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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 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 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, according to the same source. 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 began 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.

We pioneered the unique fully integrated “grass-to-glass” organic production model to ensure that our production is end-to-end traceable and controllable from raw materials to end retail product by us and Shengmu Forage. We stringently control each major step of the organic production process under our “grass-to-glass” organic production model: (i) organic environment — no other agricultural or industrial activities on the sites of our organic dairy farms located on the Ulan Buh desert, the eighth largest desert in China; (ii) organic forage planting — effective control over the source and quality of our dairy cow feed by sourcing our forage substantially from Shengmu Forage, which primarily grows corn silage and alfalfa in the Ulan Buh desert without using any agricultural chemicals or chemical synthetic fertilizers; (iii) organic dairy farming — we are committed to raising our dairy cows in a low density, low stress environment with organic feed using no growth hormones; (iv) organic dairy product processing — all of the raw milk we use to produce our liquid milk products is supplied internally by our organic dairy farms, with no preservatives, artificial colorings and

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artificial flavorings added during the production process; (v) organic milk origin tracing — each unit of our organic milk products 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.

The strategic location of our organic dairy farms at the Ulan Buh desert is core to our organic dairy production model. Pangu Group, controlled by the family of Mr. WU Jianye (our president), began a large-scale greening effort in 1997, with tens of millions of trees planted over a period of more than 12 years. Such greening effort has substantially reduced dust storms and improved the quality of soil and the overall environment, making it possible to grow organic forage in a large scale. Leveraging on the environmental improvements made by Pangu Group as well as its forage growing experience, Shengmu Forage began growing forages in 2010, and currently grows organic forages on approximately 115,000 mu of growing fields, in the Ulan Buh desert and by 2020, Shengmu Forage expects to develop a total of approximately 560,000 mu of growing fields for organic forages. Shengmu Forage supplied substantially all the forage crops organically grown in its growing fields to us during the Track Record Period, and has entered into the Long-term Strategic Cooperation Agreement with us under which Shengmu Forage agreed to continue its exclusive supply arrangement and support our future expansion plans.

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, according to the F&S Report. As of December 31, 2013, we had a total of 30,621 organic dairy cows and 29,836 non-organic dairy cows. 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 capacity to house between 2,500 to 4,500 cows. Our average annual milk yield in 2013 was 8.5 tonnes. Mengniu Group, Yili Group and Want Want purchase our raw milk for the production of their high-end product lines.

Our own “Shengmu 圣牧” branded organic liquid milk products are rapidly gaining recognition as the premium organic liquid milk product in China since its launch in June 2012. We only offer organic dairy products, comprising of organic whole milk, organic low fat milk, and organic children’s milk, under our brand. The average retail selling price of our organic liquid milk products has been significantly higher than the industry average price for high-end liquid milk, according to the F&S Report.

Since June 2012, our nationwide distribution network has grown rapidly from 108 distributors as of December 31, 2012 to 316 as of December 31, 2013 covering 31 provinces, municipalities and autonomous regions in China. For three consecutive years since 2011, we were awarded the Gold Medal of BioFach China International Organic Trade Fair and Conference (中國國際有機食品博覽會金獎) in recognition of the premium quality of our products.

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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 ⁽¹⁾	—	—	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.

We have experienced rapid growth over the Track Record Period. Our revenue increased from RMB389.4 million in 2011 to RMB1,143.7 million in 2013, or a CAGR of 71.4%. Our profit for the year before biological asset fair value adjustments increased from RMB106.1 million in 2011 to RMB365.0 million in 2013, or a CAGR of 85.5%. Our gross margin was 29.4%, 33.4% and 42.9% in 2011, 2012 and 2013, respectively.

COMPETITIVE STRENGTHS

We believe that our achievements to date have given us certain competitive advantages, which position us well for continued growth to capture the growing organic dairy and premium non-organic dairy market, and collectively are barriers to entry for new competitors.

Market leader well-positioned to benefit from China’s fast-growing organic dairy market

The organic food retail market in China has grown rapidly in recent years, increasing from RMB10.6 billion in 2009 to RMB32.7 billion in 2013, representing a CAGR of 32.5%, according to the F&S Report. Driven by increasing consumer awareness on healthy diet and rising disposable income, as well as the continuing development of distribution channels, this market is expected to continue to grow, reaching RMB144.6 billion in 2018, representing a CAGR of 34.6%, also according to the F&S Report. In particular, the retail market of organic liquid milk products, which grew at a CAGR of 93.2% from 2009 to 2013, is expected to increase from RMB1.9 billion in 2013 to RMB25.8 billion in 2018, representing a CAGR of 68.5% from 2013 to 2018, according to the same source. The growth of organic liquid milk product supply, on the other hand, has significantly lagged the growth of demand. According to the F&S Report, the gap between organic liquid milk supply and demand is expected to widen, reaching RMB1.14 billion in 2018, in terms of retail market value.

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Due to the high barriers to entry to the organic milk market, the supply of organic raw milk in China is highly concentrated. According to the F&S Report, the top three organic raw milk producers accounted for 86.9% of the total organic raw milk produced in China in 2013. We believe that the high entry barriers primarily include (i) limited availability of large parcels of clean and unpolluted land with climates suitable for organic dairy farming; (ii) lengthy and stringent organic certification process; (iii) limited supply of organic feed; (iv) significant initial capital requirement and (v) experienced management team.

We are an early mover in the PRC organic dairy farming industry and have achieved a leading position in the organic milk market in China. According to the F&S Report, we are the largest organic dairy farming company in China based on 2013 organic raw milk production volume, with a 54.2% market share. As of December 31, 2013, we had 30,621 organic dairy cows, or approximately three times that of the company with the second largest herd of organic dairy cows in China, according to the F&S Report. As the market leader in the PRC organic dairy farming industry, we believe we are well-positioned to continue to capture the rapid growth in demand for organic dairy in China.

Unique vertically integrated “grass-to-glass” organic production model ensuring product safety and quality

Together with our associate, Shengmu Forage, we are the only organic dairy company in China that applies a vertically integrated “grass-to-glass” (“全程有機”) organic production model in China with all major steps of the industry value chain, including forage growing, dairy farming to produce raw milk and milk processing meeting E.U. organic standards. We stringently control each major step of the production process under our “grass-to-glass” organic production model, which consists of the following:

- *Organic environment.* The Ulan Buh desert offers a number of benefits compared to conventional farming environments in China. These benefits include cool and dry weather preferred by dairy cows, as well as limited human activity, little pollution and very low levels of bacteria, viruses and pests. In addition, the land underneath Ulan Buh desert is formed as a result of the alluviation of the Yellow River, the second longest river in Asia, and there is rich soil and abundant water resources underneath the sandy surface, according to the F&S Report.
- *Organic forage planting.* Effective control over the source and quality of our dairy cow feed is the first step of our “grass-to-glass” organic production process. We currently source our organic forage 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.
- *Organic dairy farming.* We are committed to cattle welfare as part of the culture of organic dairy farming, which we believe contributes to our product quality. We raise our dairy cows in a low density environment with organic feed without using any growth hormones.

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- *Organic milk processing.* All of our liquid milk products are produced from organic raw milk supplied internally by our organic dairy farms. No preservatives, and artificial coloring and artificial flavorings are added during the production process.
- *Organic milk origin tracing.* Each unit of our organic liquid milk products 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.

Strategic desert location providing the ideal environment to raise organic dairy cows

We consider our strategic location in the Ulan Buh desert, where Shengmu Forage plants forage crops and where we operate our organic dairy farms, core to our “grass-to-glass” organic production model. We believe, based on the F&S Report, that our Ulan Buh desert location is ideal for operating organic dairy farms because of its following features:

- *Clean environment.* There is little pollution and very low levels of bacteria, viruses and pests.
- *Sand and sunlight.* The soft and permeable desert sand provides comfortable lying ground for our cows to rest and reduce their chances of common cow diseases. The intensity and the long hours of the sunlight in the desert help forage crops grow and our cows produce higher levels of calcium in their milk, according to the F&S Report.
- *Preferred climate.* Cows prefer relatively cool temperature and dry weather. The Ulan Buh desert is located in a region which is generally considered the ideal geographic region for dairy farming known as the Golden Raw Milk Belt. According to the F&S report, the temperature range from 0°C to 15°C is a favorable range for dairy cows and the Ulan Buh desert has an annual average temperature of 7.8°C and an annual average precipitation of approximately 103 millimeters. Compared to some cold and humid regions in China, the climatic environment in the Ulan Buh desert is more suitable for dairy farming.
- *Sufficient room for growth.* Shengmu Forage currently grows organic forages on approximately 115,000 mu (76.7 square kilometers) of growing fields 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 to support our cow herd expansion. Shengmu Forage supplied substantially all the forage crops organically grown in its growing fields to us during the Track Record Period, and has recently entered into the Long-term Strategic Cooperation Agreement with us under which Shengmu Forage agreed to continue its exclusive supply arrangement and support our future expansion plans.
- *Convenient transportation.* Our organic dairy farms are all located within 100 kilometers from our processing plant by local highways. Because of the dry desert weather of the Ulan Buh desert, we are less susceptible to transportation delays due to severe weather conditions than many other regions in China.

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Based on our experience, it would require significant efforts, costs, time and expertise to convert a sand desert area of a similar size into arable land. Therefore, we believe that our unique location for our organic dairy farms provides us with a significant competitive advantage that is highly difficult to replicate by other dairy companies in China.

Farm management system and commitment to promoting cattle welfare contributing to industry leading milk quality

We believe that cattle welfare contributes to milk quality, and seek to provide our dairy cows with a relatively comfortable, low stress environment and nutritious feed. In particular, our organic dairy cows enjoy superior living conditions, including the following:

- *The environment.* The natural conditions of the Ulan Buh desert are ideal for organic dairy farming.
- *Farm management.* Our dairy farms are designed with an aim to provide organic dairy cows with the maximum comfort. Our organic dairy cows have an average living space of 60 to 80 square meters per cow. All of our farms are free stall farms with easy access to food and water, clean and comfortable dry sand bedding and spacious outdoor sand sport fields that allow our dairy cows to eat, drink, and relax freely. Dairy cows are ruminants and prefer to lie down to digest food. The bedding and sport fields covered with the fine dry sand from the Ulan Buh desert are aimed to provide our dairy cows with a comfortable place to lie on and reduce their chance of developing mastitis and limping diseases.
- *Food and water.* To promote cow health and improve milk yield, we feed our organic dairy cows with customized nutritious organic forages based on their development stage, lactation stage and milk yield. We purify drinking water for dairy cows on our organic dairy farms to meet the health standards for human consumption in China.
- *Physical and mental health.* We have implemented a strict and effective disease control policy at our farms. Each of our dairy farms has five to eight veterinarians and assistants onsite, depending on its herd size.

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We believe our efforts to promote the welfare of our dairy cows have contributed to the superior quality of our milk products. Set forth below are comparisons of certain key quality indicators between our raw milk, both organic and premium non-organic, raw milk by certain other leading PRC raw milk producers and certain government standards.

	Nutrition Standard		Safety Standard	
	Protein Content ⁽¹⁾	Fat Content ⁽¹⁾	Aerobic Plate Count ⁽²⁾	Somatic Cell Count ⁽²⁾
	(%)		(CFU/mL)	
Our products ⁽³⁾				
- Organic raw milk	3.4	4.3	28,000	110,000
- Premium non-organic raw milk	3.3	4.1	30,000	130,000
Huishan Dairy ⁽⁴⁾	≥3.2	≥4.1	<50,000	<200,000 ⁽⁴⁾
Modern Dairy ⁽⁴⁾	≥3.1	≥3.7	<50,000	<250,000
YuanShengTai ⁽⁴⁾	3.4	4.2	4,000	162,000
PRC Standard	≥2.8	≥3.1	≤2,000,000	N/A ⁽⁴⁾
E.U. Standard	N/A	N/A	<100,000	<400,000
U.S. Standard	≥3.2	≥3.5	<100,000	<750,000

- (1) Protein content and fat content are two major indicators used to determine the nutritional value of raw milk. Generally a higher protein and fat content indicates higher quality. The E.U. Standard does not provide for a minimum protein or fat requirement.
- (2) Aerobic plate count and somatic cell count are two major indicators used to determine safety quality of raw milk. Generally a lower aerobic plate count indicates improved sanitation and a lower somatic cell count indicates better animal health. The PRC Standard does not provide for a maximum somatic cell count requirement.
- (3) Information on protein content, fat content and aerobic plate count based tests of our raw milk sample by SGS - CSTC Standards Technical Services Co., Ltd., a leading testing lab, and information on somatic cell count based on tests of our raw milk sample by a testing laboratory operated by Mengniu Group and accredited by China National Accreditation Service for Conformity Assessment.
- (4) Based on the data for 2013 in the F&S Report.

Premium and trusted brand recognized for its quality and safety

The quality of our upstream raw milk is well-recognized by branded dairy players in China. Our industrial customers primarily include Mengniu Group and Yili Group, which are the leading dairy companies in China, and purchase our raw milk only for the production of their high-end product lines. In addition, Want Want, a leading maker of rice crackers, dairy products and beverages in China, purchases our raw milk for their dairy products.

In the downstream branded liquid milk market, our “Shengmu 圣牧” brand is rapidly gaining recognition as a premium organic dairy brand. Since we began to market our own organic liquid milk products under the “Shengmu 圣牧” brand in June 2012, our distribution network has grown rapidly from 108 distributors as of December 31, 2012 to 316 as of December 31, 2013, with sales increasing from RMB33.9 million in 2012 to RMB303.0 million in 2013. For three consecutive years since 2011, we were awarded the Gold Medal of BioFach China International Organic Trade Fair and Conference (中國國際有機食品博覽會金獎) in recognition of the premium quality of our products.

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Chinese consumers are increasingly focused on health and food safety. According to the consumer survey in the F&S Report, Chinese consumers consider “grass-to-glass” organic milk products to be healthier and safer than conventional organic milk products, which in turn are considered healthier and safer than non-organic milk products, and are willing to pay a premium for “grass-to-glass” organic milk products over conventional organic milk. In 2013, the average retail sales price for our liquid milk products was RMB23,211 per tonne, substantially higher than the industry average of RMB15,840 per tonne for high-end liquid milk products, according to the F&S Report. As Chinese consumers increasingly recognize the benefits of our “grass-to-glass” organic milk products and of organic milk products in general and the disposable income of Chinese consumers continues to grow, we expect that consumer trust in organic milk products will help increase our brand recognition, drive our business growth and enhance our profit margins.

Vertically integrated model and portfolio of premium non-organic and organic milk products offering flexibility that allow us to achieve attractive returns

We began operations in 2010 with a dairy farming business of supplying premium non-organic raw milk to industrial customers. That business ramped up quickly, generating RMB487.8 million in sales of premium non-organic raw milk in 2013. Our non-organic dairy farming business has helped us fund our investments into our organic dairy farming business, which we began in 2011, and our organic liquid milk products business, which began generating sales in 2012. As a result of these efforts, by 2013, we have a diverse revenue mix from premium non-organic raw milk, organic raw milk and organic liquid milk products. This diverse revenue mix, together with our vertically integrated model of combining dairy farming businesses with the manufacturing and sales of liquid milk products business allows us to:

- continue to benefit from a stable cash flow provided by our premium non-organic raw milk business;
- capture higher profit margins resulting from the growing revenue stream from our organic dairy farming and liquid milk products businesses; and
- respond timely to changes in the supply-demand dynamics in the market of raw milk vis-a-vis organic liquid milk products and premium non-organic milk vis-a-vis organic milk by adjusting our business focus and revenue mix.

Benefiting from this one-of-a-kind vertically integrated “grass-to-glass” organic production model, we have been able to price our organic raw milk and liquid milk products at a premium to achieve higher profit margins and returns. In 2013, we generated a gross profit margin of 35.9% for premium non-organic raw milk, 44.0% (before elimination of internal profit from inter-segment sales) for organic raw milk and 33.7% (before elimination of internal profit from inter-segment sales) for liquid milk products, and our overall gross profit margin was 42.9%. Our return on equity and return on assets were 21.9% and 12.0% in 2013, respectively.

As we continue to shift our revenue mix towards organic milk in the next phase of our expansion, and as our production scale for liquid milk products continues to expand, we will be well-positioned to continue growing our revenue while improving our overall profitability.

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Visionary management team with a proven track record of successful execution

Less than six years ago, Mr. YAO Tongshan, our chairman and founder, had a vision of building an organic dairy company based on the proposition of offering to the consumer a wholesome product that is “grass-to-glass” organic and played a key management and leadership role in our development. Today, under Mr. YAO’s leadership, our business has grown rapidly, and we have become the largest organic dairy company in China based on organic raw milk production volume and organic herd size in 2013, according to the F&S Report. We believe that our rapid growth over such a short period of time would not have been possible without the cohesive collaboration of an experienced management team led by Mr. YAO. Mr. YAO is in charge of our overall business operations and strategic direction and personally oversees our sales and marketing function. Mr. YAO had accumulated extensive experience and in-depth knowledge about the dairy industry from his prior working experience at Mengniu Group. He served as vice president of finance and chief financial officer at Mengniu Group for eight years before founding our Group, and led the development of an advanced finance management system for enhancing the coordination among different business departments and improving employee performance through effective employee performance review. The Chief Financial Officer magazine, a third party publication in China, credited Mengniu Group’s stable business operations during its rapid growth partly to its highly recognized internal control system developed under Mr. YAO’s leadership. In 2008, Mr. YAO became an executive director at Mengniu Group, and since then he had participated increasingly more in its management and business decisions. Leveraging on his expertise and experience in the dairy industry, Mr. YAO has implemented a similar management system tailored to our company’s needs, which has been instrumental in our development. In addition, Mr. YAO also brought together this experienced management team, including:

- *Feed and crops.* Mr. WU Jianye, our president, whose family controls the Pangu Group, which planted tens of millions of trees in the Ulan Buh desert, co-founded Shengmu Forage with Shengmu Holding to hold the land that supplies feed to our dairy cows. Although we no longer control Shengmu Forage, Mr. WU continues to be instrumental in coordinating its development plans to meet our development requirements. In addition, Mr. WU is primarily in charge of formulating our organic business value chain development plan and the implementation of the related budget.
- *Production.* Ms. GAO Lingfeng, our vice president, also joined from Mengniu Group. With 15 years of management experience in milk production and product quality, Ms. GAO is primarily responsible for the operations of our liquid milk business, as well as the setting up and implementing key performance indicators for various business units, production chain’s quality management and organic certification management.
- *Dairy farms operations.* Our vice president of operations, Mr. LI Yundong, with 11 years of management experience in business operations at Mengniu, is in charge of our dairy farm operations.

In addition, Mr. CUI Ruicheng, our chief financial officer, has over 10 years of experience in financial accounting and business management, including six years of related work experience at Mengniu Group, and significant knowledge in dairy farming related financial accounting system. He

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has been instrumental in the establishment and strengthening of our financial accounting system, providing strong accounting and budgeting support for our rapid business expansion. We believe that this management team will continue its successful record of execution and lead us to our next phase of expansion.

BUSINESS STRATEGY

Our long-term objective is to become a leading organic dairy company in the world. We intend to continue to be headquartered in Bayannur, Inner Mongolia, where we and the local government aim to build a world-class organic raw milk production base. To achieve this goal, we plan to implement a business strategy with the following components.

Expand our organic dairy farming operations and ensure our product safety and quality

As of December 31, 2013, we operated 13 organic dairy farms with 30,621 dairy cows, including 16,825 milkable cows, in the Ulan Buh desert. According to the F&S Report, the organic liquid milk retail market in China is expected to increase at a CAGR of 68.5% from 2013 to 2018. To meet the increasing market demand, we plan to significantly expand our organic dairy farming operation and increase milk yield with the following initiatives:

- *Expand organic dairy farms.* We currently have three organic dairy farms under construction, which are expected to commence operation by September 2014. We plan to invest RMB700 million to build an additional 18 organic dairy farms by the end of 2016.
- *Increase herd size of dairy cows.* We plan to grow our herd of organic dairy cows to approximately 120,000 organic dairy cows by 2016. We expand our herd primarily by breeding calves and heifers using imported frozen semen, supplemented by purchasing heifers from domestic dairy farmers and from overseas markets. We expect to invest RMB480 million to purchase no less than 28,000 additional organic dairy cows by the end of 2016.
- *Improve milk yield.* We plan to improve the physical conditions and average milk yield of purchased dairy cows and our herd in general and our operating efficiency through various measures, including feeding our dairy cows with customized feed that we developed in-house, fine tuning and implementing our standardized organic dairy farming process in new dairy farms, and cooperating with leading national and international research institutions and animal care and breeding companies.
- *Further strengthen relationship with Shengmu Forage.* We will seek to further strengthen our relationship with Shengmu Forage to ensure that they develop additional organic growing fields to meet our increasing requirements for organic forages.

The expansion of our organic dairy farms and herd size will allow us to capitalize on the rising demand for organic milk products in China. In addition, we believe that our expanded operation will allow us to enjoy economies of scale, improve our operating efficiency and consolidate our position as the leading organic dairy company in China. We will also continue to invest in quality control and product safety to support growth.

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Increase our liquid milk processing capacity

We plan to further expand our “Shengmu 圣牧” branded liquid milk business to capture additional margin along the value chain. We currently have three production lines in our organic milk processing facilities with a maximum daily processing capacity of 330 tonnes of organic liquid milk. As we continue to expand organic dairy farming operation and dairy cow herd, we expect that our organic raw milk production capacity will increase to 1,800 tonnes per day by the end of 2016. Accordingly, we plan to invest a total of approximately RMB360 million to increase our daily liquid milk processing capacity to 1,150 tonnes per day by the end of 2016, with the remaining organic raw milk to be sold to our industrial customers. Specifically, we are in the process of assembling our new production line for organic yogurt products and expect to commence operation in the third quarter of 2014 with a daily production capacity of 30 tonnes of organic yogurt, which we plan to increase to 200 tonnes by the end of 2015 and further to 380 tonnes by the end of 2016. We plan to install additional production lines to achieve an expected daily processing capacity of 440 tonnes per day of other organic liquid milk products by the end of 2016.

Expand our premium organic product portfolio

We currently offer organic liquid milk products under our “Shengmu 圣牧” brand, including organic whole milk, organic low-fat milk and organic milk for children, all made from our organic raw milk. We aim to continue to develop new products which can leverage our increasing raw organic milk production, share our existing processing, marketing and distribution platforms, as well as benefit from our increasingly recognized brand. We plan to develop additional organic milk products to cater to capture demand for organic dairy products, cater to customer preferences, and expand our revenue sources. We expect to market yogurt and milk beverage products, all made from our organic milk, by the third quarter of 2014 and the end of 2016, respectively. By expanding our organic milk based product portfolio, we believe we will be able to capture the increasing market demand for safe and high-quality dairy products in China, broaden our revenue sources and increase our profitability.

Build an extensive nationwide distribution network and strengthen brand recognition

We currently sell our liquid milk products through distributors. As of December 31, 2013, we had approximately 316 distributors covering 31 provinces, municipalities and autonomous regions in China. We plan to expand our distribution network to over 400 distributors by the end of 2014. We intend to increase efforts in engaging additional distributors in tier three and tier four cities. In terms of points of sale, we intend to continue to increase our product presence in department stores and large supermarket chains in order to promote our brand recognition. We also plan to focus on expanding convenience store chains as a key future revenue source. Furthermore, in addition to our direct sales to consumers via VIP membership cards and corporate wholesale, we plan to develop online-to-offline (O2O) sales channels by setting up an Internet direct sales portal to reach a wider customer base. To ensure prompt delivery of products to our rapidly growing customers, we plan to set up regional distribution centers by leasing warehouse facilities close to regional transportation hubs throughout China and purchase trucks to establish our own delivery fleet to support our sales growth.

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We also intend to increase our brand recognition and solidify our high-end image in our target markets through the following initiatives:

- developing and implementing a uniform marketing strategy and coordinating nationwide advertising and marketing campaigns, including online advertising, to promote the benefits of organic milk as well as our own brand;
- promoting the establishment of more specialty shops which, in addition to their sales function, will serve to educate consumers about our “grass-to-glass” organic production model and the benefits of our organic milk and promote our brand image; and
- demonstrating our “grass-to-glass” organic concept through more open-house events at our dairy farms and production facilities.

OUR BUSINESS

Our business consists of dairy farming business and liquid milk business. We began our operation in 2010 by engaging in the premium non-organic raw milk production in Hohhot with our own dairy farms. We expanded into organic dairy farming business in 2011. In 2012, we further expanded into liquid milk products business under which we produce and sell packaged liquid milk products under the “Shengmu 圣牧” brand. All of the raw milk we use to produce our liquid milk products is supplied internally by our organic dairy farms. We expect that our future growth will primarily come from the growth of our organic raw milk and liquid milk products businesses.

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 ⁽¹⁾)
	Segment revenue	Inter- segment sales ⁽¹⁾	External sales	External sales as % of total revenue	Segment revenue	Inter- segment sales	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.

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The following table sets forth the sales volume of 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 ⁽¹⁾	—	—	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 our liquid milk business.

As of December 31, 2013, all of our 13 organic dairy farms were located at the Ulan Buh desert while all of our 12 non-organic dairy farms were located in Hohhot, Inner Mongolia. 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 cows
	Dairy farms	Calves and heifers	Milkable cows	Subtotal	Dairy farms	Calves and heifers	Milkable 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

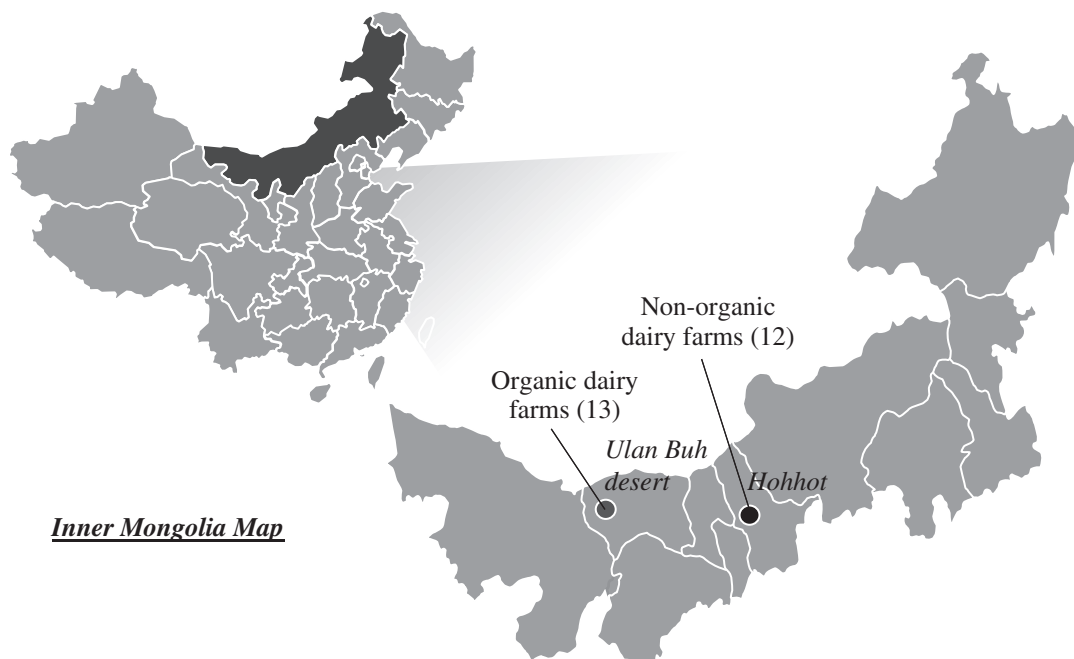
The table below sets forth the movement in the number of our organic and non-organic dairy cows as of the date indicated.

	2011			2012			2013		
	Organic cows	Non-organic cows	Total	Organic cows	Non-organic cows	Total	Organic cows	Non-organic cows	Total
As of January 1 .	4,032	12,706	16,738	8,982	26,134	35,116	14,111	35,272	49,383
Addition ⁽¹⁾	7,201	18,381	25,582	9,654	14,535	24,189	25,895	15,372	41,267
Reduction ⁽²⁾	(2,251)	(4,953)	(7,204)	(4,525)	(5,397)	(9,922)	(9,385)	(20,808)	(30,193)
As of December 31	<u>8,982</u>	<u>26,134</u>	<u>35,116</u>	<u>14,111</u>	<u>35,272</u>	<u>49,383</u>	<u>30,621</u>	<u>29,836</u>	<u>60,457</u>

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- (1) Includes primarily births and purchases of cows, of which the addition of organic cows also includes nil, 286 and 8,278 organic cows in 2011, 2012 and 2013, respectively, converted from non-organic cows following a six-month transition period.
- (2) Includes primarily deaths, culling and sales of cows, of which the reduction of non-organic cows also includes a corresponding number of non-organic cows converted into organic cows following a six-month transition period as mentioned in Note (1) above.

The following map illustrates the location and number of our dairy farms in Inner Mongolia as of December 31, 2013.

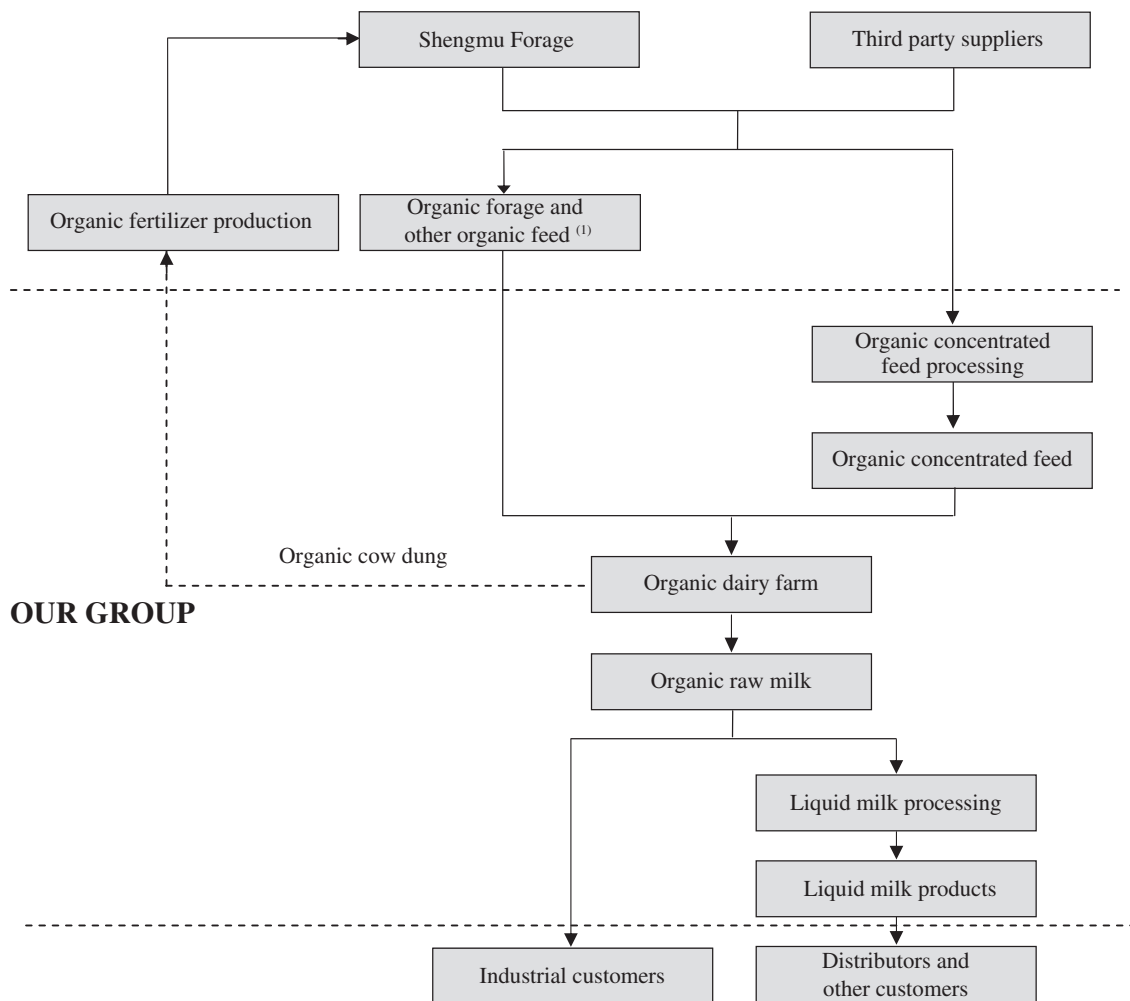


Dairy Farming Business

We are the largest organic dairy company in China in terms of 2013 production volume, according to the F&S Report. In 2013, we produced an aggregate 94,152 tonnes of organic raw milk, representing a 54.2% market share in China in terms of 2013 production volume, according to the F&S Report. As of May 31, 2014, we were the only vertically integrated Chinese dairy farming company that meets E.U. organic standards, according to the F&S Report.

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The diagram below illustrates our “grass-to-glass” organic production process.



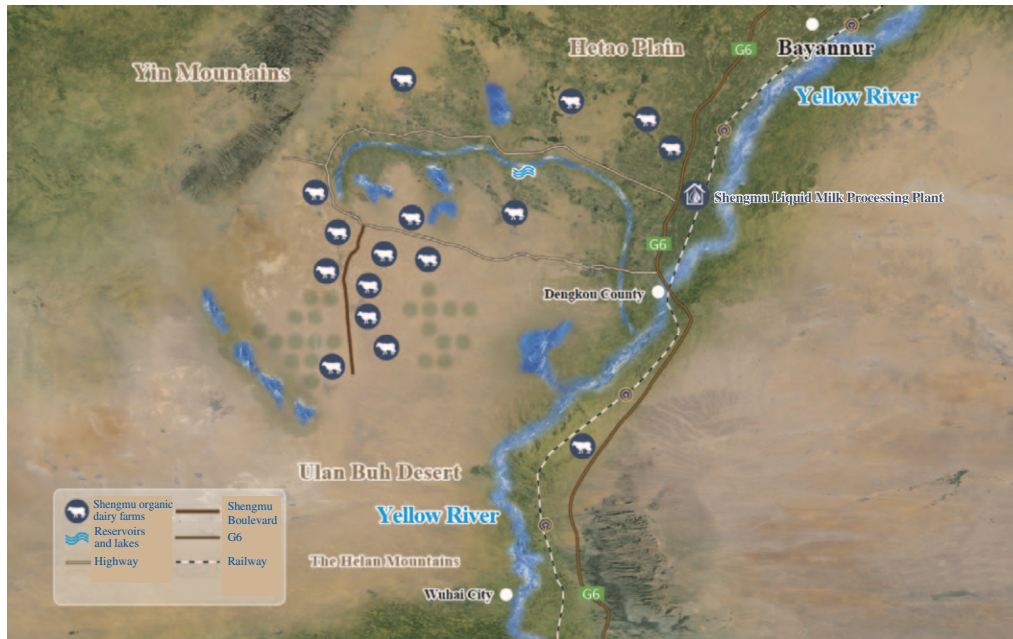
(1) Since 2013, we have processed organic concentrated feed based on our own feed formulae from raw materials purchased primarily from Shengmu Forage.

Organic environment

Core to our “grass-to-glass” organic production model is our Ulan Buh desert location in which Shengmu Forage plants forage crops and where we operate our organic dairy farms. Located in Bayannur League and Alxa League of Inner Mongolia with a total area of approximately 11,000 square kilometers, the Ulan Buh desert is the eighth largest desert in China.

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The following map illustrates the location of our organic dairy farms (including three farms currently under construction) in the Ulan Buh desert.



We believe that our Ulan Buh desert location is the ideal location to plant forage crops and operate organic dairy farms because of its following features:

- *Clean environment.* As of the Latest Practicable Date, we are not aware of any chemical or industrial plants within the close vicinity of our organic dairy farms that could lead to the suspension or revocation of our organic certifications. The absence of industrial activities coupled with the desert weather conditions means that there is little pollution and very low levels of bacteria, viruses and pests. The desert sand also provides comfortable lying ground for our cows to rest and reduce their chances of developing mastitis.
- *Sand and sunlight.* The soft and breathable desert sand provides comfortable lying ground for our cows to rest and reduce their chances of developing limping disease. According to the F&S Report, the Ulan Buh desert has an average of almost 3,200 hours of sunlight annually with an average solar radiation intensity of 6,280 MJ/square meter, compared to an average 1,800 to 2,000 hours of sunlight annually with an average solar radiation intensity of 4,250 to 5,000 MJ/square meter in central and southern China. The intensity and the long hours of sunlight in the desert help forage crops grow and our cows produce higher levels of calcium in their milk, according to the F&S Report.
- *Preferred climate.* Cows prefer relatively cool temperature and dry weather. The Ulan Buh desert is located within the latitude zone generally considered ideal for dairy farming and known as the Golden Raw Milk Belt. According to the F&S report, the temperature range from 0°C to 15°C is a favorable range for dairy cows and the Ulan Buh desert has an annual average temperature of 7.8°C, and an annual average precipitation of approximately 103

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millimeters. Compared to some cold and humid regions in China, the climatic environment in Ulan Buh desert is more suitable for dairy farming. In addition, the temperature difference between day and night in the desert helps to improve the quality of forage crops.

- *Rich soil and abundance of water.* Unlike other large deserts in China, the Ulan Buh desert is the product of alluviation of the upper reaches of the Yellow River, the second longest river in Asia, which has formed a thick layer of rich soil under the sand surface of the desert conducive to plantation. The lateral seepage of the upper reaches of the Yellow River also provides abundant shallow underground water. According to the survey conducted by Inner Mongolia Hetao Irrigation Administration, the Ulan Buh desert area has an aquifer holding an aggregate of approximately 5.7 billion cubic meters of water under the sand surface. The water of the upper reaches of the Yellow River is very clean and is purified as it percolates through layers of rock, fine sand and gravel to form the desert lakes and aquifers.
- *A long history of greening.* In a large-scale greening effort that began in 1997, Pangu Group, controlled by the family of Mr. WU Jianye, our president, had continuously planted trees on the Ulan Buh desert to improve its ecological conditions, with tens of million trees planted. Such greening effort has substantially reduced dust storms, improved the quality of soil and the overall environment and, coupled with the abundant water and land resources, has made it possible to grow organic forage in a large scale.
- *Sufficient room for growth.* The desert provides sufficient land resource for us to build new farms and our associate, Shengmu Forage, to grow organic forages. Shengmu Forage currently grows organic forages on approximately 115,000 mu of growing fields in the Ulan Buh desert. In addition, Shengmu Forage has obtained the right, through cooperation with local governments and third parties, to further develop an additional 400,000 mu of growing fields for organic forages. By 2020, Shengmu Forage expects to develop a total of approximately 520,000 mu of growing fields in the Ulan Buh desert to grow organic forages. Shengmu Forage supplied substantially all the forage crops organically grown in its growing fields to us during the Track Record Period, and has entered into the Long-term Strategic Cooperation Agreement with us recently under which Shengmu Forage agreed to continue its exclusive supply arrangement and support our future expansion plans.
- *Convenient transportation.* Our organic dairy farms are all located within 100 kilometers from our processing plant by local highways. Given the close proximity between our organic dairy farms and processing plant, we are able to deliver the raw milk to our processing plant within an average of 1.5 hours to maintain the freshness of raw milk. Because of the dry desert weather of the Ulan Buh desert, we are less susceptible to transportation delays due to severe weather conditions than many other regions in China.

We estimate that it would require significant efforts, costs, time and expertise to convert a sand desert area of a similar size into fertile land. Therefore, we believe the unique location of the Ulan Buh desert makes our operations highly difficult to replicate by other dairy companies in China.

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Organic feed

Shengmu Forage

As of the Latest Practicable Date, Shengmu Forage had developed approximately 115,000 mu of growing fields in the Ulan Buh desert to grow forage crops for our dairy cows. Because of the favorable ecological conditions, climatic advantages and unique desert characteristics of the Ulan Buh desert (see “— Organic Environment” above), Shengmu Forage has grown the forages without using any synthetic pesticides. To protect the organic environment and maintain and enhance the soil conditions in the Ulan Buh desert, Shengmu Forage does not use chemical synthetic fertilizers but organic fertilizers produced from the cow dung generated on our organic dairy farms. In this connection, Shengmu Forage has adopted a production method of using biologic germ and cow dung to produce organic fertilizers through high temperature fermentation. Shengmu Forage established and began the operation of four modern processing facilities of organic fertilizers in 2013 in close proximity to many of our organic dairy farms and plans to build similar facilities close to our other organic dairy farms in the future. As a result, we believe we are able to establish a self-sustained ecological cycle in a cost-efficient manner.

All of the growing fields developed by Shengmu Forage meet the E.U. organic standards and are certified organic under the PRC organic standards by the COFCC. See “— Permits, Approval and Product Certificates.” ECOCERT SA inspectors audit its operation each year. The scope of audit generally covers air quality, water quality, risk of pollution, use of chemical synthetic fertilizer, use of genetically modified organisms, use of antibiotics and use of synthetic pesticide. Shengmu Forage expects that it will have a total of approximately 180,000 mu of growing fields in the Ulan Buh desert that meet the E.U. organic standards by December 2014 which are able to supply the principal organic forages for approximately 53,000 dairy cows. In addition, Shengmu Forage has also obtained the right, through cooperation with local governments and other parties, to develop an additional 400,000 mu of desert land. It is expected that Shengmu Forage will have approximately 280,000 mu and 380,000 mu of growing fields by the end of 2015 and 2016, respectively. By 2020, Shengmu Forage expects to develop a total of approximately 560,000 mu of growing fields to grow organic forages to support our cow herd expansion.

In March 2014, we entered into the Long-term Strategic Cooperation Agreement with Shengmu Forage, under which Shengmu Forage has undertaken to continue the exclusive supply of organic forages to us and formulate its expansion plan according to our expansion plans. For further details of the Long-term Strategic Cooperation Agreement, see “— Suppliers and Procurement — Organic Feed — Shengmu Forage.” 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. Shengmu Holding (our PRC holding company), Mr. WU Jianye and Ms. GAO Lingfeng, 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 which Shengmu Holding, Mr. WU and Ms. GAO held an aggregate of 48.35% equity interests in Shengmu Forage. We are able to exercise significant

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influences over the management and operations of Shengmu Forage through our active involvement in the following aspects:

- *Active participation in management and operations.* We controlled the management and operations of Shengmu Forage as our subsidiary until the end of 2011, after which time we continued to be involved in its day-to-day management and operations. We typically have approximately 12 to 18 employees participating in the monitoring, supervision and management of Shengmu Forage’s production process, in addition to Shengmu Forage’s approximately 30 full-time operation-related employees (i.e., excluding management and administrative personnel). Since the establishment of Shengmu Forage, our employees have worked onsite in each stage of Shengmu Forage’s forage growing process. Set forth below are the details of Shengmu Forage’s production process and quality control policy measures, which have been formulated under our supervision:
 - Seed procurement. Our employees and Shengmu Forage jointly formulate procurement plans for seeds, select qualified seed suppliers according to such procurement plans and conduct on-site inspections to assess the reliability of the organic certifications held by prospective suppliers.
 - Fertilizing management. Our employees conduct on-site inspections to verify the type and quantity of fertilizers, participate in the testing of the composition of fertilizers and provide guidance on the application of fertilizers. Shengmu Forage’s organic fertilizers are primarily derived from the organic biowaste from our organic dairy farms.
 - Sowing management. Our employees participate in the inspection of the sowing procedures to ensure that the use of seeds and the sowing process are proper and meet the relevant organic standards.
 - Irrigation management. Our employees participate in the inspection of the irrigation procedures to ensure that the combined utilization of drip irrigation system and sprinkler irrigation system meets both forage growing needs and water conservation requirements.
 - Weed control. Our employees and Shengmu Forage jointly formulate weed control plans and schedules, and the purchase of suitable weed control machinery. We also engage in on-site supervision of the implementation of such weed control plans and schedules, including the restriction on the use of chemical synthetic herbicides.
 - Pest control. Our employees participate in the inspection of the pest control procedures and enforce the restriction on the use of synthetic pesticides to ensure the quality of organic forages.
 - Harvesting management. Our employees assist Shengmu Forage with the inspection of each step of forage harvesting and supervise the harvesting process. We and Shengmu Forage assign a number to each plat of land and establish traceability system based on such batch numbering for harvesting, storage and transportation to our organic dairy farms.

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- Organic certification. Our employees also engage in on-site coordination with the audits conducted by the COFCC and ECOCERT S.A., including initial testing, conversion period inspection, acceptance testing and follow-on inspections. Through such involvement, we supervise Shengmu Forage’s production process to ensure that it meets the relevant organic standards.
- *Shareholding overlap*. As of the Latest Practicable Date, we and our Ultimate Controlling Shareholders (together with their associates) held 8.60% and 33.82% of equity interests, respectively, in Shengmu Forage (although we are not aware of any acting-in-concert arrangements among the shareholders of Shengmu Forage other than the one among Shengmu Holding, Mr. WU and Ms. GAO holding an aggregate equity interest of 23.03% as of the Latest Practicable Date), which we believe will have significant influence in aligning the interests of Shengmu Forage with our Group’s interests. In addition, as of the Latest Practicable Date, other shareholders of Shengmu Forage with more than 5% equity interest include LIU Wenguang (劉文光) (19.39%), CHENG Yongli (程永利) (7.35%) and CHANG Pengfei (常鵬飛) (5.93%). To the best knowledge of our Directors, notwithstanding that CHENG Yongli is the head of Hateng Farm (哈騰牧場), which is operated by Shengmu Hateng, all of them are Independent Third Parties.
- *Influence on board of directors*. Although we do not control Shengmu Forage in terms of shareholding, our Directors, Mr. WU and Ms. GAO, are also directors of Shengmu Forage, giving us two out of three seats on its board of directors, and as a result, we have significant influence over its development strategy, management and operations. Mr. WU is responsible for coordinating with Shengmu Forage’s business development, and Ms. GAO is also responsible for Shengmu Forage’s quality control efforts.
- *Full support for our expansion plan*. Because we are Shengmu Forage’s only customer, its expansion plan has been prepared specifically to support the requirements of our expansion plan, which is also explicitly provided for in the Long-term Strategic Cooperation Agreement. Particularly, Shengmu Forage has undertaken to (i) not change its current business direction as an organic forage company, (ii) not change its development plans as the organic feed supplier for our organic dairy farms, (iii) follow our supervision over its forage growing operations under the relevant organic standards and (iv) continue to supply its forage crops exclusively to us on normal commercial terms.
- *Exclusive customer*. We are currently Shengmu Forage’s only customer for its organic forages. As its only customer, we provide to Shengmu Forage our annual forage procurement plans, pursuant to which Shengmu Forage formulates its own forage growing plans to ensure its supplies meet our production requirements. Such arrangement has also been reduced to writing under the Long-term Strategic Cooperation Agreement. Under this agreement, Shengmu Forage has agreed to supply to us on an exclusive basis, i.e. we would be its only customer. We, however, are permitted to seek alternative suppliers of organic forages. As a result, although currently an exclusive relationship for both sides, Shengmu Forage is, as a result of the agreement, more reliant on our Group than is the case vice versa.

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- *Major supplier.* We are a major raw material supplier of Shengmu Forage, supplying cow dung required for producing organic fertilizers necessary for its forage growing operations. Shengmu Forage uses cow dung generated on our organic dairy farms, which are adjacent to its growing fields, to process organic fertilizers to be used on its organic growing fields.
- *Prepayment.* Shengmu Forage depends significantly on our prepayment, which we use to secure the supply of organic forage, to support its operations. As of December 31, 2013, our prepayment to Shengmu Forage totaled RMB57.5 million, which will be settled subsequently through purchases. We expect such prepayment to continue in the future.

In addition, Shengmu Forage and its shareholders (except Shengmu Holding) have provided us with undertakings not to issue or transfer any equity interest of Shengmu Forage to any third party 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 this 20-year term. For details, please see “— Suppliers and Procurement — Organic Feed — Shengmu Forage.”

At its early development stage, Shengmu Forage required significant financial and human resources for its organic forage growing business. On one hand, it sought capital injections from third-party investors, and on the other, it enlisted the assistance of local farmers to grow primarily corn for processing into corn silage. Shengmu Forage entered into leasing agreements with these local farmers in 2011, 2012 and 2013. Pursuant to these agreements, these local farmers were contracted to grow specified types of forages on the leased growing fields owned by Shengmu Forage. Pursuant to these agreements, Shengmu Forage monitored and supervised the growing process to ensure that the forage crops grown by the local farmers met our organic and quality standards, including the following aspects: (i) local farmers were required to use seeds obtained from qualified suppliers designated by Shengmu Forage; (ii) local farmers were required to apply organic fertilizers obtained from Shengmu Forage and should not use chemical synthetic fertilizers; (iii) local farmers were required to strictly follow Shengmu Forage’s organic dairy farming protocols, and Shengmu Forage could unilaterally terminate the leasing agreements for breach of this requirement; and (iv) Shengmu Forage supervised and managed every step of the local farmers’ field activities and conducted sampling tests on the soil quality. The local farmers were required to sell all the forage crops harvested from the leased growing fields to us if they met our organic and quality standards, and Shengmu Forage agreed to waive an annual management fee, which would otherwise be payable by the local farmers, if they were able to supply sufficient amount of organic forage crops to us. To the best knowledge of our Directors, each of these local farmers is, except for his/her leasing arrangements with Shengmu Forage, an Independent Third Party and has not held any equity interest in any company of our Group since the commencement of such leasing arrangements up to and including the Latest Practicable Date.

Shengmu Forage does not currently lease any of its growing fields to local farmers. To the understanding of our Directors, however, we cannot exclude the possibility that Shengmu Forage will in the future decide to lease a portion of its growing fields to local farmers, if necessary, to grow organic forages in accordance with its own organic dairy farming protocols to supplement its operations in order to enhance flexibility in its resources allocation and ensure the fulfillment of applicable organic standards.

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Organic forages

We feed our organic dairy cows forages, including primarily corn silage and alfalfa, that Shengmu Forage grows organically in its growing fields in the Ulan Buh desert. Shengmu Forage supplied substantially all the forage crops organically grown in its growing field to us during the Track Record Period and pursuant to the Long-term Strategic Cooperation Agreement, Shengmu Forage has undertaken to continue to supply its forage crops exclusively to us on normal commercial terms. Below is a brief description of the forages that we purchased from Shengmu Forage.

- *Corn silage.* Corn silage is the principal type of feed for our dairy cows. It is made from corn after dough stage through fermentation in a sealed silage cellar at our dairy farms. The corn silage we feed our cows generally has more than 20% of starch, more than 7% of crude protein and other nutritional elements that can provide sufficient energy for the cows.
- *Alfalfa.* Alfalfa, a perennial leguminous plant, is a primary source of protein for dairy cows, and is essential for high protein content in raw milk. The high fiber content in alfalfa also helps improve milk yield.

In addition to corn silage and alfalfa, our cows’ feed includes a small portion of guinea grass supplied by third-party suppliers. We obtained organic certification by the COFCC for 310,000 mu of wild growing fields of guinea grass in December 2013. See “— Suppliers and Procurement” and “— Permits, Approval and Product Certificates.”

Organic concentrated feed

In addition to organic forages, our organic cow feed includes organic concentrated feed, which is lower-fiber feed primarily consisting of processed corn kernels and oil sunflower. We began purchasing corn kernels and oil sunflower primarily from Shengmu Forage in 2012 and 2014, respectively. Organic concentrated feed accounts for approximately no more than 40% of a dairy cow’s aggregate daily feed consumption in terms of volume. In 2013, we set up a new processing plant within approximately 80 kilometers from our organic dairy farms to process concentrated feed. We process all of our organic concentrated feed at this processing plant to meet the needs of our organic dairy farms. As of December 31, 2013, our processing plant had an aggregate annual production capacity of approximately 50,000 tonnes organic concentrated feed and a maximum annual production capacity of 200,000 tonnes, sufficient to meet the requirements of 120,000 dairy cows.

Feeding management

To promote cow health and ensure sufficient nourishment, we use different feed formulae developed in-house employing the total mixed ration, or TMR, concept based on the cow’s development stage, lactation stage and milk yield. We plan to continuously improve our feed formulae for our dairy cows to receive better nutrition. Such improvement will lead to an increase in our average feed costs, which may negatively affect our profit margins if the improved feed formulae fail, or prove to be less effective than we expected, to increase our milk yield or enhance the nutrition contents of our raw milk and increase its sales price, and we are unable to pass such increased cost

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onto our customers. See “Risk Factors — Risks Relating to Our Business — Increases in feed prices and disruptions of our feed supply could adversely affect our business and results.” We have installed feed-mixing equipment on the feeding trucks at our dairy farms to mix forages and concentrated feed based on such formulae to reduce cost and better control feed quality.

Organic dairy farming

Overview

We are the largest organic dairy farming company in China in terms of organic raw milk production and organic herd size, according to the F&S Report. As of December 31, 2013, we owned and operated 13 organic dairy farms with approximately 30,621 dairy cows and the capacity of housing a maximum number of 45,100 dairy cows. Our organic dairy farms are located in the Ulan Buh desert with an aggregate gross land area of approximately 7.7 million square meters. All of our milk producing organic dairy farms have obtained organic certification under the E.U. organic standards by ECOCERT S.A. and under the PRC organic standards by the COFCC.

Herd size and growth

All of our dairy cows are Holsteins, which generally have higher milk yield than other types of dairy cows, according to the F&S Report. Historically, we have grown our herd primarily by purchasing dairy cows domestically and breeding dairy cows by ourselves. As our herd has grown sufficiently large, we intend to grow our herd primarily by breeding our own dairy cows using imported frozen semen, supplemented by purchasing dairy cows from domestic dairy farmers as well as from overseas.

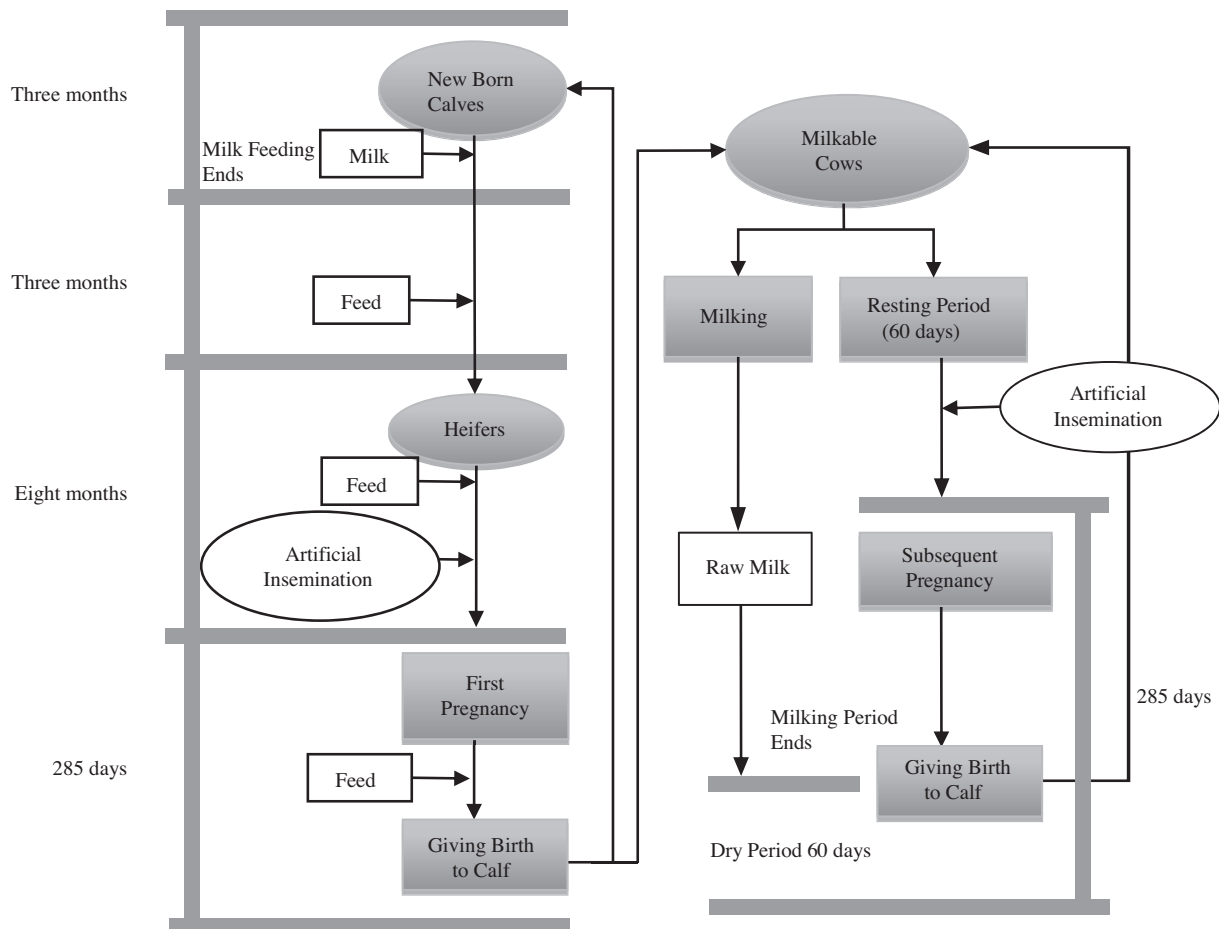
Historically, we have grown our herd primarily by purchasing dairy cows domestically, which are less expensive than imported dairy cows. In particular, when we began operations in 2010, our dairy cows were purchased at particularly low prices after the PRC dairy market was negatively impacted by the melamine incident in 2008 as a result of which dairy farmers were eager to dispose of their dairy cows. We require dairy cows purchased from our suppliers to receive various health certifications to ensure that they do not carry diseases. In addition, purchased dairy cows are vaccinated for foot-and-mouth disease and quarantined for at least 21 days before receiving clearance to enter into our farms.

We also grew our herd size by cooperating with local experienced dairy farmers operating medium sized farms. We generally selected one or more such local farmers to form a new subsidiary company with us. We are the majority shareholder of these companies and control the operations of the newly formed farms and implement our standard dairy farming process on these farms. The farmers, as minority shareholders, are primarily responsible for the day-to-day management of such newly formed farms.

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Purchased cows are non-organic cows and require a six-month transition period to be converted into organic cows based on E.U. and China GB standards, during which time such cows are kept according to our organic production standards. For information about organic dairy certification, see “Industry Overview — Raw Milk Production in China — Organic Raw Milk — Organic Dairy Certification.”

The following diagram illustrates a typical birth cycle of dairy cows:



- Calves normally refer to dairy cows of up to six months old. We keep the new born calves and sell all male new-borns. Calves are typically fed by milk for three months, and then fed by dairy cow feed afterwards.
- Heifers normally refer to dairy cows aged between seven months and the date of giving birth. Heifers are typically artificially inseminated at approximately 14 months old, and the pregnancy period is approximately 285 days. As of December 31, 2013, we had 13,796 organic calves and heifers.

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- After giving birth to a calf, the cow can be milked and therefore becomes a milkable cow. Milking starts immediately after the birth of the calf. Therefore, heifers typically become milkable cows as early as at the age of 24 months. As of December 31, 2013, we had 16,825 organic milkable cows.
- After giving birth to a calf, a milkable cow will rest for 60 days (commonly referred to as “resting period”) before being artificially inseminated again. Therefore, it typically takes 65 days to 90 days for a milkable cow to get pregnant again after giving birth to its calf. Milking starts immediately after giving birth and continues during the resting period.
- We stop milking a pregnant milkable cow 60 days before its due date to ensure a higher milk yield for the subsequent lactation period. This period is called the dry period and a cow during the dry period is normally referred to as a dry cow.
- Typically, a milkable cow can be milked for approximately 305 days before the start of the 60-day dry period ahead of giving birth to another calf.

We determine whether to stop milking and sell a milkable cow based on its health condition and milk yield. Typically, a milkable cow can be milked for five lactation periods. To maintain the quality of our milk products, we typically stop milking cows older than eight years, equivalent to five lactation periods.

As of December 31, 2013, approximately 48.1%, 28.9%, 18.9% and 4.1% of our organic milkable cows were in the first, second, third and fourth lactation period and beyond, respectively.

Farm management

We are committed to cattle welfare as part of the culture of organic dairy farming, which we believe contributes to our product quality. Our dairy farms are designed with an aim to provide dairy cows with the maximum comfort. Our organic dairy cows have an average living space of 60 to 80 square meters per cow. All of our farms are free stall farms with easy access to food and water, clean and comfortable dry sand bedding and spacious sport fields that allow our dairy cows to eat, drink and relax freely. A majority of our dairy farms have a capacity to house between 2,500 to 4,500 dairy cows. We believe that the size of our farms enables us to enjoy economies of scale without over-burdening the environment.

We have adequate access to water supply to support the operation of both our organic and non-organic dairy farms. The water supply for our dairy farms primarily consists of underground water underneath the farm land. All of our dairy farms have obtained necessary permit to draw underground water to feed our dairy cows and support the daily operation of the farm. The volume of underground water to be drawn as stated in the permits obtained by our dairy farms ranges from 10,000 cubic meters to 220,000 cubic meters annually depending on the actual need of each farm. Each of our dairy farms is also required to pay water resource fees for the consumption of underground water that is obtained through the aforementioned permit. In 2011, 2012 and 2013, we paid RMB46,000, RMB57,000 and RMB73,000, respectively, for such water resource fees. In accordance with applicable PRC laws, we are required to pay additional water resource fees if the actual volume of underground water used by

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our dairy farms exceeds the volume as stated in the relevant permit. See “Regulatory Overview” for more information about the permit to draw underground water. During the Track Record Period, we have not experienced any shortage of water supply for our organic and non-organic dairy farms and there has been no third party claims with respect to the water sources used by us.

We operate our dairy farms in accordance with standardized operational procedures, including a special set of organic procedures primarily related to organic feeding, breeding and medical treatment. We feed our organic cows with organic feed, and do not treat our organic cows with growth hormones. These standardized design and procedures enable us to devise unified supplying and feeding plans and operate our farms under uniform protocols. Therefore, we are able to apply a uniform benchmark to evaluate the performance of each of our dairy farms and improve our operational efficiency. Such standardized processes also allow us to replicate our experiences amongst our dairy farms through the sharing of management techniques and operational best-practices. In addition, we believe that the scale of our dairy farms enables us to better control certain diseases as compared with super large-scale dairy farms. We use a variety of feed formulae developed in-house based on the cow’s development stage, lactation stage and milk yield to promote cow health and ensure sufficient nourishment.

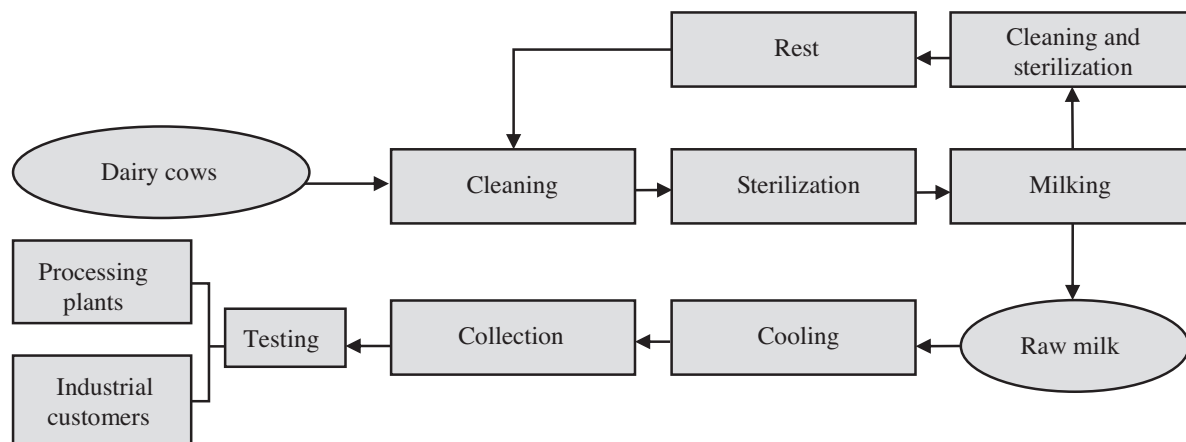
Milking process

We generally milk our dairy cows two or three times a day depending on a particular cow’s lactation stage, physical and health conditions. We believe that the design and size of our dairy farms also help reduce the fatigue of pregnant milkable cows in the milking process by reducing their walking distance, and thereby maintaining a high milk yield and raw milk quality. We milk our dairy cows primarily using imported automatic milking systems, which are automated and require low involvement of individual workers during the milking process. We follow strict hygiene standards at all of our milking facilities as well as during the milking process. Before milking, the udders and teats of cows are sprayed with sanitizing fluids. We also clean and sterilize the teat cups before milking. The udders and teats of cows are wiped dry with dry towels after sterilization. After finishing the above procedures, our dairy workers will attach the teat cups, which are connected directly to an automatic pump and a temperature-controlled central milk tank, to our cows’ udders. After completion of the milking process, raw milk will be cooled to 3°C and will flow to the central milk tank before delivery to our industrial customers or our milk processing plants. In addition, we carry out further testing and inspection before the raw milk leaves our central milk tanks.

We continuously monitor our milking process through closed circuit television systems in our control room and our computer systems that record data from our dairy farms. We carry out inspections at systematic intervals throughout the process to ensure consistency in the quality of our raw milk and compliance with applicable milk safety and organic processing standards.

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The following diagram illustrates our milking process.



Disease control

We have implemented a strict and effective disease control policy at all of our organic and non-organic dairy farms, which primarily consists of these aspects:

- *Prevention.* We have set up stringent protocols for any personnel and vehicles and dairy cows entering our dairy farms. To minimize the possible spread of any contagious disease, our milk transport trucks and drivers are assigned to a specific dairy farm exclusively, and are prohibited from transporting the milk of other farms. In addition, we disinfect our staff living quarters, barns, milking halls, trucks, machines and equipment, and the veterinary hospitals on a regular basis. We require dairy cows purchased from our suppliers to receive standard health certifications to ensure that they do not carry diseases, including foot-and-mouth disease, tuberculosis and brucellosis. In addition, purchased dairy cows are vaccinated for foot-and-mouth disease and quarantined for at least 21 days before receiving clearance to enter into our dairy farms.
- *Immunization.* Our dairy cows are vaccinated regularly throughout their lives, receiving with foot-and-mouth disease vaccines twice a year. We only use vaccines that meet E.U. and PRC organic standards. Moreover, we conduct annual checks for tuberculosis and brucellosis and carry out routine health inspections based on, among other things, the movement and rumination of dairy cows. Those cows with disease symptoms and are suspected to come in heat wear pedometers to facilitate observation and detection of illness and heat.
- *Treatment and containment.* Upon detection of any sign of sickness, the relevant dairy cows will be immediately quarantined in a separate zone and examined by our professional veterinarians. We seek to avoid the use of antibiotics in treating sick cows and instead treat them with herbal remedies to the extent appropriate. Where medical treatment is not cost-effective or not feasible, the diseased dairy cows will be culled, their bodies will be sterilized and disposed of, and the immediate areas will be disinfected. Where there is a concern of substantial risk of infection, we carry out farm-wide disinfection and

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immunization to prevent the spread of the disease. We are required to make relevant filings to government authorities for outbreak of certain classified diseases. See “Regulatory Overview” for further details. During the Track Record Period and up to the Latest Practicable Date, there had been no outbreak of any disease in our farms.

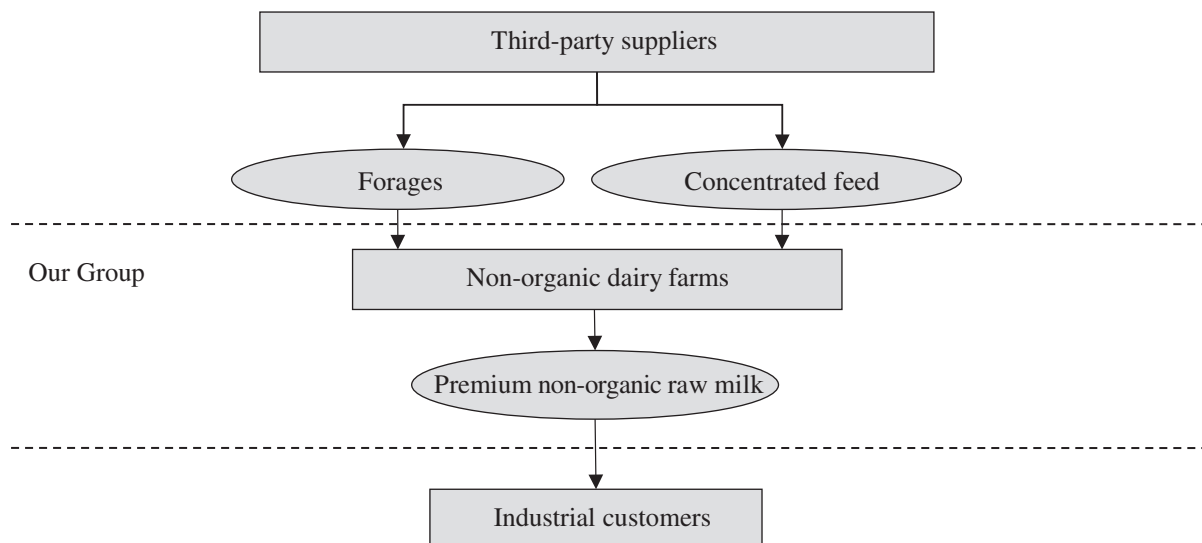
Milk produced by any cow during the period it is under medical treatment and for an additional “withdrawal period” is discarded. We generally milk the recently recovered dairy cows after the withdrawal period in a separate zone, where the milk produced is discarded until it passes all of our quality tests. The length of the withdrawal period varies depending on the medical treatment received by the cow and generally is twice as long as the recommended withdrawal period for non-organic cows.

Non-organic Dairy Farming

Overview

We are among the top eight producers of premium non-organic raw milk in China with a total production volume of approximately 113,300 tonnes in 2013, according to the F&S Report. As of December 31, 2013, we operated 12 non-organic dairy farms in Hohhot, Inner Mongolia with a total of 29,836 dairy cows. We seek to provide our non-organic cows with a comfortable, low stress environment and with nutritious feed to promote their health and productivity. We feed our dairy cows at these non-organic dairy farms with the same types of forages and concentrated feed as our organic dairy cows purchased from third-party suppliers, but we do not require them to be organically grown or processed. During the Track Record Period, substantially all of our premium non-organic raw milk was sold to Mengniu Group and Yili Group for their further processing into high-end dairy products.

The following diagram illustrates the production process of our non-organic dairy farming operation.



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Non-organic dairy farms

In addition to our organic dairy farms in the Ulan Buh desert, we operated 12 non-organic dairy farms, including eight farms owned by us and four farms leased from Mengniu Group, with a total number of 29,836 dairy cows as of December 31, 2013 and the capacity to house up to 41,700 dairy cows. All of our non-organic dairy farms are located in the rural area of Hohhot, Inner Mongolia. We leased the farms from Mengniu Group in 2010 and 2011 for a period of six years. We own all the dairy cows and Mengniu Group owns all the facilities and equipment, and we have agreed to sell all the raw milk produced on such farms to Mengniu Group. For details on our lease arrangements with Mengniu Group, see “— Our Customers — Agreements with Mengniu Group.”

All of our non-organic dairy cows are Holsteins which generally have higher milk yield than other types of dairy cows, according to the F&S report. Historically, we have grown our herd primarily by purchasing dairy cows domestically and breeding dairy cows by ourselves. Like our organic dairy farms, we require dairy cows purchased from our suppliers to receive various health certifications to ensure that they do not carry diseases. The birth cycle of non-organic dairy cows is the same as our organic cows, see “— Organic Dairy Farming — Herd size and growth” for details.

As of December 31, 2013, approximately 41.8%, 30.8%, 22.2% and 5.2% of our non-organic milkable cows were in the first, second, third and fourth lactation period and beyond, respectively.

Farm Management

We are committed to the welfare of dairy cows at our non-organic dairy farms. Our non-organic dairy farms are free stall farms with an average space per cow of approximately 30 square meters. A majority of our non-organic dairy farms have a capacity to house between 2,500 and 4,500 dairy cows. We believe that the size of our farms enables us to achieve greater economies of scale and optimal cost-benefit ratio. Same as 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. We generally follow the same milking process as our organic dairy farms with substantially the same types of equipment as used on our organic dairy farms. See “— Organic Dairy Farming — Milking process” for details.

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. To ensure sufficient protein intake, we primarily feed our dairy cows with alfalfa imported from the United States. In addition, we sourced corn silage and guinea grass, as well as concentrated feed, locally, during the Track Record Period, and require our suppliers to meet our internal quality standards. We use different feed formulae developed in-house employing the total mixed ration, or TMR, concept based on the cow’s development stage, lactation stage and milk yield. We have also installed feed-mixing equipment on the feeding trucks at our non-organic

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dairy farms to mix forages and concentrated feed based on such formulae to reduce cost and better control feed quality. In addition, unlike our organic dairy cows which drink purified water, our non-organic dairy cows drink groundwater from wells on our farms. We inspect the water quality regularly to ensure that it is clean and safe.

Environmental impact

Biowaste and wastewater are the primary wastes from our non-organic dairy farming operation. We supply biowaste generated from our non-organic dairy farms to our local feed suppliers and charge a fee for the provision of processing services with our own facilities. We have also installed anti-pollution equipment in our farms to minimize the impact to surrounding environment caused by our farming operation. See “— Environmental, Health and Safety Matters” for further details.

Future plans

Although we began our operation in 2010 by engaging in premium non-organic raw milk production, we have shifted our focus to organic dairy farming business following our expansion into organic raw milk and liquid milk businesses in 2011 and 2012 respectively. We expect that our future growth will primarily be driven by the growth of our organic raw milk and liquid milk businesses. In comparison, our premium non-organic raw milk business is expected to maintain a relatively steady growth in the future.

Liquid Milk Business

We began to produce and sell liquid milk products made from our internally produced organic raw milk by launching our organic whole milk under “Shengmu 圣牧” brand in June 2012. In 2013, we further expanded our product portfolio by offering organic low-fat milk and organic milk for children. We also have developed an e-commerce pack for sale through leading e-commerce operators such as JD.com (“京東”) and Tmall (“天貓”). In addition, we recently launched our organic whole milk and organic low-fat milk in business pack in May 2014. Our liquid milk products are fully organic, certified by the COFCC in China and ECOCERT S.A. in Europe.

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Products

Our organic whole milk products are made directly from our organic raw milk through UHT process. We believe that the protein and fat content of our organic whole milk contributes to its smooth and rich taste. Our organic low-fat milk products are made from our organic raw milk with reduced fat content. Our organic milk products for children are made from our organic raw milk with the addition of ingredients appealing to children or beneficial to their health, such as fructose and DHA. Set forth below is certain information about our organic milk products by product type.

Product type	Commercial launch date	Packaging (mL per carton x cartons per pack)	Suggested retail price per pack
Organic whole milk			
Gift pack	June 2012	250 mL x 12	RMB98
			
Business pack	May 2014	250 mL x 12	RMB80
			
Environmentally friendly pack	December 2012	250 mL x 12	RMB78
			

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Product type	Commercial launch date	Packaging (mL per carton x cartons per pack)	Suggested retail price per pack
E-commerce pack	August 2013	200 mL x 12	RMB58
			
Organic low-fat milk			
Gift pack	January 2013	250 mL x 12	RMB108
			
Business pack	May 2014	250 mL x 12	RMB90
			
Environmentally friendly pack	September 2013	250 mL x 12	RMB88
			

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Product type	Commercial launch date	Packaging (mL per carton x cartons per pack)	Suggested retail price per pack
Organic milk for children (whole milk).	January 2013	190 mL x 12	RMB68



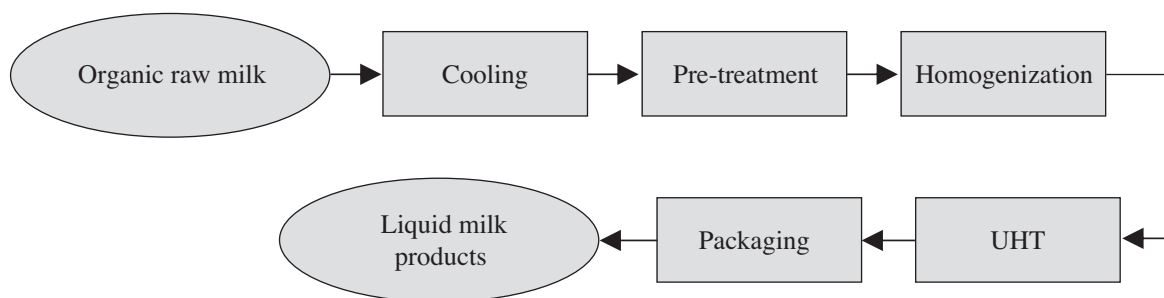
Set forth below is certain information about our liquid milk products as of December 31, 2013.

Product type	Protein content g/100mL	Fat content g/100mL	Calcium content mg/100mL	Other ingredients	Shelf life Days
Organic whole milk (gift pack, business pack and environmentally friendly pack) ..	3.5	4.1	115	—	180
Organic whole milk (e-commerce pack)	3.4	4.1	115	—	180
Organic low-fat milk.....	3.4	1.4	110	—	180
Organic milk for children.....	3.2	3.7	115	Fructose; DHA	180

Processing and facilities

Our organic milk processing plants are located in Dengkou Food Industry Zone, which is within 100 kilometers from our organic dairy farms. Our processing plants encompass approximately 12,000 square meters of office, processing, and warehouse space.

The following diagram illustrates how organic raw milk is processed into liquid milk products.



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- *Cooling.* Raw milk is cooled to 3°C to ensure the freshness of the milk.
- *Pre-treatment.* Raw milk is treated to achieve the uniform content standard that is required for sale.
- *Homogenization.* Raw milk is treated to prevent separation of fat and liquid and to improve texture and taste.
- *UHT.* Raw milk is heated to a temperature of approximately 137°C to 139°C for approximately four to six seconds. UHT eliminates bacteria and microbes from the raw milk and significantly extend the shelf life of liquid milk.

Our liquid milk processing uses advanced equipment and machinery purchased from well-recognized manufacturers, including Tetra Pak (Sweden). Particularly, we have purchased aseptic treatment, homogenization, UHT treatment and filling machines from Tetra Pak, an industry-leading supplier of food packaging equipment and materials. All of our major machinery units were purchased around three years ago and are in good condition for sustainable operation.

We perform all these processes in our liquid milk processing plants, and we closely monitor each production step to ensure the safety and quality of liquid milk products. We do not use any artificial colorings, preservatives and flavorings in the course of processing other than fructose and DHA for our organic milk for children. We use packaging materials for milk cartons produced by Tetra Pak (Sweden).

During the Track Record Period, our utilization rate was 10.4% and 38.1% in 2012 and 2013 respectively. Our utilization rate was relatively low in 2012 since we launched our liquid milk products in June 2012. Our utilization rate rose significantly from 10.4% in 2012 to 38.1% in 2013 primarily because we ramped up our production and our products became more recognized by the market. The following table sets forth the designed production capacity, production volume and utilization rate of our milk processing plants as of the date or for the period indicated.

As of or for the year ended December 31,								
2011			2012			2013		
Production capacity ⁽¹⁾	Production volume	Utilization rate	Production capacity ⁽¹⁾	Production volume	Utilization rate	Production capacity ⁽¹⁾	Production volume	Utilization rate
—	—	—	21,600	2,246	10.4%	54,828	20,885	38.1%

(In tonnes, except percentages)

(1) Calculated as the sum of the monthly production capacity of each of our production lines multiplied by the respective number of months during which such production line was in operation.

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QUALITY CONTROL

Quality Control Function

Quality control is one of our core values and vital to our business. We implement stringent quality control and production safety measures throughout our production process, including the procurement and storage of feed, dairy farming, milking and raw milk processing, storage and transportation of raw milk and finished products.

As of December 31, 2013, we had approximately 33 employees dedicated to product safety and quality control. These employees are all specialized in food inspection, many of whom had an average of five years of relevant experience from Mengniu Group. At the group level, our vice president and our executive Director, Ms. GAO Lingfeng (高凌鳳), is primarily responsible for the evaluation, improvement and monitoring of our quality control system. She also audits product quality, formulates quality control targets, supervises their implementation and reports directly to our president. Ms. GAO Lingfeng previously held various management positions with Mengniu Group, including head of quality control department, and had over 10 years of management experience in food quality control systems. Our quality control team also serves research and development functions. For more details, see “— Research and Development” below.

Quality Control Management

Our comprehensive quality control system consists of the following elements: (i) control over the quality of feed, (ii) control over the quality of dairy cows, (iii) control over the milking process and storage of raw milk, (iv) control during delivery of raw milk, (v) control over raw materials and suppliers, (vi) control over production process, and (vii) control over storage and delivery of finished products.

Quality of feed

We have implemented stringent quality control standards and monitoring mechanism for the feed used at our dairy farms. The feed for our dairy cows consists of primarily corn silage, alfalfa and concentrated feed. We have adopted a comprehensive set of standards for each type of forage crops and raw materials used in our feed. Such standards generally include color, odor, moisture, appearance, texture and chemical composition, as well as hygiene standards for certain types of feed. The quality control staff at each farm is required to inspect the feed on a sampling basis in accordance with our feed quality control manual.

After receipt of the feed at each farm, the responsible feed manager conducts initial inspection in accordance with the applicable quality standards. If there is any material defect, we will return the entire batch of feed delivered to us and notify the quality management department as well as other farms. After passing the initial sensory inspection, the feed manager conducts at least five random sensory inspections during the unloading process to ensure there is no unqualified feed.

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After passing the random sensory inspections, our quality control staff located at each farm will take samples for chemical indicators testing. We have established a feed inspection laboratory to conduct inspections and experiments on numerous indicators that are crucial to the quality of feed and to provide feedback to our dairy farms. If the testing results satisfy each and every indicator, we will accept the relevant batch of feed delivered to us. The quality management department compiles monthly quality control reports for all the feed inspected which include the results of inspection.

Quality of dairy cows

We have implemented a strict and effective disease control policy at all of our organic and non-organic dairy farms. For details, see “— Organic Dairy Farming — Disease Control.” We require the frozen semen imported from North America to be accompanied by a quarantine report of each supplying bull before the frozen semen is accepted.

Milking process and storage of raw milk

We milk our dairy cows in our dairy farms primarily using imported automatic milking systems. We have adopted strict hygiene standards for all of our milking facilities and procedures to ensure the quality and safety of raw milk, including, among other things, sanitizing the teats of our dairy cows, the apparel and gloves of milking personnel and towels before milking commences, discarding the first three squeezes of raw milk from the dairy cows and dipping the dairy cows’ teats with disinfectant after milking.

The hygiene of the milking facilities is crucial to the safety and quality of raw milk. We have implemented strict cleaning standards for our milking facilities, including the frequency of cleaning, among other things, to ensure high hygiene level of our milking facilities. For example, we clean the milking equipment, including the milking cups, on a daily basis and conduct a thorough clean-up of the entire milking facilities on a weekly basis. We also sterilize the milking facilities and all passages to the milking facility with disinfectant solutions.

After completion of the milking process, raw milk will be cooled-off and then transported to a temperature-controlled milk tank before delivery to our industrial customers or our milk processing plants. We carry out rigorous testing and inspection before the raw milk leaves our farms. After each milking shift of a given day, our milking personnel conduct temperature tests, sensory tests, odor tests, antibiotic tests, foreign substance tests and grain alcohol tests before the milk tanks are sealed. These tests are designed to ensure the raw milk does not contain any forbidden substances.

As a preventive measure, we conduct antibiotic tests on milk produced by cows that are in their first lactation period or are receiving or have recently received medication before milking them with our automatic milking systems together with other cows. The purpose of the tests is to ensure that our raw milk does not get contaminated with milk containing antibiotics. We also conduct chemical tests of the water source of our farms on a quarterly basis and tests for recessive mastitis of our cows on a monthly basis to ensure the quality and safety of our raw milk.

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Delivery of raw milk

We primarily engage third-party logistics companies to deliver and transport our raw milk. We have implemented a stringent safety and quality control policy throughout the transportation process. Each logistics company is required to maintain a certain number of trucks including back-up trucks with specifications strictly in accordance with its contract with us. We require the logistics companies to maintain the sanitary conditions of the trucks and conduct random inspections to ensure compliance. In addition, we prohibit any cross-use of delivery trucks that are used to transport milk with antibiotic residuals. If any antibiotic residuals are detected in the milk delivered, the delivery truck must be thoroughly sanitized and tested by our laboratory before next delivery.

We require each delivery truck to deliver the raw milk within the pre-determined timeframe without any delay. The logistics company will be responsible for any loss in the quantity and quality of milk caused by any delivery delay. The delivery trucks are also required to leave our farms within one hour after each milking shift to ensure the freshness of our raw milk. If we detect certain conduct of a third-party logistics company that is in material breach of our contract, we will immediately terminate the contract with such logistics company. During the Track Record Period and up to the Latest Practicable Date, we did not discover any conduct of a third-party logistics company that is in breach of our contract.

Raw materials and suppliers

We implement stringent quality control standards with respect to the raw materials we source from third-party suppliers and stringent evaluation and engagement policies for new suppliers. Before engaging a new supplier, our procurement team will first review the qualifications of the supplier and then conduct thorough on-site inspection. A supplier will only be qualified if it passes the qualifications review and on-site inspections. Both the qualified suppliers and our current suppliers remain subject to periodic review and evaluation, covering the quality of the raw materials we procured, the timeliness of delivery, compliance with our quality control protocols and their production facilities. We conduct inspection on raw materials upon delivery in compliance with the raw material acceptance standards set by our quality management department.

Production process

We implement stringent safety and quality standards at each stage of our production process. Our major production equipment was purchased from national and international manufacturers, including Tetra Pak, an international supplier of food packaging materials. We enforce strict hygiene standards for our personnel involved in production activities. Our quality control staff members conduct sample tests on our products at each stage of our production process, to ensure the appearance, color, odor, taste and nutrients of our products comply with our safety and quality standard.

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Storage and delivery of finished products

We perform quality inspection on our products by batch before delivery to ensure compliance with national food safety standards. Each unit of our organic milk products 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. We have implemented stringent internal control protocols to ensure that each product meets the relevant quality and safety standards by conducting strict sample tests on our products. Our warehousing facilities have designated zones for the storage of finished products by product type and batch, with identification cards recording the production time and batch number for tracking purposes. A batch of products is allowed for delivery only after we complete our tests and issue a quality inspection report for such batch.

Compliance with organic certifications

See “— Permits, Approval and Product Certificates.”

Record of Quality Control

As of the Latest Practicable Date, our brand and products had never been associated with any food safety incidents. In addition, we have received various certifications from government authorities or recognized organizations including the ISO9001 quality management system certification and HACCP certification, food safety management system certification.

AWARDS

The table below sets forth the major awards that we received since 2011.

Time	Award	Awarding Organization
May 2011.....	Gold Medal of BioFach China International Organic Trade Fair and Conference (中國國際有機食品博覽會金獎)	Organizing Committee of BioFach China International Organic Trade Fair and Conference (第五屆中國國際有機食品博覽會組委會)
May 2012.....	Gold Medal of BioFach China International Organic Trade Fair and Conference (中國國際有機食品博覽會金獎)	Organizing Committee of BioFach China International Organic Trade Fair and Conference (第六屆中國國際有機食品博覽會組委會)
May 2013.....	Gold Medal of BioFach China International Organic Trade Fair and Conference (中國國際有機食品博覽會金獎)	Organizing Committee of BioFach China International Organic Trade Fair and Conference (第七屆中國國際有機食品博覽會組委會)
August 2013	2013 Hohhot Excellent Local Private Enterprise (2013呼和浩特市優秀本土民營企業)	Hohhot Municipal Government (呼和浩特市人民政府)
December 2013 ...	Mayor’s Medal of Quality (市長質量獎)	Bayannur Municipal Government (巴彥淖爾市政府)
December 2013 ..	Key Leading Enterprise for Industrialization of Animal Husbandry in Inner Mongolia (內蒙古自治區農牧業產業化重點龍頭企業)	People’s Government of Inner Mongolia Autonomous Region (內蒙古自治區人民政府)

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OUR CUSTOMERS

Our customer base may be categorized into industrial customers and distributors. 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 January 2014, we also entered into an annual raw milk supply agreement with Want Want. For reliance risks, see “Risk Factors — Risks Relating to Our Business — We rely on a major customer for the sale of our raw milk, which may adversely affect our operating results if it terminates its relationship with us or reduces its purchases.” A portion of our organic milk is also sold as raw milk 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 then distribute them to retail chains such as supermarket chains and department stores. A very small portion of our liquid milk products are sold directly to end-consumers mainly via VIP card membership and corporate wholesale. See “— Sales, Marketing and Distribution — Distribution Network” for further details.

The table below set forth certain information about our customers.

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

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

Our largest customer, Mengniu Group, accounted for 87.4%, 94.6% and 58.3% of our total revenue in 2011, 2012 and 2013, respectively. We also sold raw milk to Mengniu Group through two individuals who were the then directors of Shengmu Holding in 2011, which accounted for 12.0% of our total revenue for the same period. In 2011, 2012 and 2013, our five largest customers contributed in aggregate 99.7%, 95.6% and 77.0% of our total revenue, respectively. Mengniu Investment, an investment company wholly owned by Mengniu Group, subscribed for a 5.44% equity interest in Shengmu Holding in May 2011. See “History, Reorganization and Group Structure — History and Development — Early Investors and Shareholders — Investment by Mengniu Group” for further details. 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

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issued share capital of our Company. Other than disclosed above, during the Track Record Period, our Directors confirm that the remainder of our five largest customers were Independent Third Parties and none of our Directors and their respective associates or any of our Shareholders (which, to the knowledge of our Directors, owned more than 5% of our issued share capital) held any interest in any of our five largest customers.

Mengniu Group is a leading dairy company in China, with which we have had a business relationship since we began producing raw milk. We elected to sell substantially all of our products to Mengniu in 2011 and 2012 because a number of our founders and shareholders were employees at Mengniu Group. In addition, as a leading dairy company in China, and in light of the growing demand for premium milk, Mengniu Group had sufficient demand to agree to offtake all our production of raw milk. See “— Agreements with Mengniu Group.” As our business operations expanded and as our reputation grew, other leading dairy companies such as Yili Group and other food companies such as Want Want also became our customers. Our entry into the liquid milk business in 2012 further diversified our customer base and revenue stream.

Due to their organic quality and high-end image, we believe that our liquid milk products are suitable as gifts during traditional Chinese holidays, such as the Mid-Autumn Festival and the Spring Festival. Seasonality has no impact on the pricing of our liquid milk products as we impose a uniform suggested retail price on all of our liquid milk products. See “— Sales, Marketing and Distribution — Distribution Network — Distributor Management” for further details. During the Track Record Period, we did not experience any material fluctuation of product pricing that had an adverse impact on our business and results of operations.

Agreements with Mengniu Group

Prior to June 2013, we had sold all of our raw milk primarily to Mengniu Group, a single large-scale nationwide dairy product manufacturer in China. Sales to this single customer accounted for approximately 87.4%, 99.4% and 79.3% of our sales of raw milk in 2011, 2012 and 2013, respectively.

We entered into a framework cooperation agreement with Mengniu Group in March 2010, 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. Mengniu Group agreed to purchase on a priority basis and we agreed to meet certain milk output volume requirements and supply all of our raw milk outputs that meet its quality standards from the leased dairy farms. In addition, as contemplated under the framework agreement, we also entered into a series of dairy farm lease and equipment lease agreements. For more information, see “Relationship with Mengniu Group — Current Relationship with Mengniu Group — Business Partnership.”

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Supply Agreements with Yili Group

In July 2013, we entered into raw milk supply agreements with Yili Group, pursuant to which we sell our raw milk to Yili Group. Set forth below are certain key aspects of these supply agreements.

- *Term.* These supply agreements have a term of one year. The parties may negotiate renewal upon expiration with a 30-day prior written notice.
- *Minimum quantity requirement.* We are committed to minimum supply requirement specified in the relevant supply agreements with exceptions of disease outbreaks or seasonal changes, in which case we will supply raw milk based on our actual output. In return, Yili Group agreed to purchase all the raw milk we are able to supply that meets its quality requirements.
- *Quality.* The raw milk sold to Yili Group is required to meet all the applicable national quality requirements as well as certain quality standards stated in the supply agreements. We are also required to meet Yili Group’s policies relating to raw milk procurement, including as sanitary and quality control requirements, which must be provided to and confirmed by us. During the contract term, Yili Group has the right to conduct periodical on-site inspections of our premises and make recommendations on rectifications of any quality control deficiencies or defects. We will be held responsible for any substandard raw milk if we fail to rectify such deficiencies or defects. In addition, we are subject to liquidated damages for each occasion of contamination in the raw milk committed by us.
- *Pricing.* The supply price will be based on market prices of raw milk of the same quality determined based on a pre-agreed scale included in the agreements, adjustable in the case of market or seasonal changes.
- *Payment terms.* Yili Group is required to pay in the following month for all the raw milk purchased in the previous month.
- *Inspection.* Yili Group is required to complete the inspection and other procedures for acceptance of our raw milk within eight hours upon our delivery to the designated location, and bear any loss resulting from the prolonged waiting period. Yili Group has the right to reject any raw milk from us if it is tested to be substandard by Yili Group. The parties may submit samples to third-party laboratories for additional inspections to resolve any quality disputes.
- *Return policy.* Yili Group is entitled to reject the delivery of any substandard or spoiled products.

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- *Termination.* Except in general, neither party may unilaterally terminate the supply agreements. We are entitled to unilaterally terminate the supply agreements if Yili Group (i) refuses to purchase the raw milk that meets its quality requirements on a timely basis or at all or arbitrarily changes the quality requirements, and repeatedly fails to rectify such breach upon our written notice, or (ii) fails to make payments pursuant to the agreements for up to a set time limit.

Supply Agreements with Want Want

In the first quarter of 2014, we entered into raw milk supply agreements with Want Want, pursuant to which we sell our premium non-organic and organic raw milk to Want Want. Set forth below are certain key aspects of these supply agreements.

- *Term.* These supply agreements have a term of one year. The party intending to renew these agreements upon the expiration must give a 10-day prior notice to the other party.
- *Minimum quantity requirement.* Want Want is committed to purchasing and we are committed to supplying a minimum daily quantity of raw milk from certain designated dairy farms. We are also obligated to submit to Want Want a monthly report on the number of milkable cows and the estimated milk output for the following month, and Want Want is entitled to conduct periodic on-site inspections to verify our number of dairy cows and daily quantity of supply.
- *Quality.* The raw milk sold to Want Want is required to meet all the applicable national quality requirements as well as certain quality standards stated in the relevant agreements and supplemental agreements, as applicable.
- *Pricing.* The supply price is fixed by the relevant agreements, adjustable in the case of local market price rise. If the parties cannot agree on the price adjustment, either party may unilaterally terminate the agreement without any liability. In addition, for any price adjustment proposed by Want Want, it must obtain our prior written consent. Otherwise we are entitled to discontinue the supply of raw milk at the adjusted price.
- *Payment terms.* Want Want is required to pay in the following month for all the raw milk purchased in the previous month.
- *Inspection.* Want Want may conduct sampling inspection of our raw milk, and has the right to reject any raw milk from us if it is tested to be substandard by Want Want. The parties may submit samples to third-party laboratories for additional inspections to resolve any quality disputes.
- *Return policy.* Want Want is entitled to reject the delivery of substandard or spoiled products.

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- *Termination.* Except as otherwise allowed thereunder, neither party may unilaterally terminate the supply agreements. Want Want is entitled to unilaterally terminate the supply agreements if (i) we decline its entry into our premises for on-site inspections, or (ii) our supply of raw milk is sourced outside the designated dairy farms. In addition, we will be deemed to have unilaterally terminated the supply agreements without cause if we repeatedly fail to supply raw milk to Want Want, and as a result, we will be subject to liquidated damages.

SALES, MARKETING AND DISTRIBUTION

Sales and Marketing

We sell raw milk directly to our industrial customers. For our sales of liquid milk products to retail customers, we market our organic liquid milk products exclusively under the brand “Shengmu 圣牧.” We or our distributors also engage in a variety of marketing and promotional campaigns tailored to different consumers groups to promote brand recognition of our products, including the following:

- Undertaking image advertising, which includes placing advertisements on the television and in inflight media. In 2013, we entered into advertisement placement agreements with advertising agent, to promote our organic concept and organic products on CCTV, the official and leading television station in China. In 2013, we also entered into advertisement placement arrangements with an advertisement agency to display promotional videos at certain airports and on Air China flights.
- Organizing open-house events at our dairy farms and production facilities to demonstrate our stringent safety control and advanced production processes.
- Establishing specialty shops to educate consumers about our “grass-to-glass” organic production model and the benefits of our organic milk and promote our brand image.
- Promoting our brand image and consumer loyalty through the Internet.
- Actively participating in philanthropic and public interest activities to further develop trust in our brand.

We continuously seek to develop our brand and product portfolio to meet evolving consumer preferences and target key growth markets. Our dedicated sales and marketing teams are regularly in contact with our customers and distributors to understand consumers’ needs and market trends.

Distribution Network

We sell our liquid milk products to consumers primarily through regional distributors. We believe that our distributor-based model provides us with the following benefits: (i) contributing to a faster expansion to markets nationwide and market penetration; (ii) enabling us to reach a wide range of points of sale, including department stores, supermarket chains and convenience stores; and (iii)

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allowing us to focus our management resources and attention on our core businesses. We believe that the use of distributors is generally in line with the industry practice in China. We have built a retail distribution network that now covers major cities in China. Sales to distributors accounted for substantially all of our total revenue of liquid milk business in 2012 and 2013. Our distribution network is structured to facilitate the sales of our liquid milk products in different geographic markets. Particularly, we use regional distributors to enter into new geographic markets in order to benefit from their established relationships with the local sales channels. We also sell a very small portion of our liquid milk products directly to end-consumers via VIP card membership and corporate wholesale in Hohhot and Beijing. See also “— Our Customers.”

Distribution coverage

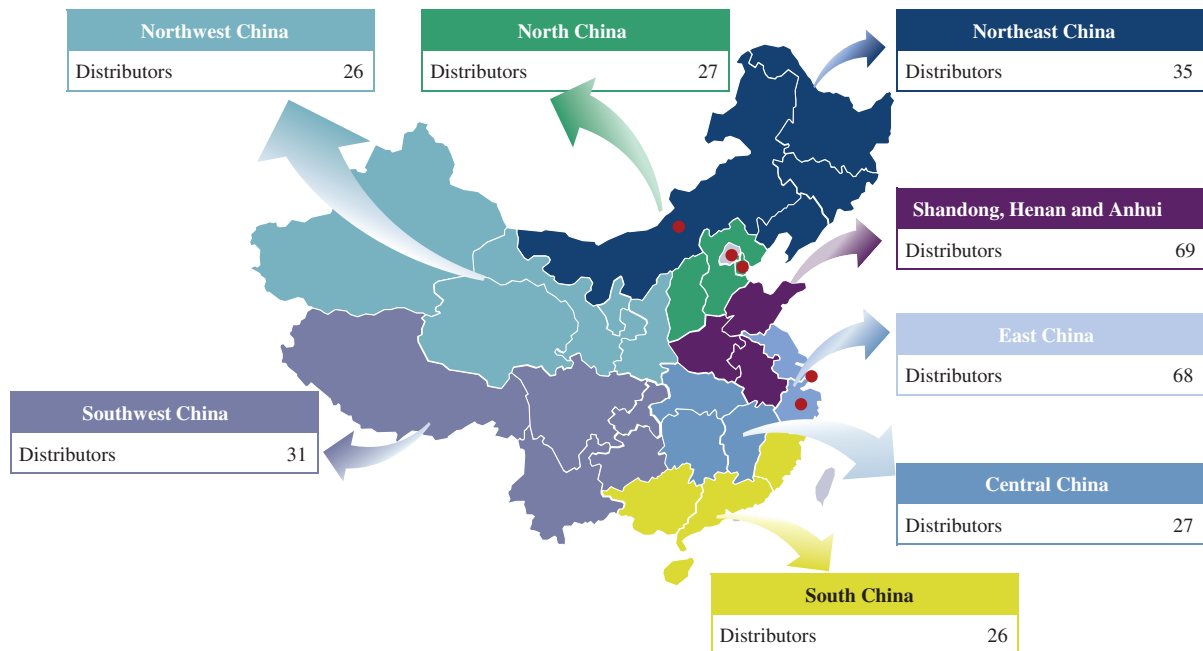
Geographically, we divide our distribution network into nine regions. The table below sets forth the geographic distribution of our distributors as of the date indicated.

	For the year ended December 31,		
	2011 ⁽¹⁾	2012	2013
Southwest China ⁽²⁾	—	2	31
Northeast China ⁽³⁾	—	16	35
North China ⁽⁴⁾	—	12	27
East China ⁽⁵⁾	—	19	68
South China ⁽⁶⁾	—	8	26
Central China ⁽⁷⁾	—	13	27
Shandong, Henan and Anhui	—	26	69
Northwest China ⁽⁸⁾	—	8	26
Beijing.....	—	1	3
E-commerce channels ⁽⁹⁾	—	3	4
Total		108	316

-
- (1) We began selling liquid milk products to distributors in 2012.
- (2) Consisting of Sichuan, Tibet, Chongqing, Guizhou and Yunnan.
- (3) Consisting of Heilongjiang, Jilin, Liaoning and Inner Mongolia.
- (4) Consisting of Hebei, Shanxi and Tianjin.
- (5) Consisting of Jiangsu, Shanghai and Zhejiang.
- (6) Consisting of Fujian, Guangdong, Guangxi and Hainan.
- (7) Consisting of Hunan, Hubei and Jiangxi.
- (8) Consisting of Gansu, Ningxia, Qinghai, Xinjiang and Shaanxi.
- (9) Represent distributors engaging in e-commerce sales.

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The following map illustrates the number of distributors in our distribution network as of December 31, 2013.



As of December 31, 2013, our distribution network covered over 50,000 points of sale in China, growing from over 12,000 outlets as of December 31, 2012. Our distributors either sell the products directly to end-consumers or points of sale, or to their sub-distributors which in turn sell to end-consumers or points of sale. We believe that our distributors engage sub-distributors primarily to supplement and expand their sales networks in regions not covered by their own sales and marketing teams. We have no contractual relationship with and do not directly supervise or manage these sub-distributors.

We currently own minority equity interests in four distribution companies. We believe that our investment in these distribution companies could enable us to more closely monitor and manage their sales activities in certain key markets with great growth potentials. We have entered into standard distribution agreements with these distribution companies. For the principal terms, see “— Sales, Marketing and Distribution — Distributor Management.”

Distributor management

We select regional distributors for our liquid milk products based on a number of criteria. We primarily choose candidates with established distribution network and regional expertise. We also require candidates to have adequate warehousing and transportation capabilities, as well as management capabilities.

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We generally enter into standard distribution agreements with our distributors. Set forth below are certain key aspects of management of our distributors.

- *Term.* Our distribution agreements generally have a term of one year with a three-month probation period. We are entitled to immediately terminate the distribution agreements if the distributors’ performance did not measure up to our expectations during the probationary period. Upon expiration of the contractual term, we may grant preference right of renewal to distributors who were in good standing and achieved satisfactory sales records during the previous term. Typically, our distributors will place purchase orders in accordance with their sales and inventory level.
- *Designated distribution channels and areas; competition.* The distribution agreements specify the designated distribution channels and areas for each of our distributors. We do not permit our distributors to market or sell our products outside their designated distribution channels and areas. Under the distribution agreements, we are entitled to terminate the distributorship for non-compliance with this term. We generally allow our distributors to carry competing products in line with market practice.
- *Pricing mechanism.* We generally price products based on a number of factors including the prices of competing products, high-end positioning strategy, as well as our cost of production. We supply our products at a uniform suggested retail price as specified in the purchase orders placed by distributors. Our distributors sell the products to end-consumers or points of sale, such as supermarkets and department stores. We have no contractual relationship with these points of sale. In addition, we require our distributors not to sell our products below cost which in turn may adversely affect our brand image and positioning. We have not discovered any instances of failure by our distributors to comply with our pricing policies. Our local manager periodically make on-site visits to points of sale to collect pricing information from our distributors as part of our sales and marketing activities.
- *Sales targets.* We generally have pre-set annual sales targets for our distributors. Failure to meet our sales targets may result in non-renewal of the distribution agreements and, in serious cases, immediate termination of the distributorship.
- *Retail and promotional campaigns.* The distributors are generally responsible for any entry fees, display fees, and/or marketplace management fees associated with the points of sale to which they on-sell our products. We will provide for any nationwide advertisement or large-scale regional promotional campaigns. We will also provide product logos and shop-front designs for promotional purposes.
- *Payment terms.* We generally dispatch shipment upon receiving the payment in full, and do not extend credit to distributors. We occasionally grant credit limits to distributors, which is negotiated on a case-by-case basis and approved by us.

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- *Delivery and revenue recognition.* We are generally responsible for arranging delivery of products from our warehousing facilities in Dengkou, Inner Mongolia, to locations designated by our regional distributors. Third-party logistic providers are entirely responsible for products damaged in transit. We recognize revenue from sales to our distributors when we deliver our products and the significant risk and rewards of ownership of our products are transferred to them.
- *Returns and exchanges.* We do not allow returns or exchanges except for quality defects or spoilage. In practice, we require our distributors to sell out a batch of order within three months. During the Track Record Period, our distributors were generally able to comply with this requirement and we did not experience any product returns or exchanges from our distributors that had a material impact on our operations.
- *Product liability claims and after-sales services.* We are primarily responsible for any quality defects of our products and require our distributors to cooperate with us in resolving any product liability claims. Our distributors are responsible for the provision of after-sales services, and are entirely responsible for any escalation of claims or any other loss due to poor after-sales services.
- *Inventory management.* Our local managers periodically visit these points of sale and supervise promotional campaigns carried out by our distributors. The on-going active monitoring of our distributors and the points of sale enables us to efficiently manage their inventory levels. We generally allow our distributors and the points of sale to maintain inventories of up to three months.
- *Non-compliance with contractual requirements.* We generally require our distributors to post a performance bond. We are entitled to unilaterally deduct fines from the bond for sales outside its designated distribution area. We may terminate the distribution agreements for repeated breaches of these contractual requirements. During the Track Record Period, all of our regional distributors complied with the distribution agreements in all material aspects and the salient reason for non-renewal or termination of a distribution agreement is failure to meet our sales targets.
- *No agency and no liability.* The distribution agreements specify that the distributors are not the agents of our Company. The distributors are not authorized to enter into any agreement with any other parties in the name of our Company, nor is our Company liable for any dispute arising from such agreement between the distributors and such other parties.
- *Use of our “Shengmu 圣牧” brand.* The names of our distributors cannot include “Shengmu 圣牧” without our authorization. We may authorize our distributors to include our brand in their corporate names at our discretion. Our sales and marketing department and legal department are responsible for reviewing, approving and/or rejecting related applications by distributors. An authorization will expire upon the expiration of the relevant distributor’s distribution agreement with us. If the distribution agreement is not renewed upon expiration, the distributor is required to remove our brand from its corporate name within three months.

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As of December 31, 2013, we had approximately 316 distributors covering 31 provinces, municipalities and autonomous regions in China. Except for Beijing Shengmu and Shanghai Saihan, in which we held equity interests, all the other distributors as of December 31, 2013 were Independent Third Parties. We also acquired minority equity interests in two other distribution companies (i.e., Anhui Meilichen and Tianjin Mengmu) in April 2014. The following table sets forth the changes in the number of our regional distributors during the Track Record Period.

	2011 ⁽¹⁾	2012	2013
As of January 1	—	—	108
Addition of new distributors	—	132	252
Termination of distributors ⁽²⁾	—	24	44
Net change in distributors	—	108	208
As of December 31	—	108	316

(1) We began selling liquid milk products to distributors in 2012.

(2) The termination was primarily due to our replacement of distributors with poor track records or voluntary termination of business dealings with us by the distributors.

SUPPLIERS AND PROCUREMENT

The principal raw materials that we use are dairy cow feed, primarily including corn silage, alfalfa and concentrated feed. Currently we source organic feed primarily from our associate, Shengmu Forage and purchase various non-organic feed from multiple third-party suppliers. We have had generally three to four years of business relationships with our major feed suppliers.

Except for organic forage which is sourced substantially from Shengmu Forage, we typically maintain multiple suppliers for each type of our major raw materials to minimize any potential disruption of our operations, maintain sourcing stability and secure competitive prices from suppliers. We did not experience any raw material supply shortages and prices of our major raw materials were relatively stable during the Track Record Period.

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The table below sets forth certain information of our raw materials and their respective external suppliers.

<u>Raw materials</u>	<u>Principal sources</u>
<u>Organic feed</u>	
- Corn silage and alfalfa	Shengmu Forage
- Guinea grass.....	Multiple local suppliers
- Concentrated feed ⁽¹⁾	Shengmu Forage and multiple local suppliers
<u>Non-organic feed</u>	
- Corn silage, alfalfa and guinea grass ...	Multiple local suppliers and one supplier from the United States
- Concentrated feed.....	Multiple local suppliers
<u>Other raw materials</u>	
- Packaging materials.....	Tetra Pak (Sweden) and multiple domestic suppliers
- Frozen semen	North America

(1) Since 2013, we have processed organic concentrated feed based on our own feed formulae from raw materials purchased primarily from Shengmu Forage.

Organic Feed

Shengmu Forage

Shengmu Forage has historically supplied substantially all the forage crops organically grown in its growing fields to us. Our transactions with Shengmu Forage were based on normal commercial terms and we were required to make prepayments on the orders. Our purchase from Shengmu Forage amounted to RMB0.7 million, RMB27.3 million and RMB111.8 million in 2011, 2012 and 2013, respectively.

Established in April 2010, Shengmu Forage is a company specialized in growing organic forage crops in the Ulan Buh desert without using any synthetic pesticides or synthetic fertilizers. Shengmu Holding, our PRC holding company, and Mr. WU Jianye were among the founding shareholders of Shengmu Forage. Our shareholding in Shengmu Forage decreased to 23.77% by the end of 2011 as a result of capital injections from certain individuals associated with Pangu Group, a company based in Inner Mongolia and controlled by Mr. WU Jianye’s family. Shengmu Forage subsequently obtained additional equity investments from third-party investors to support its growth and, as a result, our shareholding in Shengmu Forage further decreased to 8.60% by the end of 2013. In December 2011, Shengmu Forage ceased to be a member of our Group. For further details, see “History, Reorganization and Group Structure — History and Development — Shengmu Forage.”

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As organic feed is an essential raw material in the production of organic milk, we sought to secure a stable supply of organic forages from Shengmu Forage through a long-term agreement. 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. We were able to enter into a long-term agreement with Shengmu Forage because, among other reasons, (i) we have significant influence in Shengmu Forage; and (ii) our relationship with Shengmu Forage is one of mutual reliance as we are its exclusive customer. For further details, see “— Our Business — Dairy Farming Business — Organic Feed — Shengmu Forage” above. Our Directors believe that the Long-term Strategic Cooperation Agreement is necessary for securing us a stable supply of organic forages for years to come, which is mutually beneficial to both us and Shengmu Forage. The Joint Sponsors concur with the view of our Directors and are of the view that taking into account the business of our Company, the duration of the Long-term Strategic Cooperation Agreement entered into by our Company with Shengmu Forage is fair and reasonable and is in the interests of our Company and Shareholders as a whole.

Pursuant to the Long-term Strategic Cooperation Agreement, the price of Shengmu Forage’s forage crops will 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. We do not have any profit sharing arrangements with Shengmu Forage. Furthermore, Shengmu Forage has covenanted not to operate dairy farms in competition with us without our prior written consent. Neither we nor Shengmu Forage may terminate the Long-term Strategic Cooperation Agreement, save in the case of, among others, compliance with applicable laws, regulations or the Listing Rules.

Shengmu Forage is expected to be able to increase its supply of organic forages to us in accordance with our expansion plan. Shengmu Forage currently grows organic forages on approximately 115,000 mu of growing fields in the Ulan Buh desert, which meet the E.U. organic standards and are certified organic under the PRC standards by the COFCC. By December 2014, Shengmu Forage expects to increase its growing fields in the Ulan Buh desert to approximately 180,000 mu which are able to supply the principal organic forages for approximately 53,000 dairy cows. In addition, Shengmu Forage has obtained the right, through cooperation with local government and other parties, to further develop an additional approximately 400,000 mu of growing fields for organic forages. By 2020, Shengmu Forage expects to develop a total of approximately 560,000 mu of growing fields to grow organic forages to support our cow herd growth. Shengmu Forage has received the local governments’ support for its expansion plans, which are consistent with the government policies to develop a self-sustainable ecological economy.

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We believe that Shengmu Forage will have sufficient funding to support our expansion plan taking into account the following:

- *Increasing forage production.* After the initial investment period, Shengmu Forage has significantly ramped up its production of organic forages since 2012. Our total purchases of organic forage from Shengmu Forage increased from RMB0.7 million in 2011 to RMB27.3 million in 2012, and to RMB111.8 million in 2013, and are expected to continue to increase in the future with the growth of our organic dairy farming business.
- *Continuing prepayment.* In 2013, we made prepayments of RMB57.5 million to Shengmu Forage to secure the supply of organic forages and support Shengmu Forage’s operations. We expect such prepayments to continue in the near future.
- *Availability of bank financing.* As Shengmu Forage’s expansion continues, it becomes better-positioned to obtain bank financing. In April 2014, Shengmu Forage obtained credit facilities totaling RMB100 million.
- *Additional capital contribution.* Shengmu Forage received significant capital contribution from its shareholders during the Track Record Period, with an aggregate of RMB146.4 million from 2011 to the Latest Practicable Date. We believe that a number of its major shareholders, including our Company and shareholders also holding [REDACTED] of our Company, would be willing to contribute further capital into Shengmu Forage to support its expansion, subject to the requirements under the letters of undertaking described below.

To establish a self-sustainable ecological cycle, in 2013, Shengmu Forage established and began the operation of modern organic fertilizer production facilities adjacent to our organic dairy farms to produce organic fertilizers. We supply the cow dung produced on our organic dairy farms free of charge to Shengmu Forage, which is responsible for collecting, transporting and processing the dung into organic fertilizers to be used on its growing fields.

In addition to the Long-term Strategic Cooperation Agreement, Shengmu Forage and its shareholders (except Shengmu Holding) have also undertaken to us not to issue, sell, transfer or otherwise dispose any equity interests in Shengmu Forage to any third party 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 this 20-year term. Furthermore, the existing shareholders of Shengmu Forage (except Shengmu Holding) have also undertaken to cause Shengmu Forage to perform all of its obligations under the Long-term Strategic Cooperation Agreement, including the obligation to continuously execute its own business plans to support our future expansion plans. For further details of these undertakings, see “Relationship with Controlling Shareholders — Major Retained Businesses of Our Ultimate Controlling Shareholders — Long-term Strategic Cooperation Agreement with Shengmu Forage and Undertakings from Shengmu Forage and Its Shareholders.”

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Further, in 2011, 2012 and 2013, Shengmu Forage leased a portion of its organic growing fields to local farmers to grow organic forages in accordance with its own organic dairy farming protocols and in compliance with applicable organic standards. These local farmers were required to supply all such organic forages that met our organic and quality requirements to us. For further details, see “— Our Business — Dairy Farming Business — Organic Feed — Shengmu Forage” above.

Other Organic Feed Suppliers

We also purchase organic feed from other qualified suppliers, which are Independent Third Parties to the best knowledge of our Directors. We purchase a small portion of guinea grass from qualified third-party suppliers to supplement our purchases of organic alfalfa and corn silage.

In 2011, we purchased organic forages primarily from other qualified suppliers as Shengmu Forage was in the early stage of its development and was only able to supply us with a limited amount of alfalfa. As Shengmu Forage expanded its operation, including the area of its growing fields and quantity of forages it grew, our purchases of feed for our organic dairy farming business from suppliers other than Shengmu Forage decreased as a percentage of our total purchases. In 2011 and 2012, we purchased a small amount of concentrated feed from qualified local suppliers in addition to Shengmu Forage. We started to purchase corn kernels and oil sunflower primarily from Shengmu Forage in 2012 and 2014, respectively and process concentrated feed based on our own feed formulae in our processing plant.

Non-organic Feed

We generally purchase non-organic feed for our non-organic dairy farms in Hohhot from multiple third-party suppliers in close proximity to our farms. In particular, we purchase alfalfa imported from the United States through both overseas sellers and domestic traders and concentrated feed from multiple local suppliers.

Our supply agreements impose specific quality requirements on the outsourced feed and allow us to reject or return a delivery if it fails to meet our quality requirements. We also impose minimum supply requirements on our suppliers under the penalty of liquidated damages. We are generally entitled to terminate the relevant supply agreement for a supplier’s repeated failure to meet our quality requirements and/or prolonged delay of delivery. We generally make payments on the invoices when the aggregate batches of delivery exceed a certain amount specified in the supply agreements.

Top Suppliers

In 2011, 2012 and 2013, purchases from our largest supplier accounted for 12.2%, 11.2% and 10.7% of our total purchase, respectively, and purchases from our five largest suppliers together accounted for 37.2%, 31.0% and 24.6% of our total purchases, respectively. During the Track Record Period, our Directors confirm that other than Shengmu Forage, our five largest suppliers were Independent Third Parties and none of our Directors or their respective associates or our existing Shareholders (who, to the knowledge of our Directors, owned more than 5% of our issued share capital) held any interest in any of our five largest suppliers other than Shengmu Forage as disclosed above.

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LOGISTICS PROVIDERS

We primarily use third-party logistics providers to deliver our products. We select logistics providers via a competitive bidding process. We first send bidding invitations to qualified logistic providers. Upon receipt of bidding documents from each of the qualified logistics providers, our bidding committee will evaluate such bidding documents based on qualification verification, commercial review, technology review and price review. We then enter into contract with logistics providers that meet our bidding requirements. We have stringent criteria for the selection of logistics providers, such as price, scale, industry experience and track record. We require them to have a distribution network that is compatible with ours and implement a set of strict quality control standards for them to follow. For further details of our quality control over the delivery of raw milk, see “— Quality Control — Quality Control Management — Delivery of Raw Milk.”

We require our logistics providers for raw milk delivery to have at least two insulation trucks to meet our output volume of raw milk on a timely basis and complete delivery within a pre-set timeframe. The logistics providers are entirely responsible for any quality or quantity-related issues due to the transportation. Our logistics providers for liquid milk product delivery are required to arrange loading with an eight-hour prior notice and dispatch within 24 hours; otherwise, we have the right to arrange substituting transportation services and the defaulting logistics providers must compensate us for any additional cost so incurred. We evaluate the performance of our liquid milk product logistics providers on a semi-annual basis. All of our logistics providers are required to make a deposit with us, from which we may make deductions for breach of contract terms. Their payment is calculated based on the actual transportation volume and settled on a monthly basis.

During the Track Record Period, we did not experience any material disruption or delay in the delivery of our products. We believe this outsourcing arrangement allows us to focus our resources on our core business and reduce our capital requirements and risk of liability for transportation accidents, delivery delays or losses. We also believe that alternative qualified logistics providers are readily available in the market, and we may substitute our current logistics providers with alternative logistics providers without causing material disruptions to our operations.

INVENTORY MANAGEMENT

Our inventory comprises of raw materials we procure and produce, packaging materials and finished products. In accordance with our inventory policy, we typically keep three months of raw materials, except certain perishable raw materials such as raw milk, which is processed or delivered on the day of milking, and we typically maintain approximately seven days of concentrated feed. In addition, we typically make purchase for corn silage once a year to meet our annual needs and maintain six-month inventory of alfalfa. For finished products, our local managers periodically monitor the inventory level and performance of our distributors and the points of sale. Our distributors normally submit their purchase plans on a monthly basis, designed based on their inventory levels of the current month and confirmed by the inspection of our local managers. Due to the short shelf life of our liquid milk products, we generally allow our distributors and the points of sale to maintain inventories of up to three months.

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RESEARCH AND DEVELOPMENT

Since our establishment, we have focused our research and development efforts on organic dairy farming, enhancing milk yield and offering new products. In particular, we have been focusing our research and development efforts on feed formulae, dairy cows breeding, herd management and disease control. We have also devoted substantial efforts in developing new products to address the evolving consumer preferences and also to improve profitability. As of December 31, 2013, our research and development team consisted of 33 members, led by Ms. GAO Lingfeng, who has over 10 years of relevant experience with Mengniu Group. Our research and development team also serves quality control functions. For more details, see “— Quality Control” above. We incurred approximately RMB0.8 million, RMB1.1 million and RMB1.2 million as research and development expenses for the three years ended December 31, 2013.

We have also entered into a number of cooperation or joint development agreements with local universities and research companies, including the following:

- *Inner Mongolia University*. In January 2011, we entered into a cooperation agreement with an asset management company affiliated with Inner Mongolia University (內蒙古大學), or IMU Company, pursuant to which the parties agreed to incorporate a dairy-farm company, IMU-Shengmu Dairy, as business partners. IMU-Shengmu Dairy launched a research-oriented dairy farm by commercializing a proprietary know-how contributed by IMU Company and became the legal owner of such intellectual property rights. We are responsible for the day-to-day operations of IMU-Shengmu Dairy and our business partner is responsible for formulating development plans and providing technical support. As of its establishment, IMU-Shengmu Dairy was held as to 55% by Shengmu Holding and as to 45% by IMU Company. In March 2014, Shengmu Holding acquired a 15% equity interest in IMU-Shengmu Dairy from a then-existing shareholder. Subsequently, our shareholding in IMU-Shengmu Dairy increased to 70% while IMU Company’s shareholding decreased to 30%.
- *Baolai-Leelai*. In November 2013, we entered into a joint development agreement with Baolai-Leelai Bio-tech Co., Ltd. (山東寶來利來生物工程股份有限公司), or Baolai-Leelai. Pursuant to this agreement, Baolai-Leelai agreed to help us set up a microbiology workshop and train technicians. This workshop focuses on the development and production of bio-fermented cow feed with the yeast strain and fermentation know-how provided by Baolai-Leelai. Bio-fermented feed with specially-designed supplements can support cow health and lower feed costs. For internal production and consumption, we are permitted to use for free Baolai-Leelai’s intellectual property rights involved in this joint development program. Baolai-Leelai is a PRC-based high-tech company focused on ecological feeding and animal nutrition. For the production of such bio-fermented feed, we purchase yeasts and other ingredients from Baolai-Leelai at agreed-upon prices.

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COMPETITION

Competitive landscapes vary from segment to segment of the dairy market in China. We are the largest organic milk company in China with a 54.2% market share based on 2013 organic raw milk production volume, more than twice the market share of the second largest organic raw milk producer in China, according to the F&S Report. In addition, we were the only vertically integrated Chinese dairy farming company meeting E.U. organic standards as of May 31, 2014, which is among the highest standards in the world, according to the F&S Report. Together with our associate, Shengmu Forage, we are the only dairy company in China that applies a “grass-to-glass” organic (“全程有機”) production model in China, with all major steps of the industry value chain, including forage, dairy farming and milk processing, meeting E.U. standards and PRC standards. Therefore, we believe that we are well positioned to successfully compete in the submarkets of organic raw milk and liquid milk products by capitalizing our market leadership and first mover advantages.

As a portion of our organic raw milk is sold to industrial customers, such as Mengniu Group, to be processed into liquid milk products and marketed and distributed under their respective brands and we sell organic liquid milk products under our “Shengmu 圣牧” brand, these industrial customers 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.

MANAGEMENT OF GROWTH

We plan to significantly expand our organic dairy farming operation to meet the increasing market demand. The market demand for organic raw milk is primarily driven by the demand for organic milk products which are produced solely or principally from organic raw milk. According to the F&S Report, market demand for organic milk products continues to increase rapidly as a result of growing concern for food safety and rising disposable incomes in China. As a result, demand for organic raw milk increased from 18,000 tonnes in 2009 to 187,000 tonnes in 2013 and is expected to reach 1.602 million tonnes in 2018. Although organic raw milk production volume experienced rapid growth from 17,000 tonnes in 2009 to 174,000 tonnes in 2013, with a CAGR of 79.6%, demand for organic raw milk has been under-served and the gap between demand and supply is expected to continue to increase from 13,000 tonnes in 2013 to 122,000 tonnes in 2018. In 2013, the top three organic raw milk producers, including us, accounted for 86.9% of the total organic raw milk production volume in China, according to the F&S Report. The total production volume of organic raw milk is expected to reach 1.48 million tonnes in 2018. Despite the comparatively small market size of organic milk in the overall raw milk market, we are well positioned to leverage on our market leadership in this niche segment to capitalize on the increasing shortage for organic milk through active expansion. Based on the foregoing, we believe that it is critical to expand our organic dairy farming operation to narrow the supply-demand gap for organic milk and further increase our market share.

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Aside from the measures designed to expand our organic dairy farming operation in “— Business Strategy — Expand our organic dairy farming operations and ensure our product safety and quality,” we also intend to focus our expansion efforts on the following areas to support and manage our growth.

- *Land resources.* We will continue to build more organic dairy farms to support our expansion plan and to increase our organic raw milk output. We have sufficient vacant land area near our existing organic dairy farms to build approximately nine additional farms. In addition, Shengmu Forage has obtained the right to develop approximately 400,000 mu of growing fields in the Ulan Buh desert. To further integrate our dairy farming operation with Shengmu Forage’s forage growing operation, we may enter into leasing arrangements with Shengmu Forage to use the aforementioned land resources to build organic dairy farms in accordance with the applicable laws, regulations and the Listing Rules.
- *Production capacity.* We will continue to ramp up our utilization rate of the liquid milk production capacity as well as increase our daily liquid milk processing capacity to meet the increasing market demand for organic milk products. Our utilization rate for the production of liquid milk products increased significantly from 10.4% in 2012 to 38.1% in 2013, primarily due to production ramp-up and improved brand recognition.
- *Raw materials.* We will continue to closely coordinate with Shengmu Forage, our primary source of organic feed, to support our expansion plans. To this end, we and Shengmu Forage entered into the Long-term Strategic Cooperation Agreement for a term of 20 years, pursuant to which Shengmu Forage undertakes to continue its exclusive supply of organic forages to us and support our future expansion plans. In addition, Shengmu Forage expects to increase its growing fields in the Ulan Buh desert from approximately 115,000 mu at present to approximately 180,000 mu by December 2014 and has obtained the right, through cooperation with local government and other parties, to further develop approximately 400,000 mu of growing fields. By 2020, Shengmu Forage expects to develop a total of approximately 560,000 mu of growing fields to grow organic forages to support our cow herd growth through 2020.
- *Labor.* We will continue to expand through, among others, collaboration with local experienced dairy farmers and leverage on their experience in managing and operating dairy farms through the establishment of dairy-farm companies with these farmers being the minority shareholders. We will also continue to offer competitive compensation packages in order to maintain a sustainable workforce to support our growth.
- *Quality control.* We will continue to implement our quality control system across our existing and new dairy farms. In the second half of 2013, we established an organic production management center, which is charged with the responsibility of (i) designing organic certification protocols and procedures as internal guidance, (ii) managing and monitoring production quality and (iii) providing relevant trainings to new farm managers and quality control personnel. In respect of new organic dairy farms, we will assign experienced personnel and clone from our existing organic certification procedures so as to obtain organic certifications from the COFCC and ECOCERT S.A. as soon as practicable.

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- *Distributors and consumers.* We will continue to devote marketing and promotional efforts designed to enhance our brand recognition and ultimately boost our sales, leveraging on the growing consumer preference on the “grass-to-glass” organic products. We also seek to expand our distribution network by adding new distributors and further explore direct-sales opportunities. Our distributors increased significantly from 108 as of December 31, 2012 to 316 as of December 31, 2013, and plan to further increase to over 400 by the end of 2014. As our current distribution network reaches mostly tier one and tier two cities, we seek to penetrate further into lower-tier cities.
- *Industrial customers.* We entered into long-term agreements with Mengniu Group in 2010 and 2011, and developed additional industrial customers, namely, Yili Group in 2013 and Want Want in 2014. These industrial customers are committed to minimum order requirements. We will continue to seek strategic cooperation opportunities with reputable industrial customers.

PERMITS, APPROVAL AND PRODUCT CERTIFICATES

Permits and Approval for Dairy Farming Activities

In addition to the usual licences, permits and approvals in relation to the operation of business on our properties, the undertaking of our dairy farming activities also require the animal epidemic prevention permit and raw milk permit. As advised by our PRC legal advisers, as of the Latest Practicable Date, all of our organic dairy farms and non-organic dairy farms which are required to obtain these two permits have obtained them to support their dairy farming operations. For details of the status of certain licences, permits and approvals in relation to the operation of business on our properties, see “— Properties” and “— Legal Proceedings and Compliance— Non-compliance Incidents” of this section.

Product Certificates

For our organic dairy farming and liquid milk production operations, we have obtained organic certifications from ECOCERT S.A. under E.U. standards and/or the COFCC under the PRC standards. Our associate, Shengmu Forage, has obtained PRC organic certifications from the COFCC for its forage growing operations and is currently undergoing conversion periods for organic certification under E.U. standards.

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The following table sets forth certain information about the ECOCERT S.A. organic certificates held by us.

Certificate No.	Company	Product	Category of certificate	Issue date	Expiry date
22119CN1300z2ec (EOS)	Shengmu Dairy	Liquid milk — organic milk for children	Organic product	January 27, 2014	September 30, 2014
		Liquid milk — organic low-fat milk	Organic product	January 27, 2014	September 30, 2014
		Liquid milk — organic whole milk	Organic product	January 27, 2014	September 30, 2014
22349CN1300z1ec (EOS)	Shengmu Pangu	Raw milk	Organic product	December 10, 2013	September 30, 2014
22282CN1300z1ec (EOS)	Shengmu Xintai	Raw milk	Organic product	November 20, 2013	October 25, 2014
9010CN1300z1ec (EOS)	Shengmu Farming ⁽¹⁾	Raw milk	Organic product	November 20, 2013	October 23, 2014
9010CN1400z1ec (EOS)	Shengmu Farming	Raw milk	Organic product	March 21, 2014	April 27, 2015
22358CN1400z1ec (EOS)	Shengmu Liuhe	Raw milk	Organic product	March 24, 2014	April 27, 2015
22357CN1400z1ec (EOS)	Shengmu Hateng	Raw milk	Organic product	March 24, 2014	May 1, 2015
22359CN1400z1ec (EOS)	Shengmu Taohai	Raw milk	Organic product	March 24, 2014	April 25, 2015
22371CN1400z1ec (EOS)	Shengmu Wuxing	Raw milk	Organic product	March 21, 2014	April 24, 2015
22372CN1400z1ec (EOS)	Shengmu Xinhe	Raw milk	Organic product	March 21, 2014	April 26, 2015

(1) Shengmu Farming currently operates five organic dairy farms.

Shengmu Forage first applied to ECOCERT S.A. for organic certification under the E.U. standards in 2012 and is currently undergoing conversion periods under E.U. organic standards. Such conversion periods are two years for growing fields for forages that live for one year (e.g. corn) and three years for forages that live for more than one year (e.g. alfalfa). If Shengmu Forage continues to comply with E.U. organic standards through the remainders of the conversion periods, it is expected to receive organic certification by ECOCERT S.A. upon the end of the conversion periods. According to ECOCERT S.A., forages produced by Shengmu Forage during the conversion periods meet E.U. organic standards.

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The following table sets forth certain information about the COFCC organic certificates held by us and Shengmu Forage.

Certificate No.	Company	Product	Category of certificate	Issue date	Expiry date
100OP1300114	Shengmu Dairy	Liquid milk — organic whole milk Liquid milk — organic low-fat milk Liquid milk — organic milk for children	Milk processing	January 15, 2014	January 14, 2015
100OP1200139	Shengmu Farming ⁽¹⁾	Raw milk	Dairy farming	July 21, 2013	July 20, 2014
100OP1200140	Shengmu Farming	Raw milk	Dairy farming	July 21, 2013	July 20, 2014
100OP1200235	Shengmu Farming	Raw milk	Dairy farming	October 27, 2013	October 26, 2014
100OP1300941	Shengmu Farming	Cows	Dairy farming	October 31, 2013	October 30, 2014
100OP1301016	Shengmu Farming	Guinea grass	Forage processing	December 10, 2013	December 09, 2014
100OP1300950	Shengmu Xintai	Corn silage	Forage processing	October 24, 2013	October 23, 2014
100OP1300800	Shengmu Xintai	Raw milk	Dairy farming	August 4, 2013	August 3, 2014
100OP1300801	Shengmu Pangu	Raw milk	Dairy farming	August 4, 2013	August 3, 2014
100OP1400235	Shengmu Taohai	Raw milk	Dairy farming	June 6, 2014	June 5, 2015
100OP1400236	Shengmu Liuhe	Raw milk	Dairy farming	June 6, 2014	June 5, 2015
100OP1400237	Shengmu Hateng	Raw milk	Dairy farming	June 6, 2014	June 5, 2015
100OP1400238	Shengmu Wuxing	Raw milk	Dairy farming	June 6, 2014	June 5, 2015
100OP1400239	Shengmu Xinhe	Raw milk	Dairy farming	June 6, 2014	June 5, 2015
100OP1300894	Shengmu Forage	Forage	Forage growing	August 1, 2013	July 31, 2014
100OP1200214	Shengmu Forage	Forage	Forage growing	August 1, 2013	July 31, 2014
100OP1200215	Shengmu Forage	Forage	Forage growing	October 10, 2013	October 9, 2014
100OP1300932	Alxa Forage	Forage	Forage growing	October 12, 2013	October 11, 2014

(1) Shengmu Farming currently operates five organic dairy farms.

The organic certificates from ECOCERT S.A. and the COFCC are generally valid for one year. The certificate holder must apply for renewal with all necessary supporting documents three months prior to the expiration date, and the certification agency will arrange for on-site annual audit to determine whether the applicant’s operation is in continued compliance with the relevant organic standards. During such annual audit, inspectors from these agencies will examine Shengmu Forage’s growing fields and our dairy farms and production facilities and the scope of such examinations generally covers substantially all aspects of our operations, including the air quality, the water quality, the usage of synthetic fertilizers, the usage of GMOs, as well as the usage of antibiotics, synthetic pesticides and chemical detergent. These certificates are critical to our operations. We did not

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experience any material difficulty in obtaining or renewing our organic certificates and have not been admonished or penalized by the certificate-granting agencies for any material non-compliance. We cannot, however, assure you that we will be able to obtain or renew such certificates in the future. See “Risk Factors — Risks Relating to Our Business — Loss of or failure to obtain or renew certifications for organic dairy farming and processing could materially and adversely affect our business.”

INSURANCE

In general, insurance companies in the PRC could provide insurance coverage for dairy cows and heifers that are aged at or over 12 months and the amount of the insurance premiums would depend on factors such as the type, age and milk yield of the cows and heifers, as applicable. We have maintained insurance policies for all our milkable cows against losses caused by certain diseases, illnesses, accidents and natural disasters. The diseases covered by the insurance policies for our dairy cows and heifers, include foot-and-mouth disease, mad cow disease, bovine ephemeral fever, tuberculosis and brucellosis. Upon the occurrence of an insurable event, the maximum compensation under the insurance policies would generally cover some of our costs to purchase a replacement heifer. The insurance policies we purchased are renewable on an annual basis. Our Directors believe that our insurance coverage is in line with what is usual and common practice in the industry in China, including with respect to the terms of and the coverage provided by such insurance. As of the Latest Practicable Date, no significant claims have been made by us under these insurance policies.

We do not currently maintain insurance coverage for our products or production facilities and machinery units. During the Track Record Period and up to the Latest Practicable Date, we had not experienced any material product liability claims or material disruption to our business as a result of major equipment failures or other workplace accidents. Additionally, we maintain mandatory social insurance contribution plans for our employees in China pursuant to PRC laws. Our Directors believe that our insurance coverage currently in place is adequate and is in line with customary industry practice.

INTELLECTUAL PROPERTY

We rely primarily on a combination of patents, copyrights, trademarks and trade secrets, as well as employee and third-party confidentiality agreements to protect our intellectual property.

As of the Latest Practicable Date, we had received a total of seven patents in China. With respect to, among others, proprietary know-how that is not patentable and processes for which patents are difficult to enforce, we rely on trade secret protection and confidentiality agreements to safeguard our interests. We believe that certain elements in our operations are not covered by patents or copyrights, and we have taken security measures to protect these elements. All of our research and development personnel have entered into confidentiality and proprietary information agreements with us. These agreements address intellectual property protection issues. In addition, under the PRC laws, we are the owner of all of the patentable inventions, utility models and designs developed by our employees during the course of their employment.

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As of the Latest Practicable Date, we had 13 registered trademarks in China, including “圣牧,” and had 19 trademark applications in China. As our brand name is rapidly gaining recognition, we are working to increase, maintain and enforce our rights in our trademark portfolio, the protection of which is important to our reputation and branding.

As of the Latest Practicable Date, we were the registered owner of three domain names, including our corporate website, www.youjimilk.com.

During the Track Record Period and as of the Latest Practicable Date, we had not been subject to any material infringement of our intellectual property rights or allegation of infringements by third parties.

PROPERTIES

Our PRC principal executive offices are located in Bayannur, Inner Mongolia. We occupy certain properties in China in connection with our business operations. These properties are used for non-property activities as defined under Rule 5.01(2) of the Listing Rules. They mainly include premises for our dairy farms, processing plants, offices, warehouses and employee dormitories.

As of December 31, 2013, each of our properties had a carrying amount below 15% of our combined total assets. On this basis, no property valuation report in respect of our Group’s property interests is required in reliance upon the exemption provided by Rule 5.01A of the Listing Rules and Section 6(2) of the Companies (Exemption of Companies and Prospectuses from Compliance with Provisions) Notice (Chapter 32L of the Laws of Hong Kong). Therefore, this [REDACTED] is exempted from compliance with the requirements of Section 342(1)(b) of the Companies (Winding up and Miscellaneous Provisions) Ordinance in relation to paragraph 34(2) of the Third Schedule to the Companies (Winding up and Miscellaneous Provisions) Ordinance, which requires a valuation report with respect to all of our interests in land or buildings.

Owned Properties

As of December 31, 2013, we had obtained the land use right for a parcel of land with a site area of 54,696 square meters, the land contract use right (承包經營權) for approximately 15 parcels of land with a total area of approximately 3,980,000 square meters (5,973 mu), and building ownership right for buildings and units with a total gross floor area of 12,354 square meters. Except as otherwise disclosed below and elsewhere in this [REDACTED] we have obtained land use right, land contract use right or building ownership right for all of our land or buildings and units.

We had not obtained the title certificate of two parcels of land, operated by Shengmu Agriculture and Shengmu Dairy respectively, with a site area of approximately 17,500 square meters (26 mu) in Hohhot and approximately 30,671 square meters in Bayannur, respectively, as of the Latest Practicable Date.

Shengmu Agriculture

- *Title defects.* We had commenced construction on a parcel of land in Hohhot, Inner Mongolia, operated by Shengmu Agriculture, without first obtaining the land use right certificate and the planning and construction permits. We intend to use this land as office space designed for research and development purposes upon completion of construction.

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- *Potential legal consequences.* As advised by our PRC legal advisers, the competent government authorities may order us to pay fines of up to 10% of the construction fees, cease construction and/or return the land if deemed illegally occupied if we cannot obtain the required permit and title certificate.
- *Latest status.* We entered into a binding agreement with Management Committee of Hohhot Economic and Technological Development Zone Ruyi Industrial Park (呼和浩特經濟技術開發區如意工業園區管理委員會) in April 2012 and made a prepayment totaling RMB262,550 to purchase this land. In addition, we obtained a no-action confirmation from Hohhot Economic and Technological Development Zone Ruyi Industrial Park Bureau of Land Planning, Construction and Environmental Protection (呼和浩特經濟技術開發區如意區規劃土地建設環保局) on March 25, 2014. This confirmation acknowledges the fact that Shengmu Agriculture is currently undergoing the procedures for obtaining the required planning and construction permits and therefore it is not subject to any administrative penalties. As advised by our PRC legal advisers, this bureau is a competent authority for purpose of issuing such confirmation. We are currently in the process of completing the public auction procedures to obtain the land use right certificate. We expect to expend a total of RMB0.1 million in connection with our applications and obtain the relevant permits and title certificates by the end of 2014. Our Directors believe that they do not expect any material legal impediment to obtaining such permits and title certificates. We currently have no intention to occupy the buildings under construction before obtaining the required permits and title certificates. Because we intend to use such office space under construction primarily for non-production purposes and comparable premises are readily available in close proximity, our Directors are of the view that this construction site is not crucial to our operations.

Shengmu Dairy

- *Title defects.* We had commenced construction on a parcel of land in Bayannur, Inner Mongolia, operated by Shengmu Dairy, we had commenced construction on this site without first obtaining the land use right certificate. We intend to use this land to expand our production facilities for organic yogurt upon completion of construction.
- *Potential legal consequences.* As advised by our PRC legal advisers, if we cannot obtain the land use right certificate, the competent government authorities may order us to return the land if deemed illegally occupied.
- *Latest status.* We are currently in the process of completing the land purchase procedures and expect to expend a total of RMB1.3 million for obtaining the land use right certificate. We obtained a no-action confirmation from Dengkou County State Land Resources Bureau (磴口縣國土資源局) on February 25, 2014, which stated that the local government had approved this construction site and acknowledged the fact that Shengmu Dairy was undergoing the required public auction procedures to purchase this land and therefore it was not subject to any administrative penalties. As advised by our PRC legal advisers, this bureau is a competent authority for purpose of issuing such confirmation. We currently have no intention to occupy the buildings under construction before obtaining the required title

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certificate. Based on the foregoing, our Directors believe that there is no material impediment to completing the land purchase procedures and obtaining the land use right certificate by the end of July 2014. Because we have not yet commenced operations at our existing production facilities for processing yogurt products and comparable premises are readily available in close proximity, our Directors are of the view that this construction site is not crucial to our operations.

For details on other incidents of non-compliance relating to our owned properties, see “Legal Proceedings and Compliance — Non-compliance Incidents” below.

Except for the land and buildings with title defects disclosed above and elsewhere in this [REDACTED], as confirmed by our PRC legal advisers, we are entitled to use all of our land and we legally own all of our buildings. Our PRC legal advisers have also advised us that we do not have proper ownership right in the two parcels of land mentioned above due to the existence of title defects, which will also prevent the relevant parcel of land from being sold or accepted by banks as securities for mortgages.

Leased Properties

As of December 31, 2013, we leased eight parcels of state-owned land with a total area of approximately 3,460,000 square meters and eight parcels of collectively-owned land with a total area of approximately 2,980,000 square meters for dairy farming. The lessor had not completed the relevant facility agricultural use land approval procedures (設施農用地審核手續) and the large-scale husbandry use land filing procedures (規模化畜禽養殖專案用地備案手續) from the competent land administration authorities with respect to three parcels of land with a total area of approximately 470,000 square meters in Hohhot. We operate Hohhot Farm No.10, Hohhot Farm No.11 and Hohhot Farm No.13 on these three parcels of land pursuant to certain lease agreements. The lessor is the entity required by law to obtain such approvals and filings. If the lessor fails to rectify these title defects, we may be ordered by the competent government authorities to cease operations and restore the conditions of the land. If we are required to cease operations at these farms, we intend to relocate the cows on these farms to our other non-organic dairy farms in Hohhot.

In March 2014, we received compliance confirmations from the county governments where we operate these leased farms. According to these confirmations, the local governments acknowledged that we, as the lessee, are in full compliance with the relevant legal and regulatory requirements with our operations of the leased farms and are not subject to any administrative penalties. As advised by our PRC legal advisers, these county governments are competent authorities to issue such confirmations. However, if we were required to cease operations on these three parcels of land, our Directors believe that the relocation costs would be immaterial and such relocation would not result in any material disruption in our operations as our other non-organic dairy farms have sufficient excess capacity. In 2011, 2012 and 2013, the aggregate revenue generated on these farms amounted to RMB72.2 million, RMB141.2 million and RMB160.0 million, respectively, representing 18.5%, 20.1% and 14.0% of the total revenue, respectively. As of December 31, 2013, there were approximately 7,000 dairy cows on these farms with an aggregate maximum capacity to house 9,000 dairy cows. As of December 31, 2013, these farms had an aggregate carrying amount of RMB14.3 million in terms of facilities and equipment.

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EMPLOYEES

We had 1,055, 1,596, 1,858 and 2,439 employees as of December 31, 2011, 2012 and 2013 and the Latest Practicable Date, respectively. The following table sets forth the number of employees categorized by function as of the Latest Practicable Date.

<u>Function</u>	<u>Number of employees</u>	<u>Percentage of total</u>
Management.....	120	4.9%
Farm personnel	1,801	73.8%
Production	86	3.5%
Sales and marketing.....	120	4.9%
Quality control.....	55	2.3%
Administration	150	6.2%
Information management.....	49	2.0%
Others.....	58	2.4%
Total	<u>2,439</u>	<u>100.0%</u>

The following table sets forth the number of employees categorized by geographic location as of the Latest Practicable Date.

<u>Geographic Location</u>	<u>Number of employees</u>	<u>Percentage of total</u>
Inner Mongolia	2,341	96.0%
Other locations	98	4.0%
Total	<u>2,439</u>	<u>100.0%</u>

We provide management personnel and employees with on-the-job education, training and other opportunities to improve their skills and knowledge. The compensation we offer to our employees primarily includes base salary and bonuses. In general, we determine employee compensation based on each employee’s performance, qualifications, position and seniority. We are subject to social insurance contribution plans organized by PRC local governments. We have paid, on behalf of our employees, monthly social insurance premiums covering pension insurance, medical insurance, unemployment insurance and housing reserve fund in accordance with the relevant national and local labor and social welfare laws and regulations.

We believe we have maintained good relationships with our employees. Our employees do not negotiate their terms of employment through any labor union or by way of collective bargaining agreements. We have not experienced significant labor disputes which have had or are likely to have a material adverse effect on our business operations.

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ENVIRONMENTAL, HEALTH AND SAFETY MATTERS

We are subject to extensive PRC national and local environmental laws and regulations where we operate concerning, among others, emissions to the air, discharges to land, surface water and subsurface water, the generation, handling, storage, transportation, treatment and disposal of waste and other materials, and the remediation of environmental pollution relating to our properties and operations. Such environmental laws and regulations levy fees for the discharge of waste substances above prescribed levels and impose fines for serious violations. Environmental protection authorities may at their own discretion close or suspend the operation of any facility that fails to comply with orders requiring it to cease or remedy operations causing environmental damage. See “Regulatory Overview” for additional information.

Environmental Protection Facilities

Biowaste and wastewater are the primary wastes from our operations. Our associate, Shengmu Forage, cleans and collects the biowaste from our organic dairy farms and stores it in its organic fertilizer processing facilities adjacent to our dairy farms to allow the biowaste composting into organic fertilizers. Shengmu Forage uses these fertilizers on its growing fields only. Such biowaste processing facilities were sufficient to contain all the biowaste produced at our organic dairy farms during the Track Record Period. In respect to our non-organic dairy farms, we supply biowaste produced on these farms for free to our local feed suppliers that have the capabilities of collecting and processing the biowaste into fertilizers, and charge a fee for our provision of collection and processing services on the biowaste supplied to third-party feed suppliers without such capabilities.

We have installed various types of anti-pollution equipment in all our farms in operation to reduce, treat, and where feasible, recycle the wastes generated in our manufacturing process. We have also built appropriate facilities to filter and treat waste water and recycle it into our manufacturing process, as well as treat liquid waste to reduce contaminant levels to below the applicable environmental protection standard before emission. Our equipment and facilities for treatment of biowaste and sewage primarily consist of solid-fluid separator, solid-fluid separation tank, biowaste storage tank, sedimentation tank and oxidation pond. The biowaste generated by our dairy cows is generally kept at the storage tanks located at each of our dairy farms, then sent to the solid-fluid separation tank to be processed by the solid-fluid separator. After such processing, the solid biowaste is collected by Shengmu Forage if generated from our organic dairy farms or primarily by local feed suppliers if generated from our non-organic dairy farms. The fluid biowaste, together with our sewage, is drained into sedimentation tank for purification treatment and further placed in the oxidation pond for decomposition and fermentation.

Except as otherwise disclosed in this [REDACTED], according to written confirmations issued by local environmental protection bureaus, the environmental protection measures adopted by our dairy farms have complied with the relevant laws and regulations in all material aspects and there were no circumstances that would lead to administrative penalties. In addition, ECOCERT S.A. and the COFCC conducted on-site inspection on, among others, the environment within the close vicinity of our certified organic dairy farms annually according to their respective organic certification standards for the purpose of renewing the respective organic certificates. Neither ECOCERT S.A. nor the COFCC was aware of any circumstances that constituted material non-compliance or breach of any

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relevant organic certification standards that could lead to revocation or suspension of any of our organic certificates based on their respective annual inspections. We also obtained a certification from Inner Mongolia Department of Agriculture (內蒙古自治區農業廳) on May 12, 2014, which confirmed the legality of the organic certificates issued to us by the COFCC. According to this certification since the establishment of the companies operating our dairy farms and up to the date of this certification, there had been no penalty imposed on us due to non-compliance or breach of any relevant rules and regulations applicable to such organic certificates, and there were no circumstances that could lead to revocation of such organic certificates. As advised by our PRC legal advisers, Inner Mongolia Department of Agriculture is a competent authority for the purpose of issuing such certification.

Our annual cost of compliance with environmental protection rules and regulations was approximately RMB6.1 million, RMB6.5 million and RMB16.0 million for 2011, 2012 and 2013, respectively. We expect our annual cost of compliance with environmental protection rules and regulations for 2014 to be 30.0 million.

Health and Safety Law Compliance

We are also subject to the PRC laws and regulations regarding labor, safety and work-related incidents. We provide our employees working on our dairy farms and in our processing facilities with adequate safety equipment and precautionary measures. In addition, we provide safety-related education to our employees to increase workplace safety awareness. During the Track Record Period and up to the Latest Practicable Date, there had not been any material workplace injury or fatality on our premises or our production facilities.

As advised by our PRC legal advisers, we have obtained all material environmental and work safety permits necessary to conduct our business and are currently in compliance with applicable environmental and work safety laws and regulations in all material respects except as disclosed in “— Legal Proceedings and Compliance” below. During the Track Record Period, no administrative sanctions or penalties that had a material and adverse effect on our financial condition or business operations had been imposed upon us for the violation of environmental protection or safety laws or regulations.

RISK MANAGEMENT

We are exposed to various risks during our operation. For more details, see “Risk Factors.” We have implemented various policies and procedures to ensure effective risk management at each aspect of our operations, including the production and sales of products, administration of daily operations, financial reporting and recording, fund management, compliance with applicable laws and regulations on environmental protection, production safety and product safety. Our Board oversees and manages the overall risks associated with our operations. We have established an audit committee to review and supervise the financial reporting process and internal control system of our Group. Please refer to “Directors and Senior Management — Board Committees — Audit Committee” for the qualifications and experience of these committee members as well as a detailed description of the responsibility of our audit committee.

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We have prepared written terms of reference in compliance with Rule 3.21 of the Listing Rules and the Corporate Governance Code and Corporate Governance Report as set out in Appendix 14 to the Listing Rules.

LEGAL PROCEEDINGS AND COMPLIANCE

We are subject to legal proceedings, investigations and claims incidental to the conduct of our business from time to time. Except as otherwise disclosed in this [REDACTED], as of the Latest Practicable Date, we were not involved in any material litigation or arbitration proceedings pending or, to our knowledge, threatened against us or any of our Directors that could have a material adverse effect on our business, financial condition or results of operations.

Non-compliance Incidents

We are subject to a number of regulatory requirements and guidelines issued by the regulatory authorities in the PRC. We have, from time to time, been involved in regulatory non-compliance incidents. We set out below the details of our non-compliance incidents relating to Bayannur Farm No. 6 and the primary rectification measures we adopted in response to these incidents.

- *Non-compliance.* Shengmu Farming had failed to complete the following procedures before commencing operations on Bayannur Farm No.6 with a site area of 380,000 square meters, namely, (i) the facility agricultural use land approval procedures (設施農用地審核手續), and (ii) the environmental completion approval procedures (環保竣工驗收手續). These incidents of non-compliance were primarily due to employee oversight and our lack of communication with local regulatory authorities with respect to the regulatory requirements for setting up a dairy farm.
- *Potential legal consequences.* We may be ordered to (i) restore the conditions of the land if our operations do not conform to the regulatory requirements on facility agricultural use land and/or (ii) cease operations and complete the environmental impact assessment procedures within a time limit or pay a fine of up to RMB100,000 for failure to rectify such non-compliance within such time limit. As our Directors believe that the risk of administrative penalties would be immaterial, we did not make any provision for potential economic losses as a result of these incidents of non-compliance.
- *Latest status and rectification measures.* To the best of our knowledge, the local government may approve the establishment of a chemical plant close to Bayannur Farm No. 6, which could negatively affect its suitability for organic dairy farming. We are currently applying for the permits and certificates for the construction of a new farm at another location in the Ulan Buh desert and plan to relocate the dairy cows and other properties on Bayannur Farm No.6 to this new location in November 2014. We expect to expend approximately RMB36 million and RMB1 million on the construction of and relocation to

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the new farm, respectively. If we are required to suspend our operations at Bayannur Farm No. 6 before the construction of the new farm is completed, we intend to relocate the cows on this farm to our other organic dairy farms. We estimate the costs required for the relocation could be immaterial and such relocation would not result in any material disruption in our operations as our other organic dairy farms have sufficient excess capacity. In 2011, 2012 and 2013, the revenue generated from Bayannur Farm No.6 amounted to RMB24.1 million, RMB74.9 million and RMB97.0 million, respectively, representing 6.2%, 10.7% and 8.5% of the total revenue, respectively. As of December 31, 2013, there were approximately 3,400 dairy cows on this farm with a maximum capacity to house 3,500 dairy cows. As of December 31, 2013, this farm had a carrying amount of RMB35.0 million in terms of facilities and equipment. We obtained a no-action confirmation from the county government on March 18, 2014, which stated that the type, scope and scale of our use of this farm is in full compliance with the relevant land administrative rules and therefore we were not subject to any administrative penalties for non-compliance. As advised by our PRC legal advisers, the county government is a competent government authority for purpose of issuing such confirmation. We had not been subject to any material administrative penalties due to the non-compliance during the Track Record Period and up to the Latest Practicable Date. Since the respective dates of the issuance of the organic certificates of our dairy farms up to and including the Latest Practicable Date, there had been no chemical plants, industrial plants or any other potential sources of pollutants within the close vicinity of the Group’s organic dairy farms that would lead to the revocation or suspension of any of our organic certificates. ECOCERT S.A. and the COFCC conducted on-site inspection on, among others, the environment within the close vicinity of our certified organic dairy farms annually according to their respective organic certification standards for the purpose of renewing the respective organic certificates. Neither ECOCERT S.A. nor the COFCC was aware of any circumstances that constituted material non-compliance or breach of any relevant organic certification standards that would lead to revocation or suspension of any of our organic certificates based on their respective annual inspections. The planned relocation of the dairy cows in Bayannur Farm No.6 was our proactive measure in anticipation for the possible approval of establishment for a chemical plant near that farm.

- *Inspection report.* At our request, the Inner Mongolia Green Food Development Center (內蒙古自治區綠色食品發展中心) conducted on-site inspections of certain of our organic dairy farms, including Bayannur Farm No.6, and concluded its findings in an inspection report dated October 15, 2013. According to this inspection report, (i) to the knowledge of the Inner Mongolia Green Food Development Center, we had not used any chemical fertilizer; (ii) we had developed and maintained a comprehensive quality management system and had been managing our organic dairy farms in accordance with the relevant standards applicable to organic dairy farming; and (iii) the relevant organic dairy farms met all the bio-safety disposal requirements and pollutant discharge standards for large-scale dairy farming set by the relevant environmental protection authorities. As advised by our PRC legal advisers, the Inner Mongolia Green Food Development Center is a provincial arm of the China Green Food Development Center (中國綠色食品發展中心), the latter of which is a specialized agency designated by PRC Ministry of Agriculture (農業部) to develop and manage green food in China.

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Internal Controls

Our Directors are responsible for monitoring our internal control system and for reviewing its effectiveness. In accordance with the applicable PRC and Hong Kong laws and regulations, we have implemented internal procedures. Particularly, in view of the above issues in respect of the licenses and filings of our dairy farms and production sites, we will implement the following internal control procedures to reduce our exposure to risk of penalties from the PRC regulatory authorities in respect of dairy farms and production plants that we operate in the future:

- We have maintained a list of licenses and filings that are required in order for us to commence operation of a dairy farm and production plant and will update this list from time to time based on our experience with local authorities and advice from our external advisers.
- In determining the development plan and timetable for the development of a new dairy farm and production plant, we will prescribe specific timelines within which the various licenses and filings should be applied for and should be obtained so that our operation team will follow such timelines to make the necessary applications. A management personnel will be designated to review and monitor the progress of the license and permit applications.
- As an internal control measure, we will monitor the attainment of licenses and filings against the list referred to above and ensure that all relevant licenses and filings are obtained prior to the formal operation of any dairy farm or production plant.
- Before the commencement of formal operation of any dairy farm and production plant, a designated management personnel will perform an examination on the licenses and filings and ensure that all of the relevant licenses and filings are obtained and report the status to the farm manager or plant manager, as the case may be. The farm manager or plant manager, as the case may be, cannot approve the commencement of formal operation until all of the relevant licenses and filings have been obtained.

We have appointed an internal compliance officer, Mr. LI Tiejun (李鐵軍), a certified public accountant in China with eight-year relevant experience with Mengniu Group in respect of financial system monitoring, management and evaluation. Mr. LI Tiejun directly reports to our chief executive officer, Mr. YAO Tongshan, and oversees the application and maintenance of required registrations, licenses, permits, filings and approvals for our operations.

In addition, we will continue to engage external professional advisers as necessary and work with our internal audit and legal teams to conduct regular review to ensure that all registrations, licenses, permits, filings and approvals are valid and that the renewals of such documents are made in a timely manner. We have also appointed TC Capital Asia Limited as our external compliance adviser with effect from the date of the Listing to advise on on-going compliance with the Listing Rules and other applicable securities laws and regulations in Hong Kong. During the Track Record Period, our Directors did not identify any material internal control weaknesses or failures.

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In light of the nature of, and reasons for, the incidents of non-compliance, and on the basis of the rectification measures taken, our Directors believe, and the Joint Sponsors have no reason to doubt, that the enhanced internal control measures are adequate and effective to address the incidents of non-compliance as set out above, and they are not aware of any facts or circumstances that might affect the suitability of our Directors and our suitability for listing.