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**If you are in any doubt** about this supplemental circular or as to the action to be taken, you should consult your licensed securities dealer or registered dealer in securities, bank manager, solicitor, professional accountant or other professional adviser.

**If you have sold or transferred** all your securities in Honghua Group Limited, you should at once hand this supplemental circular and the accompanying supplemental form of proxy to the purchaser or the transferee or to the bank, licensed securities dealer or other agent through whom the sale or transfer was effected for transmission to the purchaser or the transferee.

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**宏华集团**  
HONGHUA GROUP

**Honghua Group Limited**

**宏華集團有限公司**

*(Incorporated in the Cayman Islands with limited liability)*

**(Stock Code: 196)**

**SUPPLEMENTAL CIRCULAR TO  
ANNUAL GENERAL MEETING IN RELATION TO  
CONTINUING CONNECTED TRANSACTIONS AND  
MAJOR TRANSACTIONS —  
LEASE FRAMEWORK AGREEMENT AND  
FINANCIAL COOPERATION AGREEMENT  
AND  
SUPPLEMENTAL NOTICE OF ANNUAL GENERAL MEETING**

**Independent Financial Adviser to the Independent Board Committee  
and the Independent Shareholders**



**Gram Capital Limited**  
**嘉林資本有限公司**

This supplemental circular (the “**Supplemental Circular**”) should be read in conjunction with the circular of Honghua Group Limited (the “**Company**”) dated 9 May 2018 (the “**Original Circular**”).

A letter from the Board is set out on pages 4 to 24 of this supplemental circular. A letter from the Independent Board Committee is set out on pages 25 to 26 of this supplemental circular. A letter from Gram Capital, the independent financial adviser to the Independent Board Committee and the Independent Shareholders containing its advice in relation to the Transactions is set out on pages 27 to 50 of this supplemental circular.

The supplemental notice of AGM is set out on pages 59 to 61 in this supplemental circular. The AGM of the Company will be held as originally scheduled at 9:30 a.m. on 21 June 2018, Thursday, at Novotel Century Hong Kong, 238 Jaffe Road, Wan Chai, Hong Kong. If you do not propose to attend the AGM, you are requested to complete the enclosed supplemental form of proxy in accordance with the instructions printed thereon and return it to the Company’s branch share registrar and transfer office in Hong Kong, Computershare Hong Kong Investor Services Limited, at 17M Floor Hopewell Centre, 183 Queen’s Road East, Wanchai, Hong Kong as soon as possible and in any event not later than 48 hours before the time appointed for holding the AGM or any adjournment thereof. Completion and return of the supplemental form of proxy will not preclude you from attending and voting in person at the AGM or any adjourned meeting if you so wish, and in such event, the supplemental form of proxy shall be deemed to be revoked.

5 June 2018

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## DEFINITIONS

*In this supplemental circular, unless the context otherwise requires, the following expressions have the following meanings:*

“Aerospace Science and Industry Financial Corporation”	Aerospace Science and Industry Financial Corporation, a company incorporated in the PRC, and a non-bank financial institution established by CASIC and its subsidiaries;
“AGM”	the annual general meeting of the Company to be held at 9:30 a.m. on 21 June 2018, Thursday, at Novotel Century Hong Kong, 238 Jaffe Road, Wan Chai, Hong Kong for the purpose of, inter alia, considering and approving the Transactions;
“ASIFL”	Aerospace Science & Industry Financial Leasing Co., Ltd. (航天科工金融租賃有限公司), a company incorporated in the PRC, in which CASIC and its subsidiaries hold a 46.5% equity interest;
“associate(s)”	has the meaning ascribed to it under the Listing Rules;
“Board”	the board of Directors;
“business day(s)”	a day on which banks are generally open for business in Hong Kong (other than a Saturday, Sunday or public holiday or a day on which a tropical cyclone warning No. 8 or above or a “black rainstorm warning signal” is hoisted or remains hoisted in Hong Kong at any time between 9:00 a.m. and 5:00 p.m.);
“CASIC”	China Aerospace Science and Industry Corporation* (中國航天科工集團有限公司), a company incorporated in the PRC;
“Company”	Honghua Group Limited, a company incorporated in the Cayman Islands with limited liability, the Shares of which are listed on the Main Board of the Stock Exchange of Hong Kong Limited;
“connected person(s)”	has the meaning ascribed to it under the Listing Rules;
“Director(s)”	director(s) of the Company;
“Financial Cooperation Agreement”	the financial cooperation agreement for the provision of financial services dated 1 June 2018 entered into between the Company and Aerospace Science and Industry Financial Corporation;
“Group”	the Company and its subsidiaries;

## DEFINITIONS

“HK\$”	Hong Kong dollars, the lawful currency of Hong Kong;
“Hong Kong”	the Hong Kong Special Administrative Region of the People’s Republic of China;
“Honghua Investment”	Honghua (China) Investment Co., Ltd (宏華（中國）投資有限公司), a limited liability company incorporated in the PRC and a wholly-owned subsidiary of the Company;
“Honghua Shenzhen”	Honghua Financial Leasing (Shenzhen) Co., Ltd (宏華融資租賃（深圳）有限公司), a limited liability company incorporated in the PRC and in which the Company directly and indirectly holds a 60% equity interest;
“Honghua Shanghai”	Honghua Financial Leasing (Shanghai) Co., Ltd (宏華融資租賃（上海）有限公司), a limited liability company incorporated in the PRC and a wholly-owned subsidiary of the Company;
“Independent Board Committee”	the independent committee of the Board, comprising all the independent non-executive Directors, established to make recommendations to the Independent Shareholders in respect of the Transactions;
“Independent Financial Adviser” or “Gram Capital”	Gram Capital Limited, a licensed corporation to carry out Type 6 (advising on corporate finance) regulated activity under the SFO, being the independent financial adviser appointed to advise the Independent Board Committee and the Independent Shareholders in respect of the Lease Framework Agreement and deposit services under Financial Cooperation Agreement;
“Independent Shareholder(s)”	Shareholders other than CASIC and its associates;
“Independent Third Party(ies)”	third parties independent of and not connected with the directors, chief executive and substantial shareholders of CASIC or any of its subsidiaries, or any of their respective associates;
“Kehua”	Kehua Technology Co., Limited, a limited liability company incorporated in Hong Kong and a wholly owned subsidiary of CASIC;
“Latest Practicable Date”	1 June 2018, being the latest practicable date prior to the printing of this supplemental circular for the purpose of ascertaining certain information contained herein;

## DEFINITIONS

“Lease Framework Agreement”	the framework agreement for strategic cooperation (2018 amended) dated 1 June 2018 entered into between Honghua Investment, Honghua Shenzhen, Honghua Shanghai and ASIFL to amend the relevant contents of the 2017 Framework Agreement;
“Listing Rules”	the Rules Governing the Listing of Securities on the Stock Exchange;
“Main Board”	the stock market operated by the Stock Exchange other than the GEM;
“PBOC”	The People’s Bank of China;
“PRC”	the People’s Republic of China;
“RMB”	Renminbi, the lawful currency of the PRC;
“SFO”	the Securities and Futures Ordinance (Chapter 571 of the laws of Hong Kong);
“Share(s)”	the ordinary share(s) of HK\$0.1 each in the share capital of the Company;
“Shareholder(s)”	holder(s) of ordinary share(s) of nominal value of HK\$0.10 each in the share capital of the Company;
“Stock Exchange”	The Stock Exchange of Hong Kong Limited;
“Transactions”	the transactions contemplated under the Lease Framework Agreement and the Financial Cooperation Agreement (as to deposit service); and
“%”	per cent.

LETTER FROM THE BOARD



宏华集团  
HONGHUA GROUP

**Honghua Group Limited**  
**宏華集團有限公司**

*(Incorporated in the Cayman Islands with limited liability)*

**(Stock Code: 196)**

*Executive Directors:*

Mr. Chen Yajun (*Chairman*)  
Mr. Zhang Mi  
Mr. Ren Jie

*Non-executive Directors:*

Mr. Han Guangrong  
Mr. Chen Wenle

*Independent non-executive Directors:*

Mr. Liu Xiaofeng  
Mr. Chen Guoming  
Ms. Su Mei  
Mr. Poon Chiu Kwok  
Mr. Chang Qing  
Mr. Wu Yuwu

*Registered office:*

Clifton House, 75 Fort Street  
PO Box 1350, Grand Cayman  
KY1-1108, Cayman Islands

*Head Office:*

99 East Road, Information Park  
Jinniu District, Chengdu Sichuan  
People's Republic of China  
Post code: 610036

*Principal place of business  
in Hong Kong:*

Room 2508, Harcourt House  
39 Gloucester Road  
Wan Chai, Hong Kong

5 June 2018

*To the Shareholders*

Dear Sir or Madam,

**SUPPLEMENTAL CIRCULAR TO  
ANNUAL GENERAL MEETING IN RELATION TO  
CONTINUING CONNECTED TRANSACTIONS AND  
MAJOR TRANSACTIONS —  
LEASE FRAMEWORK AGREEMENT AND  
FINANCIAL COOPERATION AGREEMENT  
AND**

**SUPPLEMENTAL NOTICE OF ANNUAL GENERAL MEETING**

**INTRODUCTION**

Reference is made to the announcements in respect of the continuing connected transactions in relation to the Framework Agreement and the supplemental agreement to the Framework Agreement entered into between Honghua Investment, Honghua Shenzhen,

## LETTER FROM THE BOARD

Honghua Shanghai and ASIFL published by the Company on 3 October 2017 and 7 November 2017 respectively (the “**2017 Framework Agreement**”), and the related circular published on 13 November 2017.

Reference is made to the announcement in relation to the Lease Framework Agreement entered into between Honghua Investment, Honghua Shenzhen, Honghua Shanghai and ASIFL (to amend the relevant contents of the 2017 Framework Agreement), and in relation to the Financial Cooperation Agreement entered into between the Company and Aerospace Science and Industry Financial Corporation published by the Company on 1 June 2018.

This supplemental circular (the “**Supplemental Circular**”) should be read in conjunction with the circular of the Company dated 9 May 2018 (the “**Original Circular**”). Unless the context otherwise requires, capitalised terms used in this supplemental circular shall have the same meaning as those defined in the Original Circular.

The purposes of this supplemental circular are to provide the Shareholders with, among others, (i) details of the Transactions; (ii) the letter of recommendation from the Independent Board Committee to the Independent Shareholders regarding the Transactions; (iii) the letter of advice from Gram Capital to the Independent Board Committee and the Independent Shareholders regarding the Transactions; and (iv) the supplemental notice of AGM at which relevant resolutions will be proposed to consider and approve the Transactions.

### CONTINUING CONNECTED TRANSACTIONS

#### A. Lease Framework Agreement

The principal terms of the Lease Framework Agreement are summarized as follows:

Date: 1 June 2018

Parties: (1) ASIFL;  
(2) Honghua Investment;  
(3) Honghua Shenzhen; and  
(4) Honghua Shanghai

Term of Lease Framework Agreement: Term of the Lease Framework Agreement starts from the date of the agreement to 6 November 2020.

## LETTER FROM THE BOARD

Amendments under Lease Framework Agreement:

2017 Framework Agreement has been amended in the following aspects:

- (1) the proposed annual caps for 2018, 2019, and 2020 related to finance leases were revised to accommodate the additional finance leases business in 2018 and 2019; and
- (2) relevant contents of operating leases and the proposed relevant annual caps were added.

After the above amendments, the transactions under the Lease Framework Agreement are divided into the following two categories:

- (i) Sales Transactions and Finance Lease Transactions; and
- (ii) Sales Transactions and Operating Lease Transactions.

Save for the above, there are no changes to other terms of the 2017 Framework Agreement.

The principal terms and particulars of the transactions under the Lease Framework Agreement are as follows:

### *Sales Transactions:*

ASIFL agreed to purchase from Honghua Investment certain equipment and products, including the drilling rigs and other drilling equipment required for oil drilling business (such as new fracturing pumps and top drives), for the aggregated consideration of up to RMB1,200 million through the Sales Transactions in 2018 and 2019, among which Sales Transactions amounting to RMB800 million and RMB400 million will be used on finance leases and operating leases respectively. Details of the purchase of the equipment and products will be set forth in specific agreements to be entered into between ASIFL and Honghua Investment.

### *Leasing Transactions:*

According to the Lease Framework Agreement, under these 2 types of transaction models, following the respective Sales Transaction(s), ASIFL will provide finance lease and operating lease services to the Group by leasing such equipment and products through Finance Lease and Operating Lease Transactions to Honghua Shenzhen or Honghua Shanghai, which will in turn enter into sub-leasing arrangement with third party customers in relation to such equipment and products. The term(s) of the sub-leasing arrangement(s) that Honghua Shenzhen or Honghua Shanghai may enter into with individual third party customer(s) will depend on the customer(s)' nature of operation and particular needs for the equipment and product, which may exceed three years. Consequently, the term of the related Finance Lease and Operating Lease Transactions pursuant to the Lease Framework

## LETTER FROM THE BOARD

Agreement between ASIFL and Honghua Shenzhen or Honghua Shanghai may also exceed three years. In such case, the Company will comply with the disclosure requirement and, if required, obtain the Independent Shareholder's approval under the Listing Rules to extend the term of the Lease Framework Agreement. In each of the sublease agreement with an individual third party customer, Honghua Shenzhen or Honghua Shanghai will be entitled to unilaterally terminate the sub-leasing arrangement on or prior to the expiration date of the Lease Framework Agreement, should the requisite Independent Shareholders' approval, if required, to extend the Lease Framework Agreement cannot be obtained.

Pursuant to Rule 14A.52 of the Listing Rules, the Company shall appoint an independent financial advisor to explain why the relevant finance leases and operating leases under the Lease Framework Agreement require for a longer period of time and to confirm that the terms of such agreements are in conformity with the industry normal business practices for this period. For this purpose, the Company has engaged Gram Capital as the independent financial adviser to provide such confirmation, particulars of which are set out below:

In assessing the reasons for the duration of relevant finance leases and operating leases under the Lease Framework Agreement to exceed three years, Gram Capital considered the following factors:

- (i) by entering into the finance leases and operating leases with a longer duration, the payment obligation of the costs of the equipment of the Group is allowed to be spread over a longer period, which would reduce the stress to the planning of working capital by the relevant members of the Group; and
- (ii) the lease period of each finance lease and operating lease service shall be determined with reference to, among other things, the useful life of the relevant leasing equipment and products, which, as confirmed by the Directors, is ranged from 5 to 20 years, subject to the type of equipment and products and their respective utilisation rate.

In considering whether it is normal business practice for agreements of similar nature with those finance leases and operating leases under the Lease Framework Agreement to have a term of such duration, Gram Capital identified similar finance lease and operating lease agreements entered into by companies listed on the Stock Exchange regarding the provision of finance lease and/or operating lease services to the listed companies, with duration of more than three years.

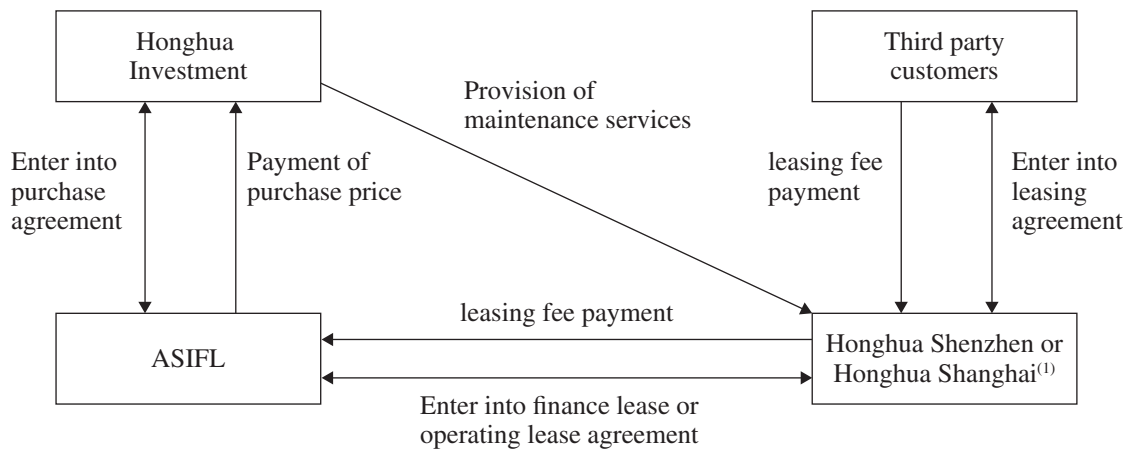
As mentioned above, the transactions under sales transactions and finance lease transactions model are in line with the transaction structure of the transactions under the 2017 Framework Agreement. In this regard, Gram Capital noted from the circular dated 13 November 2017 that the duration of the relevant finance leases under the 2017 Framework Agreement may also be more than three years.

## LETTER FROM THE BOARD

Gram Capital also obtained and reviewed the finance lease agreements entered into between the Group and independent third parties during 2017, which are in similar nature as the transactions under 2017 Framework Agreement/the Lease Framework Agreement. Gram Capital noted that the lease terms of finance leases conducted under such agreements are more than three years.

Taking into account of the above, Gram Capital are of the view that that the lease term of the relevant finance leases and operating leases under the Lease Framework Agreement, which is longer than three years is required and it is normal business practice for the relevant finance leases and operating leases under the Lease Framework Agreement to be of such duration.

The following diagram illustrates the operation flow of the finance lease and operating lease and leasing business with third party customers of the Group:



*Note:*

- (1) Honghua Shenzhen or Honghua Shanghai may enter leasing arrangement(s) through a subsidiary of the Group with certain third party customer(s) if such customer(s) has/have particular quality and license requirement of the lessor.

The transactions contemplated under the Lease Framework Agreement are conducted on a non-exclusive basis. Should the need arises, the Company believes it has the ability to obtain financing for its finance leasing business from commercial banks or other financial institutions.

Based on the business model described above, it is the current intention of the Company that Honghua Investment and Honghua Shenzhen or Honghua Shanghai will enter into the Sales Transactions and Leasing Transactions with ASIFL only after Honghua Shenzhen or Honghua Shanghai has secured sub-leasing arrangements with third party customers. The type and specifics of the equipment or products for each Sales Transaction and Leasing Transaction will depend on the nature of operation and needs of the third party customer.

Even though the Group may be exposed to credit risk in the event that its third party customers fail to settle the rental of the sub-leasing arrangement while the Group is obligated to pay for the leasing and related fees to ASIFL, such credit risk can be mitigated by the

## LETTER FROM THE BOARD

Group's right to (i) sue the defaulted customer for breach of the lease; (ii) terminate the sub-leasing arrangement with the defaulted customer; (iii) recoup the relevant equipment and products from the defaulted customer; and (iv) enter into sub-leasing arrangement with other customer given that the legal title of the relevant equipment and products does not rest with any particular customer.

### ***Legal and accounting implications of the transactions under Lease Framework Agreement***

- (i) Sales and finance lease transactions with ASFIL and finance lease transactions with end customers

#### *Legal title*

In this case, the legal title of the relevant equipment will be transferred to ASFIL upon sales to ASFIL by Honghua Investment pursuant to the sales agreements. The legal title of the equipment belongs to ASFIL during the terms of the Leasing Transaction between ASFIL and Honghua Shenzhen or Honghua Shanghai. Upon the expiration of the Leasing Transactions and sub-leasing arrangement, the end customer shall have the right to purchase the equipment and products and the legal title of which will be transferred from Honghua Shenzhen or Honghua Shanghai (which would need to obtain the title from ASFIL first if the relevant Leasing Transaction is still in force) to the end customer.

#### *Accounting treatment*

Pursuant to the applicable accounting standard, IAS 17 Leases, the end customers of Honghua Shenzhen or Honghua Shanghai will record the equipment and products as fixed assets on their balance sheets at the commencement of the arrangement and subsequently recognize amortization expenses of the equipment over the useful life of the equipment and products. The leasing fees paid to ASFIL by Honghua Shenzhen or Honghua Shanghai will be recognized as expense by Honghua Shenzhen or Honghua Shanghai during the term of the Leasing Transaction. At the same time, Honghua Shenzhen or Honghua Shanghai will recognize account receivables from the end customer pursuant to the sub-leasing agreement. Leasing fee received from end customers will be recognized as revenue.

- (ii) Sales and finance lease transactions with ASFIL and operating lease transactions with end customers

#### *Legal title*

In this case, the legal title of the equipment and products will be transferred to ASFIL upon sales to ASFIL by Honghua Investment pursuant to the sales agreements. The legal title of the equipment belongs to ASFIL during the terms of the Leasing Transaction between ASFIL and Honghua Shenzhen or Honghua Shanghai. On fulfilment of the finance lease with ASFIL, Honghua Shenzhen or

## LETTER FROM THE BOARD

Honghua Shanghai can acquire the legal title of relevant equipment and products from ASFIL when it shall be entitled to deal with or dispose of the relevant equipment and product at its discretion.

### *Accounting treatment*

Pursuant to the applicable accounting standard, IAS 17 Leases, Honghua Shenzhen or Honghua Shanghai will record the equipment and products as fixed assets on its balance sheet at the commencement of the arrangement and subsequently recognize amortization expenses of the equipment over the useful life of the equipment and products. The leasing fees paid to ASFIL by Honghua Shenzhen or Honghua Shanghai will be recognized as expense by Honghua Shenzhen or Honghua Shanghai during the term of the Leasing Transaction. At the same time, Honghua Shenzhen or Honghua Shanghai will recognize account receivables from the third party customers pursuant to the sub-leasing agreement. Leasing fee received from the end customer will be recognized as revenue.

- (iii) Sales and operating lease transactions with ASFIL and operating lease transactions with end customers

### *Legal title*

In this case, the legal title of the equipment and products will be transferred to ASFIL upon sales to ASFIL by Honghua Investment pursuant to the sales agreements. On fulfilment of the operating lease transaction with ASFIL, Honghua Shenzhen or Honghua Shanghai would not acquire the legal title of relevant equipment and products from ASFIL.

### *Accounting treatment*

Pursuant to the applicable accounting standard, IAS 17 Leases, ASFIL will record the equipment and products as fixed assets on its balance sheet at the commencement of the arrangement and subsequently recognize amortization expenses of the equipment over the useful life of the equipment and products. Honghua Shenzhen or Honghua Shanghai is not required to record the relevant equipment and products as fixed assets on its balance sheet. The leasing fees paid to ASFIL by Honghua Shenzhen or Honghua Shanghai is required to recognize as expense by Honghua Shenzhen or Honghua Shanghai during the term of the Leasing Transaction. At the same time, Honghua Shenzhen or Honghua Shanghai will recognize account receivables from the third party customers pursuant to the sub-leasing agreement. Leasing fee received from the end customer will be recognized as revenue.

- (iv) Sales and operating lease transactions with ASFIL and finance lease transactions with end customers

In this case, the Group and end customers will not enter into a finance lease in respect of relevant equipment and products.

## LETTER FROM THE BOARD

### *Proposed Revised Annual Caps*

#### *(1). Sales Transactions and Finance Lease Transactions*

During the relevant periods of the Sales Transactions, the proposed revised annual caps are:

	For the fiscal year ended 31 December 2018 <i>RMB</i>	For the fiscal year ended 31 December 2019 <i>RMB</i>	From 1 January 2020 to 6 November 2020 <i>RMB</i>
Sales prices	400,000,000	400,000,000	0

During the relevant periods of the Finance Lease Transactions, the proposed revised annual caps are:

	For the fiscal year ended 31 December 2018 <i>RMB</i>	For the fiscal year ended 31 December 2019 <i>RMB</i>	From 1 January 2020 to 6 November 2020 <i>RMB</i>
Maximum daily balance of the leasing principal	639,400,000	989,536,000	867,196,000
Annual interests and other payments:			
Outstanding interest fee <sup>(1)</sup>	102,615,000	164,234,000	130,866,000
One-off handling fee	18,000,000	18,000,000	0

*Note:*

- (1) Based on the leasing fee and a maximum interest rate of 6.6% per annum, which was determined after arm's length negotiations with ASIFL. In determining the maximum interest rate, the parties used the prevailing PBOC rate for bank loans as a starting point and took into consideration of other factors such as transaction cost in the leasing arrangements to be entered into and room of prudence for future adjustment. The Company believes the interest rate is reasonable and comparable to the market rates quoted by financial leasing companies of comparable size and customer portfolio.

The revisions to proposed annual caps of the transactions under the Sales and Finance Lease Transactions (including the aforesaid Sales Transactions and Finance Lease Transactions) are determined based on the historical transaction amounts, and after arm's length negotiations between the Company and ASIFL and taking into consideration the aggregate value of the equipment and products currently under negotiation by the Group and its finance lease services customers.

<b>LETTER FROM THE BOARD</b>
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(2). *Sales Transactions and Operating Lease Transactions*

During the relevant periods of the Sales Transactions, the proposed annual caps are:

	For the fiscal year ended 31 December 2018 <i>RMB</i>	For the fiscal year ended 31 December 2019 <i>RMB</i>	From 1 January 2020 to 6 November 2020 <i>RMB</i>
Sales prices	200,000,000	200,000,000	0

During the relevant periods of the Operating Lease Transactions, the proposed annual caps are:

	For the fiscal year ended 31 December 2018 <i>RMB</i>	For the fiscal year ended 31 December 2019 <i>RMB</i>	From 1 January 2020 to 6 November 2020 <i>RMB</i>
Amount of Rental to be paid	29,812,000	119,245,000	119,245,000

The proposed annual caps of transactions under the Sales and Operating Lease Transactions models (including the aforesaid Sales Transactions and Operating Lease Transactions) are determined after arm's length negotiations between the Company and ASIFL and taking into consideration the aggregate value of the equipment and products currently under negotiation by the Group and its operating lease services customers with reference to the market rental of the same type of equipment. The rental of the Operating Lease Transactions with ASIFL was determined with reference to the average price in the industry and the acceptable price of the customers to the practicable extent.

***Historical Transaction Amount***

(1). *Sales and Finance Lease Transactions*

In respect of the Sales Transactions, the transaction amounts for the two fiscal years ended 31 December 2016 and 31 December 2017 are as follows:

	For the fiscal year ended 31 December 2016 <i>RMB</i>	For the fiscal year ended 31 December 2017 <i>RMB</i>
Sales prices	0	266,000,000

## LETTER FROM THE BOARD

In respect of Finance Lease Transactions, the transaction amounts for the two fiscal years ended 31 December 2016 and 31 December 2017 are as follows:

	<b>For the fiscal year ended 31 December 2016 RMB</b>	<b>For the fiscal year ended 31 December 2017 RMB</b>
Maximum daily balance of the leasing principal	0	239,400,000
Annual interests and other payments:		
Outstanding interest fee	0	29,730,000
One-off handling fee	0	6,600,000

### *(2). Sales Transactions and Operating Lease Transactions*

There is no historical transaction amount between the Company and ASIFL in respect of the transactions of this type.

### ***Pricing Policy***

#### *(1). Sales Transactions and Finance Lease Transactions*

Pursuant to the Lease Framework Agreement, the pricing and payment terms under the product procurement agreement and finance lease agreement entered into by the parties shall be determined after arm's length negotiations between the Group and ASIFL and based on normal commercial terms with reference to the prevailing market prices that are fair and reasonable for the relevant equipment and in any event shall be no less favorable to the prices offered by the Group to its independent third parties. The Group will comply with its relevant internal pricing policies in the negotiation with ASIFL.

The sales prices will be determined after arm's length negotiations between the Group and ASIFL and mainly based on the net book value of the relevant equipment and products with reference to the leasing terms.

The leasing price of the Finance Lease Transactions between ASIFL and Honghua Shenzhen or Honghua Shanghai will be determined after arm's length negotiations between ASIFL and Honghua Shenzhen or Honghua Shanghai, subject to a maximum interest rate of 6.6% per annum. Honghua Shenzhen or Honghua Shanghai will normally refer to the prevailing PBOC rate for bank loans and will take into consideration of other factors such as transaction cost (including one-off handling fee) for each finance lease arrangement and comparable transactions entered into between Honghua Shenzhen or Honghua Shanghai and independent third parties, while in any event the interest rate for such finance lease transactions will not exceed 6.6% per annum. Meanwhile, the Board of Directors has taken the following steps to ensure that such maximum interest rate is comparable to the prevailing market rate: (i) the relevant departments of the Group obtained contemporaneous terms and interest rates relating to the finance lease

## LETTER FROM THE BOARD

transactions from other similar financial leasing companies which are independent of the Group and conducted comparison with the interest rate offered in transactions with ASFIL; (ii) once the preliminary terms (including interest rate) became available, the terms were reviewed first by the internal control department and then by an approval committee formed by staff from relevant functional departments (including the business development department, credit review department, risk control department) and the general manager of Honghua Shenzhen and/or Honghua Shanghai; and (iii) the terms of the transactions (including interest rate) were submitted for the consideration and approval by the Board of Directors before execution. In addition, according to the relevant pricing policy of Honghua Shenzhen, any finance lease arrangement of RMB 10 million or above shall be subject to approval of the board of directors of Honghua Shenzhen. The board of directors shall consider and approve such finance lease arrangement based on the qualification of the lessee, the prospect of the industry, the sustainability of the project, the guarantee of repayment of the lessee and the profitability of the project.

The price of the Finance Lease Transactions will also be affected by the price of sub-leasing transaction entered into or to be entered into between Honghua Shenzhen or Honghua Shanghai and the end customer. Honghua Shenzhen or Honghua Shanghai will charge the price of sub-leasing based on the cost and the interest rate of leasing to ensure that the Group can obtain a reasonable gross profit margin during the sub-leasing and hence the Finance Lease Transactions. In this regard, Honghua Shenzhen implemented the Tiered Pricing Approval Procedure in June 2017, which established a tiered structure for leasing price approval based on expected returns, with prices that generate lower returns needing approval by more senior management member. The price tiers are further divided by the business segments of the customer, such as governmental organizations, enterprises and related parties. Honghua Shanghai will follow the practice and procedure requirements of Honghua Shenzhen.

### *(2). Sales Transactions and Operating Lease Transactions*

Pursuant to the Lease Framework Agreement, the pricing and payment terms under the product procurement agreement and operating lease agreement entered into by the parties shall be determined after arm's length negotiations between the Group and ASIFL and based on normal commercial terms with reference to the prevailing market prices that are fair and reasonable for the relevant equipment and in any event shall be no less favorable to the prices offered by the Group to its independent third parties. The Group will comply with its relevant internal pricing policies in the negotiation with ASIFL.

The sales prices will be determined after arm's length negotiations between the Group and ASIFL and mainly based on the net book value of the relevant equipment and products with reference to the leasing terms.

The price of the Operating Lease Transactions between ASIFL and Honghua Shenzhen or Honghua Shanghai will be affected by the price of sub-leasing entered into or to be entered into between Honghua Shenzhen or Honghua Shanghai and the end customer, and will be determined after arm's length negotiations between ASIFL and

## LETTER FROM THE BOARD

Honghua Shenzhen or Honghua Shanghai. In addition, according to the relevant pricing policy of Honghua Shenzhen, any leasing arrangement of RMB 10 million or above shall be subject to approval of the board of directors of Honghua Shenzhen. The board of directors shall consider and approve such operating lease arrangement based on the qualification of the lessee, the prospect of the industry, the sustainability of the project, the guarantee of repayment of the lessee and the profitability of the project.

### ***Internal Control Procedures Governing the Transactions under the Lease Framework Agreement***

#### *(1). Sales Transactions and Finance Lease Transactions*

Internal control for the transactions of this type

Honghua Shenzhen implemented the Project Review Procedures and the Approval Committee Procedures in May 2017 and the Finance Lease Contract Review and Approval Procedures in June 2017. Pursuant to these procedures:

- (a) the relevant departments of the Group will obtain terms and interest rates relating to the Finance Lease Transactions from major financial leasing companies which are independent of the Company and connected persons of the Company, and conduct comparison based on the benchmark lending rate for term loans promulgated by PBOC from time to time in order to allow the Group to obtain the most favorable terms relating to such Finance Lease Transactions;
- (b) the one-off handling fee that may be charged by ASIFL at the time of conclusion of the finance lease under the Framework Agreement shall be on terms no less favorable than those offered to the Company and its subsidiaries by independent third parties and at such rate as determined with reference to the rates charged by other major financial institutions for finance leases of equipment of the same or similar type or the applicable rate (if any) published by the PBOC from time to time in relation to such services and the provisions of the relevant written agreements;
- (c) once the preliminary terms, including the price, are available, the terms will be reviewed first by the internal control department and then by an approval committee formed by staff from relevant functional departments, including the business development department, credit review department, risk control department, and the general manager of Honghua Shenzhen. The agreement is subject to approval of the board of the directors of Honghua Shenzhen before execution.

Honghua Shanghai will follow the practice and procedure requirements of Honghua Shenzhen.

## LETTER FROM THE BOARD

Additional measures to safeguard the interests of the Group in the sub-leasing arrangements

If Honghua Shenzhen or Honghua Shanghai enters into a sub-lease regarding particular equipment or products with end customer who subsequently fails to pay the sub-leasing fees to the Group or fulfil the terms of the sub-lease, the Group will still be liable to pay the leasing fees to ASIFL under the terms of the corresponding Finance Lease Transactions under the Lease Framework Agreement. As such, the Group will adopt the following additional measures to safeguard the interests of the Group in the sub-leasing arrangements:

1. before entering into the sub-lease, Honghua Shenzhen or Honghua Shanghai will carry out background check to ensure that the creditworthiness and repayment ability of the relevant end customer. Currently, the Group intends to carry out the sub-lease services with quality customers;
2. depending on the results of the credit checking, the Group may require the end customer to provide guarantee or payment of security deposits before entering into the sub-leasing arrangement;
3. the terms of the sub-lease will be subject to approval by the Approval Committee and the Group will enter into the finance lease arrangement with ASIFL only when the Group secures the sub-leasing arrangement with end customer; and
4. in addition to its right to proceed against the end customer in the event of default by end customer, the Group may (i) terminate the leasing arrangement with the end customer immediately; (ii) recoup the relevant equipment or products from the end customer; and (iii) enter into sub-leasing arrangement with other customer given that the title of the relevant equipment or products does not rest with any particular end customer.

### *(2). Sales Transactions and Operating Lease Transactions*

Internal control for the transactions of this type

Honghua Shenzhen implemented the Project Review Procedures and the Approval Committee Procedures in May 2017. Pursuant to these procedures:

- (a) the relevant departments of the Company will review contemporaneous prices and relevant terms of agreements offered by at least two independent third parties operating at the same or nearby area before the commencement of the relevant transactions, in order to allow the Group to obtain the most favorable terms relating to such leasing transactions; and

## LETTER FROM THE BOARD

- (b) once the preliminary terms, including the price, are available, the terms will be reviewed first by the internal control department and then by an approval committee formed by staff from relevant functional departments, including the business development department, credit review department, risk control department, and the general manager of Honghua Shenzhen. The agreement is subject to approval of the board of the directors of Honghua Shenzhen before execution.

Honghua Shanghai will follow the practice and procedure requirements of Honghua Shenzhen.

Measures to safeguard the interests of the Group in the sub-leasing arrangements

If Honghua Shenzhen or Honghua Shanghai enters into a sub-lease regarding particular equipment or products with end customer who subsequently fails to pay the sub-leasing fees to the Group, the Group will still be liable to pay the leasing fees to ASIFL under the terms of the Operating Lease Transactions. As such, the Group will adopt the following additional measures to safeguard the interests of the Group in the sub-leasing arrangements:

1. Before entering into a sub-lease with end customer, Honghua Shenzhen or Honghua Shanghai will carry out background check to ensure that the creditworthiness and repayment ability of the relevant end customer. Currently, the Group intends to carry out the sub-leasing services with quality customers;
2. depending on the results of the credit checking, the Group may require the end customer to provide guarantee or payment of security deposits before entering into the sub-leasing arrangement;
3. the terms of the sub-lease will be subject to approval by the Approval Committee and the Group will enter into the operating leasing arrangement with ASIFL only when the Group secures the sub-leasing arrangement with end customer; and
4. in addition to its right to proceed against the end customer in the event of default by end customer, the Group may (i) terminate the leasing arrangement with the end customer immediately; (ii) recoup the relevant equipment or products from the end customer; and (iii) enter into sub-leasing arrangement with other customers.

### ***Internal control for continuing connected transactions of the Group***

The Group has implemented stringent approval and control measures for connected transactions and continuing connected transactions, including a provision requiring any connected transaction with a consideration of more than RMB1 million to be subject to the approval of the Board of the Company. The Sales Transactions and the Leasing Transactions shall be reviewed and approved by the operational control center of Honghua

## LETTER FROM THE BOARD

Shenzhen or Honghua Shanghai and the internal control department prior to the entering into of the relevant transaction agreements with ASIFL to ensure that the terms are set in compliance with the Group's pricing policy.

Following the entering into of the continuing connected transactions, the finance department and the legal and securities compliance department will monitor the transactions to ensure that the annual caps are not exceeded. The relevant departments are required to produce a monthly report on the continuing connected transactions and submit to the legal and securities compliance department. Any responsible department is required to report to the legal and securities compliance department within 3 working days upon discovering that the aggregate consideration of the continuing connected transactions of the year to date is more than 80% of the relevant annual cap. Any proposed adjustment to the approved transaction consideration shall be reported to the legal and securities compliance department, which will coordinate the required approval procedures.

The auditors and the independent non-executive Directors of the Company will also conduct annual review of the continuing connected transactions entered into by the Group on whether the continuing connected transactions have been conducted in compliance of the pricing policies and whether the relevant annual caps have been exceeded.

Based on the above procedures and policies, the Board considers that there are adequate internal controls in place to ensure the Transactions are to be conducted on normal commercial terms and not prejudicial to the interests of the Company and the minority Shareholders.

### ***Reasons for entering into the Lease Framework Agreement***

The Group is principally engaged in the business of developing, manufacturing and selling drilling rigs, rig parts and components and after-sales services.

Honghua Investment is an investment holding company and a wholly-owned subsidiary of the Company.

Honghua Shenzhen is a subsidiary of the Company under the definition of the Listing Rules as the Company indirectly holds 60% of its issued shares (the remaining 40% of which is held by third parties independent of the Company and its connected persons), although its financial statements are not consolidated in the accounts of the Group. The principal business of Honghua Shenzhen is finance leasing, asset leasing, purchase of assets for leasing and related consultancy service.

Honghua Shanghai is a wholly-owned subsidiary of the Company. The principal business of Honghua Shanghai is finance leasing, asset leasing, purchase of assets for leasing and related consultancy service.

ASIFL is a company incorporated in the PRC and its principal business includes finance leasing, disposal of assets under finance lease and related consultancy service.

## LETTER FROM THE BOARD

Pursuant to the Lease Framework Agreement, the Company uses Honghua Investment, Honghua Shenzhen and Honghua Shanghai as platforms to carry out finance lease business and operating lease business and to introduce capital from ASIFL for financing, which is beneficial to the expansion of production and market development of the subsidiaries of the Group. In addition, in collaboration with ASIFL's project, the efficiency of review and approval procedures will be improved and the transaction costs will be reduced, realizing the business synergy between the Group and CASIC.

The relevant arrangement under the Lease Framework Agreement allows ASIFL to have access to customers in the oil & gas industry. Generally, ASIFL has not yet engaged in, and is not familiar with, the operation of oil & gas industry. Honghua Shenzhen or Honghua Shanghai has customer resources and industrial know-how in this regard, and can assist ASIFL in obtaining quality customers for its finance lease business. In addition, ASIFL is not included in the list of suppliers of major customers of Honghua Shenzhen and Honghua Shanghai, therefore it is not allowed to conduct transactions with these customers directly, and the transactions are required to be conducted through the subsidiaries of the Group. The cooperation with ASIFL will enable Honghua Shenzhen or Honghua Shanghai to diversify its offerings of services and products and enlarge its source of income. The arrangement between ASIFL and Honghua Shenzhen or Honghua Shanghai is a commercial arrangement beneficial to both parties.

Accordingly, the Directors (including the independent non-executive Directors) are of the view that the terms of the Lease Framework Agreement (including the transactions contemplated thereunder and the Proposed Annual Caps) are fair and reasonable and on normal commercial terms, and that the entering into of the Lease Framework Agreement is in the ordinary and usual course of business of the Group and in the interests of the Company and the Shareholders as a whole.

### *Listing Rules Implications*

As at the Latest Practicable Date, CASIC indirectly holds 29.98% of the shares in the Company through its wholly-owned subsidiary Kehua, and therefore is a substantial shareholder and connected person of the Company. CASIC and its subsidiaries together hold a 46.5% equity interest in ASIFL, thus ASIFL is an associate of CASIC and in turn a connected person of the Company. Therefore, the transactions under the Lease Framework Agreement constitute connected transactions of the Company under Chapter 14A of the Listing Rules.

In addition, in respect of the transactions under the Lease Framework Agreement, one or more of the applicable percentage ratios in respect of the aggregated transactions is higher than 25.0% but less than 100%, the finance lease transactions and operating lease services also constitute major transactions of the Company under Chapter 14 of the Listing Rules.

Therefore, the above transactions are subject to the reporting, announcement, annual review and the Independent Shareholders' approval requirements under Chapters 14 and 14A of the Listing Rules. CASIC, being a substantial shareholder and connected person of the Company, and its associates will abstain from voting in the general meeting.

## LETTER FROM THE BOARD

### B. Financial Cooperation Agreement

The principle terms of the Financial Cooperation Agreement are summarized as follows:

Date:	1 June 2018
Parties:	(1) the Company; and  (2) Aerospace Science and Industry Financial Corporation
Term:	3 years from the date of entering into the Financial Cooperation Agreement
The provision of financial services:	According to the Financial Cooperation Agreement, Aerospace Science and Industry Financial Corporation will provide the Group with financial services including:  (1) deposit services; and  (2) settlement services.

#### *Proposed Annual Caps*

During the relevant periods, the proposed annual caps of the deposit services under the Financial Cooperation Agreement are:

	From 1 June 2018 to 31 December 2018 <i>RMB</i>	For the fiscal year ending 31 December 2019 <i>RMB</i>	For the fiscal year ending 31 December 2020 <i>RMB</i>	From 1 January 2021 to 31 May 2021 <i>RMB</i>
Daily maximum balance of deposits (including accrued interests)	1,500,000,000	1,500,000,000	1,500,000,000	1,500,000,000

In determining the proposed maximum daily balance of deposits (including accrued interests) of the Group with Aerospace Science and Industry Financial Corporation during the term of the Financial Cooperation Agreement, the Board has considered the following factors: (i) the total cash and cash equivalents of the Group of RMB1.104 billion and RMB1.316 billion as at 31 December 2016 and 31 December 2017 respectively; and (ii) the total cash and cash equivalents of the Group of RMB2.309 billion for the corresponding period of last year (as at 30 June 2017).

## LETTER FROM THE BOARD

### *Historical transaction amounts*

There are no historical transaction amounts in respect of the deposit transactions between the Company and Aerospace Science and Industry Financial Corporation.

### *Pricing Policy*

The interest rate applicable to the Group for its deposits with Aerospace Science and Industry Financial Corporation will not be lower than: (i) the benchmark interest rate specified by the PBOC for deposits of the same type over the same period; and (ii) the interest rate for deposits of the same type with Aerospace Science and Industry Financial Corporation placed by the other members of CASIC over the same period.

### *Internal control procedures for the deposit transactions under the Financial Cooperation Agreement*

In respect of the deposit service, the personnel in the finance department of the Group is responsible for the comparing the interest rates offered by Aerospace Science and Industry Financial Corporation against the deposit interest rates announced by the PBOC, and further against the deposit interest rates offered by at least three major commercial banks in the PRC, to confirm the interest rates offered by Aerospace Science and Industry Financial Corporation are not less favourable to the Group, which all of these information together with the daily deposit amount (with the corresponding accrued interests) will be included in the report to be submitted to the Chief Financial Officer of the Group for review, verification and approval. The approved report will be regularly submitted to the Audit Committee of the Company for further review and confirmation. The above control procedures will ensure the interest rates and terms of the deposit services offered to the members of the Group are in line with the terms and conditions under the Financial Cooperation Agreement and can monitor the aggregate daily deposit amount (together with the corresponding accrued interests) with Aerospace Science and Industry Financial Corporation by the Group not exceeding the relevant proposed annual caps.

### *Reasons for entering into the Financial Cooperation Agreement*

The Group is principally engaged in the business of developing, manufacturing and selling drilling rigs, rig parts and components and after-sales services. Aerospace Science and Industry Financial Corporation, a non-bank financial institution established by CASIC and its subsidiaries, provides the Group with comprehensive and diversified financial services, which enhances the economies of scale of the capital, accelerates the capital turnover, saves the transaction costs and expenses, and further improves the quality and efficiency of the capital utilization of the Group.

## LETTER FROM THE BOARD

The entering into the Financial Cooperation Agreement between the Company and Aerospace Science and Industry Financial Corporation is in line with the financial policies of the Group, the major reasons and benefits for entering into the Financial Cooperation Agreement are as follows:

*(1) Increase interest income and save finance cost*

Subject to compliance with the relevant laws, regulations and regulatory requirements, Aerospace Science and Industry Financial Corporation will provide deposit services to the Group on normal commercial terms or more favourable terms, which is beneficial in improving the interest income of the Group.

*(2) Enhance the efficiency of fund utilization*

The deposit services by Aerospace Science and Industry Financial Corporation will strengthen the Company's centralized fund management of its subsidiaries and will shorten the time for capital transfers, which is beneficial for the Group to enhance fund management and control and to reduce the remittance time and accelerate cash flows.

*(3) Enhance fund management and control by the Group*

Aerospace Science and Industry Financial Corporation has a sophisticated information system through which the Group can access the latest information concerning the collecting and payment of funds of the Group as well as the status of fund balance at any time (in particular, to enable the Group to monitor the daily balance of deposits with Aerospace Science and Industry Financial Corporation such that it would not exceed the cap), thereby reducing and avoiding operational risks.

Accordingly, the Directors (including the independent non-executive Directors) are of the view that the terms of the Financial Cooperation Agreement (including the deposit transactions contemplated thereunder and the Proposed Annual Caps) are fair and reasonable and on normal commercial terms, and that the entering into of the Framework Agreement is in the ordinary and usual course of business of the Group and in the interests of the Company and the Shareholders as a whole.

### ***Listing Rules Implications***

As at the Latest Practicable Date, CASIC indirectly holds 29.98% of the shares in the Company through its wholly-owned subsidiary Kehua, and therefore is a substantial shareholder and connected person of the Company. CASIC and its subsidiaries together hold a 100% equity interest in Aerospace Science and Industry Financial Corporation, thus Aerospace Science and Industry Financial Corporation is an associate of CASIC and in turn a connected person of the Company. Therefore, the the deposit transactions under the Financial Cooperation Agreement constitute connected transactions of the Company under Chapter 14A of the Listing Rules.

## **LETTER FROM THE BOARD**

In respect of the deposit services under the Financial Cooperation Agreement, as one or more of the applicable percentage ratios of the transactions is higher than 25.0% but less than 100%, the above transactions also constitute a major transaction of the Company under Chapter 14 of the Listing Rules.

Therefore, the deposit services under the Financial Cooperation Agreement are subject to the reporting, announcement, annual review and the Independent Shareholders' approval requirements under Chapters 14 and 14A of the Listing Rules.

In respect of the settlement services under the Financial Cooperation Agreement, as all the applicable percentage ratios of the transactions are less than 0.1%, the transactions are fully exempt from the reporting, announcement, annual review and the Independent Shareholders' approval requirements under Chapters 14 and 14A of the Listing Rules.

CASIC, being a substantial shareholder and connected person of the Company, and its associates will abstain from voting in the general meeting.

### **INDEPENDENT BOARD COMMITTEE AND INDEPENDENT FINANCIAL ADVISER**

The Independent Board Committee comprising all the independent non-executive Directors (namely Mr. Liu Xiaofeng, Mr. Chen Guoming, Ms. Su Mei, Mr. Poon Chiu Kwok, Mr. Chang Qing and Mr. Wu Yuwu) has been established to advise the Independent Shareholders in respect of the Transactions. Gram Capital has been appointed by the Company with the approval of the Independent Board Committee to advise the Independent Board Committee and the Independent Shareholders in this regard.

Save as disclosed above, to the best of the Directors' knowledge, information and belief and having made all reasonable enquiries, there is no other Shareholder who has a material interest in the Lease Framework Agreement and the Financial Cooperation Agreement who is required to abstain from voting on the relevant resolutions at the AGM as at the Latest Practicable Date.

### **ANNUAL GENERAL MEETING**

The supplemental notice of AGM is set out on pages 59 to 61 in this circular. The AGM of the Company will be held as originally scheduled at 9:30 a.m. on 21 June 2018, Thursday, at Novotel Century Hong Kong, 238 Jaffe Road, Wan Chai, Hong Kong.

Please refer to the Original Circular of the Company and the notice of the AGM for the details of other resolutions to be considered at the AGM, the eligibility for attending the AGM, the registration procedures, the closure of register of members, voting by poll and other relevant matters.

CASIC and its associates including Kehua (holding 1,606,000,000 Shares or approximately 29.98% of the shares in the Company as at the Latest Practicable Date) who are involved in, or interested in the Lease Framework Agreement and the Financial Cooperation Agreement will abstain from voting in the relevant resolution approving the Transactions at the AGM.

## LETTER FROM THE BOARD

### RECOMMENDATION

The Board considers that the Transactions are fair and reasonable and in the interests of the Company and the Shareholders as a whole and accordingly recommends the Independent Shareholders to vote in favour of the resolutions to be proposed at the AGM for approving the Transactions. The entering into the Lease Framework Agreement and the Financial Cooperation Agreement (including the Transactions contemplated thereunder and the relevant Proposed Caps) were approved by all the Directors, except for Mr. Chen Yajun, Mr. Han Guangrong and Mr. Chen Wenle, who are directors appointed by CASIC and its associates and are deemed to be interested in the Transactions and thus had abstained from voting.

The Independent Board Committee, having taken into account the advice of Gram Capital, considers that the Transactions are fair and reasonable so far as the Independent Shareholders are concerned and in the interests of the Company and the Shareholders as a whole, and accordingly recommends the Independent Shareholders to vote in favour of the resolutions to be proposed at the AGM for approving the Transactions.

### GENERAL INFORMATION

Your attention is drawn to the letter of advice from Gram Capital set out in pages 27 to 50 of this supplemental circular which contains its advice to the Independent Board Committee and the Independent Shareholders in connection with the Transactions and the letter from the Independent Board Committee set out in pages 25 to 26 of this supplemental circular which contains its recommendation to the Independent Shareholders in relation to the Transactions.

### FURTHER INFORMATION

Your attention is also drawn to the additional information set out in the appendix to this supplemental circular.

Yours faithfully,  
By order of the Board  
**Honghua Group Limited**  
**Chen Yajun**  
*Chairman*



宏华集团  
HONGHUA GROUP

**Honghua Group Limited**

宏華集團有限公司

*(Incorporated in the Cayman Islands with limited liability)*

**(Stock Code: 196)**

5 June 2018

*To the Independent Shareholders,*

Dear Sir or Madam,

**CONTINUING CONNECTED TRANSACTIONS AND  
MAJOR TRANSACTIONS —  
LEASE FRAMEWORK AGREEMENT AND  
FINANCIAL COOPERATION AGREEMENT**

We refer to the Supplemental circular of the Company dated 5 June 2018 (the “**Supplemental Circular**”) to the Shareholders of which this letter forms part. Terms defined in the Supplemental Circular shall have the same meanings when used herein unless the context otherwise requires.

We have been appointed as the Independent Board Committee to advise the Independent Shareholders on whether the Lease Framework Agreement (including finance lease and operating lease) and the deposit service under the Financial Cooperation Agreement (including the Transactions contemplated thereunder and the Proposed Annual Caps) are fair and reasonable and on normal commercial terms, and are entered into in the ordinary and usual course of business of the Group and in the interests of the Company and the Shareholders as a whole.

We wish to draw your attention to the letter from the Board set out in pages 4 to 24 of the Supplemental Circular and the letter from Gram Capital, the Independent Financial Adviser appointed to advise the Independent Board Committee and the Independent Shareholders in relation to the Transactions, set out in pages 27 to 50 of the Supplemental Circular.

Having considered the factors and reasons considered by and the opinion of Gram Capital stated in its letter of advice contained in the Supplemental Circular, we are of the view that the Lease Framework Agreement (including finance lease and operating lease) and the deposit service under the Financial Cooperation Agreement (including the Transactions contemplated thereunder and the Proposed Annual Caps) are in the ordinary and usual course of business of the Group, on normal or better commercial terms, fair and reasonable and in the interests of the Company and the Shareholders as a whole.

**LETTER FROM THE INDEPENDENT BOARD COMMITTEE**

Accordingly, we recommend the Independent Shareholders to vote in favour of the resolutions to be proposed at the AGM to approve the Transactions.

Yours faithfully,

For and on behalf of the  
**Independent Board Committee**

**Mr. Liu Xiaofeng**  
**Mr. Poon Chiu Kwok**

**Mr. Chen Guoming**  
**Mr. Chang Qing**  
*Independent non-executive Directors*

**Ms. Su Mei**  
**Mr. Wu Yuwu**

## LETTER FROM GRAM CAPITAL

*Set out below is the text of a letter received from Gram Capital, the Independent Financial Adviser to the Independent Board Committee and the Independent Shareholders in respect of the CCTs for the purpose of inclusion in this circular.*



Room 1209, 12/F.  
Nan Fung Tower  
88 Connaught Road Central/  
173 Des Voeux Road Central  
Hong Kong

5 June 2018

*To: The independent board committee and the independent shareholders  
of Honghua Group Limited*

Dear Sir/Madam,

### CONTINUING CONNECTED TRANSACTIONS AND MAJOR TRANSACTION

#### INTRODUCTION

We refer to our appointment as the Independent Financial Adviser to advise the Independent Board Committee and the Independent Shareholders in respect of the CCTs, details of which are set out in the letter from the Board (the “**Board Letter**”) contained in the circular dated 5 June 2018 issued by the Company to the Shareholders (the “**Circular**”), of which this letter forms part. Terms used in this letter shall have the same meanings as defined in the Circular unless the context requires otherwise.

On 1 June 2018, Honghua Investment, Honghua Shenzhen, Honghua Shanghai and ASIFL entered into the Lease Framework Agreement to amend the relevant contents of the 2017 Framework Agreement. On even date, the Company and Aerospace Science and Industry Financial Corporation entered into the Financial Cooperation Agreement, pursuant to which Financial Cooperation Agreement, Aerospace Science and Industry Financial Corporation will provide the Group with financial services including deposit services and settlement services.

With reference to the Board Letter, the transactions contemplated under the Lease Framework Agreement when aggregated with the transactions contemplated under the 2017 Framework Agreement constitute major and continuing connected transactions of the Company and are subject to the reporting, announcement, annual review and the Independent Shareholders’ approval requirements under Chapters 14 and 14A of the Listing Rules; and the deposit services under the Financial Cooperation Agreement (the deposit services under the Financial Cooperation Agreement together with the transactions contemplated under the Lease Framework Agreement, the “**CCTs**”) constitute major and continuing connected transactions of the Company and are subject to the reporting, announcement, annual review and the Independent Shareholders’ approval requirements under Chapters 14 and 14A of the Listing Rules.

## LETTER FROM GRAM CAPITAL

The Independent Board Committee comprising Mr. Liu Xiaofeng, Mr. Chen Guoming, Ms. Su Mei, Mr. Poon Chiu Kwok, Mr. Chang Qing and Mr. Wu Yuwu (all being independent non-executive Directors) has been established to advise the Independent Shareholders on (i) whether the terms of the CCTs (including the proposed annual caps thereunder) are on normal commercial terms and are fair and reasonable so far as the Independent Shareholders are concerned; (ii) whether the CCTs are in the interests of the Company and the Shareholders as a whole and in the ordinary and usual course of business of the Group; and (iii) how the Independent Shareholders should vote in respect of the resolution(s) to approve the CCTs (including the proposed annual caps thereunder) and transactions contemplated thereunder at the AGM. We, Gram Capital Limited, have been appointed as the Independent Financial Adviser to advise the Independent Board Committee and the Independent Shareholders in this respect.

### **BASIS OF OUR OPINION**

In formulating our opinion to the Independent Board Committee and the Independent Shareholders, we have relied on the statements, information, opinions and representations contained or referred to in the Circular and the information and representations as provided to us by the Directors. We have assumed that all information and representations that have been provided by the Directors, for which they are solely and wholly responsible, are true and accurate at the time when they were made and continue to be so as at the Latest Practicable Date. We have also assumed that all statements of belief, opinion, expectation and intention made by the Directors in the Circular were reasonably made after due enquiry and careful consideration. We have no reason to suspect that any material facts or information have been withheld or to doubt the truth, accuracy and completeness of the information and facts contained in the Circular, or the reasonableness of the opinions expressed by the Company, its advisers and/or the Directors, which have been provided to us. Our opinion is based on the Directors' representation and confirmation that there is no undisclosed private agreement/arrangement or implied understanding with anyone concerning the CCTs. We consider that we have taken sufficient and necessary steps on which to form a reasonable basis and an informed view for our opinion in compliance with Rule 13.80 of the Listing Rules.

The Circular, for which the Directors collectively and individually accept full responsibility, includes particulars given in compliance with the Listing Rules for the purpose of giving information with regard to the Company. The Directors, having made all reasonable enquiries, confirm that to the best of their knowledge and belief the information contained in the Circular is accurate and complete in all material respects and not misleading or deceptive, and there are no other matters the omission of which would make any statement herein or the Circular misleading. We, as the Independent Financial Adviser, take no responsibility for the contents of any part of the Circular, save and except for this letter of advice.

We consider that we have been provided with sufficient information to reach an informed view and to provide a reasonable basis for our opinion. We have not, however, conducted any independent in-depth investigation into the business and affairs of the Company, Honghua Investment, Honghua Shenzhen, Honghua Shanghai, ASIFL, Aerospace Science and Industry Financial Corporation or their respective subsidiaries or associates, nor have we considered the taxation implication on the Group or the Shareholders as a result of the CCTs. Our opinion is

## LETTER FROM GRAM CAPITAL

necessarily based on the financial, economic, market and other conditions in effect and the information made available to us as at the Latest Practicable Date. Shareholders should note that subsequent developments (including any material change in market and economic conditions) may affect and/or change our opinion and we have no obligation to update this opinion to take into account events occurring after the Latest Practicable Date or to update, revise or reaffirm our opinion. In addition, nothing contained in this letter should be construed as a recommendation to hold, sell or buy any Shares or any other securities of the Company.

Lastly, where information in this letter has been extracted from published or otherwise publicly available sources, it is the responsibility of Gram Capital to ensure that such information has been correctly extracted from the relevant sources while we are not obligated to conduct any independent in-depth investigation into the accuracy and completeness of those information.

### PRINCIPAL FACTORS AND REASONS CONSIDERED

In arriving at our opinion in respect of the CCTs, we have taken into consideration the following principal factors and reasons:

#### Information on the Group

With reference to the Board Letter, the Group is principally engaged in the business of developing, manufacturing and selling drilling rigs, rig parts and components and after-sales services.

Set out below are the audited consolidated financial information of the Group for the two years ended 31 December 2017 as extracted from the annual report of the Company for the year ended 31 December 2017 (the “**2017 Annual Report**”):

	<b>For the year ended 31 December 2017 <i>RMB'000</i></b>	<b>For the year ended 31 December 2016 <i>RMB'000</i></b>	<b>Change from 2016 to 2017 %</b>
Revenue from continuing operation	2,175,856	2,147,592	1.32
Gross profit	635,093	357,876	77.46
Loss for the year	1,229,582	627,249	96.03
	<b>As at 31 December 2017 <i>RMB'000</i></b>	<b>As at 31 December 2016 <i>RMB'000</i></b>	<b>Change from 2016 to 2017 %</b>
Cash and cash equivalents	1,100,292	544,360	102.13
Net assets	4,177,650	4,083,452	2.31

## LETTER FROM GRAM CAPITAL

As illustrated in the above table, the Group's revenue from continuing operations amounted to approximately RMB2.18 billion for the year ended 31 December 2017 ("FY2017"), representing an increase of approximately 1.32% as compared to that for the year ended 31 December 2016 ("FY2016"). For FY2017, the Group recorded loss of approximately RMB1.23 billion, representing an increase of approximately 96.03% as compared to FY2016. With reference to the 2017 Annual Report, the loss for FY2017 was mainly due to the continuous losses on the discontinued operations of the offshore drilling rigs segment (loss from the Group's discontinuing operations for FY2017 amounted to approximately RMB834.39 million). Besides, the Group made impairment provision for (i) assets exposed to significant impairment risk for the offshore drilling rigs segment; and (ii) certain assets and related lawsuits for the oil and gas engineering services segment. As confirmed by the Directors, the aforesaid factors contributed to the Group's loss for FY2017.

As at 31 December 2017, the Group recorded cash and cash equivalents and net assets of approximately RMB1.10 billion and RMB4.18 billion respectively.

### A. The Lease Framework Agreement

#### 1. Information on the parties to the Lease Framework Agreement

##### *Information on Honghua Investment*

With reference to the Board Letter, Honghua Investment is an investment holding company and a wholly-owned subsidiary of the Company.

##### *Information on Honghua Shenzhen*

With reference to the Board Letter, Honghua Shenzhen is a subsidiary of the Company under the definition of the Listing Rules as the Company indirectly holds 60% of its issued shares (the remaining 40% of which is held by Independent Third Parties of the Company and its connected persons), although its financial statements are not consolidated in the accounts of the Group. The principal business of Honghua Shenzhen is finance leasing, asset leasing, purchase of assets for leasing and related consultancy service.

##### *Information on Honghua Shanghai*

With reference to the Board Letter, Honghua Shanghai is a wholly-owned subsidiary of the Company. The principal business of Honghua Shanghai is finance leasing, asset leasing, purchase of assets for leasing and related consultancy service.

## LETTER FROM GRAM CAPITAL

### *Information on ASIFL*

With reference to the Board Letter, ASIFL is a company incorporated in the PRC and its principal business includes finance leasing, disposal of assets under finance lease and related consultancy service. CASIC (a substantial Shareholder) and its subsidiaries together hold 46.5% equity interest in ASIFL as at the Latest Practicable Date.

### **2. *Reasons for entering into the Lease Framework Agreement***

With reference to the Company's circular dated 13 November 2017 (the "**2017 Circular**"), the Group has been carrying out innovative finance leasing business, and expanded the business with customers that are small and medium oil companies since 2013. In June 2017, the Company cooperated with ASIFL to sign a finance leasing agreement to sell the inventory products worth over RMB30 million domestically. In this respect, we noted from the announcement of the Company dated 26 June 2017 that (i) Sichuan Honghua Petroleum Equipment Co., Ltd., an indirect wholly-owned subsidiary of the Company, entered into a sale and purchase agreement with ASIFL and Shenzhen Honghua, whereby ASIFL agrees to purchase six sets of top drive drilling systems from Sichuan Honghua Petroleum Equipment Co., Ltd.; and (ii) Shenzhen Honghua entered into a finance lease agreement with ASIFL pursuant to which ASIFL will lease the six sets of top drive drilling systems to Shenzhen Honghua. On 30 September 2017 and 7 November 2017, Honghua Investment, Honghua Shenzhen, Honghua Shanghai and ASIFL entered into the 2017 Framework Agreement.

As further mentioned in the 2017 Circular, there is an increase in shale gas drilling activities in the PRC. Large-scale drilling and fracturing operations require a significant amount of capital investment and relevant equipment. Consequently, demands for oil drilling equipment through finance leasing arrangements are also increasing in recent years. The Company intended to capitalize on such opportunity and gain market share in the financial leasing industry, which the Company believed to be a good way to make capital gains. In particular, the Company believed the benefits in entering into the 2017 Framework Agreement with ASIFL include: (i) reducing the initial capital investment needed in the finance leasing transactions and leasing transactions for the Group; (ii) strengthening the Group's the ability to provide finance leasing services and leasing services to existing and potential customers as a value-added service and alternative solution; and (iii) creating synergy with the Group's other business operations in the oil & gas industry.

For our due diligence purpose, we noted from the National Bureau of Statistics of the PRC that (i) the investment in crude oil and natural gas exploration industry amounted to approximately RMB233.10 billion in 2016; (ii) the investment in fixed assets for state-owned economy crude oil and natural gas exploration industry amounted to approximately RMB206.80 billion in 2015; and (iii) the crude oil production amount increased from approximately 202.88 million tons in 2011 to approximately 214.56 million tons in 2015,

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representing a compounded annual growth rate of approximately 1.41%. Accordingly, we consider that there is a positive demand for oil drilling equipment and the related finance leasing/leasing arrangements in the PRC.

With reference to the Board Letter, the Company uses Honghua Investment, Honghua Shenzhen and Honghua Shanghai as platforms to carry out finance lease business and operating lease business and to introduce capital from ASIFL for financing pursuant to the Lease Framework Agreement, which is beneficial to the expansion of production and market development of the subsidiaries of the Group. In addition, in collaboration with ASIFL's project, the efficiency of review and approval procedures will be improved and the transaction costs will be reduced, realizing the business synergy between the Group and CASIC.

As further mentioned in the Board Letter, the relevant arrangement under the Lease Framework Agreement allows ASIFL to have indirect access to customers in the oil & gas industry. ASIFL has not yet engaged in, and is not familiar with, the operation of oil and gas industry. Honghua Shenzhen/Honghua Shanghai has customer resources and industrial know-how in the oil and gas industry. The cooperation with ASIFL will enable Honghua Shenzhen/Honghua Shanghai to diversify its offerings of services and products and enlarge its source of income. The arrangement between ASIFL and Honghua Shenzhen/Honghua Shanghai is a commercial arrangement beneficial to both parties.

Having considered the above factors, we concur with the Directors that the transactions under the Lease Framework Agreement are conducted in the ordinary and usual course of business of the Group and in the interests of the Company and the Shareholders as a whole.

### ***3. Principal terms of the Lease Framework Agreement***

#### *Date*

1 June 2018

#### *Parties*

(1) ASIFL; (2) Honghua Investment; (3) Honghua Shenzhen; and (4) Honghua Shanghai

#### *Term*

Starting from the date of the Lease Framework Agreement to 6 November 2020

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### *Amendments to the 2017 Framework Agreement under the Lease Framework Agreement*

The Lease Framework Agreement amended the 2017 Framework Agreement in the following aspects:

- (1) the proposed annual caps for 2018, 2019, and 2020 related to finance leases were revised to accommodate the additional finance leases business in 2018 and 2019; and
- (2) relevant contents of operating leases and the proposed relevant annual caps were added.

After the above amendments, the transactions under the Lease Framework Agreement are divided into the following two categories:

- (i) sales transactions and finance lease transactions; and
- (ii) sales transactions and operating lease transactions.

Saved for the above, there are no changes to other terms of the 2017 Framework Agreement.

### *Particulars of transactions under the Lease Framework Agreement*

#### Sales transactions:

According to the Lease Framework Agreement, ASIFL agreed to purchase from Honghua Investment certain equipment and products, including the drilling rigs and other drilling equipment required for oil drilling business (such as new fracturing pumps and top drives), for the aggregated consideration of up to RMB1,200 million through the sales transactions for the two years ending 31 December 2019, among which RMB800 million and RMB400 million will be used on finance leases and operating leases respectively. Details of the purchase of the equipment and products from will be set forth in specific agreements to be entered into between ASIFL and Honghua Investment.

#### Leasing transactions:

According to the Lease Framework Agreement, following the respective sales transaction(s) under the two types of transaction models, ASIFL will provide finance lease and operating lease services to the Group by leasing such equipment and products through finance lease and operating lease transactions to Honghua Shenzhen or Honghua Shanghai, which will in turn enter into sub-leasing arrangement with third party customers in relation to such equipment and products.

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For details regarding the business model, operation flow and legal and accounting implications of (i) the sales transactions and finance lease transactions; and (ii) the sales transactions and operating lease transactions, please refer to the section headed “Lease Framework Agreement” of the Board Letter.

With reference to the Board Letter, the term(s) of the sub-leasing arrangement(s) that Honghua Shenzhen or Honghua Shanghai may enter into with individual third party customer(s) will depend on the customer(s)' nature of operation and particular needs for the equipment and products, which may exceed three years. Consequently, the term of the related finance lease and operating lease transactions pursuant to the Lease Framework Agreement between ASIFL and Honghua Shenzhen or Honghua Shanghai may also exceed three years. In such case, the Company will comply with the disclosure requirement and, if required, obtain the Independent Shareholder's approval under the Listing Rules to extend the term of the Lease Framework Agreement. In each of the sublease agreement with an individual third party customer, Honghua Shenzhen or Honghua Shanghai will be entitled to unilaterally terminate the sub-leasing arrangement on or prior to the expiration date of the Lease Framework Agreement, should the requisite Independent Shareholders' approval, if required, to extend the Lease Framework Agreement cannot be obtained. Pursuant to Rule 14A.52 of the Listing Rules, the Company shall appoint an independent financial advisor to explain why the relevant finance leases and operating leases under the Lease Framework Agreement require for a longer period of time and to confirm that the terms of such agreements are in conformity with the industry normal business practices for this period.

In assessing the reasons for the duration of relevant finance leases and operating leases under the Lease Framework Agreement to exceed three years, we considered the following factors:

- (i) by entering into the finance leases and operating leases with a longer duration, the payment obligation of the costs of the equipment of the Group is allowed to be spread over a longer period, which would reduce the stress to the planning of working capital by the relevant members of the Group; and
- (ii) the lease period of each finance lease and operating lease service shall be determined with reference to, among other things, the useful life of the relevant leasing equipment and products, which, as confirmed by the Directors, is ranged from 5 to 20 years, subject to the type of equipment and products and their respective utilisation rate.

In considering whether it is normal business practice for agreements of similar nature with the Lease Framework Agreement to have a term of such duration, we identified similar finance lease and operating lease agreements entered into by companies listed on the Stock Exchange regarding the provision of finance lease and operating lease services to the listed companies, with duration of more than three years.

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As mentioned above, the transactions under sales transactions and finance lease transactions model are in line with the transaction structure of the transactions under the 2017 Framework Agreement. In this regard, we noted from the 2017 Circular that the duration of the relevant finance leases under the 2017 Framework Agreement may also be more than three years.

We also obtained and reviewed the finance lease agreements entered into between the Group and independent third parties during 2017, which are in similar nature as the transactions under 2017 Framework Agreement/the Lease Framework Agreement. We noted that the lease terms of finance leases conducted under such agreements are more than three years.

Taking into account of the above, we are of the view that that the lease term of the relevant finance leases and operating leases under the Lease Framework Agreement, which is longer than three years is required and it is normal business practice for the relevant finance leases and operating leases under the Framework Lease Agreement to be of such duration (“**Our View on the Lease Term**”).

### *Pricing Policy*

#### (1) Sales transactions and finance lease transactions

Pursuant to the Lease Framework Agreement, the pricing and payment terms under the product procurement agreement and finance lease agreement entered into by the parties shall be determined after arm’s length negotiations between the Group and ASIFL and based on normal commercial terms with reference to the prevailing market prices that are fair and reasonable for the relevant equipment and in any event shall be no less favorable to the prices offered by the Group to its Independent Third Parties. The Group will comply with its relevant internal pricing policies in the negotiation with ASIFL.

With reference to the Board Letter, the sales prices will be determined after arm’s length negotiations between the Group and ASIFL and mainly based on the net book value of the relevant equipment and products with reference to the leasing terms, while the leasing price of the finance lease transactions between ASIFL and Honghua Shenzhen or Honghua Shanghai will be determined after arm’s length negotiations between ASIFL and Honghua Shenzhen or Honghua Shanghai, subject to a maximum interest rate of 6.6% per annum. Honghua Shenzhen or Honghua Shanghai will normally refer to the prevailing PBOC rate for bank loans and will take into consideration of other factors such as transaction cost (including one-off handling fee) for each finance lease arrangement and comparable transactions entered into between Honghua Shenzhen or Honghua Shanghai and Independent Third Parties, while in any event the interest rate for such finance lease transactions will not exceed 6.6% per annum.

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For our due diligence purpose, we further inquired into the Directors as to the basis for determining the said maximum interest rate of 6.6% per annum. As advised by the Directors, the maximum interest rate of 6.6% per annum were determined after arm's length negotiations with ASIFL and it is a cap for the leasing price (i.e. interest rate) in case of unexpected increase in the interest rate promulgated by PBOC.

The Directors has taken the steps to ensure that such maximum interest rate is comparable to the prevailing market rate, details of which are set out in the sub-section headed "Internal Control Procedures Governing the Transactions under the Lease Framework Agreement" of the section headed "Lease Framework Agreement" of the Board Letter. In addition, according to the relevant pricing policy of Honghua Shenzhen, any finance lease arrangement of RMB10 million or above shall be subject to approval of the board of directors of Honghua Shenzhen, who shall consider and approve such finance lease arrangement based on the qualification of the lessee, the prospect of the industry, the sustainability of the project, the guarantee of repayment of the lessee and the profitability of the project.

As further mentioned in the Board Letter, the price of the finance lease transactions will also be affected by the price of subleasing transaction entered into or to be entered into between Honghua Shenzhen or Honghua Shanghai and the end-customer. Honghua Shenzhen or Honghua Shanghai will charge the price of sub-leasing based on the cost and the interest rate of leasing to ensure that the Group can obtain a reasonable gross profit margin during the sub-leasing and hence the finance lease transactions. Details are set out in the sub-section headed "Pricing Policy" of the section headed "Lease Framework Agreement" of the Board Letter.

In relation to the sales transactions (i.e. sale of equipment and products by Honghua Investment and its subsidiaries to ASIFL), for our due diligence purpose, we requested and the Company provided (i) agreements in relation to the sale of equipment and products by a subsidiary of Honghua Investment to ASIFL during 2017 and (ii) agreements in relation to the sale of equipment and products by the subsidiary of Honghua Investment to Independent Third Parties during 2017. We noted from the above documents that the sale prices offered to ASIFL by Honghua Investment group were not lower than those offered to Independent Third Parties for the same type and same quantity of equipment and products ("**Our Findings on the Lease Framework Agreement Sales Transactions**").

In relation to the leasing transactions (i.e. finance lease of equipment and products by ASIFL to Honghua Shenzhen or Honghua Shanghai), for our due diligence purpose, we requested and the Company provided (i) agreements in relation to the lease of equipment and products by ASIFL to Honghua Shenzhen during 2017; and (ii) agreements in relation to the lease of equipment and products by Independent Third Parties to Honghua Shenzhen during 2017. We also noted the then PBOC rate for bank loans during similar time period as the date of such agreements. We noted from the above documents and information that (i) the leasing interest rate offered by ASIFL to Honghua Shenzhen were lower than those offered

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by Independent Third Parties; and (ii) the leasing interest rate offered by ASIFL to Honghua Shenzhen were lower than the then the prevailing PBOC rate for bank loans and 6.6% per annum (“**Our Findings on the Lease Framework Agreement Leasing Transactions**”).

With reference to the Board Letter, the Group implemented certain internal control procedures in relation to the sales transactions and finance lease transactions under the Lease Framework Agreement, details of which are set out in the sub-sections headed “Internal Control Procedures Governing the Transactions under the Lease Framework Agreement” and “Internal control for continuing connected transactions of the Group” of the section headed “Lease Framework Agreement” of the Board Letter. Having considered, in particular, that (i) the Group will obtain terms and interest rates in relation to the finance lease transactions from major financial leasing companies which are Independent Third Parties and conduct comparison with relevant benchmark lending rate promulgated by PBOC from time to time; (ii) the Group adopted certain background checking and approval procedures to ensure the creditworthiness and repayment ability of the sub-finance lease end-customers; and (iii) the sales transactions and finance lease transactions under the Lease Framework Agreement shall be reviewed and approved by the operational control center and the internal control department prior to entering into any relevant transaction agreements with ASIFL to ensure that the terms are set in compliance with the Group’s pricing policy, we consider the effective implementation of the aforesaid internal control procedures would help to ensure fair pricing of the sales transactions and finance lease transactions under the Lease Framework Agreement according to the pricing policy.

In light of (i) Our Findings on the Lease Framework Agreement Sales Transactions; (ii) Our Findings on the Lease Framework Agreement Leasing Transactions; and (iii) the Group’s implementation of internal control procedures in relation to the sales transactions and finance lease transactions under the Lease Framework Agreement, we are of the view that the terms of the sales transactions and finance lease transactions under the Lease Framework Agreement are on normal commercial terms and are fair and reasonable so far as the Independent Shareholders are concerned.

### (2) Sales transactions and operating lease transactions

Pursuant to the Lease Framework Agreement, the pricing and payment terms under the product procurement agreement and operating lease agreement entered into by the parties shall be determined after arm’s length negotiations between the Group and ASIFL and based on normal commercial terms with reference to the prevailing market prices that are fair and reasonable for the relevant equipment and in any event shall be no less favorable to the prices offered by the Group to its Independent Third Parties. The Group will comply with its relevant internal pricing policies in the negotiation with ASIFL.

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With reference to the Board Letter, the sales prices will be determined after arm's length negotiations between the Group and ASIFL and mainly based on the net book value of the relevant equipment and products with reference to the leasing terms, while the price of the operating lease transactions between ASIFL and Honghua Shenzhen or Honghua Shanghai will be affected by the price of subleasing transaction entered into or to be entered into between Honghua Shenzhen or Honghua Shanghai and the end-customer, and will be determined after arm's length negotiations between ASIFL and Honghua Shenzhen or Honghua Shanghai. In addition, according to the relevant pricing policy of Honghua Shenzhen, any leasing arrangement of RMB10 million or above shall be subject to approval of the board of directors of Honghua Shenzhen, who shall consider and approve such operating lease arrangement based on the qualification of the lessee, the prospect of the industry, the sustainability of the project, the guarantee of repayment of the lessee and the profitability of the project.

As advised by the Directors, the Group did not enter into any transactions in relation to the sales transactions and operating lease transactions (i.e. sale of equipment and products by Honghua Investment and its subsidiaries to ASIFL plus operating lease of such equipment and products by Honghua Investment and its subsidiaries to ASIFL).

With reference to the Board Letter, the Group implemented certain internal control procedures in relation to the sales transactions and operating lease transactions under the Lease Framework Agreement, details of which are set out in the sub-sections headed "Internal Control Procedures Governing the Transactions under the Lease Framework Agreement" and "Internal control for continuing connected transactions of the Group" of the section headed "Lease Framework Agreement" of the Board Letter. Having considered, in particular, that (i) the Group will review contemporaneous prices and relevant terms of agreements offered by at least two independent third parties operating at the same or nearby area before the commencement of the relevant leasing transactions; (ii) the terms of the sales transactions and operating lease transactions will be reviewed by the internal control department and then by an approval committee formed by staff from relevant functional departments, and the agreement will be subject to approval of the board of the directors of Honghua Shenzhen before execution; and (iii) the Group adopted certain background checking and approval procedures to ensure the creditworthiness and repayment ability of the sub-finance lease end-customers, we consider the effective implementation of the aforesaid internal control procedures would help to ensure fair pricing of the sales transactions and operating lease transactions under the Lease Framework Agreement according to the pricing policy.

In light of the Group's implementation of internal control procedures in relation to the sales transactions and operating lease transactions under the Lease Framework Agreement, we are of the view that the terms of the sales transactions and operating lease transactions under the Lease Framework Agreement are on normal commercial terms and are fair and reasonable so far as the Independent Shareholders are concerned.

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Accordingly, we are of the view that the terms of the transactions under the Lease Framework Agreement are on normal commercial terms and are fair and reasonable so far as the Independent Shareholders are concerned.

#### 4. *Proposed annual caps*

##### (1) *Sales transactions and finance lease transactions*

The sales transactions

Set out below are (i) the historical transaction amount for the two years ended 31 December 2017; and (ii) the proposed annual caps for the two years ending 31 December 2019 and the period from 1 January 2020 to 6 November 2020 in respect of the sales transactions under the 2017 Framework Agreement and the Lease Framework Agreement as extracted from the Board Letter:

	<b>For the year ended 31 December 2016 RMB</b>	<b>For the year ended 31 December 2017 RMB</b>
<b>Historical transaction amount</b>	Nil	266,000,000
		<b>From</b>
	<b>For the year ending 31 December 2018 RMB</b>	<b>For the year ending 31 December 2019 RMB</b>
		<b>1 January 2020 to 6 November 2020 RMB</b>
<b>Proposed annual caps</b>	400,000,000	400,000,000
		Nil

With reference to the Board Letter, the proposed annual caps of the sales and finance lease transactions model are determined based on the historical transaction amounts, and after arm's length negotiations between the Company and ASIFL and taking into consideration the aggregate value of the equipment and products currently negotiated by the Group and its finance lease services customers.

As advised by the Directors, the Company will enter into the sales transactions and the leasing transactions with ASIFL after the Company secured sub-leasing arrangements with its end-customers. To assess the fairness and reasonableness of the proposed annual caps for the sales transactions, we obtained a list of potential sub-leasing transactions under negotiations between the Company and end-customers (the "**Sub-leasing List**"). The Sub-leasing List contains information such as the name of the end-customers, the type and quantity of equipment/products involved, the value of equipment and lease type.

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We noted from the Sub-leasing List that for each of the two years ending 31 December 2019, the aggregate value of equipment of sub-leasing transactions (involving sales and finance lease) exceeds the respective proposed annual cap. Accordingly, we consider that the proposed annual caps for the sales transactions are fair and reasonable.

The finance lease transactions

Set out below are (i) the historical transaction amount for the two years ended 31 December 2017; and (ii) the proposed annual caps for the two years ending 31 December 2019 and the period from 1 January 2020 to 6 November 2020 in respect of the finance lease transaction under the 2017 Framework Agreement and the Lease Framework Agreement as extracted from the Board Letter:

	<b>For the year ended 31 December 2016 RMB</b>	<b>For the year ended 31 December 2017 RMB</b>	
<b>Historical transaction amount</b>			
Maximum daily balance of the leasing principal	Nil	239,400,000	
Annual interests and other payments:			
<i>Outstanding interest fee</i>	Nil	29,730,000	
<i>One-off handling fee</i>	Nil	6,600,000	
	<b>For the year ending 31 December 2018 RMB</b>	<b>For the year ending 31 December 2019 RMB</b>	<b>From 1 January 2020 to 6 November 2020 RMB</b>
<b>Proposed annual caps</b>			
Maximum daily balance of the leasing principal	639,400,000	989,536,000	867,196,000
Annual interests and other payments:			
<i>Outstanding interest fee</i>	102,615,000	164,234,000	130,866,000
<i>One-off handling fee</i>	18,000,000	18,000,000	Nil

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With reference to the Board Letter, the proposed annual caps of the sales and finance lease transactions model are determined based on the historical transaction amounts, and after arm's length negotiations between the Company and ASIFL and taking into consideration the aggregate value of the equipment and products currently negotiated by the Group and its finance lease services customers.

As mentioned above, the Company will enter into the sales transactions and the leasing transactions with ASIFL after the Company has secured sub-leasing arrangements with its end-customers. As advised by the Directors, when determining the proposed annual caps for the finance lease transactions, the Directors took into account the historical finance lease transactions in 2017 and potential new finance lease transactions (as a result of new sub-leasing transactions).

For our due diligence purpose, we obtained a calculation of the proposed annual caps. We noted that the proposed annual caps for the maximum daily balance of the leasing principal and the outstanding interest fee consist of two parts: the part due to the historical finance lease transactions in 2017 and the part due to potential new finance lease transactions.

For the part due to the historical finance lease transactions in 2017, as advised by the Directors, the proposed annual caps were calculated based on the terms of the historical transactions. As mentioned in the sub-section above, we requested and the Company provided agreements in relation to the lease of equipment and products by ASIFL to Honghua Shenzhen during 2017. We noted from such agreements that the historical transaction amount, lease term, interest rate (including its payment interval) and the monthly lease rents are in line with the calculation.

For the part due to potential new finance lease transactions, we noted that the proposed annual caps were estimated based on estimated finance lease transaction amount of RMB400 million in each of the two years ending 31 December 2019, an assumed interest rate of 6.6% per annum payable quarterly and an assumed lease term of five years. As mentioned in the sub-section above, we requested and the Company provided (i) agreements in relation to the lease of equipment and products by ASIFL to Honghua Shenzhen during 2017; and (ii) agreements in relation to the lease of equipment and products by Independent Third Parties to Honghua Shenzhen during 2017. We noted that the leasing term of such agreements ranged from four to five years (“**Our Findings on the Group’s Finance Lease Term**”). In addition, as stated earlier, the leasing rate will not be higher than the prevailing interest rate promulgated by PBOC or 6.6% per annum. Given that the prevailing interest rate promulgated by PBOC (i.e. 4.75% per annum for one-to-five-year loan, being the prevailing interest rate as at the Latest Practicable Date and published by PBOC on 23

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October 2015) is lower than 6.6% per annum, the Directors applied 6.6% per annum as the interest rate for prudence's sake. In light of the above, we consider the basis of estimation to be reasonable.

In relation to the proposed annual caps for maximum daily balance of the leasing principal, we noted that for the part arising from the historical finance lease transactions in 2017, the proposed annual cap for the two years ending 31 December 2019 and the period from 1 January 2020 to 6 November 2020 is in line with the calculation (i.e. based on the terms of the historical transaction). As for the part arising from potential new finance lease transactions, (i) for the year ending 31 December 2018, the proposed annual cap is the same as the proposed annual caps for the sales transactions; (ii) for the year ending 31 December 2019, the proposed annual cap is the sum of (a) the estimated outstanding principal carried forward from the year ending 31 December 2018; and (b) the proposed annual caps for the sales transactions for the year ending 31 December 2019; and (iii) for the period from 1 January 2020 to 6 November 2020, the proposed annual cap is the estimated outstanding principal carried forward from the year ending 31 December 2019.

In relation to the proposed annual caps for outstanding interest fee, we noted that for the part arising from the historical finance lease transactions in 2017, the proposed annual cap for the two years ending 31 December 2019 and the period from 1 January 2020 to 6 November 2020 is in line with the calculation (i.e. based on the terms of the historical transaction). As for the part arising from potential new finance lease transactions, the proposed annual caps are the outstanding interest fees for the potential new finance lease transactions (i.e. RMB400 million respectively for the two years ending 31 December 2019) based on the aforementioned basis of finance lease terms in the calculation.

In relation to the proposed annual caps for one-off handling fee, we noted that the proposed annual caps for one-off handling fee are the same for each of the two years ending 31 December 2019. As mentioned above, the Company will enter into the sales transactions and the leasing transactions with ASIFL after the Company has secured sub-leasing arrangements with its end-customers. As advised by the Directors, the one-off handling fee occurs when entering into finance lease agreements with ASIFL. As such, the proposed annual caps were determined based on the finance lease principal amount and an estimated handling fee (as a percentage of the principal). For our due diligence, we obtained from the Company information regarding the principal amount and handling fee for finance lease transactions with ASIFL and Independent Third Parties during 2017. We noted that the aggregated handling fee represented approximately 4.58% of the aggregated principal amount for Independent Third Parties (while the percentage for ASIFL was lower). Taking into account (i) that the proposed annual caps for one-off handling fee represented 4.5% of the proposed annual caps for sales transactions for each of the two years ending 31 December 2019 (i.e. the implied rate of handling fee as a percentage of the finance lease principal is also 4.5%); (ii) that the implied rate of handling fee

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for the proposed annual cap is in line with the historical rate of handling fee charged by Independent Third Parties; and (iii) proposed annual caps for the sales transactions being fair and reasonable as mentioned above, we consider the proposed annual caps for one-off handling fee to be fair and reasonable.

In light of the above, we consider that the proposed annual caps for the finance lease transactions are fair and reasonable.

### (2) *Sales transactions and operating lease transactions*

With reference to the Board Letter, there is no historical transaction amount between the Company and ASIFL in respect of the transactions of this type.

Set out below are the proposed annual caps for the two years ending 31 December 2019 and the period from 1 January 2020 to 6 November 2020 in respect of the sales transaction and operating lease transactions under the Lease Framework Agreement as extracted from the Board Letter:

	<b>For the year ending 31 December 2018 RMB</b>	<b>For the year ending 31 December 2019 RMB</b>	<b>From 1 January 2020 to 6 November 2020 RMB</b>
<b>Proposed annual caps</b>			
Sales prices	200,000,000	200,000,000	Nil
Amount of rent to be paid	29,812,000	119,245,000	119,245,000

With reference to the Board Letter, the proposed annual caps of transactions under the sales and operating lease transactions models are determined after arm's length negotiations between the Company and ASIFL and taking into consideration the aggregate value of the equipment and products currently under negotiation by the Group and its operating lease services customers with reference to the market rent of the same type of equipment. The rental of the Operating Lease Transactions with ASIFL was determined with reference to the average price in the industry and the acceptable price of the customers to the practicable extent.

#### The sales transactions

As mentioned above, (i) the Company will enter into the sales transactions and the leasing transactions with ASIFL after the Company has secured sub-leasing arrangements with its end-customers; and (ii) we obtained the Sub-Leasing List. We noted from the Sub-leasing List that for each of the two years ending 31 December 2019, the aggregate transaction amount of sub-leasing transactions (involving sales and operating lease) exceeds the respective proposed annual cap. Accordingly, we consider that the proposed annual caps of sales prices for the sales transactions are fair and reasonable.

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### The operating lease transactions

In relation to the proposed annual caps for the operating lease transactions, we obtained a calculation of the estimated the rental amount (which included the interest fees for the lease) for the two years ending 31 December 2019 and the period from 1 January 2020 to 6 November 2020. We noted from the calculation that the estimated interest fees were calculated based on an assumed interest rate per annum (which is higher than that of the finance lease transactions under the Lease Framework Agreement) payable quarterly and an assumed lease term of four years. As mentioned earlier, there is no historical transaction amount between the Company and ASIFL in respect of the sales transactions and operating lease transactions. In this regard, we further inquired into the Directors as to the basis for the assumed interest rate and lease term of the calculation. As advised by the Directors, the assumed interest rate was estimated after taking into consideration the derived internal rate of return of the finance lease transactions (i.e. the Group assumed the internal rate of return of the operating lease transactions and the finance lease transactions to be similar). Due to (i) the absence of handling fee; and (ii) the fact that the lessor assumes higher risk in re-leasing the equipment/products in an operating lease as the title of ownership of the equipment/products will not be transferred to the lessee upon the end of lease term (unlike a finance lease), the assumed interest rate per annum in the operating lease is higher than that of the finance lease in the calculation. In respect of the lease term assumed in the calculation, having consider the nature of the operating lease transactions (leasing the equipment/products for operation), the Directors assumed a shorter lease term (i.e. four years) for operating lease transactions than a five-year term for finance lease transactions (the nature of which is to finance the acquisition of equipment/products). In light of Our View on the Lease Term and Our Findings on the Group's Finance Lease Term, we consider the assumed lease term of four years in the calculation to be justifiable. Having considered the above, we consider the proposed annual caps of the amount of rent to be paid for the operating lease transactions are fair and reasonable.

Shareholders should note that as the proposed annual caps are relating to future events and were estimated based on assumptions which may or may not remain valid for the entire period up to 6 November 2020, and they do not represent forecasts of purchase/cost to be incurred from the transactions under the Lease Framework Agreement. Consequently, we express no opinion as to how closely the actual cost to be incurred from the transactions under the Lease Framework Agreement will correspond with the proposed annual caps.

**B. The deposit services under Financial Cooperation Agreement**

***1. Information on Aerospace Science and Industry Financial Corporation***

With reference to the Board Letter, Aerospace Science and Industry Financial Corporation is a company incorporated in the PRC and a non-bank financial institution established by ASIFL and its subsidiaries.

***2. Reasons for entering into the Financial Cooperation Agreement***

With reference to the Board Letter and as advised by the Directors, the Group and Aerospace Science and Industry Financial Corporation are both members of ASIFL. Aerospace Science and Industry Financial Corporation provides the Group with comprehensive and diversified financial services, which enhances the economies of scale of the capital, accelerates the capital turnover, saves the transaction costs and expenses, and further improves the quality and efficiency of the capital utilization of the Group.

The Directors consider that the entering into the Financial Cooperation Agreement between the Company and Aerospace Science and Industry Financial Corporation is in line with the financial policies of the Group. The detailed reasons and benefits for entering into the Financial Cooperation Agreement are set out in the sub-section headed “Reasons for entering into the Financial Cooperation Agreement” under the section headed “Financial Cooperation Agreement” of the Board Letter.

As advised by the Directors, Aerospace Science and Industry Financial Corporation is required to operate in compliance with the Administration of the Finance Companies of Enterprise Groups Procedures issued by the China Banking Regulatory Commission on 27 July 2004 (amendment on 28 December 2006) (the “**Procedures**”). We noted that the Procedures set out certain compliance and risk control requirements/measures in relation to the operation of group financing companies, including but not limited to maintaining certain financial ratios at all times, reporting to the CBRC, etc.

## LETTER FROM GRAM CAPITAL

The table below sets out the key financial ratio requirements of the Procedures and the respective financial ratios of Aerospace Science and Industry Financial Corporation as 31 December 2017 and 31 March 2018 as provided by the Company.

<b>Financial ratio</b>	<b>Requirements</b>	<b>Financial ratios of Aerospace Science and Industry Financial Corporation</b>	
		<b>As at 31 December 2017 (approximate %)</b>	<b>As at 31 March 2018 (approximate %)</b>
Capital adequacy ratio	Not less than 10%	14.55	13.79
Inter-financial institution borrowing balances to total capital ratio	Not more than 100%	Nil	Nil
Total amount of outstanding guarantees to total capital ratio	Not more than 100%	10.54	4.11
Long-term and short-term investment to total capital ratio	Not more than 70%	64.27	64.43
Self-owned fixed assets to total capital ratio	Not more than 20%	1.43	1.35

As shown in the table above, we note that Aerospace Science and Industry Financial Corporation complied with the relevant financial ratio requirements as set out in the Procedures as at 31 December 2017 and 31 March 2018. As advised by the Directors, non-performing loan ratios of Aerospace Science and Industry Financial Corporation were both nil as at 31 December 2017 and 31 March 2018. As also confirmed by the Directors of the Company that to the best of their knowledge, up to the Latest Practicable Date, there was no record of non-compliance with relevant laws and regulations of the PRC on Aerospace Science and Industry Financial Corporation.

As also advised by the Directors, Aerospace Science and Industry Financial Corporation will provide financial services only to the members within the CASIC group and will therefore be exposed to a lower level of potential risk compared to other PRC commercial banks which conduct business with clients of various credit ratings. We also noted from the Procedures and 商業銀行資本管理辦法(試行) (Capital Rules for Commercial Banks (provisional)\*) published by the China Banking Regulatory Commission on 7 June 2012, which regulates the PRC commercial banks, that the capital adequacy ratio requirement for the Aerospace Science and Industry Financial Corporation is stricter than that for PRC commercial banks (i.e. 8%).

Having considered the above, we concur with the Directors that the deposit transactions under the Financial Cooperation Agreement are conducted in the ordinary and usual course of business of the Group and in the interests of the Company and the Shareholders as a whole.

## LETTER FROM GRAM CAPITAL

### ***3. Principal terms of the deposit services under Financial Cooperation Agreement***

#### *Date*

1 June 2018

#### *Parties*

(1) the Company; and (2) Aerospace Science and Industry Financial Corporation

#### *Term*

3 years from the date of entering into the Financial Cooperation Agreement

#### *Subject matter of the Financial Cooperation Agreement*

Pursuant to the Financial Cooperation Agreement, Aerospace Science and Industry Financial Corporation will provide the Group with financial services including: (1) deposit services; and (2) settlement services.

#### *Pricing Policy*

With reference to the Board Letter, the interest rate applicable to the Group for its deposits with Aerospace Science and Industry Financial Corporation will not be lower than: (i) the benchmark interest rate specified by the PBOC for deposits of the same type over the same period; and (ii) the interest rate for deposits of the same type with Aerospace Science and Industry Financial Corporation placed by the other members of CASIC over the same period.

As further mentioned the Board Letter, the Group implemented certain internal control procedures in relation to the transactions under the Financial Cooperation Agreement, details of which are set out in the sub-section headed “Internal control procedures for the deposit transactions under the Financial Cooperation Agreement” of the section headed “Financial Cooperation Agreement” of the Board Letter. Having considered, in particular, that (i) the Group will compare the interest rate offered by Aerospace Science and Industry Financial Corporation against the deposit interest rates announced by the PBOC and deposit interest rates offered by at least three major commercial banks in the PRC to confirm the interest rates offered by Aerospace Science and Industry Financial Corporation are not less favourable to the Group; and (ii) the interest rates information mentioned in (i) above will be included in the report to be submitted to the chief financial officer of the Group for review, verification and approval; while the approved report will be regularly submitted to the audit committee of the Company for further review and confirmation, we consider the effective implementation of the aforesaid internal control procedures would help to ensure fair pricing of the deposit transactions under the Financial Cooperation Agreement according to the pricing policy.

## LETTER FROM GRAM CAPITAL

In light of the above factors, we are of the view that the terms of the deposit transactions under the Financial Cooperation Agreement are on normal commercial terms and are fair and reasonable so far as the Independent Shareholders are concerned.

#### 4. *Proposed annual caps*

With reference to the Board Letter, there is no historical transaction amounts in respect of the deposit transactions between the Company and Aerospace Science and Industry Financial Corporation.

Set out below are the proposed annual caps in respect of the deposit transactions under the Financial Cooperation Agreement as extracted from the Board Letter:

	<b>From 1 June 2018 to 31 December 2018 RMB</b>	<b>For the year ending 31 December 2019 RMB</b>	<b>For the year ending 31 December 2020 RMB</b>	<b>From 1 January 2021 to 31 May 2021 RMB</b>
<b>Proposed annual caps</b>				
Daily balance of deposits (including accrued interests)	1,500,000,000	1,500,000,000	1,500,000,000	1,500,000,000

With reference to the Board Letter, in determining the proposed maximum daily balance of deposits (including accrued interests) of the Group with Aerospace Science and Industry Financial Corporation during the term of the Financial Cooperation Agreement, the Board has considered the cash position of the Group as at 31 December 2016, 30 June 2017 and 31 December 2017.

For our due diligence purpose, we noted from the 2017 Annual Report and the interim report of the Company the followings:

	<b>As at 31 December 2016 (audited) RMB'000</b>	<b>As at 30 June 2017 (unaudited) RMB'000</b>	<b>As at 31 December 2017 (audited) RMB'000</b>
Available-for-sale financial assets	15,000	18,800	Nil
Pledged bank deposits	559,737	528,386	191,140
Cash and cash equivalents	544,360	1,850,033	1,100,292
<b>Total</b>	<b>1,119,097</b>	<b>2,397,219</b>	<b>1,291,432</b>

## LETTER FROM GRAM CAPITAL

As shown in the table above, the sum of available-for-sale financial assets, pledged bank deposits and cash and cash equivalents (the “Sum”) amounted to approximately RMB1.12 billion, RMB2.40 billion and RMB1.29 billion respectively as at 31 December 2016, 30 June 2017 and 31 December 2017, with an average Sum of approximately RMB1.60 billion. The proposed annual cap is within the said range of the Sum.

As advised by the Directors, apart from Aerospace Science and Industry Financial Corporation, the Group may also place deposits in other commercial banks in PRC subject to the terms of the relevant deposits. Given that it is difficult to forecast the Group’s cash position for the relevant period under the Financial Cooperation Agreement, the Group may opt to deposit certain portion of cash in commercial banks or re-comply with the applicable provisions of the Listing Rules governing continuing connected transaction to revise the proposed annual caps for deposit transactions under the Financial Cooperation Agreement should there be any substantial increase in cash position of the Group. Accordingly, we consider the proposed annual caps of the deposit transactions under the Financial Cooperation Agreement to be fair and reasonable.

Shareholders should note that as the proposed annual caps are relating to future events and were estimated based on assumptions which may or may not remain valid for the entire period up to 31 May 2021, and they do not represent forecasts of cost to be incurred from the deposit transactions under the Financial Cooperation Agreement. Consequently, we express no opinion as to how closely the actual deposits to be placed under the deposit transactions under the Financial Cooperation Agreement will correspond with the proposed annual caps.

### **Listing Rules implication**

The Directors confirmed that the Company shall comply with the requirements of Rules 14A.53 to 14A.59 of the Listing Rules pursuant to which (i) the values of the CCTs must be restricted by their respective proposed annual caps; (ii) the terms of the CCTs (including their respective proposed annual caps) must be reviewed by the independent non-executive Directors annually; (iii) details of independent non-executive Directors’ annual review on the terms of the CCTs must be included in the Company’s subsequent published annual reports and financial accounts. Furthermore, it is also required by the Listing Rules that the auditors of the Company must provide a letter to the Board confirming, among other things, whether anything has come to their attention that causes them to believe that the CCTs (i) have not been approved by the Board; (ii) were not, in all material respects, in accordance with the pricing policies of the Group if the transactions involve the provision of goods or services by the Group; (iii) were not entered into, in all material respects, in accordance with the relevant agreement governing the transactions; and (iv) have exceeded the proposed annual caps. In the event that the total amounts of the CCTs are anticipated to exceed their respective proposed annual caps, or that there is any proposed material amendment to the terms of the CCTs, as confirmed by the Directors, the Company shall comply with the applicable provisions of the Listing Rules governing continuing connected transaction.

## LETTER FROM GRAM CAPITAL

Given the above stipulated requirements for continuing connected transactions pursuant to the Listing Rules, we are of the view that there are adequate measures in place to monitor the CCTs and thus the interest of the Independent Shareholders would be safeguarded.

### RECOMMENDATION

Having taken into consideration the factors and reasons as stated above, we are of the opinion that (i) the terms of the CCTs are on normal commercial terms and are fair and reasonable so far as the Independent Shareholders are concerned; and (ii) the CCTs are conducted in the ordinary and usual course of business of the Group and are in the interests of the Company and the Shareholders as a whole. Accordingly, we recommend the Independent Board Committee to advise the Independent Shareholders to vote in favour of the resolution(s) to be proposed at the AGM to approve the CCTs and we recommend the Independent Shareholders to vote in favour of the resolution(s) in this regard.

Yours faithfully,  
For and on behalf of  
**Gram Capital Limited**  
**Graham Lam**  
*Managing Director*

\* *For identification purpose only*

## 1. FINANCIAL INFORMATION OF THE GROUP

Details of the financial information of the Group for each of the three years ended 31 December 2015, 2016 and 2017 are disclosed in the annual reports of the Company for the years ended 31 December 2015, 2016 and 2017, respectively. These annual reports are published on the website of the Stock Exchange (<http://www.hkexnews.hk>) and the website of the Company (<http://www.hh-gltd.com>):

- annual report of the Company for the year ended 31 December 2015 published on 20 April 2016;
- annual report of the Company for the year ended 31 December 2016 published on 26 April 2017; and
- annual report of the Company for the year ended 31 December 2017 published on 27 April 2018.

## 2. STATEMENT OF INDEBTEDNESS

### Borrowings

As at the close of business on 30 April 2018, being the latest practicable date for the purpose of this indebtedness statement, the total indebtedness of the Group amounted to approximately RMB 3,065,776,000, details of which are set out below:

	<i>RMB'000</i>
Secured bank loans <sup>(i)</sup>	133,000
Unsecured bank loans	1,690,023
Secured loan from a related party <sup>(i)</sup>	2,000
Unsecured loan from a related party	480,000
Senior notes <sup>(ii)</sup>	760,753
	3,065,776

(i) As at 30 April 2018, the bank loans and the secured loan from related party were secured by interest in land use rights of approximately RMB 157,821,000, property, plant and equipment of approximately RMB 207,292,693, trade and other receivables of approximately RMB10,000,000 and 20% equity interest of Sichuan Honghua Petroleum Equipment Co., Ltd., a subsidiary of the Group.

(ii) The Senior Notes are guaranteed by the Group's existing subsidiaries other than those established/incorporated under the laws of the PRC, Honghua America, Sichuan Honghua International (H.K.) Limited, Alaman Tech Story Limited Liability Partnership, PT. Newco Indo Resources, Sichuan Honghua Petroleum Equipment (H.K.) Limited and Golden Asia Success Limited.

Save as aforesaid or as otherwise disclosed herein, and apart from intra-group liabilities and normal trade payables, as at the close of business on 30 April 2018, the Group did not have any outstanding issued or agreed-to-be-issued loan capital, bank overdrafts, loans, or other similar borrowings, liabilities or liabilities under acceptance credit, debentures, mortgages, charges, hirepurchase commitments, guarantees or other material contingent liabilities.

### **3. WORKING CAPITAL**

Having taken into account the financial resources available to the Group, including internally generated funds and the available banking facilities, the Directors of the Company are of the opinion that the Group has sufficient working capital for its requirement for at least 12 months from the date of this circular.

### **4. FINANCIAL AND TRADING PROSPECTS OF THE GROUP**

In 2018, the rebalance of global oil market has made significant progress: the support from the market fundamentals pushed up crude oil price to USD70 per ton at the beginning of the year, keep reaching its peak of recent years under the influence of the geopolitical pattern. Although fluctuation is still possible in the future, a general trend of recovery for oil and gas industry is expected. It is promising that the Company will record a turnaround to profit and the break-even point will be achieved. The collection rate the future accounts receivable and the inventory turnover rate of the Company will be improved due to the economic revival of USA, China and new markets and capital expenditures resumption of oil companies.

In terms of business development, the Company will focus on the oil and gas equipment manufacturing and services sector with the aim to enhance our business value. We will take unconventional oil and gas resources exploitation and application as new business growth drivers, to achieve comprehensive development and healthy growth.

In terms of enhancement of business value, the Company will cooperate with CASIC, our largest shareholder, and its subsidiaries to integrate the resources from both companies and maximize the synergies, in order to promote the sales of a large-sum oil and gas exploration and production equipment and services through increased oil trade. Our business values can also be enhanced through improving the quality of the goods and services to our customers domestically and abroad, as well as focusing on the development of the 'One Belt, One Road' market.

In terms of exploitation and application of unconventional oil and gas resources, we will capitalize the emerging trend of energy structure adjustment in China and seize the huge opportunity of natural gas market, implement our strategy through shale gas special equipment sales and provide shale gas integrated solutions, in order to increase its marker shares in domestic market. In the land drilling rigs and related product business segment, we will accelerate the sales of new products, prioritize in promoting electric fracture pumps and new drilling rigs specialized for large scale shale gas exploitation, in order to realize business scale expansion and increase profit. In the oil and gas engineering service business segment, we will

rely on our equipment manufacturing advantages, and the implementation of our first Shale Gas integrated Solutions project, to enhance our EPC capability, as well as scaling up the domestic unconventional oil and gas (shale gas) market.

For the year ended 31 December 2017, the Group's revenue from continuing operations (oil and gas equipment manufacturing and oil and gas engineering services) for the year amounted to approximately RMB2.176 billion, representing an increase of 1.3% from RMB2.148 billion in the last year. Gross profit from continuing operations was approximately RMB635 million, representing an increase of 77.5% from RMB358 million last year. In view of the current oil and gas industry, the Company is optimistic and confident about the future development of its continuing operations. It is believed that the Company's revenue is expected to continue to grow in 2018.

## 1. RESPONSIBILITY STATEMENT

This supplemental circular, for which the Directors collectively and individually accept full responsibility, includes particulars given in compliance with the Listing Rules for the purpose of giving information with regard to the Company. The Directors, having made all reasonable enquiries, confirm that to the best of their knowledge and belief the information contained in this supplemental circular is accurate and complete in all material respects and not misleading or deceptive, and there are no other matters the omission of which would make any statement herein or this supplemental circular misleading.

## 2. DISCLOSURE OF INTERESTS

### (A) Directors and chief executive of the Company

As at the Latest Practicable Date, the following Directors of the Company had interests or short positions in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which would be required (a) to be 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 (b) pursuant to section 352 of the SFO, to be entered in the register referred to therein; or (c) to be notified to the Company and the Stock Exchange pursuant to the requirements of the Model Code for Securities Transactions by Directors of Listed Issuers (the “Model Code”):

#### (a) Ordinary shares of HK\$0.1 each of the Company

Name	Long/ Short position	Nature of interest	Number of Shares capital	% of the issued shares held of the Company
Mr. Zhang Mi	Long	Personal interest, corporate interest and settlor of a discretionary trust	1,083,554,363 <sup>(1)</sup>	20.23%
Mr. Ren Jie	Long	Personal interest and settlor of a discretionary trust	33,776,200 <sup>(2)</sup>	0.63%
Miss. Su Mei	Long	Personal interest	150,000 <sup>(3)</sup>	0.002%

#### Notes:

- (1) Zhang Mi individually owns 3,050,000 Shares. Yi Langlin, spouse of Zhang Mi owns 2,156,000 Shares. Zhang Mi is the settlor of a discretionary trust, The ZYL Family Trust, whose trustee, through Wealth Afflux Limited, holds 36% of the issued share capital of Ally Giant Limited which holds 920,548,363 Shares. The Trustee of The ZYL Family Trust owns 157,800,000 Shares.

- (2) Ren Jie individually owns 1,549,000 Shares. He is the settlor of a discretionary trust. The Trustee of The RJDJ Victory Trust owns 33,227,200 Shares.
- (3) Su Mei individually owns 150,000 Shares.

(b) *Share option of the Company*

	<b>Long/Short Position</b>	<b>Number of options held- Personal interest</b>
Mr. Zhang Mi	Long	5,127,000
Mr. Ren Jie	Long	5,472,000
Mr. Liu Xiaofeng	Long	3,450,000
Mr. Chen Guoming	Long	2,550,000

As at the Latest Practicable Date, so far as was known to the Directors, none of the Directors is a director or employee of a company which has an interest or short position in the Shares and underlying Shares of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO.

**(B) Substantial Shareholders**

As at the Latest Practicable Date, the register of substantial shareholders maintained by the Company pursuant to Section 336 of Part XV of the SFO showed that the following shareholders had an interest of 5% or more in the issued share capital of the Company and this interest represents long positions in the ordinary shares of HK\$0.1 each of the Company.

Name	Long/ Short Position	Personal interest Shares Interest	Corporate interest	Number of shares held		% of the issued share capital of the Company
				corporate interest and settlor of a discretionary trust	Total	
Ally Giant Limited	Long	920,548,363	—	—	920,548,363 <sup>(1)</sup>	17.18%
Wealth Afflux Limited	Long	157,800,000	920,548,363	—	1,078,348,363 <sup>(2)</sup>	20.13%
Equity Trustee Limited	Long	—	—	1,237,305,763	1,237,305,763 <sup>(3)</sup>	23.10%
Yi Langlin	Long	2,156,000	—	—	1,088,681,363 <sup>(4)</sup>	20.32%
		1,086,525,363 <sup>(4)</sup> (family interest)				
Kehua Technology Co., Limited	Long	1,606,000,000	—	—	1,606,000,000 <sup>(5)</sup>	29.98%
Shenzhen Aerospace Industry Technology Research Institute	Long	—	1,606,000,000	—	1,606,000,000 <sup>(5)</sup>	29.98%
China Aerospace Science and Industry Corporation	Long	—	1,606,000,000	—	1,606,000,000 <sup>(5)</sup>	29.98%

*Notes:*

- (1) Ally Giant Limited is owned by Wealth Afflux Limited and others 33 shareholders, holding 920,548,363 Shares in total.
- (2) Wealth Afflux Limited is held by Equity Trustee Limited (as the trustee of The ZYL Family Trust). The ZYL Family Trust is a discretionary trust established by Zhang Mi (as the settlor), with Equity Trustee Limited (as the trustee). The beneficiaries under The ZYL Family Trust are Zhang Mi and his family members.
- (3) Equity Trustee Limited, as the trustee of The ZYL Family Trust, and the 9 other Trusts hold 1,237,305,763 Shares in total.
- (4) Yi Langlin, spouse of Zhang Mi, is deemed to be interested in 1,088,681,363 Shares in which Zhang Mi holds 5,127,000 share options.
- (5) Kehua Technology Co., Limited is owned 40% by Shenzhen Aerospace Industry Technology Research Institute and 60% by China Aerospace Science and Industry Corporation and holds 1,606,000,000 Shares.

Save as disclosed above, there is no person or entity other than a director or chief executive of the Company whose interests are disclosed under the paragraph headed “Directors’ interests” below, who had an interest or short position in the shares and underlying shares of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO, or were directly or indirectly, interested in 5% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of the Company.

### **3. DIRECTORS’ INTERESTS**

As at the Latest Practicable Date, none of the Directors had any interests, either directly or indirectly, in any assets which had been acquired or disposed of by or leased to any member of the Group, or which were proposed to be acquired or disposed of by or leased to any member of the Group since 31 December 2017, the date to which the latest published audited consolidated accounts of the Group were made up.

As at the Latest Practicable Date, there was no subsisting contracts of significance in relation to the Group’s business to which the Company or any of its subsidiaries was a party and in which a director of the Company had a material interest, whether directly or indirectly.

### **4. MATERIAL ADVERSE CHANGE**

As at the Latest Practicable Date, the Directors were not aware of any material adverse change in the financial or trading position of the Group since 31 December 2017, being the date to which the latest published audited consolidated financial statements of the Group were made up.

## 5. COMPETING INTERESTS

As at the Latest Practicable Date, none of the Directors nor their respective associates had an interest in any business apart from the Group's business which competes or is likely to compete, either directly or indirectly, with the Group's business.

## 6. SERVICE CONTRACTS

As at the Latest Practicable Date, none of the Directors had any existing or proposed service contract with the Company or any of its subsidiaries which is not expiring nor determinable by the Company or any of its subsidiaries within one year without payment of compensation other than statutory compensation.

## 7. EXPERTS AND CONSENTS

The following is the qualification of the expert who has given opinions or advice contained in this supplemental circular:

<b>Name</b>	<b>Qualification</b>
Gram Capital	Gram Capital Limited, a corporation licensed under the SFO to carry out Type 6 (advising on corporate finance) regulated activities

Gram Capital has confirmed that as at the Latest Practicable Date, it did not have any beneficial shareholding in any member of the Group or the right (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for securities in any member of the Group nor did it have any direct or indirect interests in any assets which had been since 31 December 2017 (being the date to which the latest published audited consolidated financial statements of the Company were made up) acquired or disposed of by or leased to any member of the Group, or were proposed to be acquired or disposed of by or leased to any member of the Group.

Gram Capital has given and has not withdrawn its written consent to the issue of this supplemental circular with the inclusion herein of its opinion prepared for the purpose of incorporation in this supplemental circular, and the references to its name and opinion in the form and context in which they respectively appear.

## 8. DOCUMENTS AVAILABLE FOR INSPECTION

Copies of the following documents will be available for inspection at the principal place of business of the Company in Hong Kong from 9:00 a.m. to 6:00 p.m. on any business day from the date of this supplemental circular up to and including the closing date of the AGM:

- (i) this supplemental circular;
- (ii) the Lease Framework Agreement;

- (iii) the Financial Cooperation Agreement;
- (iv) the letter of recommendation from the Independent Board Committee, the full text of which is set out on pages 25 to 26 of this supplemental circular;
- (v) the letter of advice from Gram Capital to the Independent Board Committee and the Shareholders, the full text of which is set out on pages 27 to 50 of this supplemental circular;
- (vi) the written consent as referred to under the section headed “Experts and Consents” in this appendix; and
- (vii) the Memorandum and Articles of Association, and the annual report for the financial years of 2016 and 2017 of the Company.

## 9. MATERIAL CONTRACTS

No contract, not being contracts in the ordinary course of business of the Group, has been entered into by the members of the Group within the two (2) years immediately preceding the Latest Practicable Date.

## 10. LITIGATION

Save for the announcement of the Company dated 24 May 2018, neither the Group nor any other member of the Group has engaged in any litigation, arbitration or claim of material importance and no litigation, arbitration or claim of material importance known to the Directors to be pending or threatened against any member of the Group as at the Latest Practicable Date.

## 11. MISCELLANEOUS

- (i) Ms Lee Mei Yi of Tricor Services Limited has been engaged by the Company as its joint company secretary. Its primary contact person at the Company is Mr. He Bin, another joint company secretary of the Company.
- (ii) The registered office of the Company is situated at Clifton House, 75 Fort Street, PO Box 1350, Grand Cayman, KY1-1108, Cayman Islands and the principal place of business of the Company in Hong Kong is situated at Room 2508, Harcourt House, 30 Gloucester Road, Wanchai, Hong Kong.
- (iii) The Hong Kong branch share registrar and transfer office of the Company is Computershare Hong Kong Investor Services Limited, at Shops 1712–1716, 17th Floor, Hopewell Centre, 183 Queen’s Road East, Wanchai, Hong Kong.
- (iv) In the event of any inconsistency, the English text of this supplemental circular shall prevail over the Chinese text.

## SUPPLEMENTAL NOTICE OF ANNUAL GENERAL MEETING



宏华集团  
HONGHUA GROUP

**Honghua Group Limited**

宏華集團有限公司

*(Incorporated in the Cayman Islands with limited liability)*

**(Stock Code: 196)**

## SUPPLEMENTAL NOTICE OF ANNUAL GENERAL MEETING

Reference is made to the notice of Annual General Meeting (the “AGM”) of Honghua Group Limited (the “Company”) dated 9 May 2018, which sets out the resolutions for the Shareholders to consider at the AGM to be held at 9:30 a.m. on 21 June 2018, Thursday, at Novotel Century Hong Kong, 238 Jaffe Road, Wan Chai, Hong Kong. Unless the context otherwise requires, capitalised terms used herein shall have the same meaning as those defined in the circular dated 9 May 2018 and the supplemental circular dated 5 June 2018 of the Company.

Supplemental notice is hereby given that the AGM will be held as originally scheduled. In addition to the resolutions set out in the Notice of AGM of the Company dated 9 May 2018, the following resolutions will be considered and, if thought fit, approved:

### ORDINARY RESOLUTIONS

“THAT:

7. (a) the Lease Framework Agreement (as defined in the Supplemental Circular to the shareholders of the Company dated 5 June 2018 (the “**Supplemental Circular**”)) and the sales and finance lease transactions contemplated thereunder be and are hereby approved;
- (b) the Proposed Revised Annual Caps for the periods concerned under the Supplemental Circular be and are hereby approved; and
- (c) any one director be and is hereby authorised on behalf of the Company to sign, execute, perfect, deliver and do all such documents, deeds, acts, matters and things as he may in his discretion consider necessary or desirable for the purposes of or in connection with or to give effect to the aforesaid Lease Framework Agreement and the transactions contemplated thereunder (including the Proposed Revised Annual Caps).

**SUPPLEMENTAL NOTICE OF ANNUAL GENERAL MEETING**

8. (a) the Lease Framework Agreement and the sales and operating lease transactions contemplated thereunder be and are hereby approved;
- (b) the Proposed Annual Caps for the periods concerned under the Supplemental Circular be and are hereby approved; and
- (c) any one director be and is hereby authorised on behalf of the Company to sign, execute, perfect, deliver and do all such documents, deeds, acts, matters and things as he may in his discretion consider necessary or desirable for the purposes of or in connection with or to give effect to the aforesaid Lease Framework Agreement and the transactions contemplated thereunder (including the Proposed Annual Caps).
9. (a) the deposit service under the Financial Cooperation Agreement (as defined in the Supplemental Circular) are hereby approved;
- (b) the Proposed Annual Caps for the periods concerned under the Supplemental Circular be and are hereby approved; and
- (c) any one director be and is hereby authorised on behalf of the Company to sign, execute, perfect, deliver and do all such documents, deeds, acts, matters and things as he may in his discretion consider necessary or desirable for the purposes of or in connection with or to give effect to the aforesaid Financial Cooperation Agreement and the deposit services transactions contemplated thereunder (including the Proposed Annual Caps).

By order of the Board  
**Honghua Group Limited**  
**Chen Yajun**  
*Chairman*

Hong Kong, 5 June 2018

*Registered office:*

Clifton House, 75 Fort Street  
PO Box 1350, Grand Cayman  
KY1-1108, Cayman Islands

*Head Office:*

99 East Road, Information Park  
Jinniu District, Chengdu Sichuan  
People's Republic of China  
Post code: 610036

*Principal place of*

*business in Hong Kong:*

Room 2508, Harcourt House  
39 Gloucester Road  
Wan Chai, Hong Kong

## SUPPLEMENTAL NOTICE OF ANNUAL GENERAL MEETING

*Notes:*

1. Save for the newly proposed resolutions, there are no other changes to the resolutions set out in the Notice of the AGM dated 9 May 2018. For details of the other resolutions to be considered at the AGM and other relevant matters, please refer to the Notice of the AGM and the circular of the Company dated 9 May 2018.
2. The form of proxy sent by the Company together with the circular on 9 May 2018 (the “**First Form of Proxy**”) does not contain the additional resolutions as set out in this supplemental notice. A supplemental proxy form (the “**Supplemental Proxy Form**”) containing the above additional resolutions has been prepared and is enclosed herein. The Supplemental Proxy Form is the supplemental proxy form for the purpose of the supplemental resolutions set out in this supplemental notice, and it only serves as a supplement to the First Form of Proxy. The Supplemental Proxy Form will not affect the validity of the First Form of Proxy duly completed and submitted to the Share Registrar of the Company.
3. If a shareholder has properly completed and submitted only the First Proxy Form in accordance with the instructions set out therein, the appointed proxy will vote on the resolutions set out in the First Proxy Form per the shareholder’s direction and he is also entitled to vote or abstain at his discretion on the additional resolution(s) set out in the Supplemental Proxy Form. Similarly, if a shareholder has properly completed and submitted only the Supplemental Proxy Form in accordance with the instructions set out therein, the appointed proxy will vote on the resolution(s) set out in the Supplemental Proxy Form per the shareholder’s direction and he is also entitled to vote or abstain at his discretion on the resolutions set out in the First Proxy Form. If a shareholder wishes to provide specific direction to his proxy regarding to the voting of all resolutions set out in the First Proxy Form and the Supplemental Proxy Form, he should duly complete and submit the First Proxy Form and the Supplemental Proxy Form in accordance with the instructions set out therein.
4. A member of the Company who is entitled to attend and vote at the AGM convened by the above notice is entitled to appoint a proxy to attend and vote on his behalf. A proxy need not be a member of the Company but must attend in person to represent the member. A member who is the holder of two or more shares may appoint more than one proxy to represent him and vote on his behalf. If more than one proxy is so appointed, the appointment shall specify the number and class of shares in respect of which each such proxy is so appointed. Every member present in person or by proxy shall be entitled to one vote for each share held by him.
5. In order to be valid, the supplemental form of proxy together with the power of attorney or other authority under which it is signed or a certified copy of such power of attorney or authority, must be deposited at the Company’s Hong Kong branch share registrar and transfer office in Hong Kong, Computershare Hong Kong Investor Services Limited, at 17M Floor Hopewell Centre, 183 Queen’s Road East, Wanchai, Hong Kong not less than 48 hours before the time for holding the AGM or any adjourned meeting. Completion and return of the supplemental form of proxy will not preclude a member from attending and voting in person at the above meeting or any adjourned meeting, and in such event, the supplemental form of proxy shall be deemed to be revoked.
6. Where there are joint registered holders of any share of the Company, any one of such persons may vote at the AGM, either personally or by proxy, in respect of such share as if he were solely entitled thereto; but if more than one of such joint holders be present at the AGM personally or by proxy, that one of the said persons so present whose name stands first on the register of shareholders of the Company in respect of such share shall alone be entitled to vote in respect thereof.

*As at the date hereof, the executive directors of the Company are Mr. Chen Yajun (Chairman), Mr. Zhang Mi and Mr. Ren Jie, the non-executive directors of the Company are Mr. Han Guangrong and Mr. Chen Wenle, and the independent non-executive directors of the Company are Mr. Liu Xiaofeng, Mr. Chen Guoming, Ms. Su Mei, Mr. Poon Chiu Kwok, Mr. Chang Qing and Mr. Wu Yuwu.*