

RELATIONSHIP WITH MENGNIU GROUP

HISTORICAL RELATIONSHIPS WITH MENGNIU GROUP

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

The following table sets forth the nature of significant relationships between our Ultimate Controlling Shareholders, our Directors and senior management members on the one hand, and Mengniu Group on the other.

Name	Significant relationship with Mengniu Group	Year of commencement
Ultimate Controlling Shareholders		
SHI Jianhong (史建宏)	Former business associate	1999
WANG Fuzhu (王福柱)	Former shareholder	1999
YAO Tongshan (姚同山)	Former employee	2001
GUO Yunfeng (郭運鳳)	Former employee	1993
WU Jianye (武建鄴)	None	N/A
WANG Zhenxi (王振喜)	Former shareholder	1999
GAO Lingfeng (高凌鳳)	Former employee	1999
YUN Jindong (雲金東)	None	N/A
YANG Yaping (楊亞萍)	Business associate	2000
LU Shunyi (盧順義)	None	N/A
WANG Zhen (王鎮)	Son of WANG Jishan (王繼山), former shareholder	1999
YANG Yali (楊亞利)	Business associate	2000
ZHANG Junke (張俊科)	None	N/A
CUI Ruicheng (崔瑞成)	Former employee	2003
Director and senior management		
YAO Tongshan (姚同山)	See above	See above
WU Jianye (武建鄴)	See above	See above
GAO Lingfeng (高凌鳳)	See above	See above
CUI Ruicheng (崔瑞成)	See above	See above
WU Jingshui (吳景水)	Employee	1999
FAN Xiang (范翔)	None	N/A
CUI Guiyong (崔桂勇)	Alternate director	2009
SUN Qian (孫謙)	None	N/A
WONG Kun Kau (黃灌球)	None	N/A
LI Changqing (李長青)	None	N/A
GE Xiaoping (葛曉萍)	None	N/A
YUAN Qing (袁清)	None	N/A
LI Yundong (李運動)	Former employee	2000

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CURRENT RELATIONSHIP WITH MENGNIU GROUP

Because of our founders’ historical relationships with Mengniu Group, after our Company was founded, Mengniu Group became a key business partner, an early investor, a major customer and, in our downstream business, a competitor.

Business Partnership

Framework Cooperation Agreement

In March 2010, we entered into a binding framework cooperation agreement with Mengniu Group, with cooperation in the following areas:

- *Lease of dairy farms and equipment.* Mengniu Group agreed to lease dairy-farming facilities and equipment to our dairy farms located in Hohhot and Bayannur as well as its established dairy farms in Hohhot. As of December 31, 2011, 2012 and 2013 and as of the Latest Practicable Date, we leased seven, seven, four and four dairy farms from Mengniu Group, respectively.
- *Guarantees.* Mengniu Group agreed to support our purchase of dairy cows with credit facilities in the form of guarantee to assist the early development of our dairy farming business. As of December 31, 2011, 2012 and 2013 and as of the Latest Practicable Date, Mengniu Group provided guarantees on a total of RMB99.0 million, RMB79.0 million, nil and nil on our bank loans. Such loans had been fully repaid as of December 31, 2013.
- *Minimum quantity requirements.* We agreed to sell all the raw milk produced on the leased dairy farms to Mengniu Group, subject to certain minimum milk supply volume requirements. If we fail to meet such requirements, we would be subject to a 50% increase on our rent payment calculated on an annualized basis for the non-compliance period. In addition, if we fail to meet such minimum supply volume requirements as specified in the underlying lease agreements, Mengniu Group is entitled to lease the properties to other tenants. We have complied with these minimum quantity requirements during the Track Record Period and up to the Latest Practicable Date, and have not been subject to any contractual penalty under the underlying lease agreements.
- *Supply offtake.* Mengniu Group agreed to purchase on a priority basis all of our raw milk output that meets its quality standards from the leased dairy farms. With respect to pricing, Mengniu Group agreed to adopt a quality-based pricing system with reference to the prevailing market conditions.

We entered into this framework cooperation agreement with Mengniu Group at a time when we were at an early stage of growth and required significant funding for future growth, which coincided with Mengniu Group’s need for premium raw milk. The guarantees provided by Mengniu Group facilitated our efforts to obtain bank funding, and all the bank loans guaranteed by Mengniu Group had been fully repaid as of December 31, 2013. In addition, other aspects of our cooperation agreement with Mengniu Group, such as lease of dairy farms and supply offtake, enabled us to expand

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our business operations more rapidly with relatively lower capital expenditure, and gain a major customer with stable demand and a favorable credit profile. In return, Mengniu Group also gained a major raw milk supplier of stable outputs and good qualifications. We have been advised by our PRC legal advisers that this framework cooperation agreement is legally binding under the PRC laws.

Dairy Farm Lease Agreements

As contemplated under our framework cooperation agreement with Mengniu Group, we entered into several lease agreements, under which we agreed to sell the premium non-organic raw milk produced by these farms exclusively to Mengniu Group during the lease terms. Set forth below are certain key aspects of these agreements:

- *Term.* The leases are valid for six years commencing from 2010 or 2011. We have a preferential right of renewal upon the expiry of the lease terms.
- *Rent.* The dairy farms are rent-free for a one-year “construction period” which commences when dairy cows are first placed on the farms. The annual rent for the remaining terms of the lease agreements is calculated based on the total investment amount of the relevant dairy farms.
- *Minimum quantity requirement.* Mengniu Group is committed to purchasing and we are committed to supplying a minimum annual quantity of raw milk. We are required to maintain a minimum annual milk output, depending on the relative size of the dairy farms, after the construction period. Mengniu Group is entitled to unilaterally terminate the relevant lease agreement and receive agreed-upon liquidated damages if we fail to meet the minimum milk output requirement.
- *Quality and pricing.* The raw milk sold to Mengniu Group is required to meet all the applicable national quality requirements. The supply price will be based on the quality of our raw milk and the market price of similar milk and may not be lower than certain minimum prices calculated based on market prices of certain concentrated feed. In addition, Mengniu Group is required to purchase our raw milk at a premium compared to purchases from milk stations if the protein and fat contents of our raw milk meet certain pre-set threshold. The pricing details are set out in a uniform pricing standard implemented by Mengniu Group.
- *Facilities and equipment.* Mengniu Group owns all the facilities and equipment, including barns and feeding and milking machinery. If Mengniu Group sells the facilities and equipment upon the expiry of the lease terms, we will have a right of first refusal to purchase them.
- *Termination.* Except as otherwise allowed thereunder, neither party may unilaterally terminate the lease agreements. Mengniu Group is entitled to unilaterally terminate the relevant lease agreements and receive agreed-upon liquidated damages if we fail to meet the minimum annual milk yield requirement or sublease the dairy farms or dairy-farm facilities

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to third parties without Mengniu Group’s written consent. Mengniu Group may also unilaterally terminate the relevant lease agreement and have other claims against us if our operations result in losses to the dairy farms or we fail to meet the milk quality and quantity requirements from Mengniu Group for three consecutive months.

Mengniu Group is required to pay in the following month for all the raw milk purchased in the previous month. No return of raw milk is allowed; however, Mengniu Group is entitled to reject the delivery of any substandard or spoiled raw milk.

Equipment Lease Agreements

Also as contemplated under our framework agreement, in 2010 and 2012, we entered into two equipment lease agreements with Mengniu Group. Pursuant to these agreements, we leased dairy-farming equipment and machinery, including, among others, milking machines, tractors, generators, mixers and loaders, from Mengniu Group to be used on our dairy farms. Set forth below are certain key aspects of these agreements.

- *Term.* The leases are valid for five years commencing from the dates of the agreements. Mengniu Group retains the ownership right to the leased equipment and machinery, and the parties agreed to negotiate the disposition of the leased equipment and machinery upon the expiry of the lease terms.
- *Rent and payment terms.* The equipment is rent-free for the first two years. The annual rent for the remaining terms of the lease agreements is calculated based on procurement cost of the leased equipment and machinery, payable on a quarterly basis. We will be subject to liquidated damages for failure to make payments on a timely basis.
- *Maintenance.* We are responsible for the day-to-day maintenance of the leased equipment and machinery. Mengniu Group agreed to coordinate with us and the manufacturers for any maintenance issues within the warranty periods. We are also responsible for the outcome arising from any improper use of leased equipment and machinery.
- *Stock count.* Mengniu Group is entitled to conduct annual stock count of the leased equipment and machinery, so long as the process does not interfere with our normal operations of the dairy farms. We are required to use the leased equipment and machinery on the designated dairy farms and notify Mengniu Group in writing of our intention to change the service location of the leased equipment and machinery. We are also required to compensate Mengniu Group for the residual value of any missing equipment and machinery. However, we are entitled to liquidated damages if Mengniu Group transfers or leases the leased equipment and machinery to any third party during the lease terms.

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Early Investment

In May 2011, Mengniu Investment, an investment company wholly owned by Mengniu Group, subscribed for a 5.44% equity interest in Shengmu Holding for a consideration of RMB104.4 million. Its equity investment in us at our early development stage helped us finance our fast-growing business and enabled us to quickly expand into organic dairy farming operations. Immediately following the completion of the [REDACTED] and assuming none of the [REDACTED] and options that have been granted under the Pre-[REDACTED] Share Option Scheme or may be granted under the Share Option Scheme has been exercised, Mengniu Group will own 4.25% of the then issued share capital of our Company. For more information, see “History, Reorganization and Group Structure — History and Development — Investment by Mengniu Group.”

Declining Reliance

Since we were founded, Mengniu Group has been our largest customer, accounting for RMB340.4 million, RMB662.8 million and RMB666.6 million in revenue in 2011, 2012 and 2013, respectively, or 87.4%, 94.6%, and 58.3% of our total revenue, respectively. We also sold raw milk to Mengniu Group through two individuals in 2011, which accounted for RMB46.8 million in revenue, or 12.0% of our total revenue in 2011.

Revenue derived from sales ultimately to Mengniu Group has continuously decreased from 99.4% in 2011 to 58.3% in 2013 of our total revenue. We believe that our reliance on sales to Mengniu Group has been reduced based on the following factors although historically our reliance had been high:

- (a) *Customer diversification.* 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. We believe that we are able to attract more leading industrial customers based on growing brand recognition and demand for premium raw milk.
- (b) *Business diversification.* In 2012, we expanded our operation by launching our liquid milk business which further diversified our customer base and revenue stream. We expect that our liquid milk business will grow rapidly given the fast-growing market of organic liquid milk products according to the F&S report. In addition, we also seek to expand our distribution network by adding new distributors and further explore direct-sales opportunities. The number of our distributors increased significantly from 108 as of December 31, 2012 to 316 as of December 31, 2013, and we plan to further increase this number to over 400 by the end of 2014.
- (c) *Industry concentration.* According to the F&S Report, China’s liquid milk market was highly concentrated and dominated by several large and well-known participants including Mengniu Group and Yili Group. Mengniu Group is a leading producer of liquid milk products and had the largest market share from 2011 to 2013 in terms of retail sales value. See “Industry Overview — China’s Dairy Products Market — Overall Market Size and Growth” for further details. We expect that Mengniu Group will continue to be one of our major customers for our raw milk given its strong market position.

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- (d) *Mutual and beneficial reliance.* We believe that our relationship with Mengniu Group is mutually beneficial to us and to Mengniu Group. According to the F&S Report, the gap between organic raw milk supply and demand is expected to widen, reaching 0.12 million tonnes in 2018. Due to the high barriers to entry to the organic milk market, the supply of organic raw milk in China is highly concentrated and the top three organic raw milk producers including us accounted for 86.9% of the total organic raw milk produced in China in 2013. We believe that it is strategically important for Mengniu Group to secure stable supply of organic raw milk to support its organic dairy products business. By partnering with Mengniu Group, we believe that we are able to expand our organic raw milk business rapidly and further consolidate our market share in this segment. In addition, we are also able to maintain the growth of our premium non-organic milk business because of Mengniu Group’s recognition of our commitment to producing high quality raw milk.
- (e) *Favorable industry growth prospects.* Driven by the increasing demand for dairy products by Chinese consumers, China’s raw milk shortage is expected to continue to increase from 2014 to 2018, according to the F&S Report. See “Industry Overview — Raw Milk Production in China” for further detail. The market size of organic raw milk in the overall raw milk market is expected to grow significantly in the foreseeable future. In addition, 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 F&S Report. We believe that we are well positioned to capture the growth in organic and premium non-organic dairy markets.

Competition

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. In addition, we sell organic liquid milk products produced from our organic raw milk under our “Shengmu 圣牧” brand. As such, industrial customers of our organic raw milk such as Mengniu Group are also our competitors in the liquid milk product markets. As we expand our organic liquid milk business, we expect competition with our organic raw milk industrial customers to intensify in terms of both their organic liquid milk products and premium non-organic liquid milk products. 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.”