

Report of the Directors

The Directors are pleased to present the annual report together with the audited financial statements of the Group for the year ended 31 December 2018.

PRINCIPAL PLACE OF BUSINESS

The Company is incorporated and domiciled in Hong Kong and has its registered office and principal place of business at Room 1601, Emperor Group Centre, 288 Hennessy Road, Wanchai, Hong Kong.

PRINCIPAL ACTIVITIES AND BUSINESS REVIEW

The principal activity of the Company is investment holding. The principal activities of the Company's subsidiaries are research and development, production and sale of Chinese medicine and pharmaceutical products in the People's Republic of China (the "PRC"). Further discussion and analysis of these activities as required by Schedule 5 to the Hong Kong Companies Ordinance, including a fair review of the business and a discussion of the principal risks and uncertainties facing the Group, particulars of important events affecting the Group that have occurred since the end of the financial year 2018, and an indication of likely future development in the Group's business, can be found in the "Five Year Financial Summary", "Chairman's Statement", "Management Discussion and Analysis", "Corporate Governance Report" and "Notes to the Consolidated Financial Statements" sections of this report. In addition, a discussion on the Company's environmental policies and performance, the Company's compliance with the relevant laws and regulations that have a significant impact on the Company and the Company's relationships with its employees, customers and suppliers are contained in "Corporate Governance Report" section of this report.

RESULTS AND DIVIDENDS

The Group's profit for the year ended 31 December 2018 and the financial position of the Company and the Group as at that date are set out in the financial statements on pages 83 to 204 of this report.

An interim dividend of HK6.04 cents (approximately RMB5.28 cents) per share for the six months ended 30 June 2018 was paid on 15 October 2018 (six months ended 30 June 2017: HK4.75 cents (approximately RMB4.05 cents) per share).

The Board recommended a final dividend of HK5.51 cents (approximately RMB4.71 cents) per share for the year ended 31 December 2018 (2017: HK4.96 cents (approximately RMB3.97 cents) per share). The total distribution for year ended 31 December 2018 is HK11.55 cents (approximately RMB9.99 cents) per share (2017: HK9.71 cents (approximately RMB8.02 cents) per share).

DIVIDEND POLICY

The Board has adopted a dividend policy, with effect from 1 January 2019. The dividend policy of the Company aims to provide reasonable and sustainable returns to the shareholders and at the same time, maintain a stable financial position so that the Company can fully grasp any available investment and expansion opportunities from time to time.

The Board may declare dividends on an annual basis and/or declare interim dividends (as the case may be). Dividends may be distributed in the form of cash or shares. The Company determines the profit attributable to its shareholders based on the Hong Kong Accounting Standards. The Board must take into account:

- the Group's actual and anticipated operating results, liquidity and financial condition;
- capital commitment requirement;
- market environment and challenges;
- future development and investment opportunities; and
- any other factors that the Board deems appropriate.

The management will continue to review the dividend policy and propose any amendments for the Board's approval.

TRANSFER TO RESERVES

Profits attributable to shareholders, before dividends, of RMB1,439,018,000 (2017: RMB1,170,434,000) have been transferred to reserves. Other movements in reserves are set out in the Consolidated Statement of Changes in Equity in the financial statements.

INVESTMENT PROPERTY, OTHER PROPERTY, PLANT AND EQUIPMENT AND LEASEHOLD LAND

Details of movements in investment property, other property, plant and equipment and leasehold land during the year are set out in notes 17 and 18 to the financial statements.

SHARE CAPITAL AND RESERVES

Details of the movements in share capital and reserves of the Company and the Group during the year are set out in note 47 and the Consolidated Statement of Changes in Equity in the financial statements, respectively.

EQUITY-LINKED AGREEMENTS

No equity-linked agreements were entered into by the Company during the year or subsisted at the end of the year.

BANK LOANS AND OTHER BORROWINGS

Particulars of bank loans and other borrowings of the Group as at 31 December 2018 are set out in notes 34 and 35 to the financial statements.

FIVE YEAR FINANCIAL SUMMARY

A summary of the results and of the assets and liabilities of the Group for the last five financial years is set out on page 3 of this report.

SUBSIDIARIES

Particulars of the Company's subsidiaries as at 31 December 2018 are set out in note 46 to the financial statements.

PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S LISTED SECURITIES

During the year, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities.

DIRECTORS

The Board comprises the following Directors during the Reporting Period and up to the date of this report:

Executive Directors

Mr. WU Xian	<i>Chairman</i>
Mr. WANG Xiaochun	<i>Managing Director</i>
Mr. YANG Wenming	<i>(appointed on 24 December 2018)</i>
Mr. ZHAO Dongji	<i>(resigned on 24 December 2018)</i>
Ms. HUANG He	<i>(resigned on 24 December 2018)</i>

Non-executive Directors

Mr. YANG Shanhua	<i>(appointed on 28 March 2018)</i>
Ms. LI Ru	<i>(appointed on 18 February 2019)</i>
Mr. YANG Binghua	<i>(appointed on 24 December 2018)</i>
Mr. WANG Kan	<i>(appointed on 24 December 2018)</i>
Mr. KUI Kaipin	<i>(appointed on 30 May 2018)</i>
Mr. LIU Cunzhou	<i>(resigned on 24 December 2018)</i>
Ms. TANG Hua	<i>(resigned on 24 December 2018)</i>
Mr. DONG Zenghe	<i>(resigned on 28 March 2018)</i>
Ms. RONG Yan	<i>(appointed on 24 December 2018 and resigned on 18 February 2019)</i>

Independent Non-executive Directors

Mr. XIE Rong	
Mr. YU Tze Shan Hailson	
Mr. QIN Ling	<i>(appointed on 18 February 2019)</i>
Mr. LI Weidong	<i>(appointed on 18 February 2019)</i>
Mr. ZHOU Bajun	<i>(resigned on 28 January 2019)</i>
Mr. LO Wing Yat	<i>(resigned on 25 January 2019)</i>

During the reporting period and up to the date of this report, the reasons for resignation of the resigned directors are as follows:

- Mr. DONG Zenghe resigned on 28 March 2018 due to changes of his work arrangements;
- Mr. ZHAO Dongji and Ms. HUANG He resigned on 24 December 2018 due to adjustment of job duties and position;
- Mr. LIU Cunzhou and Ms. TANG Hua resigned on 24 December 2018 as more time was devoted to other businesses they engaged in;
- Mr. LO Wing Yat resigned on 25 January 2019 due to the expiry of his appointment letter. Mr. LO has decided not to renew the tenure of office because he wants to schedule his works in various aspects more efficiently;
- Mr. ZHOU Bajun resigned on 28 January 2019. The Directors have received a notice of resignation from Mr. ZHOU on 27 January 2019. As the Company hopes to introduce professionals with a solid background in pharmaceutical industry as independent directors, Mr. ZHOU has been informally informed that the Company would not renew his appointment after the end of his term on 4 February 2019; and
- Ms. RONG Yan resigned on 18 February 2019 due to change of her work arrangement within the China National Pharmaceutical Group Corporation.

The Company has received from each independent non-executive Director an annual confirmation pursuant to Rule 3.13 of the Rules Governing the Listing of Securities (the “Listing Rules”) on The Stock Exchange of Hong Kong Limited (the “Stock Exchange”) and the Company considers all the independent non-executive Directors to be independent.

All the Directors are appointed for a specific term subject to retirement by rotation and re-election in accordance with the Articles of Association of the Company.

In accordance with Article 92 of the Company’s Articles of Association, Mr. YANG Wenming, Ms. LI Ru, Mr. YANG Binghua, Mr. WANG Kan, Mr. KUI Kaipin, Mr. QIN Ling and Mr. LI Weidong shall hold office only until the next general meeting of the Company and, shall then be eligible of re-election.

In accordance with Article 101 of the Company’s Articles of Association, Mr. WU Xian, Mr. WANG Xiaochun, Mr. YANG Shanhua and Mr. XIE Rong shall retire by rotation at the AGM and, being eligible, offer themselves for re-election. None of the Directors proposed for re-election at the forthcoming AGM has an unexpired service contract which is not determinable by the Company and any of its subsidiaries within one year without payment of compensation, other than normal statutory obligations.

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The appointment letter of Mr. ZHOU Bajun as an independent non-executive director of the Company will expire on 4 February 2019. In view of the Company's future business development needs, we will endeavor to introduce professionals with a solid background in pharmaceutical industry as independent directors to provide more extensive industry suggestions. Therefore, we have decided not to renew the appointment of Mr. ZHOU after the end of his current term. Mr. ZHOU has been informally informed that the Company would not renew its appointment after the end of his term on 4 February 2019. On 27 January 2019, the directors were notified by Mr. ZHOU that he would resign as an independent non-executive director, with effect from 28 January 2019. Please refer to the two announcements of the Company dated 28 January 2019 for details.

DIRECTORS AND SENIOR MANAGEMENT

Biographical details of the existing Directors and senior management as at the date of this report, including the particulars required under paragraph 12 of Appendix 16 to the Listing Rules (if and as applicable and appropriate), are set out on pages 71 to 76 of this report.

EXECUTIVE DIRECTORS' SERVICE CONTRACTS

Mr. WU Xian entered into an appointment letter with the Company for a term of two years commencing from 5 February 2013. In 2014, Mr. WU Xian entered into an employment agreement with the Company with effect from 22 June 2014 and which shall automatically be effective thereafter until terminated by either party to the service agreement by giving a one month's prior notice.

Mr. WANG Xiaochun renewed an appointment letter with the Company for a term of two years commencing from 23 October 2015. Due to re-designation of Mr. Wang as the Managing Director with effect from 31 March 2017, Mr. WANG entered into a supplemental appointment letter with the Company for an initial term of two years commencing from 3 April 2017.

Mr. YANG Wenming entered into an appointment letter with the Company for a term of three years commencing from 24 December 2018.

NON-EXECUTIVE DIRECTORS' SERVICE CONTRACTS

Mr. YANG Shanhua entered into an appointment letter with the Company for a term of two years commencing from 28 March 2018.

Ms. LI Ru entered into an appointment letter with the Company for a term of three years commencing from 18 February 2019.

Mr. YANG Binghua entered into an appointment letter with the Company for a term of three years commencing from 24 December 2018.

Mr. WANG Kan entered into an appointment letter with the Company for a term of three years commencing from 24 December 2018.

Mr. KUI Kaipin entered into an appointment letter with the Company for a term of two years commencing from 30 May 2018.

Ms. RONG Yan entered into an appointment letter with the Company for a term of three years commencing from 24 December 2018. However, Ms. RONG Yan resigned on 18 February 2019.

INDEPENDENT NON-EXECUTIVE DIRECTORS' SERVICE CONTRACTS

Mr. XIE Rong renewed an appointment letter with the Company for a term of three years commencing from 5 February 2019.

Mr. YU Tze Shan Hailson renewed an appointment letter with the Company for a term of two years commencing from 25 November 2017.

Mr. QIN Ling entered into an appointment letter with the Company for a term of three years commencing from 18 February 2019.

Mr. LI Weidong entered into an appointment letter with the Company for a term of three years commencing from 18 February 2019.

MANAGEMENT CONTRACTS

No contract other than employment contracts, concerning the management and administration of the whole or any substantial part of the Company's business was entered into or existed during the year.

DONATIONS

During the Reporting Period, the charitable and other donations made by the Group amounted to approximately RMB6,080,000.

DIRECTORS OF SUBSIDIARIES

A list of names of the directors who held office in the Company's subsidiaries during the year and up to the date of this report is available on the Company's website at www.china-tcm.com.cn.

DIRECTORS' FEES

The emoluments of the executive Directors are determined by the remuneration committee of the Company (the "Remuneration Committee") and the emoluments of the non-executive Director and independent non-executive Directors are recommended by the Remuneration Committee to the Board, having regard to the relevant Director's experience, responsibility and the time devoted to the business of the Group. For the year ended 31 December 2018, the fee for the eligible non-executive and independent non-executive Directors were fixed at HK\$250,000 per annum.

PERMITTED INDEMNITY PROVISION

Article 178 of the Articles of Association of the Company provides that every Director or other officer or auditors shall be indemnified out of assets of the Company against all losses or liabilities which he may sustain or incur in or about the execution of the duties of his office or otherwise in relation thereto. Such provisions were in force during the course of the year and remained in force as at the date of this report.

Article 179 of the Articles of Association of the Company provides that every Director and officer shall be entitled to be insured against any liability to the Company, a related company or any other party in respect of any negligence, default, breach of duty or breach of trust (save for fraud) of which he may be guilty in relation to the Company or a related company. Every Director and officer shall be entitled to be insured against any liability incurred by him in defending any proceedings, whether civil or criminal, taken against him for any negligence, default, breach of duty or breach of trust

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(including fraud) of which he may be guilty in relation to the Company or a related company. The Company has arranged appropriate liability insurance to indemnify its directors and officers in respect of legal actions against the Directors. The amount of coverage is reviewed on an annual basis.

CHANGES OF DIRECTOR'S INFORMATION UNDER RULES 13.51B(1) OF THE LISTING RULES

Pursuant to Rule 13.51B(1) of the Listing Rules, the change of Directors' information of the Company after the date of 2018 interim report is as follows:

- Mr. YANG Wenming was appointed as an executive Director with effect from 24 December 2018.
- Mr. YANG Binghua was appointed as a non-executive Director with effect from 24 December 2018.
- Mr. WANG Kan was appointed as a non-executive Director with effect from 24 December 2018.
- Mr. LI Ru was appointed as a non-executive Director with effect from 18 February 2019.
- Mr. XIE Rong was appointed as an independent non-executive director of Shanghai Bairun Investment Holding Group Co.,Ltd., a company listed on the Shenzhen Stock Exchange, and Baoshan Iron & Steel Co.,Ltd., a company listed on the Shanghai Stock Exchange with effect from June 2015 and June 2018, respectively.
- Mr. QIN Lin was appointed as an independent non-executive Director with effect from 18 February 2019.
- Mr. LI Weidong was appointed as an independent non-executive Director with effect from 18 February 2019.
- Mr. ZHAO Dongji resigned as an executive Director with effect from 24 December 2018. Mr. ZHAO received an emolument of RMB1,400,000 in 2018.
- Ms. HUANG He resigned as an executive Director with effect from 24 December 2018. Ms. HUANG received an emolument of RMB1,890,000 in 2018.
- Mr. LIU Cunzhou resigned as a non-executive Director with effect from 24 December 2018.
- Ms. TANG Hua resigned as a non-executive Director with effect from 24 December 2018.
- Mr. ZHOU Bajun resigned as an independent non-executive Director with effect from 28 January 2019.
- Mr. LO Wing Yat resigned as an independent non-executive Director with effect from 25 January 2019.
- Ms. RONG Yan was appointed as a non-executive Director on 24 December 2018 and resigned as a non-executive Director on 18 February 2019.
- Mr. WANG Xiaochun, an executive Director, did not receive annual directors' fees, but received an emolument of RMB2,100,000 in 2018.

Save as disclosed above, the Company is not aware of any other information which is required to be disclosed pursuant to Rule 13.51B(1) of the Listing Rules.

ALLOTMENT AND ISSUE OF NEW SHARES

Subscription of new shares by Ping An Life Insurance under Specific Mandate

On 16 March 2018, the Company and Ping An Asset Management (Hong Kong) Company Limited (the investment manager appointed by Ping An Life Insurance (the “Subscriber”)) entered into a memorandum of understanding setting out the intention of the Subscriber to subscribe for a certain number of new shares. On 19 March 2018, the Company and the Subscriber entered into the subscription agreement, pursuant to which the Company conditionally agreed to allot and issue, and the Subscriber conditionally agreed to subscribe for, 604,296,222 shares (“Subscription Shares”) at the total subscription price of HK\$2,677,032,265, equivalent to the issue price of HK\$4.43 (the “Issue Price”) per Subscription Share. Subscription Shares represented approximately 13.64% of the total number of issued shares of the Company on 19 March 2018. The total subscription price is payable in cash by the Subscriber to the Company at completion. The net proceeds from the subscription is approximately HK\$2,674 million so the net issue price is approximately HK\$4.42535 per Subscription Share. The Subscriber is subsidiary of Ping An Insurance (Group) Company of China, Ltd. (“Ping An”). For details, please refer to the announcement of the Company dated 19 March 2018.

The Issue Price of HK\$4.43 per Subscription Share represented a discount of approximately 19.89% to the closing price of HK\$5.53 per Share as quoted on the Stock Exchange on 15 March 2018, being the last trading day on which the Shares were traded on the Stock Exchange prior to the date of the subscription agreement (the “Last Trading Day”). On the other hand, it represented a discount of approximately 9.03% to the average of the closing prices per Share as quoted on the Stock Exchange for the last 30 consecutive trading days up to and including the Last Trading Day of approximately HK\$4.87.

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The Company used/will use the net proceeds of the Subscription of HK\$2,674 million for the following purposes:

		Allocation	Amount	Remaining	Amount	Remaining	
		amount	utilised as at	balance as at	utilised as at	balance as at	Expected
		RMB million	30 June 2018	30 June 2018	31 December 2018	31 December 2018	timeline of utilisation
Usage							
The nationwide expansion of coverage of its TCM decoction pieces and concentrated TCM granules businesses	For the establishment of six TCM industrial parks and TCM intelligent distribution centres in different region	454.94	36.50	418.44	418.44	0.00	2018
	For the expansion of production capacity for TCM decoction pieces and concentrated TCM granules	641.80	0.00	641.80	641.80	0.00	2018
	For the acquisitions of suitable targets engaged in TCM decoction pieces and concentrated TCM granules businesses	121.86	0.00	121.86	121.86	0.00	2018
Research and establishment of quality standards in concentrated TCM granules		81.24	3.27	77.97	68.03	9.94	2019
Research and development in classical TCM prescription		81.24	0.00	81.24	4.01	77.23	2019
Repayment of bank loans		365.58	360.00	5.58	5.58	0.00	2018
The Group's general working capital	For the settlement of outstanding trade payables	243.72	213.27	30.45	30.45	0.00	2018
	For the purchase of raw materials	81.24	0.00	81.24	81.24	0.00	2018
	For the payment of other expenses	100.74	90.93	9.81	9.81	0.00	2018
Total		2,172.36	703.97	1,468.39	1,381.22	87.17	

The Hong Kong dollar has been converted into RMB at the exchange rate of HK\$1 to RMB0.8124 on 10 May 2018.

The use of the net proceeds from the Subscription meets with the usage as stated in the circular of the Company dated 10 April 2018.

The Group is a leading TCM enterprise in the PRC and is principally engaged in the manufacture and sale of TCM and pharmaceutical products with a focus on concentrated TCM granules, TCM finished drugs and TCM decoction pieces. In order to enhance competitiveness and maintain rapid growth, it is the strategy of the Group to expand the geographical coverage of its TCM business to the whole country and consolidate the entire TCM industry chain.

Ping An and its subsidiaries ("Ping An Group") possesses excellent brand awareness, strong financial strength, diversified sale channels and network resources across the nation. It has made a number of successful investments in the pharmaceutical and healthcare industries in recent years, covering areas such as biomedical engineering and pharmaceutical and healthcare services, and therefore has an in-depth understanding in the pharmaceutical and healthcare industries.

The Group intends to, through the Subscription, introduce Ping An Group as a long-term strategic partner, which will help to bring together the Group's expertise in the TCM medicinal herbs, decoction pieces, concentrated TCM granules and finished drugs businesses, and Ping An Group's customer base, sales network, and technology, platform and resources advantages in the pharmaceutical and healthcare sector for developing the TCM business. In particular, it is the Group's intention to explore and promote strategic cooperation in TCM-related businesses with Ping An Group through a joint venture being established by Ping An Group and Tsumura & Co. (a Japanese leading Kampo medicine manufacturer) as the primary strategic partner, which is expected to bring the global advanced research and development and production technology in the TCM industry to the Group, create synergies and further enhance the value of the Company.

The Company agrees that, as long as the total number of Shares held by the Subscriber and its associates collectively is equal to or exceeds 5% of the total number of Shares in issue and outstanding, the Subscriber shall be entitled to nominate one candidate with such appropriate qualification and experience to serve as a member of the Board to be appointed as a non-executive Director. For the avoidance of doubt, the Nomination Right is not one-off and shall remain enforceable for so long as the aggregate shareholding of the Subscriber and its associates in the Company is equal to or exceeds 5% of the total number of Shares in issue. On 30 May 2018, Mr. KUI Kaipin was appointed as a non-executive director by the Board.

All transactions contemplated under the subscription shares, subscription agreement and allot and issue the Subscription Shares under specific mandate were approved by the shareholders of the Company at the extraordinary general meeting held on 30 April 2018. Details of the subscription, please to the announcement and circular of the Company dated 19 March 2018 and 10 April 2018 respectively. The Subscription Shares were completed on 10 May 2018 and represent approximately 12.00% of the total number of issued Shares as enlarged by the allotment and issue of the Subscription Shares. Please refer to the announcement of the Company for completion of subscription dated 10 May 2018.

DISCLOSURE OF INTERESTS

Directors' and Chief Executives' Interests

As at 31 December 2018, the interests or short positions of the Directors and chief executives of the Company in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) which were notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which they were taken or deemed to have under such provisions of the SFO), or which were recorded in the register required to be kept by the Company under Section 352 of the SFO, or which were required, pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers ("Model Code") set out in Appendix 10 to the Listing Rules as adopted by the Company, to be notified to the Company and the Stock Exchange, were as follows:

Name of Directors	Capacity	Number of Ordinary Shares	Approximate Percentage of Total Interests to Issued Share Capital
WANG Xiaochun	Interest of controlled corporation	380,001,042 (long position) (Note 1)	7.55%

Note:

1. The 380,001,042 shares are held by Hanmax Investment Limited ("Hanmax") which is wholly owned by Mr. WANG Xiaochun.

Save as disclosed above, none of the Directors and chief executives of the Company had, as at 31 December 2018, any interests or short positions in any shares and underlying shares or debentures of the Company or any of its associated corporations as recorded in the register which were required to be kept by the Company under section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code.

Substantial Shareholders' Interests

As at 31 December 2018, the interests and short positions of the shareholders, other than a Director or chief executive of the Company, in the shares and underlying shares of the Company as recorded in the register required to be kept by the Company under section 336 of the SFO were as follows:

Name of Substantial Shareholders	Capacity	Number of Ordinary Shares	Approximate Percentage of Total Interests to Issued Share Capital
Sinopharm Hongkong	Beneficial owner	1,614,313,642 (long position) (Note 1)	32.06%
CNPGC	Interest of controlled corporations	1,614,313,642 (long position) (Note 1)	32.06%
Ping An Life Insurance	Beneficial owner	604,296,222 (long position) (Note 2)	12.00%
Ping An	Interest of controlled corporations	604,296,222 (long position) (Note 2)	12.00%
Hanmax	Beneficial owner	380,001,042 (long position)	7.55%

Notes:

1. The 1,614,313,642 shares are held by Sinopharm Group Hongkong Co., Limited ("Sinopharm Hongkong"), which is indirectly wholly owned by CNPGC.
2. The 604,296,222 shares are held by Ping An Life Insurance which is a subsidiary of Ping An. Ping An is deemed to be interested in Ping An Life Insurance's interest in the Company under SFO.

Save as disclosed above, the register which was required to be kept under section 336 of the SFO showed that the Company had not been notified of any interests or short positions in the shares and underlying shares of the Company as at 31 December 2018.

CONNECTED TRANSACTIONS

Acquisition of four pharmaceutical companies

On 20 October 2017, Sinopharm Group Feng Liao Xing (Foshan) Medicinal Material & Slices Co., Ltd. (國藥集團馮了性(佛山)藥材飲片有限公司) (a wholly-owned subsidiary of the Company) (the “Purchaser”) and China National Traditional Chinese Medicine Corporation (the “Vendor”) entered into the following agreements:

(i) The Huamiao Agreement in relation to the Beijing Huamiao Acquisition

Pursuant to the Huamiao Agreement, the Purchaser conditionally agreed to acquire, and the Vendor conditionally agreed to sell, the entire registered capital of Beijing Huamiao free from encumbrances and together with all rights attaching thereto from the date of Beijing Huamiao Completion. The consideration was approximately RMB216,600,000 (equivalent to approximately HK\$255,600,000) and was determined after arm’s length negotiations between the Purchaser and the Vendor taking into account the profitable track record of Beijing Huamiao, the complementary nature of Beijing Huamiao’s business with those of the Group and the synergy expected to be created by consolidating the TCM decoction pieces business of Beijing Huamiao with those of the Group. Beijing Huamiao is principally engaged in the manufacture and sale of TCM decoction pieces in Beijing, the PRC.

The completion of the Huamiao Agreement was on 5 January 2018, and the industrial and commercial registration was completed on 8 February 2018.

(ii) The Huatai Agreement in relation to the Beijing Huatai Acquisition

Pursuant to the Huatai Agreement, the Purchaser conditionally agreed to acquire, and the Vendor conditionally agreed to sell, the entire registered capital of Beijing Huatai free from encumbrances and together with all rights attaching thereto from the date of Beijing Huatai Completion. Apart from the lease of certain properties which are being leased to Beijing Huamiao, Huayi (an indirect wholly-owned subsidiary of the Company) and Beijing Huatai respectively, Beijing Huatai does not have other business operation. The consideration was approximately RMB139.6 million (equivalent to approximately HK\$164.7 million). At the same time, the Purchaser had agreed to guarantee the settlement of the amount owed by Beijing Huatai to the Vendor of approximately RMB163.6 million (equivalent to approximately HK193.0 million) after the Beijing Huatai Completion.

The completion of the Huatai Agreement was on 5 January 2018, and the industrial and commercial registration was completed on 31 January 2018.

(iii) The HLJ Sinopharm Agreement in relation to the Heilongjiang Sinopharm Medicinal Materials Co., Limited (“HLJ Sinopharm”) Acquisition

Pursuant to the HLJ Sinopharm Agreement, the Purchaser conditionally agreed to acquire, and the Vendor conditionally agreed to sell, the entire registered capital of HLJ Sinopharm free from encumbrances and together with all rights attaching thereto from the date of the HLJ Sinopharm Completion. The consideration was approximately RMB61,400,000 (equivalent to approximately HK\$72,500,000). HLJ Sinopharm is principally engaged in the distribution of TCM products and chemical drugs to pharmaceutical companies in several regions and hospitals in Heilongjiang Province, the PRC. It also holds certain retail properties in Harbin, the PRC which are being leased to independent third parties. In addition, it owns two plantation bases of medicinal herbs in Heilongjiang Province, the PRC.

The completion of the HLJ Sinopharm Agreement was on 5 January 2018, and the industrial and commercial registration was completed on 12 January 2018.

(iv) The Jiangyou Agreement in relation to the Sichuan Jiangyou Zhongba Fuzi Technology Development Co., Limited (“Jiangyou”) Acquisition

Pursuant to the Jiangyou Agreement, the Purchaser conditionally agreed to acquire, and the Vendor conditionally agreed to sell, the entire registered capital of Jiangyou free from encumbrances and together with all rights attaching thereto from the date of the Jiangyou Completion. The consideration was approximately RMB81,700,000 (equivalent to approximately HK\$96,400,000). Jiangyou is principally engaged in the manufacture and sale of TCM decoction pieces in Sichuan Province, the PRC. Jiangyou had invested approximately RMB50 million in the establishment of a new production plant in Sichuan which completed in late 2016. The production plant is equipped with a production capacity of 4,000 tonnes of TCM decoction pieces of toxic Chinese medicinal herbs.

The completion of the Jiangyou Agreement was completed on 5 January 2018, and the industrial and commercial registration was completed on 24 January 2018.

Through the acquisition of Beijing Huamiao and HLJ Sinopharm, the Company can leverage on their mature hospital sales networks to bring synergetic effects and economies of scale into with the existing sales channels of the Group in order to expand the Company’s market share of its concentrated TCM granule business in Beijing and the northeast region.

The acquisition of Beijing Huamiao and Jiangyou was in line with the Group’s mission to strengthen this segment and would immediately enhance the Group’s production capacity, market share and distribution channel in Beijing and Sichuan Province respectively. Together with its existing production bases in Guangdong, Shanghai, Guiyang and Gansu, the Group would have nationwide geographical coverage of TCM decoction pieces business in the key regions in the PRC (such as the eastern, northern, southern, southwestern and northwestern regions) after the acquisitions and benefit from integration of resources in terms of management, procurement, production and financial aspects.

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These three enterprises have their own characteristics. Beijing Huamiao is the largest manufacturing and processing company for TCM decoction pieces in Beijing which owns more than 800 kinds of TCM decoction pieces. As an authorised manufacturer in respect of 28 kinds of toxic TCM materials designated by Beijing Food and Drug Administration, it also holds the production and processing permit for the processed products of some of the endangered and protected wild animals. Huamiao's modernized decoction and storage centre built in Beijing greatly facilitates the expansion of the Company's decoction business. Jiangyou possesses the largest production base for toxic decoction pieces in the PRC. Leveraging on its special Aconite decoction pieces business, the Company will develop the best Aconite brand in China within the sub-category of toxic decoction pieces after the acquisition. HLJ Sinopharm is the only enterprise in Heilongjiang Province that holds the qualification of poppy shell operation. In the meantime, its possession of retail pharmacies and direct sales qualification is of strategic significance to the Company's business expansion towards retailing of pharmaceutical products in the future. Making use of HLJ Sinopharm's rich TCM resources, distribution channels and retail platforms, it is able to position itself as a northeast TCM resources centre, warehousing and sales centre as well as logistics centre, covering the three northeast provinces and the Northern China region to promote the Company's concentrated TCM granules, finished drugs and decoction pieces businesses in those regions.

Beijing Huatai owns an industrial complex in Beijing, which comprises two production plants currently being leased to Beijing Huamiao and Huayi respectively for their production use. The Huatai Acquisition merely represents an asset reorganisation to enhance management efficiency and realign the ownership and user of the assets.

On 20 October 2017, the Company was owned as to approximately 36.43% by Sinopharm Hongkong, which was the controlling shareholder of the Company and a wholly-owned subsidiary of the Vendor. Accordingly, the Vendor was a connected person of the Company and the Acquisitions constituted connected transactions of the Company under Chapter 14A of the Listing Rules.

From time to time, Beijing Huamiao, HLJ Sinopharm and Jiangyou purchase TCM materials from the CNPGC Group and sell various pharmaceutical products to the CNPGC Group. Upon completion of the Beijing Huamiao Acquisition, the HLJ Sinopharm Acquisition and the Jiangyou Acquisition, such three enterprises had become the indirect subsidiaries of the Company and such transactions became continuing connected transactions for the Company under Chapter 14A of the Listing Rules and fall within the transactions contemplated under the master purchase agreement and the master supply agreement as disclosed in the circular of the Company dated 19 December 2016 in relation to the continuing connected transactions. Transaction amount of each of such transactions will account for the usage of the annual caps. The Company will continue to monitor the usage of the annual caps and comply with the Listing Rules as and when necessary.

The acquisition agreements of the above four pharmaceutical factories were approved by the Company's independent shareholders at an extraordinary general meeting of the Company held on 22 December 2017. For details of such connected transactions, please refer to the announcement and the circular of the Company dated 20 October 2017 and 24 November 2017 respectively.

Acquisition of Zhonglian Pharmaceutical

On 20 July 2018, Jiangyin Tianjiang (the “Purchaser”), China National Traditional Chinese Medicine Co., Ltd. (formerly named as China National Traditional & Herbal Medicine Co., Ltd. (the “Vendor”)), Shanghai Shyndec Pharmaceutical Co., Ltd. (“Shyndec”), 武漢光谷產業投資有限公司(Wuhan Guanggu Industry Investment Co., Limited*) (“Guanggu”) and Zhonglian Pharmaceutical (the “Target”) entered into the equity transfer and capital increase agreement (the “Agreement”) pursuant to which (i) the Purchaser has agreed to acquire approximately 0.71% of the equity interest in the Target from the Vendor at the consideration of approximately RMB1.8 million (equivalent to approximately HK\$2.1 million) as at the date of the Agreement; and (ii) the Purchaser has agreed to make capital contribution of approximately RMB260.0 million (equivalent to approximately HK\$301.6 million) into the Target. Immediately after completion, the Purchaser will hold 51% of the equity interest in the Target. The Target will become an indirect non-wholly owned subsidiary of the Company.

The Vendor is the holding company of Sinopharm Group Hongkong Co., Limited (“Sinopharm Hongkong”), which is the controlling shareholder holding 1,614,313,642 shares of the Company, representing approximately 32.06% of the total issued Shares as at the date of the Agreement. The Target is currently owned as to approximately 96.95% by Shyndec, which is ultimately controlled by China National Pharmaceutical Group Corporation (“CNPGC”), the ultimate controlling shareholder of the Company. Accordingly, the Vendor and the Target are connected persons of the Company and the Agreement constituted connected transactions of the Company under Chapter 14A of the Rules Governing the Listing of Securities (the “Listing Rules”) on The Stock Exchange of Hong Kong Limited (the “Stock Exchange”).

As one or more of the applicable percentage ratios (as defined under the Listing Rules) in respect of the share transfer and the capital increase exceed 0.1% but are less than 5%, the share transfer and the capital increase are subject to the reporting and announcement requirements, but are exempt from the independent shareholders’ approval requirement under Chapter 14A of the Listing Rules.

The Acquisition will create synergic effects in the Group’s finished drugs business and granules business. As announced by the Hubei Economy and Information Technology Commission, Health and Family Planning Commission of Hubei Province and Hubei CFDA in September 2017, the Target will become one of the six enterprises with provincial pilot license to develop, manufacture and use concentrated TCM granules in Hubei Province. Once the final approval is obtained, the Target together with its subsidiaries (the “Target Group”) will focus on developing the concentrated TCM granules business while steadily promoting its finished drugs business. As the Group’s subsidiary producing concentrated TCM granules in Hubei Province in the future, the Target Group will help expand the Group’s market share in concentrated TCM granule business in Hubei Province. Moreover, the Target Group’s development range of TCM varieties will be a great complement to the Group’s existing product varieties. Together with the Group’s promotion experience in the TCM segment, it is suggested that the Target Group’s market coverage will be rapidly expanded in the next few years. At the same time, with the Group’s large-scale procurement of TCM raw materials, the Target Group will be able to reduce its procurement cost of raw materials and increase the level of gross profit.

On 13 December 2018, Zhonglian Pharmaceutical obtained the provincial approval, and became one of concentrated TCM granules pilot manufacturers in Hubei Province.

Report of the Directors

For details of the connected transaction, please refer to the announcement dated 20 July 2018 and 17 December 2018 of the Company, respectively. The industrial and commercial registration date was 26 September 2018.

Disposal of 20% Equity Interest in Sinopharm Group Guizhou Blood Products Company Limited

On 9 October 2018, Sinopharm Group Guangdong Medi-World Pharmaceutical Co., Ltd.* (the “Vendor”), an indirect wholly-owned subsidiary of the Company, and Chengdu Rongsheng Pharmaceutical Co., Ltd.* (the “Purchaser”), a subsidiary of China Biotechnology and Beijing Tiantan Biological Products, entered into the Agreement, pursuant to which the Vendor has agreed to sell and the Purchaser has agreed to acquire a 20% equity interest in Sinopharm Group Guizhou Blood Products Company Limited* (formerly known as Guizhou Zhongtai Biological Technology Company Limited*) for a cash consideration of RMB90.6 million (equivalent to approximately HK\$102.4 million).

The Purchaser is an indirect subsidiary of CNPGC, which is the holding company of Sinopharm Hongkong. Sinopharm Hongkong is the controlling Shareholder holding 1,614,313,642 Shares, representing approximately 32.06% of the total issued Shares as at the date of the agreement. The Purchaser is therefore a connected person of the Company and the Disposal constitutes a connected transaction for the Company under Chapter 14A of the Listing Rules.

As the applicable percentage ratios under Rule 14.07 of the Listing Rules are more than 0.1% but less than 5%, the Disposal is subject to reporting and announcement but is exempt from the circular (including independent advice) and independent shareholders’ approval requirements under Chapter 14A of the Listing Rules.

The Target Group is principally engaged in the research and development, manufacture and sale of biological products in the PRC. Although the Target Group had profit contribution to the Group in last two years, its business does not form part of the development direction for the Group’s core businesses. At the same time, the business of the Target Group has been facing severe competition which impacted its performance in the first half of year 2018. In light of the Group’s devotion to dedicate more resources and focus on the consolidation of TCM supply chain and strengthening its leading position in the core businesses, the Board decided to dispose of the remaining interest in the Target.

For details of the connected transaction, please refer to the announcement of the Company dated 9 October 2018. The industrial and commercial registration date was 26 November 2018. Immediately after Completion, the Group will cease to hold any equity interest in the Target.

* for identification purpose only

CONTINUING CONNECTED TRANSACTIONS

New Master Purchase Agreement and New Master Supply Agreement with CNPGC

On 18 November 2016, the Company entered into the agreements to govern the terms of the Purchases and the Sales and to set the annual caps for the three financial years ending 31 December 2017, 2018 and 2019.

Pursuant to the New Master Purchase Agreement, the Group conditionally agreed to purchase the materials supplied by the CNPGC and its subsidiaries (collectively, the "CNPGC Group") during the period from 1 January 2017 to 31 December 2019. The value of the purchases shall not exceed the annual caps of RMB45 million (equivalent to approximately HK\$50.9 million) for each of the three financial years ending 31 December 2017, 2018 and 2019.

Pursuant to the New Master Supply Agreement, the Group conditionally agreed to sell the products to the CNPGC Group during the period from 1 January 2017 to 31 December 2019.

Pursuant to the New Master Supply Agreement, the Group agreed to supply and CNPGC Group agreed to purchase the products during the period from 1 January 2017 to 31 December 2019. Pursuant to the New Master Supply Agreement, the value of the sales shall not exceed the annual caps of RMB800 million (equivalent to approximately HK\$904 million), RMB900 million (equivalent to approximately HK\$1,017 million) and RMB1,000 million (equivalent to approximately HK\$1,130 million) for each of the three financial years ending 31 December 2017, 2018 and 2019 respectively.

On 18 November 2016, CNPGC wholly owned Sinopharm Hongkong, a controlling shareholder of the Company. Therefore, CNPGC is a connected person of the Company. The sales and purchases of the products and the materials contemplated under the New Master Supply Agreement and the New Master Purchase Agreement respectively constitute continuing connected transactions of the Company under Chapter 14A of the Listing Rules.

The agreements were entered into for the purpose of enabling the Group to continue the business relationship with the CNPGC in compliance with the Listing Rules as well as to capture the opportunities that may be brought about by the CNPGC Group to the Group. CNPGC is a state-owned enterprise in the PRC and is one of the largest state-owned pharmaceutical and healthcare groups administered directly by the State-owned Assets Supervision and Administration Commission of the State Council. Its principal activities are pharmaceutical distribution, pharmaceutical scientific research and manufacture of medical and biotech products. Members of the CNPGC Group have been the suppliers of the materials and customers of the products of the Group since 1998. The CNPGC Group is a reliable business partner of the Group which has a strong supply capacity as well as a well-established distribution network. The New Master Purchase Agreement enables the Group to source stable and quality Materials from the CNPGC Group, while the New Master Supply Agreement enables the Group to tap into a larger market and approach a much wider clientele base with the support of the extensive sales and distribution network of the CNPGC Group in the PRC. As CNPGC is one of the largest pharmaceutical companies in the PRC and has a long-term relationship with the Group, the Directors considered that the partnership with the CNPGC can secure the distribution of the Products to hospitals and retail pharmacies in the PRC.

For details of these renewed continuing connected transactions, please refer to the announcement and the circular of the Company dated 20 November 2016 and 19 December 2016 respectively. The New Master Purchase Agreement, the New Master Supply Agreement and the respective annual caps were approved by the Company's independent shareholders at an extraordinary general meeting of the Company held on 6 January 2017.

Report of the Directors

During the period from 1 January 2018 to 31 December 2018, the actual purchases of materials by the Group from CNPGC Group amounted to RMB22,767,000 (excluding value added tax) which was below the cap amount of RMB 45,000,000 for the year ended 31 December 2018.

During the period from 1 January 2018 to 31 December 2018, the actual sales of products by the Group to CNPGC Group amounted to RMB678,795,000 (excluding value added tax) which was below the cap amount of RMB 900,000,000 for the year ended 31 December 2018.

Research and Development Agreements with SIPI and SPERC

On 23 December 2013 and 5 March 2014, Guangdong Medi-World (currently known as “Sinopharm Group Guangdong Medi-World Pharmaceutical Co., Ltd.”, “Guangdong Medi-World”), an indirect wholly-owned subsidiary of the Company, entered into research and development agreements (the “R&D Agreements”) with SIPI and Shanghai Pharmaceutical Engineering Research Centre Co., Ltd. (上海現代藥物製劑工程研究中心有限公司 or “SPERC”) respectively in relation to the engagement by Guangdong Medi-World of SIPI and SPERC for the provision to Guangdong Medi-World of the research and development of certain drugs. The aggregate maximum research and development fee payable by Guangdong Medi-World pursuant to the R&D Agreements amounts to approximately RMB136,270,000.

Both SIPI and SPERC are subordinated unit/company of China State Institute of Pharmaceutical Industry (“CSPI”), which is a subsidiary of CNPGC. CNPGC wholly owned Sinopharm Hongkong, a controlling shareholder of the Company. Therefore, CNPGC is a connected person of the Company. Each of SIPI and SPERC is a connected person of the Company under the Listing Rules and the transactions contemplated under the R&D Agreements constitute connected transactions of the Company under Chapter 14A of the Listing Rules.

SIPI is principally engaged in the research of organic synthesized pharmaceuticals, microbiological and biochemical pharmaceuticals, biotechnological drugs, traditional Chinese medicines and novel preparations, pharmaceutical preparations, and new drug delivery systems.

SPERC is principally engaged in the development, consultancy, service and transfer of applied technology on traditional Chinese medicine, chemical drug, healthcare product and medicinal materials, design, analysis and sale of pharmaceutical equipment, research of technical test on medicinal material and packaging material.

The Group is committed to product innovation and has dedicated resources to the research and development on new drugs in order to stay competitive in the industry and capitalise on the growth opportunities of the Chinese medicine market brought about by the recent reforms in the pharmaceutical industry in the PRC. With the expertise and technical know-how of SIPI and SPERC, the collaboration under the R&D Agreements is expected to enrich the product mix of the Group with new products and benefit the Group in terms of sustainable development.

For details of the R&D Agreements, please refer to the announcements of the Company dated 23 December 2013 and 5 March 2014.

During the period from 1 January 2018 to 31 December 2018, there is no actual research and development fee payable by the Group to SIPI and SPERC. The sum of such fees payable by the Group to SIPI and SPERC during 2014 to 2018 amounted to RMB21,780,000 (including value added tax), which was below the contract amount of RMB136,270,000 under the R&D Agreements.

Review by the Independent Non-executive Directors

The independent non-executive Directors have reviewed the above continuing connected transactions of the Group and have confirmed that the transactions have been entered into:

- (i) in the ordinary and usual course of business of the Group;
- (ii) on normal commercial terms or on terms no less favourable to the Group than terms available to or from Independent third parties; and
- (iii) in accordance with the relevant agreement governing them on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole. During 2018, the Group entered into certain transactions with related parties as defined in accordance with applicable accounting standards, and details of which are set out in note 45 of the audited consolidated financial statements of this report. Such related party transactions include the transactions as disclosed in the “CONNECTED TRANSACTIONS” and “CONTINUING CONNECTED TRANSACTIONS” of this section. The Company confirms that it has complied with the disclosure requirements in accordance with Chapter 14A of Listing Rules.

Review by the Auditors

For the propose to Rule 14A.56 of the Listing Rules, the auditors of the Company has provided a letter to the Board, confirmed that nothing has come to their attention that causes them to believe that the disclosed continuing connected transactions:

- (i) have not been approved by the Board;
- (ii) were not, in all material respects, in accordance with the pricing policies of the Group for transactions involving the provision of goods or services by the Group;
- (iii) were not entered into, in all material respects, in accordance with relevant agreements governing the transactions; and
- (iv) have exceeded the annual cap.

A copy of the auditor’s letter has been provided by the Company to the Stock Exchange.

ARRANGEMENT TO ACQUIRE SHARES OR DEBENTURES

At no time during the year was the Company or its subsidiaries a party to any arrangement to enable the Directors to acquire benefits by means of the acquisition of shares in or debentures of the Company or any other body corporate.

DEBENTURES ISSUED

For the year ended 31 December 2018, no debenture is issued by the Company.

DIRECTORS' RIGHTS TO ACQUIRE SHARES AND DEBENTURES

At no time during the year were there any rights to acquire benefits by means of the acquisition of shares in or debentures of the Company granted to any director or their respective spouses or children under 18 years of age, or were there any such rights exercised by them; or was the Company or any of its subsidiaries a party to any arrangement to enable the Directors to acquire such rights in any other body corporate.

DIRECTORS' INTERESTS IN COMPETING BUSINESS

None of the Directors or any of their respective associates have engaged in any business that competes or may compete with the business of the Group or have any other conflict of interests with the Group during the year.

DIRECTORS' INTERESTS IN TRANSACTIONS, ARRANGEMENTS OR CONTRACTS

No contracts 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 connected entity had a material interest, either directly or indirectly, subsisted at the end of the year or at any time during the year.

CONTROLLING SHAREHOLDERS' INTEREST IN CONTRACTS

Save as disclosed in "CONNECTED TRANSACTIONS" and "CONTINUING CONNECTED TRANSACTIONS" of this section, none of the Company or any of its subsidiaries entered into contract of significance with the controlling shareholders or any of its subsidiaries other than the Group, nor was there any contract of significance between the Group and the controlling shareholders or any of its subsidiaries other than the Group in relation to provision of services.

MAJOR CUSTOMERS AND SUPPLIERS

The revenue attributable to the largest customer and the five largest customers of the Group accounted for around 6.0% and 14.2% of the Group's total revenue during the year. The revenue attributable to CNPGC Group accounted for around 6.0% of the Group's total revenue during the year.

The purchases from the Group's largest supplier and five largest suppliers accounted for around 4.4% and 10.2% of the Group's total purchases during the year. The purchases from CNPGC Group accounted for around 0.3% of the Group's total purchases during the year.

Save as disclosed above, at no time during the year, none of the Directors, their close associates, or any shareholders of the Company (which to the best knowledge of the directors own more than 5% of the Company's share capital) had any interest in the Group's five largest suppliers and customers.

RETIREMENT SCHEME

Details of the employees' retirement plans of the Group are set out in note 37 to the financial statements.

CHANGE OF AUDITORS

After obtaining the approval in the AGM of 2015, the Company appointed Deloitte Touche Tohmatsu as the auditors of the Company.

Deloitte Touche Tohmatsu shall retire and, being eligible, offer themselves for re-appointment as auditors of the Company at the forthcoming AGM. A resolution for the re-appointment of Deloitte Touche Tohmatsu as auditors of the Company is to be proposed at the forthcoming AGM.

AUDIT COMMITTEE

The Group's final results and audited financial statements for the year ended 31 December 2018 have been reviewed by the audit committee ("Audit Committee"). Information on the work of Audit Committee and its composition are set out in the Corporate Governance Report on pages 52 to 70 of this report.

CORPORATE GOVERNANCE

The Company is dedicated to maintaining a high standard of corporate governance. Information regarding the corporate governance practices adopted by the Company are set out in the Corporate Governance Report on pages 52 to 70 of this report.

SUFFICIENCY OF PUBLIC FLOAT

Based on the information that is publicly available to the Company and within the knowledge of its Directors, as at the date of this report, there is sufficient public float as not less than 25% of the Company's issued shares are held by the public.

By Order of the Board

WU Xian

Chairman

Hong Kong, 15 March 2019