

Hong Kong Exchanges and Clearing Limited and The Stock Exchange of Hong Kong Limited take no responsibility for the contents of this announcement, make no representation as to its accuracy or completeness and expressly disclaim any liability whatsoever for any loss howsoever arising from or in reliance upon the whole or any part of the contents of this announcement.

CHINA SHENGMU ORGANIC MILK LIMITED

中國聖牧有機奶業有限公司

(Incorporated in the Cayman Islands with limited liability)

(Stock Code: 1432)

FINAL RESULTS ANNOUNCEMENT FOR THE YEAR ENDED DECEMBER 31, 2016

FINANCIAL HIGHLIGHTS	For the year ended December 31,		
	2016	2015	Movements
	RMB'000	RMB'000	
Revenue	3,466,544	3,100,711	+11.8%
Gross profit	1,675,411	1,477,543	+13.4%
Profits attributable to the owners of the parent	680,615	800,652	-15.0%

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

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

The board (the “**Board**”) of directors (the “**Directors**”) of China Shengmu Organic Milk Limited (the “**Company**” or “**China Shengmu**”) is pleased to announce the consolidated financial results of the Company and its subsidiaries (the “**Group**” or “**Shengmu**”) for the year ended December 31, 2016, together with the comparative figures for the year ended December 31, 2015.

CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

	Notes	For the year ended	
		December 31,	
		2016	2015
		RMB'000	RMB'000
REVENUE	4	3,466,544	3,100,711
Cost of sales		<u>(1,791,133)</u>	<u>(1,623,168)</u>
Gross profit		1,675,411	1,477,543
Gain/(loss) arising from changes in fair value			
less costs to sell of biological assets		(15,729)	52,722
Other income and gains/(losses)	4	(87,146)	47,424
Selling and distribution expenses		(287,949)	(265,468)
Administrative expenses		(141,714)	(107,470)
Other expenses	6	(56,233)	—
Finance costs	7	(124,667)	(99,147)
Share of profits and losses of associates		(16,242)	(18,041)
Gain on disposal of a subsidiary		<u>—</u>	<u>265</u>
PROFIT BEFORE TAX	5	945,731	1,087,828
Income tax credit/(expense)	8	<u>11,077</u>	<u>(4,606)</u>
PROFIT FOR THE YEAR		<u>956,808</u>	<u>1,083,222</u>

CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME (CONTINUED)

	Notes	For the year ended	
		December 31, 2016	2015
		RMB'000	RMB'000
OTHER COMPREHENSIVE INCOME			
Exchange differences on translation of foreign operations		<u>12,158</u>	<u>1,893</u>
Net other comprehensive income to be reclassified to profit or loss in subsequent periods		<u>12,158</u>	<u>1,893</u>
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		<u>968,966</u>	<u>1,085,115</u>
Profit attributable to:			
Owners of the parent		<u>680,615</u>	800,652
Non-controlling interests		<u>276,193</u>	<u>282,570</u>
		<u>956,808</u>	<u>1,083,222</u>
Total comprehensive income attributable to:			
Owners of the parent		<u>692,773</u>	802,545
Non-controlling interests		<u>276,193</u>	<u>282,570</u>
		<u>968,966</u>	<u>1,085,115</u>
Earnings per share attributable to ordinary equity holders of the parent:			
	10		
Basic		<u>RMB0.107</u>	<u>RMB0.126</u>
Diluted		<u>RMB0.106</u>	<u>RMB0.124</u>

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

	Notes	As at	
		December 31,	December 31,
		2016	2015
		RMB'000	RMB'000
NON-CURRENT ASSETS			
Property, plant and equipment		2,710,368	2,093,230
Prepaid land lease payments		37,566	5,066
Other intangible assets		14,847	15,518
Investments in associates		112,658	32,055
Available-for-sale investments		1,427	1,404
Biological assets	11	3,884,257	3,285,436
Prepayments for property, plant and equipment and biological assets		11,963	15,690
Long term receivables		19,684	—
Deferred tax assets		24,634	1,076
Other non-current assets		16,565	—
Total non-current assets		<u>6,833,969</u>	<u>5,449,475</u>
CURRENT ASSETS			
Inventories		928,816	824,514
Trade and bills receivables	12	1,108,787	915,312
Prepayments, deposits and other receivables		393,550	468,456
Pledged deposits		66,791	70,277
Available-for-sale investments		120,000	—
Cash and bank balances		1,047,382	1,731,759
Total current assets		<u>3,665,326</u>	<u>4,010,318</u>

CONSOLIDATED STATEMENT OF FINANCIAL POSITION (CONTINUED)

	Notes	As at	
		December 31,	December 31,
		2016	2015
		RMB'000	RMB'000
CURRENT LIABILITIES			
Trade and bills payables	13	920,631	1,018,126
Receipts in advance		13,152	17,320
Other payables and accruals		438,550	338,293
Interest-bearing bank and other borrowings		918,404	1,599,855
Income tax payable		1,581	1,974
Total current liabilities		<u>2,292,318</u>	<u>2,975,568</u>
NET CURRENT ASSETS		<u>1,373,008</u>	<u>1,034,750</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		<u>8,206,977</u>	<u>6,484,225</u>
NON-CURRENT LIABILITIES			
Interest-bearing bank and other borrowings		1,751,950	1,117,000
Long term payables		107,900	—
Total non-current liabilities		<u>1,859,850</u>	<u>1,117,000</u>
Net assets		<u>6,347,127</u>	<u>5,367,225</u>
EQUITY			
Equity attributable to owners of the parent			
Share capital	14	50	50
Reserves		<u>5,338,989</u>	<u>4,551,605</u>
Non-controlling interests		<u>5,339,039</u>	4,551,655
		<u>1,008,088</u>	<u>815,570</u>
Total equity		<u>6,347,127</u>	<u>5,367,225</u>

CONSOLIDATED STATEMENT OF CASH FLOWS

	For the year ended	
	December 31,	
	2016	2015
	RMB'000	RMB'000
Net cash flows from operating activities	942,225	928,527
Net cash flows used in investing activities	(1,233,968)	(1,371,025)
Net cash flows (used in)/from financing activities	(191,498)	1,118,751
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	(483,241)	676,253
Cash and cash equivalents at beginning of year	1,411,499	734,703
Effect of foreign exchange rate changes, net	4,124	543
CASH AND CASH EQUIVALENTS AT END OF YEAR	932,382	1,411,499

NOTES

1. CORPORATE INFORMATION

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

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

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

Basis of Preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs") (which include all International Financial Report Standards, International Accounting standards ("IASs") and Interpretations) issued by the International Accounting Standards Board ("IASB"), and the disclosure requirements of the Hong Kong Companies Ordinance. They have been prepared under the historical cost convention, except for certain biological assets and agricultural produce which have been measured at fair value less costs to sell. These financial statements are presented in Renminbi ("RMB") and all values are rounded to the nearest thousand except when otherwise indicated.

Basis of Consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year ended December 31, 2016.

The financial statements of the subsidiaries are prepared for the same reporting period as the Company, using consistent accounting policies. The results of subsidiaries are consolidated from the date on which the Group obtains control, and continue to be consolidated until the date that such control ceases.

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

Changes in Accounting Policies and Disclosures

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

Amendments to IFRS 10, IFRS 12 and IAS 28	<i>Investment Entities: Applying the Consolidation Exception</i>
Amendments to IFRS 11	<i>Accounting for Acquisitions of Interests in Joint Operations</i>
IFRS 14	<i>Regulatory Deferral Accounts</i>
Amendments to IAS 1	<i>Disclosure Initiative</i>
Amendments to IAS 16 and IAS 38	<i>Clarification of Acceptable Methods of Depreciation and Amortisation</i>
Amendments to IAS 27	<i>Equity Method in Separate Financial Statements</i>
<i>Annual Improvements 2012-2014 Cycle</i>	<i>Amendments to a number of IFRSs</i>

Except for the amendments to IFRS 10, IFRS 12 and IAS 28, amendments to IFRS 11, IFRS 14, amendments to IAS 27, and certain amendments included in the Annual Improvements 2012-2014 Cycle, which are not relevant to the preparation of the Group's financial statements, The nature and the impact of the amendments are described below:

- (a) Amendments to IAS 1 include narrow-focus improvements in respect of the presentation and disclosure in financial statements. The amendments clarify:
 - (i) the materiality requirements in IAS 1;
 - (ii) that specific line items in the statement of profit or loss and the statement of financial position may be disaggregated;
 - (iii) that entities have flexibility as to the order in which they present the notes to financial statements; and
 - (iv) that the share of other comprehensive income of associates and joint ventures accounted for using the equity method must be presented in aggregate as a single line item, and classified between those items that will or will not be subsequently reclassified to profit or loss.

Furthermore, the amendments clarify the requirements that apply when additional subtotals are presented in the statement of financial position and the statement of profit or loss. The amendments have had no significant impact on the Group's financial statements.

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

- (b) Amendments to IAS 16 and IAS 38 clarify the principle in IAS 16 and IAS 38 that revenue reflects a pattern of economic benefits that are generated from operating a business (of which the asset is part) rather than the economic benefits that are consumed through the use of the asset. As a result, a revenue-based method cannot be used to depreciate property, plant and equipment and may only be used in very limited circumstances to amortise intangible assets. The amendments are applied prospectively. The amendments have had no impact on the financial position or performance of the Group as the Group has not used a revenue-based method for the calculation of depreciation of its non-current assets.
- (c) Annual Improvements to IFRSs 2012-2014 Cycle issued in September 2014 sets out amendments to a number of IFRSs. Details of the amendments are as follows:

IFRS 5 Non-current Assets Held for Sale and Discontinued Operations: Clarifies that changes to a plan of sale or a plan of distribution to owners should not be considered to be a new plan of disposal, rather it is a continuation of the original plan. Accordingly, there is no change in the application of the requirements in IFRS 5. The amendments also clarify that changing the disposal method does not change the date of classification of the non-current assets or disposal group held for sale. The amendments are applied prospectively. The amendments have had no impact on the Group as the Group did not have any change in the plan of sale or disposal method in respect of the disposal group held for sale during the year.

The adoption of the above revised standards and interpretation has had no significant financial effect on these financial statements.

3. OPERATING SEGMENT INFORMATION

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

- (a) Dairy farming — breeding dairy cows to produce and distribute raw milk; and
- (b) Liquid milk products — producing and distributing self-owned brand ultra-heat treated liquid milk, organic yogurt and other dairy products.

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

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

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

3. OPERATING SEGMENT INFORMATION (Continued)

Intersegment sales and transfers are transacted with references to the prices internally agreed between dairy farming segment and liquid milk products segment.

For the year ended December 31, 2016	Dairy farming RMB'000	Liquid milk products RMB'000	Total RMB'000
Segment revenue			
Sales to external customers	1,360,401	2,106,143	3,466,544
Intersegment sales	1,302,553	—	1,302,553
	<u>2,662,954</u>	<u>2,106,143</u>	<u>4,769,097</u>
<i>Reconciliation:</i>			
Elimination of intersegment sales			<u>(1,302,553)</u>
Revenue			<u><u>3,466,544</u></u>
Segment results	1,018,835	(5,145)	1,013,690
<i>Reconciliation:</i>			
Elimination of intersegment results			(25,995)
Loss arising from changes in fair value less costs to sell of biological assets			(15,729)
Corporate and other unallocated expenses			<u>(15,158)</u>
Profit for the year			<u><u>956,808</u></u>
As at December 31, 2016			
Segment assets	9,098,425	2,189,724	11,288,149
<i>Reconciliation:</i>			
Elimination of intersegment receivables			(919,698)
Corporate and other unallocated assets			<u>130,844</u>
Total assets			<u><u>10,499,295</u></u>
Segment liabilities	3,488,046	1,512,368	5,000,414
<i>Reconciliation:</i>			
Elimination of intersegment payables			(919,698)
Corporate and other unallocated liabilities			<u>71,452</u>
Total liabilities			<u><u>4,152,168</u></u>

3. OPERATING SEGMENT INFORMATION (Continued)

For the year ended December 31, 2015	Dairy farming RMB'000	Liquid milk products RMB'000	Total RMB'000
Segment revenue			
Sales to external customers	1,445,022	1,655,689	3,100,711
Intersegment sales	<u>1,076,373</u>	<u>—</u>	<u>1,076,373</u>
	2,521,395	1,655,689	4,177,084
<i>Reconciliation:</i>			
Elimination of intersegment sales			<u>(1,076,373)</u>
Revenue			<u>3,100,711</u>
Segment results	996,931	110,668	1,107,599
<i>Reconciliation:</i>			
Elimination of intersegment results			(72,596)
Gain arising from changes in fair value less costs to sell of biological assets			52,722
Corporate and other unallocated expenses			<u>(4,503)</u>
Profit for the year			<u>1,083,222</u>
As at December 31, 2015			
Segment assets	8,347,005	1,537,127	9,884,132
<i>Reconciliation:</i>			
Elimination of intersegment receivables			(551,363)
Corporate and other unallocated assets			<u>127,024</u>
Total assets			<u>9,459,793</u>
Segment liabilities	3,560,796	1,083,123	4,643,919
<i>Reconciliation:</i>			
Elimination of intersegment payables			(551,363)
Corporate and other unallocated liabilities			<u>12</u>
Total liabilities			<u>4,092,568</u>

4. REVENUE, OTHER INCOME AND GAINS/(LOSSES)

Revenue represents the net invoiced value of goods sold, after allowances for returns and trade discounts.

An analysis of revenue, other income and gains/(losses) is as follows:

	For the year ended December 31,	
	2016	2015
	RMB'000	RMB'000
Revenue		
- Sales of raw milk	1,360,401	1,445,022
- Sales of liquid milk products	2,106,143	1,655,689
	<u>3,466,544</u>	<u>3,100,711</u>
Other income and gains/(losses)		
- Government grants	7,924	31,791
- Bank interest income	3,953	12,234
- Foreign exchange differences, net	(4,662)	(40)
- Loss on disposal of items of property, plant and equipment	(14,677)	(141)
- Impairment of trade receivables	(86,310)	(369)
- Others	6,626	3,949
	<u>(87,146)</u>	<u>47,424</u>
	<u>3,379,398</u>	<u>3,148,135</u>

5. PROFIT BEFORE TAX

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

	For the year ended December 31,	
	2016	2015
	RMB'000	RMB'000
Cost of inventories sold	1,791,133	1,623,168
Loss/(gain) arising from changes in fair value less costs to sell of biological assets	15,729	(52,722)
Depreciation of items of property, plant and equipment	146,783	105,046
Amortisation of prepaid land lease payments	266	186
Amortisation of other intangible assets	1,434	1,454
Research and development costs	11,662	8,981
Minimum lease payments under operating leases	1,200	9,532
Auditor's remuneration	2,700	3,450
Employee benefit expense (including directors' and chief executive's remuneration):		
Wages, salaries, bonuses and allowances	241,272	236,787
Other social insurances and benefits	27,411	12,504
Pension scheme contributions	11,506	9,434
Equity-settled share option expenses	45,151	27,011
	<u>325,340</u>	<u>285,736</u>

6. OTHER EXPENSES

The Group made donations with a total amount of RMB56,233,000 (2015:Nil) during the year of 2016.

7. FINANCE COSTS

	For the year ended December 31,	
	2016	2015
	RMB'000	RMB'000
Interest on bank loans	61,373	107,319
Interest on short-term notes	5,730	250
Interest on corporate bonds	64,299	—
Interest on long term payables	6,157	—
Less: Interest capitalised	(12,892)	(8,422)
	<u>124,667</u>	<u>99,147</u>

8. INCOME TAX EXPENSE/(CREDIT)

	For the year ended December 31,	
	2016	2015
	RMB'000	RMB'000
Current — PRC	12,481	4,772
Deferred	<u>(23,558)</u>	<u>(166)</u>
	<u><u>(11,077)</u></u>	<u><u>4,606</u></u>

A reconciliation of the tax expense applicable to profit before tax at the statutory rates for the countries in which the Company and the majority of its subsidiaries are domiciled to the tax expense at the effective tax rate is as follows:

	For the year ended December 31,	
	2016	2015
	RMB'000	RMB'000
Profit before tax	945,731	1,087,828
Tax at the statutory tax rate (note (i))	236,433	271,957
Income not subject to tax (note (ii))	(265,479)	(266,858)
Lower tax rate for specific provinces (note (iii))	(3,089)	(4,073)
Expenses not deductible for tax, net (note (iv))	21,042	5,083
Adjustments in respect of current tax of previous periods	<u>16</u>	<u>(1,503)</u>
Tax charge/(credit) of the Group	<u><u>(11,077)</u></u>	<u><u>4,606</u></u>

Notes:

- (i) The Company and its subsidiaries incorporated in the Cayman Islands and the British Virgin Islands are not subject to any income tax pursuant to the local rules and regulations. Hong Kong profits tax has not been provided as there were no assessable profits arising in Hong Kong during the year. Entities in the PRC were generally subject to the PRC enterprise income tax rate of 25% for the year ended December 31, 2016 (2015: 25%).
- (ii) According to the Enterprise Income Tax Law of the PRC (the “EIT Law”), the Group’s income arising from agricultural activities, such as dairy farming and processing of raw agricultural products, is exempt from income tax.

8. INCOME TAX EXPENSE/(CREDIT) (Continued)

(iii) In accordance with “The notice of tax policies relating to the implementation of the Western China Development Strategy” jointly issued by Ministry of Finance, General Administration of Customs and State Administration of Taxation (財政部、海關總署、國家稅務總局《關於深入實施西部大開發戰略有關稅收政策問題的通知》), the Group’s taxable income arising from the processing of non-raw agricultural products is subject to a preferential tax rate of 15% from 2013 to 2020.

(iv) Non-deductible expenses are mainly share of losses of associates, donation and staff welfares exceeding the tax limit.

9. DIVIDENDS

The directors do not recommend the payment of any dividend for the year ended December 31, 2016 (2015: Nil).

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

The basic earnings per share amount is calculated by dividing the profit for the year attributable to ordinary equity holders of the company, by the weighted average number of ordinary shares of 6,354,400,000 (2015: 6,354,400,000) in issue during the year.

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

	Number of shares For the year ended December 31,	
	2016	2015
Weighted average number of ordinary shares in issue during the year used in the basic earnings per share calculation	6,354,400,000	6,354,400,000
Effect of dilution of share options	<u>57,439,740</u>	<u>86,155,092</u>
Weighted average number of ordinary shares in issue during the year used in the diluted earnings per share calculation	<u>6,411,839,740</u>	<u>6,440,555,092</u>

11. BIOLOGICAL ASSETS

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

(A) Quantity of biological assets

The quantity of dairy cows owned by the Group as at December 31, 2016 and 2015 is shown below. The Group's dairy cows include milkable cows, heifers and calves. Heifers and calves are dairy cows that have not had their first calves.

	As at	
	December 31, 2016	December 31, 2015
	Head	Head
Dairy cows		
Milkable cows	69,887	66,790
Heifers and calves	59,442	44,605
Total dairy cows	129,329	111,395

(B) Value of biological assets

The value of Group's biological assets as at December 31, 2016 and 2015 is as follows:

	As at	
	December 31, 2016	December 31, 2015
	RMB'000	RMB'000
Dairy cows		
Milkable cows	2,632,009	2,359,795
Heifers and calves	1,252,248	925,641
Total value of dairy cows	3,884,257	3,285,436

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

12. TRADE AND BILLS RECEIVABLES

	As at	
	December 31, 2016	December 31, 2015
	RMB'000	RMB'000
Trade receivables	1,194,099	915,181
Bills receivable	200	500
Impairment	<u>(85,512)</u>	<u>(369)</u>
	<u>1,108,787</u>	<u>915,312</u>

The Group normally allows a credit limit or offer to its customers credit terms which are adjustable in certain circumstances. The Group closely monitors overdue balances. In view of the aforementioned and the fact that the Group's trade receivables relate to a large number of diversified customers, there is no significant concentration of credit risk. The Group does not hold any collateral or other credit enhancements over its trade receivables. The trade and bills receivables are non-interest-bearing.

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

	As at	
	December 31, 2016	December 31, 2015
	RMB'000	RMB'000
Within 3 months	484,116	627,740
4 to 6 months	331,798	224,208
7 to 12 months	268,863	60,042
Over 1 year	<u>24,010</u>	<u>3,322</u>
	<u>1,108,787</u>	<u>915,312</u>

13. TRADE AND BILLS PAYABLES

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

	As at	
	December 31, 2016	December 31, 2015
	RMB'000	RMB'000
1 to 3 months	895,338	680,070
4 to 6 months	14,790	191,138
7 to 12 months	5,120	137,390
1 to 2 years	3,297	8,183
2 to 3 years	2,086	1,312
Over 3 years	—	33
	<u>920,631</u>	<u>1,018,126</u>

14. ISSUED CAPITAL

The Company was incorporated in the Cayman Islands on December 11, 2013. As at December 31, 2016 and December 31, 2015, the Company has authorized share capital of HK\$300,000, divided into 30,000,000,000 shares with a par value of HK\$0.00001 each.

As at December 31, 2016 and December 31, 2015, the Company's share capital was HK\$63,544 with 6,354,400,000 shares in issuance.

MANAGEMENT DISCUSSION AND ANALYSIS

MARKET REVIEW

In recent years, the problem of domestic environmental pollution in the PRC has been widely recognized and there is increasing awareness of environmental protection by the Chinese government and its people has been increasing. The green ecofriendly lifestyle has gradually become a new trend, and is recognized and advocated by the Chinese government and by the society at large. With the vigorous development of the organic food market in the PRC, more and more domestic consumers have chosen to buy organic food products, which have obtained extensive recognition and popularity among mass consumers. Meanwhile, the dairy product market in the PRC has begun to generate the “organic effect” and the market share of high-end organic dairy product brands has increased significantly, showing a strong terminal market performance.

According to the “Several Opinions on the Implementation of New Concepts on the Development and the Acceleration of the Agricultural Modernization for the Realization of the Moderate Prosperity in All Respects” (中國國務院《關於落實發展新理念加快農業現代化實現全面小康目標的若干意見》) issued by the State Council of the PRC, in order to promote agricultural sustainable development, the concept that developing green agriculture equals ecological protection must be established, so as to accelerate the formation of a new agricultural development landscape of effective resource utilization, a steady ecological system, good environmental conditions of production areas and safe product quality. At an important Economic Work Conference convened in early 2016, Xi Jinping, President of the PRC, also pointed out that the fundamental purpose of supply-side structural reform was to raise the social production level and to implement the people-oriented development philosophy, “to strengthen premium supply from production areas, reduce ineffective supply and expand effective supply”. The above concepts were construed as positive encouragement and explicit support from the Chinese government for a premium, safe, natural and green agricultural industrial system and product supply. The organic green industry and premium organic food market have shown a continuous and rapid growth momentum.

Li Keqiang, Premier of the State Council of the PRC, attended the opening ceremony of the Summer Davos Forum 2016 and delivered a special speech, clearly pointing out that the rapid development of “five happiness industries”, including tourism, culture, sports, health and pension, not only boosted the growth of consumption, but also promoted consumption upgrade. Organic food, generally recognized as a representative of healthy food in today’s society because of its unique qualities of being premium, safe, natural and green, has obtained popularity and extensive recognition among mass consumers, while organic dairy products, for the characteristics of being green, ecofriendly, natural and being associated with pollution-free production with quality safety, as well as for the significant health care effects of dairy products, have become a high-end representative of a green ecofriendly dairy industry of health and happiness with great future development potential.

The raw milk production base of China Shengmu is located in the Inner Mongolia Autonomous Region, the PRC, the government of which, in early January 2017, issued the “Government Work Report of the Inner Mongolia Autonomous Region 2017”, which stated that “the Inner Mongolia Autonomous Region Government had made a good effort to develop modern agriculture and animal husbandry industry in 2016, where the production volume of organic food accounted for more than 1/3 of the production volume of the country” under the conclusion of speeding up industrial transformation and upgrade; the report also specified the work focus of its government in 2017, that is “to promote supply-side structural reform of agriculture and animal husbandry industry, to pay more attention on increasing in the supply of green premium agricultural and livestock products, to vigorously develop modern agriculture and animal husbandry industry, to adjust the structure of agriculture and animal husbandry industry, and to expand the production of green, organic, pollution-free agricultural and livestock products in line with the trend of consumption upgrade”.

We believe that based on the support and promotion of national and local governments’ industrial policies and the pursuit of people of a happy life, there will be a great potential for the green, healthy, safe, and ecofriendly organic industry.

BUSINESS REVIEW

China Shengmu is the largest organic dairy company in the PRC in terms of the herd size of organic dairy cows and the production volume of organic raw milk for the year ended December 31, 2016. China Shengmu is the only vertically integrated grass-to-glass organic dairy company in the PRC that meets the E.U. organic standards. It is also the only dairy company in the PRC that offers branded organic dairy products that are 100% processed from raw milk produced by self-owned certified organic dairy farms and the only sizeable dairy company in the PRC to operate the “desert-based grass-to-glass organic production model” (沙漠全程有機產業體系).

With increasing competition in the dairy industry in the PRC and the upstream raw milk being relatively under pressure, by leveraging on its unique desert-based grass-to-glass organic raw milk based on its unique “desert-based grass-to-glass organic production model”, and by benefitting from its innovative grass-to-glass organic liquid milk products for many years and its sophisticated downstream product marketing and sales channel building strategy, China Shengmu continued to record excellent operating results in 2016. The revenue of the Group amounted to RMB3,466.5 million, representing an increase of 11.8% as compared to 2015, and its gross profit amounted to RMB1,675.4 million, representing an increase of 13.4% as compared to 2015, of which the revenue of grass-to-glass organic liquid milk under its self-owned brand amounted to RMB2,054.3 million, representing an increase of 24.1% as compared to 2015, accounted for 59.3% of the total revenue of the Group in 2016 from 53.4% in 2015. The successful development of the grass-to-glass organic liquid milk of the Group delivered an excellent brand image, market awareness and reputation of “Shengmu” brand into the minds of Chinese consumers, forming a stable and increasing consumer group with a bright prospects.

High-End Organic Liquid Milk Based on China Shengmu's Unique "Desert-Based Grass-to-Glass Organic Production Model" Certified by E.U. Has Obtained Popularity among Consumers and Markets and Won a Number of Awards

According to a research statistical report issued by the AskCI Consulting Co., Ltd. (中 商 產 業 研 究 院) in 2016, the concentration of high-end milk market in the PRC is high. Through monitoring the market sales data of nationwide large-scale retail enterprises, the top ten brands in the high-end milk market in the PRC accounted for 90.01% market share in total, where Shengmu's grass-to-glass organic liquid milk accounted for 9.85% and ranked third in terms of overall market share in the PRC market, and its market share accounted for 16.24% and its market coverage reached 5.59%. The research data from the AskCI Consulting Co., Ltd. showed that Shengmu's grass-to-glass organic liquid milk was active in the market and obtained popularity among mass consumers.

Shengmu's grass-to-glass organic liquid milk products have obtained recognition and acclaim from mass consumers and the society because of its unique desert-based grass-to-glass production model certified by the E.U., its international first-class product quality and its green ecofriendly organic healthy life philosophy. In the BIOFACH CHINA Organic Trade Fair (中國國際有機食品博覽會) held in May 2016, China Shengmu was awarded Gold Medal jointly by the China Green Food Development Center (中國綠色食品發展中心) and the NürnbergMesse Group for the fifth time. Shengmu grass-to-glass organic liquid milk products won this international honor again because of its excellent product quality and adherence to global highest organic standard, receiving unanimous recognition and acclaim from consumers and professionals at home and abroad. Meanwhile, China Shengmu was also awarded the "Outstanding Exhibitors" award by the Organization Committee of the this expo in recognition of the continuous efforts made by China Shengmu to maintain excellent product quality for many years.

In July 2016, the China Children and Women Industry Expo (中國(北京)國際婦女兒童產業博覽會) 2016 was grandly held in Beijing National Convention Center with the theme of "green dream +", covering many areas such as women and infants' food, commodities, education and services. Because of its excellent product quality, Shengmu's grass-to-glass organic liquid milk products have won the "2016 Public Thumb Award" in this children and women's expo.

In August 2016, Shengmu's sea buckthorn flavored organic fermented milk was awarded the 2016 "Technical Progress Second Prize" and 2016 "Excellent New Product Award" by the China Dairy Industry Association, showing that Shengmu's grass-to-glass organic liquid milk products have once again obtained the recognition and acclaim from the PRC dairy industry.

The Scarcity and Advanced Nature of Shengmu’s Unique “Desert-Based Grass-to-Glass Organic Production Model” Have Obtained the Recognition and Popularity from Leading Dairy Companies

In 2016, in order to broaden its global vision, China Shengmu and Food Union (Dairy) Hong Kong Limited (“**Food Union**”) established a joint-stock company, Food Union Shengmu Dairy Co., Ltd. (“**Food Union Shengmu**”), as to which 20% equity interests were owned by the Group. Food Union Shengmu will produce organic products, such as high-end children’s dairy products, which are 100% processed from organic raw milk purchased from China Shengmu. Shengmu’s unique desert-based grass-to-glass organic production model certified by the E.U. has been recognized by internationally renowned dairy companies such as Food Union because of its scarcity and advanced nature all over the world. Food Union has extensive product research and development experience in the processing field of high-end dairy products, together with excellent brand awareness and abundant resources of market channels. Leveraging on the opportunity to cooperate with Food Union, China Shengmu will obtain more extensive markets resources and product research resources, and also improve its brand image to generate positive impact for its future development.

Being a Green Industry, It Creates Value and Gives Back to the Society and Benefits the Nation and People

The “desert-based grass-to-glass organic production model” was initiated by China Shengmu in the PRC, which provides the foundation for China Shengmu to produce quality organic products and is also necessary for China Shengmu to establish its sustainable ecological circle. Based on the theory of “sand-to-grass industry” initiated by Mr. Qian Xuesen, a renowned scientist, China Shengmu has transformed barren land in the desert into an oasis to grow economic crops. As such, economic benefits have been generated while sustainable green development has been achieved. As at the end of 2016, Shengmu Forage and Shengmu has successfully transformed and greened nearly 200 thousand mu of soil in the hinterland of Ulan Buh Desert and planted tens of millions of trees for sand fixation, successfully transforming barren desert into fertile oasis, which not only actively benefits the national desert treatment, but also significantly reduces the wind and sand encroachment that has been suffered by people living in the surrounding cities for many years.

While achieving economic benefits and improving the natural environment, Shengmu has not forgotten to contribute to the society and make effort to support public welfare undertakings to send health, warmth and love to people at all levels of society.

When meeting the national model representatives of the National Double Support Models in July 2016, the General Secretary, Xi Jinping, pointed out that “double support work is a unique good tradition and political advantage for our party, our military and our people. Rock-firm unity of the military and government, as well as the military and people, has always been crucial for us to overcome all difficulties and continue to succeed from one to another.” In response to the General Secretary’s call for double support work and to learn the army’s spirit of fearlessness of danger and difficulties, as well as overcoming difficulties and marching forward bravely, and to incorporate such spirits into the management culture of the Company, China Shengmu spontaneously organized a large team to support the military,

along with many enterprises and civil bodies and institutions including religious groups, to encourage hundreds of armies covering navy, land forces, and air forces nationwide, and also donated Shengmu's best grass-to-glass organic liquid milk products to the most lovable people defending our homeland, which brought enthusiastic social response and encouraged a new trend for social teams to express patriotism spontaneously.

In 2016, while performing its corporate responsibilities, China Shengmu continued to participate in many social welfare activities such as organizing to visit the elderly and physically handicapped persons in domestic charity houses, donating to Hope Primary School and primary schools for peasant workers' children, encouraging cleaner teams and donating to various charities, and actively carried out public welfare undertakings, as well as actively gave back to the society and benefited the people while creating economic value.

Shengmu's Unique Vertically Integrated "Desert-Based Grass-to-Glass Organic Production Model" Continued to Develop in 2016

In 2016, China Shengmu continued to deploy its unique vertically integrated "desert-based grass-to-glass organic production model" with scientific planning in Ulan Buh Desert in line with international standards. The green ecofriendly production model is the core business model and philosophy of China Shengmu as well as the foundation for China Shengmu to produce quality organic products, enabling it to provide consumers with premium quality and safe grass- to-glass organic dairy products.

In 2016, China Shengmu continued to achieve its organic quality control across the vertically integrated production chain covering planting, farming and processing from farming of organic cows to production of organic liquid milk through developing an organic environment, monitoring the growing of organic forage and establishing self-owned dairy farms.

Farming Business

Organic Dairy Farming

As the key component of China Shengmu's "desert-based grass-to-glass organic production model", the Group continued to invest in and manage organic dairy farming and organic raw milk production in 2016.

Since its establishment seven years ago, China Shengmu has persisted with a scientific and innovative development strategy. Our dairy farming business is premised on scale of economy, and most farms have 3,500-4,500 dairy cows. Meanwhile, our dairy farming business has always persisted with the breeding of dairy cows in the golden regions of milk resources which is the most suitable place for dairy cows to grow. Especially, Shengmu's organic dairy farms are all located in the hinterland of Ulan Buh Desert whose unique geographic location has many more advantages as compared with the PRC's traditional farming environment of golden regions of milk resources. In this region, Shengmu has persisted with the combination model of planting and farming, being "to plant forage with farming and to breed cows with forage". On one hand, the dairy cow dung in the organic farm

can be used as fertilizer to form an organic ecological circle. On the other hand, the strong and long-time sunshine in the desert helps forage grow and enables dairy cows to transform plant protein to animal protein so as to increase the calcium content in the milk to further improve the quality of milk.

In 2016, the Group used internationally advanced feed management system and equipment, in conjunction with its self-developed feed formulae and scientific management model, to ensure that each of its organic dairy cows grows healthily. To promote the health of dairy cows, ensure the milk production quality and provide a more comfortable environment for dairy cows to grow, Shengmu continued to manage the farm in a refined and precise way and carried out over 20 technical innovation projects such as “automatically feeding equipment for acidified milk”, “automatically milking system” and “application equipment of air power”, thereby increasing production efficiency and obtaining good operation optimization on the premise of improving wellbeing of dairy cows.

Herd Size and Production

As at December 31, 2016, the Group had 23 organic dairy farms in operation, and 12 non-organic farms in operation. The organic and non-organic herd size of the Group have changed from 72,843 and 38,552 dairy cows as at December 31, 2015 to 94,815 and 34,514 dairy cows as at December 31, 2016, respectively.

	As at December 31,							
	2016				2015			
	Number of Dairy farms	Calves and heifers	Milkable cows	Dairy Cows Subtotal	Number of Dairy farms	Calves and heifers	Milkable cows	Dairy Cows Subtotal
Organic	23	45,534	49,281	94,815	21	30,049	42,794	72,843
Non-organic	12	13,908	20,606	34,514	12	14,556	23,996	38,552
Total	35	59,442	69,887	129,329	33	44,605	66,790	111,395

The Group produced 421,023 tonnes of organic raw milk and 177,356 tonnes of premium non-organic raw milk in 2016, and produced 357,434 tonnes of organic raw milk and 179,866 tonnes of premium non-organic raw milk in 2015.

Organic Forage Planting

Forage is an essential raw material in organic dairy farming. Pursuant to a long-term strategic cooperation agreement entered into with us, Shengmu Forage continues to exclusively supply organic forage to us. In 2016, in order to persist in the philosophy that “all staff participate in the organic management”, Shengmu Forage has entered into the Organic Management Agreement with its staff to divide responsible areas of organic management and carry out non-scheduled internal checks so as to ensure the precise and effective implementation of the organic management. In order to achieve its precise and

refined management objectives, during this year, Shengmu Forage sowed seeds in its sprinkler irrigation fields with comprehensive adoption of a GPS system, thereby enhancing its precise sowing standard in its drip irrigation fields, and installed scribes to enhance planting uniformity and adopt rational close planting, while continuing to use green organic cow dung to thicken the humus layer of soil, so as to improve the fertility of original organic planting fields to make them more suitable for the growth of natural plants, which ensured the improvement of production volume and quality of forage planting.

Shengmu Forage has greened nearly 200 thousand mu of organic planting fields in aggregate in the hinterland of Ulan Buh Desert as at the end of 2016. With continuous production of organic forage and expansion of new planting fields, the green area in the hinterland of Ulan Buh Desert has been enlarged significantly, with annual precipitation having obviously increased, showing a remarkable achievement of desert control. On the other hand, in order to safeguard the organic planting environment in the desert and to block the wind and sand encroachment, Shengmu Forage and Shengmu have also continued to proceed with sand fixation afforestation in the hinterland of Ulan Buh Desert and to plant tens of millions of trees for all types of sand fixation, greening and safeguarding these areas to create plant zones for sand fixation and windbreaks, thus achieving a glorious transformation from barren desert to fertile oasis and facilitating the desert control of the country.

Liquid Milk Business

All the raw milk used by China Shengmu to produce grass-to-glass organic liquid milk products under its self-owned brand was supplied internally by its organic dairy farms without adding any preservatives, artificial coloring and artificial flavoring during the production process. Each of our organic milk products is stamped with a code of Certification and Accreditation Administration of the People's Republic of China for consumers to trace the production origin of every batch of products at any time, which provides for the safety of products and also provides that the grass-to-glass organic process can be traceable.

In 2016, the liquid milk business department implemented refined and precise management based on the theme of "refined practice and efficient operation" for the purposes of guaranteeing the quality of organic products, optimizing the standardization process of key businesses, overcoming and preventing equipment failures, carrying out clear and detailed overhaul, maintenance and inspection of work, and upgrading equipment to a leading level among industry peers. While enhancing efficiency, the Group achieved a flat management and performance management system with respect to all staff through precise management, optimization of work process and consolidation of management structure, thereby leading to the quality of grass-to-glass organic liquid milk products further improving during this year.

There is an aggregate of 16 production lines of liquid milk products operated by the Group during the year, and the production volume of organic liquid milk products under its self-owned brand which were entirely processed from raw milk produced by self-owned certified organic dairy farms increased to 197,276 tonnes as compared to 135,960 tonnes for the year of 2015.

Unique Sales Channel Development and Brand Promotion Development for Grass-to-Glass Organic Liquid Milk Products

In 2016, based on its current sales network covering first and second tier cities and major third and fourth tier cities, the Group continued to expand its market network to third and fourth tier cities. Furthermore, the Group continued to optimize its market network management at all levels, to consolidate and further develop its sales channels and to improve the management of individual shops so as to increase the sales revenue from such markets, channels and shops. The Group has upgraded its model for distribution network development from horizontal expansion at early stage to vertical deepening.

In 2016, the Group continued to implement the “blue ocean” strategy and community flagship store strategy to develop large chain-community stores. Shengmu products have entered into over 100,000 large chain-community stores and community flagship stores with independent promotional counters and a good image across the country, which effectively enhanced the awareness of its liquid milk products among target consumers and made substantial contribution to the increase in the sales of its liquid milk products.

In 2016, with the increase in the downstream sales business, the Shengmu organic liquid milk brand continued to make headlines in the market and gained extensive attention across the whole society. The feature film *Conquering the Flaming Mountain with Bare Feet* (《赤脚踏平火焰山》), produced by CCTV jointly with China Shengmu, was on the air on CCTV 7 and the website of CCTV, to publicise China Shengmu’s unique desert-based grass-to-glass organic production model, premium organic liquid milk products and its organic, green and eco-friendly production and the lifestyle and values consistently followed by China Shengmu. China Shengmu’s organic planting fields located in the hinterland of Ulan Buh Desert was also chosen by CCTV as the representative of autumn harvest scene for nationwide advertisement. In addition, many renowned media at home and abroad also reported positive hot news about China Shengmu.

In 2016, China Shengmu hosted the large scale event, “Shengmu Desert Organic Journey”, and accommodated a number of consumers at its production base in the Ulan Buh Desert to gain personal experience of its “grass-to-glass organic production model” in order to promote the organic concept and promote the industrial, green and eco-friendly philosophy, so as to further facilitate the people of the PRC to understand our green, organic and sustainable industry model . Through “Shengmu Desert Organic Journey”, in addition to the visitors’ better knowledge of the “desert-based grass-to-glass organic production model” of China Shengmu, the understanding of and confidence in the Group’s products by the market have been enhanced, and the brand awareness and reputation of China Shengmu have been increased.

At the same time, China Shengmu continued its refined and precise marketing strategy and carried out a comprehensive, extensive and precise brand promotion campaigns through opening standardized large chain- community stores and launching large nationwide “product-experience” promotion activities, with the support from broadcasting advertisements through online, offline and media (including TV) channels. Meanwhile, we delivered speeches on the theme of “having courage to challenge the impossible and pursue an organic dream in the desert” in over 20 universities nationwide in 2016 to encourage undergraduates to confront challenges and practice green ecology. The implementation of every precise marketing strategy by the Group for the year has substantially enhanced the brand recognition and awareness of the “Shengmu” brand among a wide range of consumers and has effectively established its image of “No. 1 organic milk brand” in the PRC.

Revolutionary Innovation in the Industry — Shengmu Yogurt Machines

In May 2016, China Shengmu grandly launched its unique yogurt machines, the technology of which is owned by China Shengmu. China Shengmu yogurt machines can produce fresh and delicious low-temperature organic liquid milk products immediately on site with China Shengmu organic liquid milk products through refrigerating them and adding active lactobacillus, dispensing with the shackles of traditional cold-chain logistic transportation and storage in cold warehouses of supermarkets for low temperature organic milk products. China Shengmu yogurt machines can offer healthy, fresh and delicious low-temperature organic liquid milk products directly to crowded public venues such as restaurants and canteens, office and entertainment areas, which effectively further develops the “blue ocean” marketing strategy by offering premium fresh low-temperature organic liquid milk products directly to consumers while deducting the middle sales and logistic sections and effectively lowering cost of sales. As at the end of 2016, China Shengmu yogurt machines have already been placed in public venues such as crowded restaurants and canteens, as well as office and entertainment areas across dozens of cities including Beijing, Shanghai, Guangzhou, Shenzhen, etc. The launch of this revolutionary product with its independent research and development technology guides brand new development direction for the sales of high-end liquid milk products and provides steady sales channels of liquid milk for dairy companies with whole industrial chain model, effectively enhancing the ability to use its own raw milk and providing unique and positive support for the continuous and rapid growth of China Shengmu.

FINANCIAL REVIEW

The Group recorded a revenue of RMB3,466.5 million in 2016, representing an increase of 11.8% from RMB3,100.7 million in 2015. Gross profit of the Group increased by 13.4% from RMB1,477.5 million in 2015 to RMB1,675.4 million in 2016. Profit attributable to owners of the parent decreased by 15.0% from RMB800.7 million in 2015 to RMB680.6 million in 2016.

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

Revenue

Unit: RMB in thousands, except percentages

For the year ended December 31,	Dairy farming business				Liquid milk business				Total revenue
	Segment revenue	Inter-segment sales ⁽¹⁾	External sales	External sales as % of total revenue	Segment revenue	Inter-segment sales	External sales	External sales as % of total revenue	
2016	2,662,954	1,302,553	1,360,401	39.2%	2,106,143	—	2,106,143	60.8%	3,466,544
2015	2,521,395	1,076,373	1,445,022	46.6%	1,655,689	—	1,655,689	53.4%	3,100,711

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

In 2016, revenue of the Group continuously increased by 11.8% from 2015. Revenue from self-owned brand liquid milk business increased by approximately 27.2% from 2015, and accounted for 60.8% of total revenue (2015: 53.4%), implicating a rising core position of the self-owned brand liquid milk business in the overall businesses of the Group and in contributing to the overall growth of the Group's revenue. Against the backdrop of intensified competition in the PRC dairy industry and relatively higher pressure on upstream raw milk, the Group has developed its unique "desert-based-grass-to-glass organic production model" in a stable and healthy manner, which was proved to be strategically forward-looking.

Dairy Farming Business

	For the year ended December 31,							
	2016				2015			
	Revenue	Sales volume	Average selling price	Revenue as % of dairy farming segment revenue	Revenue	Sales volume	Average selling price	Revenue as % of dairy farming segment revenue
	(RMB'000)	(Tonnes)	(RMB/Tonne)		(RMB'000)	(Tonnes)	(RMB/Tonne)	
Organic raw milk								
External sales	784,631	166,986	4,699	29.5%	712,677	139,290	5,116	28.3%
Inter-segment sales ⁽¹⁾	<u>1,222,020</u>	<u>228,761</u>	<u>5,342</u>	<u>45.9%</u>	<u>1,076,373</u>	<u>202,352</u>	<u>5,319</u>	<u>42.7%</u>
Subtotal	<u>2,006,651</u>	<u>395,747</u>	<u>5,071</u>	<u>75.4%</u>	<u>1,789,050</u>	<u>341,642</u>	<u>5,237</u>	<u>71.0%</u>
Premium non-organic raw milk								
External sales	575,770	156,455	3,680	21.6%	732,345	173,026	4,233	29.0%
Inter-segment sales ⁽²⁾	<u>80,533</u>	<u>18,765</u>	<u>4,292</u>	<u>3.0%</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>0.0%</u>
Subtotal	<u>656,303</u>	<u>175,220</u>	<u>3,746</u>	<u>24.6%</u>	<u>732,345</u>	<u>173,026</u>	<u>4,233</u>	<u>29.0%</u>
Dairy farming segment	<u>2,662,954</u>	<u>570,967</u>	<u>4,664</u>	<u>100.0%</u>	<u>2,521,395</u>	<u>514,668</u>	<u>4,899</u>	<u>100.0%</u>

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

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

Revenue from dairy farming segment continued to record an increase from RMB2,521.4 million in 2015 to RMB2,663.0 million in 2016. By benefitting from the stable and quick development of Shengmu's "desert-based-grass-to-glass organic production model", up to 57.8% of total growing organic raw milk sales volume was sold for the production of self-owned brand organic liquid milk products in order to meet growing end market needs. Revenue from inter-segment sales to organic liquid milk processing plant accounted for 45.9% of revenue from dairy farming segment (2015: 42.7%). With further market expansion and penetration of Shengmu's self-owned brand organic liquid milk products, the self-owned brand organic liquid milk business will continue to drive the growth of dairy farming business.

Liquid milk business

Revenue from liquid milk business increased by 27.2% from RMB1,655.7 million in 2015 to RMB2,106.1 million in 2016, accounting for 60.8% of total revenue of the Group (2015: 53.4%). Revenue from self-owned brand organic liquid milk business increased by 24.1% from RMB1,655.7 million in 2015 to RMB2,054.3 million in 2016, accounting for 59.3% of

total revenue of the Group. The rapid growth of liquid milk business was mainly attributable to the brand awareness, market profile and recognition of Shengmu's organic liquid milk products, which secures stable and growing consumers in China. Meanwhile, the construction of unique product promoting and brand marketing channels by the Group further improved the market share of its self-owned brand organic liquid milk products. Driven by liquid milk business, revenue from organic business (comprising organic liquid milk business and organic raw milk business) accounted for 81.9% of total revenue of the Group (2015: 76.4%). The "desert-based-grass-to-glass organic production model" of Shengmu has been further improved, representing a strong driver for business growth of the Group.

Organic liquid milk business

	For the year ended December 31,		
	2016	2015	Increase/ (Decrease)
Revenue (RMB'000)	2,054,292	1,655,689	24.1%
Sales volume (Tonnes)	186,393	145,214	28.4%
Average selling price (RMB/Tonne)	11,021	11,402	(3.3%)

Revenue from Organic/Non-organic Business and Percentages

Unit: RMB in thousands, except percentages

	For the year ended December 31,			
	2016		2015	
	Amount	Percentage	Amount	Percentage
Organic products				
Organic liquid milk	2,054,292	59.3%	1,655,689	53.4%
Organic raw milk	784,631	22.6%	712,677	23.0%
Subtotal of organic products	2,838,923	81.9%	2,368,366	76.4%
Non-organic products				
Premium non-organic raw milk	575,770	16.6%	732,345	23.6%
High-end non-organic liquid milk	51,851	1.5%	—	—
Subtotal of non-organic products	627,621	18.1%	732,345	23.6%
Total	3,466,544	100.0%	3,100,711	100.0%

Cost of Sales, Gross Profit and Gross Margin

	For the year ended December 31,					
	2016			2015		
	Cost of sales	Gross profit	Gross margin	Cost of sales	Gross profit	Gross margin
	(RMB in thousands, except percentages)					
Dairy farming business						
Organic raw milk						
Before elimination	965,276	1,041,375	51.9%	902,814	886,236	49.5%
After elimination ⁽¹⁾	407,299	377,332	48.1%	368,084	344,593	48.4%
Premium non-organic raw milk						
Before elimination	434,862	221,441	33.7%	456,719	275,626	37.6%
After elimination ⁽³⁾	388,292	187,478	32.6%	456,719	275,626	37.6%
Subtotal of dairy farming business						
Before elimination	1,400,138	1,262,816	47.4%	1,359,533	1,161,862	46.1%
After elimination	795,591	564,810	41.5%	824,803	620,219	42.9%
Liquid milk business						
Organic liquid milk business						
Before elimination	1,615,850	438,442	21.3%	1,267,411	388,278	23.5%
After elimination ⁽²⁾	969,298	1,084,994	52.8%	798,365	857,324	51.8%
High-end non-organic liquid milk business						
Before elimination	51,702	149	0.3%	—	—	0.0%
After elimination ⁽³⁾	26,244	25,607	49.4%	—	—	0.0%
Subtotal of liquid milk business						
Before elimination	1,667,552	438,591	20.8%	1,267,411	388,278	23.5%
After elimination	995,542	1,110,601	52.7%	798,365	857,324	51.8%
Total	1,791,133	1,675,411	48.3%	1,623,168	1,477,543	47.7%

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

- (2) Represents gross profit after adding back the internal profit attributable to inter-segment sales of organic raw milk. Such internal profit is arrived at by calculating the difference of (i) the inter-segment sales of organic raw milk used in this segment and (ii) the production costs for such organic raw milk, calculated using the formula in note (1) above.
- (3) Premium non-organic raw milk after elimination is calculated using the formula in note (1) above, and the premium non-organic liquid milk after elimination is calculated using the formula in note (2) above.

Cost of sales of the Group increased from RMB1,623.2 million in 2015 to RMB1,791.1 million in 2016. Gross profit increased from RMB1,447.5 million in 2015 to RMB1,675.4 million in 2016. Gross profit margin increased from 47.7% in 2015 to 48.3% in 2016.

In 2016, cost of sales of the Group increased by 10.3% from 2015, lower than 11.8% increase of revenue, mainly attributable to the Group's effective control and reduction of production and procurement cost of the whole production chain by continuous implementation of the precision and meticulous management model. Meanwhile, further increased contribution from high profit margin business, such as organic business (in particular, the self-owned brand organic liquid milk business), to the total revenue of the Group compared with 2015 resulted in a 13.4% increase in gross profit of the Group in 2016.

Overall, though affected by intensified competition in the dairy industry and relatively higher pressure on upstream raw milk, the consolidated gross margin of the Group increased from 47.7% in 2015 to 48.3% in 2016, attributable to (1) decrease in its average unit cost as a result of enhancement of effect of scale and efficiency resulting from the expansion of the scale of the Group; and (2) increase in the percentage of revenue from organic raw milk and organic liquid milk with higher gross margin to total revenue as for product structure.

Other Income and Gains/(Losses)

Other income and gains/(losses) of the Group decreased from a net gain of RMB47.4 million in 2015 to a net loss of RMB87.1 million in 2016, mainly attributable to the provision for impairment of trade receivables referring to the collectability of individual account receivables and aging analysis by the Group.

Selling and Distribution Expenses

Selling and distribution expenses of the Group primarily include logistics and transportation expenses, warehouse fees and relevant employees' remunerations. In 2016 and 2015, selling and distribution expenses of the Group were RMB287.9 million and RMB265.5 million, accounting for 8.3% and 8.6% of revenue, respectively.

Administrative Expenses

Administrative expenses mainly include salary and welfare, travel expenses and transportation expenses of management and administrative employees. In 2016 and 2015, administrative expenses of the Group were RMB141.7 million and RMB107.5 million, accounting for 4.1% and 3.5% of revenue, respectively. Such increase in administrative expenses as a percentage of revenue in 2016 was mainly due to increase of equity-settled share option expense compared with 2015. Excluding this, administrative expenses of the Group accounted for 2.8% and 2.6% of revenue in 2016 and 2015 respectively.

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

Net gains or losses arising from changes in fair value less costs to sell of biological assets represents fair value changes in the dairy cows, due to the changes in physical attributes and market prices of and discounted future cash flow to be generated by those cows. In general, when a heifer grows into a milkable cow, its value increases, as the discounted cash flow from milkable cow is higher than the selling price of heifer. Further, when a milkable cow is ousted and sold, its value decreases.

The Group recorded net gains or losses arising from changes in fair value less costs to sell of biological assets of RMB-15.7 million and RMB52.7 million in 2016 and 2015 respectively. The changes in fair value less costs to sell of biological assets in 2016 decreased as compared to 2015 and recorded a net loss, mainly because the net losses arising from changes in fair value less costs to sell of biological assets associated with non-organic dairy cows was higher than the net gains arising from changes in fair value less costs to sell of biological assets associated with organic dairy cows.

Major Investment

During 2016, as an effort to expand its international business horizon, the Group established Food Union Shengmu Dairy Co., Ltd. (富友聯合聖牧乳品有限公司) (“**Food Union Shengmu**”), a joint-stock company with Food Union (Dairy) Hong Kong Limited (“**Food Union**”). The Group holds 20% equity interest in Food Union Shengmu. Food Union Shengmu will produce organic dairy products including high-end children dairy products, with all the organic raw milk to be purchased from the Group. Food Union and the Group invest in Food Union Shengmu and provide financing support based on the contract. During 2016, the Group invested approximately RMB75.2 million in Food Union Shengmu and provided guarantee of approximately RMB51.5 million for its bank borrowings.

Other Expenses

In 2016, the Group incurred other expenses of RMB56.2 million, mainly as Shengmu offered strong support to social public welfare during the year to contribute to the society while seeking economic and environmental efficiency.

Share of Profits and Losses of Associates

The associates mainly include (a) the companies that were jointly established by the Group and its premium distributors in its key distribution cities to distribute the liquid milk products with the Group's self-owned brand; and (b) Bayannur Shengmu High-tech Ecological Forage Co., Ltd. (巴彥淖爾市聖牧高科生態草業有限公司) and its subsidiary (“**Shengmu Forage**”) in which the Group invested and held minority interests; and (c) Food Union Shengmu and Inner Mongolia Shengmu Low Temperature Dairy Product Company Limited (內蒙古聖牧低溫乳品有限公司) in which the Group invested and held minority interests and which produce dairy products with the raw milk to be purchased from the Group. The Group recorded share of losses of associates of RMB16.2 million and RMB18.0 million in 2016 and 2015 respectively.

Income Tax Credit/(Expense)

All profits of the Group was derived from its operations in the PRC. According to the Enterprise Income Tax Law of the PRC (the “**EIT Law**”), the Group's subsidiaries in the PRC are generally subject to a corporate income tax at a rate of 25%. According to the preferential provisions of the EIT Law, the Group's income arising from agricultural activities, such as dairy farming and processing of raw agricultural products, is exempted from enterprise income tax. Under the PRC tax laws and regulations, there is no statutory time limit for such tax exemption as long as the relevant PRC subsidiaries of the Group complete filings with the relevant tax authorities as required.

In accordance with “The Notice of Tax Policies Relating to the Implementation of the Western China Development Strategy” jointly issued by Ministry of Finance, General Administration of Customs and State Administration of Taxation (財政部、海關總署、國家稅務總局《關於深入實施西部大開發戰略有關稅收政策問題的通知》(財稅[2011]58號)), the Group's taxable income arising from processing of non-raw agricultural products is subject to preferential tax rate of 15% from 2013 to 2020.

Income tax credit of the Group was RMB11.1 million in 2016 while income tax expense of the Group was RMB4.6 million in 2015, among which current income tax expenses were RMB12.5 million and RMB4.8 million respectively. Based on the percentage of the current income tax expenses of the profit before tax, the effective enterprise income tax rate of the Group was 1.3% and 0.4% for 2016 and 2015 respectively.

Profit Attributable to Owners of the Parent and Profit Attributable to Non-controlling Interests

Profit attributable to non-controlling interests mainly represents the profit entitled to the non-controlling equity interests in the Group's farms held by dairy farmers with whom the Group cooperates in relation to farm management. In 2016 and 2015, profit attributable to owners of the parent were RMB680.6 million and RMB800.7 million, and profit attributable to non-controlling interests were RMB276.2 million and RMB282.6 million, respectively.

Profit attributable to owners of the parent in 2016 decreased by RMB120.1 million compared with 2015, mainly due to the provision of RMB86.3 million for impairment of trade receivables for the year and donation of RMB56.2 million occurred by the Group for exerting great efforts in public welfare undertakings in 2016. As such, the profit attributable to owners of the parent in 2016 decreased by 15.0% compared with 2015.

Analysis on Consolidated Statement of Financial Position

Current Assets

As at December 31, 2016, the total current assets of the Group were RMB3,665.3 million (RMB4,010.3 million as at December 31, 2015), primarily consisting of inventories of RMB928.8 million (RMB824.5 million as at December 31, 2015), trade and bills receivables of RMB1,108.7 million (RMB915.3 million as at December 31, 2015), prepayments, deposits and other receivables of RMB393.6 million (RMB468.5 million as at December 31, 2015) and cash and bank balances available-for-sale investments and pledged deposits of RMB1,234.2 million (RMB1,802.0 million as at December 31, 2015).

Trade and bills receivables

Unit: RMB in thousands, except percentages

	As at	
	December 31, 2016	December 31, 2015
Trade receivables	1,194,099	915,181
Bills receivables	200	500
Impairment	(85,512)	(369)
Total	<u>1,108,787</u>	<u>915,312</u>

Aging	As at			
	December 31, 2016		December 31, 2015	
	Amount	Percentage	Amount	Percentage
Within 6 months	815,914	73.6%	851,948	93.1%
7 to 12 months	268,863	24.2%	60,042	6.5%
Over 1 year	24,010	2.2%	3,322	0.4%
Total	1,108,787	100.0%	915,312	100.0%

Trade and bills receivables of the Group increased substantially as compared to last year, mainly attributable to the increase in revenue from self-owned brand liquid milk products as the Group took into consideration the recovery days of the receivables from terminal supermarkets and department stores and aimed to increase and consolidate its share in organic liquid milk market.

The Group formulated its policy in respect of making provisions for asset impairment based on the practical situation of production and operation. Based on such policy, the Group determined the receivables group based on the aging as the credit risk characteristics, made provisions for bad debt of receivables and other receivables through aging analysis, and estimated the provisions for asset impairment based on recoverability of individual receivables and customer creditworthiness at the same time. In 2016, the Group made a total provision of RMB86.3 million for the impairment of receivables.

Current Liabilities

As at December 31, 2016, the total current liabilities of the Group amounted to RMB2,292.3 million (RMB2,975.6 million as at December 31, 2015), primarily consisting of trade and bills payables of RMB920.6 million (RMB1,018.1 million as at December 31, 2015), receipts in advance of RMB13.2 million (RMB17.3 million as at December 31, 2015), other payables and accruals of RMB438.5 million (RMB338.3 million as at December 31, 2015), interest-bearing bank and other borrowings of RMB918.4 million (RMB1,599.9 million as at December 31, 2015), and income tax payable of RMB1.6 million (RMB2.0 million as at December 31, 2015). Current liabilities of the Group as at December 31, 2016 decreased substantially as compared to December 31, 2015, primarily because the Group repaid short-term borrowings due with the proceeds from the issue of long-term corporate bonds and began to partially obtain financing by the way of offshore directional borrowings in 2016, optimizing the debt structure of the Group while enriching the forms of financing.

Non-Current Liabilities

As at December 31, 2016, the total non-current liabilities of the Group amounted to RMB1,859.9 million (RMB1,117.0 million as at December 31, 2015), primarily consisting of interest-bearing bank and other borrowings of RMB1,752.0 million (RMB1,117.0 million as at December 31, 2015) and long-term payables of RMB107.9 million. The substantial increase in the non-current liabilities as at December 31, 2016 as compared to December 31, 2015 is primarily due to the increase in the long-term interest-bearing bank and other borrowings resulted from the issue of RMB600 million long-term corporate bonds by the Group in 2016. Such issue of corporate bonds optimized the Group's debt structure and reduced its overall financing cost rate.

Foreign Exchange Risk

The Group's businesses are principally located in the mainland China and substantially all transactions are conducted in RMB. As at December 31, 2016, the Group did not have significant foreign currency exposure from its operations, except interest-bearing bank borrowings equivalent to approximately RMB70.8 million which were denominated in Euros, bank balances equivalent to approximately RMB11.9 million and RMB0.8 million which were denominated in Hong Kong dollars and United States dollars, respectively. In 2016, the Group did not enter into any arrangements to hedge against any fluctuation in foreign exchange.

Credit Risk

The Group only trades with recognized and creditworthy third parties. It is the Group's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. As the Group's trade receivables relate to a large number of diversified customers, there is no significant concentration of credit risk. Since the Group trades only with recognized and creditworthy third parties, collateral is not required.

Charge on Assets

As at December 31, 2016, the Group has pledged deposits in the amount of approximately RMB66.8 million (RMB70.3 million as at December 31, 2015) to banks in the PRC as deposits for the issuance of letters of credit and bank drafts.

Liquidity, Financial Resources and Capital Structure

In 2016, the Group financed its daily operations mainly from internally generated cash flows and bank and other borrowings. As at December 31, 2016, the Group had (a) cash and bank balances of RMB1,047.4 million (RMB1,731.8 million as at December 31, 2015), and (b) interest-bearing bank and other borrowings of RMB2,670.4 million (RMB2,716.9 million as at December 31, 2015), of which, RMB1,686.5 million were repayable within one to five years and RMB65.4 million repayable within five to eight years, while the remaining interest-bearing bank and other borrowings were repayable within one year. The gearing ratio (calculated as total debt (total interest bearing bank and other borrowings) divided by

total equity) was 42.1% as at December 31, 2016 (50.6% as at December 31, 2015). Except bank and other borrowings equivalent to RMB70.8 million which are denominated in Euros and bear fixed interest rates, the Group's remaining bank and other borrowings are denominated in RMB and bear fixed interest rates. In 2016, the annual interest rate of bank and other borrowings was 1.55% to 5.87% (2015: 4.48% to 7.14%). In 2016, the Group started to partially obtain financing by the way of offshore directional borrowings, which reduced the financing cost while enriching the ways of financing.

Environmental Policies and Performance

The Group's operations were in compliance in all material respects with currently applicable national and local environmental protection laws and regulations in the PRC in 2016.

Capital Commitments

As at December 31, 2016, the Group's capital commitments amounted to RMB352.6 million (RMB201.2 million as at December 31, 2015), primarily relating to the expansion of liquid milk production capacity by investing and constructing new production plants and production lines for liquid milk business in 2016, in order to keep up with the rapid development of the downstream self-owned brand liquid milk business of Shengmu's desert-based grass-to-glass organic production model. The Group has sufficient internal and financial resources to fund its capital expenditures.

HUMAN RESOURCES

As at December 31, 2016, the Group had a total of 3,849 employees (3,713 employees in total as at December 31, 2015). Total staff costs for 2016 (including the emoluments of Directors and senior management of the Company) amounted to RMB280.2 million (excluding equity-settled share option expenses) (RMB258.7 million in 2015).

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

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

Contingent Liabilities

For the year and as at December 31, 2016, the Group provided guarantees with amounts of RMB300,000,000 (2015: RMB300,000,000) and RMB51,450,000 (2015: Nil) for the bank loans of Shengmu Forage and Food Union Shengmu, respectively.

Material Acquisitions and Disposals

The Company did not make any material acquisitions and disposals of subsidiaries and associated companies in 2016.

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

Save as disclosed above in connection with capital commitments under the paragraph headed “Capital Commitments” and in the prospectus under the section headed “Future Plans and Use of Proceeds”, the Group does not have any plan for material investments or acquisition of capital assets as at the date of this announcement.

OUTLOOK

The Group’s long-term objective is to become a leading organic dairy company in the world.

Continue to Increase the Investment of Organic Dairy Farms to Build the Most Beautiful Organic Dairy Farms

In 2017, the Group intends to continue to increase the investment of organic dairy farms to build comfortable garden-like organic dairy farms, so as to further improve the herd growing environment and staff working environment and the whole environment of the dairy farms, striking to further turn the current high standard advanced dairy farms into the world-class most beautiful dairy farms where the best living welfare is provided to the organic dairy cows in the desert, turning them into “happy cows and healthy cows”.

Continue to Enhance the Processing Ability of Self-Owned Brand Liquid Milk and New Plant Will Commence Trial Production in the Second Quarter of in 2017

In order to enhance the Group’s ability to produce liquid milk and meet the increasing market demand, the new production plant and production lines of liquid milk built by the Group during the year will commence trial production in the second quarter of in 2017. Three production lines of liquid milk are currently under construction and are expected to produce 320 tonnes of milk per day when completed.

Continue to Implement Industrial Technology Innovation and Develop New Grass-to-Glass Organic Liquid Milk Products under Its Self-Owned Brand

In 2017, the Group will adhere to the principle of “innovation leads to success” and implement industrial technology innovation to develop new organic liquid milk products. Based on the continuous increase in the promotion of Shengmu yogurt machine, the Group successfully launched its new desert-based grass-to-glass organic product “Shengmu Naijue” (聖 牧 奶 爵) in early 2017. This product selects premium milk resources from Shengmu desert-based top-level organic dairy cows, and the milk resources contain natural DHA, pure and rare. “Shengmu Naijue” contains premium protein of 3.7 g/100ml and native calcium of 120 mg/100ml, approximately 30% higher than regular milk, and it contains DHA beneficial to human bodies, i.e. Omega-3. This product is produced with adoption of lactose hydrolysis technique to refine nutrition and therefore dispenses with the problem of lactose intolerance so as to be better absorbed and be suitable for more, and a wider range of people.

Continue to Proceed Marketing Channel Development and Innovation Development to Enhance Awareness of Brand

In 2017, the Group will continue to expand its “blue ocean” strategy development channel of large chain- community stores and to open 20,000 large chain-community stores on top of over the 100,000 existing large chain-community stores while consolidating and enhancing the sales volume per large chain-community store. In 2017, the Group will expand the scope of promotion and installation activities of China Shengmu yogurt machines across special channels such as hospitals, schools, and restaurants and canteens nationwide and expects to install 20,000 - 30,000 machines in the first half of 2017, the achievement of which will lead to a bigger and more effective brand effect and economic benefits for China Shengmu.

In 2017, the Group will enhance and improve its “key account (KA)” distribution channels and standardized image of large chain-community stores through integration of the VI system, and innovate its marketing channel development by taking measures such as encouraging the navy, land and air forces and cooperating with veterans so as to promote the organic, green and loving brand image of China Shengmu.

In 2017, the Group intends to invite many news media groups to host a variety of new product launches and organic promotion activities to make headlines. Meanwhile, the Group intends to plan to record its desert-based grass-to-glass organic production model details in more detail and more comprehensively in the form of a VCR documentary so as to more intuitively and conveniently present before the consumers a clean desert, a beautiful grassland, dairy farms and modern processing facilities, namely, our grass-to-glass integrated organic industrial chain covering planting, farming and processing, thereby sufficiently indicating the advantage of the grass-to- glass organic green industry of Shengmu.

CORPORATE GOVERNANCE PRACTICES

The Company ensures that the Company and its subsidiaries are committed to achieving and maintaining high standards of corporate governance. The Board understands the influence and importance of high standards of corporate governance on the value of the Company, and that good corporate governance is in the interest of the Group and shareholders on the whole.

We have adopted, applied and complied with the code provisions contained in the Code on Corporate Governance and Corporate Governance Report (the “**Code**”) as set out in Appendix 14 to the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (the “**Listing Rules**”) (as amended from time to time) for the year ended December 31, 2016, except for provision A2.1 of the Corporate Governance Code as disclosed below.

Pursuant to provision A2.1 of the Corporate Governance Code, the roles of chairman and chief executive officer should be separate and should not be performed by the same individual. However, the Company does not have a separate chairman and chief executive officer and Mr. YAO Tongshan currently performs these two roles. The Board believes that vesting the roles of both chairman and chief executive officer in the same person has the benefit of ensuring the consistent leadership within the Group and enables more effective and efficient overall strategic planning and implementation for the Group. The Board considers that the balance of power and authority for the present arrangement will not be impaired and this structure will enable the Company to make and implement decisions promptly and effectively. The Board will continue to review and consider splitting the roles of chairman of the Board and chief executive officer of the Company at a time when it is appropriate and suitable by taking into account the circumstances of the Group as a whole.

MODEL CODE FOR DIRECTORS’ SECURITIES TRANSACTIONS

The Company has adopted a code of conduct regarding securities transactions on terms no less exacting than the required standard of dealings set out in the Model Code for Securities Transactions by Directors of Listed Issuers (the “**Model Code**”) as set out in Appendix 10 to the Listing Rules. Having made specific queries to the Directors, all Directors have confirmed that they have complied with the required standards as set out in the Model Code for the year ended December 31, 2016.

PURCHASE, REDEMPTION OR SALE OF LISTED SECURITIES OF THE COMPANY

For the year ended December 31, 2016, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company’s shares.

USE OF NET PROCEEDS FROM THE GLOBAL OFFERING

The net proceeds from the Global Offering of the Company were approximately RMB801.2 million. The relevant net proceeds are intended to be or have been used in accordance with the proposed usages as set out in the section headed “Future Plans and Use of Proceeds” in the Prospectus of the Company dated June 30, 2014.

As at December 31, 2016, the net proceeds were applied as follows:

	Funds utilized as at December 31, 2016 RMB'000
Constructing six additional organic dairy farms	182,525
Acquiring dairy cows domestically and from overseas	145,644
Sales and marketing activities and expansion of distribution network	40,102
Expanding the Group’s liquid milk production capacity	120,306
Repayment of loans	120,306
Additional working capital and general corporate purposes	<u>80,204</u>
Total:	<u><u>689,087</u></u>

AUDIT COMMITTEE

The Company established the Audit Committee on June 18, 2014 in compliance with the Corporate Governance Code set out in Appendix 14 to the Listing Rules. The Audit Committee was established with written terms of reference in compliance with the Corporate Governance Code. The primary duties of the Audit Committee are to review and supervise the financial reporting process and internal control system of the Group. The Company modified the terms of reference of the Audit Committee on January 1, 2016. As at December 31, 2016, the Audit Committee comprised two independent non-executive Directors (Ms. GE Xiaoping and Mr. LI Changqing) and one non-executive Director (Mr. CUI Guiyong) and was chaired by Ms. GE Xiaoping.

The Audit Committee has reviewed the accounting standards and practices adopted by the Group and discussed with the management on the internal control and financial reporting matters, including the review of the annual results for 2016.

SCOPE OF WORK OF ERNST & YOUNG

The financial information in respect of the announcement of the Group's results for the year ended December 31, 2016 have been agreed by the Group's auditors, Ernst & Young, to the amounts set out in the Group's draft consolidated financial statements for the year. The work performed by Ernst & Young in this respect did not constitute an assurance engagement in accordance with Hong Kong Standards on Auditing, Hong Kong Standards on Review Engagements or Hong Kong Standards on Assurance Engagements issued by the Hong Kong Institute of Certified Public Accountants and consequently no assurance has been expressed by Ernst & Young on the results announcement.

DIVIDEND DISTRIBUTION

The Board does not recommend the payment of final dividend for the year ended December 31, 2016 (2015 : Nil).

ANNUAL GENERAL MEETING

The 2017 annual general meeting will be held on or before June 30, 2017. A notice convening the 2017 annual general meeting will be published on the website of the Stock Exchange and the Company and dispatched to the Shareholders in due course.

PUBLICATION OF ANNUAL RESULTS ANNOUNCEMENT AND ANNUAL REPORT

This annual results announcement is published on the website of the Hong Kong Stock Exchange at www.hkexnews.hk and on the website of the Company at www.youjimmilk.com. The annual report of the Company for the year of 2016 containing all the information required by the Listing Rules will be dispatched to Shareholders and published on the above websites in due course.

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

Hong Kong, March 20, 2017

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