

Hong Kong Exchanges and Clearing Limited and The Stock Exchange of Hong Kong Limited take no responsibility for the contents of this announcement, make no representation as to its accuracy or completeness and expressly disclaim any liability whatsoever for any loss howsoever arising from or in reliance upon the whole or any part of the contents of this announcement.



廣州白雲山醫葯集團股份有限公司

GUANGZHOU BAIYUNSHAN PHARMACEUTICAL HOLDINGS CO., LTD.

(a joint stock company with limited liability established in the People's Republic of China)

(H Share Stock Code: 0874)

**OVERSEAS REGULATORY ANNOUNCEMENT
IN RELATION TO REPLY TO ENQUIRY LETTER
FROM THE SHANGHAI STOCK EXCHANGE**

This announcement is made pursuant to Rule 13.10B of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited.

References are made to the announcements of Guangzhou Baiyunshan Pharmaceutical Holdings Company Limited (the “**Company**”) dated 1 January 2018 and 2 January 2018 regarding the receipt by the Company of the “Enquiry Letter in relation to the Disclosure of Information on the Report on the Material Acquisition of Assets of Guangzhou Baiyunshan Pharmaceutical Holdings Company Limited” (Shang Zheng Gong Han [2017] No. 2553) (《關於對廣州白雲山醫葯集團股份有限公司重大資產購買報告書信息披露的問詢函》上證公函[2017] 2553號) (the “**Enquiry Letter**”) from the Shanghai Stock Exchange (the “**SSE**”) on 29 December 2017, requesting the Company to elaborate on, and to provide further disclosure in relation to, the issues set out in the Enquiry Letter.

The Company has submitted a reply to the Enquiry Letter (the “**Reply**”) to the SSE and published an announcement dated 5 January 2018 regarding the Reply on the website of the SSE (<http://www.sse.com.cn>), the full text of which is set out below for information purpose only.

The Board of
Guangzhou Baiyunshan Pharmaceutical Holdings Company Limited

Guangzhou, the PRC, 5 January 2018

As at the date of this announcement, the board of directors of the Company comprises Mr. Li Chuyuan, Mr. Chen Mao, Ms. Liu Juyan, Ms. Cheng Ning, Mr. Ni Yidong and Mr. Wu Changhai as executive directors, and Mr. Chu Xiaoping, Mr. Jiang Wenqi, Mr. Wong Hin Wing and Ms. Wang Weihong as independent non-executive directors.

* For identification purpose only

Announcement on the Reply of Guangzhou Baiyunshan Pharmaceutical Holdings Company Limited to the Enquiry Letter in relation to the Disclosure of Information on the Report on the Material Acquisition of Assets of Guangzhou Baiyunshan Pharmaceutical Holdings Company Limited from the Shanghai Stock Exchange

The board of directors (the “Board”) of the Company and all members of the Board warrant that this announcement does not contain any false information, misleading statements and material omissions, and are collectively and individually responsible for the truthfulness, accuracy and completeness of the content herein.

In respect of the requirements set out in the Enquiry Letter in relation to the Disclosure of Information on the Report on the Material Acquisition of Assets of Guangzhou Baiyunshan Pharmaceutical Holdings Company Limited (Shang Zheng Gong Han [2017] No. 2553) issued by the Shanghai Stock Exchange, Guangzhou Baiyunshan Pharmaceutical Holdings Company Limited (hereinafter referred to as “GYBYS” or the “Listed Company” or the “Company”) and relevant intermediaries have conducted a serious analysis and reply on the relevant issues as follows:

Unless otherwise specified, the abbreviations or terms used in this reply are the same as those disclosed in the “Report on the Material Acquisition of Assets of Guangzhou Baiyunshan Pharmaceutical Holdings Company Limited (Revised)”. The main abbreviations and definitions include:

General Terms	
Target Asset	30% of the equity interest of Guangzhou Pharmaceuticals Corporation
Reporting Periods	the years of 2015, 2016 and the period from January to September 2017
End of each of the Reporting Periods	December 31, 2015, December 31, 2016 and September 30, 2017
Report	the Report on the Material Acquisition of Assets of Guangzhou Baiyunshan Pharmaceutical Holdings Company Limited (Revised)

Announcement on the Reply/the Announcement on the Reply	the Announcement on the Reply of Guangzhou Baiyunshan Pharmaceutical Holdings Company Limited to the Enquiry Letter in relation to the Disclosure of Information on the Report on the Material Acquisition of Assets of Guangzhou Baiyunshan Pharmaceutical Holdings Company Limited from the Shanghai Stock Exchange
GYBYS/the Listed Company/the Company/Company	Guangzhou Baiyunshan Pharmaceutical Holdings Company Limited
Counterparty/Alliance BMP	Alliance BMP Limited* (聯合美華有限公司)
Guangzhou Pharmaceuticals/Transaction Target/Target Company	Guangzhou Pharmaceuticals Corporation
the Transaction/the Material Assets Reorganization/the Reorganization	GYBYS's acquisition from Alliance BMP of 30% of equity interest in Guangzhou Pharmaceuticals held by Alliance BMP by way of cash, and grant of a put option to Alliance BMP pursuant to which Alliance BMP has the option to sell the remaining 20% equity interest in Guangzhou Pharmaceuticals held by it to GYBYS during the exercise period
Guang Yao Kang Jian	Shanxi Guangyao Kangjian Pharmaceutical Co., Ltd.* (陝西廣藥康健醫藥有限公司)
SSE	the Shanghai Stock Exchange
Yuan,10,000 Yuan, 100 million Yuan	RMB, RMB10,000, RMB100 million
Terminology	
Prescription Drugs	Drugs that can be dispensed, purchased and used through prescriptions issued by a medical practitioner or assistant medical practitioner
OTC, Over-the-counter Drugs	Drugs that can be freely purchased and used without the prescriptions issued by a medical practitioner or assistant medical practitioner
Medical Institutions	The collective term of the health institutions that have obtained the Practitioner's License for Medical Institutions in accordance with the provisions set out in the "Regulations on the Administration of Medical Institutions" and are engaged in disease diagnosis and treatment activities
Direct Sales	Pharmaceutical distribution companies provide direct sales and distribution of medicines to hospitals, health centers and other medical institutions as well as retail pharmacies and clinics
Distribution	Pharmaceutical distribution companies, as pharmaceuticals, medical devices sales distributors, sell the purchased medicines and medical devices to other pharmaceutical commercial enterprises

Some of the totals in the Announcement on the Reply may differ in the mantissa from the sum of each addend directly due to rounding.

1. As disclosed in the Report, in addition to the acquisition from Alliance BMP of 30% equity interest in Guangzhou Pharmaceuticals held by Alliance BMP by way of cash, the Company has granted a put option to Alliance BMP pursuant to which Alliance BMP has the option to sell the remaining 20% equity interest in Guangzhou Pharmaceuticals that it held to the Company during the exercise period. The Company is required to make supplementary disclosure on: (1) the main consideration(s) in granting the aforesaid put option; (2) whether the impact of the put option has been taken into account when determining the consideration of the transaction; (3) the accounting recognition and specific quantification of the aforesaid put option and explanation of the potential impact on the operating results of the Company in the future. The financial adviser and the accountant are asked to express their views.

Reply:

I. Main considerations in granting the aforesaid put option

GYBYS, Guangzhou Pharmaceuticals and Alliance BMP entered into an equity interest transfer agreement and a joint venture contract on 21 December 2017. The Transaction includes: (1) the acquisition by GYBYS from Alliance BMP of 30% of equity interest in Guangzhou Pharmaceuticals held by Alliance BMP by way of cash; (2) the grant of a put option by GYBYS to Alliance BMP pursuant to which Alliance BMP shall have the option to sell the remaining 20% equity interest in Guangzhou Pharmaceuticals held by it to GYBYS during the exercise period. The terms of the Transaction are determined through friendly negotiations between the parties under the principle of fairness and voluntariness and the result of negotiations between the parties. The main considerations are as follows:

(I) GYBYS becoming the controlling shareholder of Guangzhou Pharmaceuticals is in line with the common interest of both parties to the Transaction

During the past 10-year of joint venture operations, Guangzhou Pharmaceuticals has achieved rapid growth, benefitting from the rich industry experience, market position, expertise and localization support of GYBYS as well as the business model, staff training and operational processes and other international advanced experience introduced by the counterparty imported. In recent years, China has vigorously promoted the reforms in the pharmaceutical industry. Policies such as “the division of medical consultation and drug dispensary”, “two-invoice system” and “zero mark-up of drugs” are set to significantly change the competitive landscape of the pharmaceutical distribution industry and accelerate the pace of mergers and acquisitions within the industry, as a result of which will further set higher requirements for the pharmaceutical distribution companies in terms of understanding of policies and response efficiency.

Against this backdrop, both GYBYS and Alliance BMP agree that it will be better for Guangzhou Pharmaceuticals to change its original jointly controlled shareholding structure, and for GYBYS, which is closer to the domestic market and has greater domestic resource advantages, to become the controlling shareholder, which is beneficial to further promote the development of Guangzhou Pharmaceuticals, enhance its comprehensive competitive strength, thus creating more values for both parties and achieving a

win-win situation for all parties involved.

(II) The grant of put option is for the purpose of protecting the interest of both parties

The Transaction is designed to fully satisfy the interests of all parties involved:

1. Arrangement for the transfer of 30% equity interest

Upon completion of the Transaction, GYBYS will hold 80% equity interest while Alliance BMP will hold 20% equity interest in Guangzhou Pharmaceuticals. As for GYBYS, it will acquire the controlling shareholding interest in Guangzhou Pharmaceuticals; as for Alliance BMP, it can further share the future benefits from the development of Guangzhou Pharmaceuticals with 20% equity interest that it continues to hold; as for Guangzhou Pharmaceuticals, its continuity and stability of operations are maintained as the existing shareholders can continue to provide support of resources without exiting completely.

2. Arrangement for the put option in relation to the remaining 20% equity interest

The exercise price of the put option should be based on the valuation provided by a qualified third-party independent appraisal agency. The exercise price should not be lower than the consideration of the Transaction in respect of 30% equity interest in Guangzhou Pharmaceuticals after adjusting proportionally to the extent permissible under the PRC laws governing the administration of state-owned assets, as well as the relevant laws and regulations, normative documents and the regulatory policies promulgated by the China Securities Regulatory Commission, the Shanghai Stock Exchange and/or The Stock Exchange of Hong Kong Limited.

As for Alliance BMP, the arrangement for the put option is able to sufficiently safeguard its right of exit as a minority shareholder.

As for GYBYS, the exercise price is determined on the basis of the appraised value, on the principle of fairness and in line with the relevant requirements of state-owned assets without prejudice to the interest of the Company. In addition, if Alliance BMP exercises the put option, GYBYS is able to purchase the remaining 20% equity interest directly to reduce the possibility of third-party biddings and avoid uncertainty in pricing method, which is in line with the Company's strategic goal of making utmost efforts in developing the "great commerce" section by continuing to expand its stake in Guangzhou Pharmaceuticals.

II. Whether the impact of the put option has been taken into account when determining the consideration of the Transaction

The price of this transaction in respect of the transfer of 30% equity interest was determined based on the valuation of the target asset as appraised by asset valuation agency qualified for carrying out securities and futures activities, and on the principle of fairness and voluntariness for both parties.

The arrangement of the put option is the basis for the success of the transfer of 30% equity interest, and not only benefit the purchaser or the vendor, but is beneficial to the satisfaction of interest demands by

all parties involved. The effect of the put option has not been taken into account in determining the consideration of the transaction in respect of the transfer of 30% equity interest.

III. The accounting recognition and specific quantification of the aforesaid put options

As the arrangement for put option is the basis for arriving the 30% equity transfer, which is beneficial to realize the interests of each transaction party, the exercise of such put option by Alliance BMP in future is uncertain, whether an outflow of economic benefits from the Listed Company could be caused in future is uncertain, the transaction price will be determined based on the future appraisal value, and even if such put option is exercised by Alliance BMP, the transaction price will remain uncertain before the put option is exercised.

According to the requirements of the Accounting Standards for Business Enterprises, “liability refers to the current obligations of the enterprise that is arising from past transactions or events, and is expected to result in the outflow of economic benefits from enterprise.” The obligations which meet the aforesaid definition of liability “shall be recognized when both of the following conditions are satisfied simultaneously:

(I) It is likely that there will be an outflow of economic benefits relating to such obligation from the enterprise;

(II) The amount of future outflow of economic benefits could be measured in a reliable way.”

As such, in the event that management of GYBYS has not obtained any evidence that it is probable that Alliance BMP will exercise its share options, the arrangement for the put option does not satisfy the recognition condition of liability, the Listed Company has not recognized as liability in respect of such matter, the Company will consider to disclose such contingent matter in the notes to accounting statements.

IV. Explanation of the potential impact on the operating results of the Company in the future

If Alliance BMP exercises such put option in future, GYBYS will treat it as an acquisition of the minority interests: capital reserve-capital premium shall be adjusted according to the difference between the consideration for the acquisition of such 20% equity interests and the share of net asset of Guangzhou Pharmaceuticals accrued from the date of acquisition in the proportion of 20%. If capital reserve is insufficient for writing off, retained profits shall be adjusted. Namely immediately upon the acquisition of 20% equity interests, no impact would have on the operating results of GYBYS. In addition, as the transaction price shall be determined based on the appraisal value from the third independent appraisal institutions with qualification, it will not impair the interests of the Listed Company.

Upon acquisition of 20% equity interests, there is no change in the revenue and net profit of consolidated income statement of GYBYS as only acquisition of minority interests of GYBYS, but the net profit attributable to shareholders of the parent company will be increased, however, as the net profit of Guangzhou Pharmaceuticals accounted for a relatively small proportion of that of GYBYS, the increase in

net profit attributable to shareholders of the parent company of the listed Company would be relatively low.

In view of the above, the arrangement for put option will have no material impact on future operating result of the Listed Company.

V. Further Disclosure Information

The related contents have been further disclosed in “I. Summary of the Transaction Proposal” under “Notes to Material Events” and “II. Summary of the Transaction Proposal” under “Section I Summary of the Transaction” of the Report.

VI. Review Opinion from the Intermediary Agencies

(I) Opinion from Financial Adviser

Upon review, the independent financial adviser is of the opinion that, the terms of the Transaction is determined by each transaction party after friendly negotiations under the principles of fairness and willingness, the arrangement for put option is the basis for arriving the Transaction of 30% equity transfer, which is beneficial to realize the interests of each transaction party, the impact of put option was not taken into account the Transaction consideration for the 30% equity transfer; in the event that management of GYBYS has not obtained any evidence that it is probable that Alliance BMP will exercise its share options · the arrangement for the put option does not satisfy the recognition condition of liability, the Listed Company has not recognized as liability in respect of such matter, the Company will consider to disclose such contingent matter in the notes to accounting statements; the arrangement for put option will have no material impact on future operating result of the Listed Company.

(II) Opinion of the accountant

Upon review, the BDO accountant is of the opinion that, “there was no very clear and practical accounting treatment for the aforesaid granting of put option in the Accounting Standards for Business Enterprises in the PRC as of 2017. From a practical and operational perspective, we considered that it is appropriate to refer to the relevant requirements of the Accounting Standards for Business Enterprises No.13- Contingencies, where there is no evidence obtained by the management of GYBS that Alliance BMP is likely to exercise put option, disclosed as contingencies.”

2. As disclosed in the Report, various reforms have been implemented in the pharmaceutical industry in recent years, of which the “Two-invoice system* (兩票制)” is expected to be implemented in the pharmaceutical distribution industry. All provinces in China will fully implement the “Two-invoice system” in 2018. The Health and Family Planning Commission of Guangdong Province* (廣東省衛計委) has also released the consultation paper on the implementation of the “Two-invoice system”, in which it is proposed that the “Two-invoice system” will be fully implemented from 1 April 2018. The Company is required to make supplementary disclosure on: (1) explanation of the specific impact on various business models of the “Two-invoice system” on the pharmaceutical distribution industry in conjunction with its implementation progress; (2) the impact of the “Two-invoice system” on various business segments of Guangzhou Pharmaceuticals, as well as the proposed solutions to be taken and details on the implementation, etc., and the risk in full. The financial adviser and the accountant are asked to express their views.

Reply:

I. Explanation of the specific impact of “Two-invoice system”, together with its implementation progress on various business models of the pharmaceutical distribution industry

(I) Implementation progress of “Two-invoice system”

“Two-invoice system” represents when the drugs are sold from the production enterprises to the distribution enterprises, only one instance of invoices will be issued; when the drugs were sold from the distribution enterprises to the medical institutions, only one instance of invoices will to be issued.

On 26 April 2016, the General Office of the State Council published the Working Priorities for Deepening Pharmaceuticals and Health System Reform in 2016* (《深化醫藥衛生體制改革 2016 年重點工作任務》), to propose that the provinces chosen to be the comprehensive medical reform pilots were required to carry out the “Two-invoice system” nationwide, and proactively encourage public hospitals chosen to be the comprehensive pilots and the cities chosen to be the reform pilots to advance “Two-invoice system”. In January 2017, the Medical Reform Office of the State Council along with other departments jointly published the “Notice on the Opinions on Implementation of Advancement of “Two-invoice system” in the Drug Procurement of the Public Medical Institutions (Trial)” * (《關於在公立醫療機構藥品採購中推行「兩票制」的實施意見(試行)》), pursuant to which, the public medical institutions were required to gradually advance “Two-invoice system” in drug procurement, other medical institutions were encouraged to advance “Two-invoice system” in drug procurement; the regions chosen to be comprehensive medical reform pilots and the cities chosen to be the public hospitals reform pilots were required to take the lead in the implementation of the “Two-invoice system” and other areas were encouraged to implement the “Two-invoice system”. The efforts will be made to implement such “Two-invoice system” nationwide in 2018.

With the introduction of implementation scheme for “Two-invoice system” in Tibet in October 2017, all 31 provinces in the country have specified the implementation time of “Two-invoice system”. In

particular, 21 provinces and cities including Fujian, Anhui, Chongqing, Qinghai, Shanxi, Shanxi, Ningxia, Liaoning, Tianjin, Heilongjiang, Guangxi, Sichuan, Jilin, Hunan, Gansu, Yunnan, Hainan, Hebei, Zhejiang, Inner Mongolia and Shandong have entered the implementation state, 4 provinces and cities including Shanghai, Beijing, Henan and Jiangxi will implement by the end of the year; Hubei, Guangdong, Fujian and Tibet will clearly implement in 2018. On 2 January 2018, Notice on Publishing the Implementation Programmes of “Two-invoice system” for Pharmaceutical Transactions in Medical Institutions by Eight Departments including Human Resources and Social Security Department of Guangdong Province (Trail)* (《廣東省人力資源和社會保障廳等八部門關於印發醫療機構藥品交易「兩票制」的實施方案(試行)的通知》) was published on the official website of Health and Family Planning Commission of Guangdong Province, the “Two-invoice system” was implemented in Guangdong province on 2 December 2017, with an effective term of three years and a bridging period of 6 months.

(II) Impact of the “Two-invoice system” on the pharmaceutical distribution industry

Under the “Two-invoice system”, after the distribution enterprise accepts the entrustment of pharmaceuticals manufacturing enterprises which won the bidder, it shall make direct delivery to each medical institution which participated in the bidding, and not allowed to separately entrust.

The main businesses of pharmaceutical distribution industry are wholesale of pharmaceuticals, which could be classified into Distribution business and Direct Sales business aims at different end users. As such, “Two-invoice system” led to the changes in pharmaceutical distribution industry’s own business mode, the original Distribution business will experience the decline pressure. However, in the long term, pharmaceutical distribution industry will be more of a carrier of assuming the two-time bargaining and will eventually develop to be the primary agent of hospitals to a certain extent. With the increasing coverage in end market, it will make efforts to develop the Direct Sales business, integrated pharmaceutical management service mode will also gradually emerge, the gross profit margin of such business will be higher than that of Distribution business.

The specific impacts of advancement of “Two-invoice system” on the pattern of pharmaceutical distribution industry were shown as follows:

1. Under the “Two-invoice system”, the management on end users will be more difficult, the credit period of small and medium distribution companies will be longer, the pharmaceutical manufacturing enterprises are more inclined to choose the distributor with strength, rich distribution network and guaranteed collection of payment;

2. Certain provinces, in the course of implementation of “Two-invoice system”, would select the distributor, restrict the number of distributor, which directly result in the out of small and medium distributor from the pharmaceutical distribution business of public hospitals;

3. Larger capital pool of Large-scale pharmaceutical distribution enterprises with larger capital pool have strong ability to advance to upstream and downstream of pharmaceutical distribution and a strong

payment ability, which are easier to enlarge the scale of operations.

As such, the advancement of “Two-invoice system” makes higher demands on the terminal network and distribution ability of distribution enterprises, the enterprise with wide terminal network coverage, strong logistics and distribution capacity, and strong financial strength will have a greater competitive advantage. Agents that do not have terminal channel and the billing services business company will not have the value of existence after implementating “Two-invoice system”, the small and medium business companies with a certain terminal channel will be merged and acquired. As a result, the “Two-invoice system” will promote the pharmaceutical distribution industry to enhance the degree of concentration, form a situation that stronger ones will stay and maintain the leading position, the national pharmaceutical distribution enterprises and regional leaders will constantly enlarge market share through mergers and acquisitions.

II. The impact of the “Two-invoice system” on various business segments of Guangzhou Pharmaceuticals, as well as the proposed solutions to be taken and details on the implementation, etc.

Guangzhou Pharmaceuticals is the leader of pharmaceutical distribution industry, during each reporting periods, the proportion of Direct Sales business of the Company accounted for 45.06%, 47.97% and 54.89%, respectively of the Company’s sales from operations, the proportion of Direct Sales business increased year by year and recorded a higher proportion of Direct Sales business in the latest period.

After the implementation of “Two-invoice system”, the Distribution business of Guangzhou Pharmaceuticals will continue to decline, the cash flow advantages from Distribution business will also decrease; Direct Sales business will continue to increase, occupy more terminal hospital channels, market share and gross profit margin of overall business will also be increased.

As for this, Guangzhou Pharmaceuticals will take the following measures to cope with the challenge of “Two-invoice system”:

1. Strengthen the communications between the marketing headquarters and subsidiaries, establish a guarantee system including relevant persons in charge in marketing headquarters and each subsidiary, coordinate and enhance the overall market competition level;

2. Localization, localization strategy, establish local subsidiaries to provide high-quality service to suppliers;

3. Strive for more high-quality varieties including imported varieties and OTC varieties to provide variety support for the national sales network;

4. Strengthen the establishment of business system of the Company and improve the development of information system related to “Two-invoice system”;

5. Set up an internal communication mechanism during the bridging period to deal with the problems

in “Two-invoice system” in a timely manner;

6. Enhance the promotion efforts of hospital service extension project and explore the business of various medical terminal service markets, such as outpatient pharmacies, community pharmacies, etc.

Up to now, Guangzhou Pharmaceuticals proactively strengthens the leading edge of the procurement center of the marketing headquarters, shares the network of various subsidiaries, exerts the synergistic effect and increases the market share. It has established a number of subsidiaries, proactively developed its localization strategy, and establish internal communication and coordination mechanism to deal with the issues of “Two-invoice system”. In addition, Guangzhou Pharmaceuticals has reached a variety of system information docking and cooperation projects with Guangdong Medicine Trading Platform to improve the efficiency of order capture and ticketing information transmission. It also focused on strengthening the hospital service extension project and successfully implemented several hospital service extension projects.

In view of the above, by leveraging on years of regional network foundation, commercial channels, logistics coverage and certain brand awareness in provinces of South China, mainly focusing on Guangdong, Guangzhou Pharmaceuticals will exert its more extensive advantages in regional market and regional operations experiences, make use of the accumulated abundant hospital terminal resources, mature network coverage, and proactively respond to the “Two-invoice system” reform, and proactively realize the business transformation, strengthen the advantages of terminal network and enlarge the market share in South China.

III. Further Disclosure Information

The implementation progress and respective impact of “Two-invoice system” have been further disclosed in part of “II. Industry characteristics where the target asset operates and business situation” under “Section VIII Management discussion and analysis” of the Report. The relevant risk warning of “Two-invoice system” has been further disclosed in “II. The risk on the impact of the Target Company on the relating to the continuing operations of the Listed Company” under “Notes to material events” and “II. The risk on the impact of the Target Company on the continuing operations of the Listed Company” under “Notes to material events” under “Section XI Risk factors” of the Report.

IV. Review Opinion from the Intermediary Agency

Upon review, the independent financial adviser is of the opinion that, after the implementation of “Two-invoice system”, the Distribution business of Guangzhou Pharmaceuticals will continue to decline, the cash flow advantages from Distribution business will also decrease; Direct Sales business will continue to increase, occupy more terminal hospital channels, market share will also be increased; Guangzhou Pharmaceuticals will take corresponding measures to cope with the challenges brought from “Two-invoice system”.

3. As disclosed in the Report, the target company, namely Guangzhou Pharmaceutical, conducts quality control on each step over the course of its operating activities, which includes the step of quality control and product acceptance, in which the quality inspector conducts quality inspection and sampling check against the in-stock products, rejects and returns the unqualified products to the manufacturers. During the Reporting Periods, Guangzhou Pharmaceutical unknowingly distributed the sub-standard medicines produced by Kaifeng Yugang Pharmaceutical Co., Ltd.* (開封豫港製藥有限公司), Guangdong Hongying Technology Co., Ltd.* (廣東宏盈科技有限公司) and Chengdu Brilliant Pharmaceutical Co., Ltd.* (成都倍特藥業有限公司), the fake medicines illegally produced and sold by Jilin Changzhong Pharmaceutical Co., Ltd.* (吉林省長中製藥有限公司), and purchased and sold sub-standard injection and medical equipment. Please supplement and disclose: (1) the period of cooperation and accumulative purchase amount between the aforesaid suppliers and the target company; (2) if the sampling methodology and proportion of quality inspection for product acceptance and main inspection items of the target company are adequate to guarantee the quality control standard. Please provide the opinion from the financial adviser.

Reply:

I. The term of cooperation and accumulative purchase amount between the aforesaid suppliers and the Target Company

The term of cooperation and accumulative purchase amount between the aforesaid suppliers and the Target Company were listed in the following table:

Purchaser	Supplier	Term of cooperation/ Purchase information	Relevant products involved in administrative penalty	Purchase quantity	Purchase amount
Guangzhou Pharmaceuticals Corporation	Guangdong Zirui Pharmaceutical Co., Ltd.* (廣東梓瑞藥品有限公司)	June to October 2015, accumulated purchase by two times	Ceftazole Sodium for Injection produced by Kaifeng Yugang Pharmaceutical Co., Ltd.* (開封豫港製藥有限公司) (batch No.: 2015051002)	6,000 boxes	RMB933,600
Guangzhou Pharmaceuticals Corporation	Guangdong Tianshili Yuejian Pharmaceutical Co., Ltd.* (廣東天士力粵健醫藥有限公司)	October 2015, one-off purchase	Chloramphenicol Eye Drops produced by Guangdong Hongying Technology Co., Ltd.* (廣東宏盈科技有限公司) (batch No.: 15090801)	27,200 bottles	RMB32,096
Guangzhou Pharmaceuticals Corporation	Chengdu Brilliant Pharmaceutical Co., Ltd.* (成都倍特藥業有限公司)	March 2016, one-off purchase	Flavoxate Hydrochloride Tablets produced by Chengdu Brilliant Pharmaceutical Co., Ltd. (batch No.: 150504)	1,200 boxes	RMB12,200

Purchaser	Supplier	Term of cooperation/ Purchase information	Relevant products involved in administrative penalty	Purchase quantity	Purchase amount
Shanxi Guang Yao Kang Jian Company Limited	Sichuan Jinli Pharmaceutical Trade Co., Ltd.** (四川金利 醫藥貿易有限公司)	2012 to 2016	Da Huo Luo pills (大活絡丸) produced by Jilin Changzhong Pharmaceutical Co., Ltd.* (吉林省 長中製藥有限公司)	10,800 boxes	RMB44,960
Shanxi Guang Yao Kang Jian Company Limited	Anhui Huayuan Pharmaceutical Company Limited* (安徽華源醫藥股份 有限公司)	2011 to 2016	Da Huo Luo pills (大活絡丸) produced by Jilin Changzhong Pharmaceutical Co., Ltd.* (吉林省 長中製藥有限公司)	6,200 boxes	RMB19,730

Note: The aforesaid purchase amount is the amount of the relevant pharmaceuticals involved in administrative penalty purchased by Guangzhou Pharmaceuticals and Guang Yao Kang Jian from the aforesaid suppliers

II. If the sampling methodology and proportion of quality inspection for product acceptance and main inspection items of the Target Company are adequate to guarantee the quality control standard

1. The sampling methodology and proportion of quality inspection for product acceptance and main inspection items of Guangzhou Pharmaceuticals

Guangzhou Pharmaceuticals has established a complete pharmaceutical quality management and operations system and established management standards covering the first-time commodity supplier, purchasing, receipt and acceptance, inventory management, shipping and transportation, sales management and after-sales service, and carried out risk control by adopting prospective and reviewing way in the course of operations to ensure that the operations and quality management of pharmaceuticals complies with the requirements of various laws and regulations.

For the sampling and acceptance on purchasing pharmaceuticals, Guangzhou Pharmaceuticals strictly implements various requirements of Good Supply Practice* (《藥品經營質量管理規範》) and its appendix, Receipt and Acceptance of Pharmaceuticals* (《藥品收貨與驗收》), conducts random sampling inspection of the pharmaceuticals contained in boxes of the same batch number arrived based on the stacking. Sampling inspection is conducted on all of the quantity of pharmaceuticals contained in boxes of 2 and below; sampling inspection is conducted at least on 3 for the quantity of pharmaceuticals contained in boxes of more than 2 to less than 50; sampling inspection is conducted of at least on an additional 1 for every 50 increased with the quantity of pharmaceuticals contained in boxes of more than 50, for which of less than 50 would be regarded as 50; the pharmaceuticals contained in boxes extracted required to be sampling inspected out of the box by randomly extracting 3 minimum package from different positions in the upper, middle and lower of each box for inspection; staff in charge of acceptance of goods shall and

check through the appearance, packaging, labeling and manuals of the sampling pharmaceuticals. Completed acceptance records are kept for all acceptance processes. Guangzhou Pharmaceuticals carries out pharmaceutical business activities strictly in accordance with the provisions of Drug Administration Law* (《藥品管理法》) and Good Supply Practice* (《藥品經營質量管理規範》) and other laws and regulations, fulfills the duties and obligations of pharmaceuticals operations enterprises on acceptance of pharmaceuticals purchased.

2. Guangzhou Pharmaceuticals signed relevant quality assurance agreement with each supplier, and agreed the right of recourse

(1) Guangzhou Pharmaceuticals signed Quality Assurance Agreement and relevant agreement(s) with each supplier

Guangzhou Pharmaceuticals signed Quality Assurance Agreement with each supplier, and agreed the following in the agreement:

- ① The pharmaceuticals supplied by the supplier must comply with the Pharmacopoeia of the People's Republic of China* (《中華人民共和國藥典》) and the pharmaceutical standards promulgated by the drug administrative department of the State Council or the pharmaceutical standards and relevant quality requirements of provinces, autonomous regions and municipalities. If the pharmaceuticals supplied are fake, the supplier must bear all legal responsibility, and ensure the purchaser will not suffer losses therefrom at any time, if the purchaser suffers losses such as fine or compensation in this respect, the supplier shall compensate the purchaser in full;
- ② For the goods provided by the supplier, if there is quality issue detected by the competent department after sampling inspection, the supplier shall bear all the consequent losses of the goods and expenses caused by the sampling inspection by the administrative department;
- ③ The supplier shall bear all compensation responsibilities for economic or reputation losses caused to the purchaser from customers complaining or being exposed by the media due to the poor reactions other than those set out in the manual of products supplied by the supplier.

(2) Guang Yao Kang Jian signed Pharmaceutical Products Quality Assurance Agreement and relevant agreement(s) with each supplier

Guang Yao Kang Jian signed Pharmaceutical Products Quality Assurance Agreement with each supplier, and agreed the following in the agreement:

The medical apparatus, food, healthcare food, disinfection products and cosmetics provided by the supplier shall comply with the prevailing administrative regulations of the relevant laws and regulations of the state; for the compensation arising from the internal quality problems of the products supplied by the supplier, the supplier shall bear the corresponding economic losses according to the written documents of the administrative department provided by the purchaser.

As such, Guangzhou Pharmaceuticals and Guang Yao Kang Jian have the right to recourse the corresponding compensation from the suppliers for the administrative penalties suffered as a result of selling fake medicines and sub-standard medicines without their knowledge.

3. Guangzhou Pharmaceuticals and Guang Yao Kang Jian have obtained a proof of no violation of laws and regulations issued by relevant competent authorities

On 4 September 2017, the office of Guangdong Food and Drug Administration issued Illustration of Information on Guangzhou Pharmaceuticals Corporation (Yue Shi Yao Jian Yao Tong Zheng [2017] No. 26)*, (《關於廣州醫藥有限公司有關情況的說明》) which proved that, “Guangzhou Pharmaceuticals Corporation is an enterprise which held Pharmaceutical Operations Permit* (《藥品經營許可證》) and obtained GSP certificate in Guangdong Province, the company has not been subject to administrative penalty by our bureau for serious violation of relevant regulations on drug control since 1 January 2015”.

On 19 December 2016, Xi’an Food and Drug Administration issued Verification Table on Violation of Laws by Pharmaceutical and Medical Device Enterprises in Xi’an, which verified that, “there was no issue on Shanxi Guang Yao Kang Jian Company Limited relating to distribution of fake and sub-standard medicines caused by illegal business in recent two years”; on 26 October 2017, Xi’an Food and Drug Administration issued Verification Table on Violation of Laws by Pharmaceutical and Medical Device Enterprises in Xi’an* (《西安市藥械企業違法情況核實表》), which verified that, “there was no violation of laws and regulations in the sectors related to pharmaceutical and medical device by Shanxi Guang Yao Kang Jian Company Limited by recent one year”.

The quantity of drugs involved in three cases of selling inferior drugs and one case of selling counterfeit drugs by Guangzhou Pharmaceuticals accounted for an extremely small proportion of its total sales volume. The occurrence of such incidents conformed to normal probability of law as they took place in strict sampling procedure of Guangzhou Pharmaceuticals which were unknown to and not subjective intentions of Guangzhou Pharmaceuticals. During the Reporting Periods, the incidents subject to administrative penalties that Guangzhou Pharmaceuticals received did not fall within the “serious circumstances” stipulated in the corresponding punishment basis. After receiving relevant administrative penalties, Guangzhou Pharmaceuticals and Guang Yao Kang Jian have ceased procurement of relevant products involved in the penalties from aforesaid suppliers; Guangzhou Pharmaceuticals and Guang Yao Kang Jian have taken positive measures to rectify and eliminate adverse effects of such incidents in a timely manner. Such measures include enhancing supervision and regulation of drug quality and drug sales and improving internal management system. In addition, penalties have been paid in full and in a timely manner. Meanwhile, the office of Guangdong Food and Drug Administration and Xi'an Food and Drug Administration also issued proof of non-violation of laws and regulations for Guangzhou Pharmaceuticals and Guang Yao Kang Jian respectively.

In conclusion, the above penalties that Guangzhou Pharmaceuticals was subject to will not affect its legal existence and on-going operations, and will not have any material adverse impact on the Transaction.

III. Supplementary Disclosure

Supplementary disclosure on relevant information is made in “V. Information about the title, external guarantee and major liability of the main asset” under “Section IV Basic information of the Transaction Subject” of the Report.

IV. Inspection and verification Opinions of Intermediary

Upon inspection and verification, the independent financial adviser considers that the quantity of drugs involved in three cases of selling inferior drugs and one case of selling counterfeit drugs by Guangzhou Pharmaceuticals accounted for an extremely small proportion of its total sales volume. The occurrence of such incidents conformed to normal probability of law as they took place in strict sampling procedure of Guangzhou Pharmaceuticals which were unknown to and not subjective intentions of Guangzhou Pharmaceuticals. During the Reporting Periods, the incidents subject to administrative penalties that Guangzhou Pharmaceuticals received did not fall within the “serious circumstances” stipulated in the corresponding punishment basis. After receiving relevant administrative penalties, Guangzhou Pharmaceuticals and Guang Yao Kang Jian have ceased procurement of relevant products involved in the penalties from aforesaid suppliers; Guangzhou Pharmaceuticals and Guang Yao Kang Jian have taken positive measures to rectify and eliminate adverse effects of such incidents in a timely manner. Such measures include enhancing supervision and regulation of drug quality and drug sales and improving internal management system. In addition, penalties have been paid in full and in a timely manner. Meanwhile, the office of Guangdong Food and Drug Administration and Xi'an Food and Drug Administration also issued proof of non-violation of laws and regulations for Guangzhou Pharmaceuticals and Guang Yao Kang Jian respectively.

In conclusion, the above penalties that Guangzhou Pharmaceuticals was subject to will not affect its legal existence and on-going operations, and will not have any material adverse impact on the transaction.

4. As disclosed in the Report, the target asset, namely Guangzhou Pharmaceutical, is principally engaged in the wholesale and retail of pharmaceutical products, with its business distributed within and outside Guangdong Province. The Company is required to make supplementary disclosure on: (1) basic financial data information on revenue, cost and gross profit margin of various business models by geographic regions, and illustrate the trend and reasons of the changes; (2) analysis and explanation of the main competitive advantages and disadvantages of Guangzhou Pharmaceutical taking into consideration of the market capacity and competitive situation of each main region. Please provide the opinion from the financial adviser.

Reply:

I. The basic financial data information on revenue, cost and profit margin and their trends and reasons of different business models by geographic regions

(I) Analysis of revenue, cost and profit margin of different business modules

During the Reporting Periods, revenue, cost and profit margin of different business models of the principal operations of Guangzhou Pharmaceuticals are as follows:

Unit: RMB10,000

Item	January – September 2017		2016		2015	
	Amount	Proportion	Amount	Proportion	Amount	Proportion
Revenue from Wholesale business	2,668,081.37	98.05%	3,234,471.58	98.14%	2,890,468.73	98.45%
- Medical institutions	1,493,584.14	54.89%	1,581,010.36	47.97%	1,323,108.09	45.06%
- Distributors	1,174,492.13	43.16%	1,653,461.21	50.17%	1,567,360.64	53.38%
Revenue from Retail business	35,283.84	1.30%	41,445.27	1.26%	32,560.97	1.11%
Revenue from E-commerce	16,589.89	0.61%	17,850.97	0.54%	11,049.12	0.38%
Revenue from warehouse and logistics service	1,143.72	0.04%	2,088.33	0.06%	1,934.80	0.07%
Total revenue from principal operations	2,721,098.82	100.00%	3,295,856.15	100.00%	2,936,013.63	100.00%
Cost of Wholesale business	2,517,610.19	98.25%	3,071,231.55	98.38%	2,743,133.06	98.71%
- Medical institutions	1,389,577.42	54.23%	1,475,428.22	47.26%	1,235,696.39	44.47%
- Distributors	1,128,032.77	44.02%	1,595,803.33	51.12%	1,507,436.66	54.24%
Cost of Retail business	29,319.19	1.14%	33,862.71	1.08%	25,489.17	0.92%
Cost of E-commerce	14,797.99	0.58%	15,703.74	0.50%	9,180.77	0.33%
Cost of warehouse and logistics service	723.95	0.03%	1,102.52	0.04%	1,189.00	0.04%
Total cost of principal operations	2,562,451.32	100.00%	3,121,900.51	100.00%	2,778,992.00	100.00%
Profit margin of wholesale business	5.64%	-	5.05%	-	5.10%	-
- Medical institutions	6.96%	-	6.68%	-	6.61%	-
- Distributors	3.96%	-	3.49%	-	3.82%	-
Profit margin of retail business	16.90%	-	18.30%	-	21.72%	-
Profit margin of e-commerce	10.80%	-	12.03%	-	16.91%	-
Profit margin of warehouse and logistics service	36.70%	-	47.21%	-	38.55%	-
Profit margin of principal operations	5.83%	-	5.28%	-	5.35%	-

The revenue from principal operations of Guangzhou Pharmaceuticals mainly derived from the revenue from wholesale business. The wholesale business has been targeting at medical institutions and distributors, maintaining a proportion of over 98% of revenue from principal operations during the Reporting Periods. As the Direct Sales business directly deal with medical institutions as end-users and skipped circulation process, the profit margin of Direct Sales business of Guangzhou Pharmaceuticals was higher than that of the Distribution business. During the Reporting Periods, the proportion of revenue from Direct Sales increased year by year.

(II) Analysis of revenue, cost and profit margin in different geographic regions

During the Reporting Periods, revenue, cost and profit margin in different geographic regions covered by the principal operations of Guangzhou Pharmaceuticals are as follows:

Unit: RMB10,000

Item		January – September 2017		2016		2015	
		Amount	Proportion	Amount	Proportion	Amount	Proportion
Revenue from principal operations	Guangdong	2,277,047.96	83.68%	2,708,111.71	82.17%	2,380,854.83	81.09%
	Southern China (excluding Guangdong)	252,678.08	9.29%	304,626.37	9.24%	257,507.50	8.77%
	Other regions	174,770.86	6.42%	265,267.10	8.05%	286,602.17	9.76%
	Online retail	16,601.93	0.61%	17,850.97	0.54%	11,049.12	0.38%
	Total	2,721,098.82	100.00%	3,295,856.15	100.00%	2,936,013.63	100.00%
Cost of principal operations	Guangdong	2,149,222.78	83.87%	2,568,032.51	82.26%	2,253,944.97	81.11%
	Southern China (excluding Guangdong)	232,845.39	9.09%	286,419.36	9.17%	242,271.15	8.72%
	Other regions	165,392.65	6.45%	251,719.36	8.06%	273,142.02	9.83%
	Online retail	14,990.49	0.59%	15,729.27	0.50%	9,633.86	0.35%
	Total	2,562,451.32	100.00%	3,121,900.51	100.00%	2,778,992.00	100.00%
Profit margin of principal operations	Guangdong	5.61%	-	5.17%	-	5.33%	-
	Southern China (excluding Guangdong)	7.85%	-	5.98%	-	5.92%	-
	Other regions	5.37%	-	5.11%	-	4.70%	-
	Online retail	9.71%	-	11.89%	-	12.81%	-
	Consolidated profit margin	5.83%	-	5.28%	-	5.35%	-

Products of Guangzhou Pharmaceuticals are mainly sold in Guangdong Province. During the Reporting Periods, the sales revenue attributable to Guangdong Province accounted for 81.09%, 82.17% and 83.68% of the revenue from principal operations respectively. During the Reporting Periods, Guangzhou Pharmaceuticals saw a slight upward trend in profit margin of principal operations in most geographic regions, due to the increase in the proportion of revenue from Direct Sales business.

II. Analysis and description of the main competitive advantages and disadvantages of Guangzhou Pharmaceuticals based on the market capacity and competitive landscape in each major

regions

The sales regions of Guangzhou Pharmaceuticals mainly comprises southern China, of which Guangdong Province accounts for the largest portion and Hainan Province comes second.

(I) Market capacity and competitive landscape in Guangdong Province

1. A Huge market capacity in Guangdong Province

With its developed economy, Guangdong Province is one of the most important supply and sales markets for pharmaceutical distribution in our country. According to the Report of Statistical Analysis on the Operations of Pharmaceutical Distribution Industry of 2016* (《藥品流通行業運行統計分析報告(2016)》) released by the Ministry of Commerce, the national total sales volume of pharmaceutical products was 1,839,300 million Yuan, of which the sales volume of the pharmaceutical distribution industry in Guangdong Province was 160,300 million Yuan in 2016 accounting for 8.72% of the national total, ranking the first in the state; Among the four major categories of pharmaceutical products namely Western medicine, Chinese patent medicine, Chinese herbal medicine and medical equipment, the sales volume of each in Guangdong Province ranked the top two in the state, details of which are as follows:

Unit: RMB10,000

Item	Western medicine	Chinese patent medicine	Chinese herbal medicine	medical equipment	Total sales
National	136,864,797	27,541,943	5,531,827	6,110,914	183,925,774
Guangdong Province	11,691,135	2,580,320	697,694	569,808	16,030,340
proportion	8.54%	9.37%	12.61%	9.24%	8.72%
ranking	2	2	2	1	1

Note: Sources are from the Report of Statistical Analysis on the Operations of Pharmaceutical Distribution Industry of 2016* (《藥品流通行業運行統計分析報告(2016)》) released by Department of Market Supervision of Ministry of Commerce (商務部市場秩序司) and the total sales include sales of Western medicine, Chinese patent medicine, Chinese herbal medicine, medical equipment, chemical reagents, glassware and others.

In the past five years, the sales volume of the pharmaceutical distribution industry in Guangdong Province has achieved a compound annual growth rate of 17.17% which is higher than the national average over the same period. According to the statistical analysis of the Analysis and Forecast Report on the Operations of the Pharmaceutical Distribution Industry in 2017-2022* (《2017-2022年藥品流通行業運行情況分析及預測報告》) released by the China Academy of Industrial Research* (中商產業研究院), the total sales of the pharmaceutical distribution industry in Guangdong Province was expected to reach 187,021 million Yuan in 2017 increasing by 16.67% as compared with that in 2016.

2. Competitive landscape

There are regional characteristics in the pharmaceutical distribution industry indicating that Guangzhou Pharmaceuticals mainly derives its revenue from operations in Guangdong Province and its main competitors are situated in the Guangdong market, details of which are as follows:

Company Name	Company Profile
Sinopharm Accord* (國藥一致)	China National Accord Medicines Corporation Ltd.* (國藥集團一致藥業股份有限公司) (“Sinopharm Accord”) was established in August 1986, located in Shenzhen. It is a integrated pharmaceutical listed company (stock code: 000028.SZ) controlled by Sinopharm Group* (國藥集團) and its principal businesses include pharmaceutical distribution, pharmaceutical retail and pharmaceutical industry. Sinopharm Accord's distribution network is mainly based in Guangdong and Guangxi regions serving clients including hospitals above first level, primary medical customers and retail end-users. In 2016, its revenue amounted to 41,248 million Yuan, of which the revenue from pharmaceutical distribution in Guangdong Province reached 21,800 million Yuan.
CR Guangdong* (華潤廣東)	CR Guangdong Pharmaceutical Co., Ltd.* (華潤廣東醫藥有限公司) (“CR Guangdong”) was established in December 1993, located in Guangzhou. It is a holding company under CR Pharmaceutical* (華潤醫藥) and is principally engaged in pharmaceutical import trade, domestic pharmaceutical distribution, end-retail business and supply chain related services. In 2016, CR Guangdong recorded a revenue of 24,794 million Yuan and its revenue from pharmaceutical distribution business in Guangdong Province reached 18,700 million Yuan.
SPH Guangdong* (上藥廣東)	SPH Guangdong Pharmaceutical Co., Ltd.* (上藥控股廣東有限公司) (“SPH Guangdong”) was established in January 1998, located in Guangzhou. It is a holding company under Shanghai Pharma (上海醫藥) and is principally engaged in pharmaceutical distribution, pharmaceutical retail, third-party logistics and pharmaceutical research and development. SPH Guangdong mainly serves medical institution clients and drug delivery commercial clients. In 2016, its revenue from pharmaceutical distribution business in Guangdong Province reached 5,600 million Yuan.
General Pharm* (通用醫藥)	Guangdong General Pharm Co., Ltd.* (廣東通用醫藥有限公司) (“General Pharm”) was established in March 1998, located in Guangzhou. It is a holding company under China Meheco Group Co., Ltd.* (中國醫藥健康產業股份有限公司) and is principally engaged in pharmaceutical distribution. In 2016, its revenue from pharmaceutical distribution business in Guangdong Province reached 4,500 million Yuan.
Guangdong Jointown* (廣東九州通)	Guangdong Jointown Pharmaceutical Co., Ltd.* (廣東九州通醫藥有限公司) (“Guangdong Jointown”) was established in November 2002, located in Zhongshan. It is a holding company under Jointown* (九州通) and is principally engaged in pharmaceutical distribution. In 2016, its revenue from pharmaceutical distribution business in Guangdong Province reached 4,200 million Yuan.

Note: Sources are from the corporate websites and the pointing information "China Pharmaceutical Distribution Market Research Report" (2016)* (《中國醫藥流通行業市場研究報告》(2016))

The revenue of Guangzhou Pharmaceuticals in 2016 and January to September 2017 reached 33,005 million Yuan and 27,271 million Yuan respectively, sustaining the leading position of Guangzhou Pharmaceuticals in Guangdong Province. Among the national top 100 pharmaceutical wholesale enterprises published by the Ministry of Commerce in 2016, Guangzhou Pharmaceuticals ranked the top five in terms of revenue.

(II) Market capacity and competitive landscape in Hainan Province

In 2016, the sales volume of the pharmaceutical distribution industry in Hainan Province amounted to 17,696 million Yuan (excluding Chinese patent medicine and Chinese herbal medicine). Among which, Hainan Chenfei* (海南晨菲), a subsidiary of Guangzhou Pharmaceuticals, ranked the first for four consecutive years in the distribution share of medical institutions in Hainan Province through the bidding platform and achieved 100% coverage in the second and third level hospitals. With the commercial distribution covering mainstream commercial and retail chain pharmacies and the steady progress of the business of the third terminal and primary medical institutions, the Direct Sales business of Hainan Chenfei accounted for 10.37% of the total Direct Sales market in Hainan Province.

(III) Main competitive advantages and disadvantages of Guangzhou Pharmaceuticals

1. Main competitive advantages

(1) As a large pharmaceutical distribution company in southern China, Guangzhou Pharmaceuticals is a leading pharmaceutical distribution company in Guangdong Province and southern China with extensive terminal coverage and strong regional competitive advantages;

(2) After years of operations, Guangzhou Pharmaceuticals has accumulated a good reputation in the industry and has a large number of suppliers and varieties of resources;

(3) Guangzhou Pharmaceuticals has a professional team with independent research and development capability as well as a modern logistics and warehousing logistics and distribution system;

(4) GYBYS, a shareholder of Guangzhou Pharmaceuticals, is a domestic listed company in the pharmaceutical industry which holds an important position in the market of subdivision areas such as traditional Chinese medicine, chemical active pharmaceutical ingredients and chemical pharmaceutical preparations and has rich industry experience, important market position, professional knowledge and localization support; Its shareholder Alliance BMP is a wholly-owned subsidiary of Walgreens Boots Alliance which is the largest retail pharmacy and health commodity retailer in the United States and Europe with international advanced experiences in business model, staff training and operational processes and other aspects. Supported by its powerful shareholders, Guangzhou Pharmaceuticals will develop steadily and rapidly.

2. Main competitive disadvantages

(1) Due to the unbalanced regional development, Guangzhou Pharmaceuticals' principle businesses are concentrated in southern China and the business scales in other regions are small, thus its market position is at risk of being marginalized;

(2) In terms of business types, its wholesale and retail businesses are not well-balanced and the scale of its retail business fails to match the growth and development of Guangzhou Pharmaceuticals;

(3) With its unbalanced product categories, it is difficult for Guangzhou Pharmaceuticals' to meet the diverse needs of customers. The existing categories of medicines accounts for more than 95%, while medical equipment and health products account for a lower proportion and national distributing product varieties represent a smaller proportion.

III. Supplementary disclosure

Basic financial data including the revenue, cost and gross profit margin of different business modules of Guangzhou Pharmaceuticals and trends and reasons therefor have been supplemented in the section "III. Financial Analysis of the Target Assets" under the "Section VIII Management Discussion and Analysis" of the Report; market capacity and competitive landscape in the main operating regions of Guangzhou Pharmaceuticals and the main competitive advantages and disadvantages of Guangzhou Pharmaceuticals have been supplemented and disclosed in the section "II. Industry Characteristics and Business Operations of the Target Asset" under the "Section VIII Management Discussion and Analysis" of the Report.

IV. Inspection opinions from intermediary

Through inspection, the Independent Financial Adviser is of the view that the changes in basic financial data including the revenue, costs and gross profit margin of different regions and different business modules of Guangzhou Pharmaceuticals are reasonable; As a large-scale pharmaceutical distribution enterprise in southern China, Guangzhou Pharmaceuticals has an extensive terminal coverage in many regions, meanwhile it holds a good reputation in the industry and with many high-quality suppliers and variety resources and has trained a professional information technology team with independent R&D capability to establish a modern logistics warehousing and distribution system; At the meantime, there exists an imbalance in the regional development, an imbalance on the scale of the wholesale and retail businesses, and an imbalance of the product categories within, which are the disadvantages for Guangzhou Pharmaceuticals.

5. As disclosed in the Report, as at 30 September 2017, the account receivables of the target asset, namely Guangzhou Pharmaceutical, was RMB10,030,000,000, representing an increase of 60.62% as compared with the end of last year; the prepayment was RMB459,000,000, representing a decrease of RMB956,000,000 as compared with the end of last year. The Company is required to make supplementary disclosure on: (1) the changes in the account receivables and prepayments of Guangzhou Pharmaceutical as compared with the corresponding period of last year, and illustrate if there are any seasonal characteristics; (2) illustration on the reason and the reasonableness of the significant increase in the amount of the account receivables at the end of the reporting periods taking into consideration of the operational characteristics of Guangzhou Pharmaceutical. Please provide the opinions from the financial adviser and the accountant.

Reply:

I. The changes in the accounts receivable and the prepayments of Guangzhou Pharmaceuticals over the corresponding period of last year and the description of seasonal features (if any)

(I) Analysis of accounts receivable

During the Reporting Periods, the balances of accounts receivable of Guangzhou Pharmaceuticals at the end of each period and as at 30 September 2016 are set out as follows:

Unit: RMB10,000

	31 December 2015	30 September 2016	31 December 2016	30 September 2017
balance of accounts receivable	638,352.27	824,964.76	624,461.71	1,003,016.66

Note: the financial figure as at 30 September 2016 is unaudited.

1. Changes in accounts receivable year-on-year

As at 30 September 2017, the balance of accounts receivable of Guangzhou Pharmaceuticals amounted to 10,030,166,600 Yuan, increasing by 1,780,519,000 Yuan or 21.58% as compared with 30 September 2016, which was mainly due to the increase in the Direct Sales of the Company. Since medical institution clients are the major end users in the pharmaceutical distribution industry in our country, the companies grant a longer credit cycle to medical institutions 'customers', and at the same time, as the settlement and payment processes of the medical institutions' clients are generally longer, collection of payments is usually higher in the fourth quarter than that in the other quarters as a result. Therefore as at 30 September 2017, the balance of accounts receivable has increased significantly.

2. Seasonal features of accounts receivable

As at 30 September 2017, the balance of accounts receivable of Guangzhou Pharmaceuticals

increased by 3,785,549,500 Yuan as compared with 31 December 2016; and as at 30 September 2016, the balance of accounts reasonable increased by 1,866,124,900 Yuan as compared with 31 December 2015. As some of the customers of Guangzhou Pharmaceuticals are medical institutions and the payment of medical institutions is usually higher in the fourth quarter than that in the other quarters, the accounts receivable of Guangzhou Pharmaceuticals is of certain seasonal features.

(II) Analysis of prepayments

During the Reporting Periods, the balances of prepayments of Guangzhou Pharmaceuticals at the end of each of the periods as at 30 September 2016 are set out as follows:

Unit: RMB10,000

	31 December 2015	30 September 2016	31 December 2016	30 September 2017
balance of prepayments	144,343.87	138,775.86	141,532.08	45,941.11

Note: the financial figure as at 30 September 2016 is unaudited.

1. Changes in prepayments year-on-year

The balances of prepayments of Guangzhou Pharmaceuticals as at the end of 2015, the end of September 2016 and the end of 2016 remained stable. As at the end of September 2017, prepayments decreased by 955,909,700 Yuan as compared with the end of 2016, representing a decrease of 67.54%. Taking the market reputation, the sales channels along with other factors into consideration, Guangzhou Pharmaceuticals made purchases from few suppliers or on specific drugs by making pre-payments prudently and thus the total amount of prepayments was relatively lower when comparing to the total amount of purchases. As at 30 September 2017, the prepayments of Guangzhou Pharmaceuticals decreased as compared with the corresponding period of last year and the end of last year, which was mainly due to its increased effort in fund management and decreased the use of making prepayments when making purchases as negotiated in the course of business negotiation with suppliers, which therefore reduced the use of funds in the purchase process.

2. Seasonal features of prepayments

The balance of prepayments of Guangzhou Pharmaceuticals did not show obvious seasonal features.

II. The reason(s) and reasonableness for the significant increase in accounts receivable of Guangzhou Pharmaceuticals at the end of the Reporting Periods

As at 30 September 2017, the reason for the significant increase in accounts receivable of Guangzhou Pharmaceuticals mainly lies in the implementation of the “Two-invoice system”. During the Reporting Periods, the proportion of the Direct Sales business in the revenue from principal businesses of Guangzhou Pharmaceuticals was 45.06% 47.97% and 54.89% respectively accounting for a steady increase, in which

2017 obtained a rapid increase in the proportion. Since medical institution clients are the major end users in the pharmaceutical distribution industry in our country, companies grant longer credit cycles to medical institutions' customers, meanwhile as medical institutions' clients make longer settlement and payment process, collection of payments is usually higher in the fourth quarter than that in the other quarters. Therefore as at 30 September 2017, the balance of accounts receivable increased significantly.

Based on the open market information, the balance of accounts receivable of the most comparable listed companies in the same industry shows a situation that the balance as at September 30 each year is higher than the balance at the end of that year, which indicates it has certain seasonal features as set out as follows:

Unit: RMB10,000

Stock Name	31 December 2015	30 September 2016	Increase ratio from 31 December 2015 to 30 September 2016	31 December 2016	30 September 2017	Increase ratio from 31 December 2016 to 30 September 2017
Jointown	779,808.86	1,199,465.83	53.82%	907,601.68	1,681,813.40	85.30%
Int'l Group* (英特集團)	270,728.08	381,779.80	41.02%	324,700.62	457,936.11	41.03%
Sinopharm Accord	615,383.09	761,027.00	23.67%	765,422.55	977,320.49	27.68%
Nanjing Pharmaceutical* (南京醫藥)	603,778.82	742,083.21	22.91%	645,646.04	816,972.09	26.54%
Liuzhou Pharmaceutical* (柳州醫藥)	233,788.98	315,246.11	34.84%	290,315.34	422,642.17	45.58%
Realcan Pharmaceutical* (瑞康醫藥)	444,361.30	763,642.60	71.85%	781,861.16	1,206,298.87	54.29%
Guangzhou Pharmaceuticals	638,352.27	824,964.76	29.23%	624,461.71	1,003,016.66	60.62%

The changes in accounts receivable of Guangzhou Pharmaceuticals are in line with those of the comparable listed companies over the corresponding period, which matches the industry conditions.

Summing up, in light of the industry conditions and Guangzhou Pharmaceuticals' own reasons, the significant increase in accounts receivable of Guangzhou Pharmaceuticals at the end of the Reporting Periods is of rational commercial reasons.

III. Supplementary disclosure

Relevant details have been supplemented and disclosed in the section of “III. Financial Analysis on the Target Assets” in “Section VIII Management Discussion and Analysis” of the Report.

IV. Inspection opinions from intermediary

(I) Financial Advisor’s opinion

Through inspection, the Independent Financial Advisor is of the view that the accounts receivable of Guangzhou Pharmaceuticals have certain seasonal features that are in line with the industry features. In light of the industry conditions and Guangzhou Pharmaceuticals’ own reasons, the significant increase in accounts receivable of Guangzhou Pharmaceuticals as at 30 September 2017 is of reasonable commercial reasons.

(II) Accountant’s opinion

Based on the audit procedures conducted by KPMG, KPMG is of the view that “the above description and rationality regarding the reasons for the changes in the accounts receivable and prepayments of Guangzhou Pharmaceuticals are in line with the information as we comprehended from auditing the financial statements in material respects”.

6. As disclosed in the Report, the net cash flow generated from the operating activities of Guangzhou Pharmaceutical, the target asset, for 2015, 2016 and January to September 2017 was RMB132,000,000, RMB354,000,00 and negative RMB1,787,000,000, respectively. Please take into consideration of the industry characteristics and changes in the business situation of the target asset, illustrate the reason and rationality of the material negative cash flow generated from the operating activities for January to September 2017. If necessary, please disclose the corresponding risks. Please provide the opinion from the financial adviser and the accountant.

Reply:

I. Reason for the significant cash outflow from operating activities of Guangzhou Pharmaceuticals during January to September 2017

During each Reporting Period, the cash inflow and outflow from the operating activities of Guangzhou Pharmaceuticals are as follows:

Unit: RMB10,000

Item	January to September 2017	2016	2015
Cash inflow from operating activities	2,781,318.48	3,836,592.09	3,421,124.43
Cash inflow / revenue from operating activities	101.99%	116.24%	116.39%
Cash outflow from operating activities	-2,959,974.34	-3,801,170.74	-3,407,883.98
Cash outflow / revenue from operating activities	108.54%	115.17%	115.94%
Net cash flow from operating activities	-178,655.86	35,421.35	13,240.45

During each Reporting Periods, the cash inflow from operating activities accounted for 116.39%, 116.24% and 101.99% of the revenue for the corresponding period respectively. By comparison, the main reason for the negative net cash flow from operating activities during January to September 2017 lies in the decrease in cash inflow from operating activities, which is mainly due to the implementation of the “Two-invoice system”. During the Reporting Periods, the proportion of the Direct Sales business to the revenue from principal businesses of Guangzhou Pharmaceuticals was 45.06% 47.97% and 54.89% respectively, representing a steady increase, in which 2017 obtained a relatively rapid increase in the proportion. Since medical institution clients are the major end users in the pharm--aceutical distribution industry in our country, companies grant longer credit cycles to medical institution 'customers, meanwhile as medical institutions' clients make longer settlement and payment process, collection of payments is usually higher in the fourth quarter than that in the other quarters. Therefore, the proportion of cash inflow from operating activities during January to September 2017 to the revenue for the corresponding period decreased, resulting in a negative net cash flow from operating activities during January to September 2017.

II. Rationality for the significant cash outflow from operating activities of Guangzhou Pharmaceuticals during January to September 2017

(I) In line with the business model of Guangzhou Pharmaceuticals

As at 30 September 2017, medical institution clients accounted for a large proportion of the accounts receivable of Guangzhou Pharmaceuticals, which is in line with the characteristics of Company's business and the features of collection of payments from medical institution clients, which in turn led to a negative cash flow from operating activities during January to September 2017.

(II) In line with industry conditions

During the Reporting Periods, the net cash flow from operating activities of Guangzhou Pharmaceuticals amounted to 132 million Yuan, 354 million Yuan and -1,787 million Yuan respectively. According to the open market data, the cash flow from operating activities of comparable listed companies in the same industry is as follows:

Unit: 10,000 Yuan

Stock Name	January to September 2017	2016	2015
Jointown	-500,661.23	43,126.38	43,595.60
Int'l Group	-121,209.19	14,152.84	9,433.62
Sinopharm Accord	51,108.34	147,254.56	104,797.91
Nanjing Pharmaceutical	-104,360.45	-24,087.80	-30,608.41
Liuzhou Pharmaceutical	-95,014.00	10,838.51	-10,724.58
Realcan Pharmaceutical	-224,857.72	-175,904.58	-46,626.17
Guangzhou Pharmaceuticals	-178,655.86	35,421.35	13,240.45

The cash flow from operating activities of Guangzhou Pharmaceuticals is basically in line with that of comparable listed companies in the same industry.

Summing up, the significant cash outflow from operating activities of Guangzhou Pharmaceuticals during January to September 2017 is of rational commercial reasons.

III. Supplementary disclosure

Relevant details have been supplemented and disclosed in the section of “III. Financial analysis on the target assets” in “Section VIII Management discussion and analysis” of the Report.

IV. Inspection opinions from intermediary

(I) Financial Advisor's opinion

After review, the Independent Financial Advisor is of view that the significant cash outflow from operating activities of Guangzhou Pharmaceuticals during January to September 2017 is of rationality and in line with the industry features.

(II) Accountant's opinion

Based on the audit procedures conducted by KPMG, KPMG is of view that “The disclosure of the cash flow statement of Guangzhou Pharmaceuticals complies with the requirements of the Accounting Standards for Business Enterprises in all material aspects and no material inconsistency has been found”.

Guangzhou Baiyunshan Pharmaceutical Holdings Company Limited

5 January 2018