

8 December 2021

*To the Independent Board Committee and the Independent Shareholders*

Dear Sirs,

**CONTINUING CONNECTED TRANSACTION IN RELATION TO  
THE NEW ENGINEERING CONSTRUCTION SERVICE  
FRAMEWORK AGREEMENT**

**INTRODUCTION**

We refer to our engagement as the independent financial adviser to the Independent Board Committee in respect of the terms of the New Engineering Construction Services Framework Agreement and the transactions contemplated thereunder, details of which are set out in the letter from the Board (the “**Letter from the Board**”) contained in a circular of the Company (the “**Circular**”) to the Shareholders dated 8 December 2021, of which this letter forms part. Capitalised terms used in this letter shall have the same meanings as those defined in the Circular unless the context otherwise requires.

On 22 November 2021, the Company and Zhongming Zhiye entered into the New Engineering Construction Service Framework Agreement to renew the Engineering Construction Service Framework Agreement dated 17 May 2019, pursuant to which the Group would provide engineering construction services, including but not limited to engineering procurement construction, decoration and landscape engineering, to Zhongming Zhiye and its associates in the daily business process, and Zhongming Zhiye and its associates would pay service fees to the Group.

Since Zhongming Zhiye is held as to 92.5% by Zhongru Investment and as to 7.5% by Qianbao Investment, and each of Zhongru Investment and Qianbao Investment is a controlling Shareholder, Zhongming Zhiye is a connected person under Rule 14.07A(4) of the Listing Rules. By virtue of the aforesaid relationship, the provision of labor subcontracting services under the New Engineering Construction Service Framework Agreement constitutes continuing connected transaction under Chapter 14A of the Listing Rules.

The Independent Board Committee, comprising Ms. Shen Lifeng, Ms. Chen Xin and Mr. Chan Ngai Sang Kenny, being all the independent non-executive Directors, has been formed to advise the Independent Shareholders as to (i) whether the New Engineering Construction Service Framework Agreement and its proposed annual caps (the “Annual Caps”) are conducted in ordinary and usual course of business of the Company, are on normal commercial terms which are fair and reasonable, and are in the interests of the Company and the Independent Shareholders as a whole; and (ii) how the Independent Shareholders should vote on the relevant resolutions regarding the New Engineering Construction Service Framework Agreement and the Annual Caps at the Extraordinary General Meeting.

Our role, as the independent financial adviser to the Independent Board Committee and the Independent Shareholders in relation to the New Engineering Construction Service Framework Agreement and the transactions contemplated thereunder, is to (i) provide the Independent Board Committee and the Independent Shareholders an independent opinion and recommendation as to whether the New Engineering Construction Service Framework Agreement are entered into on normal and commercial terms, in the ordinary and usual course of business of the Group and in the interests of the Group and the Independent Shareholders as a whole, and whether the terms thereof and the Annual Caps are fair and reasonable so far as the Company and the Independent Shareholders are concerned; and (ii) advise the Independent Shareholders on how to vote on the relevant resolutions regarding the New Engineering Construction Service Framework Agreement and the Annual Caps at the Extraordinary General Meeting.

We are not associated with the Company, Zhongming Zhiye or their respective core connected persons, close associates or associates and accordingly are considered eligible to give independent advice on the terms of the New Engineering Construction Service Framework Agreement. Except for being appointed as the independent financial adviser to the then independent board committee and independent shareholders of the Company (details of which have been set out in the letter from Halcyon Capital Limited as contained in the circular of the Company dated 22 January 2020), there was no other engagement between the Group and Halcyon Capital in the last two years from the date of this letter. Apart from the normal professional fees paid to us in connection with our independent financial advisory appointments under the aforesaid engagement and this engagement, no arrangements exist whereby we had received any fees or benefits from the Company or any other party to the transactions and therefore we consider that such relationship will not affect our independence as the independent financial adviser to the Independent Board Committee and the Independent Shareholders in relation to the New Engineering Construction Service Framework Agreement and the transactions contemplated thereunder.

## **BASIS OF OUR OPINION**

In formulating our advice and recommendation to the Independent Board Committee, we have relied on the information, financial information and the facts supplied to us and representations expressed by the Directors and/or management of the Group and have assumed that all such information, financial information and facts and any representations made to us, or referred to in the Circular, in all material aspects, are true, accurate and complete as at the time they were made and continue to be so as at the date of the Circular, has been properly extracted from the relevant underlying accounting records (in the case of financial information) and made after due and careful inquiry by the Directors and/or the management of the Group. The Directors have confirmed in the Circular that, having made all reasonable enquiries, confirm that to the best of their knowledge and belief, the information contained in this 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 circular misleading and we have further been confirmed by the Company that no material facts have been omitted from the information supplied and representations expressed to us. We have also relied on certain information available to the public and have assumed such information to be accurate and reliable. We have no reason to doubt the completeness, truth or accuracy of the information and facts provided and we are not aware of any facts or circumstances which would render such information provided and representations made to us untrue, inaccurate or misleading.

Our review and analysis were based upon, among others, the information provided by the Group including the New Engineering Construction Service Framework Agreement, the annual report of the Company for the year ended 31 December 2020 (the “**2020 Annual Report**”), the interim report of the Company for the six months ended 30 June 2021 (the “**2021 Interim Report**”), the Circular and certain published information from the public domain.

We have also discussed with the Directors and/or the management of the Group with respect to the terms of and reasons for the entering into of the New Engineering Construction Service Framework Agreement, and considered that we have reviewed sufficient information to reach an informed view and to provide a reasonable basis for our opinion. We have not, however, conducted an independent verification or appraisal of the information nor have we conducted any form of in-depth investigation into the businesses, affairs, financial position, profitability or the prospects of the Group, Zhongming Zhiye or any of their respective subsidiaries or associates. Nothing contained in this letter should be construed as a recommendation to hold, sell or buy and shares or any other securities of the Company.

## PRINCIPAL FACTORS AND REASONS CONSIDERED

In arriving at our opinion for the New Engineering Construction Service Framework Agreement and the respective transactions contemplated thereunder, we have considered the following principal factors and reasons:

### 1. Information of the Group

#### *Principal business*

As stated in the 2021 Interim Report, the Group is a leading non-state owned construction group in the PRC and is principally engaged in construction contracting business and other businesses mainly including service concession arrangements. Based on the 2020 Annual Report, the Group provides construction contracting services mainly as a contractor for building construction projects and infrastructure construction projects, and over 95% of the revenue of the Group in 2020 was derived from the provision of construction contracting services.

According to the 2020 Annual Report, approximately 49% of the value of the new contracts of the Group's contracting construction business were attributable to the Beijing-Tianjin-Hebei Region and over 70% of the value of the new contracts of the Group's contracting construction business were attributable to building construction, followed by infrastructure construction of approximately 23%.

#### *Financial highlights*

Set out below is the summary of key financial information of the Group for each of the two years ended 31 December 2020 and the six months ended 30 June 2020 and 2021 as extracted from the 2020 Annual Report and 2021 Interim Report:

|  | For the year ended 31 December |                   | Six months ended 30 June |                   |
|--|--------------------------------|-------------------|--------------------------|-------------------|
|  | 2020                           | 2019              | 2021                     | 2020              |
|  | RMB'mil                        | RMB'mil           | RMB'mil                  | RMB'mil           |
| Operating revenue  | 40,150                         | 41,077            | 19,970                   | 14,372            |
| Operating costs  | <u>(38,010)</u>                | <u>(39,024)</u>   | <u>(18,891)</u>          | <u>(13,604)</u>   |
| Implied gross profit ( <i>Note</i> )                             | 2,140                          | 2,053             | 1,079                    | 768               |
| Profit before tax  | 936                            | 1,209             | 282                      | 317               |
| Income tax expense   | <u>(184)</u>                   | <u>(446)</u>      | <u>(53)</u>              | <u>(70)</u>       |
| <b>Profit for the year/period<br/>from continuing operations</b> | <b><u>752</u></b>              | <b><u>763</u></b> | <b><u>229</u></b>        | <b><u>247</u></b> |

*Note:* Such amount was calculated based on the operating revenue and operating costs of the Group and was not disclosed in the 2020 Annual Report and the 2021 Interim Report.

As illustrated in the above table, the Group has recorded net profit for each of the two years ended 31 December 2020 and six months ended 30 June 2020 and 2021, and according to the 2021 Interim Report, the consolidated net assets value of the Company attributable to the Shareholders reached approximately RMB6,248 million as at 30 June 2021.

For the six months ended 30 June 2021, revenue of the Group increased considerably by approximately 39.0%, which was principally driven by the increase in revenue derived from construction contracting business of approximately RMB5,466 million. According to the 2021 Interim Report, the increase in revenue from construction contracting business for the six months ended 30 June 2021 was mainly due to the fact that as compared to the same period of last year, the relevant business of the Group was not significantly affected by the COVID-19 pandemic during the six months ended 30 June 2021. During the first half of 2021, approximately 67.7% of revenue of the Group was generated from its building construction business, with approximately 24.3% generated from infrastructure construction business.

The Group recorded similar level of gross profit margin in the first half of 2020 and 2021, while the improvement in gross profit was mainly driven by the improvement in revenue. The gross profit margin of the building construction business was approximately 4.7% for each of the first half 2020 and 2021, while the gross profit margin for the infrastructure construction business slightly increased from approximately 6.1% in the first half of 2020 to approximately 6.3% in the first half of 2021.

Despite the improvement in gross profit, the Group recorded a reduction in net profit from approximately RMB247 million in the first half of 2020 to approximately RMB229 million in the first half of 2021. The reduction was principally attributable to the increase in losses on asset impairment from approximately RMB31 million in the first half of 2020 to approximately RMB232 million in the first half of 2021, and the increase in administrative expenses and credit impairment losses.

For the year ended 31 December 2020, revenue of the Group slightly decreased by approximately 2.3%, or approximately RMB927 million from approximately RMB41,077 million in 2019 to RMB40,150 million in 2020, which was mainly due to the decrease in revenue from construction contracting segment of RMB692 million. During 2020, approximately 65.8% of revenue of the Group was generated from its building construction business, with approximately 22.7% generated from infrastructure construction business.

The Group recorded improvements in both gross profit and gross profit margin for 2020 which were principally attributable to the improvement in gross profit and gross profit margin from the construction contracting business. The gross profit margin of the construction contracting business improved from approximately 4.7% in 2019 to approximately 5.1% in 2020. According to the 2020 Annual Report, the new projects undertaken by the Group in recent years are more quality-oriented with higher gross profit for infrastructure construction projects, thus the Group has undertaken more such projects in recent years.

The profit of the Group for the year ended 31 December 2020 was slightly reduced by approximately 1.4% from approximately RMB763 million in 2019 to approximately RMB752 million in 2020. The reduction in net profit was principally attributable to the increase in losses on assets impairment of approximately RMB314 million and partially offset by the decrease in income tax expenses of approximately RMB262 million.

*Financial position*

Set out below is the highlight of financial position of the Group as at 30 June 2021 extracted from the 2021 Interim Report:

|                   | <b>As at 30 June<br/>2021</b><br><i>RMB'mil</i> |
|-------------------|---|
| Total assets      | 60,572  |
| Total liabilities | 54,133  |
| Net assets        | 6,439   |

The Group recorded total assets of approximately RMB60,572 million as at 30 June 2021 and over 90% of which were current assets. As at 30 June 2021, the current assets of the Group principally comprised contract assets of approximately RMB36,720 million, accounts receivable of approximately RMB6,139 million, currency funds of approximately RMB6,216 million.

The Group recorded total liabilities of approximately RMB54,132 million as at 30 June 2021 and over 95% of which were current liabilities. As at 30 June 2021, the current liabilities of the Group principally comprised trade payable of approximately RMB33,491 million, contract liabilities of approximately RMB5,284 million and other payables of approximately RMB5,208 million.

The Group recorded a relatively slight increase in net assets attributable to shareholders of the parent of the Company from approximately RMB6,246 million as at 31 December 2020 to approximately RMB6,248 million as at 30 June 2021 as the effect of dividend distribution of approximately RMB246 million during the period had substantially offset the effect of profit for the period.

## **2. Reasons for and benefits of entering into of the New Engineering Construction Service Framework Agreement**

As stated in the Letter from the Board, given that: (i) the Group has provided engineering construction services to Zhongming Zhiye and its branches and subsidiaries in the past, and the relevant services provided in the past have provided stable and profits to the Group; (ii) the pricing of construction services provided by the Group to Zhongming Zhiye and its affiliated real estate companies is fair and on normal commercial terms; and (iii) Zhongming Zhiye and its affiliated real estate companies have made timely payments in the past without incurring any bad debts. In the future, Zhongming Zhiye and its affiliated real estate companies will also give priority to the payment of project funds to the Group. The Directors (including independent non-executive Directors) are of the opinion that, the New Engineering Construction Service Framework Agreement and its proposed annual caps are entered into on normal commercial terms in the ordinary and usual course of business of the Company and are fair and reasonable, and in the interests of the Company and the Shareholders as a whole.

We noted that according to the 2020 Annual Report, building construction business was the largest revenue contributing business segment, over 70% of the new contract value of the Group in 2020 was attributable to building construction business. As advised by the Company and based on our analysis below, the terms of contracting services offered to Zhongming Zhiye and its associates were on normal commercial terms and comparable to the terms offered to third parties. Accordingly, we concur with the view of the Directors that the continuation of provision of contracting services to Zhongming Zhiye and its associates is in the interests of the Company and the Independent Shareholders as a whole.

## **3. Principal terms of the New Engineering Construction Service Framework Agreement**

As set out in the Letter from the Board, the principal terms of the New Engineering Construction Service Framework Agreement are set out below:

**(1) Date**

22 November 2021

**(2) Parties**

The Company (as the service provider); and

Zhongming Zhiye (as the service recipient).

**(3) Principal terms**

According to the New Engineering Construction Service Framework Agreement, the Group provides engineering construction services (the “**Construction Services**”), including but not limited to engineering procurement construction, decoration and landscape engineering, to Zhongming Zhiye and its associates in the daily business process, and Zhongming Zhiye and its associates will pay service fees to the Group. The term of the New Engineering Construction Service Framework Agreement will commence from 1 January 2022 until 31 December 2024 (both dates inclusive). Subject to the relevant laws, regulations and the Listing Rules, the term can be renewed for another three years upon its expiry as agreed by the specific parties to the agreement, upon which the Group will continue to comply with the applicable requirements under the Listing Rules. Relevant subsidiaries or associated companies of both parties will separately enter into specific agreements and specify specific terms and conditions according to the principles stipulated in the New Engineering Construction Service Framework Agreement.

**(4) Pricing policy**

According to the New Engineering Construction Service Framework Agreement, the cost for the Group to provide construction services to Zhongming Zhiye and its associates will be determined based on arm’s length negotiation with Zhongming Zhiye and its associates. The main reference factors include: (i) availability and cost of raw materials and equipment and machinery, labor and subcontractors; (ii) the local guiding prices of all kinds of raw materials as set out in the monthly cost information manual subscribed by the Company from the cost units under the local housing and urban-rural construction bureaus; (iii) the project schedule, the complexity and scale of the construction project, and the potential revision of the scope of work; (iv) the geographical location and environmental conditions of the project site; (v) the Group’s estimate of competitive bidding; and (vi) contractual risks.

As further stated under the New Engineering Construction Service Framework Agreement, regarding the evaluation and analysis of competitive bidding, the Company has mainly formulated the following mechanisms: (i) the competitive quotation analysis mechanism, which is based on collecting bid opening records, network data, competitors’ usual quotation methods and the importance attached to the project, which provides a comprehensive and overall analysis basis for quotation decision-making procedures; (ii) the bidding decision-making process mechanism led by the market operation department with the overall participation of each functional department (including but not limited to the production and technology department, the material procurement department and the finance department), where the bidding documents will be interpreted and the bidding strategic plan, division of responsibilities and specific timetable will be formulated through the pre-bidding meeting with the participation of the management of the above departments; and (iii) the final quotation decision-making team comprising the Company’s general manager and market operation manager will determine the final quotation of the project with reference to the relevant information of competitors, the specific needs of the project and impacts of the project on the Company’s macro strategy.



In order to ensure that the fees charged by the Group for the provision of construction services are fair and reasonable and conform to market practices, the Group will closely follow the current level of market fees and market conditions and Independent Third Party cost consultation institutions will review the pricing. In addition, the Group will also refer to the fees charged historically for providing similar construction services to Independent Third Party customers.

**4. Pricing policies and internal control measures regarding price determination for the continuing connected transactions under the New Engineering Construction Service Framework Agreement**

Based on our discussions with the management of the Company and as disclosed in the Letter from the Board, we understand that in addition to the pricing policies under the New Engineering Construction Service Framework Agreement, the Group has adopted the following internal control measures (the “**Internal Control Measures**”) and will apply these measures when determining the price of products in respect of the continuing connected transactions under the New Engineering Construction Service Framework Agreement:

- The Company has adopted and implemented a set of connected transaction management system. According to the system, the Audit Committee of the Board is responsible for reviewing compliance with relevant laws, regulations, the Company's policies and the Listing Rules regarding continuing connected transactions. In addition, the Audit Committee of the Board, the office of the Board and various internal departments of the Company (including but not limited to the market operation department, the financial securities department and the finance management department and the legal department) are jointly responsible for evaluating the terms and service fees (including but not limited to identifying transactions with Independent Third Parties to determine the market prices) under the New Engineering Construction Service Framework Agreement, especially the pricing policy of the transaction; the market operation department, the production security department and the finance management department are responsible for the approval of the annual caps and its fairness under such transaction;

- The Audit Committee of the Board, the office of the Board and various internal departments of the Company (including but not limited to the finance department and the legal department) will also regularly review the implementation of the New Engineering Construction Service Framework Agreement and the progress of the transaction semi-annually and quarterly, respectively. In addition, the Board of the Company will regularly review the pricing policy of the New Engineering Construction Service Framework Agreement on an annual basis; the Company's independent non-executive Directors and auditors will conduct annual reviews of the continuing connected transactions under the New Engineering Construction Service Framework Agreement in accordance with the Listing Rules and provide annual confirmations to confirm that the transaction is conducted in accordance with the terms of the agreement and in accordance with normal commercial terms and pricing policy; and
- When considering the Construction Services provided by the Group to the above-mentioned connected persons, the finance management department of the Company will continue to regularly study the prevailing market conditions and practices on a semi-annual basis and refer to the pricing and terms of similar transactions concluded between the Group and Independent Third Parties to ensure that the pricing and terms provided by the above-mentioned connected persons through the bidding process or mutual commercial negotiation (as the case may be) are fair and reasonable, and no less favourable than those provided to Independent Third Parties.

Furthermore, as set out in the management system on connected transactions adopted by the Company, the pricing of the connected transactions must be fair and with reference to the following principles that, among other things, except where the government pricing or the government-guided prices apply, if there is a comparable independent third party market price or charging standard, the transaction price may be determined with reference to such price or standard with priority; where there is no comparable independent third party market price, the transaction price may be determined with reference to the price of a non-related party transaction occurring between the related party and a third party independent of such related party; and if there is neither independent third party market price nor independent non-related party transaction price for reference, a reasonable price could be served as the pricing basis, the final price is the reasonable cost plus the reasonable profit. For pricing of connected transactions determined based on the abovementioned principles, different pricing methodologies shall be adopted depending on the types and circumstances of connected transactions to be entered into, which include cost-plus method, resale price method, comparable sales method, comparable net profit method and profit split method. In particular, for cost-plus method, the pricing is determined based on the relevant costs of the Group plus a gross profit margin which are determined based on the gross profit margin of comparable transactions with Independent Third Parties.

Taking into account the nature of the Construction Services and given the scope of services to be provided by the Group varies across different projects, and having further confirmed with the management of the Company, we noted that in determining the pricing of the construction services to be provided by the Group under a particular contract as a whole (i) there is no standard pricing or charging standard; (ii) the government pricing or the government-guided prices does not apply; and (iii) there is neither independent third party market price nor independent non-related party transaction price for reference for such price as a package. Accordingly, the pricing of the Construction Services shall be based on reasonable cost plus a reasonable profit pursuant to the management system on connected transactions of the Group. According to the pricing policy under the New Engineering Construction Service Framework Agreement, the cost for the Group to provide construction services to Zhongming Zhiye and its associates will be determined based on arm's length negotiation with Zhongming Zhiye and its associates, and the main reference factors include: (i) availability and cost of raw materials and equipment and machinery, labor and subcontractors; (ii) the local guiding prices of all kinds of raw materials as set out in the monthly cost information manual subscribed by the Company from the cost units under the local housing and urban-rural construction bureaus; (iii) the project schedule, the complexity and scale of the construction project, and the potential revision of the scope of work; (iv) the geographical location and environmental conditions of the project site; (v) the Group's estimate of competitive bidding; and (vi) contractual risks. We concur with the management of the Company that the pricing policy under the New Engineering Construction Service Framework Agreement is consistent with the management system on connected transactions of the Group.

In addition, we noted from the annual reports of the Company for the year ended 31 December 2019 and 2020 that the auditors and the then independent non-executive directors of the Company have reviewed the Group's continuing connected transactions and confirmed that, among other things, the relevant transactions carried out in the years ended 31 December 2019 and 2020 were carried out in accordance with the terms of the relevant Engineering Construction Service Framework agreement. Moreover, we have obtained and reviewed the report from auditors of the Company confirming that, among other things, the relevant continuing connected transactions carried out in the years ended 31 December 2019 and 2020 were carried out in accordance with the terms of the relevant Engineering Construction Service Framework Agreement and the transactions carried out in the years ended 31 December 2019 and 2020 were in accordance with the pricing policies of the Company.

Meanwhile, we have obtained and reviewed the list of construction contracting contracts with Zhongming Zhiye and its associates for the three years ended 31 December 2021 (“**Connected Contract List**”) which contains the existing contracts with Zhongming Zhiye and its associates and the contracts expected to be entered into with Zhongming Zhiye and its associates in the three years ending 31 December 2021. We have selected the six largest revenue generating contracts during the three years ending 31 December 2021 from the Connected Contract List, and obtained and reviewed the relevant supporting documents in relation to the contract sum and the planned cost of services (the “**Relevant Documents**”) for these contracts. In addition, we have obtained and reviewed the list of construction contracting contracts between the Group and Independent Third Parties regarding ten residential property development contracts that are comparable to the contracts which we selected from the Connected Contract List in terms of size, nature and location, and the transactions contemplated thereunder were expected to cover the three years ending 31 December 2021 (the “**Independent Contract List**”), together with the planned gross profit margin of the relevant projects. We noted from the Relevant Documents in relation to the samples selected from the Connected Contract List that the planned gross profit margins are comparable to those stated in the Independent Contract List. We consider that our finding is in line with the pricing policy and management system on connected transactions adopted by the Company.

#### 5. Rationale for determining the Annual Caps

The table below sets out the historical transaction amounts between the Group and Zhongming Zhiye and its associates in respect of the Engineering Construction Services under the Engineering Construction Service Framework Agreement for each of the two years ended 31 December 2020 and the nine months ended 30 September 2021, the annual caps under the Engineering Construction Service Framework Agreement for each of the three years ended 31 December 2021 and the proposed Annual Caps for each of the three years ending 31 December 2024:

|                  | For the year ended 31 December |         | Nine months ended |
|------------------|--------------------------------|---------|-------------------|
|                  | 2019                           | 2020    | 30 September      |
|                  | RMB'mil                        | RMB'mil | 2021<br>RMB'mil   |
| Actual amount    | 534.05                         | 410.53  | 551.79            |
| Annual cap       | 1,100                          | 1,200   | 1,400 (Note)      |
| Utilisation rate | 48.6%                          | 34.2%   | 52.6% (Note)      |

*Note:* The annual cap of the Construction Services under the Engineering Construction Service Framework Agreement for the year ending 31 December 2021 was RMB1,400 million and the utilisation rate for the nine months ended 30 September 2021 was annualised based on the actual transaction amount for the nine months ended 30 September 2021 multiplied by 4/3 and divided by the annual cap for the year ending 31 December 2021.

**Proposed Annual Caps**  
**For the year ending 31 December**

| 2022           | 2023           | 2024           |
|----------------|----------------|----------------|
| <i>RMB'mil</i> | <i>RMB'mil</i> | <i>RMB'mil</i> |
| 1,200          | 1,000          | 900            |

As stated in the Letter from the Board, the Annual Caps have been determined mainly with reference to: (i) the construction service fees previously paid to the Group by Zhongming Zhiye and its affiliated real estate companies; (ii) expected project contract amount and construction progress; (iii) the number of projects currently available to the Group that requires construction services; and (iv) new construction service projects in the next three years expected by the Group. In particular:

- (i) although the historical amounts of the Group's relevant engineering construction services with Zhongming Zhiye and its associates recorded a declining trend in the past few years, the Company estimates an increase in the annual caps of engineering construction service fees charged to Zhongming Zhiye and its associates for the coming three years. On the one hand, the Company's project backlog for the next three years records a significant increase from its historical level. During the period from 2019 to 2021, the Company completed seven projects and it is expected that 17 projects will be conducted from 2022 to 2024. On the other hand, the cost of construction contracting services has been on the rise in the past few years. According to Beijing Lange Steel and the price guidance for labor cost of construction work, from the first half of 2019 to the second half of 2021, the price of steel and labor increased by approximately 40% and 21%, respectively. Therefore, the prospective increase in construction costs was also taken into account in the formulation of the relevant annual caps. In addition, an appropriate buffer has been added when formulating the annual caps to cope with potential new projects that cannot be confirmed at present;
- (ii) major considerations referred by the Company in estimating prospective project contract amounts of the engineering construction service provided to Zhongming Zhiye and its associates include:
  - (a) the existing agreements entered into between the Group and Zhongming Zhiye and its associates, total contract amount of the relevant agreements as well as the estimation of cost according to the expected construction progress during the term of the Engineering Construction Service Framework Agreement;
  - (b) the prospective agreements to be entered into between the Group and Zhongming Zhiye and its associates for the three years ending 31 December 2024, the prospective total contract value and the prospective project progress;

of which, the total contract amount of the existing agreements and the total contract amount of the projects to be entered into are estimated based on the Company's cost budget for related projects with reference to the gross profit margin of similar projects. The prospective construction progress is estimated based on the Company's experience and the construction schedules in the previous similar projects;

- (iii) when the Company estimates the service fees that it may receive from the newly added construction services projects in the next three years, the principal factor for reference is the transaction amount generated by the new projects in each year. As mentioned in (i) above, the Company expected that 17 projects would be conducted from 2022 to 2024. Of such 17 projects, six are under construction, two have been acquired but yet to be commenced and another nine have not been acquired but are currently under the Company's continuous and active tracking, which are expected to be acquired with high chance of which:

the transaction amount of the above six projects under construction is estimated based on the signed contract and the contract schedule, amongst which, three projects are currently expected to be completed by 31 December 2022, with a total contract amount of approximately RMB138.4 million, one project is currently expected to be completed by 31 December 2023, with a total contract amount of approximately RMB118.24 million, and another two projects are currently expected to be completed by 31 December 2024, with a total contract amount of approximately RMB119.01 million;

the transaction amount of the above remaining 11 outstanding projects is estimated based on the planned gross floor area of each project, the delivery standard and the cost budget of related projects, with reference to the gross profit margin of similar projects; the construction progress is estimated according to the planned acquisition time of each project with reference to the experience and construction schedule in previous similar projects. For the three years ending 31 December 2022, 2023 and 2024, the service fees expected to be charged by the Group under such projects for providing engineering construction services to Zhongming Zhiye and its associates are approximately RMB1,061.39 million, RMB872.58 million and RMB780.57 million, respectively.

#### ***Our analysis on the proposed Annual Caps***

To assess the fairness and reasonableness of the Annual Caps, we have discussed with the management of the Company and reviewed the calculation (the "Annual Caps Calculation") in relation thereto, including the projected transaction amounts for each existing projects and potential projects for each of the three years ending 31 December 2024. Based on the Annual Caps Calculation and we are given to understand that for the proposed annual cap for the year ending 31 December 2022, approximately 58.5% based on the existing agreements of the projects under construction, approximately 25.2% based on contracts acquired but yet to be commenced and the remaining approximately 16.3% based on projects yet to be acquired but are currently under the Company's continuous and active tracking (which are expected to be acquired with high chance). We noted that amongst the six largest revenue generating contracts during the three years ending 31 December 2021 which we selected from the Connected Contract List, five of them are also included in the Annual Caps Calculation and we further noted that the relevant contract sum of these five contracts are consistent with the information as stated in the Annual Caps Calculation. Meanwhile, we noted that the respective proposed annual cap under the New Engineering Construction Service Framework Agreement for each of the year ending 31 December 2022, 2023 and 2024 only represented less than 3.5% of the total construction contracting segment revenue of the Group in 2020.

As stated in the Letter from the Board, the Annual Caps are principally attributable to the provision of engineering construction services. We have discussed with the Company and understand that the projected transaction amounts for the Construction Services are determined by the Company based on the following principal factors:

- (i) in respect of the existing agreements entered into by the Group with Zhongming Zhiye and its associates, the total contract value of such relevant agreements and the Company's estimation on the fee schedule based on the expected project progress over the duration of the New Engineering Construction Service Framework Agreement; and
- (ii) in respect of the prospective agreements expected to be entered into by the Group with Zhongming Zhiye and its associates in the three years ending 31 December 2024, the projected total contract value and the projected project progress.

We noted that the historical annual transaction amounts between the Group and Zhongming Zhiye and its associates in respect of the Construction Service for the year ended 31 December 2019 and 2020 and nine months ended 30 September 2021 was approximately RMB534 million, RMB411 million and RMB552 million, respectively, and the proposed Annual Caps for the year ending 31 December 2022 represented a considerable increase as compared to the transaction amount for the nine months ended 30 September 2021.

As advised by the management of the Company, the property development industry is cyclical with a relatively long development cycle. The construction development may span over years and will be affected by a number of factors including government environmental policies, the climate of the northern part of China during winter time, which may prolong the construction works, the 2022 Winter Olympic which will be hosted in Beijing and the recent pandemic situation. As stated in the 2020 Annual Report, as the Company carries out construction and garden engineering business mainly in Northern China such as the Beijing-Tianjin-Hebei region where operations shall be suspended during winter time (normally November to the end of March) according to relevant national laws and regulations.

As advised by the management of the Company, the Annual Caps for the three years ending 31 December 2024 are mainly attributable to the existing project pipeline of Zhongming Zhiye and its affiliated real estate companies and determined based on the assumption that there is no delay in the latest estimated construction development schedule. On the other hand, the utilisation rate of the annual cap for the two years ended 31 December 2020 and the nine months ended 30 September 2021 was below 60% and the major reason of that is attributable to (i) the actual commencement date of certain projects was later than the Group's expectation; and (ii) the estimated duration of work of certain projects was shorter than the actual duration. Based on information provided by the Company, the contracts of certain construction service performed during the nine months ended 30 September 2021 were executed in or before 2019 while certain of the projects are now expected to be completed after the year ending 31 December 2022.

As advised by the management of the Company, the Annual Caps were determined with reference to 17 construction service projects of Zhongming Zhiye and its affiliated real estate companies, amongst which, six of them are currently expected to be completed during the three years ending 31 December 2024, five of them are currently expected to be completed during the year ending 31 December 2025 and the construction of the remaining six projects are currently expected to complete in or after the year ending 31 December 2026.

On the other hand, we noted that the Annual Cap for the year ending 31 December 2022 represented an increase of approximately 63.1% of the annualised service fee pursuant to construction services provided by the Group to Zhongming Zhiye and its associates for the nine months ended 30 September 2021. As advised by the management of the Company, the cost of Construction Services had been increasing over the past years. As stated in the letter from the Board, from the first half of 2019 to the second half of 2021, the price of steel and labor increased by approximately 40% and 21%, respectively. We have obtained and reviewed the monthly construction price reports published by Beijing Municipal Commission of Housing and Urban-rural Development of the PRC and the Shanghai Construction Market Information Service Platform maintained by Shanghai Municipal Commission of Housing and Urban-rural Development of the PRC. We noted that during December 2018 to October 2021, (i) the salary range of general construction workers in Beijing increased by approximately 22.1% for the lower bound and 30.0% for the upper bound; (ii) the price of hot rolled round steel (type 16) in Beijing increased by approximately 42.3%; (iii) the salary range of general workers for construction and installation in Shanghai increased by approximately 23.0% for the lower bound and approximately 21.7% for the upper bound; and (iv) the price (exclusive of tax) of rebar (comprehensive) in Shanghai increased by approximately 47.3%.

Furthermore, as advised by the management of the Company, given the planning of some projects under Connected Contract List had not been formally approved, the amount of Construction Services to be provided by the Group under such projects is determined with reference to the historical amount of construction services under similar projects in the past and further adjusted after taking into account of different factors including, but not limited to, the increase in labour and material costs, location and duration of the project. Meanwhile, we noted that a buffer of not more than RMB20 million had been included in determining the Annual Caps for each of the two years ending 31 December 2024, to cater for potential changes in contract values of the projects which cannot be reasonably ascertained currently, which represent less than 2.0% and 2.3%, respectively, of the Annual Caps for the two years ending 31 December 2024.

Taking into account of the aforesaid and the fact that the proposed annual cap under the New Engineering Construction Service Framework Agreement for each of the years ending 31 December 2022, 2023 and 2024 only represented less than 3.5% of the total construction contracting segment revenue of the Group in 2020, we consider that the proposed Annual Caps are fair and reasonable.



## 6. Conclusion

Taking into account of the aforesaid, we concur with the view of the Directors that the entering into of the New Engineering Construction Service Framework Agreement with Zhongming Zhiye and the Annual Caps are fair and reasonable and in the interests of the Company and the Independent Shareholders as a whole.

## RECOMMENDATION

Having considered the factors and analyses above, we consider that (i) the labour subcontracting services under the New Engineering Construction Service Framework Agreement is related to the construction contracting services of the Group, which is part of the ordinary and usual course of business of the Group; (ii) the terms of New Engineering Construction Service Framework Agreement are on normal commercial terms; (iii) the entering into of the New Engineering Construction Service Framework Agreement and the Annual Caps are fair and reasonable so far as the Company and the Independent Shareholders are concerned; and (iv) the entering into of the New Engineering Construction Service Framework Agreement are in the interests of the Company and the Independent Shareholders as a whole.

Accordingly, we advise (i) the Independent Board Committee to recommend the Independent Shareholders and (ii) the Independent Shareholders to vote in favour of the ordinary resolutions to be proposed at the Extraordinary General Meeting to approve the New Engineering Construction Service Framework Agreement and the Annual Caps.

Yours faithfully,  
for and on behalf of  
**HALCYON CAPITAL LIMITED**

A handwritten signature in black ink, appearing to be "Derek C.O. Chan".

**Derek C.O. Chan**  
Chairman

A handwritten signature in black ink, appearing to be "Barton Lai".

**Barton Lai**  
Director

*Mr. Chan is a licensed person registered with the Securities and Futures Commission and a responsible officer of Halcyon Capital Limited, which is licensed under the SFO to carry out Type 6 (advising on corporate finance) regulated activities. Mr. Chan has participated in the provision of independent financial advisory services for various transactions involving companies listed on the Stock Exchange.*

*Mr. Lai is a licensed person registered with the Securities and Futures Commission and a responsible officer of Halcyon Capital Limited, which is licensed under the SFO to carry out Type 6 (advising on corporate finance) regulated activities. Mr. Lai has participated in the provision of independent financial advisory services for various transactions involving companies listed on the Stock Exchange.*