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Zhongzhi Pharmaceutical Holdings Limited **中智藥業控股有限公司**

(Incorporated in the Cayman Islands with limited liability)
(Stock Code: 3737)

CHANGE IN USE OF PROCEEDS

Reference is made to the prospectus issued by Zhongzhi Pharmaceutical Holdings Limited (the “**Company**”, together with its subsidiaries, the “**Group**”) dated 30 June 2015 (the “**Prospectus**”) in relation to the public offer and placing of the shares of the Company for the listing on the Main Board of The Stock Exchange of Hong Kong Limited (the “**Listing**”). Unless otherwise defined, capitalised terms used in this announcement shall have the same meanings as those defined in the Prospectus.

USE OF PROCEEDS

The net proceeds from the Listing received by the Company, after deducting underwriting commissions and related expenses in connection with the Listing, amounted to approximately HK\$452.9 million (the “**IPO Proceeds**”).

It was disclosed under the section headed “Future Plans and Use of Proceeds” in the Prospectus that the Group intended to use the IPO Proceeds (adjusted on a pro-rata basis according to the net proceeds) for the following purposes:

- (i) approximately HK\$90.6 million (equivalent to approximately 20% of the IPO Proceeds) will be used for the expansion of the distribution networks;
- (ii) approximately HK\$90.6 million (equivalent to approximately 20% of the IPO Proceeds) will be used for the purchase of machineries for our manufacturing of modern decoction pieces and to upgrade the existing production facilities;

- (iii) approximately HK\$135.9 million (equivalent to approximately 30% of the IPO Proceeds) will be used for the expansion of the pharmaceutical chain in the Guangdong province;
- (iv) approximately HK\$90.6 million (equivalent to approximately 20% of the IPO Proceeds) will be used to continue the research and development activities with a focus on the application of modern decoction pieces production techniques and strengthening the product portfolio of the Group; and
- (v) approximately HK\$45.3 million (equivalent to approximately 10% of the IPO Proceeds) will be used for working capital and other general corporate purposes.

As at the date of this announcement, approximately HK\$199.1 million of the IPO Proceeds remain unutilised.

CHANGE IN USE OF PROCEEDS

The board of the directors of the Company (the “**Board**”) has resolved to change the use of the remaining unutilised IPO Proceeds. An analysis of the utilisation of the IPO Proceeds up to the date of this announcement and the proposed change of use of the remaining IPO Proceeds (the “**Proposed Change**”) are summarized as follows:

	Proposed use of proceeds as disclosed in the Prospectus <i>HK\$'000</i> <i>Approximate</i>	Utilised IPO Proceeds up to the date of this announcement <i>HK\$'000</i> <i>Approximate</i>	Unutilised IPO Proceeds as at the date of this announcement <i>HK\$'000</i> <i>Approximate</i>	Proposed change of use of proceeds <i>HK\$'000</i> <i>Approximate</i>
(i) Expansion of distribution network				
— Recruitment of additional sales staff and increase of sales and marketing activities	45,290	(45,290)	—	52,086
— Placing advertisements	45,290	(45,290)	—	20,274
	<u>90,580</u>	<u>(90,580)</u>	<u>—</u>	<u>72,360</u>
(ii) Expansion of pharmaceutical chain in the Guangdong province				
— Establishment of 30 self-operated pharmacies in each of Jiangmen and Zhuhai	40,760	—	40,760	—
— Establishment of 40 self-operated pharmacies in each of Foshan and Dongguan	54,350	—	54,350	—
— Establishment of 60 self-operated pharmacies in other cities of the Guangdong province	40,760	(40,760)	—	22,750
	<u>135,870</u>	<u>(40,760)</u>	<u>95,110</u>	<u>22,750</u>
(iii) Expansion of production capacity				
— Purchase of machineries for the manufacturing of modern decoction pieces	72,460	(32,371)	40,089	22,248
— Automation of current production procedures by upgrading existing production facilities	18,120	(2,942)	15,178	1,359
— Construction of new factory building and ancillary facilities	—	—	—	20,706
— Renovation of existing factory building and ancillary facilities	—	—	—	10,954
	<u>90,580</u>	<u>(35,313)</u>	<u>55,267</u>	<u>55,267</u>
(iv) Providing funding for research and development activities				
— Recruitment of additional experts and staff for different aspects of research and development	22,650	(419)	22,231	—
— Purchase of new equipment required for research and development activities	31,700	(5,257)	26,443	1,214
— Funding of research and development activities	36,230	(36,230)	—	47,460
	<u>90,580</u>	<u>(41,906)</u>	<u>48,674</u>	<u>48,674</u>
(v) General working capital purposes				
	<u>45,290</u>	<u>(45,290)</u>	<u>—</u>	<u>—</u>
	<u>452,900</u>	<u>(253,849)</u>	<u>199,051</u>	<u>199,051</u>

REASON FOR CHANGE IN USE OF PROCEEDS

The major reasons for the Proposed Change are as follows:

(i) *Expansion of distribution network*

With reference to the annual results announcement of the Company for the year ended 31 December 2017, our modern Chinese medicine decoction pieces — Caojinghua cell wall broken herbs has recorded significant increase in sales by approximately RMB157 million to approximately RMB357 million for the year ended 31 December 2017, which was mainly contributed by the Group's extensive distribution network.

As such, the Board considers the expansion of the distribution network for our modern Chinese medicine decoction pieces products to enhance public awareness of the Group's brand may allow the Group to capture the increasing demand of the modern Chinese medicine decoction pieces products in a timely manner. The Proposed Change for the expansion of the distribution network will include but not limited to the following:

- (a) approximately HK\$52.1 million for the recruitment of additional sales staff and increase of our sales and marketing activities, including but not limited to, organization of seminars and conferences to educate or promote our product knowledge to existing and/or new distributors; consolidate our relationship with our existing distributors and independent chain pharmacies; and explore new relationship with other distributors and independent chain pharmacies; and
- (b) approximately HK\$20.3 million for placing advertisements through television, newspapers, medical journals and sponsoring certain pharmaceutical conferences to promote our brands, our own-branded products and our chain pharmacies.

(ii) *Expansion of pharmaceutical chain*

The Group has recorded steady progress for the expansion of the self-operated pharmaceutical chain in the Guangdong province with over 70 new shops opened since the Listing up to the date of this announcement. Revenue contributed by the operation of chain pharmacies has increased by approximately 12.3% from approximately RMB389 million for the year ended 31 December 2016 to approximately RMB437 million for the year ended 31 December 2017. As such,

the Group will continue to expand the self-operated in the Guangdong province in the future, where approximately HK\$22.8 million will be allocated for the establishment of over 30 self-operated pharmacies in the Guangdong province.

Nevertheless, the Board considered that the prospect of expansion of self-operated pharmaceutical chains in Jiangmen, Zhuhai, Foshan and Dongguan may not be favorable taking into account the existing independent pharmaceutical chains established, consumer behavior and spending power in these regions. As such, the Group has not yet opened any pharmaceutical chains in the said regions.

As the sales growth contributed by our distribution network is significantly higher than that of our operation of self-operated chain pharmacies, the Group has shifted its business focus in the expansion of distribution network as discussed under point (i) above in order to maximize the return for the Shareholders.

As such, the Board considers that the unutilised IPO Proceeds for the expansion of pharmaceutical chain in Jiangmen, Zhuhai, Foshan and Dongguan be reallocated for the expansion of the self-operated pharmaceutical chain in other regions in Guangdong province and the expansion of our distribution network as discussed under point (i) above.

(iii) *Expansion of production capacity*

In view of the increasing sales demand of the Group's modern Chinese medicine decoction pieces products, the Board considers that the Group shall continue to increase its production capacity to meet with such demand. The Board has reassessed the funding needs for the expansion of production capacity as follows:

- (a) approximately HK\$22.2 million for the purchase of machineries for the manufacturing of modern decoction pieces;
- (b) approximately HK\$1.4 million for upgrading existing production lines and facilities;
- (c) approximately HK\$20.7 million for the construction of new factory buildings and ancillary facilities including but not limited to, factory building with new production lines, freezer compartment building and staff canteen; and

(d) approximately HK\$11.0 million for the renovation of existing factory buildings and ancillary facilities including but not limited to, upgrading existing infrastructure in accordance to GMP certificate standard, electrical utilities expansion and renovation of staff canteen.

(iv) *Providing funding for research and development activities*

The Group is committed to continue its research and development activities to strengthen our product portfolio in order to support our long term growth. Since the Listing, our research and development on the application of modern decoction pieces technologies has continued to record satisfactory progress.

With the collaboration of our in-house research and development team with certain independent institutions and universities, the Board has reassessed the funding needs for the research and development activities and considers the existing research and development team and equipment are sufficient, therefore the Group may not require additional in-house experts and staff and new equipment.

As such, the Group would reallocate the unutilised IPO Proceeds totaling of approximately HK\$47.5 million for the recruitment of additional experts and staff and purchase of new research and development equipment to provide funding for research and development activities.

Taking into account the current business focus and strategies of the Company above, the Board considers that the Proposed Change will allow the Company to deploy its financial resources more effectively, which is in the best interest of the Company and its shareholders as a whole.

By order of the Board
Zhongzhi Pharmaceutical Holdings Limited
Mr. Lai Zhi Tian
Chairman and Executive Director

Hong Kong, 4 April 2018

As at the date of this announcement, the Board comprises eight directors. The executive directors are Mr. Lai Zhi Tian, Ms. Mou Li, Mr. Cao Xiao Jun and Mr. Cheng Jin Le. The non-executive director is Ms. Jiang Li Xia. The independent non-executive directors are Mr. Ng Kwun Wan, Mr. Wong Kam Wah and Mr. Zhou Dai Han.