OVERVIEW

Our business operations can broadly be divided into two segments in the pharmaceutical industry in the PRC, namely, (i) pharmaceutical manufacturing; and (ii) operation of chain pharmacies in Zhongshan, Guangdong province, the PRC.

- *Pharmaceutical manufacturing*: We develop, manufacture and sell own-branded pharmaceutical products including (i) Chinese patent medicines; and (ii) decoction pieces consisting of traditional decoction pieces and modern decoction pieces, which are sold in the PRC markets. Our core brands are "Zeus (中智)", "Liumian* (六棉牌)" and "Caojinghua* (草晶華)". For the manufacturing of our own-branded products, we have two self-owned GMP certified production plants located in Zhongshan with an aggregate gross floor area of approximately 46,700 sq.m. All our pharmaceutical products comply with the relevant standards and registration requirements in the PRC. Our Chinese patent medicines are duly registered with the CFDA and our decoction pieces have met the standards of the Chinese Pharmacopoeia, the Drug Standards or standards pronounced by the GFDA.

- *Operation of chain pharmacies in Zhongshan*: We have been operating chain pharmacies in Zhongshan under our brand "Zeus (中智)" for the sale of pharmaceutical products since 2001. As at the Latest Practicable Date, we had a total of 201 self-operated GSP certified chain pharmacies. According to the Ipsos Report, we are the largest self-operated pharmaceutical chain in Zhongshan in terms of the number of pharmacies and revenue for three consecutive years from 2012 to 2014. During the Track Record Period, a majority of our revenue generated from our operations of chain pharmacies was derived from the sale of non-own branded products. As at the Latest Practicable Date, we sold over 5,000 types of non-own branded products including Chinese patent medicines, Western medicines, medical devices and healthcare products (such as vitamins, mineral supplements and protein powder) sourced from independent GMP certified pharmaceutical manufacturers or GSP certified suppliers (including pharmaceutical wholesalers and distributors). In our chain pharmacies, we also sell our own-branded pharmaceutical products developed and manufactured by us. For the three years ended 31 December 2014, the revenue generated from the sale of our own-branded products in our chain pharmacies represented approximately 22.9%, 24% and 23.7% of our total revenue derived from our chain pharmacies.

Our Directors believe that our success was mainly attributed to our well established reputation for manufacturing quality pharmaceutical products under our own brands, our extensive distribution network in the PRC and our leading market position of our chain pharmacies in Zhongshan. Our total revenue for each of the three years ended 31 December 2014 was approximately RMB410.1 million, RMB482.8 million and RMB595.6 million respectively, representing a CAGR of approximately 20.5%.

The following table sets forth the revenue of our two business segments for each of the three years ended 31 December 2014:

	For the year ended 31 December					
	2012		2013		2014	
	RMB'000	% of revenue	RMB'000	% of revenue	RMB'000	% of revenue
Pharmaceutical manufacturing	172,240	42.0	207,262	42.9	294,840	49.5
Operation of chain pharmacies	237,812	58.0	275,543	57.1	300,725	50.5
Total Revenue	410,052	100.0	482,805	100.0	595,565	100.0

Note: Our own-branded products are sold under both of our business segments.

For each of the three years ended 31 December 2014, we derived all our revenue in the PRC and mainly from the Guangdong province, which accounted for approximately 72.8%, 71.9% and 65.8% of our Group's total revenue, respectively.

Our own-branded products

We manufacture and sell Chinese patent medicines and decoction pieces under our core brands of "Zeus (中智)", "Liumian* (六棉牌)" and "Caojinghua* (草晶華)". Our own-branded products are sold in our self-operated chain pharmacies and on a wholesale basis to our distributors and independent chain pharmacies. For each of the three years ended 31 December 2014, the revenue derived from our own-branded products was approximately RMB226.5 million, RMB273.4 million and RMB366.1 million, representing approximately 55.2%, 56.6% and 61.5% of our Group's total revenue for the respective years.

As at the Latest Practicable Date, we launched 35 types of own-branded Chinese patent medicines (of which 27 types are OTC medicines) and 158 types of decoction pieces in the PRC market. Our major own-branded Chinese patent medicines include Cough Tablets* (克咳片), Cool Lozenges* (清涼喉片) and Yinhuang Granules* (銀黃顆粒). Our decoction pieces are intended for health maintenance and improvement. With an aim to enhance the functional effectiveness of traditional decoction pieces and for consumption convenience, we have applied our patented techniques for the manufacturing of modern decoction pieces which have been launched in the PRC market since 2011. Our modern decoction pieces can be readily used for oral consumption whereas traditional decoction pieces generally require boiling before consumption. Our major modern decoction pieces include dendrobium (石斛), sanqi (三七) and red sage root (丹參). The success of our products can be reflected by the increase in revenue derived from own-branded products from approximately RMB226.5 million to approximately RMB366.1 million, representing a CAGR of approximately 27.1%, from 2012 to 2014.

Distribution of our own-branded products

We distribute our own-branded products across the PRC through an extensive distribution network comprising of contractual distributors, non-contractual distributors and independent chain pharmacies. We require that all our distributors and independent chain pharmacies customers are GSP certified. As at 31 December 2014, we had 523 contractual distributors comprising 68 upper-level distributors and 455 lower-level distributors; 588 non-contractual distributors and 381 independent chain pharmacies for the distribution of our own-branded products, covering 30 provinces, autonomous regions and municipality cities in the PRC. This distribution arrangement enables us to focus our resources on research and development, manufacturing, and marketing of our own-branded products because we do not need to maintain an extensive logistics network covering different regions in the PRC at our own expenses. We also believe that we can benefit from our distributors' established distribution channels, independent chain pharmacies' retail networks and their resources to enhance and expedite the market penetration of our products within a short period of time.

Our pricing policy

We primarily price our products on a cost plus basis with reference to the prevailing market conditions such as changing demands from customers, pricing and availability of comparable products in the market, competitions and with respect to some of the non-own branded products sold in our chain pharmacies, the recommended prices set by the relevant pharmaceutical suppliers. During the Track Record Period, over 800 types of the non-own branded products sold in our chain pharmacies and 18 types of our own-branded Chinese patent medicines, including some of our major products such as Cough Tablets* (克咳片), Yinhuang Granules* (銀黃顆粒) and Yinqiao Detoxification Granules* (銀翹解毒顆粒) were included in the National Medical Insurance Drugs Catalogue or Provincial Medical Insurance Drugs Catalogue, and/or National List of Essential Drugs and were subject to the relevant pricing policies. Hence, these products could not be sold above their maximum retail prices as imposed by the PRC government. For each of the three years ended 31 December 2014, we recorded revenue of approximately RMB152.8 million, RMB167.2 million and RMB171.5 million from the sale of these products, which accounted for approximately 37.3%, 34.6% and 28.8% of our total revenue, respectively. The PRC government's price control policies did not have material adverse impact on our Group during the Track Record Period.

Pursuant to the Drug Pricing Reform Notice, the price controls on all pharmaceutical products, except for anesthetics and some types of psychiatric drugs, were lifted with effect from 1 June 2015. This move aims to improve the purchasing mechanism of pharmaceutical products in the PRC and allow their selling prices to be determined by the market. Accordingly, all our pharmaceutical products are not subject to any government price controls. Our Directors believe that our Group will be more flexible in product pricing. We also envisage that most pharmaceutical manufacturers will commence the production and sale of those popular or essential pharmaceutical products which were used to be subject to price control. As a result, we may face increasing competition from these pharmaceutical manufacturers in respect of our Chinese patent medicines which were previously under government price controls. Whilst we are free to price these products, their profitability may

or may not be improved and would be affected by the prevailing market conditions such as demands, competitions and availability of comparable products. To maintain our competitiveness, we will continue to expand our product portfolio and further strengthen our research and development capabilities in order to improve our product quality and develop products that are unique, highly competitive and with high profit margin.

Research and development

Leveraging on the strength of our research and development team, up to the Latest Practicable Date, we had developed and maintained 125 types of new pharmaceutical products, which have been approved for production by the relevant government authorities but are yet to be launched in the market. As at the Latest Practicable Date, we had successfully registered in the PRC 29 invention patents (發明專利), one utility model patent (實用新型專利) and 15 design patents (外觀設計專利) in relation to our own-branded products. In April 2014, we were approved by the State Administration of Traditional Chinese Medicine of the PRC (國家中醫藥管理局) to establish a State-level laboratory for the development of the techniques and applications of modern decoction pieces. This laboratory was put into use by the end of 2014.

COMPETITIVE STRENGTHS

We believe that our success and future growth are and will be attributable to the following competitive strengths:

"Zeus (中智)" is a well established brand in the pharmaceutical industry

According to the Ipsos Report, we are the largest self-operated pharmaceutical chain in Zhongshan in terms of the number of pharmacies and revenue for three consecutive years from 2012 to 2014. We set up our first "Zeus Chain Pharmacy* (中智大藥房)" in Zhongshan for the sale of pharmaceutical products and healthcare products in 2001. Since then, our Zeus (中智) chain pharmacies have gained recognition in Zhongshan.

On the other hand, our core brands "Zeus (中智)", "Liumian* (六棉牌)" and "Caojinghua* (草晶華)" have gained increasing recognition among consumers and medical practitioners. This can be reflected by the increase in sales of our own-branded products from approximately RMB226.5 million to approximately RMB273.4 million from 2012 to 2013, and further to approximately RMB366.1 million for the year ended 31 December 2014, representing a CAGR of approximately 27.1% from 2012 to 2014. Our Directors believe that our Group has established creditability, recognition and acceptance by our business partners and consumers.

In light of the above, our Directors believe that the strong brand recognition has supported and will continue to support our business growth by providing a significant foundation for the promotion of both of our own-branded products and our chain pharmacies.

We have strong marketing capabilities and an extensive distribution network, which allows us to achieve efficient distribution of our own-branded products to consumers across the PRC and enable us to closely monitor market demand of our products

We had established an extensive sales and distribution network for selling and distributing our own-branded pharmaceutical products to 30 provinces, autonomous regions and municipality cities across the PRC during the Track Record Period.

As at 31 December 2014, we had 523 contractual distributors, 588 non-contractual distributors and 381 independent chain pharmacies operators for the distribution of our own-branded products.

Our extensive distribution network has not only enabled us to cost-effectively market our own-branded products but also allowed us to achieve high level of efficiency in the distribution of our own-branded products to all market levels across the PRC. We can benefit from the established sales and distribution networks of our distributors and retail networks of our independent chain pharmacies. This has enhanced and expedited the market penetration of our own-branded products and enabled us to launch new products to the market within a comparatively short period. Our Directors also believe that chain pharmacies can provide a direct and effective channel to promote and sell our own-branded products, in particular new products, to the consumers.

We are able to generate a high profit margin from our own-branded modern decoction pieces

The gross profit margin of our own-branded products was approximately 52.9%, 55.8% and 61.9% respectively for each of the three years ended 31 December 2014 as compared to 37.5%, 41.5% and 40.9% respectively for our non-own branded products. Our Directors believe that we are able to generate a relatively high gross profit margin from our own-branded products primarily because we are committed to the research, development and manufacturing of new products and the continuous improvement of our product quality. One of our major research and development projects was on the application and development of the techniques related to modern decoction pieces, which in our opinion, enhances the functional effectiveness of traditional decoction pieces. During the Track Record Period, we received a satisfactory market response to our modern decoction pieces, which are sold at higher prices and thus, enable us to generate higher gross profit margins than traditional decoction pieces. For each of the three years ended 31 December 2014, the gross profit margin of our own-branded modern decoction pieces were approximately 80.3%, 78.3% and 77.6%, respectively.

Furthermore, we sell our modern decoction pieces to independent chain pharmacies which then directly sell our products to consumers. This eliminates intermediaries in the distribution chain and thus enhances the efficiency of distribution as well as profitability of our own-branded products.

We maintain a stringent quality control system

We recognise the importance in maintaining high quality of both our products and the services we rendered to our customers. We have therefore adopted stringent standards and measures in relation to the quality control of our products and services. In particular, our "Zeus (中智)" brand products are renowned for their high product quality.

In respect of the operation of our chain pharmacies, all our chain pharmacies have GSP certification. We strictly follow the GSP requirements and we had not experienced any compulsory suspension, termination or cessation of our GSP certification in any of our chain pharmacies during the Track Record Period.

In respect of the manufacturing of our own-branded products, we strictly follow the GMP requirements. We have devised a complete set of quality control guidelines covering different stages of production in order to ensure product safety and maintain our quality standards. Our quality control procedures commences from the selection of suppliers and procurement of raw materials to the inspection of products before delivery and sales of the products to our customers. We had not experienced any compulsory suspension, termination or cessation of our GMP certification in any of our two production plants during the Track Record Period.

We have maintained long term relationships with most of our suppliers. This would provide a stable supply of quality raw materials for our manufacturing and merchandise for resale in our chain pharmacies. For further details, see the paragraphs respectively headed "Business — Quality control — Operation of chain pharmacies" and "Business — Quality control — Pharmaceutical manufacturing" in this [REDACTED].

As at the Latest Practicable Date, we had a total of 73 quality control staff members. We believe that our quality control efforts will continue to help us maintain and enhance our reputation and market position.

We have strong research and development capabilities and are able to develop new products and respond swiftly to changing market trends and demands

We adopt a market-oriented approach in developing our own-branded pharmaceutical products in order to keep abreast of changing market trends and consumer preference. Hence, our research and development projects are primarily aimed at (i) enhancing the quality and effectiveness of our existing pharmaceutical products; (ii) developing and expanding our pool of new pharmaceutical products; (iii) improving our production effectiveness and efficiency; and (iv) cultivating our research and development personnel.

During the past years, we strategically focused our research and development on decoction pieces to enhance their functional effectiveness. Among the 29 invention patents (發明專利) registered by us in the PRC, three of them are related to the manufacturing of certain types of modern decoction pieces. All our modern decoction pieces have met the quality standards promulgated by the GFDA.

In accordance with the Letter of State Chinese Medicine Technology [2014] No. 26* (國家中醫藥科技函 [2014] 26號文) issued by the State Administration of Traditional Chinese Medicine of the PRC (國家中醫藥管理局) in April 2014, we were given the approval to set up a laboratory for the development of "modern decoction pieces techniques and applications". This is a State-level authorised modern decoction pieces laboratory. Apart from our in-house research and development team, we have also formed collaborations with various research institutions and universities in the PRC to jointly develop new pharmaceutical products and production techniques. By doing so, we can benefit from their expertise, skills, resources and knowledge in these areas.

Leveraging on our strong research and development capabilities, we have developed a pool of products including Chinese patent medicines and modern decoction pieces. Up to the Latest Practicable Date, we have obtained approvals from the relevant government authorities for the production of a total of 60 Chinese patent medicines, 196 types of traditional decoction pieces and 62 types of modern decoction pieces, of which 35, 136 and 22 types have been launched in the market, respectively. We will launch other registered or approved products in the market at the time when our Directors find suitable, depending on the prevailing consumer preferences and market demands.

Our Directors believe that this diversified product portfolio enables us to meet the changing needs of consumers in different age groups and with different consuming powers as well as to maintain our competitiveness in the market.

We have an experienced and committed management team

Our Directors believe that our success to date is attributable to our experienced, goal-oriented and stable management team with a proven track record in the PRC pharmaceutical industry. Our management team has comprehensive and extensive experience in different areas of the pharmaceutical industry. Their experience ranges from research and development to manufacturing and to marketing different types of pharmaceutical products in the PRC. Our Chairman and executive Director, Mr. Lai, has over 30 years of experience in the pharmaceutical industry. Members of our management team have, on average, over ten years of experience in the pharmaceutical industry in the PRC. We believe that our management team will continue to implement our strategies for sustainable growth in the pharmaceutical industry in the PRC.

BUSINESS STRATEGIES

We aim to become a leading pharmaceutical company in the PRC. We intend to achieve our goal by pursuing the following principal strategies:

We plan to expand our chain pharmacies in the Guangdong province

We believe that we are well-positioned to take advantage of the significant growth potential in the PRC pharmaceutical industry. According to the Ipsos Report, our chain pharmacies accounted for approximately 16.3% of the market share in Zhongshan in 2013. Leveraging on our experience and established reputation in chain pharmacies operations, we intend to expand the network of our chain pharmacies in the Guangdong province by establishing self-operated pharmacies in other cities such as Jiangmen, Zhuhai and Dongguan. For details of our expansion plan, please refer to the "Future Plans and Use of Proceeds" section in this [REDACTED]. By establishing a presence in other cities, our Directors believe that it will enable us to build up our brands in cities outside Zhongshan as well as to serve as an effective channel to promote our new products in the market. Currently, we mainly rely on independent chain pharmacies to promote and sell our new products directly to consumers outside Zhongshan. Our Directors also believe that by establishing self-operated chain pharmacies in cities outside Zhongshan will reduce our reliance on independent chain pharmacies for the promotion and sale of our products directly to consumers and will also improve our profitability in the future.

We plan to expand the breadth and depth of our distribution network

We plan to expand our distribution network by increasing both the number of distributors and independent chain pharmacies operators, thereby enabling us to further penetrate into our existing markets, in particular the Eastern and Southern China.

We believe that an expansion of our distribution network will allow us to have access to a large consumer base and therefore achieve higher sales and market share for our own-branded products. We also plan to strengthen our sales and marketing team by recruiting more sales staff to support the expansion of our distribution network and also to further enhance the management and efficiency of our distribution network.

We plan to expand our production capacity

During the Track Record Period, revenue from the sale of our own-branded products amounted to approximately RMB226.5 million, RMB273.4 million and RMB366.1 million, respectively. Our Directors believe that the growth in the sales of our own-branded products in the PRC will continue in the near future taking into account the increasing public awareness on their health condition and well-being. We therefore believe that it is crucial for us to

enhance our production capacity in order to capture more opportunities in the growing market. In this connection, we intend to purchase additional machineries and equipment for the manufacturing of our Chinese patent medicines and decoction pieces.

We plan to further strengthen our research and development capabilities and product range

Our research and development projects will continue to focus on the development and application of techniques to enhance the functional effectiveness of different kinds of modern decoction pieces.

We intend to hire 50 to 60 additional experienced personnel with relevant sound academic background for our research and development team. We will continue to collaborate with research institutions and universities in the PRC to develop the techniques and know-how in the development and manufacturing of new pharmaceutical products and refine our existing ones in terms of their production process, effectiveness and forms in order to benefit from the expertise, skills, resources and knowledge of these research partners.

We plan to further strengthen our brand recognition and awareness by enhancing our marketing and promotional activities

We plan to increase our budgets on various advertising channels mainly through television, newspapers, medical journals and sponsoring certain pharmaceutical conferences to promote (i) our core brands including "Zeus (中智)", "Liumian* (六棉牌)" and "Caojinghua* (草晶華)"; (ii) our own-branded products; and (iii) our chain pharmacies. We believe that this will enhance our brand image and awareness in the consumer market and thus increase our sales volume.

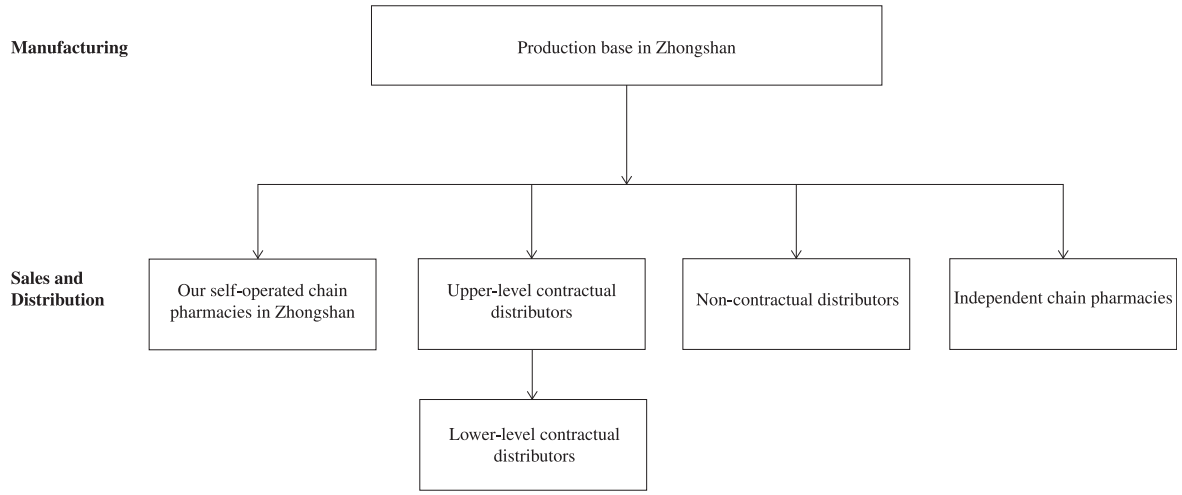
OUR BUSINESS SEGMENTS

Our operations can be divided into two segments in the PRC pharmaceutical industry, namely (i) pharmaceutical manufacturing; and (ii) operation of chain pharmacies in Zhongshan.

Revenue derived from our pharmaceutical manufacturing amounted to approximately RMB172.2 million, RMB207.3 million, and RMB294.8 million for the each of the three years ended 31 December 2014, which represented approximately 42%, 42.9% and 49.5% of our Group's total revenue, respectively, for the respective periods. Revenue derived from our operation of chain pharmacies in Zhongshan amounted to approximately RMB237.8 million, RMB275.5 million, and RMB300.7 million for the each of the three years ended 31 December 2014, which represented approximately 58%, 57.1% and 50.5% of our Group's total revenue, respectively, for the respective periods.

PHARMACEUTICAL MANUFACTURING

The following diagram illustrates the business model of our pharmaceutical manufacturing:



Our own-branded products

We engage in the research and development, manufacturing, sale and distribution of own-branded pharmaceutical products. As at the Latest Practicable Date, we produced two types of pharmaceutical products namely, Chinese patent medicines and decoction pieces. The core brands of our pharmaceutical products are "Zeus (中智)", "Liumian* (六棉牌)" and "Caojinghua* (草晶華)".

The following table sets forth the revenue from the sale of our own-branded products in these two categories for each of the three years ended 31 December 2014, their respective percentages to the total revenue derived from the sales of our own-branded products:

	For the year ended 31 December					
	2012		2013		2014	
	RMB'000	% of revenue	RMB'000	% of revenue	RMB'000	% of revenue
Chinese patent medicines	166,771	73.6%	167,418	61.2%	169,952	46.4%
Decoction pieces	59,776	26.4%	105,934	38.8%	196,157	53.6%
Total	226,547	100.0%	273,352	100.0%	366,109	100.0%

During the Track Record Period, our sales were not affected by seasonality.

Chinese patent medicines

As at the Latest Practicable Date, we sold 35 types of Chinese patent medicines, of which 27 are OTC medicines. Our Chinese patent medicines are intended to treat different illnesses such as cough, throat inflammation, indigestion and common cold.

All our Chinese patent medicines are duly registered with the CFDA and manufactured in accordance with the formula set out in the monographs in the Chinese Pharmacopoeia or the Drug Standards. Each monograph details the exact ingredients that make up the patent formula, the proportion of each ingredient, specific cautions, contraindications and production processes in relation to a particular type of Chinese patent medicine.

Seven of our Chinese patent medicines are protected by our invention patents (發明專利) registered in the PRC, namely Cough Tablets* (克咳片), Shiqi Waigan Granules* (石岐外感顆粒), Seven Star Tea Oral Solution* (小兒七星茶口服液), Menthol and Eucalyptus Oil Buccal Tablets* (薄荷桉油含片), Osteophyte Pain Relief Capsules* (骨刺消痛膠囊), Dangshen and Milkvetch Root Oral Solution* (參芪口服液) and Milkvetch Root and Jujube Oral Solution* (芪棗口服液). Our invention patents protect certain processing techniques including steaming, drying, emulsification and sedimentation for the production of these products. Cough Tablets* (克咳片) were our major Chinese patent medicines during the Track Record Period, in terms of sales revenue and volume.

Sales of our own-branded Chinese patent medicines amounted to approximately RMB166.8 million, RMB167.4 million and RMB170 million for each of the three years ended 31 December 2014 respectively, accounted for approximately 73.6%, 61.2% and 46.4% of the total revenue derived from the sales of our own-branded products for the respective years. Our own-branded Chinese patent medicines are sold mainly in our self-operated chain pharmacies and to our distributors.

The following were our major own-branded Chinese patent medicines for the year ended 31 December 2014:

Product Name		Intended functions	Year of launch	OTC/ prescription medicines	Medicine registration certificate number	Expiration date of product approval	National List of Essential Drugs *(Note 1)*	National/ Provincial Medical Insurance Drugs Catalogue *(Note 2)*	For the year ended 31 December 2014		
									Average unit selling price *(Note 3)*	Sales volume	Sales revenue
									(RMB)	(Thousand packs)	(RMB'000)
Cough Tablets* (克咳片) *(Note 4)*		Relieves cough	2005	OTC	Z20050690	29 September 2015	No	Yes	5.2	5,912	30,577
Cool Lozenges* (清凉喉片)		Relieves sore throat	2002	OTC	Z44020180	29 January 2020	No	No	1.0	23,335	23,581
Yinhuang Granules* (銀黃顆粒) *(Note 5)*		Clears heat and relieves sore throat	2005	OTC	Z20053526	31 May 2020	No	Yes	3.0	6,250	18,878
Anti-Inflammatory Cough Tablets* (消炎止咳片)		Reduces inflammation and relieves cough	2005	OTC	Z20054832	29 September 2015	No	No	1.0	10,367	10,474
Yinqiao Detoxification Granules* (銀翹解毒顆粒) *(Note 5)*		Clears heat and detoxification	2002	OTC	Z44020191	9 February 2020	Yes	Yes	4.6	2,246	10,234

Notes:

1. Government controls on the retail prices of the products included in the National List of Essential Drugs were lifted with effect from 1 June 2015.
2. All or part of the costs for the products listed on the National Medical Insurance Drugs Medicines Catalogue/Provincial Medical Insurance Drugs Catalogue are reimbursed by the national basic medical insurance fund. Government controls on the retail prices of these products were lifted with effect from 1 June 2015.
3. The average unit selling price is calculated by dividing the total revenue from wholesale and retail sale of our major own-branded Chinese patent medicines by their respective sales volume.
4. The Chinese patent medicine is listed on Part B of the National Medical Insurance Drugs Catalogue.
5. The Chinese patent medicines are listed on Part A of the National Medical Insurance Drugs Catalogue.

Among our major own-branded Chinese patent medicines, Cough Tablets* (克咳片) are protected by our registered patent. For details of this patent, please refer to the paragraph headed "Intellectual Property Rights — Patents" in Appendix V headed "Statutory and General Information" to this [REDACTED]. The shelf lives of our Chinese patent medicines are generally 24 months.

Decoction pieces

In the Chinese community, decoction pieces have been traditionally used as supplements for health improvement and maintenance. As at the Latest Practicable Date, we sold 158 types of own-branded decoction pieces, of which 136 types are traditional decoction pieces and 22 types are modern decoction pieces. Sales of our own-branded decoction pieces amounted to approximately RMB59.8 million, RMB105.9 million and RMB196.2 million for each of the three years ended 31 December 2014 respectively, which accounted for approximately 26.4%, 38.8% and 53.6% of the total revenue derived from sales of our own-branded products. Our decoction pieces are sold in our self-operated chain pharmacies and independent chain pharmacies. All our decoction pieces are filed in the system of GFDA and follow standards of the Chinese Pharmacopoeia or the Drug Standards or the standards pronounced by the GFDA, in relation to, among others, the respective standards of purity, description, testings on microbial limits, extractions, dosage, precaution and storage. The production of all our modern decoction pieces are protected by invention patent (發明專利), which is mainly related to additive-free granulation techniques after ultra-fine pulverisation of the relevant Chinese herbs. These patented techniques would not affect the conformity of our decoction pieces to the Chinese Pharmacopoeia or the Drug Standards or the standards pronounced by the GFDA.

The following table sets forth the revenue from the sales of our traditional and modern decoction pieces for each of the three years ended 31 December 2014, their respective percentages to the total revenue derived from the sales of our own-branded decoction pieces:

	For the year ended 31 December					
	2012		2013		2014	
	RMB'000	% of revenue	RMB'000	% of revenue	RMB'000	% of revenue
Traditional decoction pieces *(Note)*	37,367	62.5	40,479	38.2	39,631	20.2
Modern decoction pieces	22,409	37.5	65,455	61.8	156,526	79.8
Total	59,776	100.0	105,934	100.0	196,157	100.0

Note: Most of the revenue was derived from sales of our self-operated chain pharmacies.

The revenue derived from sales of our traditional decoction pieces represented 62.5%, 38.2% and 20.2% of our revenue derived from the sales of our own-branded decoction pieces and 9.1%, 8.4% and 6.6% of our total revenue for each of the three years ended 31 December 2014, respectively. Despite launching 136 types of our traditional decoction pieces in the market, revenue derived from our traditional decoction pieces was relatively low compared to our other own-

branded products. This can be explained by the reason that our traditional decoction pieces are mainly sold in our self-operated chain pharmacies in Zhongshan, whereas our other own-branded products are distributed throughout the PRC.

Traditional decoction pieces manufactured by us are sold in our self-operated chain pharmacies and are also used for the production of Chinese patent medicines and modern decoction pieces. The following table sets forth a breakdown of the volume of our traditional decoction pieces that are used for different purposes during the Track Record Period:

	For the year ended 31 December		
	2012	2013	2014
	tonnes	tonnes	tonnes
For direct sales	627	774	1,188
For the production of			
— Chinese patent medicines	1,604	1,496	1,168
— modern decoction pieces	33	83	184
Total	2,264	2,353	2,540

Traditional decoction pieces are usually used for the production of Chinese patent medicines by pharmaceutical manufacturers and diet therapy by making soups or cooking for general consumers. According to the Ipsos Report, during the past few years, pharmaceutical manufacturers had developed techniques such as ultra-fine pulverisation, additive-free granulation, extraction and concentration to provide various modern forms of decoction pieces for easy consumption, such as concentrated traditional Chinese medicines granules (中藥配方顆粒), syrup and paste of concentrated decoction pieces. With a view to enhancing the functional effectiveness and consumption convenience of traditional decoction pieces, we have commenced our research and development on the manufacturing of modern decoction pieces since 2003.

Our research and development team takes the view that the ingredients and functions of certain types of Chinese herbs can be better preserved in modern decoction pieces as compared to those in the traditional decoction pieces. For our manufacturing of modern decoction pieces, Chinese herbs are ultra-fine pulverised for breaking the cell walls of the herbs thus releasing the effective ingredients inside the cell, which can then be easily absorbed by the human body.

Plant products such as Chinese herbs can currently be pulverised by three commonly used methods in the pharmaceutical and healthcare products industry, namely (i) vibration grinding; (ii) jet stream ultra-fine pulverisation; and (iii) mechanic ultra-fine pulverisation. We choose the jet stream ultra-fine pulverisation for production of our modern decoction pieces because, in our opinion, (i) it provides a low temperature processing environment, which is suitable for Chinese herbs sensitive to heat; (ii) it produces very fine particles; and (iii) it would not contaminate the herbs being pulverised.

After ultra-fine pulverisation, the particles are combined to form granules. We developed and patented the additive-free granulation techniques (Patent number: ZL200610122171.7), which mainly utilise the adhesiveness of cell-broken Chinese herbs to form granules. For details of this patent, please refer to the paragraph headed "Intellectual Property Rights — Patents" in Appendix V headed "Statutory and General Information" to this [REDACTED]. Thanks to our additive-free granulation technique, surface areas of the granules would be reduced and the finished products are more resistant to moisture, mold and bacteria and therefore no preservatives have to be added to our products.

In 2011, the GFDA gave consent to Zhongzhi Herb Pieces the status of modern decoction pieces pilot production enterprise* (中藥破壁飲片試點生產企業). During the pilot period, Zhongzhi Herb Pieces is required to conduct researches on the clinical safety assessment and production quality control on modern decoction pieces and submit the relevant research reports. To the best knowledge and belief of our Directors, up to the Latest Practicable Date, apart from our Group, the GFDA had not yet granted pilot production status for same types of modern decoction pieces to any other enterprises. Our Directors believe that this status allows us to become the pioneer for the development of the quality standards of modern decoction pieces.

Our Directors also consider that this pilot status is a recognition of our research and development capability in the pharmaceutical industry. Also, it has strengthened our image as one of the market leaders in the development and production of modern decoction pieces. Our Directors believe that the pilot production status would also place us in a better position to entail more collaboration opportunities with profound universities and institutions in the PRC for developing both the know-how of our techniques in the production of new products and improving the quality standards of our existing products. However, the consent letter did not set out when the pilot period will end. Hence, the pilot production status of Zhongzhi Herb Pieces is subject to termination, prohibition, restrictions, limitation or suspension imposed by relevant authorities of the PRC in the future.

On 11 May 2015, the Sole Sponsor interviewed the director of the Division of Drug Safety and Supervision of GFDA, which is, as advised by our PRC Legal Advisors, the competent authority in charge of the pharmaceutical industry in the Guangdong province. The relevant officer verbally confirmed that (i) GFDA has no intention to terminate or revoke our pilot production status; (ii) there is no end date for our pilot production status; and (iii) GFDA currently does not have a timetable setting out when our pilot production status will become permanent. The Division of Drug Safety and Supervision of GFDA has various functions, including but not limited to, (i) guide the implementation of management standard of drug manufacturing; and (ii) undertake the licensing of drug manufacturing.

If our pilot production status is terminated or is subjected to any prohibitions, restrictions, limitations or suspensions, our research and development plan in relation to our modern decoction pieces may be hindered and we can no longer enjoy the privileges set out above. We may face fierce competitions from our competitors who may also develop and manufacture other forms of modern decoction pieces for sale in the market. If this happens, our business and operations would be adversely affected. For each of the three years ended 31 December 2014, revenue derived from the sales of our modern decoction pieces accounted for approximately 5.5%, 13.6% and 26.3% of our total revenue, respectively. Please refer to the paragraph headed "Risk Factors — Our status of modern decoction pieces pilot production enterprise may be subject to revocation, termination, suspension or alteration any time by the relevant authorities in the PRC." in this [REDACTED].

As at the Latest Practicable Date, our 62 types of modern decoction pieces had met the standards pronounced by the GFDA and 22 types of which had been launched in the market. As advised by our PRC Legal Advisors, as at the Latest Practicable Date, our modern decoction pieces complied with the relevant PRC laws and regulations for decoction pieces. There are no specific laws, regulations or standards in the PRC which are particularly devised for regularising or limiting the manufacture and sale of modern decoction pieces in the PRC.

Four types and three types of our modern decoction pieces were accredited as Guangdong province High and New Technology Products* (廣東省高新技術產品) by the Guangdong Provincial Bureau for Science and Technology (廣東省科學技術廳) respectively in 2009 and 2011.

Under the applicable PRC laws and regulations, foreign investors are prohibited from holding equity interest in entity engages in the production of decoction pieces. Accordingly, we are not allowed to hold any equity interest in Zhongzhi Herb Pieces. We entered into the Contractual Arrangements in order for our Group to manage the business of Zhongzhi Herb Pieces with all economic benefits derived from the business, financial and operating activities of Zhongzhi Herb Pieces transferred to Zhongzhi Pharmaceutical by means of service fees payable by Zhongzhi Herb Pieces to Zhongzhi Pharmaceutical. For details of the Contractual Arrangements, please refer to the "Contractual Arrangements" section in this [REDACTED].

The following are our major modern decoction pieces:

			For the year ended 31 December 2014		
Product name		**Intended functions**	**Average unit selling price**	**Sales volume**	**Sales revenue**
			(RMB)	**(Thousand cans)**	**(RMB'000)**
Red sage root modern decoction pieces* (丹參破壁飲片)		Eases pain, promotes blood circulation	19.3	754	14,563
American ginseng modern decoction pieces* (西洋參破壁飲片)		Reinforces vitality	66.7	212	14,140
Sanqi modern decoction pieces* (三七破壁飲片)		Heals bruises, stops bleeding and reduces swelling	48.1	286	13,755
Dendrobium modern decoction pieces* (石斛破壁飲片)		Invigorates stomach	84.8	148	12,565
Milkvetch root modern decoction pieces* (黃芪破壁飲片)		Nourishes vitality, promoting diuresis and reduces swelling	20.4	589	12,007

The production of all our modern decoction pieces are protected by our registered patent. For details of this patent, please refer to the paragraph headed "Intellectual Property Rights — Patents" in Appendix V headed "Statutory and General Information" to this [REDACTED]. The shelf lives of our decoction pieces range from 12 to 24 months.

Price ranges

The table below sets forth the wholesale price ranges of our own-branded products as at the Latest Practicable Date:

Product category	**Price ranges** *(Note)*
Chinese patent medicines	RMB1.2 to RMB75.0
Decoction pieces	
— Traditional decoction pieces	RMB5.5 to RMB2,720.0
— Modern decoction pieces	RMB12.5 to RMB280.0

Note: The price ranges are based on the smallest individual package as one unit and are inclusive of value added tax.

Production plants and facilities

As at the Latest Practicable Date, we had 315 employees in our two production plants. Our production plants were built on land properties owned by our Group in Zhongshan for the manufacturing of our pharmaceutical products. Our production plants had obtained the GMP certificates and their operation and management follows the GMP requirements.

The following table sets out details of our two production plants:

	Approximate total gross floor area (sq. m.)	**Products manufactured**	**Number of employees as at the Latest Practicable Date**
Honeson Pharmaceutical	25,730	Chinese patent medicines	145
Zhongzhi Herb Pieces *(Note)*	20,970	Decoction pieces	170

Note: We control the management and operation of Zhongzhi Herb Pieces through Contractual Arrangements. For details, please refer to the "Contractual Arrangements" section in this [REDACTED].

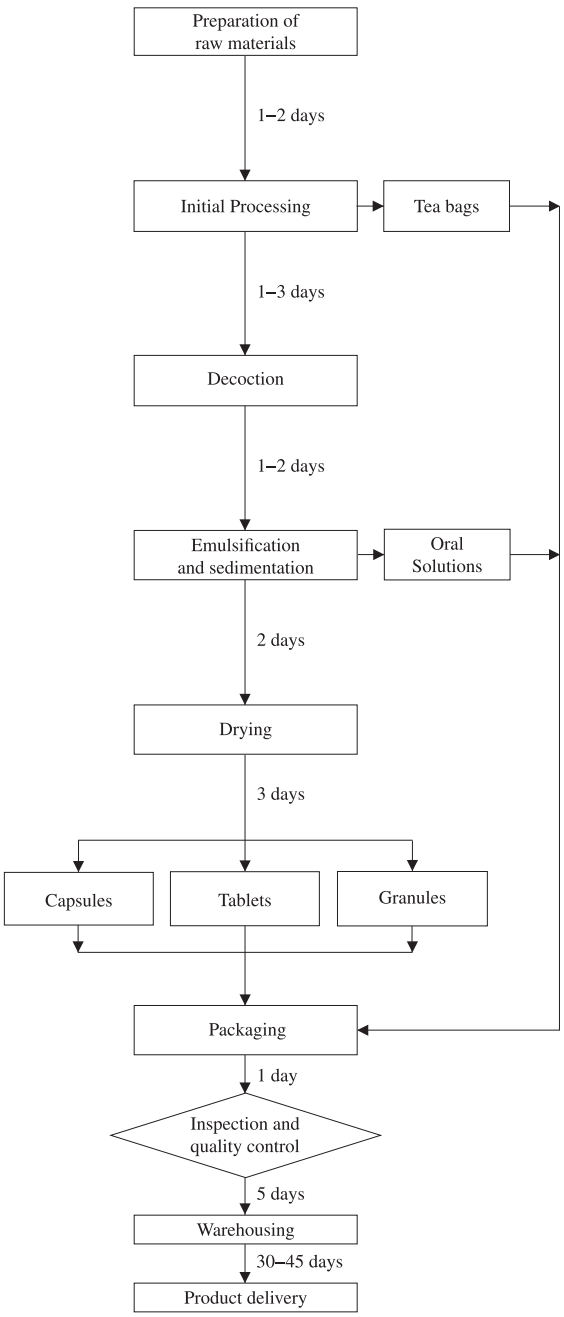
As advised by our PRC Legal Advisors, we have obtained all relevant and valid licences, permits and certificates for our pharmaceutical manufacturing. We also closely monitor quality assurance and safety control processes in the manufacturing of our products and we had not experienced any suspension or termination of our GMP certifications or any licences, permits or certificates necessary for the operation of our production plants during the Track Record Period. We believe that our manufacturing expertise and efficiency have enabled us to produce quality products in a cost-effective manner and to sell our products to our customers at competitive prices.

Production process

For the manufacturing of Chinese patent medicines, we have to follow the production methods and formula as set out in the Chinese Pharmacopoeia or the Drug Standards. The production process of our Chinese patent medicines typically involves the major steps set forth below:

Chinese Patent Medicines

- *Preparation of raw materials:*
  Based on the formula set out in the Chinese Pharmacopoeia or the Drug Standards, select and measure the required types and quantities of Chinese herbs and/or decoction pieces.
- *Initial processing*:*
  Cleaning, chopping, steaming and drying.
- *Decoction:*
  Extract the effective ingredients of the raw materials by boiling. The extracted solution is further condensed.
- *Emulsification and sedimentation*:*
  The concentrated solution is then mixed with alcohol and sedimented. Any impurities and alcohol will be removed leaving the desired herbal sediment layer for further processing.
- *Drying:*
  The herbal sediment is dried and grinded into powder.
- *Inspection and quality control:*
  Product testing with a focus on heavy metal and microbials levels.

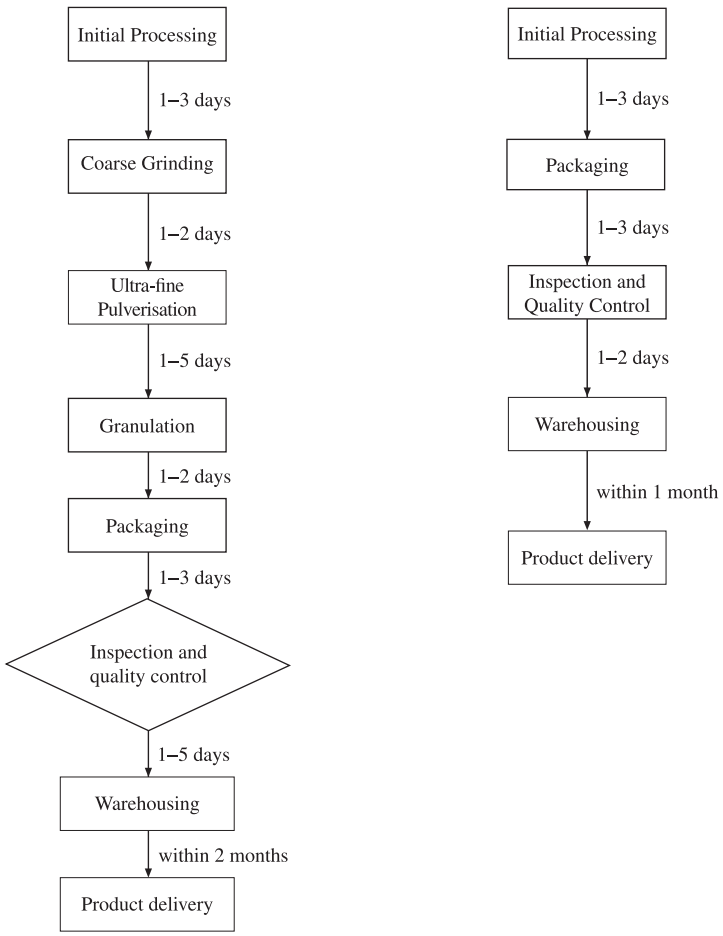


Note: As required by our quality control system, we perform quality checks before initial processing, during different stages of production process and after packaging.

* We registered invention patents (發明專利) for seven of our Chinese patent medicines to protect certain processing techniques including steaming, drying, emulsification and sedimentation for the production of these products.

The production process of our decoction pieces typically involves the major steps set forth below:

- *Initial Processing:* Cleaning, chopping, steaming, stir-frying, moxibustion, calcination and drying.
- *Coarse Grinding:* Herbs are ground into coarse powder grains.
- *Ultra-fine pulverisation:* Using the jet stream ultra-fine pulverisation.
- *Granulation:* The herb grains are then granulated using our patented additive-free technique.
- *Inspection and quality control:* Product testing with a focus on heavy metal and microbials levels.



Note: As required by our quality control system, we perform quality checks before initial processing, during different stages of production process and after packaging.

Production capacity and utilisation rate

The following table sets forth the designed capacity, actual production volume and utilisation rates of our production facilities for each of the three years ended 31 December 2014:

		For the year ended 31 December								
		2012			2013			2014		
	Unit	Designed capacity *(Note 1)*	Production volume	Utilisation rate *(Note 2)*	Designed capacity *(Note 1)*	Production volume	Utilisation rate *(Note 2)*	Designed capacity *(Note 1)*	Production volume	Utilisation rate *(Note 2)*
		(approximate unit)	(approximate unit)		(approximate unit)	(approximate unit)		(approximate unit)	(approximate unit)	
Chinese patent medicines										
Granule*(Note 3)*	bag	270,000,000	234,184,000	87%	270,000,000	214,228,000	79%	270,000,000	191,824,000	71%
Capsule	capsule	140,000,000	113,107,000	81%	140,000,000	134,928,000	96%	140,000,000	126,091,000	90%
Tablet	tablet	1,280,000,000	1,046,442,000	82%	1,280,000,000	1,074,688,000	84%	1,280,000,000	993,597,000	78%
Oral solution*(Note 4)*	bottle	15,000,000	9,642,000	64%	15,000,000	10,965,000	73%	15,000,000	16,026,000	107%
Tea bag*(Note 3)*	bag	5,300,000	4,800,000	91%	5,300,000	3,382,000	64%	5,300,000	3,501,000	66%
Decoction pieces										
Traditional decoction pieces	tonnes	2,561	2,264	88%	2,561	2,353	92%	2,561	2,540	99%
Modern decoction pieces*(Note 5)*	tonnes	53	30	57%	159	75	47%	212	165	78%

Notes:

(1) Designed capacity is computed based on 252 effective production days per year and one shift of seven hours per day for each of the three years ended 31 December 2014.

(2) The utilisation rate is calculated by dividing the production volume by the designed capacity.

(3) The utilisation rates for granules and tea bags for the two years ended 31 December 2014 were relatively lower than that of 2012. This reflected the decrease in the production volume of less popular Chinese patent medicines which were in the form of granules and tea bags.

(4) The actual production activities for oral solution in 2014 were conducted occasionally over seven hours per day to meet the demand for the relevant products, which resulted in the utilisation rate for oral solution in 2014 to exceed 100%.

(5) The utilisation rate related to the production of modern decoction pieces decreased from 57% for the year ended 31 December 2012 to 47% for the year ended 31 December 2013, primarily due to the increase in the designed capacity resulting from the acquisition of one jet stream ultra-fine pulverisation machine and one granulating machine in 2013.

Production machineries and equipment

Our production plants are equipped with a variety of machineries and equipment for various stages of the production process. The primary machineries and equipment that we use for production of Chinese patent medicines include the machines that process the medicine powder into various forms, boilers, granulating machines, capsule filling machines and tablet pressing machines. On the other hand, the primary machineries and equipment we use for production of modern

decoction pieces include jet stream ultra-fine pulverisation machines and granulating machines. As at the Latest Practicable Date, we had five jet stream ultra-fine pulverisation machines and three granulating machines.

In order to meet the increasing demands for our modern decoction pieces, we plan to further acquire five jet stream ultra-fine pulverisation machines and five granulating machines for the year ending 31 December 2016.

Our machineries and equipment were purchased in the PRC and have useful lives in average of ten years.

We implement strict repair and maintenance procedures for our major machineries and equipment. Our production team will conduct a routine checking on our machineries and equipment, in particular, their cleanliness and functions, before commencing production on a daily basis. Technicians of our engineering department conduct a checking on our machineries and equipment and subsequently fill in and submit the operation records on a monthly basis. Our engineers and technicians possess the required skills and experiences in repairing the machineries and equipment where malfunctions of which are detected or found. Our Directors confirm that during the Track Record Period, we had not experienced any significant interruptions in our production due to the breakdowns or contamination of our machineries or equipment.

As advised by our PRC Legal Advisors, we have obtained all necessary and relevant PRC approvals and permits in relation to our business, which primarily include the Pharmaceutical Manufacturing Permits, the GMP certificates and other required approvals and all such approvals and permits were valid as at the Latest Practicable Date.

Production plan

At the end of each year, our sales and finance department work together to prepare a monthly sales forecast for the coming year based on, *inter alia*, the actual sales performance of the current year; anticipated changes, if any, according to the latest market trend; and order indications received from our customers. Our production department will then formulate a monthly production plan for the coming year based on the sales forecast and our then prevailing production capability. Our procurement department is responsible for monitoring the inventory level of raw materials. Based on the production plan and the current inventory level, our procurement department will then procure raw materials on a timely basis to ensure that our production plans will not be interrupted due to a shortage of raw materials thus allowing us to be able to meet the demands from our customers.

Raw materials and suppliers

The principal raw materials used for production of our products are Chinese herbs (including red sage root (丹参), American ginseng (西洋参), sanqi (三七), milkvetch root (黄芪) and dendrobium (石斛)), packaging materials and ancillary materials including sucrose. The market prices of Chinese herbs may be affected by a number of factors including weather and harvest conditions and market demands. Our Directors confirm that there had not been any major fluctuation of market prices for these major raw materials during the Track Record Period. For each of the three years ended 31 December 2014, raw material costs amounted to approximately RMB64.7 million, RMB72 million and RMB89.1 million, representing approximately 29.2%, 29.6% and 32.4% of our Group's total cost of sales, respectively. We source Chinese herbs, packaging materials and ancillary materials from PRC suppliers who are Independent Third Parties. We commenced to import approximately 5.8 tonnes of American ginseng from Canada in 2014, for the production of our modern decoction pieces. For the year ended 31 December 2014, our revenue from the sales of our American ginseng decoction pieces amounted to approximately RMB0.6 million. We have obtained importation permits and quality inspection reports for the import of American ginseng. Save for this, all our raw materials are of PRC origin.

Our Directors confirm that during the Track Record Period and up to the Latest Practicable Date, we had not encountered any quality issues on or shortages of Chinese herbs or other principal raw materials that we use for production, which would have adversely affected our manufacturing process.

Suppliers of Chinese herbs

Our Directors believe that it is important for us to ensure that the Chinese herbs we used for the production of our pharmaceutical products meet our requirements for quality and standards of safety. As required by the PRC law, all our Chinese herbs used for the production of Chinese patent medicines and decoction pieces are required to follow the standards set out in the Chinese Pharmacopoeia or Drug Standards. We require that our suppliers of Chinese herbs are either GMP certified manufacturers or GSP certified wholesalers in the PRC.

Under our stringent quality control system, we strive to control the origins of Chinese herbs by sourcing our major raw materials directly from the plantation bases. This ensures that the Chinese herbs are grown in the designated plantation areas where (i) the climates are most suitable for cultivation of good quality herbs, such as sanqi (三七) from the Yunnan province, red ginseng (紅參) from the Jilin province, in the PRC; and (ii) the Chinese herbs meet the safety levels of harmful substances or pollutants such as heavy metals and chemicals. For some of the plantation bases from where we source the Chinese herbs, we also set out our prerequisite standards for the uses of pesticides and fertilisers. Therefore, we can manage the quality and safety of the Chinese herbs used for our production from an early stage during cultivation. Since we can have close involvement during the cultivation and we also require inspection before harvesting, we are willing to pay a premium which we believe to be higher than the market norm, over the market price for certain types of the Chinese herbs used for our production. As at the Latest Practicable Date, we

entered into master agreements with 12 plantation bases operators for the supplies of 19 types of Chinese herbs and with Supplier A, one of our top five suppliers, for the supplies of various types of Chinese herbs for the production of our major products. The following table sets out the major terms of the master supply agreements with our suppliers for Chinese herbs:

Principal terms	Summary	
	Plantation bases operators	Supplier A
Term	From one year to five years and is renewable subject to negotiation	Two years and is renewable subject to negotiation
Specified types of Chinese herbs	Yes	No
Designated plantation areas	Yes	No
Purchase price	5–30% above market price	Not specified
Minimum purchase or supply amount	Not specified	Not specified
Payment terms	20 days after issue of invoice	20 days after issue of invoice
Delivery cost	To be borne by the suppliers	To be borne by the supplier
Inspection of Chinese herbs	Prior to harvesting of the Chinese herbs and upon receipt of the deliveries	Upon receipt of the deliveries
Specified quality standard	Yes. Including but not limited to: — compliance with GSP and GMP standards (where applicable) and Chinese Pharmacopoeia standards; — specified safety levels of pesticide residues, harmful substances such as heavy metals and chemicals	To be specified in separate purchase orders
Sales return	Allowed for quality reasons	Allowed for quality reasons
Termination	By either party if the other party is in breach of the terms of the agreement	By either party if the other party is in breach of the terms of the agreement

We believe that we have established good relationships with our suppliers of Chinese herbs, which enable us to maintain a reliable source of raw materials for production. In addition, to reduce our reliance on any single supplier, we generally have alternative sources of supply for every type of raw materials, therefore we do not anticipate there being significant difficulties for us in sourcing raw materials in the future.

Other suppliers

We do not enter into any master supply agreements or long term agreements with the suppliers of raw materials other than Chinese herbs as these raw materials are readily available in the market. To ensure better management of the availability of resources and our operations, we do not rely on any single major supplier and have at least two suppliers for each type of principal raw material as

well as packaging material respectively. Our Directors believe that by ensuring suitable alternative suppliers and raw materials, we will be able to minimise the risk of supply shortages and purchase raw materials for production at competitive prices.

Inventory of pharmaceutical manufacturing

The inventories of our operations primarily consist of raw materials, work-in-progress and finished goods. Our inventories are stored in accordance with GMP requirements. As some of our raw materials and finished products are temperature and humidity sensitive, warehouses in our factories are equipped with temperature and humidity control systems to maintain the quality and stability of such raw materials and finished products.

We use an enterprise resource planning system to track our inventory movements. This system enables us to monitor inventory levels in a timely manner so as to ensure that there would be a stable level of raw materials and finished products. We also conduct stock takes semi-annually. In order to minimise the risks of excess inventory held or shortages of raw materials in production, we regularly review our inventory levels and formulate corresponding policies, pursuant to which we manage our inventory according to different product types and their respective minimum inventory levels.

DISTRIBUTION CHANNELS OF OUR OWN-BRANDED PRODUCTS

Our own-branded products are sold in our self-operated chain pharmacies in Zhongshan and through an extensive distribution network comprising distributors and independent chain pharmacies outside Zhongshan. The following table sets forth a breakdown of the revenue of our pharmaceutical manufacturing by different distribution channels (other than our self-operated chain pharmacies) and their respective percentage during the Track Record Period:

	For the year ended 31 December					
	2012		2013		2014	
	RMB'000	% of revenue	RMB'000	% of revenue	RMB'000	% of revenue
Distributors						
— contractual *(Note)*	81,394	47.3	84,478	40.8	90,234	30.6
— non-contractual	61,038	35.4	69,478	33.5	57,156	19.4
	142,432	82.7	153,956	74.3	147,390	50.0
Independent chain pharmacies	29,808	17.3	53,306	25.7	147,450	50.0
Total revenue from pharmaceutical manufacturing	172,240	100.0	207,262	100.0	294,840	100.0

Note: These represented our sales to upper-level distributors as we do not sell directly to lower-level distributors.

Our distributors are broadly categorised into (i) contractual distributors which comprise upper- and lower-level distributors; and (ii) non-contractual distributors. All our distributors are Independent Third Parties.

The following sets forth the brief description of our distributors and independent chain pharmacies:

	Contractual distributors	**Non-contractual distributors**	**Independent chain pharmacies**
Distribution/master agreements with us	Yes	No	Yes
Nature of business	Pharmaceutical distribution corporations, wholesalers or pharmaceutical logistics companies	Mainly small-sized local pharmaceutical distributors and wholesalers	Operators of chain pharmacies outside Zhongshan
Types of our products being distributed	Mainly Chinese patent medicines except those we only sell to non-contractual distributors	A pool of Chinese patent medicines which are not sold to our contractual distributors or independent chain pharmacies	Mainly modern decoction pieces which are not sold to our distributors
Two-level Distribution Model	Comprising: (i) Upper-level distributors: — Mainly sizable pharmaceutical distribution corporations, wholesalers or pharmaceutical logistics companies and have maintained satisfactory track record with us — Our direct customers to whom we sell and deliver our products — They resell our products to other customers including our lower-level distributors (ii) Lower-level distributors: — Mainly smaller-sized pharmaceutical distributors and wholesalers or have relatively shorter relationship with us — Not our direct customers. They purchase our products from our designated upper-level distributors who directly sell and deliver the goods to them (iii) Relationship between upper- and lower-level distributors — Seller and buyer — Lower-level distributors can only purchase from our designated upper-level distributors and at prices not less than those set by us in the distribution agreements	N/A	N/A

The following map illustrates the geographical coverage of our distribution network as at the Latest Practicable Date:

Note:

- Refers to the provinces where we engaged distributors and/or independent chain pharmacies to distribute our own-branded products.

The following table sets forth the revenue from our pharmaceutical manufacturing by different regions in the PRC during the Track Record Period:

	For the year ended 31 December					
	2012		2013		2014	
	RMB'000	% of revenue	RMB'000	% of revenue	RMB'000	% of revenue
Southern China *(Note 1)*	65,458	38.0%	79,475	38.3%	106,425	36.1%
Eastern China *(Note 2)*	40,513	23.6%	43,155	20.8%	59,041	20.0%
Southwest China *(Note 3)*	14,363	8.3%	19,427	9.4%	47,621	16.2%
Central China *(Note 4)*	25,351	14.7%	31,689	15.3%	41,214	14.0%
Northern China *(Note 5)*	18,647	10.8%	17,320	8.4%	17,299	5.9%
Northeast China *(Note 6)*	4,486	2.6%	9,443	4.6%	15,757	5.3%
Northwest China *(Note 7)*	3,422	2.0%	6,753	3.2%	7,483	2.5%
Total revenue from pharmaceutical manufacturing	**172,240**	**100%**	**207,262**	**100%**	**294,840**	**100%**

Notes:

(1) Southern China: Guangdong, Guangxi and Hainan
(2) Eastern China: Shandong, Jiangsu, Anhui, Zhejiang, Fujian and Shanghai
(3) Southwest China: Sichuan, Yunnan, Guizhou, Tibet and Chongqing
(4) Central China: Hubei, Hunan, Henan and Jiangxi
(5) Northern China: Beijing, Tianjin, Hebei, Shanxi and Inner Mongolia
(6) Northeast China: Liaoning, Jilin and Heilongjiang
(7) Northwest China: Ningxia, Xinjiang, Qinghai, Shaanxi and Gansu

(I) Distributors

According to the Ipsos Report, the PRC pharmaceutical distribution chain has customarily been fragmented to a large number of distributors of different sizes. We engage our distributors to sell and distribute mainly our own-branded Chinese patent medicines. They then resell our products to hospitals, medical clinics, wholesalers and retail pharmacies of various sizes. We believe our existing distribution model is in accordance with customary industry practice and allows us to (i) benefit from our distributors' established distribution networks and resources in the sale and distribution of our Chinese patent medicines and save the costs that would otherwise be incurred to build up our own logistics network across the PRC; and (ii) enhance and expedite the market penetration of our existing products and new products. As at 31 December 2014, we have a total of 1,111 distributors which are categorised as (i) contractual distributors; and (ii) non-contractual distributors covering 30 provinces, autonomous regions and municipality cities in the PRC. We require all our distributors (contractual and non-contractual) to be GSP-certified.

Revenue from our sales to our distributors amounted to approximately RMB142.4 million, RMB154 million and RMB147.5 million for each of the three years ended 31 December 2014 respectively, which accounted for approximately 82.7%, 74.3% and 50.0% of the total revenue generated from our pharmaceutical manufacturing respectively.

(a) Contractual distributors — Two-level Distribution Model

We enter into distribution agreements with our contractual distributors where we can manage their sales of our products in respect of their, *inter alia*, selling price, sales volume and geographical coverage through the terms in the distribution agreements. To ensure a more effective management of our distribution network, we maintain the "Two-level Distribution Model" comprising upper-level and lower-level contractual distributors. As at the Latest Practicable Date, we had 71 upper-level distributors and 396 lower-level distributors. Having adopted such an arrangement, we reduce the credit risk inherent in our sales as we only deal directly with the upper-level distributors, which are mainly reputable and established pharmaceutical distributors and wholesalers, and have maintained long and satisfactory trading record with us. Furthermore, we can benefit from the logistics resources of our upper-level distributors for the deliveries of our products to lower-level distributors, hence help saving our costs.

The following table sets forth the number of contractual distributors and the relevant movements during the Track Record Period:

	For the year ended 31 December		
	2012	2013	2014
Upper-level Distributors			
At the beginning of the period	62	59	70
Added during the period	13	22	7
Termination during the period *(Note)*	16	11	9
At the end of the period	59	70	68
Lower-level Distributors			
At the beginning of the period	355	270	502
Added during the period	154	316	209
Termination during the period *(Note)*	239	84	256
At the end of the period	270	502	455
Total at the end of the period	329	572	523

Note: Termination of contractual distributors during the Track Record Period was primarily due to their failure to meet our sales target; suspension or termination of their GSP certifications or mergers and consolidation of the distributors.

We have established business relationships with our major contractual distributors with a minimum of three years. For each of the three years ended 31 December 2014, our sales to contractual distributors were approximately RMB81.4 million, RMB84.5 million and RMB90.2 million, accounting for approximately 47.3%, 40.8% and 30.6% of our revenue derived from pharmaceutical manufacturing, respectively.

(i) *Upper-level Distributors*

Our major upper-level distributors include, Guangdong Dongguan Guoyao Group Co., Ltd.* (廣東省東莞國藥集團有限公司) and Jointown Pharmaceutical Group Co., Ltd.* (九州通醫藥集團股份有限公司) which were two of our top five customers for the year ended 31 December 2014. We generally appoint one to eight upper-level distributors in one territory in the PRC, depending on whether the distribution territory is at city or provincial level, for the sale and distribution of our products, mainly Chinese patent medicines. They then sell our products to hospitals, medical institutions, pharmacies and/or our lower-level distributors. Pursuant to the distribution agreements entered with our upper-level distributors, we do not designate our upper-level distributors to any lower-level distributors. However, in the distribution agreements with our lower-level contractual distributors, we generally assign each lower-level distributor to one to four upper-level distributors from whom they can purchase our products. For details of the terms of the distribution agreements with our upper- and lower-level distributors, please refer to the paragraph headed "Business — Distribution channels of our own-branded products — Distribution agreements" in this [REDACTED].

Save for the terms set out in the respective distribution agreements which our distributors have to comply with our upper- and lower-level distributors are free to negotiate terms of purchases between themselves. Based on the agreed terms, upper-level distributors directly sell and deliver to lower-level distributors at prices not less than those set out by us in the respective distribution agreements.

(ii) *Lower-level Distributors*

To increase our sales through the distribution network of our upper-level distributors, we will identify smaller-sized distributors or wholesalers in the designated territories of these upper-level distributors for the distribution of our products. These smaller-sized distributors or wholesalers become our lower-level distributors and directly purchase from our upper-level distributors. We enter into distribution agreements with our lower-level distributors in order to facilitate our management over them. The major terms include assigning to each lower-level distributor one to four upper-level distributors from whom they can purchase our products, restricting their sales of our products in designated territories and disallowing purchases from designated upper-level distributors at prices less than those set out by us. Our lower-level distributors usually choose to purchase our products from the respective upper-level distributors by taking into account the availability of inventories and other terms such as credit terms offered to them and/or delivery services offered by respective upper-level distributors from time to time.

The following table sets forth the number of our upper- and lower-level contractual distributors in different regions in the PRC at the Latest Practicable Date:

	Number of upper-level contractual distributors	**Number of lower-level contractual distributors**
Southern China *(Note 1)*	12	98
Eastern China *(Note 2)*	20	57
Southwest China *(Note 3)*	6	69
Central China *(Note 4)*	18	130
Northern China *(Note 5)*	6	34
Northeast China *(Note 6)*	3	—
Northwest China *(Note 7)*	6	8
Total	**71**	**396**

Notes:

(1) Southern China: Guangdong, Guangxi and Hainan
(2) Eastern China: Shandong, Jiangsu, Anhui, Zhejiang, Fujian and Shanghai
(3) Southwest China: Sichuan, Yunnan, Guizhou, Tibet and Chongqing
(4) Central China: Hubei, Hunan, Henan and Jiangxi
(5) Northern China: Beijing, Tianjin, Hebei, Shanxi and Inner Mongolia
(6) Northeast China: Liaoning, Jilin and Heilongjiang
(7) Northwest China: Ningxia, Xinjiang, Qinghai, Shaanxi and Gansu

Distribution Agreements

Our relationships with upper-level distributors are of a seller/buyer relationship. We generally enter into standard distribution agreements with all our upper-level distributors, which specify terms such as deliveries, payments and sales targets. As for the lower-level distributors, we generally enter into a simplified version of distribution agreements with them containing a few key terms.

(i) *Major terms of our distribution agreements with upper-level contractual distributors*

Principal terms	Summary
Designated distribution territory	Yes
Designated types of Chinese patent medicines	Yes
Term	One year and is renewable subject to negotiation
Annual sales target qualified for rebate	Yes
Rebates	Yes, in the form of discount on products to be purchased in the future if the annual sales target is met. The discount is normally in the range of 2% to 3% of the wholesale price of the relevant products
Payment terms	Cash on delivery, credit terms of 30–45 days
Monthly product flow report from distributors	Yes
Specified minimum resell price	Yes
Minimum purchase amount	Not specified
Delivery costs	We bear the delivery costs
Sales return	Allowed only for quality reasons
Price adjustment clause	Yes. Subject to government pricing policy or other factors such as changes in material cost or technology changes
Termination	We are entitled to terminate the distribution agreements with our distributors when, *inter alia*, they (i) have materially breached any term of the distribution agreement, such as selling our products outside the designated distribution territory or selling our products below our suggested minimum sales price; (ii) have lost or been deprived of their relevant GSP certificates and other relevant licences for the distribution of pharmaceutical products; and/or (iii) have failed to make payments within the credit period.
Qualification and compliance requirements	Distributors are required to comply with all applicable laws and regulations, including maintaining a valid GSP certificate and if applicable, pharmaceutical supply permits.

(ii) *Major terms of our distribution agreements with lower-level contractual distributors*

Principal terms	Summary
Designated distribution territory	Yes
Designated types of Chinese patent medicines	Yes
Designated upper-level distributor(s)	Yes
Term	One year and is renewable subject to negotiation
Annual sales target qualified for rebate	Yes
Rebates	Yes, in the form of discount on products to be purchased in the future if the annual sales target is met. The discount is normally in the range of 1% to 2% of the wholesale price of the relevant products
Monthly product flow report from distributors	Yes
Minimum purchase price from upper-level distributor(s)	Yes
Specified minimum resell price	Yes
Minimum purchase amount	Not specified
Responsibilities of our Group	Our Group only provides the support services in relation to our products and will not take any responsibility in relation to any dispute or economic relationship between the upper-level and lower-level contractual distributors
Termination	No termination clause contained in the distribution agreement

Sales to hospitals and other medical institutions by contractual distributors

During the Track Record Period, we sold some of our Chinese patent medicines including Banlangen Granules* (板藍根顆粒), Yinhuang Granules* (銀黃顆粒) and Yinqiao Detoxification Tablets* (銀翹解毒片) to hospitals and other medical institutions through our contractual distributors. For the sale of these products, we had to go through the provincial government organised tender processes under statutory requirements before we sold these products to hospitals and other medical institutions through our distributors. Our staff members regularly visit the relevant government websites in order to obtain update information on the sourcing requirements of pharmaceutical products of different hospitals and medical institutions. In the tender documents, we designate distributors on the government list for the supply of our products to such hospitals and medical institutions. The selection of suppliers is based on a number of criteria including, but not limited to, tender price, product quality, pharmaceutical manufacturer's reputation and service quality. The successful tender prices are the procurement prices at which pharmaceutical product distributors have to sell the products to the public hospitals and medical institutions, and in part this determines the prices at which we sell our products to our distributors. We have a designated team responsible for participating in statutory tender processes. For each of the three years ended

31 December 2014, revenue from sales to hospitals and other medical institutions amounted to approximately RMB7.2 million, RMB16.6 million, RMB16.5 million, representing approximately 1.8%, 3.4% and 2.8% of our total revenue, respectively.

Pursuant to the Guiding Opinions on Enhancing Centralised Procurement of Pharmaceutical Products by Public Hospitals* (《國務院辦公廳關於完善公立醫院藥品集中採購工作的指導意見》) which became effective on 9 February 2015, all drugs used by public hospitals, except decoction pieces shall be procured through the provincial centralised drug procurement platform. For details of the regulations on procurement of pharmaceutical products by medical institutions, please refer to the paragraph headed "Regulation — Collective tendering system for procurement of pharmaceutical products by medical institutions" in this [REDACTED]. Our Directors are of the view that under the new regulations, procurement prices of pharmaceutical products will become more apparent. As our sales to medical institutions during the Track Record Period were immaterial and that, our Group currently has no plans to expand our sales to hospitals and other medical institutions, our Directors are of the view that the new regulations will have no material impact on our business operations.

Upon successful tendering, we will enter into an agreement with the designated distributor who will then resell our products to the hospitals or medical institutions named in the tender.

(b) Non-contractual distributors

During the Track Record Period, we selected a pool of about ten types of our Chinese patent medicines for sale to our non-contractual distributors, who then resell the products to medical clinics, small-sized wholesalers and pharmacies in different parts of the PRC, except Zhongshan. In Zhongshan, we sell this pool of Chinese patent medicines in our self-operated chain pharmacies. These Chinese patent medicines generally have forms and/or packaging different from those being sold to contractual distributors and are sold at higher selling prices. For example, Yinhuang Granules* (銀黃顆粒) being sold to contractual distributors are in granules whereas Yinhuang Capsules* (銀黃膠囊) being sold to non-contractual distributors are in capsules and the packaging of Seven Star Tea Granules* (小兒七星茶顆粒) being sold to contractual and non-contractual distributors are different. The gross profit margins of the similar types of products being sold to non-contractual distributors can in general be higher than those being sold to contractual distributors. We believe that this sales strategy will increase the market share of our Chinese patent medicines and our profitability. We also engage our non-contractual distributors to launch and sell new products in order to test their market receptiveness. Our non-contractual distributors are mainly small-sized local distributors and they usually sell our products in the areas where they are located.

Although revenue derived from non-contractual distributors only accounted for approximately 14.9%, 14.4% and 9.6% of our Group's total revenue for each of the three years ended 31 December 2014, respectively, we consider that our non-contractual distributors are important to the development of our business as they enable our products to penetrate into different market segments in particular, to those consumers who have higher spending powers.

These non-contractual distributors are also important for us in promoting our products and building up our brands in new markets, such as the Western and Northern China where our presence is of a relatively short history and has less contractual distributors being engaged, as compared to those in the Eastern and Southern China. As our non-contractual distributors are of smaller size, they are more flexible in procurement and sales of our products. We do not accept return of goods except for quality reasons.

The following table sets forth the number of non-contractual distributors and the relevant movements during the Track Record Period:

	Year ended 31 December		
	2012	**2013**	**2014**
At the beginning of the period	220	690	633
Added during the period	567	276	279
Termination during the period *(Note)*	97	333	324
At the end of the period	690	633	588

Note: Termination of non-contractual distributors during the Track Record Period was primarily due to their performance, the suspension or their termination of their GSP certifications or mergers and consolidation of the distributors.

We do not enter into any distribution agreements with our non-contractual distributors. We sell to a diversified base of non-contractual distributors and sales to each of them are relatively small. As at 31 December 2014, we had 588 non-contractual distributors in different provinces, autonomous regions and municipality cities in the PRC. For each of the three years ended 31 December 2014, our sales to non-contractual distributors were approximately RMB61 million, RMB69.5 million and RMB57.2 million, accounted for approximately 35.4%, 33.5% and 19.4% of our revenue derived from pharmaceutical manufacturing, respectively. For the year ended 31 December 2014, the ranges of sales to non-contractual distributors and the respective percentage to the revenue derived from non-contractual distributors were set out as below:

	As at 31 December					
	2012		**2013**		**2014**	
Revenue range	**Number of distributors**	**% of revenue**	**Number of distributors**	**% of revenue**	**Number of distributors**	**% of revenue**
Over or equal to RMB1 million	5	12.1	4	19.9	7	24.1
Over or equal to RMB0.3 million and under RMB1 million	37	45.4	30	35.9	26	34.0
Over or equal to RMB50,000 and under RMB0.3 million	130	29.4	149	34.3	117	31.3
Under RMB50,000	518	13.0	450	9.9	438	10.6
Total	**690**	**100.0**	**633**	**100.0**	**588**	**100.0**

The following table sets forth the number of non-contractual distributors in different regions in the PRC as at the Latest Practicable Date:

Regions in the PRC	Number of non-contractual distributors
Southern China *(Note 1)*	170
Eastern China *(Note 2)*	86
Southwest China *(Note 3)*	39
Central China *(Note 4)*	64
Northern China *(Note 5)*	59
Northeast China *(Note 6)*	37
Northwest China *(Note 7)*	34
Total	**489**

Notes:
(1) Southern China: Guangdong, Guangxi and Hainan
(2) Eastern China: Shandong, Jiangsu, Anhui, Zhejiang, Fujian and Shanghai
(3) Southwest China: Sichuan, Yunnan, Guizhou, Tibet and Chongqing
(4) Central China: Hubei, Hunan, Henan and Jiangxi
(5) Northern China: Beijing, Tianjin, Hebei, Shanxi and Inner Mongolia
(6) Northeast China: Liaoning, Jilin and Heilongjiang
(7) Northwest China: Ningxia, Xinjiang, Qinghai, Shaanxi and Gansu

All of our non-contractual distributors are required to place purchase orders with us and make full payment on products before delivery. For our major non-contractual distributors who have annual sales amount equal to or above RMB1 million for the year ended 31 December 2014, they have an average of four years of relationship with us.

We may consider promoting our non-contractual distributors to lower-level contractual distributors if their performance and their sales volume are satisfactory and/or when we consider that their sales network has potential for further expansion.

Criteria for selection of distributors

We select our distributors (including upper-level and lower-level contractual distributors and non-contractual distributors) who are able to meet our assessment criteria, including their industry track records, validity of their GSP certificates, reputations, credit standings (for contractual distributors to which credit terms are granted), years of operation, their sales networks and coverage, delivery capability, compliance record and financial strength. We keep track of the business licences and GSP certificates of each of our distributors from time to time.

Management of our distributors

Contractual Distributors

We manage and monitor the performances of our contractual distributors on an ongoing basis in respect of their compliance with the terms and conditions of the distribution agreements, in particular, our pricing policies and the restrictions on the sale of our own-branded products outside the designated distribution territories. Our sales staff visit both upper- and lower-level distributors

at least once a month and maintain frequent contact with them to keep track of the status of their business licences and GSP certificates and their inventory level of our Chinese patent medicines. By doing so, we can monitor the performance of our contractual distributors, and also obtain their feedback on the market perception of our own-branded products. We believe that these frequent visits will help nurturing our relationship with our contractual distributors. We can also ensure that growth in the sales of our own-branded products during the Track Record Period was mainly due to market demands rather than accumulation of inventories at the distributors' level. Other measures to ensure genuine market demand of our Chinese patent medicines mainly include (i) requiring cash on delivery for new and smaller-sized contractual distributors; (ii) giving rebates in the form of discount on products in succeeding purchases and based on actual proceeds received on products sold instead of in the form of cash; and (iii) not accepting the return of unsold products. For each of the three years ended 31 December 2014, the rebates given to our contractual distributors, in the form of discount on products, amounted to approximately RMB2.6 million, RMB3.5 million and RMB3.8 million, respectively.

We also review the monthly product flow reports from our contractual distributors and conduct random check on the sales invoices issued by them. The product flow reports and sales invoices set forth date of sale, names of customers to whom our contractual distributors sold, product names, sales prices, quantities and batch numbers. We will review the performance of each individual distributor on a regular basis. Based on the results of our reviews, we may decide whether to promote such lower-level distributors with established networks to upper-level distributors.

Non-contractual distributors

We do not enter into distribution agreements with our non-contractual distributors as (i) the purchase amounts and quantities from individual non-contractual distributors are comparatively small; and (ii) the functions of our non-contractual distributors are mainly for promotion and market testing of our new products and other products which are not being sold by our contractual distributors. Although we do not enter into any agreements with our non-contractual distributors, we monitor the performances of these distributors by a series of measures, such as on a monthly basis (i) tracking where each batch of our products is sold through the product serial numbers labelled thereon; (ii) paying visits to them to keep track on the status of their business licences and GSP certificates and the sales of our products; and (iii) reviewing the product flow reports from our non-contractual distributors and conducting random check on the sales invoices issued by our non-contractual distributors to their customers to ensure that they do not sell our products to their customers below the minimum selling prices provided by us. Though there are no distribution agreements entered into with these non-contractual distributors restricting their distribution territories, during the Track Record Period, our Directors were not aware of any competitions among non-contractual distributors of the same locations or locations in vicinity. The serial number labelled on each batch of our products enables us to check whether our products are sold by any individual non-contractual distributor to other regions, which may result in potential competition among non-contractual distributors. If we find any non-contractual distributor not following our policies, in particular, selling our products outside the areas where they are located, we may

terminate our relationship with them. All our sales to non-contractual distributors are fully paid before delivery. Accordingly, we do not have any credit risk in dealing with non-contractual distributors whilst ensuring a genuine market demand of our products. We do not accept return of goods from our non-contractual distributors other than for quality reasons. During the Track Record Period, there were no sales returns from our non-contractual distributors.

Mitigation of the risk of cannibalisation among distributors

To mitigate the risk of potential competition and cannibalisation, we have taken the following measures, which in our Directors' opinions, are effective: (i) monitoring and restricting the number of contractual distributors in any designated distribution area through the signing of distribution agreements with individual contractual distributors; (ii) disallowing contractual distributors to resell our products below the minimum price set by us; (iii) keeping track of any potential competition among our distributors by frequent communications with distributors and paying visits to them; (iv) keeping track of the sales of our products by reviewing the product flow reports obtained from individual distributor; and (v) having forms and/or packaging of the Chinese patent medicines being sold by our non-contractual distributors different from those being sold by our contractual distributors.

(II) Independent chain pharmacies

We mainly sell our modern decoction pieces to independent chain pharmacies outside Zhongshan, of which some of them are major operators in the market such as Yunnan Hongxiang Yixintang Pharmaceutical Co., Ltd.* (雲南鴻翔一心堂藥業(集團)股份有限公司). We require all of these independent chain pharmacies to be GSP certified. We generally enter into standard master agreements with independent chain pharmacies for a term of one year. The major terms include the designated territory for sale of our products, types and retail prices of our products and independent chain pharmacies not allowed to sell our products below the retail price set by us. We generally grant credit terms ranging from 30 to 45 days to independent chain pharmacies for the sale of our products.

Revenue from the sale of our own-branded products (including modern decoction pieces and Chinese patent medicines) to these independent chain pharmacies amounted to approximately RMB29.8 million, RMB53.3 million and RMB147.4 million for each of the three years ended 31 December 2014 respectively, which accounted for approximately 17.3%, 25.7% and 50% of the total revenue generated from our pharmaceutical manufacturing segment respectively. As at the Latest Practicable Date, we sold to 386 independent chain pharmacies for the distribution of our modern decoction pieces, the majority of which are located in the Guangdong province. Our Directors believe that the distribution of our products through independent chain pharmacies is an effective channel to promote our new products as sales persons in pharmacies can explain face-to-face to retail customers the characteristics of our products and directly promote our products. Furthermore, this would eliminate intermediaries in the distribution chain and thus enable us to improve our profitability.

Our sales and marketing team

For our pharmaceutical manufacturing, our sales and marketing team was led by Mr. Cao and comprised 326 full time sales staff as at the Latest Practicable Date. For details of the biography of Mr. Cao, please refer to the "Directors and Senior Management" section in this [REDACTED]. Our sales staff are responsible for the sales and marketing of the assigned type of products in assigned geographical locations. Our sales staff are mainly local residents of their assigned locations. Our Directors believe that this allows a cost effective and efficient management of our distributors and independent chain pharmacies in their assigned regions.

Our sales staff visit our distributors and independent chain pharmacies on a regular basis to ensure that they maintain valid business licences and GSP certificates and in particular, for contractual distributors, are in compliance with the terms of distribution agreements. Our sales staff keep themselves updated of the business and financial performances of our distributors and independent chain pharmacies, sales and market responses of our products and, market trends of the pharmaceutical industry. Our sales and marketing team also convene seminars on a regular basis to sales persons of independent chain pharmacies to enhance their knowledge of our products. In formulating marketing and promotion strategies for a particular type of product, our sales and marketing department may, if necessary, consult our research and development team regarding the functions and characteristics of the products.

Our sales staff are remunerated by basic salaries and commissions based on their sales performances and the sales proceeds received from customers. In this regard, we can ensure our sales to customers in the distribution network are genuine.

CHAIN PHARMACY OPERATIONS

All our chain pharmacies in Zhongshan are self-operated and are GSP certified. As advised by our PRC Legal Advisors, as at the Latest Practicable Date, we had obtained all necessary licences, permits and certificates in accordance with relevant PRC laws and regulations for our chain pharmacies operations. For more details, please refer to the paragraph headed "Business — Legal and compliance — Licences and permits" in this [REDACTED].

According to the Ipsos Report, we were the largest self-operated pharmacy chain in Zhongshan in terms of the number of pharmacies and revenue for three consecutive years from 2012 to 2014. As at the Latest Practicable Date, we had 201 pharmacies located in all districts of Zhongshan under our "Zeus (中智)" brand.

The following table sets forth the changes in the number of our self-operated pharmacies during the Track Record Period and up to the Latest Practicable Date:

	2012	2013	2014	Latest Practicable Date
At commencement of the year/period	150	198	195	198
Addition of new pharmacies	49	1	9	3
Closure of existing pharmacies *(Note)*	(1)	(4)	(6)	—
Net increase/(decrease) in pharmacies	48	(3)	3	3
At end of the year/period	198	195	198	201

Note: Closure of the relevant pharmacies was due to (i) expiration of the relevant lease; (ii) the relocation of the relevant pharmacies; or (iii) unsatisfactory performance of the relevant pharmacies.

Locations and sizes of our chain pharmacies

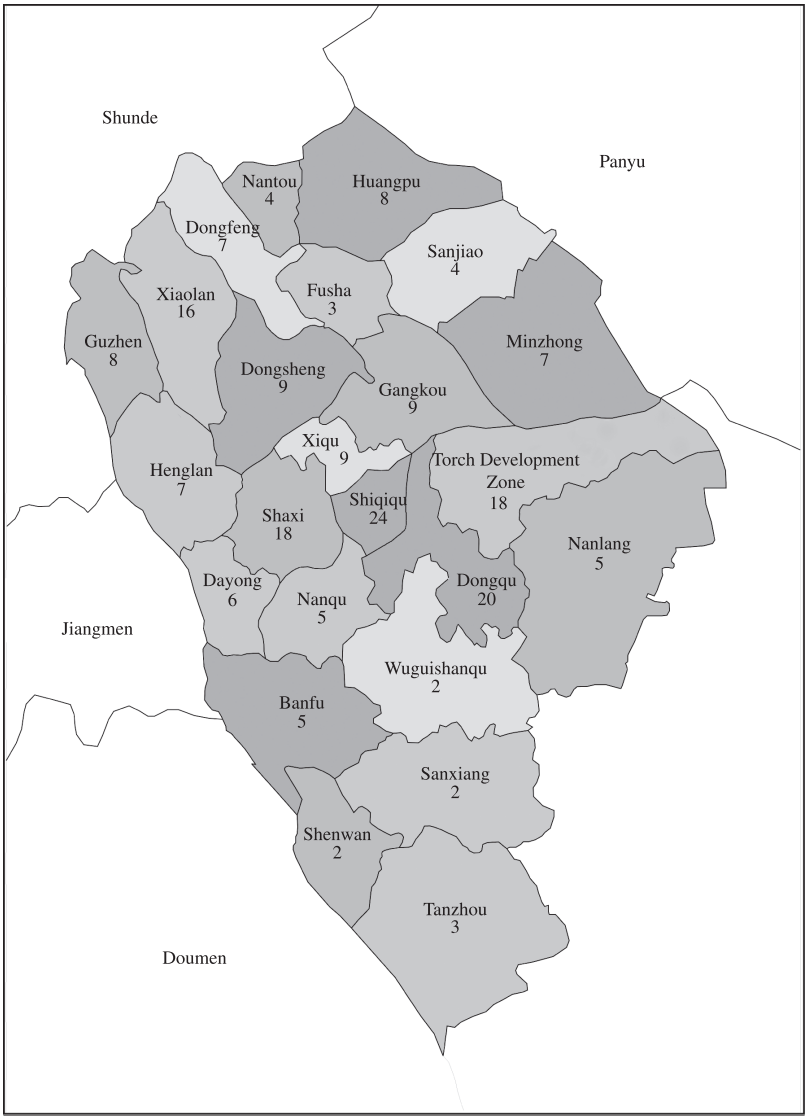
We consider that identifying a suitable location for operation of our chain pharmacies is crucial to the success of our chain pharmacies. Most of our existing pharmacies are located in convenient areas in Zhongshan. The factors that we take into account in making decisions on the location and the size of a pharmacy include consumer traffic, accessibility, spending patterns of the local population, strategic geographic coverage of our pharmacies and the presence of other pharmacies and their product mix so as to avoid direct competition. During the Track Record Period and as at the Latest Practicable Date, the gross floor area of our pharmacies ranged from approximately 40 to 600 sq.m.

Set out below is the size profile of our chain pharmacies:

Gross floor area (approximate)	Number of pharmacies as at the Latest Practicable Date
Under 100 sq.m.	104
Over or equal to 100 and under 200 sq.m.	87
Over or equal to 200 sq.m. *(Note)*	10

Note: We have a flagship pharmacy with gross floor area of approximately 600 sq.m.

The number of pharmacies in each district of Zhongshan as at Latest Practicable Date is set forth in the map below:



Note: Figures in the map represent the number of our self-operated pharmacies in each district of Zhongshan.

Leases of our chain pharmacies

Except for one pharmacy which operates in our owned property, all of our chain pharmacies are located and operate in leased premises. Our leases have terms of approximately two to five years. The following table sets forth terms of the leases of our pharmacies:

Number of leased pharmacy	Dates of expiry
28	On or before 31 December 2015
52	On or before 31 December 2016
121	After 31 December 2016

If we cannot procure renewal of any of the above leases upon its expiry, we may have to relocate the relevant chain pharmacies to other premises. Notwithstanding that, our Directors believe that comparable premises at comparable locations can be identified without difficulty and the relocation costs will not have material adverse impacts on our operation and financial performance.

The branding and unique layout of our chain pharmacies

All our chain pharmacies are operated under the "Zeus (中智)" brand and are subject to a uniform and unique layout by adopting uniform style in their exterior and interior designs and decorations, such as colour scheme and design specifications. These have successfully promoted our corporate image and distinguished our chain pharmacies amongst other chain pharmacies and individual pharmacies in the market.

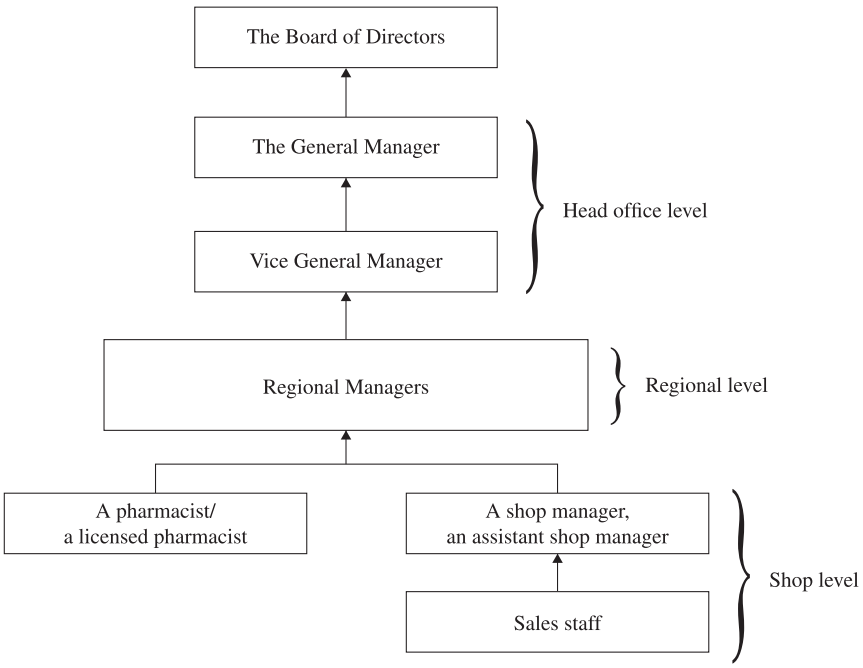
Accreditations from government authorities

According to Zhongshan Social Medical Insurance Medical Expenses Settlement Methods* (中山市社會醫療保險醫療費用結算辦法), effective from 1 July 2014, customers who are registered with the relevant medical insurance scheme can pay for the pharmaceutical products listed in Zhongshan Outpatient Essential Medical Insurance Drugs Catalogue* (中山市門診基本醫療保險藥品目錄), healthcare products and medical devices in the pharmacies accredited by the PRC national medical insurance programme through their medical insurance cards. Following the revision of Zhongshan Outpatient Essential Medical Insurance Drugs Catalogue on 1 July 2014, the number of pharmaceutical products eligible thereunder has increased to 1,029 types.

As at the Latest Practicable Date, among our 201 pharmacies, 86 were accredited pharmacies under the relevant PRC national medical insurance programme and our Directors believe that the sales in these pharmacies will increase due to the convenient payment method and the inclusion of additional pharmaceutical products in the National Medical Insurance Drugs Catalogue.

Management and operation of our chain pharmacies

Our chain pharmacies operations are supported by various in-house departments, which include sales and marketing, accounting and administration, procurement, warehousing, pricing, logistics and quality control of products. All these departments are under the management of Ms. Jiang Mei Fang, the general manager of our chain pharmacies operations, who reports to our Board. The hierarchy in respect of the management of our chain pharmacies is as follows:

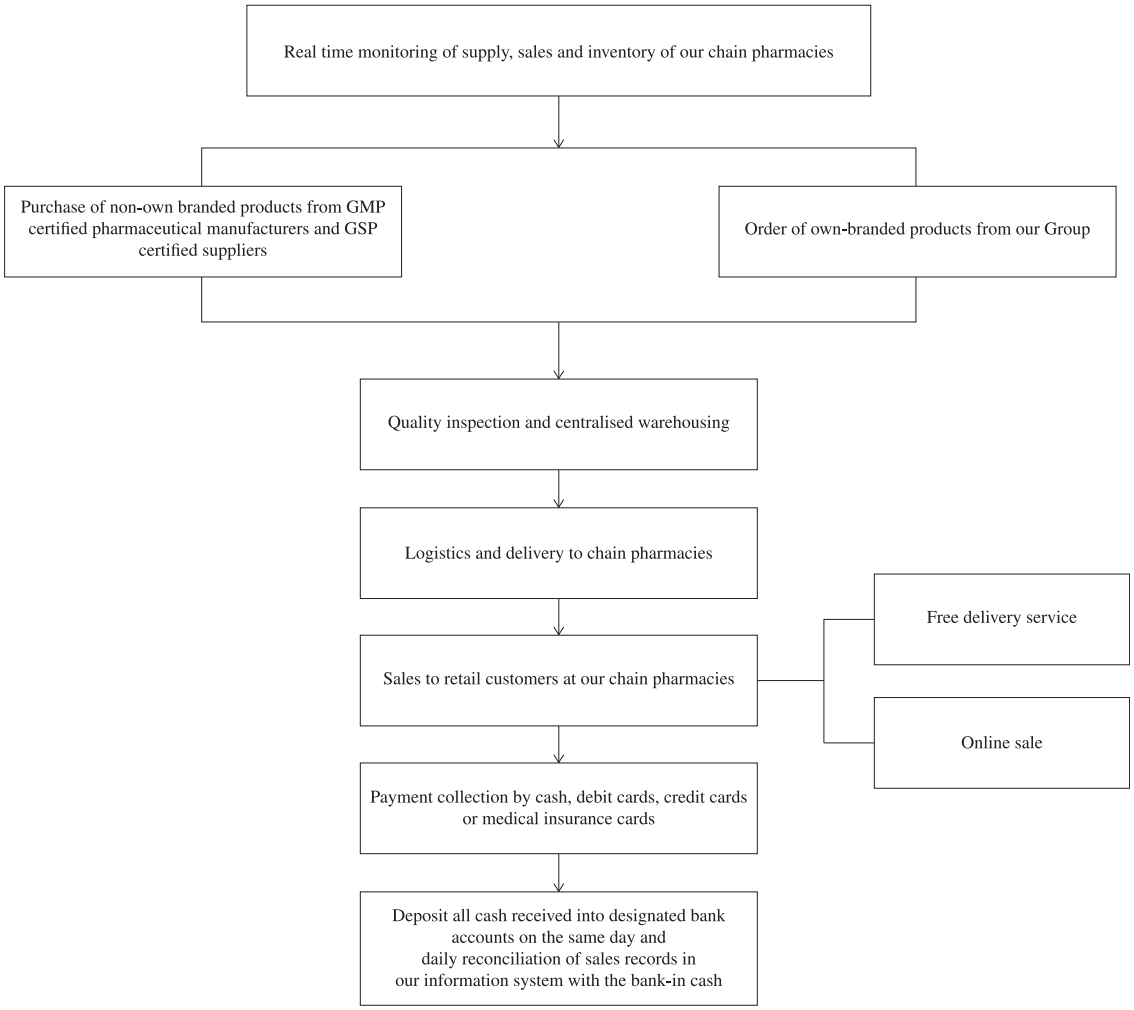


For the effective management of our chain pharmacies, we have divided our chain pharmacies into ten regions. In each region, we have appointed a regional manager responsible for the management and operation of a region consisting of 17 to 26 chain pharmacies. Each shop manager will in turn report to the corresponding regional manager.

As at the Latest Practicable Date, our Group had a total of 1,235 staff members employed for the operation of our chain pharmacies. Each of our chain pharmacies is staffed with a shop manager, a few sales persons and a licensed pharmacist or pharmacist. Depending on the size of a pharmacy, there is also an assistant shop manager in some chain pharmacies and in general, the number of sales staff ranges from three to seven. According to the new GSP requirements, by the end of 2015, all pharmacies shall have an in-house licensed pharmacist stationed who is responsible for checking prescriptions and directing drug uses. For the compliance with this regulatory requirement and for our expansion purpose, we provide in-house trainings to our existing pharmacists who have already gained the relevant experiences in our chain pharmacies to prepare for the examination required for the qualification of licenced pharmacists. As at the Latest Practicable Date, our Group had 225 licensed pharmacists and 229 pharmacists. If necessary, we may also recruit additional licenced pharmacists from the market.

Our Directors confirm that we will have a licensed pharmacist in each of our chain pharmacies in order to comply with the new GSP requirements mentioned above. We regularly conduct training programmes related to health products, pharmaceutical products, nutritional information and sales skills for our sales staff and pharmacists in order to ensure that they have sufficient knowledge and understanding on our products available for sale in our chain pharmacies and be able to give correct information to our customers.

The following diagram illustrates the business model and operating process of our chain pharmacies:



To ensure smooth operation of our chain pharmacies, we have installed an information system in all our chain pharmacies, which provides real-time operational data such as our inventory levels and product sales information. The information system of each chain pharmacy is connected to our head office, which allows our management to have a quick analysis on the sales performance and monitoring of the inventory level of each pharmacy as well as the sales trends of different types of products.

Procurement of products for sale in the chain pharmacies

Our sales and marketing department will work with our accounting department for the preparation of a sales forecast for each month in the succeeding year, by making reference to, *inter alia*, the actual sales performance of the current year and anticipated changes in market trends. Based on the sales forecast, our procurement department will work out a procurement schedule for the sourcing of various types of products for the sale in our chain pharmacies. Our information system enables us to have real-time information on the inventory level of each pharmacy. Based on this, our procurement department will place purchase orders to suppliers on a timely basis to ensure that each chain pharmacy will have sufficient stock to meet customer demands from time to time. Our management will set a minimum stock level for each chain pharmacy based on its historical sales performance and taking into consideration our sales forecast and market trends. When the minimum stock level is reached, a stock replenishment order will be automatically generated by our information system. This stock replenishment order has to be reviewed and approved by the shop manager of individual pharmacy before submission to our head office. Our shop manager may adjust the quantities to be replenished according to the latest market demands on our products, when our store manager deems fit. Our procurement department can arrange for the delivery of products to our chain pharmacies within two days of receiving the stock replenishment orders.

Quality Inspection and warehousing

On the day the products are delivered to us by our suppliers, they are temporarily placed in the central inspection area where they will be checked by our quality inspection staff. Our quality inspection staff count and confirm the receipt of the correct quantity of the products and routinely perform quality control checks on random samples for defects and damages. Our staff strictly adhere to the GSP guidelines and inspect the physical appearance, packaging, labeling and the instruction manual of the products. Our staff will also check the respective expiry dates of the pharmaceutical products and reject any products which will expire in the next 12 months. Unless the products are required to be delivered to the pharmacies shortly after their arrival, they will be stored in our centralised warehouse.

Inventory management

We manage our inventory with a focus on controlling our inventory holding costs and maintaining the variety of products available for sale in our chain pharmacies. On a monthly basis, we perform analysis on the sales performance and inventory level of each chain pharmacy by using the operational data collected by our information system, which in turn optimises the stock level of

each chain pharmacy and minimises the stock aging problems. We perform stocktaking every month to verify the record of inventory level of our head office and each chain pharmacy. Any inventory discrepancies discovered during each stocktake will be followed up and reported to the general manager of our chain pharmacy segment and our finance department.

Free delivery services

We provide 24-hour free delivery services within the urban area of Zhongshan. Our delivery team sends the ordered pharmaceutical products to customers within a short period of time upon receipt of our customer orders. As at the Latest Practicable Date, to the best knowledge of our Directors, we are the only pharmacy which provides free delivery service in Zhongshan. Hence, this service has enhanced the reputation and popularity of our chain pharmacies in the local community of Zhongshan.

Methods of payment and cash management

We offer a variety of methods of payment including cash, debit cards, credit cards and medical insurance cards. Our information system records every transaction that occurs in our chain pharmacies. We have implemented a set of cash control procedures to manage the collection and handling of cash payments.

The cashier and shop manager in each pharmacy are responsible for counting cash received and ensuring the accuracy thereof. We generally require each pharmacy to deposit all cash received into our designated bank accounts on a daily basis and to conduct a daily reconciliation of sales records in the information system with the bank-in cash.

During the Track Record Period, we had not experienced any misappropriation of cash by our employees, customers or other relevant third parties that had a material adverse impact on our business and results of operations.

We also receive reimbursements from the social security bureau for the sales transactions settled by medical insurance cards.

Product return policy

We recognise revenue from the sale of products to our retail customers in our chain pharmacies when the products are sold. Generally, products sold to our retail customers are not refundable except for product quality reasons. Sales returns from our retail customers amounted to approximately RMB0.3 million, RMB0.5 million and RMB0.6 million for each of the three years ended 31 December 2014, respectively.

Retail Product Portfolio

Our goal is to provide a wide variety of high quality pharmaceutical and healthcare products in our chain pharmacies so that customers can choose products with similar functions or therapeutic purposes at different price ranges at convenient store locations, with pharmaceutical-related advisory services provided. We offer both own-branded products and non-own branded products procured from third party manufacturers and suppliers for sale in our chain pharmacies. The revenue of our chain pharmacies was mainly generated from the sale of non-own branded products during the Track Record Period. We sold over 4,000 non-own branded products including Chinese patent medicines, Western medicines, medical devices and healthcare products (such as vitamins, mineral supplements and protein powder) sourced from independent GMP certified pharmaceutical manufacturers or GSP certified suppliers (including distributors and pharmaceutical wholesalers). During the Track Record Period, the sales of both own-branded products and non-own branded products in our chain pharmacies were not affected by seasonality.

The following table sets forth the revenues generated from the sale of our own-branded and non-own-branded products and their respective percentages to the total revenue generated by our chain pharmacies for the periods indicated:

	For the year ended 31 December					
	2012		2013		2014	
	Revenue		Revenue		Revenue	
	RMB'000	%	RMB'000	%	RMB'000	%
Own-branded products	54,307	22.9	66,090	24.0	71,269	23.7
Non-own branded products	183,505	77.1	209,453	76.0	229,456	76.3
Total	237,812	100.0	275,543	100.0	300,725	100.0

The table below sets forth the details of the main categories of our products (both own-branded products and non-own branded products) and the number of product types and certain major products in each category that are offered in our chain pharmacies:

Product category	Number of products types *(Note)*	Certain major products within each category
Chinese patent medicines	Own-branded: 33	Cough and Cold: Cough Tablet* (克咳片), Yinhuang Granules* (銀黃顆粒), Compound Indigowoad Root Granules* (複方板藍根顆粒)
	Non-own branded: 1,111	Digestive system: Compound Vitamin U Tablets* (複方維生素U片), Wanglaoji Po Chai Pills* (王老吉保濟丸)
		Children: Seven Star Tea* (小兒七星茶), Comfort Children Granules* (保兒安顆粒)
		Bone and Joint: Caoqinghua Pain Relief Capsules* (薏辛除濕止痛膠囊(曹清華)), Axe Brand Red Flower Oil* (斧標正紅花油)
Western medicines	All non-own branded: 1,232	Anti-biotics: Valaciclovir Hydrochloride Tablets* (鹽酸伐昔洛韋片) (麗珠威), Itraconazole Capsules* (伊曲康唑膠囊)
		Cardiovascular system: Compound Red Sage Root Dripping Pills* (複方丹參滴丸), Simvastatin Tablets* (舒降之)
		Respiratory system: Montelukast Sodium Chewable Tablets* (孟魯司特鈉咀嚼片(順爾寧)), Theophylline Sustained-release Tablets* 茶鹼緩釋片(舒弗美)
Medical devices	All non-own branded: 497	Defervescence patch* (退熱貼), electronic blood pressure meter* (電子血壓計)
Healthcare products	All non-own branded: 209	Donkey-hide gelatin* (阿膠), vitamin tablets, protein powder, fish oil softgel capsules
Decoction pieces (including traditional decoction pieces and modern decoction pieces)	Own-branded: 158	Frutukkarua currgisa* (川貝), dendrobium* (石斛), Chinese wolfberries* (枸杞王), dendrobium modern decoction pieces* (石斛破壁飲片), sanqi modern decoction pieces* (三七破壁飲片), red sage root modern decoction pieces* (丹參破壁飲片)
	Non-own branded: 956	Shaxi herbal tea* (沙溪凉茶), red ginseng* (紅參), caterpillar fungus* (冬蟲夏草)
Others	All non-own branded: 282	Personal care products: Toothpaste, deodorant, shampoo

Note: Figures provided are approximate figures.

The revenue generated from the sales of our top ten products in our chain pharmacies amounted to approximately RMB21.8 million, RMB22.5 million and RMB24.3 million for each of the three years ended 31 December 2014, accounting for approximately 9.2%, 8.2% and 8.1% of our total revenue generated from our chain pharmacies operations, respectively. We regularly review the sales trend of individual products and adjust the product mix if necessary.

Pricing of our products offered for sale in our chain pharmacies

In general, we price our products offered for sale in our chain pharmacies on a cost plus basis with reference to the prevailing market condition such as changing demands from customers, availability of comparable products in the market and prevailing competitions with other pharmacies. For some non-own branded products being sold in our chain pharmacies, we set the retail prices with reference to the recommended prices, if any, provided by the relevant suppliers.

Government Policies affecting the pricing of pharmaceutical products

(i) *National Medical Insurance Drugs Catalogue, Provincial Medical Insurance Drugs Catalogue and National List of Essential Drugs and the notice in the price of "low-price drugs" issued by the NDRC*

During the Track Record Period, some of the products sold in our chain pharmacies were included in the National Medical Insurance Drugs Catalogue, Provincial Medical Insurance Drugs Catalogue and/or National List of Essential Drugs and/or subject to other relevant policies. Hence, the retail prices of these products were subject to the government price controls in the form of fixed prices or retail price ceilings, which in turn affected our pricing for these products for sale in our chain pharmacies. Pursuant to the Drug Pricing Reform Notice, except for anesthetic and certain psychiatric drugs, the price controls on all pharmaceutical products were lifted with effect from 1 June 2015. As we do not sell any anesthetic or psychiatric drugs in our chain pharmacies, all pharmaceutical products being sold in our chain pharmacies are not subject to any government price control. Subject to the prevailing market conditions, such as demands, pricing and competition, we may consider (i) manufacturing and selling those of our own-branded Chinese patent medicines which were previously subject to the PRC government price control and had already been approved for production by the relevant government authorities and registered with the CFDA, but had not been manufactured and launched in the market due to the low profit margin; and/or (ii) selling in our chain pharmacies those pharmaceutical products which were previously subject to price controls and not sold by us in order to broaden our product portfolio.

As at the Latest Practicable Date, amongst our own-branded Chinese patent medicines, eight and 22 of which are respectively listed on Part A and Part B of the National Medical Insurance Drugs Catalogue whereby the participants of the National Medical Insurance Programme are entitled to reimbursement of the entire purchase amount for medicines listed on Part A or part of the purchase price for medicines listed on Part B. For details of the National Medical Insurance Programme, please refer to the paragraph headed "Regulation — Catalogue and Price Controls of Pharmaceutical Products — The National Medical Insurance Programme" in this [REDACTED].

For each of the three years ended 31 December 2014, the respective revenue generated from the sale of our own-branded Chinese patent medicines listed on Part A and Part B of the National Medical Insurance Drugs Catalogue was approximately RMB82.7 million and RMB16.6 million; RMB83.5 million and RMB21.8 million; and RMB83.0 million and RMB19.8 million, respectively. Of the total revenue from Part A and Part B medicines, approximately RMB5.2 million, RMB5.3 million and RMB6.1 million were derived from sales in our self-operated chain pharmacies.

(ii) *The policy of preferential price pharmacies implemented by the Price Control Administration of Guangdong Province (*廣東省物價局*)*

The selection of preferential price drugs is catered for the demands of the general public for certain pharmaceutical products, such as drugs for treatment of common diseases and chronic diseases. The preferential price drugs therefore have to be offered at some of our chain pharmacies which are designated as preferential price pharmacies* (藥品平價商店) at a price which is about 5% to 10% lower than the selling price in nearby pharmacies. As at the Latest Practicable Date, 32 of our chain pharmacies out of a total of 44 designated pharmacies in Zhongshan were preferential price pharmacies. For each of the three years ended 31 December 2014, we recorded revenue from our preferential price chain pharmacies of approximately RMB86.3 million, RMB92.6 million and RMB98.4 million, representing for approximately 36.3%, 33.6% and 32.7% of our total revenue derived from our chain pharmacies operations, respectively. Gross profit for these preferential price chain pharmacies were approximately RMB36.4 million, RMB43.3 million and RMB47.1 million for the corresponding periods.

We receive government subsidies every year from the Ministry of Finance of Zhongshan (中山市財政局) in this regard, which amounted to approximately RMB0.81 million, RMB0.96 million and RMB0.61 million for each of the three years ended 31 December 2014, respectively. The negative impact on our revenue due to the difference in prices for preferential price drugs for the respective years amounted to approximately RMB2.3 million, RMB2.1 million and RMB1.9 million, respectively. Though the amounts of subsidies could not make up the difference in prices for preferential price drugs, our Directors believe that being accredited as preferential price pharmacies would help promote customers' awareness of our chain pharmacies and attract more customers to our chain pharmacies for purchase of preferential price drugs and other products.

Price Ranges

The table below sets forth the price ranges of major categories of our products sold in our chain pharmacies as at the Latest Practicable Date.

Product category	Price ranges *(Note)*
Chinese patent medicines	RMB1.5 to RMB1,986.0
Western medicines	RMB0.8 to RMB1,336.0
Decoction pieces	RMB1.1 to RMB22,980.0
Healthcare products	RMB1.5 to RMB1,488.0

Note: The price ranges are based on the smallest individual package as one unit and are inclusive of value added tax.

Suppliers of our chain pharmacies

We sourced merchandises from over 200 independent pharmaceutical manufacturers, wholesalers and distributors for sale in our chain pharmacies during the Track Record Period.

Selection of suppliers

Our Group only selects suppliers which are either GMP certified pharmaceutical manufacturers or GSP certified wholesalers and distributors taking into account their product quality, price competitiveness and past track records. We maintain a list of suppliers which are approved by our management. Our procurement department is required to make purchases only from those suppliers on our approved list. All our suppliers are in the PRC, including reputable pharmaceutical corporations such as Shandong Dong-E E-jiao Co., Ltd* (山東東阿阿膠股份有限公司) and Jointown Pharmaceutical Group Co., Ltd.* (九州通醫藥集團股份有限公司). Our procurement department reviews the approved list of suppliers on a regular basis.

The general manager and vice general manager of our chain pharmacy operations are responsible for the approval of pharmaceutical products to be put on sale in our chain pharmacies. New products are subject to a 3-month trial period. We will continue to sell these new products if they meet our criteria such as having a satisfactory market response and meeting an expected sales target.

As we have a wide network of suppliers, we are not reliant on any single supplier. We believe that alternative suppliers or alternative products are readily available for all of the products we source and, thus, the loss of any one supplier or one product for sale would not have any material effect on our chain pharmacy operations. During the Track Record Period, we did not experience any significant difficulties in maintaining reliable sources of supply, and we expect that we would be able to maintain adequate sources of supplies of pharmaceutical and other products to be sold in our chain pharmacies.

We generally enter into framework supply agreements with our major suppliers. These framework supply agreements are provided by the suppliers and therefore contain different terms and conditions as required by different suppliers. The following table sets forth the general terms contained in most framework supply agreements:

Principal terms	Summary
Term	One year and is renewable subject to negotiation
Types of products specified	Yes
Payment terms	Not exceeding 60 days upon delivery
Minimum purchase amount	• Yes, but applicable to some framework supply agreements only • No penalty clause for non-fulfillment of the minimum purchase amount
Recommended Price	Yes, but applicable to some framework supply agreements only
Delivery of products	Suppliers are generally responsible for delivering the products to our designated warehouse in Zhongshan
Sales return	Yes, but only due to quality reasons
Termination	The agreement will be terminated upon happening of certain events such as overdue payment, our failure to obtain requisite licences and permits, our non-compliance of the agreed sale policy (if any) and selling of counterfeit products
Exclusive distribution right	Yes, but applicable to some framework supply agreements only

We require the suppliers of our chain pharmacies (including manufacturers and distributors of the non-own branded products) to enter into quality assurance agreements with us before we purchase from them. Pursuant to the quality assurance agreement, the supplier agrees to, among other things, be responsible for all liabilities due to product defects including, but not limited to, indemnifying us and our customers for all losses, damages and personal injuries resulted from the quality of their products. In the case where the pharmaceutical products supplied to us are imported from overseas, the relevant supplier shall also provide a quality report issued by the relevant authority of the pharmaceutical products' place of origin or the import permit approving the importation of pharmaceutical products to the PRC. There is no restriction that our Group can claim against the suppliers for all losses and damages arising from any defect of the non-own branded products supplied to us.

Marketing and Promotion of our chain pharmacies

Leveraging on over ten years of experience in chain pharmacies operations in Zhongshan, we have acquired an in-depth understanding on the needs and preferences of the customers in Zhongshan. We have also established proven marketing strategies to promote our chain pharmacies

including advertising in newspapers and the internet, billboards and banners. We have also launched a wide range of marketing activities including gift packs and online sales to promote our chain pharmacies and the "Zeus (中智)" brand.

Online Sales

Our online sales platform 中智藥房網 *www.zzdyf.cn* was launched in August 2014 for the sale of our own-branded products. We obtained the internet medicine dealership certificate (互聯網藥品交易服務資格證書) and internet medicine information service certificate (互聯網藥品信息服務資格證書) on 13 January 2014, pursuant to which we are allowed to sell pharmaceutical products, healthcare products and health supplements through internet. Our Directors believe that our online platform can further promote our "Zeus (中智)" brand and expand the retail sales of our own-branded products. For each of the three years ended 31 December 2014, our revenue from online sales amounted to approximately RMB0.1 million, RMB0.4 million and RMB0.4 million, respectively. Our online sales revenue prior to the launch of our online sales platform in August 2014 was derived from independent PRC online trading platforms.

Gift packs

We offer a range of gift packs of assorted decoction pieces for different intended functions such as for health maintenance and beauty and energising purposes targeting for the high-ended market. As at the Latest Practicable Date, we had six types of gift packs, such as the Zeus Wellbeing Formula* (中智養生方) and the Zeus Blood Nourishment Formula* (中智補血方).

We believe that through these marketing and promotional activities, we can increase public awareness of our "Zeus (中智)" brand and reputation, which in turn has a positive effect on our business operation and profitability.

RECENT BUSINESS DEVELOPMENT

As at the Latest Practicable Date, we had obtained the business licence for the production and distribution of food products and relevant food production licences for the manufacturing of three kinds of food products, namely the granulated siraitia grosvenorii (羅漢果), granulated rose petals (玫瑰) and granulated Chinese hawthorn (山楂). These products are processed from traditional decoction pieces manufactured by us and granulated by using our patented techniques which are currently used for our production of modern decoction pieces and are readily used for oral consumption.

Our food products will be sold in our self-operated chain pharmacies and supermarkets in the PRC. As at the Latest Practicable Date, all of our self-operated chain pharmacies had obtained the relevant food circulation permit (食品流通許可). We also intend to tap into the food product market through the sale of our food products to supermarkets with a focus on the Guangdong province at the inception stage. We had commenced to manufacture small quantities of food products, which had been launched in our self-operated chain pharmacies in June 2015 to test the

market response. Based on the market response, we will formulate our sales and marketing strategy and gradually roll out our food products. Apart from the regulatory requirements as set out in the paragraph headed "Regulation — Manufacturing and distribution of food products" in this [REDACTED], our Directors are not aware of any regulatory restrictions on our production and distribution of food products.

OUR GROUP'S CUSTOMERS

Our Group's customers include distributors, and independent chain pharmacies and customers of our chain pharmacies in Zhongshan.

During the Track Record Period, our top five customers were Independent Third Parties in our pharmaceutical manufacturing segment. For each of the three years ended 31 December 2014, our sales to our five top customers accounted for approximately 8.5%, 8.7% and 13.7% of our total revenue, respectively. In the corresponding periods, our sales to our largest customer accounted for approximately 3.1%, 2.7% and 4.6% of our total revenue, respectively. None of our Directors, their respective associates, and existing Shareholders hold more than 5% of our issued share capital or have any interest in any of our five largest customers during the Track Record Period.

The tables below set out the basic information of our top five customers during the Track Record Period:

For the year ended 31 December 2012:

	Major products sold to the customer	Business relationship since	Business nature of the customer	% to total revenue of our Group (approximate)
Jointown Pharmaceutical Group Co., Ltd.* (九州通醫藥集團股份有限公司)	Chinese patent medicines	2003	Distribution of pharmaceutical products	3.1
Customer A	Chinese patent medicines	2007	Distribution of pharmaceutical products	1.5
Customer B	Chinese patent medicines	2004	Distribution of pharmaceutical products	1.4
Customer C	Chinese patent medicines	2003	Distribution of pharmaceutical products	1.3
Customer D	Chinese patent medicines	2011	Distribution of pharmaceutical products	1.2

For the year ended 31 December 2013:

	Major products sold to the customer	Business relationship since	Business nature of the customer	% to total revenue of our Group (approximate)
Jointown Pharmaceutical Group Co., Ltd.* (九州通醫藥集團股份有限公司)	Chinese patent medicines	2003	Distribution of pharmaceutical products	2.7
Customer B	Chinese patent medicines	2004	Distribution of pharmaceutical products	1.9
Customer C	Chinese patent medicines	2003	Distribution of pharmaceutical products	1.7
Guangdong Focus Pharmaceutical Co., Ltd.* (廣東福卡斯藥業有限公司)	Modern decoction pieces	2013	Distribution of pharmaceutical products	1.6
Zhaoqing Bangjian Pharmaceutical Co., Ltd.* (肇慶邦健醫藥有限公司)	Chinese patent medicines and modern decoction pieces	2004	Distribution of pharmaceutical products	0.8

For the year ended 31 December 2014:

	Major products sold to the customer	Business relationship since	Business nature of the customer	% to total revenue of our Group (approximate)
Yunnan Hongxiang Yixintang Pharmaceutical Co., Ltd.* (雲南鴻翔一心堂藥業(集團)股份有限公司)	Modern decoction pieces	2014	Operation of chain pharmacies	4.6
Customer B	Chinese patent medicines	2004	Distribution of pharmaceutical products	2.8
Guangdong Dongguan Guoyao Group Co., Ltd.* (廣東省東莞國藥集團有限公司)	Chinese patent medicines	2005	Distribution of pharmaceutical products	2.8
Jointown Pharmaceutical Group Co., Ltd.* (九州通醫藥集團股份有限公司	Chinese patent medicines	2003	Distribution of pharmaceutical products	2.2
Customer C	Chinese patent medicines	2003	Distribution of pharmaceutical products	1.3

During the Track Record Period, we did not have any material disputes with our customers.

OUR GROUP'S SUPPLIERS

We source Chinese herbs, packaging materials and ancillary materials from our suppliers for the manufacturing of our pharmaceutical products as well as non-own branded products for sale in our chain pharmacies. We maintain a list of approved suppliers and conduct ongoing reviews on these suppliers and remove those who cannot satisfy our quality or other requirements. Details of

evaluation procedures on our suppliers are set out in the paragraph headed "Business — Quality control" in this [REDACTED]. We generally have alternative sources of supply for all of our products thus the loss of any single supplier would not have a material impact on our operations.

Our suppliers generally grant a credit period of not exceeding 60 days to us and we are allowed to settle our purchase amounts in cash or by way of bank acceptance notes.

For each of the three years ended 31 December 2014, total purchases from our top five suppliers amounted to approximately RMB65.2 million, RMB89.3 million and RMB88.7 million, respectively, representing approximately 30%, 36.5% and 40% of our total costs of purchase for the corresponding periods. For each of the three years ended 31 December 2014, our purchases from our largest supplier, accounted for approximately 9.5%, 10.3% and 12.6% of our total costs of purchase, respectively. All our suppliers are domestic suppliers except that we have imported small quantity of American ginseng in 2014 from Canada in the sum of approximately RMB4.9 million.

None of our Directors, their respective associates, and existing Shareholders hold more than 5% of our issued share capital or have any interest in any of our five largest suppliers during the Track Record Period.

The following tables set forth certain information about our top five suppliers during the Track Record Period:

For the year ended 31 December 2012:

	Major products procured from the supplier	**Business relationship since**	**Business nature of the supplier**	**% to total costs of purchase of our Group (approximate)**
Customer B *(Note)*	Pharmaceutical products	2004	Distribution of pharmaceutical products	9.5
Jointown Pharmaceutical Group Co., Ltd.* (九州通醫藥集團股份有限公司) *(Note)*	Pharmaceutical products	2003	Distribution of pharmaceutical products	6.7
Zhongshan Lianfeng Sugar Refinery Co., Ltd.* (中山市聯豐煉糖有限公司)	Sucrose	2010	Distribution of sugar and sucrose	4.7
Supplier A	Chinese herbs	2010	Distribution of Chinese herbs	4.6
Guangdong Dongguan Guoyao Group Co., Ltd.* (廣東省東莞國藥集團有限公司)	Pharmaceutical products	2005	Distribution of pharmaceutical products	4.5

Note: The suppliers were also two of our top five customers for the year.

For the year ended 31 December 2013:

	Major products procured from the supplier	Business relationship since	Business nature of the supplier	% to total costs of purchase of our Group (approximate)
Customer B *(Note)*	Pharmaceutical products	2004	Distribution of pharmaceutical products	10.3
Supplier A	Chinese herbs	2010	Distribution of Chinese herbs	8.9
Jointown Pharmaceutical Group Co., Ltd.* (九州通醫藥集團股份有限公司) *(Note)*	Pharmaceutical products	2003	Distribution of pharmaceutical products	6.9
Customer C *(Note)*	Pharmaceutical products	2003	Distribution of pharmaceutical products	6.8
Jian Jiju Ginseng Co., Ltd." (集安市吉聚參業有限公司)	Chinese herbs	2013	Operation of Chinese herbs plantation bases	3.6

Note: The suppliers were also three of our top five customers for the year.

For the year ended 31 December 2014:

	Major products procured from the supplier	Business relationship since	Business nature of the supplier	% to total costs of purchase of our Group (approximate)
Customer B *(Note)*	Pharmaceutical products	2004	Distribution of pharmaceutical products	12.6
Customer C *(Note)*	Pharmaceutical products	2003	Distribution of pharmaceutical products	10.7
Jointown Pharmaceutical Group Co., Ltd.* (九州通醫藥集團股份有限公司) *(Note)*	Pharmaceutical products	2003	Distribution of pharmaceutical products	8.9
Supplier A	Chinese herbs	2010	Distribution of Chinese herbs	4.4
Shandong Dong-E E-jiao Co., Ltd* (山東東阿阿膠股份有限公司)	Healthcare products	2002	Manufacturing and trading of healthcare products	3.4

Note: The suppliers were also three of our top five customers for the year.

Overlap between customers and suppliers

During the Track Record Period, two, three and three of our top five customers were also among our top five suppliers for the year ended 31 December 2014. Our sales to these parties were approximately RMB18.7 million, RMB30.0 million and RMB37.4 million and our purchases from them were approximately RMB35.3 million, RMB58.6 million and RMB71.5 million for each of the three years ended 31 December 2014, respectively. These parties contributed approximately 4.5%, 6.3% and 6.3% respectively to our total revenue for each of the three years ended 31 December 2014. They are long-established and sizeable pharmaceutical products distributors in the PRC with over ten years of establishment up to the Latest Practicable Date. These suppliers are GSP certified distributors of pharmaceutical products. They purchase our own-branded products for further

distribution through their distribution network and we also purchase products from them including decoction pieces for our manufacturing as well as pharmaceutical products for sale in our chain pharmacies.

Return of products to suppliers

According to the terms of various agreements with the suppliers, our suppliers allow us to return any raw materials we purchased for manufacturing our own-branded products which are contaminated or damaged, or fail to meet our specified quality standards. As for non-own branded products to be put on sale in our chain pharmacies, we cannot return the products to the suppliers save for those due to quality reasons or the expiration of their effective dates after mutual consultation or inspection by the independent third party professional inspection agency. During the Track Record Period, we did not experience any material return of supplies due to quality problems or any shortage or delay in the delivery of raw materials that would have a material adverse effect on our operations or performance.

QUALITY CONTROL

We believe that the quality of our products is crucial to our continued success. We place strong emphasis on achieving a consistently high quality for the products to be sold under both our pharmaceutical manufacturing and chain pharmacy operations. Our quality control department is responsible for formulating our Group's quality control policy which sets out guidelines in accordance with the respective requirements of GMP and GSP, covering various key steps from procurement, production, storage to sales and distribution of pharmaceutical products. Our quality control department is also responsible for ensuring that we are in compliance with all applicable regulations, standards and internal policies at all times. Our senior management team is actively involved in setting quality policies and managing internal and external quality performance. As at the Latest Practicable Date, our quality control department consisted of 73 employees.

As a result of our stringent quality control procedures, we had not experienced any claims, litigations and arbitrations or material adverse findings in inspection by government authorities with respect to the quality of our own-branded products and non-own branded products during the Track Record Period.

We generally do not allow product returns in both business segments, except for quality reasons. Our suppliers in both business segments generally provide quality assurance and shall bear all liabilities if we become aware of any quality issues. During the Track Record Period, we had not experienced any product recall on our own-branded products. Our Group's sales return was all related to our chain pharmacies operation and amounted to approximately RMB0.3 million, RMB0.5 million and RMB0.6 million, representing approximately 0.1%, 0.1% and 0.1% of our total revenue for each of the three years ended 31 December 2014, respectively. For non-own branded products, we returned the defective products to our suppliers for further handling.

Pharmaceutical manufacturing

We implement stringent quality control measures throughout the production process to ensure the quality and safety of our pharmaceutical products. We have established a quality control system in accordance with the relevant PRC laws and regulations and both of our production plants are GMP certified. Our quality control measures cover every stage of our production process and all factors that would influence the quality of our pharmaceutical products. The following table sets forth the key requirements under the GMP standards in the PRC, how our operations comply with such standards and how we ensure that our pharmaceutical products are consistently manufactured in accordance with their respective registration requirements, and are suitable for intended use.

Requirements under GMP standards	Corresponding measures taken by our Group for compliance with the GMP standards
Organisation and key personnel:	
The manufacturer should establish a management structure and has an organisation chart. The quality control department should be independent from other departments to carry out responsibilities of quality assurance and quality control.	We have established a comprehensive organisational structure according to the GMP standards. Our quality control team consists of a quality assurance division and a quality control division, both of which are completely independent from the production team. It is responsible for the quality control matters as required by the GMP standards such as formulating internal quality control guidelines, selecting suppliers, monitoring the entire production process and conducting annual review.
The head of production management should, at a minimum, possess a college degree in pharmaceutical or relevant specialties, with at least three years of practical experience in pharmaceutical production and quality management, among which at least one year in production management, with necessary training relating to the products being manufactured.	The general managers of Zhongzhi Herb Pieces and Honeson Pharmaceutical possess the required academic background and experience. For details of their biographies, please refer to the paragraph headed "Directors and Senior Management — Senior management" in this [REDACTED].
Production plants and facilities:	
The location, design, lay-out, construction, adaption and maintenance of premises should suit the drug production requirements, and should minimise the risk of contamination, cross-contamination, mixups and errors, as well as permit effective cleaning, operation and maintenance	We separate production areas for different products and clean the production areas immediately after completion of each batch of production to avoid contamination, mix ups and error. All production staff are required to wear production uniform, working caps and shoes. Access to our production line is under strict control and each production staff member is assigned to designated post(s) of a production line.

Requirements under GMP standards	Corresponding measures taken by our Group for compliance with the GMP standards
Equipment:	
The design, selection, installation, adaption and maintenance of equipment should be suitable for its intended use, minimise the risk of contamination, cross-contamination, mixups or errors, and facilitate operation, cleaning, maintenance, as well as disinfection or sterilisation if necessary	We manage the entire life cycle of each piece of production equipment according to such requirements. We have established procedures for the use, cleaning, maintenance and repair of the equipment. The activities of each phase are documented, recorded and achieved.
Procurement of raw materials and packaging materials:	
Quality assessment should be performed for the determination and change of material suppliers, and procurement can only be carried out after the suppliers have been approved by quality control department.	Our quality control staff reviews the qualifications of our raw material suppliers both before and after engaging them. We require our suppliers to provide documents in respect of compliance including their business licences, manufacturing permits, import registration certificates, GMP or GSP certificates or other related documents. Our procurement department can only procure raw materials from suppliers on the approved list. All raw materials (in particular Chinese herbs) are tested for the level of pesticide residues, heavy metals and harmful elements contamination in accordance with the requirements laid down in the Chinese Pharmacopoeia or Drug Standards, whereby laboratory reports are issued regarding the raw materials. We also visit regularly the plantation bases that supply Chinese herbs to us for ensuring the quality of their Chinese herbs. For detail of our suppliers of Chinese herbs, please refer to the paragraph headed "Business — Pharmaceutical manufacturing — Raw materials and suppliers — Suppliers of Chinese herbs" in this [REDACTED].
Management of quality control laboratories:	
The personnel, facilities, and equipment in the quality control laboratories should be appropriate to the tasks imposed by the product nature and the scale of the manufacturing operations	We have one quality control laboratory in each of our two production plants. The head and other senior members of our quality control team possessed appropriate qualifications and experience in managing laboratories. Necessary reference books such as the Chinese Pharmacopoeia or Drug Standards, and primary reference substances are available in quality control laboratories.

Requirements under GMP standards	Corresponding measures taken by our Group for compliance with the GMP standards
The head of the quality management should, at a minimum, possess a college degree in pharmaceutical or relevant specialties, with at least five years of practical experience in pharmaceutical production and quality management, among which at least one year in quality management, with necessary training relating to the products being manufactured.	The head of our quality control department is a licensed pharmacist and obtained a degree in pharmacy and possesses relevant experience in pharmaceutical production and quality management.
Documents management:	
Each batch of pharmaceutical products shall have a corresponding batch production record that allows one to trace the product batch's production history.	Each batch of our products has a corresponding serial number, which contains details of the key information of each stage of production to ensure the traceability of its production process, such as date, product name, batch number, the operating staff, the quality assurance staff, production procedures and quality indicators of the intermediate products in various phases and quality indicators of the finished products.
Production Management:	
An enterprise shall establish operation procedures to differentiate different batches of pharmaceutical products and ensure that pharmaceutical products of the same batch have consistent quality and features.	Our quality control staff members are responsible for overseeing our quality control procedures in the course of production of our products. Intermediate products are sample tested after each stage of the production process to ensure their compliance with GMP requirements and our quality standards. Only those products which pass the quality testing processes can proceed to the next stage of production. Defective intermediate products are taken out from the production lines and then repossessed or destroyed based in the views of our production department. We perform quality checks on samples from each batch of finished products to ensure that the products can satisfy our required standards. Product approval certificate and quality assurance report are issued with each batch of completed products which pass the inspection and obtain approval from our quality control team. Our warehouses only release products that obtain both the product approval certificate and the quality assurance report. Finished products that fail to meet our quality standards will be destroyed.
Finished Products	
Finished products should be stored under conditions in accordance with the approved specifications of drug registration.	All finished products are stored separately in our warehouses according to the approved specifications of relevant registration of the products.

In addition to the strict compliance of the GMP standards in the production of our products as set out above, to ensure that the quality of the Chinese herbs can meet our requirements for production, we had, in collaboration with Central South University* (中南大學), built up and registered the copyright of the "Zeus Chinese Medicine Fingerprint Quality Control Database System Abbreviated Form: ZEUSys V1.0* 中智中藥指紋圖譜質量控制數據庫系統 簡稱: ZEUSys" V1.0 (the "**ZEUSys**"). ZEUSys is a data base containing the fingerprints, characteristics and components of different kinds of Chinese herbs. These information help us identify the regional species, source, collection period, processing method and toxicity (if any) of the Chinese herbs, thus ensuring that the quality and stability of different batches of Chinese herbs to be used for production can meet our quality standard. The copyright of this ZEUSys is jointly owned by both Central South University* (中南大學) and us. Pursuant to the collaboration agreement entered into between Central South University* (中南大學) and our Group, Central South University is not entitled to any profits arising from the use of this copyright.

Operation of chain pharmacies

Our operation of chain pharmacies follows the GSP requirements. Our quality control system provides quality standards and operating procedures for different aspects of our business, including product purchases, quality inspections before products are arranged to be stored in our warehouses and quality checks before products exit our warehouses. The following table sets forth the key requirements under the GSP standards in the PRC and how our operations comply with such standards.

Requirement under GSP standards	Corresponding measures taken by our Group for compliance with the GSP standard
Personnel and Training:	
The personnel of enterprise engaging in drug operation and quality control shall comply with the requirements of relevant laws and regulations and the GSP on qualification	We provide pre-job training and continuing on-the-job training relating to the responsibilities and scope of work to the personnel on each position. Our quality control staff regularly visit our pharmacies in order to monitor the service quality of individual chain pharmacy and ensure that their operations comply with the requirements of relevant laws and regulations and the GSP qualification. We will analyse the feedback received during these inspections when determining employee promotions or bonuses. Each of our chain pharmacies has at least one in-store licensed pharmacist or pharmacist.
Facilities and Equipment:	
Enterprises shall have operation sites and warehouses that suit the operation range and scale of the drugs	Our location, design, layout, construction, and maintenance of warehouse meet the requirements on drug storage and prevent contamination of drugs, cross-contamination of drugs, confusions and errors. We provide adequate equipment in our warehouse including equipment for automatic monitoring and recording of warehouse temperature and humidity, special storage place for nonconforming drugs and appropriate lighting devices and installations.

Requirement under GSP standards	Corresponding measures taken by our Group for compliance with the GSP standard
Procurement:	
The purchase activities of enterprises shall meet the following requirements: (i) determine the legal qualification of supplier; (ii) determine the validity of the drugs purchased; (iii) verify the legal qualification of the sales personnel of supplier; and (iv) sign quality assurance agreement with supplier	We require our suppliers to provide copies of all relevant licences and certificates including business licence, annual inspection certificate, GMP or GSP certificates and pharmaceutical production licence. We require evidential documents for drug manufacturing affixed with the original official seal of supplier. We verify the legal qualification of the sales personnel and sign quality assurance agreement with suppliers. We conduct spot quality inspections of each batch of products we receive. We promptly replace our suppliers if they fail to pass our quality inspections.
Sales:	
Enterprises are required to maintain proper sales records of pharmaceutical products, including but not limited to product specification, dosage form, batch number, expiry date, manufacturer, sales quantity, unit price, sales amount and date of sale.	We have an information system to properly maintain the sales record of pharmaceutical products.

RESEARCH AND DEVELOPMENT

Overview

We consider research and development to be fundamental and essential to our continued development and future growth. We conduct our product research and development primarily through our in-house research and development team. We also collaborate with external research partners such as research institutions and universities. For each of the three years ended 31 December 2014, our research and development expenses amounted to approximately RMB10.8 million, RMB14 million and RMB11.2 million respectively.

During the Track Record Period and up to the Latest Practicable Date, our research and development projects are primarily aimed at (i) enhancing the quality and effectiveness of our existing pharmaceutical products; (ii) developing and expanding our pool of new pharmaceutical products; (iii) improving our production effectiveness and efficiency; and (iv) cultivating our research and development personnel.

In-house research and development

As at the Latest Practicable Date, our research and development team had over 14 personnel, including one doctorate degree holder and four master's degree holders. Most of our research staff members are experienced pharmaceutical engineers or licenced pharmacists in the PRC or have an experience of over seven years in pharmaceutical industry. These personnel are responsible for

(i) making recommendations to our senior management with respect to research scope and direction after reviewing the prevailing needs of general consumers and the market trends; (ii) coordinating and managing product development and research projects for collaborations with external research partners; (iii) conducting researches primarily for upgrading existing products; and (iv) conducting researches on Chinese patent medicines and decoction pieces. Our in-house research and development enables us to develop new pharmaceutical products at a comparatively low cost. As at the Latest Practicable Date, we had 29 invention patents (發明專利), one utility model patent (實用新型專利) and 15 design patents (外觀設計專利) registered in the PRC, 12 patents registered in Hong Kong and Macau, and had 33, six and 20 patent applications pending registration in the PRC, Taiwan and Hong Kong, respectively.

Our pipeline products under research and development are mainly new types of Chinese patent medicines for various curative functions and modern decoction pieces to be made of different types of Chinese herbs for health maintenance. As at the Latest Practicable Date, in addition to the 62 types of modern decoction pieces that had met the standards pronounced by the GFDA, we had developed 18 types of modern decoction pieces which were awaiting the approval from the GFDA, including snow lotus herb modern decoction pieces* (天山雪蓮破壁飲片), giant knotweed root modern decoction pieces* (虎杖破壁飲片) and common motherwort fruit modern decoction pieces* (益母草破壁飲片). As to Chinese patent medicines, we were currently developing shuanghuang gout capsules* (雙黃痛風膠囊) which was undergoing phase IIa of clinical trial.

Collaboration with external research partners

To strengthen our research and development capabilities, apart from our in-house research and development team, we have set up a research base with Guangzhou University of Chinese Medicine (廣州中醫藥大學) (the "**University**") for a term of five years commencing from July 2014 whereby, we agree to provide funding to the research base for nurturing professionals in Chinese medicine for a total sum not less than RMB1 million and separate co-operation agreement will be signed on individual research projects. In consideration thereof, the University agrees to use its best efforts to provide us with research support and we would have the first right to request the research base to conduct research and development on the particular subject requested by us and the first right of entitlement to its research findings and results.

We also entered into a technical support agreement with Institute of Chinese Materia Medica China Academy of Chinese Medical Sciences (中國中醫科學院中藥研究所) (the "**Institute**") in June 2014 with retrospective effect from May 2014 to December 2014, pursuant to which the Institute agreed to provide technical support to our research projects, i.e. the deoxyribonucleic acid (DNA) code of ginseng and American ginseng modern decoction pieces. The consideration payable to the Institute was RMB100,000. During the term of the technical support agreement, the intellectual property right of the research result should belong to us but any new technology resulted from the research shall be jointly owned by our Group and the Institute if the technology was developed by the Institute.

We also collaborate with various external research partners including research institutions and universities for our research and development of new products, their functions and effectiveness and new production techniques. The types of collaboration arrangements vary from project-based technical services and ad hoc consultancy to longer-term cooperation. Our research partners provide the necessary equipment, know-how and personnel. Our role, in addition to our participation in the entire research and development process, also includes the provision of necessary funding for these joint research and development projects. In addition, all of our research partners are bound by confidentiality obligations, which prohibit them from divulging any information relating to the products under development to third parties.

Pursuant to the collaboration agreements with our research partners, we have the sole proprietary rights or joint proprietary rights over the know-how, techniques, findings and results of the research projects.

Owing to our achievements in research and development activities, Zhongzhi Herb Pieces and Honeson Pharmaceutical had been accredited the status as a High and New Technology Enterprise* (高新技術企業) since 2003 and 2008 respectively, which entitled us to a preferential income tax rate of 15%. The current status of Zhongzhi Herb Pieces and Honeson Pharmaceutical as High and New Technology Enterprise and their entitlement to the reduced EIT rate will expire in 2017.

In April 2014, we were granted an approval to build a State-level laboratory for the development of "modern decoction pieces techniques and its application" by the State Administration of Traditional Chinese Medicine of the PRC (國家中醫藥管理局). We started to set up this laboratory in mid-2014 and was put into use by the end of 2014. This laboratory has a floor area of approximately 3,000 sq.m.

LOGISTICS

We outsource the transportation of most of the products developed and manufactured by us to qualified logistics companies for delivery outside Zhongshan. The transportation of products inside Zhongshan is undertaken by our logistics team. We generally select our logistics providers based on prices, reputations, transportation efficiencies, transportation capabilities and track records. We also require our logistics providers to possess valid transportation permits and other relevant qualifications to conduct their business. These outsourcing arrangements allow us to reduce our capital investment and the logistics companies bear the risks associated with the delivery of our pharmaceutical products.

ENVIRONMENT AND SAFETY MATTERS

Our operations and facilities are subject to environmental laws and regulations stipulated by the national and local environmental protection bureaus in the PRC. We obtained the Pollutant Emission Permit for Honeson Pharmaceutical and Zhongzhi Herb Pieces, which is valid from October 2010 till October 2015 and from February 2013 till February 2018, respectively. The pollutants generated from our production process mainly include waste water and waste gas. We

installed various types of pollution control equipment in our facilities to reduce, treat and recycle the waste generated in our production process. We also improve our production techniques in order to reduce the pollutants we discharge to the environment.

Our Directors confirm that our production facilities comply with all relevant environmental and manufacturing standards required by the GMP standards. As at the Latest Practicable Date, we had not been subject to any material environmental compliant or administrative penalties with respect to environmental violations. Our PRC Legal Advisors are of the opinion that we complied with all applicable environmental laws and regulations in all material respects during the Track Record Period. Our production facilities in the PRC are subject to regular inspections by environmental regulatory authorities. If these facilities are found to be not in compliance with the applicable environmental standards, we may be subject to penalties, which may range from fines to suspension from production. As the PRC legal system continues to evolve, we may be required to undertake significant expenditures in order to comply with environmental laws and regulations that may be adopted or imposed in the future. For each of the three years ended 31 December 2014, our total environmental compliance costs were approximately RMB46,000, RMB46,000 and RMB53,000, respectively. As at the Latest Practicable Date, we are not aware of any pending litigation or significant financial obligations arising from our current or past environmental practices that are likely to have a material adverse effect on our business operations and financial position. However, we cannot predict the impact that unforeseeable environmental contingencies or any new or amended laws or regulations which may affect us or our use of production facilities. For further information on the environmental laws and regulations governing our operations, please refer to the paragraph headed "Regulation — Environmental protection" in this [REDACTED].

The PRC government imposes a number of regulatory requirements on pharmaceutical companies with regard to employees' health and safety. We regard occupational health and safety as one of our important social responsibilities and have implemented safety guidelines at our production facilities, to which all employees are required to strictly adhere. We also conduct regular work place safety trainings for our employees and have dedicated personnel who are well-versed with the regulatory requirements applicable to our operation to monitor different stages of the production process to ensure work place safety.

Fire accident occurred during the Track Record Period

On 6 March 2013, there was an explosion occurred in the production plant of Zhongzhan Zeus Pharmaceutical Manufacturing Limited ("**Zeus Pharmaceutical**"). The incident had destroyed some of the production equipments and inventories and resulted in minor injuries of three workers. At that time, Zeus Pharmaceutical was engaged in the production of Chinese patent medicines. Our Group's other production processes and order deliveries had not been affected by the fire accident.

The Administration of Work Safety of Zhongshan Municipality* (中山市安全生產監督管理局) (the "**Authority**") conducted an investigation into this incident and issued a report on 29 March 2013 (the "**Report**"). The Report stated that the explosion was caused by excessively high concentration of alcohol in the furnace for drying the ingredients during the trial production of new products. According to the relevant PRC laws and regulations for production safety, this incident was a general production safety accident i.e. casualty of less than three or serious injuries of less than ten or direct economic loss below RMB10 million. Zeus Pharmaceutical was required to enhance its trainings and education on production safety and implement production safety system in order to ensure the production activities were carried out safely. The estimated loss on production equipments and inventories was approximately RMB1.6 million, which was fully covered by insurance of which claims were fully received in 2013. Zeus Pharmaceutical was deregistered on 15 July 2014 as its operations were taken over by Honeson Pharmaceutical.

Our PRC Legal Advisors are of the opinion that, during the Track Record Period, we complied with all relevant national or local occupational health and safety laws and regulations. Our Directors confirm that there were no accidents that resulted in the death or serious injury of our employees during the Track Record Period. Though we have maintained insurance policy related to the safety of our employees working in our production plants, there is no assurance that our insurance policies will be adequate to cover all losses incurred in the event of an accident or other unexpected event in the future. In such event, if the coverage of our existing insurance policies is not adequate, our financial condition and results of operations may be materially adversely affected. Please refer to the paragraph headed "Risk Factors — Risks relating to our business — Our insurance coverage may not completely cover the risks related to our business and operations" in this [REDACTED] for the associated risks.

EMPLOYEES

We strive to retain and recruit employees who share our commitment as a successful pharmaceutical enterprise. We offer competitive remuneration packages to attract and retain talented and experienced employees. We also provide various types of on-the-job training for all staff in order to ensure that our employees are able to understand and adapt to our Group's policies in an efficient manner. We have adopted our appraisal system in terms of individual employee's attendance, performance and ability.

As at each of the three years ended 31 December 2014, we had 1,761, 1,883 and 2,097 full-time employees, respectively. Set forth below is the distribution of our employees by function as at the Latest Practicable Date:

Function	Number
Production	315
Research and Development	14
Quality Control	73
Sales and Marketing	
— pharmaceutical manufacturing	326
— operation of chain pharmacies	1,235
Procurement	15
Logistics	65
Finance and Accounting	31
Information Technology	5
Others *(Note)*	177
Total	2,256

Note: Others include general administration and human resources.

Remuneration

The employees of our Group are generally remunerated by way of a fixed salary or basic salary plus incentives such as sales commission based on sales targets and sales proceeds recovery for distribution business. We have devised an appraisal system of our employees and we consider the appraisals of individual employees being effective for our salary reviews and making promotion decisions of individual employees.

Training

We had devised a comprehensive training system during the Track Record Period. We require our new employees to attend an orientation training program in order to provide pre-job trainings to them. From time to time we provide on-the-job training to our employees to improve their customer service skills, technical skills and product knowledge.

We regularly organise in-house training programs to our staff at different levels in our pharmacies to enhance their knowledge on our product features, functionalities and dosages so as to ensure that they are able to correctly respond to enquiries from retail customers and refer the enquires to our pharmacist stationed in each pharmacy.

By participating in our training programs, our employees' knowledge on our products, sales and communication skills and techniques would be enhanced. In respect of recruitment, we recruit new employees based on specific job requirements, our resources and needs from time to time.

Employee relationship

In accordance with the applicable laws in the PRC, a trade union was formed by our employees, and we have provided the necessary facilities and venues and other resources for the union to carry out its activities. We believe that we maintain good working relationships with our employees. During the Track Record Period, we had not experienced any strikes or any labour disputes with our employees which had or might have a material adverse effect on our business.

Anti-corruption and anti-bribery policies

As part of our risk management and internal control measures, we have the following policies applicable across our Group, including our subsidiaries:

— Our management is responsible for the formulation and execution of anti-corruption and anti-bribery policies and measures.

— We conduct an assessment of risks of corruption and bribery each year.

— We conduct background investigations, including educational backgrounds, work experiences, criminal records, of any person to be employed or promoted for key positions as well as our distributors, suppliers and other intermediaries.

— We circulate our anti-bribery and anti-corruption guidelines and work ethics standards to all of our Directors and employees. The anti-bribery and anti-corruption systems prohibit all of our Directors and employees from providing or accepting any forms of gifts or rebates while conducting business. Our work ethics standards set out various guidelines concerning conflict of interest, confidentiality and reporting mechanism, etc.

— If corruption or bribery takes place within our Group, written reports of assessment and rectification measures will be circulated internally.

The Sole Sponsor and our Directors are of the view that the aforesaid internal control measures are sufficient and effective as there is no material incident of bribery, corruption or misconduct during the Track Record Period.

INTELLECTUAL PROPERTY RIGHTS

We value the intellectual property rights of our own-branded products and are committed to their protection. We rely on a combination of patents, trademarks, copyright and trade secrets, as well as employee and third-party confidentiality agreements to safeguard our intellectual property rights. We assigned a few staff specifically responsible for our product registration, patent application, intellectual property rights protection and other related matters.

Though all our operations took place in the PRC during the Track Record Period, we also obtained or applied for registration of some of our patents and trademarks in Hong Kong, Macau and Taiwan as our Directors take the view that due to the vicinity of these regions to the Guangdong province from where a majority of our revenue was derived during the Track Record Period, the registration of patents and trademarks in these regions would protect our interests in these intellectual property rights.

Patents

We own and have applied for patents to protect the techniques, inventions and advancements that we believe are significant to our business. As at the Latest Practicable Date, we had 29 invention patents (發明專利), one utility model patent (實用新型專利) and 15 design patents (外觀設計專利) registered in the PRC. According to our PRC Legal Advisors, under the Patent Law of the PRC, the respective validity period for our invention patents (發明專利), utility model patents (實用新型專利) and design patents (外觀設計專利) is 20 years, 10 years and 10 years, respectively, starting from the date when the relevant application was filed. 11 and one patents are registered in Hong Kong and Macau respectively, and we had 33, six and 20 invention patent (發明專利) applications pending for registration in the PRC, Taiwan and Hong Kong, respectively.

Our patents registered in the PRC protect seven types of our Chinese patent medicines and all of our modern decoction pieces. For details about our material patents, please refer to the paragraph headed "Intellectual Property Rights — Patents" in Appendix V headed "Statutory and General Information" to this [REDACTED].

The patent holder enjoys the right to exclude others from using, licensing and otherwise exploiting the patent. However, there is no assurance that our patents will not be challenged, which could be costly to defend and could divert our management from their normal responsibilities.

Trademarks

In addition to patents, as at the Latest Practicable Date, we had 110 trademarks including but not limited to 中智,  , 

and 

, of which 78 were registered in the PRC and 32 were registered outside the PRC including Hong Kong, Macau and Taiwan. We also have lodged 30 application(s) for trademark registration in the PRC. One of our principal trademarks, namely, "中智" was awarded as Guangdong Famous Trademark in 2010, which was renewed in 2013, the current expiry date of which will be in 2016. If we discover that any third-party has infringed the

exclusive right of our registered trademark, we would, through appropriate administrative and civil procedures, institute proceedings to apply for an injunction from the relevant court, authority or resolution of the infringement through consultation. The relevant court or authority can also impose fines, confiscate or destroy the infringing products or equipment used to manufacture the infringing products. For details about our material trademarks, please refer to the paragraph headed "Intellectual Property Rights — Trademarks" in Appendix V to this [REDACTED].

Some elements of our pharmaceutical product composition, formulation and delivery, as well as production methods or processes, involve unpatented, proprietary technology, processes, know-how or data. With respect to such proprietary know-how that is not patentable, we would rely on trade secret protection and confidentiality agreements in order to safeguard our interests. All of our research and development personnel have entered into confidentiality, non-competition and proprietary information agreements with us. These agreements require such employees to assign to us all of their inventions, designs and technologies that they may develop during their periods of employment with us. In addition, there is a strict segregation of duties among personnel involved in different stages of our production process. This, we believe, serves to reduce the risk of any single staff member obtaining the technical know-how relating to the entire production process.

If our trademark registrations are being challenged, our brand name is being damaged or our trade secrets are being divulged to our competitors, there could be a material adverse effect on our business. Please refer to the paragraph headed "Risk Factors — Risks relating to our business — We may not have sufficient protection to our intellectual property rights which may result in a negative impact on our business, financial condition and results of operation." in this [REDACTED] for the associated risks. Our Directors confirm that we had not violated any intellectual property rights of any third party or faced intellectual property claims by any third parties during the Track Record Period.

Domain names

We have registered the two domain names of zeus.cn and zzdyf.cn.

Copyrights

We have registered the copyright of Zeus Chinese Medicine Fingerprint Quality Control Database System (Abbreviated Form: ZEUSys)* (中智中藥指紋圖譜質量控制數據庫系統 (簡稱: ZEUSys)) V1.0 jointly owned by Zhongzhi Pharmaceutical and Central South University* (中南大學) with the National Copyright Administration of the PRC.

For details of our intellectual property rights, please refer to Appendix V to this [REDACTED].

Risk of Infringement

In addition to protecting our own intellectual property rights, our success also depends on our ability to minimise the risk that any of our products may have infringed the intellectual property rights of others. We follow a procedure under which our internal research and development staff and external patent agent or legal advisors would conduct a patent search for each product at the beginning of the product development process. Product development is only approved if the conclusion is that the proposed product would not infringe any third-party intellectual property rights discovered in our searches. We believe that the risk of infringing third-party intellectual property rights can be effectively reduced by our rigorous adherence to these procedures. During the Track Record Period, we were not involved in or threatened by any claim for infringement of any intellectual property rights, which would have a material financial and operational impact on us, either as claimant or as respondent. However, despite our internal control procedures, the risk of infringing third-party intellectual property cannot be eliminated entirely.

INSURANCE

We currently maintain the following insurance policies:

(a) accident insurances for certain of our employees;

(b) social welfare insurances in accordance with the relevant laws and regulations in the PRC; and

(c) insurance policies that cover our major fixed assets against damage caused by accidents and natural disasters such as fire.

Our Directors believe that our current insurance coverage is sufficient. We will continue to review and assess our risk portfolio and make necessary and appropriate adjustments to our insurance practice aligned with our needs and with industry practice in the PRC. During the Track Record Period, we did not submit any material insurance claims.

COMPETITION

Pharmaceutical manufacturing

The pharmaceutical industry in the PRC is highly fragmented and competitive. According to the Ipsos Report, there were more than 1,500 Chinese patent medicine manufacturers and approximately 1,900 decoction pieces manufacturers in the PRC in 2013. In terms of sales revenue, the top five largest manufacturers of Chinese patent medicines and decoction pieces accounted for approximately 3.9% and 5.9% of the total industry revenue in 2013.

Our pharmaceutical manufacturing business faces competition from other pharmaceutical manufacturers with respect to product quality, price, variety, production capacity and marketing. Our Directors believe that we can compete effectively by virtue of (i) our well established brand name; (ii) our strong marketing capabilities and extensive sales and distribution network; (iii) our stringent quality control system; (iv) our strong research and development capabilities; and (v) our experienced and committed management team.

Operation of chain pharmacies

According to the Ipsos Report, the pharmaceutical retail market in Zhongshan is also very fragmented with approximately 687 chain pharmacies and 2,218 individual pharmacies in 2013. We are the largest self-operated pharmaceutical chain in Zhongshan in terms of the number of pharmacies and revenue for three consecutive years from 2012 to 2014.

We have certain competitive advantages over our competitors, including (i) our own-branded products are well received by the market; (ii) our pharmacies operate in convenient locations; and (iii) a wide range of pharmaceutical and healthcare products are offered in our pharmacies for customer selection. Furthermore, the new GSP standard promulgated by the CFDA on 1 June 2013 further increased the operating costs of individual pharmacies as all pharmacies are required to have a licensed pharmacist on site by end of 2015. It is expected that certain individual pharmacies will be forced out of the market. In light of the aforesaid, our Directors believe that we will maintain our leading position in the pharmaceutical retail market in Zhongshan.

PROPERTIES

Owned Properties

Our production facilities and offices of total gross floor area of approximately 46,700 sq.m. were built on six self-owned land parcels with an aggregate area of approximately 64,800 sq.m. in Zhongshan. We also own properties in Zhongshan including two parcels of land with an aggregate area of approximately 7,100 sq.m. for future development of our production facilities and shop units of approximately 634 sq.m. for our self-operated chain pharmacies and 45 sq.m. for rental purpose. The total market values of these owned properties were RMB94.8 million as at 31 May 2015. According to the opinion of our PRC Legal Advisors, we have obtained all the land use rights of the above land parcels and real estate title certificates of the buildings thereon.

We own certain units in Zhongshan with an aggregate gross area of approximately 1,600 sq.m. for staff quarters. According to our PRC Legal Advisors, as the land parcel on which the units were built is for industrial use, the owner of the land parcel has to obtain approval from the relevant government authorities for the change of the use of the land parcels from industrial to commercial and residential use before the building ownership certificates for the units can be issued. As at the Latest Practicable Date, the use of the land parcel has yet to be changed and thus, no building ownership certificates can be issued in relation to the units erected thereon. Notwithstanding that, our PRC Legal Advisors are of the opinion that we acquired the units legally and properly and had

paid the entire purchase price for the units in the sum of RMB1.5 million. Our Directors confirmed that since the date of our acquisition of these units in 2004 and 2005 and up to the Latest Practicable Date, we have not been subject to any penalty imposed by the relevant government authorities in respect of our uses of these units. If required, we would be able to identify alternatives for relocation of our staff quarters without any difficulty at minimal costs. We consider that the lack of building ownership certificates of these units would not affect our financial position and operations. For details of these properties, please refer to the valuation report as set out in Appendix III headed "Property Valuation" to this [REDACTED]. No market value was ascribed to these properties in the valuation report.

To ensure the safety of our staff residing in the staff quarters, we have implemented a series of internal house rules and regulations, such as prohibiting our staff from smoking or using electric heater and cooking stoves in the quarters. We have engaged an independent property management company to provide property management services in our staff quarters, such as security services, cleaning services as well as repair and maintenance of our fire safety system and water and electricity supply. The security officers of this property management company will inspect the quarters from time to time to ensure that our staff residing at the quarters would observe the above house rules and regulations from time to time.

Leased Properties

As at the Latest Practicable Date, save for one pharmacy which is operated in our own property, we entered into lease agreements in Zhongshan, for the operations of all other 200 chain pharmacies. We have also entered into five lease agreements for our self-operated chain pharmacies with operations to be commenced in or about July 2015.

In relation to 22 properties leased by us for the operation of our chain pharmacies, the lessors of these properties have not provided us with the relevant building ownership certificates. According to our PRC Legal Advisors, despite the lack of building ownership certificates, the relevant landlords were able to provide us with other certificates such as temporary property right certificates and construction certificates proving their rights to lease those properties to us.

As at the Latest Practicable Date, the lease agreements of 169 properties for operation of our chain pharmacies had not been registered with the relevant government authorities. As advised by our PRC Legal Advisors, the validity of these lease agreements is not affected by such failure to register and hence, we are entitled to continue to use the leased properties for the operation of our chain pharmacies. In respect of the non-registered lease agreements, correction orders may be given by the relevant government authorities to register the lease agreements within a prescribed period, failing which a fine ranging from RMB1,000 to RMB10,000 per unregistered lease agreement may be imposed on the relevant lessors. As at the Latest Practicable Date, we had not received any such correction orders.

We have requested the relevant lessors to register the lease agreements with the competent authorities. However, since they are all Independent Third Parties, we are not in the position to control whether and when each of them would register the lease agreements.

Save for the above, our PRC Legal Advisors are in the opinion that the lease agreements of the leased properties are legal and valid.

Our Directors confirm that as of 31 May 2015, none of our property interests has a carrying amount of 15% or more of our combined total assets.

LEGAL AND COMPLIANCE

Licences and permits

As a manufacturer of pharmaceutical products and pharmacy chains operator, we are subject to regulation and supervision by different levels of the food and drug administration in the PRC. We are also subject to other PRC laws and regulations that are applicable to manufacturers and distributors of pharmaceutical products in general.

A summary of the relevant PRC laws and regulations to which our business operations are subject in the PRC is set out in the "Regulation" section in this [REDACTED]. As confirmed by our PRC Legal Advisors, we have obtained all material licences, permits, approvals and consents for our business operations in the PRC and have complied with all relevant laws and regulations.

According to the Measures on the Administration of Pharmaceutical Products Registration* (《藥品註冊管理辦法》) promulgated by the CFDA on 10 July 2007 which became effective on 1 October 2007, pharmaceutical manufacturers are required to register their products with the CFDA and to obtain the necessary approval number prior to commencement of the manufacture of a particular type of pharmaceutical product. The registration is valid for a term of five years, which must be re-registered within six months prior to expiration by submitting required application materials to the relevant drug administration authorities. We will apply for renewal of the relevant certificates for our Chinese patent medicines as and when they are due to expire. We had not, in the past, encountered any difficulty in renewing such certificates for our products. As our products currently in production have been sold in the PRC for a considerable period of time, we do not foresee that there will be any major obstacle to the renewal process for our products. Our Director based on their experience in the pharmaceutical industry, take the view that the renewal of our prerequisite certificates is essentially a procedural matter.

The following permits are the major permits we have obtained as at the Latest Practicable Date for the purposes of our business and operations (apart from those pertaining to general business requirements):

Permits	Name of entities	Permit/licence/ certificate number	Expiry date
Pharmaceutical Manufacturing Permit (藥品生產許可證)	• Honeson Pharmaceutical	Yue 20110321	31 December 2015 *(Note)*
	• Zhongzhi Herb Pieces	Yue 20110328	31 December 2015 *(Note)*
Pharmaceutical Operation Permit (藥品經營許可證)	• Zhongzhi Pharmaceutical	Yue AA7600284	10 September 2019
	• Zhongzhi Chain Pharmacies	Yue BA7600036	25 August 2019
Production licence of industrial products (全國工業產品生產許可證)	• Zhongzhi Food	QS442014020306	25 March 2018
GMP Certificate (藥品生產質量管理規範認證證書)	• Honeson Pharmaceutical	GD20130135	27 October 2018
	• Zhongzhi Herb Pieces	GD20140307	22 December 2019
GSP Certificate (藥品經營質量管理規範認證證書)	• Zhongzhi Chain Pharmacies	B-GD-14-068	13 July 2019
	• Zhongzhi Pharmaceutical	A-GD-14-0845	17 August 2019
Medical Devices Operation Permit (醫療器械經營許可證)	• Zhongzhi Chain Pharmacies	Yue 481049	17 April 2019
Food circulation permit (食品流通許可證)	• Zhongzhi Pharmaceutical	SP4420000910106636	22 November 2015 *(Note)*
	• Zhongzhi Chain Pharmacies	SP4420001010402414	7 February 2017
Work Safety Standardisation Certificate (安全生產標準化證書)	• Zhongzhi Herb Pieces	Yue 201303566	December 2016
	• Honeson Pharmaceutical	Yue AQBQG 201401086	September 2017
Hygiene permit (衛生許可證)	• Zhongzhi Pharmaceutical	GDFDA Jian Zheng Zi No. (2014) 2000J4670	1 April 2018
	• Zhongzhi Chain Pharmacies	GDFDA Jian Zheng Zi No. (2013) 2000J2164	5 May 2017

Note: We will submit the applications for renewal approval of these permits to the relevant authority on or around 30 June 2015 and our Directors do not foresee there being any obstacles for the renewal.

LEGAL PROCEEDINGS AND NON-COMPLIANCE

Legal proceedings in relation to our Group

Civil judgment against Honeson Pharmaceutical

On 13 November 1995, Zhongshan Intermediate People's Court* (中山市中級人民法院) (the "**Court**") pronounced a judgment namely, Civil Judgment (1993) Zhong Zhong Jing Chu Zi No.13* (民事判決書(1993)中中經初字第13號) (the "**Civil Judgment No.13**") in favour of Guangdong Overseas Chinese Trust and Investment Company* (廣東華僑信託投資有限公司) ("**Overseas Investment Company**"), being the complainant against Zhongshan Chinese Medicine Factory* (中山市中藥廠) (which name was changed to Honeson Pharmaceutical in January 2001) ("**Predecessor Honeson Pharmaceutical**") and Zhongshan Western Region Economic Development Company* (中山市西區經濟發展總公司) ("**Western Development Company**"), being together the defendants in relation to a dispute arising from a loan agreement entered into among Overseas Investment Company as lender, Predecessor Honeson Pharmaceutical as borrower and Western Development Company as guarantor in respect of a loan in the sum of RMB1 million. Western Development Company is an Independent Third Party but it was a group company to the then shareholder of the Predecessor Honeson Pharmaceutical. Both Predecessor Honeson Pharmaceutical and Western Development Company had defaulted repayment of the loan and accrued interests when they fell due in 1992. Pursuant to the Civil Judgment No.13, it was ordered that Predecessor Honeson Pharmaceutical and Western Development Company should jointly and severally pay the loan principal in the sum of RMB1 million and the respective interests and penalty interests to Overseas Investment Company.

On 9 December 2009, the Court ordered that all the creditor's right of Overseas Investment Company in the relevant loan agreement and the proceedings against Honeson Pharmaceutical had been properly assigned to Ms. Liang Miao Fen ("**Ms. Liang**"), an Independent Third Party, and thus, Ms. Liang was entitled to enforce the Civil Judgment No. 13 in lieu of Overseas Investment Company. In July 2011, Western Development Company had provided a sum of RMB1 million in cash and certain properties as securities for the enforcement of Civil Judgment No. 13.

Western Development Company lodged a claim on 23 October 2013 on the grounds that Overseas Investment Company, being a state-owned enterprise, did not follow the relevant laws and regulations when it transferred its right to enforce the judgment debt, which constituted a state-owned asset, to an individual and the claim was subsequently dismissed. Western Development Company had thereafter filed an appeal, and the result of the appeal was not determined as at the Latest Practicable Date.

By a written confirmation sealed with the seal of Western Development Company dated 14 April 2015, Western Development Company confirmed that, it had undertaken to Honeson Pharmaceutical that it should bear all liabilities arising from the Civil Judgment No. 13 (the "**Western Development Company's Undertaking**") when we acquired Honeson Pharmaceutical.

Our Directors estimated that the maximum financial exposure of our Group in the enforcement of the Civil Judgment No.13 would be approximately RMB4 million, being the aggregate of (i) the sum of RMB3,133,360 (as set out in the judgment pronounced by the relevant court in 2013, consisting of both the principal of RMB1 million and the interests accrued up to 22 July 2011); and (ii) the interests subsequently accrued therefrom and up to the Latest Practicable Date.

Notwithstanding Western Development Company's Undertaking, the Controlling Shareholders have, pursuant to the deed of indemnity (details of which were set out in the paragraph headed "Summary of material contracts" in Appendix V to this [REDACTED]), jointly and severally, irrevocably and unconditionally, agreed to indemnify our Group for all losses and damages arising from the dispute amongst Predecessor Honeson Pharmaceutical, Western Development Company and Overseas Investment Company, the Civil Judgment No.13 and the appeal lodged by Western Development Company. In light of the above, our Directors take the view that the possibility of any outflow in settlement from Honeson Pharmaceutical or our Group as a whole as a result of the enforcement of Civil Judgment No. 13 would be remote.

Administrative penalty against Honeson Pharmaceutical

Prior to our acquisition of Honeson Pharmaceutical in 2007, Honeson Pharmaceutical had been subjected to administrative penalty by the PRC government for contravention of the National Anti-Unfair Competition Law in the PRC 《中華人民共和國反不正當競爭法》from 2005 to 2006 (the "**2005/2006 Anti-Unfair Competition Contravention**"). According to our PRC Legal Advisors, the Zhongshan Administration for Industry and Commerce* (中山市工商行政管理局) pronounced a judgment, namely Administration Penalty (2015) No. 5* (行政處罰決定書) (the "**Administration Penalty**"), pursuant to which as a result of the 2005/2006 Anti-Unfair Competition Contravention, the illegal income in the sum of RMB677,627.06 would be confiscated and a penalty in the sum of RMB80,000 was imposed on Honeson Pharmaceutical. The said confiscated illegal income and the penalty in an aggregate amount of RMB757,627.06 was fully settled by Honeson Pharmaceutical in March 2015.

Further, according to the confirmation issued by Zhongshan Administration for Industry and Commerce* (中山市工商行政管理局), dated 28 February 2015, it was confirmed, among others, that after we had acquired Honeson Pharmaceutical, both Honeson Pharmaceutical and Zhongzhi Pharmaceutical had not been in breach of any relevant laws and regulations.

Non-compliance incidents

The table below summarises the material non-compliance incidents relating to our Group during the Track Record Period:

Non-compliance incidents	Reasons for the non-compliance	Measures taken to prevent any future breaches and ensure on-going compliance
1. Production and sale of sub-standard "Ganoderma" (靈芝) As set out in the administrative penalty letter from the Zhongshan Food and Drug Administration ("**ZFDA**") dated 24 August 2012, Zhongzhi Herb Pieces was fined for RMB1,500 for the production of sub-standard "Ganoderma" and confiscated an amount and products for the total value of RMB750. As set out in the administrative penalty letter from the ZFDA dated 21 August 2012, Zhongzhi Pharmaceutical was confiscated a sum of RMB108.75, being the amount it gained from the sale of sub-standard "Ganoderma" to Zhongzhi Chain Pharmacies, which was purchased from Zhongzhi Herb Pieces. As set out in the administrative penalty letter from the ZFDA dated 21 August 2012, Zhongzhi Chain Pharmacies was confiscated the amount and products for the total value of RMB767.11 for the sale of sub-standard "Ganoderma" which was purchased from Zhongzhi Pharmaceutical.	Pursuant to Article 49 and Article 75 of the Drug Administration Law (藥品管理法) and Article 81 of the Regulations for the Implementation of the Drug Administration Law (藥品管理法實施條例), it is illegal to produce and sell pharmaceutical products of standard which is different from that set out in the Chinese Pharmacopoeia. At the material time, we were not aware that the standard of "Ganoderma" produced by us was different from those as set out in the prevailing Chinese Pharmacopoeia.	(i) Our production team and quality control team work together to ensure that all our products will comply with the prevailing standard of the Chinese Pharmacopoeia or the Drug Standards before we commence production of the products; (ii) our quality control department will double check the products to ensure compliance with the standard set out in the prevailing Chinese Pharmacopoeia before we launch the products in the market; (iii) Mr. Tang Lin, the head of technical department of Zhongzhi Pharmaceutical and a member of our senior management, will review and examine the quality control procedures performed by our quality control team when there is an update on the standards set out in the prevailing Chinese Pharmacopoeia and the Drug Standards; and (iv) we will enhance our quality control policy by increasing the number of quality inspections to be performed by external quality control laboratories.

Non-compliance incidents	Reasons for the non-compliance	Measures taken to prevent any future breaches and ensure on-going compliance
2. Production of sub-standard "Agarwood" (沉香) As set out in the administrative penalty letter of the ZFDA dated 27 February 2013, Zhongzhi Herb Pieces was confiscated an amount and products for the total value of RMB1,376.38 and was fined for RMB2,752.75 for the production of sub-standard "Agarwood"	— ditto —	— ditto —

Our Directors confirm that apart from the above non-compliance incidents, no penalties had been imposed on us by the relevant food and drug administration authorities in the PRC during the Track Record Period and up to the Latest Practicable Date.

Non-compliance incidents	Reasons for the non-compliance	Measures taken to prevent any future breaches and ensure on-going compliance
3. Failure to pay adequate social insurance fund contributions and housing provident fund contributions for our employees	According to the Social Insurance Law of the PRC (中華人民共和國社會保險法) and the Administrative Regulations on the Housing Provident Fund of the PRC (住房公積金管理條例), we are required to make social insurance fund contributions and housing provident fund contributions for our employees in the PRC. Due to administrative oversight, our PRC subsidiaries (being Zhongzhi Pharmaceutical, Zhongzhi Chain Pharmacies, Zhongzhi Herb Pieces and Honeson Pharmaceutical) did not make adequate contributions to the social insurance fund and housing provident fund for our employees during the Track Record Period. For each of the three years ended 31 December 2014, the underpaid social insurance fund contributions and housing provident fund contributions amounted to approximately RMB1.9 million, RMB1.9 million and RMB0.5 million, respectively. According to the relevant laws and regulations, we may be subject to a fine equal to 0.05% per day of the underpaid social insurance fund contribution, and in certain situations, a fine equal to three times of the amount due. As regards the housing provident fund contributions, the relevant government authority may require us to make the underpaid amount within a given period, and, if we fail to do so, it may impose a fine ranging from RMB10,000 to RMB50,000 and may apply for a PRC court order to enforce payment.	From 1 July 2014 onwards, our PRC subsidiaries have been paying adequate contributions to the social insurance fund and housing provident fund for our employees. Furthermore, we have made provisions for the underpaid social insurance fund contributions and housing provident fund contributions of approximately RMB1.9 million, RMB1.9 million and RMB0.5 million for the underpaid social insurance and housing provident fund contributions for each of the three years ended 31 December 2014, respectively. We have provided trainings on corporate governance to our Directors. On a monthly basis, the head of our human resources department carries out the following procedures to ensure that we comply with the laws and regulations related to social insurance fund and housing provident fund contributions: i) review the staff record and examine whether our Group has made social insurance fund and housing provident fund contributions for every staff; ii) report to our finance department on the number of staff, social insurance fund and housing provident fund contribution. Our finance department would check the amount of contributions against the staff list; and iii) investigate variances with the records kept by our finance department, if any.

Pursuant to the respective confirmation issued by the Human Resources and Social Protection Bureau of Zhongshan City* (中山市人力資源和社會保障局) on 13 January 2015 (with respect to Zhongzhi Pharmaceutical and Zhongzhi Herb Pieces) and on 19 January 2015 (with respect to Honeson Pharmaceutical and Zhongzhi Chain Pharmacies), the competent authority in issuing confirmations with respect to social insurance issue in Zhongshan, it was confirmed that each of Zhongzhi Pharmaceutical, Honeson Pharmaceutical, Zhongzhi Chain Pharmacies and Zhongzhi Herb Pieces had made social insurance fund contributions for its employees from 1 January 2012 to 31 December 2014 and up to the dates of the respective confirmations and each of Zhongzhi Pharmaceutical, Honeson Pharmaceutical, Zhongzhi Chain Pharmacies and Zhongzhi Herb Pieces is not subject to any administrative action or penalty for breach of the relevant social insurance laws or regulations.

Pursuant to the respective confirmation issued on 20 January 2015 by the Housing Provident Fund Administrative Centre of Zhongshan City* (中山市住房公積金管理中心), the competent authority in issuing confirmation with respect to housing provident fund in Zhongshan, it was confirmed that each of Zhongzhi Pharmaceutical, Honeson Pharmaceutical, Zhongzhi Chain Pharmacies and Zhongzhi Herb Pieces had made contributions to the housing provident funds for its employees from 1 January 2012 to 31 December 2014 and up to the date of the confirmation and each of Zhongzhi Pharmaceutical, Honeson Pharmaceutical, Zhongzhi Chain Pharmacies and Zhongzhi Herb Pieces is not subject to any administrative action or penalty for breach of the relevant housing provident fund laws or regulations.

As at the Latest Practicable Date, we did not receive any notifications from the relevant government authorities requiring us to make the outstanding social insurance fund and housing provident fund contributions.

In light of the above-mentioned confirmations, our PRC Legal Advisors have confirmed that (i) the non-compliance relating to such underpaid contributions is not material to our Group; and (ii) the risks of being penalised for such historical non-compliances are low in practice.

On-going compliance measures

To avoid recurrence of the abovementioned non-compliance incidents and to ensure ongoing compliance with relevant laws, rules and regulations by our Group, we have implemented the following internal control measures:

(a) our Group appointed Ms. Chow Fung Ling, an associate member of The Hong Kong Institute of Company Secretaries and an associate member of the Institute of Chartered Secretaries and Administrators, on 9 March 2015, to act as company secretary to oversee the company secretarial matters of our Group;

(b) our Group has appointed Guosen Securities (HK) Capital Company Limited as the compliance advisor to advise on ongoing compliance requirements and other issues under the Listing Rules and other applicable laws and regulations in Hong Kong;

(c) our Group will continue to engage Ernst & Young to audit the accounts of our Group; and

(d) our Group has established an audit committee comprising all independent non-executive Directors to oversee the financial reporting and internal control procedures of our Group, and aims to review the effectiveness of our Group's internal control system.

Our Directors are of the view that the aforesaid remedial measures and on-going compliance measures are sufficient and effective in preventing similar non-compliance incidents from re-occurring again in the future as no such similar non-compliance incidents have occurred since its implementation and up to the Latest Practicable Date. In light of the preventive measures and its effectiveness, the Sole Sponsor is of the view that our Group has adequate and effective internal control procedures in place for the purpose of Rule 8.04 of the Listing Rules.

AWARDS AND CERTIFICATIONS

During the Track Record Period and up to the Latest Practicable Date, we had received numerous awards and certifications in recognition of our achievements, including the following:

Major awards and certifications of Zhongzhi Pharmaceutical

Date of awards and certifications	Awards/Certificates	Awarding authority
June 2014	Guangdong province enterprise of observing contract and valuing credit* (廣東省守合同重信用企業)	Guangdong Province Administration for Industry and Commerce* (中山市工商行政管理局)
May 2014	Top 10 potential products of pharmaceutical E-Commerce — American ginseng modern decoction pieces* (醫藥電商十大潛力產品西洋參破壁飲片榮獲)	Pharmaceutical E-Commerce Branch of China Medical Pharmaceutical Material Association* (中國醫藥物資協會醫藥電子商務分會)
May 2014	Top Ten Meritorious Enterprise for the 5th Anniversary of Chain Pharmacy Branch Association of China Medical Pharmaceutical Material Association during 2009–2014* (中國醫藥物資協會連鎖藥店分會成立五周年2009–2014 十大功勳企業)	China Medical Pharmaceutical Material Association* (中國醫藥物資協會)
December 2013	Guangdong Innovative Enterprises* (effective from 2013 till 2016) (廣東省新型企業，有效期自2013年至2016年)	Guangdong Provincial Bureau for Science and Technology* (廣東省科學技術廳), Development and Reform Commission of Guangdong Province* (廣東省發展和改革委員會), The Economic & Information Commission of Guangdong Province (廣東省經濟和信息化委員會) and others
May 2013	Enterprise of advanced technology of pharmaceutical industry of Guangdong province in 2012* (2012年度廣東省醫藥行業科技創新先進企業)	Guangdong Province Pharmaceutical Industry Association* (廣東省醫藥行業協會)
February 2013	Second prize for research and industrialisation of modern decoction pieces* (中藥破壁飲片關鍵技術研究與產業化二等獎)	People's Government of Guangdong Province* (廣東省人民政府)
February 2013	Second prize for research and industrialisation of modern decoction pieces* (中藥破壁飲片關鍵技術研究與產業化二等獎)	People's Government of Guangdong Province* (廣東省人民政府)
July 2012	Zhongshan science technology award — First prize of technology advancement* (中山市科學技術獎勵 — 科技進步獎一等獎)	People's Government of Zhongshan* (中山市人民政府)

Date of awards and certifications	Awards/Certificates	Awarding authority
February 2012	Best potential award in 2011* (2011年度最具發展潛力獎)	Chain Pharmacy Committee of China Medical Pharmaceutical Material Association* (中國醫藥物資協會連鎖藥店委員會)
November 2011	Zhongshan Patent Excellence Award — Method for processing traditional decoction pieces into modern decoction pieces* (中山市專利優秀獎 — 一種中藥材破壁粉的加工方法)	Zhongshan Intellectual Property Bureau* (中山市知識產權局)

Major awards and certifications of Zhongzhi Chain Pharmacies

Date of awards and certifications	Awards/Certificates	Awarding authority
March 2014	Enterprise of advance human resources* (2013年度人才工作先進企業)	Zhongshan Government Shiqi Office (中山市人民政府石岐區辦事處)

Major awards and certifications of Zhongzhi Herb Pieces

Date of awards and certifications	Awards/Certificates	Awarding authority
August 2013	Enterprise of observing contract and valuing credit* (2013年廣東省守合同重信用企業)	Guangdong Province Administration for Industry & Commerce* (廣東省工商行政管理局)
July 2012	Zhongshan science technology award — First prize of technology advancement* (中山市科學技術獎勵 — 科技進步獎一等獎)	People's Government of Zhongshan* (中山市人民政府)

Major awards and certifications of Honeson Pharmaceutical

Date of awards and certifications	Awards/Certificates	Awarding authority
July 2014	2014 Corporate Culture Outstanding Unit* (2014年度企業文化卓越單位)	Zhongshan Government West District Office* (中山市人民政府西區辦事處)
4 May 2014	Certificate of inclusion of Seven Star Tea Oral Solution in level 2 of state protected Chinese medicine* (小兒七星茶口服液列為國家二級中藥保護品種)	State Food and Drug Administration* (國家食品藥品監督管理總局)
March 2014	Enterprise with tax amount over RMB5 million in 2013* (2013年度創税超500萬企業)	Zhongshan Government West District Office* (中山市人民政府西區辦事處)
1 June 2013	Enterprise of observing contract and valuing credit for 16 consecutive years* (連續十六年廣東省守合同重信用企業)	Guangdong Province Administration for Industry & Commerce* (廣東省工商行政管理局)
May 2013	Enterprise of harmonious labour relations in 2012* (2012年度勞動關係和諧企業)	Zhongshan Human Resources and Social Security Bureau* (中山市人力資源和社會保障局)
March 2013	Enterprise with tax amount over RMB5 million in 2012* (2012年度創税超500萬企業)	Zhongshan Government West District Office* (中山市人民政府西區辦事處)
December 2012	Certificate of Technology Association Membership* (技術協會會員單位)	Guangdong Food and Drug Technology Association for Evaluation and Certification* (廣東省食品藥品審評認證技術協會)
December 2012	Safe production advance Unit in 2012* (2012年度安全生產工作先進單位)	Zhongshan Government West District Office* (中山市人民政府西區辦事處)
June 2012	Zhongshan Environmental Protection Integrity Enterprise* (2011年度中山市環保誠信企業)	Zhongshan Environmental Protection Bureau* (中山市環境保護局)