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

If you have sold or transferred all your shares in Shandong Xinhua Pharmaceutical Company Limited, you should at once hand this circular to the purchaser or transferee or to the bank, stockbroker or other agent through whom the sale or transfer was effected for transmission to the purchaser or transferee.

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山東新華製藥股份有限公司
Shandong Xinhua Pharmaceutical Company Limited

(a joint stock company established in the People's Republic of China with limited liability)

(Stock Code: 00719)

**(1) PROPOSED ADOPTION OF THE SHARE OPTION SCHEME AND
THE PROPOSED GRANT THEREUNDER;
(2) CONTINUING CONNECTED TRANSACTIONS; AND
(3) NOTICE OF EGM
AND OF H SHAREHOLDERS' CLASS MEETING**

**Independent Financial Adviser
to the Independent Board Committee and the Independent Shareholders
in respect of the continuing connected transactions**

ALTUS CAPITAL LIMITED

A letter from the Board is set out on pages 1 to 30 of this circular. A letter from Altus Capital Limited, the Independent Financial Adviser in respect of the continuing connected transactions, containing its advice to the IBC and the Independent Shareholders is set out on pages 32 to 55 of this circular.

(i) A notice convening the EGM to be held at the conference room of the Company at No. 1 Lutai Ave., Hi-tech District, Zibo City, Shandong Province, PRC on 31 December 2021, Friday at 2:00 p.m.; and (ii) a notice convening the H Shareholders' Class Meeting to be held at the conference room of the Company at No. 1 Lutai Ave., Hi-tech District, Zibo City, Shandong Province, PRC on 31 December 2021, Friday at 4:00 p.m. (or immediately after the conclusion or adjournment of the A Shareholders' Class Meeting to be held on the same day at the same venue at 3:00 p.m. or immediately after the conclusion or adjournment of the EGM) are enclosed herewith in this circular.

The proxy forms for use at and the reply slips in relation to the EGM and the H Shareholders' Class Meeting will be despatched by the Company on the date of this circular and also published and available for downloading on the websites of The Stock Exchange of Hong Kong Limited at <http://www.hkex.com.hk> and of the Company at <http://www.xhzy.com>.

Whether or not you intend to attend the EGM and the H Shareholders' Class Meeting, we encourage you to complete and return the proxy forms in respect of the EGM and the H Shareholders' Class Meeting in accordance with the instructions printed thereon as soon as possible and in any event not less than 24 hours prior to the commencement of such meetings (or any adjournments thereof). Completion and return of the proxy forms will not preclude you from attending and voting in person at the abovementioned meetings or any adjournment thereof (as the case may be) should you so wish. Shareholders who intend to attend the EGM and the H Shareholders' Class Meeting should also complete and return the reply slips in accordance with the instructions printed thereon.

15 December 2021

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DEFINITION

In this circular, a reference to one gender includes a reference to other genders, and the following expressions shall have the meanings set out below unless the context otherwise requires:

“A Share(s)”	the domestic Shares of the Company which are listed on Shenzhen Stock Exchange and traded and denominated in RMB, with a nominal value of RMB1.00 each
“A Shareholder(s)”	holder(s) of A Shares
“A Shareholders’ Class Meeting”	the A Shareholders’ class meeting of the Company to be held on 31 December 2021
“Announcement in relation to the Share Option Scheme”	the announcement in relation to the Share Option Scheme of the Company dated 29 October 2021
“Announcement in relation to the CCT Agreements”	the announcement in relation to, <i>inter alia</i> , the CCT Agreements of the Company dated 23 November 2021
“Articles of Association”	the articles of association of the Company, as amended from time to time
“Assessment Methods”	the <i>Assessment Management Methods in Respect of the Implementation of the 2021 Share Option Scheme</i> (《2021年股票期權激勵計劃實施考核管理辦法》), as set out in Appendix II of this circular
“associate(s)”	has the meaning ascribed to it under the Listing Rules
“Board”	the board of Directors of the Company
“CCT Agreements”	collectively, the Shandong Lukang Agreement, the China Shandong Agreement and the Hualu Hengsheng Agreement
“China Shandong Group”	China Shandong Group Ltd. (華魯集團有限公司), a company incorporated in Hong Kong with limited liability and the issued share capital of which is held as to 99.75% by, and is a subsidiary of, HHC as at the Latest Practicable Date
“China Shandong Agreement”	the agreement entered into between the Company and China Shandong Group on 23 November 2021 as described in this circular
“Class Meetings”	collectively the class meeting of the A Shareholders’ Class Meeting and the H Shareholders’ Class Meeting

DEFINITION

“Company”	Shandong Xinhua Pharmaceutical Company Limited (山東新華製藥股份有限公司), a joint stock limited company incorporated in the PRC, the H Shares and A Shares of which are listed on the Hong Kong Stock Exchange (stock code: 00719) and the Shenzhen Stock Exchange (stock code: 000756) respectively
“Company Law”	the Company Law of the PRC, as may be amended, supplemented or otherwise modified from time to time
“connected person(s)”	has the meaning ascribed thereto under the Listing Rules
“controlling shareholder(s)”	has the meaning ascribed thereto under the Listing Rules
“Core Staff”	means such staff which the contribution of which the Board considers to be important to the strategic development and success of the Group and may include, without limitation, senior researchers, senior technological supervisors, senior technicians and other senior staff
“CSRC”	China Securities Regulatory Commission
“Director(s)”	director(s) of the Company
“EGM”	the 2021 first extraordinary general meeting of the Shareholders or any adjournment thereof to approve, among others, (i) the proposed adoption of the Share Option Scheme, the Grant (including the Initial Grant and the Reserved Grant) and relevant authorisation in relation to the Share Option Scheme; and (ii) the CCT Agreements, their respective annual caps and the continuing connected transactions contemplated thereunder
“Exercise Conditions”	the conditions that must be met by the Company and the Participants in respect of an exercise of the Options as described in the paragraph headed “I. Proposed Adoption of the Share Option Scheme – 6. Conditions of Grant and Exercise Conditions” in the Appendix I to this circular
“Exercise Date”	the date on which the Participants is entitled to exercise the Options under the Share Option Scheme, which must be a trading day of the Shenzhen Stock Exchange
“Exercise Period”	the period during which the Participants may exercise the Options

DEFINITION

“Grant”	the proposed Grant of Options (including the Initial Grant and the Reserved Grant) to Participants pursuant to the Share Option Scheme of up to a total of 24,900,000 Options, and unless the context should otherwise requires, the word “Grant” should be construed accordingly
“Grant Date”	the proposed Grant Date of the Share Option Scheme
“Group”	the Company and its subsidiaries from time to time
“HHC”	Hualu Holdings Co. Ltd. (華魯控股集團有限公司), a company incorporated in the PRC and holding approximately 32.65% of the total number of Shares of the Company in issue as at the Latest Practicable Date
“H Share(s)”	H shares of the Company which are listed on Hong Kong Stock Exchange and traded and denominated in Hong Kong dollar, with a nominal value of RMB1.00 each
“H Shareholder(s)”	holder(s) of H Shares
“H Shareholders’ Class Meeting”	the H Shareholders’ class meeting of the Company to be held on 31 December 2021
“HKD”	Hong Kong dollars, the lawful currency of Hong Kong
“Hong Kong”	the Hong Kong Special Administrative Region of the PRC
“Hong Kong Stock Exchange”	The Stock Exchange of Hong Kong Limited
“Hualu Hengsheng”	Shandong Hualu Hengsheng Chemical Company Limited (山東華魯恒升化工股份有限公司), a company incorporated in the PRC with limited liability and the issued share capital of which is indirectly held as to approximately 32.19% by HHC as at the Latest Practicable Date
“Hualu Hengsheng Agreement”	the agreement entered into between the Company and Hualu Hengsheng on 23 November 2021 as described in this circular
“IBC”	the independent board committee (consisting only independent non-executive Directors) established by the Company

DEFINITION

“Independent Financial Adviser”	Altus Capital Limited, a corporation licensed to carry out type 4 (advising on securities), type 6 (advising on corporate finance) and type 9 (asset management) regulated activity under the SFO, which has been appointed as the independent financial adviser to advise the IBC and the Independent Shareholder(s) in relation to CCT Agreements, their respective annual caps and the continuing connected transactions contemplated thereunder
“Incentive Measures”	Measures for the Administration of Equity Share Incentives of Listed Companies (2018) issued by the CSRC, as may be amended, supplemented or otherwise modified from time to time
“Independent Shareholder(s)”	means Shareholders other than HHC and its associates
“independent third par(ties)”	a person or persons or a company or companies that is not or are not connected person(s) of the Group
“Initial Grant”	the initial Grant of 23,150,000 Share Options to the Participants pursuant to the Share Option Scheme, representing 92.97% of the total amount granted under the Share Option Scheme
“Latest Practicable Date”	7 December 2021, being the latest practicable date prior to the printing of this circular for ascertaining certain information referred to in this circular
“Listing Rules”	the Rules Governing the Listing of Securities on the Hong Kong Stock Exchange, as may be amended, supplemented or modified from time to time
“Option(s)”	the right to be granted to a Participant to acquire certain amount of A Shares of the Company at a pre-determined price in a particular period of time and subject to certain conditions under the Share Option Scheme
“Participant”	a person eligible to be granted the Option(s) under the Share Option Scheme
“Pricing Policy”	the pricing policy adopted by the Company in connection with procurement and sale or provision of products and services as further described in the section “Pricing Policy” under the section headed “III. Continuing Connected Transactions” of the Letter from the Board in this circular

DEFINITION

“PRC”	the People’s Republic of China which, for the purpose of this circular, excludes Hong Kong, the Macau Special Administrative Region and Taiwan
“Remuneration and Examination Committee”	the Remuneration and Examination Committee of the Board
“Reserved Grant”	the Grant of up to 1,750,000 Share Options (representing 7.03% of the total amount available for Grant under the Share Option Scheme) which are reserved for Grant to Participants subsequent to the Initial Grant in accordance with the Share Option Scheme, the Participants of which shall be determined by the Board within 12 months after the approval of the Share Option Scheme by the Shareholders at the EGM and the Class Meetings
“RMB”	Renminbi, the lawful currency of the PRC
“SASAC”	The State-owned Assets Supervision and Administration Commission of Shandong Provincial People’s Government
“Scheme Documents”	collectively, the Share Option Scheme and the Assessment Methods
“Securities Law”	the Securities Law of the PRC, as amended, supplemented or otherwise modified from time to time
“SFO”	the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong)
“Shandong Lukang”	Shandong Lukang Pharmaceutical Co., Ltd (山東魯抗醫藥股份有限公司), a company incorporated in the PRC with limited liability (the issued share capital of which is held as to approximately 21.12% by HHC and which HHC has the right to appoint or remove a majority of its board of directors) and is a subsidiary of HHC as at the Latest Practicable Date
“Shandong Lukang Agreement”	the agreement entered into between the Company and Shandong Lukang on 23 November 2021 as described in this circular
“Share(s)”	collectively, A Share(s) and H Share(s)

DEFINITION

“Share Option Scheme”	the proposed share option incentive scheme of the Company described in this circular
“Shareholder(s)”	holder(s) of Share(s)
“Shenzhen Listing Rules”	Rules Governing the Listing of Securities on the Shenzhen Stock Exchange
“Shenzhen Stock Exchange”	the Shenzhen Stock Exchange of the PRC
“Supervisors”	the supervisors of the Company
“Vesting Date”	the date on which the granted Options shall vest (i.e. 24 months, 36 months and 48 months from the Grant Date)
“Validity Period”	the period during which the Share Option Scheme is in effect
“Zibo”	Zibo City, Shandong Province, the PRC
“%”	per cent

Certain English translations of Chinese names or words marked with “” in this circular are included for reference purpose only and should not be regarded as the official English translations of such Chinese names or words.*

LETTER FROM THE BOARD



山東新華製藥股份有限公司
Shandong Xinhua Pharmaceutical Company Limited

(a joint stock company established in the People's Republic of China with limited liability)

(Stock Code: 00719)

Executive Directors:

Mr. Zhang Daiming (*Chairman*)
Mr. Du Deping
Mr. He Tongqing

Registered Address:

Chemical Industry Area of Zibo Hi-tech
Industry Development Zone,
Zibo City,
Shandong Province, PRC

Non-executive Directors:

Mr. Xu Lie
Mr. Cong Kechun

Independent Non-executive Directors:

Mr. Lo Wah Wai
Mr. Pan Guangcheng
Mr. Zhu Jianwei

15 December 2021

To Shareholders

Dear Sir or Madam,

**(1) PROPOSED ADOPTION OF THE SHARE OPTION SCHEME AND
THE PROPOSED GRANT THEREUNDER; AND
(2) CONTINUING CONNECTED TRANSACTIONS**

I. INTRODUCTION

Reference is made to (i) the Announcement in relation to the Share Option Scheme in respect of the proposed adoption of the Share Option Scheme and the proposed Grant (including the Initial Grant and the Reserved Grant) thereunder by the Company; (ii) the Announcement in relation to the CCT Agreements and (iii) the Notice of EGM and of H Shareholders' Class Meeting.

LETTER FROM THE BOARD

The purpose of this circular is to provide you with, among other things:

- (i) information reasonably necessary to enable you to make an informed decision on whether to vote for or against the resolutions to be proposed at the EGM and the H Shareholders' Class Meeting;
- (ii) further details of the proposed adoption of the Share Option Scheme and the proposed Grant (including the Initial Grant and the Reserved Grant) under the Share Option Incentive Scheme;
- (iii) further details of the terms of the Share Option Scheme and the Assessment Methods; and
- (iv) further details of the CCT Agreements, their respective annual caps and the continuing connected transactions.

At the EGM and the H Shareholders' Class Meeting, special resolutions will be proposed to approve:

- (i) the proposed adoption of the Share Option Scheme and the proposed Grant (including the Initial Grant and the Reserved Grant) under the Share Option Scheme;
- (ii) the proposed adoption of the Assessment Methods; and
- (iii) the authorisation to the Board in relation to the Share Option Scheme and the proposed Grant (including the Initial Grant and the Reserved Grant) thereunder.

At the EGM, ordinary resolutions will be proposed to approve the CCT Agreements, their respective annual caps and the continuing connected transactions contemplated thereunder.

II. PROPOSED ADOPTION OF SHARE OPTION SCHEME

A. Introduction

At the EGM and the Class Meetings, resolutions will be proposed for the approval and adoption of (i) the Share Option Scheme (in which, amongst other things, details of the number of Options proposed to be Granted under the Initial Grant and Reserved Grant and the proposed Initial Grant to selected Participants are contained); and (ii) the Assessment Methods. Each proposed Grant (including the Initial Grant and the Reserved Grant) to a Director has been approved by the independent non-executive Directors in compliance with Rule 17.04(1) of the Listing Rules. Pursuant to the Share Option Scheme, independent non-executive Directors are not eligible Participants and no independent non-executive Director is or will become a Participant.

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Please refer to Appendices I and II to this circular for further details of key information relating to the Share Option Scheme contained in this section including, without limitation, the scope of eligible Participants, the amount of the Options proposed to be Granted to Participants under the Initial Grant and Reserved Grant, the Validity Period, the minimum period for which the Options must be held before it can be exercised, the performance related assessment conditions that must be fulfilled for an exercise of Options, the Assessment Methods, the exercise price and adjustment mechanisms in certain circumstances, the Exercise Period, and circumstances under which the Options shall lapse.

B. Purpose of the Share Option Scheme and scope of eligible Participants

The Share Option Scheme is to further establish and enhance the long-term incentive mechanism of the Company with a view to attract and retain talent, incentivise the Directors, senior and mid-level management as well as other Core Staff, effectively align interests of the Shareholders with those responsible for the business and operation of the Company with a review of encouraging the relevant persons to focus on the long-term development of the Company.

The scope of eligible Participants include Directors (other than independent non-executive Directors), members of senior management and mid-level management as well as the Core Staff.

The Board is of the view that the adoption of the Share Option Scheme serves to enable the Company to move towards reaping the abovementioned benefits and therefore recommend the Shareholders to approve the resolutions in relation to the Scheme Documents at the EGM and the Class Meetings.

C. Source and number of the underlying Shares in respect of the Options to be Granted

Save for the proposed Share Option Scheme and the A share option scheme adopted in the Shareholders' meeting held on 28 December 2018, the Company has not adopted any other share option scheme as at the Latest Practicable Date.

Only new A Shares will be issued upon exercise of the Options to be Granted and no H Shares will be issued under the Share Option Scheme. The Scheme Documents (comprising the Share Option Scheme and the Assessment Methods) which govern the performance related assessment conditions on which the exercise of the Options is, amongst other things, conditional upon the obtaining of approval by the Shareholders, A Shareholders and H Shareholders at the EGM, the A Shareholders' Class Meeting and H Shareholders' Class Meeting, respectively.

LETTER FROM THE BOARD

After the approval of the Scheme Documents at the EGM and the Class Meetings, the Board will have to determine the Grant Date which, pursuant to and as part of the Share Option Scheme, shall not be more than 60 days after the date of the said approval. The relevant filing/registration and disclosures required to be made under applicable laws of the PRC must be completed within the said period, failing which the Share Option Scheme shall terminate and any Option(s) granted thereunder will lapse accordingly.

Assuming full acceptance and exercise of the Options Granted, the Share Option Scheme will involve an issuance of a total of up to 24,900,000 new A Shares to Participants, representing approximately 3.97% of the total issued Shares (being 627,367,447 Shares) and 5.76% of the total A Share capital (being 432,367,447 A Shares) of the Company, respectively, as at the Latest Practicable Date. Upon satisfaction of the terms and conditions of the exercise of the Options, each Option to be Granted to a Participant shall provide its holder a right to purchase at the exercise price during the Validity Period one new A Share ranking *pari passu* with the fully-paid A Shares in issue in all aspects including without limitation to voting, entitlements to distributions, transferability and any rights arising on liquidation of the Company.

It is proposed that the Board shall implement and manage the Share Option Scheme pursuant to the terms of the Scheme Documents and applicable laws, rules and regulations. However, none of the Directors is or shall be deemed to be a trustee of the Share Option Scheme nor have any direct or indirect interest in any trustee of the Share Option Scheme.

D. Exercise Period

Upon satisfaction of the Exercise Conditions, Participants may exercise Options that are granted to them in three tranches over a period of 36 months from the first date on which they become vested (i.e. from the first Vesting Date).

The Exercise Period of Options granted under the Share Option Scheme are as follows:

Exercise arrangement	Exercise Period	Proportion of Options granted which may be exercised
First Exercise Period	Commencing from the first trading day after the expiry of the 24th month from the Grant Date of the corresponding part, and ending on the last trading day of the 36th month from the Grant Date of the corresponding part	34%

LETTER FROM THE BOARD

Exercise arrangement	Exercise Period	Proportion of Options granted which may be exercised
Second Exercise Period	Commencing from the first trading day after the expiry of the 36th month from the Grant Date of the corresponding part, and ending on the last trading day of the 48th month from the Grant Date of the corresponding part	33%
Third Exercise Period	Commencing from the first trading day after the expiry of the 48th month period from the Grant Date of the corresponding part, and ending on the last trading day of the 60th month period from the Grant Date of the corresponding part	33%

Participants may exercise the Options granted to them that are vested during the relevant Exercise Period. Where the Exercise Conditions are not fulfilled, the relevant Options may no longer be exercised. Options which have not been exercised by the Participants notwithstanding fulfilment of the Exercise Conditions will be cancelled by the Company upon expiry of the relevant Exercise Period.

Further, the Exercise Date of an Option must be a day on which the Shenzhen Stock Exchange is open for trading and shall not fall within any of the following periods:

1. the period commencing 30 calendar days prior to the announcement of periodic financial reports of the Company (or in the event of delay in publishing the reports due to special reasons, the period commencing 30 calendar days prior to the original date of publication and ending on day immediately preceding the publication date);
2. the period commencing 10 calendar days prior to the announcements of any results forecast or preliminary results of the Company;
3. the period commencing on the date of the occurrence of any material event that may have significant impacts on price of securities (including Shares and derivatives) of the Company (or during the period when such material event is in the process of being approved) and ending on the second trading days following the making of relevant disclosures to the market in accordance with applicable laws; and

LETTER FROM THE BOARD

4. any other periods as may be stipulated by the CSRC or the Shenzhen Stock Exchange.

The above transactions or other material events shall be disclosed by the Company in accordance with the Shenzhen Listing Rules.

E. Performance related assessment conditions on which the exercise of the Options Granted are conditional

Pursuant to Share Option Scheme, a Participant's exercise of Options is conditional on and subject to his or her grading in the performance related assessment conditions review in the immediately preceding year. The details are provided for in the Assessment Methods which are set out in Appendix II of this circular.

F. Exercise price

The exercise price of the Options for the Initial Grant shall be RMB7.96 per A Share. Such exercise price may be adjusted in the event of any capitalisation issue, bonus issue, shares subdivision, share consolidation, right issues and/or dividend payment over the period from the date of the Announcement in relation to the Share Option Scheme up to the date of completion of exercise of Options by Participants.

Under the Share Option Scheme and applicable laws of the PRC, the exercise price of the Options for the Initial Grant shall not be less than the nominal value of the Shares, and shall not be less than the higher of the following:

- (i) the average trading price of the A Shares quoted on the Shenzhen Stock Exchange on the trading day immediately preceding the date of the Announcement in relation to the Share Option Scheme, being RMB7.36 per A Share;
- (ii) the average trading price of the A Shares quoted on the Shenzhen Stock Exchange for the last 20 trading days, 60 trading days or 120 trading days immediately preceding the date of the Announcement in relation to the Share Option Scheme, being RMB7.85 per A Share (representing the average of the trading prices of the A Shares quoted on the Shenzhen Stock Exchange for the last 20 trading days immediately preceding the date of the Announcement in relation to the Share Option Scheme);
- (iii) the closing price of the A Shares quoted on the Shenzhen Stock Exchange on the trading day immediately preceding the date of the Announcement in relation to the Share Option Scheme, being RMB7.37 per A Share;

LETTER FROM THE BOARD

- (iv) the average closing price of the A Shares quoted on the Shenzhen Stock Exchange for the last 30 trading days immediately preceding the date of the Announcement in relation to the Share Option Scheme, being RMB7.96 per A Share; and
- (v) the most recent audited net assets for the financial year ended 2020 per A Share preceding the date of the Initial Grant, being RMB5.45 per A Share.

Any Reserved Grant shall require the prior approval by the Board (including independent non-executive Directors) in accordance with Rule 17.04(1) of the Listing Rules and a summary of the Grant shall be announced by the Company as soon as possible upon the granting of the Reserved Grant by the Company. The total number of A Share to be issued upon exercise of the Options under the Reserved Grant to each Participant (including both exercised and outstanding options) in any 12-month period shall not exceed 1% of the total A Share capital of the Company in accordance with Rule 17.03(4) of the Listing Rules.

Under the Share Option Scheme and applicable laws of the PRC, the exercise price of Options under the Reserved Grant shall not be lower than the fair market price of the A Shares, which shall be no less than the higher of the following prices:

- (i) the average trading price of the A Shares quoted on the Shenzhen Stock Exchange on the trading day immediately preceding the date of the announcement of the Board's resolution of Granting the Reserved Grant;
- (ii) the average trading price of the A Shares quoted on the Shenzhen Stock Exchange for the last 20 trading days, 60 trading days or 120 trading days immediately preceding the date of the announcement of the Board's resolution of Granting the Reserved Grant;
- (iii) the closing trading price of the A Shares quoted on the Shenzhen Stock Exchange on the trading day immediately preceding the date of the announcement of the Board's resolution of Granting the Reserved Grant;
- (iv) the average closing price of the A Shares quoted on the Shenzhen Stock Exchange for the last 30 trading days immediately preceding the date of the announcement of the Board's resolution of Granting the Reserved Grant; and
- (v) the most recent audited net assets per A Share preceding the date of the Reserved Grant.

LETTER FROM THE BOARD

G. Conditions of the Scheme Documents

The proposed Scheme Documents have been approved by HHC and have been approved by the Board and filed with the SASAC and shall take effect upon obtaining Shareholders' approval at the EGM and Class Meetings.

H. Implications under the Listing Rules

The Share Option Scheme constitutes a share option scheme under Chapter 17 of the Listing Rules and, pursuant to rule 14A.92(3)(a) of the Listing Rules, any Grant to a connected person of the Company is fully exempted from Shareholders' approval, annual review and all disclosure requirements under Chapter 14A of the Listing Rules.

Note 1 to Rule 17.03(9) of the Hong Kong Listing Rule

According to Note 1 to Rule 17.03(9) of the Listing Rules, the exercise price of the relevant Options must be at least the higher of (i) the closing price of the securities as stated in the daily quotations sheet of the Hong Kong Stock Exchange on the date of grant, which must be a business day; and (ii) the average closing price of the securities as stated in the daily quotations sheets of the Hong Kong Stock Exchange for the five business days immediately preceding the Grant Date.

The Company has applied for, and the Hong Kong Stock Exchange has granted a waiver from strict compliance with Note 1 to Rule 17.03(9) of the Listing Rules in respect of the exercise price of the Options on the basis that, among other things, (i) the Shares to be issued upon the exercise of the Options are A Shares traded on the Shenzhen Stock Exchange; (ii) the basis of determination of the exercise price of the Options is required by and in accordance with the relevant laws and regulations in the PRC; (iii) the proposed adoption of the Share Option Scheme will be subject to the approval of the Shareholders at the EGM and the Class Meetings, whereby the H Shareholders will have the opportunity to fully consider and evaluate the terms of the Share Option Scheme based on its merits and the interest of the H Shareholders will not be prejudiced; and (iv) the Share Option Scheme contains the provisions to ensure that the exercise price of the Options is no less than the prevailing market price of the relevant A Shares on the Shenzhen Stock Exchange as at the time of the Announcement in relation to the Share Option Scheme and Board approval. For details of the determination of the exercise price under the Share Option Scheme, please refer to the paragraph headed "3. Exercise price for the Initial Grant of Options and basis of determination" and "4. Exercise price for the Reserved Grant of Options and basis of determination" under the section headed "II. Proposed Grant Under the Share Option Scheme" in the Appendix I to this circular.

LETTER FROM THE BOARD

Rule 17.03(13) of the Hong Kong Listing Rules

According to Rule 17.03(13) of the Listing Rules, a scheme document must include a provision for adjustment of the exercise price or the number of securities subject to options already granted and to the scheme in the event of a capitalisation issue, rights issue, sub-division or consolidation of shares or reduction of capital.

In addition to the events of a capitalisation issue, rights issue, sub-division or consolidation of shares or reduction of capital, the exercise price of the Options shall also be adjusted in the event of distribution of dividend under the Share Option Scheme (the “**Adjustment for Dividend Distribution**”). For details of the determination of the exercise price under the Share Option Scheme, please refer to the paragraph headed “3. Exercise price for the Initial Grant of Options and basis of determination” and “4. Exercise price for the Reserved Grant of Options and basis of determination” under the section headed “II. Proposed Grant Under the Share Option Scheme” in the Appendix I to this circular.

On the basis of, without limitation, the following factors, the Company has applied for, and the Hong Kong Stock Exchange has granted a waiver from strict compliance with Rule 17.03(13) of the Listing Rules in respect of the Adjustment for Dividend Distribution:

- (i) the proposed terms of the Share Option Scheme (including the Adjustment for Dividend Distribution) have been prepared:
 - (a) in accordance with applicable laws, regulations and requirements of regulatory authorities of the PRC (including, without limitation, (a) the Incentive Measures which stipulates the requirements applicable to equity incentive plans adopted by issuers listed on PRC stock exchange (including Shenzhen Stock Exchange); and (b) the provision of “Working Guidelines for Implementation of Share Option Incentive by Listed Companies Controlled by Central Enterprise” (《中央企業控股上市公司實施股權激勵工作指引》 issued by the SASAC (the “**Working Guidelines**”) which stipulates the requirements that must be complied with in respect of equity incentive plans adopted by listed companies controlled by central enterprises); and
 - (b) in line with market practice whereby it is customary for provisions concerning Adjustment for Dividend Distribution to be included in Share Option Schemes involving A Shares.

LETTER FROM THE BOARD

PRC legal advisers to the Company are of the view that the contents of the Scheme Documents (which have been approved by the Board (including the Independent non-executive Directors) are in compliance with the Incentive Measures, the Working Guidelines and the relevant laws and regulations of the PRC and are in line with the market practice in the PRC;

- (ii) the Adjustment of Dividend Distribution would not give rise to an aggregate increase in intrinsic value (being difference between the market price (or theoretical entitlement price) of shares under option and the exercise price (or revised exercise price) of the option) of the outstanding Options but would only have a neutral impact from the perspective of the Participants;
- (iii) according to the applicable laws of the PRC, the issue price of a Share shall not be below the nominal value of the Shares and therefore, the A Shares shall not be issued at less than its nominal value of RMB1 per A Share pursuant to the exercise of the Options in compliance with the note to rule 17.03(13) of the Listing Rules; and
- (iv) the proposed adoption of the Share Option Scheme will be subject to the approval of the Shareholders at the EGM and the Class Meetings. The Company is of the view that the Shareholders, including both the holders of the A Shares and H Shares, will all have the opportunity to fully consider and evaluate the principal terms of the Share Option Scheme, including the Adjustment for Dividend Distribution.

I. Solicitation of votes by Independent Non-executive Directors

Pursuant to the Incentive Measures, independent directors of a company whose securities are listed on the Shenzhen Stock Exchange should solicit votes publicly from its shareholders on resolutions in relation to the adoption of an equity incentive scheme. The purpose of such arrangement is to encourage the securities holders to participate in the voting on the resolutions on the adoption of equity incentive schemes as by providing them with an additional way of participation in the meeting(s) of such securities holders.

As the A Shares of the Company are listed and tradable on the Shenzhen Stock Exchange, the independent non-executive Directors have nominated Mr. Pan Guangcheng to solicit on their behalf Shareholders' votes on all special resolutions in relation to the Scheme Documents to be tabled at the Meetings. No solicitation is made on the other resolutions which are not related to the Scheme Documents.

LETTER FROM THE BOARD

Mr. Pan Guangcheng has for the abovementioned purpose prepared the proxy forms for appointing himself as a proxy at the EGM and the H Shareholders' Class Meeting respectively. Such proxy form specific to the independent non-executive Directors' solicitation of votes were, together with the notice of the EGM and the H Shareholders' Meeting (collectively, the "**Meeting Notice**"), the regular proxy forms (together with the independent non-executive Directors' proxy forms, collectively, the "**Proxy Forms**") and the reply slips in respect of such meetings, despatched by the Company on or around the date of this circular and also published and made available for downloading on the websites of The Stock Exchange of Hong Kong Limited at www.hkex.com.hk and of the Company at <http://www.xhzy.com>. Please refer to the Meeting Notice and the instructions imprinted on the Proxy Forms for details of the solicitation arrangement.

III. CONTINUING CONNECTED TRANSACTIONS

A. Background information

Reference is made to the announcements of the Company dated 22 October 2018 and 30 March 2021, the Announcement in relation to the CCT Agreements and the circular of the Company dated 12 December 2018 and the annual reports of the Company for each of the years ended 31 December 2018, 2019 and 2020.

As the Company expects to continue procuring and supplying certain pharmaceutical related products and drugs from and to certain connected persons (including associates of HHC), the Company has entered into the CCT Agreements with Shandong Lukang, China Shandong Group and Hualu Hengsheng, respectively, on 23 November 2021, to renew the continuing connected transactions contemplated thereunder for a term from 1 January 2022 to 31 December 2024, respectively.

The purpose of this circular is to set out the terms and details of the continuing connected transactions constituted by the CCT Agreements and the respective proposed annual caps in respect of the continuing connected transactions for the years ending 31 December 2022, 2023 and 2024.

LETTER FROM THE BOARD

B. Renewal of the Shandong Lukang Agreement

Reference is made to the announcement of the Company dated 30 March 2021 in relation to the entering into by the Company of a supply of goods and service agreement with Shandong Lukang on even date concerning the purchase of preparation products and bulk drugs by the Group from, and the sale of pharmaceutical intermediaries and bulk drugs and provision of engineering design services by the Group to, Shandong Lukang and/or its subsidiaries over the period commencing from 1 January 2021 to 31 December 2021 (both dates inclusive) (the “**Existing Shandong Lukang Agreement**”). As the Existing Shandong Lukang Agreement shall expire on 31 December 2021, and the transactions contemplated thereunder will continue to be entered into on a recurring basis, the Company has entered into the Shandong Lukang Agreement with Shandong Lukang on 23 November 2021 (after trading hours) to renew the Existing Shandong Lukang Agreement.

The principal terms of the Shandong Lukang Agreement are set out below:

Date

23 November 2021

Parties

1. The Company; and
2. Shandong Lukang

Term

From 1 January 2022 to 31 December 2024 (both dates inclusive), subject to early termination by either party giving the other party at least three (3) months’ prior written notice.

Subject matter

The Company and/or its subsidiaries shall purchase pharmaceutical preparation products and active ingredients (“**APIs**”) from Shandong Lukang and/or its subsidiaries.

The Company and/or its subsidiaries shall sell pharmaceutical intermediaries, APIs as well as provide engineering design services to Shandong Lukang and/or its subsidiaries.

LETTER FROM THE BOARD

Pricing

The price of pharmaceutical preparation products and API to be acquired from, and the price of pharmaceutical intermediaries and APIs and the consideration for engineering design services to be sold to, Shandong Lukang and/or its subsidiaries, shall be determined through arm's length negotiations with Shandong Lukang and/or its subsidiaries with reference to:

- (i) the Pricing Policy; and
- (ii) the prevailing market price charged by independent third parties for comparable products and services.

In any event, the Company shall ensure that the price and consideration charged by Shandong Lukang and/or its subsidiaries or, as applicable, on, Shandong Lukang and/or its subsidiaries, shall be no less favourable to the Company than those entered into by the Company with independent third parties. On such basis, the Company is of the view that the pricing terms based on the above would reflect normal commercial terms or better for the Company.

Historical amounts and proposed annual caps

The following table summarises (i) the historical amounts in respect of the transactions under the Existing Shandong Lukang Agreement; and (ii) the annual caps proposed by the Board in respect of the transactions under the Shandong Lukang Agreement for the years ending 31 December 2022, 2023 and 2024:

	Historical amounts		Proposed annual cap for	
	<i>(RMB'000)</i>		<i>(RMB'000)</i>	
	<i>(unaudited)</i>			
	Nine months from			
	1 January 2021 to	Year ending 31	Year ending 31	Year ending 31
	30 September 2021	December 2022	December 2023	December 2024
Purchase of pharmaceutical preparation products and APIs by the Group from Shandong Lukang and/or its subsidiaries	4,624	12,500	13,500	13,500

LETTER FROM THE BOARD

	Historical amounts		Proposed annual cap for	
	<i>(RMB'000)</i>		<i>(RMB'000)</i>	
	<i>(unaudited)</i>			
	Nine months from			
	1 January 2021 to	Year ending 31	Year ending 31	Year ending 31
	30 September 2021	December 2022	December 2023	December 2024
Sale of pharmaceutical intermediaries, APIs and provisions of engineering design services by the Group to Shandong Lukang and/or its subsidiaries	2,899	6,000	9,000	9,000
Total	7,523	18,500	22,500	22,500

Basis for the proposed annual caps

The proposed annual caps under the Shandong Lukang Agreement was arrived at after taking into account:

- (i) the historical amounts for the transactions between the Group and Shandong Lukang and/or its subsidiaries as disclosed above;
- (ii) the expected demand for products to be purchased by the Group from Shandong Lukang and/or its subsidiaries:
 - (a) based on expected demand from customers of the Group for these products as well as end-products which require the use of these products in their product; and
 - (b) given the expected restoration of supply of raw chemical products necessary for the production of pharmaceutical preparation products and APIs demanded by the Group, the shortage of which hampered the production and supply of relevant products by Shandong Lukang and/or its subsidiaries to the Group in the year ended 31 December 2021 (during which period the Group have had to source the relevant products from independent third parties);

LETTER FROM THE BOARD

- (iii) expected demand of products and services to be supplied by the Group to Shandong Lukang and/or its subsidiaries based on discussions with Shandong Lukang, with consideration given to the expected increase in sales of a certain product to Shandong Lukang and/or its subsidiaries following the expected completion of supplier evaluation of the Group in the year ending 31 December 2023 as part of its new procurement policy adopted and necessitated by the relocation of relevant production plants and equipment in the year ended 31 December 2021;
- (iv) the prevailing market price as well as the market price trend for the relevant products and services to be purchased and/or sold (in particular, the increase in price of supply of a certain product to Shandong Lukang and/or its subsidiaries as agreed under the Shandong Lukang Agreement); and
- (v) the anticipated business volume and production capacity of the Group.

C. Renewal of the China Shandong Agreement

Reference is made to the announcement of the Company dated 30 March 2021 in relation to the entering into by the Company of a sales of goods agreement with China Shandong Group on even date concerning the sale of chemical drug products and chemical products by the Group to China Shandong Group and/or its subsidiaries over the period commencing from 1 January 2021 to 31 December 2021 (both dates inclusive) (the “**Existing China Shandong Agreement**”). As the Existing China Shandong Agreement shall expire on 31 December 2021, and the transactions contemplated thereunder will continue to be entered into on a recurring basis, the Company has entered into the China Shandong Agreement with China Shandong Group on 23 November 2021 (after trading hours) to renew the Existing China Shandong Agreement.

The principal terms of the China Shandong Agreement are set out below:

Date

23 November 2021

Parties

1. The Company; and
2. China Shandong Group

LETTER FROM THE BOARD

Term

From 1 January 2022 to 31 December 2024 (both dates inclusive), subject to early termination by either party giving the other party at least three (3) months' prior written notice.

Subject matter

The Company and/or its subsidiaries shall sell chemical drug products and chemical products to China Shandong Group and/or its subsidiaries.

Pricing

The price of chemical drug products and chemical products to be sold to China Shandong Group and/or its subsidiaries shall be determined through arm's length negotiations with China Shandong Group and/or its subsidiaries with reference to:

- (i) the Pricing Policy; and
- (ii) the prevailing market price charged by independent third parties for comparable products.

In any event, the Company shall ensure that the price charged on China Shandong Group and/or its subsidiaries shall be no less favourable to the Company than those entered into by the Company with independent third parties. On such basis, the Company is of the view that the pricing terms based on the above would reflect normal commercial terms or better for the Company.

LETTER FROM THE BOARD

Historical amounts and proposed annual caps

The following table summarises (i) the historical amounts in respect of the transactions under the Existing China Shandong Agreement; and (ii) the annual caps proposed by the Board in respect of the transactions under the China Shandong Agreement for the years ending 31 December 2022, 2023 and 2024:

	Historical amounts (USD' 000) (unaudited)		Proposed annual cap for (USD' 000)	
	Nine months from 1 January 2021 to 30 September 2021	Year ending 31 December 2022	Year ending 31 December 2023	Year ending 31 December 2024
Sale of chemical drug products and chemical products by the Company to China Shandong Group and/or subsidiaries	4,104	8,000	10,000	11,000

Basis for the proposed annual caps

The proposed annual caps under the China Shandong Agreement was arrived at after taking into account (i) the historical amounts for the transactions between the Group and China Shandong Group and/or its subsidiaries as disclosed above; (ii) the expected demand for the chemical drug products and chemical products to be sold by the Group to China Shandong Group and/or its subsidiaries based on discussions with China Shandong Group; (iii) the prevailing market price as well as market price trend for chemical drug products and chemical products to be sold under the agreement; and (iv) the anticipated business volume and production capacity of the Company.

D. Renewal of the Hualu Hengsheng Agreement

Reference is made to the announcement of the Company dated 22 October 2018 and the circular of the Company dated 12 December 2018 in relation to the entering into by the Company of a purchase agreement with Hualu Hengsheng on 22 October 2018 in relation to the purchase by the Group of chemical raw materials from Hualu Hengsheng over the period commencing from 1 January 2019 to 31 December 2021 (both dates inclusive) (the “**Existing Hualu Hengsheng Agreement**”). As the Existing Hualu Hengsheng Agreement shall expire on 31 December 2021, and the transactions contemplated thereunder will continue to be entered into on a recurring basis, the Company has entered into the Hualu Hengsheng Agreement with Hualu Hengsheng on 23 November 2021 (after trading hours) to renew the Existing Hualu Hengsheng Agreement.

LETTER FROM THE BOARD

The principal terms of the Hualu Hengsheng Agreement are set out below:

Date

23 November 2021

Parties

1. The Company; and
2. Hualu Hengsheng

Term

From 1 January 2022 to 31 December 2024 (both dates inclusive), subject to early termination by either party giving the other party at least three (3) months' prior written notice.

Subject matter

The Company and/or its subsidiaries shall purchase chemical raw materials from Hualu Hengsheng and/or its subsidiaries.

Pricing

The price of chemical raw materials to be purchased from Hualu Hengsheng and/or its subsidiaries shall be determined through arm's length negotiations with Hualu Hengsheng and/or its subsidiaries with reference to:

- (i) the Pricing Policy; and
- (ii) the prevailing market price charged by independent third parties for comparable products.

In any event, the Company shall ensure that the price charged on Hualu Hengsheng and/or its subsidiaries shall be no less favourable to the Company than those entered into by the Company with independent third parties. On such basis, the Company is of the view that the pricing terms based on the above would reflect normal commercial terms or better for the Company.

LETTER FROM THE BOARD

Historical amounts and proposed annual caps

The following table summarises (i) the historical amounts in respect of the transactions under the Existing Hualu Hengsheng Agreement; and (ii) the annual caps proposed by the Board in respect of the transactions under the Hualu Hengsheng Agreement for the years ending 31 December 2022, 2023 and 2024:

	Historical amounts			Proposed annual cap for		
	<i>(RMB'000)</i>			<i>(RMB'000)</i>		
	<i>(unaudited)</i>					
	Year ended 31	Year ended 31	Nine months from	Year ending 31	Year ending 31	Year ending 31
	December 2019	December 2020	1 January to 30	December 2022	December 2023	December 2024
			September 2021			
Purchase of chemical raw materials by the Group from Hualu Hengsheng and/or its subsidiaries	139,108	127,345	140,489	257,000	234,000	234,000

Basis for the proposed annual caps

The proposed annual cap under the Hualu Hengsheng Agreement was arrived at after taking into account (i) the historical amounts for the transactions between the Group and Hualu Hengsheng and/or its subsidiaries as disclosed above; (ii) the expected demand for the chemical raw materials to be purchased by the Group from Hualu Hengsheng and/or its subsidiaries based on expected demand from customers of the Group for end-products which require the use of relevant chemical raw materials; (iii) the prevailing market price as well as market price trend for chemical raw materials to be purchased under the agreement; and (iv) the anticipated business volume and production capacity of the Company.

LETTER FROM THE BOARD

E. Pricing policy

The Pricing Policy for the transactions contemplated under each of the CCT Agreements is summarised in the following table:

<i>Relevant transactions in relation to purchase of products</i>	<i>Pricing policy</i>
<ul style="list-style-type: none">purchase of pharmaceutical preparation products and APIs by the Company from Shandong Lukang under the Shandong Lukang Agreement	The prices and terms in respect of any purchase of products by the Group shall be negotiated on an arm's length basis with relevant counterparties taking into account the prevailing market price of the same or substantially similar products announced by at least two independent third parties in the same period which offer the same or substantially similar products in the same or nearby areas through inquiries via websites.
<ul style="list-style-type: none">purchase of chemical raw materials by the Company from Hualu Hengsheng under the Hualu Hengsheng Agreement	

<i>Relevant transactions in relation to sale of products</i>	<i>Pricing policy</i>
<ul style="list-style-type: none">sale of pharmaceutical intermediaries, APIs and by the Company to Shandong Lukang under the Shandong Lukang Agreement	The prices and terms for any sale of products, chemical materials and/or provision of utility from the Group will be negotiated on arm's length basis with relevant counterparties taking into account and/or with reference to the following:
<ul style="list-style-type: none">sale of chemical drug products and chemical products by the Company to China Shandong Group under the China Shandong Agreement	(i) the actual costs incurred plus a reasonable profit margin (with reference to the general range of profit in the industry).

LETTER FROM THE BOARD

*Relevant transactions in relation to
sale of products*

Pricing policy

The Company will refer to the historical average price for the relevant products and profit margins of comparable products and services disclosed by at least two other PRC listed companies to determine whether the profit margin charged is in line with the industry.

In this regard, some PRC listed companies publish profit margins of their principal goods and services on the Shanghai Stock Exchange, the Shenzhen Stock Exchange or domestic bond markets (including but not limited to the inter-bank market of the PRC operated by the National Association of Financial Market Institutional Investors), from which the Company is able to draw references. As information are categorised by the industry and the region in the PRC, the Company will select and refer to profit margins of comparable products and services in the same or nearby areas or in the PRC (to the extent available) to determine whether the profit margin charged is in line with the industry.

- (ii) the demand and supply in the market for the relevant products and the urgency of the orders from counterparties at the relevant time will be considered in determining the final transaction price.

LETTER FROM THE BOARD

***Relevant transactions in relation to
provision of engineering design services***

Pricing policy

- provision of engineering design services by the Company to Shandong Lukang under the Shandong Lukang Agreement
- The determination of the service fees chargeable by the Group on relevant counterparties will be negotiated on arm's length basis with the counterparties taking into account and/or with reference to the following:
- (i) the urgency of the requested services to be provided;
 - (ii) the estimated man-hours and/or man-days of the human resources required to provide the relevant services;
 - (iii) the materiality and complexity of the proposed services to be provided; and
 - (iv) the fees charged for historical transactions of similar nature.

LETTER FROM THE BOARD

F. Internal controls

To ensure that the continuing connected transactions contemplated under the CCT Agreements will be conducted on normal commercial terms and not prejudicial to the interests of the Company and its public shareholders, the Company has adopted the following internal control procedures:

- (i) the management of the Company will hold meetings to discuss and consider the terms and conditions and the pricing mechanism of each transaction contemplated under the CCT Agreements before entering into such transactions to ensure that they are on normal commercial terms;
- (ii) the finance department of the Company shall review the relevant transactions on a monthly basis and submit the relevant information (including, but not limited to, historical and actual transaction amounts) to the Board for review to ensure, without limitation, that the relevant transactions are conducted in accordance with the terms of the CCT Agreements, that the annual caps (as applicable) have not been exceeded, and that the pricing mechanism has been effectively implemented; and
- (iii) the independent non-executive Directors and the auditors of the Company will conduct annual review on the continuing connected transactions contemplated under the CCT Agreements to confirm that the pricing mechanisms and annual caps remain fair and reasonable, and provide confirmation of the same annually in the annual report of the Company in accordance with the Listing Rules.

G. Reasons for and benefits of the continuing connected transactions

By entering into the Shandong Lukang Agreement, the Company and/or its subsidiaries is able to expand their sales channels by selling pharmaceutical intermediates and APIs to Shandong Lukang and/or its subsidiaries. The purchase of pharmaceutical preparation products and APIs from Shandong Lukang and/or its subsidiaries enables the Company to distribute such products to medical institutions on a large scale in the Luzhong region (the surrounding areas of the Company) and to meet the Company's production needs. The provision of engineering design service to Shandong Lukang and/or its subsidiaries can enable the Company to utilise its pharmaceutical engineering capabilities as well as product and solution innovation experience in the pharmaceutical industry.

By entering into the China Shandong Agreement, the Company and/or its subsidiaries is able to scale up the international sales of its products and expand its business into international markets, as well as secure a stable source of income from the sale of its products.

LETTER FROM THE BOARD

By entering into the Hualu Hengsheng Agreement, the Company is able to minimise procurement costs by reducing intermediate layers, as well as secure a steady supply of chemical products without incurring extra costs by purchasing them through other third parties.

H. Listing Rules Implications

Connected persons of the Company

Each of Shandong Lukang (the board of which is controlled by HHC), China Shandong Group (the issued share capital of which is held as to 99.75% by HHC) and Hualu Hengsheng (the issued share capital of which is indirectly held as to approximately 32.19% by HHC) are associates of HHC, the controlling shareholder of the Company, and are therefore connected persons of the Company under Chapter 14A of the Listing Rules. The CCT Agreements therefore constitute continuing connected transactions of the Company.

Listing Rules implications concerning CCT Agreements

Since the Shandong Lukang Agreement, the China Shandong Agreement and the Hualu Hengsheng Agreement are of a similar nature and have been entered into by the Company with the parties which are connected with each other within a 12-month period, the Directors consider that the transactions contemplated under the CCT Agreements should be aggregated as if they were one transaction pursuant to Rule 14A.81 of the Listing Rules.

As the applicable percentage ratios (other than the profits ratio) under the Listing Rules for the transactions contemplated under the CCT Agreements calculated on an aggregated basis pursuant to Rule 14A.81 of the Listing Rules exceed 5% on an annual basis, the transactions contemplated under the CCT Agreements constitute non-exempt continuing connected transactions and are subject to the reporting, announcement, circular (including independent financial advice), annual review, annual caps, the Independent Shareholders' approval and other requirements under Chapter 14A of the Listing Rules.

I. Information of the parties to the CCT Agreements

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 Shenzhen Stock Exchange respectively. The Company is principally engaged in the development, manufacture and sale of bulk pharmaceuticals, preparations and chemical products. The ultimate beneficial owner of the Company is the State-owned Assets Supervision and Administration Commission of the State Council of Shandong province.

LETTER FROM THE BOARD

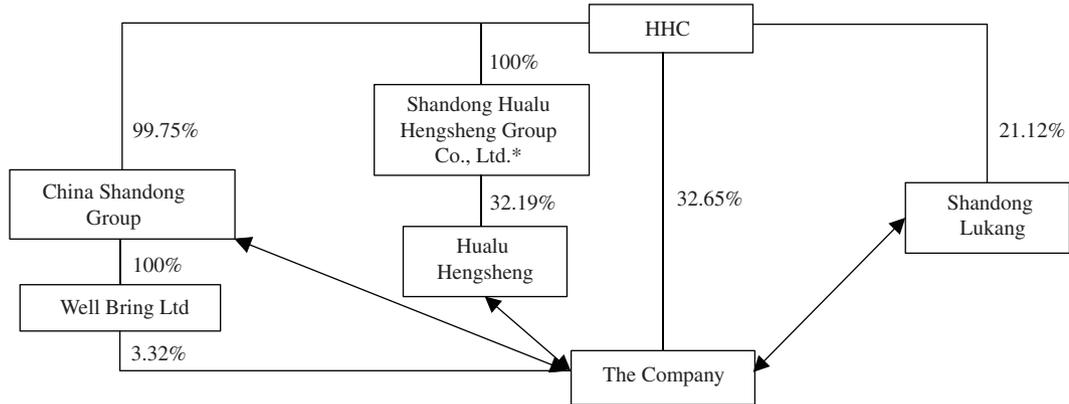
HHC is a state-owned enterprise principally engaged in investment holding of various listed public companies (listed on the stock exchanges of the Mainland China and Hong Kong) and private companies, and is the controlling shareholder of the Company).

Shandong Lukang is a company incorporated in the PRC with limited liability and its principal businesses include, among others, manufacturing, processing and sales of chemical raw materials and preparations products for pharmaceutical production, auxiliary materials and intermediates, veterinary drugs, pharmaceutical packaging products and feed additives.

China Shandong Group is a company incorporated in Hong Kong with limited liability and its principal businesses include project investment and import and export trade.

Hualu Hengsheng is a company incorporated in the PRC with limited liability and its principal businesses include, the production and sales of chemical products. The company's main businesses include the production and sales of chemicals and chemical fertilizers, as well as the electricity generation and heating supply businesses.

As of the date of this circular, the following chart shows the shareholding relationship between the Group and each of Shandong Lukang, China Shandong Group and Hualu Hengsheng:



* For indication only

LETTER FROM THE BOARD

J. Approval by the Board

The Board (including the independent non-executive Directors, but excluding Mr. Cong Kechun who has abstained from voting in respect of the CCT Agreements) (the “**Interested Director**”) who is considered to have a material interest in the CCT Agreements due to his respective directorships or capacities as a member of the management of a subsidiary of HHC) have considered and reviewed the terms and provisions of the CCT Agreements and are of the view and resolved, in a duly convened meeting of the Board, that the CCT Agreements have been entered into on an arm’s length basis and in the ordinary and usual course of business, and that the transactions contemplated thereunder and the relevant proposed annual caps are on normal commercial terms, fair and reasonable and in the interests of the Company and its shareholders as a whole.

Other than the Interested Director, none of the other Directors has any material interest in the CCT Agreements and were required to abstain from voting, or abstained from voting, on the relevant resolutions of the Board concerning approval of the CCT Agreements.

K. Approval by Independent Shareholders

Approval of the Independent Shareholders on the CCT Agreements, their respective annual caps and the continuing connected transactions contemplated thereunder will be sought at the EGM by way of ordinary resolutions. In view of the direct or indirect interests of HHC and/or its associates in the CCT Agreements and transactions contemplated thereunder, HHC and its associates will abstain from the resolutions for approving the CCT Agreements, their respective annual caps and the continuing connected transactions contemplated thereunder at the EGM. The IBC has been established to advise the Independent Shareholders on the CCT Agreements and the proposed annual caps in relation to the relevant continuing connected transactions contemplated thereunder. Further, the Company has appointed an Independent Financial Adviser to advise the IBC and the Independent Shareholders on the terms of and the proposed annual caps in relation to the continuing connected transactions under the CCT Agreements. A letter from the IBC containing its recommendations is set out on page 31 of this circular.

Altus Capital Limited, a corporation licensed to carry out type 4 (advising on securities), type 6 (advising on corporate finance) and type 9 (asset management) regulated activity under the SFO, has been appointed by the Company as the Independent Financial Adviser to advise the IBC and the Independent Shareholders on the CCT Agreements. A letter from the Independent Financial Adviser containing its advice to the IBC and the Independent Shareholders is set out on pages 32 to 55 of this circular.

LETTER FROM THE BOARD

The IBC, having taken into account the advice of and the principal factors and reasons considered by the Independent Financial Adviser and the interest of the Independent Shareholders, considers the CCT Agreements and their respective annual caps and the continuing connected transactions contemplated thereunder are fair and reasonable and are in the interests of the Company and the Shareholders as a whole. Accordingly, the IBC recommends the Independent Shareholders to vote in favour of the relevant resolutions at the EGM to approve the CCT Agreements.

IV. EGM AND CLASS MEETINGS

1. The Proposed Share Option Scheme

The proposed resolutions in relation to the Scheme Documents are subject to, among other things, obtaining approval by way of special resolutions of Shareholders at a general meeting and of the H Shareholders and A Shareholders at their respective class meetings. It is therefore proposed that the EGM and the Class Meetings be convened to propose resolutions to vote, among other things, to approve the abovementioned resolutions.

All eligible Participants under the Share Option Scheme and any of their respective associates must abstain from voting at the EGM and Class Meetings. As such, each of the Directors who are eligible Participants under the proposed Share Option Scheme (i.e. Mr. Zhang Daiming, Mr. Du Deping, Mr. He Tongqing and Mr. Xu Lie) will abstain from voting at the EGM and, if applicable, the Class Meetings.

2. The CCT Agreements

The CCT Agreements, their respective annual caps and the continuing connected transactions contemplated thereunder are subject to the approval of the Independent Shareholders by way of ordinary resolutions at the EGM. Any Shareholder with a material interest in the CCT Agreements or continuing connected transactions thereunder will not vote on the relevant resolutions at the EGM.

In view of the direct or indirect interests of HHC and/or its associates in the CCT Agreements and transactions contemplated thereunder, HHC and its associates will abstain from the resolutions for approving the CCT Agreements, their respective annual caps and transactions contemplated thereunder at the EGM.

Save as disclosed above, to the best knowledge and belief of the Directors, none of the Shareholders would be required to abstain from voting on the proposed resolutions at the EGM and the Class Meetings.

LETTER FROM THE BOARD

The following documents were despatched by the Company to Shareholders on or around the date of this circular, and have been published and made available for downloading on the websites of Hong Kong Stock Exchange at <http://www.hkex.com.hk> and of the Company at <http://www.xhzy.com>:

- (i) the Meeting Notice convening the EGM and the H Shareholders' Class Meeting to be held at the conference room of the Company at No. 1 Lutai Ave., Hi-tech District, Zibo City, Shandong Province, PRC on 31 December 2021, Friday at 2:00 p.m. and 4:00 p.m. (or immediately after the conclusion or adjournment of the A Shareholders' Class Meeting of even date at the same venue) respectively; and
- (ii) the Proxy Forms for use at and the reply slips in relation to the EGM and the H Shareholders' Class Meetings.

As disclosed in the Meeting Notice, for the purpose of determining the H Shareholders entitled to attend and vote at the EGM and the H Shareholders' Class Meeting, the register of members of the H Shares of the Company has been scheduled to close from 17 December to 31 December 2021 (both days inclusive), during which period no transfer of H Share will be registered. Shareholders whose names appear on the register of members of the H Shares of the Company kept with the Hong Kong Registrars Limited at 4:30 p.m. on Thursday, 16 December 2021 are entitled to attend the EGM and the H Shareholders' Class Meeting. Whether or not you intend to attend, we encourage you to complete and return the Proxy Forms in accordance with the instructions printed thereon as soon as possible and in any event not less than 24 hours prior to the respective commencements of such meetings (or any adjournments thereof). For the corresponding arrangements applicable to the A Shareholders, please refer to the meeting notices to A Shareholders with which the relevant forms of proxy and reply slips were enclosed, as published by the Company on the website of the Shenzhen Stock Exchange on or around the date of this circular.

LETTER FROM THE BOARD

V. RECOMMENDATIONS

1. The Proposed Share Option Scheme

Having considered the following provisions and proposed arrangements in respect of the Share Option Scheme (as further described in Appendices I and II to this circular), the Directors are of the view that the terms of the Scheme Documents would serve its intended objectives for the reasons stated:

- (i) the following terms of the Share Option Scheme are intended to encourage eligible Participants' to remain employed with, and provide valuable services to, the Group:
 - (a) Options that are Granted would only become exercisable after they become vested commencing a minimum of 24-months from the Grant Date, during which they must remain employed with the Group;
 - (b) Options that are Granted would vest in three approximately equal tranches (on each of the dates falling 24 months, 36 months and 48 months from the Grant Date); and
 - (c) any outstanding Options which has not been vested will be cancelled if a Participant resigns or is discharged from employment relationship with the Group (other than in the event of certain stipulated circumstances, such as ceasing to hold office due to reaching statutory retirement age, death or loss of civil capacity).
- (ii) the Exercise Conditions that must be met for Options granted to become exercisable in the applicable Exercisable Periods are designed to incentivise Participants to deliver (i) outstanding work performance in order to meet the targets of their individual assessment; and (ii) financial performance of the Group in order to meet target financial benchmarks (measured in terms of net profits and growth rate of dividend per Share) of the Company. Such Exercise Conditions therefore effectively aligns the interests of the Company and its Shareholders, on the one hand, with the interests of Participants (who are responsible for business and operations and dedicated to delivering sustainable growth and long-term development of the Company), on the other; and

LETTER FROM THE BOARD

- (iii) the fact that the exercise price of the Options are set at a price that is no lower than the historical trading prices of underlying Shares prior to the date of the Announcement in relation to the Share Option Scheme or the most recent audited net assets per Share preceding the Grant would mean that the Options would remain of no value shall the Group not record any growth or depreciates in value as from the Grant Date. Conversely, the value of Options would be expected to appreciate if the underlying Share price increase in the event of an increase in value of the Company. This will further ensure that Participants will be incentivised to focus on delivering financial performance with regard to the long-term interests of the Company.

For the foregoing reasons, the Board (including Independent Non-executive Directors) considers that the proposed resolutions set out above (including the adoption of the Share Option Scheme) are in the interests of the Company and the Shareholders as a whole. Accordingly, the Board recommends that Shareholders eligible to vote at the EGM and the Class Meetings to attend and vote in favour of the resolutions.

2. The CCT Agreements, their respective annual caps and the continuing connected transactions contemplated thereunder

The IBC, having taken into account the advice from the Independent Financial Adviser, considers the CCT Agreements, their respective annual caps and the continuing connected transactions contemplated thereunder fair and reasonable and are in the interests of the Company and the Shareholders as a whole. Accordingly, the IBC would recommend the Independent Shareholders to vote in favour of the relevant resolutions at the EGM to approve the CCT Agreements, their respective annual caps and the continuing connected transactions contemplated thereunder.

Yours faithfully,

By Order of the Board
Shandong Xinhua Pharmaceutical Company Limited
Zhang Daiming
Chairman

LETTER FROM THE INDEPENDENT BOARD COMMITTEE



山東新華製藥股份有限公司
Shandong Xinhua Pharmaceutical Company Limited

(a joint stock company established in the People's Republic of China with limited liability)

(Stock Code: 00719)

15 December 2021

To the Independent Shareholders

Dear Sir or Madam,

We have been appointed as members of the IBC to advise the Independent Shareholders of the Company on the CCT Agreements, their respective annual caps and the continuing connected transactions contemplated thereunder, of which details are set out in the letter from the Board contained in the circular of the Company (the “**Circular**”) of which this letter forms part. Unless the context otherwise requires, terms defined in the Circular shall have the same meanings when used in this letter.

Your attention is drawn to the letter from the Board and the advice of Altus Capital Limited in its capacity as the Independent Financial Adviser in respect of whether the CCT Agreements, their respective annual caps and the continuing connected transactions contemplated thereunder are on normal commercial terms, fair and reasonable and in the interests of the Company and its Shareholders as a whole, as set out in the letter from the Independent Financial Adviser and in the Circular.

Having taken into account the advice of and the principal factors and reasons considered by the Independent Financial Adviser in relation thereto as stated in its letter and the interests of the Independent Shareholders, we consider the CCT Agreements, their respective annual caps and the continuing connected transactions contemplated thereunder fair and reasonable and are in the interests of the Company and the Shareholders as a whole. Accordingly, we recommend the Independent Shareholders to vote in favour of the ordinary resolutions to be proposed at the EGM in respect of the CCT Agreements, their respective annual caps and the continuing connected transactions contemplated thereunder.

The Independent Board Committee

Mr. Lo Wah Wai

Mr. Pan Guangcheng

Mr. Zhu Jianwei

Independent non-executive Directors

LETTER FROM THE INDEPENDENT FINANCIAL ADVISER

The following is the text of a letter of advice from the Independent Financial Adviser to the IBC and the Independent Shareholders in relation to the CCT Agreements, their respective annual caps and the continuing connected transactions contemplated thereunder, which has been prepared for the purposes of incorporation in this circular.

ALTUS .

Altus Capital Limited
21 Wing Wo Street
Central
Hong Kong

15 December 2021

To the IBC and the Independent Shareholders

Shandong Xinhua Pharmaceutical Company Limited
No. 1 Lutai Ave.
Hi-tech Industry Development Zone
Zibo City
Shandong Province
PRC

Dear Sirs,

RENEWAL OF CONTINUING CONNECTED TRANSACTIONS

INTRODUCTION

We refer to our appointment as the Independent Financial Adviser to advise the IBC and the Independent Shareholders on the terms of and the proposed annual caps in relation to the continuing connected transactions under the CCT Agreements. Details of which are set out in the “Letter from the Board” contained in the circular of the Company dated 15 December 2021 (the “**Circular**”). Terms used in this letter shall have the same meanings as those defined in the Circular unless the context requires otherwise.

As the Company and/or its subsidiaries expects to continue procuring and supplying certain pharmaceutical related products and drugs from and to certain connected persons (including associates of HHC), the Company has entered into the CCT Agreements with Shandong Lukang, China Shandong Group and Hualu Hengsheng, respectively, on 23 November 2021, to renew the continuing connected transactions contemplated thereunder for a term from 1 January 2022 to 31 December 2024, respectively.

LETTER FROM THE INDEPENDENT FINANCIAL ADVISER

LISTING RULES IMPLICATIONS

Each of Shangdong Lukang (the board of which is controlled by HHC), China Shandong Group (the issued share capital of which is held as to 99.75% by HHC) and Hualu Hengsheng (the issued share capital of which is indirectly held as to approximately 32.19% by HHC) are associates of HHC, the controlling shareholder of the Company and are therefore connected persons of the Company. The CCT Agreements therefore constitute continuing connected transactions of the Company.

Given that the Shandong Lukang Agreement, the China Shandong Agreement and the Hualu Hengsheng Agreement are of a similar nature and have been entered into by the Company with the parties which are connected with each other within a 12-month period, the Directors consider that the transactions contemplated under these Agreements should be aggregated as if they were one transaction pursuant to Rule 14A.81 of the Listing Rules.

As the applicable percentage ratios (other than the profits ratio) under the Listing Rules for the transactions contemplated under the CCT Agreements calculated on an aggregated basis pursuant to Rule 14A.81 of the Listing Rules exceed 5% on an annual basis, the transactions contemplated under the CCT Agreements constitute non-exempt continuing connected transactions and are subject to the reporting, announcement, circular (including independent financial advice), annual review, annual caps, Independent Shareholders' approval and other requirements under Chapter 14A of the Listing Rules.

THE IBC

The IBC comprising all the independent non-executive Directors, namely Mr. Pan Guangcheng, Mr. Zhu Jianwei and Mr. Lo Wah Wai, has been established to advise the Independent Shareholders on (i) whether the terms of the continuing connected transactions under the CCT Agreements are on normal commercial terms and are fair and reasonable; (ii) whether the continuing connected transactions under the CCT Agreements are in the interests of the Company and the Shareholders as a whole and are conducted in the ordinary and usual course of business of the Group; and (iii) how the Independent Shareholders should vote in respect of the resolutions to approve the continuing connected transactions under the CCT Agreements at the EGM, taking into account the recommendation of the Independent Financial Adviser.

THE INDEPENDENT FINANCIAL ADVISER

As the Independent Financial Adviser to the IBC and the Independent Shareholders, our role is to give an independent opinion to the IBC and the Independent Shareholders on (i) whether the terms of the continuing connected transactions under the CCT Agreements are on normal commercial terms and are fair and reasonable; (ii) whether the continuing connected transactions under the CCT Agreements are in the interests of the Company and the Shareholders as a whole and are conducted in the ordinary and usual course of business of the Group; and (iii) how the Independent Shareholders should vote in respect of the relevant resolutions to approve the CCT Agreements at the EGM.

LETTER FROM THE INDEPENDENT FINANCIAL ADVISER

We have not acted as independent financial adviser in relation to any transactions of the Company in the last two years prior to the date of the Circular. Pursuant to Rule 13.84 of the Listing Rules, and given that remuneration for our engagement to opine on the continuing connected transactions under the CCT Agreements is at market level and not conditional upon successful passing of the resolution to be proposed at the EGM, and that our engagement is on normal commercial terms, we are independent of and not associated with the Company, its controlling shareholder(s) or connected person(s).

BASIS OF OUR ADVICE

In formulating our opinion, we have reviewed, amongst others, (i) announcement of the Company dated 22 October 2018, 30 March 2021 and 23 November 2021; (ii) the circular of the Company dated 12 December 2018; (iii) the annual reports of the Company for each of the years ended 31 December 2018, 2019 and 2020; (iv) the interim report of the Company for the six months ended 30 June 2021 (the “**2021 Interim Report**”); (v) full invoice list for transactions under the Hualu Hengsheng Agreement for the two years ended 31 December 2020 and the nine months ended 30 September 2021; (vi) full invoice list for transactions under the Shandong Lukang Agreement and the China Shandong Agreement for the nine months ended 30 September 2021; (vii) sample invoices and purchase orders under the CCT Agreements for the relevant periods; and (viii) Company’s internal sales target for the year ending 31 December 2021.

We have also relied on the statements, information, opinions and representations contained or referred to in the Circular and/or provided to us by the Company, the Directors and the management of the Group (the “**Management**”). We have assumed that all the statements, information, opinions and representations for matters relating to the Group contained or referred to in the Circular and/or provided to us by the Company, the Directors and the Management were reasonably made after due and careful enquiry and were true, accurate and complete at the time they were made and continued to be so as at the date of the Circular.

We have no reason to believe that any of such statements, information, opinions or representations are untrue, inaccurate or misleading, nor are we aware of any material facts the omission of which would render them untrue, inaccurate or misleading.

We consider that we have been provided with, and have reviewed, sufficient information to reach an informed view and provide a reasonable basis for our opinion in accordance with Rule 13.80 of the Listing Rules. We have not, however, conducted an independent investigation into the business, financial conditions and affairs or future prospects of the Group.

LETTER FROM THE INDEPENDENT FINANCIAL ADVISER

PRINCIPAL FACTORS AND REASONS CONSIDERED

1. BACKGROUND INFORMATION

1.1 Principal business of the Company

The Company is a joint stock limited company incorporated in the PRC with its H shares and A shares listed on the Stock Exchange and Shenzhen Stock Exchange respectively. The Company is principally engaged in the development, manufacture and sale of bulk pharmaceuticals, preparations and chemical products. The ultimate beneficial owner of the Company is the State-owned Assets Supervision and Administration Commission of the State Council of Shandong province.

1.2 Principal business of HHC

HHC is a state-owned enterprise principally engaged in investment holding of various companies listed or not listed on the stock exchanges of the Mainland China and Hong Kong, and is the controlling shareholder of the Company.

1.3 Principal business of Shandong Lukang

Shandong Lukang is a company incorporated in the PRC with limited liability and its principal business include, among others, manufacturing, processing and sales of chemical raw materials and preparations products for pharmaceutical production, auxiliary materials and intermediates, veterinary drugs, pharmaceutical packaging products and feed additives.

1.4 Principal business of China Shandong

China Shandong is a company incorporated in Hong Kong with limited liability and its principal business include project investment and import and export trade.

1.5 Principal business of Hualu Hengsheng

Hualu Hengsheng is a company incorporated in the PRC with limited liability and its principal businesses include, the production and sales of chemical products. Its main businesses include the production and sale of chemicals and chemical fertilizers, as well as the electricity generation and heating supply business.

LETTER FROM THE INDEPENDENT FINANCIAL ADVISER

1.6 *Financial performance of the Group*

The Group is mainly engaged in the development, manufacturing and sale of chemical bulk drugs, including active pharmaceutical ingredients (“APIs”), preparations and medical intermediates and other products.

The table below sets out the financial performance of the Group during the financial year ended 31 December (“FY”) 2020 and 2019, as well as the 6-month ended (“1H”) 2021 and 2020.

	FY2020	FY2019	1H2021	1H2020
	<i>RMB million</i>	<i>RMB million</i>	<i>RMB million</i>	<i>RMB million</i>
Operating income	6,005.6	5,606.0	3,551.0	3,285.8
Net profits attributable to shareholders after deduction of non-recurring profit and loss	290.8	258.6	185.9	154.3

The Group’s operating income increased by 7.1% to approximately RMB6,005.6 million in FY2020 due mainly to increased sales of chemical bulk drugs, and in particular, the 33.4% growth in sales of medical intermediate and other products. Due to continued control on sales expenses and market development and terminal sales costs, the Group’s selling expenses decreased by 20.0%. In line with improvement in operating income and lower selling expenses, the Group’s net profits attributable to shareholders after deduction of non-recurring profit and loss increased by 12.5% from approximately RMB258.6 million in FY2019 to approximately RMB290.8 million in FY2020.

Comparing 1H2021 and 1H2020, the Group recorded increases in operating income of 8.1% to approximately RMB3,551.0 million, underpinned by income growth of preparations and, in particular, medical intermediate and other products. In line with the higher operating income, the Group’s net profits attributable to shareholders after deduction of non-recurring profit and loss increased by 20.5% from approximately RMB154.3 million in 1H2020 to approximately RMB185.9 million in 1H2021.

1.7 *Prospects of the Group*

As set out in the Company’s annual report for the year ended 31 December 2020, the Management believes that the domestic big circulation in the PRC and dual circulations of domestic and international complementing each other are becoming the new development pattern, which creates more development opportunities for enterprises. The introduction of

LETTER FROM THE INDEPENDENT FINANCIAL ADVISER

various preferential policies and acceleration of population aging and urbanisation, coupled with the enhancement of public health awareness and national health insurance coverage and payment capabilities, the Management expected that the demand for medicine will continue to grow rapidly. As such, the bio-pharmaceutical industry is strategically poised to maintain a rapid development.

However, the Management also noted that the global landscape is facing more instabilities and uncertainties. The Company is facing challenges such as the COVID-19 pandemic, rising of de-globalisation, RMB appreciation and skyrocketing prices for international transportation. The intensified competition in the pharmaceutical market as well as the rising price of basic chemical raw materials are also impacting the Group's profitability.

As set out in the 2021 Interim Report, the Management expects that the COVID-19 pandemic is expected to continue to affect the world for some time in the future. The international freight rates will continue to run high and the exchange rates will be fluctuating, putting greater pressure on the export of Company's products. As it is difficult for the Company to pass on the cost by increasing the price of its products, the Management expects the high price of bulk commodities will slow down the improvement of the Company's profitability. Nevertheless, given the development of the Group's characteristic chemical APIs maintains a rapid pace, the market share of strategic formulations continues to increase, international cooperation projects for formulations and commercial production are rapidly advancing. The Management believes that the Group will be able to overcome numerous difficulties and maintain a strong momentum for development.

In response to the challenging environment, the Group will continue to capture market opportunities and strive for market initiative by implementing a proactive price strategy to ensure the stability of the bulk API market, as well as promoting multiple series of speciality products. The Group will also fully leverage its leading role in the market and continue to capture more market share, in particular in areas such as featured bulk drugs such as EPA and carbidopa.

We note that the continuing connected transactions under the CCT Agreements which involve purchase and sales of chemical products and APIs, forms part of the strategy above and is in line with the overall plan of the Group. We also note that the increasing trend of the proposed annual caps is consistent with the operating income growth recorded by the Group since FY2019.

LETTER FROM THE INDEPENDENT FINANCIAL ADVISER

2. RATIONALE FOR THE CONTINUING CONNECTED TRANSACTIONS

With reference to the “Letter from the Board”, the Directors believe that it is in the best interest of the Group to enter into transactions under the CCT Agreements with Shandong Lukang, China Shandong and Hualu Hengsheng, respectively.

As set out in the “Letter from the Board”, the Directors are of the view that, by entering into the Shandong Lukang Agreement, the Group will sell its pharmaceutical intermediates and APIs to Shandong Lukang and/or its subsidiaries, which allows the Group to expand its sales channels. The Company also will purchase pharmaceutical preparation products and APIs from Shandong Lukang and/or its subsidiaries, which enables the Group to increase its scale of distribution to medical institutions in Luzhong region (the surrounding areas of the Company) as well as to meet its own production needs. Furthermore, the Company will provide engineering design service to Shandong Lukang and/or its subsidiaries, and therefore the Company can utilise its pharmaceutical engineering capabilities and its product and solution innovation experience in the pharmaceutical industry.

As set out in the “Letter from the Board”, the Directors are of the view that, by entering into the China Shandong Agreement, the Group will sell chemical raw materials and products to China Shandong and/or its subsidiaries. Such transactions between the Group and China Shandong and/or its subsidiaries enable the Group to increase its international sales so as to expand its business into international markets. Other than that, it also allows the Group to secure a stable source of income from selling those materials and products.

As set out in the “Letter from the Board”, the Directors are of the view that, by entering into the Hualu Hengsheng Agreement, the Company will purchase chemical products from Hualu Hengsheng. Purchasing chemical products from Hualu Hengsheng helps the Company minimise procurement costs by reducing intermediate layers and secure a steady supply without additional costs which might be incurred by buying from other third parties.

Furthermore, we understand from the Management that the Group also sells chemical raw materials and products, pharmaceutical intermediates and APIs to, as well as purchase pharmaceutical preparation products and APIs from independent third parties. As such, the transactions contemplated under the CCT Agreements are in the ordinary and usual course of business of the Group.

Based on the abovementioned rationale for entering the CCT Agreements, we concur with the Directors that the transactions contemplated under the CCT Agreements are conducted in the ordinary and usual course of business of the Group and in the interests of the Company and the Shareholders as a whole.

LETTER FROM THE INDEPENDENT FINANCIAL ADVISER

3. PRINCIPAL TERMS OF THE CCT AGREEMENTS

(i) *The Shandong Lukang Agreement*

Pursuant to the Shandong Lukang Agreement, the Group shall purchase pharmaceutical preparation products and active pharmaceutical ingredients from Shandong Lukang and/or its subsidiaries, while the Group shall sell pharmaceutical intermediaries, active pharmaceutical ingredients as well as provide engineering design services to Shandong Lukang and/or its subsidiaries.

The term of the Shandong Lukang Agreement is from 1 January 2022 to 31 December 2024 (both dates inclusive), subject to early termination by either party giving the other party at least three months' prior written notice.

We have reviewed the Shandong Lukang Agreement and noted that the transactions contemplated thereunder shall be conducted on normal commercial terms and on terms no less favourable to the Company than those available to or from other independent third parties. We also noted that the Shandong Lukang Agreement does not restrict the Group from conducting similar transactions with any other independent third parties. As such, we are of the view that the terms of the Shandong Lukang Agreement are fair and reasonable. For details of other terms of the Shandong Lukang Agreement, please refer to the "Letter from the Board" in the Circular.

(ii) *The China Shandong Agreement*

Pursuant to the China Shandong Agreement, the Group shall sell chemical drug products and chemical products to China Shandong and/or its subsidiaries.

The term of the China Shandong Agreement is from 1 January 2022 to 31 December 2024 (both dates inclusive), subject to early termination by either party giving the other party at least three months' prior written notice.

We have reviewed the China Shandong Agreement and noted that the transactions contemplated thereunder shall be conducted on normal commercial terms and on terms no less favourable to the Company than those available to other independent third parties. We also noted that the China Shandong Agreement does not restrict the Group from conducting similar transactions with any other independent third parties. As such, we are of the view that the terms of the China Shandong Agreement are fair and reasonable. For details of other terms of the China Shandong Agreement, please refer to the "Letter from the Board" in the Circular.

LETTER FROM THE INDEPENDENT FINANCIAL ADVISER

(iii) The Hualu Hengsheng Agreement

Pursuant to the Hualu Hengsheng Agreement, the Group shall purchase chemical raw materials from Hualu Hengsheng and/or its subsidiaries.

The term of the Hualu Hengsheng Agreement is from 1 January 2022 to 31 December 2024 (both dates inclusive), subject to early termination by either party giving the other party at least three months' prior written notice.

We have reviewed the Hualu Hengsheng Agreement and noted that the transactions contemplated thereunder shall be conducted on normal commercial terms and on terms no less favourable to the Company than those available from other independent third parties. We also noted that the Hualu Hengsheng Agreement does not restrict the Group from conducting similar transactions with any other independent third parties. As such, we are of the view that the terms of the Hualu Hengsheng Agreement are fair and reasonable. For details of other terms of the Hualu Hengsheng Agreement, please refer to the "Letter from the Board" in the Circular.

4. PRICING POLICY

Pursuant to the CCT Agreements, the price will be determined through arm's length negotiations with reference to (i) the respective Pricing Policy; and (ii) the prevailing market price charged by independent third parties for comparable products and/or services. In any event, the price shall not be less favourable to the Company than those entered into by the Company with independent third parties.

The Pricing Policy for the transactions contemplated under each of the CCT Agreements is summarised in the table below:

<i>Relevant transactions in relation to purchase of products</i>	<i>Pricing policy</i>
<ul style="list-style-type: none">purchase of pharmaceutical preparation products and APIs by the Company from Shandong Lukang under the Shandong Lukang Agreementpurchase of chemical raw materials by the Company from Hualu Hengsheng under the Hualu Hengsheng Agreement	The prices and terms in respect of any purchase of products by the Group shall be negotiated on an arm's length basis with relevant counterparties taking into account the prevailing market price of the same or substantially similar products announced by at least two independent third parties in the same period which offer the same or substantially similar products in the same or nearby areas through inquiries via websites.

LETTER FROM THE INDEPENDENT FINANCIAL ADVISER

Relevant transactions in relation to sale of products

- sale of pharmaceutical intermediaries, APIs and by the Company to Shandong Lukang under the Shandong Lukang Agreement
- sale of chemical drug products and chemical products by the Company to China Shandong Group under the China Shandong Agreement

Pricing policy

The prices and terms for any sale of products, chemical materials and/or provision of utility from the Group will be negotiated on arm's length basis with relevant counterparties taking into account and/or with reference to the following:

- (i) the actual costs incurred plus a reasonable profit margin (with reference to the general range of profit in the industry).

The Company will refer to the historical average price for the relevant products and profit margins of comparable products and services disclosed by at least two other PRC listed companies to determine whether the profit margin charged is in line with the industry.

In this regard, some PRC listed companies publish profit margins of their principal goods and services on the Shanghai Stock Exchange, the Shenzhen Stock Exchange or domestic bond markets (including but not limited to the inter-bank market of the PRC operated by the National Association of Financial Market Institutional Investors), from which the Company is able to draw references. As information are categorised by the industry and the region in the PRC, the Company will select and refer to profit margins of comparable products and services in the same or nearby areas or in the PRC (to the extent available) to determine whether the profit margin charged is in line with the industry.

LETTER FROM THE INDEPENDENT FINANCIAL ADVISER

*Relevant transactions in relation to
sale of products*

Pricing policy

- (ii) the demand and supply in the market for the relevant products and the urgency of the orders from counterparties at the relevant time will be considered in determining the final transaction price.

*Relevant transactions in relation to
provision of engineering design services*

Pricing policy

- provision of engineering design services by the Company to Shandong Lukang under the Shandong Lukang Agreement
 - The determination of the service fees chargeable by the Group on relevant counterparties will be negotiated on arm's length basis with the counterparties taking into account and/or with reference to the following:
 - (i) the urgency of the requested services to be provided;
 - (ii) the estimated man-hours and/or man-days of the human resources required to provide the relevant services;
 - (iii) the materiality and complexity of the proposed services to be provided; and
 - (iv) the fees charged for historical transactions of similar nature.

We understand that the Group has established internal control procedure to monitor the implementation of pricing mechanism of the transactions contemplated under the CCT Agreements including, amongst others, (i) making reference to relevant market information; and (ii) comparing quotation from independent third parties.

LETTER FROM THE INDEPENDENT FINANCIAL ADVISER

In this respect, we have obtained (i) the full invoice list for transactions under the Hualu Hengsheng Agreement for the two years ended 31 December 2020 and the nine months ended 30 September 2021; (ii) the full invoice list for transactions under the Shandong Lukang Agreement for the nine months ended 30 September 2021; and (iii) the full invoice list for transactions under the China Shandong Agreement for the nine months ended 30 September 2021. Based on the full invoice lists, we randomly selected 5 sample walkthroughs for each of the year ended 31 December 2019, 2020 and the nine months ended 30 September 2021 (where applicable) for each CCT Agreement's transaction type, namely:

- purchase of pharmaceutical preparation products and APIs by the Company from Shandong Lukang under the Shandong Lukang Agreement;
- purchase of chemical raw materials by the Company from Hualu Hengsheng under the Hualu Hengsheng Agreement;
- sale of pharmaceutical intermediaries, APIs and by the Company to Shandong Lukang under the Shandong Lukang Agreement;
- sale of chemical drug products and chemical products by the Company to China Shandong Group under the China Shandong Agreement; and
- provision of engineering design services by the Company to Shandong Lukang under the Shandong Lukang Agreement.

Each set of sample walkthrough includes (i) the transaction invoice (including the unit prices of products and/or services) between the Group and its connected persons (i.e. Shandong Lukang, China Shandong, Hualu Hengsheng and their respective subsidiaries); and (ii) the corresponding comparison quotations of unit prices of products/services provided by independent third parties or obtained through online trading platforms. In view of the large transaction volume and the relatively small transaction value for each invoice, and given the samples were randomly selected from the full invoice list, we believe the approach is practical and the selected walk-through documents are sufficient for this purpose.

Based on review of the 35 randomly selected samples, it is noted that the price for the transactions entered into between the Group and the connected persons (i.e. Shandong Lukang, China Shandong, Hualu Hengsheng and their respective subsidiaries) for each category of the products and/or services are no less favourable than those in the market.

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In light of the above and considering the monitoring measures undertaken as set out under the section headed “6. Internal control measures” in this letter below, we are of the view that the Group’s internal control measures to ensure fair pricing of the transactions contemplated under the CCT Agreements have been adhered to. As such, we are of the view that there exist internal control mechanisms to protect the interests of the Company and the Shareholders as a whole in respect of the continuing connected transactions contemplated under the CCT Agreements.

5. PROPOSED ANNUAL CAPS

(i) *The Shandong Lukang Agreement*

2021 approved annual cap and historical transaction amount

The table below sets out the 2021 approved annual cap and the historical transaction amount for the nine months ended 30 September 2021.

For the year ending
31 December 2021
RMB’000

Purchase of pharmaceutical preparation products and APIs by the Group from Shandong Lukang and/or its subsidiaries:

Approved annual cap	14,000
Historical transaction amount (<i>Note 1</i>)	4,624
Utilisation percentage (<i>Note 2</i>)	33.0%

Sale of pharmaceutical intermediaries, APIs and provisions of engineering design services by the Group to Shandong Lukang and/or its subsidiaries:

Approved annual cap	14,000
Historical transaction amount (<i>Note 3</i>)	2,899
Utilisation percentage (<i>Note 4</i>)	20.7%

Notes:

1. Such amount represents the transaction amount for the purchase of pharmaceutical preparation products and APIs by the Group from Shandong Lukang and/or its subsidiaries for the nine months ended 30 September 2021.
2. The utilisation rate was calculated by dividing the transaction amount for the purchase of pharmaceutical preparation products and APIs by the Group from Shandong Lukang and/or its subsidiaries for the nine months ended 30 September 2021 against the total annual cap for the year ending 31 December 2021.

LETTER FROM THE INDEPENDENT FINANCIAL ADVISER

3. Such amount represents the transaction amount for the sale of pharmaceutical intermediaries, APIs and provisions of engineering design services by the Group to Shandong Lukang and/or its subsidiaries for the nine months ended 30 September 2021.
4. The utilisation rate was calculated by dividing the transaction amount for the sale of pharmaceutical intermediaries, APIs and provisions of engineering design services by the Group to Shandong Lukang and/or its subsidiaries for the nine months ended 30 September 2021 against the total annual cap for the year ending 31 December 2021.

As shown in the table above, for the nine months ended 30 September 2021, the Group utilised approximately 33.0% of the approved annual cap for the purchase of pharmaceutical preparation products and APIs from Shandong Lukang and/or its subsidiaries for the year ending 31 December 2021. According to the Management, the relatively low utilisation rate was mainly due to the shortage in supply of the chemical raw materials, which affected the production capacity of Shandong Lukang. Due to such production capacity limitation of Shandong Lukang, the Group had to source pharmaceutical preparation products and APIs from other suppliers.

For illustration purpose, the annualised transaction amount for the purchase of pharmaceutical preparation products and APIs by the Group from Shandong Lukang and/or its subsidiaries for the year ending 31 December 2021 is approximately RMB6.2 million, which represents a utilisation rate of approximately 44.3%.

In addition to the above, for the nine months ended 30 September 2021, the Group utilised approximately 20.7% of the approved annual cap for the sale of pharmaceutical intermediaries, APIs and provisions of engineering design services to Shandong Lukang and/or its subsidiaries for the year ending 31 December 2021. We understand from the Management that the low utilisation rate was primarily due to the implementation of a new procurement policy for Prednisone Acetate by Shandong Lukang during the year due to the relocation of its relevant production plant and facilities requiring the use of Prednisone Acetate, and the Group had to be re-evaluated as a supplier under the new policy. This in turn delayed the supply of Prednisone Acetate from the Group to Shandong Lukang and had a negative impact on the Group's sales to Shandong Lukang for the nine months ended 30 September 2021.

For illustration purpose, the annualised transaction amount for the sale of pharmaceutical intermediaries, APIs and provisions of engineering design services by the Group to Shandong Lukang and/or its subsidiaries for the year ending 31 December 2021 is approximately RMB3.9 million, which represents a utilisation rate of approximately 27.9%.

LETTER FROM THE INDEPENDENT FINANCIAL ADVISER

Proposed Annual Caps

	Proposed annual cap for		
	Year ending	Year ending	Year ending
	31 December 2022	31 December 2023	31 December 2024
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Purchase of pharmaceutical preparation products and APIs by the Group from Shandong Lukang and/or its subsidiaries	12,500	13,500	13,500
Sale of pharmaceutical intermediaries, APIs and provisions of engineering design services by the Group to Shandong Lukang and/or its subsidiaries	6,000	9,000	9,000
Total	18,500	22,500	22,500

With reference to the Letter from the Board, we noted that the proposed annual cap for the three years ending 31 December 2024 under the Shandong Lukang Agreement has been determined with reference to

- (i) the historical amounts for the transactions between the Group and Shandong Lukang and/or its subsidiaries as disclosed above;
- (ii) the expected demand for products to be purchased by the Group from Shandong Lukang and/or its subsidiaries:
 - (a) based on expected demand from customers of the Group for these products as well as end-products which require the use of these products in their product; and
 - (b) given the expected restoration of supply of raw chemical products necessary for the production of pharmaceutical preparation products and APIs demanded by the Group, the shortage of which hampered the production and supply of relevant products by Shandong Lukang and/or its subsidiaries to the Group in the year ended 31 December 2021 (during which period the Group have had to source the relevant products from independent third parties);

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- (iii) expected demand of products and services to be supplied by the Group to Shandong Lukang and/or its subsidiaries based on discussions with Shandong Lukang, with consideration given to the expected increase in sales of a certain product to Shandong Lukang and/or its subsidiaries following the expected completion of supplier evaluation of the Group in the year ending 31 December 2023 as part of its new procurement policy adopted and necessitated by the relocation of relevant production plants and equipment in the year ended 31 December 2021;
- (iv) the prevailing market price as well as the market price trend for the relevant products and services to be purchased and/or sold (in particular, the increase in price of supply of a certain product to Shandong Lukang and/or its subsidiaries as agreed under the Shandong Lukang Agreement); and
- (v) the anticipated business volume and production capacity of the Group.

We had obtained and reviewed the Group's internal budget in relation to the transactions with Shandong Lukang and/or its subsidiaries for the three years ending 31 December 2024. We noted that the transaction volume was determined in accordance with the agreed transaction volume estimate between the Group and Shandong Lukang, as set out in the Shandong Lukang Agreement which we reviewed. We also noted that the unit prices stated in the internal budget for the products/services are in line with the historical prices of similar products/services.

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In relation to the purchase of pharmaceutical preparation products and APIs, we noted the historical utilisation was limited by the limited production capacity of Shandong Lukang as a result of a shortage in supply of chemical raw materials necessary for its production. We had reviewed correspondences between the Group and Shandong Lukang in which Shandong Lukang has confirmed that its production capacity shall resume to normal for the year ending 31 December 2022, and hence the Group expects the purchase of pharmaceutical preparation products and APIs will increase accordingly.

In relation to the sale of pharmaceutical intermediaries and APIs, we understand from the Management that the re-evaluation of the Group under the new procurement policy of Shandong Lukang for Prednisone Acetate is expected to be completed by 2023. As such, the agreed transaction volumes between the Group and Shandong Lukang for the two years ending 31 December 2024 have taken into account the expected increase in sales of Prednisone Acetate. Furthermore, the agreed transaction amount between the Group and Shandong Lukang has also taken into consideration the expected increase in price of Tetramethyl Guanidine of approximately 1.5 times, which has been agreed between the Group and Shandong Lukang in the Shandong Lukang Agreement which we reviewed.

Furthermore, we noted that the proposed annual caps have been adjusted downwards as compared to the approved annual cap for the year ending 31 December 2021, reflecting the Management's consideration of the actual utilisation of the relevant cap to-date.

Taking into account the Group's expanding operations and growing revenue as elaborated under the section headed "1.6 Financial performance of the Group" in this letter, the Management believes, and we concur, that the proposed annual caps offer flexibility to the Group to source pharmaceutical preparation products and APIs from different suppliers, and expand its sales channel regarding the sale of pharmaceutical intermediaries and APIs. This is also in line with the Group's intention to leverage on its leading role in market and expand its market share as elaborated under the section headed "1.7 Prospects of the Group" in this letter.

In light of the above, we believe the proposed annual caps for the three years ending 31 December 2024 under the Shandong Lukang Agreement were estimated based on reasonable ground, and are therefore fair and reasonable so far as the Company and the Independent Shareholders are concerned.

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(ii) *The China Shandong Agreement*

2021 approved annual cap and historical transaction amount

The table below sets out the 2021 approved annual cap and the historical transaction amount for the nine months ended 30 September 2021.

**For the year ending
31 December 2021**
USD'000

**Sale of chemical drug products and chemical products
by the Company to China Shandong Group and/or
its subsidiaries:**

Approved annual cap	15,000
Historical transaction amount (<i>Note 1</i>)	4,104
Utilisation percentage (<i>Note 2</i>)	27.4%

Notes:

1. Such amount represents the transaction amount for the sale of chemical drug products and chemical products by the Company to China Shandong Group and/or its subsidiaries for the nine months ended 30 September 2021.
2. The utilisation rate was calculated by dividing the transaction amount for the sale of chemical drug products and chemical products by the Company to China Shandong Group and/or its subsidiaries for the nine months ended 30 September 2021 against the total annual cap for the year ending 31 December 2021.

As shown in the table above, for the nine months ended 30 September 2021, the Group utilised approximately 27.4% of the approved annual cap for the sale of chemical drug products and chemical products to China Shandong Group and/or its subsidiaries for the year ending 31 December 2021. The relatively low utilisation rate was mainly attributable to the COVID-19 pandemic, resulting in an increase in the ocean freight price. As a result, the increasing costs had transferred partly into the price of the products, and negatively affected the demand and sales of chemical drug products and chemical products to China Shandong Group and/or its subsidiaries.

For illustration purpose, the annualised transaction amount for the sale of chemical drug products and chemical products to China Shandong Group and/or its subsidiaries for the year ending 31 December 2021 is approximately USD5.5 million, which represents a utilisation rate of approximately 36.7%.

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Proposed Annual Caps

	Proposed annual cap for		
	Year ending	Year ending	Year ending
	31 December 2022	31 December 2023	31 December 2024
	USD'000	USD'000	USD'000
Sale of chemical drug products and chemical products by the Company to China Shandong Group and/or subsidiaries	8,000	10,000	11,000

With reference to the Letter from the Board, we noted that the proposed annual cap for the three years ending 31 December 2024 under the China Shandong Agreement has been determined with reference to (i) the historical amounts for the transactions between the Group and China Shandong Group and/or its subsidiaries; (ii) the expected demand for the chemical drug products and chemical products to be sold by the Group to China Shandong Group and/or its subsidiaries based on discussions with China Shandong Group; (iii) the prevailing market price as well as market price trend for chemical drug products and chemical products to be sold under the agreement; and (iv) the anticipated business volume and production capacity of the Company.

We had obtained and reviewed the Group's internal budget in relation to the transactions with China Shandong Group and/or its subsidiaries for the three years ending 31 December 2024. We noted that the transaction volume was determined in accordance with the agreed transaction volume estimate between the Group and the China Shandong Group, as set out in the China Shandong Agreement which we reviewed. We also noted that the unit prices stated in the internal budget for the products/services are in line with the historical prices of similar products/services.

Furthermore, we noted that the proposed annual caps have been adjusted downwards as compared to the approved annual cap for the year ending 31 December 2021, reflecting the Management's consideration of the actual utilisation of the relevant cap to-date.

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Taking into account the Group's expanding operations and growing revenue as elaborated under the section headed "1.6 Financial performance of the Group" in this letter, the Management believes, and we concur, that the proposed annual caps offer flexibility to the Group to expand its sales channel regarding the sale of chemical drug products and chemical products. This is also in line with the Group's intention to leverage on its leading role in market and expand its market share as elaborated under the section headed "1.7 Prospects of the Group" in this letter.

In light of the above, we believe the proposed annual caps for the three years ending 31 December 2024 under the China Shandong Agreement were estimated based on reasonable ground, and are therefore fair and reasonable so far as the Company and the Independent Shareholders are concerned.

(iii) The Hualu Hengsheng Agreement

Approved annual caps and historical transaction amount

The table below sets out the approved annual caps and the historical transaction amounts for the two years ended 2020 and the nine months ended 30 September 2021.

	Historical amounts		
	Year ended	Year ended	Year ending
	31 December 2019	31 December 2020	31 December 2021
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Purchase of chemical raw materials by the Group from Hualu Hengsheng and/or its subsidiaries:			
Approved annual caps	310,000	330,000	340,000
Historical transaction amount	139,108	127,345	140,489 <i>(Note 1)</i>
Utilisation percentage	44.9%	38.6%	41.3% <i>(Note 2)</i>

Notes:

1. Such amount represents the transaction amount for the purchase of chemical raw materials by the Group from Hualu Hengsheng and/or its subsidiaries for the nine months ended 30 September 2021.
2. The utilisation rate was calculated by dividing the transaction amount for the purchase of chemical raw materials by the Group from Hualu Hengsheng and/or its subsidiaries for the nine months ended 30 September 2021 against the total annual cap for the year ending 31 December 2021.

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As shown in the table above, the Group utilised approximately 44.9% and 38.6% of the approved annual caps for the two years ended 31 December 2020, respectively. For the nine months ended 30 September 2021, the Group utilised approximately 41.3% of the approved annual cap for the year ending 31 December 2021.

We understand from the Management, various repairment and improvement on the Company's production facilities during the year ended 31 December 2019 had slowed down the production. As such, the demand for chemical raw materials had decreased, which in turn affected the purchase amount of chemical raw materials by the Group from Hualu Hengsheng and/or its subsidiaries.

The purchase amount further decreased during the year ended 31 December 2020 as a result of the ongoing COVID-19 pandemic, which created significant delays in global logistics and uncertainties in the market. As a result, the demand from downstream customers decreased and the Group had to decrease the production, which in turn affected the purchase amount of chemical raw materials by the Group from Hualu Hengsheng and/or its subsidiaries.

Both the transaction amount and the utilisation rate had increased slightly for the year ending 31 December 2021. We understand from the Management that such increase was mainly attributable to the slight recovery of global logistics and market sentiment during the nine months ended 30 September 2021.

For illustration purpose, the annualised transaction amount for the purchase of chemical raw materials by the Group from Hualu Hengsheng and/or its subsidiaries for the year ending 31 December 2021 is approximately RMB187.3 million, which represents a utilisation rate of approximately 55.1%.

Proposed Annual Caps

	Proposed annual cap for		
	Year ending	Year ending	Year ending
	31 December 2022	31 December 2023	31 December 2024
	RMB'000	RMB'000	RMB'000
Purchase of chemical raw materials by the Group from Hualu Hengsheng and/or its subsidiaries	257,000	234,000	234,000

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With reference to the Letter from the Board, we noted that the proposed annual cap for each year under the Hualu Hengsheng Agreement has been determined with reference to (i) the historical amounts for the transactions between the Group and Hualu Hengsheng and/or its subsidiaries as disclosed above; (ii) the expected demand for the chemical raw materials to be purchased by the Group from Hualu Hengsheng and/or its subsidiaries based on expected demand from customers of the Group for end-products which require the use of relevant chemical raw materials; (iii) the prevailing market price as well as market price trend for chemical raw materials to be purchased under the agreement; and (iv) the anticipated business volume and production capacity of the Company.

We had obtained and reviewed the Group's internal budget in relation to the transactions with Hualu Hengsheng and/or its subsidiaries for the three years ending 31 December 2024. We noted that the transaction volume was determined in accordance with the agreed transaction volume estimate between the Group and Hualu Hengsheng, as set out in the Hualu Hengsheng Agreement which we reviewed. We also noted that the unit prices stated in the internal budget for the products/services are in line with the historical prices of similar products/services.

Furthermore, we noted that the proposed annual caps have been adjusted downwards as compared to the approved annual cap for the year ending 31 December 2021, reflecting the Management's consideration of the actual utilisation of the relevant cap to-date.

Taking into account the Group's expanding operations and growing revenue as elaborated under the section headed "1.6 Financial performance of the Group" in this letter, the Management believes, and we concur, that the proposed annual caps offer flexibility to the Group to source chemical raw materials from different suppliers. This is also in line with the Group's intention to leverage on its leading role in market and expand its market share as elaborated under the section headed "1.7 Prospects of the Group" in this letter.

In light of the above, we believe the proposed annual caps for the three years ending 31 December 2024 under the Hualu Hengsheng Agreement were estimated based on reasonable ground, and are therefore fair and reasonable so far as the Company and the Independent Shareholders are concerned.

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6. INTERNAL CONTROL MEASURES

According to the “Letter from the Board” in the Circular, we understand that the Group has adopted a set of internal control measures in connection with the transactions contemplated under the CCT Agreements.

The Management will discuss and consider the terms and conditions as well as the pricing mechanism of each transaction contemplated under the CCT Agreements before entering into those transactions in order to ensure that they are on normal commercial terms.

In addition, we noted that the finance department of the Company will review the relevant transactions on a monthly basis and submit the relevant information, including but not limited to, the historical and actual transaction amounts, to the Board for review in order to ensure that (i) the relevant transactions are conducted in accordance with the terms of the CCT Agreements; (ii) the annual caps (as applicable) have not been exceeded; and (iii) the pricing mechanism has been effectively implemented.

Furthermore, we also noted that the independent non-executive Directors and the auditors of the Company will conduct annual review on the continuing connected transactions contemplated under the CCT Agreements to confirm that the pricing mechanisms and annual caps remain fair and reasonable, and provide confirmation of the same annually in the annual report of the Company in accordance with the Listing Rules.

Having reviewed (i) sample monthly reports issued by the finance department of the Company regarding the actual transaction amounts between the Group and the connected persons including the remaining transaction amounts under the approved annual caps for transactions under each of the CCT Agreements; (ii) independent auditors’ confirmation in respect of the transactions between the Group and the connected persons under the Hualu Hengsheng Agreement in the annual report of the Group for the year ended 31 December 2020; and (iii) confirmation made by the independent non-executive Directors’ on the annual report of the Group for the year ended 31 December 2020 regarding transactions under the Hualu Hengsheng Agreement; and after taking into account the fact that the annual caps for the CCT Agreements had not been exceeded, we are of the view that such internal control measure for monitoring the transactions contemplated under the CCT Agreements have been effectively implemented.

In view of the procedures and arrangements set out above, we consider that there exists the appropriate procedures and arrangements to ensure the transactions contemplated under the CCT Agreements will be conducted on terms that are fair and reasonable and in the interests of the Company and the Shareholders as a whole.

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RECOMMENDATION

Having considered the factors and reasons as stated above, we are of the view that (i) the terms of the continuing connected transactions under the CCT Agreements are on normal commercial terms and are fair and reasonable; and (ii) the continuing connected transactions under the CCT Agreements are conducted in the ordinary and usual course of business of the Group and in the interests of the Company and the Shareholders as a whole. Accordingly, we recommend the IBC to advise the Independent Shareholders, to vote in favour of the resolutions to be proposed at the EGM to approve the continuing connected transactions under the CCT Agreements (including the respective proposed annual caps thereof) and we recommend the Independent Shareholders to vote in favour of the resolutions in this regard.

Yours faithfully
For and on behalf of
Altus Capital Limited
Chang Sean Pey
Executive Director

Mr. Chang Sean Pey (“Mr. Chang”) is a Responsible Officer of Altus Capital Limited licensed to carry on Type 4 (advising on securities), Type 6 (advising on corporate finance) and Type 9 (asset management) regulated activities under the SFO and permitted to undertake work as a sponsor. He is also a Responsible Officer of Altus Investments Limited licensed to carry on Type 1 (dealing in securities) regulated activity under the SFO. Mr. Chang has over 25 years of experience in banking, corporate finance advisory and investment management. In particular, he has participated in sponsorship work for initial public offerings and acted as financial adviser or independent financial adviser in various corporate finance advisory transactions.

The Share Option Scheme was originally drafted in Chinese and the English translation is for your reference only. In case of any inconsistencies between the Chinese and the English version, the Chinese version shall prevail.

The following summarises all principal terms of the Share Option Scheme and the proposed Grant thereunder.

I. PROPOSED ADOPTION OF THE SHARE OPTION SCHEME

1. Purpose of the Share Option Scheme

The objective of the Share Option Scheme is to further establish and enhance the long-term incentive mechanisms of the Company with a view to attract and retain talent, incentivise Directors, members of senior and mid-level management as well as the Core Staff, effectively align interests of the Shareholders with those responsible for the business and operation of the Company with a view of encouraging the relevant persons to focus on the long-term development and prospects of the Company.

2. Eligible Participants and basis for determining Participants

(1) Basis for determining Participants

The criteria adopted concerning eligibility of Participants to the Share Option Scheme were determined in compliance with requirements of applicable laws, regulations and authoritative documents (including the Company Law, the Securities Law, the Incentive Measures and the Articles of Association) with reference to the actual conditions of the Company.

(2) Eligible Participants

Eligible Participants of the Share Option Scheme include Directors, members of senior management and mid-level management as well as the Core Staff.

Directors and members of senior management concerning the abovementioned eligible Participants must have been elected in a duly convened Shareholders' meeting or otherwise appointed by the Board. Eligible Participants exclude any independent non-executive Directors, Supervisors, or external directors who are not a controlling Shareholder of the Company and Shareholders or actual controllers (together with their respective spouse, parents and children) individually or collectively holding more than 5% of the Shares. Participants must be employed (and have entered into a labor contract or employment contract) with the Company or its subsidiaries at the times of the Grant under the Share Option Scheme and during evaluation of their achievement of applicable performance targets.

All Participants of the Share Option Scheme are prohibited from participating in any equity incentive scheme of other listed companies concurrently, and persons who are participants of such other incentive schemes are prohibited from participating in the Share Option Scheme.

Participants of the Reserved Grant will be determined within 12 months after the Share Option Scheme has been reviewed and approved by Shareholders at the EGM and Class Meetings. Details of Participants of the Reserved Grant shall be disclosed in a timely and accurate manner in compliance with requirements of applicable regulations following nomination by the Board, taking into account the views of independent non-executive Directors, the board of Supervisors and having received the professional advice and legal opinions of PRC legal advisors. If the Participants have not been determined after lapse of the 12 months period, the relevant Reserved Grant shall lapse. Directors and related persons who are proposed to be Participants of the Share Option Scheme must abstain from voting on resolutions of the Board concerning approval of Grant of Options in respect of the Reserved Grant.

3. Issuance and number of Shares involved under the Share Option Scheme

(1) The underlying Shares of the Share Option Scheme

The Shares which may be issued to Participants by the Company in accordance with relevant terms and provisions of the Share Option Scheme shall be ordinary A Shares.

The Company shall not provide any loan or any other form of financial assistance (including provision of any guarantee) to Participants in respect of any exercise of Options under the Share Option Scheme. Participants do not have to pay any amount to the Company on acceptance of any Option.

(2) Number of the underlying Shares

The Share Option Scheme contemplates the Grant of up to 24,900,000 Options to eligible Participants and the maximum number of RMB-dominated ordinary A Shares which may be issued upon the exercise of the Options represent approximately 3.97% of the total issued Shares of the Company (being 627,367,447 Shares) and approximately 5.76% of the total A Share capital of the Company (being 432,367,447 Shares), respectively, as at the Latest Practicable Date. 23,150,000 Options shall be granted under the Initial Grant, representing approximately 92.97% of total Options that may be granted under the Share Option Scheme (relating to underlying Shares

representing approximately 3.69% of the total issued shares capital of the Company and approximately 5.35% of the total A Share capital of the Company, respectively, as at the Latest Practicable Date). 1,750,000 Options shall be granted under the Reserved Grant, representing approximately 7.03% of total Options that may be granted under the Share Option Scheme (relating to underlying Shares representing approximately 0.28% of the total issued shares capital of the Company and approximately 0.41% of the total A Share capital of the Company, respectively, as at the Latest Practicable Date). Upon satisfaction of the Exercise Conditions, each Option shall provide its holder a right to purchase one A Share at an exercise price during the Validity Period.

The Options granted to Participants shall not be transferred, pledged or used for repayment of debts.

Unless an Option has been exercised in accordance with the Share Option Scheme, the holder of the Options shall not be entitled to any voting, dividend, transfer and other rights (including rights arising on a liquidation of the Company) attached to the underlying A Shares.

Save for the proposed Share Option Scheme and the A share option scheme adopted in the Shareholders' meeting held on 28 December 2018, the Company has not adopted any other share option scheme as at the Latest Practicable Date.

4. Validity Period, Grant Date, vesting schedule, Exercise Date, Exercise Period and the relevant lock-up requirements

(1) *Validity Period*

The Share Option Scheme shall commence on the Grant Date and end on the date on which all the Options have been exercised or cancelled, provided that such period shall not exceed 72 months.

(2) *Grant Date*

Please see the section headed "II. Proposed Grant Under the Share Option Scheme – 2. Grant Date" below for further information on the Grant Date of the Share Option Scheme.

(3) *Vesting schedule*

According to the vesting schedule prescribed under the Share Option Scheme, Options that are granted under the Share Option Scheme shall be exercised in three tranches, each of which shall vest on each date falling 24 months, 36 months and 48 months from the Grant Date (each, a “**Vesting Date**”).

(4) *Exercise Date*

Following adoption of the Share Option Scheme, Options that are granted shall become exercisable once they are vested on a Vesting Date. The Exercise Date of an Option must be a day on which the Shenzhen Stock Exchange is open for trading and shall not fall within any of the following periods:

- (i) the period commencing 30 calendar days prior to the announcement of periodic financial reports of the Company (or in the event of delay in publishing the reports due to special reasons, the period commencing 30 calendar days prior to the original date of publication and ending on day immediately preceding the publication date);
- (ii) the period commencing 10 calendar days prior to the announcements of any results forecast or preliminary results of the Company;
- (iii) the period commencing on the date of the occurrence of any material event that may have significant impacts on price of securities (including Shares and derivatives) of the Company (or during the period when such material event is in the process of being approved) and ending on the second trading days following the making of relevant disclosures to the market in accordance with applicable laws; and
- (iv) any other periods as may be stipulated by the CSRC or the Shenzhen Stock Exchange.

The above transactions or other material events shall be disclosed by the Company in accordance with the Shenzhen Listing Rules.

(5) Exercise Period

Upon satisfaction of the Exercise Conditions, Participants may exercise Options that are granted to them in three tranches over a period of 36 months from the first date on which they become vested (i.e. from the first Vesting Date).

The Exercise Period of Options granted under the Share Option Scheme are as follows:

Exercise arrangement	Exercise period	Proportion of Options granted which may be exercised
First Exercise Period	Commencing from the first trading day after the expiry of the 24th month from the Grant Date of the corresponding part, and ending on the last trading day of the 36th month from the Grant Date of the corresponding part	34%
Second Exercise Period	Commencing from the first trading day after the expiry of the 36th month from the Grant Date of the corresponding part, and ending on the last trading day of the 48th month from the Grant Date of the corresponding part	33%
Third Exercise Period	Commencing from the first trading day after the expiry of the 48th month period from the Grant Date of the corresponding part, and ending on the last trading day of the 60th month period from the Grant Date of the corresponding part	33%

Participants may exercise the Options granted to them that are vested during the relevant Exercise Period. Where the Exercise Conditions are not fulfilled, the relevant Options may no longer be exercised. Options which have not been exercised by the Participants notwithstanding fulfilment of the Exercise Conditions will be cancelled by the Company upon expiry of the relevant Exercise Period.

(6) *Lock-up arrangements*

Lock-up provisions in the Share Option Scheme shall be implemented in accordance with requirements under applicable laws, regulations and authoritative documents (including the Company Law, the Securities Law, the Shenzhen Listing Rules and the Articles of Association). Under these requirements:

- (i) where a Participant is a Director or a member of the senior management of the Company:
 - (a) he must not transfer or dispose more than 25% of all Shares held by him in each year during his term of office;
 - (b) he must not transfer or dispose any Shares held by him within six months from the last day of his termination of all office with the Company and/or its subsidiaries;
 - (c) any gains derived from any disposal of any Shares within six months from its acquisition, or any subsequent acquisition of Shares within six months of any disposal, shall vest with the Company and be recoverable by the Board;
- (ii) where, during the Validity Period, there is any change to the requirements regarding the transfer of Shares previously held by a Director and senior management under applicable laws, regulations and regulatory documents (including the Company Law, the Securities Law and/or the Articles of Association), the transfer of the Company's Shares held by such Participant shall comply with the amended laws, regulations, regulatory documents and/or the Articles of Association at the time of the transfer; and
- (iii) a Director and/or a member of senior management of the Company to whom Options are granted shall, after exercising the Option, hold no less than 20% of the aggregate amount of Shares issued to him, and can only sell his Shares after passing the performance assessment during the term of office and after the lock-up has expired.

5. Exercise price and basis of determination

Please see the sub-sections headed “3. Exercise price for the Initial Grant of Options and basis of determination” and “4. Exercise price for the Reserved Grant of Options and basis of determination” under the section headed “II. Proposed Grant Under the Share Option Scheme” below for further information on the exercise price of the Options and its basis of determination.

6. Conditions of Grant and Exercise Conditions

Please refer to Appendix II (The Assessment Management Methods in Respect of the Implementation of the Share Option Scheme) of this circular for details of the conditions for Grant and Exercise Conditions.

7. Methods of and procedures for adjustments

(1) *Adjustment of the number of Options*

In the event of a capitalisation issue, bonus issue, rights issue, share subdivision or share consolidation of the Company prior to any exercise of Options, the number of Options which are and/or may be granted will be adjusted as follows:

(i) *Capitalisation issue, bonus issue and share subdivision*

$$Q = Q_0 \times (1 + n)$$

Where: Q_0 represents the number of the Options prior to adjustment

n represents the ratio of increase per Share resulting from capitalisation issue, bonus issue or share subdivision (i.e. the number of increased Share(s) per Share upon capitalisation issue, bonus issue or share subdivision)

Q represents the number of the Options after adjustment

(ii) *Rights issue*

$$Q = Q_0 \times P_1 \times (1 + n) / (P_1 + P_2 \times n)$$

Where: Q_0	represents the number of the Options prior to adjustment
P_1	represents the closing price of Shares on the record date
P_2	represents the subscription price in respect of the rights issue
n	represents the basis of the rights issue (i.e. the number of Shares to be issued under the rights issue in proportion to the total share capital of the Company prior to the rights issue)
Q	represents the number of Options after adjustment

(iii) *Share consolidation*

$$Q = Q_0 \times n$$

Where: Q_0	represents the number of Options prior to the adjustment
n	represents the ratio of consolidation of Shares (i.e. one Share of the Company be consolidated into n Shares)
Q	represents the number of Options subsequent to the adjustment

(2) *Adjustment of the exercise price*

In the event of a dividend distribution, capitalisation issue, bonus issue, rights issue, share subdivision or share consolidation of the Company prior to any exercise of Options, the exercise price of the Options will be adjusted as follows:

(i) *Capitalisation issue, bonus issue and Share subdivision*

$$P = P_0 / (1 + n)$$

Where: P_0	represents the exercise price of the Options prior to the adjustment
n	represents the ratio of increase per Share resulting from the issue of Shares under the capitalisation issue, bonus issue or Share subdivision
P	represents the adjusted exercise price of the Options

(ii) Rights issue

$$P = P_0 \times (P_1 + P_2 \times n) / [P_1 \times (1 + n)]$$

Where: P_0 represents the exercise price of the Options prior to the adjustment

P_1 represents the closing price of Shares as at the record date

P_2 represents the subscription in respect price of the rights issue

n represents the ratio of the rights issue (i.e. the number of Shares to be issued under the rights issue in proportion to the total share capital of the Company prior to the rights issue)

P represents the adjusted exercise price of the Options

(iii) Share consolidation

$$P = P_0 / n$$

Where: P_0 represents the exercise price of the Options prior to the adjustment

n represents the ratio of Share consolidation (i.e. one Share of the Company be consolidated into n Shares)

P represents the adjusted exercise price of the Options

(iv) Dividend distribution

$$P = P_0 - V$$

Where: P_0 represents the exercise price of the Options prior to the adjustment

V represents the dividend per Share

P represents the adjusted exercise price of the Options. After the dividend adjustment, P must still be a positive number

(3) *Issuance of new Shares*

Save as disclosed above, an issuance of new Shares will not result in the adjustment of the number or exercise price of the Options.

(4) *Procedures for adjustments*

The Shareholders' meeting authorises the Board to adjust the exercise price and/or the number of Options in the event of the abovementioned circumstances. Legal advisers will be engaged to advise the Board as to whether the relevant adjustment is in compliance with the provision of the Incentive Measures, the Articles of Association and the Share Option Scheme. If it is necessary to make adjustments to the number of Options and exercise price due to matters other than any of the aforementioned circumstances, the Board shall propose a resolution and obtain approval from the Shareholders at a duly convened meeting of the Company.

8. Amendments to or termination of the Share Option Scheme

The Company will disclose any proposed amendments to the Share Option Scheme which are made prior to obtaining approval of Shareholders at the EGM and the Class Meetings following a Board decision concerning the relevant amendment.

Any proposed amendments to, or termination of, the Share Option Scheme following the obtaining Shareholders approval for its adoption at the EGM and the Class Meetings may be tabled for consideration and approval at further EGM and Class Meetings, provided that any amendment must not:

- (1) result in Options becoming exercisable at an earlier date; or
- (2) the lowering of the exercise price of Options.

Where the Share Option Scheme is terminated, no other equity incentive scheme may be submitted by the Company to Shareholders for approval or adoption within three months from the date of announcement of the resolution for its termination.

The PRC legal advisers to the Company shall give professional opinions on whether the termination of the Share Option Scheme conforms to the Incentive Measures and relevant laws and regulations, and whether the Company and the interests of all Shareholders are prejudiced. After the termination of the Share Option Scheme, the Company shall apply to the Shenzhen Stock Exchange and the registration and clearing company for cancellation of the granted Options in a timely manner after performing the relevant procedures.

9. Management agency

- (1) The Share Option Scheme was formulated by the Remuneration and Examination Committee and approved by the Board and will become effective from the date of approval at the EGM and Class Meetings.
- (2) If approved by the Shareholders, the Board shall be authorised to implement, manage and construe the Share Option Scheme in accordance with the terms and provisions of the Share Option Scheme and in compliance with the applicable laws, rules and regulations, including without limitation to the Listing Rules and the Shenzhen Listing Rules.

The proposed plan in respect of the Share Option Scheme (including but not limited to the Initial Grant and the Reserved Grant) has been approved by the Remuneration and Examination Committee and has been made available for the review and opinion of the independent non-executive Directors and the Supervisory Committee of the Board. The Initial Grant to Directors has been approved by the independent non-executive Directors in accordance with rule 17.04(1) of the Listing Rules.

II. PROPOSED GRANT UNDER THE SHARE OPTION SCHEME

Key terms of the proposed Grant of Options (which complies with the terms and provisions of the Share Option Scheme) are set out in detail in this section.

1. Options proposed to be granted under the Initial Grant pursuant to the Share Option Scheme

It is proposed that the Options will be granted to a total number of 196 Participants (representing 2.99% of the total number of the staff of the Company as at 30 September 2021) under the Initial Grant, and the Participants shall comprise Directors, members of senior management and mid-level management and the Core Staff. Details of the Grant is set out below:

Name	Position	Number of Options to be granted <i>(in 10,000)</i>	Percentage to	Percentage to	Percentage to
			total number of Options under the Grant <i>(%)</i>	total share capital of the Company as of the Latest Practicable Date <i>(%)</i>	total A share capital of the Company as of the Latest Practicable Date <i>(%)</i>
Zhang Daiming (張代銘)	Chairman	40	1.61	0.064	0.093
Du Deping (杜德平)	Director, General Manager	36	1.45	0.057	0.083
Xu Lie (徐列)	Director	32	1.29	0.051	0.074
Wang Xiaolong (王小龍)	Deputy General Manager	32	1.29	0.051	0.074
Du Deqing (杜德清)	Deputy General Manager	32	1.29	0.051	0.074
He Tongqing (賀同慶)	Director, Deputy General Manager	32	1.29	0.051	0.074
Hou Ning (侯寧)	Financial Controller	32	1.29	0.051	0.074
Zheng Zhonghui (鄭忠輝)	Deputy General Manager	32	1.29	0.051	0.074
Wei Changsheng (魏長生)	Deputy General Manager	32	1.29	0.051	0.074
Xu Wenhui (徐文輝)	Deputy General Manager	32	1.29	0.051	0.074
Cao Changqiu (曹長求)	Secretary to the Board	20	0.80	0.032	0.046
Other staff (185 persons)		1,963	78.84	3.13	4.54
Total Initial Grant		2,315	92.97	3.69	5.35
Reserved Grant		175	7.03	0.28	0.41
Total		2,490	100	3.97	5.76

Notes:

- None of the Participants of the Share Option Scheme are participants of two or more equity incentive schemes of the Company and/or other listed companies.
- None of the abovementioned Participant will be/has been granted Options convertible into Shares representing over 1% of the total issued capital of the Company on a cumulative basis through all valid share option schemes of the Company. The aggregate amount of underlying Shares involved in all valid share option schemes of the Company shall not exceed 10% of the total issued capital of the Company at the time the Share Option Scheme is submitted for approval and adoption at the EGM and Class Meetings.
- The equity value of Shares that may be issued pursuant to Options (“**Underlying Shares**”) that may be granted for Directors and members of senior management shall be no more than 40% of the total level of remuneration of the relevant persons at the time of Grant (inclusive of the equity value of the Underlying Shares). The equity value of the Underlying Shares for the other Participants (including management, technical and the Core Staff) shall be reasonably determined by the Board.

4. Participants of the Reserved Grant shall be determined within 12 months after the Share Option Scheme has been approved at the EGM and Class Meetings.
5. The limit on the number of Shares which may be issued upon exercise of all outstanding Options granted and yet to be exercised under the Share Option Scheme and any other equity incentive schemes of the Company must not exceed 30% of the relevant class of securities of the Company (or any subsidiary) in issue from time to time. No options may be granted under any schemes of the Company (or any subsidiary) if this will result in the limit being exceeded.

2. Grant Date

The Grant Date shall be determined by the Board after the Share Option Scheme has been approved by HHC and filed with SASAC, and approved at the EGM and Class Meetings. The Grant Date shall be a day on which the Shenzhen Stock Exchange and the Hong Kong Stock Exchange are open for trading. The Company shall grant the Options to Participants, publish an announcement and carry out relevant filings and registrations within 60 days from the date of obtaining approval at the EGM and the Class Meetings (excluding any period(s) during which Options must not be granted according to applicable laws and regulations) (the “**60-day period**”). If the Company fails to complete the above matters within the 60-day period, the Company shall promptly disclose the reasons for failure to do so and announce the termination of the Share Option Scheme. Any Options that have not been granted will lapse accordingly. The Grant Date of the Reserved Grant shall be the date of announcement of the Board decision for approving the Reserved Grant.

The Grant Date in respect of both the Initial Grant and the Reserved Grant must be a trading day and shall not fall within any of the following periods:

- (i) the period commencing 60 calendar days prior to the announcement of annual report of the Company (or in the event of delay in publishing the annual report due to special reasons, the period commencing 60 calendar days prior to the original date of publication and ending on the publication date);
- (ii) the period commencing 30 calendar days prior to the announcement of half-year report or quarterly report of the Company (or in the event of delay in publishing the reports due to special reasons, the period commencing 30 calendar days prior to the original date of publication and ending on the publication date);
- (iii) the period commencing 10 calendar days prior to the announcement of any results forecast or preliminary results of the Company;

- (iv) the period commencing on the date of the occurrence of any material event that may have significant impacts on price of securities (including Shares and derivatives) of the Company (or during the period when such material event is in the process of being approved) and ending on the second trading days following the making of relevant disclosures to the market in accordance with applicable laws; and
- (v) any other periods as may be stipulated by the CSRC, the Shenzhen Stock Exchange and/or the Hong Kong Stock Exchange.

For the avoidance of doubt, the abovementioned periods during which the Company must not Grant Options is not included in the 60-day period.

3. Exercise price for the Initial Grant of Options and basis of determination

The exercise price of the Options for the Initial Grant shall be RMB7.96 per A Share. Such exercise price may be adjusted in the event of any capitalisation issue, bonus issue, shares subdivision, share consolidation, right issues and/or dividend payment from the date of the Announcement in relation to the Share Option Scheme to the completion of exercise of any Options by Participants.

The exercise price of the Options for the Initial Grant shall not be less than the nominal value of the Shares and shall not be less than the higher of the following:

- (i) the average trading price of the A Shares quoted on the Shenzhen Stock Exchange on the trading day immediately preceding the date of the Announcement in relation to the Share Option Scheme, being RMB7.36 per A Share;
- (ii) the average trading price of the A Shares quoted on the Shenzhen Stock Exchange for the last 20 trading days, 60 trading days or 120 trading days immediately preceding the date of the Announcement in relation to the Share Option Scheme, being RMB7.85 per A Share (representing the average of the trading prices of the A Shares quoted on the Shenzhen Stock Exchange for the last 20 trading days immediately preceding the date of the Announcement in relation to the Share Option Scheme);
- (iii) the closing trading price of the A Shares quoted on the Shenzhen Stock Exchange on the trading day immediately preceding the date of the Announcement in relation to the Share Option Scheme, being RMB7.37 per A Share;
- (iv) the average closing price of the A Shares quoted on the Shenzhen Stock Exchange for the last 30 trading days immediately preceding the date of the Announcement in relation to the Share Option Scheme, being RMB7.96 per A Share; and

- (v) the most recent audited net assets for the financial year ended 2020 per A Share preceding the date of the Initial Grant, being RMB5.45 per A Share.

4. Exercise price for the Reserved Grant of Options and basis of determination

Any Reserved Grant shall require the prior approve by the Board and a summary of the Grant shall be announced by the Company. The exercise price of Options under the Reserved Grant shall not be lower than the fair market price of the A Shares, which shall be no less than the higher of the following prices:

- (i) the average trading price of the A Shares quoted on the Shenzhen Stock Exchange on the trading day immediately preceding the date of the announcement of the Board's resolution of Granting the Reserved Grant;
- (ii) the average trading price of the A Shares quoted on the Shenzhen Stock Exchange for the last 20 trading days, 60 trading days or 120 trading days immediately preceding the date of the announcement of the Board's resolution of Granting the Reserved Grant;
- (iii) the closing trading price of the A Shares quoted on the Shenzhen Stock Exchange on the trading day immediately preceding the date of the announcement of the Board's resolution of Granting the Reserved Grant;
- (iv) the average closing price of the A Shares quoted on the Shenzhen Stock Exchange for the last 30 trading days immediately preceding the date of the announcement of the Board's resolution of Granting the Reserved Grant; and
- (v) the most recent audited net assets per A Share preceding the date of the Reserved Grant.

III. MECHANISM FOR DEALING WITH SPECIFIC CIRCUMSTANCES CONCERNING THE COMPANY OR PARTICIPANTS UNDER THE SHARE OPTION SCHEME

(1) Changes to or events involving Participants

- (i) If a Participant has changed his position or duties with the Group but still held a position in the Group (including its branches or its subsidiaries), the Options granted to him continue to be governed by the Share Option Scheme prior to the change of position or duties.

- (ii) If a Participant becomes an independent non-executive Director, Supervisor or other person who cannot hold the Shares of the Company or be granted Options in accordance with applicable laws and regulations, and the said granted Options are capable of meeting the Exercise Conditions (including performance related assessment conditions for the exercise), the relevant granted Options which are exercisable may be exercised within 6 months from the resignation date, following which all relevant rights and interests in the granted Options shall become invalid. If the granted Options are not able to meet the Exercise Conditions (including performance related assessment conditions for the exercise), such Options shall be cancelled by the Company.

- (iii) If a Participant:
 - (a) contravenes any national laws, regulations, provisions of the Articles of Association or internal management rules and regulations of the Company, or is involved in dereliction of duty as stipulated in the employment contract which prejudice the interests and reputation of the Company, thereby resulting in direct or indirect losses to the Company;
 - (b) is dismissed due to violation of the Company's rules and regulation to a severe extent according to relevant provisions of the Company's reward and punishment;
 - (c) was sufficiently proven by the Company to have been involved, during his term of office, in a violation of laws or disciplinary proceedings involving bribery, solicitation of bribes, corruption, theft, divulgence of confidential operational and technological information of the Company or carrying out related party transactions which prejudice the interests and reputation of the Company and/or results in a significant negative impact to the Company, thereby resulting in direct or indirect losses to the Company;
 - (d) is being held criminally liable for any criminal acts in accordance with applicable laws;
 - (e) has been placed on probation or removed from any office or position in the Communist Party;
 - (f) has direct leadership responsibility at the Communist Party but fails to accomplish specific designated tasks concerning reform and development, as determined by the higher level of the Communist Party committee,

then the outstanding Options granted to the Participant under the Share Option Scheme but not yet exercised shall be cancelled by the Company. The Company may require the Participant to return any gains derived from any Options which he has exercised.

- (iv) In the event that a Participant discharges or terminates the employment relationship with the Company due to objective reasons such as being transferred out of the Company and ceases to hold office in the Company due to reorganisation, retirement upon reaching the statutory retirement age, death (to be exercised by his/her lawful successor as stipulated) or loss of civil capacity, and the granted Options are able to meet the applicable Exercise Conditions (including performance related assessment conditions for the exercise) at that year, the relevant granted Options which are exercisable may be exercised within 6 months from the resignation date and therefrom the Options that has not been exercised will become invalid and shall be cancelled by the Company. Any granted Options which are not able to meet the Exercise Conditions (including any performance related assessment conditions shall not be exercised), such Options shall be cancelled by the Company.

- (v) In the event that a Participant resigns or is discharged from employment relationship with the Group, all outstanding Options granted to the Participant shall be cancelled by the Company.

- (vi) All outstanding Options granted to a Participant shall be cancelled by the Company as of the date of occurrence of any of the following events:
 - (a) he has been held by the Shenzhen Stock Exchange to be a person unsuitable to hold the relevant position or office held by him in the Group in the last 12 months;
 - (b) he has been held by the CSRC or ancillary agencies as a person unsuitable to hold the relevant position or office held by him in the Group in the last 12 months;
 - (c) the imposition by the CSRC or ancillary agencies of administrative penalties and/or measures which prohibits or restricts his access to financial markets by reason of any material violation of laws and regulations in the last 12 months;
 - (d) he is prohibited from acting as a director or a member of the senior management of a company under the Company Law;
 - (e) he is not allowed to participate in an equity incentive scheme of a listed company under applicable laws and regulations; and
 - (f) other events and circumstances as may be determined by the CSRC.

- (vii) Other circumstances concerning Participants not specified above as well as the methods or mechanisms in dealing with such circumstances shall be determined by the Board.

(2) Changes to or events involving in relation to the Company

On the occurrence of any of the following event in respect of the Company:

- (i) where a certified public account issues an auditor's report with a qualified opinion or otherwise indicates that it is unable give an opinion with respect to the financial report of the Company for its most recent financial year;
- (ii) where a certified public account issues an auditor's report with a qualified opinion or otherwise indicates that it is unable give an opinion with respect to the internal controls of the Company in its financial report for its most recent financial year
- (iii) violation of applicable laws and regulations, the Articles of Association or any undertaking publicly made in respect of distribution of profits in the 36 months after listing of the securities on a stock exchange;
- (iv) under applicable laws and regulations, no equity incentive is allowed; and
- (v) other events or circumstances as may be determined by the CSRC,

the Share Option Scheme shall be terminated and all outstanding Options granted but yet to be exercised by Participants shall be cancelled by the Company.

Where false statements or misleading statements in or material omissions from the information disclosure documents of the Company result in non-compliance with the conditions of Grant of Options or exercise arrangements, outstanding Options shall be uniformly cancelled by the Company. If Options granted to the Participants have been exercised, all Participants shall return to the Company all rights and interests gained. If a Participant who is not responsible for the above matters suffers from losses due to the return of rights and interests, such Participant can recover such losses from the Company or the responsible targets in accordance with the relevant arrangements under the Share Option Scheme. The Board shall recover the proceeds from the Participants in accordance with the preceding paragraph and the relevant arrangements under the Share Option Scheme.

For the avoidance of doubt, any merger, spinoff or change of control of the Company will not on its own cause any change to the Share Option Scheme.

IV. INFORMATION OF THE GROUP AND REASONS FOR AND BENEFITS OF THE ADOPTION OF THE SHARE OPTION SCHEME AND THE GRANT

The Group is principally engaged in the development, manufacture and sale of bulk pharmaceuticals, preparations and chemical products.

The objective of the Share Option Scheme is to further establish and enhance the long-term incentive mechanisms of the Company with a view to attract and retain talent, incentivise Directors, members of senior and mid-level management as well as the Core Staff, effectively align interests of the Shareholders with those responsible for the business and operation of the Company, with a view of encouraging the relevant persons to focus on the long-term development and prospects of the Company.

The Board is of the view that the adoption of the Share Option Scheme serves to enable the Company to move towards reaping the abovementioned benefits, and that the terms and conditions of the Share Option Scheme are on normal commercial terms, fair and reasonable and in the interests of the Company and its Shareholders as a whole.

V. SHAREHOLDERS' MEETING

The Share Option Scheme shall be filed with SASAC and will become effective upon obtaining the approval of Shareholders (including HHC) at the EGM and the Class Meetings. The Share Option Scheme may be amended upon the request of the SASAC.

VI. ACCOUNTING TREATMENTS

Pursuant to the relevant requirements in respect of fair value determination under the *Accounting Standards for Business Enterprises No. 22 – Recognition and Measurement of Financial Instruments* (the “**Accounting Standards for Business Enterprise No. 22**”), a suitable pricing model is required to be applied to compute the fair value of Options. As such the Black-Scholes model has been applied by the Company to compute the fair value of the Options prior to the re-application thereof for the definitive computation at the time of the Grant.

Pursuant to the relevant requirements under *Accounting Standards for Business Enterprises No. 11 – Share-based Payments* (the “**Accounting Standards for Business Enterprise No. 11**”), the Company will update the number of Options expected to be exercisable on each balance sheet day during the Vesting Period with reference to such subsequent information as the latest available figures of Participants entitled to exercise the Options and the status of attainment of the performance targets. Services received during the current period will be charged to relevant costs or fees and capital reserve based on the fair value on the Grant Date.

By applying the Black-Scholes Model as the pricing model, the fair value of each Option amount to RMB2.53. Parameters were as follows:

- (1) price of the underlying Share: RMB7.96 per Share (assuming the closing price of RMB7.96 per Share on the Grant Date)
- (2) exercise price: RMB7.96 per Share
- (3) expected life: 3.5 years
- (4) historical volatility: 38.8833% (the volatility rate of the Company for the last 3.5 years adopted)
- (5) risk-free interest rate: 2.6742% (the three-year yield to maturity of the treasury bond adopted)

The Company will determine the fair value of the Options on the Grant Date with the relevant tools of valuation and ultimately recognise the share-based payment expenses in respect of the Share Option Scheme. Such expenses will be recognised at phrases along the implementation process of the Share Option Scheme with reference to proportion of the Options exercised. The incentive costs incurred in respect of the Share Option Scheme will be recorded as recurring items.

Assuming the grant of Options takes place in early November 2021, the amortisation costs of Share Options from 2021 to 2025 will be as follows:

Amount of Options	Costs of Options	2021	2022	2023	2024	2025
(0,000)	(0,000)	(0,000)	(0,000)	(0,000)	(0,000)	(0,000)
2,315	5856.94	353.86	2123.14	1957.19	1020.08	402.66

Note:

1. The above is not the final definitive accounting costs which would, amongst others, relate to the actual numbers of Options alive and lapsed, the actual Grant Date and the closing price of the date on Grant. Shareholders are also advised to note that dilutive effects are possible.
2. All effects on the operating results of the Group will be subject to annual financial accounts audited by the external auditor of the Company. The following summarises all principal terms of the Assessment Method.
3. The accounting treatment for the Reserved Grant is the same as the accounting treatment for the Initial Grant.

APPENDIX II THE ASSESSMENT MANAGEMENT METHODS IN RESPECT OF THE IMPLEMENTATION OF THE SHARE OPTION SCHEME

The Assessment Methods was originally drafted in Chinese and the English translation is for your reference only. In case of any inconsistencies between the Chinese and the English version, the Chinese version shall prevail.

PURPOSE OF ASSESSMENT

The purpose of the Assessment Methods is to further improve the corporate governance structure of the Company, to develop a sound appraisal system for assessing the performance related assessment conditions of the Participants (the “**Assessment**”), to establish a mechanism for evaluating the effects of incentives that aligns responsibilities, rights and interests and to incentivise the Participants to perform duties with honesty and diligence, so that the development strategies and operation objectives of the Company can be attained, the sustainable development of the Company can be furthered and the implementation of the Share Option Scheme smoothed.

PRINCIPLES OF ASSESSMENT

The principles of Assessment is impartiality, openness and fairness. Assessment should be conducted in strict accordance with the measures herein and the performance related assessment conditions of the Participants so as to align the Share Option Scheme with the work performance and contribution of the Participants, which would in turn help enhance performance and maximise the interests of Company and its Shareholders.

OBJECTS OF ASSESSMENT

The Participants of the 2021 Share Option Scheme include Directors (excluding any external directors of the controlling shareholder of the Company (e.g. independent non-executive Directors), members of senior management mid-level management and the Core Staff.

ASSESSMENT BODIES

The Remuneration and Examination Committee shall lead and be in charge of conducting the Assessment, reviewing and making decisions and making necessary adjustments on such indicators and results substantially impacted on by changes objectively in the prevailing circumstances. The departments of human resources, of development planning and of finance and assets shall be responsible for providing such assistance as collecting, providing and verifying the relevant data and computing and collating the assessment performance for producing assessment result reports.

APPENDIX II THE ASSESSMENT MANAGEMENT METHODS IN RESPECT OF THE IMPLEMENTATION OF THE SHARE OPTION SCHEME

ASSESSMENT PROCEDURE

Under the guidance of the Remuneration and Examination Committee, the departments of human resources, of finance and assets and of development planning and other relevant departments are responsible for the specific examination work, the calculation of the examination scores of Participants, collating the results and producing the assessment result report on this basis. The Remuneration and Examination Committee shall review and make decisions on the performance examination report.

ASSESSMENT PERIOD AND FREQUENCY

The assessment as to whether performance targets in respect of Granted Options have been met (i.e. whether the Exercise Conditions in respect of Granted Options have been satisfied) shall be conducted annually for the years 2022, 2023 and 2024.

CONDITIONS OF GRANT

(1) Conditions of Grant

The Grant of Options shall be conditional upon there being no occurrence of any of the following in respect of the Company:

- (i) where a certified public account issues an auditor's report with a qualified opinion or otherwise indicates that it is unable give an opinion with respect to the financial report of the Company for its most recent financial year;
- (ii) where a certified public account issues an auditor's report with a qualified opinion or otherwise indicates that it is unable give an opinion with respect to the internal controls of the Company in its financial report for its most recent financial year
- (iii) violation of applicable laws and regulations, the Articles of Association or any undertaking publicly made in respect of distribution of profits in the 36 months after listing of the securities on a stock exchange;
- (iv) under applicable laws and regulations, no equity incentive is allowed; and
- (v) other events or circumstances as may be determined by the CSRC.

APPENDIX II THE ASSESSMENT MANAGEMENT METHODS IN RESPECT OF THE IMPLEMENTATION OF THE SHARE OPTION SCHEME

The Grant of Options to a Participant shall be conditional upon there being no occurrence of any of the following in respect of the Participant:

- (i) he has been held to be an inappropriate candidate by a stock exchange in the last 12 months;
- (ii) he has been held to be an inappropriate candidate by the CSRC or ancillary agencies in the last 12 months;
- (iii) the imposition by the CSRC or ancillary agencies of administrative penalties or measures which prohibits or restricts his access to financial markets by reason of any material violation of laws and regulations in the last 12 months;
- (iv) he is prohibited from acting as a director or a member of the senior management of a company under the Company Law;
- (v) he is not allowed to participate in an equity incentive scheme of a listed company under applicable laws and regulations; and
- (vi) other events and circumstances as may be determined by the CSRC.

In the event that any of the above events should occur, all relevant outstanding Options granted shall lapse accordingly and shall be cancelled by the Company.

The Grant of Options shall be conditional of fulfilment of the following performance-related indicators by the Company:

- (i) net profit of the Company for the 2020 financial year shall not be less than RMB280 million;
- (ii) year-on-year growth of dividend per Share between the 2019 and 2020 financial years shall not be less than 20%; and
- (iii) the above indicators not being lower than the industry average.

Notes:

1. “Net profit” refers to the net profit attributable to the Shareholders after deducting non-recurring gains and losses.
2. For the purpose of calculating industry average, all A-Share listed companies in the chemical pharmaceutical manufacturing industry of the medicine/biological sector are selected in accordance with the “Shenyin Wanguo industry classification standard” (“**Market Comparables**”). Material changes in the business structure, or outliers (i.e. those with excessive deviances or extreme values) of the samples used in same industry may be removed or substituted with other samples by the Board during the assessment.

**APPENDIX II THE ASSESSMENT MANAGEMENT METHODS IN RESPECT
OF THE IMPLEMENTATION OF THE SHARE OPTION SCHEME**

(2) Exercise Conditions

Further and subject to the satisfaction of the abovementioned conditions, any Options granted are only exercisable upon satisfaction of the following Exercise Conditions:

(i) Performance conditions relevant to the Company

Options granted pursuant to the Initial Grant and Reserved Grant under the Share Option Scheme are subject to annual performance assessment over the financial years from 2022 to 2024. The annual performance assessment conditions are set out below:

Exercise Period	Performance assessment conditions
First Exercise Period	<ol style="list-style-type: none">1. The net profit of the Company in the 2022 financial year shall not be less than (i) RMB340 million (which must represent an increase in percentile level when compared to Market Comparables values); and (ii) the industry average net profits of Market Comparables, from the time of the Grant. 2. The growth rate of the dividend per Share in the 2022 financial years shall not be less than (i) 50% of the average dividend per Share over the 2018 to 2020 financial years (such growth rate must represent an increase in percentile level when compared to Market Comparables values); and (ii) the industry average dividend per share of Market Comparables, from the time of the Grant.
Second Exercise Period	<ol style="list-style-type: none">1. The net profit of the Company in the 2023 financial year shall not be less than (i) RMB375 million (which must represent an increase in percentile level when compared to Market Comparables values); and (ii) the industry average net profits of Market Comparables, from the time of the Grant.

APPENDIX II THE ASSESSMENT MANAGEMENT METHODS IN RESPECT OF THE IMPLEMENTATION OF THE SHARE OPTION SCHEME

Exercise Period	Performance assessment conditions
	<ol style="list-style-type: none">2. The growth rate of the dividend per Share in the 2023 financial years shall not be less than (i) 60% of the average dividend per Share over the 2018 to 2020 financial years (such growth rate must represent an increase in percentile level when compared to Market Comparables values); and (ii) the industry average dividend per share of Market Comparables, from the time of the Grant.
Third Exercise Period	<ol style="list-style-type: none">1. The net profit of the Company in the 2024 financial year shall not be less than (i) RMB410 million (which must represent an increase in percentile level when compared to Market Comparables values); and (ii) the industry average net profits of Market Comparables, from the time of the Grant.2. The growth rate of the dividend per Share in the 2024 financial years shall not be less than (i) 70% of the average dividend per Share over the 2018 to 2020 financial years (such growth rate must represent an increase in percentile level when compared to Market Comparables values); and (ii) the industry average dividend per share of Market Comparables, from the time of the Grant.

Notes:

1. The above “net profit” refers to the net profit attributable to the Shareholders after deducting non-recurring gains and losses.
2. For the purpose of calculating industry average, the Market Comparables are used. Material changes in the business structure, or outliers (i.e. those with excessive deviances or extreme values) of the samples used in same industry may be removed or substituted with other samples by the Board during the assessment.

If the Exercise Conditions are fulfilled, Participants may exercise the Option granted in accordance with the Share Option Scheme. On the contrary, if any of the Exercise Conditions is not satisfied, the Company will cancel the Options granted to the Participants in accordance with the Share Option Scheme.

APPENDIX II THE ASSESSMENT MANAGEMENT METHODS IN RESPECT OF THE IMPLEMENTATION OF THE SHARE OPTION SCHEME

(ii) *Performance conditions relevant to Participants*

Participants shall be assessed annually in accordance with the Company's *Assessment Management Methods in Respect of the Implementation of the 2021 Share Option Scheme* (《2021年股票期權激勵計劃實施考核管理辦法》), and the assessment results shall be determined according to individual performance assessment indicators, as extracted below:

Assessment results	Excellent (A)	Good (B)	Passed (C)	Failed (D)
Standard co-efficient	1.0	1.0	0.8	0

Actual individual exercisable limit of the current assessment year = standard coefficient × individual exercisable limit of the current year.

If a Participant fails to pass the assessment, the Company will cancel the Options granted but not exercised during the corresponding Exercise Period according to the provisions of the Share Option Scheme.

FEEDBACK AND GRIEVANCE

Participants who differ about their Assessment results may communicate with the corresponding assessment bodies and, if failed, may lodge their cases with the Remuneration and Examination Committee which shall within 10 business days reply thereto.

These Assessment Methods take effect on approval of Shareholders and in event of conflict with applicable laws, rules and regulations such applicable laws, rules and regulations shall prevail.

1. RESPONSIBILITY STATEMENT

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

2. INTERESTS OF DIRECTORS AND SUPERVISORS

As at the Latest Practicable Date, the following Directors and Supervisors are interested in the securities of the Company:

Name	Number of A Shares	Approximate percentage of shareholding in total issued A Shares	Approximate percentage of shareholding in total issued share capital
Directors:			
Mr. Zhang Daiming	117,470(L) <i>(Note 2)</i>	0.0272	0.0187
	174,888(L) <i>(Note 3)</i>	0.0404	0.0279
Mr. Du Deping	151,568(L) <i>(Note 3)</i>	0.0351	0.0242
	91,800(L) <i>(Note 4)</i>	0.0212	0.0146
Mr. Xu Lie	81,614(L) <i>(Note 3)</i>	0.0189	0.0130
	74,800(L) <i>(Note 4)</i>	0.0173	0.0119
Mr. He Tongqing	116,592(L) <i>(Note 3)</i>	0.0270	0.0186
	74,800(L) <i>(Note 4)</i>	0.0173	0.0119
Mr. Cong Kechun	Nil	–	–
Mr. Pan Guangcheng	Nil	–	–
Mr. Zhu Jianwei	Nil	–	–
Mr. Lo Wah Wai	Nil	–	–
Supervisors:			
Mr. Liu Chengtong	Nil	–	–
Mr. Tao Zhichao	Nil	–	–
Ms. Hu Yanhua	34,977(L) <i>(Note 3)</i>	0.0081	0.0056
Mr. Wang Jianping	Nil	–	–
Mr. Xiao Fangyu	Nil	–	–

(L) – Long Position

Notes:

1. All interests in the securities of the Company owned by the Directors, Supervisors and senior management of the Company are long position in A Shares.
2. Mr. Zhang Daiming personally holds 117,470 A Shares (among them 102,000 Shares were issued pursuant to first exercise of options under the A share option scheme adopted in the Shareholders' meeting held on 28 December 2018 (the "2018 Share Option Scheme").
3. The relevant Shares are held under the 2018 Share Option Scheme of which the relevant person is a participant.
4. The relevant Shares were issued pursuant to the first exercise of options under the stock option incentive plan.
5. Save as disclosed above, no Directors, Supervisors or chief executive of the Company was interested in the equity or debt securities of the Company or any associated corporations (within the meaning of the SFO) which (i) were required to be notified to the Company and the Hong Kong Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they are taken or deemed to have under such provisions of the SFO); (ii) were required, pursuant to section 352 of the SFO, to be entered in the register referred to therein; or (iii) were required, pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers, to be notified to the Company and the Hong Kong Stock Exchange.

3. MATERIAL INTEREST

As at the Latest Practicable Date, save as disclosed, none of the Directors had a material interest in the CCT Agreements and the continuing connected transactions contemplated thereunder.

As at the Latest Practicable Date, none of the Company, its holding company and fellow subsidiaries of its controlling shareholder had entered into any contracts in relation to the Group's business in which any Directors or Supervisors had a material interest, whether directly or indirectly.

As at the Latest Practicable Date, none of the Directors had any direct or indirect interest in any assets which have been, since the date to which the latest published audited accounts of the Group were made up, acquired or disposed of by, or leased to any member of the Group, or are proposed to be acquired or disposed of by, or leased to, any member of the Group.

4. COMPETING INTEREST

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

5. INTERESTS OF SUBSTANTIAL SHAREHOLDERS

As at the Latest Practicable Date, so far as was known to the Directors, the persons (other than a Director, a Supervisor or chief executive of the Company) who had an interest or a short position in the Shares or underlying Shares which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO or who was (other than HKSCC (Nominees) Limited), directly or indirectly, interested in 10% or more of the nominal value of any class of Shares carrying rights to vote in all circumstances at general meetings of the Company were as follows:

Name of Shareholder	Class of Shares	Number of Shares held	Percentage of the total issued Shares (%)
HHC <i>(Note 1)</i>	A Shares	204,864,092	32.65%

Note:

- Such figure excludes the 4,143,168 A Shares held by Hualu Investment Co. Ltd (“**Hualu Investment**”), a direct wholly owned subsidiary of HHC. As at the Latest Practicable Date, each of Hualu Investment and Well Bring Limited (“**Well Bring**”) is a direct wholly owned subsidiary and an indirect wholly owned subsidiary of HHC, respectively. Well Bring owns 20,827,800 H Shares of the Company (being overseas listed foreign shares), representing approximately 3.32% of the issued share capital of the Company. Hualu Investment owns 4,143,168 A Shares of the Company, representing approximately 0.66% of the issued share capital of the Company.

6. MATERIAL ADVERSE CHANGE

The Directors confirm that there has been no material adverse change in the overall financial or trading position or outlook of the Group since 31 December 2020, being the date to which the latest published audited consolidated financial statements of the Group were made up, up to and including the Latest Practicable Date.

7. CONSENT OF EXPERT

The following expert has given and has not withdrawn its written consent to the issuance of this circular with the inclusion of its letter and reference to its name in the form and context in which it appears:

Name	Qualification
Altus Capital Limited	a licensed corporation to carry out type 4 (advising on securities), type 6 (advising on corporate finance) and type 9 (asset management) regulated activity under the SFO

To the best knowledge of the Directors, as at the Latest Practicable Date, the Independent Financial Adviser did not have any shareholding in any member of the Group or the right (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for securities in any member of the Group.

To the best knowledge of the Directors, as at the Latest Practicable Date, the Independent Financial Adviser did not have any direct or indirect interest in any asset which had been acquired or disposed of by or leased to the Company, or were proposed to be acquired or disposed of by or leased to the Company, since 31 December 2020, being the date to which the latest published audited financial statements of the Company were made up.

8. SERVICE CONTRACT

As at the Latest Practicable Date, none of the Directors and Supervisors had entered into, or proposed to enter into, a service contract with the Company or any member of the Group which does not expire or is not terminable by such member of the Group within one year without payment of compensation, other than statutory compensation.

9. VOTE BY POLL

Pursuant to Rule 13.39(4) of the Listing Rules, the vote of Shareholders at the EGM shall be taken by poll.

10. DOCUMENTS AVAILABLE FOR INSPECTION AND ON DISPLAY

In relation to the Share Option Scheme, copies of the Scheme Documents and the articles of association of the Company will be available for inspection at the office of Charltons, the Hong Kong legal advisers to the Company, at 12th Floor, Dominion Centre, 43–59 Queen’s Road East, Hong Kong during normal business hours on any weekday (except general holidays) from the date of this circular up to and including the date of the EGM and the Class Meetings.

In relation to the renewal of continuing connected transactions under CCT Agreements, a copy of each of the following documents will be available on display online on the Stock Exchange’s website through e-Submission System and on the Company’s website from the date of this circular up to and including the date of the EGM:

- (a) the letter from the IBC dated 15 December 2021, the text of which is set out on page 31 of this circular;

- (b) the letter of recommendation from the Independent Financial Adviser dated 15 December 2021, the text of which is set out on pages 32 to 55 of this circular;
- (c) the written consent of Independent Financial Adviser, which was referred to in the section headed “7. Consent of Expert” in this appendix;
- (d) the CCT Agreements; and
- (e) a copy of this circular.

NOTICE OF EGM AND OF H SHAREHOLDERS' CLASS MEETING

Hong Kong Exchanges and Clearing Limited and The Stock Exchange of Hong Kong Limited take no responsibility for the contents of this notice, make no representation as to its accuracy or completeness and expressly disclaim any liability whatsoever for any loss howsoever arising from or in reliance upon the whole or any part of the contents of this notice.



山東新華製藥股份有限公司
Shandong Xinhua Pharmaceutical Company Limited

(a joint stock company established in the People's Republic of China with limited liability)

(Stock Code: 00719)

NOTICE OF EXTRAORDINARY GENERAL MEETING AND OF H SHAREHOLDERS' CLASS MEETING

NOTICE IS HEREBY GIVEN that the board of directors (the “**Board**”) of Shandong Xinhua Pharmaceutical Company Limited (the “**Company**”) has decided to hold an extraordinary general meeting (the “**EGM**”), the Class Meeting (the “**A Shareholders Class Meeting**”) of the Shareholders of A Shares (the “**A Shareholders**”) and the Class Meeting (the “**H Shareholders Class Meeting**”; together with the EGM and the A Shareholders Class Meeting, the “**Meetings**”) of the Shareholders of H Shares (the “**H Shareholders**”; together with the A Shareholders, the “**Shareholders**”) of the Company from 2 p.m. on 31 December 2021, Friday.

The details of the Meetings are provided as follows:

A. CONVENING OF THE MEETINGS

1. Time of the Meetings

The EGM and the H Shareholders Class Meeting will commence at 2:00 p.m. and 4:00 p.m. (or immediately after the conclusion or adjournment of the A Shareholders Class Meeting) respectively on 31 December 2021, Friday.

NOTICE OF EGM AND OF H SHAREHOLDERS' CLASS MEETING

2. Venue of the physical Meetings

The Meetings will be held at the Company's conference room at No. 1 Lutai Ave., Hi-tech District, Zibo City, Shandong Province, The People's Republic of China (the "PRC").

3. Convenor

The Meetings were convened by the Board.

4. Ways of conducting the Meetings

The A Shareholders or the duly appointed proxies thereof may vote at the EGM and the A Shareholders Class Meeting by way of physical voting or online voting, whereas the H Shareholders or the duly appointed proxies thereof may vote at the EGM and the H Shareholders Class Meeting by way of physical voting.

5. Eligible attendees

(1) *Shareholders*

The EGM:

All the A Shareholders whose names appear on the register of members, kept by China Securities Depository and Clearing Corporation Limited, Shenzhen Office, as at the close of A share trading session on Shenzhen Stock Exchange on 28 December 2021, Tuesday.

For information on the attendance of the A Shareholders, please refer to the notice(s) to A Shareholders in respect of the EGM and A Shareholders Class Meeting published by the Company on the website of the Shenzhen Stock Exchange of even date.

All the H Shareholders whose names appear on the register of members of H shares of the Company ("H Shares") at 4:30 p.m. on 16 December 2021, Thursday.

The H Shareholders Class Meeting:

All the H Shareholders whose names appear on the register of members of H Shares on 16 December 2021, Thursday after 4:30 p.m.

NOTICE OF EGM AND OF H SHAREHOLDERS' CLASS MEETING

- (2) Proxies duly appointed by the Shareholders;
- (3) Directors (“**Directors**”), supervisors (“**Supervisors**”) and senior management (with the meaning ascribed thereto under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the “**Listing Rules**”), (the “**Senior Management**”) of the Company;
- (4) Legal advisers to the Company; and
- (5) Auditors of the Company.

B. MATTERS FOR CONSIDERATION AND APPROVAL AT THE EGM

The following resolutions will be submitted for consideration and approval at the EGM:

Special Resolutions ^{Note 11}

1. To consider and approve the proposed Share Option Scheme of the Company, the proposed Grant of Options (including the Initial Grant and the Reserved Grant) thereunder and a summary thereof (copies of which were tabled at the meeting and marked “**A**” and “**B**” respectively and initialed by the chairperson of the meeting for identification purpose).

“**THAT** the Share Option Scheme and the summary thereof (copies of which were tabled at the meeting and marked “**A**” and “**B**” respectively and initialed by the chairperson of the meeting for identification purpose) be and is hereby approved and adopted.”

2. To consider and approve the assessment methods in respect of the implementation and management of the Share Option Scheme (a copy of which were tabled at the meeting and marked “**C**” and initialed by the chairperson of the meeting for identification purpose) (the “**Assessment Methods**”, and together with the Share Option Scheme, collectively, the “**Scheme Documents**”).

“**THAT** the Assessment Methods thereof (of which a copy was tabled at the meeting and marked “**C**” and initialed by the chairperson of the meeting for identification purpose) be and is hereby approved.”

3. To authorise the Board throughout the Validity Period to determine and deal with and to make delegations as appropriate to deal with any matters in relation to, in furtherance of, for the implementation and management of and/or for the construction or interpretation of the Scheme Documents pursuant to Shareholders’ approval and to the applicable laws, rules and regulations.

NOTICE OF EGM AND OF H SHAREHOLDERS' CLASS MEETING

“**THAT** the Board be and is hereby authorised throughout the Validity Period of the Share Option Scheme to determine and deal with and to make delegations to deal with all matters in relation to, in furtherance of, for the implementation and management of and/or for the construction or interpretation of the Scheme Documents pursuant to Shareholders’ approval and to the applicable laws, rules and regulations including without limitation to the Grant of Options (including the Initial Grant and the Reserved Grant) to Participants eligible or specified under the Scheme Documents, the issuance of the underlying Shares on the exercise of the Options and any registration, filing or procedures otherwise for such purposes as the listing of the issued Shares on the Shenzhen Stock Exchange, and any adjustment of the Options, the Grant (including the Initial Grant and the Reserved Grant) or the Scheme Documents to the extent permissible under such applicable laws, rules and regulations as the Listing Rules and pursuant to the approval of the Shareholders hereof and the terms of the Scheme Documents.”

Ordinary Resolutions ^{Note 12}

To consider and approve the Shandong Lukang Agreement dated 23 November 2021, the China Shandong Agreement dated 23 November 2021 and the Hualu Hengsheng Agreement dated 23 November 2021 (collectively, the “**CCT Agreements**”), their respective annual caps and the continuing connected transactions contemplated thereunder.

C. MATTERS FOR CONSIDERATION AND APPROVAL AT THE H SHAREHOLDERS CLASS MEETING

The following resolutions will be submitted for consideration and approval at the H Shareholders Class Meeting:

Special Resolutions ^{Note 11}

1. To consider and approve the proposed Share Option Scheme of the Company, the proposed Grant of Options (including the Initial Grant and the Reserved Grant) thereunder, and a summary thereof.

“**THAT** the Share Option Scheme, the proposed Grant of Options (including the Initial Grant and the Reserved Grant) thereunder and the summary thereof (copies of which were tabled at the meeting and marked “**A**” and “**B**” respectively and initialed by the chairperson of the meeting for identification purpose) be and is hereby approved and adopted.”

NOTICE OF EGM AND OF H SHAREHOLDERS' CLASS MEETING

2. To consider and approve the Assessment Methods.

“**THAT** the Assessment Methods thereof (of which a copy was tabled at the meeting and marked “C” and initialed by the chairperson of the meeting for identification purpose) be and is hereby approved.”

3. To authorise the Board throughout the Validity Period to determine and deal with and to make delegations as appropriate to deal with any matters in relation to, in furtherance of, for the implementation and management of and/or for the construction or interpretation of the Scheme Documents pursuant to Shareholders' approval and to the applicable laws, rules and regulations.

“**THAT** the Board be and is hereby authorised throughout the Validity Period of the Share Option Scheme to determine and deal with and to make delegations to deal with all matters in relation to, in furtherance of, for the implementation and management of and/or for the construction or interpretation of the Scheme Documents pursuant to Shareholders' approval and to the applicable laws, rules and regulations including without limitation to the Grant of Options (including the Initial Grant and the Reserved Grant) to Participants eligible or specified under the Scheme Documents, the issuance of the underlying Shares on the exercise of the Options and any registration, filing or procedures otherwise for such purposes as the listing of the issued Shares on the Shenzhen Stock Exchange, and any adjustment of the Options, the Grant (including the Initial Grant and the Reserved Grant) or the Scheme Documents to the extent permissible under such applicable laws, rules and regulations as the Listing Rules and pursuant to the approval of the Shareholders hereof and the terms of the Scheme Documents.”

D. REGISTRATION OF THE MEETINGS

1. The register of members of the Company will be closed from 17 December to 31 December 2021 (both days inclusive), during which period no H Share transfers will be registered. Shareholders whose names appear on the register of members of the Company kept by the Hong Kong Registrars Limited at 4:30 p.m. on 16 December 2021, Thursday and on the register of members kept by the China Securities Registrar Company Limited Shenzhen Branch after the closing of Shenzhen Stock Exchange on 28 December 2021, Tuesday and the Directors, the Supervisors and the Senior Management are entitled to attend the EGM or any adjournment thereof.
2. H Shareholders who wish to attend the EGM shall lodge their share transfer instruments accompanied by the relevant share certificates with the share registrar for the Company's H Shares not later than 4:30 p.m. on 16 December 2021, Thursday.

NOTICE OF EGM AND OF H SHAREHOLDERS' CLASS MEETING

The address of the share registrar for the Company's H Shares:

Hong Kong Registrars Limited
Rooms 1712–1716, 17th Floor, Hopewell Centre
183 Queen's Road East, Wanchai, Hong Kong

3. Shareholders who intend to attend the EGM and/or H Shareholders Class Meeting are requested to send the completed and signed reply slip for attendance despatched to the Shareholders together with this notice to the office of the secretary to the Board (see Note 8 below) or to the share registrar for the Company's H Shares (see Note 2 above) on or before 30 December 2021, by hand, by post or by facsimile. The written reply will not affect the right of the Shareholders to attend and vote at the EGM and/or the H Shareholders Class Meeting.
4. Shareholders entitled to attend and vote at the EGM and/or the H Shareholders Class Meeting may appoint one or more proxies (whether the person is a Shareholder or not) to attend and vote on his/her/its behalf at the EGM and/or the H Shareholders Class Meeting. When a Shareholder appoints more than one proxy, such proxies may only vote by way of poll.
5. Shareholders may only appoint a proxy or proxies in writing i.e. the proxy forms ("**Proxy Forms**") despatched to the Company's shareholders together with this notice or a copy thereof, which shall be in compliance with the instructions thereon and signed by the person appointing the proxy or proxies or by his/her/its duly authorised attorney. If the form of proxy is signed by an attorney, the document appointing the attorney must be certified by a notary public. If the appointing Shareholder is a legal entity, its seal or the signature of its director(s) or representative(s) duly authorised in writing is required. To be valid, a notarised power of attorney or other authority (if any) and the forms of proxy must be received by the office of the secretary to the Board (see Note 8 below) 24 hours prior to the commencements of the EGM and the H Shareholders Class Meeting (as the case may be). The completion and deposit of a form of proxy will not preclude any Shareholder from attending and voting in person at the EGM and/or the H Shareholders Meeting (as the case may be) or any adjournment thereof.
6. Shareholders or their proxies shall present proof of identity as required upon attending the EGM and/or the H Shareholders Class Meeting (as the case may be). Should a proxy be appointed, the proxy shall also present his/her form of proxy.
7. The Meetings are expected to last half a day. Shareholders who attend any of the Meetings shall bear their own traveling and accommodation expenses.

NOTICE OF EGM AND OF H SHAREHOLDERS' CLASS MEETING

8. The address of the office of the secretary to the Board is as follows:
- No.1 Lutai Ave., Hi-tech District, Zibo City, Shandong Province, PRC
Postal Code: 255086
Telephone: 86 533 2196024
Facsimile: 86 533 2287508
9. All references to time herein refer to Hong Kong time.
10. For the arrangements applicable to the A Shareholders in respect of the EGM and the A Shareholders Class Meeting, please refer to the notice(s) to A Shareholders published by the Company on the website of the Shenzhen Stock Exchange of even date.
11. The principal terms of the Scheme Documents have been set out in the announcement of the Company dated 29 October 2021 and all capitalised terms under these resolutions and this note shall have the same meanings as defined in the abovementioned announcement. A circular containing, amongst others, a summary of the terms of the Scheme Documents, the proposed exercise price of the Options, the methods and procedures for adjusting the number and the exercise price of the Options, the proposed Participants and the proposed Grant has been despatched to Shareholders as at the date of this notice in due course.
12. The details of the CCT Agreements, their respective annual caps and the continuing connected transactions contemplated thereunder and the regulatory implications thereof have been set out in the announcement of the Company dated 23 November 2021. A circular in relation thereto has been despatched to H Shareholders as at the date of this notice in due course.

E. DOCUMENTS AVAILABLE FOR INSPECTION

Resolutions passed at the 2021 fourth and the fifth extraordinary meeting of the tenth session of the Board.

NOTICE OF EGM AND OF H SHAREHOLDERS' CLASS MEETING

F. SOLICITATION OF VOTES BY INDEPENDENT NON-EXECUTIVE DIRECTORS

Pursuant to the 上市公司股權激勵管理辦法 (the Administrative Measures on Equity Incentives of Listed Companies) issued by the China Securities Regulatory Commission, independent directors of a company whose securities are listed on the Shenzhen Stock Exchange should solicit votes publicly from its shareholders on resolutions in relation to the adoption of an equity incentive scheme. The purpose of such arrangement is to encourage the securities holders to participate in the voting on the resolutions on the adoption of equity incentive schemes as by providing them with an additional way of participation in the meeting(s) of such securities holders.

As the A Shares of the Company are listed and tradable on the Shenzhen Stock Exchange, the independent non-executive Directors have nominated Mr. Pan Guangcheng (the “**INED**”) to solicit on their behalf Shareholders, votes on all special resolutions in relation to the Scheme Documents to be tabled at the Meetings. No solicitation is made on the other resolutions which are not related to the Scheme Documents.

The INED has for the abovementioned purpose prepared and enclosed herewith the proxy forms for appointing the INED as a proxy at the EGM and the H Shareholders Class Meeting respectively (collectively, the “**INED Proxy Forms**”). Should you wish to appoint the INED as your proxy to vote for you and on your behalf at the EGM and/or the H Shareholders Class Meeting, please complete and return the relevant INED Proxy Form(s) to Hong Kong Registrars Limited at 17M Floor, Hopewell Centre, 183 Queen’s Road East, Wanchai, Hong Kong 24 hours prior to the EGM and/or the H Shareholders Class Meeting (as the case may be).

You may appoint the INED as your proxy by filling in the INED Proxy Forms in accordance with the instructions imprinted thereon to vote for you and on your behalf solely on the special resolutions in relation to the Scheme Documents. Should you wish to appoint your own proxy to vote for you on the special resolutions including those related to the Scheme Documents and the ordinary resolution in relation to the CCT Agreements at the EGM and/or the H Shareholders Class Meeting (as the case may be), you may disregard the INED Proxy Forms and complete and return the Proxy Forms (enclosed herewith). Should you return both the Proxy Forms and the INED Proxy Forms and your voting instructions thereon are inconsistent, your voting instructions in the INED Proxy Form shall prevail in relation to the resolutions on the Scheme Documents.

NOTICE OF EGM AND OF H SHAREHOLDERS' CLASS MEETING

Your appointment of the INED as the proxy by way of an INED Proxy Form shall be deemed revoked if (a) the INED Proxy Form is not completed in accordance with the instructions imprinted thereon; (b) prior to the commencement(s) of the EGM and/or the H Shareholders Class Meeting (as the case may be) you have duly notified the Company in writing revocation of such appointment; or (c) your duly appointed proxy other than the INED has prior to the EGM and/or the H Shareholders Class Meeting (as the case may be) been present at the meeting venue and produced your written revocation of the appointment of the INED as your proxy.

By Order of the Board
Shandong Xinhua Pharmaceutical Company Limited
Zhang Daiming
Chairman

15 December 2021, Zibo, PRC

As at the date hereof, the Board comprises:

Executive Directors:

Mr. Zhang Daiming (*Chairman*)
Mr. Du Deping
Mr. He Tongqing

Independent Non-executive Directors:

Mr. Lo Wah Wai
Mr. Pan Guangcheng
Mr. Zhu Jianwei

Non-executive Directors:

Mr. Xu Lie
Mr. Cong Kechun