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 ANNUAL RESULTS FOR THE YEAR ENDED 31 DECEMBER 2013

HIGHLIGHTS

For the year ended 31 December	**2013** **RMB'000**	2012 RMB'000 Restated*	Change %
Revenue	**43,356,908**	35,999,990	20.4%
Gross profit	**11,697,245**	8,949,998	30.7%
Profit attributable to owners of the Company	**1,630,925**	1,303,101	25.2%
Net cash inflow from operating activities	**3,283,679**	1,881,484	74.5%
Earnings per share (RMB)			
– Basic	**0.904**	0.737	22.7%
– Diluted	**0.896**	0.737	21.6%

* *Certain amounts stated above do not correspond to the consolidated financial statements as at 31 December 2012. According to the revised requirements of IFRS 11 on "Joint Venture Arrangement", Mengniu's investment in Mengniu-Arla joint venture has been adjusted from based on the proportion of investment to recognition using the equity method.*

* *For identification purposes only*

- The Chinese government has initiated policies to facilitate industry consolidation, set higher entry barriers, investigate monopolistic practices on imported milk formula products and relax the one-child policy. These policies support the long term healthy development of the industry and create immense opportunities for leading enterprises such as Mengniu.

- Mengniu has actively adjusted product portfolio based on the market situation, embarked on the development of the yogurt and milk beverage businesses with stronger growth potential, and reduced the proportion of raw milk-based products. The Group enhanced its profitability through restructuring of its brands, allocating more resources to key brands, and integrating sales channels. These efforts have steadily boosted the Group's revenue and profit.

- The ratio of milk sources provided by scaled ranches and farms has reached 94%, ensuring product safety from the source.

- Mengniu has increased shareholding in China Modern Dairy Holdings Ltd. ("Modern Dairy", stock code: 1117) and invested in YuanShengTai Dairy Farm Limited ("YST Dairy", stock code: 1431) to better assure quality milk sources.

- Mengniu has signed a framework agreement with Danone S.A. and its subsidiaries (collectively the "Danone Group") to integrate and restructure both parties' chilled dairy business in China and jointly develop the chilled product business through a joint venture.

- Mengniu has acquired Yashili International Holdings Ltd ("Yashili", stock code: 1230) to capture the swift growth opportunities in the domestic pediatric milk formula market.

- Data from market research firm Nielsen reveals that Mengniu's liquid milk and chilled yogurt retained their throne in terms of market share.

The board (the "**Board**") of directors (the "**Directors**") of China Mengniu Dairy Company Limited (the "**Company**") is pleased to present the results of the Company and its subsidiaries (the "**Group**" or "**Mengniu**") for the year ended 31 December 2013, together with the comparative amounts.

CONSOLIDATED STATEMENT OF PROFIT OR LOSS

For the year ended 31 December 2013

	Notes	**2013** **RMB'000**	2012 RMB'000 Restated
CONTINUING OPERATIONS			
REVENUE	*4*	**43,356,908**	35,999,990
Cost of sales		**(31,659,663)**	(27,049,992)
GROSS PROFIT		**11,697,245**	8,949,998
Other income and gains	*4*	**288,633**	249,195
Selling and distribution expenses		**(8,168,238)**	(6,222,749)
Administrative expenses		**(1,605,791)**	(1,174,851)
Other expenses	*5*	**(360,125)**	(193,811)
PROFIT FROM OPERATING ACTIVITIES		**1,851,724**	1,607,782
Interest income		**359,295**	218,148
Finance costs	*7*	**(160,377)**	(39,159)
Share of profits and losses of:			
A joint venture		**–**	(66,763)
Associates		**153,861**	13,855
PROFIT BEFORE TAX FROM CONTINUING OPERATIONS	*6*	**2,204,503**	1,733,863
Income tax expense	*8*	**(366,713)**	(245,476)
PROFIT FOR THE YEAR FROM CONTINUING OPERATIONS		**1,837,790**	1,488,387
DISCONTINUED OPERATIONS			
Profit for the year from discontinued operations	*9*	**24,198**	429
PROFIT FOR THE YEAR		**1,861,988**	1,488,816
Attributable to:			
Owners of the Company		**1,630,925**	1,303,101
Non-controlling interests		**231,063**	185,715
		1,861,988	1,488,816
EARNINGS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE COMPANY (EXPRESSED IN RMB PER SHARE)	*11*		
Basic			
– For profit for the year		**0.904**	0.737
– For profit from continuing operations		**0.891**	0.737
Diluted			
– For profit for the year		**0.896**	0.737
– For profit from continuing operations		**0.883**	0.737

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2013

	Notes	**31 December 2013 RMB'000**	31 December 2012 RMB'000 Restated	1 January 2012 RMB'000 Restated
NON-CURRENT ASSETS				
Property, plant and equipment		**9,246,109**	7,739,259	6,635,921
Construction in progress		**1,275,875**	596,812	886,674
Investment properties		**115,816**	–	–
Land use rights		**1,048,813**	801,191	578,604
Goodwill		**5,694,938**	482,436	482,436
Other intangible assets		**1,612,293**	224,228	223,442
Investments in a joint venture		**–**	–	66,763
Investments in associates		**2,843,155**	77,921	153,352
Deferred tax assets		**155,739**	72,093	66,749
Biological assets		**36,707**	211,686	–
Non-current financial assets		**1,699,666**	563,309	365,167
Long term prepayments		**289,145**	299,947	243,942
		24,018,256	11,068,882	9,703,050
CURRENT ASSETS				
Other current financial assets		**1,744,747**	441,377	148,711
Inventories		**2,577,078**	1,362,673	1,643,290
Trade and bills receivables	*12*	**754,265**	855,708	810,391
Prepayments, deposits and other receivables		**2,485,297**	1,383,611	1,034,538
Pledged deposits		**561,709**	51,602	174,430
Cash and bank balances		**7,101,580**	5,752,041	6,485,269
		15,224,676	9,847,012	10,296,629
Assets of disposal groups classified as held for sale	*9*	**1,096,464**	–	–
		16,321,140	9,847,012	10,296,629
CURRENT LIABILITIES				
Trade and bills payables	*13*	**4,761,298**	3,629,460	3,653,349
Other payables and accruals		**4,354,840**	2,550,911	2,727,161
Interest-bearing bank and other borrowings		**8,461,506**	573,777	402,075
Other loans		**92,565**	24,915	119,094
Deferred income		**19,389**	19,056	18,912
Income tax payable		**170,483**	58,426	103,228
		17,860,081	6,856,545	7,023,819
Liabilities directly associated with the assets classified as held for sale	*9*	**203,250**	–	–
		18,063,331	6,856,545	7,023,819
NET CURRENT ASSETS/(LIABILITIES)		**(1,742,191)**	2,990,467	3,272,810
TOTAL ASSETS LESS CURRENT LIABILITIES		**22,276,065**	14,059,349	12,975,860

CONSOLIDATED STATEMENT OF FINANCIAL POSITION *(continued)*
As at 31 December 2013

	31 December 2013 *RMB'000*	31 December 2012 *RMB'000* *Restated*	1 January 2012 *RMB'000* *Restated*
NON-CURRENT LIABILITIES			
Interest-bearing bank and other borrowings	**3,235,535**	–	–
Long term payables	**100,678**	144,593	188,739
Deferred income	**200,326**	215,740	234,940
Deferred tax liabilities	**64,429**	33,051	22,830
Other financial liabilities	**663,959**	544,858	480,531
	4,264,927	938,242	927,040
NET ASSETS	**18,011,138**	13,121,107	12,048,820
EQUITY			
Equity attributable to owners of the Company			
Issued capital	**186,476**	181,151	181,087
Shares held under Restricted Share Award Scheme	**(394,121)**	–	–
Other reserves	**10,628,142**	8,491,301	8,190,634
Retained earnings	**4,940,421**	3,816,793	3,099,337
	15,360,918	12,489,245	11,471,058
Non-controlling interests	**2,650,220**	631,862	577,762
TOTAL EQUITY	**18,011,138**	13,121,107	12,048,820

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").

2.1 BASIS OF PREPARATION

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs") issued by the International Accounting Standards Board ("IASB") and the disclosure requirements of the Hong Kong Companies Ordinance. They have been prepared on a historical cost basis except for share options, certain available-for-sale equity investments, biological assets and derivative financial instruments, which have been measured at fair value. Disposal groups held for sale are stated at the lower of their carrying amounts and fair values less costs to sell. These financial statements are presented in Renminbi ("RMB") and all values are rounded to the nearest thousand except when otherwise indicated.

Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries (collectively referred to as the "Group") for the year ended 31 December 2013. The financial statements of the subsidiaries are prepared for the same reporting period as the Company, using consistent accounting policies. The results of subsidiaries are consolidated from the date on which the Group obtains control, and continue to be consolidated until the day that such control ceases.

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

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

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

2.2 CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES

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

IFRS 1 Amendments	Amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards – Government Loans*
IFRS 7 Amendments	Amendments to IFRS 7 *Financial Instruments: Disclosures – Offsetting Financial Assets and Financial Liabilities*
IFRS 10	*Consolidated Financial Statements*
IFRS 11	*Joint Arrangements*
IFRS 12	*Disclosure of Interests in Other Entities*
IFRS 10, IFRS 11 and IFRS 12 Amendments	Amendments to IFRS 10, IFRS 11 and IFRS 12 – *Transition Guidance*
IFRS 13	*Fair Value Measurement*
IAS 1 Amendments	Amendments to IAS 1 *Presentation of Financial Statements – Presentation of Items of Other Comprehensive Income*
IAS 19 (Revised)	*Employee Benefits*
IAS 27 (Revised)	*Separate Financial Statements*
IAS 28 (Revised)	*Investments in Associates and Joint Ventures*
IAS 36 Amendments	Amendments to IAS 36 *Impairment of Assets – Recoverable Amount Disclosures for Non-Financial Assets*
IFRIC 20	*Stripping Costs in the Production Phase of a Surface Mine*
Annual Improvements 2009-2011 Cycle	Amendments to a number of IFRSs issued in May 2012

Other than as further explained below regarding the impact of IFRS 10, IFRS 11, IFRS 12, IFRS 13, IAS 19 (Revised), amendments to IFRS 10, IFRS 11,IFRS 12, IAS 1 and IAS 36, and certain amendments included in *Annual Improvements 2009-2011 Cycle (Include other standards as appropriate*), the adoption of the new and revised IFRSs has had no significant financial effect on these financial statements.

The principal effects of adopting these new and revised IFRSs are as follows:

(a) IFRS 10 replaces the portion of IAS 27 *Consolidated and Separate Financial Statements* that addresses the accounting for consolidated financial statements and addresses the issues in SIC – 12 *Consolidation – Special Purpose Entities*. It establishes a single control model used for determining which entities are consolidated. To meet the definition of control in IFRS 10, an investor must have (a) power over an investee, (b) exposure, or rights, to variable returns from its involvement with the investee, and (c) the ability to use its power over the investee to affect the amount of the investor's returns. The changes introduced by IFRS 10 require management of the Group to exercise significant judgement to determine which entities are controlled.

As a result of the application of IFRS 10, the Group has changed the accounting policy with respect to determining which investees are controlled by the Group.

The application of IFRS 10 does not change any of the consolidation conclusions of the Group in respect of its involvement with investees as at 1 January 2013.

2.2 CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES *(continued)*

(b) IFRS 11 replaces IAS 31 *Interests in Joint Ventures* and SIC – 13 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers*. It describes the accounting for joint arrangements with joint control. It addresses only two forms of joint arrangements, i.e., joint operations and joint ventures, and removes the option to account for joint ventures using proportionate consolidation. The classification of joint arrangements under IFRS 11 depends on the parties' rights and obligations arising from the arrangements. A joint operation is a joint arrangement whereby the joint operators have rights to the assets and obligations for the liabilities of the arrangement and is accounted for on a line-by-line basis to the extent of the joint operators' rights and obligations in the joint operation. A joint venture is a joint arrangement whereby the joint venturers have rights to the net assets of the arrangement and is required to be accounted for using the equity method in accordance with IAS 28 (Revised).

The directors of the Company reviewed and assessed the classification of the Group's investment in joint arrangements in accordance with the requirements of IFRS 11, and concluded that the Group's investments in Mengniu Arla (Inner Mongolia) Dairy Products Co., Ltd. ("Mengniu Arla"), which was previously classified as a jointly-controlled entity under IAS 31 and was accounted for using the proportionate consolidation method, should be classified as a joint venture under IFRS 11 and be accounted for using the equity method. The change in accounting for the investment in a joint venture has been applied retrospectively. The opening balances as at 1 January 2012 and comparative information for the year ended 31 December 2012 have been restated in the consolidated financial statements. The quantitative impact on the financial statements is recognised below:

Impact on the consolidated statement of profit or loss:

	2012 *RMB'000*
Decrease in revenue	(79,354)
Increase in cost of sales	(24,373)
Decrease in gross profit	(103,727)
Decrease in other income and gains	(816)
Decrease in selling and distribution expenses	203,093
Decrease in administrative expenses	13,365
Decrease in other operating expenses	1,675
Increase in operating profit	113,590
Decrease in interest income	(164)
Decrease in finance costs	2,595
Increase in share of losses of a joint venture	(66,763)
Net increase on profit before tax	49,258
Net impact on income tax expense	–
Net increase on profit for the year and total comprehensive income	49,258
Net increase on earning per share	0.026

2.2 CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES *(continued)*

(b) *(continued)*

Impact on the consolidated statement of financial position:

	As at 31 December 2012 *RMB'000*	As at 1 January 2012 *RMB'000*
Decrease in property, plant and equipment	(152,655)	(170,618)
Decrease in construction in progress	–	(429)
Decrease in land use rights	(6,252)	(6,403)
Decrease in other intangible assets	(1,749)	(1,445)
Increase in investments in a joint venture	–	66,763*
Decrease in total non-current assets	(160,656)	(112,132)
Increase/(decrease) in trade and bills receivables	54,235	(25,367)
Decrease in inventories	(57,225)	(41,957)
Increase in prepayments, deposits and other receivables	115,155	16,115
Decrease in pledged deposits	–	(859)
Decrease in cash and bank balances	(26,349)	(37,806)
Increase/(decrease) in total current assets	85,816	(89,874)
Decrease in trade and bills payables	(49,405)	(31,197)
Decrease in other payables and accruals	(74,693)	(35,340)
Decrease in interest-bearing bank loans and other borrowings	–	(135,469)
Decrease in total current liabilities	(124,098)	(202,006)
Increase in net current assets	209,914	112,132
Impact on net assets and equity	49,258	–

* The Group recognised the initial investment in the joint venture as at 1 January 2012 at the aggregate of the carrying amounts of the assets and liabilities that the Group had previously proportionately consolidated including any goodwill arising from acquisition.

As at 31 December 2012, the Group's unrecognised cumulative losses of the joint venture were RMB49,258,000 (1 January 2012: Nil). The Group does not have legal or constructive obligations in relation to the negative net assets of the joint venture and accordingly the Group did not recognise the corresponding liabilities but adjusted it against the retained earnings.

2.2 CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES *(continued)*

(b) *(continued)*

Impact on the consolidated statement of cash flows:

	2012
	RMB'000
Decrease in net cash flows from operating activities	(125,412)
Decrease in net cash flows used in investing activities	3,504
Decrease in net cash flows used in financing activities	133,394
Net increase in cash and cash equivalents	11,486

(c) IFRS 12 sets out the disclosure requirements for subsidiaries, joint arrangements, associates and structured entities previously included in IAS 27 *Consolidated and Separate Financial Statements,* IAS 31 *Interests in Joint Ventures* and IAS 28 *Investments in Associates*. It also introduces a number of new disclosure requirements for these entities. Details of the disclosures for subsidiaries, joint ventures and associates are included in the financial statements.

(d) The IFRS 10, IFRS 11 and IFRS 12 Amendments clarify the transition guidance in IFRS 10 and provide further relief from full retrospective application of these standards, limiting the requirement to provide adjusted comparative information to only the preceding comparative period. The amendments clarify that retrospective adjustments are only required if the consolidation conclusion as to which entities are controlled by the Group is different between IFRS 10 and IAS 27 or SIC – Int 12 at the beginning of the annual period in which IFRS 10 is applied for the first time.

(e) IFRS 13 provides a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The standard does not change the circumstances in which the Group is required to use fair value, but rather provides guidance on how fair value should be applied where its use is already required or permitted under other IFRSs. IFRS 13 is applied prospectively and the adoption has had no material impact on the Group's fair value measurements. As a result of the guidance in IFRS 13, the policies for measuring fair value have been amended. Additional disclosures required by IFRS 13 for the fair value measurements of investment properties and financial instruments are included in the financial statements.

(f) The IAS 1 Amendments change the grouping of items presented in other comprehensive income ("OCI"). Items that could be reclassified (or recycled) to profit or loss at a future point in time (for example, exchange differences on translation of foreign operations, net movement on cash flow hedges and net loss or gain on available-for-sale financial assets) are presented separately from items which will never be reclassified (for example, the revaluation of land and buildings). The amendments have affected the presentation only and have had no impact on the financial position or performance of the Group. The consolidated statement of comprehensive income has been restated to reflect the changes. In addition, the Group has chosen to use the new title "consolidated statement of profit or loss" as introduced by the amendments in these financial statements.

2.2 CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES *(continued)*

(g) IAS 19 (Revised) includes a number of amendments that range from fundamental changes to simple clarifications and re-wording. The revised standard introduces significant changes in the accounting for defined benefit pension plans including removing the choice to defer the recognition of actuarial gains and losses. Other changes include modifications to the timing of recognition for termination benefits, the classification of short-term employee benefits and disclosures of defined benefit plans. As the Group does not have any defined benefit plan or employee termination plan and the Group does not have any significant employee benefits that are expected to be settled for more than twelve months after the reporting period, the adoption of the revised standard has had no effect on the financial position or performance of the Group.

(h) The IAS 36 Amendments remove the unintended disclosure requirement made by IFRS 13 on the recoverable amount of a cash-generating unit which is not impaired. In addition, the amendments require the disclosure of the recoverable amounts for the assets or cash-generating units for which an impairment loss has been recognised or reversed during the reporting period, and expand the disclosure requirements regarding the fair value measurement for these assets or units if their recoverable amounts are based on fair value less costs of disposal. The amendments are effective retrospectively for annual periods beginning on or after 1 January 2014 with earlier application permitted, provided IFRS 13 is also applied. The Group has early adopted the amendments in these financial statements. The amendments have had no impact on the financial position or performance of the Group. Disclosures about the Group's impaired non-financial assets are included in the financial statements.

(i) *Annual Improvements 2009-2011 Cycle* issued in June 2012 sets out amendments to a number of standards. There are separate transitional provisions for each standard. While the adoption of some of the amendments may result in changes in accounting policies, none of these amendments have had a significant financial impact on the Group. Details of the key amendments most applicable to the Group are as follows:

- IAS 1 *Presentation of Financial Statements:* Clarifies the difference between voluntary additional comparative information and the minimum required comparative information. Generally, the minimum required comparative period is the previous period. An entity must include comparative information in the related notes to the financial statements when it voluntarily provides comparative information beyond the previous period. The additional comparative information does not need to contain a complete set of financial statements.

  In addition, the amendment clarifies that the opening statement of financial position as at the beginning of the preceding period must be presented when an entity changes its accounting policies; makes retrospective restatements or makes reclassifications, and that change has a material effect on the statement of financial position. However, the related notes to the opening statement of financial position as at the beginning of the preceding period are not required to be presented.

- IAS 32 *Financial Instruments: Presentation:* Clarifies that income taxes arising from distributions to equity holders are accounted for in accordance with IAS 12 *Income Taxes*. The amendment removes existing income tax requirements from IAS 32 and requires entities to apply the requirements in IAS 12 to any income tax arising from distributions to equity holders.

2.3 ISSUED BUT NOT YET EFFECTIVE IFRSs

The Group has not applied the following new and revised IFRSs, that have been issued but are not yet effective, in these financial statements.

IFRS 9	*Financial Instruments*[3]
IFRS 9, IFRS 7 and IAS 39 Amendments	*Hedge Accounting and amendments to* IFRS 9, IFRS 7 and IAS 39[3]
IFRS 10, IFRS 12 and IAS 27 (Revised) Amendments	Amendments to IFRS 10, IFRS 12 and IAS 27 (Revised) – *Investment Entities*[1]
IAS 19 Amendments	Amendments to IAS 19 *Employee Benefits – Defined Benefit Plans: Employee Contributions*[2]
IAS 32 Amendments	Amendments to IAS 32 *Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities*[1]
IAS 39 Amendments	Amendments to IAS 39 *Financial Instruments: Recognition and Measurement – Novation of Derivatives and Continuation of Hedge Accounting*[1]
IFRIC – Int 21	*Levies*[1]
IFRS 14	*Regulatory Deferral Accounts*[4]
Annual Improvements 2010–2012 Cycle	*Amendments to a number of IFRSs*[2]
Annual Improvements 2011–2013 Cycle	*Amendments to a number of IFRSs*[2]

1 Effective for annual periods beginning on or after 1 January 2014
2 Effective for annual periods beginning on or after 1 July 2014
3 No mandatory effective date yet determined but is available for adoption
4 Effective for annual periods beginning on or after 1 January 2016

The Group is in the process of determining whether these new and revised standards and interpretations will have any material impact on the Group's results of operations and financial position.

3. OPERATING 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 beverages and yogurt;

- Ice cream products segment – manufacture and distribution of ice cream; and

- Milk powder segment – manufacture and distribution of milk powder.

- Other dairy products segment – principally the Group's cheese 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 from continuing operations. The adjusted profit/(loss) before tax from continuing operations is measured consistently with the Group's profit/(loss) before tax from continuing operations except that interest income, finance costs, dividend income, 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.

3. OPERATING SEGMENT INFORMATION *(continued)*

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.

Year ended 31 December 2013

	Liquid milk products *RMB'000*	Ice cream products *RMB'000*	Milk powder products *RMB'000*	Other dairy products *RMB'000*	Total *RMB'000*
Segment revenue:					
Sales to external customers	37,902,833	3,023,370	2,177,251	253,454	43,356,908
Intersegment sales	281,572	40,549	38,829	43,066	404,016
	38,184,405	3,063,919	2,216,080	296,520	43,760,924
Reconciliation:					
Elimination of intersegment sales					(404,016)
Revenue from continuing operations					43,356,908
Segment results	2,350,741	51,866	95,413	(22,796)	2,475,224
Reconciliation:					
Interest income					359,295
Finance costs					(160,377)
Share of profits and losses of associates					153,861
Unallocated corporate expenses					(623,500)
Profit before tax from continuing operations					2,204,503
Income tax expense					(366,713)
Profit for the year from continuing operations					1,837,790
Segment assets	19,362,089	1,536,988	11,861,065	474,480	33,234,622
Reconciliation:					
Elimination of intersegment receivables					(8,618,415)
Unallocated corporate assets					14,626,725
Assets related to discontinued operations					1,096,464
Total assets					40,339,396
Segment liabilities	15,102,984	1,251,766	2,051,448	482,434	18,888,632
Reconciliation:					
Elimination of intersegment payables					(8,618,415)
Unallocated corporate liabilities					11,854,791
Liabilities related to discontinued operations					203,250
Total liabilities					22,328,258

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

Year ended 31 December 2013

	Liquid milk products *RMB'000*	Ice cream products *RMB'000*	Milk powder products *RMB'000*	Other dairy products *RMB'000*	Total *RMB'000*
Other segment information:					
Depreciation and amortisation	**961,248**	**112,220**	**92,535**	**6,307**	**1,172,310**
Unallocated amounts					**45,272**
Total depreciation and amortisation					**1,217,582**
Capital expenditure	**4,547,984**	**338,550**	**7,280,321**	**12,539**	**12,179,394**
Unallocated amounts					**417,135**
Total capital expenditure*					**12,596,529**
Impairment losses recognised in the consolidated statement of profit or loss	**79,750**	**10,431**	**1,477**	**239**	**91,897**
Other non-cash expenses	**15,322**	**3,755**	**–**	**–**	**19,077**
Unallocated amounts					**184,413**
Total non-cash expenses					**295,387**

* Capital expenditure consists of cash paid for the purchase of property, plant and equipment, construction in progress, investment properties, intangible assets, land use rights, biological assets, and for the acquisition of associates and subsidiaries.

3. OPERATING SEGMENT INFORMATION *(continued)*

Year ended 31 December 2012 (Restated)

	Liquid milk products *RMB'000*	Ice cream products *RMB'000*	Milk powder products *RMB'000*	Other dairy products *RMB'000*	Equity accounting adjustments *RMB'000*	Total *RMB'000*
Segment revenue:						
Sales to external customers	32,335,971	3,171,482	441,552	130,339	(79,354)	35,999,990
Intersegment sales	245,591	27,153	151,898	111,526	–	536,168
	32,581,562	3,198,635	593,450	241,865	(79,354)	36,536,158
Reconciliation:						
Elimination of intersegment sales						(536,168)
Revenue from continuing operations						35,999,990
Segment results	1,830,613	39,048	(113,579)	(30,456)	113,590	1,839,216
Reconciliation:						
Interest income						218,148
Finance costs						(39,159)
Share of profits and losses of a joint venture and associates						(52,908)
Unallocated corporate expenses						(231,434)
Profit before tax from continuing operations						1,733,863
Income tax expense						(245,476)
Profit for the year from continuing operations						1,488,387
Segment assets	16,458,513	1,405,014	274,677	366,459	(74,840)	18,429,823
Reconciliation:						
Elimination of intersegment receivables						(5,424,716)
Unallocated corporate assets						7,910,787
Assets related to a discontinued operation						–
Total assets						20,915,894
Segment liabilities	10,988,647	816,066	315,185	393,189	(124,098)	12,388,989
Reconciliation:						
Elimination of intersegment payables						(5,424,716)
Unallocated corporate liabilities						830,514
Liabilities related to a discontinued operation						–
Total liabilities						7,794,787

3. OPERATING SEGMENT INFORMATION *(continued)*

Year ended 31 December 2012 (Restated)

	Liquid milk products *RMB'000*	Ice cream products *RMB'000*	Milk powder products *RMB'000*	Other dairy products *RMB'000*	Equity accounting adjustments *RMB'000*	Total *RMB'000*
Other segment information:						
Share of profits and losses of a joint venture	–	–	(66,763)	–	–	(66,763)
Depreciation and amortisation	851,104	90,441	21,572	5,513	(21,572)	947,058
Unallocated amounts						48,241
Total depreciation and amortisation						995,299
Capital expenditure*	1,819,585	334,865	3,416	5,372	(3,416)	2,159,822
Unallocated amounts						103,291
Total capital expenditure						2,263,113
Impairment losses recognised in the consolidated statement of profit or loss	31,396	418	1,142	879	(1,142)	32,693
Other non-cash expenses	21,273	3,277	–	(380)	–	24,170
Unallocated amounts						(4,998)
Total non-cash expenses						51,865

* Capital expenditure consists of cash paid for the purchase of property, plant and equipment, construction in progress, investment properties, intangible assets, land use rights, biological assets, and for the acquisition of associates and subsidiaries.

Geographical information

a. *Revenue from external customers*

Over 90% of the revenue is contributed by customers in Mainland China.

b. *Non-current assets*

Over 90% of the Group's non-current assets are located in Mainland China.

Information about a major customer

There is no single customer contributing over 10% of the Group's revenue.

4. **REVENUE, OTHER INCOME AND GAINS**

Revenue, being the turnover of the Group, 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 from continuing operations is as follows:

	2013	2012
	RMB'000	*RMB'000*
		Restated
Revenue:		
Sale of goods	**43,356,908**	35,999,990
Other income and gains:		
Government grants related to		
– Assets other than biological assets	**19,385**	19,056
– Income	**71,775**	136,544
Gain on deemed disposal of an associate	**–**	4,384
Gain on disposal of associates	**–**	50,635
Foreign exchange gains, net	**155,147**	–
Others	**42,326**	38,576
	288,633	249,195
	43,645,541	36,249,185

5. **OTHER EXPENSES**

	2013	2012
	RMB'000	*RMB'000*
		Restated
Donation	**18,634**	6,029
Loss on disposal of items of property, plant and equipment	**17,496**	5,992
Write-off of inventories	**–**	4,828
Write-down of inventories to net realisable value	**277**	1,495
Provision for property, plant and equipment	**9,162**	–
Provision for trade receivables and other receivables	**81,934**	31,198
Educational surcharges and city construction tax	**194,886**	132,738
Foreign exchange losses, net	**–**	2,393
Others	**37,736**	9,138
	360,125	193,811

6. PROFIT BEFORE TAX

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

	2013	2012
	RMB'000	*RMB'000*
		Restated
Cost of inventories sold	**31,656,106**	27,048,280
Realised and unrealised fair value losses of derivative financial instruments, net	**3,557**	1,712
Cost of sales	**31,659,663**	27,049,992
Employee benefit expense (excluding directors' and chief executive's remuneration)		
– Wages, salaries, housing benefits and other allowances	**2,331,661**	1,707,334
– Retirement benefit contributions	**239,757**	172,766
– Share-based payment expense	**39,809**	16,508
– Restricted share expense	**114,321**	–
	2,725,548	1,896,608
Depreciation of items of property, plant and equipment	**1,180,323**	972,652
Depreciation of investment properties	**415**	–
Amortisation of land use rights	**21,748**	14,711
Amortisation of other intangible assets	**15,096**	7,936
Research and development costs – current year expenditure	**57,007**	55,022
Provision for trade receivables and other receivables	**81,934**	31,198
Minimum lease payments under operating leases on buildings and certain production equipment	**322,341**	212,342
Display space leasing fees	**690,831**	590,251
Auditors' remuneration	**4,440**	4,220

7. FINANCE COSTS

An analysis of finance costs from continuing operations is as follows:

	2013	2012
	RMB'000	*RMB'000*
		Restated
Interest on long term payables	**11,659**	15,913
Interest on bank loans wholly repayable within five years	**123,114**	18,419
Interest on US$500,000,000 3.50% bond due 2018	**10,392**	–
Increase in discounted amounts of contingent consideration arising from the passage of time	**15,212**	4,827
	160,377	39,159

8. INCOME TAX EXPENSE

Under the Law of the People's Republic of China on Corporate Income Tax ("PRC CIT law"), except for certain preferential treatment available to twenty-one (2012: eighteen) of the Group's subsidiaries, the entities within the Group are subject to the PRC corporate income tax ("CIT") at a rate of 25% (2012: 25%) on the taxable income as reported in their statutory accounts which are prepared in accordance with the PRC accounting standards and financial regulations.

	2013	2012
	RMB'000	*RMB'000*
		Restated
Current income tax		
Current charge for the year	**385,903**	255,739
Adjustments recognised in the year for current tax of prior years	**(9,224)**	(4,919)
Deferred income tax		
Relating to origination and reversal of tax losses and temporary differences	**(9,285)**	(5,344)
Relating to origination and reversal of withholding tax of the undistributed earnings of certain subsidiaries	**(681)**	–
	366,713	245,476

8. INCOME TAX EXPENSE *(continued)*

A reconciliation of the income tax expense applicable to profit before tax at the statutory income tax rate to the income tax expense at the Group's effective income tax rate for the year is as follows:

	Note	**2013** ***RMB'000***	2012 *RMB'000* *Restated*
Profit before tax from continuing operations		**2,204,503**	1,733,863
At CIT rate of 25% (2012: 25%)		**551,126**	433,466
Non-deductible items and others, net		**25,085**	23,203
Adjustment recognised in the year for current tax of prior years		**(9,224)**	(4,919)
Effect of preferential tax rates	*(a)*	**(66,081)**	(64,900)
Effect of tax exemptions	*(a)*	**(159,879)**	(124,540)
Effect of withholding tax at 5% on the distributable profits of the Group's certain PRC subsidiaries		**(681)**	–
Tax losses not recognised		**26,367**	3,948
Utilisation of previously unrecognised tax credits		**–**	(20,782)
At the effective income tax rate of 16.63% (2012: 14.16%)		**366,713**	245,476

Notes:

(a) Twenty-one (2012: eighteen) subsidiaries were subject to tax concessions in 2013. The total taxable profits of the subsidiaries that are subject to tax concessions amounted to approximately RMB745,140,000 (2012: RMB723,966,000) in aggregate. Out of the twenty-one subsidiaries, eleven (2012: nine) were granted tax concessions by the state tax bureau in accordance with the PRC CIT law and the corresponding transitional tax concession policy and "The notice of tax policies relating to the implementation of the western China development strategy." Eighteen (2012: fifteen) subsidiaries were granted tax concessions in accordance with the policy of "The notice of preferential tax policy for preliminary processing of agriculture products".

(b) The share of tax attributable to a joint venture and associates amounting to approximately RMB12,010,000 (2012: RMB8,613,000) is included in the share of profits and losses of a joint venture and associates on the face of the consolidated statement of profit or loss.

9. DISCONTINUED OPERATIONS

Plan to disposal of dairy farming business

On 25 November 2013, Inner Mongolia Fuyuan Farming Co., Ltd. ("Fuyuan"), Inner Mongolia Hehe Investment Co., Ltd. ("Hehe"), Inner Mongolia Mengniu Dairy (Group) Company Limited ("Inner Mongolia Mengniu") and certain third parties entered into a series of agreements in order to better finance Fuyuan's business expansion. In accordance with the agreements, third parties will inject additional capital to Fuyuan, consequently resulting in the dilution of Hehe's equity interest in Fuyuan from 100% to around 45%. Fuyuan engages in the dairy farming business. The deemed disposal of Fuyuan is due to be completed in 2014, upon which Hehe will lose the control of Fuyuan. As at 31 December 2013, Fuyuan was classified as a disposal group held for sale.

Acquisition of a subsidiary exclusively with a view to subsequent disposal

On 29 August 2013, Inner Mongolia Mengniu Founding Industry Management Co., Ltd. ("Founding") acquired an additional 64% equity interest in Chengdu Mengniu Dairy Sales Co., Ltd. ("Chengdu Sales") exclusively with a view to subsequent disposal within one year. Prior to the acquisition, Chengdu Sales was a 36% associate of Founding. The purchase consideration for the acquisition was in the form of cash of RMB5,763,000 paid at the acquisition date. Chengdu Sales engages in the dairy products trading business. The subsidiary was acquired for the purpose of the Group's distributorship reorganisation. The Group expects to complete the subsequent disposal by 30 June 2014. Upon the acquisition of Chengdu Sales by the Group and as at 31 December 2013, the net assets of Chengdu Sales have been classified as a disposal group and as a discontinued operation in the consolidated financial statements.

The Group has not recognised any impairments loss in respect of Fuyuan and Chengdu Sales, neither when the assets and liabilities of the operations were classified as held for sale nor at the end of the reporting period.

The combined results of discontinued operations (i.e., Fuyuan and Chengdu Sales) for the year are presented below:

	2013	2012
	RMB'000	*RMB'000*
Revenue	**43,081**	1,084
Net expenses	**(18,650)**	(655)
Finance costs	**(233)**	–
Profit before tax from discontinued operations	**24,198**	429
Income tax expense	**–**	–
Profit for the year from discontinued operations	**24,198**	429

9. DISCONTINUED OPERATIONS *(continued)*

The major classes of assets and liabilities of discontinued operations (i.e., Fuyuan and Chengdu Sales) classified as held for sale as at 31 December are as follows:

	2013
	RMB'000
Assets	
Property, plant and equipment	**275,126**
Construction in progress	**67,624**
Land use rights	**6,522**
Other intangible assets	**2,676**
Biological assets	**495,568**
Inventories	**74,102**
Trade and bills receivables	**12,711**
Prepayments, deposits and other receivables	**390,376**
Cash and bank balances	**56,299**
	1,381,004
Less: Intra-group receivables	**(284,540)**
Assets classified as held for sale	**1,096,464**
Liabilities	
Trade and bills payables	**54,320**
Other payables and accruals	**663,705**
Interest-bearing bank and other borrowings	**30,000**
	748,025
Less: Intra-group payables	**(544,775)**
Liabilities directly associated with the assets classified as held for sale	**203,250**
Net assets directly associated with the disposal groups	**893,214**

The net cash flows incurred by discontinued operations (i.e., Fuyuan and Chengdu Sales) are as follows:

	2013	2012
	RMB'000	*RMB'000*
Operating activities	**(167,712)**	(29,725)
Investing activities	**(487,142)**	(111,852)
Financing activities	**667,297**	183,550
Net cash inflow	**12,443**	41,973

9. DISCONTINUED OPERATIONS *(continued)*

The calculations of basic and diluted earnings per share from discontinued operations are based on:

	2013 Number of shares *RMB'000*	2012 Number of shares *RMB'000*
Profit attributable to ordinary equity holders of the Company from discontinued operations	**24,198**	429
Weighted average number of ordinary shares for the purpose of the basic earnings per share calculation	**1,804,966**	1,767,801
Weighted average number of ordinary shares for the purpose of the diluted earnings per share calculation	**1,820,397**	1,767,966
Earnings per share:		
Basic, from discontinued operations	**0.013**	–
Diluted, from discontinued operations	**0.013**	–

10. DIVIDENDS

	Notes	**2013 *RMB'000***	2012 *RMB'000*
Declared and paid during the year			
Equity dividends on ordinary shares		**290,488**	350,009
Proposed for approval at the AGM			
Equity dividends on ordinary shares: Proposed final – RMB0.20 (2012: RMB0.16) per ordinary share	*(a)/(b)*	**367,053**	282,917

Notes:

(a) The proposed final dividend for the year is subject to the approval of the Company's shareholders at the forthcoming Annual General Meeting (the "AGM"). This dividend was not recognised as a liability in the consolidated financial statements as at 31 December 2013 but was reflected as an appropriation of retained earnings for the year ending 31 December 2014.

(b) The proposed final dividend for the year is appropriated from the Company's distributable share premium.

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

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

The diluted earnings per share was calculated by dividing the profit for the year attributable to ordinary equity holders of the Company by the weighted average number of ordinary shares in issue during that year, 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 of all share options during the year pursuant to the contingent ordinary share provision in IAS 33 *Earnings per Share*.

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

	2013 Number of shares ***'000***	2012 Number of shares *'000*
Weighted average number of ordinary shares for the purpose of the basic earnings per share calculation	**1,804,966**	1,767,801
Weighted average number of ordinary shares, assuming issued at no consideration on the deemed exercise of all share options during the year	**5,271**	165
Adjustments for restricted share award	**10,160**	–
Weighted average number of ordinary shares for the purpose of the diluted earnings per share calculation	**1,820,397**	1,767,966

12. TRADE AND BILLS RECEIVABLES

	2013 ***RMB'000***	2012 *RMB'000*
Bills receivable	**64,628**	172,596
Trade receivables	**762,577**	699,813
Impairment	**(72,940)**	(16,701)
	754,265	855,708

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 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.

12. TRADE AND BILLS RECEIVABLES *(continued)*

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

	2013	2012
	RMB'000	*RMB'000*
Within 3 months	**635,620**	624,808
4 to 6 months	**95,743**	223,517
7 to 12 months	**11,353**	6,788
Over 1 year	**11,549**	595
	754,265	855,708

13. TRADE AND BILLS PAYABLES

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

	2013	2012
	RMB'000	*RMB'000*
Within 3 months	**4,199,004**	2,884,261
4 to 6 months	**524,303**	729,048
7 to 12 months	**29,127**	12,442
Over 1 year	**8,864**	3,709
	4,761,298	3,629,460

MANAGEMENT DISCUSSION AND ANALYSIS

MARKET REVIEW

In 2013, China's dairy cumulative production was about 27 million tons, a year-on-year increase of 5.2%, while consumption rose by 6.7% to more than 28 million tons. In particular, the consumption of liquid milk was about 23 million tons, a year-on-year increase of 6.4%, maintaining growth momentum. As the world's second largest milk producing country, China is also one of the largest dairy consumers. However, the per capita consumption of dairy products is less than one-third of the world's average, reflecting that China's dairy industry has a broad scope for development. With the continued enhancement of China's per capita disposable income and the accelerated pace of urbanisation, consumers are increasingly in pursuit of higher quality and healthier products, a trend which has benefitted the dairy industry.

Dairy consumption of China's urban residents is comprised of mainly liquid milk, making up a major part of the total consumption, followed by yogurt and milk formula. The development of the domestic liquid milk market is relatively mature. Meanwhile, along with the rapid growth of the yogurt market in previous years, its current consumption accounts for 20% of the dairy market. Yogurt represents an important direction in the development of the market, and without doubt will become a new growth point of the dairy industry.

To restore the community's confidence in local dairy products, the PRC government introduced a number of significant measures in 2013 with a view to improve environment for the domestic dairy industry. During the year under review, nine ministries including the China Food and Drug Administration ("CFDA") and the Ministry of Industry and Information Technology ("MIIT") initiated measures to raise the industry's entry barriers with an intention to phase out original equipment manufacturers ("OEM") and rationalise the market. Infant milk formula companies are required by MIIT to comply with Good Manufacturing Practice certification in international pharmaceutical production. Also, MIIT encourages infant milk formula companies to conduct mergers and acquisitions, so that within two years 10 famous dairy giants with over RMB2 billion of annual sales income and intellectual property rights that are internationally competitive can be formed. The degree of concentration within the milk formula industry will then be raised to more than 70%, strengthening the competitiveness of local brands, which will in turn benefit the long-term positive development of the industry and bring enormous opportunities for leading players such as Mengniu. The acquisition of Yashili by Mengniu represents the largest M&A in the history of China's dairy industry to date.

In addition, the National Development and Reform Commission has conducted an anti-monopoly investigation on the imported milk formula products, leading to a fall in the prices of imported milk formula and the divestment of some foreign dairy companies. This bodes well for domestic dairy companies. Another measure of far-reaching significance on the milk industry during the year was the relaxation of the one-child policy, whereas, a couple among which either the wife or husband is an only child is allowed to have two children, thus expanding prospects for the infant milk formula industry. Moreover, at the end of the year, the CFDA issued a notice prohibiting the production of infant milk formula by way of commission, OEM, sub-packaging, etc., thereby further reinforcing the quality and safety supervision on infant milk formula.

BUSINESS REVIEW

In 2013, strategic initiatives undertaken by Mengniu included both the control of upstream milk sources, as well as the adherence to international standards through strategic cooperation with foreign companies, thereby achieving a comprehensive upgrade from quality control to technology management. These initiatives involved both vertical and horizontal cooperation among dairy enterprises. They were reflections of Mengniu's confidence in the dairy market with the support of COFCO Group. The positive response from the capital market was also an indication of the strong vote of confidence in a series of major investments made by Mengniu.

In response to the consolidation and internationalisation trend of China's dairy industry, Mengniu actively expanded its business and extended its position along the industry chain, so as to pave a solid path for its future development. Mengniu has engaged in M&As and strategic partnerships with a number of top-notch enterprises within and outside China, thus assuring quality raw milk supply, expanding the chilled business and establishing a milk formula platform.

Strategic Cooperation

– *Raw milk supply: Modern Dairy and YST Dairy*

  The Company became the largest single shareholder of Modern Dairy by increasing its equity shareholdings in Modern Dairy to about 28% at a consideration of approximately HK$3,177.5 million in May. The Company also became the cornerstone investor of YST Dairy at US$60 million (approximately HK$469.8 million) in November. The Group thus has retained its unparalleled edge in milk sourcing. Based on the size of the livestock population, both Modern Dairy and YST Dairy are leading suppliers of raw milk in China. In particular, Modern Dairy is the largest supplier of raw milk for Mengniu. Given the present intense situation of milk resources in China, the increase in equity shareholdings in Modern Dairy and YST Dairy better assures Mengniu of quality raw milk supply.

– *Chilled business: Danone Group*

  The Group, through its operating subsidiary, entered into a framework agreement with Danone Group, the world's largest fresh dairy enterprise, dated 20 May 2013 for a joint venture in relation to the merger and reorganisation of their chilled dairy business in China and the establishment of a long-term equity joint venture as the only platform to acquire, invest and operate the business of chilled yogurt, chilled yogurt drinks and chilled spoonable dairy based desserts in China, with the aim of developing an extensive chilled yogurt product portfolio.

  In addition, COFCO Group, through a joint venture with Danone Group, transferred a part of the Company's shares to a joint venture set up by Danone Group and COFCO Group, which officially became a strategic shareholder holding approximately 4% of the shares in the Company. On 9 August, the Group and Danone Group further entered into an Equity Joint Venture Contract to set up a joint venture engaging in chilled business. The joint venture is 80% held by Mengniu and 20% held by Danone Group.

On 12 February 2014, Mengniu and Danone Group further boosted their cooperation in share capital. Through COFCO Dairy Investments Limited, Danone Group increased its holdings in Mengniu from 4.0% to 9.9% of the enlarged share capital, involving a consideration of HK$5,153 million (about US$665 million). The transaction was approved by independent shareholders of Mengniu on 20 March.

By leveraging Danone Group's global-leading yogurt R&D technology, brand management and marketing experience, Mengniu will further tap the potential of China's yogurt market. Meanwhile, Mengniu's innovation capability within the dairy industry will be beefed up, placing it in a better position to offer consumers a wider array of quality yogurt products.

– *Milk formula business: Yashili*

On 18 June 2013, Mengniu announced to make a general offer to acquire Yashili at a consideration of approximately HK$11.4 billion, the largest acquisition in China's dairy industry so far. As at 13 August (the final closing date of the offer), valid acceptances of the share offer have been received in respect of 3,196,747,945 Yashili shares, representing approximately 89.82% of the issued share capital of Yashili. To comply with the minimum percentage of public float prescribed by the Stock Exchange of Hong Kong and to maintain Yashili's independent operating listing platform, Mengniu, through its subsidiary, sold 471,135,389 shares of Yashili at HK$3.50 per share on 11 November, with a total consideration of about HK$1,649.0 million. Upon the transaction, the number of Yashili shares held by Mengniu was reduced to 2,725,612,556 shares, representing approximately 76.58% of the issued share capital of Yashili.

Yashili is one of the largest manufacturers and distributors of milk formula in China. Its quality imported dairy raw materials, self developed milk formula products, advanced production systems and professional marketing team which understands China's consumer market will bring significant growth to Mengniu's milk formula business, enabling the Group to capture high growth opportunities in the domestic infant milk formula market.

As per the announcement dated 6 January 2014, Mengniu acquired 100% equity interest in Yashili (Zhengzhou) Nourishment Co., Ltd. ("Yashili (Zhengzhou)") at a consideration of RMB376.7 million in conjunction with The WhiteWave Foods Company, a packaged food and beverages company in North America. Both parties would hold a 51% and 49% interest respectively in Yashili (Zhengzhou) through a joint venture. Yashili (Zhengzhou) is mainly engaged in the manufacturing, packaging and distribution of nutrious products in China. The acquisition helps Mengniu extend into the nutrition business with higher profitability, while allowing Yashili to focus on the milk formula business, thereby achieving a win-win result. Yashili's independent shareholders approved the sale of the entire equity in Yashili (Zhengzhou) on February 18.

– *Arla Foods Amba ("Arla Foods")*

Mengniu introduced Arla Foods, a European dairy company as a strategic shareholder in 2012. Through the China-Denmark Milk Technical and Cooperation Center, Mengniu has introduced advanced dairy technology and quality management systems from Denmark. In 2013, Mengniu, Arla Foods and Denmark's FOSS Analytical A/S Company collaborated in joint research to develop "raw milk fingerprint spectrum" testing technology, which facilitates the effective monitoring and early warning of abnormal raw milk through spectral data in screening. This detection technology has been recognised by the relevant government institutions of the PRC. This recognition is an indication of the successful development and application of the technology as an efficient, controllable new approach that helps assure the quality and safety of raw milk. The widespread application of the technology in the industry is under consideration.

On the product front, in light of the rapidly emerging high-end dairy market and the increasingly stringent expectations for product quality from consumers, Mengniu has introduced organic products of Arla Foods gradually. In April, it rolled out premium *Baby&Me Organic Infant Milk Formula*, while in September, Mengniu introduced Arla Foods' UHT organic milk in Shanghai and through mainstream e-commerce platforms. Mengniu intends to introduce a wider diversity of quality products such as Arla Foods' cheese and butter.

Quality Management

In 2013, Mengniu reinforced industry chain-wide quality management by setting up standards, and strengthening the end-to-end quality control capability.

The "four carriages", namely a quality and safety management system and three quality management centers on milk sources, operations and sales respectively, are operationally coordinated. Discussions are held monthly with focus on strengthening quality management in various processes. The quality and safety management system led the three quality management centers to assess the maturity of regional quality management, in order to have a good grasp of the quality control level at production, supply and sales processes.

The quality management centre on milk sources has standardised ranch technology and improved cow breeding techniques so as to enhance the quality of raw milk. Meanwhile, it has also set up a quality management system for the plants and adopted Statistical Processes Control tools to strengthen its control over production. In order to solve the problem of "heat stress", Mengniu has installed fans and water-cooled air conditioning systems for suppliers in the southern region, which greatly improves the breeding environment for milking cows. In addition, Mengniu has organised a centralised tender on raw milk suppliers and implemented stringent requirements ranging from fodder to packaging specifications so that fodder and veterinary drugs can be better controlled and the food safety problems arising from counterfeiting, license assignment and restrictions can be eradicated. To further build up quality assurance, Mengniu's raw milk suppliers are equipped with self-inspection capability. Mengniu has implemented precautionary quality measures for the plants. If raw milk fails to meet the standards, the suppliers will be notified and take immediate pre-emptive measures.

Based on the comprehensive quality management model, the operations quality management center has rationalised its product processing workflow so as to achieve end-to-end quality control over the production chain and ensure that raw milk production and transportation processes are conducted in a completely closed environment. The raw milk transported to the plants must pass inspection. Meanwhile, the center has set up laboratory management standards for raw and auxiliary materials and unified the management flow for inspection equipment in order to ensure that all the raw and auxiliary materials used for production fulfill the requirements.

The sales quality management center has conducted planning and improvements for the identification, prevention and handling of quality and safety risks and established the online institute of sales management system. The platform was launched in September and covered 11 courses in three categories, in which sales personnel/distributors can polish their skills, such as market negotiation, sales techniques and quality management. In respect to the standardisation of market quality management, Mengniu has cultivated the awareness for quality management among its distributors so as to implement effective retail-end quality management.

With the support from the Government of the PRC and New Zealand, Mengniu, alongside with COFCO Group and PricewaterhouseCoopers in New Zealand, signed a cooperation framework agreement with a New Zealand state-owned enterprise, AsureQuality Limited – the largest food quality and safety certification institution in the Southern Hemisphere – proposing the establishment of a third party independent certification institution in food quality and safety. It helps Mengniu pioneer the introduction of international advanced food quality and safety certification, and promote such certification within the national dairy industry chain so as to satisfy consumers' escalating demands for food safety.

Building Milk Sources

In 2013, a supply shortage brought about hikes in raw milk prices, posing a mounting challenge to dairy enterprises in the PRC. With regard to supply, dairy farmers, faced with declining profits and a decreasing inventory of dairy cows, exited at a pace unmatched by construction of scaled ranches. Restricted import of international milk formula exacerbated the milk sources shortage across the country. Meanwhile, the demand for dairy products was spurred by a gradual recovery of consumer confidence, causing a wider gap between the supply and demand and an ongoing increase of raw milk prices. In order to mitigate the cost pressure brought by higher raw milk prices, Mengniu sped up the construction of its own base of milk sources. Eight self-built ranches had already commenced operation, four of which had started milk production. The remaining four are to follow suit in a staged manner during 2014. Mengniu plans to kick-start the construction of two additional ranches in 2014, with a view to further boost its own supply of milk sources.

As a leading domestic dairy enterprise, Mengniu shoulders the responsibility to enhance food safety. It aims to support the modernised development of dairy farmers, scaling of ranches with better technical guidance in order to increase the unit production of dairy cows. Such assistance ensures an improved efficiency for dairy farmers and product quality at its sources and encourages consumers' confidence in the safety of dairy products. After taking measures of consolidation, milk suppliers of Mengniu decreased from 3,200 in 2010 to almost 2,000 in 2013, with a ratio of milk sources provided by scaled ranches and farms of 94%. Mengniu regards the dairy industry chain as a big family where all market players thrive or die together and a collection of the best milk farmers would also be favourable to Mengniu. Thus, other than financial allowances, Mengniu also shares with milk farmers industry-leading farm operational experience so as to enhance their technological standards and efficiency.

Sales Channels

Mengniu has established sales operations standards and improved its distribution and retail sales model. While the Regional Business Unit ("RBU") covers the 18 major sales regions across the nation, model markets, such as the Central Business Unit ("CBU") and "branch company direct operations", have also been set up as reference business models for new distributors. The RBU deploys specialised staff to expand point of sales in third – and fourth-tier cities to improve product penetration. The CBU deploys supporting staff to manage retail outlets and distributors to ensure a thorough implementation of Mengniu's policies in its retail channels, so that expenses are utilised in a more specialised and timely manner which enhances the control over channels and retail outlets. In contrast, the establishment of branch company for direct operations enables Mengniu to strengthen its control over brand promotion and product sales channels in core markets in first– and second-tier cities.

In terms of Mengniu's focus on modern sales channels, through standardisation and process management of major hypermarkets, the service and operating efficiency of retail customers can be enhanced. Quarterly business review and planning meetings have been held between headquarters client team and KA teams of key regions, dealer's KA team and retail client headquarters as well as regional trading departments and retail outlets. Modern sales channel retailers has been managed systematically at the levels of headquarters, major regions and retail outlets. Each level is supported by a corresponding service team, resulting in improved communication, service and management quality. The KA management center and the SAP project team have established a database, which enabled KA management personnel to track the latest weekly sales data of retail customer outlets, creating a sophisticated data-based sales management model for Mengniu.

In addition to the establishment of KA business management team, Mengniu has also expanded its customer base and sales reach by providing products only for special channels, such as hotels, catering and aviation.

Branding Strategy

Branding forms the foundation of a business, with quality and safety absolutely essential to win the trust of consumers. Therefore Mengniu has devoted significant energy and resources into activities aimed at securing their confidence in its brands. Towards this end, it has maintained open, transparent and direct communication with consumers in order to further understand their needs and concerns. This effort has also proven to be a key driver for its continuous growth. Mengniu has built an online communication mechanism "Your Question, Our Responsibility", as well as platforms such as Weibo, CS Weibo and WeChat for consumers to ask questions at any time. Besides, Mengniu has also opened its plants to visitors across the country. For instance, through its nationwide promotion "Enjoyable Visits to Green Mengniu", consumers can witness Mengniu's strict supervision of milk sources, quality management, inspection, etc.. These initiatives have helped them better understand how Mengniu has fulfilled its promise, thus increasing their confidence in Mengniu.

Beyond production, Mengniu has also streamlined its product portfolio and optimised its brand structure in response to market demand. By reducing the number of brands and categorising them into star brands, backbone brands, profit contributor brands and opportunity brands respectively, Mengniu can pool more resources to promote its key products, thus boosting the profits with clear brand positioning. Star brands and opportunity brands have posted growth well ahead of the average growth of Mengniu and the market.

In utilising the media for its branding campaigns, in addition to traditional channels including TV, newspapers and magazines, Mengniu has increased the use of digital media, which has effectively increased the return of investment. Currently, Mengniu has over two million followers in total for its WeChat and Weibo accounts. On top of tapping different new social media and mobile network and platforms, Mengniu has also used creative videos for promotion with the aim to increase its branding exposure and reach.

Mengniu *Suan Suan Ru* has become the title sponsor of a popular music reality show *The X Factor* on Hunan Satellite TV in a focused effort to demonstrate its young and energetic branding image. The TV program has enjoyed a high rating during the same time slot in China and every episode has ranked first among the age 12 to 19 audience segment, thereby effectively and precisely targeting the youth market. The Group has captured a 41% share of voice as a result of its 25% share of spending on the title sponsorship, a highly satisfactory return. This superbly executed marketing campaign has boosted brand awareness, enabling *Suan Suan Ru* to win three accolades at the China Advertising Great-wall Awards hosted by China Advertising Association, namely the "2013 Advertising Marketing Communications Award – Gold", the "Interactive Creative Award – Silver" and "Media and Marketing Award – Silver".

Mengniu employed innovative 3D music to portray a unique *Latte* experience by correlating its brand with multi-sensory enjoyment. *Latte* leverages the surround-sound 3D music to stimulate the ears as well as the taste buds of consumers, offering consumers a new sensation far beyond the flat 2D traditional taste and feeling. Since its launch, the 3D music has recorded a high hit rate and has been widely shared by consumers across various social media, bringing consumers superior enjoyment through the superior 3D music experience. This marketing campaign represents another successful example of digital marketing.

E-commerce has experienced substantial uptake in China and online sales has emerged as an important channel. To tap this unprecedented opportunity to expand its customer base and attract young consumers, Mengniu has commenced online sales across a wide range of major e-commerce platforms. These efforts are aimed at further boosting market share of its products, while maximising its value with the lowest operating cost. During the Tmall.com shopping festival of the week of 11 November, also known as Singles' Day, five high-end products, *Milk Deluxe*, *Latte*, *Just Yogurt*, *Awakening Youth* and *Banana Organic Milk* registered an outstanding sales performance at Mengniu's flagship online store. Tmall.com is China's largest B2C integrated online marketplace with more than 400 million buyers.

Management System

Adhering to its Five-Year Strategic Plan and to enhance its competitiveness, Mengniu has applied the world leading SAP system to boost its management capabilities in six aspects – precise marketing and in-depth sales channel management, an integrated management platform for business and finance, a responsive synergetic system for production, supply and demand, integrated quality management and refined quality tracking, rational industrial planning and efficient management on procurement and logistics. The aim is to substantially enhance operating efficiency and cut management costs.

As Mengniu's most comprehensive informationalisation project, the SAP system covers milk sourcing, procurement, planning, production, storage, logistics, sales, sales terminals, marketing, quality and finance. The SAP projects comprise an Enterprise Resource Planning (ERP) System, a Customer Relationship Management (CRM) System, an Advanced Planning Optimisation (APO) System, a Dealer Management System (DMS), a Sales Force Automation (SFA) System, a Transportation Management System (TMS) and a Business Intelligence (BI) System. The projects are being implemented in three stages, with the first phase focusing on the two ERP and CRM sub-projects underway.

The blueprint design of the ERP project has been completed, with a full pilot run scheduled for the first half of 2014. Mengniu aims to unify commands for supply chain management plan, process business information and boost the management capability of an integrated supply chain through the ERP information platform, with a view to balancing resources allocation with markets, factories and ranches as well as monitoring service implementation and supporting subsequent managerial decisions.

Meanwhile, the CRM project has completed the "Purchase-Sale-Stock Collection" for all customers in late 2013 and is now conducting a trial run for "in-depth network management", with the full implementation scheduled for mid-2014. The "Lean Sales Management" system also got underway and is expected to be applied in late 2014. The CRM project is to extend the value chain and supply chain system aiming to strengthen sales channels and market integration. It enhances data analysis, creates synergies and promotes the management capability across various sales levels and sharpens the market competitiveness for Mengniu's products.

FINANCIAL REVIEW

Revenue

Mengniu kept making further adjustments on its internal structure, perfecting its quality management system, extending its sales network and streamlining its product portfolio, with a view to reconstructing its brand credibility and boosting customer loyalty. As the Group has carried out a series of reforms to stimulate organic growth, in addition to the revenue generated since the acquisition of Yashili during the year, the Group's revenue for 2013 grew significantly by 20.4% to RMB43,356.9 million (2012: RMB36,000.0 million). Excluding Yashili, the Group's revenue for 2013 rose by 16.3% to RMB41,857.8 million. The products with a greater revenue contribution were *Milk Deluxe*, *Yoyi C* and *Champion*, while *Milk Deluxe*, *Champion*, *Latte*, *Future Star* and *Fruit Milk Drink* achieved scale of sales and rapid growth, each recording a double-digit growth rate.

Yashili's revenue for the year amounted to RMB3,890.0 million (2012: RMB3,655.1 million), representing a year-on-year increase of 6.4%. Profit attributable to owners of the company for the year amounted to RMB437.6 million (2012: RMB468.5 million).

In August 2013, Yashili was consolidated into Mengniu's financial statements, contributing a revenue of RMB1,499.1 million and a profit of RMB95.3 million to the Group.

Gross Profit

In addition to addressing the increase in raw milk prices, the Group has endeavoured to enhance the quality of milk sources and increase the proportion provided by ranches and scaled farms, while allocating more quality inspection staff and deploying more equipment for quality inspection, which led to rising costs for raw milk and quality control – an inevitable industry trend. Nevertheless, the Group has been proactively grasping the trends of market development. Efforts were made to adjust product portfolio and develop high-end products with higher margins. As a result, the gross profit of the Group increased to RMB11,697.2 million (2012: RMB8,950.0 million), while gross profit margin reached 27.0% (2012: 24.9%), representing an increase of 2.1 percentage points as compared with last year. Excluding Yashili, the Group's gross profit was RMB10,918.4 million, while gross profit margin rose 1.2 percentage points to 26.1% as compared with last year.

Yashili's gross profit for the year amounted to RMB2,080.1 million (2012: RMB1,961.7 million), recording a year-on-year increase of 6.0%.

Operating Expenses

In 2013, the Group modified its strategies on expenditures in response to market conditions. As a result, operating expenses rose to RMB10,134.1 million (2012: RMB7,591.4 million), representing approximately 23.4% (2012: 21.1%) of the Group's revenue. Excluding Yashili, the Group's operating expenses were RMB9,464.1 million, representing 22.6% of the revenue excluding Yashili.

Selling and distribution expenses increased by 31.3% to RMB8,168.2 million (2012: RMB6,222.7 million), and its percentage to the Group's revenue increased to 18.8% (2012: 17.3%). Excluding Yashili, the selling and distribution expenses were RMB7,604.0 million, representing 18.2% of the revenue excluding Yashili, up 0.9 percentage point as compared with last year. The increase was mainly attributed to the expansion of the sales network and a greater investment in sales channels and the increase in sales staff costs.

Meanwhile, the Group's escalated efforts in digital media resulted in an increase in advertising and promotion expenses of 20.0% to RMB2,710.1 million (2012: RMB2,257.6 million), representing 6.3% of the Group's revenue (2012: 6.3%). Excluding Yashili, the Group's advertising and promotion expenses rose by 10.8% to RMB2,502.5 million, representing 6.0% of the revenue excluding Yashili, down 0.3 percentage point as compared with last year.

Administrative and other operating expenses increased by 43.6% to RMB1,965.9 million (2012: RMB1,368.7 million), and its percentage to the revenue increased to 4.5% (2012: 3.8%). Excluding Yashili, the Group's administrative and other operating expenses was RMB1,860.1 million, representing 4.4% of the revenue excluding Yashili, up 0.6 percentage point as compared with last year. The increase was mainly a result of the rise in salaries of management staff, the grant of restricted shares, the increase in taxes and the professional agency fees incurred in relation to mergers and acquisitions.

Profit from Operating Activities and Profit Attributable to the Owners of the Company

Despite the growth in revenue and gross profit was partially offset by the increase in cost and operating expenses, the Group's earnings before interest, taxes, depreciation and amortisation (EBITDA) increased by 27.3% to RMB3,247.4 million (2012: RMB2,550.6 million). The EBITDA margin grew to 7.5% (2012: 7.1%). Excluding Yashili, the Group's EBITDA was RMB3,086.5 million, and the EBITDA margin was up to 7.4%.

Profit attributable to owners of the Company amounted to RMB1,630.9 million (2012: RMB1,303.1 million), representing a growth of 25.2% as compared with last year. Basic earnings per share amounted to RMB0.904 (2012: RMB0.737), representing a year-on-year increase of 22.7%. Excluding Yashili, profit attributable to owners of the Company was up 17.8% to RMB1,535.6 million as compared with last year, and basic earnings per share rose amounted to RMB0.851, representing a year-on-year increase of 15.5%.

Income Tax Expenses

In 2013, the effective income tax rate for the Group was 16.6%, representing a year-on-year increase of 2.4 percentage points over last year. Excluding Yashili, the effective income tax rate rose to 17.0%, representing a year-on-year growth of 2.8 percentage points. The increase in income tax rate was due to the gradual reduction of tax incentives enjoyed by the Group.

Capital Expenditure

As of the end of 2013, the total capital expenditure (CAPEX) of the Group amounted to RMB12,596.5 million (2012: RMB2,263.1 million), a 456.6% increase as compared with last year. Excluding Yashili, the total CAPEX of the Group was RMB12,374.6 million. The CAPEX was mainly used in: land, construction of production plants and procurement of equipment amounting to RMB2,508.1 million; purchase of biological assets amounting to RMB359.0 million and the equity investments expenses amounting to RMB9,729.4 million (among which, RMB2,536.6 million for Modern Dairy and RMB6,795.6 million for Yashili). The Group has adopted a prudent policy in its CAPEX so as to lay a solid foundation for future development.

During the consolidation period of Yashili, its CAPEX amounted to RMB221.9 million, mainly used on the construction of the plant in New Zealand.

Capital Structure, Liquidity and Financial Resource

The Group's net cash inflow from operating activities increased to RMB3,283.7 million (2012: RMB1,881.5 million). The increase was primarily attributable to the tightened credit limit extended to customers in addition to the higher revenue and profit of the Group.

As of 31 December 2013, the Group's net borrowings (cash and bank deposits net of total bank loans and bonds) amounted to RMB4,595.5 million (31 December 2012: net cash of RMB5,178.3 million). Excluding Yashili, the Group's net borrowings was RMB5,204.0 million. The change was primarily attributable to the increase in equity interest in Modern Dairy, the acquisition of equity interest in Yashili and the equity investment in YST Dairy, involving a total cash consideration of approximately RMB9,701.5 million.

As of 21 November 2013, the Group successfully completed the book building for the first offshore issuance of 5-year US$500,000,000 bonds. The proceeds of the bond issue will be fully used to repay a bridge loan incurred due to the acquisition of Yashili. Resulting from the equity investments in Modern Dairy and Yashili, the Group's outstanding bank loans and bonds as at 31 December 2013 surged to RMB11,697.0 million. Excluding Yashili, the Group's outstanding bank loans and bonds amounted to RMB11,495.5 million (31 December 2012: RMB573.8 million).

On 12 February 2014, Mengniu announced to place shares to Danone Group for estimated proceeds of HK$5,153.0 million (approximately US$665.0 million), which would be fully utilised to pay the related outstanding amount of loans for the acquisition of Yashili and other outstanding corporate debts in order to improve Mengniu's capital structure.

The total equity of the Group was RMB18,011.1 million as of 31 December 2013 (31 December 2012: RMB13,121.1 million), while the debt-to-equity ratio (total bank loans and bonds over total equity) was 64.9% (31 December 2012: 4.4%).

The Group's finance costs amounted to RMB160.4 million (2012: RMB39.16 million), accounting for approximately 0.4% of the Group's revenue (2012: 0.1%). Excluding Yashili, the Group's finance costs was RMB150.3 million, representing a 0.4% of the revenue excluding Yashili, up 0.3 percentage point as compared with last year.

Products

As upmarket spending intensifies and diversifies within the PRC, coupled with a shortage of raw milk supply, Mengniu has proactively adjusted its product portfolio to achieve a stable growth of market share for its basic products. At the same time, it has increased the percentage of high-end products and diversified its products. Mengniu has strengthened the yogurt and the milk formula businesses which have enormous potential, while reducing the proportion of products over-relying on raw milk.

Data from market research firm Nielsen reveals that Mengniu's liquid milk and chilled yogurt retained their throne in terms of market share in 2013. During the year, star products, such as *Milk Deluxe*, *Yoyi C* and *Fruit Milk Drink*, achieved substantial increase in sales and continued to be top-sellers while the new product, *Just UHT Yogurt*, was well-received by the market.

Mengniu's businesses are categorised into liquid milk, ice cream, milk formula and other dairy products. The performances during the year are as follows:

Product category	**Financial performance**	**Highlights**
Liquid milk	Revenue amounted to RMB37,902.8 million (2012: RMB32,336.0 million), accounting for 87.4% of Mengniu's total revenue (2012: 89.6%)	
UHT milk	Revenue amounted to RMB22,053.3 million (2012: RMB19,705.5 million), accounting for 58.2% (2012: 60.9%) of the liquid milk segment revenue	– Launch of Mengniu-branded *Prime Ranch Pure Milk* during December in nine provinces, including Shandong, Henan and Jiangsu, with a Quick Response code ("QR code") that enables tracking. The product was available nationwide in February 2014. QR code scanning enables consumers to track milk sources and understand managerial details of ranches, ensuring quality and satisfying consumers' escalating demand for quality – Cooperation with Arla Foods to introduce organic whole milk, low-fat milk and fat-free milk. The flagship store on Tmall.com was established to expand sales channels for e-commerce and facilitate a multi-channel sales model – A packaging upgrade for *Cereal Breakfast Milk* and the launch of *Red Bean and Black Bean Cereal Breakfast Milk* in mid-April. The new package focuses on food ingredients and emphasises the nutritional values, which target young white-collar workers and students in first – to third-tier cities. Sales soared after the packaging upgrade – Full launch of two high-end functional milk products for the elderly, *Strengthener* and *Energiser* under the brand *Awakening Youth*. They address the needs for strong bones and cardiovascular system and advance a young and spirited brand image. Resources were allocated for promotion in key regions. Mengniu co-hosted the "China Bone Health Campaign" with the China Health Promotion Foundation to cultivate the concept of bone health in key cities in the PRC. A year-long promotion stimulated an ongoing growth in market share and sales for *Strengthener* – *Future Star* is made from prime ranch milk sources and meets the needs for four nutritional aspects – outstanding intelligence, strong bones, healthy digestion and balanced diet – for the healthy growth of kids. The product was a popular choice among parents and kids and its market share continued to increase with above-average growth

Product category	Financial performance	Highlights
Milk beverages	Revenue amounted to RMB10,425.5 million (2012: RMB8,038.5 million), accounting for 27.5% (2012: 24.9%) of the liquid milk segment revenue	– A full packaging upgrade for *Latte*. An unprecedented sales growth was recorded on Tmall.com in the shopping campaign during the "Double-11" week, spurring a rapid sales growth for *Latte* for the year – Launch of *Fruit Fiber Suan Suan Ru Nutritional Milk Drink* in early April registering a stable sales performance
Yogurt	Revenue amounted to RMB5,424.0 million (2012: RMB4,592.0 million), accounting for 14.3% (2012: 14.2%) of the liquid milk segment revenue	– Launch of a high-end product *Just Yogurt*, an UHT yogurt, targeting mid to high income consumers in late May. This product is made from quality milk sources and fermented with lactobacillus without additives, artificial colour or preservatives. Incorporating advanced Danish technology ensures the safe preservation of yogurt under room temperature
Ice cream	Revenue amounted to RMB3,023.4 million (2012: RMB3,171.5 million), accounting for 7.0% (2012: 8.8%) of Mengniu's total revenue	– Launch of a new product *Milk Stick* with plain, banana, melon and durian flavours in stylish and attractive packaging that appeals to young consumers – A packaging upgrade of *Deluxe* and launch of *Deluxe Vanilla Ice Cream Sandwich*, the first ice cream sandwich product created in the PRC, grabbing market share in the rapidly developing mid to high-end ice cream market. The product targets female consumers who enjoy a mid to high income and emphasise the quality of life – Launch of *Mood for Green Ice Crystal Cup*, made with pioneering "Ice Crystal" technology in the PRC. The classic product *Green Bean Ice-cream* maintained its sales while a new flavour in condensed milk and red bean, emerged as a new star product

Product category	Financial performance	Highlights
Milk formula	Revenue amounted to RMB2,177.3 million (2012: RMB441.6 million[1]), accounting for 5.0% (2012: 1.2%) of Mengniu's total revenue	– Introduction of ultra-high-end *Baby&Me Organic Infant Milk Formula* from Arla Foods in late April with a 100% natural and organic formula certified by the European Union, Denmark and China – Launch of *Oushi Super Gold Infant Formula*, made from 100% milk imported from Northern Europe with complete source tracking. It contains six ingredients that promote the development of infant's intelligence and health
Other dairy products	Revenue amounted to RMB253.5 million (2012: RMB130.3 million), accounting for 0.6% (2012: 0.4%) of Mengniu's total revenue	– Nationwide launch of the original and strawberry flavoured *Kids Cheese Sticks (Future Star's products)*, which targets kids above three-year-old. It is made from condensed milk essence and is rich in calcium and vitamins – Fermented in each individual cup, fresh cheese *European Fermented Milk* is made from quality fresh milk without any preservatives or artificial colours, thus offering a purity of taste. It was one of the country's best-selling cheese products, accounting for the highest sales volume among Mengniu's cheese products

Mengniu's products are available in four overseas markets, namely Hong Kong, Macau, Mongolia and Singapore. During the year, *Fruit Milk Drink Strawberry* and *Fruit Milk Drink Peach* debuted in these four overseas markets, while *Milk Deluxe* and the plain and aloe flavored *Yoyi C* were launched in Hong Kong with huge success. Currently, Mengniu products cover more than 1,000 points of sale in Hong Kong alone.

PRODUCTION

Mengniu's layout of production capacity is based on market potential and product strategy. As of December 2013, Mengniu has 31 production bases across the country, with a total production capacity of 7.77 million tons (as of December 2012: 7.58 million tons). The enhancement of production capacity was mainly realised through the optimisation of the existing production equipment and technology, as well as the combination of Yashili's capacity.

[1] Included 50% of revenue of the joint venture MENGNIU Arla.

SOCIAL RESPONSIBILITY

As one of the leading dairy manufacturers in China, Mengniu believes in giving to and caring for the community. While focusing on the production, it also put active efforts on fulfilling its corporate social responsibility, particularly evidenced by a few aspects including environmental protection, public activities and joint partnerships.

– **Environmental protection**

In support of resources conservation and sustainable development, Mengniu remains committed to the protection of water resources and recycling. Each of Mengniu's plants is equipped with a sewage treatment facility, which is subject to on-line monitoring. The discharge treatment meets the national grade 1 standards, and is used for the green irrigation. In 2013, the total volume of sewage treatment reached 17.47 million tons. Through full recovery and recycling of reclaimed water, 1.92 million tons of water has been saved annually.

Mengniu also made efforts on implementing the in-depth treatment and reconstruction project relating to Mengniu's high-tech sewage treatment plant. Thanks to the improvement of sewage treatment technology as well as the recycling of water, the operating costs of production reduced. The analysis of water quality, the techniques collection and the verification of the project have been completed on schedule. The construction and renovation of the project would commence in 2014.

Wastes produced in the process of production are mainly renewable and recyclable paper packaging materials, which are recycled and reused upon collection and processing by outsourcing to garbage handling companies. In addition, Mengniu embraced the low-carbon environmental philosophy by participating in a large-scale charity tree-planting activity "Carbon Reduction with Forest Wood". In respect to the construction of sizeable ranches, Mengniu made efforts on conducting biogas power generation and organic fertiliser projects, effective solutions to the cow excrement pollution of the environment. These efforts have been a positive example in the construction of large ranches in China, thereby achieving huge social and economic benefits.

– **Charity events**

While promoting environmental protection, Mengniu also plays an active role in charity activities, which is an important way to contribute to the community. Immediately after the earthquake in Ya'an City, Sichuan Province on 20 April 2013, Mengniu promptly sent a rescue team to the disaster zone providing relief supplies and donated RMB10 million. In response to the earthquake in Dingxi City, Gansu Province, Mengniu formed a rescue team of 35 volunteers who gave their assistance to victims. Building on the experience in disaster relief in the earthquake in Ya'an, the volunteers again provided manpower and supplies to victims in the stricken areas. Moreover, Mengniu has quickly acted and provided donations for disaster relief including the floods in Zhaoyuan County, Heilongjiang Province as well as the typhoon in Zhejiang Province and eastern area of Guangdong.

To give a much-needed boost to the challenging education situation faced by rural teachers and children, Mengniu continued to play the role as a charity partner of the large charity event – the third "Looking for Teachers with the Most Beautiful Hearts in Rural Areas" in 22 provinces across the country with the sincere efforts from all of its staff and regional business partners. This activity was aimed at looking for, recommending and praising outstanding rural teachers. Meanwhile, Mengniu also organised a number of events such as "Have a Lesson in My Home Town", "Happy Gift", "Public Lessons by Teachers in Rural Areas" and "Care from Ten CEOs for Teachers with the Most Beautiful Hearts in Rural Areas".

Mengniu has established the "Blue Sky Green Land Fund", to which Mengniu will make donations as a match of the participation of consumers in its charity activities. All funds are used for the prevention and control of air pollution, as well as the protection of natural habitats and biodiversity. The activities have received strong support from more than 1.5 million consumers. Specifically, in September, Mengniu hosted the "Sweeping Haze Together" charity experience activity, supported by more than 40 volunteers who cleared bird droppings and rubbish in Shanghai Chongming Dongtan National Nature Reserve to protect the wetland. This activity provided in-depth environmental experience and education.

– **Partnerships**

Mengniu integrates the fulfillment of corporate social responsibility into its strategy, operation and management in an effort to encourage various departments including milk sources, R&D, quality, production and marketing to map out their planning for social responsibility. Also, Mengniu prompts its upstream and downstream industry partners to play a more active role in charity events. Collaborating with 58 business partners, Mengniu organised the "Exchange of Calories" running charity event, in which, the calories consumed by volunteers in running were exchanged for gloves. Mengniu together with its partners donated a total of 100,000 pairs of gloves to rural children, and sent an extra 100,000 pairs to various regions across the country, spreading warmth to children in winter. Apart from fulfilling its corporate social responsibility in respect to charity events, Mengniu also bears the responsibility towards the related interested parties. Mengniu remains committed to mitigating the risk exposure of upstream and downstream enterprises by providing financial and technical support to upstream raw milk suppliers and by joining forces with downstream distributors in market research. With this integrated "Cooperation and Development Model" in place, Mengniu can share "each and every drop of happiness" with the relevant interested parties.

Mengniu's consistent efforts in fulfilling its corporate social responsibility have enabled it to significantly elevate its brand image, receiving an overwhelmingly positive response from different sectors of the community. Mengniu was the sole enterprise winning Weibo's "Outstanding Contribution to the Charity for the Year" award. It also garnered several honors, including the "2013 Corporate Social Responsibility Case Award" from People's Daily Online, the "2013 China Business News Good Practice Award of China Corporate Social Responsibility Ranking", as well as the "2013 Top Brand with the Best Social Responsibility Practice" award at the China Business Leaders and Media Leaders Annual Conference.

HUMAN RESOURCES

As at 31 December 2013, the Group employed a total of about 38,000 employees in China and Hong Kong, including around 6,100 from Yashili. Total costs of employees (excluding salaries of directors and senior executives) amounted to approximately RMB2,725.5 million (2012: RMB1,896.6 million). The increase in total cost of employees was mainly due to the rise in the number of employees, average salaries, social security costs as well as the grant of restricted shares.

To achieve Mengniu's Five-Year Strategic Plan and inspire employees to realise their full potential, the Group has put in place a five-tier incentive system, including personal performance incentives, group benefit sharing incentives, group over-turnover incentives, group appraisal incentives and group restricted share award scheme, which are aimed at motivating employees to grow in step with the Group and share the fruits of its success. According to the restricted share award scheme adopted by the Board on 26 March 2013, Mengniu will allocate no more than 5% of the issued share capital for the scheme. The scheme will combine the interests of shareholders, employees and the Group, with common interest in the Group's long-term development.

With the expansion of Mengniu's platform and the addition of more outstanding domestic and international partners, the Group has been focusing on the Five-Year Strategic Plan. To fuel future growth over the longer term, Mengniu is committed to bringing up a new generation of leaders. In respect of human resources planning, the Group has set up a core management team. The senior management team comprises employees with professional know-how, innovation and ambition. Middle-level managers with seasoned experience and distinctive capabilities from various sectors as well as newly-joined staff of Mengniu with lesser experience but higher education are to be grouped into different teams. In addition, Mengniu recruits outstanding graduates every year. The year 2013 marked the inauguration of the campus recruitment program. With the implementation of its human resources plan, Mengniu is taking gradual steps to build up a stronger and more professional team of employees.

PROSPECTS

With the gradual restoration of customers' confidence in the domestic milk formula products, the dairy industry is anticipating exciting opportunities ahead. With the imposition of limitation on infant milk formula purchases around the globe, there is a re-adjustment in the supply-demand structure of China's milk formula market, such that the purchasing sentiment for domestic brands is resuming on a rational basis. Moreover, in light of the determination of the PRC government to restore consumers' confidence in domestic dairy products, we envisage wider policies to further regulate the domestic dairy product market is expected, fuelling the positive development of the industry and presenting massive opportunities for leading players such as Mengniu.

In view of the maturity of the liquid milk market, Mengniu will step up the development of its high potential yogurt and milk formula businesses. According to the Chinese Academy of Social Sciences, the birth rate in the PRC is likely to be buoyed by the relaxation of the family planning policy at a moderate rate of approximately 6.3%, equivalent to the birth of 1 million extra infants annually. This should help drive the demand for the infant milk formula market in the near term. In the long run, Mengniu will be taking steps to adjust its product structure and expand the proportion of the infant milk formula business in line with our overall business strategy.

In 2013, the "metamorphosis" Mengniu set out to achieve was initiating reform, while the "metamorphosis" for 2014 is to be focused on "revolutionary innovation". To this end, Mengniu put forward the four guiding principles: "revolutionary innovation", "strategic integration", "management for efficiency" and "open and transparent communication" to achieve an upgrade in Mengniu's partnerships and continuous professional advancement of managers, thereby realising a "lean management" and enabling our people to be entitled to the five-layer incentive scheme and thus share the benefits of growth.

With ever-changing market conditions, the primary focus for Mengniu is to accomplish "disruptive innovation" in marketing, operational system and product development. In terms of marketing, the seven key factors that Mengniu will be focusing on include the parent brand, growth and profit, geographical division, communication from TV to digital media, an optimal market operation system, innovation and milk sources. It will also maintain close interaction with its consumers, by which its brand value is to be re-defined. As to operational system, Mengniu will adopt an O2O (Online to Offline) model to enhance its marketing efforts. We would fully implement our ERP system in pursuit of greater efficiency in our integrated supply chain management. In terms of product development, Mengniu would strike a balance between seeking gross profit margins and sensitivity to raw milk sources. Specifically, it intends to develop more products less susceptible to milk source issues, e.g., yogurt and nutrition businesses, along with a greater emphasis on fashionable and diversified product packaging.

With a number of strategic co-operation projects implementing in 2013, greater effort would be dedicated to strategic integration in 2014, which includes the exploration of a wider range of synergies with Yashili, the formulation of a five-year strategic plan, the strengthening of the professional work force, and the initiation of organisational reform. Meanwhile, Mengniu would also work with Danone Group (through the joint venture company) to optimise its brand and product mix, exerting stronger promotional efforts on *Yoyi C*, *Champion, BIO* and other brands with higher profitability and brighter growth prospects, as well as to further enhance its operating efficiency.

Technological progress and technical upgrade are of fundamental importance to the long-term development of an enterprise. Mengniu will cement stronger technical co-operation with Arla Foods, an international partner to introduce streamlined management in production and operation, implement ranch quality management system, and develop new testing techniques on raw milk. These three research projects are expected to start in 2014.

Mengniu will continue to extend its scope of sophisticated management through the implementation of the SAP system and working closely with its strategic partners to achieve management efficiency. As for internal communication, Mengniu upholds the values of "sunshine, nobility, responsibility and innovation". We strive to realise "open and transparent communication" by building up a synergetic cross-system and cross-regional corporate culture, so as to raise the time-to-market capability of its organisational structure.

Milk sources development presents a major challenge for the industry. Mengniu remains focused on strengthening its leading position in milk sources. While assuring the quality of milk sources, it is also working on the regional development of milk sources, shifting from a highly diversified distribution to a more focused network, mainly in the northeastern, northern and northwestern areas of China where there is a relatively low downstream processing capacity but raw milk quality is relatively high, and which features lower costs and high production volume. In essence, Mengniu intends to assist third party dairy farmers to establish small to medium-sized ranches and scaled farms with not more than 1,000 milking cows, thereby further diversifying the channels for milk sources, improving the milk source structure and reducing the overall cost of raw milk.

Mengniu will actively explore new distribution channels. It will prepare sales personnel from regional offices as well as from distributors to grasp a better understanding of the new sales channels through operational standardisation in our principal customer procedures and systems, so that a better sales performance, a stronger capability in execution and innovation may all be realised.

Mengniu firmly believes that the crucial keys to resume consumers' confidence in domestic dairy products are to provide a guarantee on product quality and safety, as well as to put in place an open and transparent operation model that offers consumers a fabulous experience and assurance of quality. Mengniu resolves to strive its utmost to make a difference and take all necessary action, in an effort to become the most professional dairy enterprise in China and remain focused on delivering products of superior quality, so as to turn Mengniu into a century-old 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 of 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.

Throughout the year, the Board has reviewed the Company's corporate governance practices and is satisfied that the Company has been in compliance with all applicable code provisions of the CG Code, except that

(i) ten Directors (2 executive Directors, 5 non-executive Directors (including the Chairman) and 3 independent non-executive Directors) were unable to attend the annual general meeting of the Company held on 7 June 2013; and

(ii) fifteen Directors (3 executive Directors, 6 non-executive Directors and 6 independent non-executive Directors) were unable to attend the extraordinary general meeting held on 16 July 2013,

due to unavoidable business engagements and other commitments outside Hong Kong.

SECURITIES TRANSACTIONS OF DIRECTORS

The Company has adopted the Model Code for Securities Transactions by Directors of Listed Companies (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 year ended 31 December 2013.

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 year ended 31 December 2013, except that the trustee of the Restricted Share Award Scheme, pursuant to the rules of the Scheme, purchased on the open market a total of 16,215,000 the Company's listed securities at a total consideration at about RMB394.1 million.

AUDIT COMMITTEE

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, internal control and financial reporting matters, including the review of the Group's financial statements for the year ended 31 December 2013.

SCOPE OF WORK OF ERNST & YOUNG

The financial information in respect of the preliminary announcement of the Group's results for the year ended 31 December 2013 have been agreed by the Group's auditors, Ernst & Young, to the amounts set out in the Group's draft consolidated financial statements for the year. The work performed by Ernst & Young in this respect did not constitute an assurance engagement in accordance with Hong Kong Standards on Auditing, Hong Kong Standards on Review Engagements or Hong Kong Standards on Assurance Engagements issued by the Hong Kong Institute of Certified Public Accountants and consequently no assurance has been expressed by Ernst & Young on the preliminary announcement.

PROPOSED FINAL DIVIDEND

The Board has recommended the payment of a final dividend of RMB0.2 (2012: RMB0.16) per ordinary share for the year ended 31 December 2013. Upon shareholders' approval at the forthcoming AGM, the proposed final dividend will be paid on or about Monday, 23 June 2014 to shareholders whose names appear on the register of members of the Company on Thursday, 12 June 2014.

CLOSURE OF REGISTER OF MEMBERS

The register of members will be closed (i) from Wednesday, 4 June 2014 to Friday, 6 June 2014, both days inclusive, for determining shareholders' eligibility to attend and vote at the AGM, and (ii) on Thursday, 12 June 2014, for determining shareholders' entitlement to the proposed final dividend, during such periods no transfer of shares will be registered.

In order to qualify for attending and voting at the forthcoming AGM of the Company to be held on Friday, 6 June 2014, all transfers, accompanied by the relevant share certificates must be lodged with the Company's branch share registrar, Computershare Hong Kong Investor Services Limited, at Shops 1712-16, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, for registration no later than 4:30 p.m. on Tuesday, 3 June 2014.

In order to qualify for the proposed final dividend, all transfers, accompanied by the relevant share certificates must be lodged with the Company's branch share registrar, Computershare Hong Kong Investor Services Limited, at Shops 1712-16, 17th Floor, Hopewell Centre,183 Queen's Road East, Wanchai, Hong Kong, for registration no later than 4:30 p.m. on Wednesday, 11 June 2014.

PUBLICATION OF ANNUAL RESULTS AND ANNUAL REPORT

This 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 annual 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 are Ms. Sun Yiping, Mr. Bai Ying and Mr. Wu Jingshui. The Non-executive Directors are Mr. Ning Gaoning, Mr. Yu Xubo, Mr. Niu Gensheng, Mr. Ma Jianping, Mr. Finn S. Hansen, Ms. Liu Ding and Mr. Christian Neu. The Independent Non-executive Directors are Mr. Jiao Shuge (alias Jiao Zhen), Mr. Julian Juul Wolhardt, Mr. Liu Fuchun, Mr. Zhang Xiaoya, Mr. Andrew Y. Yan and Mr. Wu Kwok Keung Andrew.

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
Sun Yiping
Chief Executive Officer and Executive Director

Hong Kong, 25 March 2014