



SOMERLEY CAPITAL LIMITED

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January 16, 2024

To: the Independent Board Committee and the Independent Shareholders

Dear Sirs,

**CONTINUING CONNECTED TRANSACTION IN RELATION TO
CDMO SERVICES FRAMEWORK AGREEMENT
AND
THE SUPPLEMENTAL CDMO SERVICES FRAMEWORK AGREEMENT**

INTRODUCTION

We refer to our appointment to advise the Independent Board Committee and the Independent Shareholders in relation to the CDMO Services Framework Agreement, the Supplemental CDMO Services Framework Agreement and the Proposed Revised Cap. On November 13, 2023, the Company and Lepu Medical conditionally entered into the CDMO Services Framework Agreement in respect of GLP-1 and related products, pursuant to which the Company and/or its subsidiaries has conditionally agreed to provide CDMO services to Lepu Medical and/or its subsidiaries. On December 22, 2023, the Company and Lepu Medical entered into the Supplemental CDMO Services Framework Agreement to adjust the original proposed monetary cap(s) for the transactions contemplated under the CDMO Services Framework Agreement. Details of which are set out in the letter from the Board contained in the circular of the Company to the Shareholders dated January 16, 2024 (the “**Circular**”), of which this letter forms a part. Unless the context otherwise requires, terms used in this letter shall have the same meanings as defined in the Circular.

As at the Latest Practicable Date, as Lepu Medical holds approximately 13.58% of the issued share capital of the Company, and Dr. Pu Zhongjie, the controlling shareholder of the Company, is its actual controller, Lepu Medical is, accordingly, a connected person of the Company, and the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) and the transactions contemplated thereunder constitute continuing connected transactions of the Company under Chapter 14A of the Listing Rules. As the highest applicable percentage ratio in respect of the amount of the Proposed Revised Cap is more than 5%, the continuing connected transactions contemplated under the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) are subject to the reporting, annual review, announcement, circular and Independent Shareholders' approval requirements under Chapter 14A of the Listing Rules.



An EGM will be convened to seek the approval of the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) and the Proposed Revised Cap by the Independent Shareholders. In view of the interests of Lepu Medical and Ningbo Houde Yimin, holding in aggregate approximately 39.69% of the issued share capital of the Company as at the Latest Practicable Date, they will abstain from voting at the EGM in respect of the relevant resolution in relation to the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) and the Proposed Revised Cap.

The Independent Board Committee comprising all the independent non-executive Directors, namely Mr. Zhou Demin, Mr. Yang Haifeng and Mr. Fengmao Hua, has been established to advise the Independent Shareholders in relation to the terms of the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) and the continuing connected transactions contemplated thereunder (including the Proposed Revised Cap). We, Somerley Capital Limited, have been appointed to advise the Independent Board Committee and the Independent Shareholders in this regard.

We are not associated or connected with the Company, Lepu Medical or their respective associates, close associates or core connected persons and, accordingly, are considered eligible to give independent advice on the CDMO Services Framework Agreement, the Supplemental CDMO Services Framework Agreement and the Proposed Revised Cap. In the two years prior to this engagement, there was no engagement between the Group and us. Apart from normal professional fees payable to us in connection with this appointment, no arrangement exists whereby we will receive any fees or benefits from the Company, Lepu Medical or their respective core associates, close associates or core connected persons.

In formulating our advice and recommendation, we have reviewed, among others, (i) the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement); (ii) annual reports of the Company for the year ended December 31, 2021 (“**FY2021**”) and 2022 (“**FY2022**”); (iii) interim report of the Company for the six months ended June 30, 2023; and (iv) the Circular. In addition, we have relied on the information and facts supplied, and the opinions expressed, by the Directors and management of the Company (collectively, the “**Management**”) and the respective professional advisers of the Company and have assumed that they are true, accurate and complete in all material aspects and in relation to any opinions to be honestly held at the time they were made and will remain, in relation to the facts to be true, accurate and complete in all material aspects and in relation to any opinions to be honestly held, up to the date of the EGM. We have also sought and received confirmation from the Group that no material facts have been omitted from the information supplied by them and that their opinions expressed to us are not misleading in any material respect. We consider that the information we have received is sufficient for us to formulate our opinion and recommendation as set out in this letter and have no reason to believe that any material information has been omitted or withheld, nor to doubt the truth or accuracy of the information provided to us. We have, however, not conducted any independent investigation into the businesses and affairs of the Group, nor have we carried out any independent verification of the information supplied.



PRINCIPAL FACTORS AND REASONS CONSIDERED

In arriving at our opinion and recommendation on the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) in relation to the provision of CDMO services by the Company to Lepu Medical (including the Proposed Revised Cap), we have taken into consideration the following principal factors and reasons:

1. Information on the parties

The Group

The Company is a joint stock company incorporated in the PRC on January 19, 2018 as a limited liability company, whose H Shares are listed on the Stock Exchange (stock code: 2157). The Company is a biopharmaceutical company focusing on the research, development and commercialization oncology therapeutics drug candidates. Dr. Pu Zhongjie is the ultimate beneficial owner and controlling shareholder of the Company.

As disclosed in the interim report of the Company for the six months ended June 30, 2023, the Group has established an integrated end-to-end platform across drug discovery, clinical development, CMC and GMP compliant manufacturing, encompassing all critical functions of the biopharmaceutical value chain, and is building dedicated sales and marketing forces. The Group has strategically designed its pipeline with a range of oncology products. For clinical-stage candidates, the Group has (i) one clinical/commercialization-stage drug candidate; (ii) six clinical-stage drug candidates, including one co-developed through a joint venture; and (iii) three clinical-stage combination therapies of its candidates. One of its drug candidates has obtained marketing approval with respect to two of its targeted indications, with clinical trials for other indications ongoing. Among the six clinical-stage drug candidates, five are targeted therapeutics and one is an immunotherapeutic, which is an oncolytic virus drug.

In FY2022, the Group generated its first revenue of approximately RMB15.6 million, primarily attributed to the successful commercialization of HX008, a humanized IgG4 mAb against human PD-1. The loss attributable to shareholders of the Company narrowed to approximately RMB689.1 million as compared with approximately RMB1,011.0 million recorded in FY2021, mainly due to (i) the first generation of revenue by the Group in FY2022; (ii) the decrease in research and development expenses from approximately RMB791.2 million in FY2021 to approximately RMB524.3 million in FY2022 mainly due to prioritization of resources on drug candidates and indications which the Company considers to have the most potential; and (iii) the increase in finance income from approximately RMB4.1 million in FY2021 to approximately RMB45.9 million in FY2022 mainly due to foreign exchange gains from the proceeds from the Global Offering.

For the six months ended June 30, 2023, the Group recorded revenue of approximately RMB153.6 million. The revenue generated from the out-licensing of CMG901 for development and commercialization amounted to approximately RMB109.5 million. The loss attributable to shareholders of the Company narrowed to approximately RMB141.9 million for the six months



ended June 30, 2023 as compared with approximately RMB344.3 million recorded for the same period in 2022, mainly due to (i) the significant increase in revenue for the six months ended June 30, 2023 compared to that of nil for the same period in prior year; (ii) the decrease in administrative expenses from approximately RMB84.7 million for the six months ended June 30, 2022 to approximately RMB39.1 million for the six months ended June 30, 2023 primarily due to a decrease in the listing expenses by approximately RMB33.5 million; and (iii) the fair value gains on financial liabilities at fair value through profit or loss of approximately RMB17.7 million for the six months ended June 30, 2023 compared with a fair value loss of approximately RMB60.8 million for the same period in 2022.

Lepu Medical

Lepu Medical is a medical device and pharmaceutical company listed on the Shenzhen Stock Exchange (stock code: 300003) dedicated to the development, manufacturing and sales of cardiovascular products. Lepu Medical is also engaged in the research and development of insulin drugs. Dr. Pu Zhongjie, an executive Director and controlling shareholder of the Company, is its actual controller.

As disclosed in the annual report of Lepu Medical for FY2022, Lepu Medical recorded a revenue of approximately RMB10,609.4 million in FY2022, which is relatively stable compared to approximately RMB10,659.7 million recognised in FY2021. The profit attributable to the shareholders of Lepu Medical has increased from approximately RMB1,719.3 million in FY2021 to approximately RMB2,202.8 million in FY2022. As disclosed in the interim report of Lepu Medical for the six months ended June 30, 2023, Lepu Medical recorded a revenue of approximately RMB4,301.5 million for the six months ended June 30, 2023 compared to that of approximately RMB5,333.5 million for the same period in prior year. The profit attributable to the shareholders of Lepu Medical has decreased from approximately RMB1,268.0 million for the six months ended June 30, 2022 to approximately RMB961.5 million in for the six months ended June 30, 2023.

2. Background to and reasons for entering into the framework agreements in relation to CDMO Services

As disclosed in the letter from the Board in the Circular, the Group is primarily engaging in the research and development of its drug candidates and owns and operates a GMP-compliant bioreactor production line, which has been put into operation since late 2019 and for which the Company have recently been utilising approximately 60% of its designed capacity of 2,000L to satisfy the demand from the research and development of its pre-clinical drug candidates and clinical drug candidates. It is expected that not more than 35% of the manufacturing capacity would be utilised to provide such services to Lepu Medical and/or its subsidiaries. The Group is well-equipped with an antibody drug substance production line, which includes individual upstream and downstream lines, a drug product line, as well as other production facilities. The fact that the Group's manufacturing facility is in compliance with GMP standards also demonstrates that its drug manufacturing functions are of a high quality and standard. Complementary with its manufacturing facility, the Group is well equipped with a complete production management organizational structure and houses a professional production team backed by rich experience.



Taking into account the needs of the Group for drugs manufacturing to cater for its clinical trials and commercialization, the Group can utilize its excess production capacity to provide CDMO services for appropriate business. By entering into the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement), the Directors believe this will enable a more effective use of the Group's excess production capacity and can generate supplementary cashflow for the Group as a whole. The principal business operation has been and remains as the research and development of the Company's drug candidates and the sales of its commercialized drug candidates, and the provision of CDMO services to Lepu Medical (and/or its subsidiaries) is only a way for the Company to monetise on their excess production capacity in the short run to enhance the efficiency of its assets. Given the provision of CDMO services to Lepu Medical (and/or its subsidiaries) does not form part of the Company's principal business operations, the Company is of the view that the transactions contemplated under the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) do not give rise any reliance issue, and the actual transaction amount to be incurred under the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) is not expected to constitute a material portion of the Company's consolidated revenue for the year ending December 31, 2024. Nevertheless, the Company's main source of income has been and will remain as sales revenue from the sales of its commercialized products and revenue from CDMO services has not been and is not currently expected to be the main source of income of the Company in the future, and the provision of the CDMO services or any cessation of such collaboration relationship with Lepu Medical will not have a material impact on the Company's financial condition. Furthermore, the Company's counterparties in its sales of commercialized products include various Independent Third Parties and no sales of commercialized products have been conducted with Lepu Medical (and/or other companies controlled by Dr. Pu Zhongjie, the Controlling Shareholder). Accordingly, the Company is of the view that the transactions contemplated under the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) will not give rise to any sustainability or business viability concern.

In addition, taking into account the relevant time needed to complete the requisite regulatory and corporate procedures for both the Company and Lepu Medical before the CDMO Services Framework Agreement can take effect, and in turn, before the contemplated transactions under the CDMO Services Framework Agreement can commence, the Company and Lepu Medical, upon discussion, noted that such underlying transactions can only commence in 2024. Therefore, the Company and Lepu Medical decided to enter into the Supplemental CDMO Services Framework Agreement, such that the Proposed Revised Cap for the period ending December 31, 2024 can cover the estimated maximum transaction amount for the underlying CDMO services transactions through aggregating the original proposed monetary caps for the periods ending December 31, 2023 and December 31, 2024.



In view of the above, and having taken into account, among others, (i) the principal business of the Group; (ii) the excess production capacity of the Group, which could be more effectively utilised through the provision of CDMO services to Lepu Medical; and (iii) the entering into the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) would allow the Group to generate additional revenue and supplementary cash flow, we are of the view that entering into the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) will be in the ordinary course of business and in the interests of the Company and the Shareholders as a whole.

3. Principal terms of the CDMO Services Framework Agreement and the Supplemental CDMO Services Framework Agreement

The following sets forth the principal terms of the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement):

Date

CDMO Services Framework Agreement: November 13, 2023

Supplemental CDMO Services Framework Agreement: December 22, 2023

Parties

- (i) The Company; and
- (ii) Lepu Medical

Term

The period commencing from the date on which the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) is approved by the Independent Shareholders at the EGM to December 31, 2024 (both dates inclusive).



Subject matter

The CDMO services to be provided by the Company and/or its subsidiaries to Lepu Medical and/or its subsidiaries include CMC technical services.

The CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) is a framework agreement which contains the principles, mechanisms and terms and conditions upon which the parties thereto are to carry out the transactions contemplated thereunder. The Company and/or its subsidiaries and Lepu Medical and/or its subsidiaries may from time to time enter into specific agreements in respect of the specific CDMO services required for the development of a particular drug undertaken by Lepu Medical and/or its subsidiaries, provided that the terms and conditions of such specific agreements shall not be inconsistent with the terms of the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement). The provision of CDMO services by the Company and/or its subsidiaries to Lepu Medical and/or its subsidiaries will be carried out in accordance with such specific agreements to be entered into between the Company and/or its subsidiaries and Lepu Medical and/or its subsidiaries from time to time.

Pricing basis

The fees payable by Lepu Medical and/or its subsidiaries to the Company and/or its subsidiaries under the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) and the specific agreements will be determined at arm's length and on a fair and reasonable basis based on a number of factors, including but not limited to (i) the scope and volume of tasks to be performed at each stage of each area of work; (ii) the volume, nature, complexity and value of the service involved, and the materials required to complete the work order; (iii) the expected operational costs (including, among others, laboratory costs, labor costs (which is determined by the number of personnel and hours expected to be scheduled and utilized for providing the particular service, the historical hourly rates of the relevant operations and management personnel)); and (iv) the then prevailing market rates by obtaining and comparing against fees charged by two independent CDMO service providers for similar service in respect of similar types of tasks in the market.

The payment and settlement terms of such fees payable by Lepu Medical and/or its subsidiaries to the Company and/or its subsidiaries in respect of such CDMO service transactions shall be separately agreed upon between the relevant parties in the implementation agreements to be entered into pursuant to the terms of the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement).



Further details of the terms of the CDMO Services Framework Agreement are set out in the section headed “*1. CDMO SERVICES FRAMEWORK AGREEMENT AND THE SUPPLEMENTAL CDMO SERVICES FRAMEWORK AGREEMENT*” in the letter from the Board in the Circular.

Our assessment of the terms of the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement)

As set out in the paragraphs headed “*3. Principal terms of the CDMO Services Framework Agreement and the Supplemental CDMO Services Framework Agreement*” above, the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) is a framework agreement and the Company and/or its subsidiaries and Lepu Medical and/or its subsidiaries may from time to time enter into specific agreements in respect of the specific CDMO services required for the development of a particular drug undertaken by Lepu Medical and/or its subsidiaries, provided that the terms and conditions of such specific agreements shall not be inconsistent with the terms of the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement).

We have discussed with the Management and noted that the Group will adhere to a series of internal control measures to ensure the terms, including the fee charged and the payment and settlement terms, offered to Lepu Medical and/or its subsidiaries in relation to CDMO services will be determined in the ordinary course of business, on normal commercial terms, negotiated at arm’s length and shall be on terms which are no less favorable to the Group than those offered to other Independent Third Parties. As at the Latest Practicable Date, the Company had not provided any CDMO services to Independent Third Parties similar to those pursuant to the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement). When considering the service fees for the CDMO services to be provided by the Group to Lepu Medical, the Group will constantly research into prevailing market conditions and practices and make reference to the pricing and terms offered by at least two Independent Third Party CDMO service providers for similar services, to make sure that the pricing and terms offered to Lepu Medical from mutual commercial negotiations (as the case may be), are fair, reasonable and are no more favorable than those offered to Independent Third Parties. As part of the Company’s internal control, the finance department of the Company shall be responsible for monitoring changes in the prevailing market rates and report material changes to the Board. In monitoring the prevailing market rates, we were advised by the management of the Company that, during the ordinary course of its business, the Group would from time to time obtain information on the general market condition on the prevailing market rates from various Independent Third Party CDMO service providers, which includes different major independent CDMO service providers in the market.



As set out in the letter from the Board in the Circular, as a biotech company principally engaged in the research and development of drug candidates, the Group, in the ordinary course of its business, has collaborated and has been actively engaged in communications and collaboration with other independent CDMO service providers in the market for its past and ongoing clinical trials approved at the time when the relevant drug/clinical trial application/registration was made. Therefore, the Company would be able to obtain information on the general market condition on the prevailing market rates for similar CDMO services for similar types of tasks. We have reviewed the Company's calculation basis of the CDMO services fees it expects to charge Lepu Medical during the term of the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) and compared with those offered by other independent CDMO service providers for similar CDMO services for key tasks. From our review, we noted that the fees the Company expects to charge Lepu Medical for each tasks to be performed covered all expected operational costs (including, among others, laboratory costs, labor costs (which is determined by the number of personnel and hours expected to be scheduled and utilised for providing the particular service, the historical hourly rates of the relevant operations and management personnel)), and are comparable to those quoted by two independent CDMO service providers for similar CDMO services for key tasks and not less than at least one of such quotations. As such, we are of the view that the fees charged for the provision of CDMO services by the Group to Lepu Medical, given the fees charged are generally in line with the market and no less favorable than terms available from at least one of the Independent Third Parties, are fair and reasonable so far as the Independent Shareholders are concerned.

Taking into account the above, as well as (i) the excess production capacity of the Group, which could be more effectively utilised through the provision of CDMO services to Lepu Medical and generate additional revenue and supplementary cash flow to the Group; and (ii) the internal control measures of the Group to monitor changes in the prevailing market rates and the costs involved in the provision of CDMO services and the reporting requirements by the Listing Rules in relation to the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) as set out in the section headed "*5. Internal control measures and reporting requirements by the Listing Rules regarding the continuing connected transactions under the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement)*" below, we are of the view that the CDMO Services Framework Agreement and the Supplemental CDMO Services Framework Agreement were entered into on normal commercial terms and are fair and reasonable so far as the Independent Shareholders are concerned.



4. The Proposed Revised Cap

Historical transaction amount

Prior to entering into the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement), the Group has not conducted transactions of the same nature with Lepu Medical and/or its subsidiaries. The Group has not conducted any transactions contemplated under the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) up to the Latest Practicable Date.

Our assessment of the Proposed Revised Cap

Set out below are the Proposed Revised Cap for the transactions contemplated under the CDMO Services Framework Agreement as supplemented by the Supplemental CDMO Services Framework Agreement:

	For the year ending December 31, 2024 RMB'000
The Proposed Revised Cap	46,000

Based on our discussions with the Management, the above Proposed Revised Cap are determined with reference to the estimated demand for CDMO services by Lepu Medical and/or its subsidiaries, which is based on the anticipated clinical trial development plan for the drug candidates of Lepu Medical and/or its subsidiaries, the corresponding volume of drugs required to be manufactured to satisfy clinical drug supply and batch release testing services, and the expected costs for the services (including labor costs to be incurred) at each stage of each area of work during the provision of CDMO services to Lepu Medical and/or its subsidiaries. During the Company's discussion with Lepu Medical on its needs for CDMO services, the Company noted that Lepu Medical has immediate demand for cell viability assays task services, and for a number of other CDMO services (including process and product characterization, analytical method validation, clinical drug supply and batch release testing services) with respect to one of its on-going clinical development projects, all of which are services that the Group is equipped to offer. We have obtained and reviewed the aforementioned development plan and understood from the Management that, Lepu Medical has immediate demand for cell viability assays task services, and for a number of other CDMO services (including process and product characterization, analytical method validation, clinical drug supply and batch release testing services) with respect to one of its on-going clinical development projects, all of which are services that the Group is equipped to offer. Given the fact above, the costs are expected to be incurred and charged to Lepu Medical and/or its subsidiaries in 2024 and the Proposed Revised Cap will be RMB46 million for the year ending December 31, 2024.



To assess the fairness and reasonableness of the Proposed Revised Cap, we have obtained and reviewed the details of the forecasts and relevant breakdown of the transaction amount. We understand from the Management that the forecasted transaction amounts are principally based on the estimated development timeline, scope and workload of tasks to be performed at each stage of each scope of work, namely (i) analytical method validation; (ii) process and product characterization; and (iii) clinical material supply and batch release testing, based on the Group's discussion with Lepu Medical. In addition, the Company has also considered the fees charged by other comparable CDMO services providers for similar services in respect of similar types of tasks in the market. We have discussed and understood from the Management that the pricing for CDMO services is mainly determined by the number of personnel and hours expected to be scheduled and consumed for providing the particular service, necessary material costs and laboratory costs. In this regard, we have obtained from the Management two sample quotations from other independent CDMO services providers for similar services in respect of similar types of tasks in the market, and compared the relevant forecasted transaction amounts for key tasks in the development plan in formulating the Proposed Revised Cap. From our review, we noted that fees for key tasks to be charged to Lepu Medical under the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) are generally in line with those quoted by the two independent CDMO services providers for similar services in respect of similar types of tasks in the market. As each of such quotation covered key tasks of the CDMO services to be provided by the Group and Lepu Medical, we are of the view that such quotations are fair and representative.

In our opinion, it is in the interests of the Group and the Shareholders to determine the Proposed Revised Cap in a way that can accommodate the potential growth of the Group's business. Provided that transactions contemplated under the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) are subject to annual review by the independent non-executive Directors and auditors of the Company (as summarised below), as required under the Listing Rules and other effective internal control measures (as summarised in the section headed "*5. Internal control measures and reporting requirements by the Listing Rules regarding the continuing connected transactions under the CDMO Services Framework Agreement*" below) to safeguard the Group's interest, the Group would have desirable flexibility in conducting its business as the Proposed Revised Cap are tailored to future business activities.

Having considered the basis on which the Proposed Revised Cap are determined as described above, we are of the view that the Proposed Revised Cap are fair and reasonable so far as the Independent Shareholders are concerned.



5. Internal control measures and reporting requirements by the Listing Rules regarding the continuing connected transactions under the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement)

As set out in the letter from the Board in the Circular, to ensure that the terms under the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) for the continuing connected transactions are fair and reasonable, or no less favorable than terms available to Independent Third Parties, and are carried out under normal commercial terms, the Company has adopted the following internal control procedures:

- (i) the joint responsibility for evaluating the terms under the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) for the continuing connected transactions, in particular, the fairness of the pricing policy and the Proposed Revised Cap by the Audit Committee, the Board and various other internal departments of the Company (including but not limited to the finance department and compliance and legal department);
- (ii) the regular monitoring of the fulfilment status and the transaction updates under the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) by the Audit Committee, the Board and various other internal departments of the Company;
- (iii) the procedures governing the pricing basis and price determination method of continuing connected transactions, whereby transactions should be priced in accordance with the prevailing market rates. The finance department of the Company shall (i) be responsible for monitoring changes in the prevailing market rates or in the costs involved in the continuing connected transactions, and report material changes to the Board; and (ii) perform half-yearly checks on the transactions entered into under the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) to ensure compliance with pricing policies;
- (iv) the monitoring of the utilisation of the Proposed Revised Cap by the financial department of the Company and report to the senior management of the Company if the actual transaction amount reach approximately 75% of the Proposed Revised Cap at any time of the year, and the monthly report of the actual transaction amount incurred in the underlying transactions of the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) in the monthly management accounts;



- (v) when considering the service fees for the services to be provided by the Group to any connected persons of the Company, the Group will constantly research into prevailing market conditions and practices and make reference to the pricing and terms offered by at least two Independent Third Party CDMO service providers for similar services, to make sure that the pricing and terms offered to the above connected persons from mutual commercial negotiations (as the case may be), are fair, reasonable and are no more favorable than those offered to Independent Third Parties; and
- (vi) the interested Directors and Shareholders shall abstain from voting and Independent Board Committee and Independent Shareholders have the right to consider if the terms of the non-exempt continuing connected transactions (including the proposed annual caps) under the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) are fair and reasonable, and on normal commercial terms and in the interests of the Company and Shareholders as a whole.

Please refer to the section headed “2. *INTERNAL CONTROL MEASURES*” in the letter from the Board in the Circular for further details.

Pursuant to Rules 14A.55 to 14A.59 of the Listing Rules, the transactions contemplated under the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) are subject to the following annual review requirements:

- (a) the independent non-executive Directors must review the continuing connected transactions under the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) every year and confirm in the annual report and accounts that they have been entered into:
 - (i) in the ordinary and usual course of business of the Group;
 - (ii) on normal commercial terms or better; and
 - (iii) according to the agreements governing them on terms that are fair and reasonable and in the interests of the Shareholders as a whole;



- (b) the Company's auditors must provide a letter to the Board (with a copy to be provided to the Stock Exchange at least ten business days before the bulk printing of the Company's annual report) confirming whether anything has come to their attention that causes them to believe that the continuing connected transactions under the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement):
 - (i) have not been approved by the Board;
 - (ii) were not, in all material respects, in accordance with the pricing policies of the Group;
 - (iii) were not entered into, in all material respects, in accordance with the relevant agreements governing them; and
 - (iv) have exceeded the relevant Proposed Revised Cap;
- (c) the Company must allow, and ensure that the counterparties to the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) allow, the Company's auditors sufficient access to their records for the purpose of the reporting on the continuing connected transactions under the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement); and
- (d) the Company must promptly notify the Stock Exchange and publish an announcement if the independent non-executive Directors and/or auditors of the Company cannot confirm the matters as required. The Stock Exchange may require the Company to re-comply with the announcement and Shareholders' approval requirements and may impose additional conditions.

In light of the internal control measures adopted by the Group and the reporting requirements attached to the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement), in particular, (i) the restriction of the transaction value by way of the Proposed Revised Cap; and (ii) the ongoing review by the independent non-executive Directors and auditors of the Company of the terms of the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) and the Proposed Revised Cap not being exceeded, we are of the view that appropriate measures will be in place to govern the conduct of the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) and assist in safeguarding the interests of the Company and the independent Shareholders as a whole.



OPINION AND RECOMMENDATION

Having taken into account the above principal factors and reasons, we consider that the transactions contemplated under the CDMO Services Framework Agreement (as supplemented by the Supplemental CDMO Services Framework Agreement) in relation to the provision of CDMO services by the Company and/or its subsidiaries to Lepu Medical and/or its subsidiaries (including the Proposed Revised Cap) are on normal commercial terms, fair and reasonable so far as the Independent Shareholders are concerned, in the ordinary and usual course of business of the Group and in the interests of the Company and the Shareholders as a whole. Accordingly, we advise the Independent Board Committee to recommend, and we ourselves recommend, the Independent Shareholders to vote in favour of the relevant resolution at the EGM to approve the CDMO Services Framework Agreement as supplemented by the Supplemental CDMO Services Framework Agreement (including the Proposed Revised Cap).

Yours faithfully,
for and on behalf of
SOMERLEY CAPITAL LIMITED

Calvin Leung
Director

Mr. Calvin Leung is a licensed person registered with the Securities and Futures Commission of Hong Kong and a responsible officer of Somerley Capital Limited, which is licensed under the SFO to carry out Type 1 (dealing in securities) and Type 6 (advising on corporate finance) regulated activities. He has over 19 years of experience in the corporate finance industry.