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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)

CONNECTED TRANSACTION

Increase of Capital of Shengmu Forage

The Company wishes to announce that, on 8 December 2014, Shengmu Farming (a wholly-owned subsidiary of the Company), Mr. Wu, Ms. Gao, Mr. Liu and Shengmu Forage have entered into the Capital Increase Agreement in relation to the further contribution of a total RMB60,020,000 to the registered capital of Shengmu Forage. Pursuant to the Capital Increase Agreement, Shengmu Farming, Mr. Wu, Ms. Gao and Mr. Liu have agreed to make further capital contribution by cash in the amount of RMB6,094,000, RMB4,750,000, RMB23,206,000 and RMB25,970,000 respectively.

After the completion of the Capital Increase Agreement, the registered capital of Shengmu Forage will be increased from RMB168,660,000 to RMB228,680,000. The percentage of equity interest held by the Group in Shengmu Forage will be increased from 8.60% to 9.01%. Pursuant to the acting-in-concert arrangement entered into among Shengmu Holding, Mr. Wu and Ms. Gao in relation to their exercise of voting rights at the shareholders and board meetings of Shengmu Forage, the Group will be able to control a total of approximately 31.88% equity interest in Shengmu Forage (being the equity interest held by Shengmu Holding, Shengmu Farming, Mr. Wu and Ms. Gao). Shengmu Forage will continue to be accounted for as an associate of the Company after the completion of the Capital Increase Agreement.

Pursuant to the Letter of Undertaking made by Shengmu Forage in favour of the Company, among others, Shengmu Forage shall not, within 20 years after the date of the Letter of Undertaking, issue any share/equity interest to any third party (other than the Company) without the Company's written consent. In this connection, the Board has resolved to give consent to Shengmu Forage to issue further shares to Mr. Wu, Ms. Gao and Mr. Liu.

As at the date of this announcement, certain of the Ultimate Controlling Shareholders (including Mr. Wu and Ms. Gao) and their family members hold in aggregate approximately 33.82% equity interest in Shengmu Forage. Mr. Wu and Ms. Gao are also directors of Shengmu Forage. As a result, Shengmu Forage is an associate of the Ultimate Controlling Shareholders and therefore a connected person of the Company as defined under the Listing Rules. As such, the transaction contemplated under the Capital Increase Agreement constitutes a connected transaction of the Company as defined under the Listing Rules. Based on the applicable ratios, the transaction contemplated under the Capital Increase Agreement is subject to the reporting and announcement requirements, but is exempt from the independent shareholders' approval requirements under the Listing Rules.

The Company wishes to announce that, on 8 December 2014, Shengmu Farming (a wholly-owned subsidiary of the Company), Mr. Wu, Ms. Gao, Mr. Liu and Shengmu Forage have entered into the Capital Increase Agreement in relation to the further contribution of a total RMB60,020,000 to the registered capital of Shengmu Forage. Pursuant to the Capital Increase Agreement, Shengmu Farming, Mr. Wu, Ms. Gao and Mr. Liu have agreed to make further capital contribution by cash in the amount of RMB6,094,000, RMB 4,750,000, RMB23,206,000 and RMB25,970,000 respectively.

CAPITAL INCREASE AGREEMENT

Date: 8 December 2014

Parties: Shengmu Farming, Mr. Wu, Ms. Gao, Mr. Liu and Shengmu Forage

Increase in the registered capital of Shengmu Forage

Pursuant to the Capital Increase Agreement, Shengmu Farming, Mr. Wu, Ms. Gao and Mr. Liu have agreed to make further capital contribution by cash in the amount of RMB6,094,000, RMB 4,750,000, RMB23,206,000 and RMB25,970,000 respectively. After the completion of the Capital Increase Agreement, the registered capital of Shengmu Forage will be increased from RMB168,660,000 to RMB228,680,000.

Shengmu Farming is not an existing shareholder of Shengmu Forage while Mr. Wu, Ms. Gao and Mr. Liu are existing shareholders of Shengmu Forage. Shengmu Holding, a wholly-owned subsidiary of the Company, currently holds 8.60% equity interest in Shengmu Forage. As both Shengmu Holding and Shengmu Farming are wholly-owned subsidiary of the Company, the percentage of equity interest held by the Group in Shengmu Forage will be increased from 8.60% to 9.01% after the completion of the Capital Increase Agreement.

The following table shows the changes of shareholding percentages in Shengmu Forage:

	Shareholding percentage before the completion of the Capital Increase Agreement	Shareholding percentage after the completion of the Capital Increase Agreement
Shengmu Holding <i>Note</i>	8.60%	6.34%
Shengmu Farming <i>Note</i>	Nil	2.67%
Mr. Wu	4.68%	5.53%
Ms. Gao	9.75%	17.34%
Mr. Liu	19.39%	25.66%
Other shareholders	<u>57.58%</u>	<u>42.46%</u>
Total	<u>100%</u>	<u>100%</u>

Note:

Both Shengmu Holding and Shengmu Farming are wholly-owned subsidiaries of the Company.

Pursuant to the acting-in-concert arrangement entered into among Shengmu Holding, Mr. Wu and Ms. Gao in relation to their exercises of voting rights at the shareholders and board meetings of Shengmu Forage, the Group will be able to control a total of approximately 31.88% equity interest in Shengmu Forage (being the aggregate amount of equity interests held by Shengmu Holding, Shengmu Farming, Mr. Wu and Ms. Gao) after the completion of the Capital Increase Agreement. Shengmu Forage will continue to be accounted for as an associate of the Company after the completion of the Capital Increase Agreement.

Payment of the contributed amount

Each of the parties shall make their respective contribution under the Capital Increase Agreement before 30 June 2015.

FURTHER INFORMATION ON SHENGMU FORAGE

Shengmu Forage is principally engaged in growing organic forage in the Ulan Buh desert where is in the proximity of the Group's organic dairy farms. In March 2014, the Company entered into a 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 forage with the Group and support the

Group's future expansion plans. Shengmu Forage and Shengmu Holding also entered into a forage supply framework agreement on 25 June 2014, pursuant to which Shengmu Forage and its subsidiaries shall sell all the forage produced by them to the Group on an exclusive basis for the term from 1 January 2014 to 31 December 2016.

Based on its unaudited financial statements (prepared under the PRC accounting rules and regulations), the net asset value of Shengmu Forage amounted to RMB173,428,131 as at 30 June 2014.

Based on its audited financial statements (prepared under the PRC accounting rules and regulations), the net profit (both before and after tax) of Shengmu Forage amounted to RMB3,661,662 and RMB1,074,116 for the year ended 31 December 2013 and 2012, respectively.

REASONS FOR AND BENEFITS OF ENTERING INTO THE CAPITAL INCREASE AGREEMENT

The Board is informed by the management of Shengmu Forage that additional capital is required for its business expansion. The Directors consider that the entry into of the Capital Increase Agreement is beneficial to the Group, having considered the following factors:

- (a) Shengmu Forage is an important supplier of organic forage which exclusively supplies all its organic forage to the Group and an essential part of the Group's unique vertically integrated "grass-to-glass" organic ("全程有機") production model. As such, further contribution to the capital of Shengmu Forage to support its business expansion will benefit the Group in the long term and is in line with the Group's strategic and overall business development plan; and
- (b) To participate in further contribution to the capital of Shengmu Forage will increase the Group's equity interest in Shengmu Forage and enhance its influence over Shengmu Forage.

The Directors (including all the independent non-executive Directors) are of the view that (a) the Capital Increase Agreement is entered into in the ordinary course of business of the Group; and (b) the terms of the Capital Increase Agreement are on normal commercial terms and are fair and reasonable and in the interests of the Company and the Shareholders as a whole.

Further, pursuant to the Letter of Undertaking made by Shengmu Forage in favour of the Company, among others, Shengmu Forage shall not, within 20 years after the date of the Letter of Undertaking, issue any share/equity interest to any third party (other than the Company) without the Company's written consent. Based on the factors mentioned above, the Board has resolved to give consent to Shengmu Forage to issue further shares to Mr. Wu, Ms. Gao and Mr. Liu.

Mr. Yao Tongshan (姚同山), Mr. Wu and Ms. Gao, each being an executive Director and an existing shareholder of Shengmu Forage, has a material interest in the transaction contemplated under the Capital Increase Agreement. They have abstained from voting on the board resolutions in relation to the Capital Increase Agreement.

LISTING RULES IMPLICATIONS

As at the date of this announcement, certain of the Ultimate Controlling Shareholders (including Mr. Yao Tongshan, Mr. Wu and Ms. Gao) and their family members hold in aggregate approximately 33.82% equity interest in Shengmu Forage. Mr. Wu and Ms. Gao are also directors of Shengmu Forage. As a result, Shengmu Forage is an associate of the Ultimate Controlling Shareholders and therefore a connected person of the Company as defined under the Listing Rules. As such, the transaction contemplated under the Capital Increase Agreement constitutes a connected transaction of the Company as defined under the Listing Rules. Based on the applicable ratios, the transaction contemplated under the Capital Increase Agreement is subject to the reporting and announcement requirements, but is exempt from the independent shareholders' approval requirements under the Listing Rules.

INFORMATION ON THE GROUP AND OTHER PARTIES TO THE CAPITAL INCREASE AGREEMENT

The Group is principally engaged in dairy farming business and liquid milk business. The Group is the largest organic dairy group in China and, together with Shengmu Forage, the only vertically integrated organic dairy group in China that meets E.U. organic standards.

Mr. Wu is an executive Director, an Ultimate Controlling Shareholder, the president of Group and an existing shareholder of Shengmu Forage.

Ms. Gao is an executive Director, an Ultimate Controlling Shareholder, the vice president of the Group and an existing shareholder of Shengmu Forage.

Mr. Liu is the legal representative of Shengmu Forage, an Independent Third Party and an existing shareholder of Shengmu Forage.

DEFINITIONS

In this announcement, the following expressions shall have the meanings ascribed to them below unless the context requires otherwise:

“associate”	has the meaning ascribed to the term under the Listing Rules
“Board”	the board of Directors
“Capital Increase Agreement”	the capital increase agreement dated 8 December 2014 among Shengmu Farming, Mr. Wu, Ms. Gao, Mr. Liu and Shengmu Forage in relation to further contribution to the registered capital of Shengmu Forage
“connected person(s)”	has the meaning ascribed to it under the Listing Rules
“Independent Third Party”	an entity or person who is not a connected person within the meaning ascribed under the Listing Rules
“Letter of Undertaking”	the letter of undertaking dated 16 April 2014 made by Shengmu Forage in favour of the Company, pursuant to which, among others, Shengmu Forage has undertaken not to issue/allot any share/equity interest to any third party (other than the Company) without the Company’s written consent within 20 years after the date thereof the Letter of Undertaking.
“Company”	China Shengmu Organic Milk Limited (中國聖牧有機奶業有限公司), a company incorporated in the Cayman Islands with limited liability, the issued Shares of which are listed on the Stock Exchange
“Director(s)”	the director(s) of the Company
“Group”	the Company and its subsidiaries from time to time and “member(s) of the Group” shall be construed accordingly
“Listing Rules”	the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited

“Ms. Gao”	Gao Lingfeng (高凌鳳), an executive Director, an Ultimate Controlling Shareholder, the vice president of the Group and an existing shareholder of Shengmu Forage
“Mr. Liu”	Liu Wenguang (劉文光), the legal representative of Shengmu Forage, an Independent Third Party and an existing shareholder of Shengmu Forage
“Mr. Wu”	Mr. Wu Jianye (武建鄴), an executive Director, an Ultimate Controlling Shareholder, the president of Group and an existing shareholder of Shengmu Forage
“PRC”	the People’s Republic of China and for the purpose of this announcement, does not include Hong Kong, Macao Special Administrative Region and Taiwan
“Shengmu Forage”	Bayannur Shengmu High-tech Ecological Forage Co., Ltd. (巴彥淖爾市聖牧高科生態草業有限公司), a company with limited liability established under the laws of the PRC
“Shengmu Farming”	Inner Mongolia Shengmu Holding Co., Ltd (內蒙古聖牧控股有限公司) (formerly known as Bayannur Shengmu High-tech Farming Co., Ltd. (巴彥淖爾市聖牧高科牧業有限公司)), a company with limited liability established under the laws of the PRC and a wholly-owned subsidiary of the Company
“Shengmu Holding”	Inner Mongolia Shengmu High-tech Farming Co., Ltd (內蒙古聖牧高科牧業有限公司), a company with limited liability established under the laws of the PRC and a wholly-owned subsidiary of the Company
“Stock Exchange”	The Stock Exchange of Hong Kong Limited

“Ultimate Controlling Shareholders”

a group of 14 individuals (including Mr. Yao Tongshan, Mr. Wu and Ms. Gao) who, by an acting-in-concert arrangement, are entitled to exercise, through a holding company, more than 30% of the voting rights at general meeting of the Company and are therefore together regarded as the controlling shareholders as defined under the Listing Rules

By Order of the Board of
China Shengmu Organic Milk Limited
Yao Tongshan
Chairman and Executive Director

Hong Kong, 8 December 2014

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