



SOMERLEY CAPITAL LIMITED

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14 February 2017

To: *the Independent Board Committee*

Dear Sirs,

CONDITIONAL MANDATORY CASH OFFERS BY UBS AG AND DBS ASIA CAPITAL LIMITED FOR AND ON BEHALF OF CHINA MENGNIU DAIRY COMPANY LIMITED TO ACQUIRE ALL THE ISSUED SHARES IN CHINA MODERN DAIRY HOLDINGS LTD. (OTHER THAN THOSE ALREADY OWNED OR AGREED TO BE ACQUIRED BY CHINA MENGNIU DAIRY COMPANY LIMITED AND PARTIES ACTING IN CONCERT WITH IT) AND FOR CANCELLATION OF ALL OUTSTANDING OPTIONS IN CHINA MODERN DAIRY HOLDINGS LTD.

INTRODUCTION

We refer to our appointment to advise the Independent Board Committee in relation to the conditional mandatory cash offers by UBS and DBS on behalf of Mengniu to acquire all the issued CMD Shares not already owned or agreed to be acquired by Mengniu and its Concert Parties, and for cancellation of all outstanding CMD Options. Details of the Offers are set out in the Composite Document dated 14 February 2017, of which this letter forms part. Terms used in this letter shall have the same meanings as those defined in the Composite Document unless the context otherwise requires.

As set out in the Joint Announcement, Mengniu entered into the SPA, pursuant to which Mengniu has conditionally agreed to acquire and Success Dairy II has conditionally agreed to sell 965,465,750 CMD Shares (being the Subject Shares) for a consideration of HK\$1,873,003,555, representing HK\$1.94 or US\$0.25 per CMD Share at SPA Completion. Further details of the SPA are set out in the Joint Announcement. SPA Completion took place on 7 February 2017 where by the Subject Shares were transferred by Success Dairy II to Mengniu SPV, as directed by Mengniu. Immediately following issuance of the New CMD Shares to Success Dairy II and prior to the SPA Completion, Mengniu and its Concert Parties (other than Success Dairy II) were interested in 1,347,903,000 CMD Shares, representing approximately 22.0% of the then total issued share capital of CMD. Immediately following the SPA Completion but before commencement of the Offers, Mengniu and its Concert Parties beneficially own in aggregate of 2,313,368,750 CMD



Shares, representing approximately 37.7% of the total issued share capital of CMD as at the Latest Practicable Date. Accordingly, upon the SPA Completion, Mengniu is required to make (i) a conditional mandatory cash offer for all the issued CMD Shares not already owned or agreed to be acquired by Mengniu and its Concert Parties pursuant to Rule 26.1 of the Takeovers Code; and (ii) an appropriate offer to the Optionholders for the cancellation of the outstanding CMD Options pursuant to Rule 13 of the Takeovers Code.

The Independent Board Committee comprising all non-executive CMD Directors and independent non-executive CMD Directors (who have no direct or indirect interest in the Offers other than the holding of the CMD Options), namely Mr. SUN Yugang, Mr. LI Shengli, Mr. LEE Kong Wai Conway, Mr. KANG Yan and Mr. ZOU Fei, has been established to advise the CMD Shareholders and the Optionholders as to whether the Offers are fair and reasonable and as to their acceptance. Mr. YU Xubo, Mr. WOLHARDT Julian Juul, Mr. HUI Chi Kin Max and Mr. ZHANG Ping, all of whom are non-executive CMD Directors, do not form part of the Independent Board Committee due to their respective interests in the Offers as out in the section headed "Independent Board Committee and Independent Financial Adviser" in the "Letter from the CMD Board" of the Composite Document. The Independent Board Committee has approved our appointment as the Independent Financial Adviser to advise the Independent Board Committee in relation to the Offers.

During the past two years, Somerley Capital Limited has acted as the independent financial adviser to the independent board committee and the independent shareholders of Yashili International Holdings Ltd (stock code: 1230) ("Yashili"), a subsidiary of Mengniu, in relation to (a) two major and connected transactions as detailed in Yashili's circulars dated 29 October 2015 and 3 May 2016 respectively; and (b) continuing connected transaction as detailed in Yashili's circular dated 23 November 2016. The aforesaid past engagements were limited to providing independent advisory services to the independent board committee and the independent shareholders of Yashili pursuant to the Listing Rules, for which Somerley Capital Limited received normal professional fees. Accordingly, we do not consider the past engagements give rise to any conflict of interest for Somerley Capital Limited in acting as the Independent Financial Adviser.

We are not associated with CMD, Mengniu or any party acting, or presumed to be acting, in concert with any of them and, accordingly, are considered eligible to give independent advice on the Offers. Apart from normal professional fees payable to us in connection with this appointment, and except as disclosed above, no arrangement exists whereby we will receive any fees or benefits from CMD, Mengniu or any party acting, or presumed to be acting, in concert with any of them.

BASIS OF OUR OPINION

In formulating our opinion, we have reviewed, among other things, (i) the Composite Document; (ii) the annual report of CMD for the year ended 31 December 2015, and the interim report of CMD for the six months ended 30 June 2016; (iii) the announcements published by CMD on the website of the Stock Exchange since 1 January 2016; and (iv) the material change statement set out in Appendix II to the Composite Document. We have sought and received confirmation from the CMD Directors that no



material facts have been omitted from the information supplied and opinions expressed by them. We consider that the information we have received is sufficient for us to reach our opinion and recommendation as set out in this letter. We have no reason to doubt the truth and accuracy of the information provided to us or to believe that any material facts have been omitted or withheld. We have, however, not conducted any independent investigation into the business and affairs of the CMD Group or Mengniu Group, nor have we carried out any independent verification of the information supplied. We have also assumed that all representations contained or referred to in the Composite Document are true as at the Latest Practicable Date, and that the CMD Shareholders will be notified of any material changes to such representations as soon as reasonably practicable during the Offer Period.

We have not considered the tax and regulatory implications on the CMD Shareholders and the Optionholders of acceptance or non-acceptance of the Offers since these depend on their individual circumstances. In particular, CMD Shareholders and Optionholders who are resident overseas or subject to overseas taxes or Hong Kong taxation on securities dealings should consider their own tax positions and, if in any doubt, consult their own professional advisers.

PRINCIPAL TERMS OF THE OFFERS

The Share Offer

UBS as the financial adviser and DBS as the joint financial adviser, are making the Offers, for and on behalf of Mengniu on the following basis:

For each Offer Share HK\$1.94 or US\$0.25 in cash

The Offer Price of HK\$1.94 or US\$0.25 for each Offer Share under the Share Offer is equivalent to the consideration per CMD Share of HK\$1.94 or US\$0.25 pursuant to the SPA, assuming the Investor Option is exercised and as determined using the Exchange Rate.

The Offer Price will remain at HK\$1.94 or US\$0.25 per CMD Share and will not be increased, and Mengniu does not reserve the right to do so. Further, the Offers will be open for acceptance for 21 days following the date on which the Composite Document is posted. Unless the Offers become unconditional as to acceptances, the Offers will not be extended beyond the first date on which they are permitted to be closed.



The Option Offer

For each CMD Option with exercise price
below the Offer Price HK\$1.94 or US\$0.25
less the exercise price
in respect of the relevant
CMD Option in cash

For each CMD Option with exercise price
above the Offer Price HK\$0.0001 or US\$0.000013 in cash

Further details regarding the Option Offer is set out in the "Letter from UBS and DBS" of the Composite Document.

As at the Latest Practicable Date, there are 6,131,406,706 CMD Shares in issue (of which 2,313,368,750 are held by Mengniu and its Concert Parties) and 315,401,705 outstanding CMD Options conferring rights on the Optionholders to subscribe for CMD Shares. Out of the 315,401,705 CMD Options, there are 215,757,083 CMD Options with exercise prices lower than the Offer Price and 99,644,622 CMD Options with exercise prices higher than the Offer Price.

Conditions to the Offers

The Share offer is conditional only upon Mengniu through its nominee, Mengniu SPV, having received acceptances in respect of the CMD Shares which, together with the CMD Shares held by Mengniu and its Concert Parties as at the Latest Practicable Date, will result in Mengniu and its Concert Parties holding more than 50% of the total issued share capital of CMD.

The Option Offer will be conditional only upon the Share Offer becoming or being declared unconditional.

The last day on which the Offers can become unconditional is the First Closing Date.

Non-Accepting Shareholders

As set out in section headed "Non-Accepting Shareholders" in the "Letter from UBS and DBS" of the Composite Document, Mengniu and CMD have received written unconditional and irrevocable confirmations and undertakings from certain CMD Shareholders that they will not accept the Share Offer. As at the Latest Practicable Date, the number of CMD Shares held by the Non-Accepting Shareholders was 564,983,938, representing approximately 9.21% of issued CMD Shares (assuming none of the outstanding CMD Options is exercised). Further details in relation to the Non-Accepting Shareholders are set out abovementioned section of the Composite Document.



PRINCIPAL FACTORS AND REASONS CONSIDERED

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

1. Information and prospects of the CMD Group

(a) *Background and information of the CMD Group*

CMD is a company incorporated in the Cayman Islands with limited liability, and CMD Shares have been listed on the Main Board of the Stock Exchange since 2010. As set out in CMD's 2015 annual report, the CMD Group is the largest dairy farming company and the largest producer of raw milk in China in terms of herd size, and is primarily engaged in two business segments: (i) dairy farming business, which mainly involves the production and sales of raw milk to customers for processing into dairy products; and (ii) liquid milk products business under the CMD Group's own brand, which mainly involves the production and sales of liquid milk products.

In July 2015, CMD and Success Dairy II (a joint venture entity ultimately held by New Dairy Investment Ltd and Crown Dairy Holdings Limited, which in turn held by KKR China Growth Fund L.P. and CDH Fund IV, L.P. respectively) entered into, among others, an agreement pursuant to which CMD agreed to purchase certain equity interests in companies engaged in dairy farm operations held by Success Dairy II and the consideration was paid by CMD by issuance of consideration shares (the "Consideration Shares"). The share purchase agreement contained a value adjustment mechanism ("VAM") in relation to the Consideration Shares, under which if the value of such shares calculated pursuant to the share purchase agreement is less than US\$308 million (the "Guaranteed Value") on 21 July 2018, CMD shall compensate Success Dairy II for the difference between the Guaranteed Value and the actual value. As set out in an announcement of CMD dated 12 December 2016, in view of the then market volatility and uncertain market conditions, CMD granted the Investor Option to Success Dairy II to terminate its obligations under VAM at a discounted price to the Guaranteed Value. On 4 January 2017, Mengniu entered into the Sale and Purchase agreement with Success Dairy II to acquire the Subject Shares (comprising the Existing CMD Shares and New CMD Shares issued under the Investor Option) and the Subject Shares were transferred to Mengniu upon SPA Completion, where Mengniu and its Concert Parties beneficially owned approximately 37.7% of the issued share capital of CMD immediately following SPA Completion but before commencement of the Offers. Further details are set out in announcements of CMD dated 6 July 2015, 20 July 2015, 12 December 2016, 21 December 2016, 4 January 2017, 6 February 2017, 7 February 2017 and the Joint Announcement.



(b) *Financial information of the CMD Group*

(i) *Financial performance*

The following is an extract of the financial results of the CMD Group (a) for the two years ended 31 December 2014 and 2015 (both of 2014 and 2015 annual results having been extracted from CMD's 2015 annual report); and (b) for the six months ended 30 June 2015 and 2016 (both of 2015 and 2016 interim results having been extracted from CMD's 2016 interim report).

	For the six months ended 30 June		For the year ended 31 December	
	2016 RMB'000 (unaudited)	2015 RMB'000 (unaudited)	2015 RMB'000 (audited)	2014 RMB'000 (audited)
Revenue	2,229,110	2,437,320	4,826,341	5,026,706
Cost of sales before biological fair value adjustment	(1,503,741)	(1,548,426)	(3,167,298)	(3,161,345)
Biological fair value adjustment included in cost of sales	(557,307)	(636,944)	(1,203,011)	(1,666,242)
Loss arising from changes in fair value less costs to sell of dairy cows	(499,245)	(199,269)	(474,910)	(329,069)
Gains arising on initial recognition of raw milk at fair value less costs to sell at the point of harvest	557,307	636,944	1,203,011	1,666,242
Other income	40,177	14,708	32,094	40,213
Selling and distribution costs	(136,172)	(67,688)	(194,542)	(111,909)
Administrative expenses	(129,891)	(111,485)	(243,566)	(214,561)
Share of (loss) profit of an associate	(1,583)	1,432	(1,192)	(6,791)
Share of profit of joint ventures	–	2,569	5,782	7,004
Other gains and losses, net	(388,752)	148,733	(107,077)	(209,648)
Other expenses	(3,786)	(2,063)	(5,173)	(4,635)
(Loss) profit before finance costs and tax	(393,883)	675,831	670,459	1,035,965
Finance costs	(195,790)	(153,917)	(315,078)	(265,601)
(Loss) profit before tax	(589,673)	521,914	355,381	770,364
Income tax expense	(205)	(14,600)	(11,663)	(7,476)
(Loss) profit and total comprehensive income for the period/year	(589,878)	507,314	343,718	762,888



	For the six months ended 30 June		For the year ended 31 December	
	2016 RMB'000 (unaudited)	2015 RMB'000 (unaudited)	2015 RMB'000 (audited)	2014 RMB'000 (audited)
Attributable to:				
Owners of CMD	(565,668)	476,952	321,296	735,317
Non-controlling interests	<u>(24,210)</u>	<u>30,362</u>	<u>22,422</u>	<u>27,571</u>
(Loss) profit and total comprehensive income for the period/year	<u>(589,878)</u>	<u>507,314</u>	<u>343,718</u>	<u>762,888</u>
(Loss) earnings per share (RMB)				
Basic	(10.66) cents	9.88 cents	6.37 cents	15.23 cents
Diluted	<u>(10.66) cents</u>	<u>9.80 cents</u>	<u>6.32 cents</u>	<u>15.08 cents</u>

(1) Revenue

The revenue of the CMD Group was generated from two operating segments, namely (a) dairy farming business; and (b) liquid milk products business. Breakdown of the revenue from external sales by the two operating segments is set out below:

	For the six months ended 30 June		For the year ended 31 December	
	2016 RMB'000 (unaudited)	2015 RMB'000 (unaudited)	2015 RMB'000 (audited)	2014 RMB'000 (audited)
Sales from dairy farming business	1,573,715	1,647,827	3,324,466	4,194,020
Sales from liquid milk products business	<u>655,395</u>	<u>789,493</u>	<u>1,501,875</u>	<u>832,686</u>
Total revenue	<u>2,229,110</u>	<u>2,437,320</u>	<u>4,826,341</u>	<u>5,026,706</u>

As set out above, the total revenue of the CMD Group decreased by approximately 4.0% from RMB5,026.7 million for the year ended 31 December 2014 to RMB4,826.3 million for the year ended 31 December 2015. Revenue generated from dairy farming business amounted to approximately RMB4,194.0 million and RMB3,324.5 million for the year ended 31 December 2014 and 2015, accounting for approximately 83.4% and 68.9% of the CMD Group's total revenue respectively. Decrease in revenue from



dairy farming business for the year ended 31 December 2015 by approximately 20.7% comparing to that in 2014 was primarily due to decrease in average selling price of CMD's quality raw milk affected by the decrease in raw milk price in the PRC during 2015. Revenue from liquid milk products business increased by approximately 80.4% from approximately RMB832.7 million for the year ended 31 December 2014 to approximately RMB1,501.9 million for the year ended 31 December 2015, which accounted for approximately 16.6% and 31.1% of the CMD Group's total revenue for the years ended 31 December 2014 and 2015 respectively. The strong growth of liquid milk products business was a result of strong market demand for the CMD Group's liquid milk products, attributable to rising demand for high-end dairy products in the relatively safe Chinese market as stated in CMD's 2015 annual report.

For the six months ended 30 June 2016, total revenue of the CMD Group amounted to approximately RMB2,229.1 million, representing a decrease by approximately 8.5% from approximately RMB2,437.3 million for the six months ended 30 June 2015. Dairy farming business remained the major contributor of the CMD Group's revenue for the six months ended 30 June 2016, with its revenue representing approximately 70.6% of the CMD Group's total revenue. Revenue from dairy farming business decreased by approximately 4.5% during the first half of 2016 from the first half of 2015 mainly due to decrease in average selling price of the CMD Group's quality raw milk as a result of the decrease in selling price of raw milk in the PRC. Revenue from liquid milk products business decreased by approximately 17.0% for the six months ended 30 June 2016 compared to the same period in 2015 because of the decrease in volume of liquid milk sold as a result of the impact and effect of imported bulk milk powder and reconstituted milk.

- (2) (Loss) profit and total comprehensive income attributable to owners of CMD

The CMD Group recorded profit and total comprehensive income attributable to owners of CMD of approximately RMB321.3 million for the year ended 31 December 2015, representing a decrease of approximately 56.3% from 2014. The significant decrease was mainly due to (a) the decrease in revenue by approximately RMB200.4 million; (b) the increase in the loss arising from changes in fair value less costs to sell of dairy cows by approximately RMB145.8 million; and (c) the increase in operating expenses (including selling and distribution costs and administrative expenses) in a total of approximately RMB111.6 million, and the effect was partly offset by the gain arising on



remeasurement of joint ventures of approximately RMB121.3 million. The loss arising from changes in fair value less costs to sell of dairy cows was mainly attributable to (i) the fact that after milk production by milkable cows, along with an extended lactation period, impairment will occur as less cash flow will be generated in the future, and (ii) a decrease in the market selling price of raw milk. The increase in operating expenses was mainly due to the increase in transportation costs as a result of increased sales volume of liquid milk products and increase of management personnels with the enlargement of brand milk scale during the year ended 31 December 2015.

For the six months ended 30 June 2015 and 2016, the CMD Group recorded a profit and total comprehensive income attributable to owners of CMD of approximately RMB477.0 million and a loss and total comprehensive income attributable to owners of CMD of approximately RMB565.7 million respectively. The main reasons for the loss incurred for the six months ended 30 June 2016 include (a) the fair value losses from value adjustment undertakings (i.e. VAM as discussed in the paragraph headed "Background and information of the CMD Group" of this sub-section above) recorded as other net gains and losses amounted to approximately RMB387.8 million incurred during the first half of 2016, and (b) the increase in loss arising from changes in fair value less costs to sell of dairy cows by approximately RMB300.0 million compared to the same period in 2015 mainly attributable to the decrease in selling price of raw milk. Under the VAM, the value of the Consideration Shares will be calculated upon the expiry of the three-year lock-up period according to the agreement and the fair value adjustment (by comparing the value of the Consideration Shares at spot price and US\$308 million (i.e. guaranteed value), in case the value of the Consideration Shares based on the spot price is less than US\$308 million, as stated in CMD's 2016 interim report) has been recorded as a financial liability with the fair value changes recorded in the profit and loss account. Further details are set out in CMD's 2016 interim report.

CMD published the Profit Warning Announcement on 6 February 2017 and it was expected that the CMD Group will record a consolidated net loss attributable to equity holders of CMD of not less than RMB600 million for the year ended 31 December 2016 (the "Profit Warning"). Further details of the Profit Warning are set out in the Profit Warning Announcement.



(3) (Loss) earnings per share

Basic earnings per share for the year ended 31 December 2014 and 2015 were approximately RMB15.23 cents and RMB6.37 cents respectively and basic loss per share for the six months ended 30 June 2016 was approximately RMB10.66 cents. The Consideration Shares issued by CMD to Success Dairy II as mentioned above increased the number of ordinary shares of CMD at the end of 2015 by approximately 9.9% compared to that at the end of 2014. Other than the increase in number of ordinary shares, the movements in the (loss) earnings per share generally followed the movements of the CMD Group's financial results. Diluted earnings per share for the year ended 31 December 2014 and 2015 were approximately RMB15.08 cents, RMB6.32 cents and diluted loss per share for the six months ended 30 June 2016 was approximately RMB10.66 cents. The calculation of diluted earnings per share has taken into account the effect of share options issued by CMD.

(ii) *Financial position*

Set out below is an extract of the financial position of the CMD Group (a) as at 31 December 2014 and 2015 (both the 2014 and 2015 financial position having been extracted from CMD's 2015 annual report); and (b) as at 30 June 2016 (as extracted from CMD's 2016 interim report).

	As at 30 June 2016 RMB'000 (unaudited)	As at 31 December 2015 RMB'000 (audited)	2014 RMB'000 (audited)
NON-CURRENT ASSETS			
Property, plant and equipment	5,310,139	5,376,897	4,457,970
Land use rights	125,345	120,622	64,868
Goodwill	1,441,494	1,441,494	310,426
Interest in an associate	–	25,076	18,931
Interest in joint ventures	–	–	95,208
Available-for-sale investment	24,955	–	–
Biological assets	7,576,003	7,590,878	6,530,814
	14,477,936	14,554,967	11,478,217



	As at 30 June 2016 RMB'000 (unaudited)	As at 31 December	
		2015 RMB'000 (audited)	2014 RMB'000 (audited)
CURRENT ASSETS			
Inventories	793,211	834,099	640,581
Trade and other receivables	1,204,430	1,097,794	826,772
Land use rights	3,913	3,743	1,667
Pledged bank balances	178,765	183,664	612,909
Cash and bank balances	<u>1,139,694</u>	<u>833,569</u>	<u>556,964</u>
	<u>3,320,013</u>	<u>2,952,869</u>	<u>2,638,893</u>
CURRENT LIABILITIES			
Trade and other payables	1,986,910	2,012,976	1,403,003
Tax payable	149	281	2,787
Bank borrowings – due within one year	3,079,631	4,825,521	1,858,398
Short-term debenture	997,950	400,000	1,100,000
Other borrowing – due within one year	<u>39,066</u>	<u>–</u>	<u>–</u>
	<u>6,103,706</u>	<u>7,238,778</u>	<u>4,364,188</u>
NET CURRENT LIABILITIES	<u>(2,783,693)</u>	<u>(4,285,909)</u>	<u>(1,725,295)</u>
TOTAL ASSETS LESS CURRENT LIABILITIES	<u><u>11,694,243</u></u>	<u><u>10,269,058</u></u>	<u><u>9,752,922</u></u>
CAPITAL AND RESERVES			
Share capital	452,959	452,959	415,261
Share premium and reserves	<u>6,775,739</u>	<u>7,328,938</u>	<u>6,094,978</u>
Equity attributable to owners of CMD	7,228,698	7,781,897	6,510,239
Non-controlling interests	<u>119,325</u>	<u>168,135</u>	<u>145,713</u>
	<u>7,348,023</u>	<u>7,950,032</u>	<u>6,655,952</u>



	As at 30 June 2016 RMB'000 (unaudited)	As at 31 December	
		2015 RMB'000 (audited)	2014 RMB'000 (audited)
NON-CURRENT LIABILITIES			
Bank borrowings – due after one year	815,430	821,730	2,829,450
Medium-term notes	1,795,446	200,000	–
Deferred income	134,895	141,824	120,421
Other financial liabilities	1,543,265	1,155,472	147,099
Other borrowing – due after one year	57,184	–	–
	<u>4,346,220</u>	<u>2,319,026</u>	<u>3,096,970</u>
	<u>11,694,243</u>	<u>10,269,058</u>	<u>9,752,922</u>

As at 30 June 2016, the CMD Group's total assets were approximately RMB17,797.9 million. Assets of the CMD Group mainly include (a) biological assets, representing dairy cows held to produce raw milk; and (b) property, plant and equipment. As at 30 June 2016, the CMD Group recorded total liabilities of approximately RMB10,450.0 million, which mainly consisted of (a) bank borrowings; (b) trade and other payables; (c) medium-term notes; and (d) other financial liabilities, i.e. the fair value adjustment of the Consideration Shares as described above. As set out in the section headed "Indebtedness" in Appendix II to the Composite Document, the CMD Group has outstanding borrowings (including bank loans, other loans, corporate bond, medium term notes and short term bills) of approximately RMB6.8 billion as at 31 December 2016.

Net assets value attributable to owners of CMD amounted to approximately RMB7,228.7 million as at 30 June 2016, with a value per ordinary share of approximately RMB1.36 (equivalent to approximately HK\$1.52 per ordinary share, being converted in the exchange rate of RMB1:HK\$1.1142) and calculated based on 5,304,767,883 ordinary shares as at 30 June 2016. The Offer Price of HK\$1.94 per Offer share represents premium of approximately 27.6% over the net assets value attributable to owners of CMD per ordinary share.



(c) *Prospects of the CMD Group*

The executive CMD Directors believe, and as set out in CMD's 2016 interim report, that there will be growth in total domestic consumption of dairy products in the PRC in the long run as a result of urbanisation, increase in per capita income of consumers and implementation of the Two Children Policy in the PRC. It is expected that the implementation of the Two Children Policy will increase the size of the consumer group for dairy products. We note from the website of National Bureau of Statistics of the PRC that there has been growth in per capita disposable income in the PRC from 2013 to 2015. Together with the implementation of the Two Children Policy, it is expected that the spending of consumers on dairy products will increase. On the other hand, the current operating environment of the CMD Group is challenging as a result of the slowdown in the macroeconomic growth of the PRC and intensive competition in the market due to the increased consumption of imported whole milk powder which can be used as a substitute for raw milk for certain dairy products. The CMD Group will continue to maintain the standard and requirement of quality in raw milk and expand the distribution network of its downstream milk products. Following the SPA Completion, Mengniu (together with its Concert Parties)'s shareholdings in CMD increased from approximately 22.0% to 37.7%, remaining as the single largest CMD Shareholder. The Mengniu Group is also a primary customer of the CMD Group and the revenue from sales of raw milk to the Mengniu Group accounted for approximately 48% and 50% of the CMD Group's revenue for the year ended 31 December 2015 and six months ended 30 June 2016 respectively. As set out in the section headed "Financial and trading prospect of the enlarged group" in Appendix I to Mengniu's circular dated 16 January 2017, the Mengniu Group (after completion of the Offers) plans to conduct more efficient distribution of the CMD Group's products as well as drive further integration such as sharing e-commerce resources, joint negotiation for key account channels and cross-selling opportunities. The executive CMD Directors are of the view that the strategic cooperation between the CMD Group and Mengniu Group will be further enhanced through the increase in shareholdings in CMD. Taking into account the above, the executive CMD Directors consider the long term prospect of the CMD Group remains positive and we concur that long-term prospects seem encouraging despite current challenges. Further details on Mengniu's intention on the CMD Group are set out in the sub-section headed "Information on Mengniu Group and Mengniu's intention for the CMD Group" of this letter below.

2. Information on Mengniu Group and Mengniu's intention for the CMD Group

The Mengniu Group is one of the leading dairy product manufacturers in the PRC, principally engaged in manufacturing and distribution of quality dairy products including liquid milk, ice-cream, milk formula and other dairy products. Mengniu Shares have been listed on the Main Board of the Stock Exchange since



2004. Mengniu SPV is a directly wholly-owned subsidiary of Mengniu. Its main business is to hold the Subject Shares to be transferred from Success Dairy II upon SPA Completion, and to receive the Offer Shares from accepting CMD Shareholders.

As set out in the section headed "Mengniu's intention on the CMD Group" in the "Letter from UBS and DBS" of the Composite Document, after the close of the Offers, Mengniu intends to continue the existing principal business of the CMD Group. Mengniu will conduct a review of the business operations and financial position of the CMD Group with a view to formulating a long term strategy and business plan suited to the CMD Group. No major changes are expected to be introduced in the existing principal business of the CMD Group. Other than proposed changes to the CMD Board as mentioned in the same section of the Composite Document, Mengniu has no intention to make material changes to the management of the CMD Group or to terminate the employment of any employee or other personnel of the CMD Group.

As further stated in the same section of the Composite Document, the CMD Board is currently made up of 11 directors. It is expected that Mr. WOLHARDT Julian Juul and Mr. HUI Chi Kin Max will resign as CMD Directors with effect from the First Closing Date or such date as permitted by the Executive. Success Dairy II has agreed to use reasonable endeavors to procure certain of Mengniu's nominees to the CMD Board with effect from the date when the Composite Document is posted or such other date as the Executive may permit under Rule 26.4 of the Takeovers Code. Such appointments will be made in accordance with CMD's constitutional documents, the Takeovers Code and the Listing Rules.

3. Maintenance of the listing status of CMD

As set out in the "Letter from UBS and DBS" of the Composite Document, as the Non-Accepting Shareholders have indicated that they will not accept the Share Offer, Mengniu is not expected to be able to acquire the requisite percentage of CMD Shares to enable it to compulsorily acquire all the issued CMD Shares under Cayman Islands Companies Law and the Takeovers Code. Accordingly, after completion of the Offers, Mengniu will maintain the listing status of CMD. The Stock Exchange has stated that if, at the close of the Offers, less than the minimum prescribed percentage applicable to CMD, being 25% of the issued CMD Shares, are held by the public, or if the Stock Exchange believes that (i) a false market exists or may exist in the trading of the CMD Shares; or (ii) there are insufficient CMD Shares in public hands to maintain an orderly market, it will consider exercising its discretion to suspend dealings in the CMD Shares. Assuming the Offers become or are declared unconditional in all respects, Mengniu Directors have jointly and severally undertaken to the Stock Exchange to take appropriate steps to ensure that sufficient public float exists in the CMD Shares, and the new directors to be appointed to the CMD Board will jointly and severally undertake to the Stock Exchange to take appropriate steps to ensure that sufficient public float exists in the CMD Shares.



The shareholding structure of CMD (i) immediately following issuance of the New CMD Shares to Success Dairy II and prior to SPA Completion; (ii) immediately following SPA Completion but before the commencement of the Offers, assuming no CMD Options are exercised; and (iii) immediately following completion of the Offers, assuming none of the outstanding CMD Options is exercised and all CMD Shares are tendered for acceptance by CMD Shareholders under the Share Offer (other than the Non-Accepting Shareholders) are as follows. Further details regarding the shareholding structure and accompanying notes to the table are set out in section headed "Information of the CMD Group" in the "Letter from UBS and DBS" of the Composite Document.

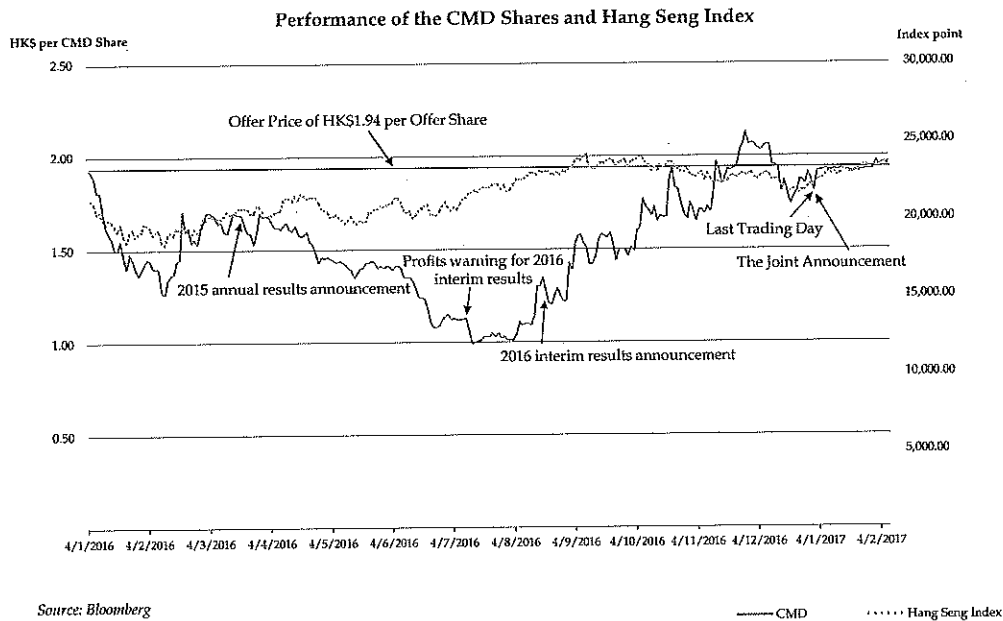
	Immediately following issuance of New CMD Shares to Success Dairy II pursuant to the exercise of the Investor Option and prior to SPA Completion		Immediately following SPA Completion but before commencement of the Offers, assuming no CMD Options are exercised		Immediately following the completion of the Offers, assuming none of the outstanding CMD Options is exercised and all CMD Shares are tendered for acceptance by CMD Shareholders under the Share Offer (other than the Non-Accepting Shareholders)	
	<i>Number of Shares</i>	<i>Approximate %</i>	<i>Number of Shares</i>	<i>Approximate %</i>	<i>Number of Shares</i>	<i>Approximate %</i>
Substantial Shareholders						
Mengniu and its Concert Parties (excluding Success Dairy II)	1,347,903,000	22.0%	2,313,368,750	37.7%	5,566,422,768	90.8%
Success Dairy II	965,465,750	15.7%	0	0.0%	0	0.0%
Xinmu Holdings Co. Ltd	671,021,025	10.9%	671,021,025	10.9%	0	0.0%
Yinmu Holdings Co. Ltd	446,465,419	7.3%	446,465,419	7.3%	0	0.0%
Jinmu Holdings Co. Ltd	221,581,733	3.6%	221,581,733	3.6%	221,581,733	3.6%
Directors and Chief Executive						
Gao, Lina	4,800,000	0.1%	4,800,000	0.1%	4,800,000	0.1%
Other Public Shareholders	2,474,169,779	40.4%	2,474,169,779	40.4%	338,602,205	5.5%
Total	6,131,406,706	100.0%	6,131,406,706	100.0%	6,131,406,706	100.0%



4. Analysis of the Offer Price

(a) Historical price performance of the CMD Shares

The chart below illustrates the daily closing price per CMD Share and comparison of the CMD Share price performance with the Hang Seng Index on trading days from 1 January 2016, being approximately one year before the date of the Joint Announcement, up to and including the Latest Practicable Date (the "Review Period").



The Offer Price of HK\$1.94 per Offer Share is above the closing price of the CMD Shares for most of the trading days from 1 January 2016 up to and including the Last Trading Day, except for 15 November 2016 and the period from 24 November 2016 to 13 December 2016. The performance of the CMD Shares was in general poorer than that of the Hang Seng Index before the publication of the Joint Announcement during the Review Period. The CMD Shares closed at HK\$1.88 per CMD Share and HK\$1.81 per CMD Share respectively on 3 January 2017 (being the Last Trading Day) and 4 January 2017 (being the date of the Sale and Purchase Agreement and the Joint Announcement). The Joint Announcement was published before trading hours on 5 January 2017 and the CMD Shares closed at HK\$1.91 per CMD Share on the same day, representing an increase of approximately 5.5% from the previous day. The CMD Shares closed at HK\$1.93 per CMD Share, slightly below the Offer Price, on 3 February 2017. After trading hours on 3 February 2017, Mengniu announced that Mengniu Shareholders approved the Transaction at the EGM. On 6 February 2017 (i.e. the trading day immediately following the announcement of the poll results of the EGM issued by Mengniu), the closing price of the CMD Shares was HK\$1.97 per CMD Share,



slightly above the Offer Price. The closing price of the CMD Shares continued to be slightly above the Offer Price starting from 6 February 2017. The CMD Shares closed at HK\$1.95 per CMD Share on the Latest Practicable Date and the Offer Price of HK\$1.94 per Offer Share represents a discount of approximately 0.5% to the closing price on the Latest Practicable Date.

(b) Share Offer price comparisons

The Offer Price of HK\$1.94 per Offer Share represents:

- (i) a premium of approximately 3.2% over the closing price of HK\$1.88 per CMD Share as quoted on the Stock Exchange on 3 January 2017 (i.e. the Last Trading Day);
- (ii) a premium of approximately 3.4% over the average closing price of HK\$1.876 per CMD Share for the five consecutive trading days immediately prior to and including the Last Trading Day based on the daily closing prices as quoted on the Stock Exchange;
- (iii) a premium of approximately 5.6% over the average closing price of HK\$1.837 per CMD Share for the ten consecutive trading days immediately prior to and including the Last Trading Day based on the daily closing prices as quoted on the Stock Exchange;
- (iv) a discount of approximately 0.1% to the average closing price of approximately HK\$1.9427 per CMD Share for the thirty consecutive trading days immediately prior to and including the Last Trading Day based on the daily closing prices as quoted on the Stock Exchange;
- (v) a premium of approximately 5.3% over the average closing price of approximately HK\$1.8425 per CMD Share for the sixty consecutive trading days immediately prior to and including the Last Trading Day based on the daily closing prices as quoted on the Stock Exchange; and
- (vi) a discount of approximately 0.5% to the closing price of HK\$1.95 per CMD Share as quoted on the Stock Exchange on the Latest Practicable Date.

As set out above, save as the slight discount of approximately 0.1% to the average closing price of the CMD Shares for the thirty consecutive trading days, the Offer Price of HK\$1.94 per Offer Share represents a premium ranging from approximately 3.2% to 5.6% to the closing prices of the CMD Shares before the Last Trading Day. As set out in the paragraph headed "Financial information of the CMD Group" in the sub-section headed "Information and prospects of the CMD Group" above of this letter, the Offer Price represents a premium of approximately 27.6% over the net assets value attributable to owners of CMD per ordinary share as at 30 June 2016 of approximately HK\$1.52.



(c) *Trading liquidity*

Set out in the table below are the monthly total trading volumes of the CMD Shares and the percentages of such monthly total trading volumes to the total issued share capital and the public float of CMD during the Review Period:

	Monthly total trading volume of the CMD Shares (Note 1)	Percentage of the monthly total trading volume of the CMD Shares to the total issued CMD Shares (Note 2)	Percentage of the monthly total trading volume of the CMD Shares to public float of CMD (Notes 2 & 3)
2016			
January	161,358,804	3.0%	7.6%
February	197,387,529	3.7%	9.2%
March	130,518,186	2.5%	6.1%
April	82,943,550	1.6%	3.9%
May	156,319,594	2.9%	7.3%
June	264,699,758	5.0%	12.4%
July	284,209,600	5.4%	13.3%
August	547,510,850	10.3%	25.6%
September	399,669,073	7.5%	18.7%
October	365,688,197	6.9%	17.1%
November	446,634,683	8.4%	20.9%
December	281,389,076	5.3%	13.2%
2017			
January	337,068,271	6.0%	13.6%
From 1 February 2017 to the Latest Practicable Date	108,159,969	1.8%	4.4%

Notes:

1. Source: Bloomberg
2. The calculation is based on the monthly total trading volume of the CMD Shares divided by the total issued share capital of CMD or the total number of the CMD Shares in public float at the end of each month (or at the Latest Practicable Date for February 2017).
3. The total number of CMD Shares in public float is calculated based on the number of total issued CMD Shares excluding the CMD Shares held by the substantial shareholders and director of CMD at the end of each month (or at the Latest Practicable Date for February 2017).



Based on the above table, the trading volume of the CMD Shares in 2016 has not been consistent, ranging between approximately 1.6% and 10.3% of the total issued CMD Shares, and between approximately 3.9% and 25.6% of the total issued CMD Shares in public hands. As advised by the executive CMD Directors, the more active monthly trading volumes from August to November 2016 ranging between approximately 17.1% to 25.6% of the public float may be attributable to, among other things, improved ratings from investment banks covering CMD because of expected improvement in the industry generally. On 5 January 2017 (i.e. the trading day immediately following the publication of the Joint Announcement), trading volume of the CMD Shares reached approximately 120 million. Trading volume of the CMD Shares in January 2017 was approximately 337.1 million, representing an average daily trading volume of approximately 17.7 million. From 1 February 2017 to the Latest Practicable Date, trading volume of the CMD Shares was approximately 108.2 million, representing an average daily trading volume of approximately 13.5 million. In our opinion, the higher trading volume in January 2017 and February 2017 is likely to be due to the market reaction after the publication of the Joint Announcement.

Given the above, the CMD Shareholders should note that if they wish to sell a significant number of their CMD Shares within a short period in the market, it is possible that a downward pressure would be exerted on the market price of the CMD Shares. The higher level of trading volume subsequent to the Joint Announcement may not be sustainable if the Offers lapse. Therefore, the Offers provides an opportunity for the CMD Shareholders to dispose of their entire holdings at a fixed consideration for cash if they so wish. The CMD Shareholders, who intend to dispose of their CMD Shares, should accept the Share Offer if they are not able to sell the CMD Shares in the market at a price higher than the Offer Price.

(d) Peer comparison

As mentioned in the paragraph headed "Background and information of the CMD Group" in the sub-section headed "Information and prospects of the CMD Group" above of this letter, the CMD Group is a dairy farming company and raw milk producer, and principally engaged in dairy farming (which involves breeding dairy cows to produce and sell raw milk) and liquid milk products production (which involves producing and selling processed liquid milk). As set out in the 2015 annual report of CMD, revenue from sales of raw milk contributed to approximately 69% of the CMD Group's revenue for the year ended 31 December 2015. Accordingly, we have conducted a search on Bloomberg for companies (the "Comparable Companies") primarily listed on the Main Board of the Stock Exchange where, based on their latest published annual reports available as at the date immediately before the Latest Practicable Date, revenue from dairy farming and sales of raw milk accounted for approximately 50% or more of their total revenue. The Comparable Companies set out in the table below represent all the companies comparable to the Company based on the above criteria.

As mentioned in the paragraph headed "Financial information of the CMD Group" in the sub-section headed "Information and prospects of the CMD Group" above of this letter, the CMD Group recorded a consolidated loss attributable to owners of CMD of approximately RMB565.7 million for the



six months ended 30 June 2016, compared to a consolidated profit attributable to owners of CMD of approximately RMB477.0 million in 2015. CMD announced the Profit Warning on 6 February 2017 and it was expected that the CMD Group will record a consolidated net loss attributable to the equity holders of CMD of not less than RMB600 million for the year ended 31 December 2016. The 2016 annual results announcement of CMD has not yet been published as at the Latest Practicable Date. We consider that analysis of the Offer Price based on the 2015 annual results of CMD is not meaningful. Alternatively, we have performed an analysis of the Offer Price based on the historical price to book (P/Bs) of the Company and the Comparable Companies. The results are as follows:

Comparable Companies	Closing share price as at the Latest Practicable Date (HK\$) (Note 1)	Net assets value attributable to shareholders per share (HK\$) (Note 2)	Historical P/B (Approximate times) (Note 3)
China Shengmu Organic Milk Limited (stock code: 1432)	2.08	0.883	2.36
China ZhongDi Dairy Holdings Company Limited (stock code: 1492)	0.90	1.013	0.89
YuanShengTai Dairy Farm Limited (stock code: 1431)	0.54	1.224	0.44
Mean			1.23
The Share Offer (Note 4)			1.28

Notes:

1. Closing share price of the Comparable Companies is sourced from Bloomberg.
2. Figures are calculated based on (i) the net assets attributable to shareholders of the Comparable Companies as set out in their respective latest interim report available as at the date immediately before the Latest Practicable Date; and (ii) the number of issued shares as at the respective period end, where figures in Renminbi were translated at an exchange rate of 1 Renminbi = HK\$1.1142.
3. The historical P/Bs of the Comparable Companies are calculated based on their respective net assets value attributable to shareholders per share as set out in note 2 above and their respective closing share price as at the Latest Practicable Date.
4. The implied P/B of the Share Offer is calculated based on the Offer Price of HK\$1.94 per Offer Share and the net assets per CMD Share of approximately HK\$1.52 (translated at an exchange rate of RMB1 = HK\$1.1142) as at 30 June 2016.



As set out in the table above, the historical P/B of the Comparable Companies range from approximately 0.44 time to approximately 2.36 times, with an average of approximately 1.23 times. The implied P/B of the Share Offer as discussed above of approximately 1.28 times is within the range and slightly above the mean of the historical P/Bs of the Comparable Companies.

Based on our analysis on the Offer Price as set out in this sub-section, we consider the Offer Price to be fair and reasonable to the CMD Shareholders.

5. Mandatory general offers precedents

We have compared the Offer Price to the offer prices of the Comparable Offers (as defined below) of all eleven companies which are listed on the Main Board of the Stock Exchange with their respective market capitalisations over HK\$3 billion as at the date immediately prior to the Latest Practicable Date, and announced a mandatory cash offer (the "Comparable Offers") during the period from 1 January 2016 and up to the date immediately prior to the Latest Practicable Date.

It should be noted that all the subject companies involved in the Comparable Offers may have different principal activities, market capitalisations and financial positions as compared with those of CMD. Circumstances leading to the offeror to the subject companies to determine the offer prices may also be different from that of CMD. Accordingly, the Comparable Offers are set out for general reference only and do not form a basis for us to assess the fairness of the Offer Price. The table below illustrates the details of the Comparable Offers:

Date of announcement	Company (Stock code)	Market capitalisation as at the date immediately prior to the Latest Practicable Date HK\$ million	Offer price HK\$	Premium/(discount) of offer price over/to closing price or average closing share price prior to the announcement of the offer			
				Last trading day (the "LTD Price") %	5 days average (the "5 Days Average Price") %	10 days average (the "10 Days Average Price") %	30 days average (the "30 Days Average Price") %
12 December 2016	Yat Sing Holdings Limited ("Yat Sing") (3708) (Note)	6,120	0.94	(77.18)	(74.83)	(71.88)	(51.42)
17 November 2016	Yida China Holdings Limited (3639)	5,116	2.2	(33.53)	(31.46)	(31.25)	(28.57)
2 November 2016	China Shengmu Organic Milk Limited (1432)	13,281	2.25	(7.41)	(5.46)	0.90	11.39
22 September 2016	Dan Form Holdings Company Limited (271)	3,094	2.75	15.06	27.55	32.08	43.83



Date of announcement	Company (Stock code)	Market capitalisation as at the date immediately prior to the Latest Practicable Date HK\$ million	Offer price HK\$	Premium/(discount) of offer price over/ to closing price or average closing share price prior to the announcement of the offer			
				Last trading day (the "LTD Price") %	5 days average (the "5 Days Average Price") %	10 days average (the "10 Days Average Price") %	30 days average (the "30 Days Average Price") %
19 August 2016	China Smarter Energy Group Holdings Limited (1004)	6,937	0.33	(35.29)	(36.29)	(38.20)	(42.00)
12 August 2016	Armada Holdings Limited (583)	3,261	1.3459	(30.98)	(29.75)	(27.52)	(21.69)
3 July 2016	China Greenland Rundong Auto Group Limited (1365)	3,332	3.5273	7.9	8.9	12.3	12.7
19 April 2016	Tysan Holdings Limited (687)	5,421	4.53	2.49	2.35	3.05	8.90
15 February 2016	Bestway International Holdings Limited (718)	7,493	0.66	(1.49)	(3.23)	(7.95)	(20.42)
11 January 2016	Mastercraft International Holdings Limited (3966)	3,066	1.5	(20.63)	(10.18)	(4.46)	1.35
4 January 2016	Chiho-Tiande Group Limited (976)	8,471	3.5	(32.3)	(31.7)	(32.1)	(32.2)
			Average	(19.40)	(16.74)	(15.00)	(10.74)
			Maximum	15.06	27.55	32.08	43.83
			Minimum	(77.18)	(74.83)	(71.88)	(51.42)
	CMD		1.94	3.2	3.4	5.6	(0.1)

Source: Bloomberg and relevant published announcements of the companies for the Comparable Offers

Note: As stated in Yat Sing's announcement dated 12 December 2016, as Mr. Bao Xibin, a party acting in concert with the offeror, has dealt in the Yat Sing's shares within the six-month prior to the commencement of the offer period, the offer price of HK\$0.563 per offer share announced on 27 October 2016 was required to be increased to HK\$0.94 per offer share under Rule 26.3 of the Takeovers Code.



As shown in the table above, the premia and discounts of offer price over/to the LTD Price, the 5 Days Average Price, the 10 Days Average Price and the 30 Days Average Price of the Comparable Offers show a wide range from the maximum premium of approximately 43.83% to the deepest discount of approximately 77.18%, with the average at a discount ranging from approximately 10.7% to 19.4%. The Offer Price represents a premium ranging from approximately 3.2% to 5.6% over the LTD Price, the 5 Days Average Price and the 10 Days Average Price of the CMD Shares, and a discount of approximately 0.1% to the 30 Days Average Price of the CMD Shares. Such premium and discount are within the range of the Comparable Offers.

THE OPTION OFFER

A cash offer is being made to the Optionholders under the Option Offer to cancel the outstanding CMD Options, conditional upon the Share Offer becoming or being declared unconditional. As at the Latest Practicable Date, there were 315,401,705 outstanding CMD Options conferring rights on the Optionholders to subscribe for CMD Shares. Details of the offer price per CMD Option under the Option Offer as extracted from the Composite Document are set out below:

CMD Option	Vested	Exercise price per CMD Share	Offer price per CMD Option (HK\$/US\$) ^{Note}
CMD Options granted under the Management Option Scheme	Yes	HK\$0.86	HK\$1.08/ US\$0.14
CMD Options granted under the Share Option Scheme I	Yes	HK\$2.89	HK\$0.0001/ US\$0.000013
CMD Options granted under the Share Option Scheme II	No	HK\$3.38	HK\$0.0001/ US\$0.000013
		HK\$2.83	HK\$0.0001/ US\$0.000013
		HK\$1.52	HK\$0.42/ US\$0.05
CMD Options granted under the Share Option Scheme III	No	HK\$1.71	HK\$0.23/ US\$0.03

Note: The US\$ is converted using the Exchange Rate



Under the Option Offer, for in-the-money CMD Options (i.e. exercise prices of these CMD Options are lower than the Offer Price), the Option Offer price is calculated on a “see-through” basis, being the amount of the Offer Price of HK\$1.94 or US\$0.25, less the exercise prices of such in-the-money CMD Options. For out-of-the-money CMD Options (i.e. exercise prices of these CMD Options are higher than the Offer Price), the “see-through” price of such CMD Options is zero while the offer price for such out-of-the-money CMD Options are at a nominal price of HK\$0.0001/US\$0.000013. The “see-through” principle is normally adopted in Hong Kong for general offers of a similar nature.

Valid acceptance of the Option Offer by the Optionholders will result in the cancellation of those outstanding CMD Options, together with all rights attaching thereto with effect from the date of despatch of the Composite Document. Optionholders should note that under the respective rules of the Share Option Scheme I, Share Option Scheme II and Share Option Scheme III, all CMD Options that remain unexercised (to the extent vested) prior to the earlier of (i) the date of expiry of the option period, or (ii) the last day of the period of 10 Business Days after the date on which the Share Offer becomes or is declared unconditional, shall lapse. Under the rules of the Management Option Scheme, the relevant CMD Options that remain exercisable but are unexercised may continue to be exercised.

DISCUSSION

The obligation of Mengniu to make the Offers arises from the increase in Mengniu’s stake in CMD from approximately 22.0% to 37.7%, crossing the 30% ‘trigger point’ requiring an offer under the Takeovers Code, to be made at the same price of HK\$1.94 per Share. Mengniu was already the largest shareholder of CMD prior to the transactions, with an over 25% interest, and had influence on CMD’s management through Board representatives.

The CMD Group is the largest dairy farming company and the largest producer of raw milk in China in terms of herd size. However, competition in the dairy industry has increased and growth in revenue has stalled. Profits declined sharply for the year ended 31 December 2015 compared to 2014. For the six months ended 30 June 2016, the CMD Group suffered losses mainly due to declines in the selling price of raw milk and fair value adjustments. On 6 February 2017, CMD issued the Profit Warning as regards its results for the full year 2016. The net assets of the CMD Group as at 30 June 2016 were approximately RMB7.3 billion, and borrowings, debenture and notes (net of cash) were approximately RMB5.5 billion. On this basis, the gearing ratio was approximately 75%, which in our view is relatively high.

The intentions of Mengniu for the CMD Group are summarised in the letter from UBS and DBS. No major changes are expected to the principal activities of the CMD Group but a review of its business operations and financial position will be conducted. Mengniu will maintain the listed status of CMD after the close of the Offers and shareholders holding approximately 9.21% of the share capital have undertaken that they will not accept the Share Offer.



Offer Price of HK\$1.94 per Offer Share generally represents premia of between approximately 3% to 5% over market prices prevailing before the Last Trading Day (3 January 2017). These premia are relatively low and there was a recent period, in November to December 2016, when the closing prices of the CMD Shares were above HK\$1.94 (see chart in sub-section headed "Analysis of the Offer Price" under the section headed "Principal factors and reasons considered" of this letter). As a general reference, we note from the precedents set out in sub-section headed "Mandatory general offers precedents" of this letter that recent mandatory cash offers precedents showed a wide range of premia and discounts to the relative offer prices. The closing market price of the CMD Shares after the Joint Announcement were in general slightly below the Offer Price and were slightly above the Offer Price starting from 6 February 2017. The closing market price of the CMD Shares on the Latest Practicable Date was HK\$1.95 per CMD Share, slightly above the Offer Price. This is to be expected during the currency of a mandatory cash offer and may not remain the case after the close of the Share Offer. The volume of trading in the CMD Shares in 2016 has not been consistent with a minimum of approximately 3.9% to the public float of CMD before issue of the Joint Announcement during the Review Period so the fixed price cash exit (subject to the 50% acceptance condition) under the Share Offer is of value to CMD Shareholders.

As CMD has issued a warning of loss for the year ended 31 December 2016 and its 2016 annual results have not yet been published, it is not possible to calculate a price earnings ratio for CMD at the Offer Price. The price to book (P/B) ratio for CMD at the Offer Price is approximately 1.28 times, slightly above the average for the three Comparable Companies we have identified. The Offer Price represents a premium over the net assets value attributable to owners of CMD per CMD Share as at 30 June 2016 of approximately 27.6%.

CMD Shareholders should bear in mind that the Offer Price is based on negotiations which took place between Mengniu and shareholders independent of Mengniu and is therefore at arm's length. Mengniu is obliged to extend the Share Offer at the same price, so there is no necessary implication that Mengniu does, or does not, wish to acquire further CMD Shares. The premia of the Offer Price to recent market prices is low. However, the Offers come at a time where CMD has just issued a warning that 2016 will see losses and when competition in the dairy market is fierce. Consequently, CMD Shareholders, particularly those who are risk averse, should consider the opportunity to realise their investment at a fixed cash price. CMD Shareholders who are attracted by the long term prospects of the dairy industry in the PRC despite present difficulties may consider keeping some or all of their CMD Shares.

OPINION AND RECOMMENDATIONS

(i) The Share Offer

Based on the above overall principal factors and reasons and as summarised in the section headed "Discussion" above, we consider the terms of the Share Offer, which include a price agreed upon arm's length negotiations with fund investors, are fair and reasonable so far as the CMD Shareholders are concerned. Accordingly, we advise the Independent Board Committee to recommend the CMD Shareholders to accept the Share Offer.



CMD Shareholders should note that the Offer Price of HK\$1.94 per Offer Share represents a slight discount of approximately 0.5% compared to the closing price of the CMD Shares of HK\$1.95 per CMD Share as at the Latest Practicable Date. Starting from 6 February 2017, the closing prices of the CMD Shares have been above the Offer Price. This in our opinion may be influenced by the approval of the Transaction by Mengniu Shareholders at the EGM and by the Offer Price. If the market price of the CMD Shares continues to exceed HK\$1.94 per CMD Share, CMD Shareholders who are inclined to accept the Share Offer should instead sell their CMD Shares in the market if the sales proceeds, net of transaction costs, exceed HK\$1.94 per CMD Share. Those CMD Shareholders who are attracted to the prospects of CMD may consider retaining some or all of their CMD Shares. Such CMD Shareholders may note that the Non-Accepting Shareholders have undertaken that they will not accept the Share Offer. Although Mengniu intends to maintain the listing of CMD, such CMD Shareholders should bear in mind possibility of a temporary suspension in trading of CMD Shares following the close of the Offers if the public float requirement of 25% is not met. As set out in the section headed "Mengniu's intention on the CMD Group" in the "Letter from UBS and DBS" of the Composite Document, Mengniu Directors have jointly and severally undertaken to the Stock Exchange to take appropriate steps to ensure that sufficient public float exists in the CMD Shares, and the new directors to be appointed to the CMD Board will jointly and severally undertake to the Stock Exchange to take appropriate steps to ensure that sufficient public float exists in the CMD Shares.

CMD Shareholders are reminded to monitor carefully and closely the market price and the liquidity of the CMD Shares during and before the end of the Offer Period.

CMD Shareholders are reminded that the Share Offer is conditional on the 50% control condition and should be alert for an announcement as to whether this condition has been fulfilled.

(ii) The Option Offer

We consider the terms of the Option Offer, which are based on the "see through" principle, to be fair and reasonable so far as the Optionholders are concerned.

For in-the-money CMD Options (i.e. where exercise prices are lower than the Offer Price), Optionholders are recommended to accept the Option Offer. However, as the CMD Share price as at the Latest Practicable Date is slightly above the Offer Price, such Optionholders should monitor closely the CMD Share prices and consider exercising their CMD Options and disposing of the resulting CMD Shares in the open market during the Offer Period, rather than accepting the Option Offer, if the sales proceeds, net of transaction costs, exceed the net amount receivable under the Option Offer.

For out-of-the-money CMD Options (i.e. where exercise prices of these CMD Options are higher than the Offer Price), as the CMD Share price as at the Latest Practicable Date is lower than the exercise prices so that their "see-through" value is zero, we recommend such Optionholders to accept the Option Offer.



Optionholders should consider and are reminded that under the terms and conditions of the Option Schemes (save for the Management Option Scheme), all CMD Options that remain unexercised (to the extent vested) prior to the earlier of (i) the date of expiry of the option period, or (ii) the last day of the period of 10 Business Days after the date on which the Share Offer becomes or is declared unconditional, shall lapse.

(iii) General

The procedures for acceptance of the Offers are set out in Appendix I to the Composite Document. The latest time and date for acceptance of the Offers on the First Closing Date is 4:00 p.m. on Tuesday, 7 March 2017. CMD Shareholders and Optionholders are urged to read carefully the Composite Document and appendices and act according to the timetable if they wish to accept the Offers. As stated above, they should also monitor the market prices and the liquidity of the CMD Shares and watch for an announcement as to whether the Offers have become unconditional.

Yours faithfully,
for and on behalf of
SOMERLEY CAPITAL LIMITED

M. N. Sabine
Chairman

Mr. M. N. Sabine is a licensed person registered with the SFC and a responsible officer of Somerley Capital Limited, which is licensed under the SFO to carry out Type 1 (dealing in securities) and Type 6 (advising on corporate finance) regulated activities. He has over thirty years' experience in the corporate finance industry.