



金融有限公司
OCTAL Capital Limited

31 May 2021

Dear Sirs,

**(1) PROPOSED NON-PUBLIC ISSUANCE OF NEW A SHARES;
(2) CONNECTED TRANSACTION IN RELATION TO THE PROPOSED
SUBSCRIPTION OF A SHARES BY HUALU INVESTMENT; AND
(3) APPLICATION FOR WHITEWASH WAIVER**

INTRODUCTION

We refer to our appointment as the Independent Financial Adviser to advise the Code Independent Board Committee, the Listing Rule Independent Board Committee and the Independent Shareholders in relation to the Proposed A Shares Issue, the Specific Mandate and the Whitewash Waiver, details of which are contained in the letter from the Board (the “Letter from the Board”) contained in the circular of the Company dated 31 May 2021 (the “Circular”). Unless the context otherwise requires, terms used in this letter shall have the same meanings as those defined in the Circular.

As set out in the Letter from the Board, on 14 April 2021, the Board approved the Proposed A Shares Issue, and the Company entered into the A Shares Subscription Agreement with Hualu Investment, pursuant to which the Company will, subject to satisfaction of the conditions precedent set out therein, issue 36,284,470 A Shares (representing approximately 5.78% of the total existing number of Shares in issue) to Hualu Investment for a cash issue price of RMB6.89 per A Share (the “Issue Price”). The proceeds expected to be raised from the Proposed A Shares Issue (before deducting relevant expenses related to the issuance) will amount to RMB250,000,000.

As at the Latest Practicable Date, Hualu Investment is a wholly owned subsidiary of HHC, the controlling shareholder holding approximately 36.63% of the total number of Shares in issue of the Company, and is therefore a connected person of the Company under the Listing Rules. As such, the subscription by Hualu Investment of A Shares pursuant to the A Shares Subscription Agreement in respect of the Proposed A Shares Issue constitutes a connected transaction of the Company and is subject to the reporting, announcement and Independent Shareholders' approval requirements under Chapter 14A of the Listing Rules.

The Specific Mandate is sought from the Shareholders as required under Rule 13.36 of the Listing Rules, as modified by Chapter 19A of the Listing Rules.

HHC's aggregate shareholding in the Company is expected to increase from approximately 36.63% to (i) approximately 40.10% immediately after the completion of the Proposed A Shares Issue ("Completion"); and (ii) approximately 39.46% immediately after the Completion and exercise of all outstanding Share Options. In the absence of an applicable waiver, the Proposed A Shares Issue will give rise to an obligation on the part of HHC (and persons acting in concert with it) to make a mandatory offer for all the Shares (other than those already owned or agreed to be acquired by it) under Rule 26.1 of the Takeovers Code.

HHC has applied for the Whitewash Waiver from compliance with Rule 26.1 of the Takeovers Code. The Whitewash Waiver, if granted by the Executive, is expected to be subject to, among other things, the Whitewash Waiver being approved by at least 75% of the independent votes that are cast either in person or by proxy by the Independent Shareholders at the AGM and the Proposed A Shares Issue and the A Shares Subscription Agreement being approved by more than 50% of the independent votes that are cast either in person or by proxy by the Independent Shareholders at the AGM, as required under the Takeovers Code. Further, under the Articles of Association, the Proposed A Shares Issue and the A Shares Subscription Agreement will have to be approved by at least two-thirds of the votes cast on a poll by the Independent Shareholders at each of the AGM, the A Shares Class Meeting and the H Shares Class Meeting.

The Proposed A Shares Issue will not proceed if the Whitewash Waiver is not granted by the Executive or the Proposed A Shares Issue is not approved by the Independent Shareholders at the AGM and the Class Meetings, or if the Whitewash Waiver is not approved by at least 75% of the independent votes that are cast either in person or by proxy by the Independent Shareholders at the AGM.

The Listing Rules Independent Board Committee (comprising Mr. Pan Guangcheng, Mr. Zhu Jianwei and Mr. Lo Wah Wai, being all the independent non-executive Directors) has been formed in accordance with Chapter 14A of the Listing Rules to advise the Independent Shareholders on the Proposed A Shares Issue and the Specific Mandate. The Code Independent Board Committee (comprising all non-executive Directors and independent non-executive Directors (excluding Mr. Cong Kechun due to his directorships or capacities as a member of the management of HHC) has been formed in accordance with Takeovers Code to advise the Independent Shareholders on the Proposed A Shares Issue, the Specific Mandate and the Whitewash Waiver. Our appointment as the Independent Financial Adviser has been approved by the Code Independent Board Committee to advise the Code Independent Board Committee, the Listing Rule Independent Board Committee and the Independent Shareholders in relation to the Proposed A Shares Issue and Whitewash Waiver.

As at the Latest Practicable Date, we, Octal Capital Limited, (i) are not connected with the directors, chief executives and substantial shareholders of the Company, HHC or Hualu Investment or any of their respective subsidiaries or associates or parties acting in concert with any of them; and (ii) do not have any shareholding, directly or indirectly, in any members of the Group or any right (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for securities in any member of the Group. We are therefore considered suitable to give independent advice to the Code Independent Board Committee, the Listing Rule Independent Board Committee and the Independent Shareholders.

During the last two years, other than this appointment concerning the Proposed A Shares Issue, we have not entered into any engagement with the Company, HHC, Hualu Investment or any of their respective subsidiaries or associates. Apart from normal professional fees payable to us in connection with this appointment, no arrangement exists whereby we have or will receive any fees or benefits from the Group or any director, chief executive or substantial shareholders of the Company, HHC, Hualu Investment or any of its subsidiaries, or their respective associates.

In formulating our opinion set out herein, we have relied on the accuracy of the information and representations contained in the Circular (other than in this letter) and have assumed that all information and representations made or referred to in the Circular (other than in this letter) were true at the time they were made and continue to be true as at the date of the Circular. We have also relied on our discussion with the Directors and management of the Company in relation to the terms of the Proposed A Shares Issue, the Specific Mandate and Whitewash Waiver, including the information and representations contained in the Circular. We consider that we have reviewed sufficient information to reach an informed view to justify our reliance on the accuracy of the information contained in the Circular and to provide a reasonable basis for our advice. We have no reason to suspect that any material facts have been omitted or withheld from the information contained or opinions expressed in the Circular nor to doubt the truth, accuracy and completeness of the information and representations provided to us by the Directors and management of the Company. We have not, however, conducted an independent in-depth investigation into the business and affairs of the Company, HHC, Hualu Investment or their respective associates nor

have we carried our any independent verification of the information supplied to us. Should there be any subsequent material changes which occurred during the period from the date of the Circular up to the date of the AGM and H Share Class Meeting that would affect or alter our opinion on the Proposed A Shares Issue, we will notify the Code Independent Board Committee, the Listing Rule Independent Board Committee and the Independent Shareholders as soon as possible.

PRINCIPAL FACTORS AND REASONS CONSIDERED

In arriving at our opinion set out herein, we have taken into account the following principal factors and reasons.

1. Background of the Group, Hualu Investment and HHC

The Company is a joint stock limited company incorporated in the PRC with its H shares and A shares listed on the Hong Kong Stock Exchange and SZSE respectively. The Company principally engages in the development, manufacture and sale of bulk pharmaceuticals, preparations and chemical products.

Hualu Investment is a company incorporated in the PRC with limited liability and is a wholly-owned subsidiary of HHC. It is principally engaged in making foreign investments through the use of its own funds as well as investment management and consulting.

HHC is a state-owned enterprise principally engaged in investment holding of various private companies and companies listed on the stock exchanges of the Mainland China and Hong Kong.

As at the Latest Practicable Date, the shares in HHC is owned:

- (i) as to 59.16% owned by Shandong State-owned Assets Supervision and Administration Commission (山東省國有資產監督管理委員會);
- (ii) as to 8.45% owned by Shandong Social Security Fund Council (山東省社會保障基金理事會);
- (iii) as to 12.17% owned by Shandong Finance & Finance Investment Group Co., Ltd. (山東省財金投資集團有限公司);
- (iv) as to 3.32% owned by Shandong Development Investment Holding Group Co., Ltd. (山東發展投資控股集團有限公司); and
- (v) as to 16.90% owned by Shandong Guohui Investment Co., Ltd. (山東國惠投資有限公司).

2. Historical financial performance and prospects of the Group

The summary of the consolidated financial information of the Group for the years ended 31 December 2018 (“FY2018”), 2019 (“FY2019”) and 2020 (“FY2020”) and the three months ended 31 March 2020 (“1Q2020”) and 2021 (“1Q2021”) as extracted from the annual reports of the Company for FY2019 and FY2020 and the Company’s first quarterly report for 1Q2021 published on the SZSE (the “1Q2021 Quarterly Report”) respectively are set out as follows:

| | FY2018 <i>(restated)</i> <i>(audited)</i> RMB'million | FY2019 <i>(audited)</i> RMB'million | FY2020 <i>(audited)</i> RMB'million | 1Q2020 <i>(unaudited)</i> RMB'million | 1Q 2021 <i>(unaudited)</i> RMB'million |
|---|--|---|---|---|--|
| Total revenue | 5,244 | 5,606 | 6,006 | 1,706 | 1,768 |
| – Chemical bulk drugs | 2,319 | 2,388 | 2,566 | 824 | 805 |
| – Preparations | 2,213 | 2,593 | 2,606 | 740 | 746 |
| – Pharmaceutical intermediates and other products | 712 | 625 | 834 | 142 | 217 |
| Operating profit | 345 | 387 | 422 | 116 | 130 |
| Net profit after tax | 280 | 323 | 347 | 93 | 106 |
| Net profit attributable to owners of the Company | 255 | 300 | 325 | 86 | 100 |
| Net profit margin <i>(Note 1)</i> | 5.3% | 5.8% | 5.8% | 5.5% | 6.0% |

| | As at 31 December | | As at 31 March | |
|-----------------------|--|---|---|---|
| | 2018 <i>(restated)</i> <i>(audited)</i> RMB'million | 2019 <i>(audited)</i> RMB'million | 2020 <i>(unaudited)</i> RMB'million | 2021 <i>(audited)</i> RMB'million |
| Current Assets | 2,381 | 2,428 | 2,687 | 2,851 |
| – Monetary funds | 786 | 690 | 856 | 914 |
| – Inventories | 968 | 1,130 | 1,124 | 915 |
| – Accounts receivable | 343 | 309 | 380 | 708 |
| Non-current Assets | 3,572 | 4,008 | 4,406 | 4,428 |
| – Fixed assets | 2,649 | 2,807 | 3,117 | 3,036 |
| Total Assets | 5,953 | 6,436 | 7,093 | 7,279 |



| | As at 31 December | | As at 31 March | |
|--|--|---|---|---|
| | 2018 <i>(restated)</i> <i>(audited)</i> RMB'million | 2019 <i>(audited)</i> RMB'million | 2020 <i>(unaudited)</i> RMB'million | 2021 <i>(audited)</i> RMB'million |
| Current Liabilities | 2,361 | 2,485 | 2,381 | 2,150 |
| – Short-term borrowings | 240 | 540 | 200 | 309 |
| – Accounts payable | 465 | 434 | 453 | 515 |
| – Other payables | 289 | 334 | 495 | 477 |
| – Notes payable | 427 | 364 | 290 | 360 |
| Non-current Liabilities | 777 | 840 | 1,321 | 1,594 |
| – Long-term loans | 523 | 590 | 463 | 721 |
| – Long-term payables | – | – | 639 | 642 |
| Total Liabilities | 3,138 | 3,325 | 3,702 | 3,744 |
| Net Current (Liabilities)/Assets | 20 | (57) | 306 | 701 |
| Total Equity | 2,815 | 3,111 | 3,391 | 3,535 |
| Equity attributable to the equity holders of the Company | 2,695 | 2,969 | 3,224 | 3,359 |
| Gearing Ratio (Note 2) | 27.1% | 36.3% | 37.3% | 46.1% |

Notes:

1. Net profit margin was calculated by dividing net profit after tax by revenue.
2. Gearing ratio of the Group was calculated by dividing total borrowings by total equity. Total borrowings comprise of short-term borrowings, long-term loans and borrowing from controlling shareholders recorded under the long-term payables.

Financial performance of the Group

The revenue of the Group in the reported periods was generated from (i) the development, production and sales of chemical bulk drugs (the “**Chemical Bulk Drugs**”); (ii) the development, production and sales of preparations (e.g. tablets and injections) (the “**Preparations**”); and (iii) the production and sales of medical intermediate and other products (the “**Medical Intermediates & Other Products**”).

For FY2019, the total revenue of the Group was approximately RMB5,606 million, representing an increase of approximately 6.9% compared to that for FY2018. The increase was mainly due to the increase in revenue generated from the sales of Preparations. The operating profit of the Group increased from approximately RMB345 million for FY2018 to RMB387 million for FY2019 and the net profit attributable to owners of the Company increased from approximately RMB255 million for FY2018 to RMB300 million for FY2019, mainly due to the strategy of the Group to focus on expanding sales of Preparations into the international market and the overall enhancement of production efficiency of the Group after upgrading its production chain.

For FY2020, the total revenue of the Group was approximately RMB6,006 million, representing an increase of approximately 7.1% compared to that for FY2019. The increase was mainly due to the increase in revenue generated from the Chemical Bulk Drugs. The operating profit of the Group increased from approximately RMB387 million for FY2019 to RMB422 million for FY2020 and the net profit attributable to owners of the Company increased from approximately RMB300 million for FY2019 to RMB325 million for FY2020, mainly due to the Group's continuous effort in market development and effective cost control on selling expenses.

For 1Q2021, the total revenue of the Group was approximately RMB1,768 million, representing an increase of approximately 3.6% compared to that for 1Q2020. The increase was mainly due to increase in revenue generated from the sales of Medical Intermediates & Other Products. The operating profit increased from approximately RMB116 million for 1Q2020 to RMB130 million for 1Q2021 and the net profit attributable to owners of the Company increased from approximately RMB86 million for 1Q2020 to RMB100 million for 1Q2021, mainly due to the strategy of the Group to focus on expanding the market coverage concerning sales of Medical Intermediates & Other Products and Preparations.

Financial position of the Group

As at 31 March 2021, the major assets of the Group included (i) fixed assets primarily consisting of premises and building, machinery and equipment, transportation equipment and electronic equipment and others which amounted to approximately RMB3,036 million; (ii) inventories mainly consisting of the products in process and goods in stock which amounted to approximately RMB915 million; (iii) monetary funds mainly consisting of bank deposit which amounted to approximately RMB914 million; and (iv) accounts receivable which amounted to approximately RMB708 million, which together these assets accounted for approximately 76.6% of the total assets of the Group.

As at 31 March 2021, the major liabilities of the Group included (i) credit loan in the amount of approximately RMB1,030 million, of which approximately RMB309 million was regarded as current portion and are required to be repaid or settled within one year; (ii) long-term payables in the amount of approximately RMB642 million, of which approximately RMB600 million were borrowings from the controlling Shareholder; (iii) account payable in the amount of approximately RMB515 million; (iv) other payables, which mainly consisted of payment payable for engineering equipment which amounted to approximately RMB477 million; and (v) notes payable which amounted to approximately RMB360 million, and together these liabilities accounted for approximately 80.8% of the total liabilities of the Group.

The Group recorded unaudited net asset value attributable to Shareholders (“NAV”) of approximately RMB3,359 million as at 31 March 2021. The unaudited NAV per Share of the Company (including the A Shares and the H Shares) was approximately RMB5.35 as at 31 March 2021, calculated by dividing the unaudited NAV of approximately RMB3,359 million by the total number of Shares in issue of 627,367,447 Shares as at 31 March 2021.

The gearing ratio of the Group, calculated by dividing total borrowings which included short-term borrowing, long-term loans and borrowing from the controlling Shareholder by total equity, was approximately 46.1% as at 31 March 2021 as compared to approximately 37.3% as at 31 December 2020. Such increase arose mainly from an increase in amount of outstanding long term loans.

3. Background of and reasons for the Proposed A Shares Issue

As disclosed in the Letter from the Board, the background of and reasons for the Proposed A Shares Issue are as follows:

Enhancing capital strength to ensure capital needs for the Group’s development

In FY2018, FY2019 and FY2020, the operating revenue of the Group was approximately RMB5.245 billion, RMB5.606 billion and RMB6.006 billion respectively, representing a compound annual growth rate of 9.76%. With the continuous expansion of the Company’s business size, its demand for working capital will continue to grow.

The Company is involved in the pharmaceutical manufacturing industry, and its business involves the development, production and sale of pharmaceutical raw materials, preparations, medical intermediate and other products. Due to demands in terms of production, circulation and management to operate in this industry, the Company is required to incur material annual expenditures for the purchase, maintenance and repair of fixed assets as well as in projects under construction. Further, the industry in which the Company operates in is technology-intensive. As such, in order to maintain its competitive edge and ensure its sustainable development, the Company needs to continue its investing in research and development and technological

improvements. In addition, in order to further expand and optimise the Company's position as a contract manufacturing and contract research organization as well as in other business areas, the Company will also increase its research and development expenditure in the future. With the steady development of the Company's business, there will be increasing working capital requirements.

It is expected that the raising of funds to supplement the Company's working capital through the Proposed A Shares Issue will be conducive to facilitating the Company's resources integration, accelerating the Company's development strategy and strengthening the foundation of sustainable development for the purpose of laying a solid foundation for the healthy, stable and sustainable development of the Company in order to maximise Shareholders' interests.

Optimising the asset structure and improving the ability to resist risks

As of 31 March 2021, the Company's combined asset-liability ratio was 51.43%, considerably higher than the average of listed companies in the same industry. The capacity to expand the size of the Company's business is limited to a certain extent by the Company's overall capital and debt position. In addition, changes in the external environment such as the COVID-19 pandemic and international trade friction have had a great impact on businesses in various industries. Specifically, in the pharmaceutical industry, higher requirements have become applicable requiring companies in the industry to have a healthy capital structure, be more robust against business risks and to have more operational flexibility.

It is expected that the Proposed A Shares Issue will increase the amount of working capital of the Company, reduce its asset-liability ratio and optimise its capital structure. As a result, the Company's financial position will be further enhanced and in particular, its financial risks will be reduced and capacity to tolerate risks will be enhanced.

Against the background of the impact of the COVID-19 pandemic on the global macro-economy and on the economy of the PRC, the Proposed A Shares Issue will strengthen the Company's capital base to support the growth and development of the Group's business in the future.

The subscriber of the new A Shares to be issued under the Proposed A Shares Issue is Hualu Investment, which is a wholly-owned subsidiary of HHC, the controlling Shareholder of the Company and such subscription reflects the support and confidence the controlling Shareholder has in the Company, which is crucial for the long-term development of the Group. As compared to placing new Shares to independent third parties, the non-public issuance of A Shares under the Proposed A Shares Issue provides an efficient means of raising capital for the Company's present and future needs, as well as reinforces the Group's ties with its controlling Shareholder. Further, the issue price for the new A Shares to be issued was set in compliance with the "Measures for Administration of the Issuance of Securities by Listed Companies" (《上市公司證券發行管理辦

法》) and the “Implementation Rules for Non-public Issuance of Shares by Listed Companies” (《上市公司非公开发售股票实施细则》) promulgated by the CSRC, which require that the minimum issue price of A shares under non-public issuance of A shares must be not less than 80% of the average trading price of the relevant company’s shares during the 20 trading days preceding the relevant pricing benchmark date. The Company has additionally considered the audited net asset value per share attributable to the holders of ordinary shares of the parent company at the end of the Company’s most recent financial year prior to the Pricing Benchmark Date in determining the Issue Price. Therefore, the Directors (excluding members of the Listing Rules Independent Board Committee and Code Independent Board Committee) believe that the terms of the A Shares Subscription Agreement are fair and reasonable and in the interests of the Shareholders as a whole.

Our views on the reasons for the Proposed A Shares Issue

According to the Proposal for Non-public Issuance of A Shares as set out in Appendix I to the Circular, the total raised proceeds for the Non-Public Issuance shall not exceed RMB250 million, and all of the net proceeds after deducting issue expenditure will be used to repay the interest-bearing liability and supplement the working capital of the Company. Hereinto, the amount of the proceeds used to repay the interest-bearing liability shall not exceed RMB140 million, and the rest of the proceeds shall be used for supplementing the working capital of the Company.

As disclosed in the Company’s annual report for FY2020, the Group will fully implement the “Big Research and Development Strategy”, further improve the research and development system and research and development platform establishment, further enrich and improve the new drugs of pain control, cardiovascular and cerebrovascular, and anti-cancer in R&D pipeline, accelerate the application of new preparation technology, further improve the high-end drug delivery system, and achieve breakthroughs in antibody drugs and major innovative drugs. In FY2020, the increase in the Group’s expenditure on its fixed assets by way of purchase, transfer from construction in progress and investment properties was approximately RMB700.4 million, representing an increase of approximately 42.0% when compared with that of FY2019. During the same period, the Group’s research and development expenses was approximately RMB298.3 million, representing an increase of approximately 26.7% when compared with that of FY2019. We are of the view that the continuous expansion of the Group’s asset base and research scale would increase its working capital needs and the Proposed A Shares Issue will supplement such working capital necessary to meet its daily production and operation capital needs, further enhance its financial strength as well as strengthen its foundation for sustainable development.

According to the Drug Administration Law of the PRC (《中華人民共和國藥品管理法》) promulgated and amended by the Standing Committee of the National People's Congress of the PRC in 2019, the PRC government encourages the research and development of new drugs, and protects the legal rights and interests of citizens, legal persons and other organizations in the research and development of new drugs. When a new drug has gone through clinical trials and passed the evaluation related to the drug safety, effectiveness and quality controllability and the applicant is competent in quality management, risk control and liability compensation, a drug registration certificate will be issued upon approval by the National Medical Products Administration (國家藥品監督管理局). In order to enhance its ability to obtain regulatory approval and commercialise new pharmaceutical products, the Group would need to continue investing in research and development and conduct research on significant clinical generic drugs and innovative drugs. We noted that in order for the Group to support its investments in research and development and maintain sufficient liquidity cushion to support its daily operation, the Group has increased its total borrowings (including short-term borrowings, long-term loans and long-term payables) from approximately RMB836.8 million as at 31 December 2018 to RMB1,672.6 million as at 31 March 2021. As at 31 March 2021, the Group had short-term borrowings (repayable within one year) of approximately RMB309 million, representing an increase of approximately 54.5% as compared to that as at 31 December 2020. Such borrowings have led the Group's gearing ratio to increase from approximately 37.3% as at 31 December 2020 to approximately 46.1% as at 31 March 2021. The reliance on debt financing has increased the liquidity risk and financial risk of the Group as well as the amount of interest expenses incurred, which would hinder the profitability of the Group. We are of the view that the Proposed A Shares Issue (the net proceeds of which would be utilised for, without limitation, the repayment of bank loans due in late 2021 and early 2022 respectively) can alleviate the immediate pressure on the liquidity position and gearing level of the Group, which in turn will enhance the financial stability of the Group.

Having considered (i) the Group's on-going financing need to maintain sufficient working capital to facilitate its operations and support its research and development activities; and (ii) the immediate pressure on the liquidity position and gearing level of the Group, we are of the view that the Proposed A Shares Issue will enhance the Group's capital flexibility and relieve the pressure from liquidity risk in the unstable economic environment, and therefore the Proposed A Shares Issue is in the interests of the Company and Shareholders as a whole.

Other fund raising methods available to the Company

As advised by the Board, other than the Proposed A Shares Issue, the Board has considered the feasibility of other fundraising methods (such as debt financing from bank or money lenders and other forms of equity financing) to raise sufficient funding to finance its interest bearing obligations falling due and to supplement its working capital.

The Board considered that fund raising by way of debt financing would lead to incurrance of additional interest expenses and leverage of the Group, which would worsen gearing level and liquidity position of the Group. Furthermore, debt financing may also be subject to lengthy due diligence and internal risk assessment by banks or money lenders. Under such circumstances, the Board considered that debt financing is not a preferable option for fund raising.

Further, the Board has advised us that it has also considered potential fund raising by way of public or non-public issuance of H Shares. However, with reference to Article 23 of Measures for the Supervision and Administration of State-owned Equity of Listed Companies in China (《上市公司國有股權監督管理辦法》) (SASAC, Ministry of Finance, and CSRC Order No. 36), the price of shares of state-owned listed companies through public issuance or transfer shall not be lower than the higher of (i) the arithmetic average of the daily weighted average price of the 30 trading days before the informative announcement; and (ii) the audited net asset value per share of the listed company in the most recent fiscal year. As the Company is a state-controlled listed company, the Board shall refer to the provisions of the abovementioned article and use no less than the net asset value per share as the pricing basis in equity financing. Meanwhile, the arithmetic average trading price of the H Shares during the 30 consecutive trading days immediately preceding the Pricing Benchmark Date was approximately HK\$4.55 per H Share (equivalent to approximately RMB3.86 per H Share), representing a discount of approximately 25.5% to the latest audited NAV as at 31 December 2020 of RMB5.18 per Share. As such, the issuance of H Shares of which the issue price is based on its arithmetic average trading price is not viable under the regulatory requirements of the CSRC.

The Board also considered whether it would be desirable to offer A Shares to the public rather than a private placement as contemplated in the Proposed A Shares Issue. In this regard, the Board considered the regulatory requirements set forth in “Regulatory Requirements for Guiding and Regulating the Financing Behavior of Listed Companies (Revised Edition)” (《關於引導規範上市公司融資行為的監管要求(修訂版)》) (the “**Requirements for Financing**”) published by the CSRC on 14 February 2020, wherein it is stated that the portion of proceeds used for supplementing working capital and debt repayment a listed company which has conducted fundraising through means other than non-public issuance or placement of shares or issuance to designated persons approved by the board of directors shall not exceed 30% of the total amount of funds raised. Given that the net proceeds for the Proposed A Shares Issue are intended to be used entirely for repaying interest-bearing liabilities and supplementing the working capital of the Group, the Board considered that equity financing through public issuance of A Share would not be an appropriate fund raising method for the Group.

Having considered the above, the Company is of the view that the Proposed A Shares Issue is an appropriate fundraising method for the Group. Based on the foregoing, after considering (i) the existing gearing level and liquidity position of the Group; (ii) the Measures for the Supervision and Administration of State-owned Equity of Listed Companies in China; and (iii) restriction on equity financing as stipulated in the Requirements for Financing, we concur with the Company that the Proposed A Shares Issue is a more desirable fundraising approach for the Group to finance its interest bearing obligations, improve its financial position and supplement its working capital.

4. Principal terms of the Proposed A Shares Issue

The major terms and conditions of the Proposed A Shares Issue are set out as follows:

| | |
|--|---|
| Class and par value of Shares to be issued: | Shares to be issued under the Proposed A Shares Issue are new domestically listed ordinary share (A Shares) denominated in RMB, with a par value of RMB1.00 each. |
| Number of A Shares to be issued: | Subject to the satisfaction of the conditions precedent (as disclosed below), 36,284,470 new A Shares will be issued under the Proposed A Shares Issue, which represent: <ul style="list-style-type: none">(i) approximately 8.39% of the existing number of A Shares in issue as at Latest Practicable Date, and approximately 5.78% of the existing total number of Shares in issue as at Latest Practicable Date; and(ii) approximately 7.74% of the number of A Shares in issue and approximately 5.47% of the total number of Shares in issue, in each case as enlarged by the number of A Shares to be issued upon Completion. |

The number of A Shares to be issued under the Proposed A Shares Issue (being 36,284,470 A Shares) is arrived at by dividing the total amount of funds to be raised by the Company thereunder (being RMB250,000,000) by the issue price per A Share to be determined based on the principles as set out in the paragraph headed “Issue price, Pricing Benchmark Date and pricing principles” in the Letter from the Board. Provided that such number of A Shares to be issued shall not be more than 30% of the total existing number of Shares in issue, the final number of A Shares to be issued under the Proposed A Shares Issue shall be subject to (i) determination by the sponsor and lead underwriter in accordance with the relevant requirements of the CSRC; (ii) obtaining applicable approval from the CSRC; and (iii) obtaining the Specific Mandate required for the issuance of the relevant A Shares in the AGM and the Class Meetings.

The number of A Shares to be issued under the Proposed A Shares issue will be adjusted if, during the period from the Pricing Benchmark Date to the Issuance Date, any event which may alter the total number of Shares of the Company (such as, without limitation, a dividend distribution, an issuance of bonus shares or a conversion of capital reserve into share capital) occurs which may lead to an adjustment to the issue price (as set out in the paragraph headed “Issue price, Pricing Benchmark Date and pricing principles” below).

Subscriber and method of subscription:

The subscriber of the Proposed A Shares Issue is Hualu Investment, which has agreed to subscribe for all the A Shares to be issued under the Proposed A Shares Issue by way of cash in RMB.

Method and time of issue:

The Proposed A Share Issue will be carried out by way of non-public issuance of A Shares to Hualu Investment. Subject to the satisfaction of all the conditions precedent, the Company will issue A Shares to Hualu Investment (within the validity period of the resolutions described below) after obtaining the approval from the CSRC.



**Issue price, Pricing
Benchmark Date and
pricing principles**

The issue price of the A Shares, being the subscription price payable by Hualu Investment under the Proposed A Shares Issue, is RMB6.89 per A Share, which is: (i) not less than 80% of the average trading price of the A Shares over the 20 trading days preceding the Pricing Benchmark Date (which is calculated by dividing the total trading turnover of A Shares traded in the 20 trading days preceding the Pricing Benchmark Date by the total volume of A Shares traded in those 20 trading days); and (ii) not less than the unaudited net asset value per share attributable to the holders of ordinary shares of the parent company at the end of the Company's most recent financial year prior to the Pricing Benchmark Date, whichever is higher, in each case rounded up to two decimal places.

If, during the period from the Pricing Benchmark Date to the Issuance Date, any ex-right or ex-dividend event (such as, without limitation, a dividend distribution, an issue of bonus shares or a conversion of capital reserve into share capital) occurs, the issue price shall be adjusted based on the following formula:

Cash distribution:

$$P1 = P0 - D$$

Issue of bonus shares or conversion of capital reserve into share capital:

$$P1 = P0 / (1 + N)$$

Cash distribution and issue of bonus shares or conversion of capital reserve into share capital take place simultaneously:

$$P1 = (P0 - D) / (1 + N)$$

where:

- (i) P0 denotes the issue price before adjustment;
- (ii) D denotes the amount of cash to be distributed per Share;
- (iii) N denotes the number of Shares to be distributed as bonus or converted from the capital reserve per Share; and
- (iv) P1 denotes the new issue price after adjustment.

The above adjustment shall be made in accordance with requirements prescribed under Rule 12 of the “Implementation Rules for Non-public Issuance of Shares by Listed Companies” 《上市公司非公开发行股票实施细则》(the “**Implementation Rules**”) promulgated by the CSRC.

Conditions precedent for the A Shares Subscription Agreement to take effect:

Completion of the A Shares Subscription Agreement is conditional upon satisfaction of the following conditions, and will take effect when all those conditions have been satisfied:

- (i) in accordance with the relevant laws and the Articles of Association, the approval of the plan of the Proposed A Shares Issue and related matters has been obtained at the Board meeting, the AGM and the Class Meetings;
- (ii) the obtaining of approval of the Whitewash Waiver from Independent Shareholders at the AGM in compliance with applicable requirements of the Takeovers Code, and HHC and persons acting in concert with it being exempt from the obligation to make a general offer under applicable laws and regulations of the PRC;
- (iii) the approval from the relevant state-owned assets supervision and administration authorities of the PRC for the Proposed A Shares Issue having been obtained;
- (iv) the approval from the CSRC for the Proposed A Shares Issue having been obtained; and

- (v) the grant of the Whitewash Waiver by the Executive to HHC and the parties acting in concert with it in accordance with the Takeovers Code.

None of the above conditions precedent are waivable.

In relation to condition (ii) above, under section 63 of the Measures for the Administration of the Takeover of Listed Companies (《上市公司收購管理辦法》) and the applicable PRC rules, a person would be exempt from making a general offer arising from his subscription a new issuance of shares if the approval of independent shareholders of a listed company has been obtained. In this regard, it is intended that the approval of Independent Shareholders of relevant resolutions be passed at the AGM such that HHC and persons acting in concert with it would be exempt from making a general offer for securities of the Company as a result of the Proposed A Shares Issue.

As at the Latest Practicable Date, the approval from the Board for the Proposed A Shares Issue has been obtained. However, the conditions precedent set out under the A Shares Subscription Agreement described above have not been satisfied.

Under the Listing Rules, the resolutions for the approval of the Proposed A Shares Issue, the A Shares Subscription Agreement and the Specific Mandate are required to be approved by a simple majority of the votes that are cast either in person or by proxy by the Independent Shareholders at the AGM and the Class Meetings.



The Whitewash Waiver, if granted by the Executive, would be subject to, among other things, the Whitewash Waiver being approved by at least 75% of the independent votes that are cast either in person or by proxy at the AGM, and the Proposed A Shares Issue and the A Shares Subscription Agreement being approved by more than 50% of the independent votes that are cast either in person or by proxy at the AGM, as required under the Takeovers Code. Further, under the Articles of Association, the Proposed A Shares Issue and the A Shares Subscription Agreement will have to be approved by at least two-thirds of the votes cast on a poll by the Independent Shareholders at each of the AGM and the Class Meetings.

Lock-up period:

Hualu Investment shall not, and undertakes not to, transfer the A Shares subscribed for under the Proposed A Shares Issue within 36 months from the date of Completion.

The above lock-up arrangement shall also apply to any Shares derived from the A Shares subscribed by Hualu Investment under the Proposed A Shares Issue in the circumstances such as those derived from, without limitation, a distribution of stock dividend or a conversion of capital reserves to share capital.

Total funds to be raised and used:

The total funds expected to be raised from the Proposed A Shares Issue (before deducting relevant expenses related to the issuance) will amount to RMB250,000,000.

Proposed use of proceeds:

The net proceeds from the Proposed A Shares Issue (after deducting relevant expenses related to the issuance) are intended to be used to supplement working capital, and repay interest-bearing liabilities, of the Group.

In particular, it is intended that (subject to necessary adjustments based on actual operational needs under prevailing circumstances):

- (i) approximately RMB50,000,000 would be used for the repayment of the one-year term loan granted to the Group by Zhangdian District Branch of Industrial and Commercial Bank of China, the repayment of which is due on 9 November 2021;



- (ii) approximately RMB90,000,000 would be used for the repayment of the three-year term loan granted to the Group by Zibo Branch of China CITIC Bank, the repayment of which is due on 12 April 2022; and
- (iii) the remaining net proceeds would be used for supplementing the working capital of the Group, of which (a) approximately RMB80,000,000 is expected to be used for purchasing raw materials for the production of chemical bulk drugs and preparations (in anticipation of expected demand for such products given that there has been an uptrend of demand in pharmaceuticals active pharmaceutical ingredients (such as antipyretic and analgesic and preparations) produced by the Group in recent years); and (b) the remainder would be used for settling increased production costs (including utility expenses) associated with the expected increase in our production capacity.

Place of listing: The Company will apply to the SZSE for the listing of, and permission to deal in, the A Shares to be issued under the Proposed A Shares Issue. Upon Completion, these A Shares will be listed on the SZSE.

Validity period of the resolutions: The resolutions regarding the Proposed A Shares Issue shall be valid for 12 months from the date on which the relevant resolutions are considered and approved at the AGM and the Class Meetings.

Further details of the Proposed A Shares Issue are set out in the Letter from the Board.

Issue Price

The Issue Price of RMB6.89 represents:

- (i) a discount of approximately 23.0% over the closing price of RMB8.95 per A Share as quoted on the SZSE on the Latest Practicable Date;
- (ii) a discount of approximately 20.5% to the closing price of RMB8.67 per A Share on the last trading date (i.e. 14 April 2021) before the publication of the Announcement (i.e. the last day immediately preceding the Pricing Benchmark Date);

- (iii) a discount of approximately 20.3% over the closing price of RMB8.64 per A Share as quoted on the SZSE on the Pricing Benchmark Date;
- (iv) a discount of approximately 21.5% over the average closing price of RMB8.78 per A Share as quoted on the SZSE for the last five consecutive trading days immediately prior to Pricing Benchmark Date;
- (v) a discount of approximately 20.5% over the average closing price of RMB8.67 per A Share as quoted on the SZSE for the last ten consecutive trading days immediately prior to Pricing Benchmark Date;
- (vi) a discount of approximately 19.1% over the average closing price of RMB8.52 per A Share as quoted on the SZSE for the last 20 consecutive trading days immediately prior to Pricing Benchmark Date;
- (vii) a premium of approximately 28.8% over the unaudited NAV per Share of RMB5.35 as at 31 March 2021; and
- (viii) a premium of approximately 8.0% over the unaudited adjusted NAV (the “Adjusted NAV”)^{Note} per Share of RMB6.38 as at 31 March 2021

Note:

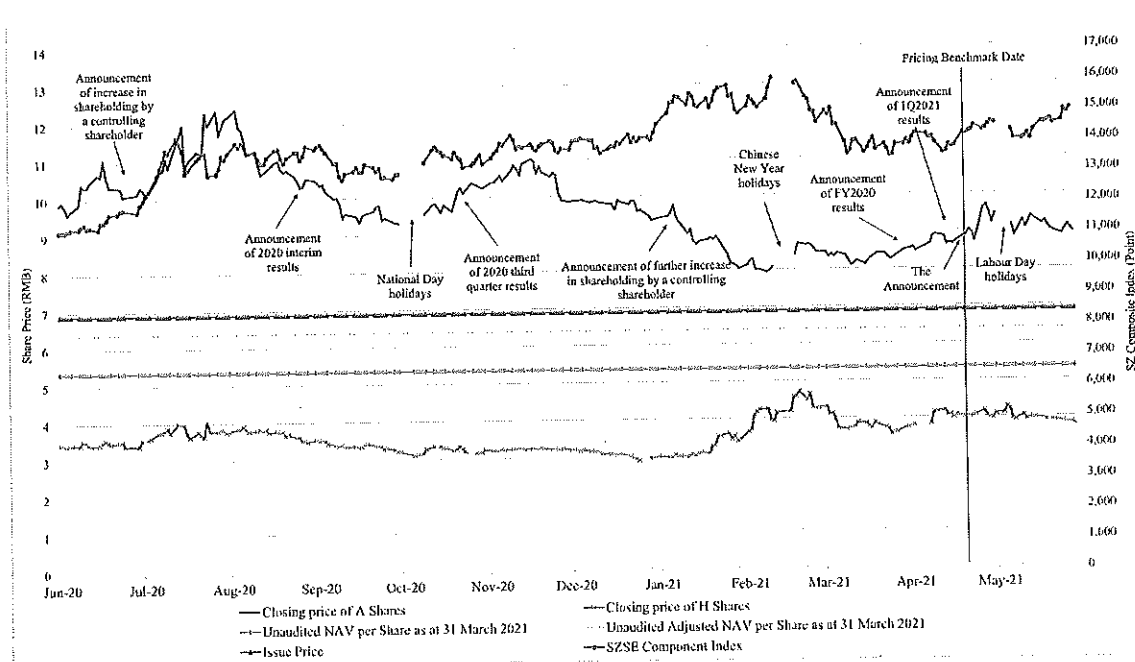
The Adjusted NAV is calculated based on the unaudited NAV as at 31 March 2021, adjusted with reference to the valuation of properties as at 30 April 2021 as set out in Appendix VI to the Circular. Details of the adjustment are set out in the table below:

| | <i>RMB' million</i> |
|---|---------------------|
| The unaudited NAV as at 31 March 2021 | 3,359.5 |
| Add: | |
| The valuation of properties as at 30 April 2021 (including the value of both property interests with and without proper title certificates) as set out in Appendix VI to the Circular | 2,414.5 |
| Less: | |
| The carrying value of the properties held by the Group as at 31 March 2021 | (1,770.9) |
| The unaudited Adjusted NAV as at 31 March 2021 | 4,003.1 |

To further assess the fairness and reasonableness of the Issue Price, we set out the following analysis for illustrative purposes:

(i) Review of A Share price

We have analysed the historical closing price of the A Shares during the past twelve months and up to the Pricing Benchmark Date. The following chart illustrates the daily closing price of the A Shares as quoted on the SZSE, the daily closing price of the H Shares as quoted on the Hong Kong Stock Exchange, SZSE Composite Index, the unaudited NAV per Share as at 31 March 2021 and the unaudited Adjusted NAV per Share per Share as at 31 March 2021, during the period commencing from 1 June 2020 up to the Pricing Benchmark Date (the “Historical Price Period”) and the period following the Pricing Benchmark Date up to the Latest Practicable Date (the “Post-announcement Period”). We consider that the Historical Price Period, being twelve months from the Pricing Benchmark Date, is a fair and reasonable period for our analysis as it can reflect the recent trend of the Shares and provide a general overview of the market sentiment of the A share stock market.



Source: SZSE (<http://www.szse.cn/>) and Hong Kong Stock Exchange (<http://www.hkex.com.hk>)

Notes:

1. Trading dates of the A Shares may vary from those of the H Shares.
2. The closing prices of the A Shares and H Shares were adjusted after taking into account the final dividend for FY2019.
3. For illustrative purpose, the exchange rate used to calculate the RMB equivalent of the H Share price is RMB1:HK\$1.18.

Based on the above chart, the A Shares were generally traded within a range between approximately RMB9 and RMB12 during the period from 1 June 2020 to 31 December 2020 and were generally traded within a range between RMB8 to RMB10 during the period from 1 January 2021 to the Pricing Benchmark Date.

From June 2020 to early August 2020, the share price of A Shares experienced a rebound and increased generally in line with the trend of the SZSE Component Index (with the closing price of the A Shares increasing from RMB9.87 on 1 June 2020 to RMB12.40 on 3 August 2020). According to the Company's announcement as at 30 June 2020, Well Bring, an indirect wholly-owned subsidiary of HHC, increased its shareholding of the Company by acquiring an aggregate number of 1,200,000 H Shares through the Hong Kong Stock Exchange and this may have been one of the factors which stimulated the closing price of A Shares to move upward during the said period.

From early August 2020 to the Price Benchmark Date, the share price of A Shares exhibited a downward trend. We noted that, on 3 August 2020, the National Healthcare Security Administration of the PRC (國家醫療保障局) promulgated the Work Plan for the Adjustment of 2020 National Medical Insurance Catalog (《2020年國家醫保藥品目錄調整工作方案》) (the "2020 Work Plan"), according to which, the price negotiation with drug companies for 2020 National Reimbursement Drug List will be arranged between October and November 2020 and such list will be finalised and published between November and December 2020. Such 2020 Work Plan may place pressure on margins of pharmaceutical companies and this may have been a cause for the closing price of A shares to decrease (from RMB12.40 on 3 August 2020 to RMB8.64 on the Pricing Benchmark Date) following its release.

After the publication of the Announcement on 14 April 2021, the closing price of the A Shares increased from RMB8.67 on date of the Announcement to RMB8.95 on the Latest Practicable Date, representing an increase of approximately 3.23% over the closing price on the date of the Announcement.

Notwithstanding the Issue Price was below the closing price of A Shares during the Historical Price Period, taking into account factors including (i) the Group's funding need for repayment of its short-term borrowings and maintaining of sufficient working capital; (ii) the Issue Price being determined in compliance with the New Decisions (as defined below); (iii) the Issue Price representing a premium of approximately 28.8% and 8.0% over the unaudited NAV per Share as at 31 March 2021 and the unaudited Adjusted NAV per Share as at 31 March 2021 respectively; and (iv) the Issue Price being above the average closing price of H Shares during the Historical Price Period, we are of the view that the Issue Price is acceptable so far as the Independent Shareholders are concerned.

(ii) *Comparison of key terms of the Proposed A Shares Issue with comparable non-public A shares issuances by listed issuers*

Pursuant to the decisions (the "New Decisions") announced by the CSRC on 14 February 2020 (the "Effective Date"), namely the decision on amending the "Administration Measures for the Issuance of Securities by Listed Companies" (《上市公司證券發行管理辦法》) (中國證券監督管理委員會令 第163號) and the decision on amending the Implementation Rules (中國證監會公告[2020]11號), the minimum issue price of A shares under non-public issuance of A shares must be not less than 80% of the average trading price of the company's shares during the 20 trading days preceding the pricing benchmark date.

In the following table, we set out (i) the basis for determination of the issue price of A shares; (ii) the lock-up periods which are imposed on the relevant A shares; (iii) where applicable, the premium/(discount) of issue price over/to the average trading price over the 20 trading days preceding pricing benchmark date ("20 Trading Days Premium/(Discount)") of the Proposed A Shares Issues as compared to those involving non-public issuance of A shares for fund-raising purpose by listed issuers ("Transaction Comparables") which are dually listed on the Hong Kong Stock Exchange as well as a recognised stock exchange in the PRC (i.e. the SZSE or the Shanghai Stock Exchange) to their respective controlling shareholders (or a group of subscribers comprising the controlling shareholders and other investor(s)) over the period from the Effective Date up to the Latest Practicable Date; and (iv) where applicable, the premium/(discount) of issue price over/to the closing price as at pricing benchmark date ("PBD Premium/(Discount)") of the Proposed A Shares Issues as compared to the Transaction Comparables. We believe that a comparison of the said key terms of the Proposed A Shares Issue with the non-public issuance of A shares by these Transaction Comparables would be appropriate and meaningful for the reasons that they all relate to non-public issuance of A shares by listed companies dually listed on the Hong Kong Stock Exchange as well as a PRC recognised stock exchange to controlling shareholders, and all such transactions are required to comply with the requirements of applicable PRC laws, including the New Decisions. Based on such selection criteria, we have identified an exhaustive list of 10 Transaction Comparables as set out in the table below, which we believe is an adequate sample size for meaningful comparison and analysis.

| Company name | Announcement date | Basis for A-share issue price | Lock-up period (in months) | 20 Trading Days Premium/ (Discount), being the premium/ (discount) of issue price over/ to the average trading price over the 20 trading days preceding pricing benchmark date | PBD Premium/ (Discount), being the premium/ (discount) of issue price over/ to the closing price as at pricing benchmark date |
|--|---|--|----------------------------|--|---|
| 1 First Tractor Company Limited (38.HK) (601038.SH) | 24 April 2020 | Not less than 80% of the average trading price of the A Shares during the 20 trading days preceding the pricing benchmark date | 36 | (20.0)% | (27.3)% |
| 2 Dynagreen Environmental Protection Group Co., Ltd. (1330.HK) (601330.SH) | 29 May 2020 | The higher of (i) 80% of the average trading price of the A Shares during the 20 trading days preceding the pricing benchmark date; and (ii) the latest audited net asset value per share attributable to the shareholders of ordinary shares of the company before issuance of A shares | 18 | (19.6)% | (19.2)% |
| 3 Tianjin Capital Environmental Protection Group Company Limited (1065.HK) (600874.SH) | 13 July 2020, 30 March 2021 ^(Note 1) | Not less than 80% of the average trading price of the A Shares during the 20 trading days preceding the pricing benchmark date | 36 | (20.0)% | (24.9)% |
| 4 Postal Savings Bank of China Co., Ltd. (1658.HK) (601658.SH) | 30 November 2020 | The higher of (i) 80% of the average trading price of the A Shares during the 20 trading days preceding the pricing benchmark date; and (ii) the latest audited net asset value per share attributable to the shareholders of ordinary shares of the company before issuance of A shares | 60 ^(Note 2) | 14.4% ^(Note 3) | 6.1% ^(Note 3) |



| Company name | Announcement date | Basis for A-share issue price | Lock-up period (in months) | 20 Trading Days Premium/ (Discount), being the premium/ (discount) of issue price over/ to the average trading price over the 20 trading days preceding pricing benchmark date | PBD Premium/ (Discount), being the premium/ (discount) of issue price over/ to the closing price as at pricing benchmark date |
|---|-------------------|--|----------------------------|--|---|
| 5 China Suntien Green Energy Corporation Limited (956.HK) (600956.SH) | 21 December 2020 | The higher of (i) 80% of the average trading price of the A Shares during the 20 trading days preceding the pricing benchmark date; and (ii) the latest audited net asset value per share attributable to the shareholders of ordinary shares of the company before issuance of A shares | 18 | N/A ^(Note 4) | N/A ^(Note 4) |
| 6 Luoyang Glass Company Limited (1108.HK) (600876.SH) | 31 December 2020 | The higher of (i) 80% of the average trading price of the A Shares during the 20 trading days preceding the pricing benchmark date; and (ii) the latest audited net asset value per share attributable to the shareholders of ordinary shares of the company before issuance of A shares | 36 | N/A ^(Note 4) | N/A ^(Note 4) |
| 7 COSCO Shipping Development Co., Ltd. (2866.HK) (601866.SH) | 27 January 2021 | The higher of (i) 80% of the average trading price of the A Shares during the 20 trading days preceding the pricing benchmark date; and (ii) the latest audited net asset value per share of A shares | 36 | N/A ^(Note 4) | N/A ^(Note 4) |
| 8 China Eastern Airlines Corporation Limited (670.HK) (600115.SH) | 2 February 2021 | The higher of (i) 80% of the average trading price of the A Shares during the 20 trading days preceding the pricing benchmark date; and (ii) the latest audited net asset value per share attributable to the shareholders of ordinary shares of the company before issuance of A shares | 36 | (4.9)% | (7.9)% |



| Company name | Announcement date | Basis for A-share issue price | Lock-up period (in months) | 20 Trading Days Premium/ (Discount), being the premium/ (discount) of issue price over/ to the average trading price over the 20 trading days preceding pricing benchmark date | PBD Premium/ (Discount), being the premium/ (discount) of issue price over/ to the closing price as at pricing benchmark date | |
|----------------------------------|---|--|--|--|---|-------------------------|
| 9 | China Suntien Green Energy Corporation Limited (956.HK) (600956.SH) | 5 March 2021 | The higher of (i) 80% of the average trading price of the A Shares during the 20 trading days preceding the pricing benchmark date; and (ii) the latest audited net asset value per share attributable to the shareholders of ordinary shares of the company before issuance of A shares | 36 | N/A ^(disc #) | N/A ^(disc #) |
| 10 | Shanghai Pharmaceuticals Holding Co., Ltd. (2607.HK) (601607.SH) | 12 May 2021 | The higher of (i) 80% of the average trading price of the A Shares during the 20 trading days preceding the pricing benchmark date; and (ii) the latest audited net asset value per share attributable to the shareholders of ordinary shares of the company before issuance of A shares | 36 | (20.0)% | (18.2)% |
| | | | | Maximum | 14.4% | 6.1% |
| | | | | Minimum | (20.0)% | (27.3)% |
| | | | | Median | (19.8)% | (18.7)% |
| | | | | Average | (11.7)% | (15.2)% |
| The Company (719.HK) (000756.SZ) | 14 April 2021 | The higher of (i) 80% of the average trading price of the A Shares during the 20 trading days preceding the Pricing Benchmark Date; and (ii) than the unaudited NAV per Share at the end of the Company's most recent financial year prior to the Pricing Benchmark Date | 36 | (20.0)% | (20.3)% | |

Source: Hong Kong Stock Exchange (<http://www.hkex.com.hk/>)

Notes:

- On 30 March 2021, the listed issuer of Transaction Comparable #3 announced that at the forty-seventh meeting of its board of directors held on 30 March 2021, its board of directors considered and approved the relevant resolutions in relation to the adjustments to the proposed non-public issuance of A shares. Information disclosed hereof refers to the announcement made by the listed issuer of Transaction Comparable #3 on 30 March 2021.



2. According to the circular of the listed issuer of Transaction Comparable #4 dated 4 December 2020, its lock-up period was determined in accordance with 《中資商業銀行行政許可事項申請材料目錄及格式要求》 (Catalogue and Requirements for the Formats of the Application Materials for the Administrative Licensing Items of Chinese-funded commercial banks*) which requires a lock-up period of 60 months commencing from the date of settlement for the proposed subscribers who will be interested in 5% or more equity interests of PRC commercial bank.
3. The issue price of Transaction Comparable #4 was based on the latest audited net asset value per share of the listed issuer of Transaction Comparable #4 prior to its pricing benchmark date as its latest audited net asset value per share was higher than its average trading price during the 20 trading days preceding the pricing benchmark date.
4. The issue price has not yet been determined up to the Latest Practicable Date.

As shown in the above table, the issue price of A shares of all of the Transaction Comparables comply with the requirements of the New Decisions (i.e. their issue price was not less than 80% of the average trading price of the A shares during the 20 trading days preceding the pricing benchmark date). Further, similar to the pricing mechanism for the Issuer Price in connection with the Proposed A Shares Issue, eight out of 10 Transaction Comparables included a further qualification that the issue price of A shares must be not lower than the net asset value per share as shown based on latest audited information (although we observed that such additional criteria had limited implications on the issue price of A shares in respect of Transaction Comparables the issue price of which has been determined as at the Latest Practicable Date, given that the minimum issue price per A share determined pursuant to the New Decisions was higher than the issue price per A share determined based on this additional criteria). On such basis, we believe that the pricing mechanism for the Issue Price is based on similar criteria used by, and is not less favourable than those adopted by, the Transaction Comparables.

In respect of non-public issuance of A shares of the Transaction Comparables in which their issue price has been determined up to the Latest Practicable Date (i.e. Transaction Comparable #1, #2, #3, #4, #8 and #10) (“Transaction Comparables With Issue Price”), we observed that majority of the issue price of Transaction Comparables were set at a discount to the average trading price of the A shares during the 20 trading days preceding the pricing benchmark date and four of which (i.e. Transaction Comparable #1, #2, #3 and #10) were set at a level of approximately 80% of the average trading price during the 20 trading days preceding the pricing benchmark date. Upon comparison, the 20 Trading Days Discount of the Issue Price of approximately 20.0% was within the range of the 20 Trading Days Premium/(Discount) of the Transaction Comparables With Issue Price (from a premium of approximately 14.4% to a discount of approximately 20.0%), close to the median of the 20 Trading Days Discount of the Transaction Comparables With Issue Price of approximately 19.8% and below the average of the 20 Trading Days Discount of the Transaction Comparables With Issue Price of approximately 11.7%; and (ii) the PBD Discount of the

Issue Price of approximately 20.3% was within the range of the PBD Premium/(Discount) of the Transaction Comparables With Issue Price (from a premium of approximately 6.1% to a discount of approximately 27.3%), close to the median of the PBD Discount of the Transaction Comparables With Issue Price of approximately 18.7% and below the average of the PBD Discount of the Transaction Comparables With Issue Price of approximately 15.2%. On the other hand, the issue price of Transaction Comparable #4 was based on its latest audited net asset value per share prior to its pricing benchmark date as its latest audited net asset value per share of approximately RMB5.55 was higher than its average trading price during the 20 trading days preceding the pricing benchmark date of approximately RMB4.85. Taking into account the above and that the Issue Price was set at a discount which in line with the majority of the Transaction Comparables With Issue Price, we consider that the basis in determining the Issue Price is not less favourable than those of the Transaction Comparables.

Except for the Transaction Comparable #4, the subscribers of all Transaction Comparables are subject to a lock-up period of 18 months to 36 months and six of them are subject to a lock-up period of 36 months. The lock-up period of the Proposed A Shares Issue, being 36 months, is within the range of that of the Transaction Comparables and the same as the majority of the Transaction Comparables. On such basis, we are of the view that the lock-up period of the Proposed A Shares Issue is not less favourable than those of the Transaction Comparables.

(iii) Comparison of the Issue Price with A shares of industry peers

In order to assess the fairness and reasonableness of the Issue Price, we have considered the price-to-earnings multiple (the “**P/E Ratio**”) and the price-to-book multiple (the “**P/B Ratio**”) implied by the Issue Price and by the P/E Ratio and the P/B Ratio of market comparable companies. We consider that the P/E Ratio and the P/B Ratio are appropriate parameters for evaluating the valuation of profit-generating and asset-based companies, where significant capital expenditure is required to operate a pharmaceutical related business.

We have identified two market comparable companies (the “**Industry Comparable(s)**”) based on the following criteria: (i) dually listed on the Hong Kong Stock Exchange and SZSE or Shanghai Stock Exchange; (ii) principally engages in pharmaceutical related business with a focus on the development of chemical Active Pharmaceutical Ingredients (API), pharmaceutical preparations and chemical products; and (iii) are profit-making in their latest financial year. We believe that such selection criteria is reasonable as they are key characteristics which are possessed by the Company. The Industry Comparables set out below represent an exhaustive list of companies comparable to the Company based on the above criteria.



| Company name (stock code) | Market capitalization (Note 1) RMB' million | Net profit (Note 2) RMB' million | Net asset value (Note 3) RMB' million | CAGR of net profit (Note 4) % | Net profit margin (Note 5) % | P/E Ratio (Note 5) times | P/B Ratio (Note 6) times | 2019 P/E Ratio (Note 7) times | 2019 P/B Ratio (Note 8) times |
|--|--|---|--|-------------------------------------|------------------------------------|--------------------------------|--------------------------------|-------------------------------------|-------------------------------------|
| Livzon Pharmaceutical Group Inc. (1513.HK) (000513.SZ) ("Livzon") | 39,423 | 1,715 | 12,519 | 25.9 | 20.3 | 23.0 | 3.1 | 30.3 | 3.5 |
| Shenzhen Hepalink Pharmaceutical Group Co., Ltd. (9989.HK) (002399.SZ) ("Shenzhen Hepalink") | 24,988 | 1,024 | 11,569 | 26.5 | 19.2 | 24.4 | 2.2 | 23.6 | 3.4 |
| | | | | | Maximum | 24.4 | 3.1 | 30.3 | 3.5 |
| | | | | | Minimum | 23.0 | 2.2 | 23.6 | 3.4 |
| | | | | | Median | 23.7 | 2.7 | 26.9 | 3.5 |
| | | | | | Average | 23.7 | 2.7 | 26.9 | 3.5 |
| The Company (719.HK) (000756.SZ) | 5,408 | 325 | 3,359 | 12.8 | 5.8 | 16.7 | 1.3 (Note 10) | 18.0 | 1.8 |
| The Issue Price | 4,323 (Note 9) | 325 | 3,359 | 12.8 | 5.8 | 13.3 | 1.1 (Note 10) | 14.4 | 1.5 |

Source: Shanghai Stock Exchange (<http://www.sse.com.cn/>) and SZSE (<http://www.szse.cn/>) and Hong Kong Stock Exchange (<http://www.hkex.com.hk/>)

Notes:

- Market capitalization is derived from multiplying the total issued shares of the company (including both A shares and H shares) by the respective closing price of A shares quoted on the Shanghai Stock Exchange and SZSE (as applicable) as at the Pricing Benchmark Date.
- Net profit refers to net profit attributable to the owners of the company reported in the respective companies' latest published annual reports.
- Net asset value refers to net assets attributable to the owner of the company reported in the respective companies' latest published financial information.
- CAGR of net profit refers to 3-year compound annual growth rate ("CAGR") of net profit attributable to shareholder of the company from FY2018 to FY2020.
- P/E ratio is calculated based on the respective market capitalization as at the Pricing Benchmark Date divided by their latest respective net profit attributable to the owners of the company.
- P/B Ratio is calculated based on the respective market capitalization as at the Pricing Benchmark Date divided by their respective latest net asset value attributable to the owners of the company attributable to the owner of the company.

7. 2019 P/E ratio (“2019 P/E ratio”) is calculated based on the average closing price of A shares one year prior and included the Pricing Benchmark Date (i.e. 16 April 2020 to 15 April 2021) multiplied total issued shares of the company as at the Pricing Benchmark Date divided by their net profit attributable to the owners of the company for the year ended 31 December 2019.
8. 2019 P/B ratio (“2019 P/B ratio”) is calculated based on the average closing price of A shares one year prior and included the Pricing Benchmark Date (i.e. 16 April 2020 to 15 April 2021) multiplied total issued shares of the company as at the Pricing Benchmark Date divided by their net assets value attributable to owners of the company as at 31 December 2019.
9. The implied market capitalization of the Company is calculated based on Issue Price, being RMB6.89 per Share, and the total number of issued A Shares and H Shares of the Company.
10. The P/B Ratio of the Company is calculated based on the unaudited Adjusted NAV of the Company as at 31 March 2021.

Upon comparison, we noted that the P/E Ratio of the Industry Comparables ranged from approximately 23.0 times to 24.4 times and its median and average are both approximately 23.7 times. The P/E Ratio of the Company of approximately 16.7 times falls outside the range of the P/E Ratio of the Industry Comparables. Meanwhile, the P/B Ratio of the Industry Comparables ranged from approximately 2.2 times to 3.1 times and its median and average are both approximately 2.7 times. The P/B Ratio of the Company of approximately 1.3 times falls outside the range of the P/B Ratio of the Industry Comparables.

As set out in the above table, we noted that Livzon and Shenzhen Hepalink recorded CAGR of net profit by approximately 25.9% and 26.5% during the period from FY2018 to FY2020, whereas the Company recorded CAGR of net profit by approximately 12.8% during the corresponding period. Moreover, we noted that the net profit margin of Livzon and Shenzhen Hepalink for FY2020 were approximately 20.3% and 19.2% respectively, whereas the net profit margin of the Company for FY2020 was approximately 5.8%. In addition, we have conducted research on the Industry Comparables. In particular, Livzon recorded revenue of over RMB10 billion in FY2020 according to its annual report for FY2020 and owned 458 patents registered up to 31 July 2018 according to its official website. For Shenzhen Hepalink, it was the largest China-based and third largest global manufacturer and marketer of enoxaparin sodium injection, with a global market share of 6.5%, and the second largest supplier in the enoxaparin injection market with a market share of 10.9% in 2019, according to its prospectus dated on 24 June 2020. The higher growth rate of net profit, the higher net profit margin and the sophisticated background in the pharmaceutical industry of the Industry Comparables are the factors to support premium on their market valuation.

Furthermore, we noted that the 2019 P/E Ratio and 2019 P/B Ratio of the Company, being calculated based on average historical closing price and financial figures for FY2019, are also lower than those of the Industry Comparables, reflecting that the Company has been consistently trading at lower P/E Ratio and P/B Ratio than the Industry Comparables.



Taking into account the above noticeable differences on growth perspective and background between the Industry Comparables and the Company, we consider that the relatively lower P/E Ratio and P/B Ratio of the Company to be justified. Besides, with reference to our analysis of the Transaction Comparables as discussed in the sub-section headed “(ii) Comparison of key terms of the Proposed A Shares Issue with comparable non-public A shares issuances by listed issuers” in this letter, the majority of the issue price of non-public A shares under the Transaction Comparables were determined based on a similar pricing mechanism to that used for determining the Issue Price. Hence, we consider that the P/E Ratio and P/B Ratio implied by the Issue Price are acceptable.

Based on above factors and reasons set out in this letter and, in particular, the fact that (i) the Proposed A Shares Issue will optimise the Company’s capital structure and reduce its financial risks; (ii) the Proposed A Shares Issue will improve the Company’s liquidity, ease its funding pressure and reduce its amount of short-term liabilities; (iii) the Issue Price represents a premium of approximately 28.8% and 8.0% over the unaudited NAV per Share as at 31 March 2021 and the unaudited Adjusted NAV per Share as at 31 March 2021 respectively; (iv) the determination of the Issue Price is similar to the majority of the issue price of Transaction Comparables of which the issue prices were set at a level of approximately 80% of the average trading price during the 20 trading days preceding the pricing benchmark date; and (v) the P/E Ratio and P/B Ratio implied by the Issue Price to be justified for the reasons set out above, we are of the view that the Issue Price is fair and reasonable and in the interests of the Company and the Shareholders as a whole.

5. Financial effects of the Proposed A Shares Issue on the Group

(i) *Cashflow*

According to the 1Q2021 Quarterly Report, the monetary funds of the Group amounted to approximately RMB914 million as at 31 March 2021. Upon Completion and save for the relevant expenses related to the Proposed A Shares Issue, the cash position of the Group will be improved as the Proposed A Shares Issue will supplement the working capital of the Group by approximately RMB250 million. Accordingly, the cash position, net current assets and current ratio of the Company are expected to be improved upon Completion.

(ii) *Earnings*

The earnings per Share is expected to decrease as the number of issued Shares will increase upon Completion. However, immediate financial burden of the Group will also be alleviated as certain borrowings of the Company will be repaid. Nevertheless, Shareholders are reminded that the actual impact of the Proposed A Shares Issue on the Company’s earnings will also be dependent on the actual financial performance of the Group in the long run.

(iii) Net Asset Value

According to the 1Q2021 Quarterly Report, the unaudited NAV of the Group as at 31 March 2021 was approximately RMB3,359 million. The unaudited Adjusted NAV of the Group as at 31 March 2021 based on the valuation of the properties of the Group is approximately RMB4,003 million (for details, please refer to the section headed “Issue Price” in this letter). Upon Completion and save for the relevant expenses related to the Proposed A Shares Issue, the total assets of the Group will increase, and the liabilities of the Group will decrease with the repayment of debts. Accordingly, there will be a positive impact on the unaudited NAV and unaudited Adjusted NAV of the Group. Furthermore, the NAV per Share will also be enhanced as the Issue Price of RMB6.89 is higher than the unaudited NAV per Share of approximately RMB5.35 as at 31 March 2021 and the unaudited Adjusted NAV per Share of approximately RMB6.38 as at 31 March 2021.

(iv) Gearing

The gearing ratio of the Group as at 31 March 2021 was approximately 46.1%, as calculated by dividing total borrowings by total equity of the Group according to the 1Q2021 Quarterly Report. Upon Completion, the total liabilities of the Group will decrease, while the total assets of the Group will increase. Thus, the gearing level of the Group is expected to decrease upon Completion.

Based on the above, the Proposed A Shares Issue would have an overall positive effect on the future earnings and the financial position of the Group in terms of cashflow, net asset value, and gearing upon Completion. On such basis, we are of the view that the Proposed A Shares Issue is in the interests of the Company and the Shareholders as a whole.

6. Potential dilution effect on the shareholding of the Company

As set out in the table showing the shareholdings changes of the Company under the section headed “Effect of the Proposed A Shares Issue on the Shareholding Structure of the Company” as contained in the Letter from the Board, the shareholding of the existing public Shareholders (other than HHC and parties acting in concert with it) as at the Latest Practicable Date was approximately 63.37%, comprising the A Shares and the H Shares held by existing public Shareholders.

The number of shares to be issued under the Proposed A Shares Issue will be 36,284,470 A Shares, represents (i) approximately 8.39% of the existing number of A Shares in issue as at the Latest Practicable Date, and approximately 5.78% of the existing total number of Shares in issue as at the Latest Practicable Date; and (ii) approximately 7.74% of the number of A Shares in issue and approximately 5.47% of the total number of Shares in issue, in each case as enlarged by the number of A Shares to be issued upon Completion.

HHC's aggregate shareholding in the Company is expected to increase from approximately 36.63% to (i) approximately 40.10% immediately after the Completion; and (ii) approximately 39.46% immediately after the Completion and exercise of all outstanding Share Options. Assuming there are no other changes to the total issued share capital of the Company other than the Proposed A Shares Issue from the Latest Practicable Date to the date of Completion, the shareholdings of the existing public Shareholders (other than HHC and parties acting in concert with it) will be diluted from approximately 63.37% to approximately 59.9%.

Having considered the reasons stated in details in the section headed "Background of and reasons for the Proposed A Shares Issue" above in this letter, in particular, the following:

- (i) the Proposed A Shares Issue will enhance the Company's liquidity cushion and replenishes the working capital of the Group for its operation;
- (ii) the Proposed A Shares Issue will reduce the Company's borrowings and interest expenses, and should eventually improve its the overall gearing position and profitability of the Group; and
- (iii) the terms of the Proposed A Shares Issue are fair and reasonable so far as the Independent Shareholders are concerned,

we are of the opinion that the possible shareholding dilution to the Independent Shareholders is acceptable so far as the Independent Shareholders are concerned.

7. The Whitewash Waiver

As at the Latest Practicable Date, HHC holds 209,007,260 A Shares (itself and through Hualu Investment) and 20,827,800 H Shares, (itself and through Well Bring) representing approximately 36.63% of the total issued share capital of the Company. Upon Completion, HHC's aggregate shareholding in the Company is expected to increase from approximately 36.63% to approximately 40.10% (on a fully diluted basis). In the absence of an applicable waiver, the Proposed A Shares Issue will give rise to an obligation on the part of HHC to make a mandatory offer for all the Shares in issue other than those already owned or agreed to be acquired by it under Rule 26.1 of the Takeovers Code.

HHC has applied to the Executive for the Whitewash Waiver from compliance with Rule 26.1 of the Takeovers Code. The Whitewash Waiver, if granted by the Executive, is expected to be subject to, among other things, the Whitewash Waiver being approved by at least 75% of the independent votes that are cast either in person or by proxy at the AGM, and the Proposed A Shares Issue and the A Shares Subscription Agreement being approved by more than 50% of the independent votes that are cast either in person or by proxy at the AGM as required under the Takeovers Code. Further, under the Articles of Association, the Proposed A Shares Issue and the A Shares Subscription Agreement will have to be approved by at least two-thirds of the votes cast on a poll by the Independent Shareholders at each of the AGM, the A Shares Class Meeting and the H Shares Class Meeting. The Proposed A Shares Issue will not proceed if the Whitewash Waiver is not granted by the Executive or the Proposed A Shares Issue is not approved by the Independent Shareholders at the AGM and the Class Meetings, or if the Whitewash Waiver is not approved by at least 75% of the independent votes that are cast either in person or by proxy by the Independent Shareholders at the AGM.

Given the possible benefits of the Proposed A Shares mentioned in the section headed “3. Background of and Reasons for the Proposed A Shares Issue” above in this letter and having considered our view described above that the terms of the Proposed A Shares Issue are fair and reasonable so far as the Independent Shareholders are concerned to the reasons set out herein, we are of the opinion that the approval for the Whitewash Waiver, which is a prerequisite of the Proposed A Shares Issue, is in the interests of the Company and the Shareholders as a whole and is fair and reasonable for the purpose of proceeding with the Proposed A Shares Issue.

RECOMMENDATIONS

Having considered the above principal factors and reasons, we consider that the Proposed A Shares Issue and the Whitewash Waiver, though not in the ordinary and usual course of business of the Group, is in the interests of the Company and the Shareholders as a whole and the terms of the Proposed A Shares Issue are on normal commercial terms and fair and reasonable so far as the Independent Shareholders are concerned.

We therefore advise the Code Independent Board Committee and the Listing Rule Independent Board Committee to advise the Independent Shareholders to vote in favour of the resolutions to be proposed at the AGM and the Class Meetings to approve the Proposed A Shares Issue and the Whitewash Waiver and we recommend the Independent Shareholders to vote in favour of the resolution(s) in this regard.

Yours faithfully,
For and on behalf of
Octal Capital Limited



Alan Fung
Managing Director



Louis Chan
Director

Note:

Mr. Alan Fung has been a responsible officer of Type 1 (dealing in securities) and Type 6 (advising on corporate finance) regulated activities since 2003. Mr. Fung has more than 28 years of experience in corporate finance and investment banking and has participated in and completed various advisory transactions in respect of mergers and acquisitions, connected transactions and transactions subject to the compliance to the Takeovers Code of listed companies in Hong Kong.

Mr. Louis Chan has been a responsible officer of Type 1 (dealing in securities) and Type 6 (advising on corporate finance) regulated activities since 2008. Mr. Chan has more than 20 years of experience in corporate finance and investment banking and has participated in and completed various advisory transactions in respect of mergers and acquisitions, connected transactions and transactions subject to the compliance to the Takeovers Code of listed companies in Hong Kong.