

10 February 2022

To the Independent Board Committee

Dear Sirs,

**MANDATORY CONDITIONAL CASH OFFERS
BY CLSA LIMITED FOR AND ON BEHALF OF
HONGKONG JINGANG TRADE HOLDING CO., LIMITED
TO ACQUIRE ALL THE ISSUED SHARES OF
AUSNUTRIA DAIRY CORPORATION LTD
(OTHER THAN THOSE ALREADY OWNED AND/OR
AGREED TO BE ACQUIRED BY THE OFFEROR AND/OR
THE PARTIES ACTING IN CONCERT WITH IT) AND
FOR THE CANCELLATION OF ALL THE OUTSTANDING OPTIONS OF
AUSNUTRIA DAIRY CORPORATION LTD**

INTRODUCTION

We refer to our appointment as the independent financial adviser to the Company to advise the Independent Board Committee in respect of the Offers, details of which are contained in the composite document jointly issued by the Offeror and the Company dated 10 February 2022 (the “**Composite Document**”) of which this letter forms a part. Capitalised terms used in this letter shall have the same meanings as those defined in the Composite Document unless the context otherwise requires.

The Independent Board Committee, comprising all the independent non-executive Directors, namely Mr. Jason Wan, Mr. Lau Chun Fai Douglas and Mr. Aidan Maurice Coleman, who have no direct or indirect interest in the Offers and the Share Subscription, has been established by the Company to make recommendation to the Independent Shareholders in respect of the Offers, and in particular, as to whether the Offers are fair and reasonable and as to the acceptance of the Offers pursuant to Rule 2.1 of the Takeovers Code. We, Optima Capital, have been appointed by the Company as the independent financial adviser in accordance with Rule 2.4 of the Takeovers Code to advise the Independent Board Committee in respect of the Offers. Our appointment has been approved by the Independent Board Committee.

We are not associated or connected with the Company, the Offeror, the Vendors, their respective substantial shareholders or any party acting, or presumed to be acting, in concert with any of them. We are therefore considered eligible to give independent advice in respect of the Offers. Apart from normal professional fees payable to us in connection with the current appointment, no arrangement exists whereby we will receive any fees or benefits from the Company, the Offeror, the Vendors, their respective substantial shareholders or any party acting, or presumed to be acting, in concert with any of them. During the past two years immediately prior to date of this letter, we have only acted as the independent financial adviser in relation to the Share Subscription, and accordingly, we consider that we are independent pursuant to the Listing Rules and the Takeovers Code to act as the Independent Financial Adviser to the Independent Board Committee in respect of the Offers.

In formulating our advice and recommendation, we have relied on the information and facts supplied, and the opinions expressed, by the executive Directors and management of the Company (the "Management") and have assumed that the information and facts provided and opinions expressed to us are true, accurate and complete in all material respects at the time they were provided and expressed, and continue to be true, accurate and complete in all material respects up to the Latest Practicable Date. We have reviewed, among other things, (i) the Rule 3.5 Announcement; (ii) the Circular; (iii) the annual reports of the Company for the three years ended 31 December 2018 (the "2018 Annual Report"), 2019 (the "2019 Annual Report") and 2020 (the "2020 Annual Report"); (iv) the interim report of the Company for the six months ended 30 June 2021 (the "2021 Interim Report"); and (v) other information obtained from the public domain. We have also sought and received confirmation from the Management that no material facts have been omitted from the information supplied and opinions expressed to us. We have relied on such information and consider that the information we have received is sufficient for us to reach an informed view and have no reason to believe that any material information have been withheld, nor doubt the truth or accuracy of the information provided. We have not, however, conducted any independent investigation into the business and affairs of the Group or the Offeror or the associates of any of them, nor have we carried out any independent verification of the information supplied. Should there be any subsequent material changes in such information during the Offer Period, the Company will inform the Shareholders as soon as practicable in accordance with Rule 9.1 of the Takeovers Code. The Shareholders shall also be informed as soon as practicable when there are any material changes to the information contained or referred to in this letter and our opinion after the Latest Practicable Date and throughout the Offer Period.

In relation to the Offers, we have not considered the tax and regulatory implications of the Offers on the Independent Shareholders and the Optionholders since these are particular to their individual circumstances. In particular, the Independent Shareholders and Optionholders who are overseas residents or subject to overseas taxation or Hong Kong taxation on securities dealings should consider their own tax position and, if in any doubt, should consult their own professional advisers.

This letter is issued to the Independent Board Committee solely in connection with and for their consideration of the Offers. Except for its inclusion in the Composite Document, this letter is not to be quoted or referred to, in whole or part, nor shall this letter be used for any other purpose without our prior written consent.

PRINCIPAL FACTORS AND REASONS CONSIDERED

In formulating our opinion and recommendation with regard to the Offers, we have taken into account the following principal factors and reasons:

1. Terms and conditions of the Offers

CLSA Limited is making the Offers, for and on behalf of the Offeror, in compliance with the Takeovers Code on the following basis:

1.1 The Share Offer

For each Offer Share HK\$10.06 in cash

The Share Offer Price of HK\$10.06 is equal to the per Sale Share consideration under the Share Purchase Agreement and the subscription price of the Subscription Shares under the Subscription Agreement. The Offer Shares to be acquired under the Share Offer shall be fully paid and clear of any lien and together with all rights and interests attaching thereto, including all rights to any dividend or other distribution declared, made or paid on or after the date on which the Share Offer is made, being the date of the despatch of the Composite Document. The Company has no intention to make any distribution or declare dividends before the Closing Date and there is no unpaid dividend as at the Latest Practicable Date.

The Offeror will not increase the Share Offer Price for the Offer Shares as set out above. Shareholders and potential investors should be aware that, following the making of this statement, the Offeror will not be allowed to increase the Share Offer Price and the Offeror does not reserve the right to increase the Share Offer Price.

1.2 The Option Offer

For the cancellation of each Option HK\$0.06 in cash

Pursuant to Rule 13 and Practice Note 6 of the Takeovers Code, the Option Offer Price would normally represent the difference between the exercise price of the Options and the Share Offer Price. Under the Option Offer, given that the exercise price of the Options, being HK\$10.00, is below the Share Offer Price of HK\$10.06, the Options are in-the-money and the Option Offer Price is set at the see-through price of HK\$0.06.

1.3 Other terms and conditions to the Offers

The Share Offer is conditional only on valid acceptances being received in respect of such number of Offer Shares, which together with Shares owned, acquired or agreed to be acquired by the Offeror and parties acting in concert with it before or during the Share Offer, will result in the Offeror and parties acting in concert with it holding more than 50% of the voting rights in the Company. The Option Offer will be conditional on the Share Offer becoming or being declared unconditional in all respects. Subject to the Option Offer becoming unconditional and following acceptance of the Option Offer, the relevant Options tendered in acceptance of the Option Offer will be cancelled, and all Options which have not been exercised or tendered in acceptance of the Option Offer by 4:00 p.m. on the Closing Date will lapse (following which the holder of such Options will not be able to accept the Option Offer in respect of such Options). Further terms and conditions of the Offers, including the procedures for acceptance, are set out in the letter from CLSA Limited and the letter from the Board contained in the Composite Document and in Appendix I to the Composite Document and the accompanying Form(s) of Acceptance.

2. Principal businesses of the Group

The Company was incorporated in the Cayman Islands with limited liability, the shares of which are listed on the Main Board of the Stock Exchange. The Group is principally engaged in two segments, the (i) dairy industry with activities ranging from the research and development, milk collection, processing, production, packaging, marketing and distribution of infant formula and other dairy products to customers in the PRC, the Netherlands, Australia and other overseas countries (the “**Dairy Operation**”); and (ii) the research and development, production, marketing and distribution of nutrition products to customers principally located in the PRC and Australia (the “**Nutrition Operation**”).

The Group has formulated the “Golden Decade” strategy plan in late 2015 as its long term development plan to further strengthen its position in the dairy industry, and has been expanding its business into the nutrition and healthcare industry. In view of its long term strategic plan to become one of the major global players in the nutrition and healthcare sector, particularly on infant formula products, the Group continues to streamline its business structure and strategies, increase its effort into building its global supply chain on formula milk powder products and establishing its overseas nutritional business. According to the management of the Group, the above steps have contributed promising results in terms of operation performance, product diversification as well as strengthened the business chain of the Group. In addition, the Group believes it has achieved satisfactory results by developing its market network and enhancing consumer services in recent years.

The Group sells its infant formula products under its own brands, including but not limited to, the Allnutria series, the Hyproca 1897 series and the Puredo series for cow milk based infant formula, and the Kabrita series for goat milk based infant formula. Except for Kabrita which is distributed globally, most of the own-branded cow milk based infant formula products (with milk source from the overseas) are principally designated for consumers located in the PRC. Along with the development of its own-branded formula milk powder business, the Group also produces formula milk powder products for other customers worldwide on an original equipment manufacturing basis.

The Group also sells different nutrition products (e.g. probiotics and gastrointestinal products) under different brand names. The Group acquired an Australian nutrition business in 2016, subsequently launched its nutrition products under the brand name Nutrition Care (NC) and established a sales platform of which sales were mainly conducted offline. Furthermore, the Group acquired an Australian probiotics brand, Aunulife, in 2019 to further expand its nutrition business. In 2020, the Group successfully expanded its branded probiotics business in the PRC and Australia.

Set out below is the breakdown of segment revenue and results of the Group for each of the three financial years ended 31 December 2018 (“FY2018”), 2019 (“FY2019”) and 2020 (“FY2020”) and the six months ended 30 June 2020 (“HY2020”) and 30 June 2021 (“HY2021”) (collectively, the “Track Record Period”).

	FY2018 (Audited) RMB'M	FY2019 (Audited) RMB'M	FY2020 (Audited) RMB'M	HY2020 (Unaudited) RMB'M	HY2021 (Unaudited) RMB'M
Dairy Operation					
<i>Own-branded formula milk powder products:</i>					
Cow milk	2,368.0	3,167.2	3,820.2	1,755.3	2,052.8
Goat milk	<u>2,033.4</u>	<u>2,856.2</u>	<u>3,106.2</u>	<u>1,655.6</u>	<u>1,688.2</u>
Subtotal	4,401.4	6,023.4	6,926.4	3,410.9	3,741.0
<i>Private Label and others</i>	<u>852.1</u>	<u>594.1</u>	<u>917.1</u>	<u>382.4</u>	<u>461.2</u>
Total segment revenue from Dairy Operation	5,253.5	6,617.5	7,843.5	3,793.3	4,202.2
Nutrition Operation	<u>136.1</u>	<u>118.7</u>	<u>142.3</u>	<u>66.0</u>	<u>68.3</u>
Total revenue	<u><u>5,389.6</u></u>	<u><u>6,736.2</u></u>	<u><u>7,985.8</u></u>	<u><u>3,859.3</u></u>	<u><u>4,270.5</u></u>

2.1 The Dairy Operation

The Dairy Operation comprised (i) own-branded formula milk powder business, and (ii) the original equipment manufacturing for other customers worldwide (the “Private Label”) and other business.

Own-branded formula milk powder business has always been the Company's core business and accounted for approximately 81.7%, 89.4%, 86.7%, 88.4% and 87.6% of the total revenue of the Group for FY2018, FY2019, FY2020, HY2020 and HY2021 respectively. The increase in sales of own-branded formula milk powder business throughout the Track Record Period was mainly attributable to (i) the implementation of the Group's effective strategic plans, the constant refinement of its business chain and the continuous improvement of its upstream operational efficiency and product quality; (ii) the constant enhancement of its product mix in accordance with its well-established multiple-brand strategy that caters to the rising market demand for high-end products; and (iii) the synergies between its brands and channels resulting from its unremitting efforts to develop mama and baby store channels by high-frequency and high-quality marketing activities.

Private Label and other business in relation to the Dairy Operation accounted for approximately 15.8%, 8.8%, 11.5%, 9.9% and 10.8% of the total revenue of the Group for FY2018, FY2019, FY2020, HY2020 and HY2021 respectively.

2.2 The Nutrition Operation

The Nutrition Operation comprised the manufacturing and sale of nutrition products (other than dairy related) to its customers principally in the PRC and Australia. The Nutrition Operation accounted for approximately 2.5%, 1.8%, 1.8%, 1.7% and 1.6% of the total revenue of the Group for FY2018, FY2019, FY2020, HY2020 and HY2021 respectively.

3. Historical financial results of the Group

Set out below is a summary of the financial results of the Group during the Track Record Period extracted from the annual reports and interim report of the Company:

	FY2018	FY2019	FY2020	HY2020	HY2021
	(Audited)	(Audited)	(Audited)	(Unaudited)	(Unaudited)
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Revenue	5,389,568	6,736,153	7,985,816	3,859,336	4,270,546
Cost of sales	<u>(2,728,933)</u>	<u>(3,202,836)</u>	<u>(4,003,859)</u>	<u>(1,836,932)</u>	<u>(2,134,141)</u>
Gross profit	2,660,635	3,533,317	3,981,957	2,022,404	2,136,405
Other income and gains	114,109	69,191	90,105	46,750	51,660
Selling and distribution expenses	(1,444,237)	(1,771,834)	(2,066,765)	(985,260)	(1,117,430)
Administrative expenses	(461,853)	(558,289)	(692,996)	(321,458)	(334,987)
Other expenses	(59,621)	(138,666)	(88,707)	(213,607)	(26,426)
Finance costs	(29,753)	(33,332)	(28,850)	(14,519)	(11,631)
Share of profits of a joint venture	1,159	–	–	–	–
Share of profits of associates	<u>11,553</u>	<u>6,797</u>	<u>26,102</u>	<u>15,152</u>	<u>619</u>
Profit before tax	791,992	1,107,184	1,220,846	549,462	698,210
Income tax expense	<u>(147,440)</u>	<u>(228,288)</u>	<u>(220,812)</u>	<u>(129,690)</u>	<u>(126,614)</u>
PROFIT FOR THE YEAR/ PERIOD	<u>644,552</u>	<u>878,896</u>	<u>1,000,034</u>	<u>419,772</u>	<u>571,596</u>
Attributable to:					
Owners of the parent	635,100	878,390	1,004,106	408,761	593,990
Non-controlling interests	9,452	506	(4,072)	11,011	(22,394)
Earnings per Share (RMB cents)					
Basic	47.20	54.92	60.93	25.37	34.60
Diluted	46.63	54.50	60.57	24.97	34.50

3.1 Total revenue

Total revenue of the Group represented (i) sales of own-branded formula milk powder business which comprised cow milk and goat milk; (ii) sales of Private Label and others side business including dairy related products under the customers' own brands; and (iii) sales of nutrition products.

FY2018 versus FY2019

Total revenue increased from approximately RMB5,389.6 million in FY2018 to approximately RMB6,736.2 million in FY2019, representing an increase of approximately 25.0%, which was mainly driven by the increase in sales of the Group's own-branded cow and goat milk formula products by 33.8% and 40.5% respectively compared to that in FY2018 as a result of the continuous strengthening of sales network and brand building. Such increase was partly offset by the decrease in revenue from the sales of the Private Label and sales of dairy related products as a result of the Company's strategy to prioritise more resources to better serve its own-branded formula milk powder business.

FY2019 versus FY2020

Total revenue increased from approximately RMB6,736.2 million in FY2019 to approximately RMB7,985.8 million in FY2020, representing an increase of approximately 18.6%, which was mainly due to the increase in sales of the Group's own-branded cow and goat milk formula products by 20.6% and 8.8% respectively compared to that in FY2019, and the increase in the trading of commodities such as milk powder, cream and whey protein as a result of the increase in its intake of fresh goat milk since the second quarter of 2020.

HY2020 versus HY2021

Total revenue increased from approximately RMB3,859.3 million in HY2020 to approximately RMB4,270.5 million in HY2021, representing an increase of approximately 10.7%, which was mainly due to (i) the increase in sales of the Group's own-branded formula milk powder products by 9.7% as a result of the Group's rapid and proactive response of adjusting its strategies to accommodate for the market change and the continuous strengthening of the distribution channels (mainly mama and baby stores); and (ii) the increase in sales of other dairy related products such as milk, milk powder, cream and other milk derived ingredients such as whey protein powder, as a result of the increase in the intake of milk, particularly goat milk, for the processing of related ingredients in order to fulfil the internal production needs.

3.2 Other income and gains

Other income and gains mainly represented (i) incentive granted from the PRC government; (ii) interest income from the Group's deposits with banks; (iii) fair value gain of derivative financial instruments; and (iv) gain on re-measurement in relation to the acquisition of the remaining interest in Ozfarm Royal Pty Ltd ("Ozfarm").

FY2018 versus FY2019

Other income and gains decreased from approximately RMB114.1 million in FY2018 to approximately RMB69.2 million in FY2019, representing a decrease of approximately 39.4%. Such decrease was mainly attributable to the decrease in (i) the fair value gain of derivative financial instruments arising from the contingent consideration of RMB22.3 million as a result of an acquisition in May 2018; and (ii) the gain on re-measurement due to the acquisition of the remaining 50% equity interest in Ozfarm in June 2018. Such effect was partly offset by the increase in government grant in FY2019 of approximately RMB12.1 million.

FY2019 versus FY2020

Other income and gains increased by approximately 30.2% from approximately RMB69.2 million in FY2019 to approximately RMB90.1 million in FY2020. Such increase was mainly attributable to the increase in government grants of RMB28.1 million in FY2019 to RMB43.6 million in FY2020.

HY2020 versus HY2021

The Group recorded other income and gains of approximately RMB51.7 million for HY2021 as compared to approximately RMB46.8 million for HY2020, representing an increase of approximately 10.5%. Such increase was mainly due to the increase in incentive granted by the PRC government and partly offset by the decrease in interest income from bank deposits.

3.3 Selling and distribution expenses

Selling and distribution expenses mainly comprised advertising and promotion expenses, rebates to distributors and customers, exhibition and trade show expenses, salaries and travelling costs of the sales and marketing staff and delivery cost. Such expenses increased from approximately RMB1,444.2 million in FY2018 to approximately RMB1,771.8 million in FY2019, and further increased to approximately RMB2,066.8 million in FY2020. Selling and distribution expenses increased from RMB985.3 million in HY2020 to RMB1,117.4 million in HY2021. The increase in such expenses was mainly because more resources were allocated to the advertising and promotion activities in face of the intense market competition in order to increase the market share of the Group, and such increase was generally in line with the increase in revenue in the corresponding year/period.

3.4 Administrative expenses

Administrative expenses mainly comprised staff costs (including the non-cash equity-settled share option expense), travelling expenses, auditor's remuneration, professional fees, depreciation and research and development costs. Such expenses increased from approximately RMB461.9 million in FY2018 to approximately RMB558.3 million in FY2019 and further increased to approximately RMB663.0 million in FY2020, mainly due to the increase in research and development costs and the increase in the scale of operations of the Group. No material fluctuation in such expenses was noted in HY2021 as compared with those in HY2020.

3.5 Other expenses

Other expenses mainly comprised loss on fair value change of a derivative financial instrument, charitable donations and net foreign currency exchange losses arising from the foreign currency transactions.

FY2018 versus FY2019

Other expenses recorded by the Group increased by approximately 132.6% from approximately RMB59.6 million in FY2018 to approximately RMB138.7 million in FY2019. Such increase was mainly attributable to the increase in loss on fair value change of a derivative financial instrument of RMB63.6 million as compared to a gain of RMB22.3 million in FY2018 and the increase in charitable donations in FY2019, partly offset by the decrease in net foreign currency exchange losses arising from the foreign currency transactions as compared to that in FY2018.

FY2019 versus FY2020

Other expenses recorded by the Group decreased by approximately 36.0% from approximately RMB138.7 million in FY2019 to approximately RMB88.7 million in FY2020. Such decrease was mainly due to the decrease in loss on fair value change of a derivative financial instrument from RMB63.6 million in FY2019 to RMB43.0 million in FY2020 and the decrease in net foreign currency exchange losses arising from the foreign currency transactions.

HY2020 versus HY2021

Other expenses recorded by the Group decreased by approximately 87.6% from approximately RMB213.6 million in HY2020 to approximately RMB26.4 million in HY2021. Such significant decrease was mainly due to exclusion of fair value change of a derivative financial instrument of approximately RMB165.9 million recorded in HY2020 arising from the contingent consideration as a result of an acquisition, after the settlement of such consideration in August 2020.

3.6 Finance costs

The finance costs of the Group represented mainly the interest on bank loans and other borrowings for the financing of the upstream capital expenditures of the Group, particularly in the Netherlands. Such expenses increased from approximately RMB29.8 million in FY2018 to approximately RMB33.3 million in FY2019 and decreased to approximately RMB28.9 million in FY2020. Finance costs recorded in HY2021 decreased to RMB11.6 million from RMB14.5 million in HY2020. The fluctuations in finance costs were mainly attributable to the increase or decrease in interest-bearing bank loans and other borrowings in the corresponding year/period.

3.7 Share of profit of associates

The Group's share of profit of associates referred to the share of profits of Farmel Holding B.V. and its subsidiaries (the "Farmel Group"), Bioflag International Corporation and its subsidiaries, etc.

FY2018 versus FY2019

The Group's share of profit of associates for FY2018 and FY2019 represented the share of profits of Farmel Group. Profit sharing decreased from approximately RMB11.6 million in FY2018 to RMB6.8 million in FY2019, mainly due to the share of loss and impairment of investment in an associate in FY2019.

FY2019 versus FY2020

The Group's share of profit of associates increased significantly from RMB6.8 million in FY2019 to approximately RMB26.1 million in FY2020, which was mainly attributable to the increase in profit sharing of Farmel Group, which is principally engaged in the collection and trading of milk in Europe.

HY2020 versus HY2021

The decrease in the share of profits of associates from RMB15.2 million for the HY2020 to RMB0.6 million for the HY2021 was mainly due to the decrease in results of the Farmel Group as a result of the decrease in commodity prices.

3.8 Share of profit of a joint venture

The Group's share of profit of a joint venture in FY2018 represented the share of profit of Ozfarm until it became a wholly-owned subsidiary of the Company on 29 June 2018.

3.9 Profit for the year/period attributable to equity holders of the Company

The Group's profit attributable to equity holders of the Company for FY2019 amounted to RMB878.4 million, representing an increase of RMB243.3 million, or 38.3%, when compared with that in the FY2018, and further increased to RMB1,004.1 million in FY2020. The Group's adjusted profit attributable to equity holders of the Company was RMB581.5 million, RMB942.0 million and RMB1,083.3 in FY2018, FY2019 and FY2020 respectively, which was arrived at after excluding the non-recurring or non-cash items.

The Group's profit attributable to equity holders of the Company for HY2021 amounted to RMB594.0 million, representing an increase of RMB185.2 million, or 45.3%, when compared with that in HY2020. The Group's adjusted profit attributable to equity holders of the Company was RMB574.7 million and RMB594.0 in HY2020 and HY2021 respectively, which was arrived at after excluding the non-recurring or non-cash items.

The continuous improvement in the Group's financial performance was spurred by (i) better brand awareness and acceptance of the Group's goat and cow brands in the market; (ii) the implementation of the Group's strategic plans, in particular, continuous improvement of the upstream operational efficiency, streamlining of the supply chain and enhancement in the product mix; and (iii) the improvement in business structure as a result of the rising proportion of the sales of the Group's own-branded goat and cow milk formula products.

4. Historical dividend payout

The Company has a consistent track record of paying final dividends in the past few years. The following table summarises the dividend payout of the Company during the Track Record Period:

	FY2018	FY2019	FY2020	HY2020	HY2021
Dividend per Share (HK\$)	0.15	0.22	0.27	Nil	Nil
Dividend payout ratio (%) (Note 1)	27.1	35.6	39.6	N/A	N/A
Dividend yield (%) (Note 2)	1.70	1.96	2.07	N/A	N/A

Notes:

1. Dividend payout ratio is calculated by dividing dividend per Share by earnings per Share for the relevant year. As the earnings per Share were denominated in RMB, the average exchange rate RMB to HK\$ for the relevant year have been used for currency translation.
2. Dividend yield is calculated by dividing the dividend per Share by the year end closing price of the Shares for the relevant year.

As shown above, the Company's dividend payout ratio was about 27.1% for FY2018, 35.6% for FY2019 and 39.6% for FY2020. The Share Offer Price of HK\$10.06 per Share translates to a dividend yield of approximately 2.1% based on the average dividend of approximately HK\$0.213 per Share for FY2018, FY2019 and FY2020.

5. Financial position of the Group

Set out below is a summary of the financial position of the Group as at 31 December 2020 and 30 June 2021 extracted from the annual report and interim report of the Company:

	31 December 2020	30 June 2021
	(Audited)	(Unaudited)
	<i>RMB'000</i>	<i>RMB'000</i>
Non-current assets		
Property, plant and equipment	1,840,357	1,866,874
Right-of-use assets	359,731	329,262
Goodwill	297,541	280,745
Other intangible assets	411,642	440,306
Investments in associates	581,188	599,460
Prepayments, deposits and other assets	136,992	140,721
Deferred tax assets	<u>257,981</u>	<u>237,357</u>
	<u>3,885,432</u>	<u>3,894,725</u>
Current assets		
Inventories	2,400,946	2,464,324
Trade and bills receivables	456,425	506,795
Prepayments, other receivables and other assets	435,576	492,195
Pledged deposits	212,062	173,210
Cash and cash equivalents	<u>1,857,516</u>	<u>1,428,920</u>
	<u>5,362,525</u>	<u>5,065,444</u>
Total assets	<u><u>9,247,957</u></u>	<u><u>8,960,169</u></u>
Current liabilities		
Trade and bills payables	409,247	485,137
Other payables and accruals	2,267,673	1,853,068
Derivative financial instruments	109	104
Interest-bearing bank loans and other borrowings	558,973	685,438
Tax payable	<u>156,666</u>	<u>126,644</u>
	<u>3,392,668</u>	<u>3,150,391</u>

	31 December 2020 (Audited) RMB'000	30 June 2021 (Unaudited) RMB'000
Non-current liabilities		
Interest-bearing bank loans and other borrowings	527,299	466,004
Defined benefit plan	8,932	6,619
Deferred revenue	65,121	62,610
Other long-term liability	7,477	6,489
Deferred tax liabilities	<u>94,520</u>	<u>72,055</u>
	<u>703,349</u>	<u>613,777</u>
Total liabilities	<u>4,096,017</u>	<u>3,764,168</u>
Total equity	<u>5,151,940</u>	<u>5,196,001</u>
Equity attributable to:		
Owners of the parent	5,171,372	5,227,046
Non-controlling interests	<u>(19,432)</u>	<u>(31,045)</u>
	<u>5,151,940</u>	<u>5,196,001</u>

5.1 Assets

As at 30 June 2021, total assets of the Group amounted to approximately RMB8,960.2 million. Major components of the total assets include (i) inventories of approximately RMB2,464.3 million, representing approximately 27.5% of the total assets; (ii) property, plant and equipment of approximately RMB1,866.9 million, representing approximately 20.8% of the total assets; (iii) cash and cash equivalents of approximately RMB1,428.9 million, representing approximately 15.9% of the total assets; (iv) investments in associates of approximately RMB599.5 million, representing approximately 6.7% of the total assets; (v) trade and bills receivables of approximately RMB506.8 million, representing approximately 5.7% of the total assets; (vi) prepayments, other receivables and other assets of approximately RMB492.2 million, representing approximately 5.5% of the total assets; and (vii) other intangible assets of approximately RMB440.3 million, representing approximately 4.9 % of the total assets.

The decrease in total assets of the Group to RMB8,960.2 million as at 30 June 2021 as compared with that of RMB9,248.0 million as at 31 December 2020 was mainly due to the decrease in cash and cash equivalent. Cash and cash equivalents decreased by approximately 23.1% to RMB1,428.9 million as at 30 June 2021 as compared with that of RMB1,857.5 million as at 31 December 2020 as a result of the payment of final dividend of RMB388.1 million for FY2020 and the decrease in cashflows generated from operating activities as a result of the decrease in prepayments received from customers.

Trade and bills receivables increased by approximately RMB50.4 million, or approximately 11.0%, as at 30 June 2021 as compared with that as at 31 December 2020 which was in line with the increase in sales.

Prepayments, other receivables and other assets increased by 13.0% to RMB492.2 million as at 30 June 2021 as compared with that of RMB435.6 million as at 31 December 2020 which was also in line with the increase in scale of operation.

5.2 Liabilities

As at 30 June 2021, total liabilities of the Group amounted to approximately RMB3,764.2 million, which mainly consisted of (i) other payables and accruals of approximately RMB1,853.1 million, representing approximately 49.2% of the total liabilities; (ii) interest-bearing bank loans and other borrowings of approximately RMB1,151.4 million, representing approximately 30.6% of the total liabilities; and (iii) trade and bills payables of approximately RMB485.1 million, representing approximately 12.9% of total liabilities.

Other payables and accruals decreased by approximately 18.3% from RMB2,267.7 million as at 31 December 2020 to RMB1,853.1 million as at 30 June 2021 which was mainly due to the decrease in advanced payments received from customers.

Trade and bills payables increased by 18.5 % to RMB485.1 million as at 30 June 2021 as compared with that of RMB409.2 million as at 31 December 2020. The increase was in line with the increase in sales, which has been explained above.

As at 30 June 2021, the Group had contracted, but not provided for, capital commitments mainly in respect of purchase of plant and machineries of a total of RMB48.0 million. The Group did not have any material contingent liabilities as at 30 June 2021.

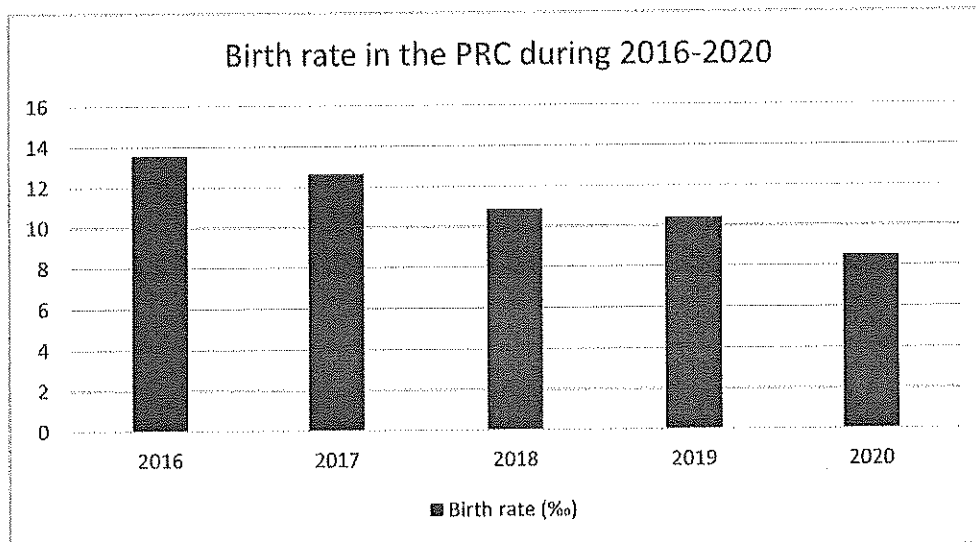
5.3 Equity attributable to owners of the parent

Equity attributable to the owners of the parent increased from approximately RMB5,171.4 million as at 31 December 2020 to approximately RMB5,227.0 million as at 30 June 2021. The increase was mainly attributable to the profits generated for HY2021 attributable to the owners of the parent of approximately RMB594.0 million; partly offset by the exchange differences on translation of foreign operations and the 2020 final dividend declared.

6. Prospects of the Group

The ongoing global spread of COVID-19 (the “**Pandemic**”) has caused some short-term interruptions in the business development of the Group, particularly in (i) the Group’s own-branded formula milk powder business (both in the PRC and the overseas) which had fewer marketing and promotional activities conducted for the concerned period due to lockdowns; and (ii) the dairy commodities trading business due to lower dairy related commodity prices. Despite of that, the Company managed to contain the negative impact of these challenges during the Track Record Period. As shown in the paragraph headed “3. Historical financial results of the Group” above, it is noted that the financial performance of the Company has been improving during the Track Record period with the compound annual growth rate in revenue and profit for the year attributable to owners of the parent of approximately 21.7% and 25.7% during FY2018 to FY2020, respectively. Though the Group had contained the negative impact of these challenges and recorded growth in revenue and profit during the Track Record Period as discussed above, it is uncertain as to the impacts of the Pandemic may have on the future performance of the Group.

Besides, as mentioned in the 2020 Annual Report, with the continuous drops in the female population at childbearing age and the reduced willingness to marry and bear children, particularly in the PRC, the number of newborns has been decreasing over the past few years and as a result, the competition of formula milk powder business has become more intense. The downward trend of birth rate would be a key challenge to be faced by the Group in the future. As shown in the table below, the birth rate in the PRC decreased from approximately 13.57‰ in 2016 to approximately 8.52‰ in 2020, representing a compounded annual decline rate of approximately 11.0%.



Source: National Bureau of Statistic, PRC

On a brighter note, in response to the decline in the birth rate, the PRC Government has made changes to certain policies which may bring positive impacts and opportunities to the Company in the upcoming years. As mentioned in the 2021 Interim Report, on 20 July 2021, the State Council of the PRC issued the Decision Regarding the Optimisation of Family Planning Policies for Long-Term Balanced Population Growth (《關於優化生育政策促進人口長期均衡發展的決定》), which laid down certain supportive policies such as promulgating the three-child policy and cancelling Social Maintenance Fees, etc. The measures primarily focus on reducing the cost of raising a child and aim to appropriately increasing birth rate by 2025 and boost long-term and balanced population growth. The Management considers and we concur that such policies may have a long-term positive contribution to the PRC dairy industry as the demand for infant formula milk powder will be increased with the increasing birth rate.

In 2020, the Chinese government issued a consultation memorandum including various measures to further strengthen the regulations and quality standards of infant formula. In February 2021, the Announcement of the State Administration for Market Regulation (“SAMR”) on Matters Concerning the Registration of Infant Formula Milk Powder Product Formulas was issued, whereby all infant formula players are required to re-register their products with the SAMR according to a new set of rules and standards (the “New GB Standard”). According to the announcement, the New GB Standard will become effective in February 2023. As the New GB Standard have stricter requirements for key raw material content, quality, and quantity in IMF products, many producers may have to adjust their product formulas, change raw materials, and reapply for China Food and Drug Administration (“CFDA”) registration. We are of the view that such New GB Standard would be a double-edge sword to the Company. On one hand, as advised by the Management, extra costs may be incurred by the Group for the compliance of the New GB Standard. It is expected that the New GB Standard may further spur the industry consolidation and small companies may choose to exit the market in upcoming years given their smaller operations and potentially significant costs for the changes in formulas, which may create opportunities for the Company to further increase its market share.

In view of the above, facing the new opportunities and challenges arising from the new policies and the Pandemic, it is uncertain as to whether the Group would be able to turn the above challenges into opportunities and grasp the opportunities to further the growth of the Group. In particular, there is no guarantee that any further tightening of administration or implementation of more stringent policies and standards on the infant milk formula industry in the future would not impose possible challenges and disturbances to the businesses and the profitability of the Group.

7. Information of the Offeror and intention of the Offeror

7.1 Background of the Offeror

As set out in the letter from the Board, Jingang Trade is a company incorporated in Hong Kong, primarily engaged in investment and trading businesses. As at the Latest Practicable Date, Jingang Trade was wholly and beneficially owned by Yili Industrial, and the board of Jingang Trade comprised Mr. Pan Gang, Mr. Wang Xiaogang, Ms. Yuan Ping and Ms. Jiang Yuanzi.

Yili Industrial is a joint stock company incorporated in the PRC with limited liability, the shares of which are listed on the Shanghai Stock Exchange of the PRC (stock code: 600887). Yili Industrial is principally engaged in the business of processing and manufacturing dairy products in the PRC. As at the Latest Practicable Date, the board of Yili Industrial comprised Mr. Pan Gang, Ms. Zhao Chengxia, Mr. Wang Xiaogang, Ms. Zhao Ying, Ms. Wang Aiqing, Mr. Zhang Junping, Mr. Lv Gang, Mr. Peng Heping, Ms. Ji Shao, Mr. Cai Yuanming, and Ms. Shi Fang. As at the Latest Practicable Date, Yili Industrial did not have any controlling shareholder (as defined in the Listing Rules) and the largest shareholder of Yili Industrial was Huhhot Investment Company Limited* (呼和浩特投資有限責任公司) with a shareholding of approximately 8.41%. Huhhot Investment Company Limited is a company incorporated in the PRC, which is owned as to 81% by Inner Mongolia Financial Investment Group Co., Ltd.* (內蒙古金融投資集團有限公司) and 19% by Shanghai Electric Qingcheng Inner Mongolia Industrial Co., Ltd.* (上海電氣內蒙古青城實業有限公司). Inner Mongolia Financial Investment Group Co., Ltd.* is a company incorporated in the PRC, which is owned as to 89.96% by Huhhot State-owned Assets Supervision and Administration Commission* (呼和浩特國有資產監督管理委員會), 9.99% by Inner Mongolia State-owned Assets Management Co., Ltd.* (內蒙古國有資產運營有限公司) and 0.05% by Huhhot Investment Company Limited*.

Yili Industrial is a major player in the PRC dairy market. As set out in the annual report of Yili Industrial, according to the report "Asia Brand Footprint 2020" published by Kantar, an international data, insights and consulting company with presence in over 70 countries, Yili Industrial ranked first in the list of most chosen brands in terms of fast-moving consumer goods by consumers in China market for five consecutive years. Further, as stated in the annual report and interim report of Yili Industrial, Yili Industrial recorded audited consolidated revenue and net profit attributable to shareholders of Yili Industrial of approximately RMB96,524.0 million and RMB7,078.2 million respectively for FY2020 and unaudited consolidated net assets attributable to shareholders of Yili Industrial of approximately RMB32,210.7 million as at 30 June 2021. As at the Latest Practicable Date, the market capitalisation of Yili Industrial amounted to approximately RMB248,069 million.

7.2 *Intention of the Offeror*

As disclosed in the letter from CLSA Limited contained in the Composite Document, the Offeror identifies with the strategy, culture, team and business of the Company and will continue to support the independent operation of the Company and maintain the Company's listing status in the Hong Kong capital market. It is the intention of the Offeror that the Company will continue to focus on the development of its existing businesses. The Offeror does not intend to introduce any major changes to the existing operations and business of the Group upon the close of the Offers.

Following the closing of the Offers, the Offeror will conduct a review and outlook on the strategy, operations and financial position of the Group, taking into account the net proceeds of HK\$904,900,000 received by the Company through Share Subscription, for the purpose of formulating business plans and strategies for the Group's long-term business development, leverage the synergies between the Offeror and the Group and explore other business opportunities for the Group. Subject to the results of the review, should suitable investment or business opportunities arise, the Offeror may consider for purpose of enhancing the growth of the Group.

The Offeror has no intention to terminate the employment of any employees of the Group or to make significant changes to any employment (except for a proposed change to the members of the Board at a time no earlier than that permitted under the Listing Rules and the Takeovers Code or such later time as the Offeror considers to be appropriate as further disclosed in the paragraph headed "7.3 Proposed change to the Board composition" below) or to dispose of or re-allocate the Group's fixed assets which relate to the ordinary and usual course of business of the Group as a result of completion of the Offers. However, the Offeror reserves the right to make such changes that it deems necessary or appropriate to the Group's business and operations to optimize the value of the Group.

As at the Latest Practicable Date, no material investment or business opportunity has been identified nor has the Offeror entered into any agreement, arrangement, understanding or negotiation in relation to the injection of any assets or business into the Group.

Taking into account the background of the Offeror, a leading player in the dairy industry in the PRC, depending on the changes on the business plans and strategies of the Group to be introduced by the Offeror (if any), there may or may not be potential synergy effects to the Company's future prospect. However, as no concrete plan for future cooperation has been laid out, we are unable to assess such effects (if any), thus the aforesaid has not formed part of the basis of our opinion.

7.3 Proposed change to the Board composition

As at the Latest Practicable Date, the Board comprises three executive Directors, namely Mr. Yan Weibin (Chairman), Mr. Bartle van der Meer (Chief Executive Officer) and Ms. Ng Siu Hung; three non-executive Directors, namely Mr. Shi Liang (Vice-Chairman), Mr. Qiao Baijun and Mr. Tsai Chang-Hai; and three independent non-executive Directors, namely Mr. Jason Wan, Mr. Lau Chun Fai Douglas and Mr. Aidan Maurice Coleman.

Mr. Shi Liang and Mr. Tsai Chang-Hai (both being nominated by the Vendors to the Board) have tendered resignation from their offices as a non-executive Director and a member of Nomination Committee and Remuneration Committee of the Company to take effect from the day after the Closing Date. Mr. Shi Liang will also cease to be the Vice Chairman of the Board on even date. The Offeror intends to nominate Mr. Sun Donghong and Mr. Zhang Zhanqiang as new non-executive Directors, and such proposed appointment is subject to approval of the Board and expected to take effect from the day after the Closing Date. The biographical details of Mr. Sun Donghong and Mr. Zhang Zhanqiang are set out section headed "V. Proposed Change to the Board Composition" in the letter from CLSA Limited contained in the Composite Document.

Besides, to the extent existing independent non-executive Directors resign from or cease to hold their respective positions, the Offeror intends to nominate new independent non-executive Directors to the Company.

Save as disclosed above, as at the Latest Practicable Date, none of the Directors intended to resign from his/her offices as a Director.

7.4 Maintaining listing status of the Company

The Offeror has no intention to privatize the Company and intends to maintain the listing of the Shares on the Stock Exchange following the close of the Offers.

The Offeror and the new Directors to be appointed to the Board (if any) will jointly and severally undertake to the Stock Exchange to take appropriate steps to ensure that sufficient public float exists in the Shares, which may include but not limited to placing down of sufficient number of accepted Shares by the Offeror and/or issue of additional Shares by the Company for this purpose. No arrangements have been confirmed or put in place as at the Latest Practicable Date.

8. Evaluation of the Share Offer Price

8.1 Comparison of the Share Offer Price against historical Share prices and NAV per Share

The Share Offer Price of HK\$10.06 per Offer Share represents:

- (i) a premium of approximately 13.67% over the closing price of HK\$8.85 per Share as quoted on the Stock Exchange on 11 October 2021, being the Last Trading Day;
- (ii) a premium of approximately 17.11% over the average closing price of approximately HK\$8.59 per Share based on the daily closing prices as quoted on the Stock Exchange for five (5) consecutive trading days immediately prior to and including the Last Trading Day;
- (iii) a premium of approximately 24.20% over the average closing price of approximately HK\$8.10 per Share based on the daily closing prices as quoted on the Stock Exchange for ten (10) consecutive trading days immediately prior to and including the Last Trading Day;
- (iv) a premium of approximately 33.42% over the average closing price of approximately HK\$7.54 per Share based on the daily closing prices as quoted on the Stock Exchange for thirty (30) consecutive trading days immediately prior to and including the Last Trading Day;
- (v) a premium of approximately 1.51% over the closing price of HK\$9.91 per Share as quoted on the Stock Exchange on the Latest Practicable Date;
- (vi) a premium of approximately 188.50% over the audited consolidated net asset value ("NAV") attributable to the Shareholders of approximately HK\$3.487 per Share as at 31 December 2020, calculated by dividing the Group's audited consolidated net assets attributable to the Shareholders of approximately RMB5,171.37 million (equivalent to approximately HK\$6,306.55 million) as at 31 December 2020 by 1,808,545,841 Shares in issue as at the Latest Practicable Date; and

(vii) a premium of approximately 185.39% over the unaudited consolidated net asset value attributable to the Shareholders of approximately HK\$3.525 per Share as at 30 June 2021, calculated by dividing the Group’s unaudited consolidated net assets attributable to the Shareholders of approximately RMB5,227.05 million (equivalent to approximately HK\$6,374.45 million) as at 30 June 2021 by 1,808,545,841 Shares in issue as at the Latest Practicable Date.

As shown above, the Share Offer Price represents a premium over (i) the closing prices of the Shares as quoted on the Stock Exchange on the Last Trading Date; (ii) the average closing price per Share based on the daily closing prices as quoted on the Stock Exchange for the 5, 10 and 30 consecutive trading days immediately prior to and including the Last Trading Day; and (iii) the unaudited and audited consolidated net asset value attributable to the Shareholders per Share.

8.2 Historical price trend of the Shares

The chart below depicts the closing price of the Shares traded on the Stock Exchange from 27 October 2019, being the date falling two years preceding the date of the Joint Announcement, up to and including the Last Trading Day (the “Review Period”) and from 28 October 2021 (being the first trading day after the publication of the Joint Announcement) up to the Latest Practicable Date. We consider the Review Period is appropriate for our analysis of the historical Share price performance as it covers a sufficiently long period reflecting the financial results announced by the Company from time to time as well as smoothing out the distortions which may have been caused by short term volatility in the overall stock market.



Source: The website of the Stock Exchange and Bloomberg

During the Review Period, the lowest closing price and the highest closing price of the Shares were HK\$6.59 on 24 September 2021 and HK\$17.4 on 19 June 2020 respectively, with an average closing price of the Shares of approximately HK\$11.66. The Share Offer Price of HK\$10.06 per Share represents (i) a premium of approximately 13.67 % over the closing price on the Last Trading Date; (ii) a premium of approximately 17.11 % to the lowest closing price; and (iii) a discount of approximately 13.7 % to the average closing price during the Review Period. There were 96 out of the 484 trading days during the Review Period that the closing prices of the Shares below the Share Offer Price of HK\$10.06.

As shown in the chart above, we note that there was an increasing trend in the closing price of the Shares since the second quarter in 2020 and it reached the highest closing price during the Review Period of HK\$17.4 on 19 June 2020. It is noted that the Company announced an acquisition on 9 April 2020 for the remaining 15.0% equity interest in Hyproca Bio-Science (Hong Kong) Company Limited and its subsidiary and published a profit alert announcement (the “**Profit Alert**”) on 27 April 2020 which the Management is of the view that the Profit Alert may have triggered the surge in the share price as to reflect the market's positive reaction to such information. However, such growth momentum was not sustained. The closing price of the Shares dropped back to approximately HK\$11 in November 2020. As advised by the Management, they were not aware of any reason for the aforesaid sudden drop in the closing price of the Shares. The closing price of the Shares increased to approximately HK\$12 in December 2020 and remained relatively stable at approximately HK\$12 to HK\$13 since then until the second quarter in 2021, when there was a general downward trend of closing price of the Shares. We also note that on 29 July 2021, the Company published an announcement that they have noted the decrease in the trading price since July 2021 and the Management were not aware of any reason for the aforesaid fluctuations in the closing price of the Shares. Since then, the closing price of the Shares showed a downward trend in general and reached the bottom during the Review Period before the Last Trading Day of HK\$6.59 on 24 September 2021. The Shares slightly rebounded and closed at HK\$8.85 on the Last Trading Day.

Trading in the Shares was suspended from 12 October 2021 to 27 October 2021 (both days inclusive) pending the publication of the Joint Announcement. Immediately thereafter, the closing price of the Shares surged to HK\$9.45 on 28 October 2021, which is the first trading day immediately following the Joint Announcement. Since then, the closing price of the Shares maintained in the range of HK\$8.73 to HK\$9.91 and closed at HK\$9.91 as at the Latest Practicable Date.

We consider the current Shares prices were supported by the publication of the Joint Announcement on 27 October 2021 of the possible Share Offer and thus in absence of the Share Offer or any significant positive events, the current Shares prices might not sustain at the current level. Based on the above analysis and taking into account that the recent prevailing market price is more relevant for purpose of comparison, we consider that the Share Offer Price is fair and reasonable so far as the Independent Shareholders are concerned.

8.3 Liquidity of the Shares

The following table sets out the trading volume of the Shares during the period between the date falling one year preceding the date of the Joint Announcement up to and including the Latest Practicable Date which we consider to be a sufficient period of time to provide a general overview on the recent trading volume of the Shares for conducting an analysis.

	Number of trading days in the relevant month/period	Total trading volume for the month/period <i>(Note 1)</i>	Average daily trading volume for the month/period <i>(Note 2)</i>	Percentage of average daily trading volume to the total issued Shares <i>(Note 3)</i>	Percentage of average daily trading volume to the total number of Shares held by public Shareholders <i>(Note 4)</i>
2020					
From 27 October to 30 October	4	20,635,799	5,158,950	0.30%	0.69%
November	21	167,259,379	7,964,732	0.46%	1.07%
December	22	112,951,533	5,134,161	0.30%	0.69%
2021					
January	20	90,098,371	4,504,919	0.26%	0.60%
February	18	69,095,837	3,838,658	0.22%	0.52%
March	23	96,939,631	4,214,767	0.25%	0.57%
April	19	45,818,197	2,411,484	0.14%	0.32%
May	20	55,732,714	2,786,636	0.16%	0.37%
June	21	39,495,510	1,880,739	0.11%	0.25%
July	21	71,162,102	3,388,672	0.20%	0.45%
August	22	123,062,994	5,593,772	0.33%	0.75%
September	21	53,983,286	2,570,633	0.15%	0.34%
From 1 October to the Last Trading Day	6	47,035,554	7,839,259	0.46%	1.05%
From the first trading day following the Joint Announcement to the Latest Practicable Date	69	860,368,149	12,469,104	0.69%	1.67%
Average				0.29%	0.67%

Source: the website of the Stock Exchange

Notes:

1. Total trading volume is expressed in terms of number of Shares traded.
2. Average daily trading volume is calculated by dividing the total trading volume for the month/period by the number of trading days during the month/period excluding any trading days on which trading of the Shares on the Stock Exchange was suspended for the whole trading day.
3. The calculation is based on the average daily trading volumes of the Shares divided by the total issued share capital of the Company at the end of each month/period or as at the Latest Practicable Date, as applicable.
4. The total number of Shares held by the public is based on the number of Shares held by public shareholders of 745,291,288 Shares as at the Latest Practicable Date.

As illustrated in the above table, the average daily trading volume ranged from 1,880,739 Shares to 12,469,104 Shares, representing approximately 0.11% to 0.69% of the total number of Shares in issue as at the end of the respective month/period, and approximately 0.29% to 1.67% of the total number of Shares held by public Shareholders as at the end of the respective month/period.

We are of the view that the liquidity of the Shares during the one-year period preceding the date of the Joint Announcement had been thin. In this light, the Independent Shareholders may find it difficult to dispose of a large number of Shares in the open market without exerting a downward pressure on the price of the Shares.

9. Peer Comparison

In order to determine the fairness and reasonableness of the Share Offer Price, we have adopted the comparable approach whereby the Share Offer Price is compared to the valuation of its industry peers, as this approach is direct and commonly used as a valuation methodology. For our purpose of comparison, we have identified three companies (the “Comparable Companies”) that (i) the shares of which are listed in the Hong Kong Stock Exchange; (ii) principally operate in the dairy industry with at least 40% of their respective consolidated revenue generated from the sales of infant formula products; (iii) have its own-branded infant formula products; (iv) have a presence in the PRC market as industry peers; (v) are profit making for the year ended 31 December 2020, and (vi) have a closing market capitalisation below HK\$100 billion as at the Latest Practicable Date, which, in our view, excludes those companies operating in the industry with much larger scale as they may be valued with different valuation multiples, which to the best of our knowledge represent the exhaustive samples that meet the aforesaid selection criteria.

For the selection of the valuation multiples, we have considered price-to-earnings ratio(s) (“P/E Ratio(s)”) and price-to-book ratio (s) (“P/B Ratio(s)”) of the Comparable Companies based on the financial information as disclosed in their respective latest publication of annual results announcement or annual report. However, we did not consider using the price-to-sales ratio (“P/S Ratio”) is an appropriate benchmark because the P/S Ratio is mainly used to value non-profitable companies, while the Group and the Comparable Companies are profitable, hence it may not be a good metric to use for their comparison purposes.

Below sets out the table detailing our selection basis of the Comparable Companies:

Company name	Stock code	Principal activities	Approximate percentage of revenue generated from sales of infant formula or related products (%) (Note)	Approximate percentage of revenue generated from the PRC market (%) (Note)
Health and Happiness (H&H) International Holdings Limited	1112.HK	The group is principally engaged in the manufacture and sale of baby nutrition and care products.	46.8	82.8
Yashili International Holdings Limited	1230.HK	The group is principally engaged in the manufacture and sale of dairy and nourishment products.	81.5	86.4
China Feihe Limited	6186.HK	The group is principally engaged in the production and sales of infant milk formula products.	95.0	98.4

Note:

The information was extracted from the annual reports of the Comparable Companies for the year ended 31 December 2020.

Set out below are Comparables Companies together with the relevant market capitalisation, P/E Ratios and P/B Ratios:

Company name	Stock code	Market capitalisation (HK\$'billion) (Note 1)	P/E Ratio (times) (Note 2)	P/B Ratio (times) (Note 3)
Health and Happiness (H&H) International Holdings Limited	1112.HK	8.41	6.07	1.11
Yashili International Holdings Limited	1230.HK	2.61	21.17	0.37
China Feihe Limited	6186.HK	92.25	10.17	4.26
		Minimum	6.07	0.37
		Maximum	21.17	4.26
		Average	12.47	1.92
		Median	10.17	1.11
		Implied market capitalization (HK\$'billion) (Note 4)	Implied P/E Ratio (approximate times) (Note 5)	Implied P/B Ratio (approximate times) (Note 6)
The Company	1717.HK	17.92	14.63	2.84

Notes:

1. The market capitalisation is calculated as the closing price of shares of the respective Comparable Companies as at the Latest Practicable Date multiplied by their respective number of issued shares as at the Latest Practicable Date.
2. The P/E Ratio is calculated based on the market capitalisation as described in Note 1 above divided by the latest net profit attributable to equity holders of the respective Comparable Companies reported in their latest annual reports.
3. The P/B Ratio is calculated based on the market capitalisation as described in Note 1 above divided by the net asset value attributable to equity holders of the respective Comparable Companies reported in their latest annual reports.
4. The implied market capitalisation of the Company is calculated as the Share Offer Price multiplied by the number of issued Shares as at the Latest Practicable Date
5. The implied P/E Ratio is calculated as the implied market capitalisation as described in Note 4 above divided by the profit attributable to equity holders of the Company in FY2020 extracted from the 2020 Annual Report.
6. The implied P/B Ratio is calculated as the implied market capitalisation as described in Note 4 above divided by the net asset value attributable to equity holders of the Company as at 31 December 2020 extracted from the 2020 Annual Report.

As shown in the table above, the P/E Ratios of the Comparable Companies ranged from approximately 6.07 times to approximately 21.17 times, with an average P/E Ratio of approximately 12.47 times and a median P/E Ratio of approximately 10.17 times. The Implied P/E Ratio of approximately 14.63 times is slightly above both the average and median P/E Multiples of the Comparable Companies.

As shown in the table above, the P/B Ratios of the Comparable Companies ranged from approximately 0.37 time to approximately 4.26 times, with an average P/B Ratio of approximately 1.92 times and a median P/B Ratio of approximately 1.11 times. The Implied P/B Ratio of approximately 2.84 times is higher than both the average and median P/B Multiples of the Comparable Companies.

Having considered that (i) the Implied P/E Ratio, calculated based on the Share Offer Price, is within the industry range and slightly higher than the average and median of the P/E Ratios of the Comparable Companies; and (ii) the Implied P/B Ratio is within the industry range and higher than the average and median of the P/B Ratio of the Comparable Companies, we consider the Share Offer Price to be fair and reasonable so far as the Independent Shareholders are concerned.

10. The Option Offer

As at the Latest Practicable Date, the Company had 37,499,334 Options which may be exercised for an issue of 37,499,334 additional Shares at a price of HK\$10.00 per Option by the Optionholders.

Pursuant to Rule 13.5 of the Takeovers Code and Practice Note 6 of the Takeovers Code, the Option Offer to cancel each Option is calculated on a see-through basis, so that the Option Offer Price would represent the difference between the exercise price for each Option and the Share Offer Price, which is in line with the normal practice. We note that the current Option Offer Price is derived based on the "see-through" principle, which is in accordance with the general practice. On this basis, we are of the view that the Option Offer at the Option Offer Price is fair and reasonable.

DISCUSSION

In forming our opinion and recommendation below, we have taken into account the factors set out under the section headed "Principal factors and reasons considered" above, none of which can be considered in isolation. We would like to draw the attention of the Independent Shareholders and the Optionholders in particular to the points summarised below:

- (i) The Share Offer Price represented a premium over the recent prevailing market price of the Shares – 13.67% and 1.51% over the closing price of the Shares as at the Last Trading Day and as at the Latest Practicable Date respectively, and 17.11%, 24.20% and 33.42% over the average closing price of the Shares during the 5-day, 10-day and 30-day periods prior to and including the Last Trading Day. The increase in Share price after publication of the Joint Announcement is in our view likely to be associated with the Offers and there is no assurance that such level of Share price can be sustained if the Offers close or lapse.

- (ii) The Share Offer Price represented a premium of approximately 188.50% and 185.39% over the audited or unaudited consolidated net assets attributable to the Shareholders per Share as at 31 December 2020 and 30 June 2021 respectively.
- (iii) The liquidity of the Shares were in general very thin, with average trading volume representing around 0.29% and 0.67% of the total issued share capital and public float of the Shares respectively. Such low liquidity renders it difficult for the Independent Shareholders to dispose of their Shares in the market without exerting downward pressure on the Share price.
- (iv) The Offeror had indicated that it does not intend to introduce any major changes to the existing operations and business of the Group upon the close of the Offers.
- (v) The businesses of the Group had been profitable in the past and the Group has a consistent dividend payout record in the past few years. However, in view of the opportunities and challenges lying ahead of the Group as discussed in the paragraphs headed “6. Prospects of the Group”, there is uncertainty that the Company would be able to maintain the growth momentum of its business and profitability in the future and declare dividend payout in a similar ratio as it maintained before.
- (vi) The Implied P/E Ratio falls with the range of the P/E Ratios of the Comparable Companies and is above the average P/E Ratio as well as the median of the P/E Ratio of the Comparable Companies. The Implied P/B Ratio falls within the range of the P/B Ratio of the Comparable Companies and is above the average P/B Ratio and the median of the P/B Ratio of the Comparable Companies.
- (vii) The Option Offer adopts the “see-through” price, which is a common market practice and in accordance with Rule 13 and Practice Note 6 of the Takeovers Code, as such, we consider the Option Offer Price is fair and reasonable so far as the Optionholders are concerned.
- (viii) The Share Offer on the other hand provides an option with certainty for the Independent Shareholders to receive a cash consideration of HK\$10.06 per Share which represents a premium over the prevailing market prices if they wish to exit their investment in the Shares.

CONCLUSION AND RECOMMENDATION

Based on the above analysis, we are of the opinion that the terms of the Offers (being the Share Offer and the Option Offer) are fair and reasonable so far as the Independent Shareholders and Optionholders are concerned. Accordingly, we recommend the Independent Board Committee to advise (i) the Independent Shareholders to accept the Share Offer; and (ii) the Optionholders to accept the Option Offer.

For Independent Shareholders who are attracted by and confident in the future prospects of the Group, given the background of the Offeror as detailed in the letter from CLSA Limited contained in the Composite Document, they may consider to retain their Shares in full or in part. For those Independent Shareholders who would like to retain their Shares in part or in full, we would like to remind them that the Share Offer Price of HK\$10.06 per Offer Share is above closing price of the Shares as at the Latest Practicable Date. We would also like to remind them of the potential difficulties they may encounter in disposing large blocks of Shares in the open market without creating downward pressure on the market price of the Shares after the close of the Offers in view of the historical thin liquidity of the Shares and there is no guarantee that the prevailing level of the Share price will sustain. The Independent Shareholders are strongly advised that the decision to realise or to continue to hold their investments in the Shares is subject to individual circumstances and investment objectives. As each Independent Shareholder or Optionholders would have different investment objectives and/or circumstances, we advise the Independent Board Committee to also recommend the Independent Shareholders and the Optionholders who may require advice concerning any aspect of the Composite Document, or as to the action to be taken, to consult a licensed securities dealer or registered institution in securities, bank manager, solicitor, professional accountant or other professional advisers. Furthermore, they should carefully read the procedures for accepting the Offers as set out in the Composite Document, its appendices and the accompanying Form of Acceptance.

For the purpose of this letter, the exchange rate of HK\$1 = RMB0.82 have been used for currency translation, where applicable. Such an exchange rate is for illustrative purposes and does not constitute representations that any amount in HK\$ or RMB has been, could have been or may be converted at such a rate.

Yours faithfully,
for and on behalf of
OPTIMA CAPITAL LIMITED



Ng Ka Po

Co-Managing Director, Corporate Finance

Mr. Ng is a responsible officer of Optima Capital and a licensed person registered with the SFC to carry out Type 1 (dealing in securities), Type 4 (advising on securities) and Type 6 (advising on corporate finance) regulated activities under the SFO. Mr. Ng has participated in the provision of independent financial advisory services for various transactions involving companies listed on the Stock Exchange.