CHINA MENGNIU DAIRY COMPANY LIMITED

中國蒙牛乳業有限公司*

(Incorporated in the Cayman Islands with limited liability)

(Stock Code: 2319)

ANNOUNCEMENT OF THE ANNUAL RESULTS FOR THE YEAR ENDED 31 DECEMBER 2018

HIGHLIGHTS

- In 2018, Mengniu continued to be named among the "Global Dairy Top 10" by Rabobank for two years in a row, BrandZ™'s list of top 20 most valuable Chinese brands for the fourth consecutive year and topping the list of brand contribution. In 2019, for the first time, Mengniu made it among Brand Finance's list of the top 500 most valuable brands of the world.
- Mengniu introduced the "Power of Nature, Born for Greatness" brand proposition which gained unprecedented success by tying in with 2018 FIFA World Cup ("World Cup") themed marketing. During the period of World Cup, the brand power of Mengniu increased significantly, climbing to the top spot of the industry for the first time in five years.
- Mengniu's room temperature products saw a significant boost in sales volume, while overall sales recorded considerable growth and the business gained a bigger market share; the share of chilled products remained the first in the market for the 13th consecutive year. Core products delivered steady performance while its innovative new products performed brilliantly; the ice cream business achieved sales that had grown at a high single-digit rate. The milk formula business, which had turned around to profit and capitalized on the growth momentum, managing significant growth.
- During the year, Mengniu consolidated and established new business divisions, focusing on businesses with high potentials including overseas markets, fresh milk, plant-based protein beverage and yogurt, with which the overall deployment witnessed initial satisfactory results.
- Mengniu strengthened its digital marketing development and reinforced channel and POS constructions, while promoting new retail model via B2B and empowering distributors to enhance its sales capability.
- Mengniu further optimized the deployment in quality milk sources and production lines in order to enhance the efficiency of its supply chain. Also, it established a factory in Indonesia as its second overseas factory, which is also the first liquid milk factory of Mengniu located in overseas markets, serving to speed up the entry to Southeast Asian markets.

* *For identification purposes only*

The board (the "Board") of directors (the "Directors") of China Mengniu Dairy Company Limited (the "Company") is pleased to present the results of the Company and its subsidiaries (the "Group" or "Mengniu") for the year ended 31 December 2018, together with the comparative amounts.

CONSOLIDATED STATEMENT OF PROFIT OR LOSS

Year ended 31 December 2018

	Notes	**2018** *RMB'000*	2017 *RMB'000*
REVENUE	*4*	**68,977,066**	60,155,622
Cost of sales		**(43,193,440)**	(38,972,927)
GROSS PROFIT		**25,783,626**	21,182,695
Other income and gains	*4*	**736,255**	338,179
Selling and distribution expenses		**(18,833,306)**	(14,868,755)
Administrative expenses		**(2,915,035)**	(2,497,212)
Impairment losses on financial and contract asset, net		**(85,262)**	(83,893)
Other expenses	*5*	**(851,216)**	(1,098,605)
Interest income		**868,257**	584,011
Finance costs	*7*	**(550,662)**	(399,872)
Share of losses of associates		**(299,935)**	(531,587)
PROFIT BEFORE TAX	*6*	**3,852,722**	2,624,961
Income tax expense	*8*	**(649,001)**	(594,283)
PROFIT FOR THE YEAR		**3,203,721**	2,030,678
Attributable to:			
Owners of the Company		**3,043,030**	2,047,839
Non-controlling interests		**160,691**	(17,161)
		3,203,721	2,030,678
EARNINGS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE COMPANY (EXPRESSED IN RMB PER SHARE)	*10*		
Basic			
– For profit for the year		**0.779**	0.526
Diluted			
– For profit for the year		**0.778**	0.526

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Year ended 31 December 2018

	2018 *RMB'000*	2017 *RMB'000*
PROFIT FOR THE YEAR	**3,203,721**	2,030,678
OTHER COMPREHENSIVE INCOME/(LOSS)		
Other comprehensive income/(loss) that may be reclassified to profit or loss in subsequent periods:		
Exchange differences:		
Exchange differences on translation of foreign operations	**(206,615)**	194,835
Cash flow hedges:		
Effective portion of changes in fair value of hedging instruments arising during the year	**(4,196)**	30,617
Share of other comprehensive income of associates	**(21,181)**	3,617
Net other comprehensive income/(loss) that may be reclassified to profit or loss in subsequent periods	**(231,992)**	229,069
Other comprehensive loss that will not be reclassified to profit or loss in subsequent periods:		
Equity investments designated at fair value through other comprehensive income:		
Changes in fair value	**(218,287)**	(270,160)
Net other comprehensive loss that will not be reclassified to profit or loss in subsequent periods	**(218,287)**	(270,160)
OTHER COMPREHENSIVE LOSS, NET OF TAX	**(450,279)**	(41,091)
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	**2,753,442**	1,989,587
Attributable to:		
Owners of the Company	**2,589,152**	2,023,028
Non-controlling interests	**164,290**	(33,441)
	2,753,442	1,989,587

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
As at 31 December 2018

	Note	**31 December 2018 *RMB'000***	31 December 2017 *RMB'000*
NON-CURRENT ASSETS			
Property, plant and equipment		**14,733,924**	12,715,454
Construction in progress		**2,203,125**	1,363,399
Investment properties		**73,785**	59,333
Land use rights		**1,120,666**	1,055,968
Goodwill		**4,681,492**	4,532,899
Other intangible assets		**2,298,075**	2,193,901
Investments in associates		**7,202,363**	7,194,010
Deferred tax assets		**1,041,626**	665,364
Biological assets		**1,136,600**	646,143
Derivative financial instruments		**28,598**	54,602
Other financial assets		**2,131,485**	1,585,183
Long term prepayments		**64,140**	54,769
Total non-current assets		**36,715,879**	32,121,025
CURRENT ASSETS			
Other financial assets		**11,819,198**	10,690,539
Derivative financial instruments		**49,212**	5,584
Inventories		**4,281,919**	3,510,268
Trade and bills receivables	*11*	**2,891,973**	2,646,834
Prepayments, other receivables and other assets		**2,777,593**	2,541,423
Pledged deposits		**623,495**	466,265
Cash and bank balances		**7,297,988**	5,958,877
		29,741,378	25,819,790
Assets of a disposal group classified as held for sale		**–**	197,916
Total current assets		**29,741,378**	26,017,706

CONSOLIDATED STATEMENT OF FINANCIAL POSITION *(continued)*
As at 31 December 2018

	Note	**31 December 2018** *RMB'000*	31 December 2017 *RMB'000*
CURRENT LIABILITIES			
Trade and bills payables	*12*	**7,021,542**	6,342,273
Other payables and accruals		**10,889,417**	7,324,223
Interest-bearing bank and other borrowings		**6,522,915**	7,935,027
Other loans		**22,912**	22,912
Derivative financial instruments		**9,705**	1,222
Deferred income		**170,261**	160,279
Income tax payable		**472,366**	231,899
Other financial liabilities		**–**	545,594
		25,109,118	22,563,429
Liabilities directly associated with the assets classified as held for sale		**–**	2,864
Total current liabilities		**25,109,118**	22,566,293
NET CURRENT ASSETS		**4,632,260**	3,451,413
TOTAL ASSETS LESS CURRENT LIABILITIES		**41,348,139**	35,572,438
NON-CURRENT LIABILITIES			
Interest-bearing bank and other borrowings		**8,192,400**	6,015,097
Long term payables		**814**	10,894
Deferred income		**856,120**	739,459
Deferred tax liabilities		**206,122**	70,028
Derivative financial instruments		**17,457**	–
Other financial liabilities		**1,610,947**	1,629,837
Total non-current liabilities		**10,883,860**	8,465,315
NET ASSETS		**30,464,279**	27,107,123
EQUITY			
Equity attributable to owners of the Company			
Share capital		**357,602**	357,572
Treasury shares held under share award scheme		**(218,717)**	(262,929)
Other reserves		**12,450,930**	12,716,143
Retained earnings		**12,622,549**	9,793,487
		25,212,364	22,604,273
Non-controlling interests		**5,251,915**	4,502,850
TOTAL EQUITY		**30,464,279**	27,107,123

Notes:

1. CORPORATE AND GROUP INFORMATION

The Company was incorporated as an exempted company with limited liability in the Cayman Islands. The registered office of the Company is located at P.O. Box 309, Ugland House, Grand Cayman KY1-1104, Cayman Islands. The Company is an investment holding company and its subsidiaries are engaged in the manufacture and distribution of dairy products mainly in the People's Republic of China (the "PRC").

2.1 BASIS OF PREPARATION

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

Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries (collectively referred to as the "Group") for the year ended 31 December 2018. A subsidiary is an entity (including a structured entity), directly or indirectly, controlled by the Company. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee (i.e., existing rights that give the Group the current ability to direct the relevant activities of the investee).

When the Company has, directly or indirectly, less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

(a) the contractual arrangement with the other vote holders of the investee;

(b) rights arising from other contractual arrangements; and

(c) the Group's voting rights and potential voting rights.

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

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

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

2.1 BASIS OF PREPARATION *(continued)*

Basis of consolidation *(continued)*

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

2.2 CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES

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

Amendments to IFRS 2	*Classification and Measurement of Share-based Payment Transactions*
Amendments to IFRS 4	*Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts*
IFRS 9	*Financial Instruments*
IFRS 15	*Revenue from Contracts with Customers*
Amendments to IFRS 15	*Clarifications to IFRS 15 Revenue from Contracts with Customers*
Amendments to IAS 40	*Transfers of Investment Property*
IFRIC-Int 22	*Foreign Currency Transactions and Advance Consideration*
Annual Improvements 2014-2016 Cycle	Amendments to IFRS 1 and IAS 28

Except for the amendments to IFRS 4 and *Annual Improvements 2014-2016 Cycle*, which are not relevant to the preparation of the Group's financial statements, the nature and the impact of the new and revised IFRSs are described below:

(a) Amendments to IFRS 2 address three main areas: the effects of vesting conditions on the measurement of a cash-settled share-based payment transaction; the classification of a share-based payment transaction with net settlement features for withholding a certain amount in order to meet an employee's tax obligation associated with the share-based payment; and accounting where a modification to the terms and conditions of a share-based payment transaction changes its classification from cash-settled to equity-settled. The amendments clarify that the approach used to account for vesting conditions when measuring equity-settled share-based payments also applies to cash-settled share-based payments. The amendments introduce an exception so that a share-based payment transaction with net share settlement features for withholding a certain amount in order to meet the employee's tax obligation is classified in its entirety as an equity-settled share-based payment transaction when certain conditions are met. Furthermore, the amendments clarify that if the terms and conditions of a cash-settled share-based payment transaction are modified, with the result that it becomes an equity-settled share-based payment transaction, the transaction is accounted for as an equity-settled transaction from the date of the modification. The amendments have had no impact on the financial position or performance of the Group as the Group does not have any cash-settled share-based payment transactions and has no share-based payment transactions with net settlement features for withholding tax.

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

(b) IFRS 9 *Financial Instruments* replaces IAS 39 *Financial Instruments*: *Recognition and Measurement* for annual periods beginning on or after 1 January 2018, bringing together all three aspects of the accounting for financial instruments: classification and measurement, impairment and hedge accounting.

The Group has early adopted IFRS 9 (2009) and IFRS 9 (2013) on 1 January 2014 and 1 July 2014, respectively. The Group has adopted the full text of IFRS 9 (2014) on 1 January 2018. The following information sets out the impact of adopting the full text of IFRS 9 (2014) including the effect of replacing IAS 39's incurred credit loss calculation with IFRS 9's expected credit losses ("ECLs").

Impairment

The following table reconciles the aggregate opening impairment allowances under IAS 39 to the ECL allowance under IFRS 9.

	Impairment allowances under IAS 39 at 31 December 2017	**Remeasurement**	**ECL allowances Under IFRS 9 At 1 January 2018**
	RMB'000	*RMB'000*	*RMB'000*
Other financial assets at amortised cost	–	–	–
Trade and bills receivables	121,032	6,597	127,629
Financial assets included in prepayments, other receivables and other assets	30,141	–	30,141
	151,173	6,597	157,770

Impact on retained profits

The impact of transition to IFRS 9 on retained profits is as follows:

	Retained profits
	RMB'000
Retained profits	
Balance as at 31 December 2017 under IAS 39	9,793,487
Recognition of expected credit losses for trade receivables under IFRS 9	(6,367)
Balance as at 1 January 2018 under IFRS 9	9,787,120

(c) IFRS 15 and its amendments replace IAS 11 *Construction Contracts*, IAS 18 *Revenue* and related interpretations and it applies, with limited exceptions, to all revenue arising from contracts with customers. IFRS 15 establishes a new five-step model to account for revenue arising from contracts with customers. Under IFRS 15, revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The principles in IFRS 15 provide a more structured approach for measuring and recognising revenue. The standard also introduces extensive qualitative and quantitative disclosure requirements, including disaggregation of total revenue, information about performance obligations, changes in contract asset and liability account balances between periods and key judgements and estimates. As a result of the application of IFRS 15, the Group has changed the accounting policy with respect to revenue recognition in the financial statements.

The Group has adopted IFRS 15 using the modified retrospective method of adoption. Under this method, the standard can be applied either to all contracts at the date of initial application or only to contracts that are not completed at this date. The Group has elected to apply the standard to contracts that are not completed as at 1 January 2018.

The cumulative effect of the initial application of IFRS 15 was recognised as an adjustment to the opening balance of retained profits as at 1 January 2018. Therefore, the comparative information was not restated and continues to be reported under IAS 11, IAS 18 and related interpretations.

Set out below are the amounts by which each financial statement line item was affected as at 1 January 2018 as a result of the adoption of IFRS 15:

	Notes	**Increase/ (decrease)** *RMB'000*
Assets		
Inventories	*(i)*	(24,630)
Prepayment, other receivables and other assets	*(i)*	24,630
Total assets		–
Liabilities		
Other payables and accruals	*(i)/(ii)*	–
Total liabilities		–
Equity		–

Set out below are the amounts by which each financial statement line item was affected as at 31 December 2018 and for the year ended 31 December 2018 as a result of the adoption of IFRS 15. The adoption of IFRS 15 has had no impact on the Group's profit or loss, other comprehensive income or on the Group's operating, investing and financing cash flows. The first column shows the amounts recorded under IFRS 15 and the second column shows what the amounts would have been had IFRS 15 not been adopted:

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

(c) *(continued)*

Consolidated statement of financial position as at 31 December 2018:

	Notes	Amounts prepared under IFRS 15 RMB'000	Previous RMB'000	Increase/ (decrease) RMB'000
Assets				
Inventories	*(i)*	4,281,919	4,300,187	(18,268)
Prepayment, other receivables and other assets	*(i)*	2,777,593	2,759,325	18,268
Total assets		66,457,257	66,457,257	–
Liabilities				
Other payables and accruals	*(i)/(ii)*	10,889,417	10,889,417	–
Total liabilities		35,992,978	35,992,978	–
Equity		30,464,279	30,464,279	–

The nature of the adjustments as at 1 January 2018 and the reasons for the significant changes in the statement of financial position as at 31 December 2018 are described below:

(i) *Sale of goods with variable consideration*

Some contracts for the sale of dairy products provide customers with a right of return. Before adopting IFRS 15, the Group recognised revenue from the sale of goods measured at the fair value of the consideration received or receivable, net of returns. If revenue could not be reliably measured, the Group deferred revenue recognition until the uncertainty was resolved. Under IFRS 15, rights of return give rise to variable consideration which is determined using the expected value method or the most likely amount method.

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

(c) *(continued)*

(i) Sale of goods with variable consideration (continued)

Upon adoption of IFRS 15, the Group recognised a right-of-return asset which is included in prepayments, other receivables and other assets and is measured at the former carrying amount of the goods to be returned less any expected costs to recover the goods, including any potential decreases in the value of the returned goods. In addition, a refund liabilities which is included in other payables and accruals was recognised based on the amount that the Group expects to return to the customers using the expected value method. Accordingly, the Group reclassified deferred revenue of RMB36,894,000 to refund liabilities which are both included in other payables and accruals and reclassified inventories of RMB24,630,000 to right-of-return assets as included in prepayments, other receivables and other assets as at 1 January 2018.

As at 31 December 2018, the adoption of IFRS 15 resulted in an increase in prepayment, other receivables and other assets and a decrease in inventories by RMB18,268,000. Besides, refund liabilities included in other payables and accruals were increased by RMB29,365,000 and deferred revenue included in other payables and accruals were decreased by RMB29,365,000, for the year ended 31 December 2018.

(ii) Consideration received from customers in advance

Before the adoption of IFRS 15, the Group recognised consideration received from customers in advance from customers included in other payables and accruals. Under IFRS 15, the amount is classified as contract liabilities which is also included in other payables and accruals.

Therefore, upon adoption of IFRS 15, the Group reclassified RMB1,843,166,000 from advances from customers to contract liabilities as at 1 January 2018 in relation to the consideration received from customers in advance as at 1 January 2018.

As at 31 December 2018, under IFRS 15, RMB3,332,929,000 was reclassified from advances from customers to contract liabilities in relation to the consideration received from customers in advance for the sale of dairy products.

(d) Amendments to IAS 40, clarify when an entity should transfer property, including property under construction or development, into or out of investment property. The amendments state that a change in use occurs when the property meets, or ceases to meet, the definition of investment property and there is evidence of the change in use. A mere change in management's intentions for the use of a property does not provide evidence of a change in use. The amendments have had no impact on the financial position or performance of the Group.

(e) IFRIC-Int 22, provides guidance on how to determine the date of the transaction when applying IAS 21 to the situation where an entity receives or pays advance consideration in a foreign currency and recognises a non-monetary asset or liability. The interpretation clarifies that the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part of it) is the date on which an entity initially recognises the non-monetary asset (such as a prepayment) or non-monetary liability (such as deferred income) arising from the payment or receipt of the advance consideration. If there are multiple payments or receipts in advance of recognising the related item, the entity must determine the transaction date for each payment or receipt of the advance consideration. The interpretation has had no impact on the Group's financial statements as the Group's accounting policy for the determination of the exchange rate applied for initial recognition of non-monetary assets or non-monetary liabilities is consistent with the guidance provided in the interpretation.

3. OPERATING SEGMENT INFORMATION

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

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

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

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

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

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

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

Year ended 31 December 2018

	Liquid milk products *RMB'000*	Ice cream products *RMB'000*	Milk powder products *RMB'000*	Others *RMB'000*	Total *RMB'000*
Segment revenue					
Sales to external customers	**59,388,601**	**2,723,407**	**6,017,417**	**847,641**	**68,977,066**
Intersegment sales	**624,098**	**112,660**	**–**	**404,774**	**1,141,532**
	60,012,699	**2,836,067**	**6,017,417**	**1,252,415**	**70,118,598**
Reconciliation:					
Elimination of intersegment sales					**(1,141,532)**
Revenue					**68,977,066**
Segment results	**3,531,601**	**(73,881)**	**207,991**	**(30,665)**	**3,635,046**
Reconciliation:					
Interest income					**868,257**
Finance costs					**(550,662)**
Share of losses of associates					**(299,935)**
Corporate and other unallocated expenses					**200,016**
Profit before tax					**3,852,722**
Income tax expense					**(649,001)**
Profit for the year					**3,203,721**
Segment assets	**41,610,178**	**1,976,935**	**15,468,072**	**670,430**	**59,725,615**
Reconciliation:					
Elimination of intersegment receivables					**(13,248,319)**
Corporate and other unallocated assets					**19,979,961**
Total assets					**66,457,257**
Segment liabilities	**20,424,553**	**2,382,259**	**5,118,045**	**1,119,178**	**29,044,035**
Reconciliation:					
Elimination of intersegment payables					**(13,248,319)**
Corporate and other unallocated liabilities					**20,197,262**
Total liabilities					**35,992,978**

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

Year ended 31 December 2018

	Liquid milk products *RMB'000*	**Ice cream products** *RMB'000*	**Milk powder products** *RMB'000*	**Others** *RMB'000*	**Total** *RMB'000*
Other segment information:					
Depreciation and amortisation	**1,179,948**	**124,191**	**211,744**	**36,343**	**1,552,226**
Unallocated amounts					**286,225**
Total depreciation and amortisation					**1,838,451**
Capital expenditure	**2,826,508**	**241,828**	**408,972**	**10,823**	**3,488,131**
Unallocated amounts					**284,137**
Total capital expenditure*					**3,772,268**
Impairment losses recognised in the consolidated statement of profit or loss	**96,430**	**1,755**	**47,699**	**64**	**145,948**
Impairment losses reversed in the consolidated statement of profit or loss	**(2,657)**	**–**	**(17,908)**	**(44)**	**(20,609)**
Impairment losses recognised in the consolidated statement of profit or loss	**93,773**	**1,755**	**29,791**	**20**	**125,339**
Expenses relating to share option scheme and share award scheme	**82,718**	**10,184**	**7,272**	**1,300**	**101,474**
Unallocated amounts					**54,915**
Total non-cash expenses relating to share option scheme and share award scheme					**156,389**

3. OPERATING SEGMENT INFORMATION *(continued)*

Year ended 31 December 2017

	Liquid milk products *RMB'000*	Ice cream products *RMB'000*	Milk powder products *RMB'000*	Others *RMB'000*	Total *RMB'000*
Segment revenue:					
Sales to external customers	53,014,983	2,513,086	4,042,063	585,490	60,155,622
Intersegment sales	711,788	116,218	–	304,507	1,132,513
	53,726,771	2,629,304	4,042,063	889,997	61,288,135
Reconciliation:					
Elimination of intersegment sales					(1,132,513)
Revenue					60,155,622
Segment results	3,753,841	(210,645)	(262,572)	(93,885)	3,186,739
Reconciliation:					
Interest income					584,011
Finance costs					(399,872)
Share of losses of associates					(531,587)
Corporate and other unallocated expenses					(214,330)
Profit before tax					2,624,961
Income tax expense					(594,283)
Profit for the year					2,030,678
Segment assets	35,685,811	2,056,731	12,944,969	663,834	51,351,345
Reconciliation:					
Elimination of intersegment receivables					(11,223,810)
Corporate and other unallocated assets					17,813,280
Assets related to a disposal group					197,916
Total assets					58,138,731
Segment liabilities	17,946,490	2,206,829	3,206,490	1,031,113	24,390,922
Reconciliation:					
Elimination of intersegment payables					(11,223,810)
Corporate and other unallocated liabilities					17,861,632
Liabilities related to a disposal group					2,864
Total liabilities					31,031,608

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

Year ended 31 December 2017

	Liquid milk products *RMB'000*	Ice cream products *RMB'000*	Milk powder products *RMB'000*	Others *RMB'000*	Total *RMB'000*
Other segment information:					
Depreciation and amortisation	1,206,571	141,799	236,196	38,474	1,623,040
Unallocated amounts					80,810
Total depreciation and amortisation					1,703,850
Capital expenditure	1,975,594	231,965	182,400	20,363	2,410,322
Unallocated amounts					4,240,527
Total capital expenditure*					6,650,849
Impairment losses recognised in the consolidated statement of profit or loss	68,616	4,299	104,719	1,808	179,442
Impairment losses reversed in the consolidated statement of profit or loss	(1,364)	(888)	(807)	(20)	(3,079)
Impairment losses recognised in the consolidated statement of profit or loss	67,252	3,411	103,912	1,788	176,363
Unallocated amounts relating to share option scheme and share award scheme					56,126
Total non-cash expenses relating to share option scheme and share award scheme					56,126

* Capital expenditure consists of cash paid for the purchase of property, plant and equipment, construction in progress, intangible assets, land use rights, biological assets, equity interests in subsidiaries, associates and other equity investments.

Geographical information

a. *Revenue from external customers*

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

b. *Non-current assets*

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

Information about major customers

There was no sales to a single customer which amounted for 10% or more of the Group's revenue for the years ended 31 December 2018 and 2017.

4. REVENUE, OTHER INCOME AND GAINS

An analysis of the revenue is as follows:

	2018	2017
	RMB'000	*RMB'000*
Revenue from contracts with customers:		
Sale of goods	**68,895,850**	60,155,622
Consigned processing services	**81,216**	–
	68,977,066	60,155,622

	2018	2017
	RMB'000	*RMB'000*
Other income and gains		
Government grants related to		
– Recognition of deferred income	**115,945**	85,354
– Income and biological assets *(note a)*	**203,667**	100,262
Gain on disposal of a disposal group classified as held for sale	**44,147**	–
Promotion service income *(note b)*	**–**	17,000
Gross rental income	**49,280**	36,693
Foreign exchange gains, net	**14,384**	–
Net fair value gain on forward currency contracts	**2,232**	1,483
Net fair value gain on exchangeable bonds	**58,009**	2,363
Net fair value gain on a convertible promissory note	**61**	3,711
Net fair value gain on subscription right of warrants	**5,593**	–
Gain on re-measurement of an equity interest in an associate upon business acquisition *(note c)*	**101,038**	–
Others	**141,899**	91,313
	736,255	338,179

Notes:

(a) The government grants in the form of cash donations have been received for the Group's contribution to the development of the local dairy industry. There are no unfulfilled conditions or contingencies attaching to these grants.

(b) This represented promotion service income from Danone Asia Pacific Holdings Pte. Ltd. and Arla Foods amba during 2017.

(c) During 2018, Shijiazhuang Junlebao Dairy Co., Ltd. ("Junlebao"), a 51% indirectly owned subsidiary of the Group, acquired an additional 43.41% equity interest in Banner Baby Dairy Company Limited ("Banner Dairy") from third parties, increasing Junlebao's interest in Banner Dairy to 65.16%. After the acquisition, the Group controlled Banner Dairy and accordingly consolidated Banner Dairy. On the acquisition date, the Group re-measured its previously held equity interest in Banner Dairy at fair value and recognised a gain of RMB101,038,000 in the consolidated statement of profit or loss.

5. OTHER EXPENSES

	2018	2017
	RMB'000	*RMB'000*
Donations	**28,637**	20,555
Fair value change of biological assets	**152,777**	63,099
Loss on disposal of items of property, plant and equipment	**29,981**	28,280
Provision for construction in progress	**–**	256
Provision for property, plant and equipment	**–**	7,216
Provision for other intangible assets	**4,761**	–
Write-down of inventories to net realisable value	**35,316**	84,998
Educational surcharges, city construction tax, and other taxes	**490,977**	439,472
Foreign exchange losses, net	**–**	202,347
Loss on disposal of subsidiaries	**15,054**	11,698
Loss on disposal of partial interests in an associate	**–**	18,204
Loss on deemed disposal of partial interests in associates *(note a)*	**–**	125,439
Others	**93,713**	97,041
	851,216	1,098,605

Note:

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

On 25 January 2017, China Modern Dairy Holdings Ltd. ("China Modern Dairy", stock code: 1117), an associate of the Group, acquired an additional 45% equity interest in a subsidiary at the consideration of 338,602,205 shares in China Modern Dairy issued to the sellers. The acquisition diluted the Group's shareholding in China Modern Dairy from 25.41% to 23.88%, resulting in a loss of RMB53,381,000 recognised in profit or loss.

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

6. PROFIT BEFORE TAX

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

	2018	2017
	RMB'000	*RMB'000*
Cost of inventories sold	**43,139,041**	38,950,047
Realised and unrealised fair value loss/(gains) of commodity futures contracts, net	**(6,394)**	22,880
Cost of consigned processing services	**60,793**	–
Cost of sales	**43,193,440**	38,972,927
Employee benefit expense (including directors' and chief executive's remuneration)		
– Wages, salaries, housing benefits and other allowances	**5,616,109**	4,662,362
– Retirement benefit contributions	**476,061**	415,296
– Share option scheme expense	**51,199**	12,582
– Share award scheme expense	**105,190**	43,544
	6,248,559	5,133,784
Impairment of financial and contract assets, net:		
Impairment of trade receivables, net	**83,900**	59,717
Impairment of financial assets included in prepayments, other receivables and other assets, net	**1,362**	24,176
	85,262	83,893
Depreciation of items of property, plant and equipment	**1,738,806**	1,622,015
Depreciation of investment properties	**3,937**	2,447
Amortisation of land use rights	**28,843**	24,536
Amortisation of other intangible assets	**66,865**	54,852
Research and development costs – current year expenditure	**159,035**	133,379
Outsourcing expense *(note a)*	**185,884**	216,987
Minimum lease payments under operating leases	**278,395**	247,617
Auditor's remuneration *(note b)*	**8,930**	9,400

Notes:

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

(b) In addition to the above fees paid or payable to the auditors, Yashili, a subsidiary of the Company listed on the Main Board of the Stock Exchange of Hong Kong Limited, had an amount of RMB2,983,000 (2017: RMB2,726,000) paid/payable as auditor's remuneration during the year.

7. FINANCE COSTS

An analysis of finance costs is as follows:

	2018	2017
	RMB'000	*RMB'000*
Interest on bank loans	**376,147**	245,002
Interest on US$500,000,000 3.50% bonds due 2018	**107,071**	126,146
Interest on US$500,000,000 4.25% bonds due 2023	**57,696**	–
Interest on long term payables	**1,458**	3,994
Net fair value loss/(gain) on interest rate forward contracts	**8,290**	(907)
Bonds issuance cost and others	**–**	25,637
	550,662	399,872

8. INCOME TAX EXPENSE

Under the Law of the People's Republic of China on Corporate Income Tax ("PRC CIT Law"), except for certain preferential tax treatment available to certain subsidiaries of the Group, the entities within the Group are subject to PRC corporate income tax ("CIT") at a rate of 25% (2017: 25%) on the taxable income as reported in their statutory accounts which are prepared in accordance with the PRC accounting standards and financial regulations.

	2018	2017
	RMB'000	*RMB'000*
Current income tax		
Current charge for the year	**895,334**	713,385
Adjustments recognised in the year for current tax of prior years	**7,617**	10,993
Deferred income tax	**(253,950)**	(130,095)
	649,001	594,283

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

		2018	2017
	Note	***RMB'000***	*RMB'000*
Profit before tax		**3,852,722**	2,624,961
At CIT rate of 25% (2017: 25%)		**963,181**	656,240
Non-deductible items and others, net		**23,793**	5,774
Adjustment recognised in the year for current tax of prior years		**7,617**	10,993
Effect of lower tax rates	*(a)*	**(301,467)**	(271,164)
Effect of tax exemptions	*(a)*	**(199,138)**	(181,050)
Losses attributable to associates		**74,984**	132,897
Tax losses utilised from previous periods		**(79,219)**	(22,612)
Tax losses not recognised		**159,250**	263,205
At the effective income tax rate of 16.85% (2017: 22.64%)		**649,001**	594,283

8. INCOME TAX EXPENSE *(continued)*

Notes:

(a) Thirteen (2017: Thirteen) subsidiaries were granted lower tax rates by the state tax bureau in accordance with the PRC CIT law and the corresponding transitional tax concession policy and "The notice of tax policies relating to the implementation of the western China development strategy."

Thirty (2017: twenty-eight) subsidiaries were granted tax exemptions in accordance with the policy of "The notice of preferential tax policy for preliminary processing of agriculture products".

The total taxable profits of the subsidiaries that are subject to tax concessions amounted to approximately RMB3,392,397,000 (2017: RMB2,957,934,000) in aggregate.

(b) The share of tax attributable to associates amounting to approximately RMB6,949,000 (2017: RMB12,475,000) is included in the share of losses of associates on the face of the consolidated statement of profit or loss.

9. DIVIDENDS

	Notes	**2018** ***RMB'000***	2017 *RMB'000*
Declared and paid during the year			
Equity dividends on ordinary shares		**482,827**	344,816
Proposed for approval at the AGM			
Equity dividends on ordinary shares:			
Proposed final – RMB0.181 (2017: RMB0.12) per ordinary share	*(a)/(b)*	**710,915**	471,283

Notes:

(a) The proposed final dividend for the year is subject to the approval of the Company's shareholders at the forthcoming Annual General Meeting (the "AGM").

(b) This dividend was not recognised as a liability in the consolidated financial statements for the year ended 31 December 2018 but will be reflected as an appropriation of share premium account for the year ending 31 December 2019.

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

(a) Basic earnings per share

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

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

	2018	2017
	Number of shares	*Number of shares*
	'000	*'000*
Issued ordinary shares at 1 January	**3,927,361**	3,925,027
Effect of share options exercised	**80**	1,033
Effect of shares purchased under share award scheme	**(23,131)**	(30,994)
Weighted average number of ordinary shares for the purpose of the basic earnings per share calculation	**3,904,310**	3,895,066

(b) Diluted earnings per share

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

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

	2018	2017
	Number of shares	*Number of shares*
	'000	*'000*
Weighted average number of ordinary shares for the purpose of the basic earnings per share calculation	**3,904,310**	3,895,066
Weighted average number of ordinary shares, assuming issued at no consideration on the deemed exercise of all share options during the year	**3,691**	297
Adjustments for share award scheme	**1,665**	–
Weighted average number of ordinary shares for the purpose of the diluted earnings per share calculation	**3,909,666**	3,895,363

11. TRADE AND BILLS RECEIVABLES

	2018	2017
	RMB'000	*RMB'000*
Bills receivable	**85,447**	61,897
Trade receivables	**2,955,818**	2,705,969
Impairment	**(149,292)**	(121,032)
	2,891,973	2,646,834

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

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

	2018	2017
	RMB'000	*RMB'000*
Within 3 months	**2,524,831**	2,439,605
4 to 6 months	**308,887**	125,377
7 to 12 months	**38,067**	78,150
Over 1 year	**20,188**	3,702
	2,891,973	2,646,834

12. TRADE AND BILLS PAYABLES

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

	2018	2017
	RMB'000	*RMB'000*
Within 3 months	**5,988,352**	5,569,969
4 to 6 months	**809,406**	633,662
7 to 12 months	**193,712**	116,853
Over 1 year	**30,072**	21,789
	7,021,542	6,342,273

13. EVENTS AFTER THE REPORTING PERIOD

On 23 December 2018, the Group and China Shengmu Organic Milk Limited ("China Shengmu", stock code: 1432) entered into a share purchase agreement, pursuant to which the Group agreed to purchase 51% of the equity interest in Inner Mongolia Shengmu High-tech Dairy Co., Ltd. ("Shengmu High-tech Dairy"), a subsidiary of China Shengmu, for a cash consideration of RMB303,419,400. Upon completion, Shengmu High-tech Dairy will become a subsidiary and will be consolidated into the Group. As at the reporting date, the transaction is not completed.

MANAGEMENT DISCUSSION AND ANALYSIS

INDUSTRY REVIEW

In 2018, the overall economy of China continued to grow with consumption remaining steady. The country's GDP for the year amounted to approximately RMB90 trillion, representing an increase of 6.6% year-on-year. Total Retail Sales of Consumer Goods were approximately RMB38 trillion, up by 9.0% year-on-year.

As for the dairy industry, it maintained healthy development thanks to government policies supportive of revival of the industry. The continuous consumption upgrade and a growing middle class in China have given the dairy industry the drive to upgrade and optimize product structure, and the unfolding of the new consumption era is pushing dairy industry players to meet consumers' demand for healthy, readily accessible and personalized products. As such, high-end, healthy, diversified dairy products have become growth engines of the industry, and leading players are resorting to developing new products and high-quality dairy products to seize market share. The consumption power of residents in third-tier and fourth-tier cities is growing while the penetration rate of dairy products has been low, which means the penetration potential in lower-tier cities is another major growth driver of the industry. With Internet use more and more prevalent and the new online retail model developing rapidly, large dairy enterprises like Mengniu are seizing the opportunity to integrate online and offline channels to develop the "new retail" model that merges seamlessly purchase and marketing scenarios. Moreover, empowered by Big Data, they are able to enhance consumption experience and meet consumer demands at all times, thereby markedly elevate the value of dairy products.

At the introduction of new products and active brand marketing by the industry, liquid milk sales continued to register strong growth. The keen interest of consumers in healthy products have translated into demand for room temperature yogurt, high-end pure milk and chilled fresh milk products, turning them into growth engines of the industry. In addition, as the quality of domestic milk formula continues to improve, both foreign and domestic infant milk formula brands have been developing in equally strong strides in the China market. Consumption upgrade has also turned products like organic infant milk formula and goat milk powder into impetus of sales growth for milk powder industry. By the end of December 2018, a total of 1,195 infant milk product formulas had gained approval under the infant milk formula registration policy launched by the Chinese government. With players lacking in competence weeded out, the industry has further consolidated, which is conducive to high quality and strong brands seizing market shares.

In June 2018, the State Council of the PRC issued a circular to further revive the milk industry and improve the quality and safety of domestic dairy products, aiming to, with quality, safety and green development as ultimate targets, facilitate supply-side structural reform to lower cost, optimize industry structure, improve quality, build brands and enhance vitality of the industry, as well as strengthen standards, technological innovation, policy support, law enforcement and monitoring, and enhance consumption, all to the end of speeding up construction of the production system, operation system and quality and safety system of a modern dairy industry. The new policy is expected to help boost the quality, efficiency and competitiveness of the dairy industry, contributing to modernization of the industry. Additionally, the individual income tax reform in China taking effect in 2019 is expected to increase residents' disposable income, hence support the steady growth of consumption expenditure. That plus the prevailing consumption upgrade will brace the healthy development of the dairy industry.

Currently, dairy industries in different parts of the world are not developing at the same speed. Compared with Europe and Northern America, emerging markets, especially those in Asian regions, are facing pressure from such as tight production resources, lagging in technological strength and lower per capita consumption, therefore have lots of room for development and faster consumption growth. To tap the enormous market potential, dairy enterprises in China need to gain a place on the international stage, insist on the internationalization process of "bringing in, going out" to quickly enhance competitiveness, strive for a unified global dairy industry and look for more cooperation opportunities. As a leading dairy product enterprise in China, Mengniu had pressed forward with internationalization in the past year, gradually developing a global dairy community.

BUSINESS REVIEW

Business Division Performance

Room Temperature Product Business

With consumers' needs in mind, Mengniu's room temperature product business pursued product innovation, marketing innovation and stepped up route-to-market ("RTM") development, tying these efforts in with World Cup themed marketing, as such saw a significant boost in brand influence and the sales volume of products. Overall sales recorded considerable growth and the business gained a higher market share. *Mengniu Pure Milk* and high-end pure milk *Milk Deluxe* both achieved double-digit growth in sales. New products launched during the year, such as the *Just Yoghurt* easy-to-carry bottle series *Xiaomanyao* and *Fruit Yogurt*, also achieved satisfactory results, sending the sales performance of room temperature yogurts to a new height.

During the year, the high-end pure milk brand *Milk Deluxe* focused on developing its sub-categories as well as continuing product upgrade. Following the launch of super high-end products tailored for sports enthusiasts, namely *M-PLUS High Protein Milk*, in 2017, staying loyal to the high-end brand positioning of *Milk Deluxe* during the year, the new *Milk Deluxe Organic Milk* product that features the "DreamCap™" packaging was launched, giving *Milk Deluxe* a strong boost to achieve continued rapid sales growth. *Just Yoghurt* mounted the World Cup themed marketing activities with "Pure Flavor, Full Enjoyment" as the slogan, and with the help of focused advertising, effective online and offline interactive marketing plus launching the high-end easy-to carry bottle series *Just Yoghurt Xiaomanyao*, the sales of *Just Yoghurt* was boosted. Mengniu continued to launch the grapefruit flavor, enriching the *Just Yoghurt Xiaomanyao* product line at the end of the year. In addition, Mengniu unveiled to the market its first weight management fiber-rich milkshake milk product *Burnlooking* and its first hydrolyzed collagen jelly product *Ningchun*. In response to consumers' demand, these products were launched in an innovative sales mode via social marketing and publicity platforms, capturing the eyes of the health and beauty conscious mass.

Chilled Product Business

Mengniu's chilled product division made great advancement in various professional aspects, including production techniques, product research and development ("R&D"), packaging design, as well as probiotics and nutritional content. Mengniu also continued to strengthen cooperation with its strategic shareholder Danone SA and its subsidiaries (the "Danone Group") on product R&D and production techniques, which brought fruitful results. In 2018, Mengniu continued to hold the leading share in the chilled product market for the 13th consecutive year and achieved double-digit revenue growth. Core products delivered steady performance while the functional yogurt *Champion* and star probiotics beverage *Yoyi C* both grew, with brand power increasing and staying at the top in the market. *European Charcoal Yogurt* prided strong sales, claiming a larger share of market, and the new meal replacement yogurt *Bio Kaquzi* also performed brilliantly.

During the year, Mengniu launched a number of new chilled products, which bolstered growth of the chilled product business. Since the new product *BB-12* was launched in 2017, *Champion* has focused on enhancing market penetration via strengthening education of the health benefits of the functional yogurt to reinforce the "professional and functional" positioning of the brand, and as such, recorded outstanding sales performance during the year. The well received *Yoyi C LC-37* series, a revolutionary probiotics product launched in 2017, took on a new World Cup themed packaging during the year and, at the complement of the "Scan the Code for Red Packet" activity, further enhanced sales. Moreover, targeting for nationwide deployment, the *European Charcoal Yogurt* series appeared in new packaging and had new flavors added, which resulted in explosive sales growth during the year. At the end of 2017, Mengniu optimized *Bio*'s product structure by launching leading-edge product *Bio Kaquzi,* the first China meal replacement yogurt with mixed grains and yogurt separately packed, in in order to meet the growing demand of domestic consumers for food replacement. Mengniu also launched *Bio Shuangcenglaoru*, the first stirred Fruit on the Bottom ("FOB") yogurt of Mengniu in November 2018.

Milk Formula Business

As for the milk formula business, Yashili International Holding Ltd ("Yashili", stock code: (1230), in which the Group holds approximately 51% stake, owns five brands including *Yashily, Dumex, Reeborne, Doraler* and *Arla Baby & Me,* which are positioned in agreement with its comprehensive product strategies and are scientifically and effectively managed for the product lines to cover all-tier markets: mid-range, high-end and super high-end. Yashili was on the first published list of enterprises with the most infant formulas registered following the implementation of the country's infant milk formula registration policy. By the end of 2018, Yashili had completed registration of 48 formulas in 16 product series of its own brands and also the cooperative brand *Arla*. The Group's another milk formula brand *Junlebao* also completed registration of 27 formulas in 9 product series, reflective of the recognition it enjoys for product quality.

In 2018, Yashili continued to enrich its brand mix and improve product structure, and completed its comprehensive branding upgrades. It launched its new logo and a new brand image with the brand slogan of "Do Our Best for Your Loved Ones" in April 2018. On the back of honors such as CCTV's "Craftsmanship Brand" and "Official Powdered Milk of the 2018 FIFA World Cup™ (for Greater China)", it mounted all-round brand promotion on various platforms. Yashili also strengthened its penetration into counties, townships and third- and fourth-tier cities via the mother-and-baby store channels, supplemented by modern trade channels and e-Commerce channels to grow its business. The business, which had turned around to profit, had sales climbing during the year, managing significant growth.

Ice Cream Business

Tapping into the World Cup craze, the ice cream business division focused on 12 key products of its flagship brand *Suibian* and rolled out extensive promotion titled "Shake for Red Packets, Win Tickets to the World Cup", appealing to consumers online and offline through integrated promotion on television, the Internet and via outdoor advertisement. The extraordinary exposure plus the appointment of Kris Wu, who has a massive young fan base, as brand ambassador enabled the Group to enhance interaction with consumers and in turn boost sales volume and gain market share. And, the promotional efforts targeting major cities with rippling effect also helped pushed up sales nationwide. In 2018, the division achieved sales that had grown at a high single-digit rate. Gross profit margin of the business also increased notably.

During the year, Mengniu launched a total of 28 new ice cream products. For instance, *Suibian* expanded and optimized its product offerings by introducing such high-end products as the double-layer crunchy Belgian chocolate and cherry jam ice cream and strawberry and chocolate flavor ice cream. The high-end brand *Deluxe* launched the new product wonder color crunchy ice cream to drive sales of the brand. *Ice+* introduced various new products, including the special football shape passion fruit flavor ice cream launched in cooperation with Lionel Messi ("Messi"), which won the hearts of consumers. New products were also added to *Mengniu Russian* series and *Mood for Green* series, etc.

New Business Development

Cheese Business

To grasp growth opportunities in the cheese market in China, Mengniu established a cheese business division responsible for three major areas of development, namely retail, deep processing of dairy products and cheese for catering service. By strengthening cooperation with Arla Foods, the largest dairy enterprise in Europe, the Group strived to develop the cheese market with new products, new formula, new packaging, new brand image and new marketing approach as its means, aiming to realize the aspiration of "building a strong cheese industry to help make the healthy China dream come true". In the first half of 2018, Mengniu and Arla Foods together introduced *Arla* shredded mozzarella under the professional catering brand *Arla Pro*, the first cheese product customized for China market and produced in Mengniu's factories, helping Mengniu enter the high-end cheese for catering service business. Together with Arla Foods, it also became the official sponsor of the 2018 World Fencing Championships, thus strengthening brand promotion. The Group also entered the cheese retailing business by launching new kids cheese cup and kids cheese sticks under the children dairy product series *Arla Little Explorer* last November. Such products are 100% imported from Denmark.

Fresh Milk Business

To align with international standards, the fresh milk business division integrated the high quality raw milk resources of China Modern Dairy Holdings Ltd. and adopted world-leading production technology system to produce excellent quality fresh milk. During the year, Mengniu launched a total of 17 fresh milk SKUs, with *Shiny Meadow* fresh milk as the main product targeting the high-end market. Boasting high original protein and calcium contents, *Shiny Meadow* aims to lead a healthy lifestyle in a new era. During the year, the brand was the sole title sponsor of the 1st International Indie Coffee Festival in China, an endeavor to enhance brand influence. The other new product launched during the year was *Greenhouse* fresh milk that targets the mid-range to high-end markets. Using 360 relevant standards to measure milk at source to ensure freshness and also standing out in having higher protein content than peer products, it won market preference.

Since established in late 2017, Mengniu's fresh milk business division has worked hard to establish its business model, build up the service capability of its fresh milk supply chain and deploy sales channels that cover to date about 30 major cities in Eastern, Southern, Northern and Central China. Taking the characteristics of fresh milk consumers and product positioning into account, major channels have been employed to introduce fresh milk products to markets in core regions to enhance product exposure, thereby lay a sound foundation for the fresh milk business to develop.

Plant-based Protein Beverage Business

In 2018, Mengniu's plant-based protein beverage brand *ZhiPuMoFang* focused on the soymilk category, promoting *Silk Americano Soymilk's* positioning as "trendy and healthy, of international quality and great new tastes". The Group mounted precision marketing for the product by highlighting the advanced American production standards that it met and the 40-year history of the *Silk* brand, and achieved significant growth in sales volume as compared with the previous year. At the same time, *ZhiPuMoFang* added a new high-end product on the basis of *Silk Americano Soymilk's* original taste and almond flavor, launching the North American mixed berries flavor series during the year. That helped enhance the overall gross profit margin of the brand. In addition, *Silk Americano Soymilk* also strengthened B2B cooperation with Starbucks, offering plant-based solutions to all of the soymilk-based coffees of its partner and expanding cooperation in more regions and outlets. It also took advantage of the channel resources of Mengniu's liquid milk business to rally new customers, increase the number of sales points, enhance profitability of each individual store and strengthen POS control.

Overseas Business

In 2018, the overseas business division adhered to the strategy of "leveraging the World Cup to deploy business across Southeast Asia" in expanding business. It organized marketing roadshows in Hong Kong, Singapore and Myanmar for *Just Yoghurt, Yoyi C* and ice cream products to help raise the influence of the *Mengniu* brand and drive sales, which resulted in double-digit growth in export volume of the Group's products for the fifth consecutive year. Mengniu's *Yoyi C* factory in Indonesia commenced operation in November 2018. It has a designed daily production capacity of 130 tons and will contribute to the integration of production, supply and sales all in one place and be able to also supply products to major ASEAN countries in the future, as such help boost Mengniu's competitiveness in the Southeast Asian market, and in turn speed up implementation of the internationalization strategy of the Group.

QUALITY MANAGEMENT

Mengniu has aligned with international benchmark enterprises observing ISO9001, FSSC22000 and HACCP standards, and tying them in with its organizational accountability system to establish a three-tier quality and safety management system. The system comprises 26 management modules taking care of from quality management planning to implementation, evaluation and improvement, reinforcement and protection across the entire industrial chain, and covers all business and quality related processes in ranches, feed and veterinary drugs management and end consumers, among others, and with the entire chain traceable, the safety and quality of products are assured. For its new business divisions like overseas business, fresh milk and e-commerce operation, Mengniu has drawn up three-year quality assurance plans that cover aspects including their quality and safety management system, organizational structure setting and division of labor and special guidance has been provided to their personnel, and regarding their equipment and relevant craftsmanship.

The milk source business division has strived to improve the quality of milk supply by multiple ways and means, including adopting a risk alarm mechanism to keep check on the risk exposure of each milk source and plant, and with regard to use of medications on dairy cattle. It also enhanced environment and safety management at the ranches and strengthened professional training of ranch personnel. During the year, Mengniu prided a 100% passing rate of inspections conducted by 37 inspection bodies on a total of 29,354 raw milk samples from 47 projects of its milk source departments randomly selected.

As for the room temperature business division, it embraces the management direction of "refining quality". Using the new internal laser code printing technology, it is able to carry out double tracking of products and optimize the quantitative inspection management mode of production plants. During the year, it developed 109 food safety fast inspection techniques and started applying them in scale. In the area of new product development, it used Big Data analysis on testing new products and implemented a risk assessment mechanism for new products before they are deemed good for launch, plus setting testing standards for pilot test, incubation test, trial production and product stability, so as to effectively control the quality of new products.

The chilled business division continued to implement Danone Group's newly revised Food Safety Item ("FSI") standards, introducing new product management procedure and the Store Check method for management of quality at the retail-end and continuing to implement FSI food safety audits and Nepture cleansing verification, therefore integrating the good practices of Danone Group with Mengniu's business operations to achieve new breakthroughs in management and control of safety of chilled products. During the year, the division pushed ahead with standardizing process of construction and management of the cold chain at the retail-end and was able to significantly reduce the defrosting rate of chilled products.

The ice cream business division improved product packaging and management of the production process, which contributed to standardization of the business process. It also completed reforming OEM management, upgrading its laboratory and stepping up standardization of food safety protection. As for the cheese business division, it continued to upgrade techniques and craftsmanship to ensure various benchmarks agree with the features of new products. Also, the division and Arla Foods together performed audits based on European food safety management standards and better defined quality and safety control and management procedures. The fresh milk business division pressed ahead with construction of its quality and food safety management system with emphasis on three aspects, namely food safety management, quality control at factories and quality management at the retail-end. It had zero food safety incident in 2018.

In addition, 2018 was the "Year of the National Standard Revision for Dairy Products". In response to the country implementing national standards to revitalize the industry, Mengniu took the initiative to participate in drafting the industry standards. It reported to the Ministry of Industry and Information Technology the standards for "condensed milk" and "the testing results of ß-casein in dairy and related products", proof of its commitment to taking the quality of China's dairy industry to a new height. In addition, during the year, Mengniu was the only enterprise in the dairy product industry which has been given approval to setup the "National Innovation Base of Technical Standards (for the dairy industry)". It established five sub-bases for, namely quality milk sources production, application of intelligent manufacturing, research and development of dairy technology, development of testing technology and standardized services, and brought together various industry experts and 76 research institutions, testing institutions and enterprises to form a joint unit to develop a world-leading dairy industry standard innovation center.

MILK SOURCE DEVELOPMENT

In 2018, Mengniu analyzed systematically the current situation of its industrial chain. By effectively "adjusting deployment, optimizing structure and rationalizing pace", it was able to achieve a balance between supply and demand in milk source development, which helped enhance the Group's business performance. Moreover, Mengniu continued to apply its "Excellent Milk Source Operation and Management Model" to help enhance the management level and efficiency of supplier ranches, while kicking off digitalization of milk source operation to enable information sharing among ranch management and the raw milk supply chain, facilitating upgrade of the industrial chain.

The milk sources of Mengniu are primarily in Northwestern, Northeastern and Northern China, areas ideal for rearing dairy cattle. During the year, Mengniu was able to increase the proportion of milk supply from ranches of its investee companies, including China Modern Dairy Holdings Ltd., Inner Mongolia Fuyuan Farming Co., Ltd. and YuanShengTai Dairy Farm Limited, etc. Moreover, it actively expanded overseas milk sources, in such countries as Denmark, Australia and New Zealand, known for their rich milk supply to ensure the Group has access to continuous supply from quality milk sources. During the year, the percentage of milk sources of Mengniu from standardized ranches and scaled farms was maintained at 100%.

Mengniu has continued to enhance the quality of milk source and, via optimizing analysis indicators and classification methods, improve supply management to support development of high-end differentiated products. Combining outstanding local and overseas experiences and taking reference of two core indicators in relation to microorganism and somatic cells, Mengniu has drawn up a set of grading standards for raw milk. The system is integrated with the raw milk pricing and payment mechanism, and protein content benchmarks are used to aid raw milk classification for meeting the different requirements of different products, thereby allowing the Group to achieve maximum economic benefit and has enhanced supply of quality raw milk. During the year, Mengniu's "Sensory and Nutrition Map of China's Raw Milk" project started smoothly, with a professional flavor evaluation team sent to analyze the nutritional content and flavor differences of raw milk from various regions and of different kinds to provide reference for product innovation.

During the year, Mengniu continued to align with the advanced Standard Operation Procedure ("SOP") used by its Danish partner Arla Foods and the AsureQuality safety management standard from New Zealand, one of the most-respected food quality and safety certification standards in the world. It also took to greater depth the operation of the "Mengniu Ranch Quality and Safety Management System" and together with the China-Denmark Milk Technology Cooperation Center, which it set up jointly with Arla Foods, rolled out the "Heat Stress Alleviation Project" and "Regional Ranch Cost-cutting and Efficiency-enhancing Pilot Project", which effectively helped ranches improve delicacy management and further align with international ranch management standards, and ultimately enhanced the competitive strengths of Mengniu's products.

As the first mover in the dairy industry to embrace digitalization, Mengniu applies digital management across its raw milk supply chain, aiming for connection of "cattle-ranch-dairy enterprise-third party" information and, by building a "Digital Milk Source" information platform, to enable sharing of information among ranch management and the raw milk supply chain, so as to drive effective industry development. The "Digital Milk Source" project will go online by stage. In 2018 and 2019, the focus is to build the overall framework of the digital management platform and set up systems for forecasting milk yield, herd record keeping, output per cow, veterinary drugs management, and clearing and settlement. In 2020 and 2021, intelligent hardware facilities will be gradually available for automatic collection of daily ranch operation data. The Group expects to, from 2022 onwards, gradually achieve delicate and standardized ranch management with the support of the digital management platform, to help it improve ranch resources utilization and lower ranch operating cost.

In 2018, China announced the strategy to revive the country's dairy industry and Mengniu responded with efforts to consolidate different resources, build an exclusive Internet financing platform for ranches to help supplier ranches lower financing costs and promote upgrade and transformation of milk source bases. At the same time, benefiting from tightening Mengniu-ranch cooperation, both the operational efficiency and overall profitability of the ranches improved, resulting in win-win and synergistic benefits for upstream and downstream dairy operations.

CORPORATE DIGITAL STRATEGY

In 2018, Mengniu speeded up executing its digital strategy, actively optimizing the digital architecture to aid intelligent manufacturing, supply chain management and understanding of consumer behaviors. The Group is striving for digitalization of sales, channels, staff work quality, manufacturing, integration of manufacturing, supply and sales, resources integration and decision-making, that it may evolve to become the "Digital Mengniu".

Mengniu has taken on the responsibility of leading the industry in building the "Smart Dairy Enterprise" and giving "Made in China" a new and more superior definition. During the year, it steadily proceeded with the intelligent manufacturing digital factory project using Big Data analysis to help with lowering cost and heightening efficiency, and upgrading up- and down-stream operations along its industrial chain. At the heart of the project is a manufacturing execution system capable of "smart" workshop production and operation management, which when integrated with the Group's automated data collection platform and automated production facilities as well as other operation management information systems, can enable true interconnection of facilities and operation systems. Phase VI of the Helin Factory and the Jinhua Factory were the first to complete upgrading their intelligent manufacturing mode. Mengniu's active pursuit of the intelligent manufacturing digital factory project has won the recognition of the Ministry of Industry and Information Technology, which awarded it the "China Intelligent Manufacturing Pilot Demonstration Enterprise" honor, warranting its position as an intelligent manufacturing enterprise matching "Made in China 2025" and "Germany's Industry 4.0" standard. The progressive implementation of the intelligent manufacturing digital factory project will drive the dairy industry in upgrading its traditional operation model with focus on automation, informatization and integration.

In May 2018, Mengniu kicked off the intelligent supply chain project that integrates Internet of Things (IoT) technology and modern supply chain management methods and employs Big Data analysis to realize intelligent, networked and automated supply chain operation and management. With Big Data of actual sales volume as basic reference, the Group is able to more accurately forecast demand, more efficiently schedule production and optimize deployment of marketing resources, factory production resources and logistics resources to enhance the operational efficiency of its supply chain. The Group intends for the project to connect with Alibaba Cloud and other of its cooperative projects, allowing sharing of data and more effective collaboration, and ultimately help the Group lower cost and enhance effectiveness of its operations.

Furthermore, Mengniu launched its smart network project across the nation in August 2018, aiming to build a smart network online system. The system will link up the Point of Sale ("POS"), the operations of distributors, member sales companies and Mengniu headquarters, allowing visible POS management and connection with Enterprise Resource Planning ("ERP") system. It is a system that integrates business and financial functions and covers multiple brands and multiple distribution formats tailored to meet the business needs of distributors, empowering them in opening up channels, improving cost management, reducing staff costs and boosting sales management efficiency.

In June 2018, Mengniu collaborated with Alibaba Cloud to commence its consumer Big Data project entailing setting up a consumer data processing center and a "people-oriented" Mengniu consumer behavior analysis system. By establishing a unified data standardization system and an information management platform that serve the entire Group, and through integration of data and employing identity identification technology to label consumers, their behaviors and preferences, delicacy management of operation and accurate targeting of consumers and reaching them via multiple channels are possible. At the same time, through different marketing activities, useful information can be collected continuously to amass for the Group valuable consumer data assets to support marketing decision-making and give the Group yet stronger competitive advantages.

Looking ahead, Mengniu will continue to reinforce its digital competitive advantages, unearth the value of its data asset and build a digital industrial chain, all to the end of achieving at full strength the goals of its "2020 Informatization Strategy".

BRANDING STRATEGY

During the year, Mengniu focused on the World Cup themed marketing that highlighted its new brand proposition "Power of Nature, Born for Greatness" to help it with furthering its strategy to take its brand international. As an Official 2018 FIFA World Cup™ Sponsor, Mengniu gained exposure at the event venues and a total of 161 products of 27 brands in its four product categories were awarded the titles of "Official Drinkable Yogurt of the 2018 FIFA World Cup™","Official Pre-packaged Ice Cream of the 2018 FIFA World Cup™", "Official Milk of the 2018 FIFA World Cup™ (for Greater China)", and "Official Powdered Milk of the 2018 FIFA World Cup™ (for Greater China)". The famous Argentinean football player and former FIFA World Player of the Year Messi was appointed as ambassador of the "Mengniu" brand, together with other celebrities namely Li Yifeng, Zhao Liying, Kris Wu, William Chan, Zhang Yixing, TFBOYS and Celina Jade helping with promotion, Mengniu's brand spirit was perfectly represented and the brand proposition of "Born for Greatness" became buzzwords of the year. The World Cup ties also helped plant Mengniu's international brand image deep into people's heart. Moreover, with the parent brand and the sub-brands working in collaboration and using diverse communication channels for the World Cup themed marketing, the Group achieved excellent interaction with consumers.

Starting early 2018, Mengniu embarked on upgrading the packaging and marketing material for all product lines to align with the World Cup theme, undertaking all-round strategic deployment to roll out forcefully a series of integrated marketing activities which received fantastic responses. Of all the marketing initiatives, between March and July 2018, Mengniu launched a large-scale integrated marketing campaign named "Scan the Code for Red Packet". Upon purchase of Mengniu's room temperature, chilled and ice cream products, consumers can scan the QR code on the packaging for a chance to receive WeChat red packets of different amounts. In addition, another part of the promotion also encouraged consumers to collect fun cards for an opportunity to win a World Cup tour. The marketing activity had taken full advantage of social media platforms to increase interaction with consumers, not only attracting their attention, but also effectively pushing up the rate of repeated purchase of products. The activity which ended on 31 July 2018 registered accumulatively over 230 million times of QR code scannings from more than 74 million participants. According to data collected and survey findings of Kantar Millward Brown, during the period of its World Cup themed integrated marketing campaign, the brand power of Mengniu had increased by 11.4% against the same period in the previous year, climbing to the top spot of the industry the first time in five years. Consumer preference for the Mengniu brand and willingness to purchase both improved across the country.

During the World Cup period, Mengniu kicked off the charitable activity called "Show Your Skills, Young Footballers!" to help youngsters in China realize their football dream. Twenty-four outstanding young football players from different parts of the country were selected by Mengniu and four star team captains, namely Fan Zhiyi, Li Yi, Luis Figo and Yang Chen, and led by their honorary team captain, the young actress Guan Xiaotong, they visited Russia and had a match with the Russian youth football team during the World Cup event period. The match was broadcasted on Jiangsu Television, letting the audience see the power that can foster development of football in China in the future while reinforcing the positive image of Mengniu as a national dairy brand.

During the World Cup period, all Mengniu's brands launched their respective marketing activities tied in with the World Cup theme to consolidate brand power. Among room temperature and chilled product brands, *Just Yoghurt* saw its brand power strengthened by integrating core World Cup advertising resources and crucial exposure on CCTV5, complemented by the "Shake the Bottle, Drink the Best" interactive online and offline marketing activity. Mengniu's *Yoyi C* collaborated with Meitu Inc. to initiate an interactive activity called "Show your Football Fan Faces" that enticed football fans to enjoy the new experience of taking AR selfie of their faces. The initiative was a big success, attracting about 200 million times of active participation, among young consumers. As for the ice cream business, the star brand *Suibian* was the focus of World Cup related marketing resources. A large-scale promotion event "*Suibian* Shake the Red Packets, Win World Cup Tickets" was launched to stimulate consumer demand, and benefitting from brand ambassador influence, interaction with consumers was enhanced, which in turn boosted consumer awareness and preference of the brand and gave a big push to sales. As the iconic high-end ice cream brand, *Deluxe* presented a special World Cup edition ice cream called *Royal Deluxe* crunchy oat ice cream to football fans at the event venue, and by engaging the media and key opinion leaders, managed to take consumer awareness of the brand and its brand reputation to new heights.

Moreover, with enhanced international brand image, Mengniu became a brand representative of the country at international and national events. In June 2018, Mengniu, as the official partner of Shanghai Cooperation Organization Business Forum, had its *Mengniu Pure Milk* product series and star products such as *Milk Deluxe, Just Yoghurt Xiaomanyao,* and *Deluxe* made their debuts at the forum as designated products. In November 2018, Mengniu's *Milk Deluxe* pure milk, *Just Yoghurt* room temperature yogurt, *Deluxe* ice cream, and *Shiny Meadow* fresh milk gained exposure in the first China International Import Expo, helping strengthen Mengniu's international brand image.

During the year, all of Mengniu's sub-brands were active in implementing their respective brand promotion strategy in line with their brand positioning. For instance, *Milk Deluxe* was a Platinum Partner of the 2018 China Open tennis tournament, allowing it to gain maximum exposure of its healthy and active brand image via various channels. *Milk Deluxe Organic Milk* launched during the year was also the title sponsor of Hunan Television's "Super-Vocal" singing contest and that helped extend the reach of brand communications and also fortify the high-end image of the product. Another milk product tailored for sports enthusiasts, namely *Milk Deluxe M-PLUS High Protein Milk*, continued to sponsor the 2018 Beijing Marathon with the communication theme "The Next Step Is Better". The new product *Fruit Milk Drink Fruit Yogurt* boosted brand awareness employing different publicity channels including online and offline advertising and with its brand ambassadors Li Yifeng and Zhao Liying rallying support of their fans for the product. *Champion* succeeded in raising brand acceptance by having super star William Chan as the brand ambassador in *BB-12* product advertising. In addition, Mengniu speeded up developing overseas markets after its *Yoyi C* factory in Indonesia began operation. Mengniu also for the first time designated the star product brand *Yoyi C* as a parent brand in overseas markets to help it gradually realize the vision of grooming *Yoyi C* to become the "Number One" yogurt brand in Southeast Asia.

Milk formula brand *Yashili* unveiled its new brand logo and image during the year. It also became the "Official Powdered Milk of the 2018 FIFA World Cup™ (for Greater China)" and named as CCTV's "Craftsmanship Brand". Moreover, it cooperated with TV shows such as "Memory of the Taste", "Super Baby" and "Beautiful Mom" to do publicity, coupled with in-depth promotion and interaction via diverse channels. It thus has boosted the confidence of its channel partners and consumers.

In 2018, Mengniu continued to gain consumer recognition and endorsement by authoritative organizations, including continuing to be named among the "Global Dairy Top 10" by Rabobank, BrandZ™'s list of top 20 most valuable Chinese brands for the fourth consecutive year and topping the list of brand contribution the latest. On the "2018 China Brand Power Index (C-BPI)" list published by the Ministry of Industry and Information Technology of the PRC, Mengniu's chilled yogurt came first in C-BPI Brand Power in China's yogurt industry for the eighth consecutive year, while Mengniu's *Yoyi C* retained the top position in C-BPI Brand Power in the probiotics drinks industry. According to the research statistics of Kantar Worldpanel, the Consumer Reach Point of Mengniu rose to over one billion, placing it second on the list of Most Chosen Brands by Consumers in the PRC. Moreover, the Group's *Mengniu, Milk Deluxe,* and *Just Yoghurt brands* received the "China Satisfaction Brand" honor from China Enterprises Evaluation Association. Also, in 2019, for the first time, Mengniu made it among Brand Finance's list of the World's Top 500 most valuable brands.

SALES MANAGEMENT

During the year, Mengniu's business divisions stepped up execution of RTM strategy, with more effort put into channels in third- and fourth-tier cities and in exploring channels in village and town markets and also school campuses. They also pushed forcefully to develop e-commerce channels and open up new retail channels, and used channel resources, brand advantages and the digital platform to enhance sales efficiency, strengthen channel and POS control, and foster establishment for carrying out efficient distribution, precision marketing and all-channel marketing.

The room temperature product business division managed to optimize its RTM deployment, enhance penetration of products at the retail end, and help its distributor to improve their POS service capability and efficiency. While safeguarding the interest of distributors, the division forged strategic partnership with such platforms as Huixiadan.net and lst.1688.com. Leveraging the "New Retail" mode and the "Penetration into Towns and Villages Project", it was able to hasten penetration of third- and fourth-tier cities as well as village and town markets. It also, via rolling out the "Spark Program", strengthened POS coverage in towns and villages.

The chilled product business division operates in a total of 14 major sales management regions. During the year, it achieved leading share in all channel sales, with new retail business exceeding sales target. To enhance RTM, in April 2018, the division started tapping core and type A market channels to develop sample markets. In 2018, by focusing on star product categories, insisting on value marketing and enhancing product price premium, the division was able to achieve satisfactory growth in sales of new products. Furthermore, via implementing such innovative channel measures as promoting sales efforts with on-site visits and assistance by all staff of the division at the POS, traditional channels were enhanced and new channels were expanded, resulting in steady expansion of the POS network.

For the milk formula business, adhering to the channel strategy of "Focus on the Mother-and-baby Store Channel for Infant Formula Products, KA Modern Trade Channel for Nourishment Products, and All-round Development for New Channels and New Products", a product line-based management and organizational structure was thus established. It also actively expanded its sales network, penetrating county, township and third- and fourth-tier cities, to drive balanced development of the milk formula business.

In bolstering ice cream sales, the Group had its eyes on key cities and by growing sales in them drove sales volume nationwide. All sales channels performed well, with core traditional channels managing steady sales growth and sales via modern channels climbing quickly. Specialty channels including catering outlets, soft-serve ice cream stores, experience stores and gift projects were also deployed, contributing to remarkable specialty channel growth.

Mengniu's overseas business division took full advantage of the marketing efforts tied in with the World Cup. At the same time as it worked to develop sales outlets and strengthen product penetration at the retail end in existing markets including Hong Kong, Singapore and Macau, it also actively explored new markets in Southeast Asia and expanded coverage of its sales network to countries including Myanmar and Indonesia during the year. At the end of November 2018, Mengniu's factory in Indonesia commenced operation, giving the Group a local manufacturing and sale integrated business setup that can serve markets in major ASEAN countries in the future and help Mengniu speed up penetration of Southeast Asian markets.

As for the e-commerce division, it used Big Data to aid development of new products and upgrade of Mengniu's e-commerce operation. In May 2018, the "Mengniu E-commerce Data Big screen" was officially launched and, in June 2018, the global e-commerce Big Data application platform also began operation in Yungu in Horinger New Area, Inner Mongolia, marking the start of a new stage of digital sales and Big Data integration pursued by Mengniu. Moreover, the Group stepped up strategic collaboration with e-commerce platforms such as JD.com and Tmall, including setting up its own flagship stores for chilled and ice cream products in JD.com, and together with JD.com developed an intelligent supply chain system and offered more personalized products to consumers. Mengniu also tightened cooperation with Alibaba to drive consumption upgrade of fast-moving consumer goods and rolled out intelligent business. During the year, *Milk Deluxe* and *Silk* opened flagship stores in Tmall and they returned satisfactory sales performances. For instance, during the "Double 11" shopping festival, Mengniu achieved top total online sales volume in the dairy product industry for the fourth consecutive year and became the first dairy product brand to make sales of more than RMB100 million on the Alibaba platform. Mengniu was also the champion in sales volume of dairy products in JD.com the fourth consecutive year. In 2018, Mengniu's liquid milk claimed the top share of the online sales market for the third consecutive year. Mengniu's online sales for the year grew more than 50% year-on-year, higher than the average growth rate of the industry.

For the new retail business, Mengniu cooperated with the new retail brand Hema Xiansheng, with access to live broadcast of special Mengniu World Cup activities incorporated into the Hema Xiansheng APP, allowing connection of online and offline interaction. Mengniu also worked closer with business-to-business ("B2B") platforms including lst.1688.com and Huixiadan.net to roll out World Cup marketing theme activities tailored for traditional sales outlets, organized online ordering club, which translated into sales growth. Mengniu also actively deployed smart un-manned convenience stores and explored social network retailing with such products as the fiber-enriched milkshake milk *Burnlooking*.

FINANCIAL REVIEW

Revenue

Benefiting from exertion in product innovation, optimized business structure and the boosted sales volume as brought by the success of FIFA World Cup theme marketing and promotion, the Group's total revenue in 2018 was RMB68,977.1 million (2017: RMB60,155.6 million), representing an increase of 14.7% year-on-year, of which revenue from liquid milk increased 12.0% year-on-year, while that from ice-cream increased by 8.4% year-on-year, and that from the milk formula business saw a breakthrough growth of 48.9% year-on-year.

Gross profit

With a notably improved product mix and raw milk price relatively stable, gross profit of the Group for the year increased to RMB25,783.6 million (2017: RMB21,182.7 million) and gross profit margin was 37.4%, up by 2.2 percentage points as compared with last year (2017: 35.2%).

Operating expenses

To strengthen sales operation and raise brand competitiveness, the Group implemented active strategies for channel development and strengthened brand promotion during the year. As such, it incurred operating expenses of RMB22,684.8 million (2017: RMB18,548.5 million), representing an increase to 32.9%, as expressed as a percentage of the Group's revenue (2017: 30.8%).

Selling and distribution expenses for the year increased by 26.7% to RMB18,833.3 million (2017: RMB14,868.8 million), representing an increase to 27.3% of the Group's revenue (2017: 24.7%).

Advertising and promotion expenses increased by 37.8% to RMB7,005.8 million (2017: RMB5,083.1 million) and, as a percentage of the Group's revenue, increased to 10.2% (2017: 8.4%).

Administrative and other operating expenses, including impairment losses on financial and contract asset, increased by 4.7% to RMB3,851.5 million (2017: RMB3,679.7 million), accounting for 5.6% (2017: 6.1%) of the Group's revenue.

Profit from operating activities and net profit

During the year, with the Group achieving marked increase in overall revenue and gross profit and at the impact of product optimization, its EBITDA increased by 29.6% to RMB5,373.6 million (2017: RMB4,144.7 million) and EBITDA margin was 7.8% (2017: 6.9%).

Profit attributable to owners of the Company increased by 48.6% to RMB3,043.0 million (2017: RMB2,047.8 million). Basic earnings per share increased by 48.1% to RMB0.779 (2017: RMB0.526).

Income tax expenses

Income tax expense of the Group in 2018 was RMB649.0 million (2017: RMB594.3 million), up by 9.2% year-on-year. Effective income tax rate was 16.9% (2017: 22.6%), down by 5.7 percentage points year-on-year, mainly due to (i) the decrease in share of losses of associates during the year; (ii) a non-deductible item relating to the accounting losses on deemed disposal of partial interests in associates by the Group in the previous year; and (iii) previous unrecognised deferred tax arising from tax losses utilised during the year of 2018.

Capital expenditure

For the year ended 31 December 2018, capital expenditure of the Group was RMB3,772.3 million (2017: RMB6,650.9 million), down by 43.3% year-on-year. Of the total, RMB3,203.8 million was spent on building new production facilities and modifying existing ones and related investments, RMB313.7 million on purchasing biological assets and RMB254.8 million was invested in equities (including mainly payment of the consideration for the acquisition of Banner Baby Dairy Company Limited).

Working capital, financial resources and capital structure

For the year ended 31 December 2018, the Group's net cash inflow from operating activities increased to RMB6,363.5 million (2017: RMB5,505.4 million), primarily due to the Group's continuously optimizing product structure and enhanced working capital management.

As at 31 December 2018, outstanding interest-bearing bank and other borrowings of the Group increased to RMB14,715.3 million (31 December 2017: RMB13,950.1 million), including interest-bearing bank and other borrowings repayable within one year in the amount of RMB6,522.9 million (31 December 2017: RMB7,935.0 million). More than 60% of the total interest-bearing bank and other borrowings bore fixed interest rates. The increase in interest-bearing bank and other borrowings was mainly the result of increase in equity investments during the year.

Net borrowings (total amount of interest-bearing bank and other borrowings net of cash and bank balances) of the Group as at 31 December 2018 were RMB7,417.3 million (31 December 2017: RMB7,991.2 million).

The Group's total equity as at 31 December 2018 was RMB30,464.3 million (31 December 2017: RMB27,107.1 million). Debt-to-equity ratio (total amount of interest-bearing bank and other borrowings over total equity) was 48.3% (31 December 2017: 51.5%).

Finance costs of the Group in 2018 were RMB550.7 million (2017: RMB399.9 million), representing approximately 0.9% of the revenue (2017: 0.7%).

PRODUCTS

Combining its resource advantages and world-leading technologies, Mengniu kept exerting on product innovation and R&D, aiming at developing differentiated and high-end products, and enhancing its products in such aspects as product category, flavor and packaging. Alive to consumers' growing preference for personalized products and healthy diet, Mengniu also developed functional and customized products that promise consumers better experiences. In addition, with the help of Big Data, new media and new retail channels, it rolled out promotion and marketing initiatives to expand sales channels and achieved excellent results.

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

Liquid milk

Revenue amounted to RMB59,388.6 million (2017: RMB53,015.0 million), accounting for 86.1% of Mengniu's total revenue (2017: 88.1%).

UHT milk

Revenue amounted to RMB29,688.7 million (2017: RMB25,689.2 million), accounting for 50.0% of the revenue of the liquid milk segment (2017: 48.5%)

– In May 2018, *Milk Deluxe* launched another upgraded product *Organic Milk* in the packaging that adopts the "DreamCap™" in place of the traditional drinking straw, making it yet easier to carry and more practical.

– *Mengniu Pure Milk* took on an upgraded packaging design that agreed with World Cup themed promotion. Mengniu also launched the *Prime Ranch* high calcium milk during the year to fill the high calcium milk gift pack offer gap in the industry.

– In late 2017, Mengniu introduced *Future Star* A2ß Casein Pure Milk made with premium milk in limited supply from selected designated ranches, and has since raised the quality of children milk products.

Key products:

– *Milk Deluxe*

– *Mengniu Pure Milk*

– *Mengniu Flavored Milk*

– *Future Star*

– *Student's Milk*

Milk beverages

Revenue amounted to RMB9,998.3 million (2017: RMB9,879.8 million), accounting for 16.8% of the revenue of the liquid milk segment (2017: 18.6%)

– *Yoyi C LC-37* series, which targets the professional probiotics beverage market, has 50 billion active bacteria C in every 100 ml of the product, 500 times that of the national standard. It also has an exclusive 37°C highly active bacterial strain, making it a revolutionary probiotics product and marking a breakthrough of the technical bottleneck limiting the low temperature probiotics industry before. During the World Cup period, packaging featuring the national flag was launched for the series complemented by "Scan the Code for Red Packet" promotion and the *Yoyi C* brand gained popularity.

Key products:

– *Yoyi C*

– *Fruit Milk Drink*

– *Suan Suan Ru*

Yogurt

Revenue amounted to RMB19,701.6 million (2017: RMB17,446.0 million), accounting for 33.2% of the revenue of the liquid milk segment (2017: 32.9%)

– *Just Yoghurt* changed its packaging across the board to align with the World Cup theme at the beginning of the year and under the "Pure Flavor, Full Enjoyment" promotion slogan launched the new flavors mango and passion fruit, lime-matcha-avocado, and vanilla. It also introduced new PET bottle product *Xiaomanyao* and new grapefruit flavor and fruit pulp yogurt were added at year end.

– *Milk Deluxe Yogurt* is a product that combines patented bacteria from the United States, the exclusive technique of Danone Group from France and premium ingredients from all over the world. During the year, continuing to uphold the "Not all yogurts are Milk Deluxe" spirit, the brand explored the high-end yogurt market and launched six bottle packaging that feature paintings of nature to enhance brand image.

– During the year, *Champion* stepped up promotion and education of consumers regarding its "BB-12" bacteria content to bring under the spotlight its positioning as a "professional and functional" yogurt.

– In late 2017, *Bio* introduced the *Kaquzi* grain mix flavored yogurt to meet demand for meal replacements. The product contains American almonds and cranberries, Australian oats and pumpkin seeds, making it the yogurt with the most of natural grain ingredients among similar products in the Mainland market. Last November, Mengniu launched *Bio shuangcenglaoru*, its first stirred FOB yogurt.

– *European Charcoal Yogurt* expanded the series' packaging specifications and introduced new flavors like lime and yellow peach with pulps, etc.

Key products:

– *Just Yoghurt*

– *Champion*

– *Milk Deluxe Yogurt*

– *Future Star Kid Nutritious Flavored Yogurt*

– *Inner Mongolia Solid Yogurt*

– *Bio*

– *European Charcoal Yogurt*

Ice Cream

Revenue amounted to RMB2,723.4 million (2017: RMB2,513.1 million), accounting for 4.0% of Mengniu's total revenue (2017: 4.2%)

– *Suibian* launched the double-layer crunchy Belgium chocolate and cherry jam ice cream, made with world-class technique and a premium selection of ingredients from all over the world. It is the first of its kind in the country and is positioned as a high-end product. A new strawberry and chocolate flavor was also launched.

– Mengniu created a customized World Cup football-shape ice cream product – *Ice+* passion fruit flavor ice cream, and also launched *Ice+* pineapple popsicle and four fruits wonder popsicle, which drew much consumer enthusiasm.

– The high-end ice cream brand *Deluxe* launched the new product wonder color crunchy ice cream, coming in three popular flavors, namely matcha, tiramisu and toffee, to please consumers' palates.

– *Mood for Green* added a new red bean flavor popsicle with the red beans prepared using a secret recipe. Another new innovative product that hit the market was the *Bean Mill* glutinous rice and red bean ice cream.

– *Mengniu's Russian* ice cream series had new members added, including *Russian* milk block ice cream and *Russian* style chocolate flavor ice cream. They boast rich milk content, strong milk flavor and are smooth and delicate on the palate.

– Mengniu also introduced the *Mengniu Premium Ranch* milk and grape flavor ice cream, marrying pure milk with grapes treated with a unique recipe to give consumers a taste of pure and aromatic sweetness.

Key products:

– *Suibian*

– *Deluxe*

– *Mood for Green*

– *Ice+*

– *Russian*

Milk Formula

Revenue amounted to RMB6,017.4 million (2017: RMB4,042.1 million), accounting for 8.7% of Mengniu's total revenue (2017: 6.7%)

– *Yashily* brand is dedicated to providing basic nutrients. *Yashily Kieember* infant milk formula, canned in and imported from New Zealand, targets the mid-range to high-end market and owns the patented INFAT™ active energy system, altogether five patents enabling it to take care of the healthy growth of babies. *Yashily Kieevagour* and *Yashily Qinérshi* are tailored for the mid-range market, with *Yashily Qinérshuo* having a stronger appeal to the mass. The original *Yashily* formula completed upgrading with enriched probiotics and lactoferrin content.

– *Reeborne* brings Chinese babies with organic purity from the Alps. *Qinyou* series and *Organic* series of *Reeborne* completed packaging and formula upgrade and focused on penetrating the organic market, as such achieved significant growth.

– *Dumex*, originated from Europe, is committed to conducting research on Chinese babies' immune system in its bid to provide professional solutions to satisfy the nutritional needs of infants and toddlers. The *Diamor* series possesses dual patents in Europe and OPO structured fat, which is easy to digest and absorb, and good for improving babies' immune system. The *Boyoujia* series contains patented prebiotics and is rich in nutrition, being amiable and easy to absorb. *Dumex* goat milk series possess easy-to-absorb small molecule protein together with whole goat milk protein and OPO, thus producing *Dumex* domestic high-end goat milk, which is good for preventing allergy. *Dumex TruYn* series is positioned to appeal more to the mass with its precious lactoferrin and OPO structured fat specially added.

– *Arla Baby & Me* organic formula, canned and imported from Denmark, is originated from the world's largest organic dairy producer. *Arla Baby & Me* organic formula obtains certifications in 3 areas, namely hormone-free, fertilizer-free and pesticide-free. The whole single process for milk formula to be produced from fresh milk is controlled by its own ranch. Its quality organic formula contains rich DHA, whole lactose, well-proportioned prebiotics and it is positioned in the super high-end market.

– Last November, *Yashili* launched *Doraler*, which is originated from Australia and positioned in the super high-end goat milk market. It is absolutely canned and imported from overseas, containing 100% pure goat milk protein, which is mild, smooth and easy to absorb, and contains DHA and whole lactose.

– Yashili's products also include various adult milk powder products, such as *Mengniu* brand adult milk formula, *Youyi* brand adult milk formula, *Youri* brand middle-age and elderly milk formula, as well as *Future Star* milk powder for children's growth, and various soluble products such as *Zhengwei* brand oatmeal and *Yashily* infant and toddler nutritional rice cereal.

Key products:

- *Yashily Kieember and Kieevagour*
- *Reeborne*
- *Dumex Diamor*
- *Arla Baby & Me*
- *Doraler*

Other Products

Revenue amounted to RMB847.7 million (2017: RMB585.4 million), accounting for 1.2% of Mengniu's total revenue (2017: 1.0%)

- Adjustment and upgrade were carried out for the plant-based protein beverage *ZhiPuMoFang*, a joint creation of Mengniu and WhiteWave. Its *Silk Americano Soymilk* was launched in November 2017 in two flavors – original and almond. It is made with freshly grinded soybeans and uses the unique 8-second VTIS freshness preservation technology. During the year, the North American mixed berries flavor was introduced.

- Mengniu joined hands with Arla Foods to introduce the professional catering brand *Arla Pro*, with *Arla* shredded mozzarella as the debut product. The product is produced in Mengniu's cheese factory, using the exclusive recipe and advanced techniques of Arla Foods plus premium imported cheese from Denmark as the ingredient, to tap China's cheese market. Mengniu also launched new kids cheese cup and kids cheese sticks under the children dairy product brand *Arla Little Explorer* in the second half year. Its formula, apart from being low-sugar and low-sodium, contains twice the protein content of other children cheese products in the market.

Key products:

- *Silk Americano Soymilk*
- *Arla shredded mozzarella*
- *Lao Qu Bei*
- *Arla Little Explorer*

PRODUCTION

Mengniu deploys its production capacity according to the potential of relevant markets and its product strategy. As at December 2018, Mengniu had 38 production bases in China and one in New Zealand, and together with the production base in Indonesia which commenced operation at the end of November 2018, it had a total production capacity of 9.75 million tons (December 2017: 9.22 million tons).

SOCIAL RESPONSIBILITY

Aspiring to become a world-class benchmark dairy enterprise, Mengniu has aligned its operations with the United Nations Sustainable Development Goals 2030. Adhering to its corporate mission of “focusing on nutrition and health, delivering a drop of happiness for every moment and every day to more people”, it implements sustainable development strategy that covers all its business endeavors while organizing a series of long term corporate social responsibility activities like the “Inclusive Nutrition Plan”, “Golden Key of Milk Cow” and “University of Ranchers” to contribute to sustainable development of the society and the environment.

Mengniu adopts the philosophy of green and low carbon manufacturing in its production management by continuously lowering the greenhouse gas and waste emissions in order to promote the sustainable development in industry. Mengniu has established the Energy Conservation and Emission Reduction Committee headed by the CEO of the Group, and built up a three-level “Group-Business Divisions-Factories” management structure. During the year, Mengniu promoted the integrated utilization of energy and continuously increased the proportion of green and renewable energy such as solar energy, wind energy and biomass energy, such that the total greenhouse gas emission can be efficiently reduced. In 2018, with the outstanding performance in energy saving and emission reduction, Mengniu was awarded “Climate Leader Plants” by Energy Foundation and China Council for an Energy Efficient Economy, being one of the four enterprises in the first batch to win the reputation of “Climate Leader Plants”, and the sole enterprise with this honor among the domestic dairy industry.

As an important poverty alleviation project of Mengniu’s unique “Nutrition-based Poverty Alleviation+ Supporting Intellectual Growth” program, Mengniu’s charitable “Student Milk Program” which was initiated 15 years ago was upgraded in 2017 to the “Inclusive Nutrition Plan” to match to the country’s “Healthy China” strategy and call for more precise poverty alleviation. During the year, via the “Inclusive Nutrition Plan” project, Mengniu cooperated with the World Food Programme of United Nations to roll out a preschool children nutrition improvement pilot project in Xiangxi, Hunan. Moreover, the Group donated a total of approximately 4.42 million packs of student milk to 27,287 poor students and left-behind children in 18 provinces and 91 counties, and provided “lectures on nutrition” on campuses to educate schools, parents and students. In addition, Mengniu and the Research Institute of Food and Nutrition Development under the Ministry of Agriculture and Rural Affairs of the PRC jointly published the “Blue Book on Inclusive Nutrition for Children in Rural China”, the objective of which is to help improve provision of nutrition to children in rural area, especially poor children, and contribute to the success of the “Healthy China 2020 strategy”.

Mengniu cares about achieving "win-win growth" with its cooperative partners to support development of upstream ranches in the dairy industry. Mengniu had to date conducted 19 technical demonstration sessions under the "Golden Key of Milk Cow" program to explain latest breeding and rearing techniques to over 4,500 ranch personnel in over 1,000 ranches. As for the "University of Ranchers", it provided free training to over 10,000 ranch staffers, whereas the "Satellite Lectures" had accumulatively covered 470 innovative practical ranch technology topics reaching 39,000 participants, supporting multi-dimensional upgrade of herd structure, feeding management, etc. at over 1,000 ranches. The free online knowledge learning and exchange platform for the industry "Ranchers Says" launched in 2018 new video training courses given by nine experts in the national dairy industry.

Mengniu has been active in fulfilling its corporate social responsibility. Its related programs such as the "Inclusive Nutrition Plan", "Golden Key of Milk Cow" and "University of Ranchers" have made outstanding contribution to charitable causes and, for that, Mengniu enjoys high recognition from various parties in the community. During the year, the Group received the "Golden Bee Enterprise" award at the 13th China CSR International Forum, was named among the "Top 50 Brands for Chinese Corporate Citizens' Responsibility in 2018" and a "3-Star China Extraordinary Corporate Citizen 2018" by the China Association of Social Workers and the China Extraordinary Corporate Citizen Annual Awards Organizing Committee, and garnered the "13th Annual People's Corporate Social Responsibility Award – Poverty Alleviation" from People's Daily Online and the "China Corporate Social Responsibility Summit 2018 – Charitable Award" from xinhuanet.com. In addition, Mengniu's "Inclusive Nutrition Plan" received the "Asia Responsible Entrepreneurship Award 2018 – Social Empowerment Category" from Enterprise Asia. The poverty alleviation initiative of the Group were also included in the "Blue Book of Poverty Alleviation for Enterprises (2018)" of the Research Center for Corporate Social Responsibility of Chinese Academy of Social Sciences and it received the "Excellent Case in Poverty Alleviation 2018" jointly awarded by the State Council Leading Group Office of Poverty Alleviation and Development and the Chinese Academy of Social Sciences.

HUMAN RESOURCES

As at 31 December 2018, the Group had a total of about 41,031 employees in China, Hong Kong, Oceania and Southeast Asia, including around 2,920 employees of Yashili. During the year, total staff costs (including salaries of directors and senior executives) amounted to approximately RMB6,248.6 million (2017: RMB5,133.8 million).

In accordance with its pursuit of international development, Mengniu succeeded in changing its human resources service mode from "providing operational support" to "rendering strategical support and efficient services", building a new operation model centered around the forging of "new business partner relationship" and facilitated by a "shared services center". During the year, the Group set up the Human Resources Shared Services Center ("HRSSC") that brought together 11 platform systems and through extensive use of automation technology, efficiently handled administrative duties, freeing Human Resources Business Partners ("HRBP") and Centers of Expertise ("COE") to focus on offering value-added services to the Group's businesses to help them grow.

In addition, Mengniu introduced the "Five Elements of Leadership" model at the beginning of 2018 to build for the Group a unified assessment system covering leadership training, evaluation of team leaders and selection of talent for the Group, which was implemented by each business division. Mengniu also optimized all aspects of its personnel training system to provide training focusing on four areas: orientation for new recruits, general capabilities, professional skills and leadership skills, allowing every employee to receive systematic training and education pinpointing their specific requirement.

The Group renewed its corporate culture and refined the Mengniu spirit, preserving its traditional cultural genes, and at the same time enriching its cultural essence keeping up with the times. It issued the "Mengniu corporate culture manual (2018 edition)" to facilitate staff embrace of its corporate culture. In addition, through such corporate culture activities like "Keep Running Mengniu", "Mighty Mengniu Rises to Challenges" and "Mengniu's Gobi Desert Challenges", the Group continued to encourage the active and aggressive "Wolf Culture" among all Mengniu staff, instilling in employees the "Born for Greatness" spirit and value.

During the year, Mengniu optimized its existing incentive system by implementing a rank-based authorization system, strengthening the connection between work incentives for individual employees and performance of the organization, and moving from focusing on labor cost control to pushing up labor cost efficiency. During the year under the long-term incentive plan in place, a total of 6,693,084 shares and 9,593,689 share options were granted under the share award scheme and the share option scheme, respectively, to employees participating in the schemes. In addition, 37,248,880 share options were granted to core management members under the share option scheme to give them stronger motivation in leading Mengniu advance towards higher business development goals and fulfill the targets of the 2020 strategy.

PROSPECTS

The effect of supply-side structural reform of the dairy industry will become more apparent. Dairy product consumption in the market is going to enter a period of rapid growth and the dairy industry will move into a positive development cycle. In the face of consumption upgrade, the dairy product industry needs to meet new requirement in terms of quality, innovation and digital transformation. In 2019, it is expected that cost of raw milk will remain steady with mild increase and the industry will continue to see structural upgrade. From the global perspective, China's dairy industry has become a new force powering development of the global dairy industry and a "Global Dairy Community" is taking shape. The entire dairy industry is committed to revitalizing the industry, aiming for the supply-side structural reform of the industry to bring concrete results by 2020 and progress be seen with modernization of the industry that, by 2025, the overall quality level of products, competitiveness of the dairy industry and consumption penetration of China will match advanced global standards.

Looking forward, Mengniu will continue to strive for high quality and sustainable growth, and achieve breakthroughs in boosting brand power, channel power and its strength to innovate. The four major business divisions will cooperate with new business divisions in releasing the growth potential of new businesses, while consolidating the strengths of traditional businesses. The Group will push to accord with the consumption upgrade trend, pool together its advantageous resources, focus on core product categories and enhance its core products. For room temperature product business, the focus will be on speeding up growth of high-end categories like *Milk Deluxe* and *Just Yoghurt* will focus on *Xiaomanyao* to achieve higher sales target. Furthermore, Mengniu will work hard on market development for *Champion* and *Yoyi C*, and further upgrade of the product structure and market infrastructure of low temperature yogurt products to brace their leadership in the chilled product market. In addition, Mengniu will increase investment in new businesses like fresh milk to develop new growth drivers, so as to inject new vigor and vitality into the Group's business and bring synergistic benefits to its traditional businesses. Mengniu will continue to boost product innovation and upgrade by employing latest industry technologies and aligning with the world highest standards in upgrading product packaging, flavor and function, creating new product categories, leading new trends and developing new markets, as well as optimizing upstream and downstream resources deployment.

On the brand promotion front, taking advantage of the fully enhanced brand power credited to World Cup-tied publicity, Mengniu will continue to promote its "World-class Quality, Born for Greatness" brand concept and tighten the emotional connection between the brand and consumers, making Mengniu the most favorite brand among consumers and in turn boost sales growth. Moreover, through the synergistic cooperative efforts of the parent brand and all the sub-brands and promotional initiatives across all media and channels to fully release of media and resource power, Mengniu will be able to fortify its image as a world-class brand.

To offer more nutritious and healthier products and higher quality digital consumption experience, Mengniu will explore in depth the consumer Big Data it has amassed to understand more precisely consumers' demands, keep pursuing digital upgrade of its entire industrial chain and effectively expand consumption scenarios. It will continue to develop its channels by expanding new channels capitalizing on the advantages of its existing thriving e-commence channel. At the same time, it will step up execution of RTM strategy, hasten channel penetration in lower-tier markets, continue channel innovation and upgrade projects like "Penetration into Towns and Villages Project", "Smart Network Action" and "Show Sword Action" and steadily expand sales network and increase sales volume, so that its business can excel in both quality and quantity.

In collaboration with its three strategic shareholders, namely COFCO Corporation and its subsidiaries, Danone Group and Arla Foods amba, Mengniu will aim for better quality, with a more ambitious vision and higher targets on its journey to become a world-class Chinese dairy enterprise being able to take on yet greater responsibility to society. Mengniu's effective ties with World Cup stands as another milestone in internationalization of the *Mengniu* brand, telling the Group to keep up the steady strides in taking its business international, to lead dairy enterprises in Asia and build a "Global Dairy Community", realizing the sustainable development of the global dairy industry. With the *Yoyi C* factory in Indonesia in operation, Mengniu will speed up overseas business deployment and set up an Oceania center to support the deployment of "two overseas centers", allowing its overseas business to achieve leapfrog growth.

2019 marks a new development milestone – the 20th anniversary – of Mengniu. The Group has grown and evolved from "Mengniu of Inner Mongolia" to "Mengniu of the world" as one of the top 10 dairy enterprises worldwide. Mengniu will hold fast to its determination to win belief of "Born for Greatness" to turn itself into a world-leading Chinese dairy enterprise, speed up realizing its "2020 Goal" Mengniu will enjoy new glory and thrive for a hundred years and beyond.

CORPORATE GOVERNANCE CODE

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

The Board has reviewed the Company's corporate governance practices and is satisfied that the Company has been in compliance with all applicable code provisions of the CG Code during the year ended 31 December 2018, except that the Company has deviated from the Code Provisions A.5.1 and E.1.2 with the reasons explained below.

Code Provision A.5.1 of the CG Code provides that an issuer should establish a nomination committee which is chaired by the chairman of the board or an independent non-executive director and comprises a majority of independent non-executive directors. The Company deviates from this provision as less than half of the members of the Nomination Committee are independent non-executive Directors during the year of 2018. The Directors are of the view that each of Mr. Tim Ørting Jørgensen and Mr. Pascal De Petrini is able to carry out his responsibilities as a member of the Nomination Committee in the best interest of the Shareholders notwithstanding that he is not an independent non-executive director as required under Code Provision A.5.1.

Code Provision E.1.2 provides that the chairman of the board should attend the annual general meeting. The Company deviates from this provision because the chairman of the Board was unable to attend the annual general meeting of the Company held on 4 May 2018 due to other unavoidable business engagement outside of Hong Kong.

SECURITIES TRANSACTIONS OF DIRECTORS

The Company has adopted, in terms no less exacting than, the standards required by the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") set out in Appendix 10 to the Listing Rules as the Company's code of conduct and rules governing dealings by all Directors in the securities of the Company. The Directors have confirmed, following the specific enquiry by the Company, that they have complied with the required standard set out in the Model Code throughout the year ended 31 December 2018.

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

Neither the Company nor any of its subsidiaries purchased, redeemed or sold any of the Company's listed securities during the year ended 31 December 2018.

AUDIT COMMITTEE

The audit committee of the Company has reviewed with the Company's management and the external auditors, the accounting principles and practices adopted by the Company and discussed auditing, risk management, internal control, whistleblowing policy and system and financial reporting matters, including the review of the Group's financial statements for the year ended 31 December 2018.

SCOPE OF WORK OF ERNST & YOUNG

The financial information in respect of the preliminary announcement of the Group's results for the year ended 31 December 2018 has been reviewed and agreed by the Group's auditors, Ernst & Young, to the amounts set out in the Group's draft consolidated financial statements for the year. The work performed by Ernst & Young in this respect did not constitute an assurance engagement in accordance with Hong Kong Standards on Auditing, Hong Kong Standards on Review Engagements or Hong Kong Standards on Assurance Engagements issued by the Hong Kong Institute of Certified Public Accountants and consequently no assurance has been expressed by Ernst & Young on the preliminary announcement.

PROPOSED FINAL DIVIDEND

The Board has recommended the payment of a final dividend of RMB0.181 (2017: RMB0.12) per ordinary share for the year ended 31 December 2018. Upon shareholders' approval at the forthcoming AGM, the proposed final dividend will be paid on or about Thursday, 27 June 2019 to shareholders whose names appear on the register of members of the Company on Thursday, 13 June 2019.

CLOSURE OF REGISTER OF MEMBERS

The register of members will be closed (i) from Monday, 3 June 2019 to Thursday, 6 June 2019, both days inclusive, for determining shareholders' eligibility to attend and vote at the AGM, and (ii) on Thursday, 13 June 2019, for determining shareholders' entitlement to the proposed final dividend, during such periods no transfer of shares will be registered.

In order to qualify for attending and voting at the forthcoming AGM of the Company to be held on Thursday, 6 June 2019, all transfers, accompanied by the relevant share certificates must be lodged with the Company's branch share registrar, Computershare Hong Kong Investor Services Limited, at Shops 1712–16, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, for registration no later than 4:30 p.m. on Friday, 31 May 2019.

In order to qualify for the proposed final dividend, all transfers, accompanied by the relevant share certificates must be lodged with the Company's branch share registrar, Computershare Hong Kong Investor Services Limited, at Shops 1712–16, 17th Floor, Hopewell Centre,183 Queen's Road East, Wanchai, Hong Kong, for registration no later than 4:30 p.m. on Wednesday, 12 June 2019.

PUBLICATION OF ANNUAL RESULTS AND ANNUAL REPORT

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

BOARD OF DIRECTORS

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

APPRECIATION

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

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

Hong Kong, 27 March 2019