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CHINA MENGNIU DAIRY COMPANY LIMITED

中國蒙牛乳業有限公司*

(Incorporated in the Cayman Islands with limited liability)

(Stock Code: 2319)

ANNOUNCEMENT OF THE INTERIM RESULTS FOR THE SIX MONTHS ENDED 30 JUNE 2017

HIGHLIGHTS

- Mengniu was included in the “Global Dairy Top 20” list published by Rabobank for the ninth consecutive year. In 2017, for the first time, Mengniu climbed into the top 10, attaining a new height in this prestigious global dairy industry ranking.
- With the spirit of “Craftsman of Milk”, Mengniu focuses on providing nutritious and healthy products to consumers. During the period, Mengniu’s liquid milk has maintained market leadership, while its low temperature dairy products continued to claim the largest share in the chilled fresh dairy products market in China.
- Mengniu has achieved significant advances in its chilled product category. Building on the established brand position of *Milk Deluxe*, Mengniu has launched *Milk Deluxe Yogurt*, the first yogurt product in the growing *Milk Deluxe* family. In addition, *Yoyi C* has launched *LC-37* to target and build a strong brand in the probiotic drink market.
- Mengniu continued to consolidate upstream resources within its supply chain by increasing its stake in China Modern Dairy Holdings Ltd. (“Modern Dairy”; stock code: 1117) to assure the high quality and stable supply of raw milk sources. At the same time, it has actively expanded its milk sources overseas in order to achieve greater diversification in suppliers.
- Mengniu has actively advanced digitalization, building the unique “Mengniu Cloud”, the digitalized “Real-time Food Safety and Quality Monitoring and Control Platform” and Big Data base of consumer behaviour in order to generate more accurate data for managing and operating its factories, constructing milk sources, assuring product quality and improving marketing activities. At the same time, Mengniu constantly and diligently strives to advance its research and development capabilities in order to achieve breakthroughs.

* For identification purposes only

The board (the “Board”) of directors (the “Directors”) of China Mengniu Dairy Company Limited (the “Company”) is pleased to present the unaudited consolidated interim results of the Company and its subsidiaries (the “Group” or “Mengniu”) for the six months ended 30 June 2017, together with the comparative amounts. The interim results and condensed interim financial statements have been reviewed by the audit committee (the “Audit Committee”) and the auditors of the Company.

INTERIM CONDENSED CONSOLIDATED STATEMENT OF PROFIT OR LOSS

		Unaudited	
		For the six months ended	
		30 June	
	<i>Notes</i>	2017	2016
		RMB'000	RMB'000
Revenue	4	29,465,755	27,257,154
Cost of sales		<u>(18,963,182)</u>	<u>(18,075,749)</u>
Gross profit		10,502,573	9,181,405
Other income and gains	4	127,073	169,963
Selling and distribution expenses		(7,143,794)	(6,448,888)
Administrative expenses		(1,087,499)	(1,135,934)
Other expenses	5	(592,749)	(241,078)
Interest income		229,331	278,098
Finance costs	7	(191,404)	(151,460)
Share of losses of associates		<u>(354,600)</u>	<u>(154,555)</u>
Profit before tax	6	1,488,931	1,497,551
Income tax expense	8	<u>(373,846)</u>	<u>(313,030)</u>
Profit for the period		<u>1,115,085</u>	<u>1,184,521</u>
Attributable to:			
Owners of the Company		1,127,900	1,077,290
Non-controlling interests		<u>(12,815)</u>	<u>107,231</u>
		<u>1,115,085</u>	<u>1,184,521</u>
Earnings per share attributable to ordinary equity holders of the Company (expressed in RMB per share)	9		
Basic		0.290	0.277
Diluted		<u>0.290</u>	<u>0.277</u>

INTERIM CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Unaudited	
	For the six months ended	
	30 June	
	2017	2016
	RMB'000	RMB'000
Profit for the period	1,115,085	1,184,521
Other comprehensive income/(loss)		
<i>Other comprehensive income to be reclassified to profit or loss in subsequent periods:</i>		
Exchange differences on translation of foreign operations	<u>129,606</u>	<u>11,177</u>
Net other comprehensive income to be reclassified to profit or loss in subsequent periods	129,606	11,177
<i>Other comprehensive loss not to be reclassified to profit or loss in subsequent periods:</i>		
Equity investments designated as fair value through other comprehensive income:		
Changes in fair value	<u>(176,888)</u>	<u>(67,100)</u>
Net other comprehensive loss not to be reclassified to profit or loss in subsequent periods	(176,888)	(67,100)
Other comprehensive loss, net of tax	(47,282)	(55,923)
Total comprehensive income for the period	<u>1,067,803</u>	<u>1,128,598</u>
Attributable to:		
Owners of the Company	1,060,783	988,488
Non-controlling interests	<u>7,020</u>	<u>140,110</u>
	<u>1,067,803</u>	<u>1,128,598</u>

INTERIM CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION

	Unaudited 30 June 2017 RMB'000	Audited 31 December 2016 RMB'000
	<i>Notes</i>	
NON-CURRENT ASSETS		
Property, plant and equipment	12,560,899	12,698,374
Construction in progress	1,207,259	1,271,844
Investment properties	30,629	67,486
Land use rights	1,012,376	983,794
Goodwill	4,531,397	4,527,518
Other intangible assets	2,105,467	2,086,247
Investments in associates	7,648,508	4,132,099
Deferred tax assets	630,658	529,123
Biological assets	519,811	479,386
Derivative financial instruments	25,518	–
Non-current financial assets	1,583,502	2,495,681
Long term prepayments	6,762	15,566
	31,862,786	29,287,118
CURRENT ASSETS		
Other current financial assets	4,054,646	4,195,737
Derivative financial instruments	2,178	36,501
Inventories	3,323,288	3,314,282
Trade and bills receivables	2,748,596	2,340,099
Prepayments, deposits and other receivables	2,078,743	2,704,611
Pledged deposits	1,025,178	960,863
Cash and bank balances	10,536,883	6,070,078
	23,769,512	19,622,171
Assets of a disposal group classified as held for sale	214,570	215,138
	23,984,082	19,837,309
CURRENT LIABILITIES		
Trade and bills payables	6,594,312	5,405,620
Other payables and accruals	5,645,986	6,510,886
Interest-bearing bank and other borrowings	4,653,519	3,045,417
Other loans	24,234	52,559
Derivative financial instruments	3,174	–
Deferred income	148,069	135,093
Income tax payable	209,009	145,242
	17,278,303	15,294,817
Liabilities directly associated with the assets classified as held for sale	7,209	7,852
	17,285,512	15,302,669
NET CURRENT ASSETS	6,698,570	4,534,640
TOTAL ASSETS LESS CURRENT LIABILITIES	38,561,356	33,821,758

	Unaudited 30 June 2017 RMB'000	Audited 31 December 2016 RMB'000
NON-CURRENT LIABILITIES		
Interest-bearing bank and other borrowings	9,524,059	5,542,163
Long term payables	21,655	36,914
Deferred income	627,619	533,385
Deferred tax liabilities	62,244	62,190
Other non-current financial liabilities	2,066,780	2,143,378
	<hr/>	<hr/>
Total non-current liabilities	12,302,357	8,318,030
	<hr/>	<hr/>
NET ASSETS	26,258,999	25,503,728
	<hr/>	<hr/>
EQUITY		
Equity attributable to owners of the Company		
Share capital	357,457	357,374
Treasury shares held under share award scheme	(354,409)	(354,409)
Other reserves	12,636,978	12,940,822
Retained earnings	9,029,026	7,901,126
	<hr/>	<hr/>
Non-controlling interests	21,669,052	20,844,913
	4,589,947	4,658,815
	<hr/>	<hr/>
TOTAL EQUITY	26,258,999	25,503,728
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Notes:

1. CORPORATE INFORMATION

The Company was incorporated as an exempted company with limited liability in the Cayman Islands. The Company is an investment holding company and its subsidiaries are engaged in the manufacture and distribution of dairy products mainly 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 unaudited interim condensed consolidated financial statements for the six months ended 30 June 2017 have been prepared in accordance with IAS 34 *Interim Financial Reporting* and the disclosure requirements of Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited.

The unaudited interim condensed consolidated financial statements do not include all the information and disclosures required in the annual financial statements, and should be read in conjunction with the Group's annual financial statements for the year ended 31 December 2016.

New standards, interpretations and amendments adopted by the Group

The accounting policies adopted in the preparation of these interim condensed consolidated financial statements are consistent with those in the Group's annual financial statements for the year ended 31 December 2016, except for the adoption of the following new and revised standards effective as at 1 January 2017.

The nature and the effect of these changes are disclosed below. Although these new standards and amendments apply for the first time in 2017, they do not have a material impact on the annual consolidated financial statements of the Group or the interim condensed consolidated financial statements of the Group. The nature and the impact of each new standards or amendments is described below:

Amendments to IAS 7 Statement of Cash Flows: Disclosure Initiative

The amendments require entities to provide disclosures about changes in their liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes (such as foreign exchange gains or losses). On initial application of the amendment, entities are not required to provide comparative information for preceding periods. The Group is not required to provide additional disclosures in its condensed interim consolidated financial statements, but will disclose additional information in its annual consolidated financial statements for the year ending 31 December 2017.

Amendments to IAS 12 Income Taxes: Recognition of Deferred Tax Assets for Unrealised Losses

The amendments clarify that an entity needs to consider whether tax law restricts the sources of taxable profits against which it may make deductions on the reversal of that deductible temporary difference. Furthermore, the amendments provide guidance on how an entity should determine future taxable profits and explain the circumstances in which taxable profit may include the recovery of some assets for more than their carrying amount.

Entities are required to apply the amendments retrospectively. However, on initial application of the amendments, the change in the opening equity of the earliest comparative period may be recognised in opening retained earnings (or in another component of equity, as appropriate), without allocating the change between opening retained earnings and other components of equity. Entities applying this relief must disclose that fact.

The Group applied the amendments retrospectively. However, such application has no effect on the Group's financial position and performance as the Group has no deductible temporary differences or assets that are in the scope of the amendments.

Annual Improvements Cycle – 2014-2016

Amendments to IFRS 12 Disclosure of Interests in Other Entities: Clarification of the scope of disclosure requirements in IFRS 12

The amendments clarify that the disclosure requirements in IFRS 12, other than those in paragraphs B10 to B16, apply to an entity's interest in a subsidiary, a joint venture or an associate (or a portion of its interest in a joint venture or an associate) that is classified (or included in a disposal group that is classified) as held for sale.

The Group has adopted the amendments retrospectively. As the disclosure requirements in IFRS 12 do not specifically apply to the interim condensed consolidated financial statements, the Group did not provide these disclosures in its condensed interim consolidated financial statements and will disclose the required information in its annual consolidated financial statements for the year ending 31 December 2017.

3. SEGMENT INFORMATION

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

- Liquid milk products segment – manufacture and distribution of ultra-high temperature milk (“UHT milk”), milk beverage and yogurt
- Ice cream products segment – manufacture and distribution of ice cream
- Milk powder products segment – manufacture and distribution of milk powder
- Others segment – principally the Group's cheese and plant-based nutrition product business and trading business

Management monitors the results of the Group's operating segments separately for the purpose of making decisions about resources allocation and performance assessment. Segment performance is evaluated based on reportable segment profit/loss, which is a measure of adjusted profit/loss before tax. The adjusted profit/loss before tax is measured consistently with the Group's profit before tax except that interest income, finance costs, share of losses of associates, income tax expense, as well as head office and corporate expenses are excluded from such measurement.

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

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

Intersegment sales and transfers are transacted with reference to the selling prices used for sales made to third parties at the then prevailing market prices.

The following tables present the revenue, profit and certain asset and liability information for the Group's operating segments:

For the six months ended 30 June 2017 (unaudited)

	Liquid milk products RMB'000	Ice cream products RMB'000	Milk powder products RMB'000	Others RMB'000	Consolidated RMB'000
Segment revenue:					
Sales to external customers	25,372,096	1,985,259	1,786,355	322,045	29,465,755
Intersegment sales	<u>287,804</u>	<u>58,345</u>	<u>32,538</u>	<u>160,339</u>	<u>539,026</u>
	25,659,900	2,043,604	1,818,893	482,384	30,004,781
Reconciliation:					
Elimination of intersegment sales					<u>(539,026)</u>
Total revenue					<u>29,465,755</u>
Segment results	2,038,688	190,754	(181,140)	(33,180)	2,015,122
Reconciliation:					
Interest income					229,331
Finance costs					(191,404)
Share of losses of associates					(354,600)
Corporate and other unallocated expenses					<u>(209,518)</u>
Profit before tax					1,488,931
Income tax expense					<u>(373,846)</u>
Profit for the period					<u>1,115,085</u>
At 30 June 2017 (unaudited)					
Segment assets	31,503,283	2,738,644	13,158,152	678,200	48,078,279
Reconciliation:					
Elimination of intersegment receivables					(11,121,616)
Corporate and other unallocated assets					18,675,635
Assets related to a disposal group					<u>214,570</u>
Total assets					<u>55,846,868</u>
Segment liabilities	15,275,733	2,472,598	3,402,353	980,400	22,131,084
Reconciliation:					
Elimination of intersegment payables					(11,121,616)
Corporate and other unallocated liabilities					18,571,192
Liabilities related to a disposal group					<u>7,209</u>
Total liabilities					<u>29,587,869</u>

For the six months ended 30 June 2016 (unaudited)

	Liquid milk products <i>RMB'000</i>	Ice cream products <i>RMB'000</i>	Milk powder products <i>RMB'000</i>	Others <i>RMB'000</i>	Consolidated <i>RMB'000</i>
Segment revenue:					
Sales to external customers	23,761,520	1,703,333	1,660,036	132,265	27,257,154
Intersegment sales	<u>369,487</u>	<u>59,854</u>	<u>–</u>	<u>105,508</u>	<u>534,849</u>
	24,131,007	1,763,187	1,660,036	237,773	27,792,003
Reconciliation:					
Elimination of intersegment sales					<u>(534,849)</u>
Total revenue					<u>27,257,154</u>
Segment results	1,674,697	37,719	(99,938)	(59,493)	1,552,985
Reconciliation:					
Interest income					278,098
Finance costs					(151,460)
Share of losses of associates					(154,555)
Corporate and other unallocated expenses					<u>(27,517)</u>
Profit before tax					1,497,551
Income tax expense					<u>(313,030)</u>
Profit for the period					<u>1,184,521</u>
At 31 December 2016 (audited)					
Segment assets	28,933,430	2,309,669	12,829,812	632,420	44,705,331
Reconciliation:					
Elimination of intersegment receivables					(8,691,755)
Corporate and other unallocated assets					12,895,713
Assets related to disposal groups					<u>215,138</u>
Total assets					<u>49,124,427</u>
Segment liabilities	14,579,687	2,183,081	3,010,372	903,729	20,676,869
Reconciliation:					
Elimination of intersegment payables					(8,691,755)
Corporate and other unallocated liabilities					11,627,733
Liabilities related to disposal groups					<u>7,852</u>
Total liabilities					<u>23,620,699</u>

4. REVENUE, OTHER INCOME AND GAINS

Revenue represents the net invoiced value of goods sold, after allowances for goods returns and trade discounts, and after eliminations of all significant intra-group transactions.

An analysis of the Group's revenue, other income and gains is as follows:

		Unaudited	
		For the six months ended 30 June	
	<i>Notes</i>	2017	2016
		RMB'000	RMB'000
Revenue:			
Sale of goods		29,465,755	27,257,154
Other income and gains:			
Government grants related to			
– Recognition of deferred income	<i>(a)</i>	44,183	15,837
– Income and biological assets	<i>(b)</i>	45,929	39,052
Gain on disposal of a disposal group classified as held for sale		–	29,127
Gain on disposal of items of property, plant and equipment		–	2,475
Foreign exchange gains, net		–	30,897
Net fair value gain on exchangeable bonds		2,777	–
Others		34,184	52,575
		127,073	169,963
		29,592,828	27,427,117

Notes:

- (a) The Group has received certain government grants in forms of property, plant and equipment donations, cash donations to purchase items of property, plant and equipment, and cash donations with certain conditions attaching to. These grants are initially recorded as deferred income. The grants relating to property, plant and equipment are amortised to match the depreciation charge of the underlying property, plant and equipment in accordance with estimated useful lives of the assets. The cash donations with unfulfilled conditions or contingencies are only recognised in profit or loss when the Group satisfies the attached conditions.
- (b) The government grants in the form of cash donations have been received for the Group's contribution to the development of the local dairy product industry. There are no unfulfilled conditions or contingencies attaching to these grants.

5. OTHER EXPENSES

	<i>Note</i>	Unaudited	
		For the six months ended 30 June	
		2017	2016
		RMB'000	RMB'000
Provision for trade receivables and other receivables		9,902	6,873
Write-back of provision for trade receivables and other receivables		(859)	(21,740)
Write-down of inventories to net realisable value		38,594	57,535
Provision for property, plant and equipment		1,814	–
Losses on disposal of items of property, plant and equipment		13,062	–
Donations		1,000	3,317
Educational surcharges, city construction tax, and other taxes		203,358	119,816
Losses arising from changes in fair value less cost to sell of dairy cows		33,026	22,285
Net fair value loss on forward currency contracts		2,080	5,011
Foreign exchange losses, net		99,315	–
Loss on disposal of a subsidiary		11,698	–
Losses on deemed disposal of partial interests in associates	<i>(a)</i>	125,439	–
Others		54,320	47,981
		592,749	241,078

Note:

- (a) On 6 January 2017, due to the execution of share award scheme of Inner Mongolia Fuyuan International Industrial Co., Ltd, the Group's shareholding in Inner Mongolia Fuyuan International Industrial Co., Ltd was diluted from 43.35% to 42.30%, resulting in a loss of RMB21,320,000 recognised in profit or loss.

On 25 January 2017, China Modern Dairy Holdings Ltd. ("China Modern Dairy") acquired an additional 45% equity interest in a subsidiary at the consideration of 338,602,205 shares in China Modern Dairy issued to the sellers. The acquisition diluted the Group's shareholding in China Modern Dairy from 25.41% to 23.88%, resulting in a loss of RMB53,381,000 recognised in profit or loss.

On 6 February 2017, pursuant to the exercise of the investor option granted to its investor, China Modern Dairy issued 488,036,618 consideration shares and paid a cash consideration of US\$13,424,231 to the then investor. The transaction diluted Group's shareholding in China Modern Dairy from 23.88% to 21.98%, resulting in a loss of RMB50,738,000 recognised in profit or loss.

6. PROFIT BEFORE TAX

The Group's profit before tax is arrived at after charging:

	Unaudited	
	For the six months ended 30 June	
	2017	2016
<i>Note</i>	RMB'000	RMB'000
Cost of inventories sold	18,950,843	18,073,165
Realised and unrealised fair value losses of commodity future contracts, net	12,339	2,584
Cost of sales	18,963,182	18,075,749
Depreciation of items of property, plant and equipment	800,106	752,094
Depreciation of investment properties	1,293	2,474
Amortisation of land use rights	13,292	11,505
Amortisation of other intangible assets	24,039	18,080
Outsourcing expenses (a)	161,946	169,136
Minimum lease payments under operating leases	145,454	95,846
Display space leasing fees	614,196	388,578
Employee benefit expense (including directors' and senior executive's emoluments)	2,395,742	2,113,927

Note:

- (a) For the purpose of promoting operation efficiency, the Group outsourced the production of certain products. The amounts represent the total amounts paid by the Group for purchasing outsourcing services.

7. FINANCE COSTS

An analysis of finance costs is as follows:

	Unaudited	
	For the six months ended 30 June	
	2017	2016
	RMB'000	RMB'000
Interest on bank loans	102,693	84,068
Interest on US\$500,000,000 3.50% bond due 2018	63,127	61,810
Interest on long term payables	2,387	3,715
Increase in discounted amounts of contingent consideration arising from the passage of time	–	275
Net fair value loss/(gain) on interest rate forward contracts	(2,440)	1,592
Bonds issuance cost and others	25,637	–
	191,404	151,460

8. INCOME TAX EXPENSE

The major components of income tax expense in the interim condensed consolidated statement of profit or loss are:

	Unaudited	
	For the six months ended 30 June	
	2017	2016
	RMB'000	RMB'000
Current income tax		
Current income tax charge	474,183	405,438
Deferred income tax		
Relating to origination and reversal of tax losses and temporary differences	(100,337)	(92,408)
	373,846	313,030

- (a) Hong Kong profits tax has not been provided as the Group had no assessable profits arising in Hong Kong during the period.

During the period, certain PRC subsidiaries were subject to tax concessions in accordance with (i) the PRC corporate income tax law; (ii) “The notice of tax policies relating to the implementation of western China development strategy”; and (iii) “The notice of preferential tax policy for preliminary processing of agricultural products”.

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

(a) Basic earnings per share

The basic earnings per share amount for the period is calculated by dividing the profit for the period attributable to ordinary equity holders of the Company by the weighted average number of ordinary shares outstanding during the period.

A reconciliation of the weighted average number of shares used in calculating the basic earnings per share amount is as follows:

	Unaudited	
	For the six months ended 30 June	
	2017	2016
	Number of shares	Number of shares
	(in thousand)	(in thousand)
Issued ordinary shares at 1 January	3,925,027	3,923,977
Effect of shares repurchase and cancellation	–	(3,976)
Effect of share options exercised	277	655
Effect of shares purchased under share award scheme	(30,994)	(34,492)
Weighted average number of ordinary shares for the purpose of the basic earnings per share calculation	3,894,310	3,886,164

(b) Diluted earnings per share

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

A reconciliation of the weighted average number of shares used in calculating the diluted earnings per share amount is as follows:

	Unaudited	
	For the six months ended 30 June	
	2017	2016
	<i>Number of shares</i>	<i>Number of shares</i>
	(in thousand)	(in thousand)
Weighted average number of ordinary shares for the purpose of the basic earnings per share calculation	3,894,310	3,886,164
Weighted average number of ordinary shares, assuming issued at no consideration on the deemed exercise of all share options during the period	423	55
Weighted average number of ordinary shares for the purpose of the diluted earnings per share calculation	<u>3,894,733</u>	<u>3,886,219</u>

10. DIVIDENDS

The directors do not recommend the payment of an interim dividend for the six months ended 30 June 2017 (six months ended 30 June 2016: Nil).

During the six months ended 30 June 2017, the Company declared and paid a final dividend of RMB0.089 (six months ended 30 June 2016: RMB0.14) per ordinary share as proposed for the year ended 31 December 2016 to the shareholders of the Company.

11. TRADE AND BILLS RECEIVABLES

The Group normally allows a credit limit to its customers which is adjustable in certain circumstances. The Group closely monitors overdue balances. In view of the aforementioned and the fact that the Group's trade and bills 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 receivables are non-interest-bearing.

An ageing analysis of the trade and bills receivables of the Group, based on the invoice date and net of provision, is as follows:

	Unaudited 30 June 2017 RMB'000	Audited 31 December 2016 <i>RMB'000</i>
Within 3 months	2,433,165	2,041,533
4 to 6 months	186,569	224,670
7 to 12 months	88,078	63,584
Over 1 year	40,784	10,312
	<hr/> 2,748,596 <hr/>	<hr/> 2,340,099 <hr/>

12. TRADE AND BILLS PAYABLES

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

	Unaudited 30 June 2017 RMB'000	Audited 31 December 2016 <i>RMB'000</i>
Within 3 months	5,847,098	4,733,321
4 to 6 months	522,028	638,773
7 to 12 months	213,071	23,768
Over 1 year	12,115	9,758
	<hr/> 6,594,312 <hr/>	<hr/> 5,405,620 <hr/>

13. BUSINESS COMBINATION

Acquisition of Dumex China

On 31 May 2016, Yashili, a 51.01% indirectly owned subsidiary of the Company, acquired an 100% equity interest in Dumex Baby Food Co., Ltd. (“Dumex China”) from Danone Asia Pacific Holdings Pte. Ltd. (“Danone”). Dumex China is mainly engaged in the manufacture and sale of infant milk formula products of Dumex brand. The acquisition was made as part of the Group’s strategy to expand its market share of infant milk formula products in Mainland China.

The fair values of the identifiable assets and liabilities of Dumex China as at the date of acquisition were as follows:

	Fair value recognised on acquisition <i>RMB’000</i>
Assets	
Property, plant and equipment	68,290
Construction in progress	7,473
Land use rights	41,527
Intangible assets	283,120
Inventories	64,945
Trade and bills receivables	63,887
Prepayments, deposits and other receivables	14,116
Cash and bank balances	<u>112,071</u>
Total assets	<u>655,429</u>
Liabilities	
Trade payables	(43,626)
Other payables and accruals	(302,909)
Income tax payable	<u>(112)</u>
Total liabilities	<u>(346,647)</u>
Total identifiable net assets at fair value	308,782
Add: Goodwill arising on acquisition	<u>718,476</u>
Purchase consideration at fair value	<u><u>1,027,258</u></u>

An analysis of the cash flows in respect of the acquisition of Dumex China for the six months ended 30 June 2016 was as follows:

	<i>RMB'000</i>
Cash consideration	1,099,695
Cash and cash equivalents acquired	<u>(112,071)</u>
Net outflow of cash and cash equivalents included in cash flows from investing activities	987,624
Transaction costs of the acquisition included in cash flows from operating activities	<u>5,510</u>
	<u><u>993,134</u></u>

14. EVENTS AFTER THE REPORTING PERIOD

- (a) On 13 July 2017, the Company granted 6,998,575 shares under share award scheme to selected participants, representing approximately 0.2% of the issued share capital of the Company as at the grant date. These granted shares will vest in two equal batches each on the first and second anniversaries of the grant date in accordance with certain vesting conditions.

On 13 July 2017, the Company offered to grant an aggregate of 10,930,005 share options to eligible grantees under its share option scheme adopted on 3 June 2016. The exercise price per share option is HK\$14.812. The share options will vest in two equal batches each on the first and second anniversaries of the grant date in accordance with certain vesting conditions.

- (b) On 5 August 2017, the Group entered into an equity transfer agreement to sell 30,000,000 shares of China Modern Dairy, representing 0.49% of the issued share capital, for a cash consideration of HK\$41,400,000, which was equivalent to HK\$1.38 per share.

MANAGEMENT DISCUSSION AND ANALYSIS

Market Review

Since the beginning of the year, China's macro economy has been steadily gaining traction. Despite that overall consumption demand was still sluggish, with consumption continuing to recover and consumption upgrade gathering momentum, the domestic dairy industry has seen improved growth in the first half year. The younger generations in China today have stronger purchasing power and are paying more attention to the quality as well as the experience of consumption. Along with rising consumption level and the advantages brought by the change in structure of the population, new consumption patterns are emerging and driving demands for dairy products. During the first half year of 2017, thanks to stable raw milk supply and continuously improving product structure, the market segment for high-end dairy products kept expanding and yogurt has become one of the product categories with the strongest growth potential. Moreover, innovated and high-end differentiated products have surfaced as the key impetus for the future growth of the industry.

While the dairy industry in China has stepped into a new era of development characterized by growth in consumption demand, product innovation and comprehensive sales channel upgrade, the quality of dairy products remains the foundation and core competitive strength of the industry. With the government imposing stringent regulations on the entire dairy industry chain, the quality and safety levels of dairy products are rising steadily and the infant milk formula registration system, in particular, has raised both the entry barrier and regulatory standard of the milk powder industry. When the system is fully implemented in 2018, the industry can expect to further consolidate and well set for long-term development. During the period, the government also offered practical support to help the industry develop, for example, the Ministry of Agriculture launched "Five Major Actions" to help accelerate modernization of the dairy industry, boost consumer confidence in domestic dairy products and promote the dairy industry into a new development stage. Furthermore, positive effects of production capacity adjustment of the domestic upstream dairy farming industry started to show in the first half year of 2017, and raw milk price while still on the slide, was stabilizing gradually and hopefully would slowly recover. At the same time, the industry consolidation went further with leading dairy companies enjoying yet more solid advantages. Although the market is currently still rather competitive, in the long run, the dairy industry will have a more mature and stable development pattern.

It will take more time yet for consumers to build up confidence in domestic dairy products again. Meanwhile, adopting smart technologies, digitalization and personalization are the trends of the dairy industry. Hence, apart from focusing on milk source development, domestic dairy companies are stressing more and more on brand building and carrying out extensive product research, development and innovation as well as heeding domestic demands and implementing supply chain upgrade. At the same time, internationalization has become obviously the path to take for China's dairy industry. More and more dairy companies have started to pursue overseas development, seeking a place in the global dairy market and pushing to raise the influence and competitiveness of domestic brands to make sure they can meet the challenges presented by the changing market environment.

Business Review

During the first half of 2017, Mengniu continued to adjust its organizational structure and adopted the new business division system, achieving balanced and coordinated development of the four independent business segments, namely room temperature dairy products, low temperature dairy products, milk formula and ice cream products. And through centralizing management of the entire supply chain system, it has been able to improve operational efficiency and better monitor and control product quality and business growth. To capitalize on China's consumption trend of leaning towards higher-end, more nutritious and healthier products, Mengniu has focused on product research and development and innovation, combining new technology and quality milk sources to not only enrich the nutritional content of products and ensure only green and healthy products are delivered to customers, but also offer more unique flavors and rich and fun brand experiences to meet the needs of different consumer groups. During the period, Mengniu made breakthroughs in innovation in the chilled and ice cream products categories and received positive market response. Heeding the Internet+ trend, Mengniu uses digital technology on milk source construction and upgrade of factory management and operation, putting its best into developing dairy products of "aeronautic quality" based on Big Data research, giving it access to accurate information of consumer preferences and product positioning. It has kept improving research and development standard aiming for breakthroughs. On the marketing front, Mengniu employs the social media, which has become a mainstream communication platform, marrying it with online and offline promotions, to ensure its brand propositions penetrate every aspect of a consumer's daily life, that is, to achieve the best promotional effect via multi-dimensional interaction with consumers.

During the period, Mengniu's liquid milk retained its market leadership, while room temperature and chilled products recorded satisfactory sales, with *Milk Deluxe* and *Just Yoghurt* reporting continuous growth and *Yoyi C* affording outstanding performance, and basic room temperature products maintaining its market share. The high-end yogurt market grew significantly, with leisure yogurt as the new driving force. Regarding milk formula business, formula registration continued, sales channel transformation and product structure gradually became clear, and achieved stable sales and at the same time enhanced efficiency.

Mengniu was on the "Global Dairy Top 20" list for 2017 published by Rabobank for the ninth consecutive year and for the first time made it among the top 10, a new record for Mengniu in global dairy industry ranking. Also, Mengniu was once again selected by Interbrand as one of the Best China Brands in 2017, reflecting its strong brand presence and international competitiveness. Then, in the "2017 Seventh China Brand Power Index (C-BPI)", Mengniu's yogurt products garnered the C-BPI Golden Brand title and for the seventh consecutive year came first at the C-BPI Brand Power in the China Yogurt Industry, whereas *Yoyi C* clinched the top spot in C-BPI Brand Power in the China Probiotics Drinks Industry. In addition, at the Ninth China Food Safety Forum, Mengniu received the "Food Safety Demonstration Project Award for the Year 2016-2017". In the area of social responsibility, Mengniu has been active in expanding its influence. Its "University of Ranchers" project earned the Asia Responsible Entrepreneurship Awards 2017 in Social Empowerment Category.

Strategic Cooperation and Integration

- *Chilled product business: Danone S.A. and its subsidiaries (collectively “Danone Group”)*

Danone Group, which owns 9.9% stake in Mengniu, is Mengniu’s second largest strategic shareholder. Inner Mongolia Mengniu Danone Dairy Co., Ltd. (“Mengniu Danone”) is a joint-equity company held 80% by Mengniu and 20% by Danone Group.

In the first half of 2017, Mengniu Danone was active in cultivating markets and building sales channels. At such efforts plus a stronger brand awareness among consumers, all chilled milk products manifested stamina and kept the top spot in terms of market share in the chilled product market with different product categories achieving various extents of growth. Star products such as *Champion* and *Yoyi C* achieved satisfactory sales performance, while upgraded products such as *Daguoli* and *Solid Yogurt* also recorded strong sales. With regard to operational management, through project improvement and fine control and management processes, cost was saved, wastage was lowered, and efficiency was enhanced. Having Danone Group’s consistent global quality management system as base, Mengniu constantly refers to Danone Group’s key processes, including product design, production, logistics and sales, to push for subsequent matching of standards for its own factories and to provide systematic guarantee that its products indeed afford “aeronautic quality”.

Combining Danone Group’s world-class research and development technology in chilled products, Mengniu Danone has continually achieved breakthroughs in product innovation. In response to consumption upgrade and the development trend of yogurt products, Mengniu for the first time employed the exclusive patented Ystral smoothing technique from Danone Group in high-end *Milk Deluxe Yogurt* which was launched in April 2017. The new product, which blends USA-patented bacteria with raw milk from quality ranches in China, gave a new definition to premium yogurt and created a buzz in the market. The newly launched *LC-37* under *Yoyi C* uses powerful concentration technology to substantially increase the amount of probiotics – 500 times more than the national standard – in the product. In addition, with authorized use of an exclusive bacteria, the product is guaranteed to contain probiotics that are highly active, as such the product boasts significantly improved functionality. In May 2017, under *LC-37*, an upgraded low-sugar enzyme-rich product was launched to meet consumer demand for choices of healthier products. During the first half year, *Champion* actively planned for upgrade of product structure to strengthen the brand’s “professional and functional” positioning. Basic chilled products were refreshed with new packaging and mouthfeel, enabling them to rapidly gain popularity.

With product quality as the core quest and research, development and innovation as drivers, the chilled product business of Mengniu deepened its cooperation with Danone Group in terms of adjusting its product structure, improving the operation of its plants and optimizing the business structure, thereby leading development and upgrade of the entire industry. Leveraging the research and development and patented technology of Danone Group and implementing its own advanced operation and management methods tied in with distinctive Chinese characteristics, Mengniu will continue to enrich its product lines, focus on the nutritional and health value of its products and promote development of the high-end chilled dairy products market.

– *Arla Foods*

Mengniu continued its international research and development and ranch management approaches with the aim of aligning its entire industrial chain with international standard. With the support of technologies and human resources from Arla Foods and through the “Happy Cow Plan”, Mengniu has been pushing for comprehensive upgrade in areas such as management, operational standard, employees’ skills and milk source. During the period, it further modified the Standard Operational Procedure (“SOP”) brought in from Arla Foods, and launched a new version of customized SOP which better suits domestic management requirements and experience in China. At the same time, more Lean management tools were introduced with implementation tracked for systematic upgrade of management standard. Furthermore, Mengniu established an online platform for technology standards with those of Arla Foods as benchmarks. During the period, senior Arla Foods experts were invited to the plants in Qingyuan and Tianjin to carry out benchmarking assessment of the technologies used, the purpose of which was to help Mengniu improve its production craftsmanship. In addition, the China-Denmark Milk Technology and Cooperation Center (“China-Denmark Center”), a collaboration between Mengniu and Arla Foods, is preparing to release the “Housing design for cattle” book that documents and illustrates Denmark’s ranch technology and management concepts thoroughly. This will allow Mengniu to support milk sourcing effectively and, on the back of its release and related promotion, help raise consumer recognition of the “Mengniu” brand.

Apart from safeguarding milk source development, Mengniu and Arla Foods also cooperate on in-depth research and development undertaking. The China-Denmark Center plans to conduct comprehensive research and development project with topics including pilot demonstration farms, new technology validation base, research and development testing base, training base, etc. Through working closely with more research institutions, Mengniu will have the support it needs to improve the flavor and nutritional value of its dairy products. Aware of the trends of consumption upgrade and product differentiation, Mengniu and Arla Foods established a joint-project team to drive planning of research and development and production of cheeses so as to take the development of dairy products in China into a new era.

– *Milk powder business: Yashili International Holdings Ltd (“Yashili”; stock code: 1230)*

Mengniu holds 51% stake in Yashili and is its controlling shareholder. In the first half of 2017, the domestic infant milk formula market grew by 7% year-on-year, reflecting the positive impact of the two-child policy in full swing and the recovery of the industry accordingly. The launch of the infant milk formula registration system has commanded cross-border e-commerce operations to standardize practices. As for the mother-and-baby store channel, it maintained relatively fast growth, while the modern trade channel continued to shrink. Despite that demand was picking up, the domestic milk powder industry still faced challenges from channel transformation and consumption upgrade. Chinese consumers have yet to regain confidence in domestic milk powder and rebuilding their trust in domestic brands takes time. During the period, Yashili continued to adjust sales channel layout and product structure, adopting a channel and product category-oriented organizational structure, namely “four CBUs plus one project department”, and quickly increased the proportion of mother-and-baby stores channel and

e-commerce channel. Also, Yashili exerted in improving quality management standards of its entire value chain from supplier to consumer services, aiming to rebuild consumer confidence with quality products. In the first half of the year, products of *Yashily*, *Mengniu*, *Dumex* and *Scient* passed 100% the stringent sample tests conducted by the authority. Furthermore, Yashili actively strengthened integration and reconstruction of its internal production networks, integrated the resources of Danone Group, Arla Foods and other strategic partners to realize synergy in capacity and efficiency improvement, and continued to better production deployment and cost structure.

During the period, in active response to the infant milk formula registration system, Yashili's different factories filed relevant registration applications for formulas of their different product series to China Food and Drug Administration ("CFDA"). In August, Yashili was listed among the first batch of enterprises granted formula registration by CFDA. A total of 7 series and 21 formulas of Yashili were approved for registration and record, which indicated Yashili had the most approved formulas on the list. On the branding strategy front, in the first half of 2017, Yashili gradually rolled out its differentiated business model and deployment, with *Yashily* focusing on basic nutrition; *Oushi Mengniu Ruipuen* committed to differentiated competition, mainly targeting the organic market; *Dumex* positioned as professional solutions for babies; and Arla Foods emphasizing the royal concept with it being a strategic brand supported by the major shareholder. These brands are complementary to each other in terms of price range and regional strategy and have given the Group a solid foundation for combating the intense competitions in the market which is treading on the high-end trend and more and more drawn to branded products.

Affected by the infant milk formula registration system and the two-child policy, industry consolidation has hastened and demands are expected to increase. In the long run, the milk powder industry will continue to revive with competition remaining intense. To capitalize on the high-end and differentiated products trend, Yashili will undertake sales channel and capacity adjustments, continue to elevate product quality and direct efforts into product research and upgrade, explore organic milk powder, goat milk powder and other differentiated product lines, so that it may capture opportunities amid challenges.

– *Plant-based Nutrition Products Business: The WhiteWave Foods Company ("WhiteWave")*

Mengniu and WhiteWave set up an equity joint company in April 2014 in which Mengniu holds 51% equity interest and WhiteWave 49%. In April 2017, Danone Group, one of Mengniu's strategic shareholders, announced that it had completed the acquisition of WhiteWave, a move that can benefit Mengniu's plant protein drinks business, giving it access to more resources and new vigor to develop the plant-based drinks market.

In recent years, with consumers becoming more and more health conscious, the concept of plant protein has become a hot topic in the food and beverages sector. As part of a healthy lifestyle, plant protein drinks, which are healthier, more nutritious and natural, have become increasingly attractive and the market for them has grown robustly as demand for the products increases. Meanwhile, the pursuit of more in-depth research and development has helped improve the flavor of traditional plant-based products,

which resulted in the launch of better tasting and more diverse choices of products. *Silk ZhiPuMoFang*, a plant-based beverage series jointly launched by Mengniu and WhiteWave, which uses the world-leading advanced μ -Grind™ micron grinding technology, has been able to satisfy consumers' crave for healthy, nutritious and natural beverage products that come in various rich flavors. Furthermore, Mengniu continues to develop new products and plans to introduce more new flavors that agree with the preferences and dietary requirements of the Chinese market, with the aim of grabbing development opportunities in the domestic plant protein drinks market.

Backed by Mengniu's huge and strong sales network and at the effort of the equity joint company to develop sales channels, Mengniu not only maintained advantages in traditional sales channel, but also worked actively to develop e-commerce channel and special channels such as catering outlets, and plans to introduce exclusive flavors for e-commerce channel, so as to create sharp industry edges on the back of the synergies and coordination between products and channels. Mengniu and WhiteWave will constantly review and optimize future business development strategies, aiming for resource support and cooperation in aspects from product development, expansion of product categories to mode of sales to unearth the market potential of the plant protein products.

– *China Modern Dairy Holdings Ltd. (stock code: 1117)*

On 4 January 2017, Mengniu announced the acquisition of 965,465,750 additional shares of Modern Dairy, representing approximately 15.7% of the total issued share capital of Modern Dairy upon completion of the relevant share purchase agreement, for a consideration of approximately HK\$1.9 billion. When the transaction was completed, Mengniu beneficially held approximately 37.7% of the total issued share capital of Modern Dairy, which then triggered a conditional mandatory cash offer (the "Offer"). Mengniu made a mandatory general offer to acquire the entire issued shares in Modern Dairy at HK\$1.94 per share on 14 February 2017 (except the shares already owned or agreed to be acquired by Mengniu) and canceled all outstanding share options of Modern Dairy. Upon completion of the Offer on 21 March 2017, Mengniu held a total of 3,755,769,412 shares in Modern Dairy, equivalent to approximately 61.3% of the issued share capital of Modern Dairy.

Modern Dairy is the largest dairy farming company in China and also the first in the industry to obtain the national High-quality Milk Project accreditation for its UHT milk and pasteurized milk. A forerunner in the quest of quality in milk from theory to production, Modern Dairy champions the exclusive model that "integrates forage planting, cow breeding and milk processing" and, by marrying it with production processes that follow stringent standards, is able to upgrade overall raw milk quality to industry leading level. With increased shareholding in Modern Dairy, Mengniu shall be able to, with the aid of a tightened upstream and downstream cooperation system, better integrate the advantages of Mengniu in channel expansion and brand building while using Modern Dairy's original production model characterized by "the integration of forage planting, cow breeding and milk processing" and quality raw milk to boost the operational efficiency of both parties. In July 2017, Mengniu joined hands with Modern Dairy to introduce Modern Dairy's *Xianyu Pure Milk*, that employs the production technique of "milking to processing in two hours" to retain the bioactive substances, thus the freshness and nutrition of raw milk.

In the future, Mengniu will capitalize on Modern Dairy's milk source advantage, step up input of integrated resources and effort to improve operation of the Modern Dairy brand, as well as using the synergies the industrial chain presents to expand the high-end product market hand in hand.

Quality Management

Mengniu embraces the spirit of the "Craftsman of Milk" in every stage of quality management, adopting stringent "aeronautic standards" throughout the entire industrial chain, thus giving "aeronautic quality" products a new definition, thereby realizing on all levels the concept of perfect products that has the consumers at heart. During the period, Mengniu commenced the upgrade of management system, primarily focusing on meeting the requirements of four systems, namely new ISO9001:2015 standards, FSSC22000 standards, ISO14001 and ISO18001, and adopting a risk-based model for workflow management to optimize quality management end-to-end of the industrial chain from milk source to production and sales. On the foundation of years of quality management work and adopting advanced international management systems, Mengniu has constructed its own "4Q Excellence Quality Management System". With quality management and upholding technology standard as emphases, the system uses information management tactics to optimize the risk management mechanism step by step, taking Mengniu's quality management to a new height.

Mengniu continues to operate with the help of synergistic operation of the Laboratory Information Management System ("LIMS") and SAP system, providing it with nearly 0.4 million pieces of data every day and offering intelligent technologies and systematic quality assurance at every stage comprehensively. During the period, Mengniu focused on strengthening LIMS process management to ensure that each and every product is inspected at every relevant check point without a single miss. Through the integrated and collaborative operation of LIMS and SAP systems, Mengniu is able to track information forward and backward at all quality control points, and the quarterly 7x24 entire industrial chain traceability drills had been 100% successful. Mengniu's self-developed "Food Safety Cloud" platform accommodates upload of quality data of all its factories daily, realizing informatization of the entire industrial chain from ranches and factories to markets and maintaining transparent communication with regulators as well as consumers. At the same time, via the digitalized "Real-time Food Safety and Quality Monitoring and Control Platform" of international standard, which covers all ranches, production plants and major sales regions, Mengniu is able to monitor food safety real-time in every stage of production.

During the period, Mengniu overcame limitations on informatization that both local and overseas laboratories conventionally experience and upgraded the information system of its laboratories, building the "Mengniu e+ Informatization System for Laboratories". It is the first in the world to perfectly integrate inspection management and quality control and that can carry out inspections of original electronic records and automatically collect data via linkage of devices. It is a new information system for laboratories which is simple-and-convenient, scientific and rigorous while meeting personalized needs of quality management. During the period, the system covered 36 subordinate units nationwide, supporting Big Data management of automatic advance warnings, analysis and real-time transfer, contributing to improvement in the overall level of quality control and assurance of food quality and safety.

Mengniu aligns the food safety standards of its factories with Danone Group's Food Safety Item ("FSI"). It explores in depth core key modules, focusing on high-risk areas in food safety management, aiming to improve food safety management index as well as strengthening food safety control throughout the production process. In addition, Mengniu joins hands with SGS international certification company to apply advanced international resources for quality evaluation, set up quality assessment rules for and began inspecting overseas OEM factories. During the period, the Group upgraded its intelligent equipment, applying technologies for pretreatment and intelligent technologies for equipment automation and cooling, in all stages of production.

The cores of milk source management are risk control, upgrade of bases and training of professional talents. Our aim is to improve milk quality, reduce food safety risks and promote adoption of advanced technology by milk suppliers. In terms of risk control, inspection frequency and requirements were both further enhanced during the period, and milk suppliers of Mengniu's various business divisions passed 100% of the tests conducted by inspection organizations on samples of raw milk.

In accordance with the Group's overall organizational structure, quality management divisions are set up for the different product categories – room temperature, chilled and ice cream products – for accurate quality control of each. Among which, quality management of room temperature is based on consumers' perspective, which ensures the quality and safety of the products of the Group, and increases consumer satisfaction starting with the design of every little detail to achieve perfect quality. During the period, to improve customer recognition of *Just Yoghurt* products, a unique straw design with optimized functionality was created to help increase consumer satisfaction. Also, human errors were reduced through the innovation of pipette comparison software; automatic testing equipment was developed to carry out automatic testing of dynamic pulling grips, and optimized management of quality reports for effective sharing of advance warning data.

The focus of chilled product quality management is to promote the alignment with Danone Group's FSI. At the same time, efforts were made on implementing management of front-end fruit suppliers, setting up quality management standard and building a supplier communication platform to effectively reduce non-qualified rate and control safety risk. Management of cold chain was carried out in accordance with the new food safety law with a focus on perfecting the assessment standard accordingly, sorting out and identifying key risks in the different production stages of chilled products and key control points. Meanwhile, in collaboration with chilled product division, a cold chain sample market was built to promote construction of cold chain at the sales terminals and prevent market-related quality risks.

The quality management arm of ice cream products division has drawn up a "Prevention and Control Plans of Food Safety Risks", which covers market inspection and collects immediate feedback from end-users via an "Information Open Sharing System". In addition, the Group kicked off experiments on control of micro-organisms in the environment in Tai'an and Danyang with third party resources to prevent contamination by germs at food sources.

Mengniu continues to promote the ranch food safety management and assessment system. On the success in implementing the system at the facility of Mengniu's core strategic cooperation farming partners, the system was promoted to other leading farming groups in China during the period. As at 30 June 2017, the system was adopted by a total of 36 ranches, contributing to effective enhancement of the capacity of ranches to ensure product quality and providing Mengniu a solid foundation for delivering "aeronautic quality" products.

Raw Milk Sourcing

To meet market demand, Mengniu has expanded the areas from which it sources raw milk to countries such as Denmark, Australia, New Zealand, famed worldwide for their rich milk supply. At the same time, in order to put into execution the "2020 Sustainable Ecosystem of Milk Sources" strategy, it continues to push ahead with the upgrade and improvement of the fundamental setup of ranches, standardize the ranch operational procedures, enhance risk control and improve technologies and the professional skills of staff. Moreover, Mengniu and the China-Denmark Center jointly launched the "Happy Cow Plan" to strengthen the quality of milk sources and enhance the overall management level of ranches. During the period, the percentage of milk sources provided by standardized ranches and scaled farms of Mengniu was maintained at 100%.

In the first half of 2017, Mengniu and the China-Denmark Center jointly initiated the "Happy Cow Plan" which uses Mengniu's SOP for ranch management as standard and focuses on "Golden Key Platform" and "Lean Ranch Production", while building overseas training platform, ranch R&D platform and the W-W Virtual Dairy Farming Platform to enhance overall staff skills, raw milk quality, raw milk sources management and the operational level of ranches.

To further improve the health of dairy cattle and their living environment and reduce their somatic cell count, Mengniu has made added efforts during the period to assist the cooperated farms in upgrading and improving drinking water tanks, fans, spraying gears, beds, exercise ground and the silage cellars in ranches, which laid the foundation for enhancing raw milk quality. At the same time, Mengniu offers further guidance to the ranches on upgrading the standardized ranch operational management procedures, focusing on the core production areas in the ranch and the implementation of the standard. In addition, Mengniu cooperates with the regulators on checking for veterinary drugs nationwide, helping to guarantee healthy development of the China dairy market. Currently, Mengniu's TMR and silage coverage all reach 100%. The lactoprotein, milk fat, somatic cell and bacteria colony counts of the raw milk all meet international quality standards.

Mengniu continues with the “W-W Virtual Dairy Farming Project”, which involves overall upgrade of the ranch service toolbox and optimizing the Mengniu Excellent Supplier (“MES”) service management assessment system. During the period, the project covered approximately 500 milk suppliers and 80% of all front-line staff, and the concept of contractual responsibility was applied in selected ranches for four major areas of pursuits, namely source management, outcome assessment, technology management and financial management, to help milk suppliers effectively enhance profitability, lower internal operating costs, keep enhancing the operational level of ranches and cooperation with the Group. In the first half of 2017, at the roll out of the project, the average output per unit per day of the ranches increased by 2.66 kg on average year-on-year, which translated into considerable economic benefits for the ranches.

To tighten cooperation between milk suppliers and the Group and enhance the operational level of ranches, Mengniu gathered representatives of ranches rearing dairy cattle of over ten thousand to hold strategic milk suppliers meeting on quality during the period. At the meeting, participants discussed in great depths and reached consensus on issues including methods of control on veterinary drugs, ways to enhance staff performance and the direction of ranch development.

To implement the Group’s 2020 strategy, Mengniu focused on lowering cost and boosting efficiency of ranches by setting up a team dedicated to improving operational efficiency, strengthening the professional skills of staff, identifying room for improvement and optimizing ranch profitability, all for helping the milk source division achieve the three-year goals of “precise project positioning, trimming cost and boosting cost effectiveness, and industrial upgrade”.

Furthermore, 17 Mengniu’s student milk plants in raw milk source areas of Bameng, Tongliao, Hohhot and Jiaozuo have passed the national certification assessment, meeting the production requirements of milk for school students.

Management System

Mengniu has adopted the SAP system since 2013. After three years of construction efforts, Mengniu’s information system structure built with SAP at the core is basically in shape. During the period, the Group promoted in depth applications related to SAP and other relevant systems, including the profound integration of the SAP and LIMS systems, promotion at the sales end of the SAP and Wei Sales Platform (“WSP”) and Business Intelligence (“BI”) project.

As the first dairy enterprise to achieve coordinated management using the two major systems LIMS and SAP, Mengniu generates more than 0.4 million pieces of inspection data of processes from procurement of material to production to sales endeavors to achieve digital, intelligent and systematic quality assurance. Mengniu uses the SAP system for automatic decision making on quality, transfer control, quality tracking and management of quality records, and enables automation of matching of test plans, collection and transfer of monitoring results, drawing conclusion from quality monitoring results and issuing quality reports through LIMS system.

During the period, construction with regard to informatization of sales was carried further based on the three core systems SAP, WSP and BI. The sales system that integrated WSP 2.0 and the SAP systems has been gradually applied at sales companies and Core Business Unit (“CBU”), achieving the closed-loop management of Sales-Distribution-Settlement (“SDS”). In February 2017, 21 major sales regions, 47 sales companies and 50 CBUs had adopted the integrated sales and marketing system. Since the system came online, an effective operational maintenance mechanism has been established step-by-step to ensure that the system operates efficiently. During the period, the attendance, number of visits and orders of sales staff had all improved significantly. The stable operation of the system and the increase in its usage reflect the effective integration of SAP and WSP and realization of closed-loop management of SDS.

Mengniu relies on the intermediate system SAP hybris omni-channel e-commerce system to manage and construct diverse and innovative sales and operation platforms based on the characteristics and needs of the different business segments and users. And by utilizing the intermediate system connected with the internal systems of the Group, product data in different channels are standardized and prices can be controlled effectively. Moreover, Mengniu is equipped with a comprehensive Enterprise Resource Planning (ERP) system, allowing it to control order processing to sales, thus notably enhances the operational efficiency of the sales department and improves customer experience.

During the period, Mengniu built a user experience database and Mengniu digital platform, which for the first time, equipped the Group with a consumer behavior Big Database and enabled it to effectively collect and manage Big Data of the online consumer behaviors. During the Lunar New Year 2017, with effective use of consumer behavior data, Mengniu was able to actively monitor the value and activities of the online media channels and offline channels, providing it with highly reference-worthy marketing analysis charts, taking it onto new ground in understanding consumers.

Mengniu has developed with innovation a real-time food safety supervision and warning management platform, making it the first dairy enterprise and food enterprise to use information technology tools that can automatically monitor real-time food safety and give warning. The Group makes full use of Internet technology, which sends abnormalities detected immediately to the mobile terminals of relevant personnel, thereby providing solid reference for decision making by the management and thus guarantees effective real-time supervision of food safety. As for improving quality assessment, Mengniu actively uses cloud tools and is an early adopter of Salesforce PaaS-based cloud tools to standardize the quality auditing process, supporting real-time transmission of audited content, automatic analysis of auditing results and interaction in the entire auditing process.

Mengniu actively embraced the trend of Internet+ and built up the cloud ecosystem asset by connecting the ecosystems for the clients, operation and management. In May 2017, Mengniu announced the launch of “Mengniu Cloud”. “Mengniu Cloud” has five core constituents, namely “Staff Cloud”, “Partner Cloud”, “Channel Cloud”, “Consumer Cloud” and “Foundation Cloud”, which are inter-connected and share data and serve Mengniu’s three instrumental value ecosystems together. During the period, the “Foundation Cloud”, represented by construction of the southern and northern data centers of Mengniu, was taking shape, and construction of the “Staff Cloud” which focuses on standardization of terminals and new Office Automation (OA) has been successfully commenced, facilitating the fulfillment of Mengniu’s 2020 strategic goals.

Mengniu established the first Finance Shared Service Center of the dairy industry in China, which currently covers 59 subordinate units of Mengniu and the coverage will be expanded to branch companies in the future. Its functions included expense reimbursement, asset management, investment management, video e-management, payment management and budget control, covering five major business cycles from investment to assets, general ledger to statements, purchase to payables, sales to receivables and reimbursement of expenses. In the first half of 2017, it processed on average 30,000 billing documents a month, markedly improved the efficiency of financial processing. Backed by the innovative SAP-SSF (Share Service Framework) technology, the Group’s business and finance systems are connected and a solid foundation has been laid for realizing subsequent sharing of human resources, information technology and procurement. The successful rollout of the finance shared platform fully supports financial management of the Group and will continue to promote upgrades of workflow at the shared service center so as to ensure the effectiveness of the management model, intensive cost saving, technology integration and innovation, and business transformation, etc. of the Group.

Sales Channels

Mengniu continues to push ahead with integration of procurement, production and sales, taking its Route to Market (“RTM”) project to greater depth and using consistently the sales operation model with distributors at the center complemented by the sales companies and CBUs. Through refining market layout and precise market grading, Mengniu has been able to penetrate county and village markets in a fast manner, achieving the largest market coverage as well as improving overall service level at terminal points-of-sales and the ability to control the core nodes in its sales network. Furthermore, Mengniu has built its unique distributor management system, which covers essentially development of distributors, enhancement of their capabilities, target management of distributors and evaluation of distributors. And, the BI platform is used for sales and marketing analysis to support closed-loop management of sales and marketing.

WSP system tools are used by Mengniu to implement standardized and integrated retail network management, thus helping to strengthen the Group’s omni-channel delicacy management system. During the period, the WSPs of sales companies and CBUs were completed, the finance and business integrated model began operation and real-time order assignment started, which together effectively boosted sales results.

Mengniu also focuses on strengthening Key account (“KA”) management and, by improving point-of-sales display and using lively marketing tactics, it has been able to consistently enhance average sales of single sales point. Mengniu further fortified cooperation with retailers by putting its differentiated marketing strategy to work and saw some preliminary result, earning for it the “Best Supplier in Shopping Experience” award from Wal-Mart Stores. By forming a strategic alliance with major retailers and suppliers, Mengniu and the retail outlets enjoy strong ties and a unified pool of resources for injecting into key markets and product categories to build a win-win platform for cooperation between business ecosystems.

Mengniu has been strengthening its e-commerce sales channel and interacting with consumers through the Internet, and through analyzing and sharing of consumer Big Data, integrating supply chain and replacing platform resources, it is capable of precise marketing. With the help of Big Data from the e-commerce platform, Mengniu can optimize creative content real-time and customize products to fit the characteristics of online consumer groups, such as the *Tianxiaohai* and special customized *Just Yoghurt* for Transformers IP series of products. Mengniu has found its targeted consumer communities for accurate direction of resources and as such has boosted sales by integrating the crowd tagging model of the Alibaba data center. Currently, Mengniu’s products have well-established presence on different e-commerce platforms, including Tmall, JD, Suning.com, and Womai.com. During the period, Mengniu ranked first in sales of dairy products on platforms like Tmall, Suning.com, and Womai.com. In addition, on the day of the “618 Mid-Year Shopping for All Festival”, its JD Mengniu self-operated flagship store, Tmall Mengniu official flagship store and Suning Mengniu official flagship store all ranked first in terms of sales of dairy products.

At the end of 2016, Mengniu launched the new business division system to facilitate formulation of more professional sales strategy, allowing it to effectively integrate the resources of different sales regions and significantly improve cost efficiency. During the period, Mengniu focused on launching new products, enhancing overall market coverage, strengthening cooperation with distributors and developing more sales terminals. By adopting new channels and new business model, such as experience store and e-commerce, it unearthed new sales growth drivers. At the same time, with front-line and back-office staff working closely and in concert as well as giving their best support to the sales arm in meeting all market demands, overall sales performance significantly improved.

Mengniu has kept expanding its overseas business footprint. Its products are now available in Hong Kong, Macau, Singapore, Myanmar and Mongolia, and plans are in place to help it foray into other markets that it may perfect its business layout. Currently available room temperature products in overseas markets include *Milk Deluxe*, *Just Yoghurt*, *Fruit Milk Drink*, *Pure Milk* and *Low-Fat High Calcium Milk*; and chilled products mainly include *Yoyi C*; and ice cream product brands such as *Deluxe*, *Suibian* and *Mood for Green*, etc.

Brand Strategy

Steadfast at upholding its brand concept of “A Little Happiness Matters”, Mengniu provides safe and nutritious high quality dairy products to consumers, tying consumers closely with Mengniu so as to pass on its brand values of health, happiness and care to consumers in the generations to come. Following social trends and with Big Data support, Mengniu mounts multi-dimension marketing online and offline, achieving close interaction and two-way communication with consumers while planting the brand’s advocacy of valuing nature into consumers’ daily life, thereby boosting loyalty, trust and preference of consumers towards the Mengniu brand. At the same time, to implement the strategy of “internationalization”, Mengniu cooperates strategically with leading international brands, so that the “Mengniu” brand can gain global influence and build itself into a world grade Chinese brand. Mengniu is currently an official dairy product partner of NBA China, the Shanghai Disney Resort and Universal Beijing Resort.

Dedicated to supporting aeronautic endeavors of the country with its resources, Mengniu has been providing nutritional support to Chinese astronauts for 14 consecutive years. It wears the title of “Strategic Partner of China’s Aerospace Program” presented to it by the China Space Foundation, adding to its brand image representative of high quality. During the period, Mengniu mounted aerospace-themed marketing under the “aeronautic quality, healthy China” banner, highlighting its commitment to providing products fit for astronauts to consumers in the future, publicizing the “aeronautic quality” concept among the public and letting consumers know they, the same as astronauts, can consume “aeronautic quality” dairy products provided by Mengniu.

Milk Deluxe continues to strengthen its high-end brand image by upgrading its organic milk series and developing a nature documentary zone with Tencent Video Documentary Channel, which allows it to plant brand messages innovatively in the content of the videos and, at the complement of WeChat and Weibo platforms, create more buzz, thus realizing integrated marketing. Also, *Milk Deluxe* has been a sponsor of the Boao Forum for 11 years in a row as the event’s sole official dairy product supplier. The high-profile cooperation with the Boao Forum platform has given *Milk Deluxe*’s high-end brand assets strong backing and helped fortify supremacy of the brand. On the strong brand advantage of *Milk Deluxe*, Mengniu has developed high-end yogurt, gradually expanding the *Milk Deluxe* family. During the period, *Milk Deluxe Yogurt* forged strategic partnership with the Top 10 Lawrence Champion Award and became its sole official dairy product. Apart from cross-segment cooperation with supreme sports award, *Milk Deluxe Yogurt* has gained the full support of a Michelin star chef, helping it to build a superb brand image that conveys perfectly the brand spirit of “Not all yogurts are *Milk Deluxe*”.

After the cooperation with “Independence Day: Resurgence” and “Ice Age: Collision Course”, Mengniu partnered with Hollywood movie again. *Just Yoghurt* was seamlessly incorporated into the Hollywood movie “Transformers: The Last Knight”, interacting with the heroes in the movie, and in association a special edition of *Just Yoghurt* was launched and related on – and off-line publicity activities were organized together with maoyan and Tmall to attract wide consumer interest. In addition, *Just Yoghurt* is one of the sponsors of the popular iQiyi show “U Can U Bibi Season 4” and delivering the brand attitude of “Dare not to add additives”. The strong exposure and excited discussion about the brand among consumers had successfully bolstered sales.

Future Star, the first milk product professionally tailored for kids in China has upgraded product formula of the product series, going back to agreeing with the human nutritional structure while delivering to kids the mother's power. As a partner of Shanghai Disney Resort, *Future Star* has launched a limited-edition themed packaging and used QR code to open consumers to the "Together with *Future Star*, explore the wonderful world" activities. The first brand activity held in the Walt Disney Grand Theatre attracted a full-house. Moreover, *Future Star* cooperated with Jiangsu TV on the "Wings of Song" show, which enabled it to achieve a new height of entertainment marketing and, by implanting brand elements in the event, boost consumer awareness of the brand.

Yoyi C launched *LC-37* that caters particularly the professional probiotics beverage market, building with success its image as a professional functional probiotics brand. The brand secured super star Kris Wu as its brand ambassador to quickly enhance the reputation and influence of the brand, aiming to grab a share of the young consumer market and deliver to consumers the core brand concept of "This is a small but powerful bottle of *Yoyi C*". In addition, in association with Dianping, Toutiao, Sina Weibo, Tencent and iQiyi, it launched the integrated digital marketing activity "Global Food Festival" to present the core brand proposition of "Healthy Intestines Keep You Young" and ultimately turns that into a new generation health declaration.

Mengniu's ice cream products kicked off the nationwide "Scan the code, Shake the red packet, Win a phone" activity. Via placement of TV commercials, the activity quickly gained a lot of attention. Mengniu overcame the communication barrier of traditional media and instead exchanged feelings with consumers on the mobile social platform, which has boosted the "good feeling" among consumers towards the brand. At the same time, by creating the Mengniu ice cream shake-shake song, a talk of the town was created and it spread far and wide, helping raise awareness of the brand and ignited a trend.

During the period, Mengniu focused on promoting the high-end ice cream brand *Deluxe*, upgrading it in multi-dimension including branding, product, packaging and marketing communications with the hope of building its image as the best high-end ice cream brand in China. The brand took advantage of the Disney IP to raise attention to it, starting the "Taste the Chinese high-end ice cream, enjoy your time at Shanghai Disney" activity and launched online the H5 scan code interactive activity, which received great feedback from consumers. *Deluxe* won the "Integrated Marketing Communication Award" and "Reputation Spreading Award" at the "17th IAI International Advertising Awards" and "6th Entertainment Marketing 5S Gold Award" respectively, speaking volume to the strong recognition it enjoys.

Mengniu's hard work has been time and again recognized by the society and the industry. For three years in a row, it made it among the top 20 on the BrandZ™ list of the most valuable Chinese brands. Also, Mengniu is one of the "TOP10 most effective brands" and "TOP10 most effective advertisement owners" at the "2017 Greater China Effie Awards", honoring its excellent performance in effective marketing. It was the only dairy enterprise to win accolades at the event.

FINANCIAL REVIEW

Revenue

Benefiting from product innovation, an optimized business structure and active marketing efforts, the Group recorded sales growth, with revenue for the six months ended 30 June 2017 amounting to RMB29,465.8 million (2016: RMB27,257.2 million), an increase of 8.1% year-on-year. *Milk Deluxe* and *Just Yoghurt* were the biggest contributors to revenue growth of the Group.

Gross Profit

With raw milk price staying relatively low and a constantly improving product mix, the Group's gross profit for the period increased to RMB10,502.6 million (2016: RMB9,181.4 million) and gross profit margin increased by 1.9 percentage points to 35.6% as compared with the same period last year (2016: 33.7%).

Operating Expenses

Facing intense market competition, the Group implemented proactive channel and brand promotion strategies during the period, which led to an increase in operating expenses to RMB8,824.0 million (2016: RMB7,825.9 million), representing an increase to 29.9% of the Group's revenue (2016: 28.7%).

During the period, selling and distribution expenses increased by 10.8% to RMB7,143.8 million (2016: RMB6,448.9 million), representing an increase of 0.5 percentage point to 24.2% of the Group's revenue (2016: 23.7%).

During the period, advertising and promotion expenses decreased by 6.3% to RMB2,647.9 million (2016: RMB2,825.7 million), representing a decrease to 9.0% of the Group's revenue (2016: 10.4%).

During the period, administrative and other operating expenses increased by 22.0% to RMB1,680.2 million (2016: RMB1,377.0 million), accounting for 5.7% (2016: 5.1%) of the Group's revenue.

Profit from Operating Activities and Net Profit

Although profit attributable to an associate recorded relatively significant loss and Yashili incurred loss during the period, with the revenue and gross profit of the Group's core business (including liquid milk and ice cream products) increasing significantly and the Group's product structure optimized, EBITDA increased by 6.2% to RMB2,289.7 million (2016: RMB2,155.1 million), and EBITDA margin was 7.8% (2016: 7.9%).

Profit attributable to owners of the Company increased by 4.7% year-on-year to RMB1,127.9 million (2016: RMB1,077.3 million). Basic profit per share was RMB0.290 (2016: RMB0.277), up by 4.7% year-on-year.

Income Tax Expenses

For the six months ended 30 June 2017, income tax expense of the Group was RMB373.8 million (2016: RMB313.0 million), increased by 19.4% year-on-year. Effective income tax rate was 25.1% (2016: 20.9%), up by 4.2 percentage points year-on-year, mainly due to the loss contribution from a major associate to the Group and the accounting losses on deemed disposal of partial interests in associates by the Group.

Capital Expenditure

For the six months ended 30 June 2017, capital expenditure (“CAPEX”) of the Group was RMB5,313.2 million (2016: RMB2,706.5 million), up by 96.3% year-on-year. Of the total, RMB1,015.0 million was spent on building new production facilities and modifying existing ones and related investments, RMB79.9 million was spent on purchasing biological assets and RMB4,218.3 million was investment in new equity (mainly Modern Dairy).

Working Capital, Financial Resources and Capital Structure

For the six months ended 30 June 2017, the Group’s net cash inflow from operating activities increased to RMB3,434.1 million (2016: RMB2,675.3 million), primarily due to continuous product structure optimization, cost control and enhanced working capital management.

For the six months ended 30 June 2017, outstanding bank loans and bonds of the Group increased to RMB14,177.6 million (31 December 2016: RMB8,587.6 million), of which bank loans repayable within one year amounted to RMB4,653.5 million (31 December 2016: RMB3,045.4 million).

Net borrowings (total amount of bank loans and bonds net of cash and bank balances) of the Group as at 30 June 2017 were RMB3,640.7 million (31 December 2016: RMB2,517.5 million).

The Group’s total equity as at 30 June 2017 was RMB26,259.0 million (31 December 2016: RMB25,503.7 million). Its debt-to-equity ratio (total amount of bank loans and bonds over total equity) was 54.0% (31 December 2016: 33.7%).

Finance costs of the Group were RMB191.4 million (2016: RMB151.5 million), representing approximately 0.6% of the Group’s total revenue (2016: 0.6%).

Products

Innovation is the key to sustainable improvement of an enterprise. Therefore, Mengniu attaches great importance to product innovation, research and development and meeting the demand of different consumer groups with premium, more nutritious and better tasting products. It also puts great efforts into integrating its resources and using leading international technologies, resources and platforms to build a world-class Chinese brand and regain consumers' trust in Chinese brands. During the period, Mengniu was devoted to developing functional and customized products that meet the demands of fine market segments, focusing specifically on enhancing such aspects as product variety, flavor and packaging so as to create new experiences for consumers.

The principal businesses of the Group are liquid milk, ice cream, milk formula and other products. Their performances during the period are outlined in the table below:

Liquid milk Revenue amounted to RMB25,372.1 million (2016: RMB23,761.5 million), accounting for 86.1% of Mengniu's total revenue (2016: 87.2%)

UHT milk Revenue amounted to RMB11,797.2 million (2016: RMB11,513.8 million), accounting for 46.5% of the liquid milk segment revenue (2016: 48.4%)

- Upholding the brand attitude of “New Nutritional Level Makes a Better Life” and highlighting the concept of “Better Understanding of Natural Sciences, Better Organic Nutrition”, *Milk Deluxe* upgraded its organic milk product and continued to boost its image as a high-end brand.
- Innovative research and development on the formula undertaken by *Future Star Kid Growth Milk* led it to return to that human nutritional structure to offer kids nutrients that can more easily be absorbed by their bodies, showing children the mother's power.
- *Prime Ranch Pure Milk* in updated packaging was launched to the market. Adopting “One Pack, One Code” that entails the use of barcodes for access to product batch numbers, launch of the product marked the full application of product tracking technology by Mengniu.
- *Mengniu Pure Milk* took on an optimized packaging design, carrying an aerospace-themed label to emphasize the excellence of the product quality and incorporated into the product the brand concept of “Let's Enjoy Aeronautic Quality Milk”.

Key products:

- *Milk Deluxe*
- *Mengniu Pure Milk*
- *Prime Ranch Pure Milk*
- *Future Star Kid Growth Milk*
- *Awakening Youth Milk*

Milk beverages Revenue amounted to RMB4,910.3 million (2016: RMB4,915.9 million), accounting for 19.4% of the liquid milk segment revenue (2016: 20.7%)

- *Yoyi C* launched *LC-37* targeting the professional probiotics beverage market. Every 100ml of the product contains 50 billion active bacteria C, 500 times that of the national standard. It also has an exclusive 37°C highly active bacterial strain proof of it having overcome the technical bottleneck of the low temperature probiotics industry. *LC-37* is a revolutionary new product, a perfect representation of *Yoyi C*'s core brand concept of “This is a small but powerful bottle of *Yoyi C*”. The brand secured super star Kris Wu as its brand ambassador to quickly improve the awareness and influence of the brand as it hit the market.
- *Fruit Milk Drink* added the new flavor “Blueberry”, with a promotional campaign themed “Bring Your Blue Friend Home” and the famous artist Li Yifeng as a spokesperson, making it the talk of the town.

Key products:

- *Yoyi C*
- *LC-37*
- *Fruit Milk Drink*
- *Suan Suan Ru*

Yogurt Revenue amounted to RMB8,664.6 million (2016: RMB7,331.8 million), accounting for 34.1% of the liquid milk segment revenue (2016: 30.9%)

- Building on the strong brand advantage of *Milk Deluxe*, *Milk Deluxe Yogurt* was launched. The product is an ingenious yogurt, a combination of patented bacteria from the US, Danone's exclusive craftsmanship and premium ingredients from all over the world. It redefined yogurt and embodies the brand spirit of “Not all yogurts are *Milk Deluxe*”.
- *Just Yogurt* and the Hollywood movie “Transformer 5: The Last Knight” jointly launched the Transformer special edition packaging.
- *Champion* focused on optimizing product structure and launched a series of products including “Jianzihao”, “Mailaoru” and “Xianlaoru”, which were created with the brand's core asset “BB-12” bacteria to strengthen the “professional and functional” positioning of the product.

Key products:

- *Just Yogurt*
- *Milk Deluxe Yogurt*
- *Champion*
- *Future Star Kid Nutritious Flavored Yogurt*
- *Inner Mongolia Solid Yogurt*

Ice Cream Revenue amounted to RMB1,985.3 million (2016: RMB1,703.4 million), accounting for 6.7% of Mengniu's total revenue (2016: 6.2%)

- High-end ice cream brand *Deluxe* carried out upgrades on multi-dimensions such as branding, products, packaging, marketing and communications to help it build the image of the best high-end ice cream brand in China. During the period, *Deluxe* created oatmeal ice cream, vanilla ice cream and milk ice cream and launched two new products, namely rose and cheese ice cream and durian golden ice cream cone.
- *Mood for Green* launched sticky rice red bean ice cream made with a unique technique that allows the sticky rice dumplings to stay soft and chewy. The product won market acclaims.
- Mengniu launched a new *Russian Milk Ice Cream*, which brings out the original flavor of Russian ice cream. It has high milk content, a rich milk flavor and smooth texture promising to give the greatest delight to consumers' taste buds.

Key products:

- *Deluxe*
- *Mood for Green*
- *Ice+*
- *Suibian*

Milk Formula Revenue amounted to RMB1,786.4 million (2016: RMB1,660.0 million), accounting for 6.1% of Mengniu's total revenue (2016: 6.1%)

- *Yashily* emphasizes the provision of basic nutrition. Imported from New Zealand, *Yashily Super α -Golden Stage* owns the patented INFAT active energy system and five international patents in relation to promotion of probiotics growth in the intestines of babies, thus encouraging good bowel activities. The formula was launched in China and New Zealand simultaneously, hoping to rebuild consumer confidence with international quality milk formula
- *Oushi Mengniu's Ruipuen* continued to engage in differentiated competition and expand organic markets. It also kicked off large-scale road-shows that covered tier three and four cities in China and married online promotions and onsite product trials to help it reach target audience groups and improve brand reputation
- The upgraded *Diamor* and *Precinutrl* brands under *Dumex* are committed to building systematic professional formula solutions. To satisfy babies' special nutritional needs, these brands also offer series that pinpoint issues such as allergy, digestion and under-weight

- *Baby & Me*, the imported canned organic milk powder brought into China together with Arla Foods is originated in Denmark and targets the super high-end market in Tier one and two cities, highlighting its royal origination and aiming for penetration in mother-and-baby stores
- Yashili’s R&D team has completed research of milk powder formulated for pregnant women and the product has entered the final leg of preparation for launch

Key products:

- *Yashily Super α -Golden Stage*
- *Oushi Mengniu Ruipuen*
- *Dumex Diamor*
- *Arla Baby & Me*
- *Yashily α -Golden Stage*

Other Products Revenue amounted to RMB322.0 million (2016: RMB132.3 million), accounting for 1.1% of Mengniu’s total revenue (2016: 0.5%)

- Mengniu and WhiteWave jointly created the plant-based protein beverage *ZhiPuMoFang*. Using the world-leading nanoparticles milling technique μ - Grind™ in cold water at 4°C, original nutrients of the nuts can be preserved, giving consumers a pleasing mouth feel. *ZhiPuMoFang* comes in two flavors, walnut and almond, and the Mellow Soy Milk series was added subsequently, all of which have been well received by consumers.

Key products:

- *ZhiPuMoFang*

Production

Mengniu deploys its production capacity according to market potential and its own product strategy. As at 30 June 2017, Mengniu had 37 production bases in China and 1 in New Zealand, which together has a total production capacity of 9.00 million tons (December 2016: 9.21 million tons).

Social Responsibility

Mengniu has been active in honoring its social responsibility and delivering the mission of “Focus on nutrition and health, deliver a drop of happiness for every moment and every day to more people”. It has made strenuous effort to strike a balance between business development and corporate social responsibility that consumers may come to appreciate the love and care it wishes to spread. In fulfilling its social responsibility, Mengniu has always been “people-oriented” from being responsible for product quality and green development to caring for employees and the society. It also shoulders such contemporary responsibilities as promoting sustainable development of the industry, giving back to nature and serving the community.

Answering actively to the call of the “Healthy China 2030 Planning Outline” issued by the State Council and supporting the “Milk Action for Affluence in China” jointly initiated by the Ministry of Agriculture and the Dairy Association of China, Mengniu kicked off the “Mengniu Inclusive Nutrition Plan”. In 2017, it launched a milk sponsorship charity program across the nation and committed to donate 4.8 million packs of student milk to rural schools in a hundred counties and cities in 22 provinces. As a part of the effort, experts were invited to give lectures to students and teachers to teach them professional nutritional knowledge, proper milk drinking habit and boost their health awareness. The activity covered 209 schools to date, benefitting approximately 28,000 students and approximately 150 thousand boxes of milk in all were donated.

With the most tender and loving care, Mengniu never hesitates to offer support to those in need of nutrition. During Lunar New Year 2017, Mengniu established “Nutrient Miles” volunteer teams which delivered 12,000 cartons of *breakfast milk* to the soldiers stationed at the border in Xinjiang Kashgar. In May 2017, earthquakes hit Xinjiang Kashgar area, affecting approximately 12,000 people. Mengniu voluntarily joined related relief effort and sent 32,000 cartons of Mengniu *Breakfast Milk* to the affected area within 35 hours after the disaster. Mengniu’s volunteer teams also set up a service station to distribute milk to the rescue teams and local residents to let them feel Mengniu’s cares.

Mengniu has continued to push ahead with the “University of Ranchers”, “Star Ranchers” and “Golden Key of Milk Cow” projects, and Golden Key technology workshops and advanced seminars have been organized to enhance the professional skills of ranch staff and Mengniu’s partners. During the period, the “University of Ranchers” ran six sessions of themed activity that stressed both theoretical and practical knowledge in six major areas in China, covering a broad range of content including rearing management, veterinary management, breeding management and equipment management. The “Star Ranchers” project has offered two sessions of mandatory courses on practical ranch management skills and advanced industry technologies. These courses were availed to ranchers and over 2,000 front line ranch personnel. As for Golden Key technology workshop, three technical demonstration sessions were arranged in the first half of 2017, with over 40 experts invited to introduce latest breeding techniques to over 700 ranch staff in Shandong, Hebei and Inner Mongolia. In addition, Mengniu and the China Agricultural University became strategic partners and cooperated in organizing the fifth session 100-people advanced seminars to provide tailored programs to 100 outstanding front line technicians and ranchers from across the country. This year’s training session included for the first time internal training programs, giving internal trainers of milk source technology a solid foundation to work from.

Mengniu has continued to integrate love and responsibility into every aspect of its industrial chain. Its efforts of delivering happiness to the society are well recognized by different sectors of the community. During the period, Mr. Jeffrey, Minfang Lu, CEO of Mengniu, led the Group in continuing to contribute in the social responsibility arena and for that was presented the “Asian Social Caring Leadership Award” by the Social Enterprise Research Institute. In addition, Mengniu was among the “Community Enterprises of China 2016” named by the China Philanthropy Times and it was the only dairy enterprise to win the title. And at the China Business Sustainable Conference 2017 and the “Third China Industry CSR Five-star Rating 2016” hosted by the China Federation of Industrial Economics, Mengniu was named the “National Five-star Rating Responsible Enterprise” yet again and also again made the

“CSR Fulfillment Star Enterprise”, which showed that Mengniu’s tireless pursuit of quality responsibility as well as green and low-carbon development has earned unanimous industry recognition. Furthermore, Mengniu ranked first in the Chinese dairy enterprise corporate social responsibility fulfillment level index in the “Blue Book of China Corporate Social Responsibility (2016)” and was the only dairy enterprise that received five-star rating in the “White Book of China Corporate Social Responsibility Report (2016)” published later. These accolades are evidence of the high recognition of authoritative organizations for Mengniu’s steadfast commitment to fulfilling social responsibility.

Human Resources

As at 30 June 2017, the Group had a total of about 40,483 employees in China and Hong Kong, including around 2,723 employees of Yashili. During the period, total staff costs (including salaries of directors and senior executives) amounted to approximately RMB2,395.7 million (2016: RMB2,113.9 million).

To let each business unit develop in a more focused and balanced manner, Mengniu started to adjust the organizational structure and set up the new business division structure at the end of 2016, turning the original core business segments into independent business segments of room temperature products, chilled products and ice cream products. At the same time, Mengniu combined the control and operation models under the new business division system, established new job grading system and completed the value assessment of each management position in the new system and the change in job grades of employees transferring from the original to the new system.

With the design of the dual channel for professional development completed in 2016, the training curriculum system of Mengniu is gradually taking shape. The system entails regular offer of career development related courses that can effectively match the need for enhancement of skills of employees at all levels. In 2017, Mengniu continued to optimize and roll out its unique personnel training system, providing curriculum system in relation to induction, cultural training, general career development skills and leadership, etc. The more systematic and focused training ensures every employee of Mengniu is in sync with the Group’s philosophy, behavior and language. Through system building and implementation of leadership development programs, Mengniu is able to develop a strong talent stream and enhance the ability of managers at all levels. General career development courses and high potential leadership programs were provided as planned in the first half of 2017. In addition, Mengniu developed a four-in-one mobile learning platform called “Zhi De”, meaning customized training is offered both offline and online for employees’ access anytime, anywhere.

Mengniu launched an “Employee Happiness Program” with each project targeting to take care of employees and their family members’ daily needs and provide them with diverse thoughtful benefits, the aim of which is to create a caring corporate culture that can enhance employees’ satisfaction and dedication to working for the Group. Mengniu has improved the menu of the staff canteen, adding over a hundred new dishes and nutritious set meals, and also the working environment, setting up leisure zone, activity room, café and bookstore; a library with child education books has been set up and scientific parenting training is available. Mengniu helped

175 children of employees, including those at Helin headquarters, Tai'an and Jiaozuo, solve the enrollment in schools and free milk powder had been offered to almost 1,300 pregnant female employees. At the same time, Mengniu has established the "Community Care Fund" and "Mutual Aid Fund" to provide financial assistance to employees in need.

To ensure it has the support required to achieve its five-year strategic goal, Mengniu launched a retention plan for key management personnel, using the award of restricted shares as incentive to retain and reward staffers in core key positions at level four or above of the Group and also those affording excellent performance and strong potential.

Mengniu also exerted in planning a quality personnel training scheme and implemented in 2017 the 100 series personnel training plan to rebuild the quality 100 training system in such aspects as staff selection, curriculum design, class management, personnel training system and standards, curriculum arrangement, and appraisal and certification, etc., in order to provide solid manpower support to the Group for attaining sustainable development.

Prospects

China's dairy market is gradually recovering. With the further improvement of laws and regulations on the industry and adjustment in consumption structure, consumers today are looking for higher end and customized dairy products. As a global top 10 dairy enterprises, Mengniu holds fast to its quality as core value and has its eye set on the global market. With the spirit of the "Craftsman of Milk", it is dedicated to providing consumers with healthier and more nutritious products of "aeronautic quality".

Looking ahead, Mengniu will continue to emphasize the theme of "Focusing on Development and Gathering Strengths" and keep on developing the various product segments on its new business division system. At the same time, it will continue to optimize its sales channels and integrate resources. Upholding the principles of "Quality, Innovation, Internationalization", it will strive for excellence in milk sources, products, production and operation, system management, brand strategy and sales channels, etc. Mengniu endeavors to promote the global deployment of milk sources and research and development, and align with international dairy product standards with the ultimate goal of taking the quality of Chinese dairy products to new heights.

Mengniu will continue to push for sustainable development of milk sources and integrate upstream supply chain resources to ensure stable supply of quality milk sources. To diversify its raw milk source, Mengniu has expanded source areas to cover also such major milk supplier countries as Denmark, Australia and New Zealand. Moreover, Mengniu will bring in advanced international technologies and management models to help it match or even surpass international standards, while pursuing innovation based on local needs, thereby constantly providing the Group with impetus to develop.

Mengniu will continue to join hands with its three major shareholders, namely COFCO Group, Danone Group and Arla Foods, and leading international partners including WhiteWave and UC Davis from the United States. "Internationalization" is its new normal and Mengniu will leverage the advanced world-class resources and platforms to become a world-class dairy products enterprise. Through deploying an internationalized industrial chain, Mengniu will utilize overseas resources to reinforce its advantages in the industry.

As consumers are looking for higher end and customized products, Mengniu will continue to strengthen product research and development and innovation, adjust its product segment structures and hasten brand upgrade, so as to offer consumers higher end, healthier, and more nutritious and tasty products as well as perfect experience to strengthen their trust in the brand. Mengniu will continue to reinforce its market advantages as a high-end brand and actively develop its chilled and ice cream products. Building on its relationship with Shanghai Disney Resort and Universal Beijing Resort as their exclusive official dairy product partner and the strength of its brand and product quality assurance, Mengniu's international clout will be further enhanced.

Mengniu precisely obtains consumption data based on Big Data platform and its exclusive "Mengniu Cloud" in a bid to maintain close interaction with consumers and is provided with a concrete foundation for innovative digital marketing. Mengniu will continue to pursue digitalization to seize the first opportunities in Internet+ environment.

Mengniu will focus on boosting product quality and its brand, shoulder the responsibility of contributing to the health and nutritional well-being of the Chinese people, as well as ingeniously providing high quality Chinese milk products and march in steady strides towards realizing its "2020 Strategy". With the aspiration of developing into China's most dynamic and internationalized hundred-billion-dollar dairy enterprise, Mengniu will continue to make effort to achieve the objective of becoming a world class dairy product enterprise.

CORPORATE GOVERNANCE CODE

The Company has adopted the code provisions set out in the Corporate Governance Code (the "CG Code") contained in Appendix 14 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") as its own code of corporate governance practices.

The Board has reviewed the Company's corporate governance practices and is satisfied that the Company has been in compliance with all code provisions of the CG Code during the six months ended 30 June 2017, except that the Group has deviated from the Code Provision A.5.1 with the reasons explained below.

Code Provision A.5.1 of the CG Code provides that an issuer should establish a nomination committee which is chaired by the chairman of the board or an independent non-executive director and comprises a majority of independent non-executive directors. With effect from 15 September 2016, each of Mr. Jiao Shuge and Mr. Zhang Xiaoya (each an independent non-executive Director) ceased to be a member of the Nomination Committee, and each of Mr. Tim Ørting Jørgensen and Mr. Filip Kegels (each a non-executive Director) became a member of the Nomination Committee. As such, less than half of the members of the Nomination Committee are independent non-executive Directors starting from 15 September 2016. The Directors are of the view that each of Mr. Tim Ørting Jørgensen and Mr. Filip Kegels is able to carry out his responsibilities as a member of the Nomination Committee in the best interest of the Shareholders notwithstanding that he is not an independent non-executive director as required under Code Provision A.5.1.

SECURITIES TRANSACTIONS OF DIRECTORS

The Company has adopted, in terms no less exacting than, the standards required by the Model Code for Securities Transactions by Directors of Listed Issuers (the “Model Code”) set out in Appendix 10 to the Listing Rules as the Company’s code of conduct and rules governing dealings by all Directors in the securities of the Company. The Directors have confirmed, following the specific enquiry by the Company, that they have complied with the required standard set out in the Model Code throughout the six months ended 30 June 2017.

PURCHASE, SALE OR REDEMPTION OF THE COMPANY’S LISTED SECURITIES

Neither the Company nor any of its subsidiaries purchased, redeemed or sold any of the Company’s listed securities during the six months ended 30 June 2017.

AUDIT COMMITTEE

The Audit Committee currently comprises three independent non-executive Directors, namely Mr. Yau Ka Chi (chairman), Mr. Julian Juul Wolhardt and Mr. Zhang Xiaoya.

The Audit Committee has reviewed with the Company’s management and the external auditors, the accounting principles and practices adopted by the Company and discussed auditing, risk management, internal control, whistleblowing policy and system and financial reporting matters, including the review of the Group’s unaudited interim financial statements for the six months ended 30 June 2017.

SCOPE OF WORK OF ERNST & YOUNG

The unaudited interim condensed consolidated financial statements of the Company and its subsidiary companies for the six months ended 30 June 2017 have been reviewed and agreed by the Company’s auditor, Ernst & Young, in accordance with Hong Kong Standard on Review Engagements 2410, “Review of Interim Financial Information Performed by the Independent Auditor of the Entity” issued by the Hong Kong Institute of Certified Public Accountants. The auditor’s independent review report will be included in the Company’s 2017 Interim Report to the shareholders.

PUBLICATION OF INTERIM RESULTS ANNOUNCEMENT AND INTERIM REPORT

This interim results announcement is published on the websites of the Company at www.mengniuir.com and Hong Kong Exchanges and Clearing Limited at www.hkexnews.hk. The interim report of the Company will be despatched to shareholders and available at the aforesaid websites in due course.

BOARD OF DIRECTORS

As at the date of this announcement, the executive directors of the Company are Mr. Jeffrey, Minfang Lu, Mr. Bai Ying and Ms. Wu Wenting; the non-executive directors of the Company are Mr. Ma Jianping, Mr. Niu Gensheng, Mr. Tim Ørting Jørgensen and Mr. Filip Kegels; and the independent non-executive directors of the Company are Mr. Jiao Shuge (alias Jiao Zhen), Mr. Julian Juul Wolhardt, Mr. Zhang Xiaoya and Mr. Yau Ka Chi.

APPRECIATION

The Board would like to take this opportunity to express gratitude to our shareholders and the public for their continued support, and to all staff for their hard work and commitment.

By order of the Board
China Mengniu Dairy Company Limited
Jeffrey, Minfang Lu
Chief Executive Officer and Executive Director

Hong Kong, 30 August 2017