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## **CHINA SHENGMU ORGANIC MILK LIMITED**

### **中國聖牧有機奶業有限公司**

*(Incorporated in the Cayman Islands with limited liability)*

**(Stock Code: 1432)**

### **INTERIM RESULTS ANNOUNCEMENT FOR THE SIX MONTHS ENDED JUNE 30, 2014**

#### **FINANCIAL HIGHLIGHTS**

- Revenue for the six months ended June 30, 2014 amounted to approximately RMB905.6 million, representing an increase of 96.2% from approximately RMB461.5 million for the same period of 2013.
- Profit for the six months ended June 30, 2014 amounted to approximately RMB355.7 million, representing an increase of 201.7% from approximately RMB117.9 million for the same period of 2013.
- Profit attributable to owners of the Company for the six months ended June 30, 2014 amounted to approximately RMB279.1 million, representing an increase of 171.5% from approximately RMB102.8 million for the same period of 2013.

In this announcement “we”, “us” and “our” refer to the Company (as defined below) and where the context otherwise requires, the Group (as defined below).

The board of directors (the “**Board**”) of China Shengmu Organic Milk Limited (the “**Company**”) is pleased to announce the unaudited consolidated financial results of the Company and its subsidiaries (the “**Group**”) for the six months ended June 30, 2014, together with the comparative figures for the corresponding period in 2013 as follows:

**INTERIM CONDENSED CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME**

		<b>For the six-month period ended</b>	
	Notes	<b>June 30, 2014 (unaudited) RMB’000</b>	<b>June 30, 2013 (unaudited) RMB’000</b>
<b>REVENUE</b>	4	<b>905,629</b>	461,543
Cost of sales		<b>(461,904)</b>	(294,073)
Gross profit		<b>443,725</b>	167,470
Gain arising from changes in fair value less costs to sell of biological assets		<b>10,016</b>	4,337
Other income and gains	4	<b>9,235</b>	792
Selling and distribution expenses		<b>(33,899)</b>	(31,725)
Administrative expenses		<b>(40,490)</b>	(10,212)
Finance costs		<b>(28,609)</b>	(12,201)
Share of profits and losses of associates		<b>(3,706)</b>	(508)
<b>PROFIT BEFORE TAX</b>		<b>356,272</b>	117,953
Income tax expense	5	<b>(615)</b>	(9)
<b>PROFIT FOR THE PERIOD</b>		<b>355,657</b>	117,944

		<b>For the six-month period ended</b>	
		<b>June 30, 2014 (unaudited) RMB'000</b>	<b>June 30, 2013 (unaudited) RMB'000</b>
Notes			
<b>OTHER COMPREHENSIVE INCOME</b>			
Other comprehensive income to be reclassified to profit or loss in subsequent periods:			
Exchange differences on translation of foreign operations		<u>3,613</u>	<u>—</u>
<b>TOTAL COMPREHENSIVE INCOME FOR THE PERIOD</b>		<u><b>359,270</b></u>	<u><b>117,944</b></u>
Profit attributable to:			
Owners of the parent		<b>279,090</b>	102,802
Non-controlling interests		<u><b>76,567</b></u>	<u>15,142</u>
		<u><b>355,657</b></u>	<u><b>117,944</b></u>
Total comprehensive income attributable to:			
Owners of the parent		<b>282,703</b>	102,802
Non-controlling interests		<u><b>76,567</b></u>	<u>15,142</u>
		<u><b>359,270</b></u>	<u><b>117,944</b></u>
Earnings per share attributable to ordinary equity holders of the parent:			
– Basic and diluted		<u><b>RMB0.049</b></u>	<u><b>RMB0.024</b></u>

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# INTERIM CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION

		As at	
	Notes	June 30, 2014 (unaudited) RMB'000	December 31, 2013 (audited) RMB'000
<b>NON-CURRENT ASSETS</b>			
Property, plant and equipment		1,177,784	922,764
Prepaid land lease payments		5,360	3,381
Other intangible assets		14,784	14,192
Investments in associates		19,620	17,727
Biological assets	8	1,997,401	1,510,160
Prepayments for property, plant and equipment and biological assets		22,359	9,043
Deferred tax assets		782	187
Total non-current assets		3,238,090	2,477,454
<b>CURRENT ASSETS</b>			
Inventories		239,806	335,218
Trade and bills receivables		173,500	63,470
Prepayments, deposits and other receivables		203,819	94,377
Pledged deposits		8,993	15,030
Cash and cash equivalents		325,586	127,059
Total current assets		951,704	635,154
<b>CURRENT LIABILITIES</b>			
Trade and bills payables		174,726	191,037
Receipts in advance		53,169	82,481
Other payables and accruals		204,959	198,565
Interest-bearing bank and other borrowings		944,000	932,000
Tax payable		1,479	633
Total current liabilities		1,378,333	1,404,716
<b>NET CURRENT LIABILITIES</b>		(426,629)	(769,562)
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>		2,811,461	1,707,892
Net assets		2,811,461	1,707,892
<b>EQUITY</b>			
<b>Equity attributable to owners of the parent</b>			
Issued capital	9	1	—
Reserves		2,471,248	1,494,160
		2,471,249	1,494,160
<b>Non-controlling interests</b>		340,212	213,732
Total equity		2,811,461	1,707,892

# INTERIM CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

	For the six-month period ended	
	June 30, 2014 (unaudited) RMB'000	June 30, 2013 (unaudited) RMB'000
Net cash flows from operating activities	258,793	152,269
Net cash flows used in investing activities	(788,470)	(234,125)
Net cash flows from financing activities	717,138	97,674
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>187,461</b>	<b>15,818</b>
Cash and cash equivalents at beginning of period	127,059	29,838
Effect of foreign exchange rate changes, net	11,066	—
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<b>325,586</b>	<b>45,656</b>

# NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

For the six-month period ended June 30, 2014

*(All amounts in RMB thousands unless otherwise stated)*

## 1. CORPORATE INFORMATION

The Company is an exempted limited liability company incorporated in the Cayman Islands. The registered office of the Company is located at Maples Corporate Services Limited, P.O. Box 309, Ugland House, Grand Cayman, KY1-1104, Cayman Islands.

The Group was primarily engaged in the production and distribution of raw milk and dairy products in the People's Republic of China ("PRC").

## 2. BASIS OF PREPARATION AND CHANGES TO THE GROUP'S ACCOUNTING POLICIES

### *Basis of preparation*

The interim condensed consolidated financial statements for the six-month period ended June 30, 2014 have been prepared in accordance with IAS 34 *Interim Financial Reporting*.

The interim condensed consolidated financial statements do not include all the information and disclosures required in the annual financial statements, and should be read in conjunction with the accountants' report included as Appendix I to the Company's prospectus dated June 30, 2014 ("Prospectus") in conjunction with the initial public offering of the shares of the Company on the Main Board of The Hong Kong Stock Exchange Limited (the "Accountants' Report").

### *Going concern*

The Group had net current liabilities of RMB426,629,000 and RMB769,562,000 as of June 30, 2014 and December 31, 2013, respectively. In view of the net current liabilities position, the directors have given careful consideration to the future liquidity and performance of the Group and its available sources of finance in assessing whether the Group will have sufficient financial resources to continue as a going concern.

Having considered the cash inflow from operations, and the bank facilities of RMB1,317,000,000 granted by banks with expiry dates not earlier than June 30, 2015, the directors are satisfied that the Group is able to meet in full its financial obligations as they fall due in the foreseeable future. On July 15, 2014, the Company completed its initial public offering by issuing 444,800,000 shares with offer price of HK\$2.39 per share on the Main Board of Stock Exchange of Hong Kong Limited. To mitigate any liquidity issues that might be faced by the Group, the Group may curtail or defer its expansion plans based on the availability of sufficient funds. Accordingly, the interim condensed consolidated financial statements have been prepared on a going concern basis.

Should the Group be unable to continue in business as a going concern, adjustments would have to be made to restate the values of assets to their recoverable amounts, to provide for any further liabilities which might arise and to reclassify non-current assets as current assets. The interim condensed consolidated financial statements do not include any adjustments that would result from the failure of the Group to continue in business as a going concern.

### ***New standards, interpretations and amendments adopted by the Group***

The accounting policies adopted in the preparation of the unaudited interim condensed consolidated financial statements are consistent with those followed in the preparation of the Group's Accountants' Report, except for the adoption of new standards and interpretations effective as of January 1, 2014. These new and revised IFRSs do not impact the interim condensed consolidated financial statements of the Group.

The nature and the impact of each new standard or amendment is described below:

### ***Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)***

These amendments provide an exception to the consolidation requirement for entities that meet the definition of an investment entity under IFRS 10 *Consolidated Financial Statements*. The exception to consolidation requires investment entities to account for subsidiaries at fair value through profit or loss.

### ***Offsetting Financial Assets and Financial Liabilities - Amendments to IAS 32***

These amendments clarify the meaning of "currently has a legally enforceable right to set-off" and the criteria for non-simultaneous settlement mechanisms of clearing houses to qualify for offsetting.

### ***Novation of Derivatives and Continuation of Hedge Accounting – Amendments to IAS 39***

These amendments provide relief from discontinuing hedge accounting when novation of a derivative designated as a hedging instrument meets certain criteria. These amendments have no impact to the Group as the Group has not novated its derivatives during the current or prior periods.

### ***Recoverable Amount Disclosures for Non-Financial Assets – Amendments to IAS 36***

These amendments remove the unintended consequences of IFRS 13 *Fair Value Measurement* on the disclosures required under IAS 36 *Impairment of Assets*. In addition, these amendments require disclosure of the recoverable amounts for the assets or cash-generating units (CGUs) for which an impairment loss has been recognised or reversed during the period, and expand the disclosure requirements regarding the fair value measurement for these assets or units if their recoverable amounts are based on fair value less costs of sale.

### ***IFRIC 21 Levies***

IFRIC 21 is effective for annual periods beginning on or after January 1, 2014 and is applied retrospectively. It is applicable to all levies imposed by governments under legislation, other than outflows that are within the scope of other standards (e.g., IAS 12 *Income Tax*) and fines or other penalties for breaches of legislation.

The interpretation clarifies that an entity recognises a liability for a levy no earlier than when the activity that triggers payment, as identified by the relevant legislation, occurs. It also clarifies that a levy liability is accrued progressively only if the activity that triggers payment occurs over a period of time, in accordance with the relevant legislation. For a levy that is triggered upon reaching a minimum threshold, no liability is recognised before the specified minimum threshold is reached. The interpretation requires these same principles to be applied in interim financial statements.

### **3. OPERATING SEGMENT INFORMATION**

For management purposes, the Group is organised into business units based on their products and services and has two reportable operating segments as follows:

- (a) Dairy farming - breeding dairy cows to produce and distribute raw milk;
- (b) Liquid milk products - producing and distributing ultra-heat treated liquid milk.

Management monitors the results of the Group's operating segments separately for the purpose of making decisions about resources allocation and performance assessment. Segment performance is evaluated based on reportable segment profit/(loss), which is a measure of adjusted profit/(loss) for the period. The adjusted profit/(loss) for the period is measured consistently with the Group's profit after tax except that gain arising from fair value less costs to sell of biological assets is excluded from this measurement as management believes that such adjusted information is most relevant in comparing with the results of dairy farming segment relative to other entities that operate within dairy farming industry.

Intersegment sales and transfers are transacted with reference to the selling prices used for sales made to third parties at the then prevailing market prices.



<b>For the six-month period ended June 30, 2014 (unaudited)</b>	<b>Dairy farming RMB'000</b>	<b>Liquid milk products RMB'000</b>	<b>Total RMB'000</b>
<b>Segment revenue:</b>			
Sales to external customers	662,058	243,571	905,629
Intersegment sales	122,984	—	122,984
	<u>785,042</u>	<u>243,571</u>	<u>1,028,613</u>
<i>Reconciliation:</i>			
Elimination of intersegment sales			(122,984)
			<u>905,629</u>
<b>Segment profit</b>	<b>295,447</b>	<b>50,194</b>	<b>345,641</b>
<i>Reconciliation</i>			
Gain arising from changes in fair value less costs to sell of biological assets	10,016	—	10,016
	<u>305,463</u>	<u>50,194</u>	<u>355,657</u>
<b>As at June 30, 2014 (unaudited)</b>			
<b>Segment assets</b>	<b>3,927,846</b>	<b>345,151</b>	<b>4,272,997</b>
<i>Reconciliation:</i>			
Elimination of intersegment receivables			(83,203)
Total assets			<u>4,189,794</u>
<b>Segment liabilities</b>	<b>1,192,642</b>	<b>248,894</b>	<b>1,441,536</b>
<i>Reconciliation:</i>			
Elimination of intersegment payables			(63,203)
Total liabilities			<u>1,378,333</u>

For the six-month period ended June 30, 2013 (unaudited)	Dairy farming RMB'000	Liquid milk products RMB'000	Total RMB'000
<b>Segment revenue:</b>			
Sales to external customers	356,806	104,737	461,543
Intersegment sales	47,125	—	47,125
	<u>403,931</u>	<u>104,737</u>	<u>508,668</u>
<i>Reconciliation:</i>			
Elimination of intersegment sales			<u>(47,125)</u>
			<u>461,543</u>
<b>Segment profit</b>	111,602	2,005	113,607
<i>Reconciliation</i>			
Gain arising from changes in fair value less costs to sell of biological assets	4,337	—	4,337
	<u>115,939</u>	<u>2,005</u>	<u>117,944</u>
<b>As at December 31, 2013 (audited)</b>			
<b>Segment assets</b>	2,932,182	242,784	3,174,966
<i>Reconciliation:</i>			
Elimination of intersegment receivables			<u>(62,358)</u>
Total assets			<u>3,112,608</u>
<b>Segment liabilities</b>	1,250,354	196,720	1,447,074
<i>Reconciliation:</i>			
Elimination of intersegment payables			<u>(42,358)</u>
Total liabilities			<u>1,404,716</u>

#### 4. REVENUE, OTHER INCOME AND GAINS

Revenue, which is also the Group's turnover, represents the net invoiced value of goods sold, after allowances for returns and trade discounts.

An analysis of revenue, other income and gains is as follows:

	For the six-month period ended June 30,	
	2014	2013
	(unaudited)	(unaudited)
	RMB'000	RMB'000
Revenue		
– Sales of raw milk	662,058	356,806
– Sales of liquid milk products	243,571	104,737
	<u>905,629</u>	<u>461,543</u>
Other income and gains		
– Government grants	200	—
– Bank interest income	1,125	232
– Foreign exchange differences, net	7,453	—
– Others	457	560
	<u>9,235</u>	<u>792</u>
	<u>914,864</u>	<u>462,335</u>

#### 5. INCOME TAX EXPENSE

	For the six-month period ended June 30,	
	2014	2013
	(unaudited)	(unaudited)
	RMB'000	RMB'000
Current income tax expense	1,210	43
Deferred income tax expense	(595)	(34)
	<u>615</u>	<u>9</u>

## 6. EARNINGS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE PARENT

The calculation of basic earnings per share for the six-month period ended June 30, 2014 is based on the profit attributable to ordinary equity holders of the Company of RMB279,090,000 (for the six-month period ended June 30, 2013: RMB102,802,000) and the weighted average of 5,709,250,000 (for the six-month period ended June 30, 2013: 4,338,170,000) ordinary shares of the Company in issue during the period, on the assumption that the Group's capitalisation issue had been completed on January 1, 2013.

There were no dilutive potential ordinary shares outstanding during the six-month period ended June 30, 2014 and 2013. For the six-month period ended June 30, 2014, the outstanding share options did not have any dilutive effect because the performance targets for the grantees have not been met, which is required for the share options to be vested.

## 7. DIVIDEND

The directors do not recommend the payment of an interim dividend for the six-month period ended June 30, 2014 (for the six-month period ended June 30, 2013: Nil).

## 8. BIOLOGICAL ASSETS

The biological assets of the Group are dairy cows held to produce raw milk.

### *(A) Quantity of biological assets*

The quantity of dairy cows owned by the Group is shown below. The Group's dairy cows include heifers and calves and milkable cows. Heifers and calves are dairy cows that have not had their first calves.

	<b>June 30, 2014 Head</b>	<b>December 31, 2013 Head</b>
Dairy cows		
Milkable cows	<b>44,619</b>	35,850
Heifers and calves	<b>34,634</b>	24,607
	<hr/>	<hr/>
Total dairy cows	<b>79,253</b>	60,457
	<hr/>	<hr/>

**(B) Value of biological assets**

The value of Group's biological assets as at June 30, 2014 and December 31, 2013 is as follows:

	<b>June 30, 2014 (unaudited) RMB'000</b>	<b>December 31, 2013 (audited) RMB'000</b>
Milkable cows	<b>1,399,456</b>	1,085,461
Heifers and calves	<b>597,945</b>	424,699
Total dairy cows	<b><u>1,997,401</u></b>	<b><u>1,510,160</u></b>

The Group's dairy cows in the PRC were independently valued by Jones Lang LaSalle Corporate Appraisal and Advisory Limited ("JLL"), a firm of independent qualified professional valuers not connected with the Group, which has appropriate qualifications and recent experience in valuation of biological assets.

The fair value of the Group's biological assets are measured based on valuation techniques using significant unobservable inputs and accordingly is categorized as level 3.

The valuation techniques and principal valuation assumptions used in the determination of the fair value of dairy cows are the same as those set out in the Group's accountants' report.

**9. ISSUED CAPITAL**

The Company was incorporated in the Cayman Islands on December 11, 2013. Upon incorporation, the Company has authorized share capital of HK\$300,000, divided into 300,000 shares with a par value of HK\$1 each.

On February 14, 2014, the authorized share capital of the Company was sub-divided into 30,000,000,000 Shares of par value of HK\$0.00001 each by sub-dividing every share of par value HK\$1.00 each into 100,000 Shares of par value of HK\$0.00001 each.

As at June 30, 2014, the Company's issued capital was HK\$1,438, with 143,839,020 shares in issuance.

## MANAGEMENT DISCUSSION AND ANALYSIS

### Market Review

Rapid growth in China's dairy industry began in the 1990s and has continued in recent years. In China, with the rising health consciousness among the public and increasing disposable income of consumers, more and more consumers will pursue organic food, including organic dairy products.

With the higher concentration in China's dairy farming industry, the production of premium raw milk is expected to increase accordingly. As high-end milk products become more popular among Chinese consumers, it is expected that the increasing demand for premium raw milk in China will remain unchanged in the long term, and such demand will continue to grow steadily. The proportion of organic raw milk in total premium raw milk production has been rising in recent years, indicating that there is a strong growth in market demand for organic raw milk. The demand-over-supply situation in China's organic raw milk market is expected to continue and the gap will further expand.

According to the report of Frost & Sullivan, the Group enjoyed a 54.2% market share as based on 2013 organic raw milk production volume. The Company is the largest organic dairy company in China and also the only vertically integrated grass-to-glass organic dairy company in China that meets E.U. organic standards as of June 30, 2014, the Group is well-positioned to continue to capture the rapid growth in demand for organic dairy in China, and will maintain its position as a leading organic dairy company in China.

### Business Review

The Group's business consists of dairy farming business and liquid milk business. All the organic raw milk which the Group uses to produce its liquid milk products is supplied internally by certified organic dairy farms. In the first half of 2014 ("**2014 Interim Period**"), the Group have achieved significant growth in its revenue from raw milk and liquid milk products as compared to the same period of 2013 ("**2013 Interim Period**").

### *Herd Size and Production Volume*

As of June 30, 2014, the Group had 13 organic dairy farms and 12 non-organic dairy farms. The Group also expanded its herd size to 44,779 organic dairy cows and 34,474 non-organic dairy cows as of June 30, 2014 from 30,621 organic dairy cows and 29,836 non-organic dairy cows as of December 31, 2013.

The Group produced 83,921 tonnes of organic raw milk and 68,751 tonnes of premium non-organic raw milk in the first half of 2014 as compared to 38,451 tonnes of organic raw milk and 55,142 tonnes of premium non-organic raw milk in the same period of 2013. Production volume of liquid milk products which were entirely produced from organic raw milk supplied internally by its certified organic dairy farms increased to 18,210 tonnes in the first half of 2014 as compared to 7,546 tonnes in the same period of 2013.

## ***Distribution Network***

In light of the increasing market demand and the effective expansion of the Group's distribution network, the Group experienced significant growth in the first half of 2014 as compared to the same period of 2013.

The customers of the Group are mainly categorized into industrial customers and distributors. The Group sells its premium non-organic raw milk and a portion of its organic raw milk to a limited number of leading dairy companies in China. The Group increasingly sells its organic raw milk after processing as liquid milk products under its "Shengmu 聖牧" brand. Its liquid milk products are primarily sold to distributors, which in turn sell to supermarket chains, department stores, convenience store chains and other points of sales. As of June 30, 2014, the Group had 332 distributors with over 68,000 points of sale as compared to 316 distributors with over 50,000 points of sale as of December 31, 2013.

## **Event after the Reporting Period**

The Company completed its initial public offering of 444,800,000 shares at the offer price of HK\$2.39 per share and dealings in the shares of the Company commenced on the Main Board of The Stock Exchange of Hong Kong Limited (the "**Stock Exchange**") on July 15, 2014 (the "**Listing Date**").

## **Financial Review**

The Group continued to enjoy a rapid growth in the first half of 2014. The Group recorded a total revenue of RMB905.6 million in the 2014 Interim Period, representing an increase of 96.2% from RMB461.5 million in the 2013 Interim Period. Profit of the Group increased by 201.7% from RMB117.9 million in the 2013 Interim Period to RMB355.7 million in the 2014 Interim Period.

## ***Analysis on Interim Condensed Consolidated Statement of Profit or Loss and Other Comprehensive Income***

### ***Revenue***

	<b>For the six months ended</b>	
	<b>June 30,</b>	
	<b>2014</b>	<b>2013</b>
	<b>(Unaudited)</b>	<b>(Unaudited)</b>
	<b>(RMB'000)</b>	
Dairy farming business	<b>662,058</b>	356,806
Liquid milk business	<b>243,571</b>	104,737
<b>Total</b>	<b>905,629</b>	461,543

For the six months ended June 30,	Dairy farming business				Liquid milk business				Total revenue (after elimination of inter- segment sales)
	Segment revenue	Inter- segment sales <sup>(1)</sup>	External sales	External	Segment revenue	Inter- segment sales	External sales	External	
				sales as				sales as	
				% of total revenue				% of total revenue	
(RMB in thousands, except percentages)									
2014									
(Unaudited)	785,042	122,984	662,058	73.1%	243,571	—	243,571	26.9%	905,629
2013									
(Unaudited)	403,931	47,125	356,806	77.3%	104,737	—	104,737	22.7%	461,543

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

For the 2014 Interim Period, the Group recorded revenue of RMB905.6 million, representing an increase of 96.2% from RMB461.5 million for the 2013 Interim Period. The Group began its operation with the dairy farming business and expanded into the liquid milk business in 2012. Liquid milk business has grown rapidly since then. Revenue from liquid milk business represented 26.9% of total revenue for the 2014 Interim Period (22.7% for the 2013 Interim Period). The Group expects that the revenue from its liquid milk business will continue to increase both in absolute amounts and as a percentage of the Group's total revenue in the foreseeable future.



### ***Dairy farming business***

	For the six months ended June 30,					
	2014 (Unaudited)			2013 (Unaudited)		
	Sales amount	Sales volume	Average	Sales	Sales	Average
	(RMB'000)	(Tonnes)	selling price	Amount	Volume	selling price
			(RMB/Tonne)	(RMB'000)	(Tonnes)	(RMB/Tonne)
<b>Organic raw milk</b>						
External sales	337,913	60,330	5,601	140,310	29,199	4,805
Inter-segment sales <sup>(1)</sup>	122,984	21,356	5,759	47,125	8,601	5,479
Subtotal	460,897	81,686	5,642	187,435	37,800	4,959
<b>Premium non-organic raw milk</b>						
External sales	324,145	67,263	4,819	216,496	54,273	3,989
Segment revenue	785,042	148,949	5,271	403,931	92,073	4,387
External sales	662,058	127,593	5,189	356,806	83,472	4,275

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

The Group's revenue from its dairy farming business increased by 85.6% from RMB356.8 million in the 2013 Interim Period to RMB662.1 million in the 2014 Interim Period. The increase was primarily due to increase in its herd size and production volume of raw milk. As of June 30, 2014, the Group had a total of 79,253 dairy cows consisting of 44,779 in its organic dairy farms and 34,474 in its non-organic dairy farms, as compared to a total of 60,457 dairy cows as of December 31, 2013.

### ***Liquid milk business***

	For the six months	
	ended June 30,	
	2014	2013
	(Unaudited)	(Unaudited)
Sales amount (RMB in thousands)	243,571	104,737
Sales volume (Tonnes)	16,400	7,527
Average selling price (RMB/tonne)	14,852	13,915

The Group's revenue from its liquid milk business increased by 132.7% from RMB104.7 million in the 2013 Interim Period to RMB243.6 million in the 2014 Interim Period. The increase was primarily due to the increasing demand of its products and the expansion of its distribution network. As of June 30, 2014, the Group had 332 distributors as compared to 316 distributors as of December 31, 2013.

***Cost of sales, gross profit and gross margin***

	For the six months ended June 30,					
	2014 (Unaudited)			2013 (Unaudited)		
	Cost of Sales Amount	Gross Profit Amount	Gross Margin %	Cost of Sales Amount	Gross Profit Amount	Gross Margin %
(RMB in thousands, except percentages)						
<b>Dairy farming business</b>						
Organic raw milk						
Before elimination	230,415	230,482	50.0%	115,940	71,495	38.1%
After elimination <sup>(1)</sup>	170,175	167,738	49.6%	89,559	50,751	36.2%
Premium non-organic raw milk	187,215	136,930	42.2%	151,218	65,278	30.2%
Subtotal:						
Before elimination	417,630	367,412	46.8%	267,158	136,773	33.9%
After elimination <sup>(1)</sup>	357,390	304,668	46.0%	240,777	116,029	32.5%
<b>Liquid milk business</b>						
Before elimination	167,258	76,313	31.3%	74,040	30,697	29.3%
After elimination <sup>(2)</sup>	104,514	139,057	57.1%	53,296	51,441	49.1%
Total, after elimination	461,904	443,725	49.0%	294,073	167,470	36.3%

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

The Group's cost of sales for the 2014 Interim Period was RMB461.9 million, representing an increase of 57.1% from RMB294.1 million for the 2013 Interim Period. The increase in cost of sales was primarily due to increase in sales volume. The gross profit of the Group increased by 164.9% from RMB167.5 million for the 2013 Interim Period to RMB443.7 million for the 2014 Interim Period. The increase in gross profit was primarily due to increase in sales volume and average selling price. The gross margin of the Group increased from 36.3% to 49.0% for the 2013 Interim Period to the 2014 Interim Period, mainly due to increase in selling price per tonne and increase in average annual milk yield per dairy cow.

#### ***Net Gains or Losses arising from Changes in Fair Value Less Costs to Sell of Biological Assets***

Net gains or losses arising from changes in fair value less costs to sell of biological assets represents fair value changes in its dairy cows, due to the changes in physical attributes and market prices of and discounted future cash flow to be generated by those cows. In general, when a heifer becomes a milkable cow, its value increases as the discounted cash flow from milkable cow is higher than the selling price of heifer. Further, when a milkable cow is culled and sold, its value decreases. The Group recorded net gains arising from changes in fair value less costs to sell of biological assets of RMB4.3 million in the 2013 Interim Period and RMB10.0 million in the 2014 Interim Period.

#### ***Other Income and Gains***

Other income and gains include government grants, bank interest income, foreign exchange differences (net) and others. Other income and gains of the Group amounted to RMB 0.8 million in the 2013 Interim Period and RMB9.2 million in the 2014 Interim Period. Increase in other income and gains in the 2014 Interim Period as compared to the 2013 Interim Period was mainly due to the increase in foreign exchange differences (net) and bank interest income.

#### ***Selling and Distribution Expenses***

	For the six months ended June 30,					
	2014 (Unaudited)			2013 (Unaudited)		
	Amount	% of	% of	Amount	% of	% of
	(RMB'000)	total	segment	(RMB'000)	total	segment
		revenue	revenue		revenue	revenue
Dairy farming business	7,774	0.8%	1.2%	5,429	1.2%	1.5%
Liquid milk business	26,125	2.9%	10.7%	26,296	5.7%	25.1%
Total	<u>33,899</u>	<u>3.7%</u>	<u>N/A</u>	<u>31,725</u>	<u>6.9%</u>	<u>N/A</u>

Selling and distribution expenses of the Group's dairy farming business represent transportation and logistics expenses associated with the delivery of raw milk to its customers.

Selling and distribution expenses of the Group's liquid milk business mainly consist of transportation and logistics expenses incurred when delivering liquid milk to distributors, salary and welfare expense for marketing staff and promotion and advertisement expenses associated with liquid milk products.

### ***Administrative Expenses***

Administrative expenses primarily consist of salary and welfare of management and administrative employees. Administrative expense as a percentage of revenue was 2.2% in the 2013 Interim Period and 4.5% in the 2014 Interim Period. Such increase was mainly due to the inclusion of the listing expenses incurred in the 2014 Interim Period in the administrative expenses for the same period. Disregarding the listing expenses, the administrative expenses as a percentage of revenue for the 2014 Interim Period was 2.9%.

### ***Income Tax Expense***

The profits generated by the Group were entirely derived from its operations in the PRC. The Group's subsidiaries in the PRC are generally subject to a corporate income tax at a rate of 25%. According to the Enterprise Income Tax Law of the PRC ("EIT Law"), the Group's income arising from agricultural activities, such as dairy farming and processing of primary agricultural products, is exempt from enterprise income tax. In accordance with "The notice of tax policies relating to the implementation of the Western China Development Strategy" (財政部、海關總署、國家稅務總局《關於深入實施西部大開發戰略有關稅收政策問題的通知》(財稅[2011]58號), the Group's taxable income arising from processing of non-primary agricultural products is subject to preferential tax rate of 15% from 2013 to 2020.

Income tax expenses of the Group were RMB9,418 and RMB0.6 million in the 2013 Interim Period and 2014 Interim Period, respectively, and the effective income tax rate was 0.0% and 0.2% during the same periods.

### ***Profit for the 2014 Interim Period***

Profit of the Group increased by 201.7% from RMB117.9 million in the 2013 Interim Period to RMB355.7 million in the 2014 Interim Period. By comparison, the Group's profit before biological assets fair value adjustments was RMB345.6 million in the 2014 Interim Period, representing an increase of 204.2% when compared with RMB113.6 million in the 2013 Interim Period.

## ***Analysis on Interim Condensed Consolidated Statement of Financial Position***

### ***Non-Current Assets***

As of June 30, 2014, the total non-current assets of the Group were RMB3,238.1 million (as compared to RMB2,477.5 million as of December 31, 2013), primarily consisting of property, plant and equipment of RMB1,177.8 million (as compared to RMB922.8 million as of December 31, 2013), biological assets of RMB1,997.4 million (as compared to RMB1,510.2 million as of December 31, 2013) and prepayments for property, plant and equipment and biological assets of RMB22.4 million (as compared to RMB9.0 million as of December 31, 2013).

The increase in biological assets was primarily due to increase in herd size. The increase in property, plant and equipment was primarily due to continuing investment in construction of organic dairy farms of the Group. Organic farms of the Group increased from 13 operating farms and 3 farms under construction as of December 31, 2013 to 13 operating farms and 6 farms under construction as of June 30, 2014.

### ***Current Assets***

As of June 30, 2014, the total current assets of the Group were RMB951.7 million (as compared to RMB635.2 million as of December 31, 2013), primarily consisting of inventories of RMB239.8 million (as compared to RMB335.2 million as of December 31, 2013), trade and bill receivables of RMB173.5 million (as compared to RMB63.5 million as of December 31, 2013), prepayments, deposits and other receivables of RMB203.8 million (as compared to RMB94.4 million as of December 31, 2013) and cash and cash equivalents of RMB325.6 million (as compared to RMB127.1 million as of December 31, 2013).

#### ***Trade and bills receivables***

	<b>As of June 30, 2014 (Unaudited) (RMB'000)</b>	<b>As of December 31, 2013 (Audited)</b>
Trade and bills receivables	<b><u>173,500</u></b>	<b><u>63,470</u></b>

Aging analysis of the trade and bills receivables is as follows:

	<b>As of June 30, 2014 (Unaudited) RMB'000</b>	<b>As of December 31, 2013 (Audited) RMB'000</b>
Within 3 months	<b>172,909</b>	63,470
4-6 months	<b>591</b>	—
	<hr/>	<hr/>
Total	<b><u>173,500</u></b>	<b><u>63,470</u></b>

The Group requires its industrial customers to settle the trade receivables according to the previously agreed arrangements. The Group occasionally grants credit limits to its distributors depending on their specific operation in case-by-case basis. As of August 20, 2014, a total of RMB154.0 million, or 88.7% of the Group's total trade receivables, which were outstanding as of June 30, 2014 have been settled.

#### *Prepayments, deposits and other receivables*

The Group's prepayments, deposits and other receivables totaled RMB203.8 million and RMB94.4 million as of June 30, 2014 and December 31, 2013, respectively. The increase was primarily due to the increase in the prepayments to Bayannur Shengmu High-tech Ecological Forage Co., Ltd and its subsidiaries ("Shengmu Forage") as a result of the increased purchase by the Group from Shengmu Forage and other forage suppliers.

#### ***Current Liabilities***

As of June 30, 2014, the total current liabilities of the Group amounted to RMB1,378.3 million (as compared to RMB1,404.7 million as of December 31, 2013), primarily consisting of trade and bills payables of RMB174.7 million (as compared to RMB191.0 million as of December 31, 2013), receipts in advance of RMB53.2 million (as compared to RMB82.5 million as of December 31, 2013), other payables and accruals of RMB205.0 million (as compared to RMB198.6 million as of December 31, 2013) and interest-bearing bank and other borrowings of RMB944.0 million (as compared to RMB932.0 million as of December 31, 2013).

#### ***Human Resources***

As of June 30, 2014, the Group had a total of 2,489 employees. Total staff costs for the 2014 Interim Period (including the emoluments of directors and senior management) amounted to approximately RMB77.4 million (in the 2013 Interim Period: RMB49.2 million).

## ***Contingent Liabilities***

As of June 30, 2014 and December 31, 2013, the Group did not have any material contingent liabilities.

## **OUTLOOK**

The Group's long-term objective is to become a leading organic dairy company in the world. To achieve this goal, we will continue to (a) expand the organic dairy farming operation and ensure its product safety and quality; (b) increase the liquid milk processing capacity; (c) expand the premium organic product portfolio; and (d) build an extensive nationwide distribution network and strengthen brand recognition.

### ***Expand Organic Dairy Farming Operations and Ensure Product Safety and Quality***

The Group plans to expand its organic dairy farming operation by (i) building up additional organic dairy farms; (ii) expanding its organic herd size primarily due to breeding by our own dairy farms, supplemented by purchasing heifers from domestic dairy farmers and from overseas markets according to the organic standards and specifications; (iii) improving the physical conditions and average milk yield of its dairy cows and its operating efficiency; and (iv) further strengthening its relationship with Shengmu Forage to ensure that they develop additional organic growing fields to meet the Group's increasing requirements for organic forages.

The Group is now constructing six additional organic dairy farms, and will also continue to invest in quality control and product safety to support growth.

### ***Increase Liquid Milk Processing Capacity***

The Group plans to further expand its “Shengmu 聖牧” branded liquid milk production business capacity to capture additional margin along the value chain. To achieve this, the Group will continue to acquire and construct new production lines to increase liquid milk processing capacity.

### ***Expand Premium Organic Product Portfolio***

In the first half of 2014, the Group offered organic liquid milk products under the “Shengmu 聖牧” brand, including organic whole milk, organic low-fat milk and organic milk for children, all of them are made from organic raw milk supplied internally from the certified organic farms of the Group. The Group aims to continue to develop new products which can leverage the increasing raw organic milk production, share its existing processing, marketing and distribution platforms, as well as benefit from its increasingly recognized brand. Specifically, the Group has commenced production of organic yogurt products since July 2014. The Group's organic yogurt products are currently being sold in 138 cities in 26 provinces, municipalities and autonomous regions.

### ***Build an extensive nationwide distribution network and strengthen brand recognition***

The Group currently sells its liquid milk products through distributors. The Group plans to expand its distribution network to over 400 distributors by the end of 2014 and will increase efforts in engaging additional distributors in tier three and tier four cities. In terms of points of sale, the Group plans to continue to increase its product presence in department stores and large supermarket chains in order to promote its brand recognition. The Group will also focus on expanding convenience store chains as a key sales channel. Furthermore, in addition to its direct sales to consumers via VIP membership cards and corporate wholesale, the Group plans 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 its rapidly growing customers, the Group plans to set up regional distribution centers by leasing warehouse facilities close to regional transportation hubs throughout China and purchase trucks to establish its own delivery fleet to support its sales growth.

On the other hand, the Group also plans to increase our brand recognition and solidify its high-end image in target markets through (i) 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 its own brand; (ii) promoting the establishment of more specialty shops which, in addition to their sales function, will serve to educate consumers about the “grass-to-glass” organic production model and the benefits of organic milk and promote its brand image; and (iii) demonstrating our “grass-to-glass” organic production chain through more open-house events at our dairy farms and production facilities.

### **PURCHASE, REDEMPTION OR SALE OF LISTED SECURITIES OF THE COMPANY**

In the 2014 Interim Period, the shares of the Company have not been listed on the Stock Exchange, nor were there any other listed securities issued by the Company or any of its subsidiary. From the Listing Date up to the date of this interim result announcement, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company’s listed securities.



## **CORPORATE GOVERNANCE PRACTICES**

The Company has adopted the code provisions as set out in the Corporate Governance Code and Corporate Governance Report (the “**Code**”) as contained in Appendix 14 to the Rules Governing the Listing of Securities on the Stock Exchange (as amended from time to time) (the “**Listing Rules**”) as its own code to govern its corporate governance practices.

In the opinion of the Directors, the Company, since the Listing Date and up to the date of this interim result announcement, has adopted, applied and complied with the code provisions contained in the Code except the code provision A.2.1 of the Code as disclosed below.

Pursuant to provision A.2.1 of the Corporate Governance Code, the roles of chairman and chief executive officer should be separate and should not be performed by the same individual. However, the Company does not have a separate chairman and chief executive officer and Mr. YAO Tongshan currently performs these two roles. The Board believes that vesting the roles of both chairman and chief executive officer in the same person has the benefit of ensuring the consistent leadership within the Group and enables more effective and efficient overall strategic planning for the Group. The Board considers that the balance of power and authority for the present arrangement will not be impaired and this structure will enable the Company to make and implement decisions promptly and effectively. The Board will continue to review and consider splitting the roles of chairman of the Board and chief executive officer of the Company at a time when it is appropriate and suitable by taking into account the circumstances of the Group as a whole.

## **AUDIT COMMITTEE AND REVIEW OF INTERIM RESULTS**

The Company has established the Audit Committee in compliance with Rule 3.21 of the Listing Rules. The primary duties of the Audit Committee are to review the financial reporting process and internal control system of the Group, and to make proposals to the Board as to the appointment, re-appointment and removal of the Company’s independent auditors and the related remuneration and appointment terms. The Audit Committee has reviewed the accounting standards and practices adopted by the Group and discussed with the management about the internal control and financial reporting matters, including the review of the unaudited interim results for the 2014 Interim Period.

## **MODEL CODE FOR DIRECTORS' SECURITIES TRANSACTIONS**

The Company has adopted a code of conduct regarding securities transactions by Directors on terms no less exacting than the required standard of dealings as set out in the Model Code for Securities Transactions by Directors of Listing Issuers (the “**Model Code**”) as set out in Appendix 10 to the Listing Rules. Having made specific queries to the Directors, all Directors have confirmed that they have complied with the required standards as set out in the Model Code from the Listing Date to the date of this interim result announcement.

## **DIVIDEND DISTRIBUTION**

The Board of Directors does not recommend the payment of any interim dividend for the 2014 Interim Period (for the 2013 Interim Period: Nil).

## **PUBLICATION OF RESULTS ANNOUNCEMENT AND INTERIM REPORT**

This interim results announcement is published on the website of the Stock Exchange at [www.hkexnews.hk](http://www.hkexnews.hk) and on the website of the Company at [www.youjimilk.com](http://www.youjimilk.com). The interim report of the Company for the 2014 Interim Period containing all the information required by the Listing Rules will be dispatched to Shareholders and published on the above websites in due course.

By Order of the Board  
**China Shengmu Organic Milk Limited**  
**Yao Tongshan**  
*Chairman*

Hong Kong, August 26, 2014

*As at the date of this announcement, the executive directors of the Company are Mr. Yao Tongshan, Mr. Wu Jianye, Ms. Gao Lingfeng and Mr. Cui Ruicheng; and the non-executive directors of the Company are Mr. Wu Jingshui, Mr. Fan Xiang, Mr. Cui Guiyong and Mr. Sun Qian; and the independent non-executive directors of the Company are Mr. Wong Kun Kau, Mr. Li Changqing, Ms. Ge Xiaoping and Mr. Yuan Qing.*