Grande Capital Limited
均富融資有限公司

12 May 2023

To the independent board committee and the Independent shareholders of
上海復旦張江生物醫藥股份有限公司
(Shanghai Fudan-Zhangjiang Bio-Pharmaceutical Co., Ltd.)*

Dear Sirs/Madams,

CONTINUING CONNECTED TRANSACTIONS
SALES AND DISTRIBUTION AGREEMENT WITH SHANGHAI PHARMACEUTICALS

INTRODUCTION

We refer to our engagement as the Independent Financial Adviser to advise the Independent Board Committee and the Independent Shareholders in respect of the terms of the Sales and Distribution Agreement, the Transactions and the proposed annual caps for the three years ending 31 December 2026 contemplated under the Sales and Distribution Agreement, details of which are set out in the letter from the Board (the "**Letter from the Board**") contained in the circular of the Company dated 12 May 2023 (the "**Circular**"), of which this letter forms part. Capitalised terms in this letter shall have the same meanings as defined in the Circular unless the context otherwise requires.

On 30 March 2023, the Company has entered into the Sales and Distribution Agreement with Shanghai Pharmaceuticals for the sales and distribution of the Group's pharmaceutical products by the Shanghai Pharmaceuticals Group during the Contractual Period.

Shanghai Pharmaceuticals is a promoter of the Company and a substantial Shareholder, and therefore is a connected person of the Company under the Listing Rules. The Transactions under the Sales and Distribution Agreement will be carried out on a continuing or recurring basis in the ordinary and usual course of business of the Company and therefore, constitute continuing connected transactions of the Company under the Listing Rules. Since the highest applicable percentage ratio in respect of the proposed annual caps for the three years ending 31 December 2026 for the Transactions under the Sales and Distribution Agreement exceeds 5%, the Transactions are subject to the reporting, announcement, annual review and Independent Shareholders' approval requirements under Chapter 14A of the Listing Rules.

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Since Shanghai Pharmaceuticals and its associates, holding approximately 20.42% of the total issued share capital of the Company as at the Latest Practicable Date. Shanghai Pharmaceuticals and its associates shall abstain from voting on the resolution at the AGM for approving the Sales and Distribution Agreement and the proposed annual caps. Save as mentioned above, to the best of the Directors' knowledge, information and belief, none of the other Shareholders has any material interest in the Transactions and will be required to abstain from voting on the relevant resolution at the EGM.

The Board has appointed the Independent Board Committee, comprising four independent non-executive Directors, to advise the Independent Shareholders in relation to the Sales and Distribution Agreement and the proposed annual caps. We, Grande Capital Limited, have been appointed as an Independent Financial Adviser to advise the Independent Board Committee and the Independent Shareholders as to (i) whether the terms of the Sales and Distribution Agreement in relation to the Transactions and the proposed annual caps for the three years ended 31 December 2026 are on normal commercial terms, in the ordinary and usual course of business of the Group, fair and reasonable and in the interests of the Company and the Shareholders as a whole, and (ii) whether the Independent Shareholders should vote in favour of the resolution to be proposed at the EGM to approve the Sales and Distribution Agreement, the Transactions and the proposed annual caps for the three years ended 31 December 2026.

OUR INDEPENDENCE

As at the Latest Practicable Date, we did not have any relationship with or interest in the Company or any other parties that could reasonably be regarded as relevant to our independence. In the last three years, we have acted as the independent financial adviser to the independent board committee and the independent shareholders of the Company for the following transaction:

Date of the relevant circular and our letter of advice	**Nature of the transaction**
7 May 2021	Connected transaction – Proposed issue and grant of restricted shares by the Company to the connected participants under the incentive scheme

Apart from normal professional fees paid or payable to us in connection with the previous appointment mentioned above as well as this appointment as the Independent Financial Adviser, no arrangements exist whereby we had received or will receive any fees or benefits from the Company or any other parties that could reasonably be regarded as relevant to our independence. Accordingly, we consider that the aforementioned previous appointment would not affect our independence, and that we are independent pursuant to Rule 13.84 of the Listing Rules.

BASIS OF OUR OPINION

In formulating our opinion, we have relied on the statements, information, opinions and representations contained in the Circular and the information and representations provided to us by the Directors and the management of the Company. We have assumed that all statements, information and representations provided by the Directors and the management of the Company, for which they are solely and wholly responsible, were true and accurate at the time when they were provided and continue to be so as at the Latest Practicable Date. We have also assumed that all statements of belief, opinion and expectation made by the Directors in the Circular were reasonably made after due enquiry and careful consideration. We have no reason to suspect that any material facts or information has been withheld or to doubt the truth, accuracy and completeness of the information and facts contained in the Circular, or the reasonableness of the opinions expressed by the Directors and the management of the Company. We believe that we have been provided with sufficient information to reach an informed view and to provide a reasonable basis for our opinion. We have not, however, carried out any independent verification of the information provided by the Directors and the management of the Company, nor have we conducted an independent investigation into the business and affairs of the Group.

The Directors collectively and individually accept full responsibility for the accuracy of the information contained in the Circular, which includes particular 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 the Circular is accurate and complete in all materials respects and not misleading or deceptive, and there are no other matters the omission of which would make any statement herein or in the Circular misleading.

This letter is issued for the information of the Independent Board Committee and the Independent Shareholders solely in connection with their consideration of the Sales and Distribution Agreement, the Transactions and the proposed annual caps for the three years ended 31 December 2026, and except for its inclusion in the Circular, is not to be quoted or referred to, in whole or in part, nor shall this letter be used for any other purposes, without our prior written consent.

PRINCIPAL FACTORS AND REASONS CONSIDERED

In arriving at our recommendation to the Independent Board Committee and the Independent Shareholders, we have taken the following principal factors and reasons into consideration:

(a) Background of the Sales and Distribution Agreement

The historical amounts for the continuing connected transactions conducted under the Former Sales and Distribution Agreement for the two years ended 31 December 2022 and for the three months ended 31 March 2023 were approximately RMB139.5 million, RMB124.0 million, and RMB13.2 million respectively, while the annual caps were RMB144.0 million, RMB182.0 million and RMB228.0 million for the three years ended 31 December 2023, respectively. We understand from the management that the continuing connected transactions under the Former Sales and Distribution Agreement is expected to bound back and resume its growth trajectory for the year ending 31 December 2023 if there are no material adverse events caused by other unpredictable and force majeure factors, which will be further discussed below. Since the Group intends to continue its business relationship with Shanghai Pharmaceutical Group, on 30 March 2023, the Company has entered into the Sales and Distribution Agreement with Shanghai Pharmaceuticals for the sales and distribution of the Group's pharmaceutical products by the Shanghai Pharmaceuticals Group during the Contractual Period.

Further details of the terms of the Sales and Distribution Agreement are set out in the Letter from the Board.

(b) Reasons for and benefits of entering into the Sales and Distribution Agreement

As disclosed in the Letter from the Board, the Company conducts the Sales and Distribution Agreement with the Shanghai Pharmaceuticals Group in order to leverage the established and extensive sales and distribution network of the Shanghai Pharmaceuticals Group. According to the official website of Shanghai Pharmaceuticals Group, the Shanghai Pharmaceuticals Group has the second largest distribution network in the PRC, covering 31 provinces, municipalities and autonomous regions as at Latest Practicable Date. Leveraging on the extensive network of the Shanghai Pharmaceuticals Group, the Group is able to sell its products to a broader area and effectively improves the market penetration and market share of the Group.

The Company is a bio-pharmaceutical company that is principally engaged in the innovative research and development, production and manufacture and sales of bio drugs. On commercialisation, the major products of the Group are ALA, LIBOd®, FuMeiDa and various kinds of diagnostic reagents. We also note that Shanghai Pharmaceuticals Group is primarily engaged in (i) research and development, manufacturing and sale of a broad range of pharmaceutical and healthcare products; (ii) pharmaceutical distribution, warehousing, logistics, and other value-added pharmaceutical supply chain solutions and related services to pharmaceutical manufacturers and dispensers, such as hospitals, distributors and retail pharmacies; and (iii) operation and franchising of a network of retail pharmacy stores in the PRC.

Having considered the principal business activities of Shanghai Pharmaceuticals Group, in particular, the operation and franchising of a network of retail pharmacy stores in the PRC, the nature of the Transaction as well as the principal business activities of the Group, we are of the view that the Transactions are of a revenue nature for the Group and are in the ordinary and usual course of business of the Group.

(c) Principal terms of the Sales and Distribution Agreement

Pursuant to the Sales and Distribution Agreement, the price of the pharmaceutical products to be sold by the Group to the Shanghai Pharmaceuticals Group shall be determined on fair market basis with reference to the ultimate selling price of a particular pharmaceutical product to be sold to the ultimate customers as prescribed by the local statutory pricing authorities, which will be set downward from the prescribed price by leaving a reasonable mark-up of 5% to 10% of the Shanghai Pharmaceuticals Group for the provision of sales and distribution services. The pricing policy to Shanghai Pharmaceuticals Group is the same as and no less favorable to the Group than that offered by the Group to the Independent Third Parties for comparable sales and distribution services.

The abovementioned reasonable mark-up of approximately 5%-10% of the Shanghai Pharmaceuticals Group is determined with reference to (i) the mark-up of a comparable quantity of the similar products sold to at least two Independent Third Parties by the Group in similar geographical area in the financial year; and (ii) the mark-up of a comparable quantity of the similar products sold to the Shanghai Pharmaceuticals Group in similar geographical area by the Group in past transactions. Such mark-up of the Shanghai Pharmaceuticals Group will be within a range from 5% to 10% of the price of the particular pharmaceutical product as prescribed by the local statutory pricing authorities. The mark-up of approximately 5% to 10% represents the reasonable cost and the profit of Shanghai Pharmaceutical Group in providing the sales and distribution services for the Group. We have conducted searches using Bloomberg for companies that are (i) listed in Hong Kong; (ii) headquartered in the PRC; and (iii) classified as "Biotechnology and Pharmaceuticals" or "Healthcare Distributors" under the Global Industry Classification Standards. We have selected the five largest companies in terms of revenue (including Shanghai Pharmaceutical Group, Sinopharm Group Co. Ltd., China Resources Pharmaceutical Group Limited, Shanghai Fosun Pharmaceutical (Group) Co., Ltd., and Guangzhou Baiyunshan Pharmaceutical Holdings Co., Ltd.) and the selling expenses over revenue of these five companies ranged from approximately 3.0% to approximately 20.9% according to their latest annual report available, and the median and average of the five companies are 7.5% and 9.2%, respectively, which is within the Group's mark-up of 5% to 10%. The range dispersed between approximately 3.0% to approximately 20.9%, as these pharmaceutical companies are selling wide range of various pharmaceutical products (such as products for the treatment of central nerve system tumours, cervical cancers and duodenal ucler, and etc.). We consider that different type of pharmaceutical products have different mark-up and different selling strategies. Hence, we consider that mark-up of 5% to 10% is reasonable, as it falls within the range of the five largest pharmaceutical companies. In addition, having considered the pharmaceutical products sold by the five largest pharmaceutical companies are not exactly identical with the Group, we also randomly selected samples to compare the price of which the Group sold to Shanghai Pharmaceutical Group and the Independent Third Parties on the same products. Based on our review, the distribution price offered by the Group to Shanghai Pharmaceutical Group is equal to or higher than the Independent Third Party, given the same geographical area and the sales quantities are comparable. Please refer to the below paragraphs for further details.

In addition, the credit period granted to the Shanghai Pharmaceuticals Group by the Group in respect of the trade receivables generated under the Sales and Distribution Agreement will not exceed 4 months. We note from the latest available annual report that the credit periods of the five large pharmaceutical companies ranged from 1 month to 12 months, and the Group is within the range. We consider that different companies have different credit terms and such credit terms depend on various factors including the business relationship, background and the negotiation with the customers. Some of these companies stated their credit term in a range, such as one to six months. We note that apart from one company who has a credit term of no more than 12 months, the credit terms of other companies ranged from no more than 3 months to no more than 7 months, and the companies' credit term of no more than 4 months are similar to these comparables. We understand from the management of the Company that such credit terms are determined based on factors such as geographical area of the place of delivery of the pharmaceutical products, financial standing, business relationship and background of the customers and the quantity ordered by the customers. We consider the credit term of the Group of no more four months are reasonable as the credit terms are similar to the other four companies. In addition, having considered the pharmaceutical products sold by the five largest pharmaceutical companies are not exactly identical with the Group, we also randomly selected samples to compare the credit terms offered by the Group to Shanghai Pharmaceutical Group and the Independent Third Parties on the same products. Based on our review, the credit terms offered by the Group to Shanghai Pharmaceutical Group is equal to or shorter than the Independent Third Party, given the same geographical area and the sales quantities are comparable. Please refer to the below paragraphs for further details.

In assessing the fairness and reasonableness of the price and payment terms under Sales and Distribution Agreement, we have randomly selected and reviewed sales records of the ALA and LIBOd®, the only two products sold under the Sales and Distribution Agreement for the year ended 31 December 2021 and 2022 and the three months ended 31 March 2023. Please refer to the below paragraph for the selection criteria of the samples. The prices and payment terms of the samples are in line with the Company's pricing policy and payment terms. As discussed in the section headed "Measures to safeguard interests of Independent Shareholders" below in this letter, the Company adopts a series of internal control policies to ensure the Company's conformity with the pricing policy of the Sales and Distribution Agreement, including but not limited to the segregation of duties between different departments for the determination of price in accordance with the pricing policies under the Sales and Distribution Agreement by the business department, the approval by the management team, the monitoring of the implementation by each of the sales department, the finance department and the internal audit and control department. We have reviewed the above procedure of approving the connected transaction, please refer to the section headed "Measures to safeguard interests of Independent Shareholders" below in this letter for further details of our workdone.

We understand from the management team that the selling price of ALA and LIBOd® to the ultimate customers (the "**Ultimate Selling Price**") are determined on fair market basis with reference to the local statutory pricing authorities. Hence, the Ultimate Selling Price varies by regions, but the Ultimate Selling Price of ALA and LIBOd® sold by the Shanghai Pharmaceutical Group or Independent Third Parties are identical within the same region. The Group sets the distribution price offered to both Shanghai Pharmaceutical Group or

Independent Third Party based on the Ultimate Selling Price and factored in a reasonable mark-up as mentioned above, and such price is known as the "Distribution Price". We have also, for comparison purpose, randomly selected and reviewed five distribution agreements of each of ALA and LIBOd® signed between the distributors of Shanghai Pharmaceutical Group and the Group and another five distribution agreements between the Independent Third Parties and the Group in the corresponding region for each of the two years ended 31 December 2022. For the three months ended 31 March 2023, we understand from the management team that only four geographical areas, where the Group signed its distribution agreements with both Shanghai Pharmaceutical Group and the Independent Third Parties for each of ALA and LIBOd®, are currently available for comparison. Based on our review, we note that the Distribution Price of the LIBOd® offered by the Group to the Shanghai Pharmaceutical Group were equal to the Distribution Price offered to the Independent Third Parties, given that the sales quantity are comparable. We further note that the Distribution Price of the ALA offered by the Group to the Shanghai Pharmaceutical Group were either equal to or higher than the prices offered to the Independent Third Parties, given that the sales quantity are comparable. In addition, we also note that given that the sales quantity are comparable, the credit period offered by the Group to the Shanghai Pharmaceutical Group was generally equal to the credit period offered by the Group to the Independent Third Parties in the same geographical area, and even some distribution agreements between the Shanghai Pharmaceutical Group and the Group has a shorter credit term as compared to the Independent Third Parties, based on our review. We are of the view that a shorter credit term could improve the Group's liquidity and is in the interest of the Company and its shareholders as a whole.

Our review has covered all products, namely ALA and LIBOd® under Sales and Distribution Agreement for each of the two years ended 31 December 2022 and the three months ended 31 March 2023 sold to both Shanghai Pharmaceutical Group and other Independent Third Parties such as Sinopharm Group Co. Ltd. (listed on the Stock Exchange with the stock code of 1099), Hapharm Group Co., Ltd. (listed on the Shanghai Stock Exchange with the stock code of 600664) and China Health Care Baheal Pharmaceutical Holdings Limited (listed on the Shenzhen Stock Exchange with the stock code of 301015), etc. Based on the record of the latest available annual report and our understanding from the management, none of the aforesaid samples with the Independent Third Parties constitutes connected transaction. As such, we consider that the samples are fair and representative.

Taking into account that (i) the Sales and Distribution Agreement will enable the Group to increase its revenue; and (ii) the Distribution Price of the ALA and LIBOd® offered by the Group to the Shanghai Pharmaceutical Group were equal to or higher than the Distribution Price offered to an Independent Third Party, given the sales quantity are comparable; and (iii) the credit period offered by the Group to the Shanghai Pharmaceutical Group was generally equal to with or shorter than the credit period offered by the Group to the Independent Third Parties as mentioned above, we are of the view that the terms of the Sales and Distribution Agreement and the Transactions contemplated thereunder are on normal commercial terms, are fair and reasonable so far as the Independent Shareholders are concerned and are in the interest of the Company and its shareholders as a whole.

(d) Annual Caps

Pursuant to the Sales and Distribution Agreement, the proposed annual caps for the three years ending 31 December 2026 are approximately RMB226.0 million, RMB241.0 million and RMB260.0 million, respectively.

In assessing the fairness and reasonableness of the proposed annual caps, we have discussed with the management of the Company regarding the principal assumptions and basis adopted for the determination of the proposed annual caps, and are given to understand that the Company has taken into account the following principal factors:

(i) Historical transaction values

As disclosed in the Letter from the Board, we note that the historical transaction values for the continuing connected transactions conducted under the Former Sales and Distribution Agreement amounted to approximately RMB139.5 million for the year ended 31 December 2021, approximately RMB124.0 million for the year ended 31 December 2022 and approximately RMB13.2 million for the three months ended 31 March 2023. We note that approximately 96.9% and approximately 68.1% of the historical annual caps under the Former Sales and Distribution Agreement were utilised by the Group for the two years ended 31 December 2022, and approximately 5.8% for the year ending 31 December 2023. We understand from the management that the continuing connected transactions under the Former Sales and Distribution Agreement is expected to bound back and resume its growth trajectory for the year ending 31 December 2023 if there are no material adverse events caused by other unpredictable and force majeure factors, which will be further discussed below.

We understand from the management that recently there are two products under the Sales and Distribution Agreement, namely ALA and LIBOd®. The sales of ALA under the Former Sales and Distribution Agreement were over RMB43 million, over RMB37 million and over RMB2 million for the two years ended 31 December 2022 and for the three months ended 31 March 2023, respectively. The sales of LIBOd® under the Former Sales and Distribution Agreement were over RMB95 million, over RMB86 million and over 10 million for the two years ended 31 December 2022 and for the three months ended 31 March 2023, respectively.

We understand from the management that the sales volume of ALA and LIBOd® were significantly affected by the outbreak of the Epidemic in Shanghai for the year ended 31 December 2022. We note that Shanghai experienced a large-scale outbreak of Epidemic in the first half of 2022. To contain the spread of Epidemic, stringent quarantine measures such as travel restrictions, public traffic control and a temporary lockdown had been imposed in Shanghai from March to June 2022. As a result of the static management in Shanghai, hospitals and clinics in Shanghai provided limited non-urgent outpatient clinic services and most of the local retail pharmacies were closed during the aforesaid period. Consequently, the continuing connected transactions conducted under the Former Sales and Distribution Agreement in Shanghai dropped significantly by approximately 97.1% for the three months ended 30 June 2022 and approximately 78.6% for the six months ended 30 June 2022, as compared to the same period in 2021. As mentioned in the interim report of the Group for the six months ended 30 June 2022, the Group's production, operation and research and development team are based in Shanghai and the static management in Shanghai, in particular, the control of external logistics had a great impact on the Group's raw materials supply and external drug distribution. The stringent control of external logistics had affected not only the transport within Shanghai, as well as the transport from Shanghai to areas outside Shanghai, or vice versa. ALA and LIBOd®, which produced in Shanghai, could not be delivered to the distributors in both Shanghai and outside Shanghai, and therefore, the sales of ALA and LIBOd® in areas outside Shanghai were also affected. The continuing connected transactions conducted under the Former Sales and Distribution Agreement in areas outside Shanghai also dropped by approximately 67.1% in the second quarter of 2022, as compared to the second quarter of 2021.

The Shanghai Municipal People's Government gradually lifted the static management restrictions in June 2022 and according to the interim report of the Group for the six months ended 30 June 2022, the operation of the Group gradually resumed normal business activities since then. The continuing connected transactions for the three months ended 31 March 2022, 30 June 2022, 30 September 2022 and 31 December 2022 conducted under the Former Sales and Distribution Agreement amounted to approximately RMB21.6 million, RMB4.7 million, RMB45.8 million and RMB51.9 million, respectively. The continuing connected transactions conducted under the Former Sales and Distribution Agreement for the three months ended 30 September 2022 surpassed the continuing connected transactions for the six months ended 30 June 2022 and further grew by 13.2% in the fourth quarter of 2022. The continuing connected transactions conducted under the Former Sales and Distribution Agreement for the six months ended 31 December 2022 utilised approximately 53.7% of the historical cap in 2022. Such upward trend recorded in the second half of 2022 demonstrated a strong demand of ALA and LIBOd®.

On 7 December 2022, the National Health Commission of People's Republic of China announced a notice on optimising and implementing the new prevention and control measures in relation to the Epidemic and the quarantine measures were further released – the scope and frequency of nucleic acid testing had reduced, negative nucleic acid test certificates was not required for most of the places and also stated that all forms of temporary static management should not be adopted. The National Health Commission of the People's Republic of China further announced the decision to manage the Epidemic with measures against Class B infectious diseases, instead of Class A infectious diseases with the effect from 8 January 2023. The World Health Organisation expressed their view in March 2023 and expected that the Epidemic would be over as a public health emergency of international concern in 2023 and to a point where it poses a threat similar to seasonal influenza. Therefore, we consider that the impact of the Epidemic appears to be alleviating and that the sales of ALA and LIBOd® to bound back and resume its growth trajectory for the year ending 31 December 2023 if there are no material adverse events caused by other unpredictable and force majeure factors.

Despite the alleviating impact of the Epidemic, we note that the historical continuing connected transactions conducted during the three months ended 31 March 2023 merely accounted for approximately 5.8% of the historical annual caps under the Former Sales and Distribution Agreement for the year ending 31 December 2023. We note that the historical utilisation rate of annual caps in the first quarter amounted to 6.7%, 15.5% and 11.9% for the three years ended 31 December 2022, and the corresponding utilisation rate of the annual caps for the whole year amounted to 80.5%, 96.9% and 68.1%. We understand from the management that the historical low utilisation rate of annual caps in the first quarter of each year was primarily because the management team will discuss and adjust its annual sales channels and distribution strategies of ALA and LIBOd® under continuing connected transaction based on the market condition in the first quarter of each year, in order to ensure the continuing connected transaction will be in the interest of the Company and Shareholders as a whole.

(ii) Expected increase in the transaction values under the Sales and Distribution Agreement

We understand from the management that regarding to choosing Shanghai Pharmaceuticals Group or its agencies as the distributor, the management have considered (i) the distributor's distribution network; (ii) the terms and conditions offered by the distributors; and (iii) other factors such as the procedures and the delivery time in relation to the distribution. Having considered (i) the above factors in relation to Shanghai Pharmaceuticals Group or its agencies as the distributor; (ii) the historical transaction values for the continuing connected transactions conducted under the Former Sales and Distribution Agreement amounted to approximately RMB139.5 million for the year ended 31 December 2021, denoting that approximately 96.9% of the historical annual caps under the Former Sales and Distribution Agreement were utilised; (iii) the upward trend of the continuing connected transactions conducted under the Former Sales and Distribution Agreement for the six months ended 31 December 2022 as compared to the six months ended 30 June 2022 as discussed above; and (iv) the impact of the Epidemic on the continuing connected transactions conducted under the Former Sales and Distribution Agreement is expected to alleviate, the aggregate expected sales of ALA and LIBOd® by the Group under the Sales and Distribution Agreement for the three years ending 31 December 2026 are estimated to be approximately RMB205.4 million, RMB218.9 million and RMB235.8 million, respectively, according to the expected demand as discussed between the Group and Shanghai Pharmaceuticals Group. We understand from the management that the remaining portion is reserved for capturing any unforeseen market opportunities. Hence, the proposed annual cap is approximately RMB226.0 million, RMB241.0 million and RMB260.0 million, respectively for the three years ending 31 December 2026.

Set out below are the expected sales of ALA, LIBOd® and other products by the Group under the Sales and Distribution Agreement for each of the three years ending 31 December 2026 based on the expected demand as discussed between the Group and Shanghai Pharmaceuticals Group:

	For the year ending		
	2024	**2025**	**2026**
	RMB'000	*RMB'000*	*RMB'000*
ALA	53,100	59,000	67,850
LIBOd®	152,327	159,944	167,941
Buffer to capture unforeseen market opportunities	20,573	22,056	24,209
Total	**226,000**	**241,000**	**260,000**
Proposed annual caps	226,000	241,000	260,000
Total expected sales of ALA and LIBOd® as a percentage of proposed annual caps	90.9%	90.8%	90.7%

In arriving the above projected sales, the management adopted the following assumptions:

(i) steady growth of the PRC economy in the next decade;

(ii) the stability of the PRC social, economic and political environment in the forecast period;

(iii) related key industry drivers and the below drivers of the Group remain relevant and applicable during the forecast period;

(iv) no substantial changes to the related industries during the forecast period; and

(v) no region-wide static management in Shanghai or elsewhere in the PRC during the forecast period.

In addition on the general assumptions above, we also understand from the management that the increase in the expected sales of ALA and LIBOd® by the Group under the Sales and Distribution Agreement for the three years ending 31 December 2026 was mainly because of the following:

(i) Apart from the continuing connected transactions conducted under the Former Sales and Distribution Agreement, we have also reviewed the annual reports of the Group and noted that the historical sales of ALA and LIBOd® of the Group have demonstrated a general increasing trend from 2017 to 2022. According to the annual report of the Group for the year ended 31 December 2017 to 2022, we noted that ALA and LIBOd® contributed approximately 90%, 89%, 89%, 89%, 88% and 88% of the revenue to the Group for each of the six years ended 31 December 2022, respectively, where the revenue of the Group increased from approximately RMB497.7 million for the year ended 31 December 2017 to approximately RMB741.8 million and RMB1,029.3 million for the year ended 31 December 2018 and 2019, respectively, then decreased to approximately RMB833.8 million for the year ended 31 December 2020 due to the outbreak of Epidemic, then increased to approximately RMB1,140.3 million for the year ended 31 December 2021, then decreased to approximately RMB1,031.2 million for the year ended 31 December 2022 due to the outbreak of Epidemic as discussed above, representing an increase of approximately 107.2% across six years;

(ii) We reviewed the Group's interim report for the six months ended 30 June 2022 and noted a decrease in revenue of the Group of approximately 32.0% for the six months ended 30 June 2022 as compared to the six months ended 30 June 2021 . Despite the decrease in revenue for the first half of 2022, we reviewed and noted from the Group's third quarterly report for the three months ended 30 September 2022 that the revenue for the three months ended 30 September 2022 increased by approximately 48.8% as compared to the three months ended 30 September 2021, and the revenue for the nine months ended 30 September 2022 increased by approximately 2.6% as compared to the nine months ended 30 September 2021 despite the outbreak of Epidemic and the static management in Shanghai in the first half of 2022. However, the number of daily reported cases of Epidemic rose in the fourth quarter of 2022. We reviewed and noted from the statistics from the Chinese Centre for Disease Control and Prevention that the daily reported cases peaked at 6.9 million in late-December 2022. We reviewed the annual report for the year ended 31 December 2022 and noted that the Group had experienced delay in the supply of imported raw materials due to the impact of multiple factors beyond expectations, and as a result, the Group could not complete some of their production and delivery of products as planned in the fourth quarter of 2022. It is stated on the announcement of preliminary unaudited annual results for the year ended 31 December 2022 dated 27 February 2023 that such factor included the reversal of Epidemic in multiple regions in the forth quarter of 2022. Despite so, we noted that the Group still recorded an increase in the revenue for the six months ended 31

December 2022, which had indicated that a strong demand of ALA and LIBOd® in the second half of 2022, in particular in the third quarter of 2022. In addition, we reviewed the announcement published by the National Health Commission of the People's Republic of China on 26 December 2022 and noted that the National Health Commission of the People's Republic of China further released its quarantine measures based on the current Epidemic situation in the PRC, and in particular, the decision to manage the Epidemic with measures against Class B infectious diseases, instead of Class A infectious diseases, where no more mandatory isolation policy for the infected person and no more mandatory nucleic acid testing. Therefore, we consider that the impact of the Epidemic appears to be alleviating and that the sales of ALA and LIBOd® to bound back and resume its growth trajectory for the year ending 31 December 2023 if there are no material adverse events caused by other unpredictable and force majeure factors;

(iii) The Group places emphasis on research and development of its products. The therapy of ALA, combining with photodynamic technology, has been used for the treatment of condyloma acuminate since its commercialisation. We reviewed and noted from their annual reports that the Group has been continuously performing clinical research to study the possibility of applying ALA to the therapy of other diseases, such as cervical diseases infected by HPV, acne, actinic keratosis and brain gliomas. In particular, we reviewed and noted from the annual report of the Group for the year ended 31 December 2021 and the announcement dated 24 August 2022 that the investigation new drug application for ALA used for the treatment of actinic keratosis was accepted on 14 October 2021 as disclosed on the annual report for the year ended 31 December 2021, and the first patient has been successfully enrolled in the study as at the date of the announcement made by the Group on 24 August 2022 (the "**Actinic Keratosis Announcement**"). We reviewed and further note from the Actinic Keratosis Announcement that, the existing treatment of actinic keratosis in the PRC include freezing, curettage, topical drug application, etc., but not photodynamic therapy which has been approved abroad. There were two drugs containing aminolevulinic acid hydrochloride, which is the major component of ALA, approved by the US Food and Drug Administration in 1999 and 2016, respectively, and the combination of the above drugs and specific photodynamic therapy instruments is one of the preferred therapies for the treatment of multiple lesions actinic keratosis located in the head and neck abroad, as mentioned in the Actinic Keratosis Announcement. Having considered (1) the past success of applying aminolevulinic acid hydrochloride to the treatment of actinic keratosis abroad, and (2) it is one of the most preferred therapies for the treatment of actinic keratosis abroad, the management of the Company is of the view that upon the completion of the clinical trial and registration of new indications will widen the application of ALA and boost the sales of ALA. We reviewed the Group's annual report for the year ended 31 December 2022 and further noted that the Group is currently performing clinical research to apply ALA to the therapy of four other diseases; and

(iv) The Group continues to develop targeted promotional and marketing activities, which mainly include participating in seminars or other activities organised by relevant industry professional associations to introduce the past treatments of the products and organising medical experts to share and analyse the related cases. Through these activities, the understanding of the patients, experts and relevant industry professional associations on the products of the Group has been deepened gradually, which facilitates the improvement of the market recognition of the products of the Group. We reviewed the Group's annual report for the year ended 31 December 2021 and 2022 and noted that the marketing and sales promotion expenses of the Group has increased significantly from approximately RMB347.9 million for the year ended 31 December 2020 to approximately RMB456.9 million for the year ended 31 December 2021, and slightly decreased to approximately RMB422.2 million for the year ended 31 December 2022 due to the static management imposed in the first half of 2022 representing an overall increase of approximately 21.4%. The management further anticipates that the sales of their products would increase significantly for the three years ending 31 December 2026 after taking into account the abovementioned promotional/marketing activities and the improvement in the market recognition of their pharmaceutical products.

We note that the proposed annual caps set by the Group is consistent with the expected sales of ALA and LIBOd®. As the Company has set the proposed annual caps mainly based on the expected demand of ALA and LIBOd®, we have based our opinion on (i) the historical transaction values under Former Sales and Distribution Agreement where approximately 96.9% of the historical annual caps under the Former Sales and Distribution Agreement were utilised by the Group for the year ended 31 December 2021; (ii) the strong demand of ALA and LIBOd® in the third quarter of 2022 as evidenced by the fact that the revenue of the Group for the nine months ended 30 September 2022 increased by approximately 2.6% as compared to the nine months ended 30 September 2021 despite the outbreak of Epidemic in the first half of 2022; (iii) the impact of the Epidemic on the continuing connected transactions conducted under the Former Sales and Distribution Agreement would be alleviating; and (iv) the demand projections provided by the Group in assessing the fairness and reasonableness of the proposed annual caps. Among the demand projections, the management of the Company is expected (i) approximately 20% to 30% of the proposed annual caps are driven by the diminishing impact of the Epidemic. Having considered that the first quarter, second quarter and fourth quarter of 2022 were affected by the Epidemic, we note that the continuing connected transaction conducted during first quarter, second quarter and fourth quarter of 2021 (where no static management and no large outbreak of the Epidemic) used to account for 68.2% of the annual caps of that year, while the first quarter, second quarter and fourth quarter of 2022 merely accounted for 43.0% of the annual caps of the year, which roughly indicated that approximately 25.2% of the annual caps in 2022 were unutilised due to the Epidemic; (ii) approximately 60% to 70% of the proposed annual caps are driven by the historical sales and the expected growth boosted by the promotional and marketing activities. The promotional and marketing activities is expected to improve the Group's market recognition of their pharmaceutical products and boost the sales. As mentioned above, we note that the revenue of the Group increased by approximately 107.2% between 2017 to 2022 (where ALA and LIBOd® contributed over 85% of the revenue during the said period), which roughly equivalent to an annual growth of approximately 17.9% and such annual growth is higher than expected growth of the proposed annual caps of approximately 6.6% and 7.9% under the Sales and Distribution Agreement for the year ended 31 December 2025 and 2026, respectively; and (iii) approximately 10% buffer to capture other market opportunities such as the possibility to apply ALA to the therapy of other diseases to widen the application of ALA and boost the sales of ALA, having considered that the Group is performing clinical research to apply ALA to the therapy of four other diseases.

In addition, we reviewed the circular of the Group dated 14 September 2018, 11 October 2019 and 27 November 2020 and noted that the historical annual cap for the continuing connected transaction with Shanghai Pharmaceuticals Group amounted to RMB46.0 million, RMB81.0 million, RMB109.0 million, RMB144.0 million, RMB182.0 million and RMB228.0 million for the six years ended 31 December 2023, respectively, which denoted an increase in the annual caps of approximately 76.1%, 34.6%, 32.1%, 26.4% and 25.3%, respectively. And historically, approximately 99.0%, 96.6%, 80.4%, 96.9% and 68.1% of the annual caps were utilised by the Group for the five years ended 31 December 2022, respectively. Across the historical annual caps for the continuing connected transaction with Shanghai Pharmaceuticals Group for the five years ended 31 December 2022, the historical utilisation rate of the annual cap were over 95%, except for the year ended 31 December 2020 and 2022, which were due to the outbreak of Epidemic in 2020 and 2022 as explained in the circular of the Group dated 27 November 2020 in relation to the continuing connected transactions with Shanghai Pharmaceuticals Group for the Epidemic in 2020 and the discussion above for the Epidemic in 2022. Although only approximately 68.1% of the historical annual cap were utilised by the Group for the year ended 31 December 2022 due to the outbreak of Epidemic in 2022, there were an upward trend of the continuing connected transactions during the six months ended 31 December 2022 as discussed above. The management of the Company has set its proposed annual caps for the three years ending 31 December 2026 at RMB226.0 million, RMB241.0 million and RMB260.0 million, respectively, representing an increase in the annual caps of approximately 6.6% in 2025 and 7.9% in 2026. Having considered the increase in the historical annual caps across each of the five years ended 31 December 2022 and the historical utilisation rate of the annual caps during the said period, we are of the view that the increase in the proposed annual caps for each of three years ending 31 December 2026 is reasonable.

We have also reviewed the figures from the internal assessment provided by the management of the Company in respect of the expected demand of ALA and LIBOd® under the Sales and Distribution Agreement for each of the three years ending 31 December 2026. We note that the indicated sales for such products for the three years ending 31 December 2026 are expected to be close to but not exceeding RMB226.0 million, RMB241.0 million and RMB260.0 million, respectively. We also understand that such expected increase in demand for ALA and LIBOd® under the Sales and Distribution Agreement are based on the Group's internal assessments, assumptions and projections. Having considered that (i) the historical revenue of the Group increase by approximately 107.2% between 2017 and 2022, (ii) the revenue of the Group for the six months ended 31 December 2022 surpassed the same period during 2021 despite the outbreak of Epidemic in the fourth quarter of 2022, (iii) the continuing connected transactions conducted under the Former Sales and Distribution Agreement recorded approximately RMB45.8 million and RMB51.9 million for the three months ended 30 September 2022 and 31 December 2022, respectively, (iv) the impact of the Epidemic on the continuing connected transactions conducted under the Former Sales and Distribution Agreement is expected to alleviate; (v) the possible new application of ALA to the therapy of other diseases, and (vi) the promotion and marketing activities to improve the market recognition of the Group's pharmaceutical product, we are of the view that the assumptions and projections made by the Company are fair and reasonable.

Our view

Having considered that:

(i) the historical transaction values under Former Sales and Distribution Agreement where approximately 96.9% of the historical annual caps under the Former Sales and Distribution Agreement were utilised by the Group for the year ended 31 December 2021;

(ii) the operation of the Group gradually resumed normal business activities since June 2022, which the Shanghai Municipal People's Government lifted the static management restrictions, and the continuing connected transactions for the six months ended 31 December 2022 conducted under the Former Sales and Distribution Agreement amounted to approximately RMB97.7 million, which accounted for approximately 53.7% of the historical cap in 2022;

(iii) the diminishing impact of the Epidemic on the Group;

(iv) the general increasing trend of the historical revenue of the Group;

(v) the possible new application of ALA to the therapy of other diseases; and

(vi) the marketing/promotion activities and the improvement in the market recognition of the Group's pharmaceutical products as mentioned above,

we are of the view that the proposed annual caps set by the Group (which are consistent with the demand projections provided by the Group) are fair and reasonable.

However, the Shareholders should note that the proposed annual caps are determined based on various factors relating to future events and they do not represent forecasts of revenue to be generated from the operations of the Group. Consequently, we express no opinion as to how closely the actual amounts to be received by the Group will correspond with the proposed annual caps. The Shareholders should also note that the Shanghai Pharmaceuticals Group has not secured any sales and distribution of ALA and LIBOd® for the three years ending 31 December 2026, as the management considers that such long-term commitment contract is not a common practice among the pharmaceutical distributors in the PRC.

(e) Measures to safeguard interests of Independent Shareholders

To ensure the Company's conformity with the pricing policy of the Sales and Distribution Agreement, the Company adopts a series of internal control policies during its daily operation. Such internal control policies are conducted and supervised by the internal audit and control department of the Company, the independent non-executive Directors and the external auditors of the Company:

(i) The business department will be responsible for the determination of each specific price in accordance with the pricing policies under the Sales and Distribution Agreement (including taking into account the selling price of a comparable quantity of the similar products sold to at least two Independent Third Parties by the Group in the financial year when entering into the specific transactions under the Sales and Distribution Agreement), and will submit the prepared specific price quote to the management for review and approval in due course. After the approval, the sales department, the finance department and the internal audit and control department of the Company will monitor the implementation of the relevant price throughout the transaction on a joint basis, and will review the fairness and reasonableness of the price under the Sales and Distribution Agreement on an average quarterly basis and will assist the person in charge of sales to adjust the price (if necessary);

(ii) The internal audit and control department of the Company monitors the connected transactions of the Company and reports to the audit committee of the Company and independent non-executive Directors together with the external auditors' report for their review and approval. The Audit Committee of the Company supervises the connected transactions to ensure they were entered into: (a) in accordance with the pricing policy under the Sales and Distribution Agreement; (b) in the ordinary and usual course of business of the Group; (c) on normal commercial terms; and (d) according to the Sales and Distribution Agreement on terms that are fair and reasonable and in the interests of the Company and Shareholders as a whole;

(iii) The independent non-executive Directors have reviewed and will continue to review the continuing connected transactions to ensure that the transactions have been entered into on normal commercial terms, and according to the Sales and Distribution Agreement on terms that are fair and reasonable and in the interests of the Company and the Shareholders as a whole, and provide confirmation in the Company's annual report; and

(iv) The external auditors of the Company will also conduct an annual review on the pricing policy and annual cap implementation for transactions of the Sales and Distribution Agreement, and issue an independent auditor's assurance report on continuing connected transactions.

We have reviewed the past transaction records under the Former Sales and Distribution Agreement, board meeting minutes in relation to the transactions under the Former Sales and Distribution Agreement, the actual procedure of approving the connected transaction and the annual report of the Group and note that the above measures has been properly implemented.

Having considered, in particular, (i) the restriction of the value of the continuing connected transactions by way of the proposed annual caps; (ii) the ongoing review by the independent non-executive Directors and the auditors of the Company of the terms of the continuing connected transactions, the pricing policy and the proposed annual caps not being exceeded; and (iii) the above internal control measures have been properly implemented, we are of the view that there are appropriate measures in place to govern the conduct of the continuing connected transactions and such measures are effective and safeguard the interests of the Independent Shareholders.

RECOMMENDATION

Having taken into account the principal factors discussed above, we are of the view that the Sales and Distribution Agreement, the Transactions and the proposed annual cap are on normal commercial terms, in the ordinary and usual course of business of the Group, fair and reasonable, and in the interests of the Company and the Shareholders as a whole. Accordingly, we recommend the Independent Shareholders, and the Independent Board Committee to advise the Independent Shareholders, to vote in favour of the resolution to be proposed at the EGM to approve the Sales and Distribution Agreement, the Transactions and the proposed annual caps.

Yours faithfully,
For and on behalf of
Grande Capital Limited

Matthew Leung
Managing Director

Sumwing Shum
Managing Director

Mr. Matthew Leung is licensed under the Securities and Futures Ordinance to carry on Type 6 (advising on corporate finance) regulated activity and is currently a responsible officer and sponsor principal of Grande Capital Limited. Mr. Leung has over 12 years of experience in the corporate finance industry.

Mr. Sumwing Shum is licensed under the Securities and Futures Ordinance to carry on Type 6 (advising on corporate finance) regulated activity and is currently a responsible officer and sponsor principal of Grande Capital Limited. Mr. Shum has over 8 years of experience in the corporate finance industry.