

## SUMMARY

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### OVERVIEW

Shengmu is the largest organic dairy company in China and the only vertically integrated organic dairy company in China that meets E.U. organic standards, according to the F&S Report. We had a 54.2% market share in China based on 2013 organic raw milk production volume, according to the F&S Report. Together with our associate, Shengmu Forage, our unique vertically integrated “grass-to-glass” organic (“全程有機”) production model covers the entire dairy industry value chain, meeting E.U. organic standards for all major stages of the dairy production process: forage growing, dairy farming to produce raw milk, and processing to produce high-end liquid milk products. According to the F&S Report, we are a major producer of organic liquid milk with a market share of 25.3% in terms of retail sales value of organic liquid milk in China in 2013. In addition, we are also among the top eight producers of premium non-organic raw milk (which refers to the raw milk that meets certain nutrition and safety standards) in China with a market share of 2.6% based on 2013 production volume, according to the F&S Report.

China’s organic raw milk market accounted for 0.5% of the overall raw milk market in China in terms of production volume in 2013, and is expected to grow at a CAGR of 53.5%, reaching 3.2% of China’s total raw milk production volume in 2018, according to the F&S Report. The total retail sales value of organic liquid milk in China was RMB1.9 billion in 2013, accounting for 1.3% of the total liquid milk market in China. In addition, China’s high-end liquid milk market accounted for 28.8% of the overall liquid milk product market in China in terms of retail sales value in 2013, according to the F&S Report.

Our business consists of the dairy farming business and the liquid milk business. We commenced our dairy farming operations in 2010 by engaging in the premium non-organic raw milk production in Hohhot, Inner Mongolia, and in 2011 expanded into the production of organic raw milk in Bayannur, Inner Mongolia. In 2012, we further expanded into the liquid milk business under which we produce and sell packaged organic liquid milk products under our “Shengmu 圣牧” brand. All of our liquid milk products are produced from organic raw milk produced internally by our organic dairy farms. We are the only dairy company in China that offers branded organic dairy products that are 100% processed from raw milk produced by self-owned certified organic dairy farms, according to the F&S Report. We expect that our future growth will primarily be driven by the growth of our organic dairy farming and liquid milk businesses.

## SUMMARY

The following table sets forth the components of our revenue by operating segment for the period indicated.

| For the year ended December 31,        | Dairy farming business |                                    |                |                                      | Liquid milk business |                                    |                |                                      | Total revenue (after elimination of inter-segment sales) |
|--|------------------------|------------------------------------|----------------|--------------------------------------|----------------------|------------------------------------|----------------|--------------------------------------|--|
|  | Segment revenue        | Inter-segment sales <sup>(1)</sup> | External sales | External sales as % of total revenue | Segment revenue      | Inter-segment sales <sup>(1)</sup> | External sales | External sales as % of total revenue |  |
| (RMB in thousands, except percentages) |                        |                                    |                |                                      |                      |                                    |                |                                      |  |
| 2011 .....                             | 389,417                | —                                  | 389,417        | 100.0%                               | —                    | —                                  | —              | —                                    | 389,417  |
| 2012 .....                             | 682,179                | 15,345                             | 666,834        | 95.2%                                | 33,929               | —                                  | 33,929         | 4.8%                                 | 700,763  |
| 2013 .....                             | 972,308                | 131,561                            | 840,747        | 73.5%                                | 302,962              | —                                  | 302,962        | 26.5%                                | 1,143,709  |

(1) Represents internally produced organic raw milk sold to our liquid milk business.

The following table sets forth the sales volume of our organic and premium non-organic raw milk for the period indicated.

|  | For the year ended December 31, |            |         |            |         |            |
|--|---------------------------------|------------|---------|------------|---------|------------|
|  | 2011                            |            | 2012    |            | 2013    |            |
|  | Tonnes                          | % of total | Tonnes  | % of total | Tonnes  | % of total |
| Organic raw milk                         |                                 |            |         |            |         |            |
| External sales .....                     | 21,484                          | 20.9%      | 33,397  | 21.2%      | 68,518  | 33.6%      |
| Inter-segment sales <sup>(1)</sup> ..... | —                               | —          | 2,708   | 1.7%       | 23,813  | 11.7%      |
| Subtotal .....                           | 21,484                          | 20.9%      | 36,105  | 22.9%      | 92,331  | 45.3%      |
| Premium non-organic raw milk .....       | 81,165                          | 79.1%      | 121,300 | 77.1%      | 111,465 | 54.7%      |
| Total .....                              | 102,649                         | 100.0%     | 157,405 | 100.0%     | 203,796 | 100.0%     |

(1) Represents internally produced organic raw milk sold to the liquid milk business.

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The following table sets forth our gross profit and gross margin for each of our segments both before and after elimination of internal profit from inter-segment sales for the period indicated.

|  | For the year ended December 31,        |              |              |               |              |              |               |              |              |
|--|--|--------------|--------------|---------------|--------------|--------------|---------------|--------------|--------------|
|  | 2011                                   |              |              | 2012          |              |              | 2013          |              |              |
|  | Cost of sales                          | Gross profit | Gross margin | Cost of sales | Gross profit | Gross margin | Cost of sales | Gross profit | Gross margin |
|  | Amount                                 | Amount       | %            | Amount        | Amount       | %            | Amount        | Amount       | %            |
|  | (RMB in thousands, except percentages) |              |              |               |              |              |               |              |              |
| <b>Dairy farming business</b>          |  |              |              |               |              |              |               |              |              |
| Organic raw milk                       |  |              |              |               |              |              |               |              |              |
| Before elimination .....               | 64,829                                 | 17,945       | 21.7%        | 125,144       | 58,297       | 31.8%        | 271,176       | 213,303      | 44.0%        |
| After elimination <sup>(1)</sup> ..... | 64,829                                 | 17,945       | 21.7%        | 115,758       | 52,338       | 31.1%        | 201,237       | 151,681      | 43.0%        |
| Premium non-organic raw milk .....     | 209,987                                | 96,656       | 31.5%        | 331,712       | 167,026      | 33.5%        | 312,670       | 175,160      | 35.9%        |
| Subtotal:                              |  |              |              |               |              |              |               |              |              |
| Before elimination .....               | 274,816                                | 114,601      | 29.4%        | 456,856       | 225,323      | 33.0%        | 583,846       | 388,462      | 40.0%        |
| After elimination <sup>(1)</sup> ..... | 274,816                                | 114,601      | 29.4%        | 447,470       | 219,364      | 32.9%        | 513,907       | 326,841      | 38.9%        |
| <b>Liquid milk business</b>            |  |              |              |               |              |              |               |              |              |
| Before elimination .....               | —                                      | —            | N/A          | 25,193        | 8,736        | 25.7%        | 200,998       | 101,964      | 33.7%        |
| After elimination <sup>(2)</sup> ..... | —                                      | —            | N/A          | 19,235        | 14,694       | 43.3%        | 139,377       | 163,585      | 54.0%        |

(1) Represents gross profit after elimination of internal profit attributable to inter-segment sales of organic raw milk. Such internal profit is calculated as the difference of (i) the inter-segment sales of organic raw milk used in our liquid milk business and (ii) the production costs for such organic raw milk calculated as the product of (a) total cost of sales of organic raw milk and (b) the volume of organic raw milk sold to our liquid milk business divided by total sales volume of organic raw milk.

(2) Represents gross profit after adding back the internal profit attributable to inter-segment sales of organic raw milk. Such internal profit is calculated as the difference of (i) the inter-segment sales of organic raw milk used in this segment and (ii) the production costs for such organic raw milk calculated using the formula in note (1) above.

As of December 31, 2013, we owned the largest herd of organic dairy cows in China, with a 58.0% market share in terms of herd size, and the third largest herd of dairy cows overall in China, according to the F&S Report. As of that date, all of our 13 organic dairy farms were located in the Ulan Buh desert while all of our 12 non-organic dairy farms were located in Hohhot, Inner Mongolia, with a majority of our dairy farms having the capacity to house between 2,500 to 4,500 cows. Our average annual milk yield in 2013 was 8.5 tonnes. The following table sets forth the number of our dairy farms and dairy cows as of the date indicated.

| As of December 31, | Organic     |                    |               |                     | Non-organic |                    |               |                     | Total dairy cows |
|--------------------|-------------|--------------------|---------------|---------------------|-------------|--------------------|---------------|---------------------|------------------|
|                    | Dairy farms | Calves and heifers | Milkable cows | Dairy cows subtotal | Dairy farms | Calves and heifers | Milkable cows | Dairy cows subtotal |                  |
| 2011 .....         | 4           | 3,423              | 5,559         | 8,982               | 13          | 8,405              | 17,729        | 26,134              | 35,116           |
| 2012 .....         | 7           | 5,557              | 8,554         | 14,111              | 14          | 16,190             | 19,082        | 35,272              | 49,383           |
| 2013 .....         | 13          | 13,796             | 16,825        | 30,621              | 12          | 10,811             | 19,025        | 29,836              | 60,457           |

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The table below sets forth the sales amount, sales volume and average selling price of our products by product segment for the period indicated.

| For the year ended December 31,                              |                 |                             |                 |                 |                             |                 |                 |                             |        |
|--|-----------------|-----------------------------|-----------------|-----------------|-----------------------------|-----------------|-----------------|-----------------------------|--------|
| 2011   |                 |                             | 2012            |                 |                             | 2013            |                 |                             |        |
| Sales<br>amount  | Sales<br>volume | Average<br>selling<br>price | Sales<br>amount | Sales<br>volume | Average<br>selling<br>price | Sales<br>amount | Sales<br>volume | Average<br>selling<br>price |        |
| RMB  | Tonnes          | RMB/<br>tonne               | RMB             | Tonnes          | RMB/<br>tonne               | RMB             | Tonnes          | RMB/<br>tonne               |        |
| (In thousands except sales volume and average selling price) |                 |                             |                 |                 |                             |                 |                 |                             |        |
| Raw milk <sup>(1)</sup>                                      |                 |                             |                 |                 |                             |                 |                 |                             |        |
| Organic .....  | 82,774          | 21,484                      | 3,853           | 168,096         | 33,397                      | 5,033           | 352,918         | 68,518                      | 5,151  |
| Premium non-organic ..                                       | 306,643         | 81,165                      | 3,778           | 498,738         | 121,300                     | 4,112           | 487,829         | 111,465                     | 4,377  |
| Subtotal .....   | 389,417         | 102,649                     | 3,794           | 666,834         | 154,697                     | 4,311           | 840,747         | 179,983                     | 4,671  |
| Liquid milk products.....                                    | —               | —                           | —               | 33,929          | 2,246                       | 15,106          | 302,962         | 20,715                      | 14,625 |

(1) Represents sales to external customers.

### Our Business Model

#### *Our organic business model*

We stringently control each major step of the production process under our “grass-to-glass” organic milk production model, which focuses on the following aspects:

- *Organic environment.* The Ulan Buh desert, where both Shengmu Forage’s growing fields and our organic dairy farms are located, offers a number of benefits compared to conventional farming environments in China. These benefits include cool and dry weather preferred by dairy cows, limited human activity, little pollution as well as very low levels of bacteria, viruses and pests. In addition, according to F&S Report, there is abundant water resources and rich soil underneath the sandy surface.
- *Organic forage planting.* Currently we source our organic forages substantially from Shengmu Forage, which grows, among others, corn and alfalfa in the Ulan Buh desert without using any agricultural chemicals or chemical synthetic fertilizers. Shengmu Forage currently grows organic forages on parcels of land with a total area of approximately 115,000 mu (76.7 square kilometers) in the Ulan Buh desert; by 2020, Shengmu Forage expects to develop a total of approximately 560,000 mu (373.3 square kilometers) of growing fields for organic forages.
- *Organic dairy farming.* We are committed to cattle welfare as part of the culture of organic dairy farming, which we believe also contributes to our product quality. We raise our organic dairy cows in a low density environment with organic feed using no growth hormones.

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- *Organic processing.* All of the raw milk we use to produce our liquid milk products is supplied internally by our organic dairy farms. No preservatives, artificial coloring or artificial flavoring is added during the production process.
- *Organic milk origin tracing.* Each unit of our organic milk product is given a code recognized by PRC Certification and Accreditation Administration (中國國家認證認可監督管理委員會) to trace the origin of production of each product as a quality control measure.

### ***Our non-organic business model***

We also operate non-organic free-stall dairy farms with rationalized herd size, uniform farm designs and layout, standardized operating procedures and automated equipment. We currently implement substantially the same procedures in our premium non-organic raw milk production process as in our organic raw milk production process, including farm management, feeding management, milking process and disease control. The major differences between our non-organic production process and organic production process include the following:

- *Location.* All of our non-organic dairy farms are located in Hohhot, Inner Mongolia. Hohhot has a cool and dry weather similar to that of the Ulan Buh desert that is favorable to dairy farming.
- *Average space per cow.* Our non-organic dairy farms are free-stall farms designed similarly to our organic dairy farms except that the average space per cow is approximately 30 square meters as compared to 60 to 80 square meters for our organic dairy farms. As with our organic dairy farms, our non-organic dairy farms have easy access to food and water, clean, comfortable, dry sand bedding and sport fields that allow our dairy cows to eat, drink and relax freely.
- *Conventional feed.* We feed our non-organic dairy cows with the same types of feed as our organic cows, including corn silage, guinea grass, alfalfa and concentrated feed purchased from third party suppliers; however, we do not require them to be organic. In addition, unlike our organic cows which drink purified water, our non-organic dairy cows drink underground water from wells on our farms. We inspect the water quality regularly to ensure that it is clean and safe.

### **Customer Base and Distribution Network**

Our customer base may be largely categorized into industrial customers and distributors. In 2013, sales of raw milk accounted for 73.5% of our revenue (consisting of 30.9% from organic raw milk and 42.6% from premium non-organic raw milk). Our premium non-organic raw milk is sold to a limited number of leading dairy companies in China, including primarily Mengniu Group and Yili Group. In the first quarter of 2014, we also entered into annual raw milk supply agreements with Want Want. A portion of our organic raw milk is sold to these industrial customers, but increasingly sold after processing as liquid milk products under our “Shengmu 圣牧” brand. Our liquid milk products are primarily sold to distributors, which in turn sell to supermarket chains, department stores, convenience store chains and other points of sales. In 2013, sale of liquid milk products accounted for 26.5% of our revenue. As of December 31, 2013, we had 316 distributors with over 50,000 points of sale. A minimal amount of our liquid milk products is also sold directly to consumers.

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The table below sets forth certain information about our customers.

| Product type               | Major customers                          | Points of sale  | Use of our products                        |
|----------------------------|--|---|--|
| Raw milk.....              | Mengniu Group<br>Yili Group<br>Want Want | N/A   | Production of end products                 |
| Liquid milk products ..... | Distributors                             | Supermarket chains, department stores, convenience store chains and specialty channels <sup>(1)</sup> | Sale to sub-distributors or points of sale |
|                            | Consumers                                | VIP card membership, corporate wholesale  | Consumption                                |

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(1) Our specialty channels include restaurants, gas stations, fitness centers and e-commerce platforms.

### Suppliers and Procurement

The principal raw materials that we use are dairy cow feed, primarily including forages (such as corn silage, alfalfa and guinea grass) and concentrated feed. Currently we source feed for organic dairy cows primarily from Shengmu Forage, and purchase various feed for non-organic dairy cows from multiple third-party suppliers. The packaging materials for our liquid milk products are primarily purchased from Tetra Pak. We have historically grown our herd size primarily through purchases of dairy cows from local farmers in China and organic growth. We source frozen semen from suppliers in North America.

### Relationship with Shengmu Forage

#### *Shareholding history*

Shengmu Forage was established in April 2010, with Shengmu Holding (our onshore holding company) and Mr. WU Jianye (our president and executive Director) among the founding shareholders. Since its establishment, Shengmu Forage has required significant capital to expand. As our dairy farming business was also in its early development stage and required significant capital and other resources, we chose to allocate our resources to our dairy farming business and helped obtain funding for Shengmu Forage from third-party investors.

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Shengmu Holding owned 65.02% equity interests in Shengmu Forage at the beginning of 2011. By December 26, 2011, among certain other investors, Mr. WU and Ms. GAO Lingfeng (our vice president and executive Director) had contributed additional capital to Shengmu Forage, as a result of which Mr. WU and Ms. GAO held 20.32% and 15.49%, respectively, and Shengmu Holding held 23.77%. As a result, we consolidated the statement of profit or loss and other comprehensive income of Shengmu Forage for the period from January 1, 2011 to December 26, 2011, but did not consolidate its statement of financial position as of December 31, 2011, as our equity interest and voting right in Shengmu Forage decreased to 23.77% due to such capital contributions. For accounting purposes, Shengmu Forage has been accounted for as an associate of our Group since the end of 2011 as we have had more than 20% effective voting power. In 2012 and 2013, Shengmu Forage obtained additional capital injections from third party investors, and our shareholding in Shengmu Forage further decreased to 8.60%. Nonetheless, Shengmu Forage remained as an associate of our Group as Shengmu Holding, Mr. WU and Ms. GAO, who are two of our Ultimate Controlling Shareholders, entered into an acting-in-concert arrangement which became effective on June 25, 2012 after the completion of further capital investments in Shengmu Forage by other investors. As a result of the foregoing, Shengmu Holding, Mr. WU and Ms. GAO held an aggregate of 48.35% equity interests in Shengmu Forage. For details, see “Relationship with Controlling Shareholders — Major Retained Businesses of Our Ultimate Controlling Shareholders — Shengmu Forage.” See “Relationship with Controlling Shareholders” for further details about our relationship with Shengmu Forage. For more details on Shengmu Forage’s history, see “History, Reorganization and Group Structure — History and Development — Shengmu Forage.”

### *Agreements with Shengmu Forage*

Shengmu Forage currently supplies organic forage exclusively to our organic dairy farms. In March 2014, we entered into the Long-term Strategic Cooperation Agreement with Shengmu Forage for a term of 20 years, under which Shengmu Forage undertakes to continue its exclusive supply arrangement for organic forages with us and support our future expansion plans. In addition, Shengmu Forage and its shareholders (except Shengmu Holding) entered into letters of undertaking in April 2014 and agree not to issue, sell, transfer or otherwise dispose of any equity interests in Shengmu Forage to any third party (other than to existing shareholders) without our prior written consent for a term of 20 years unless all the equity interests in Shengmu Forage have been transferred to us prior to the expiration of the 20-year term.

Furthermore, in order to carry out the purchase of organic forage from Shengmu Forage based on the principles under the Long-term Strategic Cooperation Agreement and in accordance with the relevant requirements under the Listing Rules, In April 2014, we entered into the Forage Supply Framework Agreement with Shengmu Forage to further set out certain specific terms for the purchase of forage by our Group from Shengmu Forage and its subsidiaries for a three-year term from January 1, 2014 to December 31, 2016. For further details of the Forage Supply Framework Agreement, see “Continuing Connected Transactions — Non-Exempt Continuing Connected Transactions — Continuing Connected Transactions with Shengmu Forage — Purchase of Forage.” Our purchase of organic forage from Shengmu Forage under the Long-term Strategic Cooperation Agreement and the Forage Supply Framework Agreement constitutes a continuing connected transaction of our Group.

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Upon expiration of the Forage Supply Framework Agreement, we will enter into new framework agreements for the remaining term of the Long-term Strategic Cooperation Agreement based on the principles under the Long-term Strategic Cooperation Agreement and in accordance with the relevant requirements under the Listing Rules then in effect.

The principal terms under both the Long-term Strategic Cooperation Agreement and the Forage Supply Framework Agreement include the exclusive supply arrangement as set out above and the terms relating to the determination of our purchase price. Our purchase price of organic forage from Shengmu Forage shall be determined with reference to (a) the prevailing market prices for organic forage if there is a readily available market price, or (b) the prevailing market prices of imported premium non-organic forage (excluding transportation cost) or domestic premium non-organic forage plus a mark-up rate which will be not more than the lower of (i) the percentage difference in the average selling prices between our organic raw milk and premium non-organic raw milk, and (ii) the percentage difference in the average selling prices between organic raw milk and premium non-organic raw milk in the comparable segments of PRC market (if available), in the 12 months before the determination of the prices for the relevant forage crops.

### **Relationship with Mengniu Group**

Our founders, Mr. YAO Tongshan together with 21 other parties, founded Shengmu Holding, our PRC holding company, in October 2009. Before our establishment, Mr. YAO had spent eight years with Mengniu Group, a leading PRC dairy company, and served as its chief financial officer before he left. A majority of our founders, like Mr. YAO, had become acquainted with each other through employment, investment or business dealings related to Mengniu Group. Our business relationship with Mengniu Group continued after we were founded, and included the following aspects:

- *Business partnership.* In March 2010, we entered into a framework cooperation agreement with Mengniu Group, pursuant to which Mengniu Group agreed to lease dairy-farming facilities and equipment to our dairy farms located in Hohhot and Bayannur as well as their established dairy farms in Hohhot. As of December 31, 2013, four of our 12 non-organic dairy farms in Hohhot were leased from Mengniu Group. Mengniu Group agreed to purchase on a priority basis and we agreed to meet certain milk supply volume requirements and supply all of our raw milk outputs that meet its quality standards from the leased dairy farms. Mengniu Group also provided guarantees on certain of our bank loans in 2011 and 2012 to assist the early development of our dairy farming business, which had been fully repaid as of December 31, 2013.
- *Early investment.* In May 2011, Mengniu Investment, an investment company wholly owned by Mengniu Group, subscribed for a 5.44% equity interest in Shengmu Holding for a consideration of RMB104.4 million. Following the completion of the [REDACTED] and assuming none of the [REDACTED] and options that have been granted under the Pre-[REDACTED] Share Option Scheme or may be granted under the Share Option Scheme has been exercised, Mengniu Group will own 4.25% of the then issued share capital of our Company, which is subject to a six-month [REDACTED] period from the date of [REDACTED].



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- *Major customer.* Mengniu Group was our largest customer during the Track Record Period, accounting for RMB340.4 million, RMB662.8 million and RMB666.6 million in revenue in 2011, 2012 and 2013, respectively, or 87.4%, 94.6%, and 58.3% of our total revenue, respectively. We also sold raw milk to Mengniu Group through two individuals in 2011, which accounted for RMB46.8 million in revenue, or 12.0% of our total revenue in 2011. The material decrease of percentage revenue contribution from Mengniu Group from 2012 to 2013 was mainly due to the major increase in sales from our organic liquid milk products and the introduction of another industrial customer in 2013, which diversified our revenue sources.
- *Competition.* We sell a portion of our organic raw milk to industrial customers such as Mengniu Group who process it into liquid milk products and market and distribute these products under their own brands. In addition, we sell organic liquid milk products produced from our organic raw milk under our “Shengmu 圣牧” brand. As such, industrial customers of our organic raw milk such as Mengniu Group are also our competitors in the liquid milk product markets. As we expand our organic liquid milk business, we expect competition with our organic raw milk industrial customers to intensify in terms of both their organic liquid milk products and premium non-organic liquid milk products.

For more information, see “Relationship with Mengniu Group.”

### **Continuing Connected Transactions**

We expect to continue certain transactions with certain connected persons after the [REDACTED], which will therefore constitute continuing connected transactions of our Group under Chapter 14A of the Listing Rules. Such transactions are (a) purchase of forage from Shengmu Forage (our associate); (b) purchase of organic raw milk from Shengmu Pangu and Shengmu Xiwang (our non-wholly owned subsidiaries); (c) sales of pregnant heifers to Shengmu Pangu and Shengmu Xiwang; (d) purchase of calves and heifers from Shengmu Pangu and Shengmu Xiwang; and (e) provision of financial assistance (in the form of guarantee) to Shengmu Pangu and Shengmu Xiwang. As our business continues to expand in the near future, we expect to incur significant amounts of transactions with the aforementioned connected parties. Based on the respective size of such transactions, we expect that they will be subject to announcement, reporting, annual review and shareholders’ approval requirements under Chapter 14A of the Listing Rules. We have received from the Stock Exchange a waiver from strict compliance with the relevant requirement set out in Chapter 14A of the Listing Rules for such continuing connected transactions.

For more information, see “Continuing Connected Transactions.”

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### Financial Track Record

We have experienced significant growth during the Track Record Period. The following table sets forth selected combined statements of profit or loss and other comprehensive income items for the period indicated.

|   | For the year ended December 31,        |                 |         |                 |           |                 |
|---|--|-----------------|---------|-----------------|-----------|-----------------|
|   | 2011                                   |                 | 2012    |                 | 2013      |                 |
|   | Amount                                 | % of<br>revenue | Amount  | % of<br>revenue | Amount    | % of<br>revenue |
|   | (RMB in thousands, except percentages) |                 |         |                 |           |                 |
| Revenue .....   | 389,417                                | 100.0%          | 700,763 | 100.0%          | 1,143,709 | 100.0%          |
| Gross profit .....  | 114,601                                | 29.4%           | 234,059 | 33.4%           | 490,425   | 42.9%           |
| Gain/(loss) arising from changes<br>in fair value less costs to sell of<br>biological assets .....                              | 117,139                                | 30.1%           | 4,406   | 0.6%            | 9,484     | 0.8%            |
| Profit before tax .....   | 223,241                                | 57.3%           | 198,903 | 28.4%           | 375,350   | 32.8%           |
| Profit and total comprehensive<br>income for the year .....   | 223,241                                | 57.3%           | 198,903 | 28.4%           | 374,498   | 32.7%           |
| Attributable to:<br>Owners of parent .....  | 223,268                                | 57.3%           | 195,782 | 27.9%           | 327,309   | 28.6%           |
| Other financial data:<br>Adjusted EBITDA <sup>(1)</sup> /Adjusted<br>EBITDA margin <sup>(2)</sup> .....                         | 113,669                                | 29.2%           | 218,458 | 31.2%           | 427,590   | 37.4%           |
| Profit and total comprehensive<br>income for the year before<br>biological asset fair value<br>adjustments <sup>(3)</sup> ..... | 106,102                                | 27.2%           | 194,497 | 27.8%           | 365,014   | 31.9%           |

- (1) Adjusted EBITDA refers to our profit and total comprehensive income for the year before income tax expense, finance costs, depreciation of items of property, plant and equipment, amortisation of prepaid land lease payments, amortisation of other intangible assets and gain arising from changes in fair value less costs to sell of biological assets. Adjusted EBITDA is not a standard measure under IFRS. Adjusted EBITDA is a widely used financial indicator of a company’s ability to service and incur debt. Adjusted EBITDA should not be considered in isolation or construed as an alternative to cash flows, net income or any other measure of financial performance or as an indicator of our operating performance, liquidity, profitability or cash flows generated by operating, investing or financing activities. In evaluating adjusted EBITDA, we believe that investors should consider, among other things, the components of adjusted EBITDA such as selling and distribution expenses and administrative expenses and the amount by which adjusted EBITDA exceeds capital expenditures and other charges. We have included adjusted EBITDA because we believe it is a useful supplement to cash flow data as a measure of our performance and our ability to generate cash flow from operations to cover debt service and taxes. Adjusted EBITDA presented herein may not be comparable to similarly titled measures presented by other companies. Investors should not compare our adjusted EBITDA to adjusted EBITDA presented by other companies because not all companies use the same definition. See “Financial Information — Principal Statements of Profit or Loss and Other Comprehensive Income Components” for a reconciliation of our profit and other comprehensive income for the year under IFRS to our definition of adjusted EBITDA.
- (2) Adjusted EBITDA margin is calculated by dividing adjusted EBITDA by revenue.
- (3) Represents profit and total comprehensive income for the year minus gain/(loss) arising from changes in the fair value less costs to sell of biological assets, which is not a standard measure under IFRS.

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The following table sets forth selected combined statements of financial position items as of the date indicated.

|   | As of December 31, |           |           |
|---|--------------------|-----------|-----------|
|   | 2011               | 2012      | 2013      |
|   | (RMB in thousands) |           |           |
| Non-current assets .....                    | 952,579            | 1,515,310 | 2,477,454 |
| Current assets .....                        | 228,591            | 301,418   | 635,154   |
| Current liabilities .....                   | 256,904            | 598,259   | 1,404,716 |
| Net current liabilities .....               | (28,313)           | (296,841) | (769,562) |
| Total assets less current liabilities ..... | 924,266            | 1,218,469 | 1,707,892 |
| Total non-current liabilities .....         | 49,000             | —         | —         |
| Net assets .....                            | 875,266            | 1,218,469 | 1,707,892 |

The following table sets forth selected combined statements of cash flows items for the period indicated.

|  | For the Year Ended December 31, |                      |                       |
|--|---------------------------------|----------------------|-----------------------|
|  | 2011                            | 2012                 | 2013                  |
|  | (RMB in thousands)              |                      |                       |
| Net cash generated from operating activities .....           | 141,204                         | 177,942              | 363,630               |
| Net cash used in investing activities .....                  | (408,376)                       | (535,215)            | (934,299)             |
| Net cash generated from financing activities .....           | <u>269,550</u>                  | <u>317,427</u>       | <u>667,890</u>        |
| Net (decrease)/increase in cash and cash equivalents .....   | 2,378                           | (39,846)             | 97,221                |
| Cash and cash equivalents at the beginning of the year ..... | 67,980                          | 69,550               | 29,838                |
| Effect of foreign exchange rate changes .....                | <u>(808)</u>                    | <u>134</u>           | <u>—</u>              |
| Cash and cash equivalents at the end of the year .....       | <u><u>69,550</u></u>            | <u><u>29,838</u></u> | <u><u>127,059</u></u> |

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## SUMMARY

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### Biological Assets

Our biological assets represent our dairy cows, which were independently valued by Jones Lang LaSalle, a firm of independent qualified professional valuers not connected with us, which has appropriate qualifications and experiences in valuation of biological assets. The following table sets forth the fair value of our dairy cow herd as of the date indicated.

|                          | As of December 31,                     |                      |                         |                      |                         |                      |
|--------------------------|--|----------------------|-------------------------|----------------------|-------------------------|----------------------|
|                          | 2011                                   |                      | 2012                    |                      | 2013                    |                      |
|                          | (RMB in thousands, except percentages) |                      |                         |                      |                         |                      |
| Calves and heifers ..... | 185,125                                | 25.9%                | 353,443                 | 34.3%                | 424,699                 | 28.1%                |
| Milkable cows.....       | <u>528,701</u>                         | <u>74.1%</u>         | <u>676,098</u>          | <u>65.7%</u>         | <u>1,085,461</u>        | <u>71.9%</u>         |
| <b>Total</b> .....       | <u><u>713,826</u></u>                  | <u><u>100.0%</u></u> | <u><u>1,029,541</u></u> | <u><u>100.0%</u></u> | <u><u>1,510,160</u></u> | <u><u>100.0%</u></u> |

The fair value of our biological assets accounted for 81.6%, 84.5% and 88.4% of our net assets as of December 31, 2011, 2012 and 2013, respectively. We recorded gain arising from changes in fair value less costs to sell of biological assets in the amount of RMB117.1 million, RMB4.4 million and RMB9.5 million in 2011, 2012 and 2013, respectively, representing 52.5%, 2.2% and 2.5% of our profit for the year during the same periods, respectively. Our net profit margin of 57.3%, 28.4% and 32.7% in 2011, 2012 and 2013, respectively, would have been 27.2%, 27.8% and 31.9%, respectively, if the impact of biological asset fair value adjustments were excluded from the corresponding period.

See “Financial Information — Valuation of Biological Assets” for more information about key assumptions and inputs used for valuation of our biological assets. See “Financial Information — Valuation of Biological Assets — Sensitive Analysis” for more information about the sensitivity analysis on the estimated value of milkable cows.

### RECENT DEVELOPMENTS

For the three months ended March 31, 2014, our revenue increased by 98.8% from RMB208.7 million for the three months ended March 31, 2013 to RMB414.9 million during the same period in 2014. Our gross profit increased by 172.7% from RMB73.3 million for the three months ended March 31, 2013 to RMB199.9 million during the same period in 2014. Our gross margin increased from 35.1% for the three months ended March 31, 2013 to 48.2% for the same period in 2014.

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## SUMMARY

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### Revenue

#### *Dairy farming business*

Revenue of our dairy farming business increased by 91.3% from RMB157.0 million for the three months ended March 31, 2013 to RMB300.3 million for the same period in 2014, primarily reflecting the following:

- *Organic raw milk.* Total revenue from sales of organic raw milk increased from RMB80.3 million for the three months ended March 31, 2013 to RMB195.8 million for the same period in 2014, consisting of (i) a 155.0% increase in external sales from RMB55.8 million to RMB142.3 million; and (ii) a 118.4% increase in inter-segment sales to our liquid milk business from RMB24.5 million to RMB53.5 million. The increase in our revenue was primarily due to an increase in sales volume as a result of an increase in herd size. In addition, the average selling price of organic raw milk increased from RMB4,850 for the three months ended March 31, 2013 to RMB5,610 for the same period in 2014.
- *Premium non-organic raw milk.* Revenue of premium non-organic raw milk increased by 56.1% from RMB101.2 million for the three months ended March 31, 2013 to RMB158.0 million during the same period in 2014. The increase was primarily due to a combination of (i) an increase in sales volume as a result of an increase in herd size; and (ii) an increase in average selling price of premium non-organic raw milk which increased from RMB3,920 for the three months ended March 31, 2013 to RMB4,820 for the same period in 2014.

#### *Liquid milk business*

Revenue of our liquid milk business increased by 121.7% from RMB51.7 million for the three months ended March 31, 2013 to RMB114.6 million during the same period in 2014. The increase primarily reflected a combination of (i) our expanding distribution network and (ii) rising market demand. In addition, the average selling price of our liquid milk products increased from RMB14,300 for the three months ended March 31, 2013 to RMB14,960 for the same period in 2014.

### Gross Profit and Gross Margin

#### *Dairy farming business*

Gross profit (before elimination of internal profit from inter-segment) and gross profit (after elimination of internal profit from inter-segment sales) of our dairy farming business increased by 183.7% and 192.0%, respectively, from RMB56.5 million and RMB46.0 million for the three months ended March 31, 2013 to RMB160.3 million and RMB134.3 million for the same period in 2014.

- *Organic raw milk.* Gross profit (before elimination of internal profit from inter-segment sales) and gross profit (after elimination of internal profit from inter-segment sales) increased by 232.0% and 281.6%, respectively, from RMB28.4 million and RMB17.9 million for the three months ended March 31, 2013 to RMB94.3 million and RMB68.3 million during the same period in 2014. For the three months ended March 31, 2014, the

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## SUMMARY

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gross margin (before elimination of internal profit from inter-segment sales) and gross margin (after elimination of internal profit from inter-segment sales) was 48.2% and 48.0%, respectively, as compared to 35.4% and 32.0%, respectively, during the same period in 2013. The increase in our gross margin was also primarily due to (i) increased production scale and efficiency and (ii) increased average selling price.

- *Premium non-organic raw milk.* Gross profit of premium non-organic raw milk increased by 134.5% from RMB28.1 million for the three months ended March 31, 2013 to RMB65.9 million during the same period in 2014. The gross margin increased from 27.8% for the three months ended March 31, 2013 to 41.7% during the same period in 2014. The increase in our gross margin was also primarily due to (i) increased production scale and efficiency and (ii) increased average selling price.

### *Liquid milk business*

Gross profit of our liquid milk business (before elimination of internal profit from inter-segment sales) increased significantly from RMB16.8 million for the three months ended March 31, 2013 to RMB39.6 million during the same period in 2014. By comparison, after elimination of internal profit from inter-segment sales, our gross profit of liquid milk business increased by 140.3% from RMB27.3 million for the three months ended March 31, 2013 to RMB65.6 million during the same period in 2014. The gross margin of our liquid milk business (before elimination of internal profit from inter-segment sales) was 32.5% and 34.6% for the three months ended March 31, 2013 and 2014, respectively. By comparison, after elimination of internal profit from inter-segment sales, our gross margin was 52.8% and 57.2% during the same periods. The increase in our gross margin was primarily due to increased average selling price of our liquid milk products.

The financial information as mentioned above was extracted from the unaudited condensed consolidated financial statements for the three months ended March 31, 2014 prepared by our Directors in accordance with International Accounting Standard 34 “Interim Financial Reporting” (the “IAS 34”) issued by the International Accounting Standards Board (the “IASB”), and reviewed by Ernst & Young, our reporting accountant in accordance with Hong Kong Standard on Review Engagements 2410 “Review of Interim Financial Information Performed by the Independent Auditor of the Entity,” and from the unaudited condensed consolidated financial statements for the three months ended March 31, 2013 prepared by our Directors in accordance with IAS 34 issued by the IASB.

As of the Latest Practicable Date, we had credit facilities of an aggregate amount of RMB1,317.0 million, for RMB1,272.0 million of which we have obtained pre-approval letters from the relevant banks (stating that the banks will grant new facilities to us upon expiration of the current term and repayment of existing facilities), and of which RMB428.0 million have not been utilized. In addition, we were approved in March 2014 to issue short-term notes of up to RMB200 million and we have not issued any such notes as of the Latest Practicable Date.

## SUMMARY

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Our Directors confirm that since our most recent audited financial statements dated December 31, 2013, the movements in our revenue and gross profits are in line with our expectations. Our Directors confirm that there has been no material adverse change in the financial trading position, indebtedness or prospects of our Group since December 31, 2013 up to the date of this [REDACTED]. To our knowledge, there has been no material change in the general regulatory, economic and market conditions in China or the industry in which we operate that materially and adversely affected our business, results of operations or financial condition since December 31, 2013 up to the date of this [REDACTED].

## STRENGTHS AND STRATEGY

Our most important achievements to date and the factors that we believe distinguish us from our competitors include: (i) our market leadership well-positioned to benefit from China’s fast-growing organic dairy market; (ii) our unique vertically integrated “grass-to-glass” organic production model ensuring product safety and quality; (iii) our strategic desert location providing the ideal environment to raise organic dairy cows; (iv) our farm management system and commitment to promoting cattle welfare contributing to industry leading milk quality; (v) the premium and trusted brand of “Shengmu 圣牧” recognized for its quality and safety; (vi) our vertically integrated model and portfolio of premium non-organic and organic milk products offering flexibility that allow us to achieve attractive returns; and (vii) our visionary management team with a proven track record of successful execution.

Our long-term objective is to become a leading organic dairy company in the world. To achieve this goal, we plan to implement a business strategy with the following components: (i) expanding our organic dairy farming operation and ensure our product safety and quality; (ii) increasing our liquid milk processing capacity; and (iii) expanding our premium organic product portfolio; and (iv) building an extensive nationwide distribution network and strengthen brand recognition.

## RISK FACTORS

We face a number of risks and uncertainties in our business and industry as set out in “Risk Factors.” In particular, we have a limited operating history and may be unable to adequately manage our future expansion of operations and growth or achieve our growth plan within our desired timeframe or at all. We also rely on a limited number of industrial customers, and in particular Mengniu Group, for the sale of our raw milk. Furthermore, we do not have direct control over our associate, Shengmu Forage, our primary organic feed supplier, and certain operating risks applicable to us also apply to Shengmu Forage. We had net current liabilities as of December 31, 2011, 2012 and 2013 and may not be able to have net current assets in the future. In addition, we may lose or be unable to obtain or renew our organic certifications, which could materially and adversely affect our business.

## SUMMARY

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### OUR SHAREHOLDERS

We trace our history back to the establishment of Shengmu Holding, our PRC holding company, in Inner Mongolia in October 2009. Our lead founder, Mr. YAO Tongshan (姚同山), together with 21 other parties, were the initial shareholders of Shengmu Holding. Twelve of the founding shareholders, as well as Mr. WU Jianye (our president) and Mr. CUI Ruicheng (our chief financial officer), who subsequently joined Shengmu Holding, entered into an acting-in-concert agreement on October 18, 2010 and a supplemental agreement on March 24, 2014 to extend the acting-in-concert arrangement to our Group upon completion of the Reorganization. These are our ultimate Controlling Shareholders, who will control, through World Shining 56.56% of our issued and outstanding share capital [REDACTED].

As part of our Reorganization, we have introduced a number of pre-[REDACTED] investors, including Goldman Sachs, Baring, BOCI, Sequoia and King Capital. These investors collectively will own approximately 24.10% of our issued and outstanding share capital immediately upon completion of the [REDACTED] (assuming no exercise of the [REDACTED] or any option which has been granted under the Pre-[REDACTED] Share Option Scheme or may be granted under the Share Option Scheme) and their [REDACTED] are subject to a six-month [REDACTED] period.

### SHARE OPTION SCHEMES

Pursuant to the resolutions of our Shareholders passed on April 30, 2014 and June 18, 2014, we have conditionally adopted the Pre-[REDACTED] Share Option Scheme and the Share Option Scheme, respectively.

The principal terms of these share option schemes are set out in the sections headed “Pre-[REDACTED] Share Option Scheme” and “Share Option Scheme” respectively in Appendix IV to this [REDACTED]. As of the Latest Practicable Date, options to subscribe for an aggregate of [REDACTED] [REDACTED] have been conditionally granted under the Pre-[REDACTED] Share Option Scheme by our Company, and remained outstanding as of the Latest Practicable Date. The subscription price in respect of each option granted under the Pre-[REDACTED] Share Option Scheme is HK\$1.56.

The [REDACTED] subject to the options granted under the Pre-[REDACTED] Share Option Scheme represent (i) approximately 7.94% of our issued share capital immediately after completion of the [REDACTED] (excluding all [REDACTED] which may be allotted and issued upon the exercise of any options granted under the Pre-[REDACTED] Share Option Scheme or to be granted under the Share Option Scheme or the exercise of the [REDACTED]); and (ii) approximately 7.36% of our issued share capital immediately after completion of the [REDACTED], assuming that all options granted under the Pre-[REDACTED] Share Option Scheme are exercised, but without taking into account any [REDACTED] which may be allotted and issued upon the exercise of any options which may be granted under the Share Option Scheme or the exercise of the [REDACTED].



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## SUMMARY

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Further, assuming that (i) our Company had been [REDACTED] on the Stock Exchange since January 1, 2013 with [REDACTED] [REDACTED] in issue; and (ii) all the options granted under the Pre-[REDACTED] Share Option Scheme in respect of [REDACTED] were exercised in full on January 1, 2013, the earnings per Share on a [REDACTED] basis would have been diluted from approximately [REDACTED] (unaudited) to approximately [REDACTED] (unaudited) for the year ended December 31, 2013.

### [REDACTED] EXPENSES

We incurred [REDACTED] expenses (excluding [REDACTED] commissions) of [REDACTED] during the Track Record Period, of which [REDACTED] was recognized as administrative expenses and [REDACTED] was capitalized as deferred [REDACTED] expenses that are expected to be charged against equity upon [REDACTED] under the relevant accounting standards. We expect to incur further [REDACTED] expenses (excluding [REDACTED] commissions) of approximately [REDACTED], of which [REDACTED] will be recognized as administrative expenses and [REDACTED] will be charged against equity. We do not believe the remaining expenses will have a material impact on our results of operations for 2014.

### [REDACTED] STATISTICS

|   |  |
|---|--|
| [REDACTED] size:  | [REDACTED] [REDACTED], representing [REDACTED] share capital of the Company (subject to the [REDACTED])  |
| [REDACTED] structure:   | [REDACTED] [REDACTED], representing approximately [REDACTED] (subject to adjustment) and [REDACTED] [REDACTED], representing approximately [REDACTED] (subject to adjustment and [REDACTED]) |
| [REDACTED]:   | Up to [REDACTED] of the number of [REDACTED] initially available under the [REDACTED]  |
| Offer Price per Share:  | HK\$[REDACTED] to HK\$[REDACTED] per [REDACTED]  |
| Market capitalization upon completion of the [REDACTED] (assuming the [REDACTED], the options that may be granted under the Pre-[REDACTED] Share Option Scheme and Share Option Scheme are not exercised) | HK\$[REDACTED] million based on the [REDACTED] of HK\$[REDACTED] per Share, or HK\$[REDACTED] million based on the [REDACTED] of HK\$[REDACTED] per Share                                    |

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## SUMMARY

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Unaudited [REDACTED] adjusted net tangible assets per Share (assuming the [REDACTED] and the options which have been granted under the Pre-[REDACTED] Share Option Scheme or may be granted under the Share Option Scheme are not exercised):

HK\$[REDACTED] based on the [REDACTED] of HK\$[REDACTED] per Share, or HK\$[REDACTED] based on the [REDACTED] of HK\$[REDACTED] per Share

[REDACTED] (assuming an [REDACTED] of [REDACTED] per Share, being the mid-point of the indicative [REDACTED] range):

[REDACTED] to our Company from the offer of new [REDACTED] — [REDACTED], after deduction of [REDACTED] fees and commissions and estimated expenses payable by us in connection with the [REDACTED]:

- approximately [REDACTED] of the [REDACTED], or [REDACTED] million, for constructing 6 new dairy farms from 2014 to 2015;
- approximately [REDACTED] of the [REDACTED], or [REDACTED] million, for acquiring no less than 15,000 dairy cows from 2014 to 2015;
- approximately [REDACTED] of the [REDACTED], or [REDACTED] million, for sales and marketing activities and expansion of our distribution network from 2014 to 2015;
- approximately [REDACTED] of the [REDACTED], or [REDACTED] million, for expanding our liquid milk production capacity;
- approximately [REDACTED] of the [REDACTED], or [REDACTED] million, for the repayment of loans; and
- approximately [REDACTED] of the [REDACTED], or [REDACTED] million, for additional working capital and other general corporate purposes.

See “[REDACTED]” for more details.

## DIVIDENDS

We did not declare any dividends during the Track Record Period. Our Board at its discretion may declare dividends in the future after taking into account our operations, earnings, financial condition, cash requirements and availability and other factors as it may deem relevant at such time. The payment of any dividends will also be subject to our articles of association, the Companies Law, applicable laws and other relevant factors.