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# ANNUAL REPORT 2020

Zhongzhi Pharmaceutical Holdings Limited
中智藥業控股有限公司

(Incorporated in the Cayman Islands with limited liability)

Stock code: 3737

# Content



# Corporate Information

## BOARD OF DIRECTORS

### Executive Directors

Mr. Lai Zhi Tian (Chairman)
Mr. Lai Ying Feng
Mr. Cao Xiao Jun
Mr. Cheng Jin Le

### Non-executive Directors

Ms. Jiang Li Xia
Mr. Yang Ai Xing

### Independent Non-executive Directors

Mr. Ng Kwun Wan
Mr. Wong Kam Wah
Mr. Zhou Dai Han

## COMMITTEES OF THE BOARD

### Audit Committee

Mr. Ng Kwun Wan (Chairman)
Mr. Wong Kam Wah
Mr. Zhou Dai Han

### Remuneration Committee

Mr. Wong Kam Wah (Chairman)
Mr. Lai Zhi Tian
Mr. Lai Ying Feng
Mr. Ng Kwun Wan
Mr. Zhou Dai Han

### Nomination Committee

Mr. Wong Kam Wah (Chairman)
Mr. Lai Zhi Tian
Mr. Lai Ying Feng
Mr. Ng Kwun Wan
Mr. Zhou Dai Han

## AUTHORIZED REPRESENTATIVES

Mr. Lai Ying Feng
Ms. Ho Wing Yan

## COMPANY SECRETARY

Ms. Ho Wing Yan

## REGISTERED ADDRESS

Windward 3
Regatta Office Park
P.O. Box 1350
Grand Cayman
KY1-1108
Cayman Islands

## HEADQUARTER IN THE PRC

No. 3 Kangtai Road South
Torch Development Zone
Zhongshan
Guangdong Province
PRC

## PRINCIPAL PLACE OF BUSINESS IN HONG KONG

Unit 10B, 15/F
Cable TV Tower
9 Hoi Shing Road
Tsuen Wan, New Territories
Hong Kong

## OFFICE IN SHENZHEN

Unit A-H on the 20th Floor
Dream City Office Tower
Mei Lin Lu, Futian Qu, Shenzhen
PRC

## AUDITOR

**Ernst & Young**
22/F, CITIC Tower
1 Tim Mei Avenue
Central
Hong Kong

# Corporate Information

## PRINCIPAL BANKERS

Bank of Communications Co., Ltd.
China Construction Bank Corporation

## CAYMAN ISLANDS PRINCIPAL SHARE REGISTRAR AND TRANSFER OFFICE

Ocorian Trust (Cayman) Ltd.
Windward 3
Regatta Office Park
P.O. Box 1350
Grand Cayman
KY1-1108
Cayman Islands

## HONG KONG BRANCH SHARE REGISTRAR AND TRANSFER OFFICE

Union Registrars Limited
Suites 3301-04, 33/F.,
Two Chinachem Exchange Square,
338 King's Road,
North Point, Hong Kong

## STOCK NAME

ZHONGZHIPHARM

## STOCK CODE

3737

## COMPANY WEBSITES

www.zeus.cn
www.caojinghua.cn

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# Chairman's Statement

On behalf of the board (the "Board") of directors (the "Directors") of Zhongzhi Pharmaceutical Holdings Limited (the"Company" and together with its subsidiaries, the "Group"), I am pleased to present to you the annual report and audited consolidated financial statements of the Group for the year ended 31 December 2020 (the "Reporting Period").

## BUSINESS REVIEW

During the outbreak of the pandemic, Zhongzhi Pharmaceutical made every effort to ensure the resumption of production. Not only the chain pharmacies remained operational and provided professional services to Zhongshan citizens, the production line also conducted advance planning to organise the full production of preventive and protective Chinese medicines in response to the pandemic. During the year, the Company promoted intensive humanitarian spirit and devotion to love as we actively organised the preparation of medical supplies including but not limited to medical masks, disinfectants, our own Milkvetch root modern decoction pieces (黃芪破壁飲片), Houttuynia cordata cell wall broken decoction pieces (魚腥草破壁飲片) during the severe pandemic period. In addition, we donated materials of RMB7.1 million to the Red Cross Society of Zhongshan in three batches. Among them, the first batch of medical masks, disinfectants, anti-flu Chinese medicine ShiqiWaigan Granules (石岐外感顆粒) and other materials, valued at RMB1.07 million, was donated to the city's designated treatment hospitals; the second batch of products including but not limited to Milkvetch root modern decoction pieces (黃芪破壁飲片), Houttuynia cordata cell wall broken decoction pieces (魚腥草破壁飲片), valued at RMB5.3 million, was donated to the medical staff of Wuhan Medical Institution; and the third batch of ShiqiWaigan Granules (石岐外感顆粒), valued at RMB0.73 million, was donated to police and police assistants in Zhongshan City.

### In 2020, the Group achieved many breakthroughs around in the market:

- The unique entrepreneurial partner model successfully established a group of key partners for the Caojinghua brand and strong financial results were achieved with the aid of the Company's professional traditional Chinese medicine training team, creating a new force of growth momentum.

- The Group's e-commerce sales team further explored on new sales, strategies, products and other dimensions in approach to the ever changing e-commerce environments. The team successfully rolled out a new product line namely the "Colored Box Series" which received high praises from its customers.

- The Group's primary brand Caojinghua (草晶華) continues to evolve and receive the recognition of both consumers and all related government parties. The brand Caojinghua (草晶華) was included in the Guangdong Key Trademark Protection List for the first time in the year, meaning it will receive more attention and protection from related parties.

# Chairman's Statement

**In 2020, the Group achieved several breakthroughs in scientific research technology:**

- On December 22, 2020, the National Development and Reform Commission, National Ministry of Science and Technology, Ministry of Finance, General Administration of Customs, State Administration of Taxation jointly announced the 27th batch of National Enterprise Technology Centres (國家企業技術中心) and Zhongzhi Pharmaceutical was one of the certified enterprises. This was another enterprise innovation platform award recognized on a national level following the National Level Scientific Research Platform with Chinese Herbal Broken Piece recognized by The National Development and Reform Commission in 2019.

- In the year, the Group's Chief Scientist Mr. Cheng Jin Le, also a Director of the Group, proudly received the 7th annual Guangdong Outstanding Inventor Award along with nine other candidates. The award started in 2014 by the Guangdong Provincial government aimed to recognize ten outstanding inventors and designers in the province on an annual basis. Competition for the award is highly intensive, other recipients of the award include scientists from Huawei, Tencent, Gree amongst others.

- Zhongzhi continues to register for Canadian National Health Product (NHP) on three new products and were approved in the year. To date, the Company has received a total of six certifications of Chinese cell broken pieces in Canada.

## FUTURE PROSPECTS

2021 is the beginning of the National Fourteenth Five-Year Plan, and included in the plan are further improvements aimed at the health industry. In the post-Covid-19 period, health industry reforms quicken to improve overall Chinese healthcare quality, and reduce cost burden beared by the People. Aging global population, greater focus on the Chinese medicine industry, greater health conscientiousness, adoption of the new Medical Insurance Directory, Purchase In Quantity (帶量採購), trend towards online healthcare are all trends and policies already taken material affect in society, propelling all organizations in the medical industry to rebuild itself. In this era where business environment is ever changing, ability to quickly adapt to new market conditions becomes an indispensable capability. Below is a brief description on the Company's operations by segments:

**Manufacturing and E-commerce:** Throughout the Covid-19 pandemic, interest around Chinese medicine and natural herbs rose as the people began to focus on the benefits of such remedies. As well, Chinese medicine played a critical role in the control of the spread of the virus, helping to restore order in society quickly. This benefited both the Group's cell wall-broken herbs segments and it's Chinese patented medicine segments, helping to increase market capacity. In 2020, Caojinghua (草晶華) successfully hosted the second annual Healthy Guangdong Herbal Health Festival and the first annual Healthy Shandong Herbal Health Festival, further educating consumers knowledge on Chinese medicine and increasing brand awareness. The Herbal Health Festivals have achieved pleasing results in both areas, with Guangdong showing stronger retention as it finishes its second year. In the same year, the Caojinghua trademark entered into the Guangdong Key Trademark Protection List, signifying a wider range of brand recognition as well as increased oversight and protection on the trademark in legal related matters. The pandemic also hasten the adoption online purchasing habits from all customers, and increased the demand for online shopping. In 2020, the Group's e-commerce team introduced the "Color Box Series" which better tailored to the needs of the online target audiences and has achieved great results to date. In 2021, the Group will continue to spread awareness around Chinese medicine as a preventative option, continue to grow existing product lines while exploring the new, expand production capacity, capitalise on the e-commerce trend and to develop more great products. The Group will also increase investments in branding, expand coverage and continue to build the Caojinghua brand.

# Chairman's Statement

**Chain Pharmacies:** In first half of 2020, chained pharmacies around the nation took on the task to aid local governments in combating Covid-19 virus. Anti-pandemic supplies became a short-term need for customers, driving in greater customer visits and greater sales of all product categories due to the headcount increase, resulting in more than usual sales increases. Government soon contained the spread of the virus, and customer traffic resumes to pre-pandemic levels. Purchase in Quantity, adoption of new Medical Insurance Directory, Prescription outflow (處方外流) and other policies lowered costs for end consumers while compressing margins throughout the supply chain. As well, these policies encouraged product mix changes due to shifts in demands as well as increased the overall market size to be serviced by pharmacies. Further, by consumers going on-line for both the diagnosis of minor medical conditions and purchase of common medication have caused brick-and-mortar stores more costly to operate. At the same time, however, it has removed the location barrier for enterprises to reach more end consumers, all of which have become a catalyst pushing enterprises to transform its business. In 2021, the Group's pharmacy chain will continue to lead the development of pharmacies in Zhongshan while increasing investments in franchise stores and in online operations.

## Digital Management

Under the catalysis of the Covid-19 pandemic in 2020, the Group accelerated the development of remote office and mobile office platforms, minimizing the impact of the pandemic on working inconvenience. The platforms took working environment from off-line to on-line; from working in a set location to any location of choice; from working 9 to 5 to anytime of the day, thus speeding up the overall reaction time of the Group and improved overall work efficiency. At the same time, the successful launch of the new OA (Office Assistance) system streamlined all of the Group's work processes and procedures, and has established a strong systems foundation for future business expansions. With the new OA system, the Group has achieved substantial cost savings from simplifying processes and minimizing labour intensive tasks. In 2021, the Group will implement a Manufacturing Execution System (MES) and build an automated logistics warehouse to further improve the work efficiency of the enterprise and reduce costs.

## Science and Innovation

In 2020, the National Development of Reform Commission, the Ministry of Science and Technology, the Ministry of Finance, the General Administration of Customs, and the State Administration of Taxation in joint issued a list of the 27th batch of national enterprise technology centers. Among them, the technology center of Zhongzhi Pharmaceutical Group was recognized as a National Technology Center, signifying the achievement of a milestone in the Group's technological domain. In the same year, the Group's Chief Scientist Mr. Cheng Jin Le, also a Director of the Group, proudly received the 7th annual Guangdong Outstanding Inventor Award along with nine other candidates. This signifies another milestone demonstrating the Group's continuing ability to innovate and to improve on technologies and designs moving towards the modernization and globalisation of Chinese medicine. The Group continues to take the development of Caojinghua cell-broken herbs (cell wall-broken decoction pieces) as its core development direction, speeding up the research of technology and the development of new products, to respond quickly to the needs of the market. The Group will, as always, respond to the requirements of national leaders and continue to promote the internationalization of Chinese Medicine.

# Chairman's Statement

### Capital Investments

The demand for the Company's pharmaceutical products has continued to increase and the Group continued record steady growth on its revenue. With the increasing recognition of Chinese medicine and the economy recovering from the pandemic, it is expected that the demand for pharmaceutical products will continue to increase in the future. As such, the Directors are of view that the Company should capture opportunities by constructing the Yunfu Factory and Zhongshan Factory to expand the production capacity of the Group and enhance the production efficiency in order to meet the demand of the customers and capturing more market share. The Zhongshan Factory will also act as a Headquarters for the Group's chain pharmacies operations along with a new automated logistics and distribution centre.

## APPRECIATION

On behalf of the Company, I would like to express my sincere gratitude to our valued customers, employees, suppliers, shareholders and partners that have supported us through our journey to date. We expect the year ahead to be full of opportunities and challenges. As always, we will strive to create greater value for our shareholders and investors.

By order of the Board
**Lai Zhi Tian**
*Chairman*

Hong Kong, 24 March 2021

# Management Discussion and Analysis

## BUSINESS OVERVIEW

During the Reporting Period, the Group continued to engage principally in pharmaceutical manufacturing in the PRC and the operation of chain pharmacies in Zhongshan in the Guangdong Province, the PRC. Revenue of the Group rose by approximately 19.5% to approximately RMB1,603.9 million.

Profit attributable to owners of the parent increased by approximately 20.8% to RMB138.5 million due to the strong growth momentum of the modern decoction pieces (Caojinghua Cell-broken Herb) (草晶華破壁草本), stricter controls over sales and management costs as well as from slight adjustments in sales modes.

## FINANCIAL ANALYSIS

### Revenue

The Group's operations can be divided into three segments in the PRC pharmaceutical industry, namely (i) pharmaceutical manufacturing; (ii) operation of chain pharmacies in Zhongshan; and (iii) operation of on-line pharmacies. Below is an analysis of revenue by segment.

| | **Revenue for the year ended 31 December** | | | **% of total revenue for the year ended 31 December** | | |
|---|---|---|---|---|---|---|
| | **2020 RMB'000** | 2019 RMB'000 | Change (%) | **2020 (%)** | 2019 (%) | Change (%) |
| Pharmaceutical manufacturing | **916,076** | 753,400 | +21.6 | **57.1** | 56.1 | +1.0 |
| Operation of chain pharmacies | **624,874** | 535,380 | +16.7 | **39.0** | 39.9 | -0.9 |
| Operation of on-line pharmacies | **62,926** | 53,402 | +17.8 | **3.9** | 4.0 | -0.1 |
| | **1,603,876** | 1,342,182 | +19.5 | **100.0** | 100.0 | |

### Pharmaceutical manufacturing

The Group is engaged in the research and development, manufacturing and sale of (i) Chinese patent medicines; and (ii) decoction pieces (consisting of traditional decoction pieces and modern decoction pieces) under the Group's brands in the PRC. The Group's brand include "Zeus (中智)", "Liumian (六棉)" and "Caojinghua (草晶華)".

Revenue derived from pharmaceutical manufacturing increased by approximately 21.6% to RMB916.1 million for the year ended 31 December 2020 (2019: RMB753.4 million) and accounted for 57.1% of the total revenue during the year (2019: 56.1%). The increase in revenue was primarily attributable to the sales of the modern decoction piece (Caojinghua Cell-broken Herb) (草晶華破壁草本) driven by the Group's continuous efforts in marketing and expansion of new sales channels around the brand.

# Management Discussion and Analysis

## Operation of chain pharmacies

The Group has been operating chain pharmacies in Zhongshan under the brand "Zeus (中智)" for the sale of pharmaceutical products since 2001. As at 31 December 2020, the Group has 366 self-operated chain pharmacies in Zhongshan (2019: 328), of which 325 are medical insurance designated pharmacies (醫保定點藥店). Meanwhile, the Group has started to explore the franchise business model in the year.

Segment revenue of the operation of chain pharmacies increased by approximately 16.7% to approximately RMB624.9 million for the year ended 31 December 2020 (2019: RMB535.4 million) and accounted for 39.0% of the total revenue during the year (2019: 39.9%). The increase was primarily attributable to new sales driven by the 38 new stores opened at the end of 2020. In addition, due to the impact of coronavirus pneumonia pandemic, the sales of anti-pandemic drugs increased as compared with the corresponding period in 2019.

## Operation of on-line pharmacies

Revenue derived from operation of on-line pharmacies increased by approximately 17.8% to RMB62.9 million for the year ended 31 December 2020 (2019: RMB53.4 million) and accounted for 3.9% of the total revenue during the Reporting Period (2019: 4.0%). The increase in sales was due to continuous efforts devoted to exploring new sales opportunities in new e-commerce platforms and the increase in the sales of the Group's Caojinghua branded products.

## Gross Profit and Gross Profit Margin

Gross profit of the Group for the year was RMB991.2 million, representing an increase of RMB156.5 million or 18.8% as compared with RMB834.7 million for the year ended 31 December 2019. The analysis of gross profit by segment is as below:

| | **Gross profit for the year ended 31 December** | | | **Gross profit margin for the year ended 31 December** | | |
|---|---|---|---|---|---|---|
| | **2020 RMB'000** | 2019 RMB'000 | Change (%) | **2020 (%)** | 2019 (%) | Change (%) |
| Pharmaceutical manufacturing | **700,037** | 557,624 | +25.5 | **76.4** | 74.0 | +2.4 |
| Operation of chain pharmacies | **252,021** | 235,454 | +7.0 | **40.3** | 44.0 | -3.7 |
| Operation of on-line pharmacies | **39,145** | 41,611 | -5.9 | **62.2** | 77.9 | -15.7 |
| | **991,203** | 834,689 | 18.8 | **61.8** | 62.2 | -0.4 |

## Pharmaceutical manufacturing

The gross profit of pharmaceutical manufacturing segment increased by approximately 25.5% to RMB700.0 million for the year ended 31 December 2020 (2019: RMB557.6 million). The gross profit margin increased to 76.4% for the year ended 31 December 2020 (2019: 74.0%). The increase was mainly attributable to the increase in the sale of Caojinghua.

# Management Discussion and Analysis

### Operation of chain pharmacies

The gross profit of chain pharmacies segment increased by approximately 7.0% to RMB252.0 million for the year ended 31 December 2020 (2019: RMB235.5 million). The gross profit margin of the chain pharmacies segment decreased to 40.3% for the year ended 31 December 2020 (2019: 44.0%). Gross profit margin decreased compared to prior year as there was a temporary increase in the sales of lower margin products related to the pandemic.

### Operation of on-line pharmacies

The gross profit of on-line pharmacies segment decreased by approximately 5.9% to RMB39.1 million for the year ended 31 December 2020 (2019: RMB41.6 million). The gross profit margin decreased to 62.2% for the year ended 31 December 2020 (2019: 77.9%), which was primarily attributable to the increase in sales promotion related to the Caojinghua products resulting in lower margin.

### Other Income and Gains

Other income and gains mainly comprise of bank interest income, interest income from bank financial products and government grants. For the year ended 31 December 2020, other income and gains of the Group were approximately RMB31.6 million (2019: RMB23.2 million), representing an increase of approximately RMB8.4 million as compared to last year, which was mainly attributable to (i) the increase in government grants of approximately RMB3.8 million; and (ii) the increase in changes in fair value of financial assets of RMB4.2 million.

### Selling and Distribution Expenses

Selling and distribution expenses mainly represent staff costs, advertisement and promotional costs and rental expenses of the Group's chain pharmacies. For the year ended 31 December 2020, selling and distribution expenses amounted to approximately RMB698.8 million (2019: RMB569.7 million), representing an increase of approximately 22.7% as compared to last year. Selling and distribution expense ratio increased to approximately 43.6% (2019: 42.4%) against revenue for the year ended 31 December 2020, which was mainly due to the increase of marketing and promotion activities on the Company's Caojinghua Cell-broken Herb (草晶華破壁飲片) through various channels and platforms.

### Administrative Expenses

Administrative expenses mainly represent salaries and benefits of the administrative and management staff as well as legal and professional fees. For the year ended 31 December 2020, administrative expenses amounted to approximately RMB91.8 million (2019: RMB78.1 million), representing an increase of approximately 17.6% as compared to last year. The Group had higher salaries expense throughout the year due to increase in headcount, which was offsetted by stricter cost controls including but not limited to travel expenses.

# Management Discussion and Analysis

## Other Expenses

Other expenses mainly represented research and development expenses and the donation expenses in relation to the coronavirus pneumonia pandemic.

The research and development expenses mainly represented various expenses incurred in the course of research and development of products, technologies, materials, crafts and standards. For the year ended 31 December 2020, research and development expenses amounted to approximately RMB50.2 million (2019: RMB47.4 million), representing an increase of approximately 5.8% compared to that for the same period of last year. The increase in the research and development expenses was due to the increased manpower investment for the clinical research of the science of Caojinghua Cell-broken Herb (cell-broken decoction pieces) to prove its safety, efficacy and controllable qualities.

The donation expenses in relation to the coronavirus pneumonia pandemic amounted to approximately RMB7.1 million (2019: Nil). The increase in the donation expenses in relation to the coronavirus pneumonia pandemic was due to the Group's donation of a total of RMB7.1 million worth of anti-pandemic drugs and materials to various organizations during the outbreak of coronavirus pneumonia pandemic.

## Finance Costs

Finance costs represented interest on bank borrowings and interest on lease liabilities, which amounted to RMB5.2 million for the year ended 31 December 2020 (2019: RMB4.0 million). The increase was due to the increase in bank loans.

## Income Tax Expense

Income tax expense amounted to RMB28.6 million for the year ended 31 December 2020 (2019: RMB41.2 million). The decrease was primarily due to tax incentives/allowances for research and development activities.

## Profit attributable to owners of the parent

As a result of the factors discussed above, profit attributable to owners of the parent increased by 20.8% to RMB138.5 million for the year ended 31 December 2020 (2019: RMB114.7 million). The Group's net profit margin amounted to 8.6% for the year ended 31 December 2020 (2019: 8.5%).

## Liquidity and Capital Resources

### *Net Current Assets*

The Group had net current assets of approximately RMB398.4 million as at 31 December 2020 (2019: RMB416.4 million). The Group's cash and bank balances decreased from RMB380.3 million as at 31 December 2019 to RMB294.0 million (which consisted of cash and bank balances of RMB285.6 million and HK$8.5 million denominated in RMB and HKD respectively) as at 31 December 2020. The current ratio of the Group decreased from approximately 2.0 as at 31 December 2019 to 1.8 as at 31 December 2020.

# Management Discussion and Analysis

***Borrowing and the Pledge of Assets***

The Group had outstanding unsecured borrowings of RMB20 million and HK$70 million as at 31 December 2020 (2019: HK$35 million).

As at 31 December 2020, the Group had available unutilised banking facilities of RMB40 million (2019: RMB30 million) and HK$nil (2019: HK$5 million).

***Gearing Ratio***

The Group's gearing ratio as at 31 December 2020 was 9.6% (2019: 4.1%).

## Capital Structure

The shares of the Company (the "Shares") were listed on The Stock Exchange of Hong Kong Limited (the "Stock Exchange") on 13 July 2015. The capital of the Company comprises ordinary Shares and other reserves. As at 31 December 2020, the number of issued shares of the Company was 840,000,000 ordinary Shares of HK$0.01 each.

## Foreign Exchange Exposure and Exchange Rate Risk

The Group's transactions are mainly denominated in RMB. Certain of the Group's cash and bank deposits are denominated in Hong Kong dollars. In addition, the Company will pay dividend in Hong Kong dollars in the future. Any significant exchange rate fluctuations of Hong Kong dollars against RMB may have financial impacts on the Group. The Group did not use any forward contracts, currency borrowings or other means to hedge its foreign currency exposure for the year of 2020. Nevertheless, the Group will from time to time review and adjust the Group's hedging and financing strategies based on the RMB and Hong Kong dollars exchange rate movement.

## EMPLOYEES AND EMOLUMENTS POLICY

The key components of the Group's remuneration package include basic salary, and where appropriate, other allowances, commission, bonuses and the Group's contribution to mandatory provident funds or state-managed retirement benefits scheme. Other benefits include share options to be granted under the share option scheme and Shares to be granted under the share award plan.

As at 31 December 2020, the Group had 3,289 employees (2019: 3,243) with a total remuneration of RMB329.7 million during the Reporting Period (2019: RMB320.2 million) (including wages and salaries, pension scheme contributions, staff welfare expenses, equity-settled share award expenses and others). The salaries of the employees are determined with reference to individual performance, work experience, qualification and current industry practices.

# Management Discussion and Analysis

## SIGNIFICANT INVESTMENTS

### Discloseable Transaction: Subscription of Wealth Management Products – Unit Customer Smart Deposits

On 2 January 2020 and 7 July 2020, Zhongshan Zhongzhi Pharmaceutical Group Co., Ltd.* (中山市中智藥業集團有限公司), as a subscriber and a wholly owned subsidiary of the Company, entered into the first customer smart deposits business agreement and the second customer smart deposits business agreement with Guangdong Huaxing Bank Zhongshan Branch, pursuant to which, Zhongshan Zhongzhi Pharmaceutical Group Co., Ltd. subscribed for wealth management products of Guangdong Huaxing Bank Zhongshan Branch in the principal amount of RMB50,000,000 and RMB80,000,000, respectively, totaling RMB130,000,000. For details, please refer to the announcement of the Company dated 7 July 2020.

Save as disclosed above, the Group had no significant investments held during the Reporting Period.

## MATERIAL ACQUISITIONS AND DISPOSALS OF SUBSIDIARIES, ASSOCIATES AND JOINT VENTURES

The Group had no material acquisitions or disposals of subsidiaries, associates or joint ventures during the Reporting Period.

## EVENT AFTER THE REPORTING PERIOD

On 24 March 2021, the Group entered into construction contracts for the second phase of the new factory premises in Zhongshan and Yunfu at a total consideration of RMB71.0 million.

The Yunfu manufacturing facility is aimed to increase the Group's production capacity in response to increasing sales demands, where the building in Zhongshan will serve as the headquarter of the Group's pharmacy division with improved logistics warehouse systems, aimed to improve overall management of inventory and to improve working condition for its employees.

## CAPITAL COMMITMENT

As at 31 December 2020, the Group's capital commitment amounted to RMB65.9 million (2019: RMB55.5 million). The capital commitment is mainly related to the construction of two new buildings and the additions of new fixed assets, which relate to the purchasing of new equipment for research and development activities and to expand the Group's production capacity.

* The English name is for identification purpose only

# Management Discussion and Analysis

## FUTURE PLANS FOR MATERIAL INVESTMENTS OR CAPITAL ASSETS

Apart from strengthening the Group's current business and the future plans as disclosed in the prospectus of the Company dated 30 June 2015, the Group will devote its best effort and resources to cope with the increasing market demand in the Group's own-branded products, in order to enhance shareholder's value. In particular, the Group has commenced the construction of new factories premises and additional production lines in Zhongshan and Yunfu, Guangdong province, for the expansion of production capacity to cater for the increase in demand of the Group's products. It is expected that the construction of the new factory premises will be completed by the end of 2021.

Save for the above, the Group will also consider any potential investment opportunities which may benefit its shareholders as and when these opportunities arise.

## CONTINGENT LIABILITIES

The Group did not have any contingent liabilities as at 31 December 2020 (2019: nil).

# Biographical Details of Directors and Senior Management

Biographies of Directors and senior management team are set out below:

## EXECUTIVE DIRECTORS

**Mr. Lai Zhi Tian (賴智填)**, aged 53, is the founder, controlling shareholder, an executive Director and Chairman of the Board. He is also a member of each of the remuneration committee and the nomination committee of the Company. He joined our Group on 27 September 1999 and is responsible for formulating the corporate strategies and planning the business development of our Group. He is the spouse of Ms. Jiang Li Xia, a non-executive Director, and father of Mr. Lai Ying Feng, an executive Director and Mr. Lai Ying Sheng, a chief financial officer.

Mr. Lai has over 30 years of experience in the pharmaceutical industry and has extensive experience in pharmaceutical products development, manufacturing and distribution. From September 1981 to April 1994, he worked as a salesperson at the Puning Chang Mei Herbs Shop* (普寧市長美藥材站). From May 1994 to September 1998, he worked as a salesperson at Zhongshan Herbs Company* (中山市藥材公司). Mr. Lai was a manager of Zhongshan Zhongzhi Pharmaceutical Group Co., Ltd. (中山市中智藥業集團有限公司) ("Zhongzhi Pharmaceutical") before its transformation from a collective enterprise to a limited liability company. In September 1999, he became a shareholder of our Group. Under the leadership of Mr. Lai, our Group's business expanded from the distribution of pharmaceutical products to the operation of chain pharmacies and the production of pharmaceutical products.

Mr. Lai is currently the vice chairman of China Pharmaceutical Materials Association* (中國醫藥物資協會) and the president of Guangdong Pharmacies Union* (廣東藥店聯盟). Mr. Lai is an adjunct associate professor and a mentor of the Master's programme at the Research Centre of Chinese Herbal Resources (Science and Engineering)* (中藥資源科學與工程研究中心) of Guangzhou University of Chinese Medicine* (廣州中醫藥大學).

**Mr. Lai Ying Feng (賴穎豐)**, aged 29, was appointed as the executive Director on 14 May 2018, chief executive of the Company on 24 March 2021 and is a member of each of the remuneration committee and the nomination committee of the Company. He joined the Group since April 2014 and has served as a director of sales in several sales divisions, helping to formulate sales strategies, and has served as the head of branding for the Company, leading the Group's brand and marketing strategies. Since July 2016, Mr. Lai has served as a director of Zhongshan Zhongzhi Pharmaceutical Group Co., Ltd.* (中山市中智藥業集團有限公司), a subsidiary of the Company, mainly responsible for organizing the formulation of business plan of the Company, investment and financing plan, and making decisions on major issues. He is the son of Mr. Lai Zhi Tian, an executive Director and Ms. Jiang Li Xia, a non-executive Director, and brother to Mr. Lai Ying Sheng, a chief financial officer.

In July 2014, Mr. Lai obtained a bachelor's degree in economics from the Faculty of Arts and Social Sciences at Simon Fraser University in Canada and obtained a qualification certificate for the secretary of the board. Since April 2016, Mr. Lai has also been the vice president of the 1st Youth Entrepreneurs Association of Zhongshan Torch Hi-tech Industrial Development Zone* (第一屆中山火炬高技術產業開發區青年企業家協會).

* For identification purpose only

# Biographical Details of Directors and Senior Management

**Mr. Cao Xiao Jun (曹曉俊)**, aged 53, was appointed as the executive Director on 30 January 2015 and the vice president of our Group. He joined our Group on 8 March 2010 and is responsible for supervising business development and overseeing sales and marketing activities of our Group. He obtained a Bachelor degree of Chemistry and Pharmacy Training from China Pharmaceutical University* (中國藥科大學) in July 1989. Mr. Cao was qualified as a pharmaceutical manufacturing engineer* (製藥工程師) and obtained a professional qualification in pharmacy* (藥學) in July 1999 and October 2002 respectively.

Mr. Cao has over 25 years of experience in the pharmaceutical industry. He served as the marketing manager in Guangdong Shiqi Pharmaceutical Company Limited* (廣東石岐製藥公司) from July 1989 to March 1997 and since then to June 2000, he became the deputy general manager of Shenzhen Wedge Pharmaceutical Chains Company Limited* (深圳市萬澤醫藥有限公司). From June 2000 to July 2009, he served as the deputy general manager of Shenzhen Naber Medicine Company Limited* (深圳市南北醫藥有限公司).

**Mr. Cheng Jin Le (成金樂)**, aged 58, was appointed as the executive Director on 19 September 2016 and is the vice president and chief engineer of the Group. He joined our Group in June 2003 and is responsible for overseeing the research and development of decoction pieces. Mr. Cheng is a licensed pharmacist* (執業中藥師) in the People's Republic of China and has over 35 years of experience in the pharmaceutical industry. Prior to joining our Group, he served as the chief pharmacist of Chinese medicine in the Hubei Macheng People's Hospital* (湖北麻城市人民醫院). Mr. Cheng is also an adjunct professor in the Guangzhou University of Chinese Medicine* (廣州中醫藥大學) since December 2007 and the Chairman of the Zhongshan Pharmaceutical Association* (中山市藥學會) since November 2013.

## NON-EXECUTIVE DIRECTORS

**Ms. Jiang Li Xia (江麗霞)**, aged 56, was appointed as the executive Director on 12 September 2014 and was re-designated as the non-executive Director on 19 September 2016. She is the controlling shareholder of the Company. Prior to joining our Group, Mrs. Lai has been a volunteer in the local community centre in a suburb of Vancouver, Canada from 2005 to 2008. She assisted in the operation of the centre where she gained her relevant experience in administration. Mrs. Lai joined our Group on 24 February 2009 and was responsible for supervising business administration of our Group. Her duties included overseeing human resources matters and co-ordinating among different departments to ensure sufficiency of office support for the operation of our Group. She is the spouse of Mr. Lai Zhi Tian, an executive Director, and mother of Mr. Lai Ying Feng, an executive Director and Mr. Lai Ying Sheng, a chief financial officer.

**Mr. Yang Ai Xing (陽愛星)**, aged 54, was appointed as a non-executive Director on 14 May 2018. He obtained a Bachelor of Science degree in Chemistry from the Chemistry Department of Xiangtan University in 1988 and an executive MBA degree from the Royal Roads University in Canada in 2002.

From September 1988 to September 1995, Mr. Yang served as the technician, the deputy head of the quality control department, and the center chief chemist director of Zhuzhou Pharmaceutical Factory in Hunan Province* (湖南省株洲製藥廠). From October 1995 to January 2016, he served as the sales director, marketing director, vice president of marketing and group chief executive of Jiaduobao Holdings Limited* (加多寶集團有限公司). Since February 2016, he has been the managing partner of Shanghai Novich Positioning Investment Management Co., Limited* (上海諾偉其定位投資管理有限公司).

* For identification purpose only

# Biographical Details of Directors and Senior Management

## INDEPENDENT NON-EXECUTIVE DIRECTORS

**Mr. Ng Kwun Wan (吳冠雲)**, aged 57, was appointed as an independent non-executive Director on 8 June 2015. He is the chairman of the audit committee and a member of each of the remuneration committee and the nomination committee of the Company. He obtained the Bachelor of Arts degree in Accounting and Finance from the Manchester Polytechnic in July 1988 and the Master of Commerce majoring in Accounting from the University of New South Wales in May 1990. He has been an associate member of the Hong Kong Institute of Certified Public Accountants since 1993.

Mr. Ng has over 20 years of experience in management. From November 1994 to October 1995 and from October 1995 to June 1998, Mr. Ng worked as a project manager for New World Development (China) Limited and New World Infrastructure Limited respectively. From July 1998 to August 2004, he worked for New World China Enterprises Projects Limited, a wholly owned subsidiary of New World Development Company Limited (Stock Code: 17), and his last position was deputy general manager. From September 2006 to March 2009, he worked as the general manager of industrial operations in the real estate department of Smart Faith Management Limited (a subsidiary of South China (China) Limited (Stock Code: 413)). Mr. Ng has been an independent non-executive director of China Flavors and Fragrances Company Limited (Stock Code: 3318) since December 2009.

**Mr. Wong Kam Wah (黃錦華)**, aged 52, was appointed as an independent non-executive Director on 8 June 2015. He is the chairman of each of the remuneration committee and the nomination committee and a member of the audit committee of the Company. He obtained his Bachelor's degree in Laws from the City Polytechnic of Hong Kong, the predecessor institution of the City University of Hong Kong, in December 1994. He obtained a postgraduate certificate in laws from the City University of Hong Kong in November 1995 and a Master degree in Laws from the King's College London, the University of London in November 1996. He further completed the Diploma in Insolvency held by the Hong Kong Institute of Certified Public Accountants in June 2010. Mr. Wong was admitted as a solicitor of Hong Kong in August 1999.

Mr. Wong has over 15 years of experience in legal practice. He is currently a partner of Messrs. Lau Edward, Wong & Lou.

**Mr. Zhou Dai Han (周岱翰)**, aged 79, was appointed as an independent non-executive Director on 8 June 2015. He is a member of each of the audit committee, the remuneration committee and the nomination committee of the Company. He obtained a Bachelor degree of Medical Treatment awarded by the Guangzhou College of Chinese Medicine* (廣州中醫學院) (the predecessor institution of the Guangzhou University of Chinese Medicine* (廣州中醫藥大學)) in August 1966. Mr. Zhou was accredited as an instructor of the Teaching and Inheritance of Experience of Famous and Veteran Doctors of Traditional Chinese Medicine* (全國老中醫藥專家學術經驗繼承指導老師) in November 2002. He was accredited as a Renowned Chinese Medical Practitioner of Guangdong Province* (廣東省名中醫) in October 2012.

Mr. Zhou has over 30 years of experience in the field of Chinese medicines. Since 1976, Mr. Zhou has been working at the Guangzhou College of Chinese Medicine as a lecturer, associate professor, associate dean of the tumor research center* (腫瘤研究室副主任), chief medical practitioner* (主任醫師), dean of the tumor department* (腫瘤科主任) and professor.

Mr. Zhou completed the Listed Companies Independent Directors Training Programme* (上市公司獨立董事培訓班) co-organised by the Securities Association of China and the Shenzhen Stock Exchange in January 2003.

* For identification purpose only

# Biographical Details of Directors and Senior Management

## SENIOR MANAGEMENT

**Mr. Lai Ying Sheng (賴穎盛)**, aged 27, joined our Group on 1 October 2018 as the Group's Assistant Financial Controller and on 24 March 2021 as the Chief Financial Controller. Mr. Lai graduated from the University of British Columbia, Canada, in 2016 with an undergraduate degree in Commerce, specialized in Accounting. Since then, he has worked in the audit practice of KPMG LLP, Vancouver office, and has completed his Chartered Professional Accounting Qualifications during his time at KPMG.

Upon joining the Group in 2018, Mr. Lai headed the Group's Accounting department in its daily operations and, over time, began to manage the Group's other management functions including Human Resources, Internal Controls, Investor Relationships and Purchasing. He is the son of Mr. Lai Zhi Tian, an executive Director and Ms. Jiang Li Xia, a non-executive Director, and brother to Mr. Lai Ying Feng, an executive Director and Chief Executive.

**Mr. Qiao Wei Lin (喬衛林)**, aged 45, holds a bachelor's degree and is a senior engineer and registered pharmacist. He is currently the vice president of Zhongzhi Pharmaceutical Group and is responsible for technical research and development, quality control, Chinese medicine resources management and administration.

Mr. Qiao graduated from Tongji Medical College of Huazhong University of Science & Technology in July 2000. He joined Grünenthal Pharmaceutical (China) Company Limited (格蘭泰製藥(中國)有限公司) in August 2000, during which he received systematic training on the German pharmaceutical manufacturing technology system. After three years of service, he joined the Company's subsidiary, Honeson Pharmaceutical, in August 2003 and worked in the quality control and production departments successively. Since 2010, he has been the director of quality and chief executive officer of the Group, responsible for implementing the Group's quality policy, ensuring the healthy operation of the quality control system, as well as being responsible for the external public affairs of the Company.

His current social positions include: deputy secretary general of Guangdong Chinese Medicine Association (廣東省中藥協會), director of Guangdong Provincial Association of Chinese Medicine, member of the Technical Committee on Chinese Medicine Standardization of Guangdong Province (廣東省中藥標準化技術委員會), member of the Professional Committee on Lingnan Chinese Herbal Resources of the Guangdong Pharmaceutical Association (廣東省藥學會嶺南中草藥資源專業委員會), etc.

**Mr. He Gui Quan (何貴全)**, aged 41, joined Honeson Pharmaceutical in July 2003. He worked as a production workshop supervisor from July 2003 to December 2007. From January 2008 to December 2009, he was the production manager of Honeson Pharmaceutical. From January 2010 to December 2015, he worked as the assistant to the general manager of Honeson Pharmaceutical and worked as the general manager from January 2016 to December 2020, responsible for the overall management of Honeson Pharmaceutical. In January 2021, he was promoted to the vice president of the Group, responsible for the management of production segments of the Group.

Mr. He graduated from Guangdong Pharmaceutical University* (廣東藥學院) and is a licensed pharmacist as approved by the Ministry of Personnel of the PRC* (中華人民共和國人事部).

* For identification purpose only

# Biographical Details of Directors and Senior Management

**Mr. Ran Qiang (冉強)**, aged 47, joined Zhongshan Zhongzhi Pharmaceutical Group Co., Ltd. (中山市中智藥業集團有限公司) in March 2016 and is currently the vice president of the Group, the deputy secretary general of the Academic Expert Committee of the Key Research Laboratories (重點研究室學術專家委員會), member of the Professional Committee on Quality and Safety of Chinese Medicines of China Association of Traditional Chinese Medicine (中國中藥協會中藥品質與安全專業委員會) and executive director of Guangdong Provincial Association of Chinese Medicine. He graduated from Anhui College of Traditional Chinese Medicine in 1996 with a degree in pharmacology and from the Business School of Renmin University of China in 2005 with an MBA in Pharmaceutical Business Administration.

Prior to joining the Group, he worked for Buchang Pharmaceutical Co., Ltd. (步長製藥有限公司).

**Ms. Jiang Mei Fang (姜梅芳)**, aged 59, joined our Group on 1 June 2000 as a pharmacist (藥師) of Zhongzhi Chain Pharmacies Company Limited* (中山市中智大藥房連鎖有限公司) ("Zhongzhi Chain Pharmacies", a subsidiary of the Group). In March 1980, Ms. Jiang graduated from the School of Hygiene of Huangshi City of Hubei* (湖北省黃石市衛生學校). In 1995, Ms. Jiang became a licensed pharmacist as approved by the Ministry of Personnel of the PRC* (中華人民共和國人事部). In December 2011, she was qualified as a medical devices enterprise supervisor* (醫療器械企業負責人).

Prior to joining our Group, from March 1980 to May 1987, Ms. Jiang worked as a pharmacist (藥師) at Huangshi Hua Xin Hospital Company Limited* (黃石市華新醫院有限責任公司), formerly known as Hua Xin Cement Group Worker's Hospital* (華新水泥集團職工醫院). From June 1987 to June 2000, she worked as a supervisor at the pharmaceutical department of the same company. She served as the general manager of Zhongzhi Chain Pharmacies from June 2003 to March 2017. She has been the chairman of Zhongzhi Chain Pharmacies since April 2017.

**Ms. Shen Man Na (沈嫚娜)**, aged 40, currently works as the general manager of Zhongzhi Chain Pharmacies, and the representative of the People's Congress of Zhongshan. In 2001, she joined Zhongzhi Pharmaceutical Group and worked in quality department and procuring department successively. From 2007 to March 2017, she worked as the manager of the commodities department, manager of the procuring department and the director of the commodities department of Zhongzhi Chain Pharmacies successively. Since April 2017, she has served as the general manager of the Zhongzhi Chain Pharmacies.

She graduated from Shaoguan Health College (韶關衛生學校) in 2000, majoring in pharmaceutics and from Guangzhou University of Chinese Medicine in 2013, majoring in Chinese medicine. She obtained the qualification of Senior Nutritionist (高級營養師) in 2014, and the qualification of licensed pharmacist of Chinese medicine (執業中藥師) in 2015.

* For identification purpose only

# Biographical Details of Directors and Senior Management

**Mr. Chen Jiong (陳炯)**, aged 47, joined our Group on 31 August 2007 as the production manager of Honeson Pharmaceutical. In July 1997, Mr. Chen obtained a Bachelor degree of Science in pharmacy awarded by the Guangdong Pharmaceutical University* (廣東藥學院). In February 2001, Mr. Chen became a licensed pharmacist as approved by the Ministry of Personnel of the PRC* (中華人民共和國人事部).

Prior to joining our Group, from July 1997 to November 2001, Mr. Chen served as the production worker of Guangzhou Chen Li Ji Pharmaceutical Factory* (廣州陳李濟藥廠) responsible for the operation of the production line and maintaining the GMP production standard. From January 2004 to December 2007, he worked as the manager of the production department of Honeson Pharmaceutical. From January 2008 to June 2008, he was the production supervisor of the same department. From July 2008 to December 2009, he worked as the assistant to the general manager of Honeson Pharmaceutical and was the general manager of Honeson Pharmaceutical from January 2010 to December 2015. Mr. Chen is now the general manager of Guangdong Caojinghua Cell-broken Herb Company Limited* (廣東草晶華破壁草本有限公司) ("Guangdong Caojinghua"), an indirect wholly owned subsidiary of the Company, and is responsible for the overall management of Guangdong Caojinghua.

**Mr. Tang Lin (唐琳)**, aged 57, joined our Group on 31 August 2007 as the head of the technical development department of Honeson Pharmaceutical. In June 1985, Mr. Tang obtained a Bachelor degree of Science in Chinese Medicine awarded by the Hunan College of Chinese Medicine* (湖南中醫學院), the predecessor institution of the Hunan University of Chinese Medicine* (湖南中醫藥大學). In September 1996, he became a licensed pharmacist as approved by the Ministry of Personnel of the PRC* (中華人民共和國人事部).

Prior to joining our Group, from August 1985 to May 1987, Mr. Tang worked as a pharmacist at Fuchuan Yaozu Autonomous Region People's Hospital* (富川瑤族自治縣人民醫院). From May 1987 to October 1994, he worked as an assistant factory manager of Guangxi Province Wuzhou Third Medicinal Factory* (廣西梧州地區第三製藥廠). From December 1997 to December 2000, he worked as a deputy head of the production department of Europharm Laboratories Co., Ltd.* (廣州歐化藥業有限公司). From March 2001 to October 2001, he worked as the head of the production department of Guangdong Jiangmen Ming Sheng Medicine Manufacturing Limited* (廣東江門名盛製 藥有限公司).

From November 2001 to December 2009, Mr. Tang worked as the head of technical development department of Honeson Pharmaceutical. From January 2010 to December 2013, he worked as the general manager of the technical department of Zhongzhi Pharmaceutical. Since January 2010 and December 2017, he had been the chief engineer of Honeson Pharmaceutical and the director of the technical department of Zhongzhi Pharmaceutical respectively. Since January 2018, he has been the deputy general manager and chief engineer of Honeson Pharmaceutical. Mr. Tang is also responsible for reviewing the quality control procedures performed by our quality control team.

* For identification purpose only

# Corporate Governance Report

## CORPORATE GOVERNANCE PRACTICES

The Company has adopted and complied with the code provisions set out in the Corporate Governance Code (the "CG Code") as set out in Appendix 14 to the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules") during the Reporting Period except the following deviation:

### Code Provision A.2.1

Pursuant to CG Code provision A.2.1, the role(s) of a chairman and chief executive should be separate and should not be performed by the same individual. Mr. Lai Zhi Tian ("Mr. Lai") is the Chairman and the general manager of the Group. In view of Mr. Lai is the founder of the Group and has been operating and managing the Group since 1999, the Board believes that it is in the best interest of the Group to have Mr. Lai taking up both roles for effective management and business development. Therefore the Directors consider that the deviation from the CG Code provision A.2.1 is appropriate in such circumstances.

As all major decisions are made in consultation with the members of the Board, and there are three independent non-executive Directors on the Board offering independent perspectives, the Board is therefore of the view that there are adequate safeguards in place to ensure sufficient balance of powers within the Board. The Board will also continue to review and monitor the practices of the Company for the purpose of complying with the CG Code and maintaining a high standard of corporate governance practices of the Company.

## MODEL CODE FOR SECURITIES TRANSACTIONS OF DIRECTORS OF LISTED ISSUERS (THE "MODEL CODE")

The Company has adopted the Model Code set out in Appendix 10 to the Listing Rules as its code of conduct regarding Directors' securities transactions. All Directors have confirmed that, following specific enquiry by the Company, they have complied with the required standard set out in the Model Code during the year ended 31 December 2020.

## CHAIRMAN AND CHIEF EXECUTIVE OFFICER

CG Code provisions A.2.1 stipulates that the roles of chairman and chief executive officer should be separate and should not be performed by the same individual. As at the date of this report, the roles of the chairman and the chief executive officer are separate. Mr. Lai Zhi Tian was the chairman while the role of the chief executive was performed by Mr. Lai Ying Feng.

## INDEPENDENT NON-EXECUTIVE DIRECTORS

The independent non-executive Directors are highly skilled professionals with a broad range of expertise and experience in the fields of accounting, finance, law and business. Their skills, expertise and number in the Board ensure that strong independent views and judgement are brought in the Board's deliberations and that such views and judgement carry weight in the Board's decision-making process. Their presence and participation also enable the Board to maintain high standards of compliance in financial and other mandatory reporting requirements, and provide adequate checks and balances to safeguard the interests of shareholders of the Company and the Company.

# Corporate Governance Report

The Company annually assesses the independence of each independent non-executive Director during their terms of appointment. During the Reporting Period, the Company received from each of the independent non-executive Directors a written confirmation of their independence pursuant to Rule 3.13 of the Listing Rules. The Company considers that all the independent non-executive Directors are independent.

## THE BOARD

The Board currently comprises four executive Directors, namely Mr. Lai Zhi Tian (Chairman), Mr. Lai Ying Feng, Mr. Cao Xiao Jun and Mr. Cheng Jin Le; two non-executive Directors, namely Ms. Jiang Li Xia and Mr. Yang Ai Xing; and three independent non-executive Directors, namely Mr. Ng Kwun Wan, Mr. Wong Kam Wah and Mr. Zhou Dai Han. The number of independent non-executive Directors represents more than one third of the Board. The biographical details of and relationships among the members of the Board are disclosed under the section headed "Biographical Details of Directors and Senior Management" on pages 15 to 20 of this annual report.

The Directors believe that the composition of the Board reflects the necessary balance of skills and experience appropriate for the requirements of the business development of the Group and for effective leadership as all the Executive Directors possess extensive experience in management and professional knowledge in business, while the three independent non-executive Directors possess professional knowledge and broad experience in finance, law and business. The Directors are of the opinion that the present structure of the Board can ensure the independence and objectivity of the Board and provide a system of checks and balances to safeguard the interests of the shareholders of the Company and the Company.

The Directors acknowledge their responsibilities for preparing the financial statements of the Company for the year ended 31 December 2020. The Directors are not aware of any material uncertainties relating to events or conditions that may cast significant doubt upon the Company's ability to continue as a going concern. The statement of the independent auditor of the Company about their reporting responsibilities on the financial statements is set out in the Independent Auditor's Report on pages 97 to 101.

The Board is responsible for leadership and control of the Company and oversees the Group's business, strategic decisions and performance and is collectively responsible for promoting the success of the Company by directing and supervising its affairs. Directors of the Board shall take decisions objectively in the interests of the Company.

## APPOINTMENT, RE-ELECTION AND REMOVAL OF DIRECTORS

All Directors are appointed for a specific term. Each of the non-executive Directors of the Company is under a service contract with the Company for a period of three years commencing from 13 July 2018 (except for Ms. Jiang Li Xia whose contract commenced from the Listing day and shall continue thereafter and Mr. Yang Ai Xing whose contract commenced from 14 May 2018 and shall continue thereafter).

According to the articles of association of the Company (the "Articles"), all Directors are subject to retirement by rotation at least once every three years and are eligible for re-election at the Company's annual general meeting ("AGM"). Any new director appointed by the Board to fill a casual vacancy shall submit himself/herself for re-election by shareholders at the first general meeting after his/her appointment, and any new director appointed by the Board as an addition to the Board shall submit himself/herself for re-election by shareholders at the next AGM.

## PROCEEDINGS OF BOARD MEETINGS AND BOARD COMMITTEE MEETINGS

The Board may meet together for the dispatch of business, adjourn and otherwise regulate its meeting and proceedings as it thinks fit and may determine the quorum necessary for the transaction of business. An AGM and an extraordinary general meeting called for the passing of a special resolution shall be called by at least 21 days' notice in writing, and a meeting of the Company other than an AGM or an extraordinary general meeting for the passing of a special resolution shall be called by at least 14 days' notice in writing. A meeting of the Board of any committee of the Board may be held by means of such telephone, electronic or other communication facilities as permit all persons participating in the meeting.

When a Director and the enterprise(s) involved in a proposal of a Board meeting have connected relations, such Director shall not exercise his/her voting rights on such proposal nor shall he/she exercise any voting rights on behalf of other Directors.

Set out below are details of the attendance record of each Director at the Board, committee and general meetings of the Company held during the year ended 31 December 2020:

| | Attendance/Number of Meetings Held | | | | |
|---|---|---|---|---|---|
| **Name of Directors** | **Regular Board Meeting** | **Audit Committee Meeting** | **Nomination Committee Meeting** | **Remuneration Committee Meeting** | **General Meeting** |
| **Executive Directors** | | | | | |
| Mr. Lai Zhi Tian | 4/4 | — | 1/1 | 1/1 | 2/2 |
| Mr. Lai Ying Feng | 4/4 | — | — | — | 2/2 |
| Mr. Cao Xiao Jun | 4/4 | — | — | — | 2/2 |
| Mr. Cheng Jin Le | 4/4 | — | — | — | 2/2 |
| **Non-Executive Directors** | | | | | |
| Ms. Jiang Li Xia | 4/4 | — | — | — | 2/2 |
| Mr. Yang Ai Xing | 4/4 | — | — | — | 2/2 |
| **Independent Non-Executive Directors** | | | | | |
| Mr. Ng Kwun Wan | 4/4 | *2/2 | 1/1 | 1/1 | 2/2 |
| Mr. Wong Kam Wah | 4/4 | 2/2 | *1/1 | *1/1 | 2/2 |
| Mr. Zhou Dai Han | 4/4 | 2/2 | 1/1 | 1/1 | 2/2 |

* representing chairman of the board or the committees

# Corporate Governance Report

The Board has established three committees, namely, the audit committee ("Audit Committee"), the remuneration committee ("Remuneration Committee") and the nomination committee ("Nomination Committee"), for overseeing particular aspects of the Company's affairs. All committees have been established with defined written terms of reference, which were posted on the Stock Exchange (www.hkex.com.hk) and the Company website (www.zeus.cn). All committees should report to the Board on their decisions or recommendations made.

All committees are provided with sufficient resources to discharge their duties and, upon reasonable request, are able to seek independent professional advice in appropriate circumstances, at the Company's expense.

## Audit Committee

The Audit Committee was established on 8 June 2015 with terms of reference (amended on 31 December 2015) in compliance with the CG Code for the purpose of making recommendations to the Board on the appointment and removal of the external auditor, to review the financial statements and related materials and provide advice in respect of the financial reporting process, and to oversee the risk management and internal control systems of the Group. The Audit Committee comprises three members, all being independent non-executive Directors, namely, Mr. Ng Kwun Wan (Chairman), Mr. Wong Kam Wah and Mr. Zhou Dai Han. The Group's accounting principles and policies, financial statements and related materials for the year had been reviewed by the Audit Committee.

The external auditor was invited to attend two Audit Committee meetings held during the year to discuss with the Audit Committee members on the audit and financial reporting related matters. The Chairman of the Audit Committee provided the Board with a briefing on the significant issues after each Audit Committee meeting. There was no disagreement between the Board and the Audit Committee on the selection and appointment of the external auditor.

## Remuneration Committee

The Remuneration Committee was established on 8 June 2015 with terms of reference in compliance with the CG Code for the purpose of making recommendations to the Board on the overall remuneration policy and structure relating to the Directors and senior management of the Group, to review and evaluate their performance in order to make recommendations on the remuneration package of each of the Directors and senior management as well as other employee benefit arrangements. The Remuneration Committee comprises a total of five members, being two executive Directors, namely, Mr. Lai Zhi Tian and Mr. Lai Ying Feng, and three independent non-executive Directors, namely, Mr. Ng Kwun Wan, Mr. Wong Kam Wah (Chairman) and Mr. Zhou Dai Han. Accordingly, a majority of the members are independent non-executive Directors.

During the year ended 31 December 2020, the Remuneration Committee has held one meeting. Full minutes of the Remuneration Committee meetings are kept by the Company Secretary. Draft and final versions of the minutes of the Remuneration Committee meetings are circulated to all members of the Remuneration Committee for comments and approval and all decisions of the Remuneration Committee are reported to the Board subject to applicable restriction.

The terms of reference of the Remuneration Committee are available on the website of the Company and of the Stock Exchange.

# Corporate Governance Report

For the year ended 31 December 2020, the annual salary of the senior management of the Company falls within the following bands.

| Remuneration bands (HK$) | Number of senior management |
|---|---|
| Nil to 500,000 | 6 |
| 500,000 to 1,200,000 | 2 |

## Nomination Committee

The Nomination Committee was established on 8 June 2015 with terms of reference in compliance with the CG Code for the purpose of making recommendations to the Board on the appointment of Directors and the management of the Board succession. The Nomination Committee comprises a total of five members, being two executive Directors, namely, Mr. Lai Zhi Tian and Mr. Lai Ying Feng, and three independent non-executive Directors, namely, Mr. Ng Kwun Wan, Mr. Wong Kam Wah (Chairman) and Mr. Zhou Dai Han. Accordingly, a majority of the members are independent non-executive Directors.

The Board would follow a set of formal, considered and transparent procedures for the appointment of new directors to the Board. The appointment of a new director has been a collective decision of the Board, taking into consideration the candidate's qualification, expertise, experience, integrity and commitment to his/her responsibilities within the Group. In addition, all candidates to be selected and appointed as a director must be able to meet the standards set out in Rules 3.08 and 3.09 of the Listing Rules.

During the year ended 31 December 2020, the Nomination Committee has held one meeting. Full minutes of the Nomination Committee meetings are kept by the Company Secretary. Draft and final versions of the minutes of the Nomination Committee meetings are circulated to all members of the Nomination Committee for comments and approval and all decisions of the Nomination Committee are reported to the Board subject to applicable restriction.

The terms of reference of the Nomination Committee are available on the website of the Company and of the Stock Exchange.

## Nomination Policy

The Board has adopted the nomination policy (the "Nomination Policy") on 29 August 2018 which sets out the nomination criteria and procedures for the Company to select candidate(s) for possible inclusion in the Board. The Nomination Policy could assist the Company to achieve board diversity in the Company and enhance the effectiveness of the Board and its corporate governance standard.

When assessing the suitability of a candidate, factors such as the qualifications, skills, integrity and experience will be taken into consideration as a whole. In the case of independent non-executive Directors, they must further satisfy the independence criteria set out within Rule 3.13 of the Listing Rules. Since the selection of candidates should ensure that diversity remains a central feature of the Board, a range of diverse perspectives, including but not limited to gender, age, cultural and educational background, or professional experience would be considered.

# Corporate Governance Report

The process to identify potential candidates for the Board would be as follows:

(1) identifying potential candidates, including recommendations from the Board members, professional search firms and the shareholders of the Company;

(2) evaluating the candidates based on the approved selection criteria through methods such as reviewing the resume and conducting the background checks;

(3) reviewing the profiles of the shortlisted candidates and interview them; and

(4) making recommendations to the Board on the selected candidates.

The Nomination Policy also includes the Board succession plan to assess whether vacancies on the Board would be created or expected due to the Directors' resignation, retirement, death and other circumstances and to identify candidates in advance if necessary. The Nomination Policy will be reviewed on a regular basis.

### Board Diversity Policy

The Board has adopted a board diversity policy which sets out the approach to achieve diversity on the Board. The Company recognises the benefits of a Board that possesses a balance of skills, experience, expertise and diversity of perspectives appropriate to the requirements of the businesses of the Company.

The Company seeks to achieve board diversity through the consideration of a number of factors in the Board members' selection process, including but not limited to gender, age, cultural and educational background, ethnicity, professional experience, skills, knowledge and length of service. All Board appointments will be based on meritocracy, and candidates will be considered against objective criteria, having due regard for the benefits of diversity on the Board.

The Nomination Committee will review the board diversity policy, as appropriate, to ensure the effectiveness of the board diversity policy and also discusses any revisions that may be required and recommend any such revisions to the Board for consideration and approval.

## CORPORATE GOVERNANCE FUNCTION

The Board does not have a Corporate Governance Committee. The functions that would be carried out by a Corporate Governance Committee are performed by the Board as a whole and are as follows:

1. to develop and review the Company's policies and practices on corporate governance;

2. to review and monitor the training and continuous professional development of directors and senior management;

3. to review and monitor the Company's policies and practices on compliance with legal and regulatory requirements;

4. to develop, review and monitor the code of conduct and compliance manual (if any) applicable to employees and directors; and

5. to review the Company's compliance with the CG code and disclosure in the Corporate Governance Report.

# Corporate Governance Report

The corporate governance policy is formulated with an emphasis on the Board's quality, effective internal control, stringent disclosure practices and transparency and accountability to all shareholders of the Company. The Board strives to comply with the code provisions and reviews its corporate governance policy regularly in order to maintain high standards of business ethics and corporate governance, and to ensure the full compliance of the Group's operations with applicable laws and regulations.

## CONTINUOUS PROFESSIONAL DEVELOPMENT

Pursuant to the CG Code provision A.6.5, all Directors should participate in a programme of continuous professional development to develop and refresh their knowledge and skills to ensure that their contribution to the Board remains informed and relevant. The Company should be responsible for arranging and funding training, placing an appropriate emphasis on the roles, functions and duties of the Directors. During the year ended 31 December 2020, the Company had arranged to provide trainings to all the Directors.

For the year ended 31 December 2020, the Directors participated in the following continuous professional development:

| Name of Directors | Training organized by professional organization[1] | Reading materials updating on new rules and regulations |
|---|---|---|
| **Executive Directors** | | |
| Mr. Lai Zhi Tian | ✓ | ✓ |
| Mr. Lai Ying Feng | ✓ | ✓ |
| Mr. Cao Xiao Jun | ✓ | ✓ |
| Mr. Cheng Jin Le | ✓ | ✓ |
| **Non-executive Directors** | | |
| Ms. Jiang Li Xia | ✓ | ✓ |
| Mr. Yang Ai Ying | ✓ | ✓ |
| **Independent Non-executive Directors** | | |
| Mr. Ng Kwun Wan | ✓ | ✓ |
| Mr. Wong Kam Wah | ✓ | ✓ |
| Mr. Zhou Dai Han | ✓ | ✓ |

Notes:

1. Professional training namely "Case Study: Merger and Acquisition" was arranged by the Company to update the Directors' knowledge.

2. The Company received from each of the Directors the confirmations on taking continuous professional training.

# Corporate Governance Report

## EXTERNAL AUDITOR'S REMUNERATION

The Company engaged Ernst & Young as its external auditor for the year ended 31 December 2020. There was no disagreement between the Board and the Audit Committee on the selection, appointment, resignation or dismissal of the external auditor.

During the year ended 31 December 2020, the fee payable to Ernst & Young, is set out as follows:

| Nature of Services | Fee paid/payable RMB'000 |
|---|---|
| Audit services | 2,600 |
| Non-audit services | 689 |

Non-audit services fees include (1) fees for providing internal control services and (2) fees related to ESG report.

## INTERNAL CONTROL

### Risk Management and Internal Control

The Board puts emphasis on risk management and has established and maintained suitable and effective risk management and internal control system. Such system aims to manage, rather than eliminate, risks of failure to achieve business objective, and provides reasonable, though not absolute, assurance against material misstatement or loss by the Group.

To attain the objective, with reference to the COSO (Committee of Sponsoring Organizations of the Treadway Commission) standards and best practices from excellent management companies, the management balances the actual situation and business features of the Company, while continuously allocates resources to optimize risk management and internal control system. The management assessed the effectiveness and appropriateness of the internal control system on the ground of the above to ensure the effective operation of the control system.

### Risk Management Organization System

With respect to the organizational structure, the Group has established a set of complete organizational structure to manage risks that the Group is exposed to.

***Risk Supervision Function***

*The Board's Responsibilities to Shareholders Regarding the Effectiveness of Comprehensive Risk Management*

- Recognizing overall objectives of risk management, risk appetite and risk tolerance of the corporation, approving risk management strategies and substantial risk-mitigating plans as well as risk management measures;

- Understanding every material risk that the corporation will encounter and its current risk management status and making effective risk-control decisions;

- Approving the annual comprehensive risk management report;

- Overseeing the cultivation of risk management culture of the corporation.

# Corporate Governance Report

***Risk Management Function***

*Audit Committee is the top risk management body of the Company and is held accountable to the Board*

- Considering the construction plan of comprehensive risk management system;
- Determining the plan on set-up of risk management organizational structure and their duties;
- Approving the regulation, system and the key procedures in risk management;
- Considering and assessing on the strategies of the Group in risk management;
- Approving the annual risk management work plan;
- Considering and assessing the significant solutions and measures in risk management;
- Reviewing and submitting annual comprehensive risk management report to the Board.

***Daily Risk Management Function***

*Risk Management Project Team leads daily risk management works and reports to Audit Committee*

- Responsible for the establishment and improvement of the risk management system and mechanism of the Company;
- Proposing annual risk management work plan and submitting the plan to Audit Committee for consideration;
- Organizing the process owners from various functions and departments of the Group and the respective subsidiaries to identify and assess risks on regular basis, and identify significant risks the Company is exposed to;
- Organizing the process owners from various functions and departments of the Group and the respective subsidiaries to discuss and formulate risk response strategies and solutions for the risks the Company is exposed to and to prepare comprehensive risk management report;
- Organizing or jointly organizing various functions and departments of the Group and the respective subsidiaries to improve the internal control system based on the risk response plan;
- Following up the implementation of the risk response plan performed by various functions and departments of the Group and the respective subsidiaries, and reviewing the operational effectiveness of the internal control system.

# Corporate Governance Report

***Risk Management Implementation Function***

*Respective functional departments of the Company commences risk management under the coordination of risk management project team*

- Executing basic procedures for risk management and internal control;
- Identifying and assessing risks, and recognizing significant risks that the Company is exposed to under the guidance of risk management project team;
- Discussing and implementing risk control measures and solutions against risks the Company is exposed to under the guidance of the risk management project team;
- Enhancing the internal control system of the functions and departments in accordance with the risk response plan.

***Internal Audit Function***

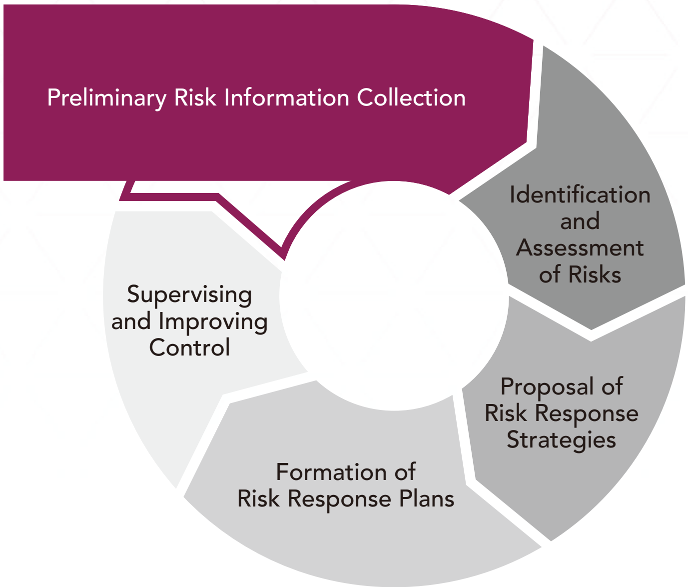
*Internal Audit Department analyzes and makes independent assessment on the adequacy and effectiveness of the risk management and internal control system of the Group*

- Responsible for establishing and amending the internal reviewing system and work mechanism of the Company;
- Formulating internal audit plan and determining internal audit focuses, audit methods and procedures, time of audit and staff arrangement/engagement arrangement of third party professional institutions based on the substantial risks and business fields the Company is exposed to, and submitting the Board and Audit Committee for consideration;
- Reviewing the effectiveness of risk management and the internal control system, including the annual comprehensive risk management report, risk management plan and daily risk management solutions; assessing the design and operational effectiveness of the internal control system;
- Auditing the assessment results of risk management and internal control system issued by the third party;
- Reporting the risk management and internal control works to Audit Committee and the Board.

# Corporate Governance Report

## Risk Management Procedures

The Group has established a set of complete risk management procedures to identify, assess and manage substantial risks, to review the effectiveness of risk management and the internal control system, and to resolve serious deficiencies on internal control. Specific procedures of risk management are as follows:




**(a) Preliminary Risk Information Collection:**

The risk management project team organizes various functions and departments of the Company and the Group and the respective subsidiaries to extensively and continuously collect internal and external preliminary information related to risk management for the list of risk information.

**(b) Identification and Assessment of Risks:**

Risk assessment questionnaires were designed based on the list of risk information by the risk management project team. Various functions and departments of the Company and the Group and the respective subsidiaries are regularly organized to carry out risk analysis and assessment. Risks are sorted and significant risks are identified according to the assessment results.

For material issues, the risk management project team organizes and convenes special assessment meetings for the assessment of material issues and risk issues in order to provide support regarding decisions-making.

**(c) Proposal of Risk Response Strategies:**

The risk management project team organizes various functions and departments of the Company and the Group and the respective subsidiaries to select management strategies for each of the risks.

# Corporate Governance Report

**(d) Formation of Risk Response Plans:**

The risk management project team organizes various functions and departments of the Group and the respective subsidiaries to discuss and propose risk response plans and designs, amends or optimizes internal control files based on the risk response plans.

**(e) Supervising and Improving the Implementation of Risk Management of Each Business Unit:**

The risk management project team supervises and assesses the implementation of risk management and the effectiveness of internal control of each business unit; Keeping track of the development of material risk issues.

Internal audit department analyzes and makes independent assessment on whether risk management and the internal control system of the Group are sufficient and effective.

## Identification, Assessment and Management of Risks

In 2020, the risk management project team, in accordance with the risk management procedures aforementioned, commenced risk identification and assessment from five dimensions, namely strategies, marketing, operation, compliance and finance. Senior management as well as middle-and-basic level staff of the Group were extensively organized to identify and assess the risks exposed to in the course of their work. In the light of the top ten significant risks assessed and identified, the risk management project team organized senior management of the Group to discuss and determine risk response strategies and specific risk response plans based on the level of risk tolerance. For other identified risks, the risk management project team assessed the risk response plans of business units and formed a comprehensive risk management report by proposing adjustments or recommendations for improvement.

The risk management project team kept track on the execution of response plans and measures of significant risks and reported to senior management of the Group.

## Assessment on the Effectiveness of the Risk Management and the Internal Control System

In 2020, the Board continuously supervised and performed annual review on the effectiveness of the risk management and the internal control system of the Group and its subsidiaries through the Audit Committee. The review covered aspects of significant control, such as financial control, operational control, supervision on compliance and risk management. The directors are of the view that, the operation of the internal control system is effective and sufficient, and effectively controls various risks that might disturb the Company from achieving its objectives. The Board was not aware of any significant issues that might affect the shareholders and needed to be brought to their attention, and believed that the internal control of the Group has complied with every code provision in connection with internal control within the Corporate Governance Code, including the compliance of the requirements of laws and regulations.

# Corporate Governance Report

The Board has, with reference to the assessment made by Audit Committee, reviewed in the board meeting on whether the resources in accounting, internal audit and financial reporting functions, staff's qualification and experience, and training courses provided to staff and the relevant budget were sufficient. In 2020, the Internal Audit Department, based on the aforementioned risk management procedures, entrusted third party professional institutions to conduct review and assessment on the effectiveness of design and operational compliance of the relevant internal control system in relation to risk management, control and governance practices, regarding the risk management system and the internal control system of significant business fields. Audit Committee under the Board reviewed the assessment results of risk management and internal control system of the Group for the year ended 31 December 2020 issued by third party professional institution and no significant concern that constituted impacts to the Company's shareholders was found.

### Management of Inside Information

The Group has formulated a set of complete procedures for inside information management to supervise the inside information revealed during business development and standardized the practice of conveying relevant information to shareholders, media and analysts. Those management procedures state expressly that confidential or inside information is strictly prohibited to use without permission and set out the reply procedures in respect of the enquiry towards the Group's affairs made by external parties.

## DELEGATION BY THE BOARD

In general, the Board oversees the Company's strategic development and determines the objectives, strategies and policies of the Group. The Board also monitors and controls operating and financial performance and sets appropriate policies for risk management in pursuit of the Group's strategic objectives. The Board delegates the implementation of strategies and day-to-day operation of the Group to the management.

## COMPANY SECRETARY

Ms. Ho Wing Yan ("Ms. Ho") has been appointed as the company secretary of the Company since 5 May 2017 and is responsible for overseeing all the company secretarial matters of the Group. In the opinion of the Board, Ms. Ho possesses the necessary qualification and experience, and is capable of performing the functions of the company secretary. Mr. Lai Zhi Tian, the chairman of the Company, is the primary corporate contact person of the Company with Ms. Ho. During the year ended 31 December 2020, Ms. Ho confirmed that she has taken no less than 15 hours of relevant professional training. The Company will provide fund for Ms. Ho to take no less than 15 hours of appropriate professional training in each financial year as required under Rule 3.29 of the Listing Rules.

## SHAREHOLDERS' RIGHTS

The general meetings of the Company provide an opportunity for communication between the shareholders and the Board. An AGM of the Company shall be held in each year and at the place as may be determined by the Board. Each general meeting, other than an AGM, shall be called an extraordinary general meeting.

# Corporate Governance Report

## Shareholders to Convene an Extraordinary General Meeting

Pursuant to article 64 of the Articles, extraordinary general meeting shall be convened on the requisition of one or more shareholders of the Company holding, at the date of deposit of the requisition, not less than one tenth of the paid up capital of the Company having the right of voting at general meetings. Such requisition shall be made in writing to the Board or the company secretary of the Company for the purpose of requiring an extraordinary general meeting to be called by the Board for the transaction of any business specified in such requisition. Such meeting shall be held within two months after the deposit of such requisition. If within 21 days of such deposit, the Board fails to proceed to convene such meeting, the requisition(s) himself (themselves) may do so in the same manner.

## Putting Enquiries by Shareholders to the Board

Shareholders may send written enquiries to the Company for the attention of the Company Secretary at the Company's principal place of business in Hong Kong.

## Procedures for Putting Forward Proposals by Shareholders at Shareholders' Meetings

Shareholders of the Company are requested to follow article 64 of the Articles for including a resolution at an extraordinary general meeting. The requirements and procedures are set out above in the paragraph headed "Shareholders to convene an extraordinary general meeting".

Pursuant to article 113 of the Articles, no person (other than a retiring Director) shall be eligible for election to the office and Director at any general meeting unless a notice in writing of the intention to propose that person for election as a Director and notice in writing by that person of his willingness to be elected shall have been lodged at the head office of the Company or at the Hong Kong branch share registrar and transfer office of the Company no earlier than the day after the dispatch of the notice of the general meeting appointed for such election and end no later than seven days prior to the date of such general meeting and the minimum length of the period during which such notices to the Company may be given will be at least seven days.

The procedures for shareholders of the Company to propose a person for election as a Director is posted on the website of the Company. Shareholders or the Company may refer to the above procedures for putting forward any other proposals at general meetings.

## Voting by Poll

Pursuant to Rule 13.39(4) of the Listing Rules, any vote of shareholders at a general meeting must be taken by poll except where the Chairman, in good faith, decides to allow a resolution which relates purely to a procedural or administrative matter to be voted on by a show of hands. As such, all the resolutions to be set out in the notice of AGM will be voted by poll.

# Corporate Governance Report

## DIVIDEND POLICY

The Board has adopted the dividend policy (the "Dividend Policy") on 29 August 2018 which sets out the appropriate procedure on declaring and recommending the dividend payment of the Company. The Company takes priority to distributing dividends in cash and shares its profits with the shareholders of the Company. The dividend distribution decision of the Company will depend on, among others, the financial results, the current and future operations, liquidity and capital requirements, financial condition and other factors as the Board may deem relevant. The Board may also declare special dividends from time to time. The Dividend Policy will be reviewed on a regular basis.

## INVESTORS RELATIONS

The Company is committed to a policy of open and regular communication and reasonable disclosure of information to its shareholders. Information of the Company is disseminated to the shareholders in the following manner:

- Delivery of annual and interim results and reports to all shareholders;
- Publication of announcements on the annual and interim results on the Stock Exchange website, and issue of other announcements and shareholders' circulars in accordance with the continuing disclosure obligations under the Listing Rules; and
- The general meeting of the Company is also an effective communication channel between the Board and shareholders.

### Constitutional Documents

The was no significant changes in the constitutional documents of the Company during the year ended 31 December 2020.

# Environmental, Social and Governance Report

## 1. ABOUT THIS REPORT

### Overview

This report is the fifth environmental, social and governance (ESG) report published by Zhongzhi Pharmaceutical Holdings Limited. Following the principles of materiality, quantification, balance and consistency, we focus on the disclosure of relevant information on the economic, social and environmental performance of the Company for the period from 1 January 2020 to 31 December 2020. This report is reported on an annual basis.

### Basis of preparation

This report is prepared in accordance with the Environmental, Social and Governance Reporting Guide (the "Guidelines") of Appendix 27 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited. The contents of this report are determined in accordance with a set of systematic procedures, which include identifying and prioritizing key stakeholders, identifying and prioritizing key issues relating to ESG, determining reporting scope and boundary, collecting relevant materials and receipts, compiling data based on information, and reviewing data.

In this report, the Company illustrates how to identify and engage with our stakeholders, determining the materiality matrix and key issues. On this basis, the Company has made quantifiable disclosures on the key performance metrics, enabling effective comparison of ESG data for years while comprehensively and fairly reporting on its ESG performance.

### Reporting scope and boundary

The disclosure scope and boundary in this report are consistent with the 2020 annual report of Zhongzhi Pharmaceutical Holdings Limited.

### Explanation for abbreviations

In order to facilitate the presentation and reading, for the purpose of this report, each of "Zhongzhi Pharmaceutical", the "Group", the "Company" and "We" refers to "Zhongzhi Pharmaceutical Holdings Limited" in this report.

### Source of data and reliability assurance

The data and information in this report are mainly from the relevant documents, reports and statistic results of the Company. Zhongzhi Pharmaceutical, in the name of the board of directors (the "Board"), undertakes that this report contains no false statements or misleading statements, and is responsible for the truthfulness, accuracy and completeness of its contents.

### Confirmation and approval

This report is confirmed by the management and approved by the Board on 24 March 2021.

# Environmental, Social and Governance Report

## 2. ENVIRONMENTAL, SOCIAL AND GOVERNANCE STRUCTURE

### 2.1 Management Mechanism of Environmental, Social and Governance

The ESG management within the Group is coordinated by the ESG Working Committee, which is chaired by Mr. Lai Ying Feng, an executive director of the Group and deputy general manager of the Company, with members including the Chair of Operations, all department heads at our head office and employees capable of identifying and managing ESG risks. In strict compliance with the Environmental, Social and Governance Reporting Guide and related guidelines issued by the Stock Exchange of Hong Kong and with reference to the Social Responsibility System of the Group, the Committee regularly reviews the effectiveness of the Group's ESG-related management systems and reports to the Board on, among others, material ESG issues, relevant risks identified and achievements in ESG.

**Table 1 ESG Management Level and Delineation of Function of Zhongzhi Pharmaceutical (2020)**

| Working Level | Function Setup | Specific Duties and Responsibilities |
|---|---|---|
| Decision-making level | Board of Directors | 1. Discuss major environmental, social and governance (ESG) matters and future development<br>2. Review ESG strategy and approach<br>3. Review ESG action plans and results<br>4. Review the effectiveness of ESG management<br>5. Review ESG objectives and progress regularly |
| Communication level | ESG Working Committee | 1. Identify ESG risks and opportunities<br>2. Coordinate stakeholder communications and materiality analysis of ESG issues<br>3. Formulate ESG strategy and approach<br>4. Develop ESG action plans<br>5. Coordinate day-to-day ESG management and information disclosure<br>6. Regularly report to the Board on ESG management status<br>7. Set ESG objectives and review progress regularly |
| Execution level | Coordinators in departments at the head office and subsidiaries | 1. Implement ESG information and policy management<br>2. Report to the ESG Working Committee on relevant outcomes<br>3. Implement ESG objectives and report regularly on progress |

# Environmental, Social and Governance Report

## 2.2 Communication with Stakeholders

Zhongzhi Pharmaceutical maintains close communications with its stakeholders to understand their requirements for and expectations of the Group, which are adequately addressed through different ways of communication, including this report. In terms of the forms of communication, we communicate with all stakeholders in all respects by ways of, among others, face-to-face interview, telephone interview, questionnaire survey and on-site visit.

**Table 2 2020 Stakeholders of Zhongzhi Pharmaceutical and Communication Issues**

| Stakeholders | Appeals and Expectations for the Company | Communication and Response |
|---|---|---|
| Customers and consumers | • Products and service quality<br>• Protection of consumers' interest | • Implement customer satisfaction survey<br>• Establish and improve customer service and complaint handling processes<br>• Establish a complete information exchange mechanism |
| Employees | • Reasonable remuneration and benefits<br>• Employee training, development and promotion<br>• Employee care and welfare<br>• Democratic management | • Develop and regularly evaluate the remuneration and benefit system<br>• Support employees' skill learning and career development through training<br>• Arrange for medical checks and care for mental and physical health of employees<br>• Establish a feedback and communication mechanism with multiple channels |
| Investors | • Investment return<br>• Timely and transparent disclosures | • General meetings<br>• Announcements and disclosures<br>• Investor relations email box |
| Partners and industry partners | • Maintain sound industrial development<br>• Win-win partnership | • Conduct regular supervision on suppliers<br>• Maintain long-term partnership with qualified suppliers<br>• Host industry exchange and promotion activities |
| Media | • Positive interaction with media<br>• Keep information transparent | • Improve the media disclosure system<br>• Provide publicity materials and products on a timely manner<br>• Disclose information through multiple channels |

| Stakeholders | Appeals and Expectations for the Company | Communication and Response |
|---|---|---|
| Community | • Support for community charity<br>• Promote healthy knowledge and culture | • Launch volunteer service and public charity campaigns<br>• Promote knowledge of safety of food and pharmaceuticals to citizens |
| Environment | • Environment protection<br>• Energy conservation and emission reduction | • Constantly improve the environment management and examination system<br>• Proactively identify factors affecting the environment and potential risks<br>• Effectively monitor, analyze and assess emission and energy consumption performance |

## 2.3 Analysis of Material ESG Issues

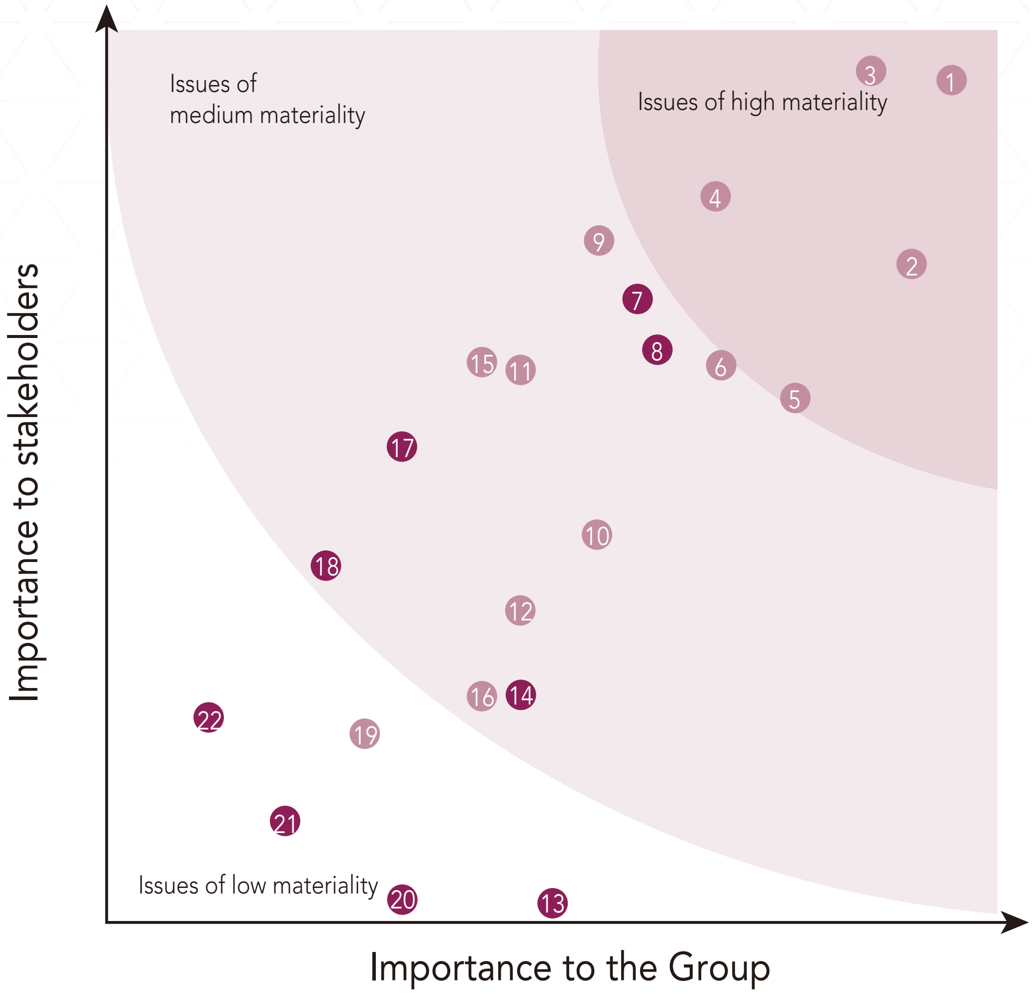
As the Company's business continues to evolve in a fast changing external environment, it is necessary to determine the priorities of the contents and various issues addressed by the ESG report for the year by identifying and prioritising ESG issues material to Zhongzhi Pharmaceutical through stakeholder engagement and materiality analysis during the year, in order to respond to the concerns of stakeholders. By taking into account our development strategy, the approach of Zhongzhi Pharmaceutical to corporate social responsibility and the outcome of stakeholder communication, we have shortlisted the following 22 issues of most concern to our stakeholders, and then prioritised them based on their materiality to stakeholders and the Company.

**Table 3 Zhongzhi Pharmaceutical's Material ESG Issues for 2020**

| | | |
|---|---|---|
| Issues of high materiality | 1 | Product quality and safety |
| | 2 | Information security and transparency |
| | 3 | Occupational health and safety |
| | 4 | Anti-corruption |
| Issues of medium materiality | 5 | Compliant operation |
| | 6 | Protection of intellectual property rights |
| | 7 | Water conservation |
| | 8 | Energy conservation |
| | 9 | Employee training and development |
| | 10 | Talents attraction and retention |
| | 11 | Prevention of child and forced labour |
| | 12 | Public welfare participation and contribution |
| | 13 | Relationships with the government |
| | 14 | Packaging materials management |
| | 15 | Universal access to health products and services |
| | 16 | New product research and development |
| | 17 | Waste treatment |
| | 18 | Climate change risk identification and management |
| Issue of low materiality | 19 | Supplier management |
| | 20 | Emission management |
| | 21 | Ecology protection |
| | 22 | Greenhouse gas emissions |

# Environmental, Social and Governance Report

## ZHONGZHI PHARMACEUTICAL'S ESG MATERIALITY MATRIX FOR 2020




Zhongzhi Pharmaceutical's ESG Materiality Matrix for 2020

## 3. GREEN OPERATION

Zhongzhi Pharmaceutical upholds the philosophy of green operation and strictly complies with applicable laws and regulations on environmental protection, while regularly tracking our compliance with the requirements and robustly controlling risks in environmental protection compliance. We have established a comprehensive environment management system to quantify and monitor our emissions and usage of resources under an effective organizational and information framework. We continue to improve our environmental performance by carrying other dedicated projects.

**ESG issues involved in this chapter**

- Emission management
- Greenhouse gas emissions
- Waste treatment
- Energy conservation
- Water conservation
- Packaging materials management
- Ecology protection
- Climate change risk identification and management

**Our management policy**

- Strengthen the monitoring of exhaust emissions, improve sewage discharge standards, improve solid waste management, to achieve green production
- Save energy, establish water conservation enterprise, reduce the use of packaging materials, to achieve equipment management efficiency enhancement and clean production
- Protect biodiversity, pay attention to self-development and environmental protection, identify and manage climate change risks, and become a responsible green enterprise

**Our management system**

- Environmental Protection Management System of Zhongzhi Pharmaceutical Company
- Sewage Discharge Management System
- Gas Emission Management System
- Solid Waste Management Measures
- Workplace Safety Management System of the Zhongzhi Pharmaceutical Group
- Environmental Protection Emergency Plan

# Environmental, Social and Governance Report

## 3.1 Green Production

The Group constantly enhances green production to establish itself as a green enterprise through improving system and framework development, refining environment information management and raising staff awareness of environmental protection.

### *3.1.1 Emission management*

The Group puts strong emphasis on the environmental impact caused by its production process. In compliance with laws and regulations such as the Environmental Protection Law of the People's Republic of China and the Administrative Measures on Environmental Protection for Pharmaceutical Industry, we have formulated and implemented the "Environmental Protection Management System of Zhongzhi Pharmaceutical Company". Each of subsidiaries has developed their own detailed policies including the Sewage Discharge Management System, Gas Emission Management System and Solid Waste Management Measures in line with their own production processes and compliance requirements on environmental protection. We regularly assess the suitability of our environmental policies in view of the compliance requirements in the places where we operate and amend them where necessary. Subsidiaries of Zhongzhi Pharmaceutical are committed to reducing the waste pollution to the surrounding ecological environment, and ensuring that the impact of production and operation activities on the environment is minimized. Honeson Pharmaceutical, a subsidiary of the Group passed the Cleaner Production Audit in 2019 and continued its clean production efforts in 2020 to further achieve energy saving, consumption reduction, pollution reduction and efficiency enhancement.

*Gas emission management*

The Group's exhaust gas emissions mainly come from organized emission arising from the operation of gas boilers. Key controlled emission include nitric oxide, sulfur dioxide and particulate matters. We conduct regular repair and inspection on our boilers and related equipment, as well as environmental protection facilities, and have engaged a qualified third-party testing firm to monitor our gas emission, ensuring that they meet the standard.

*Sewage discharge management*

The Group's sewage is generated mainly from the production of Chinese patent medicine and decoction pieces products and equipment maintenance, and discharged into the municipal drainage pipeline after being treated in the sewage treatment facility located in the factory. Then, it is further treated through the municipal sewage treatment system to further mitigate its impact on the environment. In strict compliance with the Water Pollution Prevention Law of the People's Republic of China and according to relevant requirements of the Sewage Discharge Management System, we make detailed records on the daily operation and maintenance of sewage treatment facility and conduct discharge examination each year. In case of equipment failure or emergency, our operators will take corresponding steps pursuant to the Environmental Protection Emergency Plan to avoid or mitigate water pollution. In 2020, the Group's subsidiaries, Honeson Pharmaceutical and Zhongzhi Chinese Medicine Herb in Pieces Co., Ltd., obtained national pollutant discharge permits and strictly complied with the regulatory requirements to ensure that sewage discharge meets the standards.

# Environmental, Social and Governance Report

*Solid waste management*

In strict compliance with the Law of People's Republic of China on the Prevention and Treatment of Solid Waste Pollution to Environment, Directory of National Hazardous Wastes and other local regulations and industry standards, Zhongzhi Pharmaceutical has formulated various policies including the Solid Waste Management Measures, to enable systematic management of wastes, which are classified as hazardous or non-hazardous, generated from research, production and office operation.

Hazardous wastes generated by the Group mainly include waste liquids from laboratory and reagents as well as waste medicines. Pursuant to the Pollution Control Standard for Hazardous Waste Storage of China and other rules, we have set up storage areas for hazardous wastes and prominent hazard warning signs, appointed dedicated personnel who are responsible for the storage, transport, handling and contingency management of hazardous wastes, and conducted prudent review and filing of important documents such as disposal contracts and transfer notes of hazardous wastes. In 2020, in accordance with the requirements of the Guidelines for the Development and Implementation of Environmental Emergency Response Plans for Enterprises and Institutions in Guangdong Province (Trial), Honeson Pharmaceutical, a subsidiary of the Group, has prepared Hazardous Wastes Contingency Plan for Zhongshan Honeson Pharmaceutical to sort out potential environmental risks, establish a sound emergency mechanism for environmental pollution incidents, improve the ability to deal with emergencies and dangerous situations, protect the ecological environment and resources, and ensure the safety of employees' lives and properties.

Non-hazardous wastes are classified as recyclable or non-recyclable. Recyclable wastes such as used cans, used corrugated paper are recovered by recycling agencies regularly, while non-recyclable wastes will be stored centrally and disposed of periodically. In 2020, the Group launched a comprehensive equipment preventive maintenance programme to prevent and reduce equipment breakdown so as to reduce the amount of waste plastic film and packaging materials generated. The Company carried out regular maintenance of equipment according to schedule, conducted equipment checks on a regular basis, established an equipment lubrication management mechanism and implemented on-site management of equipment lubrication, thereby reducing the equipment breakdown rate and overfulfilling the total annual equipment breakdown rate target of 0.5%. In addition, Zhongzhi Herb Pieces led suppliers to improve the friction coefficient and slitting process of composite membrane, which reduced the winding tension and increased the winding taper, and also significantly reduced membrane waste and loss. As of October 2020, the number and frequency of abnormalities such as membrane breakage, membrane skewing and pouch jamming have decreased by 96.5% and 60.4%, respectively, compared to 2018.

# Environmental, Social and Governance Report

### Table 4 List of Emissions

| Type of Emissions | Name | Unit | 2020 | 2019 | 2018 |
|---|---|---|---|---|---|
| Waste gas and water emissions produced in the process of operation | $NO_X$ | Tonne | 2.77 | 3.30 | 2.94 |
| | $SO_2$ | Tonne | 0.10 | 0.17 | 0.15 |
| | PM | Tonne | 0.09 | 0.13 | 0.10 |
| | Chemical Oxygen Demand (COD) | Tonne | 4.96 | 7.16 | 8.10 |
| | Ammonia nitrogen | Kilogram | 0 | 89 | 102 |
| | Waste water from production | Tonne | 135,558 | 166,805 | 161,673 |
| | Office and domestic waste water | Tonne | 18,959 | 21,021 | 24,845 |
| Emission quantity of greenhouse gases[1] | Emission quantity of greenhouse gases generated from combustion of fossil fuels | $tCO_2e$ | 2,680.69 | 2,934.07 | 2,654.27 |
| | Emission quantity of greenhouse gases generated from consumption of power and steam | $tCO_2e$ | 14,343.08 | 13,127.29 | 10,558.31 |
| | Total emission quantity of greenhouse gases | $tCO_2e$ | 17,023.76 | 16,061.36 | 13,212.58 |
| | Total emission intensity of greenhouse gases | $tCO_2e$/revenue in million | 10.61 | 11.97 | 11.57 |
| Hazardous wastes quantity | Waste liquids from laboratory | Tonne | 2.66 | 4.79 | 4.12 |
| | Waste medicines | Tonne | 0.57 | 1.10 | 1.19 |
| | Other hazardous wastes | Tonne | 3.05 | 1.20 | 0.29 |
| | Total quantity of hazardous wastes | Tonne | 6.28 | 7.09 | 5.60 |
| | Total intensity of hazardous wastes | K.g./revenue in million | 3.91 | 5.29 | 4.90 |
| Non-hazardous wastes quantity | Office and domestic wastes | Tonne | 176.64 | 176.01 | 221.29 |
| | Discarded packaging materials | Tonne | 53.91 | 53.05 | 46.50 |
| | Wastes containing Herb residues | Tonne | 634.91 | 776.60 | 744.80 |
| | Other general industrial wastes | Tonne | 1.41 | 1.35 | 1.04 |
| | Total quantity of non-hazardous wastes | Tonne | 866.87 | 1,007.00 | 1,013.63 |
| | Total intensity of non-hazardous wastes | Tonne/revenue in million | 0.54 | 0.75 | 0.89 |

[1] The calculation method of the greenhouse gas emissions in this report mainly refers to the relevant contents listed in the "Guidelines for Accounting and Reporting of Greenhouse Gas Emissions of Enterprises in Other Industries by the National Development and Reform Commission (Trial)".

# Environmental, Social and Governance Report

### *3.1.2 Resource utilization*

*Energy conservation*

Zhongzhi Pharmaceutical places strong emphasis on efficiency of resource utilization and energy conservation and emission reduction. Adhering to the equipment energy management policy of "improving overall efficiency, ensuring normal operation and reducing operating costs" and by continuously optimizing the establishment of relevant systems, it improves energy efficiency and reduces greenhouse gas emission through day-to-day lean management and implementation of transformation projects for energy conservation. We formulated the Workplace Safety Management System of Zhongzhi Pharmaceutical Group, which provides that routine inspections must incorporate examinations of equipment operation, lighting management, pipeline opening and closure and other aspects, and revised the Specification of Good Condition of Equipment to normalize daily operation management, thereby maximizing the utilization rate of the Company's production equipment and avoiding energy waste. Workshops of each subsidiary actively responded to the energy conservation call of the Group and explored energy conservation in depth so as to maximize energy management in safety inspection and energy-consuming equipment maintenance in line with their own circumstances.

In 2020, the Group continued the implementation of the "Efficiency Improvement Program for Equipment and Facilities Management", established a "Management Efficiency Improvement" action group led by the Group's executive directors and the leadership of the Safety Office, and set 2020 action targets from saving power and water for production and improving equipment utilization and other aspects. In terms of procedures, each level assumes corresponding responsibility with clear objectives, and the overall goal is broken down into specific targets for implementation in each department; in terms of assessment, an assessment, reward and penalty mechanism is established, with the Company's performance assessment team and the machine transport area conducting monthly assessments of the energy consumption of functional departments and units with specific targets, and honoring rewards and penalties. The Company comprehensively standardized the management of idle equipment by strengthening the strict energy-saving implementation system, improving the new approval procedures for equipment engineering projects. It adopted "Internet + equipment" data-based monitoring and operation, to save energy use from three aspects including the management mechanism secure, efficiency improvement, and equipment improvement.

In order to achieve the current target for 2020 more effectively, the following measures were taken during the reporting period in respect of saving energy consumption and improving energy efficiency:

- Centralised production was achieved through the production scheduling system, which enhanced energy efficiency: the production department formulated weekly, monthly and annual production plans through production orders and sales forecasts, such as arranging for centralised production of small items, which directly reduced the need for single process or small number of processes production arrangements for multiple periods, in order to efficiently coordinate with departments and workshops to realise centralized use of water, electricity and steam, thus achieving the goal of efficient energy utilisation. The remaining functional departments ensured the use of materials in production through planned material procurement control, timely material acceptance and accurate material inspection, as well as equipment running time through spare parts planning and timely maintenance response system.

# Environmental, Social and Governance Report

- An appointment system for use of public systems on production lines was promoted and energy was used according to demand, thereby reducing energy wastage: the Company launched the appointment system for air compressors, steam, air conditioning and pure water, which enabled production time to be matched, energy to be supplied centrally and shut down in a timely manner after use.

- Stricter management of electricity consumption effectively controlled the loss and wastage of electricity: the safety office made division according to areas and work nature and conducted classified management to control the use of high energy-consuming and inefficient equipment; energy-saving initiatives were carried out throughout the Company and efficient and energy-saving signs are posted to promote energy conservation; control of private connections, electricity theft and failure to switch off equipment in a timely manner is increased.

**Guangdong Caojinghua optimized steam appointment system**

Guangdong Caojinghua, a subsidiary of the Group, optimized the management of the steam appointment system and implemented the following measures in order to reduce steam usage and save energy: before using steam, the production department booked the steam usage time through DingTalk, and the equipment department turned on the steam on time; after using, the production department staff closed the steam valve of the equipment in time and informed the equipment department to close the steam master valve. This measure synchronised the production time with the steam switch. Since 2018, Caojinghua has implemented an appointment system for use of the public system of the production line, and the power consumption of a single tank dropped from 2.86 kWh to 0.75 kWh, which is an obvious energy saving effect; after the implementation of the steam appointment system, the steam consumption per kilogram of granules produced also dropped from 0.4 k.g. to 0.15 k.g., which greatly reduced energy loss.

**Consumption per unit before and after the implementation of Caojinghua appointment system**

| | Consumption of steam per kilogram of granules (k.g.) | Electricity consumption per single tank (kWh) |
|---|---|---|
| Before the implementation of appointment system | 0.4 | 2.86 |
| After the implementation of appointment system | 0.15 | 0.75 |

In 2020, the efficiency improvement management projects of the Group achieved satisfactory results. The total energy consumption was 36.06 GWh, and the intensity of total energy consumption was 22.48 MWh per million of revenue, a decrease of 15% compared to 2019.

# Environmental, Social and Governance Report

*Water conservation*

Zhongzhi Pharmaceutical is committed to being a practitioner and promoter of water saving actions. According to the Environmental Protection Management System of Zhongzhi Pharmaceutical Company, it promoted the rational and recycled use of water to continuously improve the utilization rate of water resources. The Group's subsidiaries and production units also continued to consolidate employees' water-saving awareness through the reuse of water resources used for equipment cleaning. The Group's Safety Office promotes water conservation by posting water-saving signs at prominent locations in the Company and analysing the Company's water consumption on a monthly basis. Departments with abnormalities or large fluctuations will be singled out for analysis, and water wastage will be dealt with in a timely manner.

In 2020, the Group's intensity of water consumption decreased by 20% as compared with that of 2019.

*Packaging materials usage reduction*

To ensure the quality of our diversified products, the Group uses packaging materials including composite membrane, paper materials and plastics. Without prejudice to product storage, Zhongzhi Pharmaceutical continues to upgrade its packaging process to reduce usage of packaging materials and printing ink, and to mitigate the impact on environment throughout the product life cycle.

# Environmental, Social and Governance Report

### Table 5 List of Resource Consumption

| Type | Name | Unit | 2020 | 2019 | 2018 |
|---|---|---|---|---|---|
| Fossil fuel | Gasoline | Liter | 91,510 | 86,310 | 66,013 |
| | Diesel | Liter | 28,999 | 30,796 | 29,305 |
| | Natural gas | $m^3$ | 1,064,882 | 1,187,850 | 1,091,276 |
| Purchased power | Outlet power consumption | KWh | 5,203,889 | 4,984,655 | 4,755,546 |
| | Office power consumption | KWh | 2,414,942 | 2,611,230 | 1,645,702 |
| | Power consumption in production | KWh | 14,159,581 | 12,288,734 | 10,330,575 |
| | Total power consumption | KWh | 19,363,470 | 19,884,620 | 16,731,824 |
| Purchased steam | Steam | Tonne | 2,883 | 2,753 | 3,440 |
| Total energy consumption | | GWh | 36.06 | 35.31 | 31.49 |
| Intensity of total energy consumption | | MWh/revenue in million | 22.48 | 26.30 | 27.57 |
| Water resource | Office and domestic water consumption | Tonne | 29,537 | 32,571 | 33,852 |
| | Water consumption for production | Tonne | 176,320 | 181,539 | 176,016 |
| | Total water consumption | Tonne | 205,857 | 214,110 | 219,827 |
| | Intensity of water consumption | Tonne/revenue in million | 128.34 | 159.52 | 192.47 |
| Packaging materials | Metal | Tonne | 1,987.47 | 1,474.24 | 1,079.19 |
| | Plastics | Tonne | 594.90 | 597.44 | 504.23 |
| | Paper materials | Tonne | 1,461.59 | 1,159.92 | 1,137.40 |
| | Composite membrane | Tonne | 487.30 | 448.70 | 372.54 |
| | Total consumption of packaging materials | Tonne | 4,531.26 | 3,680.31 | 3,093.38 |
| | Intensity of packaging material consumption | Tonne/revenue in million | 2.82 | 2.74 | 2.71 |
| Herbs | Raw herbal medicinal materials | Tonne | 2,165.22 | 2,227.00 | 1,810.00 |

## 3.2 Protection of Ecological Environment and Coping with Climate Change

***Protection of ecological environment***

As a responsible green enterprise, Zhongzhi Pharmaceutical always strives to balance the corporate development and the sustainable social development. We identify the possible impact of our own activities, products and services on the ecological environment through a range of systematic procedures, while identifying, monitoring and reviewing stakeholders' expectations for ecological environment protection via clear internal division of duties. We have formulated and implemented the "Environmental Protection Emergency Plan", which seeks to minimise the negative impact of any accident occurring in production on the ecological environment. The Group is also committed to the development of standardized plantation bases for Chinese medicine herbs and attaches great importance to biodiversity protection, in order to develop Chinese medicine resources while further reducing the environmental impact of base planting activities. In 2020, the Group conducted research with China Academy of Chinese Medical Sciences to improve the cultivation of traditional Chinese medicine through ecological technologies, reduce the use of pesticides and inhibit the accumulation of heavy metals in some traditional Chinese medicine cultivation, protect the local soil environment, and contribute to biodiversity protection. The result of the study, Patterns of Enrichment of Heavy Metals Cadmium and Lead in Various Parts of Houttuynia cordata at Different Growth Stages, was published in Research and Practice on Chinese Medicines.

***Coping with climate change***

Climate change has become a major environmental challenge faced by the society. The state has proposed the long-term climate targets of carbon peaking by 2030 and carbon neutrality by 2060. The 14th Five-Year Plan for the protection of the ecological environment has also made carbon reduction the overall focus, making energy saving, consumption reduction and carbon reduction a new direction for corporate development. Zhongzhi Pharmaceutical has incorporated climate and environmental risk management into its business strategies and decisions, and strengthened its climate and environmental risk management in order to build up a responsible corporate image.

Zhongzhi Pharmaceutical is actively concerned about the impact of its business activities on climate change. In response to the national policy, the Group attaches great importance to energy saving and emission reduction, and explores the path of low-carbon transformation and development. Energy saving and emission reduction targets were set for the year 2020 and decentralised to various business units, with the concept of greening being implemented in all aspects of operations. The Company has continued to improve its production and processing technics, implemented layout optimisation solutions and tried out new equipment and technologies to reduce greenhouse gas emissions, thereby pursuing green development and sustainable development. The Company has been promoting green office in an orderly manner, and has carried out a comprehensive digitalisation project by launching a collaborative office automation (OA) system and promoting paperless office in the long run to reduce resource consumption through informatization control.

# Environmental, Social and Governance Report

**Green office measures:**

- Timely switching off of lighting when not in use to reduce energy consumption for lighting;
- Turning off office equipment such as computers, monitors, printers, photocopiers and water dispensers in a timely manner to reduce standby energy consumption;
- Controlling the use of air conditioning (air conditioning in use from 15 April to 31 October). In summer, the indoor temperature in the office is 26 degrees or more, and the air conditioning must not be switched on when the indoor temperature is below 26 degrees.

In addition, the Company is proactive in addressing the possible impact of climate change on its business. Chinese medicine resources are special agricultural resources and their cultivation, growth and harvesting may be affected by climate change. Changes in light, heat, water and air may have an impact on the medicinal properties and quality of Chinese herbal medicines, and climate fluctuations may also cause changes in the genuine producing area of medicine herbs. In the face of the challenges of climate change, Zhongzhi Group has stepped up its efforts in climate monitoring and regularly collected climate-related indicators (such as light, rainfall, temperature and humidity) from various Chinese medicine cultivation bases. The Group's Chinese medicine resources department has carried out a long-term special research project on the quality of Chinese herbs to assess the active constituent of herbs under different climatic conditions and continuously monitor and evaluate the impact of climate factors on the quality of Chinese medicine herbs.

## 4. EMPLOYMENT

Zhongzhi Pharmaceutical adheres to the protection of employees' rights and interests, conducts employee training, and implements a number of employee care programs to provide a broad development space for various talents.

**ESG issues involved in this chapter**

- Talent attraction and retention
- Occupational health and safety
- Employee training and development
- Prevention of child and forced labour

**Our management policy**

- Inclusive and people-oriented

**Our management system**

- Human Resources Management System
- Staff Code of Ethics

# Environmental, Social and Governance Report

## 4.1 Protection of Staffs' Rights and Interests

### *4.1.1 Equal employment*

Zhongzhi Pharmaceutical regards human resources as the utmost resource and optimises the management of personalised and revitalised resources in a systematic and standardised manner. The Group complies with laws and regulations promulgated by national and local governments, and has formulated and implemented various systems, such as the "Human Resources Management System", which set requirements in respect of employees recruitment, appointment, promotion, dismissal, staff training, code of conducts, working hours, performance appraisal, benefits packages, diversification and anti-discrimination, in order to support the achievement of talent strategic objectives of the Company.

The Company adheres to the principles of "justice, fairness and openness", and will not discriminate any employee based on their social identity, such as ethnicity, race, nationality, religion, gender, age, sexual orientation, political factions and marital status, when it comes to their employment, remuneration and promotion. The Company strictly complies with the Labour Law of the People's Republic of China and the Labour Contract Law of the People's Republic of China and other laws. The labour contract is entered into upon negotiation between the Company and employees to protect the rights and interests of both parties. The Company manages the turnover of employees and stipulates the approval procedures for dimission in the Company's internal system. During the reporting period, there is no non-compliance in relation to default in compensation payment or breach of the minimum wage standard. The Company also strictly complies with the "Provisions on the Prohibition of Using Child Labour" issued by the State Council through stringent scrutiny of candidate identity during recruitment. In case the Company discovers the employment of child labour, the child labourer would be sent to his/her original place of residence and handed over to their parents or other guardians by the relevant authorities. In summary, Zhongzhi Pharmaceutical did not have any non-compliance or complaint related to human rights or labour practice with a significant impact on the Group during the reporting year.

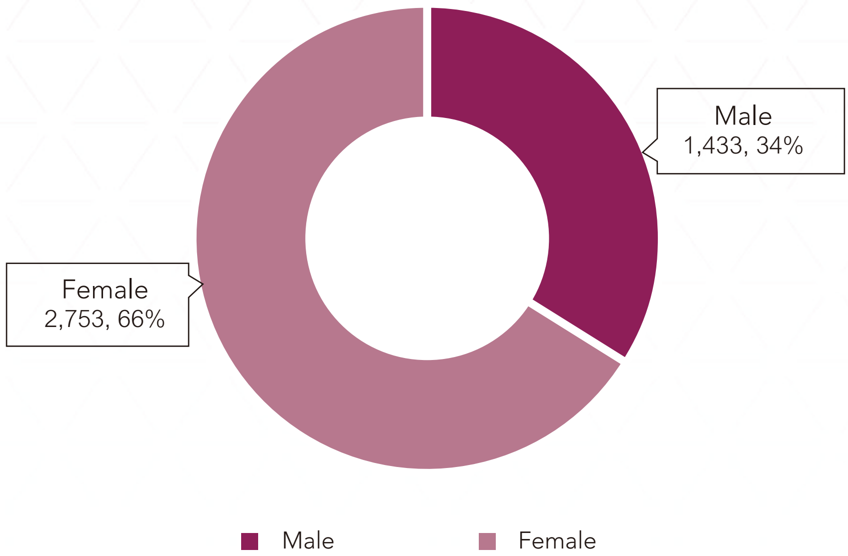
The Company has made clear provisions for new staff appraisal and employee rehiring. The Management Rules on the Confirmation after Probation for New Employees of the Group is designed to govern the management process of the confirmation after probation for new staff with comprehensive evaluations on their suitability for the position so as to help them swiftly adapt to their positions and corporate culture. The Company has formulated the Management Rules on Employee Rehiring to govern the rehiring mechanism for retirees and fully protect their lawful interests, helping them to comfortably make the most of their advantage in experience for the Company.

Zhongzhi Pharmaceutical continued to improve its talent pipeline by upgrading its talent introduction incentives, optimising the interview process and improving recruitment efficiency to meet the demand for talents from various departments to the fullest extent. During the year, the Group's human resources centre launched campus recruitment for the first time, visiting 17 universities to conduct briefing sessions and offline job interviews, bringing in fresh blood and providing a number of outstanding fresh graduates to the Company's talent pool.

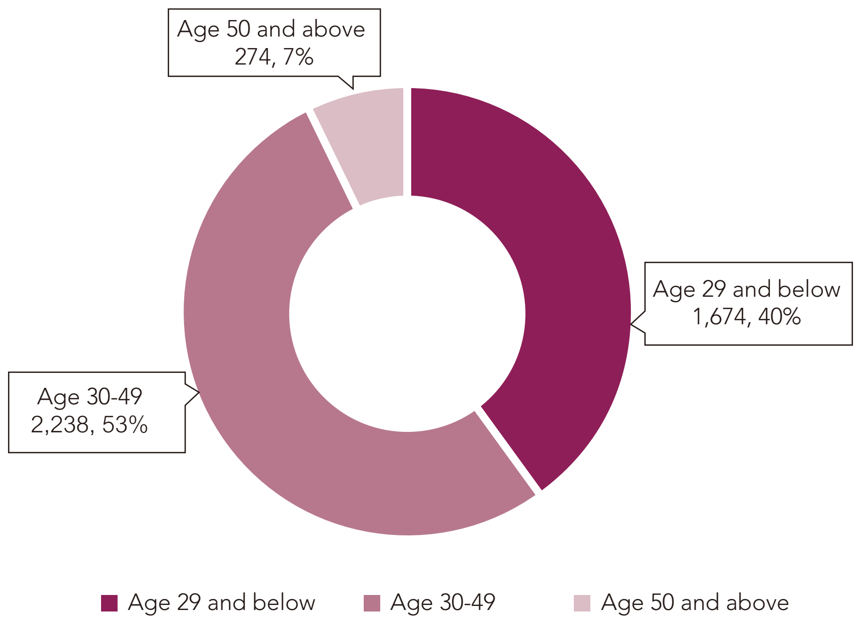
# Environmental, Social and Governance Report

By 31 December 2020, the total number of the Group's employees is 4,186.

**Total number of employees by gender**




**Total number of employees by age**



# Environmental, Social and Governance Report

### *4.1.2 Protection of remuneration and benefits*

The Group has formulated policies such as the Attendance Management System and the Remuneration Structure Management Methods, to regulate attendance and vacation and provide basis for remuneration and benefits, thereby effectively safeguarding employees' interests. The policies of the Company expressly stipulate that the staff remuneration comprises of basic salary, other allowances, commissions, bonuses and contributions to the mandatory provident fund or stated-managed retirement benefit scheme; other benefits include share options granted under the share option scheme and shares granted under the share award scheme. At the same time, we provide our staff with various holidays and benefits, such as paid holidays, social and commercial insurance, housing funds, corporate annuity, annual body check, education, and continuing education opportunities.

### *4.1.3 Protection of safety and health*

Zhongzhi Pharmaceutical consistently improves workplace safety conditions as the foundation for safeguarding the occupational health of employees.

*Production safety*

The Company strictly complies with the "Production Safety Law of the People's Republic of China" and has formulated the Safety Standard Document. Under the document, the Group requires that production areas should be designed reasonably to separate hazardous operating area from non-hazardous ones, and that alarm systems are installed, emergency plans are formulated, on-site emergency appliances are set and necessary venting areas are in place, so as to provide work environment and conditions which meet the production safety requirements. In 2020, the Group continued to improve the safety management system, set up annual safety production targets for the Group and its subsidiaries, and promoted to achieve such targets by strengthening the reminding of risk points in key areas, potential safety hazards checking and rectification, safety training and drills, and implementation of operating position certification and implementation of the safety reward and punishment system.

| Key Production Safety Work in 2020 |
|---|
| **Examination for production management positions**<br>Candidates for key positions in the Group's production management have to pass "four barriers" – competition, study, examination and practical operation. The Safety Office has set up a "job-specific" assessment scheme for the major risk factors of production positions, covering safety precautions before, during and after production process. Candidates must pass both theoretical and practical examinations before they are allowed to take up their duties. |

# Environmental, Social and Governance Report

**Key Production Safety Work in 2020**

**Potential safety hazards checking and rectification**

During the year, the Group conducted a total of 96 safety inspections on scenarios or subjects including the resumption of work after the festival season, special equipment, key areas, summer power rooms and outdoor electric cabinets on the roofs. A total of 423 potential hazards were detected, and all rectifications were completed on time subsequently.

**Honeson Pharmaceutical's safety culture construction**

During the year, 9 large-scale safety trainings and 21 safety conferences were carried out, covering topics such as mechanical injury safety, electrical safety, and office area safety, so that key concepts and knowledge of production safety were effectively implemented and communicated.

| | |
|---|---|
| Laws and regulations study | 2 training sessions on safety law, fire law, environmental law, labour law and other regulations were organised with 60 participants and 150 participants in the transferred training. |
| Specific safety training | Trainings on traffic safety, special equipment, machinery safety, electrical safety, hazardous chemical safety, resumption of work and production, and safety training for work-related accidents were carried out. The total number of training participants was 688, with more than 1,000 participants in the transferred trainings. |
| Safety culture activities | Safety month activity and fire-fighting skills competition were carried out. |
| Safety inspections | The Company conducted 20 internal safety inspections, including 10 monthly inspections, 4 Honeson specific inspections and 6 Group inspections. |
| Safety drills | Two safety drills were conducted, including fire evacuation, mechanical injury, special equipment emergency response and simulated electric shock drills with 596 participants and full participation of relevant staff. |
| Safety management enhancement | To strengthen the management of the key positions, the certificate for position will be issued only after passing the practical and theoretical examinations. 80 people were issued with the certificate during the year. A negative incentive policy for safety managers and regional safety officers was adopted. 20 people were given negative incentive during the reporting period. |

In 2020, the total days of common work injury related leave taken by the employees of the Group were 89, representing a decrease of 85% compared with 596 days in 2019. There were 8 times of common work injury incidents, representing a decrease of 47% compared to 32 times in 2019, which satisfied our target of year-on-year decline in work-related accidents. There was neither serious nor fatal incident during the year.

# Environmental, Social and Governance Report

*Occupational health*

The Group is dedicated to the protection of the health and related rights and interests of employees by mitigating occupational hazards and preventing occupational diseases. According to the Law on the Prevention and Control of Occupational Diseases of the People's Republic of China, the Management Rules of Occupational Health and other laws and regulations, we have formulated the Management System of Corporate Potential Occupational Hazards, performing regular review of causes of occupational hazards. In addition, the Company arranged for relevant personnel to have professional medical check, and those in special positions shall conduct special medical check at the Disease Control Center or the approved and recognized hospitals, and the result of the medical check shall be included in the "Occupational Health Monitoring File".

In accordance with the Management Rules of Occupational Health, we have prepared labor protection articles such as anti-static clothing, anti-dust respirators, sterilized gloves and others for every position in workshop, while requiring the department which generates dust to strictly manage all dust-generating equipment and opening and closing of dust source points. Warning signs were posted in obvious workplaces for the operational positions that are vulnerable to occupational diseases as a reminder for the threat imposing by such diseases.

In order to prevent and control occupational diseases, prevent and control occupational hazards and protect workers' health and related rights, in September 2020, Guangdong Caojinghua commissioned a third-party testing institute to conduct on-site spot tests on occupational hygiene and health in the working environment of the production workshops, including coarse powder, micro powder, granulation, packaging, outsourcing and laboratories, etc. The test results showed that the standards were met, effectively preventing the risk of occupational diseases and protecting the health and safety of the Company's employees.

## 4.2 Training and Development

### *4.2.1 Staff training*

Zhongzhi Pharmaceutical values the improvement in the professional quality of staff and provides a comprehensive training system for employees to maintain occupational and professional competitiveness in support of its long-term development. The Company has formulated, among others, the Management System on Training, the Training Structure and Plan and provided diversified training opportunities, including corporation-level training, department training, external training, orientation training, transfer training, promotion training, special work training, and other specific training, the courses of which cover corporate culture, management knowledge and skills, professional knowledge and skills, safety management knowledge, professionalism and systems, annual GMP training, etc.

# Environmental, Social and Governance Report

**Double Hundred Talents Academy**

In order to cultivate outstanding marketing and management talents, the Group has launched the "Double Hundred Talents Academy" training programme, actively organising key staff from the middle level and above to participate in courses on the Group's corporate culture, the teaching of Confucianism and organisational behavioural science. The training courses are conducted in various ways, such as course learning and development training, and the staff's training assessment results are linked to their promotion opportunities and stock incentives, which effectively increases staff participation and enhances their management ability and leadership, laying a solid foundation for achieving the Group's goal of decoction pieces of 10 billion and a market value of 10 billion.

In 2020, the Group conducted a number of trainings at the level of the Group and its subsidiaries based on the overall business development trend, the new amendments to the Medicine Management Law of the People's Republic of China and the requirements of GSP and GMP external review and certification. The participants received about 51 hours of training on average.

### *4.2.2 Occupational development*

The Group adheres to the principle of the "Integration of uniform plan, personnel leveling and diversification of methods with supervision control", encouraging employees to obtain occupational development opportunities through outstanding performances and work performances. On a semi-annual basis, we will evaluate the performance of managerial and technical employees, and offer promotions based on their performance. The Company has formed a talent pipeline program, conducted selection and evaluation for all the classes of position, so as to optimize human resource distribution and internal promotion, and train employees to become leaders of respective fields. Employees are encouraged to pursue further education to help them upgrade their qualifications and obtain vocational certificates.

Zhongzhi Pharmaceutical Group is highly concerned about the development of its staff and encourages them to upgrade their academic qualifications. The Group and Torch Polytechnic have jointly organised the "Modern Apprenticeship Pilot Class" – " Zhongzhi Class". The program recruits the employees of Zhongzhi Pharmaceutical Group through the national adult examination, and the main cultivation method is school-enterprise on-the-job training and alternate school-enterprise work-learning. The program is a three-year program. Upon completion of the prescribed courses during their employment, students will be awarded graduation certificates from full-time general vocational college education after meeting the graduation requirements as evaluated by Zhongzhi and Torch Polytechnic. Based on the professional curriculum system of vocational competencies, the college and the enterprise have jointly formulated and implemented the talent cultivation program, curriculum standards, job standards, quality control standards and corresponding implementation plans. At present, the first phase of student selection and recruitment has been completed.

**Zhongzhi Chain Pharmacies Encourage the Acquisition of the Qualification of Chronic Disease Management Consultant**

In order to provide more convenient and better services to the chronic disease group, the Group's subsidiary, Zhongzhi Chain Pharmacies, has gradually allocated chronic disease managers to suitable shops to create special services for chronic diseases. In 2020, Zhongzhi Chain Pharmacies vigorously promoted the development of a team of talents specialized in chronic disease by launching a training program for practicing pharmacists on chronic disease management and setting up a graded curriculum. The course content covers hypertension, hyperglycaemia, hyperuricemia, hyperlipidaemia, documentation, return visits, sales and case studies. Staff who have successfully obtained the China Chronic Disease Management Consultant Certificate will be rewarded with the "Chronic Disease Manager Learning Award". Currently, 21 online training sessions, 52 offline training sessions and 12 internal examinations have been conducted.

## 4.3 Staff Care and Communication

By putting in place various personnel management policies for staff care, and hosting a wide range of activities, such as garden party, annual tour and birthday gifts, the Group aims to create a harmonious and friendly workplace atmosphere and an active workplace environment for employees. In 2020, the Company organised three large-scale fun and educational activities and set up six hobby clubs to carry out related activities on a regular basis. During the Reporting Period, the Group completed the decoration project of staff recreation center, providing employees with a better bodybuilding environment.

We have formulated the Management Procedures of Staff Whistle-blowing and Complaints to provide employees with communication and feedback channels such as regular staff and department meeting, internal publication and bulletin board and intranet communication, while conducting employee satisfaction survey to understand their needs and facilitate democratic management.

In 2020, to improve staff satisfaction and retention, Zhongzhi Chain Pharmacies, a subsidiary of the Group, employed a labour relations specialist to manage staff relations and improve staff turnover, which was lower than last year. In addition, we conducted an employee satisfaction survey and made positive improvements based on feedback from staff. A questionnaire was sent to 322 shop managers to find out how they are doing in their daily work and what they really think. Based on the survey results, we found that the key sore point of shop managers is that the daily work of shops is rather tedious. In this regard, during the Reporting Period, the Company made targeted improvements and launched an information system to help shop managers manage their tasks and reduce their workload.

# Environmental, Social and Governance Report

## 5. SUPPLY CHAIN MANAGEMENT

**ESG issues involved in this Chapter**

- Suppliers management

**Our management policy**

- Quality first

**Our management system**

- Management Regulations on Suppliers

### 5.1 Appraisal and Review of Suppliers

Zhongzhi Pharmaceutical ensures the quality of procured materials satisfies the requirements of the Group. According to the Pharmaceutical Operation Quality Management Standard and "GSP Certification Site Inspection Item of Drug Retail Chain Enterprise Head Office of Guangdong Province", the Group formulated the Management Regulations on Suppliers to appraise suppliers in terms of qualification, environmental safety and information access. During the year, the Group conducted quarterly performance evaluations of 12 suppliers, evaluated multiple aspects such as delivery quality, delivery service and coordination, and kept the supplier notified on a quarterly basis and requested improvement to the complaints. Through the assessment, we effectively implemented the supplier assessment management system, strengthened supplier management, and provided guarantee for quality and delivery. In addition, the Company commenced second on-site audits of its long-term suppliers on a regular basis. During the reporting period, we reviewed 5 raw material suppliers and 3 packaging material suppliers, and immediately requested each supplier to rectify the problems identified in the on-site audits. The suppliers have implemented all rectification measures.

***Stringent assessment to ensure material quality***

We require suppliers to possess materials production and operation qualifications as well as relevant certificates, such as "Permits on Pharmaceuticals Production" and "Business Licenses for Corporations", and the pharmaceuticals registration certificates, drugs packaging certificates, quality standards and inspection standards for relevant materials.

To ensure that the quality and safety of medicine and other medical products are up to standard, the Company conducts quality assessment on materials and makes objective evaluation of suppliers in consideration of factors such as quality risks for pharmaceuticals, materials usage and the extent of materials' impacts on pharmaceutical quality. We will include those qualified suppliers into the list of qualified suppliers, and specify the permitted scope of materials supply of each supplier, so as to ensure that raw materials procurement complies with the internal standards of the Company. Any pharmaceuticals or materials found to be sub-standard will be rejected and returned to the suppliers. We update our supplier requirements from time to time based on the conditions of materials to ensure that quality of materials is able to satisfy the business needs.

# Environmental, Social and Governance Report

***Support for accountability to drive common development***

Zhongzhi Pharmaceutical supports the information-based operation of suppliers and builds a sustainable supply chain by strengthening the assessment of aspects including environmental risks and operational integrity of suppliers.

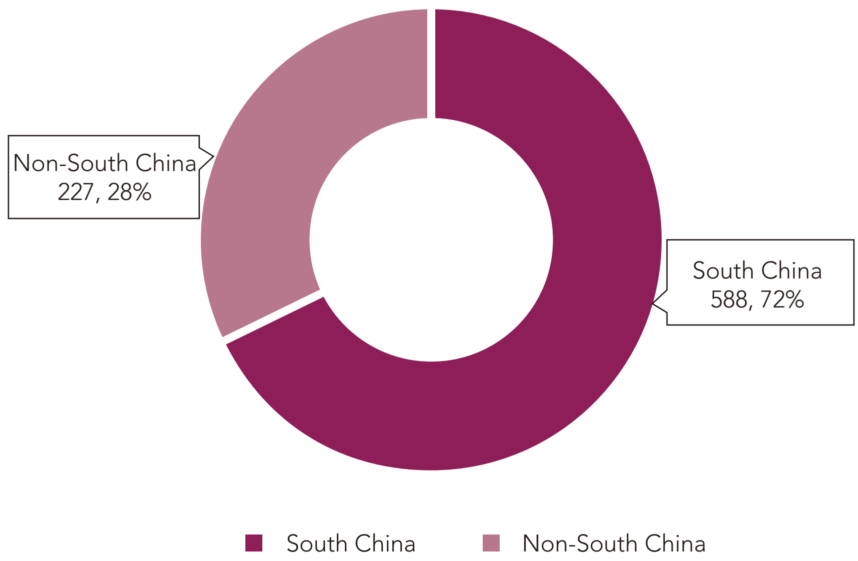
**Environmental risk control:** We perform environment evaluation on suppliers in the process of appraisal and sign environmental protection agreements. We put forward requirements in aspects of packaging materials reduction, energy-saving and emissions reduction, chemical management and product transportation, to improve the management standard of environmental risks for our supply chain.

**Operational integrity assessment:** The Group implements disciplinary management on suppliers, which are required to sign an integrity agreement covering operation with integrity and self-discipline. Bribery of any kind is strictly prohibited in procurement.

## 5.2 Geographical Distribution of the Suppliers

Zhongzhi Pharmaceutical selects quality suppliers from all over the country to ensure product quality. As of 31 December 2020, Zhongzhi Pharmaceutical had a total of 815 suppliers all from Mainland China, of which 588 were located in South China and the remaining 227 in the rest of Mainland China.

**Total numbers of suppliers by region**



# Environmental, Social and Governance Report

## 6. PRODUCT RESPONSIBILITY

**ESG issues involved in this Chapter**

- Product quality and safety
- Information security and transparency
- New product R&D

**Our management policy**

- Quality first, service first, creating boutiques and pursuit of excellence

**Our management system**

**Raw materials management**

- Quality Standard for the Ecological Environment in Standardized Chinese Herb Plantation Bases
- Selection and Assessment Criteria for Standardized Chinese Herb Plantation Bases
- Management System of Production and Operation for Standardized Chinese Herb Plantation Base
- Technical Guidelines for the Development of Ecological and Traceable Bases of Chinese Decoction Pieces
- Assessment Criteria for the Chinese Herb Ecological and Traceable Bases of Zhongzhi Pharmaceutical Group
- Herbs Numbering Management System

**Product quality management**

- Administrative Measures for Drug Registration
- Administrative Measures for Supervision on Drug Production
- Quality Control Rules for Drug Production
- Pharmaceutical Operation Quality Management Standard
- Management Standard for Medicine Instruction and Label Filing
- Management of Pharmaceutical Inspection and Acceptance

**Product after-sales and recall management**

- Management Standards on Recall, Rework, Reprocessing and Re-packaging
- Administrative Measures for Drug Recalls
- Emergency Plan for Material Quality and Safety Incidents of Products
- Management System for Sub-standard Product Disposal
- Operating Procedures for Quality Control Standard of Returned Products
- Management of Drug Inspection and Acceptance
- Management of Consumer Complaints
- Management and Measures of Consumer Privacy Protection
- Complaint Management Standard
- Standard Operating Procedures for Complaint Handling
- Requirements on Relevant Works on Confidentiality of Corporate Technologies

# Environmental, Social and Governance Report

## 6.1 Products Quality Assurance

In August 2019, the amendment to the "Drug Management Law" was passed to further strengthen drug supervision and management, ensure the public's medication safety, and promote the development of the drug industry. Zhongzhi Pharmaceutical attaches great importance to product quality management. With the goal of "creating a healthy life through intelligent manufacturing", it is committed to making quality management one of the core competitiveness of the Company, continuously improving the quality management system, and insisting on providing healthy and safe products to the public.

### *6.1.1 Quality management system*

The Administrative Quality Center of the Group comprehensively interpreted the "Drug Management Law", strictly complied with the requirements of the revised contents including the Drug Marketing Authorization Holder System (MAH) and the Pharmacovigilance (PV) system, and continued to supplement and improve it based on the existing quality management system of the Group. Based on the Quality Control Rules for Drug Production (GMP) and the Pharmaceutical Operation Quality Management Standard (GSP), the Company established and improved the Administrative Measures for Supervision on Drug Production, the Administrative Measures for Drug Registration and other management systems to fully guarantee the safety, effectiveness and quality reliability of drugs in the entire process of drug development, production, operation and use.

The Administrative Quality Center of the Group cooperated with the quality management departments of each production unit and continued to promote the construction of a quality management standardization system for each production unit in accordance with the Administrative Measures for Supervision on Drug Production and the Administrative Measures for Drug Registration. Chinese Medicine Herb in Pieces Co., Ltd. re-examined, revised and optimized the product quality standards and package design drafts according to the latest version of Chinese Pharmacopoeia, to ensure that the quality documents are in line with the regulatory requirements so as to guarantee the quality of raw materials and products from the standard control. As of the end of the reporting period, each production unit under the Company passed GMP certification, and both the Group and chain drug business units passed GSP certification.

Zhongzhi Pharmaceutical Group organizes GMP training programs every year. Compared with that in the previous year, the Group secured an improvement to a certain extent regarding the number of training programs, courses held, and people trained during the year. In 2020, we formulated training management procedures in line with the new GMP requirements, improved the education and training system, and conducted training in the areas of sampling and retention, deviation assessment, acceptance of pharmaceutical materials and quality risk assessment during the production process. The Group also conducted assessments through oral questions and written examinations to enhance a sense of responsibility and motivation of employees in pharmaceutical quality management.

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At the same time, Zhongzhi attaches great importance to product quality verification and continues to advance the quality standardization of laboratories. In 2020, China National Accreditation Service for Conformity Assessment (CNAS) appointed an accreditation team to continue to regularly monitor the physical, chemical and microbiological testing of Zhongzhi Herb Pieces testing center. The center satisfied the CNAS accreditation requirements after implementing various measures, marking further recognition of the testing capability of laboratory of Zhongzhi Pharmaceutical by China National Accreditation Service for Conformity Assessment.

**Completion of decoction pieces automation workshop of Zhongzhi Herb Pieces Company**

The decoction pieces automation workshop on the first floor of Zhongzhi Herb Pieces Company is characterized by its automation, varieties and production in batches. The workshop established a quality control system for the entire industry chain, and passed GMP certification. All production data, parameters and records are generated online in real time. The transparent management of the workshop also enabled the Group to ensure product quality.

### *6.1.2 Promote the establishment of quality standards for traditional Chinese medicine*

The establishment of quality standards for traditional Chinese medicine is a topic of common concern and dedication to improvement in the industry. Zhongzhi responded to the requirements of the "drafting of uniform drug traceability standards and specifications, promoting the exchange and sharing of drug traceability information, and achieving drug traceability" in the new Medicine Management Law, and with reference to the Pharmaceutical Operation Quality Management Standard (GAP), the Company has formulated a series of management systems, including the Quality Standard for the Ecological Environment in Standardized Chinese Herb Plantation Bases, the Selection and Assessment Criteria for Standardized Chinese Herb Plantation Bases and the Management System of Production and Operation for Standardized Chinese Herb Plantation Base, in order for the standardized management featuring centralized seedling planting, centralized cultivation, centralized management and consistent standards, and to promote the establishment of authentic medicinal ecological traceability bases relying on the technical advantages of decoction pieces.

Compared with traditional decoction pieces and formula granules, decoction pieces have certain advantages in terms of stability, safety and controllability. In order to ensure the quality of decoction pieces and the safety and effectiveness of clinical medicines, Zhongzhi has continuously established and improved the quality assurance system and traditional Chinese medicine source system of the entire industry chain of traditional Chinese medicine, and formulated the Technical Guidelines for the Development of Ecological and Traceable Bases of Chinese Decoction Pieces and Assessment Criteria for the Chinese Herb Ecological and Traceable Bases of Zhongzhi Pharmaceutical Group, further standardized the principles for the construction of ecological traceability systems for decoction pieces. Since 2015, Zhongzhi has built the first comprehensive monitoring platform for the production of traditional Chinese medicinal materials. Since then, the Company has implemented the concept of advancing product quality assurance to the front end, comprehensively carried out the ecological traceability cultivation of Chinese medicinal materials, conducted real-time monitoring of the entire process of raw material cultivation, and provided employees at the processing site with relevant training according to the quality and process requirements of the Company. In 2020, 2 new bases for atractylodes macrocephala koidz and white peony root ecological planting were established in Anhui. As of the reporting period, Zhongzhi Pharmaceutical has established 32 authentic traceability bases of authentic medicinal materials across the country to ensure the stability of the supply of raw materials and the stable quality. It also guarantees the authenticity, locality and safety of raw materials and medicinal products such as decoction pieces from the source.

In addition, Zhongzhi actively carried out research on DNA and fingerprints of traditional Chinese medicine, and actively assisted the systematization and standardization of the quality of traditional Chinese medicine. During the reporting period, the transformation of 5 fingerprints including Houttuynia cordata, Angelica sinensis, Cassia seed, Epimedium, Chrysanthemum has been completed.

In 2020, Zhongzhi Pharmaceutical was elected as the executive vice president unit of Guangdong Chinese Medicine Association (廣東省中藥協會) and actively participated in the establishment of the professional authority of the Chinese medicine industry. The Group conducted quality control regarding each key aspect of the entire industry chain, from research and development, such as the origin, seeds and seedlings, plantation, production processing and transportation of Chinese medicine, to concoction, modern industry production, sales and management after product launch, ensuring stable product quality and assisting the regulatory authorities in regulating industry development.

### *6.1.3 Quality audit*

In order to further implement the requirements of the MAH system in the Medicine Management Law, Zhongzhi, led by the Administrative Quality Center of the Group, formulated annual quality audit work plan in accordance with the Administrative Measures for Supervision on Drug Production, and cooperated with the quality management department of each pharmaceutical production unit to carry out quality audit in accordance with the plan. The internal quality audit team conducted at least one quality audit per year of the production units, conducted a comprehensive evaluation in accordance with the five elements of "human, machine, material, law and environment" in accordance with the GMP norms, and assisted each production unit to respond to the quality inspection from the drug supervision and management department to timely identify problems and provided recommendations and suggestions for improvement in quality management.

During the reporting period, the Group and its production units carried out 4 internal quality audits, and received 1 quality inspections and GMP random inspections from the drug supervision and administration department. All production site operation and material storage complied with GMP and SOP requirements of the Company. No major quality problems occurred, and rectifications were completed in a timely manner under the guidance of on-site inspection experts, effectively improving the overall quality management level.

For possible product quality issues, Zhongzhi has formulated the Emergency Plan for Material Quality and Safety Incidents of Products, the Management System for Sub-standard Product Disposal, the Operating Procedures for Quality Control Standard of Returned Products, the Management of Drug Inspection and Acceptance and the Management of Drug Recalls, to ensure that the quality of medicines are secured through quality examination and that products can be traced and recalled in a timely manner in case of significant quality or safety incident.

During the reporting period, the Company did not have any sold products that required a recall due to safety and health concerns.

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#### *6.1.4 Protection of customer rights*

During the operation and management of chain pharmacies, Zhongzhi strictly complied with the requirements of drug management in the Medicine Management Law and the Law on Protection of Consumer Interests, and formulated Management of Consumer Complaints, the Complaint Management Standard and the Standard Operating Procedures for Complaint Handling to provide customer with communication channels including service hotline, email box and official Weibo account, each with a dedicated department responsible for follow-up with customer feedback.

In the meantime, in the online and offline pharmaceutical business process, Zhongzhi attaches great importance to consumer privacy protection, and formulated the Management and Measures of Consumer Privacy Protection, which comprehensively guarantees the security of personal information of customers in the process of consulting and purchasing products. It continuously improves the construction of information system security, and carries out standardized data security and privacy protection laws and regulations and company system announcements for all employees in the pharmaceutical business unit, ensures that employees properly handle and keep the customers' personal information, and seriously deals with illegal leakage of customer privacy.

Regular training sessions are provided to employees to improve their legal and professional qualities, and all employees are required to keep consumer privacy in strict confidence with severe consequences for those responsible for illegal leakage of consumer private information.

Zhongzhi Pharmaceutical values the after-sales services for products and the protection of consumer privacy. Pursuant to laws and regulations including the Law on Protection of Consumer Interests, the Company has formulated various policies such as the Management of Consumer Complaints and the Management and Measures of Consumer Privacy Protection, to effectively protect the lawful interests and personal privacy of customers. During the reporting period, the Company did not have any violations of leakage of customer privacy information.

### 6.2 Insist on Innovation-driven approach

Zhongzhi Pharmaceutical has continued to invest in R&D and innovation, and has continuously expanded the size of its R&D team. At present, it has 18 national, provincial and municipal scientific and technological innovation platforms, and a research team comprising professors, senior engineers, doctors and masters. It has introduced an academic committee consisting of 16 top experts in various research fields in the domestic pharmaceutical industry, including Academician Zhou Honghao as director member, Academician Wang Guangji and Academician Huang Luqi as deputy director member and member, all from China Academy of Engineering. At present, the R&D team of Zhongzhi has published 77 academic papers, 3 of which have been indexed by SCI, and won a number of domestic and foreign invention patents and intellectual property related awards.

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### *6.2.1 Focus on the research of decoction pieces*

Zhongzhi Pharmaceutical attaches great importance to technological improvement and innovation, and is committed to promoting the modernization and internationalization of Chinese medicine. The core product of Zhongzhi Pharmaceutical, which is decoction pieces of Chinese medicine, has the characteristics of high-end, convenient and trendy. It has effectively changed the uneven characteristics of traditional pieces, improved the utilization of traditional Chinese medicine, and achieved controllable quality. In combination with source control, it comprehensively improved the safety, efficacy, stability and controllability of traditional Chinese medicine decoction pieces.

The Group continued to invest in the research on the standard of Chinese medicine decoction pieces, participated in the formulation of 62 local standards of "Chinese medicine decoction pieces" and 54 finished product quality standards of "Chinese medicine decoction pieces". The Group has the national and local joint engineering research center of Chinese medicine decoction pieces, and key research institutes on the technology and application of Chinese medicine decoction pieces of State Administration of Traditional Chinese Medicine, and other national, provincial and municipal scientific research platforms. It also undertook more than 40 national torch plans, national major new drug creation and provincial and municipal scientific and technological innovation projects; established close industrial-university-research cooperation with the University of Mississippi, Hong Kong Baptist University, Macau University of Science and Technology, Shanghai Institute of Materia Medica, Chinese Academy of Chinese Medical Sciences and other reputable universities and research institutes at home and abroad.

In 2020, the technology center of Zhongzhi Pharmaceutical was awarded as a "National Enterprise Technology Center", which was another enterprise innovation platform at national level approved after the approval by the National Development and Reform Commission in 2019 for the establishment of the "National and Local Joint Engineering Research Center for Chinese Herbal Broken Pieces". The successive national recognition of the cell-broken herb technology platform has built up the confidence of Zhongzhi Pharmaceutical in promoting the high-quality development of Chinese medicine.

**Discussion session on Chinese decoction pieces clinical experiment program**

On 14 June 2020, Zhongzhi Pharmaceutical, an innovative Chinese medicine enterprise in Guangdong Province, organized experts from Guangdong, Jiangsu, Hunan, Sichuan, Shanghai, Xiamen and other provinces and cities to convene a discussion session on Chinese decoction pieces clinical experiment program to commence an in-depth discussion regarding the "Clinical experiment on treatment of stable angina with Danshen and other four pharmaceutical of decoction pieces" (丹參等四味破壁飲片治療穩定型心絞痛的臨床試驗) and "Clinical experiment on treatment of acute upper respiratory tract infection of children with Houttuynia cordata decoction pieces" (魚腥草破壁飲片治療兒童急性上呼吸道感染的臨床試驗) programs, respectively. The clinical and GCP experts of each unit discussed the content and implementation details of the programs and put forward their professional opinions and suggestions.

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Zhongzhi Pharmaceutical has successively achieved a number of important results in its research on decoction pieces of Chinese medicine, and has won many honors including the first prize of the Chinese Traditional Medicine Association Science and Technology Award, the Chinese Patent Excellence Award, and the second prize of Guangdong Science and Technology Progress Award.

**Cheng Jin Le was granted the 7th Guangdong Outstanding Inventor Award**

In September 2020, Cheng Jin Le, the leader of the Group's Chinese medicine decoction pieces technology, was granted the 7th Guangdong Outstanding Inventor Award. The "Guangdong Outstanding Inventor Award" was established by the People's Government of Guangdong Province and is awarded once a year to no more than 10 candidates at each event. This award demonstrated further recognition of Zhongzhi 's invention and creation ability and innovation level of Chinese decoction pieces, which will further provide a momentum for the Company to fully leverage on its advantage of independent intellectual property rights and strengthen technological advancement and innovation.

### *6.2.2 Protection of intellectual property rights*

Zhongzhi Pharmaceutical values intellectual property rights protection and carried out patent registration and declaration based on the Requirements on Relevant Works on Confidentiality of Corporate Technologies in strict accordance with the Patent Law of the People's Republic of China and the Law on Intellectual Property Rights of the People's Republic of China.

The technology center of the Group comprehensively conducted patent search and investigation of risks before product R&D was initiated, and comprehensively collected and screened relevant patent documents to avoid infringement of external intellectual property rights. The technology center actively registered and applied for patents of the Group's R&D achievements. During the reporting period, the Group successfully applied for 16 patents (including 7 inventions and 9 designs) and 12 authorization (3 inventions and 9 designs).

The Group also actively safeguarded brand rights in accordance with relevant trademark management regulations and systems, reported to the market supervision and management department and complained about counterfeit and inferior products of well-known trademarks owned by the Group such as "Caojinghua" in the market, and fully protected the Group's intellectual property rights. During the reporting period, the Group applied for a total of 200 trademarks. As of the end of the reporting period, Zhongzhi Pharmaceutical has accumulated a total of 809 registered trademarks.

## 7. ANTI-CORRUPTION

**ESG issues involved in this Chapter**

- Anti-corruption
- Compliant operation

**Our management policy**

- Continues to promote operation with integrity, strengthen supervision, constantly improve the integrity system, and firmly establish the integrity of employees

**Our management system**

- Directors and Management's Code of Ethics
- Staff Code of Ethics
- Management Procedures of Staff Whistle-blowing and Complaints
- Zhongzhi Pharmaceutical High-voltage Grid Commitment Letter
- Integrity Policies

Zhongzhi Pharmaceutical continues to promote operation with integrity and strictly complies with the Provisional Requirements for Prohibiting Commercial Bribery and other related laws and regulations. We have formulated the policies such as "Directors and Management's Code of Ethics", "Staff Code of Ethics", "Management Procedures of Staff Whistle-blowing and Complaints", "Zhongzhi Pharmaceutical High-voltage Grid Commitment Letter" and "Integrity Policies", and the corruption behavior will be rigorously handled by the legal department and legal counsel. The Company communicates stringent anti-corruption and anti-fraud requirements to our staff, while providing them with whistle-blowing channels, so as to enhance corporate governance and internal control as well as safeguard the legal interests of the Company and shareholders. In 2020, the Company conducted integrity training for 110 key business personnel.

In the implementation of anti-bribery work, the Company actively communicated with suppliers to prevent commercial bribery and eliminate corruption. A reporting telephone number was published in the Business Integrity Agreement to ensure smooth reporting channels. In addition, the Company clearly stipulated that all suppliers must sign the Business Integrity Agreement when entering into formal contracts, with the aim of enhancing their awareness of anti-corruption and preventing corruption risks.

Zhongzhi Pharmaceutical's Integrity Policies set out a range of requirements for business operation and employee behaviours:

- All staff of the Company shall be subject to the supervision of national and capital market regulatory institutions based on the relevant law, and shall safeguard the legal interests of the Company in a self-conscious manner.

- Staff shall be in strict compliance with the laws as well as regulations and regulatory requirements in relation to anti-business corruption, and distinguish the boundaries between ordinary business dealings and irregular trading. Breaches of business ethics and market rules as well as those improper trading conducts affecting fair competition in operation are strictly rectified. Cooperation with regulatory institutions based on the law is made for the investigation and handling of business corruption cases in breach of laws as well as of giving and receiving properties or other benefits.

- The Company shall strengthen safety management measures such as whistle-blowing mailbox, telephone hotline and email, and strictly distinguish the responsibilities and division of labor for whistle-blowing information management and investigation. The usage of information and files shall undergo stringent approval procedures.

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- Staff shall refuse fraud conducts in a self-conscious manner and enhance the corresponding awareness of prevention thereon, while effectively prevent and report fraud conducts. The Company advocates honesty as its corporate culture, and encourages and protects its staff for honestly revealing any conducts in breach of laws and regulations and dishonesty within the Company.

No corruption litigation case was initiated against the Company or its employees for Zhongzhi Pharmaceutical during the reporting period.

## 8. COMMUNITY SUPPORT

**ESG issues involved in this chapter**

- Public welfare participation and contribution
- Promotion of healthy products and services

**Our management policy**

- Herbal health, paying attention to national health
- Leveraging advantages to support targeted poverty alleviation
- Feedback to the society with care

**Our management system**

- Management Regulations on Caojinghua Charity Fund

Zhongzhi Pharmaceutical is a pharmaceutical company with a high sense of social responsibility. While continuously improving its business operations, it also keeps in mind to give back to the society. We always consider the improvement of the health of all people as the strategic goal of a healthy China. Zhongzhi Pharmaceutical promotes the high-quality development of the Chinese medicine business and industry, inherits the essence of Chinese medicine civilization, fully leverages on the unique advantages and functions of Chinese medicine in disease prevention and treatment, and promotes healthy products and services to the public, attempting to better provide medical welfare to society. In recent years, Zhongzhi Pharmaceutical has actively participated in various public welfare and charities, and kept pace with the times to pass on love to those in need through targeted poverty reduction activities.

### 8.1 Promotion of healthy products and services

In September 2020, Zhongzhi Pharmaceutical made every effort to create the "Healthy Guangdong" and "Healthy Shandong" Herbal Health Festival, which aims to promote Chinese medicine culture, with a total of 65 offline activities in 22 cities in Guangdong and Shandong.

In the "Healthy Guangdong" Herbal Health Festival, Zhongzhi Chain Pharmacies actively promoted health products and services to the public, established nine body constitutions rooms where a number of consultants and experts of healthcare examine health conditions through hand, face and tongue and give advice on healthcare. In addition, some fun games related to healthcare were set up for the general public to learn herbal healthcare knowledge in the games, bringing new scientific healthcare concept and scientific healthcare knowledge of "Love health, Use herbs" to the general consumers, enhancing health awareness of the public, and establishing an emerging health concept for the whole society. We promoted sustainable corporate development while enhancing harmonious co-existence and prosperity with the society.

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## 8.2 Promoting precise poverty alleviation by continuing specialty industry

Zhongzhi Pharmaceutical vigorously conducted "Precise Poverty Alleviation Project of the Development of Standardized Gastrodia Elata f.Glauca Plantation Base" in 2018, started to help farmers of Gastrodia Elata f.Glauca in Daguan County, Zhaotong, Yunnan Province, and planned to build thousands of acres of Standardized Gastrodia Elata f.Glauca Plantation Base of Zhongzhi Pharmaceutical in Yizhu Village, Daguan County in three years.

In 2020, Daguan County achieved poverty elimination, and the Gastrodia Elata f.Glauca industry became a special local industry. The Gastrodia Elata f.Glauca planting realized gradual improvement in scale and efficiency with continuous enhancement in quality, thereby continuously fulfilling scale and standardized development.

## 8.3 Dedicated to support community development

***Caojinghua Charity Fund***

In the three years since the establishment of Caojinghua Charity Fund, the foundation has strictly complied with the laws and regulations of the Charity Law of the People's Republic of China and the Foundation Management Regulations of People's Republic of China. It also formulated and implemented the Management Regulations of Caojinghua Love Fund, rigorously reviewed and implemented the application approval process and related procedures to ensure that each love fund can help those in need. Caojinghua Charity Fund donated a total amount of RMB189 thousand in 2020, involving 32 employees of two chain pharmacies of China Nepstar and Qianjin Pharmacy, with an average of RMB5,906 per person.

## 8.4 Orderly resumption of work and production

In early 2020, an outbreak caused by a COVID-19 impacted the nationals all over the country. In the face of the pandemic, it is imperative that in this anti-pandemic action, Zhongzhi Pharmaceutical actively responded to the national call to fight the pandemic, and has been silently adhering to its own social responsibility. Through strict supervision of drug prices, donation of anti-pandemic materials, and care for employees and other activities, we strived to contribute to the disease control needs of the general public.

***Play a critical role in ensuring supply***

A total of 1,400 employees of Zhongzhi Chain Pharmacies stayed at the front line to fight against the pandemic, keeping 328 stores open, providing 24-hour business and door-to-door drug delivery services, increasing the number of pharmacists consulting on the online micronet platform to meet the healthcare consultation needs of the citizens, and providing mental health counseling to allay the public's fears.

In response to the call by the government, we raised supplies in an active manner to ensure the provision of emergency supplies such as masks, sanitizer, thermometers and other supplies needed by the general public and enterprises, and to assist the government in distributing pandemic prevention supplies. By the end of February, more than 3 million masks, more than 300,000 units of alcohol, 84 disinfectant and other sanitizers, and more than 60,000 thermometers (including mercury, electronic thermometers, infrared thermometers, etc.) were distributed.

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***Orderly resumption of work and strengthen management***

In order to fully satisfy the market demand for Chinese decoction pieces and related Chinese medicine products, Zhongzhi Pharmaceutical speeded up the organization of front-line production staff to resume work in advance, formulated emergency plans for resumption of work and production, pandemic prevention and control, established the resumption implementation plan, completed relevant management documents for the filing of work resumption, including pandemic prevention and control team structure, pandemic prevention and control plan, pandemic management system, resumption of work report, etc., and established 6 pandemic prevention and control management systems. The Group enhanced internal management, strengthened personnel filing and screening, ensured sufficient supplies, reduced crowd gathering, promoted knowledge of pandemic prevention, and implemented monitoring for employees with "two histories" (travel history and contact history with personnel in the key areas of the pandemic) in the key areas of the pandemic, and reported the monitoring to relevant government authorities on a regular basis as required. The overall pandemic prevention measures of Zhongzhi Pharmaceutical were in place, and it had undergone more than 22 pandemic prevention and control inspections by various pandemic prevention units in Zhongshan City. Zhongzhi Pharmaceutical successfully passed the audit conducted by the superior pandemic prevention and control working group and resumed work, effectively alleviating the shortage of Chinese medicine products on the basis of ensuring safety.

***Resilience in Adversity, widespread recognition***

The entire staff of Zhongzhi Pharmaceutical stayed tough to confront all the challenges arising from the sudden outbreak of the pandemic, and took the initiative and courage to assume social responsibility by donating medical supplies in a total of RMB6.8 million to Zhongshan and Wuhan. The Group was granted the "Love China" honor for the year in the "Love China – 2020 China Pharmaceutical Public Welfare Event" jointly organized by the China College of Pharmacy Management and 21st Century Pharmacy News. Our love, responsibility and commitment had been widely recognized and strongly supported by professional organizations in the industry, media and the society.

The contribution made by Zhongzhi Pharmaceutical to the pandemic prevention also touched the personnel fighting against the pandemic at the front line in Hubei and Zhongshan. Medical personnel in Wuhan expressed their gratitude for the timely donation through online messages, and the public security police in Zhongshan also thanked Zhongzhi Pharmaceutical for its concern for the frontline police officers in Zhongshan and its strong support for the work of Zhongshan public security at the donation ceremony.

In addition, we also held a commendation ceremony for the advanced prevention and control of the COVID-19 pandemic in Zhongzhi Pharmaceutical, and commended 45 advanced groups, 103 outstanding individuals and one exemplary fighter in the prevention and control of the COVID-19 pandemic to promote their remarkable achievements, and demonstrated the original mission and social responsibility of individuals in the pharmaceutical sector to enable employees to realize their own value.

## 9. APPENDIX I LIST OF MAJOR ESG POLICIES AND REGULATIONS

This form is a review of the major ESG policies and the relevant laws and regulations that have a significant impact on Zhongzhi Pharmaceutical mentioned in the report, and is based on the 11 ESG issues listed in the Environmental, Social and Governance Reporting Guide.

| ESG Issue | Policies | Laws and regulations |
|---|---|---|
| **A1. Emissions** | • Environmental Protection Management System of Zhongzhi Pharmaceutical Company<br>• Exhaust Emission Management System<br>• Wastewater Discharge Management System<br>• Solid Waste Management Measures | • Environmental Protection Law of the People's Republic of China<br>• Environmental Protection Tax Law of the People's Republic of China<br>• Water Pollution Prevention Law of the People's Republic of China<br>• Air Pollution Prevention and Control Law of the People's Republic of China<br>• Law of People's Republic of China on the Prevention and Treatment of Solid Waste Pollution to Environment<br>• Administrative Measures on Environmental Protection for Pharmaceutical Industry |
| **A2. Use of Resources** | • Workplace Safety Management System of Zhongzhi Pharmaceutical Company<br>• Power Facility Management Standard | – |
| **A3. The Environment and Natural Resources** | • Environmental Protection Management System of Zhongzhi Pharmaceutical Company<br>• Environmental Protection Emergency Plan | • Environmental Protection Law of the People's Republic of China |

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| ESG Issue | Policies | Laws and regulations |
|---|---|---|
| **B1. Employment** | • Human Resources Management System<br>• Human Resource Management System<br>• Management Rules on the Confirmation of Probation for New Employees of the Group<br>• Group Employees Recruitment Management System<br>• Labor Contract Management System<br>• Management Rules on Employee Rehiring<br>• Group Employees Attendance Management System<br>• Group Staff Remuneration Management System<br>• Group Staff Performance Management System<br>• Regulations on the Management of Resignation<br>• Regulations on the Management of Changes in Position of the Group<br>• Remuneration Structure Management Measures | • Labor Law of the People's Republic of China<br>• Employment Contract Law of the People's Republic of China<br>• Social Insurance Law of the People's Republic of China |
| **B2. Health and Safety** | • Management Rules of Occupational Health<br>• Safety Standard Document<br>• Management System of Corporate Potential Occupational Hazards<br>• High Voltage Grid Commitment<br>• Safety Production, Fire Safety and Traffic Safety Responsibility Document | • Production Safety Law of the People's Republic of China<br>• Law on the Prevention and Control of Occupational Diseases of the People's Republic of China<br>• Social Insurance Law of the People's Republic of China |
| **B3. Development and Training** | • Management System on Training<br>• Training Structure and Plan<br>• Corporate Culture Training System of the Group Companies<br>• Skill Rating Methods for Production Staff | – |

| ESG Issue | Policies | Laws and regulations |
|---|---|---|
| **B4. Labour Standards** | • Human Resources Management System<br>• Human Resource Management System<br>• Attendance Management System | • Labor Law of the People's Republic of China<br>• Employment Contract Law of the People's Republic of China<br>• Provisions on the Prohibition of Using Child Labour |
| **B5. Supply Chain Management** | • Supplier Management Standard<br>• Supplier Evaluation and Assessment System<br>• Supplier Access Management Standards<br>• Supplier Freezing and Elimination Management Standard | • Pharmaceutical Operation Quality Management Standard<br>• GSP Certification Site Inspection Item of Drug Retail Chain Enterprise Head Office of Guangdong Province |
| **B6. Product Responsibility** | • Quality Standard for the Ecological Environment in Standardized Chinese Herb Plantation Bases<br>• Selection and Assessment Criteria for Standardized Chinese Herb Plantation Bases<br>• Management System of Production and Operation for Standardized Chinese Herb Plantation Bases<br>• Technical Guidelines for the Development of Ecological and Traceable Bases of Chinese Decoction Pieces<br>• Assessment Criteria for the Chinese Herb Ecological and Traceable Bases of Zhongzhi Pharmaceutical Group<br>• Herbs Numbering Management System<br>• Administrative Measures for Drug Registration<br>• Administrative Measures for Supervision on Drug Production<br>• Quality Control Rules for Drug Production<br>• Pharmaceutical Operation Quality Management Standard<br>• Management Standard for Medicine Instruction and Label Filing<br>• Management of Pharmaceutical Inspection and Acceptance | • Medicine Management Law of the People's Republic of China<br>• Pharmacopoeia of the People's Republic of China<br>• Law on Protection of Consumer Interests<br>• Patent Law of the People's Republic of China<br>• Law on Intellectual Property Rights of the People's Republic of China<br>• Notice of the Office of the General Administration of Market Supervision on the launch of special rectification of solid beverages, pressed tablets and candies, tea substitutes and other food products<br>• Administrative Measures for the Recordation of Medical Representative Cases (for Trial Implementation) |

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| ESG Issue | Policies | Laws and regulations |
|---|---|---|
| | • Management Standards on Recall, Rework, Reprocessing and Re-packaging<br>• Administrative Measures for Drug Recalls<br>• Emergency Plan for Material Quality and Safety Incidents of Products<br>• Management System for Sub-standard Product Disposal<br>• Operating Procedures for Quality Control Standard of Returned Products<br>• Management of Drug Inspection and Acceptance<br>• Management of Consumer Complaints<br>• Management and Measures of Consumer Privacy Protection<br>• Complaint Management Standard<br>• Standard Operating Procedures for Complaint Handling<br>• Management and Measures of Consumer Privacy Protection<br>• Requirements on Relevant Works on Confidentiality of Corporate Technologies<br>• Filing Standards on Cell-broken Herb Series (Solid Beverage) | |
| **B7. Anti-corruption** | • Directors and Management's Code of Ethics<br>• Staff Code of Ethics<br>• Management Procedures of Staff Whistle-blowing and Complaints<br>• Zhongzhi Pharmaceutical High-voltage Grid Commitment Letter<br>• Integrity Policies<br>• Integrity Agreement | • Anti-unfair Competition Law of the People's Republic of China<br>• Provisional Requirements for Prohibiting Commercial Bribery |
| **B8. Community investment** | • Caojinghua Charity Fund Management Provisions | • Charity Law of the People's Republic of China<br>• Foundation Management Regulations of People's Republic of China |

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## 10. APPENDIX II LIST OF ESG DATA

| ESG Indexes | | Unit | Data of 2020 | Data of 2019 | Data of 2018 |
|---|---|---|---|---|---|
| **A. Environmental** | | | | | |
| **A1. Emissions** | | | | | |
| **A1.1 The types of emissions and emissions data** | | | | | |
| | $NO_X$ | Tonne | 2.77 | 3.30 | 2.94 |
| | $SO_2$ | Tonne | 0.10 | 2.94 | 0.15 |
| | PM | Tonne | 0.09 | 0.13 | 0.10 |
| **A1.2 Greenhouse gas emissions and intensity[1]** | | | | | |
| | Scope 1: Emission quantity of greenhouse gases generated from combustion of fossil fuels | $tCO_2e$ | 2,680.69 | 2,934.07 | 2,654.27 |
| | Scope 2: Emission quantity of greenhouse gases generated from consumption of power and steam | $tCO_2e$ | 14,343.08 | 13,127.29 | 10,558.31 |
| | Total emission quantity of greenhouse gases | $tCO_2e$ | 17,023.76 | 16,061.36 | 13,212.58 |
| | Emission intensity of greenhouse gases | $tCO_2e$/revenue in million | 10.61 | 11.97 | 11.57 |
| **A1.3 Hazardous waste produced** | | | | | |
| | Waste liquids from laboratory | Tonne | 2.66 | 4.79 | 4.12 |
| | Waste medicines (WH03) | Tonne | 0.57 | 1.10 | 1.19 |
| | Other hazardous waste | Tonne | 3.05 | 1.20 | 0.29 |
| | Total amount of hazardous waste discharged | Tonne | 6.28 | 7.09 | 5.60 |
| | Intensity of hazardous waste | K.g./revenue in million | 3.91 | 5.29 | 4.90 |
| **A1.4 Non-hazardous waste produced** | | | | | |
| | Office and domestic wastes | Tonne | 176.64 | 176.01 | 221.29 |
| | Discarded packaging materials | Tonne | 53.91 | 53.05 | 46.50 |
| | Wastes containing herb residues | Tonne | 634.91 | 776.60 | 744.80 |
| | Other general industrial wastes | Tonne | 1.41 | 1.35 | 1.04 |
| | Total quantity of non-hazardous wastes | Tonne | 866.87 | 1,007.00 | 1,013.63 |
| | Non-hazardous waste intensity | Tonne/revenue in million | 0.54 | 0.75 | 0.89 |

1 The calculation method of the greenhouse gas emissions in this report mainly refers to the relevant contents listed in the "Guidelines for Accounting and Reporting of Greenhouse Gas Emissions of Enterprises in Other Industries by the National Development and Reform Commission (Trial)".

# Environmental, Social and Governance Report

| ESG Indexes | Unit | Data of 2020 | Data of 2019 | Data of 2018 |
|---|---|---|---|---|
| **A2. Use of Resources** | | | | |
| **A2.1 Total consumption of energy and energy intensity** | | | | |
| Gasoline | Liter | 91,510 | 86,310 | 66,013 |
| Diesel | Liter | 28,999 | 30,796 | 29,305 |
| Office power consumption | KWh | 2,414,942 | 2,611,230 | 1,645,702 |
| Power consumption in production | KWh | 14,159,581 | 12,288,734 | 10,330,575 |
| Outlet power consumption | KWh | 5,203,889 | 4,984,655 | 4,755,546 |
| Power consumption in total | KWh | 19,363,470 | 19,884,620 | 16,731,824 |
| Steam | Tonne | 2,883 | 2,753 | 3,440 |
| Natural gas | $m^3$ | 1,064,882 | 1,187,850 | 1,091,276 |
| Biomass particle | Tonne | 0.00 | 0.00 | 0.00 |
| Total energy consumption | GWh | 36.06 | 35.31 | 31.49 |
| Intensity of total energy consumption | MWh/revenue in million | 22.48 | 26.30 | 27.57 |
| **A2.2 Water consumption and intensity** | | | | |
| Office and domestic water consumption | Tonne | 29,537 | 32,571 | 33,852 |
| Water consumption for production | Tonne | 176,320 | 181,539 | 176,016 |
| Total water consumption | Tonne | 205,857 | 214,110 | 219,827 |
| Intensity of water consumption in total | Tonne/revenue in million | 128.34 | 159.52 | 192.47 |
| **A2.5 Usage amount of raw and auxiliary materials and packaging materials** | | | | |
| Packaging materials: Metal | Tonne | 1,987.47 | 1,474.24 | 1,079.19 |
| Packaging materials: Plastics | Tonne | 594.90 | 597.44 | 504.23 |
| Packaging materials: Paper materials | Tonne | 1,461.59 | 1,159.92 | 1,137.40 |
| Packaging materials: Composite membrane | Tonne | 487.30 | 448.70 | 372.54 |
| Total consumption of packaging materials | Tonne | 4,531.26 | 3,680.31 | 3,093.38 |
| Intensity of packaging material consumption | Tonne/revenue in million | 2.82 | 2.74 | 2.71 |
| **A3.1 Raw herbal medicinal materials** | Tonne | 2,165.22 | 2,227.00 | 1,810.00 |

# Environmental, Social and Governance Report

| ESG Indexes | | Unit | Data of 2020 | Data of 2019 | Data of 2018 |
|---|---|---|---|---|---|
| **B. Social** | | | | | |
| **B1. Employment** | | | | | |
| **B1.1** | Total workforce by gender, employment type, age group and geographical region | | | | |
| | Total number of employees | Persons | 4,186 | 3,243 | 3,398 |
| **Gender** | Male | Persons | 1,433 | 1,219 | 1,186 |
| | Female | Persons | 2,753 | 2,024 | 2,212 |
| **Age** | 29 and below | Persons | 1,674 | 1,419 | 1,734 |
| | 30-49 | Persons | 2,238 | 2,692 | 1,565 |
| | 50 and above | Persons | 274 | 132 | 99 |
| **B2. Health and Safety** | | | | | |
| **B2.1 Number of work-related fatalities** | | | | | |
| | Number of work-related fatalities | Persons | 0 | 0 | 0 |
| | Number of work injury | Incidence | 8 | 15 | 21 |
| **B2.2 Total lost days due to work injury** | | | | | |
| | Days of common work injury | Day | 89 | 596 | 592 |
| **B3. Development and Training** | | | | | |
| **B3.1 The percentage of employees trained** | | | | | |
| | Total number of employees trained | Persons | 66,788 | 157,626 | 90,437 |
| **B3.2 Training hours of employees** | | | | | |
| | Average training hours per employee | Hour | 50.63 | 54.11 | 73.81 |
| **B5. Supplier Management** | | | | | |
| **B5.1 Number of Suppliers** | | | | | |
| **Region** | South China | Number | 588 | 400 | 509 |
| | Non-South China | Number | 227 | 328 | 221 |
| **B6. Product Responsibility** | | | | | |
| **B6.2 Number of products and service related complaints received** | | | | | |
| | Subject to recall due to safety reasons | Incidence | 0 | 0 | 0 |
| | Subject to recall due to safety reasons | Batch | 0 | 0 | 0 |
| | Other complaints related to products and service | Incidence | 77 | 59 | 69 |
| **B7. Anti-corruption** | | | | | |
| **B7.1 Number of legal cases regarding corrupt practices** | | | | | |
| | Initiated or concluded legal cases regarding corrupt practices | Case | 0 | 0 | 0 |
| **B8. Community Investment** | | | | | |
| **B8.2 Resources contributed to the focus area** | | | | | |
| | Monetary donation | RMB10,000 | 41.98 | 31.95 | 21.59 |
| | Value of goods donated | RMB10,000 | 648.89 | 24.05 | 27.70 |
| | Number of volunteers | Persons | 44 | 652 | 235 |
| | Volunteer hours | Hour | 152 | 2,676 | 900 |

# Environmental, Social and Governance Report

## 11. APPENDIX III ESG INDEX OF THE STOCK EXCHANGE

| Environmental, Social and Governance Areas, General Disclosures and KPIs | | | Corresponding section |
|---|---|---|---|
| **Environmental** | | | |
| **A1: Emissions** | General Disclosure | | 3. Green Operation |
| | A1.1 | The types of emissions and respective emissions data | 3. Green Operation |
| | A1.2 | Greenhouse gas emissions in total and intensity | 3. Green Operation |
| | A1.3 | Total hazardous waste produced and intensity | 3. Green Operation |
| | A1.4 | Total non-hazardous waste produced and intensity | 3. Green Operation |
| | A1.5 | Description of measures to mitigate emissions and results achieved | 3. Green Operation |
| | A1.6 | Description of how hazardous and non-hazardous wastes are handled, reduction initiatives and results achieved | 3. Green Operation |
| **A2: Use of Resources** | General Disclosure | | 3. Green Operation |
| | A2.1 | Energy consumption in total and intensity | 3. Green Operation |
| | A2.2 | Water consumption in total and intensity | 3. Green Operation |
| | A2.3 | Description of energy use efficiency initiatives and results achieved | 3. Green Operation |
| | A2.4 | Description of whether there is any issue in sourcing water that is fit for purpose, water efficiency enhancement initiatives and results achieved | 3. Green Operation |
| | A2.5 | Total packaging material used for finished products and amount per production unit | 3. Green Operation |
| **A3: Environment and Natural Resources** | General Disclosure | | 3. Green Operation |
| | A3.1 | Description of the significant impacts of activities on the environment and natural resources and the actions taken to manage them | 3. Green Operation |
| **Social** | | | |
| **B1: Employment** | General Disclosure | | 4. Employment |
| | B1.1 | Total workforce by gender, employment type, age group and geographical region | 4. Employment |
| | B1.2 | Employee turnover rate by gender, age group and geographical region | 4. Employment |
| **B2: Health and Safety** | General Disclosure | | 4. Employment |
| | B2.1 | Number and rate of work-related fatalities | 4. Employment |
| | B2.2 | Lost days due to work injury | 4. Employment |
| | B2.3 | Description of occupational health and safety measures adopted, how they are implemented and monitored | 4. Employment |

# Environmental, Social and Governance Report

| Environmental, Social and Governance Areas, General Disclosures and KPIs | | | Corresponding section |
|---|---|---|---|
| **B3: Development and Training** | General Disclosure | | 4. Employment |
| | B3.2 | The average training hours completed per employee | 4. Employment |
| **B4: Labour Standards** | General Disclosure | | 4. Employment |
| | B4.1 | Description of measures to review recruitment practices to avoid child and forced labour | 4. Employment |
| | B4.2 | Description of steps taken to eliminate non-compliances when discovered | 4. Employment |
| **B5: Supply Chain Management** | General Disclosure | | 5. Supply Chain Management |
| | B5.1 | Number of suppliers by geographical region | 5. Supply Chain Management |
| | B5.2 | Description of practices relating to engaging suppliers, number of suppliers where the practices are being implemented, how they are implemented and monitored | 5. Supply Chain Management |
| **B6: Product Responsibility** | General Disclosure | | 6. Products and Services |
| | B6.1 | Percentage of total products sold or shipped subject to recalls for safety and health reasons | 6. Products and Services |
| | B6.2 | Number of products and service related complaints received and how they are dealt with | 6. Products and Services |
| | B6.3 | Description of practices relating to maintaining and protecting intellectual property rights | 6. Products and Services |
| | B6.4 | Description of quality assurance process and recall procedures | 6. Products and Services |
| | B6.5 | Description of consumer data protection and privacy policies, how they are implemented and monitored | 6. Products and Services |
| **B7: Anti-corruption** | General Disclosure | | 7. Anti-corruption |
| | B7.1 | Number of initiated or concluded legal cases regarding corrupt practices brought against the issuer or its employees during the reporting period and the outcomes of the cases | 7. Anti-corruption |
| | B7.2 | Description of preventive measures and whistle-blowing procedures, how they are implemented and monitored | 7. Anti-corruption |
| **B8: Community Investment** | General Disclosure | | 8. Community Support |
| | B8.1 | Focus areas of contribution | 8. Community Support |
| | B8.2 | Resources contributed to the focus area | 8. Community Support |

# Report of Directors

The Directors are pleased to present to the Shareholders the sixth annual report and the audited consolidated financial statements for the year ended 31 December 2020.

## PRINCIPAL ACTIVITIES

The principal activity of the Company is investment holding and the Group is principally engaged in the pharmaceutical manufacturing in the PRC and the operation of chain pharmacies in Zhongshan in the Guangdong province, the PRC. Details of the principal activities of the Company's subsidiaries are set out in note 1 to the consolidated financial statements.

## BUSINESS REVIEW

The business review of the Group for the year is set out in the sections of Financial Summary, Chairman's Statement, Management Discussion and Analysis, Environmental, Social and Governance Report and the paragraphs below.

The Group complies with the requirements under the Hong Kong Companies Ordinance, the Listing Rules and the Securities and Futures Ordinance (the "SFO") for the disclosure of information and corporate governance. The Group also complies with the requirements of Employment Ordinance and ordinances relating to occupational safety for the interest of employees of the Group. No important event affecting the Group has occurred since the end of the year.

## KEY RISK FACTORS

The following lists out the key risks and uncertainties facing the Group.

### Impact of Local and International Regulations

The business operation of the Group is also subject to government policy, relevant regulations and guidelines established by the regulatory authorities. Failure to comply with the rules and requirements may lead to penalties, amendments or suspension of the business operation by the authorities. The Group closely monitors changes in government policies, regulations and markets as well as conducting studies to assess the impact of such changes.

### Third-Party Risks

The Group has been relying on third-party service providers in parts of business to improve performance and efficiency of the Group. While gaining the benefits from external service providers, the management realizes that such operational dependency may pose a threat of vulnerability to unexpected poor or lapses in service including reputation damage, business disruption and monetary losses. To address such uncertainties, the Group engages only reputed third-party providers and closely monitors their performance.

### Key Relationships with Employees, Customers and Suppliers

The Group recognises the accomplishment of the employees by providing comprehensive benefit package, career development opportunities and internal training appropriate to individual needs. The Group provides a healthy and safe workplace for all employees. No strikes and cases of fatality due to workplace accidents are found in the year.

The Group places great emphasis on working relationships with suppliers to meet our customers' needs in an effective and efficient manner. Our departments work closely with our suppliers to make sure the tendering and procurement process is conducted in an open, fair and just manner. The Group's requirements and standards are also well-communicated to suppliers before the commencement of a project.

# Report of Directors

Our major suppliers are generally providing materials for pharmaceutical production and had business relationship with the Group for over six years on average, which spreading over various regions, such as Northern China, Central China and Southern China.

The payment terms granted by suppliers were generally from telegraphic transfers before shipment to 120 days. The payables were usually settled within the credit period.

The Group is principally engaged in the pharmaceutical manufacturing in the PRC and the quality of the procured materials from the suppliers is important. In order to alleviate quality risks for pharmaceuticals produced, the Group has formulated the "Management Regulations on Suppliers" based on the "Pharmaceutical Operation Quality Management Standard" and the "GSP Certification Site Inspection Item of Drug Retail Chain Enterprise Head Office of Guangdong Province", which regulates and makes specific requirements in respect of the supplier assessment methods, audit methods and types as well as the removal and replacement procedures for unqualified suppliers, and ensured the legality and safety of the operation of the Group.

During the Reporting Period, the Group did not have any significant disputes with our major suppliers.

The Group values the views and opinions of all customers through various means and channels, including usage of business intelligence to understand customer trends and needs and regular analyze on customer feedback. The Group also conducts comprehensive tests and checks to ensure that only quality products and services are offered to the customers.

Our major customers are wholesale customers and the trading terms with them are mainly on credit. The credit period is generally not more than three months for major customers. As to new customers, payment in advance is normally required. The years of business relationship with the Group ranged from an average of four to six years.

In order to alleviate the credit risk, the Group trades only with recognized and creditworthy third parties and all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis.

During the Reporting Period, the Group has not experienced any major disruption of business due to material delay or default of payment by our customers due to their financial difficulties. We did not have any major product dispute with our customers.

## RESULTS AND DIVIDENDS

The results of the Group for the year ended 31 December 2020 and the state of affairs of the Company and of the Group at that date are set out in the financial statements on pages 102 to 181.

As the Group has commenced the construction of new factory premises and additional production lines to expand its production capacity, the Board proposed not to distribute any dividend at the end of 2020 in order to maintain a healthy cash flow. The total dividend for fiscal year 2020 was HK5.15 cents per share, consisting of the interim dividend of HK3.70 cents per share and a special dividend of HK1.45 cents per share.

# Report of Directors

## CLOSURE OF REGISTER OF MEMBERS

The register of members of the Company will be closed from Wednesday, 12 May 2021 to Tuesday, 18 May 2021, both days inclusive, during which period no transfers of shares shall be effected. In order to qualify for attending and voting at the forthcoming annual general meeting, all transfers of shares accompanied by the relevant share certificates must be lodged with the Company's Hong Kong branch share registrar and transfer office, Union Registrars Limited, at Suites 3301-04, 33/F., Two Chinachem Exchange Square, 338 King's Road, North Point, Hong Kong for registration not later than 4:00 p.m. on Tuesday, 11 May 2021.

## PROPERTY, PLANT AND EQUIPMENT

Details of movements in the property, plant and equipment of the Group during the year are set out in note 14 to the consolidated financial statements.

## SHARE CAPITAL

Details of the movements in share capital of the Company during the year are set out in note 29 to the consolidated financial statements.

## TAX RELIEF AND EXEMPTION

The Directors are not aware of any tax relief and exemption available to the shareholders of the Company by reason of their holding of the Company's securities.

## PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights under the Company's article of association or the laws of Cayman Islands which would oblige the Company to offer new shares on a pro rata basis to existing shareholders.

## PURCHASE, REDEMPTION OR SALE OF LISTED SECURITIES OF THE COMPANY

Neither the Company nor any of its subsidiaries had purchased, sold or redeemed any of the Company's listed securities during the Reporting Period.

## RESERVES

Details of the movements in the reserves of the Company and the Group during the year are set out in the note 41 to the consolidated financial statements and in the consolidated statement of changes in equity, respectively.

## DISTRIBUTABLE RESERVES

As at 31 December 2020, the Company's reserve available for distribution, calculated in accordance with the Companies Law, Chapter 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands, amounted to RMB122.0 million. The amount of RMB122.0 million includes the Company's share premium and retained profits at 31 December 2020, and the Company will be able to pay off its debts as they fall due in the ordinary course of business.

## CHARITABLE DONATIONS

The Group donated RMB7.1 million during the Reporting Period (2019: RMB0.2 million).

## MANAGEMENT CONTRACTS

Save as disclosed in this report, no contracts concerning the management and administration of the whole or any substantial part of the business of the Company or its subsidiaries were entered into or existed during the year.

## MAJOR SUPPLIERS AND CUSTOMERS

During the Reporting Period, sales to the Group's five largest customers accounted for less than 30% of the total sales for the year.

During the Reporting Period, purchases from the single largest supplier of the Group and the five largest suppliers of the Group in aggregate accounted for approximately 8.2% and 22.8% (2019: 9.1% and 30.4%) of the total purchases of the year, respectively.

None of the Directors of the Company or any of their close associates or any shareholders (which, to the best knowledge of the directors, own more than 5% of the Company's issued share capital) had any beneficial interest in the Group's five largest customers or suppliers.

# Report of Directors

## DIRECTORS

The directors of the Company during the year and up to the date of this report were:

*Executive Directors*
Mr. Lai Zhi Tian *(Chairman)*
Mr. Lai Ying Feng
Mr. Cao Xiao Jun
Mr. Cheng Jin Le

*Non-executive Directors*
Ms. Jiang Li Xia
Mr. Yang Ai Xing

*Independent non-executive Directors*
Mr. Ng Kwun Wan
Mr. Wong Kam Wah
Mr. Zhou Dai Han

In accordance with article 108(a) of the Articles, Mr. Lai Zhi Tian, Mr. Lai Ying Feng and Mr. Cheng Jin Le retire by rotation at the forthcoming annual general meeting of the Company and, being eligible, offer themselves for re-election.

Every Director shall retire from office once every three years and for this purpose, at each AGM one-third (1/3) of the Directors for the time being, or, if their number is not three (3) or a multiple of three (3), then the number nearest one-third (1/3) but not less than one-third (1/3) shall retire from office by rotation. The Directors to retire in every year will be those who have been longest in office since their last election but as between persons who became Directors on the same day those to retire shall (unless they otherwise agree between themselves) be determined by lot. Subject to the Articles, a retiring Director shall be eligible for re-election at the meeting at which he or she retires. For avoidance of doubt, each Director shall retire at least once every three (3) years.

## DIRECTORS' AND SENIOR MANAGEMENT'S BIOGRAPHIES

Biographical details of the Directors of the Company and the senior management of the Group are set out on pages 15 to 20 of this annual report.

# Report of Directors

## DIRECTORS' SERVICE CONTRACTS

Each of the executive Directors and the non-executive Director has entered into a service agreement with the Company for an initial term of three years commencing from the Listing Date and will continue thereafter and each of the independent non-executive Directors has enter into a service agreement with the Company for a term of three years and renewed each of three years commencing on 13 July 2021. All the service agreements may be terminated by either party by giving to the other party not less than three months' prior notice in writing.

None of the Directors proposed for re-election at the AGM has a service contract with the Company which is not determinable by the Company within one year without payment or compensation, other than statutory compensation.

## INDEMNITY OF DIRECTORS

The Company has maintained appropriate directors and officers liability insurance and such permitted indemnity provision for the benefit of the Directors is currently in force and was in force throughout the year.

## DIRECTORS' INTERESTS IN TRANSACTIONS, ARRANGEMENTS OR CONTRACTS

Save as disclosed in this report, no transaction, arrangement or contract of significance to which the company, or any of its holding company, subsidiaries or fellow subsidiaries was a party, and in which a director of the company or his or her connected entity had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

## DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

As at 31 December 2020, the interests and short positions of the Directors and chief executive in the share capital and underlying shares and debentures of the Company or its associated corporations (within the meaning of Part XV of the SFO), as recorded in the register required to be kept by the Company pursuant to section 352 of the SFO, or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code and Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which were taken or deemed to have under such provisions of the SFO) are as follows:

# Report of Directors

## (i) Long position in the ordinary shares of the Company

| Name of Director | Beneficial interest Number of ordinary Shares | Interest in a controlled corporation Number of ordinary shares | Family interest Number of ordinary shares | Total interest Number of ordinary shares | Approximate percentage of the issued share capital of the Company |
|---|---|---|---|---|---|
| Mr. Lai Zhi Tian ("Mr. Lai") (Note 1) | 1,176,000 | 471,105,000 (Note 2) | 42,240,000 (Note 3) | 514,521,000 | 61.25% |
| Ms. Jiang Li Xia ("Mrs. Lai") | — | 42,240,000 (Note 3) | 472,281,000 (Note 2) | 514,521,000 | 61.25% |
| Mr. Lai Ying Feng | 5,990,000 | — | — | 5,990,000 | 0.71% |

Notes:

1. Mr. Lai is personally interested in 21.518% shareholding interest in Advance Keypath Global Investments Limited which is interested in 7.14% shareholding in the Company.

2. Crystal Talent Investment Group Limited ("Crystal Talent"), which holds 471,105,000 ordinary shares of the Company, is 100% beneficially owned by Mr. Lai. As Mrs. Lai is the spouse of Mr. Lai, Mrs. Lai is deemed to be interested in the shares of Crystal Talent held by Mr. Lai. Accordingly, each of Mr. Lai and Mrs. Lai is deemed to be interested in the ordinary shares of the Company held by Crystal Talent under the SFO.

3. Cheer Lik Development Limited ("Cheer Lik"), which holds 42,240,000 ordinary shares of the Company, is 100% beneficially owned by Mrs. Lai. As Mr. Lai is the spouse of Mrs. Lai, Mr. Lai is deemed to be interested in the shares of Cheer Lik held by Mrs. Lai. Accordingly, each of Mrs. Lai and Mr. Lai is deemed to be interested in the ordinary shares of the Company held by Cheer Lik under the SFO.

### (ii) Long position in Crystal Talent, an associated corporation of the Company

| Name of Director | Capital/Nature of Interest | Percentage of the issued share capital of associated corporation |
|---|---|---|
| Mr. Lai | Beneficial owner | 100% |
| Mrs. Lai | Family Interest (Note) | 100% |

Note: Crystal Talent is 100% beneficially owned by Mr. Lai. As Mrs. Lai is the spouse of Mr. Lai, Mrs. Lai is deemed to be interested in the shares of Crystal Talent held by Mr. Lai under the SFO.

### (iii) Long position in Cheer Lik, an associated corporation of the Company

| Name of Director | Capital/Nature of Interest | Percentage of the issued share capital of associated corporation |
|---|---|---|
| Mrs. Lai | Beneficial owner | 100% |
| Mr. Lai | Family Interest (Note) | 100% |

Note: Cheer Lik is 100% beneficially owned by Mrs. Lai. As Mr. Lai is the spouse of Mrs. Lai, Mr. Lai is deemed to be interested in the shares of Cheer Lik held by Mrs. Lai under the SFO.

Save as disclosed above, none of the Directors or chief executive of the Company and/or any of their respective associates had registered any interests or short positions in any shares and underlying shares in, and debentures of, the Company or any associated corporations as at the date of this report, as recorded in the register required to be kept by the Company pursuant to section 352 of the SFO, or as otherwise notified to the Company and the Stock Exchange pursuant to Part XV of the SFO or the Model Code.

## SUBSTANTIAL SHAREHOLDERS' AND OTHER PERSONS' INTERESTS AND SHORT POSITIONS IN SHARES AND UNDERLYING SHARES

As at 31 December 2020, the following persons (other than the interests of the Directors of the Company as disclosed above) had interests or short positions in the ordinary shares of the Company or underlying shares which fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO or as recorded in the register required to be kept by the Company pursuant to section 336 of the SFO:

# Report of Directors

### Long positions in the ordinary shares of the Company

| Name | Beneficial interest Number of ordinary shares | Total interest Number of ordinary shares | Approximate percentage of issued share capital of the Company |
|---|---|---|---|
| Crystal Talent (Note 1) | 471,105,000 | 471,105,000 | 56.08% |
| Cheer Lik (Note 2) | 42,240,000 | 42,240,000 | 5.03% |
| Advance Keypath Global Investment Limited (Note 3) | 60,000,000 | 60,000,000 | 7.14% |
| Novich Positioning Investment Limited Partnership (Note 4) | 51,058,000 | 51,058,000 | 6.07% |

Notes:

1. These 471,105,000 shares are held by Crystal Talent, a company incorporated in the British Virgin Islands with limited liability and is 100% beneficially owned by Mr. Lai.

2. These 42,240,000 shares are held by Cheer Lik, a company incorporated in the British Virgin Islands with limited liability and is 100% beneficially owned by Mrs. Lai.

3. These 60,000,000 shares are held by Advance Keypath Global Investment Limited, a company incorporated in the British Virgin Islands with limited liability.

4. These 51,058,000 shares are held by Novich Positioning Investment Limited Partnership, a company incorporated in the Cayman Islands.

Save as disclosed above, the Company has not been notified of any other relevant interests or short positions in the issued share capital of the Company as at 31 December 2020 which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO, or which were recorded in the register required to be kept by the Company under Section 336 of the SFO.

## ARRANGEMENT FOR DIRECTORS TO PURCHASE SHARES OR DEBENTURES

Saved as disclosed in the section "Directors' and Chief Executive's Interests and Short Positions in Shares, Underlying Shares and Debentures" above and in the section "Share Option Scheme" below, at no time during the year were rights to acquire benefits by means of the acquisition of Shares in or debentures of the Company granted to any Director of the Company or their respective spouses or minor children, or were such rights exercised by them, or was the Company, its holding company or any of its subsidiaries a party to any arrangements to enable the Directors of the Company to acquire benefits by means of the acquisition of Shares in, or debt securities (including debentures) of the Company or any other body corporate.

# Report of Directors

## DIRECTORS' INTEREST IN A COMPETING BUSINESS

Save as disclosed in the section headed "Connected Transactions" of this report, none of the Directors or any of their respective associates has engaged in or has any interest in any business that competes or may compete with the business of the Group, or has any other conflict of interest with the Group during the Reporting Period and up to the date of this report.

Each of Mr. Lai, Mrs. Lai, Crystal Talent and Cheer Lik (together the "Controlling Shareholders"), had entered into a non-competition deed dated 8 June 2015 (the "Non-competition Deed") in favour of the Company (for itself and on behalf of all members of the Group), pursuant to which, each of the Controlling Shareholders would not, and would procure his/her/its associates not to (other than through the Group or in respect of each covenanter (together with his/her/its associates), as a holder of not more than 5% of the issued shares or stock of any class or debentures of any company listed on any recognized stock exchange) directly or indirectly carry on, engage or otherwise be interested (in each case whether as shareholder, partner, agent or otherwise and whether for profit, reward or otherwise) in any business which may be in competition with the business carried on by the Group from time to time, except where the Company's approval is obtained.

In order to ensure the Controlling Shareholders have complied with the Deed of Non-competition, each of the Controlling Shareholders has provided to the Company a written confirmation (i) in respect of his/her/its compliance with the Non-competition Deed for the Reporting Period; (ii) no personal interests were ever declared by any Controlling Shareholders who are also Directors at the Directors' meetings; and (iii) stating that they have not entered into any business which may be in competition with the business carried on by the Group from time to time. As there was no change in terms of the undertaking since the Company's listing on the Stock Exchange, the independent non-executive Directors of the Company are of the view that the Controlling Shareholders have complied with the Non-competition Deed and no matters are required to bring to the attention of the public.

## DISCLOSURE OF CHANGE IN INFORMATION ON DIRECTORS

Pursuant to Rule 13.51B(1) of the Listing Rules, the change of information on Directors are as follows:

Mr. Ng Kwun Wan, Mr. Wong Kam Wah and Mr. Zhou Dai Han are independent non-executive Directors, have re-entered into Service agreements with the Company for a term of three years commencing from 13 July 2021.

## EQUITY-LINKED AGREEMENT

Details of the equity-linked agreement entered into during the year or subsisting at the end of the year are set out below:

## SHARE OPTION SCHEME

A share option scheme was conditionally adopted on 8 June 2015 (the "Share Option Scheme"), which became effective on the Listing Date.

The Share Option Scheme is a share incentive scheme and is established to recognize and motivate the contributions that eligible participants (as defined in the Prospectus) have made or may make to the Group.

Subject to the terms and conditions of the Share Option Scheme, the maximum numbers of shares in respect of which options may be granted under the Share Option Scheme and any other schemes shall not, in aggregate, exceed 10% of the share of the Company in issue at the Listing Date (i.e. 80,000,000 shares) unless approved by the shareholders of the Company.

# Report of Directors

The maximum entitlement for any one participant is that the total number of the Shares issued and to be issued upon exercise of the options granted under the Share Option Scheme to each participant (including both exercised and outstanding options) in any 12-month period shall not exceed 1% of the total number of Shares in issue unless otherwise approved by the Shareholders at a general meeting of the Company.

The exercise price for any Share under the Share Option Scheme shall be a price determined by the Board and notified to each grantee and shall not be less than the highest of:

(i) the closing price of a Share as stated in the Stock Exchange's daily quotations sheet on the date of grant of the relevant option;

(ii) an amount equivalent to the average closing price of a Share as stated in the Stock Exchange's daily quotations sheets for the five business days immediately preceding the date of grant of the relevant option; and

(iii) the nominal value of a Share on the offer date.

An offer for the grant of options shall be deemed to have been accepted when our Company receives the letter containing the offer duly signed by the grantee together with a remittance of HK$1.00 (or such other nominal sum in any currency as the Board may determine) in favour of our Company as consideration for the grant thereof within such time as may be specified in the offer (which shall not be later than 21 days from the offer date).

Subject to earlier termination by the Company in general meeting or by the Directors, the Share Option Scheme shall be valid and effective for a period of ten years from date of adoption. The remaining life of the Share Option Scheme is 5 years. There is no share option outstanding, granted, exercised, cancelled and lapsed during the year ended 31 December 2020.

As at the date of this report, the total number of shares available for issue under the Share Option Scheme is 80,000,000, representing approximately 9.52% of the issued shares of the Company.

## SHARE AWARD PLAN

A share award plan was adopted on 8 January 2016 (the "Share Award Plan"). The Share Award Plan is a share incentive scheme and is established to recognise the contributions made by certain selected persons and to attract suitable individuals with experience and ability to further develop and expand the business of the Group.

The awarded shares will be either (i) allotted and issued by the Company, by using the general or specific mandates granted or to be granted to the board of directors by the shareholders of the Company at general meetings of the Company from time to time, or (ii) acquired by an independent trustee (the "Trustee") from the open market by utilising the Company's resources provided to the Trustee. The maximum number of shares in respect of which options may be granted under the Share Award Plan cannot result in the aggregate number of shares awarded by the board of directors throughout the duration of the plan exceeding 1% of the issued share capital of the Company.

In order to recognise and reward the contribution of and solidify the relationship with the service providers and distributors, the Board has resolved to increase the limit of the Share Award Plan from 1% of the issued share capital of the Company to 2.5% of the issued share capital of the Company on 25 March 2019.

Subject to any early termination as may be determined by the board of directors pursuant to the terms of the Share Award Plan, the plan will be valid and effective for a term of 10 years commencing on the date of adoption.

In 2017, the Company granted 1,072,500 shares to certain employees on 7 April 2017 and the vesting date of the shares was 7 April 2017. The fair value of the granted shares is calculated based on the closing market price of the shares (HK$1.70) on the day of the grant, amounting to HK$1,823,000 (equivalent to approximately RMB1,618,000).

The Company granted 127,000 shares to certain employees on 2 January 2019 and the vesting date of the shares was 2 January 2019. The fair value of the granted shares is calculated based on the closing market price of the shares (HK$1.45) on the day of the grant, amounting to HK$184,000 (equivalent to approximately RMB161,000).

The board of directors also approved to grant certain shares with a maximum number of 5,940,000 shares to certain employees, service providers and distributors (the "Eligible Persons") on 25 March 2019, which was subject to the satisfaction of certain performance target for year 2019. As at 31 December 2019, according to the achievement status of the performance of the Eligible Persons, 1,200,000 shares shall be vested while the remaining was forfeited due to the failure to meet the performance target. The fair value of the granted shares is calculated based on the closing market price of the shares (HK$1.439) on the day of the grant, amounting to HK$1,727,000 (equivalent to approximately RMB1,477,000).

The Company granted 850,000 shares to certain employees on 2 November 2020 and the vesting date of the shares was 2 November 2020. The fair value of the granted shares is calculated based on the closing market price of the shares (HK$1.52) on the day of the grant, amounting to HK$1,292,000 (equivalent to approximately RMB1,117,000).

On 20 October 2020, the board of directors approved to purchase shares as reserve for future granting. From 21 December 2020 to 30 December 2020, the Group purchased 8,677,000 shares in an aggregate of amount HK$14,268,000 (equivalent to approximately RMB12,322,000).

The Group recognised a share award expense of RMB1,638,000 and RMB1,117,000 for 2019 and 2020, respectively.

As at 31 December 2020, 13,278,500 shares of the Company were held by the Trustee and have yet to be awarded.

## CONNECTED TRANSACTIONS

### Non-exempt Continuing Connected Transactions

We have entered into a number of continuing agreements and arrangements ("Contractual Arrangements") with our connected persons in our ordinary and usual course of business, which constitute continuing connected transactions under the Listing Rules. We set out below details of the continuing connected transactions for our Group.

### Contractual Arrangements

On 31 August 2014, our Group, Zhongzhi Herb Pieces and the holders of its equity interests ("Registered Shareholders") entered into the Contractual Arrangements, which consist of: (i) an operation services agreement; (ii) a call option agreement; (iii) an equity pledge agreement; (iv) a power of attorney; and (v) an exclusive intellectual property purchase agreement. For details of these contracts, please refer to the "Contractual Arrangements – Details of the Contractual Arrangements" section in the Prospectus.

# Report of Directors

The Contractual Arrangements that were in place as at 31 December 2020 are as follows:

1. ***Operation services agreement***

   On 31 August 2014, Zhongzhi Pharmaceutical, Zhongzhi Herb Pieces and the Registered Shareholders entered into the operation services agreement. Pursuant to the operation services agreement, Zhongzhi Pharmaceutical was engaged exclusively to provide Zhongzhi Herb Pieces with, inter alia, management and consultancy services in consideration of service fees payable by Zhongzhi Herb Pieces to Zhongzhi Pharmaceutical. The service fee payable by Zhongzhi Herb Pieces to Zhongzhi Pharmaceutical for the year ended 31 December 2020 is approximately RMB24.8 million.

   The amount of fees payable by Zhongzhi Herb Pieces shall be calculated in accordance with the PRC accounting principles, which shall be the revenue of Zhongzhi Herb Pieces (which included sales of RMB210.9 million to Zhongzhi Pharmaceutical) after deducting, inter alia, all the expenses (which included rental fee of RMB5.6 million and royalty fee of RMB26.4 million to Zhongzhi Pharmaceutical) and reserve fund. All the above transactions have been eliminated upon consolidation of the financial results of Zhongzhi Herb Pieces into the Group's consolidated financial statements.

2. ***Call Option Agreement***

   On 31 August 2014, Zhongzhi Pharmaceutical, Zhongzhi Herb Pieces and the Registered Shareholders entered into the call option agreement, pursuant to which the Registered Shareholders have granted an irrevocable and exclusive option to Zhongzhi Pharmaceutical to purchase all or any part of their entire equity interests in Zhongzhi Herb Pieces according to the terms contained therein.

3. ***Equity Pledge Agreement***

   On 31 August 2014, Zhongzhi Pharmaceutical, Zhongzhi Herb Pieces and the Registered Shareholders entered into the equity pledge agreement, pursuant to which the Registered Shareholders have pledged their entire equity interests in Zhongzhi Herb Pieces (together with the rights derived therefrom) in favour of Zhongzhi Pharmaceutical as security for the performance of all the contractual obligations by Zhongzhi Herb Pieces and the Registered Shareholders under the Operation Services Agreement, the call option agreement, the Power of Attorney and the Exclusive Intellectual Property Purchase Agreement.

4. ***Power of Attorney***

   On 31 August 2014, the Registered Shareholders executed the power of attorney, pursuant to which, among others, the Registered Shareholders jointly and severally and irrevocably appointed Zhongzhi Pharmaceutical as their attorney to exercise their shareholders' rights in Zhongzhi Herb Pieces by Zhongzhi Pharmaceutical itself or through its nominee(s). The said shareholders' rights include but not limited to the rights to exercise voting rights in shareholders' meeting, to sign minutes of the shareholders' meetings, to file documents with the relevant government authorities, and to appoint directors and supervisors.

5. ***Exclusive Intellectual Property Purchase Agreement***

   On 31 August 2014, Zhongzhi Pharmaceutical, Zhongzhi Herb Pieces and the Registered Shareholders entered into the Exclusive Intellectual Property Purchase Agreement, pursuant to which Zhongzhi Herb Pieces and the Registered Shareholders jointly and severally granted an irrevocable and exclusive option to Zhongzhi Pharmaceutical to purchase all or any of the intellectual property that Zhongzhi Herb Pieces has by Zhongzhi Pharmaceutical itself or through its nominee(s) at the lowest price and to the extent permitted by the applicable PRC laws and regulations.

Apart from the above, there are no new Contractual Arrangements entered into, renewed or reproduced between our Group, Zhongzhi Herb Pieces and the Registered Shareholders during the year ended 31 December 2020.

For the year ended 31 December 2020, none of the Contractual Arrangements has been unwound as none of the restrictions that led to the adoption of the Contractual Arrangements has been removed.

### Risk relating to the Contractual Arrangements

The following risks are associated with the Contractual Arrangements. Further details of the risks are set out on pages 37 to 41 of the Prospectus.

- The PRC government may determine that the Contractual Arrangements are not in compliance with applicable PRC laws, rules, regulations or policies.
- Uncertainties of the interpretation under the relevant PRC laws, rules, regulations or explanatory notes may result in our Contractual Arrangements becoming invalid and illegal.
- Certain terms of the Contractual Arrangements may not be enforceable under the PRC laws.
- Our Group relies on the Contractual Arrangements for the production of decoction pieces in PRC, which may not be as effective in providing operational control as direct ownership.
- The Registered Shareholders may have conflicts of interest with us, which may materially and adversely affect our business and financial condition.
- Our exercise of the option to acquire equity interests of Zhongzhi Herb Pieces may be subject to certain limitations and the ownership transfer may subject us to substantial costs.

### Actions taken to mitigate the risks

In light of the above risks associated with the Contractual Arrangements, the Group has adopted relevant procedures and internal control measures to ensure the effective operation of the Group and the implementation of the Contractual Arrangements, including (i) discuss and make all necessary modification to the Contractual Arrangements in order to maintain the economic interests; (ii) regular report by relevant divisions of the Group to the senior management of the Company in relation to the compliance of the Contractual Arrangements; (iii) regular report by the senior management of the Group to the Board any non-compliance issues; (iv) retain legal adviser and/or other professional to assist the Group to deal with specific issues arising from the Contractual Arrangements, if required; and (v) annual review by the independent non-executive Directors the compliance of the Contractual Arrangements.

# Report of Directors

***Conflicts of Interests***

We have implemented measures to protect against the potential conflicts of interest between our Group and the Registered Shareholders. Pursuant to the operation services agreement, the Registered Shareholders have undertaken that they will cause Zhongzhi Herb Pieces to strictly adopt and follow the advices and decisions made by Zhongzhi Pharmaceutical and will not raise objection to the same. If there is any potential conflict of interests between the Registered Shareholders and Zhongzhi Pharmaceutical, especially when the Registered Shareholders are also the directors or senior management of Zhongzhi Pharmaceutical, the Registered Shareholders shall protect, and shall not harm the interests of Zhongzhi Pharmaceutical. Under the call option agreement, the Registered Shareholders granted Zhongzhi Pharmaceutical an irrevocable and exclusive option to purchase all or any part of the equity interests in Zhongzhi Herb Pieces at the lowest price and to the extent permitted by the applicable PRC laws and regulations. Furthermore, under the power of attorney executed by the Registered Shareholders, Zhongzhi Pharmaceutical was irrevocably appointed as the attorney of the Registered Shareholders to exercise the shareholders' rights in Zhongzhi Herb Pieces on behalf of the Registered Shareholders. As a result, we have minimised the Registered Shareholders' influence on the business operations of Zhongzhi Herb Pieces.

## Reasons for the Contractual Arrangements

The principal business of Zhongzhi Herb Pieces is the production of decoction pieces, of which the processing techniques such as steaming, stir-frying, moxibustion and calcinations, are prohibited from foreign investment under the relevant PRC laws and regulations. We cannot own any equity interest in Zhongzhi Herb Pieces. As a result, the Contractual Arrangements were necessary 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 flow to our Group. Other than the information that were disclosed in the Prospectus, there were no changes to the relevant PRC laws and regulations for the year ended 31 December 2020.

Our Directors, including our independent non-executive Directors, are of the view that (i) the Contractual Arrangements are fundamental to our Group's legal structure and business operations; and (ii) the Contractual Arrangements are on normal commercial terms, in the ordinary and usual course of our Group's business and are fair and reasonable, and are in the interests of our Group and our Shareholders as a whole.

## Waiver from the Stock Exchange and Annual Review

Zhongzhi Herb Pieces is owned as to 89.56% by Mr. Lai and is therefore an associate of Mr. Lai and hence a connected person of our Company pursuant to 14A.07(4) of the Listing Rules. The Group operates its decoction pieces business in the PRC through a series of Contractual Arrangements entered into between Zhongzhi Pharmaceutical, Zhongzhi Herb Pieces and the Registered Shareholders. The transactions contemplated under the Contractual Arrangements constitute continuing connected transactions under the Listing Rules.

The Stock Exchange has agreed to grant a waiver from strict compliance with (i) announcement and independent Shareholders' approval requirements under Chapter 14A of the Listing Rules in respect of the transactions under the Contractual Arrangements; (ii) the requirement of setting a maximum aggregate annual value (i.e. an annual cap) for the fees payable to our Group under the Contractual Arrangements; and (iii) the requirement of limiting the term of the Contractual Arrangements to three years or less, for so long as the Shares are listed on the Stock Exchange, subject to the certain conditions as disclosed on pages 203 to 205 of the Prospectus.

# Report of Directors

### Confirmation from Independent Non-executive Directors

Our independent non-executive Directors have reviewed the Contractual Arrangements and confirmed that (i) the transactions carried during the year ended 31 December 2020 have been entered into in accordance with the relevant provisions of the Contractual Arrangements and that the profit generated by Zhongzhi Herb Pieces has been substantially retained by Zhongzhi Pharmaceutical, (ii) no dividends or other distributions have been made by Zhongzhi Herb Pieces to the holders of its equity interests which are not otherwise subsequently assigned or transferred to our Group during the year ended 31 December 2020, and (iii) any new contracts entered into, renewed or reproduced between the Group and Zhongzhi Herb Pieces during the year ended 31 December 2020 are fair and reasonable, or advantageous, so far as the Group is concerned and in the interests of the shareholders of the Company as a whole.

### Confirmations from our Company's Independent Auditor

The auditor of our Company has confirmed in a letter to the Board that, with respect to the aforesaid continuing connected transactions entered into during the year ended 31 December 2020:

1. nothing has come to their attention that causes the auditor to believe that the disclosed continuing connected transactions have not been approved by the Board;

2. for transactions involving the provision of goods or services by the Group, nothing has come to their attention that causes the auditor to believe that the transactions were not, in all material respects, in accordance with the pricing policies of the Group;

3. nothing has come to their attention that causes the auditor to believe that the transactions were not entered into, in all material respects, in accordance with the relevant agreements governing such transactions; and

4. nothing has come to their attention that causes the auditor to believe that dividends or other distributions have been made by Zhongzhi Herb Pieces to the holders of its equity interests which are not otherwise subsequently assigned or transferred to our Group.

### Zhongzhi Herb Pieces

Revenue attributable to Zhongzhi Herb Pieces was approximately RMB216.4 million during the year ended 31 December 2020. As at 31 December 2020, the total asset and net asset attributable to Zhongzhi Herb Pieces was approximately RMB121.8 million and RMB79.7 million respectively.

## FUTURE PROSPECT AND DEVELOPMENT

With reference to the Outlook & Strategy section of the Chairman's Statement, the Group will continue to focus on developing the PRC market in 2020 by building our Caojinghua brand, further expanding its distribution network, increasing the number of chain pharmacies in the Guangdong province and increasing production capacities. The Board will also consider any potential investment opportunities which may benefit its shareholders as and when these opportunities arise.

## PUBLIC FLOAT

Based on publicly available information, and to the best of the Directors' knowledge, information and belief, the Company had maintained sufficient public float of not less than 25% of its issued shares as required under the Listing Rules during the Reporting Period up to the date of this report.

# Report of Directors

## AUDIT COMMITTEE

The Audit Committee comprised of three independent non-executive Directors, namely Mr. Ng Kwun Wan (Chairman), Mr. Wong Kam Wah and Mr. Zhou Dai Han. The main duties of the Audit Committee are to examine, review and monitor the financial data and financial reporting procedure of the Company.

The Audit Committee had reviewed the audited annual results of the Group for the year ended 31 December 2020.

## CORPORATE GOVERNANCE

The Company is committed to maintaining high standards of corporate governance to safeguard the interests of shareholders and to enhance corporate value and accountability. The Company has complied with all applicable code provisions under the CG Code as set out in Appendix 14 to the Listing Rules throughout the year ended 31 December 2020, save for the deviation as disclosed in Corporate Governance Report from pages 21 to 35, which provide further information on the Company's corporate governance practices. The Company will continue to review and enhance its corporate governance practices to ensure compliance with the CG Code.

## AUDITOR

Ernst & Young, the auditor of the Company, will retire at the conclusion of the forthcoming AGM of the Company and be eligible to offer themselves for re-appointment. A resolution will be submitted to the AGM to be held on 18 May 2021 to seek Shareholders' approval on the appointment of Ernst & Young as the Company's auditor until the conclusion of the next AGM and to authorise the Board to fix their remuneration.

By order of the Board
**Lai Zhi Tian**
*Chairman*

Hong Kong, 24 March 2021

# Independent Auditor's Report

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**To the shareholders of Zhongzhi Pharmaceutical Holdings Limited**
*(Incorporated in the Cayman Islands with limited liability)*

## OPINION

We have audited the consolidated financial statements of Zhongzhi Pharmaceutical Holdings Limited (the "Company") and its subsidiaries (the "Group") set out on pages 102 to 181, which comprise the consolidated statement of financial position as at 31 December 2020, and the consolidated statement of profit or loss, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 2020, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRSs") issued by the International Accounting Standards Board ("IASB") and have been properly prepared in compliance with the disclosure requirements of the Hong Kong Companies Ordinance.

## BASIS FOR OPINION

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"). Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the consolidated financial statements section of our report. We are independent of the Group in accordance with the HKICPA's Code of Ethics for Professional Accountants (the "Code"), and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

## KEY AUDIT MATTERS

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

# Independent Auditor's Report

## KEY AUDIT MATTERS (Continued)

We have fulfilled the responsibilities described in the Auditor's responsibilities for the audit of the consolidated financial statements section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the consolidated financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying consolidated financial statements.

| Key audit matter | How our audit addressed the key audit matter |
|---|---|
| ***Recoverability of trade receivables*** | |
| We focused on the recoverability of trade receivables because a high level of management judgement is required in assessing whether there would be credit losses for trade receivables. Furthermore, trade receivable balances were significant to the Group as they represented 19.9% of the total assets of Group as at 31 December 2020.<br><br>The Group has applied the expected credit loss ("ECL") model to measure the impairment provision against trade receivables at the reporting date and estimated the loss allowance of trade receivables based on the lifetime of expected credit losses. The Group initially develop the matrix based on the Group's historical default rates, considering the ageing of the balances and recent historical payment patterns. Management then calibrated the matrix to adjust the historical credit loss experience with forward-looking information such as existence of disputes and forecasted economic conditions.<br><br>Related disclosures are included in notes 3, 21 and 39 to the consolidated financial statements. | We understood, evaluated and tested the key internal controls over the Group's assessment on recoverability of trade receivables. We evaluated techniques and methodology in the ECL model against the requirements of IFRS 9. We evaluated the reasonableness of management's loss allowance estimates by examining the information used by management to form such judgements, including checking the correctness of the ageing of receivables and the underlying data of the historical default rate, evaluating whether the expected credit loss are adjusted based on forward-looking information, and checking historical and subsequent settlement records of the customers. We assessed the adequacy of the Group's relevant disclosures in the financial statements. |
| ***Provision for inventories*** | |
| We focused on the provision of inventories because the inventory balance was material to the consolidated financial statements representing 17.4% of the total assets of the Group as at 31 December 2020 and significant management judgement is required in assessing the net realisable values of inventories. The specific factors considered by management in the estimation of the provision include types of inventories, the ageing and conditions of the inventories, expiration dates of medicines, and the forecasted inventory usage and sales.<br><br>Related disclosures are included in notes 3 and 20 to the consolidated financial statements. | We performed testing on internal controls of the provision for inventories. We tested the provision amount for inventories by checking the ageing of inventories, expiration dates of medicines and the subsequent usage and sales of inventories etc. for different types of inventories on a sampling basis. We tested the key information used by the management in calculating net realisable values, including selling prices, cost to be incurred upon completion, selling expense and the relevant taxes etc., by comparing to the supporting documents, and compared the net realisable values to the carrying amounts of inventories to check for adequacy and calculation of provisions on a sampling basis. We also attended and observed management's inventory counts at the material inventory locations and in certain self-owned chain pharmacies of the Group, to check if any damaged, slow-moving or obsolete inventories identified. We checked the adequacy of the Group's disclosure of the provision for inventories. |

# Independent Auditor's Report

## OTHER INFORMATION INCLUDED IN THE ANNUAL REPORT

The directors of the Company are responsible for the other information. The other information comprises the information included in the Annual Report, other than the consolidated financial statements and our auditor's report thereon.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

## RESPONSIBILITIES OF THE DIRECTORS FOR THE CONSOLIDATED FINANCIAL STATEMENTS

The directors of the Company are responsible for the preparation of the consolidated financial statements that give a true and fair view in accordance with IFRSs issued by the IASB and the disclosure requirements of the Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the directors of the Company are responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors of the Company either intend to liquidate the Group or to cease operations or have no realistic alternative but to do so.

The directors of the Company are assisted by the Audit Committee in discharging their responsibilities for overseeing the Group's financial reporting process.

## AUDITOR'S RESPONSIBILITIES FOR THE AUDIT OF THE CONSOLIDATED FINANCIAL STATEMENTS

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Our report is made solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

# Independent Auditor's Report

## AUDITOR'S RESPONSIBILITIES FOR THE AUDIT OF THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As part of an audit in accordance with HKSAs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.

- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

# Independent Auditor's Report

## AUDITOR'S RESPONSIBILITIES FOR THE AUDIT OF THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

We communicate with the Audit Committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the Audit Committee with a statement that we have complied with relevant ethical requirements regarding independence and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, actions taken to eliminate threats or safeguards applied.

From the matters communicated with the Audit Committee, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditor's report is M.L. Chau.

**Ernst & Young**
*Certified Public Accountants*

Hong Kong
24 March 2021

# Consolidated Statement of Profit or Loss

Year ended 31 December 2020

| | Notes | 2020<br>RMB'000 | 2019<br>RMB'000 |
|---|---|---|---|
| **REVENUE** | 5 | **1,603,876** | 1,342,182 |
| Cost of sales | | **(612,673)** | (507,493) |
| **Gross profit** | | **991,203** | 834,689 |
| Other income and gains | 5 | **31,583** | 23,206 |
| Selling and distribution expenses | | **(698,799)** | (569,685) |
| Administrative expenses | | **(91,777)** | (78,068) |
| Other expenses | 6 | **(59,770)** | (50,194) |
| Finance costs | 7 | **(5,218)** | (4,007) |
| **PROFIT BEFORE TAX** | 8 | **167,222** | 155,941 |
| Income tax expense | 11 | **(28,603)** | (41,247) |
| **PROFIT FOR THE YEAR** | | **138,619** | 114,694 |
| Attributable to: | | | |
| Owners of the parent | | **138,532** | 114,694 |
| Non-controlling interests | | **87** | — |
| **PROFIT FOR THE YEAR** | | **138,619** | 114,694 |
| **EARNINGS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE PARENT** | 13 | | |
| Basic | | | |
| — For profit for the year | | **RMB0.17** | RMB0.14 |
| Diluted | | | |
| — For profit for the year | | **RMB0.17** | RMB0.14 |

# Consolidated Statement of Comprehensive Income

Year ended 31 December 2020

| | 2020<br>RMB'000 | 2019<br>RMB'000 |
|---|---|---|
| **PROFIT FOR THE YEAR** | **138,619** | 114,694 |
| **OTHER COMPREHENSIVE (LOSS)/INCOME** | | |
| Other comprehensive (loss)/income that may be reclassified to profit or loss in subsequent periods: | | |
| Exchange differences on translation of foreign operations | **(125)** | 1,282 |
| **OTHER COMPREHENSIVE (LOSS)/INCOME FOR THE YEAR, NET OF TAX** | **(125)** | 1,282 |
| **TOTAL COMPREHENSIVE INCOME FOR THE YEAR** | **138,494** | 115,976 |
| Attributable to: | | |
| Owners of the parent | **138,407** | 115,976 |
| Non-controlling interests | **87** | — |
| | **138,494** | 115,976 |

# Consolidated Statement of Financial Position

31 December 2020

| | Notes | 2020<br>RMB'000 | 2019<br>RMB'000 |
|---|---|---|---|
| **NON-CURRENT ASSETS** | | | |
| Property, plant and equipment | 14 | **303,163** | 279,361 |
| Right-of-use assets | 15(a) | **128,832** | 109,537 |
| Prepayments for property, plant and equipment | | **25,924** | 1,593 |
| Goodwill | 16 | **1,628** | 1,628 |
| Other intangible assets | 17 | **19,560** | 18,559 |
| Investment in a joint venture | 18 | **392** | 417 |
| Equity investments at fair value through profit or loss | 19 | **17,713** | 10,396 |
| Deferred tax assets | 28 | **16,208** | 13,377 |
| Prepayments | 22 | **16,150** | — |
| Other non-current assets | | **7,067** | 7,112 |
| **Total non-current assets** | | **536,637** | 441,980 |
| **CURRENT ASSETS** | | | |
| Inventories | 20 | **247,121** | 199,039 |
| Trade and notes receivables | 21 | **283,088** | 242,764 |
| Prepayments, deposits and other receivables | 22 | **59,063** | 16,423 |
| Equity investments at fair value through profit or loss | 19 | **580** | — |
| Cash and bank balances | 23 | **294,032** | 380,333 |
| **Total current assets** | | **883,884** | 838,559 |
| **CURRENT LIABILITIES** | | | |
| Trade payables | 24 | **110,439** | 104,300 |
| Other payables and accruals | 25 | **201,416** | 196,389 |
| Interest-bearing bank borrowings | 26 | **78,915** | 31,352 |
| Lease liabilities | 15(b) | **35,772** | 32,187 |
| Amounts due to related parties | 36(a) | **8,786** | 8,786 |
| Deferred income | 27 | **23,497** | 19,353 |
| Amount due to a joint venture | | **65** | 70 |
| Tax payable | | **26,580** | 29,712 |
| **Total current liabilities** | | **485,470** | 422,149 |
| **NET CURRENT ASSETS** | | **398,414** | 416,410 |
| **TOTAL ASSETS LESS CURRENT LIABILITIES** | | **935,051** | 858,390 |

# Consolidated Statement of Financial Position

31 December 2020

| | Notes | 2020 RMB'000 | 2019 RMB'000 |
|---|---|---|---|
| **NON-CURRENT LIABILITIES** | | | |
| Deferred income | 27 | **14,215** | 17,768 |
| Lease liabilities | 15(b) | **73,216** | 63,966 |
| Deferred tax liabilities | 28 | **25,857** | 13,273 |
| **Total non-current liabilities** | | **113,288** | 95,007 |
| **Net assets** | | **821,763** | 763,383 |
| **EQUITY** | | | |
| **Equity attributable to owners of the parent** | | | |
| Issued capital | 29 | **6,650** | 6,650 |
| Reserves | 32 | **813,526** | 756,733 |
| | | **820,176** | 763,383 |
| Non-controlling interests | | **1,587** | — |
| **Total equity** | | **821,763** | 763,383 |

**Lai Zhitian**
*Director*

**Cao Xiaojun**
*Director*

# Consolidated Statement of Changes in Equity

Year ended 31 December 2020

| | Attributable to owners of the parent | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **Issued capital** | **Shares held for the share award plan** | **Share premium** | **Merger reserve** | **Statutory surplus reserve** | **Share-based payment reserve** | **Share award reserve** | **Exchange fluctuation reserve** | **Retained profits** | **Total** |
| | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 |
| | Note 29 | Note 31 | | Note 32(a) | Note 32(b) | Note 32(c) | Note 31 | | | |
| At 1 January 2019 | 6,650 | (13,181) | 304,263 | 31,200 | 40,616 | 5,680 | (549) | 19,764 | 312,149 | 706,592 |
| Profit for the year | — | — | — | — | — | — | — | — | 114,694 | 114,694 |
| Exchange differences on translation of foreign operations | — | — | — | — | — | — | — | 1,282 | — | 1,282 |
| Total comprehensive income for the year | — | — | — | — | — | — | — | 1,282 | 114,694 | 115,976 |
| Equity-settled share award scheme | — | 2,603 | — | — | — | — | (965) | — | — | 1,638 |
| Transfer from retained profits | — | — | — | — | 7,363 | — | — | — | (7,363) | — |
| Final 2018 dividend | — | — | (26,367)[(i)] | — | — | — | — | — | — | (26,367) |
| Interim 2019 dividend | — | — | (34,456)[(i)] | — | — | — | — | — | — | (34,456) |
| At 31 December 2019 | 6,650 | (10,578)* | 243,440* | 31,200* | 47,979* | 5,680* | (1,514)* | 21,046* | 419,480* | 763,383 |

# Consolidated Statement of Changes in Equity

Year ended 31 December 2020

| | Attributable to owners of the parent | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Issued capital RMB'000 Note 29 | Shares held for the share award plan RMB'000 Note 31 | Share premium RMB'000 | Merger reserve RMB'000 Note 32(a) | Statutory surplus reserve RMB'000 Note 32(b) | Share-based payment reserve RMB'000 Note 32(c) | Share award reserve RMB'000 Note 31 | Exchange fluctuation reserve RMB'000 | Retained profits RMB'000 | Total RMB'000 | Non-controlling interests RMB'000 | Total equity RMB'000 |
| At 1 January 2020 | 6,650 | (10,578) | 243,440 | 31,200 | 47,979 | 5,680 | (1,514) | 21,046 | 419,480 | 763,383 | – | 763,383 |
| Profit for the year | – | – | – | – | – | – | – | – | 138,532 | 138,532 | 87 | 138,619 |
| Other comprehensive loss for the year | | | | | | | | | | | | |
| Exchange differences on translation of foreign operations | – | – | – | – | – | – | – | (125) | – | (125) | – | (125) |
| Total comprehensive income for the year | – | – | – | – | – | – | – | (125) | 138,532 | 138,407 | 87 | 138,494 |
| Capital contribution by a non-controlling shareholder | – | – | – | – | – | – | – | – | – | – | 1,500 | 1,500 |
| Shares repurchased | – | (12,322) | – | – | – | – | – | – | – | (12,322) | – | (12,322) |
| Equity-settled share award scheme | – | 1,683 | – | – | – | – | (565) | – | – | 1,118 | – | 1,118 |
| Transfer from retained profits | – | – | – | – | 9,719 | – | – | – | (9,719) | – | – | – |
| Final 2019 dividend | – | – | (33,241)[ii] | – | – | – | – | – | – | (33,241) | – | (33,241) |
| Interim 2020 dividend | – | – | (37,169)[ii] | – | – | – | – | – | – | (37,169) | – | (37,169) |
| At 31 December 2020 | 6,650 | (21,217)* | 173,030* | 31,200* | 57,698* | 5,680* | (2,079)* | 20,921* | 548,293* | 820,176 | 1,587 | 821,763 |

* These reserve accounts comprise the consolidated reserves of RMB813,526,000 (2019: RMB756,733,000) in the consolidated statement of financial position.

(i) Dividend income arising from the shares held for the share award plan of RMB210,000 is deducted from the aggregate of the final 2018 dividend and that of RMB275,000 is deducted from the aggregate of the interim 2019 dividend.

(ii) Dividend income arising from the shares held for the share award plan of RMB217,000 is deducted from the aggregate of the final 2019 dividend and that of RMB243,000 is deducted from the aggregate of the interim 2020 dividend.

# Consolidated Statement of Cash Flows

Year ended 31 December 2020

| | Notes | 2020 RMB'000 | 2019 RMB'000 |
|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | | |
| Profit before tax | 8 | **167,222** | 155,941 |
| Adjustments for: | | | |
| Finance costs | 7 | **5,218** | 4,007 |
| Bank interest income | 5 | **(5,271)** | (4,728) |
| Interest income from financial assets at fair value through profit or loss | 5 | **(4,749)** | (3,472) |
| Dividend income from an equity investment at fair value through profit or loss | 5 | **(58)** | (76) |
| Fair value gains, net: | | | |
| Equity investment at fair value through profit or loss | 5 | **(7,509)** | (3,386) |
| Gain on disposal of an equity investment at fair value through profit or loss | 5 | **—** | (5,376) |
| Loss/(gain) on disposal of items of property, plant and equipment, net | 5,6 | **217** | (3) |
| Covid-19-related rent concessions from lessors | 15 | **(698)** | — |
| Depreciation | 8,14 | **59,736** | 29,565 |
| Depreciation of right-of-use assets | 8,15 | **37,173** | 32,147 |
| Amortisation of other intangible assets | 8,17 | **2,840** | 1,822 |
| Equity-settled share award expense | 8 | **1,117** | 1,638 |
| Government grants released | 27 | **(8,920)** | (5,114) |
| Impairment losses on trade receivables | 6,8 | **394** | 1,246 |
| Write-down of inventories to net realisable value | 6,8 | **114** | 451 |
| | | **246,826** | 204,662 |
| Increase in inventories | | **(48,197)** | (20,498) |
| Increase in trade and notes receivables | | **(52,993)** | (86,987) |
| (Increase)/decrease in prepayments, deposits and other receivables | | **(58,790)** | 6,152 |
| Decrease in non-current assets | | **45** | 3,660 |
| Increase in trade payables | | **6,139** | 18,882 |
| Increase in other payables and accruals | | **14,007** | 49,805 |
| Increase in deferred income | 27 | **9,511** | 14,701 |
| Cash generated from operations | | **116,548** | 190,377 |
| Interest paid | | **(1,387)** | (77) |
| Income tax paid | | **(21,982)** | (22,473) |
| Net cash flows from operating activities | | **93,179** | 167,827 |

# Consolidated Statement of Cash Flows

Year ended 31 December 2020

| | Notes | 2020 RMB'000 | 2019 RMB'000 |
|---|---|---|---|
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | | |
| Purchases of items of property, plant and equipment | | **(89,658)** | (56,388) |
| Increase in prepayments for purchases of property, plant and equipment | | **(24,331)** | (780) |
| Proceeds from disposal of items of property, plant and equipment | | **9,220** | 421 |
| Purchase of other intangible assets | | **(3,840)** | (8,875) |
| Purchase of right-of-use assets | | **(8,502)** | (8,867) |
| Proceeds from disposal of intangible assets | | **—** | 68 |
| Purchase of an equity investment at fair value through profit or loss | | **(389)** | (210) |
| Purchases of financial assets at fair value through profit or loss | | **(320,000)** | (202,925) |
| Proceeds upon maturity of financial assets at fair value through profit or loss | | **320,000** | 202,925 |
| Proceeds from disposal of an equity investment at fair value through profit or loss | | **—** | 10,300 |
| Acquisition of a subsidiary | 33 | **—** | (560) |
| Bank interest received | 5 | **5,271** | 4,728 |
| Interest received from financial assets at fair value through profit or loss | 5 | **4,749** | 3,472 |
| Dividend received from an equity investment | 5 | **58** | 76 |
| Increase in non-pledged time deposits with original maturity of more than three months when acquired | | **(143,000)** | — |
| Net cash flows used in investing activities | | **(250,422)** | (56,615) |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | | |
| Principal portion of lease payments | 34(a) | **(38,264)** | (34,010) |
| New bank borrowings | | **78,915** | 31,352 |
| Repayments of bank borrowings | | **(31,352)** | (1,379) |
| Dividends paid | | **(70,410)** | (60,822) |
| Purchase of shares held under the share award plan | | **(12,322)** | — |
| Capital contribution from a non-controlling shareholder | | **1,500** | — |
| Net cash flows used in financing activities | | **(71,933)** | (64,859) |

# Consolidated Statement of Cash Flows

Year ended 31 December 2020

| | Note | 2020 RMB'000 | 2019 RMB'000 |
|---|---|---|---|
| **NET (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS** | | **(229,176)** | 46,353 |
| Cash and cash equivalents at beginning of year | | **380,333** | 332,698 |
| Effect of foreign exchange rate changes, net | | **(125)** | 1,282 |
| **CASH AND CASH EQUIVALENTS AT END OF YEAR** | | **151,032** | 380,333 |
| **ANALYSIS OF BALANCES OF CASH AND CASH EQUIVALENTS** | | | |
| Cash and bank balances | 23 | **151,032** | 373,996 |
| Non-pledged time deposits | 23 | **143,000** | 6,337 |
| Cash and bank balances as stated in the statement of financial position | | **294,032** | 380,333 |
| Non-pledged time deposits with original maturity of more than three months when acquired | | **(143,000)** | — |
| Cash and cash equivalents as stated in the statement of cash flows | | **151,032** | 380,333 |

# Notes to the Consolidated Financial Statements

31 December 2020

## 1. CORPORATE AND GROUP INFORMATION

Zhongzhi Pharmaceutical Holdings Limited (the "Company") was incorporated in the Cayman Islands on 12 September 2014 as an exempted company with limited liability under the Companies Law (2013 Revision) of the Cayman Islands. The address of the registered office of the Company is Clifton House, 75 Fort Street, P.O. Box 1350, Grand Cayman, KY1-1108, Cayman Islands. The shares of the Company were listed on the Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") on 13 July 2015 (the "Listing Date").

The Company is an investment holding company. The Company and its subsidiaries (collectively referred to as the "Group") are principally engaged in the manufacture and sale of pharmaceutical products in the People's Republic of China (the "PRC"). There has been no significant change in the Group's principal activities during the year.

In the opinion of the directors, as at the date of this report, the immediate and ultimate holding company of the Company is Crystal Talent Investment Group Limited, a company incorporated in the British Virgin Islands ("BVI").

### Information about subsidiaries

Particulars of the Company's subsidiaries as at 31 December 2020 are as follows:

| Name | Place and date of incorporation/ registration and place of business | Issued ordinary/ registered share capital | Percentage of equity attributable to the Company Direct | Indirect | Principal activities |
|---|---|---|---|---|---|
| Windom Talent Company Limited ("Windom Talent") | BVI 16 September 2014, BVI | US$1 | 100% | — | Investment holding |
| Grant Talent Development Limited ("Grant Talent") | Hong Kong 1 August 2014, Hong Kong | HK$1 | — | 100% | Investment holding |
| Zhongshan Zhongzhi Pharmaceutical Group Co., Ltd. ("Zhongzhi Pharmaceutical") [(a)] | PRC 27 September 1999, Mainland China | RMB220,000,000 | — | 100% | Sale of pharmaceutical drugs |
| Zeus Medicine Hong Kong Limited | Hong Kong 14 April 2011, Hong Kong | HK$10,000 | — | 100% | Sale of pharmaceutical drugs |
| Zhongshan Zhongzhi Chain Pharmacies Company Limited ("Zhongzhi Chain Pharmacies") | PRC 27 July 2001, Mainland China | RMB4,600,000 | — | 100% | Sale of pharmaceutical drugs |

# Notes to the Consolidated Financial Statements

31 December 2020

## 1. CORPORATE AND GROUP INFORMATION (Continued)

### Information about subsidiaries (Continued)

| Name | Place and date of incorporation/ registration and place of business | Issued ordinary/ registered share capital | Percentage of equity attributable to the Company Direct | Indirect | Principal activities |
|---|---|---|---|---|---|
| Zhongshan Zhongzhi Chinese Medicine Herb in Pieces Co., Ltd. ("Zhongzhi Herb Pieces") [(b)] | PRC 10 July 2001, Mainland China | RMB6,600,000 | — | 100% | Manufacture and sale of Chinese decoction pieces |
| Zhongshan Honeson Pharmaceutical Co., Ltd. ("Honeson Pharmaceutical") | PRC 2 March 1986, Mainland China | RMB10,000,000 | — | 100% | Manufacture and sale of pharmaceutical drugs |
| Guangdong Caojinghua Cell-broken Herb Co., Ltd. ("Guangdong Caojinghua") | PRC 10 December 2014, Mainland China | RMB500,000 | — | 100% | Manufacture and sale of food |
| Yulin Yixian Chinese Medicinal Materials Co., Ltd. ("Yulin Yixian") | PRC 8 August 2016, Mainland China | RMB2,000,000 | — | 100% | Manufacture and sale of Chinese herb |
| Shenzhen Caojinghua Electronic Business Co., Ltd. ("Shenzhen Caojinghua") | PRC 10 January 2017, Mainland China | RMB1,000,000 | — | 100% | Sale of pharmaceutical drugs |
| Guangzhou Yunzhi Health Technology Co., Ltd. ("Guangzhou Yunzhi") | PRC 1 December 2017, Mainland China | RMB1,000,000 | — | 100% | Sale of pharmaceutical drugs |
| Guangdong Zhongzhida Pharmaceutical Co., Ltd. ("Guangdong Zhongzhida") | PRC 25 October 2019, Mainland China | RMB10,000,000 | — | 100% | Wholesale of pharmaceutical products |
| Guangdong Yunzhi Chinese Medicine Herb in Pieces Co., Ltd. ("Guangdong Yunzhi") | PRC 12 November 2019, Mainland China | RMB50,000,000 | — | 100% | Manufacture and sale of Chinese decoction pieces |
| Guangdong Yunzhi Chain Pharmacies Company Limited ("Yunzhi Chain Pharmacies") | PRC 29 April 2020, Mainland China | RMB10,000,000 | — | 100% | Sale of pharmaceutical drugs |
| Gansu Zhongzhi Shunhe Chinese Medicinal Materials Co., Ltd. ("Gansu Shunhe") | PRC 26 March 2020, Mainland China | RMB10,000,000 | — | 100% | Manufacture and sale of Chinese herb |

# Notes to the Consolidated Financial Statements

31 December 2020

## 1. CORPORATE AND GROUP INFORMATION (Continued)

### Information about subsidiaries (Continued)

| Name | Place and date of incorporation/ registration and place of business | Issued ordinary/ registered share capital | Percentage of equity attributable to the Company Direct | Percentage of equity attributable to the Company Indirect | Principal activities |
|---|---|---|---|---|---|
| Zhongshan Zhongzhi Property Management Co., Ltd. ("Zhongzhi Property Management") | PRC 2 September 2020, Mainland China | RMB3,000,000 | — | 100% | Property management |
| Guangdong Honeson Pharmaceutical Co., Ltd. ("Guangdong Honeson Pharmaceutical") | PRC 2 September 2020, Mainland China | RMB5,000,000 | — | 100% | Manufacture and sale of pharmaceutical drugs |

(a) Zhongzhi Pharmaceutical was registered as a wholly-foreign-owned enterprise under PRC law.

(b) Zhongzhi Herb Pieces was ultimately controlled by the Company as a result of a series of contractual arrangements between Zhongzhi Pharmaceutical with Zhongzhi Herb Pieces and the holders of its equity interests ("Registered Shareholders").

## 2.1 BASIS OF PREPARATION

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs") (which include all International Financial Reporting Standards, International Accounting Standards ("IASs") and Interpretations) issued by the International Accounting Standards Board ("IASB"), accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. They have been prepared under a historical cost convention, except for equity investments and financial assets at fair value through profit or loss which have been measured at fair value. These financial statements are presented in Renminbi ("RMB"), and all values are rounded to the nearest thousand except otherwise indicated.

### Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year ended 31 December 2020. A subsidiary is an entity (including a structured entity), directly or indirectly, controlled by the Company. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee (i.e., existing rights that give the Group the current ability to direct the relevant activities of the investee).

# Notes to the Consolidated Financial Statements

31 December 2020

## 2.1 BASIS OF PREPARATION (Continued)

### Basis of consolidation (Continued)

When the Company has, directly or indirectly, less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

(a) the contractual arrangement with the other vote holders of the investee;
(b) rights arising from other contractual arrangements; and
(c) the Group's voting rights and potential voting rights.

The financial statements of the subsidiaries are prepared for the same reporting period as the Company, using consistent accounting policies. The results of subsidiaries are consolidated from the date on which the Group obtains control, and continue to be consolidated until the date that such control ceases.

Profit or loss and each component of other comprehensive income are attributed to the owners of the parent of the Group and to the non-controlling interests, even if this results in the non-controlling interests having a deficit balance. All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

The Group reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control described above. A change in the ownership interest of a subsidiary, without a loss of control, is accounted for as an equity transaction.

If the Group loses control over a subsidiary, it derecognises (i) the assets (including goodwill) and liabilities of the subsidiary, (ii) the carrying amount of any non-controlling interest and (iii) the cumulative translation differences recorded in equity; and recognises (i) the fair value of the consideration received, (ii) the fair value of any investment retained and (iii) any resulting surplus or deficit in profit or loss. The Group's share of components previously recognised in other comprehensive income is reclassified to profit or loss or retained profits, as appropriate, on the same basis as would be required if the Group had directly disposed of the related assets or liabilities.

## 2.2 CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES

The Group has adopted the *Conceptual Framework for Financial Reporting 2018* and the following revised IFRSs for the first time for the current year's financial statements.

| | |
|---|---|
| Amendments to IFRS 3 | *Definition of a Business* |
| Amendments to IFRS 9, IAS 39 and IFRS 7 | *Interest Rate Benchmark Reform* |
| Amendment to IFRS 16 | *Covid-19-Related Rent Concessions* (early adopted) |
| Amendments to IAS 1 and IAS 8 | *Definition of Material* |

# Notes to the Consolidated Financial Statements

31 December 2020

## 2.2 CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (Continued)

The nature and the impact of the *Conceptual Framework for Financial Reporting 2018* and the revised IFRSs are described below:

(a) *Conceptual Framework for Financial Reporting 2018* (the "Conceptual Framework") sets out a comprehensive set of concepts for financial reporting and standard setting, and provides guidance for preparers of financial statements in developing consistent accounting policies and assistance to all parties to understand and interpret the standards. The Conceptual Framework includes new chapters on measurement and reporting financial performance, new guidance on the derecognition of assets and liabilities, and updated definitions and recognition criteria for assets and liabilities. It also clarifies the roles of stewardship, prudence and measurement uncertainty in financial reporting. The Conceptual Framework is not a standard, and none of the concepts contained therein override the concepts or requirements in any standard. The Conceptual Framework did not have any significant impact on the financial position and performance of the Group.

(b) Amendments to IFRS 3 clarify and provide additional guidance on the definition of a business. The amendments clarify that for an integrated set of activities and assets to be considered a business, it must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output. A business can exist without including all of the inputs and processes needed to create outputs. The amendments remove the assessment of whether market participants are capable of acquiring the business and continue to produce outputs. Instead, the focus is on whether acquired inputs and acquired substantive processes together significantly contribute to the ability to create outputs. The amendments have also narrowed the definition of outputs to focus on goods or services provided to customers, investment income or other income from ordinary activities. Furthermore, the amendments provide guidance to assess whether an acquired process is substantive and introduce an optional fair value concentration test to permit a simplified assessment of whether an acquired set of activities and assets is not a business. The Group has applied the amendments prospectively to transactions or other events that occurred on or after 1 January 2020. The amendments did not have any impact on the financial position and performance of the Group.

(c) Amendments to IFRS 9, IAS 39 and IFRS 7 address issues affecting financial reporting in the period before the replacement of an existing interest rate benchmark with an alternative risk-free rate ("RFR"). The amendments provide temporary reliefs which enable hedge accounting to continue during the period of uncertainty before the introduction of the alternative RFR. In addition, the amendments require companies to provide additional information to investors about their hedging relationships which are directly affected by these uncertainties. The amendments did not have any impact on the financial position and performance of the Group as the Group does not have any interest rate hedging relationships.

# Notes to the Consolidated Financial Statements

31 December 2020

## 2.2 CHANGES IN ACCOUNTING POLICIES AND DISCLOSURES (Continued)

(d) Amendment to IFRS 16 provides a practical expedient for lessees to elect not to apply lease modification accounting for rent concessions arising as a direct consequence of the covid-19 pandemic. The practical expedient applies only to rent concessions occurring as a direct consequence of the pandemic and only if (i) the change in lease payments results in revised consideration for the lease that is substantially the same as, or less than, the consideration for the lease immediately preceding the change; (ii) any reduction in lease payments affects only payments originally due on or before 30 June 2021; and (iii) there is no substantive change to other terms and conditions of the lease. The amendment is effective for annual periods beginning on or after 1 June 2020 with earlier application permitted and shall be applied retrospectively.

During the year ended 31 December 2020, certain monthly lease payments for the leases of the Group's plant and machinery have been reduced or waived by the lessors upon reducing the scale of production as a result of the pandemic and there are no other changes to the terms of the leases. The Group has early adopted the amendment on 1 January 2020 and elected not to apply lease modification accounting for all rent concessions granted by the lessors as a result of the pandemic during the year ended 31 December 2020. Accordingly, a reduction in the lease payments arising from the rent concessions of RMB698,000 has been accounted for as a variable lease payment by derecognising part of the lease liabilities and crediting to profit or loss for the year ended 31 December 2020.

(e) Amendments to IAS 1 and IAS 8 provide a new definition of material. The new definition states that information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements. The amendments clarify that materiality will depend on the nature or magnitude of information, or both. The amendments did not have any significant impact on the financial position and performance of the Group.

## 2.3 ISSUED BUT NOT YET EFFECTIVE IFRSs

The Group has not applied the following new and revised IFRSs, which have been issued but are not yet effective, in these financial statements.

| | |
|---|---|
| Amendments to IFRS 3 | *Reference to the Conceptual Framework*[1] |
| Amendments to IFRS 10 and IAS 28 (2011) | *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*[2] |
| Amendments to IAS 37 | *Onerous Contracts — Cost of Fulfilling a Contract*[1] |

1 Effective for annual periods beginning on or after 1 January 2022
2 No mandatory effective date yet determined but available for adoption

Further information about those IFRSs that are expected to be applicable to the Group is described below.

# Notes to the Consolidated Financial Statements

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## 2.3 ISSUED BUT NOT YET EFFECTIVE IFRSs (Continued)

Amendments to IFRS 3 are intended to replace a reference to the previous *Framework for the Preparation and Presentation of Financial Statements* with a reference to the *Conceptual Framework for Financial Reporting* issued in June 2018 without significantly changing its requirements. The amendments also add to IFRS 3 an exception to its recognition principle for an entity to refer to the Conceptual Framework to determine what constitutes an asset or a liability. The exception specifies that, for liabilities and contingent liabilities that would be within the scope of IAS 37 or IFRIC 21 if they were incurred separately rather than assumed in a business combination, an entity applying IFRS 3 should refer to IAS 37 or IFRIC 21 respectively instead of the Conceptual Framework. Furthermore, the amendments clarify that contingent assets do not qualify for recognition at the acquisition date. The Group expects to adopt the amendments prospectively from 1 January 2022. Since the amendments apply prospectively to business combinations for which the acquisition date is on or after the date of first application, the Group will not be affected by these amendments on the date of transition.

Amendments to IFRS 10 and IAS 28 (2011) address an inconsistency between the requirements in IFRS 10 and in IAS 28 (2011) in dealing with the sale or contribution of assets between an investor and its associate or joint venture. The amendments require a full recognition of a gain or loss when the sale or contribution of assets between an investor and its associate or joint venture constitutes a business. For a transaction involving assets that do not constitute a business, a gain or loss resulting from the transaction is recognised in the investor's profit or loss only to the extent of the unrelated investor's interest in that associate or joint venture. The amendments are to be applied prospectively. The previous mandatory effective date of amendments to IFRS 10 and IAS 28 (2011) was removed by the HKICPA in January 2016 and a new mandatory effective date will be determined after the completion of a broader review of accounting for associates and joint ventures. However, the amendments are available for adoption now.

Amendments to IAS 37 clarify that for the purpose of assessing whether a contract is onerous under IAS 37, the cost of fulfilling the contract comprises the costs that relate directly to the contract. Costs that relate directly to a contract include both the incremental costs of fulfilling that contract (e.g., direct labour and materials) and an allocation of other costs that relate directly to fulfilling that contract (e.g., an allocation of the depreciation charge for an item of property, plant and equipment used in fulfilling the contract as well as contract management and supervision costs). General and administrative costs do not relate directly to a contract and are excluded unless they are explicitly chargeable to the counterparty under the contract. The amendments are effective for annual periods beginning on or after 1 January 2022 and shall be applied to contracts for which an entity has not yet fulfilled all its obligations at the beginning of the annual reporting period in which it first applies the amendments. Earlier application is permitted. Any cumulative effect of initially applying the amendments shall be recognised as an adjustment to the opening equity at the date of initial application without restating the comparative information. The amendments are not expected to have any significant impact on the Group's financial statements.

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Investments in joint ventures

A joint venture is a type of joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the joint venture. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

# Notes to the Consolidated Financial Statements

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## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Investments in joint ventures (Continued)

The Group's investments in joint ventures are stated in the consolidated statement of financial position at the Group's share of net assets under the equity method of accounting, less any impairment losses. The Group's share of the post-acquisition results and other comprehensive income of joint ventures is included in the consolidated statement of profit or loss and consolidated statement of comprehensive income, respectively. In addition, when there has been a change recognised directly in the equity of the joint ventures, the Group recognises its share of any changes, when applicable, in the consolidated statement of changes in equity. Unrealised gains and losses resulting from transactions between the Group and its joint ventures are eliminated to the extent of the Group's investments in the joint ventures, except where unrealised losses provide evidence of an impairment of the assets transferred.

### Business combinations and goodwill

Business combinations are accounted for using the acquisition method. The consideration transferred is measured at the acquisition date fair value which is the sum of the acquisition date fair values of assets transferred by the Group, liabilities assumed by the Group to the former owners of the acquiree and the equity interests issued by the Group in exchange for control of the acquiree. For each business combination, the Group elects whether to measure the non-controlling interests in the acquiree that are present ownership interests and entitle their holders to a proportionate share of net assets in the event of liquidation at fair value or at the proportionate share of the acquiree's identifiable net assets. All other components of non-controlling interests are measured at fair value. Acquisition-related costs are expensed as incurred.

The Group determines that it has acquired a business when the acquired set of activities and assets includes an input and a substantive process that together significantly contribute to the ability to create outputs.

When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts of the acquiree.

If the business combination is achieved in stages, the previously held equity interest is remeasured at its acquisition date fair value and any resulting gain or loss is recognised in profit or loss.

Any contingent consideration to be transferred by the acquirer is recognised at fair value at the acquisition date. Contingent consideration classified as an asset or liability is measured at fair value with changes in fair value recognised in profit or loss. Contingent consideration that is classified as equity is not remeasured and subsequent settlement is accounted for within equity.

Goodwill is initially measured at cost, being the excess of the aggregate of the consideration transferred, the amount recognised for non-controlling interests and any fair value of the Group's previously held equity interests in the acquiree over the identifiable net assets acquired and liabilities assumed. If the sum of this consideration and other items is lower than the fair value of the net assets acquired, the difference is, after reassessment, recognised in profit or loss as a gain on bargain purchase.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. The Group performs its annual impairment test of goodwill as at 31 December. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Group are assigned to those units or groups of units.

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Business combinations and goodwill (Continued)

Impairment is determined by assessing the recoverable amount of the cash-generating unit (group of cash-generating units) to which the goodwill relates. Where the recoverable amount of the cash-generating unit (group of cash-generating units) is less than the carrying amount, an impairment loss is recognised. An impairment loss recognised for goodwill is not reversed in a subsequent period.

Where goodwill has been allocated to a cash-generating unit (or group of cash-generating units) and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on the disposal. Goodwill disposed of in these circumstances is measured based on the relative value of the operation disposed of and the portion of the cash-generating unit retained.

### Fair value measurement

The Group measures its financial instruments at fair value at the end of each reporting period. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either in the principal market for the asset or liability, or in the absence of a principal market, in the most advantageous market for the asset or liability. The principal or the most advantageous market must be accessible by the Group. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Group uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

Level 1 — based on quoted prices (unadjusted) in active markets for identical assets or liabilities
Level 2 — based on valuation techniques for which the lowest level input that is significant to the fair value measurement is observable, either directly or indirectly
Level 3 — based on valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable

For assets and liabilities that are recognised in the financial statements on a recurring basis, the Group determines whether transfers have occurred between levels in the hierarchy by reassessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

# Notes to the Consolidated Financial Statements

31 December 2020

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Impairment of non-financial assets

Where an indication of impairment exists, or when annual impairment testing for an asset is required (other than inventories, deferred tax assets and financial assets), the asset's recoverable amount is estimated. An asset's recoverable amount is the higher of the asset's or cash-generating unit's value in use and its fair value less costs of disposal, and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case the recoverable amount is determined for the cash-generating unit to which the asset belongs.

An impairment loss is recognised only if the carrying amount of an asset exceeds its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. An impairment loss is charged to the statement of profit or loss in the period in which it arises in those expense categories consistent with the function of the impaired asset.

An assessment is made at the end of the reporting period as to whether there is an indication that previously recognised impairment losses may no longer exist or may have decreased. If such an indication exists, the recoverable amount is estimated. A previously recognised impairment loss of an asset is reversed only if there has been a change in the estimates used to determine the recoverable amount of that asset, but not to an amount higher than the carrying amount that would have been determined (net of any depreciation) had no impairment loss been recognised for the asset in prior years. A reversal of such an impairment loss is credited to the statement of profit or loss in the period in which it arises.

### Related parties

A party is considered to be related to the Group if:

(a) the party is a person or a close member of that person's family and that person

- (i) has control or joint control over the Group;
- (ii) has significant influence over the Group; or
- (iii) is a member of the key management personnel of the Group or of a parent of the Group;

or

(b) the party is an entity where any of the following conditions applies:

- (i) the entity and the Group are members of the same group;
- (ii) one entity is an associate or joint venture of the other entity (or of a parent, subsidiary or fellow subsidiary of the other entity);
- (iii) the entity and the Group are joint ventures of the same third party;
- (iv) one entity is a joint venture of a third entity and the other entity is an associate of the third entity;
- (v) the entity is a post-employment benefit plan for the benefit of employees of either the Group or an entity related to the Group; (If the Group is itself such a plan) and the sponsoring employers of the post-employment benefit plan;

# Notes to the Consolidated Financial Statements

31 December 2020

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Related parties (Continued)

(b) (Continued)

(vi) the entity is controlled or jointly controlled by a person identified in (a);

(vii) a person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity); and

(viii) the entity, or any member of a group of which it is a part, provides key management personnel services to the Group or to the parent of the Group.

### Property, plant and equipment and depreciation

Property, plant and equipment, other than construction in progress, are stated at cost less accumulated depreciation and any impairment losses. The cost of an item of property, plant and equipment comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use.

Expenditure incurred after items of property, plant and equipment have been put into operation, such as repairs and maintenance, is normally charged to the statement of profit or loss in the period in which it is incurred. In situations where the recognition criteria are satisfied, the expenditure for a major inspection is capitalised in the carrying amount of the asset as a replacement. Where significant parts of property, plant and equipment are required to be replaced at intervals, the Group recognises such parts as individual assets with specific useful lives and depreciates them accordingly.

Depreciation is calculated on the straight-line basis to write off the cost of each item of property, plant and equipment to its residual value over its estimated useful life. The estimated useful lives of property, plant and equipment used are as follows:

| | |
|---|---|
| Leasehold improvements | 1-10 years |
| Buildings | 5-50 years |
| Machinery | 2-20 years |
| Motor vehicles | 4-5 years |
| Office equipment | 2-5 years |

Where parts of an item of property, plant and equipment have different useful lives, the cost of that item is allocated on a reasonable basis among the parts and each part is depreciated separately. Residual values, useful lives and the depreciation method are reviewed, and adjusted if appropriate, at least at each financial year end.

An item of property, plant and equipment including any significant part initially recognised is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss on disposal or retirement recognised in the statement of profit or loss in the year the asset is derecognised is the difference between the net sale proceeds and the carrying amount of the relevant asset.

Construction in progress mainly represents a building under construction, leasehold improvements under construction and machinery received but not completely installed. It is stated at cost less any impairment losses, and is not depreciated. Cost comprises the direct costs of construction. Construction in progress is reclassified to the appropriate category of property, plant and equipment when completed and ready for use.

# Notes to the Consolidated Financial Statements

31 December 2020

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Intangible assets (other than goodwill)

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is the fair value at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and accumulated impairment losses. Internally generated intangibles, excluding capitalised development costs, are not capitalised and the related expenditure is reflected in profit or loss in the period in which the expenditure is incurred.

The useful lives of intangible assets are assessed as finite. Intangible assets with finite lives are amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least at each financial year end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are considered to modify the amortisation period or method, as appropriate, and are treated as changes in accounting estimates. The amortisation expense on intangible assets with finite lives is recognised in the statement of profit or loss as the expense category that is consistent with the function of the intangible assets.

Intangible assets are amortised on the straight-line basis over the following estimated useful life:

| | |
|---|---|
| Software | 10 years |

Gains or losses arising from de-recognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the statement of profit or loss when the asset is derecognised.

***Patents and licences***

Purchased patents and licences are stated at cost less any impairment losses and are amortised on the straight-line basis over their estimated useful lives of 3 to 5 years.

***Research and development costs***

All research costs are charged to the statement of profit or loss as incurred.

Expenditure incurred on projects to develop new products is capitalised and deferred only when the Group can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale, its intention to complete and its ability to use or sell the asset, how the asset will generate future economic benefits, the availability of resources to complete the project and the ability to measure reliably the expenditure during the development. Product development expenditure which does not meet these criteria is expensed when incurred.

### Leases

The Group assesses at contract inception whether a contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

# Notes to the Consolidated Financial Statements

31 December 2020

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Leases (Continued)

***Group as a lessee***

The Group applies a single recognition and measurement approach for all leases, except for short-term leases and leases of low-value assets. The Group recognises lease liabilities to make lease payments and right-of-use assets representing the right to use the underlying assets.

*(a) Right-of-use assets*

Right-of-use assets are recognised at the commencement date of the lease (that is the date the underlying asset is available for use). Right-of-use assets are measured at cost, less any accumulated depreciation and any impairment losses, and adjusted for any remeasurement of lease liabilities. The cost of right-of-use assets includes the amount of lease liabilities recognised, initial direct costs incurred, and lease payments made at or before the commencement date less any lease incentives received. Right-of-use assets are depreciated on a straight-line basis over the shorter of the lease terms and the estimated useful lives of the assets as follows:

| | |
|---|---|
| Pharmacies and office premises | 3 to 5 years |
| Leasehold land | 40 to 50 years |

If ownership of the leased asset transfers to the Group by the end of the lease term or the cost reflects the exercise of a purchase option, depreciation is calculated using the estimated useful life of the asset.

*(b) Lease liabilities*

Lease liabilities are recognised at the commencement date of the lease at the present value of lease payments to be made over the lease term. The lease payments include fixed payments (including in-substance fixed payments) less any lease incentives receivable, variable lease payments that depend on an index or a rate, and amounts expected to be paid under residual value guarantees. The lease payments also include the exercise price of a purchase option reasonably certain to be exercised by the Group and payments of penalties for termination of a lease, if the lease term reflects the Group exercising the option to terminate the lease. The variable lease payments that do not depend on an index or a rate are recognised as an expense in the period in which the event or condition that triggers the payment occurs.

# Notes to the Consolidated Financial Statements

31 December 2020

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Leases (Continued)

***Group as a lessee*** (Continued)

*(b) Lease liabilities (continued)*

In calculating the present value of lease payments, the Group uses its incremental borrowing rate at the lease commencement date because the interest rate implicit in the lease is not readily determinable. After the commencement date, the amount of lease liabilities is increased to reflect the accretion of interest and reduced for the lease payments made. In addition, the carrying amount of lease liabilities is remeasured if there is a modification, a change in the lease term, a change in lease payments (e.g., a change to future lease payments resulting from a change in an index or rate) or a change in assessment of an option to purchase the underlying asset.

The Group's lease liabilities are included in interest-bearing bank and other borrowings.

*(c) Short-term leases and leases of low-value assets*

The Group applies the short-term lease recognition exemption to its short-term leases of machinery and equipment (that is those leases that have a lease term of 12 months or less from the commencement date and do not contain a purchase option). It also applies the recognition exemption for leases of low-value assets to leases of office equipment and laptop computers that are considered to be of low value.

Lease payments on short-term leases and leases of low-value assets are recognised as an expense on a straight-line basis over the lease term.

***Group as a lessor***

When the Group acts as a lessor, it classifies at lease inception (or when there is a lease modification) each of its leases as either an operating lease or a finance lease.

Leases in which the Group does not transfer substantially all the risks and rewards incidental to ownership of an asset are classified as operating leases. When a contract contains lease and non-lease components, the Group allocates the consideration in the contract to each component on a relative stand-alone selling price basis. Rental income is accounted for on a straight-line basis over the lease terms and is included in revenue in the statement of profit or loss due to its operating nature. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognized over the lease term on the same basis as rental income. Contingent rents are recognized as revenue in the period in which they are earned.

Leases that transfer substantially all the risks and rewards incidental to ownership of an underlying asset to the lessee are accounted for as finance leases.

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Investments and other financial assets

***Initial recognition and measurement***

Financial assets are classified, at initial recognition, as subsequently measured at amortised cost, fair value through other comprehensive income, and fair value through profit or loss.

The classification of financial assets at initial recognition depends on the financial asset's contractual cash flow characteristics and the Group's business model for managing them. With the exception of trade receivables that do not contain a significant financing component or for which the Group has applied the practical expedient of not adjusting the effect of a significant financing component, the Group initially measures a financial asset at its fair value, plus in the case of a financial asset not at fair value through profit or loss, transaction costs. Trade receivables that do not contain a significant financing component or for which the Group has applied the practical expedient are measured at the transaction price determined under IFRS 15 in accordance with the policies set out for "Revenue recognition" below.

In order for a financial asset to be classified and measured at amortised cost or fair value through other comprehensive income, it needs to give rise to cash flows that are solely payments of principal and interest ("SPPI") on the principal amount outstanding. Financial assets with cash flows that are not SPPI are classified and measured at fair value through profit or loss, irrespective of the business model.

The Group's business model for managing financial assets refers to how it manages its financial assets in order to generate cash flows. The business model determines whether cash flows will result from collecting contractual cash flows, selling the financial assets, or both. Financial assets classified and measured at amortised cost are held within a business model with the objective to hold financial assets in order to collect contractual cash flows, while financial assets classified and measured at fair value through other comprehensive income are held within a business model with the objective of both holding to collect contractual cash flows and selling. Financial assets which are not held within the aforementioned business models are classified and measured at fair value through profit or loss.

All regular way purchases and sales of financial assets are recognised on the trade date, that is, the date that the Group commits to purchase or sell the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

***Subsequent measurement***

The subsequent measurement of financial assets depends on their classification as follows:

*Financial assets at amortised cost (debt instruments)*

Financial assets at amortised cost are subsequently measured using the effective interest method and are subject to impairment. Gains and losses are recognised in the statement of profit or loss when the asset is derecognised, modified or impaired.

# Notes to the Consolidated Financial Statements

31 December 2020

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Investments and other financial assets (Continued)

***Subsequent measurement*** (Continued)

*Financial assets at fair value through other comprehensive income (debt instruments)*

For debt investments at fair value through other comprehensive income, interest income, foreign exchange revaluation and impairment losses or reversals are recognised in the statement of profit or loss and computed in the same manner as for financial assets measured at amortised cost. The remaining fair value changes are recognised in other comprehensive income. Upon derecognition, the cumulative fair value change recognised in other comprehensive income is recycled to the statement of profit or loss.

*Financial assets at fair value through profit or loss*

Financial assets at fair value through profit or loss are carried in the statement of financial position at fair value with net changes in fair value recognised in the statement of profit or loss.

### Derecognition of financial assets

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is primarily derecognised (i.e., removed from the Group's consolidated statement of financial position) when:

- the rights to receive cash flows from the asset have expired; or

- the Group has transferred its rights to receive cash flows from the asset, or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a "pass-through" arrangement; and either (a) the Group has transferred substantially all the risks and rewards of the asset, or (b) the Group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Group has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, it evaluates if, and to what extent, it has retained the risk and rewards of ownership of the asset. When it has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the Group continues to recognise the transferred asset to the extent of the Group's continuing involvement. In that case, the Group also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Group has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

### Impairment of financial assets

The Group recognises an allowance for expected credit losses ("ECLs") for all debt instruments not held at fair value through profit or loss. ECLs are based on the difference between the contractual cash flows due in accordance with the contract and all the cash flows that the Group expects to receive, discounted at an approximation of the original effective interest rate. The expected cash flows will include cash flows from the sale of collateral held or other credit enhancements that are integral to the contractual terms.

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Impairment of financial assets (Continued)

***General approach***

ECLs are recognised in two stages. For credit exposures for which there has not been a significant increase in credit risk since initial recognition, ECLs are provided for credit losses that result from default events that are possible within the next 12 months (a 12-month ECL). For those credit exposures for which there has been a significant increase in credit risk since initial recognition, a loss allowance is required for credit losses expected over the remaining life of the exposure, irrespective of the timing of the default (a lifetime ECL).

At each reporting date, the Group assesses whether the credit risk on a financial instrument has increased significantly since initial recognition. When making the assessment, the Group compares the risk of a default occurring on the financial instrument as at the reporting date with the risk of a default occurring on the financial instrument as at the date of initial recognition and considers reasonable and supportable information that is available without undue cost or effort, including historical and forward-looking information.

The Group considers a financial asset in default when contractual payments are 90 days past due. However, in certain cases, the Group may also consider a financial asset to be in default when internal or external information indicates that the Group is unlikely to receive the outstanding contractual amounts in full before taking into account any credit enhancements held by the Group. A financial asset is written off when there is no reasonable expectation of recovering the contractual cash flows.

Debt investments at fair value through other comprehensive income and financial assets at amortised cost are subject to impairment under the general approach and they are classified within the following stages for measurement of ECLs except for trade and notes receivables which apply the simplified approach as detailed below.

Stage 1 — Financial instruments for which credit risk has not increased significantly since initial recognition and for which the loss allowance is measured at an amount equal to 12-month ECLs

Stage 2 — Financial instruments for which credit risk has increased significantly since initial recognition but that are not credit-impaired financial assets and for which the loss allowance is measured at an amount equal lifetime ECLs

Stage 3 — Financial assets that are credit-impaired at the reporting date (but that are not purchased or originated credit-impaired) and for which the loss allowance is measured at an amount equal to lifetime ECLs

***Simplified approach***

For trade and notes receivables that do not contain a significant financing component or when the Group applies the practical expedient of not adjusting the effect of a significant financing component, the Group applies the simplified approach in calculating ECLs. Under the simplified approach, the Group does not track changes in credit risk, but instead recognises a loss allowance based on lifetime ECLs at each reporting date. The Group has established a provision matrix that is based on its historical credit loss experience, adjusted for forward-looking factors specific to the debtors and the economic environment.

For trade and notes receivables that contain a significant financing component and lease receivables, the Group chooses as its accounting policy to adopt the simplified approach in calculating ECLs with policies as described above.

# Notes to the Consolidated Financial Statements

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## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Financial liabilities

***Initial recognition and measurement***

Financial liabilities are classified, at initial recognition, as loans and borrowings, payables, as appropriate.

All financial liabilities are recognised initially at fair value and in the case of loans and borrowings and payables, net of directly attributable transaction costs.

The Group's financial liabilities include trade payables, financial liabilities included in other payables and accruals, an amount due to a joint venture, amounts due to related parties and interest-bearing bank borrowings.

***Subsequent measurement***

The subsequent measurement of financial liabilities depends on their classification as follows:

*Financial liabilities at amortised cost (loans and borrowings)*

After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost, using the effective interest rate method unless the effect of discounting would be immaterial, in which case they are stated at cost. Gains and losses are recognised in the statement of profit or loss when the liabilities are derecognised as well as through the effective interest rate amortisation process.

Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the effective interest rate. The effective interest rate amortisation is included in finance costs in the statement of profit or loss.

### Derecognition of financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled, or expires.

When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and a recognition of a new liability, and the difference between the respective carrying amounts is recognised in the statement of profit or loss.

# Notes to the Consolidated Financial Statements

31 December 2020

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Offsetting of financial instruments

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position if there is a currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liabilities simultaneously.

### Shares held under the share award scheme

The Group's own equity instruments which are reacquired (shares held under the share award scheme) are recognised at cost and deducted from equity. No gain or loss is recognised in profit or loss on the purchase, sale, issue or cancellation of the Group's own equity instruments. Any difference between the carrying amount and the consideration is recognised in equity.

### Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the weighted average cost method. Net realisable value is based on estimated selling prices less any estimated costs to be incurred to completion and disposal.

### Cash and cash equivalents

For the purpose of the consolidated statement of cash flows, cash and cash equivalents comprise cash on hand and demand deposits, and short term highly liquid investments that are readily convertible into known amounts of cash, are subject to an insignificant risk of changes in value, and have a short maturity of generally within three months when acquired, less bank overdrafts which are repayable on demand and form an integral part of the Group's cash management.

For the purpose of the consolidated statement of financial position, cash and cash equivalents comprise cash on hand and at banks, including term deposits, and assets similar in nature to cash, which are not restricted as to use.

# Notes to the Consolidated Financial Statements

31 December 2020

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Income tax

Income tax comprises current and deferred tax. Income tax relating to items recognised outside profit or loss is recognised outside profit or loss, either in other comprehensive income or directly in equity.

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period, taking into consideration interpretations and practices prevailing in the countries in which the Group operates.

Deferred tax is provided, using the liability method, on all temporary differences at the end of the reporting period between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised for all taxable temporary differences, except:

- when the deferred tax liability arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

- in respect of taxable temporary differences associated with investments in subsidiaries, when the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, and the carryforward of unused tax credits and any unused tax losses. Deferred tax assets are recognised to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carryforward of unused tax credits and unused tax losses can be utilised, except:

- when the deferred tax asset relating to the deductible temporary differences arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

- in respect of deductible temporary differences associated with investments in subsidiaries, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at the end of the reporting period and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred tax assets are reassessed at the end of the reporting period and are recognised to the extent that it has become probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

# Notes to the Consolidated Financial Statements

31 December 2020

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Income tax (Continued)

Deferred tax assets and deferred tax liabilities are offset if and only if the Group has a legally enforceable right to set off current tax assets and current tax liabilities and the deferred tax assets and deferred tax liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities which intend either to settle current tax liabilities and assets on a net basis, or to realise the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered.

### Government grants

Government grants are recognised at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. When the grant relates to an expense item, it is recognised as income on a systematic basis over the periods that the costs, for which it is intended to compensate, are expensed.

Where the grant relates to an asset, the fair value is credited to a deferred income account and is released to the statement of profit or loss over the expected useful life of the relevant asset by equal annual instalments.

### Revenue recognition

***Revenue from contracts with customers***

Revenue from contracts with customers is recognised when control of goods or services is transferred to the customers at an amount that reflects the consideration to which the Group expects to be entitled in exchange for those goods or services.

When the consideration in a contract includes a variable amount, the amount of consideration is estimated to which the Group will be entitled in exchange for transferring the goods or services to the customer. The variable consideration is estimated at contract inception and constrained until it is highly probable that a significant revenue reversal in the amount of cumulative revenue recognised will not occur when the associated uncertainty with the variable consideration is subsequently resolved.

When the contract contains a financing component which provides the customer with a significant benefit of financing the transfer of goods or services to the customer for more than one year, revenue is measured at the present value of the amount receivable, discounted using the discount rate that would be reflected in a separate financing transaction between the Group and the customer at contract inception. When the contract contains a financing component which provides the Group with a significant financial benefit for more than one year, revenue recognised under the contract includes the interest expense accreted on the contract liability under the effective interest method. For a contract where the period between the payment by the customer and the transfer of the promised goods or services is one year or less, the transaction price is not adjusted for the effects of a significant financing component, using the practical expedient in IFRS 15.

***Other income***

Interest income is recognised on an accrual basis using the effective interest method by applying the rate that exactly discounts the estimated future cash receipts over the expected life of the financial instrument or a shorter period, when appropriate, to the net carrying amount of the financial asset.

Dividend income is recognised when the shareholders' right to receive payment has been established, it is probable that the economic benefits associated with the dividend will flow to the Group and the amount of the dividend can be measured reliably.

# Notes to the Consolidated Financial Statements

31 December 2020

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Contract liabilities

A contract liability is recognised when a payment is received or a payment is due (whichever is earlier) from a customer before the Group transfers the related goods or services. Contract liabilities are recognised as revenue when the Group performs under the contract (i.e., transfers control of the related goods or services to the customer).

### Share-based payments

The Company operates a share option plan and a share award scheme for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operations. Employees (including directors) of the Group receive remuneration in the form of share-based payments, whereby employees render services as consideration for equity instruments ("equity-settled transactions").

The cost of equity-settled transactions is recognised in employee benefit expense, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled. The cumulative expense recognised for equity-settled transactions at the end of each reporting period until the vesting date reflects the extent to which the vesting period has expired and the Group's best estimate of the number of equity instruments that will ultimately vest. The charge or credit to the statement of profit or loss for a period represents the movement in the cumulative expense recognised as at the beginning and end of that period.

Service and non-market performance conditions are not taken into account when determining the grant date fair value of awards, but the likelihood of the conditions being met is assessed as part of the Group's best estimate of the number of equity instruments that will ultimately vest. Market performance conditions are reflected within the grant date fair value. Any other conditions attached to an award, but without an associated service requirement, are considered to be non-vesting conditions. Non-vesting conditions are reflected in the fair value of an award and lead to an immediate expensing of an award unless there are also service and/or performance conditions.

For awards that do not ultimately vest because non-market performance and/or service conditions have not been met, no expense is recognised. Where awards include a market or non-vesting condition, the transactions are treated as vesting irrespective of whether the market or non-vesting condition is satisfied, provided that all other performance and/or service conditions are satisfied.

Where the terms of an equity-settled award are modified, as a minimum an expense is recognised as if the terms had not been modified, if the original terms of the award are met. In addition, an expense is recognised for any modification that increases the total fair value of the share-based payments, or is otherwise beneficial to the employee as measured at the date of modification.

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any expense not yet recognised for the award is recognised immediately. This includes any award where non-vesting conditions within the control of either the Group or the employee are not met. However, if a new award is substituted for the cancelled award, and is designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph.

The dilutive effect of outstanding options is reflected as additional share dilution in the computation of earnings per share.

# Notes to the Consolidated Financial Statements

31 December 2020

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Other employee benefits

***Pension scheme***

The employees of the Group's subsidiaries which operate in Mainland China are required to participate in a central pension scheme operated by the local municipal government. The subsidiaries operating in Mainland China are required to contribute a certain percentage of their payroll costs to the central pension scheme. The contributions are charged to the statement of profit or loss as they become payable in accordance with the rules of the central pension scheme.

### Provision

A provision is recognised when a present obligation (legal or constructive) has arisen as a result of a past event and it is probable that a future outflow of resources will be required to settle the obligation, provided that a reliable estimate can be made of the amount of the obligation.

When the effect of discounting is material, the amount recognised for a provision is the present value at the end of the reporting period of the future expenditures expected to be required to settle the obligation. The increase in the discounted present value amount arising from the passage of time is included in finance costs in the statement of profit or loss.

### Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, i.e., assets that necessarily take a substantial period of time to get ready for their intended use or sale, are capitalised as part of the cost of those assets. The capitalisation of such borrowing costs ceases when the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs capitalised. All other borrowing costs are expensed in the period in which they are incurred. Borrowing costs consist of interest and other costs that an entity incurs in connection with the borrowing of funds.

### Dividends

Final dividends are recognised as a liability when they are approved by the shareholders in a general meeting. Proposed final dividends are disclosed in the notes to the financial statements.

Interim dividends are simultaneously proposed and declared, because the Company's memorandum and articles of association grant the directors the authority to declare interim dividends. Consequently, interim dividends are recognised immediately as a liability when they are proposed and declared.

# Notes to the Consolidated Financial Statements

31 December 2020

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Foreign currencies

These financial statements are presented in RMB, which is the Company's presentation currency. The functional currency of the Company is the Hong Kong dollars which is the currency of the primary environment in which the Company operates. Since the Company does not conduct any substantive operations of its own and conducts its primary business operations through its subsidiaries in the Mainland China, the Company adopts RMB as the presentation currency of the Group. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency. Transactions in foreign currencies are initially recorded at the functional currency rate ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated at the functional currency rates of exchange ruling at the reporting date. All differences arising on settlement or translation of monetary items are taken to the statement of profit or loss.

Differences arising on settlement or translation of monetary items are recognised in the statement of profit or loss with the exception of monetary items that are designated as part of the hedge of the Group's net investment of a foreign operation. These are recognised in other comprehensive income until the net investment is disposed of, at which time the cumulative amount is reclassified to the statement of profit or loss. Tax charges and credits attributable to exchange differences on those monetary items are also recorded in other comprehensive income.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined. The gain or loss arising on translation of a non-monetary item measured at fair value is treated in line with the recognition of the gain or loss on change in fair value of the item (i.e., translation difference on the item whose fair value gain or loss is recognised in other comprehensive income or profit or loss is also recognised in other comprehensive income or profit or loss, respectively).

In determining the exchange rate on initial recognition of the related asset, expense or income on the derecognition of a non-monetary asset or non-monetary liability relating to an advance consideration, the date of initial transaction is the date on which the Group initially recognises the non-monetary asset or non-monetary liability arising from the advance consideration. If there are multiple payments or receipts in advance, the Group determines the transaction date for each payment or receipt of the advance consideration.

The functional currencies of the subsidiaries established outside the PRC are currencies other than the RMB. As at the end of each reporting period, the assets and liabilities of these entities are translated into RMB at the exchange rates prevailing at the end of the reporting period and their statements of profit or loss are translated into RMB at the weighted average exchange rates for the year.

# Notes to the Consolidated Financial Statements

31 December 2020

## 2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Foreign currencies (Continued)

The resulting exchange differences are recognised in other comprehensive income and accumulated as a separate component of equity until the disposal of the respective foreign operation entity. On disposal of a foreign operation, the component of other comprehensive income relating to that particular foreign operation is recognised in the statement of profit or loss.

Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition are treated as assets and liabilities of the foreign operation and translated at the closing rate.

For the purpose of the consolidated statement of cash flows, the cash flows of the subsidiaries established outside the PRC are translated into RMB at the exchange rates ruling at the dates of the cash flows. Frequently recurring cash flows of the companies established outside the PRC which arise throughout the year are translated into RMB at the weighted average exchange rates for the year.

## 3. SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES

The preparation of the financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and their accompanying disclosures, and the disclosure of contingent liabilities. Uncertainty about these assumptions and estimates could result in outcomes that could require a material adjustment to the carrying amounts of the assets or liabilities affected in the future.

### Judgements

In the process of applying the Group's accounting policies, management has made the following judgements, apart from those involving estimations, which have the most significant effect on the amounts recognised in the financial statements:

***Contractual arrangements***

Zhongzhi Herb Pieces is engaged in the manufacture and sale of Chinese decoction pieces, which falls in the scope of "Catalogue of Restricted Foreign Investment Industries" and foreign investors are prohibited to invest in such business.

As disclosed in note 1, as part of the historical reorganisation, the equity interests in Zhongzhi Herb Pieces were transferred to the Registered Shareholders and the Group exercises control over Zhongzhi Herb Pieces and enjoys all economic benefits of Zhongzhi Herb Pieces through the Contractual Arrangements.

# Notes to the Consolidated Financial Statements

31 December 2020

## 3. SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES (Continued)

### Judgements (Continued)

***Contractual arrangements*** (Continued)

The Group considers that it controls Zhongzhi Herb Pieces, notwithstanding the fact that it does not hold a direct equity interest in Zhongzhi Herb Pieces, as it has power over the financial and operating policies of Zhongzhi Herb Pieces and receives all economic benefits from the business activities of Zhongzhi Herb Pieces through the Contractual Arrangements. Accordingly, Zhongzhi Herb Pieces has been accounted for as a subsidiary during the reporting period.

***Withholding taxes arising from the distribution of dividends***

The Group's determination as to whether to accrue for withholding taxes from the distribution of dividends from a subsidiary in the PRC according to the relevant tax jurisdictions is subject to judgement on the timing of the payment of the dividends. The estimation process is highly based on assumptions, which are influenced by projected future market and economic conditions and future financing requirements of the Group, and it is not probable that such subsidiary will distribute dividends in the foreseeable future.

### Estimation uncertainty

The key assumptions concerning the future and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

***Impairment of goodwill***

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the value in use of the cash-generating units to which the goodwill is allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating units and also to choose a suitable discount rate in order to calculate the present value of those cash flows. The carrying amount of goodwill at 31 December 2020 was RMB1,628,000 (2019: RMB1,628,000). Further details are given in note 16.

***Impairment of non-financial assets (other than goodwill)***

The Group assesses whether there are any indicators of impairment for all non-financial assets (including the right-of-use assets) at the end of the reporting period. The non-financial assets are tested for impairment when there are indicators that the carrying amounts may not be recoverable. An impairment exists when the carrying value of an asset or a cash-generating unit exceeds its recoverable amount, which is the higher of its fair value less costs of disposal and its value-in-use. The calculation of the fair value less costs of disposal is based on available data from binding sales transactions in an arm's length transaction of similar assets or observable market prices less incremental costs for disposing of the asset. When value in use calculations are undertaken, management must estimate the expected future cash flows from the asset or cash-generating unit and choose a suitable discount rate in order to calculate the present value of those cash flows.

# Notes to the Consolidated Financial Statements

31 December 2020

## 3. SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES (Continued)

### Estimation uncertainty (Continued)

***Deferred tax assets***

Deferred tax assets are recognised for deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. Significant management judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and level of future taxable profits together with future tax planning strategies.

***Provision for expected credit losses on trade receivables***

The Group uses a provision matrix to calculate ECLs for trade receivables. The provision rates are based on the ageing analysis of groupings of various customer segments that have similar loss patterns (i.e., by geography, product type and customer type).

The provision matrix is initially based on the Group's historical observed default rates. The Group will calibrate the matrix to adjust the historical credit loss experience with forward-looking information. At each reporting date, the historical observed default rates are updated and changes in the forward-looking estimates are analysed.

The assessment of the correlation among historical observed default rates, forecast economic conditions and ECLs is a significant estimate. The amount of ECLs is sensitive to changes in circumstances and forecast economic conditions. The Group's historical credit loss experience and forecast of economic conditions may also not be representative of a customer's actual default in the future. The information about the ECLs on the Group's trade receivables is disclosed in note 21 to the financial statements.

***Fair value of unlisted equity investments***

The unlisted equity investments have been valued based on a market-based valuation technique. The valuation requires the Group to determine the comparable public companies (peers) and select the price multiple. In addition, the Group makes estimates about the discount for illiquidity and size differences. The Group classifies the fair value of these investments as Level 3. The fair value of the unlisted equity investments at 31 December 2020 was RMB658,000 (2019: RMB506,000). Further details are included in note 19 to the financial statements.

# Notes to the Consolidated Financial Statements

31 December 2020

## 3. SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES (Continued)

### Estimation uncertainty (Continued)

***Provision for inventories***

Management reviews the ageing analysis of inventories of the Group at the end of each reporting period, and makes a provision for inventory items. The assessment of the provision amount required involves management judgements and estimates. Where the actual outcome or expectation in future is different from the original estimate, such differences will have an impact on the carrying value of the inventories and provision charge/ write-back in the period in which the estimate has been changed. In addition, physical counts on all inventories are carried out on a periodical basis in order to determine whether a provision needs to be made in respect of any damaged, slow-moving or obsolete inventories identified. The Group carries out an inventory review at the end of each reporting period and makes a provision against damaged, obsolete and slow-moving items. Management reassesses the estimation at the end of each reporting period. The directors of the Company are satisfied that a sufficient provision for damaged, obsolete and slow-moving inventories has been made in the consolidated financial statements.

***Leases — Estimating the incremental borrowing rate***

The Group cannot readily determine the interest rate implicit in a lease, and therefore, it uses an incremental borrowing rate ("IBR") to measure lease liabilities. The IBR is the rate of interest that the Group would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment. The IBR therefore reflects what the Group "would have to pay", which requires estimation when no observable rates are available (such as for subsidiaries that do not enter into financing transactions) or when it needs to be adjusted to reflect the terms and conditions of the lease (for example, when leases are not in the subsidiary's functional currency). The Group estimates the IBR using observable inputs (such as market interest rates) when available and is required to make certain entity-specific estimates (such as the subsidiary's stand-alone credit rating).

## 4. OPERATING SEGMENT INFORMATION

The board of directors is the Group's chief operating decision-maker. Management has determined the operating segments based on the information reviewed by the board of directors for the purposes of allocating resources and assessing performance.

For management purposes, the Group is organised into business units based on its sales channels and has three reportable operating segments as follows:

(a) Pharmaceutical manufacturing

(b) Operation of chain pharmacies

(c) Operation of on-line pharmacies

Separate individual financial information for different types of channels is presented to the board of directors who reviews the internal reports in order to assess performance and allocate resources.

Segment results are evaluated based on gross profit. No analysis of the Group's assets and liabilities by operating segments is disclosed as it is not regularly provided to the board of directors.

# Notes to the Consolidated Financial Statements

31 December 2020

## 4. OPERATING SEGMENT INFORMATION (Continued)

Intersegment sales and transfers are transacted with reference to the selling prices used for sales made to third parties at the then prevailing market prices.

### Geographical information

Since over 90% of the Group's revenue and operating profit were generated in the PRC and over 90% of the Group's non-current assets were located in the PRC, no geographical segment information in accordance with IFRS 8 Operating Segments is presented.

### Information about major customers

During each of the years ended 31 December 2020 and 2019, no revenue from transactions with a single customer accounted for 10% or more of the Group's sales.

Operating segment information for the year ended 31 December 2020:

**Year ended 31 December 2020**

| | Pharmaceutical manufacturing RMB'000 | Operation of chain pharmacies RMB'000 | Operation of on-line pharmacies RMB'000 | Total RMB'000 |
|---|---|---|---|---|
| **Segment revenue:** | | | | |
| Revenue from external customers (note 5) | 916,076 | 624,874 | 62,926 | 1,603,876 |
| Intersegment sales | 69,482 | — | — | 69,482 |
| Elimination of intersegment sales | (69,482) | — | — | (69,482) |
| **Revenue** | 916,076 | 624,874 | 62,926 | 1,603,876 |
| Cost of sales | (216,039) | (372,853) | (23,781) | (612,673) |
| **Segment results** | 700,037 | 252,021 | 39,145 | 991,203 |
| **Reconciliation:** | | | | |
| Other income and gains | | | | 31,583 |
| Selling and distribution expenses | | | | (698,799) |
| Administrative expenses | | | | (91,777) |
| Other expenses | | | | (59,770) |
| Finance costs | | | | (5,218) |
| **Profit before tax** | | | | 167,222 |

# Notes to the Consolidated Financial Statements

31 December 2020

## 4. OPERATING SEGMENT INFORMATION (Continued)

### Information about major customers (Continued)

**Year ended 31 December 2019**

| | Pharmaceutical manufacturing RMB'000 | Operation of chain pharmacies RMB'000 | Operation of on-line pharmacies RMB'000 | Total RMB'000 |
|---|---|---|---|---|
| **Segment revenue:** | | | | |
| Revenue from external customers (note 5) | 753,400 | 535,380 | 53,402 | 1,342,182 |
| Intersegment sales | 40,335 | — | — | 40,335 |
| Elimination of intersegment sales | (40,335) | — | — | (40,335) |
| **Revenue** | 753,400 | 535,380 | 53,402 | 1,342,182 |
| Cost of sales | (195,776) | (299,926) | (11,791) | (507,493) |
| **Segment results** | 557,624 | 235,454 | 41,611 | 834,689 |
| **Reconciliation:** | | | | |
| Other income and gains | | | | 23,206 |
| Selling and distribution expenses | | | | (569,685) |
| Administrative expenses | | | | (78,068) |
| Other expenses | | | | (50,194) |
| Finance costs | | | | (4,007) |
| **Profit before tax** | | | | 155,941 |

# Notes to the Consolidated Financial Statements

31 December 2020

## 5. REVENUE, OTHER INCOME AND GAINS

An analysis of revenue, other income and gains is as follows:

| | 2020 RMB'000 | 2019 RMB'000 |
|---|---|---|
| *Revenue from contracts with customers* | | |
| Sale of pharmaceutical products | **1,603,876** | 1,342,182 |

### (i) Disaggregated revenue information

The Group's revenue is mainly derived from the sale of pharmaceutical products to customers in Mainland China and is recognised at a point in time.

Disaggregation of revenue from contracts with customers is disclosed in Note 4.

The following table shows the amounts of revenue recognised in the current reporting period that were included in the contract liabilities at the beginning of the reporting period:

| | 2020 RMB'000 |
|---|---|
| Revenue recognised that was included in contract liabilities at the beginning of the reporting period: | |
| Sale of pharmaceutical products | **13,229** |

### (ii) Performance obligations

Information about the Group's performance obligations is summarised below:

***Sale of pharmaceutical products***

The performance obligation is satisfied upon delivery of the pharmaceutical products and payment is generally due within 15 to 90 days from delivery, except for the new customers and one-off purchase order customers, where payment in advance is normally required. Some contracts provide customers with a right of return and volume rebates which give rise to variable consideration subject to constraint.

# Notes to the Consolidated Financial Statements

31 December 2020

## 5. REVENUE, OTHER INCOME AND GAINS (Continued)

| | Note | 2020 RMB'000 | 2019 RMB'000 |
|---|---|---|---|
| **Other income** | | | |
| Bank interest income | | **5,271** | 4,728 |
| Dividend income | | **58** | 76 |
| Rental income | | **322** | 361 |
| Interest income from financial assets at fair value through profit or loss | | **4,749** | 3,472 |
| | | **10,400** | 8,637 |
| **Gains, net** | | | |
| Government grants: | | | |
| — Related to assets | | **1,342** | 1,308 |
| — Related to income | | **7,578** | 3,806 |
| Gain on disposal of items of property, plant and equipment | | **43** | 28 |
| Gain on disposal of an equity investment at fair value through profit or loss | 8 | **—** | 5,376 |
| Gain on disposal of financial instruments at fair value through profit or loss | 8 | **303** | — |
| Fair value gains, net | | | |
| Equity investments at fair value through profit or loss | 8 | **7,509** | 3,386 |
| Others | | **4,408** | 665 |
| | | **21,183** | 14,569 |
| | | **31,583** | 23,206 |

## 6. OTHER EXPENSES

| | Note | 2020 RMB'000 | 2019 RMB'000 |
|---|---|---|---|
| Loss on disposal of items of property, plant and equipment | | **260** | 25 |
| Research and development costs | | **50,189** | 47,448 |
| Write-down of inventories to net realisable value | | **114** | 451 |
| Impairment losses on trade receivables | 21 | **394** | 1,246 |
| Others | | **8,813** | 1,024 |
| | | **59,770** | 50,194 |

# Notes to the Consolidated Financial Statements

31 December 2020

## 7. FINANCE COSTS

| | 2020 RMB'000 | 2019 RMB'000 |
|---|---|---|
| Interest on lease liabilities | **3,831** | 3,930 |
| Interest on a bank borrowing | **1,387** | 77 |
| | **5,218** | 4,007 |

## 8. PROFIT BEFORE TAX

The Group's profit before tax is arrived at after charging/(crediting):

| | Notes | 2020 RMB'000 | 2019 RMB'000 |
|---|---|---|---|
| Cost of inventories sold | 4 | **612,673** | 507,493 |
| Depreciation of property, plant and equipment | 14 | **59,736** | 29,565 |
| Depreciation of right-of-use assets | 15(a) | **37,173** | 32,147 |
| Research and development costs | 6 | **50,189** | 47,448 |
| Advertising, marketing and promotion expenses | | **189,256** | 126,358 |
| Amortisation of other intangible assets* | 17 | **2,840** | 1,822 |
| Write-down of inventories to net realisable value | | **114** | 451 |
| Lease payments not included in the measurement of lease liabilities | 15(c) | **3,785** | 6,343 |
| Auditor's remuneration | | **2,590** | 2,908 |
| Impairment losses on trade receivables | 21 | **394** | 1,246 |
| Gain on disposal of an equity investment at fair value through profit or loss | 5 | **—** | (5,376) |
| Gain on disposal of financial assets at fair value through profit or loss | 5 | **(303)** | — |
| Fair value gains, net: | | | |
| Equity investments at fair value through profit or loss | 5 | **(7,509)** | (3,386) |
| | | | |
| Employee benefit expenses (including directors' remuneration (note 9)): | | | |
| Wages and salaries | | **297,070** | 279,138 |
| Pension scheme contributions (defined contribution scheme) | | **11,163** | 15,402 |
| Staff welfare expenses | | **20,348** | 23,722 |
| Equity-settled share award expense | | **1,117** | 1,638 |
| Others | | **—** | 267 |
| | | **329,698** | 320,167 |

* The amortisation of other intangible assets for the reporting period is included in "Administrative expenses" in the consolidated statement of profit or loss.

# Notes to the Consolidated Financial Statements

31 December 2020

## 9. DIRECTORS' AND CHIEF EXECUTIVE'S REMUNERATION

Directors' and chief executive's remuneration for the reporting period, disclosed pursuant to the Listing Rules, section 383(1)(a), (b), (c) and (f) of the Hong Kong Companies Ordinance and Part 2 of the Companies (Disclosure of Information about Benefits of Directors) Regulation, is as follows:

| | **2020**<br>**RMB'000** | 2019<br>RMB'000 |
|---|---|---|
| Fees | **1,968** | 2,012 |
| Other emoluments: | | |
| Salaries, allowances and benefits in kind | **3,401** | 2,978 |
| Pension scheme contributions | **82** | 97 |
| Others | **—** | 267 |
| | **5,451** | 5,354 |

### (a) Independent non-executive directors

The fees paid to independent non-executive directors during the year were as follows:

| | **2020**<br>**RMB'000** | 2019<br>RMB'000 |
|---|---|---|
| Ng Kwun Wan | **156** | 159 |
| Wong Kam Wah | **156** | 159 |
| Zhou Daihan | **156** | 159 |
| | **468** | 477 |

There were no other emoluments payable to the independent non-executive directors during the year (2019: Nil).

# Notes to the Consolidated Financial Statements

31 December 2020

## 9. DIRECTORS' AND CHIEF EXECUTIVE'S REMUNERATION (Continued)

### (b) Executive directors, non-executive directors and the chief executive

**2020**

| | Fees RMB'000 | Salaries, allowances and benefits in kind RMB'000 | Pension scheme contributions RMB'000 | Others RMB'000 | Total remuneration RMB'000 |
|---|---|---|---|---|---|
| **Executive directors:** | | | | | |
| Lai Zhitian | 440 | 992 | 21 | — | 1,453 |
| Lai Yingfeng | 266 | 801 | 17 | — | 1,084 |
| Cheng Jinle | 266 | 806 | 22 | — | 1,094 |
| Cao Xiaojun | 267 | 802 | 22 | — | 1,091 |
| | 1,239 | 3,401 | 82 | — | 4,722 |
| **Non-executive directors:** | | | | | |
| Jiang Lixia | 261 | — | — | — | 261 |
| Yang Aixing | — | — | — | — | — |
| | 261 | | | | 261 |
| | 1,500 | 3,401 | 82 | — | 4,983 |

# Notes to the Consolidated Financial Statements

31 December 2020

## 9. DIRECTORS' AND CHIEF EXECUTIVE'S REMUNERATION (Continued)

### (b) Executive directors, non-executive directors and the chief executive (Continued)

2019

| | Fees RMB'000 | Salaries, allowances and benefits in kind RMB'000 | Pension scheme contributions RMB'000 | Others RMB'000 | Total remuneration RMB'000 |
|---|---|---|---|---|---|
| **Executive directors:** | | | | | |
| Lai Zhitian | 458 | 954 | 25 | 267 | 1,704 |
| Lai Yingfeng | 266 | 700 | 20 | — | 986 |
| Cheng Jinle | 266 | 710 | 26 | — | 1,002 |
| Cao Xiaojun | 266 | 614 | 26 | — | 906 |
| | 1,256 | 2,978 | 97 | 267 | 4,598 |
| **Non-executive directors:** | | | | | |
| Jiang Lixia | 279 | — | — | — | 279 |
| Yang Aixing | — | — | — | — | — |
| | 279 | | | | 279 |
| | 1,535 | 2,978 | 97 | 267 | 4,877 |

There was no arrangement under which a director or the chief executive waived or agreed to waive any remuneration during the reporting period.

## 10. FIVE HIGHEST PAID EMPLOYEES

The five highest paid employees during the year included four directors (2019: four directors), details of whose remuneration are set out in note 9 above. Details of the remuneration for the year of the remaining one (2019: one) highest paid employee who is neither a director nor chief executive of the Company are as follows:

| | **2020 RMB'000** | 2019 RMB'000 |
|---|---|---|
| Salaries, allowances and benefits in kind | **509** | 461 |
| Pension scheme contributions | **15** | 16 |
| | **524** | 477 |

# Notes to the Consolidated Financial Statements

31 December 2020

## 10. FIVE HIGHEST PAID EMPLOYEES (Continued)

The number of non-director and non-chief executive highest paid employees whose remuneration fell within the following band is as follows:

| | **2020** | 2019 |
|---|---|---|
| Nil to HK$1,000,000 | **1** | 1 |

During the reporting period, no highest paid employees waived or agreed to waive any remuneration and no remuneration was paid by the Group to any of the five highest paid employees as an inducement to join or upon joining the Group or as compensation for loss of office.

## 11. INCOME TAX EXPENSE

The Group is subject to income tax on an entity basis on profits arising in or derived from the jurisdictions in which members of the Group are domiciled and operate.

Pursuant to the rules and regulations of the BVI, the Group is not subject to any income tax in the BVI.

The Hong Kong profits tax rate is 16.5% (2019: 16.5%) of assessable profits derived from Hong Kong during the year. Since the Group had no such profits during the reporting period, no provision for Hong Kong profits tax has been made.

Taxes on profits assessable in Mainland China have been calculated at the prevailing tax rates, based on existing legislation, interpretations and practices in respect thereof.

Pursuant to the PRC Corporate Income Tax Law (the "PRC Tax Law") effective on 1 January 2008, the Group's subsidiaries which operate in Mainland China are subject to Corporate Income Tax ("CIT") at a rate of 25% on the taxable income.

Zhongzhi Pharmaceutical and Honeson Pharmaceutical are qualified high and new technology enterprises and were subject to income tax at a preferential tax rate of 15% for the reporting period.

The income tax expense of the Group for the reporting period is analysed as follows:

| | **2020**<br>**RMB'000** | 2019<br>RMB'000 |
|---|---|---|
| Current – Mainland China | | |
| Charge for the year | **24,903** | 28,517 |
| (Overprovision)/underprovision in prior years | **(6,053)** | 3,026 |
| Deferred income tax credit (note 28) | **9,753** | 9,704 |
| Total income tax expense | **28,603** | 41,247 |

# Notes to the Consolidated Financial Statements

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## 11. INCOME TAX EXPENSE (Continued)

A reconciliation of the tax expense applicable to profit before tax at the statutory rate for the jurisdictions in which the Company and the majority of its subsidiaries are domiciled to the tax expense at the effective tax rates is as follows:

| | 2020 RMB'000 | 2020 % | 2019 RMB'000 | 2019 % |
|---|---|---|---|---|
| Profit before tax | **167,222** | | 155,941 | |
| Tax at the PRC statutory tax rate | **41,806** | **25.0** | 38,985 | 25.0 |
| Effect of different applicable tax rates for certain subsidiaries | **(12,306)** | **(7.4)** | (10,394) | (6.7) |
| Effect of withholding tax at 10% on the distributable profits of the Group's PRC subsidiaries | **8,289** | **5.0** | 9,501 | 6.1 |
| Additional deduction for research and development expenses | **(4,298)** | **(2.6)** | (866) | (0.5) |
| Adjustment in respect of current tax of previous years | **(6,053)** | **(3.6)** | 3,026 | 1.9 |
| Income not subject to tax | **(21)** | **(0.0)** | (57) | (0.0) |
| Tax losses utilised from previous periods | **(924)** | **(0.6)** | (1,995) | (1.2) |
| Tax losses not recognised | **626** | **0.4** | 534 | 0.3 |
| Expenses not deductible for tax | **1,484** | **0.9** | 2,513 | 1.6 |
| Tax charge at the Group's effective tax rate | **28,603** | **17.1** | 41,247 | 26.5 |

The effective tax rate of the Group was 17.1% in 2020 (2019: 26.5%).

In accordance with the Enterprise Income Tax Law of the PRC effective on 1 January 2008, a 10% (or a lower rate if there is a tax treaty between Mainland China and the jurisdiction of the foreign investors) withholding tax is levied on dividends declared to foreign investors from the foreign investment enterprises established in Mainland China. The requirement is effective from 1 January 2008 and applies to earnings after 31 December 2007. The Group is therefore liable to withholding taxes on dividends distributed by those subsidiaries established in Mainland China in respect of earnings generated from 1 January 2008. As at 31 December 2020, the Group recognised a deferred tax liability of RMB8,289,000 (31 December 2019: RMB9,501,000) in respect of the withholding tax on future dividends.

# Notes to the Consolidated Financial Statements

31 December 2020

## 12. DIVIDENDS

| | **2020 RMB'000** | 2019 RMB'000 |
|---|---|---|
| Interim — HK3.7 cents (2019: HK3.15 cents) per ordinary share | **26,878** | 23,782 |
| Special interim — HK1.45 cents (2019: HK1.45 cents) per ordinary share | **10,533** | 10,947 |
| Proposed final — Nil (2019: HK2.9 cents) per ordinary share | **—** | 21,821 |
| Proposed special — Nil (2019: HK1.45 cents) per ordinary share | **—** | 10,911 |
| | **37,411** | 67,461 |

The proposed final dividend and special dividend for the year are subject to the approval of the Company's shareholders at the forthcoming annual general meeting.

## 13. EARNINGS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE PARENT

The calculation of the basic earnings per share amounts is based on the profit for the year attributable to ordinary equity holders of the parent, and the adjusted weighted average number of ordinary shares of 828,797,947 (2019: 833,348,152) in issue during the year.

The calculation of the diluted earnings per share amounts is based on the profit for the year attributable to ordinary equity holders of the parent. The weighted average number of ordinary shares used in the calculation of diluted earnings per share is the adjusted weighted average number of ordinary shares in issue during the year, as used in the basic earnings per share calculation, and the weighted average number of ordinary shares assumed to have been issued at no consideration on the deemed exercise or conversion of all dilutive potential ordinary shares into ordinary shares under the share award plan.

The calculations of basic and diluted earnings per share are based on:

| | **2020 RMB'000** | 2019 RMB'000 |
|---|---|---|
| **Earnings** | | |
| Profit attributable to ordinary equity holders of the parent, used in the basic earnings per share calculation | **138,532** | 114,694 |

# Notes to the Consolidated Financial Statements

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## 13. EARNINGS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE PARENT

(Continued)

| | 2020 | 2019 |
|---|---|---|
| **Shares** | | |
| Weighted average number of ordinary shares in issue | **840,000,000** | 840,000,000 |
| Weighted average number of shares held for the share award plan | **(11,202,053)** | (6,651,848) |
| Adjusted weighted average number of ordinary shares in issue used in the basic earnings per share calculation | **828,797,947** | 833,348,152 |
| Effect of dilution — weighted average number of ordinary shares: | | |
| Share award plan | **—** | 1,200,000 |
| Adjusted weighted average number of ordinary shares in issue used in the diluted earnings per share calculation | **828,797,947** | 834,548,152 |

## 14. PROPERTY, PLANT AND EQUIPMENT

| | Leasehold improvements RMB'000 | Buildings RMB'000 | Machinery RMB'000 | Motor vehicles RMB'000 | Office equipment RMB'000 | Construction in progress RMB'000 | Total RMB'000 |
|---|---|---|---|---|---|---|---|
| **31 December 2020** | | | | | | | |
| At 1 January 2020 | | | | | | | |
| Cost | 119,844 | 161,766 | 79,032 | 6,690 | 30,832 | 59,305 | 457,469 |
| Accumulated depreciation | (80,165) | (45,699) | (29,030) | (3,349) | (19,865) | — | (178,108) |
| Net carrying amount | 39,679 | 116,067 | 50,002 | 3,341 | 10,967 | 59,305 | 279,361 |
| At 1 January 2020, net of accumulated depreciation | 39,679 | 116,067 | 50,002 | 3,341 | 10,967 | 59,305 | 279,361 |
| Additions | 14,686 | 31,455 | 11,286 | 2,092 | 4,418 | 29,038 | 92,975 |
| Disposals | (34) | (8,224) | (376) | (10) | (195) | (598) | (9,437) |
| Depreciation provided during the year (note 8) | (17,426) | (29,149) | (7,551) | (840) | (4,770) | — | (59,736) |
| Transfers | 9,368 | 33,737 | 8,667 | — | 528 | (52,300) | — |
| At 31 December 2020, net of accumulated depreciation | 46,273 | 143,886 | 62,028 | 4,583 | 10,948 | 35,445 | 303,163 |
| At 31 December 2020: | | | | | | | |
| Cost | 143,864 | 195,503 | 97,981 | 8,576 | 35,104 | 35,445 | 516,473 |
| Accumulated depreciation | (97,591) | (51,617) | (35,953) | (3,993) | (24,156) | — | (213,310) |
| Net carrying amount | 46,273 | 143,886 | 62,028 | 4,583 | 10,948 | 35,445 | 303,163 |

# Notes to the Consolidated Financial Statements

31 December 2020

## 14. PROPERTY, PLANT AND EQUIPMENT (Continued)

| | Leasehold improvements RMB'000 | Buildings RMB'000 | Machinery RMB'000 | Motor vehicles RMB'000 | Office equipment RMB'000 | Construction in progress RMB'000 | Total RMB'000 |
|---|---|---|---|---|---|---|---|
| **31 December 2019** | | | | | | | |
| At 1 January 2019 | | | | | | | |
| Cost | 102,715 | 120,588 | 65,168 | 4,732 | 25,360 | 88,479 | 407,042 |
| Accumulated depreciation | (66,291) | (40,839) | (24,547) | (2,893) | (16,008) | — | (150,578) |
| Net carrying amount | 36,424 | 79,749 | 40,621 | 1,839 | 9,352 | 88,479 | 256,464 |
| At 1 January 2019, net of accumulated depreciation | 36,424 | 79,749 | 40,621 | 1,839 | 9,352 | 88,479 | 256,464 |
| Additions | 16,793 | — | 2,905 | 2,241 | 6,022 | 24,679 | 52,640 |
| Disposals | — | — | (70) | (15) | (93) | — | (178) |
| Depreciation provided during the year (note 8) | (13,874) | (4,860) | (5,793) | (724) | (4,314) | — | (29,565) |
| Transfers | 336 | 41,178 | 12,339 | — | — | (53,853) | — |
| At 31 December 2019, net of accumulated depreciation | 39,679 | 116,067 | 50,002 | 3,341 | 10,967 | 59,305 | 279,361 |
| At 31 December 2019: | | | | | | | |
| Cost | 119,844 | 161,766 | 79,032 | 6,690 | 30,832 | 59,305 | 457,469 |
| Accumulated depreciation | (80,165) | (45,699) | (29,030) | (3,349) | (19,865) | — | (178,108) |
| Net carrying amount | 39,679 | 116,067 | 50,002 | 3,341 | 10,967 | 59,305 | 279,361 |

As at 31 December 2020, the Group was still in the process of obtaining the property ownership certificates for certain buildings with a net carrying amount of RMB280,000 (2019: RMB352,000). The Group is not able to assign, transfer or mortgage the properties until the certificates are obtained.

# Notes to the Consolidated Financial Statements

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## 15. LEASES

### The Group as a lessee

The Group has lease contracts for various items of land, pharmacies and office premises used in its operations. Lump sum payments were made upfront to acquire the leased land from the owners with lease periods of 40 to 50 years, and no ongoing payments will be made under the terms of these land leases. Leases of pharmacies and office premises generally have lease terms between 3 and 5 years. Generally, the Group is restricted from assigning and subleasing the leased assets outside the Group.

### *(a) Right-of-use assets*

The carrying amounts of the Group's right-of-use assets and the movements during the year are as follows:

| | **Pharmacies and office premises** RMB'000 | **Land use rights** RMB'000 | **Total** RMB'000 |
|---|---|---|---|
| As at 1 January 2019 | 104,652 | 13,426 | 118,078 |
| Additions | 14,739 | 8,867 | 23,606 |
| Depreciation charge | (31,677) | (470) | (32,147) |
| As at 31 December 2019 and 1 January 2020 | **87,714** | **21,823** | **109,537** |
| Additions | **47,966** | **8,502** | **56,468** |
| Depreciation charge | **(36,427)** | **(746)** | **(37,173)** |
| As at 31 December 2020 | **99,253** | **29,579** | **128,832** |

# Notes to the Consolidated Financial Statements

31 December 2020

## 15. LEASES (Continued)

### The Group as a lessee (Continued)

#### *(b)* ***Lease liabilities***

The carrying amount of lease liabilities and the movements during the year are as follows:

| | 2020<br>RMB'000 | 2019<br>RMB'000 |
|---|---|---|
| Carrying amount at 1 January | **96,153** | 111,494 |
| New leases | **47,966** | 14,739 |
| Accretion of interest recognised during the year | **3,831** | 3,930 |
| Covid-19-related rent concessions from lessors | **(698)** | — |
| Payments | **(38,264)** | (34,010) |
| Carrying amount at 31 December | **108,988** | 96,153 |
| Analysed into: | | |
| Current portion | **35,772** | 32,187 |
| Non-current portion | **73,216** | 63,966 |

The maturity analysis of lease liabilities is disclosed in note 39 to the financial statements.

As disclosed in note 2.2 to the financial statements, the Group has early adopted the amendment to IFRS 16 and applied the practical expedient to all eligible rent concessions granted by the lessors for certain plant and equipment during the year.

*(c)* The amounts recognised in profit or loss in relation to leases are as follows:

| | 2020<br>RMB'000 | 2019<br>RMB'000 |
|---|---|---|
| Interest on lease liabilities | **3,831** | 3,930 |
| Depreciation charge of right-of-use assets | **37,173** | 32,147 |
| Expense relating to short-term leases and other leases with remaining lease terms ended on or before 31 December 2019 | **3,785** | 6,343 |
| Covid-19-related rent concessions from lessors | **(698)** | — |
| Total amount recognised in profit or loss | **44,091** | 42,420 |

The total cash outflows for leases and future cash outflows relating to leases that have not yet commenced are disclosed in notes 34(b) and 35, respectively, to the financial statements.

# Notes to the Consolidated Financial Statements

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## 15. LEASES (Continued)

### The Group as a lessor

The Group leases its leased properties under operating lease arrangements. The terms of the leases generally require the tenants to pay security deposits and provide for periodic rent adjustments according to the then prevailing market conditions. Rental income recognised by the Group during the year was RMB322,000 (2019: RMB361,000), details of which are included in note 5 to the financial statements.

At 31 December 2020, the undiscounted lease payments receivable by the Group in future periods under non-cancellable operating leases with its tenants are as follows:

| | **2020** **RMB'000** | 2019 RMB'000 |
|---|---|---|
| Within one year | **234** | 218 |
| After one year but within two years | **137** | 91 |
| After two year but within three years | **64** | — |
| | **435** | 309 |

## 16. GOODWILL

| | **2020** **RMB'000** | 2019 RMB'000 |
|---|---|---|
| At 1 January and 31 December | **1,628** | 1,628 |

Goodwill is acquired through the business combination of Honeson Pharmaceutical in the prior year. Goodwill acquired through the business combination is allocated to the pharmaceutical drugs cash-generating unit for impairment testing. There was no impairment charge made against goodwill for the years ended 31 December 2020 and 2019.

# Notes to the Consolidated Financial Statements

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## 17. OTHER INTANGIBLE ASSETS

| | Software RMB'000 | Patents and licences RMB'000 | Total RMB'000 |
|---|---|---|---|
| **31 December 2020** | | | |
| Cost at 1 January 2020, net of accumulated amortisation | **16,020** | **2,539** | **18,559** |
| Additions | **3,810** | **31** | **3,841** |
| Amortisation provided during the year (note 8) | **(2,202)** | **(638)** | **(2,840)** |
| At 31 December 2020 | **17,628** | **1,932** | **19,560** |
| At 31 December 2020: | | | |
| Cost | **24,765** | **2,729** | **27,494** |
| Accumulated amortisation | **(7,137)** | **(797)** | **(7,934)** |
| Net carrying amount | **17,628** | **1,932** | **19,560** |
| **31 December 2019** | | | |
| At 1 January 2019: | | | |
| Cost | 12,166 | — | 12,166 |
| Accumulated amortisation | (3,289) | — | (3,289) |
| Net carrying amount | 8,877 | — | 8,877 |
| Cost at 1 January 2019, net of accumulated amortisation | 8,877 | — | 8,877 |
| Additions | 8,875 | — | 8,875 |
| Acquisition of a subsidiary (note 33) | — | 2,697 | 2,697 |
| Disposals | (68) | — | (68) |
| Amortisation provided during the year | (1,664) | (158) | (1,822) |
| At 31 December 2019 | 16,020 | 2,539 | 18,559 |
| At 31 December 2019 and at 1 January 2020: | | | |
| Cost | 20,956 | 2,697 | 23,653 |
| Accumulated amortisation | (4,936) | (158) | (5,094) |
| Net carrying amount | 16,020 | 2,539 | 18,559 |

# Notes to the Consolidated Financial Statements

31 December 2020

## 18. INVESTMENT IN A JOINT VENTURE

| | 2020 RMB'000 | 2019 RMB'000 |
|---|---|---|
| Share of net assets | **392** | 417 |

Particulars of the joint venture are as follows:

| Name | Particulars of issued shares held | Place of registration and business | Percentage of ownership interest | Principal activity |
|---|---|---|---|---|
| Scienwi Pharmaceutical Technology Company Limited | Ordinary shares | Macao | 48% | Sale of pharmaceutical products |

The above investment is held through the wholly-owned subsidiaries of the Company.

## 19. EQUITY INVESTMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS

| | 2020 RMB'000 | 2019 RMB'000 |
|---|---|---|
| **Equity investments at fair value through profit or loss** | | |
| Listed equity investment, at fair value | **17,635** | 9,890 |
| Unlisted equity investment, at fair value | **658** | 506 |
| | **18,293** | 10,396 |

The above listed equity investment at 31 December 2020 was classified as equity investment at fair value through profit or loss as it was held for trading.

The above unlisted equity investment at 31 December 2020 was classified as equity investment at fair value through profit or loss as the Group has not elected to recognise the fair value gain or loss through other comprehensive income.

## 20. INVENTORIES

| | 2020 RMB'000 | 2019 RMB'000 |
|---|---|---|
| Raw materials | **46,779** | 47,043 |
| Work in progress | **11,599** | 6,841 |
| Finished goods | **188,743** | 145,155 |
| | **247,121** | 199,039 |

Inventories with a value of RMB4,711,000 (2019: RMB4,851,000) are carried at net realisable value, which is lower than cost.

# Notes to the Consolidated Financial Statements

31 December 2020

## 21. TRADE AND NOTES RECEIVABLES

| | 2020<br>RMB'000 | 2019<br>RMB'000 |
|---|---|---|
| Trade receivables | **226,034** | 166,046 |
| Less: Impairment of trade receivables | **(3,107)** | (2,713) |
| Trade receivables, net | **222,927** | 163,333 |
| Notes receivable | **60,161** | 79,431 |
| | **283,088** | 242,764 |

The Group's trading terms with its wholesale customers are mainly on credit. The credit period is generally not more than three months for major customers. As to new customers and one-off purchase order customers, payment in advance is normally required. Each customer has a maximum credit limit. The Group seeks to enforce strict control over its outstanding receivables. Overdue balances are reviewed regularly by senior management. In view of the aforementioned and the fact that the Group's trade and notes receivables relate to customers with good track records, there is no significant concentration of credit risk. Trade and notes receivables are non-interest-bearing. The fair value of trade and notes receivables approximates to their carrying amount.

An ageing analysis of the trade receivables as at the end of the reporting period, based on the invoice date and net of loss allowance, is as follows:

| | 2020<br>RMB'000 | 2019<br>RMB'000 |
|---|---|---|
| Within 1 month | **117,916** | 99,705 |
| 1 to 3 months | **64,630** | 31,467 |
| 3 to 6 months | **26,930** | 16,763 |
| 6 to 12 months | **8,821** | 11,007 |
| Over 12 months | **4,630** | 4,391 |
| | **222,927** | 163,333 |

# Notes to the Consolidated Financial Statements

31 December 2020

## 21. TRADE AND NOTES RECEIVABLES (Continued)

The movement in the loss allowance for impairment of trade receivables is as follows:

| | **2020 RMB'000** | 2019 RMB'000 |
|---|---|---|
| At beginning of year | **2,713** | 1,467 |
| Impairment losses, net | **394** | 1,246 |
| At end of year | **3,107** | 2,713 |

The Group manages its notes receivable using the business model whose objective is achieved by both collecting contractual cash flows and selling such financial assets and hence, they are categorised as financial assets measured at fair value through other comprehensive income after the adoption of IFRS 9.

The notes receivable are settled within 180 days. No notes receivable were discounted as at 31 December 2020 and 2019. As at 31 December 2020, the Group continued to recognise endorsed notes receivable and associated liabilities amounting to RMB6,084,000 (2019: RMB18,360,000). The directors considered that the Group has retained the substantial risks and rewards, which include default risks relating to such remaining endorsed notes (note 40).

An impairment analysis is performed at each reporting date using a provision matrix to measure expected credit losses. The provision rates are based on the ageing analysis for groupings of various customer segments with similar loss patterns (i.e., by geographical region, product type and customer type). The calculation reflects the probability-weighted outcome, the time value of money and reasonable and supportable information that is available at the reporting date about past events, current conditions and forecasts of future economic conditions. Generally, trade receivables are written off if past due for more than two years and are not subject to enforcement activity.

Set out below is the information about the credit risk exposure on the Group's trade receivables using a provision matrix:

**As at 31 December 2020**

| | **Less than 1 year** | **1 to 2 years** | **Over 2 years** | **Total** |
|---|---|---|---|---|
| Expected credit loss rate | **0.82%** | **19.13%** | **100.00%** | **1.37%** |
| Gross carrying amount (RMB'000) | **220,109** | **5,725** | **200** | **226,034** |
| Expected credit losses (RMB'000) | **1,812** | **1,095** | **200** | **3,107** |

As at 31 December 2019

| | Less than 1 year | 1 to 2 years | Over 2 years | Total |
|---|---|---|---|---|
| Expected credit loss rate | 0.74% | 19.77% | 100.00% | 1.63% |
| Gross carrying amount (RMB'000) | 160,129 | 5,473 | 444 | 166,046 |
| Expected credit losses (RMB'000) | 1,187 | 1,082 | 444 | 2,713 |

# Notes to the Consolidated Financial Statements

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## 22. PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

| | 2020<br>RMB'000 | 2019<br>RMB'000 |
|---|---|---|
| **Current** | | |
| Prepayments | **40,466** | 4,926 |
| Value added tax recoverable | **2,170** | 3,635 |
| Deposits and other receivables | **16,427** | 7,862 |
| | **59,063** | 16,423 |
| **Non-current** | | |
| Prepayments | **16,150** | — |

## 23. CASH AND BANK BALANCES

| | 2020<br>RMB'000 | 2019<br>RMB'000 |
|---|---|---|
| Cash and bank balances | **151,032** | 373,996 |
| Time deposits | **143,000** | 6,337 |
| | **294,032** | 380,333 |
| Denominated in: | | |
| — RMB | **285,557** | 377,333 |
| — Hong Kong Dollars ("HK$") | **8,475** | 3,000 |
| | **294,032** | 380,333 |

At the end of the reporting period, the cash and bank balances of the Group were denominated in RMB and HK$. The RMB is not freely convertible into other currencies, however, under Mainland China's Foreign Exchange Control Regulations and Administration of Settlement, Sale and Payment of Foreign Exchange Regulations, the Group is permitted to exchange RMB for other currencies through banks authorised to conduct foreign exchange business.

Cash at banks earns interest at floating rates based on daily bank deposit rates. Short-term time deposits are made for varying periods of between one day and twelve months depending on the immediate cash requirements of the Group, and earn interest at the respective short-term time deposit rates. The bank balances are deposited with creditworthy banks with no recent history of default.

# Notes to the Consolidated Financial Statements

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## 24. TRADE PAYABLES

An ageing analysis of the trade payables as at the end of the reporting period, based on the invoice date, is as follows:

| | **2020** **RMB'000** | 2019 RMB'000 |
|---|---|---|
| Within 3 months | **96,653** | 90,813 |
| 3 to 6 months | **4,905** | 3,686 |
| 6 to 12 months | **6,283** | 1,082 |
| Over 12 months | **2,598** | 8,719 |
| | **110,439** | 104,300 |

The trade payables are non-interest-bearing and are normally settled on terms of not exceeding 120 days.

## 25. OTHER PAYABLES AND ACCRUALS

| | Notes | **31 December 2020 RMB'000** | 31 December 2019 RMB'000 |
|---|---|---|---|
| Contract liabilities | (a) | **12,030** | 13,229 |
| Other payables | (b) | **69,034** | 69,185 |
| Accruals | | **368** | 380 |
| Accrued salaries and welfare | | **38,850** | 35,147 |
| Endorsed notes | 40 | **6,084** | 18,360 |
| Deposits received | | **49,082** | 43,359 |
| Payables for purchases of property, equipment and other intangible assets | | **10,482** | 7,187 |
| Other tax payables | | **15,486** | 9,542 |
| | | **201,416** | 196,389 |

# Notes to the Consolidated Financial Statements

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## 25. OTHER PAYABLES AND ACCRUALS (Continued)

(a) Details of contract liabilities are as follows:

| | **31 December 2020 RMB'000** | 31 December 2019 RMB'000 | 1 January 2019 RMB'000 |
|---|---|---|---|
| *Short-term advances received from customers* | | | |
| Sales of goods | **12,030** | 13,229 | 9,559 |
| Total contract liabilities | **12,030** | 13,229 | 12,030 |

Contract liabilities include short-term advances received to deliver pharmaceutical products. The decrease in contract liabilities in 2020 was mainly due to the decrease in short-term advances received from customers, and the increase in 2019 was mainly due to the increase in short-term advances received from customers in relation to the number of new customers increased.

(b) Other payables are non-interest-bearing and have an average term of six months.

## 26. INTEREST-BEARING BANK BORROWINGS

| | **31 December 2020** | | | 31 December 2019 | | |
|---|---|---|---|---|---|---|
| | **Effective interest rate (%)** | **Maturity** | **RMB'000** | Effective interest rate (%) | Maturity | RMB'000 |
| **Current** | | | | | | |
| Bank overdrafts – unsecured | **1.41-3.25** | **2021** | **78,915** | 3.46 | 2020 | 31,352 |
| | | | **78,915** | | | 31,352 |

| | **2020 RMB'000** | 2019 RMB'000 |
|---|---|---|
| Analysed into: | | |
| Bank overdrafts repayable: | | |
| Within one year or on demand | **78,915** | 31,352 |
| | **78,915** | 31,352 |

The Group's unsecured overdraft facilities amounting to RMB60,000,000 (2019: RMB30,000,000) and HK$70,000,000 (2019: HK$40,000,000), of which RMB20,000,000 (2019: Nil) and HK$70,000,000 (2019: HK$35,000,000) had been utilised as at the end of the reporting period.

# Notes to the Consolidated Financial Statements

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## 27. DEFERRED INCOME

| | 2020<br>RMB'000 | 2019<br>RMB'000 |
|---|---|---|
| At 1 January | **37,121** | 27,534 |
| Received amounts | **9,511** | 14,701 |
| Released amounts | **(8,920)** | (5,114) |
| At 31 December | **37,712** | 37,121 |
| Current | **23,497** | 19,353 |
| Non-current | **14,215** | 17,768 |
| | **37,712** | 37,121 |

Deferred income represents grants received from the government for the purpose of subsidising the expenses arising from research and development activities and the improvement of manufacturing facilities on certain special projects. Upon completion of the related projects and having passed the final assessment of the relevant government authorities, the grants related to the expense items would be recognised as other income directly in the statement of profit or loss and the grants related to an asset would be released to the statement of profit or loss over the expected useful life of the relevant asset.

# Notes to the Consolidated Financial Statements

31 December 2020

## 28. DEFERRED TAX ASSETS AND DEFERRED TAX LIABILITIES

The movements in deferred tax assets and liabilities during the reporting period are as follows:

| | 2020 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Deferred tax assets | | | | | | | |
| | Accruals RMB'000 | Impairment of inventories RMB'000 | Impairment of trade and other receivables RMB'000 | Government grants RMB'000 | Advertising and promotion expenses RMB'000 | Lease liabilities RMB'000 | Unrealised profit from intercompany transactions RMB'000 | Total RMB'000 |
| At 1 January 2020 | 943 | 1,102 | 406 | 5,836 | — | 2,110 | 2,980 | 13,377 |
| Deferred tax credited to the statement of profit or loss during the year (note 11) | 105 | 17 | 60 | 56 | 755 | 303 | 1,535 | 2,831 |
| As at 31 December 2020 | 1,048 | 1,119 | 466 | 5,892 | 755 | 2,413 | 4,515 | 16,208 |

| | 2019 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Deferred tax assets | | | | | | | | |
| | Accruals RMB'000 | Impairment of inventories RMB'000 | Impairment of trade and other receivables RMB'000 | Government grants RMB'000 | Advertising and promotion expenses RMB'000 | Lease liabilities RMB'000 | Unrealised profit from intercompany transactions RMB'000 | Fair value adjustment of equity investments at fair value through profit or loss RMB'000 | Total RMB'000 |
| At 1 January 2019 | 943 | 1,159 | 220 | 4,331 | 1,379 | — | 2,611 | 556 | 11,199 |
| Deferred tax credited/(charged) to the statement of profit or loss during the year (note 11) | — | (57) | 186 | 1,505 | (1,379) | 2,110 | 369 | (556) | 2,178 |
| As at 31 December 2019 | 943 | 1,102 | 406 | 5,836 | — | 2,110 | 2,980 | — | 13,377 |

# Notes to the Consolidated Financial Statements

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## 28. DEFERRED TAX ASSETS AND DEFERRED TAX LIABILITIES (Continued)

| | 2020 | | | | |
|---|---|---|---|---|---|
| | Deferred tax liabilities | | | | |
| | Depreciation allowance in excess of related depreciation RMB'000 | Fair value adjustment on acquisition RMB'000 | Fair value adjustment of equity investments at fair value through profit or loss RMB'000 | Withholding taxes RMB'000 | Total RMB'000 |
| At 1 January 2020 | **(2,045)** | **(1,158)** | **(569)** | **(9,501)** | **(13,273)** |
| Deferred tax charged/(credited) to the statement of profit or loss during the year (note 11) | **(2,188)** | **42** | **(2,149)** | **(8,289)** | **(12,584)** |
| As at 31 December 2020 | **(4,233)** | **(1,116)** | **(2,718)** | **(17,790)** | **(25,857)** |

| | 2019 | | | | |
|---|---|---|---|---|---|
| | Deferred tax liabilities | | | | |
| | Depreciation allowance in excess of related depreciation RMB'000 | Fair value adjustment on acquisition RMB'000 | Fair value adjustment of equity investments at fair value through profit or loss RMB'000 | Withholding taxes RMB'000 | Total RMB'000 |
| At 1 January 2019 | (195) | (1,196) | — | — | (1,391) |
| Deferred tax charged/(credited) to the statement of profit or loss during the year (note 11) | (1,850) | 38 | (569) | (9,501) | (11,882) |
| As at 31 December 2019 | (2,045) | (1,158) | (569) | (9,501) | (13,273) |

## 28. DEFERRED TAX ASSETS AND DEFERRED TAX LIABILITIES (Continued)

At 31 December 2020, the Group had tax losses arising in Mainland China of RMB2,503,000 (2019: RMB3,568,000) that will expire in one to five years for offsetting against future taxable profits.

Deferred tax assets have not been recognised in respect of the following items:

| | **2020 RMB'000** | 2019 RMB'000 |
|---|---|---|
| Tax losses | **2,503** | 3,568 |

Deferred tax assets have not been recognised in respect of the above items as it is not considered probable that taxable profits will be available against which the above items can be utilised.

Pursuant to the PRC Corporate Income Tax Law, a 10% withholding tax is levied on dividends declared to foreign investors from the foreign investment enterprises established in Mainland China. The requirement is effective from 1 January 2008 and applies to earnings after 31 December 2007. A lower withholding tax rate may be applied if there is a tax treaty between Mainland China and the jurisdiction of the foreign investors. For the Group, the applicable rate is 10%. The Group is therefore liable for withholding taxes on dividends distributed by its subsidiaries established in Mainland China in respect of earnings generated from 1 January 2008.

As at 31 December 2020, deferred tax liabilities for withholding taxes have not been provided on unremitted earnings of RMB548,937,000 (31 December 2019: RMB386,148,000) of the Group's subsidiaries established in Mainland China. In the opinion of the directors, it is not probable that these subsidiaries will distribute such earnings in the foreseeable future.

## 29. ISSUED CAPITAL

| | **2020** | 2019 |
|---|---|---|
| Issued and fully paid:<br>840,000,000 (2019: 840,000,000) ordinary shares of HK$0.01 each (HK$'000) | **8,400** | 8,400 |
| Equivalent to RMB'000 | **6,650** | 6,650 |

A summary of movements in the Company's issued capital is as follows:

| | **Number of issued and fully paid ordinary shares** | **Share capital** RMB'000 |
|---|---|---|
| **At 1 January 2019** | 840,000,000 | 6,650 |
| Issue of new shares | — | — |
| **At 31 December 2019 and 1 January 2020** | 840,000,000 | 6,650 |
| Issue of new shares | — | — |
| **At 31 December 2020** | **840,000,000** | **6,650** |

# Notes to the Consolidated Financial Statements

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## 30. SHARE OPTION SCHEME

The Company operates a share option scheme (the "Scheme") for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operations. Eligible participants of the Scheme include the Company's directors, including independent non-executive directors, other employees of the Group, suppliers of goods or services to the Group, customers of the Group, the Company's shareholders, and any non-controlling shareholder in the Company's subsidiaries. The Scheme was conditionally adopted on 8 June 2015 which became effective on 13 July 2015.

Share options granted to a director, chief executive or substantial shareholder of the Company, or to any of their associates, are subject to approval in advance by the independent non-executive directors. In addition, any share options granted to a substantial shareholder or an independent non-executive director of the Company, or to any of their associates, in excess of 0.1% of the shares of the Company in issue at any time or with an aggregate value (based on the price of the Company's shares at the date of grant) in excess of HK$5 million, within any 12-month period, are subject to shareholders' approval in advance in a general meeting.

The offer of a grant of share options may be accepted within the date as specified in the offer letter issued by the Company, upon payment of a nominal consideration of HK$1 in total by the grantee. The exercise period of the share options granted is determinable by the directors in its absolute discretion, save that no option may be exercised more than ten years after it has been granted.

The exercise price of share options is determinable by the directors, but may not be less than the higher of (i) the Stock Exchange closing price of the Company's shares on the date of offer of the share options; and (ii) the average Stock Exchange closing price of the Company's shares for the five trading days immediately preceding the date of offer.

Share options do not confer rights on the holders to dividends or to vote at shareholders' meetings.

Further details of the Company's share option scheme are set out in the Group's Report of the Directors on pages 89 to 90.

No share options were granted during the year ended 31 December 2020 and no share options were outstanding under the Scheme as at 31 December 2020 and 2019.

# Notes to the Consolidated Financial Statements

31 December 2020

## 31. SHARE AWARD PLAN

A share award plan was adopted on 8 January 2016 (the "Share Award Plan"). The Share Award Plan is a share incentive scheme and is established to recognise the contributions made by certain selected persons and to attract suitable individuals with experience and ability to further develop and expand the business of the Group.

The awarded shares will be either (i) allotted and issued by the Company, by using the general or specific mandates granted or to be granted to the board of directors by the shareholders of the Company at general meetings of the Company from time to time, or (ii) acquired by an independent trustee (the "Trustee") from the open market by utilising the Company's resources provided to the Trustee. The maximum number of shares in respect of which options may be granted under the Share Award Plan cannot result in the aggregate number of shares awarded by the board of directors throughout the duration of the plan exceeding 1% of the issued share capital of the Company.

In order to recognise and reward the contribution of and solidify the relationship with the service providers and distributors, the Board has resolved to increase the limit of the Share Award Plan from 1% of the issued share capital of the Company to 2.5% of the issued share capital of the Company on 25 March 2019.

Subject to any early termination as may be determined by the board of directors pursuant to the terms of the Share Award Plan, the plan will be valid and effective for a term of 10 years commencing on the date of adoption.

In 2017, the Company granted 1,072,500 shares to certain employees on 7 April 2017 and the vesting date of the shares was 7 April 2017. The fair value of the granted shares is calculated based on the closing market price of the shares (HK$1.70) on the day of the grant, amounting to HK$1,823,000 (equivalent to approximately RMB1,618,000).

The Company granted 127,000 shares to certain employees on 2 January 2019 and the vesting date of the shares was 2 January 2019. The fair value of the granted shares is calculated based on the closing market price of the shares (HK$1.45) on the day of the grant, amounting to HK$184,000 (equivalent to approximately RMB161,000).

The board of directors also approved to grant certain shares with a maximum number of 5,940,000 shares to certain employees, service providers and distributors (the "Eligible Persons") on 25 March 2019, which was subject to the satisfaction of certain performance target for year 2019. As at 31 December 2019, according to the achievement status of the performance of the Eligible Persons, 1,200,000 shares shall be vested while the remaining was forfeited due to the failure to meet the performance target. The fair value of the granted shares is calculated based on the closing market price of the shares (HK$1.439) on the day of the grant, amounting to HK$1,727,000 (equivalent to approximately RMB1,477,000).

The Company granted 850,000 shares to certain employees on 2 November 2020 and the vesting date of the shares was 2 November 2020. The fair value of the granted shares is calculated based on the closing market price of the shares (HK$1.52) on the day of the grant, amounting to HK$1,292,000 (equivalent to approximately RMB1,117,000).

On 20 October 2020, the board of directors approved to purchase shares as reserve for future granting. From 21 December 2020 to 30 December 2020, the Group purchased 8,677,000 shares in an aggregate of amount HK$14,268,000 (equivalent to approximately RMB12,322,000).

The Group recognised a share award expense of RMB1,638,000 and RMB1,117,000 for 2019 and 2020, respectively.

As at 31 December 2020, 13,278,500 shares of the Company were held by the Trustee and have yet to be awarded.

# Notes to the Consolidated Financial Statements

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## 32. RESERVES

The amounts of the Group's reserves and the movements therein for the reporting period are presented in the consolidated statement of changes in equity on pages 106 to 107.

### (a) Merger reserve

The merger reserve of the Group represents the capital contribution from its then shareholders of Zhongzhi Pharmaceutical amounting to RMB31,200,000.

### (b) Statutory surplus reserve

In accordance with the Company Law of the PRC, certain subsidiaries of the Group which are domestic enterprises are required to allocate 10% of their profit after tax, as determined in accordance with the relevant PRC accounting standards, to their respective statutory surplus reserves until the reserves reach 50% of their respective registered capital. Subject to certain restrictions set out in the Company Law of the PRC, part of the statutory surplus reserve may be converted to share capital, provided that the remaining balance after the capitalisation is not less than 25% of the registered capital.

### (c) Share-based payment reserve

The share-based payment reserve represents the difference between the fair value of the shares granted to employees of the Group and the costs paid by these employees through Zhongshan Yu Xin Investment Limited with a corresponding increase in the share-based payment reserve within equity. The fair value is measured at the grant date based on the discounted cash flow method. As there were no future service conditions attached to the share-based payments, the share-based payments were vested immediately in 2012 and were recognised as an employee benefit expense.

## 33. ACQUISITION OF A SUBSIDIARY

On 25 October 2019, the Group acquired 100% interests in Guangdong Zhongzhida Pharmaceutical Co., Ltd. ("Guangdong Zhongzhida") from independent third party individuals Feng Guoqiang and Zeng Rong. Guangdong Zhongzhida is a privately-owned company incorporated under the Laws of Mainland China. The purchase consideration for the acquisition was in the form of cash of RMB700,000.

The fair values of the identifiable assets and liabilities of Guangdong Zhongzhida as at the date of acquisition were as follows:

| | Note | **2020**<br>**RMB'000** | 2019<br>RMB'000 |
|---|---|---|---|
| Trade receivables | | — | 224 |
| Prepayments, deposits, and other receivables | | — | 136 |
| Cash and cash equivalents | | — | 140 |
| Other intangible assets | 17 | — | 2,697 |
| Interest-bearing bank borrowings | | — | (1,379) |
| Other payables and accruals | | — | (1,118) |
| Total identifiable net assets at fair value | | — | 700 |
| Satisfied by cash | | — | 700 |

# Notes to the Consolidated Financial Statements

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## 33. ACQUISITION OF A SUBSIDIARY (Continued)

An analysis of the cash flows in respect of the acquisition of Guangdong Zhongzhida is as follows:

| | **2020** **RMB'000** | 2019 RMB'000 |
|---|---|---|
| Cash consideration | — | (700) |
| Cash and bank balances acquired | — | 140 |
| Net outflow of cash and cash equivalents included in cash flows from investing activities | — | (560) |

In the opinion of the directors, the acquisition of Guangdong Zhongzhida does not constitute a business. Therefore, the transactions were determined by the directors of the Company to be the acquisition of assets and liabilities through acquisition of subsidiaries rather than a business combination as defined in IFRS 3 *Business Combinations*.

## 34. NOTES TO THE CONSOLIDATED STATEMENT OF CASH FLOWS

### (a) Changes in liabilities arising from financing activities

**2020**

| | **Bank and other loans RMB'000** | **Lease liabilities RMB'000** | **Total RMB'000** |
|---|---|---|---|
| At 1 January 2020 | **31,352** | **96,153** | **127,505** |
| Changes from financing cash flows | **47,563** | **(38,264)** | **9,299** |
| New leases | **—** | **47,966** | **47,966** |
| Interest expense | **—** | **3,831** | **3,831** |
| Covid-19-related rent concessions from lessors | **—** | **(698)** | **(698)** |
| At 31 December 2020 | **78,915** | **108,988** | **187,903** |

2019

| | Bank and other loans RMB'000 | Lease liabilities RMB'000 | Total RMB'000 |
|---|---|---|---|
| At 1 January 2019 | — | 111,494 | 111,494 |
| Changes from financing cash flows | 31,352 | (34,010) | (2,658) |
| New leases | — | 14,739 | 14,739 |
| Interest expense | — | 3,930 | 3,930 |
| At 31 December 2019 | 31,352 | 96,153 | 127,505 |

# Notes to the Consolidated Financial Statements

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## 34. NOTES TO THE CONSOLIDATED STATEMENT OF CASH FLOWS (Continued)

### (b) Total cash outflow for leases

The total cash outflow for leases included in the statement of cash flows is as follows:

| | **2020**<br>**RMB'000** | 2019<br>RMB'000 |
|---|---|---|
| Within financing activities | **38,264** | 34,010 |

## 35. COMMITMENTS

(a) The Group had the following capital commitments at the end of the reporting period:

| | **2020**<br>**RMB'000** | 2019<br>RMB'000 |
|---|---|---|
| Contracted, but not provided for: | | |
| Plant and machinery | **65,850** | 55,506 |
| | **65,850** | 55,506 |

At 31 December 2020 and 31 December 2019, the Group had significant capital commitments, which are authorised but not contracted for, of RMB71,000,000 and RMB45,469,820, respectively.

(b) The Group has various lease contracts that have not yet commenced as at 31 December 2020. The future lease payments for these non-cancellable lease contracts are RMB1,839,000 due within one year, RMB7,006,000 due in the second to fifth years, inclusive and RMB675,000 due after five years.

## 36. RELATED PARTY TRANSACTIONS

### (a) Outstanding balances with related parties

Amounts due to related parties as at 31 December 2020 and 2019 represent consideration received from the Registered Shareholders as part of the historical reorganisation. Pursuant to the Contractual Arrangements, the consideration is repayable to the Registered Shareholders upon exercise of the option to repurchase the equity interests of Zhongzhi Herb Pieces by the Group. The amounts are unsecured, interest-free and have no fixed terms of repayment.

(b) Compensation of key management personnel of the Group:

| | **2020**<br>**RMB'000** | 2019<br>RMB'000 |
|---|---|---|
| Salaries, allowances and benefits in kind | **8,020** | 7,572 |
| Pension scheme contributions | **149** | 189 |
| Others | **—** | 267 |
| | **8,169** | 8,028 |

Further details of directors' and the chief executive's emoluments are included in note 9.

# Notes to the Consolidated Financial Statements

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## 37. FINANCIAL INSTRUMENTS BY CATEGORY

The carrying amounts of each of the categories of financial instruments of the Group as at the end of the reporting period are as follows:

**2020**

***Financial assets***

| | Financial assets at fair value through profit or loss | | Financial assets at fair value through other comprehensive income | | |
|---|---|---|---|---|---|
| | Designated as such upon initial recognition RMB'000 | Held for trading RMB'000 | Debt investments RMB'000 | Financial assets at amortised cost RMB'000 | Total RMB'000 |
| Trade receivables | — | — | — | 222,927 | 222,927 |
| Notes receivable | — | — | 60,161 | — | 60,161 |
| Equity investments at fair value through profit or loss | 658 | 17,635 | — | — | 18,293 |
| Financial assets included in prepayments, deposits and other receivables | — | — | — | 16,428 | 16,428 |
| Financial assets included in other non-current assets | — | — | — | 6,704 | 6,704 |
| Cash and bank balances | — | — | — | 294,032 | 294,032 |
| | 658 | 17,635 | 60,161 | 540,091 | 618,545 |

***Financial liabilities***

| | Financial liabilities at amortised cost RMB'000 |
|---|---|
| Amount due to a joint venture | 65 |
| Trade payables | 110,439 |
| Interest-bearing bank borrowings | 79,785 |
| Lease liabilities | 108,988 |
| Financial liabilities included in other payables and accruals | 135,050 |
| Amounts due to related parties | 8,786 |
| | 443,113 |

# Notes to the Consolidated Financial Statements

31 December 2020

## 37. FINANCIAL INSTRUMENTS BY CATEGORY (Continued)

2019

***Financial assets***

| | Financial assets at fair value through profit or loss | | Financial assets at fair value through other comprehensive income | | |
|---|---|---|---|---|---|
| | Designated as such upon initial recognition RMB'000 | Held for trading RMB'000 | Debt investments RMB'000 | Financial assets at amortised cost RMB'000 | Total RMB'000 |
| Trade receivables | — | — | — | 163,333 | 163,333 |
| Notes receivable | — | — | 79,431 | — | 79,431 |
| Equity investments at fair value through profit or loss | 506 | 9,890 | — | — | 10,396 |
| Financial assets included in prepayments, deposits and other receivables | — | — | — | 7,862 | 7,862 |
| Financial assets included in other non-current assets | — | — | — | 5,967 | 5,967 |
| Cash and bank balances | — | — | — | 380,333 | 380,333 |
| | 506 | 9,890 | 79,431 | 557,495 | 647,322 |

***Financial liabilities***

| | Financial liabilities at amortised cost RMB'000 |
|---|---|
| Amount due to a joint venture | 70 |
| Trade payables | 104,300 |
| Interest-bearing bank borrowings | 31,352 |
| Lease liabilities | 96,153 |
| Financial liabilities included in other payables and accruals | 106,617 |
| Amounts due to related parties | 8,786 |
| | 347,278 |

# Notes to the Consolidated Financial Statements

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## 38. FAIR VALUE AND FAIR VALUE HIERARCHY OF FINANCIAL INSTRUMENTS

Management has assessed that the fair values of cash and bank balances, trade and notes receivables, financial assets included in prepayments, deposits and other receivables, financial assets included in other non-current assets, trades payables, financial liabilities included in other payables and accruals and an amount due to a joint venture approximate to their carrying amounts largely due to the short term maturities of these instruments or immaterial impact on discounting for financial assets included in other non-current assets.

The Group's finance department headed by the finance manager is responsible for determining the policies and procedures for the fair value measurement of financial instruments. The finance manager reports directly to the chief financial officer and the audit committee. At each reporting date, the finance department analyses the movements in the values of financial instruments and determines the major inputs applied in the valuation. The valuation is reviewed and approved by the chief financial officer.

The fair values of the financial assets and liabilities are included at the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

The fair values of listed equity investments are based on quoted market prices. The fair values of unlisted equity investments designated at fair value through profit or loss have been estimated using a market-based valuation technique based on assumptions that are not supported by observable market prices or rates. The valuation requires the directors to determine comparable public companies (peers) based on industry, size, leverage and strategy, and to calculate an appropriate price multiple, such as enterprise value to earnings before interest and taxes ("EV/EBIT"), for each comparable company identified. The multiple is calculated by dividing the enterprise value of the comparable company by an earnings measure. The trading multiple is then discounted for considerations such as illiquidity and size differences between the comparable companies based on company-specific facts and circumstances. The discounted multiple is applied to the corresponding earnings measure of the unlisted equity investments to measure the fair value. The directors believe that the estimated fair values resulting from the valuation technique, which are recorded in the consolidated statement of financial position, and the related changes in fair values, which are recorded in profit or loss, are reasonable, and that they were the most appropriate values at the end of the reporting period.

# Notes to the Consolidated Financial Statements

31 December 2020

## 38. FAIR VALUE AND FAIR VALUE HIERARCHY OF FINANCIAL INSTRUMENTS (Continued)

### Fair value hierarchy

The following tables illustrate the fair value measurement hierarchy of the Group's financial instruments:

Assets measured at fair value:

**As at 31 December 2020**

| | Fair value measurement using | | | |
|---|---|---|---|---|
| | **Quoted prices in active markets (Level 1) RMB'000** | **Significant observable inputs (Level 2) RMB'000** | **Significant unobservable inputs (Level 3) RMB'000** | **Total RMB'000** |
| Equity investments at fair value through profit or loss | **17,635** | **—** | **658** | **18,293** |

As at 31 December 2019

| | Fair value measurement using | | | |
|---|---|---|---|---|
| | Quoted prices in active markets (Level 1) RMB'000 | Significant observable inputs (Level 2) RMB'000 | Significant unobservable inputs (Level 3) RMB'000 | Total RMB'000 |
| Equity investments at fair value through profit or loss | 9,890 | — | 506 | 10,396 |

# Notes to the Consolidated Financial Statements

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## 39. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's principal financial instruments comprise financial assets at fair value through profit or loss, interest-bearing bank borrowings and cash and bank balances. The Group has various other financial assets and liabilities such as trade and notes receivables and trade payables, which arise directly from its operations.

The main risks arising from the Group's financial instruments are interest rate risk, foreign currency risk, credit risk and liquidity risk. The board of directors reviews and agrees policies for managing each of these risks and they are summarised below.

### Interest rate risk

Interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Group's exposure to the risk of changes in market interest rates relates primarily to the Group's cash and time deposits at banks. Therefore, the Group does not have any significant exposure to risk of changes in market interest rates. The Group currently does not have a specific policy to manage its interest rate risk and has not entered into interest rate swaps.

### Foreign currency risk

The Group's transactions are mainly denominated in RMB. Certain of the Group's cash and bank deposits are denominated in HK$. In addition, the Company will pay dividends in HK$ in the future. Any significant exchange rate fluctuations of HK$ against RMB may have financial impacts on the Group.

The Group did not experience any material impact or difficulties in liquidity on its operations resulting from the fluctuation in exchange rates, and no hedging transaction or forward contract arrangement was made by the Group during the reporting period. Nevertheless, the Group will from time to time review and adjust the Group's hedging and financing strategies based on the RMB and HK$ exchange rate movement.

The following table demonstrates the sensitivity at the end of the reporting period to a reasonably possible change in the HK$ exchange rate, with all other variables held constant, of the Group's profit before (or after) tax (due to changes in the fair value of monetary assets and liabilities) and the Group's equity.

| | Increase/ (decrease) in HK$ rate % | Increase/ (decrease) in profit before (or after) tax RMB'000 | Increase/ (decrease) in equity* RMB'000 |
|---|---|---|---|
| **2020** | | | |
| If RMB weakens against HK$ | **5** | **131** | **6,803** |
| If RMB strengthens against HK$ | **(5)** | **(131)** | **(6,803)** |
| 2019 | | | |
| If RMB weakens against HK$ | 5 | — | 10,695 |
| If RMB strengthens against HK$ | (5) | — | (10,695) |

* Excluding retained profits

# Notes to the Consolidated Financial Statements

31 December 2020

## 39. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

### Credit risk

The Group trades only with recognised and creditworthy third parties. It is the Group's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis and the Group's exposure to bad debts is not significant.

***Maximum exposure and year-end staging***

The tables below show the credit quality and the maximum exposure to credit risk based on the Group's credit policy, which is mainly based on past due information unless other information is available without undue cost or effort, and year-end staging classification as at 31 December. The amounts presented are gross carrying amounts for financial assets.

**As at 31 December 2020**

| | 12-month ECLs | Lifetime ECLs | | | |
|---|---|---|---|---|---|
| | Stage 1 RMB'000 | Stage 2 RMB'000 | Stage 3 RMB'000 | Simplified approach RMB'000 | Total RMB'000 |
| Trade and notes receivables* | — | — | — | 286,195 | 286,195 |
| Financial assets included in prepayments, deposits and other receivables | | | | | |
| — Normal** | 16,428 | — | — | — | 16,428 |
| Financial assets included in other non-current assets | | | | | |
| — Normal** | 6,704 | — | — | — | 6,704 |
| Cash and cash equivalents | | | | | |
| — Not yet past due | 294,032 | — | — | — | 294,032 |
| | 317,164 | — | — | 286,195 | 603,359 |

# Notes to the Consolidated Financial Statements

31 December 2020

## 39. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

### Credit risk (Continued)

***Maximum exposure and year-end staging*** (Continued)

As at 31 December 2019

| | 12-month ECLs | Lifetime ECLs | | | |
|---|---|---|---|---|---|
| | Stage 1 RMB'000 | Stage 2 RMB'000 | Stage 3 RMB'000 | Simplified approach RMB'000 | Total RMB'000 |
| Trade and notes receivables* | — | — | — | 245,477 | 245,477 |
| Financial assets included in prepayments, deposits and other receivables | | | | | |
| — Normal** | 7,862 | — | — | — | 7,862 |
| Financial assets included in other non-current assets | | | | | |
| — Normal** | 5,967 | — | — | — | 5,967 |
| Cash and cash equivalents | | | | | |
| — Not yet past due | 380,333 | — | — | — | 380,333 |
| | 394,162 | — | — | 245,477 | 639,639 |

* For trade and notes receivables to which the Group applies the simplified approach for impairment, the provision for ECLs for notes receivable is considered to be minimal and the information based on the provision matrix of trade receivables is disclosed in note 21 to the financial statements.

** The credit quality of the financial assets included in prepayments, deposits and other receivables and the financial assets included in other non-current assets are considered to be "normal" when they are not past due and there is no information indicating that the financial assets had a significant increase in credit risk since initial recognition.

Further quantitative data in respect of the Group's exposure to credit risk arising from trade and notes receivables are disclosed in note 21.

Since the Group trades only with recognised and creditworthy third parties, there is no requirement for collateral. Concentrations of credit risk are managed by customer/counterparty, by geographical region and by industry sector. There are no significant concentrations of credit risk within the Group.

# Notes to the Consolidated Financial Statements

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## 39. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

### Liquidity risk

The Group's objective is to maintain a balance between continuity of funding and flexibility through the use of trade payables, bank overdrafts, lease liabilities and other borrowings. The Group regularly reviews its major funding positions to ensure that it has adequate financial resources in meeting its financial obligations.

The maturity profile of the Group's financial liabilities as at the end of the reporting period, based on the contractual undiscounted payments, was as follows:

| | 2020 | | | | | |
|---|---|---|---|---|---|---|
| | **On demand RMB'000** | **Less than 3 months RMB'000** | **3 to less than 12 months RMB'000** | **1 to 5 years RMB'000** | **Over 5 years RMB'000** | **Total RMB'000** |
| Amount due to a joint venture | **65** | **—** | **—** | **—** | **—** | **65** |
| Trade payables | **43,800** | **66,639** | **—** | **—** | **—** | **110,439** |
| Lease liabilities | **—** | **10,322** | **26,356** | **67,405** | **529** | **104,612** |
| Financial liabilities included in other payables | **121,244** | **9,084** | **4,643** | **79** | **—** | **135,050** |
| Interest-bearing bank borrowings | **—** | **79,785** | **—** | **—** | **—** | **79,785** |
| Amounts due to related parties | **8,786** | **—** | **—** | **—** | **—** | **8,786** |
| | **173,895** | **165,830** | **30,999** | **67,484** | **529** | **438,737** |

| | 2019 | | | | | |
|---|---|---|---|---|---|---|
| | On demand RMB'000 | Less than 3 months RMB'000 | 3 to less than 12 months RMB'000 | 1 to 5 years RMB'000 | Over 5 years RMB'000 | Total RMB'000 |
| Amount due to a joint venture | 70 | — | — | — | — | 70 |
| Trade payables | 21,311 | 82,989 | — | — | — | 104,300 |
| Lease liabilities | — | 9,654 | 28,889 | 66,587 | 3,755 | 108,885 |
| Financial liabilities included in other payables | 105,819 | 19,942 | 12,241 | 88 | — | 138,090 |
| Interest-bearing bank borrowings | — | 31,622 | — | — | — | 31,622 |
| Amounts due to related parties | 8,786 | — | — | — | — | 8,786 |
| | 135,986 | 144,207 | 41,130 | 66,675 | 3,755 | 391,753 |

## 39. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

### Capital management

The primary objectives of the Group's capital management are to safeguard the Group's ability to continue as a going concern and to maintain healthy capital ratios in order to support its business and maximise the shareholders' value.

The Group manages its capital structure and makes adjustments to it in light of changes in economic conditions. To maintain or adjust the capital structure, the Group may adjust the dividend payment to the shareholders, return capital to the shareholders or issue new shares. The Group is not subject to any externally imposed capital requirements. No changes were made in the objectives, policies or processes for managing capital during the reporting period.

The Group monitors capital using a gearing ratio, which is calculated by dividing total interest-bearing bank borrowings by total equity. Capital represents equity attributable to owners of the parent. The Group's policy is to maintain the gearing ratio at a reasonable level. The gearing ratio as at the end of the reporting period was as follows:

| | **2020**<br>**RMB'000** | 2019<br>RMB'000 |
|---|---|---|
| Interest-bearing bank borrowings | **78,915** | 31,352 |
| Equity attributable to owners of the parent | **820,176** | 763,383 |
| Gearing ratio | **10%** | 4% |

## 40. TRANSFERS OF FINANCIAL ASSETS

As at 31 December 2020 and 2019, the Group endorsed certain notes receivable accepted by certain banks in Mainland China (the "Endorsed Notes") to certain of its suppliers in order to settle the trade payables due to such suppliers (the "Endorsement"). Subsequent to the Endorsement, the Group does not retain any rights to the use of the Endorsed Notes, including the sale, transfer or pledge of the Endorsed Notes to any other third parties. In accordance with the Law of Negotiable Instruments in the PRC, the holders of the Endorsed Notes have a right of recourse against the Group if the PRC banks default (the "Continuing Involvement"). The total carrying amount of the Endorsed Notes as at 31 December 2020 was RMB32,865,000 (2019: RMB71,426,000), of which the Endorsed Notes and the associated trade payables with a carrying amount of RMB26,781,000 as at 31 December 2020 (2019: RMB53,066,000) had been fully derecognised. The Group carefully assesses the default risk of the PRC banks. The Group only derecognises the notes receivable that have been accepted by banks with high credit reputation as the directors are of the view that the default risk of these banks is remote and the Group has transferred substantially all the risks and rewards relating to such notes (the "Derecognised Notes"). The Derecognised Notes had a maturity of 1 to 9 months at the end of the reporting period. The maximum exposure to loss from the Group's Continuing Involvement in the Derecognised Notes and the undiscounted cash flows to repurchase the Derecognised Notes is equal to their carrying amounts. In the opinion of the directors, the fair values of the Group's Continuing Involvement in the Derecognised Notes are not significant, given the insignificant default risk of the related PRC banks.

During the years ended 31 December 2020 and 2019, the Group has not recognised any gain or loss on the date of transfer of the Derecognised Notes. No gains or losses were recognised from the Continuing Involvement, both during the years ended 31 December 2020 and 2019 or cumulatively. The Endorsement has been made evenly throughout the years ended 31 December 2020 and 2019.

# Notes to the Consolidated Financial Statements

31 December 2020

## 40. TRANSFERS OF FINANCIAL ASSETS (Continued)

The Group continued to recognise the carrying amount of the remaining Endorsed Notes and the associated trade payables settled of RMB6,084,000 as at 31 December 2020 (2019: RMB18,360,000), as the directors considered that the Group has retained the substantial risks and rewards, which include default risks relating to such remaining Endorsed Notes.

## 41. STATEMENT OF FINANCIAL POSITION OF THE COMPANY

Information about the statement of financial position of the Company at the end of the reporting period is as follows:

| | **2020**<br>**RMB'000** | 2019<br>RMB'000 |
|---|---|---|
| **NON-CURRENT ASSETS** | | |
| Interests in subsidiaries | **197,431** | 273,260 |
| Right-of-use assets | **96** | 330 |
| **Total non-current assets** | **197,527** | 273,590 |
| **CURRENT ASSETS** | | |
| Prepayments, deposits and other receivables | **219** | 230 |
| Cash and bank balances | **16,363** | 8,904 |
| **Total current assets** | **16,582** | 9,134 |
| **CURRENT LIABILITIES** | | |
| Due to subsidiaries | **16,241** | 17,287 |
| Other payables and accruals | **204** | 240 |
| Interest-bearing bank borrowings | **58,915** | 31,352 |
| Lease liabilities | **99** | 333 |
| **Total current liabilities** | **75,459** | 49,212 |
| **NET CURRENT ASSETS** | **(58,877)** | (40,078) |
| **TOTAL ASSETS LESS CURRENT LIABILITIES** | **138,650** | 233,512 |
| **Net assets** | **138,650** | 233,512 |
| **Equity** | | |
| Issued capital | **6,650** | 6,650 |
| Reserves (note) | **132,000** | 226,862 |
| **Total equity** | **138,650** | 233,512 |

# Notes to the Consolidated Financial Statements

31 December 2020

## 41. STATEMENT OF FINANCIAL POSITION OF THE COMPANY (Continued)

Note:

A summary of the Company's reserves is as follows:

| | Share premium* RMB'000 | Shares held for the share award plan* RMB'000 | Share award reserve* RMB'000 | Exchange fluctuation reserve* RMB'000 | Retained profits* RMB'000 | Total RMB'000 |
|---|---|---|---|---|---|---|
| **At 1 January 2019** | 304,263 | (13,181) | (549) | 37,137 | (39,373) | 288,297 |
| Loss for the year | — | — | — | — | (8,433) | (8,433) |
| Exchange differences on translation of foreign operations | — | — | — | 6,183 | — | 6,183 |
| Total comprehensive loss for the year | — | — | — | 6,183 | (8,433) | (2,250) |
| Equity-settled share award expense | — | 2,603 | (965) | — | — | 1,638 |
| Final 2018 dividend | (26,367) | — | — | — | — | (26,367) |
| Interim 2019 dividend | (34,456) | — | — | — | — | (34,456) |
| **At 31 December 2019** | 243,440 | (10,578) | (1,514) | 43,320 | (47,806) | 226,862 |
| Loss for the year | — | — | — | — | (3,201) | (3,201) |
| Exchange differences on translation of foreign operations | — | — | — | (10,047) | — | (10,047) |
| Total comprehensive loss for the year | — | — | — | (10,047) | (3,201) | (13,248) |
| Shares repurchased | — | (12,322) | — | — | — | (12,322) |
| Equity-settled share award expense | — | 1,683 | (565) | — | — | 1,118 |
| Final 2019 dividend | (33,241) | — | — | — | — | (33,241) |
| Interim 2020 dividend | (37,169) | — | — | — | — | (37,169) |
| **At 31 December 2020** | **173,030** | **(21,217)** | **(2,079)** | **33,273** | **(51,007)** | **132,000** |

* Included in the reserves in the statement of financial position of the Company

## 42. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors on 24 March 2021.

# Five Year Financial Summary

The following is a summary of the consolidated results, assets and liabilities of the Group for the last five financial years, as extracted from the Prospectus and published audit financial statements of the Group. This Summary does not form part of the audited financial statements.

## RESULTS

| | Year ended 31 December | | | | |
|---|---|---|---|---|---|
| | **2020** | 2019 | 2018 | 2017 | 2016 |
| | **RMB'000** | RMB'000 | RMB'000 | RMB'000 | RMB'000 |
| **REVENUE** | **1,603,876** | 1,342,182 | 1,142,150 | 944,634 | 730,472 |
| **GROSS PROFIT** | **991,203** | 834,689 | 708,272 | 564,253 | 399,438 |
| **PROFIT BEFORE TAX** | **167,222** | 155,941 | 101,823 | 89,875 | 69,159 |
| Income tax expense | **(28,603)** | (41,247) | (16,754) | (19,819) | (15,287) |
| **PROFIT FOR THE YEAR AND ATTRIBUTABLE TO OWNERS OF THE COMPANY** | **138,532** | 114,694 | 85,069 | 70,056 | 53,872 |
| Earnings per share – Basic | **RMB0.17** | RMB0.14 | RMB0.10 | RMB0.09 | RMB0.07 |
| – Diluted | **RMB0.17** | RMB0.14 | RMB0.10 | RMB0.09 | RMB0.07 |

## ASSETS AND LIABILITIES

| | Year ended 31 December | | | | |
|---|---|---|---|---|---|
| | **2020** | 2019 | 2018 | 2017 | 2016 |
| | **RMB'000** | RMB'000 | RMB'000 | RMB'000 | RMB'000 |
| **TOTAL ASSETS** | **1,420,521** | 1,280,539 | 1,011,486 | 911,952 | 755,228 |
| **TOTAL LIABILITIES** | **598,758** | 517,156 | 304,894 | 243,677 | 186,847 |