華升資本
CHINA SUNRISE CAPITAL

**CHINA SUNRISE CAPITAL LIMITED**
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The Center
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The Board of Directors
The Offeror
No. 368 Zhen'an Middle Road
Chang'an Town, Dongguan City
Guangdong Province
the People's Republic of China

China International Capital Corporation Hong Kong Securities Limited
29/F, One International Finance Centre
1 Harbour View Street, Central
Hong Kong

10 May 2024

Dear Sirs,

**PROPOSED PRE-CONDITIONAL PRIVATISATION OF THE COMPANY BY THE OFFEROR BY WAY OF MERGER BY ABSORPTION OF THE COMPANY ESTIMATED VALUE OF THE OFFEROR H SHARES**

## I. INTRODUCTION

We refer to our engagement as the Valuation Adviser to the board of directors of the Offeror in respect of providing an estimated value of the Offeror H Shares ("**Estimated Value**"). The Offeror H Shares are to be issued to the shareholders of the Company according to the proposed pre-conditional privatisation of the Company. Capitalised terms used in this letter shall have the same meanings as those defined in the joint announcement dated 10 May 2024 jointly issued by the Offeror and the Company (the "**Joint Announcement**") unless the context requires otherwise.

On 10 May 2024, the Offeror and the Company have entered into the Merger Agreement, pursuant to which the Offeror and the Company have agreed to implement the Merger subject to the terms and conditions of the Merger Agreement, including the Pre-Conditions and the Conditions. Following the fulfilment (or waiver, as applicable) of the Pre-Conditions and Conditions and the completion of the Share Exchange, the Company will be delisted from the Stock Exchange, the Offeror H Shares will be listed on the Main Board of the Stock Exchange by way of introduction and the Company will be merged into and absorbed by the Offeror in accordance with the terms of the Merger Agreement and PRC Company Law and other applicable PRC Laws. The Share Exchange Shareholders (which do not include the Offeror or its subsidiaries (if any)) will become shareholders of the Offeror.

We have been appointed to provide the Estimated Value of the Offeror H Shares, to be offered to the Shareholders, pursuant to paragraph 30 of Schedule I of the Takeovers Code which provides that the offer document should contain "*when the offer involves the issue of unlisted securities, an estimate of the value of such securities by an appropriate adviser, together with the assumptions and methodology used in arriving at the value*". Although as at the date of this letter the Offeror H Shares are not listed on any stock exchange, it is one of the Pre-Conditions of the Merger that the Listing Committee of the Stock Exchange approves the listing of and permission to deal in the Offeror H Shares on the Stock Exchange pursuant to the Listing.

## II. PURPOSE

The Estimated Value has been provided to the board of directors of the Offeror and CICC solely for the purpose of paragraph 30 of Schedule I of the Takeovers Code and shall not be used or relied upon for any other purpose whatsoever. This letter is not addressed to and may not be relied upon by any third party for any purposes whatsoever and we expressly disclaim any duty or liability to any third party with respect to the contents of this letter.

The Estimated Value assumes a willing buyer and seller, neither being under any compulsion to buy or sell, dealing on an arm's length basis, each having knowledge of all relevant facts. The Estimated Value is also prepared on the basis of a value as to investors acquiring a minority interest as a portfolio investment. It does not include any premium for control.

The Estimated Value does not constitute an opinion as to the price at which the Offeror H Shares may trade at any point, present or in the future, or represent the value that a holder of the Offeror H Shares may realise on any sale, present or in the future, where such a value may be higher or lower than the Estimated Value contained in this letter. We assume no obligation to update or revise the Estimated Value based upon circumstances or events occurring after the date of this letter.

In formulating the Estimated Value, we have reviewed, among other things, the following materials (the "**Materials**"):

1. the Joint Announcement;

2. the unaudited financial report of the Offeror for year ended 31 December ("**FY**") 2023;

3. the announcement of the Company for FY2023; and

4. other publicly available information related to the Offeror and the Company

We have assumed that all information, facts, opinions and representations contained in the Materials which we have relied on, are true, complete and accurate and not misleading in all material respects. We have not conducted any independent verification of the Materials.

We would like to draw your attention that the Shares are publicly traded securities and will be subject to the fluctuations of the capital market. Those certain market uncertainties and contingencies are difficult to predict and are beyond our control. Consequently, the Estimated Value expressed in this letter is not necessarily indicative of the price at which the Offeror H Shares might actually trade in any public market as at the date of this letter or at any future date, or the amount which might be realised upon a sale of the Offeror H Shares to a third party. The Estimated Value may differ substantially from estimates available from other sources such as research reports published by brokers. In addition, our view would be expected to fluctuate with changes in prevailing market conditions, the financial conditions and prospects of the Offeror and other factors which generally influence the valuation of securities. As a result, there can be no assurance that the actual price of the Offeror H Shares will be higher or lower than implied by the Estimated Value.

## III. METHODOLOGY

There are three generally accepted approaches to appraise the Estimated Value of the Offeror H Shares, namely the income approach, the asset-based approach and the market approach. All three of them have been considered regarding this valuation:

### 1. Income Approach

The income approach provides an indication of value based on the principle that an informed buyer would pay no more than the present value of anticipated future economic benefits generated by the subject asset.

The fundamental method for income approach is the discounted cash flow ("**DCF**") method. Under the DCF method, the value depends on the present value of future economic benefits to be derived from the ownership of the enterprise. Thus, an indication of the equity value is calculated as the present value of the future free cash flow of a company less outstanding interest-bearing debt, if any. The future cash flow is discounted at the market-derived rate of return appropriate for the risks and hazards of investing in a similar business.

2. **Asset-based Approach**

The asset-based approach considers the cost to reproduce or replace in new condition the assets appraised in accordance with current market prices for similar assets, with allowance for accrued depreciation arising from condition, utility, age, wear and tear, or obsolescence (physical, functional or economical) present, taking into consideration the past and present maintenance policy and rebuilding history.

3. **Market Approach**

The market approach provides an indication of value by comparing the subject asset to the same asset or similar assets that have been sold in the market, with appropriate adjustments for the differences between the subject asset and the assets that are comparable to the subject asset.

There are three methods under the market approach. Firstly, the guideline company method computes a price multiple for publicly listed companies that are considered to be comparable to the subject company and then applies the multiple to the corresponding financial metric of the subject company. Secondly, the comparable transaction method computes a price multiple using recent transactions of assets that are considered to be comparable to the subject asset and then applies the result to the corresponding financial metric of the subject company. Thirdly, the market price method directly takes reference to the trading prices of the assets in the open market.

4. **Selected Valuation Approach**

Each of the above-mentioned approaches is appropriate in one or more circumstances, and sometimes, two or more approaches may be used together. Whether to adopt a certain approach will be determined by the most adopted practice in valuing business entities that are similar in nature.

For the purpose of this valuation, we have determined that sum-of-the-parts approach is the most appropriate valuation methodology as we have taken into consideration the following:

(a) referring to the discussion with the management team of the Offeror (the "**Management**") and the review of all the Offeror's subsidiaries (which are all wholly-owned subsidiaries), we understand that out of the 25 subsidiaries of the Offeror, 9 subsidiaries do not have any principal business activities. Additionally, the remaining subsidiaries, except Shenzhen HEC Detection Technology Co. Ltd. ("**Shenzhen HEC DT**"), that are currently in operation are experiencing losses (details as set out in the table below). For Shenzhen HEC DT, although it is profit-making, its revenue and profit only accounted for approximately 0.45% and 0.66% of that of the Offeror, respectively, according to the unaudited report for FY2023.

Considering that all 25 subsidiaries of the Offeror, although they are either operational or possess assets, and none of them exhibit significant cash generating activities, we believe it is appropriate to employ the asset-based approach for the valuation of the 25 subsidiaries;

(b) the Offeror directly holds approximately 51.41% equity interest in the Company (the "**Long-term Equity Investment**") which is evaluated by market approach; and

(c) the Offeror has been investing into its pipeline products (the "**Pipeline Products**") through research and development, which has built assets with substantial value in the form of capitalized expenditure and directly holds them. Such capitalized expenditure is expected to provide income benefit streams in the future. Therefore, income approach is appropriate for the Pipeline Products.

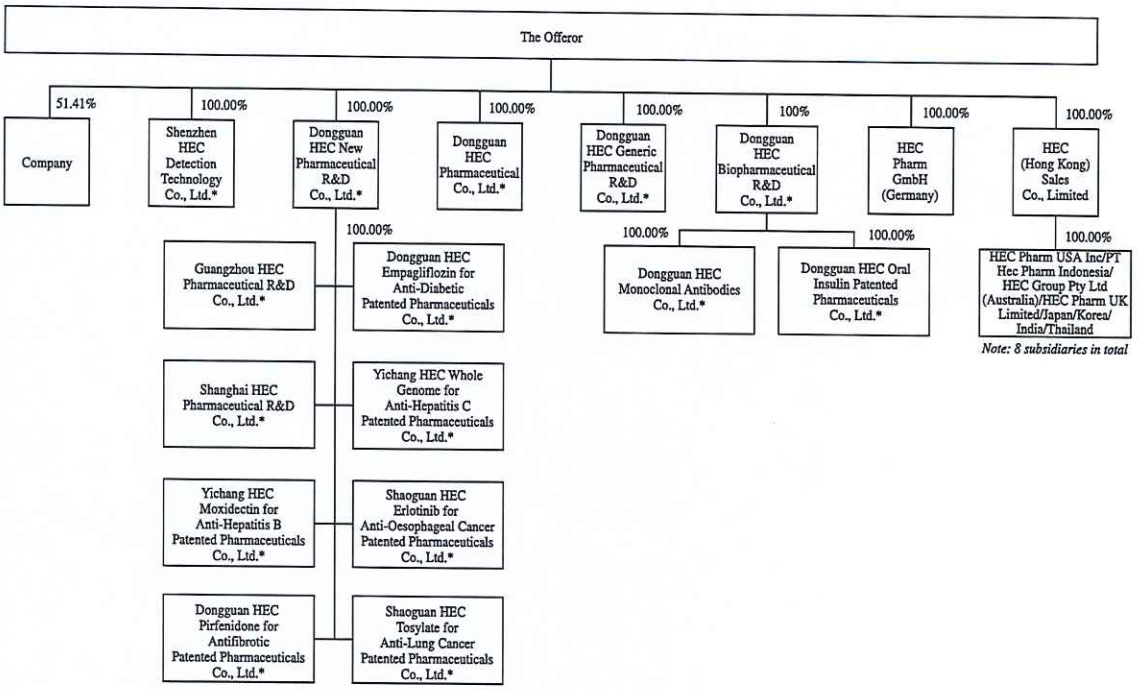


**Table 1 — List of 25 subsidiaries of the Offeror**

| Number | Company name | Principal business |
|---|---|---|
| 1 | Shenzhen HEC Detection Technology Co. Ltd.* (深圳市東陽光檢測技術有限公司) | Pharmaceutical testing business |
| 2 | Dongguan HEC New Pharmaceutical R&D Co., Ltd.* (東莞市東陽光新藥研發有限公司) | No principal business |
| 3 | Guangzhou HEC Pharmaceutical R&D Co., Ltd.* (廣州東陽光醫藥研發有限公司) | Clinical business in Guangzhou |
| 4 | Shanghai HEC Pharmaceutical R&D Co., Ltd.* (上海東陽光醫藥研發有限公司) | Clinical business in Shanghai |
| 5 | Yichang HEC Moxidectin for Anti-Hepatitis B Patented Pharmaceuticals Co., Ltd.* (宜昌東陽光莫非賽定抗乙肝專利新藥有限公司) | Project company has no principal business |
| 6 | Dongguan HEC Pirfenidone for Antifibrotic Patented Pharmaceuticals Co., Ltd* (東莞市東陽光伊非尼酮抗纖維化專利新藥有限公司) | Project company has no principal business |
| 7 | Shaoguan HEC Tosylate for Anti-Lung Cancer Patented Pharmaceuticals Co., Ltd* (韶關市東陽光寧格替尼抗肺癌專利新藥有限公司) | Project company has no principal business |
| 8 | Shaoguan HEC Erlotinib for Anti-Oesophageal Cancer Patented Pharmaceuticals Co., Ltd* (韶關市東陽光萊洛替尼抗食道癌專利新藥有限公司) | Project company has no principal business |
| 9 | Yichang HEC Whole Genome for Anti-Hepatitis C Patented Pharmaceuticals Co., Ltd.* (宜昌東陽光全基因抗丙肝專利新藥有限公司) | Project company has no principal business |
| 10 | Dongguan HEC Empagliflozin for Anti-Diabetic Patented Pharmaceuticals Co., Ltd.* (東莞市東陽光榮格列淨抗糖尿病專利新藥有限公司) | Project company has no principal business |
| 11 | Dongguan HEC Pharmaceutical Co., Ltd.* (東莞東陽光製藥有限公司) | No principal business |
| 12 | Dongguan HEC Generic Pharmaceutical R&D Co., Ltd.* (東莞市東陽光仿製藥研發有限公司) | Research and development of generic drugs |

| Number | Company name | Principal business |
|---|---|---|
| 13 | Dongguan HEC Biopharmaceutical R&D Co., Ltd.* (東莞市東陽光生物藥研發有限公司) | Research and development of biopharmaceutical drugs |
| 14 | Dongguan HEC Monoclonal Antibodies Co., Ltd.* (東莞市東陽光單抗生物藥有限公司) | Research and development of monoclonal antibodies |
| 15 | Dongguan HEC Oral Insulin Patented Pharmaceuticals Co., Ltd.* (東莞市東陽光口服胰島素專利新藥有限公司) | Project company has no principal business |
| 16 | HEC (Hong. Kong) Sales Co., Limited ("香港東陽光銷售公司") | Sales of overseas pharmaceutical products. |
| 17–24 | HEC Pharm USA Inc./PT Hec Pharm Indonesia/HEC Group Pty Ltd (Australia)/ HEC Pharm UK Limited/Japan/Korea/India/ Thailand | Sales of overseas pharmaceutical products. |
| 25 | HEC Pharm GmbH (Germany) | Sales of overseas pharmaceutical products. |

Thus, we determined that the asset-based approach was the most appropriate valuation approach to value the 25 wholly-owned subsidiaries of the Offeror and we have applied the adjusted net assets value method under the asset-based approach in this valuation by considering the assets and liabilities of the 25 subsidiaries.

Apart from the asset-based approach, we adopted market approach for the Long-term Equity Investment and income approach for the Pipeline Products.

*(i) Long-term Equity Investment*

Given that the Shares are listed on the Stock Exchange, we are of the view that the market price reflects the willingness of buyers and sellers to transact at a particular price, making it an objective and representative measure of the investment's value. We have adopted the 90-trading day timeframe which allows us to consider the medium-term perspective, looking beyond short-term fluctuations.

*(ii) Intangible assets and development expenditure — Pipeline Products*

We understand from the Management that capitalised development expenditure are mainly for the Pipeline Products. As the Pipeline Products are expected to generate income benefit streams in the future, by which the value of the Pipeline Products is determined, we consider that the income benefit streams could be valued as intangible assets. The capitalised development expenditure would be assigned nil value as its value is included in the valuation of the Pipeline Products.

The income benefit streams of the Pipeline Products could be identified based on projected cash flows prepared by the Management. Therefore, we consider income approach is applicable for the Pipeline Products.

The Exchange Rate of HK$1 = RMB0.90765 as at 8 March 2024, being the market reference date (the "**Market Reference Date**") prior to the date of this Valuation Report for the purpose of ascertaining certain information contained in this Valuation Report was applied in our calculations.

## IV. INFORMATION OF THE OFFEROR

### 1. Overview of the Offeror

The Offeror was established in 2003. It is an integrated pharmaceutical company driven by independent R&D, rooted in China and opened to the world. It has comprehensive strength in R&D, production and sales. The Offeror focuses on the three key areas of infectious diseases, chronic diseases and oncology. In particular, according to the industry data collected by Frost & Sullivan, Kewei (oseltamivir phosphate), the core product in the anti-infectious field, has a leading position in the influenza market with a market share of approximately 69.8% of China's anti-influenza drug market in 2022. With its rich pipeline of anti-infective drugs, it has been approved by the Ministry of Science and Technology of the PRC to establish a State Key Laboratory of Anti-Infective Drug Development. The Offeror focuses on innovative drugs and is also involved in modified new drugs, generic drugs and biosimilars. It currently has a diversified and large product portfolio and a sustainable development pipeline. After over 20 years of experience accumulation, the Offeror has established a leading R&D platform, international standard production capacity and a global sales network. The Offeror has been named in the Top 20 of "China Drug Research and Development Comprehensive Strength Ranking" published by Yaozh.com, for seven consecutive years since 2017. In 2023, it was successfully selected as one of the "Top 100 Competitive Enterprises in Chinese Pharmaceutical Industry" and ranked at the top of the list of the "Top 100 Chinese Pharmaceutical Innovators for 2023" released by Healthcare Executive Magazine.

The Offeror is committed to developing products that are first-of-its-kind or best-in-class with breakthrough potential in the global market. It has built outstanding R&D capabilities and created a diversified and robust pipeline portfolio with broad and deep indication coverage through differentiated molecular design and comprehensive technology platforms. The Offeror has formed a large-scale,

professional and comprehensive R&D team with more than 1,200 personnels as of 31 March 2024, and has established a comprehensive and integrated independent R&D system and a R&D platform covering the complete development cycle of large and small molecule drugs. Its R&D capabilities are independent and systematic, which enables the Offeror to swiftly advance its drugs under development to commercialisation. As of 31 March 2024, the Offeror has 146 approved drugs in the world, including in China, the United States and Europe, more than 100 drugs in the pipeline, including 45 Class I Innovative Drugs candidates among which three are under the NMPA's review for launching in China and 10 are in Phases II or III of clinical trials. The Offeror is one of a handful of PRC pharmaceutical companies who has successfully launched one Class I Innovative Drug and applied for the launch of three Class I Innovative Drugs through in-house R&D. The Offeror attaches great importance to the protection of core technologies. Its patents cover new drug compounds, protein molecular structures, manufacturing processes, usage and preparation formulation, providing a sufficient and long-life patent protection strategy for the Offeror's products. As of 31 December 2023, the Offeror had applied for a total of 2,306 invention patents, including 350 Patent Cooperation Treaty (PCT) applications, 1,076 domestic invention patents, and 880 overseas invention patents; among them, a total of 1,260 invention patents have been granted by the relevant patent authorities, including 651 domestic invention patents and 609 overseas invention patents. According to Frost & Sullivan, the Offeror ranked first among PRC pharmaceutical companies in the number of patents published and the number of authorised patent announcements in China between 1 January 2014 and 31 December 2023, and the Offeror ranked 44th in the world and 4th in China in terms of the number of public invention patent applications for the global biomedical industry in 2022.

As of 31 December 2023, the Offeror has two high-standard production bases in Songshan Lake, Dongguan, Guangdong and Yidu, Hubei, covering a total area of more than 1,300 mu, covering the entire pharmaceutical production process in respect of the formulation production. It has production capabilities for tablets, capsules, granules, dry suspensions and freeze-dried powder injections. The Offeror has also formed a pharmaceutical production and quality management system with international standards, aiming to provide high-quality medicines and laying the foundation for the subsequent sales of the Offeror's products in overseas jurisdictions.

The Offeror has an extensive global sales network, covering the Chinese mainland market, European market, North American market and other areas of the world. In the domestic market, as of 31 December 2023, the Offeror has a nationwide sales and distribution network and more than 1,788 professional sales personnels, covering 32 provincial-level regions and nearly 300 prefecture-level cities. The Offeror extensively covers more than 2,400 Class III Hospitals, more than 8,900 Class II Hospitals and more than 65,000 Class I Hospitals in the PRC as well as many large-scale national or regional pharmacy chains.

As at the date of the joint announcement, the Offeror has a total issued share capital of 463,943,215 ordinary shares. The Offeror has no other relevant securities (as defined in Note 4 to Rule 22 of the Takeovers Code) as at the date of the joint announcement. The ultimate controlling shareholders of the Offeror are Ms. Guo Meilan and her son Mr. Zhang Yushuai, who together controlling approximately 62.12% equity interests in the Offeror as at the date of the joint announcement.

Please refer to section 7(1) headed "Information on the Offeror" in the Joint Announcement for further details of the Offeror.

## 2. Financial highlights of the Offeror

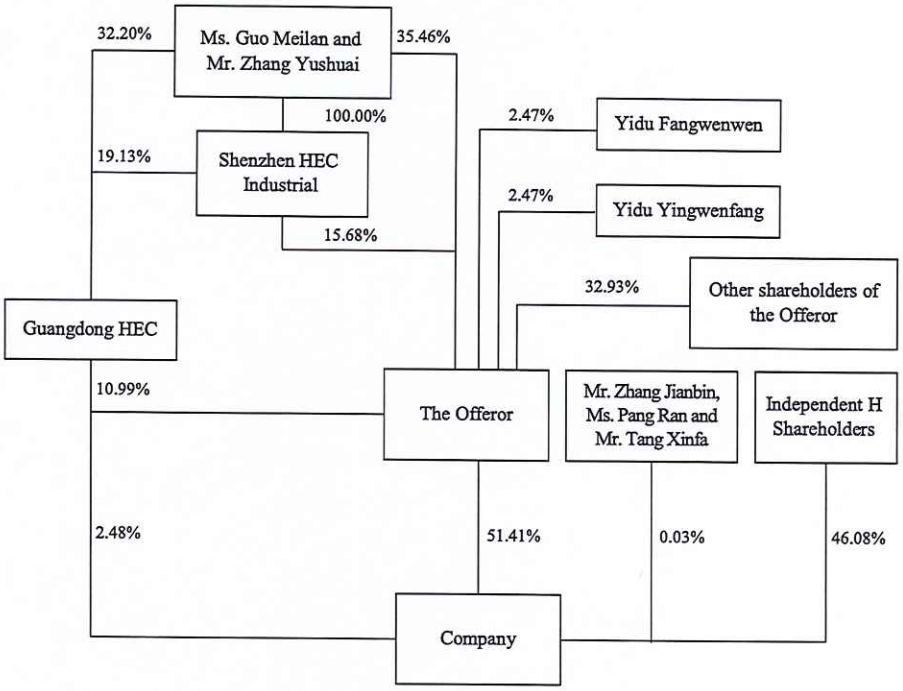
| | **FY2023** (unaudited) *(RMB Million)* | **FY2022** (unaudited) *(RMB Million)* |
|---|---|---|
| Revenue | 6,386 | 3,814 |
| Profit/(loss) for the year | 1,014 | (1,416) |
| | | |
| Non-current assets | 6,246 | 6,538 |
| Property, plant and equipment | 3,732 | 3,528 |
| Intangible assets | 1,605 | 1,915 |
| Current assets | 6,412 | 4,151 |
| Inventories | 529 | 366 |
| Cash and cash equivalents | 1,920 | 972 |
| Non-current liabilities | 2,330 | 2,605 |
| Current liabilities | 6,153 | 8,958 |
| Total equity/(deficit) | 4,175 | (874) |

For the year ended 31 December 2023, the Offeror recorded revenue of approximately RMB6,386 million, representing an increase of approximately 67.44% as compared with the that of the previous financial year. The net profit for the year of the Offeror recorded approximately RMB1,014 million for the year ended 31 December 2023, reversing the loss of approximately RMB1,416 million as at 31 December 2022.

As at 31 December 2023, the Offeror had cash and cash equivalents of approximately RMB1,920 million, registered an increase of approximately 97.65% as compared with approximately RMB972 million as at 31 December 2022. The net asset value attributable to shareholders of the Offeror was approximately RMB4,175 million as at 31 December 2023, reversing the deficit of approximately RMB874 million as at 31 December 2022.

### 3. Shareholding structure

The diagram below shows the existing shareholding structure of the Offeror.




* *Most of the other subsidiaries are wholly-owned by the Offeror.*

## V. INFORMATION OF THE COMPANY

### 1. Overview of the Company

The Company is a pharmaceutical manufacturing company that focuses on the production, sales and development of pharmaceutical products in the therapeutic areas of anti-infectives, endocrine and metabolism. The ultimate controlling Shareholders owners of the Company are Ms. Guo Meilan and her son Mr. Zhang Yushuai as they control approximately 62.12% interests in the Offeror, which in turn controls approximately 51.41% interests in the Company.

Please refer to section 8(3) headed "Information on the Company" in the Joint Announcement for further details of the Company.

## 2. Financial highlights of the Company

| | FY2023 (audited) *(RMB'000)* | FY2022 (audited) *(RMB'000)* |
|---|---|---|
| Revenue | 6,294,585 | 3,744,952 |
| Gross profit | 4,985,764 | 2,846,074 |
| Profit for the year | 1,855,826 | 49,239 |
| Non-current assets | 6,691,273 | 6,875,780 |
| Fixed assets | 3,740,424 | 3,518,765 |
| Intangible assets | 2,565,626 | 2,920,646 |
| Current assets | 6,065,056 | 5,014,020 |
| Inventories | 409,050 | 315,027 |
| Cash and cash equivalents | 1,674,413 | 923,543 |
| Non-current liabilities | 476,596 | 879,018 |
| Current liabilities | 4,332,220 | 4,940,781 |
| Total equity | 7,935,513 | 6,070,001 |

For the year ended 31 December 2023, the Company had revenue of approximately RMB6,294.6 million, representing an increase of approximately 68.1% as compared with the previous financial year. Net profit for year recorded RMB1,855.8 million for the year ended 31 December 2023, increased by approximately 3,669.0% from RMB49.2 million for the year ended 31 December 2022.

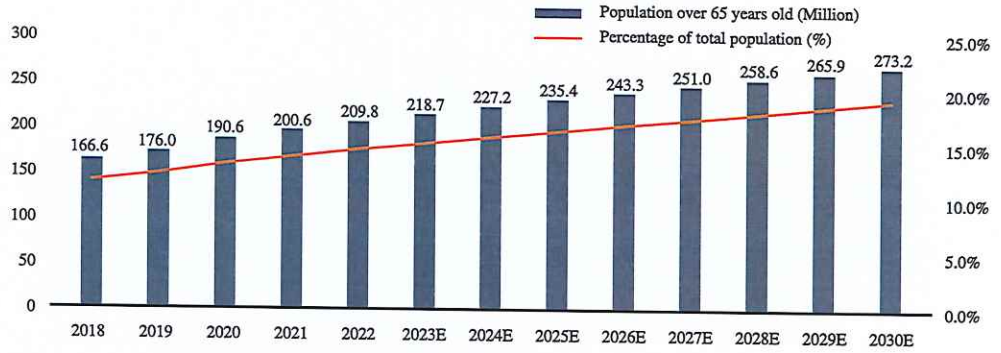
As at 31 December 2023, the Company had cash and cash equivalents of approximately RMB1,674.4 million, an increase of approximately 81.3% as compared with approximately RMB923.5 million as at 31 December 2022. The net asset value attributable to shareholders was approximately RMB7,935.5 million as at 31 December 2023, approximately 30.7% comparing with approximately RMB6,070.0 million as at 31 December 2022.

# VI. OVERVIEW OF PHARMACEUTICAL MARKET

## 1. Pharmaceutical market in China

The pharmaceutical market in China has been expanding rapidly, driven by factors such as an aging population, increasing healthcare expenditure, rising middle-class incomes, government initiatives to improve healthcare access, the decline in birth rate of newborns and the increase in life expectancy, the gaining trend of the Chinese population is accelerating. From 2018 to 2022, the ageing of the Chinese population continued to intensify, with approximately 209.8 million people over 65 years old in 2022. This number is expected to reach approximately 243.3 million by 2026, growing at a compounded annual growth rate of approximately 3.77% from 2022 to 2026. China's ageing population is expected to reach approximately 273.2 million by 2030, accounting for approximately 19.57% of the total population.

**Chart 1: China ageing population trend, 2018–2030E**

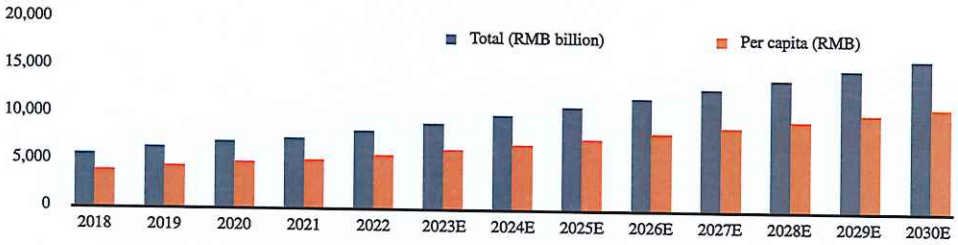



*Source: National Bureau of Statistics and Frost and Sullivan*

China's total health expenditure has been increasing significantly over the years as the country focuses on improving healthcare access and quality for its population. China's total health expenditure has been growing at a robust rate, driven by factors such as population growth, urbanisation, aging population, and increased healthcare needs. The Chinese government has been increasing its healthcare budget to meet these demands and actively investing in healthcare infrastructure, facilities, and services. It has implemented several healthcare reform initiatives to enhance healthcare access, including the establishment of primary healthcare centers, the expansion of healthcare insurance coverage, and the implementation of the "Healthy China 2030 plan"* (健康中國2030規劃綱要).

The demand for medical and health services in China is on the rise due to the increasing prevalence of adult diseases at younger ages. As a result, health expenditure per capita in the country has been experiencing rapid growth. According to the National Bureau of Statistics, from 2018 to 2021, health expenditure per capita increased from approximately RMB4,206.7 to approximately RMB5,348.1, reflecting a compound annual growth rate of approximately 8.33%. Projections indicate that by 2025 and 2030, health expenditure per capita is expected to reach approximately RMB7,723.7 and approximately RMB11,242.8, respectively, with a compound annual growth rate of approximately 7.80%.

**Chart 2: China health expenditure, 2018–2030E**

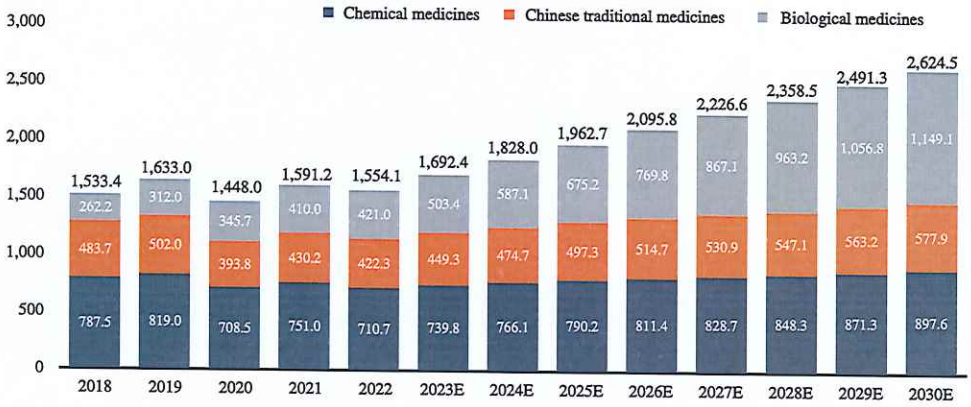



*Source: National Bureau of Statistics and Frost and Sullivan*

During the period from 2018 to 2021, China witnessed a substantial increase in total healthcare expenditure, rising from approximately RMB5.9 trillion to approximately RMB7.6 trillion, reflecting a compound annual growth rate of approximately 8.54% during the period. This upward trend is projected to continue in the future, with China's total health expenditure expected to reach approximately RMB11.0 trillion by 2025 and approximately RMB16.3 trillion by 2030.

From 2018 to 2022, the total size of China's pharmaceutical market increased from approximately RMB1,533.4 billion to approximately RMB1,554.1 billion, with a compound annual growth rate of approximately 0.34%. It is expected to reach approximately RMB2,095.8 billion in 2026 and approximately RMB2,624.5 billion in 2030.

**Chart 3: China medical market, 2018–2030E**




*Source: National Bureau of Statistics and Frost and Sullivan*

In 2022, the chemical medicines market dominated the China medical market, with a value of approximately RMB710.7 billion, representing approximately 45.73% of the total market. The remaining market share is divided between the biological medicines market and Chinese traditional medicines. However, projections indicate a shift in the future years, with the biological medicines market expected to surpass the chemical medicines market. By 2027, the biological medicines market is anticipated to reach a value of approximately RMB867.1 billion, accounting for approximately 38.94% of the total market.

## 2. Driving forces of China's pharmaceutical market development

### *(i) Improvement of people's health awareness and medical expenditure*

China's medical expenditure has been on the rise, driven by the improved health awareness of its population and the increase in residents' disposable income. This shift in focus from merely treating diseases to a more holistic approach of long-term comprehensive health management, along with the prevention and treatment of complications, has been observed with the progress of people's health awareness. The 2020 Report on the Status of Nutrition and Chronic Diseases* (中國營養與慢性病狀況報告(2020年)) in China highlights a significant increase in the proportion of individuals regularly monitoring health indicators such as weight, blood pressure, blood sugar, and blood lipids. This growing health consciousness among patients with chronic diseases is expected to contribute to the development of China's pharmaceutical market to a certain degree.

### *(ii) Growing demand for chronic disease management due to ageing*

China's economic and social development, along with advancements in health services, have led to a continuous increase in life expectancy per capita. Consequently, the survival period for patients with chronic diseases like diabetes, cardiovascular diseases, and cerebrovascular diseases has significantly lengthened. Additionally, factors such as an aging population, urbanisation, industrialisation, and lifestyle changes have contributed to a notable rise in the incidence of chronic diseases in China. As a result, the number of patients with chronic diseases has been expanding steadily, which in turn drives further growth in the related pharmaceutical market.

### *(iii) Government policy support*

The Chinese government has implemented a range of policies in recent years to foster the growth of the pharmaceutical industry. In October 2019, the National Development and Reform Commission introduced the Industrial Structure Adjustment Guidance Catalogue (2019 Edition)* (產業結構調整指導目錄(2019年本)) which, for the first time, included the development and production of new drugs with independent intellectual property rights and the production of generic drugs for the prevention and treatment of major diseases in China. These industries were listed among those encouraged for development.

Furthermore, the "14th Five-Year Plan" outline, released by the National People's Congress in March 2021, identifies biopharmaceutical technology innovation and antibody drug research and development as frontier areas of scientific and technological research. These initiatives aim to establish a new pillar in the industrial system. The outline also emphasises the need to expedite the growth of biomedicine and other industries to further enhance the bioeconomy's size and strength. The introduction of various innovation incentives by the government has provided a significant boost to the pharmaceutical industry's development and innovation efforts.

*(iv) Expansion of health insurance coverage*

As medical reform progresses, the accessibility of healthcare services in China has been steadily enhancing. The Chinese government has prioritised investments in the construction and modernisation of medical infrastructure, as well as the expansion of medical insurance coverage. According to the Chinese Pharmaceutical Association, there has been a consistent increase in the proportion of medical insurance drugs within the drugs utilised by medical institutions since 2018. This trend has further solidified the dominant position of medical insurance drugs, resulting in improved rationality in clinical drug usage. Simultaneously, the inclusion of innovative drugs in medical insurance has been accelerated, significantly reducing the approval cycle and enhancing patient accessibility to these medications.

**3. Development trend of China's pharmaceutical market**

*(i) Increased access to medications*

In 2022, the State Council of China issued the Opinions on Deepening the Reform of the Medical Security System* (關於深化醫藥衛生體制改革的意見), which outlines the importance of enhancing the basic medical insurance system. The document emphasises the need to establish a comprehensive and inclusive medical insurance system and policy framework that covers all citizens in accordance with the law. It also highlights the importance of unifying the medical insurance catalog and standardising medical insurance payment processes.

Medical insurance payment serves as a crucial mechanism to ensure that citizens can avail themselves of high-quality medical services. To adapt to the advancements in innovative pharmaceutical research and development technology and meet the clinical needs of the population, the dynamic adjustment mechanism of the medical insurance catalog is being optimised and improved. This ensures that drugs with significant clinical value and excellent economic evaluation are included in the scope of medical insurance, enhancing patients' accessibility to clinically beneficial medications.

*(ii) Accelerated expansion of the innovative drug market*

In 2021, several key departments, including the Ministry of Industry and Information Technology, the National Health Commission, the National Health Insurance Administration, and the State Food and Drug Administration, collaborated to issue the "14th Five-Year Plan for the Development of the Pharmaceutical Industry"* ("十四五"國家藥品安全及促進高品質發展規劃). This plan highlights the significant progress made during the "13th Five-Year Plan" period, with traditional pharmaceutical companies accelerating their innovation and transformation efforts. The number of innovative pharmaceutical companies has also seen a notable increase, accompanied by a rise in the number of new drugs entering the clinical stage and a surge in research and development investments. Driven by a range of incentive policies promoting innovation-driven transformation, the pharmaceutical industry is

poised to continue its investment in innovation, expedite transformation processes, and facilitate sustained growth in the number of new drugs entering the clinical stage. Furthermore, the plan sets forth a target for the "14th Five-Year Plan" period, aiming for an average annual growth rate of research and development investment across the entire industry of over 10.00%. This strategic focus will contribute to the emergence of transformative innovative drugs and therapies, fostering the continuous expansion of China's drug market.

*(iii) Research and development of innovative drugs that meet clinical needs*

Chronic diseases, including diabetes, have emerged as the leading cause of death in China, and their prevalence is escalating due to the aging population. The State Council's Report on the Status of Nutrition and Chronic Diseases in China (2020)* (中國營養與慢性病狀況報告(2020年)) reveals that chronic diseases accounted for approximately 88.50% of all deaths in China in 2019. Furthermore, as the population continues to age, the incidence of new cancer cases is projected to rise, highlighting the increasing demand for anti-tumor drugs. This industry landscape propels the acceleration of technological innovation in the field of anti-tumor drugs to cater to the evolving clinical requirements of tumor treatments. Simultaneously, the misuse of anti-infective drugs is contributing to the surge in drug resistance. Coupled with growing consumer health awareness, the use of anti-infective drugs is becoming more cautious, with consumers seeking safer, more effective, and reliable alternatives. Presently, the government places greater emphasis on drug treatments for diseases with significant clinical burdens such as diabetes, cardiovascular and cerebrovascular diseases, central nervous system diseases, tumors, and infections. In the future, the development of innovative drugs in China will prioritise medications that meet the criteria of safety, long-term efficacy, patient compliance, and comprehensive benefits. These innovative drugs will occupy a significant position in the research and development landscape, aligning with the evolving needs of the population.

**4. Pipeline Products of the Offeror**

The Offeror's products are primarily developed through independent research and development. The pipeline is rich and focuses on innovative drugs, innovative formulations, and high-end generics in the areas of infection, oncology, and chronic diseases. As of the end of 2023, the Offeror had a portfolio of 112 marketed products and 100 products in the pipeline, and 10 drugs were in phase II and III clinical trials as at the end of 2023.

## VII. OVERALL VALUATION OF THE OFFEROR

### 1. Valuation Assumptions

#### *(i) General assumptions*

a. It is assumed that there are no force majeure factors and unforeseeable factors that will have a material adverse impact on the Offeror's continuous operation.

b. It is assumed that the business scope (operation scope), operation model, product structure and decision-making procedures of the Offeror are basically consistent with those currently in place based on the existing management mode (model) and management level, and the future development trend of its business is basically consistent with the development trend of the industry in which it operates as at the Market Reference Date.

c. It is assumed that the operator of the Offeror is responsible and its management is capable of performing its duties and responsibilities.

d. It is assumed that all business-related qualifications of the appraised entity can successfully obtain the approval of relevant authorities after the expiration of the validity period, and the industry qualifications will remain valid.

e. The Offeror is currently involved in a pending legal action. The pending legal action is a lawsuit on the basis of copyright infringement and the Offeror is one of the defendants. It is pending judgement from the court of first instance. The plaintiff of the pending legal action has claimed approximately RMB50,000,000. We do not consider this potential claim amount is material because the product, which is the subject of the pending legal action, is not one of the main products of the Offeror. Based on our discussion with the management of the Offeror and KPMG, the reporting accountants of the Offeror, the accrued provision for the potential outcome of the legal proceedings is sufficient as Dongguan HEC New Pharmaceutical R&D Co., Ltd, an indirect substantial shareholder of the Offeror, has indemnified the Offeror for any potential claims or damages resulting from the pending legal action. Therefore, it is assumed that the main operating assets and businesses of the appraised entity are free from material legal disputes and obstacles, and the property rights of the assets are clear.

f. It is assumed that the enterprise will maintain its existing credit policy and will not encounter any major problem of fund recovery in the future.

g. It is assumed that the contracts and agreements entered into by the appraised entity in previous years and the current year are valid and enforceable.

h. It is assumed that the Offeror fully complies with all relevant current laws and regulations.

*(ii) Specific assumptions for income approach*

a. Assumption of continuous use of assets: continuous use assumption is an assumption of the conditions of the market where the assets are intended to enter and the status of the assets under such market conditions. Firstly, the appraised assets associated with the Pipeline Products are in use, and secondly, it is assumed that the assets associated with the Pipeline Products will continue to be used.

b. Enterprise going concern assumption: the production and operation of the appraised entity associated with the Pipeline Products can continue to operate in its current condition, and there will be no material changes in its operating conditions in the foreseeable operating period (i.e. 10 years).

*(iii) Valuation of restricted conditions*

The valuation results from three different approaches are derived from the evaluation of various factors. The asset-based approach considers the value, book value, and appraisal value of assets and liabilities of the Offeror (excluding the Long-term Equity Investment and the Pipeline Products). The market approach focuses on the market price of the Long-term Equity Investment. Lastly, the income approach estimates the present value of the income benefit streams generated by the Pipeline Products. By utilizing these three approaches, a comprehensive assessment of the valuation is obtained, considering different aspects of the assets, liabilities, and income potential.

Based on the assumption of an open market, the appraised value does not consider the impact of potential price fluctuations in special transactions, nor does it consider the influence of macroeconomic changes, natural forces, or other force majeure events on the asset price.

The valuation results in this Valuation Report are based on the above assumptions and limitations. When the above valuation assumptions and limitations change significantly, the valuation results will be invalid.

## 2. Asset-based approach

### *(i) Application of specific valuation methods for various assets and liabilities under the asset-based approach*

As the Offeror has provided the list of main assets of the Offeror which are normally used or in use, and the replacement value of the relevant assets of the Offeror is easily accessible and the depreciation can be reasonably predicted, the asset-based approach is suitable for this valuation excluding the Pipeline Products.

### *(ii) Valuation of current assets*

*a. Monetary funds*

Monetary funds include bank deposits and other monetary funds. For non-foreign currency accounts, the appraised value is determined based on the verified book value. For foreign currency accounts, the appraised value is determined by multiplying the foreign currency exchange rate on the Market Reference Date by the book value of foreign currency.

*b. Bills receivables*

Bills receivable are non-interest bearing bank acceptance bills. The appraised value is determined based on the verified book value.

*c. Trade and other receivables*

On the basis of verification, the appraised value of various receivables is determined based on the amount of each payment that may be recovered. For the receivables that are believed to be fully recoverable with reasons, the appraised value is calculated based on the entire amount of receivables; for the amounts that may be partially unrecoverable, in the event that it is difficult to determine the amount of unrecoverable accounts, the amounts are estimated based on the historical information and on-site investigation, specifically analysing the amount, time and reason of the arrears, recovery of the amounts, the funds, credit, operation and management status of the debtors, and with reference to the ageing analysis method, and the appraised value is calculated after deducting the risk loss; for those that have conclusive evidence that they are unable to be recovered, the appraised value is zero; as the aforementioned calculation of trade and other receivables has taken provision for bad debts and the deduction of risk loss into consideration, the Offeror's subsidiaries have made provisions for all receivables. Therefore, the appraised value of "provision for bad debts" items of the accounts is zero.

d. *Prepayments*

The valuation of prepayment is based on the accounting treatment as to determine if the value of assets or rights of the corresponding goods that can be recovered. We have also discussed with the Management and understand that, historically, the Offeror has not experienced any recoverability issues involving the prepayment. Therefore, the verified book value is taken as the appraised value.

e. *Inventories*

Inventories evaluated include materials procurement (material in transportation), raw materials, work in progress, finished goods and goods delivered. Based on the spot check and verification of the reported quantity and amount, the estimations are as follows:

For materials procurement and raw materials, the replacement cost method is adopted which is based on the prevailing market prices of various materials, plus reasonable transportation and miscellaneous expenses and other reasonable expenses, multiplied by the actual quantity and recognised as the appraised value.

For semi finished products, on the basis of verification, considering that the production cycle is short, the enterprise records the actual cost. The cost comprised raw materials used for production, and the book value can basically be reflected in the current value of the products. Therefore, the verified book value is recognised as the appraised value.

For finished products, the appraised value is determined by multiplying the verified quantity by the prevailing market selling price after deducting reasonable sales costs, taxes and appropriate profits.

***(iii) Valuation of long-term equity investments***

a. For the Long-term Equity Investment, the book value is replaced by the value obtained from the market approach, details of which are set out below in section "3. Market approach for the Long-term Equity Investment";

b. For the Offeror's interests in subsidiaries (other than the Company), we conducted an overall asset appraisal based on their operation condition:

(i) for the 9 subsidiaries have assets but do not have any principal business activities, we conducted an overall asset appraisal;

(ii) for the remaining subsidiaries, except Shenzhen HEC DT, they are currently in operation but are experiencing losses, we conducted an overall asset appraisal; and

(iii) for Shenzhen HEC DT, since it is not significant cash generating in nature as its revenue and profit only accounts for approximately 0.45% and 0.66% of that of the Offeror, respectively, we conducted an overall asset appraisal.

***(iv) Valuation of fixed assets***

The verified book value is taken as the appraised value in this valuation.

***(v) Valuation of right-of-use assets***

The verified book value is taken as the appraised value in this valuation.

***(vi) Valuation of intangible assets — land use rights***

The verified book value is taken as the appraised value in this valuation.

***(vii) Valuation of intangible assets — other intangible assets***

As at the Market Reference Date, intangible assets — other intangible assets include purchased software and off-book research and development projects recorded in the book.

*a. Purchased software and other intangible assets*

We have reviewed the book value of the software system and estimated the amortisation of the software system based on the market selling price. The estimated value after amortisation is equivalent to the book value. The verified book value is taken as the appraised value in this valuation.

*b. Research and development projects*

The Pipeline Products in the research and development projects are appraised based on income approach, details of which are set out below in section "4. Income approach for the Pipeline Products".

***(viii) Valuation of development expenditures***

In this valuation, the development expenditures are appraised as part of the research and development projects of other assets in intangible assets. The capitalized development expenditure would be assigned nil value as its value is replaced by the valuation of the Pipeline Products.

***(ix) Valuation of other non-current assets***

All other non-current assets are receivables, which we have adopted the same valuation as trade receivable as set out above in the subsection headed c. Trade and other receivables.

*(x) Valuation of liabilities*

Liabilities include short-term borrowings, note payable, accounts payable, contract liabilities, staff emoluments payable, taxes payable, other payables, long-term borrowings, lease liabilities, long-term payables, provisions and deferred income.

*a. Contract liabilities*

The appraised amount is determined according to the subsequent obligations agreed in the contracts and the relevant tax payment obligations. For advances from other non-related parties, as the contract cost cannot be reasonably estimated, the appraised amount is determined based on the verified book value.

*b. Borrowings*

On the basis of verification, the appraised amount is determined based on the amount of principal and interest payable according to actual term of the borrowings.

*c. Accounts and other payable*

On the basis verification and out of the purpose of conservatism, the appraised amount is determined based on the verified book value, except for accounts and other payable aged more than 5 years with non-related parties, which are appraised as nil.

*d. Estimated liability*

As estimated liability only involve the contingent liability under a pending legal action, on the basis verification and out of the purpose of conservatism, the appraised amount is determined based on the verified book value.

*e. Other liabilities*

On the basis of verification, the appraised amount is determined based on the book value.

**3. Market approach for the Long-term Equity Investment**

We have chosen to analyze the Company's stock performance over a 90-trading day period as part of our evaluation of the Long-term Equity Investment. This approach is based on the market's assessment, which reflects the willingness of buyers and sellers to transact at a particular price, making it an objective and representative measure of the investment's value. We have considered the Company's positive profit alert dated 26 July 2023 and the interim results for the six months ended 30 June 2023, which were announced on 31 August 2023. Since then, we have not observed any announcements that significantly impacted the performance of the shares. It is important to note that the market may take time to fully reflect such announcements in stock prices. As the 90-trading day timeframe allows us to consider the medium-term perspective, looking beyond short-term fluctuations, we believe it is reasonable to reference the 90-trading day period for the purpose of valuing the Long-term Equity Investment.

Taking reference to 90-trading day average price of the Shares, which is from 20 October 2023 to 1 March 2024, the last trading day before the Market Reference Date, the estimated value of the Company is approximately RMB7,155.5 million or approximately for RMB8.13 per share (equivalent to approximately HK$8.96 per share based on the Exchange Rate).

As such, the valuation of the Long-term Equity Investment is approximately RMB3,678.6 million.

Moreover, the appraised value above in relation to the Long-term Equity Investment does not constitute an opinion as to the price at which the Offeror H Shares may trade at any point, present or in the future, or represent the value that a holder of the H Shares may realise on any sale, present or in the future, where such a value may be higher or lower than the appraised value above.

**4. Income approach for the Pipeline Products**

Considering that research and development projects, which are the Pipeline Products, are the main business of pharmaceutical research and development enterprises and the main source of future profits of enterprises, the income approach is adopted in this valuation for the Offeror's innovative drugs and biological drugs research and development projects.

In connection with the Pipeline Products, assuming that (i) the future income can be reasonably estimated and measured; (ii) the risks associated with the expected returns can be measured; and (iii) the income period can be determined or reasonably expected, we have adopted income approach by conducting discounted cashflow valuation. The appraisal period of the Pipeline Products is 10 years. We consider the appraisal period of 10 years is reasonable on the following basis:

(i) forecasting accuracy: as the time horizon increases, the uncertainty and difficulty in accurately predicting future cash flows also increase. The longer the appraisal period, the more likely the estimates will be less reliable due to various factors such as changes in the business environment, market conditions, and technological advancements. A 10-year period is often considered a reasonable compromise between capturing long-term value and maintaining a reasonable level of forecasting accuracy;

(ii) business cycles: many businesses and industries experience cyclical patterns that can significantly impact their performance. By using a 10-year period, we aim to capture at least one full business cycle, including periods of expansion and contraction. This allows for a more comprehensive assessment of the investment's potential over different economic conditions; and

(iii) stages of Pipeline Products: The Pipeline Products are anticipated to be listed within the next 1–3 years. Using a shorter evaluation period may not significantly improve the accuracy of the valuation.

Additionally, considering that the Pipeline Products are in various stages of development, their valuation will be affected by the timing of listing and success probabilities. Therefore, the WACC (as defined below) will be used to discount projected pre-listing costs and post-listing revenues for each year and for each Selected Pipeline Products (as defined below).

*(i) Pipeline Products with clinical approvals*

The Pipeline Products that have reached clinical stage (the "**Selected Pipeline Products**", as set out in the table below) are valued mainly based on their expected revenue, research and development expenses, expected commercialisation date and success probability.

**Table 2: Selected Pipeline Products**

| Indication(s) | Name | Latest clinical stage | Success probabilities |
|---|---|---|---|
| **Diabetes** | Guang Jian You* (光健優) | Applying for listing | 93% |
| | Guang Jian Tang* (光健坦) | Pre-clinical phase | 81% |
| | Guang Jian Da* (光健達) | Clinical phase 3/ Clinical phase 1 | 93% |
| | Guang Jian Cheng* (光健成) | Completed Clinical phase 1 | 81% |
| | Guang Jian Bao* (光健寶) | Clinical phase 2/ Completed clinical phase 1 | 61% |
| **Hepatitis** | Dong Antai* (東安泰) | Applying for listing | 90% |
| | Dong Andi* (東安帝) | Clinical phase 3 | 67% |
| **Depression** | Dong Tong Shen* (東通神) | Clinical phase 2/3 | 61% |
| **Esophageal carcinoma** | Dong Ningguan* (東寧冠) | Clinical phase 3 | 67% |
| **Acute myelogenous leukemia** | Dong Ningchun* (東寧春) | Clinical phase 3 | 67% |
| **Idiopathic pulmonary fibrosis** | Dong Jiandi* (東健帝) | Clinical phase 2 | 61% |
| **Cancer-associated anemia** | Dong Ningsheng* (東寧生) | Clinical phase 2 | 61% |
| **Alzheimer's disease** | Injector* (美金剛長效注射劑) | Clinical phase 1 | 52% |
| **Asthma** | Inhalers*吸入噴霧劑 | Pre-clinical phase | 52% |
| **Gastric ulcer** | Vonoprazan Fumarate* 富馬酸伏諾拉生* | Completed clinical phase 1 | 57% |
| **Other** | Other (New drugs) | Clinical phase 1/2 | 47% |

*(ii) Basis of success probabilities of the Selected Pipeline Products*

The Management has provided the expected success probabilities of the Selected Pipeline Products. Having reviewed the average success probabilities of the industry, the reasons provided by the Management and the discussion with the industry adviser, Frost and Sullivan, we have adjusted downward the success probabilities to better reflect the risk nature of the Selected Pipeline Products and be closer to the industry average suggested below.

We have also reviewed the data of average success probabilities of the industry provided by Frost and Sullivan and academic journal (International Journal of Pharmacology, 18 (6): 1137–1150, 2022) which summarized the success probabilities of various stages in China, which are approximately 30%–91%. In addition, we have reference to Frost and Sullivan's report and the average success probabilities of the industry, combined with the different clinical stages of the Pipeline Products, in order to determine the success probabilities. Thus, we consider the success probabilities are reasonable and able to reflect the risk nature of the Selected Pipeline Products. For the success probabilities, of the Selected Pipeline Products, please refer to the table 2 above.

*(iii) Basis of revenue*

Revenue is projected by the estimated number of patients for indication of each Selected Pipeline Products respectively, diagnostic rate, treatment rate, product penetration rate and unit revenue.

*(iv) Basis of cost of sales*

Cost of sales represents the direct cost incurred in the production. According to the Management, the cost of sales for new drugs is higher and then gradually decreases due to scale of economics. We have reviewed the industry average (the "**Industry Average**") and the industry median (the "**Industry Median**") of the Comparable Public Companies (as defined below under the subsection headed "(3) Beta"), which are approximately 21.5% and 20.1%, respectively. Due to the high cost of sales for new drugs and for the purpose of conservatism, the costs of sales will be 25.00% of the projected revenue for the first year of listing for each Selected Pipeline Products, and then drop by 1.00% per year until it reaches 15.00% as we have discussed with Frost and Sullivan and noted that such decrease in percentage is due to scale of economics and in line with industry average in terms of new drugs. Such decrease in costs per year is based on the equal distribution taken into consideration of resource planning and cost management, the assumption of which can assist the company to maintain stability and sustainability in expenses throughout the appraisal period.

*(v) **Basis of operating expenses***

In the financial projection, the operating expenses consist of the following items:

*(1) Tax and surcharge*

Tax and surcharge were projected as a percentage of revenue. It is understood that taxes and surcharges include urban construction and maintenance tax, education surcharge, real estate tax, land use tax, stamp duty, etc., but not corporate income tax. As the tax and surcharge of the Offeror in the past 3 years prior to the appraisal period was 1.41% in average, it is projected to remain stable at approximately 1.41% during the appraisal period.

*(2) Selling expenses*

Selling expenses were projected as a percentage of revenue. We have reviewed the Industry Average and the Industry Median of the selling expenses, which are approximately 31.5% and 32.8%, respectively. We understand from the Management that, the selling expenses of new drugs at first are higher and then gradually drops. Therefore, the selling expense percentage of revenue is projected to be 40.00%, and then drop by 1.00% per year until it reaches 30.00%, which is closer to the industry average.

*(3) Management expenses*

Management expenses were projected as a percentage of revenue. We have reviewed the Industry Average and the Industry Median of the management expenses, which are approximately 9.2% and 8.2%, respectively. The management expense of the Offeror in the past 3 years prior to the appraisal period was approximately 6.53%, 23.29% and 25.73%, respectively and was 18.51% in average. We have discussed with the Management and noted that such high percentages were mainly due to the distortion of the pandemic that leads to the decrease in revenue, which in turn increases the management expenses in terms of the percentage of revenue.

Therefore, we have also reviewed the 2-year period before the pandemic and noted that the average of the management expense in terms of percentage of revenue is approximately 6.25%. We assume that the percentage will drop and resume to the pre-pandemic level. However, for the purpose of conservatism, we suggest that percentage will decrease gradually. we adopted the average of approximately 18.51%, rather than the latest year figure, for the first year of the appraisal period, and then drop by 1.00% per year over the appraisal period of 10 years by which it reaches approximately 8.51%, which is closer to the Industry Average. Besides, although the management expenses should cover the whole business of the Offeror, for the purpose of the valuation, we adopted

activity-based costing, by which we identified the cost of the Selected Pipeline Products and allocated the corresponding management expenses based on their revenue respectively.

*(4) Research and development expenses*

The Management has provided the research and development plan for the Pipeline Products, which includes the budget covering the clinical trial expenses, material costs, salaries, patent registry and maintenance costs, etc. Certain part of the expenses is capitalised into research and development expense on the balance sheet, depending on the clinical trial stage. Based on the prevailing accounting treatment, expenses incurred during the pre-clinical phase to clinical phase 3 of a project are not capitalized. However, during the clinical phase 3 to pre-listing stage, a substantial portion of expenses, typically ranging from 90% to 100%, are capitalized and recorded as research and development expenses on the balance sheet.

*(5) Depreciation and amortisation*

As the depreciation expenses of the fixed assets, not including the research and development projects, in the past 3 years prior to the appraisal period were 7.03% of the beginning balance of the fixed assets in average, they were projected with the assumption that the annual depreciation is 7.03% of the beginning balance of the fixed assets.

As the depreciation and amortisation expenses of the research and development expenses in the past 3 years prior to the appraisal period were 3.43% and 0.05% respectively, they were projected with the assumption that the annual depreciation and amortisation are 3.43% and 0.05%, respectively.

As the depreciation expenses of the fixed assets and the depreciation and amortisation expenses of the research and development expenses are non-cash items, such amounts would be subsequently added back when calculating the cash flow for the year.

***(vi) Basis of capital expenditure***

Capital expenditure represented expenditure to be incurred in the construction of additional production lines and upgrade or replacement of existing fixed assets. Referring to the Management, there is a capital expenditure plan to ensure that the capacity of production lines can match with the future revenue.

*(vii) Working capital requirement*

Working capital mainly includes accounts receivable, prepayment, inventory, bills payable, trade payable, salary payable and tax payable. In order to determine the movement of net working capital, working capital is projected based on the estimation of the Management and historical working capital ratios as follows:

i. Accounts receivables would be collected in approximately 43.28 days;

ii. Prepayment would be exchanged into services or products in approximately 136.58 days;

iii. Inventory would be sold and replaced in approximately 108.89 days;

iv. Bills payables would be paid in approximately 110.95 days;

v. Trade payable would be paid in approximately 110.95 days;

vi. Salary payable would be paid in approximately 160.49 days; and

vii. Tax payable would be paid in approximately 15.64 days.

*(viii) Basis of corporate income taxes*

Referring to the Management, the corporate income tax rate of the Offeror is 15.00% as it is a national high-tech enterprise that enjoys a lower corporate income tax in accordance with "Administrative measures for the determination of high and new technology enterprises"* (高新技術企業認定管理辦法).

*(ix) Other projects of new drugs and biological drugs ("Other (New drugs)")*

Other (New drugs), are the drugs and biological drugs that have entered the clinical stage I or II but are excluded from the Selected Pipeline Products. Despite considering that they are at the early stage of research and development and the research and development cycle is long, from the perspective of cash outflow, their research and development expenses pose impacts on future cash flow. In view of this, we include them into valuation while adjust their success probabilities to approximately 47.00% based on the average industry success probabilities in China from the academic journal (International Journal of Pharmacology, 18 (6): 1137–1150, 2022).

*(x) Determination of discount rate*

We developed weighted average cost of capital (the "**WACC**"), which is based on the cost of equity for this valuation based on data and factors relevant to the economy, the industry as at the Market Reference Date, and the cost of debt based on the Offeror's historical financial information and capital structure.

*a. Cost of Equity*

(1) Modified capital asset pricing model ("**MCAPM**")

MCAPM, as applied to this valuation, can be summarised as follows:

$$Re = R_f + Beta * ERP + RP_u$$

Where

Re: Cost of equity,

$R_f$: Risk free rate;

Beta: A measure of systematic risk;

ERP: Equity risk premium; and

$RP_u$: Specific company adjustment

(2) Risk free rate

Risk free rate was determined by identifying the return yields of the local government bonds. Ideally, the duration of the security used as an indication of risk free rate should match the horizon of the projected cash flows that were being discounted, which was into perpetuity in the present case. Despite the Offeror's intention to pursue a listing in Hong Kong, we relied on the 10-year MOF-China Government Bond Yield, which was 2.28% as at the Market Reference Date according to Ministry of Finance of the PRC, taking into consideration below:

1. Geographic relevance: Since the Offeror's business operations are primarily located in China, it makes sense to use a risk-free rate that reflects the local economic and financial conditions. The MOF-China Government Bond Yield represents the prevailing interest rate on government bonds in China, which is directly tied to the local market and economic factors; and

2. Currency alignment: Using the MOF-China Government Bond Yield ensures consistency in terms of currency. By adopting a risk-free rate based on China's financial market, which operates in RMB, we could align the valuation with the same currency in which the Offeror conducts its business operations. This approach avoids potential inconsistencies that could arise from using a risk-free rate based on a different currency.

By taking into consideration the Offeror's business operations, we have selected the 10-year MOF-China Government Bond Yield as the risk free rate which is more appropriate in the current context. The 10-year MOF-China Government Bond Yield is more align with the Offeror's business operations, which are primarily located in China and directly tied to the local market and economic factors. By using the 10-year MOF-China Government Bond Yield, we aim to capture the risk and market conditions that closely impact the Offeror's operations. We believe that the 10-year MOF-China Government Bond Yield provides a more appropriate basis for the risk free rate. In the event that if the 10-year yield-to-maturity of Hong Kong was adopted as the risk free rate, for illustration purpose, the Appraised value of the Pipeline Products under the base-case scenario would be approximately RMB26,519.3 million, which is lower by approximately 16%.

(3) Beta

In the MCAPM formula, beta is a measure of the systematic risk of a particular investment relative to the market for all investment assets. Due to the business nature of the Offeror is different from the Company, we selected an exhaustive list of comparable companies and obtained betas of nine (9) comparable public companies (the "**Comparable Public Companies**") for this valuation. In order to obtain betas of the Comparable Public Companies, we have collected the historical daily price data for FY2023, including the Hang Seng Index as the benchmark index and the Comparable Public Companies. After calculating the daily returns of the benchmark index Comparable Public Companies, covariance between the daily return of the benchmark index and the Comparable Public Companies, and the variance of the benchmark return, we could obtain the betas which is a measure of systematic risk and represents the stock's sensitivity to market movements. The identified betas have been un-levered to remove the effects of financial leverage on the indication of relative risk provided by the beta, then taken the market capitalisation weighted average, and re-levered at the estimated capital structure of the Offeror in the long run.

As aforementioned, the Comparable Public Companies were selected to compute beta in the determination of cost of equity, we have selected the companies based on the following criteria:

1. pharmaceutical companies listed on the Sock Exchange;

2. companies principally engaged in the production, sale and development of pharmaceutical products;

3. companies focused on drug research and development; and

4. companies that are primarily engaged in retail, distribution, contract manufacturing organisation or contract development and manufacturing organisation are excluded.

The median of market capitalisation weighted average of beta is approximately 0.89 and that of un-levered beta is approximately 0.74.

(4) Equity risk premium

Equity risk premium is the excess return equity investors required to compensate them for taking on relatively higher equity risks above zero risks. We acknowledged the Offeror is planning to seek listing on the Stock Exchange, we have referred to equity risk premium of the Hong Kong stock market published by GuruFocus (GuruFocus, established in Texas, United States in 2024, is a website for stock market research, data and tools, with over 1 million user base, the clientele of which includes, among others, the Wall Street Journal, Fortune, Forbes and BusinessWeek), which is approximately 6.97%, as at the Market Reference Date.

(5) Specific company adjustment

Specific company adjustment for unsystematic risk attributable to the specific company is designed to account for additional risk factors specific to this valuation.

In this valuation, considering that the Offeror's businesses comprise both sales of developed products, which are generating income stream and track records, and research and development projects, which involve the development of innovative drug candidates and as such consist of uncertainty regarding the future income stream. To address these concerns, we have examined analyst reports on pharmaceutical companies in PRC and Hong Kong that have a similar business nature of the Offeror issued by various brokers within 6 months. They in general recommend incorporating a company-specific adjustment ranging from 0.00% to 6.00% as a risk premium in valuation for pharmaceutical companies. Following discussions with the Management, we consider a specific company adjustment of 3.00% risk premium in this valuation is appropriate, which represents a market mid-point average.

*b. Cost of debt*

The cost of debt is the effective interest expense over the total amount of interest-bearing debt, which was 7.63% based on the unaudited report of the Offeror for FY2023. Using FY2023 data, the forecasted cost of debt can be determined with the highest degree of accuracy.

*c. WACC*

The WACC, as applied to this valuation as discount rate, can be summarised as follows:

$$WACC = \text{Re} * \left(\frac{\text{E}}{\text{D}+\text{E}}\right) + Rd * \left(\frac{D}{D+E}\right) * (1 - Tax\ rate)$$

Where WACC: Weighted average cost of capital;

Re: Cost of equity

E: Total amount of shareholders' equity

D: Total amount of interest-bearing debt

Rd: Cost of debt

Tax rate: 15.00%

For the total amount of shareholders' equity and total amount of interest-bearing debt, we understand from the Management that, within 5 years after listing by introduction, they intend to modify the capital structure of the Offeror that is closer to the Industry Average, which consists of approximately 20% debt and approximately 80% equity. Therefore, we adopted the Industry Average of the capital structure as the estimated capital structure of the Offeror in the long run. The WACC is approximately 9.64%.

***(xi) Determination of value***

To determine total the value of a company's cash flows beyond the projected period, known as the terminal value, there are three commonly used approaches:

1. Exit Multiple Method: This method involves applying a multiple to relevant financial metrics, such as enterprise multiple to estimate the terminal value. However, this method is applicable only to the entire company and not specific product lines.

2. Perpetuity Growth Method: This method assumes that the company's cash flows will continue to grow at a constant rate indefinitely into the future.

3. Liquidation method: This method assumes that the company will cease operations at a point in time in the future and sell the assets it has accumulated to the highest bidders.

Since the exit multiple method and liquidation method are not suitable for evaluating specific product lines and considering our inability to predict the impact and timing of new drug advancements, we can only rely on the perpetuity growth method to obtain the terminal value for the Pipeline Products.

As we adopted the perpetual cash flow model, this model calculates the terminal value by summing up its future cashflow beyond the appraisal period (i.e. 10 years) discounted by the corresponding compounded WACC for each year. It is noteworthy that such assumption of the perpetual cash flow is only applicable to the calculation of the terminal value while the appraisal period remains 10 years and such terminal value is discounted by 10-year compounded WACC.

As required by the perpetuity growth method, we have to assign a long-term sustainable growth rate (the "**Growth Rate**") and we assume to be 1.00% for the purpose of conservatism, whereas it is often to be the expected gross domestic product growth rate in the country of its business and operation.

The formula for calculating the terminal value using the perpetual cash flow model is:

Terminal Value = Cash Flow in the Last Forecasted Year * (1 + Growth Rate) / (WACC – Growth Rate)

After that, we applied WACC to discount the cash flow and the terminal value so as to obtain the valuation.

Based on the investigation and analysis stated above and on the valuation method employed, it was our opinion that the appraised value of the Pipeline Products as at the Market Reference Date was as follows:

As the appraisal period is 10 years which we may capture at least one full business cycle, we have considered the best-case scenario which contains optimistic assumptions about the key variables and the worst-case scenario which contains pessimistic assumptions about the key variables.

Based on our discussion with the Management, the best-case scenario assumes that (i) the gross profit margin improves by 1.00%; and (ii) the operating expenses, including but not limited to tax and surcharge, selling expenses and management expenses, decrease by the range from 0.10%–0.50%.

Based on our discussion with the Management, the worst-case scenario assumes that (i) the gross profit margin deteriorates by 1.00%; and (ii) the operating expenses, including but not limited to tax and surcharge, selling expenses and management expenses, increase by the range from 0.10%–0.50%.

**Table 3 Appraised value of the Pipeline Products as at the Market Reference Date**

| Indication(s) | Product name | Best-case valuation *(RMB million)* | Base-case valuation *(RMB million)* | Worst-case valuation *(RMB million)* |
|---|---|---|---|---|
| **Diabetes** | Guang Jian You* (光健優) | 6,010.80 | 5,659.60 | 5,369.30 |
| | Guang Jian Tan* (光健坦) | 1,196.60 | 1,124.40 | 1,058.80 |
| | Guang Jian Da* (光健達) | 1,448.30 | 1,357.50 | 1,272.60 |
| | Guang Jian Cheng* (光健成) | 2,261.60 | 2,113.10 | 1,974.10 |
| | Guang Jian Bao* (光健寶) | 2,927.60 | 2,725.10 | 2,536.20 |
| **Hepatitis** | Dong Antai* (東安泰) | 4,514.00 | 4,268.00 | 4,047.40 |
| | Dong Andi* (東安帝) | 3,866.50 | 3,627.30 | 3,402.90 |
| **Depression** | Dong Tong Shen* (東通神) | 2,539.60 | 2,380.90 | 2,233.60 |
| **Esophageal carcinoma** | Dong Ningguan* (東寧冠) | 2,169.30 | 2,035.30 | 1,909.70 |
| **Acute myelogenous leukemia** | Dong Ningchun* (東寧春) | 1,164.60 | 1,086.00 | 1,015.30 |
| **Idiopathic pulmonary fibrosis** | Dong Jiandi* (東健帝) | 2,492.10 | 2,337.50 | 2,192.50 |
| **Cancer-associated anemia** | Dong Ningsheng* (東寧生) | 545.7 | 509.3 | 475.5 |
| **Alzheimer's disease** | Injector* (美金剛長效注射劑) | 802.1 | 752.9 | 706.8 |
| **Asthma** | Inhalers* (吸入噴霧劑) | 139.8 | 124.7 | 110.6 |
| **Gastric ulcer** | Vonoprazan Fumarate* 富馬酸伏諾拉生* | 511.3 | 478.8 | 448.3 |
| **Other** | Other (New drugs) | 357 | 294.1 | 235.1 |
| **Total** | | 32,947.00 | 30,874.50 | 28,989.00 |

*Sensitivity Analysis*

The WACC, the Growth Rate, gross profit margin and selling expenses play the pivotal roles in the valuation given their high sensitivity to the appraised value of the Pipeline Products. The appraised value of the Pipeline Products under different combination of the WACC, the Growth Rate, gross profit margin and selling expenses are presented below:

As slight change in the WACC and the Growth Rate will lead to large valuation deviation, we have discussed with the Management and relied on the industry practice. To demonstrate the sensitivity of the valuation to the WACC and Growth Rate, we considered the WACC range of approximately 9.16% to 10.12% (with a deviation of 5.00% from the WACC of approximately 9.64%) and the Growth Rate range of approximately 0.95% to 1.05% (with a deviation of 5.00% from the Growth Rate of 1.00%), the valuation is estimated to range from approximately RMB28,158.7 million to approximately RMB33,987.6 million.

**Table 4 Sensitivity analysis — Change in WACC and Growth Rate to the appraised value of the Pipeline Products**

| | | Growth rate | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | RMB Million | 0.95% | 0.96% | 0.97% | 0.98% | 0.99% | 1.00% | 1.01% | 1.02% | 1.03% | 1.04% | 1.05% |
| WACC | 10.12% | 28,158.70 | 28,185.09 | 28,211.53 | 28,238.03 | 28,264.59 | 28,291.21 | 28,317.89 | 28,344.63 | 28,371.42 | 28,398.27 | 28,425.19 |
| | 10.02% | 28,646.32 | 28,673.49 | 28,700.72 | 28,728.01 | 28,755.35 | 28,782.76 | 28,810.23 | 28,837.76 | 28,865.35 | 28,893.01 | 28,920.72 |
| | 9.93% | 29,145.93 | 29,173.91 | 29,201.95 | 29,230.05 | 29,258.21 | 29,286.44 | 29,314.73 | 29,343.09 | 29,371.51 | 29,399.99 | 29,428.54 |
| | 9.83% | 29,657.91 | 29,686.73 | 29,715.62 | 29,744.57 | 29,773.58 | 29,802.66 | 29,831.81 | 29,861.02 | 29,890.30 | 29,919.64 | 29,949.06 |
| | 9.73% | 30,182.70 | 30,212.40 | 30,242.16 | 30,271.99 | 30,301.88 | 30,331.85 | 30,361.88 | 30,391.98 | 30,422.16 | 30,452.40 | 30,482.71 |
| | 9.64% | 30,720.74 | 30,751.34 | 30,782.01 | 30,812.75 | 30,843.57 | **30,874.45** | 30,905.41 | 30,936.43 | 30,967.54 | 30,998.71 | 31,029.95 |
| | 9.54% | 31,272.47 | 31,304.02 | 31,335.64 | 31,367.33 | 31,399.10 | 31,430.94 | 31,462.85 | 31,494.84 | 31,526.91 | 31,559.05 | 31,591.27 |
| | 9.45% | 31,838.39 | 31,870.92 | 31,903.52 | 31,936.21 | 31,968.96 | 32,001.80 | 32,034.71 | 32,067.71 | 32,100.78 | 32,133.93 | 32,167.15 |
| | 9.35% | 32,419.00 | 32,452.55 | 32,486.18 | 32,519.89 | 32,553.68 | 32,587.55 | 32,621.50 | 32,655.54 | 32,689.65 | 32,723.85 | 32,758.13 |
| | 9.25% | 33,014.82 | 33,049.44 | 33,084.13 | 33,118.91 | 33,153.78 | 33,188.73 | 33,223.76 | 33,258.88 | 33,294.08 | 33,329.37 | 33,364.75 |
| | 9.16% | 33,626.41 | 33,662.13 | 33,697.94 | 33,733.84 | 33,769.82 | 33,805.89 | 33,842.05 | 33,878.30 | 33,914.64 | 33,951.06 | 33,987.58 |

**Table 5 Sensitivity analysis — Change in gross profit margin and selling expenses as percentage of revenue to the appraised value of the Pipeline Products**

In order to demonstrate the sensitivity of the gross profit margin and selling expenses as percentage of revenue in line with the best-case and worst-case scenario, we considered the gross profit margin range of 74.00% to 76.00% (with a deviation of approximately 1.00% around the gross profit margin of 25.00%) and the selling expenses as percentage of revenue range of 39.50% to 40.50% (with a deviation of approximately 0.50% around the selling expenses as percentage of revenue of 40.00%). The valuation is estimated to range from approximately RMB29,487.61million to approximately RMB32,261.3million.

It provides a systematic way of analyzing the sensitivity of the valuation output to different key input parameters according to the best-case and worst-case scenario.

| | | Selling expenses as percentage of revenue | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | RMB Million | 39.50% | 39.60% | 39.70% | 39.80% | 39.90% | 40.00% | 40.10% | 40.20% | 40.30% | 40.40% | 40.50% |
| Gross profit margin | 76.00% | 32,261.29 | 32,163.34 | 32,065.39 | 31,967.44 | 31,869.49 | 31,771.54 | 31,673.59 | 31,575.63 | 31,477.68 | 31,379.73 | 31,281.78 |
| | 75.80% | 32,081.88 | 31,983.93 | 31,885.97 | 31,788.02 | 31,690.07 | 31,592.12 | 31,494.17 | 31,396.22 | 31,298.27 | 31,200.31 | 31,102.36 |
| | 75.60% | 31,902.46 | 31,804.51 | 31,706.56 | 31,608.61 | 31,510.65 | 31,412.70 | 31,314.75 | 31,216.80 | 31,118.85 | 31,020.90 | 30,922.95 |
| | 75.40% | 31,723.04 | 31,625.09 | 31,527.14 | 31,429.19 | 31,331.24 | 31,233.28 | 31,135.33 | 31,037.38 | 30,939.43 | 30,841.48 | 30,743.53 |
| | 75.20% | 31,543.62 | 31,445.67 | 31,347.72 | 31,249.77 | 31,151.82 | 31,053.87 | 30,955.92 | 30,857.96 | 30,760.01 | 30,662.06 | 30,564.11 |
| | 75.00% | 31,364.21 | 31,266.26 | 31,168.30 | 31,070.35 | 30,972.40 | **30,874.45** | 30,776.50 | 30,678.55 | 30,580.60 | 30,482.64 | 30,384.69 |
| | 74.80% | 31,184.79 | 31,086.84 | 30,988.89 | 30,890.94 | 30,792.98 | 30,695.03 | 30,597.08 | 30,499.13 | 30,401.18 | 30,303.23 | 30,205.28 |
| | 74.60% | 31,005.37 | 30,907.42 | 30,809.47 | 30,711.52 | 30,613.57 | 30,515.62 | 30,417.66 | 30,319.71 | 30,221.76 | 30,123.81 | 30,025.86 |
| | 74.40% | 30,825.95 | 30,728.00 | 30,630.05 | 30,532.10 | 30,434.15 | 30,336.20 | 30,238.25 | 30,140.29 | 30,042.34 | 29,944.39 | 29,846.44 |
| | 74.20% | 30,646.54 | 30,548.59 | 30,450.63 | 30,352.68 | 30,254.73 | 30,156.78 | 30,058.83 | 29,960.88 | 29,862.93 | 29,764.97 | 29,667.02 |
| | 74.00% | 30,467.12 | 30,369.17 | 30,271.22 | 30,173.27 | 30,075.31 | 29,977.36 | 29,879.41 | 29,781.46 | 29,683.51 | 29,585.56 | 29,487.61 |

## VIII. CONCLUSION

The market value of the total shareholders' equity of the Offeror as at the Market Reference Date was appraised in accordance with the principles of independence, impartiality and objectivity and necessary valuation procedures. Based on the above valuation work, the following valuation conclusion is reached:

We have taken into consideration that:

a. regarding the Long-term Equity Investment, the valuation is approximately RMB3,678.6 million;

b. regarding the Pipeline Products, referring to Table 3 Appraised value of the Pipeline Products as at the Market Reference Date, the valuation ranges from approximately RMB28,989.0 million to RMB32,947.0 million, with a base case scenario of approximately RMB30,874.5 million;

c. regarding the assets excluding the Long-term Equity Investment and the Pipeline Products, the valuation is approximately RMB–3,723.1 million, due to the deduction of the book value of the Long-term Equity Investment and development expenditure; and

d. the current number of total issued shares of the Offeror is 463,943,215.

By adopting the sum-of-the-parts approach:

a. The book value and appraised value of the total assets of the Offeror were approximately RMB7,897.2 million and approximately RMB36,851.6 million, which includes the valuation for the Long-term Equity Investment and the Pipeline Products, respectively, and the appraised value represents an appreciation of approximately 366.6% of the book value.

b. The book value and appraised value of the total liabilities of the Offeror were approximately RMB6,021.5 million.

c. The market value of the entire shareholders' equity of the Offeror appraised as at the Market Reference Date is approximately RMB30,830.0 million.

Therefore, we are of the view that the total estimated value of the Offeror as of the Market Reference Date is approximately RMB30,830.0 million, with a range from approximately RMB28,944.6 million and RMB32,902.5 million, which implies the theoretical Estimated Value is approximately RMB66.45 per Offeror H Share, with a range from approximately RMB62.39 to RMB70.92 per Offeror H Share (equivalent to approximately HK$73.21, HK$68.74, and HK$78.14 respectively based on the Exchange Rate).

Warning: H Shareholders and potential investors should be aware that, regarding the Pipeline Products, our relevant valuation results contained in our report, in particular under the section headed "Sensitivity Analysis" on page 37 to page 38 of our report, may deviate to a great extent from real life scenario based on different variations in the WACC rate, the Growth Rate, the gross profit margin and selling expenses of the Company.

Yours faithfully,
for and on behalf of
**CHINA SUNRISE CAPITAL LIMITED**

**Larry Chan** *Managing Director*

**Lenny Li** *Executive Director*

*Mr. Larry Chan and Mr. Lenny Li are licensed persons registered with the SFC and are responsible officers of China Sunrise Capital Limited to carry out Type 1 (dealing in securities) and Type 6 (advising on corporate finance) regulated activities under the SFO who have over 30 years and over 17 years of experience in corporate finance industry respectively.*

* *For identification purposes only*