
CONNECTED TRANSACTIONS

OVERVIEW

Prior to the [REDACTED], our Company has entered into certain transactions with parties who will, upon the [REDACTED], become connected persons of the Company. We will continue to engage in certain connected transactions after the [REDACTED]. Details of such one-off connected transactions and continuing connected transactions of our Company under Chapter 14A of the Listing Rules upon [REDACTED] are set out below.

RELEVANT CONNECTED PERSONS

The table below sets forth certain parties who will become our connected persons upon [REDACTED] and the nature of their relationships with our Company:

Connected Persons	Connected Relationship
Kelun Pharmaceutical (including its subsidiaries other than our Group)	Kelun Pharmaceutical is our Controlling Shareholder.
Sichuan Kelun Pharmaceutical Research Institute Co., Ltd. (四川科倫藥物研究院有限公司) (“ Kelun Research Institute ”)	Kelun Research Institute is a wholly-owned subsidiary of Kelun Pharmaceutical and a connected person to us.
Sichuan Kelun Medicine & Trade Group Co. Ltd. (四川科倫醫藥貿易集團有限公司) (“ Kelun Medicine & Trade ”) (including its subsidiaries)	Kelun Medicine & Trade is held as to (i) 68.2% by Sichuan Huifeng Investment Development Co., Ltd (四川惠豐投資發展有限責任公司), a company controlled by our Director Mr. Liu Sichuan, (ii) 29.8% by Sichuan Kelun Industrial Group Co., Ltd (四川科倫實業集團有限公司), a company controlled by our Director Mr. Liu Gexin and (iii) 2% by Mr. Liu Sichuan directly. Therefore, Kelun Medicine & Trade is an associate of Mr. Liu Sichuan and a connected person to us.

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ONE-OFF CONNECTED TRANSACTIONS

Lease of Properties

Historically, we leased certain land-use-right and properties from Kelun Pharmaceutical. We entered into a property lease agreement (the “**Property Lease Agreement**”) with Kelun Pharmaceutical, pursuant to which, we agreed to lease properties with a total gross area of approximately 35,000 sq.m. located at Wenjiang District, Chengdu from Kelun Pharmaceutical with a term of three years commencing on January 1, 2022. The leased properties under the Property Lease Agreement are used by our Company for daily operations and business, such as R&D activities, storage house, office spaces and staff housing. The Land Lease Agreement and the Property Lease Agreement were entered into (i) in the ordinary and usual course of business of our Group, (ii) on arm’s length basis, and (iii) on normal commercial terms or better with the rents being agreed with reference to the prevailing markets rates of comparable properties in the locality and acreage of the properties, which have been assessed by Cushman & Wakefield Limited, an independent property valuer engaged by our Company.

The balance of the lease liabilities, being the present value of the lease payments recognized by our Group in relation to the Land Lease Agreement and the Property Lease Agreement according to IFRS16 as of September 30, 2022 amounted to RMB21.1 million. As of December 31, 2021 and September 30, 2022, the right-of-use assets in connection with the Land Lease Agreement and relevant property lease agreements were approximately RMB1.1 million and RMB15.3 million, respectively.

Reasons and Benefits of the Transaction

It is a common practice in the pharmaceutical industry that a pre-profit biotech company, like us, operates by leasing properties so as to allocate a substantial part of its cash flow into R&D activities.

We have been leasing the relevant properties from Kelun Pharmaceutical during the Track Record Period. Continuous leasing the relevant properties from Kelun Pharmaceutical can reduce our costs associated with looking for new premises and involving in prolonged negotiations of lease agreements with third party property’s owners. Additionally, given that any relocation of facility or change of the current arrangements under the currently effective property lease agreement may cause certain disruption to our business operation and incur additional relocation costs, it is cost efficient and beneficial to our operations to continue leasing the relevant properties from Kelun Pharmaceutical. In light of the foregoing, our Directors are of the view that such arrangement is fair and reasonable and in the best interest of our Group and our Shareholders as a whole.

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Notwithstanding the above, such arrangement under the Land Lease Agreement and the Property Lease Agreement does not affect our operational independence. For further details, see “Relationship with our Controlling Shareholders – Independence of Our Group from Our Controlling Shareholder – Operational Independence – Leasing properties from our Controlling Shareholder.”

Listing Rules Implications

IFRS 16 (Leases) (which became effective from January 1, 2019) requires a lessee to recognize assets and liabilities for lease with a term of more than 12 months. A lessee is required to recognize a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments in future. In accordance with IFRS 16, our Group recognized a right-of-use asset on the statement of financial position in connection with the lease under the Land Lease Agreement and the Property Lease Agreement. Therefore, the leases under the Land Lease Agreement and the Property Lease are regarded as an acquisition of a capital asset of our Group and a one-off connected transaction entered into by our Group prior to the [REDACTED], rather than a continuing connected transaction, for the purposes of the Listing Rules. Accordingly, the reporting, announcement, annual review, circular and independent shareholders’ approval requirements under Chapter 14A of the Listing Rules will not be applicable.

Equipment Lease Agreement

Kelun Pharmaceutical, our Controlling Shareholder, implements a centralized equipment procurement policy under which Kelun Pharmaceutical procures equipment necessary to its subsidiaries’ business and daily operations and then leases these equipment to its subsidiaries for use. Such centralized procurement policy has strengthened Kelun Pharmaceutical’s bargaining power when negotiating with equipment suppliers and therefore enables Kelun Pharmaceutical to procure these equipment at a favorable price. As a subsidiary of Kelun Pharmaceutical, we have been leasing certain equipment used in connection with our R&D activities and daily operations from Kelun Pharmaceutical under such arrangement. We have been entering into an equipment lease agreement with Kelun Pharmaceutical on a yearly basis for a term of one year since 2019, covering the term of each of the year of 2019, 2020 and 2021.

Our Company further entered into a new equipment lease agreement (the “**Equipment Lease Agreement**”) with Kelun Pharmaceutical, pursuant to which, our Group agreed to lease certain equipment used in connection with our R&D activities and daily operations from Kelun Pharmaceutical with a term of three years commencing on January 1, 2022. The Equipment Lease Agreement was entered into (i) in the ordinary and usual course of business of our Group, (ii) on arm’s length basis, and (iii) on normal commercial terms or better with the rents being agreed with reference to (i) the acquisition cost of these equipment incurred by Kelun Pharmaceutical; and (ii) the results of valuation of such equipment prepared by an independent external appraiser.

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The balance of the lease liabilities, being the present value of the lease payments recognized by our Group in relation to the relevant equipment lease agreement according to IFRS16 as of September 30, 2022 amounted to RMB100.3 million. As of December 31, 2021 and September 30, 2022, the right-of-use assets in connection with the relevant equipment lease agreements were nil and RMB72.7 million, respectively.

Reasons and Benefits of the Transaction

As discussed above, under the centralized equipment procurement policy, Kelun Pharmaceutical has been procuring equipment necessary for its subsidiaries’ business and daily operations and then leasing these equipment to its subsidiaries including us. Such centralized procurement policy enables Kelun Pharmaceutical to procure these equipment at a favorable price. Under such equipment lease arrangement, we do not need to contribute a significant portion of our funds to procure equipment necessary for our R&D activities and daily operations so that we can allocate a substantial part of our cash flow into R&D activities. In light of the foregoing, our Directors are of the view that such arrangement is fair and reasonable and in the best interest of our Group and our Shareholders as a whole.

Notwithstanding the above, such arrangement under the Equipment Lease Agreement does not affect our operational independence. For further details, see “Relationship with our Controlling Shareholders – Independence of Our Group from Our Controlling Shareholder – Operational Independence – Leasing equipment from our Controlling Shareholder.”

Listing Rules Implications

IFRS 16 (Leases) (which became effective from January 1, 2019) requires a lessee to recognize assets and liabilities for lease with a term of more than 12 months. A lessee is required to recognize a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments in future. In accordance with IFRS 16, our Group recognized a right-of-use asset on the statement of financial position in connection with the lease under the Equipment Lease Agreement. Therefore, the lease under the Equipment Lease Agreement is regarded as an acquisition of a capital asset of our Group and a one-off connected transaction entered into by our Group prior to the [REDACTED], rather than a continuing connected transaction, for the purposes of the Listing Rules. Accordingly, the reporting, announcement, annual review, circular and independent shareholders’ approval requirements under Chapter 14A of the Listing Rules will not be applicable.

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CONTINUING CONNECTED TRANSACTIONS

The following table sets forth a summary of our continuing connected transactions upon [REDACTED]:

Transaction	Applicable Listing Rules	Waiver Sought	Proposed Annual Caps for the years ending December 31,		
			2023	2024	2025
<i>(RMB in thousands)</i>					
Fully exempt continuing connected transactions					
Trademark License Agreements	14A.52, 14A.76(1)(a)	Waiver from limiting the period of agreement to a fixed term	N/A	N/A	N/A
Shared Administrative Services Framework Agreement	14A.98	N/A	N/A	N/A	N/A
Partially exempt continuing connected transactions					
Auxiliary R&D Services Framework Agreement	14A.34 to 14A.36, 14A.49, 14A.51 to 14A.59 and 14A.71	Waiver from announcement requirement	<i>In terms of procurement of services from the Remaining Kelun Group</i>		
			22,000	18,000	15,000
			<i>In terms of provision of services to the Remaining Kelun Group</i>		
			16,000	16,000	16,000
R&D-related Drugs and Consumables Framework Agreement	14A.34 to 14A.36, 14A.49, 14A.51 to 14A.59 and 14A.71	Waiver from announcement requirement	20,000	40,000	30,000
Non-exempt continuing connected transaction					
Licensing Agreement	14A.34 to 14A.36, 14A.49, 14A.51 to 14A.59 and 14A.71	Waiver from monetary annual cap, announcement requirement, circular, and independent shareholders' approval requirements and a maximum term of three years of the agreement	N/A	N/A	N/A

CONNECTED TRANSACTIONS

FULLY EXEMPT CONTINUING CONNECTED TRANSACTIONS

We set out below a summary of the continuing connected transactions for our Group, which will be exempt from the reporting, annual review, announcement, circular and independent shareholders’ approval requirements under Chapter 14A of the Listing Rules.

Trademark Licensing Agreement

Our Group and Kelun Pharmaceutical entered into a trademark licensing agreement (the “**Trademark Licensing Agreement**”) on November 5, 2022, pursuant to which Kelun Pharmaceutical agreed to exclusively grant us the rights to use certain trademarks which have been or are being registered by Kelun Pharmaceutical in the PRC and the United Kingdom for our use in connection with our operations on a royalty-free basis for a term commencing from the date of the agreement and continue to be in force and effect until the expiration date of such trademarks.

As the usage right of the trademarks were granted by Kelun Pharmaceutical to us is on a royalty-free basis, the transactions under the Trademark Licensing Agreement fall within the de minimis threshold under Rule 14A.76(1)(a) of the Listing Rules and are exempt from the annual review, reporting, announcement, circular and independent shareholders’ approval requirements under Chapter 14A of the Listing Rules.

Rule 14A.52 of the Listing Rules provides that the period for the agreement of a continuing connected transaction must not exceed three years except in special circumstances where the nature of the transaction requires a longer period. We have applied for, and the Stock Exchange [has granted], a waiver from strict compliance with Rule 14A.52 of the Listing Rules such that the term of the Trademark Licensing Agreement can be of a perpetual term for so long as our Shares are [REDACTED] on the Stock Exchange, based on the grounds that (i) the Trademark License Agreement is on a royalty-free basis and allows our Group to use the licensed trademarks of Kelun Pharmaceutical during the daily business operations, which is long term in nature. Imposing a restriction on the term of the Trademark Licensing Agreement for a period of three years would deviate from the market prevailing practice and be contrary to the business intention of the parties; (ii) such a perpetual term of trademark licensing agreement can ensure the stable use of the relevant trademarks by our Group, which is in the interest of our Company and the Shareholders as a whole; (iii) as confirmed by Frost & Sullivan, the term of the Trademark Licensing Agreement, which exceeds three years, is in line with the industry prevailing practice; and (iv) Kelun Pharmaceutical cannot terminate the Trademark Licensing Agreement without obtaining prior written consent from our Group provided that there is no material breach of the Trademark Licensing Agreement on our end.

Shared Administrative Services Framework Agreement

We have historically shared with the Remaining Kelun Group certain administrative services such as catering, utilities, shuttle bus operation, office park greening, office space cleaning and staff dormitory services (the “**Shared Administrative Services**”) in our ordinary and usual course of business. We intend to continue such arrangement with the Remaining Kelun Group after the [REDACTED]. On [●], 2023, our Company and Kelun Pharmaceutical (for itself and on behalf of the Remaining Kelun Group) entered into a shared administrative

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services framework agreement (the “**Shared Administrative Services Framework Agreement**”), pursuant to which the Remaining Kelun Group shall provide the Shared Administrative Services to us. The Shared Administrative Services will be charged to us on a cost basis, and the relevant costs (i) are made reference to the prevailing prices for similar services readily on the market; and (ii) must be identifiable and allocated to us based on the actual expenses incurred by us. Our Directors consider that the sharing of the Shared Administrative Services between the Remaining Kelun Group and our Group under the Shared Administrative Services Framework Agreement would allow our Group to take advantage of bulk purchasing of resources at lower average costs and to enjoy economies of scale brought by the sharing of the Shared Administrative Services which would maximize cost efficiency and optimize the overall administrative cost structure.

The Shared Administrative Services Framework Agreement will commence from the [REDACTED] and continue until December 31, 2025 (both days inclusive). Subject to compliance with Listing Rules and applicable laws and regulations, the Shared Administrative Services Framework Agreement may be renewed for a further term of three years from time to time, unless either party notifies the other party to the contrary with three months’ written notice prior to the expiry of the agreement’s term.

As the Shared Administrative Services will be shared between the Remaining Kelun Group and our Group on a cost basis where the costs (being costs paid by the Remaining Kelun Group to their suppliers and/or their labor costs based on relevant work hours) will be identifiable and allocated to the parties on a fair and equitable basis, pursuant to Rule 14A.98 of the Listing Rules, the Shared Administrative Services Framework Agreement will be exempt from the announcement, circular, independent Shareholders’ approval, reporting and annual review requirements under Chapter 14A of the Listing Rules.

PARTIALLY EXEMPT CONTINUING CONNECTED TRANSACTIONS

Procurement and Provision of Auxiliary R&D Services

We have historically procured auxiliary R&D services, which include process development and optimization, sample purification, crystallization screening, GMP batch release testing, packing material and releasing testing from the Remaining Kelun Group, and have provided auxiliary R&D services, which include preclinical animal studies (including toxicology, pharmacokinetics, pharmacodynamic and screening studies), clinical biostatistics, data management, quality control and clinical audit, and other supporting services, to the Remaining Kelun Group (collectively, the “**Auxiliary R&D Services**”) from time to time in our ordinary and usual course of business. We intend to continue such procurement and provision of services with the Remaining Kelun Group after the [REDACTED]. On [●] 2023, our Company and Kelun Pharmaceutical (for itself and on behalf of the Remaining Kelun Group) entered into a framework agreement in relation to the procurement of the Auxiliary R&D Services (the “**Auxiliary R&D Services Framework Agreement**”), pursuant to which Kelun Pharmaceutical (for itself and on behalf of the Remaining Kelun Group) agreed to provide and procure the Auxiliary R&D Services to/from our Group.

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Principal Terms

The term of the Auxiliary R&D Services Framework Agreement will commence from the [REDACTED] and continue until December 31, 2025 (both days inclusive). Subject to compliance with Listing Rules and applicable laws and regulations, the Auxiliary R&D Services Framework Agreement may be renewed for a further term of three years from time to time, unless either party notifies the other party to the contrary with three months' written notice prior to the expiry of the agreement's term. Upon renewal of the Auxiliary R&D Services Framework Agreement, the parties may amend the terms of the agreement based on the then prevailing circumstances.

Pricing Policy

The services fees have been and will be based on cost-plus basis according to (i) the actual cost of provisions of such services (such as the labor cost and the cost of consumables used for providing the services); plus (ii) the agreed margin rates. The margin rates are determined through arm's length negotiation with reference to the range between the lower quartile and the upper quartile of the three-year weighted average cost-plus-margins of comparable companies offering similar services as stated in a transfer pricing analysis report prepared by an independent certified public accountant. Such margin rates may be changed from time to time and shall not be deemed to be the fixed rate for the transactions throughout the term of the Auxiliary R&D Services Framework Agreement.

Each of the services provided by the Remaining Kelun Group can be readily sourced from third-party suppliers. We have been identifying alternative suppliers for such services and we will continue to engage the Remaining Kelun Group to provide such services only if they are provided to our Group on normal commercial terms or better when compared with other third-party suppliers.

Reasons for and Benefits of the Transaction

The Auxiliary R&D Services provided by the Remaining Kelun Group are not core to our R&D activities. It is common for pre-profit biopharmaceutical companies like us to outsource these auxiliary R&D services to third parties so the pre-profit biopharmaceutical companies can concentrate on core R&D of their drug candidates. We have been engaging the Remaining Kelun Group to provide the Auxiliary R&D Services because (i) the Remaining Kelun Group has competent and reliable expertise in providing such Auxiliary R&D Services and can provide such services at arm's length and with good quality; and (ii) we have been cooperating with the Remaining Kelun Group for the Auxiliary R&D Services for a number of years and the Remaining Kelun Group is familiar with our quality requirement for these services. In addition, we have been providing Auxiliary R&D Services to the Remaining Kelun Group. The Remaining Kelun Group will continue to procure the Auxiliary R&D Services from us because our fully integrated innovation capabilities have been proven to meet the needs and requirements of the Remaining Kelun Group. Continuous procuring and providing the Auxiliary R&D Services from/to the Remaining Kelun Group can reduce our costs associated with involving in prolonged negotiations with new service providers and customers, and cooperating with them in run-in period.

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We believe that the risk of the Remaining Kelun Group terminating the connected transactions under the Auxiliary R&D Services Framework Agreement is remote as the parties under this agreement have limited termination rights and the termination would not be in the commercial interest of the Remaining Kelun Group. In an unlikely event that the Remaining Kelun Group terminates the connected transactions under the Auxiliary R&D Services Framework Agreement with us, given (i) that the Auxiliary R&D Services we procured can be readily sourced from suppliers who are Independent Third Parties, and (ii) that the Auxiliary R&D Services we supplied to the Remaining Kelun Group is not a part of our primary business, we don't consider such termination will materially and adversely affect our business. Accordingly, we believe that our procurement and provision of the Auxiliary R&D Services from/to the Remaining Kelun Group does not constitute any undue reliance on it. For details, please see “Relationship with our Controlling Shareholders – Independence of Our Group from our Controlling Shareholder – Operational Independence – Research and Development.”

Corporate Governance Measures

In order to ensure that the aforesaid pricing basis for the Auxiliary R&D Services Framework Agreement is adhered to, the Group will monitor the relevant costs to ensure that the selling price of such services are determined properly. The Company and the Remaining Kelun Group will (i) negotiate the terms of such transactions to ensure that prices are fair and reasonable, and properly reflect the level of costs incurred by both parties in the such transactions; (ii) determine the margin rate with reference to a transfer pricing analysis report prepared by an independent certified public accountant or an institution with the same qualification; and (iii) review the scope of Auxiliary R&D Services on a yearly basis (or more frequently if it is determined necessary) to determine whether updated transfer pricing analysis report shall be obtained for the determination of the margin rate. The margin rate will be determined with reference to the lower quartile and upper quartile of the three-year weighted average cost-plus-margins of the comparable companies as stated in such updated transfer pricing analysis report.

Historical Amounts

The following table sets forth the historical amounts of procurement of the Auxiliary R&D Service by our Group from the Remaining Kelun Group for the year ended December 31, 2021 and the nine months ended September 30, 2022:

	For the year ended December 31, 2021	For the Nine Months Ended September 30, 2022
	<i>(RMB in thousands)</i>	
<i>In terms of procurement of services from the Remaining Kelun Group:</i>		
	74,147	13,127
<i>In terms of provision of services to the Remaining Kelun Group:</i>		
	19,919	10,099

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Annual Caps and Basis of Annual Caps

The following table sets forth the proposed annual caps for the amounts payable by our Group to the Remaining Kelun Group in respect of the procurement of the Auxiliary R&D Services under the Auxiliary R&D Services Framework Agreement:

Proposed annual cap for the year ending December 31,		
2023	2024	2025
<i>(RMB in thousands)</i>		
22,000	18,000	15,000

The proposed annual caps are determined based on the following factors:

- (i) the fee rates of the Auxiliary R&D Services charged by the Remaining Kelun Group and the expected fluctuation in the rate;
- (ii) the historical transaction amounts in respect of our procurement of the Auxiliary R&D Services from the Remaining Kelun Group;
- (iii) the anticipated demand for the Auxiliary R&D Services from the Remaining Kelun Group driven by the R&D progress of our product candidates for the next three years, taking into account the anticipated improvement of our R&D capabilities; and
- (iv) the relevant service provision capacity of Remaining Kelun Group in providing Auxiliary R&D Services.

The following table sets forth the proposed annual caps for the amounts payable by the Remaining Kelun Group to us in respect of the provision of the Auxiliary R&D Services under the Auxiliary R&D Services Framework Agreement:

Proposed annual cap for the year ending December 31,		
2023	2024	2025
<i>(RMB in thousands)</i>		
16,000	16,000	16,000

The proposed annual caps are determined based on the following factors:

- (i) the fee rates of the Auxiliary R&D Services charged by us and the expected fluctuation in the rate;
- (ii) the historical transaction amounts in respect of our provision of the Auxiliary R&D Services to the Remaining Kelun Group;

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- (iii) the anticipated demand for the Auxiliary R&D Services from us; and
- (iv) the relevant service provision capacity of our Group in providing Auxiliary R&D Services.

Listing Rules Implications

As our Group is eligible for [REDACTED] on the Stock Exchange under Chapter 18A of the Listing Rules and the revenue we record during the Track Record Period was not derived from R&D, manufacturing and commercialization of novel drugs, the calculation of revenue ratio under Rule 14.07 of the Listing Rules is inappropriate to the sphere of activity of our Group, and thus we consider it inapplicable. As an alternative, we have applied a percentage ratio test based on the total expenses for R&D and general and administrative matters of our Group.

As the highest of all applicable percentage ratios (as defined in Rule 14.07 of the Listing Rules) in respect of the proposed annual caps of the Auxiliary R&D Services Framework Agreement will be no less than 0.1% but will not exceed 5%, the transactions under the Auxiliary R&D Services Framework Agreement are continuing connected transactions exempt from the circular (including independent financial advice) and shareholders’ approval requirements but are subject to the relevant annual reporting and announcement requirements set out in Chapter 14A of the Listing Rules.

Procurement of R&D-related Drugs and Consumables

We have historically procured R&D-related drugs and consumables (the “**R&D-related Drugs and Consumables**”) from Kelun Medicine & Trade and its subsidiaries from time to time in our ordinary course of business. R&D-related Drugs and Consumables primarily include clinical comparator drugs which are used in clinical trials to compare the efficacy of an investigational drug to the efficacy of an existing treatment and medical consumables including protective equipment and laboratory supplies. We intend to continue such procurement with Kelun Medicine & Trade after the [REDACTED] for clinical trial. On [●] 2023, our Company and Kelun Medicine & Trade entered into a framework agreement in relation to the procurement of the R&D-related Drugs and Consumables (the “**R&D-related Drugs and Consumables Framework Agreement**”), pursuant to which our Group agreed to purchase the R&D-related Drugs and Consumables from Kelun Medicine & Trade (for itself and on behalf of its subsidiaries, Kelun Medicine & Trade and its subsidiaries collectively referred to as “**Kelun Medicine & Trade Group**”).

Principal Terms

The term of the R&D-related Drugs and Consumables Framework Agreement will commence from the [REDACTED] and continue until December 31, 2025 (both days inclusive). Subject to compliance with Listing Rules and applicable laws and regulations, the R&D-related Drugs and Consumables Framework Agreement may be renewed for a further term of three years from time to time, unless either party notifies the other party to the contrary with three months’ written notice prior to the expiry of the agreement’s term. Upon renewal of the R&D-related Drugs and Consumables Framework Agreement, the parties may amend the terms of the agreement based on the then prevailing circumstances.

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Pricing Policy

The prices payable by us for procuring the R&D-related Drugs and Consumables have been and will be determined through arm’s length negotiation primarily based on the production cost of the R&D-related Drugs and Consumables, the sales price to external third parties and our procurement volume, with reference to a number of factors applicable to all suppliers, including but not limited to the prevailing market price of the relevant drugs and consumables of same quality, specifications of the products, delivery capability, response time and the fees charged for historical transactions of similar nature.

The R&D-related Drugs and Consumables can be readily sourced from third-party suppliers. We have been identifying alternative suppliers for the R&D-related Drugs and Consumables and we will continue to procure the relevant R&D-related Drugs and Consumables from Kelun Medicine & Trade Group only if they are provided to our Group on normal commercial terms or better when compared with other third-party suppliers.

Reasons for and Benefits of the Transaction

In the ordinary course of our business, we need to source comparator drugs in our clinical trials to compare the efficacy of our novel drugs to the efficacy of an existing treatment, and procure consumables to facilitate our R&D activities. Kelun Medicine & Trade Group is primarily engaged in wholesale of medicines and medical consumables, which is able to source R&D-related Drugs and Consumables from various drug and consumable manufacturers that could satisfy the need of our clinical trials. During the Track Record Period, we have been procuring R&D-related Drugs and Consumables from Kelun Medicine & Trade Group from time to time, which are with high quality, stable and quick delivery at reasonable prices. To ensure continuously stable and high-efficient support of our R&D activities, our Directors are of the view that continuous procurement of the R&D-related Drugs and Consumables from Kelun Medicine & Trade Group is in the interest of our Company and our Shareholders as a whole and will be beneficial to our Group.

We believe that the risk of Kelun Medicine & Trade Group terminating the connected transactions under the R&D-related Drugs and Consumables Framework Agreement is remote as the parties under this agreement have limited termination rights and the termination would not be in the commercial interest of Kelun Medicine & Trade Group. In an unlikely event that Kelun Medicine & Trade Group terminates the connected transactions under the R&D-related Drugs and Consumables Framework Agreement with us, given these R&D-related Drugs and Consumables can be readily sourced from suppliers who are Independent Third Parties, we don’t consider such termination will materially and adversely affect our business. Accordingly, we believe that our procurement of the R&D-related Drugs and Consumables from Kelun Medicine & Trade Group does not constitute any undue reliance on it. For details, please see “Relationship with our Controlling Shareholders – Independence of Our Group from our Controlling Shareholder – Operational Independence – Research and Development.”

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Corporate Governance Measures

During the ordinary and usual course of business of our Company, the procurement activities are governed by our procurement policy. When procurement of raw materials or procurement from new suppliers is necessary, we would strictly follow our internal procurement policy to select suppliers. For selecting providers for the R&D-related Drugs and Consumables, our procurement team normally requests the potential supplier to provide, among others, its industrial background and credentials and the quotations with breakdown of detailed components of the materials involved. Furthermore, our procurement team routinely monitors market price for procurement of the relevant R&D-related Drugs and Consumables necessary for our R&D activities, for benchmarking and cost control purposes.

The commercial negotiations with potential suppliers are led by our Procurement Department, which independently evaluates the terms taking into account all relevant factors as we consider necessary. A decision on whether to engage such supplier will be made purely based on commercial considerations and only if we consider it is in the best interest of our Company and the Shareholders to enter into such procurement arrangement.

Historical Amounts

The following table sets forth the historical amounts of procurement of the R&D-related Drugs and Consumables by our Group from Kelun Medicine & Trade Group for the year ended December 31, 2021 and the nine months ended September 30, 2022:

For the year ended December 31, 2021	For the Nine Months Ended September 30, 2022
<i>(RMB in thousands)</i>	
9,838	25,016

Annual Caps and Basis of Annual Caps

The following table sets forth the proposed annual caps for the amounts payable by our Group to Kelun Medicine & Trade Group in respect of the procurement of the R&D-related Drugs and Consumables under the R&D-related Drugs and Consumables Framework Agreement:

Proposed annual cap for the year ending December 31,		
2023	2024	2025
<i>(RMB in thousands)</i>		
20,000	40,000	30,000

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The proposed annual caps are determined based on the following factors:

- (i) the unit price of the R&D-related Drugs and Consumables and the potential price fluctuation;
- (ii) the historical purchase volume of the R&D-related Drugs and Consumables by our Group from Kelun Medicine & Trade Group;
- (iii) the anticipated demand for the R&D-related Drugs and Consumables driven by the R&D progress of our product candidates for the next three years; and
- (iv) the relevant supply capacity of Kelun Medicine & Trade Group in providing the R&D-related Drugs and Consumables.

Listing Rules Implications

As our Group is eligible for [REDACTED] on the Stock Exchange under Chapter 18A of the Listing Rules and the revenue we record during the Track Record Period was not derived from R&D, manufacturing and commercialization of novel drugs, the calculation of revenue ratio under Rule 14.07 of the Listing Rules is inappropriate to the sphere of activity of our Group, and thus we consider it inapplicable. As an alternative, we have applied a percentage ratio test based on the total expenses for R&D and general and administrative matters of our Group.

As the highest of all applicable percentage ratios (as defined in Rule 14.07 of the Listing Rules) in respect of the proposed annual caps of the R&D-related Drugs and Consumables Framework Agreement will be no less than 0.1% but will not exceed 5%, the transactions under the R&D-related Drugs and Consumables Framework Agreement are continuing connected transactions exempt from the circular (including independent financial advice) and shareholders’ approval requirements but are subject to the relevant annual reporting and announcement requirements set out in Chapter 14A of the Listing Rules.

NON-EXEMPT CONTINUING CONNECTED TRANSACTION

Licensing Agreement

Kelun Research Institute, a wholly-owned subsidiary of Kelun Pharmaceutical, as the licensor, and our Company, as the licensee, entered into a patent and technology license agreement in relation to A167 (the “**Licensing Agreement**”) on January 12, 2017, pursuant to which Kelun Research Institute agreed to grant exclusive license rights to us to globally promote and commercialize A167 (the “**Licensed Product**”).

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Principal terms

Under the Licensing Agreement, we don’t need to pay any upfront payment to Kelun Research Institute. However, we need to share with Kelun Research Institute the profit derived from the sale of the Licensed Product after its commercialization (the “**Profit Sharing**”). The Profit Sharing was determined after arms’ length negotiations between our Group and the Kelun Research Institute with reference to various factors, including but not limited to the costs and risk of development of the Licensed Product, expected prospects of the development and commercialization of the Licensed Product and the reasons for and benefits of the transactions contemplated under the License Agreement. The term of License Agreement commenced on the date of the agreement and continues to be in force and effect until the expiration date of the patent of the Licensed Product. Up to the Latest Practicable Date, we hadn’t paid any amount to Kelun Research Institute in connection with the Licensing Agreement as the Licensed Product has not commercialized.

Reasons for and benefits of the transaction

The License Agreement was entered into by our Group and Kelun Research Institute out of independent commercial considerations since the Kelun Research focuses its resources on the research and development of generic drugs, while our Group is committed to the R&D, manufacturing and commercialization of novel drugs to address significant unmet medical needs. It is natural and commercially beneficial for both groups to enter into the License Agreement so that both groups will be able to stick to their respective business plans and development paths. Pursuant to the License Agreement, our Group was granted the exclusive license to use all of the relevant intellectual property rights to carry out the R&D, manufacturing and commercialization of A167 and Kelun Research Institute would be able to benefit from the potential Profit Sharing. Therefore, our role and the role of Kelun Research Institute in the arrangement under the License Agreement are complementary and beneficial to each other. As confirmed by Frost & Sullivan, the License Agreement (including the Profit Sharing contemplated thereunder) is in line with the industry prevailing practice. As such, our Directors are of the view that the License Agreement is in the interest of our Company and the Shareholders as a whole.

Corporate Governance Measures

During the ordinary and usual course of business of our Company, we review potential product licensing opportunities, including product in-licensing and out-licensing, from time to time. When potential opportunity arises, we would normally assess the advantages and development prospect of the product, market forecasts for the demand of the product, competitive landscape and regulatory requirements of the product for that market as well as the regulatory and commercial capability of the potential business partner to commercialize the product. Furthermore, our business development team routinely evaluates licensing arrangement by third parties with similar mechanism of action for deal benchmarking and for term sheet evaluation purposes.

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In addition, the commercial negotiations with potential licensing partners are led by our senior management, who are not interested in the licensing and will independently evaluate the terms taking into account all relevant factors as we consider necessary. A decision on whether to enter into licensing arrangements with another company will be made purely based on commercial considerations and only if we consider it is in the best interest of our Company and the Shareholders to enter into such licensing arrangement.

Term of the License Agreement

Rule 14A.52 of the Listing Rules provides that the period for the agreement of a continuing connected transaction must not exceed three years except in special circumstances where the nature of the transaction requires a longer period. We have applied for, and the Stock Exchange [has granted], a waiver from strict compliance with the requirement under Rule 14A.52 of the Listing Rules such that the License Agreement can be of a term commencing from the date of the agreement and continue to be in force until the expiration date of the patent of the Licensed Product, for so long as our Shares are [REDACTED] on the Stock Exchange, on the grounds that: (i) the License Agreement allowed our Group and Kelun Research Institute to spread the risks and costs associated with the marketing and sales of the Licensed Product and to better deploy their respective resources and established capabilities to expeditiously establish an advantageous position in relevant markets. Imposing a restriction on the term of the License Agreement for a period of three years would deviate from the market prevailing practice and be contrary to the business intention of the parties; (ii) such a long-term cooperation is in the interest of our Company and the Shareholders as a whole; (iii) as confirmed by Frost & Sullivan, the term of the License Agreement, which exceeds three years, is in line with the industry prevailing practice; and (iv) we can terminate the License Agreement unilaterally if, among other things, the Kelun Research Institute is in material breach of the terms of the relevant agreement and fails to cure such breach within a prescribed period of time.

Historical Transaction Amounts

Under the Licensing Agreement, we don't need to pay any upfront payment to Kelun Research Institute. As the Licensed Product has not yet been approved for commercialization by the relevant authorities, there was no historical amount paid by our Group to the Kelun Research Institute under the License Agreement during the Track Record Period.

Caps on Future Transaction Amounts

The payment receivable by the Kelun Research Institute from us for Profit Sharing pursuant to the License Agreement will be determined in accordance with the following formula:

Sales within the PRC

Amount receivable by Kelun Research Institute under Profit Sharing = net sales revenue¹
x percentage of the profit sharing ratio²

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Sales outside the PRC

Amount receivable by Kelun Research Institute under Profit Sharing = net sales revenue¹
x 6%

Notes:

1. The net sales revenue refers to the revenue generated from the sales of products excluding packing and shipping fees, relevant tax, advertising fees and commercial discounts.
2. The profit sharing rate will be no more than 4% and will be determined based on the NDA filing status of the Licensed Product as compared to that of its competitors in the market.

Taking into account the clinical trial stage of the Licensed Product as opposed to concept stage or R&D stage products, the arrangement of the Profit Sharing is fair and reasonable and in the interest of our Company and the Shareholders as a whole because (i) the Profit Sharing contemplated under the License Agreement, including the formula as stated above, was determined after arm's length negotiation between Kelun Research Institute and us and in the ordinary and usual course of the business of the two groups; (ii) we are not obliged to pay any upfront payment to Kelun Research Institute under the License Agreement. If the formula produces negative results, we would not need to pay any amount to Kelun Research Institute. As advised by Frost & Sullivan, the License Agreement and the Profit Sharing arrangements thereunder are in line with the market practice.

We have applied to the Stock Exchange for a waiver from strict compliance with the requirement under Rule 14A.53 of the Listing Rules so as to allow us to set the annual caps in relation to continuing connected transactions under the License Agreement as the formula in accordance with the terms as set out in the License Agreement for the following reasons:

- (i) there was no historical amount and sufficient data for us to establish a model to estimate the future sales volume and amount for the Licensed Product as it is a newly developed drug without sufficient market data to analyze the extent of acceptance of this drug by the addressable market. It is impractical for us to accurately estimate the amount of payment to be paid under the Profit Sharing as the amount of Licensed Product and the revenue to be derived from the sale of Licensed Products depends on the actual addressable market of the product, which will in turn depend on various factors including but not limited to the acceptance by the medical community and patient access, drug pricing, reimbursement and the number of patients, all of which are beyond the control of our Group. Even if we are able to set up a projection model for estimation purpose, such a model will only present hypothetical predictions, which is not based on scientific analysis using historical data, and could be inaccurate, unreliable and even misleading;
- (ii) imposing an arbitrary cap on the potential sales volume of the Licensed Product does not demonstrate commercial reasonableness and would be counter-productive as far as the interests of the Company and our Shareholders are concerned. In the absence of a factually and mathematically reliable model to estimate the annual supply

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volume of the Licensed Products, imposing an arbitrary monetary cap may become an arbitrary ceiling on the transaction amount under Profit Sharing. In addition, a fixed annual cap is not helpful to incentivize our Group to generate more revenue and profit from commercializing the Licensed Product, and will restrict business growth of our Group, which would go against the commercial objective of the Licensing Agreement. If the actual sales volume of the Licensed Product exceeds the cap, the Company would be suspended from selling the Licensed Products to the market until relevant shareholder approval of the adjusted annual caps is obtained, which will affect not only our business but also the patients who need the Licensed Product for treatment, and further affect our market recognition among the doctors and hospitals because they are not able to sustain a stable supply of the Licensed Product. As far as the transactions are on normal commercial terms or better, and the profit margin of the Licensed Product and the profit sharing percentage are commercially reasonable and in line with market standards, the interests of our Group and our Shareholders are protected, and there is no reason or benefit to impose such fixed cap;

- (iii) given most of our products are in the research and development stage, the revenue generated from the Profit Sharing may account for a sizeable portion of our total revenue before the commercialization of other drugs of our Group. Therefore, the disclosure of the annual caps in monetary terms would in effect provide Shareholders and investors as well as competitors of our Company with an indication of our estimated revenue, and may allow them to extrapolate the likely volume of the Licensed Product to be supplied and even the unit supply price of the Licensed Product. Such information is highly sensitive and would therefore put us in disadvantageous position in relation to our business operation and competition with other market players; and
- (iv) instead of setting a fixed annual cap on the Profit Sharing, if there is any material change to the percentage of the profit sharing ratio under the Profit Sharing, we will re-comply with the applicable rules under Chapter 14A of the Listing Rules, including seeking independent shareholders' approval where the case may so require, so as to further ensure the interest of our Group and our Shareholders.

The Stock Exchange [has granted] the waiver from strict compliance with the requirement under Rule 14A.53 of the Listing Rules in respect of the continuing connected transactions under the License Agreement subject to the following conditions:

- (i) our Company will comply with the announcement, circular and independent Shareholder's approval requirements under Chapter 14A of the Listing Rules if there is any material change to the terms of the License Agreement;
- (ii) our Company will designate a team to execute and ensure that the transactions in relation to the License Agreement are undertaken in accordance with the terms of the License Agreements;

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- (iii) our chief executive officer will use his best endeavours to supervise the compliance with the terms of the License Agreement and applicable Listing Rules requirements to the extent not waived by the Stock Exchange on a regular basis;
- (iv) the independent non-executive Directors and the auditors of the Company will review the transactions in relation to the License Agreement on an annual basis and confirm in our annual reports the matters set out in Rules 14A.55 and 14A.56 of the Listing Rules, respectively;
- (v) the Company will disclose in the document the background for entering into the License Agreement, the terms of the License Agreement, the grounds for the waiver sought and the Directors' views on the fairness and reasonableness of the transactions under the License Agreement; and
- (vi) in the event of any future amendments to the Listing Rules imposing more stringent requirements than those as at the date of this document on the above continuing connected transactions, the Company will take immediate steps to ensure compliance with such new requirements.

The waiver set out above is for a term of [three] years ending on December 31, 2025. The Company will, after taking into account, among other things, the addressable market, the drug pricing and the historical transaction amount of the relevant products, re-assess whether a further waiver is required at the expiry of such initial term.

Listing Rules Implications

Since the highest of all applicable percentage ratios in respect of the License Agreement might be 5% or more, the transactions under the License Agreement will constitute a continuing connected transaction subject to reporting, annual review, announcement, circular and independent Shareholders' approval requirements under Chapter 14A of the Listing Rules.

WAIVER APPLICATION FOR PARTIALLY EXEMPT AND NON-EXEMPT CONTINUING CONNECTED TRANSACTIONS

By virtue of Rule 14A.76(2) of the Listing Rules, each of the transactions under the sub-section "– Partially Exempt Continuing Connected Transactions" will constitute connected transactions which are subject to reporting, annual review and announcement under Chapter 14A of the Listing Rules. Each of the transactions under the sub-section "– Non-Exempt Continuing Connected Transaction" will constitute connected transactions which are subject to reporting, annual review, announcement and independent shareholders' approval requirements under Chapter 14A of the Listing Rules.

As the above partially exempt and non-exempt continuing connected transactions are expected to continue on a recurring and continuing basis, our Directors consider that compliance with the above announcement and/or independent shareholders' approval requirements would be impractical, would add unnecessary administrative costs to us and would be unduly burdensome to us.

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Accordingly, we have applied to the Stock Exchange for, and the Stock Exchange [has granted], a waiver to us under Rule 14A.105 of the Listing Rules from compliance with the announcement and/or independent shareholder’s approval requirements in respect of the above partially exempt and non-exempt continuing connected transactions. In addition, we confirm that we will comply with the Listing Rules in relation to the discloseable and non-exempt continuing connected transactions. In the event of any future amendments to the Listing Rules imposing more stringent requirements than those applicable as of the Latest Practicable Date on the continuing connected transactions referred to in this document, our Company will take immediate steps to ensure compliance with such new requirements within a reasonable time.

We have applied for, and the Stock Exchange [has granted], a waiver from strict compliance with the requirement under Rule 14A.52 of the Listing Rules such that the terms of the Trademark Licensing Agreement and the License Agreement can be of an unspecified term.

For reasons set out in the paragraph headed “– Non-exempt Continuing Connected Transaction – Licensing Agreement – Caps on Future Transaction Amounts” above, our Company has applied for, and the Stock Exchange [has granted], a waiver from strict compliance with Rule 14A.53 of the Listing Rules.

CONFIRMATION FROM OUR DIRECTORS

Our Directors (including independent non-executive Directors) are of the view that (i) the partially exempt and non-exempt continuing connected transactions set out above have been and will be entered into in the ordinary and usual course of our business on normal commercial terms or better which are fair and reasonable and in the interests of our Group and our Shareholders as a whole; (ii) the proposed monetary annual caps in respect of the partially exempt and non-exempt continuing connected transactions are fair and reasonable and in the interests of our Group and our Shareholders as a whole; and (iii) the License Agreement, notwithstanding that it has not adopted monetary annual caps, has been entered into in the ordinary and usual course of the Group’s business, is on normal commercial terms or better, and is fair and reasonable and in the interests of our Company and its Shareholders as a whole.

CONFIRMATION FROM THE JOINT SPONSORS

Having considered the above, the Joint Sponsors are of the view that (i) the aforesaid non-exempt continuing connected transactions have been entered into in the ordinary and usual course of business of the Company on normal commercial terms or better which are fair and reasonable, and in the interests of the Company and the Shareholders as a whole; (ii) the proposed monetary annual caps or alternative caps (as applicable) in respect of the partially exempt and non-exempt continuing connected transactions are fair and reasonable and in the interests of the Company and the Shareholders as a whole; and (iii) taking into consideration (a) the reasons for and benefits of entering into the Trademark Licensing Agreement and the License Agreement as set out above, (b) the confirmation from Frost & Sullivan on the terms of the Trademark Licensing Agreement and the License Agreement, which exceeds three years, is in line with the industry prevailing practice, and (c) the fact that the relevant arrangements were negotiated on an arm’s length basis and in accordance with the corporate governance measures of the Company as set forth above, it is reasonable for the Trademark Licensing Agreement and the License Agreement to be entered into for a term as set out above, and it is normal business practice for agreements of this type to be of such duration.