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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)**

### **FINAL RESULTS ANNOUNCEMENT FOR THE YEAR ENDED DECEMBER 31, 2014**

#### **FINAL RESULTS SUMMARY FOR THE YEAR OF 2014**

	<b>For the year ended December 31</b>		
	<b>2014</b>	<b>2013</b>	<b>Movements</b>
	<b><i>RMB'000</i></b>	<b><i>RMB'000</i></b>	
Revenue	<b>2,132,428</b>	1,143,709	<b>+86.4%</b>
Gross profit	<b>1,069,808</b>	490,425	<b>+118.1%</b>
Profits attributable to the owners of the parent	<b>711,228</b>	327,309	<b>+117.3%</b>
Basic earnings per share attributable to ordinary equity holders of the parent	<b><u>RMB0.118</u></b>	<b><u>RMB0.075</u></b>	<b>+57.3%</b>
Diluted earnings per share attributable to ordinary equity holders of the parent	<b><u>RMB0.116</u></b>	<b><u>RMB0.075</u></b>	<b>+54.7%</b>

The board of directors (the “Board”) of China Shengmu Organic Milk Limited (the “Company”) is pleased to announce the final results of the Company and its subsidiaries (collectively the “Group” or “Shengmu”) for the year ended December 31, 2014, together with the comparative figures for the year ended December 31, 2013.

## CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

		For the year ended December 31,	
	Notes	2014 RMB'000	2013 RMB'000
<b>REVENUE</b>	4	<b>2,132,428</b>	1,143,709
Cost of sales		(1,062,620)	(653,284)
Gross profit		<b>1,069,808</b>	490,425
Gain arising from changes in fair value less costs to sell of biological assets		<b>87,098</b>	9,484
Other income and gains	4	<b>28,405</b>	6,868
Selling and distribution expenses		(128,111)	(71,821)
Administrative expenses		(101,733)	(25,436)
Finance costs	6	(60,272)	(32,821)
Share of profits and losses of associates		(7,651)	(1,349)
<b>PROFIT BEFORE TAX</b>	5	<b>887,544</b>	375,350
Income tax expense	7	(3,736)	(852)
<b>PROFIT FOR THE YEAR</b>		<b>883,808</b>	374,498
<b>OTHER COMPREHENSIVE INCOME</b>			
Exchange differences on translation of foreign operations		2,779	—
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>		<b>886,587</b>	374,498
Profit attributable to:			
Owners of the parent		711,228	327,309
Non-controlling interests		172,580	47,189
		<b>883,808</b>	374,498
Total comprehensive income attributable to:			
Owners of the parent		714,007	327,309
Non-controlling interests		172,580	47,189
		<b>886,587</b>	374,498
<b>EARNINGS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE PARENT</b>	9		
Basic		<b>RMB0.118</b>	RMB0.075
Diluted		<b>RMB0.116</b>	RMB0.075

## CONSOLIDATED STATEMENT OF FINANCIAL POSITION

		As at December 31,	
	Notes	2014	2013
		RMB'000	RMB'000
<b>NON-CURRENT ASSETS</b>			
Property, plant and equipment		1,657,827	922,764
Prepaid land lease payments		5,252	3,381
Other intangible assets		15,969	14,192
Investments in associates		28,160	17,727
Available-for-sale investments		980	—
Biological assets	10	2,720,126	1,510,160
Prepayments for property, plant and equipment and biological assets		26,985	9,043
Deferred tax assets		910	187
Total non-current assets		4,456,209	2,477,454
<b>CURRENT ASSETS</b>			
Inventories		701,183	335,218
Trade and bills receivables	11	397,543	63,470
Prepayments, deposits and other receivables		185,175	94,377
Pledged deposits		16,431	15,030
Cash and cash equivalents		734,703	127,059
Total current assets		2,035,035	635,154
<b>CURRENT LIABILITIES</b>			
Trade and bills payables	12	423,963	191,037
Receipts in advance		32,440	82,481
Other payables and accruals		293,443	198,565
Interest-bearing bank and other borrowings		1,334,000	932,000
Tax payable		2,299	633
Total current liabilities		2,086,145	1,404,716
<b>NET CURRENT LIABILITIES</b>		( 51,110)	( 769,562)
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>		4,405,099	1,707,892

# **CONSOLIDATED STATEMENT OF FINANCIAL POSITION (Continued)**

	<b>As at December 31,</b>	
<i>Notes</i>	<b>2014</b>	2013
	<b><i>RMB'000</i></b>	<i>RMB'000</i>
<b>NON-CURRENT LIABILITIES</b>		
Interest-bearing bank and other borrowings	<u>150,000</u>	—
Total non-current liabilities	<u>150,000</u>	—
Net assets	<u><b>4,255,099</b></u>	<u>1,707,892</u>
<b>EQUITY</b>		
<b>Equity attributable to owners of the parent</b>		
Share capital: nominal value	50	—
Reserves	<u>3,721,848</u>	<u>1,494,160</u>
	<b>3,721,898</b>	1,494,160
Non-controlling interests	<u>533,201</u>	<u>213,732</u>
Total equity	<u><b>4,255,099</b></u>	<u>1,707,892</u>

**Notes:**

**1. CORPORATE INFORMATION**

The Company is an exempted company incorporated in the Cayman Islands with limited liability. The registered office address of the Company is P.O. Box 309, Ugland House, Grand Cayman, KY1-1104, Cayman Islands.

The Company is an investment holding company. During the year, the Company's subsidiaries were primarily engaged in the production and distribution of raw milk and dairy products in the People's Republic of China (the "PRC").

**2.1 BASIS OF PRESENTATION**

Pursuant to the Reorganisation completed on March 26, 2014, the Company became the direct/indirect holding company of the companies now comprising the Group. As the Reorganisation only involved inserting new holding entities at the top of an existing company and has not resulted in any change of economic substance, the financial information for the year ended December 31, 2014 has been presented as a continuation of the existing company using the pooling of interest method.

The consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows are prepared as if the current group structure had been in existence throughout the year. The consolidated statement of financial position as at December 31, 2013, presents the assets and liabilities of the companies now comprising the Group, as if the current group structure had been in existence at that date.

**2.2 BASIS OF PREPARATION**

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs") as issued by the International Accounting Standards Board ("IASB"). These financial statements also comply with the applicable disclosure requirements of the Hong Kong Companies Ordinance (Cap.622) relating to the preparation of financial statements, which for this financial year and the comparative period continue to be those of the predecessor Companies Ordinance (Cap. 32), in accordance with transitional and saving arrangements for Part 9 of the Hong Kong Companies Ordinance (Cap. 622), "Accounts and Audit", which are set out in sections 76 to 87 of Schedule 11 to that Ordinance. The financial statements have been prepared under the historical cost convention, except for biological assets and agricultural produce which have been measured at fair value less costs to sell. These financial statements are presented in Renminbi ("RMB") and all values are rounded to the nearest thousand except when otherwise indicated.

***Basis of consolidation***

The consolidated financial statements include the financial statements of the Company and its subsidiaries (the "Group") for the year ended December 31, 2014. The financial statements of the subsidiaries are prepared for the same reporting period as the Company, using consistent accounting policies. The results of subsidiaries are consolidated from the date on which the Group obtains control, and continue to be consolidated until the date that such control ceases.

Profit or loss and each component of other comprehensive income are attributed to the owners of the parent of the Group and to the non-controlling interests, even if this results in the non-controlling interests having a deficit balance. All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

The Group reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control. A change in the ownership interest of a subsidiary, without a loss of control, is accounted for as an equity transaction.

If the Group loses control over a subsidiary, it derecognises (i) the assets (including goodwill) and liabilities of the subsidiary, (ii) the carrying amount of any non-controlling interest and (iii) the cumulative translation differences recorded in equity; and recognises (i) the fair value of the consideration received, (ii) the fair value of any investment retained and (iii) any resulting surplus or deficit in profit or loss. The Group's share of components previously recognised in other comprehensive income is reclassified to profit or loss or retained profits, as appropriate, on the same basis as would be required if the Group had directly disposed of the related assets or liabilities.

### **Going concern**

The Group had net current liabilities of RMB51.1 million as of December 31, 2014 (2013: RMB769.6 million). 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 unused commercial papers of RMB200 million granted by National Association of Financial Market Institutional Investors with expiry date on January 13, 2016 and bank facilities of RMB879 million granted to the Group subsequent to December 31, 2014 with expiry dates not earlier than December 31, 2015, the directors are satisfied that the Group is able to meet in full its financial obligations as they fall due for the foreseeable future. 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 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 financial statements do not include any adjustments that would result from the failure of the Group to continue in business as a going concern.

## 2.3 CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES

The Group has adopted the following revised standards and new interpretation for the first time for the current year's financial statements.

Amendments to IFRS 10, IFRS 12 and IAS 27(2011) (Revised)	<i>Investment Entities</i>
Amendments to IAS 32	<i>Offsetting Financial Assets and Financial Liabilities</i>
Amendments to IAS 36	<i>Recoverable Amount Disclosures for Non-Financial Assets</i>
Amendments to IAS 39	<i>Novation of Derivatives and Continuation of Hedge Accounting</i>
IFRIC 21	<i>Levies</i>
Amendment to IFRS 2 included in <i>Annual Improvements 2010-2012 Cycle</i>	<i>Definition of Vesting Condition<sup>1</sup></i>
Amendment to IFRS 3 included in <i>Annual Improvements 2010-2012 Cycle</i>	<i>Accounting for Contingent Consideration in a Business Combination<sup>1</sup></i>
Amendment to IFRS 13 included in <i>Annual Improvements 2010-2012 Cycle</i>	<i>Short-term Receivables and Payables</i>
Amendment to IFRS 1 included in <i>Annual Improvements 2011-2013 Cycle</i>	<i>Meaning of Effective IFRSs</i>
Amendments to IAS 16 and IAS 41	<i>Agriculture: Bearer Plants<sup>2</sup></i>

<sup>1</sup> Effective from July 1, 2014

<sup>2</sup> The Group has early adopted the Amendments to IAS 16 and IAS 41, but the effective date of the amendments itself is effective for annual periods beginning on or after 1 January 2016.

Other than explained below regarding the impact of the Amendments to IAS 16 and IAS 41, the adoption of the above revised standards and interpretation has had no significant financial effect on these financial statements.

The amendments change the accounting requirements for biological assets that meet the definition of bearer plants. Under the amendments, biological assets that meet the definition of bearer plants will no longer be within the scope of IAS 41. Instead, IAS 16 will apply. After initial recognition, bearer plants will be measured under IAS 16 at accumulated cost (before maturity) and using either the cost model or revaluation model (after maturity). The amendments also require that produce that grows on bearer plants will remain in the scope of IAS 41 measured at fair value less costs to sell. For government grants related to bearer plants, IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* will apply.

### 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 organic ultra-heat treated liquid milk and organic yogurt.

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 year. The adjusted profit/(loss) for the year 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 evaluating the results of the dairy farming segment relative to other entities that operate within the 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 year ended December 31, 2014</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	1,393,117	739,311	2,132,428
Intersegment sales	416,918	—	416,918
	<u>1,810,035</u>	<u>739,311</u>	<u>2,549,346</u>
<i>Reconciliation:</i>			
Elimination of intersegment sales			<u>(416,918)</u>
Revenue			<u><u>2,132,428</u></u>
<b>Segment results</b>	<b>752,063</b>	<b>123,733</b>	<b>875,796</b>
<i>Reconciliation:</i>			
Elimination of intersegment results			(37,345)
Gain arising from changes in fair value less costs to sell of biological assets			87,098
Corporate and other unallocated expenses			<u>(41,741)</u>
Profit for the year			<u><u>883,808</u></u>
<b>Segment assets</b>	<b>5,870,719</b>	<b>701,917</b>	<b>6,572,636</b>
<i>Reconciliation:</i>			
Elimination of intersegment receivables			(217,494)
Corporate and other unallocated assets			<u>136,102</u>
Total assets			<u><u>6,491,244</u></u>
<b>Segment liabilities</b>	<b>1,960,303</b>	<b>490,019</b>	<b>2,450,322</b>
<i>Reconciliation:</i>			
Elimination of intersegment payables			(217,494)
Corporate and other unallocated liabilities			<u>3,317</u>
Total liabilities			<u><u>2,236,145</u></u>

<b>For the year ended December 31, 2013</b>	Dairy farming <i>RMB'000</i>	Liquid milk products <i>RMB'000</i>	Total <i>RMB'000</i>
<b>Segment revenue:</b>			
Sales to external customers	840,747	302,962	1,143,709
Intersegment sales	131,561	—	131,561
	972,308	302,962	1,275,270
<i>Reconciliation:</i>			
Elimination of intersegment sales			(131,561)
Revenue			1,143,709
<b>Segment results</b>	330,511	34,503	365,014
<i>Reconciliation:</i>			
Gain arising from changes in fair value less costs to sell of biological assets			9,484
Profit for the year			374,498
<b>Segment assets</b>	2,912,182	242,784	3,154,966
<i>Reconciliation:</i>			
Elimination of intersegment receivables			(42,358)
Total assets			3,112,608
<b>Segment liabilities</b>	1,250,354	196,720	1,447,074
<i>Reconciliation:</i>			
Elimination of intersegment payables			(42,358)
Total liabilities			1,404,716

#### 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 year ended	
		December 31,	
	Note	2014	2013
		RMB'000	RMB'000
Revenue			
– Sales of raw milk		1,393,117	840,747
– Sales of liquid milk products		739,311	302,962
		<u>2,132,428</u>	<u>1,143,709</u>
Other income and gains			
– Government grants	(i)	16,204	5,454
– Bank interest income		6,016	490
– Foreign exchange differences, net		6,167	—
– Others		18	924
		<u>28,405</u>	<u>6,868</u>
		<u><u>2,160,833</u></u>	<u><u>1,150,577</u></u>

*Note:*

- (i) These government grants are unconditional government grants received by the Group from relevant government body as rewards for our contribution to the development of the local economy and for the purpose of supporting the Group to purchase dairy cows. There are no unfulfilled conditions or contingencies attaching to these grants.

## 5. PROFIT BEFORE TAX

The Group's profit before tax is arrived at after charging/(crediting):

	For the year ended December 31,	
	2014	2013
	<i>RMB'000</i>	<i>RMB'000</i>
Cost of inventories sold	<b>1,062,620</b>	653,284
Depreciation of items of property, plant and equipment	<b>58,953</b>	28,003
Amortisation of prepaid land lease payments	<b>97</b>	71
Amortisation of other intangible assets	<b>988</b>	829
Research and development costs	<b>3,591</b>	1,185
Minimum lease payments under operating leases:		
– Plant and machinery	<b>3,310</b>	3,310
– Land and buildings	<b>5,622</b>	6,331
	<b>8,932</b>	9,641
Foreign exchange differences, net	<b>(6,167)</b>	—
Auditors' remuneration	<b>2,750</b>	66
Employee benefit expense (including directors' and chief executive's remuneration):		
Wages, salaries, bonuses and allowances	<b>161,694</b>	98,109
Other social insurances and benefits	<b>8,391</b>	4,315
Pension scheme contributions	<b>7,073</b>	4,284
Equity-settled share option expenses	<b>23,396</b>	—
	<b>200,554</b>	106,708

## 6. FINANCE COSTS

	For the year ended December 31,	
Group	2014	2013
	<i>RMB'000</i>	<i>RMB'000</i>
Interest on bank loans wholly repayable within five years	<b>68,798</b>	32,821
Less: Interest capitalised	<b>(8,526)</b>	—
	<b>60,272</b>	32,821

## 7. INCOME TAX EXPENSE

Group	For the years ended December 31,	
	2014 RMB'000	2013 RMB'000
Current	4,459	1,039
Deferred	(723)	(187)
	<u>3,736</u>	<u>852</u>

### Notes:

- (i) The Company and its subsidiaries incorporated in the Cayman Islands and the British Virgin Islands are not subject to any income tax pursuant to the local rules and regulations. Hong Kong profits tax has not been provided as there are no assessable profits arising in Hong Kong during the year. Entities in the PRC are generally subject to the PRC enterprise income tax rate of 25% for the year ended December 31, 2014 (2013: 25%).
- (ii) According to the Enterprise Income Tax Law of the PRC (the "EIT Law"), the Group's income arising from agricultural activities, such as dairy farming and processing of primary agricultural products, is exempt from income tax.
- (iii) 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》), the Group's taxable income arising from the processing of non-primary agricultural products is subject to a preferential tax rate of 15% from 2013 to 2020.

## 8. DIVIDENDS

The directors do not recommend the payment of any dividend for the year ended December 31, 2014 (2013: Nil).

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

The calculation of the basic earnings per share amount is calculated by dividing the profit for the year attributable to ordinary equity holders of the parent, by the weighted average number of ordinary shares of 6,018,136,000 (2013: 4,338,170,000) in issue during the year.

The diluted earnings per share amount is calculated by dividing the profit for the year attributable to ordinary equity holders of the parent, by the weighted average number of ordinary shares used in the calculation of the basic earnings per share calculation, and the weighted average number of ordinary shares assumed to have been issued at no consideration on the deemed exercise or conversion of all dilutive potential ordinary shares into ordinary shares.

	As at December 31, Number of shares	
	2014	2013
Weighted average number of ordinary shares in issue during the year used in the basic earnings per share calculation	6,018,136,320	4,338,170,000
Effect of dilution of share options	<u>114,264,051</u>	<u>—</u>
Weighted average number of ordinary shares in issue during the year used in the diluted earnings per share calculation	<u>6,132,400,371</u>	<u>4,338,170,000</u>

## 10. 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 at December 31, 2014 and 2013 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>As at December 31,</b>	
	<b>2014</b>	2013
	<b>Head</b>	<b>Head</b>
Dairy cows		
Milkable cows	<b>55,032</b>	35,850
Heifers and calves	<b>48,220</b>	24,607
	<hr/>	<hr/>
Total dairy cows	<b>103,252</b>	60,457
	<hr/> <hr/>	<hr/> <hr/>

### (B) Value of biological assets

	<b>As at December 31,</b>	
	<b>2014</b>	2013
	<b>RMB'000</b>	<b>RMB'000</b>
Dairy cows		
Milkable cows	<b>1,775,096</b>	1,085,461
Heifers and calves	<b>945,030</b>	424,699
	<hr/>	<hr/>
Total dairy cows	<b>2,720,126</b>	1,510,160
	<hr/> <hr/>	<hr/> <hr/>

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 professional qualified valuers not connected with the Group, which has appropriate qualifications and recent experience in the valuation of biological assets.

The valuation techniques used in determination of fair values remain the same as those disclosed in Note 18 to the Accountants' Report in Appendix I to the Company's prospectus dated June 30, 2014.

## 11. TRADE AND BILLS RECEIVABLES

<b>Group</b>	<b>As at December 31,</b>	
	<b>2014</b>	2013
	<b><i>RMB'000</i></b>	<i>RMB'000</i>
Trade receivables	<b>393,443</b>	61,360
Bills receivable	<b>4,100</b>	2,110
Impairment	<b>—</b>	—
	<b><u>397,543</u></b>	<u>63,470</u>

The Group normally allows a credit limit or offer to its customers credit terms which are adjustable in certain circumstances. The Group closely monitors overdue balances. The Group does not hold any collateral or other credit enhancements over its trade receivables. The trade and bills receivables are non-interest-bearing.

An aged analysis of the trade and bills receivables as at the end of the reporting period, based on the invoice date and net of provision, is as follows:

<b>Group</b>	<b>As at December 31,</b>	
	<b>2014</b>	2013
	<b><i>RMB'000</i></b>	<i>RMB'000</i>
Within 3 months	<b>336,882</b>	63,470
4 to 6 months	<b>46,383</b>	—
7 to 12 months	<b>13,688</b>	—
Over 1 year	<b>590</b>	—
	<b><u>397,543</u></b>	<u>63,470</u>

No impairment of trade and bills receivables for the year ended December 31, 2014 (2013: Nil) was provided.

## 12. TRADE AND BILLS PAYABLES

An aged analysis of the trade payables of the Group, based on the invoice date, is as follows:

<b>Group</b>	<b>As at December 31,</b>	
	<b>2014</b>	2013
	<b><i>RMB'000</i></b>	<i>RMB'000</i>
1 to 3 months	<b>406,785</b>	187,939
4 to 6 months	<b>13,224</b>	510
7 to 12 months	<b>2,470</b>	2,112
1 to 2 years	<b>1,451</b>	359
2 to 3 years	<b>33</b>	117
	<b><u>423,963</u></b>	<u>191,037</u>

The trade payables are non-interest-bearing and are normally settled on 90-day terms.

## MANAGEMENT DISCUSSION AND ANALYSIS

### Market Review

In 2014, the Chinese government continued its steadfast effort in ensuring the stable and continuous development of its society and economy. The Certification and Accreditation Administration of People's Republic of China (the "CNCA") published the white paper "China Organic Industry Development Report" (《中國有機產業發展報告》) on September 22, 2014, which is the first white paper with a comprehensive summary and systematic research on the overall development of China's organic industry. In recent years, CNCA has issued a series of standards and technical specifications such as National Standard for Organic Product (《有機產品》國家標準), Implementation Rules on Organic Product Certification (《有機產品認證實施規則》) and Measures for the Administration of Organic Product Certification (《有機產品認證管理辦法》), to implement an overall process management covering various aspects of farming, producing, packaging, certifying, selling, etc. for organic products. In order to standardise and legalise the management of organic products, the PRC government has also implemented the "One Product, One Bar-code" traceable management system for organic products. All of the above measures have placed China's organic industry on track for standardization and institutionalization. The PRC certification and accreditation authorities have granted a total of 1.6 billion organic labels with organic codes in 2013. Currently, the annual sales of the PRC organic products is estimated to be in the range between approximately RMB20 billion to RMB30 billion, and China has become the fourth largest organic products consumer country in the world.

According to the white paper, the organic industry in the PRC has developed rapidly over the past two decades. On one hand, the organic industry provides consumers with abundant supply of high-quality, safe and healthy agricultural products. On the other hand, the organic industry reduces the pollution to the ecological environment and the consumption of non-renewable resources. In recent years, with the enhancement of the overall prosperity of the PRC, the living standard of Chinese people has been greatly improved. Along with this trend come higher expectation for overall food products quality, more attention given to daily dietary requirements and higher demand for quality life-style. At the same time, there are increasing concerns over environmental issues, and communities are opting for a more eco-friendly life-style. In this context, organic food products have gradually become more popular with consumers, begun to penetrate into mainstream sales channels and quickly occupied the high-end segment of the market. Meanwhile, the demand for high-end milk products, as fast-consumption products, have grown rapidly year by year, with consumers willing to pay a premium for high-quality dairy products. These trends have become and are expected to be the most imminent and important long-term driving force for the future growth of high-end organic dairy products, and to achieve continuous and positive developments for the organic dairy market segment.

Currently, the consumption of organic dairy products in China is growing rapidly with a constantly expanding consumer group, which demonstrate China's sizable market for organic dairy products. In light of the variety of choices offered by the high-end dairy market, consumers place more and more focus on the high-end dairy products, its production process and concerns over the safety and quality of dairy products, all of which have led to a highly dynamic high-end dairy products market segment.



In addition, the PRC government's determination on its support for the dairy product industry can be demonstrated by its astute regulatory effort and explicit policy on the dairy product industry. It is expected that the development of China's organic dairy products market will continue to accelerate, and certain aspects of organic dairy products industry such as techniques, know-how and quality will continue to be optimized and upgraded.

## **Business Review**

2014 was a milestone year for the Group with the Company's successful listing on the Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") on July 15, 2014 ("Listing Date"). Shengmu, a leading organic dairy company in China, has the largest desert grass-to-glass organic industry system in China, and enjoys a great reputation in the industry. In terms of herd size of organic dairy cows and organic raw milk production volume in 2014, Shengmu is the largest organic dairy company in China. Shengmu is the only vertically integrated organic dairy company in China that meets E.U. organic standards; 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; and the only sizeable dairy company in the PRC to operate a desert "grass-to-glass" organic industry system.

Since its establishment, Shengmu has innovated and adhered to the unique vertically integrated desert grass-to-glass organic industry system to ensure the safety and quality of its products to provide consumers with high-quality organic liquid milk products. Through years of efforts, Shengmu has strictly adhered to the organic production model in every aspect, such as the organic environment, organic planting, organic farming, organic processing and organic product, with the determination to establish a "China Premium Organic Milk Brand" for providing authentic and natural grass-to-glass organic milk for consumers who are keen on healthy living and quality products.

Shengmu's organic dairy products portfolio includes organic whole milk, organic low-fat milk and organic children's milk, all of which are made of organic raw milk produced by self-owned certified organic dairy farms. In order to cater for the market's diversified demands, Shengmu has launched an organic yogurt product series since the second-half of 2014. Furthermore, Shengmu has increased its production capacity with a view to further consolidate its leading position in the organic dairy market by increasing the production lines of organic liquid milk in the second-half of 2014.

The revenue for the year ended December 31, 2014 amounted to approximately RMB2,132 million, representing an increase of 86.4% as compared to RMB1,144 million in 2013.

## **Desert Grass-to-Glass Organic Industry System (“沙漠全程有機產業體系”)**

The “Desert Grass-to-Glass Organic Industry System” is the core business philosophy of Shengmu, the foundation for quality of organic products and the necessary requirement for establishing our self-sustainable ecosphere.

In 2014, Shengmu continued to implement its grass-to-glass organic quality control in producing organic liquid milk, through preserving organic environment, supervising the planting of organic forage, developing its self-owned dairy farms and organic feeding for dairy cow. In addition, Shengmu provided the organic cow dung to Shengmu Forage for recycling as organic fertilizer, and such recycling is comprehensively implemented in the desert organic recycling chain to achieve an organic closed-cycle. While protecting the environment, Shengmu has also built a desert ecological environment by turning desert into oasis.

### **Farming Business**

#### ***Organic Dairy Farming***

As the key component of Shengmu’s “Desert Grass-to-Glass Organic Industry System”, the Group has continued its commitment to organic dairy farming and producing organic raw milk for the year of 2014.

The organic raw milk utilized by the Group has been strictly monitored to ensure the health of dairy cows and the quality of raw milk. The Company is committed to cattle welfare as part of the culture of organic dairy farming. Each dairy cow enjoys an average living space ranging from 60 to 80 square meters as well as the access to “sport fields” for exercising and socializing. Shengmu provides comfortable living environment for dairy cows, with free-stall dairy farms offering easy access to food and water. In order to ensure the dairy cows’ health and further improve milk quality, Shengmu uses different feed formulae developed in-house by employing the total mixed ration (TMR) concept based on the cow’s development stage, lactation stage and milk yield. In relation to healthcare, Shengmu firmly adheres to the policy of “prevention ahead of cure”, and regards dairy cows’ healthcare as one of the most important aspect for the farming management . A majority of Shengmu’s dairy farms have a capacity to house between 2,500 and 4,500 dairy cows, the farm size of which could enable us to achieve great economic benefits without over-exploiting the environment.

### ***Organic Forage Planting***

Organic forage is an essential raw material in organic dairy farming. Shengmu Forage has entered into a long-term strategic cooperation agreement with us, pursuant to which Shengmu Forage will exclusively supply organic forages to us. Shengmu Forage is primarily engaged in organic forage planting and processing. The place for planting organic forage is located in Ulan Buh Desert. With the pollution-free air, soil and water resources, it is a rare piece of land well suited for the organic industry. With the advantageous environment of Ulan Buh Desert, Shengmu Forage has grown the forages without using any agricultural chemicals or chemical synthetic fertilizers. All of the planting fields developed by Shengmu Forage meet the organic standards of both E.U. and China Organic Food Certification Center (中綠華夏有機食品認證中心). Shengmu strictly adheres to the philosophy of “Grass from herd, herd from grass (以牧養草，以草畜牧)”. The fields of Shengmu are fertilized with the fertilizers processed from the organic dairy cow dung, which in turn improve the fertility of the soil gradually, generating both pollution-free and chemical-free organic forage for the exclusive use of our dairy farms.

### ***Innovative Business Models***

The stringent organic standards of Shengmu dairy farms require not only sophisticated and refined management systems, but also a large number of managerial talents for its day-to-day operation. In order to achieve long-term development for both dairy farms and managerial talents, Shengmu adopts two cooperation models for dairy farm management which are considered relatively innovative in the industry: the first is performance guarantee model, and the second is joint equity model. Innovative business models would not only help to ensure that our dairy farms are managed by competent and experienced personnels in accordance with organic standards, but also to motivate the management personnel of the dairy farms as well. Further, the cooperation models have helped many dairy farmers in breaking through technology and financing bottlenecks to achieve a win-win situation.

### **Liquid Milk Business**

#### ***Production and Processing***

In 2014, the Group continued to strictly monitor the production and processing of organic liquid milk. The processing phase includes organic raw milk collection, cooling, pre-treatment, homogenization, UHT, packaging and the final completion of liquid milk products. The Group is equipped with advanced equipment and machines purchased from famous suppliers, such as Tetra Pak (Sweden), for the processing and packaging of organic liquid milk. The Group operated several sets of control systems covering every quality control point and the processing of organic milk in order to ensure the quality safety of the products.

All the raw milk Shengmu used to produce liquid milk products was supplied internally by its organic dairy farms without using any preservatives, artificial coloring or artificial flavoring during the production process. Each of our organic liquid milk product is stamped with CNCA code for tracing the production origin.

### ***Organic Quality Control***

In order to ensure the implementation of Shengmu's desert grass-to-glass organic industry system and its product quality control, the Company continued to implement stringent quality control in 2014 year throughout the production process, such as the procurement and storage of feed, dairy farming, milking and raw milk processing and the storage and transportation of raw milk and finished products.

In terms of organic quality control, the Company adopted a combination of quality examination by internal staff, external institutions and sizeable customers to ensure the strict and consistent implementation of "grass-to-glass" organic management system and to establish stringent organic management practice along the chain from environment, planting, farming to production. In terms of organizational structure, the Company set up an organic management center under the direct supervision of its deputy chief executive officer. The organic management center is managed by officers who have solid knowledge about domestic and E.U. organic standards and are authorized to conduct regular or random inspections on any processing step according to organic standards, in order to ensure the effective operation of the organic industrial chain. In addition, the Company has established an information evaluation center and installed monitoring facilities for key areas of organic and non-organic dairy farms management, through which the Company can keep abreast of the dairy farm's operations to effectively supervise and evaluate farming operations.

In order to ensure the traceability of the grass-to-glass organic process and achieve the seamless integration of upstream and downstream processes, the Company establishes its system by standardizing and recording the procedures for all the key grass-to-glass organic processes according to the characteristics of its business units. The Company records its data by keeping track of organic fields, organic cows and organic products and establishing internal inspection team and other management systems.

External institutions such as ECOCERT S.A. (歐盟認證) and China Organic Food Certification Center, conduct frequent examinations on the Company in accordance with corresponding organic or safety standards in order to monitor the Company's implementation of organic standards. Additionally, Shengmu also assist its major customers by actively cooperating with them in various inspections and providing them with high-quality raw milk which meets their quality standards.

Shengmu has undertaken the implementation of organic standards and achieved the traceability of its organic milk's production origin through internal and external examination and supervisions.

## Non-Organic Dairy Farming

Apart from business operation under the “Desert Grass-to-Glass Organic Industry System” standards, Shengmu also operated non-organic dairy farms in the rural areas of Hohhot, Inner Mongolia for the production of high-quality non-organic raw milk. Likewise, the Company is also committed to provide its non-organic dairy cows with a comfortable and spacious environment as well as nutritious feed for the benefit of their health and milk yield.

Currently, Shengmu’s high-quality non-organic raw milk is sold to major industry players for their further processing into high-end dairy products.

## Herd Size and Production

As of December 31, 2014, we had 19 organic dairy farms in operation, 3 organic dairy farms under construction and 12 non-organic farms in operation. The organic and non-organic herd size of the Group have increased from 30,621 and 29,836 dairy cows as of December 31, 2013 to 64,769 and 38,483 dairy cows as of December 31, 2014 respectively.

	As at December 31,							
	2014				2013			
	Dairy farms	Calves and heifers	Milkable cows	Dairy Cows Subtotal	Dairy farms	Calves and heifers	Milkable cows	Dairy Cows Subtotal
Organic	19	30,768	34,001	64,769	13	13,796	16,825	30,621
Non-organic	12	17,452	21,031	38,483	12	10,811	19,025	29,836
Total	31	48,220	55,032	103,252	25	24,607	35,850	60,457

The Group produced 210,519 tonnes of organic raw milk and 142,765 tonnes of premium non-organic raw milk in 2014, and produced 94,152 tonnes of organic raw milk and 113,253 tonnes of premium non-organic raw milk in 2013. The volume of organic liquid milk products which are 100% processed from raw milk produced by self-owned certified organic dairy farms increased from 20,885 tonnes in 2013 to 62,280 tonnes in 2014.

## **Sales Channels**

### ***Distribution network***

In 2014, based on its nationwide extensive distribution network of organic liquid milk products, Shengmu built up the marketing network in major tier-1 and tier-2 cities of the PRC which had not yet been developed before, such as Harbin, Baotou, Chongqing, Chengdu, Guangzhou and Shenzhen, to broaden Shengmu's marketing network and achieved a comprehensive and thorough penetration into the major tier-1 and tier-2 cities, as well as coverage expansion into supermarkets, department stores, convenience store chains and other sales spot through the sales network from our nationwide distributors.

### ***O2O sales model***

In addition to further expand the traditional distribution network, Shengmu also proactively adopted diversified marketing models to accommodate consumers' online shopping by leveraging on rapid development of the internet and huge number of internet users. The Company officially launched Shengmu organic milk online-to-offline (O2O) marketing method in October 2014, through which the Company tried to create an innovative “exclusive to organic (專屬有機)” model, providing customers with fresher and a more convenient shopping experience and attracting customers who are keen on online shopping. With the support from authorized distributors, Shengmu O2O marketing model integrates online and offline recourses, combining convenient online payment with efficient offline delivery.

## **Brand Building and Strategy**

In 2014, Shengmu built the image of “No. 1 organic milk” through various promotion activities such as packaging, brand activities, exhibitions, online and offline advertisement. These promotion activities help Shengmu to build a unique and distinct brand association in the industry, media and customers' mind, which enhance the brand awareness, influence and credibility of the Shengmu brand. All the above measures laid solid foundations for the expansion to markets nationwide and contribute to the Company's realization of leapfrog development.

In 2014, Shengmu hosted consumers, investors and media several times for visitors who visited the Company's production base in Ulan Buh Desert to experience the production procedures of grass-to-glass organic industrial chain. Through such visits which were labelled as “Shengmu Organic Journey”, visitors gained better knowledge of the “desert grass-to-glass organic industrial chain” of Shengmu, while enhancing their understanding and confidence of the Company's products.

In May 2014, Shengmu participated in the “Shanghai International Organic Food & Green Food Expo”, inviting consumers and industry participants to know more about the spray irrigation ecosystem of organic planting (有機種植噴灌生態圈) in 3D experience zone. Participants gained immersive experience of the grass-to-glass organic life at the display booths simulating the environment in desert with blue sky and green grass.

In late August 2014, Shengmu ran series of advertisements on CCTV2 and CCTV12 to achieve better publicity. We earned trust and recognition from extensive customers, attracted more PRC consumers to understand the “desert grass-to-glass organic industrial chain” and experience the healthiness and happiness of organic lifestyle.

In addition, Shengmu launched a series of offline interactive activities such as, “Organic Day Campaign”, which called for people to support organic, ecological, environment friendly and healthy Organic Day, to live a day of organic life by eating organic food as far as possible and using chemical synthesis products as less as possible, for the purpose of protecting their own health and maintaining environment safety. These activities further deepened the customer loyalty to our brand and the recognition of our brand concept.

In December 2014, with the philosophy of “desert grass-to-glass organic industry system” and the concept of organic food becoming more and more popular, Shengmu set Beijing as the key city to promote its brand through various channels. Shengmu placed digital advertising of “Shengmu Organic Milk” in prominent areas of the Departures Hall in Terminal 2 of Beijing Capital International Airport, targeting high-end consumers and promoting Shengmu’s high-end dairy products. Also, Shengmu advertised on the trains and in the interior of Beijing Metro Line 2 to publicize the concept of “Desert Grass-to-Glass Organic Industry System”, sending consumers the message of Shengmu’s brand philosophy and organic competitive power. The train with Shengmu’s advertising is like a Shengmu Express, reflecting the “Desert Grass-to-Glass Organic Industry System” which embraces the ideas of fields, grass, cows, milk, desert to dining table, driving consumers to a new era of organic life.

## FINANCIAL REVIEW

The Group's business continued to enjoy a rapid growth in 2014. The Group recorded a revenue of RMB2,132.4 million in 2014, representing an increase of 86.4% from RMB1,143.7 million in 2013. The Group's profit attributable to owners of the parent increased by 117.3% from RMB327.3 million in 2013 to RMB711.2 million in 2014.

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

#### Revenue

*Unit: RMB in thousands, except percentages*

For the year ended December 31	Dairy farming business				Liquid milk business				Total revenue
	Segment revenue	Inter-segment sales <sup>(1)</sup>	External sales	External sales	Segment revenue	Inter-segment sales <sup>(1)</sup>	External sales	External sales	
				as % of total revenue				as % of total revenue	
2014	1,810,035	416,918	1,393,117	65.3%	739,311	—	739,311	34.7%	2,132,428
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.

In 2014, the Group's revenue increased by 86.4% over last year, which was mainly driven by both dairy farming business and liquid milk business. In 2014, our external sales for dairy farming business increased by 65.7% over last year, and our revenue for liquid milk business increased by 144.0% over last year. The strong growth of the Group's revenue was mainly attributable to the fact that the Company maintained its leading position in the PRC organic dairy products market in 2014 by increasing its investment in the grass-to-glass organic business, and the sales of both organic raw milk and organic liquid milk rose significantly. Further, as a long-term measure, the Company reinforced its marketing activities on the organic liquid milk business and expanded its coverage and channels for organic liquid milk in 2014. As a result, revenue from organic liquid milk sales has represented a higher percentage of total revenue increased to 34.7% in 2014 from 26.5% in 2013, which indicated that the business focus of the Company was being gradually shifted to liquid milk. The Group expects that the proportion of organic liquid milk to the total revenue will continue to increase.



## Dairy farming business

Unit: RMB in thousands, except percentages

	For the year ended December 31,							
	2014				2013			
	Sales volume (Tonnes)	Average selling price (RMB'000/Tonne)	revenue	% of revenue	Sales volume (Tonnes)	Average selling price (RMB'000/Tonne)	revenue	% of revenue
Organic raw milk								
External sales	132,906	5.51	731,806	40.5%	68,518	5.15	352,918	36.3%
Inter-segment sales	72,586	5.74	416,918	23.0%	23,813	5.52	131,561	13.5%
Subtotal	<u>205,492</u>	<u>5.59</u>	<u>1,148,724</u>	<u>63.5%</u>	<u>92,331</u>	<u>5.25</u>	<u>484,479</u>	<u>49.8%</u>
Premium non-organic raw milk	139,204	4.75	661,311	36.5%	111,465	4.38	487,829	50.2%
Dairy farming	<u>344,696</u>	<u>5.25</u>	<u>1,810,035</u>	<u>100.0%</u>	<u>203,796</u>	<u>4.77</u>	<u>972,308</u>	<u>100.00%</u>

The Group's revenue from its dairy farming business increased by 86.2% from RMB972.3 million in 2013 to RMB1,810.0 million in 2014, which was mainly due to (1) significant increase in sales volume of both organic raw milk and premium non-organic raw milk in 2014 over 2013, of which sales volume of organic raw milk increased by 122.6% from 92,331 tonnes in 2013 to 205,492 tonnes in 2014, and sales volume of premium non-organic raw milk increased by 24.9% from 111,465 tonnes in 2013 to 139,204 tonnes in 2014; and (2) increase in the average selling price of raw milk in 2014 over 2013.

## Liquid milk business

The Group's revenue from its liquid milk business increased by 144.0% from RMB303.0 million in 2013 to RMB739.3 million in 2014, which was mainly due to market recognition of organic liquid milk under the grass-to-glass organic industry chain and the increase in market demands. Meanwhile, the Company actively promoted the diversity of its liquid milk product portfolio by successively launching organic whole milk and organic low-fat milk (business pack) in 2014, and proactively rolling out the first organic yogurt products in the PRC, which powered the enhancement of its market position of high-end liquid milk sector.

	For the year ended December 31,		
	2014	2013	Increase
Revenue (RMB'000)	739,311	302,962	144.0%
Sales volume (Tonnes)	51,248	20,715	147.4%
Average selling price (RMB'000/tonne)	14.43	14.63	-1.4%

## Revenue from organic/non-organic business and their ratio percentage:

Unit: RMB in thousands, except percentages

	For the year ended December 31,		For the year ended December 31,	
	2014		2013	
	Amount	Percentage	Amount	Percentage
Premium non-organic raw milk	661,311	31.0%	487,829	42.6%
Organic products:				
Organic raw milk	731,806	34.3%	352,918	30.9%
Organic liquid milk	739,311	34.7%	302,962	26.5%
Subtotal of organic products	1,471,117	69.0%	655,880	57.4%
<b>Total</b>	<b>2,132,428</b>	<b>100.0%</b>	<b>1,143,709</b>	<b>100.0%</b>

## Cost of sales, gross profit and gross margin

	For the year ended December 31,			For the year ended December 31,		
	2014			2013		
	Cost of sales	Gross profit	Gross margin	Cost of sales	Gross profit	Gross margin
	Amount	Amount	%	Amount	Amount	%
<i>RMB in thousands, except percentages</i>						
<b>Dairy farming business:</b>						
Organic raw milk:						
Before elimination	575,446	573,278	49.9%	271,176	213,303	44.0%
After elimination <sup>(1)</sup>	372,181	359,625	49.1%	201,237	151,681	43.0%
Premium non-organic raw milk	385,062	276,249	41.8%	312,670	175,160	35.9%
Subtotal:						
Before elimination	960,508	849,527	46.9%	583,846	388,462	40.0%
After elimination <sup>(1)</sup>	757,243	635,874	45.6%	513,907	326,841	38.9%
<b>Liquid milk business:</b>						
Before elimination	481,685	257,626	34.8%	200,998	101,964	33.7%
After elimination <sup>(2)</sup>	305,377	433,934	58.7%	139,377	163,585	54.0%
<b>Total</b>	<b>1,062,620</b>	<b>1,069,808</b>	<b>50.2%</b>	<b>653,284</b>	<b>490,425</b>	<b>42.9%</b>

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

The Group's cost of sales increased from RMB653.3 million in 2013 to RMB1,062.6 million in 2014, gross profit increased by 118.1% from RMB490.4 million in 2013 to RMB1,069.8 million in 2014, and gross margin increased from 42.9% in 2013 to 50.2% in 2014.

The increase of cost of sales was mainly due to the expansion of sales scale. In 2014, the cost of sales of the Group increased by 62.7% as compared to 2013. As the increase in cost of sales is less than that of revenue for the same period, the gross profit of the Group increased significantly by 118.1%.

In 2014, the Group recorded a significant increase in gross margin compared with last year, which was mainly due to the increase in the unit selling price of raw milk over last year, and the decrease in average unit cost compared with last year resulting from the economies of scale and the improvement of efficiency of the Group. In respect of product structure, the sales percentage of organic raw milk and organic liquid milk with higher gross margin increased from 57.4% in 2013 to 69.0% in 2014, which led to the enhancement of the Group's gross margin.

### **Other Income and Gains**

The Group's other income and gains increased from RMB6.9 million in 2013 to RMB28.4 million in 2014, which was mainly due to the increase in the government grants and bank interest income received by the Group.

## **Selling and Distribution Expenses**

The Group's selling and distribution expenses include logistics and transportation expenses, advertisement and promotion expenses and employee remunerations. In 2014, the selling and distribution expenses of the Group amounted to RMB128.1 million, representing a significant increase as compared to RMB71.8 million in 2013, which was mainly due to significant increase in the sales volume of both dairy farming business and liquid milk business over the last year. In 2014, with the wider coverage of the distribution network in respect of liquid milk products, as a measure of delivery arrangement, the Company increased its branch warehouses in some important transport hub areas to meet the market demands. Meanwhile, in order to further enhance the exposure and strengthen the consumers' recognition on grass-to-glass organic liquid milk products, the Company has undertaken more advertisement and promotion in 2014.

## **Administrative Expenses**

Administrative expenses primarily consist of salary and welfare, travel expenses and transportation expenses of management and administrative employees. The administrative expenses of the Group amounted to RMB25.4 million and RMB101.7 million in 2013 and 2014, representing 2.2% and 4.8% of the revenue, respectively. The significant increase in 2014 over 2013 was mainly due to: (1) the inclusion of the listing expenses and the amortisation of the fair value of share options granted during the year in the administrative expenses, the listing expenses and the amortisation of the fair value of share options granted during the year of the Group was RMB46.1 million in total and the administrative expenses as a percentage of revenue was 2.2% and 2.6% (on the basis that the listing expenses and abovementioned share option expenses are disregarded), respectively; (2) the expansion of the Company's scale, which led to the increase of administrative staff and the rising of average salary, and thus the total salary and welfare included in the administrative expenses increased as compared to last year.

## **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 RMB9.5 million in 2013 and RMB87.1 million in 2014.

The significant increase of net gains arising from changes in fair value less costs to sell of biological assets in 2014 as compared to last year was mainly due to: (1) an increase in herd size from 60,457 cows as at the end of 2013 to 103,252 cows as at the end of 2014; (2) further optimization of the structure of dairy cows. The organic herd size with higher evaluation as a percentage of overall herd size increased from 50.6% in 2013 to 62.7% in 2014; (3) the number of newly-established and operating dairy farms was greater in 2014 and there was significant increase in the number of milkable cows of the Group as compared with last year, most of which entered into their peak period in milk yield, therefore, the revaluation surplus of each dairy cow increased as compared to last year.

### **Share of Profits and Losses of Associates**

The Group's associates include (a) the companies that were jointly established by the Group and the outstanding distributors in our key distributing cities to distribute the branded liquid milk products of the Group, including mainly Saihan (Shanghai) Industrial Co., Ltd. (賽罕(上海)實業有限公司), Shengmu High-tech (Beijing) Trading Co., Ltd. (聖牧高科(北京)貿易有限公司), Tianjin Mengmu Food Co., Ltd. (天津蒙牧食品銷售有限公司), Anhui Meilichen Trading Co., Ltd. (安徽美粒晨貿易有限公司), Fujian Spring Trading Co., Ltd. (福建省斯博瑞貿易有限公司), and Shenzhen Shengmu Weiye Trading Co., Ltd. (深圳市聖牧偉業貿易有限公司); and (b) 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) and its subsidiary ("Shengmu Forage"), in which the Group invested and held minority interests. The Group recorded share of losses of associates of RMB1.3 million and RMB7.7 million in 2013 and 2014, respectively. The increase in loss from investment is because the associates which are invested and established by the Company with quality distributors in key distribution cities for the purpose of taking initiative in terminal sales are in their initial stage of market development and therefore recorded losses. As the operation of Shengmu Forage, our important forage supplier, improved gradually and the Group increased its equity interests in Shengmu Forage, the Group has recognized investment income for the year based on the profit of Shengmu Forage.

### **Income Tax Expense**

According to the Enterprise Income Tax Law of the PRC ("EIT Law"), the Group's subsidiaries in the PRC are generally subject to a corporate income tax at a rate of 25%. According to the preferential provisions of the 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》(Caishui [2011] No. 58) (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.

Our income tax expenses was RMB3.7 million in 2014, representing a significant increase over RMB0.9 million in 2013, primarily due to the significant increase in the taxable income of Inner Mongolia Shengmu High-tech Milk Company Limited (內蒙古聖牧高科奶業有限公司) (one of our wholly-owned subsidiaries) arising from processing of non-primary agricultural products as compared to last year. Based on the proportion of our income tax expense in the total revenue, the enterprise income tax rate of the Group for 2013 and 2014 are 0.2% and 0.4% respectively.

### **Profit Attributable to Non-controlling Interests**

Profit attributable to non-controlling interest primarily represented the minority interests in our dairy farms held by dairy farmers with whom we cooperate in managing its farms. Profit attributable to non-controlling interest for 2014 was RMB172.6 million, representing a significant increase over RMB47.2 million in 2013, which is mainly due to the increase in both numbers of non-wholly owned subsidiaries and operating profit for the year.

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

#### **Current Assets**

As of December 31, 2014, the total current assets of the Group were RMB2,035.0 million (as compared to RMB635.2 million as of December 31, 2013), primarily consisting of inventories of RMB701.2 million (as compared to RMB335.2 million as of December 31, 2013), trade and bills receivables of RMB397.5 million (as compared to RMB63.5 million as of December 31, 2013), prepayments, deposits and other receivables of RMB185.2 million (as compared to RMB94.4 million as of December 31, 2013) and cash and cash equivalents of RMB734.7 million (as compared to RMB127.1 million as of December 31, 2013).

## Trade and bills receivables

Unit: RMB'000

	As at December 31,	
	2014	2013
Trade receivables	393,443	61,360
Bills receivables	4,100	2,110
	<hr/>	<hr/>
Total	397,543	63,470
	<hr/>	<hr/>

Trade and bills receivables of the Group increased significantly as compared to last year, primarily because the company has changed its sales strategy from delivery against payment strategy in the initial sales period to the grant of credit lines and credit terms according to the industry practice and the sales and credibility of distributors, so as to expand and solidify our organic liquid milk market.

As of March 20, 2015, RMB282.1 million or 71.0% of the outstanding trade receivables of the Group as of December 31, 2014 have been settled.

## Prepayments, deposits and other receivables

The Group's prepayments, deposits and other receivables amounted to RMB185.2 million and RMB94.4 million as of December 31, 2014 and December 31, 2013, respectively, primarily due to the corresponding increase in the prepayments as a result of the increased in purchase by the Group from Shengmu Forage and other forage suppliers.

## Current Liabilities

As of December 31, 2014, the total current liabilities of the Group amounted to RMB2,086.1 million (as compared to RMB1,404.7 million as of December 31, 2013), primarily consisting of trade and bills payables of RMB424.0 million (as compared to RMB191.0 million as of December 31, 2013), receipts in advance of RMB32.4 million (as compared to RMB82.5 million as of December 31, 2013), other payables and accruals of RMB293.4 million (as compared to RMB198.6 million as of December 31, 2013) and interest-bearing bank and other borrowings of RMB1,334.0 million (as compared to RMB932.0 million as of December 31, 2013).

As of December 31, 2014, the total current liabilities of the Group amounted to RMB2,086.1 million, representing a growth of 48.5% as compared to RMB1,404.7 million as of December 31, 2013, primarily due to our business expansion.

## **Foreign Currency Risk**

The Group's businesses are principally located in mainland China and substantially all transactions are conducted in RMB. As at December 31, 2014, the Group did not have significant foreign currency exposure from its operations, except certain bank balances of approximately RMB38.3 million and RMB21.7 million which were denominated in United States dollars and Hong Kong dollars, respectively. In 2014, the Group did not enter into any arrangements to hedge against any fluctuation in foreign currency.

## **Credit Risk**

The Group trades only with recognized and creditworthy third parties. It is the Group's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, we monitor the receivable balances on an on-going basis and the Group's exposure to bad debts is not significant. Credit risk relating to the Group's other financial assets arises from the default of the counterparty with a maximum exposure equal to the carrying amounts of these instruments. Since the Group trades only with recognized and creditworthy third parties, no collateral is required.

## **Charge on Assets**

As of December 31, 2014, the Group has pledged deposits within an aggregate amount of approximately RMB16.4 million (December 31, 2013: RMB15.0 million) to banks in the PRC as deposits for the issuance of letters of credit and bank drafts.

## **Liquidity, Financial Resources and Capital Structure**

In 2014, the Group generally finances its daily operations from internally generated cash flows, the net proceeds from the Global Offering and bank borrowings. As of December 31, 2014, the Group had (a) cash and cash equivalents of RMB734.7 million (December 31, 2013: RMB127.1 million), and (b) interest-bearing bank borrowings and other borrowings of RMB1,484.0 million (December 31, 2013: RMB932.0 million), which were denominated in Renminbi, and RMB150.0 million of which are repayable within two years while the other remaining interest-bearing bank borrowings and other borrowings are repayable within one year. The gearing ratio (calculated as total debt (total borrowings) divided by total capital) was 34.9 % as of December 31, 2014 (December 31, 2013: 54.6%).

## **Capital Commitments**

As of December 31, 2014, the Group's capital commitments amounted to RMB243.0 million (December 31, 2013: RMB86.1 million), primarily relating to the construction and acquisition of plants and the purchase of machinery for the construction of dairy farms. The Group has sufficient internal and financial resources (including the net proceeds from its global offering which was completed on July 15, 2014) to fund its capital expenditures.



## **Human Resources**

As of December 31, 2014, the Group had a total of 3,288 employees. Total staff costs in 2014 (including the emoluments of directors and senior management) amounted to approximately RMB177.2 million (excluding equity-settled share option expenses) (2013: RMB106.7 million).

The Group believes that the dedicated efforts of all of its employees are the very essence of the Group's rapid development and success in the future. The Group provides management personnel and employees with on-the-job education, training and other opportunities to improve their skills and knowledge. In general, the Group determines employee compensation based on each employee's performance, qualifications, position and seniority. The Group has made contributions to the social security funds and housing reserve for its employees in accordance with the relevant national and local social welfare laws and regulations.

The Company has also approved and adopted a pre-IPO share option scheme (the "Pre-IPO Share Option Scheme") and a share option scheme (the "Share Option Scheme"). The purpose of the Pre-IPO Share Option Scheme and the Share Option Scheme is to attract, retain and motivate the directors, senior management and employees of the Group and other participants.

## **Contingent Liabilities**

As at December 31, 2014, the Group did not have any material contingent liabilities.

## **Material Acquisitions and Disposals**

Save for the acquisitions and/or disposals during the reorganization of the Group (the "Reorganization") in anticipation of the listing of the Company, the details of which are set out in the prospectus of the Company dated June 30, 2014 (the "Prospectus"), the Company did not make any material acquisitions and disposals of subsidiaries and associated companies in 2014.

The Company increased its equity interests in Shengmu Forage on December 8, 2014, the details of which are set out in announcement of the Company dated December 8, 2014.

## **Future Plans for Material Investments or Acquisition of Capital Assets and Expected Source of Funding**

Save for those disclosed above in connection with capital commitments under the paragraph headed "Capital Commitments" and those disclosed in the Prospectus under the section headed "Future Plans and Use of Proceeds", the Group does not have any plan for material investments or acquisition of capital assets.

## **Outlook**

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

### **Expand the organic dairy farming operations and ensure product safety and quality**

The Group constructed 6 additional organic dairy farms in 2014, and as of December 31, 2014, we had 19 self-owned certified organic dairy farms in operation and 3 organic dairy farms under construction. We intend to complete the construction of the 3 organic dairy farms under construction in 2015. The Group intends to expand organic herd size principally through the herd's reproduction in self-owned dairy farms. The Group will continue to invest in quality control and product safety, to improve herd's health and the milk yield as well as operation efficiency, for the purpose of long-term performance growth.

The Group will continue to strengthen its cooperation with Shengmu Forage. The Group further invested in Shengmu Forage on December 8, 2014 after which the Group's equity interest in Shengmu Forage increased from 8.6% to 9.01%. Shengmu Forage intended to develop additional organic planting fields of over 140,000 mu in 2015 to meet the Group's growing demand for organic forage.

### **Increasing the liquid milk product processing capacity and expand premium organic product portfolio**

The Group plans to further expand its “Shengmu聖牧” brand of liquid milk business to further improve our profitability. To achieve this, the Group will continue to purchase and construct new production lines to increase its liquid milk processing capacity.

In 2014, the Group continued to offer liquid milk products including organic whole milk, organic low-fat milk and organic children's milk under our “Shengmu聖牧” brand. In order to enrich our organic products portfolio, since July 2014, the Group successfully launched the organic yogurt products which entail relatively larger market demand. In this context, the Group intends to construct additional organic yogurt production lines to improve its production capacity. In 2015, the Group plans to innovate marketing model by opening Shengmu Organic Life Houses (聖牧有機生活館), producing origin-flavored organic yogurt, flavored organic yogurt and fruity organic yogurt with Shengmu features on the premises. We will exhibit the processing techniques for consumers to sight every production step so as to create new attractions in addition to Shengmu's “organic” concept. In addition to attract consumers' purchases through personalized business model and diversified operation method, Shengmu Organic Life Houses can also enhance consumers' recognition of our brand and

increase our reputation through words of mouths. In 2015, the Group plans to build production bases of low-temperature products which are expected to commence production in the fourth quarter. The Group will constantly launch new products to enrich the liquid milk products portfolio by leveraging the increasing organic raw milk production volume, sharing its existing and new processing capacity, marketing and distribution platforms, as well as benefiting from the increasingly recognized brand.

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

The Group plans to continue selling liquid milk products through distributors and expanding its distribution channel in major tier-1 and tier-2 cities and increasing its investment in tier-3 and tier-4 cities by engaging more distributors in those areas. In terms of retail spots, the Group intends to further increase our product presence at department stores and large chain-supermarkets, as these markets are platforms to exhibit and promote Shengmu brand to enhance brand awareness and to improve product experience. The Group will also be focusing on expanding our business into channels such as convenience store chains around communities and super community stores, which will become the markets for Shengmu's future sales of liquid milk products. Additionally, the Group plans to further develop online-to-offline (O2O) sales channels to reach a wider customer base. To ensure prompt delivery of products to our rapidly growing customers, in 2015, we plan to set up additional regional distribution centers by leasing warehouse facilities close to regional transportation hubs throughout China and purchase or lease trucks to establish our own delivery fleet to support our sales growth.

The Group also intends to enhance “Shengmu” brand recognition and solidify its high-end image in the target markets through the following initiatives: (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 our own brand; (ii) promoting the establishment of more Shengmu Organic Life House 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 (iii) demonstrating the “Desert Grass-to-Glass Organic Industry System” through more open-house events at our dairy farms and production facilities, so as to let consumers gain the immersive experience of the organic, green, environmentally friendly “grass-to-glass” journey.

## **CORPORATE GOVERNANCE**

We have adopted, applied and complied with the code provisions contained in the Code on Corporate Governance Practices (the “Corporate Governance Code”) as set out in Appendix 14 to the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (the “Listing Rules”) since the Listing Date to December 31, 2014, except for provision A2.1 of the Corporate Governance Code disclosed below.

Pursuant to provision A2.1 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.

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

The Company has adopted a code of conduct regarding securities transactions on terms no less exacting than the required standard of dealings 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 throughout the period from the Listing Date to December 31, 2014.

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

From the Listing Date up to December 31, 2014, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's listed securities.

## **USE OF NET PROCEEDS FROM THE GLOBAL OFFERING**

The net proceeds from the Company's Global Offering amounted to approximately RMB801.2 million. Such net proceeds are intended to be or have been applied in accordance with the proposed applications as set out in the section headed "Future Plans and Use of Proceeds" in the Company's prospectus dated June 30, 2014.

Up to December 31, 2014, the net proceeds had been applied as follows:

	<b>Utilized Amount as at December 31, 2014</b>
	<b>RMB'000</b>
Constructing 6 new organic dairy farms	58,150
Acquiring dairy cows from domestic or overseas markets	59,250
Sales and marketing activities and expansion of our distribution network	31,060
Expanding the liquid milk production capacity of the Group	37,360
Repayment of loan	120,180
Additional working capital and other general corporate purpose	70,060
	<hr/>
Total:	<b>376,060</b>
	<hr/>

## **AUDIT COMMITTEE**

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 annual results for 2014.

## **SCOPE OF WORK OF ERNST & YOUNG**

The financial figures in respect of the preliminary announcement of the Group's results for the year ended December 31, 2014 have been agreed by the Group's auditors, Ernst & Young, to the amounts set out in the Group's draft consolidated financial statements for the year. The work performed by Ernst & Young in this respect did not constitute an assurance engagement in accordance with Hong Kong Standards on Auditing, Hong Kong Standards on Review Engagements or Hong Kong Standards on Assurance Engagements issued by the Hong Kong Institute of Certified Public Accountants and consequently no assurance has been expressed by Ernst & Young on the preliminary announcement.

## **DIVIDEND**

The board of directors does not recommend the payment of final dividend for the year ended December 31, 2014 (2013 : Nil).

## **ANNUAL GENERAL MEETING AND CLOSURE OF REGISTER OF MEMBERS**

The forthcoming annual general meeting of the Company will be held on Wednesday, June 10, 2015. For determining the entitlement to attend and vote at the annual general meeting, the register of members of the Company will be closed from June 8, 2015 to June 10, 2015, both days inclusive. In order to be eligible to attend and vote at the above meeting, unregistered holders of shares of the Company should ensure that all share transfer documents accompanied by the relevant share certificates must be lodged with the Company's branch share registrar in Hong Kong, Tricor Investor Services Limited, at Level 22, Hopewell Centre, 183 Queen's Road East, Hong Kong for registration not later than 4:00 p.m. on June 5, 2015.

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

This annual 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 annual report of the Company for the year of 2014 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, March 26, 2015

*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.*