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## THIS CIRCULAR IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION

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

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

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### **YuanShengTai Dairy Farm Limited**

**原生态牧业有限公司**

*(Incorporated in Bermuda with limited liability)*

**(Stock Code: 1431)**

### **CONTINUING CONNECTED TRANSACTIONS: 2017 FEIHE MASTER AGREEMENT**

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



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A letter from the Board is set out on pages 5 to 17 of this circular. A letter from the Independent Board Committee containing its recommendation to the Independent Shareholders is set out on pages 18 to 19 of this circular. A letter from Gram Capital, the Independent Financial Adviser, containing its advice to the Independent Board Committee and the Independent Shareholders is set out on pages 20 to 34 of this circular.

A notice convening the SGM of YuanShengTai Dairy Farm Limited to be held at Jasmine II, Rosedale Hotel & Suites, Beijing, 8 Jiang Tai Road West, Chaoyang District, Beijing, the PRC on Monday, 17 July 2017 at 10:00 a.m. is set out on pages 38 to 39 of this circular. Whether or not you are able to attend and vote at the meeting, you are requested to complete the accompanying form of proxy in accordance with the instructions printed thereon and return it to the branch share registrar and transfer office of the Company in Hong Kong, Computershare Hong Kong Investor Services Limited, 17M Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, as soon as possible and in any event no later than 48 hours before the time appointed for the holding of the meeting (i.e. no later than 10:00 a.m. (Hong Kong time) on Saturday, 15 July 2017) or any adjournment thereof. Completion and return of the form of proxy as instructed will not preclude you from subsequently attending and voting at the meeting or any adjourned meeting if you so wish.

30 June 2017

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*This circular is prepared in both English and Chinese. In the event of inconsistency, the English text of this circular will prevail.*

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## DEFINITIONS

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*In this circular, unless the context otherwise requires, the following expressions have the following meanings:*

“2013 Feihe Master Agreement”	a master agreement dated 1 November 2013 entered into between (a) Ruixinda and Ruixincheng on the one part and (b) Feihe Dairy HLJ (for itself and on behalf of its subsidiaries) in relation to the supply of raw milk and for the purpose of complying with the then Rule 14A.35 of the Listing Rules
“2014 Announcement”	announcement of the Company dated 31 October 2014 in relation to, among others, the revision of the annual caps for the transactions contemplated under the 2013 Feihe Master Agreement
“2014 Circular”	circular of the Company dated 21 November 2014 in relation to, among others, the revision of the annual caps for the transactions contemplated under the 2013 Feihe Master Agreement
“2015 Announcement”	announcement of the Company dated 14 December 2015 in relation to, among others, the renewal of the 2013 Feihe Master Agreement and the proposed annual caps for the transactions contemplated under the 2015 Feihe Master Agreement
“2015 Circular”	circular of the Company dated 31 December 2015 in relation to, among others, the renewal of the 2013 Feihe Master Agreement and the proposed annual caps for the transactions contemplated under the 2015 Feihe Master Agreement
2015 Feihe Master Agreement”	a master agreement dated 14 December 2015 entered into between (a) Ruixinda and Ruixincheng (for themselves and on behalf of their subsidiaries) on the one part and (b) Feihe Dairy HLJ and Feihe Gannan (for themselves and on behalf of their subsidiaries) in relation to the supply of raw milk and for the purpose of complying with Rules 14A.51 and 14A.52 of the Listing Rules
“2017 Feihe Master Agreement”	a master agreement dated 12 May 2017 entered into between (a) the Company (for itself and on behalf of its subsidiaries) and (b) China Feihe (for itself and on behalf of its subsidiaries) in relation to the supply of raw milk

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## DEFINITIONS

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“associate(s)”	has the same meaning ascribed to it under the Listing Rules
“Board”	board of Directors of the Company
“China Feihe”	China Feihe Limited (中國飛鶴有限公司) (formerly known as Platinum Infant Formula Holding Limited), an exempted company incorporated with limited liability in the Cayman Islands on 26 October 2012
“Company”	YuanShengTai Dairy Farm Limited (原生態牧業有限公司), an exempted company incorporated with limited liability under Bermuda Law on 1 May 2012, the ordinary shares of which are listed on the Main Board of the Stock Exchange
“Commencement Date”	the date on which the condition precedent to the 2017 Feihe Master Agreement is satisfied
“connected person”	has the same meaning ascribed to it under the Listing Rules
“Director(s)”	director(s) of the Company
“Feihe Dairy Group”	the group of companies comprising China Feihe and its subsidiaries, including Feihe Dairy International and Feihe Dairy HLJ, being one of our customers, and an Independent Third Party (but deemed by the Stock Exchange to be our connected person after Listing for the purpose of the Listing Rules)
“Feihe Dairy HLJ”	Heilongjiang Feihe Dairy Co., Ltd.* (黑龍江飛鶴乳業有限公司), a company incorporated in the PRC, which is a wholly owned subsidiary of China Feihe, an Independent Third Party and also a former owner of YST Heping and Ruixinda Gannan
“Feihe Dairy International”	Feihe International, Inc., currently known as Flying Crane International Inc., an Independent Third Party and a company incorporated in the United States, whose securities were previously listed on the New York Stock Exchange
“Feihe Gannan”	Feihe (Gannan) Dairy Farm Limited* (飛鶴(甘南)乳品有限公司), a company incorporated in the PRC, which is a member of Feihe Dairy Group

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## DEFINITIONS

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“Feihe Master Agreements”	collectively, the 2013 Feihe Master Agreement and the 2015 Feihe Master Agreement
“Gram Capital” or “Independent Financial Adviser”	Gram Capital Limited, a licensed corporation to carry out Type 6 (advising on corporate finance) regulated activity under the SFO, being the independent financial adviser to the Independent Board Committee and the Independent Shareholders in respect of the 2017 Feihe Master Agreement
“Group”	the Company together with its subsidiaries
“HK\$”	Hong Kong dollars, the lawful currency of Hong Kong
“Hong Kong”	Hong Kong Special Administrative Region of the PRC
“Independent Board Committee”	the independent board committee of the Company formed to consider the transactions contemplated under the 2017 Feihe Master Agreement and the proposed annual caps relating thereto
“Independent Third Parties”	an individual(s) or a company(ies) who or which is/are not connected (within the meaning of the Listing Rules) with any Directors, chief executive or substantial Shareholders (within the meaning of the Listing Rules) of the Company, its subsidiaries or any of their respective associates
“Independent Shareholders”	Shareholders who are not required to abstain from voting at the SGM to approve the continuing connected transactions
“Indicative Price”	the latest indicative milk price published quarterly by the Heilongjiang Animal Husbandry & Veterinary Bureau (黑龍江省牧獸醫局)
“Latest Practicable Date”	28 June 2017, being the latest practicable date prior to the printing of this circular for ascertaining certain information in this circular
“Listing Date”	26 November 2013, being the date where dealings in the Shares first commence on the Main Board of the Stock Exchange
“Listing Rules”	Rules Governing the Listing of Securities on the Stock Exchange
“May Announcement”	the announcement of the Company dated 12 May 2017 on (among other matters) the entering into of the 2017 Feihe Master Agreement

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## DEFINITIONS

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“PRC”	the People’s Republic of China, which for the purposes of this circular only, excludes Hong Kong, Macao Special Administrative Region and Taiwan
“Prospectus”	prospectus of the Company dated 14 November 2013
“Ruixincheng”	Harbin Ruixincheng Commercial Trade Co., Ltd.* (哈爾濱市瑞信誠商貿有限公司), a wholly foreign owned enterprise incorporated in the PRC on 3 May 2013 and an indirect wholly owned subsidiary of the Company
“Ruixinda”	Harbin Ruixinda Dairy Farming Co., Ltd.* (哈爾濱市瑞信達牧業有限公司), a wholly foreign owned enterprise incorporated in the PRC on 9 December 2010 and an indirect wholly owned subsidiary of the Company
“Ruixinda Gannan”	Heilongjiang Gannan Ruixinda Dairy Farming Co., Ltd.* (黑龍江甘南瑞信達原生態牧業有限公司), a company incorporated in the PRC on 9 July 2007 and since September 2011, an indirect wholly owned subsidiary of the Company
“SFO”	Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong)
“SGM”	a special general meeting of the Company to be convened to consider and approve the transactions contemplated under the 2017 Feihe Master Agreement and the proposed annual caps relating thereto
“Shareholder(s)”	registered holder(s) of ordinary share(s) of HK\$0.01 each in the capital of the Company
“Stock Exchange”	The Stock Exchange of Hong Kong Limited
“subsidiary(ies)”	has the same meaning ascribed to it under the Listing Rules
“YST Heping”	Heilongjiang Kedong Heping YuanShengTai Dairy Farming Co., Ltd.* (黑龍江克東和平原生態牧業有限公司), a company incorporated in the PRC on 3 July 2007 that became an indirect wholly owned subsidiary of the Company in September 2011, and which currently operates Kedong Oumei Farm

\* For identification purposes only

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## LETTER FROM THE BOARD

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### YuanShengTai Dairy Farm Limited

原生態牧業有限公司

(Incorporated in Bermuda with limited liability)

(Stock Code: 1431)

*Executive Directors:*

Mr. Zhao Hongliang (趙洪亮)  
Mr. Wang Shaogang (王紹崗)  
Mr. Fu Wenguo (付文國)  
Mr. Chen Xiangqing (陳祥慶)

*Non-executive Director:*

Mr. Lau Ho Fung (劉浩峰)

*Independent non-executive Directors:*

Mr. Wu Chi Keung (胡志強)  
Mr. Zhang Yuezhou (張月周)  
Mr. Zhu Zhanbo (朱戰波)

*Registered office:*

Clarendon House  
2 Church Street  
Hamilton HM 11  
Bermuda

*Head office and Principal Place  
of Business in the PRC:*

Qingxiang Street  
Kedong, Qiqihar  
Heilongjiang Province  
PRC

*Principal place of business  
in Hong Kong:*

31/F, 148 Electric Road  
North Point  
Hong Kong

30 June 2017

*To the Shareholders*

Dear Sir or Madam,

### CONTINUING CONNECTED TRANSACTIONS: 2017 FEIHE MASTER AGREEMENT

#### INTRODUCTION

Reference is made to the Prospectus, the 2014 Announcement, the 2014 Circular, the 2015 Announcement, the 2015 Circular and the May Announcement in relation to, among other matters, the continuing connected transactions under the Feihe Master Agreements and the 2017 Feihe Master Agreement.

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## LETTER FROM THE BOARD

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The Group has, since 1 November 2013, been selling raw milk to Feihe Dairy Group pursuant to the Feihe Master Agreements. The Board is pleased to announce that on 12 May 2017 (after trading hours), the Company entered into the 2017 Feihe Master Agreement with China Feihe, a member of Feihe Dairy Group, to confirm the priority arrangement of the Group's supply of raw milk to Feihe Dairy Group for a term commencing from the Commencement Date and ending on 31 December 2019 subject to the terms and conditions contained therein.

As mentioned in the May Announcement, on 12 May 2017 (after trading hours), the 2017 Feihe Master Agreement was entered into to confirm the priority arrangement of the Group's supply of raw milk to Feihe Dairy Group for a term commencing from the Commencement Date and ending on 31 December 2019 subject to the terms and conditions contained therein.

The transactions contemplated under the 2017 Feihe Master Agreement constitute continuing connected transactions of the Company, and are subject to the reporting, announcement, annual review and independent shareholders' approval requirements under Chapter 14A of the Listing Rules.

The purpose of this circular is to provide you with (i) the letter from the Board containing further information on the 2017 Feihe Master Agreement, the transactions contemplated thereunder and the proposed annual caps relating thereto, (ii) the letter of recommendation from the Independent Board Committee to the Independent Shareholders, (iii) the letter of advice from Gram Capital, and (iv) the notice convening the SGM and the proxy form and (v) other information as required under the Listing Rules.

### PRINCIPAL TERMS OF THE 2017 FEIHE MASTER AGREEMENT

On 12 May 2017 (after trading hours), the 2017 Feihe Master Agreement was entered into between the Company and China Feihe (in their respective capacity as stated below) to confirm the priority arrangement of the Group's supply of raw milk to Feihe Dairy Group.

The principal terms of the 2017 Feihe Master Agreement are summarised as follows:

Date: 12 May 2017 (after trading hours)

Parties: (a) the Company (for itself and on behalf of its subsidiaries); and  
(b) China Feihe (for itself and on behalf of its subsidiaries).

Contract period: The initial term of the 2017 Feihe Master Agreement shall commence from the Commencement Date and shall end on 31 December 2019. The 2017 Feihe Master Agreement may be extended for a period of three years after the expiry of the initial term, subject to approval of such extension and the transactions contemplated thereunder (including the related annual caps) by Independent Shareholders (if required) in accordance with the Listing Rules.



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## LETTER FROM THE BOARD

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- Condition precedent: the 2017 Feihe Master Agreement shall become effective upon the approval of the 2017 Feihe Master Agreement and the transactions contemplated thereunder (including the proposed annual caps relating thereto) by the Independent Shareholders in accordance with the provisions of the Listing Rules. Upon the satisfaction of the condition precedent, the 2017 Feihe Master Agreement will supersede the 2015 Feihe Master Agreement.
- Subject matter: Supply of raw milk by the Group to Feihe Dairy Group.
- Pricing term: For each calendar year during the term of the 2017 Feihe Master Agreement, the Group and Feihe Dairy Group will enter into an annual sales contract specifying, among others, the pricing mechanism, the quantity and quality of raw milk expected to be purchased by Feihe Dairy Group during the calendar year and payment terms. The unit selling price of raw milk generally comprises two elements, being (i) the unit base price; and (ii) certain price adjustment factors including, among others, the microbe count, the level of protein content and fat content and the freezing point of raw milk. The unit selling price of raw milk will be negotiated by the parties on arm's length basis and in good faith with reference to the Indicative Price, the aforesaid adjustment factors and the prevailing market prices offered by the Group to its Independent Third Parties customers for products of similar quality. The terms and purchase prices offered by the Group to Feihe Dairy Group shall be no more favourable than those available to other Independent Third Parties customers.
- Priority: In the event that the Group receives purchase orders from Feihe Dairy Group and other Independent Third Party customers concurrently, the Group shall give priority to Feihe Dairy Group for purchase of raw milk on terms and conditions no less favourable to the Group than that offered by the other Independent Third Party customers.
- Payment term: Generally, to be settled on accrual basis, with a credit term of no more than one month, during which no interest will accrue.
- Early termination: Both parties may, at any time during the continuance of the 2017 Feihe Master Agreement, give the other not less than three months' prior written notice to terminate the 2017 Feihe Master Agreement.

### **Pricing method and procedures**

Under the 2017 Feihe Master Agreement, the Group will, by the end of each calendar year during the term, enter into an annual sales contract agreement ("**Sales Contract**") with the Feihe Dairy Group to agree on, among others, the pricing mechanism of raw milk for the next calendar year.

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## LETTER FROM THE BOARD

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The unit selling price for the raw milk sold by the Group is determined by the formula below:

$$\begin{array}{rcccl} \text{Unit selling price of} & & \text{Base price of} & & \text{Adjustments taking into account} \\ \text{raw milk} & = & \text{raw milk (Note 1)} & + & \text{certain safety} \\ & & & & \text{and quality standards (Note 2)} \end{array}$$

*Notes:*

1. In determining the base price of raw milk, the parties to the Sales Contract take into account the Indicative Price published quarterly by the Heilongjiang Animal Husbandry & Veterinary Bureau (黑龍江省畜牧獸醫局) at its website (<http://www.hljxm.gov.cn>). According to the information on such website, the Indicative Price is determined through cost accounting and consultation with dairy farms and dairy products processing enterprises in the PRC.
2. The adjustment factors included, among others, the microbe count, the level of protein content and fat content and the freezing point of raw milk.

The Group's pricing mechanism with its customers (including Feihe Dairy Group and other Independent Third Party customers of the Group) are generally the same, and therefore the selling price of the raw milk contemplated under the 2017 Feihe Master Agreement would be comparable to that of the other Independent Third Party customers of the Group.

In order to ensure that the terms of sales of raw milk to Feihe Dairy Group (including the unit selling price) would be on normal commercial terms or on terms no less favourable to the Group than those offered to Independent Third Party customers, the Group has adopted the following pricing procedures:

- (1) the Group will from time to time check the latest Indicative Price;
- (2) due to the super premium quality of the Group's raw milk and the resulting demand from the Group's customers for the production of their high-end dairy products, the Group has been able to charge raw milk prices that are higher than the Indicative Price. In determining the unit base price of the raw milk to be sold, the Group will take into account the correlation between and trends of the historical and latest Indicative Prices and unit base prices of raw milk to the Feihe Dairy Group and the Group's other Independent Third Party customers;
- (3) the Group will check with laboratories of the Group to ascertain the actual safety and quality standard of the raw milk of the Group to be sold, such as the microbe count, the level of protein content and fat content and the freezing point of raw milk. In determining the extent of adjustment to the unit base price attributable to these adjustment factors, the Group will take into account the correlation between and trends of the historical selling prices of raw milk of comparable safety and quality standard to the Feihe Dairy Group and the Group's other Independent Third Party customers;
- (4) similar to other customers of the Group, Feihe Dairy Group may, from time to time after noting any change in the market conditions and the demand and supply of raw milk, issue a price adjustment notice to the sales department of the Group to request for adjustment to the unit selling price of raw milk. Upon receiving such notice, the sales department of the Group shall seek approval from both of the vice president in charge and the general manager of the Group for the relevant price adjustment. For the purpose of determining whether the price

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## LETTER FROM THE BOARD

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adjustment request is justifiable, the vice president in charge and the general manager of the Group, who are experienced in the dairy farming industry, will, among others, (i) take into account the correlation between and trends of the historical and latest Indicative Prices and selling prices of raw milk to the Feihe Dairy Group and Independent Third Party customers; and (ii) check with laboratories of the Group to ascertain the actual quality of the raw milk of the Group to be supplied, and will take into account the correlation between and trends of the historical selling prices of raw milk of comparable safety and quality standard to the Feihe Dairy Group and the Group's other Independent Third Party customers. Subject to obtaining of such approval, the price of the raw milk sold by the Group to Feihe Dairy Group may be adjusted.

Apart from the price adjustment controls as stated above, designated members of the Group's senior management, namely assistant manager in charge of sales department and general manager, will (i) from time to time review the raw milk price agreed between the Group and Feihe Dairy Group, and compare it with the raw milk prices (of similar quality and during the same period of time) being agreed between the Group and other Independent Third Party customers, and (ii) review other trading terms of purchase orders received from Feihe Dairy Group and other Independent Third Party customers, to ensure that (a) the unit selling prices of raw milk for all of the Group's customers remain comparable, (b) other trading terms offered by Feihe Dairy Group, such as base price, adjustment factor, payment term and driving distance, are no less favourable to the Group than that offered by the other Independent Third Party customers; and (c) the contemplated transactions between the Feihe Dairy Group and our Group are conducted on normal commercial terms.

Taking into account that (i) the Group's pricing mechanism with its customers (including Feihe Dairy Group and other Independent Third Party customers of the Group) are generally the same, and that the selling price of the raw milk contemplated under the 2017 Feihe Master Agreement would be comparable to that of the other Independent Third Party customers of the Group; and (ii) the Group's policy on review of raw milk prices agreed between the Group and its customers (including Feihe Dairy Group) as mentioned above, the Directors consider such pricing mechanism will be able to ensure the transactions contemplated under the 2017 Feihe Master Agreement be conducted on normal commercial terms or on terms no less favourable to the Company than terms available to Independent Third Parties.

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## LETTER FROM THE BOARD

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### Proposed new annual caps

The initial annual caps in respect of the transactions contemplated under the 2013 Feihe Master Agreement for each of the three years ending 31 December 2015 was, as disclosed in the Prospectus, RMB320 million, RMB520 million and RMB660 million, respectively. On 8 December 2014, the revision of the annual caps for each of the two years ending 31 December 2015 was approved by the then Independent Shareholders at the Company's special general meeting to RMB660 million and RMB838 million, respectively. As disclosed in the 2015 Announcement, the annual caps in respect of the transactions contemplated under the 2015 Feihe Master Agreement for each of the three years ending 31 December 2018 was RMB766 million, RMB881 million and RMB970 million, respectively.

The historical transaction amount in respect of the transactions contemplated under the Feihe Master Arrangements for each of the four years ended 31 December 2016 was approximately RMB319 million, RMB606 million, RMB441 million and RMB456 million, respectively.

The following table sets out the historical annual caps and the historical transaction amount in respect of the transactions contemplated under the Feihe Master Agreements for each of the three years ended 31 December 2016:

<b>Year ended 31 December</b>	<b>Historical annual caps (RMB million)</b>	<b>Historical transaction amount (RMB million)</b>	<b>% of total revenue</b>	<b>Utilisation rate of historical annual caps (%) (RMB million)</b>
2014	660	606	52.1%	91.8%
2015	838	441	42.7%	52.6%
2016	766	456	44.3%	59.5%

The differences between the historical annual caps and the historical transaction amount for each of the two years ended 31 December 2016 were mainly due to the lower-than-expected market price of raw milk and sales volume. For the two years ended 31 December 2016, market price of raw milk was 13.4% and 16.9% lower than initially expected, respectively. During the same periods, sales volume of raw milk sold to Feihe Dairy Group represented 59.5% and 71.5%, respectively of the estimated quantities of sales volume of raw milk under the 2015 Feihe Master Agreement. The business environment for China's dairy market was unfavourable in 2015 and 2016. During this period, volume of imported milk powder kept rising which had exerted pressure on the domestic milk market, resulting in an oversupply of raw milk.

As far as the Directors are aware, the annual caps in respect of the transactions contemplated under the 2015 Feihe Master Agreement for the year ending 31 December 2017 has not been exceeded as at the Latest Practicable Date.

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## LETTER FROM THE BOARD

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The following table sets out the proposed annual caps in respect of the transactions contemplated under the 2017 Feihe Master Agreement for each of the three years ending 31 December 2019:

<b>Year ending 31 December</b>	<b>Annual caps for the sale volume of raw milk to Feihe Dairy Group pursuant to the 2017 Feihe Master Agreement (RMB million)</b>
2017	812
2018	902
2019	1,015

The proposed new annual caps in respect of the transactions contemplated under the 2017 Feihe Master Agreement have been determined with reference to:

- (a) the historical transaction amount and sales volume in respect of the sales of raw milk contemplated under the 2015 Feihe Master Agreement for the year ended 31 December 2016;
- (b) the projected quantities of sales volume of raw milk by the Group to the Feihe Dairy Group for the three years ending 31 December 2019 (taking into account the Group's expansion plan for raw milk production and the expansion production plan of Feihe Dairy Group). The management of Feihe Dairy Group expects the production of infant formula products to increase significantly in the year ending 31 December 2017. As such, the volume of raw milk to be sold to Feihe Dairy Group is expected to increase accordingly;
- (c) the prospect of the PRC dairy industry following the introduction of the two-child policy by the PRC government lately;
- (d) the prevailing market price of raw milk which has been relatively stable; and
- (e) a buffer of 10% to cover any unforeseen circumstances, for instance, the unexpected increment of the market price of raw milk, the inflation rate in the PRC and unexpected substantial increase in demand of raw milk by the Feihe Dairy Group.

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## LETTER FROM THE BOARD

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### REASONS FOR AND BENEFITS OF THE CONTINUING CONNECTED TRANSACTIONS

Feihe Dairy Group was one of the Group's three largest customers for each of four years ended 31 December 2016. The three largest customers accounted for 97.2% of the Group's total revenue for the year ended 31 December 2016. The Board believes the sales of raw milk to the Feihe Dairy Group is important to the business of the Group. It is expected that the long term and continuing supply of raw milk products to the Feihe Dairy Group will further enhance the stability of the Group's customer base and ensure future demand for the Group's raw milk.

The proposed grant of priority in favour of the Feihe Dairy Group in the supply of raw milk (the "**Priority Rights**") and the extension of the existing term of the 2015 Feihe Master Agreement to beyond 31 December 2018 were initially proposed and requested by the Feihe Dairy Group. So far as the Directors understand from the management of Feihe Dairy Group, it is the intention of Feihe Dairy Group to obtain the Priority Rights with the extended term so as to facilitate its formulation of medium-term business plan for production and sale of infant formula products. By entering into the 2017 Feihe Master Agreement for the grant of the Priority Right and extending the term to beyond 2018, the Group will be able to further reinforce the business relationship with Feihe Dairy Group. Besides, the production facilities of Feihe Dairy Group in Heilongjiang province, which are within 50 km of the Group's farms in the area, are in closer proximity than that of the other major customers of the Group which are located more than 100 km from the Group's farms in the area. As such, the Group can save more transportation costs by supplying raw milk to the Feihe Dairy Group even if these other major customers offer to purchase the Group's raw milk on the same terms and conditions as that offered by the Feihe Dairy Group.

In addition, the management team of the Group believes that the grant of the Priority Rights will not jeopardize the interests of other customers and the Group, as the Group has sufficient production capacity and raw milk supply to meet the expected demands of other customers. As at 31 December 2016, the Group had seven farms in the PRC with the actual designed capacity of 90,000 heads of dairy cows. The total number of dairy cow in the Group's dairy farms was 54,749, 26,689 of which were matured milkable cows with an average annual milk yield per cow of about 10 tons during the year. By strategically increasing the number of matured milkable cows, improving the operational efficiency of the farms and feeding formula for the cow, and optimizing the age structure of herds and herd structure, the Group can further improve the overall milk yield and the average milk yield per cow so as to cater for the market demand of the Group's raw milk. While the grant of Priority Right encourages competitions among the Group's customers in offering the best purchase price to the Group in order to secure supply of raw milk by the Group, particularly when there is a strong demand or insufficient supply of super premium raw milk in the market, the Priority Right does not preclude the Group from supplying its raw milk to its other customers on less competitive terms for so long as the Group has sufficient raw milk to meet the demand of its other customers. Besides, the Group is capable of increasing its milk yield for capturing business opportunities arising from any expected increase in demand if it is commercially beneficial for the Group to do so. On the above basis, the Directors consider that the grant of the Priority Right would not jeopardize the interests of the other customers and the Group.

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## LETTER FROM THE BOARD

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The Directors consider that, by entering into the 2017 Feihe Master Agreement, the Group is not unduly reliant on Feihe Dairy Group for the following reasons:

**(i) Mutual beneficial and complementary relationship**

While Feihe Dairy Group is one of the three largest customers of the Group, the Group is the largest supplier of raw milk for Feihe Dairy Group. Based on information provided by Feihe Dairy Group, for the three years ended 31 December 2014, 2015 and 2016, purchases from the Group accounted for approximately 96.3%, 77.7% and 80.1% of Feihe Dairy Group's raw milk procurement costs, respectively. The Directors believe that the Group's business relationship with Feihe Dairy Group is mutually beneficial to both the Group and Feihe Dairy Group. It is beneficial to the Group in securing stable and long-term demand from Feihe Dairy Group, a high-quality customer and leading player in China's infant formula industry. It is also strategically important to Feihe Dairy Group by ensuring a source of high-quality raw milk for producing high-end infant formula products. In addition, the Group has maintained stable and long-term business relationship with Feihe Dairy Group, and Feihe Dairy Group has been one of the Group's three largest customers since the Group's establishment. The Directors consider that the Group would be able to maintain such stable and long-term business relationship with Feihe Dairy Group, and the risk of Feihe Dairy Group ceasing to procure raw milk from the Group is unlikely.

**(ii) Solid business relationship with other major customers**

Since the Group's establishment, the Group has also established and maintained long-term relationships with other leading dairy manufacturers in the PRC, including Mengniu Group and Bright Dairy Group. During each of the three years ended 31 December 2016, the sales volume of raw milk by the Group to its other customers (other than Feihe Dairy Group) amounted to approximately 110,300 tons, 135,700 tons and 144,200 tons, and accounted for approximately 47.9%, 58.2% and 55.7% of the total sales volume of raw milk by the Group during the corresponding period, respectively. Among these customers, the revenue generated from the largest customer of the Group, which was an Independent Third Party, accounted for approximately 44.3% of the Group's total revenue for the year ended 31 December 2016. Sales to the largest three customers of the Group (other than Feihe Dairy Group), who were also Independent Third Parties, accounted for approximately 52.9% of the Group's total revenue for the year ended 31 December 2016.

Generally, the Group's customers, being the leading dairy products manufacturers in the PRC, have stringent quality control requirements in respect of, among others, the hygiene and safety conditions of the dairy cows of their suppliers. They also require the raw milk supplied by their suppliers to meet quality standards which may even be more stringent than that of the industry standards applicable in Europe and China. Some of the Group's customers have specific personnel to station at the farms of the Group for regular inspection. Besides, given the perishable nature of raw milk, in order to maintain its freshness and to minimise the risk of contamination, it is not feasible for these customers to either keep significant inventory of raw milk, or to procure raw milk from suppliers which are too far away from these customers. It is also not cost-efficient for dairy products manufacturers to communicate and purchase raw milk from a large number of mid to small size dairy farms. As the Group is one of the limited number of raw milk suppliers in Heilongjiang, the PRC with over 10,000 dairy cows and the capability of producing super



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## LETTER FROM THE BOARD

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premium raw milk, the Directors consider that, for so long as the Group is able to continue to meet the customers' demands in terms of quantity and quality, the Group would be able to develop and maintain a stable and long-term relationship with these customers (including Feihe Dairy Group and other major customers). The Directors also consider the chance of any of these customers ceasing to procure raw milk from the Group (whether due to the grant of the Priority Right or not) to be remote and granting of the Priority Right will not affect the long term relationship with the Group's other customers.

### **(iii) The Group's measures in mitigating customer concentration risks**

As most of the Group's customers are leading dairy products manufacturers in the PRC, maintaining solid and stable business relationships with these top dairy brands, including Feihe Dairy Group, is in line with the Group's strategy and dedication to the production of super premium raw milk. Nevertheless, the Group has managed to diversify its customers to a number of other dairy products manufacturers throughout years of the Group's development, and it is the Group's intention to continue to broaden its customer base and gain wider market recognition in the dairy products industry. In such connection, the Group engaged in new business relationships with two dairy brands in late 2015. Besides, to the best of the Directors' knowledge, there are more than 10 milk products manufacturers (other than Feihe Dairy Group) located within 200 km of the Group's farms with the estimated aggregate daily raw milk demand exceeding 10,000 tons. Given the Group's scale of operation and capability in producing super premium raw milk, the Directors believe that it would not be difficult for the Group to cooperate with other new customers. The Group will continue to explore opportunities to cooperate with other dairy product manufacturers in the future.

With a view to minimize the risk arising from concentration on a few customers and on the dairy industry, the Group has also been actively diversifying its business by starting the trial operation of beef cattle feeding business. It is expected that this business will contribute revenue and earnings to the Group.

### **(iv) The Group is capable of maintaining its revenue in the future**

The Ministry of Agriculture of the PRC and other ministries jointly issued the "National Dairy Development Plan (2016-2020) (the "Plan")", which illustrated the overall planning and systematic deployment of the dairy development of the "13th Five-Year Plan". It is expected that the structural reform of the dairy supply side will achieve substantive results by 2020. Also, the Plan plays an important role to speed up the revitalization of the dairy farming industry in the PRC. The soaring disposable income of Chinese residents, the accelerating urbanization and the comprehensive implementation of the "Two-child Policy" have also boosted increasing demand for milk products in the market. Facing with the rising price of foreign milk, the dairy enterprises in the PRC can foresee an enormous potential. Given the leading edge of the Group in the dairy industry, it is expected that the policy advantages and growing market demands will create favourable opportunities for the continual development of the Group.



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## LETTER FROM THE BOARD

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Having considered (i) the background of Feihe Dairy Group; (ii) long-term business relationship between the Group and Feihe Dairy Group; (iii) that the Group will give priority to Feihe Dairy Group for purchase of raw milk on terms and conditions being no less favourable to the Group than that offered by the other purchasers; and (iv) the Group's annual capacity of raw milk, the Directors consider that the terms and conditions of the 2017 Feihe Master Agreement (including the Priority Rights) are on normal commercial terms and are fair and reasonable, and the transactions contemplated under the 2017 Feihe Master Agreement will be conducted in the ordinary and usual course of business of the Group. In view of the prevailing oversupply of raw milk in Heilongjiang province and the stable and long term business relationship between the Group and Feihe Dairy Group, the 2017 Feihe Master Agreement is in the interests of the Company and its Shareholders as a whole.

The Directors are also of the view that the proposed annual caps for the transactions contemplated under the 2017 Feihe Master Agreement for each of the three years ending 31 December 2019 are fair and reasonable and that, regardless of the potential customer concentration risk, the transactions contemplated under the 2017 Feihe Master Agreement, particularly the grant of the Priority Rights by the Group, are unlikely to have any material adverse effect on the business, financial condition and results of operations of the Group.

### IMPLICATIONS OF THE LISTING RULES

Feihe Dairy Group (comprising Feihe China and its subsidiaries) is not a connected person of the Company for the purpose of Rule 14A.06(7) of the Listing Rules. However, due to our past relationship and transactions with Feihe Dairy Group as disclosed in the section headed "History, Development and Reorganization – our Relationship with Feihe Dairy Group" in the Prospectus, Feihe Dairy Group is deemed by the Stock Exchange as a connected person pursuant to Rule 14A.19 (or the then Rule 14A.06) of the Listing Rules. As such, the Company has agreed to undertake to comply with Chapter 14A of the Listing Rules' requirements in respect of the transactions with Feihe Dairy Group from the Listing Date.

Based on the proposed annual caps for each of the three years ending 31 December 2019, given that the relevant applicable percentage ratio in respect of the transactions contemplated under the 2017 Feihe Master Agreement is expected to be more than 25% and the annual consideration is not less than HK\$10 million, such transactions are subject to the reporting, announcement and the independent shareholders' approval requirement under Chapter 14A of the Listing Rules.

An Independent Board Committee has been established to advise the Independent Shareholders in relation to the 2017 Feihe Master Agreement, the transactions contemplated thereunder and the proposed annual caps. Gram Capital, the Independent Financial Adviser, was appointed to advise the Independent Board Committee and the Independent Shareholders in this regard.

None of the Directors have a material interest in the 2017 Feihe Master Agreement and the transactions contemplated thereunder, and therefore none of them was required to abstain from voting on the resolution of the Board approving the transactions contemplated under the 2017 Feihe Master Agreement and the proposed annual caps.

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## LETTER FROM THE BOARD

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### GENERAL INFORMATION

The Company is a dairy farming company in the PRC dedicated to the production of super premium raw milk.

Feihe Dairy Group is based in Heilongjiang province and is principally engaged in the production and sale of infant formula products in the PRC. As at the Latest Practicable Date, China Feihe was wholly owned by Diamond Infant Formula Holding Limited (“**DIF Holding**”), an exempted company incorporated in the Cayman Islands with limited liability. 51.73% of the entire issued share capital of DIF Holding was held by Garland Glory Holdings Limited, a company incorporated in the British Virgin Islands with limited liability, which was wholly owned by LYB International Holding Limited (“**LYB International**”), a company incorporated in the British Virgin Islands with limited liability. LYB International was wholly-owned by Harneys Trustees Limited, a company incorporated in the British Virgin Islands, being the trustee of the Leng Family Trust where Mr. Leng. Mr. Leng Youbin (冷友斌) is its settlor and the only discretionary object.

### SGM

A resolution approving the transactions contemplated under the 2017 Feihe Master Agreement and the proposed annual caps relating thereto shall be proposed at the SGM.

A notice convening the SGM to be held at Jasmine II, Rosedale Hotel & Suites, Beijing, 8 Jiang Tai Road West, Chaoyang District, Beijing, the PRC on Monday, 17 July 2017 at 10:00 a.m. is set out on pages 38 to 39 of this circular.

In accordance with the Listing Rules, any connected person or Shareholder and its associates with a material interest in the 2017 Feihe Master Agreement and the transactions contemplated thereunder must abstain from voting on the resolution to approve the transactions contemplated under the 2017 Feihe Master Agreement and the proposed annual caps for the three years ending 31 December 2019 at the SGM. To the extent that the Company is aware having made all reasonable enquiries, as at the Latest Practicable Date, none of the Shareholders have a material interest in the 2017 Feihe Master Agreement and are required to abstain from voting on the resolution to be proposed at the SGM to approve the transactions contemplated under the 2017 Feihe Master Agreement and the proposed annual caps.

The voting of the SGM will be taken by poll.

A form of proxy for the SGM is enclosed herewith. Whether or not Shareholders are able to attend and vote at the SGM, they are requested to complete the enclosed form of proxy and return the same to the branch share registrar and transfer office of the Company in Hong Kong, Computershare Hong Kong Investor Services Limited, 17M Floor, Hopewell Centre, 183 Queen’s Road East, Wanchai, Hong Kong in accordance with the instructions printed thereon as soon as possible and in any event no later than 48 hours before the time appointed for the holding of the SGM (i.e. no later than 10:00 a.m. (Hong Kong time) on Saturday, 15 July 2017) or any adjournment thereof. Completion and return of the form of proxy as instructed will not prevent Shareholders from subsequently attending and voting at the SGM or any adjourned meeting if they so wish.

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## LETTER FROM THE BOARD

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### RECOMMENDATION

The Directors consider that the transactions contemplated under the 2017 Feihe Master Agreement will be conducted by the Group in its ordinary and usual course of business, on normal commercial terms, are fair and reasonable and in the interests of the Company and the Shareholders as a whole, and that the proposed annual caps for the transactions contemplated under the 2017 Feihe Master Agreement are fair and reasonable. The Directors therefore recommend the Independent Shareholders to vote in favour of the relevant resolution set out in the notice of the SGM.

### FURTHER INFORMATION

The Independent Board Committee comprising all three independent non-executive Directors has been appointed to recommend the Independent Shareholders in respect of the transactions contemplated under the 2017 Feihe Master Agreement (including the proposed annual caps relating thereto). Gram Capital has been appointed as the Independent Financial Adviser to advise the Independent Board Committee and the Independent Shareholders in such regard.

Accordingly, your attention is drawn to (i) the letter of recommendation from the Independent Board Committee to the Independent Shareholders set out on pages 18 to 19 of this circular, which contains its recommendation to the Independent Shareholders; (ii) the letter of advice from Gram Capital set out on pages 20 to 34 of this circular, which contains its advice to the Independent Board Committee and the Independent Shareholders; (iii) the general information set out in the Appendix to this circular; and (iv) the notice of the SGM.

Yours faithfully

For and on behalf of the Board of  
**YuanShengTai Dairy Farm Limited**  
**Zhao Hongliang**  
*Executive Director and Chairman*

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## LETTER FROM THE INDEPENDENT BOARD COMMITTEE

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### YuanShengTai Dairy Farm Limited

原生態牧業有限公司

*(Incorporated in Bermuda with limited liability)*

**(Stock Code: 1431)**

30 June 2017

*To the Independent Shareholders*

Dear Sir or Madam

#### **CONTINUING CONNECTED TRANSACTIONS: 2017 FEIHE MASTER AGREEMENT**

We refer to the circular of the Company dated 30 June 2017 (the “**Circular**”) to the Shareholders, of which this letter forms part. Terms defined in the Circular have the same meanings in this letter unless the context otherwise requires.

In compliance with the Listing Rules, we have been appointed by the Board to form the Independent Board Committee and advise the Independent Shareholders as to whether, in our opinion, the transactions contemplated under the 2017 Feihe Master Agreement will be conducted by the Group in its ordinary and usual course of business, are in the interests of the Company and the Shareholders as a whole and are fair and reasonable so far as the Independent Shareholders are concerned, and as to whether the proposed annual caps for the transactions contemplated under the 2017 Feihe Master Agreement are fair and reasonable. In this connection, Gram Capital has been appointed as the Independent Financial Adviser to advise the Independent Board Committee and the Independent Shareholders in respect of the transactions contemplated under the 2017 Feihe Master Agreement (including the proposed annual caps relating thereto).

We wish to draw your attention to the letter from the Board set out on pages 5 to 17 of the Circular, and the letter from Gram Capital to the Independent Board Committee and the Independent Shareholders set out on pages 20 to 34 of the Circular which contains its opinion in respect of the transactions contemplated under the 2017 Feihe Master Agreement (including the proposed annual caps relating thereto).

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## LETTER FROM THE INDEPENDENT BOARD COMMITTEE

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Having taken into account the advice of Gram Capital and its recommendation in relation thereto, we consider that the transactions contemplated under the 2017 Feihe Master Agreement will be conducted by the Group in its ordinary and usual course of business, on normal commercial terms, are in the interests of the Company and the Shareholders as a whole and are fair and reasonable so far as the Independent Shareholders are concerned, and the proposed annual caps for the transactions contemplated under the 2017 Feihe Master Agreement are fair and reasonable. Accordingly, we recommend that you vote in favour of the relevant resolution set out in the notice of the SGM.

Yours faithfully,

Independent Board Committee of

**YuanShengTai Dairy Farm Limited**

**Wu Chi Keung**

**Zhang Yuezhou**

**Zhu Zhanbo**

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## LETTER FROM GRAM CAPITAL

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*Set out below is the text of a letter received from Gram Capital, the Independent Financial Adviser to the Independent Board Committee and the Independent Shareholders in respect of the 2017 Feihe Master Agreement and the transactions contemplated thereunder for the purpose of inclusion in this circular.*



Room 1209, 12/F.  
Nan Fung Tower  
88 Connaught Road Central/  
173 Des Voeux Road Central  
Hong Kong

30 June 2017

*To: The independent board committee and the independent shareholders  
of YuanShengTai Dairy Farm Limited*

Dear Sir/Madam,

### **CONTINUING CONNECTED TRANSACTIONS: 2017 FEIHE MASTER AGREEMENT**

We refer to our appointment as the Independent Financial Adviser to advise the Independent Board Committee and the Independent Shareholders in respect of the 2017 Feihe Master Agreement, details of which are set out in the letter from the Board (the “**Board Letter**”) contained in the circular dated 30 June 2017 issued by the Company to the Shareholders (the “**Circular**”), of which this letter forms part. Terms used in this letter shall have the same meanings as defined in the Circular unless the context requires otherwise.

On 12 May 2017 (after trading hours), the Company entered into the 2017 Feihe Master Agreement with China Feihe, a member of Feihe Dairy Group, to confirm the priority arrangement of the Group’s supply of raw milk to Feihe Dairy Group for a term commencing from the Commencement Date and ending on 31 December 2019 subject to the terms and conditions contained therein.

With reference to the Board Letter, the transactions contemplated under the 2017 Feihe Master Agreement constitute continuing connected transactions of the Company, and be subject to the reporting, annual review, announcement and Independent Shareholders’ approval requirement pursuant to Chapter 14A of the Listing Rules.

The Independent Board Committee comprising Mr. Wu Chi Keung, Mr. Zhang Yuezhou and Mr. Zhu Zhanbo (all being independent non-executive Directors) has been established to advise the Independent Shareholders on (i) whether the terms of the 2017 Feihe Master Agreement are on normal commercial terms and are fair and reasonable so far as the Independent Shareholders are concerned; (ii) whether the entering into of the 2017 Feihe Master Agreement is in the interests of the Company and the Shareholders as a whole and is conducted in the ordinary and usual course of business of the Group; and (iii) how the Independent Shareholders should vote in respect of the resolution(s) to approve the 2017

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## LETTER FROM GRAM CAPITAL

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Feihe Master Agreement and transactions contemplated thereunder at the SGM. We, Gram Capital Limited, have been appointed as the Independent Financial Adviser to advise the Independent Board Committee and the Independent Shareholders in this respect.

### **INDEPENDENCE**

As at the Latest Practicable Date, we were not aware of any relationships or interests between Gram Capital and the Company during the past two years immediately preceding the Latest Practicable Date, or any other parties that could be reasonably regarded as hindrance to Gram Capital's independence to act as the Independent Financial Adviser to the Independent Board Committee and the Independent Shareholders.

Besides, apart from the advisory fee and expenses payable to us in connection with our appointment as the Independent Financial Adviser to the Independent Board Committee and the Independent Shareholders, no arrangement exists whereby we shall receive any other fees or benefits from the Company.

### **BASIS OF OUR OPINION**

In formulating our opinion to the Independent Board Committee and the Independent Shareholders, we have relied on the statements, information, opinions and representations contained or referred to in the Circular and the information and representations as provided to us by the Directors. We have assumed that all information and representations that have been provided by the Directors, for which they are solely and wholly responsible, are true and accurate at the time when they were made and continue to be so as at the Latest Practicable Date. We have also assumed that all statements of belief, opinion, expectation and intention made by the Directors in the Circular were reasonably made after due enquiry and careful consideration. We have no reason to suspect that any material facts or information have been withheld or to doubt the truth, accuracy and completeness of the information and facts contained in the Circular, or the reasonableness of the opinions expressed by the Company, its advisers and/or the Directors, which have been provided to us. Our opinion is based on the Directors' representation and confirmation that there is no undisclosed private agreements/arrangements or implied understanding with anyone concerning the 2017 Feihe Master Agreement. We consider that we have taken sufficient and necessary steps on which to form a reasonable basis and an informed view for our opinion in compliance with Rule 13.80 of the Listing Rules.

The Circular, for which the Directors collectively and individually accept full responsibility, includes particulars given in compliance with the Listing Rules for the purpose of giving information with regard to the Company. The Directors, having made all reasonable enquiries, confirm that to the best of their knowledge and belief the information contained in the Circular is accurate and complete in all material respects and not misleading or deceptive, and there are no other matters the omission of which would make any statement as contained in the Circular or the Circular misleading. We, as the Independent Financial Adviser, take no responsibility for the contents of any part of the Circular, save and except for this letter of advice.

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## LETTER FROM GRAM CAPITAL

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We consider that we have been provided with sufficient information to reach an informed view and to provide a reasonable basis for our opinion. We have not, however, conducted any independent in-depth investigation into the business and affairs of the Company, Feihe Dairy Group and each of their respective subsidiaries or associates, nor have we considered the taxation implication on the Group or the Shareholders as a result of the entering into of the 2017 Feihe Master Agreement. Our opinion is necessarily based on the financial, economic, market and other conditions in effect and the information made available to us as at the Latest Practicable Date. Shareholders should note that subsequent developments (including any material change in market and economic conditions) may affect and/or change our opinion and we have no obligation to update this opinion to take into account events occurring after the Latest Practicable Date or to update, revise or reaffirm our opinion. In addition, nothing contained in this letter should be construed as a recommendation to hold, sell or buy any Shares or any other securities of the Company.

Lastly, where information in this letter has been extracted from published or otherwise publicly available sources, it is the responsibility of Gram Capital to ensure that such information has been correctly extracted from the relevant sources while we are not obligated to conduct any independent in-depth investigation into the accuracy and completeness of those information.

### PRINCIPAL FACTORS AND REASONS CONSIDERED

In arriving at our opinion in respect of the 2017 Feihe Master Agreement, we have taken into consideration the following principal factors and reasons:

#### Information on the Company

With reference to the Board Letter, the Company is a dairy farming company in the PRC dedicated to the production of super premium raw milk.

Set out below are the audited consolidated financial information of the Group for the four years ended 31 December 2016 as extracted from the annual reports of the Company for each of the four years ended 31 December 2016:

	<b>For the year ended 31 December 2016 RMB'000</b>	<b>For the year ended 31 December 2015 RMB'000</b>	<b>For the year ended 31 December 2014 RMB'000</b>	<b>For the year ended 31 December 2013 RMB'000</b>
Revenue	1,029,232	1,032,648	1,162,890	880,760
– Feihe Dairy Group	456,428	440,772	606,442	319,102
– Customer A	476,050	414,064	416,438	196,169
– Customer B	67,704	111,587	28,246	277,714
– Others	29,050	66,225	111,764	87,775
(Loss)/Profit for the year	(88,569)	66,173	418,790	217,734



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## LETTER FROM GRAM CAPITAL

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As depicted from the table above, revenue of the Group for the year ended 31 December 2016 (“FY2016”) amounted to approximately RMB1.03 billion, representing a slight decrease of approximately 0.33% as compared to that for the year ended 31 December 2015 (“FY2015”). With reference to the annual report for the year ended 31 December 2016 (the “2016 Annual Report”), all revenue of the Group for the two years ended 31 December 2016 derived from sales of raw milk.

### Information on Feihe Dairy Group

With reference to the Board Letter, Feihe Dairy Group is based in Heilongjiang province and is principally engaged in the production and sale of infant formula products in the PRC.

With reference to the Board Letter, Feihe Dairy Group was one of the Group’s top five customers for each of four years ended 31 December 2016. As depicted from the above table, revenue contributed by Feihe Dairy Group amounted to over 30% of total revenue for each of the four years ended 31 December 2016.

### Reasons for the entering into of the 2017 Feihe Master Agreement

As disclosed in the Prospectus, when the Group was in its initial stage of commercial production in 2010, Feihe Dairy Group accounted for all of the Group’s revenue. Throughout years of the Group’s development, Feihe Dairy Group remained as one of the top five customers of the Group for the recent years. As stated in the Board Letter, the Board believes the sales of raw milk to the Feihe Dairy Group is important to the business of the Group. It is expected that the long term and continuing supply of raw milk products to the Feihe Dairy Group will further enhance the stability of the Group’s customer base and ensure future demand for the Group’s raw milk.

The Group entered into master agreements with Feihe Dairy Group on 14 December 2015 (i.e. the 2015 Feihe Master Agreement) for supply of raw milk by the Group to Feihe Dairy Group for the three years ending 31 December 2018.

With reference to the Board Letter, the proposed grant of priority in favour of the Feihe Dairy Group in the supply of raw milk (the “Priority Rights”) and the extension of the existing term of the 2015 Feihe Master Agreement to beyond 31 December 2018 were initially proposed and requested by the Feihe Dairy Group. So far as the Directors understand from the management of Feihe Dairy Group, it is the intention of Feihe Dairy Group to obtain the Priority Rights with the extended term so as to facilitate its formulation of medium-term business plan for production and sale of infant formula products. By entering into the 2017 Feihe Master Agreement for the grant of the Priority Right and extending the term to beyond 2018, the Group will be able to further reinforce the business relationship with Feihe Dairy Group. Besides, the production facilities of Feihe Dairy Group in Heilongjiang province, which are within 50 km of the Group’s farms in the area, are in closer proximity than that of the other major customers of the Group which are located more than 100 km from the Group’s farms in the area. As such, the Group can save more transportation costs by supplying raw milk to the Feihe Dairy Group even if these other major customers offer to purchase the Group’s raw milk on the same terms and conditions as that offered by the Feihe Dairy Group.

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## LETTER FROM GRAM CAPITAL

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In addition, the management team of the Group believes that the grant of the Priority Rights will not jeopardize the interests of other customers and the Group, as the Group has sufficient production capacity and raw milk supply to meet the expected demands of other customers. By strategically increasing the number of matured milkable cows, improving the operational efficiency of the farms and feeding formula for the cow, and optimizing the age structure of herds and herd structure, the Group can further improve the overall milk yield and the average milk yield per cow so as to cater for the market demand of the Group's raw milk.

Having considered (i) the background of Feihe Dairy Group; (ii) long-term business relationship between the Group and Feihe Dairy Group; (iii) that the Group will give priority to Feihe Dairy Group for purchase of raw milk on terms and conditions being no less favourable to the Group than that offered by the other purchasers; and (iv) the Group's annual capacity of raw milk, the Group entered into the 2017 Feihe Master Agreement with Feihe Dairy Group to, among other things, confirm the priority arrangement of the Group's supply of raw milk to Feihe Dairy Group (details of which are set out in the section headed "Principal terms of the 2017 Feihe Master Agreement" below).

In light of (i) the revenue contribution from Feihe Dairy Group, being one of the top five customers of the Group for the recent years; (ii) the annual production capacity of the Group as mentioned below; (iii) the long-term business relationship between the Group and the Feihe Dairy Group; and (iv) the priority arrangement to be acceptable (details of the analysis are set out in the sub-section headed "Priority" below), we consider that the transactions contemplated under the 2017 Feihe Master Agreement are conducted in the ordinary and usual course of business of the Group and in the interests of the Company and the Shareholders as a whole.

### **1. Principal terms of the 2017 Feihe Master Agreement**

Date:	12 May 2017
Parties:	the Company and China Feihe
Contract period:	The initial term of the 2017 Feihe Master Agreement shall commence from the Commencement Date and shall end on 31 December 2019. The 2017 Feihe Master Agreement may be extended for a period of three years after the expiry of the initial term, subject to approval of such extension and the transactions contemplated thereunder (including the related annual caps) by the Independent Shareholders (if required) in accordance with the Listing Rules.
Subject matter:	Supply of raw milk by the Group to Feihe Dairy Group.

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## LETTER FROM GRAM CAPITAL

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- Pricing term:** For each calendar year during the term of the 2017 Feihe Master Agreement, the Group and Feihe Dairy Group will enter into an annual sale contract specifying, among others, the pricing mechanism, the quantity and quality of raw milk expected to be purchased by Feihe Dairy Group during the calendar year and payment terms. The unit selling price of raw milk generally comprises two elements, being (i) the unit base price; and (ii) certain price adjustment factors including, among others, the microbe count, the level of protein content and fat content and the freezing point of raw milk. The unit selling price of raw milk will be negotiated by the parties on arm's length basis and in good faith with reference to the Indicative Price, the aforesaid adjustment factors and the prevailing market prices offered by the Group to its Independent Third Parties customers for products of similar quality. The terms and purchase prices offered by the Group to Feihe Dairy Group shall be no more favourable than those available to other Independent Third Parties customers.
- Priority:** In the event that the Group receives purchase orders from Feihe Dairy Group and other purchasers concurrently, the Group shall give priority to Feihe Dairy Group for purchase of raw milk on terms and conditions no less favourable to the Group than that offered by the other Independent Third Party customers.
- Payment term:** Generally, to be settled on accrual basis, with a credit term of no more than one month, during which no interest will accrue.
- Early termination:** Both parties may, at any time during the continuance of the 2017 Feihe Master Agreement, give the other not less than three months' prior written notice to terminate the 2017 Feihe Master Agreement.

### *Pricing method and procedures*

Under the 2017 Feihe Master Agreement, the Group will, by the end of each calendar year during the term, enter into an annual sales contract with the Feihe Dairy Group to agree on, among others, the pricing mechanism of raw milk for the next calendar year.

The Group generally negotiates the unit selling pricing for the raw milk with its customers (including both Feihe Dairy Group and its Independent Third Party customers) based on the latest Indicative Price published quarterly by the Heilongjiang Animal Husbandry & Veterinary Bureau (黑龍江省牧獸醫局) and taking into account certain adjustment factors as mentioned above. The Group's pricing mechanism with its customers (including Feihe Dairy Group and other Independent Third Party customers of the Group) are generally the same, and therefore the selling price of the raw milk contemplated under the 2017 Feihe Master Agreement would be comparable to that of the other Independent Third Party customers of the Group.

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## LETTER FROM GRAM CAPITAL

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In order to ensure that the terms of sales of raw milk to Feihe Dairy Group (including the unit selling price) would be on normal commercial terms or on terms no less favourable to the Group than those offered to Independent Third Party customers, the Group has adopted the certain pricing procedures (the “**Pricing Procedures**”). Details of the pricing procedures are set out under the sub-section headed “Pricing method and procedures” of the Board Letter.

Apart from the price adjustment controls as stated above, designated members of the Group’s senior management namely assistant manager in charge of sales department and general manager will (i) from time to time review the raw milk price agreed between the Group and Feihe Dairy Group, and compare it with the raw milk prices (of similar quality and during the same period of time) being agreed between the Group and other Independent Third Party customers; and (ii) review other trading terms of purchase orders received from Feihe Dairy Group and other Independent Third Party customers, to ensure that (a) the unit selling prices of raw milk for all of the Group’s customers remain comparable; (b) other trading terms offered by Feihe Dairy Group, (such as base price, adjustment factor, payment term and driving distance) are no less favourable to the Group than that offered by the other Independent Third Party customers; and (c) the contemplated transactions between the Feihe Dairy Group and the Group are conducted on normal commercial terms.

For our due diligence purpose, we obtained invoices/agreements (the “**Invoices/Agreements**”) for the supply of raw milk by the Group to (i) Feihe Dairy Group; and (ii) independent third parties during each of the two years ended 31 December 2016 and the four months ended 30 April 2017. We noted that the prices of the raw milk supplied by the Feihe Dairy Group to Feihe Dairy Group are no more favorable than those supplied to the Independent Third Parties.

With reference to Rule 14A.56 of the Listing Rules, among other things, the auditors of the Company must provide a letter to the Board confirming whether anything has come to their attention that causes them to believe that the continuing connected transactions were not, in all material respects, in accordance with the pricing policies of the listed issuer’s group if the transactions involve the provision of goods or services by the listed issuer’s group. We obtained the letter from the Company’s auditors, showing their confirmation that, among other things, nothing has come to their attention that causes them to believe that the continuing connected transactions regarding the supply of raw milk by the Group to the Feihe Dairy Group for the year ended 31 December 2016 was not, in all material respects, in accordance with the pricing policies of Group.

In light of the requirement of the Pricing Procedures, including but not limited to:

- a) base price of raw milk, being one of the factors for the Group to determine the selling price of raw milk, published by Heilongjiang Animal Husbandry & Veterinary Bureau quarterly (<http://www.hljxm.gov.cn/middle!hrefchannel.action?siteid=1&channelid=333>); and
- b) the sales department of the Group shall seek approval from both of the vice president in charge and the general manager of the Group for the relevant price adjustment,

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## LETTER FROM GRAM CAPITAL

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as well as (i) our findings on previous contracts regarding the supply of raw milk by the Group to Feihe Dairy Group and independent third parties as mentioned above; and (ii) the confirmation letter from Company's auditors, we consider that the effective implementation of the Pricing Procedures would help to ensure the fair pricing under the 2017 Feihe Master Agreement and we do not doubt the effectiveness of the implementation of the Pricing Procedures for the existing continuing connected transactions regarding the supply of raw milk by the Group.

### *Payment term*

Pursuant to the 2017 Feihe Master Agreement, generally, to be settled on accrual basis, with a credit term of no more than one month, during which no interest will accrue. Based on our findings on previous contracts regarding the supply of raw milk by the Group to Feihe Dairy Group and independent third parties as mentioned above, we noted that the payment terms offered by the Group to the Feihe Dairy Group are no more favourable than those offered by the Group to independent third parties.

We also noted from the 2016 Annual Report that the Group's trading terms with its customers are mainly on credit and the credit period is generally one month. The payment term under the 2017 Feihe Master Agreement is generally consistent with the credit policy adopted by the Group. As confirmed by the Directors, to the best of their knowledge, the payment term is in line with the market practice among the raw milk providers in the PRC. For our due diligence purpose, we have searched for companies listed in Hong Kong which are engaged in similar line of business as the Group, being production and sale of raw milk in the PRC and derived a majority of their turnover from such business, based on their respective latest published financial information. Set out below are our findings on credit period of comparable listed companies:

<b>Company</b>	<b>Principal business</b>	<b>Credit Period (days)</b>
China Modern Dairy Holdings Ltd. (1117)	Production and sale of raw milk to customers for processing into dairy products; and production and sale of liquid milk products.	30 to 120
China ZhongDi Dairy Holdings Company Limited (1492)	Operations of dairy farms to produce raw milk and importing and selling cows in the PRC.	30
Lanzhou Zhuangyuan Pasture Co., Ltd. (1533)	Dairy farming, manufacture and sale of liquid milk products and other dairy products.	90

We noted from the above table that the credit period of the comparable listed companies ranged from 30 days to 120 days. Accordingly, a credit term of no more than one month is in line with the market practice.

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## LETTER FROM GRAM CAPITAL

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### *Priority*

Pursuant to the 2017 Feihe Master Agreement, in the event that the Group receives purchase orders from Feihe Dairy Group and other purchasers concurrently, the Group shall give priority to Feihe Dairy Group for purchase of raw milk on terms and conditions no less favourable to the Group than that offered by the other Independent Third Party customers. As confirmed by the Directors, designated members of the Group's senior management namely assistant manager in charge of sales department and general manager will review other trading terms of purchase orders received from Feihe Dairy Group and other Independent Third Party customers, to ensure that other trading terms offered by Feihe Dairy Group are no less favourable to the Group than that offered by the other Independent Third Party customers before giving priority rights to Feihe Dairy Group. We consider that such procedure is sufficient to ensure the Priority Rights will be given to Feihe Dairy Group under the circumstances that terms and conditions no less favourable to the Group than that offered by the other purchasers.

Upon our request, the Directors advised us that Feihe Dairy Group has been a customer of the Group for over five years. To the best of the Directors knowledge, the Directors were not aware of any breach of individual contracts under the master agreements regarding supply of raw milk by the Group or any order as placed by Feihe Dairy Group.

For our due diligence purpose, we noted from website of Stock Exchange that it is not exceptional for companies supplied/purchased goods or services to/from connected persons with a priority supply/purchasing rights. We also noted that China Shengmu Organic Milk Limited (stock code: 1432, together with its subsidiaries, the "**Shengmu Group**") entered into a milk supply framework agreement (the "**Shengmu Agreement**") with its connected person in relation to the purchase of organic raw milk by the Shengmu Group on 22 November 2016. Pursuant to the Shengmu Agreement, among other things, Shengmu Group's connected person shall sell all organic raw milk it produces to the Shengmu Group on a priority basis to satisfy the demand of the Shengmu Group. The transactions contemplated under Shengmu Agreement are in relation to sale and purchase of raw milk between supplier and purchaser, such transactions are therefore similar to the transactions contemplated under the 2017 Feihe Master Agreement (i.e. sale and purchase of raw milk between supplier and purchaser).

Furthermore, we also obtained figures showing the volume of milk as supplied by the Group to (i) the Feihe Dairy Group; and (ii) other customers for each of the two years ended 31 December 2016 and the three months ended 31 March 2017. With reference to the 2016 Annual Report, as at 31 December 2016, the Group had seven farms in the PRC with total 54,749 dairy cows (i.e. 26,689 matured milkable cows and 28,060 heifers and calves (most of which would grow to matured milkable cows<sup>(Note)</sup>)). During the FY2016, the average annual milk yield per cow was 10 tons. As stated in the Board Letter, by strategically increasing the number of matured milkable cows, improving the operational efficiency of the farms and feeding formula for the cow, and optimizing the age structure of herds and herd structure, the Group can further improve the

*Note: In general, the heifers are inseminated with semen when they reach approximately 13 months old. After approximately nine months following a successful insemination, a calf is born and the dairy cow begins to produce raw milk and the lactation period begins.*

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## LETTER FROM GRAM CAPITAL

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overall milk yield and the average milk yield per cow so as to cater for the market demand of the Group's raw milk. Having considered, among other things, actual designed capacity of seven farms (i.e. 90,000 dairy cows), the number of dairy cows of the Group as at 31 December 2016, the average annual milk yield per cow, we do not doubt the capacity of the Group for the supply of raw milks to its customers.

With reference to the Board Letter, the Directors consider that, by entering into the 2017 Feihe Master Agreement, the Group is not unduly reliant on Feihe Dairy Group for the following reasons: (i) mutual beneficial and complementary relationship; (ii) solid business relationship with other major customers; (iii) the Group's measures in mitigating customer concentration risks; and (iv) the Group is capable of maintaining its revenue in the future. Details of which are set out under the section headed "Reasons and benefits for the continuing connected transactions" of the Board Letter. Due to the fact that the Group shall give priority to Feihe Dairy Group for purchase of raw milk only when (i) the Group receives purchase orders from Feihe Dairy Group and other Independent Third Party customers concurrently; and (ii) terms and conditions are no less favourable to the Group than that offered by the other Independent Third Party customers, the Directors do not consider the Priority Rights will increase reliance risk of the Group. We concur with the Directors in this regard.

As mentioned above, designated members of the Group's senior management namely assistant manager in charge of sales department and general manager will, among other things, review other trading terms of purchase orders received from Feihe Dairy Group and other Independent Third Party customers, to ensure that other trading terms offered by Feihe Dairy Group (such as base price, adjustment factor, payment term and driving distance) are no less favourable to the Group than that offered by the other Independent Third Party customers.

Having considered (i) the background of Feihe Dairy Group; (ii) long-term business relationship between the Group and Feihe Dairy Group; (iii) that the Group will give priority to Feihe Dairy Group for purchase of raw milk on terms and conditions being no less favourable to the Group than that offered by the other Independent Third Party customers; (iv) the Group's annual capacity of raw milk; and (v) that the Group has internal control procedures to ensure other trading terms offered by Feihe Dairy Group are no less favourable to the Group than that offered by the other Independent Third Party customers, we are of the view that the priority terms to be acceptable.

Despite that we can only find one case regarding supply and purchase of milk with a priority purchase rights, due to the fact that we are unable to have sufficient information from other milk suppliers/purchasers regarding priority purchase rights from public source, we could not conclude that the Priority Rights is not a normal commercial terms in raw milk supply industry. To further assess whether the Priority Rights is a normal commercial terms, we remove the industry restriction and noted that it is not exceptional for companies supplied/purchased goods or services to/from connected persons with a priority supply/purchasing rights. Having considered that transactions contemplated under the 2017 Feihe Master Agreement are in relation to sale and purchase of raw milk between supplier and purchaser, we consider that the Priority Rights is a normal commercial terms.



## LETTER FROM GRAM CAPITAL

In light of the above, we are of the view that the terms of the 2017 Feihe Master Agreement are on normal commercial terms and are fair and reasonable so far as the Independent Shareholders are concerned.

### 2. The proposed annual caps under the 2017 Feihe Master Agreement

Set out below are (i) the historical transactions amounts of the transactions and existing annual caps regarding supply of raw milk to Feihe Dairy Group for the two years ended 31 December 2016; and (ii) the proposed annual caps under the 2017 Feihe Master Agreement for the three year ending 31 December 2019 (the “**Proposed Annual Caps**”):

	<b>For the year ended 31 December 2015 <i>RMB'million</i></b>	<b>For the year ended 31 December 2016 <i>RMB'million</i></b>	<b>For the year ending 31 December 2017 <i>RMB'million</i></b>	<b>For the year ending 31 December 2018 <i>RMB'million</i></b>
Historical transactions amount	441	456	N/A	N/A
% to revenue	42.7%	44.3%	N/A	N/A
Existing/previous annual caps	838	766	881	970
Utilisation rate	52.6%	59.5%	N/A	N/A
			<b>For the year ending 31 December 2017 <i>RMB'million</i></b>	<b>For the year ending 31 December 2018 <i>RMB'million</i></b>
Proposed Annual Caps		812	902	1,015

With reference to the Board Letter, the proposed new annual caps in respect of the transactions contemplated under the 2017 Feihe Master Agreement have been determined with reference to:

- (i) the historical transaction amount and sales volume in respect of the sales of raw milk contemplated under the 2015 Feihe Master Agreement for the year ended 31 December 2016;
- (ii) the projected quantities of sales volume of raw milk by the Group to the Feihe Dairy Group for each of the three years ending 31 December 2019 (taking into account the Group’s expansion plan for raw milk production);
- (iii) the prospect of the PRC dairy industry following the introduction of the two-child policy by the PRC government lately;
- (iv) the prevailing market price of raw milk which has been relatively stable; and



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## LETTER FROM GRAM CAPITAL

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- (v) a buffer of 10% to cover any unforeseen circumstances, for instances the unexpected increment of the market price of raw milk, the inflation rate in the PRC and unexpected substantial increase in demand of raw milk by the Feihe Dairy Group.

We noted from the above table that the utilization rate for existing annual caps for the year ended 31 December 2015 and 2016 were approximately 52.6% and 59.5% respectively. In this regard, we understood that the difference between the historical transaction amounts for the year ended 31 December 2016 and proposed annual cap for the year ended 31 December 2016 were mainly due to the decrease in market price of raw milk for the year ended 31 December 2016, the average of which representing a discount of approximately 17% as compared to the previous estimated selling price. The utilization rate for historical transaction volume (in tonne) for the year ended 31 December 2016 represented approximately 72% of the estimation transaction volume (in tonne) for the year ended 31 December 2016. As such, the Directors lowered down the estimated selling price for the two years ending 31 December 2018 but kept the estimated transaction volume for the two years ending 31 December 2018 unchanged. Based on the above table, the revised annual caps for the year ending 31 December 2017 and 2018 represented a decrease of 7.8% and 7.0% as compared to the existing annual caps for the same period respectively.

To assess the fairness and reasonableness of the Proposed Annual Caps for the three years ending 31 December 2019, we have obtained and reviewed the calculation of the Proposed Annual Caps (the “**Calculation**”). We noted from the Calculation that the Proposed Annual Caps were arrived by (i) the estimated demand of raw milk for the three years ending 31 December 2019; and (ii) the estimated selling price of raw milk for the three year ending 31 December 2019.

Upon our request, we received the previous calculation, which were estimated by the Company, for the existing annual caps for the three years ending 31 December 2018 under the 2015 Feihe Master Agreement, the estimated volume of raw milk to be supplied by the Group to the Feihe Dairy Group for the two years ending 31 December 2018 were in line with the Company’s previous projection. Having considered that (i) the utilization rate for historical transaction volume (in tonne) for the year ended 31 December 2016 represented approximately 72% of the estimation transaction volume (in tonne) for the year ended 31 December 2016; and (ii) the historical transaction volume (in tonne) for the year ended 31 December 2016 represented an increase of approximately 17.3% as compared to that for the year ended 31 December 2015, we consider that it is acceptable that the estimated volume of raw milk to be supplied by the Group to the Feihe Dairy Group for the two years ending 31 December 2018 being in line with the Company’s previous projection.

With reference to the Board Letter and the 2016 Annual Report, it is expected that PRC’s economy will grow steadily in 2017, with the trend of progressing steadily being further consolidated. The Ministry of Agriculture of the People’s Republic of China and other ministries jointly issued the “National Dairy Development Plan (2016-2020)”, which defined the strategic development of the dairy industry of the PRC, and targeted to gain substance progress of the supply-side structural reform of dairy industry by 2020. The aforesaid plan pointed out that the dairy industry was an indispensable industry for “Healthy China”, and the quality and safety of dairy products should be the first priority of all.

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## LETTER FROM GRAM CAPITAL

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In addition, the soaring disposable income of PRC's residents, accelerating urbanization and full implementation of the "Two-child Policy" may further promote the demand of customers for raw milk. The Group will actively capitalize on policy advantages and growth potential, adjust cattle mix, improve production of dairy cows, and strengthen the supervision on safety of raw milk, so as to provide quality raw milk to consumers and restore consumer confidence to the dairy industry.

As mentioned above, the Group had seven farms in the PRC with total 54,749 dairy cows (i.e. 26,689 matured milkable cows and 28,060 heifers and calves (most of which would grow to matured milkable cows) as at 31 December 2016 and the average annual milk yield per cow was 10 tons during the FY2016.

In light of the above factors, we consider the estimated demand of raw milk for the year ending 31 December 2017 to be fair and reasonable.

We noted from the Calculation that the average selling price for the three years ending 31 December 2019 represented a decrease of approximately 15% as compared to the previous estimated average selling price for the three years ending 31 December 2018. We enquired into the Directors in this regard and noted that such decrease in estimated average selling price was due to the decrease in average selling price of raw milk from FY2015 to FY2016.

For our due diligence purpose, we noted from the 2016 Annual Report that average selling price of raw milk was approximately RMB3,979 per ton in 2016 (2015: RMB4,427 per ton), representing a decrease of approximately 10% as compared to the average selling price of raw milk in 2015. Furthermore, we also noted from the Invoices/Agreements that the estimated average selling price of raw milk is in line with the selling price as shown in the Invoices/Agreements. Accordingly, we are of the view that the average selling price for the three years ending 31 December 2019 to be fair and reasonable.

We noted that the Company has applied a buffer of 10% as an assumption for the determination of the Proposed Annual Caps. Having considered that the additional buffer (which forms approximately 10% of the Proposed Annual Caps for each of the three years ending 31 December 2019) was applied for unforeseeable circumstances, for instance, (a) the unpredictable increase in selling price of raw milk (i.e. the future average selling price recovering to the level in 2015, representing a premium of approximately 11.3% as compared to the average selling price in 2016); and (b) the unexpected substantial increase in demand of raw milk by the Feihe Dairy Group, we consider that a buffer of 10% to be acceptable.

In light of (i) the estimated demand of raw milk for the year ending 31 December 2017 to be fair and reasonable; (ii) the average selling price for the three years ending 31 December 2019 to be fair and reasonable; (iii) the buffer of 10% to be acceptable, we consider that the Proposed Annual Cap for the year ending 31 December 2017 (the "**2017 Annual Cap**") is fair and reasonable so far as the Independent Shareholders are concerned.

We also noted that the Proposed Annual Cap for the year ending 31 December 2018 (the "**2018 Annual Cap**") represented an increase of approximately 11% (the "**2018 Increase**") as compared to the 2017 Annual Cap and the Proposed Annual Cap for the year ending 31 December 2019 represented an increase of approximately 13% (the "**2019 Increase**") as compared to the 2018 Annual Cap.

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## LETTER FROM GRAM CAPITAL

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As mentioned above, we obtained figures showing the volume of milk as supplied by the Group to the Feihe Dairy Group for each of the two years ended 31 December 2016 and noted that the volume as supplied to the Feihe Dairy Group for FY2016 increased by approximately 17% as compared to that for FY2015. Accordingly, we consider the 2018 Increase and 2019 Increase to be acceptable.

In light of that (i) the 2017 Annual Cap is fair and reasonable as analysed above; (ii) the 2018 Increase and 2019 Increase to be acceptable, we are of the view that the Proposed Annual Caps for the two years ending 31 December 2019 are fair and reasonable so far as the Independent Shareholders are concerned.

Shareholders should note that as the Proposed Annual Cap for the three years ending 31 December 2019 are relating to future events and were estimated based on assumptions which may or may not remain valid for the entire period up to 31 December 2019, and they do not represent forecasts of cost to be incurred from the transactions contemplated under the 2017 Feihe Master Agreement. Consequently, we express no opinion as to how closely the actual cost to be incurred from the transactions contemplated under the 2017 Feihe Master Agreement will correspond with the Proposed Annual Caps.

### **3. Listing Rules implication**

The Directors confirmed that the Company shall comply with the requirements of Rules 14A.53 to 14A.59 of the Listing Rules pursuant to which (i) the values of the transactions contemplated under the 2017 Feihe Master Agreement must be restricted by the Proposed Annual Caps for the period concerned under the 2017 Feihe Master Agreement; (ii) the terms of the 2017 Feihe Master Agreement (including the Proposed Annual Caps) must be reviewed by the independent non-executive Directors annually; (iii) details of independent non-executive Directors' annual review on the terms of the transactions contemplated under the 2017 Feihe Master Agreement must be included in the Company's subsequent published annual reports and financial accounts. Furthermore, it is also required by the Listing Rules that the auditors of the Company must provide a letter to the Board confirming, among other things, whether anything has come to their attention that causes them to believe that the transactions contemplated under the 2017 Feihe Master Agreement (i) have not been approved by the Board; (ii) were not, in all material respects, in accordance with the pricing policies of the Group if the transactions involve the provision of goods or services by the Group; (iii) were not entered into, in all material respects, in accordance with the relevant agreement governing the transactions; and (iv) have exceeded their respective proposed annual caps. In the event that the total amounts of the transactions contemplated under the 2017 Feihe Master Agreement are anticipated to exceed their respective Proposed Annual Caps, or that there is any proposed material amendment to the terms of the 2017 Feihe Master Agreement, as confirmed by the Directors, the Company shall comply with the applicable provisions of the Listing Rules governing continuing connected transaction.

Given the above stipulated requirements for continuing connected transactions pursuant to the Listing Rules, we are of the view that there are adequate measures in place to monitor the transactions contemplated under the 2017 Feihe Master Agreement and thus the interest of the Independent Shareholders would be safeguarded.

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## LETTER FROM GRAM CAPITAL

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### RECOMMENDATION

Having taken into consideration the factors and reasons as stated above, we are of the opinion that (i) the terms of the 2017 Feihe Master Agreement are on normal commercial terms and are fair and reasonable so far as the Independent Shareholders are concerned; and (ii) the transactions contemplated under the 2017 Feihe Master Agreement are conducted in the ordinary and usual course of business of the Group and in the interests of the Company and the Shareholders as a whole. Accordingly, we recommend the Independent Board Committee to advise the Independent Shareholders to vote in favour of the resolution(s) to be proposed at the SGM to approve the 2017 Feihe Master Agreement and transactions contemplated thereunder and we recommend the Independent Shareholders to vote in favour of the resolution(s) in this regard.

Yours faithfully,  
For and on behalf of  
**Gram Capital Limited**  
**Graham Lam**  
*Managing Director*

*Note: Mr. Graham Lam is a licensed person registered with the Securities and Futures Commission and a responsible officer of Gram Capital Limited to carry out Type 6 (advising on corporate finance) regulated activity under the SFO. He has over 20 years of experience in investment banking industry.*

\* *For identification purpose only*

## 1. RESPONSIBILITY STATEMENT

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

## 2. INTEREST IN SECURITIES

Save as disclosed below, as at the Latest Practicable Date, none of the Directors and chief executives of the Company had any interest or short position in the Shares, underlying Shares and debt securities of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) nor had any interest in the right to subscribe for Shares in the Company which had to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they were taken or deemed to have under such provisions of the SFO) or which were required, pursuant to section 352 of the SFO, to be entered in the register of the Company referred to therein or which were required, pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers contained in the Listing Rules, to be notified to the Company and the Stock Exchange.

As at the Latest Practicable Date, Directors who had long position in the Shares were as follows:

<b>Name of Director</b>	<b>Capacity</b>	<b>Number of Shares held (Note 1)</b>	<b>Percentage of the issued share capital of the Company</b>
Zhao Hongliang	Beneficial owner	1,331,500,000 (L) (Notes 2 and 3)	28.39%
Fu Wenguo	Beneficial owner	15,000,000 (L) (Note 3)	0.32%
Wang Shaogang	Beneficial owner	9,500,000 (L) (Note 3)	0.20%
Chen Xiangqing	Beneficial owner	5,500,000 (L) (Note 3)	0.12%
Wu Chi Keung	Beneficial owner	500,000 (L) (Note 3)	0.01%

*Notes:*

1. The letter “L” denotes the person’s long position (as defined under Part XV of the SFO) in the Shares.
2. These Shares comprise of (i) the options granted to Zhao Hongliang (“Mr. HL Zhao”) by the Company pursuant to the share option scheme of the Company, which entitled him to subscribe for a total of 10,400,000 Shares upon his exercise of these options; (ii) 1,150,900,000 Shares is owned by ZHL Asia Limited, a company which is wholly owned by Mr. HL Zhao; and (iii) 170,200,000 Shares owned by ZHY Asia Limited, a company which is wholly owned by Zhao Hongyu (“Mr. HY Zhao”) who is the brother of Mr. HL Zhao. Mr. HL Zhao is the sole director of ZHL Asia Limited. Mr. HL Zhao is the brother of Mr. HY Zhao.

ZHL Asia Limited, ZHY Asia Limited, Mr. HL Zhao and Mr. HY Zhao are parties acting in concert and on 29 October 2013 they entered into a deed of acting in concert to, among others, confirm their acting-in-concert agreement. Mr. HL Zhao was taken to be interested in all the Shares in which each of ZHL Asia Limited and Mr. HY Zhao was interested under the SFO.

3. These Shares represent the Shares to be issued and allotted by the Company upon the exercise of the options granted to each of these Directors under the share option scheme of the Company.

### 3. DIRECTORS’ SERVICE CONTRACTS

As at the Latest Practicable Date, none of the Directors had or was proposed to have a service contract with the Company or any of our subsidiaries other than contracts expiring or determinable by the employer within one year without the payment of compensation (other than statutory compensation).

### 4. COMPETING INTERESTS

As at the Latest Practicable Date, none of the Directors and their respective associates was interested in any business apart from the business of the Group, which competes or is likely to compete, either directly or indirectly, with the business of the Group.

### 5. OTHER ARRANGEMENTS INVOLVING DIRECTORS

As at the Latest Practicable Date:

- (a) none of the Directors was materially interested in any contract or arrangement entered into by any member of the Group subsisting at the Latest Practicable Date and which was significant in relation to the business of the Group; and
- (b) none of the Directors had any direct or indirect interest in any assets which had been since 31 December 2016 (the date to which the latest published audited consolidated financial statements of the Company were made up), (i) acquired or disposed of by; (ii) leased to; or (iii) are proposed to be acquired or disposed of by; or (iv) are proposed to be leased to, any member of the Group.

## 6. MATERIAL ADVERSE CHANGES

The Directors have confirmed that there has been no material change in the financial or trading position or outlook of the Group since 31 December 2016, the date to which the latest published audited accounts of the Group were made up, and up to and including the Latest Practicable Date.

## 7. EXPERT

The following is the qualification of the expert who has given its opinions or advice, which are contained or referred to in this circular:

<b>Name</b>	<b>Qualification</b>
Gram Capital Limited	a licensed corporation to carry out Type 6 (advising on corporate finance) regulated activity under the SFO

As at the Latest Practicable Date, Gram Capital:

- (a) has given and has not withdrawn its written consent to the issue of this circular with the inclusion of its letter and references to its name, in the form and context in which it appears;
- (b) did not have any shareholding in any member of the Group or the right (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for securities in any member of the Group; and
- (c) did not have any direct or indirect interest in any assets which had been since 31 December 2016 (the date to which the latest published audited consolidated financial statements of the Company were made up), acquired, disposed of by, or leased to any member of the Group or were proposed to be acquired or disposed of by, or leased to, any member of the Group.

## 8. GENERAL

In the event of inconsistency, the English text of this circular shall prevail over the Chinese text.

## 9. DOCUMENTS AVAILABLE FOR INSPECTION

A copy of the 2017 Feihe Master Agreement is available for inspection during normal business hours on any weekday (excluding Saturdays, Sundays and public holidays) at the principal place of business of the Company at 31/F, 148 Electric Road, North Point, Hong Kong for a period of 14 days from the date of this circular.

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## NOTICE OF THE SPECIAL GENERAL MEETING

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### **YuanShengTai Dairy Farm Limited**

**原生态牧业有限公司**

*(Incorporated in Bermuda with limited liability)*

**(Stock Code: 1431)**

## NOTICE OF THE SPECIAL GENERAL MEETING

**NOTICE IS HEREBY GIVEN** that the special general meeting of YuanShengTai Dairy Farm Limited (“**Company**”) will be held at Jasmine II, Rosedale Hotel & Suites, Beijing, 8 Jiang Tai Road West, Chaoyang District, Beijing, the PRC on Monday, 17 July 2017 at 10:00 a.m. to consider and, if thought fit, pass, with or without modifications, the following resolution as ordinary resolution of the Company:

### **ORDINARY RESOLUTION**

1. **“THAT:**

- (a) the 2017 Feihe Master Agreement and the transactions contemplated under the 2017 Feihe Master Agreement (as defined and described in the circular to the shareholders of the Company dated 30 June 2017, a copy of which has been produced to the meeting marked “A” and signed by the Chairman of the meeting for the purpose of identification) and the proposed annual caps of RMB812 million, RMB902 million and RMB1,015 million for the years ending 31 December 2017, 31 December 2018 and 31 December 2019, respectively be and are hereby approved, ratified and confirmed; and
- (b) the directors of the Company or any other person authorised by the directors of the Company be and are hereby authorised to sign, execute, perfect and deliver all such documents and do all such deeds, acts, matters and things as they may in their absolute discretion consider necessary or desirable for the purpose of or in connection with the implementation of the 2017 Feihe Master Agreement and all transactions and other matters contemplated thereunder or ancillary thereto, to waive compliance from and/or agree to any amendment or supplement to any of the provisions of the 2017 Feihe



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## NOTICE OF THE SPECIAL GENERAL MEETING

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Master Agreement which in their opinion is not of a material nature and to effect or implement any other matters referred to in this resolution.”

For and on behalf of the Board of  
**YuanShengTai Dairy Farm Limited**  
**Zhao Hongliang**  
*Executive Director and Chairman*

Hong Kong, 30 June 2017

<i>Registered office:</i>	<i>Head office and Principal Place of Business in the PRC:</i>	<i>Principal place of business in Hong Kong:</i>
Clarendon House	Qingxiang Street	31/F, 148 Electric Road
2 Church Street	Kedong, Qiqihar	North Point
Hamilton HM 11	Heilongjiang Province	Hong Kong
Bermuda	PRC	

*Notes:*

1. The register of members of the Company will be closed from Wednesday, 12 July 2017 to Monday, 17 July 2017, both days inclusive, during which period no transfer of shares of the Company will be registered. In order to qualify for voting at the special general meeting of the Company, all transfers of shares of the Company accompanied by the relevant share certificates must be lodged for registration with the Company’s branch share registrar in Hong Kong, Computershare Hong Kong Investor Services Limited, 17M Floor, Hopewell Centre, 183 Queen’s Road East, Wanchai, Hong Kong, no later than 4:30 p.m. on Tuesday, 11 July 2017.
2. Any member of the Company (the “Member”) entitled to attend and vote at the SGM convened by the Notice or its adjourned meeting (as the case may be) is entitled to appoint one (or, if he/she/it holds two or more shares in the Company, more than one) proxy to attend and, on a poll, vote on his/her/its behalf subject to the provisions of the Bye-laws of the Company. A proxy need not be a Member but must be present in person at the SGM to represent the Member. If more than one proxy is so appointed, the appointment shall specify the number and class of shares in respect of which such proxy is so appointed.
3. In order to be valid, the form of proxy must be deposited together with a power of attorney or other authority, if any, under which it is signed or a notarially certified copy of that power or authority, at the offices of the Company’s branch share registrar and transfer office in Hong Kong, Computershare Hong Kong Investor Services Limited, at Shops 1712-1716, 17th Floor, Hopewell Centre, 183 Queen’s Road East, Wanchai, Hong Kong not less than 48 hours before the time for holding the SGM (i.e. no later than 10:00 a.m. (Hong Kong time) on Saturday, 15 July 2017) or adjourned meeting. Completion and return of a form of proxy will not preclude a Member from attending in person and voting at the SGM or any adjournment thereof should he/she so wish.
4. Where there are joint holders of any ordinary share of the Company, any one of such holders may vote at the meeting, either personally or by proxy, in respect of such share as if he were solely entitled thereto, but if more than one of such holders be present at the meeting personally or by proxy, that one of such holders so present whose name stands first on the register of members of the Company in respect of such share shall alone be entitled to vote in respect thereof.
5. Voting of the ordinary resolution set out in this notice will be by way of poll.

*As at the date of this circular, the Board comprises four executive directors of the Company, namely Mr. Zhao Hongliang (Chairman), Mr. Wang Shaogang (Vice-Chairman), Mr. Fu Wenguo (Chief Executive Officer) and Mr. Chen Xiangqing (Chief Financial Officer); one non-executive director of the Company, namely Mr. Lau Ho Fung; and three independent non-executive directors of the Company, namely Mr. Wu Chi Keung, Mr. Zhang Yuezhou and Mr. Zhu Zhanbo.*