

STATEMENT OF DISCIPLINARY ACTION

Exchange's Disciplinary Action against Fusen Pharmaceutical Company Limited (Stock Code: 1652) and Five Current Directors

SANCTIONS AND DIRECTIONS

The Stock Exchange of Hong Kong Limited (**Exchange**)

CENSURES:

- (1) **Fusen Pharmaceutical Company Limited** (Stock Code: 1652) (**Company**);
- (2) **Mr Cao Chang Cheng**, Chairman and Executive Director (**ED**) of the Company (**Mr Cao CC**);
- (3) **Mr Cao Zhi Ming**, ED and Chief Executive Officer of the Company (**Mr Cao ZM**);
- (4) **Mr Chi Yong Sheng**, ED of the Company (**Mr Chi**);
- (5) **Mr Hou Tai Sheng**, ED of the Company (**Mr Hou**); and
- (6) **Ms Meng Qing Fen**, ED of the Company (**Ms Meng**).

(The directors identified at (2) to (6) above are collectively referred to as the **Relevant Directors**.)

AND FURTHER DIRECTS:

Each of the Relevant Directors to attend 24 hours of training on regulatory and legal topics including Listing Rule compliance.

HEARINGS

On 26 July 2022, the Listing Committee held a hearing into the conduct of the Company and the Relevant Directors in relation to their obligations under the Exchange Listing Rules and the Undertakings.

On 16 November 2022, the Listing Review Committee conducted a hearing of the review application of the Company and the Relevant Directors in respect of the findings of breaches and sanctions imposed by the Listing Committee.

.../2

SUMMARY OF FACTS

The Company was listed on the Exchange in July 2018. Prior to listing, the Relevant Directors attended a training provided by the Company on Listing Rule compliance (including directors' duties and connected transactions) in January 2018. Further, as part of the due diligence process for the purpose of its listing, an external consultant had been engaged to conduct a review on the internal controls of the Company.

The Advances

From March 2019 to November 2019, the Company, via its wholly-owned subsidiary Henan Fusen Pharmaceutical Company Limited (transliteration of 河南福森藥業有限公司) (**Henan Fusen**), made twenty advances of approximately RMB258 million in total to a connected person Xichuan Fusen Chinese Medicine Raw Material Plant and Development Limited (transliteration of 浙川縣福森中藥材種植開發有限公司) (**Fusen Chinese Medicine**) (**Advances**). The aggregate amount of the Advances was significantly larger than the cash generated from operations of RMB41 million for the year ended 31 December 2019 as reported in its cash flow statement.

By 25 December 2019, Fusen Chinese Medicine had fully repaid the principal amount of the Advances.

On 23 March 2020, the Company announced the Advances.

In the same announcement, the Company admitted that the Advances constituted: (i) connected transactions subject to the reporting, announcement, circular, and independent shareholders' approval requirements under Chapter 14A of the Listing Rules; (ii) discloseable transactions subject to the notification and announcement requirements under Chapter 14 of the Listing Rules; and (iii) advances to an entity subject to the announcement requirements under Rules 13.13 and 13.14.

The Company did not consult its compliance adviser (**Compliance Adviser**) as required under the Listing Rules in respect of the Advances when they were contemplated.

The Payments

From January 2020 to February 2020, the Company (via Henan Fusen) made two transfers of RMB50 million in total to Fusen Chinese Medicine (**Payments**).

By 28 February 2020, Fusen Chinese Medicine had fully repaid the Payments to the Company.

The Payments, on an aggregated basis, constituted connected transactions subject to the announcement, circular and independent shareholders' approval requirements under Rules 14A.35, 14A.36 and 14A.46.

The Company did not announce, issue a circular to its shareholders or seek independent shareholders' approval for the Payments.

Knowledge of the Relevant Directors of the Advances

Mr Cao CC (Chairman and Executive Director of the Company) was also the legal representative, executive director and general manager of Fusen Chinese Medicine at the material time.

The Relevant Directors were fully aware of the Group's financial position, including the financial information contained in the monthly financial statements (**Monthly Financials**) for the material period between March 2019 and November 2019 (ie when the Advances were made).

Internal Controls

After discovery of the Company's Listing Rule breaches in respect of the Advances, the Company engaged an external consultant to conduct an internal control review, which reported various key deficiencies in internal controls, including that (i) there was no record of declarations for the list of connected persons, (ii) there was no request/ guideline to identify connected transactions and no identification record of connected transactions; (iii) there was no connected transaction ledger or reconciliation record for connected parties; (iv) there was no standard/ protocol for disclosure of connected transactions; and (v) there was no specific regulation/ control for the provision/ approval/ disclosure of outgoing loans.

There were other deficiencies in the Company's internal controls, including that (i) there was no system by which transactions with Fusen Chinese Medicine under a Master Purchase Agreement were regularly monitored against the relevant annual caps, (ii) the Company did not have its own connected transaction ledger or reconciliation record for Fusen Chinese Medicine, and (iii) the Company had not provided training on connected transactions and/or directors' duties to the directors in the year of 2019 and its accounting staff. The Company also acknowledged that there was no system by which advances or payments over a certain monetary threshold were required to be reported to, or approved by, the Board.

LISTING RULE REQUIREMENTS

Rule 3A.23(2) provides that, during the Fixed Period (as defined in Rule 3A.19), a listed issuer must consult with and, if necessary, seek advice from its compliance adviser on a timely basis in certain circumstances, including where a transaction, which might be a notifiable or connected transaction, is contemplated.

Rule 13.13 provides that, where an advance to an entity exceeds 8 per cent under the assets ratio, the listed issuer must announce details of the relevant advance to an entity as soon as reasonably practicable.

Rule 13.14 provides that where the relevant advance to an entity increases from that previously disclosed under Rule 13.13 and the amount of the increase since the previous disclosure is 3 per cent or more under the assets ratio, the listed issuer must announce details of the relevant advance to an entity as soon as reasonably practicable.

Rule 14.34 provides that, as soon as possible after the terms of, among other things, a discloseable transaction have been finalised, the listed issuer must in each case publish an announcement as soon as possible.

Rules 14A.35, 14A.36 and 14A.46 provide that, in the case of a connected transaction, the listed issuer must announce the connected transaction as soon as possible after its terms have been agreed and send a circular to its shareholders, and that the connected transaction must be made conditional on independent shareholders' approval at a general meeting.

Rule 3.08 provides that directors, both collectively and individually, are expected to fulfil fiduciary duties and duties of skill, care and diligence to a standard at least commensurate with the standard established by Hong Kong law, and sets out certain key fundamental general duties of directors including the duties to avoid actual and potential conflicts of interests and duty, and to disclose fully and fairly their interests in contracts with the issuer. Rule 3.08 also provides that directors must also take an active interest in the issuer's affairs and must follow up anything untoward that comes to their attention.

Each director is subject to the obligations in the Director's Undertakings (**Director's Undertakings**) (Appendix 5B to the Listing Rules) which include, amongst others, that he/ she will comply to the best of his/ her ability, and to use his/ her best endeavours to procure the Company's compliance, with the Listing Rules.

FINDINGS OF BREACH

The Exchange found as follows:

- (1) The Company breached Rules 13.13, 13.14, 14.34, 14A.35, 14A.36 and 14A.46 in respect of its delay in announcing the Advances as discloseable and connected transactions, and its failure in issuing a circular to its shareholders and obtaining independent shareholders' approval for the Advances as connected transactions. The Company admitted these breaches.
- (2) The Company breached Rule 3A.23 in respect of its failure to consult its Compliance Adviser when the Advances were contemplated. The Company admitted the breach.
- (3) The Payments constituted "transactions" within the meaning of Rule 14A.24. The Company therefore breached Rules 14A.35, 14A.36 and 14A.46 in respect of its failure in announcing, issuing a circular to its shareholders and obtaining independent shareholders' approval for the Payments as connected transactions.
- (4) There were considerable deficiencies in the Company's internal controls and risk management systems which contributed to the aforesaid Listing Rule breaches.
- (5) The Relevant Directors breached Rule 3.08 and their Directors' Undertakings by failing to use their best ability to comply with the Listing Rules and use their best endeavours to procure the Company to comply with the Listing Rules:
 - (i) Given his role/positions in Fusen Chinese Medicine, Mr Cao CC ought reasonably to have known of the Advances and/or their nature at the material time. He should have declared his interest in the Advances. If Mr Cao CC did not know about the Advances but had delegated his duties to an extent that he would not be consulted and had no insight into decisions involving high-risk payments such as the Advances (to a connected entity that Mr Cao CC controlled), then this demonstrated that Mr Cao CC had not in fact discharged his duties as a director and applied the necessary degree of skill, care and diligence in monitoring the Company's financial position.

- (ii) Given the Relevant Directors were fully aware of the financial information contained in the Monthly Financials for the material period between March 2019 and November 2019 (ie when the Advances were made), they should have made timely enquiries with the other directors and/or senior management; consulted, or procured the Company to consult, the Compliance Adviser when the Advances were contemplated; informed the Board of the Advances; raised for consideration and discussion by the Board of the Listing Rule implications of the Advances; and taken steps to procure the Company's Listing Rule compliance in respect of, including seeking professional advice on the Listing Rule implications of, the Advances. Insofar as the Relevant Directors made enquiries at a board meeting in December 2019, these enquiries came too late as they occurred several months after the time the main transactions comprising the Advances were made.
- (iii) The Relevant Directors further failed to protect the Company's interests in that the Advances, which were not evidenced by any written agreement and which were unsecured with no agreement on fixed repayment term, exposed the Company to a considerable risk of failing to recover the Advances from Fusen Chinese Medicine, and the Advances were initially provided to Fusen Chinese Medicine without any agreement on interest, i.e. not on normal commercial terms.
- (iv) The Relevant Directors failed to procure the Company to establish and maintain adequate and effective internal controls.

CONCLUSION

The Exchange decided to impose the sanctions and directions set out in this Statement of Disciplinary Action.

For the avoidance of doubt, the Exchange confirms that the above sanctions and directions apply only to the Company and the Relevant Directors, and not to any other past or present directors of the Company.

Hong Kong, 4 January 2023