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UEN No: S99SS0111B
GST Reg No: M90367530Y

Issuer: Tianjin Zhongxin Pharmaceutical Group Corporation Limited

Security: Tianjin Zhongxin Pharmaceutical Group Corporation Limited

Meeting details:
Date: 15 May 2018
Time: 1.30 p.m.
Venue: Pinnacle Suite, Wangz Business Centre, 7 Temasek Blvd, #44-01, The Penthouse Suntec Tower 1, Singapore 038987 (Video conference)

Company Description

Tianjin Zhongxin Pharmaceutical Group Corporation Limited, together with its subsidiaries, produces and sells traditional Chinese medicines, western medicines, and healthcare products primarily in the People's Republic of China. It is also involved in the manufacture and sale of biological products; wholesale and retail sale of medicines, biochemical pharmaceutical products, and daily use products; and operation of hospitals. In addition, the company provides logistics, stocks, equipment installation, and medicine processing services. Tianjin Zhongxin Pharmaceutical Group Corporation Limited sells medicinal products under its own brand and other brands to wholesalers. The company was founded in 1992 and is based in Tianjin, the People's Republic of China.
(Source: http://www.sgx.com/wps/portal/sgxweb/home/company_disclosure/stockfacts?code=T14)

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1. As noted in the Work Report of Chairman of The Board of Directors (pages 12 to 20 of the annual report), the group achieved the following results in FY2017:

- Stepped up in developing major varieties and promoted fast sales growth
- Actively built the sharing platforms to facilitate the integration of marketing resources
- Proactively adapted to the medical reform policies to capture market opportunities in advance
- Attempted the unique marketing model and expanded the marketing network at WeChat
- Stepped up advertising and promotion efforts to enhance branding
- Highlighted safety and environmental inspection checks and strictly monitored rectification to ensure stability
- Coordinated fine management to effectively reduce cost and increase efficiency
- Vigorously strengthened standardised operation to enhance risk management capabilities

On 11 January 2017, the Chinese State Council Medical Reform Office, together with seven other institutions, issued the Opinions on the Implementation of the "Two-invoice System" in Drug Procurement by Public Medical Institution (for Trial Implementation) (GYGBF [2016]) No.4 to finalise the gradual rollout of the Two-invoice System fully by 2018.

The group has stated the following:

> *"The Company's commercial segment actively coped with the "two-invoice policy" to strive for Tier-1 agency qualification. Throughout the year, the Company secured 183 new tier-1 suppliers and 918 new Tier-1 agency varieties where the key varieties under joint ventures including Novo Nordisk and Sanofi achieved a zero breakthrough in Tier-1 agency and obtained the Tier-1 agency qualification for basically all of the key Western varieties under joint ventures, which entirely eliminated the monopolistic competition. At the same time, the Company's control over the end customer market was increasing, which strengthened the market strengths of Zhong Xin's business." (page 13)*

(i) **Can management help shareholders understand the impact of and the opportunities presented by the "Two-invoice policy" which is a major part of the reform introduced by the Chinese government?**

(ii) **What changes have been made to the group's distribution model and how does it impact the group's margin, profitability and growth?**

(iii) **Similarly, can management elaborate further on the changes made to the group's marketing strategy?**

2. Would the board/management provide shareholders with better clarity on the following matters? Specifically:

(i) **Western Medicine:** As shown in Note 35 (page 118 – Financial information by operating segments), other than the core segment of Chinese medicine, the group's operates a Western Medicine segment that manufactures western pharmaceutical products through cooperation with foreign companies.

35. FINANCIAL INFORMATION BY OPERATING SEGMENTS (CONT'D)

The financial information by operating segments for the Group is as follows:

	Revenue RMB'000	Cost of sales RMB'000	Gross profit RMB'000
2017			
Chinese Medicine	**3,648,838**	**(1,695,988)**	**1,952,850**
Western Medicine	**1,490,925**	**(1,352,088)**	**138,837**
Others	**549,479**	**(497,332)**	**52,147**
Total	**5,689,242**	**(3,545,408)**	**2,143,834**
2016 (Restated)			
Chinese Medicine	4,066,791	(2,240,697)	1,826,094
Western Medicine	1,640,385	(1,557,228)	83,157
Others	535,397	(474,997)	60,400
Total	6,242,573	(4,272,922)	1,969,651

(Source: Company annual report)

As seen in the table above, the gross profit margin of the segment lags behind that of the core Chinese Medicine segment. **Would management help shareholders understand the group's strategy for its Western Medicine segment? What would be management's target for the gross profit margin of the Western Medicine segment in the mid-long term? How strategic is the Western Medicine segment in the group's overall growth strategy?**

(ii) **Inventories:** The "assessment of allowance for impairment of inventories" is a key audit matter (KAM) highlighted by the Independent Auditors in their Report on the Audit of the Financial Statements (pages 44 to 47). Key audit matters are those matters that, in the professional judgement of the Independent Auditors, were of most significance in the audit of the financial statements of the current period. The impairment losses on inventories were RMB(12.0) million and RMB(8.3) million in FY2016 and FY2017 respectively. As at the end of the financial year in FY2016 and FY2017, the carrying values of the inventories were RMB929.1 million and RMB1,104 million respectively. **Can management help shareholders understand the reason(s) for the unusually large impairment of inventories in the past two years?**

(iii) **Capital management:** In Note 23 (page 107 – Share capital), it was disclosed that management monitors the group's capital on the basis of the debt-to-adjusted capital ratio. As at 31 December 2017, the group was in a net cash position of RMB495.8 million (2016: RMB588.4 million). The company has proposed to distribute RMB153.8 million as a final dividend out of the FY2017 profit of RMB473.3 million. **Can the board/management elaborate further on the deliberations it had regarding the level of dividends? What is the group's targeted optimal capital structure?**

3. As noted in the Corporate Governance Statement, the board currently comprises 4 executive directors and 3 independent directors. As the chairman of the board is an executive director, Guideline 2.2 of the 2012 Code of Corporate Governance (2012 CG Code) recommends that independent directors should make up at least half of the board.

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The board has disclosed that it "*will use its best endeavours to meet the requirement for independent directors to make up at least half of the Board*" (page 29).

(i) Would the board help shareholders understand its efforts in meeting the requirement for independent directors to make up at least half of the board?

(ii) When does the company expect to meet the requirement for independent directors to make up at least half of the board?

(iii) What is the company's search and nomination process for directors, especially independent directors?

In addition, the nominating committee (NC) and the remuneration committee (RC) comprise just two directors since 30 June 2017.

(iv) How effective were the NC and the RC at discharging their duties given that they only have two members?

(v) What are the company's efforts to reconstitute the board committees so that they meet the requirements of the 2012 CG Code?

A copy of the questions for the Annual Report for the financial year ended 31 December 2016 could be found here:

https://sias.org.sg/qa-on-annual-reports/?company=Tianjin%20Zhongxin%20Pharmaceutical%20Group%20Corporation%20Ltd

The company's response could be found here: -----