, commencing on 1 January 2005 and expiring on 31 December 2024. The amount of the rental payments under the lease agreements is RMB200,000 per annum. The transaction value during the year amounted to RMB200,000.

4.13 *Lease of land and buildings in Fengfeng Mining Area, Handan, Hebei Province between Handan Furun and Handan Wanrun⁽²⁾*

A lease agreement dated 31 December 2004 and three supplementary agreements dated 25 March 2005, 8 May 2005 and 30 May 2005, respectively were entered into between Handan Furun as the lessor and Handan Wanrun as the lessee for the leasing of an industrial building situate at 45 Peng Xin Lu, Fengfeng Mining Area, Handan City, Hebei Province. The term of the lease is for 20 years, commencing on 1 January 2005 and expiring on 31 December 2024. The amount of the rental payments under the lease agreements is RMB430,000 per annum. The transaction value during the year amounted to approximately RMB394,000.

4.14 *Lease of land and buildings in Nangan District, Kaifeng, Henan Province between Kaifeng Furun and Kaifeng Wanrun⁽²⁾*

A lease agreement dated 31 December 2004 and two supplementary agreements dated 25 March 2005 and 30 May 2005, respectively were entered into between Kaifeng Furun as the lessor and Kaifeng Wanrun as the lessee for the leasing of an industrial building situate at 15 Wei Du Lu, Nangan District, Kaifeng City, Henan Province. The term of the lease is for 20 years, commencing on 1 January 2005 and expiring on 31 December 2024. The amount of the rental payments under the lease agreements is RMB650,000 per annum. The transaction value during the year amounted to approximately RMB596,000.

4.15 *Lease of land and buildings in Yuanba Town, Guangyuan, Sichuan Province between Guangyuan Furun and Harbin Fresh⁽²⁾*

A lease agreement dated 31 December 2004 and two supplementary agreements dated 25 March 2005 and 30 May 2005, respectively were entered into between Guangyuan Furun as the lessor and Harbin Fresh as the lessee for the leasing of an industrial building situate at Changba Cun, Yuanba Town, Guangyuan, Sichuan Province. The term of the lease is for 20 years, commencing on 1 January 2005 and expiring on 31 December 2024. The amount of the rental payments under the lease agreements is RMB350,000 per annum. The transaction value during the year amounted to approximately RMB321,000.

Report of the Directors

Notes:

- (1) Shanghai Yurun, Anhui Xuerun, Anqing Furun, Liaocheng Furun, Yurun Stock, Jiangsu Furun, Kaiyuan Yurun, Beijing Yurun Food, Baiyin Yurun, Jiangsu Yurun Food Group, Harbin Popular, Donghai Wangrun, Guangzhou Jinrun, and Suihua Dazhong are beneficially owned by Mr. Zhu Yicai, the Chairman and controlling shareholder of the Company. They are connected persons of the Company as defined in the Listing Rules.
- (2) The transactions under items 4.3, 4.4, 4.5, 4.13, 4.14 and 4.15 have ceased to be continuing connected transactions of the Company since the Group acquired the entire equity interest in each of Anhui Furun, Suzhou Furun, Sichuan Furun, Handan Furun, Kaifeng Furun and Guangyuan Furun during the year, details of which have been disclosed in the Company's announcements dated 23 June 2006 and 2 November 2006.
- (3) Since the Group acquired the entire equity interest in Kaiyuan Furun during the year, Kaiyuan Furun has ceased to be a connected person in the transaction under item 4.7 following the completion of the acquisition, details of which have been disclosed in the Company's announcement dated 2 November 2006.
- (4) "Predecessor Group" is a group of companies which operated some or all of the business of the Group prior to the reorganisation for listing.

The independent non-executive Directors have reviewed the continuing connected transactions and confirmed that the transactions have been entered into:

1. in the ordinary and usual course of business of the Company;
2. on normal commercial terms; and
3. in accordance with the relevant agreements governing them on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

The auditors of the Company have reviewed the continuing connected transactions pursuant to rule 14A.38 of the Listing Rules and advised the Board in writing with a copy provided to the Stock Exchange that the transactions:

1. have been approved by the Board;
2. have been entered into in accordance with the relevant agreements governing the transactions; and
3. have not exceeded the cap disclosed previously.

Waiver

The Company has obtained a waiver from the Stock Exchange prior to the Company's listing in relation to the above connected transactions from strict compliance with the announcement requirements relating to continuing connected transactions under the Listing Rules until 31 December 2007.

Report of the Directors

(B) *Non-recurring connected transactions*

(i) *Acquisition of Anhui Furun*

On 21 June 2006, each of Nanjing Yurun and Fuyang Yurun, both indirect wholly-owned subsidiaries of the Company, entered into two sets of agreement with Mr. Zhu, and Mr. Zhu and Ms. Wu respectively to acquire the entire equity interest in Anhui Furun for an aggregate consideration of RMB67,410,320. The acquisition of Anhui Furun is consistent with the Company's plan to acquire land use rights and production plants from the Predecessor Group as stated in the Company's prospectus dated 20 September 2005 ("Prospectus").

As of the date of the agreements, the equity interest in Anhui Furun was owned as to 98.5% by Mr. Zhu and 1.5% by Ms. Wu. The entering into of the agreements constituted connected transactions of the Company under the Listing Rules which is subject to the reporting and announcement requirements. The transaction has been announced on 23 June 2006.

(ii) *Acquisition of Six Predecessor Entities*

On 23 October 2006, Anhui Furun and Nanjing Yurun, both indirect wholly-owned subsidiaries of the Company, entered into six sets of agreements with each of Jiangsu Yurun Food Group, Anhui Yurun Food Group Co., Ltd. ("Anhui Yurun"), Jiangsu Furun, Neijiang Yurun Meat Product Co., Ltd. ("Neijiang Yurun Product"), Ms. Wu, Mr. Bi Guoxiang and Mr. Zhu Zhengfu to acquire the entire equity interest in six Predecessor Entities (comprising companies or business operations controlled by Mr. Zhu which were engaged in chilled and frozen pork businesses and/or processed meat businesses before the reorganisation for the listing of the Company), namely, Guangyuan Furun, Handan Furun, Kaifeng Furun, Kaiyuan Furun, Sichuan Furun, and Suzhou Furun for an aggregate consideration of RMB191,618,300. The acquisitions are consistent with the Company's plan to acquire land use rights and production plants from the Predecessor Group as stated in the Prospectus.

As of the date of the agreements, Mr. Zhu owned 95% of the equity interest in Jiangsu Yurun Food Group while the remaining 5% was owned by Ms. Wu. Anhui Yurun, Jiangsu Furun and Neijiang Yurun Product were wholly-owned subsidiaries of Jiangsu Yurun Food Group. Mr. Bi Guoxiang was the then Chief Executive Officer and an executive director of the Company. Mr. Zhu Zhengfu is the father of Mr. Zhu. The entering into of the agreements constituted connected transactions of the Company and approval to the acquisitions was given by the independent shareholders of the Company at the Special General Meeting on 11 December 2006.

Save as disclosed above, there are no other transactions which require disclosure in the annual report in accordance with the Listing Rules.

Report of the Directors

Use of IPO proceeds

The shares of the Company were listed on the Main Board of the Stock Exchange on 3 October 2005. The Company raised approximately HK\$1.380 billion after deduction of related expenses. These proceeds were applied in accordance with the Group's future plans, details of which are set out in the section headed "Future Plans and Use of Proceeds" in the Prospectus, as follows:

Intended use	Planned proceeds HK\$ million	Unused proceeds as of	Actual use of proceeds for the year ended	Unused proceeds as of
		1 January 2006 HK\$ million	31 December 2006 HK\$ million	31 December 2006 HK\$ million
To expand production capacity	675	649	407	242
For working capital requirements and general corporate purposes	432	382	159	223
For acquisition of land use rights and production plants	178	178	178	–
For research and development	59	58	7	51
To expand and improve sales network	36	34	14	20
	<u>1,380</u>	<u>1,301</u>	<u>765</u>	<u>536</u>

The remaining net proceeds as of 31 December 2006 were placed as deposits with interest-bearing bank accounts.

Post Balance Sheet Events

Details of the post balance sheet events of the Group are set out in note 38 to the financial statements.

Public Float

Based on the information publicly available to the Company and within the knowledge of the Directors, the Company has maintained the prescribed amount of public float during the year and up to the date of this annual report as required under the Listing Rules.

Corporate Governance

Code on Corporate Governance Practices

The Company has complied throughout the period from 1 January 2006 to 31 December 2006 with the applicable code provisions set out in the Code on Corporate Governance Practices set out in Appendix 14 to the Listing Rules except for a short period of deviation from code provision A.5.4, details of which have been disclosed in the Company's 2005 annual report and the interim report for the six months ended 30 June 2006.

Report of the Directors

Model Code for Securities Transaction by Directors

The Company has adopted the Model Code as the Company's code of conduct and rules governing dealings by all Directors in the securities of the Company. The Company, having made specific enquiry of all Directors, confirms that the Directors have complied with the required standard set out in the Model Code throughout the year.

Details of the Company's corporate governance practices are set out in the "Corporate Governance Report" on page 37 to 42 of this annual report.

Auditors

KPMG was first appointed as auditors of the Company on 14 April 2005. KPMG will retire and a resolution for their reappointment as auditors of the Company will be proposed at the forthcoming annual general meeting.

By Order of the Board

Zhu Yicai

Chairman

Hong Kong, 12 April 2007



Production capacity construction has been stepped up to cover a wider area and to satisfy the growing demand