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If you are in doubt as to any aspect of this circular or as to the action to be taken, you should consult a licensed securities dealer or registered institution in securities, bank manager, solicitor, professional accountant or other professional advisor.

If you have sold or transferred all your shares in **China Shengmu Organic Milk Limited**, you should at once hand this circular and the accompanying form of proxy to the purchaser(s) or the transferee(s) or to the bank, the licensed securities dealer or registered institution or other agent through whom the sale or transfer was effected for transmission to the purchaser(s) or the transferee(s).

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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)

**RENEWAL OF CONTINUING CONNECTED TRANSACTIONS
RAW FRESH MILK SUPPLY FRAMEWORK AGREEMENT
AND
NOTICE OF THE EXTRAORDINARY GENERAL MEETING**

**Independent Financial Advisor to
the Independent Board Committee and the Independent Shareholders**



Capitalised terms used in this cover page have the same meanings as those defined in this circular.

A letter from the Board is set out on pages 4 to 15 of this circular. A letter from the Independent Board Committee containing its recommendation to the Independent Shareholders is set out on pages 16 to 17 of this circular. A letter from the Independent Financial Advisor, Somerley Capital Limited, containing its advice to the Independent Board Committee and the Independent Shareholders is set out on pages 18 to 31 of this circular.

A notice convening the EGM to be held at Conference Room, 10/F, United Centre, 95 Queensway, Admiralty, Hong Kong on 29 December 2022 at 9:30 a.m. is set out on pages 38 to 39 of this circular. A form of proxy for use at the EGM is enclosed with this circular. Such form of proxy is also published on the websites of The Stock Exchange of Hong Kong Limited (www.hkexnews.hk) and the Company (<http://www.youjimilk.com>).

Whether or not you are able to attend the EGM, please complete and sign the enclosed form of proxy in accordance with the instructions printed thereon and return it to the office of the Company's branch share registrar in Hong Kong, Tricor Investor Services Limited, at 17/F, Far East Financial Centre, 16 Harcourt Road, Hong Kong as soon as possible and in any event not less than 48 hours before the time appointed for the holding of the EGM or any adjournment thereof. Completion and return of the form of proxy will not preclude Shareholders from attending and voting in person at the EGM or any adjourned meeting thereof if they so wish, in which event your proxy shall be deemed to be revoked.

12 December 2022

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DEFINITIONS

In this circular, the following expressions have the meanings as set out below unless the context requires otherwise:

“Aiyangniu Technology”	Inner Mongolia Aiyangniu Technology Co., Ltd.* (內蒙古愛養牛科技有限公司), a company established in the PRC with limited liability and a wholly-owned subsidiary of China Modern Dairy as at the Latest Practicable Date
“Board”	the board of Directors
“China Mengniu”	China Mengniu Dairy Company Limited (中國蒙牛乳業有限公司), a company incorporated in the Cayman Islands with limited liability, the shares of which are listed on the Stock Exchange (stock code: 2319)
“China Mengniu Group”	Inner Mongolia Mengniu and its subsidiaries from time to time
“China Modern Dairy”	China Modern Dairy Holdings Ltd. (中國現代牧業控股有限公司), a company incorporated in the Cayman Islands with limited liability, the shares of which are listed on the Stock Exchange (stock code: 1117)
“Company”	China Shengmu Organic Milk Limited (中國聖牧有機奶業有限公司), a company incorporated in the Cayman Islands with limited liability, the shares of which are listed on the Stock Exchange (stock code: 1432)
“connected person(s)”	has the meaning ascribed to it under the Listing Rules
“Dabeinong”	Beijing Dabeinong Technology Group Co., Ltd.* (北京大北農科技集團股份有限公司), a company established in the PRC with limited liability, the shares of which are listed on the Shenzhen Stock Exchange (stock code: 002385)
“Director(s)”	the director(s) of the Company
“EGM”	the extraordinary general meeting of the Company to be held at the Conference Room, 10/F, United Centre, 95 Queensway, Admiralty, Hong Kong on 29 December 2022 at 9:30 a.m. for the purpose of considering and, if thought fit, approving, among others, the Raw Fresh Milk Supply Framework Agreement (including the proposed annual caps) and the transactions contemplated under such agreement

DEFINITIONS

“Fuyuan International”	Inner Mongolia Fuyuan International Industrial (Group) Co., Limited* (內蒙古富源國際實業(集團)有限公司), a company established in the PRC with limited liability and a non-wholly owned subsidiary (as to 99.06%) of China Modern Dairy as at the Latest Practicable Date
“Group”	the Company and its subsidiaries from time to time
“Hong Kong”	Hong Kong Special Administrative Region of the PRC
“Independent Board Committee”	a committee of the Board comprising all the independent non-executive Directors, namely, Mr. Wang Liyan, Mr. Wu Liang and Mr. Sun Yansheng
“Independent Financial Advisor” or “Somerley”	Somerley Capital Limited, a corporation licensed by the Securities and Futures Commission to conduct Type 1 (dealing in securities) and Type 6 (advising on corporate finance) regulated activities under the Securities and Futures Ordinance, who is appointed to advise the Independent Board Committee and the Independent Shareholders in respect of the Raw Fresh Milk Supply Framework Agreement and the transactions contemplated under such agreement
“Independent Shareholder(s)”	Shareholders other than Start Great and its associates
“Inner Mongolia Mengniu”	Inner Mongolia Mengniu Dairy (Group) Company Limited* (內蒙古蒙牛乳業(集團)股份有限公司), a company established in the PRC with limited liability and a non-wholly owned subsidiary (as to 99.99%) of China Mengniu as at the Latest Practicable Date
“Latest Practicable Date”	7 December 2022, being the latest practicable date prior to the printing of this circular for the purpose of ascertaining certain information for inclusion in this circular
“Listing Rules”	the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited
“PRC” or “China”	the People’s Republic of China and for the purpose of this circular, does not include Hong Kong, Macao Special Administrative Region and Taiwan

DEFINITIONS

“Raw Fresh Milk Supply Framework Agreement”	the raw fresh milk supply framework agreement dated 17 November 2022, entered into between Shengmu High-tech (for itself and on behalf of its subsidiaries) and Inner Mongolia Mengniu (for itself and on behalf of its subsidiaries), in relation to the purchase of raw fresh milk by China Mengniu Group from the Group for a three-year term from 1 January 2023 to 31 December 2025
“RMB”	Renminbi, the lawful currency of the PRC
“Sales Team”	the sales team of the Group
“Shareholder(s)”	holder(s) of the Shares
“Shares”	ordinary share(s) of par value HK\$0.00001 each in the issued share capital of the Company
“Shengmu High-tech”	Inner Mongolia Shengmu High-tech Farming Co., Ltd.* (內蒙古聖牧高科牧業有限公司), a company established in the PRC with limited liability and an indirect wholly-owned subsidiary of the Company as at the Latest Practicable Date
“Start Great”	Start Great Holdings Limited, a limited liability company incorporated in the British Virgin Islands with its registered office at Vistra Corporate Services Centre, Wickhams Cay II, Road Town, Tortola, VG1110, British Virgin Islands, which is a direct wholly-owned subsidiary of China Mengniu as at the Latest Practicable Date
“Stock Exchange”	The Stock Exchange of Hong Kong Limited
“Yiyongmei Dairy”	Inner Mongolia Yiyongmei Dairy Co., Ltd.* (內蒙古益嬰美乳業有限公司), a company established in the PRC with limited liability and a subsidiary of Dabeinong as at the Latest Practicable Date
“kg”	kilogram

* For identification purpose only



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)

Executive Director:

Mr. ZHANG Jiawang

Non-executive Directors:

Mr. LU Minfang (*Chairman*)

Mr. ZHANG Ping

Mr. ZHAO Jiejun

Mr. SUN Qian

Ms. SHAO Lijun

Independent non-executive Directors:

Mr. WANG Liyan

Mr. WU Liang

Mr. SUN Yansheng

Registered address:

P.O. Box 309

Ugland House

Grand Cayman, KY1-1104

Cayman Islands

***Headquarters and principal place of
business in the PRC:***

Food Industry Park

Deng Kou County

Bayannur City

Inner Mongolia Autonomous Region

PRC

Principal place of business in Hong Kong:

Room A, 32nd Floor

COFCO Tower

262 Gloucester Road

Causeway Bay

Hong Kong

12 December 2022

To the Shareholders

Dear Sir or Madam,

**RENEWAL OF CONTINUING CONNECTED TRANSACTIONS
RAW FRESH MILK SUPPLY FRAMEWORK AGREEMENT**

INTRODUCTION

Reference is made to the announcement of the Company dated 17 November 2022 in relation to, among other things, the Raw Fresh Milk Supply Framework Agreement, the transactions contemplated under such agreement and the proposed annual caps for such transactions for the three years ending 31 December 2023, 2024 and 2025.

LETTER FROM THE BOARD

Reference is also made to the announcement of the Company dated 30 December 2019 and the circular of the Company dated 6 March 2020 in relation to, among other things, the raw fresh milk supply framework agreement dated 30 December 2019 and entered into between Shengmu High-tech and Inner Mongolia Mengniu in relation to the purchase of raw fresh milk by China Mengniu Group from the Group for a three-year term from 1 January 2020 to 31 December 2022.

The purpose of this circular is to provide you with, among other things:

- (i) information as is necessary to enable you to make an informed decision on whether to vote for or against the resolution to be proposed at the EGM relating to the Raw Fresh Milk Supply Framework Agreement, the transactions contemplated under such agreement and the proposed annual caps for such transactions for the three years ending 31 December 2023, 2024 and 2025;
- (ii) the letter of recommendation from the Independent Board Committee to the Independent Shareholders relating to the Raw Fresh Milk Supply Framework Agreement, the transactions contemplated under such agreement and the proposed annual caps for such transactions for the three years ending 31 December 2023, 2024 and 2025;
- (iii) the letter of advice from Somerley to the Independent Board Committee and the Independent Shareholders relating to the Raw Fresh Milk Supply Framework Agreement, the transactions contemplated under such agreement and the proposed annual caps for such transactions for the three years ending 31 December 2023, 2024 and 2025;
- (iv) the notice of the EGM; and
- (v) other information as required to be disclosed under the Listing Rules.

The Company announces that on 17 November 2022, Shengmu High-tech (for itself and on behalf of its subsidiaries), an indirect wholly-owned subsidiary of the Company, entered into the Raw Fresh Milk Supply Framework Agreement with Inner Mongolia Mengniu (for itself and on behalf of its subsidiaries) in relation to the purchase of raw fresh milk by China Mengniu Group from the Group for a term of three years commencing from 1 January 2023 to 31 December 2025. The Raw Fresh Milk Supply Framework Agreement is a renewal of the raw fresh milk supply framework agreement dated 30 December 2019 between the same parties.

RAW FRESH MILK SUPPLY FRAMEWORK AGREEMENT

Principal Terms

The principal terms of the Raw Fresh Milk Supply Framework Agreement are summarised as follows:

Date: 17 November 2022

LETTER FROM THE BOARD

- Parties: Shengmu High-tech (for itself and on behalf of its subsidiaries) and Inner Mongolia Mengniu (for itself and on behalf of its subsidiaries)
- Term: From 1 January 2023 to 31 December 2025
- Principal terms: The Group shall sell raw fresh milk which meets China Mengniu Group's purchasing standard and quality requirements to China Mengniu Group on a daily basis in accordance with the monthly milk supply plan to be agreed between the Group and China Mengniu Group, and the Group shall ensure that on average more than 80% of the raw fresh milk it produces in each year will be sold to China Mengniu Group. The specific amount to be purchased shall be the amount as confirmed by the Group and China Mengniu Group. The daily delivery amount is determined by the amount as weighted by China Mengniu Group.
- Delivery: The Group shall be responsible for delivering raw fresh milk to the locations designated by China Mengniu Group. If the Group is unable to deliver milk in a timely manner, the Group shall notify China Mengniu Group at least 24 hours prior to the scheduled delivery and the Group shall bear related losses suffered by China Mengniu Group.
- Payment terms: China Mengniu Group shall pay monthly in accordance with the purchase amount of raw fresh milk, and payment for raw fresh milk purchased in any month shall be settled by the end of the following month. The monthly payment date shall be before the 30th calendar day of each month (or the 28th calendar day for February). If the monthly payment date falls on a statutory holiday, the payment date will be postponed to the first working day after the statutory holiday.

Purchase Price and Pricing Mechanism

The purchase price of raw fresh milk to be sold by the Group to China Mengniu Group under the Raw Fresh Milk Supply Framework Agreement shall be determined and adjusted in accordance with the following pricing mechanism:

- (a) the base price (the "**Base Price**") shall be determined based on market conditions, taking into account (i) the latest average price of raw fresh milk for 10 selected regions (including Inner Mongolia and Hebei) ("內蒙古、河北等10個主產省份生鮮乳平均價格") published on the website of the Ministry of Agriculture and Rural Affairs of the PRC (<http://www.xmsyj.moa.gov.cn/jcyj/>), and (ii) the prices charged by other suppliers to China Mengniu Group, together with seasonal factors and sales price of raw fresh milk in the region, as agreed between Shengmu High-tech and Inner Mongolia Mengniu;

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- (b) the logistics subsidy as agreed between Shengmu High-tech and Inner Mongolia Mengniu based on the prevailing logistics costs incurred by the dairy farming industry (taking into account (i) vehicle depreciation and maintenance, (ii) wages, (iii) fuel costs, based on refined oil prices announced by the National Development and Reform Commission of the PRC (<https://www.ndrc.gov.cn/xwdt/xwfb/?code=&state=123>) from time to time, (iv) toll rates, (v) insurance premium, and (vi) cargo-loading rate) and the distance between the customer's location and Shengmu High-tech's dairy farm(s); and
- (c) adjustments as agreed between Shengmu High-tech and Inner Mongolia Mengniu based on the quality and rating of raw fresh milk, taking into account various milk quality indicators, such as level of protein, fat content, somatic cell count, microorganism count and freezing point etc. (together with the logistics subsidy referred to in paragraph (b) above, the "Adjustments").

Internal Control Mechanism

Timely Delivery of Raw Fresh Milk

The Group has established an internal control mechanism to ensure the timely delivery of raw fresh milk. The Group maintains a three-month rolling plan for the herd and milk production to ensure that the Group has sufficient milk production capacity to meet the monthly supply plans for raw fresh milk. In addition, the dairy farms of the Group and the dairy products manufacturing facilities of China Mengniu Group are located in the same region. The maximum transportation distance for the supply of raw fresh milk from the dairy farms of the Group to the manufacturing facilities of China Mengniu Group is less than 110 kilometres and the transportation time is generally less than two hours. Given the close proximity, the Group is able to coordinate additional resources to meet the monthly supply plans if there is any emergency situation or unforeseen circumstances.

To the best of the Directors' knowledge, information and belief having made all reasonable enquiry, the term in the Raw Fresh Milk Supply Framework Agreement that the Group shall bear the losses suffered by China Mengniu Group if the Group fails to deliver raw fresh milk in a timely manner is a common term in similar agreements between China Mengniu Group and its suppliers of raw fresh milk which are independent from China Mengniu Group. Therefore, the Board considers that such term is on normal commercial terms and in the interest of the Company. The Group endeavors to deliver its products in a timely manner, and as at the Latest Practicable Date, the Group has not historically incurred any penalty due to late delivery of raw fresh milk to China Mengniu Group.

Referencing Market Prices

The Group formulates an annual supply plan for raw fresh milk, which is then divided into monthly supply plans taking into account the volume required by China Mengniu Group. The unit price of raw fresh milk, which comprises the Base Price and the Adjustments, is determined on a monthly basis. The Sales Team will review on a monthly basis the actual volume of raw fresh milk supplied. The Sales Team will also evaluate the fairness of the unit price by examining and considering the quantitative data from the test results of the milk quality indicators and checking whether the unit price has correctly reflected the test results of the raw fresh milk.

LETTER FROM THE BOARD

The Group's pricing mechanism with its customers (including China Mengniu Group and other independent third party customers) is generally the same and therefore the selling price of raw fresh milk to be sold by the Group to China Mengniu Group under the Raw Fresh Milk Supply Framework Agreement would be comparable to that of the other independent third party customers. The Group has established the following internal control measures to ensure that the purchase price and other terms of the sale of raw fresh milk by the Group to China Mengniu Group contemplated under the Raw Fresh Milk Supply Framework Agreement are no less favourable to the Group than the terms offered to independent third party customers, where the Sales Team has been tasked with:

- (a) considering and comparing prices and terms of similar products offered by the Group to other purchasers every month;
- (b) conducting market research every month and comparing the selling price of similar products offered by three other raw fresh milk producers when determining the Base Price for each month;
- (c) reviewing other terms of orders received from China Mengniu Group and other independent third party customers to ensure that the other terms offered by the Group to China Mengniu Group are no less favourable to the Group than those offered to independent third party customers; and
- (d) ensuring that each sale is executed at a purchase price determined in accordance with the relevant pricing mechanism as set out above in this circular.

General

The Company has also implemented internal control procedures and policies led by the Group's compliance team to monitor connected transactions with an emphasis on, among others, (1) maintenance of a list of connected persons and connected transactions; (2) identifying connected transactions with the assistance of various departments and external legal advisors; (3) analysis on aggregating connected transactions and managing any aggregated transaction amounts; and (4) monitoring utilization of annual caps of continuing connected transactions on a monthly basis.

The Group's compliance team will conduct an annual review to verify if the continuing connected transactions are conducted in compliance with the terms of the Raw Fresh Milk Supply Framework Agreement and Chapter 14A of the Listing Rules. The compliance team will prepare and submit a report of its findings to the management and the Audit Committee of the Company.

The Group's external auditors and independent non-executive Directors shall conduct an annual review and confirm whether the transactions have been entered into in accordance with the terms of the Raw Fresh Milk Supply Framework Agreement in the Company's annual report in accordance with the Listing Rules.

LETTER FROM THE BOARD

Reasons for and Benefits of Entering into the Raw Fresh Milk Supply Framework Agreement

As one of the leading dairy product manufacturers in the PRC, China Mengniu Group is equipped with a strong management team and a solid dairy product distribution network, offering diversified products including liquid milk products, ice cream, milk formula and cheese. The Company believes that a raw fresh milk supply relationship with China Mengniu Group (taking into account, among other things, the Group's commitment to supply on average more than 80% of the raw fresh milk it produces in each year to China Mengniu Group) will help to stabilise the price and sales volume of raw fresh milk and generate stable income and cash flow for the Group.

The dairy farms of the Group are mainly located in the regions of Hohhot and Bayannur, and China Mengniu Group has sufficient raw fresh milk processing capacity in these regions. The short transportation distance ensures the freshness of raw fresh milk supplied by the Group, which in turn contributes to the high quality of milk products manufactured by China Mengniu Group. It also lowers the Group's costs of transportation and preservation, which makes the price of raw fresh milk supplied by the Group more competitive as compared to other suppliers of raw fresh milk.

Whilst focusing on the production and sale of desert-based organic milk, the Group also endeavors to satisfy customers' diversified needs for quality raw milk and continues to develop a variety of functional raw milk to enhance the Group's product mix and profitability.

The collaboration between the Group and China Mengniu Group, which eventually leads to the growth of demand for desert-based organic milk through channels such as marketing and distribution, would enhance the awareness of the Group's milk products and in turn promote the Group's sales growth, thereby achieving a win-win outcome for both groups. As at the Latest Practicable Date, the Group was the single largest organic raw milk supplier to China Mengniu Group, and organic raw milk supplied by the Group accounted for more than 80% of the organic raw milk procured by China Mengniu Group for the ten months ended 31 October 2022. In addition, desert-based organic milk is one of the product lines offered by China Mengniu Group and the Group is the only desert-based organic raw milk producer in China. Accordingly, the supply relationship between the Group and China Mengniu Group is essential to the production and sales of China Mengniu Group's organic milk products, including but not limited to the desert-based organic milk product line. As China Mengniu Group continues to promote and sell its desert-based organic milk products, this would enhance market awareness of and demand for desert-based organic milk, which would in turn increase China Mengniu Group's demand for desert-based organic raw milk and benefit the Group's sales growth. As the supply relationship is beneficial to both the Group and China Mengniu Group, the Board expects the likelihood of a significant adverse change to the business relationship with China Mengniu Group to be relatively low. So far as was known to the Company up to the Latest Practicable Date, China Mengniu Group has not raised any material concern or complaint relating to the Group's supply of raw fresh milk in the past four years and the mutual intention to deepen the business relationship is evidenced by the entering into of the Raw Fresh Milk Supply Framework Agreement with increased annual caps.

LETTER FROM THE BOARD

In the unlikely event of any change to the business relationship between the Group and China Mengniu Group, the Board believes that the raw fresh milk produced by the Group can be sold to other major customers in the region, and such change will not have a material impact on the financial position of the Group. In particular,

- (a) the Group has been actively looking for new customers. The Sales Team regularly arranges meetings and dairy farm visits with target customers. The Sales Team also attends industry events to explore more diversified sales opportunities. The Group believes that its outstanding achievements in carbon neutrality and desert circulation agriculture system will attract customers;
- (b) the Group is constantly seeking to diversify its product portfolio and develop new products based on market needs as part of the Group's effort to enhance its sales and marketing;
- (c) as the environmental and industry regulations become increasingly stringent, some small farm operators have withdrawn from the market due to increased operating costs and non-compliance as a result of substandard supervision, and such changes are conducive to the healthy development of large-scale dairy farms in the future;
- (d) with the impact of consumption upgrade, urban citizens have a growing demand of high quality organic milk. The Board expects that the Group will benefit from the upward trend of the organic dairy industry and have a relatively high growth rate; and
- (e) the high quality of the Group's milk products (in terms of purity and freshness), in particular its organic raw milk, is well recognized both in the market and by relevant authorities (as evidenced by various product certifications). Apart from China Mengniu Group, the Group also supplies raw fresh milk to other independent third party dairy product manufacturers in the PRC. As at the Latest Practicable Date, the Group had established business relationship with a number of third party dairy product manufacturers in China, including Bright Dairy & Food Co., Ltd, New Hope Dairy Co., Ltd, Shijiazhuang Junlebao Dairy Co., Ltd, Beijing Lechun Youpin Food Technology Co., Ltd* (北京樂純悠品食品科技有限公司) and Adopt A Cow Holding Group Co., Ltd. So far as was known to the Company up to the Latest Practicable Date, no third party had raised concern regarding their business relationship with the Group in connection with China Mengniu Group's substantial interest in the Company. Should there be any change to the business relationship between the Group and China Mengniu Group, the Board believes the raw fresh milk produced by the Group can be sold to other major customers in the region.

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In light of the factors mentioned above, the Directors (including the independent non-executive Directors after taking into account the advice of the Independent Financial Advisor) are of the view that the Raw Fresh Milk Supply Framework Agreement is entered into on normal commercial terms and in the ordinary course of business of the Group, is in the interests of the Company and the Shareholders as a whole, and the terms of the Raw Fresh Milk Supply Framework Agreement (including the proposed annual caps) are fair and reasonable.

Historical Transaction Amounts

The raw fresh milk sold by the Group to China Mengniu Group for the three years ended 31 December 2019, 2020 and 2021 and the nine months ended 30 September 2022 amounted to RMB2,350,989,496, RMB2,504,619,468, RMB2,621,629,144 and RMB2,171,776,462, respectively.

The annual caps for the supply of raw fresh milk by the Group to China Mengniu Group for the two years ended 31 December 2020 and 2021 and one year ending 31 December 2022 are RMB3,300 million, RMB3,700 million and RMB4,200 million, respectively.

Proposed Annual Caps

The Directors propose that the total annual sales amount by the Group to China Mengniu Group under the Raw Fresh Milk Supply Framework Agreement shall not exceed RMB3,400 million, RMB4,300 million and RMB5,000 million for the three years ending 31 December 2023, 2024 and 2025, respectively.

As disclosed in the interim report of the Company for the six months ended 30 June 2022, in order to realise the Group's strategic plans to grow its organic milk sales, the Group commenced the construction of a dairy farming demonstration zone at its base in the Ulan Buh Desert earlier this year. The Group plans to build a 10,000-head dairy farm and an organic demonstration farm in the demonstration zone, the construction of which is expected to be completed in 2023. When the demonstration zone commences full operation, it is expected the 10,000-head dairy farm will produce approximately 80,000 tonnes of high quality organic milk per year whilst the organic demonstration farm will produce an average of approximately 20,000 tonnes of fresh milk per year. The newly built demonstration zone to the Group's farming facilities will significantly enhance the production capacity of the Group which, coupled with the Group's other enhancement measures such as effective breeding and selection to increase the genomic accuracy and completeness of the Group's cows genome and hence the proportion of high yielding cows, bolsters the Group's ability to satisfy orders for raw fresh milk from its customers, including orders from China Mengniu Group. For the six months ended 30 June 2022, the Group sold a total of 311,565 tonnes of raw milk and, as at the end of that period, had a total of 130,802 cows in stock, of which 86,578 were organic cows. In addition, in determining such annual caps, the Directors have also considered the following factors:

- (a) the expected number of milkable cows of the Group (taking into account anticipated purchases and improvement in dairy cow breeding capacity, etc.). On average for 2020, 2021 and the nine months ended 30 September 2022, the Group had 51,230, 51,314, and 53,408 heads of milkable cows for the production of raw fresh milk, respectively, representing growth of approximately 0.2% from 2020 to 2021 and approximately 4% from 2021 to September 2022, and among these milkable cows, 24,414, 33,979, and 38,099

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heads of milkable cows were used for the production of organic raw fresh milk for 2020, 2021 and the nine months ended 30 September 2022, respectively, representing growth of approximately 39% from 2020 to 2021 and approximately 12% from 2021 to September 2022. In recent years, the Group endeavours to improve the internal management of its operations, and as a result of enhancement measures adopted by the Group, key indicators such as 21-day conception rate and pregnancy discovery rate of milkable cows and heifers have substantially increased when compared to those in 2020, which lay the groundwork for high natural growth in number of milkable cows in the next few years. Accordingly, the Group expects the number of milkable cows to increase at a higher rate going forward taking into account, among other things, the reducing culling rate of milkable cows, potential acquisitions from third parties and construction of the dairy farming demonstration zone;

- (b) the expected increase in the overall sales volume of raw fresh milk by the Group for the three years ending 31 December 2023, 2024 and 2025, taking into account (i) the impact of consumption upgrade where urban citizens have a growing demand of high quality organic milk, (ii) the high quality of the Group's milk products (in terms of purity and freshness), and (iii) the appeal of the Group's outstanding achievements in carbon neutrality and desert circulation agriculture system as environmental protection awareness continues to grow;
- (c) the expected increase in sales volume of raw fresh milk to China Mengniu Group taking into account, among other things, the Group's commitment to supply on average more than 80% of the raw fresh milk it produces in each year to China Mengniu Group;
- (d) the potential increase in price of dairy products in China. The average selling price of the organic raw fresh milk of the Group increased from approximately RMB4.8 per kg in 2019 to approximately RMB5.3 per kg in 2021 and slightly decreased to approximately RMB5.2 per kg for the nine months ended 30 September 2022, representing an overall increase of approximately 8%. The non-organic raw fresh milk price followed a similar trend as that of organic raw fresh milk. The average selling price surged from approximately RMB3.7 per kg in 2019 to approximately RMB4.5 per kg in 2021 and slightly decreased to approximately RMB4.3 per kg for the nine months ended 30 September 2022, representing an overall increase of approximately 16%. The Group expects the selling price of raw fresh milk to continue to increase albeit at a slower rate going forward;
- (e) the historical and prevailing purchase price for raw fresh milk paid by China Mengniu Group; and
- (f) the historical transaction amounts of raw fresh milk sold by the Group to China Mengniu Group for the three years ended 31 December 2019, 2020 and 2021 and the nine months ended 30 September 2022 respectively, as mentioned above.

LETTER FROM THE BOARD

LISTING RULES IMPLICATIONS

As at the Latest Practicable Date, Shengmu High-tech is an indirect wholly-owned subsidiary of the Company and Inner Mongolia Mengniu is a non-wholly owned subsidiary of China Mengniu.

As at the Latest Practicable Date, to the best of the Directors' knowledge, information and belief having made all reasonable enquiry, China Mengniu holds 100% equity interest in Start Great, which in turn directly holds 2,513,178,555 Shares, representing approximately 29.99% equity interest in the Company. Accordingly, each of Start Great, China Mengniu and Inner Mongolia Mengniu is a connected person of the Company.

As one or more applicable percentage ratios under the Listing Rules in respect of the highest proposed annual cap under the Raw Fresh Milk Supply Framework Agreement exceed 5%, the entering into of the Raw Fresh Milk Supply Framework Agreement and the transactions contemplated thereunder are subject to the reporting, announcement and independent shareholders' approval requirements under Chapter 14A of the Listing Rules. Start Great which, to the best of the Directors' knowledge, information and belief having made all reasonable enquiry, controls the voting rights in respect of its Shares, will be required to abstain from voting at the EGM in relation to the Raw Fresh Milk Supply Framework Agreement and the transactions contemplated under such agreement. Save as disclosed above, to the best of the Directors' knowledge, information and belief having made all reasonable enquiry, no Shareholder is required to abstain from voting at the EGM in relation to the Raw Fresh Milk Supply Framework Agreement and the transactions contemplated under such agreement.

Mr. Lu Minfang, a non-executive Director and chairman of the Board, is also an executive director and chief executive officer of China Mengniu. Mr. Zhang Ping, a non-executive Director, is also an executive director, vice president and chief financial officer of China Mengniu. Mr. Lu and Mr. Zhang have abstained from voting on the resolutions of the Directors approving the Raw Fresh Milk Supply Framework Agreement and the transactions contemplated thereunder. Other than Mr. Lu and Mr. Zhang, no Director is materially interested in the transactions contemplated under the Raw Fresh Milk Supply Framework Agreement and no Director is required to abstain from voting on the resolutions of the Directors to approve the Raw Fresh Milk Supply Framework Agreement and the transactions contemplated under such agreement.

INFORMATION ON THE PARTIES

The Company is an investment holding company. The Group is principally engaged in dairy farming business.

Shengmu High-tech is an indirect wholly-owned subsidiary of the Company and is principally engaged in dairy farming and the sale of raw milk.

Inner Mongolia Mengniu is a non-wholly owned subsidiary of China Mengniu and is principally engaged in the business of manufacture and sale of dairy products.

LETTER FROM THE BOARD

China Mengniu is a company listed on the Stock Exchange and is one of the leading dairy product manufacturers in the PRC. China Mengniu Group is principally engaged in manufacturing and distribution of quality dairy products including liquid milk, ice-cream, milk formula and other dairy products.

INDEPENDENT BOARD COMMITTEE AND THE INDEPENDENT FINANCIAL ADVISOR

The Independent Board Committee has been established to advise the Independent Shareholders in respect of the Raw Fresh Milk Framework Agreement, the transactions contemplated under such agreement and the proposed annual caps for such transactions for the three years ending 31 December 2023, 2024 and 2025. A letter from the Independent Board Committee containing its recommendation to the Independent Shareholders is set out on pages 16 to 17 of this circular.

The Board has appointed Somerley as the Independent Financial Advisor to advise the Independent Board Committee and the Independent Shareholders in respect of the Raw Fresh Milk Framework Agreement, the transactions contemplated under such agreement and the proposed annual caps for such transactions for the three years ending 31 December 2023, 2024 and 2025. A letter from Somerley containing its advice to the Independent Board Committee and the Independent Shareholders is set out on pages 18 to 31 of this circular.

EGM

A notice convening the EGM to be held at the Conference Room, 10/F, United Centre, 95 Queensway, Admiralty, Hong Kong on 29 December 2022 at 9:30 a.m. is set out on pages 38 to 39 of this circular. At the EGM, an ordinary resolution will be proposed to approve the Raw Fresh Milk Framework Agreement, the transactions contemplated under such agreement and the proposed annual caps for such transactions for the three years ending 31 December 2023, 2024 and 2025.

Pursuant to Rule 13.39(4) of the Listing Rules, any vote of the Shareholders at a general meeting must be taken by poll. Accordingly, the proposed resolution will be put to vote by way of poll at the EGM. An announcement on the poll vote results will be published by the Company after the EGM in the manner prescribed under Rule 13.39(5) of the Listing Rules.

You will find enclosed with this circular a form of proxy for use at the EGM and such form of proxy is also published on the websites of the Stock Exchange (www.hkexnews.hk) and the Company (www.youjimilk.com). Whether or not you are able to attend the EGM, please complete and sign the enclosed form of proxy in accordance with the instructions printed thereon and return it, together with the power of attorney or other authority (if any) under which it is signed or a notarially certified copy of that power of attorney or authority, to the office of the Company's branch share registrar in Hong Kong, Tricor Investor Services Limited, at 17/F, Far East Financial Centre, 16 Harcourt Road, Hong Kong as soon as possible but in any event not less than 48 hours before the time scheduled for holding the EGM or any adjournment thereof. Completion and return of the form of proxy shall not preclude you from attending and voting in person at the EGM or any adjourned meeting thereof if you so wish, in which event your proxy form shall be deemed to be revoked.

LETTER FROM THE BOARD

CLOSURE OF REGISTER OF MEMBERS

For the purpose of determining Shareholders' entitlements to attend and vote at the EGM, the register of members of the Company will be closed from 22 December 2022 to 29 December 2022 (both days inclusive), during which period no transfer of Shares will be effected. In order to be eligible to attend and vote at the EGM, all transfers, accompanied by the relevant share certificates, must be lodged with the Company's branch share registrar in Hong Kong, Tricor Investor Services Limited, at 17/F, Far East Financial Centre, 16 Harcourt Road, Hong Kong no later than 4:30 p.m. on 21 December 2022.

RECOMMENDATION

Your attention is drawn to (i) the letter from the Independent Board Committee as set out on pages 16 to 17 of this circular and (ii) the letter from Somerley as set out on pages 18 to 31 of this circular.

Having taken into account the aforementioned reasons and benefits, the Board considers that the Raw Fresh Milk Framework Agreement and the transactions contemplated under such agreement are entered into on normal commercial terms and in the ordinary course of business of the Group, are in the interests of the Company and the Shareholders as a whole, and the terms of the Raw Fresh Milk Framework Agreement and each of its proposed annual caps are fair and reasonable. Accordingly, the Board recommends that the Independent Shareholders vote in favour of the ordinary resolution to be proposed at the EGM to approve the Raw Fresh Milk Framework Agreement, the transactions contemplated under such agreement and the proposed annual caps for such transactions for the three years ending 31 December 2023, 2024 and 2025, as detailed in the EGM notice.

ADDITIONAL INFORMATION

Your attention is drawn to the additional information set out in the appendix to this circular.

Yours faithfully,
By order of the Board
China Shengmu Organic Milk Limited
Lu Minfang
Chairman



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)

12 December 2022

To the Independent Shareholders

Dear Sir or Madam,

**RENEWAL OF CONTINUING CONNECTED TRANSACTIONS
RAW FRESH MILK SUPPLY FRAMEWORK AGREEMENT**

We have been appointed by the Board to advise the Independent Shareholders in connection with the Raw Fresh Milk Supply Framework Agreement, the transactions contemplated under such agreement and the proposed annual caps for such transactions for the three years ending 31 December 2023, 2024 and 2025, details of which are set out in the letter from the Board contained in the circular of the Company to the Shareholders dated 12 December 2022 (the “**Circular**”), of which this letter forms a part. Terms used in this letter shall have the same meanings as those defined in the Circular unless the context otherwise requires.

Somerley has been appointed as the Independent Financial Advisor to advise us and the Independent Shareholders on the Raw Fresh Milk Supply Framework Agreement, the transactions contemplated under such agreement and the proposed annual caps for such transactions for the three years ending 31 December 2023, 2024 and 2025. We wish to draw your attention to the letter from the Board as set out on pages 4 to 15 of the Circular, and the letter from Somerley to us and the Independent Shareholders as set out on pages 18 to 31 of the Circular, which contains its advice and recommendation in respect of the Raw Fresh Milk Supply Framework Agreement and the transactions contemplated thereunder.

Having considered, inter alia, the factors and reasons considered by, and the opinion of, Somerley, as stated in its aforementioned letter, we consider the Raw Fresh Milk Framework Agreement and the transactions contemplated under such agreement are entered into on normal commercial terms and in the ordinary course of business of the Group, are in the interests of the Company and the Shareholders as a whole so far as the Independent Shareholders are concerned, and the terms of the Raw Fresh Milk Framework Agreement and each of its proposed annual caps are fair and reasonable.

LETTER FROM THE INDEPENDENT BOARD COMMITTEE

Accordingly, we recommend that the Independent Shareholders vote in favour of the relevant ordinary resolution to be proposed at the EGM and thereby approve the Raw Fresh Milk Framework Agreement, the transactions contemplated under such agreement and the proposed annual caps for such transactions for the three years ending 31 December 2023, 2024 and 2025.

Yours faithfully,
For and on behalf of
The Independent Board Committee

Wang Liyan
*Independent non-executive
Director*

Wu Liang
*Independent non-executive
Director*

Sun Yansheng
*Independent non-executive
Director*

LETTER FROM SOMERLEY

Set out below is the text of a letter received from Somerley Capital Limited, the Independent Financial Adviser to the Independent Board Committee and the Independent Shareholders in respect of the Raw Fresh Milk Supply Framework Agreement and the transactions contemplated thereunder for the purpose of inclusion in this circular.



SOMERLEY CAPITAL LIMITED
20th Floor
China Building
29 Queen's Road Central
Hong Kong

12 December 2022

*To: The Independent Board Committee and the Independent Shareholders of
China Shengmu Organic Milk Limited*

Dear Sirs,

RENEWAL OF CONTINUING CONNECTED TRANSACTIONS RAW FRESH MILK SUPPLY FRAMEWORK AGREEMENT

INTRODUCTION

We refer to our appointment as the independent financial adviser to advise the Independent Board Committee and the Independent Shareholders in relation to the entering into the Raw Fresh Milk Supply Framework Agreement. Details of the terms of the Raw Fresh Milk Supply Framework Agreement are contained in the circular issued by the Company to the Shareholders dated 12 December 2022 (“**Circular**”), of which this letter forms part. Unless the context otherwise requires, capitalised terms used in this letter shall have the same meanings as those defined in the Circular.

On 17 November 2022, Shengmu High-tech (for itself and on behalf of its subsidiaries) entered into the Raw Fresh Milk Supply Framework Agreement with Inner Mongolia Mengniu (for itself and on behalf of its subsidiaries) in relation to the sale of raw fresh milk by the Group to China Mengniu Group for a term of three years commencing from 1 January 2023 to 31 December 2025.

As at the Latest Practicable Date, Shengmu High-tech is an indirect wholly-owned subsidiary of the Company and Inner Mongolia Mengniu is a non-wholly owned subsidiary of China Mengniu. China Mengniu holds 100% equity interest in Start Great, which in turn directly holds approximately 29.99% equity interest in the Company. Accordingly, each of Start Great, China Mengniu and Inner Mongolia Mengniu is a connected person of the Company. As one or more applicable percentage ratios under the Listing Rules in respect of the highest proposed annual cap under the Raw Fresh Milk Supply Framework Agreement exceed 5%, the entering into the Raw Fresh Milk Supply Framework Agreement and the transactions contemplated thereunder are subject to the reporting, announcement and independent shareholders' approval requirements under Chapter 14A of the Listing Rules.

LETTER FROM SOMERLEY

The Independent Board Committee comprising all the independent non-executive Directors, namely Mr. Wang Liyan, Mr. Wu Liang and Mr. Sun Yansheng, has been established to advise the Independent Shareholders in respect of, among other things, the Raw Fresh Milk Supply Framework Agreement and to make recommendation as to voting. We, Somerley Capital Limited, have been appointed to advise the Independent Board Committee and the Independent Shareholders in the same regard.

We are not associated with the Company, Shengmu High-tech, Inner Mongolia Mengniu and their respective associates, close associates or core connected persons (all as defined under the Listing Rules) and accordingly are considered eligible to give independent advice on the above matters. Apart from normal professional fees payable to us in connection with this and similar appointments, no arrangement exists whereby we will receive any fees or benefits from the Company, Shengmu High-tech, Inner Mongolia Mengniu or their respective associates, close associates or core connected persons.

In formulating our opinion and recommendation, we have reviewed, among other things, the Raw Fresh Milk Supply Framework Agreement, the annual report of the Company for the year ended 31 December 2021 (“**2021 Annual Report**”), the interim report of the Company for the six months ended 30 June 2022 (“**2022 Interim Report**”) and the information as set out in the Circular. We have also discussed with the management of the Group (“**Management**”) regarding the business and prospects of the Group.

We have relied on the information and facts supplied, and the opinions expressed, by the Directors and the Management and have assumed that they are true, accurate and complete. We have also sought and received confirmation from the Directors that no material facts have been omitted from the information supplied and opinions expressed to us. We have no reason to believe that any material information has been withheld from us, or to doubt the truth or accuracy of the information provided. We have relied on such information and consider that the information we have received is sufficient for us to reach an informed view. We have not, however, conducted any independent investigation into the business and affairs of the Group.

PRINCIPAL FACTORS AND REASONS CONSIDERED

In arriving at our opinion and recommendation, we have taken into account the following principal factors and reasons:

1. Information on the Group

(a) Business of the Group

The Company was incorporated in the Cayman Islands with limited liability and its issued shares have been listed on the Main Board of the Stock Exchange since July 2014. As set out in the 2022 Interim Report, the principal business of the Group is dairy farming, production and sales of high-end desert-based organic raw milk and quality non-organic raw milk. The Group has 33 farms with a stock of 130,000 cows and a daily production capacity of approximately 1,869 tonnes of fresh milk, of which 20 are certified organic farms and 3 are docosahexaenoic acid (commonly known as DHA) farms.

LETTER FROM SOMERLEY

(b) *Financial results of the Group*

Set out below is a summary of the financial results of the Group for the years ended 31 December 2020 and 2021 and the six months ended 30 June 2021 and 2022.

	For the six months ended 30 June		For the year ended 31 December	
	2022	2021	2021	2020
	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>	<i>RMB</i>
	<i>(million)</i>	<i>(million)</i>	<i>(million)</i>	<i>(million)</i>
Revenue	1,548.6	1,446.2	2,984.6	2,660.8
Cost of sales	<u>(1,035.8)</u>	<u>(898.9)</u>	<u>(1,920.2)</u>	<u>(1,635.7)</u>
Gross profit	512.8	547.3	1,064.4	1,025.1
Loss arising from changes in fair value less costs to sell of biological assets	(197.2)	(154.9)	(248.8)	(224.2)
Selling and distribution expenses	(23.5)	(25.3)	(53.8)	(32.1)
Administrative expenses	(66.6)	(47.6)	(111.7)	(111.7)
Finance costs	(10.0)	(31.1)	(71.2)	(116.8)
Others	<u>27.7</u>	<u>(16.7)</u>	<u>(68.5)</u>	<u>(79.3)</u>
Profit before tax	243.2	271.7	510.4	461.0
Income tax expense	<u>—</u>	<u>(0.2)</u>	<u>(0.8)</u>	<u>—</u>
Profit for the period/year	<u>243.2</u>	<u>271.5</u>	<u>509.6</u>	<u>461.0</u>
Profit for the period/year attributable to:				
- the Shareholders	228.8	259.3	471.7	406.7
- non-controlling interests	14.4	12.2	37.9	54.3

The Group derives revenue from the production and distribution of raw milk in the PRC. For the year ended 31 December 2021, the Group's revenue enhanced by approximately 12.2% as compared to that for the prior year, which was mainly attributable to increases in both the sales volume and average selling price of organic raw milk. The gross profit margin of the Group for the year ended 31 December 2021 was down by approximately 2.8% to approximately 35.7% due to, among other things, the increase in bulk feed prices. The net profit of the Group for the year ended 31 December 2021 attributable to the Shareholders was approximately RMB471.7 million, representing an improvement of approximately RMB65.0 million or approximately 16.0% as compared to that for the prior year. The enhanced net profit was largely driven by the increase in the revenue and the control of various expenses of the Group.

LETTER FROM SOMERLEY

For the six months ended 30 June 2022, the Group recorded a revenue of approximately RMB1,548.6 million, representing a year-on-year increase of approximately 7.1%, primarily due to the increase in sales volume of raw milk. The gross profit margin of the Group for the six months ended 30 June 2022 continued to decline to approximately 33.1% as a result of, among other things, the increase in bulk feed prices. The net profit of the Group attributable to the Shareholders for the period was approximately RMB228.8 million, representing a year-on-year decrease of approximately RMB30.5 million or approximately 11.8%. This was mainly due to a significant increase in feed prices and a slight fall in raw milk prices as compared with those for the corresponding period in the previous year.

(c) Financial position of the Group

Set out below is a summary of the financial position of the Group as at 30 June 2022 and 31 December 2021.

	As at 30 June 2022	As at 31 December 2021
	<i>RMB (million)</i>	<i>RMB (million)</i>
Non-current assets		
Property, plant and equipment	1,680.4	1,699.6
Biological assets	2,790.8	2,698.6
Other non-current assets	665.7	683.6
	5,136.9	5,081.8
Current assets		
Inventories	437.4	768.1
Trade receivables	272.1	248.1
Restricted bank deposits	209.3	256.5
Cash and bank balances	802.9	531.8
Other current assets	254.0	245.3
	1,975.7	2,049.8
Current liabilities		
Trade and bills payables	811.1	1,253.4
Interest-bearing bank borrowings	1,653.4	1,299.5
Other current liabilities	229.7	309.9
	2,694.2	2,862.8
Net current liabilities	(718.5)	(813.0)

LETTER FROM SOMERLEY

	As at 30 June 2022	As at 31 December 2021
	<i>RMB (million)</i>	<i>RMB (million)</i>
Non-current liabilities		
Interest-bearing bank borrowings	300.0	379.6
Lease liabilities	<u>10.5</u>	<u>—</u>
	310.5	379.6
Equity		
Equity attributable to the Shareholders	3,884.2	3,679.8
Non-controlling interests	<u>223.7</u>	<u>209.4</u>
	<u><u>4,107.9</u></u>	<u><u>3,889.2</u></u>

The majority of the Group's assets as at 30 June 2022 were (i) biological assets consisting of dairy cows held to produce raw milk and cows held for sale; and (ii) property, plant and equipment primarily comprising buildings and machinery and equipment. Current assets as at 30 June 2022 mainly consisted of inventories, trade receivables and cash and bank balances.

The Group's operations were chiefly financed by Shareholders' equity and bank borrowings. As at 30 June 2022, the Group had interest-bearing bank borrowings of approximately RMB1,953.4 million. The gearing ratio, being total interest-bearing bank borrowings less cash and bank balances divided by the total equity, was approximately 28.0% as at 30 June 2022. As the majority of the interest-bearing bank borrowings were due within one year, the Group was in net current liability position of approximately RMB718.5 million as at 30 June 2022.

2. Information on Inner Mongolia Mengniu and China Mengniu Group

Inner Mongolia Mengniu is a non-wholly owned subsidiary of China Mengniu and is principally engaged in the business of manufacturing and sale of dairy products.

China Mengniu (stock code: 2319) has listed on the Main Board of the Stock Exchange since 2004. China Mengniu Group is one of the leading dairy product manufacturers in the PRC, principally engaged in manufacturing and distribution of quality dairy products including liquid milk products, ice-cream, milk formula and other dairy products. Based on its latest financial reports, China Mengniu recorded revenue and net profit after tax of approximately RMB88.1 billion and approximately RMB5.0 billion respectively in 2021 and had net asset value and cash and bank balances of approximately RMB44.0 billion and approximately RMB9.8 billion, respectively, as at 30 June 2022. In addition, China Mengniu had a market capitalisation of approximately HK\$133.3 billion as at the Latest Practicable Date.

LETTER FROM SOMERLEY

3. Reasons for and benefits of entering into the Raw Fresh Milk Supply Framework Agreement

As discussed in the letter from the Board contained in the Circular, there are a number of benefits of entering into the Raw Fresh Milk Supply Framework Agreement for the Group, which include:

- (a) As one of the leading dairy product manufacturers in the PRC, China Mengniu Group is equipped with a strong management team and a solid dairy product distribution network, offering diversified products including liquid milk products, ice cream, milk formula and cheese. The Company believes that a raw fresh milk supply relationship with China Mengniu Group (taking into account, among other things, the Group's commitment to supply on average more than 80% of the raw fresh milk it produces in each year to China Mengniu Group) will help to stabilise the price and sales volume of raw fresh milk and generate stable income and cash flow for the Group.
- (b) The dairy farms of the Group are mainly located in the regions of Hohhot and Bayannur, and China Mengniu Group has sufficient raw fresh milk processing capacity in these regions. The short transportation distance ensures the freshness of raw fresh milk supplied by the Group, which in turn contributes to the high quality of milk products manufactured by China Mengniu Group. It also lowers the Group's costs of transportation and preservation, which makes the price of raw fresh milk supplied by the Group more competitive as compared to other suppliers of raw fresh milk.
- (c) Whilst focusing on the production and sale of desert-based organic milk, the Group also endeavors to satisfy customers' diversified needs for quality raw milk and continues to develop a variety of functional raw milk to enhance the Group's product mix and profitability.
- (d) The collaboration between the Group and China Mengniu Group, which eventually leads to the growth of demand for desert-based organic milk through channels such as marketing and distribution, would enhance the awareness of the Group's milk products and in turn promote the Group's sales growth, thereby achieving a win-win outcome for both groups.

The business activities of the Group is dairy farming, production and sales of high-end desert-based organic raw milk and quality non-organic raw milk. We note that the revenue generated from the sales of raw fresh milk by the Group to China Mengniu Group has been substantial and has accounted for a significant majority of the revenue of the Group in the past few years. The entering into the Raw Fresh Milk Supply Framework Agreement, particularly the term that on average at least 80% of the raw fresh milk the Group produces in each year will be sold to China Mengniu Group, secures a continuing demand for the raw fresh milk produced by the Group and provides a regular revenue stream to the Group. Furthermore, the price of raw fresh milk to be sold to China Mengniu Group will be no less favourable to the Group than the price offered from independent third party customers. Having considered the above, we are of the view that the entering into the Raw Fresh Milk Supply Framework Agreement is beneficial to the Group and in the ordinary and usual course of the business of the Group.

LETTER FROM SOMERLEY

4. Principal terms of the Raw Fresh Milk Supply Framework Agreement

Date

17 November 2022

Parties

- (i) Shengmu High-tech (for itself and on behalf of its subsidiaries); and
- (ii) Inner Mongolia Mengniu (for itself and on behalf of its subsidiaries)

Term

From 1 January 2023 to 31 December 2025

Principal terms

The Group shall sell raw fresh milk which meets China Mengniu Group's purchasing standard and quality requirements to China Mengniu Group on a daily basis in accordance with the monthly milk supply plan to be agreed between the Group and China Mengniu Group, and the Group shall ensure that on average more than 80% of the raw fresh milk it produces in each year will be sold to China Mengniu Group. The specific amount to be purchased shall be the amount as confirmed by the Group and China Mengniu Group. The daily delivery amount is determined by the amount as weighted by China Mengniu Group.

Purchase price and pricing mechanism

The purchase price of raw fresh milk to be sold by the Group to China Mengniu Group under the Raw Fresh Milk Supply Framework Agreement shall be determined and adjusted in accordance with the following pricing mechanism:

- (a) the base price ("**Base Price**") shall be determined based on market conditions (taking into account (i) the latest average price of raw fresh milk for 10 selected regions (including Inner Mongolia and Hebei) published on the website of the Ministry of Agriculture and Rural Affairs of the PRC, and (ii) prices charged by other suppliers to China Mengniu Group), together with seasonal factors and sales price of raw fresh milk in the region, as agreed between Shengmu High-tech and Inner Mongolia Mengniu;
- (b) the logistics subsidy as agreed between Shengmu High-tech and Inner Mongolia Mengniu based on the prevailing logistics costs incurred by the dairy farming industry (taking into account (i) vehicle depreciation and maintenance, (ii) wages, (iii) fuel costs, based on refined oil prices announced by the National Development and Reform Commission of the PRC from time to time, (iv) toll rates, (v) insurance premium, and (vi) cargo-loading rate) and the distance between the customer's location and Shengmu High-tech's dairy farm(s); and

LETTER FROM SOMERLEY

- (c) adjustments as agreed between Shengmu High-tech and Inner Mongolia Mengniu based on the quality and rating of raw fresh milk, taking into account various milk quality indicators, such as level of protein, fat content, somatic cell count, microorganism count and freezing point etc. (together with the logistics subsidy referred to in paragraph (b) above, “**Adjustments**”).

We have obtained and reviewed four recent raw fresh milk long-term supply agreements entered into between the Group as the supplier and each of two independent third parties and two associate companies of the Group as the purchaser. We note that the purchase price in the four supply agreements was either a fixed rate or determined based on the market conditions and seasonal factors. For the logistics service costs, except for one purchaser which does not require such service, all the remaining three purchasers agreed to either bear the costs or provide a subsidy for such service to the Group. In respect of the adjustments for milk quality to the base price, save for one of the supply agreements provides downward adjustment when milk quality factors are not met, there is no similar adjustment in all other three supply agreements. We have also obtained the supply listings of one farm of the Group, which supplied raw fresh milk to both China Mengniu Group and an independent third party during the period from 1 January 2022 to 30 September 2022, and we randomly selected two transactions between the Group as the supplier and China Mengniu Group and the independent third party as the purchasers. We have obtained and reviewed the selected raw fresh milk supply transaction documents and we note that the selling prices of raw fresh milk to China Mengniu Group were not lower than those of the independent third party.

Quality of milk

The quality of raw fresh milk supplied by the Group shall comply with the standards set by the government and the requirements of China Mengniu Group. We have reviewed the aforesaid recent raw fresh milk supply agreements and note that similar milk quality requirements were in place in the agreements.

Punctual delivery

The Group shall be responsible for delivering raw fresh milk to the locations designated by China Mengniu Group. If the Group is unable to deliver milk in a timely manner, the Group shall notify China Mengniu Group at least 24 hours prior to the scheduled delivery and the Group shall bear related losses suffered by China Mengniu Group (“**Late Delivery Charge**”).

As stated in the letter from the Board contained in the Circular, the Group has established an internal control mechanism to ensure the timely delivery of raw fresh milk. The Group maintains a three-month rolling plan for the herd and milk production to ensure that the Group has sufficient milk production capacity to meet the monthly supply plans for raw fresh milk. In addition, the dairy farms of the Group and the dairy products manufacturing facilities of China Mengniu Group are located in the same region. The maximum transportation distance for the supply of raw fresh milk from the dairy farms of the Group to the manufacturing facilities of China Mengniu Group is less than 110 kilometers and the transportation time is generally less than two hours. Given the close proximity, the Group is able to coordinate additional resources to meet the monthly supply plans if there is an emergency situation.

LETTER FROM SOMERLEY

Moreover, the Late Delivery Charge is a common term in similar agreements between China Mengniu Group and its suppliers of raw fresh milk which are independent from China Mengniu Group. Therefore, the Board considers that such term is on normal commercial terms and in the interest of the Company. Having considered the existence of such term in similar agreements entered into between China Mengniu Group and their other suppliers of raw fresh milk, we concur with the view of the Board that the Late Delivery Charge is on normal commercial terms.

Payment terms

China Mengniu Group shall pay monthly in accordance with the purchase amount of raw fresh milk, and payment for raw fresh milk purchased in any month shall be settled by the end of the following month. The monthly payment date shall be before the 30th calendar day of each month (or the 28th calendar day for February).

Based on our review of the aforesaid four recent raw fresh milk long-term supply agreements, we note that the purchaser shall pay raw fresh milk purchased in any month by the end of that month or a few days before the end of the following month. Accordingly, it is considered that the payment terms of the aforesaid raw fresh milk supply agreements are generally in line with that of the Raw Fresh Milk Supply Framework Agreement.

5. Internal control procedures in determining the purchase price

As set out in the letter from the Board contained in the Circular, the Group formulates an annual supply plan for raw fresh milk, which is then divided into monthly supply plans taking into account the volume required by China Mengniu Group. The unit price of raw fresh milk, which comprises the Base Price and the Adjustments, is determined on a monthly basis. The Sales Team will review on a monthly basis the actual volume of raw fresh milk supplied. The Sales Team will also evaluate the fairness of the unit price by examining and considering the quantitative data from the test results of the milk quality indicators and checking whether the unit price has correctly reflected the test results of the raw fresh milk.

The Group's pricing mechanism with its customers (including China Mengniu Group and other independent third party customers) is generally the same and therefore the selling price of raw fresh milk to be sold by the Group to China Mengniu Group under the Raw Fresh Milk Supply Framework Agreement would be comparable to that of the other independent third party customers. The Group has established the following internal control measures to ensure that the purchase price and other terms of the sale of raw fresh milk by the Group to China Mengniu Group contemplated under the Raw Fresh Milk Supply Framework Agreement are no less favourable to the Group than the terms offered to independent third party customers, where the Sales Team has been tasked with:

- (a) considering and comparing prices and terms of similar products offered by the Group to other purchasers every month;
- (b) conducting market research every month and comparing the selling price of similar products offered by three other raw fresh milk producers when determining the Base Price for each month;

LETTER FROM SOMERLEY

- (c) reviewing other terms of orders received from China Mengniu Group and other independent third party customers to ensure that the other terms offered by the Group to China Mengniu Group are no less favourable to the Group than those offered to independent third party customers; and
- (d) ensuring that each sale is executed at a purchase price determined in accordance with the relevant pricing mechanism as set out above.

Based on our review of the Group's internal controls policies in relation to connected transactions, in particular the pricing policies of raw fresh milk, we note that the responsible officer of the Group (who is independent to the purchasers and responsible for comparison of the quotations and negotiation with the purchasers) will determine the pricing of the raw fresh milk delivered to the relevant purchasers with supply agreements in that month at the beginning of each month. The responsible officer of the Group will review all the quotations and negotiate with the various purchasers to ensure the final unit price, before taking into account the Adjustments, is consistent among the purchasers. We have obtained the supply listings of one farm of the Group, which supplied raw fresh milk to both China Mengniu Group and an independent third party, during the period from 1 January 2022 to 30 September 2022 and we randomly selected two transactions between the Group as the supplier and China Mengniu Group and the independent third party as the purchasers. We have obtained and reviewed the selected raw fresh milk supply transaction documents and we note that the selling prices of raw fresh milk to China Mengniu Group were not lower than those of the independent third party.

Based on the above, we concur with the view of the Board that the aforesaid pricing procedures can result in the transactions contemplated under the Raw Fresh Milk Supply Framework Agreement to be conducted on normal commercial terms.

6. The Annual Caps

The proposed total annual sale amount by the Group to China Mengniu Group under the Raw Fresh Milk Supply Framework Agreement shall not exceed RMB3,400 million, RMB4,300 million and RMB5,000 million (“**Annual Caps**”) for the years ending 31 December 2023, 2024 and 2025 (“**Cap Period**”), respectively.

As stated in the letter from the Board contained in the Circular, the Annual Caps were determined with reference to a number of factors, particularly (i) the expected number of milkable cows of the Group (taking into account anticipated purchases and improvement in dairy cow breeding capacity, etc.); (ii) the expected increase in the overall sales volume of raw fresh milk by the Group for the years ending 31 December 2023, 2024 and 2025; (iii) the expected increase in sales volume of raw fresh milk to China Mengniu Group taking into account, among other things, the Group's commitment to supply on average at least 80% of the raw fresh milk it produces in each year to China Mengniu Group; (iv) the potential increase in price of dairy products in China; (v) the historical and prevailing purchase price of raw fresh milk paid by China Mengniu Group; and (vi) the historical transaction amounts of raw fresh milk sold by the Group to China Mengniu Group for the years ended 31 December 2019, 2020 and 2021 and the nine months ended 30 September 2022.

LETTER FROM SOMERLEY

We have reviewed the following factors to assess the fairness and reasonableness of the Annual Caps:

(a) The expected number of milkable cows of the Group

On average for 2020, 2021 and the nine months ended 30 September 2022, the Group had 51,230, 51,314, and 53,408 heads of milkable cows for the production of raw fresh milk, respectively, representing growths of approximately 0.2% from 2020 to 2021 and approximately 4% from 2021 to September 2022. Among these milkable cows, 24,414, 33,979, and 38,099 heads of milkable cows were used for the production of organic raw fresh milk (“**Organic Milkable Cow(s)**”) for 2020, 2021 and the nine months ended 30 September 2022, respectively, representing growths of approximately 39% from 2020 to 2021 and approximately 12% from 2021 to September 2022. The remaining 26,816, 17,335, and 15,309 heads of milkable cows were used for the production of non-organic raw fresh milk (“**Non-organic Milkable Cow(s)**”) for 2020, 2021 and the nine months ended 30 September 2022, respectively, representing decreases of approximately 35% from 2020 to 2021 and approximately 12% from 2021 to September 2022. Such fluctuations of the numbers of the Organic Milkable Cows and the Non-organic Milkable Cows, as stated in the 2021 Annual Report, were mainly due to the conversion of regular farms to organic farms.

As advised by the Management and for the purpose of determining the Annual Caps, it was anticipated that the total number of milkable cows during the Cap Period would grow by approximately 10% to 22% per annum, consisting of (i) the expected growths in the number of the Organic Milkable Cows of approximately 17% to 27% per annum; and (ii) the expected changes in the number of the Non-organic Milkable Cows between a decline of approximately 9% per annum and a growth of approximately 8% per annum. The expected higher growth in the total number of milkable cows during the Cap Period is driven by, among others, the reducing culling rate of milkable cows. As stated in the 2021 Annual Report and the 2022 Interim Report, the annualised culling rate of milkable cows continued to decline from 35.9% to 32.9% for the year ended 31 December 2021 and further down to 31.1% for the first half of 2022. We concur with the Management’s expected growths of the total number of milkable cows are reasonable taking into account the historical decreasing culling rate of milkable cows.

As advised by the Management, additional expected growths of the number of the Organic Milkable Cows would be contributed by the potential acquisition of milkable cows from other parties during the Cap Period for a new dairy farm and an organic demonstration farm in the demonstration zone, which was expected to produce additional approximately 100,000 tonnes of organic raw fresh milk per year. We have obtained and reviewed the calculation of expected growth of the number of the Organic Milkable Cows and we note that the potential acquisition of the Organic Milkable Cows in 2023 and 2024 will produce additional approximately 100,000 tonnes or more of organic raw fresh milk for 2024 and 2025, respectively. We consider the projected numbers of the Organic Milkable Cows and the Non-organic Milkable Cows are reasonable having taken into account the historical movement of the numbers of the Organic Milkable Cows and the Non-organic Milkable Cows and the potential acquisition of milkable cows.

LETTER FROM SOMERLEY

(b) The expected production volume of raw fresh milk of the Group

We have obtained and reviewed calculation of expected production volume of raw fresh milk of the Group provided by the Management, and we note that the production volume of organic raw fresh milk per day by each Organic Milkable Cow for the Cap Period would grow by approximately 1% to 3% per annum. For the production of non-organic raw fresh milk per day by each Non-organic Milkable Cow for the Cap Period, it was anticipated to grow by approximately 1% to 5% per annum. As stated in the 2022 Interim Report, the Group hired cow feeding experts during the first half of 2022 to develop better feeding practices for different farms and cows and as a result, the raw fresh milk production levels improved with average annualised production volume per milkable cow increased by approximately 0.24 tonnes to 10.53 tonnes, representing a growth of approximately 2% compared with that for the corresponding period in the prior year. Based on our discussion with the Management, the Group would continued to implement a series of measures to gradually improve the yield of the milkable cows of the Group during the Cap Period. Multiplying the expected number of milkable cows by the expected production volume of raw fresh milk per day per milkable cow as discussed above, the Management has arrived at the expected production volume of organic raw fresh milk and non-organic raw fresh milk of the Group for the years ending 31 December 2023, 2024 and 2025. Based on the historical growth in production volume of the milkable cows and the continuing implementation of measures to improve the yield of the milkable cows, we are of the view that the expected production volumes of raw fresh milk of the Group during the Cap Period are reasonable.

(c) The potential increase in the price of dairy products in China

Based on the annual reports published by the Company and as advised by the Management, we note that the average selling price of the organic raw fresh milk of the Group increased from approximately RMB4.8 per kg in 2019 to approximately RMB5.3 per kg in 2021 and slightly decreased to approximately RMB5.2 per kg for the nine months ended 30 September 2022, representing an overall increase of approximately 8%. Based on our review of calculation of the Annual Caps, it was projected that the average selling price of the organic raw fresh milk during the Cap Period would increase by approximately 2% to 3% per annum.

The non-organic raw fresh milk price followed a similar trend as that of organic raw fresh milk. The average selling price surged from approximately RMB3.7 per kg in 2019 to approximately RMB4.5 per kg in 2021 and slightly decreased to approximately RMB4.3 per kg for the nine months ended 30 September 2022, representing an overall increase of approximately 16%. Based on our review of calculation of the Annual Caps, it was projected that the average selling price of the non-organic raw fresh milk during the Cap Period would be at the same level or increase by approximately 2% to 4% per annum.

We consider the projected average selling prices of the organic raw fresh milk and the non-organic raw fresh milk during the Cap Period are reasonable taking into account the historical growths of the average selling prices from 2019.

LETTER FROM SOMERLEY

(d) The expected sales of substantial proportion of raw fresh milk to China Mengniu Group

In determining the Annual Caps, the Management estimated that up to approximately 89% of the raw fresh milk to be produced by the Group would be sold to China Mengniu Group, which would be equivalent to approximately RMB3,400 million, RMB4,300 million and RMB5,000 million for the years ending 31 December 2023, 2024 and 2025, respectively. As set out in the letter from the Board contained in the Circular, the historical transaction amounts of raw fresh milk (including both organic raw fresh milk and non-organic raw fresh milk) sold by the Group to China Mengniu Group for the years ended 31 December 2019, 2020 and 2021 and the nine months ended 30 September 2022 amounted to approximately RMB2,462.1 million, RMB2,505.1 million, approximately RMB2,621.6 million and approximately RMB2,171.4 million, respectively, representing approximately 89%, approximately 94%, approximately 88% and approximately 92% of the total revenue of the Group for the corresponding year or period, respectively. Based on our discussion with the Management, the significant majority of sales of raw fresh milk to China Mengniu Group was mainly due to the deepened collaboration between the Group and China Mengniu Group, in particular after completion of the disposal of the downstream dairy product business to China Mengniu Group in May 2019. Accordingly, it was anticipated that China Mengniu Group would continue to be the largest customer of the Group in the Cap Period.

Having considered that (i) the percentages of raw fresh milk sold to China Mengniu Group by the Group were up to 94% in recent years; (ii) the requirement of at least 80% of the raw fresh milk produced by the Group have to be sold to the China Mengniu Group pursuant to the Raw Fresh Milk Supply Framework Agreement; and (iii) the raw fresh milk supply relationship between the Company and China Mengniu Group and the expected synergistic benefits as stated in the letter from the Board contained in the Circular, we are of the view that it is acceptable to have the aforesaid percentages (i.e., up to approximately 89%) of the projected production of raw fresh milk to be sold to China Mengniu Group for the purpose of determining the Annual Caps.

OPINION AND RECOMMENDATION

Having taken into account the above principal factors and reasons, we consider that, the entering into the Raw Fresh Milk Supply Framework Agreement are in the ordinary and usual course of business of the Group and in the interests of the Company and the Shareholders as a whole. We are also of view that the terms of the Raw Fresh Milk Supply Framework Agreement (including the Annual Caps) are on normal commercial terms and fair and reasonable so far as the Independent Shareholders are concerned.

LETTER FROM SOMERLEY

We therefore advise the Independent Board Committee to recommend, and we ourselves recommend, the Independent Shareholders to vote in favour of the resolution in relation to the Raw Fresh Milk Supply Framework Agreement (including the Annual Caps) at the EGM.

Yours faithfully,
for and on behalf of
SOMERLEY CAPITAL LIMITED
Danny Cheng
Director

Mr. Danny Cheng is a licensed person registered with the Securities and Futures Commission and a responsible officer of Somerley Capital Limited, who is licensed under the Securities and Futures Ordinance to carry out Type 1 (dealing in securities) and Type 6 (advising on corporate finance) regulated activities. He has over 15 years of experience in the corporate finance industry.

1. RESPONSIBILITY STATEMENT

This circular, for which the Directors collectively and individually accept full responsibility, includes particulars given in compliance with the Listing Rules for the purpose of giving information with regard to the Company. The Directors, having made all reasonable enquiries, confirm that to the best of their knowledge and belief, the information contained in this circular is accurate and complete in all material respects and not misleading or deceptive, and there are no other matters the omission of which would make any statement herein or this circular misleading.

2. DISCLOSURE OF INTERESTS

(i) *DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES*

As at the Latest Practicable Date, the interests or short positions of the Directors and chief executive of the Company in the Shares, underlying Shares and debentures of the Company or its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) (the "SFO")) which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which they were taken or deemed to have under such provisions of the SFO) or which were required, pursuant to Section 352 of the SFO, to be entered in the register referred to therein, or which were required, pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers contained in Appendix 10 to the Listing Rules (the "Model Code"), to be notified to the Company and the Stock Exchange, were as follows:

Long position in the Shares and underlying Shares

Name	Capacity/Nature of interest	Number of Shares/underlying Shares	Percentage
Zhang Jiawang (張家旺)	Beneficial Owner	151,825,580	1.81% (L)

Mr. Zhang has a beneficial interest in a total of 151,825,580 Shares, comprising 138,130,000 Shares and 13,695,580 Shares underlying a share award which has not yet vested.

Save as disclosed above and so far as was known to the Directors, as at the Latest Practicable Date, none of the Directors or chief executive of the Company had any interest or short position in the Shares or underlying Shares or debentures of the Company or any of its associated corporations which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which they were taken or deemed to have under such provisions of the SFO) or which were required, pursuant to Section 352 of the SFO, to be entered in the register referred to therein, or which were required to be notified to the Company and the Stock Exchange pursuant to the Model Code.

(ii) DIRECTORS' SERVICE CONTRACTS

As at the Latest Practicable Date, none of the Directors had any existing or proposed to enter into a service contract with any member of the Group which does not expire or is not determinable by such member of the Group within one year without payment of compensation, other than statutory compensation.

(iii) INTERESTS OF SUBSTANTIAL SHAREHOLDERS

As at the Latest Practicable Date, according to the register kept by the Company pursuant to Section 336 of the SFO and, so far as was known to the Directors, the persons or entities, other than a Director or chief executive of the Company, who had an interest or a short position in the Shares or underlying Shares which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO were as follows:

Name	Capacity/Nature of interest	Number of Shares/underlying Shares	Percentage
Start Great Holdings Limited	Beneficial owner	2,513,178,555 (L)	29.99% (L)
China Mengniu Dairy Company Limited	Interest of a controlled corporation	2,513,178,555 (L)	29.99% (L)
Nong You Co., Ltd.	Beneficial owner	1,301,651,000 (L)	15.53% (L)
Beijing Zhi Nong Investment Co., Ltd.	Interest of a controlled corporation	1,301,651,000 (L)	15.53% (L)
Greenbelt Global Limited	Beneficial owner	536,097,305 (L)	6.40% (L)
Baring Private Equity Asia GP V Limited	Interest of a controlled corporation	536,097,305 (L)	6.40% (L)
Baring Private Equity Asia GP V LP	Interest of a controlled corporation	536,097,305 (L)	6.40% (L)
The Baring Asia Private Equity Fund V LP	Interest of a controlled corporation	536,097,305 (L)	6.40% (L)
Salata Jean Eric	Interest of a controlled corporation	536,097,305 (L)	6.40% (L)

Save as disclosed above and so far as was known to the Directors, as at the Latest Practicable Date, no person (other than a Director) had, or was deemed to have, an interest or short position in the Shares or underlying Shares which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO.

Mr. Lu Minfang, a non-executive Director and chairman of the Board, is also an executive director and chief executive officer of China Mengniu. Mr. Zhang Ping, a non-executive Director, is also an executive director, vice president and chief financial officer of China Mengniu. Save as

disclosed above, as at the Latest Practicable Date, none of the Directors was a director or employee of a company which had an interest or short position in the Shares or underlying Shares which would fall to be disclosed to the Company and the Stock Exchange under the provisions of Divisions 2 and 3 of Part XV of the SFO.

3. DIRECTORS' INTEREST IN THE COMPANY AND ITS SUBSIDIARIES' ASSETS OR CONTRACT

As at the Latest Practicable Date, save as disclosed in this circular, (a) none of the Directors was materially interested, directly or indirectly, in any contract or arrangement entered into by any member of the Group subsisting at the Latest Practicable Date and which was significant in relation to the business of the Group; and (b) none of the Directors had any direct or indirect interest in any assets which have been since 31 December 2021 (being the date to which the latest published audited consolidated financial statements of the Group were made up), (i) acquired or disposed of by; (ii) leased to; (iii) are proposed to be acquired or disposed of by; or (iv) are proposed to be leased to, any member of the Group:

- (1) On 28 March 2022, Shengmu High-tech (for itself and on behalf of its subsidiaries) entered into a raw fresh milk supply framework agreement with Yiyongmei Dairy in relation to the sale of raw fresh milk from the Group to Yiyongmei Dairy for a term of period commencing from 28 March 2022 and ending on 31 December 2024, details of which are set out in the announcements of the Company dated 28 March 2022 and 20 April 2022.
- (2) On 28 March 2022, Shengmu High-tech (for itself and on behalf of its subsidiaries) and Aiyangniu Technology (for itself and on behalf of its subsidiaries) entered into the Aiyangniu technology materials supply framework agreement in relation to the supply of materials (including but not limited to feed, veterinary medicines and dipping liquid for cows) by Aiyangniu Technology to the Group for a term of period from 28 March 2022 to 31 December 2024, details of which are set out in the announcement of the Company dated 28 March 2022.
- (3) On 28 March 2022, Shengmu High-tech (for itself and on behalf of its subsidiaries) and Dabeinong (for itself and on behalf of its subsidiaries) entered into a materials supply framework agreement in relation to the supply of materials (including but not limited to feed, additives and medicines) by Dabeinong to the Group for a term of period from 28 March 2022 to 31 December 2024, details of which are set out in the announcement of the Company dated 28 March 2022.
- (4) On 24 November 2022, Shengmu High-tech (for itself and on behalf of its subsidiaries) and Fuyuan International (for itself and on behalf of its subsidiaries) entered into a bulk raw materials supply framework agreement in relation to the supply of raw materials (including but not limited to maize, soybean meals, coarse fodder and feed additives, etc.) by Fuyuan International and its subsidiaries to the Group for a term of period from 1 January 2023 to 31 December 2025, details of which are set out in the announcement of the Company dated 24 November 2022.

4. MATERIAL ADVERSE CHANGE

As at the Latest Practicable Date, the Directors confirmed that there had been no material adverse change in the financial or trading position of the Group since 31 December 2021, being the date to which the latest published audited consolidated financial statements of the Group were made up.

5. LITIGATION

As at the Latest Practicable Date, save as disclosed below, no member of the Group was engaged in any litigation or arbitration or claim of material importance and, so far as the Directors were aware, no litigation or claim of material importance was pending or threatened by or against any member of the Group:

A civil judgement was issued by the Intermediate People's Court of Huhhot on 16 August 2021 in relation to a claim made against Shengmu High-tech and two former Directors concerning certain alleged payment obligations under an investment agreement. Provision amounting to RMB49.2 million was made for the probable losses in the audited consolidated financial statements of the Group for the year ended 31 December 2021, which may be suffered by the Group based on the management's reasonable estimation of the outcome of the lawsuits after taking into account legal advice. For further details, please refer to the announcements published by the Company on 16 September 2021 and 22 October 2021, the 2021 annual report and the 2022 interim report. Shengmu High-tech had applied to the High People's Court of Inner Mongolia Autonomous Region for a second trial and no adjudication had yet been made as at the Latest Practicable Date.

6. COMPETING INTERESTS

As at the Latest Practicable Date, each of the following Directors had an interest in a competing business:

Mr. LU Minfang, a non-executive Director and the chairman of the Board, is currently an executive director and chief executive officer of China Mengniu. Mr. LU is the chairman and a non-executive director of Yashili International Holdings Ltd (雅士利國際控股有限公司) (“**Yashili**”), a company incorporated in the Cayman Islands with limited liability whose shares are listed on the Stock Exchange (stock code: 1230), the chairman and a non-executive director of China Modern Dairy, and the chairman and a non-independent director of Shanghai Milkground Food Technology Co., Ltd (上海妙可藍多食品科技股份有限公司) (“**Milkground**”), a company established in the PRC with limited liability whose shares are listed on the Shanghai Stock Exchange (stock code: 600882). Mr. LU is also a director of International Dairy Federation.

Mr. ZHANG Ping, a non-executive Director, is currently an executive director, vice president and chief financial officer of China Mengniu. Mr. ZHANG is also a non-executive director of each of Yashili and China Modern Dairy and a non-independent director of Milkground.

Mr. ZHAO Jiejun, a non-executive Director, is currently the vice president, head of milk sourcing and supply chain business unit of China Mengniu. He is also a non-executive director of China Modern Dairy.

Save as disclosed above, as at the Latest Practicable Date, none of the Directors or, so far as was known to them, any of their respective associates was interested in any business (apart from the Group's business) which competes or is likely to compete either directly or indirectly with the Group's business (as would be required to be disclosed under Rule 8.10 of the Listing Rules if each of them were a controlling shareholder).

7. EXPERT AND CONSENT

The following is the qualification of the expert who has given opinion or advice which is contained in this circular:

Name	Qualification
Somerley Capital Limited	a corporation licensed to carry out Type 1 (dealing in securities) and Type 6 (advising on corporate finance) regulated activities under the SFO

As at the Latest Practicable Date, Somerley did not have any shareholding, direct or indirect, in any member of the Group or any right (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for securities in any member of the Group.

As at the Latest Practicable Date, Somerley did not have any direct or indirect interest in any assets which have been acquired or disposed of by or leased to any member of the Group, or which are proposed to be acquired or disposed of by or leased to any member of the Group since 31 December 2021, being the date to which the latest published audited consolidated financial statements of the Group were made up.

As at the Latest Practicable Date, Somerley has not withdrawn its written consent to the issue of this circular with the inclusion in this circular of its letter and reference to its name and opinion in the form and context in which they appear in this circular.

8. MISCELLANEOUS

- (1) The company secretary of the Company is Mr. Li Kwok Fat.
- (2) The registered address of the Company is P.O. Box 309, Ugland House, Grand Cayman, KY1-1104, Cayman Islands.
- (3) The principal place of business of the Company in Hong Kong is Room A, 32nd Floor, COFCO Tower, 262 Gloucester Road, Causeway Bay, Hong Kong.
- (4) The Company's Hong Kong branch share registrar is Tricor Investor Services Limited at 17/F, Far East Finance Centre, 16 Harcourt Road, Hong Kong.
- (5) In the event of any discrepancy, the English version of this circular shall prevail.

9. DOCUMENTS ON DISPLAY

Copies of the following documents will be made available on the websites of the Stock Exchange (www.hkexnews.hk) and the Company (<http://www.youjimilk.com>) for a period of 14 days from the date of this circular (inclusive):

- (1) the Raw Fresh Milk Supply Framework Agreement;
- (2) the letter from the Independent Board Committee, the text of which is set out in this circular;
- (3) the letter the letter from Somerley, being the Independent Financial Advisor, the text of which is set out in this circular; and
- (4) the written consent letter from Somerley as referred to in paragraph headed “7. Expert and Consent” in this appendix.

NOTICE OF THE EGM



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)

NOTICE IS HEREBY GIVEN THAT an extraordinary general meeting (the “**EGM**”) of China Shengmu Organic Milk Limited (中國聖牧有機奶業有限公司) (the “**Company**”, together with its subsidiaries, the “**Group**”) will be held at the Conference Room, 10/F, United Centre, 95 Queensway, Admiralty, Hong Kong on 29 December 2022 at 9:30 a.m. for the purposes of considering and, if thought fit, passing, with or without modifications, the following resolution as an ordinary resolution of the Company:

ORDINARY RESOLUTION

“**THAT**

- (a) the raw fresh milk supply framework agreement dated 17 November 2022 (the “**Raw Fresh Milk Supply Framework Agreement**”) entered into by Inner Mongolia Shengmu High-tech Farming Co., Ltd. (內蒙古聖牧高科牧業有限公司) (“**Shengmu High-tech**”) (for itself and on behalf of its subsidiaries) and Inner Mongolia Mengniu Dairy (Group) Company Limited (內蒙古蒙牛乳業(集團)股份有限公司) (for itself and on behalf of and its subsidiaries (the “**China Mengniu Group**”)) in relation to the purchase of raw fresh milk by China Mengniu Group from the Group for a term of three years commencing from 1 January 2023 to 31 December 2025, the transactions contemplated under such agreement and the proposed annual caps for such transactions for the three years ending 31 December 2023, 2024 and 2025 be and are hereby approved, ratified and confirmed; and
- (b) any one of the directors of the Company be and is/are hereby authorised to do all such acts or things and sign all documents which he or she considers necessary, desirable or expedient for the purposes of or in connection with the Raw Fresh Milk Supply Framework Agreement, the transactions contemplated under such agreement and the proposed annual caps for such transactions for the three years ending 31 December 2023, 2024 and 2025.”

By Order of the Board
China Shengmu Organic Milk Limited
Lu Minfang
Chairman

Hong Kong, 12 December 2022

As at the date of this notice, the executive Director of the Company is Mr. Zhang Jiawang; the non-executive Directors of the Company are Mr. Lu Minfang, Mr. Sun Qian, Mr. Zhang Ping, Mr. Zhao Jiejun and Ms. Shao Lijun; and the independent non-executive Directors of the Company are Mr. Wang Liyan, Mr. Wu Liang and Mr. Sun Yansheng.

NOTICE OF THE EGM

Notes:

1. Any member of the Company entitled to attend and vote at the EGM shall be entitled to appoint another person as his proxy to attend and vote instead of him. A member who is the holder of two or more shares of the Company (the “**Share(s)**”) may appoint more than one proxy to represent him and vote on his behalf at the EGM. A proxy need not be a member of the Company. On a poll, votes may be given either personally or by proxy.
2. The instrument appointing a proxy shall be in writing under the hand of the appointer or of his attorney duly authorized in writing or, if the appointer is a corporation, either under its seal or under the hand of an officer, attorney or other person authorized to sign the same.
3. In order to be valid, the instrument appointing a proxy and (if required by the board of directors of the Company) the power of attorney or other authority (if any) under which it is signed, or a notarially certified copy of such power or authority, shall be delivered to the office of the Company’s branch share registrar in Hong Kong, Tricor Investor Services Limited, at 17/F, Far East Financial Centre, 16 Harcourt Road, Hong Kong not less than 48 hours before the time appointed for holding the EGM or any adjournment thereof. Completion and return of the form of proxy shall not preclude shareholders of the Company from attending and voting in person at the EGM or any adjourned meeting thereof, in which event the proxy form shall be deemed to be revoked.
4. No instrument appointing a proxy shall be valid after expiration of 12 months from the date named in it as the date of its execution, except at an adjourned EGM or on a poll demanded at the EGM or any adjournment thereof in cases where the EGM was originally held within 12 months from such date.
5. Where there are joint holders of any Shares, any one of such joint holders may vote at the EGM, either in person or by proxy, in respect of such Share as if he/she were solely entitled thereto, but if more than one of such joint holders be present at the EGM, the vote of the senior who tenders a vote, whether in person or by proxy, shall be accepted to the exclusion of the votes of the other joint holders, and for this purpose, seniority shall be determined by the order in which the names stand in the register of members of the Company in respect of the joint holding.
6. For the purpose of determining shareholders’ entitlements to attend and vote at the EGM, the register of members of the Company will be closed from 22 December 2022 to 29 December 2022 (both days inclusive), during which period no transfer of Shares will be effected. In order to be eligible to attend and vote at the EGM, all transfers, accompanied by the relevant share certificates, must be lodged with the Company’s branch share registrar in Hong Kong, Tricor Investor Services Limited, at 17/F, Far East Financial Centre, 16 Harcourt Road, Hong Kong no later than 4:30 p.m. on 21 December 2022.
7. A form of proxy for use at the EGM is enclosed.