CHINA SHENGMU ORGANIC MILK LIMITED
中國聖牧有機奶業有限公司

(Incorporated in the Cayman Islands with limited liability)

(Stock Code: 1432)

INTERIM RESULTS ANNOUNCEMENT FOR THE SIX-MONTHS PERIOD ENDED JUNE 30, 2018

FINANCIAL HIGHLIGHTS

	For the six-month period ended June 30,		
	2018	2017	**Movements**
	RMB'000	RMB'000	
Revenue	**1,400,105**	1,152,184	**21.5%**
Gross profit	**435,045**	500,413	**(13.1%)**
(Loss)/profit for the period	**(1,186,474)**	131,388	**(1,003.0%)**
(Loss)/profit for the period before fair value adjustment of biological assets	**(300,403)**	193,313	**(255.4%)**
(Loss)/profit attributable to owners of the parent	**(1,066,894)**	6,381	**(16,819.9%)**
(Loss)/profit attributable to owners of the parent before fair value adjustment of biological assets	**(372,674)**	96,834	**(484.9%)**

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

Translated English names of Chinese natural persons, legal persons, governmental authorities, institutions or other entities for which no official English translation exists are unofficial translations for identification purpose only.

The board (the "**Board**") of directors (the "**Directors**") of China Shengmu Organic Milk Limited (the "**Company**" or "**China Shengmu**") herein presents the unaudited consolidated interim results of the Company and its subsidiaries (the "**Group**"or "**Shengmu**") for the six-month period ended June 30, 2018 (the "**2018 Interim Period**" or the "**Interim Period**"), together with the comparative figures for the corresponding period in 2017 as follows:

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

	Notes	**For the six-month period ended June 30, 2018**	June 30, 2017
		(unaudited) RMB'000	(unaudited) RMB'000
REVENUE	4	**1,400,105**	1,152,184
Cost of sales		**(965,060)**	(651,771)
Gross profit		**435,045**	500,413
Loss arising from changes in fair value less costs to sales of biological assets		**(886,071)**	(61,925)
Other income and losses	5	**(486,387)**	(85,435)
Selling and distribution expenses		**(114,888)**	(120,659)
Administrative expenses		**(49,525)**	(50,949)
Finance costs		**(75,753)**	(68,386)
Other expenses		**(104)**	—
Share of profits and losses of associates		**(3,673)**	(7,425)
(LOSS)/PROFIT BEFORE TAX		**(1,181,356)**	105,634
Income tax (expense)/credit	6	**(5,118)**	25,754
(LOSS)/PROFIT FOR THE PERIOD		**(1,186,474)**	131,388
OTHER COMPREHENSIVE (LOSS)/ INCOME			
Exchange differences on translation of foreign operations		**(4,198)**	634
Net other comprehensive (loss)/income to be reclassified to profit or loss in subsequent periods		**(4,198)**	634
TOTAL COMPREHENSIVE (LOSS)/ INCOME FOR THE PERIOD		**(1,190,672)**	132,022

	Notes	For the six-month period ended June 30, 2018	June 30, 2017
		(unaudited)	(unaudited)
		RMB'000	RMB'000
(Loss)/profit attributable to:			
Owners of the parent		**(1,066,894)**	6,381
Non-controlling interests		**(119,580)**	125,007
		(1,186,474)	131,388
Total comprehensive (loss)/income attributable to:			
Owners of the parent		**(1,071,092)**	7,015
Non-controlling interests		**(119,580)**	125,007
		(1,190,672)	132,022
(Loss)/earnings per share attributable to ordinary equity holders of the parent:	7		
Basic		**(RMB0.168)**	RMB0.001
Diluted		**(RMB0.168)**	RMB0.001

INTERIM CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION

	Notes	As at June 30, 2018	December 31, 2017
		(unaudited)	(audited)
		RMB'000	RMB'000
NON-CURRENT ASSETS			
Property, plant and equipment		**2,738,310**	2,798,328
Prepaid land lease payments		**37,324**	36,550
Other intangible assets		**14,014**	13,611
Investments in associates		**102,110**	105,784
Available-for-sale investments		**2,007**	2,007
Biological assets	9	**3,027,820**	3,867,389
Prepayments for property, plant and equipment and biological assets		**1,367**	6,209
Long term receivables		**14,059**	14,059
Deferred tax assets		**27,209**	32,197
Other non-current assets		**42,100**	39,212
Total non-current assets		**6,006,320**	6,915,346
CURRENT ASSETS			
Inventories		**551,709**	860,828
Biological assets	9	**4,713**	33,511
Trade and bills receivables		**777,611**	1,100,006
Prepayments, deposits and other receivables		**979,154**	898,837
Pledged deposits		**369,477**	128,884
Cash and bank balances		**242,346**	582,283
Total current assets		**2,925,010**	3,604,349

	Notes	As at June 30, 2018	As at December 31, 2017
		(unaudited)	(audited)
		RMB'000	RMB'000
CURRENT LIABILITIES			
Trade and bills payables		**1,525,774**	1,188,964
Receipts in advance		**170,865**	14,700
Other payables and accruals		**467,031**	441,718
Interest-bearing bank and other borrowings		**2,423,613**	2,654,046
Income tax payable		**1,455**	1,455
Total current liabilities		**4,588,738**	4,300,883
NET CURRENT LIABILITIES		**(1,663,728)**	(696,534)
TOTAL ASSETS LESS CURRENT LIABILITIES		**4,342,592**	6,218,812
NON-CURRENT LIABILITIES			
Interest-bearing bank and other borrowings		**91,866**	720,201
Long term payables		**53,888**	82,829
Total non-current liabilities		**145,754**	803,030
Net assets		**4,196,838**	5,415,782
EQUITY			
Equity attributable to owners of the parent			
Share capital	10	**50**	50
Reserves		**3,281,417**	4,356,281
		3,281,467	4,356,331
Non-controlling interests		**915,371**	1,059,451
Total equity		**4,196,838**	5,415,782

INTERIM CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

	For the six-month period ended	
	June 30, 2018	June 30, 2017
	(unaudited)	(unaudited)
	RMB'000	RMB'000
Net cash flows from operating activities	**677,520**	28,297
Net cash flows used in investing activities	**(35,848)**	(667,027)
Net cash flows (used in)/from financing activities	**(696,781)**	785,671
NET (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS	**(55,109)**	146,941
Cash and cash equivalents at beginning of period	**297,672**	932,382
Effect of foreign exchange rate changes, net	**(417)**	1,893
CASH AND CASH EQUIVALENTS AT END OF PERIOD	**242,146**	1,081,216

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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 2018 Interim Period, 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. BASIS OF PREPARATION AND CHANGES TO THE GROUP'S ACCOUNTING POLICIES

Basis of preparation

The interim condensed consolidated financial statements for the six-month period ended June 30, 2018 have been prepared in accordance with IAS 34 *Interim Financial Reporting*.

The interim condensed consolidated financial statements do not include all the information and disclosures required in the annual financial statements, and should be read in conjunction with the Group's annual financial statements as at December 31, 2017.

Going concern

The Group had net current liabilities of RMB1,663,728,000 as at June 30, 2018 (as at December 31, 2017: net current liabilities of RMB696,534,000). In view of the net current liabilities position, the board of 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 unutilised banking facilities of RMB1,848,815,000 and unused credit facility of super short- term notes of RMB1,300,000,000 and unused credit facility of medium-term notes of RMB300,000,000 available as at June 30, 2018, 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 Directors have prepared the consolidated financial statements on a going concern basis.

2. BASIS OF PREPARATION AND CHANGES TO THE GROUP'S ACCOUNTING POLICIES (continued)

Going concern (continued)

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.

Changes in accounting policies and disclosures

The accounting policies adopted in the preparation of the unaudited interim condensed consolidated financial statements are consistent with those followed in the preparation of the Group's annual consolidated financial statements for the year ended December 31, 2017, except for the adoption of new and revised IFRSs effective as at January 1, 2018. The Group has not early adopted any other standards or amendments that have been issued but are not yet effective.

Amendments to IFRS 2	*Classification and Measurement of Share-based Payment Transactions*
Amendments to IFRS 4	*Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts*
IFRS 9	*Financial Instruments*
IFRS 15	*Revenue from Contracts with Customers*
Amendments to IFRS 15	*Clarifications to IFRS 15 Revenue from Contracts with Customers*
Amendments to IAS 40	*Transfers of Investment Property*
IFRIC 22	*Foreign Currency Transactions and Advance Consideration*
Included in Annual Improvement to IFRSs 2014-2016 Cycle	*Amendments to IFRS 1 and IAS 28*

2. BASIS OF PREPARATION AND CHANGES TO THE GROUP'S ACCOUNTING POLICIES (continued)

Changes in accounting policies and disclosures (continued)

1. The Group adopts IFRS 9 from January 1, 2018. The impacts relate to the classification and measurement and the impairment requirements are summarised as follows:

   (a) Classification and measurement

   The adoption of IFRS 9 by the Group does not have a significant impact on the classification and measurement of its financial assets. The Group continues measuring at fair value all financial assets currently held at fair value. Equity investments currently held as available for sale are measured at fair value through other comprehensive income as the investments are intended to be held for the foreseeable future and the Group expects to apply the option to present fair value changes in other comprehensive income. Gains and losses recorded in other comprehensive income for the equity investments cannot be recycled to profit or loss when the investments are derecognised.

   (b) Impairment

   IFRS 9 requires an impairment on debt instruments recorded at amortised cost or at fair value through other comprehensive income, lease receivables, loan commitments and financial guarantee contracts that are not accounted for at fair value through profit or loss under IFRS 9, to be recorded based on an expected credit loss model either on a twelve-month basis or a lifetime basis. The Group will apply the simplified approach and record lifetime expected losses that are estimated based on the present values of all cash shortfalls over the remaining life of all of its trade receivables. Furthermore, the Group will apply the general approach and record twelve- month expected credit losses that are estimated based on the possible default events on its other receivables within the next twelve months.

2. BASIS OF PREPARATION AND CHANGES TO THE GROUP'S ACCOUNTING POLICIES (continued)

Changes in accounting policies and disclosures (continued)

The reconciliation of the impairment provision of financial assets by adopting IFRS 9 as at the initial applicable date of January 1, 2018 is as follows:

	Impairment provision under IAS 39 and IAS 37 December 31, 2017	Impairment provision under IFRS 9 ((a), (b))		
		Reclassifed	Remeasured	January 1, 2018
	RMB'000	RMB'000	RMB'000	RMB'000
Trade and other receivables, except for prepayments	1,399,568	–	(3,772)	1,395,796
Total	1,399,568	–	(3,772)	1,395,796

The impact of the Group's statement of changes in equity by adopting IFRS 9 as at the initial applicable date of January 1, 2018 is as follows:

	Opening balances ((a), (b))			
	Attributable to owners of the parent			
	Retained Earnings	Other Reserve	Total Reserve	Non-controlling Interests
	RMB'000	RMB'000	RMB'000	RMB'000
As at December 31, 2017	1,596,598	2,759,683	4,356,281	1,059,451
Increase in provision for trade and other receivables except for prepayments and contract assets, net of tax	(3,772)	–	(3,772)	–
As at January 1, 2018	1,592,826	2,759,683	4,352,509	1,059,451

2. **BASIS OF PREPARATION AND CHANGES TO THE GROUP'S ACCOUNTING POLICIES (continued)**

Changes in accounting policies and disclosures (continued)

2. The Group adopts IFRS 15 and Amendments to IFRS 15 from January 1, 2018. IFRS 15, issued in May 2014, establishes a new five-step model to account for revenue arising from contracts with customers. Under IFRS 15, revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The principles in IFRS 15 provide a more structured approach for measuring and recognising revenue. The standard also introduces extensive qualitative and quantitative disclosure requirements, including disaggregation of total revenue, information about performance obligations, changes in contract asset and liability account balances between periods and key judgements and estimates. The standard will supersede all current revenue recognition requirements under IFRSs. Either a full retrospective application or a modified retrospective adoption is required on the initial application of the standard. In April 2016, the IASB issued amendments to IFRS 15 to address the implementation issues on identifying performance obligations, application guidance on principal versus agent and licences of intellectual property, and transition. The amendments are also intended to help ensure a more consistent application when entities adopt IFRS 15 and decrease the cost and complexity of applying the standard.

   The transitional adjustment to be made on January 1, 2018 upon initial adoption of IFRS 15 isn't material to the Group. The Group's principal activities consist of the sales of raw milk and dairy products. The impacts arising from the adoption of IFRS 15 on the Group are not significant.

   In addition to IFRSs that disclosed the impact to the Group, the Group first applied other IFRSs listed above on January 1, 2018, but the application of other IFRSs has had no financial effect on the amounts reported in these condensed consolidated financial statements.

3. OPERATING SEGMENT INFORMATION

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

(a) Dairy farming – breeding dairy cows to produce and distribute raw milk;

(b) Liquid milk products – producing and distributing self-owned brand ultra-heat treated liquid milk, organic yogurt and other dairy products.

Management monitors the results of the Group's operating segments separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on reportable segment profit/(loss), which is a measure of adjusted profit/(loss) for the period. The adjusted profit/(loss) for the period is measured consistently with the Group's profit after tax except that gain/(loss) arising from fair value less costs to sales 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 as compared to the results of other entities that operate within the dairy farming industry.

Segment assets exclude unallocated head office and corporate assets as these assets are managed on a group basis.

Segment liabilities exclude unallocated head office and corporate liabilities as these liabilities are managed on a group basis.

3. OPERATING SEGMENT INFORMATION (continued)

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 and internally agreed between dairy farming segment and liquid milk products segment.

For the six-month period ended June 30, 2018 (unaudited)	Dairy farming RMB'000	Liquid milk products RMB'000	Total RMB'000
Segment revenue			
Sales to external customers	**919,705**	**480,400**	**1,400,105**
Intersegment sales	**207,040**	**—**	**207,040**
	1,126,745	**480,400**	**1,607,145**
Reconciliation			
Elimination of intersegment sales			**(207,040)**
Revenue			**1,400,105**
Segment results	**173,894**	**(577,749)**	**(403,855)**
Reconciliation			
Elimination of intersegment results			**99,428**
Loss arising from changes in fair value less costs to sales of biological assets			**(886,071)**
Corporate and other unallocated expenses			**4,024**
Loss for the period			**(1,186,474)**
As at June 30, 2018 (unaudited)			
Segment assets	**9,027,171**	**2,086,858**	**11,114,029**
Reconciliation			
Elimination of intersegment receivables			**(2,304,646)**
Corporate and other unallocated assets			**121,947**
Total assets			**8,931,330**
Segment liabilities	**4,098,164**	**2,872,655**	**6,970,819**
Reconciliation			
Elimination of intersegment payables			**(2,304,646)**
Corporate and other unallocated liabilities			**68,319**
Total liabilities			**4,734,492**

3. **OPERATING SEGMENT INFORMATION (continued)**

For the six-month period ended June 30, 2017 (unaudited)	Dairy farming RMB'000	Liquid milk products RMB'000	Total RMB'000
Segment revenue			
Sales to external customers	454,814	697,370	1,152,184
Intersegment sales	880,239	—	880,239
	1,335,053	697,370	2,032,423
Reconciliation			
Elimination of intersegment sales			(880,239)
Revenue			1,152,184
Segment results	517,653	(162,539)	355,114
Reconciliation			
Elimination of intersegment results			(155,475)
Loss arising from changes in fair value less costs to sales of biological assets			(61,925)
Corporate and other unallocated expenses			(6,326)
Profit for the period			131,388
As at December 31, 2017 (audited)			
Segment assets	9,993,243	2,437,525	12,430,768
Reconciliation			
Elimination of intersegment receivables			(2,212,939)
Corporate and other unallocated assets			301,866
Total assets			10,519,695
Segment liabilities	4,250,247	2,741,230	6,991,477
Reconciliation			
Elimination of intersegment payables			(2,212,939)
Corporate and other unallocated liabilities			325,375
Total liabilities			5,103,913

4. REVENUE

Revenue represents the net invoiced value of goods sold, after allowances for returns and trade discounts. Revenue of the Group from contracts with customers is as follows:

	For the six-month period ended June 30, 2018 (unaudited) RMB'000	2017 (unaudited) RMB'000
Types of goods		
– Raw milk	**919,705**	454,814
– Liquid milk products	**480,400**	697,370
	1,400,105	1,152,184
Geographical region		
– PRC	**1,400,105**	1,152,184
Timing of revenue recognition		
– At a point in time	**1,400,105**	1,152,184

5. OTHER INCOME AND LOSSES

An analysis of other income and losses is as follows:

	For the six-month period ended June 30,	
	2018	2017
	(unaudited)	(unaudited)
	RMB'000	RMB'000
– Government grants	**5,524**	60
– Bank interest income	**2,110**	4,051
– Impairment of trade receivables and other receivables	**(496,648)**	(72,234)
– Loss from sales of raw materials	**(2,480)**	(17,030)
– Foreign exchange differences, net	**6,888**	1,866
– Loss on disposal of items of property, plant and equipment	**(443)**	(1,991)
– Others	**(1,338)**	(157)
	(486,387)	(85,435)

6. INCOME TAX (EXPENSE)/CREDIT

	For the six-month period ended June 30,	
	2018	2017
	(unaudited)	(unaudited)
	RMB'000	RMB'000
Current - PRC	**130**	148
Deferred	**4,988**	(25,902)
	5,118	(25,754)

7. (LOSS)/EARNINGS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE PARENT

The basic loss per share amount for the six-month period ended June 30, 2018 is calculated by dividing the loss for the period attributable to ordinary equity holders of the parent of RMB1,066,894,000 (profit for the six-month period ended June 30, 2017: RMB6,381,000), by the weighted average number of ordinary shares of 6,354,400,000 (for the six-month period ended June 30, 2017: 6,354,400,000) of the Company in issue during the period.

The diluted earnings per share amount is calculated by dividing the (loss)/profit for the period 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.

	Number of shares For the six-month period ended June 30	
	2018	2017
Weighted average number of ordinary shares in issue during the period used in the basic earnings per share calculation	**6,354,400,000**	6,354,400,000
Effect of dilution of share options	**—**	—
Weighted average number of ordinary shares in issue during the period used in the diluted earnings per share calculation	**6,354,400,000**	6,354,400,000

8. DIVIDEND

The Directors do not recommend the payment of any interim dividend for the six-month period ended June 30, 2018 (for the six-month period ended June 30, 2017: Nil).

9. BIOLOGICAL ASSETS

The biological assets of the Group comprise primarily dairy cows held to produce raw milk and beef cattle raised for sale.

(A) Quantity of biological assets

The quantity of biological assets owned by the Group as at 30 June 2018 and 31 December 2017 is shown below. The Group's biological assets include milkable cows, heifers and calves, beef cattle. Heifers and calves are dairy cows that have not had their first calves. The Group's beef cattle are raised for sale.

	As at	
	June 30, 2018	December 31, 2017
	(unaudited)	(audited)
	Head	Head
Milkable cows	**76,334**	72,959
Heifers and calves	**40,578**	51,383
Beef cattle	**1,819**	7,675
Total	**118,731**	132,017

(B) Value of biological assets

The value of Group's biological assets as at June 30, 2018 and December 31, 2017 is as follows:

	As at	
	June 30, 2018	December 31, 2017
	(unaudited)	(audited)
	RMB'000	RMB'000
Milkable cows	**2,182,058**	2,720,866
Heifers and calves	**845,762**	1,146,523
Beef cattle	**4,713**	33,511
Total	**3,032,533**	3,900,900

The Group's biological assets 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 and principal valuation assumptions used in the determination of the fair value of dairy cows are the same as those set out in the Group's 2017 annual report.

10. ISSUED CAPITAL

The Company was incorporated in the Cayman Islands on December 11, 2013. As at June 30, 2018 and December 31, 2017, the Company has authorized share capital of HK$300,000, divided into 30,000,000,000 shares with a par value of HK$0.00001 each.

As at June 30, 2018 and December 31, 2017, the Company's issued share capital was HK$63,544 with 6,354,400,000 shares in issuance.

MANAGEMENT DISCUSSION AND ANALYSIS

MARKET OVERVIEW

According to relevant data, the outputs of milk products and dairy products in China reached 36.55 million tonnes and 29.35 million tonnes respectively in 2017, with the total scale only second to India and the United States, and ranking the third in the world. Now dairy industry has become one of the most vigorous and fastest growing industries in the modern agriculture and food industry.

On May 23, 2018, *the Opinions on Accelerating the Revitalization of Dairy Industry and Ensuring the Quality of Safety of Dairy Products* was passed in the executive meeting of the State Council, and the comprehensive deployment has been made on such aspects as the construction of the milk source bases, processing and circulation of dairy products, safety supervision on the dairy product quality and guidance for consumption. Yu Kangzhen, the Vice Minister of the Ministry of Agriculture and Rural Affairs held that: Firstly, we should properly raise cows and we should consolidate the foundation for the construction of high-quality milk source bases. We should carry out the genetic improvement plan of cows, build the national core cow breeding farms, step up the standardized and big-scaled raising of cow, substantially increase the proportion of the farms whose massive cultivation rate are more than 100 cows respectively, and steadily enhance the per head yield of cows; Secondly, we should strengthen supervision; namely, we should enhance the quality and safety level of fresh and raw milk. We should perfect the standards and specifications of cow cultivation, establish and perfect standardized production system for fresh and raw milk, implement the responsibility system with the cultivators as the main body, and constantly enhance the output level. Thirdly, we should promote fusion; namely, we should perfect the mechanism of linking cultivation, processing and benefits; and fourthly, we should establish a good brand; namely, we should strengthen the influence of the dairy industry in China as well as the confidence of consumers.

On June 28, Gao Hongbin, Honorary Chairman of the Dairy Association of China said at the 9th Chinese Dairy Industry Conference & 2018 Chinese Dairy Industry Exhibition in Chengdu, "Our enterprises have already laid the foundation for tremendously increasing the production capacity in a short period." He also added that given the factors such as the importation of dairy products, the market prices of dairy products in China are still at the low level; "however, they are poised for retaking the market shares. They will witness a large-scale explosion in the output so long as the market shifts to a good trend."

The healthy development of the dairy industry concerns the benefits of the great number of dairy farmers, as well as the safety of milk products and the health of the masses. China is a large country in terms of production and consumption of dairy products. It is the only road for the country to revitalize its milk industry by making larger and stronger the Chinese dairy industry, producing high-quality dairy products and cultivating the world-known milk brands.

BUSINESS REVIEW

The business of the Group includes the cow breeding and liquid milk businesses.

By virtue of its industrial theory of the sand and grass industry, Shengmu has successfully converted the Ulan Buh Desert with an area of 200 square kilometers into an oasis, created the pollution-free and zero-additive organic milk produced in deserts, thus has realized the whole-process organic industrial chain mode in the desert which covers the tree planting, grass planting, sand treatment, factory building, cow cultivation, milk production and processing. By means of controlling all links in the production, the Company produces the good-quality milk which has passed the ECOCERT and the China Organic Food Certification Center. Shengmu has combined the ecology and industry and blended the enterprise development and ecological treatment in the Ulan Buh Desert so as to realize the economization of ecotype resource and initiated the new mode of desert treatment.

Ulan Buh Desert is located at the golden milk source belt at the 40 degrees north latitude, thanks to the fertile soils and adequate water resource in the upstream of the Yellow River formed by the alluviation. The Group has made full use of the little pollution, the precious little bacteria, viruses and pests as well as the favorable climate as to the adequate sunlight in the desert hinterland to form the standard cow cultivation system with the characteristics of Shengmu in the aspects of feeding with proper nutrition, breeding in a healthy manner, and putting feces back to the fields. As the result, it has produced the raw milk whose nutritive standard and hygiene standard are higher than the industrial one.

Facing the intense and changing market competition, the Group will accelerate the construction of the corporate culture, brand, bases, cooperative partners and team in 2018. By exporting corporate culture, inspiration of career, strict training, the Company strives to create a great team; and by conducting the high-end orientation and adhering to the principle of "price and mark the first and exclusive," it strives to make its cooperative partners stronger, and share benefits with and make common progress with them.

The first half of 2018 has witnessed the slide in price of raw milk in the main producing areas in China on a year-on-year basis; the milk price in the upstream was still weak. Given the influence by the overall environment of the industry, as well as the optimization, adjustment and innovation in the fields of sales channels, brand promotion and partners and teams since 2018, the Group is in the orderly promotion of the work at such stage; and its still needs time to reach perfection. In the 2018 Interim Period, the Group initiatively adjusted its sales structure of the downstream products and upstream products so as to match the new sales strategy of the organic milk; namely, "sales-oriented production for end product freshness" (以銷定產，保證終端產品的新鮮度). On the one hand, it reduced the output of liquid milk of its self-owned brands, strengthened the receivable management, and optimized the quality of sales outstanding of the Group; on the other hand, the Group had increased the sales volume of raw milk to the clients in the industry by virtue of its excellent cooperative relationship with the clients in the industry. As the result, it had provided protection for the steady operation of the Group by virtue of the high-quality sales cash flows.

In the 2018 Interim Period, revenue of the Group reached RMB1,400.1 million, up by 21.5% as compared with the first half of 2017 (the "**2017 Interim Period**"). The rate of received payment of product sales in the Interim Period exceeded 90.0%.

Herd Size and Production Volume

On June 30, 2018, the quantity of dairy herds of the Group was 116,912 heads, including 89,607 heads which produce organic milk, and 27,305 heads which produce non-organic milk. In the 2018 Interim Period, the Group had produced a total of 244,551 tonnes of organic raw milk and 95,030 tonnes of high-quality non-organic raw milk. Moreover, the output of the organic liquid milk under its self-owned brands which was produced from the raw milk supplied by the organic farms with the full self-owned certification was 37,193 tonnes.

Market Promotion

The first half of 2018 saw the slide in the prices of the raw milk in the main producing areas in China on a year-on-year basis; and the milk prices in the upstream was still weak. Given the influence by the overall environment of the industry, as well as the optimization, adjustment and innovation in the fields of sales channels, brand promotion and partners and teams since 2018, the Group is in the orderly promotion of the work at such stage; and it still needs time to reach perfection.

Comprehensively upgrade products and establish the high-end and new image of Shengmu brand

At the beginning of 2018, the Group systematized and planned the current products, and redefined the segments of the online and offline products. It had completed the design and perfection of 7 product series. By means of its high-end product image, it has further strengthened the feeling with consumers.

Create organizational structure, focus on creating the markets in its bases and the market development tends to be positive

At the beginning of 2018, the Group separated the marketing center from the Group and established the business unit, which had achieved the goal of full empowerment, flat management and more flexible decision-making.

For the marketing and promotion, it focuses on creating and establishing the markets in the bases. For the development of new markets, it had implemented the flattening of channels to cooperate with the online business. At present, the Company's sales system has approximately 500 distributors. Meanwhile, the market prices of its products tended to be stable, with the increased profit space, and basically realized the zero sales on account.

Expand new business forms and facilitate the great development of undertaking

Traditional E-commerce: For the traditional E-commerce, it adopted the differentiated competitive tactics and implemented the customer experience-type marketing. By combining with Shengmu's whole industrial chain and production of high-quality organic milk, the two major advantages, it had created the exclusive ranches with Jingdong and Suning to create the online Shengmu Brand Day. Also, it had invited online celebrities to conduct live broadcasting in the hinterland in the Ulan Buh Desert. Making use of the advantages of such online celebrities, the Group had let more consumers witness the whole industrial chain mode of Shengmu.

New-type E-commerce platform: From 2017, the Group began its cooperation with the social-type E-commerce enterprises with Yunji as the representative, thus entering this field earlier than the competitors. Meanwhile, Yunji had given more chances to the Company to demonstrate its brands. Its sales in the first half of 2018 has been close to the total sales of 2017.

The Group had optimized the innovative sales channels, focused on expanding such new business forms as high-end markets and supermarkets, fully integrating the advantageous resources, set up the strategic cooperation with such known platforms as T-mall, Jingdong and Yunji, as well as such big names as PetroChina, Starbuck, Holiland and Siebel, customized the exclusive products and expanded the market shares.

Strengthen the brand building and promotion, and enhance the brand influence

Desert Miracle---the large experience-type activity of organic milk: To let more consumers learn about the Ulan Buh Desert, the base of milk source of Shengmu and its whole-process industrial chain, Shengmu upgraded the Tour of Discovering the Ulan Buh Desert and enrichened the form and contents of the activity in 2018. To fully empower the activity, it is expected that more than 10,000 people over the country, including business partners, consumers and media people will join the activity, feel the great undertaking of Shengmu at the site and increase the recognition of the society to the enterprise.

VR immersed experience: The whole industrial base of Shengmu in the desert will be moved to the marketing terminals. By cooperating with Pico, the high quality, high-end orientation and ecological public welfare of Shengmu will be conveyed to consumers in a comprehensive manner, thus breaking the pure demonstrative method used in the making of VR videos. The method of Discovery-style documentary+storyline and the combination of location shooting and CG animation are employed to demonstrate the whole industrial chain advantages of Shengmu in the desert in a comprehensive manner and at multiple angles.

FINANCIAL REVIEW

Revenue of the Group increased by 21.5% from RMB1,152.2 million in the 2017 Interim Period to RMB1,400.1 million in the 2018 Interim Period. Gross profit of the Group decreased by 13.1% from RMB500.4 million in the 2017 Interim Period to RMB435.0 million in the 2018 Interim Period. (Loss)/profit for the period decreased by 1,003.0% from profit of RMB131.4 million in the 2017 Interim Period to loss of RMB1,186.5 million in the 2018 Interim Period. (Loss)/profit for the period before fair value adjustment of biological assets decreased by 255.4% from profit of RMB193.3 million in the 2017 Interim Period to loss of RMB300.4 million in the 2018 Interim Period. Of these, (loss)/profit attributable to owners of the parent decreased by 16,819.9% from profit of RMB6.4 million in the 2017 Interim Period to loss of RMB1,066.9 million in the 2018 Interim Period. (Loss)/profit attributable to owners of the parent before fair value adjustment of biological assets decreased by 484.9% from profit of RMB96.8 million in the 2017 Interim Period to loss of RMB372.7 million in the 2018 Interim Period.

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

Revenue

Unit: RMB in thousands, except percentages

	For the six-month period ended June 30	
	2018	2017
	(Unaudited)	(Unaudited)
Dairy farming business	**919,705**	454,814
Liquid milk business	**480,400**	697,370
Total	**1,400,105**	1,152,184

For the six-month period ended June 30	Dairy farming business				Liquid milk business				Total revenue
	Segment revenue	Inter-segment sales[(1)]	External sales	External sales as % of total revenue	Segment revenue	Inter-segment sales	External sales	External sales as % of total revenue	
2018 (Unaudited)	**1,126,745**	**207,040**	**919,705**	**65.7%**	**480,400**	**—**	**480,400**	**34.3%**	**1,400,105**
2017 (Unaudited)	1,335,053	880,239	454,814	39.5%	697,370	—	697,370	60.5%	1,152,184

(1) Represents self-produced raw milk sold to the Group's liquid milk business.

Given the rising competition existing in the dairy products market, the Group required the market terminals to stabilize prices globally to improve the brand image of Shengmu. As such, the Group proactively adapted the sales structure of its upstream and downstream products to the new sales strategy of its organic liquid milk products, i.e. "sales-oriented production for end product freshness" (以銷定產,保證終端產品的新鮮度). It optimized the quality of sales outstanding of the Group, and on the basis of ensuring the effective operation of its self-owned brand organic liquid milk, expanded the sales of raw milk to clients of the industry. External sales of the Group's raw milk increased from RMB454.8 million in the 2017 Interim Period to RMB919.7 million in the 2018 Interim Period, representing an increase of 102.2% as compared to the same period of last year. Sales of self-owned brand liquid milk decreased from RMB697.4 million in the 2017 Interim Period to RMB480.4 million in the 2018 Interim Period, representing a decrease of approximately 31.1% as compared to the same period last year.

Dairy farming business

	For the six-month period ended June 30							
	2018 (Unaudited)				2017 (Unaudited)			
	Revenue (RMB'000)	**Sales volume (Tonnes)**	**Average selling price (RMB/ Tonne)**	**Revenue as % of dairy farming segment revenue**	Revenue (RMB'000)	Sales volume (Tonnes)	Average selling price (RMB/ Tonne)	Revenue as % of dairy farming segment revenue
Organic raw milk								
External sales	**628,298**	**189,816**	**3,310**	**55.8%**	235,282	56,100	4,194	17.6%
Inter-segment sales(1)	**186,927**	**46,819**	**3,993**	**16.6%**	827,441	158,150	5,232	62.0%
Subtotal	**815,225**	**236,635**	**3,445**	**72.4%**	1,062,723	214,250	4,960	79.6%
Premium non-organic raw milk								
External sales	**291,407**	**86,523**	**3,368**	**25.8%**	219,532	65,832	3,335	16.4%
Inter-segment sales(2)	**20,113**	**6,221**	**3,233**	**1.8%**	52,798	13,970	3,779	4.0%
Subtotal	**311,520**	**92,744**	**3,359**	**27.6%**	272,330	79,802	3,413	20.4%
Daily farming segment								
External sales	**919,705**	**276,339**	**3,328**	**81.6%**	454,814	121,932	3,730	34.0%
Inter-segment sales	**207,040**	**53,040**	**3,903**	**18.4%**	880,239	172,120	5,114	66.0%
Total	**1,126,745**	**329,379**	**3,421**	**100.0%**	1,335,053	294,052	4,540	100.0%

(1) Represents self-produced organic raw milk sold to the Group's organic liquid milk business.

(2) Represents self-produced premium non-organic raw milk sold to the Group's high-end non-organic liquid milk business.

In the 2018 Interim Period, sales volume of raw milk increased by 12.0% from 294,052 tonnes in the 2017 Interim Period to 329,379 tonnes in the 2018 Interim Period. Leveraging its sound cooperation relationship with clients of the industry, the Group expanded the sales of raw milk to its clients. The external sales volume accounted for 83.9% of sales volume of raw milk in the 2018 Interim Period, compared with 41.5% in the 2017 Interim Period. Affected by supply and demand factors in the dairy industry, some organic raw milk were sold at a price of non-organic raw milk to the industry clients, as a result, external selling price of raw milk decreased by 21.1% from RMB4,194/tonne in the 2017 Interim Period to RMB3,310/tonne in the 2018 Interim Period. Meanwhile, due to the adjustment to the sales strategy of liquid milk products, inter-segment sales volume of organic raw milk decreased. As a result, revenue from the daily farming segment decreased by 15.6% from RMB1,335.1 million in the 2017 Interim Period to RMB1,126.7 million in the 2018 Interim Period.

Liquid milk business

In the 2018 Interim Period, due to implementation of the Group's market strategy of "sales-oriented production for end product freshness" (以銷定產,保證終端產品的新鮮度), revenue from the Group's liquid milk business decreased by 31.1% from RMB697.4 million in the 2017 Interim Period to RMB480.4 million. Revenue from liquid milk business accounted for 34.3% of total revenue of the Group in the 2018 Interim Period, a significant decrease from 60.5% in the 2017 Interim Period. Despite a significant decrease in sales volume of liquid milk products, unit selling price of liquid milk products improved notably as compared to the 2017 Interim Period and quality of sales outstanding also improved significantly, showing the effect of new market strategy.

Organic liquid milk business

	For the six-month period ended June 30		
	2018	2017	Increase/
	(Unaudited)	(Unaudited)	(Decrease)
Revenue (RMB'000)	**450,378**	688,438	(34.6%)
Sales volume (Tonnes)	**39,967**	70,860	(43.6%)
Average selling price (RMB/Tonne)	**11,269**	9,716	16.0%

Cost of Sales, Gross Profit and Gross Margin

Unit: RMB in thousands, except percentages

	For the six-month period ended June 30					
	2018 (Unaudited)			2017 (Unaudited)		
	Cost of sales Amount	**Gross profit Amount**	**Gross margin**	Cost of sales Amount	Gross profit Amount	Gross margin
Dairy farming business						
Organic raw milk						
Before elimination	**614,462**	**200,763**	**24.6%**	512,512	550,211	51.8%
After elimination[1]	**492,276**	**136,022**	**21.6%**	134,199	101,083	43.0%
Premium non-organic raw milk						
Before elimination	**225,507**	**86,013**	**27.6%**	192,238	80,092	29.4%
After elimination[3]	**210,201**	**81,206**	**27.9%**	153,637	65,895	30.0%
Subtotal						
Before elimination	**839,969**	**286,776**	**25.5%**	704,750	630,303	47.2%
After elimination	**702,477**	**217,228**	**23.6%**	287,836	166,978	36.7%
Liquid milk business						
Organic liquid milk						
Before elimination	**335,851**	**114,527**	**25.4%**	591,297	97,141	14.1%
After elimination[2]	**237,307**	**213,071**	**47.3%**	358,260	330,178	48.0%
High-end non-organic liquid milk						
Before elimination	**31,971**	**(1,949)**	**(6.5%)**	8,286	646	7.2%
After elimination[3]	**25,276**	**4,746**	**15.8%**	5,675	3,257	36.5%
Subtotal						
Before elimination	**367,822**	**112,578**	**23.4%**	599,583	97,787	14.0%
After elimination	**262,583**	**217,817**	**45.3%**	363,935	333,435	47.8%
Total after elimination	**965,060**	**435,045**	**31.1%**	651,771	500,413	43.4%

(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 plus (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 (1) above.

(3) Premium non-organic raw milk after elimination is calculated using the formula in note (1) above, and the premium non-organic liquid milk after elimination is calculated using the formula in note (2) above.

Cost of sales of the Group increased from RMB651.8 million in the 2017 Interim Period to RMB965.1 million in the 2018 Interim Period. Gross profit decreased from RMB500.4 million in the 2017 Interim Period to RMB435.0 million in the 2018 Interim Period. Gross profit margin decreased from 43.4% in the 2017 Interim Period to 31.1% in the 2018 Interim Period.

In the 2018 Interim Period, the Group adjusted the product sales structure, which led to an obvious decrease in the sales of grass-to-glass organic liquid milk of high gross profit. Further, affected by factors including organic raw milk supply and demand, the unit price of external sales of organic raw milk decreased significantly. As a result, cost of sales of the Group in the 2018 Interim Period increased by 48.1% from the 2017 Interim Period and gross profit of the Group in the 2018 Interim Period decreased by 13.1% from the 2017 Interim Period.

Other Income and Losses

Other income and losses of the Group increased from net losses of RMB85.4 million in the 2017 Interim Period to net losses of RMB486.4 million in the 2018 Interim Period, mainly attributable to the provision for impairment of trade receivables and other receivables referring to expected credit losses and the recoverability of individual account receivables using aging analysis by the Group.

Selling and Distribution Expenses

Selling and distribution expenses of the Group primarily include logistics and transportation expenses, marketing fee and employees' remunerations. In the 2018 Interim Period, selling and distributing expenses of the Group amounted to RMB114.9 million, less than RMB120.7 million in the 2017 Interim Period, mainly attributable to the decline of sales volume of liquid milk business as compared to the 2017 Interim Period.

Administrative Expenses

Administrative expenses mainly include salary and welfare, travel expenses and transportation expenses of management and administrative employees. In the 2018 Interim Period and the 2017 Interim Period, administrative expenses of the Group were RMB 49.5 million and RMB 50.9 million respectively, representing a decrease of approximately 2.8% as compared to the same period of last year.

Net Losses Arising from Changes in Fair Value Less Costs to Sales of Biological Assets

Net losses arising from changes in fair value less costs to sales of biological assets represents fair value changes in the dairy cows, due to the changes in physical attributes and market prices of the dairy cows 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 ousted and sold, its value decreases

In the 2018 Interim Period and the 2017 Interim Period, the Group's net losses arising from changes in fair value less costs to sales of biological assets were RMB886.1 million and RMB61.9 million respectively. The significant increase in losses arising from changes in fair value less costs to sales of biological assets of the Group from the 2018 Interim Period to the 2017 Interim Period was mainly attributable to the combined effects of (1) the Group's control over its cow numbers in response to the weak demand for raw milk in the market and (2) the sharp decline of raw milk price.

Share of Profits and Losses of Associates

The Group's associates include (a) the companies that were jointly established by the Group and its premium distributors in its key distribution cities to distribute the liquid milk products with the Group's self-owned brand; (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; and (c) Food Union Shengmu Dairy Co., Ltd. ("**Food Union Shengmu**") and Inner Mongolia Shengmu Low Temperature Dairy Product Company Limited (內蒙古聖牧低溫乳品有限公司) in which the Group invested and held minority interests and which produces dairy products with the raw milk to be purchased by it from the Group. In the 2018 Interim Period and the 2017 Interim Period, the Group recorded share of losses of associates of RMB3.7 million and RMB7.4 million respectively.

Income Tax (Expense)/Credit

All profits of the Group were derived from its operations in the PRC. According to the Enterprise Income Tax Law of the PRC (the "**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 raw agricultural products, is exempted from enterprise income tax. Under the PRC tax laws and regulations, there is no statutory time limit for such tax exemption as long as the relevant PRC subsidiaries of the Group complete filings with the relevant tax authorities as required.

In accordance with "The Notice of Tax Policies Relating to the Implementation of the Western China Development Strategy" jointly issued by Ministry of Finance, General Administration of Customs and State Administration of Taxation (Cai Shui [2011] No.58) (財政部、海關總署、國家稅務總局《關於深入實施西部大開發戰略有關稅收政策問題的通知》(財稅 [2011]58 號)), the Group's taxable income arising from processing of non-raw agricultural products is subject to preferential tax rate of 15% from 2013 to 2020.

Income tax expense of the Group was RMB5.1 million in the 2018 Interim Period while income tax credit was RMB25.8 million in the 2017 Interim Period. Income tax expense of the Group in the 2018 Interim Period was due to the write down of deferred income tax assets for decrease in the Group's unrealised profit or loss from internal sales relatively to the beginning of the year.

(Loss)/profit Attributable to Owners of the Parent and (Loss)/profit Attributable to Non-Controlling Interests

(Loss)/profit attributable to non-controlling interests mainly represents the (loss)/profit for the period attributable to dairy farmers with whom we cooperate in relation to dairy farm management in our farms. In the 2018 Interim Period, loss attributable to non-controlling interests was RMB119.6 million and in the 2017 Interim Period, profit attributable to non-controlling interests was RMB125.0 million.

In the 2018 Interim Period, due to combined effects of (1) a significant decrease in the sales volume of the Group's self-owned brand organic liquid milk products; (2) a sharp decrease in the selling price of the Group's raw milk as compared to the corresponding period last year; (3) a substantial loss arising from changes in fair value less cost to sales of biological assets attributable to the parent; and (4) the provision for asset impairment of trade receivables and other receivables, loss attributable to owners of the parent of the Group was RMB1,066.9 million, decreasing by 16,819.9% as compared with profit of RMB6.4 million in the 2017 Interim Period.

ANALYSIS ON INTERIM CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION

Current Assets

As at June 30, 2018, total current assets of the Group were RMB2,925.0 million (as at December 31, 2017: RMB3,604.3 million), primarily consisting of inventory of RMB551.7 million (as at December 31, 2017: RMB860.8 million), biological assets of RMB4.7 million (as at December 31, 2017: RMB33.5 million), trade and bills receivables of RMB777.6 million (as at December 31, 2017: RMB1,100.0 million), prepayments, deposits and other receivables of RMB979.2 million (as at December 31, 2017: RMB898.8 million), and cash and bank balances and pledged deposits of RMB611.8 milion (as at December 31, 2017: RMB711.2 million). There was a relatively significant decrease in the Group's current assets as at June 30, 2018 as compared with that of December 31, 2017, which was mainly attributable to the facts that (1) on one hand, some achievements have been made in the Group's control over trade receivables; on the other hand, the Group made provisions for impairment pursuant to the provision policy for asset impairment established by the Group based on its actual production and operation conditions and by reference to its expected credit losses; (2) there was a remarkable reduction in inventory, i.e. feed at the end of this period as compared with that of the beginning of the year affected by the dairy farming industry featuring volatility in inventories.

Trade and Bills Receivable

Unit: RMB in thousands

	As at	
	June 30, 2018	December 31, 2017
	(Unaudited)	(Audited)
Trade and bills receivables	**1,935,874**	1,840,492
Impairment	**(1,158,263)**	(740,486)
Total	**777,611**	1,100,006

Pursuant to the provision policy for asset impairment established by the Group based on its actual production and operation conditions and the expected credit loss of trade receivables, the Group determined the receivable group by using aging as a credit risk characteristic and, by aging analysis, made provisions for bad debts in respect of account and other receivables, and also estimated the expected credit losses with reference to the recoverability of individual account receivables and customer creditworthiness, so as to estimate the provisions for asset impairment. In the 2018 Interim Period, the Group made a total provision of RMB430.8 million for the impairment of trade receivables.

Current Liabilities

As at June 30, 2018, total current liabilities of the Group amounted to RMB4,588.8 million (as at December 31, 2017: RMB4,300.9 million), primarily consisting of trade and bills payables of RMB1,525.8 million (as at December 31, 2017: RMB1,189.0 million), receipts in advance of RMB170.9 million (as at December 31, 2017: RMB14.7 million), other payables and accruals of RMB467.0 million (as at December 31, 2017: RMB441.7 million), interest-bearing bank and other borrowings of RMB2,423.6 million (as at December 31, 2017: RMB2,654.0 million), and income tax payable of RMB1.5 million (as at December 31, 2017: RMB1.5 million).

Non-Current Liabilities

As at June 30, 2018, the total non-current liabilities of the Group amounted to RMB145.8 million (as at December 31, 2017: RMB803.0 million), primarily consisting of interest-bearing bank and other borrowings of RMB91.9 million (as at December 31, 2017: RMB720.2 million) and long-term payables of RMB53.9 million (as at December 31, 2017: RMB82.8 million). There was a relatively significant decrease in the Group's non-current liabilities as at June 30, 2018 as compared with that of December 31, 2017, which was mainly attributable to the facts that the domestic corporate bonds issued by the Group with a nominal amount of RMB600 million would fall due within 12 months, while the Group does not have an unconditional right to defer settlement of the liability. Accordingly, such corporate bonds would be classified as non-current liability due within one year.

Foreign Exchange Risk

The Group's businesses are principally located in the mainland China and substantially all transactions are conducted in RMB. As at June 30, 2018, the Group did not have significant foreign exchange risk from its operations nor has it entered into any arrangements to hedge against any fluctuation in foreign exchange.

Credit Risk

The Group only trades 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. Credit risk related to the Group's other financial assets arises from 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, collateral is generally not required.

Charge on Assets

As at June 30, 2018, the Group had pledged deposits of approximately RMB369.5 million (as at December 31, 2017: RMB128.9 million) in total to banks as deposits for the issuance of letters of credit and bank drafts and as guarantees for the bank loans of Shengmu Forage.

Liquidity, Financial Resources and Capital Structure

In the first half of 2018, the Group financed its daily operations mainly from internally generated cash flows and bank and other borrowings. As at June 30, 2018, the Group had (a) cash and bank balances of RMB352.7 million (as at December 31, 2017: RMB582.3 million), and (b) interest-bearing bank and other borrowings of RMB2,515.5 million (as at December 31, 2017: RMB3,374.2 million), of which, RMB28.4 million were repayable within one to five years and RMB63.5 million repayable within five to eight years, while the remaining interest-bearing bank and other borrowings were repayable within one year. The gearing ratio (calculated as total debt (total bank borrowings) divided by total equity) was 59.9% as at June 30, 2018 (as at December 31, 2017: 62.3%). For the six months period ended June 30, 2018, the annual interest rate of bank borrowings ranged from 1.55% to 6.97% (for the six months period ended June 30, 2017: 1.55% to 6.50%).

CAPITAL COMMITMENTS

As at June 30, 2018, the Group's capital commitments amounted to RMB190.0 million (as at December 31, 2017: RMB214.6 million), primarily relating to construction of plants and purchase of machinery for the expansion of liquid milk production capacity.

HUMAN RESOURCES

As at June 30, 2018, the Group had a total of 3,809 employees (as at June 30, 2017: 3,609 employees). Total staff costs in the 2018 Interim Period (including the emoluments of Directors and senior management of the Company) amounted to RMB142.4 million (2017 Interim Period: RMB138.9 million) (excluding equity-settled share option expenses).

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 Group 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 June 30, 2018, the Group provided guarantees with amount of RMB252.6 million (December 31, 2017: RMB160.0 million), RMB133.4 million (December 31, 2017: RMB102.88 million) and RMB71.75 million for the bank borrowings of Shengmu Forage, Food Union Shengmu and some distributors respectively.

MATERIAL ACQUISITIONS AND DISPOSALS

The Company did not make any material acquisitions and disposals of subsidiaries and associated companies in the 2018 Interim Period.

FUTURE PLANS FOR MATERIAL INVESTMENTS OR ACQUISITION OF CAPITAL ASSETS AND EXPECTED SOURCE OF FUNDING

Save as disclosed above in "Capital Commitments" and 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 as at the date of this announcement.

OUTLOOK

"By treatment of the industry, we will strive to convert the Ulan Buh Desert with an area of 1,000 square kilometers into an oasis and create the No.1 brand in the organic milk industry in China"---this is the vision of Shengmu as well as the long-range goal of all staff of the Group. To increase its brand influence and expand its marketing channels, the Group has made the following development strategies:

Implement the whole industrial chain QC system and strictly control the product quality

Shengmu has always insisted on the concept of "good milk comes from high-quality grass" so that it has strengthened the whole industrial chain QC system from the grasslands, pastures to the processing plants. The quality of each link can be traced so that the quality of each pack of milk can be guaranteed.

Create a great team which is bold enough to win the competition

Inspired by the great entrepreneurship stories of Shengmu and its advantage of the whole-process organic milk industrial chain, an increasing number of its staff members have been encouraged and more people join the Group. It has set up the Shengmu Entrepreneurship Academy at such universities as Qinghua University and Zhejiang University to provide its employees and cooperative partners with the systematic training which features three layers: business skills, entrepreneurship and business management. In such way the Group has fully motivated the capacity of the team, and created a team which has the sense of mission and is bold enough to win the competition.

Increase the investment in the promotion of the brand

With the enhancement of the sales volume and market share of Shengmu's products, the Group will launch the promotional strategy for its brand, which will further vigorously assist in the expansion of the market and increase its market share. It will greatly boost the development of Shengmu's organic milk in a healthy, benign and fast manner.

Step up the construction of the markets in its bases

With respect to the market promotion, Shengmu will continue to expand market share in its bases, and enhance the support for its product distributing and displaying in the market, as well as personnel arrangement, promotion and marketing; it will strive to enhance the management level and the business capability, summarize the standard and duplicable business management methods, and by means of establishing a benchmark, it will tap more markets and assist the great development of Shengmu's great undertaking.

Facing the complicated severe and challenging situation in the industry, Shengmu has focused on the construction of its bases, optimized and created new sales channels, upgraded its product image and enhanced the capability of its business partners since 2018; moreover, it has made progress and kept exploring in the brand building, thus has accumulated valuable experience for the significant development of Shengmu. The whole staff of Shengmu are full of confidence about its future, and will forge ahead to create the Top 1 organic milk brand in the world.

PURCHASE, REDEMPTION OR SALE OF LISTED SECURITIES OF THE COMPANY

During 2018 Interim Period, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's shares.

CORPORATE GOVERNANCE PRACTICES

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

In the opinion of the Board, during 2018 Interim Period, the Company has adopted, applied and complied with the code provisions contained in the Code except the code provision A.2.1 of the Code as disclosed below.

Pursuant to code provision A.2.1 of the Corporate Governance Code, the roles of chairman and chief executive officer should be separate and should not be performed by the same individual. However, the Company does not have a separate chairman and chief executive officer and Mr. SHAO Genhuo currently performs these two roles (chairman and chief executive officer). 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 and implementation for the Group. The Board considers that the balance of power and authority for the present arrangement will not be impaired and this structure will enable the Company to make and implement decisions promptly and effectively. The Board will continue to review and consider splitting the roles of chairman of the Board and chief executive officer of the Company at a time when it is appropriate and suitable by taking into account the circumstances of the Group as a whole.

AUDIT COMMITTEE AND REVIEW OF INTERIM RESULTS

The Company has established the Audit Committee in compliance with the Listing Rules. The Audit Committee has been established with written terms of reference in compliance with the Listing Rules. The Audit Committee comprises Mr. WANG Liyan, Mr. FU Wenge and Mr. LI Xuan, and is chaired by Mr. WANG Liyan. 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, renewal and resignation 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 on the internal control and financial reporting matters, including the review of the unaudited interim results for the 2018 Interim Period.

MODEL CODE FOR DIRECTORS' SECURITIES TRANSACTIONS

The Company has adopted a code of conduct regarding securities transactions by its Directors on terms no less exacting than the required standard of dealings set out in the Model Code for Securities Transactions by Directors of Listed 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 during the 2018 Interim Period.

DIVIDEND DISTRIBUTION

The Board does not recommend the payment of any interim dividend for the 2018 Interim Period (2017 Interim Period: Nil).

PUBLICATION OF RESULTS ANNOUNCEMENT AND INTERIM REPORT

This interim results announcement is published on the website of the Stock Exchange at www.hkexnews.hk and on the website of the Company at www.youjimilk.com. The interim report of the Company for the 2018 Interim Period containing all the information required by the Listing Rules will be dispatched to Shareholders and published on the above websites in due course.

By Order of the Board
China Shengmu Organic Milk Limited
Shao Genhuo
Non-executive Director and Chief Executive Officer

Hong Kong, 30 August 2018

As at the date of this announcement, the executive directors of the Company are Mr. Yao Tongshan, Mr. Wu Jianye and Mr. Wang Yuehua; and the non-executive directors of the Company are Mr. Shao Genhuo, Mr. Wen Yongping and Mr. Sun Qian; and the independent non-executive directors of the Company are Mr. Fu Wenge, Mr. Wang Liyan and Mr. Li Xuan.